INVESTMENT UPDATE

FEBRUARY 2023

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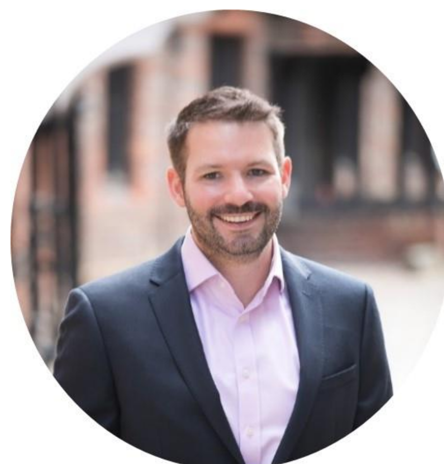


Adam Flack
Principal Financial Planner

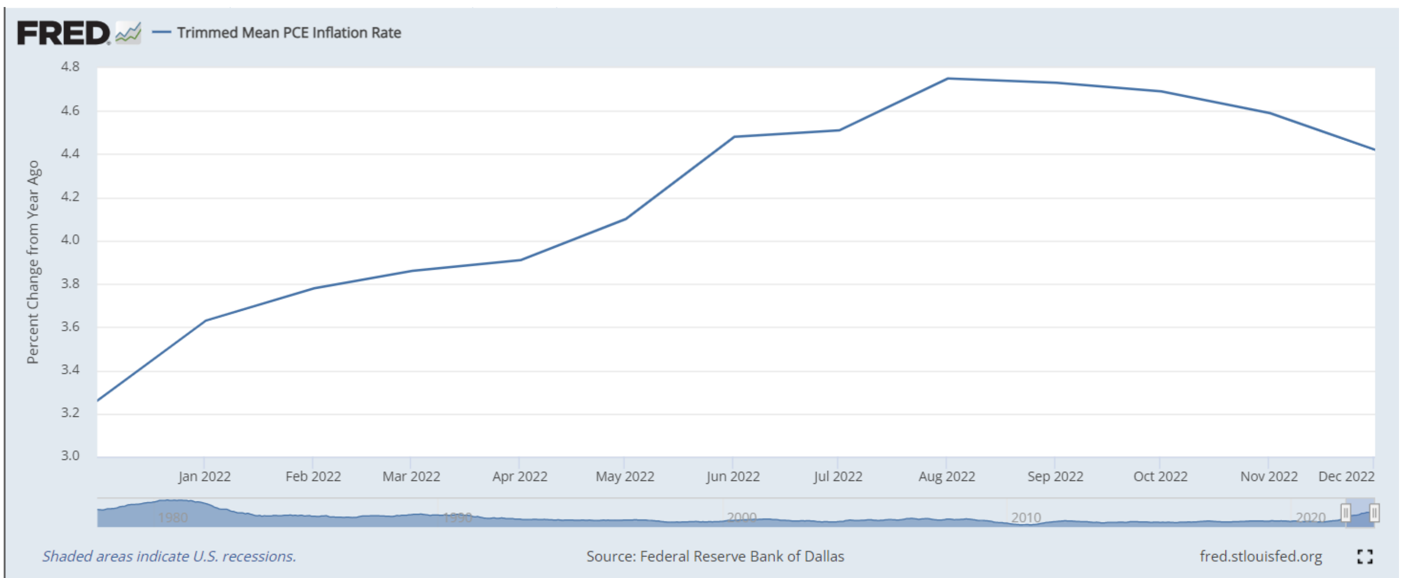
INVESTMENT UPDATE

FEBRUARY 23

INDEX	LEVEL 31ST DECEMBER	LEVEL 31ST JANUARY	CHANGE
S&P 500	3839	4076	+6.2
FTSE 100	7451	7772	+4.3%
Euro Stoxx 600	425	453	+6.5%
Shanghai	3089	3265	+5.7%
US 10 Yr Treasury Yield	3.87%	3.47%	-0.40
UK 10 Yr Gilt Yield	3.66%	3.24%	-0.42
Bund 10 Yr	2.56%	2.23%	-0.33

Following a difficult 2022, culminating in declines through December, January saw markets turn positive, as many indicators continued to signal declines in the rate of inflation and the possibility of recession being avoided. These factors combined to lead investors to speculate about the potential for a peak in interest rates being lower, and the point at which they start to decline again as moving closer. The jury may well be out on certain of these points, but it seems clear that rate of inflation is declining, which is good news for all.

In the US, we saw the Consumer Price Index (CPI) decline to 6.5% from 7.2% and the Federal Reserve's preferred measure, Personal Consumption Expenditure (PCE) inflation, also continued to decline from the previous month.



