Investment Outlook

A monthly round-up of global markets and trends

September 2023

In this issue

Please read the important information section

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Investment outlook

Servicing the global economy

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The global economy continues to show resilience against tighter monetary policy. Much of this strength has come from increased spending on services, a sector that represents 63% and 71% of GDP in the UK and US, respectively.[1] As we discussed in the *July Investment Outlook*, Covid-era policies led to "excess" household savings. Along with solid labour markets this has helped to sustain consumption and growth. A key unknown for investors is how much longer consumers can continue to spend their way through the sharpest increase in interest rates in decades. While there is plenty of uncertainty, we think the consumer recovery has further to run.

For a start, the pandemic restrained the ability of consumers to spend money on services, which held back overall demand. To put this into context, US real expenditure (spending adjusted for inflation) on services has only now recovered from pandemic lows to be in line with the 50-year upward trend.[2] Meanwhile, spending on goods soared during lockdowns as online sales boomed to be 16% higher than trend in the second quarter of 2020.[3]

Looking forward, we expect the rotation from goods towards services to continue. Anecdotally, this is apparent in the entertainment industry. Taylor Swift, the American pop star, is on track to make a staggering $1bn in ticket sales between March and August, a record in US concert history.[4] The economic significance of this tour is highlighted by the fact it came up in discussion during Fed Chair Powell's monetary policy press conference in July. Further afield, the 2023 women's football World Cup in Australia last month drew in crowds of nearly 31,000 per match, the highest since the 2007 tournament in China, suggesting that the service industry is buoyant over there too.[5]

Greater spending on services is supported by the boost to real household incomes seen from lower energy costs. In the eurozone, both wholesale natural gas and electricity prices are down more than 80% from their peaks in August 2022.[6] While in the UK, retail unleaded petrol prices are back down to 148p per litre, compared to 192p per litre seen last summer.[7] Less money spent on energy is leading to a bounce back in consumer confidence across Europe and in the US.

The message from the manufacturing sector is more sobering. In August, Germany's manufacturing Purchasing Managers Index, a proxy for activity in the sector, fell to levels seen during the depths of the pandemic. It will be difficult for the services sector to decouple from a depressed manufacturing sector for very long periods, but not impossible. The stimulus for increased factory output could come from the recent equity rally, which can encourage companies to invest in production facilities to allow the manufacturing sector to recover.

We believe that spending on services (and overall consumption) will continue to provide an uplift to the global economy. In its mid-year review, the International Monetary Fund slightly upgraded its estimate for global real GDP growth to 3.0% in 2023, up from the 2.8% estimate it made in April, and maintains its prediction for a 3.0% expansion in 2024. The risk for equity markets is that growth rebounds too fast and drives up bond yields on the expectation that central banks need to raise interest rates further. This probably explains why global stocks pulled back a little in August. Nevertheless, fundamentally, improving growth prospects are helping to bolster trade and capital flows. As a result, global foreign exchange reserves are rising, and this provides market liquidity for stocks to rally – see market highlights.

Turning point for the world population

In 1950, the world population was 2.5 billion. Today, there are more than 8 billion people on the planet – a 220% increase in just over 70 years. By 2100, the UN expects a global population of around 10.4 billion.[8]

The massive expansion between 1950 and 2018 was primarily driven by a growing number of births. But we've reached a turning point. Looking forward, the UN doesn't expect the number of children born each year to increase by much. Instead, the number of people of working age and old age will increase substantially.

This change in composition will have major implications for economies and investors. We think that demographics are going to shift from being a tailwind behind advanced economies to more of a headwind. In contrast, emerging economies will benefit from more favourable demographics.

At the country level 'peak child', is typically followed by a 'demographic dividend'. This occurs when the share of the dependent young generation declines, and the proportion of the working age population increases. In recent decades, advanced economies have benefitted from this transition: as the baby boomer generation aged, the working-age population ratio surged in the advanced world. But as this generation reaches retirement age the number of workers is falling.

In the coming decades it may be the emerging world that could benefit from this demographic dividend. Countries like Pakistan, Nigeria, Egypt, and India will see their working age population ratios increase. Rapid population growth and more workers will strain resources. Investment needs will increase, especially in areas like housing and infrastructure. This is likely to have spill over effects to the broader economy.

