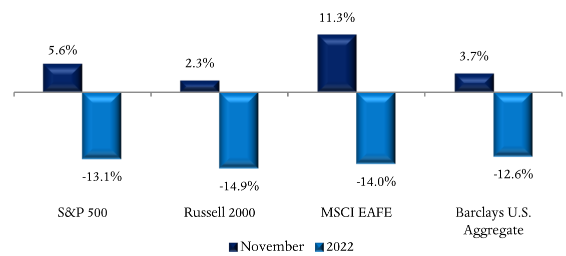
PAPAMARKOU WELLNER
ASSET MANAGEMENT, INC.

November / December 2022 Issue # 235

Markets



Global equity markets continued their recovery off recent lows. The outlook for inflation and central bank monetary policy remained at the forefront of investors' minds. Sentiment improved significantly after the release of the latest US inflation figures, which indicated a deceleration to 7.7% year-over-year. Subsequent language from Federal Reserve and ECB officials telegraphed a downshift in the pace of interest rate increases, giving investors courage that the current tightening cycle is nearing its end. During November the S&P 500 gained +5.6% (-13.1% ytd), the Nasdaq Composite rose +4.5% (-26.1% ytd), the Dow Jones Industrial Average added +6.0% (-2.9% ytd) boasting a 20.7% rebound off the lows, and the Russell 2000 index of smaller capitalization stocks increased +2.3% (-14.9% ytd). Overseas, stocks, as measured by the MSCI EAFE index advanced +11.3% (-14.0% ytd). Asian stocks rocketed higher by +18.8% during the month, driven by China. The Hang Seng Index produced its best monthly performance (+27.3%) since the Asian financial crisis of October 1998. Emerging markets as a whole rallied by +14.9% in November (-18.7% ytd).

The forecasted narrowing of interest rate differentials between the US and the rest of the developed world resulted in a decline in the Dollar (-5% in November but still +11% ytd). In cryptocurrencies, the collapse of the FTX exchange sent ripples throughout the space, raising concerns of solvency and government oversite. Bitcoin declined nearly -27% in November, making a new 52-week low of $15,3631.95 before rallying back late in the month to close down -17% (-63% ytd).

Bonds registered a strong month with long dated yields in the US and Europe retreating significantly, leading to a +4.7% rally (-16.7% ytd) for the Barclays Global Aggregate Bond index. While the Federal Reserve raised policy rates by 75 basis points to 4.0%, the yield on 2-year Treasury Notes peaked at 4.72% (the highest level since 2007) before settling at 4.31%. Concurrently, the yield on the benchmark US 10-year Treasury Note retraced to 3.60%, from October's high of 4.25%.

In commodity markets, during November, energy and fertilizer prices fell while metals prices rose, leading the S&P GSCI index lower by -2.5% (+27.8% ytd). WTI crude oil declined -6.9% during the month (down -35% from the March high) but remains up +7.2% ytd. As a result, the average cost of a gallon of regular gas in the US settled at $3.50, down $0.26 or 7% from last month. One year ago, that figure was $3.39.

Geopolitics

Nine months into the Russo-Ukrainian war, winter weather has ushered in freezing and muddy conditions sure to bog down the invading Russian forces, but also leading to severe hardship for Ukrainian civilians. The latest Russian strategy of widespread bombing of infrastructure across the country has made for extremely hostile living conditions with power blackouts as well as energy and water shortages, affecting millions. The war of attrition is predicted to last longer, leading to continued deaths on both sides and the loss of domestic and international political capital by the Kremlin. Putin has tried to distance himself from a series of humiliating defeats for Russia on the battlefield, first with the withdrawal from the Kyiv region in northern Ukraine in March, then the abandonment of Kharkiv in northeastern Ukraine and recently, the disengagement from a portion of Kherson in southern Ukraine, a region that Putin had said was Russia's "forever" only six weeks before the retreat. The most optimistic outcome is an eventual regime change in Moscow.

In the US, midterm elections have (mostly) concluded with Republicans winning enough seats in the House of Representatives to constitute a majority when the 118th Congress is seated in January. The Democrats will retain control of the Senate regardless of the outcome of Georgia's runoff. Historically, a divided congress following a midterm election, with a Democrat in the White House, is good for stocks. A split government makes it harder for major policy changes to take place, offering some stability to investors.

United States

Macro data continues to point to a resilient US economy, driven by the all-important consumer. A record 196.7 million shoppers sought bargains in stores and online over the Thanksgiving weekend (Black Friday - Cyber Monday), according to the National Retail Federation (NRF), a 9.4% increase. Adobe Analytics reported that online sales on Cyber Monday totaled $11.3 billion, up 5.8% from 2021, while Black Friday online sales were $9.1 billion, 2.3% above 2021's $8.9 billion. The NRF estimates US retail holiday spending will increase by a record 6-8% compared to 2021, to the tune of $950 billion. Excess savings and a resilient labor market (featuring rising wages) appear to be buttressing consumer purchasing power.

On the labor front, employers added 263,000 jobs in November and unemployment remained steady 3.7% (0.2% above March's level). Notable job gains occurred in leisure and hospitality, health care, and government. Employment declined in retail trade, transportation and warehousing. Over the past 12 months, average hourly earnings have increased by 5.1%.

Of concern, housing starts, which topped an annualized 1.8 million units in April, the highest since 2006, fell to 1.4 million in October. Further, the most recent existing home sales showed a continuation of their downtrend. The near doubling of 30-year fixed-rate mortgage rates, presently 6.7%, is depressing housing affordability.

