Marlborough

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December 2022

Global Investment Commentary

- ***All markets stronger on the view that pace of rate rises might slow***
- ***Caution still warranted***

There are plenty of reasons to be positive that markets are over the worst, and that this year's turmoil may be behind us. Inflation in the US continues to fall, and prices in Europe are now also coming down. Combined with government support in many parts of the world - as well as the excess savings built up during the pandemic - this will allow consumers to spend more, and this in turn will support economic growth. So far, even though survey-based figures (which are heavily influenced by sentiment) unanimously point towards recession, hard data shows that growth rates have actually been holding up relatively well. And on the corporate front, although analysts have been bringing down their forecasts for earnings growth in 2023, they still expect a net 5% improvement on 2022.

So far this year we have seen 350 rate hikes from 82 central banks around the world. This compares with 123 rate hikes in the whole of 2021. Policymakers now want to assess the lagged impact of higher rates, and so, with inflationary pressures beginning to ease, the pace of rate hikes may also ease soon. As noted above, this has already boosted investor sentiment.

But we believe it's too soon to sound the all-clear. With mortgage servicing costs having ramped up dramatically, house prices are coming under pressure. If the housing market falls sharply, that can have a significant impact on consumption. Secondly, although the pace of rate hikes might ease, the end point may yet be higher than markets are currently predicting. Unemployment is still close to record lows, and wage growth is still high. The US Fed sees this as a key driver of inflation, and will be reluctant to bring rates down until this is in check. Thirdly, there's the issue noted earlier: the lagged effect of rate hikes. It's not yet clear how much the higher rates will eventually impact economic growth. Nor is it clear what impact the rate hikes, or the spiralling wage costs for that matter, will have on corporate earnings.

So, with this uncertainty still present, we are treading cautiously, maintaining neutral overall exposure to equities, tilted towards more defensive income-oriented strategies. And on the fixed income side, we still have a slight underweight position, as inflation could yet surprise to the upside.

UK

- ***Difficult economic situation, but this is reflected in the price of UK shares***

In the UK, we are facing an inflation double-whammy of an energy supply shock and excess labour demand.

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The latter is a combination of the post-pandemic reduction in labour participation, and the impact of Brexit on migration. Although fiscal support has provided a cushion of sorts, real disposable incomes are declining. This will only be exacerbated as interest rates grind higher.

We are seeing more concerns being raised about the state of the housing market. But low unemployment, low current arrears levels, higher personal savings levels, and overall better lending standards mean the housing industry is in a relatively robust position. So, whilst there may be pressure in this area, we don't think a housing crash is the most likely outcome.

While the economic situation looks challenging, the UK stock market remains attractive. We've noted previously that the mix of industries represented in the FTSE 100 have helped keep returns positive this year. Despite this outperformance, the UK market is still cheap when compared to other leading indices, and when compared to its own history.

US

- ***Equity index strength masks underlying turmoil***

In the US, the energy supply shock has not been as severe as elsewhere. On the consumer demand side, wages in the US have risen faster than elsewhere. The upshot is that real disposable incomes in the US are actually expected to rise by about 3% in 2023 (by way of comparison, UK real disposable incomes are likely to fall by 3% next year).

But that labour market strength is precisely why Jerome Powell is talking tough on rates. He is desperate to avoid a wage/inflation spiral which will require a deep recession to cure. True, the rate hikes already enacted may already have done enough - time will tell - but even if the pace of increases from here is slower, there remains the risk that the peak level reached may be higher than markets are currently predicting.

Europe

- ***Recession creeping ever closer***

Although natural gas prices have fallen a long way since the summer, they are still 6-7 times higher than they were before Russia's invasion of the Ukraine (in the US, they're "only" twice as high). The relatively mild weather so far this year has helped the region reach its gas storage targets well ahead of schedule, but the higher prices will nevertheless create a powerful headwind to consumer spending. Some of this will be offset by fiscal support packages that have been announced. But then higher costs imposed by interest rate hikes will come into play, exacerbating the energy cost impact. The European Central bank (ECB) has a tricky - almost impossible - path to tread to minimise the looming recession.

Asia and Emerging Markets

- ***China concerns mount***

In China, too, a tug-of-war is playing out. At least in this region, though, inflation is not one of the contestants. Here, the weakening economic growth picture is being countered by improving policy measures. The government finally seems to be willing to consider moving away from the zero-Covid policy that has hobbled large swathes of the country, and they are also providing support to the beleaguered property sector. These measures will help in the medium-term, but in the very near term, rising Covid cases are tempering that optimism.
The "risk-on" Asian and Emerging Markets regions rebounded very strongly in November, but remain the worst performing markets this year.

