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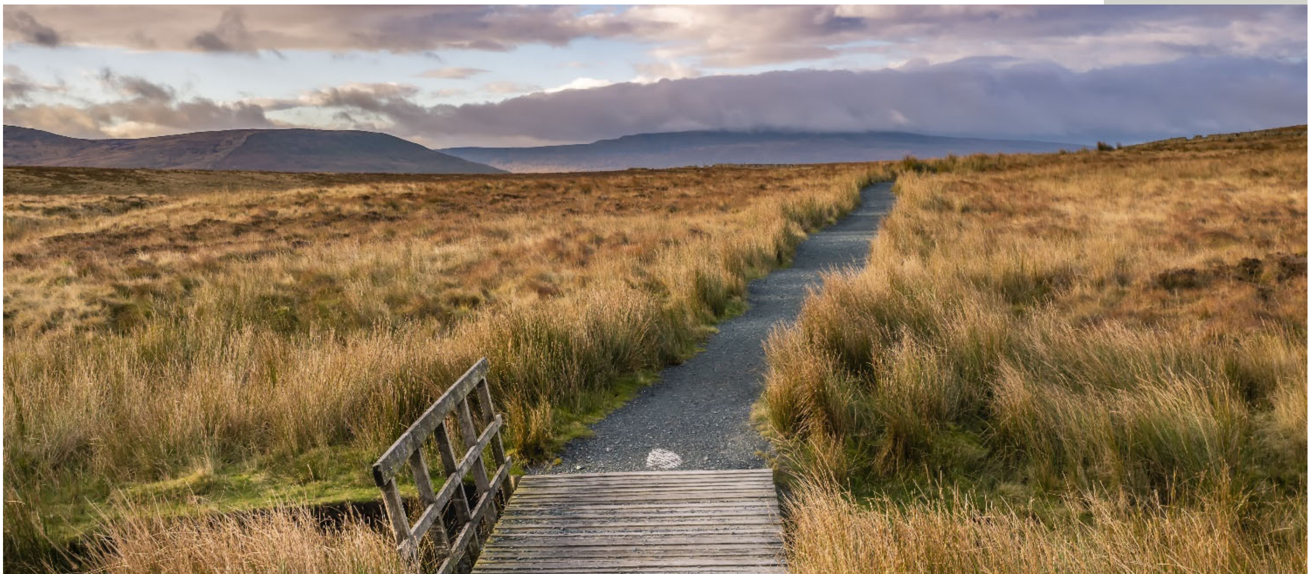
Market reflection



John Wyn-Evans
Head of investment strategy

Overview

The optimistic tone of markets in January was followed by a more cautious mood in February. Whereas at the beginning of the year investors had been happy to price out the risk of a deeper global recession, more recently the positive economic data has rekindled fears that central banks will have to raise interest rates even further to combat persistently high inflation. In market parlance, we have entered a period during which "good news is bad news". Not only has the expected level of peak interest rates risen, but they are also forecast to remain at those peaks for an extended time, market shorthand for this being "higher for longer". Higher rates depress the valuations of most financial assets.

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The reporting season, during which companies unveiled their earnings for 2022, was a relatively muted affair in aggregate. Although it provided the usual beating of analysts' forecasts, the margin of the beat was not as great as we have been used to in the past, and there were further signs of margin pressure in the face of rising costs, especially wages. Indeed, cost-cutting measures were a feature of the season, notably amongst disruptive growth companies who have struggled to generate profits historically, but also amongst the bigger technology companies, who admitted to having over-hired in response to an extrapolation of the Covid-related spending spree. There is increasing evidence that investors are demanding a path to profitability in a world where money is no longer free.

We continue to believe that markets will remain choppy as growth finally succumbs to the lagged effects of the big increase in interest rates we have already seen. However, that slowdown will also, eventually, allow the next rate-cutting cycle to begin, thus limiting the downside risk. We are still awaiting a more opportune moment to increase equity weightings in balanced portfolios.

- We have finally seen a tick up in global growth expectations. The Bloomberg consensus World GDP growth forecast for 2023 has risen from a trough of 2.1% to 2.4%. Much of this is the result of the reversal of extreme pessimism on two fronts. Europe avoided severe energy shortages thanks to a warm winter, a hasty renegotiation of supplies and voluntary reduced consumption. China reversed its zero-Covid policy and embraced a rapid re-opening of its economy in time for the Lunar New Year. The growth forecast for 2024 remains at 2.9%, which suggests a fairly shallow recovery by historic standards and certainly not the V-shape that followed the outbreak of the Covid pandemic.

- Inflation remains the major bugbear for policymakers. Although it is widely acknowledged that headline consumer price indices have peaked in terms of their year-on-year increases, they remain well above the 2% target of most central banks. Moreover, core inflation, which strips out volatile food and energy prices, is proving to be more obstinate. Hence the need for higher interest rates.

- One feature of the current cycle is that unemployment rates remain very low compared with the past. At least some of this is the result of a reduced labour force, with many having permanently retired and others affected by long-term illness. This could perpetuate the upward pressure on wages and, by extension, inflationary pressures.

- The month ended with some positive political news in the form of a new trade deal for Northern Ireland. This helped to inject some much-needed confidence into the pound.

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