



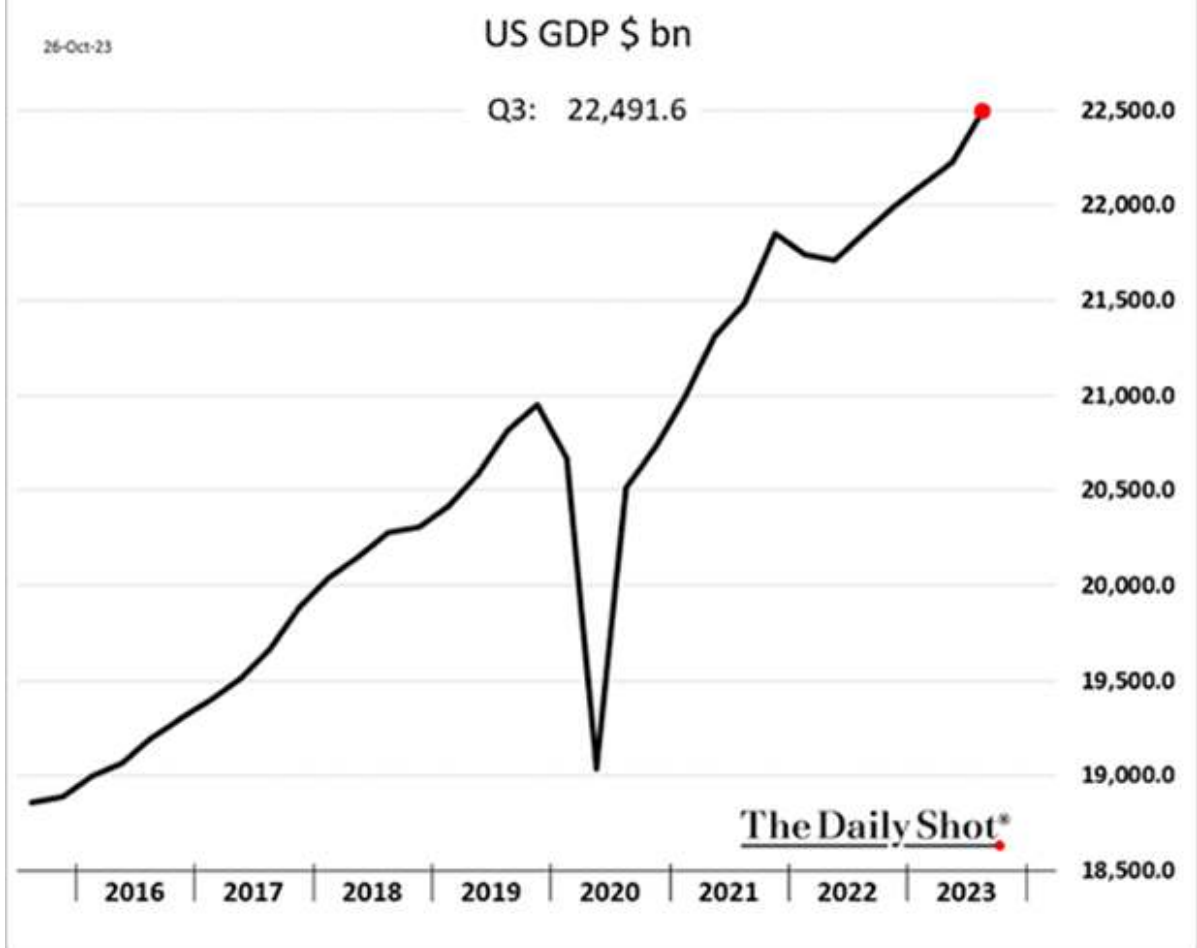
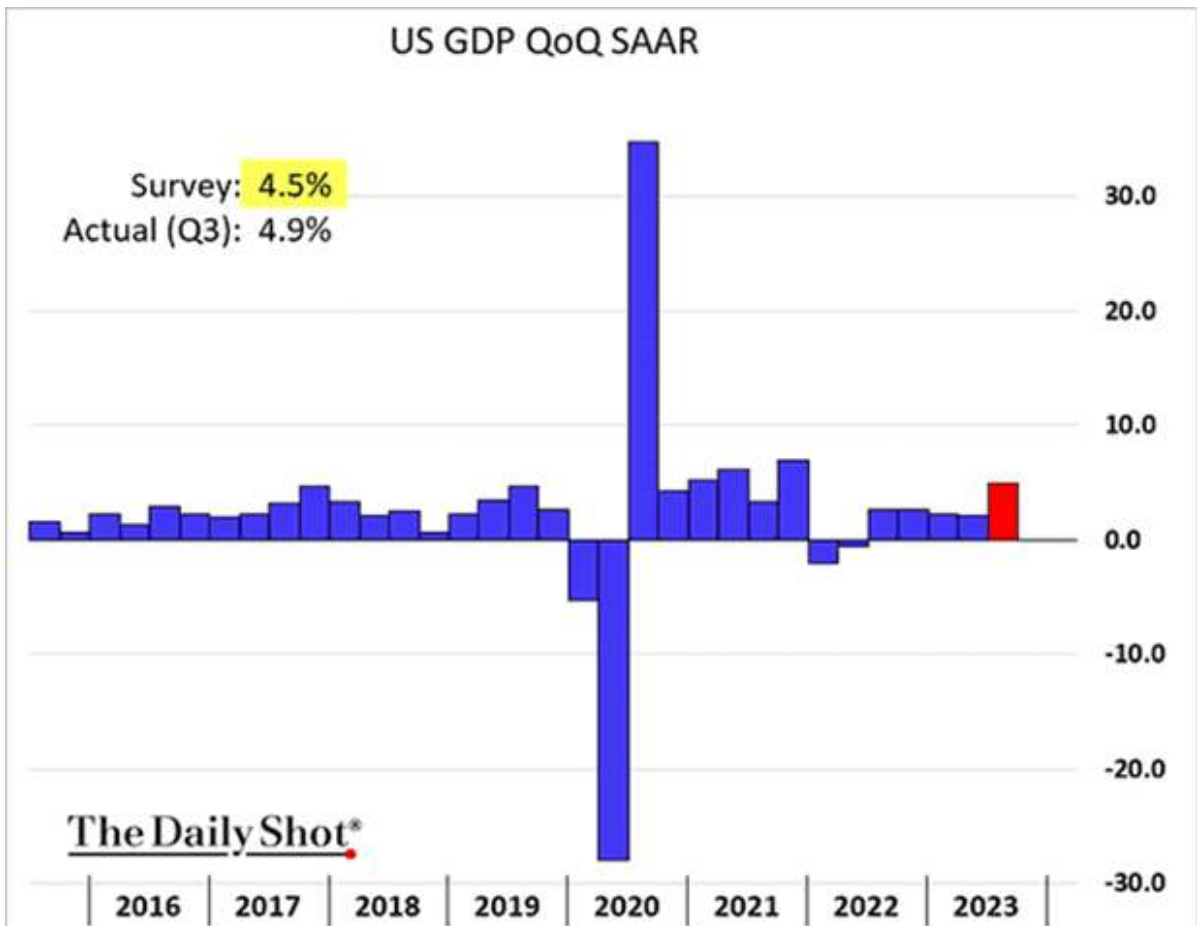
# Monthly Market Report

