Market review December 2023

What a month November turned out to be! To say the least, investors looked at the glass half full and interpreted the recently published economic statistics positively. The revised increase in US gross domestic product (GDP) for the third quarter, accompanied by a faster-than-expected fall in inflation in Germany, helped to reinforce the prevailing optimism. The "Goldilocks" scenario, characterized by a steady and gradual fall in inflation, which in turn leads to a reduction in interest rates, has given rise to euphoria among investors. Plus, as we saw between Black Friday and Cyber Monday, household consumption is not weakening and, despite the abysmal public deficits, government spending remains buoyant. This combination of positive news fueled the 'soft landing' scenario and triggered a short squeeze on equities that many bears will remember. Most Western indices gained between 7 and 10% over the month. Even the Nikkei, which covers the main Japanese equities, joined in the party, gaining 8.5% as the yen strengthened. For a country as heavily dependent on its exports like Japan, it is unusual to see a rise in equities while its currency appreciates, but this can happen over a short period, especially as the Japanese currency has fallen by more than 11% against the greenback since the start of the year. With the Bank of Japan (BoJ) becoming less accommodative, we can imagine that the yen will rise again next year, which could weigh on equities in the land of the rising sun, or so many strategists expect. As far as we are concerned, our exposure to Japanese equities is relatively low, and we are keeping it that way for the time being.

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It is interesting to note that non-profitable companies strongly outperformed the indices last month, a perfect illustration of short-covering in a bear market rally. Indeed, the Goldman Sachs index of non-profitable technology companies jumped by more than 18% in November, almost double that of the other indices. Investors therefore seem to have rushed into heavily oversold stocks with a view to making a short-term profit, an attitude more akin to speculation than investment.
On the interest rate front, the fall continued across the curve. The US 10-year yield fell from 4.93% to 4.27%, an uncharacteristic monthly contraction of more than 65 basis points. Its German counterpart followed the same trend, dropping 40 basis points to 2.40%. This sharp downward movement caused the yield differential between the 2-year and 10-year yields to plummet. Credit spreads remained relatively stable. In commodities, despite the fact that Russia and Saudi Arabia maintained their production cuts, oil fell by 6.25% following an already marked fall of over 10% in October. Conversely, gold, which is closing in on its all-time high of August 2020, did well, gaining 2.65% and closing above its resistance of $2,000 per ounce. In a less favorable environment for the greenback, the yellow metal should continue to be sought after in the coming months, especially as various central banks such like the PBOC continue to accumulate gold in their reserves.

Market trends to end November 2023

	Equities in Local Currencies							
End of November	MSCI World	S&P 500	EuroStoxx	CAC	Spain	Switzerland	MSCI EM	CSI 300
Perf 1 Month	9.21%	8.92%	7.91%	6.17%	11.54%	4.46%	7.86%	-2.14%
Perf 3 Month	1.26%	1.33%	1.99%	-0.08%	5.81%	-2.44%	0.69%	-7.15%
Perf YTD	16.17%	18.97%	15.52%	12.93%	22.23%	1.16%	3.21%	-9.70%

	Commodities				Currencies vs EUR			
End of November	WTI Oil	Brent Oil	Gold	Copper	USD	JPY	GBP	CHF
Perf 1 Month	-6.25%	-5.24%	2.65%	4.36%	-2.88%	-0.59%	0.91%	1.04%
Perf 3 Month	-9.17%	-4.64%	4.96%	0.50%	-0.41%	-2.20%	-0.80%	0.52%
Perf YTD	-5.36%	-3.59%	11.64%	1.10%	-1.68%	-12.99%	2.65%	3.84%

	Bloomberg Indices Bonds Total returns							
End of November	Global Aggregate	US Aggregate	Euro Aggregate	US 10 Year Treasury	German 10 Year Bund	Global Credit	Global High Yield	Emerging Sovereign $
Perf 1 Month	5.04%	4.53%	2.72%	4.54%	6.16%	5.50%	5.36%	5.30%
Perf 3 Month	0.76%	0.26%	0.98%	-0.65%	-0.77%	1.48%	2.70%	1.38%
Perf YTD	1.50%	1.64%	3.74%	-0.44%	0.75%	4.84%	9.63%	4.69%

Source: Bloomberg 30/11/23.

