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Monthly Market Review

September 2023

By Anthony Walters

Head of ESG - Clever

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Turbulence to Stability: The Long Journey of Reducing Inflation.

Inflation is trending down, but we're not out of the storm yet

Central banks indicate an end to the money tightening cycle

Rekindled expectations that interest rates will remain higher for longer

Almost half of developed market indices made a gain in September

Inflation data, monetary policy, energy costs and economic resilience continued to drive markets in September 2023. Data from the UK, US and Eurozone released in September on Core inflation (which exclude volatile items such as food and energy) all indicated a trend towards reduced price increases. In response, the Bank of England in the UK and the Federal Reserve in the US held interest rates unchanged in September. Conversely, the European Central Bank increased the Eurozone's interest rate by 0.25% but indicated that they have probably reached the end of their money tightening policy.

Despite this, a continuous tight oil supply by OPEC+ countries pushed Oil commodities higher for the month. In addition, US and UK GDP data released in September for Q2 2023 re-kindled expectations that interest rates will remain higher for longer. The Balanced portfolio benchmark declined marginally for the month with a return of -0.67%.

> ***"Based on its current assessment, the Governing Council considers that the key ECB interest rates have reached levels that, maintained for a sufficiently long duration, will make a substantial contribution to the timely return of inflation to the target."***

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Inflation and interest rates

The Bank of England (BoE) retained interest rates unchanged at 5.25% in September 2023, following the release of data showing a reduction in inflation for Q2 2023. Andrew Bailey, BOE's governor stated regarding this decision: "Our previous increases in interest rates are working. But let me be clear that inflation is still not where it needs to be, and there is absolutely no room for complacency. We will be watching closely to see if further increases are needed, and we will need to keep interest rates high enough for long enough to ensure that we get the job done."

In the US, the Federal Reserve (FED) kept the interest rate steady in September 2023 in line with market expectations. However, it also signalled there could be another 0.25% rise this year according to the FED's projections, depending on market conditions, inflation and US growth.

Core inflation (which exclude food and energy) fell in Q2 2023, however the US economy expanded by 2.1% in Q2 2023, suggesting interest rates might remain higher for longer.

Inflation in the euro zone fell to its lowest level in two years in September, suggesting the European Central Bank's (ECB) stream of interest rate hikes was making progress in taming inflation. However, the ECB increased interest rates for the 10th consecutive time in September but signalled that it is likely done tightening its monetary policy, as inflation has started to decline but is still expected to remain too high for too long. According to the September ECB staff macroeconomic projections for the Euro Area, average inflation is forecasted to be at 5.6% in 2023 and 3.2% in 2024, both higher than previous estimates, primarily due to an expectations of higher energy prices. In contrast, the 2025 rate projection has been cut to 2.1%.

Country/Region	Manufacturing PMI	Services PMI
United States	**49.0** ↑	**53.6** ↓
United Kingdon	**44.3** ↑	**49.3** ↓
Eurozone	**43.4** ↓	**48.7** ↑

In the US, business confidence improved for September 2023 as the ISM Manufacturing PMI (Purchase Managers' Index) rose to 49.0 from 47.6 in the previous month, well above market expectations of 47.8. PMI readings below 50 indicate that a manufacturing economy is generally declining, with the data pointing to nearly one year's worth of consecutive monthly contractions in US factory activity, underscoring the impact of higher borrowing costs from the Federal Reserve in the sector.

PMI readings above 50 indicate that a non-manufacturing economy is generally expanding.

In the UK, the Manufacturing PMI increased in September 2023 (44.3 vs 43.0 prior), slightly higher than expectations of 44.2 for the month. However, it still ranked among the weakest readings seen over the past 14 years. Output continued to decline for the seventh consecutive month as demand continued to fall due to ongoing market uncertainty, the cost-of-living crisis, and weak conditions in overseas markets.

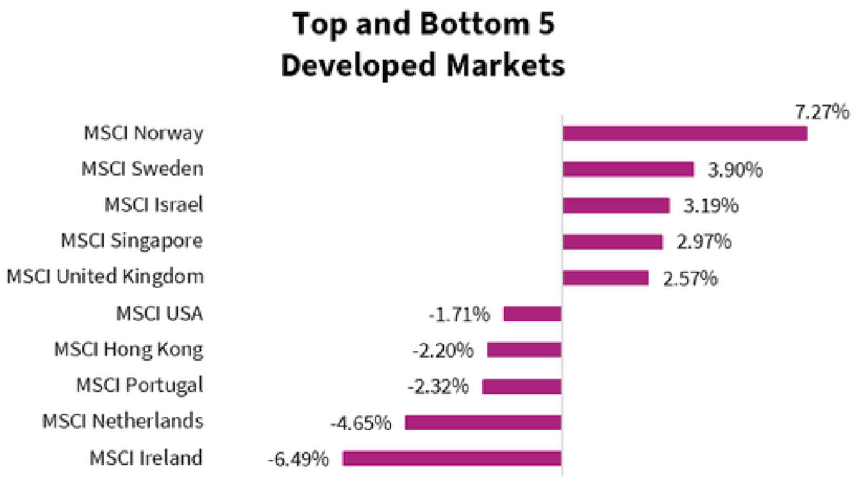
Service business activity slightly fell in September as the UK Services PMI declined to 49.3 (49.5 prior). Total new work decreased marginally as backlogs of existing work declined for the fourth consecutive month and at the second-fastest rate since February 2021. Regarding prices, the overall rate of 'prices charged inflation' across the service economy eased again in September and was the weakest for 29 months.