## December 2023



*With commentary from David Stevenson*

One of the reasons why stockmarkets in the US and to a lesser degree Japan and Europe have had a strong 2023 is that equity investors have shrugged off concerns about a recession and bet on corporate earnings continuing to surge. And as we discuss in a later section there's good reason for that positive take on profits, not least because the US consumer is still spending like crazy - and wages are still rising. This renewed confidence to date shows no signs of flagging as evidenced in the chart below from the Daily Shot research service. It shows that the most recent US GDP quarter on quarter numbers showed a rebound i.e a much bigger increase than many analysts had expected.



There is though a downside to this continued resilience. These GDP numbers are closely watched by the US Federal Reserve and will have reinforced fears that the US economy is running too hot,

and that inflation is still a problem. That in turn may have informed central bankers as they warn that interest rates might have to stay higher for longer. As we also discuss later, higher for longer simply postpones the inevitable volatility, especially as corporate debt matures later in 2024 and into 2025.

We're now caught in a something approaching a trade-off scenario. Strong GDP numbers simply reinforce central bankers worry about surging prices and wages and makes them more determined to hold interest rates at high levels. But interest rates - and bond market activities - operate on a lag to the real-world economy i.e. it takes time for the impact to feed through into backward looking numbers. If central banks keep rates too high for too long, the impact on the real economy in 2024 could be dramatic, possibly even resulting in a quite nasty recession. Thus, we have the recession delayed narrative butting up against the Economy is Still strong narrative. The next few months will be revealing - a real, crucial turning point will be revealed.

