MARKET COMMENTARY

Executive Summary

The somewhat surprising risk-on sentiment seen so far this year continued during July, supported by a notable markdown in inflation for some of the major developed economies.

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Global Equities

Global equities finished the month with gains in every major region, returning 2.2%, outperforming global bonds, which returned -0.5% (both in sterling terms). Several tailwinds contributed to the performance of equity markets during the period – with the notable continued decline in the rate of inflation and a series of improved GDP forecasts further fuelling hopes for a ‘soft landing’ in the US in particular. The anticipation among many investors is that the US Federal Reserve (Fed) have, at least for now, dealt the economy their final, or at least penultimate, interest rate rise. Whilst there has been little signalling from the Fed that its 18-month-long hiking cycle is officially coming to an end, the reduction in US headline inflation from 4% to 3% year-on-year buoyed investors’ hopes that the Fed’s action thus far has all but done the trick to control previously spiralling costs, paving the way for interest rate cuts in the not-too-distant future. However, Fed Chair Jerome Powell maintained a cautionary tone, particularly given that core inflation (which excludes highly volatile factors such as food and energy prices) remains at 4.8%. GDP data released during the month showed preliminary growth of 2.4% for Q2, beating both market expectations (1.8%) and Q1’s figure (2.0%), further increasing the case for a less pronounced market ‘correction’ in the US than previously feared.

US Markets

July saw an aggregate return of 3.4% across the three major US stock markets, with gains widespread among all major sectors. A notable feature of the month, however, was the outperformance of ‘value’ stocks over their ‘growth’ counterparts, in what was very much a reversal from the year-to-date trend. Upbeat economic data for things like consumer spending activity and retail footfall has led to a fear that despite the Fed seemingly being towards the end of their hiking cycle, rates may need to remain elevated for longer than anticipated before they can realistically be cut. This weighed on growth-oriented areas of the market, in addition to other factors, such as profit taking from sectors such as mega-cap technology following an exceptionally strong (albeit narrow) H1, as well as significant contribution from certain ‘value’ sectors during the month, such as financials and energy. Sentiment towards the US from major global allocators remained relatively neutral during the month, citing drivers such as resilient economic data and ahead-of-consensus GDP growth, but also questioning the valuations of certain areas of the market and in particular whether or not they have priced in enough macroeconomic pain for the forthcoming 12 months. The Fed doesn’t appear to share the same level of optimism as some investors yet and is seemingly committed to doing everything they can to get inflation levels back down to target. Labour market data from the nonfarm payrolls announcement in July indicated a robust yet slightly more subdued picture, with unemployment remaining close to five-decade lows, but only 209,000 new jobs added – below consensus and the lowest monthly figure in over a year.

Other Developed Markets.

There were also strong gains in other developed markets, with the UK among the major winners during the month. The risk-on theme was buoyed by lower-than-expected inflation data (7.9% down from 8.7%), which saw UK small (+3.2%) and mid-cap (+3.9%) indices outperform their large-cap (+2.2%) counterparts. Despite the positive inflation surprise, it remains very high, meaning the Bank of England will likely continue with its mission to control prices in the form of several more interest rate hikes between now and the end of the year. UK economic data was mixed, with weak manufacturing output data and muted GDP growth forecasts, but relatively positive wage growth figures. In Europe, there were aggregate returns of 1.8%, buoyed by a second consecutive month of inflation contraction (5.5% down from 6.1%). Although this was in line with consensus and there was an inflationary upside surprise in April, the latest figures now represent nearly half the level reported in October 2022. This trajectory, as well as a series of weak economic data releases, have meant that a temporary pause in the current rate hiking cycle is now a real possibility. Similarly, Japanese equities gained 1.8% during the month and remain the best-performing region year-to-date. The Bank of Japan surprised investors towards the end of the month by unexpectedly altering yield curve control policy again – essentially tightening policy (more aligned with other developed markets). Inflation remains under a semblance of control at 3.3% - a marginal increase from 3.2% the month before but comfortably below estimates of 3.5%.

Asia & Emerging Markets

It was an exceptionally strong month for Asian and emerging markets, outperforming developed markets considerably. Aggregate Asia-ex Japan returns were 4.9%, boosted by significant gains in China. Despite evidence in Q2 depicting a weakening post-reopening economy, the low inflationary environment and supportive government policy thus far led to hopes of further stimulus and a continued easing of policy in the not-too-distant future. Although returning 9.4% during the month, Chinese equity returns are still in negative territory year-to-date following a disappointing H1. Obvious headwinds remain too, such as market valuations and ongoing geopolitical tension. There was also the positive contribution from other Asian markets, such as Hong Kong, South Korea, India and Taiwan. Emerging markets returned 5.0% on aggregate in July, helped by Asia's significant weighting within the asset class. There was also a favourable gain in sentiment from investors, given appealing valuations and near-peak interest rate cycles. One of the attractions for investors this year has been the fact that many emerging nations experienced (in some cases extreme) inflation before developed markets did and are a) further down the line in controlling it, and b) arguably more used to navigating high inflationary environments. In addition to contributions from the aforementioned Asian markets, there were also positive returns from Brazil, Chile, Mexico, South Africa, Saudi Arabia and the United Arab Emirates. The rally now places Asian and emerging markets ahead of the UK year-to-date, both producing high single-digit returns thus far.

Fixed Income & Other Asset Classes

Given the arguably surprising risk-on backdrop year-to-date, bonds continued to underperform equities. High-yield bonds (that is those with a lower credit quality rating) were among the better performers, typifying a month where risk assets generally outperformed. The same could be said for corporate bonds, which broadly outperformed their government-issued counterparts. From a regional perspective, emerging market debt was among the best performing in corporate and the UK was a rare winner among government debt. It was a relatively eventful month for commodities, where prices regained some of their H1 losses. The aggregate index was up 9.4% during July, helped by a rally in energy (with the exception of natural gas) and agriculture prices – Russia's decision to withdraw from the Black Sea grain export deal created a sharp increase in the price of wheat. Despite us recently reporting on the global slowdown in demand for new manufactured goods, July saw solid gains for industrial metals, such as copper, nickel and zinc. Prices of precious metals also rose, with gold returning 1.4%, silver 7.7%, platinum 4.2% and palladium 3.6%. Finally, there were positive returns for UK commercial property, with marginal (+0.1%) gains for direct property and strong gains for listed property – the sector that includes vehicles such as Real Estate Investment Trusts – up 3.3%, mimicking the trend of the UK stock market.

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