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Market Pulse

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AI OPTIMISM BOOSTS US AMID SLOWING GLOBAL GROWTH

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The global macro backdrop in May continued to suggest that inflation remains sticky, but that the world economy may be entering a slowdown. The US Federal Reserve (Fed) and the European Central Bank (ECB) tightened at their May policy meetings, with both projected to hike rates further. Global stock markets were down marginally, as losses in Europe and emerging markets were offset by gains in the US. The former were weighed down by slowing growth while the technology sector in the US benefited from positive sentiment around the expansion of artificial intelligence (AI). Bond markets were somewhat directionless, posting small gains overall. The US dollar rose against the euro, wiping out most of its losses this year as the Fed was seen as less likely to ease in 2023 compared to a month ago.

Macro

The global macroeconomic backdrop in May continued to suggest that inflation remains sticky, but that the world economy may be entering a slowdown. While certain sectors – like the labour market – showed strength, there were indications of slowing manufacturing activity and tighter credit conditions.

Federal Reserve

The Fed raised the federal funds rate by 25 basis points (bps) to a range of 5.00-5.25% at its meeting in May. Chair Powell suggested that the central bank would be data dependent in terms of future policy moves, playing down the notion of rate cuts later in the year. However, following JP Morgan's takeover of the stricken First Republic Bank, fears rose around the viability of other regional US banks, prompting rate markets to price in three rate cuts before end-2023 amid recession concerns. As expected, lending standards tightened; also significant was falling loan demand. Hence, US growth concerns were heightened.

US economy

Inflation data released later in the month suggested prices remain sticky. April consumer prices decelerated to 4.9% year-on-year, but core prices rose by 5.5%. Following this data release, rate markets began to price out rate cuts; at the end of May, markets expected just one more hike and a cut for the rest of 2023.

US labour data remained strong in April with 253,000 non-farm payrolls added over the month, well above the expected 180,000. Average hourly earnings rose by 4.4% year-on-year, above projections of 4.2%, while unemployment unexpectedly fell to 3.4%, the joint lowest since 1953.

US debt ceiling

Meanwhile, as at the end of May, the US avoided a default associated with the debt ceiling issue. Both houses of Congress, after weeks of fraught negotiations, passed a compromise deal which suspends the debt ceiling until January 2025. The terms will cut spending plans over the next two years, reducing US growth in 2024 by approximately 0.2%.

Europe

Inflation in the eurozone remained elevated. The flash May consumer prices release rose by 6.1% year-on-year in May from 7.0% in April. Core inflation, which has been an area of focus for the ECB, decelerated from 5.6% in April to 5.3% in May. The ECB raised rates by 25bps to 3.25% at its May policy meeting, with ECB President Lagarde reiterating the focus on reducing inflation and stating: "The inflation outlook continues to be too high for too long". Markets are still expecting two further rate hikes from the ECB, which would raise the deposit rate by 50bps, back to a historical high of 3.75%. The last time the ECB deposit rate was at 3.75% was in 2001, shortly after the formation of the single currency.

However, economic activity in the region has shown signs of slowing, so the magnitude of further tightening could be limited. Eurozone retail sales fell by 1.2% month-on-month in March and industrial production fell by 4.1%. The slowdown was marked in Germany, with falls of 2.4% and 3.1%, respectively.

UK

The Bank of England hiked rates by 25bps, as expected, but now does not expect a recession this year amid better-than-expected labour market conditions. Inflation in the UK continued to be elevated – headline consumer prices rose by 8.7% year-on-year in April and core prices accelerated to 6.8%. As a result, rate markets expect three to four more hikes from the central bank in 2023.

MARKET ROUND-UP

Equities

Global stock markets were down marginally in May as losses in Europe and emerging markets were offset by gains in the US. The MSCI All Country World index fell by 0.2% (2.5% gain in euros) over the month. The MSCI USA was up by 0.7% (4.2% in euros), while European ex-UK equities declined by 2.1%. The UK was the worst performer among major equity markets, falling by 5.2% (-3.2% in euros).

