Market Brief

October's highlights

- Strong US gross domestic product (GDP) growth in Q3 massively surpassed expectations. Decent Q3 growth in China also surprised to the upside. Meanwhile, much weaker growth in the eurozone disappointed versus downbeat expectations in Q3.
- October's flash composite purchasing managers' indices (PMI) data suggest US activity accelerated in October. Meanwhile, surveys suggest the downturn deepened in Europe as service-sector activity 'caught-down' to the struggling manufacturing sector.
- US and UK year-on-year headline consumer price index (CPI) were unchanged in September. Flash estimates suggest eurozone inflation fell more than expected, to 2.9% year-on-year in October. Core CPI edged lower for all 3 economies.
- The European Central bank (ECB) left rates unchanged in September, and markets fully expected the US Federal Reserve (Fed) and Bank of England (BoE) to leave rates unchanged at their early-November meetings.
- Sovereign bond yields rose, in part due to expectations of higher-for-longer interest rates, but anticipation of large government deficits and, hence, issuance will have contributed to rises in longer-term yields.
- Geopolitical uncertainty rose as a result of the events in Gaza/Israel.
- Global equities fell, and credit spreads rose, as sharply higher bond yields and geopolitical uncertainty weighed on market sentiment.
- Safe-haven appeal drove gold prices higher. Despite the World Bank warning that oil prices might rise as high as $150 per barrel if the situation evolves into broader regional conflict, oil prices fell 8.2% in October.

Market performance to end-October 2023

UK	Q4 23*	Q3 23	2023	GLOBAL	Q4 23*	Q3 23	2023
EQUITIES	-4.1	1.9	0.3	**EQUITIES**	-2.7	-2.2	8.6
BONDS				North America	-2.2	-3.0	10.6
Conventional gilts	-0.4	-0.6	-4.4	Europe ex UK	-3.3	-3.3	6.2
Index-linked gilts	-1.3	-4.7	-8.4	Japan	-3.1	2.2	22.0
Credit	-0.0	2.3	1.1	Dev. Asia ex Japan	-4.4	-2.6	-1.3
PROPERTY**	n/a	-0.2	1.0	Emerging markets	-3.4	-0.1	0.2
STERLING				**GOVERNMENT BONDS**	-0.4	-1.6	1.1
v US dollar	-0.6	-4.0	0.9	**High yield**	-1.0	0.8	4.5
v Euro	-0.4	-1.1	1.9	**Gold**	7.5	-3.1	9.9
v Japanese yen	0.9	-0.9	15.8	**Oil**	-8.2	28.0	3.1

Percentage returns in local currency ($ for gold and oil). *All returns to 31/10/2023, **apart from property (29/09/2023). Source: DataStream and Bloomberg. FTSE Indices shown: All Share, All World, W North America , AW Developed Europe ex-UK, W Japan, AW Developed Asia Pacific ex-Japan, Emerging, Fixed Gilts All Stocks, Index-Linked Gilts All Maturities, iBoxx Non-Gilts, S&P GSCI Light Energy, Crude Oil BFO, ICE BofA Global High Yield, Gold Bullion LBM , MSCI UK Monthly Property and BBG Aggregate Government Total Return.

Monthly update

The global economy

- US GDP rose by a much-better-than-expected 1.2% quarter-on-quarter Q3, driven by strong consumer spending. A 1.3% quarter-on-quarter increase in Q3 Chinese GDP was also better than expected, as sustained monetary and fiscal stimulus offset the impact of a prolonged property crisis and weak trade. Strong US outturns stand in stark contrast to a much weaker European economy, where a 0.1% quarter-on-quarter contraction in Q3 GDP disappointed expectations. Tighter financial conditions and high prices are weighing on domestic European demand, while foreign demand remains subdued and the industrial sector continues to contract, especially in Germany.

- Survey data also highlight the transatlantic divergence. The US composite PMI points to modest economic expansion as service sector activity expanded more quickly in October and manufacturing output rose to a 6-month high. Meanwhile, eurozone surveys suggest the downturn accelerated in October as services activity declined more steeply and the manufacturing sector, which data suggests has been in recession for 16 months, continued to contract. Equivalent UK surveys are indicative of private sector output declining for the third consecutive month in October. Like the eurozone, manufacturing activity remains much weaker than services in the UK. Survey data also tempered optimism around positive Q3 Chinese growth as the manufacturing sector unexpectedly contracted in October.

- Signs that price pressures continued to ease in October, in part due to further falls in prices charged by manufacturers, were a bright spot across regional surveys. However, services inflation remains elevated, pointing to ongoing stickiness in inflation. Year-on-year UK and US headline CPI inflation surprised to the upside in September, remaining at 6.7% and 3.7%, respectively. Core measures, which exclude volatile energy and food prices, declined modestly, to 6.1% and 4.1% year-on-year, respectively. In the eurozone, the CPI flash estimate for October fell more than expected, to 2.9% year-on-year, as energy prices fell sharply year-on-year. Though, here too, there are signs of stickiness in core CPI, which fell less, to 4.2% year-on-year.

