

Hymans Robertson Investment Services (HRIS)

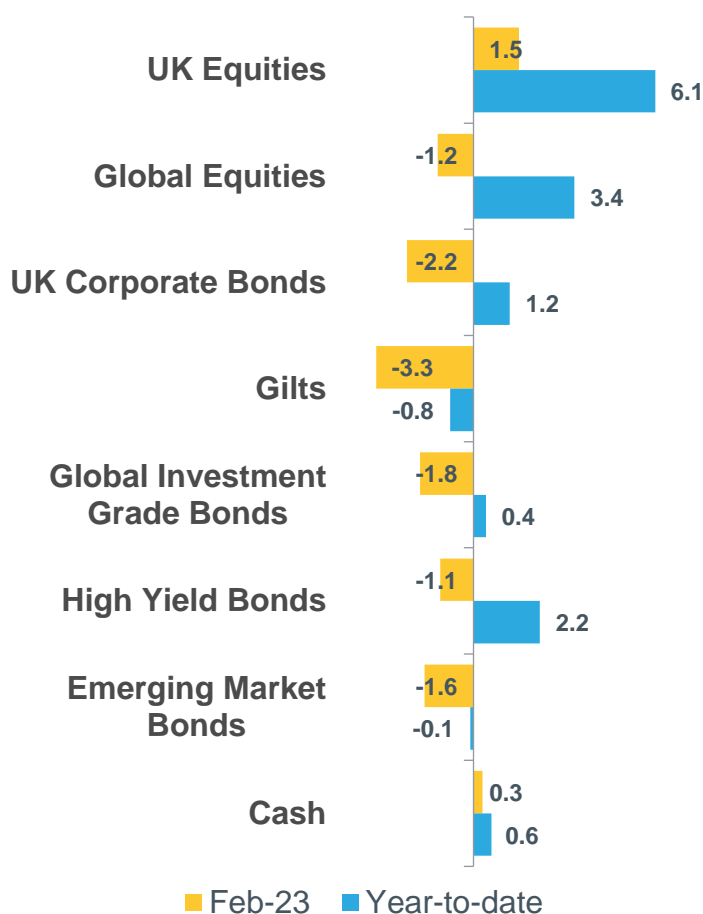
# Market Digest

February 2023

## Monthly Highlights

- Equity markets remain up on the year, but gave back some of their strong returns year-to-date, in February.
- UK CPI inflation fell from 10.5% to 10.1% in January. There were also falls in the US and euro-zone.

## Asset class returns (%)



## Market summary

- The optimistic start to the year had its first test in February, as inflation data showed it might be stickier than was anticipated just a month prior. Perversely, strong economic data in the US concerned investors, as the prospect of additional rate hikes from the Federal Reserve and a “higher-for-longer” rate environment outweighed the economic benefit.
- Our model portfolios are typically invested in a combination of equities and bonds. Over the month global equities fell slightly, however UK and European equities held up better as the economic picture improved somewhat (from a low base). Chinese geopolitical tensions meant Emerging Markets were one of the worst performers over the month as Chinese equities gave up some of the strong returns experienced since the removal of Covid restrictions. Equity markets overall remain up year-to-date.
- Bonds in general fell in value, as a worse outlook on future inflation lifted expectations of further interest rate hikes, pushing up bond yields. With only mild losses, high yield bonds performed strongest, owing to lower interest rate sensitivity, and remain in positive territory for the year.
- The rate hike from the BoE pushed up cash returns, but the Bank also signalled that they were approaching the end of this rate hiking cycle.
- At a portfolio level over February, UK equity and cash positions protected, as did the lower level of interest rate sensitivity in bond allocations. These positions also added value over the quarter so far, as did other “risk” assets such as global equities and high yield bonds, on the back of the improved economic outlook.

Source: Morningstar. Figures to 28 February 2023. Returns in sterling terms except Global IG Bonds and High Yield Bonds which are hedged. EM bonds are 50% local currency denominated and 50% US dollar denominated bonds.

## Outlook and topical market themes

- The average economic forecast expects UK inflation to fall to 4.0% by the end of the year.
- The International Monetary Fund (IMF) forecasts that the UK economy will contract by 0.6% over 2023. However, it is important to remember that markets tend to be forward looking – our long run expected returns on most asset classes are higher than a year ago. Global equities is up to 7.2%<sup>1</sup>.

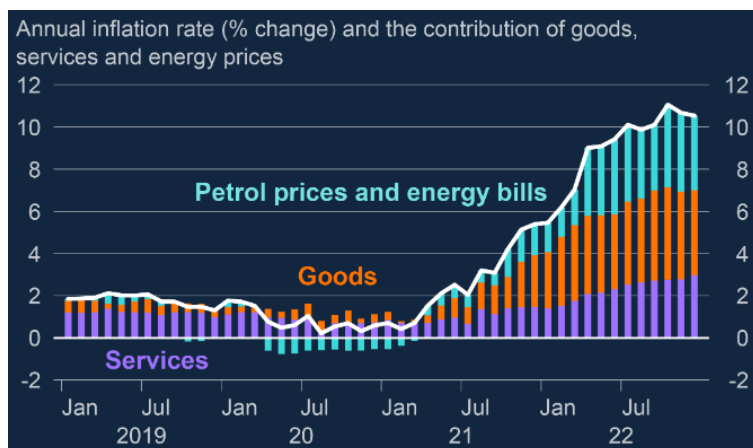
### Has inflation been tamed?

Inflation seems to be on a clear downward trajectory. Even in the UK, where inflation has only fallen by 1% since the October peak of 11.1%, the drop is expected to accelerate as we move into Spring and higher energy prices fall out of the data. How much lower is a more challenging question. Domestic inflationary pressures, such as a tight labour market driving strong wage growth, is sustaining high levels of service sector inflation (see chart below). A more persistent inflation, even at moderate levels of 3-5%, could push bond yields higher or at least sustain them at the current levels. We continue to favour shorter duration bonds with lower interest rate sensitivity for this reason.

### Economic slowdown forecast in the UK

Recent forecasts, from the likes of the IMF, indicate that the UK economy is set for a tough time in 2023, although the picture is less gloomy than expected a few months ago. Recent data, such as Purchasing Managers' surveys, point to some resilience, but the effects of interest rate hikes and higher taxes will continue to feed through to the economy throughout the year. The hope is that if a recession does materialise, tight labour markets and high levels of savings built up through the pandemic, will mean it should be relatively mild. The forward-looking nature of equity markets means that a better-than-expected outcome for the UK could boost domestic asset prices. For more info on the UK economy, please read our latest article.

### Chart of the month



Source: Bank of England

Petrol and Energy's contribution to inflation has started falling and is expected to quickly recede. Goods inflation is following as supply-chain issues abate.

However, Services inflation looks to be more persistent, as the labour market remains tight. This will be the key metric driving the path of Bank of England interest rates going forward.



**Jack Richards**  
Investment Manager

### Risk warning

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<sup>1</sup>Source: Hyman Robertson LLP ESS. The ESS consists of a collection of complex mathematical models designed to produce thousands of stochastic projections of asset class returns and other economic indicators over different time horizons. These future projections of economic variables (including gilt yields) are used across the firm for various risk-assessment applications.