AUTUMN OUTLOOK

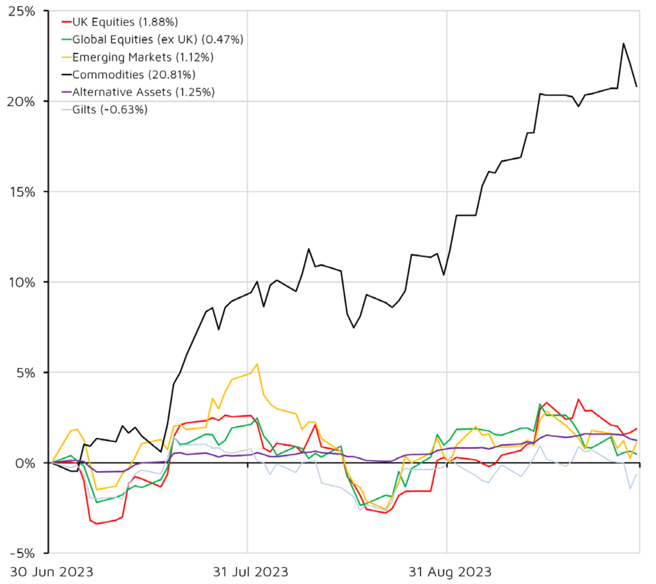
REVIEW OF THE PAST QUARTER:

The performance of global equity markets has been mixed. Investors expect interest rate hikes to end shortly but are now considering the effects of rates being held at an elevated level for an extended period.

UK equities have lagged other developed markets for much of this year due to higher inflation and a weaker economic outlook. However, strong returns in recent weeks have helped close some of the performance gap as rising interest rates once more helped banking stocks, and rising oil prices pushed up shares in the UK's energy companies.

The best performance came from Japanese equities, as modest inflation and steady economic growth rewarded investors. US and European equities have struggled this quarter. Higher interest rates have contributed to a decline in the technology stocks that fuelled the US equity rally in the first half of the year. Meanwhile, European equities have struggled as economic growth has stalled. Concerns about poor economic growth in China have dragged on the performance of emerging market equities, although this was partially offset by strong returns from Indian equities. Sterling's decline meant returns from overseas equities were positive.

Inflation has slowed and the Bank of England is expected to stop raising rates this autumn. However, the outlook remains uncertain due to inflationary pressure from rising wages and the increase in the oil price. Markets expect rates to remain higher for longer than previously forecast to ensure inflation is tamed and this caused government bonds to fall.



Performance Data Calculated on a Total Return Basis

ASSET CLASS RETURNS

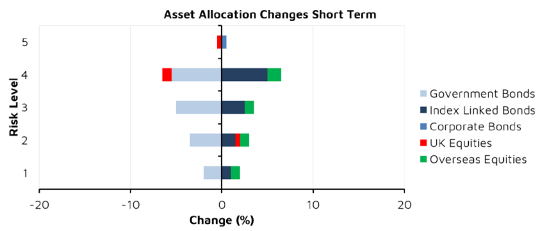
Cash	Government Bonds	Index Linked Bonds	Corporate Bonds	UK Equities	Overseas Equities	Emerging Markets	Property
+1.23%	-0.63%	-4.69%	+2.24%	+1.88%	+0.47%	+1.12%	+1.25%

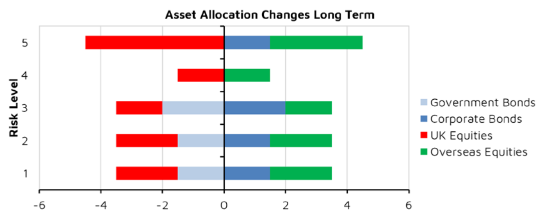
THE ACTUARIAL VIEW:

Markets seem to be priced somewhere between a soft-landing scenario and a muddle-through/mild-recession scenario, depending on the asset class. The valuations for corporate bonds and US equities suggest optimism. Cyclical stocks are pricing in a recovery already. However, there are some asset classes that are priced for a less optimistic outcome, including property, small caps and emerging markets.

The soft-landing scenario appears to be gathering support in light of stronger US data and the more rapid decline in inflation. But the picture is very mixed. While manufacturing might be close to bottoming, the service sector may be slowing as consumers finally feel the pinch.

Bond markets would appear to be starting to factor in the soft-landing scenario and its cousins 'higher for longer' interest rates and bond yields. Bonds also trade on the belief that policy is still restrictive - that the neutral rate is considerably lower than current US Federal Reserve funds. Perhaps what recent developments make more certain is that stagflation is less likely, as is an imminent recession. In a sense, the rally in risk assets merely represents a pricing out of the worst outcomes.





Data Provided by EValue

WHAT TO LOOK FOR IN THE NEXT QUARTER:

- **UK:** The Monetary Policy Committee (MPC) announcements and minutes are set to be released on 2 November and 14 December. The next monthly inflation update is due on 16 October. Preliminary GDP growth for Q3 is available on 14 November. Monthly employment data is due on 15 October. The Autumn Statement is delivered on 22 November.
- **US:** There will be interest rate decisions from the Federal Open Market Committee (FOMC) on 31 October-1 November and 12-13 December. Minutes will be published three weeks after each decision. The monthly inflation update is to be released on 11 October. GDP growth for Q3 is to be released on 26 October. The change in Nonfarm Payrolls is expected to be available on 6 October.
- **Eurozone:** Quarterly GDP flash data for Q3 is set to published on 31 October. The European Central Bank monetary policy meeting has been arranged for 26 October. The unemployment rate is set to be published on 2 October.
- **Other Data:** OPEC meeting on 4 October. Chinese GDP growth for Q3 is released on 18 October. China Caixin Manufacturing PMI is set to be published on 1 November.

