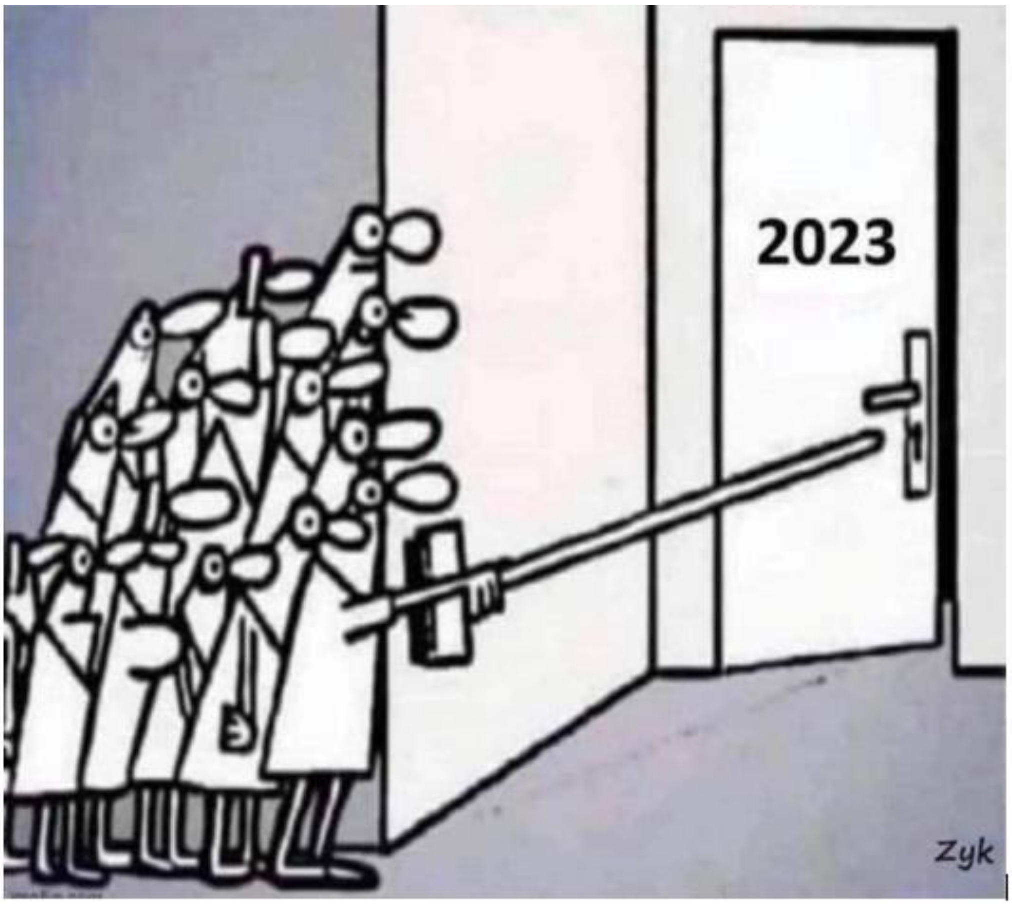
Market Review January 2023



How complicated 2022 was! When the S&P500 was making all-time highs in the first few sessions of the year, it was hard to imagine that such a "berezina" would occur on the world's stock markets. We were able to identify two major causes for the historic decline in stocks and bonds. First, the underestimation of inflation by central banks. Indeed, by hammering throughout 2021 that inflation was only transitory and that it would quickly resorb itself, central bankers fell behind the curve in their mandate of price stability, which was devastating (and difficult to catch up with without causing panic). As a result, we have seen the fastest monetary tightening in history. The FED raised rates by 425 basis points between March and December 2022, the ECB by 250 basis points between July and December and the Bank of England by 275 basis points to name but a few. We have repeatedly said that a monetary policy error between 2020 and 2021 is one of the main "black swans" for the financial markets. Unfortunately, this has been confirmed.

