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momentum

global investment management

Weekly

We caution against the view that we are likely to see a protracted period of either especially high or especially low inflation over the next five years.

Macro matters

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As a reminder, macro is only ever an input into our investment process, and it is subordinate to bottom-up company (and government) analysis. Previously, I've called this a 'macro aware approach' to differentiate it from a macro driven process, and I think that's a useful way to characterise what we do.

The scope of the macro work we do is twofold: firstly, we aim to formulate a view on key macroeconomic variables, specifically growth, inflation, interest rates and geopolitics (although not strictly a macroeconomic variable…). At times these key macroeconomic variables inform the bottom-up work the team does. Secondly, we reflect on market dynamics and whether any high-quality indicators suggest we should be bullish or bearish in the short term.

With respect to growth, we broadly agree with the International Monetary Fund which is forecasting a weak five-year period for global growth, with the global economy expected to expand more slowly than during the last 20 years and over its longer-term history. Overall, we do not see grounds for any sudden surge in growth. The implication of this for analysts doing bottom-up research is that they should use conservative economy-wide growth assumptions in their models (to the extent that growth in the global economy has a bearing on the particular company they are analysing).

As one would expect, there are big differences between regions: within emerging markets, India (which overtook China as the largest country by population in April) is expected to pick up the baton as the global growth engine, with annualised growth of 6% over the next five years. Meanwhile, in developed markets, growth in the US has surprised to the upside, whereas the outlook for the EU has deteriorated, with the spectre of stagflation re-emerging.

While inflation is highly uncertain, we think central banks are serious about delivering on their inflation targets and therefore, we expect any renewed inflationary pressures to be met by decisive action from policymakers. As such, we caution against the view that we are likely to see a protracted period of either especially high or especially low inflation over the next five years.

Interest rate policy has entered contractionary territory and policy rates are therefore likely to fall over time, consistent with the Federal Reserve's latest dot plot, which shows forecasts from members of the rate-setting Federal Open Market Committee as to where interest rates will be by the end of 2023, '24, '25 and over the longer term. However, interest rates are likely to settle at a level above their lows from the previous cycle. Zero interest rate policy and quantitative easing were a mistake in our view, leading to asset price bubbles and greater inequality; we don't expect central banks to make the same mistake again.

Finally, with regards to geopolitics, we are currently in a holding pattern in terms of US-China and Russia-Western relations. Next year's US elections will take on increasing significance, but for now, it's a case of wait and see, while building resilience into portfolios in order to deal with bouts of volatility ahead.

Taken together, we foresee a relatively tough macroeconomic environment for companies to operate within. Added to that, our five preferred risk indicators, which includes things like the shape of the yield curve, also call for a relatively cautious stance today. Despite that fact, risk aversion – as measured by our proprietary indicator, which looks at key relationships between asset prices – is not far from its median, suggesting that market participants are relatively relaxed currently.

Overall, then, our weak economic outlook is endorsed by our standard risk indicators and does not appear to be reflected in markets. Naturally, this then leads us to be cautious in the short term and to demand a high margin of safety from all our investments. However, any view of valuations/fair value is ultimately driven by detailed bottom-up analysis, from which attractive opportunities are almost certain to emerge in spite of this weak macro backdrop.

Market Focus - 11 September 2023

- Global equities fell by 1.3% last week
- Last week saw oil prices hit a new high for 2023
- Brent crude rose by 2.4% to $90.65 per barrel
- Gold fell by 1.1% to $1919.08 per ounce

US

- US equities fell by 1.3% last week
- US factory orders fell by 2.1% in July (vs. -2.5% expected)
- The Institute of Supply Management services index came in stronger than expected, with the headline number at 54.5 (vs. 52.5 expected)
- Latest data from the Mortgage Bankers Association showed that mortgage applications for home purchases fell to its lowest level since April 1995 last week
- Weekly jobless claims data fell to 216k (vs. 233k expected)

UK

- UK equities rose by 0.4% last week
- The Bank of England's (BoE) Decision Maker Panel survey suggested that inflation expectations were falling among firms
- BoE officials also struck a more dovish tone than expected, with Governor Andrew Bailey saying that policy was "near the top of the cycle"

Europe

- European equities fell by 0.9% last week
- The final composite Purchasing Managers' Index (PMI) for the entire Euro Area came in at 46.7 (vs. flash 47.0), and the services PMI came in at 47.9 (vs. flash 48.3)
- The Euro Area Producer Price Index reading showed producer prices down 7.6% over the year to July as expected, the biggest annual decline since July 2009 after the Global Financial Crisis
- German factory orders contracted by 11.7% in July (vs. -4.3% expected)
- German industrial production fell by 0.8% in July (vs. -0.4% expected)

