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Six minute strategy

Balancing the books – has the UK rediscovered fiscal prudence?

November 2022

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Global asset markets begin the long climb back

A weaker dollar, improved supply chains & bearish sentiment argue for normalised equity levels

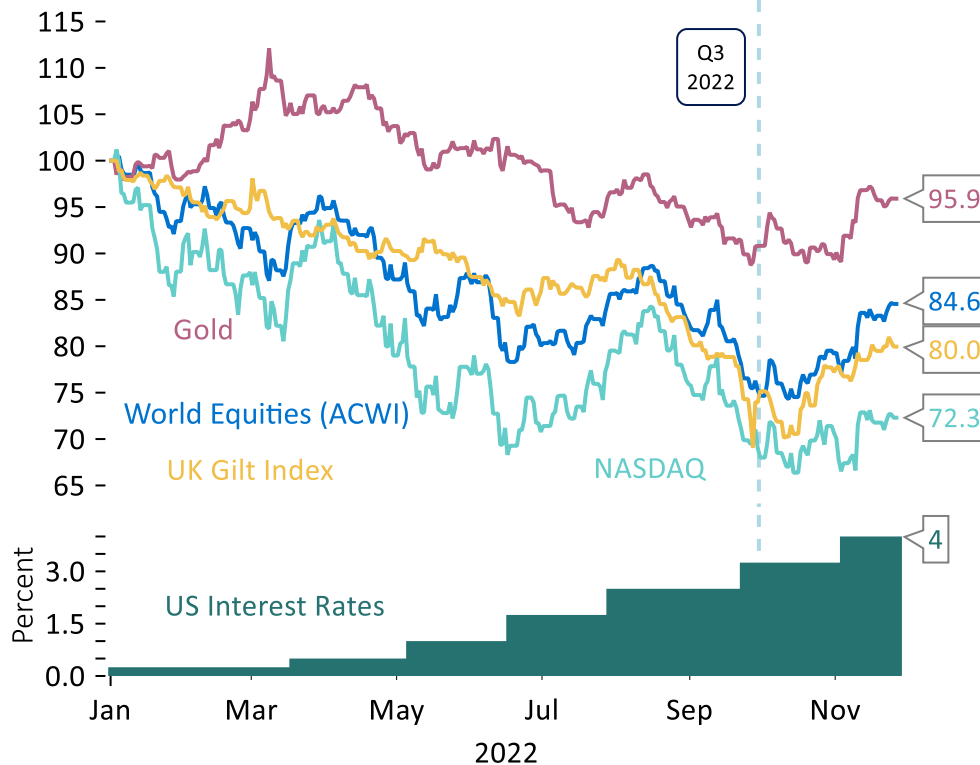


All asset classes show negative returns 2022 to date



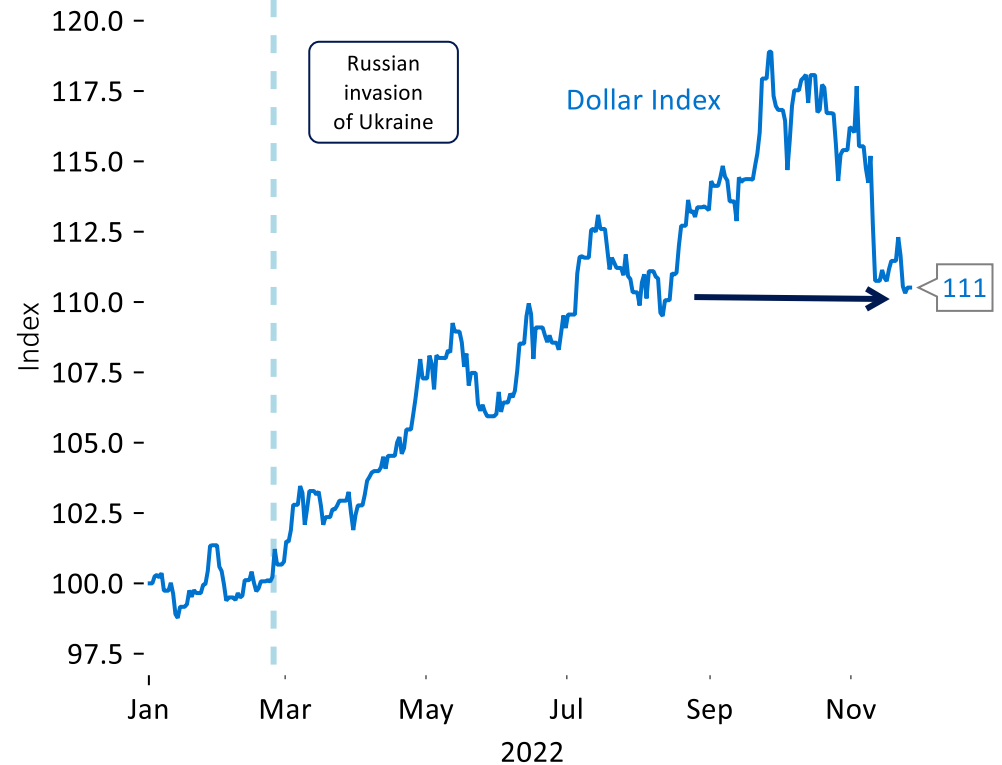
Might the dollar's ascent be drawing to a close?

