SIGMA
PRIVATE OFFICE

Q4 2023 MARKET REVIEW AND OUTLOOK

MARKET REVIEW & OUTLOOK

As 2023 draws to a close, we look back over yet another eventful year. While 2022 was marred by the second global bear market in just 3 years, 2023 started as it meant to go on. Global equity markets continued their ascent from the October '22 bear market low, with the MSCI World rebounding 33.85%. Most indices finished the year strongly higher, as shown in Chart 1, and the S&P 500 closed just 0.5% below its 2021 all-time high; an outcome only few others deemed possible going into the year.

CHART 1

GLOBAL ASSET CLASS PERFORMANCE

INDEX	Q4	2023
MSCI World Index (USD)	11.42%	23.79%
S&P 500	11.24%	24.23%
Nasdaq 100	14.34%	53.81%
STOXX Europe 600 (EUR)	6.40%	12.74%
FTSE 100 (GBP)	1.65%	3.78%
Nikkei 225 (JPY)	5.04%	28.24%
Hang Seng (HKD)	-4.28%	-13.82%
MSCI Emerging Markets Index (USD)	7.86%	9.83%
Bloomberg Global Aggregate Bond Index (USD)	8.10%	5.72%
US 10 Year Treasury Bond	6.79%	3.54%
Bloomberg Commodity Index	-5.91%	-12.55%
WTI Crude Oil	-20.92%	-10.45%
Gold	11.60%	13.34%

Source: FactSet, data as of 31/12/2023

The final quarter of 2023 was a tale of two halves. The late summer sell-off continued into October with financial conditions tightening as lending growth slowed, credit spreads widened, and the US 10 Year Treasury Yield hit a new sixteen year high of 5.02%. A resurgence in oil prices ignited fears the disinflationary progress could be quickly undone and with US Q3 GDP growth coming in at a blistering 5.2% annualised, it's strongest quarter since Q4 2021, market participants feared the Federal Reserve may have to hold rates higher for longer. Despite the report's testament to consumer resilience and labour market strength, the culmination of various economic concerns was enough to push most major equity indices into correction territory (>10% decline) by month end.

The tide quickly turned in November with the MSCI World Index (USD) surging 9.43% whilst the Bloomberg Global Aggregate Bond Index gained 5.04%, its best month since December 2008. The rally continued into December as investors increasingly speculated the Federal Reserve, and its global peers, were done with their aggressive rate hiking cycles and may start cutting interest rates sooner in 2024 than anticipated. Yields retraced, with the US 10 Year yield falling back below 4%, and equities pushed higher as inflation, consumer spending and the labour market cooled, giving investors greater confidence in a soft landing. As a result, the US Dollar Index slipped 5.3% from its year to date high.

As markets approach breakeven, it is timely to touch upon the behavioural psychology at play. Namely, loss aversion can tempt investors to exit the market once the losses from an earlier correction or bear market have been recovered. However, this urge typically arises in an early bull market, and history shows new bull markets have gone on to mark many new all-time highs. Furthermore, as shown in Chart 2, once breakeven had been met, on average the S&P 500 continued to climb for an additional forty-five months, averaging a return of 118% beyond previous highs. Cumulative returns from bear market lows are even higher, highlighting the importance of staying disciplined and invested to capture the upside needed to achieve your long-term investment objectives.

CHART 2
EQUITY MARKETS CONTINUE TO RALLY AFTER BREAKEVEN

Date of Breakeven	Next Peak	Bull Duration After Breakeven (M)	Bull Return After Breakeven	Cumulative Bull Market Returns
02/17/1945	05/29/1946	15.4	44.1%	800.0%
10/25/1949	07/15/1957	92.7	365.2%	525.6%
07/28/1958	12/12/1961	40.5	71.8%	114.4%
04/23/1963	02/09/1966	33.5	47.1%	101.2%
03/23/1967	11/29/1968	20.2	25.5%	58.4%
03/15/1971	01/11/1973	21.9	26.0%	88.7%
07/12/1976	11/28/1980	52.5	64.4%	201.0%
10/07/1982	08/25/1987	58.6	217.7%	303.0%
05/17/1989	07/16/1990	14.0	20.8%	80.6%
02/11/19910	09/01/2000	114.7	411.8%	546.7%
10/23/2006	10/09/2007	11.5	15.8%	120.7%
04/02/2012	02/19/2020	94.6	181.2%	528.9%
08/10/2020	01/03/2022	16.8	45.8%	120.4%
	Average	45.1	118.2%	276.1%
	Median	33.5	47.1%	120.7%