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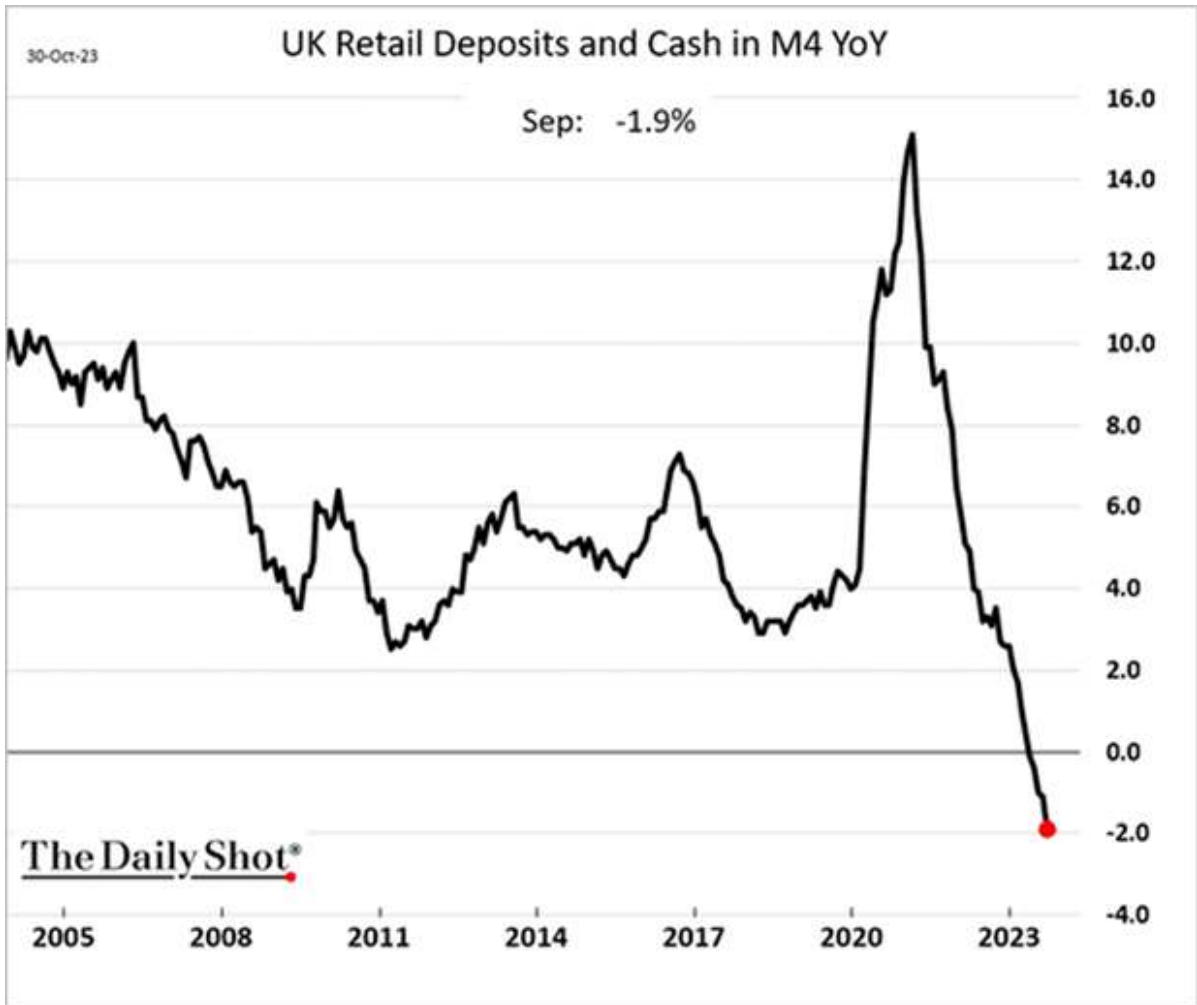
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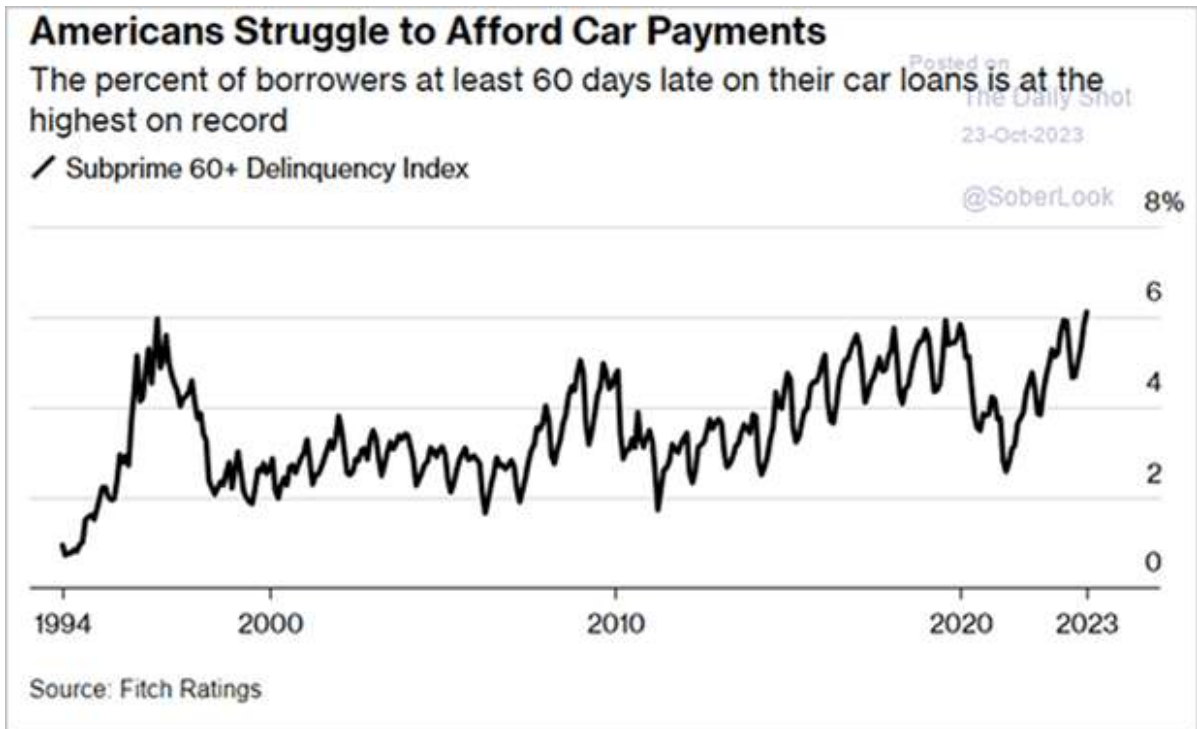
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## Headline Numbers

Staring at lots of charts goes with the job and the biggest challenge is sorting out the signal from the background noise. But in the last few weeks two charts have really caught my attention - both of which could possibly indicate more trouble ahead. The first shows a broader measure of money supply in the UK based around the M\$ money measure. Notice the sudden and very dramatic decline in money supply - this indicates a drastic tightening of monetary conditions, perhaps ahead of a slowdown or even recession.



The second chart switches to the US and shows the number of American consumers who are struggling to afford their car payments - it's now hit 6%. The obvious implication here is that the single strongest driver of the US economy - consumer spending - might be beginning to lose its vitality. Perhaps all those cash rich US consumers are now worried that they are drowning in debt.

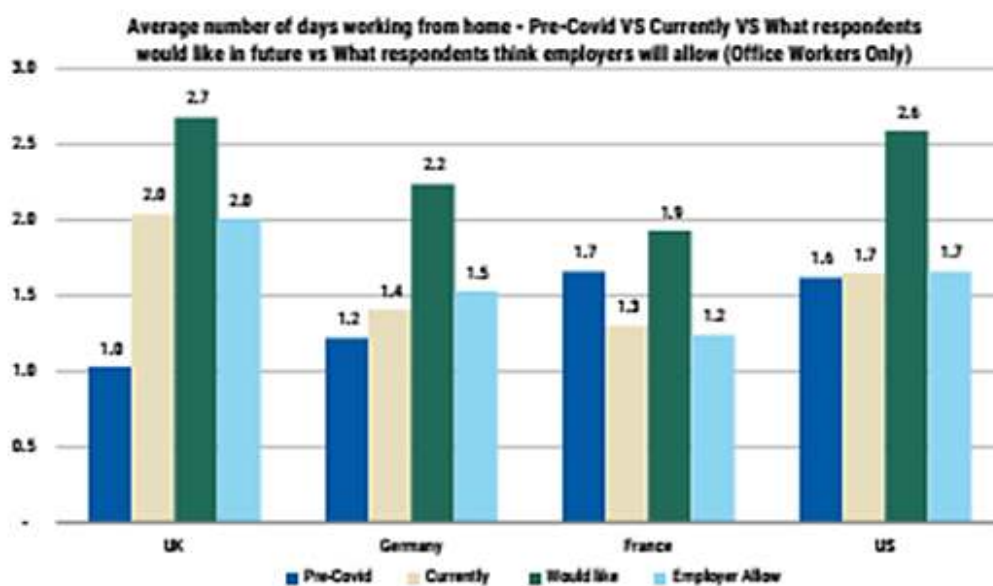


Work from Home - Brits are loving it!

