globalmatters
Weekly

momentum
global investment management

There's one thing that markets don't like and that's uncertainty.

Roll on Recession

Mark Wright, CFA
Portfolio Manager

3 July 2023

Last December I professed that 2023 would likely be a good year for UK mid-caps. Many would have found it difficult to envisage that at the time, given how poorly the UK mid-cap equity market performed in 2022. It felt the full brunt of the inflationary spiral that was turbo-charged by Russia's invasion of Ukraine, finishing the year down over 18%. My projection isn't looking too clever now, with UK mid-caps having been modestly in the red last week since the start of the year.

All was looking good up until 6 March 2023, with UK mid-caps up 8% and our own UK equity portfolio up 12%[1]. But then Silicon Valley Bank (SVB) got itself into a spot of bother, soon followed by other questionably managed mid-sized banks, Signature Bank and First Republic Bank. Credit Suisse's demise didn't help sentiment.

Whilst one was unlikely to have foreseen such banking failures that brought into question the health of the entire US banking system, it also wasn't that surprising in hindsight, given the record-breaking speed at which the Federal Reserve had raised interest rates. However, authorities were quick to react to the crisis. The US Federal Deposit Insurance Corporation (FDIC) quickly moved to guarantee all deposits, whilst Union Bank of Switzerland (UBS) was strong-armed into acquiring Credit Suisse. These prompt actions significantly reduced the risk of contagion.

Since then, UK mid-caps are now down 9% and our own portfolio has suffered too[2], despite some good earnings releases and healthy share price performances from the likes of Games Workshop (the fantasy miniature games manufacturer), and household name Marks & Spencer. Ironically, both are exposed to the UK consumer, the outlook for whom is arguably now what is holding the stock market back.

There's one thing that markets don't like and that's uncertainty. Where and when interest rates will peak has been a big source of uncertainty this year, made worse by the UK's most recent inflation print (core inflation was up for the fourth month in a row), swiftly followed by a "surprise" 50bps hike in interest rates by the Bank of England.

That said, the market now has much better visibility on this than it did 12 months ago. Arguably, it is the prospect of a recession and what that means for the UK consumer that occupies the mind of equity investors the most, especially investors in UK mid-caps.

As perverse as it may seem, an imminent recession could actually be good for UK mid-caps. There are plenty of companies reporting decent current trading, but the problem is that the market often has the attitude of "things might be okay now, but what about this time next year or even in six months' time". They do say one should sell on the rumour and buy on the news.

Companies are therefore not being rewarded for delivering in-line results or even results that are ahead of expectations. A great example was Marston's, the national pub operator, when it delivered a healthy set of interim results in May. The shares opened higher but then quickly sold off and have continued to do so since. They are now trading close to where they were in the depths of the pandemic in March 2020.

Back then, its pubs were shut and there was no sign of them reopening any time soon. It also had much higher debt levels than it does today, having since sold some property assets and 60% of its brewery business to Carlsberg. The valuation It achieved when selling the 60% stake to Carlsberg means that the remaining 40% of the brewery business that Marston's still own is valued at around £250 million today[3]. That compares to a market capitalisation for Marston's of just £190 million[4] and I strongly believe somebody will look to buy that remaining 40% ownership stake from Marston's in the future.

Also, bear in mind that Marston's has close to £1.8 billion of freehold property with just £1.2 billion of debt against it[3], i.e., £600 million of equity in its property estate which dwarfs the market capitalisation of the whole business. The entire pub estate should also be able to generate earnings before interest and tax of more than £170 million in the near future[5]. In my opinion, it is obvious that the shares are currently massively mispriced.

If it was clear we are currently in a recession, then the market could look through an imminent drop in profits and start to price in a subsequent recovery. However, the economy has been remarkably resilient so far, which is complicating matters. Roll on a recession, allowing UK mid-caps and the likes of Marston's to rally.

Sources: [1]Bloomberg Finance L.P. 31.12.22-06.03.23, [2]Bloomberg Finance L.P. 06.03.23-23.06.23, [3]Marston's Interim Results for 2023, [4]Bloomberg Finance L.P. on 29.06.23, [5]Bloomberg Finance L.P., sell-side analyst consensus forecast of £177 million on 29.06.23.

Market Focus - 3 July 2023

- **Global equities returned 2.2% last week**
- **The US-China relationship came into view again this week, reporting that the Biden administration's Commerce Department could enforce additional restrictions on exports of Artificial Intelligence (AI) chips by Nvidia and other manufacturers to China**
- **Brent crude rose by 1.4% to $74.9 per barrel**
- **Gold fell by 0.1% to $1919.35 per ounce**

US

- US equities rose by 2.4% last week
- May Core Personal Consumption Expenditures data showed a slightly below consensus reading at 4.6% year-on-year
- Weekly jobless claims dropped back to 239k (vs. 265k expected), ending a run of five consecutive weekly gains
- The Conference Board's consumer confidence indicator for June rose to 109.7 (vs. 104.0 expected), its highest reading since January 2022
- New home sales in May rebounded to an annualised rate of 763k vs. 675k expected

UK

- UK equities returned 0.9% last week
- UK mortgage approvals saw a larger than expected increase in May to 50.5k (vs. 49.7k expected)
- The latest GfK (Growth from Knowledge) consumer confidence index showed a fifth consecutive increase and reached its highest level in 17 months
- M4 money supply came in unchanged on a year-on-year basis, the lowest it has been since September 2015

