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WEEKLY BULLETIN

US inflation update encourages sector rotation

Key takeaways

Investors are confident that US interest rates will be cut in September. This has fuelled a strong move into smaller-sized companies which are regarded as major beneficiaries of cheaper borrowing costs.

Good news in the US – inflation tamed?

An eagerly awaited report on US inflation was better than expected, buoying investor hopes the US central bank - the Federal Reserve (Fed) - will cut interest rates this September. The June consumer price index (CPI) rose by 3% compared with a year ago, a slower rate of increase than the market had been expecting. CPI also fell by 0.1% between May and June 2024, which was the first monthly decline in four years. A near 4% decline in the oil price during June was a major contributor to the benign data; a slowdown in the rate of housing rents was also helpful. The odds for a September interest rate cut by the Fed have increased dramatically to over 90%, according to the widely followed ‘CME Fedwatch’ website.

UK economic growth in May exceeded expectations

Data from the Office of National Statistics revealed that the UK economy grew by 0.4% in May compared with the month before. This was twice the rate expected by analysts and in the three months to May 2024, means that the UK enjoyed its fastest economic expansion for two years. On an annual basis, UK economic growth of 1.4% is higher than the 1.2% originally forecast. The construction sector led returns, supported by services and manufacturing. Those of a more ‘glass half empty’ approach would state that despite the positive update, the size of the UK economy remains only slightly larger than it was pre-Covid.

Investors look beyond mega-cap tech

A strong belief in a September interest rate cut led investors to reassess the outlook for shares in the technology sector. Shares here have contributed the most to market returns this year, in contrast to other areas of the US stock market trading on cheaper valuations. Lower interest rates are expected to help the prospects for smaller-sized companies, which will pay a higher interest rate on their debt (reflecting their weaker credit rating) compared with larger technology companies. Property companies and industrials are further potential beneficiaries of an interest rate cut.

Market moves

Good news on inflation meant that the smaller company Russell 2000 share index in the US rallied strongly, outperforming both the Nasdaq and S&P 500. European shares rose, while those in Japan reached another record high.

The US dollar fell against a basket of other currencies, while US Treasury yields also ended lower (prices, which move in the opposite direction to yields, were higher). Sterling finished the week close to multi-year highs against a basket of currencies.

Gold rose, but the oil price was slightly weaker.

What to look out for this week

The quarterly 'earnings season' for US companies gets into its stride, with financials initially dominating the reporting calendar. Investors will be hoping for strong updates from non-tech sectors.

In the UK, CPI for June will be released on Wednesday and unemployment data on Thursday.

The European Central Bank will announce its decision on interest rates on Thursday. Expectations are for no change to the current level of 4.25%.

If you have questions about financial markets, or our investment services, please contact the Marketing team:

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