Investment Outlook

A monthly round-up of global markets and trends

March 2023

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Investment outlook

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Potentially moving away from a hard economic landing

Global stock markets have rallied around 8% (including dividends and in sterling terms) since reaching a trough in mid-October.[1] This has come on the hope that central banks have raised interest rates sufficiently to tame inflation. Investors are also buoyed by favourable macro data that suggests a lower probability of a global economic hard landing (i.e. a recession).

Events in China are helping. As the authorities open the economy up from almost three years of lockdowns, the latest manufacturing surveys have rebounded to levels that are consistent with faster output growth. And in the US, labour income (wages multiplied by hours worked) expanded at a solid 8.5% annual rate in January, which is roughly consistent with growth in consumer spending.[1] This better-than-expected economic data for the world's two largest economies reduces the odds of a global recession.

This backdrop of potentially peaking interest rates and improving economic statistics has lifted the mood of investors. According to the latest Bank of America Global Fund Manager Survey, 24% of participants expect a recession over the next 12 months, down from a peak of 77% in November last year.[2] Importantly, this shift has encouraged investors to take money out of safe-haven assets, such as cash deposits, and put it to work in riskier assets, like equities – see the **December 2022 Investment Outlook**. As stocks rally, this creates a virtuous cycle of increasing household wealth, leading to rising business and consumer confidence. In turn, this should stimulate the economy by improving demand.

Of course, there remains plenty of risks out there. Improving growth expectations raises concerns that central banks could keep interest rates higher for longer. This makes forecasting the economic outlook challenging. For instance, the inverted US yield curve is signalling an impending recession and US banks are tightening lending standards to businesses and consumers, which restricts the flow of credit to facilitate economic activity. Moreover, the rapid increase in interest rates over the last 12 months has probably not yet fully fed into the economy. Sales activity in the rate-sensitive US residential property sector has started to decelerate sharply.

Sino-US tensions are another concern investors must contend with following the downing of an errant Chinese government balloon entering US airspace. On 1 February, one Chinese balloon loitered over the Malmstrom Air Force Base in Montana – one of three sites that operates US silo-based intercontinental ballistic missiles.[3] China has since declined a call from the US Secretary of Defense, Lloyd Austin, during these ongoing "Balloon Wars". Furthermore, US Secretary of State, Anthony Blinken, recently warned China not to supply Russia with lethal aid in its war with Ukraine. It is safe to say relations between Beijing and Washington are not improving.

Other geopolitical concerns from a potential NATO confrontation with the Russian military in Ukraine and strained Western relations with Iran over the acceleration of its nuclear and missile programs are risks for investors. Nevertheless, considering the world's major economies – Europe, China and the US – are all beating economists' low growth expectations, there is room for global GDP to surprise on the upside in 2023 and to mitigate geopolitical concerns.

European equity renaissance

Back in December, we outlined how a weaker US dollar when accompanied by global growth is positive for financial assets. We believe this creates opportunities for investors, like Europe ex-UK equities, which have beaten the global stock market year-to-date by its biggest amount since 2011.[4]

European stocks have performed, largely because market risks have declined. For instance, the risk of energy rationing in Europe has been averted as sky-high gas and electricity prices have come down to levels seen before Russia's invasion of Ukraine. A mild winter has helped by reducing energy demand, while elevated levels of gas in storage and increased imports of Liquid Natural Gas (LNG) have ensured that energy has flowed to where it is needed. EU imports of LNG rose by a staggering 60% in 2022.[5]

Lower energy prices and stronger expected demand from China for European exports has lifted consumer and business optimism. Analysts have tentatively begun to revise company earnings expectations there upwards.

Investing in Europe does come with plenty of macroeconomic risks. The European Central Bank (ECB) has raised interest rates by 3.0% in 6 months, the fastest period of monetary tightening since its inception more than 20 years ago.[6] As this works its way through into the real economy, it could potentially lead to increased debt defaults, which could trouble the banking system. The health of financially vulnerable countries in the eurozone, like Spain and Italy, is another concern for markets. Yet, their additional cost of borrowing over German government bonds is not especially high. Time will tell, but it is worth noting that labour markets are still healthy: the eurozone unemployment rate currently stands at 6.6%, its lowest ratio on record.[7]

On balance, given that the MSCI Europe ex-UK Price-to-Earnings ratio is at a historically steep 20% discount to the rest of developed markets, there appear to be opportunities as the continent stages a renaissance.[8]

