



CARTLIDGE MORLAND

INDIVIDUAL WEALTH MANAGEMENT

INVESTMENT COMMENTARY



27 SEPTEMBER 2023

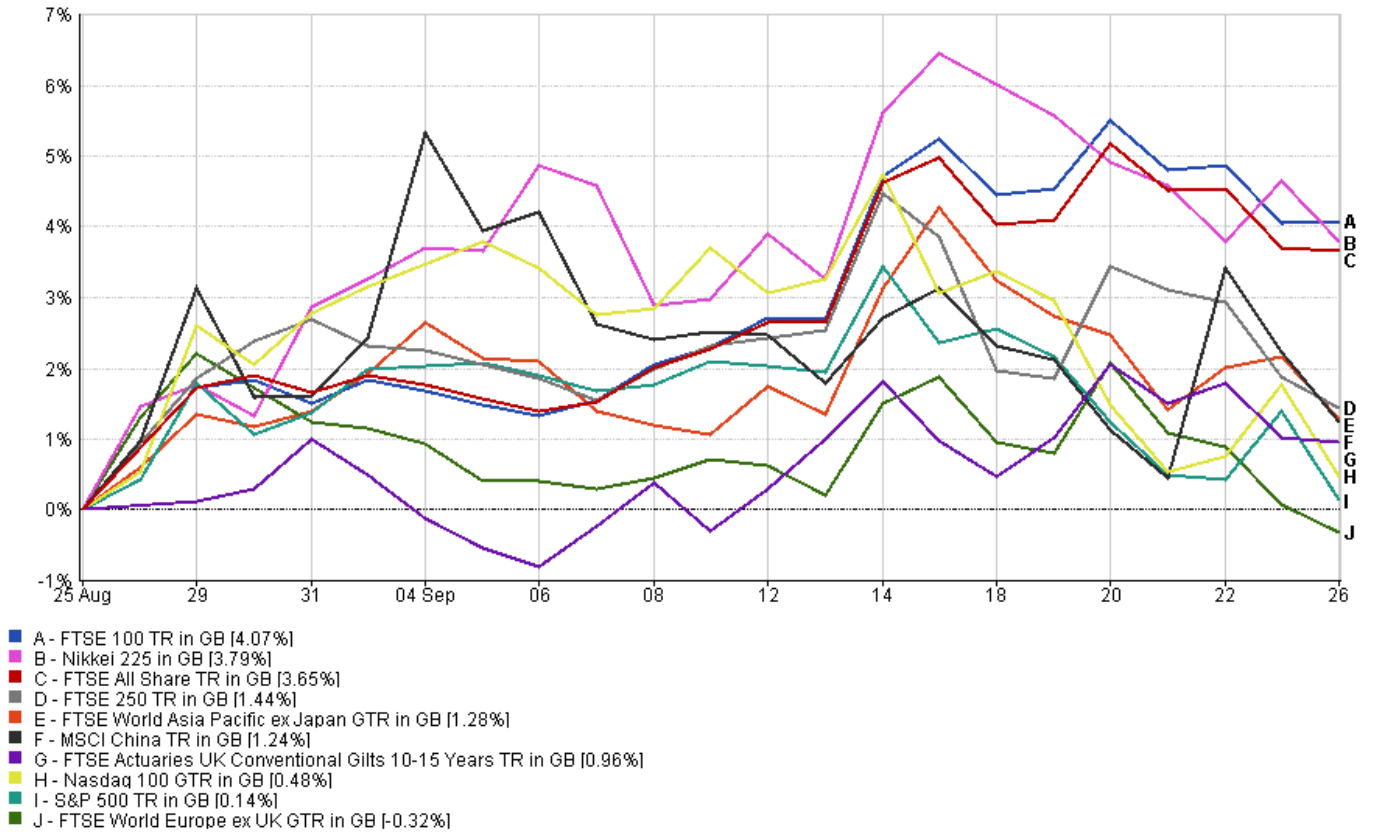


OVERVIEW

Most of the major equity markets have made positive returns in **sterling** terms over the review period with the FTSE 100 index performing well. In **local currency** terms, of the main international markets only the Japanese equity market has made a positive return, reflecting the weakening of sterling over the past month. A weaker pound is supportive of the share prices of companies deriving a vast proportion of their earnings overseas as these earnings are then worth more in sterling terms, so underpinning the valuation of the FTSE 100 index. In addition, the oil price has increased steeply over the past month as OPEC+ producers have agreed to limit supply, which has seen the share prices of oil companies increase – again beneficial for overall returns from the FTSE 100 index. However, increasing oil prices may well stoke inflation so adding further pressures with which central banks' monetary committees may have to contend. The US equity market has been held back by the prospect of interest rates remaining higher for a longer period of time than anticipated, coupled with strikes and a potential shut down of government. The US federal budget has still to be approved by both chambers of Congress with opposition coming from the right wing of the Republican party.

