Investment*Insights*

Issue 34 — Fourth quarter 2022

Taking the global economy's pulse

Understanding the differences between the challenges facing the world's largest economies can help us adapt our investment strategy in the face of an increasingly difficult backdrop.

Rathbones
Look forward

Foreword

In the midst of what continues to be a turbulent year for investors, our lead article explores the varied challenges facing some of the world's major economies, and the likelihood of different inflation and recession scenarios coming to fruition.

Our next feature, on page 5, examines in closer detail what qualities to look for in a stock – and what defines quality. We also think ahead to 2023 and what the landscape may look like for these quality companies.

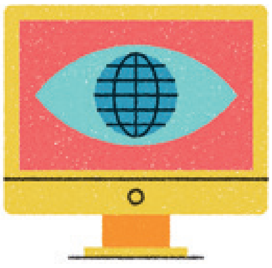
The plunging pound has been a dramatic cause for concern over the past few weeks, and on page 6 we take a look at the history of sterling's falls over the decades. How much of the pound's latest tumble against the US currency can be explained by broad dollar strength, and what comes next for the beleaguered currency?

We examine cybersecurity in our next feature on page 8. With crime moving online and nation states conducting cyber warfare with impunity, the need for cybersecurity has never been greater. How could these developments affect the future of cybersecurity firms and where are the investment opportunities? It's something we are monitoring closely and with growing interest.

Lastly on page 9, we explore what the labour movement means to environmental, social and governance (ESG) factors within a company and ask whether trade unions are making a comeback. We assess how the treatment of unionisation is viewed through an ESG risk-management lens.

We hope you and your family remain healthy and safe during this uncertain period. Please visit rathbones.com to find out more about our latest views on issues affecting the global economy and investments.

Liz Savage and Ed Smith
Co-chief investment officers



America may be running out of gas but Europe is almost on empty

The economic outlook has deteriorated around the world recently, but there are some key differences between the challenges facing each of the world's largest regions. Understanding them can help us adapt our investment strategy in the face of an increasingly difficult backdrop.

An energy supply shock of historic proportions is squeezing the UK and Eurozone. Russia has halted gas deliveries to Europe via the Nord Stream pipeline indefinitely, and wholesale gas prices are about nine times their 2015–21 average. Policies like the UK's freeze on household and business energy prices should help to cushion the blow in the short term, limiting the hit to real incomes. (France has a similar 'tariff shield' policy, and governments across Europe have announced a variety of alternative measures to protect households from the full force of surging gas prices.)

Even so, recession seems highly likely. The UK economy has already begun to shrink, while the latest business surveys from the Eurozone are also consistent with contraction. Energy bills will still be high by past standards, although they won't hit the stratospheric levels they might have done otherwise. In the UK, for example, Ofgem's price cap on gas and electricity is to be frozen at levels equating to £2,500 annually for the average household's consumption, compared with £1,971 currently and £1,277 at the end of last year. Without a freeze, the cap could have risen to more than £5,000 in early 2023. The large package of tax cuts announced by UK Chancellor Kwasi Kwarteng won't help either, especially as the Bank of England – focused on reducing inflation "no ifs no buts" – is likely to increase interest rates much further in response.

The economic outlook in the US isn't quite as bad. In contrast to Europe, it is well insulated from the Russia energy shock. It has a much greater degree of energy independence, and wholesale gas prices have risen by far less there than they have in Europe. Americans are starting from a position of relative strength too – we've written before about the large cushion of savings that they amassed during the acute phase of the pandemic.

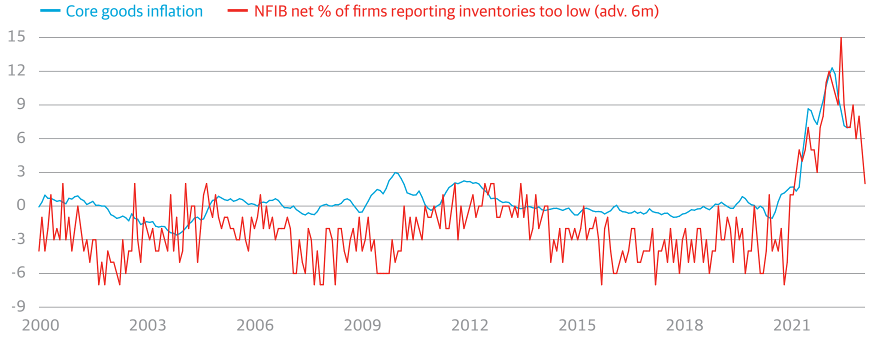
Even so, a recession there in the coming quarters still appears more likely than not as the US Federal Reserve aggressively raises interest rates in its fight against high inflation. (For clarity, we're not counting the two quarters of falling GDP in the US earlier this year as a recession – that had more to do with big swings in inventories than broad weakness in the economy.) The parts of the economy most sensitive to interest rates are starting to struggle, with the housing market the most obvious example. Home sales have already dropped by more than a quarter from their January peak, new building permits are down 10%, and the forward-looking components of key housing surveys suggest that more weakness is on the way. The housing market matters a lot (and is a key input into our quantitative estimates of recession risk) because it has a long track record of leading the economic cycle in the US more broadly.