Sources:

[1, 4, 6, 7, 8] Refinitiv, Evelyn Partners

[2] No Red Light For Risk Assets, Bank of America Global Fund Manager Survey, 14 February 2023

[3] 99 Red Balloons? UFOs? Aliens? All Of The Above, RenMac Policy Report, 16 February 2023

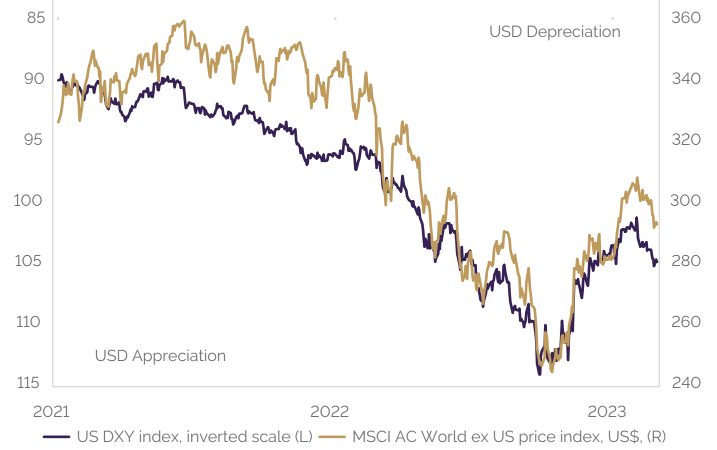
[5] What I learned this week, 13D, page 11, 2 February 2023

Market highlights

Equities

Typically, a strong US dollar results in non-US equities performing poorly. The US Dollar (DXY) Index represents the value of the USD relative to a trade-weighted basket of global currencies and is a proxy for overall dollar strength. The USD strengthened throughout 2022, due to increasing economic uncertainty and the US Federal Reserve (Fed) hiking rates faster than its peers. Meanwhile non-US equities sold off. Since November the global economic outlook has improved; China has reopened after three years of lockdowns and Europe avoided energy shortages over the winter. US Interest rates also appear close to peaking and as a result the USD has weakened. A weakening USD coupled with global growth encourages bank lending. This is a positive for financial assets as more US dollars flow into financial markets, particularly non-US equities.

USD DXY index and World ex-US equities (USD terms)

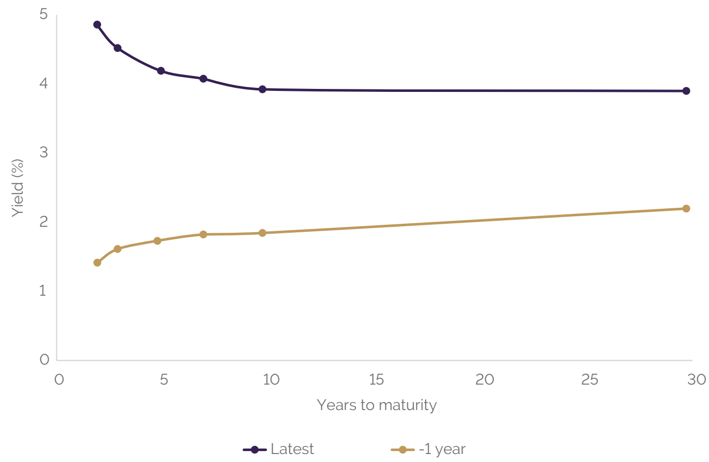


Source: Refintiv Datastream/Evelyn Partners Investment Management LLP.
Data as at 28 February 2023

Fixed income

The yield curve shows the yield an investor will receive from government bonds of various maturities. Typically, an investor will be rewarded with a higher yield for purchasing longer-dated bonds to compensate for this additional risk (this can be seen from the upward-sloping yield curve one year ago). However, when yield curves are inverted as the US treasury curve is currently, investors are receiving higher yields from shorter-dated bonds. This is reflecting that short-term interest rates are currently high, but rates are expected to trend lower. Historically, an inverted yield curve has been a lead indicator of recessions, but the timing of these recessions following inversion varies cycle to cycle. It will likely take time for the curve to flatten and recession risk to fade, even after the Fed pauses on interest rate hikes.