Europe

- European equities returned 2.3% last week
- Year-on-year core Harmonised Index of Consumer Prices inflation for the Euro Area came in slightly below expectations at 5.4% (vs. 5.5% expected)
- European Central Bank President Lagarde reiterated expectations for a July rate hike, though beyond that, she said decisions will be made on a meeting-by-meeting basis
- Germany's Ifo business climate indicator fell to 88.5 in June (vs. 90.7 expected), the second consecutive decline, and now leaves it at its lowest level since November last year
- The European Commission's consumer confidence indicator for the Euro Area hit a 16-month high last week

Rest of the World/Asia

- Global emerging market equities were flat last week
- Japanese equities rose by 1.2% last week, whilst Chinese equities were flat
- China's factory activity remained in contraction territory in June, as the official manufacturing Purchasing Manager's Index came in at 49.0. The services sector also recorded its weakest reading since China abandoned its strict COVID-19 restrictions
- Chinese data is at a point where markets are now expecting additional policy support from the administration to support the recovery despite the People's Bank of China (PBOC) cutting key lending rates last month
- Consumer prices in Tokyo rose 3.1% year-on-year in June

Market Summary

Asset Class / Region	Currency	Cumulative returns: Week ending 30 June	Month to date	YTD 2023	12 months
Developed Markets Equities					
United States	USD	2.4%	6.6%	16.6%	19.0%
United Kingdom	GBP	0.9%	1.2%	2.6%	8.1%
Continental Europe	EUR	2.3%	2.7%	12.7%	19.4%
Japan	JPY	1.2%	7.5%	22.7%	25.7%
Asia Pacific (ex Japan)	USD	0.2%	3.1%	3.0%	0.8%
Australia	AUD	1.6%	1.8%	4.5%	14.8%
Global	USD	2.2%	6.0%	15.1%	18.5%
Emerging Markets Equities					
Emerging Europe	USD	0.3%	6.9%	12.9%	41.6%
Emerging Asia	USD	0.0%	2.7%	4.0%	-0.9%
Emerging Latin America	USD	-0.6%	12.0%	18.5%	29.8%
BRICs	USD	0.6%	5.4%	-0.4%	-5.3%
China	USD	0.0%	4.0%	-5.5%	-16.8%
MENA countries	USD	-0.1%	3.1%	3.0%	-4.1%
South Africa	USD	1.5%	9.5%	-5.5%	-1.9%
India	USD	2.1%	4.5%	7.4%	18.3%
Global emerging markets	USD	0.0%	3.8%	4.9%	1.7%
Bonds					
US Treasuries	USD	-0.4%	-0.7%	1.8%	-1.9%
US Treasuries (inflation protected)	USD	-0.3%	-0.3%	2.0%	-1.3%
US Corporate (investment grade)	USD	0.0%	0.3%	3.2%	1.4%
US High Yield	USD	0.8%	1.6%	5.4%	8.9%
UK Gilts	GBP	-0.1%	-0.4%	-3.6%	-14.9%
UK Corporate (investment grade)	GBP	-0.4%	-1.1%	-1.0%	-6.9%
Euro Government Bonds	EUR	-0.3%	-0.3%	2.6%	-4.7%
Euro Corporate (investment grade)	EUR	-0.2%	-0.4%	2.0%	0.0%
Euro High Yield	EUR	-0.1%	0.5%	4.4%	8.8%
Japanese Government	JPY	-0.2%	0.2%	2.8%	0.1%
Australian Government	AUD	-0.1%	-2.3%	1.3%	0.8%
Global Government Bonds	USD	-0.4%	-0.2%	0.9%	-2.8%
Global Bonds	USD	-0.3%	0.2%	2.2%	-1.1%
Global Convertible Bonds	USD	0.8%	3.5%	4.8%	7.1%
Emerging Market Bonds	USD	0.1%	2.3%	3.3%	6.1%

Asset Class / Region	Currency	Cumulative returns: Week ending 30 June	Month to date	YTD 2023	12 months
Property					
US Property Securities	USD	5.2%	4.8%	4.8%	-1.4%
Australian Property Securities	AUD	2.6%	-1.6%	1.6%	3.1%
Asia Property Securities	USD	0.5%	1.9%	-7.0%	-11.3%
Global Property Securities	USD	3.5%	3.5%	1.1%	-4.0%
Currencies					
Euro	USD	0.3%	2.6%	1.9%	4.1%
UK Pound Sterling	USD	0.1%	2.7%	5.1%	4.4%
Japanese Yen	USD	-0.3%	-3.2%	-9.2%	-6.0%
Australian Dollar	USD	-0.2%	3.2%	-2.2%	-3.5%
South African Rand	USD	-0.2%	5.2%	-9.4%	-13.5%
Swiss Franc	USD	0.4%	2.2%	3.0%	6.6%
Chinese Yuan	USD	-1.0%*	-2.0%	-4.9%	-7.7%
Commodities & Alternatives					
Commodities	USD	-0.7%	4.5%	-7.1%	-9.6%
Agricultural Commodities	USD	-3.6%	5.7%	0.5%	0.1%
Oil	USD	1.4%	3.1%	-12.8%	-34.8%
Gold	USD	-0.1%	-2.3%	5.2%	6.0%
Hedge funds	USD	0.0%	0.6%	0.5%	1.2%

*as at 21/06/2023

Source: Bloomberg Finance L.P. Past performance is not indicative of future returns.

For more information, please contact:

Distribution Services

E: distributionservices@momentum.co.uk

T: T: +44 (0)207 618 1803