Q4 2023

UBAM – MULTIFUNDS SECULAR TRENDS

Quarterly Comment | Q4 2023

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UBAM – Multifunds Secular Trends: Article 8

Market Comment

- The last quarter of the year pushed global equity markets higher with another rally and +11% gains for the MSCI AC World. US equities rose +11.2% in Q4, Emerging Market equities +7.9%, European equities +6.4%, Japanese equities +2.9% and Swiss equities +1.4% (performances in local currencies). Over the full year 2023, the MSCI AC World delivered +22.2%, with most regional markets finishing the year in the green despite limited market breadth and elevated bond yields.
- As expected by the market, the Fed announced no change in its key rate policy in December, mentioning the pressure of financial conditions on global activity and alluding to potential interest rate cuts in 2024. The US GDP growth projection for 2024 was revised slightly down from 1.5% to 1.4%, whereas Q3 2023 growth came in strong at 4.9%, lower than the 5.2% expected, but higher than the 2.1% for the prior print, reducing hard-landing fears. The yearly trend in US headline inflation marginally declined from 3.2% to 3.1% as core inflation remained stable at 4.0% yoy. The ECB also held its key rates unchanged as Eurozone inflation gradually eased to 2.4% yoy, slightly above the 2% target. 2024 earnings growth expectations for global equities remained stable at 10%, coupled with 16.6x forward PE ratio. This growth expectation reflects a broad recovery in corporate earnings in all major markets, which will probably, at least partly, depend on inflation and interest rate trajectories.
- The stock market has surprised investors over 2023, which had started with recessionary fears projecting more muted performances. The year also saw a large divergence in results between US IT mega cap names and the rest of the market, drawing a challenging environment for active fund managers. However, Q4 revealed mixed performances for the “Magnificent 7”, with Tesla largely lagging the remaining 6 names and the rest of the market. This has again shown the importance of a medium to long term view and the benefits of staying invested in the market based on a solid fundamental stock selection process rather than trying to time sector or thematic rotations.
- Significantly as the month progressed, we appeared to see central bankers take note of this tightening in financial conditions as a reason for them to tighten policy less, as it could be viewed as a replacement for rate hikes. This idea was initially brought up by Dallas Fed President Logan, however was then echoed by Fed Chair Powell, especially if the tightening in financial conditions is “persistent”. This clear communication shift from the Fed has been helped by the disinflation trend which remains intact.

Sources: UBP, Bloomberg Finance LP.

All performance figures are given net of fees. Past performance is not a guide to current or future returns. See full disclaimer at the end of the document.

Performance Review

- During Q4, the fund returned 10.42% versus 11.03% for the MSCI AC World Index net of fees (Institutional share class).
- Manager selection and theme allocation was positive over the quarter (manager selection in Technology was the main detractors).
- Structural and marginal cash allocation was detrimental.
- Our manager selection on Technology contributed positively.

Sources: UBP, Bloomberg Finance LP.

Portfolio Activity

- While remaining wary of valuations, overall uncertainty surrounding war in Ukraine and inflation pressures prompted us to reduce overall exposure to cyclicality.
- We increased quality and defensiveness during the quarter and reduced overweight Europe on the back of weakening macro and poor short-term outlook for EUR.

Sources: UBP, Bloomberg Finance LP.

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Outlook

- Global equity markets finished 2023 on a strongly positive note, despite some signs of growth slowing, the banking sector fallouts, wars in the Middle East and Ukraine, and still elevated bond yields. US and European equities have regained all of their 2022 drawdown and are trading close to their respective end-2021 alltime market highs. Investors have factored in a soft-landing scenario for the US with possible interest rate cuts going into 2024. Moreover, with the Covid overhang now largely reflected in corporate results and the normalization of interest rates and inflation levels in sight, this should provide a supportive environment for equities in 2024, and more specifically for longer duration assets: quality companies with strong future cash flow streams.
- As valuation levels currently trade around long-term averages, earnings growth is expected to be the main market driver for 2024, after a low base of 0% growth in 2023. 2024 could thus offer a more favourable environment for active fund managers, as investors turn back towards fundamentally driven performance sources, which could lead to a catch-up of some of the lagging parts of the marke.
- Whilst the ECB and BoE chose not to make similarly dovish shifts in their communication at their December meetings, this is still expected to occur in Q1 given the outlook for both growth and inflation. At the ECB for example their latest inflation forecasts released signaled another large downgrade with headline inflation now expected to average 2.7% in 2024 compared to 3.2% in the September forecast. That said, these forecasts still appear too pessimistic on the inflation front and we would expect to see the ECB provide further downgrades in Q1, which would also open the path to a change in rhetoric. Meanwhile at the BoE, the latest CPI release was a significant downside surprise at 5.1% for core inflation, which compares to the BoE's own forecast of 5.7% and highlights the speed of the disinflation process.
- With significant progress on inflation finally made, the end of 2023 saw Fed Chair Powell communicate an important shift in his guidance, which suggested that the Fed's focus is moving away from discussing further hikes and instead towards the timing of potential rate cuts. Such a shift in messaging came perhaps earlier than many investors had been anticipating, driving a rally across fixed income and risk assets into yearend. As a result, the focus in the first part of 2024 will likely be on whether the inflation and labour market data released is able to support this message from the Fed, as well as whether other major central banks decide to communicate a similar shift. We believe that this pivot from the Fed cannot be ignored, especially given the recent progress made on inflation, where central banks such as the ECB and BoE are likely to follow suit in the coming months. This reduces the tail risk of central banks overtightening policy into a recession, keeping a soft landing scenario as the base case. We therefore continue to view this backdrop as one that warrants holding balanced portfolios of both credit risk and interest rate exposure in portfolios.

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