

Monthly Equity Market Topics

Author



Ross Cartwright
Lead Strategist
Strategy and Insights Group

In brief

- Will the UK budget unlock the equity market?
- Consumers are keeping both hands on the wheel of the economy.
- From the cheap seats, what's up with gold?

What does the UK budget mean for investors?

From my desk in London, it would be negligent to overlook the United Kingdom's first Labour budget in nearly a decade and a half. This budget signals a discernible relaxation of fiscal constraints despite a rise in taxation — predominantly due to enhanced employer contributions to National Insurance aimed at underpinning the elevated expenditures. In the short term, this spending may well stimulate growth, albeit with the risk of exerting upward pressure on both inflation and gilt yields.

The initial response from the markets was one of restraint, indicative of the Chancellor of the Exchequer's pre-budget news flow. But the gilt markets adopted a more adverse stance upon the release of a report by the Office for Budget Responsibility the subsequent day, which detailed the magnitude of prospective borrowing. The price action does not rival the Liz Truss episode two years ago, when gilt yields skyrocketed; however, rising borrowing costs and a weaker pound have left investors grappling with the prospect of a structurally elevated interest rate environment.

Regarding equities, we believe the consensus suggests resilience in the face of increased taxation and interest rates. Nevertheless, the long-term prognosis for growth hinges on whether the additional capital expenditure can surmount sizable challenges such as flagging productivity, deficient transport infrastructure as well as the challenges posed by climate change, defense and technological advancement. While the uptick in investment marks progress, it doesn't meet the mantra of Chancellor Rachel Reeves' call to "invest, invest, invest." The strategy bears a closer resemblance to a conventional tax-and-spend approach as the bulk of new borrowing is allocated to current spending.

For the government to gain the fiscal latitude necessary to drive heightened investment, we feel it must cultivate an environment that will foster private sector investment. Such an approach is integral to breaking free of the low-growth trajectory so as to drive UK equity markets.



It's about the consumer

A benign macro picture remains supportive of risk assets. Inflation continues to moderate, and while it may not get to the desired 2% soon it's close enough for companies to deal with. Cash rates are falling as central banks look to move their policy rates closer to what they consider neutral from their current restrictive settings. GDP numbers remain strong, with France and Germany both surprising to the upside, but we remain cautious on those two economies. China is also facing headwinds, with a lot riding on the muted fiscal package it is set to release. Employment and wages remain robust, though the volatility in US nonfarm payroll due to revisions, strikes and hurricanes makes it difficult to get a clear picture. Judging by tight credit spreads, some fixed income investors don't appear to have many concerns over corporate cash flows or profitability.

This brings us to the consumer, who is keeping this train on the track. When looking at PMIs, manufacturing and construction are struggling, and while the goods economy is sluggish, it's the robust service economy that continues to drive growth. This was again highlighted in the recent US GDP numbers, which were driven by services and government. Real wages and low unemployment levels continue to support consumption. Middle- and high-income cohorts, which are the major drivers of consumption, remain strong. However, there are signs that lower-income and younger consumers are stressed. Even so, they should be among the biggest beneficiary of falling interest rates.

Continued growth may trigger a new bout of inflationary pressure. Mitigating this risk is continued subdued demand for oil, though the risk of Middle Eastern supply disruptions can't be ruled out. The United States produces more energy than it needs, and OPEC is extending production cuts to keep prices elevated. On the unemployment front, falling job openings are causing the unemployment rate to tick up more than major layoffs. But falling job openings do not rhyme with inflationary pressure.

All this paints a favorable picture for risk assets such as equities. Further supporting the health of the equity market are the continuing signs of breadth in earnings returning to the market as reporting season unfolds. That's not to say we're in an early-cycle risk-on world. Since QE, zero rates and COVID, we've been stuck in this peak-to-late cycle market dynamic that lacks the creative destruction of a typical business cycle. While increased breadth offers more opportunity for investors beyond AI and the Magnificent Seven to outperform, it's still about identifying good businesses with structural tailwinds. Given the elevated levels of the S&P 500 PE multiple, it's our belief that investors should be focused on earnings rather than multiples to drive share prices.

All that glitters

Gold has been making headlines after a 33% runup year to date. Traditionally it's seen as a hedge against inflation, currency devaluation and a falling USD or as a safe haven in uncertain times. It's perhaps the ultimate hedge. So why is it rallying and what to do now?



There may be several reasons behind gold's recent strong performance. After many years of not doing much — and frankly not working as a hedge — gold has been underowned by institutional investors, though that seems to be changing, partly due to momentum but also for other reasons, such as those outlined below.

