2023 - A Year in Review

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Investment Management

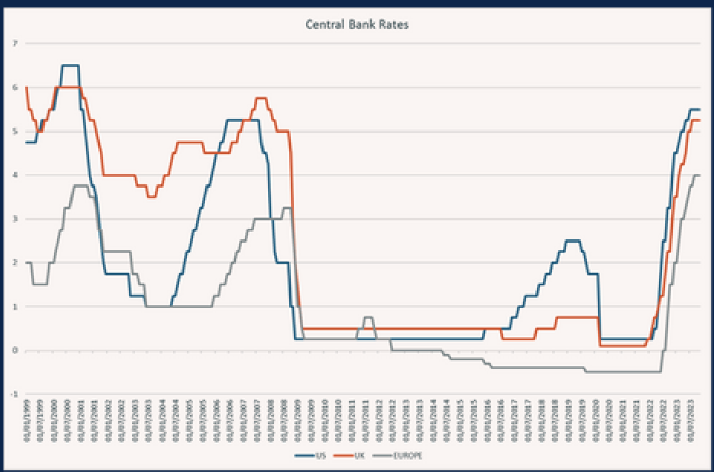
2023 closed with a bang

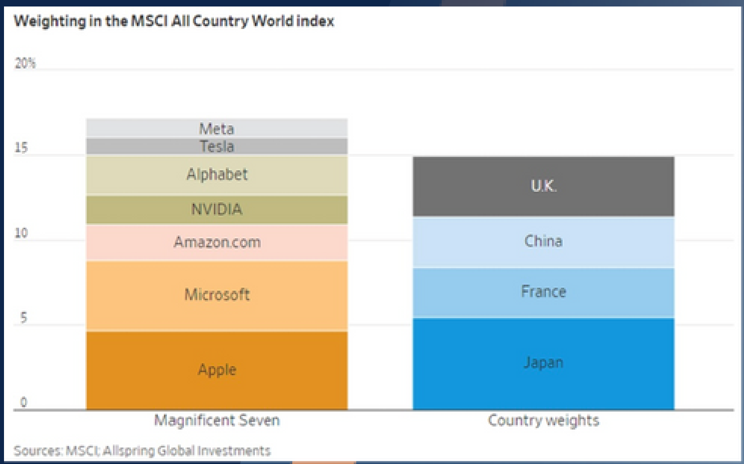
The decision from Federal Reserve Chairman Jerome Powell to announce a pivot on the outlook for US interest rates in December added further fuel to a rally in bond and equity markets in the fourth quarter of 2023. Over the course of 12 months concerns around the prospect of a recession in the US has been replaced by an overwhelming belief amongst investors that a soft landing will be achieved, and that interest rates will come down. This has prompted a significant re-pricing across multiple asset classes, some of which is likely overdone in the near term. It is worth reflecting on some of the key developments that have shaped markets over the course of 2023, including these recent developments, whilst the roadmap for 2024 can be found in our separate outlook publication.

Interest Rates Higher, Inflation Lower

Over the course of 2023 inflation across most major markets has continued to decline, but remains above central bank mandated targets of around 2%. The pace of declines has varied by country – with the US leading the way in developed markets, whilst stickier in other countries, such as our own domestic market. Emerging markets appear to be further ahead in addressing inflation, with China in particular on the cusp of deflation by the end of the year. We expect a continuation of this disinflation theme in 2024.

2023 was a year where most Central Banks continued to raise interest rates. Rates in developed markets returned to levels last seen 15 years ago. In the US, the Federal Reserve increased rates 4 times to 5.75%. The Bank of England undertook 5 hikes, 175 basis points in total, and there were six hikes from the European Central Bank. Exceptions included China, which undertook measured and targeted rate cuts designed to shore up confidence in the real estate sector, and Japan, where a loose monetary policy stance was maintained. The focus has now shifted from a hiking cycle, to a policy easing cycle in 2024, and this was a major catalyst behind the rally in equity and fixed income markets in Q4.





US Economic Growth Resilient and Defying Recession Concerns

Fears of a US recession, prevalent 12 month ago, failed to materialise, with the economy exhibiting significant resilience and outperforming expectations. A key driver has been the strength of the labour market and the consumer, with spending supported by rising real wages, which leaves the economy on track to grow by 2.5% in 2023. Europe and the UK also avoided recessions, although growth was lacklustre. The expected sharp rebound in economic activity in China following its re-opening faded quickly, and growth was slower than expected. Nevertheless the world's second largest economy is on track to expand by more than 5% in 2023.

Market Leadership In the US Has Been Narrow

The US equity market has been one of the best performing equity market this year, although this fails to tell the full story. Excitement around Artificial Intelligence (AI) has gripped the market through 2023, leading to exceptionally strong performance from the 7 largest technology companies in the US – the so-called magnificent 7 – Amazon, Alphabet Apple, Meta, Microsoft, Nvidia and Tesla. As of year end, these 7 companies had a combined market capitalisation of $11.7 trillion – accounting for circa 17% of the global equity market, and nearly 30% of the US equity market. Over the course of the 12 months they accounted for the lion's share of returns from US equities, with the residual stocks making little ground until later in the fourth quarter.

These seven technology companies have a higher weighting in global equity markets than all of the equities in the UK, China, France and Japan combined.

Some Pockets Of Concern

Volatility was elevated at points during the year. The Ukraine conflict rumbled on, and the outbreak of war in the Middle East in October led to elevated geopolitical risks, although the impact on markets was short-lived. Of more concern was the failure of three US regional banks in March, followed by the bailout of Swiss behemoth Credit Suisse, via a merger with compatriot UBS Warburg. In the case of the three US banks, poor risk management and a failure to pass on higher interests to customers ultimately led to a classic bank run. Regulators stepped in to protect deposit holders, and ultimately arrest concerns of a potential financial crisis. It led to large uptick in market volatily and a sell-off in equities. A similar bout of volatility occurred during the summer, with markets selling off on concerns that interest rates had to go higher to combat inflation. These worries receded after it became clear that the peak in interest rates had been reached, allowing markets to recover lost ground.

Capital Markets Performance

Bringing this all together, 2023 proved to be a year when recession was avoided, inflation peaked and rolled over, and interest rates were raised, but on hold from the autumn. AI also captured the imagination of investors. This laid the foundations for a rebound in equity markets. Latterly, as attention turned to 2024, and the prospect of a softer landing and likely interest rates cuts, bonds also recovered, finishing the year in positive territory.

Within equities, European indices started the year strongly, as fears of an energy shortage resulting in a recession failed to materialise. Whilst they subsequently flat lined for the rest of the year, they still posted double digit returns. As discussed earlier, US equities recorded strong gains, although this was primarily driven by seven large technology companies.

Japanese equities were the strongest performer in 2023, with the market re-rating higher amid optimism that Japanese corporates were becoming more shareholder aligned, and also hope that the country has finally moved out of its multi-decade investor slump. Having had a high exposure to this region we begin trimming back exposure here in late summer, for reinvestment into Asia ex Japan, which we expect to be a beneficiary of a recovery in Chinese economic activity.

Emerging market equities were held back weaker Chinese equity markets, which declined on concerns around the real estate sector and parts of the banking industry. Whilst measures were taken to address these risks, and restore confidence, the local Chinese market endured a challenging year, declining by more than 10% over the course of 2023. Meanwhile, our own domestic equity market lagged other developed markets, delivering a single digit return, in part due to the absence of any exposure to technology, and also weaker performance from key sectors such as healthcare and energy.