ASSET CLASS SCENARIOS:

UK EQUITY

Most Likely: Inflation falls as the Bank of England nears the end of rate hikes. The country flirts with recession as consumer sentiment remains low. The trend for large company earnings and share prices holding up better than small and mid-sized companies continues. Consumer-dependent businesses are likely to do worse than less exposed peers like healthcare, consumer staples and utilities.

Worst Case: War in Ukraine causes higher energy and food prices and fuels inflation. Aggressive rate hikes cause a deep recession and send stocks and bonds plummeting; this culminates in the collapse of an unexpected area leading to a run on the wider market. The UK should be more defensive than other regions given lower relative valuations.

Best Case – Accumulated rate hikes manage to control inflation without causing significant disruption. The UK rebounds faster than other markets due to its lower starting valuation. An end to war in Ukraine cools energy, food and commodity prices, further helping to reduce inflation. As more catalysts for a bull market materialise, flows into UK equities reverse the current negative trend. Smaller companies will benefit the most from sustained growth in equity markets.

CASH

Most Likely: Money market instruments continue to provide stable income, with yields potentially rising further as the Bank of England continues its interest rate hikes. Nevertheless, interest rate increases are likely to remain behind inflation and so returns adjusted for inflation are likely to stay negative. These instruments will also suffer from negative capital returns as their price moves inversely to yields.

Worst Case: If further signs of recession appear the Bank of England is likely to raise rates less aggressively, limiting the upside for money market funds. This also means investors might revisit the case for UK government bonds as safe-haven assets, due to their sensitivity to interest rates. Cash instruments will therefore be a less compelling option for investors.

Best Case: The Bank of England raises rates higher than currently expected because of resilient economic growth amid inflationary pressures. This would improve the expected return from money market funds as managers can lock in higher rates at longer maturity dates, which may offset the loss from capital return. It would also mean cash will further help investors to protect from any downside.

GLOBAL EQUITY

Most likely: The Federal Reserve hikes rates once more but cooling inflation and the pace of recent tightening means it stops there. In the US, sectors like technology and communications benefit from the Fed signalling peak interest rates. Plunging European economic activity leads to outperformance from more defensive sectors like consumer staples, healthcare and parts of technology. The Bank of Japan is likely to further commit to monetary tightening over the next six months, causing the yen to rise.

Worst case: The war in Ukraine continues adding to supply shortages as energy and food prices rise and forcing central banks to raise interest rates further. Energy and defensive sectors benefit but European markets struggle due to their proximity to the crisis. Declining global trade has a negative impact on the export-oriented Japanese market.

Best case: An end to the war in Ukraine eases energy shortages and prices fall. Significant Chinese stimulus and the end of central banks' interest rate hikes ushers in a global bull market and a 'rising tide lifts all boats', ie all corners of the market are buoyant.

FIXED INCOME

Most likely: At least one more rate hike is possible for the UK as inflation persists. Other central banks appear at the end of the hiking cycle but rates are likely to remain elevated and this means more volatility and raises the risk of a recession. Early rate cuts would support government bond values but may see high quality corporate bonds fall. US rate cuts could see a relative weakening in the US dollar, benefiting sterling and some emerging market bonds.

Worst Case: GDP falls and inflation remains sticky as defaults and repossessions become a reality in mortgage markets. Bonds struggle with high levels of volatility, as the continuing debate about inflation and recession is extended. Very short government bonds remain a limited safe haven.

Best case: After a pause, central banks cut rates late in 2023 to deal with flagging growth and support consumer demand. Optimism continues to build for a 'Goldilocks' soft-landing as inflation is curbed with no more than a short technical recession and government bonds rally strongly.

EMERGING MARKET EQUITY

Most Likely: Chinese consumers remain reluctant to spend as more stimulus is needed. However, optimism recovers as economic indicators turn positive. Weakness in the property market may drag on the wider economy, negatively affecting employment and potentially reducing income and spending growth. Investors continue to shun Chinese markets if political tensions rise.

Worst Case: Despite efforts to restore consumer confidence and support the property market, Chinese consumer spending declines and investor sentiment remains low. Sticky inflation in developed markets reduces demand for Chinese exports and weighs on local currencies. Heightened geopolitical tensions escalate with a Chinese invasion of Taiwan – however, the probability of this is relatively low.

Best case: Chinese stimulus sparks an increase in domestic demand. US-China tensions ease, which should improve investor sentiment. A pause or cut in rates by the US would be favourable. Indian economic growth continues, fuelled by foreign investment, and the 'nearshoring' drive by the US remains a positive catalyst for Latin American.

ALTERNATIVES

Most Likely: Given the potential for a mild recession, liquid real assets with defensive properties such as gold and energy commodities may be able to benefit. In terms of strategies that use manager skill to outperform, styles such as global macro and equity long/short strategies – which are able to react to market developments as they emerge and benefit from moves in asset prices in either direction – should be poised to benefit. However, market reversals and gyrations remain a risk as they can create challenging conditions for trading.

Worst Case: More benign conditions where equity markets rally would likely lead to relative underperformance of most alternative strategies. While some managers can benefit from elements of risk-on behaviour, they are likely to wrong-foot those that are currently positioned for more bearish conditions.

Best Case: Rising volatility and dispersion of returns allow alternative assets with low correlations to major asset classes and well-positioned active managers to deliver strong outperformance.

Data Sourced from FE Analytics, and FactSet