The Eurozone Manufacturing PMI remained little changed in September (43.4 vs 43.5 prior), signalling the fifteenth successive month of contraction in the bloc's industry sector, with employment in manufacturing reducing the most in almost three years. Regarding prices, input costs continued to decline, and prices charged fell for a fifth consecutive month, to one of the greatest extents since 2009, as Eurozone manufacturers remained focused on boosting competitiveness.

The Services PMI for September improved compared to last month (48.70 vs 47.90 prior), however this marks the second consecutive decline in services activity so far this year. Germany and France, the two largest eurozone economies both declined for the month (-1.69% and -1.44% respectively) due to slowing market conditions and weaker demand.

Market performance

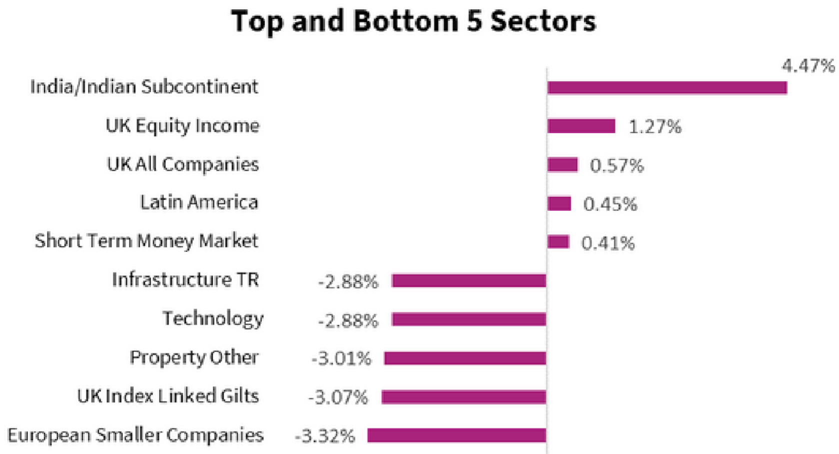
Almost half of developed market indices made a gain this month, with two out of three Scandinavian nations leading the way, helped by a rally in the Energy sector. The UK Index also made a return to the top 5, adding 2.57% for the month.



Emerging Markets also benefitted from a broader market rally, with half posting gains. Egypt continues to lead as the country endures double-digit inflation. Interestingly, the Egyptian Index is made up of 3 companies, with Commercial International Bank accounting for 80% of the market!

Sector performance

12 out of 45 sectors produced a positive return this month as broader markets fared better. India led the group once again, with a performance of 4.47%.



Summary

Central Banks' interventions to tame inflation over the past year appear to have started producing results, with Core inflation decreasing for Q2 2023 according to data released in September for the US, UK and the Eurozone. The response from Bank of England and the Federal Reserve was to hold rates steady and from European Central Bank to raise rates by 0.25% (but indicate that it has probably reached the peak of interest rate hikes).

However, resilient GDP data for the UK and US market, along with a continuous tight Oil supply suggest interest rates might remain higher for longer and might prompt further action by Central Banks, which continue monitoring the situation. Bringing inflation down to the 2% target is proving to be a slow process.

Oil gained circa 3% in September compared to August, driving production costs higher. The Services sector in Eurozone and Manufacturing sectors in the UK and US improved for the month of September compared to August (although all are still in decline), while Germany and France, the two largest eurozone economies both contracted for the month. Despite the volatility in the markets, the balanced portfolio benchmark declined marginally (-0.67%) for September.

Markets will now await fresh inflation data in October to access how the Central Banks' actions have fared. This should also provide some direction into what comes next on the monetary policy front for each economy.

Sources:

Economic indicators information from The Institute for Supply Management - Report on business, IHS Markit, Trading Economics, ECB and BOE.
The 'Balanced Portfolio Benchmark' is the UT Mixed Investment 20-60% Shares Sector.
Market and Sector performance data sourced from FE FundInfo, 03/10/2023
Fed keeps rates steady, toughens policy stance as 'soft landing' hopes grow, By Howard Schneider and Michael S. Derby Reuters, 20/09/2023
Bank of England governor says 'no room for complacency' after leaving interest rates on hold – as it happened, The Guardian, 21/09/2023

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