Investment Outlook

A monthly round-up of
global markets and trends

December 2022

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Investment outlook

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A hat-trick of positive news lifts sentiment

As the FIFA World Cup in Qatar got underway in November, the global population is estimated to have hit a milestone of eight billion people. Although the world population is now growing at its slowest rate since 1950, the UN forecasts it will reach nine billion in 2037, led by an expansion in developing nations offsetting slower growth in the developed world.[1] The first-ever FIFA recognised international football match that happened 150 years ago on 30 November 1872 between Scotland and England when there were around 1.3 billion people alive and shows the rapid population expansion since then.[2]

Over the longer term, it remains unclear how elevated Western government debt and sizeable welfare spending will be financed when demographic trends continue to deteriorate. Nevertheless, global equity (and bond) markets looked through the debt dynamics and kicked-off November in decent form. The MSCI All Country World Index equity benchmark has rallied around 5%[3] (in sterling total return terms) since mid-October. Investor sentiment is being lifted by a hat-trick of positive news.

First, after a year when US inflation beat most economists' expectations, the latest CPI inflation figure was lower than forecast, bringing down government yields and the US Federal Reserve's (Fed) interest-rate projections. Moreover, the US midterm elections delivered a majority for the Republicans in the House of Representatives. Outside of a deep recession, this makes it unlikely that the Republicans will cooperate with the Democrats in using fiscal stimulus to boost the economy while President Biden remains in the White House. Essentially, this reduces the risk of a surprise Fed tightening to offset potentially loose fiscal policy.

Second, resilient company earnings expectations provide a catalyst for equities to rebound. Many companies have demonstrated their strong pricing power. For example, Unilever has offset a 1.6% decline in sales volume with a 12.6% rise in prices in the third quarter this year.[4] This trend could well continue. Companies are using this inflationary environment as an opportunity to raise prices over and above input costs (ie higher wages and energy bills). In other words, strong corporate pricing power supports consensus forecasts for Earnings Per Share to grow 4% and 9% for 2023 and 2024, respectively.[3]

Third, China appears to be reopening its economy. Following the October announcement that President Xi has been re-elected as leader of the Chinese Communist Party for a third term, there have been several modifications to the country's zero Covid restrictions. Amongst these changes is the removal of mass testing in most areas, the promotion of vaccine usage and a reduction in the prescribed isolation period for individuals. In total, 20 relaxation measures were announced in November, increasing the probability that China can deliver faster GDP growth in 2023. The recent protests in China may well accelerate this.

For the global economy, while unblocking disrupted supply chains should be deflationary, this could be offset by increased demand for energy and commodities as China reopens.

Our view is the Fed is nearing the end of its monetary tightening cycle, and that will enable stocks to recover from here. Historically, equities tend to rally when the Fed pauses on interest rate rises – see market highlights.

US dollar may be losing its currency crown

The US dollar has reigned supreme in foreign exchange markets in 2022, making significant gains against all major currencies. The trade-weighted US Dollar Index (DXY) is up 48% since reaching a cyclical low in March 2008.[3] Dollar strength since the end of 2020 has largely been supported by the aggressive monetary stance taken by Fed and as a store of value during elevated market uncertainty. Nevertheless, in 2023, with the US unemployment rate expected to rise and inflation to slow, the Fed will be under pressure (both politically and economically) to slow its pace of raising interest rates.

Given that the bulk of Fed interest rate increases have already happened, foreign exchange traders could turn their attention to the growing US external deficit – see market highlights. Essentially, the US is becoming increasingly reliant on foreign capital to finance a widening trade deficit. With net foreign inflows falling these fault lines are gradually becoming apparent for the US dollar – the DXY Index has fallen 7% since the end of September.[3]

Broadly speaking, a weaker US dollar, when accompanied by global growth, is positive for financial assets. That's because banks lend more, creating more US dollars, which flow into financial markets. It is still early days, but the conditions (i.e. peaking inflation and interest rates) for a trough in equity markets appear to be forming – provided we can avoid a sharp global downturn.

Other assets like gold, which is priced in US dollars, are reacting favourably to a weaker US currency because it becomes cheaper for non-US buyers to purchase. Gold is also supported by central bank demand (see our May Investment Outlook). Indeed, the World Gold Council reported that in the first three quarters of this year, global central bank gold demand totalled 673 tonnes, the biggest increase since 1967. Furthermore, given its diversification characteristics, gold has a useful part to play in multi-asset portfolios.

