BOWMORE
ASSET MANAGEMENT

GLOBAL MARKETS OVERVIEW

FOR RETAIL CLIENTS

3RD QUARTER 2023

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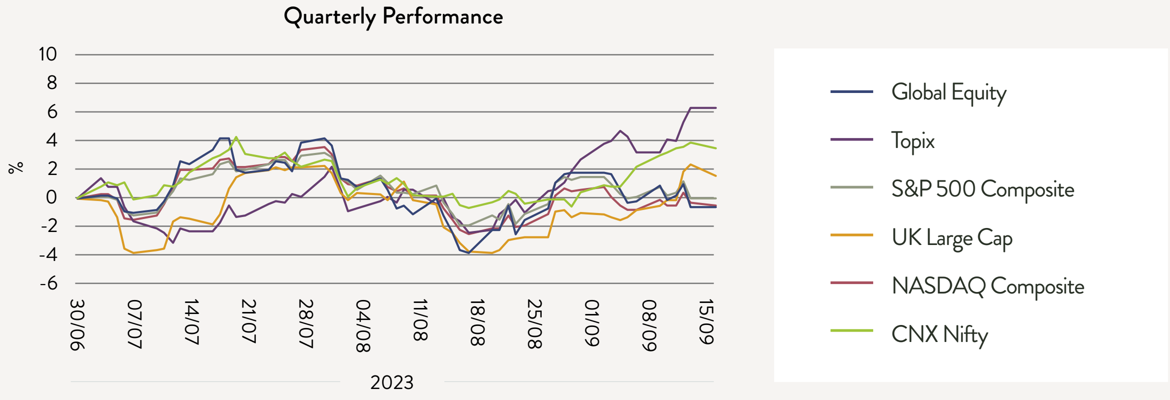
Global Markets

Our quarterly market overview provides a snapshot of recent activity within the world's financial markets. This quarter, we cover the 'higher-for-longer' interest-rate theme, the Bank of England's bond-selling programme, China's economic woes, the rise in oil prices, and more. We also highlight our views on the different areas of the market as we begin the final quarter of 2023.

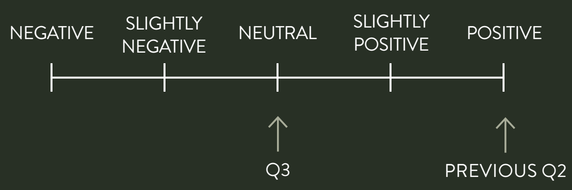


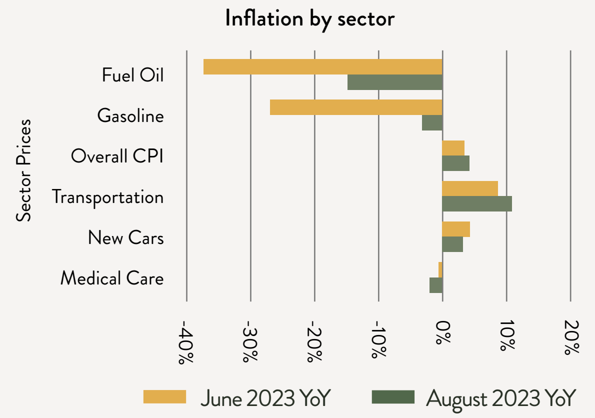
Source: LSEG, Datastream. Date Range: 30/6/23 - 15/09/23

- Global equities fell in Q3. However, in Sterling terms, returns were positive.
- UK shares delivered small gains in the third quarter, helped by rising oil stocks. US and European shares, by contrast, posted negative returns.
- Energy was the best performing sector in Q3. Tech stocks – which outperformed in H1 – saw some profit taking.
- Oil prices climbed significantly over the period with the price of Brent crude oil hitting $95 per barrel on the back of supply concerns. Looking ahead, higher oil prices could have implications for inflation.
- China continued to experience economic weakness in Q3, and this negatively impacted emerging markets equities. A slump in China's property sector has clouded the country's recovery prospects.
- The Bank of England, the US Federal Reserve, and the European Central Bank all raised interest rates during Q3 in an effort to combat inflation. Interest rates are currently near peak levels; however, we may see additional rate hikes in Q4 depending on inflation data.
- Late in the quarter, it became clear that interest rates could stay higher for longer. This led to some volatility across the world's equity markets.

Our Stance

As we move into the fourth quarter, we have a neutral stance on global equities given inflationary and interest rate pressures. Economic data is mixed, and although the turning point for interest rates now seems nearer, it may be some time before positive momentum enters markets in earnest.



