

Turning views into action

Three themes for autumn 2024

Capital at risk. The value of investments and the income from them can fall as well as rise and are not guaranteed. Investors may not get back the amount originally invested.

Since our last update before summer, sentiment towards stocks has broadly stayed positive, but there's been an increase in volatility (the size and frequency of market moves). This has largely been driven by investor concerns about a possible recession, particularly in the US, and changeable sentiment towards some of the biggest beneficiaries of the AI rally so far. We think we could see more flare-ups in markets ahead of the US presidential election. For the remainder of this eventful year, we expect to see investor focus broaden beyond tech stocks, so we look to other sectors that could be in favour. We also expect developed market (DM) central banks to lower interest rates further, after starting their cutting cycles this summer. That puts greater emphasis on the opportunity to lock in income while yields remain at elevated levels. Finally, we look to capture long-term themes in portfolios through certain commodities.

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We think concerns about the health of the US economy could be overdone, partly because corporate earnings growth is broadening after largely being driven by early AI winners for most of this year. Broadening earnings also highlight that opportunities may exist beyond tech stocks, in our view. Meanwhile, although the Bank of England and other central banks have started to cut interest rates, government bond yields remain near decade-highs – so investors can still earn relatively attractive income from government bonds.



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Our investment themes for autumn 2024:

1. The US in focus

The US election will likely have an impact on markets this autumn. We avoid trying to call the outcome and look to sectors that appear well-positioned regardless of who wins, such as financials. We think this is also a way to tap into opportunities beyond the technology sector, as sentiment starts to broaden to other areas.

3. Income still on offer

The Bank of England (BoE) has started to cut interest rates. Bond yields have fallen, but remain high relative to historical levels, particularly the pre-pandemic years. This means investors can still access attractive income in UK government bonds (gilts).

2. Adding commodities

We see long-term 'mega forces', such as a potential surge in business spending on AI and the low-carbon transition, supporting the long-term case for materials such as copper. Supply-demand challenges could support copper prices and copper miners' profits.

1. The US in focus

As we approach the end of an eventful year, one major event looms large: the US election. While some investors may try to gauge the probability of each outcome, the impact on government policy and how this might affect different sectors, we avoid trying to call the outcome and instead look to areas that we think could be well-positioned regardless of the result. We look to tap into the US economy's relatively resilient growth, tailwinds from US Federal Reserve (Fed) rate cuts, and the broadening of investor focus beyond major tech companies exposed to the AI wave.

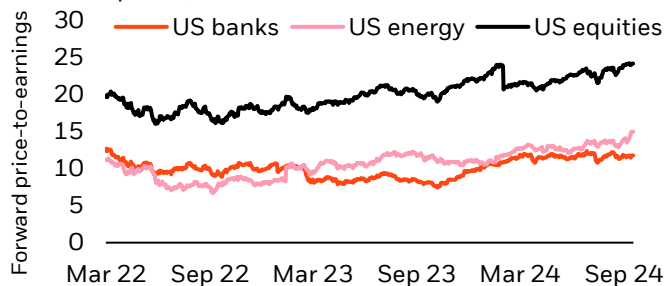
The US financials sector, particularly large-cap banks, is one area we like. Overall, the sector looks cheap, with stock prices currently at c.17x forward-looking earnings vs. 24.2x for the broader S&P 500 Index ('forward price-to-earnings' is a common gauge of how highly investors value a stock or group of stocks, based on those companies' expected future earnings).¹ Banks' earnings have been improving and we don't expect rate cuts by the Fed to have a major impact.

¹ Source: Bloomberg, as of 7 October 2024.

Banks tend to be seen as sensitive to interest rates: usually, the higher the rate, the larger the difference between the amount banks charge for borrowing and the amount they pay on deposits, increasing their profitability. However, they've been reducing interest rate sensitivity over the past year, so the impact from rate cuts should be lower. Moreover, we think that large-cap banks, in particular, can weather the fall in interest rates, due to the amount of outstanding loans taken out by borrowers at a higher interest rate, and the potential for investment banks to participate in more merger and acquisition deals.

