Investment Outlook

A monthly round-up of global markets and trends

February 2023

In this issue

Please read the important information section

evelyn PARTNERS

Investment outlook

Daniel Casali
Chief Investment Strategist

Not so broken Britain

Back in January 1979, former Labour PM James Callaghan famously denied the UK was in chaos during the 'Winter of Discontent' strikes. The public disagreed and voted in the Conservative government of Margaret Thatcher a few months later. Fast forward to today and around one million working days were lost in December 2022, due to industrial action[1]. More working days are expected to be lost in a 'Spring of Discontent', as strikes continue. We are still some way below the peak in September 1979 when nearly 12 million working days were lost[1].

The nation's mood hasn't been helped by the negative headlines. The IMF expects the UK to post the weakest real GDP growth rate out of the G7 economies in 2023. Essentially, UK consumption growth is being weighed down by especially high inflation. Moreover, individuals can expect higher rents, mortgage rates and taxes in 2023.

Yet, despite the domestic turmoil, UK stocks have outperformed their peers. In 2022, the UK equity market rose nearly 17% more than the rest of the world, its biggest beat since 1990[2]. This was partly because UK-listed multinationals are closely linked to what goes on in the rest of the world. Looking forward, the reopening of the Chinese economy from zero-Covid policy could be a shot in the arm for UK companies, which derive around 77% of their sales from overseas[3]. China seems to be willing to go for growth by relaxing restrictive policies applied to its important property sector. According to a Bloomberg report in early January, the Chinese authorities are set to raise lending caps for developers and extend the deadline for firms to meet debt limits[4]. This could be a green light from the Chinese leadership to go for growth, which would provide support for the UK-listed commodity sector.

UK stocks are also riding a rally in global stocks boosted by optimism that the Federal Reserve (Fed) is set to pause on US interest rates, in line with slowing inflation. With US rate hike expectations capped, the US dollar has begun to weaken. The greenback has also been led lower by China reopening, and sharp declines in European wholesale gas prices, reducing fears of an energy crunch. Capital is being put to work in financial markets as investor confidence returns. Even UK company earnings expectations for 2024 have picked up slightly since the autumn. At least international developments provide some reason for cheer in the UK.

The megatrends shaping the coming decade – and beyond

1980-2020 was a golden period for the global economy, so much so that it's often termed the 'Great Moderation'. World economic growth was strong, while interest rates and inflation fell sharply in advanced economies. Despite a few blips along the way, including the global financial crisis, this 40-year period fares well when compared to others in recent centuries.

However, the trends which shaped those decades are shifting, while new technologies are set to radically alter the economic landscape. As a result, we believe the global economy has reached an inflection point. The relative macroeconomic stability of the Great Moderation is over, and the years ahead are set to look very different. We see **four megatrends** shaping the next decade and beyond.

First, **demographics will shift** from being a tailwind behind the global economy to a headwind. Over the last four decades, the global population has grown from 4.5 billion to 8 billion, a 78% increase[5]. In the coming years, population growth is set to slow considerably. A higher number of retirees will mean there will be fewer workers to fund pensions and healthcare. This will have major implications for labour markets, consumption, debt levels and the healthcare sector.

Second, the current world order, which was thrashed out in the aftermath of World War II, is under threat. Growing economic powers, notably China, did not sign up for this framework and want the world's economy to work differently. This tension is likely to lead to a long-term realignment of the global economy, with new rules and new thinking. We expect to see a transition towards a **multi-polar world**, rather than one focused on the US.

Third, policymakers are scrambling to wind back the clock to achieve 'net-zero' carbon emissions – levels last seen more than 200 years ago. The war in Ukraine has accelerated this need, with Western policymakers realising the importance of having a secure supply of domestic energy. But despite the significant amount of investment allocated to the energy transition, we think the global economy faces a **bumpy path** to reach net zero as it contends with complex energy supply chains and geopolitical risks.

Finally, an exciting pipeline of new technology leads us to believe that we could be on the cusp of a **technological revolution**. No sector is immune to the disruptive influence of technology – and those who believe their business is untouchable may see the greatest shock. For businesses on the right side of technological change, either as a user or creator of technology, it can be transformative.

Assuming the next decade will look like the last has often proved a dangerous approach, particularly during times of significant social and economic change. Understanding these powerful long-term forces helps guide us towards opportunities and away from significant risks. It's an essential part of our investment process as we look towards sectors and companies with a clear runway of growth, enabling us to build better, future-proof investment portfolios.