The expectation for US rates to peak anytime soon was challenged by Federal Reserve Chairman Jerome Powell. US rates were raised 0.25% as expected, firmly restating the inflation target/goal of 2%. The Fed' pushed monetary policy further into restrictive territory but slowed the pace of increase notably as it made positive steps towards controlling inflation. The benchmark interest rate is now in a range 4.5% to 4.75%. This rise marks a second downshift from the Fed' following a slowdown to 0.5% in December after four consecutive 0.75% hikes.

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In the US, we are in the midst of "earnings season", when companies reporting their results. Earnings for 2022 have been at best lacklustre; whilst earnings have grown in comparison to previous results, they have come in below analyst forecasts. That would suggest a surprise to which markets should have reacted negatively. But yet the S&P 500 Index has rallied over 6%. Clearly, markets were not surprised: whilst analysts may not have adjusted their forecasts, investors had already taken these weaker results into consideration. Instead, the positive surprise that the market is perhaps reacting to, is the quicker-than-expected easing of Covid restrictions in China. Remember that China is the world's second-largest economy, and people there have been living under severe Zero-Covid restriction for three years. As we saw in developed markets, pent-up demand will likely drive a powerful consumption boost. Businesses can get back to doing business, both locally and internationally, without the previous restrictions. China's economy is likely to be the only major economy to accelerate in 2023.

In the US, and in other western economies, the one statistic that continues to create doubt about the direction of future interest rates is the jobless rate. Despite the anticipated slowdown in the economy, unemployment remains low, following the reduced participation of the labour market post-COVID. This creates upward pressure in wage rates, themselves a contributory factor to inflation: In the US, those staying in their current jobs enjoyed average salary increases of 7.3% in 2022; those moving jobs managed gains of 14.5%. High levels of employment mean spending is still robust. So, while inflation may come down from peak levels, it may prove difficult to bring down to central bankers' targeted levels. And with central bank credibility on the line, that may lead to interest rates staying higher for longer.

Economic data has been mixed in the UK over the last few months. UK Inflation continued to fall but this has been at a slower rate than the US and Europe. Imported energy, food prices, and a tight labour market are largely to blame for the stickier inflation. Although unemployment increased slightly to 3.7%, there are still 1.16 million vacancies in the UK, which continues to give the unions confidence to push for higher wages. Housing market activity weakened following the disastrous Kwarteng mini-budget, however recent data is suggesting a stabilisation and modest improvement in activity since the turn of the year. Consumer spending has been holding up well, despite the cost-of-living issues. Gross Domestic Product (GDP) grew again in November, and it is now looking likely that the economy will avoid the technical definition of a recession by growing in the final quarter of 2022.

The European market continued its strong performance in January posting one of the strongest returns among developed markets. GDP estimates for the Eurozone suggest that the region is likely to avoid a recession. Furthermore, headline inflation continues to trend down although core inflation remains unchanged from a month earlier at 5.2%. Balancing all this out, the language from European Central Bank board members has become less hawkish, increasing the likelihood that the region is close to a peak in rates. Two more rate rises are expected in March (0.50%) and May (0.25%) although this remains data dependent.

China's economic reopening is perhaps the single most positive item of news in the short year-to-date with positive knock-on consequences to global GDP and particularly to those nations with an enhanced trading relationship. Commodity prices pushed higher consequently in anticipation of resumed demand increases for industrial components, such as copper. Pent up demand following lengthy lockdowns is bound to drive consumption whilst the Peoples' Bank of China deploys an accommodative stance to drive GDP towards the 5.5% target. Asia and Emerging Market equities have a positive outlook for 2023 and it seems likely that portfolio allocations will be increased here.

In Japan, the widening of the tolerance band for 10-year Japanese government bonds to 0.5% took markets by surprise in December last year, leading investors to speculate that a change to a tighter monetary policy might be on the cards. Following this, there was more anticipation than usual for the Bank of Japan's Monetary Policy meeting in January. This fell flat as the Bank of Japan effectively kicked the can down the road by maintaining a status quo across all key monetary policy parameters. Investors now look to April when Governor Kuroda steps down, to see the direction of the new Governor and whether Japan's ultra-loose monetary policy will be maintained.

Overall, whilst the recovery in markets is welcome, we will have to pay close attention to corporate earnings announcements as the quarter goes on. Overall, valuations still aren't cheap in the US, although there is still a large divergence between certain sectors. The fixed interest markets now look fair value, resuming their role as a diversifier of risk and there are potential opportunities here. As with 2022, inflation data as it emerges is likely to continue to dominate market participants' positioning throughout the year.

Rockhold Asset Management, with contribution from Alpha Beta Partners and Marlborough, February 2023

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