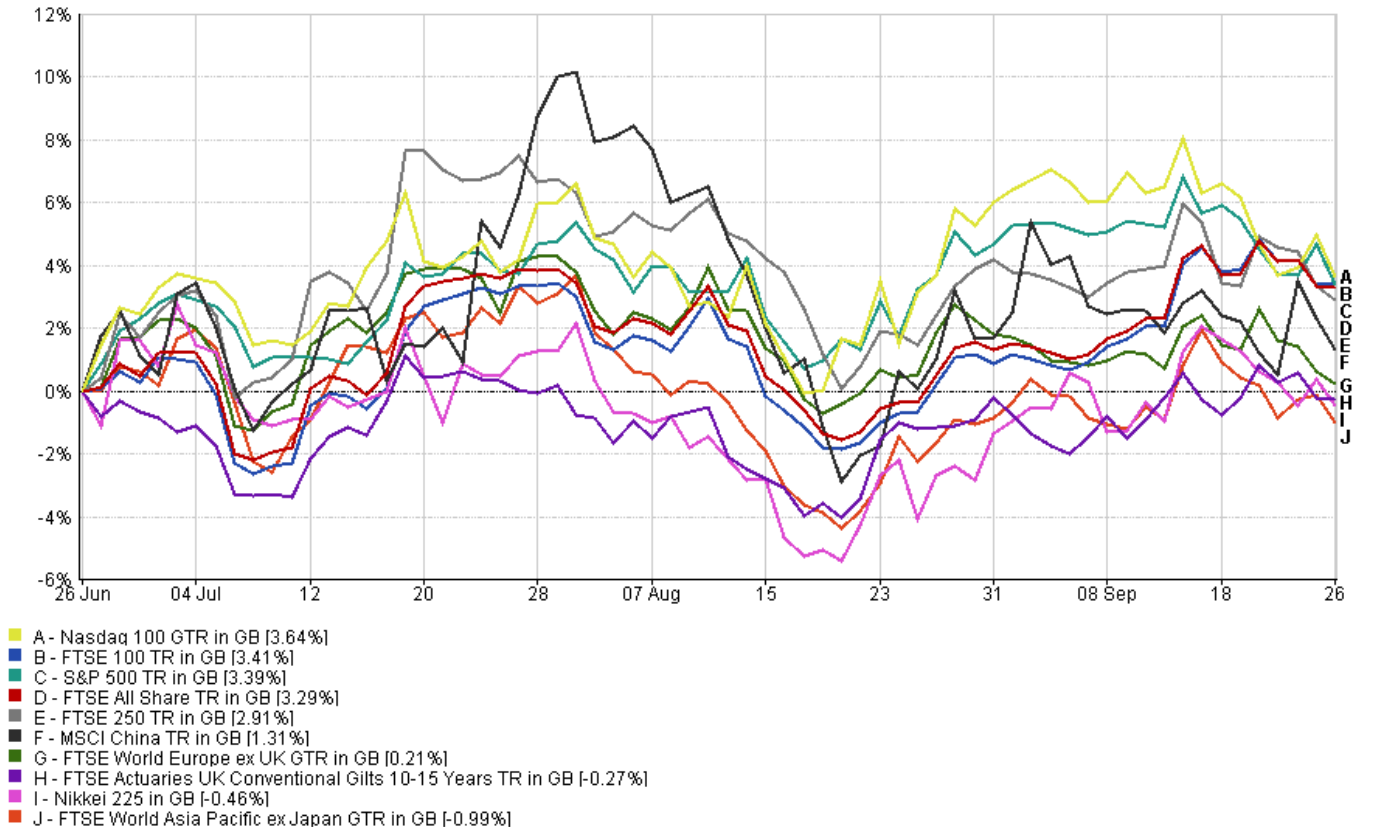


ONE MONTH INVESTMENT MARKETS STERLING TOTAL RETURNS



25/08/2023 - 26/09/2023 Data from FE fundinfo 2023

THREE MONTH INVESTMENT MARKETS STERLING TOTAL RETURNS



26/06/2023 - 26/09/2023 Data from FE fundinfo 2023

Monetary policy decisions of the central banks, in the face of continuing above target inflation, have continued to drive sentiment in investment markets. It appears that the current interest rate hiking cycle is nearing its peak after over eighteen months of substantial rate increases, as central banks have acted to slow the rate of inflation. The US Federal Reserve (Fed) left its benchmark interest rate unchanged at its most recent meeting maintaining the rate at between 5.25% and 5.50%. Official Fed expectations point to one more rate rise this year, but any rise will be determined by the economic data. Looking to 2024, it would seem that the Fed is expecting rates to remain higher for longer to drive down inflation to its 2.0% target. US inflation increased to 3.7% pa in August from 3.2% pa in July. However, core inflation (excluding energy, food and tobacco) fell to 4.3% pa from 4.7% pa. The Fed has revised its economic growth targets upwards for this year and next, so there does seem an increasing possibility of a soft economic landing ie inflation falling whilst economic growth continues – albeit at a slower pace. The 10-year US Treasury yield rose sharply following the Fed meeting as markets reflected the Fed's view that interest rates would remain elevated for a longer period than anticipated. The US dollar has also strengthened against this backdrop, whilst the US equity market has fallen.



The Monetary Policy Committee (MPC) of the Bank of England (BoE) surprised markets by also maintaining Bank Rate at 5.25% although the vote of 5-4 by MPC members was very close. Consumer Price Inflation (CPI) unexpectedly fell to 6.7% pa in August from 6.8% pa in July, with UK core inflation falling to 5.9% pa from 6.4% pa in July. It appears that high interest rates are having an impact on inflation with the MPC noting that it expects CPI to fall “significantly in the near term” as a result of lower energy bills and falls in food prices. The labour market is showing signs of weakening with jobs growth slowing and employers reining in hiring plans. Economic growth turned negative in July and house prices are falling – signs of slowing demand as high interest rates start to impact.

The European Central Bank (ECB) raised its deposit interest rate to 4.0% at its September meeting and suggested that rates are near their peak whilst indicating that rates will remain high as long as required to bring inflation back to its 2.0% pa target. Eurozone inflation was 5.2% pa in August down from 5.3% pa in July, with core inflation falling to 5.3% pa from 5.5% pa in July. Economic indicators point to the eurozone economy contracting, but at a slower rate than in August.

