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OUT OF THE ORDINARY

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Market reflection

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Overview

The rollercoaster ride that characterised markets in the first quarter of 2023 finally encountered a flat section in April, with the MSCI All-Countries World Index barely changed during the month. This lack of movement is more the result of a tug of war between opposing forces rather than a benign and stable equilibrium. On the one hand, economic growth expectations have gradually improved in many regions and corporate earnings remain resilient. This is supportive of risk assets. On the other, that very resilience, when combined with persistently high inflation, means that central banks are set to continue to tighten monetary policy with the clear intention of dampening economic activity.

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That caps the upside potential for equities. Although a US recession is widely expected by economists and investors, it is not factored into forward earnings estimates or valuations, both of which we expect to come under pressure. Another factor to consider over the summer will be the negotiations over the US Debt Ceiling. Should they be unsuccessful, there is a real risk that the US government will technically default on its debt repayments, which could be very disruptive in the short term (although we know that the situation will eventually be resolved, as it always has been). More encouragingly, the fallout from March's mini banking crisis has been limited. We continue to believe that a fully-fledged financial crisis is a low probability event owing to the stronger regulatory and capital environment developed since the Great Financial Crisis of 2008. Indeed, three containable US bankruptcies and the rescue of Credit Suisse by UBS could be viewed as being relatively constructive in that they will discourage any ill-advised relaxation of controls on the financial sector which might have created bigger problems in the future.

- The Bloomberg consensus for World GDP growth in 2023 has risen from a low of 2.1% in February to a current 2.5%. The US economy has experienced resilient consumption, although a large reduction in inventories weighed on the first quarter GDP print, which came in at +1.1% (quarter-on-quarter, annualised) against expectations of 2%. A sharp reduction in energy prices has been beneficial to both the UK and the eurozone, with both regions potentially in a position to avoid falling into recession. Even so, the margins are tight, and growth is lacklustre.

- China's first quarter GDP surprised positively, with growth of 4.5% (year-on-year). The country's exit from its zero-Covid policy has been the catalyst for recovery, with the main driver being consumption. China's better-heeled citizens have been especially active, reflected in strong sales performances by global Luxury Goods companies. LVMH became the first European company to achieve a market capitalisation of more than half a trillion dollars.

- The first quarter reporting season is far from complete, although we observe two notably strong trends. One is the pricing power exhibited by manufacturers of staple consumer goods, with double-digit price increases having only a limited impact on volume growth. The other is the strong performance of US mega-cap technology platforms such as Microsoft, Alphabet (Google) and Meta (Facebook). It supports our case for owning market leaders with strong balance sheets in the current environment.

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