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Market Pulse

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STOCK MARKETS LOWER ON ‘HIGHER FOR LONGER’ RATE EXPECTATIONS

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Global stock markets were weaker in August, dragged lower by broadly resilient economic data and the potential for interest rates to remain high in 2024. In macro terms, market participants continued to see signs of a ‘soft landing’ – an economic slowdown without a recession – in the US, as activity data was robust and core inflation fell. Evidence of slowing remained in the eurozone and China, however. Core inflation measures decelerated in July in both the US and the eurozone, but officials from the US Federal Reserve (Fed) and the European Central Bank (ECB) spoke of the need to keep policy restrictive to tame inflation. Bond markets were up slightly as carry from higher yields compensated for rate markets pricing in higher policy rates for longer. The US dollar was stronger as America’s economic data continued to outperform that of other major developed economies.

US inflation

US consumer-price inflation accelerated to 3.2% year-on-year (y/y) in July, from 3.0% in June. However, this was partly due to base effects, as July 2022 was near the cycle’s peak in inflation, and the latest figure was lower than expected. Moreover, core prices decelerated to 4.7%, the lowest since October 2021.

Despite this, rhetoric from Fed officials continued to suggest caution around inflation being tamed. Indeed, minutes from the Fed’s July meeting – when the federal funds rate was raised by 25 basis points (bps) to a range of 5.25-5.50% – stated that “most” monetary policy members saw “significant upside risk to inflation, which could require further tightening of monetary policy.” Fed Chair Powell’s speech towards the end of August at Jackson Hole was somewhat hawkish too, suggesting that the central bank remains focused on getting inflation down. Powell said: “We are prepared to raise rates further if appropriate, and intend to hold policy at a restrictive level until we are confident that inflation is moving sustainably down”.

US economy

Economic data in the US continued to show resilience, with the labour market remaining strong. July non-farm payrolls showed that 187K jobs were added in the month. Average hourly earnings rose by 4.4% y/y, above the projected 4.2%. In addition, strong July retail sales, which rose by a greater-than-expected 0.7% month-on-month (m/m), were suggestive of robust household demand. The control group (which goes into calculating GDP) rose by 1.0%. US purchasing managers indices (PMIs) fell, with the manufacturing index at 47 and the services index at 51. The composite PMI remained in expansionary territory, at 50.4. (A PMI above 50 suggests output expansion, whereas below 50 suggests contraction.)

Europe

Eurozone activity data has continued to disappoint. The composite PMI for August fell to 47, the lowest in 33 months, while German business confidence fell to the lowest in 10 months. Indeed, retail sales for the eurozone fell by 0.3% m/m in July and below the expected rise of 0.2%. Overall, these datapoints were indicative of slowing activity in the region.

Price pressures are still elevated relative to the ECB’s 2% inflation target. Eurozone headline inflation was 5.3% y/y in August, while core prices decelerated from 5.5% in July to 5.3%. The central bank remains focused on reducing inflation. At Jackson Hole, ECB President Lagarde reiterated the ECB’s focus on price stability and that this implied “setting interest rates at sufficiently restrictive levels for as long as necessary to achieve a timely return of inflation to our 2% medium-term target.”

Meanwhile, the Italian government announced a surprise plan of a 40% windfall tax on excess net interest income bank profits in August. However, following an adverse market reaction, the government re-traced somewhat by capping the tax at 0.1% of each bank’s assets in an effort to ease shareholder concerns. The policy moves were viewed as reflective of fiscal positions in the developed world amid wide budget deficits post pandemic and the need to fund increased spending to help with the increased cost of living. Indeed, Italian Prime Minister Giorgia Meloni plans to use proceeds from the tax to support households and small businesses.

Elsewhere, UK data showed continued inflationary pressures. Wages in the three months to June rose by 7.8% y/y while July consumer prices rose by 6.8% y/y (headline) and 6.9% (core), with all data above consensus expectations. Rate markets expect 50bps of further tightening this year from the Bank of England for a peak base rate of 5.75% in the current cycle.

