Signia Invest Insights

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Market Review and Outlook

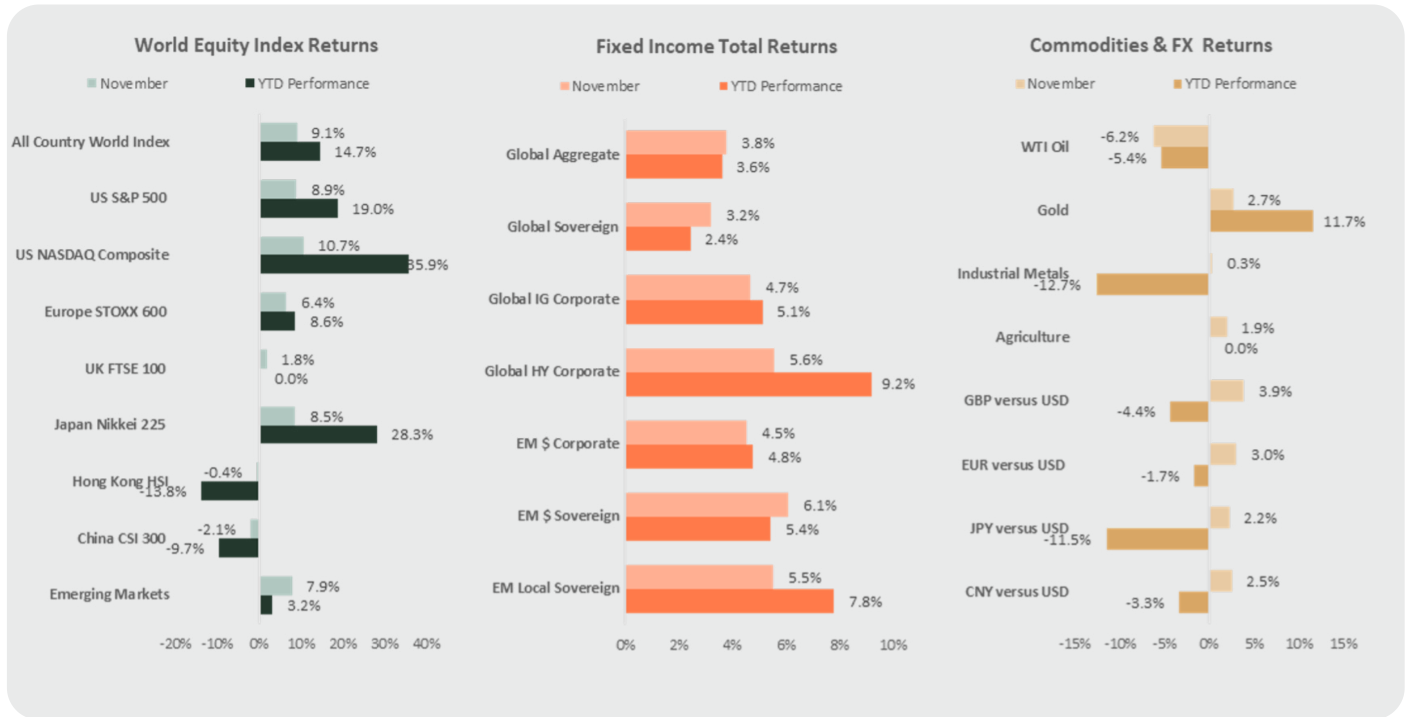
- After several weak months for markets, November saw a major rally as hopes for a soft landing and a dovish central bank pivot gathered pace. In fact, it was the best month for a global Balanced portfolio of equities and bonds since the positive Covid-19 vaccine news in November 2020, and the 7th best month for the S&P 500 in the last 100 years, up an impressive 8.9%. This was the key driver for the MSCI ACWI which gained 9.1% and is now up 14.7% YTD. European indices have been weaker this year, with the STOXX 600 up only +8.6%, and yet worse is the 0% flatline performance from the FTSE 100, a remarkably disappointing result for UK investors in 2023 as we approach year end.

- Equally astonishing is the strong performance of Japanese stocks which are up 28.3% this year on the back of rising inflation, with core CPI ex food and energy prices the highest since the 80s and 90s, and a Bank of Japan that appears marginally more willing to let yields rise more meaningfully. The local performance of Russian stocks (MICEX index) at +47% is also instructive and, even when adjusting for the weaker Ruble, scores near the top of global performance tables (the market remains inaccessible to foreigners).

- On track for a record fourth year in a row of negative returns would be Hong Kong's Hang Seng index, currently down almost 14% for the year and also down in November. The CSI 300 was also down last month and has been down for two years now. China's economy is still in a firm downtrend and, so far, government measures to resuscitate the ailing property markets and inject confidence into the consumer at home do not appear to be gaining any traction, nor is it abroad for foreign investors. Headline valuations look attractive, but investors have given up on the country's market for the obvious political risks as well as for a range of other reasons. The region continues to be on our watch list; however, it seems too early to get involved as the downtrend is entrenched and deep property market slumps can have lasting effects on sentiment and ultimately aggregate demand.

