Investment Commentary

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Market overview

Equity markets rose over July driven in part by weaker than expected inflation data from the US. This led to hopes that interest rate policy could reverse before the end of the year and, more broadly, increased hopes of a 'soft landing' (i.e. the economy holding up while inflation steadily recedes). Headline inflation also softened in the UK to a lower than expected 7.9%, driven in part by lower fuel prices.

The more dovish backdrop also sent bond yields lower (and values higher) as markets priced in potentially lower peaks in policy rates. Inflation and interest rate expectations remain key to short term market returns. Inflationary pressures overall continue to ease however the backdrop is somewhat complicated with data showing that spending is shifting towards services while goods prices fall. Central banks are unlikely to feel comfortable shifting policy until tight labour markets (and persistent wage growth) show more signs of weakening. Wage inflation remains particularly high in the UK (7.2% year on year), however labour supply issues means that participation rates (the proportion of the population of working age in employment) are still below where they were before the pandemic, in contrast with most of the developed world.

Markets are drawing encouragement from the most recent earnings updates, which continue to prove more resilient than feared, and inconsistent with what we would expect to see if a period of deep recessions was imminent. Broad economic data also continues to be slightly better than expected – for example revised figures for the first quarter of the year now show that the eurozone did in fact narrowly avoid recession.

Strategy Positioning

We remain broadly optimistic about the outlook for the second half of the year as investors increasingly start to look beyond the current uncertainty to a generally improving economic picture in 2024 - we are therefore maintaining a full commitment to equities. We have, however, trimmed our commitment to the US market and some thematic funds in favour of a small re-entry to Europe and an increase to Japan.

European equity markets have shown more resilience than anticipated to tough economic conditions and a valuation gap relative to the US is increasingly hard to ignore. Japan is finally showing signs that it can escape from its deflationary malaise of the past few decades and evidence grows that companies are increasingly prioritising shareholder returns through larger dividend pay-outs and increased share buybacks. The Japanese yen also looks particularly oversold and our increased allocation to Japan will hopefully also benefit from some currency uplift as Japan's economy gathers momentum and money flows back to the region.

Sterling's recent strength has been surprising, but a severely challenged UK economy should limit its upside. The US dollar continues to be viewed as the international currency of choice for international trade and/or safety.

We are maintaining bond market positioning, having increased duration and skewed investments more towards investment grade credit. Whilst default risks have risen, we feel investors are being more than adequately compensated and the outlook for the asset class is improving as inflation recedes and rates plateau.

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