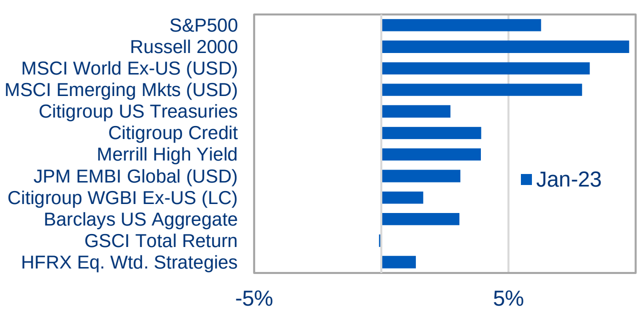
Global Market Review

With increasing signs that inflation, the pace of Fed rate hikes, and the risk of a deep recession, are all abating, risky assets soared, and safe haven sovereign yields declined in January. The reopening of the Chinese economy with the end of its zero-COVID policy further brightened the global economic outlook. In the U.S., speculative stocks led the equity market higher. European bourses benefited from unexpected economic resilience and sharply lower gas and energy prices despite the disruption in Russian supplies. Across emerging equity markets, a resurgent China drove the rebound. In the U.S. Treasury market, yields at the long end of the maturity spectrum declined most, contributing to a deeper inversion of the yield curve. Credit spreads narrowed, and both investment grade and high-yield bond prices rose. With investors expecting a slower pace of Fed rate hikes, the U.S. dollar declined against most currencies. Commodity prices, led by crude oil, also fell.

Performance of Major Market Indices

Sources: S&P, MSCI, FTSE Russell, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, HFR, Bloomberg.



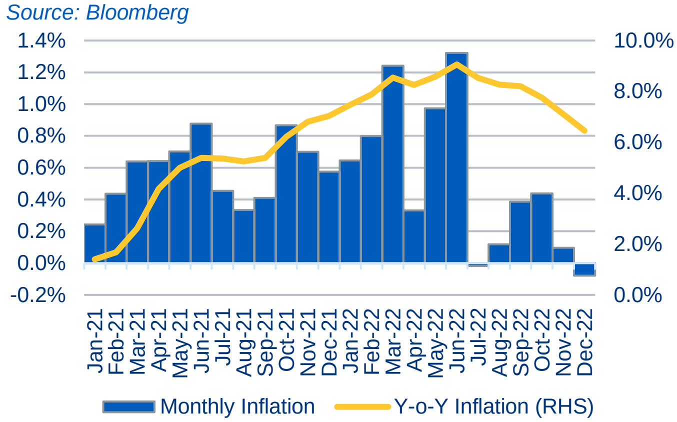
Global equity and bond markets rebound in January.

All Eyes on Inflation, and Central Banks

Global equity and bond markets have been fixated on the waxing and waning of price pressures, taking inflation as a harbinger of the path of monetary policy and, by extension, the global economy. Thanks largely to declining energy prices, price pressures across advanced economies have eased, providing a boost to stock and bond markets. In the U.S., the rate of headline inflation has slowed considerably since the summer of last year (Exhibit 1). Market- and survey-based indicators of inflation expectations in Europe and the U.S. suggest a consensus that price pressures will continue to ease, central banks will be able to slow and eventually reverse policy tightening, and recession will be avoided. In short, hopes for a soft landing appear to be spreading.

Exhibit 1. Inflationary Pressures Ease

Source: Bloomberg



Reflecting these hopes, stock markets have risen, credit spreads have narrowed, and the dollar has depreciated. Taken together, these market reactions have eased financial conditions, offsetting some of the monetary policy tightening engineered by global central banks. However, history suggests that high inflation can be a tenacious adversary. If inflationary pressures prove more difficult than expected to expunge, the anticipated slowdown in central bank tightening now priced into markets could be disappointed.

Tech Stocks Lead U.S. Equity Market Rebound

U.S. equity markets enjoyed a strong January bounce. Hopes that easing price pressures would allow the Fed to slow the

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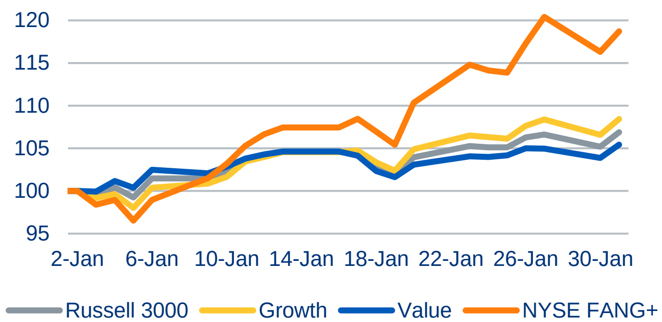
pace of tightening and thus avoid a deep recession buoyed sentiment. Moreover, economic output in 2022 proved to be more resilient than expected. The labor market remained tight. Consumer spending held up, helped in part by recourse to accumulated savings. Faced with sustained demand, businesses continued to invest. Supply side bottlenecks, shipping costs, and the all-important price of gasoline eased, helping to sustain demand and ease inflationary pressures.