Fixed Income

- ***Strong bonds***

Bonds enjoyed a strong month in November. Sovereign bonds were boosted by the improving inflation outlook, and the potential for the pace of rate rises to ease. And on the corporate bond side, credit spreads tightened as expected in a period when equities performed well.

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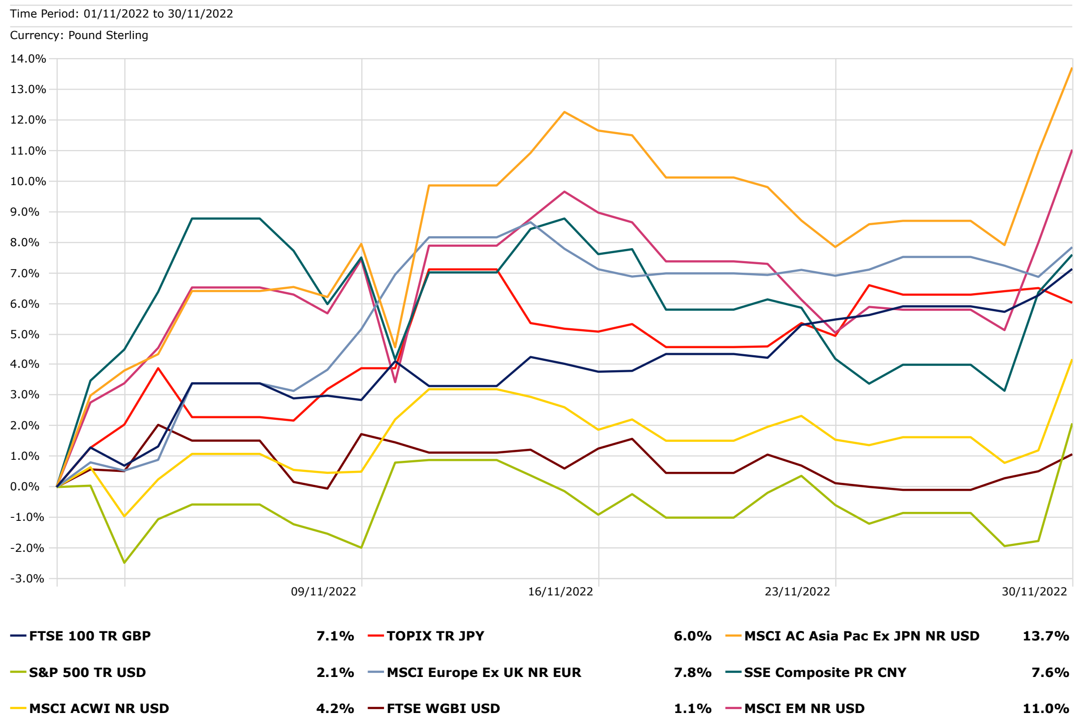
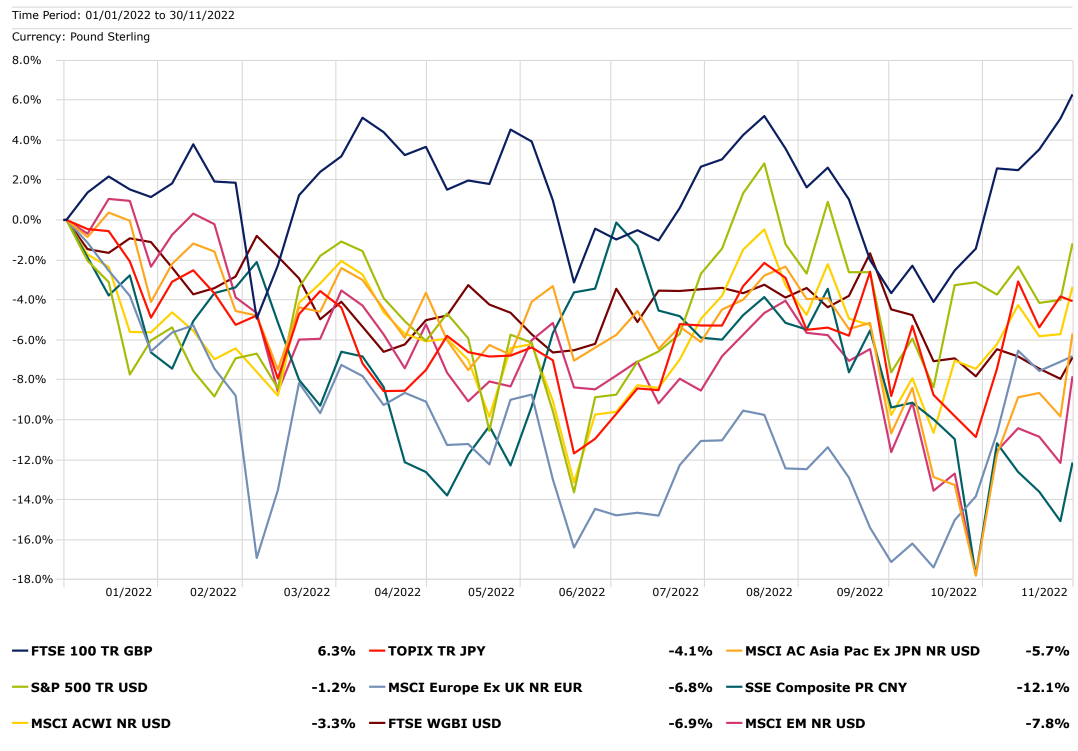
November 2022 Performance



