Macro Outlook Summary

June 2023

For the bears in May who felt things were starting to go their way, June has been a headache and done the opposite. The steady rise in equities has left most investors too bearish, sidelined with too much cash and under pressure. The bullish scenario we laid out last month has taken hold and there still seems further to go. Equity leadership in the SPX has broadened out from the tech leaders of a month ago and the factor rotation from value to momentum is confirmed. Growth centric equity sectors including biotech have rallied strongly and while these are early days it would be premature to dismiss this as a technical bounce going nowhere.

An end to Fed rate hikes is in sight, albeit our long held view is the peak will be in 3Q as the entire monetary tightening process takes time to bite. The Fed are now articulating a very similar timeline and view. The important point is not so much the timeline as the peak level which we still expect to be 5.5%-5.75%. Then, like our managers, we see rates staying firm into year-end even while many commentators are still calling for rate cuts in the autumn. As we said last month, just knowing the peak is in will be enough to bring buyers back to growth sectors.

The rhetoric from Lagarde and Governor Bailey is now consistently hawkish but coming so late in the story surely even the man on the street must be wondering what they were thinking about a year ago. What is now completely obvious is the corner the UK economy has got itself into where the only way out looks like higher rates and a hard landing. Policy decision making should take most of the blame.

The contrast with the New Zeland Reserve Bank could not be more stark. Hiking began there in Oct'21, well ahead of others, and when asked in a parliamentary hearing last year if his objective was to create a recession, governor Orr responded 'Yes, that is correct. We are deliberately trying to slow aggregate spending in the economy'. We should all be thankful for a Governor worthy of his job who is clear sighted and disarmingly willing to take responsibility for his actions.

Finally turning to Japan this story is developing in a most interesting way. Nikkei stock valuations are generally cheap. Japan's terms of trade have improved with their reversion to nuclear power. The Yen is cheap and brings competitive pricing while further depreciation is unlikely as Yen weakness has become a domestic social issue with rising food prices. Cash hoarding public companies are under instruction from the TSE and with backing from the MoF to improve their capital allocation. That means cut these cash reserves with higher dividend payouts, share buybacks and consolidations, all of which are becoming noticeable. And with these changes the market has outperformed MSCI. For years closet index tracking funds have underweighted Japan to their advantage and beaten the index. Now the tables have turned and we expect foreign inflows could become significant and drive the market further. We have created a small directional exposure to this story.