Market Brief

September's highlights

- September's flash PMI data indicated that the global economy lost momentum over the month, particularly in Europe, as waning service sector activity was unable to offset a very weak manufacturing sector.
- UK and eurozone inflation, both headline and core, fell more than expected in August. In the US, higher fuel prices pushed up headline inflation, while core inflation continued to fall.
- The Bank of England (BoE) surprised markets by leaving rates unchanged in September, at 5.25% pa. The US Federal Reserve (Fed) also left rates unchanged, at 5.25–5.5% pa. Given a more gradual approach to interest- rate rises in this cycle, the European Central Bank (ECB) raised its deposit rate by a further 0.25% pa, to 4.0% pa.
- Despite falling inflation, signs of economic weakness and expectations that central banks are at, or near, the end of their tightening cycles, sovereign bond yields rose. Investors responded to central banks' messaging that interest rates may need to stay higher for longer to sustainably return inflation to target.
- The higher-for-longer messaging from central banks and growing signs of economic weakness weighed on global equity markets in September. The prospect of slowing, but not collapsing, growth prompted modest credit-spread widening.
- Oil prices continued to rise in September, as concerns over lower-than-expected US stockpiles added to fears of a global shortfall. Weak PMI data and a fall in near-term interest-rate expectations saw trade-weighted sterling decline 2.1%, while the equivalent dollar measure rose 1.4% on hawkish Fed messaging.

Market performance to end-September 2023

UK	Q3 23*	Q2 23	2023	GLOBAL	Q3 23*	Q2 23	2023
EQUITIES	1.9	-0.5	4.5	**EQUITIES**	-2.2	6.7	11.7
BONDS				North America	-3.0	8.4	13.1
Conventional gilts	-0.6	-5.4	-4.1	Europe ex UK	-3.3	2.9	9.8
Index-linked gilts	-4.7	-6.6	-7.2	Japan	2.2	15.0	25.8
Credit	2.3	-3.4	1.2	Dev. Asia ex Japan	-2.6	1.2	3.3
PROPERTY**	0.1	1.0	1.3	Emerging markets	-0.1	1.4	3.8
STERLING				**GOVERNMENT BONDS**	-1.6	0.2	1.5
v US dollar	-4.0	2.8	1.5	**High yield**	0.8	1.5	5.5
v Euro	-1.1	2.4	2.3	**Gold**	-3.1	-3.1	2.3
v Japanese yen	-0.9	11.7	14.8	**Oil**	28.0	-6.6	12.4

Percentage returns in local currency ($ for gold and oil). *All returns to 29/09/2023, **apart from property (31/08/2023). Source: DataStream and Bloomberg. FTSE Indices shown: All Share, All World, W North America , AW Developed Europe ex-UK, W Japan, AW Developed Asia Pacific ex-Japan, Emerging, Fixed Gilts All Stocks, Index-Linked Gilts All Maturities, iBoxx Non-Gilts, S&P GSCI Light Energy, Crude Oil BFO, ICE BofA Global High Yield, Gold Bullion LBM , MSCI UK Monthly Property and BBG Aggregate Government Total Return.

Quarterly update

The global economy

- Better-than-expected Q2 data, released in Q3, led to further upwards revisions to 2023 global growth forecasts for Q3. Survey indicators suggested that economic activity weakened in Q3, particularly in Europe, but growth is expected to slow, rather than collapse. While inflation generally declined, it remained above target, and markets are coming to expect that central banks will have to keep interest rates higher for longer to return inflation to target.

- Against this backdrop, sovereign bond yields rose and global equity markets weakened. Perhaps owing to reduced expectations of outright recessions, credit spreads marginally tightened. Oil prices rose further as the release of data on low US stockpiles further compounded recent fears of a global supply shortfall.

- Backward-looking GDP growth data released in Q3 confirmed that the global economy was resilient in Q2. The final US GDP figures for Q2 revealed that the economy grew at a decent annualised quarterly pace of 2.1%. While growth was much weaker in Europe – the eurozone and UK registered modest quarter-on-quarter expansions of 0.2% and 0.1%, respectively – it still surpassed prior expectations. Meanwhile, strong net export growth on the back of previous yen weakness saw Japanese growth expand at an annualised quarterly pace of 4.8% in Q2.

- Chinese growth slowed sharply to 0.8% quarter on quarter, suggesting the post-pandemic recovery is losing momentum amid an ongoing property downturn, record high youth unemployment and declining exports. As a result, the central bank cut interest rates and the government eased property controls alongside other modest stimulus measures.

- Flash composite PMIs in the major advanced economies suggested slowing growth in Q3, as waning service sector activity was unable to offset weakness in manufacturing. Europe is the principal weak spot, where surveys for the UK and Eurozone fell to 46.8 and 47.1, respectively – well below the neutral 50-mark that separates expansion from contraction. The data pointed to a more resilient US economy but, at 50.1, the US survey suggests that the economy stagnated towards the end of Q2. The surveys also suggest that higher borrowing costs and weakening demand has weighed on business sentiment. Indeed, while the surveys indicate that input costs have accelerated in recent months, the weaker demand environment has lessened companies' ability to raise output costs.

