# INVESTMENT UPDATE

OCTOBER 2023


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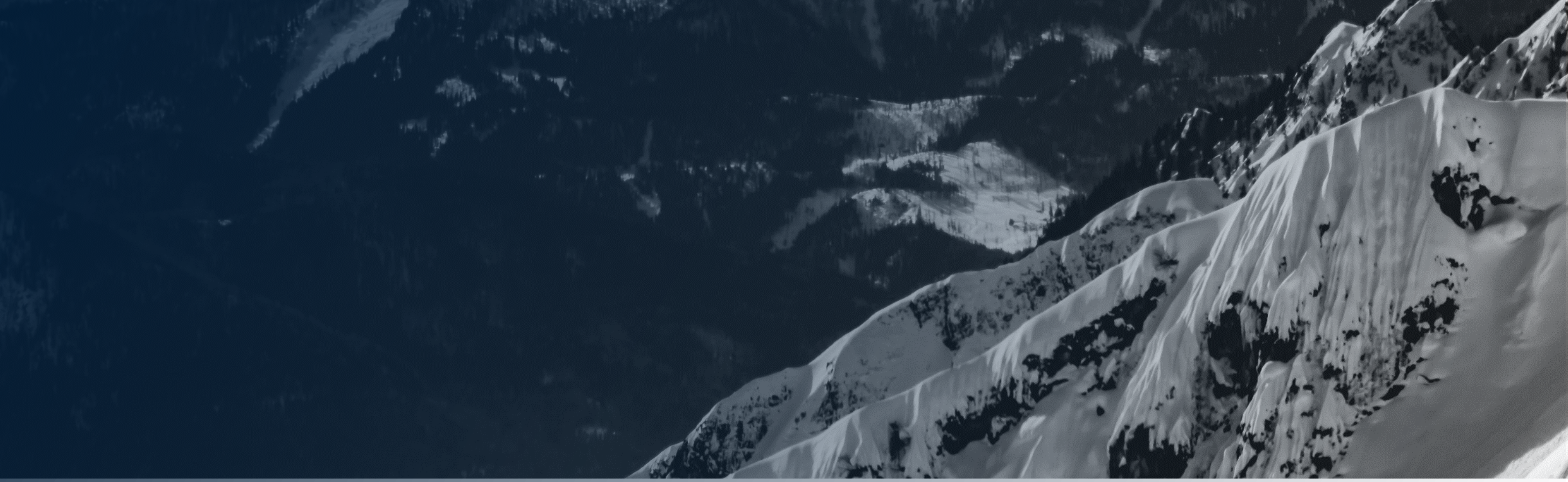

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OCTOBER 23

| INDEX | LEVEL 31ST AUGUST | LEVEL 30TH SEPT | CHANGE |
|---|---|---|---|
| **S&P 500** | 4507 | 4288 | -4.85% |
| **FTSE 100** | 7439 | 7608 | +2.27% |
| **EURO STOXX 600** | 458 | 450 | -1.75% |
| **NIKKEI 225** | 32619 | 31857 | -2.33% |
| **SHANGHAI** | 3119 | 3110 | -0.29% |
| **US 10 YR TREASURY YIELD** | 4.09% | 4.57% | +0.48 |
| **UK 10 YR GILT YIELD** | 4.36% | 4.45% | +0.09 |
| **BUND 10 YR** | 2.47% | 2.83% | +0.36 |

## Overview

September was another difficult month for both equities and bonds alike, as most major markets were down and bond yields moved higher. The notable exception was the FTSE 100, which delivered a healthy positive return. Given the index's large exposure to oil companies, this should come of little surprise as we saw a spike up in the price of oil to over $90 per barrel. The disproportionate influence energy stocks have on the index can be demonstrated by contrasting the returns to the second tier of the UK stock market, with the FTSE 250 index down 1.5% over the month. Fortunately, investors were insulated in part from the falls in overseas markets by a fall in the value of sterling.

It is perhaps ironic that much of the blame for poor market returns can be pointed at the continued rise in bond yields, in a month where central bankers were either keeping interest rates unchanged, or signifying their intention to do so. However, it was language used by central bankers which indicated rates would be higher for longer which seemed to give rise to the increase in yields. This, perhaps combined with the rise in the price of oil threatening to push up inflation, is what equity markets focussed on.

