INVESTMENT UPDATE

MARCH 2023

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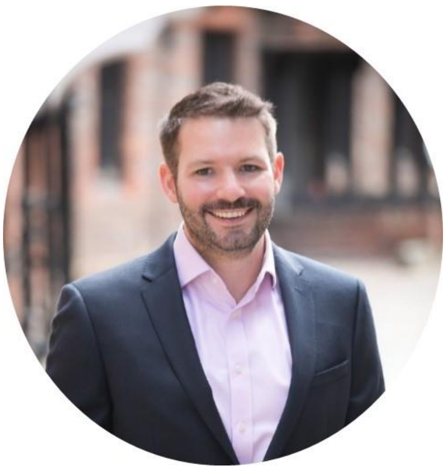


Adam Flack
Principal Financial Planner

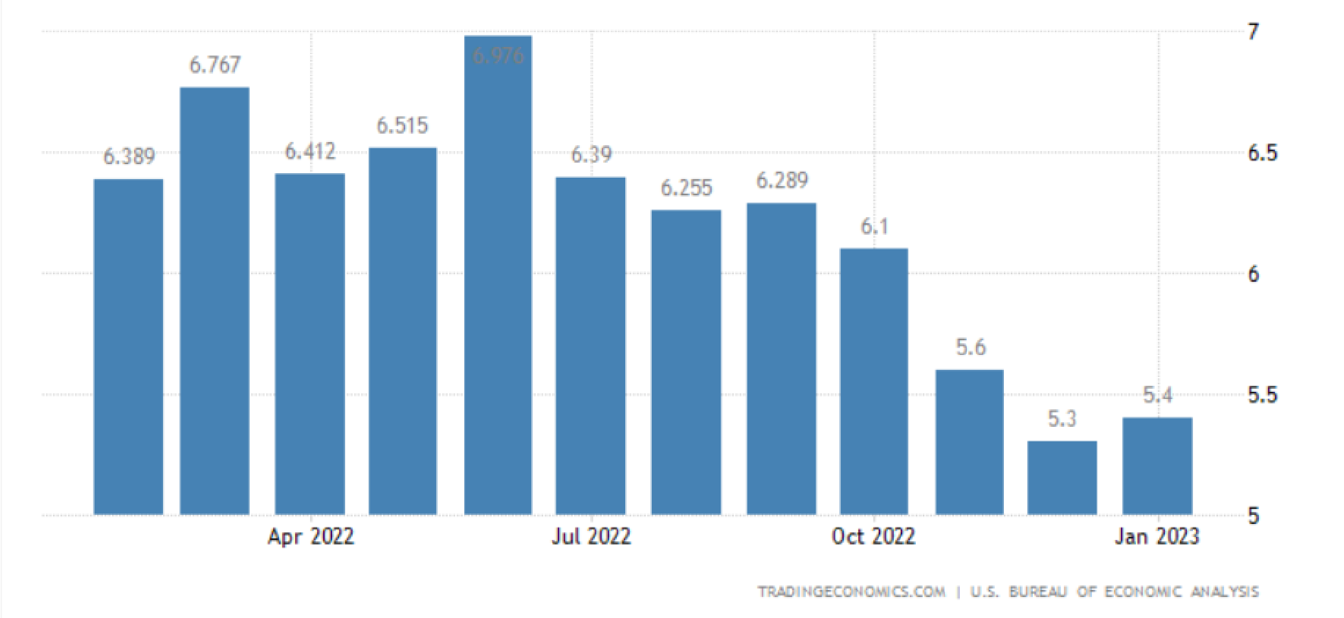
INVESTMENT UPDATE

MARCH 23

INDEX	LEVEL 31ST JANUARY	LEVEL 28TH FEBRUARY	CHANGE
S&P 500	4076	3970	-2.6%
FTSE 100	7772	7876	+1.3%
Euro Stoxx 600	453	461	+1.8%
Shanghai	3265	3280	+0.5%
US 10 Yr Treasury Yield	3.47%	3.94%	+0.37
UK 10 Yr Gilt Yield	3.24%	3.86%	+0.62
Bund 10 Yr	2.23%	2.70%	+0.47

Initially, markets in February continued the positive trend that commenced in January, as optimism grew about the possibility of an early peak in interest rates. Indeed, the FTSE 100 index briefly touched an all-time high of 8020. However, there was a feeling that perhaps markets had gotten ahead of themselves and as the month drew on a sense of reality seemed to dawn. Market expectations about the peak in interest rates steadily increased during the month, especially as we saw certain indicators that suggested inflation was a little stickier than markets were previously anticipating. The implied peak in US rates is now over 5%, having started the month around 4.7% and in Europe 4% versus 3.5%. Consequently, the gains seen earlier in the month in both bonds and equities were gradually eroded.

