

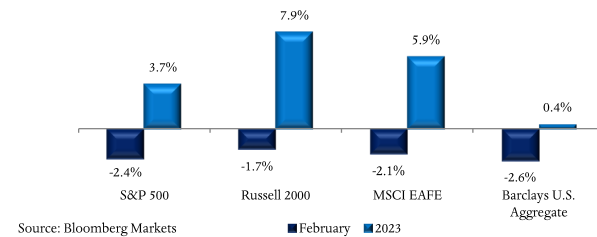


MARKETS

After a strong start to the year, helped by declining inflation and hopes of an imminent end to the global monetary tightening cycle, resilient economic data in February led to higher interest rates and a decline in equity markets. Investors reassessed their expectations for both the peak in interest rates and the subsequent timing of rate cuts, given that the road back to lower levels of inflation could take longer than expected, dashing earlier hopes. As a result, the benchmark S&P 500 declined -2.4% in February (+3.7% ytd) and the smaller capitalization Russell 2000 index pulled back -1.7% (+7.9%). International large capitalization stocks also retreated as seen by the MSCI EAFE index which dropped -2.1% (+5.9% ytd). However, select overseas markets produced positive results. The European Stoxx 600 index added +1.9% (+8.8% ytd) as risks of a deep recession decreased significantly. Likewise, in Asia, the Shanghai composite rose +0.7% (+6.2% ytd) on the back of China's post-pandemic economic reopening. Japan's Nikkei 225 index also continued its upward trajectory, rising +0.5% (+5.3% ytd) thanks to a weaker Yen and positive earnings results.

Several global central banks announced rate hikes in February, hawkishly indicating that despite recent downward trends in inflation, there is still more monetary tightening required. In the aftermath, interest rates rose across the yield curve, with the 5- and 10-year US Treasury yields jumping 58 and 44 basis points (bps), respectively, leading the Barclays US Aggregate bond index lower by -2.6% (+0.4% ytd) and high yielding bonds down by -1.3% (+2.6% ytd).

Commodity prices declined -4.0% in February (-4.6% ytd), as per the GSCI index. The energy sector dropped by -7.3% in February, led by coal (-34.8%), and US natural gas (-27.2%), while WTI crude oil declined a more



modest -2.3% to \$77.05 per barrel. On the positive side for European economies, local natural gas prices have been in freefall, (-40% in 2023 and -84% below last year's peak) as gas storage levels remain very high, despite the lack of Russian gas supply.

GEOPOLITICS

The war between Russia and Ukraine entered its second year with an understanding that the conflict is likely to be protracted and the deadliest in Europe since World War II. A year on, tens of thousands of Ukrainians and Russian soldiers have perished. The United Nations has counted nearly 10,000 Ukrainian civilian fatalities, and acknowledged that the toll is higher but cannot be tallied as millions have been displaced from their homes. Prospects for a diplomatic resolution remain low and more fighting is on the horizon. Both sides are gearing for a spring offensive, with Russia desperate for a major victory on the battlefield after numerous setbacks, and Ukrainians determined to take back more captured territory, predominantly in the south and east. The US and Europe have galvanized a broad global unity in support of Ukraine, supplying ever-more-sophisticated military armaments, as well as economic and humanitarian aid, leaving Russia struggling to make progress, as the war of attrition grinds on, with no end in sight.

China's ruling Communist Party and State Council released a plan calling for the country's digital "rejuvenation." The road map for the construction of a "digital China" calls for accelerated development of 5G networks, the Internet of Things (IoT), data centers and

supercomputing technologies. These new engines are expected to lead to significant progress in the digitization of its economy, governance, culture, society and business sectors, while strengthening digital innovation and security by 2025, in order to achieve “world-leading levels” by 2035. With more than 1 billion internet users, investment by Chinese firms in digital solutions is forecast to double over the next five years, reaching 40 per cent of total revenue from China’s top 2,000 companies.

UNITED STATES

The US economy grew at a 2.7% annual rate in the final three months of 2022, slightly less than expected, but exhibiting resilience. Other recent economic readings indicate a continued strong labor market, with record low unemployment and solid wage growth. Despite a recent surge of layoffs in some sectors like tech, media and the mortgage industry, the labor market remains robust, with almost two jobs available per job seeker. Further, retail sales, which most recently rose 3.0%, the highest since March 2021, indicate that consumer balance sheets remain healthy.

Confirming this narrative, January’s consumer price index (CPI) rose at an annual rate of 6.4% (headline) and 5.6% (core), which was lower than the previous month, but slightly higher than expectations. The CPI data acted as a reminder that the road to target levels of inflation will likely be bumpy, with housing costs (a lagging variable) remaining a major contributor.

At the beginning of February, the Federal Reserve voted unanimously to raise short-term interest rates by 25 bps to 4.75%, but the accompanying statement appeared dovish. Later, however, Fed Chairman Jay Powell warned that the process of disinflation has a long way to go, and further rate hikes are likely needed, especially if economic data continues to come in stronger than expected.

