

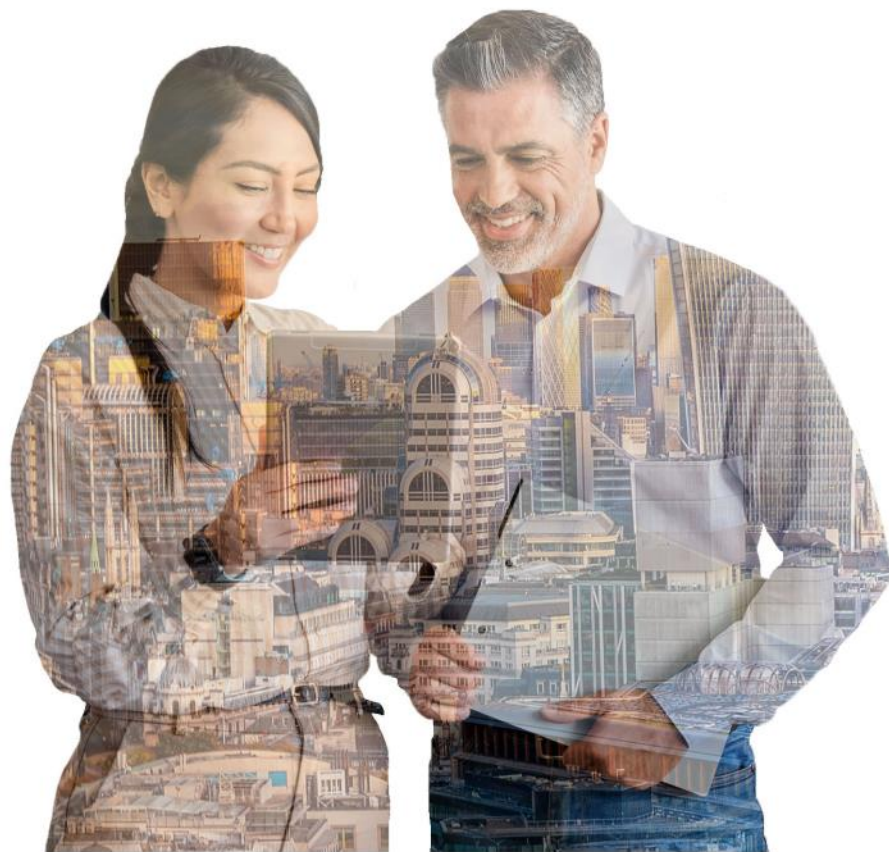


**CARTLIDGE MORLAND**

INDIVIDUAL WEALTH MANAGEMENT

# INVESTMENT COMMENTARY

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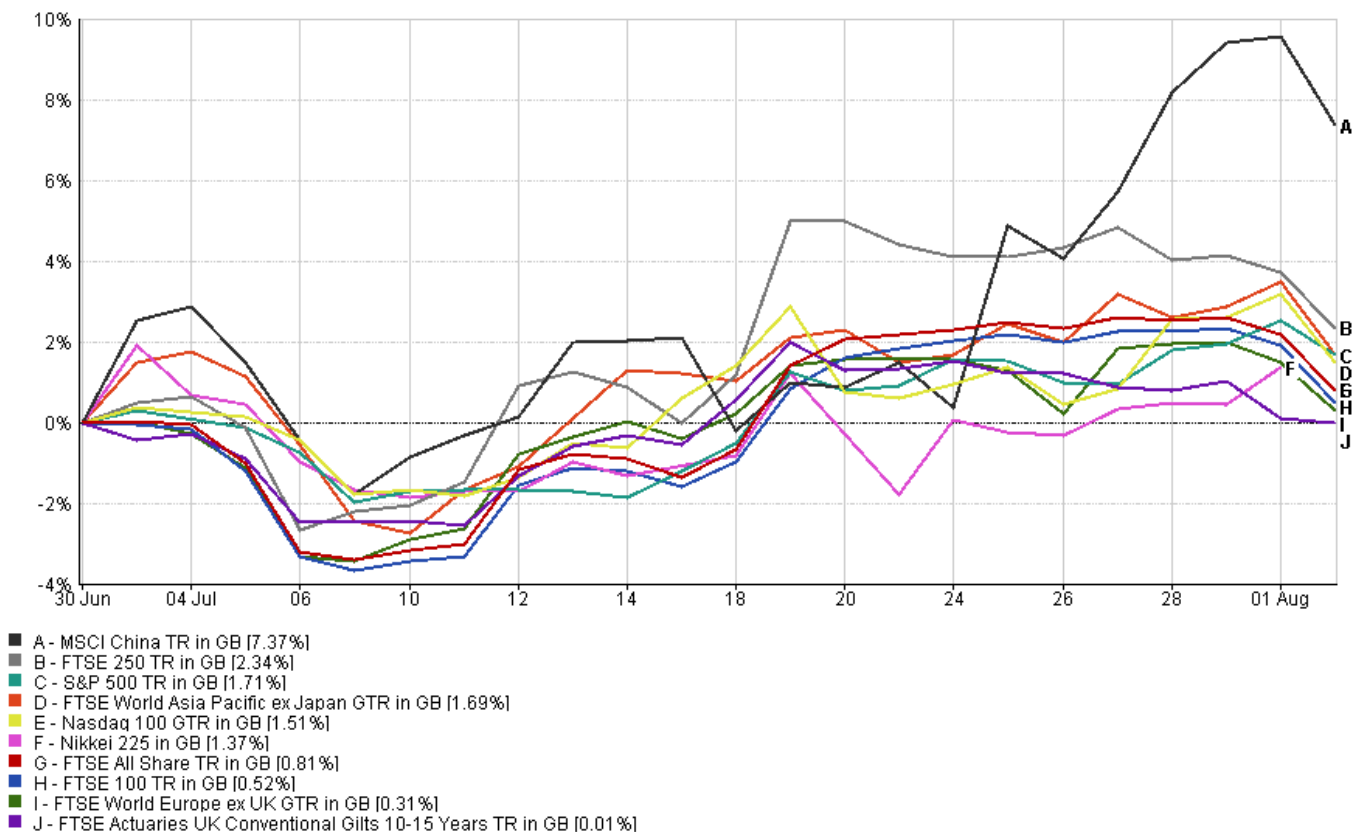
**3 AUGUST 2023**



## OVERVIEW

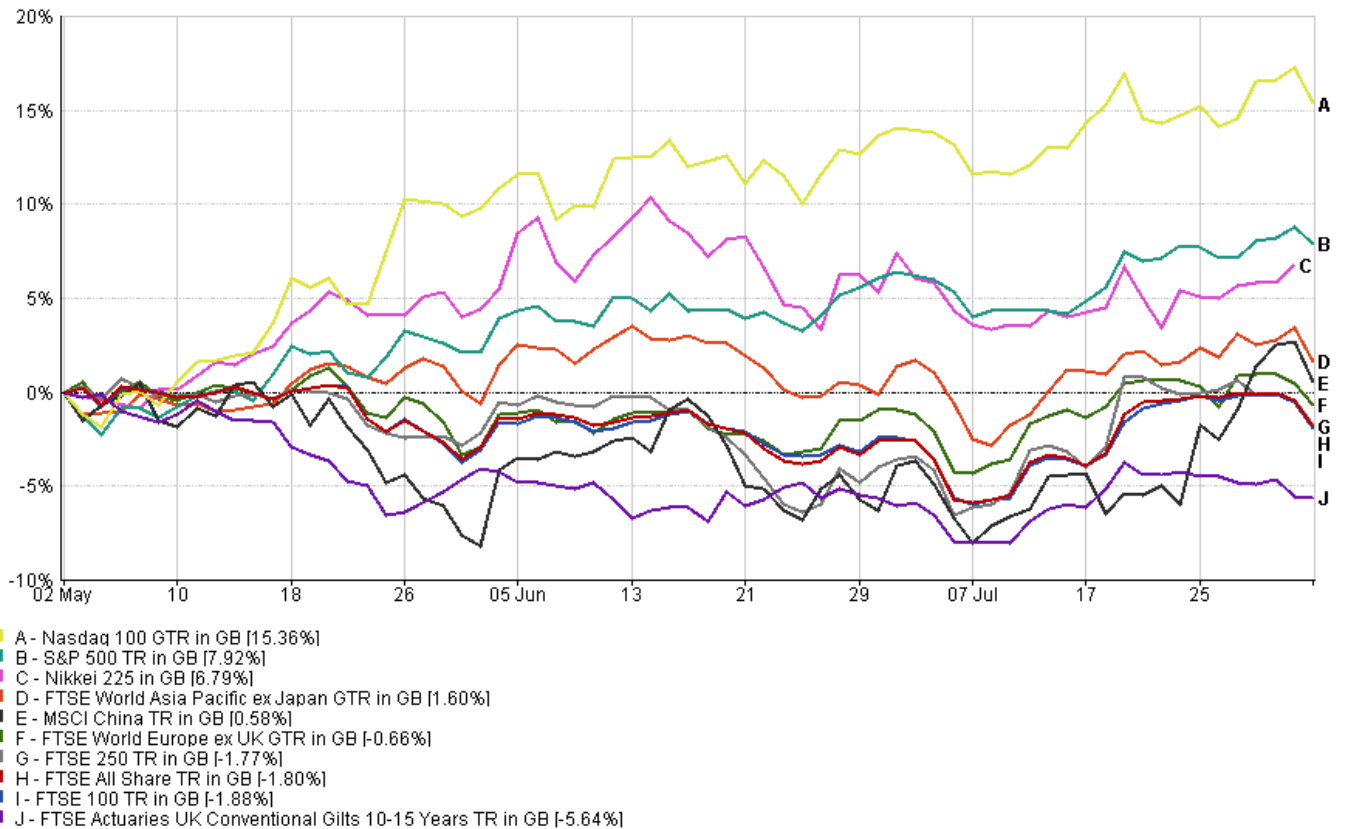
Investment market returns continue to be driven primarily by macro-economic factors: principally inflation, the trajectory of interest rates, economic growth figures, employment markets and wage growth. The US equity market performed well over July – the fifth successive month of rising returns. European equity and UK equity markets made positive returns whilst China was the stand-out performer, despite some rather gloomy economic data. The recent unexpected action by Fitch Ratings in cutting its US debt rating from AAA to AA+ due to concerns about worsening fiscal conditions and governance has seen some of July's gains eroded in the first days of August. However, the downgrade is unlikely to change the view that US Treasuries remain the global market's safest and most liquid assets.

