Monthly Review and Outlook

December 2022

Review

Global equities were broadly weaker in December.

Bond markets declined on a global basis, with government bond prices falling more steeply than company bond prices.

The US Federal Reserve met expectations in raising rates by 0.5 percentage points, after four consecutive 0.75 percentage point rises.

Company shares

UK equities fell during the month. The energy, non-essential consumer goods and essential consumer goods sectors were the poorest performers. Only the healthcare sector performed positively.

US equities fell in December. The Federal Reserve (Fed), the US central bank, met investor expectations by raising interest rates by 0.5 percentage points. Interest rates are expected to continue to rise in 2023. Inflation, as measured by the Consumer Prices Index (CPI), slowed to 0.1 per cent on a month-on-month basis in November, down from 0.4 per cent in October. Shares in the non-essential consumer goods sector were among the weakest performers, with automobiles doing particularly poorly as the share price of electric car manufacturer Tesla came under pressure.

Eurozone shares declined, with information technology and non-essential consumer goods among the weakest sectors. The financials sector performed relatively well but still registered a negative return. Christine Lagarde, president of the European Central Bank, said eurozone policymakers were ‘not done’ with raising interest rates after a 0.5 percentage point rate rise in the month.

Asian equities (excluding Japan) had mixed performances. There were strong gains in China and Hong Kong, but India, Indonesia, South Korea and Taiwan performed more weakly. Hong Kong performed particularly strongly after Beijing loosened pandemic restrictions; Chinese equities also rose on the news. Taiwan was weaker due to ongoing geopolitical tensions, higher US interest rates and lower demand for electronic goods. Emerging markets had a stronger performance than global markets during the month.

Bonds

Bond prices fell in December, reflecting market disappointment as comments from some central banks suggested more interest rate rises would be forthcoming. Falls in government bonds were generally larger than falls in company bonds, although US high-risk (high yield) company bonds were a notable exception. The yield on US government bonds with a 10-year expiry date rose from 3.61 per cent to 3.88 per cent (bond yields rise when bond prices fall), with two-year US government bond yields rising from 4.34 per cent to 4.42 per cent. Germany's 10-year yield increased from 1.93 per cent to 2.57 per cent. The UK 10-year yield increased from 3.16 per cent to 3.67 per cent and the two-year went up from 3.26 per cent to 3.56 per cent.

Commodities

In commodities, the benchmark index for investment in global commodity markets fell in December. Energy was the worst-performing component of the index, with the price of natural gas sharply lower in the month. In agriculture, the price of cocoa, soybeans, corn and sugar gained, while coffee, cotton and wheat prices all declined. In precious metals, the price of both gold and silver gained in December.

Outlook

We see opportunities in equity markets outside the US, in emerging market debt (priced in local currencies) and in high-quality (investment grade) European debt. But, with central banks still raising interest rates and the risk of recession, we are balancing these positions with a negative view of US equities. With markets having now rallied off their lows, we are concerned that valuations of some types of riskier assets are still not cheap enough. And there is still a risk the bond market is underestimating the Fed's (and other central banks') commitment to bringing inflation under control through higher interest rates. This leaves us neutral on government bonds. But we do expect inflation to fall as interest rates take effect. We would also expect central banks to then consider interest rate reductions towards the end of 2023 and into 2024, to help kick start economies and emerge from recession. Finally, we are positive on European and emerging market equities as compared with the US: European banks remain in rude health and China appears to be phasing out its zero-Covid policy.

Asset overview

Our general view of assets in the coming months is summarised as follows. These are our in-house view as at the end of December 2022.

Equities	🔴	We have moved to a negative stance again amid growing fears about recession and company earnings.
Government bonds	🟡	In our view there is still a risk the bond market is underestimating the Fed's (and other central banks') commitment to bringing inflation under control through higher interest rates.
Corporate bonds	🟢	We favour high-quality (investment grade) to higher risk (high yield) company bonds given recessionary fears. We now prefer US to Europe and emerging markets company bonds on valuation grounds.
Commodities	🟡	We consider China's tentative steps towards phasing out its zero-Covid policy to be a positive factor, but view a potential economic slowdown as a negative factor.

	Legend
🟢	Positive outlook
🔴	Negative outlook
🟡	Neutral outlook

Source: Schroders, 11 January 2023

Important information

Forecasts of future performance are not a reliable guide to actual results, neither is past performance a reliable indicator of future results. The value of investments and the income from them can fall as well as rise and are not guaranteed, and the investor might not get back their initial investment.

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