MARKET ROUND-UP

Equities

Global stock markets were weaker in August. The MSCI All Country World index fell by 2.0% (-1.2% in euros) over the month as stocks were dragged lower by broadly resilient economic data and the potential for interest rates to stay high in 2024. The MSCI USA was down by 1.7% (-0.1% in euros); European ex-UK equities lagged, with the economic outlook less supportive, falling by 2.2% (-2.4% in euros).

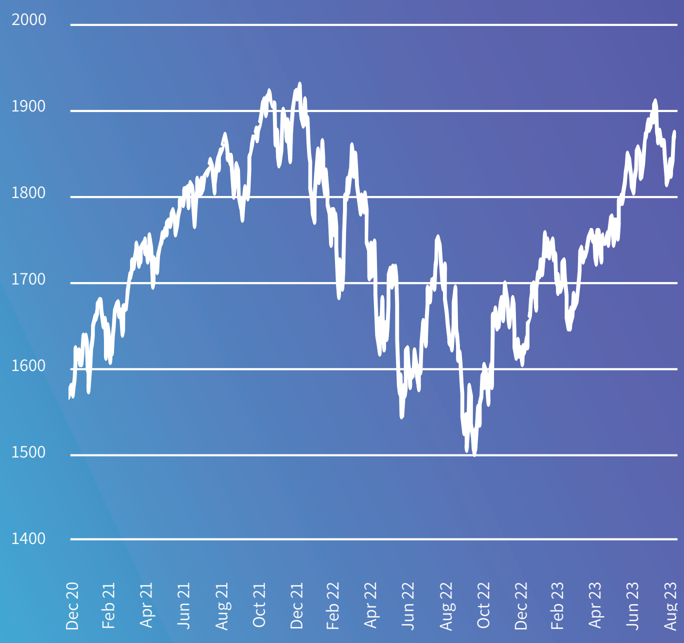
Emerging market (EM) equities underperformed developed markets, falling by 4.7% (-4.6% in euros). The asset class was dragged lower by weakness in Chinese equities, which declined by 8.3% amid continued soft economic data and a lack of significant stimulus measures to support growth. Small cap equities fell by 2.8% (-2.3% in euros) and underperformed large caps as expectations for tighter monetary and credit conditions weighed on smaller companies.

Bonds

Bond markets were close to flat in August, eking out a small gain. Core sovereign bond markets fell for most of the month as a combination of strong activity data in the US and sticky inflation in major developed economies led rate markets to price in higher rates for longer; somewhat softer activity data, however, led to lower yields later in the month. The ICE BofA 5+ Year Euro Government bond index rose by 0.3%. Italian 10-year spreads against Germany widened by 4bps to 165bps, while Spanish spreads narrowed marginally by 1bp to 102bps.

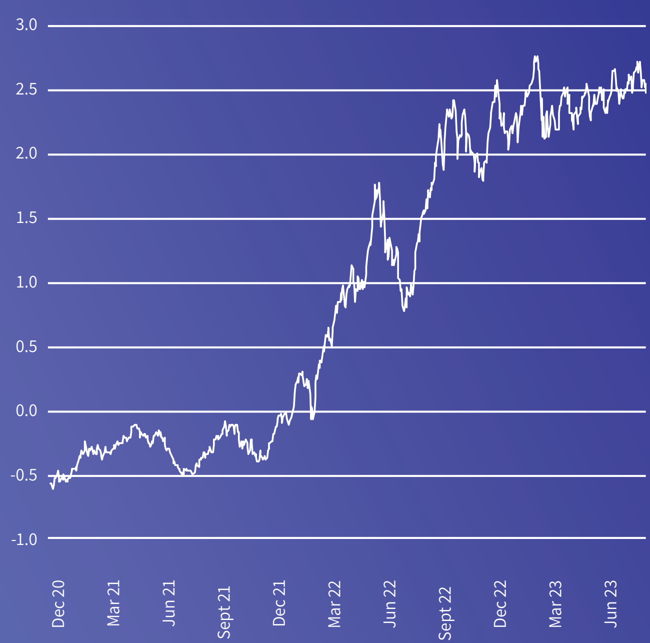
CHARTS OF THE MONTH

Global Equities



Source: ILIM, Bloomberg. Data is accurate as at 31 August 2023.

