PAPAMARKOU WELLNER PERKIN

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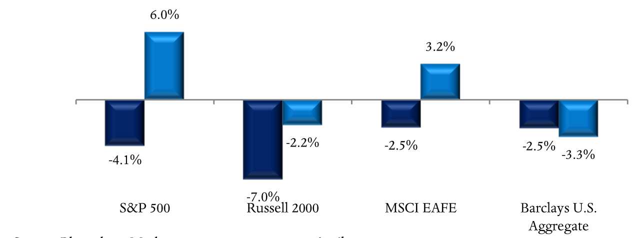
Markets

April was a difficult month for financial markets. A combination of stubborn inflation readings and softer economic datapoints fueled investor fears that central banks will not ease monetary policy as quickly as previously hoped. Stocks declined for the first time since October and bond yields moved higher. During the month, the S&P 500 index fell -4.1% (+6.0% ytd) while the more interest rate sensitive smaller capitalization Russell 2000 was thumped -7.0% (-2.2% ytd). The lower interest rate sensitivity of value oriented stocks allowed them to outperformed the growth segment.

Overseas equities also lost ground in April. The MSCI EAFE index declined -2.5% (+3.2% ytd) amid broad regional stock market pull-backs. In Europe, the Stoxx 600 benchmark dropped -0.8% for the month (+7.0% ytd). In Asia, Japanese equities gave up some of the gains that they had made over the last five months (-4.4% in April; +15.6% ytd). Widening interest rate differentials between Japan and other developed market countries has put significant downward pressure on the yen, for which foreigners must adjust their net returns. Chinese stocks in the Shanghai composite bucked the trend in April, rising +3.2% (+4.4% ytd) on the back of a more dovish Commitee stance with regard to real estate and financial vehicle deleveraging.

Fixed income markets suffered from the change in Fed Funds interest rate expectations, now pricing between one and three quarter-point cuts, with the timing also pushed out. 2-year US Treasury Note yields rose 40 basis points (bps) to 5.0%, while sovereign 10-year yield rose 47 bps to 4.7%. As a result, the Barclays US Aggregate bond index declined -2.5% in April (-3.3% ytd).

A resilient economic environment, constrained supply, and the danger of escalation in the Middle East boosted commodity prices. Copper prices rose significantly, at-



Source: Bloomberg Markets

tributed to increased use in military (second most widely used material in weapons platforms, comprising 9% of global production, estimated to grow by 14% per year through 2026) and technology (AI, EVs, decarbonization, and other macro trends are increasingly using the metal). Overall, the Bloomberg Commodities Index increased +2.7% in April ending as the top performing asset class for the month (+6.1% ytd). After briefly achieving record highs in April, digital assets encountered significant profit-taking, with Bitcoin and Ethereum giving-up -15.4% and -17.8% (+42.7% and +31.5% ytd), respectively.

Geopolitics

Geopolitical tensions remain elevated in the Middle East. Hostilities between Israel and Iran flared during April, but tensions eased after an exchange of military actions. As Israel ponders the next steps with regard to the weeding out of Hamas in Gaza, senior Israeli officials are contemplating and expansive postwar plan. There is a vision where Israel would share oversight of the enclave with an alliance of Arab countries (including Egypt, Saudi Arabia and the UAE), as well as the US. A precondition would be normalized relations between Israel and Saudi Arabia. Key differences are likely to include whether a Palestinian sovereignty would be created and if Israeli military could operate in Gaza in the interim. It is likely that extremists on both sides will object, but the concept suggests flexibility and offers hope for a peaceful and more unified path forward.

Meanwhile, efforts continue to seal a truce between Israel and Hamas.

United States

The US economy has been robust, with the trailing six quarters, through year-end 2023, showing annualized Gross Domestic Product (GDP) growth rates in excess of 2.0%. However, signs of a potential slowdown are starting to surface. First-quarter GDP growth increased at a 1.6% annualized pace, below the 2.4% consensus estimate. Additionally, April nonfarm payrolls rose by a less-than-expected 175,000 (versus consensus of 240,000), with associated wage growth of 3.9% (versus 4.1% in March). The Consumer Confidence Index also deteriorated for the third consecutive month in April, retreating to 97.0 from a downwardly revised 103.1 in March. Meanwhile, the associated Expectations Index, based on consumers' short-term outlook for income, business, and labor market conditions, fell to 66.4 from a slightly upwardly revised 74.0 last month. A reading below 80 often signals a forthcoming recession. Manufacturing survey data also pointed to areas of economic weakness, such as a decline in new orders in April's PMI and deteriorating regional manufacturing reports from multiple Federal Reserve districts.

With regard to inflation, CPI and PPI data released in April came in hotter than anticipated at 3.5%, while "supercore" inflation, which tracks prices of core services, excluding housing, rose at an annual rate of 4.7%. The Federal Reserve's favored indicator, the Personal Consumption Expenditure (PCE) came in at an annualized rate of 3.4%, the highest in a year. In all, these data points are viewed as still too high for the Fed to consider easing monetary policy.

Given the aforementioned economic situation, there has been a significant shift in market sentiment regarding the Federal Reserve's potential monetary policy actions, with the magnitude of rate cuts decreased and the timing pushed out. During the final quarter of 2023 and early 2024, there was strong confidence in the potential for three, or more, rate cuts starting in June.

