Capital Markets Group

Points to Ponder

January 13, 2023

The First Tee...

Global Warming…world equity prices lost $18 trillion in market-cap during 2022 *1st degree burn!*

- The MSCI All-Country World Index fell over 20% in value, its worst performance since 2008:
  - 2023 looks also challenging, with recession talk and central banks holding to their tightening strategies:
    - On a positive historical note, the S&P 500 has only contracted in consecutive years just four times since 1928:
      - Unfortunately, when the value of the S&P has fallen two-years in a row, the second year's losses have typically been greater.
- Possibilities of an economic soft landing, falling interest rates and inflation expectations, stable corporate earnings, China reopening and stimulating its economy, could be positives
  - A majority of central banks should be reaching the end of their benchmark rate hikes by mid-year:
    - Inflation numbers have been trending lower the past few months…the University of Michigan's inflation expectation index is lowest in 9 months.
    - Corporate earnings projections are currently being downgraded…pressured by high costs for materials and labor.
    - The consumer could be the wild card, given the strong job market and rising wages, consumption carrying the economy.
- Market volatility should remain the norm, as trading trends are changing on the street:
  - There has been a major shift to trading in very short-term equity options (raising the probability of large intraday swings):
    - Technical trading strategies are increasingly driving day-to-day stock moves…dominated by algorithmic-focused institutions.

A Raw Deal…with equity and fixed-income values floundering last year, raw materials were the place to be…commodities are expected to be the best performing asset class again in 2023:

- While stocks were suffering bear market losses of 20% or more, and government bonds had historic losses (10-year T-Note lost 16% in value, while 30-year T-Bond lost 36%), commodities gained 20% in value:
  - Commodities have been trending towards a long-term shortage problem…despite the exceptionally high prices for raw materials, there is still not enough sufficient capital inflows to solve the supply issue:
    - Without sufficient capital expenditures to help create spare supply capacity, commodities will continue to experience long-term shortages, creating higher and increasingly volatile prices…including lack of exploration for new oil fields and investment in mines.
- **Boom to bust**…the high-flying big-name commodity traders of the mid-2000's are being replaced by technical quantitative investors:
  - From 2002 to mid-2008 the CRB Index (Commodity Research Bureau) rose by 226%...only to fall by 58% during the next 8 months:
    - Today, much of the cash being invested in the commodity space is deployed into huge macro funds, whose strategy is to profit from broad market moves created by political and economic events *(which we are not lacking in the current environment!)*:
      - Last year, the 15 largest commodity hedge funds posted gains over 10%, while returning over 20% the previous two years:
        - The S&P GSCI Total Return Index (which measures commodity price movement) is predicted by Goldman Sachs to rise over 40% this year.

Car Crash…the used car buying frenzy has ended, prices moving towards historical norms

- During height of the pandemic, the global auto industry enjoyed unabated pricing power:
  - New cars were selling for sticker price or higher, while used-car prices surged almost 30% (average cost $29k):
    - Despite the spike in car prices, demand remained robust due to a strong job market and low borrowing rates:
      - Used car retailers such as CarMax and Carvana were riding high on the strong car market wave (Carvana is now fighting insolvency).
  - With new car production ramping-up, the auto market is experiencing the sharpest swing from under-supply to over-supply in light vehicles in over twenty years…breaking the price support for used cars and trucks:
    - The early months of the pandemic were the most disruptive to auto production seen since World War II…with manufacturing coming to a halt due to employee shortages and supply-chain issues (especially in the lack of semi-conductors):
      - New vehicle inventories were up 81% towards the end of last year…740k more new vehicles were available compared to 2021.
  - The rebound in new car supply, combined with the sharp increase in auto borrowing rates, has helped to push used-car values in December down the most in 27 years (wholesale used car prices have declined 22% since July).

At the turn...

The Back Nine…

Less than Zero, no more…the upside-down world of negative interest rates has ended

- The amount of bonds with sub-zero rates peaked in late 2020 at $18.4 trillion (4,000 bond issues):
  - The spike in the level of global inflation last year was the death knell for negative rates…that had spawned from central banks developing new monetary policy tools to stimulate economic growth:
    - Central bank actions associated with negative rates included quantitative easing, rate caps and helicopter money.
- Japan was the last hold-out to move away from a zero interest-rate monetary policy:
  - The Bank of Japan's surprise move in December of doubling the cap-rate on a 10-year government bond, saw the remaining 46 bonds with negative rates turn positive *(paying the government to hold your money)*:
    - Japan's ambitious monetary stimulus policy saw the Japanese central bank become the largest owner of stocks and bonds in Japan, with 43% of the total…Japan has government debt of $9.2 trillion, which is 266% of GDP (the most of any developed nation).
  - The aggressive monetary policy has failed to boost the Japanese economy in a sustainable manner:
    - Japan is the 3rd largest economy in the world…but its GDP has averaged only an annual gain of .66% over the past two decades.

Should auld markets be forgot?...most investors would prefer to not bring 2022 to mind:

- Data format: January 1, 2022 / Oct 1, 2022 / January 1, 2023:

Equities
- **Dow:** 36338 / 28725 / 33147
- **S&P 500:** 4766 / 3586 / 3839
- **NASDAQ:** 15644 / 10575 / 10466
- **Russell 2000:** 2245 / 1664 / 1762

Commodities
- **CRB:** 232 / 268 / 277
- **Oil:** $75.21 / $79.49 / $80.26
- **Gold:** $1829 / $1660 / $1824
- **Copper:** $446 / $341 / $381
- **Natural Gas:** $5.85 / $6.76 / $4.47
- **Bitcoin:** $46,333 / $19425 / $16539

Borrowing Benchmarks
- **SOFR:** (U.S. Secured Overnight Financing Rate)
  - **1 day:** .05% / 2.96% / 4.30%
  - **1mo:** .080% / 3.04% / 4.36%
  - **3mo:** .091% / 3.59% / 4.78%
- **IORB** (Interest on Reserve Balances): .15% / 3.15% / 4.40%

Treasuries Issues
- **3mo:** .03% / 2.79% / 4.24%
- **6mo:** .17% / 3.92% / 4.58%
- **1yr:** .37% / 4.05% / 4.47%
- **2yr:** .73% / 4.22% / 4.42%
- **3yr:** .95% / 4.25% / 4.22%
- **5yr:** 1.26% / 4.06% / 4.00%
- **7yr:** 1.43% / 3.97% / 3.96%
- **10yr:** 1.51% / 3.83% / 3.87%
- **20yr:** 1.93% / 4.08% / 4.14%
- **30yr:** 1.90% / 3.79% / 3.96%

Currencies
- **Euro:** 1.137 / .908 / 1.070
- **Yen:** 115.08 / 144.74 / 131.12
- **Peso:** 20.529 / 20.138 / 19.499
- **Canadian $:** 1.263 / 1.382 / 1.355
- **Yuan:** 6.356 / 7.128 / 6.898

Grain Futures
- **Corn:** $5.93 / $6.78 / $6.785
- **Soybeans:** $12.53 / $13.83 / $15.24
- **Wheat:** $7.70 / $9.23 / $7.92
- **Random Lumber:** $1147 / $422 / $373

Job / Inflation Indicators
- **Unemployment:** 3.9% / 3.5% / 3.5%
- **Consumer Price Index:** 7.0% / 8.2% / 6.5%
- **Core PCE Index:** 4.7% / 4.9% / 4.7%

- **Federal Funds Open:** .07% / 3.05% / 4.32%
- **Prime Rate:** 3.25% / 6.25% / 7.50%

19th Hole...

It is not certain that everything is uncertain. Blaise Pascal

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