The outlook for inflation

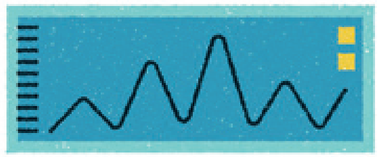
On a more positive note, we've probably already seen the peak in US inflation. The decline in global oil prices means that energy inflation there is now in retreat and should fall much further by the middle of next year. Goods inflation has been falling too, as last year's pandemic-induced disruption to global supply chains has continued to unwind (see figure 1). The strength of the dollar has helped too, as it means Americans get more bang for their buck.

Figure 1: US CPI core goods inflation and inventory shortages

Goods inflation has been falling as last year's pandemic-induced disruption to global supply chains has continued to unwind.



Source: Refinitiv and Rathbones



Nonetheless, it's still too early to declare victory. Headline CPI inflation is still above 8%, and there's lots of uncertainty about the downward path. The Atlanta Fed's measure of nominal wage growth is still running well above 6%, with the tightness of the labour market indicating that it will fall back only slowly. At the same time, the prior strength of the housing market is still pushing up shelter inflation, which is uncomfortably high. The recent weakness in housing will take a long time to filter through fully to the inflation numbers.

Closer to home, the inflation outlook arguably looks even more difficult. Admittedly, the decision to freeze households' energy prices for two years means that the UK should avoid the huge surge in utility bill-driven inflation that had previously seemed likely. The peak in headline CPI inflation is now likely to be lower and earlier – probably in the 10–11% range later this year, rather than in the high teens early next year.

However, there are plenty of reasons to be cautious about how quickly inflation subsequently declines from its peak. Freezing energy prices represents a major loosening of fiscal policy, potentially worth more than 4% of GDP, and that has been followed up with tax cuts worth well over 1% of GDP. Even though this is probably happening too late to prevent recession, it is likely to keep demand stronger than it would otherwise have been, adding to underlying inflationary pressure.

Growth in the UK's labour force has been worryingly weak recently, helping to keep the labour market very tight. And in contrast to the US, recent currency weakness will only add to inflationary pressure. Meanwhile, countries in the Eurozone have mostly offered less fiscal policy support than the UK. But they are vulnerable to further inflationary pressure from energy prices – most have stopped short of the UK's policy of freezing household energy prices.

Bringing everything together

We find it helpful to think in terms of four key economic scenarios, set out in figure 2. These four scenarios are:

i) a typical demand-driven recession, in which inflation falls significantly (to below 4%) in 2023;
ii) stagflation, a recession in which inflation stays uncomfortably high (above 4%) next year;
iii) a 'soft landing', in which inflation comes down but recession is avoided (the outcome policymakers are striving to achieve);
iv) inflation resilience, in which the economy continues to grow but inflation remains too high throughout next year.

We've assessed the probability of each using a combination of quantitative modelling and qualitative judgement. We think that the probabilities of each scenario are slightly different in the US compared with Europe (including the UK), as you can see in figure 2 below.

In both cases, we think that a recession is more likely than not. But we judge that the chances are higher in Europe than in the US (a combined 90% versus 75%), given the weaker starting point and greater vulnerability to the Russia energy shock. Meanwhile, we suspect that the likelihood of inflation remaining uncomfortably high are also greater in Europe (a combined 40% versus 15%), reflecting a combination of energy costs, currency weakness and fiscal loosening.

This feeds into our strategies in a few ways. Reflecting the still-significant risk of inflation remaining high, we're still underweight conventional government bonds, instead favouring other diversifying assets (including a variety of actively managed strategies) and cash. With the chances of recession high globally, we are also positioned very cautiously, both reducing equity-type risk overall and favouring defensive sectors over ones with more exposure to the economic cycle.

Reflecting the tougher economic backdrop in Europe specifically, we're underweight European equities, which we don't think fully reflect the likely scale of the downturn there. We're also cautious about smaller UK stocks, though the FTSE 100 may provide some resilience given its skew to defensive sectors and preponderance of multinationals earning most of their revenue overseas.

There are plenty of reasons to be cautious about how quickly inflation could decline from its peak.

Figure 2: Probability of different inflation and recession scenarios

We find it helpful to think in terms of four key economic scenarios.

