MONTHLY MARKET
Commentary

Albemarle
STREET PARTNERS

February 2023

Hopeful beginnings

The gloom and doom that pervaded most of 2022 has faded in recent months.

This improvement is well-justified. The spectre of runaway inflation has disappeared and month by month the data has confirmed that the tough talk and interest rate hikes enacted by Central Banks has driven it away.

We believe that a real risk of a global recession as a consequence of this tightening still exists, but in recent weeks the economic data has been somewhat better than had been expected. This reduction of this risk has also helped markets.

Inflation continues to ebb

As we approach the one-year anniversary of the start of the Ukraine war, year over year comparisons of commodity prices will turn sharply negative. Market expectations imply inflation to fall to 2% in the US by mid-year. Natural gas prices in Europe are already down 80% from their peak.

Services inflation, the last bastion of inflationist, has stabilized and there are no signs of an impending wage price spiral.

For the first time on the 1st of February, Federal Reserve chairman Jerome Powell acknowledged that conditions have meaningfully improved. Although US interest rates were still raised by 0.25%, this marked a slowdown of increases and he noted that there was now uncertainty about how many more rises are needed. We believe there may well be just one more rise before the Federal Reserve pauses its efforts and waits to see how significantly economic growth is affected.

Here in the United Kingdom it may take a little longer. For this reason the Bank of England raised interest rates by 0.5% again on the 2nd of February. We believe they too will have one further rise to go. However, an end is in sight.

February 2023

Economic activity slowing but not collapsing

Forward-looking indicators of economic activity have continued to weaken in the last month across the developed world, but less than had been feared. Manufacturing and services surveys show a slowdown in consumer spending on both sides of the Atlantic.

The negative backdrop for consumer spending has been helped by the strength of the labour market and robust year on year wage growth. Both Europe and the US recorded positive GDP growth in the fourth quarter. Even in the UK, where cost of living pressures are fairly acute, large retailers noted a pickup in revenue growth during the festive period.

Our base case for this year remains a recession. US fourth quarter earnings are trending down 5% on 10% revenue growth. Revenue growth is expected to slow to 0% by the end of the second quarter when earnings are expected to bottom. However, this does not mean it will be a severe recession. We should remember that we have in the past 15 years lived through two of the worst recessions ever after the Global Financial Crisis and during the Covid-19 pandemic. However, this is not typical and there is no reason to believe the coming recession will follow this pattern.

China – the year of the rabbit

Additional positive news in recent weeks comes from China where the Government has relented on its zero COVID stance and will allow a complete and rapid re-opening of its economy. The news has caused a sharp rally in local stocks as investors look to take advantage of a resurgence in consumer spending. China's economy faces many challenges in the near term and the removal of COVID restrictions will enable a shift away from infrastructure dependent growth.

Within our portfolios we are treating the improving conditions with a real but also very rational sense of optimism. We know that opportunity is to be embraced but only to the extent that our investors are willing to accept the risks that come with that opportunity.

Our portfolios are gradually turning into a market recovery by beginning to buy bonds which now offer high expected returns as well as increasing our holdings in Europe and Asia.

We know though that the world is an uncertain place. We are not in the business of predicting an uncertain future. Rather we plan carefully to cope with different scenarios and build resilience into portfolios to cope with that uncertainty.

2023 is the year of the rabbit in China. The rabbit symbolises hope and good fortune, something we could all do with this year.