Investment Outlook

A monthly round-up of global markets and trends

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Breaking the bad news cycle

Data from Google Trends shows internet users are less pre-occupied with a global recession than they were a year ago.[1] After a poor stock market performance in 2022, reduced recessionary concerns are being reflected in rising share prices. Looking forward, we see three reasons why stocks could break the bad news associated with a recession and may go on to rally further.

1. Momentum behind stocks: in early June, the US S&P 500 benchmark equity index rose 20% from the low point it reached in October 2022 to enter a commonly (if arbitrarily) defined 'bull market'.[2] So far, this rally has lasted just nine months, well short of the typical length of around 5.5 years of the last seven bull markets going back to 1969.[3] In other words, once stocks enter a bull market, history shows that momentum can take over and provide stimulus to the real economy by lifting consumer and business confidence to drive a longer market rally.

The rally has been narrowly led by artificial intelligence (AI) related stocks and this could be a risk for investors. Should investor sentiment sour on the AI theme, this could drag down the market. However, there is growing evidence that the AI-led rally is spreading to the broader market. Over 60% of the companies in the S&P 500 have recorded positive returns over the past 12 months.[4]

2. Ongoing economic support from Covid-era policies: although the World Health Organisation officially declared the pandemic over in May 2023, Citi, an investment bank, estimates that households have plenty of unspent funds left over from Covid. In developed economies, the household 'excess savings' range from 6% (US), 7% (eurozone), 8% (the UK) and 9% (Japan) of GDP and are a useful source of finance to support consumption growth.[5]

Moreover, labour markets are tighter after the pandemic. During Covid, employees left the workforce to improve their lifestyle or retire early. Not only did this keep the labour supply tight, but it also encouraged firms to hire staff and boost job vacancies. By keeping unemployment rates down, healthy labour markets insulated economies somewhat from the impact of higher interest rates.

Another consequence from pandemic policies is that households used the opportunity to refinance mortgages at lower rates when central banks cut interest rates to zero. For example, in the US, where homebuyers can finance their debt over the life of the mortgage, 84% are charged at a more manageable rate below 5% on a 30-year mortgage, compared to the current rate of around 6.8%.[6,7] In the UK, the impact of higher interest rates on the economy is also likely to be slow. That's because the popular five-year fixed rate mortgage product accounts for 59% of outstanding mortgages.[8] So, it will take some time for most mortgages to roll over onto more expensive rates to cool domestic demand.

3. Dollar depreciation boost to stocks: the outlook for the dollar appears negative – see ***down with the dollar.*** As we discussed in our ***December Investment Outlook***, a weaker US dollar, when accompanied by global growth, is positive for financial assets. That's because banks lend more, effectively creating more US dollars, which flow into financial markets. Furthermore, given that the bulk of global debt is denominated in US dollars, more dollars floating around the global financial system reduces credit risk by making it easier to source finance.

Looking out to the rest of 2023 and beyond

Beyond these three tailwinds, the global economy is expected to expand, supported by solid services consumption. According to Bloomberg, a financial data provider, economists expect global real GDP to rise by 2.6% in 2023 and 2.7% in 2024.[9] While that is below the long-term trend of around 3%, it is far from the -2.8% seen during the pandemic-led contraction of 2020.[10] And even if the US economy were to slip into a mild recession in 2024, the Federal Reserve (Fed) would be in a better position to deliver monetary easing to deal with any potential tail risks. That's because, slowly but surely, the biggest US inflation surge seen for four decades is gradually being brought under control.

For markets, the important point is that the world avoids an economic hard landing or a long and extended recession. This provides the opportunity for equity investors to broaden out from defensive areas (i.e. healthcare, consumer staples and utilities, and the UK) towards the growth-oriented parts of the market, including, for example, the semiconductor sector and the US.