	Inflation <4% by end 2023	Inflation >4% by end 2023
Recession in 2023	Typical recession	Stagflation
No recession in 2023	Soft landing	Inflation resilience
US probabilities		
Recession in 2023	60%	15%
No recession in 2023	25%	0%
Europe (including UK) probabilities		
Recession in 2023	55%	35%
No recession in 2023	5%	5%

Source: Rathbones

Recession resilience at a reasonable price

Quality is a commonly discussed 'style' factor in equity investing, but what do we mean by 'quality'? It generally refers to a greater degree of stability and profitability, which is expected to generate higher or more predictable returns. Quality companies tend to outperform in tougher economic conditions, given their more stable and predictable earnings.

Quality has many aspects. They can relate to business models: a strong competitive advantage and a market-leading position – from uniqueness of product or offering, perhaps through barriers to entry such as knowhow, patents or brands – which in turn leads to pricing power. This can be shown by consistently high profit margins and returns on invested capital, and strong cash generation.

The importance of high returns on invested capital is that they demonstrate that a company's returns are above its cost of capital, enabling it to finance reinvestment to sustain its competitive edge and exploit growth opportunities. Sustainability of a business model is another key attribute of quality – if a company's products have a low risk of obsolescence then their future revenues are more predictable and can be valued with more certainty today.

Low levels of financial leverage (e.g. debt) and a good management track record are other hallmarks of quality.

You could be forgiven for thinking that quality stocks, with their typically more resilient earnings, would've outperformed over the past year as the economic outlook has darkened. So why have they underperformed? This stems from the fact that many, if not most, quality stocks are also associated with the 'growth' factor. Growth stocks, which as the name suggests are expected to have higher than average earnings growth, performed strongly in the 2010s.

At a time of historically low interest rates, investors on the hunt for better returns were willing to pay a higher price for the rising future profits of growth companies, which looked particularly attractive when discounted back to the present day using low discount rates. This culminated in a 'last hurrah' during the COVID pandemic as already low interest rates were cut to the bone. In the post-COVID recovery, as inflation has spiked and interest rates have risen sharply, the value today of those future earnings has been rapidly eroded, and growth stocks have underperformed.

The overlap between growth and quality companies is understandable. Quality companies typically generate an economic surplus – their profits grow faster than the growth rate of the broader economy and ahead of the cost of capital – and this surplus can be invested in growth opportunities at solid returns.

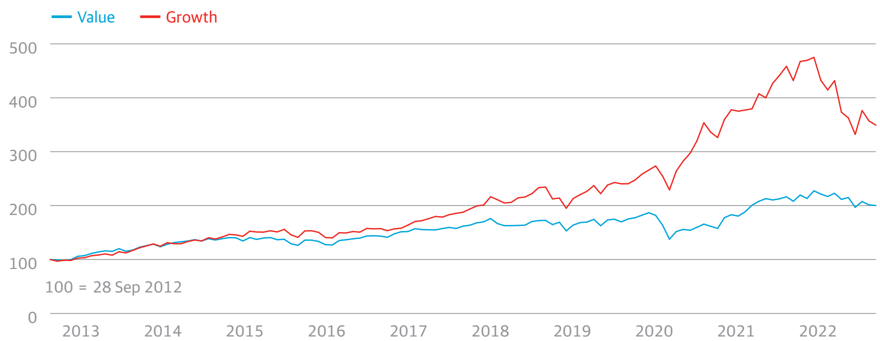
As we look ahead to 2023, we see a high risk of recession as monetary authorities in the US, UK and Europe prioritise conquering inflation over economic growth, coupled with energy and cost-of-living crises. This is a classic environment for quality companies to perform well in, as their earnings hold up far better than lower quality companies with less differentiation, more volatile demand for their products and services and weaker market positions. Quality tends to outperform when earnings are downgraded in anticipation of a slowdown or recession.

However, valuation premia for growth companies are still at historically high levels despite the recent setback. With interest rates set to rise further into next year, there could be further pressure on those valuations. We therefore believe a sensible approach is to maintain a skew towards quality and defensive companies, while limiting exposure to higher valued growth companies.

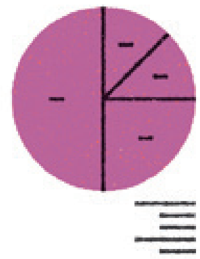
Fortunately, there are pockets of quality companies that have defensive characteristics and resilient earnings in such sectors as consumer staples (for example tobacco), defence (benefiting from increasing NATO defence budgets post-Ukraine) and healthcare. These companies have the pricing power that enables them to pass on higher raw material and labour costs to customers, and maintain their profit margins. We believe this quality-focused approach, with sensitivity to valuations, should protect portfolios as the risks grow of a UK and wider global recession in the months ahead.