### ONE MONTH INVESTMENT MARKETS STERLING TOTAL RETURNS



30/06/2023 - 02/08/2023 Data from FE fundinfo2023

## THREE MONTH INVESTMENT MARKETS STERLING TOTAL RETURNS



02/05/2023 - 02/08/2023 Data from FE fundinfo2023

The US equity market was supported by increasing optimism about inflation returning towards target and economic growth seemingly resilient. Investors are becoming more hopeful that the US Federal Reserve (Fed) will avoid pushing the US economy into recession. It now seems that equity market gains are more broadly based with companies outside the 'Magnificent Seven' (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla) performing better over the last two months. The Fed raised interest rates by another 0.25% at its most recent meeting to a range of 5.25-5.50%, the highest level in 22 years. Despite eleven interest rate rises since March 2022, the US economy grew by 2.4% pa in the second quarter of 2023 following growth of 2.0% pa in the first quarter. Inflation slowed to 4.1% pa in June from 4.6% in May. Wages, a key contributor to inflation, continued to rise – by 1% in the second quarter falling from 1.2% in the first quarter. Jay Powell, the Chair of the Fed, said that the Fed now believed the US would not enter recession although more rate rises may be required to bring inflation back to a 2% target particularly if growth remains strong. This current interest rate hiking cycle appears to be nearing its peak. However, if the US does enter recession, it is likely that it would be due to a policy mistake by the Fed in tightening monetary policy too much.

Better than expected European economic data also led to positive performance from the main European equity markets in July. The eurozone economy grew by 0.3% in the second quarter of 2023 following no growth in the first quarter. Inflation is slowing too, falling to 5.3% in July whilst core inflation, excluding energy and food, remained at 5.5%. Services inflation did increase to 5.6%. Against this background the European Central Bank (ECB) increased interest rates by 0.25% to 3.75% at its latest meeting as largely expected. There remains tightness in the European labour market with unemployment at an all-time low of 6.4% which could be inflationary if wage levels increase as a result.

The Bank of Japan (BoJ) which has maintained very loose monetary policy, recently announced that it will continue to control the yield curve so that yields do not rise above 1%, previously set at 0.5%. Although denying that this was a policy change, the move does appear to be a move away from the BoJ's highly accommodative monetary policy. The yen rallied to some degree on this news and the equity market fell, with the exception of the banking sector which saw gains as higher interest rate margins are expected.