- Central banks have been buying gold to diversify their assets away from the USD, particularly BRICS central banks, which are actively looking to break the dollar's hegemony and feel vulnerable holding greenbacks after Russia's dollar reserves were seized following the invasion of Ukraine.
- There's been a debasement of fiat currencies, and government fiscal policies are profligate.
- There exist geopolitical concerns ranging from trade tensions to hot wars.
- China's property crisis and economic slowdown, as well as a clampdown on cross-border flows, has seen demand from the Asia region rise steadily.
- India has traditionally been a buyer of gold because of its cultural significance. As the Indian economy has flourished in recent years, the demand for the precious metal has risen.
- Gold has momentum as the price continues to rise, drawing in more investors.

However, according to the World Gold Council (WGC), central banks have slowed their purchases by some 49%, the lowest level in two years. The rising price has also slowed demand for jewelry, which the WGC says accounts for 40% of global demand. Jewelry demand fell 7% in the third quarter.

There are three key variables that need to be understood in valuing any investment: cash flow, growth and risk. Gold is particularly difficult to value as it doesn't have a cash flow, so investors need to focus on growth in demand to push the price up and factor in the risks to that growth. Models have been built to try to price gold. These are often linked to macro variables like real yields (with which gold has traditionally been highly correlated), but in recent years few of these have been helpful.

Retreating central banks and slowing jewelry demand may hinder momentum, and we could see a near-term air pocket. That said, the momentum is still with gold, and this augurs steady demand for the metal as a hedge in portfolios. ▲



The views expressed herein are those of the MFS Strategy and Insights Group within the MFS distribution unit and may differ from those of MFS portfolio managers and research analysts. These views are subject to change at any time and should not be construed as the Advisor's investment advice, as securities recommendations, or as an indication of trading intent on behalf of MFS.

Diversification does not guarantee a profit or protect against a loss. Past performance is no guarantee of future results.

GLOBAL DISCLOSURE

Unless otherwise indicated, logos and product and service names are trademarks of MFS® and its affiliates and may be registered in certain countries.

