GALT & TAGGART
CREATING OPPORTUNITIES

Global Equity Markets
1Q23 Update
13 April 2023

1Q23 Investment Outlook - DM Inflation & China Growth in Spotlight

Key themes in global economy

- On a global scale, Russia-Ukraine war, China's reopening, and recession fears in DMs remain key themes.
- Inflation has fallen sharply in most DMs, yet still remaining well above the central bank target levels. Even though Fed and ECB hiking cycles are nearing the end, the impact of higher rates is yet to be felt (see Chart 1 below).
- Turbulence in US and European financial systems has likely faded. Despite the failures of some regional banks, diversified baking sector displays strong balance sheets.
- China's reopening is driving the global GDP growth in 2023.

Key themes in global markets

- In equity markets, Europe and Asia-Pacific provide the most attractive valuations and, therefore, return potentials in short-term (tactical view). The US and emerging markets (EM) equities, on the other hand, seem to have better growth prospects over the longer-run (strategic view).
- In fixed income markets, government credits provide attractive yields in US, Europe, as well as EMs. In terms of corporate fixed income, bankruptcy risks reduce the attractiveness of credit. European corporate credit, however, has a positive short-term outlook.

Table 1: Major asset class performances

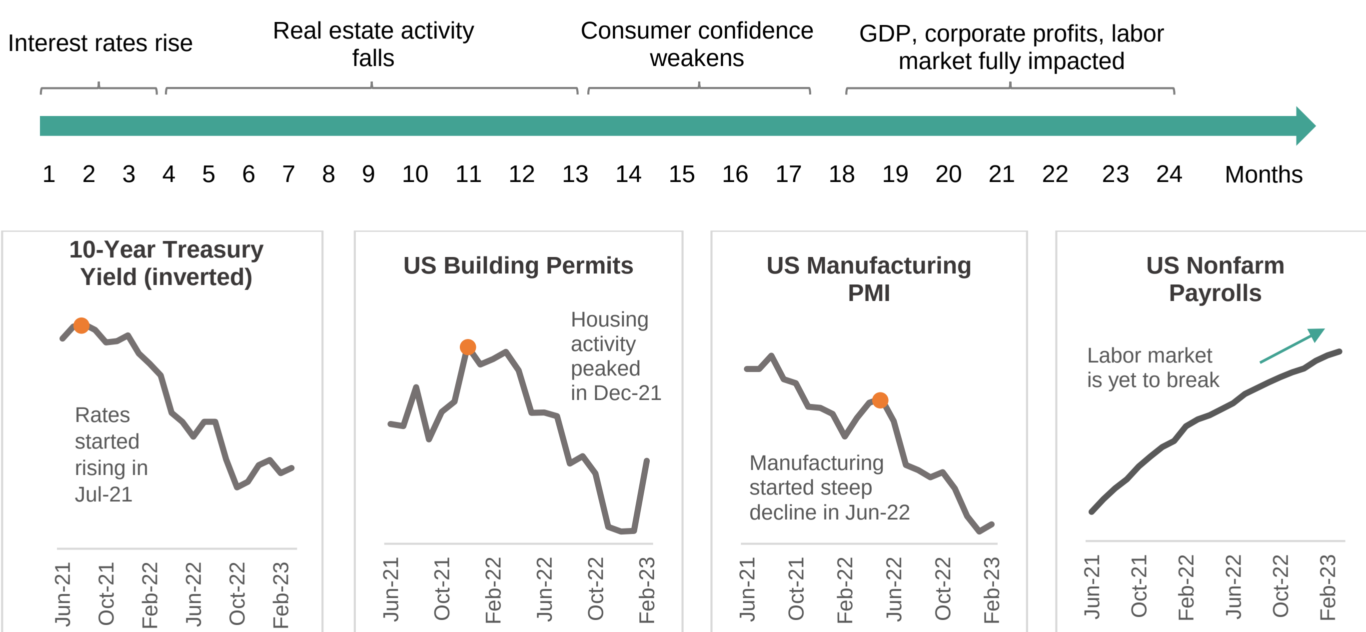
Equities	Level*	1Q23, %	2022, %
MSCI World	117.67	7.9	-18.0
S&P 500	4,109	7.5	-17.9
MSCI Europe	52.38	9.1	-18.7
Nikkei 225	28,041	9.0	-8.4
MSCI DM	71.52	8.0	-16.7
MSCI EM	39.46	3.2	-22.5
MSCI China	49.89	1.6	-23.4
MSCI Asia-Pacific ex. Japan	67.87	3.4	-21.7

