MONTHLY UPDATE

Latest views from the investment team

Central banks hit the pause button

In a departure from what is typical, it was central bank inactivity that made headlines in September. The Bank of England paused (at 5.25%) its aggressive interest rate hiking cycle for the first time in nearly two years in September and, in the US, the Federal Reserve also held policy rates unchanged (at 5-5.25%). We feel this now signals a near peak in the current interest rate cycle but believe we are not yet out of the woods on the impact that it has had on the global economy.

September was a poor month for most asset classes, with equity and bond markets broadly lower over the period. The UK market bucked the trend with UK equities generating positive returns over the month. This followed a welcome, and unexpected, decline in UK consumer price inflation to 6.7%, as well as revisions to reported growth data showing that economic performance since the pandemic has been much stronger than we had thought. UK equities were also supported in September by the decline in the pound (driven by lower-than-expected inflation and the central bank interest rate pause) and increase in oil prices. The UK equity market has a large representation of energy companies, as well as companies with overseas earnings, which benefit from a weaker home currency.

Whilst we have seen a pause in interest rates in the UK and US, bond yields have continued to rise – particularly longer dated bonds – which are an important factor in how one values assets such as equities. The US has seen its 10-year bond yield rise to the highest level since 2007. This leads us to question why the increasingly sanguine tone from central banks has not been accompanied by lower bond yields. Firstly, it is not yet clear that the inflation fight is over – oil prices have increased by more than 30% since the summer lows and this is already evident in US inflation which increased to 3.7% in September from a recent low of 3.2% in July. Secondly, market participants are interpreting these policy decisions as an indication that central banks are more comfortable with a higher base level of inflation than their target level (of 2%).

For us, as multi-asset investors, this regime change has led to activity in portfolios we run for clients. In recent months, we have been turning more "defensive". A couple of years ago, this would mean coming out of equities and holding something that generated very little return (cash or bonds yielding close to 0%). Now, however, turning defensive means we can build up bond allocations, where the yields on offer range from 5-10%. Not bad for reducing risk in your portfolio. Bonds also offer the potential for capital uplift – for example, in a recessionary environment, which is quite possible in the next 12 months, investors can reasonably expect government bond prices to rise as investors look for safety and the expectation that interest rates will fall.

Bottom Line

The re-pricing of cash rates has provided a credible alternative asset for investors to consider, but also materially improved the attractiveness of investing in equities and (more so) bonds. For investors with longer-term goals, the valuation backdrop of a multi-asset portfolio, and thus the expected longer-term returns, has improved dramatically with the rise in cash rates.

Month by numbers

Change in various markets over the month:

Asset		Change / Value
Equities		
UK	↑	2.95%
Europe	↓	-2.50%
US	↓	-4.72%
Emerging Markets	↓	-1.79%
Japan	↑	0.35%
Bonds / Rates (*Absolute change (%))		
UK Base Rates	–	0.00% / 5.25
Fed Funds Rate	–	0.00% / 5.5
UK 10-Year Yield	↑	0.08% / 4.44
US 10-Year Yield	↑	0.48% / 4.57
Currencies		
GBP / USD	↓	-3.68% / $1.22
GBP / EUR	↓	-1.26% / €1.15
DXY (USD Index)	↑	2.51% / 106.22
Commodities		
Gold	↓	-4.72% / $1848.58
Oil (Brent)	↑	9.73% / $95.31
Noteworthy		
Ocado Group	↓	-31.10%

Q&A

What’s on your mind?

Can we now relax about UK inflation?

UK inflation fell unexpectedly in August to 6.7%, still well above the 2% target but down significantly from its recent peak of over 11% last October. The decline was reassuringly broad-based with lower food, hotel, rent, furniture and recreation inflation. This will be a welcome surprise to both consumers and politicians, particularly as fuel prices rose again. The Bank of England expects inflation to fall further to around 5% by the end of this year. However, for the last two years, the Bank of England’s forecasts have proved to be of limited use with inflation being grossly underestimated and, as a result, they have recently announced a review into their processes. With so many global uncertainties impacting commodity prices, as well as elevated wage inflation, it may be too early to declare victory on inflation.

Should I sell my portfolio and move to cash, with interest rates at 5%?

Cash is now a credible asset to consider as part of overall wealth planning, especially for short-term liquidity requirements. However, whilst cash is clearly attractive, investors need to consider what holding cash means, relative to their longer-term goals. Whilst stocks and bonds have struggled in the last 18 months, they have (historically) been a sensible blend of assets to hold over the long-term to provide inflation beating returns, well ahead that of cash. And that has held true during periods of low and high interest rates. Even during the high inflationary period of the 70’s and as interest rates remained elevated in the 80’s a mix of stocks and bonds served investors better than holding cash. So, if one’s time horizon for investment affords it, we do not see the current backdrop as being any different.

What is Donald Trump on trial for?

On October 2nd, Donald Trump began his civil fraud trial in Manhattan, separate from the upcoming election fraud trial scheduled for next year. The case alleges Trump fraudulently inflated the value of his assets to secure better loan terms for business ventures, some $825m from Deutsche Bank during the late 1990s and early 2000s. Notable instances include a reported 2118% price increase on his Mar-a-Lago resort from $27.6m to $612.1m, and an exaggerated claim about the size and value of his New York apartment, estimated at $120m but claimed at $327m. The New York State Attorney General seeks a $250m fine and a ban on Trump and his associates conducting business in the state. Trump intends to run for office again in 2024, and although considered the Republican frontrunner, his legal challenges could complicate his political ambitions. It's worth noting that, legally, one can hold the office of president from jail in the United States.

For more information, please contact your adviser.