Market Commentary – September 2023

Further progress towards economic revival, but no declaration of victory

In the history of mistaken political slogans, one that ranks above most others was the moment when President George W Bush stood on the deck of the USS Missouri and declared the war in Iraq to be over under a banner screaming 'Mission Accomplished'.

Politicians like declaring they have solved problems quickly because they are worried they will be judged by electorates.

However, Central Bankers are different. They are fundamentally academics who worry how they will be judged by history. This means that, when they are tackling a problem such as the current inflation, they are deeply reluctant to claim victory too soon. They would rather wait until the evidence was utterly overwhelming before even hinting they have been successful.

The current battle against inflation has dominated market returns over the past year. For many people there is now clear evidence that the inflationary problem has been defeated. However, there is not yet enough for those Central Bankers, who need certainty before they are willing to begin the process of reducing interest rates and allowing conditions for households to ease.

This gap between good news in the economic and inflation data and the fact that the world's largest Central Bank, the US Federal Reserve, will not yet celebrate it means that markets have seesawed between optimism and pessimism in August.

However, this should not trouble long-term investors. We can see this as part of the normal process of defeating inflation and recognise that it will take time.

So far, the evidence is that not only will the inflation be bought to bear but that it can be achieved without triggering a global recession. Indeed, the general pattern over the first half of 2023 has been one where it seems inflation is falling as expected but economic growth is stronger than many had feared.

Our approach in this scenario has been to build portfolios which stand to benefit from the recovery that can come. However, we are not so naïve as to believe that it will be a smooth process and so we have avoided adding significantly to our allocation the riskiest areas of stock markets, such as smaller companies.

Our portfolios have continued to participate in narrow market rallies as our diverse large-cap equity exposures have benefitted from improved investor sentiment. Our medium-risk and lower-risk portfolios have maintained exposure to government and investment grade corporate debt, which provides protection against a sudden recession.

Overall, we should conclude that the prospects for the global economy have improved and that we are at or very close to the peak of the interest rate hikes that have put such a squeeze on households. As this process runs through and interest rates begin to fall, markets have enormous potential to deliver strong absolute returns.

Falling interest rates enable bonds to rally and companies to deliver stronger earnings. So, whilst this period at the end of rate rises can feel challenging it sets up what we believe to be a positive period for market returns.