Figure 3: Growth has underperformed value this year

MSCI US Growth vs Value indices



Source: Refinitiv, Rathbones



Searching for a clear perspective on the plunging pound

The dramatic slide in the value of the pound this year has raised plenty of questions. How does the latest fall compare with previous crisis periods? How much harder does exchange rate weakness make the Bank of England's fight against elevated inflation? What's next for the beleaguered currency?

By way of background, two distinct factors have weighed on the pound this year. The first has been the global strength of the dollar, which has benefited from its status as the premier safe-haven currency (against a backdrop of slowing global growth), plus the relative resilience of the US compared with other major economies.

The dollar has risen strongly against most other major currencies, gaining more than 10% against the Chinese renminbi, 15% against the euro and 20% against the Japanese yen so far in 2022. In both China and Japan, policymakers are sufficiently concerned that they have been intervening in foreign exchange markets by selling dollars.

The second factor has been UK-specific concerns about the direction of policy, especially in the wake of Chancellor Kwarteng's 'fiscal event'. With inflation already way too high and the Bank of England struggling to rein it in, the announcement of a substantial loosening of fiscal policy was extremely hard to defend.

The Chancellor announced the largest package of tax cuts since the early 1970s (worth nearly 2% of GDP) hot on the heels of the decision to freeze energy prices at a possible cost of more than 4% of GDP. This combination raised the risk of inflationary pressures sticking around for longer, and of the Bank of England increasing interest rates even more aggressively than previously seemed likely. The government's refusal to publish the usual independent forecasts from the UK's fiscal watchdog added to the impression that this isn't the evidence-based policymaking the country needs.

That helps to explain why sterling has also weakened relative to the currencies of the UK's trading partners generally, not just the dollar, this year (even though the extreme moves immediately after the budget have unwound). Figure 4 puts that decline into perspective, showing past falls in the currency versus a basket of its peers, weighted by their relative importance to UK trade. Its recent drop, of just over 10%, is the fourth largest of the past three decades. It's large, but not yet in the same league as previous crises – the declines of 19% after the UK left the ERM on Black Wednesday in 1992, 22% around the Brexit vote in 2016 and 30% during the Global Financial Crisis.

An inflationary impact

Whatever the cause, the weaker pound has only added to the UK's inflation problem. Falls in the currency typically increase the sterling prices of the goods and services that the UK imports – particularly affecting things like fruit, vegetables, clothes and cars (figure 5).

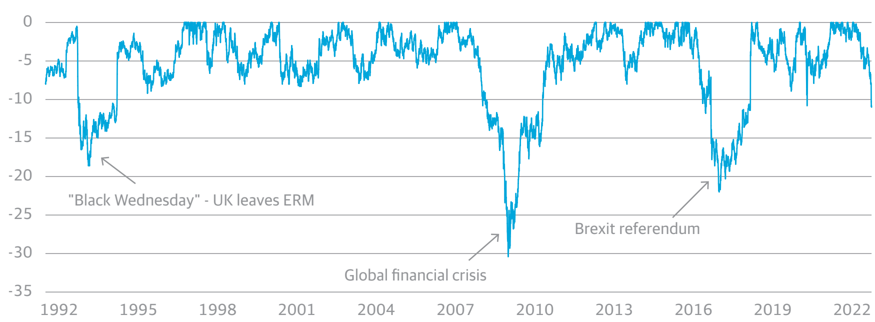
The Bank of England has previously used the rule of thumb that a 1% fall in the currency (versus a weighted basket of the UK's trading partners) ultimately increases consumer prices by nearly 0.3% over a three-year period. It estimates that the peak impact on inflation typically comes about a year later, when it is 0.1 percentage point (pp) higher than it would otherwise have been. Since the sterling trade-weighted index has now dropped by just over 10% since January to the end of September, that would imply a 3% increase in consumer prices over three years, and inflation 1pp higher than it would otherwise have been in a year's time.

Of course, the rule of thumb is just that – the Bank acknowledges that in practice the actual effect may be much larger or smaller depending on the precise circumstances. There are a lot of other moving parts influencing inflation in the meantime. However, it's still a useful illustration of the potential inflationary impact.

Sterling's recent drop is not yet in the same league as previous crises – the declines of 19% after the UK left the ERM on Black Wednesday in 1992, 22% around the Brexit vote in 2016 and 30% during the Global Financial Crisis.

Figure 4: Charting the pound's fall

Change in trade-weighted sterling index versus peak of previous 18 months (%)



Source: Refinitiv and Rathbones

This inflationary impact arguably matters even more than usual because price pressures are already far too strong, and the government's tax cuts have just injected more demand into the economy. Headline CPI inflation is 9.9%, and its high level is a product of more than just previous increases in energy prices. Wage growth is 5.5%, and the labour market is still extremely tight with the unemployment rate the lowest in five decades. It's also particularly concerning that inflation expectations have been increasing recently.