Bonds – German 10-year yield



Source: ILIM, Bloomberg. Data is accurate as at 31 August 2023.

MARKET SNAPSHOT

Market returns (EUR)

Equity Markets (EUR)	MTD Return (%)	YTD Return (%)	2022 Return (%)
MSCI Ireland	-2.2	28.9	-21.1
MSCI United Kingdom	-2.5	5.9	1.4
MSCI Europe ex UK	-2.4	12.8	-11.9
MSCI North America	-0.2	16.6	-13.8
MSCI Japan	-0.9	11.9	-10.8
MSCI EM (Emerging Markets)	-4.6	3.1	-14.5
MSCI AC World	-1.2	13.3	-12.6

10-Year Yields	Yield Last Month (%)	2022 Yield (%)	2021 Yield (%)
US	4.11	3.87	1.51
Germany	2.47	2.57	-0.18
UK	4.36	3.67	0.97
Japan	0.65	0.42	0.07
Ireland	2.85	3.13	0.24
Italy	4.12	4.70	1.17
Greece	3.78	4.62	1.34
Portugal	3.19	3.59	0.47
Spain	3.48	3.66	0.57

FX Rates	End last month	2022 Rates	2021 Rates
U.S. Dollar per Euro	1.08	1.07	1.14
British Pounds per Euro	0.86	0.89	0.84
U.S. Dollar per British Pounds	1.27	1.21	1.35

Commodities (USD)	MTD Return (%)	YTD Return (%)	2022 Return (%)
Oil (Brent)	1.5	1.1	10.5
Gold (Oz)	-1.5	6.5	-0.3
S&P Goldman Sachs Commodity Index	0.6	3.0	26.0

Source: ILIM, Bloomberg. Data is accurate as at 31 August 2023.

THE ILIM VIEW – LOOKING AHEAD

Global equities have proved resilient in 2023 as recession fears have receded and a peak in central bank policy rates has come into view. While global earnings are forecast to be down slightly in 2023 overall, they have held up better than feared at the start of the year as sales have surprised to the upside and the margin squeeze for corporates has been less than anticipated.

Following the gains year-to-date, global equities appear slightly expensive, trading on a 12-month forward price-to-earnings (P/E) multiple of 16.4x against a long-term average of 16.0x. The 12-month forward P/E for the MSCI USA is 19.5x against a long-term average of 17.2x. Equities outside the US offer better value. Europe ex-UK equities trade at a multiple of 12.6x against a long-term average of 13.1x, Japanese equities trade at 15.2x versus a long-term average of 15.5x, while UK equities trade at 10.5x against a long-term average of 12.2x. Emerging markets are trading at 12.0x versus a long-term average of 11.6x. Equities remain expensive against both bonds and cash given the high yields currently available on these assets.

Despite equities appearing pricy, the outlook for the asset class on a 12-month view is positive. Central banks are likely to pivot towards looser policy in 2024 as inflation continues to fall. An increasing probability of a soft landing with a rebound in both growth and earnings in 2024 should also provide support. Over the medium term, the rollout of artificial intelligence (AI) should boost efficiencies and earnings across the whole market and allow equities to trade at higher valuation levels. The ongoing green-related capex cycle could also boost earnings over the medium term. Any short-term volatility in markets is likely to be offset by the above factors, resulting in positive returns on a 12-month timeframe.

THE MONTH AHEAD

SEPTEMBER

MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
	12 GB Unemployment Rate	13 US Inflation Rate YoY	14 EA ECB Interest Rate Decision and Press Conference US PPI MoM US Retail Sales MoM	15 US Michigan Consumer Sentiment Prel
		20 US Fed Interest Rate Decision and Press Conference GB Inflation Rate YoY	21 GB BoE Interest Rate Decision	22 BoJ Interest Rate Decision
			28 US GDP Growth Rate QoQ Final	29 EA Inflation Rate YoY Flash

Source: tradingeconomics.com

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Figures referenced herein have been sourced from ILIM and Bloomberg. Forecast figures have been prepared by ILIM based on reasonable assumptions, internal data and data sourced from Bloomberg.

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