The Chinese economy is continuing to recover from the Covid-related restrictions which were lifted at the end of 2022 but progress is "tortuous" according to Chinese leaders. Inflation is at 0% although not in deflation according to Chinese Bank officials whilst economic growth increased by 0.8% in the second quarter from the previous one. Annualised growth was 6.3% but from a very low base last year. Demand remains weak in the economy following three years of Covid restrictions. Rising interest rates in developed economies have also had a negative impact on demand for Chinese goods and exports have fallen sharply. The Chinese authorities have indicated that measures will be introduced to encourage consumer spending, reduce unemployment and support the property sector in the wake of weak economic data. The central bank has already cut lending rates and tax breaks have been extended for electric vehicle sales. The announcement that supportive measures were on the way for the Chinese economy saw its equity market rally sharply in late July. However these gains have been tempered to some extent very recently by data showing that the manufacturing sector is contracting and growth in services has slowed.



The UK equity market has also made a positive return over the past month with the more domestically oriented FTSE 250 Index (mid cap) performing well. At last there was some good news about inflation with the Consumer Price Index (CPI) rising less than expected in June – the CPI rose by 7.9% pa in June 2023, the lowest level since March 2022. Core inflation also fell to 6.9% from 7.1% in May. Economic activity has slowed in the UK as a result of higher interest rates impacting consumer spending. The Bank of England raised Bank Rate by 0.25% at its August meeting. A larger increase of 0.5% had been expected but the recent economic data led to a more moderate rise. Inflation is still far above target level and more interest rate rises are likely, but it is probable that interest rates are nearing their peak. The BoE will be monitoring inflationary pressures - looking at resilience of the economy, the tightness of the labour market, wage growth and services price inflation when deciding whether to tighten monetary policy further. The mid-cap area of the market contains a significant amount of consumer related stocks including housebuilders. Their share prices have been supported by the prospect of interest rates peaking and then falling, so leading to improving demand.



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

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## OUR VIEW

Markets remain nervous at the prospect that the central banks have already done enough to curb inflation and that they may in fact achieve a major downturn, instead of the so-called 'soft landing' for the global economy. A slump in global demand could affect corporate earnings to the extent share prices would fall. Conversely, much of that prospect could arguably be priced into many areas of the market, as investors remain generally cautious.

Recent rallies appear to be based on limited conviction, with the result that progress quickly reverses as markets lurch on the slightest of bad news which ironically nowadays seems to mean higher economic growth, lower unemployment and expanding consumer spending. The latter are all contributors to higher inflation and the central banks will only send interest rates into reverse once they are sure it is beaten. Tight monetary policy limits scope for growth and presently analysts are finding little ground for short term optimism, as there remains considerable uncertainty.

Sentiment will only take that decisive turn for the better once it is clear inflation is under control, heading firmly back to target rates and reductions in interest rates are in sight. Presently, the central banks are still raising rates. There is prospect of this decisive turn being taken in early/mid-Autumn **but**, so far as equities are concerned, it relies on there being no sign of increased interest rates suppressing demand so much that the world faces a major slump in economic activity.

One consolation is that, generally, major companies are in good shape and able to weather a storm. Higher dividends are well covered with 2023 being a record year for pay-outs from the FTSE 100. In the US, the share prices of the 'Magnificent Seven' continue to defy gravity and we have serious doubts about that. Conversely, as we have alluded to earlier, the wider market is beginning to perform, which is overdue. This is partly as a result of growing optimism that a 'soft landing' is achievable in the US. It is important to remain exposed to equities because when the decisive change in sentiment does occur, many sectors will rally strongly. Conversely, there could still be a decisive turn in the wrong direction – a prolonged malaise in global equity prices, or worse an abrupt or gentle drift downwards. Neither of these would be welcomed by investors, whether desirous of income or capital growth.

## OUR VIEW .... Continued



Moderating inflation and falling interest rates are certainly positive for global markets as already discussed. It now seems that we are nearing the top of this interest rate cycle with one or two further rate rises expected in 2023. It is unlikely that we will return to a world of ultra-low interest rates and little inflation. Against this background, government bonds, corporate bonds and cash are now offering attractive yields and we have certainly increased portfolio exposure as they should once again form part of the lower risk component of portfolios. Infrastructure funds are also offering strong yields. Portfolios comprise a range of equity funds including those investing in good quality companies which have the ability to pass on higher costs to customers and also deliver increased profits and dividends. We are seeking to ensure that portfolios take advantage of the attractive yields on many asset classes, and so have built up fixed interest and infrastructure fund holdings, and have allocated to money market funds which are now offering relatively good yields.

At this time of the year, we often find ourselves looking towards Autumn for definite direction but by then, we expect the picture to be much clearer so far as the trajectories for inflation, interest rates and financial markets are concerned.

**If you have any queries  
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