



# LWM Consultants Ltd

**Quarterly Market Update  
– January 2023**



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*“Rough seas make stronger sailors.  
Tough times build greater people.”*

*— Robin Sharma*

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There will be many experts who will look to explain what has happened recently, and what will happen next. The reality is that it will be almost impossible to explain 2022, and most will fail at guessing what will happen next.

Markets, like investors, crave some form of certainty, and the flow of news during 2022 meant that it was hard to move forward. We saw bursts of optimism, and then another dark cloud hovered over.

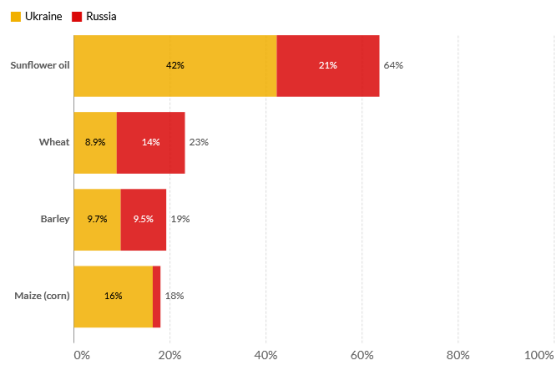
So, what happened in 2022?

We expected inflation to peak and then drop back to a more normalised level.

Russia’s invasion of Ukraine is undoubtedly one of the deadliest and most destructive wars Europe has seen since World War II. The cost to human life and to the displacement of people will impact the region for many years to come.

The world’s reliance on the region for commodities, as illustrated in the charts below, meant that inflation was heading in one direction during 2022.

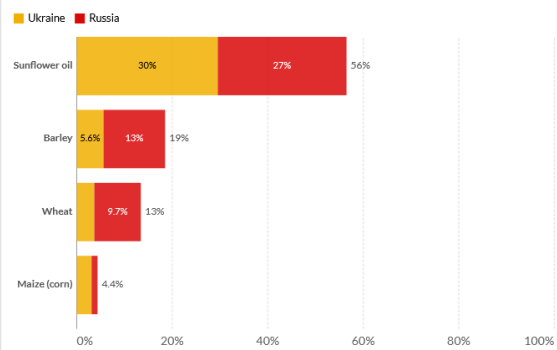
Global food exports: how much comes from Ukraine & Russia?, 2019  
This is shown for the largest crops grown by Ukraine and Russia.



Source: Calculated by Our World in Data based on the Food and Agriculture Organization of the United Nations  
OurWorldinData.org/agricultural-production • CC BY

