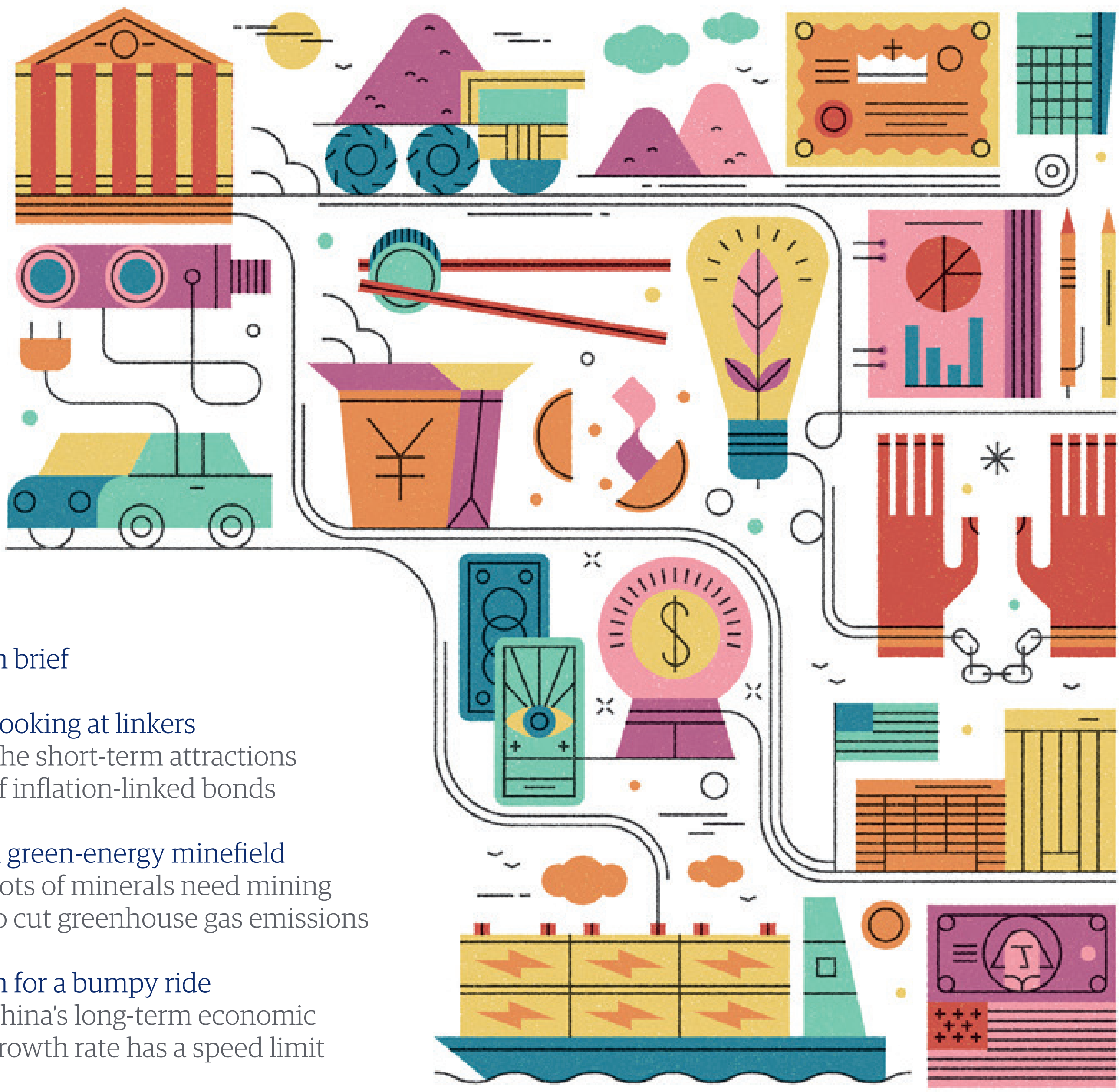
Investment*Insights*

Issue 36 – Second quarter 2023

A reality check on earnings forecasts

The consensus outlook for US company profits looks too optimistic against a background of rising interest rates and likelihood of mild recession



Rathbones
Look forward

Foreword

With Spring just around the corner, could markets be in for a brighter period after a difficult start to the year? Our lead article looks at the outlook for US company profits against a backdrop of rising interest rates and slowing economic growth. Even before the latest turmoil in the banking system, we thought a US recession looked more likely than not in 2023. We explore what this means for our exposure to US equities.

Our next article on page 5 examines the short-term attraction of inflation-linked bonds. Rising yields mean the value of conventional government bonds is falling. We explain why we are wary of longer-dated linkers compared with their shorter-dated counterparts.

Electric vehicle and battery manufacturers are expected to be major consumers of critical minerals. Will there be enough mineral supply to enable companies and countries to deliver on commitments to phase out the production of internal combustion engines? Read more on page 6, where we also ask if the minerals can be mined ethically.

We explore China's long-term economic growth prospects in the next feature on page 8. We're already well over a decade into a structural slowdown in China's economy. What are the headwinds facing the country and the challenges that lie ahead for labour, capital and productivity?

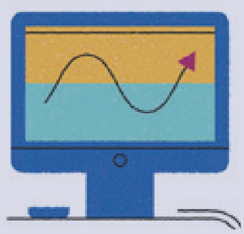
The final article explores the vital role businesses and investors can play in eradicating modern slavery. Despite the UK's landmark 2015 Modern Slavery Act, there is no legal redress in law for companies that fail to comply. Rathbones convened an investor collaboration called Votes Against Slavery to address this gap in the law via direct action from investors. Read more about this on page 9.

