2023: Year-End Markets Review

Each year comes with its own set of highs and lows, but 2023 stands out from many others due to the significance of both its peaks and troughs. Including but not limited to the sharpest monetary policy tightening in decades, geopolitical tensions, an uptrend in AI, and an abrupt banking crisis. Overall, the global economy surprised on the upside with the U.S. economy not only steering clear of a widely expected recession but also sustaining steady growth throughout the year. Furthermore, unemployment rates haven't seen any massive pick-up across the globe while high interest rates led to a steady decline in inflation rates.

The Fed concludes 2023 on a high note, signaling that rate hikes are over after making four increases throughout the year, bringing the Fed fund rate to 5.50% in efforts to tackle high inflation. Surprisingly, the unemployment rate in the US continued to reflect a resilient job market as it showed unemployment rates that are consistent with an economy in full employment despite the highest interest rate in multiple decades. The unemployment rate has reverted to 3.7% at year-end, aligning with the 2% target for price inflation. Inflation and unemployment are other main themes carried out in the past year and will continue to be of importance.

Geopolitical tensions led to increased market volatility in 2023. Russia witnessed a significant erosion of its soft power globally amidst the ongoing conflict in Ukraine while Western support to Ukraine started to falter toward year-end. In addition, tensions escalated in the Middle East with a new raging war between Israel & Hamas which threatened to evolve into a regional conflict. Finally, the U.S. and China cold war continued unabated despite multiple gestures by both sides to de-escalate tensions and embrace diplomacy.

Artificial Intelligence (AI) has extraordinary advancements that have captured the interest and minds of many investors. AI led the equity market -specifically in the US- to deliver significant returns mainly led by the 'Magnificent 7' which was responsible for nearly two-thirds of the S&P 500 24% gain the past year.

Financials have had a tough year, the biggest failure of US banks since the global financial crisis. The collapse of some major banks like Silicon Valley and First Republic Bank sent shockwaves through global markets and eroded confidence within the financial system. After the fall of two US lenders, Europe followed through with Switzerland's second-largest bank, Credit Suisse, coming back under the spotlight in a saga that ended with a government-arranged acquisition of the bank by UBS. Despite the banking crisis in the US, it emerged as a clear winner posting solid gains for the year, unlike Europe where it continued to struggle with lackluster growth prospects without hope for a turnaround soon.

Quantifying the events that occurred is as important as their qualitative acknowledgment. Despite all mentioned market turmoil, many corners of the market have shown resilience. This surpassed many bearish expectations of a hard landing and an imminent recession which never came to fruition. Furthermore, geopolitical tensions pushed gold to reach a new high with a price of $2,063 towards the end of 2023. Equities were a clear winner in 2023, while REITs had a challenging year influenced by high-interest rates.

Across the Pacific, optimism at the beginning of the year on China's reopening story faded away as the Chinese economy continued to disappoint amid an ongoing crisis in the real estate sector. For the third year in a row, MSCI China has seen consecutive declines, with the most recent year marking a -13% decrease.

The real estate crisis has intensified as a result of sharply declining home sales, pushing even robust developers such as Country Garden to the verge of collapse. This turmoil has extended into the extensive shadow banking sector, leading to defaults and triggering protests nationwide. Earlier in the year, many economists were expecting rate cuts alongside a recession. However, yields moved upward before taking a pivotal turn close to year-end as market participants overreacted to the FED's guidance. the 10Y treasury yield went up by 97 bps between the end of July and October before dropping 105 bps in the last two months of the year. This decline in long-term yields toward year end has pushed the U.S. dollar to register its first annual loss against a basket of major currencies since 2020.

As we enter 2024, we remain vigilant on events that are likely to shape the market. Our focus remains on central banks' next moves, particularly the timing of rate cuts, given these moves will influence market sentiment. Additionally, despite our firm belief in the promise of AI technologies, we are still skeptical about the current market valuations of some of the leaders in the AI space.

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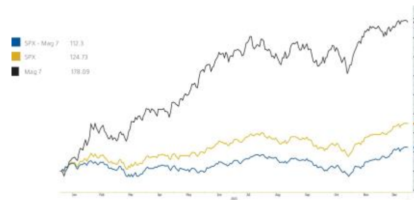
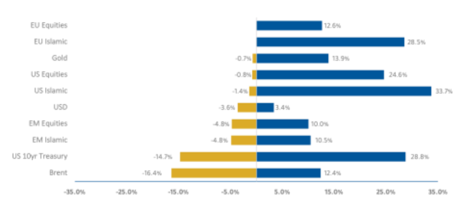
Not to forget China; will 2024 be another year of disappointment, or will it bring positive surprises? Furthermore, 2024 is promising to be a hot political year with upcoming elections in multiple major countries, including the US, European Union, India, the UK, and Russia. With all these open subjects, 2024 is shaping up to be yet another volatile year, but we should be used to it by now, right?

The Outburst of the Magnificent 7



Source: SEDCO Capital Analytics

Ranges of Asset Class Returns in 2023



Source: SEDCO Capital Analytics

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