Shaking off the dust: Markets bounce back in first half of 2023

Overall, the world equity benchmark has yet to fully recover from last year's bear market, with stocks, on the average, still more than 10 percent below their peak

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Now that we are just past the halfway mark for 2023, it is time to take stock of what has happened in asset markets around the world: in equities, fixed incomes, currencies and commodities.

But first, the back story. 2022 was about the worst year in asset markets... even on a one-century basis!

During CY22, major indices like NASDAQ, Global markets Ex-US (ACWX), and EM markets (EEM) experienced significant declines of 17-28 percent.

Even other asset classes, including fixed income and REITs, also saw notable losses.

How much of an outlier year 2022 was is borne out by the fact that it was the worst year for bond markets in 230 years of recorded history.

And, one of the worst years for stocks and bonds falling together, which itself had happened last in 1969!

The only assets up for the year were a couple of subsets of commodities: Energy (oil and gas) and a few agricultural commodities… that is it. Every single regional equity index was down, as was virtually every bond index.

After this disastrous year, I was clear that it was extremely unlikely that 2023 would be a down year as such years do not repeat back to back.

Lo and behold, the first half of 2023 witnessed a reversal in the fortunes of previously beaten-down assets, surprising many market participants who were simply extrapolating the recent past.

This bounce-back has been in spite of the fact that many reasons or excuses could have been found if the markets had gone down. The narrative could have been built to explain either a rally or a rout.

To summarise the major events of H1 2023:

- There was a brief period of optimism surrounding China's reopening as it ended its zero-Covid policy.

- In the US, Silicon Valley Bank collapsed on the back of a bank run, leading to a 28 percent drop in the US regional banks index.

- JP Morgan took over First Republic Bank, and UBS took over Credit Suisse in Europe through a government-backed deal.

- The cost of insurance on US government default spiked, exacerbating the US debt ceiling drama.

- OpenAI made ChatGPT available to the public, and Nvidia's AI-focused earnings report supercharged the mega tech rally.

- Central banks in developed markets accelerated rate hikes.

- The Wagner Group staged a short-lived rebellion against the Russian military.

Despite these hurdles, major asset classes rebounded sharply in H1 2023, with the exception of commodities, which fell by 8 percent. Global bond benchmarks rose between 1.5 percent and 5 percent, with high yield securities leading the way.

Macroeconomic data turned out better than feared, and inflation continued to decline, albeit at a slower pace than anticipated by some.

In H1CY23, the global equity benchmark, the All Country World Index, which experienced an 18 percent drop in the previous year, surged by 15 percent. The US, Latin America, and the Eurozone saw significant gains of 17-18 percent.

However, Asia ex-Japan lagged behind, mainly due to China.

Japan's Nikkei 225, the poster child for how long equity markets need NOT give returns, reached a 33-year high.

While many global markets are yet to reach their former peaks, India, Japan, France, Italy, and Spain have achieved new highs.

And, of course, the star was last year's super laggard NASDAQ, which has made a remarkable recovery by erasing nearly all its losses from 2022 with a 39 percent increase.

Overall, the world equity benchmark has yet to fully recover from last year's bear market, with stocks, on the average, still more than 10 percent below their peak.

COUNTRY-WISE PERFORMANCE IN H1CY23 AND CY22

Major Global Indices Performance (As of 30th June 2023)

YTD Rank	Indices	Country	Region	2023 CYTD(%)	2022(%)
1	NASDAQ-100 INDEX	United States	Developed	39.40%	-32.30%
2	SRI LANKA COLOMBO ALL SH	Srilanka	Emerging	36.10%	-60.30%
3	S&P/BMV IPC	Mexico	Emerging	27.80%	-1.10%
4	BUDAPEST STOCK EXCH INDX	Hungary	Emerging	25.70%	-24.40%
5	FTSE MIB INDEX	Italy	Developed	25.70%	-14.20%
6	WIG 20	Poland	Emerging	23.80%	-24.10%
7	IBEX 35 INDEX	Spain	Developed	21.60%	-7.30%
8	TAIWAN TAIEX INDEX	Taiwan	Emerging	20.00%	-26.90%
9	CAC 40 INDEX	France	Developed	19.70%	-12.20%
10	BRAZIL IBOVESPA INDEX	Brazil	Emerging	18.70%	10.10%
11	DFM GENERAL INDEX	UAE	Emerging	18.70%	8.20%
12	DAX INDEX	Germany	Developed	18.20%	-17.00%
13	S&P 500 INDEX	United States	Developed	16.90%	-18.10%
14	NIKKEI 225	Japan	Developed	16.80%	-18.50%
15	S&P/CLX IPSA (CLP) TR	Chile	Emerging	16.30%	22.90%
16	AEX-Index	Netherlands	Developed	16.10%	-16.70%
17	OMX COPENHAGEN 20 INDEX	Denmark	Developed	15.30%	-4.90%
18	All Country World Index	Global	Global	13.90%	-18.40%
19	HO CHI MINH STOCK INDEX	Vietnam	Emerging	12.20%	-34.10%
20	OMX STOCKHOLM 30 INDEX	Sweden	Developed	12.00%	-24.30%
21	SWISS MARKET INDEX	Switzerland	Developed	11.60%	-15.00%