- November also saw notably solid returns for fixed-income indices, driven by a combination of lower core government yields, tighter credit spreads and attractive levels of underlying yield/income/carry. Commodity indices were dragged down by energy markets as expectations for sluggish global demand in 2024 were priced into markets, WTI oil declined -6.2% during the month, whereas natural gas prices were down a much sharper -21.6%. Overall however, it was an incredibly solid month across the board, with 33 out of the 38 non-currency assets in the Deutsche Bank survey of assets posting positive returns.

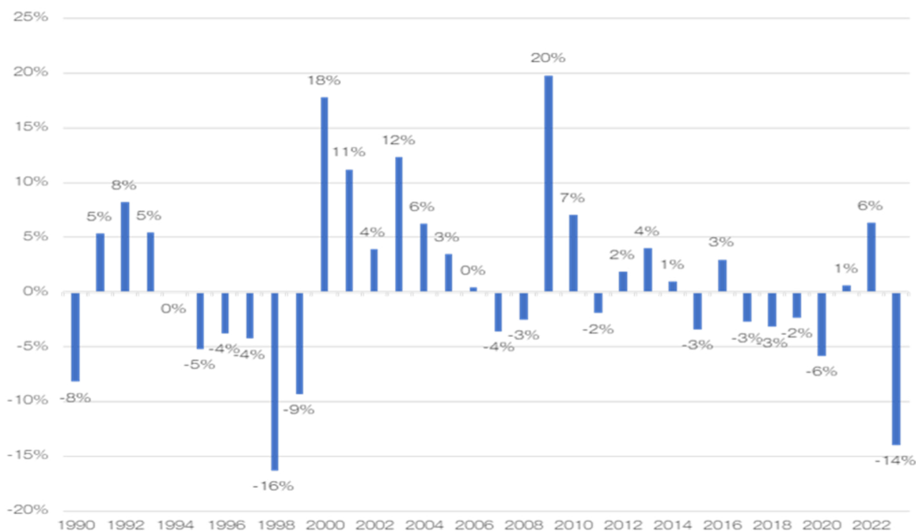
MARKET PERFORMANCE AS OF 30 NOVEMBER 2023:



Source: Bloomberg Finance L.P., Arbion Ltd

- The nature of the equity rally in November was slightly more nuanced compared to previous months as value stocks started to rebound, ending a ten-month outperformance of growth relative to value. As a result, equal-weighted indices outperformed cap-weighted versions last month. Despite this countertrend move, the reality is still that more than 80% of this year's performance in the S&P 500 was generated by the ten largest names, in particular the Magnificent Seven (M7) mega cap broad technology companies (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla). Similarly, the 14% YTD underperformance of equal-weighted versus cap-weighted indices is the largest since 1998.

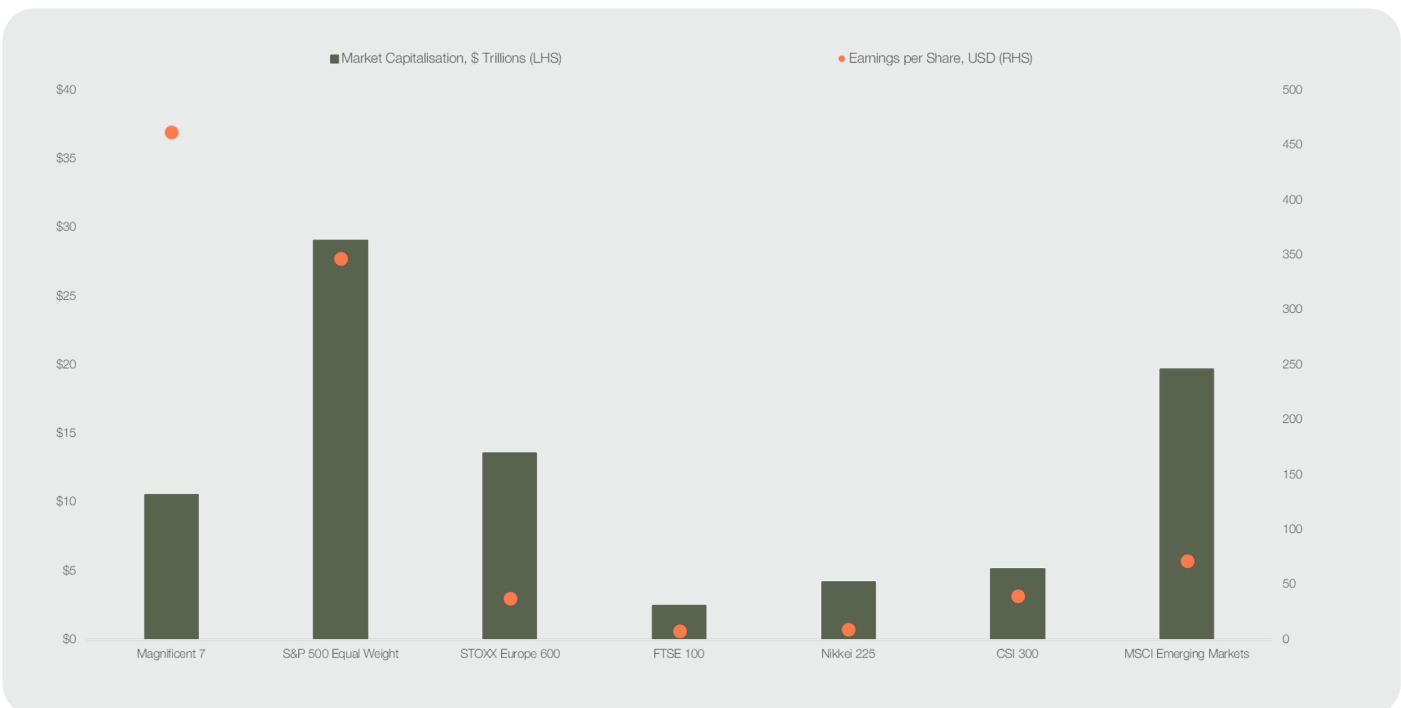
DIFFERENCE IN ANNUAL PERFORMANCE OF S&P 500 EQUAL-WEIGHTED VERSUS MARKET CAP-WEIGHTED INDEX:



