Market 2 Market

A forward view of the global economy and financial markets

March 2023

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Something Cheerful for Ukraine

"It's supposed to be bad. And the worse it is, the more fun it is."
Terry Wogan, 1997

Source: Wikipedia

Last week saw tickets for this year's Eurovision Song Contest, being held in Liverpool on behalf of Ukraine, go on sale. The event starts on Monday 9th May with the first Semi-Final and culminates with the live Grand Final on Saturday 13th May. There are no less than 9 shows and tickets sold out in 36 minutes with the website crashing.

I discovered some interesting facts about Liverpool and the event. Liverpool is a UNESCO Music City and it has more galleries and arts venues than any other city in the UK outside of London. Moroccanoil is the Presenting Partner for the second year running and Diageo has acquired three-year official partnering status for its Baileys Cream Liqueur Brand. The slogan for this year is going to be "United by Music". I have to say that I am puzzled by Moroccanoil sponsoring the event but with an estimated global television audience of 200 million it will certainly help name awareness. By the way Moroccan Oil is not a company that produces oil from offshore wells in the Atlantic but rather it is the purveyor and pioneer of oil-infused hair care products.

It is going to cost the BBC £17m this year but that is cheap when considering that Azerbaijan spent around £43m to host the event in 2012. The good news is that Liverpool will benefit from a huge influx of Eurovision tourists with over 100,000 music fans converging on the city. It is also important to remember that this is Ukraine's contest to host and it will give that embattled country a chance to put forward its story to a global audience. The good news is that there will not be entries from Russia or Belarus.

The contest will be hosted by Graham Norton along with the award-winning Ukrainian singer Julia Samina of the band The HARDKISS. Hannah Waddingham and Alesha Dixon are also hosting and will appeal to the younger viewers. The demographics of the viewing audience are interesting and to my mind quite surprising. Younger viewers (under 35) make up 46% of the viewers. 61% are male and a massive 50% of the viewers are single and 62% of the viewers come from the LGBT community.

So, what about the runners and riders for the event itself. Mae Muller is the UK's entry but the bookies don't fancy her chances as much as Vesna of the Czech Republic and Sudden Light of Latvia. My eye was caught by Germany's entry called Lord of the Lost, which might be an appropriate name for the Russian President. Voting will be interesting and the Ukraine is sure to win a large number of votes as people, understandably, want to show their support for this country.

It is easy to make fun of Eurovision but it is a huge event that is watched by a global audience and it is unquestionably, an event for good. I enjoy the strange acts and over the top outfits but I will definitely be thinking of the Ukraine this year and I hope the event is a roaring success.

Richard Harper
Head of Asset Allocation
GHC Capital Markets Limited

Asset Allocation

In which **Tim Harris**, the Chair of our Asset Allocation Committee, describes the factors influencing our latest Asset Allocation decisions

Recent strong US economic data provide evidence of a resurgence in inflation

The Federal Reserve's preferred measure of inflation, the Personal Consumption Expenditures index, is rising more strongly than expected. January's month-on-month rise of 0.6% follows a 0.2% increase in December. This confounded market expectations that inflation was on a downward trajectory. Furthermore, a surge in wholesale price inflation, which showed prices rose 0.7% from December to January, compared with a 0.2% drop from November to December, only showed how sticky the inflation saga has been.

A 1.8% month-on-month jump in US retail sales in January added to the market's fears that inflation will be higher for longer and that the Fed will have to keep raising rates. The recent strong employment report only reinforces the fact that the US economy is still running hot despite the earlier increases in interest rates.

The Fed will be worried about the developments since its last board meeting and a 50bps increase in the Fed funds rate at the next meeting now looks quite possible. The market is currently pricing an approximately 75bps increase in the rates by July this year – so the next leg of a renewed bull market for risky asset markets might have to await the latest concerns of tighter monetary policy.

Poor inflation data presents a significant headwind to the markets

The US 10-year government bond yield has surged past the high levels seen at the end of 2022. We suspect the US 10-year will push on through 4.0% with an initial target of 4.10% to 4.20%. Institutional bond buying gained momentum the last time we saw the 10-year yield breach the 4.0% level in early November. But we must remind ourselves that the US 10-year government bond yield is still negative in real terms. History tells us that bondholders must be compensated for inflation and more. Hence, the US 10-year bond yield may push even higher if the market loses confidence that the Fed will be able bring inflation under control in a timely manner.

