OUT OF THE ORDINARY

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Market reflection

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Overview
The downturn in equity and bond markets that was triggered by hawkish central bank comments at the annual Jackson Hole symposium extended through September.

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Following a surprisingly strong August US inflation print which encouraged the Federal Reserve to lay out a path to even tighter policy at its September meeting, equities revisited their June lows and bond yields reached new highs for the cycle. Many other central banks around the world, including the Bank of England and the European Central Bank, also raised rates.

Perhaps the greatest drama played out on these shores. As the world bade farewell to Queen Elizabeth II and welcomed a new King, Downing Street also welcomed a new Prime Minister and Chancellor of the Exchequer. Ms Truss and Mr Kwarteng hit the ground running.

First, they deployed a potential £150bn safety net for households facing ruinous increases in energy bills at the start of October. That was a reasonable policy in the circumstances. However, the Chancellor's "dash for growth" mini-budget was another matter entirely, and markets were swift to pass damning judgement upon unfunded tax cuts and a barely credible 2.5% growth target.

Bond yields rose sharply, anticipating more gilt issuance and further tightening from the Bank of England to offset increased inflation risks. The pound hit lows against the dollar not seen since the 1980s. Domino effects in the bond market raised the prospect of pension schemes collapsing, leading to intervention from the Bank of England. This move provided reassurance to investors, and bonds and sterling regained much of their lost ground with little of the Bank's ammunition being used.

However, the subsequent extension of the Bank's support scheme speaks to an underlying fragility. Overall, we remain cautious, but weaker markets begin to provide better long-term opportunities.

- The Bloomberg consensus growth forecast for global GDP in 2022 is 2.9%, down from 4.4% at the turn of the year. High inflation, tighter monetary policy and ongoing supply chain disruptions all contribute to the weakness.

- The outlook for 2023 continues to deteriorate, with growth now projected to be 2.5%, down from 3.6% in January, as central banks collectively commit to "higher for longer" interest rates.

- We approach the Q3 corporate earnings season with some trepidation. Profits held up well through Q2, but there is another quarter of input cost increases to account for, while demand has been mixed, depending upon the sector. The world aggregate earnings growth expectation, as compiled by Bloomberg from analysts' forecasts, has fallen back from 6.5% in January to 1.8%.

- A big shift in the global terms of trade, especially as they concern energy costs, continues to benefit the United States. And the relatively lower drag on US consumers has led to a more resilient US economy. This will encourage the Fed to remain hawkish.

- Europe remains at risk of suffering a severe shortage of energy over the winter, although replenished storage facilities provide some encouragement. Even so, recent attacks on energy pipelines emphasise the risks.

- The episode in which UK pension funds experienced existential stress owing to soaring bond yields was a reminder that a highly indebted and financialised global economy is vulnerable to sudden, unforeseen shocks.

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