Source: Bloomberg

COUNTRY-WISE PERFORMANCE IN H1CY23 AND CY22

Major Global Indices Performance (As of 30th June 2023)

YTD Rank	Indices	Country	Region	2023 CYTD(%)	2022(%)
22	TADAWUL ALL SHARE INDEX	Saudi Arabia	Emerging	11.60%	-5.10%
23	KOSPI INDEX	South Korea	Emerging	10.10%	-27.60%
24	FTSE 100 INDEX	United Kingdom	Developed	8.40%	-6.50%
25	S&P/TSX COMPOSITE INDEX	Canada	Developed	8.20%	-11.90%
26	S&P BSE SENSEX INDEX	India	Emerging	8.10%	-4.70%
27	MSCI COLCAP INDEX	Colombia	Emerging	7.70%	-18.40%
28	JAKARTA COMPOSITE INDEX	Indonesia	Emerging	4.50%	-1.60%
29	S&P/ASX 200 INDEX	Australia	Developed	2.90%	-5.80%
30	PSEi - PHILIPPINE SE IDX	Philippines	Emerging	1.00%	-13.70%
31	S&P/NZX 50 Index Gross	New Zealand	Developed	0.40%	-18.40%
32	Straits Times Index STI	Singapore	Developed	0.20%	9.10%
33	BEL 20 INDEX	Belgium	Developed	0.20%	-16.70%
34	SHANGHAI SE COMPOSITE	China	Emerging	-0.30%	-19.70%
35	EGX 30 INDEX	Egypt	Emerging	-1.30%	-18.90%
36	HANG SENG INDEX	Hong Kong	Developed	-3.20%	-12.60%
37	OMX HELSINKI 25 INDEX	Finland	Emerging	-3.50%	-14.80%
38	FTSE/JSE AFRICA ALL SHR	South Africa	Emerging	-4.00%	-2.80%
39	TA-35 Index	Israel	Developed	-7.40%	-19.70%
40	STOCK EXCH OF THAI INDEX	Thailand	Emerging	-9.90%	-0.40%
41	FTSE Bursa Malaysia KLCI	Malaysia	Emerging	-11.30%	-6.20%
42	BIST 100 INDEX	Turkey	Emerging	-23.10%	117.40%

Source: Bloomberg

Market breadth, a concern

Equity returns this year have been quite narrow, driven by a small group of tech stocks, and particularly the semiconductor stocks.

The heavy reliance on these stocks may pose a risk to the world's best-performing equity markets if sentiment on AI weakens.

For instance, over half of Korea's H1 gain is attributed to Samsung, and more than half of Taiwan's return comes from Taiwan Semiconductors. In the Netherlands, 64 percent of the advance is from ASML.

In the US, more than 70 percent of the return was driven by seven mega-cap tech stocks in the index: Apple, Alphabet, Microsoft, Meta Platforms, Amazon.com, NVIDIA and Tesla.

Tech-heavy markets like Taiwan and Korea are up 10-20 percent in dollar terms, but still have a way to go in fully recovering from the losses of 27-28 percent witnessed in 2022.

Beaten down sectors and markets of 2022 catch up in H1 2023

In the All Country World Index, which tracks equities from developed and emerging markets, every sector except Energy (-1.8 percent) and Gas Utilities (-0.5 percent) showed positive performance.