Despite January's return to exuberance, the outlook for the U.S. economy and equity market remains uncertain. The latest ISM manufacturing output and new orders indices point to recession. New home sales and construction spending are also falling. The steep inversion of the U.S. Treasury yield curve continues to signal a likely recession. Consensus expectations for corporate earnings growth in 2023 have plummeted. Moreover, the combination of higher borrowing costs, slowing growth of economic output and corporate earnings, full asset valuations, and a large stock of debt forms a potentially volatile brew that could prove destabilizing to markets.

Exhibit 2. Tech and Growth Stocks Lead Rebound

Source: Bloomberg. January 1, 2023 = 100.



Against this backdrop, the S&P500 index rose 6.3% in January, taking some of the sting out of its 18.1% plunge last year. Highly overvalued growth stocks in the tech sector that had fallen from their lofty but unsteady pedestal last year, rebounded strongly in January. The NYSE FANG+ index (including Facebook, Amazon, Apple, Netflix, Google, Microsoft, and Tesla among others) gained 18.7% (Exhibit 2). The U.S. market's gains were unevenly spread, although all sectors recorded at least slight gains. Consumer discretionary and tech stocks led other sectors by a wide margin.

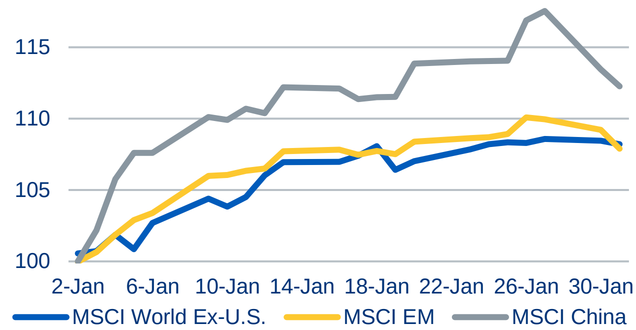
Non-U.S. Equity Markets Also Rally

European economies proved far more resilient than feared. The combination of sharply falling energy prices and fiscal support to households and corporations helped to sustain positive European economic growth and low unemployment throughout last year, despite the contraction of the German and Italian economies in the fourth quarter. Against this backdrop, the MSCI World ex-U.S. index of advanced economy stocks gained 8.2% in January, with markets in Europe and Japan rising by 8.7% and 6.2%, respectively.

Expectations for a strong rebound in the Chinese economy with the lifting of COVID-related restrictions buoyed Chinese equity markets, which jumped 12.2% in January (Exhibit 3). China's rebound contributed to the strong performance of the MSCI EM index, which gained 7.9%. Bourses in Latin America also performed well, rising 9.7%, while those in the EMEA region lagged with a 2.3% increase.

Exhibit 3. China's Rebound Boosts EM Returns

Source: Bloomberg. January 1, 2023 = 100.



Yields Decline on Easing Price Pressures

The inversion of the U.S. Treasury yield curve deepened in January as long-term yields declined and short-term rates rose. The broad U.S. Treasury index gained 2.7% while U.S. Treasuries with maturities of 10+ years rose 6.2%. The decline in yields largely reflected lower real yields on TIPS. U.S. credit markets also rebounded. Following last year's largest decline on record, the U.S. aggregate bond index rebounded, gaining 3.1% in January. High yield bonds performed somewhat better, generating a return of 3.9%, as credit spreads narrowed.

Outside of the U.S., the WGBI ex-U.S. index of advanced sovereign bonds rose 3.5% in January. European sovereign bonds gained 4.4%, reflecting reduced fears over inflation following the sharp decline in European energy prices. Emerging market bond markets also enjoyed positive returns, rising 3.1% in January.

Falling Oil Prices Drag Down Commodity Index

Despite the prospect of stronger demand for industrial metals with the reopening of the Chinese economy, commodity prices as measured by the GSCI declined slightly in January, dragged down by the 1.7% fall in oil prices.

Performance of Major Market Indices through 1-31-2023

Sources: MSCI, FTSE, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, S&P GSCI, HFR, Bloomberg.

	1-Month	QTD	YTD	1-Year	3-Year	5-Year
S&P500	6.3%	6.3%	6.3%	-8.2%	9.9%	9.5%
Russell 2000	9.7%	9.7%	9.7%	-3.4%	7.5%	5.5%
MSCI World Ex-US (USD)	8.2%	8.2%	8.2%	-3.0%	4.6%	2.5%
MSCI Emerging Mkts (USD)	7.9%	7.9%	7.9%	-12.1%	1.4%	-1.5%
Citigroup US Treasuries	2.7%	2.7%	2.7%	-8.6%	-2.6%	0.7%
Citigroup Credit	3.9%	3.9%	3.9%	-9.6%	-2.4%	1.4%
Merrill High Yield	3.9%	3.9%	3.9%	-5.0%	1.1%	2.8%
JPM EMBI Global (USD)	3.1%	3.1%	3.1%	-11.3%	-4.1%	-0.4%
Citigroup WGBI Ex-US (LC)	1.6%	1.6%	1.6%	-12.1%	-5.0%	-1.3%
Barclays US Aggregate	3.1%	3.1%	3.1%	-8.4%	-2.3%	0.9%
GSCI Total Return	-0.1%	-0.1%	-0.1%	12.8%	14.8%	5.7%
HFRX Eq. Wtd. Strategies	1.4%	1.4%	1.4%	-1.4%	1.9%	0.8%