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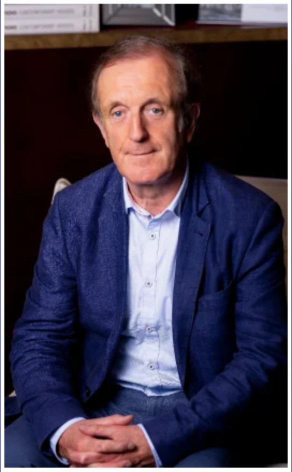
FINANCIAL MARKETS IN 2023

A VIEW



BY MICHAEL J. BOURKE
CHAIRMAN OF THE COUNCIL
OF AQUARIUM INVESTMENTS

THE CONTEXT

As we begin the journey through 2023, the Financial Markets are coming in from a turbulent and mainly negative outturn in 2022. The Central Banks in all major economies took aggressive control on the Monetary situations as rapidly increasing inflation became a fact of real lives globally. It was inevitable that unprecedented Monetary expansion during the early period of the Worldwide Pandemic, together with the supply chain bottlenecks when Economies reopened, would lead to sharp and rapid increases in the price levels of goods. In a perfect storm scenario, the Russian invasion of Ukraine in February 2022, added to rapid price level increases reflected in big hikes in Gas and Oil prices in particular. In a very fast catch-up move, Central Banks, led by the Fed, rapidly raised benchmark interest rates and threatened more rises to get a grip on fast rising inflation. In response, Equity markets fell significantly from their highs with drops as high as -40% in many cases. Bond markets dropped in prices to give higher yields reflecting the new interest rate levels.

FACING IRE IN 2023

‘IRE’ will dominate financial markets in 2023 - Inflation/Interest Rates, Recession and Earnings.

Inflation is starting to show a reduction in the pace of increase, mainly reflecting the rapid Interest Rates hikes by Central Banks, coupled with the threats of more to come. Its not clear how entrenched the high inflation levels (around 10%) are in the general price levels, especially with regards to wages. Its clear that most of the large Central Banks will stick at the task until they feel they have reined in inflation. It will take at least six months in 2023 to gauge this. Its hard to believe as some commentators say, that Central Banks will start to cuts rates after some months in 2023. Its significant that the ECB which came late to the table, have indicated regular increases in 2023.

Recession is the potential result of the higher costs of money / capital. That means a reduction in Economic activity and no doubt job losses. Governments will be left to pick up this tab with less taxes collected and Unemployment welfare increasing. We are already seeing these job cuts being announced, mainly so far, in the Tech Sector but, also in major employers like Amazon. We have not yet seen confirmation of Recession anywhere, but it is likely that the UK is already in Recession (two quarters of negative growth). Recession also threatens in Europe, which has the added challenge next door, from the conflict in Ukraine.

Earnings are already dropping in most companies and while these have not yet been formally reported, we can expect a lot of negative news, especially in the first quarter of 2023.

OPPORTUNITIES

Short dated Bonds especially good quality Corporate Bonds, 3-5 year maturities, offer decent yields of 4%- 5% (Euros) which can really lock in good returns, when Inflation and Interest rates peak and possibly ease towards the end of 2023.

Investors in Equities should look for good solid companies with strong steady financial performance, especially those that have stable Dividends track records. Banks should perform quite well as Banks always benefit when Interest rates rise, as they use the opportunity to wider their profit margins by increasing lending rates faster than Deposit rates. In the context of euro yields, Irish banks offer an interesting opportunity as their stock prices are coming from very low levels after rescue and now, with cleaned up Balance Sheets, more stringent Lending rules and less competition, they should grow profitability steadily. Ireland is not suffering as much as other EU economies, thanks mainly to the benefits of the very large Multinationals who operate here.

On the general Equity front, current levels are far more sensible and attractive for Longer Term investors, but we need to get a clearer picture on Company Earnings before rushing in.

Finally, the conflict in Ukraine can trundle on but no doubt there are Worldwide pressures to put a cease- fire in place. Any such announcement will no doubt boost Equity markets but perhaps not by as much as some expect. The Western World, especially the EU, has learned to adapt fairly rapidly and there are signs from Germany that the anticipated negative result for Germany and its Economy will not be so bad. For now, a mild winter also helps Europe avoid rising energy prices and eases inflationary pressure. Let's hope for a resolution of the conflict and the recovery of the European economy.