# MONTHLY MARKET Commentary

*March 2023*

Albemarle STREET PARTNERS

## You can't have your cake and eat it too:

March 2023

The last few weeks have unearthed a potential downside to the unexpected strength in the global economy. 2023 started with a plethora of positive economic data. European retail sales were better than expected, the US economy created 517,000 new jobs in January and Chinese industrial activity rebounded.

All the while, the main driver of investor anxiety, inflation, appeared to be in rapid decline. Markets started to price in peak monetary tightening and a benign recession for corporate profits. Risk assets (equities, high yield bonds and commodities) buoyed by high expected returns enjoyed their best start to a year since 2019.

Unfortunately, January's inflation readings have scuppered hopes of the perfect landing investors wanted. While the base affect for inflation (the prior year price for comparison) creates meaningful downside pressure on inflation, month to month inconsistencies in the data can unsettle risk appetite.

Peak interest rate forecasts for the US have moved from 5% to 5.5% in recent weeks. This change creates some additional risk for cyclical assets and increases the probability that the Federal Reserve keeps policy tight for a protracted period.

Our investment process is data dependent and built on the direction of inflation and bond yields. January's data is material but it fails to change the direction of both these variables. We expect inflation to continue to fall, but a sharper decline in bond yields may need to be reassessed. The Fed has set a high bar for rate cuts and we may have to wait till the end of the year for there to be any easing in monetary conditions.

In the meantime, earnings, a key supporting factor for equity markets may start to wane. Fourth quarter earnings from the US were down 5% despite mid-single digit rising revenue growth. Analysts expect revenues to start to fall from the second quarter but margins to remain resilient. While this assessment is rooted in detailed bottom-up forecasts, they fly in the face of conventional wisdom. We are not forecasting a severe economic recession but see a risk to profit expectations in 2023.

## Conclusion:

As we entered 2023, we saw signs that the tide may be turning. We increased diversification in portfolios by allocating to Asia, Europe, and parts of the fixed income market. These steps were purposefully modest as we envisaged a bumpy journey. We removed undue complexity in our asset allocation this year and will look to embrace asset classes with higher than average expected returns as the year progresses. This includes parts of the fixed income market and UK mid-cap stocks. As always, we will be patient and measured in our approach.