MAPM: Markets Weekly

27th January 2023

Summary

- The latest flash PMI survey data shows signs of global growth diversion. US and UK composite PMI's are still in contraction while the Eurozone composite PMI surprises to move into expansion territory
- US Q4 GDP shows the economy grew by +2.9%, above consensus of +2.6%, driven by consumer spending and private inventory investment
- Bank of Canada (BoC) hiked its bank rate by 25bps and announced a "conditional pause"
- China Lunar New Year mobility and tourism data shows signs of mobility and consumption recovery

Market and Economic review

Both equity and fixed income assets finished the week in positive territory. Signs of a possible peak in bond yields and inflation, China reopening, more resilient European growth and lower energy prices helped drive positive market sentiment. The big questions now are whether the more positive view on global growth being signalled by recent market advances is warranted from a corporate fundamental's perspective, and whether a global growth diversion will be the key investment theme this year.

This week saw some evidence of global growth diversion, and this diversion might mean opportunities in select parts of global markets. The latest US leading indicators hinted at a weakening economic outlook, despite some data points being better than feared. Conference Board's leading index (a leading indicator to forecast future economic activity) for December fell by -1% (vs. -0.7% expected), the 10th successive monthly decline for the leading index. The Richmond Fed's manufacturing index came in at a post-Covid low of -11 (vs. -5 expected), while the US composite PMI printed at 46.6 (vs. 46.4 expected); its 7th consecutive month beneath the expansionary 50-mark, despite beating market expectations for both Services and Manufacturing. On the positive note, the latest PMI data was above market expectations and US Q4 GDP beat estimates at 2.9% (vs. 2.6% expected), despite falling from the Q3's 3.2% reading. Inflation continues to show signs of slowing down, with the core PCE price index rising at its slowest pace since Q1 2021, at +3.9%.

The year so far has brought some relatively good news from the Euro area, with signs that economic sentiment is beginning to recover. The latest Composite PMI suggests that Euro area growth momentum likely resumed at the beginning of the year, breaking the expansionary "50" mark at 50.2 in January, increasing from 49.3 in December and above a consensus of 49.8. Germany's IFO business climate index rose to 90.2 in January, with sentiment improvement being broad-based across all sectors except construction. While the recent UK November GDP print surprised to the upside, composite flash PMI decreased to 47.8 (vs. 49 last), below consensus expectations. The latest weak retail sales and consumer confidence data also indicated that the UK economic is still in contraction.

Following the lifting of social restrictions in China, the spread of the virus has pushed the country closer towards "herd immunity". The government estimates about 80% of the population has already been infected with Covid and severe cases dropped by more than 70% from peak levels. The Lunar New Year mobility and tourism industry data showed signs of mobility and consumption recovery. According to the Ministry of Transport, on a Lunar calendar basis, the daily average number of passenger trips was 50.8% above the same period in 2022. LY.COM, a tourism booking platform, showed hotel bookings rose 19% from last year. Peaking US inflation, a weaker US dollar and the positive China reopening spill-over effect are supportive of emerging market and Asian assets.

The Bank of England and the European Central Bank rate decisions next week will be closely watched by the market. Following better data, lower energy prices and China's reopening, the Euro area's growth prospects have improved recently. However, underlying inflationary pressures remain a cause for concern across the Euro area. Leading wage indicators, including services input prices, point to further pay growth strength. Resilient economic growth and strength in core inflation means ECB (European Central Bank) may not signal a slowdown just yet. ECB President Lagarde repeated the mantra of "staying the course" to ensure a timely return of inflation to target. In the UK, the combination of deteriorating economic prospects, receding inflation expectation and a rapid slowdown in the housing market might mean the central bank will opt for a slower pace of tightening, while the tight labour market conditions could push against a pivot. In other central banks, Bank of Canada (BoC) hiked its bank rate by 25bps and announced a "conditional pause". The BoC decision spurred speculation that the Federal Reserve might reach a similar point in their own hiking cycle.

On the earnings side, more than 20% S&P 500 companies have reported fourth-quarter earnings. For those companies that have reported so far, EPS beat consensus expectations by an aggregate of 2.7%, while growth surprised by -0.7%. Microsoft reported better-than-expected earnings due to strength from their cloud-services business (Azure) even as the consumer business faltered but provided negative outlook for Azure sales in Q1 2023. Tesla reported adjusted 4Q 2022 revenue up 37% year over year and expanded margins over time.

Amongst economic data out next week, we have the Bank of England and the European Central Bank interest rate decisions, China PMI, US job data, as well as Eurozone GDP and inflaton data.

Movers

Equity	Current Level	WoW	YTD	YoY
MSCI DM	648	1.87%	7.09%	-7.53%
MSCI EM	1,052	1.57%	10.05%	-13.12%
S&P500	4,060	2.21%	5.75%	-6.66%
FTSE 100	7,775	0.05%	4.33%	4.08%
Eurostox	4,178	1.42%	10.14%	0.33%
FTSE MIB	26,263	1.89%	10.78%	-1.34%
US Value vs Growth	--	0.38%	0.84%	6.62%
Government bond				
US 10 year Yield	3.54%	6.3	-33.3	167.9
US 2 / 10 Spread	-0.66%	3.3	-10.6	-137.0
Germany 10 Year Yield	2.27%	8.8	-30.6	233.9
UK 10 Year Yield	3.35%	-2.7	-32.1	215.3
Italy / Germany 10 Year Yield	1.86%	4.4	-28.4	45.8
Credit Spreads				
Barclays £ Corp TR Index	1.66%	-4.9	-27.2	48.8
Eur High Yield Spread (XOVER)	4.12%	-16.7	-61.7	141.2
US High Yield Spread (CDX HY)	4.31%	-15.3	-53.1	92.5
EM $ Spread (CDX EM)	2.27%	-3.4	-11.4	9.3
Currency				
USD Index	101.90	-0.11%	-1.57%	5.62%
GBPUSD	1.2368	-0.23%	2.36%	-8.13%
GBPEUR	1.14	-0.49%	0.60%	-5.14%
EM FX Spot (JPM Index)	51.36	0.53%	2.93%	-2.73%
Other				
Crude (1st Future)	88.60	1.11%	3.13%	-1.51%
Vix index	18.89	-1.0	-2.8	-13.1
Treasury Vol index (SMOVE)	109.17	-6.1	-22.8	24.9

Source: Bloomberg as at 10:02am on 27/01/23

Outlook

The core theme for investors remains central banks' attitudes towards the task of bringing down inflation using monetary policy tools, without excessively tightening conditions and driving economies into severe recession. With inflation data appearing to suggest a possible peak, one question is whether central banks can continue to drive inflation down to target levels or whether we are now entering a regime of persistently higher inflation; albeit not as extreme as we have seen through the second half of last year. Markets currently price in a mild contraction in economic activity but remain very sensitive to monthly inflation data and the trajectory of corporate earnings growth. The ongoing economic side effects of the war in Ukraine, and the supply chains scars caused by COVID-19, provide additional complexity and uncertainty in the calibration of monetary policy. An additional variable is China's uneven path out of its Zero-COVID strategy and the impact of its stimulus measures.

We maintain a small equity overweight with 1/3 in China, 1/3 in Asia and Emerging Markets combined, to provide diversified exposure to the China re-opening theme, and the remainder 1/3 in the US. In addition to the equity overweight, we retain a small overweight in Alternatives, which can act as a good diversifier and offer inflation protection characteristics over the longer term. The overweight positions are funded largely through a Fixed Income underweight and, where possible, this is implemented using a mix of UK and European Fixed Income where we see more upward potential drivers of yields (as compared to US fixed income).