We hope you and your family are well and looking forward to sunnier days ahead. Please visit rathbones.com to find out more about our latest views on issues affecting the global economy and investments.

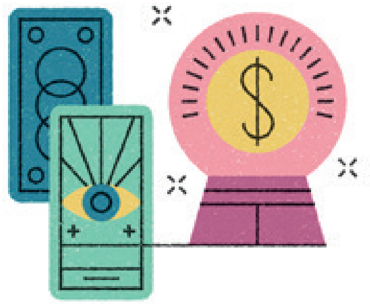
Liz Savage and Ed Smith
Co-chief investment officers

Investment*Insights* webinar with Q&A

Join our next webinar on 12 April from 12:30 to 13:00 to hear our thoughts on the banking sector, the outlook for growth, inflation and markets, and also an update on China. Register here.



Why US company earnings forecasts look dead wrong



Even before the latest turmoil in the banking system, we thought a US recession looked more likely than not in 2023. Given a clear contrast between analyst forecasts for earnings and America's economic outlook, plus the risks to valuations there, we're cautious on US equities.

Before the recent banking-related selloff, US stocks were not pricing in a recession. Investors probably overinterpreted a few encouraging bits of data from the start of the year, which may have been flattered by exceptionally warm winter weather – with New York experiencing its longest winter period without snow in half a century – and problems with the adjustments government statisticians make to account for seasonal consumption patterns, which have changed since the pandemic.

The bigger picture is that the US economy has already slowed significantly since its boom in 2021. While GDP growth has been volatile due to swings in inventories and international trade patterns, measures of growth in underlying domestic demand had already slowed to a crawl by the end of last year. At the same time, our quantitative modelling – which incorporates the signal from a range of variables with a track record of leading the economic cycle – suggests that recession risk increased significantly from mid-2022 and remains high.

The economy would have slowed even more last year had consumers not spent some of the extra savings they built up during the pandemic lockdowns – but there's evidence to show that support from this source is fading. Loan delinquency rates began to rise again late last year, a sign that at least some households have already burned through their cash buffers.

Other households may not plan to spend any extra savings they accumulated during the pandemic. They may have used their stimulus cheques to build a precautionary cash buffer they always wished they held. In aggregate, we can see that so-called excess savings are now providing less support.

Delayed is not denied

Even more significantly, interest rates rose at the fastest rate since the early 1980s in the second half of last year. The key point here is that monetary tightening tends to hit the economy with a lag. Most evidence suggests that it's typically more than a year before the peak impact of rate hikes is felt.

There are lots of reasons why it takes time for higher rates to bite. For example, loans aren't all refinanced at once, so they roll onto higher rates over time. Meanwhile, layoffs in the most rate-sensitive sectors like construction typically happen only months after activity in those sectors weakens.

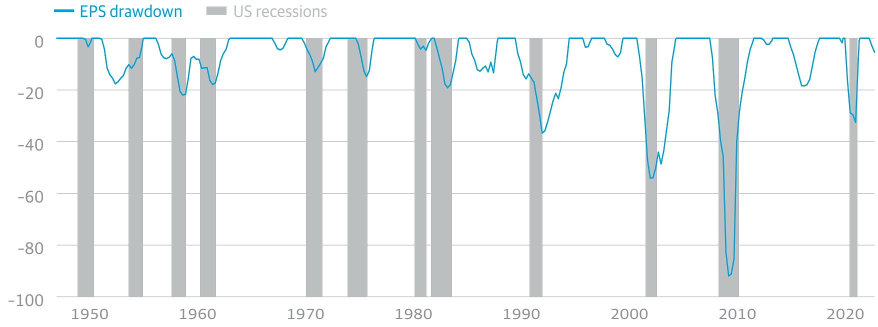
The delayed impact on the financial system, evident in the recent failure of three regional banks, should also be seen in this context. Rapid rate increases and the associated sharp moves in bond yields often create strains in the financial system which are not evident immediately.

We shouldn't take this final point too far. There are good reasons to be optimistic that a systemic crisis in the banking system in the style of 2008, and the very deep recession that followed, will be avoided (see our Investment Update 'It takes time for things to break' published on 17 March 2023). The US Federal Reserve has acted quickly to quell the acute stress that followed the failure of Silicon Valley Bank (plus its smaller regional-bank peers Signature Bank and Silvergate Bank).

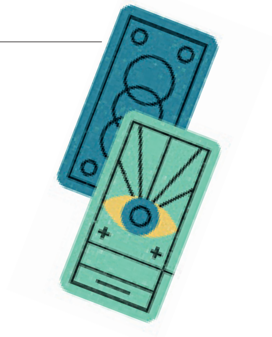
It has established a new lending facility (the Bank Term Funding Program) to provide liquidity to the domestic banking system. In addition, it has enhanced its swap lines with

Figure 1: Company earnings and recessions

This chart shows the peak-to-trough declines in US company earnings (measured as earnings per share) and how they have coincided with periods of economic contraction.



Source: Robert J. Shiller, Rathbones.



other major central banks – which help provide dollar liquidity to banks elsewhere in the world. The banking system today also looks different than it did on the eve of the global financial crisis. Large banks around the world are much better capitalised, meaning they have much greater capacity to absorb losses. We don't see the same evidence that they've engaged in widespread lending to risky borrowers, or fuelled an economy-wide credit bubble, as they had done then.