Source: FactSet, S&P 500 Total Returns Index, 01/06/1932 – 03/01/2022

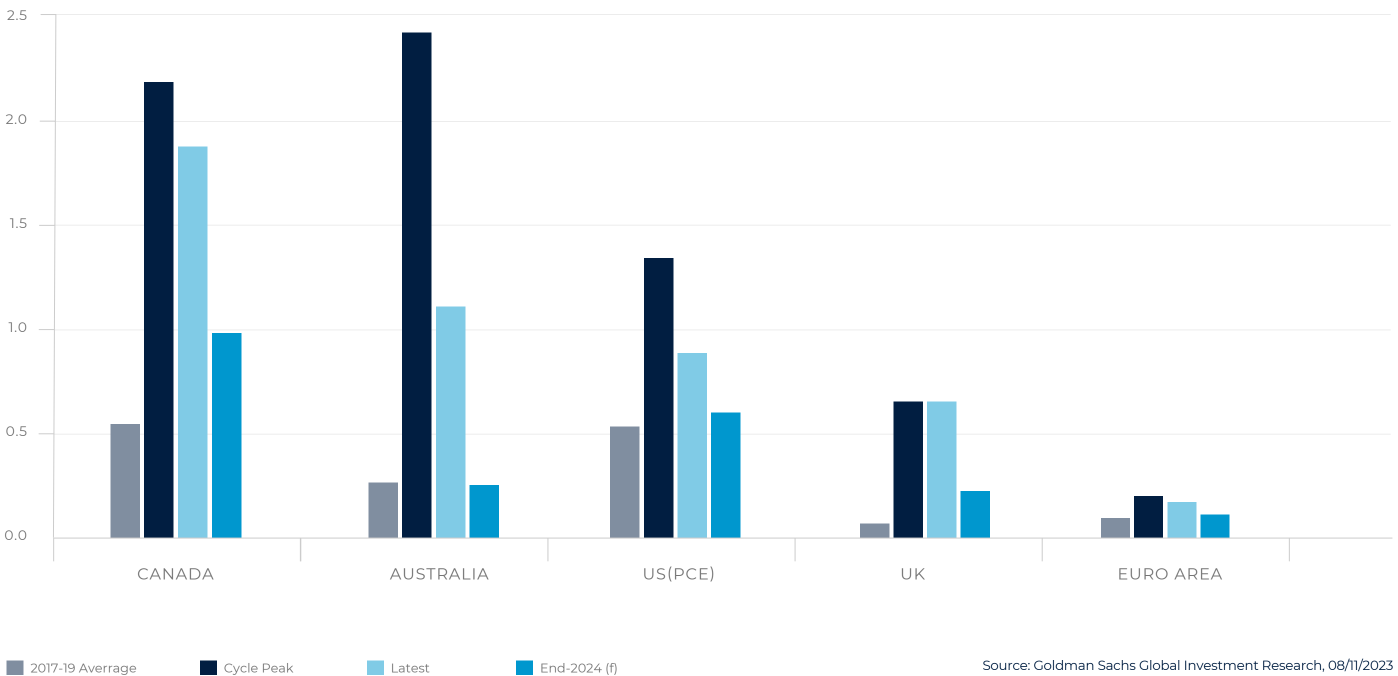
With deeply depressed sentiment and economists predicting a 70% chance for a 2023 US recession as of late 2022, we should not downplay the progress made over the past twelve months. Not only has global economic growth surprised to the upside in the face of several negative shocks (including a very real threat to the banking sector), but unemployment has also remained historically low. All this has occurred alongside much lower inflation across economies that saw a large and unwanted post-pandemic price surge.

This resilience of global economies can largely be put down to two main factors. First and foremost, consumers and businesses benefited from generally low levels of debt overall and proved far less interest rate sensitive than expected, having refinanced, and locked in rates at historically low levels. Secondly, consumers have been able to rely on excess savings and wage growth to help maintain high levels of spending despite inflationary pressures.

Looking ahead to 2024, we enter the New Year with a more constructive macroeconomic backdrop than just a year ago. Headline CPI (Consumer Price Index) in the US has fallen from 6.5% in December '22 to 3.1% this November, whilst in Europe the reading has fallen from 9.2% to a mere 2.4%. Furthermore, recent data points to a further cooling in 2024 with Goldman Sachs noting core inflation, averaging across the G-10 (minus Japan) plus the early Emerging Market hikers, ran at an annualised pace of 2.2% over the past three months.

