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Market Observations Q4 2024

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Market overview

In the fourth quarter, global markets and sentiment were shaped by political shifts and central bank actions.

November was dominated by the US election, starting with the lead up to the election date and results announcement to the subsequent nominations for key office position appointments. The Trump victory led to a further increase in the US dollar accompanied by a strong rally in US equity markets.

Central banks globally continued to adjust their policies well into the latter part of December. Several rate cuts were announced in December, including the US Federal Reserve (Fed), European Central Bank (ECB), Canada, Switzerland, Mexico, and Turkey. The Bank of England (BOE) and Bank of Japan (BOJ) held rates steady. The Fed's rate cut, accompanied by a hawkish tone, suggested that it could be the last cut for a while, and the market reacted by selling off as expected. Meanwhile, China's stimulus package announcement in September resulted in volatility in equity markets continuing into the quarter.

Global equities experienced a slight decline of 1% in the fourth quarter, but showed a strong annual gain of 17.5%, as measured by the All Country World Index (ACWI). Both developed and emerging market equities saw negative returns in the fourth quarter, with developed markets down by 0.2% and emerging markets down by 8.0%. In emerging markets, sentiment was dampened by President Trump's victory, which raised concerns over trade tariffs, especially with China. Brazilian equities struggled, with the Bovespa falling by 29.5%, while China underperformed by 4.9% due to tariff fears. Other markets such as India (-10.6%) and Turkey (-3.1%) also contributed to weaker performance. Despite this, for 2024, the MSCI Emerging Market Index added 7.5%, though it lagged behind the ACWI's 17.5% return, primarily due to the stellar performance in US markets. Global property also faced losses, down 9.2% for the quarter but ended the year in positive territory with 1.6%.

Global bonds were one of the weakest asset classes, with the Bloomberg Global Aggregate Index showing a 5.1% decline for the quarter and a 1.7% decline for the year. This was unexpected, considering the start of a rate-cutting cycle. However, market expectations for a shallow cutting cycle, coupled with concerns over persistent US inflation above the 2% target, dampened bond market performance. Volatility in the bond market was driven by rising inflation expectations and central bank actions, leading to selloffs in key government bond markets, particularly US Treasuries and UK Gilts.

Source: M&G Investments, Bloomberg, data to 31 December 2024

Asset class	Total return Q4 2024 (Rand and US$)
SA equity - FTSE/JSE All Share Index (Rand	-2.1%
SA equity – FTSE/JSE Capped SWIX All Share (Rand)	-2.1%
SA bonds - FTSE/JSE All Bond Index	0.4%
SA listed property – FTSE/JSE All Property Index (Rand)	-0.4%
SA inflation-linked bonds - RSA Composite Inflation-Linked Bond Index (Rand)	0.8%
SA cash - STeFI Composite Index (Rand)	2.0%
Global equity – MSCI World (US$)	-0.2%
Global equity - MSCI Emerging Markets (US$)	-8.0%
Global bonds - Bloomberg Global Aggregate Bond Index (US$)	-5.1%
Global property - FTSE EPRA/NAREIT Global Property REIT Index (US$)	-9.2%

US

Political developments played a significant role in shaping market sentiment during the fourth quarter. US equities rose in the quarter, driven by President Trump's election victory and Republican control of Congress, which fuelled optimism around expectations of tax cuts, deregulation, and pro-growth policies.

Meanwhile, US inflation rose to 2.7% y/y in November, slightly up from 2.6% y/y in October, in line with expectations. This didn't sway the Federal Reserve's decision to cut interest rates by 25 basis points in both November and December, bringing the target range to 4.25%-4.5%. US third quarter growth reached 3.1%, driven by strong consumer spending, and slightly better than the second quarter's 3.0% growth.