There's been lots of excitement recently amongst real estate investors that we might be near peak interest rates, and thus the turn is coming i.e., with lower rates in the future, real assets might stage a comeback. The problem is that although rates may have peaked, another trend is still causing carnage within the broad real estate spectrum: WFH. Anyone on a train into London from the suburbs on Mondays and Fridays won't be surprised by the latest survey from analysts Morgan Stanley.

Their latest Alphawise report looks at attitudes to working from home across the US, UK, France and Germany. The key surprise? We Brits are the most WFH obsessed. "The US, which has seen vacancy in key office markets move to record highs, is often thought of as the slowest market to return to the office, but our AlphaWise survey suggests the UK is in fact the market most impacted by home working and hot-desking. Even with higher levels of home working post covid, respondents across the US, UK, France and Germany would like to work from home more than they are currently, but crucially do not think their employers will allow this."

### Exhibit 1 : Except France, more are WFH post covid, particularly the UK. All would like to WFH more, but don't think employers will allow it.



Source: AlphaWise, Morgan Stanley Research  
*Anita Bhardwaj is a member of Morgan Stanley's AlphaWise team. She is not a research analyst and is not expressing investment recommendations on financial instruments, industries or transactions*

Measure	Values as of 16th October 2023	Values as of 16th November 2023
UK Government 10 year bond rate	4.35%	4.29%
GDP Growth rate YoY	0.60%	0.60%
CPI Core rate	6.70%	6.70%

RPI Inflation rate	9.10%	8.90%
Interest rate	5.25%	5.25%
Interbank rate 3 month	5.41%	5.36%
Government debt to GDP ratio	101%	101%
Manufacturing PMI	44.3	44.8

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## Bank CDS options

Rates for 1 and 5 year credit default swaps on the major global banks increased pretty much steadily across the board over the last month. The increases were not substantial but nearly uniform with a few exceptions. Rates for insuring against bank bond defaults for Deutsche declined, from high levels, and RBC rates showed a tiny decrease. In sum, the market seems to be repricing general risk upwards but not by very much!

Bank	One Year	Five Year	Credit Rating (S&P)	Credit Rating (Moody's)	Credit Rating (Fitch)
Santander	67.6	38.72	A+	A2	A -
Barclays	108.7	71.1	BBB	BAA1	A
BNP Parabis	52.51	30.23	A+	Aa3	A+
Citigroup	45.8	40.11	BBB+	A3	A
Credit Suisse	83.73	52.22	BBB-	BAA2	BBB
Deutsche Bank	155.76	90	A-	A1	BBB+
Goldman Sachs	105.95	54.39	BBB+	A2	A
HSBC	59.96	38.27	A+	A1	AA-
Investec	n/a	n/a	n/a	A1	BBB+
JP Morgan	68.18	38.71	A-	A1	AA-
Lloyds Banking Group	59.98	34.67	BBB+	A3	A
Morgan Stanley	98.01	49.41	A-	A1	A+
Natixis	53	23	A	A1	A+
Nomura	99.99	25.19	BBB+	BAA1	A-
RBC	48.79	29.83	AA-	A1	AA-
Soc Gen	67.6	41.87	A	A1	A-
UBS	73.4	53.12	A-	Aa3	A+

Source: Tempo Issuer & Counterparty Scorecards ('TICS') 1st November 2023 [www.tempo-sp.com](http://www.tempo-sp.com)

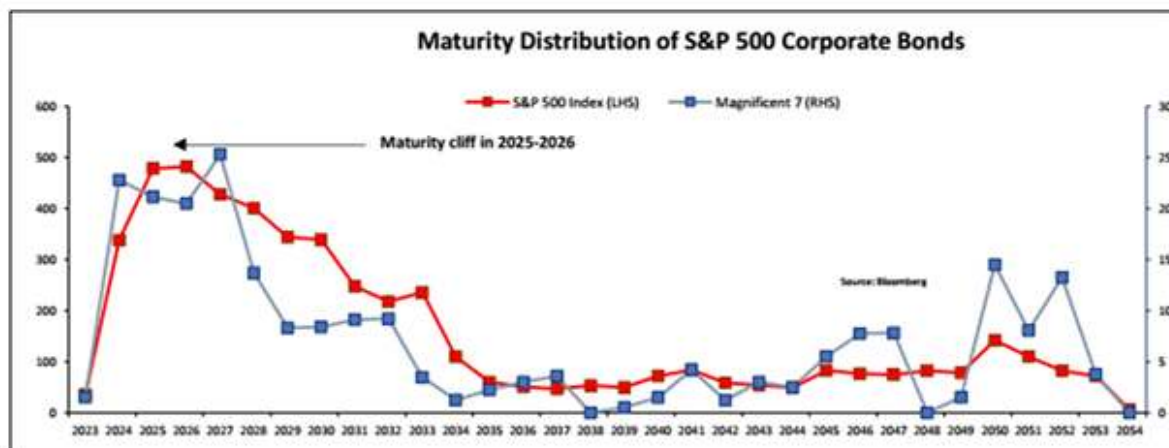
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# Government Bonds

## Fixed Income

The last few years have been terrible for bond investors as interest rates have increased. That pain has continued in the last few weeks as US and UK government bond yields have increased - and prices declined - but there's a growing sense that the worst may be over. What's fuelling that cautious optimism is that interest rates and thus government bond yields may have peaked. Most brokers report increased trading activity, especially from private investors, focused on the short end of the maturity and duration curve. As for corporate bonds there's still a sense of caution not least because those rising government bond yields also partly signal a possible imminent recession - which might result in higher corporate defaults. Vincent Deluard, a strategist at Stone X makes the very logical observation that that possible future recession might be made worse by the impending maturity distribution of US corporate debt. As shown in the chart below, just 6% of S&P 500 index companies debt matures in 2024, so interest costs should remain manageable next year.

