Haven Global Partners, LLC.
Market Outlook: 4Q 2023

2023: It's Been a Wild Ride, But Where to From Here?

One year ago, market participants were anticipating a recession. Inflation had reared its ugly head after several decades of dormancy and caused the world's most important Central Bank (the Federal Reserve and the European Central Bank) to raise policy rates dramatically. Higher rates had driven down stock prices the world over in anticipation of the economic slowdown they were meant to bring about. At the end of 2022 ninety percent of the CEO's polled expected a recession and were reining in their growth plans in hopes of getting ahead of it. Yet, one of the most widely anticipated recessions in the history of the world never came to be. When strategists attempted to surmise what derailed the downturn, the most common explanation was that the global economy may have changed or evolved, at least, to the point where interest rates are not quite as important as they once were. There were some industries that were devastated by the artificial increase in the price of money. Think of the classic interest rate sensitive parts of the economy, real estate was the prime example. Commercial real estate was particularly hard hit as the combination of a negative impact to demand for office space from the COVID-induced work-from-home trend and the higher cost of (re-)financing that the interest rate increases ushered in united to pulverize valuations. In the end, not only did the recession not materialize but stocks reversed course from 2022 and rallied, spectacularly! But how? Why?

One year ago, in this column we ventured that interest rates were reclaiming their prominence from years past, and that has proven to be correct. The MSCI ACWI ex-US index was in negative territory for the year as late as the end of October of 2023, when a fierce rally drove non-US stocks 15% higher in the year's final two months. Again, how did this happen? What forces drove stocks so furiously? Well, inflation appeared to be under control in the final quarter as it had come down dramatically in the US and in Europe. So much so, that in fact, interest rate cuts are now the watchword in Central Banking circles. Just as the warnings from hawkish Central Bank were getting us used to the idea of higher-for-longer interest rates, the yield on the United States Treasury's benchmark 10-year note plunged from 5% in late October to 3.9% at the end of the year.

As is (almost) always the case in such matters, things may have gotten ahead of themselves. Less experienced market participants who may have gotten a little too comfortable with extremely easy money in the form of super low interest rates have been very keen to buy stocks of late as the end of rate hikes in conjunction with talk of interest rate cuts have them anticipating a return to the post Global Financial Crisis period which is unlikely to come back. While interest rates may not return to super low levels (like 2-3% for the US 10-year), they may well hover at something closer to average levels (~5% for the US 10-year). With that as a backdrop, and after the topsy-turvy, flip-flop of markets going down -14% in 2018 and then up 13% p.a. from 2019-2021 to only go back down -16% in 2022 and then up again 15% in 2023 where should market participants be looking to invest in the coming year?

The end of interest rate hikes from the Federal Reserve will likely cool global demand for the dollar. The US dollar rallied 28% while the Fed was raising rates. That is over now, and lower demand for the US dollar will have significant impact on markets. Off the bat, Emerging Markets and commodities usually do well during periods of US dollar decline. In fact, Central bank rate cuts will shape the path of global currencies this year. But the most salient issue facing global equity markets going forward, may well be the Russia-Ukraine war. Because of Russia's unprovoked attempted invasion, there are now countries which because they have access to their own oil, enjoy energy security (Brazil, Canada, the US) and many other countries (most of them in Europe) which do not.

Much was made of how well European countries, especially Germany, did keeping their citizens warm last winter without the aid of cheap Russian oil. That does not address the fact that power prices in Germany have gone up by more than half. This has negatively impacted corporations' ability to operate almost any type of manufacturing plant at such prices. Germany is considering reopening coal mines because of its intention to shut down nuclear power plants and because offshore wind isn't dependable enough yet. European manufacturing will face challenges until the war is resolved. European defense manufacturers have benefitted significantly from that same war. Will that continue? Can it for very much longer?

Speaking of things that have been working, the mad crush in demand for weight-loss drugs has become a global phenomenon. Can this trend continue; will it? If it does grow, and more people lose weight while eating less will that, can that actually mean that food companies will sell less food? Must they then be less profitable? Does this mean that the recent fall in prices for Consumer Staples stocks does not represent a buying opportunity? Japan's Capital Improvement Plans for stocks, namely that companies which are not trading above book value be named and shamed into doing a better job and improve returns to their shareholders has received a significant amount of press lately, as have the allegations accusing the Abe faction of the LDP of pocketing money from fundraisers. In light of these two very different stories, should one be looking to go overweight Japanese stocks, or underweight?

Addressing the concerns associated with supply chains and the issues of reshoring, near-shoring, and friend-shoring appear to be complex and very expensive, and just like any other issue involving capital markets there will be winners and losers. Nearshoring could provide a much-needed economic boost to Mexico and help consolidate the country's position as an international logistics hub. And as long as we have mentioned Mexico, let us stay on that topic and address the issue of whether after an extended period of underperformance Emerging Markets stocks can finally catch-up to their developed peers. As we already mentioned Emerging Markets will get a much-needed catalyst from lower intertest rates. The stocks are very cheap compared to historical valuations, but that has never been enough to drive capital, not the smart money, anyway.

As it ever has, our process calls for a focus on Quality stocks. We maintain that objective irrespective of market conditions. Because to our way of thinking, a strategy of owning Quality companies which are valued reasonably leads to investment success. We intend to continue to practice our process, confident in its history of success.