Sources:

[1] World Population Reaches 8 Billion, UN.org, 15 November 2022

[2] The Contours of World Development, the word economy.org, [accessed 28 November 2022]

[3] Refinitiv/Evelyn Partners

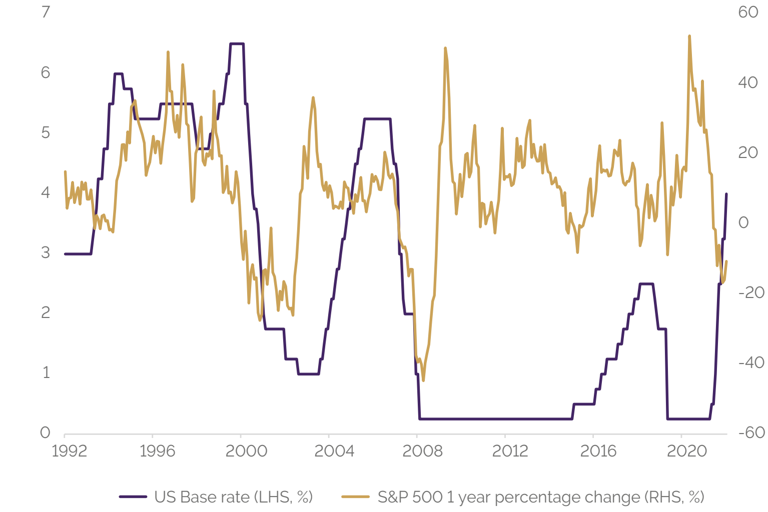
[4] Unilever/Evelyn Partners

Market highlights

Equities

2022 has broadly seen US equities suffer against the backdrop of high inflation and interest rate hikes by the US Federal Reserve. US equities have recovered slightly since mid-October, with inflation data, jobs figures and rhetoric from the Fed providing some hope for an easing in policy. Historically, a pause in interest rate hikes has coincided with a strong period for equities, as the chart to the right shows. On average the S&P 500 Index rallied 25% following a pause in interest rate hikes. The largest such rally over the last 30 years saw the index climb 39% and occurred following the Fed pivot in January 2019. The six weeks from mid-October has seen the S&P 500 rally 14% from 2022 lows, but the index remains down 14% year to date in US dollar terms.

US base rate and S&P 500 performance

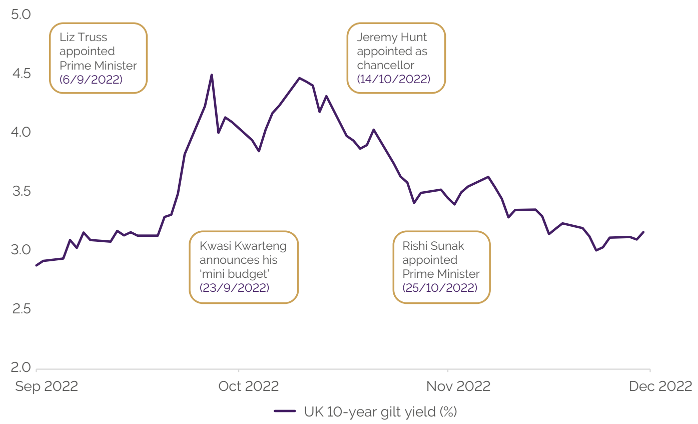


Source: Refinitiv Datastream/Evelyn Partners Investment Management LLP, data as at 30 November 2022

Fixed income

The former chancellor Kwasi Kwarteng's 'mini-budget' prompted severe turbulence in the gilt market. Announcements of significant unfunded spending spooked gilt investors and sent 10-year gilt yields soaring to a peak of 4.5%, their highest levels since 2010. The new chancellor Jeremy Hunt has since restored some confidence in the gilt market by implementing a more conservative fiscal policy, raising taxes to plug the hole in public spending. As a result 10-year gilt yields fell, and currently stand at 3.2%, broadly similar to where they were prior to Liz Truss' administration. Even with the revised fiscal plan, the second largest issuance of gilts in history (£238 billion) is expected in 2023, to help finance the Treasury's £60 billion fiscal deficit.

