Summer 2023

market outlook.

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The UK Economy

The UK has avoided a recession so far this year, helped by robust wage growth and a tight labour market. However, the economy remains on a delicate balance and growth teeters on the edge month on month.

Headline inflation fell to 7.9% in June, and we expect it to fall sharply in the coming months, largely due to base effects as the energy price hikes from last year are no longer included in the annual calculation. This has had a positive impact on company stocks, rising hopes that the BoE is nearing the end of its tightening cycle. As higher rates are yet to filter through into mortgage rates and the wider economy, we are exercising caution within some sectors. Sterling has been strong, which will benefit some UK companies, particularly domestic and those reliant on importing goods. However, sterling strength can act as a headwind for UK-listed global companies as their foreign earnings are translated into sterling.

Thus far, companies have demonstrated resilient performance in Q2. Valuations are appealing compared to their own historical levels and when benchmarked against international peers. This optimistic outlook bodes well for the medium to long term, making UK equities an attractive investment proposition.

The Japanese Economy

Japan has performed well over the period, benefitting from its lagged post-COVID reopening, enhancing the appeal of foreign investment. The recent rally in large caps has been further fuelled by Warren Buffett's trading activity. However, we remain cautious about trading short-term noise; with the greater valuation opportunities found in the under-researched companies within the small/mid-cap space.

Despite short-term positive momentum, the sizable divergence between Japan’s monetary policy and that of other central banks has led to currency weakness, which presents challenges for the economy. The impact of rate hikes from the US and Europe could affect non-Yen returns further, later in the year.

Uncertainty surrounding the yield curve remains, the Bank of Japan (BoJ) has implemented yield curve control to combat deflation risks and stimulate the economy. The recent decision to expand the yield range spooked markets and steepened the yield curve which saw the BoJ inject more stimulus twice in the following days to tame the yield curve.

Despite policy initiatives aimed at stimulating wage growth and inflation, the persistent threat of deflation remains. Subdued core inflation (which excludes food and energy) stresses the complexities of fostering sustainable price growth and highlights Japan’s unique challenges.

The Emerging Markets & Asia Economy

Despite the Chinese consumer coming back online slower than anticipated, the People's Bank of China has announced numerous policy measures to bolster the property sector and stimulate spending. The expectation of targeted interest rate cuts remains, as the government leans on lenders to cut mortgage rates which stands to benefit sentiment and growth.

In recent months China has strengthened relations with global leaders, notably forging several trade agreements with Brazilian President Lula da Silva amounting to USD10 billion. Relations between the US and China appear to be more amicable, following tensions related to Taiwan, technology trade wars and sanctions. Attractive valuations relative to the global market coupled with growing consumer confidence underpins the compelling outlook of China.

India has deepened ties with the US, as demonstrated by Biden's efforts to extend and renew visas for skilled Indian workers. Prime Minister Narendra Modi's political neutrality about Russia and Ukraine, coupled with a focus on economic growth, has positioned India as one of the best-performing regions over the quarter; this arguably strong outlook of the world's largest populus continues to develop.

Brazil has demonstrated robust performance following economic expansion informed by the commodity cycle that succeeded Russia's war in Ukraine. With upward commodity prices and inflationary pressures subsiding, policymakers are anticipated to initiate interest rate cuts in the upcoming months (marking the first reduction in three years). This support will likely deliver a considerable boost to the economy.

The US Economy

The Federal Reserve remains data dependent, pausing rate hikes in June to accommodate policy lags before resuming rate increases in July. The upcoming summer months may be uneventful with no monetary policy meetings in August. Earlier in the year markets were overly optimistic, the prospect of a severe cycle of rate cuts has now diminished, as we anticipated.

The US debt ceiling issue was successfully resolved, alleviating a source of financial uncertainty. President Biden has announced that he intends to run for the 2024 election. As elections draw nearer, campaigns will likely cause some noise in markets, with current economic conditions finely poised no candidate will not want to rock the boat too much, which is likely good news for markets.

Second quarter results of US banks exceeded expectations, showcasing the financial system's response to a small handful of unique bank failures earlier in the year. These gains have been primarily driven by higher interest rates, enabling banks to generate greater revenue from lending and savings deposits.

Performance throughout the period has been influenced by a sense of enthusiasm surrounding artificial intelligence (AI). The frenzy surrounding AI is reminiscent of a potential bubble, as such we remain cautious about the longevity of this trend. Our focus remains on growth in major tech companies, irrespective of AI, where there has been growth driven by strong outlooks as well as investors using big tech as a bond proxy play.

The European Economy

The uncertainty stemming from Russia's ongoing conflict with Ukraine still casts a shadow over Europe. Markets have not fully priced in this ambiguity as evident from the region's performance in the first half of the year.

While the prospect of further rate hikes raises valid concerns among consumers, the ECB remains aware of currency dynamics and is prepared to tailor policy, safeguarding the stability of the euro, whilst remaining data dependent.

Recent earnings seasons have been broadly disappointing. Sectors such as automobiles have an unfavourable outlook given headwinds, which has had a notable impact on Germany with its manufacturing-driven economy. Germany's historical dependence on Russia for energy supply and trade has further exacerbated the situation, contributing to its slowdown.

The forthcoming winter season introduces an element of unpredictability, given that the mitigating effects of the previous year's mild weather on energy demand might not be a recurring phenomenon. However, with valuations looking attractive, we are poised to seize opportunities should there be any signs of political resolution.

Fixed Interest

Government bond yield curves across the majority of developed markets have exhibited inversions (highlighting where longer-term bond yields are lower than shorter term ones).

Over the quarter, corporate bonds have seen spreads tighten, this is particularly significant in the financial sector which bounced back after market turbulence surrounding Credit Suisse and SVB. Generally, corporate balance sheets appear well equipped to navigate short term economic challenges, showcasing robust liquidity and access to markets.

We believe that central banks are approaching peak interest rates. Therefore, we anticipate a decline in yields and a corresponding increase in prices, given their inverse relationship with yields.

Investors continue to speculate on potential shifts in monetary policy, factoring in the likelihood of rate cuts. However, this dynamic introduces an inherent risk to the market, amplifying the potential for sell offs if expected rate cuts do not materialise. One, must also consider that UK government bond supply will remain high, encompassing both issuance and the BoE’s Quantitative tightening program (QT).

If you would like to discuss this or any other aspect of your portfolio, please do not hesitate to contact us on 0800 028 3200, Monday to Friday 9am-5pm or you can email us at mywealth@wealthatwork.co.uk

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