DART CAPITAL

Market Commentary

November 2022

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It was another positive month for equity markets, as signs of a cooling US economy and softening commodity prices bolstered hopes that Central Banks will be able to slow, and then cease, interest rate hikes through the first half of next year. We used the sharp rally in the Pound over the month to bring exposure to overseas currencies back up to a more neutral level, a move which we expect to bolster portfolio resiliency over coming months. Our portfolios remain heavily tilted towards profitable, solid companies with strong balance sheets, whilst our bond allocation – with investment grade corporate bonds yielding over 5% and inflation-linked government bonds with positive real yields – form a firm foundation for returns for this part of the portfolio.

US

The month started with the US Federal Reserve's monetary policy committee (known as the FOMC) announcing a 75 basis points increase in the Federal (Fed) funds rate, which brought the rate up to 4%. The statement accompanying the decision indicated that the Committee will likely slow their pace of rate hikes over coming months, whilst they are aware of the significant size of the monetary tightening over the last six months, and the inevitable lag in seeing the impact the policy changes are having on the underlying economy. However, Chairman of the Federal Reserve, Jerome Powell, was more hawkish following the meeting, noting that interest rates are likely to be peak at a higher level than the 4.6% level the market was pricing in at that point in time.

There were several indications that the US labour market is starting to cool over the month, with the unemployment rate edging up from 3.5% to 3.7%, whilst the ADP Employment Change figures indicated that only 127,000 jobs were added during October, the lowest level of jobs growth in over a year. The ADP figures were particularly notable, because it shows the continued divergence between – generally higher paid roles in areas such as information technology and financial services which are seeing job losses as companies cut back on hiring, whilst the leisure & hospitality sector remains strong, gaining 224,000 jobs. The housing market has clearly slowed, with house prices declining and new construction activity weakening, whilst the leading indicators for inflation – such as shipping rates, the money supply and producer inventories – are all pointing to declining inflation over the first half of next year. Despite this, we expect the Federal Reserve's messaging to remain relatively hawkish in their mid-December meeting, as the headline level of inflation – which still stands at 7.7% in the 12 months to the end of October, albeit down from 8.2% the month prior – is still uncomfortably high, whilst the outlook for wage growth remains stronger than they would like, driven in large part by labour shortages. On the back of some of the weaker data released over the month, Treasury yields declined, with the yield on the 10-year Treasury falling 38 basis points to end the month at 3.7%. US Equities, as represented by the S&P 500, gained 5.4% in US Dollar terms over the month.

UK

In their meeting a day after the Federal Reserve, the Bank's Monetary Policy Committee (MPC) agreed a 75 basis point increase in the base rate, which brought it up to 3%. Notably, two members of the Committee dissented from the decision, with one member each voting for an increase of only 25 basis points and 50 basis points respectively. Per the meeting minutes, "the majority of the Committee judged that, should the economy evolve broadly in line with the latest Monetary Policy Report projections, further increases in Bank Rate might be required for a sustainable return of inflation to target, albeit to a peak lower than priced into financial markets". On the prospects for the economy, the MPC were less optimistic than their American counterparts, with the Committee forecasting an imminent recession which could last up to two years, with the base rate likely to peak at a lower rate than the 4.75% the market had been pricing in given the significant impact of rate hikes.

The Autumn statement was broadly cautious, leaning on tax rises for higher earners and frozen tax bands doing most of the heavy lifting. Rising US interest rates have pressured all governments to emphasise cutting their budget deficits, and it is certainly possible that the UK government will have more flexibility once US interest rates have peaked. International markets have taken comfort from the more prudent approach taken by the new Conservative leadership, with the Pound rallying from $1.03 at the lows in late September to reach a peak of $1.21 towards the end of the month. We view this level as broadly fair value given the US economy's advantage in energy and food production – in which it is largely self-sufficient – whereas the UK, and continental Europe for that matter, are net importers, which is in turn forcing these countries to subsidise households and government departments over this period of elevated commodity prices. As a result, we used the sharp rally to add some more US Dollar exposure to portfolios, a move which we believe should serve to provide resilience to portfolios in the event that the Bank of England's Monetary Policy meeting in mid-December sees them raise rates by only 25 basis points, a decision which should indicate whether the Bank are more concerned with inflation expectations and the level of the Pound, or economic activity, with the housing market and consumer spending particularly at risk from further rate hikes. MSCI UK All-Cap ended the month up 6.8% in capital return terms.

Eurozone

Eurozone inflation actually came in lower than economist expectations over the month, although – at over 10% in the 12 months to the end of October – it still stands at an uncomfortably high level, which is set to remain elevated for longer than the US due to the greater increase in the price of energy on the continent. The unemployment rate across the currency bloc edged down to 6.6% in the most recent figures, although the manager survey data from the manufacturing and services sectors both indicated contracting activity. The European Central Bank (ECB) are set raise their base rate again in their next meeting, with the most recent comments from the ECB indicating that they are most concerned that elevated inflation expectations will remain entrenched, with the knock-on effect on wage demands. MSCI Europe ex-UK ended the month up 6.8% in local terms.

Asia

There are nascent signs that, under pressure from a populous which are increasingly tired of the stringent zero-COVID policies, the Chinese authorities are trying to loosen their inflexible stance. For instance, senior party officials publicly pushing for the elderly to get vaccinated, and playing down the severity of the omicron variant, whilst several major cities have scrapped PCR testing requirements for attending public venues, amongst other measures. MSCI Emerging Markets ended the month up 14.6% in US Dollar terms.