April 2024 Economic Statistics

	Apr-24	Dec-22	Dec-21
Federal Funds Target Rate	*5.25 - 5.50%*	*4.25 - 4.50%*	0 - 0.25%
Consumer Confidence Index	*97.0*	*108.3*	115.8
Manufacturing PMI Index	*49.2%*	*48.4%*	58.7%
Unemployment Rate	*3.9%*	*3.5%*	3.9%
JPY / USD	*157.80*	*131.11*	115.08
USD / EUR	*1.0665*	*1.0702*	1.1368
Gold / oz.	*$2,285.57*	*$1,824.40*	$1,828.39
Oil (WTI) / bbl	*$81.93*	*$80.26*	$75.21

Sources: see disclosure *

Those expectations have now changed to one, possibly two or three, twenty-five basis point cuts by year-end. Moreover, the combination of stubborn inflation and some weaknesses in economic growth have led to discussions of "stagflation."

Europe

The eurozone economy grew 0.3% sequentially in Q1, following a fractionally negative performance in Q3 and Q4 2023, emerging from a technical recession. German GDP rebounded from negative territory to show 0.2% growth in Q1. This contrasts with the ongoing growth-spurt in southern European countries such as Italy, Spain, Portugal and Greece whose output is now collectively 5% larger than Germany's. The peripheral economies have been boosted by a rebound in tourism following the lifting of pandemic restrictions, as well as their lower exposure to the manufacturing downturn and loss of cheap Russian gas. Looking ahead, the region's economic growth should re-accelerate to 0.7% in 2024 and 1.2% in 2025.

The eurozone's composite PMI rose to 51.7% in April, significantly above December's contractionary level of 47.6% and an eleven-month high. Improved growth prospects and inflation dynamics in the region were able to partially compensate for the headwinds of higher interest rates and geopolitical risks.

Eurozone inflation in April remained flat at 2.4% year over year, but the important services component fell 30 bps to 3.7%. A less inflationary environment, combined with the prospect of stable but slow growth, are likely to lead to a first interest rate cut from the ECB this summer, with a second to follow by year-end.

The UK remains mired in recession, with economists at the OECD predicting its GDP will fall to the bottom of the G7 growth league in 2025 at 1.0%. Meanwhile, the country's composite PMI rose to an expansive 54.0%, while local headline inflation receded to 3.2%, though there are still concerns about the stickiness of some core components. As a result, the BoE is expected to begin cutting interest rates starting in September.

Asia

China saw improved sentiment on the back of its Politburo signaling a more dovish tone on housing and Local Government Financing Vehicle deleveraging. However, there are lingering concerns about the strength of the recovery in the world's second-largest economy, weighed down by the country's real estate crisis and elevated unemployment, particularly amongst the youth.

Stubbornly loose monetary policy from the Bank of Japan has led to a vast interest rate differential between Japanese and other developed country bond markets. The 10-year Japanese government bond currently yields 0.87% compared to 4.45% for the 10-year US Treasury Note. In turn, the yen has weakened significantly, to 160 (versus the US dollar), from 142 at the start of the year. As a result, the Japanese government has expressed concern about the potential for latent inflationary pressures, including long-term wage growth. A weak yen pressures domestic consumption, but promotes foreign buying of Japanese goods and tourism. The inflationary effects were evident in the country's spring wage negotiation known as "Shunto" which concluded with historically high 5% growth.

Outlook

April highlighted that persistent inflation remains a key risk and has the potential to be a headwind for both stocks and bonds. The economic backdrop appears supportive to corporate earnings, especially those with pricing power. The first quarter earnings season saw companies broadly exceed expectations, albeit against a low bar. Markets were, however, more willing than usual to punish companies that missed expectations as investors looked to see if earnings justified the last six months of valuation expansion. It is also notable that the "Magnificent Seven" mega-cap tech-oriented companies (Microsoft, Apple, Nvidia, Alphabet, Amazon, Meta Platforms, and Tesla) are projected to report an impressive 47% Q1 (year-over-year) growth in net income (versus -12% for the remaining 493 stocks in the S&P 500 index). To us, this indicates that the broad stock market is still mired in an earnings recession while adapting to the current inflationary environment which is pressuring profit margins. Looking ahead, we see earnings acceleration in the back-half of 2024, with the S&P 500 index constituents expected to show +8.6% annual growth. Moreover, 73% of the benchmark's base are seeing positive changes in their 12-month forward estimates versus 3 months prior, the highest upward rate of change in roughly a year, according to Factset. In a continuation of the trend, 2025 S&P 500 earnings estimates imply an additional +13.6% growth.

Our research indicates it is important to also consider the potential that economies slow down amid inflationary pressures that keep interest rates elevated. In such a scenario, as well as a deflationary growth shock, high-quality bonds can contribute to portfolio returns, thus acting as a good hedge to traditional equities.

Actively managed, non-market correlated, and commodity investments can augment risk-adjusted returns of traditional portfolios, while reducing overall volatility. Inflation resistant natural resources, especially noble alloys and specialty metals, offer interesting opportunities stemming from growth in military and technology applications, as well as the potential for supply shortages, amid geopolitical instability. Smaller capitalization stocks of high quality companies may also be poised for a renewed period of investor interest. We are also seeing specific opportunities in software focused investments, with an activist element. For longer-term investors we have compelling ideas in the private equity segment, revolving around European growth, healthcare, and education-technology.

*Sources: Reuters, Bloomberg, Bureau of Labor Statistics, Conference Board, Federal Reserve, Institute for Supply Management, MSCI, Russell, Standard & Poor's, Financial Times and the Wall Street Journal.

430 Park Avenue · 17th Floor · New York, NY 10022 Tell (212) 223-2020 · Fax (212) 758-9804 · www.papamarkou.com