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MARKET INSIGHT

Prime Partners' monthly analysis of global economic and financial market news.

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Investors prefer the glass-half-full option across the board!

So market participants have chosen to enter 2023 putting their doubts behind them. As we commented last month, it seemed to us that excessive pessimism, especially regarding whether inflation could continue to fall or whether we would be able to avoid a sharp recession, prevailed at the end of last year.

A few statistics bringing confirmation, both on growth and on price increases, were therefore sufficient for the general climate in the financial markets to improve drastically. The 7% rise in equities (MSCI world index), driven by emerging stocks (nearly 8%) and above all by the strong rebound in the NASDAQ index (+11%), is the best illustration of this new enthusiasm amongst investors.

Other assets were not left behind, whether bonds or gold; only the US currency continued the decline that had started in the autumn of 2022, symbolising the end of financial markets' doubts.

Looking at this strong rise in the vast majority of financial assets, two reactions spring naturally to mind.
Firstly, there is some relief that the sharp downturns of 2022 are fading, at least in part. Secondly, it is necessary to question whether the recent price recovery can be sustained.

Let's say at the outset that it seems to us that such prices have now factored in all the good news; or to put it another way, the positive revisions in economic and monetary expectations, which are largely justified, have been realised and are reflected in asset prices.

Last month we mentioned that 2023 could be a turning point for the better in the economic and financial cycle. To say the least, market developments of the last few weeks show that investors are now firmly convinced of this. A bit too much, perhaps?
The reopening of the Chinese economy over the next few months is now a given, but the strength of the recovery remains in question; it is clearly a positive factor for the global economic outlook, at a time when the slowdown in US and European growth is expected to continue in the near future.

The decline in inflation has been under way for several months in both Europe and the United States, but certain factors (a particularly vibrant US employment market and a persistently high price index excluding food and energy) show that it would be wrong to consider that the battle has been won conclusively. Jerome Powell's talk of possible disinflation may raise hopes but the process has yet to prove inexorable, even while there are increasing expectations of price rises returning rapidly to the 2% target set by central bankers. As it happens, we are still sceptical that price increases will be able to retreat to such levels, even looking 12 to 18 months ahead.

On the monetary front, greater stability should prevail, at least over the next 12 months.

The US is expected to be the first to stop raising rates (although we have revisited the possibility of a rate hike in May following the very strong January employment figures) and Europe is expected to follow by the summer.
However, we must remain realistic in our expectations of a change of course from the policymakers; in other words, we are still not convinced that key rates will be lowered in 2023, contrary to some investors who have persuaded themselves of this over the past few weeks.

Regarding earnings per share, the current reporting season is by no means disastrous; however, it is worth noting that positive earnings surprises are below their historical average and that the forward guidance provided by companies is cautious. This is scarcely unreasonable in the midst of an economic downturn and considering the challenge of defending historically high margins.

To conclude our global economic overview, we can only be glad to have witnessed a significant shift towards positivity in investor expectations on activity and inflation; on the other hand, we cannot conceal a degree of unease when the sentiment that is now emerging no longer makes allowances for adverse developments, which could be caused either by the economy itself or by an external shock related to the geopolitical situation which remains cloudy, to say the least.
In a similar vein, we should not ignore how much the downturn in commodity prices, led by energy and food, has helped both in the fight against inflation and in supporting global demand in recent months!

Based on this overall analysis of the economic situation, we have kept our investment policy largely unchanged during the month of January.
However, we decided to reduce our overweight position in gold after a 20% rally since early November 2022. We have therefore returned to a neutral weighting on this asset.
In no way does this mean we distrust this precious metal on a medium-term outlook; however, our short-term targets had been reached, at a time when we considered both the decline in US long-term rates and dollar weakness to be excessive in the short term.

On the subject of bonds, the extent and especially the speed of the market rebound limited this month's opportunities to continue our policy of adding to this component in our allocations. From a medium-term perspective, and in view of our economic and monetary scenario, we see no reasons to call into question our recommendation to maintain a moderate overweighting in this asset class.

It still looks advisable to take advantage of periods of weakness to build up positions, particularly in investment grade corporate debt. This choice applies to issues in both dollars and euros.

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Short to medium maturities remain our preference in both our corporate debt recommendations and in US government debt, which we believe is more attractive than its European counterparts.

The decision to hold on to emerging market bonds, which had cost us in 2022, has proved wise in recent weeks, judging by their good performance. Our assumption of further weakness in the US currency over the medium term and our views on monetary policy give these assets an interesting potential that warrants holding them for the next few months. However we do note that recent developments in the Adani case pose a specific source of risk that should not be completely ignored. We will be keeping a close watch on this situation.

The multiple expansion that we have seen in recent weeks, following on from the easing of long rates, has led us to maintain a defensive position on international stock markets. This choice seemed to us to be all the more sound as profit forecasts continue to be revised downwards and the job cuts announced on the other side of the Atlantic, particularly in the technology sector, confirm the operational difficulties faced by these innovative companies.

Overall, the combination of uncertain fundamentals and price levels that do not seem particularly attractive in the short term has encouraged us to maintain our relatively defensive equity positioning. As such, we remain underweight in this asset class. The fact that the stock market rally was further fuelled by extensive short covering supported our conviction that now is not the time to chase the rising market at any cost.

We are therefore waiting for better opportunities to reposition ourselves on the stock markets; in that regard, the improvement of technical configurations on the indices has led us to make an upward revision in our short-term fluctuation margins (3800-4200). Any slight attempt to test the low end of this range could lead us to increase the equity weighting in our portfolios.

Apart from the effects brought about by the behaviour of the various markets, we have not altered our regional exposure. We feel that the outperformance of emerging markets, riding the slipstream of expectations of China's economic reopening, should be sustainable in the medium term. Beside a possible consolidation of recent gains, we maintain a positive bias on this segment of international equities over that time horizon. This option appears to us all the more justified as our negative views on the dollar have not changed.

Although small- and mid-cap stocks had a particularly tough year in 2022, we continue to include them in our allocations. The prospect of a likely halt in the process of interest rate hikes by the summer has led us to maintain the positions we hold in our portfolios. If it is confirmed that the long-term cost of capital is capable of finding a new and lasting equilibrium, we might strengthen this tactical option in the portfolios.

In conclusion, investors' return to greater calm in January is a welcome development for financial assets, which suffered erratic fluctuations in 2022. However, they have largely discounted the positive reappraisal of the economic situation made by market participants since the beginning of January. The performance recorded by our allocations at the end of the month was satisfactory, despite our defensive positioning during the period under review.

We remain committed to increasing our exposure to risk assets, but not at any cost. We have cash to redeploy, we just have to get the timing right. This remains our main challenge for the months to come.

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