Haven Global Partners, LLC.
Market Outlook: January 2023

And the Winner is…

That famous phrase in the title will be spoken many times at the Academy Awards to be held in March as the coveted trophies are presented. By then, we may also know whether market investors or the world's central bankers have prevailed in their battle currently taking place in global equity markets. Volatility in the world's stock markets was on full display in 2022. Think back first to the shock of COVID-19 in March of 2020, and how it drove frightened investors to the sidelines. The pandemic resulted in one of the fastest bear markets in history as global stocks lost ~30% in a month. From that point until the beginning of 2022, global equities basically doubled in price. US tech stocks led the way as the NASDAQ was up 130%, while cyclical plays like Japan's Nikkei lagged with only a 70% return in US dollar terms. From that peak some correction could have been expected, although it was not widely predicted. Worries over inflation caused central bankers all over the world to raise policy rates. The US Fed did, the European Central Bank followed suit as did the Bank of England. Even in Japan, an economy which has been plagued recently with more worries about deflation than inflation, policy makers backed off of a pledge to keep its interest rates low.

In the first quarter of this year the spread of tightening monetary policy seemed to surprise equity investors, and some of them chose to sell stocks quite aggressively! A battle ensued between the bears who had begun this year worried that the good news couldn't last, and the inherently upbeat bull crowd which saw reasons to believe the inflation scare was merely that. And who could blame the bulls, they had been right to buy the COVID-19 dip, hadn't they? The first quarter ended with global stocks showing single digit losses, but the second quarter brought the deluge. A massive mid-year selloff in stocks was the result of a significant increase in interest rates. At the onset of the pandemic in February of 2020 the US Treasury 10-year yield had been comfortably anchored below 1.5%, and it stayed there for two years. However, as this year progressed and the aforementioned inflation concerns caused central bankers to raise policy rates, the yield on the US Treasury 10-year note doubled from less than 2% in March to more than 4% by October. As October represented the high for interest rates, so too it brought an end to the stock market selloff. Stocks were down 25% to 30% YTD at their October lows, but they rebounded in the fourth quarter as global stock investors began to believe that the US Central Bank had done its job. The Employment Report for December was a Goldilocks moment, that seemed to prove that point. The report showed that unemployment was low enough to imply healthy economic growth, while wages were growing but the increases were at a level that ought not worry inflation hawks at the Fed too much. This resulted in a recovery by global stocks during the fourth quarter in which, for a change, non-US stock returns led the way. Especially those in Europe which returned 20% in dollar terms between September and year end. The S&P achieved a 7% return while the NASDAQ laden as it is with tech stocks could only manage a -0.4% return while Japan with its cyclical stocks now expected to benefit from a potential end to rate hikes and perhaps even a return to growth was able to show an 11% increase in dollar terms.

So, what next?

What should investors expect to be confronted with in 2023? Will there be a recession? If so, how bad will it be? Where should investors look for clues as to what will happen?

Consumer sentiment and how much households spend will be the key indicator of how the global economy fares in the next year. After government policies all over the world were geared towards helping households survive the pandemic, families are in the strongest financial position they have been in for years. Staying home to avoid COVID-19 meant spending less money. That fact combined with the government largesse: whether it consisted of direct payments, deferrals of loan re-payments, rent support or free vaccine shots, means that in order to disrupt or reverse the current level of household spending, central banks may have to raise rates higher and keep them higher for longer than market participants currently calculate. If that does happen,

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government attempts to slow their economies with rate hikes will have to be aimed directly at reducing household spending and that would mean increasing unemployment. Families in strong financial shape may find themselves pitted against policies of their own governments designed to force them to reign in their spending. Thus, 2023 could bring another colossal confrontation between major forces with serious implications for equity investors. Stay tuned.

There are other areas on which investors should focus in order to stay on top of market developments in 2023. Tight credit conditions normally precede a recession. While the Fed and other central banks have raised policy rates and the yield curve is inverted in some places, there are several other interest rate related factors that normally accompany or even precede and sometimes predict economic slowdowns that have not appeared yet. A significant reduction in demand for credit and therefore credit growth is to be expected in an economic slowdown. That just isn't happening now. Banks are lending freely and the higher interest rates do not appear to be deterring borrowers neither on the corporate nor consumer side. This would be expected to change significantly in the event of a slowdown.

Xi Jinping's government abruptly ended the country's "zero-Covid" policy at the beginning of this year, and in a near perfect illustration of the Law of Unintended Consequences, some Chinese citizens stayed home more after the lockdown than they had during the lockdowns. Apparently, the people are afraid of the virus. Even though they resented being told they couldn't go outside, they knew they shouldn't have gone outside because thus far this year precious few of them are going outside. China is the second biggest economy in the world and has been the fastest growing big economy in the world. If Chinese growth continues to surprise to the downside, there will be negative implications for global growth scenarios.

So, watch the employment statistics, follow developments in the credit markets very closely as well as Chinese growth figures. And as a general observation there remain excesses in the market; a full year's correction has still left some stocks trading at high multiples, particularly those in industries expected to produce above average earnings growth. As always, our process calls for us to focus on Quality stocks. We maintain that objective irrespective of market conditions. That is because in our experience a strategy of owning Quality companies which are valued at reasonable prices leads to investment success. As global investors head into a New Year with a litany of questions yet to be answered, we intend to continue to practice our process, confident in its history of success.

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