Yet none of this is cause for complacency. Banks had already begun to tighten their lending standards at the end of last year. Even if the immediate turmoil that has followed the regional bank failures subsides, that shot across the bows means that tightening is likely to continue in the coming months, with lenders turning more cautious once again. Firms will find it harder to borrow for investment, and households will find it harder to obtain credit for big-ticket purchases. That will add to the chances of recession, regardless of whether any more banks fail.

Recession? What recession?

Given this economic backdrop, analyst forecasts for the earnings of US companies in aggregate still look much too optimistic. While their forecasts have been falling gradually since mid-2022, in our view they haven't adjusted nearly enough yet. They remain consistent with earnings slightly higher this year than last, followed by strong growth (of about 12%) in 2024.

Those aggregate earnings forecasts look even more optimistic if we strip out the energy and materials sectors, where it's widely acknowledged that the earnings are likely to be much lower this year with commodity prices now well below their 2022 highs. (In both cases, analysts expect earnings to fall by more than 15% this year.) Outside those sectors, the consensus among analysts is for solid growth.

Current consensus forecasts clearly contrast with the typical experience in recessions. Figure 1 illustrates past peak-to-trough declines in earnings, with recessions highlighted. Nearly every recession is associated with a double-digit percentage decline in earnings. We sometimes hear the argument that earnings are nominal, and therefore might be cushioned by still-high inflation. Yet earnings fell even in the wake of the 1970s recessions, despite even higher inflation than we have now. Our top-down quantitative modelling also continues to point to significant further falls in earnings forecasts.

One particular challenge this time around is that profit margins are already very high by past standards. They jumped to all-time highs during the exceptional circumstances of the pandemic and have yet to normalise fully again. In other words, it made sense to expect some downward pressure on margins even without a recession.

Beware of falling expectations

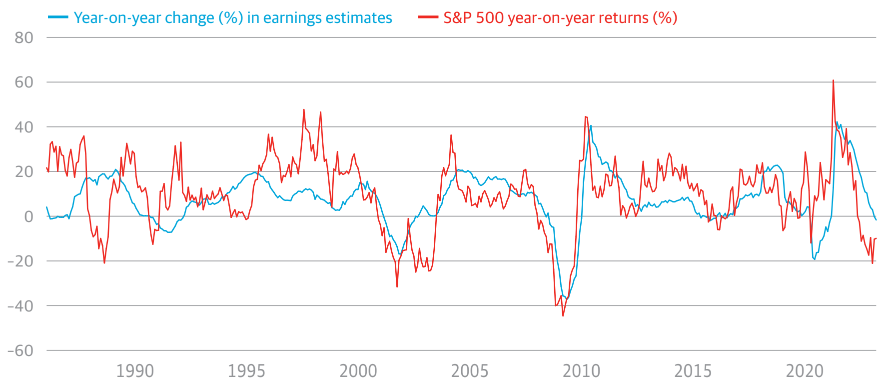
When earnings expectations fall, the market usually struggles, as figure 2 illustrates. The chart also shows that there are occasional exceptions, which tend to happen when the valuation of the market (the multiple that investors are willing to pay for a given stream of future earnings) rises by enough to offset the decline in earnings expectations. Unfortunately, though, circumstances don't seem aligned for that to happen this time around.

In the past, these earnings multiples have reacted to changes in government bond yields. The higher the returns available from government bonds, which have minimal credit risk, the less appealing the prospect of paying a big multiple for riskier equity earnings.

The key problem this time is that equity multiples in the US have yet to adjust by as much as you would expect given the scale of the surge in real (inflation adjusted) yields last year (see our related article on inflation-linked bonds on page 5). While the same is arguably true across major equity markets, it's the US market that really stands out on this count.

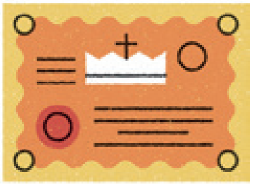
Figure 2: Earnings forecasts and stock market performance

The stock market struggles when earnings expectations fall but this relationship has broken down in the past when valuations have risen by enough to offset the decline.



Source: Refinitiv, Rathbones.

The short-term attractions of inflation-linked bonds



Rising yields mean the value of government bonds are falling. Investors have been selling them fairly heavily for most of the past two years because their low fixed returns look unattractive in a world of high inflation and rising interest rates. Fears about inflation have become especially acute in the UK.

Unlike conventional bonds, the coupon payments of inflation-linked UK government bonds (known as index-linked gilts or linkers) and the capital they return at maturity rise in line with inflation. This relationship helps to protect investors from one of the greatest threats to a sovereign bond besides default – inflation. In return for this protection, investors are willing to pay more for an index-linked gilt than a conventional one. Exactly how much more? A key determinant is how worried they are about this risk at the time.

Right now, UK bondholders are worried a lot about inflation. By comparing how much more money investors are willing to pay for an index-linked gilt as opposed to a conventional gilt with the same maturity, you can figure out how much inflation they are assuming will occur over the life of the bonds. That's because the more you pay today for a linker, the higher the inflation rate needs to be over the coming years to ensure that the extra cash you get from the index-linking boosts your return above that of the conventional bond. In the parlance, this assumed average annual inflation rate is the 'breakeven'.