## US

The other key event troubling markets in September was the ongoing saga of the US debt ceiling. Nerves jangled as the deadline of 2nd October approached. This date is when a shut down in US Government spending would have been triggered, whereby civil servants do not get paid, bins are not collected etc, unless a resolution is found. The Senate approved a late measure which effectively kicked the can down the road for 45 days until 17 November. Funding is in place for all eventualities including disaster relief at home but excludes further support for the Ukraine war.

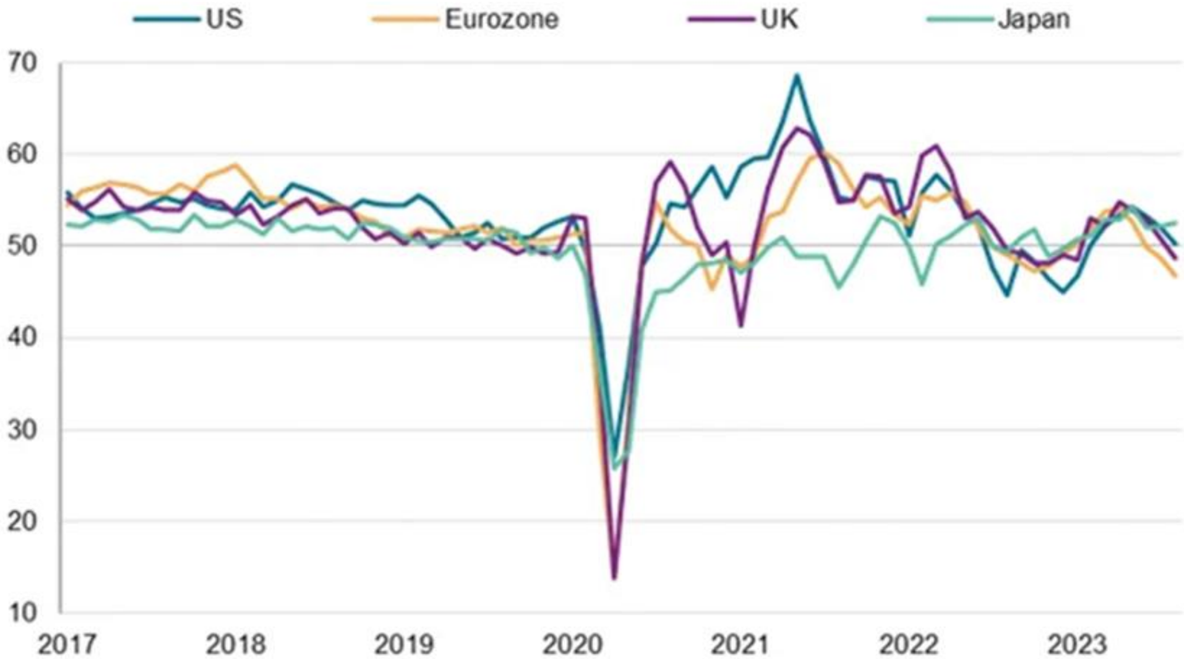
The Federal Reserve kept rates on hold at their last meeting, a policy tactic which then rippled out across other global central banks. Despite hiking rates faster than any time in recent history, inflation has begun bubbling back to the surface once again provoked by higher energy costs. One of the major indicators used to predict future interest rate moves in the US, 'Fedwatch,' indicates a probability of 25.7% that rates will rise again during November and a resounding 74.3% probability they will remain on hold. Since the Federal Reserve have cancelled so-called forward guidance, utterances from key spokespeople are seized upon by markets. Jerome Powell (Federal Reserve Chair), at his most recent press conference stated rates will be around 5.6% by the year end, 5.1% by the end of 2024 and 3.9% by the end of 2025. This is the 'higher for longer' language that most probably provoked bond markets to sell off.

