HYMANS ROBERTSON
INVESTMENT SERVICES

Hymans Robertson Investment Services (HRIS)

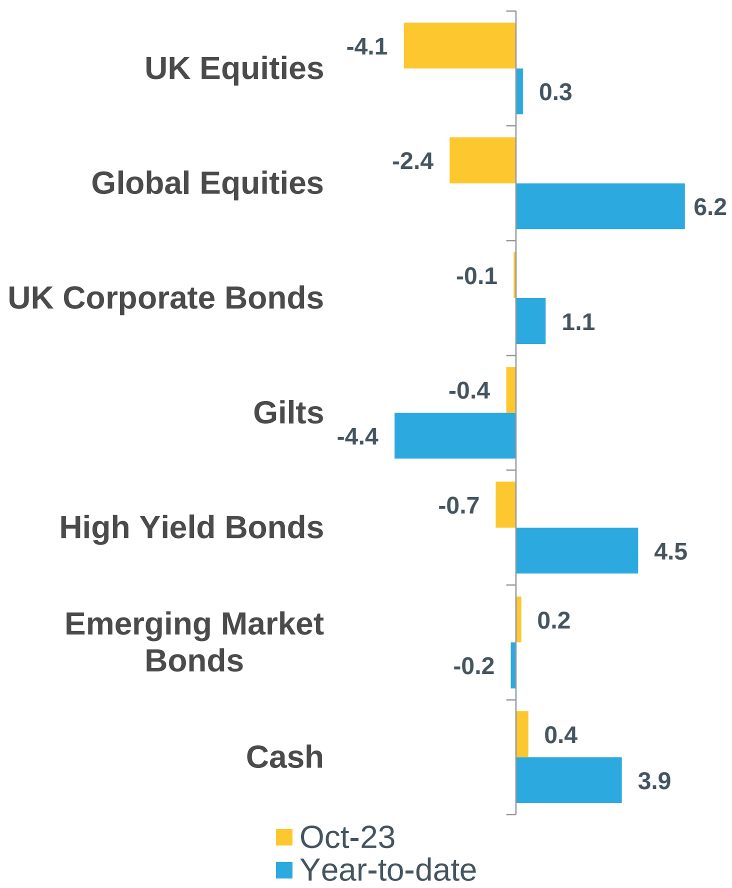
Market Digest

October 2023

Monthly Highlights

- October brought negative returns for the majority of asset classes, especially equities as market sentiment was impacted by events in Gaza.
- Central banks continued their “higher for longer” messaging; as a result bond markets adjusted their expectations leading to higher yields which hurt prices (prices fall as yields increase).
- Given these market conditions, portfolios typically generated a negative absolute return over the month. Despite falling, bonds fared relatively better than equities over the period, dampening losses for lower risk portfolios.

Asset class returns (%)



Source: Morningstar. Figures to 31 October 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 fell back in October as geopolitical uncertainty rose following a terror attack (and the resulting conflict) in the Middle East. At the same time, messaging of “higher for longer” interest rates from Central Banks pushed up bond yields.
- In the UK, inflation remained steady at 6.7% in September. This stagnation was contrary to expectations of a fall and was mostly driven by higher-than-expected services inflation.
- The Bank of England didn’t meet in October but held interest rates at 5.25% at their meeting on 2nd November.
- The UK equity market, with its above average exposure to energy and materials, underperformed as such sectors struggled amidst signs of further weakness in Europe and China. The US, however, outperformed given the continued outperformance of the technology sector.
- A rise in bond yields and credit spreads (i.e. the level of additional yield you get from investing in corporate rather than government debt) led to negative total returns in UK and US investment-grade corporate bonds.
- At a portfolio level, bonds outperformed equities meaning lower risk portfolios outperformed higher risk ones over the month.

Outlook and topical market themes

- US economic strength continues although concerns are surfacing about the level of government debt. Both have had implications on the US bond market. In our bond portfolios, we retain a bias towards short-dated bonds, as they offer attractive yields and lower levels of volatility than longer dated peers.
- October saw the outbreak of conflict in the Middle East which has the potential to have broad investment impact and acts as (yet another) reminder of the need for portfolios to be well diversified.

Bond yields push ever higher

Although there were no interest rate increases in October among the Developed World's major central banks (neither the Bank of England nor the US Federal Reserve ('the Fed') met last month), this didn't stop bond yields continuing to rise, weighing on bond prices. The US 10-year Treasury bond yield briefly breached the symbolic 5% level before falling back. Investors are looking at two key drivers for the continued drive up in bond yields. Firstly, the US economy's resilience continues to confound investors. Despite widespread expectation that higher interest rates would lead to a slowdown, recent data showed the US economy accelerated to a 4.9% annualised rate in Q3. A stronger economy may require the Fed to keep rates higher for longer. Secondly, there is ongoing concern about the size of the Federal government's deficit which could lead to a large amount of bond issuance. The budget deficit over the last year has been around 7% of GDP. The government will need to continue to offer attractive rates to entice the required level of demand.

Conflict emerges in the Middle East

The outbreak of conflict in the Middle East is first and foremost a humanitarian tragedy and a peaceful resolution is at the top of everyone's priorities. But it has also exposed a potential risk to investors. With the region being a large producer of crude oil and other fossil fuels, an increase in tensions may lead to supply disruption, pushing up the price of oil, complicating the inflation picture. The oil price jumped from $84 to $88 the Monday after the attack on Israel and rose as high as $94 over the next few days before falling back recently. As long as the conflict remains isolated to Israel and Palestine the long-term impact should be minimal but a wider escalation, dragging in larger oil producers like Iran and Saudi Arabia, could have a larger impact. In terms of direct exposure, Israel will typically make up a very small proportion of portfolios, less than 0.2% for a medium-risk investor.

Stat of the month –US budget deficit

8%

US Government budget deficit as a % of GDP

The US budget deficit is poised to exceed 8% of Gross Domestic Product this year, that is according to the IMF. On a forward-looking basis it is expected to remain above 7% over the next 5 years.

This compares to the historical average of 3.6% of GDP between 1973 and 2022.

Source: Financial Times

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