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Albemarle STREET PARTNERS

Monthly Commentary

October 2023

The market waits for the penny to drop

The great surprise for investors in 2023 has been how strong the global economy has continued to be. Despite high interest rates all over the world, unemployment has remained low. Just last month the US economy added another 336,000 jobs, blowing the socks off estimates for what could be achieved under the constant pressure of expensive money.

We could be forgiven for thinking this is universally good news. Really, it has come with a big catch. High employment means that central banks are still fretting that inflation will not come fully under control. Because they are so determined that they must not reduce interest rates until they are *sure* inflation is defeated, they take from the strong economy that it can endure more pain for now to make sure prices fall – without causing a recession.

This means that the more positive economic news that has come out in recent weeks, the more the price of bonds and shares have fallen.

Yet we are not unduly concerned by this short-term problem. After all, the central fear has been that interest rates can go higher for longer – which imposes pain on ordinary people that we can all well understand – without pushing down economic growth. Were this to be achieved it would be the first time in history it has. It is, in our view, far more likely that the true economic effects of high interest rates have just not yet been fully felt.

So much of the economic strength over the past two years has been caused by enormous government stimulus during and after the Covid-19 pandemic and we believe around half of the pain in the real economy has yet to feed through. Add to this the fact that consumers who saved money during the pandemic have now largely burnt through it, and the additional evidence that lending to private businesses on both sides of the Atlantic is slowing, you then see that it remains entirely possible that the rich world will enter recession in early 2024, albeit likely a mild one.

We believe that the economy will weaken significantly in the coming months. This will enable central banks to talk more openly about bringing down interest rates. This change might not be good news in many ways, but it could allow key asset classes such as bonds to rally. As one commentator from Capital Economics put it this week: 'the bond bears are about to make contact with economic reality.'

It may seem perverse that this bad news could become good news for investors, but such is the odd reality of investment. Markets often recover well once a recession is underway and are at their worst in the period preceding it.

We believe our portfolios are well positioned to respond to the evolving shape of the world economy and that the higher expected returns that have been created for investors by this period of high interest rates can be harvested in the years ahead.

Staying invested through these short-term travails is ultimately what unlocks the ability to profit from what we believe will be a decade of productivity growth that is unprecedented in our lifetime. This is because we stand on the verge of a rapid technological revolution triggered by accelerated computing, artificial intelligence and green technology. In the long-term, we believe it will be the successful harnessing of this extraordinary period of human history to make returns for our investors that will define the long-term success of your portfolio, rather than short-term ups and downs of the inflation and interest rate cycle.

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