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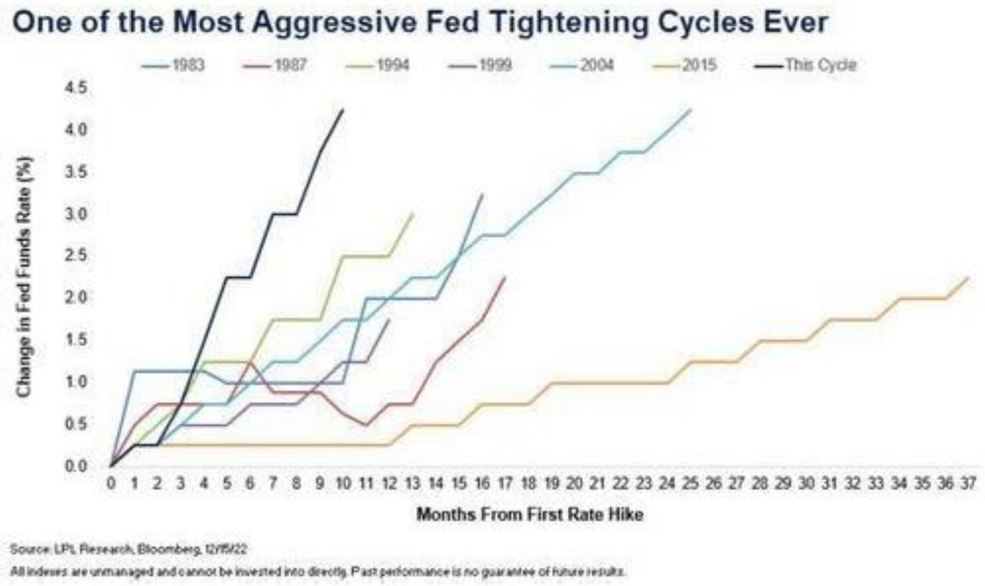

Still on the monetary policy side, even the Japanese central bank (BoJ) cracked under pressure at the end of the year. The BoJ, unlike its peers, maintained an ultra-accommodative monetary policy throughout the year, which led to a sharp depreciation of the Yen. At the last meeting of the year, its President, Mr Kuroda, who controls the Japanese yield curve with an iron fist, took everyone by surprise by extending the fluctuation range for 10-year bond yields from +/- 0.25% to +/-0.50% to "improve market functionality". Besides, the central bank will continue its monetary easing...These decisions, which may seem schisophrenic, prove once again the complexity in which the world economy is currently. Note that Japan is experiencing the highest inflation rate since 1991 at 3.7%. This is lower than in Europe and the US as Japanese companies have passed on very little of the cost increases to consumers. However, the rise in Japanese inflation is mainly due to the strength of the US dollar and the disruption of supply chains and not generated by an increase in demand, which is why it is considered toxic by Mr Kuroda. Japanese long rates will need to be closely monitored in the coming months as they could have an impact on US rates. Indeed, Japan is the largest holder of US government debt. If Japanese rates were to continue to rise, this could provoke selling flows into US debt. We are still a long way from this as yields are still much more attractive on US bonds, but it is important to bear this in mind. Moreover, on the day of the BoJ's surprise announcement, i.e. 20 December, the US 10-year yield rose sharply... This movement on Japanese rates caused the Yen to rebound, ending the year on a 13.94% decline against the US dollar after having given up more than 30% during the year. This also reduced the stock of bonds that are offering a negative yield. After reaching a cumulative amount of more than USD 18,000 billion at the end of 2020, negative yielding bonds represent "only" USD 230 billion cumulatively and the vast majority are Japanese bonds.

