2023 in the rear view

STORY 5 —

2023 will be remembered as the year of the Artificial Intelligence (AI) boom.

Read more on p3

Top 10 stories

The Resilience of the US economy, a global disinflation trend, China disillusion, the come-back of cryptos, the AI boom and the magnificent 7 while commodities ended in the year in the red. Here are ten stories to remember from an eventful 2023.

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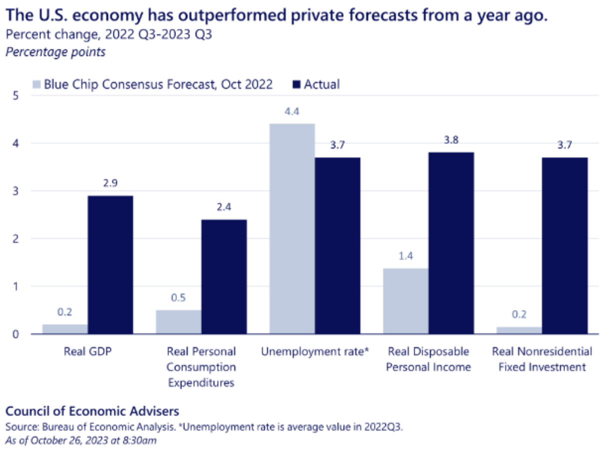
STORY 1 —

The Resilience of the US economy

2023 showcased the remarkable resilience of the US economy amidst a landscape of global uncertainties. Contrary to widespread recession fears, the US economy demonstrated robust growth, underpinned by strong consumer spending and a rebounding labour market. Key indicators, such as the unemployment rate, which remained steadily below 4%, and a GDP growth rate outpacing many forecasts, evidenced this resilience. Consumer spending, which makes up two-thirds of the U.S. economy on average, continued its upward trajectory, reflecting confidence in the economic outlook. Corporate earnings, while varied across sectors, generally surpassed expectations, indicating the underlying strength of American businesses. The resilience of the US economy in 2023 not only defied the pessimistic predictions from 2022 but played a part in stabilising global markets.

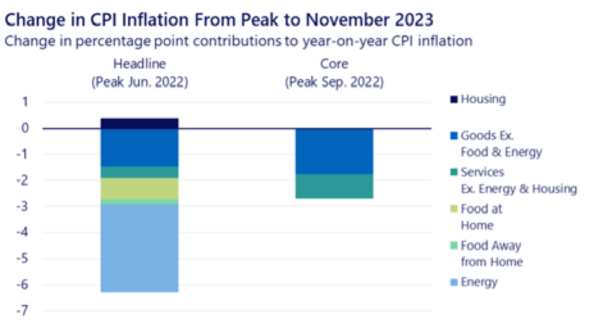


STORY 2 —

Global disinflation trend

With a much-needed shift from the 2022's inflationary pressures, 2023 witnessed a significant global disinflation trend. Central banks worldwide successfully implemented monetary policies that tempered inflation without derailing economic growth. The CPI figures across major economies reflected this trend, with the U.S. CPI falling to a manageable 3.1%, and the Eurozone reporting a similar decline to 2.4% in November.

These reductions in inflation were partly attributed to the easing of supply chain disruptions and somewhat to the stabilisation in energy prices, which had previously helped fuel the inflationary spike. The speed of the disinflation appears to have surprised many economists and reveals that the problem was largely related to supply distortions rather than excess demand. The global disinflation trend of 2023 helped in part to tame the rising cost-of-living pressures.

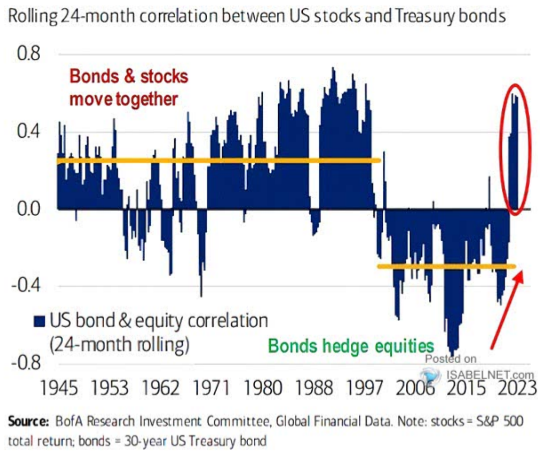


Source: Bureau of Labor Statistics; CEA calculations

STORY 3 —

The 60-40 is back as correlation between equities and bonds stands at record high

