Financial Markets - 2023 in a wrap

Abbreviation Lists: **Q1-Q4**: each quarter. **H1-H2**: each semester.
YTD: Year To Date. **YoY**: Year over Year. **bps**: basis point, 1 bp = 0.01%

Europe

This year has been marked by the resurgence of inflation and restrictive monetary policy led by the ECB, the BOE[1] and other Western central banks. Nevertheless, the major stock indices reached all-time record-breaking levels. As of mid-December, CAC 40 is up +15% (YTD) to 7,600 pts, the DAX 30 +20% (YTD) to 16,885 pts and FTSE MIB +25% (YTD) to 30,400 pts. Quality stocks in consumer staples, healthcare and technology sectors are seen to be the main drivers of European indices. However, data such as retail sales and purchasing managers' surveys (PMI[2] index) revealed a significant weakening in the economy.

Throughout the year, bond markets eagerly awaited signs of an interest rate slowdown. The French 10Y Government Bond (FR10Y), which began 2023 yielding 2.9%, reached a decade high of 3.5% (+60 bps) in mid-October. Similarly, the FR2Y and FR30Y followed similar trajectories, starting at 2.9% and 3.09% (respectively), and peaking at 3.5% (in July and in October for the 2Y) and 4.084% (for the FR30Y) by the end of Q3. As we approached year-end, softer inflation data in Q4 called central banks, in their recent decision meetings, to maintain current interest rates. Anticipating central banks to initiate rate cuts next year, FR10Y reached 2.5% in December, below its level at the beginning of 2023, and GE10Y dropped to 2%.

While this sounds encouraging for the European markets, strategists still don't put aside the risk that some of the countries will enter into recession in 2024. The Eurozone's GDP declined by 0.1% in Q3, and it is expected to stay negative in the final quarter of the year, raising concerns about the possibility of a recession. The latest data, including the PMI, which fell to 47 (vs. 47.6), paints a desolate picture of the Eurozone economy, with no signs of recovery in both the private services and manufacturing sectors in December.

US

In 2023, U.S. annual inflation decreased from 6.9% in January to 3.1% in November and that the job market stayed resilient with an average unemployment rate of 3.6% (YoY), nevertheless we saw noticeable change in U.S. job data, as monthly new hires have declined throughout H2 vs. H1. In line with those data, the U.S. 10Y Treasury Bond started the year yielding 3.8%. It

[1] ECB: European Central Bank; BOE: Bank of England
[2] The Purchasing Managers' Index is a 0 to 100 scale indicator derived from a monthly survey of the private companies in the manufacturing and services sector. A reading above 50 shows expansion, below 50 contraction.

increased by +110 bps, reaching a decade-high yield of nearly 5%, driven by market concerns regarding the debt ceiling and the risks of a recession. With the decision to keep rates unchanged in the past three meetings, the markets have anticipated that the Fed may have concluded its tightening cycle. Besides, in the December meeting, Powell unexpectedly adopted a dovish[3] tone, even suggesting the possibility of seeing 3 rate cuts in 2024. The 10-year yield, from its October peak, has declined by over 100 bps, falling below 4% level in December, marking its lowest point since August 2023.

In the stock markets, the S&P 500 is +23% YTD, the NASDAQ-Composite +40% YTD and the Dow Jones Industrial Average is +12.5% YTD, driven by the rally in Technology, Communication Services and Consumer Discretionary stocks. Growth stocks outperform (on YTD) other asset classes and regained their position from 2 years ago. The Artificial Intelligence (AI) boom of the beginning of the year, with the launch of ChatGPT has played a major role in the ambition of Big Tech companies. Nvidia, the high-end semiconductor company, registers the best performance of the S&P (+220% YTD). primarily due to robust demand in its data centre business driven by companies upgrading infrastructure for intensive AI workloads. Meta Platforms, the parent company of Facebook and Instagram, is another standout performer, witnessing a 172% YTD rally due to the recovery of the online advertising market from the 2022 downturn and its investment in AI technology and the metaverse.