Source: Bloomberg Finance L.P., Arbion Ltd

- The move in the M7 has caught many investors wrongfooted this year as they have staged a remarkable recovery from their 2022 drawdowns. Such is their dominance and significance within an increasingly concentrated S&P 500 index that portfolio managers – and not just benchmark-oriented managers – are now forced to view these seven companies as an asset class in their own right. To put this into context, their giant market cap is equivalent to the largest 625 publicly listed companies across the main UK, Japanese and Chinese equity markets combined. Interestingly, whilst their market cap contribution to the S&P 500 is currently at a record 29%, their expected earnings contribution to the index for 2024 is 'only' 21%. However, on an earnings per share basis one could argue that their valuations are justified given the continued strength and stability of their earnings power.

COMPARING THE M7'S MARKET CAP AND EPS AGAINST THE WORLD'S MAIN EQUITY BOURSES:



Source: Bloomberg Finance L.P., Arbion Ltd

- The rally in bond markets was even more impressive and the best monthly performance in decades. Headline consumer price inflation continued to decline and reached 3.2% YoY in October (sharply down from 3.7% for September), whilst earnings came in better-than-expected and the outlook still signals meaningful nominal growth for 2024. With inflationary pressures declining, there was renewed chatter from Fed governors about a potentially easier policy going forward (Christopher Waller: "If you see this [lower] inflation continuing for several more months, I don't know how long that might be—3 months? 4 months? 5 months? - you could then start lowering the policy rate because inflation is lower").

- As the playbook changed from "higher for longer" to an assumption of imminently easier monetary policy, markets have priced in another two rate cuts and expect more than four until the end of 2024 (Fed Funds lower by 1.11%). At the same time and somewhat contradictory, recession probabilities have declined over the last weeks as lower bond yields translate into easier financial conditions. The labour market is still resilient despite November payrolls slightly weaker than expected, as the unemployment rate declined from 3.9% to 3.7%. Overall macroeconomic trends appear to be slowing down somewhat especially as far as the consumer is concerned but not enough to derail the overall constructive mood. Despite the ISM manufacturing index still in recessionary territory and putting in the longest stretch of negative readings in two decades, its services sibling still signals robust demand, effectively saving the economy.

- 2024 will be an election year in the US and many other countries (more than 70 elections and more than half the world's population voting!), and the current administration has no incentive to reduce stimulative

measures next year as the likelihood of getting re-elected during a recession is unprecedented. The relevant context is that the vast majority of US nominal growth in 2023 can be explained by a record deficit (likely between 6-7%), which could persist next year. This is also consistent with largely stagnating or even recessionary economies in Europe and elsewhere, where such stark stimulus measures were not deployed. If support for the US economy continues, going into 2024 we could effectively see a goldilocks environment of declining inflation, high nominal growth and stable employment.

- However, how equity investors can assume earnings growth of 5-10% next year and rate cuts at the same time without a slumping economy is a difficult one to reconcile. As always, eventually the reality is likely to be very different, and a focus on risk management to mitigate downside risks on one hand and owning high-quality investments at reasonable valuations to ensure good upside potential on the other hand, appears to be a good recipe on the doorsteps of a year that may well bring with it more geopolitical surprises. Until then, we look forward to seeing out yet another eventful year in 2023 and I wish all our clients, partners and readers a very festive holiday season and a happy New Year!

ROBERT LEE

CO-HEAD OF MULTI-ASSET INVESTMENTS, HEAD OF RATES

Robert has been managing the wealth of private clients since 2006 as a portfolio manager and fixed income specialist. He is jointly responsible for the multi-asset investment team, global fixed income strategies, and Arbion's retail funds business. Previously, he worked for Lehman Brothers on the European Capital Markets team, and then Coutts & Co where he was a member of the fixed income and foreign exchange selection committees, responsible for managing the advisory and discretionary portfolios for private clients and institutions.

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