Importantly, shelter inflation in the US, which has accounted for over 75% of the year-over-year change in CPI, also shows encouraging signs of cooling to more manageable levels as home prices and new rents fall (Chart 3).

CHART 3
SHELTER COST INFLATION HAS COME DOWN BUT STILL HAS FURTHER TO FALL



Source: Goldman Sachs Global Investment Research, 08/11/2023

In Europe, a weaker near-term demand outlook should support further easing, while in the UK a loosening labour market is expected to slow wage growth and allow for core inflation to finally come down meaningfully. As such, short of any unforeseen shocks, it seems likely developed market central banks will near their inflation targets at various points throughout 2024.

Alongside a more sanguine inflation outlook globally, the growth outlook for the US continues to look more promising than the rest of the developed world. Unemployment has managed to remain below 4% as the labour market rebalances; the gap between job openings (labour demand) and unemployed workers (labour supply) has fallen from its peak of over 6 million to close to 2.5 million today which should help wage growth continue to ease. Furthermore, the services sector, which accounts for over 70% of GDP (Gross Domestic Product), is expanding and the housing sector is showing early signs of bottoming out with new housing starts and building permits starting to reaccelerate. The US is also positioned to gain the most from productivity enhancing Artificial Intelligence adoption. Nonetheless, with monetary policy rates firmly in restrictive territory, US economic growth faces headwinds which likely keep it at or slightly below trend growth in the near term.

European economic growth, on the other hand, has deteriorated further as weaknesses in the manufacturing sector broadened to services. Stagnating growth leaves the European Union flirting with recession and while one may have been avoided in 2023, there isn't much room left for error in 2024. However, still rising wages provide support for the consumer and a potential bottoming in manufacturing are some positives to note. Any contraction would therefore likely be relatively mild.

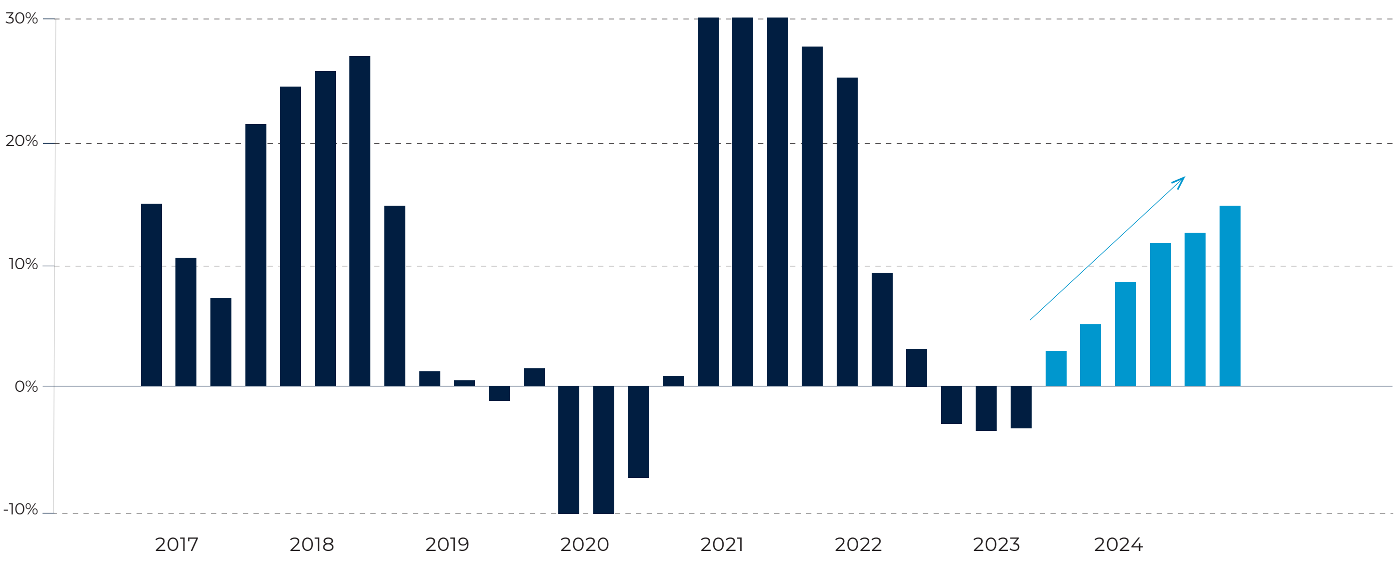
Likewise in the UK, a mild recession looks likely but at this point it is so widely discussed it is hardly surprising to UK markets, which have already lagged quite significantly this past year.

