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FINANCIAL

Market Update

January Overview

A new year brought better fortune to global markets. Inflation falling in-line or more than expected prompted hope that central bank interest rate hikes might soon end. Improving inflation figures were helped by lower energy costs, especially in Europe as demand fell helped by warmer weather. Market sentiment was also boosted by activity picking up quickly in China after they dropped their Covid restrictions late last year. During the month, bonds delivered strong returns as future interest rate expectations fell, and equities rallied on the back of improving economic data.

The IMF was gloomy about the **UK**, predicting that it will be the only advanced economy to contract in 2023. Other than that, it was a light news month with economic data releases broadly in-line with expectations. Consumers and businesses alike were heartened by a small drop in inflation, from 10.7% in November to 10.5% in December as fuel price effects eased. Disappointingly, core inflation (excluding volatile components like energy and food) remained unchanged in December at 6.3%, whilst the composite purchasing managers index (PMI) fell to 48.5 in January from 49 in December, a fall in Services more than offsetting the rise in Manufacturing. This was the 6th consecutive reading below 50 (indicating contraction), making it the longest period of decline since the global financial crisis.

January economic data releases in the **US** were mixed. Households were cheered by strong labour markets with unemployment nudging down to 3.4% in January – the lowest level in over 50 years. This was accompanied by a positive surprise on the number of new jobs created in December, +223,000, above expectations of +200,000. Inflation continued to drop in line with expectations, falling to 6.5% (from 7.1% in November), driven by lower vehicle and energy prices. Core inflation edged down too, dipping to 5.7% in December (from 6% the previous month). However, housing costs continue to put upward pressure on inflation as rental market activity remained high driven by elevated mortgage rates, which are driving down home sales and new home starts. Broader business activity seemed to be improving, and quarter-on-quarter annualised GDP growth of 2.9% for Q4 was marginally ahead of expectations. Although composite PMI remained in negative territory at 46.6 in January, it is heading in the right direction from December's 45.0 reading, with both Services and Manufacturing improving.

Perhaps the most important news from **Eurozone** was how elevated gas reserves remain: over 80% full across the EU. Reduced usage by consumers (partly driven by warmer temperatures this winter so reduced heating needs) were instrumental in lower-than-usual winter drawdowns, but so were increased imports due to the addition of new LNG infrastructure in Germany. This has helped inflation to fall more than expected in the region, to 9.2% in December from 10.1% in November, although core inflation ticked up to 5.2%, from 5% in November. In more good news, the flash estimate for euro area Q4 quarter-on-quarter GDP growth was recorded as 0.1%, above the expectation of a 0.1% contraction. Composite PMI recorded its first jump into growth territory for seven months, standing at 50.2 in January. This was driven by strength in both Manufacturing and Services sectors.

Following on from **Japan's** monetary policy shift on yield curve control last month, the Bank of Japan was forced into buying more government bonds to defend the wider band levels as markets anticipate further widening in future. Meanwhile, inflation rose to 4% in December, from 3.8% in November, its highest level in over 30 years.

In **Emerging Markets**, stronger economic activity in China boosted positive sentiment in the broader regions, resulting in yet another strong month for emerging markets in general. Markets were more muted later in the month, however, given the Chinese New Year holiday during the last full week of January.

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Currencies - Sterling had a strong month against major currencies. It was up 2.3% against the US dollar, 0.6% stronger versus the euro and 0.9% up against the Japanese yen, but it was 1.5% weaker than the Australian dollar. Against emerging market currencies, the pound was up 4.8% versus the South African rand but was down 1.3% against the Brazilian real.

Asset Classes

January saw strong returns across almost all asset classes, in pound terms. Continental European equities were the best performing asset class over the month, aided by falling energy prices. Pacific ex-Japan and Emerging Markets also performed well on the back of increased Chinese economic activity. Japan and US were the weakest equity asset classes in pound terms, with their weakening currencies contributing to this underperformance. Real asset performance was mixed: global property bounced strongly, but the more defensive listed infrastructure lagged. Commodities were the only negative returning asset class in January, due to falling energy prices and also commodities being priced in weakening US dollars.

Within UK equities, like elsewhere globally, smaller companies outperformed in January. The mid-cap FTSE 250 index was up 5.4%, whilst the large-cap FTSE 100 was ‘only’ up 4.4%.

Fixed income performance was strong too. Government bond yields fell during the month as inflation data continued to surprise to the downside, lowering expectations for the number of future rate hikes. This resulted in bond price rises across all fixed-income asset classes, with riskier bonds outperforming. High Yield was the best-performing bond asset class in this risk-on environment.

Cash & Stable Income-Assets	Global Government Bonds	Global Inflation Linked Bonds	Global Corporate Bonds	Global High Yield	Emerging Market Bonds	US Equities	Europe ex-UK Equities	UK Equities	Japan Equities	PACIFIC ex-Japan Equities	Emerging Market Equities	Global Property	Global Infrastructure	Commodities
£	HDG	HDG	HDG	HDG	HDG	£	£	£	£	£	£	£	£	£
0.30%	1.76%	2.13%	3.03%	3.70%	2.93%	4.22%	6.84%	4.50%	3.78%	6.14%	5.42%	0.25%	6.11%	-4.20%

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