MONTHLY UPDATE

Latest views from the investment team

Optimism is hiding

October was a significant month in geopolitics and financial markets. The conflict in the Middle East has naturally generated the most headlines, but the month also saw asset price volatility. Most equity and bond markets fell during the month with only a few areas of respite, such as gold and short-dated UK government bonds. Whilst it is hard to find any relief in geopolitics as the situation in Israel and Gaza persists, there are some positive drivers for financial assets over the long-term.

Tensions in the Middle East have further added to the theme of elevated geopolitical risk which is likely to have great significance for years to come. In terms of the immediate market impact oil and many other commodity prices have not moved significantly, but the World Bank has warned that any escalation could trigger a sharp increase. This further supports the case for commodities, which have a low correlation with equities and bonds, within multi-asset portfolios. A rise in commodity prices may cause problems for central banks that have recently taken relief from declines in inflation and paused interest rate rises. The safe haven appeal of gold triggered a sharp rise over the month as it is viewed as a good store of value when the environment is volatile.

Elevated geopolitical risk, as well as diverging stances from policymakers across the globe, is leading to varying outcomes across economies and markets – a backdrop we expect to persist. There is some evidence of growth weakening in the UK and Europe whilst the US has been more resilient, benefitting from high government spending, consumers having lower sensitivity to higher borrowing rates (due to mortgage rates typically being fixed over the long-term), and cheaper domestic supplies of energy in the US. Corporate earnings so far, on both sides of the Atlantic, have been largely in line with expectations. However, reactions to companies missing expectations have been harsher than the positive reactions to companies exceeding expectations. Higher bond yields have weighed on the expected value of future earnings, for now overpowering the influence of current economic activity or a more supportive stance from policymakers. UK yields were more favourable with two-year Gilt yields falling over the month.

High level uncertainties mean we favour a defensive stance at present but we still, as multi-asset investors, see good opportunities within asset classes. Within defensive assets we favour short-dated and inflation-linked bonds over long-dated bonds as inflation remains elevated with upside risks from commodity prices. With central banks pausing rate hikes, we expect a floor to be in place now for bonds and pockets of the equity market to start performing. Within equities we favour Japan and UK over Europe. Commodities remain a strategic allocation.

Bottom Line

The re-pricing of cash rates has improved long-term expected returns for multi-asset portfolios, whilst the recent pause in rate hikes is expected to provide more stability near-term. Both equities and bonds have struggled recently but weak sentiment tends to reverse quickly, benefitting long-term investors. We expect ongoing geographic divergence, driven by geopolitics and varying approaches to monetary and fiscal policy, thus providing attractive opportunities for active investment management.

Month by numbers

Change in various markets over the month:

Asset		Change / Value
Equities		
UK	↓	-3.61%
Europe	↓	-3.44%
US	↓	-2.33%
Emerging Markets	↓	-3.59%
Japan	↓	-3.08%
Bonds / Rates ** Absolute change (%)*		
UK Base Rates	–	0.00% / 5.25
Fed Funds Rate	–	0.00% / 5.5
UK 10-Year Yield	↑	0.07% / 4.52
US 10-Year Yield	↑	0.34% / 4.91
Currencies		
GBP / USD	↓	-0.60% / $1.21
GBP / EUR	↓	-0.39% / €1.15
DXY (USD Index)	↑	0.41% / 106.66
Commodities		
Gold	↑	7.27% / $1983.01
Oil (Brent)	↓	-8.29% / $87.41
Noteworthy		
Bitcoin	↑	27.98%

November

All data as of 31 October 2023

Q&A

What's on your mind?

Why is Japan attracting attention?

For decades Japan made headlines as an underperforming economy, dragged down by deflationary pressures and a debt crisis following an equity and real estate bubble, attributed to a long period of loose monetary policy. Japanese equities suffered for many years but since US policymakers started raising interest rates in March 2022, Japanese equities have outperformed the MSCI All Country World Index by more than 20%. Japan has benefitted from several factors, which include extremely low interest rates, a weak currency which has helped exports and strong international relationships which is encouraging foreign investment. Japan is part of the chips alliance which has been formed with the US, Taiwan and South Korea. TSMC and Sony are just a few names that have announced they will build facilities in Japan. Corporate governance reforms are also encouraging companies to invest for future growth, further benefitting the equity markets.

Is gold a good investment?

Gold prices have increased approximately 8% since Hamas first attacked Israel on 7th October. Gold is a unique asset that has a historically low correlation with both equities and bonds, therefore providing useful diversification to a multi-asset portfolio. It has limited industrial value and, unlike bonds, does not provide a yield. However, it serves as an alternative widely accepted currency and, therefore, tends to perform well when conditions are volatile or when there are meaningful currency devaluations, for example, due to high inflation or weak growth. At present, inflation is still above target and bonds are not providing a reliable offset to equities and a volatile geopolitical backdrop continues. This is a good environment for gold.

Will the UK housing market weather higher interest rates?

UK house prices rose by 0.9% in October, defying forecasts of a 0.4% fall, according to Nationwide Building Society. This marks the greatest rise since August of last year, raising hopes that the property market may be less impacted by higher rates than first thought. Experts caution that the housing market is still weak, and to avoid reading too much into the recent price rise. Limited supply on the market has inflated prices, likely caused by homeowners' aversion to sell properties and re-mortgage at such high rates. Mortgage approvals have also been notably lower, with just 43,300 approved in September, around 30% below the monthly average in 2019. This is pinned on affordability constraints, as prices, despite falling from their peak, are still 17.7% above pre-pandemic levels. Despite resilience in the property market, economists remain split on whether prices will settle or fall in the coming year, given the economic challenges.

For more information, please contact your adviser.

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