QUARTERLY MARKET REPORT

Q3 2023

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MARKET DEVELOPMENTS

- The big issue weighing on financial markets was the increasing realisation that anticipated falls in interest rates are likely to be farther out than previously believed. This pushed up bond yields causing values to fall – in turn putting pressure on equity valuations.

- Inflation readings have continued to fall but are still higher than policymakers would like. The most recent figure for Core inflation in the Eurozone (4.5%) is still well ahead of target. Generally tight labour markets mean that squeezing inflation without recession will take time; the demands being made by the United Auto Workers in the US are a case in point and will be closely watched by workers far and wide.

- The quarter saw the Federal Reserve increase interest rates in July before pausing at its September meeting, at which it signalled that there may be another rise before year-end. The European Central Bank implemented its 10th consecutive interest rate rise, reaching 4.0%.

- The biggest asset class mover in Q3 was commodities, led by oil. Production cuts by Saudi Arabia and Russia were the main factor driving prices. The energy sector was the star turn in equity markets – almost all others recorded losses. With energy in the 'value' camp, it helped the MSCI World Value Growth index to out-perform its value counterpart by 3%, bucking a severe underperformance YTD.

- Emerging markets were marginally ahead of developed markets notwithstanding soft economic data from China whose exports were 8.8% lower year-on-year to the end of August. The woes of two very large Chinese property development companies (Evergrande and County Garden) who are struggling badly with combined debt burdens of over €500bn are a further issue affecting sentiment towards China.

- Related to the poor tone in bond markets was a renewed focus on the scale of US debt, now standing at a record $33tn; related thereto was the prospect of a shut-down of government funding. Closer to home the scale of Italy's debt also came under renewed scrutiny, with spreads over German bonds rising.

- Irish commercial property extended its downward grind. The Irish Life Exempt Property Fund – the closest to a real-time benchmark for the sector – declined by 4.6% bringing the year-to-date fall into double digits. A sign of the malaise weighing on the international commercial property market was the payment of £149m by Meta to surrender a lease on office space in London.

- The USD rose by 4.7% against the EUR in the quarter, helped by interest rate differentials and recent raising of US growth expectations. This bolstered returns from US equities - which dominate global equity indices - and also the returns from commodities, which are almost all priced in USD.

TABLE 1: MARKET RETURNS

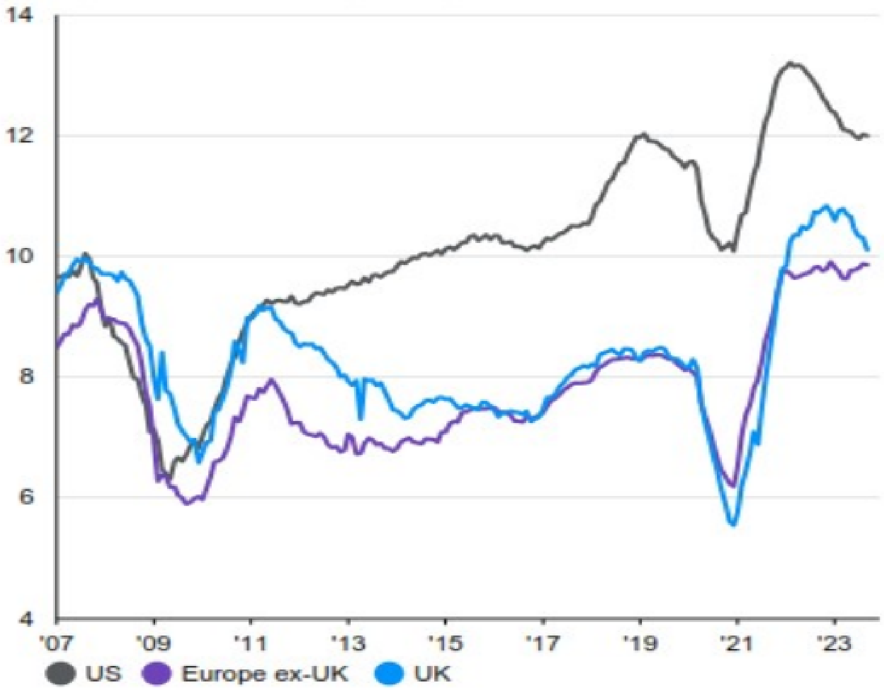
Asset Class	Index/Proxy	Net Return in EUR	
		2023 Q3	2023 YTD
Global Equities	MSCI World Net	-0.5%	12.0%
Eurozone Equities	MSCI EMU Net	-4.4%	10.2%
Emerging Market Equities	MSCI Emerging Markets Net	0.0%	2.6%
Eurozone Government Bonds	ICE BofA ML Euro Sovereign > 5 Yr	-4.4%	-1.4%
Eurozone Inflation-Linked Bonds	Barclays Euro Govt Inflation-Linked	0.6%	-3.0%
Eurozone Corporate Bonds	iBoxx Euro Corporates	-0.8%	1.9%
Emerging Market Local Currency Bonds	J.P. Morgan GBI-EM Global Diversified	-0.8%	4.9%
Irish Property	Irish Life Exempt Property Fund	-4.6%	-10.1%
Commodities	Bloomberg Commodity Index Total Return	9.4%	-2.5%
EUR vs USD		-4.7%	-0.7%