Global equities are neither enjoying the recent spike in government bond yields nor the ongoing increase in central bank policy rates.

While the UK equity market remains the cheapest of the major developed markets, there are reasons for this and the decisions of ARM Holdings and building materials giant, CRH, to seek main-US listings does little to encourage inflows from global investors to the UK.

The US equity market, with its stretched valuation, remains vulnerable to further downside. We see the index tracking the US's largest 500 companies falling ny around 6% in the near term. It is not just the US that is seeing the market impact of better-than-expected growth. In Europe, growth is surprising to the upside and inflation is persistently on the higher side of consensus. The industrial confidence surveys continue their recent strength reflecting broad-based improvement. However input prices have softened helped by weaker-than-expected energy prices, but continuing labour shortages are putting some upward pressure on inflation.

There is quite a distinction in perspectives building between the US and Europe

In the US, inflation forecasts continue to rise and growth remains robust. In the Eurozone inflation has behaved rather well, aided by the significant fall back in energy prices in recent months. More cheaply rated Eurozone markets may continue to outperform, given the reduced risks to the upside to Eurozone inflation and hence the diminished need for any aggressive central bank action.

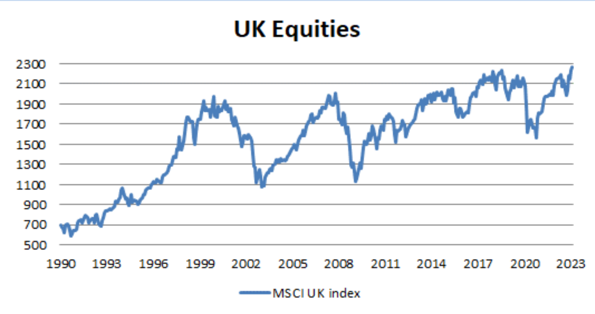
The Fed and the ECB both now look likely to raise policy rates by 50bps at their next meetings, with a further increase in their subsequent meetings not ruled out. No-one had expected the situation to evolve like this. The market has in the past priced a view that rates would have already peaked.

Emerging markets are holding up in spite of dollar strength. The prospect of higher than expected US interest rates will likely weigh on emerging markets. The dollar has continued to recover ground after its Q4-through-January slump. However, key emerging currencies have held their ground against the dollar quite well to date. They are performing largely in line with other major currency crosses.

We maintain an asset allocation broadly in line with benchmarks across portfolio risk grades

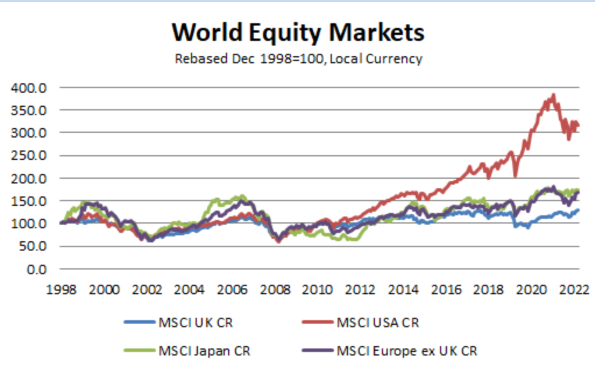
Therefore, we have captured the New Year rallies in equity markets. We are seeking good opportunities from key fund managers that we invest in. That said, we carry no exposure to real estate, where we fear further downside in prices and a risk of managers 'gating' their funds, as they try to meet investor redemptions.

