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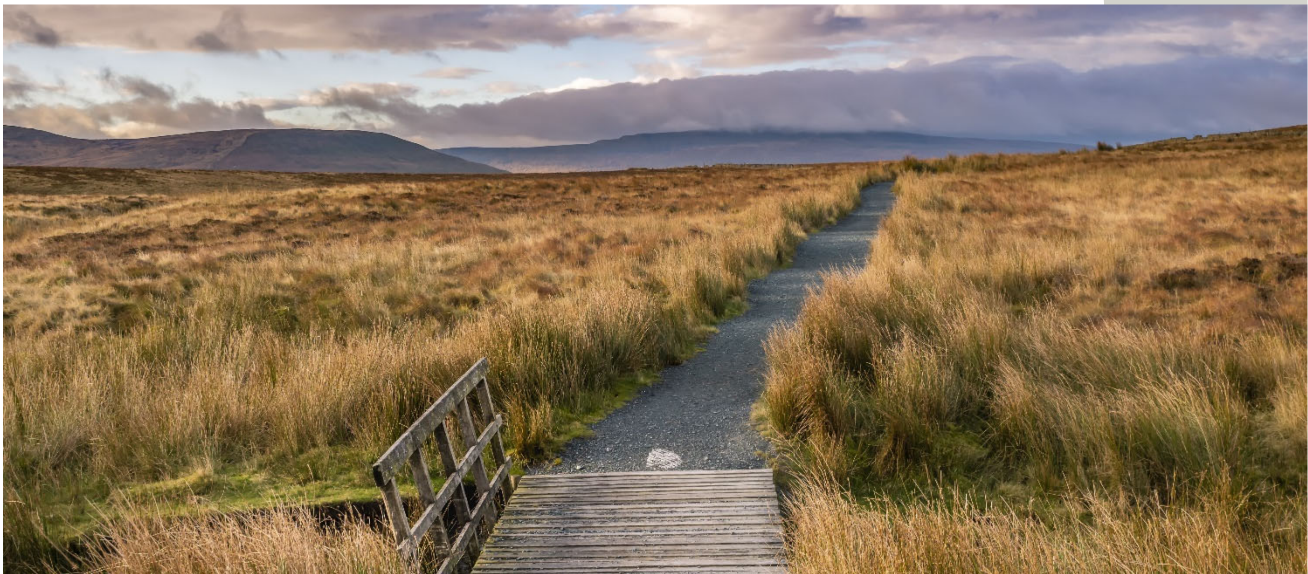
09 October 2023

Market reflection



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Overview

Global equities and bonds continued to post losses in September, extending the trend that started in August. This trend accelerated following the latest meeting of the Federal Open Market Committee, the arm of the Federal Reserve that sets monetary policy. It executed a "hawkish pause", by which it left the Fed Funds rate unchanged but suggested not only a further quarter point increase before year end, but also a commitment to keeping the rate "higher for longer".

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This intention was transmitted to the market via the Dot Plot, which records the rate outlook of individual members. The median dot for December 2024 was raised from 4.625% in June to 5.125%, a good 0.7% higher than futures markets were pricing in. The reason for such a hawkish stance is rooted in the persistent strength of the US economy and in concerns that inflation will not descend to the 2% target in a timely manner. Investors are now increasingly worried that this extended period of higher rates heightens the risk of a "hard landing" for the economy.

Furthermore, the associated rise in bond yields, which saw the 10-year Treasury yield rise to a new cycle high of 4.60%, weighed on equity valuations. The good news is that inflation expectations remain well anchored, but the bad outcome is that the real 10-year rate of 2.2% is back to levels last seen in 2009. Bucking the global trend, the 10-year Gilt yield ended the month at 4.45% following a downside surprise in August's inflation data and a dovish pause from the Bank of England. However, that further undermined this year's rally in the pound, which fell from $1.27 to $1.22 and from €1.17 to €1.15. This at least provided a relative boost to the FTSE 100 Index, thanks to its high level of overseas earnings, and also helped to provide some relief to mortgage rates, but at the expense of international purchasing power.

- The Bloomberg consensus for World GDP growth in 2023 has risen from a low of 2.1% in February to a current 2.7%. The outlook for 2024 continues to suggest limited progress, with consensus estimates at 2.60%.

- The Bank of England held the base rate at 5.25%. There has been a big opinion shift in terms of future rate expectations. At the highest, traders were pricing in a peak rate of 6.5%; now they appear almost convinced that the peak is already in.

- There is a similar view in Europe, where the European Central Bank also left its deposit rate unchanged at 4.0%.

- It is our opinion that we are pretty much at the top of the interest rate cycle. Now the market's focus turns to how long rates stay at current levels and how fast they might eventually fall. Central banks are talking tough, but market pricing (and our inclination) is that they will cut faster once economies show increased signs of weakness.

- The dollar-denominated Bloomberg Global Aggregate Index of investment grade bonds has now swung into negative total return territory for this year (-2.5%). If maintained, this would be a third successive year of losses, unprecedented since the inception of the index in 1990.

- A renewed rise in the price of oil is causing concern, with Brent crude rising from $87 to $95 per barrel. This is up from a low of $72 in June and back to the levels of a year ago, meaning that it is no longer helping to reduce inflation. Production cuts from Saudi Arabia and Russia are the main cause, emphasising ongoing geopolitical risks.

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