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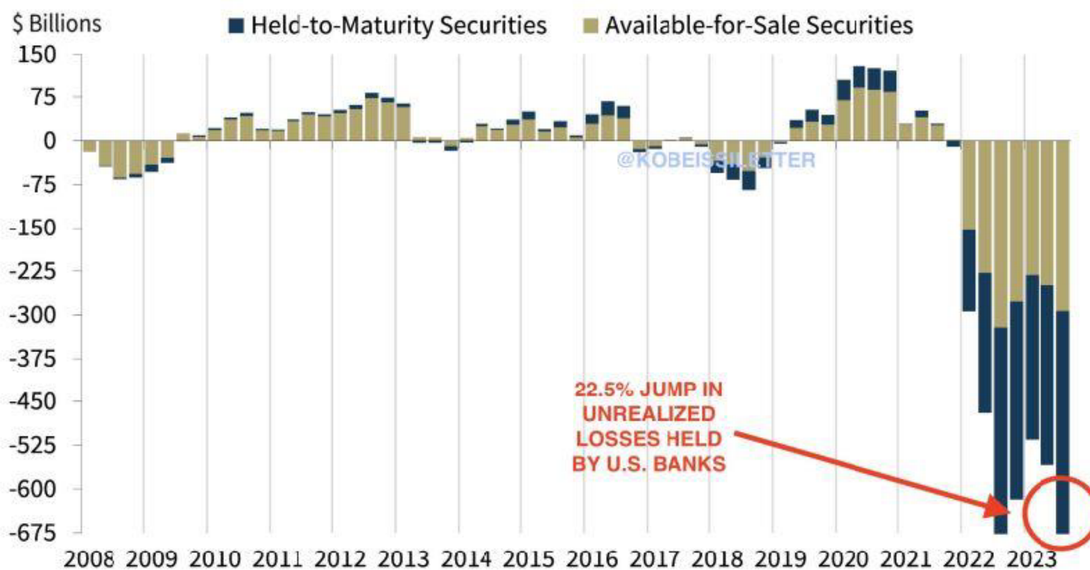
Despite the recent correction in yields, the challenges associated with rising interest rates are not going to magically disappear next year. Although credit spreads have so far remained stable, as most indebted companies have not yet needed to refinance under the new conditions, it would be unrealistic to take this situation for granted. As a reminder, in an environment where liquidity was scarce, the US commercial banking sector went through a period of extreme stress this spring as a Swiss banking flagship disappeared. At the time, the US 10-year yield was hovering around 3.50%, and the rapid rise in interest rates had put Silicon Valley Bank, Signature Bank and First Republic Bank out of business. Today, although this same yield is on a downward trend, it is hovering around 4.30%, or 80 basis points above its March level, and this is true for the curve as a whole. As the chart below illustrates, it would appear that the balance sheets of some commercial banks have not really improved since then. With mortgage and credit card rates at historically high levels, default rates are rising. Although most banks are currently generating substantial income from the interest rate differential, they will probably have to increase their provisions for potential losses on receivables, which could weaken their balance sheets. It should be noted, however, that this problem mainly concerns the United States. The credit situation in Europe is less worrying, although it should not be ignored.



Source: FDIC.
Note: Insured Call Report filers only. Unrealized losses on securities solely reflect the difference between the market value as of quarter end and the book value of non-equity securities.

