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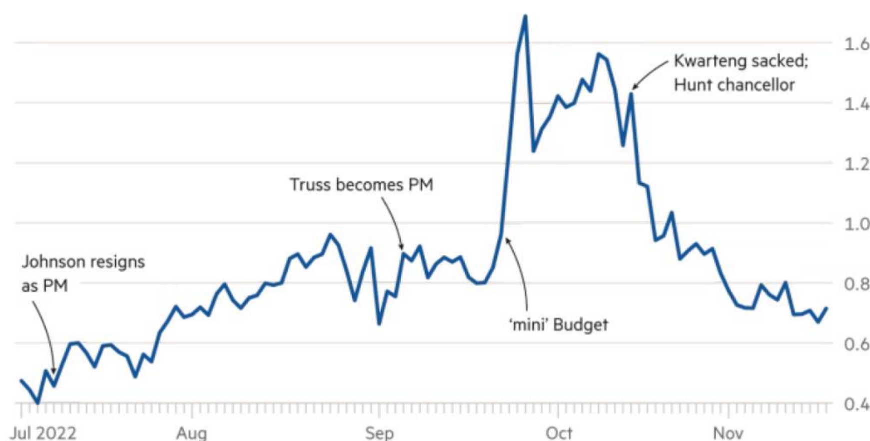
Plugging the holes

The Autumn Statement, budget-in-all-but-name, had been signposted as very likely to bring bad news to UK taxpayers, as the third Conservative government of this parliament changed course from Trussonomics back to Rishinomics. As we had suspected in our video update last week, what was announced in the end was less bad than what had been leaked beforehand, which is how bad news tends to be sold. With fiscal responsibility returning to the UK, and with it a certain predictability in policymaking, this Autumn 'budget' was perceived as quite sensible from a capital market perspective, with sterling and bond yields closing within their most recent trading ranges.

But while this Autumn Statement was intended to allay concerns of both capital markets and voters, the wider public was more focused on tax increases. For now, it seems Chancellor Jeremy Hunt has managed to keep foreign buyers of UK government bonds onside, whilst maintaining the enormous fiscal expansion of the energy price cap but pushing the bulk of the tax rises and spending cuts into the next parliament in 2024 and beyond. So, it appears this Autumn Statement amounts to no more than a short-term repair job, rather than a long-term strategy to overcome the UK's structural weakness of comparatively low productivity caused by the lack of capital and education investment, paired with Brexit-curtailed trade opportunities.

The chart below shows that the worst of the yield scare for British mortgages and the wider property market has been neutralised since Hunt was appointed but should the dire forecasts from the Office for Budget Responsibility (OBR) become reality, UK households will be faced with the inevitability of shrinking real incomes for years to come. No wonder the Shadow Chancellor called the postponement of the brunt of the tax rises and public spending cuts an election 'trap'. Luckily the OBR report also contained a few lifelines for UK wage earners, such as the prospect that inflation may well turn negative in 2024 and pull down yields with it. Given the recent steep fall in European gas and electricity prices, the energy cost price shock may also end sooner, thereby lowering the upward pressure on energy-intensive goods.

Source: The Financial Times, 18 Nov 2022



While the UK public was focused on the Autumn Statement, and despaired over the latest inflation data, the most significant news in the global investment world once again came from China. Following the display of dogmatic inflexibility at the Communist Party Congress a few weeks ago, President Xi presented a far more cooperative version of his leadership at the G20 summit in Bali, where he not only met many of the western leaders one-on-one, but also supported some harsh condemnations of Russia's Putin. Investors had only just been declaring China as un-investable, responding to Xi's power show with an up to 20% stock market drop over October. However, investment has flowed back since the beginning of November, leading to a surprise recovery, reminding investors that China is still an economic power they can ill afford to ignore. In a separate article this week, we discuss how other meaningful adjustments around China's zero-Covid policy – and its property market – led to this pivot in investor sentiment over at least the shorter term.

On the whole, investors enjoyed another positive week in markets, as better-than-expected US retail spending figures, a falling dollar and still-declining European energy prices prolonged the previous week's positive sentiment swing initiated by slowing US inflation. The trouble with this is that all these data points indicate more current and future resilience in the US economy and a potentially shallower recession in Europe. This is not providing central banks with the necessary confidence that the labour supply pressures in the inflation equation are likely to ease any time soon. As a result, a near-term pivot in their monetary policy away from tightening is no more likely now than it was a month ago.

The improvement in stock market valuations over recent weeks has been entirely due to the improvement of valuation metrics from the decline in yields, in anticipation of such a policy pivot, whilst the wider corporate earnings outlook has continued to deteriorate. The December meeting of the US Federal Reserve rate setters will be awaited with a fair dose of nervousness, and anything less than a clear signal of a pivot is likely to lead to significant market disappointment.