Treasuries*	31.Mar.23	01.Jan.23	01.Jan.22
1-year	4.64	4.72	0.40
10-year	3.48	3.79	1.63
30-year	3.67	3.88	2.01

Commodities	Price, $*	1Q23, %	2022, %
Gold	1,969.0	7.0	13.8
Silver	24.1	0.0	6.5
WTI Crude Oil	75.7	-1.6	-16.3
Natural Gas	2.216	-44.4	-8.2

Source: Bloomberg
*Equity index levels and commodity prices are as of 31-Mar-23
*Treasury figures correspond to yields on respective securities

Chart 1: Timeline of economic contractions – full impact of rate hikes in the US has not yet materialized



Source: Galt & Taggart Research, Neuberger Berman Research

Global Economy: Emerging Markets

Global growth in 2023 and 2024 is expected to be driven by emerging markets in Asia (led by China and India)

Emerging markets have outperformed developed economies in 2022 and the trend is expected to continue in 2023 and 2024. In EMs, China and India are expected to be the key economies driving growth. In contrast to their western peers, the Asian economies are not facing soaring inflation levels and, therefore, are not constrained by restrictive monetary policies.

Meanwhile, tighter financial conditions are likely to weigh on growth in both the US and Europe, as cost of borrowing increased. Despite the IMF's relatively optimistic forecast, recession in the US in 2023 remains a highly likely scenario. According to the latest FOMC minutes reading, the aftermath of recent turbulence in banking sector may tilt the US economy into a recession. This stance has gained popularity among investment banks as well: the Goldman Sachs research center has reiterated its probability estimate of the US entering recession in next 12 months from 25% to 35%.

Table 2: Growth forecasts

GDP Growth, %	2022	2023(f)	2024(f)
World	**3.4**	**2.8**	**3.0**
Developed Markets	**2.7**	**1.3**	**1.4**
US	2.1	1.6	1.1
Euro Area	3.5	0.8	1.4
Germany	1.8	-0.1	1.1
France	2.6	0.7	1.3
Italy	3.7	0.7	0.8
Japan	1.1	1.3	1.0
UK	4.0	-0.3	1.0
Canada	3.4	1.5	1.5
Emerging Markets	**4.0**	**3.9**	**4.2**
EM Asia	4.4	5.3	5.1
China	3.0	5.2	4.5
India	6.8	5.9	6.3
South America	4.0	1.6	2.2
Middle East & Central Asia	5.3	2.9	3.5

Source: International Monetary Fund (IMF)

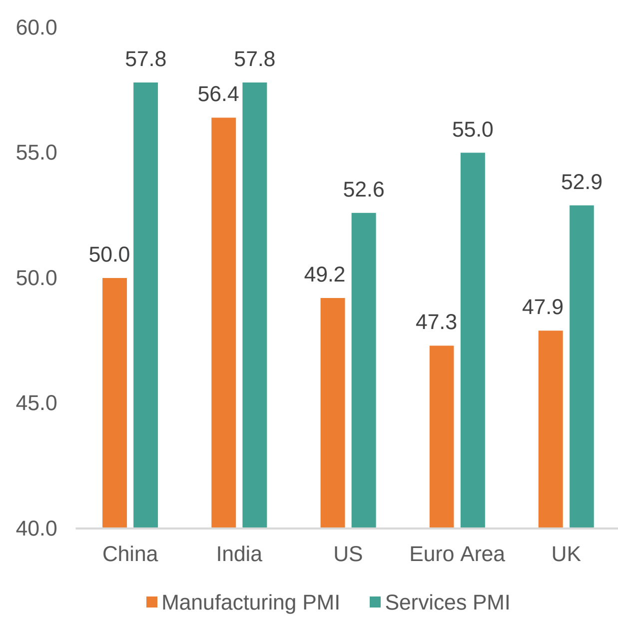
Emerging Markets are already displaying stronger production activity

Purchasing Managers' Indices (PMIs) indicate that production has proved more resilient in major EM economies (China and India) as compared to their western peers. Manufacturing sectors have entered the contraction zone (below 50 point threshold) in all major DMs. In contrast, India exhibits strength in this area, while China is in the neutral territory.

