3Q 2023 Commentary

The returns from financial markets in the third quarter of 2023 have been disappointing. The quarter started well, with investors enjoying good returns in July as investors focused on encouraging news concerning falling inflation, but, in both August and September, financial markets suffered volatility, and in the month of September the S&P 500 fell by 4.9% and the Nasdaq fell by 5.8%.

The US equity markets have, however, held on to most of their year-to-date gains, and are still being led by a handful of AI and technology sector stocks. In contrast to many developed equity markets, the UK stock market has benefited from rising energy prices, and has not suffered as much volatility in the third quarter as either US or Continental European equity markets.

The US central bank, the Federal Reserve, raised rates in July by 0.25%, and, as was fully expected, the Fed paused at the September meeting. Fed governors are telegraphing that the Fed is likely to raise rates one more time. The Bank of England followed suit with a 0.25% rise in early August and a pause in September. Falls in inflation are being experienced at different rates in global economies, and analysts still expect that a number of Western countries are close to peak rates in this current rate rising cycle.

Wage inflation has been proving sticky and creates a vicious cycle as higher prices result in higher wages which in turn results in higher prices. The most recent US unemployment data (for September) showed solid growth in employment, though the data also, helpfully, confirmed some moderation in wage gains. Energy inflation, which unhelpfully picked up in the third quarter – driven partly by seasonal weather storms and OPEC+ deciding to maintain production cuts – has more recently fallen, due to softening global economic data. Other commodity prices have also recently fallen, and this further eases inflationary pressures, especially on food prices.

China's economic growth continues to disappoint and is hampered by the overhang of difficulties from the domestic real estate market. Chinese commercial banks have lowered interest rates in a bid to stimulate more growth.

Much of the world is forecast to enter a recession, but the US economy is still proving resilient with 2% growth in both the first and second quarters. The US services sector remains in an expansionary mode and the consumer remains reasonably confident. The housing market remains steady, benefiting from the fact that the majority of US mortgages are fixed for 30 years, rather than shorter-time periods (such as in the UK), and therefore US house owners have, comparatively, not been so negatively affected by the increases in interest rates. The mortgage market is forecast to soften in the UK in 2024 and return to pre-pandemic norms. With rises in unemployment expected to be very modest, the vast majority of UK borrowers are expected to be able to keep up with their mortgage payments.

Although there are still many uncertainties, especially concerning resolution to the Russian invasion of Ukraine, and heightened geo-political conflict in the Middle East, risk assets continue to offer attractive opportunities for the longer-term investor. Likewise, following their sharp corrections, certain fixed income assets – especially emerging market debt, whose regions are ahead in the interest rate rising cycle in comparison to developed economies – provide useful diversification, as well as yield, to investor portfolios.

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