Market Brief

August's highlights

- The UK economy fared better than expected in Q2, expanding modestly and confounding expectations of stagnation. In the US, a downwardly revised second estimate of second-quarter GDP growth still showed an economy growing at a decent annualised quarterly pace of 2.1%.
- Disappointing Chinese economic data, renewed stress in the property sector, and consumer prices entering deflation prompted the People's Bank of China to cut rates in August, while the government launched initiatives to support markets.
- Flash composite PMIs (which reflect the health of the manufacturing sector) fell more than expected in the major advanced economies. In Europe, they fell to levels consistent with contraction, as the services-led recovery faded, and manufacturing activity continued to contract.
- Headline inflation continued to fall in the UK and eurozone in July, in line with expectations, but core inflation was unchanged. Though US headline inflation rose in July, it did so less than expected and core inflation fell.
- Despite recent declines, still-above-target headline and core inflation, alongside very strong wage growth, saw the Bank of England (BoE) raise rates by 0.25% pa in August to 5.25% pa.
- Amid weaker forward-looking economic data and higher sovereign bond yields, global equities fell in August, handing back some of their quarter-to-date gains. Meanwhile, credit spreads widened.
- Sovereign bond yields rose as stubborn underlying inflation pressures raised long-term interest-rate expectations.
- The recent oil-price rally lost steam in August. Growth risks in China offset the impact of production cuts and European gas prices rose sharply on potential strike action at three major Australian liquid natural gas plants.

Market performance to 31 August 2023

UK	Q3 23*	Q2 23	2023	GLOBAL	Q3 23*	Q2 23	2023
EQUITIES	0.1	-0.5	2.7	**EQUITIES**	1.2	6.7	15.5
BONDS				North America	1.7	8.4	28.5
Conventional gilts	0.3	-5.4	-3.2	Europe ex UK	-0.9	2.9	12.5
Index-linked gilts	-1.6	-6.6	-4.2	Japan	1.7	15.0	25.3
Credit	2.1	-3.4	1.0	Dev. Asia ex Japan	0.2	1.2	6.2
PROPERTY**	-0.0	1.0	1.2	Emerging markets	1.2	1.4	5.1
STERLING				**GOVERNMENT BONDS**	-0.1	0.2	3.1
v US dollar	-0.3	2.8	5.3	**High yield**	1.4	1.5	6.1
v Euro	0.2	2.4	3.6	**Gold**	1.4	-3.1	7.0
v Japanese yen	0.4	11.7	16.2	**Oil**	16.6	-6.6	2.3

Percentage returns in local currency ($ for Gold and Oil). *All returns to 31/08/2023, **apart from property (31/07/2023). Source: DataStream and Bloomberg. FTSE Indices shown: All Share, All World, W North America , AW Developed Europe ex-UK, W Japan, AW Developed Asia Pacific ex-Japan, Emerging, Fixed Gilts All Stocks, Index-Linked Gilts All Maturities, iBoxx Non-Gilts, S&P GSCI Light Energy, Crude Oil BFO, ICE BofA Global High Yield, Gold Bullion LBM , MSCI UK Monthly Property and BBG Aggregate Government Total Return.

The quarter so far

The global economy

- Unexpected economic resilience in the first half of 2023 is increasingly being weighed against weaker forward-looking data in Q3, as the lagged impact of monetary tightening weighs on economic activity. At the same time, recent resilience, particularly in labour markets, has added to speculation around how long central banks will have to keep interest rates at restrictive levels in order to reduce underlying inflation pressures.
- Global equity markets have made a modest positive return in the quarter to date, while credit spreads have generally declined, albeit with some regional dispersion. Sovereign bond yields have risen, notably in the US, eurozone and Japan, and less so in the UK, given a higher starting point.
- Backward-looking GDP growth data released in Q3 confirmed that the global economy was resilient in Q2. Despite downwards revisions to the very robust initial estimate of US Q2 GDP growth, the second estimate still showed an economy growing at a decent annualised quarterly pace of 2.1%. The eurozone and UK both registered a modest quarter-on-quarter expansions of 0.3% and 0.2%, respectively, which surpassed expectations. Japanese growth expanded at annualised quarterly pace of 6% in Q2. The strong showing is mostly due to strong net export growth, which has been boosted by prior yen weakness.
- Chinese growth slowed quarter on quarter in Q2, and recent activity has been weaker than expected. Headline CPI turned negative in July, retail sales disappointed, and private investment fell, particularly in the property sector. This led the People's Bank of China to cut rates twice in August and fuelled expectations of further policy stimulus.
- In the eurozone, flash composite PMIs indicate that business activity contracted more rapidly in August, as the region's downturn spread from manufacturing to services. Surveys also suggest UK activity contracted month on month in August, as an increasingly severe manufacturing downturn is accompanied by a now-contracting service sector. The US composite PMI remains just above 50, indicative of a month-on-month expansion in economic activity, but the survey suggests a near stalling of business activity as the service-sector-led accelerated growth in Q2 has faded.
- Headline inflation data released in August for the month of July showed that consumer price inflation slightly fell in the UK and eurozone, in line with expectations, and rose in the US, though less than expected. July's year-on-year headline CPI came in at 3.2%, 6.8%, and 5.3% in the US, UK, and eurozone, respectively. Year-on-year core CPI inflation, which excludes more volatile energy and food prices, was unchanged in the UK and eurozone in July, exceeding expectations in the UK, and continued to fall in the US. The year-on-year core CPI figures for the US, UK and the eurozone are 4.7%, 6.9%, and 5.3% respectively.
- Given above-target headline inflation and 'stickiness' in core measures, the Fed and the European Central Bank both raised rates by 0.25% pa at their July meetings, to 5.5% pa and 3.75% pa, respectively. The BoE followed suit in August, raising the base rate by 0.25 % pa, to 5.25% pa. Markets fully expect another rate rise from the BoE at its September meeting, taking rates to 5.5% pa, and are split almost evenly as to whether rates will peak at 5.75% pa or rise to 6.0% pa over the next six months. US interest rate futures imply the Fed will leave interest rates unchanged at September's meeting, but also continue to price in nearly even odds of one further rate hike by year end. Markets also expect a pause from the ECB in September, but still expect a rate rise, the last in the cycle, later this year.