Markets at a glance



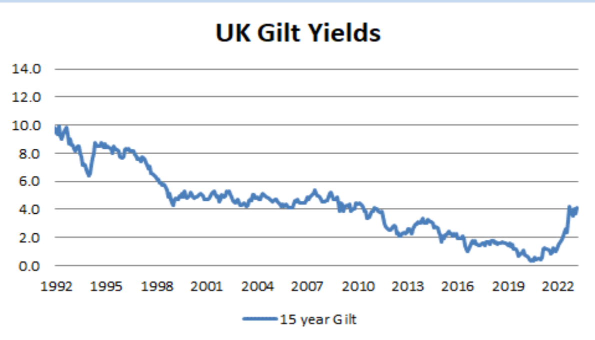
Source: Lipper for Investment Management

The Windsor Framework, agreed by the UK Prime Minister and European Commission President, replaces the old Northern Ireland Protocol, dealing with the issues it has created and providing a new legal and UK constitutional framework. It is almost 7 years since the UK's vote to leave the EU. On the economy and trade, we believe that Brexit has so far cost the UK economy 4% of growth over time. What has been the impact on equities? For large caps, we think it's been small - they've performed poorly, but we think Brexit is not the main cause - but for domestic stocks there has been a significant hit. UK equities remain cheap by international standards, but there are not yet significant catalysts to change this state.



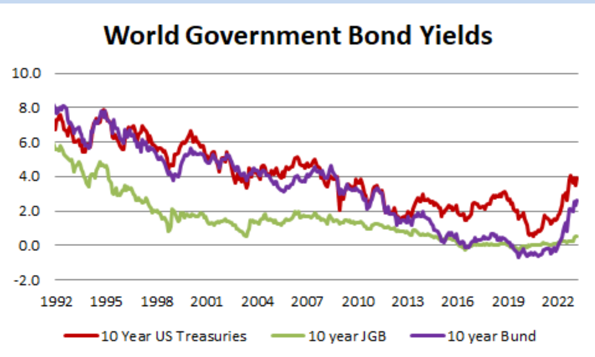
Source: Lipper for Investment Management

Developed market central banks are now further down the monetary tightening route, which has held back equity valuations. Low equity risk premia, due to markets fading growth risks, remain one of the key sources of concern for risky assets from here as they make markets more vulnerable to macro surprises. While we have turned more neutral tactically, helped by better macro outlooks, we see an increase of hedges being placed by investors in the equity space, while implied volatility remains low - volumes in the options space have been very elevated recently.



Source: Lipper for Investment Management

UK yields repriced sharply higher, as UK PMIs beat expectations, although Gilt performance is largely in line with US and EU yields, suggesting an ongoing common factor in G10 pricing. Despite this, we continue to favour UK gilts over EU and US, given diverging growth outlooks and monetary policy transmission. We expect a particularly strong transmission of the recent policy tightening in the UK, thanks in part to the relatively low maturity of mortgage debt, which should add up to a larger growth drag versus other major economies.



Source: Infront

Bond markets have been on a wild ride. After a rally heading into the year, yields have recently risen sharply on better growth and sticky inflation data. The bond story has also been joined by a character not seen in years: Japan. We foresee higher rates across developed markets this year and expect them to remain high before potentially declining sharply in 2024. Further Bank of Japan actions are more likely to cause a ripple than a crisis.

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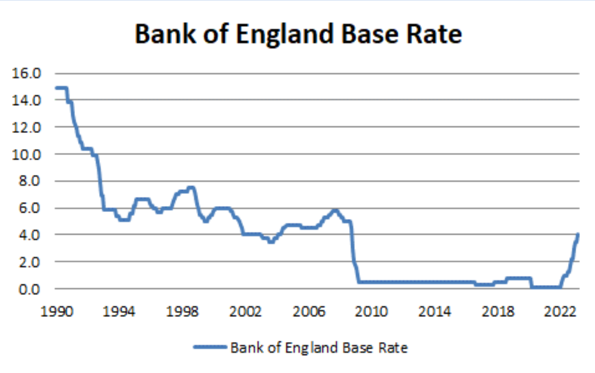
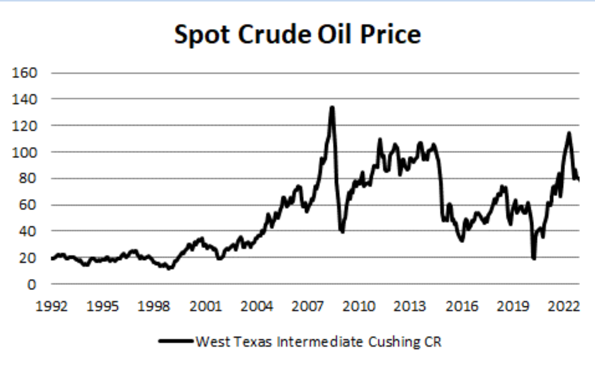