While US equities surged in November following the election results, the rally stalled in December after the Fed lowered its expectations for further rate cuts due to slower inflation progress and an uncertain policy outlook. Despite this, US equities still finished the quarter strong, with the Nasdaq leading at 6.3%, followed by the S&P 500 (2.4%) and the Dow Jones (0.9%).

Notably, US equities posted solid returns across all indices for the year led by the Nasdaq (29.6%), S&P 500 (25%), and the Dow Jones (15%), all in US dollar terms. Bonds, however, faced a more challenging quarter. Bond yields rose and the fed fund futures curve moving higher following the market expectations for fewer rate cuts in 2025 (due to persistent inflation) led to a sell-off in US Treasuries in December.

EU

Eurozone faced another challenging quarter. Equities declined due to recession fears and political instability in France and Germany. Slightly improved third quarter growth of 0.4% q/q from 0.3% q/q in the second quarter was better than the 0.2% expected.

Inflation rose by 2.2% y/y in November, driven by higher commodity prices, from 2.0% in October and slightly below the 2.3% forecast. Despite the slight uptick in inflation, the European Central Bank (ECB) unanimously decided to reduce interest rates by another 25 basis points in December, lowering its deposit rate to 3%. The ECB also signalled further cuts for 2025.

UK

Inflation in the UK rose by 2.6% y/y in November, in line with forecasts but up from 2.3% in October. As a result, the Bank of England kept interest rates unchanged at 4.75% in December, as expected.

Economic growth in the UK disappointed, with quarterly growth at 0% q/q, down from 0.5% in the previous quarter, and falling below the anticipated 0.2%, revised downward from initial estimates.

In this environment, UK equities declined, affected by rising bond yields, inflation expectations, and concerns over government fiscal policies following the Autumn Budget. The FTSE 100 ended the quarter down 6.8% but posted a 7.7% gain for the year.

China

Deflationary pressure continues in China, with the CPI slowing to 0.2% y/y in November, down from 0.3% in October. The People's Bank of China (PBOC) kept its benchmark lending rates unchanged, maintaining the one-year loan prime rate at 3.1% and the five-year rate at 3.6%. China's third quarter GDP growth slowed to 4.6% from 4.7% in the second quarter, resulting in a 4.8% growth rate for the first three quarters of the year. In recent months, China has introduced several measures to stabilise its economy, including shifting to a looser monetary policy in December, providing tax incentives for the property market, and unveiling a 10 trillion yuan debt package. Markets were spurred early November following a stimulus package unveiled late in September to support the economy and ailing property market but retraced some of those gains by quarter end. The Hang Seng Index dropped 4.9% in the fourth quarter but posted a strong 23.7% gain for the year.

Japan

Japan's core consumer price inflation rose to 2.7% y/y in November, up from 2.3% in October, in line with expectations and remaining above the Bank of Japan's 2% target.

The Bank of Japan kept its benchmark interest rate steady at 0.25% in December.

Japan's third quarter GDP was revised upward to a 1.2% annualised growth rate, compared to the initial estimate of 0.9%, though it was lower than the 2.2% annualised growth in the third quarter.

The Nikkei Index fell 4.1% in the fourth quarter due to a weak yen and strong US economic performance but finished the year with an 8.8% gain (in US$).

South Africa

South Africa's consumer price index (CPI) rose by 2.9% y/y in November, up from 2.8% y/y in October. Despite this slight inflation increase, the South African Reserve Bank (SARB) Monetary Policy Committee reduced the policy rate by 25 basis points to 7.75% in November.

The country's third quarter GDP contracted by 0.3%, primarily due to a decline in agricultural output, following a revised 0.3% growth in the second quarter. Local equity and bond markets saw slight declines, with the biggest impact coming from the weakening of the rand. Despite a solid annual return of 13.4%, the FTSE JSE All Share Index fell 2.1% in the fourth quarter. On a sector level, industrials posted modest returns of 0.2%, while financials (-1.2%) and resources (-10.1%) dragged on performance for the quarter (all in rand).

