MONTHLY UPDATE

Latest views from the investment team

Inflating Optimism

Following the pessimism evident in recent months, November has been filled with thanksgiving cheer as equity and bond markets have both made significant gains. Markets have been encouraged by falling inflation and oil prices, boosting hopes for a softer economic landing amidst a more supportive stance from policymakers. There was also a mini budget in the UK – thankfully it was far less eventful than last year.

Over summer, poor sentiment dominated markets, as inflation proved more stubborn than expected and central banks continued raising interest rates to tackle it. In November there has finally been some optimism with lower-than-expected inflation in both the US and UK and central banks holding interest rates unchanged at a second consecutive meeting. Indeed, total interest rate actions across the globe now tilt towards more cuts than hikes for the first time in nearly three years – and expectations are building for rate cuts in both the US and UK in the first half of 2024. There is still some way to go for inflation to reach 2% targets (inflation is 3.2% in US, 4.6% in UK) but now that inflation has fallen such a long way from 2022 peaks (9% in US, 11% in UK) the task is possibly less urgent. Commodity prices falling in November, aided by reduced geopolitical tensions, will help mechanically, but also put money back in consumers' pockets; thus, providing some stimulus and delaying economic slowdown. Ongoing gyrations still seem likely as economies adjust to a higher interest rate environment. In the UK, the Office for Budget Responsibility forecasts inflation will not return to its target until 2025 and the Bank of England Governor recently pushed back on the idea of rate cuts any time soon. Nonetheless, lower inflation levels should provide some comfort and some US policymakers have expressed agreement with market expectations for lower policy rates in 2024 – a welcome but unforeseen development as the US economy has proved very resilient this year.

These developments have pushed up bond and equity prices as fears that interest rates need to stay high to dampen inflation have reduced, while the estimated value of future company earnings has increased amidst positive outlooks for the economy. Some of the most unloved areas of the market benefitted most in November - such as real estate, sustainable themes and UK smaller companies. These sectors are typically very sensitive to borrowing costs. The more promising backdrop, all else equal, provides a sunnier outlook for economic growth and equity markets.

In the UK the Chancellor walked a wary tightrope at the mini-budget by announcing measures which, in aggregate, mean more fiscal spending than was expected – the cut in National Insurance and increased state pension are both examples. These changes are not on the same scale as 2022's mini-budget and, as such, did not incite a similar adverse market reaction.

Bottom Line

November serves as a good reminder about the benefit of staying invested. It is often hard to predict when positive market catalysts will come to fruition but, historically, downturns in the market have been followed by an eventual upswing and being out of the market can hurt long-term performance.

Month by numbers

Change in various markets over the month:

Asset		Change	Value
Equities			
UK	↑	2.26%	
Europe	↑	7.38%	
US	↑	9.37%	
Emerging Markets	↑	6.18%	
Japan	↑	5.97%	
Bonds / Rates ** Absolute change (%)*			
UK Base Rates	–	0.00%	5.25%
Fed Funds Rate	–	0.00%	5.5%
UK 10-Year Yield	↓	-0.34%	4.18%
US 10-Year Yield	↓	-0.57%	4.34%
Currencies			
GBP / USD	↑	4.30%	$1.27
GBP / EUR	↑	0.75%	€1.16
DXY (USD Index)	↓	-2.97%	103.5
Commodities			
Gold	↑	2.68%	$2036.07
Oil (Brent)	↓	-5.24%	$82.83
Noteworthy			
WeWork	↓	-46.70%	

December 2023

All data as of 30 November 2023

Q&A

What's on your mind?

Why are smaller companies attracting attention?

Smaller company stocks have been a laggard in recent times as the sector has factored in the adverse expected impact of higher borrowing costs and lower economic growth. Comparing historically, the bad news now priced into US small cap stocks relative to large caps on a price/earnings basis is as extreme as was observed in the early 2000s, 2008 or 2020 – a level of pessimism not priced in consistently across asset classes and sectors. Small cap stocks are often under-researched and greater beneficiaries of M&A activity than large caps, therefore offering good potential for alpha generation over the long-term. Although the overall environment may continue to exhibit volatility as economies transition to higher interest rates, the recent decline in inflation and pause in rate hikes from central banks should provide some stability and this sector is well positioned to benefit.

Will next year's increase in the UK National Living Wage fuel inflation?

The Chancellor announced in his Autumn Statement that the National Living Wage (NLW) will increase by 9.8% to £11.44 an hour from April 2024. The increase is the largest since the NLW was introduced in 2016 and, at first glance, seems inconsistent with the goal of lowering inflation (currently 4.6%) to the 2% target. However, due to the difficulty of finding and retaining workers in the aftermath of lockdowns, many low pay employers have been paying a large premium over the NLW. For example, large supermarkets have been paying 5-6% above the NLW. As unemployment has started rising from the lows observed a year ago, it seems likely that this premium will be reduced in April and the Chancellor's announcement will be less impactful for inflation than some fear.

Have geopolitical risks faded in November?

The Russia-Ukraine war has been running for 21 months with no resolution and continued global political support for Ukraine seems to be waning. Despite huge global support for Ukraine since the initial invasion, particularly from the US and Germany, Ukraine is failing to prevail and, with winter in mind, there are increasing calls for a peace treaty. Meanwhile in the Middle East, Qatar has mediated a temporary truce, leading to the release of many hostages. November also saw Xi and Biden meet in San Francisco and provided encouraging signs that both China and the US seek to improve relations. Reportedly talks led to a series of agreements, including commitments to reopen military communications. Geopolitics remains fluid and immigration continues to be a point of friction. In the Dutch election in November, the far-right populist Geert Wilders led his party to a surprise decisive victory, a reminder of fragmented views across the world.

For more information, please contact your adviser.