After having been written off last year, 2023 has marked a significant comeback for the 60-40 equity-bond portfolio. After a challenging period where both equities and bonds experienced simultaneous downturns, this year witnessed a record-high correlation between the two asset classes, the highest correlation we have seen since 1993-95. At the time of our writing, equities showed robust performance, with the S&P 500 just 2% away from a new all-time high, buoyed by resilient corporate earnings, stellar performance particularly in large-cap tech stocks, and investor optimism about global economic prospects. Meanwhile, bonds experienced a breather from the dismal year of 2022, recording their best performance since the 1980's in the month of November, as investors frantically bid up the price of US Treasuries and corporate bonds. Note however that the correlation coefficient between equities and bonds reached an unprecedented level, highlighting the regime change which was already observed in 2022.

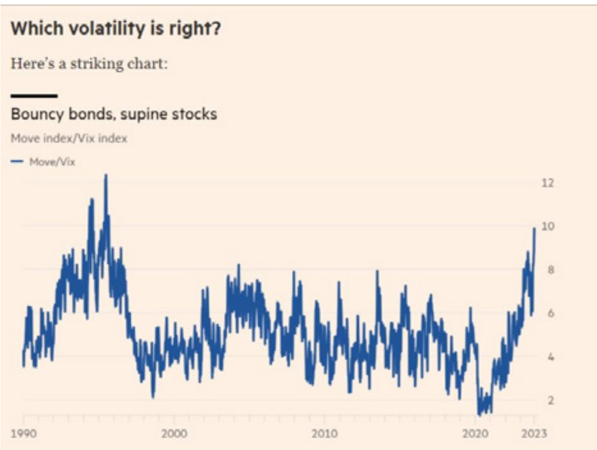


Source: BoFa

STORY 4 —

Equity volatility collapsed while bond volatility spiked

Financial Markets experienced a unique dichotomy, with a dramatic collapse in equity volatility juxtaposed with a significant spike in bond volatility. The VIX index, often referred to as the stock market's "fear gauge," plummeted to its lowest levels in years, reflecting a period of unusual calm and investor confidence in the equity markets. This tranquillity in equities, while reassuring for investors, might indicate too much market complacency and is characteristic of market tops. The markets now find themselves with a Dow Jones (US), DAX index (Germany), CAC index (France), and Nifty 50 all at an all-time high. On the other hand, the bond market experienced heightened volatility. This was largely driven by the dynamic shifts in interest rate expectations and the ongoing recalibration of monetary policies by central banks worldwide. The contrasting behaviours of these two major asset classes underscored the complexity and unpredictability of market dynamics in 2023, challenging investors to navigate a landscape where traditional risk perceptions were upended.



Source: Bloomberg, FT

STORY 5 —

The AI boom and the magnificent 7

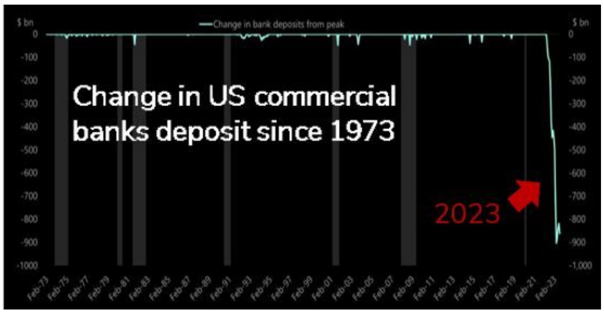
2023 will be remembered as the year of the Artificial Intelligence (AI) boom, a transformative period in technology that reshaped industries and investment landscapes. This revolution led to the birth of the term "The Magnificent 7," seven leading companies that emerged as the frontrunners, driving unprecedented growth, anticipation, and innovation. The financial markets responded enthusiastically, with these companies not only outperforming their peers but also contributing to more than all of the S&P 500's gains this year. The current top 5 companies by market cap make up ~26% of the S&P 500, The last time the top 5 had a greater concentration in the S&P 500 was 1964 w/AT&T, GM, Exxon, IBM, Texaco. The AI boom, led by these Magnificent 7, is certainly indicative of the expectations and enthusiasm that currently surround this space.