Sources:

1 Britain's new winter of discontent, Financial Times, 9 December 2022

2 Refinitiv, Evelyn Partners

3 Factset

4 www.bloomberg.com/news/articles/2023-01-06/china-may-ease-three-red-lines-property-rules-in-drastic-shift

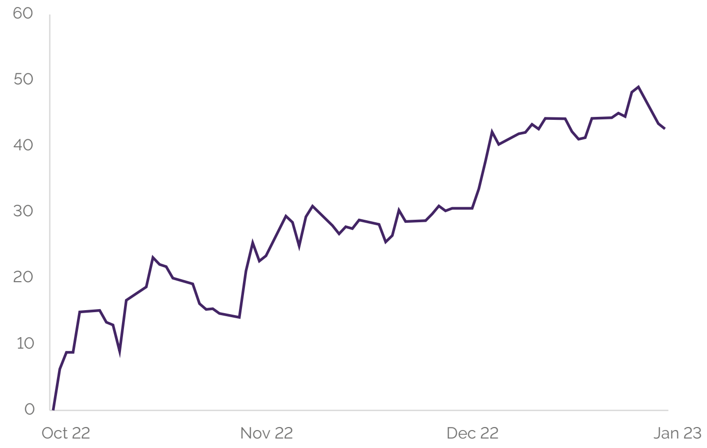
5 World Population Prospects, UN

Market highlights

Equities – China

On 7 December, the Chinese authorities announced 10 Covid-easing steps, allowing their citizens to travel between provinces and enter many public venues without needing to show a negative test result. The start of January then saw quarantine requirements for travel dropped, making foreign travel easier. With multi-year Covid restrictions ending, investors have turned bullish on China: domestic equities traded in Hong Kong have performed strongly over the last three months, gaining 43% in sterling terms. Chinese consumers are also expected to increase consumption following nearly three years of rolling lockdowns. This could provide a boost to Western firms dependent on demand from China, particularly those in luxury goods sectors.

MSCI China total returns (%, sterling)

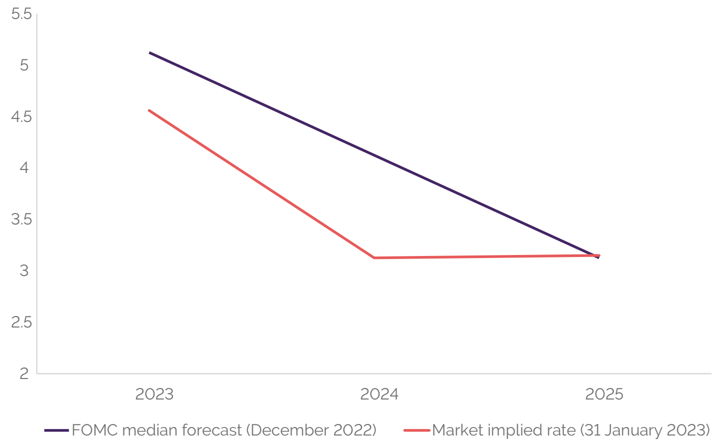


Source: Refintiv Datastream/Evelyn Partners Investment Management LLP.
Performance Total return in pounds sterling as at 31 January 2023

Fixed income – FOMC

A gap has emerged between the Federal Open Market Committee's (FOMC) base interest rate forecasts and the market-implied forward interest rates. Despite the Fed chair Jerome Powell's continued hawkish rhetoric, the market does not believe the FOMC will keep rates 'higher for longer'. Instead, the market is betting that the Fed will need to significantly ease monetary policy in 2024 as the US economy slows. Historically, financial markets have often led the Fed, although in 2022 it was the central bank which guided the market's interest rate expectations higher as inflation continued to accelerate. Only time will tell whether it's the Fed or financial markets that have it right this time.

US interest rate projections (%)

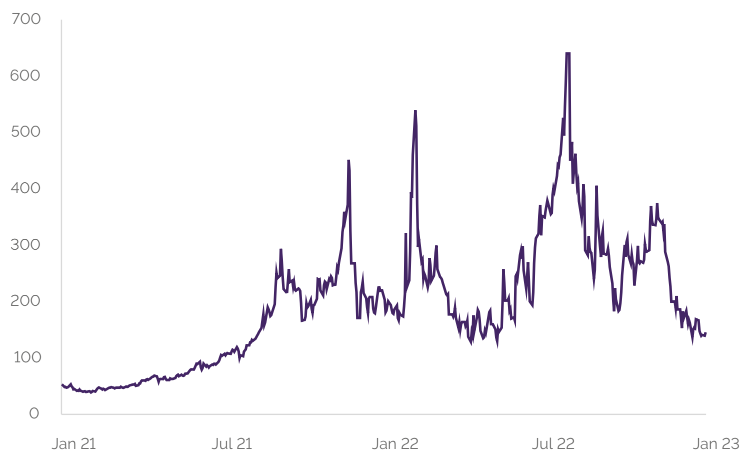


Source: Refintiv Datastream/Evelyn Partners Investment Management LLP.
Performance Total return in US dollars as at 31 January 2023

Currencies / Commodities – UK energy prices

UK wholesale natural gas prices have fallen back below levels seen prior to Russia's invasion of Ukraine. This has been driven by two main factors. First, a milder-than-average winter in Europe has led to lower energy demand, allowing European gas storage levels to remain higher than usual for this time of year. Second, increased imports of Liquified Natural Gas have helped limit reliance on piped natural gas. Despite these lower prices, natural gas is typically purchased on a forward basis, so it will be a few months before UK households start to see the benefits of falling gas prices on their energy bills.