November 2022 Economic Statistics

	Nov-22	Dec-21	Dec-20
Federal Funds Target Rate	***3.75 - 4.00%***	0 - 0.25%	0 - 0.25%
Consumer Confidence Index	***100.2***	115.8	88.6
Manufacturing PMI Index	***49.0%***	58.7%	*60.7%*
Unemployment Rate	***3.7%***	3.9%	*6.7%*
JPY/USD	***138.03***	115.08	*103.24*
USD/EUR	***1.0405***	1.1368	*1.2213*
Gold/oz.	***$1,768.45***	$1,828.39	*$1,896.49*
Oil (WTI)/bbl	***$80.55***	$75.21	*$48.52*

US inflation cooled slightly to 7.7% as prices of goods and autos fell, amid easing of supply chain bottlenecks. While food, services and shelter inflation remained stickier, the core CPI fell from a 40-year high of 6.6% in the prior month, to 6.3%.

Europe

Annual inflation in the Euro Area eased for the first time in 17 months to 10.0% in November from a record high of 10.6% prior. Excluding the main drivers (energy, food, alcohol and tobacco) the core CPI remained steady at a record high level of 5.0%. Europe continues to feel the effects of the energy crisis and the delayed price pass-through to end customers (i.e. energy costs in Italy stair-stepped +24.1% last month).

Thankfully, the worst may be past, with European energy storage at 93% of capacity, allowing German producer prices to ease -4.2% in October, the first decline since May 2000. Additional indicators of economic activity in the EU also surprised to the upside in November. The composite purchasing managers' index (PMI) increased slightly to 47.8%, but remained in contractionary territory, and consumer confidence rose off a low level.

In the UK, annualized headline inflation hit a 41-year high of 11.1%, driven by rising food and utility costs.

Core inflation remained stable at 6.5%. Similar to their EU neighbors, general economic activity improved off depressed levels, as shown by retail sales which grew +0.6% from the prior month, compared to -1.5% in September. Consumer confidence improved slightly, but remains below previous cycle lows. The squeeze in real income (expected to fall by 7% over the ensuing 18 months, despite £100 billion of government support) is likely to affect spending. Overall, the UK's Office for Budget Responsibility anticipates a 1.5% drop in GDP for 2023.

Asia

In China, policymakers introduced an easing of some Covid-19 control measures (including a shortening of the quarantine period from 10 days to eight days and making secondary contacts no longer in scope for quarantine) and increased their drive to vaccinate more of the elderly. Some 20-odd adjustments re-ignited hopes that the country is moving incrementally towards the end of its zero-Covid policy.

Contrary to their western counterparts, economic data in China surprised mostly to the downside. The composite PMI at 48.3% (indicating contraction), imports at -0.7% and retail sales of -0.5% (both year-over-year) all came in weaker than expected and continue to signal a slowdown in growth. As a result, monetary policy was eased and measures were taken to support the property sector.

Outlook

Federal Reserve Chair Jerome Powell recently spoke at the Brookings Institute, signaling future rate hikes will be in smaller increments. As a result, investors now expect a 50-basis point increase in the Fed Funds rate in December. Importantly, Powell added that the terminal rate (currently expected to approach 5% by mid-2023) may be higher than previously thought. Inflation is still hot, with CPI at 7.7%, but less than feared, and projected to trend downwards over the coming quarters as the economy slows, employment demand wanes, and supply chains normalize. Financial market volatility will likely result if inflation does not follow a linear path and interest rates remain elevated for an extended period of time.

With regard to the economy, our research indicates that developed markets are likely to enter a mild recession in 2023 on the back of tighter financial conditions, less supportive fiscal policy, and the loss of household purchasing power. Inflation should continue to moderate as the new year unfolds, but we must keep an open mind as to the magnitude of change and month-to-month progression. China is likely to be a wildcard, dealing with an ongoing domestic economic slowdown on the one hand, and a manufacturing exodus on the other. De-globalization, away from China and its extensive supply chain, is considered to be an inflationary trend.

Constituents of the S&P 500 index grew modestly during the third quarter, with earnings and sales rising by 3.4% and 11.48%, respectively. Sectors that saw outsized growth included Energy (+149%), Real Estate (+19%) and Industrials (+17%), while Communications (-21%), Financial (-16%) and Materials (-16%) declined. Looking ahead, earnings growth is expected to be slightly negative in the fourth quarter, but rise by mid-single digits in 2023, indicating the index is trading at a healthy 17.3x earnings.

The yield curve remains deeply inverted, which historically has indicated an impending economic recession. It also signals that bond market participants expect inflation to trend downwards, averaging below 3.5% over the next decade. In this context short duration Treasury Notes and investment grade credit appear to offer good value.

The partial recovery in equity markets, in a still uncertain economic environment, warrants ongoing investor patience. Credit markets have discounted relatively more, and have begun to offer some compelling opportunities. Commodities, especially energy and agriculture related ones, should benefit from expected supply shortages. For long-term investors, seeking to capitalize on disruptive technology trends, there are opportunities in the food and beverage, edu-tech and cybersecurity sectors. We also wish to reiterate the impressive growth prospects of the companies in our Nordic Technology and Innovation Fund, whose valuations have contracted meaningfully.

Sources: Barclays, Bloomberg, Bureau of Labor Statistics, Conference Board, Department of Agriculture, Federal Reserve, Financial Times, IMF, Institute for Supply Management, MSCI, Reuters, Russell, Standard & Poor's, and the Wall Street Journal.

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