The Citigroup/YouGov inflation tracker found households' long-run expectations (5 to 10 years ahead) jumped to 4.8% in August — a new record and well above the rate of around 3.5% that has prevailed for the past 15 years. Policymakers will want to avoid the possibility of lingering high inflation becoming entrenched in households' and firms' psychology and decision-making, which would add to the risks of it sticking around for much longer.

What next for sterling?

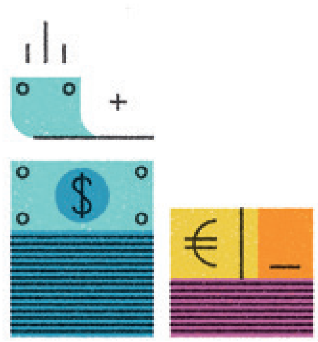
It's tempting to jump to conclusions about what will happen to the pound in the next few months, but confident predictions about its short-term direction should always be treated with plenty of scepticism. Forecasting currencies over short time periods is notoriously difficult, and as long-term investors it makes more sense for us to be humble about our ability to do it than to find false comfort in strong predictions.

There's a lot of academic literature going back almost four decades showing that reliably predicting exchange rates a year ahead is all but impossible. A host of models that have briefly appeared to fit the facts have failed to deliver good forecasts on a consistent basis. The basic problem is that, over short time horizons, currencies are far more volatile than justified by changes in economic fundamentals. So even forecasting the economy correctly (a hard enough task in its own right) isn't enough to make accurate short-term currency forecasts.

Over longer time horizons, it is possible to say a bit more about the likely direction of exchange rates — but we need to take care. For example, the UK's large current account deficit is often interpreted as an indication that sterling is likely to weaken in the long term. (A current account deficit means that overall spending in the UK exceeds its income, with the gap financed by net borrowing from the rest of the world.) It's widely assumed that large current account imbalances inevitably correct over time, with currency movements driving the adjustment. Yet in practice, models based on this assumption don't have a great track record even when it comes to long-term forecasting.

As a recent paper published by the European Central Bank has shown, so-called 'behavioural equilibrium' models have typically performed much better, and this is the approach we prefer. These models account for variables like the terms of trade (the ratio of prices of a country's exports and its imports), relative productivity and demographics.

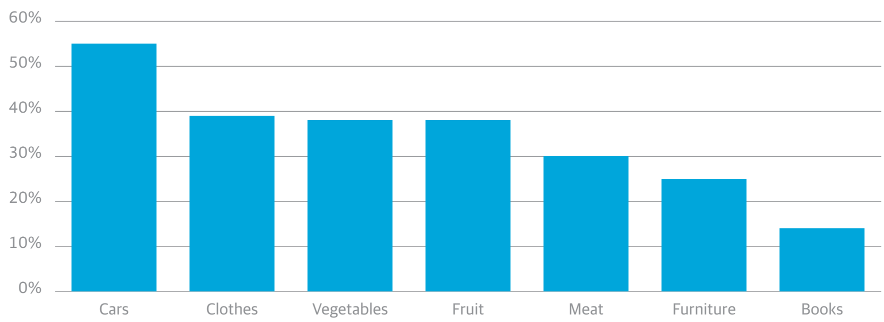
On this basis, sterling looks undervalued versus the dollar (though there's generally much less of a difference compared with other currencies). In other words, we think that sterling is more likely to rise moderately than to fall against the dollar over the next 5 to 10 years, which is something we're already factoring into our long-term decisions about where to invest.



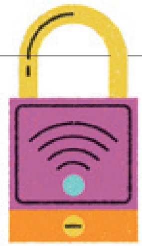
It's tempting to jump to conclusions about what will happen to the pound in the next few months, but confident predictions about its short-term direction should always be treated with plenty of scepticism.

Figure 5: The value of sterling can affect what we buy

Proportion of consumption due to imports (%)



Source: Refinitiv and Rathbones



A golden age for digital locksmiths in the fight against online crime

With crime moving online and nation states conducting cyber warfare with impunity, the need for cybersecurity has never been greater. Despite enjoying booming demand, this is a complex sector to invest in owing to the ever-evolving threats and rapid changes in market leadership.

Some $170 billion is estimated to be spent on cyber security annually, with the vast majority (90%) coming from businesses. About two-thirds of that is spent on services such as maintenance, implementation, outsourcing and hardware. The other 30% is spent on software, which is forecast to grow 15% a year until 2025 (figure 6). This is the most direct way for investors to gain exposure to this growing industry.