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Bonds with Negative yield (Total amount in USD)

The second major cause of this historic correction (and one that fed into the first) came from geopolitics with Putin's decision to attack Ukraine. This event was even more difficult to predict, even though some senior US military officials warned the world between late 2021 and early 2022 of the high probability of an armed intervention. In addition to the human disaster and the weakening of the world's peaceful balance, this war on Europe's doorstep has intensified the pressure on inflation, particularly on food and energy prices (although the latter have returned to pre-invasion levels). This anxiety-provoking context caused investors to panic. Most equity markets suffered losses of between 20 and 30% over the year, with a few exceptions for the more defensive indices such as the Dow Jones (-8.78%) or the European indices, which fell by "only" ten percent.

Major Western Equity Indices YTD performance

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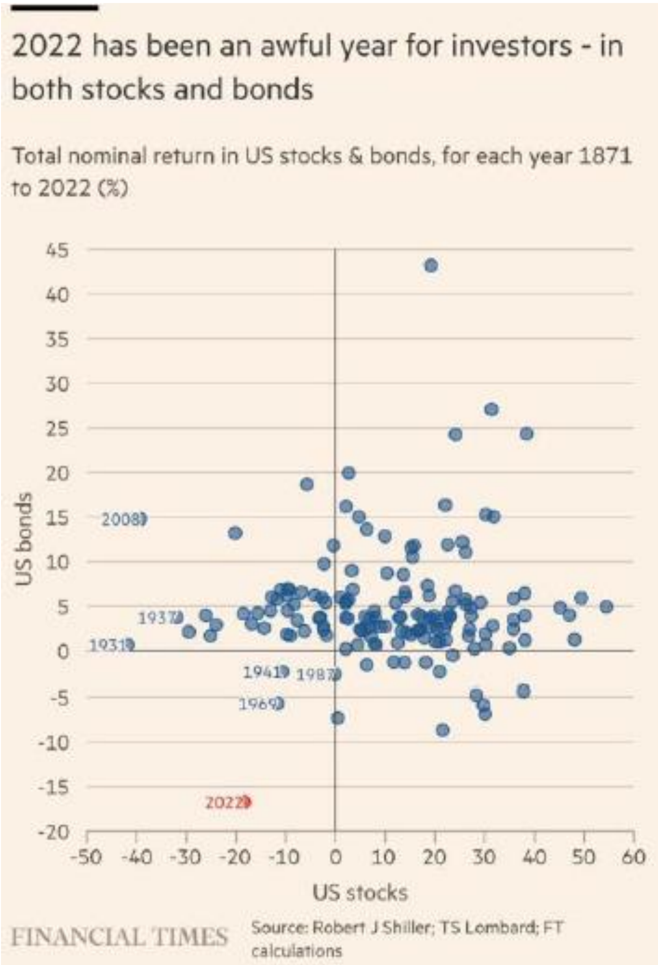
If we compare styles, growth stocks suffered the most, as they are more expensive after the strong rally in this segment between 2009 and 2020. The dollar acted as a safe haven, while gold ended the year virtually unchanged. Even digital assets, which have repeatedly been seen as inflation hedges, suffered considerable losses. The declines in these risky assets are of course damaging, but they are not out of the ordinary either. This is not the first time that major stock market indices have suffered such losses in a year, and investors seeking to generate capital gains are aware of the risks involved in these asset classes. They are therefore prepared to deal with significant declines from time to time. In contrast, declines of 15-20% for most bond indices that are considered "risk-free" investments are exceedingly rare! A bond investor is inherently more risk averse than an equity investor, which is why he or she turns to a less speculative asset class. For this investor, who for years has been trying to preserve his capital and collect recurring but modest coupons, the pill is hard to swallow. The fact remains that a loss is not realized until the investment is sold! Admittedly, the valuation of bond pockets has fallen sharply during 2022, but if issuers have strong balance sheets, the investor will eventually recover his entire investment at maturity (plus coupons), even though it is temporarily valued below par.