Bullish on China

Less than a month ago, foreign investors were fleeing China. The 20th Communist Party conference had just re-anointed Xi Jinping as the nation's paramount leader, against a backdrop of faltering growth, corporate crackdowns, Covid restrictions and heightened tensions with the US. Commentators decried yet again China was becoming "un-investable", preceding an exodus of overseas capital from the world's second-largest economy. Chinese assets hence saw significant losses.

Now, those losses are more or less recovered, thanks to an impressive two-and-a-half-week rally in the Chinese stock market. Its benchmark CSI 300 Index has gained nearly 10% in local currency terms. Hong Kong's Hang Seng index has risen above its pre-Congress level, climbing more than 24% since the end of October. Admittedly, both of these started the month from extremely low levels, suffering heavy losses throughout 2022. But even the short-term gains are evidence that investors are still willing buyers of Chinese assets.

Like the losses beforehand, recent gains have been driven by political decisions. In the last couple of weeks, Beijing has changed its tune on three extremely important issues. Firstly, policymakers issued a sweeping plan to help the struggling property sector. Secondly, official Covid rules were relaxed, in the first major sign that President Xi might change his zero-Covid directives. And finally, Xi's appearance at the G20

summit, where he held a one-on-one meeting with US President Biden, pointed to better relations between China and its major trading partners.

The property market might seem like the least important of these, but the implications could be huge for China's economy. Ever since the struggles at the property developer giant Evergrande emerged, Chinese property developers have been in perpetual crisis. Government orders to reduce leverage have drained the sector of its liquidity, putting immense pressure on property prices and leading some to suspend building indefinitely. This resulted in a number of homebuyers across the country refusing to pay their mortgages (on their yet-to-be-completed properties), putting pressure on credit and the banking system. While Beijing is no fan of dissent, there was a recognition from policymakers that mortgage strikers' complaints were valid.

Beijing has now laid out a 16-point plan to bail out the real estate market. This includes directly supporting developers by increasing financial liquidity and easing lending conditions to get the property market moving. This is an enormous turnaround – even by China's sometimes erratic standards. The government has gone from compressing the property sector, in a bid to remove overall leverage, to actively supporting the industry and encouraging more borrowing. This is the fundamental reason why the stock market bounced: it now looks like property woes may be behind, and the developers that have survived could well go on to be very profitable.

The changes to Covid rules are less sweeping, but no less welcome. Isolation times for close contacts of the infected have been reduced to five days, and traveller quarantines have similarly been cut. In truth, the updated rulebook mainly reminds us how harsh China's Covid rules still were – and how far the country has diverged from the rest of the world since January 2020. But any lessening of restrictions is a positive and should help shore up consumer demand, which has been battered by the repeated lockdown cycle.

Perhaps more important is what the changes symbolise. China has lagged behind other major economies in its vaccination programme, particularly for older or more vulnerable citizens, who have received mixed messaging on whether they can safely get jabbed. The fact Beijing is now relaxing its diktats indicates that progress has been made – a good sign for the future. By the same token, Xi Jinping now finally has an exit route from the pandemic, after the government backed itself into a corner with repeated commitments to zero-Covid. That policy is by far the biggest drag on Chinese domestic demand; its easing would therefore be a massive boost.

Equally symbolic was Xi's G20 showing, where the notably maskless president rubbed shoulders with his global counterparts. His meeting with Joe Biden was the first in-person meeting between American and Chinese leaders since 2019, since which relations between the world's two largest economies have worsened dramatically. The meeting in Bali was even more cordial than hoped, as the leaders agreed to cooperate on climate, trade and food security. Xi even agreed common "red lines" for Russia's war in Ukraine, backing up comments made to European leaders. This is the most critical Xi has ever been of his "strategic partner" in Russia, and it shows he is keen not to alienate western leaders.

That is unsurprising, given how important US and European trade is to China. But we should not get ahead of ourselves: the biggest problems in US-China relations are deep-rooted, ranging from economic ideology to Taiwan's independence. These will not go away with a few nice words. Even if Xi is happy to shelve his

plans for annexing Taiwan, it is a goal tied up in the very fabric of the People's Republic. Geopolitical flashpoints are therefore a given in the months and years ahead.

Even so, the pragmatism Beijing showed in the past couple of weeks is comforting. An apparent lack of pragmatism was exactly what markets were so worried about last month. Certainly, Xi's extreme consolidation of power of the last decade has shifted China's focus from growth and globalisation to stability and ideological conformity. But as we have often said, none of this ever suggested Beijing had become *anti*-growth or private sector. To the contrary, a vibrant private sector is crucial to China's future, and the government has repeatedly made attempts to support that.

