MONTHLY REVIEW – SEPTEMBER 2023

OUR PERSPECTIVE

The Federal Reserve set the tone for the 'higher-for-longer' narrative late in September. Alongside higher oil prices, both US fixed income and equity markets took this as a negative and we saw a meaningful correction in the last two weeks of September.

US Treasuries are typically seen as a safe-haven asset when equities struggle so the recent market correction presented a major concern. It's rare that we see US equities sell-off alongside a major bear-steepening in the US Treasury curve, especially to the extent we saw. A bear-steepening is where we see higher US treasury yields, with yields at the long-end rising more than that of the short tend.

What one would typically expect is that a sell-off in US equities is accompanied by rising uncertainty. Long term growth expectations are a primary factor in long dated US treasuries, and higher uncertainty would typically lead to lower growth expectations, and lower long dated yields. So, we ask ourselves, what has changed?

There are three key components to long-dated US treasury yields:

1. Inflation expectations
2. Growth expectations
3. Term premia

The first two are really a function of monetary policy, that is, expectations of Fed policy. In September, inflation and growth expectations have effectively offset each other. That leaves term premia – which was the primary driver in the sell-off of US treasuries in September.

The term premium can be seen as the compensation investors require in order to bear the risks of changing interest rates over time. That means it has much more to do with expectations of future treasury demand and quality, as opposed to monetary policy and inflation or growth.

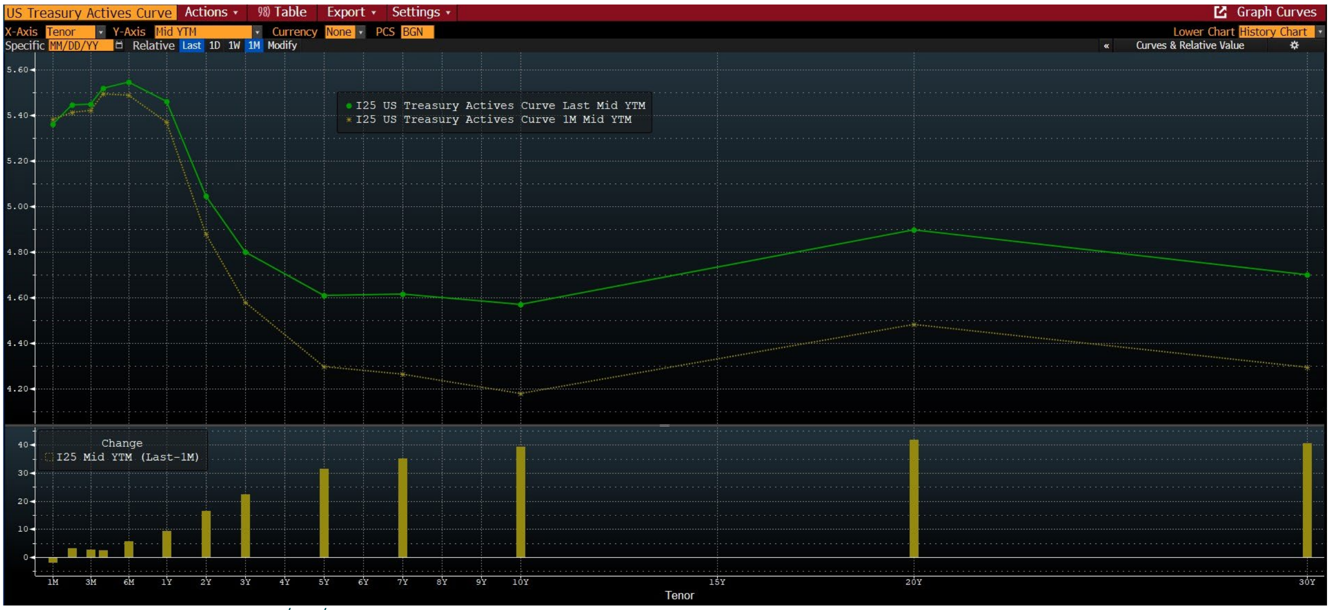
The real risk to the US economy and financial stability is that capital market lose faith in the quality and reliability of the US Treasury market. That will lead to a structurally higher term premium. The recent downgrade, rising risks of a government shutdown, and the need for more issuance in the future are all factors.

But if weak economic data doesn't result in falling long-term interest rates, the US has a problem. Structurally higher rates will have a very negative impact on both corporate and consumers, and the risks of a hard landing are intensifying.

This also highlights the risks in the 60/40 portfolio, and the need to investors diversify their portfolios. Structurally higher rates mean structurally higher risk and will lead to poorer returns in fixed income markets, and lower multiples in equity markets.

Our recommendation to investors is to diversify their portfolios. Protect against monetary devaluation, volatile inflation, structurally higher risk and subpar growth. This is what our portfolios offer!