- Easing core inflation and the lag between interest rate rises and their economic impact has encouraged central banks to pause raising rates, and market pricing suggests they are at, or near, the end of their rate-hiking cycles. The European Central Bank (ECB) left rates unchanged in September, and markets fully expected the US Fed and BoE to leave rates unchanged at their November meetings. However, given sticky core inflation, central banks have suggested interest rates might have to remain at current levels for longer than previously thought, with markets adjusting accordingly.

Fixed income markets

- A rise in long-term sovereign bond yields, to pre-global financial crisis highs, perhaps reflects this to a degree. However, very small changes in long-term implied inflation suggests upward moves in yields have compounded expectations of large government deficits and, hence, higher sovereign bond issuance. That is, term premia have increased, rather than markets purely reflecting how high interest rates might rise, and how long they might stay there.

- US 10-year treasury yields rose 0.3% pa to 4.9% pa, while UK 10-year gilt yields rose 0.1% pa to 4.5% pa. Japanese government bond yields rose 0.2% pa, to 0.9% pa, as the Bank of Japan loosened its yield curve control policy further. Given downside surprises in inflation and signs the eurozone economy may have already entered the beginning of a recession, equivalent German yields eased slightly, to 2.8% pa.

- UK 10-year implied inflation, as measured by the difference between conventional and inflation-linked bonds of the same maturity, was little changed at 3.7% pa, as nominal and real yields increased by a similar amount.

- A rise in sovereign bond yields and credit spreads led to negative total returns in sterling and US investment-grade credit markets. Global investment-grade spreads rose 0.1% pa to 1.4% pa, while global speculative-grade spreads rose 0.4% pa to 4.8% pa. Despite similar rises in credit spreads across sterling, US, and euro markets, total returns in Europe were supported by a modest fall in sovereign bond yields.
- Hard currency debt, as measured by the JP Morgan EMBI Global Diversified Index, returned -1.4% in dollar terms over the quarter as underlying treasury yields rose, and credit spreads widened 0.2% pa. Local currency debt, as measured by the JP Morgan GBI-EM Global Diversified Traded Index, returned -0.5% in US dollar terms, as yields rose modestly and index currencies, in aggregate, weakened against the US dollar.

Global equities

- The FTSE All World Total Return Index fell 2.7%, in local currency terms, as higher sovereign bond yields placed downwards pressure on equity valuations and heightened geopolitical uncertainty weighed on market sentiment.
- Perhaps owing to the ongoing manufacturing downturn, and signs of further weakness in Europe and China, the more cyclical energy, industrials, and basic materials sectors all underperformed. The consumer discretionary sector also underperformed, alongside healthcare, as large luxury goods companies reported disappointing earnings. Financials underperformed as high interest rates weighed on loan demand and net interest margins eased as prior interest rate rises were increasingly passed on to depositors. Meanwhile, the more defensive utilities, telecoms, and consumer staples sectors outperformed. Despite rising bond yields, technology also outperformed, with the sector reporting the highest percentage of companies beating earnings estimates.
- The Europe ex-UK Index underperformed, owing to its large exposure to industrials and the healthcare sector, alongside a weakening growth outlook for Europe. The UK also underperformed given its higher exposure to financials, energy, and materials sectors than global indices. Despite China’s Q3 upside growth surprise, continued weakness in the property sector weighed on sentiment, which contributed to Emerging Market and Asia Pacific ex-Japan’s underperformance. Despite ongoing yen weakness, Japanese equities also underperformed. North America outperformed, given a more defensive earnings profile and above-average exposure to the outperforming technology sector.

Currencies, commodities, and property

- Despite the World Bank warning that oil prices could rise to $150 if the events in Gaza/Israel evolves into a broader regional war, oil prices fell 8.2% below the levels reached at the end of September on the back of supply-shortfall fears. Gold prices rose 7.6% as geopolitical tensions spurred safe-haven demand; while industrial metals prices fell 3.5%. Trade-weighted sterling fell 0.5% while the equivalent US dollar and euro measures rose 0.9% and 0.2%, respectively. The Swiss Franc, which is often viewed as a safe-haven, rose 1.3% in trade-weighted terms.
- The MSCI UK Monthly Property Total Return Index declined 0.2% in September as income was offset by capital-value declines in the office and retail sectors. On a 12-month basis, capital values are down around 14% in the retail sector and around 20% in the office and industrial sectors. The office and retail sectors continue to see the largest month-on-month declines in capital values, while the industrial sector has recorded six consecutive months of growth, modestly accelerating in September.

For and on behalf of Hymans Robertson LLP

Additional Notes

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