Total spending on cyber software accounts for just 2% of overall spending on IT, but that proportion will rise according to research by management consultancy Gartner, as companies shift their budgets from hardware support and services to automated cloud based solutions (you can read more about this shift in our report *The cloud revolution*).

Companies are under pressure to upgrade their cyber defences as they become increasingly vulnerable to the rising sophistication and volume of attacks and as regulation in this area grows. IBM estimated the average cost of a data breach was $3.8 million globally and $8.6 million in the US. Breaches in general are becoming more frequent, costly and complex. For instance, the Wannacry attack on the NHS cost an estimated $100 million.

Over the past decade there has been an explosion in cybercrime. Hackers can purchase ransomware from the dark web at the click of a mouse and demand payment in bitcoin which can be harder to trace than a bank transfer. According to the Center for Strategic and International Studies, the global cost of cybercrime leapt from $523 billion to $945 billion between 2018 and 2020.

There have been several high-profile state-led attacks too. For instance, the pharmaceutical giant Merck allegedly lost $1.4 billion in sales in 2017 after it was hacked by Russia following sanctions in response to its annexation of the Crimea.

Remote work has made companies more exposed to hacking, with multiple potential entry points into companies' IT systems. Moreover, the rise in ecommerce fuels cybercrime as consumers share large amounts of sensitive data with ecommerce companies including phone numbers, dates of birth, addresses and passwords that often get stolen and traded on the dark web.

The last driver is legislation like the UK's General Data Protection Regulation (GDPR), which requires companies to disclose when they have suffered a data breach and potentially imposing large fines for delayed reporting or for improper data protection.

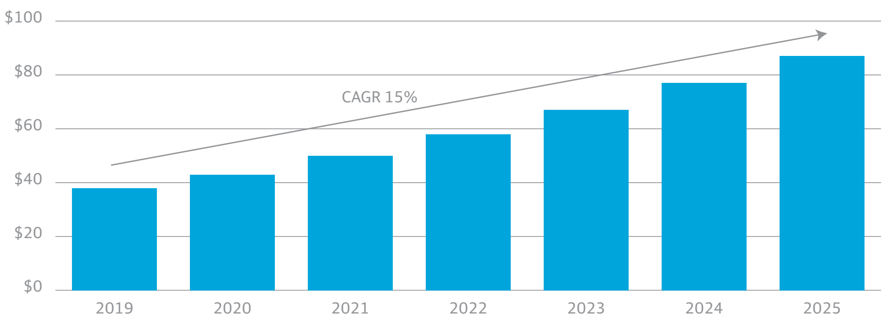
Innovations like digital services bring new risks but as with the invention of the combustion engine, rather than discourage the adoption of the car, new safety measures were introduced like the seat belt and air bag. We believe the same will be true of the cloud and internet adoption, requiring digital 'seat belts and air bags' to ensure the benefits of these new technologies outweigh the risks.

While demand for cyber security is strong, it has historically been hard to pick the winners in this sector. No single company has achieved more than a 20% share of any subsector for long. This is because new solutions are rapidly cloned, better ones come along or advances in hacking methods render them obsolete. This has meant that revenue growth and profitability for IT security vendors often fall short of expectations, leading to disappointing investment returns.

However, this industry dynamic might be set to change due to three upheavals: the move to hybrid working, cloud-based computing and the development of artificial intelligence. Optimists argue that these trends will shift cyber vendors' competitive advantage from digital code, which can be replicated, to scale, network density (the proximity of infrastructure to end users) and the degree of integration on external platforms. In other areas of technology, companies with these attributes have typically built enduring economic moats and leading market positions.

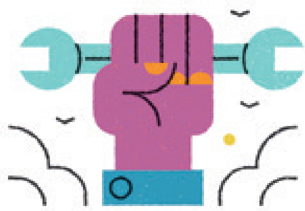
We remain on the sidelines of this debate for now, with most cybersecurity stocks in our view still lacking some combination of profitability, clear product differentiation and an attractive valuation. However, it is an area that we are continuing to monitor with growing interest.

Figure 6: Security software revenue forecast
$ billions



Source: Gartner. Note: forecasts from 2022–25, 2019–20 figures are actual.

What does the labour movement mean to ESG factors?



Are trade unions making a comeback? Following a wave of strikes, Mick Lynch has gained almost celebrity-like status, with clips of the RMT general secretary's ripostes to journalist questioning going viral on social media. Across the pond, as of early August 2022, 209 of Starbucks' 9000 US stores had voted to officially unionise. Earlier in the year, workers at tech giants Amazon and Apple also voted to form their companies' first labour unions at locations in Staten Island and Maryland respectively.