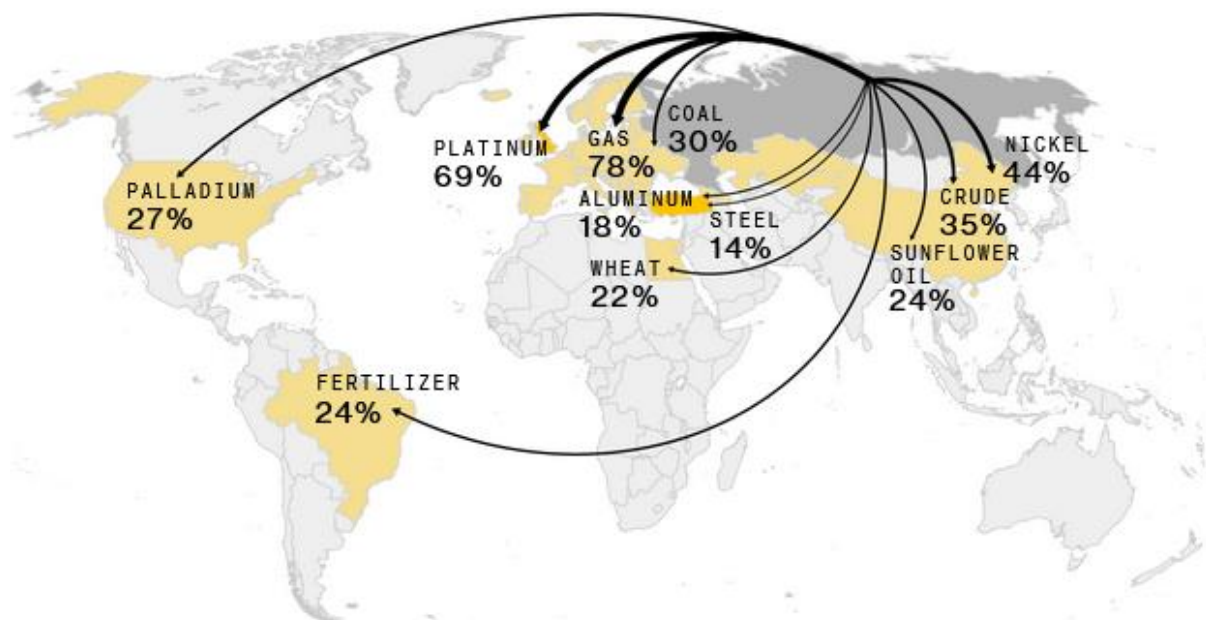
CHART TABLE SOURCES DOWNLOAD

Global food production: how much comes from Ukraine & Russia?, 2019  
This is shown for the largest crops grown by Ukraine and Russia.



Source: Calculated by Our World in Data based on the Food and Agriculture Organization of the United Nations  
OurWorldinData.org/agricultural-production • CC BY

CHART TABLE SOURCES DOWNLOAD



Note: Coal figures combine thermal and metallurgical; liquefied natural gas and pipeline gas are also combined.

Sources: UN Comtrade Database (metals); International Energy Agency (coal); UN's Food and Agriculture Organization (wheat; sunflower oil); Joint Organisations Data Initiative; Bloomberg; Eurostat; BP; (crude); Trade Data Monitor; Green Markets, a Bloomberg company (fertilizer); BP (gas)

It is important to reflect that inflation has been relatively stable for many years and seeing this rise was a shock for many people.

Central banks responded by raising rates, meaning that people are being “impacted” across two fronts: the rising cost of everyday items and the cost of borrowing. How this will impact differs across different regions as the chart below demonstrates. Ultimately this slows growth and therefore we will hear more about a global recession.

