LIONTRUST

MULTI-ASSET PROCESS

Market review: June 2023

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- **US leads equity markets higher; bonds weaken on interest rate hike fears**
- **Central bankers warn of insufficient evidence of core inflation stabilising or falling**
- **Subsiding investor confidence could mark opportunity for long-term investors**

Global equity markets ground out positive returns in June, led by the US, and most notably technology giant NVIDIA.

However, how far monetary tightening will go is still a key factor for markets. Bonds, especially US treasuries, weakened on statements made at the meeting in Sintra, Portugal, of the world's top central bankers, who warned that tight labour markets continued to push up wages and inflation and that stiffer action on interest rates could be needed. Federal Reserve chairman Jay Powell said that monetary policy had not been restrictive for long enough, raising expectations of more rate hikes when the Fed meets next in July and September.

US economy surprises on the upside

The Federal Reserve paused on rate hikes in June, and latest data showed US consumer spending and inflation moderated in May. However, upward revisions to Q1 GDP raised expectations that higher interest rates would be needed to tame inflation, sending yields on US treasuries to their highest levels in three months. The annualised growth figure was raised from the previous estimate of 1.3% to a significantly higher 2%. US initial jobless claims came in stronger than expectations after their recent run of weak figures, causing the US Treasury market to sell off and other bond markets to follow in sympathy as yields rose. We have reduced our outlook on global high yield (HY) bonds from a positive outlook to a more neutral three, having raised it in Q4 2022. We added exposure to HY when they had attractive spreads versus government bonds, but this window of opportunity has since reduced, so we took profits.

ECB points to more rate hikes

ECB president Christine Lagarde told the Sintra conference that there was still insufficient evidence that core inflation was stabilising or falling. Headline Eurozone CPI was 5.5% in June versus 6.1% previously, with core CPI rising from 5.3% in May to 5.4% in June. By country, France and Italy slightly undershot inflation expectations while Germany and Spain had upside surprises. The figures reinforced the view that the ECB would raise rates again in July, having increased them in May and June, although September's decision will depend on the summer's economic data.

A European fund manager said: "We have been taking advantage of the market sell-off by adding to companies the team have long admired in every aspect except valuation."

We have raised our outlook on European small caps to neutral, in line with our now neutral view on European equities generally. Concerns over the domestic economy are abating as Europe continues to progress after the problems associated with gas supplies from Russia.

Spectre of recession raised in UK

UK stocks were the laggards in June, weighed down by weakening oil prices and the Bank of England's aggressive rate hiking to quell inflation that is the most elevated among developed economies. The UK is dominated by energy multinationals and cash-generative stocks but lacks the technology-centric growth stocks that have benefited from the AI rally in recent months. We are still positive on UK equities, however, which we see as still relatively cheap despite the energy bounce of 2022.

A fund manager said of the UK: "With the outlook for inflation and interest rates moderating in the UK, many analysts are now questioning whether Britain is really heading for a deep recession. However, the more relevant question is whether the new economic regime of elevated inflation and higher rates will result in businesses and consumers continuing to tighten their purse strings – given Britons have already cut discretionary spending."

China's recovery is running out of steam

In Asia, Japan was a strong equities performer in June. New Bank of Japan governor Kazuo Ueda said at Sintra that economic growth and wages were picking up at home after decades of near stagnation, raising the possibility that the Bank of Japan could relent on its so-far ultra-loose economic policy. Wages were growing at 2% or so after three decades, which he saw as a good sign.

But China's post-Covid recovery appeared to be losing steam. Latest data showed manufacturing activity contracted for the third consecutive month and the country cut its benchmark lending rates in a move to ease monetary policy. Six months after reopening after Covid, China still faces issues, including declining trade activity and a weak property sector.

A fund manager commented: "China's growth rate may be slowing following years of breakneck expansion, but it is forecast to significantly outperform most developed markets in 2023.

"Looking at the short-term, China is the only major economy that is going to grow meaningfully from a low base this year."

June was largely devoid of significant news. Investor confidence has subsided from earlier in the year, with inflation looking stickier than a month ago. Sterling strengthening on heightening expectations of tighter monetary policy is also impacting UK investors' overseas unhedged assets negatively. For long-term investors who are happy to invest when others are fearful then now is a time to be a little more bullish, although never too greedy.