- August's inflation data, released in September, showed that consumer price inflation fell more than expected in the UK and eurozone. In the US, headline CPI inflation rose on the back of higher fuel prices, but core inflation continued to decline. While inflation is now well below the peaks recorded in 2022, headline inflation, at 3.7%, 6.7%, and 5.2% year on year in the US, UK, and eurozone, respectively, remains above central bank targets. Furthermore, year-on-year core CPI inflation, which excludes more volatile energy and food prices, is also substantially above central bank targets, at 4.3%, 6.2%, and 5.3%, in the US, UK and eurozone, respectively.

- The Fed and BoE both raised rates 0.25% pa in Q3, to 5.5% pa and 5.25% pa, respectively, before leaving rates unchanged at their September meetings. The BoE took markets by surprise as another 0.25% pa rate hike was expected. Given a smaller cumulative increase in interest rates in this cycle, the ECB raised its deposit rate twice, to 4.0% pa. While the major central banks and markets reflect a view that interest rates are close to peaking, they also suggested that rates may have to remain at current, or higher, levels for longer to return inflation to target.

Fixed income markets

- Amid expectations central banks may have to keep interest rates elevated for an extended period, sovereign bond yields rose. Heavy issuance compounded the moves in 10-year US treasury yields, which rose 0.7% pa to 4.6% pa, while equivalent German yields rose 0.5% p.a., to 2.8% p.a. Japanese government bond yields rose 0.4% pa, to 0.8% pa, as the Bank of Japan loosened its yield curve control policy in July. Following August's downside inflation surprise and the Bank of England's surprise pause in rate rises, short-term gilt yields fell, while longer-term yields rose – the 10-year yield saw more muted moves, rising 0.1% pa to 4.4% pa.

- UK 10-year implied inflation, as measured by the difference between conventional and inflation-linked bonds of the same maturity, rose to 3.7% pa as nominal yields rose and real yields were little changed.
- A fall in short-term gilt yields and a 0.2% pa fall in credit spreads both contributed to positive total returns in the sterling investment-grade credit market. Global investment-grade spreads fell 0.1% pa to 1.3% pa. Speculative-grade spread movements were muted. The US was little changed, at 4.0% pa, with euro spreads tightening 0.1% to 4.4%. Realised defaults are rising, but peak defaults forecasts have been revised downwards. Attractive all-in yields and a subdued pace of new issuance, particularly in speculative-grade markets, have lent technical support to credit markets.
- Hard currency debt, as measured by the Diversified Emerging Markets External Debt Sovereign Bond Index, returned -2.5% over the quarter in dollar terms as underling treasury yields rose and spreads widened modestly. Local currency debt, as measured by the Diversified Emerging Markets Sovereign Bond Index, returned -2.7% in US dollar terms, as yields rose and index currencies, in aggregate, weakened against the US dollar.

Global equities

- The FTSE All World Total Return Index erased July's gains to end the quarter 2.1% lower, in local currency terms, as sovereign bond yields rose and survey data indicated weaker global economic activity in Q3.
- Given its bond-like qualities, the utilities sector notably underperformed as long-term sovereign bond yields rose. Similar dynamics may have also driven underperformance by consumer staples, while rising sovereign bond yields weighed on the valuation of the technology sector's 'long-duration' cashflows. The industrials and consumer discretionary sectors also underperformed. The energy sector outperformed the market by 13% as sharply higher oil prices boosted earnings prospects. Energy and financials were the only sectors to produce positive returns in Q3, but telecoms, basic materials and healthcare also marginally outperformed the negative global index return.
- Europe ex-UK underperformed, given relatively weak business surveys and a large exposure to the struggling manufacturing sector. Above-average exposure to the tech sector saw North American equities also underperform. Japan outperformed as yen weakness lent support to the earnings of the export-heavy market. UK equities outperformed too, given above-average exposure to the energy sector. The returns in all other regions, except for Japan and the UK, were negative over the quarter.

Currencies, commodities, and property

- Oil prices rose 28% over the quarter, climbing close to $100 per barrel, as data on low US stockpiles compounded supply shortfall fears sparked by extensions to production cuts by Saudi Arabia and Russia. On a year-over-year basis, oil prices are up 8.1%, but the S&P GSCI Energy Spot Price Index is only 2.8% higher, given a sharp fall in gas prices over the same period. Trade-weighted sterling fell 2.2% as near-term interest rate expectations fell, while the equivalent US dollar measure rose 1.7% and the Japanese yen fell a further 1.4%.
- The MSCI UK Monthly Property Total Return Index rose by a very modest 0.1% in the quarter to end-August as income was largely offset by capital-value declines in the office and retail sectors. On a 12-month basis, capital values are down around 15% in the retail sector and close to 23% in the office and industrial sectors. The office and retail sectors continue to see month-on-month declines in capital

values, while the industrial sector has recorded six consecutive months of growth, though the pace has eased in recent months.

For and on behalf of Hymans Robertson LLP

Additional Notes

Important Information