# DOUBLE-DIGIT INFLATION

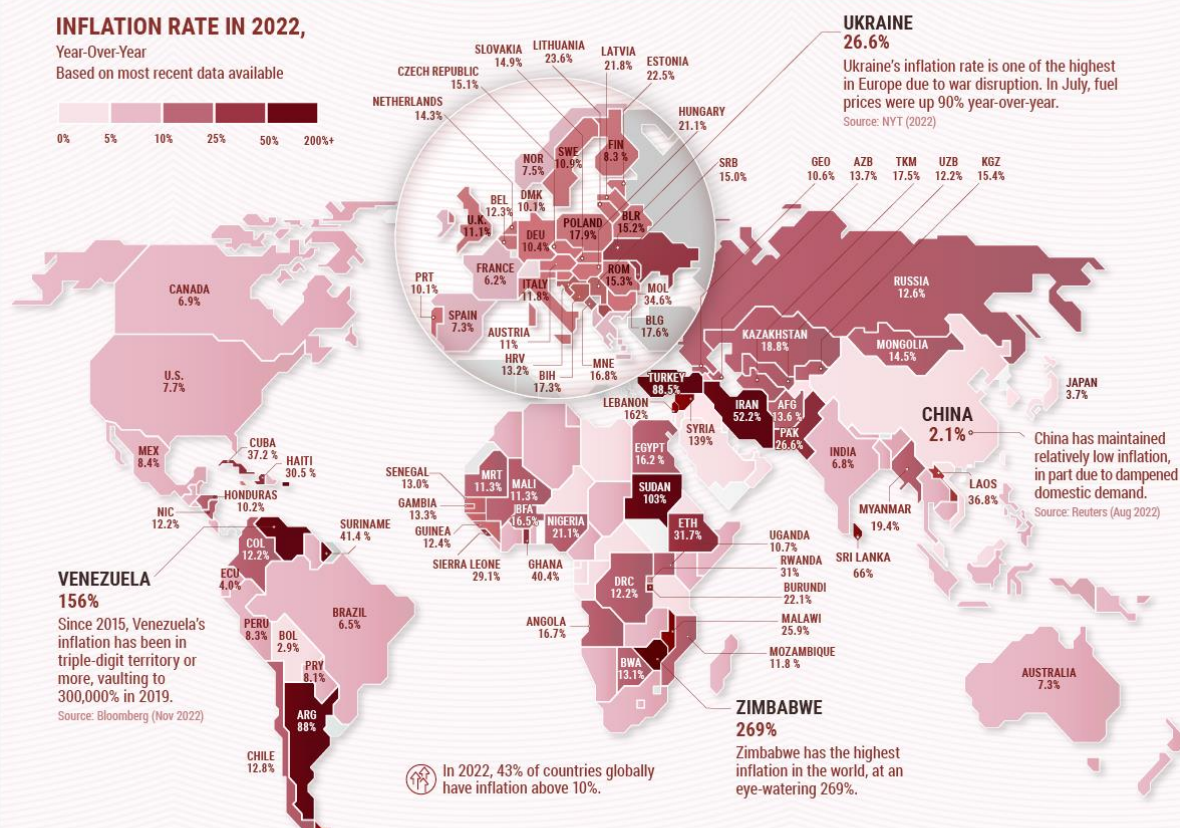
IN ALMOST HALF THE WORLD

Today, many countries around the world are experiencing double—or even triple—digit inflation.

Here are the countries with the highest inflation rates globally as soaring energy prices are driving up the cost of living.

## INFLATION RATE IN 2022, Year-Over-Year

Based on most recent data available



## Top 10 Highest Inflation Rates



Source: TradingEconomics (Nov 2022)  
Based on inflation rate data from 186 countries in 2022.

ELEMENTS

ELEMENTS.VISUALCAPITALIST.COM

China has often been the white knight that comes to the rescue of “global growth”, but the zero covid policy meant that growth was restricted, and this compounded global uncertainty. If the second biggest economy was not firing across all “cylinders” then how could they help? Then as expected President Xi Jinping broke precedent with succession rules and was elected for a third term and installed a more hard-line team, a signal that raised concerns with global markets.



The impact of climate change was felt globally with torrential rains, floods, scorching heat, wildfires, flash floods etc. The estimated cost in 2023 is expected to exceed \$1 trillion dollars. As the world grapples with a move to more sustainable energy sources it was also finding that existing sources were souring in cost due to the invasion of Ukraine, and under investment over the last few years.

And we could go on....in the UK there has been significant political uncertainty, the collapse of FTX Trading Limited sent shocks across the Crypto Currency Markets, the mid-term elections in the US didn't go the way the Republicans expected, and so on.

And then what happens going forward?

There are indications that inflation has or is peaking so we therefore should expect inflation to come down in 2023. What the new normal is, is perhaps anyone's guess. In the US I have seen people suggest a figure as low as 2% but others have been closer to 4%. It is important to understand that there are inflationary forces at work including aging workforces, geopolitical tensions, and net zero transition, but on the other side technology is disinflationary, so there is that push / pull mechanism at play.

If inflation comes down and growth slows then central banks will be under pressure to slow the pace of rate rises and potentially we could see a reversal in rates, especially when we fall into recession territory.

Inflation, interest rates and recessions are really the areas to watch. The war in the Ukraine will rumble on, China is reversing the zero Covid policy, and the UK seems to have entered a period of political stability, but worker unrest creates uncertainty.

What does this all mean for markets? When we consider where they were at the start of 2022 and what the market was predicting, we are starting a year with lower valuations and more certainty around the risks we face. A lot of the bad "stuff" is known and is priced in (we didn't have that at the start of 2022). Falling earnings could push prices down but at some point there will be a bottom.

Markets tend to recover before economies and this is important for investors. Often investors wait until they see a recovery in economies before investing and miss out on the market recovery.

