EFFICIENT GROUP

ECONOMIC COMMENTARY

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YOUR MONTHLY ECONOMIC UPDATE

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OPPORTUNITIES IN THE EQUITY MARKET

The market-based losses of 2022 make it tempting to look back in awe, in frustration, and in anger. But do not. The first month of 2023 provided active investors with a glimpse of what might lie ahead in 2023.

Global equity markets got off to a blistering start in January with the MSCI All Country World Index (a globally diversified index) gaining more than 7% at the time of writing this economic update. This strong start revived the question of whether the "January Effect" truly exists, and whether investors can place their faith in the age-old "January Barometer". Unlike the January Effect, where stock prices tend to rise in the first month of the year more so than in any other month, the January Barometer possesses the ability to predict the overall direction of the stock market's performance for that year: If January is thus a strong and positive month, the rest of the year will be strong and positive as well. Even though both phenomena lack in-depth research and credibility, investors believe that the January Effect could partly be explained by fresh equity buying activity in January following end-of-year tax-loss selling. Actual evidence to support the January Barometer is, however, much scarcer.

Without wasting any further time on theories, it is safe to say that the strong start to 2023 can be attributed to data suggesting that inflation in the world's largest economy weakened further in December, while the underlying economy remained resilient. Softer-than-expected retail spending and services data initially served to boost markets as "bad news was interpreted as good news". This was further supported by a contraction in December's reading for the Price Consumption Expenditure, the United States (US) Federal Reserve's preferred measure of inflation. On the flip side, stronger-than-expected data showed that the US economy managed to grow by 2.9% in the fourth quarter of 2022, alleviating some of the concerns around a possible hard recession.

Across the Pacific Ocean, investors were also more optimistic about Chinese equities because of the re-opening of the Chinese economy following extended zero-COVID policy measures. Chinese markets improved by 22% to kick off what could be a memorable year for Chinese equity investors. Companies such as Tencent and Alibaba, which have recently fallen on hard times because of increased regulations and lockdowns, increased by more than 117% and 90% respectively.

Warren Buffett's ally and friend, Charlie Munger, once said that China "steps on a boom in the middle of it instead of waiting for the big bust". This is very much the strategy that the Chinese implemented in 2022 amidst their zero-COVID policy measures. While eye-watering levels of inflation spread faster than the Omicron variant throughout the world, China went through this period relatively unscathed, as people and their wallets remained indoors. This essentially places China in a better position to stimulate its economy in 2023 which, together with cheap valuations and a possible weaker dollar, could position markets for a stellar year.

In the US, the picture looks different with volatility set to remain for at least the first half of 2023. It will not be smooth sailing. As a result of tight economic conditions, a great deal of 2022's fourth quarter earning reporters have already started to undershoot expectations, which could pave the way for more disappointment during the coming months. While we see 2023 as a very challenging year for earnings growth, 2024 should be a strong rebound where positive operating leverage returns, i.e. the next boom. Markets, looking forward, will start to price this in during the second half of 2023, but by then investors should have already capitalised on the vast number of opportunities currently on offer.

Active investors must remember the words of William Arthur Ward: "Opportunities are like sunrises. If you wait too long, you miss them". High-quality opportunities, such as Microsoft, Accenture, and Amazon, are trading at valuations below their long-term averages. For long-term investors, these opportunities will most certainly bear fruit and, who knows, they may even turn into a "tenbagger" according to legendary investor Peter Lynch.

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