Global Asset Performance, year-to-date



Source: Macrobond, 28.11.22

US Dollar (DXY)



Source: Macrobond, 28.11.22

Extraordinary challenges for our new PM



A new leader needs to support low income groups & win the confidence of financial markets

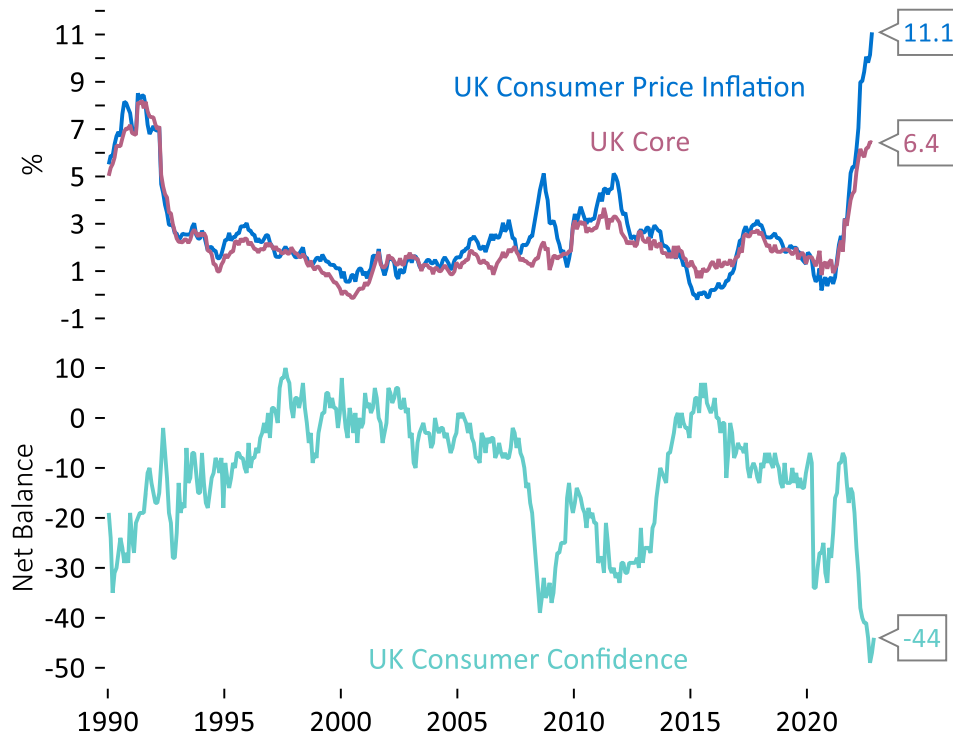


Inflation soars and takes consumer confidence to record lows



Recession forecast for 2023 will be relatively mild

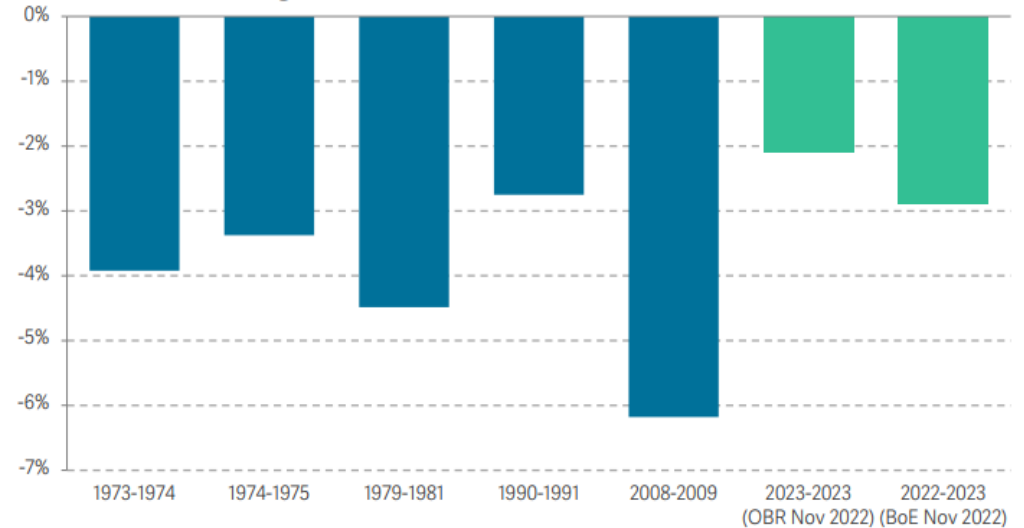
UK Inflation and Consumer Confidence



Source: Macrobond, 28.11.22

FIGURE 2: The OBR forecasts a relatively shallow recession compared to past recessions

Falls in real GDP from peak to trough in previous recessions and the November 2022 OBR and Bank of England forecasts: UK



SOURCE: OBR, Economic and Fiscal Outlook, various; Bank of England, Monetary Policy Report, November 2022.

1. Hunt/Sunak largely restore market confidence in UK



Chancellor Hunt has seen bond yields & sterling return to pre-Truss/Kwarteng levels

