Monthly Review and Outlook

February 2023

Review

Global equities declined in February, following the strong advance seen in January.

Resilient economic data dented hopes for a pause in interest rate rises.

In fixed income, prices of government bonds fell (meaning yields rose).

Company shares

UK equities rose during the month and the index of the largest 100 UK companies hit a record high. Companies in the energy, healthcare and telecoms sectors led the way, as the strong US dollar boosted these global operators. Some domestic areas of the market also performed relatively well, as the UK economy was stronger than expected.

US equities fell. The US central bank, the Federal Reserve (Fed), indicated that its actions to curb inflation were starting to work. But its decision-making committee reached a general consensus that interest rates may need to rise further to control inflation. Almost all sectors, in the index of the 500 largest US companies, declined. Energy performed particularly weakly, with investors concerned about potential cost pressures. Technology held up comparatively well.

Eurozone shares rose in February. Communication services, financials, industrials and consumer staples performed particularly strongly. But real estate, IT and healthcare posted negative returns. February's eurozone purchasing managers index (PMI) indicated the strongest expansion of eurozone business activity since May. PMIs measure month-on-month changes in manufacturing and services activity. The European Central Bank (ECB) raised interest rates by a further 0.5 percentage points, which lifted the main refinancing rate to 3.0 per cent. A further increase is expected in March.

Asian equities, excluding Japan, fell in February, driven by sharp declines in China and Hong Kong. Escalating geopolitical tensions partly drove this change. Thailand, Malaysia and South Korea fell following a strong performance in January as China's moves to reopen its economy sparked investor optimism. But the Japanese stock market rose slightly in February. Emerging market (EM) equities fell and performed more weakly than global equities as heightened US-China tensions weighed on investor sentiment.

Bonds

Global government bond prices fell, but US corporate bonds declined more markedly as markets expected central bank interest rates to remain high for longer than anticipated. European corporate bonds performed better than their US counterparts. The Fed raised interest rates by 0.25 percentage points at the start of February. The European Central Bank (ECB) raised rates by 0.5 percentage points early in the month and signalled there would be another 0.5 percentage point rise in March. The yield on US government bonds with 10-year expiry dates rose from 3.51 per cent to 3.92 per cent (bond yields rise when bond prices fall). The yield on two-year US government bonds rose from 4.21 per cent to 4.82 per cent. The yield on 10-year German government bonds increased from 2.29 per cent to 2.65 per cent. The UK 10-year yield rose from 3.34 per cent to 3.71 per cent, and two-year increased from 3.46 per cent to 4.07 per cent.

Commodities

The Bloomberg Commodity Index, a benchmark for investment in global commodities, fell in February. Industrial metals and precious metals fell particularly strongly. Silver and gold prices also declined, as did energy prices.

Outlook

We continue to maintain our positive stance on government bonds, as we believe higher rates are starting to bite and because the Fed continues to be vigilant on inflation. Consequently, we expect growth indicators in the US to slow and inflation to fall further. We have a slightly cautious stance on corporate bonds, as their prices have risen relative to government bonds.

We have a slightly cautious stance on equities. There is still the risk of a hard economic landing or persistent inflation, which would make it difficult for the Fed to bring down interest rates. In our view, lower interest rates could support equities. We continue to prefer emerging markets and European equities to the US, due to their lower valuations and what we consider to be better growth trends outside the US.

Asset overview

Our general view of assets in the coming months is summarised as follows. These are our in-house views as at the end of February 2023.

Equities	🔴	We have a slightly cautious stance. Interest rates may be peaking, which we think could help support share prices, but risks of a hard economic landing or persistent inflation remain.
Government bonds	🟢	We are positive. In our view, higher interest rates are starting to impact economic growth and the Fed remains vigilant on inflation. These factors could provide support to government bond prices.
Corporate bonds	🔴	Corporate bond prices have risen relative to government bonds prices and we are slightly cautious on corporate bonds.
Commodities	🟡	We believe a slowdown in global growth, combined with easing conditions for the production and transport of goods, limit the scope for commodity price rises.

	Legend
🟢	Positive outlook
🔴	Negative outlook
🟡	Neutral outlook

Source: Schroders, 9 March 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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