

Investment Comment

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August's major financial event took place in Jackson Hole, Wyoming as members of the Federal Reserve gathered for the annual economic symposium. In his much anticipated speech, Fed chair, Jerome Powell, took a hawkish line, stating that while headline inflation has dropped considerably from its peak, it remains uncomfortably high. The chair stated the Fed's readiness to raise rates further still if required and their intention to 'hold policy at a restrictive level until we are confident that inflation is moving sustainably down toward our objective'. Christine Lagarde used her speech to take a similar line to Powell; warning of long-term inflation risks creeping into medium-term inflation through wages repeatedly chasing prices. Lagarde gave few hints as to where ECB policy would head in the future, just reiterating the need to set rates at 'sufficiently restrictive levels for as long as necessary'. The ECB is expected to implement a single rate hike at their meeting in September, bringing the rate to 4%.

US inflation for July came in at 3.2%, well down from its peak of 9.1%, but an increase from the June rate of 3%. Powell tempered his hawkish stance with a pledge to proceed 'carefully' noting that 'doing too much could also cause unnecessary harm to the economy' and that the current policy rates would be restrictive on growth. At the start of the month, rating agency Fitch downgraded the US government from the top credit rating of AAA to AA+, citing fiscal deterioration over the next three years, repeated down-to-the-wire debt ceiling negotiations that threaten the government's ability to service its debt, and a steady decline in governance over the last 20 years. US Treasury Secretary, Janet Yellen, lambasted the decision as 'arbitrary and based on outdated data'.

UK economic activity unexpectedly fell in August for the first time in seven months as higher borrowing costs weighed on demand. Demand remains particularly subdued in the housing market, where the Nationwide UK House Price Index registered a 3.8% year-on-year decline in July, above the 3.5% measured in June. This represents the largest fall in house prices since July 2009, as the impact of higher borrowing rates becomes an increasing constraint on affordability for first-time buyers and those renewing mortgages. Borrowing rates are set to become increasingly restrictive after the Bank of England implemented another single rate hike at their August meeting, leaving the benchmark rate at 5.25%. Findings from the Bank of England suggested that the share of non-financial UK companies experiencing debt-servicing stress will rise to 50% by the end of the year (and 70% for medium-sized enterprises with turnover of £10m-£500m). This scenario would see corporate debt stress at its highest level since the global financial crisis. There was a further decline in headline inflation to 6.8% in July following a slump in fuel prices, however core inflation remained unchanged.

Preliminary estimates showed the Eurozone economy marginally surpassing expectations by posting a 0.6% year-on-year expansion for the second quarter of 2023, following a 1.1% expansion in Q1. Sustained growth during the quarter in France and Spain was to thank, enough to outweigh the German economy which stagnated and an unexpected contraction in Italy. Employment levels in the Euro Area in Q2 extended the all-time highs from the previous quarter, though growth in employment numbers slowed to its lowest rate in over two years which may suggest that rates are finally starting to bite into the tight labour market.

In Asia, China saw its first decrease in inflation for nearly two-and-a-half years, recording a 0.3% year-on-year decline in the general price level in July. Producer prices saw a significant decline of 4.4%, which outstripped expectations of a 4.1% fall. A poll of eight investment banks forecast China's median expected growth rate for the year to come in at 4.75%, below the government's 5% GDP growth target. In further signs of economic struggle, data in July showed bank lending in China falling sharply to levels not seen since November 2009, this was less than half of the lending that had been expected. Household borrowings showed a marked contraction as property owners rushed to pay off mortgages, forgoing other consumption. New support measures for Chinese stocks



were unveiled in Beijing late in August, when the Ministry of Finance announced that it would halve the stamp duty charge on purchases of Chinese 'A shares', the first tax cut on share dealing since 2008.

Elsewhere, the BRICS emerging market bloc announced the biggest expansion in its history, inviting six new members including Argentina, Saudi Arabia and the UAE to join. This is the first expansion of the BRICS since the addition of South Africa in 2010 and marks a victory for China which has pushed for a rapid expansion of the group. Brazil's President Lula claimed that the new additions will increase the BRICS share of global GDP from 32% to 37%, on a purchasing power parity basis. BRICS leaders tasked finance ministers and central bank governors with developing measures to reduce dependence on the US dollar in trade among the economies.

As many major global economies appear to be nearing the end of the most aggressive rate hiking cycle in recent times, there is now greater clarity on expectations for peak rates. The question now, however, is how long rates are likely to remain at these peaks. Recent rhetoric from the symposium in Jackson Hole has hinted at the idea of rates remaining at current levels for longer and well into 2024, despite the general acknowledgement that this will be restrictive for growth. Stubborn core inflation and labour market tightness persist and these are likely to remain the decisive factors as to when central banks begin to unwind their recent monetary measures.

The path for interest rates is likely to impact short-term equity, bond and alternative asset class returns. However, macroeconomic developments are notoriously challenging to predict correctly, as indeed are their market implications. Cantab portfolios are positioned to reflect continued uncertainty, but we are optimistic that as we approach peak interest rates, market participants will once again look towards longer term fundamental growth prospects. There remain a number of areas heavily impacted by poor sentiment, as higher returns on cash have drawn capital away from risk assets. As has been seen in previous cycles (and in narrow elements of the US market this year), this dynamic can reverse rapidly as economic fundamentals evolve.

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