UK 10-year gilt yield

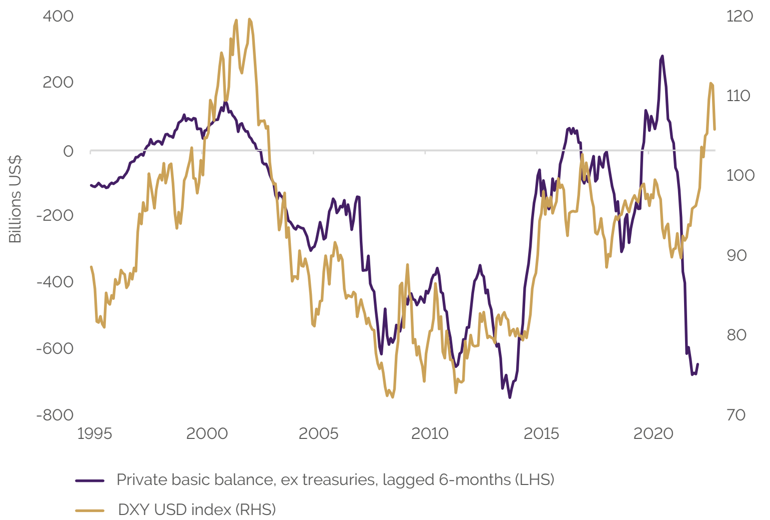


Source: Refinitiv Datastream/Evelyn Partners Investment Management LLP, data as at 30 November 2022

Currencies and commodities

Historically, the US private basic balance (a measure of the flows in and out of the US economy) has been a key driver of the value of the US dollar. This can be seen by its close relationship to the DXY Index, an index of the value of US dollar relative to a basket of trade-weighted currencies. The last year has seen a divergence in this connection with the value of the dollar soaring despite the private basic balance plunging. This disconnect has occurred due to the surging US interest and inflation rates over the last 12 months, which also play their part in dictating the value of the dollar. The question is now, with US inflation rates potentially peaking and the Fed some way through its rate-hiking cycle, will the dollar remain king or will it fall as it regains its relationship with capital and trade flows?

US private basic balance (ex-treasuries)



Source: Refinitiv Datastream/Evelyn Partners Investment Management LLP, data as at 30 November 2022

Market returns (Total return (%), sterling)	1 month	3 months	1 year	5 year
Equities				
MSCI All-Country World	4.2	1.1	-1.3	59.0
MSCI UK	7.1	4.6	13.9	25.9
MSCI UK Broad	7.2	4.0	8.0	21.3
MSCI USA	1.9	0.9	-1.2	90.5
MSCI Europe ex UK	7.9	7.1	-2.4	31.9
MSCI Japan	6.0	-0.9	-5.5	17.6
MSCI Asia Pacific ex Japan	10.9	0.6	7.6	31.5
MSCI Emerging Markets	11.0	-3.9	-7.9	13.4
Bonds				
iBoxx GBP Gilts	2.9	-2.5	-23.6	-11.6
iBoxx USD Treasuries	-0.6	-4.5	-3.2	13.9
iBoxx GBP Corporate	4.2	-0.6	-17.9	-3.8
Commodities and trade-weighted FX				
Oil Brent Crude ($/barrel)	-10.9	-11.6	21.4	33.9
Gold ($/ounce)	7.0	1.9	-1.6	37.0
GBP/USD	3.4	2.3	-10.0	-12.0
GBP/EUR	-0.7	0.0	-1.6	1.9
EUR/USD	4.2	2.4	-8.5	-13.6
USD/JPY	-6.1	0.7	22.9	24.7

Market commentary

Equities continued to rally through November with the MSCI All-Country World Index up 4.2% over the month in sterling terms. Equities have been boosted by signs that US inflation may have peaked, jobs data showing an easing in the labour market and rhetoric from Fed chair Jerome Powell signalling a slowing in rate rises going forward during his speech at the Brookings Institution. The MSCI USA is up 1.9% over the month in sterling terms, despite a weakening US dollar which fell 3.4% relative to the pound. Emerging markets have rallied, with the MSCI Emerging Markets up 11% due in part to favourable news of easing Covid-19 restrictions in China and the weaker US dollar. Brent crude oil fell 10.9% in dollar terms on the month as oversupply in the market and long-term weather forecasts projecting a mild winter in Europe has pushed energy prices lower. Following the uncertainty in UK politics over the last three months, UK gilts rose 2.9% for November, as the new chancellors revised plans reassured investors.

Key macro data	Latest	2022 Consensus forecast	Spot rates	30-Nov	Yields (%)	30-Nov
UK GDP (YoY%)	2.4	4.20	GBP/USD	1.20	MSCI UK	3.80
UK CPI Inflation (YoY%)	11.1	9.00	GBP/Euro	1.16	MSCI UK broad	3.80
Bank of England Base	3.00	3.65	Euro/USD	1.03	10 Year Gilt	3.16

The market commentary, values and charts as at 30 November 2022. Total returns in sterling.
Returns are shown on a total return (TR) basis i.e. 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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