Source : The Kobeissi Letter

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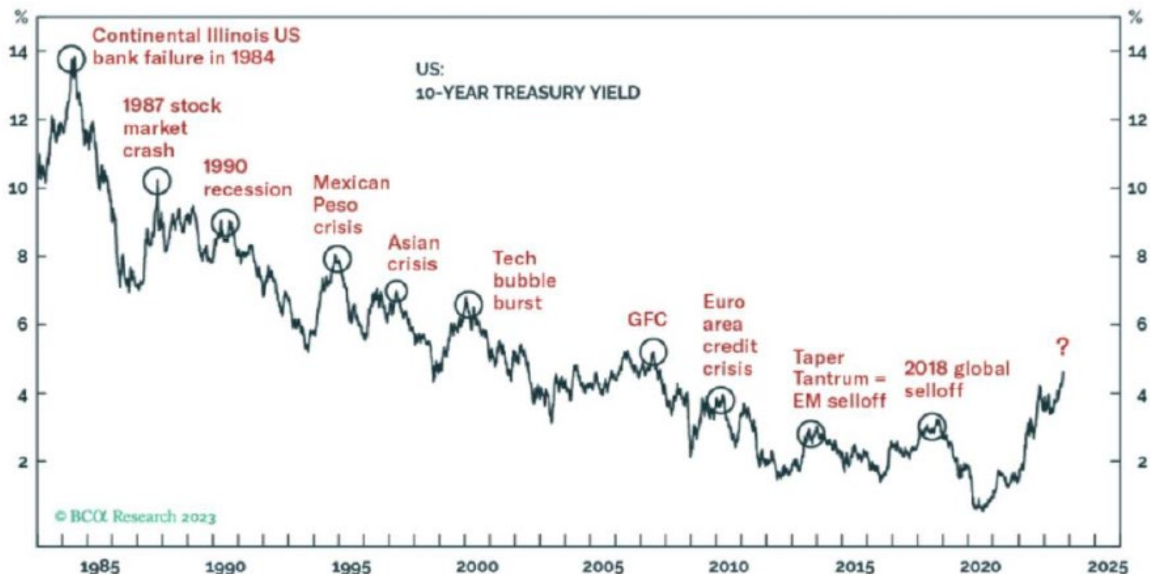
The most optimistic will say that in the event of a new panic in the banking sector, central banks will react quickly (as they did this spring) and come to the rescue of institutions in difficulty to prevent savers from suffering losses and a possible domino effect spreading throughout the sector. This theory is likely, but will this backtracking be enough?
Those who are less optimistic take a different view and put forward another argument. In the past, each phase of sharp rate rises has triggered disruption in one segment of the economy, often resulting in a recession and a deep market correction. From their point of view, it therefore seems unlikely that the FED's rate hike of more than 500 basis points between June 2022 and October 2023 will not cause an accident in one pocket of the economy or another. In their view, anticipating a "soft landing" is utopian, and they are counting instead on a deeper recession.



The favorite targets of the less optimistic camp are the property market (which was already at the epicenter of the great financial crisis of 2008) and the various consumer credits such as credit cards and car loans. And let's not forget businesses, some of which are also heavily indebted.

In the history of monetary tightening cycles, the Fed has only once succeeded in steering a soft landing after a sharp rise in interest rates. Between 1994 and 1995, under the Greenspan era at the head of the central bank, key rates rose from 3% to 6% in the space of a few months. During this period, the US economy slowed without going into recession, and the unemployment rate remained relatively stable. The statistics speak in favor of the pessimists, as this success remains exceptional in the history of the US economy. It is on this subject, then, that all the uncertainty remains for next year, and many questions remain open for the time being. Even if we probably won't see the epilogue to this chapter next year, 2024 should still provide us with some answers.