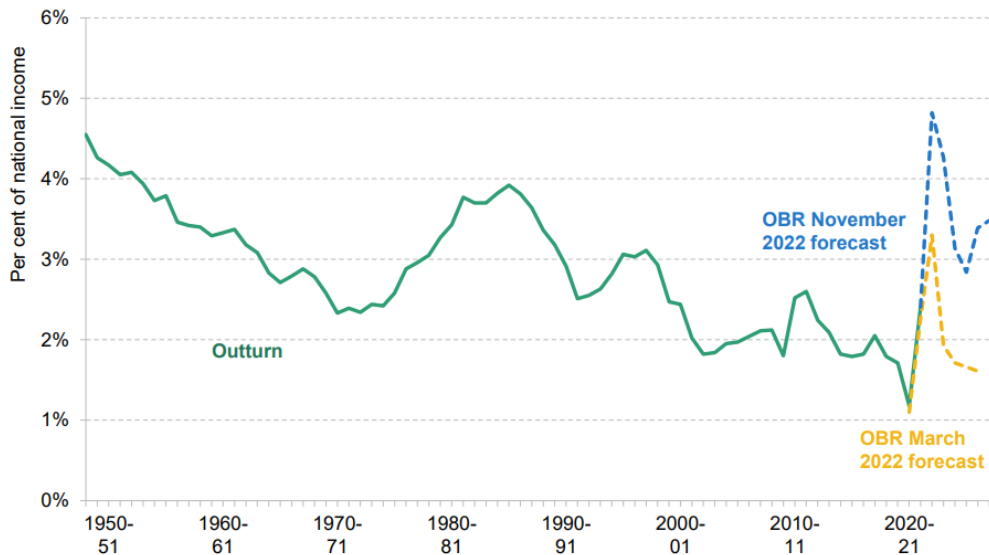


UK debt interest shock makes capping gilt yields critical



The bond market vigilantes have been stood down

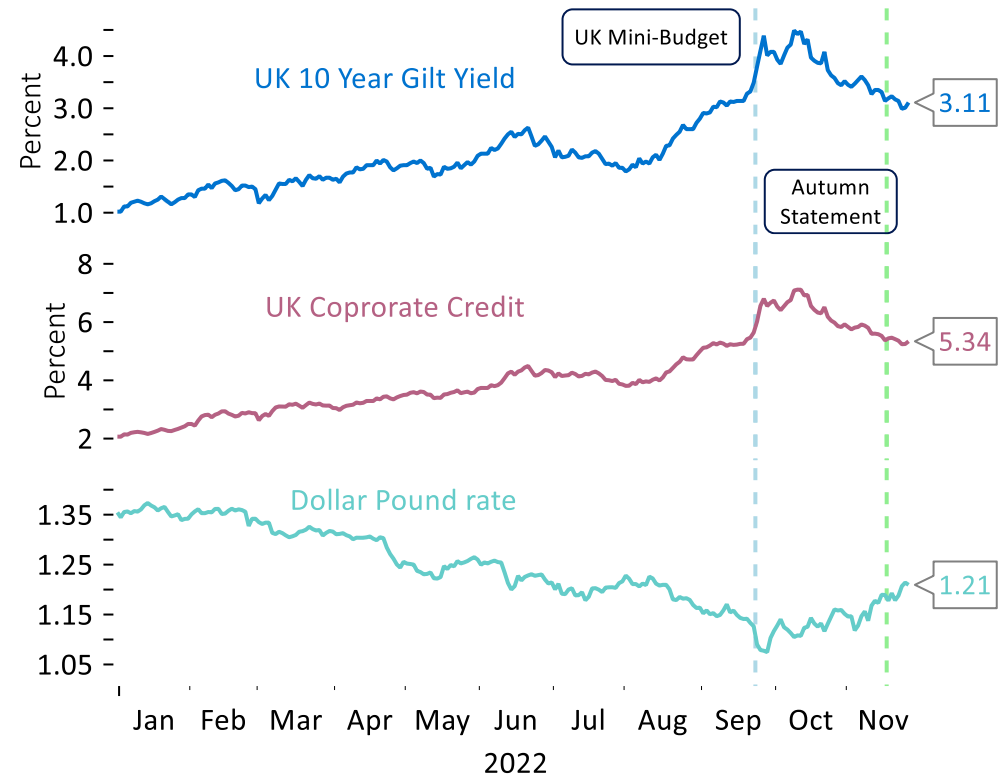
Debt interest now at its highest share of GDP in over 70 years



“UK debt to GDP rises to 97.6% in 2025/6, a 63 year high” OBR Nov 2022

Source: IFS Nov 2022

UK Borrowing Rates in 2022