In terms of services, all major economies remain relatively resilient. However, similarly to manufacturing, China and India are outperforming DMs in this respect as well. As already stated, this is because of the absence of inflation problem in Asian EMs, which allows the policymakers to keep expansionary monetary policies.

It is also important to note, that economic downturn in developed economies will have a negative impact on EMs too. Emerging markets in Asia are key suppliers of goods to DMs, meaning their exports will suffer from weakened global demand.

Chart 2: March PMIs of major economies



Source: Respective National Bureaus of Statistics

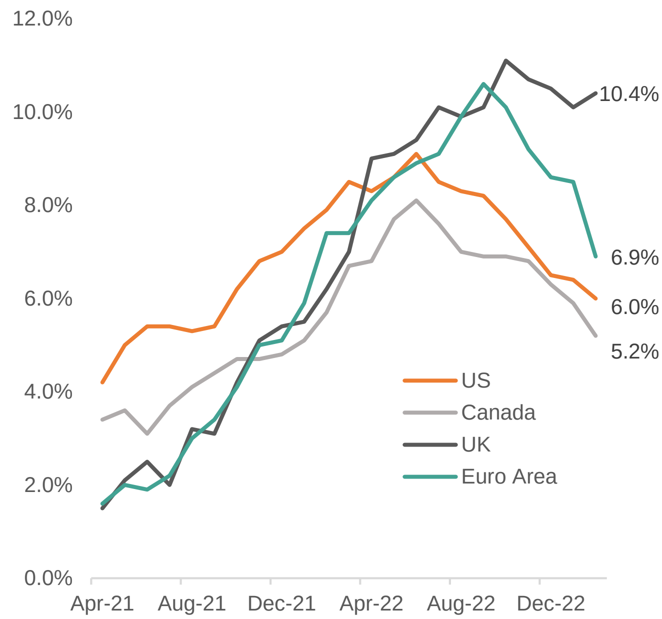
Global Economy: Developed Markets

Inflation retreated in DMs

Since 2022, the story of developed economies has revolved around one word: inflation. Decade of near-zero interest rates, structural changes in demand due to the Covid-19, and Russia-Ukraine war have created fierce inflationary pressures in the Euro-Atlantic world. While restrictive monetary policies have forced inflation to retreat from its peak already, the problem remains far from resolved. Importantly, it is the persistence in core inflation figure that troubles the monetary authorities: in contrast to the headline figure, the core CPI remains sticky. In the US, core CPI stood at annual 5.6% in March (down by a mere 0.1% since December), while in Euro Area it keeps rising and stands at 5.7%. Importantly, it is the core figure that central banks are more concerned with.

Deutsche Bank forecasts the annual headline CPI in the US to fall to 3.9% in 2023 and to 2.4% in 2024. Inflation in Euro Area is expected to be stickier, with forecasted figures of 5.7% in 2023 and 2.7% in 2024.

Chart 3: Headline CPI, Y/Y % Change



Source: Respective National Bureaus of Statistics

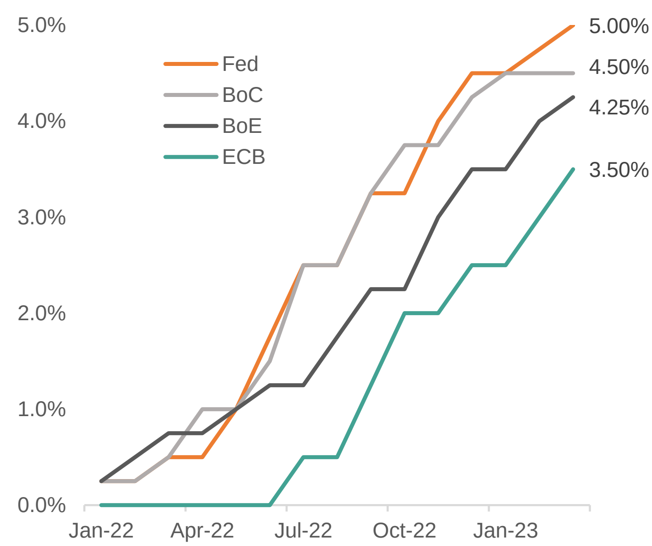
Markets price in higher equilibrium interest rates

Since the beginning of 2022, central banks in developed economies have implemented historically sharp rate hiking cycles. With the intention to curb the soaring inflation, monetary authorities are intending to compromise heavily on economic activity.

