HYMANS ROBERTSON
INVESTMENT SERVICES

Hymans Robertson Investment Services (HRIS)

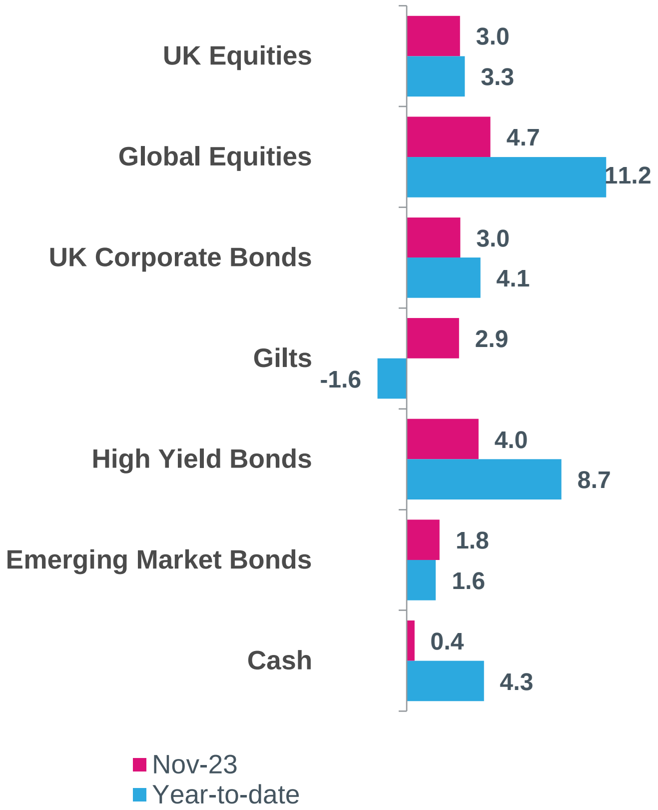
Market Digest

November 2023

Monthly Highlights

- Most asset classes performed strongly in November as positive sentiment drove equity and bond prices higher. Global equities generated 4.7% over the month and are now over 10% up year-to-date.
- Better than expected inflation data from the US, UK, and euro-zone boosted hopes of earlier interest rate cuts next year.
- The Bank of England followed the US Federal Reserve in holding interest rates at the current level at November's meetings.
- Given these market conditions, portfolios typically generated a positive absolute return over the month.

Asset class returns (%)



Source: Morningstar. Figures to 30 November 2023. Returns in sterling terms except High Yield Bonds which are hedged. EM bonds are 50% local currency denominated and 50% US dollar denominated bonds.

Market summary

- Our model portfolios are typically invested in a combination of the asset classes shown in the left-hand chart.
- Markets enjoyed a strong month of performance in November after continuing signs of easing inflation across developed economies. This strengthened the consensus that we have reached peak interest rates, while also increasing the expectations of earlier cuts to rates next year.
- Global equities, in particular, performed well and would have generated returns of almost 10% if it were not for a weaker US dollar. However, the UK equity market continued its relative underperformance year-to-date as lower commodity prices hurt the materials and energy-heavy index.
- In the UK, inflation fell significantly to 4.6% in October. This encouraged the Bank of England to hold interest rates level for the second meeting in a row (more details overleaf).
- The positive sentiment, following easing inflation, also boosted bond prices which rose broadly as yields fell (bond prices move inversely to yields). High-yield bonds performed strongly and remain one of the standout performing asset classes year-to-date. The currency hedging on this asset class contributed here by protecting from potential losses on the weaker US dollar.
- Cash returns on money-market funds remained stable at around 5.25% p.a. following the Bank of England's decision to hold rates, and therefore lagged behind other asset classes.
- At a portfolio level, equities outperformed bonds meaning higher risk portfolios outperformed lower risk ones over the month.

Outlook and topical market themes

- The Autumn Statement had a limited long-term impact on markets but a small increase in government bond yields on the day is a reminder that fiscal prudence is still important.
- UK inflation fell by 2.1% to 4.6% in October thanks to less energy price inflation. The market now believes we have reached peak interest rates, which has increased the hope of rate cuts next year.

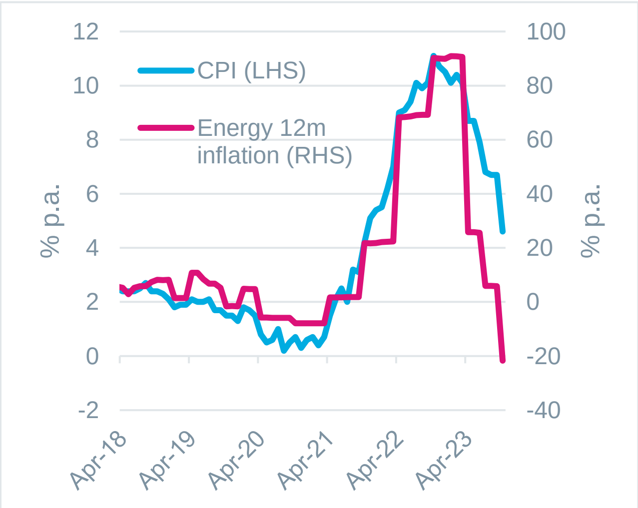
Autumn Statement highlights that the bond markets still desire fiscal prudence

Last year Liz Truss learnt a painful lesson around fiscal prudence. After her and then Chancellor Kwasi Kwarteng's "mini-budget" the pound and UK government bonds crashed in price. Last month's Autumn Statement was much more of a non-event in terms of market movements. However, the Chancellor's rabbit out of the hat moment to cut National Insurance by 2% caused a small spike in bond yields by around 0.1% (bond prices fell) within minutes of the announcement. It will have been a useful reminder for the government that the bond markets might not tolerate a more comprehensive pre-election tax giveaway next Spring, especially if the Bank of England is still a long way off their inflation target. A surge in bond yields that pushes mortgage rates higher would offset any goodwill from voters for the tax cuts, as Truss found out last year. Don't test the bond market!

Has inflation been contained?

UK inflation fell significantly in October - from 6.7% to 4.6%. This large drop was mostly expected, as October 2022's considerable increase in energy prices fell out of the annual figure. Even with this, the figure was 0.2% lower than forecasted. In addition, other key inflation metrics such as core inflation (which excludes energy and food) fell 0.4% to 5.7% and services inflation fell 0.3% to 6.6%. The Bank of England will be especially pleased with the latter two figures but will also appreciate that inflation is still over double their target. We've seen a lot of rhetoric from central bankers cautioning that interest rates will have to be held persistently high until they have more confidence of meeting their 2% targets. Despite this, investors have brought forward expectations of a rate cut, from next autumn, to summer. Most of the global factors that initially drove inflation are reversing. Even domestic drivers of inflation, like the labour shortage in the UK, are fading albeit slowly. We therefore believe inflation will continue to fall back to target but that the Bank of England will want to see further signs that inflation won't bubble back up before we see interest rate cuts.

Chart of the month – Energy has changed from an inflationary to deflationary driver



Source: ONS. Electricity, gas and misc. energy inflation with UK CPI

Since October 2021, gas and electricity prices have been one of the largest contributors to high inflation in the UK. This was exacerbated after Russia's invasion of Ukraine and peaked at around 90% earlier this year.

Recently though, energy prices have been falling, putting a key driver of inflation into reverse. This has been one of the biggest reasons inflation has fallen rapidly this year. The downward effect will also start to fade soon though, meaning the final step to reaching the inflation target may be the hardest.

Jack Richards
Investment Manager