

Investment Comment

07 November 2022

Following a tumultuous September, markets ended October on a more stable footing, in particular in the UK where the unwinding of September's 'mini budget' and the ascension of Rishi Sunak to Prime Minister saw exchange rates and yields stabilise. Elsewhere, investors turned their attention to earnings reports in the US as a gauge of the impact of the gloomy macroeconomic picture on companies' earnings and outlooks.

The MSCI USA Index ended October up 4.6%, as signals from the US economy were somewhat mixed over the month. The labour market remains tight, inflation slowed for the third consecutive month (to 8.2%) and the US economy unexpectedly grew an annualised 2.6% in Q3 2022, rebounding from a contraction in the first half of the year as the US trade gap narrowed. The mega-cap US technology companies, which have come to be barometers of the global economy due to their size and influence, reported a series of weak earnings reports. Alphabet (Google), Microsoft and Apple all faltered and Amazon shares plummeted 20% on weak revenue and muted Q4 sales guidance. The energy sector, however, continues to outperform. After 12 consecutive weeks of increasing yields, fixed income finally provided some support for portfolios at the month-end, following better than expected US GDP figures and hopes that the Federal Reserve may soon slow the pace of policy tightening. The US 10-Year Treasury yield fell from a peak of 4.3% to close the month at 4%.

The MSCI Europe ex-UK Index rose 4.3% over the month. European policymakers continue to face the unenviable task of raising interest rates aggressively enough to moderate the record-high 10.7% inflation rate without plunging Europe into a deep and protracted recession. The European energy crisis has driven inflation in the bloc, but there was some relief in October as natural gas prices dropped below 100EUR per megawatt hour for the first time since Russia cut supplies over the summer. Warm weather, close-to-full gas storage and measures agreed by EU energy ministers, such as a windfall levy on fossil fuel companies, have slightly eased concerns over winter shortages. European gas prices are now nearly 70% below the levels reached in August. The European Central Bank's (ECB) October meeting delivered few surprises, with President Christine Lagarde raising rates by 75 basis points, bringing borrowing costs to 2009 levels. Markets are pricing in further raises of around 100 basis points in the next few months, but with PMIs in October indicating a bleak growth outlook, there may be some tricky monetary policy decisions ahead.

The MSCI UK Index rose 3.0% over the month as equities, gilts and sterling stabilised following the extreme market reaction to Liz Truss and Kwasi Kwarteng's 'mini budget'. With gilt yields soaring and pension funds struggling to meet margin calls and liabilities, the Bank of England intervened with haste, buying index-linked gilts for the first half of the month to prop up the bond market. Politics and capital markets are rarely so closely intertwined, however, the reversal of Truss and Kwarteng's proposed 'growth plan', their departure from the Cabinet, and the installation of Rishi Sunak as Prime Minister and Jeremy Hunt as Chancellor of the Exchequer resulted in a notable drop in the risk premia attached to UK assets. The yield on Britain's 10-year gilt ended the month around 3.6%, its lowest in five weeks. Sunak and Hunt delayed their economic strategy update to mid-November, with the Bank of England raising interest rates by 75 basis points in their 2 November meeting in order to address the 40-year high 10.1% inflation rate.

The MSCI Asia Pacific ex-Japan and MSCI Emerging Market indices fell 7.1% and 6.1%, respectively, in October. The indices fell sharply at the month-end as China's President Xi Jinping secured a third term in office. Whilst this was expected, Xi's selection of loyalists to replace the remaining moderates in his leadership party during the party congress sent ripples through Asian markets. Investors fear



that any balance in leadership has been removed, China will continue its zero-Covid policy and will focus more on the trade-war with the US than on ensuring economic prosperity in the country. The sell-off, led by the real estate and technology sectors, was compounded by weak PMIs, slowing retail sales and softening exports growth, indicating economic weakness. Trade tensions between China and the US continue with political conflict over the strategically important semiconductor industry.

In emerging markets' best performing economy year-to-date, Brazil, former president Luiz Inacio 'Lula' da Silva, produced a historic comeback to defeat incumbent Jair Bolsonaro. Lula, who won the election by a fine margin of less than two percentage points, faces the challenge of uniting a deeply divided Brazil and convincing the wider world of the fiscal responsibility of his economic vision.

The MSCI Japan Index posted a monthly loss of 0.2%. Despite the Yen sliding to a 32-year low against the Dollar of 151.9 Yen : 1 Dollar, and September's core inflation rate reaching 3.0% (above the BoJ's 2% target), Prime Minister Fumio Kishida signalled his support for the continuation of the BoJ's ultra-loose monetary policy. The Yen recovered slightly to end the month at 147.8 Yen to the Dollar after Japan spent a record 6.35tn Yen during October to support the currency. The country's top currency official, Masato Kanda, suggested the government had 'limitless' funds to conduct interventions. Currency interventions look likely to continue while BoJ governor, Haruhiko Kuroda, refuses to entertain increasing interest rates until price inflation is matched by wage inflation.

We are now beginning to see the early signs of slowing economic growth globally. Central bank policy decisions and geo-political tensions will continue to be crucial in determining the extent of the slowdown and how quickly inflation now normalises. However, while central banks continue to make large monetary policy calls, volatility is likely to remain elevated. As ever the long-term investor should see this as an opportunity where active management can add value by investing prudently. We continue to monitor portfolios carefully, seeking to take advantage of attractive investment cases as they arise.

Risk Warnings This document has been prepared based on our understanding of current UK law and HM Revenue and Customs practice, both of which may be the subject of change in the future. The opinions expressed herein are those of Cantab Asset Management Ltd and should not be construed as investment advice. Cantab Asset Management Ltd is authorised and regulated by the Financial Conduct Authority. As with all equity-based and bond-based investments, the value and the income therefrom can fall as well as rise and you may not get back all the money that you invested. The value of overseas securities will be influenced by the exchange rate used to convert these to sterling. Investments in stocks and shares should therefore be viewed as a medium to long-term investment. Past performance is not a guide to the future. It is important to note that in selecting ESG investments, a screening out process has taken place which eliminates many investments potentially providing good financial returns. By reducing the universe of possible investments, the investment performance of ESG portfolios might be less than that potentially produced by selecting from the larger unscreened universe.

cantabam.com

Cantab Asset Management Ltd
50 Station Road, Cambridge CB1 2JH
01223 52 2000
advice@cantabam.com

5th Floor, 8 Angel Court, London EC2R 7HP
020 3651 0570
advice@cantabam.com