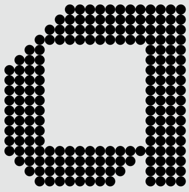
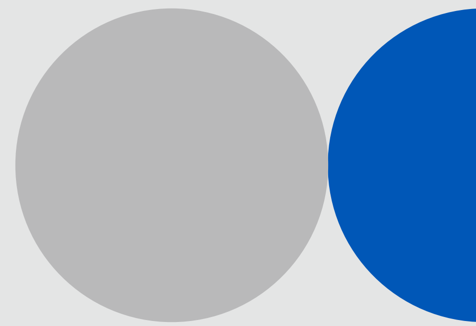
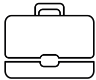


abrdn MPS

Market highlights in Q4 2022

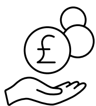
December 2022



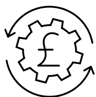


Ex-Chancellor Kwasi Kwarteng's September ill-fated mini-budget caused weeks of chaos in financial markets. After reaching a record low on 28 September 2022 of $1.0327, Sterling recovered from to $1.14 by the end of the first week of October.

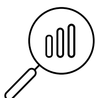
The tumultuous effect the budget created in markets saw Kwarteng dismissed from his position as Chancellor on 14 October 2022 after only 38 days in position, and a reversal on almost all the tax measures announced in the Growth Plan ensued.



The Bank of England stepped in to buy gilts to stabilise government borrowing costs and ease concerns over stability of pension funds. Jeremey Hunt was appointed as the new Chancellor and calmed investor worries over the short term with an announcement to scrap all of his predecessor's headline measures.

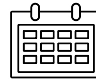


On 17 October when Jeremy Hunt did a U-Turn, yields on the 30-year gilt fell by more than 50 bps to 4.370%, marking one of its biggest daily drops on record. The pound also soared by as much as 1.4% against the US dollar and by 0.8% against the euro. Mid-cap stocks, which are often more sensitive to the UK economy also rose 2.76% on the news.

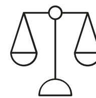


Markets carried on their late year rally as US inflation slowed down during November. Rising on an annual basis of 7.7%, which was lower than the forecast of 7.9% and their lowest since the beginning of the year. This was largely due to falling food prices but propped up by stubbornly high rental and fuel costs.

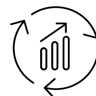
The drop in inflation was welcome news for American investors, with the S&P 500 rocketing 5.5% and the tech heavy Nasdaq up 7.35% in a single day. Sterling shot 2.5% higher against the US dollar, its best day since March 2020.



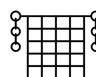
Early in November the Fed raised interest rates by 0.75%, as widely predicted, although Fed Vice Chair Lael Brainard said they would moderate rate increases going forward, while Chairman, Jerome Powell, said smaller hikes could begin in December. True to its word, the Fed adjusted the trajectory of its hikes, raising borrowing costs by just 0.5% in December. It's likely there will be more hikes to come after the latest minutes from the last meeting confirmed only two of the nineteen Fed officials saw interest rates staying below 5% next year.



The Bank of England (BoE) also raised rates by 0.75% early in November, its biggest hike in 33 years. Followed by a rise in December of 0.5% to 3.5%, a level not seen in 14 years. The bank commented that "further increases" may still be required. The news was enough to keep sterling above $1.20.



Unlike in the US, UK inflation showed no signs of slowing, rising to 11.1%, up from September's reading of 10.1%. Recessionary fears also escalated throughout the final quarter, stoked by data showing a 0.2% contraction in UK GDP over the third quarter, albeit the reading was a slightly better outcome than expected.



Not to be out down by their counterparts, the European Central Bank (ECB) also raised rates by 0.75% in November, with its president, Christine Lagarde, stating that she did not believe that inflation has peaked yet. Indeed, like their western counterparts, the ECB became the third bank in a week during December to hike their base rate by 0.5%. European markets actually enjoyed a relatively strong end to the year, led by the Eurozone's largest constituent, Germany.

Outlook for Q1

01

We expect most western economies to slip into recession next year as the hot labour market we have witnessed for much of the year begins to cool, with central bank rate hikes preventing the progress of the global economy.

02

Although central banks look to be reducing the degree in which they are increasing borrowing costs, it's possible that stubbornly high inflation will result in many having to raise rates more than expected, keeping rates at higher levels for longer, before even considering a pivot and loosening policy.

03

The outlook for major asset classes is looking challenging. They will have a difficult time this year with corporate earnings at risks to due to economic backdrop and high rates. This will have a negative effect on equities in the near term despite pockets of opportunity (e.g. in Emerging Markets and China). Bonds are becoming a more attractive investment as a result.

How are we positioned?

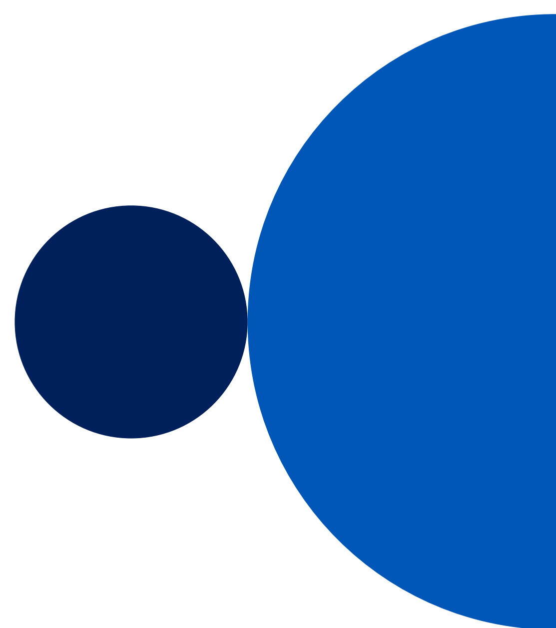
Preserving our client's wealth is our largest priority and with this in mind, we have taken several steps to de risk our more cautious portfolios in the face of an incoming recession. We have been raising our weighting to neutral in global government bonds, proactively increasing the duration of such holdings, which should perform better as safe haven assets if the predicted recession is deeper than many are anticipating.

Due to our worries over the global economy, we have also been reducing our exposure to US and European stocks, whilst maintaining our overweight to global infrastructure, which we feel should benefit from long term trends and also aided by a degree of inflation linkage.

Given the recessionary outlook ahead, we added more balance to MPS models 1, 2 and 3, towards the end of the year through global government bonds rather than adding specifically to gilts.

Within our gilt allocation, through the use of the **Royal London Short Duration Gilt Fund** combined with Vanguard, this provides us with less duration than the **Gilts All Stocks Index**.

We maintain a concern about the impact of large long-dated issuance on the UK market. Instead of adjusting our gilt positioning we added duration through global sovereign fixed income (**abrdn Global Government Bond Index Fund**).



Important Information

The value of investments, and the income from them, can go down as well as up and an investor may get back less than the amount invested.

For more information visit abrdn.com/mps

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