The Bank of Japan (BoJ) left its monetary policy unchanged too and offered no indication that it would shift its loose policy stance, despite Japanese CPI being higher than the BoJ's 2.0% pa target at 3.2% pa. The yen remains weak as a result.

The Chinese economy has struggled in the aftermath of Covid lockdowns, lack of domestic consumer demand and geo-political tensions. The authorities have introduced stimulus measures and data relating to retail sales and industrial production in August appear to be more positive, and economic growth seems to be increasing. However, problems persist in the all-important property sector which accounts for around a quarter of activity in the Chinese economy. Evergrande, the huge Chinese property company, is unable to issue new debt due to an investigation into its main subsidiary so undermining confidence in the property sector.



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

Angela runs the firms' investment management propositions, with over 30 years' experience in investment research working for investment companies, leading UK national IFAs and wealth managers. Angela graduated from the London School of Economics and is a Chartered Insurance Practitioner.

OUR VIEW

Usually, equities and bonds move in opposite directions - so bonds should provide downside protection when equity markets are falling. However, we have experienced a prolonged period when equities and bonds have moved in similar directions, which has impacted negatively on diversified portfolios. Fixed interest markets are indicating that recessions are still expected as the yield curves in both the US and UK are inverted ie 10 year government bonds still offer a lesser yield than 2 year government bonds. Bond investors believe that an economic slowdown is coming and that central banks will have to cut rates in the future to stimulate demand and support economic growth. (The reverse of recent policy in increasing interest rates.) However, the central banks continue to predict slowing inflation and positive economic growth although admittedly at lacklustre levels. Equity markets appear to be supporting the 'soft landing' scenario so making the current investment landscape very unclear. Having reduced our fixed interest exposure as interest rates climbed, yields increased and continue to look attractive in the face of this interest rate cycle nearing its peak. We have started to build exposure to UK and international fixed interest funds once again where objectives and risk profile permit. Infrastructure assets also offer attractive yields. Although they have suffered against a background of rising bond yields, there remains a strong argument for investing in infrastructure as economies need to build and renew transport, digital and energy networks over the coming years to remain productive and competitive.