As these economies grow, we expect to see a significant expansion in the middle classes: HSBC estimates that in India alone, the middle class will grow by over 400 million people in the next two decades.[9]

This exciting opportunity is not without risk. Demographics are not the only driver of growth. However, if emerging markets can capitalise on this demographic dividend, the upcoming decades will reward investors in these countries.

Sources:

[1,2,3,6,7] LSEG Datastream, Evelyn Partners, data as at 1 Sep 2023

[4] www.wsj.com/articles/taylor-swift-taylornomics-concert-eras-tour-local-economy-9fa1d492?mod=newsviewer_click

[5] FIFA

[8] United Nations World Population Prospects 2022

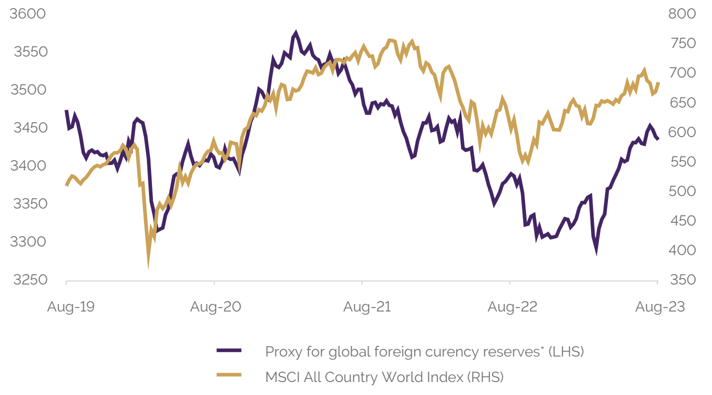
[9] HSBC, the next generation of spenders, 2022

Market highlights

Equities

Despite selling off at the start of August, global stock markets have performed strongly since their cyclical trough in October 2022. A key contributor to this performance has come from an improvement in the global growth outlook, particularly for the US. Higher economic activity leads to more trade and greater capital flows, which ultimately increases liquidity in the financial system. This is reflected by foreign exchange reserves, which show the amount of assets denominated in a foreign currency held by a central bank. A proportion of foreign exchange reserves held by overseas central banks in the US can be shown by securities held in custody at the New York Federal Reserve. This has been gradually increasing over the last 10 months, providing a liquidity boost to support higher equity valuations.

Global foreign currency reserves and global equities

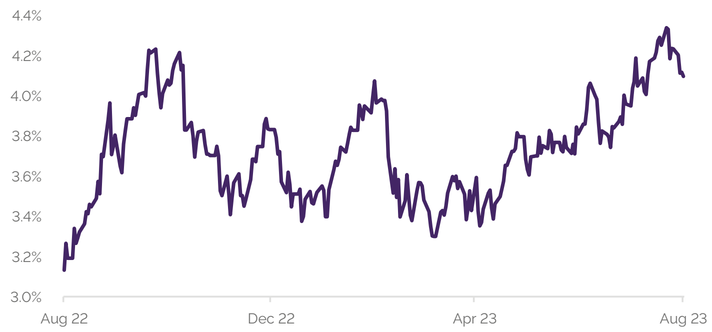


*Source: LSEG Datastream/Evelyn Partners,*Securities held in custody the New York Fed for international accounts in USD. MSCI All Country World index is in price return - excludes dividends. Data as at 1 Sep 2023. Past performance is not a guide to future performance.*

Fixed income

US government bond yields reached new highs in August, with the 10-year bond peaking at 4.3%, its highest rate since 2007. There have been a number of factors likely driving bond prices recently. First, the improving growth outlook in the US, has made markets cautious, as further interest rate hikes from the US Federal Reserve could be required to cool aggregate demand. Second, there has been a larger than expected issuance of US treasuries, increasing their supply, and causing their value to fall. Third, some weaker than expected US labour data in the last week of August showed that labour market conditions were normalising. Loosening labour market conditions reduces the chances that further rate hikes will be needed. This helped US Government bond yields recede slightly to close out the month at 4.1%.