Source: Macrobond, 28.11.22

2. Tighter spending from 2024-2025 – once economy has stabilised

Weaker economy + higher inflation + rising borrowing costs = worsening fiscal outlook



Help today, squeeze tomorrow



UK inflation will likely peak Q4 at 11 - a 40 year high

Chart 2: Public sector net borrowing

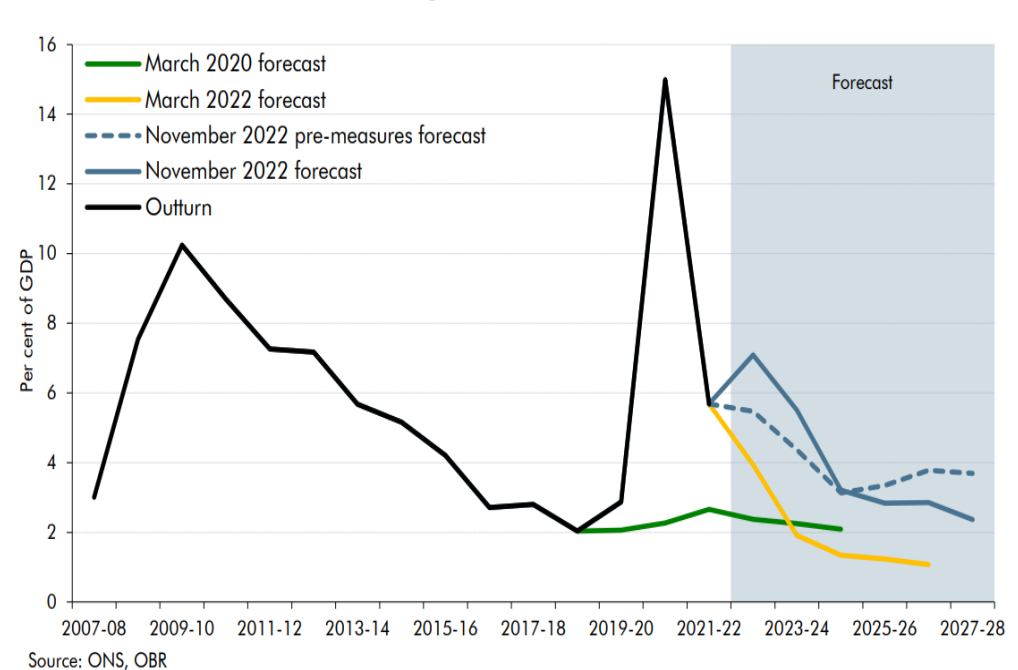
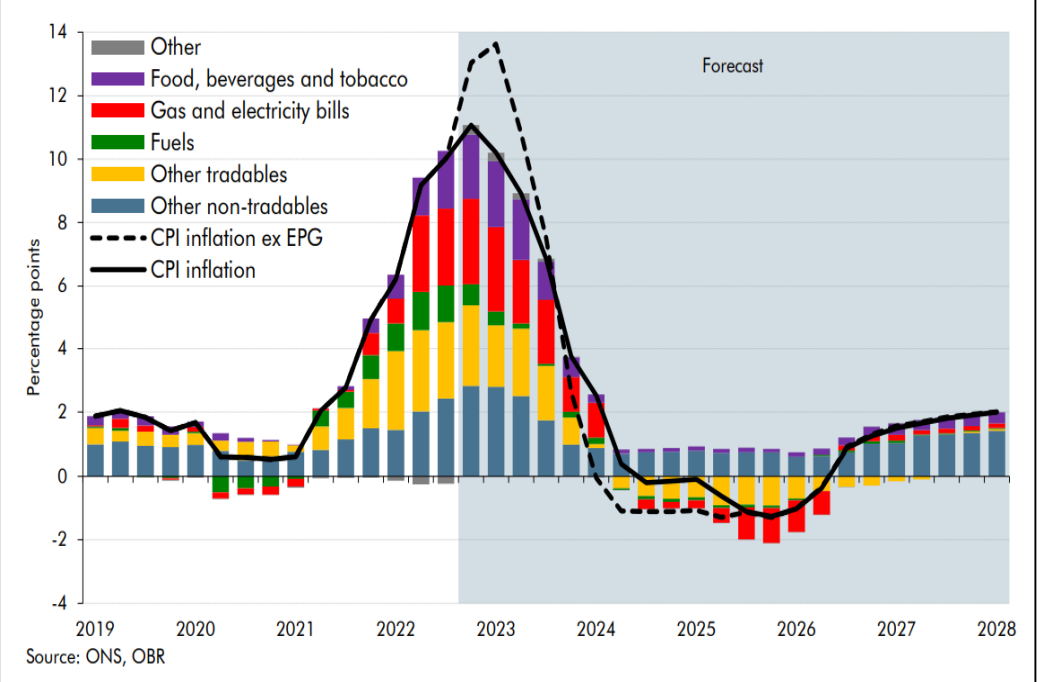