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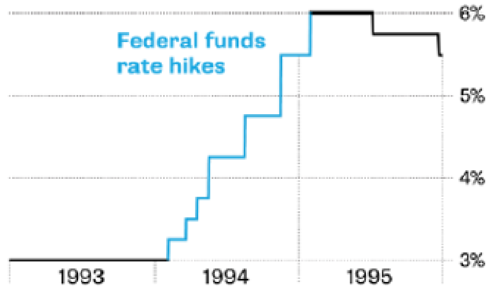
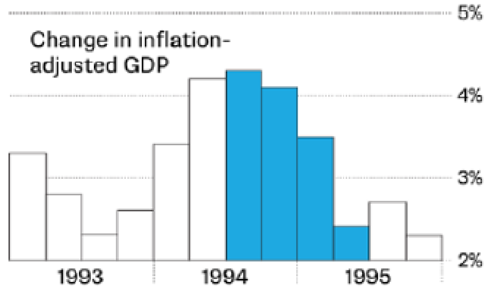
Fed doubled short-term interest rates ...

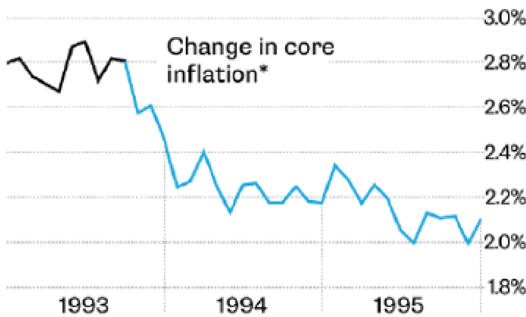


... which slowed U.S. growth ...

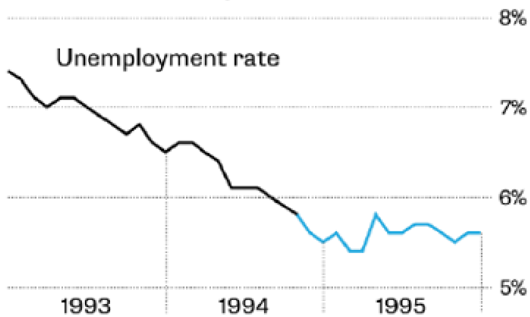


Sources: U.S. Federal Reserve; Commerce Department

... and caused inflation to fall ...



... while unemployment leveled off



Note: "Core" inflation is the change in personal consumption expenditures minus food and energy

Sources: U.S. Commerce Department; Bureau of Labor Statistics

BloombergQuickTake

The resilience of household consumption has caught economists, who were predicting a recession in 2023, by surprise. Household consumption, which accounts for almost 70% of the contribution to GDP, has remained buoyant thanks to a tight labor market that has enabled some unions to put pressure on to renegotiate higher wages. Another argument is the historically high savings rate that resulted from the post-Covid confinements. The latter, in relation to GDP, has moved into contraction territory in the US, which could have a negative impact on consumption next year.

Will this be offset by another component of US growth, such as government spending?

It is very difficult to give a clear answer to this question. The US budget deficit is colossal and a slimming down of the government's lifestyle would be welcome, especially as the cost of servicing the debt for 2024 is expected to be more than 700 billion dollars, or around 10% of the country's budget.

On the other hand, we are entering a presidential election year. President Biden may be tempted to maintain a high lifestyle in order to regain the confidence of voters.

