Market Brief

October's highlights

- Q3 GDP releases generally surprised to the upside, but the outlook continued to deteriorate with further downwards revisions to consensus forecasts for global growth in 2023, and upwards revisions to inflation forecasts.
- Composite PMIs in many developed markets fell to a level consistent with contraction, confirming the economic slowdown.
- US and EU Sovereign bond yields continue to increase on the expectation of further interest rate hikes to stabilise and subsequently reduce inflation from current high levels.
- UK government bond yields fell as Rishi Sunak was appointed prime minister while new chancellor, Jeremy Hunt, reversed many of the previously proposed tax cuts and promised much more fiscal restraint in the mid-November budget.
- Developed market equities registered healthy returns in October, although emerging market equities continued to fall, and credit spreads generally tightened.
- Sterling rallied as worries around loose fiscal policy abated while the yen continued to weaken as the Bank of Japan maintained its ultra-accommodative monetary policies.

Market Performance to 31 October 2022

UK	Q4 22*	Q3 22	2022	GLOBAL	Q4 22*	Q3 22	2022
EQUITIES	3.1	-3.4	-5.0	**EQUITIES**	6.0	-4.8	-16.5
BONDS				North America	7.9	-4.7	-18.2
Conventional gilts	3.1	-12.8	-22.8	Europe ex UK	7.1	-4.8	-16.0
Index-linked gilts	-4.4	-9.3	-32.4	Japan	5.2	-1.2	-1.0
Credit	4.0	-11.0	-19.0	Dev. Asia ex Japan	2.7	-5.1	-13.2
PROPERTY**	n/a	-4.1	5.2	Emerging Markets	-3.6	-7.7	-22.1
STERLING				**GOVERNMENT BONDS**	-0.1	-2.6	-10.1
v US dollar	3.1	-8.1	-15.0	**High Yield**	2.0	-1.2	-14.4
v Euro	2.2	-1.9	-2.2	**Gold**	-2.2	-7.4	-10.1
v Japanese yen	5.9	-2.1	9.7	**Oil**	8.7	-23.3	22.2

Percentage returns in local currency ($ for Gold and Oil). *All returns to 31/10/2022, **apart from property (30/09/2022).

Quarterly update

- Despite falling at the start of the month, global equities registered healthy returns in October. US and European sovereign bond yields continued to move higher while UK yields fell sharply, as the market staged a partial recovery from September's selloff. Credit spreads tightened with UK investment grade spreads falling more than global peers as technical selling pressure abated. Oil led commodity prices higher and trade-weighted dollar gains were more subdued as the sterling and euro recovered some ground while the Yen continued to depreciate.
- Q3 GDP data released in October generally surprised to the upside. However, as high inflation and tighter monetary policy weighs on consumers and businesses, consensus forecasts suggest growth in the major advanced economies will slow considerably in 2023, with many European economies already flirting with recession.
- The October global composite PMI (which comprises both manufacturing and service surveys) pointed to a further downturn in global economic activity, with output falling in both the manufacturing and service sectors. The composite output and new orders indices both fell to their lowest level since June 2020. With demand weak, geopolitical and market volatility high, and inflationary pressures still elevated, the surveys point to a very challenging near-term growth outlook. The labour market remains resilient, however, with job creation still positive despite the mounting headwinds.

