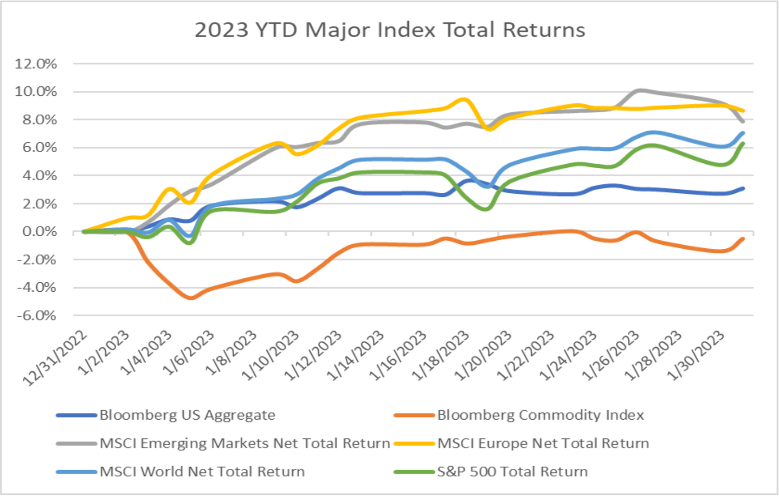
ENCORE INVESTMENT ADVISORS

JANUARY 2023 MARKET REVIEW

Market Recap: So far, 2023 is off to a fantastic start. After a solid fourth quarter to finish 2022, financial markets continued to shoot higher throughout the month of January. The strong and broad-based returns across fixed income and equity markets in January were driven by loosening financial conditions, better than expected inflation data, and a reversal of the vast tax-loss selling that occurred in late 2022. All of these factors have coincided with heightened expectations of a pause in the rate hiking cycle, and higher odds of the US and Europe avoiding recessions, although the majority of economists and strategists are still predicting a recession this year.

This month, global equities rose 7.1%, led by European and Asian stocks, while US bonds rose 3.1%. Since the end of the third quarter of 2022, global equities have rallied 17.5%, and now sit about 12% below year end 2021 levels; the point at which markets began to fall due to inflationary and geopolitical factors. From a sector standpoint, there is a stark reversal of the leaders and laggards relative to last year. Consumer Discretionary, Communications, Materials, and Technology were the best performers in January after those sectors (excluding Materials) were the three worst performers last year. The rallies of certain companies in those sectors, such as Tesla (+35% YTD), Carnival Cruises (+32%), and Nvidia (+31%), are quite remarkable after all fell greater than 50% last year. One explanation of these large reversals is that many (taxable) investors were able to harvest losses in holdings that had fallen throughout the year – increased selling put further pressure on these companies, exacerbating the downturn. Due to wash sale rules, investors were reluctant to add to these names until the turn of the calendar year, which ultimately increased demand for those shares in January, driving prices higher.

How does this impact our perspective? The big question that we, and most others, are pondering is whether we will experience a recession or a soft landing in 2023. Recent data is pointing to a fall in inflationary levels (at least in the first half of the year) and a resilient economic environment. The likelihood of a recession this year is approximately 65%, per a recent report from Goldman Sachs; however, that figure has fallen over recent months. The determining factor in the recession versus soft landing debate will perhaps be the state of the employment market. Despite all of the recent headlines regarding layoffs across the tech sector, the unemployment rate in the US remains incredibly low, at 3.4%. The silver lining of recent tech related layoffs is that many of these workers have transferrable skills across various economic sectors, leading to our prediction that there will be a rebalance of the employment market in the first half of the year. If there is a true reduction in the workforce, rather than a rebalance, the odds of a recession will increase and result in central bank policy changes. Finally, our view is that central bank policy rates will need to stay higher for longer to achieve inflationary goals, whereas the market is currently pricing in cuts later in the year.



Data Source: Y Charts

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