Five-year linkers are expensive at the moment – their breakeven rate topped 5% early last year and is at around 3.4% now. In other words, if you bought a five-year linker, RPI inflation would need to average more than 3.4% each year for the next five years for your investment to beat the return of a five-year conventional gilt. That's compared with the average inflation rate over the past decade of just under 3%.

However, short-dated linkers are appealing because they now offer real yields (yields minus inflation) close to zero, which have been significantly negative for most of the past decade (figure 3). That means they should provide returns roughly in line with inflation if held to maturity. That's attractive given the prospect of lingering high inflation undermining the real (inflation adjusted) returns from all assets, and our general view that it makes sense to maintain a cautious stance.

A long caution

We are wary of longer-dated linkers for two reasons. First, the prices of linkers – like conventional government bonds – are sensitive to changes in interest rate expectations. Long-dated linkers are much more sensitive than short-dated ones. In market parlance, they have 'longer duration'. Assets with very long duration can be extremely volatile, as we saw last year when interest rate expectations surged. While short-dated linkers delivered small positive returns in the face of last year's inflation shock, long-dated ones suffered huge losses as real yields surged. Further increases in real yields can't be ruled out.

Our second main reason for avoiding longer-dated linkers is the large degree of uncertainty about potential selling pressure from defined-benefit (DB) pension schemes, at the longer-dated end in particular. DB schemes own close to three quarters of the entire linker market, a proportion that has risen significantly over time as they have shifted their allocation from equities to bonds, with their ownership skewed towards the long end.

That could all change for a couple of reasons. DB funds may be reassessing their asset allocations in the wake of last year's crisis in the then-popular strategy known as liability driven investment, which required emergency intervention from the Bank of England to stem a rout in gilts. More DB schemes may be bought out in the coming years, after which their new owners may shift some of their longer-dated gilt holdings to other assets.

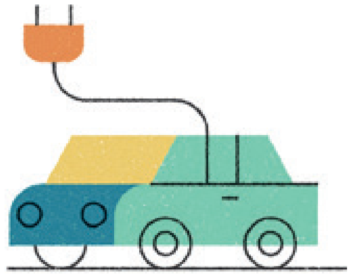
For many investors, there may also be a tax advantage to holding linkers – while income tax is due on interest payments, any gain on the capital increase between the purchase and sale price – or the value at maturity – is free of tax, regardless of the bondholder's tax band. This is more attractive for short-dated linkers, given they have fewer interest payment. The tax treatment will depend on individual circumstances, and is subject to change. If you have any questions, please speak to your investment manager or financial adviser.

Figure 3: Real yields on five-year inflation-linked gilts (%)

Short-dated linkers are appealing because they now offer real yields (yields minus inflation) close to zero, which have been significantly negative for most of the past decade.

Source: Refinitiv, Rathbones.

Lots of minerals need mining to cut greenhouse gas emissions



A record $495 billion was invested in renewable energy globally in 2022. Renewables accounted for 29% of global power generation last year, and the International Energy Agency (IEA) forecasts this figure will rise to 35% by 2025. With the shift to a low-carbon energy system well under way, demand for the minerals essential to the production of clean energy technologies is set to rise dramatically. This is true in particular for lithium, a necessary ingredient in the efficient battery storage that is necessary for renewable energy to become our primary source. The IEA estimates mineral demand would need to quadruple by 2040 to build enough clean-energy infrastructure to meet the goals set out in the Paris Agreement on combating climate change.

Electric vehicle (EV) and battery manufacturers are expected to be major consumers of these critical minerals, with demand from these industries expected to grow by at least 30 times by 2040. Transportation in general could account for a significant proportion of critical mineral demand. According to Elon Musk: "As we improve the energy density of batteries, you will see all transportation go fully electric, with the exception of rockets."

Some automakers have committed to phase out the production of internal combustion engines (ICEs), replacing them with hybrid or fully electric models – the UK government has banned sales of ICE cars from 2030 onwards. Countless businesses across a range of sectors and even countries as a whole have made pledges to have net-zero carbon emissions across their operations by different points in the future. Will there be enough critical mineral supply to enable companies and countries to deliver on these commitments? Even if there is, can it be mined ethically and in a way that does not compromise decarbonisation objectives?

Since their commercialisation in the 1990s, lithium-ion batteries have become the technology of choice in a range of products from consumer electronics to EVs. With demand rising exponentially over recent years, EVs have now overtaken consumer electronics as the largest users of lithium-ion batteries.

A variety of lithium-ion chemistries are used to manufacture EV batteries with different performance characteristics – enabling EV makers to produce vehicles at a range of prices. Typically, the negatively charged end of an EV battery, the anode – which accounts for a small fraction of the overall cost of the battery – will be made from graphite. The battery cathode – the positively charged end, and also the most expensive portion of the battery to make – is produced using various combinations and quantities of materials. Lithium is used in virtually all of the different battery chemistries, with other materials such as nickel, cobalt, manganese, aluminium or iron being interchangeable (figure 4).

Can supply keep up with demand?

Battery prices have come down rapidly since 2010. But for the first time in over a decade, prices rose year-on-year in 2022 amid surging lithium, cobalt and nickel prices. Although prices for these key EV battery materials have since come down, concerns over whether battery raw material supply will be able to keep pace with demand have heightened.