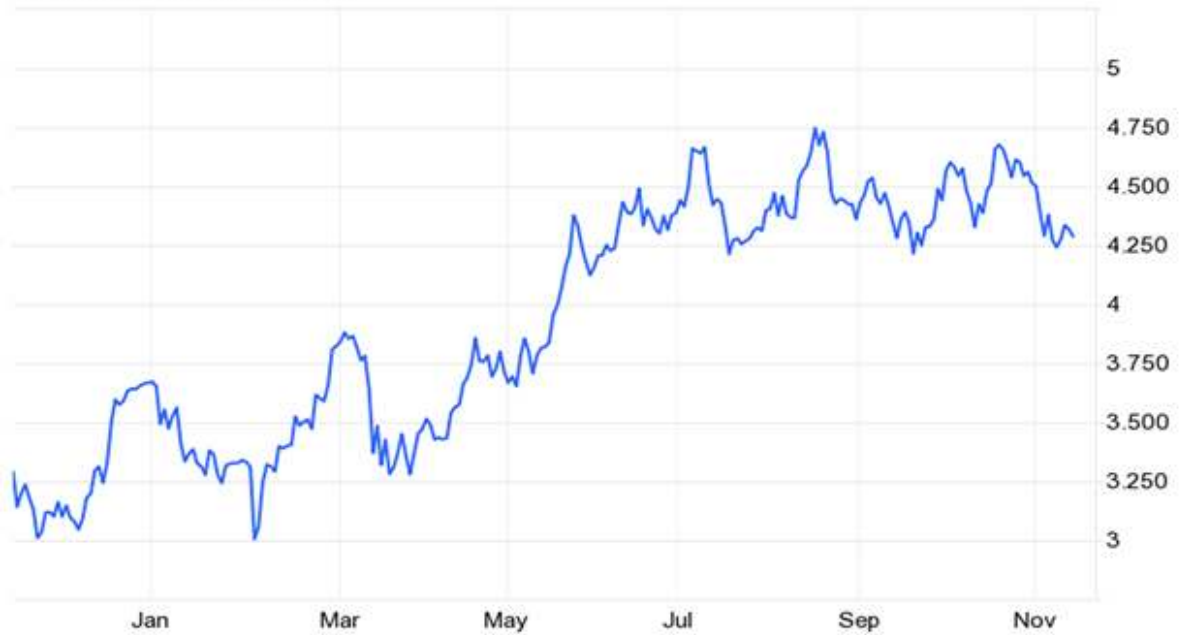
"But 20% of S&P 500 index debt will mature in 2025 and 2026: **companies will likely try to reduce headcount and compensation to preserve margins from higher refinancing costs in 2025.** The maturity cliff happen a bit later for the Magnificent seven stocks, which have smartly locked very low 30-year yields in during the COVID years."



One last point on bonds. For this observer the stand out development of the last few months has been the steady decline in yields on Greek government bonds. One interesting indicator of this shift in sentiment - relative to both Italian and Spanish government bonds - has been the narrowing spread between German bunds and Greek bonds. It peaked earlier this year at just under 200 basis points and has now collapsed to just over 125 basis points. Clearly the bond vigilantes like the look of what they see in Greece!

**UK Government Bonds 10-year Rate 4.29%**

United Kingdom 10Y Bond Yield



source: tradingeconomics.com

Source: <http://www.tradingeconomics.com/united-kingdom/government-bond-yield>

### CDS Rates for Sovereign Debt

Country	Five Year
France	27.49
Germany	19.46
Japan	31.99
United Kingdom	33.67
Ireland	27.36
Italy	105
Portugal	49.48
Spain	52.82

### Eurozone peripheral bond yields

Country	November 2023	October 2023	Spread over 10 year
Spain 10 year	3.75%	3.92%	205
Italy 10 year	4.55%	4.81%	185
Greece 10 year	3.97%	4.31%	127

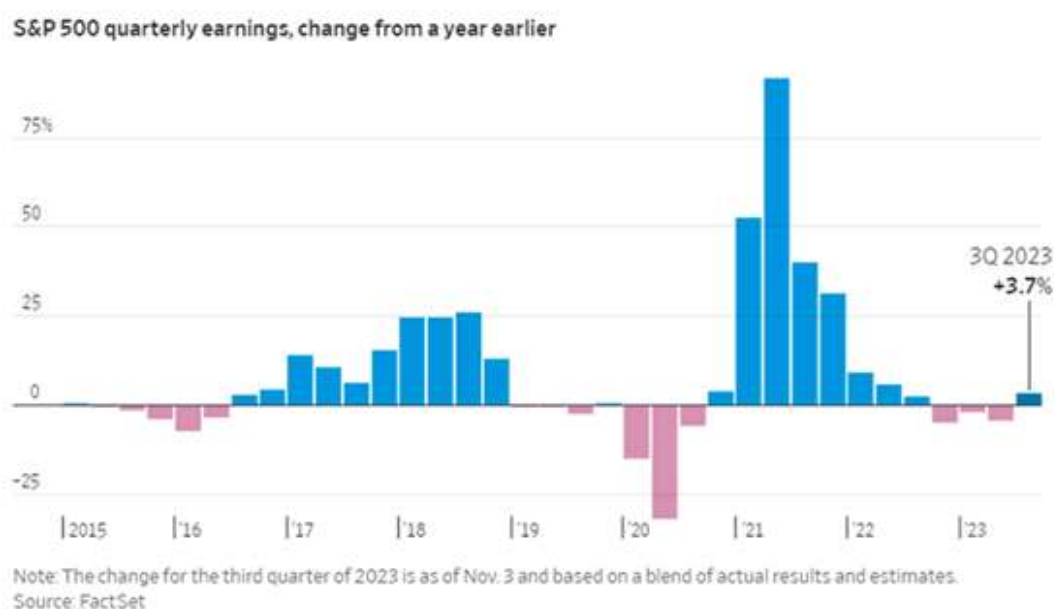
	S&P Rating		Moody's Rating		Fitch Rating
Germany	AAA	Stable	AAA	Negative	AAA
United Kingdom	AAA	Negative	AA1	Stable	AA+
United States	AA+	Stable	AAA	Stable	AAA