We thought the charts below might help:

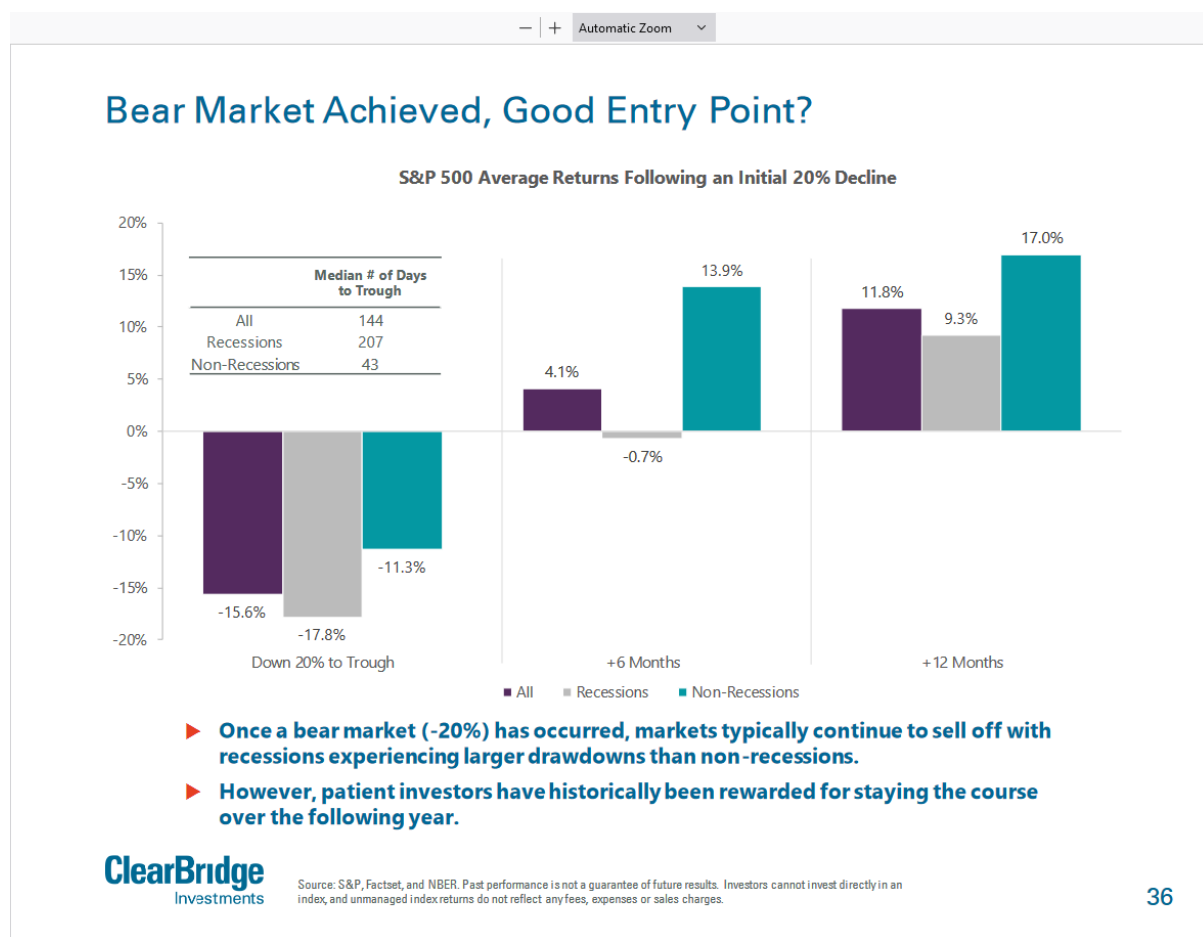
Recession Start	Recession End	Length (Months)	Market Low During Recession?	Distance from Recession Start (Months)	Distance from Recession End (Months)
Nov. 1948	Oct. 1949	11	Yes	6	-5
July 1953	May 1954	10	Yes	1	-9
Aug. 1957	April 1958	8	Yes	2	-6
April 1960	Feb. 1961	10	Yes	6	-4
Dec. 1969	Nov. 1970	11	Yes	5	-6
Nov. 1973	March 1975	16	Yes	10	-6
Jan. 1980	July 1980	6	Yes	2	-4
July 1981	Nov. 1982	16	Yes	12	-4
July 1990	March 1991	8	Yes	2	-6
March 2001	Nov. 2001	8	No	18	10
Dec. 2007	June 2009	18	Yes	14	-4
Feb. 2020	April 2020	2	Yes	1	-1
Average:		10.3		6.6	-3.8

## Stock Market Returns During Recession Years

Markets typically bottom out and rebound months before the end of a recession.

