RAYMOND JAMES

Peace in our time?

Jeremy Batstone-Carr, *European Strategist, Raymond James Investment Services*

**"Change is the law of life. And those who look only to the past or present are certain to miss the future"
- John F. Kennedy**

Even those with the longest careers in the financial markets are struggling to remember a year quite as tumultuous as 2022 has proved to be. Military conflict in Ukraine and sabre-rattling over Taiwan have made headline news all year and served to intensify volatility across all international financial markets. Product shortages and lingering supply chain disruptions, the consequence of Russian retaliation to the imposition of sanctions imposed by the US and its NATO allies on top of the Covid pandemic's unwelcome legacy have exacerbated inflationary pressures. This has forced the world's central banks to raise interest rates more aggressively than at any time in the past four decades, in turn imparting downward pressure on global economic activity and acting as a tough environment for financial assets.

On top of this already uncomfortable backdrop, the world looked on aghast as political turmoil tore apart the United Kingdom's ruling Conservative Party, a turmoil that resulted in the sudden termination of Ms Elizabeth "Liz" Truss' short-lived leadership and the eventual elevation of the former Chancellor of the Exchequer, Mr Rishi Sunak, as Prime Minister. Given the turbulence characterising the gilt-edged market and sterling's plunge to epochal lows on the foreign exchanges, the new administration had to act fast to steady frayed nerves and head off a crisis that, in a highly dramatic turn of events, at one point threatened to engulf the country's pension industry.

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One of the first decisions taken by Mr Sunak and his Chancellor, Mr Jeremy Hunt, involved scrapping almost everything remaining in the former Chancellor's ill-thought-out and unfunded 23rd September "mini-Budget" even after Ms Truss' high profile "U"-turn. The new administration has, instead, reverted to a fully costed Autumn Statement now scheduled for 17th November. Whilst the likely combination of tax increases and spending cuts may cause discomfort (and likely serve to intensify opposition parties' clamour), financial markets have reacted favourably to the promised return to fiscal policy responsibility.

To recap, the gilt-edged market experienced a period of intense volatility in the early part of the month, with unprecedented daily moves a regular feature of a normally staid and sober market. UK government bond market gyrations horrified investors, in particular those overseas investors deemed essential to the necessary financing of the country's substantial twin deficits. Immediate evasive action was required as a matter of urgency, in response to which gilt-edged yields fell sharply and sterling recovered its poise.

This does not mean that the UK is out of the woods. Financial market pricing implies that investors continue to demand a premium for committing to the UK's government bond market. An estimated £30bn "fiscal gap" still requires plugging, in addition to which adherence to an overhauled set of fiscal rules and policies with the full backing of Conservative MPs will be necessary if faith is fully to be restored. If the rules are deemed too loose and/or policies aimed at achieving them are deemed unachievable the country's credibility will likely remain on thin ice.

Looking on, the Bank of England is a far-from disinterested observer. Politics and fiscal policy are but two of the interest rate-setting Monetary Policy Committee's considerations. Irrespective of the domestic economy's weakness inflationary pressures have proved much stronger and lasted much longer than had previously been anticipated, a strong indication that yet higher interest rates are on the way.

Whilst the UK's political crisis has served to drive international events off the front pages, the all-seeing eyes of the financial markets are everywhere. The US Federal Reserve is continuing its rate-raising campaign even as important Congressional midterm elections loom. Elsewhere, Europe is facing an unprecedented energy crisis and further afield, the twice-decade Chinese Communist Party Congress has concluded as expected. President Xi's historic third five-year term as leader has been confirmed, as has his stranglehold on power. How the political and geopolitical landscape evolves from here remains a challenge to investors, but perhaps not an insurmountable one.

Financial markets are, amongst many things, a discounting mechanism. It is seldom so much a matter of what one knows, as what one doesn't know! A gloomy backdrop, both for the global economy and the corporate sector is already well known and surely largely fully priced in over what has proved to be a difficult year thus far. But financial markets inhabit the future as much as they reflect the present, a few dark hours now may presage a brighter dawn ahead and it is positioning in anticipation of such an eventuality that should dominate investor thoughts as we move into the final months of the year.

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