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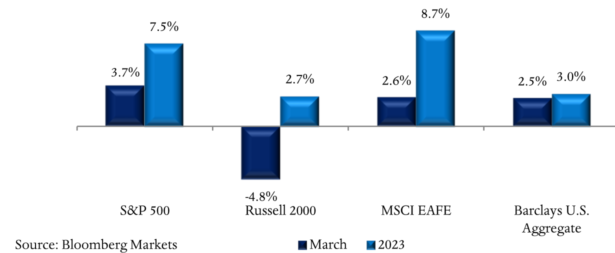
March - April 2023 Issue # 239

Markets

Global equity markets produced positive returns in the first quarter, driven by declining inflation and the prospect of easier monetary policy. Gains came despite the collapse of Silicon Valley Bank and Signature Bank (the second and third largest banking failures in US history) as well as Switzerland's Credit Suisse. Capital withdrawals from non-systemically important financial institutions ensued, expected to lead to a contraction in financial market liquidity and a headwind to economic growth. In this context, blue chip stocks in the S&P 500 advanced +3.7% in March (+7.5% in Q1), while the more economically sensitive smaller companies in the Russell 2000 index declined -4.8% (+2.8% in Q1). Growth oriented stocks in the Nasdaq index were the star performers (+6.7% in March; +17.0% in Q1) rebounding from the 2022 declines and highly geared to lower bond yields. Overseas stocks also performed well as seen by the MSCI EAFE index, which rose +2.6% in March (+8.6% in Q1). Regional markets in Europe and Asia also rallied, producing quarterly returns of 6-8%.



Source: Bloomberg Markets

Extreme demand for US Treasuries, in the aftermath of March's bank runs, was punctuated by a 48 basis point two day decline in yields (the 8th largest in history). During Q1 the US 10-year yield fell from 3.92% to 3.47%, with the 2-year declining from 4.82% to 4.03%. The Fed hiked twice, by 25bps each, marking a slowdown, while the ECB remained in catch-up mode raising rates twice, in 50bps increments. As the environment evolved, government bond markets went from pricing in further increases, to discounting sizeable rate cuts. The Barclays US Aggregate bond index returned +2.5% in March (+3.0% ytd).

The S&P GSCI commodity index recorded a loss of -1.3% in March (-5.9% ytd). Energy and livestock were the worst-performing components of the index, while industrial and precious metals achieved price gains, with gold climbing to a record high. In response to the weakening price of crude oil, which saw the WTI benchmark fall to $65 per barrel in mid-March before rebounding to close the month at $75.67 (-1.8% in March; -5.7% Q1), OPEC+ members announced the cartel would collectively cut production by 1.16 million barrels per day over the coming year. This action should put a near-term floor under oil prices, balancing lower demand from a slowing global economy.

Geopolitics

The geopolitical backdrop remains challenging, with no end in sight to the war in Ukraine, and renewed tensions between the US and China. Conversely, Sino-Russian relations have been deepening as illustrated by Chinese leader Xi Jinping and Russian President Vladimir Putin's sweeping affirmation of their alignment across a host of issues, along with a shared mistrust of the United States, following recent talks between the two leaders in Moscow. The undeclared personal, economic, military, and diplomatic alliance between Xi and Putin (and their respective countries) continues to defy expectations. This dynamic, which seeks to end US hegemony, will remain consequential for global geopolitics for the foreseeable future, especially considering that the tenure of both leaders has no expiration date, unlike that of their western counterparts.

In France, government plans to raise the retirement age (from 62 to 64) saw extensive protests across the coun-

try. At nearly 14% of GDP, the country's spending on state pensions is larger than in most other countries. President Macron's government narrowly survived a no-confidence vote over the issue.

United States

US economic data published since the beginning of the year suggests that the largest economy in the world continued to grow in the first quarter, albeit at a slower pace, estimated at 1.5% (seasonally adjusted annual rate) by the Federal Reserve Bank of Atlanta. The labor market remains resilient with 236,000 jobs added in March after a stunning 815,000 increase in the first two months of the year, leading to a historically low 3.5% unemployment rate. Average hourly earnings rose 4.2% last month from a year earlier, an easing from 4.6% in February. Manufacturing activity also decelerated in March, to the lowest level in nearly three years as new orders plunged. All subcomponents of the PMI index fell below the contractionary 50% threshold for the first time since 2009, signaling an impending economic slowdown affected by tighter credit conditions.

The Federal Reserve raised interest rates twice during the quarter, amid cooling inflation, leading to expectations the tightening cycle could shortly come to an end. The central bank's most recent rate hike, which came after the aforementioned banking collapses, expressed confidence in the resilience of the US financial system. As a result, borrowing costs are at the highest point since 2007. However, inflation, as measured by the Fed's favorite core personal consumption expenditure (PCE) index, climbed less than expected in March (5%) and marked an eighth consecutive monthly decline. It is also worth noting that fluctuations in inflation are now dominated by shelter costs, accounting for over 70% of the increase in prices, a lagging metric. This bodes well for a continuation of the deceleration, as recent data show rent increases have generally slowed and house prices are coming under pressure. As a result, another 25bp increase is possible, leaving the Fed Funds rate at 5%, where it is likely to remain throughout the rest of 2023. More importantly, the conversation is shifting towards the timing and magnitude of a much anticipated rate cutting cycle.