South African listed property posted a 0.4% loss in the fourth quarter, but still delivered strong annual returns of nearly 30%.

The FTSE All Bond Index (ALBI) returned 0.4% for the quarter, while inflation-linked bonds (ILBs) returned 0.8%. Notably, South African bonds finished the year with a robust 17% gain, while ILBs returned 7.8% (both in rand). Throughout the year, the nominal bond market experienced significant volatility, with the 10-year bond yield peaking at 12.50% in April before strengthening to around 10.30% by year-end. The yield curve also bull-flattened in 2024, with long-term bond yields falling more sharply than shorter-term ones. The ILB curve flattened slightly, coming off an already flat basis at the start of the year.

SA cash gained 2.0% for the quarter (in rand).

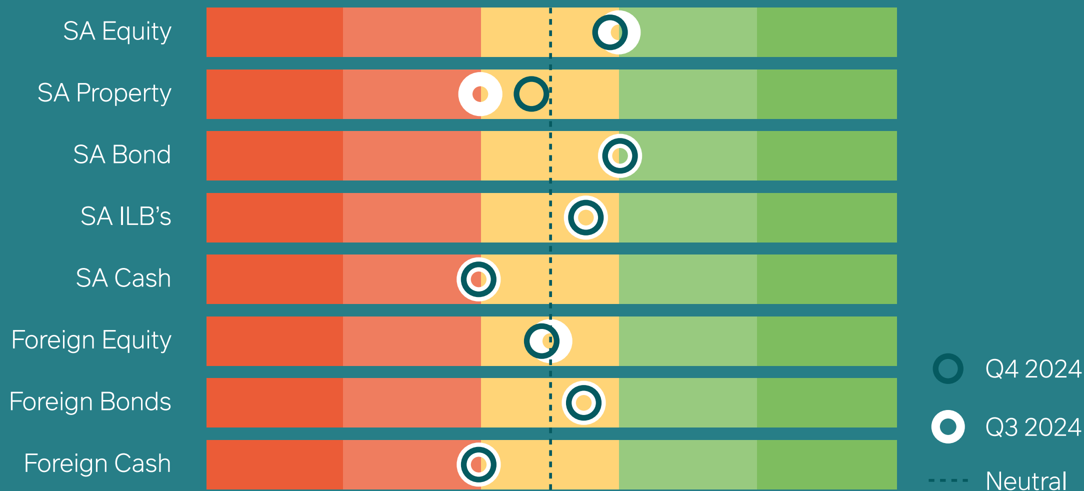
Currency

The rand weakened against the US dollar (9.5%), British pound (2.3%), and euro (1.8%) during the quarter. The strength of the US dollar was driven by a post-election rally and strong economic performance, particularly relative to the UK and other developed economies.

Commodities

Commodities also stayed true to form with volatile moves across the board and faced another challenging month of negative returns for the quarter. Notably, nickel, palladium and copper suffered losses of around 11%. After strong performance in recent months, gold retraced some of its gains this quarter with -1.3% due to US dollar strength but still ended the year with close to a 27% return.

Brent crude gained 3.6% for the quarter.



*Our best investment view preferences are implemented where fund mandates allow. Positioning will differ in portfolios with constraints in their mandates.

How have our views and positioning changed in Q4 2024?

The last quarter of 2024 saw volatile moves in most asset classes, and we exploited favourable entry points in markets to add back to risk assets using the cash available from profit taking in the third quarter.

In the broad context of offshore versus local asset allocation, we have left our positioning mostly unchanged for the quarter and continue to prefer domestic assets over foreign exposure. From a valuation perspective SA equities are coming off a very low base and continue to screen relatively cheap compared to other markets. On the bond side, our 10-year yield is still pricing a real return in excess of our fair value assumptions and, therefore, nominal bonds remain a key holding across the funds. This position led to favourable returns in the second half of the year given the post-election rally in local assets and we continue to keep the position in place due to improved fundamentals in our market.