Source: LSEG Datastream, Schroders

STORY 6 —

A bank run in slow motion

We also witnessed an unusual phenomenon in the banking sector, a slow-motion bank run. This was triggered largely by a combination of low interest rates on deposits, attractive returns from Money Market Funds and Treasury Bonds, declining customer confidence, and liquidity concerns. Deposits continue to flow out of banks at a historic pace with $1 trillion + withdrawn over the last year. Interventions were made by central banks and financial regulations, including liquidity support, public statements of confidence, and, in some cases, policy adjustments. In the end, one thing has become clear for large US banks, the era of "free money" is coming to an end, and if they don't want to face the same fate as several of their peers this year, they must raise interest paid on deposits or the capital will continue to flow elsewhere.



Source: Apollo

STORY 7 —

China disillusion

The Hang Seng Index, a barometer of Hong Kong's stock market often reflective of mainland China's economic sentiment, experienced significant volatility, and underperformance.

After a promising start to the year, the Index faced a downward trajectory, experiencing a drawdown of over 28% so far. Meanwhile, main indices in other countries have been experiencing new all-time highs. Furthermore, the Shanghai Composite Index, representing mainland China's stock market, mirrored this trend, struggling to regain momentum amid investor scepticism and domestic economic challenges. The stark underperformance of these indices reflected broader investor disillusionment with Chinese equities, as concerns over regulatory risks and geopolitical tensions overshadowed the market's potential. The year 2023 thus is coming to an end with a sentiment of shifting dynamics in the Chinese stock market, urging investors to reassess their strategies in the face of heightened uncertainty and regulatory unpredictability.

Source: Bloomberg

STORY 8 —

Another Middle East crisis

Regrettably, in 2023, the Middle East experienced a further escalation of tensions, characterised by renewed hostilities between Israel and Palestine. International efforts to broker peace faced numerous challenges, as each incident further deepened the divide and mistrust between the parties involved. The crisis also had broader geopolitical implications, eliciting varied responses from the global community, even making its way deep into university campuses. While some nations called for immediate ceasefires and negotiations, others took more definitive stances in support of either Israel or Palestine. The United Nations and various diplomatic entities actively sought to mediate, emphasising the urgent need for a sustainable resolution to the conflict. For the moment, it's difficult to tell how the conflict will be resolved.

STORY 9 —

Commodities in the red

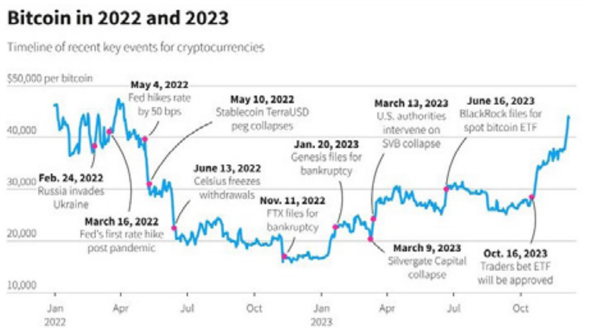
In a stark reversal from the previous year, 2023 witnessed a significant downturn in the commodities market, with many key commodities closing the year in the red. Notably, crude oil experienced a dramatic decline, with prices falling by over 20% from their peak earlier in the year. This drop was attributed to a combination of factors, including easing geopolitical tensions and increased production in response to prior high prices. Similarly, industrial metals like copper and aluminium, which had seen substantial gains in 2022, faced steep declines, reflecting a slowdown in manufacturing and construction activities across many key regions. The agriculture sector was not immune to this trend, with prices of major crops like wheat and soybeans falling significantly due to improved supply conditions and reduced demand from key markets. Certain commodities however have been spared from these drawdowns. Namely, uranium, which has reached levels not seen since 2008, mainly due to the stark reversal in perception of the utility and risk reward ratio of nuclear energy.

Source: Bloomberg

STORY 10 —

The come-back of cryptos

The year also marked a remarkable turnaround for cryptocurrencies, reinstating them as a major player in the global financial landscape. After the tumultuous 'crypto winter' of the previous year, major cryptocurrencies like Bitcoin and Ethereum made impressive recoveries. Bitcoin, which had seen a significant decline in value in 2022, rebounded strongly, with a current market cap approximating that of Meta, even with Meta having recorded a 170% increase in stock price in the last 12 months. Ethereum followed a similar trajectory, witnessing a 63% increase in value. This resurgence was driven by a combination of factors, including the adoption of cryptocurrencies by mainstream financial institutions, regulatory clarifications in key markets, and a growing recognition of digital assets as a legitimate investment class. The crypto market's recovery in 2023 not only demonstrated its resilience, but also highlighted the evolving nature of digital currencies and their increasing relevance in the modern financial ecosystem.



Source: Bloomberg

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