The theme of AI received a strong boost from American chipmaker Nvidia as it reported better-than-expected Q1 results. Perhaps more significantly, it projected $11 billion in sales for the three months to end-July – 50% above market expectations – amid strong demand for its chips that are able to handle AI-related applications. As a result, the company's share price rose by 36.3% in May, bringing the year-to-date gain to 158.9%, and its market cap rose above $1 trillion during the month. The announcements were viewed as indicative of artificial intelligence gaining traction and stocks related to this theme, particularly technology stocks, benefited, with the NASDAQ index up by 6.5% over the month.

Bonds

Bond markets were slightly higher in May, with the ICE BofA 5+ Year Euro Government bond index up by 0.5%. 10-year German bond yields fell, closing the month at 2.3%. Italian bonds outperformed as the 10-year spread over Germany tightened from 185bps to 180bps. The moves were likely reflective of a slower growth backdrop in the eurozone and lower inflation, which could result in less tightening than previously anticipated.

Currencies and commodities

The US dollar rose by 3.5% against the euro in May, wiping out most of its losses this year as the Fed was seen as less likely to ease in 2023 compared to a month ago. The euro ended May at $1.0638, down from $1.1019 at end-April. In May, commodities declined amid concerns of a slowdown in China, with copper down by 6.0% (-2.6% in euros) and Brent crude oil falling by 8.7% (-5.3% in euros).

CHARTS OF THE MONTH

Global Equities

Bonds – German 10-year yield

MARKET SNAPSHOT

Market returns (EUR)

Equity Markets (EUR)	MTD Return (%)	YTD Return (%)	2022 Return (%)
MSCI Ireland	-0.7	20.2	-21.1
MSCI United Kingdom	-3.2	4.5	1.4
MSCI Europe ex UK	-2.1	10.5	-11.9
MSCI North America	3.9	9.5	-13.8
MSCI Japan	5.5	8.9	-10.8
MSCI EM (Emerging Markets)	1.8	1.3	-14.5
MSCI AC World	2.5	8.1	-12.6
10-Year Yields	**Yield Last Month (%)**	**2022 Yield (%)**	**2021 Yield (%)**
US	3.64	3.87	1.51
Germany	2.28	2.57	-0.18
UK	4.18	3.67	0.97
Japan	0.44	0.42	0.07
Ireland	2.74	3.13	0.24
Italy	4.08	4.70	1.17
Greece	3.78	4.62	1.34
Portugal	3.02	3.59	0.47
Spain	3.33	3.66	0.57
FX Rates	**End last month**	**2022 Rates**	**2021 Rates**
US dollar per euro	1.06	1.07	1.14
British pound per euro	0.86	0.89	0.84
US dollar per British pound	1.24	1.21	1.35
Commodities (USD)	**MTD Return (%)**	**YTD Return (%)**	**2022 Return (%)**
Oil (Brent)	-8.6	-15.4	10.5
Gold (Oz)	-1.2	7.7	-0.3
S&P Goldman Sachs Commodity Index	-6.1	-11.4	26.0

Source: ILIM, Bloomberg. Data is accurate as at 31 May 2023.

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THE ILIM VIEW – LOOKING AHEAD