Starting with asset class positioning in our global portion of the portfolios, we are currently slightly overweight global equities; overweight bonds and cash; and underweight credit and property. We continued to broaden out our carry basket during the quarter by adding long positions in Turkish lira and Colombian peso to existing Mexican peso and Brazilian real exposures, funded out of new shorts in Thai baht and Taiwanese dollar being added to US dollar and euro short positions.

The valuation for the MSCI All Country World Index 12-month forward P/E ratio peaked at the beginning of December before settling back at around 18x by the end of the year. The main driving force behind this valuation remains the high multiple that the US is trading on, with the S&P 12-month forward P/E remaining elevated at the current 22x. Due to this, we have kept our underweight position to the US market in place during the quarter as we continue to see better valuation opportunities in other equity markets. We made use of market diversions post the US election to add back some of the tactical China exposure we took off at the end of September as well as reinstating a long position to the Indonesian equity market. Away from that, we continue to hold tactical long positions to Latam markets, South Korea and Japan.

Within our global bond holdings, we continue to favour long-dated US treasuries given the favourable real yields delivered by these instruments. In addition to this, we introduced a new tactical position to Brazilian bonds to the fund in December given the episodic selloff seen in bond yields in that region.

We maintain our underweight position to global corporate credit given that credit spreads have continued to contract during the quarter, increasing the unattractiveness of the risk-reward payoff for those instruments.

We continue to hold an overweight position in SA equities as market valuations point to a continued rerating in that asset class. Fundamentally, SA equities still trade at low valuation levels when looking at both the 12-month forward P/E ratio (10.1x) as well as the Price-to-Book ratio (1.72x). Local equities have experienced a moderate decline since the US elections, but we witnessed strong positive returns in the asset class leading up to that point, predominantly after the local government elections, adding positively to portfolio returns during the year.

On the local property front, we have continued with our trajectory of closing the underweight we had in the portfolios to that asset class. As at the end of the fourth quarter, we still have a small underweight to the property sector in place in the portfolios, but at a much-reduced scale compared to the start of the year. This change is on the back of improved fundamentals seen in the sector, especially the improvement in published financials reported by some companies as well as the reprieve experienced due to reduction in loadshedding and interest rates moving lower. For the year, property was the top-performing asset class in the local market but, with the move coming off a very low base, we've been comfortable making use of opportunities presented by market volatility to close the underweight we held in that asset class.

The last quarter of the year was very muted in the local bond space – especially in comparison to the second and third quarter rallies we experienced. We made use of a selloff in bonds at the start of the quarter to add some more exposure to our portfolios to reinstate some of the positions we had taken off during the third quarter rally. Real yields are still trading at attractive levels compared to our equilibrium return assumptions and we continue to see merit to holding a sizeable overweight to nominal bonds in our portfolios. Given the strong returns witnessed in this asset class during the year, our portfolios have benefitted significantly from our overweight holding to SA nominal bonds throughout the year.

Our house-view portfolios continue to have no meaningful exposure to SA inflation-linked bonds (ILBs) as our preference has been for nominal bonds in favour of ILBs, but we do hold some of these bonds in our real return portfolios, such as the M&G Inflation Plus Fund. We added to our ILB holdings in a selection of our real return portfolios during the quarter on the back of the significant price lag in ILBs compared to their nominal bond counterparts during the year. Real yields for these instruments are attractive at current levels but, given liquidity constraints and the advantage of being in nominal bonds in a rate-cutting environment, we continue to favour nominal bonds over ILBs in most of our portfolios.

Finally, our portfolios remain tilted away from SA cash as the interest rate-cutting environment will lead to lower positive real cash rates over the medium term. We continue to prefer the risk-adjusted returns we receive in the SA equity and bond space and would expect that gap to open even more as local interest rates are cut further beyond this point, even in a shallow rate-cutting cycle such as the one the market is currently pricing in.

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