

Hymans Robertson Investment Services (HRIS)

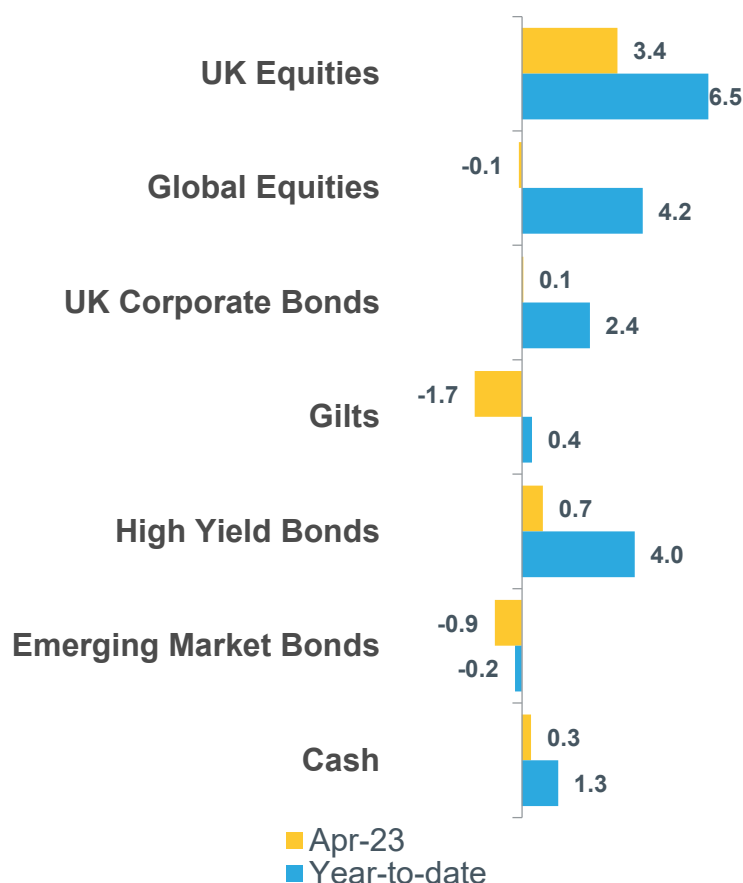
Market Digest

For April 2023

Monthly Highlights

- Asset class returns were mostly flat over the month, with some exceptions.
- UK equities outperformed Global equities, due to large exposure in the energy and financials sectors which performed well.
- Corporate bonds outperformed government debt, which fell in value after interest rate expectations increased.
- UK CPI inflation fell by less than expected from 10.4% to 10.1% in March. Despite a large drop predicted in the April data, the Bank of England is still expected to raise interest rates again in May.

Asset class returns (%)



Market summary

- Economic growth and corporate earnings data, released in April, mostly beat expectations boosting equity markets. However, inflation in the UK fell by less than expected which increased investors' expectations for further interest rate rises.
- First Republic, a US bank, was bought by JPMorgan after regulators placed it under receivership. Although smaller regional banks in the US are struggling with deposit outflows, European and large US banks are reporting bumper earnings.
- Our model portfolios are typically invested in a combination of the asset classes shown in the chart. Global equities were boosted by strong corporate earnings; however, a strengthening of the pound eroded these gains leaving performance flat for the month. The UK equity market was a notable outperformer owing to its large allocation to energy (boosted by higher oil prices) and financials.
- The higher-than-expected UK inflation pushed up bond yields which weighed on gilt prices. Corporate debt fared better, especially High Yield bonds which are less sensitive to changes in interest rates.
- No Bank of England meeting meant base rates remained at 4.25% p.a., keeping cash returns consistent with the previous month.
- At a portfolio level over the month, performance was predominantly driven by equity returns meaning higher risk portfolios outperformed lower risk ones.

Outlook and topical market themes

- First Republic became the next victim of the recent stress in the banking stocks after experiencing large outflows. The financial sector as a whole looks sound, but this is split between smaller US banks that investors and depositors are losing confidence in and the larger firms that are benefitting from this uncertainty through a wave of new deposits.
- UK inflation is falling slower than other countries, but analysis indicates this could be predominantly driven by the UK's energy policy. Inflation is still expected to fall to 3.8% by the end of the year.

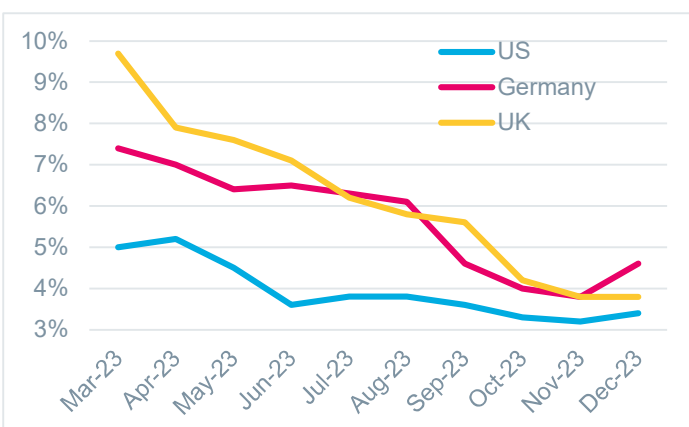
Stress in regional US banks continues

Following the purchase of Credit Suisse by UBS in mid-March there has been a recovery in large European and US banks' share prices as confidence in the banking sector returned to the market. This has been reinforced by strong earnings releases from large British banks such as HSBC and Barclays who have benefitted from the impact of higher interest rates on their profit margin. However, the story is very different for small and mid-sized US banks. When First Republic released their Q1 earnings report at the end of April it proved to be the final nail in the coffin, as it showed the extent to which it had suffered from a large amount of deposit outflows and losses on its bond portfolio. In the days that followed, the bank entered receivership and was bought by JPMorgan the following weekend. There appears to be a dichotomy emerging within the banking sector. British, European, and larger US banks look reasonably solid, but investors still lack confidence in smaller US banks. Exposure to smaller US banks in our portfolios remains low.

UK inflation falling slowly but core inflation is closer to global peers

After an unexpected increase in February to 10.4%, UK inflation fell slightly in March to 10.1%. However, this was still higher than the market forecast of 9.8%. Compared to other countries, the UK's "headline" inflation has remained stubbornly high. Food prices were a major factor behind the recent months' figures, but even the "core" inflation rate, which excludes food and energy, remained high at 6.2%. This suggests that inflationary pressures are becoming entrenched in the economy. When comparing this core figure though, the difference between other countries looks less stark. For example, Spain's headline inflation rate was as low as 3.3% in March, but core inflation was higher than the UK at 7.5%. One contributor to the difference is each country's energy policy. The UK's Energy Price Cap creates stability but also a lag between wholesale and consumer prices. This highlights the difficulty in comparing countries, but it does increase the predictability of the energy price impact on UK inflation. As we already know the energy price for the next few months, we can say with a good level of certainty that there will be a large drop in April inflation, perhaps as low as 9%.

Chart of the month – consensus inflation forecasts



Source: Consensus Forecasts

The left-hand chart shows the average economic forecast for the path of inflation for a selection of countries. As the chart shows, although the UK inflation is currently higher than peers, it is expected to fall more in line as the lagging effect of the Energy Price Cap dissipates. The challenge is, even at year end, it is still expected to be above the Bank of England's 2% target.



Jack Richards
Investment Manager

Risk warning

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