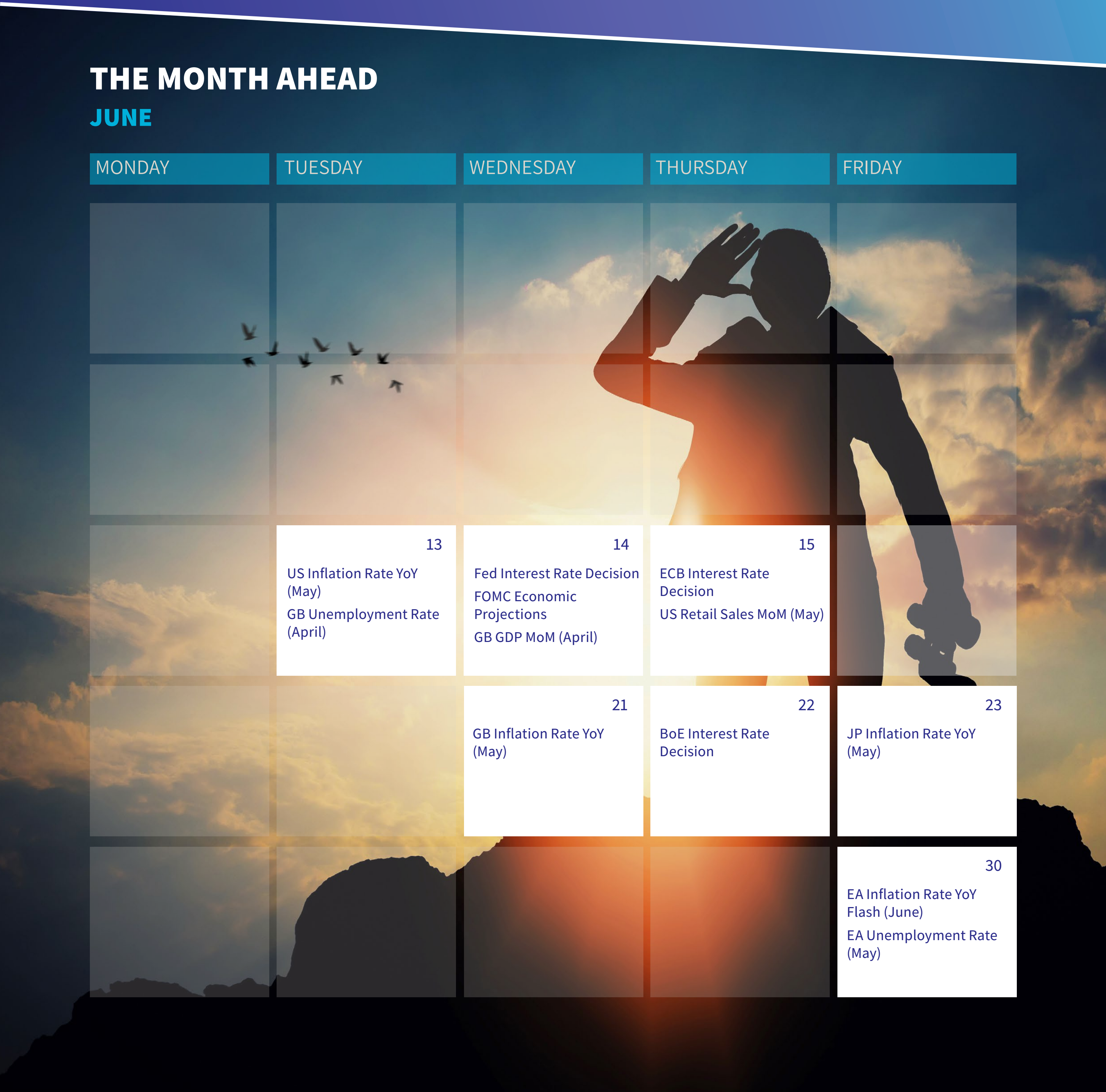
Global equities have proved resilient in the face of mounting headwinds, from lacklustre earnings to continued monetary tightening and banking crises. However, in our view, the asset class has yet to price in an adverse economic scenario like a recession, so volatility is set to stay elevated. This relates especially to the fallout from the banking crises and the resultant impact on sentiment and credit creation. Tighter credit conditions would likely crimp demand, resulting in pressure on corporate earnings and margins. Even if central banks were to ease into the slowdown, equity markets have typically fallen during previous periods of monetary easing. This has been due to the cause usually behind monetary easing in the first place: namely, recessionary conditions.

In the event of such a scenario, valuations do not look attractive: the 12-month forward P/E for the MSCI USA is 18.8x against a long-term average of 17.1x. Equities outside the US offer better value. Europe ex-UK equities trade at a multiple of 11.9x against a long-term average of 13.2x, while emerging markets are better value too – 11.8x versus a long-term average of 11.6x. On balance, we believe there could be a better entry point for equities later this year.

THE MONTH AHEAD

JUNE

MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
	13 US Inflation Rate YoY (May) GB Unemployment Rate (April)	14 Fed Interest Rate Decision FOMC Economic Projections GB GDP MoM (April)	15 ECB Interest Rate Decision US Retail Sales MoM (May)	
		21 GB Inflation Rate YoY (May)	22 BoE Interest Rate Decision	23 JP Inflation Rate YoY (May)
				30 EA Inflation Rate YoY Flash (June) EA Unemployment Rate (May)



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Figures referenced herein have been sourced from ILIM and Bloomberg. Forecast figures have been prepared by ILIM based on reasonable assumptions, internal data and data sourced from Bloomberg.

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