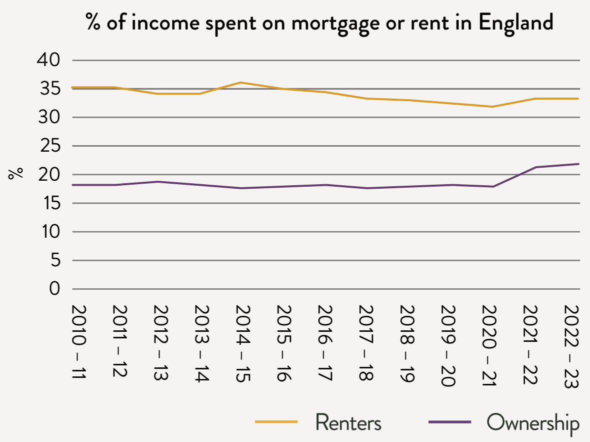


Source: LSEG, Datastream.

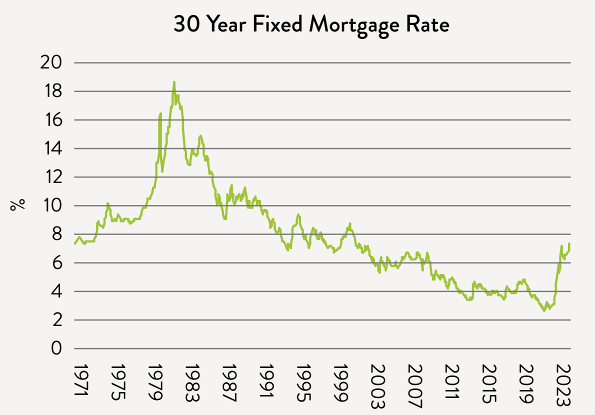
Date Range: 01/06/23 - 30/06/23 and 01/08/23-31/08/23

- Housing costs continue to be a major driver of inflation in the US.
- Food prices are generally coming down, but restaurant price inflation continues to be high.
- Higher oil prices are leading to higher transportation costs (e.g. airline fares), presenting new challenges on the inflation front.

- Over the last two years, both mortgage rates and rents have increased in the UK.
- Those with mortgages have experienced a bigger hit to disposable income than those renting.
- In the UK, rental affordability recently hit a 10-year low.



Source: LSEG, Datastream. Date Range: 2010 – 2023



Source: LSEG, Datastream.

Date Range: 29/04/71 - 29/08/23

- 30-year fixed mortgage rates have experienced a sharp spike over the last two years.
- The rise in mortgage rates have increased the costs of owning property significantly.
- Higher mortgage rates have pushed more people towards the rental market which has, in turn, pushed rents up.

UK Equities

UK equities produced small gains in Q3 with large-cap shares delivering a total return of just under 2%. The main driver of the gains was higher oil prices, as these pushed oil giants Shell and BP higher. However, solid performances from blue-chip companies such as HSBC, GSK, and BAE Systems also helped the UK market.

While overall market returns weren't prolific, there were some big gains from individual UK stocks over the period. Rolls-Royce was one of the best performers in the large-cap space, moving higher thanks to the ongoing recovery in the civil aerospace market and the company's transformation programme – both of which are helping to drive its profits up. Marks and Spencer Group was another stock that outperformed, jumping on the back of strong half-year results and an increase to its full-year guidance. On the downside, companies with exposure to China such as insurer Prudential and medical technology company Smith & Nephew underperformed. Some domestically-focused areas of the market also underperformed amid signs of a weak UK economy.

While it was revealed that the UK economy had grown by 0.2% in Q2 – versus consensus expectations of zero growth – economic indicators deteriorated during the quarter. For example, the S&P Global/CIPS flash UK Composite Purchasing Managers' Index (PMI) fell to 46.8 in September, down from August's reading of 48.6 and below the consensus forecast of 48.7. This marked the fastest reduction in private sector output since January 2021 – when the UK was on lockdown.

Clearly, higher interest rates are hurting the UK economy at present. With rates now sitting at much higher levels than they were at 18 months ago, consumers and businesses are finding that they have considerably less money to spend. Lower property prices could also be having an impact on consumer spending as people tend to spend more when the housing market is strong, in a phenomenon known as the 'wealth effect'. The Bank of England (BoE) is in a tricky position, however. For August, CPI inflation came in at 6.7% – below the forecast of 7.1% but still way above the central bank's target of 2%.

In an effort to bring inflation down, the BoE increased interest rates by 0.25% to 5.25% in August – the highest level since 2001. In September, it held rates steady, bringing to an end the longest successive period of tightening in recent BoE history (14 consecutive hikes). However, of the nine Monetary Policy Committee (MPC) members who made the interest rate decision, four voted to raise interest rates again because they felt there were 'more persistent' inflationary pressures within the economy. This suggests that there is still a significant chance that the BoE could raise rates again. Even if it doesn't, rates are unlikely to come down quickly.

Our Stance

The UK market has underperformed its peers this year, with valuations not experiencing the re-ratings seen in other global markets and remaining depressed. Our outlook for the UK is slightly negative, with appetite for UK equity exposure reduced, and the medium-term growth outlook revised lower.

