

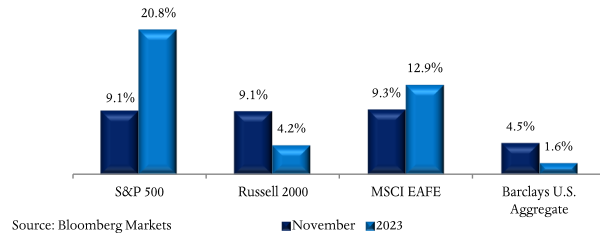


MARKETS

Equities snapped a three-month losing streak, with exhilarating returns in November, thanks to tentative signs of economic moderation and decelerating inflation. Data broadly supported the view that central banks have reached the end of their tightening cycles. The S&P 500 index rose +9.1% (+20.8% ytd). Growth stocks such as those in the tech-heavy Nasdaq composite (+10.8% in November; +37.0% ytd) outperformed their value counterparts (Russell 1000 Value index +7.5% last month; +5.6% ytd). Markets also experienced an increase in breadth as cohorts like small capitalization stocks recovered (the Russell 2000 index has recovered +13% since bottoming in October; +4.2% ytd). Foreign equity markets followed-suit with the MSCI EAFE index rallying +9.3% during the month (+12.9% ytd). The European Stoxx 600 advanced +6.7% (+12.3% ytd). In Asia, China and Japan remained on polar opposite sides of the performance spectrum. The Shanghai composite added +0.4% in November (+0.7% ytd), while Tokyo's Nikkei 225 index leaped +8.5% during the month (+30.8% ytd).

The US bond market saw its biggest monthly rally since 1985, reacting positively to the likelihood that the Federal Reserve has reached the end of its interest rate hiking campaign and the potential for future rate cuts. The US 10-year Treasury Note yield fell to 4.4%, down from mid-October's peak of 5.0%. The Barclays US Aggregate bond index rose +4.5% in November (+1.6% ytd). Similarly, the more equity sensitive high yield index returned +4.6% for the period (+9.4% ytd).

Commodity prices contracted from their October peaks. Despite the ongoing conflict in the Middle East, the price of a barrel of WTI crude oil fell, ending November just shy of \$76 (-6.2% for the month; -5.4% ytd). This was partly due to an increase in US supply and



Source: Bloomberg Markets

OPEC+ members' failure to adhere to production quotas. US natural gas prices dropped -15% in November, on excess supply fears due to an expected economic slowdown, mild weather and high storage levels.

GEOPOLITICS

The Middle East conflict between Israel and Hamas continued, escalating in mid-November when Israeli military advanced on Gaza City's Al Shifa hospital, covering over 20 acres, with some 650 patients still inside. The hospital was purported to sit atop tunnels housing a headquarters for Hamas fighters. Initially Israel uncover only a small collection of weapons but in the following days found the entrance to a concrete-walled tunnel and showed footage of what appeared to be a 55-meter (181-foot) section, 10 meters (33 feet) underground. On November 21, Israel and Hamas announced an agreement to pause fighting, with a big increase in humanitarian, medical and fuel aid to be allowed into Gaza. During the ensuing week-long truce Hamas releases 105 Israeli hostages in return for 240 Palestinian detainees. With most women, and children hostages believed free, the cease-fire collapsed over terms for releasing the remaining 136. As Israel presses its ground-campaign deep into the south of Gaza, the enclave's health ministry says the Palestinian death toll has risen above 15,000.

US President Joe Biden met with China's President, Xi Jinping, at the leader's summit in San Francisco. This was their first meeting in a year. Xi reiterated his determination to unify with Taiwan, but stopped short of

mentioning the potential use of force. He denounced what he called futile American efforts at containing China, but also acknowledged that US tech restrictions had taken a toll, and pressed for their lifting. The Chinese leader commented “the Earth is big enough to accommodate both countries” illustrating his global aspirations. Xi tried to reassure the world that China’s ambitions did not have to lead to conflict with the United States, hoping to inject stability into the volatile bilateral relationship. Biden reaffirmed the United States’ “One China” policy with regard to Taiwan, as well as the belief that any resolution must be peaceful. In their private session, President Biden appealed to Xi to use his influence to try to calm global tensions, particularly to try to pressure Iran not to widen the conflict between Israel and Hamas. The President also pressed Xi to continue to withhold military support for Russia’s invasion of Ukraine. In the aftermath, Biden said the meeting included “some of the most constructive and productive discussions we’ve had.” Nevertheless, he reiterated his view that the Chinese leader was a dictator. In the end, the summit resulted in agreements to curb fentanyl production and restart military-to-military communications.

