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MULTI-ASSET PROCESS

Market review: October 2022

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- **Several equity markets up and bond yields down as negative news abates slightly**
- **Central banks' rate hikes continue as US Big Techs warn of future weakness**
- **Optimistic investors should bear in mind that timing market entries is nigh on impossible to get perfectly right**

Global financial markets were more settled in October after a rare three successive quarterly declines. Many equity markets were even up and bond yields down as the relentless stream of negative news seen throughout the year abated slightly. The acuteness of risk aversion came out of markets and there was more belief among investors that the balance of risks was on a steadier footing following significant sell offs year to date. Some evidence emerged that inflation could at least be increasing less rampantly and even the UK, where the disruptions under Prime Minister Liz Truss's administration had spurred surprisingly far-reaching unease around markets, was looking more stable after Rishi Sunak's succession.

US Big Tech disappoints investors

In the US, the S&P 500 rose throughout the month after three quarters that saw it suffer its longest run of quarterly losses since 2008. Latest data had shown that CPI including energy and food was 8.2% in September, or little changed from the 8.3% figure announced in August. The market had to weigh up whether the Federal Reserve would need to be even more aggressive to tackle inflation.

The first estimate of US Q3 GDP growth came in at up 2.6% year-on-year after having contracted in the first half of the year. The figure masked the fact that consumer demand was weakening, however, pointing to a slowing economy. There were other signs that the Fed's aggressive measures to cool the economy were working: figures showed that US job vacancies fell by more than one million in August. US business activity also fell, with the Purchasing Managers' Index from S&P Global dropping to 47.3 from 49.5 in September and below expectations. A number above 50 denotes expansion when compared to the previous month. The hope is that the Fed will be able to engineer a soft landing and one US fund manager we met over the quarter believes the US economy has made progress towards this. But the manager adds: "The Fed is not likely to pivot from its policy at present. Although more debt may cause the interest burden to increase rapidly, this is not enough of a concern to deter the Fed from its tightening plan."

It was also Q3 reporting season in the US and although Apple rose nearly 8 per cent after announcing a year-on-year increase in revenues above expectations, several of the Big Tech groups delivered disappointing figures and their shares fell. Bellwether stocks Microsoft and Google parent Alphabet both saw their shares drop after they warned of future weakness.

We have long been cautious about US equities, which have been expensive although corrections have brought valuations back to more sensible, if not quite yet attractive levels. Value can still be found in the tech companies and the US economy remains in solid shape. In recent months we have slightly reduced our exposure to US equities.

Lagarde points to recession in Europe

In Europe, the ECB raised interest rates by 75bp to 1.5%, the highest level since 2009, after Eurozone inflation reached 9.9% in September. But bond markets rallied after Christine Lagarde, the ECB President, acknowledged the bloc was likely to be heading for a recession, which investors saw as a sign that the ECB could be on the

verge of a pivot away from its hawkish stance. But data at the end of October showed Eurozone inflation had reached 10.7%.

We have been increasingly pessimistic on European equities and we reduced the sector's target score successively over the last two quarters. It is the region most at risk from the conflict in Ukraine and parts of the bloc are reliant on Russian energy. A fund manager to whom we have spoken believes the prospects of a recession in Europe are worsening: "Electricity prices have surged to more than 15 times the pre-COVID level, stemming from droughts, cuts in Russian supplies and summer heat. Inflation in the EU is running ahead of that in the US and this has increased the likelihood of a recession."

Investors reassured by UK change

In the UK, financial markets took some reassurance that the political situation had calmed down and assets recovered. We believe equities are more attractive in the UK than Europe, having been discounted by international investors since Brexit. We are less positive on UK gilts and have been reducing exposure in favour of sovereign debt elsewhere.

Japan intervenes to support the yen

In Asia, the Japanese government announced a Y29 trillion (US$200bn) new spending package to ameliorate the impact of higher commodity prices and the weaker yen on consumers, as the Bank of Japan continues with its ultra-loose monetary policy. The country's inflation rate was much lower than other developed nations at 3% in September. The BoJ has been intervening in markets since September to support the yen, which has sunk to 32-year lows because of the country's monetary policy versus tightening by other major central banks. Our conviction on Japan has fallen over recent quarters but we have been marginally increasing exposure.

President Xi tightens grip on power

Elsewhere in Asia, investors were disconcerted by the news that President Xi Jinping tightened his grip on power after being elected Chinese Communist Party leader for a third term and avoided appointing any pro-market moderates in his leadership team. This sparked a major sell-off of Chinese companies in both Hong Kong and the US that was given further impetus by new data showing that China's economy grew by an annualised 3.9% in Q3, some way below the government' target of 5.5%. Emerging Markets generally have been hit hard by the strengthening US dollar because they pay for their imports and debts in USD and are vulnerable to a slowing global economy. An Emerging Markets manager who we speak to points out: "Emerging markets are having a hard time due to the higher commodity prices, including energy and food. The strong dollar is pushing commodity prices even further, making goods more expensive to the rest of the world."

Timing markets is difficult

As much as markets saw some recovery in October, the future returns on equities and corporate bonds will depend on companies maintaining their robust earnings and financial strength, which will be closely linked to the state of the economy. The pervasive sense of uncertainty still keeps us 'neutral' in terms of overall risk positioning.

Optimistic investors might look at the current environment as a buying opportunity. They should bear in mind though that timing market entries is nigh on impossible to get perfectly right. It may be that there is further downside in markets, but it would be easy to miss out on the upturn when a sustained rally appears.

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