For Investment Professionals only

Monthly Macro

December 2023

M&G Investments

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What were the biggest drivers of markets in November?

- November saw a major rally in markets, buoyed by hopes of a soft landing and potential central bank cuts on the horizon. Notably, the Bloomberg Global Bond Aggregate Index had its best month since the height of the Global Financial Crisis in 2008, rising +5.0%.

- November's rally was initially triggered by dovish tones from the Federal Open Market Committee (FOMC) meeting. This was then supported by economic data throughout the month. Europe saw a similar story, with supportive data and a European Central Bank (ECB) rate cut being fully priced in by the market by April 2024.

- Inflation continued to ease which helped fuel the rally. However, we are not out of the woods. Median inflation is still too high and wages continue to add to the inflationary pressure. We may see some Federal Reserve (Fed) push back, given that the rally has loosened financial conditions slightly, which is not what Fed Chair Jerome Powell wants at the moment. Although there have been indications of a policy 'pivot', the rhetoric is still indicating a pause in rates for the time being.

- The key development in the month was the sharp decline in bond yields in the developed world, which provided the backdrop for positive returns on most assets. The moves were dramatic, and in stark contrast to the market narrative since the summer.

- A conventional interpretation of the move would be to argue that the facts have changed; slightly softer US jobs and inflation data and a weaker growth outlook in Europe could be suggested as evidence that the outlook for policy has changed over the past few weeks.

- However, asset prices often move for reasons unrelated to underlying fundamentals. The extent of recent volatility in bond markets could indicate shifting sentiment and investor myopia were playing more of a role in price moves than changes in underlying fundamentals.

- Outside of bonds themselves, the positive impact of declining rate expectations upon equity markets and credit spreads outweighed any negative impacts of deteriorating growth optimism, suggesting we are still in 'goldilocks' mode when it comes to consensus beliefs about prospects for the US economy.

What will you be looking out for in December?

- Despite central banks holding to their 'pause for now' rhetoric, a rate cutting narrative has finally entered the room. For the first time in this cycle, a Fed policy maker, Christopher Waller, broke the line of 'wait and see' and discussed lowering rates in the coming months should the decline in inflation continue. This could be seen as somewhat of a turning point in terms of the Federal Reserve narrative. March 2024 is now regarded as a one in three chance of a first rate cut.

- Over the past 12 months the consensus has moved from an extremely high conviction that there would be a 2023 recession, to conviction that interest rates will be 'higher for longer,' to an apparent abandonment of this rates viewpoint within one month.

- Today, weak growth is once again the focus, but thus far it appears this ostensibly 'bad news' is driving an equity rally alongside falling bond yields. Will these growth expectations remain benign or will recession fears re-emerge?

Key dates for the month ahead:

12 Dec: US inflation data **18 Dec:** UK inflation data **04 Jan :** Fed meeting minutes **22 Dec:** Japan inflation data

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