RBC BlueBay
Asset Management

Focusing on fundamentals: global equities in 2024

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We ask Jeremy Richardson why he believes the market environment should improve in 2024, following the uncertainty and short termism of the last few years.

To give some context, what were the key events in global equity markets in 2023?

We believe that the market is concerned with a particular topic at any given moment which, in turn, drives market dynamics. 2023 started with recessionary fears, which morphed into a 'credit crunch' period in the spring, with turmoil in the US regional banking industry.

However, a gradual acceptance arose that the US would avoid the worst of a possible hard landing, and by summer there was a sentiment that a soft landing or even a no landing could be achieved.

The summer also saw Nvidia's standout results and the emergence of AI as a theme. This gave the market additional momentum, especially as the AI narrative was associated with some of the market's largest tech companies.

The 'higher for longer' narrative from the Fed in autumn poured cold water on what had been quite a supportive market until then, however positive GDP numbers continued to come through, underwriting profit expectations for the year ahead.

When Fed announced in December that it believed disinflationary trends were firmly established, it opened the floodgates for a pronounced market rotation as we headed into year end. Throughout this time, the prevailing consensus was that the US, at least, would avoid a significant downturn.

Speaking of AI, to what extent was last year's US outperformance associated with this theme?

NVIDIA's results and Microsoft's Copilot launch gave the US AI story particular strength. The rest of the world struggles to participate in the AI theme to the same extent because, despite the global opportunity set, there are regional variations across industries. To that end, Silicon Valley is the clear winner in marketing-leading technology.

The US today represents ~68% of this global opportunity set (in comparison to 48% in 2006 when our Global Equity team started managing money)[1]. This strong development has been partly driven by new technologies and industries.

[1] Bloomberg.

Market gains were led by the 'Magnificent 7' in 2023. How do you view this market narrowness?

Market-cap weighted versions of conventional indices, such as the S&P 500 and MSCI World, performed significantly better than equally-weighted versions of these indices, indicating that the bulk of companies struggled to participate. This created quite a narrow market and, in turn, gave rise to a challenging period for active investors, as fewer companies outperformed.

The Fed changed the game on investors with an announcement (just before the end of 2023) that, in its view, inflation had got to such a level where it could start thinking about cutting interest rates. Smaller and medium-sized companies had lagged prior to that point, and although there was a temporary rotation on the back of this announcement, with some of these companies starting to outperform, this hasn't extended into 2024. In the first month of this year, it was still the larger companies that were continuing to hold their positions and actually lead the market higher.

What have been the impact of recent market dynamics on your long-term investment approach?

As fundamental long-term investors, we focus on companies' contingent assets. These are intangible aspects of companies, such as human capital, culture and innovation, that we believe are important to long-term, sustainable success, as they inform company fundamentals.

However, over the past 18 months, rising interest rates and high levels of market uncertainty have meant that investors naturally shortened their time horizons.

This increased uncertainty led markets to reward short-term earnings and cash returns over longer-term value creation. In mathematical terms, the impact of higher, real interest rates increases the discount rate, and when discount rates rise, the long term is worth proportionately less than the short term.

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In our Global Equity team's language, investors favoured borrowing and the formation of contingent liabilities over investing and the creation of contingent assets. As a result, this changed where investors looked for value in the market.

And for the asset class and your team, what's in store for '24?

The impact of higher interest rates is dissipating, and we believe that business fundamentals are starting to inform share prices once again.

The disruption of value transfer (which is when value flows from extra-financials to financials to share prices and to portfolios) can present significant headwinds for bottom-up, long-term active investors.

However, this year, there is less to disrupt that transfer of value. The Fed is comfortable that inflation is stable, and the risk of ever-higher interest rates and inflation has been removed. Consequently, uncertainty has diminished, and investors' time horizons are lengthening again.

We are positive that the broader investment environment seems to be improving and that the market has had an opportunity to digest the implications of recent shocks.

In line with our philosophy and process, we continue to stay focused on fundamentals as these drive share prices and should reward investors over the long term.

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