Market risks are largely linked to the impact of monetary tightening on the financial system. Back in March, the failure of Silicon Valley Bank (SVB), the 16th largest bank in the US, raised concerns of systemic problems appearing, similar to those suffered during the Global Financial Crisis (GFC) in 2008. However, those fears proved to be unfounded as SVB was more of a manageable idiosyncratic risk – see our article ***is Silicon Valley Bank a canary in the coal mine?***

The Bank of England will be assured that financial sector tail risks caused by higher interest rates have also been reduced since the GFC. Lending criteria are now tighter under the Government's Mortgage Market Review in 2014. This included bringing in loan-to-income limitations, income verification and reducing the amount of interest-only borrowing. Interest-only mortgages to owner-occupied homeowners make up around 3% of new mortgage flow versus 30% in 2006.[11] Such regulations should work to limit systemic risk, ensure financial stability and go some way to break the bad news narrative in the media.

Sources:

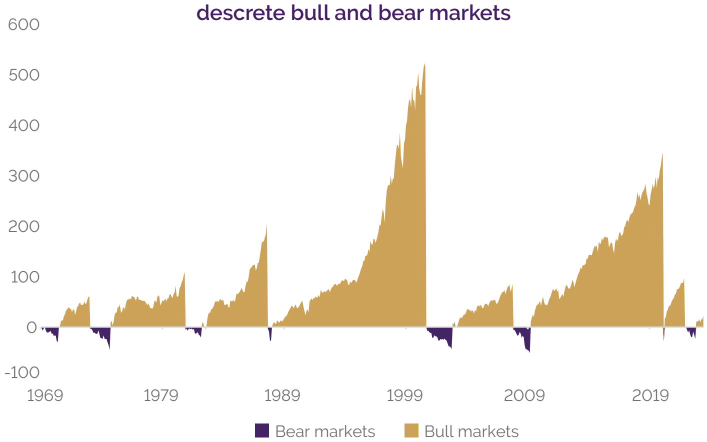
[1] Google Trends
[2,3,4,6] Refinitiv, Evelyn Partners
[5] Citi, How Much Firepower Do Consumers Have Left in DM Economies?, 5 May 2023
[7] Federal Housing Finance Agency
[8,11] JPM, First principles – UK mortgage market, 8 June 2023
[9,10] Bloomberg

Market highlights

Equities

The start of a new bull market is arbitrarily defined by a 20% increase from the lowest point in a bear market with a 20% decline from a recent peak signalling the start of a bear market. The chart shows the eight discrete bull and bear markets for the S&P 500 since 1969. We see bull markets tend to last considerably longer than bear markets. On average bull markets have lasted 5.5 years, with the longest persisting for nearly 13 years. During these periods investors have been rewarded with average annualised returns of 20%. In contrast, bear markets have been relatively short, lasting on average 1.2 years. But the downside risks to equity returns have been higher, with investors suffering an average annualised loss of 25%. Following October 2022's low, the S&P 500 recently entered a new bull market – if history is a guide, it should have further to run.

Percentage change of S&P 500 during descrete bull and bear markets



Source: Refinitiv Datastream/Evelyn Partners, data as at 30 June 2023, data is calculated using monthly returns of the S&P 500 price index in USD. Past performance is not a guide to future performance.

Fixed income

Following another higher-than-expected inflation print, the Bank of England surprised markets with a 0.5% interest rate hike at their June meeting, taking the base rate to 5%. Money markets have since priced in additional interest rate hikes, with rates now expected to peak at 6.1% in February 2024. This increase in interest rate expectations has impacted mortgage prices, where the average interest rate on a newly drawn five-year fixed term mortgage has increased to 5.8%. However, given the volume of existing fixed-term mortgages currently held by millions of households – which were taken out when mortgage rates were lower – the average effective mortgage rate in the UK has only increased to 2.8%. When these existing fixed-rate mortgages end and households move into new higher-rate products, the average mortgage rate will increase. As mortgage payments rise, this will weigh on disposable incomes, which is likely to be a drag on consumption growth.

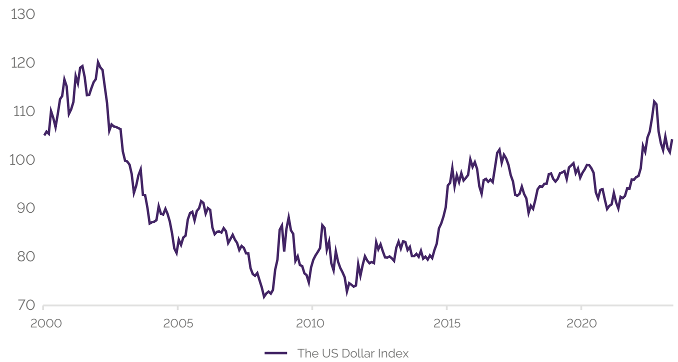
Effective UK household mortgage rate and current 5-year fixed rate

Source: Refinitiv Datastream/Evelyn Partners, data as at 30 June 2023. Past performance is not a guide to future performance..