NEGATIVE | SLIGHTLY NEGATIVE | NEUTRAL | SLIGHTLY POSITIVE | POSITIVE

↑ PREVIOUS Q2 (SLIGHTLY NEGATIVE)

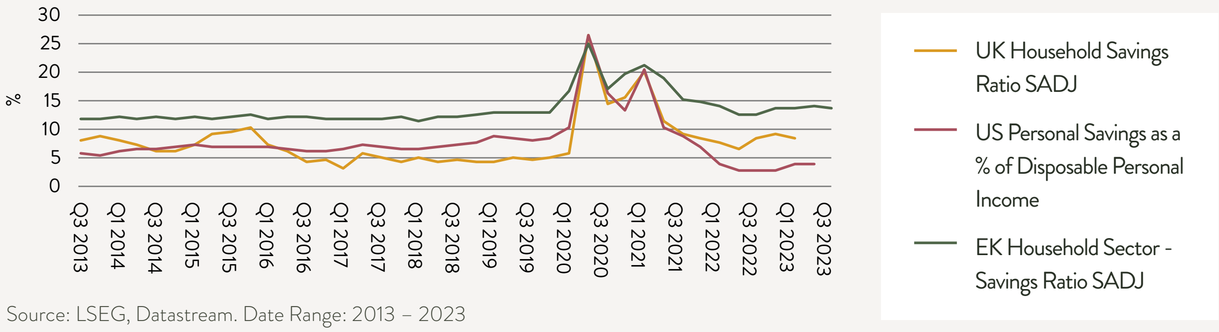
↑ Q3 (SLIGHTLY NEGATIVE)

As well as increasing interest rates, the BoE has been engaging in 'quantitative tightening' and selling the government bonds it bought during the quantitative easing (QE) era. And the aggressiveness of its sales has surprised many economists. Already, the BoE has sold off the equivalent of around 7.4% of all outstanding government debt[1], and in September, it said that over the next year it will sell off another £100 billion worth of bonds, reducing its total asset pile to £658 billion. These bond sales could have ramifications for the gilt market as they are equivalent to a significant amount of new bond issuance. However, the BoE believes that its asset sales are not likely to have a material impact on the market.

As for the pound, it had an up-and-down quarter. Early in Q3, it hit a 15-month high of 1.31 against the US dollar. However, in the second half of the quarter, it fell significantly, ending the period near 1.22 to the dollar. A lower pound makes UK exports more competitive, which could potentially increase inflation.

[1] Colombia Threadneedle

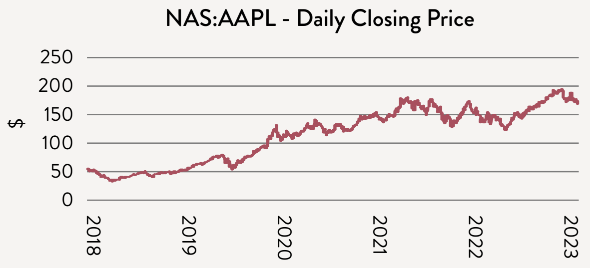
UK, US, EU saving ratios



Source: LSEG, Datastream. Date Range: 2013 – 2023

US Equities

US equities declined in Q3, however, thanks to a fall in the British pound, they still produced positive returns for UK investors. The period started well, with the S&P 500 index climbing up to around 4,600 points in late July. However, in the second half of the quarter, rising bond yields and the higher-for-longer interest rate theme spooked investors, resulting in a pullback. The best performing sector was Energy, which benefitted from higher oil prices. Tech stocks – which were the standout performers in H1 – produced mixed performances with some continuing to rise but others experiencing some profit taking.



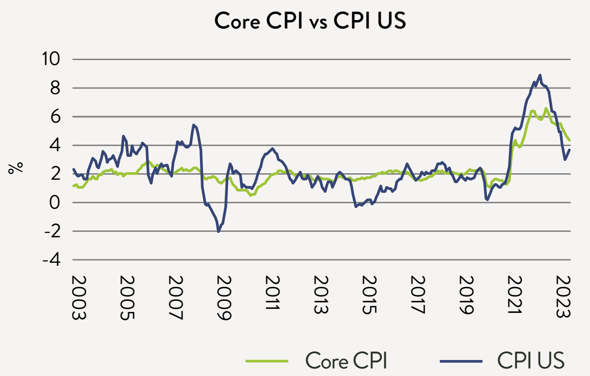
Source: Google. Date Range: 01/10/18 - 28/09/23

Given the Big Tech companies' large weightings in the major indexes, there was a lot of focus on their earnings during the quarter. Encouragingly, results here were quite good, with Meta Platforms, Amazon, and Alphabet all producing better-than-expected numbers on the back of strength across the digital advertising and cloud computing markets. As for chip designer Nvidia – which is a major player in the artificial intelligence (AI) space – it published another set of incredible results with revenue up more than 100% year on year. Yet after an initial move above the $500 mark, the stock gave up its gains in a sign that it is a little fatigued after its powerful rally in the first half of 2023. Similarly, Apple stock pulled back after earnings, with investors taking some profits off the table after its strong year-to-date rally.