Nevertheless, more than 50 percent of this move was led by the technology sector, up 40 percent. The other sectors that give good returns were Consumer Discretionary (+25 percent), Communication Services (+26 percent), and Industrials (+13 percent). Notably, these are the same sectors that dropped more than 30 percent last year (except industrials, which fell 12 percent).

Even in terms of major indexes the Nasdaq and Sri Lanka which were near the bottom of the list last year, are topping the performance chart.

CROSS-ASSET PERFORMANCE IN H1CY23 AND CY22

Cross-Asset Performance (USD)	2023 CYTD (Jan-June 2023	2022
Equities		
MSCI Eurozone	18.30%	-17.30%
Bloomberg Latin America Index	17.00%	-1.30%
S&P 500	16.80%	-18.20%
MSCI ACWI	14.20%	-18.40%
Core MSCI International Developed Markets	11.10%	-15.00%
EM ex-China	10.30%	-19.60%
MSCI Emerging Markets	5.20%	-20.60%
MSCI India	4.90%	-8.90%
MSCI Frontier and Select EM	3.30%	-24.40%
MSCI Asia ex-Japan	1.80%	-21.50%
MSCI China	-5.20%	-22.80%
Bonds		
Bloomberg Global High Yield	5.20%	-12.70%
Bloomberg Pan European High Yield	4.80%	-11.10%
Bloomberg EM USD Aggregate	3.30%	-15.30%
VanEck EM High Yield ETF	3.20%	-13.40%
Bloomberg Pan European Aggregate	2.00%	-18.90%
Bloomberg Global Aggregate	1.40%	-16.20%
REITs		
Vanguard US REITs ETF	3.40%	-26.20%
S&P Global REIT	2.70%	-23.60%
Vanguard Global ex-US REITs ETF	-2.80%	-22.90%

Source: Bloomberg

CROSS-ASSET PERFORMANCE IN H1CY23 AND CY22

Cross-Asset Performance (USD)	2023 CYTD (Jan-June 2023	2022
Commodities (Total Return)		
Bloomberg Livestock Subindex	5.00%	7.40%
Bloomberg Precious Metals Subindex	3.00%	0.10%
Bloomberg Agriculture Subindex	-1.00%	15.50%
Bloomberg Commodity Index	-7.80%	16.10%
Bloomberg Industrial Metals Subindex	-12.40%	-2.40%
Bloomberg Energy Subindex	-20.00%	36.20%
Major Currencies (Spot Return) vs US Dollar (USD)		
US Dollar Spot Index (DXY)	-0.60%	8.20%
JP Morgan EMFX Spot Index	-1.60%	-5.10%
British Pound (GBP)	5.10%	-10.70%
Swiss Franc (CHF)	3.20%	-1.30%
Canadian Dollar (CAD)	2.40%	-6.80%
Euro (EUR)	1.90%	-5.90%
Danish Krone (DKK)	1.80%	-5.90%
Australian Dollar (AUD)	-2.20%	-6.20%
Swedish Krona (SEK)	-3.40%	-13.20%
New Zealand Dollar (NZD)	-3.50%	-7.00%
Norwegian Krone (NOK)	-8.70%	-10.10%
Japanese Yen (JPY)	-9.10%	-12.20%
Mexican Peso (MXN)	13.90%	5.30%
Brazilian Real (BRL)	10.30%	5.60%
Indian Rupee (INR)	0.90%	-10.20%
Singapore Dollar (SGD)	-1.00%	0.70%
Taiwanese Dollar (TWD)	-1.40%	-9.90%
South Korean Won (KRW)	-4.00%	-6.10%
Chinese Renminbi (CNH)	-4.90%	-7.90%
South African Rand (ZAR)	-9.60%	-6.50%

Source: Bloomberg

The macro outlook

After being a primary concern for central bankers worldwide, inflation finally showed signs of slowing in 2023. Although headline inflation decreased by 2 to 5 percent points from its peak in developed regions like the US, UK, and Europe, core inflation, which excludes volatile items such as food and energy prices, remained stubbornly high.

This indicates that progress in combating inflation has been insufficient, leading to a market perception that rate cuts are unlikely this year, which had been my view all along.

Mixed growth data accompanies this sticky inflation backdrop. Economic data in the US has largely exceeded expectations, with the Bloomberg US Economic Surprise Index reaching its highest level since April 2021.