- Year-on-year headline CPI inflation is running at 10.1%, 9.9%, and 8.2%, in the UK, eurozone, and US, respectively. However, of more concern to central bankers, there is evidence of inflation pressures broadening out as tight labour markets place upwards pressure on wages. The equivalent core measures remain well above target at 6.5% in the UK, 6.6% in the US, and 4.8% in the eurozone. Headline inflation is forecast to moderate in 2023 but remain well above target in most major economies. Given it reflects stickier components, any decline in core inflation would likely be more gradual.
- Against this backdrop, the ECB raised its key interest rate by 0.75% p.a. to 2.0% p.a. in October, with the US Federal Reserve and the Bank of England (BoE) delivering similar increases in the first week of November. Further rate rises are expected but UK interest rate expectations have fallen back from recent highs touched in the wake of the “mini” budget. However, market pricing at the end of October still implies the BoE base rate will rise close to 5% p.a. in 2023.
- US and European government bond yields continued to increase as interest rate expectations ratcheted higher. In contrast, UK gilt yields fell sharply in October: the BoE supported markets in the first half of the month before the replacement chancellor unwound almost all of September’s proposed fiscal loosening and Rishi Sunak was appointed prime minister, leading to a more meaningful rally. UK 10-year yields ended the period at 3.5% p.a., 0.6% p.a. below end-September levels while equivalent US and German yields rose 0.3% p.a. and 0.1%, to 4.1% p.a. and 2.1% p.a., respectively.
- UK 10-year implied inflation, as measured by the difference between conventional and inflation-linked bonds of the same maturity, fell 0.5% p.a. to 3.5% p.a. Equivalent US implied inflation rose 0.3% p.a., to 2.5% p.a.
- US and European investment grade credit spreads tightened marginally while equivalent sterling spreads fell 0.2% p.a., to 2.3% p.a., as liquidity-driven selling pressure abated. US and European speculative grade credit spreads fell 0.8% p.a. and 0.5% p.a., to 4.6% p.a. and 5.8% p.a., respectively. Meanwhile, sterling speculative-grade credit spreads rose 0.3% p.a., to 7.3% p.a., as the UK economic outlook darkened.
- Local currency emerging market debt, as measured by the GBI-EM Global Diversified Traded Index, returned –0.9% as a 0.1% p.a. rise in yields and a weakening of emerging market currencies, in aggregate, against the dollar, offset income return. Hard currency debt, as measured by the EMBI Global Diversified Index, returned 0.2% as a decline in spreads offset a rise in underlying US treasury yields
- Global equities performed reasonably well in October despite the worsening of economic conditions, as the FTSE All World Total Return Index rose 6%. Q3 average earnings have been heavily supported by the energy sector, which massively outperformed – in the US, the sector’s earnings rose 134% year-over year. Excluding the energy sector, US Q3 earnings would have declined year-over-year by 5.1%, instead of increasing 2.2%, based on the earnings released to date. Aggregate global earnings growth forecast over 2022 and 2023 fell from 8.6% to 7.4% in October, as forecasters increasingly factored in the weaker outlook.
- Energy, industrials, healthcare, telecoms, and financials all outperformed, in that order, while utilities, consumer discretionary, technology, basic materials, and consumer staples underperformed. North America and Europe ex-UK outperformed, while the UK and Japan marginally underperformed. Heavy falls in Chinese stocks led emerging and Asian markets lower as President Xi Jinping’s re-appointment and replacement of the Politburo Standing Committee with close associates raised concerns about China’s focus on economic growth and the potential impact of redistributive policies on large companies.
- The dollar’s gains were more muted in October, rising 0.2% in trade-weighted terms, as equivalent sterling and euro measures regained some ground, rising 2.9% and 1.6%, respectively. The yen fell a 2.1% in trade-weighted terms, as the Bank of Japan’s currency ultra-accommodative monetary policy offset their attempts to prop up the yen with dollar sales.
- The MSCI UK Monthly Property Index has returned 13.5% in the 12 months to the end of September, but monthly returns entered negative territory in Q3. Capital value declines have been observed across the 3 main commercial sectors, but have been more pronounced in the industrial sector, where values dropped by 3.7% in September, versus declines of 1.8% and 2.3% in the office and retail sectors, respectively. The industrial sector had benefitted most from capital appreciation over last 12 months which may prove difficult to sustain as debt costs and the opportunity cost of capital increases. Meanwhile, a number of UK commercial property funds are limiting withdrawals as pension funds look to sell assets to rebalance portfolios and to meet demands for collateral.

For and on behalf of Hymans Robertson LLP

Additional Notes

Risk Warnings

Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of an overseas investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.

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