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INVESTOR INSIGHT

A look at the markets by RSMR

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Welcome to the latest edition of our 'Investor Insight' which provides high-level commentary on the global markets and how these might be affecting your investments.

Ken Rayner, CEO, RSMR

The global economy: What's going on?

Inflation peaks as rates rise.

Central bank interest rate rises, coupled with jobs and inflation data have continued to dominate investor confidence.

Now, as inflation is judged to have peaked, central banks are adopting a 'data dependent' approach (the US has paused) as high interest rates filter through the economic strata.

Inflation in the UK and Europe, where it fell to 5.5% in June, have different economic influences to the US and both are likely to face further rate rises.

While financial markets continue to watch the US, the biggest economy, for direction on economic policy, the signposts are unclear. The recession threat has retreated due to stronger-than-expected economic data, low unemployment and healthy consumer spending across developed countries.

Falls in inflation in developed countries are uneven with the UK seeing obstinately high levels and it will be hard to get this down to the central bank 2% target. US and European central banks concede that more tough decisions will be required to tame inflation, which could still become a longer-term problem.

> "Falls in inflation in developed countries are uneven."

The asset classes – a quick round-up

EQUITY MARKETS

The narrow band of stocks that led a US stock market rally continued to dominate returns during the last quarter. Technology, specifically Artificial Intelligence (AI), has been behind much recent speculative investing, encouraging those who 'go-with-the-flow' to join in.

There are concerns that parts of the market are overbought, or in an investment bubble – a cycle of unsustainable rapid price escalation – as values for California-based AI developer, Nvidia, have soared by more than 200% this year (FT, June 2023).

Only time will tell whether this is a bubble, followed by a sharp fall in value, but it is currently driving returns in certain sectors while others remain flat or even negative.

The UK has been marginally positive, up around 2-3% during the quarter (Financial Express, July 2023), but the real success outside the US is Japan where returns have been more broad-based as economic growth has outstripped other developed economies without causing significant inflation.

In the UK, peak interest rate predictions have moved to closer to 6% (FT, June 2023). The threat of recession looms larger under these conditions and, with UK government borrowing now above 100% of gross domestic product (GDP), the ability to cut taxes to soften any economic downturn is limited.

FIXED INTEREST

The year started with reasonable confidence after a disastrous 2022 for the bond market, with the Bloomberg Global Aggregate Index down 16% (Bloomberg, June 2023).

Gains made in the early part of the first quarter indicated a strong rebound for bonds as inflation was thought to have peaked and interest rates were expected to fall towards the year end.

Now rate cuts appear more remote as more than a year of interest rate hikes has not tamed inflation. These rises, and the increased cost of capital, will slow the global economy but most economists are trying to identify at what point rates will conquer inflation as this may indicate when interest rates may be cut.

Any fall-out from the US regional banking crisis seems to have subsided, although the Fed says it is monitoring the situation.

Fixed interest investors seem to be 'on-hold' for now as expectations of falling yields have yet to be fulfilled. This message appears to be hitting home as investors have become more cautious in the short term.

There is no definite timeline about when longer-term assets may become attractive to investors again as many were caught out by undue optimism at the start of the year.

ALTERNATIVE INVESTMENTS

2022 was challenging for investors as stocks and bonds fell together for only the third time in the last 65 years, delivering one of the worst recorded returns for a traditional 60/40 portfolio.

This demonstrates the importance of diverse investments. Alternative assets, such as infrastructure, could offset other asset classes and provide some inflation protection through an attractive income. Also, as the world shifts towards green energy, there will be significant opportunities in commodities that support this including lithium, copper and silicon.

Commodity prices, especially gas and oil, have fallen, not helped by the slow to reignite Chinese economy, but some, including industrial metals, have bucked this trend.

Commercial property has also had a difficult year with any assets sensitive to interest rates struggling. Changes in office occupation rates and company work patterns have altered the dynamic. There is lower occupancy in major centres, with companies needing less space as businesses adopt partial remote working.

Quality is an increasing theme. Developers are upgrading offices to meet new requirements such as leisure facilities and cafeterias. If we do move into recession, rents will fall making some commercial property more attractive.

RSMR Global round-up

- The opening of the Chinese economy has not been the anticipated engine for growth in Asia.
- India is booming as its population overtakes China for the first time.

- Japan's stock market has taken off as a weaker yen, higher inflation and changes to corporate governance have attracted global investors.
- The most recent UK inflation data was worrying as it maintained the overall rate in May at 8.7%.
- The US and China have not yet been able to reach a comprehensive trade deal after imposing tariffs on each other's goods in the Trump era.
- Emerging market inflation is lower than the UK for the first time in 20 years.
- Despite the Ukraine war, sharp interest rates rises, and global recession fears, the Eurozone achieved modest 0.7% growth.
- The European Central Bank has continued to raise interest rates with a 0.25% increase in June after several 0.5% hikes.
- The main challenge facing the US economy is unfilled job vacancies as unemployment fell to 3.5% in April, the lowest since 1969.

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> With UK government borrowing now above 100% of GDP; the ability to cut taxes to soften any recession is limited.

SO, WHAT'S NEXT?

Markets made progress in the second quarter after concerns about an imminent recession faded with better-than-expected economic data. The recent Fed meeting upgraded projections for economic growth and employment. So far, earnings have been resilient and investors expect greater profits in 2024, although this remains to be seen.

US valuations remain high, largely due to soaring technology ratings, especially AI, and elsewhere equity markets appear reasonably valued, unless we experience a lasting economic downturn. Even so, some pockets of value remain for long-term investors.

When US rates eventually peak, valuations within Asia and selective emerging markets, coupled with their stronger relative growth prospects, could reward investors with medium-term plans.

We are entering an uncertain period for economic growth as the effects of higher interest rates bite more strongly and central banks consider whether they have done enough to curb inflation without tipping their economies into an unnecessary recession. For most investors there is no obvious direction for markets to take so a broad diversified approach is right for the medium term at least.

About RSMR

Independent specialist research.

RSMR was formed in 2004 to meet a growing demand from financial advisers for specialist and impartial investment research.

The RSMR team is made up of individuals with expertise from across all areas of the financial industry – from asset management, strategy and fund research through to business development, strategic planning and market research.

We are best known within the financial industry for our 'R' fund ratings – this rating is given to investment funds that meet our stringent research criteria. We don't limit ourselves to just looking at performance – we also look carefully at the people, processes and capabilities that are required to make effective investment decisions.

We work in partnership with your financial adviser, providing the benefit of our broad industry insight and rigorous research. This quarterly market summary is designed as a 'snapshot' of the more thorough and lengthy commentary that we provide to your adviser on a quarterly basis.

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