US 10-year treasury yield

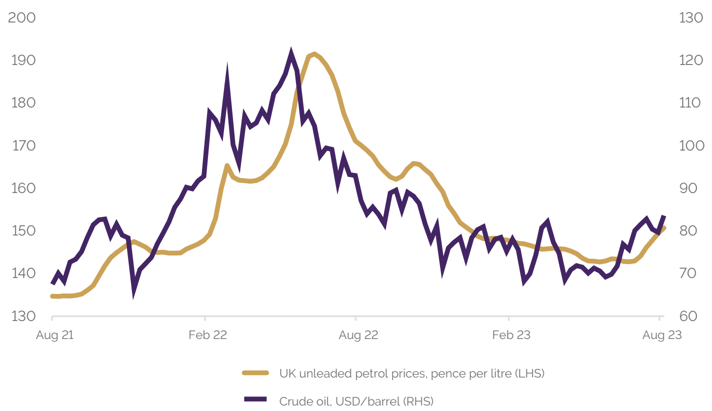


Source: LSEG Datastream/Evelyn Partners, data as at 1 Sep 2023. Past performance is not a guide to future performance.

Currencies and commodities

As the price of oil has fallen from its 2022 highs, the price of petrol has followed suit. At its peak, households were paying 192p per litre of unleaded. As supply fears have subsided and the global economy has cooled, prices have retreated, reaching lows of 143p at the end of July. However, oil prices have been on the rise in August, driven partly by the improving economic outlook in the US and recent Organisation of the Petroleum Exporting Countries (OPEC+) supply cuts. Despite this recent rise, petrol prices remain significantly lower than they were a little over a year ago. Less money spent at the pumps will be a welcome boost to disposable incomes under pressure from the cost-of-living crisis.

UK petrol and crude oil prices



Source: LSEG Datastream/Evelyn Partners, data as at 1 Sep 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	-1.3	4.4	5.2	50.6
MSCI UK	-2.5	0.9	5.4	21.4
MSCI UK Broad	-2.5	0.9	4.8	16.3
MSCI USA	-0.2	6.1	6.3	73.1
MSCI Europe ex UK	-2.5	1.7	15.7	38.5
MSCI Japan	-0.9	2.4	6.3	21.8
MSCI Asia Pacific ex Japan	-4.4	0.2	-6.3	15.4
MSCI Emerging Markets	-4.7	1.4	-6.6	9.8
Bonds				
iBoxx GBP Gilts	-0.6	-0.2	-10.2	-19.8
iBoxx USD Treasuries	0.8	-4.0	-10.3	3.2
iBoxx GBP Corporate	-0.1	1.1	-1.0	-4.6
Commodities and trade-weighted currencies				
Oil Brent Crude ($/barrel)	1.5	18.1	-10.0	11.9
Gold ($/ounce)	-1.3	-1.5	13.0	61.5
GBP/USD	-1.5	2.2	8.9	-2.5
GBP/EUR	0.0	0.4	0.9	4.5
EUR/USD	-1.6	1.8	7.9	-6.7
USD/JPY	2.5	4.2	5.0	31.3

Market commentary

August was sluggish for equities, with all major regions in the red for the month. The MSCI All Country World Index, a global equity benchmark, ended the month down 1.3% in sterling terms. Despite a month of volatile trading, the US was a relative bright spot, although it still ended the month 0.2% lower (in sterling terms), aided by resilient consumption data and cooler labour market conditions. Emerging markets underperformed, falling 4.4% over the month, driven lower by a deteriorating economic picture in China. The US dollar strengthened against sterling, euro, and yen, as markets began anticipating that US interest rates would remain higher for longer than previously anticipated. On top of this, weakening economic data in UK and eurozone further weighed on sterling and the euro.

Key macro data	Latest	2023 Consensus forecast	Spot rates	31-Aug	Yields (%)	31-Aug
UK GDP (YoY%)	0.38	0.30	GBP/USD	1.27	MSCI UK	4.28
UK CPI Inflation (YoY%)	6.80	7.40	GBP/Euro	1.17	MSCI UK broad	4.17
Bank of England Base	5.25	5.60	Euro/USD	1.09	10 Year Gilt	4.36

The market commentary, values and charts as at 31 August 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: LSEG 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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