US treasury yield curve



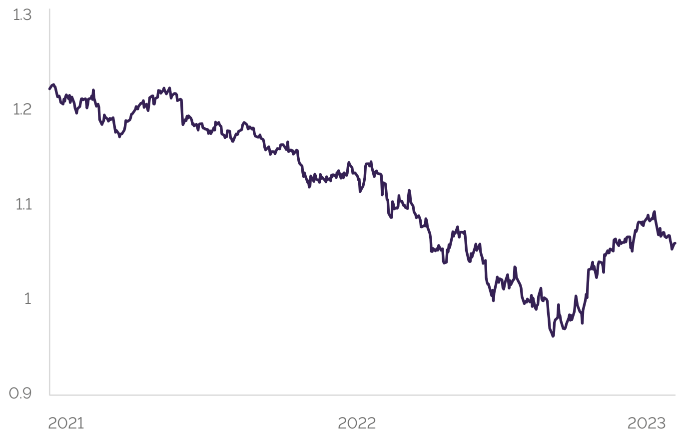
Source: Refintiv Datastream/Evelyn Partners Investment Management LLP.
Data as at 28 February 2023

Currencies / Commodities

The euro has strengthened 10.2% against the US dollar since its lows last September. This is due to two main reasons. Firstly, the European Central Bank (ECB) has been lagging the Fed in hiking interest rates over the last year. As the Fed gets closer to a pause in its hiking cycle, the ECB has indicated it is likely to continue to increase rates in the euro area. The resulting narrowing of the US-eurozone interest rate spread has been a tailwind for the euro. Secondly, the economic outlook for Europe has improved since September. Previous worries of energy shortages have subsided due to a mild winter and PMIs have improved. The eurozone composite PMI for February was 52.3 signalling the economy is expanding. The euro would have to strengthen further to realign with its long-term average.

Euro to USD exchange rate

EURUSD, spot rate



Source: Refintiv Datastream/Evelyn Partners Investment Management LLP.
Data as at 28 February 2023

Market returns (Total return (%), sterling)	1 month	3 months	1 year	5 year
Equities				
MSCI All-Country World	-1.2	-1.5	2.2	54.8
MSCI UK	1.9	4.6	10.8	32.4
MSCI UK Broad	1.8	4.8	7.9	27.6
MSCI USA	-0.7	-3.7	1.4	81.4
MSCI Europe ex UK	0.8	6.8	10.2	42.6
MSCI Japan	-2.2	0.8	0.9	16.2
MSCI Asia Pacific ex Japan	-4.9	0.4	9.2	28.9
MSCI Emerging Markets	-4.9	-2.1	-5.7	5.5
Bonds				
iBoxx GBP Gilts	-3.3	-5.0	-21.2	-15.6
iBoxx USD Treasuries	-0.8	-2.0	-0.7	15.7
iBoxx GBP Corporate	-2.4	-0.2	-12.1	-3.6
Commodities and trade-weighted currencies				
Oil Brent Crude ($/barrel)	-1.3	-1.7	-17.0	27.8
Gold ($/ounce)	-5.3	4.2	-4.1	38.4
GBP/USD	-1.7	1.7	-9.8	-12.1
GBP/EUR	0.7	-1.3	-4.4	1.0
EUR/USD	-2.4	3.0	-5.6	-13.0
USD/JPY	4.7	-2.4	18.3	27.7

Market commentary

Despite rallying throughout January, global equities pulled back during the second half of February as the market continued to price in the Fed's 'higher-for-longer' stance on monetary policy. Futures markets no longer expect the Fed to cut rates in 2023, an adjustment which contributed to the sell-off in risk assets. Emerging markets performed poorly, down 4.9% for the month in sterling terms, with the economic boost from China's reopening feeding through slower than expected. UK equities performed strongly in February, key economic data surprised on the upside and growth estimates were revised up, reducing the risk of a deep and prolonged recession. Bond yields increased as higher rate expectations were priced in. Gold underperformed in February, as the non-income yielding assets struggled in the environment of rising rate expectations.

Key macro data	Latest	2023 Consensus forecast	Spot rates	28-Feb	Yields (%)	28-Feb
UK GDP (YoY%)	0.41	-0.65	GBP/USD	1.20	MSCI UK	3.72
UK CPI Inflation (YoY%)	10.10	6.70	GBP/Euro	1.14	MSCI UK broad	3.66
Bank of England Base	4.00	4.20	Euro/USD	1.06	10 Year Gilt	3.71

The market commentary, values and charts as at 28 February 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

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