- Inflation continues to be the critical variable for financial markets, most particularly bonds. If inflation does not come down as quickly as investors expect, yields will rise further. We may well be at or very close to the pinnacle of rates for this cycle, but the emerging inflation data will determine the scale and timing of the cuts which investors are looking for 'around the corner'. Mainly because of the tightness of labour markets, we lean towards the view that inflation will prove a harder nut to crack than the consensus opinion.

- Clearly there is a major spread of opinion in relation to the likelihood and severity of recession and a number of widely used indicators are consistent with a slowdown/recession. With consensus earnings growth forecasts for global equities for 2024 at almost 10%, stock markets are are not priced for a recession. Current valuations, although reasonable in a thirty year context, are on the basis of a period in which earnings have been on high ground:

Chart 2 **Profit Margins**

% margins of 12 month trailing earnings relative to sales



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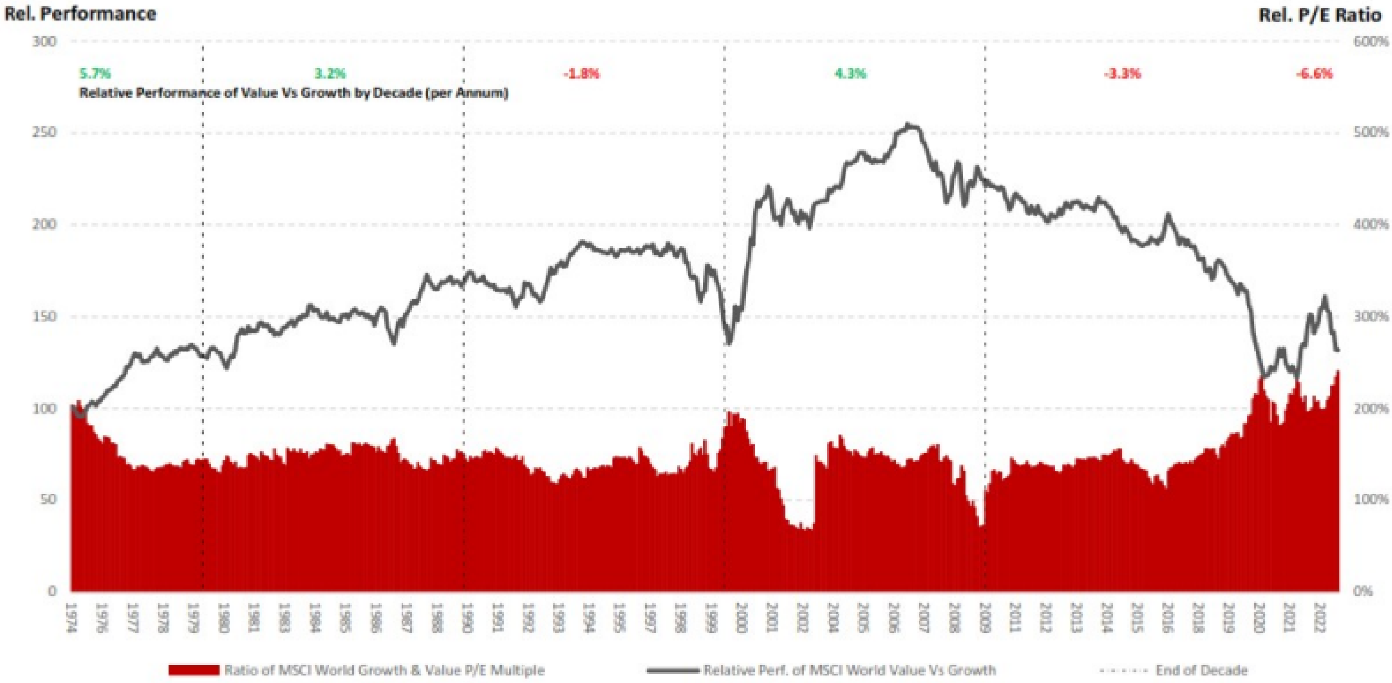
MARKET OUTLOOK CONTINUED

- Within equity markets, the relative valuation as between ‘growth’ and ‘value’ is close to historical extremes and we believe tilting towards the latter, where possible, will be beneficial.

Chart 3



Source: SSgA

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