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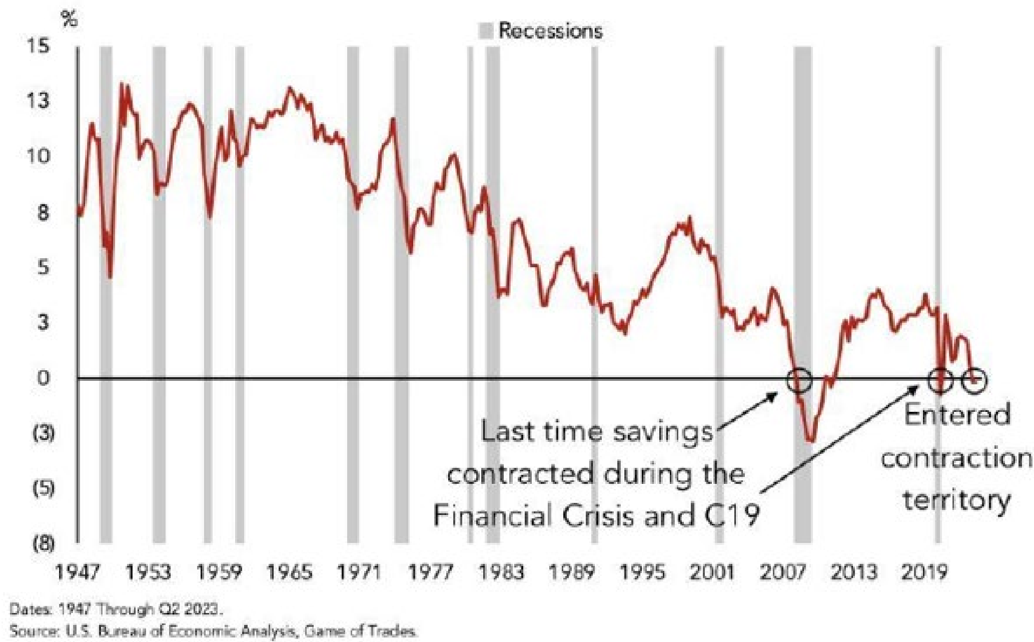
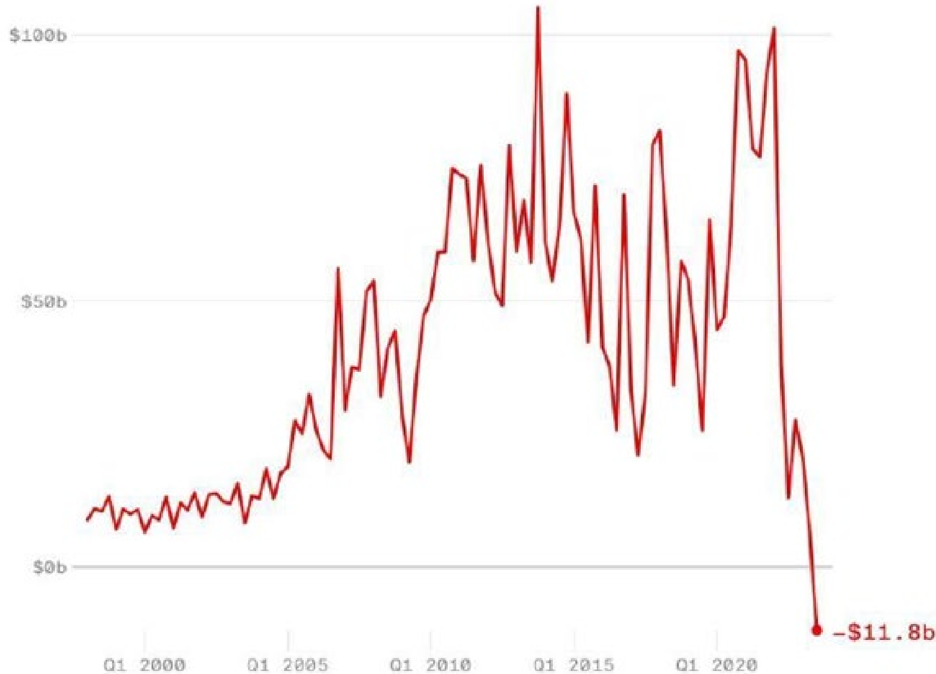


After an already complicated 2022, 2023 is likely to go down in history as an "annus horribilis" for China. The world's second-largest economy seems incapable of regaining its former vigor. The political decisions of the past three years have undermined the confidence of foreign investors. The over-indebtedness of property developers has pushed the sector to the brink of collapse, with the risk of implosion looming at any moment. This is putting considerable pressure on the central bank (PBOC) and the government to find solutions, both in terms of monetary and fiscal policy, with the aim of reviving the economy. Admittedly, a number of measures have already been taken, such as rate cuts and liquidity injections, but at this stage, these homeopathic interventions remain ineffective. China needs a powerful electroshock, like Mr Draghi's bazooka in Europe in 2015 and beyond. It is vital that the authorities regain the confidence of foreign investors if we are to hope to see a return of investment flows to the Middle Kingdom. The uncertainties surrounding the Communist Party's (CCP) ambitions for Taiwan are not conducive to a return of confidence. The current valuation of Chinese equities is attractive, which is why we have decided to give the Chinese authorities the benefit of the doubt by maintaining our allocation in our portfolios for the time being.



