Macro Outlook Summary

August 2023

It seems that August marked the point where the consensus outlook for central bank rates shifted decisively away from possible cuts on the horizon to the 'higher for longer' mantra now taken as gospel by market participants. We feel this re-think has been long overdue and as it removes one significant disconnect, we welcome the market's reconnection with reality.

While politicians may worry about the deteriorating outlook for growth and therefore their prospects for re-election the real issue facing us all is the outlook and future path of inflation. This is the statistic that will guide us to the future world we live in, whether we like it or not, because how it evolves over the final quarter of 2023 and into 2024 will define not only central bank policy but more importantly investor confidence and equity valuations. Negative surprises are unlikely to be taken in the market's stride as commentators start to raise the possibility of a world with stagnant growth but persistent inflationary forces holding back central bankers' ability to cut rates. Stagflation is good for no one and especially not for bonds or equities.

So, are there emergent inflationary forces we should be worrying about and how strong will they be? Troublingly the answer is yes and some may be stronger than we currently imagine. To be clear we do not think this is about to become the current narrative but see these risks possibly materialising further down the line.

The oil market has been deliberately tightened by OPEC and Russia albeit with different agendas; China is showing some green shoots of economic stabilisation and recovery; and G-10 nationalism towards immigration and imports shows no signs of abating. Stagflation and nationalism feed off each other with an unpleasant negative feedback loop, promoting de-globalisation.

Some countries are more likely than others to fall into this downward spiral so given its global importance is the US one of those? If the election returns Trump or someone with similar thinking then nationalism will take centre stage and inflation will not recede the way we all wish.

Post-QE governments are stretched fiscally so the scope for fiscal growth pump priming is slim and the cost would be high. For the time being however we continue to think the US enters a soft landing with a positive outlook for equities. Small dark clouds are visible on the horizon for 2024 and they need monitoring very carefully if surprises are to be avoided. The clouds may gather or disappear over the next few quarters but we are flagging one significant way in which our positive outlook might be de-railed.

As always, the key to risk management is to look forward and we will aim to be positioned to protect and profit from any such move in markets should we reach the point where we think these risks are likely to materialise.