Global Markets Minesweeper December 22, 2023

Global Markets Analysis
INVESTMENT PORTFOLIOS
MANAGEMENT DIVISION

The current year concludes with moderate economic activity, mild government bond yields and higher equity markets. The Fed and the ECB will probably keep their rates stable for a while, before mildly cutting rates.

How the narrative in markets shifted from overly cautious at the start of the year to quite risk-on at the end of the year?

Since the fourth quarter of 2022 and at the start of the current year, it had become evident that, although **high inflation was a significant worry from macroeconomic point of view, the impact on profitability was modest. A mild earnings recession happened,** but the percentage drop of earnings was single digit, less significant compared to the pandemic earnings recession and to the 2008-2009 earnings recession. **Nominal growth has been sufficient to support company revenues and earnings.** The S&P Global 1200 equity index had already risen by 20% in the period from October 12, 2022 until February 2, 2023. Around that point of time, the earnings 12-month forward estimate bottomed and started recovering.

The drop of earnings 12-month forward estimate from June 2022 until February 2023 was mild at around -5% and the gradual recovery of forward earnings estimate since February was strong enough, **so that the EPS 12-month forward estimate reached new historic high in November 2023**. The 12-month forward estimate of global **technology** is currently by 18% higher than at the start of the year. It has year to date total return of 53%. Furthermore, the stress that was evident in small-medium size US banks in the first quarter of the year, did not spread to globally systemically important financials which are sound. The S&P Global 1200 **financials** index has year to date total return of 14% and attractive P/E 12-month forward ratio at 11.5 times.

The **non-farm payrolls**, the ISM **services** and **manufacturing** indexes and **GDP** in the **US,** are currently at levels which indicate mild, slightly below average growth. These conditions are supportive for sentiment in main government bond and equity markets. **Inflation** is not yet mild enough but has also moderated.

What the corrective intervals in equities during the year suggest?
The S&P Global 1200 index had two mild corrective intervals after the initial 20% rise (2/2/23) from the bottom of October 12, 2022. The first was -7.1% (2/2-15/3) and the second was -10.3% (31/7-27/10). However, it recovered from both and currently has year to date total return of 22% and annualized 3-year total return of 8%. **This suggests that the corrections of 2023 were "healthy", serving as "buy into the dips" cases,** inside a probable mid-term upwards trend started in October 2022.

The weeks ahead

In the **US**, the Dallas Fed manufacturing index for December and S&P CoreLogic CS house price index for October are expected on December 26.

The initial jobless claims will be released on December 28. The most recent reading was below the 52-week average, indicating resiliency of employment.

In the first week of the next year, the ISM manufacturing (3/1), ISM services and non-farm payrolls (5/1) will be released.

In the **Eurozone**, there are no major economic announcements in the last week of the year.

The services PMI index for December is expected on January 4 and the inflation estimate for December will be released on January 5.

In **Japan,** industrial production (28/12) may have dropped in November, highlighting weaker activity and the need for the Bank of Japan to maintain supportive policy for some time. In **China,** the Caixin manufacturing PMI is expected on January 2 and the services PMI on January 4.

"Quote of the Week"

The President of the N. York Fed said that "it is premature to think about rate cuts".

Why the US 10-year government yield has been important for equity sentiment during the year?

The **US 10-year bond yield increased** at 3.9%-4.0% in February and this almost **coincided with the first correction** of the S&P Global 1200 **equity** index. Then, the **yield moderated** to 3.3% in mid-March and almost in parallel the **global equity index bottomed and started rising**. As the upwards trend of equities has been strengthening during the year, there was an interval that rising equities coincided with high bond yield, mainly during July. At the end of July, the S&P Global 1200 index increased at a high since April 2022 and the US 10-year yield was almost 4%. But as the **US 10-year yield increased** above 4% in August and up to 5% in late October, the **second correction of the global equity** index happened. The **global equity index started rising again from late October, in parallel with the moderation of the US 10-year yield** from 5% to the current 3.9%. While the earnings 12-month forward estimate started rising since late February, this increase has been gradual and so the relative **attractiveness of equities** vs bonds needs to be **supported by mild US 10-year yield.**

Which are the implications for the next year?

As the Fed is expected to cut rates probably in the second half of 2024 and as **growth and inflation may be lower than currently**, the **US 10-year bond yield may continue downwards** to the initial support area of 3.7%. Short-term reactions for the yield to near 4.20% cannot be excluded. **The downwards mid-term trend for the US 10-year yield will probably support the upwards mid-term trend for global equity index, along with the continuation of the rise of earnings** forward estimate.

The **German** 10-year yield dropped at nine-month low (1.94%). In parallel, the Stoxx 50 Eurozone **equity** index increased at a high since 2007 and the Stoxx 600 Europe at a high since February 2022. Both have mild P/E 12-month forward ratios at 12.5-13 times. If **German bond yields** remain low, as the **ECB** has paused and may cut rates, **equity** sentiment is expected to be supported.

