MARKET COMMENTARY

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Executive Summary

Following a strong opening month of the year, February saw a modest decline for both global equity and bond markets. Despite broadly resilient economic data throughout the month, this was viewed by investors as a sign that the economy is not yet in recession and that further interest rate increases from central banks are likely. The upshot is, of course, that the prospect of subsequent rate cuts and target inflation levels appear to be further away than previously anticipated.

All three major central banks, namely the US Federal Reserve (Fed), the Bank of England (BoE), and the European Central Bank (ECB) raised interest rates in line with expectations during the month, citing that inflation levels remain too high despite the apparent decline since last year. This weighed heavily on investor sentiment throughout the month, dampening the more jovial mood witnessed in January.

UK Markets

Of the major equity markets, the UK returned some of the strongest numbers. The gains were driven by large-cap stocks (+1.35%), with notable sector contributions from energy, telecommunications and healthcare, outperforming mid-caps (+0.25%) and small-caps (-0.6%). Whereas the performance of most other sectors was relatively flat, there was a significant depreciation for basic materials (-9.1%) from an all-time high for the sector in January. The latest figures showed that UK inflation reduced to 10.1% from 10.5% in December, representing the third consecutive monthly decline. Economic data remained robust, with significant improvements in manufacturing and services output and figures from the Office for National Statistics confirming that UK GDP remained in positive territory during Q4 2022, despite weakening in December. Unemployment remains historically low at 3.7% and wage growth figures came in 6.7% higher than a year previously.

US Markets

US equities recorded marginal losses, with the three major markets contracting -2.64% on aggregate. This comes even after a significant outperformance of the ‘growth’ stocks that typically dominate US large-cap markets over more ‘value’-oriented names year-to-date. I wrote last month that, whilst investors may have started the year in a cautiously optimistic mood, interest rate uncertainty is likely to dictate market behaviour for some time. Despite registering a seventh monthly decline, the latest US inflation figure (6.4%) was higher than expected. The Fed raised rates to 4.75% at the beginning of the month and went on to reiterate that inflation is still significantly elevated and that further rate hikes will be required, hinting that rates could well remain higher for longer. Economic data remained strong, with retail sales figures for January showing a 3% increase from the month before, and the US Non-Farm Payrolls report indicating that more jobs were added to the US economy than in any month since July 2022

European Markets.

After a significant rally in January, European equities registered another positive month, returning 0.84% on aggregate. Eurozone inflation declined for the fourth consecutive month to 8.5%, one-fifth lower than its October 2022 peak. The ECB continued with its more recent hawkish rhetoric, raising rates by 50 basis points and reiterating its stance to continue with its hiking cycle until inflation returns to the 2% target level. I wrote last month about how a mild winter and subsequently lower energy prices have quelled fears of a deep European recession somewhat, with sentiment towards the region improving from last year’s lows. Further evidence to support this observation emerged during February, with a pickup in manufacturing and services output, highlighting that January experienced the strongest expansion since May 2022. Despite the ongoing conflict in Ukraine, which reached its one-year anniversary during the month, Europe has been the best-performing region by some margin year-to-date.

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Asia & Emerging Markets

Despite Japanese equity markets registering marginal gains in local terms, the depreciation of the yen during the month resulted in marginal declines for sterling investors. Inflation levels continued to climb, reaching a 40-year high of 4.3%. Corporate earnings announcements were generally mixed, with domestically oriented firms benefiting from a rebound in Japanese tourism from overseas, and exporters experiencing headwinds from the depreciating currency. Following last month's enthusiasm surrounding the reopening of the Chinese economy, there were declines for major markets in both China and Hong Kong courtesy of rising geopolitical tension and profit-taking by investors after January's rally. This contributed to a poor month for emerging markets more broadly, which also saw losses in other major constituents such as Latin America and India, with concerns over inflation and market valuations weighing on the latter in particular.

Fixed Income

The move higher in interest rates from central banks meant higher bond yields globally, with the aggregate index declining -1.7% in sterling terms. The macroeconomic backdrop of robust consumer demand and spending has meant that inflation remains high in most major economies and thus requires interest rate policy to be more aggressive and to last longer than investors had previously hoped. As a result, February saw a reversal of the bond rally that began in October, with negative returns across the asset class. Except for Japan, all major government bonds experienced a poor month, with Gilts a notable laggard, down -3.6%. Credit markets marginally outperformed, with global high-yield bonds faring better than their investment-grade counterparts. UK direct property remained flat throughout the month, while listed property and infrastructure, unsurprisingly given their correlation to equity markets, contracted by -2.58% on aggregate.

Commodities

Finally, it was a poor month for commodity exchanges, with losses across the asset class. Notable detractors came from metals, with both industrial and precious components registering losses. Fears of a slowdown in demand for industrial metals such as aluminium, nickel and zinc saw prices move lower. Energy prices generally declined too. Although the price of natural gas increased marginally from January, levels remained relatively suppressed after the mild European winter. The price of oil remained flat, however, there were losses within agriculture, with corn and wheat prices depreciating significantly. The month also saw the European Commission announce proposals for their heavily revised 'Green Deal Industrial Plan', which aims to increase manufacturing productivity for greener alternatives, with the ultimate goal being to meet long-term regional climate targets.

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