UK wholesale natural gas price (pence/Therm)



Source: Refintiv Datastream/Evelyn Partners Investment Management LLP.
Performance Total return in pounds sterling as at 31 January 2023

Market returns (Total return (%), sterling)	1 month	3 months	1 year	5 year
Equities				
MSCI All-Country World	4.7	3.9	0.8	55.0
MSCI UK	4.1	9.9	9.5	25.5
MSCI UK Broad	4.4	10.3	5.9	21.2
MSCI USA	4.1	-1.1	-0.8	81.7
MSCI Europe ex UK	6.9	14.3	5.0	37.8
MSCI Japan	3.8	9.3	2.1	20.8
MSCI Asia Pacific ex Japan	6.1	17.0	18.1	35.3
MSCI Emerging Markets	5.4	14.3	-3.8	9.3
Bonds				
iBoxx GBP Gilts	2.8	1.1	-19.9	-12.5
iBoxx USD Treasuries	0.5	-1.8	-0.6	19.4
iBoxx GBP Corporate	4.0	6.5	-12.4	-2.4
Commodities and trade-weighted currencies				
Oil Brent Crude ($/barrel)	0.2	-11.2	-6.9	24.0
Gold ($/ounce)	6.2	17.7	7.3	43.7
GBP/USD	2.3	6.9	-8.2	-13.4
GBP/EUR	0.6	-2.7	-5.3	-0.7
EUR/USD	1.8	9.9	-3.1	-12.8
USD/JPY	-1.4	-12.5	12.9	19.1

Market commentary

Equities made a strong start to 2023 with the main country-level benchmarks in positive territory (in sterling terms) for January. Europe and Asia Pacific led the charge. Investor sentiment on Europe improved as energy supply concerns eased. While the faster-than-expected reopening of China meant that international investors have started allocating to the Asia Pacific region again. The regional equity index is up 17% (in sterling terms) over the last three months. Gold, an asset which does not produce an income stream, also performed well, with the futures market predicting the Fed is towards the end of its interest rate hiking cycle.

Key macro data	Latest	2023 Consensus forecast	Spot rates	31-Jan	Yields (%)	31-Jan
UK GDP (YoY%)	1.90	-0.90	GBP/USD	1.23	MSCI UK	3.74
UK CPI Inflation (YoY%)	10.50	7.00	GBP/Euro	1.13	MSCI UK broad	3.68
Bank of England Base	3.50	4.15	Euro/USD	1.09	10 Year Gilt	3.34

The market commentary, values and charts as at 31 January 2023. Total returns in sterling.
Returns are shown on a total return (TR) basis ie including dividends reinvested (unless otherwise stated).
Net return (NR) is total return including dividends reinvested after the deduction of withholding tax.
Source: Refinitiv Datastream/Bloomberg

Important information

Please remember the value of investments and the income from them can fall as well as rise and investors may not receive back the original amount invested. Past performance is not a guide to future performance.

This document contains information believed to be reliable but no guarantee, warranty or representation, express or implied, is given as to their accuracy or completeness. This is neither an offer nor a solicitation to buy or sell any investment referred to in this document. Evelyn Partners documents may contain future statements which are based on our current opinions, expectations and projections. Evelyn Partners does not undertake any obligation to update or revise any future statements. Actual results could differ materially from those anticipated. Appropriate advice should be taken before entering into transactions. No responsibility can be accepted for any loss arising from action taken or refrained from based on this publication. The officers, partners and employees of Evelyn Partners, and affiliated companies and/or their officers, directors and employees may own or have positions in any investment mentioned herein or any investment related thereto and may trade in any such investment. This document is produced for UK residents.

Sources

MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indexes or any securities or financial products. This report is not approved, endorsed, reviewed or produced by MSCI. None of the MSCI data is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such.

The Bank of England base rate, Retail Price Index (RPI), Consumer Price Index (CPI) and Sterling Overnight Index Average (SONIA) are public sector information licensed under the Open Government Licence, http://www.nationalarchives.gov.uk/doc/open-government-licence.

Authors and contributors:

Daniel Casali, Nathaniel Casey, David Goebel, Adrian Lowcock, and Rob Clarry

For further information:

E: contact@evelyn.com | T: 020 3131 5203

evelyn PARTNERS