EUROPE

European economies have proven to be surprisingly

February 2023 Economic Statistics

	Feb-23	Dec-21	Dec-20
Federal Funds Target Rate	4.50 - 4.75%	0 - 0.25%	0 - 0.25%
Consumer Confidence Index	102.9	115.8	88.6
Manufacturing PMI Index	47.7%	58.7%	60.7%
Unemployment Rate	3.4% (est.)	3.9%	6.7%
JPY / USD	136.20	115.08	103.24
USD / EUR	1.0576	1.1368	1.2213
Gold / oz.	\$1,827.15	\$1,828.39	\$1,896.49
Oil (WTI) / bbl	\$77.05	\$75.21	\$48.52

Sources: see disclosure *

resilient post-pandemic, given the war on its eastern borders, and the associated energy crisis. The risk of a deep recession has decreased significantly. Energy prices continue to decline, with positive effects on households and firms (some energy-intensive manufacturing sectors have begun restarting production). Consumer confidence has rebounded from the extremely low level seen in late 2022, consistent with a pick-up in consumption over the coming months.

Eurozone January headline inflation fell to 8.5%, but core inflation remained unchanged at 5.2%. This led the ECB to raise short-term interest rates by 50 bps to 2.5%, and confirm its intention to “stay the course in increasing interest rates significantly, at a steady pace, and keeping them at levels that are sufficiently restrictive to ensure a timely return of inflation to the 2% target.” ECB president Christine Lagarde expressed the intention to hike a further 50 bps in March, to 3.0%. Markets now expect EU overnight rates to rise to 3.9% by the end of the year.

The European commission announced a revamped “Green Deal Industrial Plan,” focused on increasing manufacturing capacity for carbon-free technologies and products. Combined with the ban on the sale of combustion engine cars by 2035, these initiatives confirm Europe’s commitment to accelerating the energy transition. Numerous climate-related investments are likely to be enabled and financed through the issuance of lower cost green bonds.

In the UK, headline and core inflation fell to 10.1% and 5.8%, respectively, causing the Bank of England to raise

interest rates by 50 bps, to a base rate of 4.0%. However, conversely to other central bankers, Governor Andrew Bailey's speech came across as dovish, declaring that inflation has turned the corner. Despite signs of economic moderation, with GDP showing no-growth in the December quarter, the unemployment rate remained stable at 3.7%, with wages rising at a very strong 6.7% annual pace.

ASIA

In China, the post-pandemic reopening is feeding a strong rebound in economic activity, domestically and among its global trade partners. High-frequency traffic data, such as subway passengers and domestic flights, are showing a solid rebound, returning to pre-pandemic levels. Anecdotal evidence also indicates that food and beverage, tourism and luxury items are enjoying a robust recovery. Similar to the West, the huge amount of excess savings accumulated during lockdowns are expected to fuel consumption. The rebound has mainly been driven by China's services sector, with the Caixin February services PMI showing a sizable rebound to 55.0%, up from 52.9% in January and 48.0% prior. On the other hand, reviving private corporate investment and residential real estate will require more effort. As such, China is expected to maintain a loose monetary policy to facilitate the economic recovery.

OUTLOOK

Investors are grappling with the realization that inflation isn't cooling as rapidly or to the extent envisioned. Stubbornly high prices, coupled with the stability of global economies, have been the key catalyst for markets to price in expectations that interest rates will rise further and remain higher until such time that inflation meaningfully approaches central bank targets of circa 2%. As a result of higher interest rates, the valuation backdrop of traditional asset classes has shifted, presenting an improved entry point for investors. The next year, or more, is likely to feature a transition to disinflation, featuring high interest rates, tighter monetary and fiscal policies, volatile stock markets and a slowing housing sector. Service inflation will likely remain the stickiest, with ongoing tightness in

labor markets being the primary countervailing force.

The S&P 500's forward P/E ratio has compressed to 18.3x, but remains firmly above its 15-year historical average of 15.9x. Fourth quarter index constituent earnings declined -4.9% which, coupled with above average valuations and contracting monetary policy, may lead to further multiple compression, especially if profitability continues to deteriorate. The upshot is that value oriented US equities trade at a material discount to the benchmark leaders, while international equities are valued two standard deviations below their historical trend. With regard to overseas markets, potential tailwinds include narrowing interest rate differentials, a peaking US dollar, and China's reopening (where local stocks remain -47.5% lower than their 2021 peak).

In a rapid about-face over the past year, bond markets now offer robust income while providing ballast to portfolios. Investors can now achieve annual risk-free returns of near 5%, with modest duration, from 0-5 year US Treasuries. Even greater yields available in credit markets. However, if the economy is driven by inflation, fixed income is unlikely to provide its traditional diversification benefits. Therefore, inflation-linked bonds remain an attractive asset class.

Commodities, especially energy and agricultural related ones, appear to offer compelling opportunities, benefitting from supply shortages stemming from extended periods of underinvestment and associated bottlenecks. 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 would also point to the robust growth prospects of the disruptive companies in our Nordic Technology and Innovation Fund, whose valuations have contracted meaningfully.

We are proud to announce that after 40 years in business we have rebranded as Papamarkou Wellner Perkin, welcoming long-time partner Thorne Perkin to our corporate masthead. PWP is also expanding its platform with the launch of a dedicated Mergers & Acquisitions Advisory vertical to compliment our existing businesses.

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