Source : Ian Bremmer

The year 2023 is drawing to a close, and to say the least, it has brought its share of surprises. Despite one of the fastest rate hike cycles in history, the recession widely expected by the consensus did not materialize. This led to some surprising performances in segments such as technology, but you had to be on the right 'horses' to really benefit. Indeed, apart from the 'magnificent 7' - Apple, Microsoft, Alphabet, Nvidia, Amazon, Meta and Tesla - the US market did not shine so brightly . After a strongly negative performance in 2022, bonds have only slightly recovered this year, but we remain convinced that this asset class should generate attractive returns over the next few years, starting in 2024.
So what can we expect next year?
The major challenge remains with the central banks. Will they be able to steer a soft landing? If so, the "goldilocks" scenario should continue, allowing asset allocation strategies to perform as well as they did in November. If not, we could see a significant widening of credit spreads, which could trigger a further correction in the equity markets. If this scenario were to occur, central banks would have to become more accommodative by cutting rates faster than expected while injecting new liquidity. In this scenario, we would tend to take advantage of the downturn to build up positions in quality companies.

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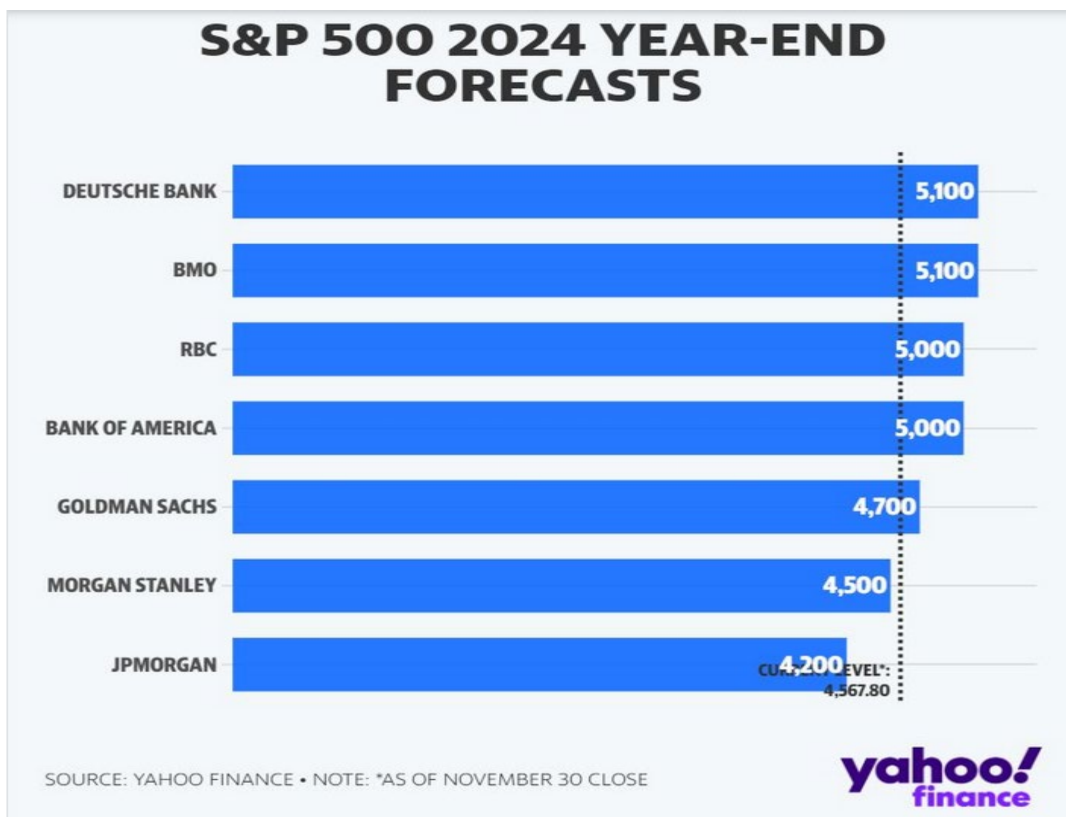
We must not underestimate the productivity gains that technology has brought to businesses, which have already enabled them to maintain solid profit margins despite the headwinds of rising inflation and labour shortages.
We will have of course to keep a close eye on geopolitical developments, but as we have said on several occasions, geopolitics should not be at the centre of our reflections. Recent elections have seen a shift towards the far right in countries such as Argentina and the Netherlands. Over 3 billion people will go to the polls next year, starting with the Taiwanese in January. The results will inevitably influence the Middle Kingdom's attitude towards Taiwan. The electoral apotheosis is expected to take place in November 2024 with the US presidential elections and the possible return of Donald Trump to power. This result (and the months leading up to it) should also influence movements on the world's stock markets.
We have included some bonus graphics below, and will be happy to discuss any of the topics in more detail.
Before turning the page on 2023, we would like to extend our warmest thanks to all our readers and investors who have placed their trust in us over the years, and look forward to seeing you in 2024 for some exciting new adventures.

