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A Month in the Markets

APRIL 2023

In this latest edition our Multi Asset Solutions Team look at the challenges investment markets faced in March. A banking crisis in Mid-March sent volatility soaring but calm was largely restored by the end of the month.

Market Overview

A banking crisis in mid-March sent volatility soaring as investors questioned the financial system's stability and how central banks would continue their fight against inflation.[1] However, calm was largely restored by the end of the month, with stock and bond markets both making gains.

The crisis began in the US. Following the collapse of Silicon Valley Bank, the 16th largest US bank, mass withdrawals from depositors caused mid-sized Signature Bank to fold too.[2]

As the uncertainty spread to Europe, Switzerland's second-largest lender Credit Suisse had to be bought by larger rival UBS to prevent its own bankruptcy.[3]

Swift action from regulators helped shares stage a comeback from the latter part of March following a slump in the middle of the month. The Federal Reserve (Fed), Bank of England (BoE) and European Central Bank (ECB) each implemented another interest rate hike in their continued fight against inflation. Senior figures at these institutions emphasised that their respective banking systems are resilient.[4]

The S&P Global Developed Sovereign Bond Index, which measures the performance of bonds issued by the governments of wealthy nations, rose by 2.38% this month[5] as inflation showed signs of easing.

The MSCI World Index, which measures the performance of large and mid-cap shares across 23 developed markets nations, delivered a 2.83% return this month[6], reflecting continued recovery from a turbulent 2022.

UK and Europe

UK economic data released this month painted an uncertain picture for investors. The UK economy was revealed to have rebounded from a 0.5% contraction in December with 0.3% growth in January.[7] On 31 March 2023, the Office for National Statistics (ONS) also confirmed that the UK had narrowly avoided a technical recession – defined as two consecutive quarters of negative growth – in the final quarter of 2022, which saw 0.1% growth.[8]

Other figures indicated that UK business activity had grown for a second consecutive month in March, suggesting that the economy has grown by 0.2% in the first quarter of 2023.[9]

The BoE raised interest rates to a 14-year high in March[10] , after inflation in February unexpectedly accelerated. Inflation for food and non-alcoholic drinks was particularly badly affected, soaring to its highest levels since 1977.[11]

The FTSE 100 Index, which lists the shares of the 100 largest companies listed on the London Stock Exchange, recorded its worst March performance since 2020. In particular, banks served as a drag on the index's performance.[12] The FTSE 250 Index, which is generally seen as a better reflection of the local economy and tracks the 101st to the 350th largest companies listed on the exchange, declined by 4.9%.[13]

Yields on UK government bonds that are quicker to reach maturity, for example, one and six-month bonds rose over the course of the month. In contrast, yields on longer-term UK government bonds fell.[14] As bond prices and yields move in opposite directions, these slipping yields drove longer-term UK government bond prices upwards, reflecting a renewed demand for these securities as investor confidence in the longer-term economic prospects of the UK gradually recovers.

Economic growth in the eurozone rose to a 10-month high in March, with an expansion in the services sector helping to offset a mild contraction in manufacturing. These figures suggest that the eurozone economy expanded by 0.5% this month, and 0.3% in the first quarter, overall.[15]

Inflation across the 20 nations that share the euro was estimated to have eased to its lowest level in a year in March, after energy prices dropped. However, a continuing increase in food prices may pressurise the ECB into further interest rate hikes.[16]

Indeed, the ECB's commitment to containing inflation was captured in its decision to proceed with its planned March interest rate rise, despite the mid-month banking crisis shaking investor confidence.[17]

The MSCI Europe ex-UK Index, which tracks the region's stock markets, returned 1.12%.

US

The Fed hiked interest rates for the ninth time in a year in March, but softened its rhetoric by stressing that future increases aren't guaranteed and will be driven by incoming data.[18]

The central bank's efforts to control inflation appear to be bearing fruit, with figures released this month confirming that US consumer inflation fell for the eighth consecutive month in February, slumping to levels unseen since September 2021.[19]

A measure of inflation watched closely by the Fed, which excludes volatile food and energy prices, also marginally beat economists' expectations.[20] Against this increasingly favourable backdrop, investors were left wondering whether the Fed will raise rates or leave them unchanged at its next meeting in May.

