Wealth Management
Weekly Market Update

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Market Update

Global equities sold off last week after the FOMC released hawkish forecasts in its meeting on Wednesday. While interest rates were left unchanged at a level of 5.25% - 5.50%, markets were rattled by the Fed's outlook for interest rates, which predicted no rate cuts in 2024. Prior to the meeting, markets had been pricing in rate cuts as early as May 2024. This caused US stocks to sell off by nearly -3% in local terms over the week (-1.7% in GBP terms due to the currency fluctuation) and the yield on the 10-year treasury bond to rise to a 16 year high of 4.46%. Japanese and emerging market stocks also fell in response. UK stocks fared the best among major regions in light of the hawkish Fed meeting, falling by -0.4% over the week, as the Bank of England held rates after a tight vote by MPC members. The decision came after UK inflation was reported to be 6.7%, notably lower than the 7% figure expected by economists. The week was otherwise light on major macroconomic releases, but the price of oil reaching $90 per barrel provided an additional drag on sentiment.

UK Stocks	US Stocks	EU Stocks	Global Stocks	EM Stocks	Japan Stocks	Gilts	GBP/USD
▼ -0.4%	▼ -1.7%	▼ -0.6%	▼ -1.5%	▼ -1.0%	▼ -1.3%	▲ +0.5%	▼ -1.2%

all returns in GBP to Friday close

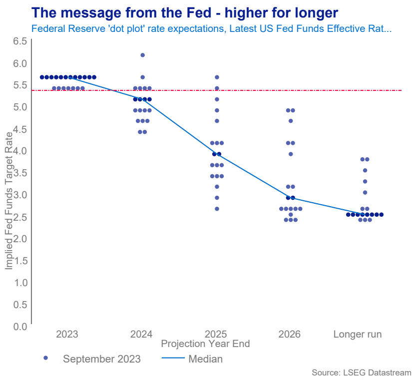
Macro News

- The Federal Reserve opted to leave interest rates at 5.5% last Wednesday, in line with market consensus. However, the Fed surprised markets by signalling a 'higher-for-longer' approach to monetary policy, raising their rates outlook for 2024 alongside their growth forecasts, acknowledging that economic activity had been more robust than initially anticipated.
- Meanwhile, the Bank of England Monetary Policy Committee (MPC) was divided on its rate decision last week, but ultimately voted 5 members to 4 to keep rates at 5.25%. The focus of the MPC has shifted towards deteriorating economic fundamentals in recent weeks, as there are signs inflation continues to soften.
- While inflation remains entrenched in the UK, a sharp decline in core inflation (6.2% in August) indicates that the impact of tighter monetary policy is beginning to be felt. However, wage pressures remain significant, with growth in regular pay at 7.8% on a year-on-year basis – the highest level since comparable records began.

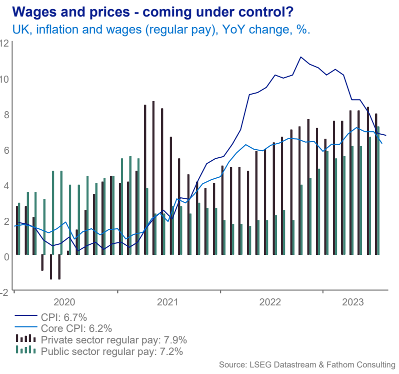
The Week Ahead

- Preliminary European inflation figures for September will be released later this week. Headline inflation is expected to markedly decline, while core inflation is expected to fall to 4.8%. Meanwhile, in the US, core PCE (a critical gauge of inflation used by the Federal Reserve) data for August will be released on Friday.

Week in Charts



The hawkish narrative from the Fed indicates that markets remain optimistic about rate cuts. Federal Reserve officials are currently anticipating a single rate cut by the end of 2024, while markets expect three 25bp cuts.



A moderation in wage inflation in conjunction with the surprise decline in August's core inflation figures may have given the BoE the wiggle room to pause rate hikes last week, but inflation in the UK remains significantly above that of other developed economies.

View From the Desk

A consistent element of this rate hike cycle has been the differential between market optimism and Fed intentions. Since early 2022, markets were never really convinced about how far the Fed was willing to take things. Expectations have consistently fallen short of reality in terms of rate hikes.

One can't really blame traders for this of course. Most came up during the 14-year quantitative easing period. A zero-rate and unlimited quantities of free money, the scenario they once took as their base. The place where, for some, the Fed might well mean revert one day.

It will take time for the idea of higher rates and a normal yield curve to sink in.

Meanwhile, markets were again surprised last week. The US Federal Reserve maintained interest rates but what rattled markets was the the "median dot", the Fed's official projection for where interest rates will be this time next year, went from 4.6% to 5.25%. i.e. The Fed forecasted no rate cuts in 2024, a sharp contrast with markets who, up until two weeks ago believed that the Fed would perform five rate cuts until January 2025, starting as early as May 2024. This caused the US stocks to retrench nearly 3% for the week and the 10y Treasury yield to climb to 4.46%, its highest level since 2007. But still, markets forecast three rate cuts next year, starting from July.

So, at this point, further rate hikes have been substituted with "higher for longer". How longer can "higher" be? Between 1994 and 2001 the Fed kept rates above 5% consistently. In 2007, the top rate was kept for 15 months. Average inflation for the period was 2.6%, exactly where economist surveyed by Bloomberg expect average inflation to be over 2024. After that, inflation is presently expected to go down only slightly, to 2.3%, which could possibly allow for some early rate cuts. However, the truth is that inflation expectations change every day. The "data-dependent" message of central banks is another way of saying "we don't know where inflation is headed".

So, investors should position as best as they can for both the good scenario (rate cuts into 2024) or the bad scenario (no rate cuts before early 2025).

George Lagarias – Chief Economist

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