## Equity Markets and Dividend Futures

I'd be a very rich man by now if I had made a \$1 for every expert, commentator and pointy head who said that US stocks were overvalued, that US corporate earnings were bound to decline, that US mega cap tech stocks were crazily priced. All of those things may be true but it doesn't really seem to stop the relentless march forwards of the benchmark US index. Here's some stats that underline the point. Over the last month (prices on Friday 10th November), the S&P 500 is up 2% versus a decline of 2.68% for the FTSE 100 - over the last six months the equivalent is +7.06% for the S&P 500 -4.63% for the FTSE 100. Over the last 12 months the S&P 500 is up 10% and over the last five years its up 62% - versus an increase of just 4% for the FTSE 100 and a decline of 6% for the FTSE 250. The only slightly jarring numbers come from the YTD numbers where the FTSE 100 is actually up 0.45% while the S&P 500 is down 7.36%. Interestingly the big winners on this metric are Japanese equities which year to date are up an impressive 13% - by contrast the FTSE 250 is down 24%, a brutal decline!

Surely this outperformance can't continue for US equities? I wouldn't bet on the bears though. The [Wall Street Journal](#) recently ran a great overview article for the forthcoming US corporate earnings season which suggested that the markets biggest companies are poised to show their first collective increase in a year, helped in part by strong consumer spending this summer.

"The members of the S&P 500 are on pace to collectively report a 3.7% rise in earnings for the year's third quarter, the first such increase since the year-ago third quarter. Revenue is on track to grow 2.3% from a year ago, according to FactSet. Driving the profit gains was consumer spending, as Americans continued to dine out, take trips and buy online."

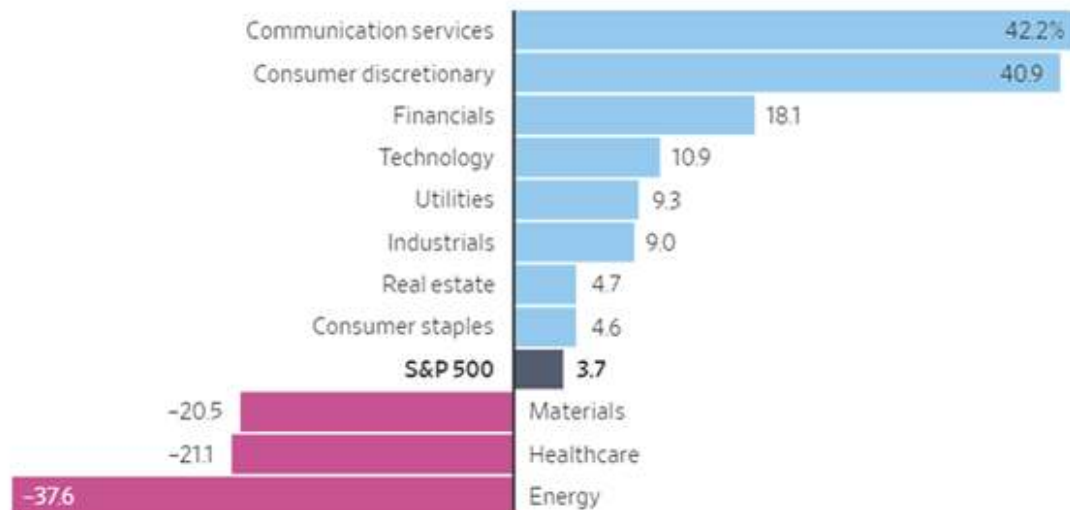


"Customer demand for us remains strong," Starbucks Chief Executive Laxman Narasimhan said on the company's earnings call Thursday. "We're not really seeing any change in the sentiment in our customer base." The two most profitable sectors in the S&P 500 index were communication services and consumer discretionary. Among the companies in those two sectors are restaurant operators such as McDonald's and Starbucks; internet giants like Amazon.com and Alphabet;

travel-related firms such as Airbnb and Marriott International; and media owners like Comcast and Netflix.

The power of that consumer spending surge can be seen clearly in the next chart from the WSJ article which shows quarterly earnings from a year earlier on a sector by sector basis. Marvel at that astonishing 40% plus surge for communications services and consumer discretionary spending!

