MONTHLY UPDATE

Latest views from the investment team

What a difference a day makes

Market sentiment throughout 2022 was particularly downbeat – inflation was out of control; war was raging in Ukraine; interest rates were rising aggressively; recession was round the corner; and, as a result, virtually all asset classes were down (substantially) on the year. However, after the clock struck 12 on New Year's Eve, 2022 was behind us, the slate was wiped clean, and investors were eager to start making some money once again. January has seen a rally for the ages, led by the stocks that were hit the hardest last year. The tech heavy NASDAQ had its best start in 40 years. The new narrative is: Inflation has peaked; interest rate hikes are close to peaking; and recession risk has subsided.

So, is the worst now behind for investors?

The rally we have seen in equities (and bonds) can be rationalised, in hindsight, as the key issues investors were grappling with last year appear to have subsided somewhat. There are now clear signs that inflation is coming down (from a very high level), and that the rate hiking cycle may be close to peaking. It therefore makes sense that those assets most sensitive to these moves, namely: long duration bonds, growth stocks (e.g. tech) and gold, have rallied strongly in 2023. There is an expectation (or elasticity in the memory of investors) that the Federal Reserve (Fed) will stop hiking rates in the summer, and then begin easing in the second half of the year: a term colloquially known as "the Fed put". The Fed have guided that this is not likely to be the case and that monetary policy will remain tight until the dual mandate of price stability (inflation at 2%) and "maximum employment" is reached. Unemployment is at its lowest since the 1950s; tick. But inflation is still more than double the Fed's target. Whilst it has fallen quite considerably, they will be conscious that extinguishing the flames of inflation does not put out the embers. Central banks will want to ensure entrenched inflation is out of the system before declaring victory. So, whilst a pause on monetary tightening might be appealing for investors in the short term, it could lead to issues down the line and second round effects (e.g. wage spiral, from a tight labour market).

Overall, we think central banks will follow through on keeping monetary policy tight but that inflation will remain higher (in the 3-5% region) for the medium term. In this environment equities have historically fared well – but investors need to be selective in allocations.

Month by numbers

Change in various markets over the month:

Asset		Change/ Value
Equities		
UK	↑	**1.20%**
Europe	↓	**-1.70%**
US	↓	**-3.50%**
Emerging Markets	↓	**-3.50%**
Japan	↓	**-1.20%**
Bonds/Rates *Absolute change (%)		
UK Base Rates	↑	**0.25%**
		1.25%
Fed Funds Rate	↑	**0.50%**
		2.50%
UK 10-Year Yield	↓	**-1.70%**
		4.20%
US 10-Year Yield	↓	**-3.50%**
		3.95%
Currencies		
GBP/USD	↑	**0.25%**
		115.25
GBP/EUR	↑	**0.50%**
		110.25
DXY (USD Index)	↓	**-3.50%**
		1.11
Commodities		
Gold	↑	**5.20%**
		$1650.25
Oil (Brent)	↑	**7.50%**
		$95.40
Noteworthy		
Bitcoin	↑	**32.00%**
Natural Gas	↓	**-35.00%**

February

As of 31st January 2023

What does this mean for investors?

Investors enjoyed a rally in most asset classes in January – with both bonds and equities having a strong start to the year. After a torrid 2022, those still holding onto the *covid winners* saw some losses recouped in January - the poster child of these stocks, being the ARK Innovation ETF, was up around 28% on the month. After a strong start to the year, investors will have a degree of caution as to whether this is just a bear market rally, or the beginning of new bull run for stocks. Our view is that 2023 will be a year where positive returns are made, but we do not see a return to the style of investing that dominated between 2010 – 2021. Rather, we believe that real assets, dividend payers, value stocks and smaller companies will be better placed in an inflation regime that will likely remain elevated.

In terms of portfolio positioning – early in January we increased equity exposure in portfolios back to neutral, having been defensively positioned for most of last year.

Q&A

What's on your mind?

What is meant by the "January Effect"?

This is the hypothesis that January tends to be the best month for stock market returns. Some academics consider this effect to be minor although numerous studies have supported this hypothesis across several periods. What could be driving this? Potential explanations are both financial and psychological. Firstly, tax planning creates an incentive for investors to sell their poor performing assets in December, locking in a capital loss and reducing their tax liability (the US tax year is Jan – Dec). This may cause a dip which recovers in January. Moreover, many employees receive their bonus at the end of the year providing cash to invest in January. Lastly, many try and start the new year with a fresh mindset which may involve increased investment and risk taking, boosting markets.

Are emerging markets re-emerging?

Emerging markets had a strong January, returning around 6.5%. This was driven by Chinese equities which returned close to 12%. This takes their total rally to 50% since their October lows. Investors are likely predicting that Chinese economic growth, which declined in 2022, has reached a bottom. The economy is expected to expand following the re-opening of the country brought by the end of the zero-covid policy. Indeed, there are expectations that the recovery will be swift as Covid infections have already peaked. An example of this reopening can be seen in the subway passenger flows, which have recovered to around 70% of their pre-covid levels in Beijing and Shanghai. Chinese New Year should also provide a consumer spending boost. This renewed optimism has boosted Chinese equities and broader emerging markets. It also provides the potential for upside in commodity prices and companies with exposure to the Chinese consumer.

For more information, please contact your adviser.

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