Market 2 Market

A forward view of the global economy and financial markets

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How Green is my Minister?

"It is time for a sustainable energy policy which puts consumers, the environment, human health, and peace first."
Dennis Kucinich (US Politician)

Source: Wikipedia

Ed Miliband was Secretary of State for Energy and Climate Change between 2008 and 2010 when he pushed forward the reduction of greenhouse emissions by 80% by 2050. He also changed the policy on coal-fired power stations. He subsequently became Leader of the Labour Party after its election defeat in 2010, a post which he held until the next election defeat in 2015. Sir Kier Starmer appointed him Secretary of State for Energy Security and Net Zero in July and within 2 days the new minister lifted the ban on offshore wind farms.

One might consider that Ed Miliband is on the way down the greasy political pole, but he is not afraid of making energy policy changes. He has approved the building of three solar farms and announced that there will be changes to the planning system and a new policy will permit onshore wind generation. However, with the creation of a National Wealth Fund to invest in green and growth industries and a 'Mission Control' to coordinate clean energy expansion along with the decision not to defend a legal challenge to a previously permitted Cumbrian coalmine you cannot say that the new Minister is not serious about Green Energy.

The government has committed to establishing a public energy company called GB Energy which, along with the National Wealth Fund, has a remit to work together with private finance to raise the necessary funds to invest in green energy projects. It is anticipated that these two bodies will manage a pot of £15bn over five years, but this looks pretty small compared to the £50bn per annum that UK policy makers believe is needed to enable the UK to decarbonize. The idea that the private sector will be able to fund the difference is wishful thinking to say the least unless the Chancellor introduces some serious tax breaks or incentives to private investors in this sector.

The Climate Change Act of 2008, which Ed Miliband brought in, now commits the government to reduce targeted greenhouse gas emissions by 100% of the 1990 levels (net zero). For GB Energy and the National Wealth Fund to succeed is going to require civil servants to work constructively with the private sector and to avoid wasteful practices that are normally associated with government bodies.

Ed Miliband has been bold, but plans by the government to increase the windfall tax on oil and gas company profits from 75% to 78% and extend the tax up to 2030 as well as abolishing tax incentives for further investment may reduce the amount that these companies invest in new green energy projects. In an open letter to the Treasury issued by Offshore Energies UK, which represents firms from across the oil and gas supply chain, 42 companies have warned that that official plans threaten £200bn of investment in all forms of domestic energy, including renewables.

The new Government wants to act quickly and show its green credentials but we will see whether rapidly introduced government policies produce the desired results in moving the UK to Net Zero. The new Chancellor has shown her teeth by removing winter fuel payments to pensioners and making it clear that taxes will rise in October. The change to net zero will not happen without substantial private sector support but this may be difficult to achieve in a climate of rising taxes on corporate profits.

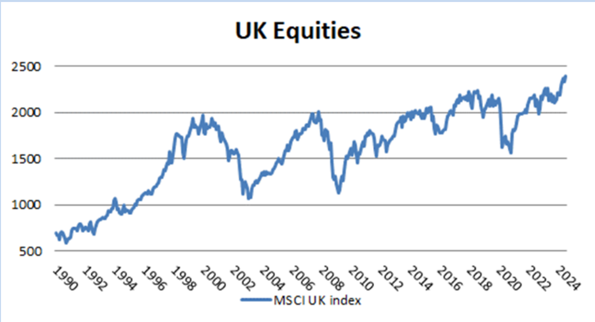
Richard Harper
Head of Asset Allocation
GHC Capital Markets Limited

Asset Allocation

In which **Tim Harris**, the Chair of our Asset Allocation Committee, describes the factors influencing our latest Asset Allocation decisions