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Market developments to the end of December 2022

End of December	MSCI World	S&P 500	EuroStoxx	CAC	Spain	Switzerland	MSCI EM	CSI 300
			Equities in Local Currencies					
Perf 1 Month	-4.34%	-5.90%	-4.32%	-3.93%	-1.60%	-3.58%	-1.64%	0.48%
Perf 3 Month	9.42%	7.08%	14.33%	12.35%	11.71%	4.50%	9.20%	1.75%
Perf YTD	-19.46%	-19.44%	-11.74%	-9.50%	-5.56%	-16.67%	-22.37%	-21.63%

End of December	WTI Oil	Brent Oil	Gold	Copper	USD	JPY	GBP	CHF
		Commodities				Currencies vs EUR		
Perf 1 Month	-0.36%	0.56%	3.14%	1.61%	-2.79%	2.33%	-2.52%	-0.55%
Perf 3 Month	0.97%	-2.33%	9.84%	10.74%	-8.44%	1.05%	-0.83%	-2.24%
Perf YTD	6.71%	10.45%	-0.28%	-13.87%	6.23%	-6.77%	-5.03%	4.85%

End of December	Global Aggregate	US Aggregate	Euro Aggregate	US 10 Year Treasury	German 10 Year Bund	Global Credit	Global High Yield	Emerging Sovereign $
			Bloomberg Indices Bonds Total returns					
Perf 1 Month	0.54%	-0.45%	-3.64%	-1.10%	-9.99%	0.20%	0.66%	0.85%
Perf 3 Month	4.55%	1.87%	-1.21%	1.00%	-5.64%	5.28%	7.97%	6.59%
Perf YTD	-16.25%	-13.01%	-17.18%	-14.79%	-32.86%	-16.96%	-12.71%	-15.26%

Source: Bloomberg 31/12/22.

It's going to take a long time...so what can we expect from 2023 already!
History teaches us that when stock markets fall sharply in one calendar year, the probability that the following year will be negative again is low. US bonds, for example, have never suffered 3 consecutive years of decline between 1928 and today. As we can see from the table below, for the 10-year US Treasury bond, during very negative annual performances such as in 1994, 1999, 2009 or 2013, the following year generated significant gains.

10 Year Treasury Annual Returns: 1928-2022

1928	0.84%	1952	2.27%	1976	15.98%	2000	16.66%
1929	4.20%	1953	4.14%	1977	1.29%	2001	5.57%
1930	4.54%	1954	3.29%	1978	-0.78%	2002	15.12%
1931	-2.56%	1955	-1.34%	1979	0.67%	2003	0.38%
1932	8.79%	1956	-2.26%	1980	-2.99%	2004	4.49%
1933	1.86%	1957	6.80%	1981	8.20%	2005	2.87%
1934	7.96%	1958	-2.10%	1982	32.81%	2006	1.96%
1935	4.47%	1959	-2.65%	1983	3.20%	2007	10.21%
1936	5.02%	1960	11.64%	1984	13.73%	2008	20.10%
1937	1.38%	1961	2.06%	1985	25.71%	2009	-11.12%
1938	4.21%	1962	5.69%	1986	24.28%	2010	8.46%
1939	4.41%	1963	1.68%	1987	-4.96%	2011	16.04%
1940	5.40%	1964	3.73%	1988	8.22%	2012	2.97%
1941	-2.02%	1965	0.72%	1989	17.69%	2013	-9.10%
1942	2.29%	1966	2.91%	1990	6.24%	2014	10.75%
1943	2.49%	1967	-1.58%	1991	15.00%	2015	1.28%
1944	2.58%	1968	3.27%	1992	9.36%	2016	0.69%
1945	3.80%	1969	-5.01%	1993	14.21%	2017	2.80%
1946	3.13%	1970	16.75%	1994	-8.04%	2018	-0.02%
1947	0.92%	1971	9.79%	1995	23.48%	2019	9.64%
1948	1.95%	1972	2.82%	1996	1.43%	2020	11.33%
1949	4.66%	1973	3.66%	1997	9.94%	2021	-4.42%
1950	0.43%	1974	1.99%	1998	14.92%	2022	-13.60%
1951	-0.30%	1975	3.61%	1999	-8.25%		