Market sentiment shifted from overly cautious at the start of the year to quite risk-on at the end of the year. Overall, ten out of eleven S&P Global 1200 **sector** indexes have positive total return year to date. The technology, communications, consumer discretionary have higher return than the index. Recession cannot be excluded in the Eurozone. However, the "wealth effect" from positive mark to market from investments during 2023 along with some rate cuts by the **Fed** and the **ECB** may be enough to support mild below average growth in main economies during next year. **The main risk is that a low probability-high impact incident happens, perhaps related to geopolitics, which triggers sudden turnaround of markets sentiment to risk-off.** Aggressive **sectors** such as technology, financials, energy may be supported by the current market environment. Defensives such as utilities can be a hedge to sudden deterioration of sentiment.

The MSCI **emerging** equity index has risen at four-month high, as **US bond yields** have moderated. In **Greece**, the ASE index is also at four-month high. Its P/E 12-month forward ratio is attractive (8 times). In fx, the **EUR/USD** is in range ($1.08-$1.12). **German-US** yield differentials may imply that the EUR/USD will be on average closer to the upper bound of the range, rather than to the lower bound of the range.

The US 10-year bond yield has moderated, supporting equity market sentiment.

Source: Bloomberg

Global Markets Minesweeper

Event Risk Calendar, December 26, 2023 - January 5, 2024

		Tuesday 26/12				
Date Time	**Country**	**Event**	**Period**	**Survey**	**Prior**	
26/12 01:30	JN	Jobless Rate	Nov	2.5%	2.5%	
26/12 15:30	US	Chicago Fed Nat Activity Index	Nov		-0.49	
26/12 16:00	US	S&P CoreLogic CS (MoM)	Oct	0.60%	0.67%	
26/12 17:30	US	Dallas Fed Manuf. Activity	Dec		-19.9	
		Wednesday 27/12				
Date Time	Country	Event	Period	Survey	Prior	
27/12 17:00	US	Richmond Fed Manuf. index	Dec		-5	
		Thursday 28/12				
Date Time	**Country**	**Event**	**Period**	**Survey**	**Prior**	
28/12 01:50	JN	Retail Sales YoY	Nov	5.0%	4.1%	
28/12 01:50	JN	Industrial Production MoM	Nov P	-1.5%	1.3%	
28/12 01:50	JN	Industrial Production YoY	Nov P	-2.0%	1.1%	
28/12 15:30	US	Advance Trade Balance	Nov	-$89.5b	-$89.8b	
28/12 15:30	US	Initial Jobless Claims	Dec 23		205k	
28/12 17:00	US	Pending Home Sales MoM	Nov	1.0%	-1.5%	
		Friday 29/12				
Date Time	**Country**	**Event**	**Period**	**Survey**	**Prior**	
12/29 10:00	SZ	KOF Leading Indicator	Dec	97.0	96.7	
12/29 16:45	US	MNI Chicago PMI	Dec	50.0	55.8	
		Tuesday 2/1				
Date Time	**Country**	**Event**	**Period**	**Survey**	**Prior**	
2/1 03:45	CH	Caixin China PMI Mfg	Dec		50.7	
2/1 11:00	EC	M3 Money Supply YoY	Nov	-0.7%	-1.0%	
2/1 11:00	EC	Eurozone Manufacturing PMI	Dec F	44.2	44.2	
		Wednesday 3/1				
Date Time	**Country**	**Event**	**Period**	**Survey**	**Prior**	
3/1 17:00	US	ISM Manufacturing	Dec	47.2	46.7	
3/1 17:00	US	ISM New Orders	Dec		48.3	
3/1 17:00	US	ISM employment	Dec		45.8	
Eco Event	US	Fed's minutes (21:00)				

Date Time	Country	Event	Period	Survey	Prior	
		Thursday 4/1				
Date Time	**Country**	**Event**	**Period**	**Survey**	**Prior**	
4/1 03:45	CH	Caixin China PMI Services	Dec		51.5	
4/1 11:00	EC	Eurozone Services PMI	Dec F	48.1	48.1	
4/1 15:15	US	ADP Employment (MoM)	Dec	115k	103k	
		Friday 5/1				
Date Time	**Country**	**Event**	**Period**	**Survey**	**Prior**	
5/1 12:00	EC	CPI Estimate YoY	Dec	2.9%	2.4%	
5/1 12:00	EC	CPI Core YoY	Dec P	3.4%	3.6%	
5/1 15:30	US	Nonfarm Payrolls (MoM)	Dec	168k	199k	
5/1 15:30	US	Unemployment Rate	Dec	3.8%	3.7%	
5/1 15:30	US	Average Earnings YoY	Dec	3.9%	4.0%	
5/1 17:00	US	ISM Services Index	Dec	52.6	52.7	

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