Divine inspiration

Global Matters Weekly

9 January 2023

– Alex Harvery — *Senior Portfolio Manager & Investment Strategist*

The month of January takes its name from the Roman god Janus, whose two opposing faces depict duality and transition, endings, and new beginnings. This god of gateways looks both backward and forward, and if ever there was a January to excite him (he is generally depicted with a beard), then this is surely it. As he looks backward, then by any measure 2022 was a horror show for most investors, as it was in the real world for the many oppressed people around the world. The Great Rate Reset led to a sharp repricing for most financial assets, leaving few places to hide. Cash was king, and only really pockets of less directional alternative strategies and some commodities made any meaningful gains. Anyone wanting a quick lesson on how interest rate 'duration'[1] affects bond prices needs to look no further than the Austria 100 year 'century' bond (issued in June 2020) which fell 55%[2] in 2022. It would take 65 years collecting the €0.85 annual coupon to recoup that loss! In fact, since its €139.3 peak price in December 2020 it has fallen by a full €100, ending 2022 at €39.3[2]. That's a 72% decline in two years, not far off Tesla's 2022 calendar year performance I might add, demonstrating somewhat simplistically how growth stocks are long duration assets.

On a brighter and less Tyrolean note, and with Janus looking forward, 2023 presents us with a fuller palette of investment opportunities than we've seen for some years. Within fixed income, yields have risen so much that for the first time in a while, there is something of a buzz around the asset class. Of course, inflation is the root of all bond evils and inflation-adjusted yields are still firmly negative and real returns will only be forthcoming if inflation does fall back. Importantly though, higher yielding investment grade bonds once again provide some ballast in portfolios with scope for capital upside, something only possible in the negative yielding world when there was a 'greater fool' to sell to (who could usually be found, to be fair). On that point, last week we saw the stock of negative yielding debt fall back to zero for the first time since 2014 and whilst it's

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possible we flirt back into negative territory in the year ahead, the slow drain of liquidity from the financial system resulting from quantitative tightening will continue to exert an upward pressure on yields. A slam dunk year for bonds is far from guaranteed, but fixed income is just that and a very bad year like 2022 mathematically improves the following years' prospects.

Equities offer an attractive entry point after the pain of last year. In the UK, the main market trades on less than 10x next year's earnings (or greater than 10% earnings yield)[2]. The more discerning active buyer can pick up high-quality, dividend growing companies for even less. The growthier small-cap names trade at a similar valuation in aggregate and only twice in the last 30 years have they underperformed the blue-chip UK index by more than the 22% they trailed by last year. Other regions now offer similar value. US equities remain optically the most expensive market, although valuations have reverted considerably over the last year, and paying up a little for the quality and resilience of that market doesn't seem unreasonable. The question Janus needs to consider when assessing 2023 is whether the current implied earnings are fair, or risk falling short as the global economy slows, as is now widely expected. If the latter eventuates then the true (and trailing) earnings multiple will be higher, the earnings yield lower, and the relative attractiveness over now higher yielding corporate bonds – the equity risk premium – will be eroded. With corporate margins being squeezed, that is a valid concern and one reason why equities are not being hoovered up today, but the uncertainty is reflected in the price.

Notes: [1]Duration is the measure of a bond's price sensitivity to changes in interest rates
Source: [2]Bloomberg Finance L.P.

It is quite possible that the market lows are retested at some point this year, but as long-term investors we, like Janus, have to look further ahead than what lies immediately before us. If policy rates do top out in the summer this year, as is currently priced, then we could see risk appetite returning more quickly than one might otherwise expect. Equities typically bottom out before the real economic pain ends and the end of the hiking cycle is often a precursor to this.

Having been positioned through most of 2022 with low bond exposure and higher allocations to real assets, alternatives, and cash, 2023 will hopefully present opportunities to recycle last year's relative winners into cheaper equities, credit, and more esoteric discounted investments that will lay the foundations for real compounded capital growth and income into the future. When Janus looks back on 2023 let's hope his face is smiling

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The Marketplace

- Global equities returned 1.8% last week
- Most World indices saw positive returns to start the new year
- Brent crude fell 8.5% to $78.57 per barrel
- Gold rose 2.3% to $1865.69 per ounce

Market Focus

US

- US equities returned 1.5% last week driven by Media, Metal and miners while Oil/ Gas and Healthcare underperformed
- Republican congressman Kevin McCarthy was voted in as house speaker on the 15th attempt, the highest number of ballots for the speakership since 1859. He has pledged to champion spending cuts and strengthen border security
- Federal Open Market Committee meeting minutes affirmed the Federal Reserve's desire to reduce inflation. Markets were warned not to underestimate their will to keep rates tight for some time.
- US nonfarm payrolls for December came in at 223k (vs 200k expected), the unemployment rate for December was 3.5% (vs 3.7 expected)

Europe

- European equities returned 4.9% last week, retail, auto/ parts, oil/gas and utilities all underperformed
- The European Central Bank expects to complete its interest-rate hikes "by the summer"
- European Consumer Price Index for December was 9.2% (vs 9.7% expected)
- German Manufacturing Purchasing Managers Index for December was 47.1 (vs 47.4 expected)
- Some Scandinavian markets were closed Friday for Epiphany

