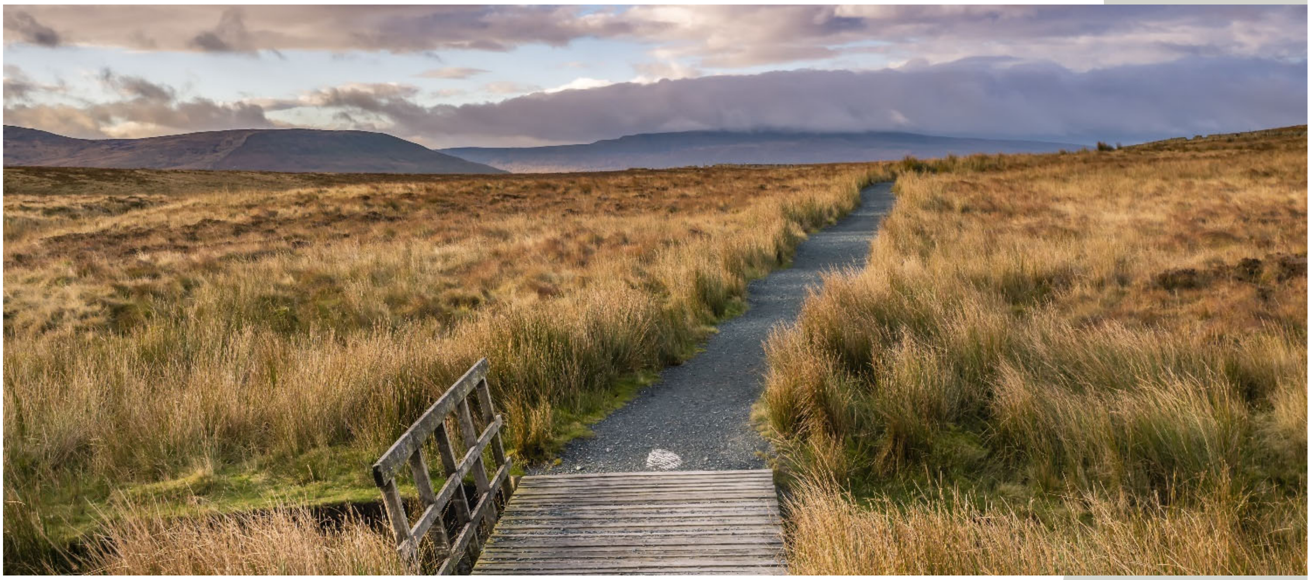
OUT OF THE ORDINARY

07 November 2022

Market reflection



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Overview

It was "all change" again in Downing Street during October, but the new residents are much more to the markets' liking. UK government bonds and the pound are trading at broadly the levels they were before ex-Chancellor Kwarteng delivered his ill-fated "mini" budget which sent shockwaves through the financial system.

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Although the experience was traumatic, an optimistic view would be that the system survived the test and that the Bank of England succeeded in maintaining financial stability. With that drama played out, investors' attention stays focused on the outlook for inflation, central banks' policy reaction and what that means for growth.

Inflation remains sticky, especially in services which are still benefitting from the post-Covid recovery, as consumers leave the privations of the last 18 months behind them. Wage pressures are exacerbated by the fact that many have left the workforce, maybe for good. But goods prices are less perky and shipping costs have also fallen, even if not back to pre-pandemic levels.

Unemployment might well be the key factor in determining the next leg of the monetary policy cycle.
On the global political front, the confirmation of President Xi's third term of office in China, combined with the elevation of like-minded individuals to key roles in government, raised the prospect of an even more autocratic style of leadership leading to reduced prosperity for investors. The US mid-term elections are expected to deliver a divided Congress, which has historically been a reasonably good outcome for markets given the inability of either party to conduct policy.

We remain in "cautious but not fearful" mode, awaiting further clarity on the corporate earnings outlook or a more definitive capitulation on the part of investors before continuing to add risk back to portfolios.

- As investors begin to focus more on the outlook for 2023, we note that although global GDP growth forecasts for 2022 have stabilised at 2.9%, the consensus expectation for next year continues to fall and now stands at 2.5%.

- The decline in economic growth will help to control inflation. Whereas, the forecast for 2022 remains elevated at 7.4%, the outlook for next year is for a fall to 4.8%, although this remains higher than central banks and politicians would like.

- The third quarter earnings seasons, while not yet complete, has not delivered the overall shock that was feared, although there have been several individual disappointments, notably amongst some of the big US technology companies. The percentage of companies beating estimates has been lower than usual and severe treatment has been handed out to those lowering expectations. Aggregate earnings growth for the MSCI World Index is now forecast to be negligible in 2022 at 0.25%.

- One reason for a lagged economic response to higher interest rates might be the mortgage market. With a far greater percentage of mortgages taken out at a fixed rate than in past monetary tightening cycles, the increased pain of higher rates will only be manifested on refinancing.

- There has been some respite on the energy front, with natural gas prices falling sharply now that storage facilities have been refilled. A mild autumn has also been beneficial. But prices remain elevated compared with the pre-pandemic era and will continue to squeeze household budgets.

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