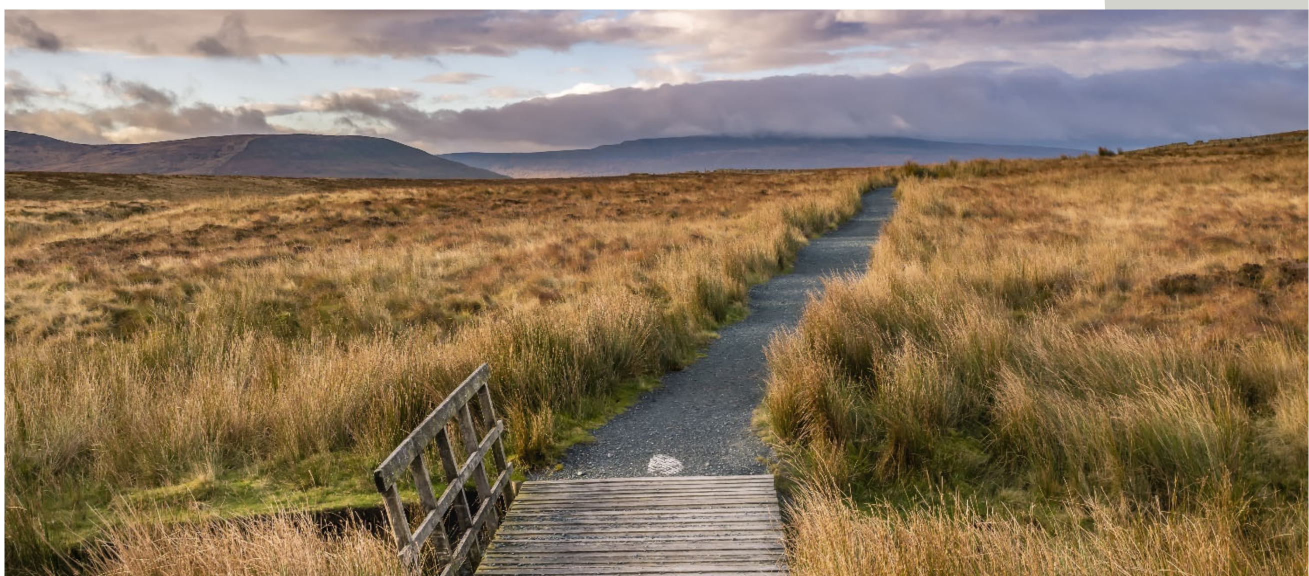
Investec

OUT OF THE ORDINARY

06 February 2023

Market reflection



John Wyn-Evans
Head of investment strategy

Overview

Following a year in which investors struggled to find any means to register gains in balanced portfolios, 2023 has begun in a much more optimistic fashion. Equity markets are higher, bond yields are lower and credit spreads have tightened. While some of this can be seen as a mean-reverting reaction to last year's losses, there are some more fundamental grounds for the recovery in sentiment.

Continued overleaf

A key one has been the reduced likelihood of a severe recession in Europe. Some of this is down to pure luck, as unseasonally warm weather reduced the need for gas, sending energy prices lower and leaving storage facilities unusually well stocked. But there was also a good response from consumers who reduced consumption and governments who created alternative sources of supply.

Another positive factor has been the abrupt ending of China's zero-Covid policy, which not only reintroduces a large element of demand into the global economy, but also improves the outlook for supply. Even so, both influences have been more about pricing out potentially very negative scenarios than establishing new positive trends. We must still negotiate further monetary policy tightening, as well as the lagged effects of what has already occurred.

Investors have got used to the idea of a deflationary economic and earnings recession that plays out quickly and is swiftly reversed by central bank rate cuts. With inflation still far above the 2% target level in all regions, activity is going to have to slow further to elicit a central bank response. We continue to maintain a cautious stance, although are far from being in "crash position". The seeds of a longer-term recovery are being sown in the current uncertainty, and central banks will ultimately achieve their goal of slowing activity. That will set up the new bull market. We find better value in equity markets outside the US, notably Europe and Emerging Markets.

- We can now start to focus on 2023 and beyond. The Bloomberg consensus World GDP growth forecast this year is 2.1%. A year ago, it was 3.6%. 2% is generally seen as the threshold for calling a "global recession", and so further downgrades could be met with negative headlines. The good news is that expectations are already low. There is still very little hope for a strong recovery in 2024, where the forecast is for growth of 2.9%.

- It is now generally acknowledged that the peak has been passed in terms of annual inflation for most countries. The collapse in oil and natural gas prices has provided a strong helping hand, but the very high comparative numbers from 2022 are also helping headline consumer price indices to decline on an annual basis. But aggregate prices are still a lot higher than they were, and wages have yet to catch up.

- One uncertainty for 2023 is the path of corporate earnings. The Q4 2022 results season is proceeding in a relatively orderly fashion, although not without the odd shock. We find that there is now a greater dispersion of outcomes, showing that companies must stand on their own merits rather than being raised on a tide that lifts all boats. We believe that this puts active managers in a better place to outperform. Profit margins will be a key determinant of performance, especially as stickier costs and lagged cost increases run into a world where it gets harder to raise prices.

- It is important to be mindful of the fact that equity markets will start to recover long before the economy or earnings. We expect market sentiment to recover during 2023.

 Continued overleaf

Investec

The information in this document is for private circulation and is believed to be correct but cannot be guaranteed. Opinions, interpretations and conclusions represent our judgement as of this date and are subject to change. The Company and its related Companies, directors, employees and clients may have position or engage in transactions in any of the securities mentioned. Past performance is not necessarily a guide to future performance. The value of shares, and the income derived from them, may fall as well as rise. The information contained in this publication does not constitute a personal recommendation and the investment or investment services referred to may not be suitable for all investors; therefore we strongly recommend you consult your Professional Adviser before taking any action. All references to taxation are based on current levels and practices which may be subject to change. The value of any tax benefits will be dependent on individual circumstances.

investecwin.co.uk

Member firm of the London Stock Exchange.
Authorised and regulated by the Financial Conduct Authority.
Investec Wealth & Investment Limited is registered in England.
Registered No. 2122340. Registered Office: 30 Gresham Street, London, EC2V 7QN.