



# January 2023 Market Pulse

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# STRONG START TO THE YEAR FOR EQUITIES AND BONDS



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Both equities and bonds enjoyed a strong start to the year, boosted by rising hopes of an economic 'soft landing', whereby inflation continues to decline while recession is avoided. The global growth outlook improved, spurred by China's economic reopening and the continued recovery of European sentiment and economic activity – the eurozone appears to have avoided a recession, with modestly positive growth recorded in the fourth quarter. Central banks are likely to pause interest rate rises later this year, though they are still planning some further increases and pushing back against investors' expectations of rate cuts in the second half.

## Inflation falling

Inflation continued to fall, with US headline inflation down to 6.5% year-on-year (y/y) in December, from a high of 9.1% in June. Eurozone inflation also surprised to the downside at 9.2% y/y from the recent high of 10.6%, although core inflation rose slightly to 5.2% y/y. Evidence of easing wage pressures in the US – as average hourly earnings growth fell to 4.6% y/y – added to hopes that inflation will continue to fall.

## China reopening

Activity data in China slowed as the surge in Covid cases, following the lifting of restrictions, contributed to short-term disruptions; however, industrial production, retail sales and investment were better than expected. More importantly, sentiment surveys improved, with Chinese Purchasing Manager Indices (PMIs) rebounding strongly back into expansionary territory (above 50). The Chinese authorities announced new measures to support the important property sector and committed to ensuring a strong economy, with regions announcing growth targets of 5.5%+ for the year.

## Eurozone economy picks up

The eurozone appears to have avoided a recession, with fourth quarter GDP rising 0.1%, quarter-on-quarter (q/q). However, excluding Ireland, where Q4 GDP grew 3.5% q/q, growth was flat to slightly down. The backdrop has, nevertheless, significantly improved in recent weeks, with gas prices down to €58 MWh from a December high of €154 MWh, as the weather has been unseasonably warm and gas storage levels across Europe are well above normal. While still sluggish, activity levels across Europe have picked up. Sentiment surveys have shown a noticeable improvement, with PMIs back above 50.

## US economy loses some momentum

In contrast to Europe and China, the US economy appears to have lost some momentum. Activity surprised to the downside at year-end, with industrial production and retail sales falling -0.7% and -1.1% month-on-month, respectively. Sentiment surveys have weakened as highlighted by the ISM services reading falling to 49.6. The labour market remains strong, however, with unemployment back to a 50-year low of 3.5% and initial unemployment claims remaining very low versus history. Q4 GDP surprised positively at an annualised rate of 2.9% q/q.

## Central banks

US Federal Reserve (Fed) rhetoric remained hawkish. The minutes for the December policy meeting noted that an unwarranted easing of financial conditions, if driven by a misperception of the Fed's reaction function, would complicate the central bank's efforts to achieve price stability. The Fed highlighted that its guidance for interest rates is above market expectations and underscored its determination to lower inflation.

European Central Bank (ECB) minutes and commentary were hawkish. Rumours that the ECB might only raise rates by 25 basis points (bps) in February were quickly quashed, with ECB President Lagarde encouraging investors to revise their expectations on rates and to expect more tightening for longer.

Despite speculation over further possible changes to the allowable trading range for Japanese 10-year bond yields, the Bank of Japan left policy unchanged. Additional policy tightening is possible when the new Bank of Japan Governor takes over in April.

## MARKET ROUND-UP

### Equities

The MSCI AC World equity index rose 6.5% (5.3% in euros) over January.

European equities outperformed, rising 7.9% (7.5% in euros) as the growth outlook improved amid falling gas prices, rising sentiment and activity levels, and China's reopening, which should benefit Europe.

Emerging market (EM) equities rose 6.6% (6.0% in euros) as growth forecasts for China were revised higher on the back of the full reopening of the economy and ongoing support measures for the property sector.

The UK lagged, rising 4.1% (4.7% in euros). Increasing wage pressures in a tight labour market suggested further policy tightening is required, despite the soft economic backdrop where consumption has disappointed and the housing market remains very weak.

Japan also lagged, rising 4.7% (4.4% in euros) as the yen strengthened on the back of tighter policy and higher bond yields following the widening of the trading range for 10-year yields. The stronger yen is negative for exporters. Further tightening of policy is anticipated in coming months, during which a new Bank of Japan Governor will be appointed.

### Bonds

The Eurozone >5 year bond index rose 3.0%. Having reached an 11-year high at year-end, the German 10-year yield fell to 2.29% as eurozone inflation fell to 9.2% y/y. While ECB rhetoric remained hawkish, investors seemed more sanguine and discounted a less aggressive tightening path than suggested by ECB commentary. The German 10-year yield hit a low of 1.97% during the month but then rose as the ECB pushed back against some of the more dovish expectations in relation to the pace and scale of tightening. Peripheral spreads narrowed, with Italian 10-year spreads against Germany falling to 186bps, while Spanish 10-year spreads declined to 99bps.

European investment grade corporate bonds rose 2.0% as yields fell 27bps to 3.91%. Spreads were down 15bps to 146bps as the economic outlook improved. High-yield corporate bonds rose 3.5% as yields fell 67bps to 7.31%, while spreads were down 44bps to 370bps.

EM local debt rose 2.7% as yields fell 28bps to 6.64%. EM currencies were slightly stronger against the euro, which also supported performance. EM hard currency debt was up 2.9% with yields down 42bps to 7.38%; spreads fell 8bps as sentiment towards EMs improved, with a recovery in Chinese growth expected following the full reopening of the economy.



