MONTHLY UPDATE

Latest views from the investment team

Optimism Grows

- **Policy adjustment in the US**
- **Inflation and Unemployment**
- **Is China reopening? Why are there Protests?**

Policy adjustment in the US

November brought more optimism to US equity markets as investors took stock of the improved inflation outlook and corresponding monetary environment. The month's final trading day included a speech from Federal Reserve (Fed) Chair Jerome Powell who suggested it may be appropriate to slow the pace of US interest rate increases to 0.5% when the committee meets in December. This follows four consecutive 0.75% increases. The major US index rallied over 3% following the speech. Powell explicitly said that there is a slim prospect of the US not entering a recession as labour markets cool, an opinion seen as improbable just last month. Indeed, Bloomberg economics put the chance of a US recession at 100% in mid-October.

Inflation and Unemployment

Data last month may have indicated that we have seen peak inflation in the US, however the Fed remains in a difficult situation. The labour market remains strong. The quantity of job openings is four million higher than the quantity unemployed, putting strong upward pressure on wages. In his speech, Powell pointed to the labour market as the single most important driver of inflation. Wage and payroll growth exceeded expectations in late November. However, both are slowing compared with the start of the year.

Is China reopening? Why are there Protests?

Turning attention away from the US, the flagship policy of the Ruling Chinese Communist party has been zero-covid for almost 3-years. Despite the return of normality in the West, many in China remain in the cycle of moving in and out of lockdown. The country remains nearly totally isolated, and the economy has been hit hard. A driver of this policy is lower vaccination rates of the elderly as restrictions on the use of the more trusted western made vaccines persists. There were unprecedented protests at the end of the month as individuals took to the streets demanding increased freedom and an end to the policy. It seems to have worked; China appears to be moving slowly out of this era with a broad but small reduction in restrictions. Markets saw sharp increases in Asian equities and sectors such as Mining which stand to benefit from the reopening.

Month by numbers

Change in various markets over the month:

Asset		Change/ Value
Equities		
UK	↑	**7.08%**
Europe	↑	**7.06%**
US	↑	**5.38%**
Emerging Markets	↑	**11.68%**
Japan	↑	**2.97%**
Bonds/Rates *Absolute change (%)		
UK Base Rates	↑	**0.75%**
		3.00%
Fed Funds Rate	↑	**0.75%**
		4.00%
UK 10-Year Yield	↓	**-0.37%**
		3.16%
US 10-Year Yield	↓	**-0.38%**
		3.70%
Currencies		
GBP/USD	↑	**3.46%**
		1.19
GBP/EUR	↓	**-0.53%**
		110.25
DXY (USD Index)	↓	**-5.00%**
		105.95
Commodities		
Gold	↑	**8.27%**
		$1,768.54
Oil (Brent)	↓	**-9.91%**
		$85.43
Note worthy		
Euro Natural Gas	↑	**26.00%**
Bitcoin/GBP	↓	**-20.00%**

December

As of 30 November 2022

What does this mean for investors?

Developed market equities gained around 6% over the month marking the first back-to-back monthly gains since 2021 following another 6% increase in October. The Asia/Pacific region rose around 14% in November, its biggest 30-day gain this century. Whilst the likely dwindling of monetary policy aggressiveness is primarily driving this upside, we do not yet believe the conditions for a sustained rally in risk assets are in place. The potential for a change in policy does not mean the fundamental risks to inflation and growth have disappeared. Instead, they remain and, as such, the defensive position reflected across our portfolio range is unchanged, albeit still able to participate in bouts of renewed risk appetite.

Q&A

What's on your mind?

What happened in the US Midterm elections?

The beginning of the month saw midterm elections in the US. The GOP (Republican party) was touted to take control of both the Senate and the House however results were more mixed. At the time of writing there will be a slight Republican majority in the House and an even share in the Senate. This matters because despite the slightly underwhelming results for the GOP, control of the House hinders the Democratic Executives ability to enact legislation which has consequences reaching from the war in Ukraine to taxation. The effect on markets, however, has been relatively muted with other issues such as inflation taking up investor attention. It is also seen as a hit to the credibility of former President and current candidate Donald Trump.

Why has the pound appreciated against the US dollar?

After an extraordinary rally the US dollar has hit the brakes this month with a depreciation against sterling and other major currencies. The reasons for this are not entirely obvious, changes in bond yields alone are not enough to explain this shift. It appears to have been amplified partially by investors looking to exit their long US dollar positions. The pound has stood out as it stabilized under the Sunak premiership and a more conventional and market friendly fiscal policy.

What is the relationship between interest rates and bond prices? What is duration?

Following our November monthly update, we received some questions on the relationship between bond yields and prices. The yield of a bond can simply be interpreted as the rate of interest you will receive from lending capital to the bond issuer. The bond market is predominantly made up of investors buying and selling existing bonds, that is buying the right to receive the repayment from the issuer. The repayment amount is agreed in advance; however, the price fluctuates. There is an inverse relationship between interest rates and bond prices, when interest rates increase the price investors are willing to pay for a bond decreases as a higher yield is demanded as compensation. The duration of a bond is essentially the sensitivity of this relationship. For example, if a bond has a duration of 2 years a 1% increase in interest rates/yields should result in a 2% fall in the price of the bond. The duration of the bond amplifies the price action.

For more information, please contact your adviser.