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A Month in the Markets

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In this latest edition our Multi Asset Solutions Team look at the challenges investment markets faced in January. The start of 2023 saw global shares and bonds rise after key inflation readings eased.

Market Overview

After a 2022 that saw global stock markets experience their largest annual rout since the global financial crisis of 2008[1] and bonds endure one of their worst years on record[2], investors had some grounds for optimism in January 2023. Global shares and bonds rose this month after key inflation readings eased, and investors grew more confident in the likelihood of central banks slowing interest rate increases over the year ahead.

The rally occurred against the backdrop of the International Monetary Fund (IMF) softening its predictions for 2023, now forecasting that the year will likely produce a slowdown rather than a recession for most major economies.[3] Even so, the effects of higher interest rates, the continued war in Ukraine and a drop in global trade are expected to weigh especially hard on advanced economies. Meanwhile, emerging markets may have reached their bottom in 2022.[4]

Global shares rose by 7.48% over the course of January, reversing December's decline.[5] The S&P Global Developed Sovereign Bond Index, which measures the bonds issued by governments of wealthy nations, returned 1.80% this month[6], while a similar gauge tracking bonds issued by private companies rose by 3.68%.[6]

UK and Europe

Britain's economy experienced the sharpest fall in business activity in two years in January, marking the sixth straight month that the private sector has contracted due to falling output levels and weak demand.[7]

Business leaders cited higher interest rates, low consumer confidence due to squeezed household budgets and greater risk aversion among companies as responsible for holding back activity. The manufacturing sector cut jobs, while the services industry recorded a slight uptick in employment.[7]

High levels of pessimism over the state of the UK economy also dragged consumer confidence downwards in January, following three months of gains. Price and tax increases were generally seen to have swallowed pay rises, especially as households prepared for higher energy bills.[8]

The FTSE 250 Index, which is considered representative of domestic shares, gained 3.63% this month.[9] More positive news came as yields on 10-year UK government bonds declined by 4.73% over the course of January.[10] Yields move inversely to prices, meaning that this resulted in bond prices rising.

In Europe, business activity edged into growth territory in January after shrinking for six consecutive months.[11] Despite this unexpectedly positive performance, the President of the European Central Bank voiced caution, stressing that subsequent interest rate rises will be necessary before inflation is fully under control.[12]

Data released this month revealed that Eurozone inflation declined back into the single digits in December, offering an indication that it may be cooling.[13] Inflationary pressures in this region have been eased by a mild winter that reduced the demand for natural oil and gas, coupled with the fact that the reopening of China's economy has improved global supply chains.[14]

The MSCI Europe ex-UK Index, a measure of the region's stock markets excluding the UK, gained 6.84% in January.[15] The S&P Eurozone Sovereign Bond Index, a gauge of government bonds issued by Eurozone nations, also rose by 1.60% in January.[16]

US

In January it was announced that the US economy expanded by 2.9% in the fourth quarter of 2022, greater than the 2.6% economists had expected. This stronger performance was likely boosted by greater consumer spending, increased state expenditure and higher spending on healthcare, utilities, housing and mining specifically.[17]

Federal Reserve (Fed) Chairman Jerome Powell subsequently cautioned that the economy hadn't yet felt the full effects of interest rate rises, with the US interest rate currently at its highest level since 2007.[18] Data released this month also revealed that economic growth in the fourth quarter had slowed from the 3.2% recorded for the prior three months.[19]

January's Consumer Sentiment Index rose for a second month following a dip in inflation and expectations that price gains will slow further over the next 12 months.[20] Figures released this month also indicated that the Fed's preferred measure of inflation – the core Personal Consumption Expenditures price index (PCE), which excludes volatile food and energy categories to represent consumer costs and spending better – recorded its lowest level since October 2021 in December.[20] The US labour market has also remained strong, with unemployment edging back down to 3.5% in December. [21]

The S&P 500 Index, a gauge measuring the performance of the 500 largest companies in the US, recorded its first January gain since 2019 amid perceptions that the Fed will only raise interest rates by 0.25% at its next meeting.[22] This would be a significantly less aggressive rate hike for the central bank, and a sign that inflation may be being brought under control.