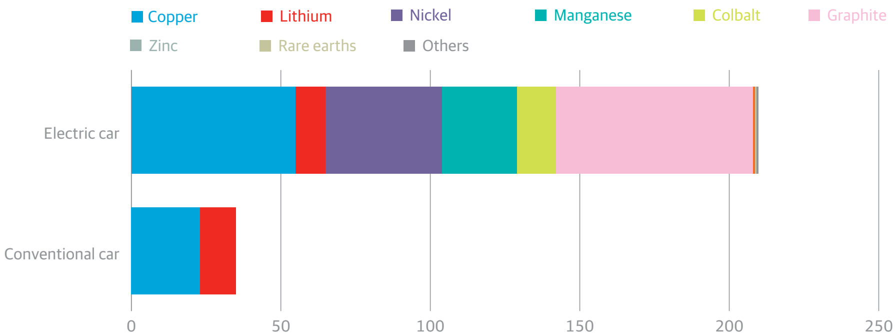
The IEA forecasts that only half of projected lithium and cobalt needed to fulfil decarbonisation objectives will be supplied by 2030, based on expected supply from existing mines and projects under construction. Lead times to move mining projects from initial discovery to production average 16.5 years. Concerns that the quality of raw materials being mined is already declining are coupled with risks that mineral supply and refining capacity – often heavily concentrated in certain countries – could be disrupted by geopolitical tension. There are concerns that supplying enough critical minerals to electrify the planet will not be achievable.

Finding the right deposits of raw materials such as lithium is a major challenge, and there are steep hurdles to be overcome to get raw materials from the ground at the scale needed and convert them into battery materials. Yet some see cause for optimism.

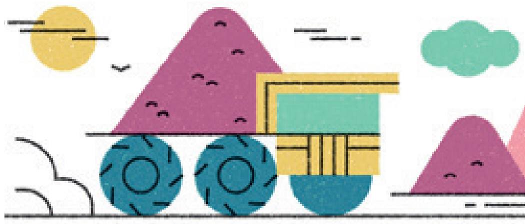
For example, Tesla's de-facto chief technology officer Drew Baglino believes that, based on US Geological Survey estimates for global critical mineral resources (what is in the ground), there will be more than enough supply of

Figure 4: Minerals used in conventional and electric cars (kg per vehicle)

The shift to electric cars creates an environmental dilemma because they require far more minerals to be produced compared with cars that burn fossil fuels.



Notes: steel and aluminium not included. Source: IEA, Rathbones.



nickel, lithium, zinc, copper and cobalt etc. to meet cumulative demand until 2050. Though this is at odds with the IEA forecasts mentioned above, Baglino is optimistic that "the more we look, the more we find."

Affiliates of the Breakthrough Institute, a US-based research centre focusing on technological solutions to environmental challenges, echoed Baglino's sentiment in a paper published in the scientific journal Joule. They concluded that global reserves of critical materials (known sources available for mining) are sufficient to meet future demand from all the infrastructure needed for electricity generation and storage, including EV batteries.

Progress is being made in boosting processing capacity and finding new critical mineral deposits. Following the passage of the US Inflation Reduction Act, which includes a $7,500 tax credit for new EV purchases – provided 40% of the critical mineral content in the vehicle's battery is extracted or processed in the US, or countries with which the US has a free-trade agreement – companies in North America have been scrambling to build out mining and refining capacity. General Motors recently invested $650 million in Lithium Americas to secure access to lithium extracted from the Thacker Pass – America's largest known source of lithium.

Is there a net positive for the planet?

Even if critical minerals can be supplied quickly and plentifully enough for EVs to rule the roads and oil refineries to be replaced with wind farms, can it be done in a socially responsible way and without threatening emissions reduction targets?

The Breakthrough Institute estimates that the mining and production of materials for use in the global electricity infrastructure will produce somewhere between 1% to 9% of the annual budget for global carbon emissions as set out in the Paris Agreement for limiting climate change. Though this is a small contribution to overall emissions, there is clearly a wide range of possibilities and at the high end 9% would be still be substantial.

Although manufacturing a battery EV is slightly more energy intensive and polluting than producing an ICE vehicle, the greenhouse gas emissions over the lifetime of EVs are estimated to be around half those of ICE cars, with potential for this to come down even further with improvements in efficiency and as low-carbon electricity becomes a larger proportion of the energy supply.

While it appears that the environmental benefits of the transition to EVs outweigh the costs of mining to support it, the social element needs to be managed carefully, and investors have an important role to play on this front. The cobalt supply chain has come under increasing scrutiny in recent years, after Amnesty International exposed the prevalence of child labour and other human rights abuses in small mines, using more basic methods, in the Democratic Republic of the Congo – the world's largest source of the mineral. Indigenous communities have also clashed with Lithium Americas after it was granted approval to excavate the Thacker Pass, a sacred site for surrounding tribes.

Responsible mining has long been part of our stewardship team's engagement agenda. In 2019 Rathbones was the lead investor in an engagement with Microsoft over the responsible sourcing of cobalt. In the same year we also became members of an investor group formed in the wake of the Brumadinho tailings dam disaster.

More recently, we supported the launch of a global investor group that monitors systemic risks related to meeting the increasing mineral demand required for the energy transition. Through these activities, we hope to be able to play our part in ensuring critical minerals are mined in an environmentally responsible way that doesn't harm local communities.