In the US, whilst we saw headline inflation numbers fall, we saw the US Federal Reserve (the Fed)'s preferred measure, the Personal Consumption Expenditure (PCE) price index, register a small gain in January, which bucked the trend of steady decline since its peak in June:



US employment figures remain stubbornly high which, as higher interest rates slow down the economy, is contradictory as you would expect to employment to fall, and the Fed has pointed to this as a key indicator they take into consideration when setting interest rates.

The problem lies with the low levels of employees returning to the labour market post COVID (something we see echoed in the UK), which makes employers wary about laying off workers even as demand slows. As a consequence of this 'stickier' inflation and low unemployment, US 2-year bond yields (an indicator as to the direction of near-term interest rates), now stand at levels last seen in 2007. This could start to impact on corporate cashflows, and we have already seen a smaller a number of companies than we would usually expect exceed analysts earning expectations. Given the higher valuations of the US market, this could start to present a problem as we approach the next corporate earnings season.

In the UK and Europe, similar themes were occupying investor's mind, particularly after some strong inflation numbers from Spain and Italy. Mrs Lagarde and the ECB remain intent on tackling inflationary pressures by hiking rates and removing liquidity, in-sync with the Federal Reserve and the Bank of England. However, Europe's rapid switch away from Russian gas has been extraordinary and this, coupled with a warmer winter on the continent, has improved the investor mood no end. Economic activity has picked up, as reported in the Purchasing Managers Index (PMI) report (an indicator of underlying economic trends in industry) during the month, which although weaker than expected, showed a pickup in manufacturing for the first time since May 2022 and equities moved ahead.

UK stocks pushed higher, driven by likely higher demand for commodities from a reopening China and robust oil company results. Banks pushed higher too, and results pleased investors – such is the concentration and skew in the UK stock market these days for the UK's largest listed firms. The falls in UK inflation continued to be small and steady, the 10.1% annual rate in January being 0.40% lower than the December level. The Bank of England raised rates by the expected 50bps to 4.0%. The accompanying statement was dovish, which suggested that inflation had turned a corner and perhaps less/no more rate increases would be needed. GDP growth in December was a negative at -0.5%. However, some recent data points have pointed to an improving UK economy. The PMI business survey at 53.1 signalled a healthy forward-looking picture (a number above 50 is regarded as a positive indicator). The Services PMI of 53.5 was particularly eye catching given that this represents over 70% of the UK Economy. The unemployment rate also continued to remain grounded at the low rate of 3.7%.

In Japan, inflation reached 4.2% in January, which although low relative to global markets is a 41 year high for the country and above the 2% target level. At present the Central Bank believes that the price increases have not led to a sustainable rise in wages and therefore loose monetary policy was still needed. With Haruhiko Kuroda (Bank of Japan Governor) set to stand down in April, we now wait to see the direction of monetary policy under the new Governor who looks set to be Economist Kazuo Ueda.

Markets across Asia and Emerging Markets disappointed in February, with escalating geopolitical tensions pushing markets down. There are still positive signs, with inflation continuing to fall across the region and typically faster than most Western counterparts.

China has injected $162 billion liquidity into her economy to help stimulate a smooth transition from the protracted Covid related lockdown. The halo effect from this and the reopening has been felt positively throughout global markets. Chinese PMI reports are expected to support the notion of a pick-up in activity. The fact China is no longer economically synchronised with the West, as authorities attempt to stimulate the economy rather than slow it, will deliver positive and negative drivers as the cycle works through. However, for now the news here is net positive and provides a counterbalance to the slowdown experienced elsewhere.

At portfolio level, cash levels remain elevated, due to concerns over the possible downturn in the US economy and the impact of higher bond yields as fixed interest markets adjust to a higher peak in interest rates. However, we are now benefitting from sensible yields on cash funds of 3.5% or more as we are "paid to wait" for the right reinvestment moment. Cash will be deployed back to risk assets when markets provide the stimulus, which is not anticipated to be too far distant.

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

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