Strategy & Outlook

MARKET UPDATE

DECEMBER 2022

Global equities finished the month higher (+3.3%) as longer dated bond yields drifted lower, the US dollar sold off aggressively and China inched closer to reopening.

The beginning of the month was all about central banks. Norway raised rates by 25bp rather than the 50bp expected, and the Bank of England raised rates by the expected 75bp but said that it expected rates to "peak at a lower level than implied by financial markets", concern about economic growth and not just inflation driving some caution. The decision was not unanimous, one member voting for 50bp, and another voting for just 25. The main event however was the Federal Reserve, the 75bp (as expected) hike being accompanied by a dovish statement and a unanimous decision. The dovish element of the statement acknowledged that for future rate hikes "the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments." The take-away from this is that the next move in December is 50bp unless data strengthens from here, or possibly 25bp if it slows materially. Jay Powell's press conference however put paid to any thoughts of dovishness from the Fed. While he acknowledged the slowdown in interest rate sensitive sectors of the economy, he argued that the employment market remained very tight and that further rate hikes, while they may be slower, were inevitable, and the terminal rate was likely higher than the estimates put forward by Fed officials (just 6 previously, during which time we have had further confirmation of and an acceleration of the slowdown in housing). When asked about the recent positive contribution of shelter costs to the CPI figures at a time when house prices and rents are falling (half of the inflation over the last three months has been shelter related) he argued that the owners' equivalent rent was merely catching up with what rents did six months ago.

While this gives the impression that the Fed is continuing to hike rates to stem inflation that happened earlier in the year (when they were still loosening policy) and has already rolled over in the real world, the likely slowdown in the rate hike cycle buys them some time to allow the impact of their aggressive tightening to come through in the numbers they focus on, before they go too far. Markets are currently priced for a terminal rate of close to 5% in mid-2023, already well above the median DOT from the most recent SEP.

Elsewhere, Powell's confidence on the strength of the labour market will perhaps have been shaken somewhat by a steady stream of announcements of layoffs and hiring freezes in the tech sector, Apple and Amazon joining Google in a hiring freeze, Lyft, Stripe and Twitter announcing large layoffs, and Meta rumoured to be moving from a hiring freeze to layoffs. The payrolls report for October seemed nominally strong at the headline level (+290k jobs including revisions), although it should be pointed out that almost half of that number came from the "business birth-deaths model" employed by the BLS, which reflects trends in the labour market from the previous couple of years. Some weakness in the household survey (a loss of 328k jobs) meant that the unemployment rate rose from 3.5% to 3.7% even as labour force participation dipped. Average hourly earnings rose by 4.7% y/y, down from the 5.0% print in September. All incremental, but the way the Fed wants to see things move.

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Over the course of the month, we had a number of significant data points. The official inflation data in the US last week has finally begun to catch up with what real world indicators have been indicating since the summer. October's saw core inflation in the US ex housing was down month on month. Ironically the vast number of layoffs announced in the US in the last month will initially provide a further boost to risk appetite - the heat is clearly coming out of the US labour market, speeding up the end to the Fed's tightening. As share prices are being rewarded for job cuts, we have seen more companies announce hiring freezes or layoffs.

Outside the US, the election of Xi Jinping has kick started a year-long formal process to re-open the Chinese economy after 3 years of the most stringent covid lockdowns and also unexpected boost to the ailing property sector, whilst Ukraine's historic victories have further isolated Russia as an unseasonal mild winter removes the risk of energy shortages this winter in Europe.

Positioning

The funds remain at the top end of their asset allocation and had a very strong month. Active positions in FX (dollar hedging), bonds (overweight peripheral Europe, long dated US treasuries) and equities (long-standing overweight positions in US semi-conductors and European Industrials, as well as the tactical decision to materially increase FANG and EM exposure earlier in the month on a record collapse in their share prices) all contributed strongly to performance.

Whilst there have been some eye-grabbing moves of late (Hong Kong, Germany up 20%+, US up more than double digits), the broad investment backdrop and opportunities we have discussed over the last few months are only beginning to play out.

WARNING: Past performance is not a reliable guide to future performance.

WARNING: The value of your investment may go down as well as up.

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