Investment commentary

June 2023

Market overview

Equity markets performed strongly over June with the global index up over 5% in local currency terms, albeit this translated into a c3.5% return for unhedged investors given the relative strength of sterling.

The Japanese market continued to lead the way with sentiment buoyed by the improving economic backdrop, the positive effect of a weak yen on corporate profitability and continued signs that corporate Japan is starting to put greater onus on shareholder value. The US market also performed well and it is encouraging to see market leadership broaden away from 'big tech', which has almost singlehandedly driven the index higher so far this year on the back of strong earnings announcements and excitement around the investment opportunity presented by Artificial Intelligence ('AI'). Corporate earnings growth is slowing across the developed world but, so far, not by as much as was feared coming into this year. The relatively modest earnings downgrades and the degree of resilience the corporate sector is showing is, to date, incompatible with a 'normal' recessionary environment.

US inflation has now come down to 4% and market expectations are that the US Federal Reserve can now (at least) pause its tightening cycle and turn its focus more towards growth rather than inflation concerns. In contrast, above expectation inflation numbers in the UK led to the Bank of England raising rates by a full 50 basis points to 5% and pushed the expected peak rate expectations up to 6%. Unemployment remains low, both in the UK and across the developed world, and wage growth remains strong (7% in the UK), which is continuing to push cost pressure on the services sector. Inflationary pressures are easing quicker in the eurozone than the UK, however the European Central Bank also raised rates by the expected 25 basis points and also highlighted that more tightening may be required. Against this backdrop sovereign bond yields rose (and prices fell), most acutely in the UK.

Central banks will now be closely observing economic indicators to assess the (typically lagged) effect of higher rates and tighter lending conditions. This will continue to add some uncertainty to the future direction of policy.

Strategy positioning

We are maintaining equity market exposures, with the strategies remaining towards the upper end of their corresponding Dynamic Planner risk profile. We are, however, reallocating some exposure towards continental Europe and Japan, slightly reducing exposure to the US.

We believe that valuations in Europe look attractive, economic and corporate data is surprising on the upside, earnings estimates are revising upwards and the energy supply risks stemming from the war in Ukraine have diminished. With regard to Japan we similarly believe that economic fundamentals are improving and that the long-term disinflationary cycle may have come to an end. Valuations look attractive, particularly on a price/book basis and companies are increasingly heeding guidance to prioritise shareholder value via measures such as higher dividend payout rates and increased share buybacks.

Our general conviction in the US dollar is being maintained, although we also see benefit in further currency diversification via the yen and euro as part of this equity reallocation. The yen looks particularly oversold and increased allocations to Japan will hopefully benefit from some currency uplift as Japan's economy gathers momentum and money flows back to the region.

We are maintaining bond market positioning, having increased duration and skewed investments more towards investment grade credit. Whilst default risks have risen, we feel investors are being more than adequately compensated and the outlook for the asset class is improving as inflation recedes and rates plateau.

Risk warnings

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