As for China, despite all the pessimism surrounding their property sector woes, fourth quarter economic data showed a welcomed reacceleration in industrial production, retail sales and quarter-over-quarter GDP growth as the economy normalises post covid. While China undoubtedly faces various longer term structural challenges, which we discussed in our Q3 Market Review, in the short term they should continue to grow modestly and contribute positively to global economic output.

Shifting focus to the corporate sector, as ultimately earnings growth and dividends propel equity returns over time, we believe Q2 2023 marked the end of the earnings recession. The third quarter saw earnings inflect positively, after nine of the eleven major sectors in the S&P 500 experienced three consecutive quarters of negative EPS (Earnings Per Share) growth as shown in Chart 4.

CHART 4

THE EARNINGS RECESSION IS OVER



Source: J.P. Morgan Private Bank, 2024 Outlook

Going forward, we anticipate improving corporate earnings as businesses emerge with leaner cost structures. Indeed, the technology sector has laid off more workers than at any time since the dot com era. Furthermore, solid balance sheet management and strong pricing power should allow large-cap businesses to increase profitability in a still resilient demand environment in 2024.

At this point it seems central banks do not need a recession to bring inflation down, so they should try hard to avoid one. Recent analysis of past hiking cycles by Goldman Sachs showed that major central banks were twice as likely to cut interest rates in response to downside growth risks once inflation had normalized to sub-3% relative to when inflation was above 5%. Although rates could normalise above their post Global Financial Crisis averages, it seems likely 2024 has at least some cuts in store for us, which history shows has been positive for equities and bonds when a recession has been avoided (Chart 5).

CHART 5

EQUITIES AND BONDS TEND TO RALLY IN CUTTING CYCLES

	Last hike	Last cut	Type	▲Policy rate (bps)	▲10Y Treasury (bps)	S&P 500 return
1	Nov-66	Apr-67	Soft landing	-225	-48	9.8%
2	Aug-69	Feb-71	Recession	-700	-52	3.0%
3	May-74	Apr-75	Recession	-775	68	-5.3%
4	May-81	Dec-82	Recession	-1150	-387	2.7%
5	Aug-84	Aug-86	Soft landing	-587	-556	46.9%
6	Feb-89	Sep-92	Recession	-638	-279	43.1%
7	Feb-95	Jan-96	Soft landing	-75	-197	35.2%
8	Mar-97	Nov-98	Soft landing	-75	-206	50.4%
9	May-00	Jun-03	Recession	-525	-313	-32.9%
10	Jun-06	Dec-08	Recession	-400	-263	-30.3%
11	Dec-18	Oct-19	Soft landing	-75	-98	21.5%
12	Oct-19	Mar-20	Recession	-150	-88	-21.7%
Average:				-448	-202	10.2%
Recession average:				-620	-188	-5.9%
Soft landing average:				-207	-221	32.7%

Source: Bloomberg, J.P. Morgan Private Bank, 01/12/2023

The upcoming year brings with it a Presidential election in the US and a General Election in the UK, increasing the scope for political uncertainty to weigh on market sentiment and restoking the debate of which party is better for markets. Yet if we look at Republicans vs. Democrats or Conservatives vs. Labour, there is no evidence to suggest one party is consistently better for markets or currencies than the other.

Additionally, while many investors fear elections are bad for equities, history suggests the contrary; in the twenty-four election years since 1926, US equities rose twenty times with average returns of 11.4%. Returns are typically back-end loaded as uncertainty falls but the political gridlock that ensues is bullish for equity and bond markets alike. As politicians turn their focus to campaigning and winning votes, major legislation is sidelined, allowing businesses to invest with confidence.

All in all, there are reasons to be optimistic for 2024, and despite recent improvements in sentiment it remains relatively depressed, suggesting there is still room for markets to surprise to the upside as they continue to climb the wall of worry in this young bull market. As investors, the path to new all-time highs may be choppy but staying the course has consistently proven the best way to achieve your longer-term investment objectives.

We thank you for taking the time to read our Market Review and wish you a happy and healthy 2024.

Sigma Investment Committee

This document is distributed by Sigma Private Office which is a trading name of Sigma Capital Partners MENA Limited who are regulated by the DFSA. The content of this document is for general information purposes only and does not constitute the offering of advice or recommendation to invest. Statements contained in this document may be considered forward looking statements. Such forward looking statements are not guarantees of future performance or events and involve risks and uncertainties. Actual results may differ materially from those described because of various factors. The value of investments and the income from them can go down as well as up and investors may not get back the amount originally invested. Past performance contained in this document is not a reliable indicator of future performance and should not be relied upon as an indication of future results.