Spiralling inflation, wage stagnation, rising income inequality and a sense of injustice felt by those that put their health at risk during the pandemic to keep the economy ticking seems to have built momentum among workers to organise in an attempt to push employers for better pay, benefits and working conditions.

Over the past two centuries, efforts by trade unions have secured substantial improvements to workers' rights and working conditions such as an end to child labour, equal pay, the eight-hour working day and two-day weekends. So why is it that companies such as Starbucks and Amazon – which claim to support the International Labour Organization's (ILO) fundamental conventions, in which the right to organise and collective bargaining is included – have allegedly fought so hard to prevent unionisation?

According to a report released by Democrats on the House and Senate's Joint Economic Committee, US workers represented by labour unions earn on average 10.2% more than non-union peers. In addition to inflating wage bills and causing business disruption, it is commonly argued that unionisation limits flexibility and stifles innovation, with employers losing the ability to communicate directly with their employees, instead having to engage with an intermediary trade union. It is true that unions are in the business of protecting their members, at times to the detriment of their employers and to other (non-union) workers who aren't in the club. We would argue that a healthy tension – and respect – between unions and businesses is best for both sides. Yet to many corporations, union busting is seen as the cost of doing business.

A lens of responsibility

How then is treatment of unionisation viewed through an environmental, social and governance (ESG) risk management lens? One ESG ratings firm says it looks at workforce unionisation as a "proxy for the presence of basic employee rights and benefits" when assigning ESG scores to a company. While companies with low or no unionisation can still score strongly on labour management measures under this assessment framework, typically companies with higher rates of unionisation are scored more favourably. The ESG ratings assigned to Starbucks and Amazon by this provider, for example, were dragged down because it believed they were mishandling efforts by their workforces to unionise.

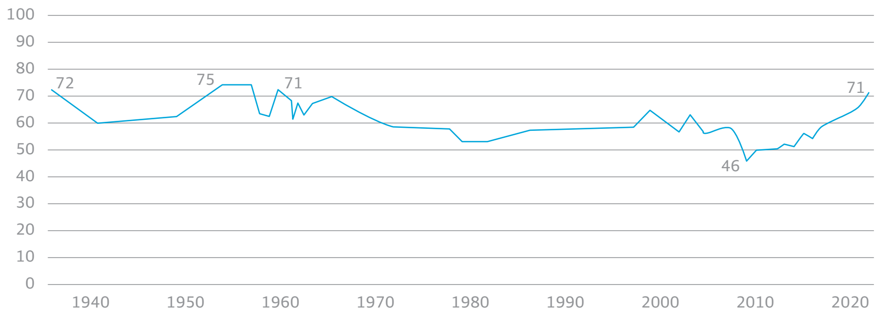
Could companies be missing a trick by failing to work with unions, or are the costs of suppressing unionisations, tangible and intangible, a price worth paying? According to research by the consultancy Gallup, voluntary employee turnover costs the US economy roughly $1 trillion dollars each year, which is around 5% of GDP. The cost of replacing an employee ranges from one-half to two times the employee's annual salary. Gallup also estimates that employees feeling disengaged at the workplace – essentially stop caring and become mutinous – costs the global economy $7.8 trillion, which equates to 11% of global GDP. What's more, separate studies have also suggested that retaining stable workforces in blue collar industries is critical to maintaining product reliability.

For all the talk of a renaissance, trade union membership in both the UK and the US is at multi-decade lows. But the tide may be turning – polling by Gallup suggests public perception of unionisation, particularly in the US, has been steadily turning more positive since reaching a low in 2010 (figure 7).

Social media has made it easier than ever for workers to organise, and companies that have taken a hard-line approach to unionisation may find it harder to keep doing so. Increasingly, companies could start to find a happier medium through engagement with workers seeking to unionise, improvements in transparency around ESG issues such as executive and median worker pay ratios, and at the very least, genuine, concerted efforts to listen to and act on employee feedback.

Figure 7: Americans' approval of labour unions (1936–2022)

Do you approve or disapprove of labour unions? (%)



Source: Gallup

Financial markets

For UK markets, the end of the quarter was dominated by the fallout from newly appointed Chancellor Kwasi Kwarteng's so-called 'mini budget'. While this added to the uncertainty surrounding the UK economic outlook, for international investors the impact on the rest of the globe should be negligible.

Growth continues to slow around the world as a result of high inflation, exacerbated by the ongoing war in Ukraine. Central bank commitments to bringing inflation under control with increases in interest rates, despite the risks to growth, weighed on equity and bond markets.

On a brighter note, US consumer confidence bounced back in August, a positive signal for consumer spending despite cost-of-living pressures. There are signs that goods prices may be starting to ease, but the outlook for inflation remains highly uncertain.