Currently, markets are pricing in *some* rate cuts in the US by late-2023. However, given the expected persistency of inflation, central banks in DMs are less likely to retreat easily. With the aim of reducing the headline inflation to 2% target level, cutting interest rates sooner than necessary may require expanding the time horizon of restrictive policy.

Despite pricing in minor cuts this year, overall, markets expect higher rates to stay for longer and, therefore, become the new equilibrium after years of near-zero percent policy. Based on the market data, in the US the Fed is expected to gradually retreat towards 2.75%-3.0% territory over the next two years and stay there for another three years. Similarly, the ECB is expected to cut rates to just above 2.5% during the next two years and stop there for three years. In contrast, given a stiffer inflation problem, Bank of England is expected to cut rates gradually to 3.0% over the next five years.

Chart 4: Base interest rates of major DM central banks



Source: Bloomberg

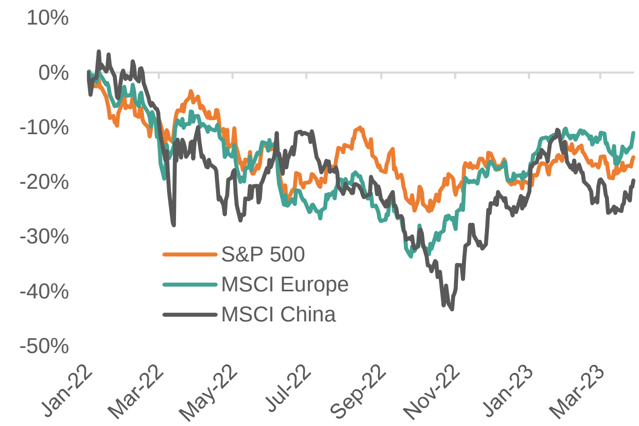
Markets: 1Q23 Summary

Overall, equity markets have rebounded considerably from 2022 lows

Larger part of this rebound took place in 4Q22, however, the latest quarter also delivered significant gains. This is especially true for the US and European equities, with S&P 500 and MSCI Europe (benchmark European index) delivering 7.5% q/q and 9.1% q/q gains, respectively. In contrast, Chinese equities, which took off sharply in late-2022, struggled to gain the ground in response to “delayed" economic reopening that underlined earlier gains.

Despite impressive results in past two quarters, equities remain well-below their peaks. From respective peaks in late-2021, S&P 500 is down -14.2% while MSCI Europe is down -10.5%. Meanwhile, MSCI China is down by staggering 50.0% form the early-2021 peak.

Chart 5: Performance of major equity indices

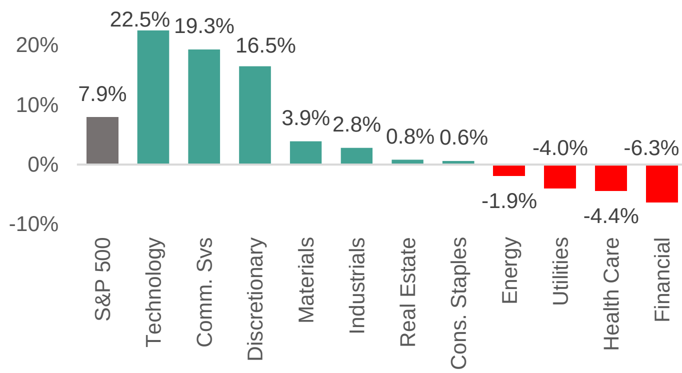


Source: Bloomberg

S&P 500 sectors have delivered contrasting results

In contrast to broad-based market rallies, 1Q23 growth was primarily driven by three cyclical sectors: Technology, Communications Services, and Consumer Discretionary. The remaining sectors underperformed significantly, with Financials being the worst performer due to recent cracks in the US and European banking systems. Defensive sectors of Health Care, Utilities, and Consumer Staples also struggled, as investor optimism resulted in the outflow of funds from these sectors towards the cyclical ones. Lastly, Energy sector lost the ground due to a fall in crude oil and natural gas prices that implied lower profits for energy-related companies.