Source: NYU

2022 Returns as of 12/13/2022

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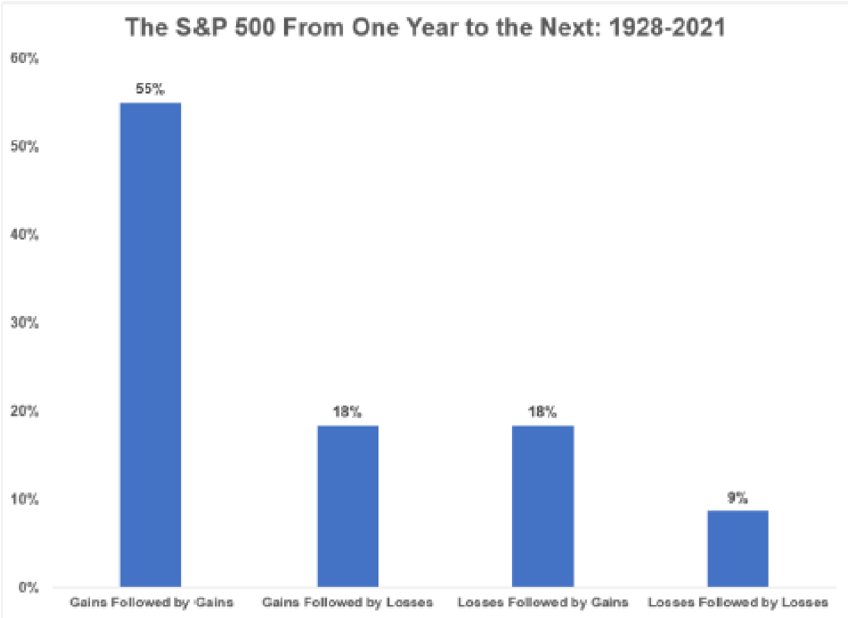
On the equity side, as we said earlier, this asset class is more volatile and has therefore logically experienced longer and relatively deep downward phases. Between 2000 and 2002, for example, the S&P500 suffered three consecutive years of decline of 9.03%, 11.85% and 21.97% respectively. It should be noted that at that time, the index rebounded by more than 80% in the following five years, i.e. between 2003 and 2007.
It is therefore not impossible for stocks to fall for 2 (or even 3) consecutive years, but the probability of this happening is less than 10%.



That was for the statistics...but what does the business cycle tell us?

The world economy is expected to grow by 2.7% in 2023, at least that is what the IMF expects. According to the non-governmental organisation, almost a third of the world economy is expected to go into recession this year. The United States could just about avoid it, while Europe might already be in a contraction as it has been hit by the war in Ukraine, which has had a major impact on energy prices. The big question mark comes from China. By relaxing the excessively restrictive measures that the country was applying to curb the spread of Covid, many investors are putting a lot of hope in the second biggest economy becoming once again the global powerhouse that it once was. We may have our doubts. First of all, the easing of measures is accompanied by a resurgence of new infections and numerous deaths, which have a negative impact on the country and put the authorities in an uncomfortable position. In addition, several countries are once again requiring all Chinese travelers to present a negative test, which could slow down mobility. Even if the Chinese economy gradually returns to a "normal" pace, it will take time for all the bottlenecks to be resolved. Finally, the property market, even if supported by the authorities and the central bank (PBOC), is still in a fragile situation and puts pressure on the banks, which does not facilitate access to credit. For all these reasons, even if China is supposed to be back on track in 2023, it may not be able to pull global growth upwards as it has done in recent years!