Chart 1: US banks appear relatively cheap

Forward price-to-earnings estimates for banks, energy and US equities, 2022-2024



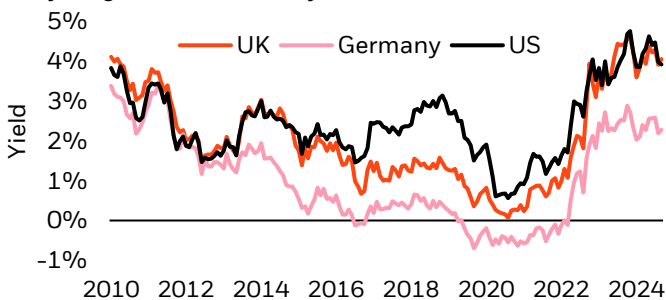
Source: Bloomberg, as of 7 October 2024. Based on S&P indices.

2. Income still on offer

Developed market central banks, including the Bank of England (BoE), European Central Bank (ECB) and US Federal Reserve (Fed), cut interest rates over the summer, after keeping them paused at high levels for over a year.

Chart 2: Despite rate cuts, bond yields remain near their highest levels in over a decade

10-year government bond yields, 2010-2024



Source: LSEG Datastream and BlackRock Investment Institute, as of 27 September 2024.

We expect more rate cuts by the end of 2024. This is very important for investors, for a few reasons. Firstly, changes in interest rates can influence the relative attractiveness of different asset classes. When interest rates fall, cash tends to become less attractive and investors might be more inclined to invest in stocks, in the hope of earning a higher return than their cash savings rate. Existing bonds that pay a fixed interest rate could see their prices rise, as investors seek to buy these bonds to 'lock in' income – which becomes more attractive as the rate paid on newly-issued bonds falls. Secondly, falling interest rates can lower costs for companies with lots of debt, meaning investors might be more attracted to these companies – potentially benefiting their share prices. Thirdly, falling

interest rates can make it less appealing to save and less expensive to borrow money. This tends to result in an increase in the amount that companies invest and the amount consumers spend on goods and services. That's generally positive for economic growth. Combined, these effects tend to mean that rate cuts are positive for stock markets and could lead to rising prices for existing bonds.

Despite interest rates having started to fall, bond yields have remained relatively high and continue to offer income for investors. We therefore think this is a good time to be locking in income as interest rates look to be heading lower. This isn't just about the short term, though. We think it's important to build diversified portfolios for the long term, including bonds alongside stocks. Bonds issued by highly rated governments (e.g. UK gilts) and firms with track records of delivering coupon payments and relatively low risk of defaulting on their debt could help bolster portfolios and provide an income stream.

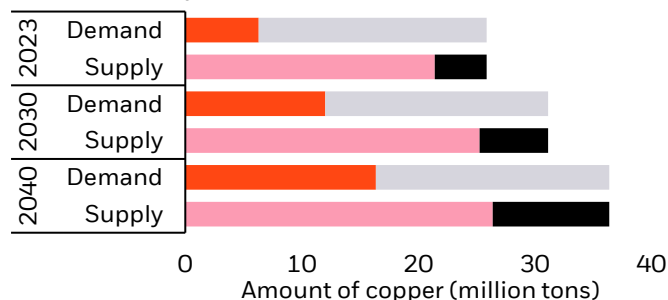
3. Adding commodities

While near-term events such as the US election are important for investors, we think it's equally important to try to identify opportunities that can stand the test of time. This is especially true for investors with long time horizons, such as those saving for retirement or an expected life event that's still several years away.

As we outlined in our last update, we see long-term 'mega forces', such as a potential surge in business spending on AI and the low-carbon transition, driving a seismic structural transformation with the potential to reshape the investment landscape.

Chart 3: Copper mining supply will need to increase significantly to match rising demand

Expected supply of and demand for copper, 2023-2040



Source: IEA, May 2024. Cleantech demand forecasts based on the 'Announced Pledges Scenario'.

We think certain commodities, such as copper, lie at the confluence of these mega forces. Copper is a critical component in technologies driving AI development and the low-carbon transition. While demand for copper is expected to increase, supply constraints could support prices and offer an attractive backdrop for copper miners: by the early 2030s, demand could outstrip the current supply by more than six million tonnes per year.² In addition to the long-term story, we also note the rebound in sentiment towards copper and other industrial metals after China's recent stimulus announcements – which could boost Chinese growth and demand for copper.

² Source: BloombergNEF, September 2022, 'Surging copper demand will complicate the clean energy boom'.

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