#### UNITED STATES

US economic data has remained resilient overall, yet there are signs that point to a cooling ahead. Third-quarter GDP growth was adjusted upwards to an annual growth rate of 5.2% versus the 4.9% initial estimate made in October. While that marks a sharp acceleration from the 2.1% growth in this year’s second quarter, it is likely an anomaly. Looking ahead, the Atlanta Fed’s GDPNow model forecasts the current quarter’s GDP will decelerate to an annual rate of 1.2%, in part due to elevated interest rates. Looking ahead to 2024, the Fed’s survey of professional forecasters calls for 1.3% GDP growth, indicative of a soft economic landing. The key variables will likely be jobless claims and credit delinquencies. Retail spending softened in October, suggesting consumers are being more cautious

#### November 2023 Economic Statistics

	Nov-23	Dec-22	Dec-21
Federal Funds Target Rate	5.25 - 5.50%	4.25 - 4.50%	0 - 0.25%
Consumer Confidence Index	102.0	108.3	115.8
Manufacturing PMI Index	46.7%	48.4%	58.7%
Unemployment Rate	3.9% est.	3.5%	3.9%
JPY / USD	148.19	131.11	115.08
USD / EUR	1.0886	1.0702	1.1368
Gold / oz.	\$2,035.75	\$1,824.40	\$1,828.39
Oil (WTI) / bbl	\$75.96	\$80.26	\$75.21

Sources: see disclosure \*

after five months of increased spending. However, record-breaking Black Friday and Cyber Monday shopping numbers indicated the consumer still maintains buying power. On the manufacturing front, economic activity contracted for the 13th consecutive month in November with the PMI registering 46.7%, flat from October. Survey respondents indicated that the economy is slowing, supply issues have been resolved, inventories need to be de-stocked, and that elevated financing costs have dampened demand.

The US Federal Reserve’s preferred gauge for tracking inflation showed that consumer prices continued to rise at a slower pace in October. The Personal Consumption Expenditures Price (PCE) index rose at a 3.0% annual rate, down from 3.4% in September. Excluding volatile food and energy prices, core PCE inflation climbed 3.5% in October versus 3.7% in September. Post the November FOMC meeting, which kept rates unchanged, Chairman Powell offered a status quo message, “[the] committee is moving carefully and is assessing oncoming data to assess the extent to which policy is restrictive enough,” noting that we are still a long way away from the 2% target for inflation. Looking ahead, the market is pricing in a ~60% chance of interest rate cuts at the Fed’s March meeting, rising to 100% by the central bank’s May meeting.

#### EUROPE

The European economy has lost momentum this year, with GDP growth of a mere 0.6% projected. This is against a backdrop of higher cost of living, weak exter-

nal demand, and monetary tightening. Regional industrial production and manufacturing activity remains depressed, mainly due to poor demand of goods from export-oriented Germany and France. However, eurozone Q3 employment growth was robust, rising 0.3% quarter-over-quarter, leaving the unemployment rate at 6%, close to its record low. EU GDP growth is forecast to improve to 1.3% in 2024 and 1.7% in 2025, both below long term trends. Eurostat's flash CPI release for November showed headline and core inflation slowing to two-year lows of 2.4% and 3.6% year-over-year, respectively. Lower energy prices were the major contributor, but within the core print both goods and services inflation decelerated.

The UK also saw a fall in headline and core inflation to a still-hot 4.6% and 5.7% y-o-y, respectively. The BoE's Monetary Policy Committee voiced concerns over services inflation amid still elevated wage growth. There were also signs that economic activity has bottomed, with the flash November services Purchasing Managers' Index moving above the critical 50 mark that distinguishes expansion from contraction.

## ASIA

China macro data was more positive than expected, with retail sales rising 7.6% year-over-year in October. However, the housing market remains a notable drag on growth, and new home sales continued to fall on an annual basis. The People's Bank of China once again injected liquidity into the local financial system and signaled that a new required reserve ratio cut could arrive before year end. However, more fiscal stimulus is likely needed to support consumer sentiment and alleviate deflation headwinds, which the political establishment appears averse to.

## OUTLOOK

The US economy is on a decelerating path, joining Europe and China. This can be firmly attributed to global central bank monetary tightening, in an attempt to ward off inflation, which should be highly effective given the vast sums of debt in the global financial system. The question whether a recession is coming is top of investors minds.

The answer is unclear, but we would argue that economic slowdowns are inevitable and the associated cyclicality is healthy, promoting solid businesses and penalizing poor or overleveraged ones.

Stock markets, which act as discounting mechanisms, are sending mixed but rational signals. The majority of equities are trading significantly below their peaks in terms of price and valuation. This is especially true of profitable small capitalization companies that are more economically sensitive and leveraged (balance sheets of Russell 2000 index constituents hold 2.0x net debt to EBITDA), thus commanding a discounted price-to-earnings multiple of 12.5. Conversely, companies in the S&P 500 (whose average leverage ratio is at an all-time low) trade at 18.8x forward earnings estimates. These large capitalization businesses showed an average earnings gain of 4.7% in Q3, according to FactSet, the first year-over-year earnings increase since 2022's third quarter, heralding the end of the post-Covid profit recession.

Data suggesting that inflation is easing reinforced investors' view that most developed market central banks have finished their monetary tightening cycles. Even if it is too early for interest rate cuts, bonds now offer solid yields and diversification against a disinflationary recession.

As we look ahead to a more normalized interest rate and monetary policy environment, our research indicates that portfolios stand to benefit from holding alternative assets, including hedge funds, commodities and gold. Such exposure should provide diversification and lower market correlation. These assets can be owned in parallel with high quality equities and value-added credit opportunities in order to maximize risk-adjusted portfolio returns. Natural resources and precious metals stand to benefit from cyclical tailwinds stemming from underinvestment and the potential for scarcity and supply shortages, amid geopolitical instability. Hedged strategies should also benefit as liquidity ceases to be the main driver of financial markets. For long-term, growth-oriented, investors, we are seeing opportunities to invest in disruptive technologies in the healthcare, defense, edu-tech and cybersecurity sectors.

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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.