London &Capital

MAY 2023
MONTHLY COMMENTARY

In May, financial markets put the US regional banking crisis to one side and shifted their focus towards monthly economic data, the US debt ceiling and a chip maker called Nvidia. Global equities, as measured by the MSCI World, fell 1% while global bonds, as measured by the Bloomberg US Aggregate index, fell 1.5%.

Time will tell if the knock-on effects of the US regional banking crisis exacerbate the wider economy. As larger financial institutions stepped in to support new depositors and businesses, there is a consensus that lending conditions will tighten – which should slow economic growth. The debt ceiling grabbed the headlines during the month, on concerns that the US federal government would run out of money with the deadline beginning of June. At the time of writing, Joe Biden and Republican leader Mitch McConnell had come to an agreement with the vote expected to be passed through the House and Senate the first week of June.

This would allow the US government to extend the 31.4trillion dollar debt cap without protest till US elections in 2025.

April US Nonfarm payrolls – which reflects the current employment situation in the US – remained resilient with new hires of 253,000 beating expectations of 179,000. The unemployment rate remained at record lows of 3.4% and wage inflation remained elevated at 4.4% but lower than the peak of 5.9% in March 2022.

April US headline inflation trended lower at 4.9% year over year while core Consumer Price Index (CPI) remained sticky at 5.5%. Lower airline fares helped depress the headline figure although inflation was strong in areas such as used car prices. Shelter costs which have kept core inflation elevated appear to be moderating.

As expected, the Fed (Federal Reserve) raised rates by 0.25% to take the benchmark overnight interest rate to a range of 5.0%-5.25% but interestingly opened the door to a pause in the tightening cycle.

Across the pond and the UK appeared to avoid a technical recession with an early Gross Domestic Product (GDP) print of +0.1%, while inflation remains stubbornly high at 8.7% and the bank of England admitting the monetary tightening may continue for longer than expected. The mortgage market remains a hot topic, with over a million homeowners expected to refinance at materially higher fixed rates this year.

European inflation data continues to remain elevated, pushing Germany into a recession with gross domestic product - a measure of a country's growth and productivity – down 0.3% in Q1. The recession was less severe given the heavy reliance on Russian energy. A mild winter and China reopening helped ease the impact of higher energy prices.

Conversely China reopening its economy has fallen below expectations, with high unemployment among the younger generation, structural issues in the property market and a wider global economic slowdown dampening exports.

ASSET CLASS

Global equities continue to trend upwards driven by a narrow set of stocks contributing to performance. This year, names such as Microsoft, Apple, Nvidia, Amazon and Google have contributed to over 70% of the S&P 500 index performance (the index is up 9.6%!).

The key driver has been the buzz around artificial intelligence (AI) with language learning models such as Chat GPT (part owned by Microsoft) & Bard (Google owned) have created an excitement around the benefits of AI. This led to Nvidia, a graphics processing unit (GPU) maker upgrading their Q2 earnings guidance by 50% on high demand for their AI linked GPU's. The stock jumped nearly 25% on the day and turned the company into the fifth trillion-dollar market cap weighted company joining the likes of Amazon, Microsoft, Saudi Aramco and Alphabet.

Sector wise, equities appeared to reverse the performance style of 2022 with the strongest performing sectors being technology and communication services and the laggards being cyclical sectors such as energy, materials, and industrials.

Bond volatility picked up as discussions around a soft or hard landing continued to influence bank interest rates. US government bond yields on the shorter and longer maturities increased on growth concerns and hawkish central bank policy. The 2-year maturing bond yields sat at 4.4% while 10-year maturities were lower at 3.6%.

Within commodities, copper prices fell 5% for the month on falling Chinese demand. Copper demand tends to be a leading measure of economic prospects and has fallen 12% from its highs at the beginning of the year. Global food prices hit their lowest level in two years with wheat, vegetable oil and dairy prices dropping globally. However, food prices on a global level remain high in both the developed and emerging markets.

Cable, the slang term used for the price of British pound (GBP) against the US Dollar, was broadly flat for the month resting at around 1.25.

Given the mixed set of economic data - resilient labour market & sticky inflation in the face of aggressive monetary tightening. The London &Capital mantra of high-quality investments shines ever brighter. Our asset allocation for multi asset balanced portfolios is defensive with an overweight to fixed income versus equities. Bond yields are extremely attractive, and our focus is on major corporations and systematically important financial institutions while our equity exposure focuses on companies with high quality global brands with resilient cash flow generation and to companies invested into long term structural growth trends that are key players in their sector.

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