Figures released this month revealed that US consumer spending growth slowed in February, following its fastest increase in nearly two years the month before.[21]

Despite much-publicised bank failures, US consumer confidence actually improved in March.[22] Nonetheless, smaller US banks felt the effects, with deposits dropping by a record $119 billion as spooked customers shifted their money to bigger banks and investment vehicles.[23]

The S&P 500 Index, which tracks shares of the largest companies listed on the New York Stock Exchange, rose in March to cap off a second consecutive quarter of gains.[24] The Nasdaq Composite Index, which tracks more than 3,000 companies, almost half of which are in the technology sector, also jumped.[25]

Asia Pacific

China's economic recovery gathered steam as the nation's services sector expanded at its fastest pace for 12 years in March, but the failure of manufacturing to grow at the same rate indicated that a recovery may be unbalanced.[26]

Growth is picking up after stringent COVID-19 restrictions were lifted. The measures reduced growth to one of its lowest levels in nearly half a century.[27] Chinese authorities have nonetheless adopted a conservative stance, setting a growth target of 5% for this year, the lowest in decades.[28]

Figures released this month revealed that China's inflation rate fell to its lowest level in a year in February, following a sharp slowdown in food, transport and education prices.[29] However, China's CSI 300 Index, which tracks shares of the largest companies listed on the Shanghai and Shenzhen stock exchanges, declined in March.[30]

The Chinese central bank, the People's Bank of China, left its benchmark lending rates unchanged in March.[31] The decision followed an earlier move to cut how much banks are required to hold in cash reserves, which is likely intended to enable greater lending and fuel economic growth.[32]

Meanwhile, the Japanese government downgraded assessments of the strength of the nation's industrial production in March for the first time in three months.[33]

However, there was some positivity to be found for Japan. Figures released this month indicated that inflation decelerated in February, slipping from its highest level in 41 years in January to its lowest since September 2022.[34] This cooling off occurred despite intersecting with a key indicator of Japanese consumer prices rising at its fastest pace for 41 years[35], indicating that volatility may persist for longer than anticipated. The Nikkei 225, which tracks shares on the Tokyo Stock Exchange, rose this month, extending gains for the first quarter.[36]

Outlook

We're cautiously optimistic. While our economic outlook is gradually brightening, we remain vigilant when it comes to risk.

Markets have passed a noticeable turning point, with investors growing in confidence that interest rate hikes will halt this year. Our view is that a single further hike from each of the Fed, BoE and ECB is the most likely scenario. Investors are anticipating anywhere from zero hikes to two, with this uncertainty contributing to stock market volatility.

As the market moves to reach a consensus on interest rates, we're planning to invest any cash we're holding into UK and US government bonds. We also plan to sell off our holdings of high-quality corporate bonds. As yields are falling, bond prices are rising, increasing the likelihood that these bonds can be sold for a higher price than we paid for them. We also intend to begin moving into shares.

Our view is that interest rates could be reduced in the first or second quarter of next year, as inflation is brought under control. This month's banking crisis has had a minimal impact on our portfolios. We held insignificant quantities of shares and bonds in a handful of affected institutions, and their value quickly rebounded once calm had been restored. Nonetheless, we've diligently applied worst-case stress scenarios.

All data as at 31 March 2023.

[1] Reuters, 30 March 2023
[2] NPR, 17 March 2023
[3] Investopedia, 28 March 2023
[4] ABC News, 23 March 2023
[5] S&P Global Developed Sovereign Bond Index, 31 March 2023
[6] Business Insider, 31 March 2023
[7] Office for National Statistics, 10 March 2023
[8] Office for National Statistics, 31 March 2023
[9] S&P Global / CIPS Flash UK PMI, 24 March 2023
[10] Bank of England, 23 March 2023
[11] Reuters, 22 March 2023
[12] Reuters, 31 March 2023
[13] London Stock Exchange, 31 March 2023
[14] Financial Times, 31 March 2023
[15] S&P Global Flash Eurozone PMI, 24 March 2023
[16] Associated Press, 31 March 2023
[17] Reuters, 15 March 2023
[18] CNBC, 22 March 2023
[19] US Bureau of Labor Statistics, 20 March 2023
[20] CNBC, 31 March 2023
[21] Reuters, 31 March 2023
[22] CNN, 28 March 2023
[23] Reuters, 27 March 2023
[24] ABC News, 31 March 2023
[25] Reuters, 31 March 2023
[26] Financial Times, 31 March 2023
[27] Reuters, 30 March 2023
[28] Financial Times, 27 March 2023
[29] South China Morning Post, 9 March 2023
[30] CSI 300 Index, 31 March 2023
[31] Dow Jones, 20 March 2023
[32] CNN, 17 March 2023
[33] Reuters, 22 March 2023
[34] Reuters, 23 March 2023
[35] Financial Times, 24 March 2023
[36] Dow Jones, 31 March 2023