AEGON Asset Management

Equities
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AEGON **INSIGHTS**

Equities Outlook

There have been two standout themes in global equities in 2023: the outperformance of the so called 'magnificent seven' US mega-cap tech stocks (without which US indices would have underperformed), and the Japanese stock market. There were also two standout underperformers - China and the UK. Will these trends continue in 2024?

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Philip Haworth manages the 25 strong global Equities team. In addition to his leadership role, Philip manages a number of UK equity portfolios and has research responsibilities for certain sectors of the UK equity market. Prior to his current role, he was deputy head of equities for five years. Philip joined Aegon AM in 1995 from Oxford University where he studied Philosophy, Politics and Economics and started in the industry at this same time. Philip also holds the SII Diploma.

The odds seem stacked against continued mega-caps leadership. At a combined 29% of the S&P500 market cap they beat the pre-covid 40 year high by a full 5 percentage points. Strategists, however, have already had to re-write their assumptions; few had anticipated these stocks outperforming their cheaper, smaller, more cyclical counterparts in a year of rising long real yields and surprisingly robust GDP growth. We believe the 'magnificent seven' may continue to perform well, especially those like Nvidia and Microsoft which are driving the development of AI, but we should absolutely expect greater market breadth in 2024.

On the macro-economic picture, the unemployment rate is near historic lows, and we expect this to start to normalize, i.e., rise. Consumers are feeling the pinch from high inflation and their wallets are no longer helped by pandemic-era state giveaways so we will see weaker consumption numbers from the US. Against this environment the Fed may be forced to lower rates which should be good for small and mid-caps; as a group, these already look very cheap relative to the valuation of the market as a whole. In short, expect more opportunities for alpha.

History is also against Japan maintaining its leadership. For decades this has been a market "to rent, not to buy" but is it different this time? We think Japan could actually outperform for several more quarters: the macro environment is supportive as interest rates are low (10 year government bonds yield below 1%); inflation is not the concern it remains in other G7 countries; the recent weakening of the currency ensures that offshore profits are even larger in Yen terms. A price/earnings ratio of 14x means the market is not expensive and suggests there is little corporate restructuring priced in. However, corporate restructuring is happening. Companies are buying back shares, increasing dividends and closing divisions. When they don't the Tokyo Stock Exchange applies pressure and, even more importantly, activist shareholders are becoming increasingly emboldened.

As for 2023's laggards; Chinese underperformance is easy to explain with hindsight. A disappointing lockdown re-opening was compounded by geo-political concerns. Debt concerns also persist in local government financing vehicles (LGFVs) and the property market (China's historic engine of growth). What easing measures there have been are failing to lift consumer and broader private sector confidence. In 2024, China's reflation is likely to remain gradual and bumpy without some form of resolution for property issues, more direct encouragement of consumption and increased fiscal spending. Any such Draghi-style moment could powerfully unlock an underheld market trading at trough multiples but in absence of that, Asia's more structural stories (India, Indonesia, Korea & Singapore) may continue to appeal.

Closer to home, the UK is the very definition of an undervalued and unloved market. So what might attract buyers? The UK economy has always been viewed as particularly sensitive to interest rates so the prospect of cuts later in 2024 is certainly one potential catalyst. Surprisingly, politics might prove to be another. Investors will, of course, worry about the looming general election but one thing that both main parties appear to have realised is that a healthy equity market is good for the economy. The Mansion House Reforms are the first of what could ultimately be a series of potential policy initiatives that support UK equity performance in 2024.

In whichever market companies operate, the 2024 environment is likely to provide a different set of challenges to that of the recent past. Chief amongst those is managing dis-inflating, in some cases outright deflating, prices against a demand backdrop that will feel the lagged impact of monetary tightening. Profit growth will be hard to come by and is certainly likely to disappoint the global consensus forecast of +10%. This suggests a stock-picking focus upon quality, strength of balance sheet and profitability could be the winning strategy in 2024.

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