UK

- UK equities returned 3.3% last week
- Prime Minister Rishi Sunak said that slowing UK inflation this year is "not a given"
- UK railway unions staged strikes throughout the week as the Government laid out plans to enforce a minimum service for all unions
- UK December Construction Purchasing Manager's Index was 48.8 (vs 49.6 expected)
- UK food prices soared 13.3% in December

Asia/Rest of The World

- Global emerging market equities returned 3.4% last week
- Japanese equities fell -0.8% last week
- Chinese equities returned 7.6% last week, as COVID-19 restrictions continued to ease
- China may relax their three red line policy easing borrowing caps on leverage and extend grace periods
- Thousands of supporters of ex-President Jair Bolsonaro ransacked Brazil's Congress, supreme court and presidential palace
- USA, UK and Germany sent additional military aid to Ukraine which significantly upgraded their firepower.

Past performance is not indicative of future returns. Source: Bloomberg. Returns in local currency unless otherwise stated.

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Asset Class/Region	Currency	Currency returns			
		Week ending 6 Jan. 2023	Month to date	YTD 2023	12 months
Developed Market Equities					
United States	USD	1.5%	1.5%	1.5%	-16.1%
United Kingdom	GBP	3.3%	3.3%	3.3%	9.5%
Continental Europe	EUR	4.9%	4.9%	4.9%	-8.1%
Japan	JPY	-0.8%	-0.8%	-0.8%	-3.5%
Asia Pacific (ex Japan)	USD	3.3%	3.3%	3.3%	-13.4%
Australia	AUD	1.0%	1.0%	1.0%	1.1%
Global	USD	1.8%	1.8%	1.8%	-15.4%
Emerging markets equities					
Emerging Europe	USD	0.7%	0.7%	0.7%	-70.6%
Emerging Asia	USD	3.8%	3.8%	3.8%	-16.9%
Emerging Latin America	USD	2.6%	2.6%	2.6%	14.4%
BRICs	USD	4.3%	4.3%	4.3%	-15.8%
China	USD	7.6%	7.6%	7.6%	-13.1%
MENA countries	USD	0.3%	0.3%	0.3%	-8.7%
South Africa	USD	3.7%	3.7%	3.7%	-2.4%
India	USD	-0.9%	-0.9%	-0.9%	-7.8%
Global emerging markets	USD	3.4%	3.4%	3.4%	-16.4%
Bonds					
US Treasuries	USD	1.8%	1.8%	1.8%	-9.4%
US Treasuries (inflation protected)	USD	1.2%	1.2%	1.2%	-9.5%
US Corporate (investment grade)	USD	1.8%	1.8%	1.8%	-12.6%
US High Yield	USD	2.3%	2.3%	2.3%	-8.6%
UK Gilts	GBP	1.1%	1.1%	1.1%	-22.3%
UK Corporate (investment grade)	GBP	1.5%	1.5%	1.5%	-17.8%
Euro Government Bonds	EUR	2.7%	2.7%	2.7%	-15.8%
Euro Corporate (investment grade)	EUR	1.2%	1.2%	1.2%	-12.7%
Euro High Yield	EUR	1.1%	1.1%	1.1%	-10.7%
Japanese Government	JPY	0.0%	0.0%	0.0%	-5.4%
Australian Government	AUD	1.2%	1.2%	1.2%	-8.7%
Global Government Bonds	USD	1.4%	1.4%	1.4%	-15.1%
Global Bonds	USD	1.6%	1.6%	1.6%	-14.8%
Global Convertible Bonds	USD	1.0%	1.0%	1.0%	-17.2%
Emerging Market Bonds	USD	1.3%	1.3%	1.3%	-22.0%

Source: Bloomberg. Past performance is not indicative of future returns

Asset Class/Region	Currency	Currency returns			
		Week ending 6 Jan. 2023	Month to date	YTD 2023	12 months
Property					
US Property Securities	USD	1.7%	1.7%	1.7%	-22.2%
Australian Property Securities	AUD	-0.1%	-0.1%	-0.1%	-21.2%
Asia Property Securities	USD	0.9%	0.9%	0.9%	-7.8%
Global Property Securities	USD	1.6%	1.6%	1.6%	-20.8%
Currencies					
Euro	USD	-0.7%	-0.7%	-0.7%	-5.8%
UK Pound Sterling	USD	-0.1%	-0.1%	-0.1%	-10.7%
Japanese Yen	USD	-0.8%	-0.8%	-0.8%	-12.3%
Australian Dollar	USD	0.7%	0.7%	0.7%	-4.1%
South African Rand	USD	-0.8%	-0.8%	-0.8%	-8.4%
Swiss Franc	USD	-0.7%	-0.7%	-0.7%	-0.8%
Chinese Yuan	USD	1.0%	1.0%	1.0%	-6.5%
Commodities & Alternatives					
Commodities	USD	-4.4%	-4.4%	-4.4%	12.5%
Agricultural Commodities	USD	-2.0%	-2.0%	-2.0%	5.8%
Oil	USD	-8.5%	-8.5%	-8.5%	-4.2%
Gold	USD	2.3%	2.3%	2.3%	4.2%
Hedge funds	USD	0.4%	0.4%	0.4%	-3.6%

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