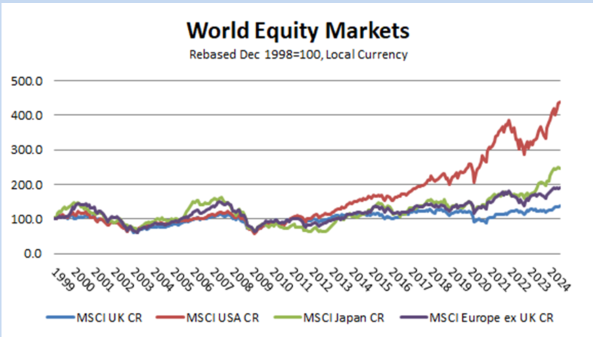
Global equities are recovering from a recent short-term rout	Equity indices are much of the way back to where they stood prior to the last US employment report. Although Japan too has recovered over half of its losses, it is further behind in percentage terms. However, note the substantial outflows from non-investment grade bond funds and the tentative recovery in technology stocks. Bond markets too, have seen their more extreme bond yield lows reversed by 50%, as risk aversion unwinds. Market sentiment is recovering, although there is a legacy shock to the system which may make investors more discerning in crowded trades.
US economic news maybe not as bad as it seemed	A slew of upbeat economic data points since the recent disappointing US labour market report has us wondering if the July employment report exaggerated the overall economic weakness. Economists are pointing to the potential distortions in the data from the poor weather in July. A record 461,000 people with full-time jobs said they were unable to work in July, significantly ahead of the long-term average of 50,000. The weaker employment report may act as a trigger for the Federal Reserve. It is likely that the US central bank will kickstart the rate cutting cycle with a larger cut in September. Many in the market now believe that a 50-bp cut in September is a done deal, and do not rule out a further reduction of 50 bps in November. US inflation data will be important to follow. The market expects the headline rate to remain unchanged at 3.0%, with the strength in food and energy prices keeping the headline rate unchanged.
UK not so bad after all	The raft of GDP, inflation, pay, employment, unemployment, industrial production, service sector output and trade data underlines that the Tory economic legacy is not as bad as portrayed by the new government. Maybe some softening up of the public is being offered after the high public sector pay deals and before the Autumn Budget on October 30.
Asian Equity Markets: Diverging Trends	In Asian equity markets, the recent sell-off in Japanese equities reflects an equity market grappling with higher interest rates, while the rest of the world toys with the idea of cutting rates. These concerns are more profound because the dialogue around cutting interest rates elsewhere is due to weakening growth, not because inflation has been beaten down. Chinese equity markets may start to revive. Valuations are not the key challenge in China; the slow pace of policy-making is. However, the leadership is more focused on supporting domestic demand now that the US economy appears at risk of slowing more sharply than previously anticipated and the prospect of higher trade tariffs looms next year. This focus on bolstering domestic demand could provide a cushion for Chinese equities amidst global economic uncertainty. Some recent government announcements of policy initiatives in support for the consumer sector should help.
Government Bonds for Safety and Sharper Rate Cuts	With talk of US recession gaining attention, government bonds are the near-term winner. However, the rally in the 10-year US Treasury bond yield has already discounted a significant amount of the bad news. The real 10-year bond yield is already at a relatively low level of around 1%. While it could go lower, this typically happens only in the event of a financial market crisis or economic distress, as seen in 2000 and 1994. In response to the market's re-pricing of the Fed rate cuts, the US 2-year bond has rallied significantly. Its yield is now 150bps below the current Fed funds rate, indicating that several rate cuts are already priced in. If we are indeed facing a US recession, the 2-year bond probably represents good value. However, if the economy stabilises or rebounds, the bond's performance may be seen as having already accounted for the expected rate cuts. Considering the economic outlook when evaluating the 2-year bond, we remain cautious. While government bonds offer a safe haven, their upside may be limited unless the economy deteriorates further.
Market Expectations	The early year rallies of equities and bonds are giving way to a more considered performance through late summer. While we believe that a soft landing of major economies is a greater risk and recession, we prefer to watch this short-term debate with a relatively risk neutral position across our portfolios. We see opportunities for upside in equities and real estate later in the year, but await the evolution of US and European interest rate policies before acting more positively.

