MARKET COMMENTARY

Executive Summary

Despite the apparent lack of obvious tailwinds for global economic growth, May offered investors a second consecutive month of relative calm following March's demise of Silicon Valley Bank and Credit Suisse.

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Global Equities

Global equities finished the month in positive territory, returning 0.6%, broadly outperforming global bonds, which returned -0.7% (both in sterling terms). Gains were fuelled in part by the prospect of developments in AI (or Artificial Intelligence) – or more specifically, the potential efficiencies it could bring for businesses in the future. US Chip maker, Nvidia, was one notable beneficiary, seeing its market value reach $1 trillion during the month. Not for the first time this year, the month was characterised by mixed, yet broadly robust economic data despite the uncertain outlook for the period ahead. As consumers continued to face an inflated cost of living, markets were left to grapple with any subsequent fallout from fluctuating interest rate expectations. The US Federal Reserve's (Fed) latest 'dot plot' (that is the chart they use to record official projections for their key short-term interest rate) suggests that the latest rate hike (to 5-5.25%) on 3rd May would be the last this year, followed by a pause, but with no cuts expected this side of Christmas. Almost as an aside to the headlines, but arguably of at least equal importance, is a backdrop that has provided the fastest money supply contraction in the US since the 1930s. The month ended with the somewhat controversial passing of a bill to raise the country's debt ceiling for the next two years. If approved by the Senate in June, the bill will essentially allow the US government to continue to meet its debt obligations without default – with any alternative scenario virtually unthinkable.

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US Markets

Although broadly out of favour with some of the biggest global asset allocators in the world, the US was one of the standout contributors for global equities during the month. There was an aggregate return of 3.1% across the two major US markets, with a notable divergence between market constituents. Whilst several large technology names, such as Nvidia (+36.3%), Microsoft (+7.6%) and Apple (+5.2%) provided strong returns, some of the more cyclical and traditional bellwethers, such as Nike (-17.3%) and Walt Disney (-12.6%) suffered. It might be a surprise to some, but in a way, this typified the dominance of ‘growth’ stocks over their ‘value’ and, to an extent, their ‘quality’ counterparts, year to date. In a reversal to last year, the former has significantly outperformed so far in 2023, albeit fuelled by pockets of the market that are arguably reliant on the prospect of cheaper financing costs in the not-too-distant future. Economic data continued to point towards a pending downturn, with evidence of only a marginal slowdown in inflation (from 5.0% to 4.9%) and the thus far relatively robust labour market also showing signs of weakness. Examples included wage growth contraction in the construction sector, a reduction in overtime hours on offer and dwindling excess household savings. The year-to-date (to end of April) also represents the highest level of US corporate bankruptcies since 2010.

Other Developed Markets.

Elsewhere in developed markets, Japan was the other significant contributor, with the two main indices returning an average of 5.3% for the month. Both are now trading at highs not seen since the 1990s, driven largely by underappreciated valuations, a weakening yen and a return of meaningful inflation. The rally has not been limited to domestic investment either – with April 2023 seeing the largest amount of overseas investment in a month since October 2017. In a reversal of fortunes from the first four months of the year, European equities weakened, with losses in major markets such as France (-5.2%) and Germany (-1.6%). Partly to blame was an upside surprise in headline inflation, which increased for the first time since October 2022, to 7%. This was swiftly followed by another (anticipated) 0.25% interest rate rise from the European Central Bank. Market performance in the region remains strong year-to-date, however, as with the US, there are signs of weakening economic data, such as a

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contraction in demand for goods, consumer confidence and manufacturing output, which fell to its lowest level since 2020. Despite a significant reduction in UK inflation (from 10.1% to 8.7%), the level was still higher than anticipated, all but confirming another interest rate rise (to 4.25%) from the Bank of England. Even though this contributed to UK equities being a major detractor, with the main index returning -5.3%, market valuations remain elevated following last year's value rally, trading at pre-pandemic level.

Asia & Emerging Markets

We reported last month that following a strong start to the year, economic data in China has started to weaken. The recovery post-lockdown has been rather more subdued than anticipated, with geopolitical tension and a slowdown in activity generally weighing on markets. There is also evidence to suggest that any recovery in the Chinese property sector – an industry that is linked to circa 35% of national GDP – is also proving more sluggish than hoped. There was positive contribution in the region from other national indices, particularly those with a high exposure to the technology sector, such as Korea and Taiwan. On aggregate, Asian equities (excluding Japan) returned -0.4% during the month for sterling investors. China's significant (31%) weighting in emerging markets restrained the performance of the asset class more broadly, however elsewhere there were positive returns from other significant constituents, such as Brazil and India. After being largely out of favour with investors during Q1, the latter has experienced a much brighter start to Q2, rallying 6.2% thus far. Whilst market valuation concerns remain, a series of domestic growth forecast upgrades helped improve sentiment towards the region. There were marginal declines in Chile, Saudi Arabia and Mexico, however the latter remains a standout performer year-to-date, up 16.7% regardless of May's performance.

Fixed Income & Other Asset Classes

Despite the apparent litany of tailwinds for fixed income as an asset class this year, they underperformed their equity counterparts during May. High Yield (that is those with a lower credit quality) were among the better performers throughout the month, typifying a month where higher risk assets outperformed. Returns of both corporate and government bonds were broadly mixed, and typically varied by region. Emerging market and US debt were among the standout performers, with the UK a notable laggard after inflation figures pushed yields higher (and therefore prices lower). Whilst UK direct commercial property registered marginal gains during the month, listed property (such as Real Estate Investment Trusts) mimicked the underperformance of UK equity markets. There was also widespread weakness in commodity markets, with the aggregate index down -4.8% during the month. There were sizeable declines for both the price of oil and natural gas, as well as poor returns for industrial metals, with the cool off in global demand for goods and weakening manufacturing output weighing on the prices of materials. The performance of precious metals was varied but also poor, with gold finishing the month flat, but silver (-4.7%), platinum (-6.6%) and palladium (-9.1%) all suffering.

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