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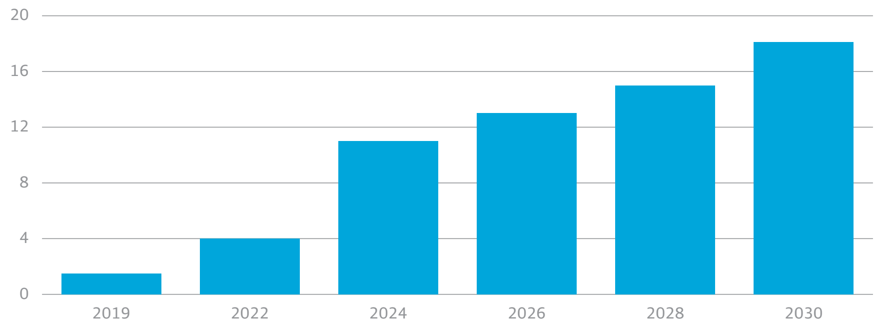
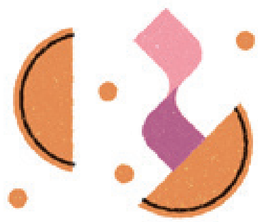
Figure 5: Global lithium-ion battery recycling market (US dollars, billions)

As the demand for metals such as lithium grows, the recycling market is forecast to expand, which will help to relieve pressure on mining raw materials.



Source: CNBC.

China's long-term economic growth rate has a speed limit



Not so long ago it was thought inevitable that China would soon surpass the US to become the world's largest economy, and few would've questioned the notion. Many still see China as a place to invest for superior growth opportunities in comparison to the major developed markets. Yet we are already well over a decade into a structural slowdown in China's economy, and our analysis of what is reflected in market pricing suggests that investors may not have fully accounted for China's diminished longer-term growth prospects.

China's economy is likely to rebound strongly this year, following the scrapping of the zero-COVID restrictions and policy turning more supportive. Yet the longer-term challenges facing China haven't changed, and we think this cyclical rebound will eventually give way to structurally slower growth. On top of that, growing geopolitical tensions will make for an even tougher environment for foreign investors to navigate in China.

First, we're sceptical that China's 'great reopening' will be as successful as many are currently assuming — to put it mildly, it seems unrealistic to think that you only get one month of bad disruption from opening up with minimal preparation after three years of effective lockdown and lower rates of vaccination than in the West.

We expect the road ahead to be bumpy, the same sawtooth pattern that characterised the first quarter or two in other economies that have reopened from COVID. There is plenty of pent-up demand for consumer services — social activities in particular — and policymakers are acting to stabilise the housing market. Both should help to lift growth in the near term, meaning this year looks much better than last.

Over the coming decade, the average growth of China's economy is likely to be much closer to that of advanced economies than the rapid rates it experienced in the 2000s and much of the 2010s (figure 6). After peaking in 2007, growth in China fell steadily through the 2010s, coinciding with a generally underwhelming period for China's equity markets, despite strong showings from a few tech firms.

Economists think of the long-term output of an economy as a function of the supply of labour, the supply of capital, and productivity (how efficiently labour and capital are deployed). All three of these 'pillars' face long-term headwinds in China.

1. Swimming against the demographic tide. China's working-age population rose rapidly during its golden age of growth in the 2000s, but broadly stagnated in the 2010s and is now starting to decline. A key reason that it is likely to contract more quickly as the decade goes on is a prior drop in fertility/birth rates.

2. Capital: the limitations of China's investment-led model. During the 2000s and 2010s China grew its capital stock at a breakneck pace, with few parallels in economic history. Yet there are clear reasons to doubt this will continue. Such capital formation included housebuilding, which until the current downturn grew rapidly amid a then-growing and rapidly urbanising population. This demand is now slowing. Another key element — infrastructure building on a massive scale - is also likely to be slower in future. China now has good infrastructure, and the biggest one-off projects like road and high-speed rail networks don't need to be built twice.

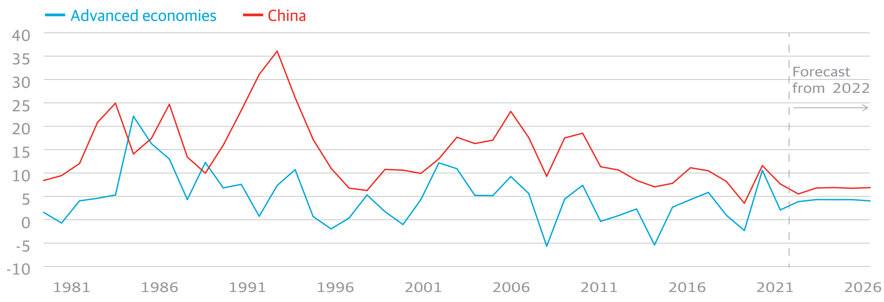
3. Productivity: more state control, more decoupling from the West. Since 2000, China has grown from a low- to an upper-middle-income economy. History shows the next step, breaking out of the middle-income bracket to become a rich country on a per capita basis, is hard. To do so, China will need to deliver consistent productivity growth. One factor that may stand in the way is the role of the state in the economy. The success of state-led development has been the exception rather than the rule, and depended on some key factors not present in China today. Another is the increasingly hostile external trade and investment environment, with the US committed to a tough line on China.

Lastly, regardless of China's long-run economic prospects, growing legal and practical hurdles may make buying Chinese equities increasingly unappealing for foreign investors.