Away from technology, bank results were decent, with JP Morgan, Bank of America, Citigroup, Wells Fargo, and Morgan Stanley all posting better-than-expected earnings thanks to higher interest rates and low provisions for losses. Travel-related companies such as Marriott, Booking Holdings, and Airbnb also produced good results thanks to a booming travel industry. Overall, US corporate earnings were solid, with 75% of companies in the S&P 500 beating expectations. Having said that, earnings across the board were down around 3% year on year as a result of higher costs[2].

[2] Hargreaves Lansdown

In August, investors turned their attention to the Jackson Hole Economic Symposium for clues from the Federal Reserve as to where interest rates are likely to go next. At the meeting, Fed Chair Jerome Powell acknowledged that progress has been made in the fight against inflation (US inflation has fallen from 9.1% in June 2022 to 3.7% in August 2023), however, he said that inflation is still too high and warned that additional interest rate increases could be on the way. In September, the Fed left rates unchanged at 5.25%-5.50% but again signalled that further rate hikes may be necessary. Currently, economists expect one more rate hike this year (in November). Late in the quarter, investors began to digest the ramifications of interest rates remaining higher for longer – the more restrictive policy remains, the less chance of a soft landing.



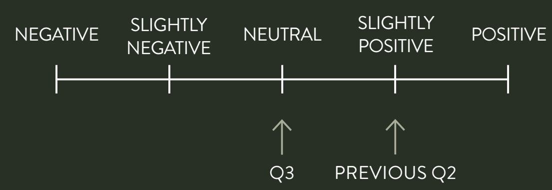
Source: LSEG, Datastream. Date Range: 15/09/03 - 15/08/23

In September, British semiconductor firm ARM Holdings came back to the public markets, listing in the US via an Initial Public Offering (IPO). Leading up to the IPO, some analysts had expressed concerns over the company's $50 billion valuation. Yet the IPO was a success, with ARM's share price rising significantly when the shares began trading. The stock gave up most of its post-IPO gains late in the month, however.

As for the outlook for US equities from here, much will depend on the state of the consumer as consumer spending accounts for around 70% of economic activity in the US. Right now, consumer data is quite mixed. For example, while Deloitte's US financial well-being index dipped to 96.7 in July from 100.6 in April[3], Amazon announced that it will be hiring 250,000 workers[4] across the US for the holiday season – nearly 70% more workers than last year. Other issues that could potentially have an impact on the US economy/market include auto worker strikes (economic losses from UAW strikes totalled $1.6 billion in the first week)[5], and the resumption of student loan payments. It's worth noting that in August, ratings agency Fitch downgraded the US to AA+ from AAA, citing fiscal deterioration over the next three years and a high and growing general government debt burden.

Our Stance

As with global equities, we have a neutral stance on US shares. This year, strong momentum in the mega-cap tech space has boosted the market, and with valuations currently at high levels, we have been taking some profits given the risk of an economic contraction. A pivot from the US Federal Reserve would be supportive for risk assets. However, interest rate cuts may be a while off, even though we have recently seen a pause from the Fed.



[3] Deloitte

[4] Amazon

[5] Investors Business Daily

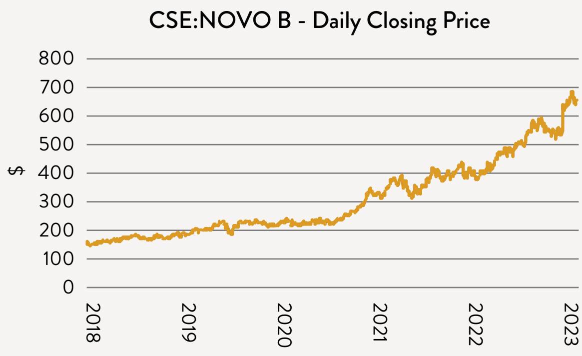
European Equities

European shares underperformed in Q3, delivering a total return of around -2%. Oil stocks such as TotalEnergies and Eni SpA performed well, however, the market was dragged down by weakness from luxury goods stocks such as LVMH and Hermes, as well as semiconductor equipment manufacturer ASML, which has the largest weighting in the index.

Corporate earnings across Europe were generally resilient, with nearly 60% of companies beating estimates for Q2[6]. Bank earnings were solid, with European banks reporting higher net-interest income from a year earlier as well as stronger margins. However, luxury goods companies' earnings disappointed. This luxury goods sector has been a phenomenal trade in recent years, with many investors seeing it as Europe's answer to America's high-flying tech stocks. However, the trade now appears to be breaking down as a result of economic issues in China – the source of as much as a fifth of European luxury retailers' sales – and higher interest rates globally.

