HOUSE VIEW

LOOKING BEYOND SANTA'S BAG OF GIFTS

BancaMarch

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As the end of the year draws near, the stock markets like to get into the Christmas spirit. Investors rally to pro t from the best three months of the year as, in historical terms, November tends to be the most bullish month, with returns of +1.9% for the S&P 500, followed by January (+1.6%) and December (+1.5%), compared to a monthly average of +0.7% for the year as a whole.

RETURN ON S&P 500 IN 2023 VS. HISTORICAL AVERAGE

Sources: Bloomberg and Banca March

This time around, US in ation has been the cause for this market exuberance: prices are already up 3.2%, almost a third of the 9.1% reported in June last year, when growth was at its highest.

While these factors are certainly good short-term catalysts for the stock market, we believe it is worth looking beyond what Santa Claus will be bringing us this season.

In ation is bene ting from falling energy and automobile prices, though this tailwind will fade as we approach April of next year.

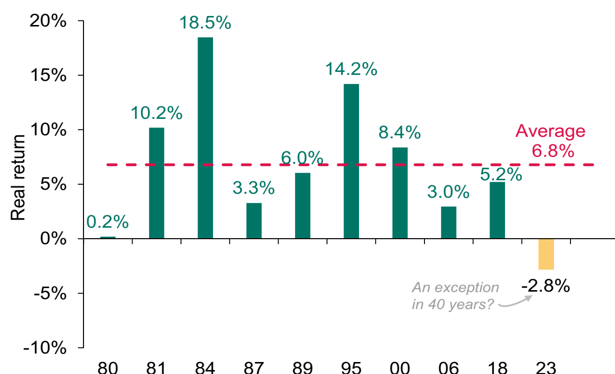
Rental prices are already a key part of the in ation puzzle: they account for one third of the total and have been growing at a pace of 6.8%, making up 72% of the overall rate in the last month. As Lisa Cook of the Fed's Board of Governors remarked a few days ago, it is one thing for in ation improvements to be seen, yet quite another for them to be lasting. In ation will continue to retreat, though at the current pace the 2% target will not be reached even by the end of next year.

However, the main risk lies not in in ation but in economic growth. The economy, hit by the highest interest rates since 2001 and gruelling nancial conditions—substantially similar in nature to past recessions—, is currently slowing and we will see the worst of the fallout in the coming months.

What seems to have been proven over the last few days with the further easing of in ation is that central banks are not going to raise o cial interest rates any further.

REAL RETURN AT 12M FOLLOWING THE FED INTEREST RATE HIATUSES

Source: Bloomberg US Treasury Index



In the last 40 years, whenever the Federal Reserve has paused in its interest rate hikes, positive returns have been achieved by buying US Treasury bonds: 6.8% on average in the rst year discounting the e ects of in ation; a situation that has not occurred this time around. To give an example, the US 10-year bond was trading at an IRR of 4% at the end of July, the day the Fed went ahead with its last rate hike, compared to 4.4% today. Simply returning to these levels, in US Treasury index terms, would mean adding a further return of 2.8% to the historical average of 6.8%.

This situation, read in conjunction with the empirical evidence shown in the diagram, suggests lengthening the duration of fixed income positions to mitigate the risk of reinvesting future maturities.

However, the performance of the stock markets is more closely linked to the economic cycle and, to achieve positive returns, will depend on whether the economy makes a soft landing and manages to stave off a recession. In our view, it is too early to say that "nothing is broken" and we certainly believe that caution is key when it comes to equity exposure. As we are now facing the most vulnerable part of the economic cycle, we see little room for further improvement in corporate earnings, for which the consensus opinion is 11% growth.

They say that slow eaters tend to choke less. Let's practise this after Christmas and fit in a lot of fixed income for the January uphill slog.

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