ARIA | CAPITAL

INVESTMENT INSIGHT

A weekly look inside the investment world.

The most effective way to do it, is to do it.
Amelia Earhart

Friday, 7 April 2023

In this week's Investment Insight

Great expectations
Last year the main theme in markets was inflation, leading to significant action from central banks. The most obvious casualty of tighter monetary policy was bond markets which recorded their worst performance in decades. However, equity markets also corrected significantly as multiples contracted. With the first quarter of 2023 behind us, global inflation rates seem to be at or near a peak. However, the direction of monetary policy remains uncertain and its effect on economic growth has yet to be felt in a meaningful way. Near term caution is probably warranted considering the likelihood of recession, although the longer-term outlook is more constructive. Against this backdrop, T Rowe Price recently published their latest Capital Market Assumptions; in this week's *Inside Track* we look at their 5-year expectations.

Beyond debt
In last week's *Pic of the Week* we illustrated the concerning trends for US debt relative to the nation's GDP. This week we double down, or up, looking at the size of the issue in absolute terms.

Newswire
Some interesting nuggets from this week's newswires.

Market view
A visual snapshot of recent market performance.

The Inside Track: Great expectations

T Rowe Price recently published their 5-year Capital Market Assumptions (CMAs). The following are extracts summarising their economic, equity and fixed income expectations.

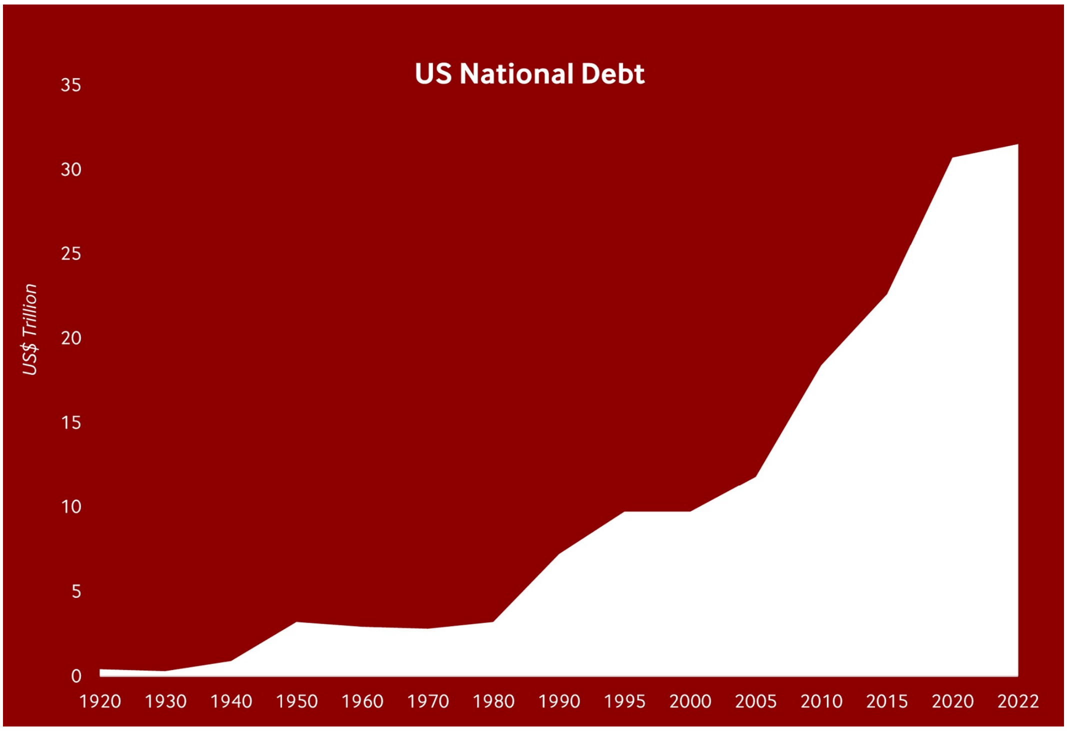
Economic
Inflationary pressures, which first appeared in the U.S., have spread across the globe. Underlying economic strength also has put pressure on central banks to rein in inflation by raising risk-free rates. Our forecasts for real gross domestic product (GDP) anticipate middling economic performance over the next five years. While we expect inflation rates to ease, high starting points result in levels that are above central bank targets across most economic regions. Overall, our global GDP growth forecasts remain positive, supported by strong economic fundamentals but sensitive to the ongoing monetary tightening cycle.

