CARTLIDGE MORLAND
INDIVIDUAL WEALTH MANAGEMENT

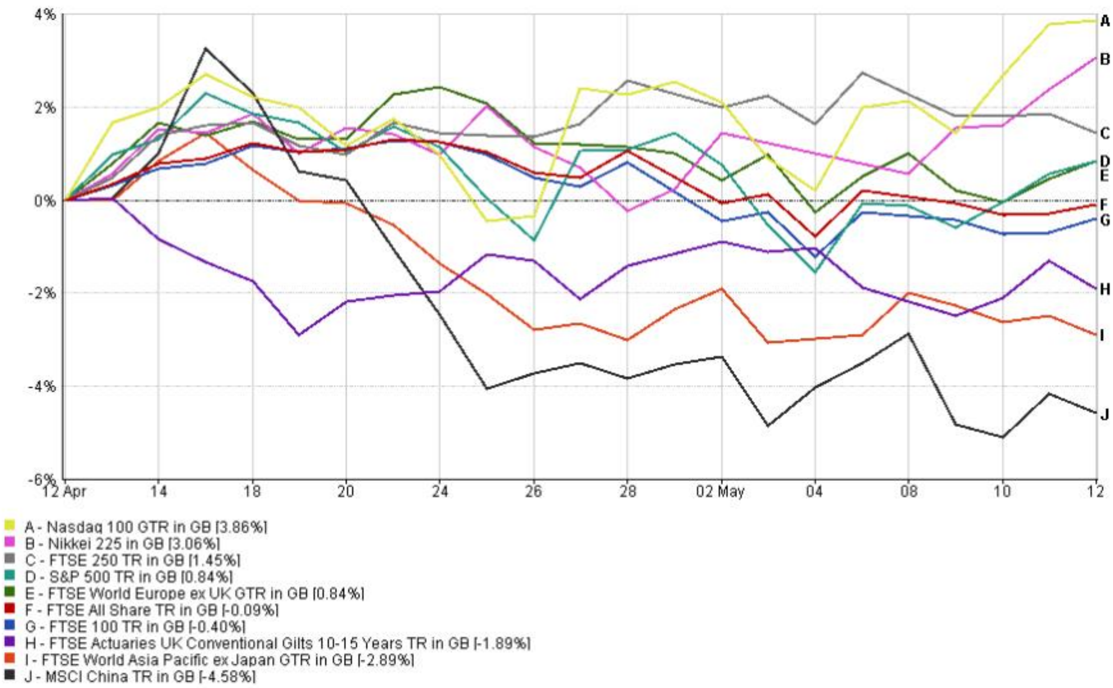
INVESTMENT COMMENTARY

12 MAY 2023

OVERVIEW

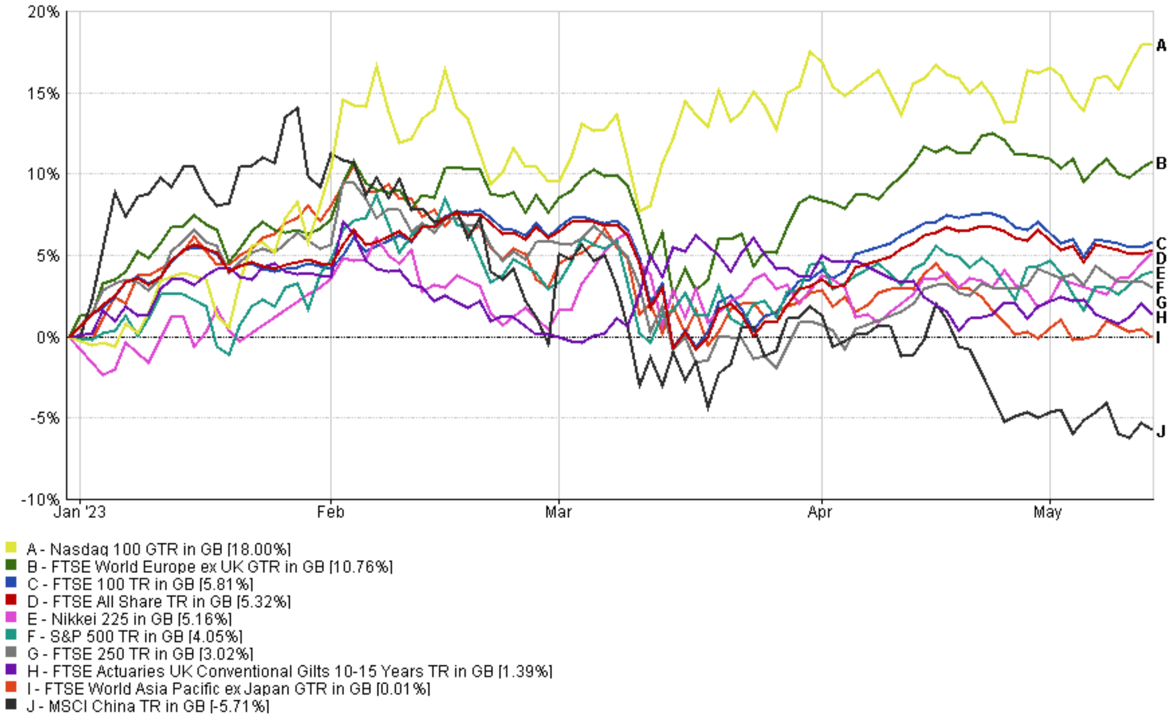
Investment markets continue to be driven by the prospects for inflation in developed economies and the monetary policy responses of the major central banks. The US Federal Reserve (Fed), the European Central Bank (ECB) and the Bank of England (BoE) all increased their respective interest rates by 0.25% following their latest monetary committee meetings as inflation levels remained far in excess of targets. The Fed may pause its rate hikes as it takes around 12-18 months for changes in interest rates to impact on the economy. However, the ECB which is lagging other central banks in its monetary tightening policy, may increase rates further.

ONE MONTH STERLING INVESTMENT MARKETS TOTAL RETURNS



12/04/2023 - 12/05/2023 Data from FE fundinfo2023

YEAR TO DATE STERLING INVESTMENT MARKETS TOTAL RETURNS



30/12/2022 - 12/05/2023 Data from FE fundinfo2023

The US economy still remains relatively resilient with the unemployment rate falling to a 53-year low of 3.4%. Plenty of jobs are still being created - around 250000 added in April. Headline inflation has fallen to 4.9% pa which is encouraging, although core inflation (excluding energy, food, alcohol and tobacco costs) remains elevated at 5.5% pa. Nevertheless concerns persist that a recession is imminent although recent corporate earnings were generally strong with future estimates upgraded. Consumer strength has continued with evidence that excess household savings will support spending through this year. The series of ten interest rates rises since March 2022, reaching a range of 5% to 5.25% following the Fed's latest meeting, coupled with the failures of a number of regional banks, have seen financial conditions tighten and economic growth slow. The extent of the slowdown may see the Fed loosen monetary conditions later this year, but only if inflation moderates further. Jay Powell, Fed Chair, commented that interest rates