



Market review: November 2022

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- Global equities see second month of gains; bond yields narrow
- Investors encouraged by signs that inflation is peaking
- Fed Chair Jay Powell signals less aggressive rate hikes

Global equities notched up successive months of gains in November for the first time since the summer of 2021, while yields narrowed in bond markets. An index of global stocks has trimmed its loss so far this year to about 18%. In the commodities sector, gold saw its biggest monthly gain since May 2021 as the dollar fell on signs the US Federal Reserve is preparing to slow the pace of interest rate hikes.

A new report from Capital Economics suggested global inflation had peaked and that the pace of rising prices would slow in the coming months. The report pointed out that price pressures on global supply chains were easing and that expectations of factory gate prices, shipping rates, commodity prices and inflation were subsiding from recent record levels. Capital Economics also said it expected high energy prices to flatten out in 2023 and that consumer prices had already peaked across emerging markets.

It is looking increasingly like a turning point in markets. A New York-based US small cap fund manager told us that now is not the time to be getting more defensive with the market down 22%: "Ultimately, [prior to this year] we have been in a FOMO ('fear of missing out') market but now we are moving to one of risk-adjusted returns, rather than return at any risk."

However, another US manager said earnings forecasts for 2023 are 10-20% too high. "A bear market ends when earnings expectations bottom, not with the final rate hike. Investors should prefer bonds over stocks when the tightening cycle matures and the yield curve inversion is at its maximum level, which has probably happened."

Although we are still cautious on equities, we are raising risk exposure in the portfolios slightly and are increasingly positive on fixed income, especially high yield, because of the attractive spreads that are now available in the market.

US dollar weakens

The US dollar fell against a basket of peers in the first half of November on expectations that the Federal Reserve would ease off its monetary tightening. The weakening eased the inflationary pressures on smaller economies around the world and the debt problems for countries and companies, especially in emerging markets, that borrow heavily in US dollars. Latest data had shown that US inflation in October slowed to 7.7%, less than the anticipated 8%. US manufacturing data also fell below forecasts, adding further credence to the peak inflation narrative. Fed Chair Jay Powell also boosted global markets when he told a press conference that the next rate rise would likely only be 50bps, ending a run of four 75bp hikes.

UK looking steadier

Inflation continued to be a worry in the UK, however, where it hit a 41-year high in October of 11.1%, driven by rising energy and food prices. The Bank of England (BoE) raised interest rates by 75bps to 3% in what was the biggest hike since 1989. But the UK was looking steadier after the disruptions caused by the previous Prime Minister and her Chancellor; Jeremy Hunt delivered an autumn statement announcing £30 billion of spending cuts and £25 billion of tax rises.

The BoE warned that rates would likely rise less than expected because of what would be the longest recession in at least a century making rate rises less of a priority, while the latest forecast from the Organisation for Economic Cooperation and Development (OECD) said that the UK would deliver the worst economic performance of any G20 country except for Russia over the next two years. In the interest of balance, neither the BoE nor the OECD have a flawless record of success in such forecasts. But we believe UK equities remain cheap despite this year's energy sector bounce and the overall skew to value. The UK has outperformed other developed markets this year but there is still a long way to go, particularly if the value rotation continues.

Across the Channel, there was also news that pointed to inflation peaking. A slowdown in energy and services prices saw eurozone inflation falling for the first time in 17 months to 10% in November. European stocks were also boosted by a German business confidence report that exceeded expectations and spurred hopes of a milder slowdown in the continent's largest economy.

Reversion to trend

Emerging markets equities and bonds enjoyed a particularly strong month, rebounding from a year of poor performance on hopes that China would loosen its Covid lockdown policy and with the US dollar sell-off relieving financial pressures on several countries. An emerging markets fund manager said Hong Kong, South Korea and Taiwan stocks dropped this year due to the reliance on China's economy but Indonesia and India markets were showing resilience because of their domestic demand-driven economies. Indonesia is considered an inflation hedge and its benchmark has hit record highs recently.

We are positive on emerging markets longer term and believe it will be one of several asset classes offering attractive potential as they revert to longer-term trend performance after a decade or so dominated by US growth stocks. We expect the strong economic growth trajectory, favourable demographics, governance improvements and risk premiums of emerging markets will bear fruit for the patient investor.

The geopolitical news was also looking better in Asia as China's Xi Jinping met both Japan Prime Minister Fumio Kishida at the Asia-Pacific Economic Cooperation forum and US President Joe Biden at the G20 summit in Bali. However, the Russia-Ukraine war grinds on. As one former ECB president commented: "Leaders of countries are either fire starters or firefighters – we have too many fire starters at the moment."

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