During the quarter, Danish diabetes and obesity drug company Novo Nordisk overtook LVMH to become Europe's largest company by market capitalisation. Novo Nordisk is enjoying strong growth right now thanks to high demand for its weight-loss drug, Wegovy. Demand for this drug has been so high that the company has been forced to reduce the supply of starter doses to the US market in order to ensure that there are enough supplies for existing patients. In a study found that Wegovy can cut the risk of heart attacks and strokes in non-diabetic people with obesity by 20% and these additional health benefits may help convince insurance companies to pay for the drug going forward, further increasing demand.

Eurozone GDP grew by 0.3% quarter on quarter in Q2. Yet recent data points to a cooling economy. In September, the HCOB Flash Eurozone Composite PMI came in at 47.1, with new orders falling for the fourth consecutive month. The European Central Bank (ECB) made its 10th consecutive hike in September, taking rates to 4.0% (its highest level ever). However, it signalled that it is likely now finished increasing rates, despite the fact that inflation – which came in at 5.3% for August – remains above its target.

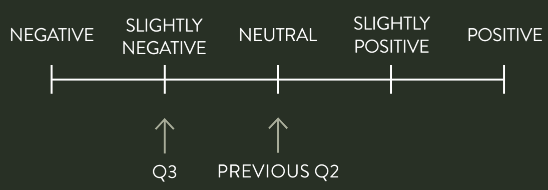


Source: Google. Date Range: 1/10/18 - 28/09/23

Looking ahead, Europe has big plans to expand its renewable energy industry. However, electricity industry association Eurelectric has said that for Europe to hit its ambitious clean energy targets, unprecedented investments will need to be made in Europe's electricity grids between now and 2050.

Our Stance

Although our allocation to European equities performed well in 2022, we are not particularly excited about the medium-term outlook for Europe. Geopolitical tension remains elevated, and the energy supply landscape is uncertain as we head towards winter. However, with the ECB suggesting that interest rates have now peaked in the region, we could see some momentum in Europe as confidence builds.



[6] BlackRock

Japanese Equities

After a strong run in the first half of 2023, Japanese stocks paused for breath in Q3.

Reflationary dynamics – driven by a pickup in domestic travel and an inflow of international tourism – are helping to drive nominal economic growth in Japan at present. And this was reflected in Q2 corporate earnings, with Japanese firms reporting strong year-on-year sales and earnings growth for the period and saying that they have the pricing power to pass on higher costs.

However, sentiment towards Japanese equities was weakened by political issues during the quarter. Prime Minister Fumo Kishida's popularity continued to decline, largely due to the effect of persistent inflation on households. Meanwhile, the release of nuclear wastewater from the Fukushima power plant drew some criticism from China, and this weighed on some areas of the market.

In July, the Bank of Japan (BoJ) announced that it would be loosening its yield curve control and said that it would have "greater flexibility" in its monetary policy going forward. This came after Tokyo CPI inflation came in at 3.2% – above the forecast of 2.8%. The move from the BoJ sent shockwaves throughout the world's financial markets as the central bank has been very accommodative with its monetary policy for a long time now.

It's worth noting that Japanese stocks have a relatively low correlation with global equities and therefore could provide some protection in the event of a global stock market sell-off. They also have a positive correlation with global yields and in an environment of higher-for-longer interest rates, could provide some attractive opportunities.