March 2023 Economic Statistics

	Mar-23	Dec-21	Dec-20
Federal Funds Target Rate	***4.75 - 5.00%***	0 - 0.25%	0 - 0.25%
Consumer Confidence Index	***104.2***	115.8	88.6
Manufacturing PMI Index	***46.3%***	58.7%	*60.7%*
Unemployment Rate	***3.5%***	3.9%	*6.7%*
JPY / USD	***132.79***	115.08	*103.24*
USD / EUR	***1.0839***	1.1368	*1.2213*
Gold / oz.	***$1,967.90***	$1,828.39	*$1,896.49*
Oil (WTI) / bbl	***$75.67***	$75.21	*$48.52*

Sources: see disclosure *

Europe

In Europe, economic activity generally surprised to the upside during the first quarter, thanks to falling energy prices and pent-up demand for services. The euro-area composite PMI for March rose to a 10-month high of 54.1%, which was well above expectations. This strong momentum was almost entirely driven by the service sector whose level increased to 55.6%, while the manufacturing sector continued to contract as shown by the drop in its metric to 47.1%. Euro-area consumer confidence, though slightly down in March, improved over the quarter.

Eurozone inflation declined to a one-year low of 6.9% last month, down from 8.5% in February. However, core inflation (excluding food and energy costs) climbed to 5.7% from 5.6% prior. As a result, the European Central Bank raised interest rates by 50bps in both February and March, taking its key rate to 3.50%.

The UK economy dodged a technical recession by producing GDP growth of 0.1% in Q4 (+0.6% for 2022) thus avoiding two consecutive quarters of decline. However, in its latest quarterly forecasts, the Bank of England said it still expected the country to fall into a recession later in 2023. Inflation remained elevated at near 10% (core circa 6%) leading the BoE to increase its policy rate by 25bps in March to 4.25% with the potential for further tightening.

Asia

During the quarter Beijing loosened its Covid-19 restrictions, supported property markets, and loosened the regulatory crackdown on China's technology companies, all of which had constrained the country's economic growth. Total social financing (TSF), a broad measure of credit and liquidity in the Chinese economy, grew by 9.9% year-over-year in February. The credit impulse (the gap between TSF growth and nominal GDP growth) rose to 5.6%, the highest since January 2021, indicating significant economic strength on the horizon.

Local inflation has so far remained surprisingly low, with general prices rising only 1.0% over the past year, while the producer price index remained in deflation territory, falling 1.4%. This has allowed the People's Bank of China to maintain an easy monetary policy. Against this backdrop, the PBOC announced a 25bps cut to its reserve requirement ratio for banks in March, and telegraphed the desire for 5-6% GDP growth in 2023.

Outlook

Global growth has generally surprised positively during the first quarter of 2023. Headline inflation continued to ease over the period on the back of lower energy prices, but core inflation generally remained stickier, forcing global central banks to tighten monetary policy further. The idiosyncratic collapses of Silicon Valley Bank (which had large exposure to emerging technology companies) and crypto-currency related Signature Bank, led to panicked cash withdrawals from smaller, non-systemically important financial institutions. This marked a significant event given that regional and local banks account for nearly 40% of all US lending, with ramifications of slowing economic growth on the horizon.

Regional US bank stocks currently trade at historically low valuations, as investors ponder regulatory concerns, balance sheet liquidity and duration risks, as well as potential future legislation. For the S&P 500 index, upcoming quarterly earnings are expected to drop -6.6%, the largest decline since the 2020 pandemic. The index's consensus 2023 earnings have also fallen to $230 per share, leading to a forward 12-month earnings multiple of 17.8. This figure is in-between the 5 and 10-year averages of 18.5 and 17.3, respectively. However, these trailing periods features near zero interest rates due to ongoing central bank quantitative easing. Loose monetary policy has now abruptly reversed and the economy is starting to feel the effects of 475 basis points of rate hikes in just 12 months, increasing the uncertainty of such comparisons. International stock markets are, however, trading at 30-40% discounts to their US counterparts, with Japan valued at 13.0x forward earnings, Europe at 12.7x, Emerging Markets at 11.9x and the UK (the cheapest developed market in the world) at 10.6x. These historically large valuation differences likely offer an opportunity for long-term oriented risk-tolerant investors. It is still uncertain to what extent the recent tightening of the lending markets will affect investor sentiment and activity. We therefore reiterate a conservative equity positioning, with a focus on quality.

In fixed income markets, after March's "bank runs," the 2-year US Treasury yield declined precipitously, presently yielding just shy of 4%. Given the stubbornly elevated levels of core inflation, circa 5%, interest rates are likely, in our opinion, to remain higher for longer, in order for the Fed to achieve its 2% inflation objective. As such, government bond investors again face the prospect of negative real (inflation adjusted) returns. We therefore revert to our prior stance of suggesting short duration high quality bonds for conservative investors seeking ballast to their portfolio. For risk tolerant investors, higher yielding credits appear compelling due to their wide spreads.

Commodities, especially energy and agricultural related, offer inflation-linked opportunities that stand to benefit from curtailed supply due to chronic underinvestment. For long-term investors, we are seeking to capitalize on disruptive trends in the food and beverage, edu-tech and cybersecurity sectors. We would also point to the robust growth prospects of the cutting-edge companies in our Nordic Technology and Innovation Fund, where the risk-reward has become increasingly favorable.

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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.