The Nasdaq, which favours technology shares, also soared to return its biggest percentage gain for the month of January since 2001.[22] The S&P US Aggregate Bond Index – which tracks the performance of dollar-denominated high-quality bonds issued by the US government, municipals and companies – returned 2.50% this month.[23]

Asia Pacific

China's economy sprang back to life after its reopening from strict COVID-19 lockdowns spurred its first expansion in manufacturing activity in four months in January.[24] The New Lunar Year also saw a boost in travel and spending as people could move around freely for the first time in years. Domestic tourism revenue was revealed to have jumped 30% year-on-year.[25]

Data released this month showed that growth in the world's second-largest economy slumped to 3% in 2022, from 8.1% in 2021. Barring 2020 – when consumer spending dried up, factory output declined, trade faltered and a debt crisis in the property sector erupted during the worst of the pandemic – this was the slowest rate of growth since at least the 1970s.[26]

China's CSI 300, which tracks shares of the largest companies listed on the Shanghai and Shenzhen stock exchanges, gained 6.92% in January.[27] The index has rallied 19.7% since its recent low on 31 October 2022, nearly constituting a bull market. A bull market is defined as a period when shares increase at least 20% from a recent low.[28]

In Japan, factory output declined in December, according to figures released in January, to remain below pre-pandemic levels. This could prompt the Bank of Japan to maintain ultra-low interest rates.[29] Japan's economic performance has been suffering amid the supply chain disruptions spurred by China's lockdown, a depreciation in the yen and global interest-rate increases.

However, January did present some relief for the Japanese economy. The Nikkei Stock Average, which measures the performance of the 225 largest listed companies in Japan, rose 4.72% in January in the largest one-month percentage increase since October 2022.[30] The reopening of China's economy has aided Japan's performance, reducing supply chain disruption in the region.

Outlook

Our outlook remains cautious. The world economy and markets are not yet out of the woods.

The slowing economy, higher wage demands, the effects of interest rate increases and rising costs will start to filter through into companies' profits. We believe this will prompt analysts to adjust their earnings estimates, and we are also seeing corporations start to cut jobs.

There is still uncertainty over whether or not the global economy will enter a recession or which countries will experience economic contraction. With all this doubt clouding the outlook, we anticipate using tailored financial instruments within the funds to benefit from any potential upside and to protect from the worst of any possible declines.

All data as at 31 January 2023.

[1] CNBC, 30 December 2022
[2] Financial Times, 30 December 2022
[3] Politico, 31 January 2023
[4] IMF, 31 January 2023
[5] MSCI ACWI, 31 January 2023
[6] S&P Global Developed Sovereign Bond Index, 31 January 2023
[7] S&P Global/CIPS UK PMI, 24 January 2023
[8] GfK, 20 January 2023
[9] FTSE 250, 31 January 2023
[10] Trading Economics, 31 January 2023
[11] S&P Eurozone PMI, 24 January 2023
[12] Financial Times, 24 January 2023
[13] Politico, 6 January 2023
[14] International Business Times, 31 January 2023
[15] Santander Asset Management, 31 January 2023
[16] S&P Global, 31 January 2023
[17] Forbes, 28 January 2023
[18] The Guardian, 26 January 2023
[19] Bureau for Economic Analysis, 26 January 2023
[20] CNN, 27 January 2023
[21] Bureau of Labor Statistics, 6 January 2023
[22] Reuters, 31 January 2022
[23] S&P U.S. Aggregate Bond Index, 31 January 2023
[24] Bloomberg, 31 January 2023
[25] Asia News Network, 31 January 2023
[26] NPR, 17 January 2023
[27] CSI 300 Index, 31 January 2023
[28] CNBC, 30 January 2023
[29] Bloomberg, 31 January 2023
[30] Dow Jones, 31 January 2023

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Important Information