Source: Morningstar Direct

Year to Date Performance



Source: Morningstar Direct

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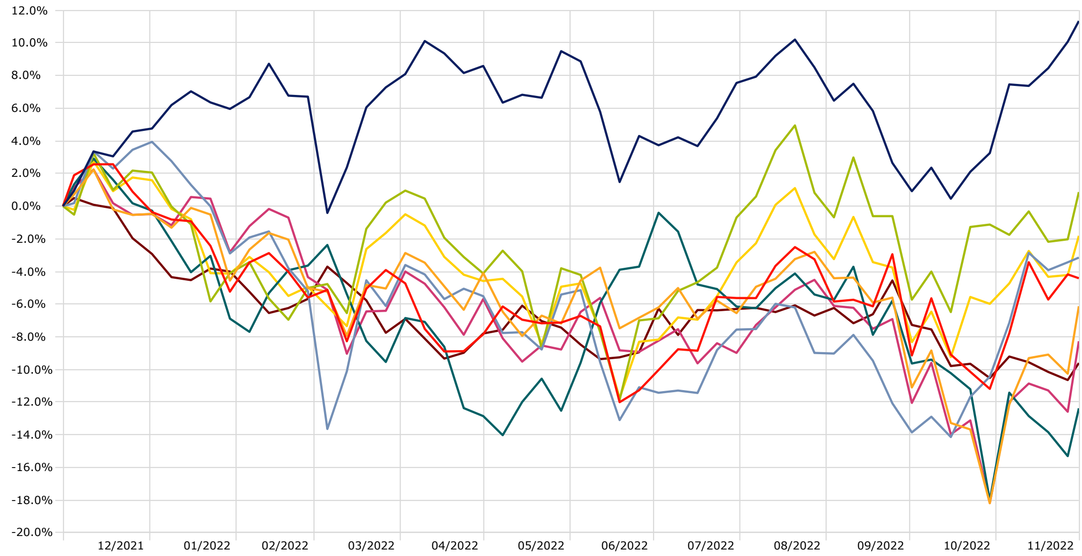
12 Month Performance

Time Period: 01/12/2021 to 30/11/2022

Currency: Pound Sterling



FTSE 100 TR GBP	11.3%	TOPIX TR JPY	-4.4%	MSCI AC Asia Pac Ex JPN NR USD	-6.1%
S&P 500 TR USD	0.9%	MSCI Europe Ex UK NR EUR	-3.2%	SSE Composite PR CNY	-12.4%
MSCI ACWI NR USD	-1.8%	FTSE WGBI USD	-9.6%	MSCI EM NR USD	-8.3%

Source: Morningstar Direct

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Market Round Up

Performance of major markets	November		Year to Date		12 months to 30th November	
	Sterling Terms	Local Currency	Sterling Terms	Local Currency	Sterling Terms	Local Currency
UK (FTSE 100)	+7.12%	+7.12%	+6.28%	+6.28%	+11.34%	+11.34%
US (S&P 500)	+2.08%	+5.59%	-1.17%	-13.10%	+0.86%	-9.21%
Europe (MSCI Europe Ex UK)	+7.83%	+7.06%	-6.82%	-9.51%	-3.15%	-4.70%
Asia (MSCI Asia Pac Ex Japan)	+13.70%	+17.60%	-5.68%	-17.07%	-6.13%	-15.50%
Japan (TOPIX TR JPY)	+6.02%	+2.95%	-4.07%	+2.21%	-4.42%	+5.74%
China (SSE Composite)	+7.59%	+8.91%	-12.14%	-13.42%	-12.38%	-11.58%
Emerging Markets (MSCI EM)	+11.02%	+14.83%	-7.82%	-18.95%	-8.27%	-17.43%
All World (MSCI ACWI)	+4.18%	+7.76%	-3.35%	-15.02%	-1.82%	-11.62%
World Govt Bonds (FTSE WGBI)	+1.07%	+4.54%	-6.88%	-18.12%	-9.61%	-18.63%

Source: Morningstar Direct

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Regulatory Information

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