Market View

The year has started positively for global equity markets. This may seem at odds with the generally negative news flow from the mainstream media, but it is typical market behaviour. Investment markets always work at least 12 months ahead of the general economy and for the markets the data is actually improving. Inflation continues to fall, with deflation last month in both the US and UK; Europe has plenty of gas, removing the recession risk and China is going back to work despite the sad news from Covid-19. This month we also had an admission from the chief architect of the market's decline, Fed Chairman Powell, that "we can now say I think for the first time that the disinflationary process has started." So the background compared to this time last year when Russia invaded Ukraine has changed dramatically. Throughout this period despite all the "noise" and "nervousness" markets have simply moved in accordance with historic patterns. Is it over? It's too early to know and there will be plenty of "walls of fear and worry" before we can say with any confidence that a new Bull market has started. There are just too many commentators still calling for a collapse in corporate earnings and a severe recession to ignore. They are not guessing, but using tried and tested economic models that indicate that a move down in economic activity is a high probability. However, there is a problem, all these models have never been tested in a post-pandemic world. In essence everyone is "flying blind". January also saw the return of normal broad based market behaviour from the "odd" commodity based one of 2022.

Where are we in the Cycle? (Source: Barclays)

This chart shows 5 years of an economic cycle, on average they last 7 years the last one was over 10 years. Each mark represents either a positive or a negative 2 month period. The first part is the classic 18 month Bear phase, which we are now in, the negative returns are concentrated here. Once we get through it, then the Bull phase of consistent positive returns begins. We seem to have bounced exactly as per the chart i.e. at the 20% timing point and could now be at the first red circle. However, could we be at the second Red circle? Only time will tell and whilst a pullback from here is widely expected, we need to be wary, as markets rarely do what they are expected to. This is why it always important to take a long term view, a pull back from here for a long term investors is almost irrelevant and no-one wants to miss the super profitable "whoosh".

What does the data tell us?

It depends which set is being analysed and the interpretation of it. Bar another Ukrainian inspired commodity shock, inflation is falling and that is a positive for markets. This so far has allowed the US Federal Reserve Bank to start slowing the rate of change in interest rates. They are still going up, but now by 0.25% increments rather than 0.5%. Not yet a positive for markets but becoming less of a headwind. The key element now is corporate earnings and much here depends on the unemployment rate. No job losses means no loan or mortgage defaults, it also means companies aren't in distress. This is why the US Jobs data is so confusing. There are clearly redundancies taking place in the US, especially in Tech companies, but as the blue line on this chart shows it is still at a low level as is the US unemployment rate.

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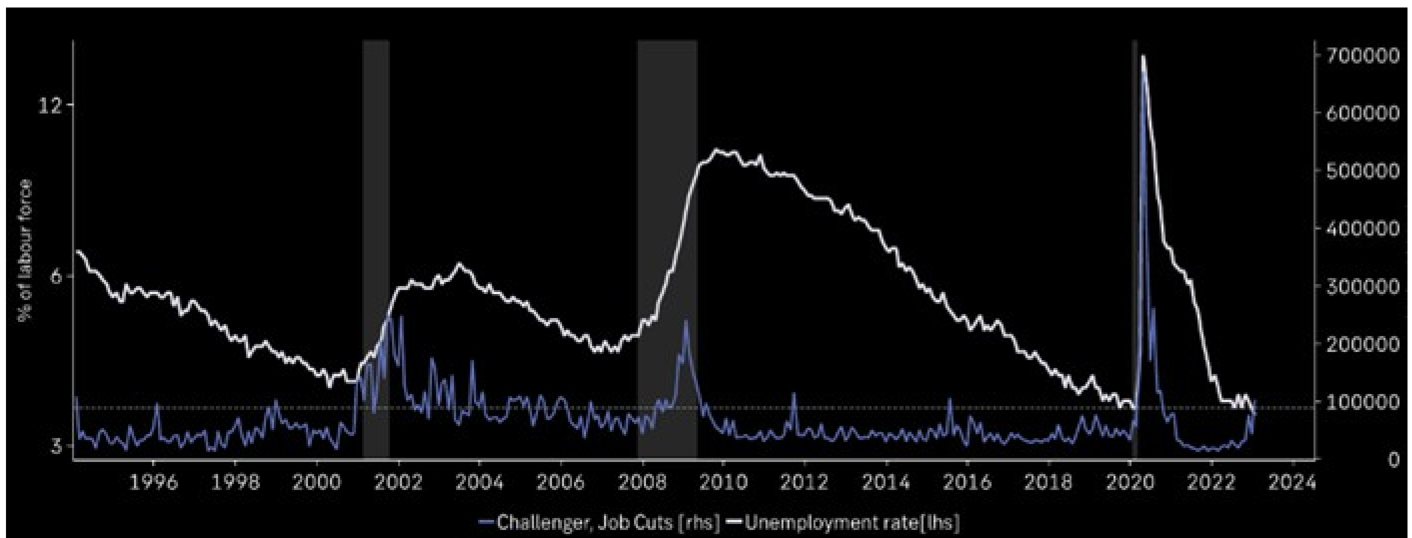

Is this just a timing issue, is the data slow to update and does not reflect the reality? Or is there something fundamentally different in the post-Covid 19 employment market? Another data set which monitors Job Openings is still showing record demand for new employees, this is common not just in the US but in the UK as well. Can there be a recession without high unemployment? Companies are clearly "hoarding" staff and thus it is, so far, different this time. Its seems for now, as long as inflation stays low, it will be very difficult for the Fed to force unemployment up, especially given that it's window for doing so before the US Presidential Election is rapidly closing. Inflation remains the key to this market.

Artificial Intelligence

Microsoft's commitment of $10bn to ChatGPT has set the Artificial Intelligence (AI) investment world alight. First launched late last year, ChatGPT has become an online sensation because of its ability to hold natural conversations and also to generate speeches, songs and essays etc. In the most basic terms, ChatGPT is a conversational AI-powered chatbot designed to answer questions and respond to queries in text form in a way that sounds natural and human. Built by US firm OpenAI, it uses information from the internet to carry out requests and has been trained for back-and-forth conversations. It is capable of understanding follow-up questions as well as admitting its own mistakes and limitations. This has the potential to transform many service based roles for many professions. Like most new technologies such as the Metaverse it promises a lot, but often these promises take decades to come true. For many businesses there are clear cost saving opportunities in customer service and it is perhaps here that we will see this new technology adopted first. With staff hard to get, the use of AI, even in its most basic form, maybe very tempting for many companies.

Markets

Even though the start of the year has been very positive for global equity markets commentators remain very divided as to the outlook for the rest of the year. For example, Goldman Sachs has reduced the probability of a US recession to 25% whereas another major Wall St. investment bank Morgan Stanley has reiterated its long held view that a recession will hit US company profits by 20% to 30% this year and thus share prices need to fall to reflect this fact. We shall have to wait and see who is right. As investors it doesn't actually matter, this all remains just "noise" around the long term trend. Late 2023 sees the start of the US Presidential Election process and politicians, as ever, will do what they need to do to get re-elected. The Fed is in control of markets for now, however, as we get closer to Thanksgiving 2023 the White House will take command. In the meantime we have to wait on the data and in particular the US inflation statistics. Low CPI/PPI numbers with low unemployment would confuse both the Fed and the markets, there is thus a risk that Chairman Powell will keep talking up US interest rates. Nevertheless, this is all a typical of the "messy" guessing game of when will the last upward move in interest rates be? The old adage of "so goes January, so goes the rest of year" does depend on this debate.

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