Recession Year	Recession Year Returns (S&P 500)	Following Year Returns (S&P 500)
1945	30.3%	-11.9%
1949	10.3%	21.8%
1953	-6.6%	45.0%
1957	-14.3%	38.1%
1960	-3.0%	23.1%
1970	0.1%	10.8%
1974	-29.7%	31.5%
1980	25.8%	-9.7%
1982	14.8%	17.3%
1990	-6.6%	26.3%
2001	-13.0%	-23.4%
2008	-38.5%	23.5%
2020	16.3%	26.9%

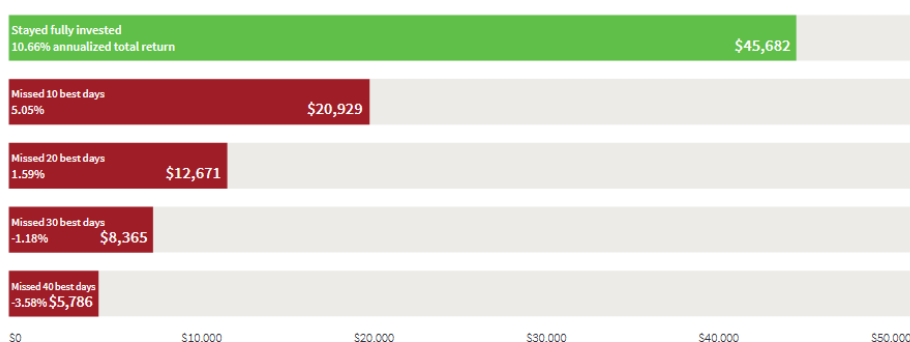
Source: CFRA Research, NBER, S&P Global. • [Get the data](#) • Created with [Datawrapper](#)



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## Stay invested so you don't miss the market's best days

\$10,000 invested in the S&P 500 (12/31/06–12/31/21)



By staying fully invested over the past 15 years, you would have earned \$24,753 more than someone who missed the market's 10 best days.

What does this tell us? Throughout history markets have recovered before the end of a recession and in some cases within a relatively short period of time. On average the year after negative returns is positive (but there are some years where this hasn't played out). Investing at this time can be a good entry point. Finally, staying invested, however painful, is proven time and time again to be best for investors.

So where does that lead us? 2022 delivered lots of different events and markets could still go down further in 2023. However, it does seem that inflation is peaking and that this will come down, and a recession may not be negative in that it may force central banks to slow / stop or reverse rate rises.

It is worth reflecting on the table below. These are expected annual returns from different asset classes from BlackRock:

	<b>5-year</b>	<b>10-year</b>	<b>Expected volatility</b>
Private Equity	11.60%	11.50%	24.90%
Europe Large Cap	10.40%	9.80%	16.00%
Emerging Markets Large Cap	10.20%	10.10%	19.00%
Global ex UK	9.60%	9.00%	11.50%
UK Large	8.70%	8.20%	14.80%
Global Infrastructure	8.20%	8.10%	16.70%
Japan Large Cap	8.10%	6.90%	16.40%
China A	7.30%	7.30%	30.60%
US Large	7.10%	7.10%	16.80%
Global Aggregate Bonds	4.70%	4.40%	3.70%
Global Core Real Estate	2.20%	3.00%	10.90%