Chart 6: S&P 500 sector performance in 1Q23



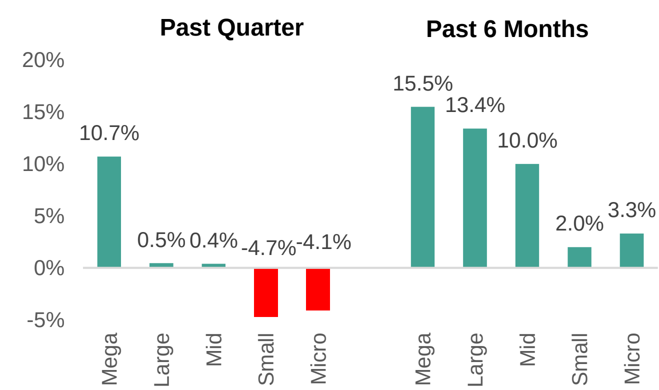
Source: Bloomberg

Sole drivers of recent market rally: Mega-Caps

The discrepancy between sector performances can be easily explained by the return distribution by equity size. In the past quarter, mega-caps (e.g., Apple, Tesla, Microsoft, etc.) have been the sole significant contributors of the broad market rally. These single stocks almost exclusively belong to the most cyclical sectors of Technology, Communications, and Consumer Discretionary.

In terms of the performance of past 6 months, growth in equities has been more diversified. While small and micro-sized stocks have underperformed significantly, large and mid-cap equities have delivered sizeable capital gains.

Chart 7: S&P 500 equity performance by size



Source: Bloomberg

Markets: 2023 Outlook

On a macro scale, China's economic restart and inflation in DMs remain the key determinants for markets in 2023. As of now, markets may be underestimating the possible damage to corporate profits given macro risks materialize. Therefore, general outlook for equities remains modest. However, bright spots can be found inside sectors with positive outlook and large, established companies with strong balance sheets that could weather economic troubles.

On the flipside, high central bank rates have important investment implication: fixed income instruments finally provide the real income. Moreover, as interest rates are already at significantly high levels the potential of further sizeable hikes is negligible. This limits the risks of capital depreciation of such credit instruments.

Table 3: Performance forecasts of major assets

Asset	Current	3M(f)	12M(f)	12M, %
S&P 500 ($)	4,092	4,000	4,000	-2.2
STOXX Europe (€)	464	465	475	2.4
MSCI Asia-Pacific ex. Japan ($)	526	535	610	16.0
10-year Treasury (%)	3.4	4.1	4.1	20.6
Euro (€/$)	1.1	1.05	1.1	0.0
Pound (£/S)	1.25	1.18	1.25	0.0
Yen ($/¥)	133	130	125	-6.0
Crude Oil ($/bbl)	83	88	100	20.5
Gold ($/troy oz)	2,043	2,050	2,050	0.3

*Current prices are given as of 12-Apr-2023

S&P 500 Sector Outlooks

Sector	ETF Ticker	Tactical View
Technology	XLK	
Financial	XLF	
Health Care	XLV	
Consumer Discretionary	XLY	
Communications	XLC	
Industrials	XLI	
Consumer Staples	XLP	
Energy	XLE	
Materials	XLB	
Utilities	XLU	
Real Estate	XLRE	

Source: S&P Capital IQ, Bloomberg

Asset Class Outlooks

EQUITY	Tactical View	Strategic View
US		
Europe		
EM		
GOVERNMENT CREDIT		
US		
DM		
EM		
CORPORATE CREDIT		
US IG		
US High Yield		
Euro Area Corporates		
REAL ASSETS		
Oil		
Gold		
Global Real Estate		

Source: Goldman Sachs Research

Disclaimer

Eva Bochorishvili - Head of Research
│evabochorishvili@gt.ge│ +995 32 2401 111 ext. 8036

Bachana Shengelia - Head of Sector Research
│bshengelia@gt.ge│ +995 32 2401 111 ext. 7562

Giorgi Tskitishvili – Equity Markets Analyst
│g.tskitishvili@gt.ge│ +995 32 2401 111 ext. 8967

Galt & Taggart
Address: 3 A. Pushkin Street, Tbilisi 0105, Georgia
Tel: + (995) 32 2401 111
Email: research@gt.ge