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Dernières projections de croissance des *Perspectives de l'économie mondiale*

(PIB réel, variation annuelle en pourcentage)	2021	PROJECTIONS 2022	PROJECTIONS 2023
Production mondiale	**6,0**	**3,2**	**2,7**
Pays avancés	**5,2**	**2,4**	**1,1**
États-Unis	5,7	1,6	1,0
Zone euro	5,2	3,1	0,5
Allemagne	2,6	1,5	-0,3
France	6,8	2,5	0,7
Italie	6,6	3,2	-0,2
Espagne	5,1	4,3	1,2
Japon	1,7	1,7	1,6
Royaume-Uni	7,4	3,6	0,3
Canada	4,5	3,3	1,5
Autres pays avancés	5,3	2,8	2,3
Pays émergents et pays en développement	**6,6**	**3,7**	**3,7**
Pays émergents et pays en développement d'Asie	7,2	4,4	4,9
Chine	8,1	3,2	4,4
Inde	8,7	6,8	6,1
ASEAN-5	3,4	5,3	4,9
Pays émergents et pays en développement d'Europe	6,8	0,0	0,6
Russie	4,7	-3,4	-2,3
Amérique latine et Caraïbes	6,9	3,5	1,7
Brésil	4,6	2,8	1,0
Mexique	4,8	2,1	1,2
Moyen-Orient et Asie centrale	4,5	5,0	3,6
Arabie saoudite	3,2	7,6	3,7
Afrique subsaharienne	4,7	3,6	3,7
Nigéria	3,6	3,2	3,0
Afrique du Sud	4,9	2,1	1,1
Pour mémoire			
Pays émergents et pays à revenu intermédiaire	6,8	3,6	3,6
Pays en développement à faible revenu	4,1	4,8	4,9

Source : FMI, *Perspectives de l'économie mondiale*, octobre 2022.

Note : Pour l'Inde, les données et les prévisions sont présentées sur la base de l'exercice budgétaire : l'exercice 2021/2022 débute en avril 2021. Les projections de croissance des *Perspectives de l'économie mondiale* d'octobre 2022 pour l'Inde sont de 6,9 % en 2022 et 5,4 % en 2023, sur la base de l'année civile.

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On the inflation front, even though Western central banks are keeping a relatively firm tone and future rate hikes are still to be expected, the economic statistics of recent months suggest that the inflation peak is behind us. Central bankers should keep the pressure on during the first half of the year, but it is not impossible that the famous "pivot" will occur in the second half of the year. This should allow long rates to continue their correction that started in October 2022 and thus allow the bond market to recover some of last year's losses.

As far as equities are concerned, the lack of visibility during the first few months of the year is likely to keep the level of uncertainty high. As we have seen in the 4th quarter, after a strong rebound between October and November, most indices suffered further declines in December. Investors will be watching central bankers' lips and should be on the lookout for any statistics to try to identify the direction the global economy will take in the coming quarters. No recession has been officially announced, but several indicators such as the inversion of yield curves and leading indicators such as PMIs suggest that the economic contraction is probably already in place. Risky assets can (and have in the past) perform well in a soft landing environment. As we have mentioned several times in recent months, corporate balance sheets are healthy and many sectors are able to defend their profit margins through innovation. Although some industries are still trading at relatively high levels by historical standards, much of the derating has already taken place.

How Do Stocks Perform Around Recessions?

On average, stocks performed worse 1 year before a recession than during a recession. In the 2 years following a recession, price returns were positive 82% of the time.

Recession Start	Length (Years)	During Recession	6M Before	12M Before	6M After	12M After	2Y After
7/31/1953	0.83	18%	-6%	-3%	17%	30%	55%
8/31/1957	0.67	-4%	5%	-5%	18%	33%	25%
4/30/1960	0.83	17%	-5%	-6%	7%	10%	1%
12/31/1969	0.92	-5%	-6%	-11%	14%	8%	34%
11/30/1973	1.33	-13%	-9%	-18%	1%	23%	18%
1/31/1980	0.50	7%	10%	14%	6%	8%	-12%
7/31/1981	1.33	6%	1%	8%	-19%	20%	18%
7/31/1990	0.67	5%	8%	3%	3%	8%	20%
3/31/2001	0.67	-2%	-19%	-23%	-6%	-18%	-7%
12/31/2007	1.50	-37%	-2%	4%	21%	12%	44%
2/29/2020	0.17	-1%	1%	6%	12%	44%	?
Average Return		-1%	-2%	-3%	7%	16%	20%
% Positive Return Periods		45%	45%	45%	82%	91%	82%

Cumulative price return of the S&P 500 during past recessions. Past performance is not indicative of future returns.