The housing sector, particularly sensitive to interest rates, has shown signs of rebound, as is also evidenced by a 30 percent surge in homebuilder stocks. Conversely, the Eurozone has experienced the worst contraction in the manufacturing sector since May 2020.

In the UK, where food inflation runs rampant at 18 percent and core inflation has reached a record high of 7.1 percent, real GDP growth has averaged close to zero percent in the past four quarters, signalling signs of stagflation.

Meanwhile, the Bank of England has already raised rates by 150 basis points this year to 5 percent, with expectations of further increases to 6 percent. This comes at a time when the nation's government debt-to-GDP ratio has exceeded 100 percent for the first time since 1961.

Emerging markets provide a glimmer of hope

Fortunately, inflation rates in major emerging markets, particularly in Latin America and Asia, have significantly declined. Some of these markets have reached multi-decade highs in interest rates, resulting in attractive real yields (nominal interest rate minus inflation).

As a result, Central European and Latin American currencies have returned between 7.5 percent and 25 percent this year, with the Colombian Peso, Mexican Peso, and Hungarian Forint leading the way.

It is worth noting that Emerging Market central banks had led the rate hike cycle in 2021-22 (India was a relative latecomer in hiking rates) and may provide indications of a rate-cutting cycle heading into 2024.

INFLATION DECLINES IN EMERGING MARKETS, REAL RATES RISE

Countries	Inflation (Latest)	Peak Inflation	Interest Rate	Real Interest Rate
Chile	8.70%	14.10%	11.30%	2.60%
Brazil	3.90%	12.10%	13.80%	9.80%
Mexico	5.80%	8.70%	11.30%	5.40%
Indonesia	4%	6.00%	5.80%	1.80%
China	0.20%	2.80%	3.60%	3.40%
Thailand	0.50%	7.70%	2.00%	1.50%
India	4.30%	7.80%	6.50%	2.30%
South Korea	3.30%	6.30%	3.50%	0.20%
Poland	11.50%	18.40%	6.80%	-4.80%
Czech Republic	11.10%	18.00%	7.00%	-4.10%

Note: Real Interest Rate is equal to Inflation (latest) minus the Interest Rate

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Not all Emerging Market currencies have benefited, though. Turkey, where inflation remains high at 40 percent (down from a peak of 85 percent in October 2022), has witnessed a 28 percent decline in the Lira this year, exacerbated by President Erdogan's re-election.

Income is making a comeback!

Central banks globally have implemented around 90 interest rate hikes this year, far surpassing the 17 rate cuts. Short-term government bond yields in developed markets have returned to cycle highs, erasing the sub-1 percent rates seen in early 2022.

As a result, fixed income assets have experienced a renaissance. Global short duration investment grade bonds and higher-quality non-investment grade bonds (BB-rated) provide the unique opportunity to generate yields of close to 6 percent to 7 percent in USD terms.

Commodities take a back seat in H1CY23

Cyclical and risk-sensitive commodities such as Energy and Industrial Metals slumped 20 percent and 12 percent respectively in H1CY23. Energy is down 20 percent in H1CY23 after a 36 percent surge witnessed in CT22.

Simultaneously, the sharp declines in grain prices, down 8 percent have all fed hopes of lower global inflation. US Natural Gas prices which rose 26 percent last year have lost 37 percent this year. Brent Crude has dropped 9 percent to $75 a barrel, despite an extension of additional voluntary cuts to production by Saudi Arabia and Russia.

Copper prices have been unchanged this year after falling 15 percent last year as macro-economic data out of China, one of the largest consumers, has been disappointing.

Finally, Gold, the only major commodity to stay in the green this year (+1.8 percent) is also down from its year-to-date peak of $2,077 per ounce to $1,932 per ounce. The move took place on the back of a strong rebound in real yields (inflation-adjusted) which reduces the allure of the non-interest bearing yellow metal.

The takeaway

The H1 2023 has been a period of recovery for financial markets.

Equities rebounded strongly, with the technology sector leading the way. Bonds and income assets experienced a revival on the back attractive yields and headline inflation displaying signs of slowing in developed markets.

The global economic landscape remains mixed, with different regions facing their own challenges and opportunities.

But all of it bears out one eternal truth that in the giant wheel of world markets, just as something goes up something else comes down and usually the laggards of one period become the winners of the next.

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