Philequity Corner (January 30, 2023)
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Market vs. Fed

Despite the risks posed by a hawkish Federal Reserve, higher for longer interest rates, a potential recession in major economies, a looming corporate earnings downturn, and bearish calls by strategists of top investment banks, global equities had a strong start in 2023. Amid signs of peaking inflation, slowing rate hikes, and the US dollar decline, the All-Country World Index (ACWI) ETF rose 7.6% year-to-date. The S&P 500 is up 6% while the Euro Stoxx 50 is 10.1% higher. The January rally was led by the 18% year-to-date return of the MSCI China ETF. This lifted many emerging market counters, resulting in the 11.6% rally of the MSCI Emerging Markets ETF (EEM) in January. The PSEi posted a year-to-date return of 7.4% and is up 9.9% in US dollar terms.

Hawks talk down the market

Whenever the stock market goes up, Powell and other Fed officials issue hawkish statements that temper the market rally. Just like Grinch who stole Christmas or Scrooge the party-pooper, the Fed is acting the same way once again (see *Fed Grinch spoils Christmas rally*, December 19, 2022). Fed Vice Chair Lael Brainard said, “Policy will need to be sufficiently restrictive for some time to make sure inflation returns to 2% on a sustained basis.” New York Fed President John Williams stated, “It is clear that monetary policy still has more work to do to bring inflation down.” The Fed is not the only major central bank that is talking down the market. European Central Bank (ECB) President said, "We shall stay the course until such a time when we have moved into restrictive territory for long enough so that we can return inflation to 2% in a timely manner.”

Disconnect

There is a disconnect between the stock market and the Fed. Many investors believe that inflation has already peaked, and that interest rate increases should slow down soon. In contrast, hawkish Fed members stressed the importance of keeping monetary policy restrictive until there are clearer signs that inflation is on a sustainable downward path. It seems that the Fed would rather err on the hawkish side. Powell cited the mistake of monetary officials during the Volcker era who had cut interest rates too early only for inflation to reappear later on. Thus, the risk remains that the Fed and other central banks may trigger a deep economic recession by overtightening.

Top strategists are bearish

Though markets have rallied strongly in January, some of the top strategists from major investment banks are bearish on the stock market. JPMorgan Strategist Marko Kolanovic, who was previously bullish, is now outright negative on the market. He said that equities have gone up despite signs of deterioration in fundamentals. Morgan Stanley CIO Mike Wilson remained bearish and warned investors that markets will make new lows because of risks posed by rising interest rates combined with slowing economic growth. UBS CIO Mark Haefele flagged the continued pressure on corporate earnings growth which may lead to an earnings recession.

Doves appear

Though Fed officials were previously unanimous in their hawkishness, some dovish Fed members are starting to appear. Kansas City Fed President Esther George supported a stepdown in rate hikes last month because she is wary of tightening too much. Fed Governor Christopher Waller believes that policy looks close to being sufficiently restrictive. Philadelphia Fed President Patrick Harker favored a 25-basis-point increase in the forthcoming Fed meeting this week.

China leads the world

China has led the rally of global equities this year. China eased its stringent regulatory crackdown on tech billionaires and mega-tech companies. This was bolstered by government stimulus which involves massive liquidity injections by the People's Bank of China (PBOC).

From "COVID Zero" to "COVID Everywhere"

One of the main catalysts driving the Chinese bull market is the change in COVID policy. From implementing a very stringent "COVID Zero" policy, China made a 180-degree turn. It seems that China's policy has shifted to "COVID Everywhere" when it suddenly reopened its economy. This has consequently allowed natural herd immunity to kick in. The Chinese government announced that about 80% of its population have already been infected, and Chinese Vice Premier Liu He declared that the country has passed its COVID peak. Since China is the biggest Asian economy and the strongest contributor to global growth, its reopening and rebound has a halo effect on Asian and emerging markets, including the Philippines.

Phil GDP - highest since 1976

Last week, the Philippine government announced that 4Q22 GDP growth came in at 7.2%. This brought full-year 2022 GDP growth to 7.6%, the highest annual GDP growth rate since 1976. This was fueled by the country's economic rebound from the pandemic. Despite the prevalence of high inflation, household consumption rose 7% in 4Q22 and 8.3% in 2022.

Goldilocks

It remains to be seen if investors are right to believe that inflation has indeed peaked and prospective rate hikes should slow. By providing a hawkish policy outlook and talking down the markets, the Fed seeks to temper overzealousness and excessive bullishness. Central banks are aiming for the delicate balance of slowing inflation without depressing economic activity too much, a "Goldilocks scenario" where the economy is not too hot and not too cold. Fed Vice Chair Lael Brainard said, "It remains possible that a continued moderation in aggregate demand could facilitate continued easing in the labor market and reduction in inflation without a significant loss of employment." The Fed will hold its first policy meeting of 2023 this week. Amid the disconnect between the market and the Fed, we are hopeful that the Fed will make a judicious decision that will lead the global economy to the right growth path.

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