Where Xi's China differs is that other concerns – like security, social conformity and equality – are given more weight. It seems that, rather than setting the stage for tighter controls and less economic focus, Xi's coronation gave him greater power to change his mind. For investors, there are certainly big risks with this kind of policy structure over the longer term, but there are obvious rewards to be found in China over the shorter term.

This is important for the global economy as much as China's. China has been one of the biggest contributors to global growth for more than a decade and, being at a completely different stage of its cycle, a policy push now could counteract weakness elsewhere. What's more, because of China's production build-up over the pandemic, the growth it pushes out to the world might not even be inflationary. This is an optimistic scenario, but a perfectly plausible one. As ever with China, investors must keep an eye on the risks – but the benefits could be vast.

Global Equity Markets

Market	Fri 16:38	% 1 Week*	1 W	Technical Short	Technical Medium
FTSE 100	7384	+0.9	+66	↗	⇘
FTSE 250	19271	-1.8	-345	↗	↘
FTSE AS	4056	+0.5	+19	↗	⇘
FTSE Small	6167	-0.4	-24	↗	↘
CAC	6644	+0.7	+49	↗	⇘
DAX	14424	+1.4	+199	↗	⇘
Dow	33699	-0.1	-49	↗	⇘
S&P 500	3962	-0.8	-31	↗	↘
Nasdaq	11120	-1.8	-203	↗	↘
Nikkei	27900	-1.3	-364	↗	→
MSCI World	2642	-1.2	-32	↗	↘
CSI 300	3802	+0.3	+13	↗	↘
MSCI EM	942	+0.7	+7	↗	↘

Top 5 Gainers

Company	%
Centrica	+13.0
BAE Systems	+7.9
Informa	+7.1
Imperial Brands	+6.0
Sage/The	+5.9

Top 5 Decliners

Company	%
Ocado	-16.5
Hargreaves Lansdown	-10.2
Dechra Pharmaceuticals	-8.1
Antofagasta	-7.9
Vodafone	-6.0

Currencies

Pair	last	%1W
USD/GBP	1.190	+0.6
GBP/EUR	0.870	+0.5
USD/EUR	1.035	+0.1
JPY/USD	140.05	-0.9
CNY/USD	7.120	-0.3
Bitcoin/$	16,657	+1.8

Commodities

Cmdty	last	%1W
Oil	87.22	-9.1
Gold	1755.1	-0.9
Silver	21.071	-2.9
Copper	365.8	-6.5
Aluminium	2391.0	+2.8
Soft Cmdties	216.13	-1.4

Global Equity Market - Valuations

Market	Div YLD %	LTM PE	NTM PE	10Y AVG
FTSE 100	3.8	11.8	9.4	14.2
FTSE 250	3.5	16.7	13.8	16.3
FTSE AS	3.8	12.4	9.7	14.4
FTSE Small x Inv_Tsts	3.9	32.1	9.5	15.2
CAC	2.9	11.1	10.7	15.2
DAX	3.2	11.8	11.5	13.8
Dow	2.0	19.4	18.4	17.1
S&P 500	1.7	19.2	17.9	18.4
Nasdaq	0.9	40.2	26.0	24.5
Nikkei	2.1	21.5	15.1	17.8
MSCI World	2.2	16.4	15.8	17.2
CSI 300	2.4	13.6	12.8	12.8
MSCI EM	3.3	11.1	11.4	12.7

Fixed Income

Govt bond	%Yield	1 W CH
UK 10-Yr	3.25	-0.11
UK 15-Yr	3.57	-0.11
US 10-Yr	3.81	-0.00
French 10-Yr	2.48	-0.18
German 10-Yr	2.02	-0.14
Japanese 10-Yr	0.25	+0.01

UK Mortgage Rates

Mortgage Rates (LTV c.75%)	18-Nov	19-Oct
Base Rate	3.00	2.25
2-yr Fixed Rate	5.69	4.17
3-yr Fixed Rate	5.54	4.46
5-yr Fixed Rate	5.25	3.96
10-yr Fixed Rate	4.94	4.21
Standard Variable	5.42	5.10

* The *% 1 week* relates to the weekly index closing, rather than our Friday p.m. snapshot values

** LTM = last 12 months' (trailing) earnings;
***NTM = Next 12 months estimated (forward) earnings

If anybody wants to be added or removed from the distribution list, please email
enquiries@cambridgeinvestments.co.uk

Please note: Data used within the Personal Finance Compass is sourced from Bloomberg/FactSet and is only valid for the publication date of this document.

The value of your investments can go down as well as up and you may get back less than you originally invested.

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