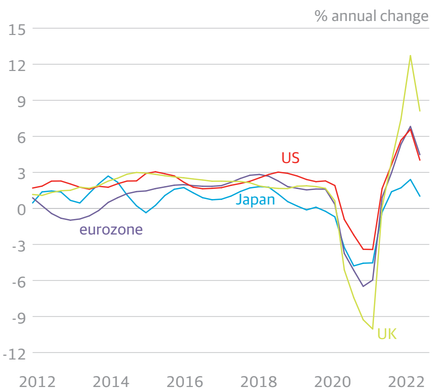
Market volatility

Euro area shares fell in August amid concerns about inflation, particularly in the form of high gas and electricity prices. But gains made by Ukrainian forces in the north east of the country helped support Europe's stock markets towards the end of the quarter. Gas prices have also trimmed their gains amid hopes that Ukraine's successes could lead to an easing of the energy crisis.

US equities fell in August after Fed chair Jerome Powell said the US central bank would keep tightening monetary policy. This dashed Wall Street's hopes that the Fed's tightening phase might come to an end early next year.

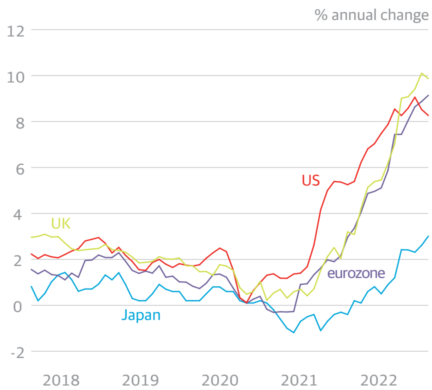
Unexpected persistence in the latest US inflation figures, despite falling energy prices, also raised concerns the Fed will need to act more aggressively to curb it. The dollar – seen as a safe haven in times of geopolitical turmoil – reached a 20-year high in September after President Vladimir Putin ordered the mobilisation of 300,000 military reserves, prolonging the war in Ukraine.

GDP growth



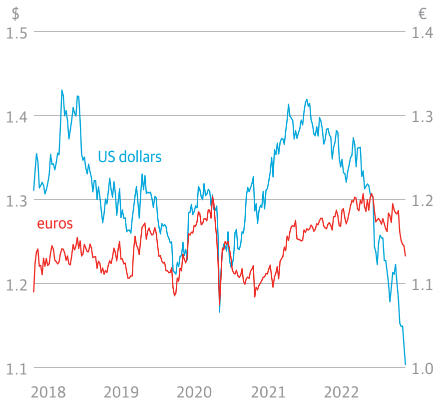
Source: Factset and Rathbones.

Inflation



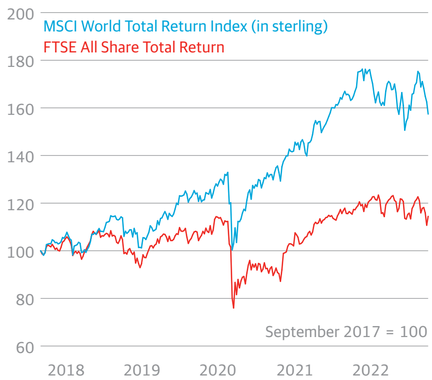
Source: Factset and Rathbones.

Sterling



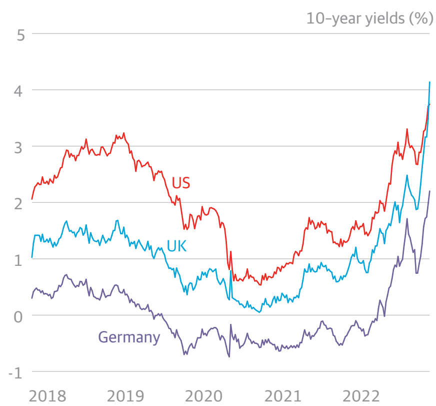
Source: Factset and Rathbones.

Equities



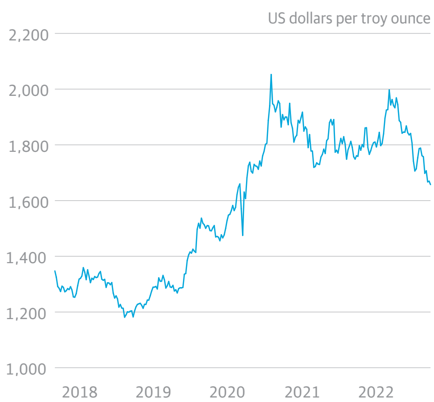
Source: Factset and Rathbones.

Government bonds



Source: Factset and Rathbones.

Gold



Source: Factset and Rathbones.

Past performance is not a reliable indicator of future performance.

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