Table: Darrow Wealth Management • Source: YCharts; Nber • Created with Datawrapper

How stocks performed before, during, and after recessions. KRISTIN MCKENNA; DARROW WEALTH MANAGEMENT

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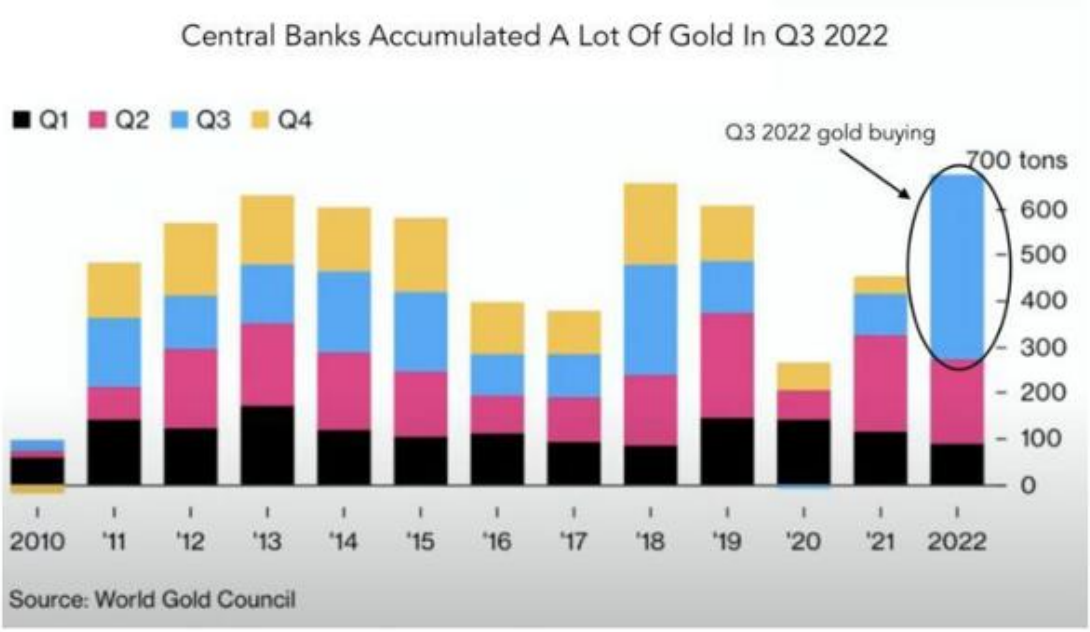
Will gold (finally) benefit from the current economic climate?

In 2022, gold has disappointed more than one investor (we are one of them...). In constructing diversified portfolios, managers are tempted to allocate a greater or lesser exposure to the yellow metal in case the economy is faced with rampant inflation or in case of worrying geopolitical tensions that influence world trade. This is exactly what happened in 2022...and after a 3.64% drop in 2021, gold fell another 0.28% against the US dollar last year and was even down almost 10% at the end of September...disappointing therefore and above all still an asset that did not cushion the shock suffered by equities and bonds in a diversified portfolio, even if it outperformed traditional assets! It is rather difficult to identify with certainty the causes of this poor performance. The 8%+ rise in the US dollar over the year probably put a damper on the yellow metal. The fact that gold does not generate any return and that US interest rates have risen sharply during the year, paying attractive returns, may also have put pressure on the metal and caused investors to lose interest. Another hypothesis that has been put forward during 2022 is that the Russian central bank, which has had 600 billion in assets frozen by Western banks following the invasion of Ukraine, has sold gold, but this hypothesis does not seem to be confirmed by the latest statistics on reserves held. However, as we can see in the chart below, global central banks have been especially active in the yellow metal in the 3rd quarter. Is this the start of a trend? Time will tell, but we should not bury this asset too quickly.



