MARKET COMMENTARY

Executive Summary

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Despite the month concluding with the high-profile failure of another US regional bank, First Republic, April saw a degree of calm restored to global markets. The collapse of Silicon Valley bank (SVB) in March – at the time, the 2nd largest bank collapse in US history – sent jitters through the global banking system. However, with fears of a contagion effect waning slightly, as well as a steady stream of positive economic news, both aggregate equities and bonds produced muted positive returns through April.

While headlines were again dominated by inflation and central bank policy, the prospect of a recession once more rose to the fore, with analysts in broad disagreement with regards to the probability and potential severity of a global downturn. In the US, the Federal Reserve (the Fed) is now predicting a mild recession in the latter half of 2023, driven in part by the recent turmoil in the banking sector. Whilst fears of global contagion appear to have passed, the last days of April saw the collapse of another US bank – First Republic. Like SVB, it suffered a run on deposits by its predominantly high net worth client base, to the tune of $100bn through the first three months of the year. While the remaining assets were purchased by the US' biggest bank, JPMorgan Chase, jitters in the US regional banking system are likely to drag on for some time. With confidence low, banks have tightened lending standards, a move expected to further impact upon economic growth. Lagging data published towards the end of April showed that US GDP rose at 1.1% through Q1, far lower than the 2% consensus estimate.

It wasn't all bad news for US investors. Business survey data showed economic momentum accelerating through April, with both manufacturing and services PMIs beating expectations. There was also positive news on the inflation front, with the latest Consumer Price Index (CPI) reading coming in below expectations at 5.0%. Whilst core inflation continued to increase, leading indicators suggest it should begin to moderate in the coming months. Against this backdrop, all eyes were on the Fed, which announced a further 25 basis point (bp) hike in early May but hinted that it may now pause to take stock.

In the UK, the outlook was more mixed. Whilst the services PMI beat expectations, the manufacturing PMI slipped further into contractionary territory. Headline inflation fell from 10.5% to 10.1% but remained stubbornly high, the fall in fuel prices more than offset by a further sharp increase in food and drink prices – inflation in this category now tops 19% for the 12 months to March. There were some grounds for optimism, with a drop in global wholesale food prices expected to filter through into stores over the next few months. The first step-down in broader energy inflation is also expected next month, as last year's peak in prices falls out of the 12-month estimate. There was no central bank action in April – markets are currently pricing (albeit with considerable uncertainty) one further 25 bp hike by the Bank of England (BoE) in May.

Like the UK, the Eurozone continued to suffer a divergence in its services and manufacturing activity, with the latter contracting for a tenth consecutive month. April did see the initial downward impact of energy base effects on inflation, with last year's spike in oil and gas prices (coinciding with Russia's invasion of Ukraine) falling out of the 12-month CPI calculation. However, there was a small uptick in core inflation, which strips out the effects of food and energy. This, along with a surprisingly resilient economy and continued wage pressures, have kept the European Central Bank (ECB) firmly in hawkish territory – markets are expecting a further 100 bps of hikes before the autumn.

Markets

Moving on to markets, and despite the improving inflation picture, the US was amongst the worst performing developed markets (in sterling terms), dragged down by a combination of style headwinds and the ongoing turmoil in the regional banking system. In a month where the value style (that is, a preference for stocks with lower valuations that are perceived to be undervalued) dominated, the growth orientated large cap and technology heavy indices returned -0.19% and -1.12%, respectively.

Back on this side of the pond, both UK and European equities fared somewhat better. UK large caps were the best performing subsector, returning 3.4% on aggregate. Financials were the top contributor, enjoying a steady recovery as fears about the stability of the global banking system subsided. The oil majors also enjoyed a month of strong performance, with Saudi Arabia announcing a surprise decision to cut oil production. More domestically focussed mid-cap stocks also held up well, despite mixed economic data and a disappointing CPI print. Eurozone equities also posted solid single-digit gains, enjoying a rally that began last year, fuelled predominantly by easing energy supply concerns.

Asia & Emerging Markets

While Japanese markets enjoyed another positive month in local currency terms, weakness in the yen led to muted losses for sterling-based investors, with the aggregate large cap index returning -1.3% through April. Despite this, the region enjoyed significant inflows from foreign investors over the month, enticed by the Tokyo Stock Exchange' initiative to boost corporate values and stock prices for more lowly valued sectors of the market.

It was a challenging month for emerging market equities, which declined 2.7% on aggregate. Despite some positive economic data, China was the worst performing component of the index, dragged down by geopolitical tensions and fears of weak domestic demand. Taiwanese equities also lost ground as demand for semiconductors fell. There were positive contributions from India (driven by positive macroeconomic news flow and easing inflation), as well as Indonesia and Saudi Arabia, the latter supported by higher oil prices.

Fixed Income

Following the sharp drop in yields through March, April was a calmer month for bond markets. With markets anticipating further near-term rate hikes from the Fed (now realised), BoE and ECB, yields began to creep up once more. UK gilts were the worst performing subsector, with resilient activity data and an upside inflation surprise weighing on market – the yield on the 10-year gilt rose 23 bps to finish April at 3.72%. US bond yields were largely flat, though the yield on the 10-year Treasury fell slightly amid concerns surrounding the regional banking sector. In general, credit spreads were tighter, as markets recovered from the March's post-SVB sell-off.

Commodities

The aggregate commodity index fell -2.4% through April, as weaker prices for agriculture, industrial metals and energy offset gains in precious metals and livestock. The surprise announcement by OPEC+ that it would cut oil production by one million barrels helped support the price of crude, however the price of refined products including heating oil, gas oil and petrol all declined due to an increase in refining capacity and lower margins. Gold and silver both gained over the month, with the former supported by a weakening dollar.

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