MORNINGSTAR Wealth

# Investment Insight
## Why are markets up so much?

**Morningstar Wealth**
**EMEA**

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**For Financial Advisers to use with their clients**

- Boom year for equities so far
- Falling inflation has reduced fears of recession
- Diversifiers have underperformed but worth sticking with

2024 has been a great year for investors.

Equity markets have rallied strongly, returns more than twice what you'd normally expect, based on long term real returns. None more so than the US, where the Information Technology (IT) sector is up circa 30%, supercharged by Nvidia gains of 174%*. Both have been re-rated and current share prices are building in optimism, with extra spending on AI a theme some investors have used to justify paying higher multiples. IT is now the dominant sector in market capitalisation weighted indices, having outperformed other industries by so much. For example, returns year to date are 4 times those of US healthcare stocks and over 7 times as much as US consumer staples, both classic defensive sectors. This is extreme by any measure. It is also why active managers have struggled to keep pace with highly concentrated stockmarket indices dominated by a very small number of companies.

Outside the US, market returns have been good by historical standards, though far less than the US, reflecting less exposure to IT (the UK) or a greater degree of pessimism about economic and market prospects (China). The best performing strategy this year has been the US stockmarket index or preferably 100% in Nvidia.

What does tell us about the future and how to invest? Well to answer that question, we need to look at what's behind the rally and where this has left economies and markets.
A key support has been the favourable backdrop of inflation trends. After rocketing in 2021 and 2022, goods inflation has dropped precipitously, as supply chain pressures ease and even supply cuts created by OPEC plus have failed to spark high energy prices. Services inflation has also come down, though labour markets still remain tight and wage growth remains above average.

The bottom line is that inflation has dropped back into the target zone of central bankers, even if it remains above. Fears of a rate rise have eased and with it concerns about a potential knock-on recession in 2024/25. This has favoured equities over bonds by a much wider margin that usual. Bond markets suffered as investors swung from giddy optimism to pessimism about prospects for lower interest rates. Only Emerging Market bonds and high yield have generated positive returns, but even then, they have struggled to match returns from cash or keep pace with inflation.

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The AI themed boom may well continue but the breakneck speed and size of gains means caution is warranted in terms of diversification. Emerging markets and the UK stockmarket, still offer attractive risk adjusted returns and have not been re-rated this year. Bonds are benefitting from more sanguine expectations about future interest rates and the clock is ticking for central banks holding rates well above inflation rates when inflation is within their ranges.

Above all it is a time for active asset allocation and fossicking across all markets to seek out diversity and not be beholden to the fortunes of a few highly valued companies. M

*Source Morningstar Direct, time period: year-to date as at 14/06/2024.

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