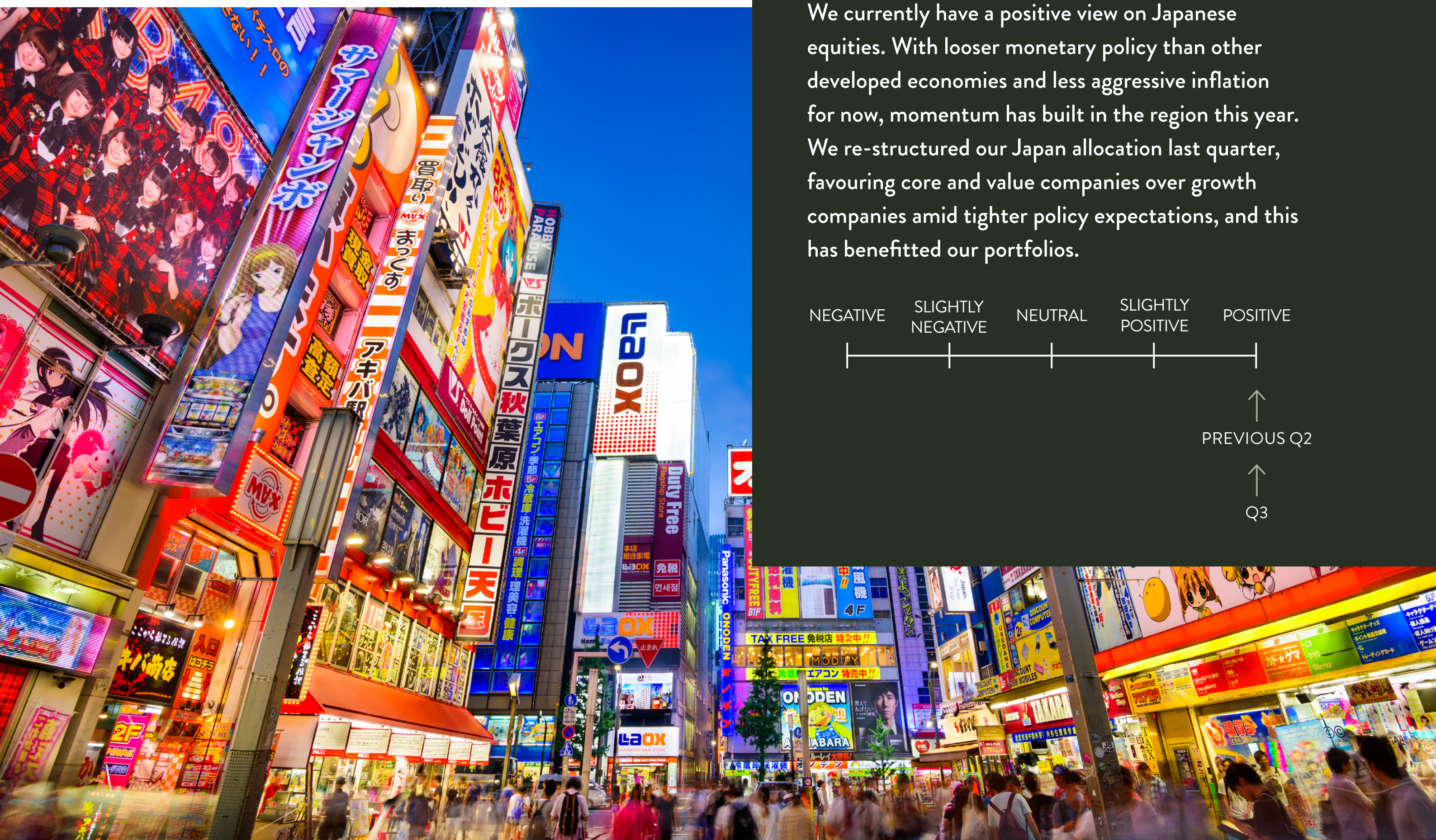
Our Stance

We currently have a positive view on Japanese equities. With looser monetary policy than other developed economies and less aggressive inflation for now, momentum has built in the region this year. We re-structured our Japan allocation last quarter, favouring core and value companies over growth companies amid tighter policy expectations, and this has benefitted our portfolios.

NEGATIVE | SLIGHTLY NEGATIVE | NEUTRAL | SLIGHTLY POSITIVE | POSITIVE

↑ PREVIOUS Q2

↑ Q3



Asia and Emerging Markets

Emerging markets stocks were up and down in Q3. They rallied in July – outperforming developed market equities – on the back of optimism over China. However, they gave up their gains later in the quarter amid concerns that a prolonged period of high interest rates will negatively impact growth prospects in the developing world.

China's economic woes continued, with data pointing to a continued slowdown. Given the economic weakness, the Chinese government pledged to step up support for the economy. However, so far, it has only announced relatively small stimulus, and many investors are concerned that the measures won't be enough to arrest the economic slide. Ultimately, China's central bank is constrained in how much it can ease monetary policy due to concerns that a widening interest rate gap with the US could trigger capital flight and currency weakness.

Late in August, the Chinese real estate sector made headlines after Evergrande Group – which was once China's leading property developer – filed for bankruptcy protection in the US. Shortly before the end of the quarter, its shares were suspended. On the back of the weakness in the property sector, the Asian Development Bank trimmed its growth forecast for China to 4.9% from 5.0%[7].

It is to be noted that Chinese stocks currently account for around 30% of the emerging markets index. So, the weakness across the Chinese market in the first three quarters of 2023 has put pressure on this index this year. The economic issues in China have also had a negative impact on a range of UK- and US-listed stocks including the likes of Prudential, Nike, and Estee Lauder.

Elsewhere in the emerging markets, India had another strong quarter with its main stock market index hitting record highs. The Indian economy has momentum at present (annualised growth of 7.8% for Q2), and has been able to resist inflation, elevated interest rates, rising oil prices, and the global slowdown. This momentum, combined with robust flows from both domestic investors and global investors (India is benefitting from China's underperformance) propelled share prices higher during the quarter. Direct Indian equities exposure in Bowmore portfolios boosted investors' returns over the period.

[7] Reuters

Our Stance

We believe Asian and emerging markets offer an attractive opportunity for investors, given their tailwinds. With many developing economies currently sitting later in the interest-rate cycle, emerging markets are not battling the same challenges developed nations are facing. This outlook will improve further if we start to see the Chinese economy strengthen, with demand and investment boosting growth.