Fixed income markets

- Amid strong GDP data and heavy issuance, US 10-year treasury yields rose 0.3% pa, to 4.1% pa. Japanese government bond yields rose 0.5% pa, to 0.6% pa, as the Bank of Japan loosened its yield-curve control band of +/-0.5% pa, offering to buy 10-year Japanese government bonds at a yield of up to 1.0% pa. Equivalent UK and German yields saw more muted rises, ending August at 4.4% pa and 2.5% pa, respectively.
- UK 10-year implied inflation, as measured by the difference between conventional and inflation-linked bonds of the same maturity, was unchanged at 3.6% pa, as nominal and real yields rose by similar amounts.

- A 0.2% pa fall in sterling investment-grade credit spreads more than offset a very modest rise in gilt yields, resulting in positive total returns in the quarter to date. Global investment grade spreads have fallen 0.1% pa, to 1.3% pa. Highlighting the divergence in recent economic data, US speculative-grade spreads fell 0.2% pa, to 3.9% pa, while European speculative-grade spreads rose over the same period, to 4.5% pa. Though defaults, both realised and forecast, have risen, a subdued pace of new issuance has lent technical support to credit markets.
- Hard currency debt, as measure by the Diversified Emerging Markets External Debt Sovereign Bond Index, has returned 0.2% quarter to date in dollar terms, as income and a modest fall in spreads offset a rise in underlying treasury yields. Local currency debt, as measured by the Diversified Emerging Markets Sovereign Bond Index, has returned -0.2% quarter to date, in dollar terms as yields rose modestly and index currencies, in aggregate, fell against the US dollar.

Global equities

- The FTSE All World Total Return Index trimmed its quarter-to-date gain to 1.2% In August, as concerns around Chinese growth and weak survey data in the major advanced economies weighed on the soft-landing narrative.
- Japanese equities outperformed quarter to date given relatively strong economic data and yen weakness, which also supported the earnings of the export-heavy market. US equities also outperformed on the back of still decent economic growth and ongoing upside earnings surprises. Europe ex-UK and UK markedly underperformed on the back of sharply weaker business surveys and rising European gas prices.
- Emerging markets performed broadly in line with the global benchmark quarter to date. Chinese and Asian markets rose strongly in July as weak Chinese activity data spurred hopes of further economic stimulus, but sentiment reversed in August, despite monetary easing and several government initiatives to support financial markets.
- Energy was the best-performing sector over the quarter to end-August, boosted by rising oil and, to some extent, gas prices. The financial and technology sectors also marginally outperformed. Utilities were the worst-performing sector in over the same period, followed by consumer staples. Industrials, consumer discretionary, telecoms, healthcare, and basic materials also all marginally underperformed in the two months to end-August.

Currencies, commodities, and property

- Despite Chinese growth risks, oil prices rose 16.6% over the quarter to end-August on the back of production cuts. Despite elevated seasonal storage levels, European gas prices rose 23% in August on the back of potential strikes at three liquid natural gas (LNG) plants in Australia responsible for 10% of global LNG supply. Trade-weighted sterling and euro rose modestly, while the equivalent US dollar measure rose 0.7% and the Japanese index fell 1.1%.
- The MSCI UK Monthly Property Capital value index slipped 0.5% in July, largely due to a 2.1% decline in office values. In aggregate, capital values are down 20.8% in the 12 months to end-July, with declines in the retail, office, and industrial sectors of 15.4%, 22.6%, and 25.0%, respectively. Total returns (ie including income) were -16.5% in the 12 months to end-July. Though declines in capital values over 12 months were most pronounced in the industrials, the sector has now recorded five consecutive months of growth, while capital values in the office sector continued to decline, and retail values are largely flat over the past few months.

For and on behalf of Hymans Robertson LLP

Additional Notes

Risk Warnings

Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of an overseas investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.

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