Wealth Management
Weekly Market Update

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Market Update

Last week, global markets rallied +0.7% as the Federal Reserve announced they would be pausing their interest rate hiking cycle to reassess global economic activity, in a bid to avoid overtightening monetary conditions. US equities rose +0.6%, led by a rally in growth stocks as the tightening cycle in the US appears to be coming to an end. Equity markets in other Western economies followed suit, despite wrestling with a weakening growth picture and more entrenched inflation. European equities rose +1.3% in GBP terms as the ECB raised interest rates to 3.5% in a bid to tackle increasingly embedded wage inflation, a phenomenon unfamiliar to the vast majority of ECB board members. UK equities also rallied +1.1% despite the Bank of England struggling to get a hold on inflation thanks to a very tight labour market. UK gilts also reacted to the hawkish rhetoric of the BoE, with the yield on 10-year UK government bonds rising +17 bps; a proportionate yet more marked movement than the US 10Y Treasury yield, which rose just +2bps to 3.77% last week. Sterling also strengthened, with GBP/USD rising +2.0% last week. Japanese equities were the main outlier last week, falling -0.7%, thanks primarily to a combination of strong Sterling and a weak Yen.

UK Stocks	US Stocks	EU Stocks	Global Stocks	EM Stocks	Japan Stocks	Gilts	GBP/USD
▲ +1.1%	▲ +0.6%	▲ +1.3%	▲ +0.7%	▲ +1.1%	▼ -0.4%	▼ -0.9%	▲ +2.0%

all returns in GBP to Friday close

Macro News

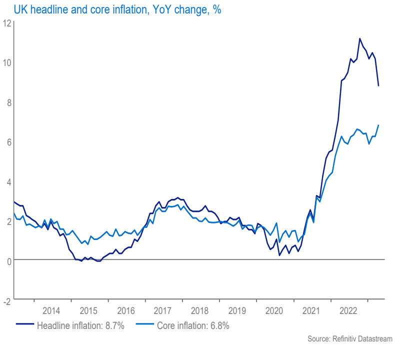
- The UK continues to wrestle with embedded inflation. While headline inflation declined to 8.7% in April, an uptick in core inflation to 6.8% has rattled officials at the Bank of England. Last week, Governor Andrew Bailey noted that inflation was taking longer than expected to fall and stressed the need for future rate hikes to prevent inflation spiralling out of control. The UK also faces an incredibly tight labour market which, in conjunction with higher inflation eating into consumers' income, has increased wage pressures significantly. Across the private sector, average pay growth was reported in May to have reached 7.0%, while the public sector also reported an increase of 5.6%. Markets anticipate an additional five rate hikes from the BoE by the end of the year.
- In stark contrast, the People's Bank of China cut the 7-day reverse repo rate by -10bps to 1.9% as the economic recovery seen earlier this year shows signs of fading and a lack of confidence has materialised in a decline in industrial output.

The Week Ahead

- Investors will be keenly awaiting the UK's May inflation figures, which will be released on Wednesday, and the subsequent Bank of England interest rate decision on Thursday. Markets are currently divided over the size of the expected rate hike, with a 75% probability of a 25bps rate hike currently priced in.

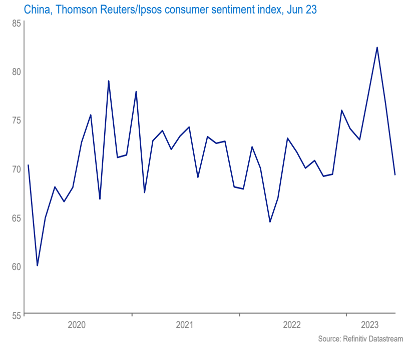
Week in Charts

Inflation is putting pressure on UK consumers
UK headline and core inflation, YoY change, %



Despite inflation coming down on a headline basis, it remains materially higher than in other developed economies. Core inflation in the UK also remains sticky, putting increasing pressure on the Bank of England to act swiftly.

Consumer confidence slides as growth concerns mount
China, Thomson Reuters/Ipsos consumer sentiment index, Jun 23



It is evident that China is facing a growing problem of weakening economic growth. Weakening property sales, rising youth unemployment and a recent decline in industrial production all point towards a more gloomy economic outlook for the world's second largest economy.

View From the Desk

Despite last week's rate pause by the Federal Reserve, the global interest rate environment remains considerably hawkish. The American rate-setting body may have paused for now, but a poll of its members known as the 'Dot Plot' suggested that two more hikes may be in store for American consumers by the end of the summer. Jerome Powell, the Fed's Chair, suggested that there may be two years before rate cuts. Those rate hikes will continue to work through the economy for about a year after they have ended.

Meanwhile, the European Central Bank raised its key interest rate by a quarter point and is further draining liquidity by letting its emergency loans expire, which would require Italian banks to go to the markets for funding. The Bank of England, meanwhile, is preparing for another possible 1% rise in interest rates.

Central banks are removing all the stops to stem the inflation wage-price spiral. What's on the line is not just prices, but, much more importantly, the public's belief that they can be trusted to bring price growth down to 2% in a timely manner. That belief, according to a poll by Ipsos, is now at an all-time low.

Policymakers are emboldened in their course of action, by the rally in equity markets, overall financial stability and a benign economic slowdown, as opposed to a possible crash. In other words, they can afford to focus on inflation because they don't see significant risks building up elsewhere.

So how can investors react to this environment?

For one, they must remain vigilant for bad decisions. Just because we have high rates, doesn't mean that everyone understands that risky behaviour is a bad idea.

Second, they must look beyond the S&P 500 headlines. The stock rally is very narrow, a gold rush on the back of Chat GPT's success. There were more articles about 'AI' at the end of May, than there ever were about Bitcoin. However, we have no assurances that this technology will continue to develop at the exponential rate that present valuations imply. Meanwhile, ex-tech, stocks are negative, bonds are flat and haven't mean-reverted after last year's horrendous performance, and the yield curve is inverted.

Third, be wary of inflation. While year-on-year headline numbers in the US improve, in Europe wage growth is persistent. Services inflation is also proving sticky, and consumers are undeterred from spending. Rates simply aren't high enough to cause the sort of economic downturn central banks want to see before 'pivoting' to an easier rate regime. And inflation could still flare up. Commodity prices have dropped significantly, so a rebound would mean supply-side inflation augmenting what is now demand-side inflation.

As we enter the summer, it makes sense to be mindful of risks. If the Fed really means it when they imply that we are two years away from cuts, then patience is warranted.

Risks can still pay off. But it will be with a significantly lower probability than two years ago.

George Lagarias – Chief Economist

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