NEGATIVE | SLIGHTLY NEGATIVE | NEUTRAL | SLIGHTLY POSITIVE | POSITIVE

PREVIOUS Q2

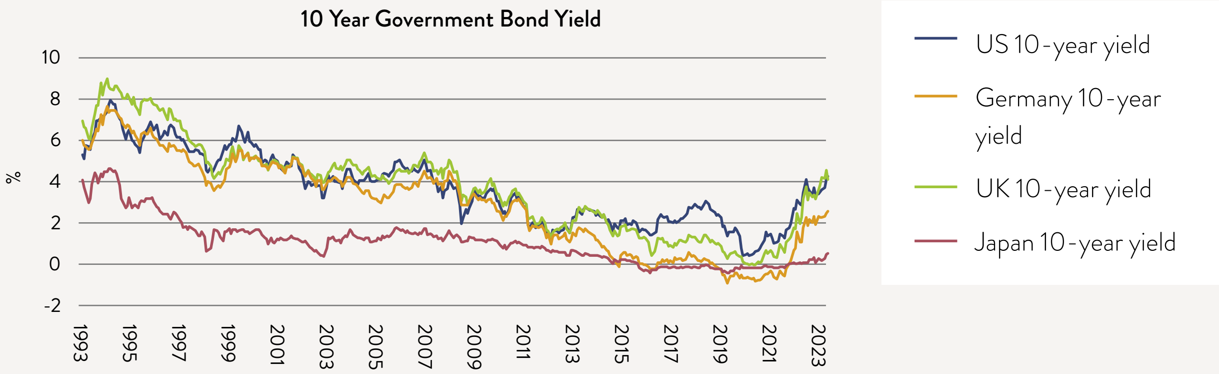
Q3

Government Bonds

In the fixed income space, there were some big moves in government bond yields during Q3.

In the US, 2-year Treasury yields climbed above 5.1% late in the quarter, outyielding the US equities by over 3.5%. Meanwhile, 10-year Treasury yields rose above 4.6% – a 16-year high. As for 10-year real yields – a measure of the stated return on Treasury bonds minus inflation – these exceeded 2% during the quarter for the first time since 2009. These higher yields resulted in equity market volatility at times.

In the UK, 10-year gilt yields rose to near 4.75% in mid-August – a 15-year high. However, they retreated in the second half of the quarter amid signs that UK interest rates could be close to their peak. Gilt exposure in Bowmore portfolios added towards the end of Q2 should provide a buffer should the economic environment deteriorate further. We have brought low-coupon gilts across the yield curve – some more sensitive to interest rate reductions, which we believe are coming. This is not just an interest rate call, however. We expect the BoE to pause quantitative tightening at some stage, bringing yields down further.



Source: LSEG, Datastream. Date Range: 20/09/93 - 20/09/23

Our Stance

We currently hold a neutral view on government bonds, reflecting a more positive landscape for fixed interest assets in general. While we prefer higher-risk fixed income assets due to their wide spreads, government bonds allow us to take advantage of attractive yields and will bring a defensive aspect to portfolios should we see growth revised down further.

NEGATIVE | SLIGHTLY NEGATIVE | NEUTRAL | SLIGHTLY POSITIVE | POSITIVE

Q3 (NEUTRAL) | PREVIOUS Q2 (SLIGHTLY POSITIVE)

Investment Grade and High Yield

With interest rates now at much higher levels, investment grade bonds – the safest class of corporate credit – are currently offering an enticing mix of high yields and defensive qualities. We added to this area of the market last autumn when the spread over government debt had widened considerably, making the risk premium more attractive. Looking ahead, higher-quality bonds with longer durations and more sensitivity to interest rate changes should benefit the most when rate increases come to an end.

There are also a lot of opportunities in the high-yield market at present. However, investors need to be aware of the risk of defaults here. Ratings agency Moody's has estimated that the default rate for global high-yield bonds could rise to almost 5% in 2024[8] as higher borrowing costs put pressure on borrowers. Of course, active managers can target quality within the high-yield market and aim to minimise risk. Yields at the shorter end of the curve have moved out furthest, so a short duration allocation is a play on the market reaction when rate expectations turn.

It's worth pointing out that the high-yield market has evolved significantly over the last 15 years. Today, BB-rated bonds – the highest-quality high-yield bonds – account for nearly 60% of the high-yield market versus around 40% at the start of 2008. By contrast, the proportion of CCC-rated bonds – the riskiest part of the market – has fallen from 17% to 9%. To give some context to these numbers, between 1981-2021, the average chance each year of a default for BB-rated bonds was just 0.6% while for CCC-rated bonds it was around 25%[9], according to ratings agency S&P.

Our Stance

Both investment grade and high-yield fixed income yields have risen markedly since 2021, leading to a positive view on these sectors. Within high yield, short-duration assets should perform better in the short term if rates are cut, and we have seen this play out when policy expectations have improved.

