Wealth Management
Weekly Market Update

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Published 21 August 2023

Market Update

Global equities sold off by -3% last week, as surging bond yields and weak Chinese data weighed on sentiment. Yields on US and UK 10 year government bonds rose by 8.3 and 10.9 basis points respectively over the week, in response to easing recession fears, greater than expected issuance by the US Treasury and hawkish Federal Reserve minutes. At the end of the week, the US 10 year bond yield stood at 4.27% while the UK yield was at 4.68%. Weak Chinese data was another catalyst for the sell-off. Chinese equities fell by -5.9% over the week, as industrial production, retail sales and fixed asset investment data disappointed. Concerns over China's growth was exacerbated by the National Bureau of Statistics' decision not to release youth unemployment figures, citing a need to review their methodology. The decision led to speculation that the omission may be due to political reasons, as the closely watched indicator had reached record highs in previous months.

UK Stocks	US Stocks	EU Stocks	Global Stocks	EM Stocks	Japan Stocks	Gilts	GBP/USD
▼ -3.0%	▼ -3.0%	▼ -3.2%	▼ -3.0%	▼ -2.6%	▼ -2.1%	▼ -0.9%	▲ +0.4%

all returns in GBP to Friday close

Macro News

- Chinese policymakers are beginning to feel the pressures of market forces, as weakening growth expectations following the pandemic re-opening rebound have weighed heavily on economic sentiment. In response, the People's Bank of China cut the one-year loan prime rate (LPR) by 10 bps. While widely anticipated by markets, the decision to hold the five-year LPR at 4.2% indicates an unwillingness to meaningfully ease monetary policy to stimulate the economy. This lack of action by policymakers comes at a time when deflationary influences and weakening exports present a real risk to the Chinese economy. Investors will be particularly reluctant to part with their capital following the news that Evergrande, once the second-largest property developer in China, filed for bankruptcy in the US last week.
- Bond yields, particularly those at the long end of the yield curve, have been rising rapidly as markets assess the probability that both yields will remain high and inflation above the 2% threshold, as a result of higher-than-expected economic growth.

The Week Ahead

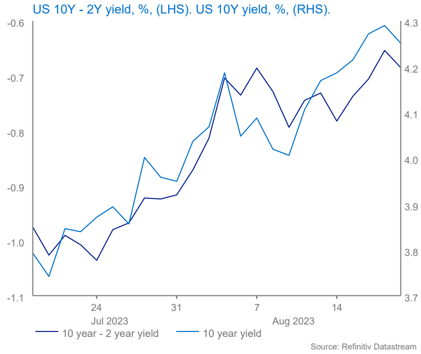
- With the current debate in markets primarily centred around whether the US will fall into recession or not, investors will be primarily concerned with the Jackson Hole conference and the words of Jerome Powell, who is expected to indicate the Fed's current view on monetary policy this Friday.

Week in Charts

Weakening exports puts strain on economic growth
China (mainland), Exports, Total, year-on-year percentage change, %.

China's exports, a critical historic indictor of the country's economic growth, was reported to have declined significantly in July, falling 12.4% on a year-on-year basis.

A bear steepener in bond markets
US 10Y - 2Y yield, %, (LHS). US 10Y yield, %, (RHS).



The yields on long-term US government debt have been rising faster than those with shorter maturity dates, known as a 'bear steepener'. The robust US economic data in recent weeks has likely contributed to rising long-term inflation expectations in markets, pushing up the long end of the yield curve.

View From the Desk

In the past few weeks, bond yields, especially at the longer end of the curve have been rising. This is because markets are seeing the possibility that yields will remain high and inflation above the 2% threshold, as a result of higher-than-expected growth.

This is ostensibly bad news for wealth managers. Firstly, defensive portfolios, which mostly consist of bonds, have been losing value (as yields rise, prices fall). Second, higher yields tend to push more conservative investors into annuities. They can pay a low price now, and enjoy a good yield for a long time.

However, this reasoning can easily be challenged both on the basis of logic and of numbers. Defensive portfolios may be weak, but if someone is ready to buy the high yield, then they should own more, not less. Second, and more importantly, yields are high, to be sure, but not exceptionally so. At just above 4%, the US 10-year yield is roughly at mid-range versus its readings since 1990. If it looks high, that's because we had fourteen years of artificially low yields through quantitative easing. A resurgence in inflation ended that practice for the foreseeable future. Judging the 4% yield against the 2%-3% we were used to in the past few years is simply wrong. The average 10y yield between 1990 and 2008, a period with no Quantitative Easing, was 5.6%, by which standards 4% is low.

Yes, one would say, but we also have a positive real yield (10y yield minus inflation). True. But we did so pre-QE and a lot of the time after QE. At roughly 1% (10y yield less the latest CPI reading), we are still around the bottom 40% of monthly observations since 1990. This means that 60% of the time real yields have been higher. So the conclusion is that we have seen real yields before and we have seen yields above 4% too. Nothing to get too excited about really. What we are seeing is simply part of yield curve normalisation, a result of abandoning years of ultra-easing policies.

Don't get me wrong. Higher yields are indeed enticing. They could even lead many managers towards an overweight in their bond holdings. But, like all investments, they work best within an active portfolio approach. These are uncertain times. This is precisely what high yields tell us: that investors don't know what growth, inflation, the yield curve or interest rates will look like in the foreseeable future.

The question thus becomes a really simple one: at a time of extreme uncertainty and volatility, does one want to invest by themselves, trusting an annuity, or do they want to trust their portfolio manager and maintain a diversified approach – one designed specifically to mitigate the risk of high uncertainty?

George Lagarias – Chief Economist

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