Markets at a Glance



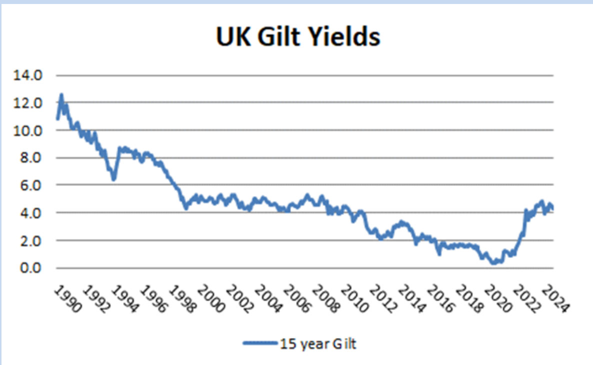
Source: Lipper for Investment Management

Following a General Election result, close to most expectations, the UK stock market has settled into studying company earnings and macro expectations. The former are progressing fine; the latter show that the UK economy is growing at a decent rate in excess of 2% with modest current inflation – a less bad legacy than the Labour government maybe portrays. That said, public finances are stretched and the forthcoming October Budget is likely to generate some steam for market watchers. Policies and the economic backdrop at the time are likely to be the main drivers. After a good recovery in the stock market earlier in the year, we expect near term gains to be harder earned. But, we do forecast the FTSE 100 to end 2025 close to 9,000, corresponding to total returns of around 17% from here.



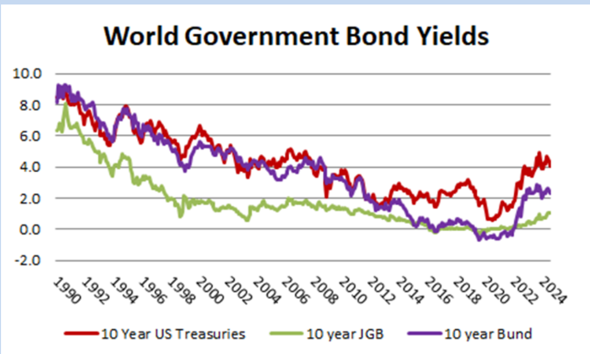
Source: Lipper for Investment Management

Before the recent shakeout in markets, higher valuations and a narrow market in the US had followed a strong first half to the year for global equities. Profits remain healthy and are rising this year in most regions, although momentum is slowing. We favour higher quality names and value stocks. That said, the strong changes in the structure of business mean that enthusiasm for the artificial intelligence (AI) theme will have legs over the longer term. We forecast the S&P 500 to end 2024 at 5,800, about 6% above its current level.



Source: Lipper for Investment Management

Political uncertainty has been a feature of the UK economic landscape for the last decade, so the General Election result may remove some of this risk. That said, we await the Budget in October. Given the relatively narrow range of macroeconomic outcomes from the recent election, policy uncertainty is lower this time around, which implies that there is unlikely to be a worsening in capital flows, and that there could be room for improvement. With inflation likely to moderate slowly, a weakening labour market and quantitative tightening past its peak, we think the outlook for Gilts is positive versus other major bond markets. We forecast the 10-year gilt yield to fall to 3.25% by the end of the year.



Source: Infront

The market is currently pricing in a high chance of a first US rate cut of 50bps. In response to the market's re-pricing of the Fed rate cuts, the US 2-year bond has rallied. The 2-year yield is now 150bps below the current Fed funds rate, indicating that several cuts are already priced in. If we are indeed facing a US recession, the 2-year bond probably represents good value. However, if the economy stabilises or rebounds, the bond's performance may be seen as having already accounted for the expected rate cuts. Investors should remain cautious and monitor economic indicators closely. Although government bonds offer a safe haven, their upside may be limited unless the economic situation deteriorates further.