cuts might not happen as investors hoped. This uncertainty held back the US equity market. The impasse in the negotiations on raising the Federal debt ceiling in the US may hinder sentiment. It seems that the Republicans and Democrats will take the issue to the brink – as has been witnessed historically. If an increase to the debt ceiling is not agreed imminently the administration is likely to prioritise debt payments in early June so that the US does not default on its debt and thus avoiding turbulence in financial markets.

In Europe, it is likely that the ECB will continue to raise interest rates over the summer as wage growth remains elevated and consumer inflation expectations are increasing. Christine Lagarde, President of the ECB, commented that "the inflation outlook continues to be too high for too long." Inflation in the eurozone increased slightly to 7.0% pa in April from 6.9% pa in March although core inflation fell to 5.6% pa from 5.7% pa.

The BoE raised Bank Rate to 4.5% as expected. The Bank has changed its view on the economy, forecasting that recession will be avoided in the near term with Gross Domestic Product (GDP) remaining flat over the first half of 2023. GDP grew by 0.1% over the first quarter of 2023. Economic indicators point to accelerating economic activity in April with growth gaining momentum going into the second quarter. Consumer confidence has also improved. Consumer Price Inflation (CPI) was 10.2% pa over the first quarter of 2023 but is expected to fall quickly from April reflecting the decrease in energy prices. The UK economy has been stronger than anticipated and the pound has strengthened against this more positive outlook and relatively high interest rates. The stronger pound weighs on the performance of the FTSE 100 index as many of the UK larger companies are globally facing, with the majority of earnings made overseas. It seems that the housing market is stabilising with mortgage approvals rising for the second consecutive month. House prices also rose unexpectedly for the first time in seven months.