Equity
Our five-year expectations for equity returns are significantly higher versus last year's CMAs. Globally, our baseline forecast foresees resilient nominal earnings per share (EPS) growth and moderate support for equity prices through multiple expansion. With the economic recovery and the monetary cycle further along in the U.S. relative to the rest of the world, our forecast includes slightly higher non-U.S. equity returns. Underlying EPS growth expectations are comparable across regions, but disparate starting valuations result in varied return estimates. In particular, we expect emerging market (EM) equities to outperform developed markets. Within the developed markets, we expect the return leaders to be the U.K., Europe ex-U.K., and Australia.

Fixed Income
In previous years, regional interest-rate environments were largely characterised by their similarities - subdued inflation, modest economic outlooks and low policy rates. In contrast, our expectations this year are for more distinct, asynchronous regional cycles. The U.S. yield curve stands out as the outlier in our interest-rate forecasts, as we foresee a moderate decline in rates across the curve over the next five years. In other regions, we expect cash and short rates to remain stable or to fall moderately - with the exception of Japan, where we anticipate continued pressure on the Bank of Japan to keep short rates lower for longer. Long rates are predicted to rise across all non-U.S. regions. Generally, our investment professionals expect yield curves to steepen, as central banks complete their hiking cycles and economic activity picks up towards the end of our forecast horizon. However, higher starting rates and greater expected carry, on average, should provide a material cushion for investors. As a result, expected total returns for most fixed income asset classes are meaningfully higher than in previous years' CMAs.

Pic of the Week: Beyond debt

National debt in the United States has been part of its economic framework since its founding in 1776. The amount of debt has fluctuated considerably over time, with major increases occurring during wars, economic recessions and government spending programs. More recently, the debt has reached unprecedented levels and the debate continues as to an appropriate course of action, with some advocating for increased spending to stimulate economic growth, while others call for spending cuts to reduce the deficit and avoid a potential debt crisis. Putting some numbers on it, on an inflation adjusted basis, it took the U.S. 224 years to hit $10 trillion in debt. In the last 20 years alone, over $21 trillion in debt has been added. Meanwhile, U.S. debt is expected to hit $51 trillion by 2033, adding another $20 trillion in 10 years.



Newswire

...on Monday
Price of oil surges on OPEC's surprise production cuts.

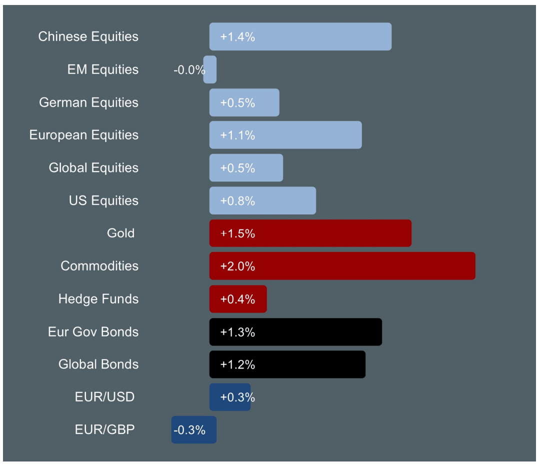
...on Tuesday
Pakistan's central bank raises interest rates to 21% to curb inflation.

...on Wednesday
According to the ECB, Eurozone food inflation continues to intensify.

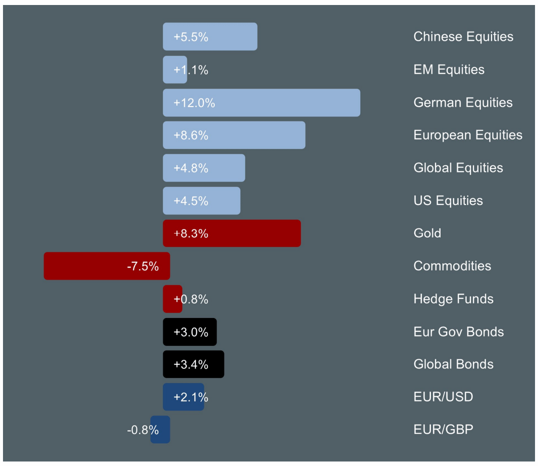
...on Thursday
Recent data from mortgage lender Halifax shows that UK house prices have risen for the 3rd month in a row.

Market View

Last 7 days (€)



Year to date (€)



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