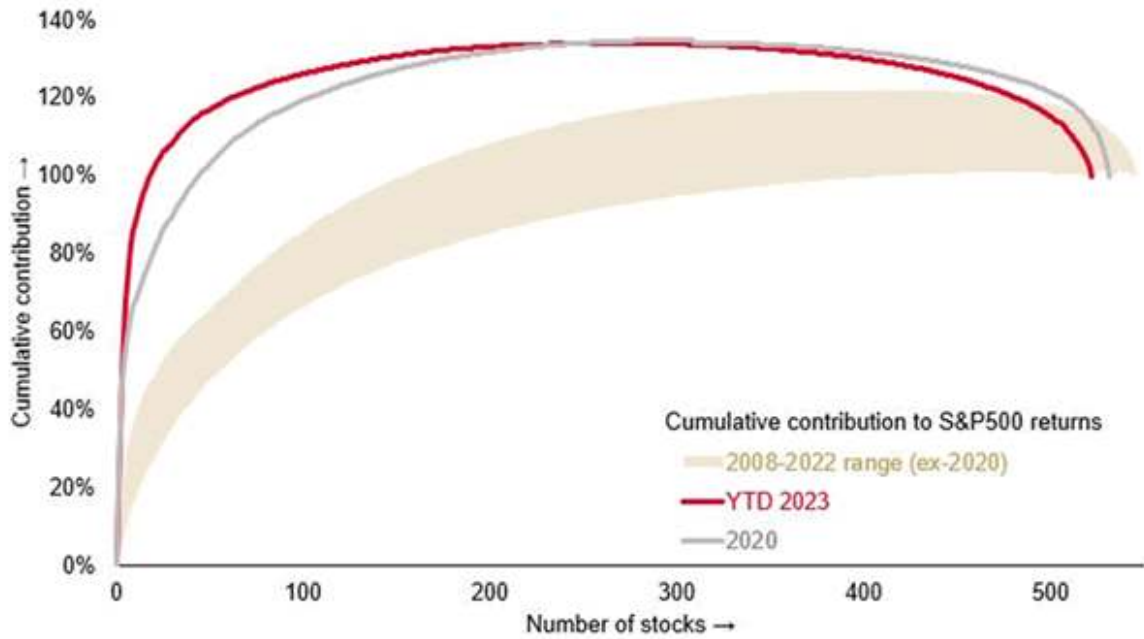
S&P 500 quarterly earnings, change from a year earlier, by sector



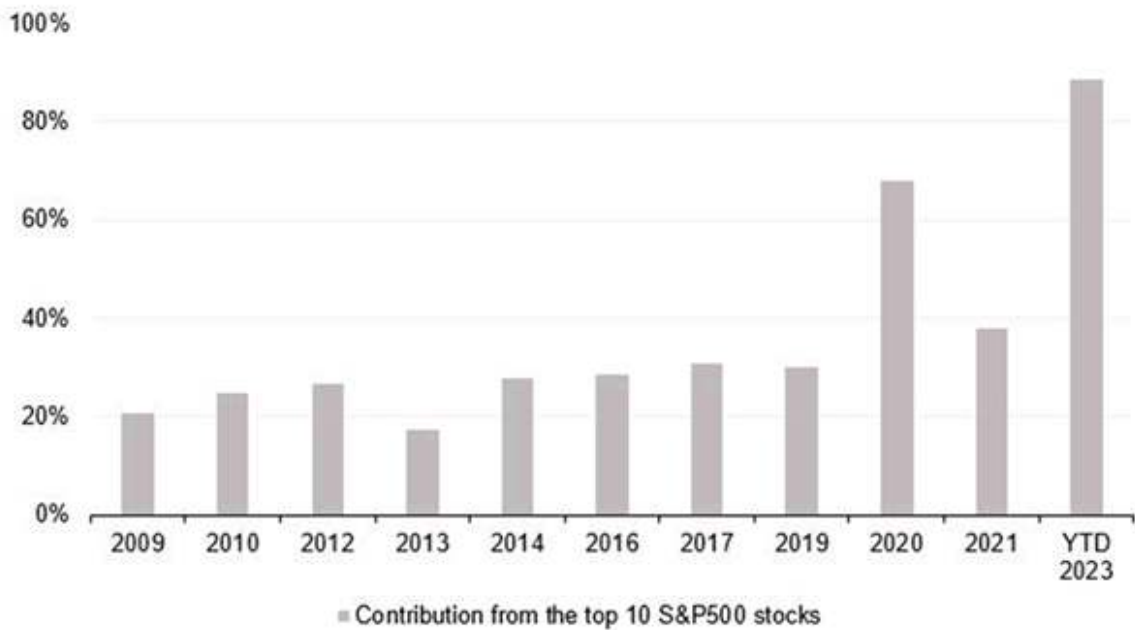
Note: As of Nov. 3.  
Source: FactSet

But the elephant in the room for this remarkable tale of US corporate resilience is that the profits surge is, of course, hugely uneven. Notice the big decline in healthcare earnings alongside the more to be expected drop in earnings for energy companies and miners. Notice also the lacklustre increase for real estate and industrials. To repeat - this is a tale of US consumers, not a surging broad economy with industrials firing on all cylinders in export markets.

That uneven picture also comes through in a recent analysis by SocGen analyst Jitesh Kumar. He observes that in the aftermath of the SVB failure in March this year, the performance of US equities has been "extremely narrow. Back then, the top-10 stocks accounted for c.86% of the index performance. With 8 weeks remaining in the year, the situation hasn't changed much: **the top-10 stocks now account for c.89% of the index performance year-to-date. This is by far the narrowest performance in post-GFC era if we count years in which S&P500 has gained at least 10%.**"



The second chart below shows that the top-10 stocks in S&P500 have consistently increased their contribution to the overall index returns over the past 15 years.



Index	October 2023	November 2023	Reference Index Value	Level 6 Months Ago
Stoxx 50 Dec 23 contract	143.2	143.3	4244	142.3
FTSE 100 Dividend Dec 2023	298.5	298.5	7397	294.4

Note changed to Dec 2023 contracts

Name	Price % change						Close
	1 mth	3 mths	6 mths	1 yr	5 yr	6 yr	
FTSE 100	-2.53	-1.33	-4.48	0.298	5.31	0.0979	7407.16
S&P 500	1.94	-1.74	6.97	11.5	63.3	71.1	4411.55

Gold Composite (Most Traded)	-0.196	-0.324	-4.06	9.05	59.9	51.3	193770¢
iShares FTSE UK All Stocks Gilt	1.42	2.65	-3.21	-6.93	-21.5	-22.6	1012.13p
VIX New Methodology	-15.1	-4.39	-16.8	-40.3	-33.3	22.3	14.17