The U.S. market seems on track to attain the long-awaited "soft landing". Job markets have remained resilient while pressure on interest rates has been strong but are now easing. It is not without forgetting the presidential campaign and its election next November, which will give the tone of the fiscal, social and economic policy of the U.S. in the coming years.

Emerging Markets (EM)

Unsurprisingly, the series of interest rate hikes by the Fed introduced some volatility into EM equities (measured by the MSCI Emerging Market Index) during 2023. The condition of the U.S. economy, combined with unmet expectations around China's recovery, emerged as the principal factor affecting this asset class. EM equities had an encouraging start to the year, registering a gain of over 9% in H2. In Q3, the index erased all of its performance by doing -11% between August and October because of the rising concern of a real estate crisis in China. However, from the end of October onward, the market has experienced a revival, marking an increase of approximately 10% by the end of November.

[3] dovish: in favour of rate cuts vs. hawkish: in favour of rate hikes
In monetary policy, a central banker adopts a dovish approach by cutting interest rates, injecting more liquidity or implementing more accommodative policies to stimulate economic activity.

Emerging market debt (EMD) as measured by the JP Morgan EMBI Global Diversified Index and EM corporate debt as measured by the JP Morgan CEMBI Broad Diversified Index has weakened during the first 3 quarters of the year, respectively -4.2 and -1.2% as investors priced the concerns of higher for longer rates, especially in the U.S. In the last quarter, while the market perception of a greater likelihood of a soft landing in the U.S., emerging market returns were positive for both indices to attain respectively as of the end of October, +6.07% and +5.28%.

Commodities

After a year 2022 marked by the Russian war in Ukraine, and the subsequent energy crisis in Europe and food prices shock in EM, the commodities markets in 2023 marked a step back. We observed a softer demand due to factors like a mild European winter, effective trade flow adjustments, and weaknesses in China's reopening. In 2023, Gold +11.37%, Silver +0.54%, Brent Oil -10.53%, Crude Oil WTI -10.79%, Natural Gas -44.83%, U.S. Wheat -20.52%. Looking ahead, monitoring OPEC+[4] policy is crucial for navigating 2024. Indeed, the group, particularly Saudi Arabia and Russia have expressed their willingness to reduce the production of oil to keep prices around $100 a barrel. Moreover, the recent tension in the Middle East and the possibility of more enforcement of U.S. sanctions against Iran could emphasise more pressure on oil prices. Additionally, COP 28 concluded disappointingly, with Saudi Arabia pledging to only reduce, or "transition away," the use of fossil fuels rather than a complete phase-out. This resulted in bearish movements in WTI oil prices emphasising concerns about fossil fuel prices in the coming years. Additionally, discussions on carbon pricing within the summit did not lead to a strong consensus, which led the EU ETS[5] carbon price to fall to its lowest level since October 2022. As of 15 December, it is now at €70 per ton of CO2 or C02 equivalent greenhouse gas.

Cryptocurrencies

Despite the banking crisis earlier in March that has affected the crypto world (Silvergate Bank and Signature Bank collapse), the cryptocurrencies have had a relatively good year. In fact, this period highlighted the risks inherent of traditional finance to the benefit of decentralised finance. Moreover, with the promising development of the Bitcoin ETF (Exchange Traded Fund) initiated by nine asset management firms, including players like BlackRock, WisdomTree and Valkyrie, the cryptocurrency has regained interest among investors and even institutionals. On YTD, the Bitcoin is +155% and the Ethereum +86.2%. Nevertheless, even after this significant rebound, Bitcoin prices are still down more than 45% from their all-time high of about $68,790 in November 2021.

[4] OPEC+: OPEC (Organization of Petroleum Exporting Countries) plus 10 other oil-producing countries.
[5] The EU Emissions Trading System is a 'cap and trade' mechanism that makes polluters pay for greenhouse gas emissions, reducing emissions and generating revenue for the EU's green transition.

Additional readings - 2024 outlook of major banks, asset managers and private equity firms.

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