Over the summer we alluded to continual market volatility related to immediate data flows, rather than longer term expectations. Markets have oscillated within bands and have shown no clear direction. We predicted this might change in the autumn and the palpable sense that the major western economies are slowing, combined with lower inflation expectations/interest rates now points to a more positive period. The growing expectation that lower inflation can be achieved at the expense of short mild recession is important too. Concern had grown that central bank action had been 'too much too late' - a scenario in which persistently high inflation/interest rates and low growth became entrenched and self-perpetuating.

[... continued](#)



OUR VIEW ... Continued

The UK has seemed especially vulnerable to the scenario set out above – and there remains danger that the Bank of England may have acted too affirmatively. The UK money supply is shrinking and as we said some time ago, that would normally ensure lower inflation AND recession. This said, the MPC narrowly voted against a further quarter point rise in interest rates this month which in our view would have been more symbolic of determination to defeat inflation, than of practical benefit. With the economy, property and labour markets all slowing, it is clear inflation will fall, as indeed the rate has been falling all calendar year. In a less heated labour market this will soon be reflected in private sector pay settlements – and it is for the government to control those in the public sector. Fears of a wage fuelled inflationary cycle have receded.

Bond yields will become very appealing if inflation drops to 3.0% pa and a 4.5% pa yield means a real yield from a lower risk asset. Presently, bonds and indeed bank deposit rates mean a real loss, which those attracted by headline rates fail to appreciate. Indeed 1.0% pa deposit rates and 2% pa inflation were better for investors than the present situation – for all headline rates are so high. In anticipation of lower interest rates and bond yields, we are seeking to lock in higher bond yields now.

In equities, we consider yields to be of fundamental importance amidst less certain prospects for capital growth. However, markets will be looking ahead to an environment of lower/controlled inflation, interest rates that are lower than presently and the return of an expansionary economic environment. Confidence has undoubtedly been shaken by fears of embedded stagflation, that is high inflation/interest rates and low growth.

Growth is needed for current global public sector debt to be affordable over the longer term and lower interest rates are required too. Although we have no expectation of interest rates returning to ultra-low levels, we know that on a long term view, current rates are unaffordable for most governments. So far the central banks' focus has been on slowing the global economy and curbing inflation. It will not be long before they will need to consider stimulating growth – without the return of unacceptable inflation rates. As the growth agenda returns, sentiment towards equities should improve.

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**If you have any queries
please do not hesitate
to contact
your Cartlidge Morland
consultant.**

OUR VIEW Continued

Presently, Japan is the only major economy with a definite 'growth' agenda reflected in the strong performance of the Japanese equity market this calendar year. The Bank of Japan is relishing inflation at over 3.0% pa after a decade of trying to nudge it to 2.0% pa. There are definite signs of the Japanese economy stirring, with increasing consumer and corporate optimism. Germany by contrast is suffering from its over-dependence on its phenomenal export success, hampered by reduced global demand – especially from a sluggish Chinese economy. German companies are increasingly willing to manufacture in lower cost locations and business/consumer confidence is dented presently.

Although political uncertainties have an increasing bearing, the US remains a bastion of growth and economic success. The Fed has slowed the economy and curbed inflation, yet corporate America powers on. The pre-eminence of US companies in business/consumer technologies, in media/entertainment, armaments-related technologies and financial services play an important part in this. In addition, the US manufacturing sector is benefitting from re-shoring amidst strategic concerns relating to overseas suppliers of essential manufactured goods. US households now enjoy unparalleled prosperity with US household income notably exceeding that in other large developed economies. The US is once again much richer than its European and Asian competitors – and is likely to remain so for some time. This factor is increasingly evident in global asset allocation considerations amongst investors – Cartlidge Morland being no exception.



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