Rest of the World/Asia

- Global emerging market equities fell 1.2% last week
- Chinese equities fell by 1.1% last week
- Japanese equities rose by 0.4% last week
- China services sector activity expanded at the slowest pace in eight months as the Caixin/S&P Global services PMI dropped to 51.8 in August (vs. 53.5 expected)
- There were also signs of improvement in China, with exports down 8.8% in dollar terms year-on-year in August (vs. -9% expected), with imports down 7.3% (vs. -9% expected)
- The Reserve Bank of Australia (RBA) decided to keep its benchmark policy rate unchanged at 4.1% for the third straight month
- Household spending in Japan in July posted its most significant decline in nearly two and a half years, falling 5% year-on-year (vs. -2.5% expected)

Market Summary - 11 September 2023

Asset Class / Region	Currency	Week ending 8 September	Month to date	YTD 2023	12 months
		Cumulative returns			
Developed Markets Equities					
United States	USD	-1.3%	-1.1%	17.0%	12.6%
United Kingdom	GBP	0.4%	0.7%	3.0%	6.4%
Continental Europe	EUR	-0.9%	-1.0%	10.8%	14.7%
Japan	JPY	0.4%	1.2%	26.5%	23.8%
Asia Pacific (ex Japan)	USD	-1.1%	-0.8%	1.5%	3.5%
Australia	AUD	-1.2%	-1.5%	5.1%	8.8%
Global	USD	-1.3%	-1.2%	14.7%	13.7%
Emerging Markets Equities					
Emerging Europe	USD	-3.0%	-2.7%	18.6%	52.4%
Emerging Asia	USD	-0.8%	-0.2%	3.4%	3.9%
Emerging Latin America	USD	-3.4%	-2.5%	12.6%	14.2%
BRICs	USD	-0.4%	0.3%	0.3%	0.5%
China	USD	-1.1%	-0.7%	-5.3%	-3.1%
MENA countries	USD	-1.5%	-1.5%	1.5%	-7.7%
South Africa	USD	-2.5%	-1.8%	-8.3%	0.7%
India	USD	1.6%	2.6%	10.0%	8.1%
Global emerging markets	USD	-1.2%	-0.6%	3.9%	4.4%
Bonds					
US Treasuries	USD	-0.3%	-0.7%	0.2%	-1.8%
US Treasuries (inflation protected)	USD	0.2%	-0.2%	0.9%	-2.7%
US Corporate (investment grade)	USD	-0.3%	-0.8%	2.1%	1.2%
US High Yield	USD	-0.3%	-0.3%	6.9%	6.2%
UK Gilts	GBP	0.0%	-0.5%	-3.8%	-7.0%
UK Corporate (investment grade)	GBP	-0.1%	-0.3%	0.9%	0.6%
Euro Government Bonds	EUR	-0.5%	-1.0%	1.8%	-3.6%
Euro Corporate (investment grade)	EUR	-0.2%	-0.4%	2.8%	1.1%
Euro High Yield	EUR	0.2%	0.3%	6.1%	6.9%
Japanese Government	JPY	-0.2%	0.0%	0.3%	-2.2%
Australian Government	AUD	-0.3%	-0.2%	2.2%	0.6%
Global Government Bonds	USD	-0.8%	-1.3%	-1.5%	-1.1%
Global Bonds	USD	-0.8%	-1.3%	0.2%	0.5%
Global Convertible Bonds	USD	-1.1%	-1.1%	3.6%	4.1%
Emerging Market Bonds	USD	-0.6%	-0.9%	2.7%	4.2%

Asset Class / Region	Currency	Week ending 8 September	Month to date	YTD 2023	12 months
		Cumulative returns			
Property					
US Property Securities	USD	-1.2%	-1.1%	3.2%	-6.8%
Australian Property Securities	AUD	-1.4%	-2.3%	4.8%	-0.1%
Asia Property Securities	USD	0.9%	1.2%	-6.7%	-5.7%
Global Property Securities	USD	-0.8%	-0.9%	1.0%	-5.0%
Currencies					
Euro	USD	-0.7%	-1.2%	-0.1%	7.4%
UK Pound Sterling	USD	-1.0%	-1.6%	3.0%	8.5%
Japanese Yen	USD	-1.1%	-1.5%	-11.3%	-2.5%
Australian Dollar	USD	-1.1%	-1.4%	-6.5%	-5.3%
South African Rand	USD	-1.7%	-1.3%	-11.0%	-8.5%
Swiss Franc	USD	-0.8%	-1.1%	3.2%	8.9%
Chinese Yuan	USD	-1.1%	-1.2%	-6.1%	-5.3%
Commodities & Alternatives					
Commodities	USD	-0.2%	0.7%	1.2%	3.2%
Agricultural Commodities	USD	-0.6%	-0.2%	3.6%	4.9%
Oil	USD	2.4%	4.4%	5.5%	1.7%
Gold	USD	-1.1%	-1.2%	5.2%	12.5%

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

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