Source: World Gold Council, Game of Trade

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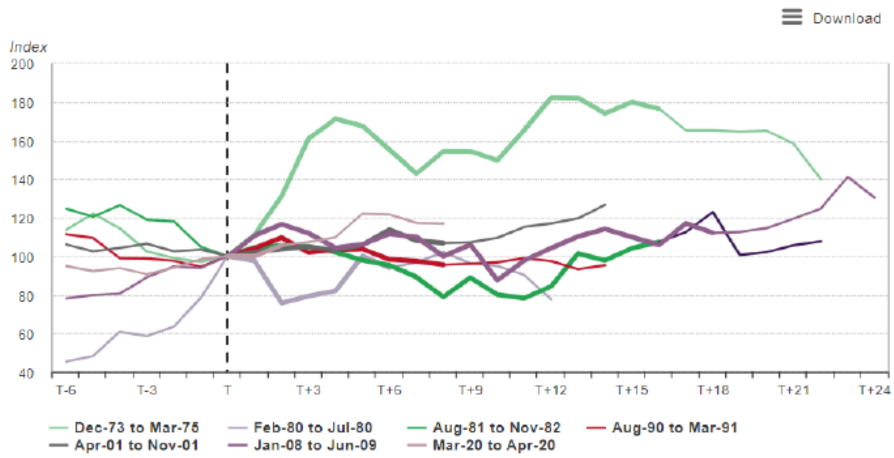
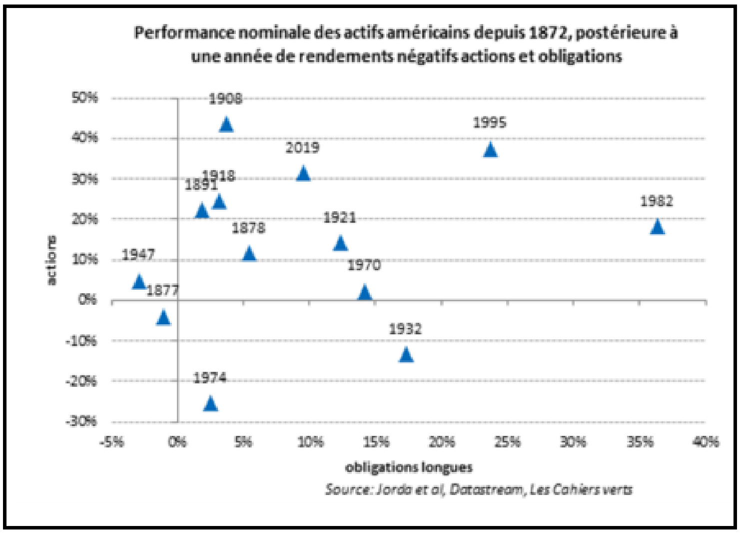
Performance of gold before, during and after NBER-designated recessions*



Sources: Bloomberg, ICE Benchmark Administration, NBER, World Gold Council; Disclaimer

The year 2023 has just begun and we can already tell that it will be challenging. But as is often the case, it is in complicated years with low visibility that the most interesting investment opportunities present themselves. After the annus horribilis we experienced last year, it seems that following the economic slowdown we have been experiencing for more than two quarters, a new prosperous cycle is taking shape. Covid and then the Russian-Ukrainian war have brought about irreversible changes in the world order. The peak of the globalisation race is certainly behind us. The energy transition should bring out promising investment themes in the coming years. However, be careful not to get caught up "too early" in an innovative theme.

We wish you happiness and success in 2023!



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