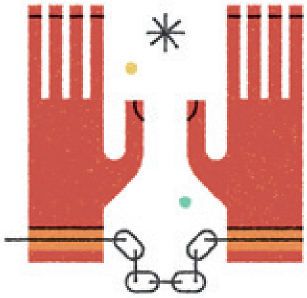
In our full report on China, due out in April, you can read more about these headwinds, and why we believe investors should be wary of chasing the recent rally in Chinese assets.

Figure 6: China's GDP growth versus advanced economies

China's economy is likely to grow at similar rates to advanced Western economies rather than the rapid pace it has enjoyed over the past two decades.



Source: Refinitiv, Rathbones.



Finding ways to battle the hidden enemies of human potential

Modern slavery is one of the great social ills of our day, imposing terrible suffering, wrecking futures, and impoverishing us all by destroying human potential. It is estimated to be a $150 billion trade that involves around 50 million people in some form of servitude, including forced labour, the sale and trafficking of people, forced and servile marriage and the exploitation of children. The suffering slavery inflicts cannot be ignored, nor can its significant economic impact.

Businesses have a huge role to play in eradicating modern slavery, and the UK's landmark 2015 Modern Slavery Act sought to bring the business community into the fight. The Act requires all companies above a certain size operating in the UK to report in detail on how they find and eliminate modern slavery within their supply chains. Despite this requirement, there is no legal redress in law for companies that fail to comply. Compliance is patchy and lacking.

Against this background, investors can play a crucial role in advancing the protection of fundamental human rights (figure 7). In 2020 Rathbones convened an investor collaboration called Votes Against Slavery to address this gap in the law via direct action from investors in the laggard companies. This initial collaboration brought together asset managers, pension funds and other institutional investors representing some £3.2 trillion in assets.

Letters were sent to the boards of targeted non-complying companies in the first instance. Investors involved in the engagement then indicated their willingness to abstain from voting on the approval of companies' annual reports and accounts, should no action be taken. By the end of that year, 20 out of 22 companies were compliant. We engaged with a further 61 companies in 2021, all of which were compliant by January 2022.

The project is continuing, and now represents around £8 trillion in assets, with a list of 29 companies considered to fall below standards of best practice and a goal of encouraging 100% of them to take up these standards of best practice.

However, the initiative is also an opportunity for investors to understand better the nature of the businesses they are investing in and to evaluate board responses to modern slavery. We also want to encourage a greater degree of challenge by investors on social issues.

Rating performance

Many asset managers rely on specialist agencies to help research and rate companies for their performance on environmental, social and governance issues – a process that is not flawless. This was made abundantly clear in 2020 when it emerged that workers making clothes for the online fashion giant Boohoo, which had high ESG ratings at the time, were being paid just £3.50 an hour – nearly 60% less than the minimum wage.

Social media lit up with shoppers promising to boycott the company, and its shares lost nearly half their value in the space of a week. One ratings agency had given Boohoo an AA rating just a month earlier, with 8.4 out of 10 for 'supply-chain labour standards' (the industry average is 5.5).

Ratings agencies often focus on different factors and can reach very different conclusions from the same evidence. After the Boohoo story broke, several of the country's biggest sustainable funds that had invested in Boohoo sold their holdings. This is known as 'divestment'.

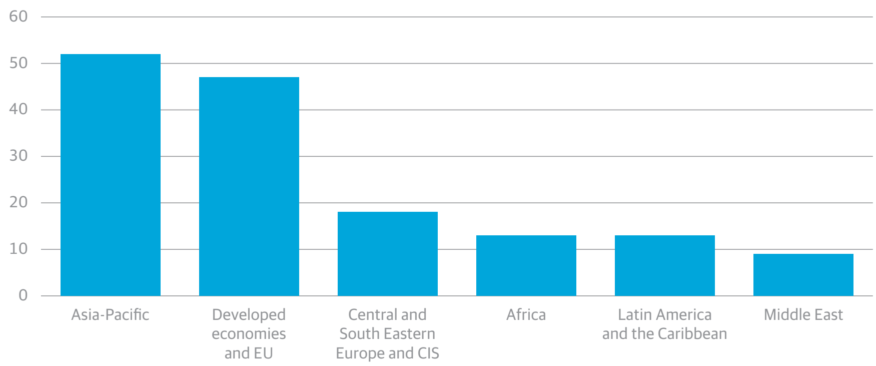
Divestment is often seen as a drastic last step for a manager because once you are no longer a shareholder your power to effect change within a company shrinks dramatically.

We believe there is a better way, a strategy of constructive engagement. Shareholders can make a change, as our Voting Against Slavery engagement project has shown. But it takes time and patience, and it can take collaboration. It's not always easy to conduct collaborative engagement, and inevitably you get some companies joining these campaigns simply to look good. But when it goes well, few methods can match it.

You can read about the Votes Against Slavery collaboration winning the highly acclaimed PRI Stewardship Initiative of the Year award for 2022 at www.unpri.org/the-pri-awards/rathbones-group-votes-against-slavery/10821.article

Figure 7: The economic scale of modern slavery (in $ billions)

Estimates of the annual profits of forced labour by region reveal the scale of the problem despite ongoing efforts to tackle the issue.



Source: International Labour Organisation

Financial markets

The collapse of Silicon Valley Bank (SVB) in the US sent shockwaves throughout the global financial sector, with tens of billions wiped off the value of some of the world's largest banks. Despite regulatory interventions and reassurances from America's President Joe Biden that people's funds were safe, US bank stocks plunged in value. European and Asian equity markets also tumbled as fears over the fallout from SVB's collapse rattled their banking sectors. Major government bonds rallied as investors bet that central banks would slow the pace of their interest rate increases.