Investment Grade

NEGATIVE | SLIGHTLY NEGATIVE | NEUTRAL | SLIGHTLY POSITIVE | POSITIVE

↑ PREVIOUS Q2 (POSITIVE)

↑ Q3 (POSITIVE)

High Yield

NEGATIVE | SLIGHTLY NEGATIVE | NEUTRAL | SLIGHTLY POSITIVE | POSITIVE

↑ PREVIOUS Q2 (SLIGHTLY POSITIVE)

↑ Q3 (POSITIVE)

[8] Bloomberg Law

[9] Portfolio Advisor

Property

High interest rates continued to put pressure on the UK property market in Q3. According to Halifax – the UK's largest lender – house prices registered a 4.6% annual fall to the end of August[10]. This represented the largest year-on-year drop since 2009. Meanwhile, figures from property website Zoopla showed that the UK is only on track for about one million house and flat sales this year[11]. This would represent the lowest level of sales since 2012.

As for UK commercial property, the latest Royal Institution of Chartered Surveyors (RICS) UK Property Monitor showed that the upward shift in interest rate expectations has placed renewed pressure on capital values. Nearly 70% of respondents to the survey said that they feel the overall market is in a downturn, with the deteriorating credit environment playing a major role[12]. However, the survey noted that there are pockets of resilience across occupier markets, with industrials continuing to exhibit positive rental growth projections for the year ahead. At global level, the RICS Global Commercial Property Monitor showed that sentiment towards commercial property continues to be downbeat due to concerns over higher interest rates.

Our Stance

Property assets have come under pressure over the last few years as Covid and the cost of living has pegged back commercial and retail valuations. While these investments provide a regular income stream and have potential to deliver capital gains when economic conditions improve, we hold a negative view on the sector at present.

NEGATIVE | SLIGHTLY NEGATIVE | NEUTRAL | SLIGHTLY POSITIVE | POSITIVE

PREVIOUS Q2

Q3

[10] Halifax

[11] Zoopla

[12] RICS

Commodities

Turning to commodities, oil had a strong quarter with the price of Bent crude oil rising as high as $95 per barrel in September. The main driver of the increase in oil prices was news that Saudi Arabia and Russia will extend their production cuts (around 1.3 million barrels per day) until the end of the year. However, positivity around demand from China – which flies in the face of a less bullish growth profile for China this year – also buoyed prices.

Whilst we do not hold an oil-specific position in portfolios, our allocation to a derivative-driven commodity fund paid off during the quarter as it delivered solid returns. This helped boost overall performance at a time when global equities were a little weak.

In the precious metals space, gold jumped early in the quarter but then pulled back later in the period on the back of strength in the US dollar, which appreciated due to rising US bond yields and higher-for-longer Fed interest rate expectations.

Our Stance

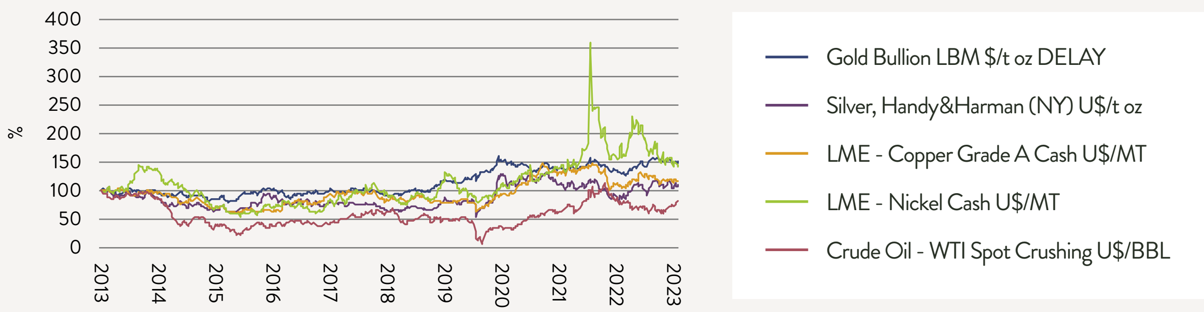
We are currently neutral on commodities. While commodities outperformed in 2022 as most asset classes fell, 2023 has seen demand fall, along with prices, with the exception of oil. Given the high level of volatility associated with commodities, timing is often the key to allocating effectively to this asset class.

NEGATIVE | SLIGHTLY NEGATIVE | NEUTRAL | SLIGHTLY POSITIVE | POSITIVE

PREVIOUS Q2

Q3

Commodities Price change in %; 10 years



Source: LSEG, Datastream. Date Range: 18/09/13 - 20/09/23

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The value of an investment with Bowmore Asset Management will be directly linked to the performance of the funds you select and the value can therefore go down as well as up. You may get back less than you invested. Past performance is not a guide to future performance. You should also bear in mind that the levels and bases of taxation and reliefs from taxation can change at any time, and are generally dependent on individual circumstances.

Past performance is not a guide to future performance.

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