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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?

Prolonged high interest rates likely.

Although investor confidence declined during the last quarter as reflected by the economic markets in August and September, the overall global economy remains resilient.

Central banks are still battling inflation. Some, including the European Central Bank (ECB), have raised rates while others, including the Bank of England and US Federal Reserve (Fed), paused any increase in the autumn. The pauses were not because the inflation threat has decreased but because policymakers are cautious about the effects that higher interest rates are having.

Inflation remains the most important economic factor as it is dictating central bank policy. We still believe that it has peaked in several western economies, but it remains well above central bank long-term targets.

A recession seems less likely than at the start of the year as low unemployment and relatively strong consumer spending across developed nations continue to defy previous expectations.

The Fed still thinks that the struggle to tame inflation is not over and 'higher-for-longer' interest rates are now expected with one possible hike this year.

> "A recession seems less likely than at the start of the year."

The asset classes – a quick round-up

EQUITY MARKETS

What promised to be a good year for equities changed in the last quarter, which was either static or falling (in local currency) for many markets as central bank statements about 'higher-for-longer' interest rates started to hit home.

While most equity markets are still showing annual gains, it looks like they will be under pressure in the coming months.

US stock market returns have been subdued as investors have been more cautious. This is because economic data is mixed with stubbornly high core inflation in some parts of the economy creating fears that the consumer price falls many economists expected later this year might follow a bumpier path than expected.

The question is what this means for interest rates rises. The Fed recently paused any increase, despite a slight rise in inflation, while allowing for one more hike this year. It also indicated that there would be fewer rate cuts in 2024 and 2025, which suggests that they will be higher for longer than expected to combat any short-term surges in inflation.

The pressure of higher interest rates has caused some significant changes for the European economy during the last 12 months. China's economy is still underperforming, and Japan's stock market has held up well without rising.

FIXED INTEREST

Returns this year have been far better than last year, with global government bonds returning around 2%.

The strongest returns have come from the high yield market which has been more sensitive to interest rate rises and there have been limited defaults, although there have recently been signs that this has started to increase.

Corporate bond investors have generally supported quality, and fixed interest managers seem more likely to favour this area of the market, especially if the global economy worsens.

There may be more significant opportunities in the bond market if there are signs of recession in the next six months.

Currently shorter-rate yields are higher than those for longer ones. As a result investors are usually choosing shorter-term assets, protecting against rising interest rates during the last two years. If rates start to fall in 2024, bonds will become more attractive due to the rise in their market price.

Emerging market debt may also offer some decent opportunities as several countries have already lowered rates.

Expectations of falling returns have stalled due to central bank 'higher-for-longer' message and because much-anticipated rate cuts appear some way off.

ALTERNATIVE INVESTMENTS

Property and infrastructure investments have faced difficulties for the last 18 months due to rising interest rates.

Other factors, including changing working patterns and moves towards logistics and data centres, have led to a reset of capital values in the global property market and, as a result, many investors have focussed on sectors with stronger income streams.

Many commodity prices have fallen in value due to fears of a potential recession and a lack of demand from China after it's reopening failed to boost demand.

In August, prices for seven out of the 12 base metals posted losses (source: Focus Economics Sept 2023) due to waning global demand, affecting copper, aluminium and nickel, steel and iron ore.

Purchasing Manager's Index (PMI) readings for the Eurozone, US and China in August indicated subdued industrial activity. The exception is oil, which has risen by 30% in price since June (source: Focus Economics Sept 2023) as restricted supplies hit global prices, raising them close to $100 a barrel.

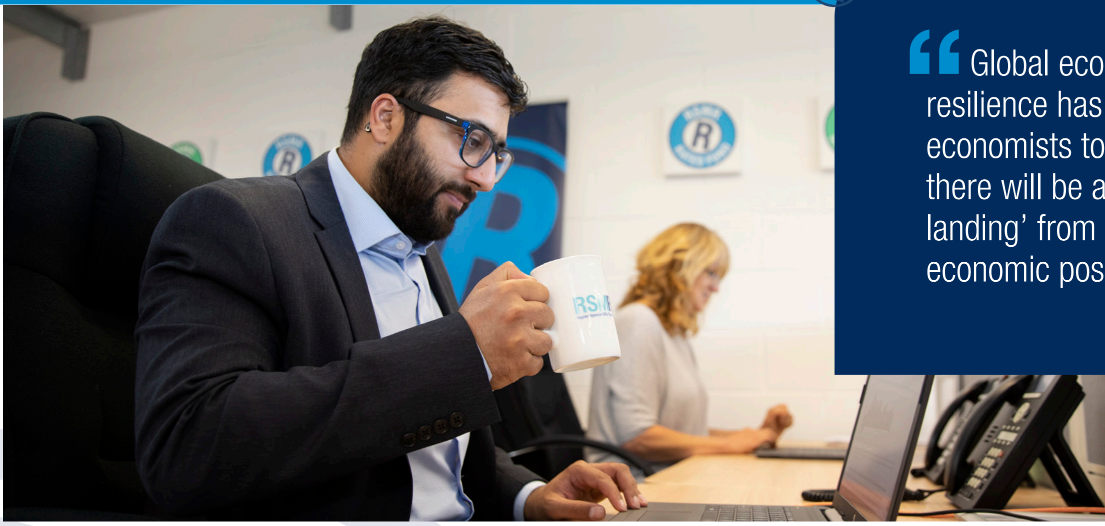
Russia has recently barred exporting diesel and petrol in retaliation for Western sanctions. This may stimulate inflation as winter approaches and will worsen if gas is also restricted, especially in Europe.

Real estate asset values can progress only if we see a change in central bank interest rates rhetoric or if we avoid global recession.

RSMR Global round-up

- In September China's renminbi fell to its lowest level against the dollar since 2007.
- India remains the standout Asian economy with 7.8% gross domestic product (GDP) growth in the year to June (source: FT Sept 2023).
- The UK economy fell 0.5% in July, although the overall quarter was better (source: ONS).
- US annual inflation, as measured by the Bureau of Labour Statistics, rose to 3.7% in August.
- The European Central Bank raised rates by 0.25% in August.
- Global supply chain issues have affected all economies, but Germany has suffered more than most.
- Asian economies, such as Indonesia and the Philippines, are showing strong growth with rising inflation.
- Spain has seen a strong post-pandemic rebound with revised GDP data very encouraging.
- Germany faces various difficulties and industrial production has fallen by 2.1% this year (source: FT Sept 2023).

"The European Central Bank raised rates by 0.25% in August."



> Global economic resilience has led some economists to suggest there will be a 'soft landing' from the current economic position.

SO, WHAT'S NEXT?

It is currently impossible to say how this economic cycle will play out as conventional economic models failed to predict this year's strong economic activity, especially in the US.

China has struggled since reopening but remains an entrepreneurial society and a world leader in many technology industries.

The high oil price threatens economic growth and taming inflation in the developed world and in emerging markets such as India, which are vulnerable to oil price shocks.

It is unclear how the move away from low inflation will evolve during the next decade, as there are longer-term conflicting forces.

How stock markets progress in the next year depends on how they perceive any opportunities and the outcome from the current high inflation and interest rates.

General global economic resilience has led some economists to suggest there will be a 'soft landing' from the current economic position, but it may be that different global regions will behave in very different ways. The US is far more resilient than Europe or the UK, while China's post-Covid recovery is tepid due to weaknesses in its property market.

Investors should remain cautious but be decisive if markets sell off sharply early in the fourth quarter.

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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