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FINANCIAL

May Overview

The US debt ceiling impasse garnered most of the market's attention in May, an impasse that was positively resolved late in the month. Elsewhere, and as expected, the Bank of England and the ECB both raised interest rates by 25 basis points to continue to put downward pressure on inflation. Unfortunately, the data continue to show that inflation remains stubbornly high in both the UK and EU and indeed most developed economies. And the divergence noted in previous months between the strength in services sectors and weakness in manufacturing sectors continued to widen. Markets were more mixed over the month, with a number of developed equity markets (with the notable exception of Japan and a lesser extent the US) falling in local currency terms whilst bonds also fell.

The biggest market headline in the **UK** was inflation remaining higher than expected. Although headline CPI fell to 8.7% in April (from 10.1% in March), it was expected to fall further (to 8.2%). Perhaps more concerning was that core inflation, excluding volatile items like food and energy, increased to 6.8% in April from 6.2% in March. This was shortly after the Monetary Policy Committee agreed to raise interest rates by 0.25% to 4.5%, with markets now expecting this to rise higher over the next few meetings. Unfortunately for households, unemployment ticked up, rising to 3.9% in March, from 3.8% in February although this is still near 45-year lows. Business activity and prospects were slightly weaker over the month too, the purchasing managers index (PMI) survey showed a picture of slowing activity as the composite PMI fell to 54 in May, down from an upwardly revised 54.9 in April. Akin to April the services sector is healthier, but still fell to 55.1 in May from 55.9 in April; whilst the manufacturing sector declined to 46.9 in May as new orders fell, well below expectations of 48.

The debt ceiling stand-off dominated **US** market news but also caused global concern. However, as the deadline to avoid default loomed, a deal was reached to suspend the debt ceiling until 2025. This was agreed by both houses and signed into law in early June, averting a US debt default that could have rocked financial markets. Separately, economic data for the month were largely positive, with inflation falling slightly to 4.9% in April from 5% in March, and core inflation also decreasing to 5.5% from 5.6% in March (largely in line with expectations). Labour market indicators showed strength, with 253,000 new jobs created and unemployment dropping to 3.4% in April from 3.5% in March. Business activity survey data also revealed underlying economic resilience, as the composite PMI rose to 54.5 in May, up from 53.4 in April, driven by a surge in services (up from 53.6 to 55.1), more than offsetting a disappointing drop in manufacturing (down to 48.5 from 50.2).

In mainland **Europe**, the European Central Bank, delivered a 0.25% rate rise as expected, to maintain downward pressure on inflation. Indeed, the latest data showed inflation remaining stubbornly high, nudging up to 7% in April (from 6.9%), with core inflation edging down to 5.6% in April (from 5.7%). As a result, markets expect another two interest rate rises in this interest rate hiking cycle. This is likely to be data-dependent and there are already signs that business activity is slowing (although still expansionary). Composite PMI fell for the first time since October, to 53.3 in May (below forecasts of 53.7), driven by falls in both services and manufacturing. The manufacturing fall gave the most cause for concern, dropping to 44.6, well below forecasts of 46.2 and the sharpest contraction in three years.

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Japan continued to garner investor interest as preliminary Q1 quarter-on-quarter GDP growth was recorded at 0.4%, above consensus of 0.1%. Inflation nudged up again (to 3.5% in April), and core inflation rose to 3.4% providing optimism that Japan might finally be able to generate some inflation, having been stuck with low to no inflation over the last 25 years. Additionally, the composite PMI crept above 50 in May (50.8) for the first time since last October.

In **Emerging Markets**, China's economic activity remains a dominant factor. Data reported for April was somewhat disappointing. Unemployment continued to fall (down to 5.2% in April), as did inflation (which stood at 0.1% in April), however, business data did not align with this as imports shrank 7.9% in April year-on-year (well below expectations of 0%) and industrial production was recorded at 5.6% in April (almost half of the expectation of 10.9%).

Currencies - Sterling was reasonably strong during May. It was 1.2% stronger versus the Japanese yen, up 2.1% against the euro, 0.7% stronger versus the Australian dollar but down 1.4% against the US dollar. Against emerging market currencies, the pound was up 6.9% versus the South African rand and 1.0% stronger than the Brazilian real.

Asset Classes

May was broadly negative for asset class performance, with two main exceptions. Japanese equities were the best-performing equity asset class, as positive macroeconomic data fuelled optimism and US equities rose slightly on the back of positive large tech company performance. European equities struggled this month, alongside the commodity-producing (particularly Australia) Pacific ex-Japan equity. Real asset performance was a little challenging with all three falling, led by Commodities.

Within UK equities, smaller companies relatively outperformed larger companies as the mid-cap FTSE 250 index was down 3.4%, whilst the FTSE 100 was down 4.9%.

Fixed income performance was steadier, but also negative as government bond yields rose slightly causing bond prices to fall. The best-performing bond asset class was global government bonds, whilst inflation-linked bonds were the weakest-performing bond asset class as their long duration meant higher sensitivity to rising yields and thus larger price falls.

Cash & Short-Term Bonds	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 Infrastructure	Global Property	Commodities
£	HDG	HDG	HDG	HDG	HDG	£	£	£	£	£	£	£	£	£
0.38%	-0.37%	-1.84%	-0.90%	-0.57%	-0.98%	1.73%	-4.33%	-4.63%	3.30%	-4.63%	-0.29%	-3.77%	-3.47%	-4.30%

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