Chart 4: Contributions to CPI inflation



The Budget “strikes the right balance between fiscal responsibility and protecting growth and vulnerable households” Kristalina Georgieva IMF MD 18 11 2022

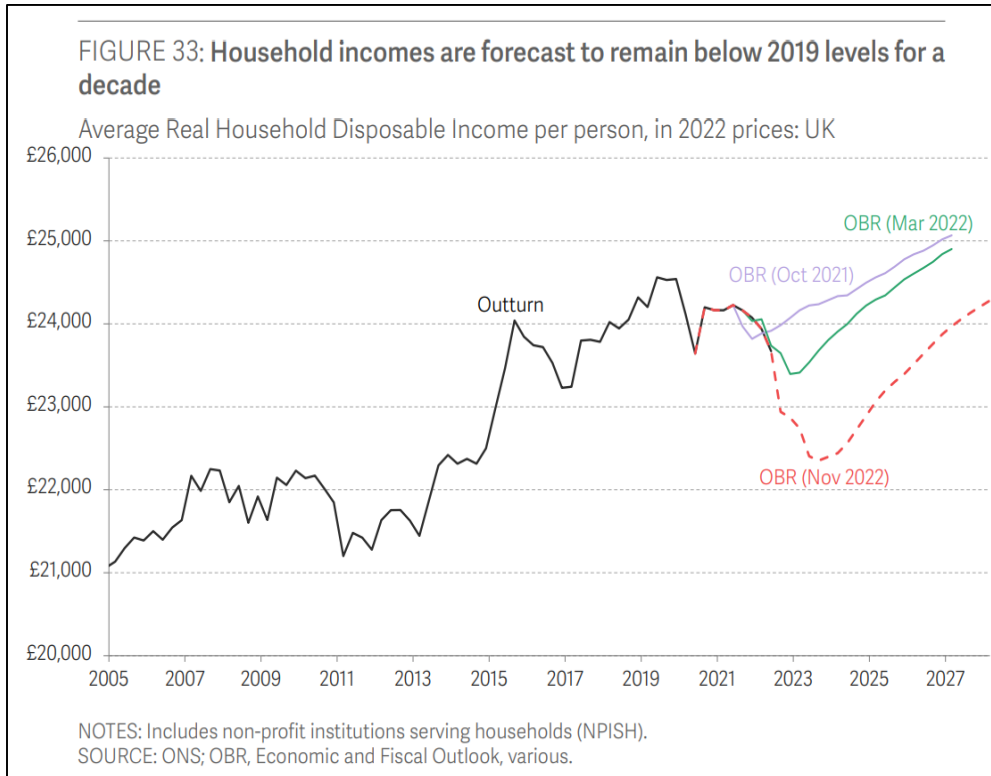
3. Tight labour markets falling real wages is driving industrial action



