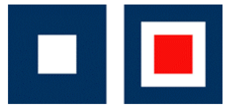

PAPAMARKOU WELLNER PERKIN

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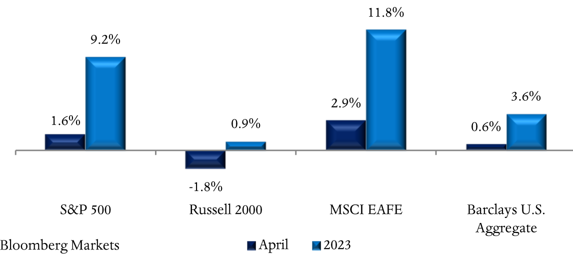
Markets

Economic data continued to show that the global economy remained remarkably resilient in the face of higher interest rates. Falling food and energy prices helped bring headline inflation down, but the core rate remained stubbornly high. These trends supported risk assets despite further stress in the banking sector. The S&P 500 index rose by +1.6% last month (+9.2% ytd), with value stocks modestly outperforming their growth counterparts. The more economically sensitive smaller capitalization Russell 2000 index declined for the third straight month -1.8% (+0.9% ytd). The tech heavy Nasdaq, which has led the way higher in 2023, returned a modest +0.1% in April (+17.1% ytd). Overseas equities continued their outperformance, with the MSCI EAFE benchmark advancing +2.9% (+11.8% ytd). European stocks added +2.6% (+11.4% ytd). In Asia, Tokyo's Nikkei 225 increased +2.9% (+11.7% ytd), while the Shanghai composite was higher by +1.6% (+7.6% ytd).

Credit markets improved as fears of broader contagion from the regional banking stress eased, aided by better than expected corporate earnings and capital market liquidity. Increased demand for bonds during April moved the 10-year US Treasury lower by 4 basis points (bps) to 3.43% and the Bloomberg Barclays US Aggregate index higher by +0.6% (+3.6% ytd).

Commodity prices were mixed in April, drawing the S&P GSCI index down by -0.8% (-5.7% ytd). Oil prices recovered slightly in April following a sharp decline in March, as OPEC+ announced a greater than 1 million cut in production aimed at stabilizing oil prices around the $80 per barrel level. Steel (+15.9%) and Nickel (+2.3%) posted positive returns. Conversely, Iron Ore declined (-8.6%), followed by Copper (-4.07%), while Aluminum was flat (+0.24%).



Source: Bloomberg Markets

Geopolitics

Politicians in Washington, faced with a "debt ceiling," are debating the terms by which they cap the amount of money the federal government can borrow to pay its bills. It is important to note that an increase or suspension of the debt limit does not authorize new spending, nor does it cost taxpayers additional money. Rather, it allows the government to finance existing obligations that the President and Congress have agreed to. Since 1995 there have been a total of four debt ceiling crises, ramifications of which led to a credit downgrade by Standard & Poor's in 2011 and a government shutdown in 2013. Treasury Secretary Janet Yellen and the CBO have indicated that the federal government will run out of funds on June 1, however it is possible that cash management and tax receipts may extend this deadline until the end of July. This coincides with Congress' scheduled recess from July 29 to September 12. Republican House Speaker McCarthy has succeeded in educating representatives about various fiscal issues and united the Republican party around a bill that would increase the debt ceiling by $1.5tn in exchange for $4.5tn of future spending cuts. The Democrats consider the proposal to be a non-starter given that it would only sustain the government for 12 months and coincide with the run-up to Presidential elections. History shows a deal will be arranged in the 11th hour. As such, emergency measures likely have been prepared by the Treasury and the Fed in anticipation of a drawn out political battle which is sure to entail concessions on both sides on

topics including student loan forgiveness and portions of the recently enacted Inflation Reduction Act. To put the fiscal situation in perspective, the US National Debt is currently $31.7 trillion, and the CBO projects a federal deficit of $1.4 trillion in 2023 and an average of $2.0 trillion per year from 2024 to 2033.

United States

April readings of various US economic data points indicate an economy being buffeted by cross-currents. The ISM's manufacturing PMI (47.1%) bounced off a 3-year low but extended its contractionary streak to six months. New orders improved slightly and employment rebounded, but activity remained depressed amid higher borrowing costs and tighter credit, hinting at the risk of a recession. Conversely, the services sector expanded for the fourth consecutive month due mostly to the increase in new orders and ongoing improvements in both capacity and supply logistics.

Investors received positive news on inflation as the decline in energy prices took 0.5% off the headline figure, which printed below expectations at 5.0%. However, core inflation ticked higher to 5.6%, though leading indicators suggest a coming moderation. The labor market also continued to be resilient, with April unemployment falling to 3.4% (tied for the lowest level since 1969) as non-farm payrolls grew by 253,000, while wage growth strengthened to 4.4% from a year ago.

The Federal Reserve raised interest rates by 25 basis points in May and indicated its intention to pause. If inflation and the economy slow in the months ahead, the central bank is expected to begin cutting interest rates soon after.

Europe

Eurozone economic data generally surprised to the upside in April. Similar to the US, manufacturing remained a weak spot (PMI 45.5%, representing the tenth consecutive month below 50%, signaling contraction) while the service sector continued to expand (PMI 56.6%), pushing the composite index to 54.4%.