Chart 1: US Treasury Curve end of September vs end of August:



Source: Bloomberg L.P., 30/09/2023

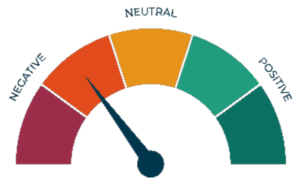
MARKET SNAPSHOT

	Index	Currency	As at Previous Close	Total Return MTD	YTD	1 Year
Equities	Bloomberg World Equity Index	USD		-4.03%	10.17%	20.63%
	Bloomberg World Equity - Growth	USD		-5.04%	13.55%	20.10%
	Bloomberg World Equity - Value	USD		-2.29%	3.75%	19.66%
	Bloomberg UK Equity Index	USD		-0.95%	6.89%	25.02%
	Bloomberg US Equity Index	USD		-4.67%	13.35%	21.38%
	Bloomberg Europe ex-UK Equity Index	USD		-4.76%	9.32%	31.19%
	Bloomberg Japan Equity Index	USD		-2.03%	11.83%	26.60%
	Bloomberg Asia ex-Japan Equity Index	USD		-2.39%	-0.03%	9.33%
	Bloomberg China Equity Index	USD		-3.25%	-8.62%	-0.79%
	Bloomberg Emerging Market Equity Index	USD		-2.31%	1.46%	9.13%
Fixed Income	Bloomberg Global Aggregate Index	USD		-2.92%	-2.21%	2.24%
	Bloomberg US Treasury Index	USD		-2.21%	-1.52%	-0.81%
	Bloomberg US Corporate Bond Index	USD		-2.67%	0.02%	3.65%
	Bloomberg UK Gilt Index	GBP		-1.01%	-4.61%	-2.99%
	Bloomberg Sterling Corporate Bond Index	GBP		0.04%	1.16%	8.11%
	Bloomberg EM Hard Currency Aggregate Index	USD		-2.28%	0.91%	7.56%
	Bloomberg EM Local Currency Govt Index	USD		-1.70%	0.44%	5.12%
Commodities	Gold Spot $/Oz	USD	$ 1,848.63	-4.59%	1.35%	11.33%
	LME Copper Spot ($)	USD	$ 8,212.50	-2.36%	-1.82%	7.40%
	Oil - Brent ($)	USD	$ 92.20	7.85%	7.32%	4.19%
	Bitcoin ($)	USD	$ 26,981.93	3.72%	63.14%	38.90%
Currencies	GBP-USD FX-Rate	USD	$ 1.22	-3.52%	0.96%	9.73%
	EUR-GBP FX-Rate	GBP	£ 0.87	-0.71%	2.16%	1.87%
	USD-JPY FX-Rate	JPY	¥ 149.37	-2.34%	-12.22%	-3.29%
	EUR-USD FX-Rate	USD	$ 1.06	-2.82%	-1.23%	7.72%

Source: Bloomberg L.P., 30/09/2023

EQUITIES

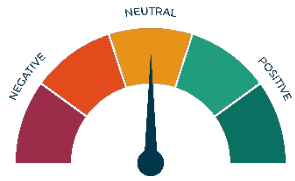
Structurally higher rates lead to growth equities taking the brunt of the sell-off in equity markets. Higher oil prices, fears of structurally higher inflation, and the risks of a higher risk premium in the US, weighed on equities globally. With corporate profitability continuing to struggle, and valuations relatively high, we remain cautious on our outlook for equities broadly. We retain a high quality, high cash-flow bias, and very focused on balance sheet quality.



FIXED INCOME

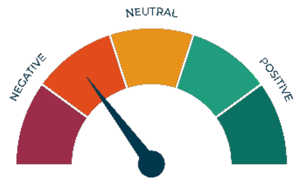
The rise in US Treasury markets is a real concern, especially in the face of a weak equity market. If capital markets are indeed questioning the quality and demand for US treasuries longer term, the risks for capital markets globally have risen materially.

Whilst credit spreads widened marginally, the significant economic slowdown, global liquidity glut and material refinancing risks are all factors that are not being priced into credit markets and accordingly and we remain underweight.



REAL ASSETS

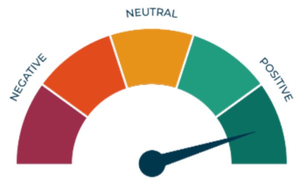
Oil prices continued to rise on the back of continued supply cuts and geopolitical uncertainty. As mentioned last month – and as we saw this one – the disinflationary benefits of the collapse in energy prices over the last 12 months are most likely behind us. Oil aside, commodities had a tough month generally, we believe an outcome of continued contraction in liquidity.



Listed Real Estate and Infrastructure markets had a real shocker, falling 6% or more during the course of the month. We do not believe this is a buying opportunity, with specific concerns for commercial real estate markets given the differential between cap-rates and short-term government bond yields.

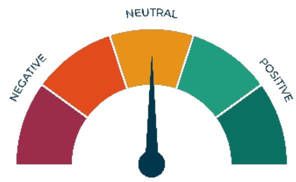
SPECIALIST STRATEGIES

Our specialist strategies continue to play a significant stabilising role within our portfolios. Our managed futures & trend following exposures continue to deliver strong performance and our market neutral and relative value hedge fund exposures had another strong month. We retain limited exposure to private markets, both credit and equity, given our concerns regarding debt and the refinancing cycle.



CURRENCIES

We remain broadly neutral on currencies. On the margin we note that inflation and interest rate differentials would support a stronger USD, The Greenback remains the global reserve currency of choice, and in a severe market sell-off, we expect it to do well. Indeed, the US Dollar Index appreciated a further 2.2% over the course of September. We also retain our positive view on the Japanese Yen, which we believe is undervalued with clear catalysts for a potential revaluation on the horizon.



CONTACT US

For further information on any of our services, or if you would like to arrange a meeting with an investment manager to see how we can work with you, please get in touch.

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