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July 2023
Market Pulse

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HOPES OF 'GOLDILOCKS' SOFT LANDING TAKE HOLD

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Global stock markets made further gains in July, with US stocks benefiting from a favourable economic backdrop. Bond markets were mixed, as changes to yield curve control management by the Bank of Japan (BoJ) contributed to higher government bond yields, whereas corporate bonds rose on an improving growth outlook. Inflation surprised to the downside for the first time since the beginning of the year; this, together with robust economic activity data releases, increased the probability of a 'soft landing' for the global economy – an economic slowdown without a recession. A divergence remained between regions, however, with the US economy showing relative strength compared to Europe and China.

US inflation

US inflation data showed signs of cooling, leaving the potential for the Federal Reserve (Fed) to dial back its tightening rhetoric. June US consumer prices rose by less than expected, with the headline rate at 3.0% y/y and core inflation at 4.8%.

At its July meeting, the Fed hiked its key rate by 25bps to a range of 5.25-5.50%, as expected. The central bank declined to give guidance on future policy moves, but suggested the end of the tightening cycle was close. Chair Powell indicated that the Fed remains data dependent and that future decisions would be determined by upcoming inflation and labour market releases.

By month end, investors believed the Fed was close to the peak of the tightening cycle with only a 20% probability of another rate hike. The tone of the press conference was deemed to be somewhat positive in relation to the growth outlook, with Powell saying that Fed staff estimates now expect a slowdown rather than a recession. As a result, hopes of a 'Goldilocks' soft landing took hold, with the potential for rate cuts in 2024, as inflation continues to fall over the next 12 months.

US economy

Economic data in the US continued to show resilience, with the labour market remaining strong. June non-farm payrolls showed that 209k jobs were added in the month. Average hourly earnings rose by 4.4% year on year (y/y), above the projected 4.2%. Initial jobless claims fell in July to 221k, the lowest level since February.

June retail sales rose by 0.2% month on month (m/m), less than the 0.5% expected. However, the control group – which is deemed a more accurate measure of consumer demand – expanded by 0.6% m/m against consensus expectations of 0.3%. Q2 GDP rose by 2.4% quarter on quarter (q/q) annualised, up from 2.0% in Q1 and above consensus expectations of 1.8%, supported by business investment, which grew 7.7%.

Europe

Meanwhile, eurozone data suggested a much more sluggish economic backdrop in Europe. Retail sales were flat in May, below the 0.2% rise expected. Sentiment surveys were also lacklustre. The European Central Bank's (ECB's) quarterly bank lending survey showed that business loan demand had fallen to a 20-year low. Household credit demand also fell while banks continued to tighten lending standards, although this was slightly less severe than in the previous quarter. Germany's IFO business climate index fell by more than expected in July, and the composite PMI for the eurozone fell a further point to 48.9 (a level below 50 indicates an output contraction). Despite the softer data points, however, the initial release of eurozone GDP for Q2 surprised slightly to the upside, growing 0.3% q/q and 0.6% y/y.

The ECB raised its key policy rate by 25bps to 3.75%, in line with expectations and matching 2001's all-time high. Like the Fed, the ECB indicated that future decisions would be data dependent, with President Lagarde suggesting that the ECB did not 'have more ground to cover' in terms of raising rates further as things stand. The ECB did, however, suggest that policy would remain restrictive and that rates would remain high for as long as necessary to bring inflation down to the 2% target. At month end, investors were assigning a 60% probability to one further rate hike from the ECB.

MARKET ROUND-UP

Equities

Global stock markets rose strongly in July. The MSCI All Country World index rallied by 3.2% (2.6% in euros) over the month as stocks were supported by broadly resilient economic data and expectations of 2024 rate cuts amid falling inflation. The MSCI USA rose by 3.4% (2.4% in euros) as hopes for a soft landing were in greater evidence than in other regions. European ex UK equities were more muted, with a less supportive economic outlook; the asset class climbed by 1.3% (1.9% in euros). Small-cap equities rose 4.3% (3.8% in euros), outperforming large caps, supported by the more resilient growth in the US and increasing hopes of a soft landing.

Emerging-market (EM) equities outperformed developed markets in July, rising by 5.4% (5.2% in euros). The asset class was boosted by a recovery in Chinese equities, which rose 10.1% as the authorities announced plans to introduce stimulus measures to support growth. The Chinese government also announced it would implement policies to boost consumption, the property sector, public and private investment and resolve local government debt issues. While no details of proposed measures were provided, the prospect of additional stimulus in coming weeks and months led to a rally in Chinese equities.

Bonds

Bond markets were mixed in July. Core sovereign markets were lower following changes to yield curve control management by the Bank of Japan (BoJ), which contributed to higher yields. The BoJ announced greater flexibility around the target range for 10-year yields, suggesting a new upper limit of 1.0% versus the previous limit of 0.5%. Following the announcement, expectations that Japanese investors could reduce holdings of overseas bonds and reinvest in domestic Japanese bonds as yields rose caused a modest sell-off in global sovereign bonds towards month end.