Currencies

The beginning of the aforementioned bull market in October 2022 coincided with the peak of the US dollar. The US Dollar Index, which shows the value of the dollar against a trade-weighted basket of global currencies, has fallen 10% since achieving a 20-year high in October. This has been driven by two key factors. Firstly, the global economic outlook has improved – Europe avoided an energy crisis and China re-opened after Covid lockdowns. This economic strength has proved challenging for the safe-haven dollar, which tends to outperform during times of economic uncertainty. Secondly, while the Fed had been aggressive in raising interest rates, other countries are now catching up as the Fed reaches the end of its hiking cycle. A smaller difference between US interest rates and those in other developed markets, such as the UK and eurozone, increases the relative attractiveness of their currencies and weighs on the dollar.

Relative value of the US dollar



Source: Refinitiv Datastream/Evelyn Partners, data as at 30 June 2023 . Past performance is not a guide to future performance.

Market returns (Total return (%), sterling)	1 month	3 months	1 year	5 year
Equities				
MSCI All-Country World	3.2	3.4	11.9	57.1
MSCI UK	1.2	-0.6	8.1	19.6
MSCI UK Broad	0.9	-0.7	7.0	14.5
MSCI USA	4.0	5.7	14.2	84.4
MSCI Europe ex UK	2.5	0.6	20.0	44.5
MSCI Japan	1.5	3.5	13.3	23.4
MSCI Asia Pacific ex Japan	1.6	-4.5	1.2	19.0
MSCI Emerging Markets	1.3	-1.7	-2.4	10.9
Bonds				
iBoxx GBP Gilts	-0.4	-6.0	-15.4	-20.1
iBoxx USD Treasuries	-3.2	-4.1	-6.5	6.1
iBoxx GBP Corporate	-1.2	-3.3	-6.1	-6.0
Commodities and trade-weighted currencies				
Oil Brent Crude ($/barrel)	1.8	-6.6	-35.2	-6.2
Gold ($/ounce)	-2.8	-3.1	6.0	53.1
GBP/USD	2.6	2.8	4.7	-3.7
GBP/EUR	0.2	2.4	0.3	3.1
EUR/USD	2.3	0.4	4.4	-6.6
USD/JPY	3.4	8.6	6.4	30.5

Market commentary

June was a strong month for equities with the MSCI All-Country World Index gaining 3.2%, driven largely by strong outperformance in the US. US equities ended June up 4.0% for the month, led by technology companies and excitement about the potential of generative artificial intelligence. Despite ending the month up 1.2%, the UK was the laggard of the equity regions, weighed down by persistent inflation and rising interest rate expectations. Bond values struggled across the board as central banks continued to sound hawkish, prompting markets to price in additional interest rate hikes. Rising yields also drove gold lower, down 2.8% for the month, as investors shifted away from the non-income generating asset in favour of stable cashflows.

Key macro data	Latest	2023 Consensus forecast	Spot rates	30-Jun	Yields (%)	30-Jun
UK GDP (YoY%)	0.23	0.20	GBP/USD	1.27	MSCI UK	4.33
UK CPI Inflation (YoY%)	8.70	7.20	GBP/Euro	1.17	MSCI UK broad	4.22
Bank of England Base	5.00	5.35	Euro/USD	1.09	10 Year Gilt	4.39

The market commentary, values and charts as at 30 June 2023. Total returns in sterling.
Returns are shown on a total return (TR) basis ie including dividends reinvested (unless otherwise stated).
Net return (NR) is total return including dividends reinvested after the deduction of withholding tax.
Source: Refinitiv Datastream/Bloomberg

Important information

Please remember the value of investments and the income from them can fall as well as rise and investors may not receive back the original amount invested. Past performance is not a guide to future performance.

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