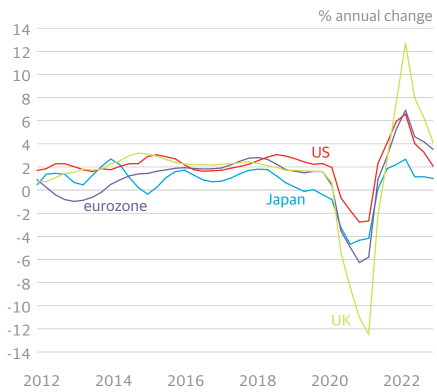
Hopes that inflation would fall back and allow central bankers to take their feet off the brakes had buoyed US and global markets from October. But global stocks and bonds had begun to pare back gains in February after higher-than-expected US inflation and strong jobs growth raised fears that the Fed will need to raise interest rates further.

Higher for longer?

In recent months financial markets have signalled that investors believed the Fed may stop raising rates by the end of 2023. But some stronger-than-expected economic data and continued uncertainty about how quickly inflation will retreat back toward central bank targets has triggered a reversal in market sentiment. Though concern about bank stability complicates the outlook, it looks as if inflation and therefore interest rates may stay higher for longer.

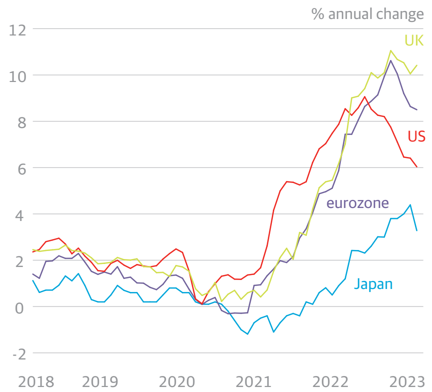
The UK's FTSE 100 share index hit a record high above 8,000 in February as fears of a global recession eased, before retreating along with its global peers as sentiment deteriorated again. The blue-chip index had been helped by bumper profits in sectors such as energy, commodities and financials, while weakness in the pound also boosted the value of overseas revenues when converted back to sterling.

GDP growth



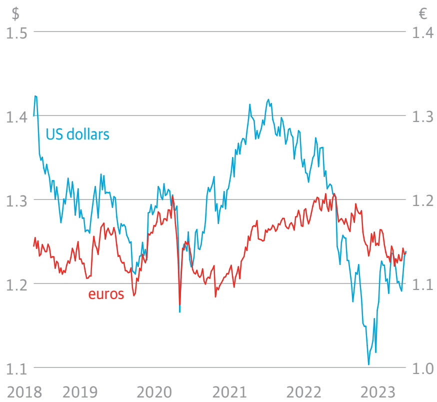
Source: Factset and Rathbones.

Inflation



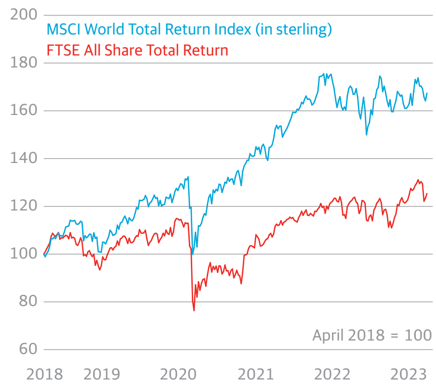
Source: Factset and Rathbones.

Sterling



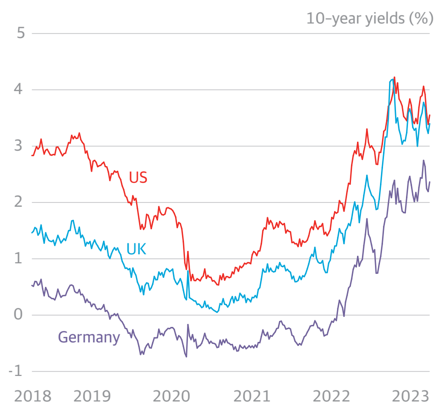
Source: Factset and Rathbones.

Equities



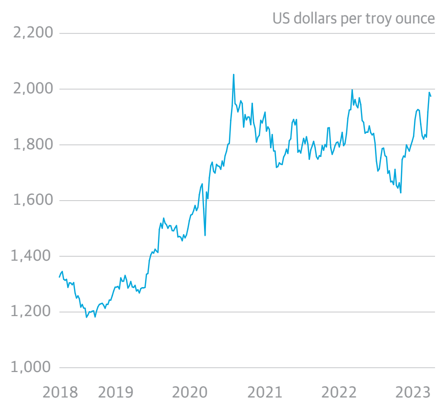
Source: Factset and Rathbones.

Government bonds



Source: Factset and Rathbones.

Gold



Source: Factset and Rathbones.

Past performance is not a reliable indicator of future performance.

Important information

Information valid at 31 March 2023, unless otherwise indicated.

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The value of investments and the income generated by them can go down as well as up.

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Contacts

Call:
020 7399 0000

Visit:
rathbones.com

Email:
enquiries@rathbones.com

For specialist ethical, sustainable and impact investment services:
Rathbone Greenbank Investments
0117 930 3000
rathbonegreenbank.com

For offshore investment management services:
Rathbones Investment Management International
01534 740 500
rathboneimi.com

@Rathbones1742
Rathbones Group Plc
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