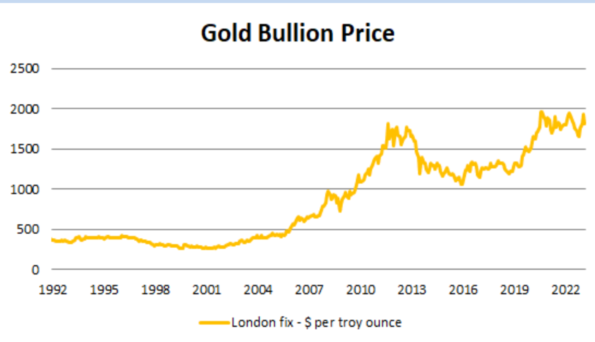
Source: Lipper for Investment Management

Markets are pricing almost 45bp of tightening at the March and May MPC meeting. We forecast that the Bank of England will raise interest rates to a peak of 4.5% this year. Public sector strikes and pay demands risk inflation have become rooted in the UK economy. The Bank of England may see the need to engineer an economic slowdown at a time of a tight labour market and high input prices. We expect the unemployment rate to remain low, wage growth to be high and the recent increases in prices to prove sticky. These will combine to keep inflation pressures elevated for a while and keep the Bank of England on a tightening tack.



Source: Lipper for Investment Management

We assume that the China demand boom and flattish non-OPEC supply will push the market in deficit from June onwards, and lead OPEC to announce a reversal of its production cut at the June meeting. However, three developments tilt the risks to flat OPEC output in H2. First, OPEC leaders emphasize that their October deal is here to stay for the rest of 2023. Second, a medium-term $90/bbl Brent oil price forecast may not be high enough to require a June OPEC response. Third, OPEC pricing power is now elevated, and the producer group has historically responded cautiously to domestic demand pulls out of China. We expect that oil prices will rise gradually to $100/bbl by December.



Source: Lipper for Investment Management

Gold prices have receded in February, undoing much of the gains achieved in January, as the Fed and other central banks again stressed inflation rather than growth risks and reiterated their resolve to continue to hike rates given economic resilient and ongoing inflationary pressures. That, in turn, meant US rates and the dollar were the dominant forces, with rising real rates and a stronger dollar offering no incentive to increase exposure to the yellow metal, leading to further declines in gold ETF holdings by investors. We believe the macroeconomic backdrop is now increasingly bullish gold, given the ongoing growth acceleration in world ex-China, the resulting downward pressure in the US Dollar and a slowing rate hike outlook.

Note that where an MSCI Index has been used for illustration. This has been sourced with permission from MSCI Inc.

Quick facts

ISA Allowance 2022/2023	Stocks & Shares ISA Cash ISA Junior ISA	£20,000 £20,000 £9,000
Pension Allowance 2022/2023	The limit is the greater of £3,600 and 100% of salary, subject to the annual allowance of £40,000 (unless money has been accessed through flexi drawdown in which case the annual allowance is limited to £4,000).	

Tax facts

Income Tax	Personal Allowance 2022/2023	Up to £12,570
	Basic Rate @ 20%	£12,571 to £50,270
	Higher Rate @ 40%	£50,271 to £150,000
	Additional Rate @ 45%	Over £150,000
	Married couple's allowance: Older spouse born before 6 April 1935	Minimum £3,530 Maximum £9,125 Up to 10% of the appropriate Min/Max
Capital Gains Tax	Annual Exemption - Individuals	£12,300
	Basic Rate tax band (residential property)	18%
	Basic Rate tax band (other assets)	10%
	Higher Rate tax band (residential property)	28%
	Higher Rate tax band (other assets)	20%
	Business Asset Disposal Relief	10%
	Business Asset Disposal Relief limit of gains	£1,000,000
Inheritance Tax	Threshold up to £325,000	Nil
	Over £325,000	40%
Corporation Tax	Full Rate	19%
	Small Companies Rate (SCR)	19%

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