Hymans Robertson Investment Services (HRIS)

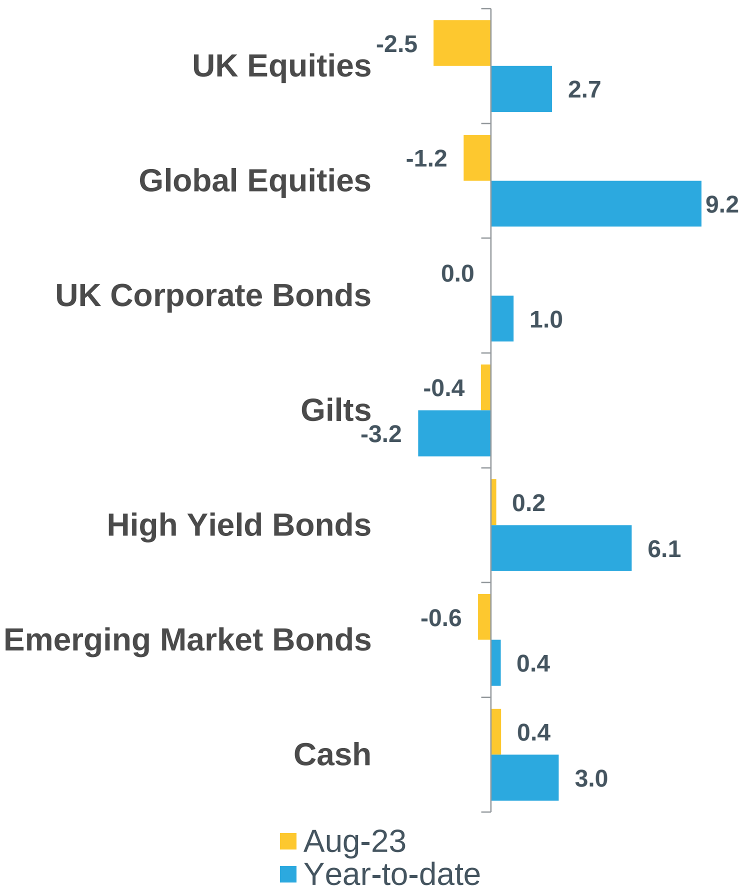
Market Digest

August 2023

Monthly Highlights

- UK inflation fell to 6.8%, in July. However, wage growth reached a new high of 7.8% adding some pressure to the Bank of England to consider further interest rate rises.
- Most asset classes experienced a small pullback in August as investors started to consider the effects of a Chinese economic slowdown.
- Portfolios therefore also generated a negative return over the month.
- Bonds in general held up better than equities over the period, dampening losses for lower risk portfolios.

Asset class returns (%)



Source: Morningstar. Figures to 31 August 2023. Returns in sterling terms except High Yield Bonds which are hedged. EM bonds are 50% local currency denominated and 50% US dollar denominated bonds.

Market summary

- Our model portfolios are typically invested in a combination of the asset classes shown in the left-hand chart.
- Markets gave up some returns in August as signs of a slowing Chinese economy held back returns. At the same time, economic data from the US continued to show signs of strength which pushed up bond yields.
- In the UK, inflation fell significantly to 6.8% in July, from 7.9% in June. However, this drop was in line with expectations and was mostly driven by the lower energy price cap.
- Weak Chinese data and higher bond yields both pushed global equity markets down slightly. Emerging and Asian markets which are more closely linked to China were more exposed. However, the US market held up better after NVIDIA's bumper earnings sustained the AI rally (further comments on next page).
- Although we are nearing the peak in interest rates, strong economic growth and rhetoric from central banks indicated that rates will be held at high levels for longer. This hurt bond prices (prices fall as yields increase).
- The Bank of England increased rates by 0.25% in August to 5.25%, pushing up cash returns.
- At a portfolio level, bonds outperformed equities meaning lower risk portfolios outperformed higher risk ones over the month.

Outlook and topical market themes

- NVIDIA has been the poster child of the AI led stock market boom this year. Their latest earnings release hugely exceeded expectations ($13.5bn sales v $11.2bn expected). However, investors shouldn't get carried away with one company or sector and instead invest more broadly.
- China's economy has disappointed so far this year and even entered deflation. While this has caused market uncertainty, it has the potential to help Western central banks contain inflation.

NVIDIA keeps the economy rolling

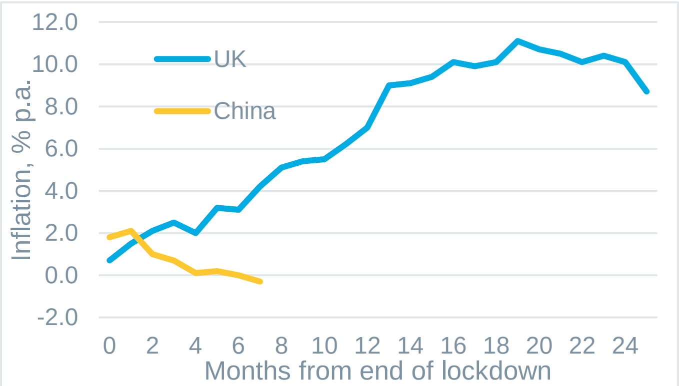
If one company symbolises the stock market rally in 2023, it's NVIDIA. The US firm specialises in designing computer chips that can be used to train artificial intelligence (AI) programmes. Investor excitement for AI exploded after so-called generative AI models were released to the public late last year. This has been reflected in NVIDIA's share price which rose 238% from January to August this year. Investors awaited NVIDIA's Q2 earnings on 23 August with as much anticipation as labour or inflation data. The earnings report showed NVIDIA had generated quarterly revenues of $13.5bn, more than double the same quarter last year. A word of caution, like the onset of the internet, which led to the dot-com boom, it's difficult to discern who will emerge as a new industry titan. For every Amazon (up almost 2,500% from its dot-com peak in 2000) there is a Cisco (still 28% down from its 2000 price). Over the long-term, for greater predictability of outcomes, it pays to stay diversified and gain broader exposure to the market instead of trying to be the hero and find that one stock.

China stutters

Late last year when China finally ended their zero-Covid policy it was expected that its economy would be roaring back into life by now. Instead, weak consumer demand contrasts the surge in spending that Western economies experienced post-lockdown. A property crisis, that has taken large developers like Evergrande to the brink, has continued to drag on the economy. Unlike Western central banks who have been raising rates to fight surging post-lockdown inflation, China's central bank has been cutting interest rates to stimulate the economy - inflation fell below zero in July.

Stock indices with larger exposure to China have already felt the effects of the slowdown. Emerging Markets (EM) equities are down 1.3% so far this year. However, it is important to remember that EM is a varied market with exposure to other parts of the world less dependent on China, such as Latin America. Meanwhile, global equities are up 9.2%, suggesting the impact more widely has so far been limited. One reason for this is the alleviation of a prior concern: the fear that a robust Chinese economy would drive up global commodity prices, exacerbating the inflation problem in Western economies. A slow China has helped central banks, like the Bank of England, in their fight against inflation. Currently, this outweighs the impact of slower global growth in the minds of investors.

Chart of the month – Chinese inflation is an outlier



Source: Office for National Statistics, Statista. End of lockdown is March 2021 for UK and December 2022 for China.

The inflation story in China post-lockdown is completely different to Western economies like the UK. Consumer demand has not bounced back as strongly and the economy is not experiencing the kind of labour shortage we see in the UK, leading to lower inflation.

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