Weakness notably in the employment market, or an unforeseen credit event is likely to be the trigger for the Federal Reserve to begin cutting rates. A structurally higher dollar has been a by-product of recent market moves and, as previously, will act as a buoyancy aid to portfolio valuations with US exposures. Meanwhile the US equity market has performed well year-to-date at headline level. Scratch the surface to see the "magnificent 7" technology behemoths have been responsible for almost all growth and the remaining 493 companies of the S&P 500 remain mostly flat. Consequently, valuations for the largest names are high but less troubling further down the capitalisation scale.

## Europe

The ECB tightened monetary policy for the 10th consecutive time in September with a rate rise of 0.25% bringing the deposit rate to 4%. Christine Lagarde gave the strongest signal to date that rates are now at a level, that if maintained for a sufficient time, will aid the timely return for inflation back to its target level of 2%. Core Inflation continued its downward trajectory in September falling to 4.5%. In data, we can now start to see the impact of higher rates and inflation on companies and consumers, with weak services and manufacturing PMI (Purchasing Managers Index – a barometer of industrial activity, with 'weak' being less than 50) and Eurozone consumer morale at a 6-month low. Despite this, there are many decent companies across Europe, plenty with internationally diversified earnings which have continued to prosper despite the colder economic forecasts domestically. The luxury house of brands LVMH and Novo Nordisk (the pharmaceuticals giant) are such examples.

**Major developed economies, output (manufacturing & services)**




Data compiled September 5, 2023 including August PMI data.
PMI index value of 50 = no change on prior month, covers manufacturing and services.
Sources: S&P Global PMI, S&P Global Market Intelligence, HCOB, CIPS, au Jibun Bank.
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## UK

In positive news, the Bank of England decided to maintain interest rates at 5.25% during the Monetary Policy Committee (MPC) meeting. The MPC reached this decision with a narrow five-to-four vote, with BoE Governor Andrew Bailey casting the decisive vote. This choice followed the release of the UK's August inflation figures, indicating a deceleration in price increases. Central bankers concluded that it was appropriate to keep interest rates steady as UK inflation eased to 6.7% in August 2023, surpassing expectations of 7.0%. This marked a decline from the 6.8% recorded in July 2023 and represented the lowest rate since February 2022. The decrease was primarily attributed to diminishing food inflation and a decline in accommodation service costs. UK stocks remain attractively priced and with upward moves in commodity prices once again we may see a recovery in a tight band. UK Gilts point to a stagflation risk with the strong potential for a weaker economy at home and inflation remaining higher than Bank of England targets.

## Japan

There is still positive sentiment towards the Japanese equities market. Corporate Governance reform has taken a lot of the headlines this year and there are signs that those reforms are working with value stocks outperforming core and growth year to date. Until recently, currency weakness has been a headwind to Sterling and Dollar returns in 2023, so all eyes will on the Ministry of Finance in Japan to give us clues as to future monetary policy. September was the first negative month of returns in 2023.

## Asia and Emerging Markets

Equity markets showed some signs of improvement in September (in sterling terms), though data continues to be weak. China remains weighed lower by structural issues including huge debt bubbles in the real estate sector a demographic profile ill-suited to her ambitions and an economic recovery which has stalled post-Covid. Chinese exports fell 8.8% in the year to August, and the renminbi (the currency in China) hit a 16-year low in response to this. Service sector activity was the weakest in 8 months during August, but their official PMI showed that industrial activity expanded in September for the first time since March. Inflation turned positive again in August, rising 0.1%. Concerns continued to grow that rates will stay higher for longer in the US, which has reduced the risk appetite of investors and has been a drag on Emerging Markets and Asia.

## Outlook

Opportunities still continue to present themselves in the fixed interest market, with attractive yields and the potential for capital returns seen in government bonds. However, an element of patience is required until we see firm evidence of peak interest rates emerging, as the increase in yields this month has ably demonstrated. Meanwhile, cash and shorter dated bonds continue to offer reasonable returns, particularly in the UK and portfolios remain poised to move should we signs of monetary policy easing. In corporate bonds, a selective approach is required, as any economic slowdown could push yields higher for some companies. Fortunately, many companies are not looking at refinancing until 2024/25, so the impact of higher rates is less than it would have been. Equity held has allowed for portfolios to enjoy the expansion of AI-led valuations in the US whilst our UK position will enable an uptick, should it arrive, from and further surge in commodities and energy. Japan equity exposure continues overweight and performing well.

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

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