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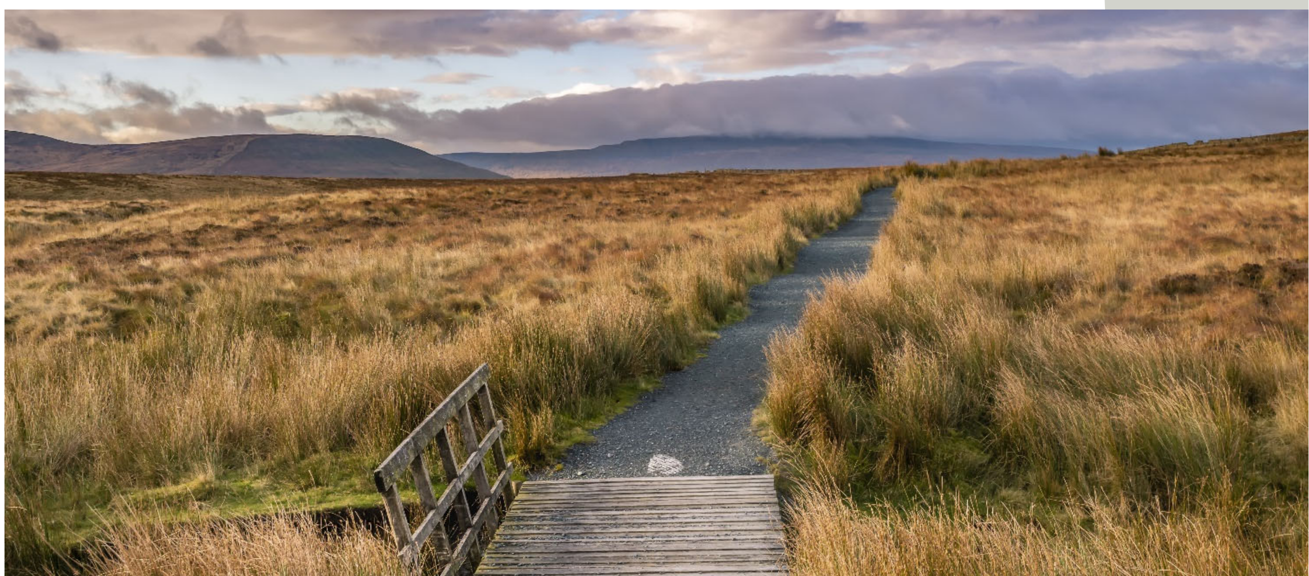
Market reflection



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Overview
The chronic uncertainties that have dogged markets all through this year persist: How fast will inflation fall from its cyclical peak? What will be the response of central banks? Will developed economies finally succumb to recession, and if so, how deep? How will corporate earnings fare if growth turns negative?

Continued overleaf

At least we seem to have side-stepped the potentially negative effects of some more acute crises. The bankruptcies of several banks that were triggered by the demise of Silicon Valley Bank in early March did not develop into a more severe banking crisis. As we go to print, the US debt ceiling negotiations appear to be close to a resolution, averting a potential technical default by the US government. But all is not gloom and doom. Investors in US technology stocks that stand to benefit from the expansion of the market for Generative Artificial Intelligence have fared exceptionally well. Indeed, US market performance is now split into two distinct segments: AI-dominated sectors are firmly in positive territory; the rest of the market is down. Economies around the world are similarly divergent. The market for Goods is weak, as companies through the supply chain built up inventories just as consumers had had their fill of "stuff". Meanwhile, Services are booming as those same consumers continue to celebrate the freedom from Covid-related restrictions.

Persistent labour shortages mean that those in employment are enjoying decent income growth (even if not always keeping pace with inflation). These variances make it difficult for policymakers to act with confidence, and investors are also struggling to read the next shifts in the interest rate cycle. Given that the latest inflation data in the US, UK and Europe have been stronger than forecast, the betting has turned again to "higher for longer" rates. This keeps us relatively restrained in terms of appetite for risk.

- The Bloomberg consensus for World GDP growth in 2023 has risen from a low of 2.1% in February to a current 2.6%. The US continues to experience resilient consumption. A sharp reduction in energy prices has been beneficial to both the UK and the euro zone, although a slowdown in the manufacturing sector has driven Germany into a technical recession (two consecutive quarters of negative growth). World GDP growth for 2024 shows no signs of a quick rebound, with consensus estimates at 2.7%.

- One of the greatest disappointments of this year has been the lacklustre nature of China's recovery. The abrupt ending of its zero-Covid policy was expected by many to lead to faster growth, but structural issues including the highly indebted real estate sector and stagnant population growth have been strong headwinds. The main beneficiaries have been Luxury Goods companies, providing a strong boost to French equity indices, which is where many of the sector leaders are listed.

- A more pleasant surprise has been the resilience of aggregate corporate earnings. In many cases, companies have been able to defend margins against higher input costs by raising prices. However, it is not clear how easy it will be for them to continue with this practice; there could be a limit to consumers' tolerance for higher prices and lower headline inflation might make it more difficult to get away with price increases while input costs are expected to continue to rise on a lagged basis.

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