

## Investment Comment

13 February 2023

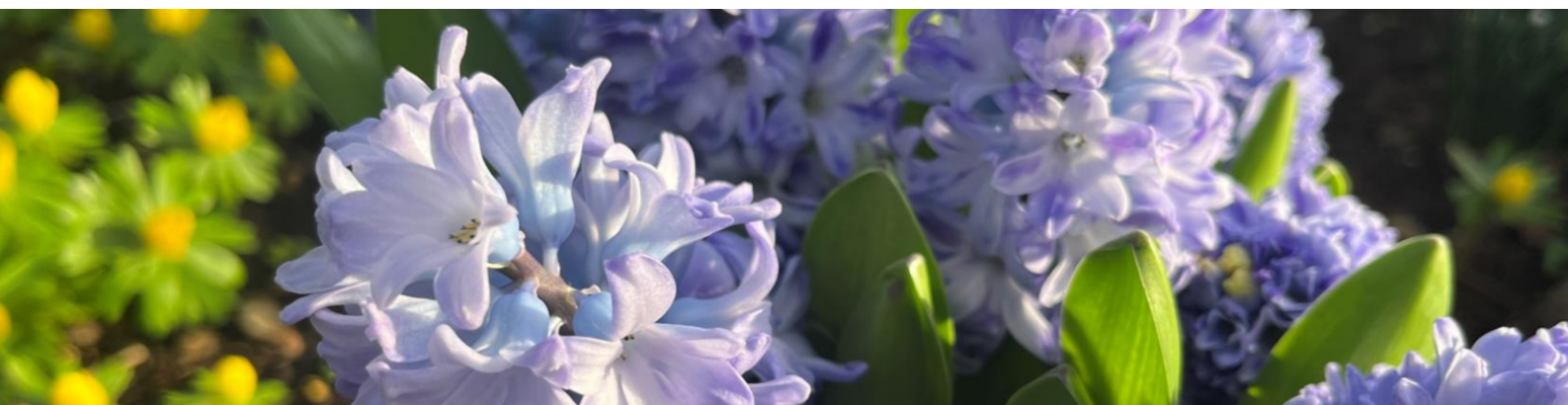
After a difficult 2022 for the majority of markets, there was some welcome relief in the first month of 2023. The MSCI ACWI rose 4.7%, while global bonds, as measured by the ICE BofA Global Broad Market Index, ticked over, rising 0.8% in January.

The MSCI USA index ended January 4.1% higher. By mid-January, earnings season was in full swing, with the major Financials reporting Q4 earnings. Bank earnings were expected to decline 15%, compared to the 4.6% anticipated for the broader S&P500. Results were mixed: Morgan Stanley narrowly beat expectations before Goldman Sachs missed by a considerable margin. Big Tech earnings take centre stage in February. Inflation continues to show signs of easing, as CPI dropped from 7.1% to 6.5%, while wage growth also eased and the services sector contracted. Despite job openings falling slightly in November, Nonfarm Payrolls overshot estimates with 232,000 jobs added in December versus an expected 200,000.

The MSCI Europe ex-UK Index posted a monthly gain of 6.8%. The outlook for Europe appears to have turned a corner in January: inflation figures came in below expectations, falling from 10.1% to 9.2%; investor sentiment in Germany turned positive for the first time since Russia's invasion of Ukraine; and a survey of economists have predicted Europe to avoid a recession in 2023 following easing supply chain issues, a strong labour market and success in filling its gas storage facilities. However, core inflation rose to 5.2% and with unemployment hitting a record low, the threat of wage pressures causing prolonged inflation in the bloc remains. At the World Economic Forum in Davos, President of the European Commission, Ursula Von der Leyen, signalled the EU's intention to rival the US as a hub for clean energy investment. The President stated that Brussels would seek to water down State Aid regulations to simplify approval of national subsidies to allow cash to flow into 'strategic climate friendly businesses'. This move comes in response to the US' Inflation Reduction Act which has set aside \$369bn for investment into green businesses.

The MSCI UK Index climbed 4.4% in January. Christmas sales were muted and failed to match the pace of inflation, registering a 6.9% annual rise as the cost of living crisis put pressure on families' Christmas budgets. Wage data showed average pay in the three months to November as 6.4% higher, year-on-year. However, average earnings are 2.6% lower than this time last year in real terms. Wage growth was considerably stronger in the private sector at 7.2% compared with 3.3% for the public sector, figures which have only exacerbated ongoing pay disputes between public sector workers and the government. Inflation in the UK remains sticky, coming in at 10.5% in December, as food prices remain stubborn. The housing market continued to cool, with the Halifax Housing Price Index showing a yearly increase of 2.0% in December, compared to the 4.6% November reading.

The MSCI Asia Pacific ex-Japan and MSCI Emerging Market Indexes ended January 6.1% and 5.4% higher, respectively. China recorded its second slowest annual growth rate since 1976, as GDP rose 3.0% in 2022. The reading was below the 5.5% target, highlighting the impact of the zero-Covid strategy which was abruptly abandoned in December. Despite fighting against a dramatic surge in Covid cases at the start of January, the Chinese government elected to lift quarantine requirements on international visitors ahead of the Lunar New Year. The Chinese Vice Premier Liu also claimed that China has passed its peak of infections in an address to the World Economic Forum. Exports, a key source of growth, fell 9.9% year-on-year in December and were down 18% and 20% to the US and EU, respectively. China's population fell 850,000 in 2022, marking the first decline in 60 years in a demographic shift that is expected to have long-term consequence for both the Chinese and global economies. The birth-rate was the lowest since records began more than seven decades ago, and China, having long relied on its growing demographic as a structural driver of economic growth, could now become reliant on automation and government initiatives to improve productivity.



In India, which has been one of the world's fastest growing economies over the past year, Prime Minister Modi announced a \$122bn business friendly budget targeting growth with a focus on key constituencies ahead of the general election next year. Modi also indicated that they would cut taxes for the 'hard-working middle class' and reduce the top income tax rate from 42.7% to 39%. At the same time, the government announced that they expected economic growth to be between 6% and 6.8% this year.

The MSCI Japan index posted a monthly gain of 3.8%. Increased volatility and a bond sell-off which saw yields on ten-year bonds temporarily rise above the 0.50% ceiling (their highest level since June 2015) prompted calls for further Bank of Japan ('BoJ') intervention in the bond markets. Prior to the renewed calls for Yield Curve Control ('YCC') measures, it was expected that the BoJ governor would end market intervention policy ahead of his tenure end in April. The BoJ chose however to defy market pressure at its monthly meeting, pursuing its ultra-loose monetary policy and leaving YCC measures unchanged. This sent Japanese stocks higher, and the Yen lower against the Dollar, falling from a seven-month high. The BoJ revised down its GDP growth forecast to 1.7% in its quarterly report, from the 1.9% previously predicted.

While 2022 was certainly a bruising year for the majority of global markets, households and economies, markets remain forward-looking. It is expected that inflation will naturally cool in 2023, as the significant energy price rises from last year drop out of the annual figures. Core inflation, however, which excludes typically more volatile energy and food prices, remains sticky and above target in most economies. Policymakers continue with the unenviable balancing act of controlling inflation without constraining growth and this is likely to remain a key influence on markets throughout the year, as analysts pay close attention to macroeconomic data and central bank statements. We continue to position Cantab portfolios with a long-term outlook, rotating as the ever-changing macroeconomic picture presents new investment opportunities.

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