# MARKET ROUND-UP (continued)



## Currencies and commodities

The euro rose 1.5% against the dollar to end the month at 1.0865. The euro benefited from improving sentiment around European growth and the likelihood of more rate rises from the ECB in coming months, compared to the Fed which is closer to a peak in rates.

Commodities were marginally lower by -0.1% (-1.8% in euros). Brent oil was volatile, ending the month down -1.7%, having fallen by -9.4% at its lowest point. An improving outlook for oil demand – driven by China’s reopening – was offset by excess supply during the month, as Russian oil remains on the global market and is diverted to Asia. European gas prices fell -21.4% on the back of warmer weather and higher-than-expected storage levels across Europe.

Metals were firmer on an expected recovery in Chinese growth, with aluminium up 11.2% and copper 10.2%. Gold rose 5.8%, boosted by a weaker US dollar and lower US real yields.

## CHARTS OF THE MONTH

### Global Equities



Source: ILIM, Bloomberg. Data is accurate as at 31 January 2023.

### Bonds – German 10-year yield



Source: ILIM, Bloomberg. Data is accurate as at January 2023.

# MARKET SNAPSHOT

## Market returns (EUR)



Equity Markets (EUR)	MTD Return (%)	YTD Return (%)	2022 Return (%)
MSCI Ireland	11.2	11.2	-21.1
MSCI United Kingdom	4.7	4.7	1.4
MSCI Europe ex UK	7.5	7.5	-11.9
MSCI North America	4.9	4.9	-13.8
MSCI Japan	4.4	4.4	-10.8
MSCI EM (Emerging Markets)	6.0	6.0	-14.5
MSCI AC World	5.3	5.3	-12.6
10-Year Yields	Yield Last Month (%)	2022 Yield (%)	2021 Yield (%)
US	3.51	3.87	1.51
Germany	2.29	2.57	-0.18
UK	3.33	3.67	0.97
Japan	0.50	0.42	0.07
Ireland	2.74	3.13	0.24
Italy	4.15	4.70	1.17
Greece	4.30	4.62	1.34
Portugal	3.19	3.59	0.47
Spain	3.28	3.66	0.57
FX Rates	End last month	2022 Rates	2021 Rates
U.S. Dollar per Euro	1.09	1.07	1.14
British Pounds per Euro	0.88	0.89	0.84
U.S. Dollar per British Pounds	1.23	1.21	1.35
Commodities (USD)	MTD Return (%)	YTD Return (%)	2022 Return (%)
Oil (Brent)	-1.7	-1.7	6.7
Gold (Oz)	5.8	5.8	-0.3
S&P Goldman Sachs Commodity Index	-0.1	-0.1	26.0

Source: ILIM, Bloomberg. Data is accurate as at 31 January 2023.

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# THE ILM VIEW – LOOKING AHEAD

The outlook for equity markets over the next 12 months is dependent on several factors, including central bank policy, growth, inflation and geopolitical issues such as the Russia/Ukraine crisis.

Equities struggled in 2022 amid slower growth and tighter monetary policy; higher bond yields also undermined the relative attractiveness of equities.

While the scale of monetary tightening and sharp rise in bond yields now seem discounted by equity markets, the lingering growth- and earnings-related uncertainty may not yet be fully discounted. Indeed, although equities are expected to generate positive returns for the year as a whole, a better buying opportunity might present itself in the early part of the 2023 as a slowing growth environment with risk of earnings downgrades could lead to further losses before a trough is reached in equity markets.

A significant risk to equities relates to the potential for further downgrades to earnings forecasts in a slower growth/recessionary environment. Consensus forecasts currently expect earnings growth of 1.5% in 2023, which could be too high if the US and global economy enter a recession. Potential downgrades to earnings estimates in early 2023 could lead to renewed weakness in equity markets.

A potential offset to the risk of another leg down in equities would be evidence that the Fed and other central banks are achieving a ‘soft landing’, whereby they successfully lower inflation and manage to avoid a recession. If consensus economic and earnings forecasts prove to be correct and we are just in a mid-cycle slowdown, there is double-digit upside in equity markets on a one-year view. A moderation in inflation – with no additional policy tightening beyond what is currently discounted in markets, and with the possibility of rate cuts at some point in 2023 – would be supportive of equity markets.

Even though one more leg down in equities in early 2023 is possible, we believe equities can end the year higher. Equity markets are forward-looking and discount ahead. With an eventual recovery in growth expected by the end of 2023/beginning of 2024, equities should begin to recover before mid-year. With returns in the initial recovery stage generally tending to be relatively strong, equities can generate positive returns for the year, even if they struggle somewhat in the early part of 2023.

Navigating equity markets is difficult even in a benign environment, but it has become more arduous against the current backdrop with heightened uncertainty on many issues. As a result, the increased volatility evident in 2022 is likely to continue.

## THE MONTH AHEAD

### FEBRUARY

MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
	7 US Balance of Trade		9 DE Inflation Rate YoY (Jan Prel)	10 GB GDP Growth Rate YoY (Q4 Prel) US Michigan Consumer Sentiment (Feb Prel)
	14 US Inflation Rate YoY (Jan)	15 GB Inflation Rate YoY (Jan) US Retail Sales MoM (Jan)		17 GB Retail Sales MoM (Jan)
		22 US FOMC Minutes		

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Figures referenced herein have been sourced from ILIM and Bloomberg. Forecast figures have been prepared by ILIM based on reasonable assumptions, internal data and data sourced from Bloomberg.

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