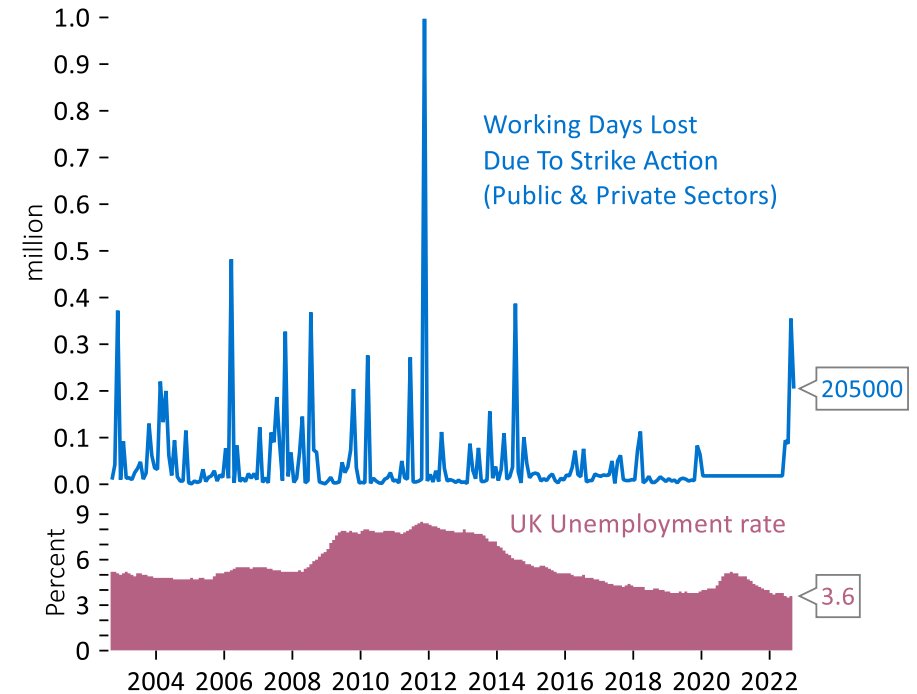
Real disposable incomes 2028 will be less than pre-Pandemic



Private sector strike days soar – public sector to follow



UK Labour Disputes & Unemployment



Source: Macrobond, 28.11.22

“Workers are facing 19 years of no cumulative wage growth while tax rises for people across the income distribution are a drag down on incomes.”

Resolution Foundation Nov 2022

Finding the light at the end of the tunnel

Investment grade bonds attractive – equity valuations fair – alternatives offer real diversification



Global strategy update – November 2022

Bonds	<p>Underweight</p> <ul style="list-style-type: none"> • UW Government Bonds – global inflationary pressures remain elevated but rates are close to peaking • Neutral UK Investment Grade Credit – yields attractive – corporate balance sheets healthy
Equities	<p>Neutral</p> <ul style="list-style-type: none"> • Recession will likely be mild limiting deterioration in overall earnings and dividends • Investor sentiment is sharply negative while equity seasonality is positive • Robust corporate balance sheets offer support to defensive & dividend strategies
Alternatives	<p>Overweight</p> <ul style="list-style-type: none"> • Neutral Other Alternatives– private equity, infrastructure and renewables will be impacted by higher discount rates • Strong OW Uncorrelated Alternatives as effective diversification • Reduce gold positions as US rates rise
Cash (tactical)	<p>Neutral – Sterling weighting neutral - gradual appreciation expected over the medium term</p>
Risks	<ol style="list-style-type: none"> 1. Inflation shock not yet abating: Core inflation continues to accelerate in 2023 meaning higher rates for longer 2. Shrinking central bank balance sheets: QT triggers tighter liquidity and volatility issues. Central bank losses accelerate budget crisis 3. Military challenges worsen: China-Taiwan re-unification risks accelerate – Putin escalates with tactical nuclear ‘event’

Source: Sarasin & Partners, November 2022

Important information

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