April 2023 Economic Statistics

	Apr-23	Dec-21	Dec-20
Federal Funds Target Rate	*5.00 - 5.25%*	0 - 0.25%	0 - 0.25%
Consumer Confidence Index	*101.3*	115.8	88.6
Manufacturing PMI Index	*47.1%*	58.7%	*60.7%*
Unemployment Rate	*3.4%*	3.9%	*6.7%*
JPY/USD	*136.28*	115.08	*103.24*
USD/EUR	*1.1020*	1.1368	*1.2213*
Gold/oz.	*$1,989.69*	$1,828.39	*$1,896.49*
Oil (WTI)/bbl	*$76.78*	$75.21	*$48.52*

Sources: see disclosure *

This divergence is the widest in over a decade and looks to continue. The services strength was enough to keep eurozone GDP moving higher in Q1, with the economy growing 0.1% quarter over quarter.

Eurozone headline inflation fell sharply thanks to base effects in energy. The consumer price index decelerated from 8.5% in March to 6.9% in April. Core inflation, however, accelerated by 0.1% to 5.7%. Ongoing GDP growth combined with continued wage pressures, led the European Central Bank to raise interest rates by 25 basis points in May, a slowing of the pace, but without signaling a pause just yet.

UK economic data followed a similar pattern, with a divergence between the manufacturing (PMI 46.6%) and services sector (54.9%) apparent. Local headline inflation fell from 10.5% to 10.1% in April, aided by lower fuel prices. Core inflation, which had been expected to fall, instead remained flat at 6.2% year on year. The inflationary impulse was notable in the robust wage growth figures that saw average weekly earnings increase by 6.6% year over year.

Asia

China's reopening continues to drive the country's economic rebound. First quarter GDP growth proved to be a positive surprise, showing a 4.5% annualized increase. Retail sales increased 5.8% in the first quarter of 2023, including 10.6% in March. The economy could accelerate further into 2Q with household spending and exports leading the way. Lending growth is already accelerating in China, reflecting confidence in both the

businesses and banking sectors. China's April Politburo meeting focused on coordinating fiscal and monetary policy to boost consumption and stimulate business investment. There were calls to open up foreign trade and attract foreign direct investment. Further there was a desire to improve social welfare and employment issues. Longer term, there is a goal to upgrade the value added of various industries, namely that of zero emission vehicles, power grids and AI technology. From a geopolitical perspective, tensions are likely to continue as seen by reports of potential US investment regulations on China's communication services and consumer discretionary sectors.

Japan is under the spotlight, with the incoming central bank governor, Kazuo Ueda, under pressure to revise the bank's Yield Curve Control policy. In Ueda's first meeting, the central bank kept its policy unchanged but removed the forward guidance that its policy would remain at its present or lower levels. The central bank is still expecting inflation to fall back below 2% later in the year. However, Japan is facing a fresh round of inflation, including a substantial wage rise following the Shunto "spring wage negotiation." Discussions have seen key unions and their employers reach a preliminary deal to raise overall wages by 3.8%, the highest rate since 1993. That would follow last year's 2.2% increase, the first in four years.

Elsewhere in Asia, several central banks paused their rate hiking campaigns; Australia, India, Singapore, South Korea, and Indonesia all decided to keep their policy rates unchanged. New Zealand was the odd one out with a 50bps increase in April.

Outlook

Economic activity has remained resilient in the face of mounting headwinds, defying skeptics. Consumption remains supportive, but the closure of another US financial institution at the end of April highlights that the cumulative impact of central bank tightening has still not been fully felt. Supply chains have finally become smoother in most industries, which presages lower corporate margins. Warren Buffett, the "Oracle of Omaha," conveyed his view that "it is a different climate than it was six months ago. Some of (the businesses) had too much inventory on order, and then all of a sudden it got delivered, and people weren't in the same frame of mind as earlier. Now we will start having discounts when we didn't need to have them before." We also remain weary of the prospect of reduced bank lending and contagion in the credit markets. Lenders are becoming proactively more conservative in anticipation of slowing economic growth and higher credit defaults. Banks may also be forced to curtail new loans due to reduced deposit bases or capital adequacy. Growing concerns over commercial real estate could also cause investors to become more defensive. In all, an economic contraction later this year would not surprise us, a possibility that US equities have not accounted for. This warrants a conservative posture with regard to risky assets, and the attractiveness of seeking geographic diversification, where assets are trading at significant discounts and which have avoided capital build-ups.

Fixed income markets are in a precarious position having discounted nearly 200 basis points lower short-term interest rates, starting in the summer. If the Fed eases and inflation remain sticky, the central bank will lose credibility, likely leading to investor disappointment and an adjustment in the yield curve. Similarly, if the currently high 5% level of overnight rates persists while the economy continues to grow, it presents a risk to bond investors that have taken on duration risk and negative real yields. As such, we remain conservative with regard to long dated bonds, preferring short maturity and floating rate securities.

We have identified opportunities for investors to capitalize should a credit dislocation occur. Energy and agricultural commodities stand to benefit from under-supply due to chronic underinvestment, while demand continues to grow, an attractive proposition for investors. Over the longer-term, we are seeking to capitalize on disruptive trends in the defense, edu-tech and cybersecurity sectors. We would also point to the discounted valuations of the growth 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.