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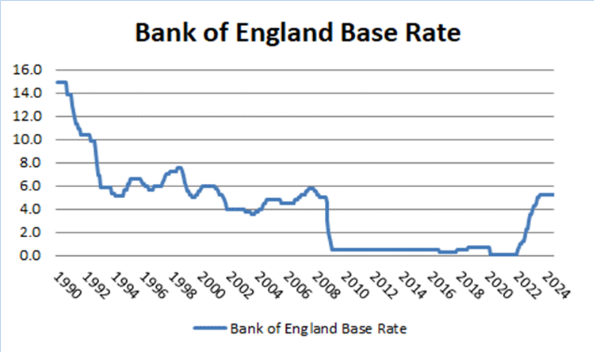
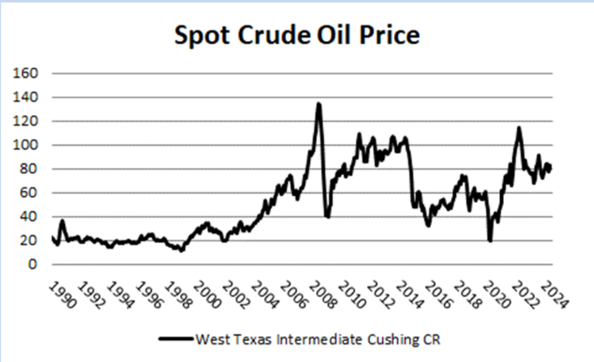


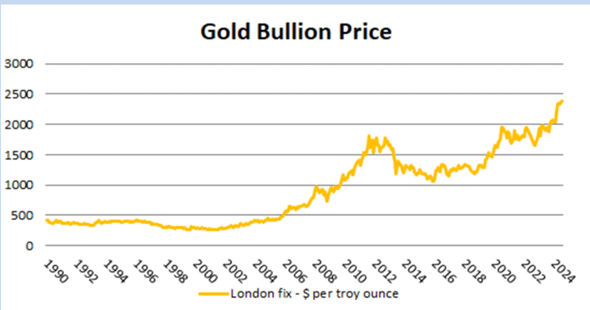
Source: Lipper for Investment Management

The Bank of England made the first cut to interest rates in four years in August. Estimates of the neutral bank rate suggest to us that the Bank of England will cut rates down to 3.5% in 2025 from a current 5.0% in order to reach a balanced policy stance. CPI inflation has trended lower, which eases wage growth pressures and the economy is still softer than potential. While the above might argue for rate cuts in the second half, the Bank will be mindful not to reignite inflation pressures in the aftermath of the UK election and future government programmes.



Source: Lipper for Investment Management

We expect the Brent crude oil spot price will increase from its current level to average $85/barrel for the remainder of 2024 and $89/b in the first quarter of 2025. The main source of this upward price pressure is falling global oil inventories resulting from OPEC+ production cuts. We expect global oil inventories will decrease by an average of 0.8 million barrels per day in 2H24, with further declines in 1Q25. We anticipate that the market will gradually return to moderate inventory builds in mid-2025 after the expiration of voluntary OPEC+ supply cuts in 4Q24 and as forecast production growth from countries outside of OPEC+ begins to outweigh global oil demand growth. We forecast the Brent price will average $86/b in 2025 and fall to $83/b by the end of the year.



Source: Lipper for Investment Management

The gold price continues to rally. The traditional fair value of gold would connect the usual catalysts – real rates, growth expectations and the dollar – to flows and the price. Gold typically guards against high inflation and large upside inflation surprises, caused by losses in central bank credibility (e.g. through the late 1970s) and geopolitical supply shocks (throughout the 1970s). Gold, however, is typically not a strong performer in response to positive demand shocks if the central bank responds quickly with higher rates. We see strong incremental flows into EM central bank buying, maybe driven by geopolitical concerns.

Note that where an MSCI Index has been used for illustration. This has been sourced with permission from MSCI Inc.

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