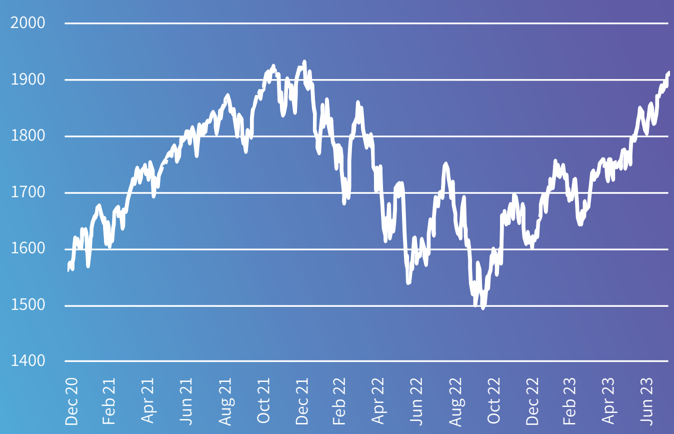
The ICE BofA 5+ Year Euro Government bond index fell -0.6%, with the German 10-year yield rising to 2.49%. Italian 10-year spreads against Germany fell 7bps to 161bps as the ECB moved closer to the end of its tightening cycle. Spanish spreads rose 3bps to 103bps on the back of an inconclusive general election, with a second election potentially required in coming months.

European investment-grade (IG) corporate bonds, however, rose by 1.1% in July, supported by expectations that central bank rate increases were close to peaking and growing hopes that a soft economic landing would be achieved and a recession would be avoided. For similar reasons, global high-yield bonds were up by 1.6% (0.6% in euros), with yields down 20bps to 7.59%, while spreads fell 24ps to 334bps.

EM local debt rose by 1.7%, aided by the attractive carry, with yields marginally down by 1bp to 6.32%. EM hard debt rose by 1.5%, aided by a weaker US dollar.

CHARTS OF THE QUARTER

Global Equities



Source: ILIM, Bloomberg. Data is accurate as at 31 July 2023.

Bonds – German 10-year yield

Source: ILIM, Bloomberg. Data is accurate as at 31 July 2023.

MARKET SNAPSHOT

Market returns (EUR)

Equity Markets (EUR)	MTD Return (%)	YTD Return (%)	2022 Return (%)
MSCI Ireland	6.1	31.9	-21.1
MSCI United Kingdom	2.4	8.6	1.4
MSCI Europe ex UK	1.9	15.6	-11.9
MSCI North America	2.4	16.9	-13.8
MSCI Japan	1.9	12.9	-10.8
MSCI EM (Emerging Markets)	5.2	8.1	-14.5
MSCI AC World	2.6	14.7	-12.6
10-Year Yields	**Yield Last Month (%)**	**2022 Yield (%)**	**2021 Yield (%)**
US	3.96	3.87	1.51
Germany	2.49	2.57	-0.18
UK	4.31	3.67	0.97
Japan	0.61	0.42	0.07
Ireland	2.89	3.13	0.24
Italy	4.10	4.70	1.17
Greece	3.76	4.62	1.34
Portugal	3.22	3.59	0.47
Spain	3.52	3.66	0.57
FX Rates	**End last month**	**2022 Rates**	**2021 Rates**
U.S. Dollar per Euro	1.10	1.07	1.14
British Pounds per Euro	0.86	0.89	0.84
U.S. Dollar per British Pounds	1.29	1.21	1.35
Commodities (USD)	**MTD Return (%)**	**YTD Return (%)**	**2022 Return (%)**
Oil (Brent)	14.2	-0.4	10.5
Gold (Oz)	2.7	8.1	-0.3
S&P Goldman Sachs Commodity Index	10.7	2.4	26.0

Source: ILIM, Bloomberg. Data is accurate as at 31 July 2023.

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THE ILIM VIEW – LOOKING AHEAD

Global equities have proved resilient in 2023 as recession fears have receded and a peak in central bank policy rates has come into view. While global earnings are forecast to be down slightly this year, they have held up better than feared: sales have surprised to the upside in the better economic backdrop, and the margin squeeze for corporates has been milder than anticipated.

Following the gains over the year to date, global equities appear slightly expensive, trading on a 12-month forward price-to-earnings (P/E) multiple of 16.9x against a long-term average of 16.0x. The 12-month forward P/E for the MSCI USA is 20.3x against a long-term average of 17.1x. Equities outside the US offer better value. Europe ex-UK equities trade at a multiple of 13.0x against a long-term average of 13.1x; Japanese equities trade at 15.1x versus a long term average of 15.8x; while UK equities trade at 10.8x against a long term average of 12.2x. Emerging markets are trading at 12.6x versus a long-term average of 11.6x. Equities remain expensive against both bonds and cash, given the high yields currently available on these assets.

Despite equities appearing slightly expensive, the outlook for the asset class on a 12-month view is positive. Central banks are likely to pivot towards looser policy in 2024 as inflation continues to fall. An increasing probability of a soft landing with a rebound in both growth and earnings in 2024 should also provide support. Over the medium term, the rollout of AI should boost efficiencies and earnings across the whole market and allow equities trade at higher valuation levels. The ongoing green-related capex cycle could also boost earnings over the medium term. Any short-term volatility in markets is likely to be offset by the above factors, resulting in positive returns on a 12-month timeframe.

THE MONTH AHEAD

AUGUST

MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
			10 US Inflation Rate YoY (July)	11 GB GDP Growth Rate YoY Prel US PPI
	15 US Retail Sales MoM GB Unemployment Rate (June)	16 GB Inflation Rate YoY US FOMC Minutes		18 JP Inflation Rate YoY (July) GB Retail Sales MoM
			24 US Durable Good Orders MoM (July)	
	29 DE Gfk Consumer Confidence	30 DE Inflation Rate YoY Prel (August)	31 EA Inflation Rate YoY Flash (August)	

Source: tradingeconomics.com

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