News

Inflation Relief

With receding inflation, UK equities anticipate a resurgence

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Inflation has fallen to 4.6%, down from 6.7% last month. But October's inflation was always going to fall significantly as last autumn's 25% energy price rises fell out of the base. Steadily falling food inflation also brought welcome relief to the annual rate of increase.

As evidence accumulates that UK interest rates are likely to be at or very near a peak, we expect consumer confidence and activity to progressively improve in the near term, and for inflation to continue to fall. Consumer price index (CPI) inflation should fall below 4% during the first quarter of 2024 and below 3% during the second.

Employment and wage data released last week showed the UK labour market is also slowing. The three-month rolling average of weekly earnings fell to 7.7% from its peak of 7.9% in July 2023. However, September showed an even sharper slowdown, to 7.5% annualised growth. This will fall further next month as the strong base effects (fall out of energy prices) are set to knock almost 1% off the growth rate.

The inflation headlines didn't move bond yields much, but they'd already fallen significantly on the softer US CPI data. Yields on two-year bonds peaked in early July 2023, and they've since fallen by 1.3% (yields move inversely to prices). This move will drive further reductions in mortgage rates in the UK.

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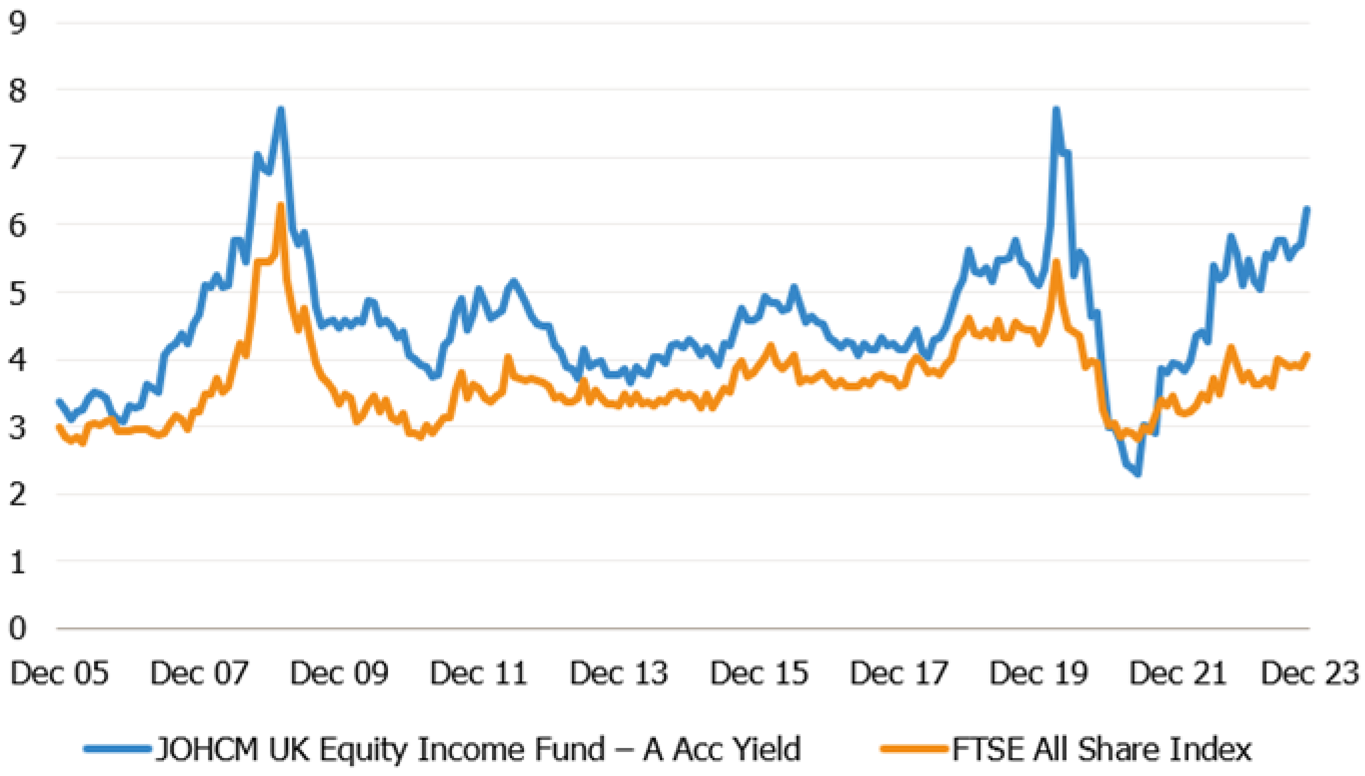
JOHCM UK Equity Income Fund

A Acc Dividend Yield History



Source: JOHCM/Lipper/FactSet as of 30 September 2023. Data to 31 December 2023 includes JOHCM estimates. JOHCM estimates of future performance based on evidence from the past performance and current market conditions and is not an exact indicator. Based on 'A' Accumulation share class price on 11 October 2023 (429p).

These latest inflation numbers should put the UK back in line with other developed economies; France reported a very similar CPI for October, at 4.5%. Signs of normalisation in the labour market will give the Bank of England further confidence in their policy, with no more monetary tightening required. We're likely to see stronger consumer activity over the next few months.

These shifts should engender a rethink of the broadly negative international view of the UK economy and UK equities. The marked valuation discount of British stocks will soon be increasingly difficult to justify. Any changing perceptions are likely to disproportionately favour consumer cyclicals, housebuilders, financials and mid and small-cap stocks, where assets are priced for an economic shock which now looks unlikely to materialise.

Source: JOHCM/Bloomberg/FactSet

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