Have a wonderful festive season.

The Weisshorn Asset Management team.



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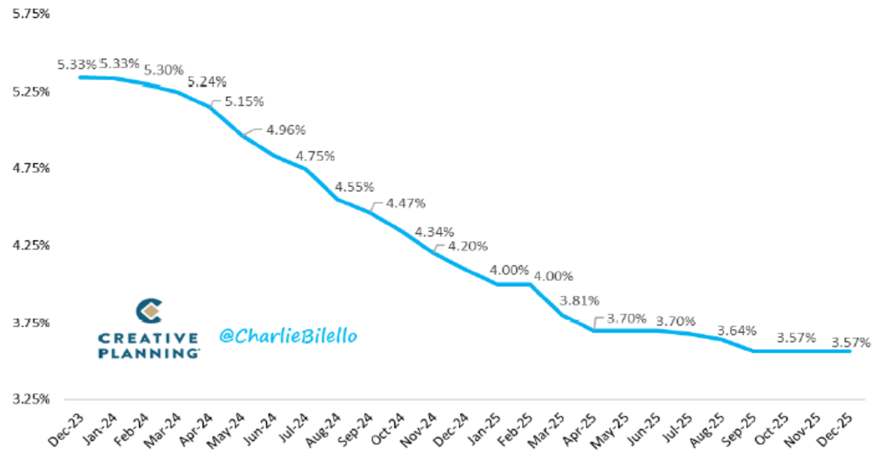

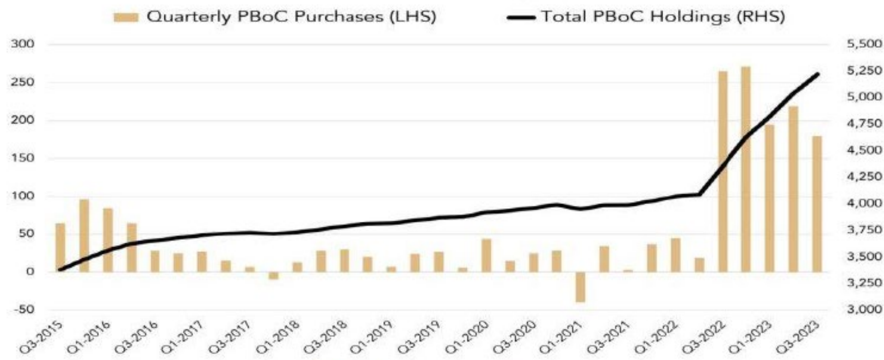

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