



VIEW FROM THE SQUARE

December 2022

View from the Square at Christmas

Despite the frost and snow on the ground, could it be that the bright blue skies above are an idiom for better markets next year?

Market expectations of future inflation are found in the predicted future yields of Gilts in the UK and Treasury bonds in the US, and there is substantial divergence between the two. Here in the UK, swap interest rates are about 6% in a year's time, against current CPI inflation rates of 10.7%; whereas CPI inflation has already dropped to 7.1% in the US, and they are looking at rates of c.2.5% in a year's time.

This suggests that after another interest rate hike or two, current measures already taken by the US are near sufficient, or may be, to quell inflation, whereas more medicine is required in the UK. The Sunak government clearly believes that conceding current wage demands will result in long term inflation in the UK, perhaps in an inflationary spiral.

This inflation rate differential suggests that the US economy will lead global growth next year, and there is likely to be a stronger contribution from a post Covid China, and surrounding areas. Markets will be difficult to predict in the interim as, although inflation may have peaked, the UK labour market remains tight. The current concern that wage inflation will persist or accelerate is a negative. However there is some softening of support by RMT members for their strike, and Mick Lynch showed signs of stress in his interview with Mishal Hussein of the BBC when answering straightforward questions. Another possible watershed moment was Labour's Wes Streeting asking why the huge backlog of postponed hospital admissions persisted when the NHS had more nursing staff than before, yet less operations were being performed. The answer appears to be bed blocking.

The UK now has a business orientated government ; putting national finances in order has to go beyond inflation control, critical as that is. The next election will be difficult to win for the Conservatives but, if they start to tackle some of the difficult issues now, then at least if defeated they will have set a useful trend for an incoming Labour government. The West has tackled Defence in a meaningful way, might a centrist government of either party set about constructive reform in similar fashion?

A weak US\$ points to China and Emerging markets as likely beneficiaries; Europe looks underpriced, already, and particularly if the US keeps raising interest rates, bond markets should prosper. Against this background, we will continue with a relatively cautious strategy. There could be a risk that, having delayed increasing interest rates, there now may be an overreaction in the US in the other direction. This would favour Bonds in the short term.

Experience tells us that political unpopularity will soon lead to relaxation of tight fiscal policy, which is likely to result in a weak dollar. We will be turning our attention in these circumstances, to Equities in general, gold, and emerging markets in China and other parts of Asia, as areas that we believe will prosper.

Important Information

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