Bond markets have been weak over the past month as US recession fears, stress in the US banking system and concerns over the debt ceiling negotiations have all weighed on sentiment. The markets have largely calmed down from the turbulence experienced in the wake of the failures of Silicon Valley Bank and Credit Suisse in March. However, corporate defaults have increased as interest rates have increased and it is likely that credit availability for riskier borrowers will be restricted.

The International Monetary Fund (IMF) raised its economic growth expectation for Asia Pacific region to 4.6% for 2023 from 3.8% in 2022. The estimate was increased from its October 2022 figure of 4.3% based on China's reopening following the easing of Covid-19 restrictions. However, following the initial boost to the economy following the removal of these restrictions, economic data point to the Chinese economy struggling once again. The manufacturing sector appears to be in contraction as orders fell and domestic demand weakened. Persistently high inflation globally, softer global demand and geo-political tensions could see Chinese economic growth remain relatively lacklustre. The services sector appears stronger but growth in output and new orders has reduced of late. The rate of job creation has also fallen. The Chinese equity market reflects this less robust state of the Chinese economy with falls experienced over the past month.

The best performing major equity index over the year to date has been the technology-related NASDAQ. This is a complete reversal from 2022 when it was the worst performing. However, the NASDAQ has not yet recovered to its 2021 high. The share prices of many technology companies, including Meta and Microsoft, rallied strongly following good first quarter results. Indeed these two stocks together with Amazon, Apple, Netflix and Alphabet have supported much of the gains made in the S&P 500 index this year. The tech rally may be based on the fact that the corrections in 2022 have resulted in value emerging in some stocks especially those with relatively dependable earnings and cashflows. The prospect of the interest rate cycle nearing its peak has also been beneficial for valuations. However, if inflation levels remain elevated and interest rates remain high, it is likely that high growth stocks offering future rewards may be less highly valued than cyclical companies offering attractive returns immediately.

The CM Investment Commentary is compiled by Angela Cooper, Managing Director of Cartlidge Morland's Investment Services team.

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OUR VIEW

There are some reasons to be positive about the global economy. Currently none of the world's major economies are yet in recession despite the very steep interest rate hiking cycle adopted by the Fed over the past fourteen months. It appears that the difficulties experienced in global supply chains have now eased significantly, with goods moving around the globe relatively smoothly. In Europe, the fall in the natural gas price from its high following the Russian invasion of Ukraine, is likely to lead to inflation levels moderating over the next few months and providing support for consumers and corporates. Sentiment towards European equities has improved as energy prices have reduced, whilst the reopening of the Chinese economy has been beneficial to many exporting European companies as demand there has increased. However, global geo-political strains, the stand off over raising the debt ceiling in the US and the possible cumulative effect of interest rate rises on growth still have the capacity to weigh on sentiment. As ever, we look to the longer term combining a range of equity, fixed income, cash and Alternatives funds in risk appropriate portfolios for the income and/or growth prospects available now.

Whilst longer term capital growth opportunities must always remain present in portfolios, potential yield prospects are far better for 'balanced' portfolios than they have been since the global financial crisis. Meaningful yields are now achievable from the highest quality sovereign bonds and those from investment grade corporate bond yields are much higher too. Dividend yields and share buy-back activity remain strong – and even UK commercial property yields appear attractive, following a tortuous downgrade in valuations. Capturing income from these various sources remains an important element in overall returns.

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OUR VIEW .... Continued

Certain 'growth areas' such as UK small-caps remain depressed, for all that mid-caps have rallied of late. In areas such as Japan and Europe, smaller companies have shown considerable life and have delivered strong returns recently. It is important to capture such growth wherever it may arise and to remain patient with areas presenting a discount to real value as a result of current sentiment.

Whilst curbing inflation remains the priority of governments/central banks, markets are likely to remain subdued. Once the end of the latter period is in sight, focus will return to economic growth. The process of fire-fighting elevated levels of inflation is now well advanced and provided evidence of longer-term success emerges over the summer, sentiment should improve.

If you have any queries please do not hesitate to contact

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