Luna Investment Management

The Luna Perspective

Q3 Market Commentary
October 2023

It was another busy quarter with inflation and interest rates still hitting the headlines, albeit for better reasons. Against the backdrop of the interest rate rises already made, economic data has deteriorated on both sides of the Atlantic. The oil price is popping and Sterling is under pressure.

The good news is that inflation continues to moderate in the UK. In July the Consumer Price Index (CPI) was 8.7% whilst in September it had fallen to 6.7%. However, this is still well above the Bank of England's (BoE) 2% threshold and the reason why interest rates were notched up again in August. That was until the BoE met in September and for the first time since November 2021 the Bank choose not to hike interest rates.

From a market perspective, the US Federal Reserve also kept interest rates flat at their meetings in July and September. Forecasts released after the meeting showed the majority of policymakers expect rates to stand above 5.5% by the end of the year, implying at least one further hike.

Looking forward, there is further good news with inflation likely to continue to fall. In October a lot of last year's increase in energy and electricity prices will drop out of the equation and will actually be a deflationary force. It's not all good news though with OPEC looking to restrict supply, the oil price has picked up markedly over the summer with Brent Oil moving from mid $70s in June to over $90 today. This will filter through over the coming months.

Sterling has been going through a particularly weak summer. In mid-July £1 was getting $1.31, that's now fallen to $1.21. Traders have predicted the end of UK interest rate rises from the Bank of England. Added to this the US economy is proving remarkably resilient. The weaker currency threatens to add to inflationary pressures and could make it harder for Rishi Sunak to meet his goal of halving inflation by the end of the year.

The bad news; Purchasing Managers' Indices often give a good insight into current activity in economies. Both the Manufacturing and Services data in the US and UK continued to deteriorate in August and is now in contraction territory which often signals a recessionary environment.

Equity markets were mixed during the quarter. The FTSE All Share was the best performing major stock market helped by weaker sterling and a bounce back in commodity prices. The Japanese market was the laggard, giving back some of the strong returns from the first half of the year. UK Government Bonds (Gilts) were slightly lower in the quarter, but UK Corporate Bonds eked out a positive return.

In summary, inflation is moderating quickly and interest rates are very close to peaking globally, if they haven't already. However, the economic backdrop has been deteriorating on both sides of the Atlantic. Against this backdrop, markets have been mixed over the last quarter with UK assets delivering better returns. Looking forward, potential long-term returns are attractive with government bond, corporate bond and equities at attractive levels. The headwind that impacted markets in 2022 from higher interest rates has gone but the risk of recession is certainly increasing. It is important to remember though that markets are forward looking and move ahead of the economy; therefore the bulk of the negativity has already been priced into asset classes.

As ever, if you have any questions please get in touch on 0161 518 3500 or email a member of the team.