Distributed by: **U.S.** – MFS Institutional Advisors, Inc. (“MFSI”), MFS Investment Management and MFS Fund Distributors, Inc., Member SIPC; **Latin America** – MFS International Ltd.; **Canada** – MFS Investment Management Canada Limited. **Note to UK and Switzerland readers:** Issued in the UK and Switzerland by MFS International (U.K.) Limited (“MIL UK”), a private limited company registered in England and Wales with the company number 03062718, and authorised and regulated in the conduct of investment business by the UK Financial Conduct Authority. MIL UK, an indirect subsidiary of MFS®, has its registered office at One Carter Lane, London, EC4V 5ER. **Note to Europe (ex UK and Switzerland) readers:** Issued in Europe by MFS Investment Management (Lux) S.à r.l. (MFS Lux) – authorized under Luxembourg law as a management company for Funds domiciled in Luxembourg and which both provide products and investment services to institutional investors and is registered office is at S.a.r.l. 4 Rue Albert Borschette, Luxembourg L-1246. Tel: 352 2826 12800. This material shall not be circulated or distributed to any person other than to professional investors (as permitted by local regulations) and should not be relied upon or distributed to persons where such reliance or distribution would be contrary to local regulation; **Singapore** – MFS International Singapore Pte. Ltd. (CRN 201228809M); **Australia/New Zealand** – MFS International Australia Pty Ltd (“MFS Australia”) (ABN 68 607 579 537) holds an Australian financial services licence number 485343. MFS Australia is regulated by the Australian Securities and Investments Commission.; **Hong Kong** - MFS International (Hong Kong) Limited (“MIL HK”), a private limited company licensed and regulated by the Hong Kong Securities and Futures Commission (the “SFC”). MIL HK is approved to engage in dealing in securities and asset management regulated activities and may provide certain investment services to “professional investors” as defined in the Securities and Futures Ordinance (“SFO”); **For Professional Investors in China** – MFS Financial Management Consulting (Shanghai) Co., Ltd. 2801-12, 28th Floor, 100 Century Avenue, Shanghai World Financial Center, Shanghai Pilot Free Trade Zone, 200120, China, a Chinese limited liability company registered to provide financial management consulting services.; **Japan** - MFS Investment Management K.K., is registered as a Financial Instruments Business Operator, Kanto Local Finance Bureau (FIBO) No.312, a member of the Investment Trust Association, Japan and the Japan Investment Advisers Association. As fees to be borne by investors vary depending upon circumstances such as products, services, investment period and market conditions, the total amount nor the calculation methods cannot be disclosed in advance. All investments involve risks, including market fluctuation and investors may lose the principal amount invested. Investors should obtain and read the prospectus and/or document set forth in Article 37-3 of Financial Instruments and Exchange Act carefully before making the investments; **Bahrain** - This document has not been approved by the Central Bank of Bahrain which takes no responsibility for its contents. No offer to the public will be made in the Kingdom of Bahrain and this document is intended to be read by the addressee only and must not be passed to, issued to, or shown to the public generally. The Central Bank of Bahrain assumes no responsibility for the accuracy and completeness of the statements and information contained in this document and expressly disclaims any liability whatsoever for any loss howsoever arising from reliance upon the whole or any part of the contents of this document. The Board of Directors and the management of the issuer accepts responsibility for the information contained in this document. To the best of the knowledge and belief of the board of directors and the management, who have all taken all reasonable care to ensure that such is the case, the information contained in this document is in accordance with the facts and does not omit anything likely to affect the reliability of such information.; **Kuwait** - This document is not for general circulation to the public in Kuwait. The information has not been licensed for offering in Kuwait by the Kuwait Capital Markets Authority or any other relevant Kuwaiti government agency. No private or public offering of the information is being made in Kuwait, and no agreement relating to the information will be concluded in Kuwait. No marketing or solicitation or inducement activities are being used to offer or market the information in Kuwait.; **Oman** - For Residents of the Sultanate of Oman: The information contained in this document does not constitute a public offer of securities in the Sultanate of Oman as contemplated by the Commercial Companies Law of Oman (Royal Decree 4/74) or the Capital Market Law of Oman (Royal Decree 80/98). This information is being circulated on a limited basis only to corporate entities that fall within the description of sophisticated investors (Article 139 of the Executive Regulations of the Capital Market Law). The recipient acknowledges that they are a sophisticated investor who has experience in business and financial matters and is capable of evaluating the merits and risks on an investment.; **South Africa** - This document, and the information contained is not intended and does not constitute, a public offer of securities in South Africa and accordingly should not be construed as such. This document is not for general circulation to the public in South Africa. This document has not been approved by the Financial Sector Conduct Authority and neither MFS International (U.K.) Limited nor its funds are registered for public sale in South Africa.; **UAE** - This document, and the information contained herein, does not constitute, and is not intended to constitute, a public offer of securities in the United Arab Emirates and accordingly should not be construed as such. The information is only being offered to a limited number of exempt investors in the UAE who fall under one of the following categories of non-natural Qualified Investors: (1) an investor which is able to manage its investments on its own, namely: (a) the federal government, local governments, government entities and authorities or companies wholly-owned by any such entities; (b) international entities and organisations; or (c) a person licensed to carry out a commercial activity in the UAE, provided that investment is one of the objects of such person; or (2) an investor who is represented by an investment manager licensed by the SCA, (each a “non-natural Qualified Investor”). The information and data have not been approved by or licensed or registered with the UAE Central Bank, the Securities and Commodities Authority, the Dubai Financial Services Authority, the Financial Services Regulatory Authority or any other relevant licensing authorities or governmental agencies in the UAE (the “Authorities”). The Authorities assume no liability for any investment that the named addressee makes as a non-natural Qualified Investor diligence on the accuracy of the information relating to the securities. If you do not understand the contents of this document you should consult an authorised financial adviser.; **Saudi Arabia** - This document may not be distributed in the Kingdom except to such persons as are permitted under the Investment Funds Regulations issued by the Capital Market Authority. The Capital Market Authority does not make any representation as to the accuracy or completeness of this document, and expressly disclaims any liability whatsoever for any loss arising from, or incurred in reliance upon, any part of this document. Prospective purchasers of the securities offered hereby should conduct their own due diligence on the accuracy of the information relating to the securities. If you do not understand the contents of this document, you should consult an authorised financial adviser.; **Qatar** - This material/fund is only being offered to a limited number of investors who are willing and able to conduct an independent investigation of the risks involved in an investment in such material/fund. The material does not constitute an offer to the public and is for the use only of the named addressee and should not be given or shown to any other person (other than employees, agents or consultants in connection with the addressee's consideration thereof). The fund has not been and will not be registered with the Qatar Central Bank or under any laws of the State of Qatar. No transaction will be concluded in your jurisdiction and any inquiries regarding the material/fund should be made to your contact outside Qatar.