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## Volatility

Earlier I mentioned that I would be a very rich man if I had been paid \$1 each time an investor or strategist said a recession was coming. I'd be even richer if I was paid £1 each time a fund manager in the UK said we were on the verge of a new era of macro volatility. I'm sure you've all seen the erudite manager commentaries, arguing that we are now in a 'uniquely' turbulent era, with lots of unknowns, lots of geopolitical uncertainty, lots of worry and nervousness. The irony is that the hard, statistical measure of volatility for the world's deepest, most liquid stockmarket index, the S&P 500, doesn't look very scary. The chart below shows the Vix measure since the pandemic. At its current level of 14 its well below the long term average - around 20 - and is below its 20 day (the green line) and 200 day moving average. There have been sudden surges, as you'd expect in recent years but nothing above 40 index points. If equity investors are supposed to be the canaries in the coal mine of fear, charts like these suggest that all those forecasts of impending doom aren't worrying investors in the US.

As an aside its also worth noting that the measure of Eurozone equity volatility, the Vstox 50, has also crashed back down to just above 15 index points, again below its long term average. So, it seems its not just US investors who seem unfazed...



Black Line - Vix since December 2020

Red line - 20 day moving average

Blue line - 200 day moving average

Measure	November Level	October Level	September Level	August Level
Vstox Volatility	15.93	20	15.47	18.98
VFTSE Volatility	14.17	16.69	14.23	16.46

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## Summary of Pricing Impact on Structured Products

Pricing Parameter	Change	Impact on Structured Product Price
Interest Rates	Up	Down
Underlying Level	Up	Up (unless product offers inverse exposure to the underlying)
Underlying Volatility	Up	Down for capped return/fixed return/capital at risk products. Up for uncapped return/capital protected products.
Investment Term	Up	Down
Issuer Funding Spread	Up	Down
Dividend Yield of Underlying	Up	Down
Correlation (if multiple underlyings)	Up	Up (unless product offers exposure to the best performing underlyings only)

*Source: UK Structured Products Association, January 2014*

*This information is provided for information purposes only, and the impact on a structured product price assumes all other pricing parameters remain constant.*

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## Explanation of Terms

### CDS Spreads and Credit Ratings

A CDS effectively acts like an option insuring at a cost in basis points a bank or government bond in case of default. The higher the basis points, the riskier the market perceives that security. Crucially CDS options are dynamic and change in price all the time. A credit rating is issued by a credit rating firm and tells us how risky the issuer is viewed based on the concept that AAA (triple A) is the least risky and ratings at C and below are regarded as much riskier. CDS and ratings are useful for structured product buyers because they give us an indication of how financial risk is viewed by the market. Crucially a high CDS rate indicates that an issuer of a bond will probably have to pay a higher yield or coupon, which could be good for structured product buyers as bonds are usually a prime source of funding for a structured product. G8 government bonds issued by the likes of the

UK and US Treasury are also sometimes used as collateral in some form of investments largely because they are viewed as being low risk. One last small note on credit ratings and CDS rates. A is clearly a good rating for a bond (and much better than B) but AA will be viewed as even safer with triple AAA the least risky. Terms of CDS rates anything much above 100 basis points (1%) would warrant some attention (implying the market has some, small, concern about the possibility of default) while anything above 250 would indicate that the market has major concerns on that day about default.

## Why does the yield matter on a bond?

As we have already explained bonds are usually used as part of a structured product. The bonds yield or coupon helps fund the payout. All things being equal a higher bond yield means more funding for the payout. But rising bond yields, especially for benchmark US and UK Treasury 10 year bonds also indicate that the markets expect interest rates to rise in the future. Rising interest rates are not usually a good sign for risky financial assets such as equities.

## Volatility measures

Share prices move up and down, as do the indices (the 500 and FTSE100) that track them. This movement up and down in price is both regular and measurable and is called volatility. It is measured by stand alone indices such as the Vix (tracking the volatility of the 500), VStoxx (the Eurozone Dow Jones Eurostoxx 50 index) and VFtse (our own FTSE index). These indices in turn allow the wider market to price options such as puts and calls that pay out as markets become more volatile. In simple terms more volatility implies higher premiums for issuers of options. That can be useful to structured product issuers as these options are usually built into an investment, especially around the barrier level which is usually only ever broken after a spike in volatility. Again all things being equal an increase in volatility (implying something like the Vix moving above 20 in index terms) usually implies higher funding levels for issuers of structured products.

## Dividend Futures

These options based contracts measure the likely total dividend payout from a major index such as the FTSE 100 or the Eurozone DJ Eurostoxx 50 index. In simple terms the contract looks at a specific year (say 2015) then examines the total dividend payout from all the companies in the index, adds up the likely payout, and then fixes it as a futures price usually in basis points. Structured product issuers make extensive use of dividend futures largely because they've based payouts on a benchmark index. That means the bank that is hedging the payout will want to be 'long' the index (in order to balance it's own book of risks) but will not want the dividends that come from investing in that benchmark index. They'll look to sell those future possible dividends via these options and then use the premium income generated to help fund their hedging position. In general terms the longer dated a dividend future (say more than a few years out) the lower the likely payout on the dividend future as the market cannot know dividends will keep on increasing in an uncertain future and must fix his price in some level of uncertainty.

## Equity benchmarks

Most structured products use a mainstream well known index such as the FTSE 100 or 500 as a reference for the payout. For investors the key returns periods are 1 year (for most auto calls) and

5 and six years for most 'growth' products. During most though not all five and six year periods it is reasonable to expect an index to increase in value although there have been many periods where this hasn't been the case especially as we lurch into a recession. Risk measures such as the sharpe ratio effectively measure how much risk was taken for a return over a certain period (in our case the last five years using annualised returns). The higher the number the better the risk adjusted return with any value over 1 seen as very good.

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To find out more about UKSPA, please visit [www.ukspassociation.co.uk](http://www.ukspassociation.co.uk).

Kind Regards,



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