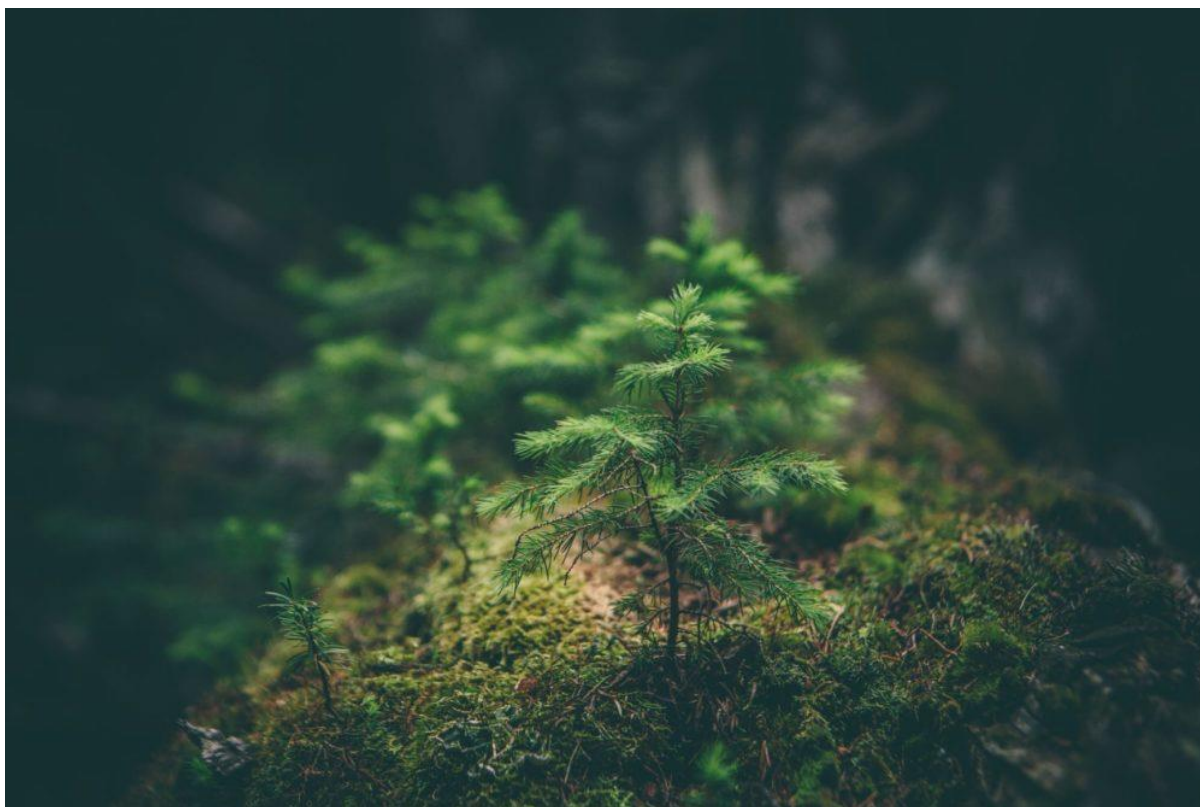
We can't guarantee these figures, but a diversified mix of quality assets should steer us through this period.

*George Ladds*

George Ladds, Director, January 2023



## Responsible Investing



The war in Ukraine shifted people's perception of sustainability, and almost its viability. In developed economies it is clear that the transition in terms of changing infrastructure is a challenge, and there is a possibility that emerging economies overtake developed economies when it comes to sustainability, including the technology that is needed.

I was fascinated to see that the expected cost of damage caused by extreme weather could top \$1 trillion in 2023.

But what 2022 exposed was an important fact. For several years the focus has been on renewables and this has seen under investment in areas such as oil and gas. The reality is that the world needs existing resources to enable the transition to more sustainable commodities. How we get to that balance is another matter.

Just focusing on COP27, the key takeaways were:

1. Establishing a dedicated fund for loss and damage
2. Maintaining a clear intention to keep 1.5 degrees within reach
3. Holding businesses and institutions to account
4. Mobilizing more financial support for developing countries
5. Making the pivot toward implementation

It is very clear that countries struggle on how they implement what is needed.

As investors, this is an area that cannot be ignored. Money is going towards this and therefore we have to get the balance between old and new right

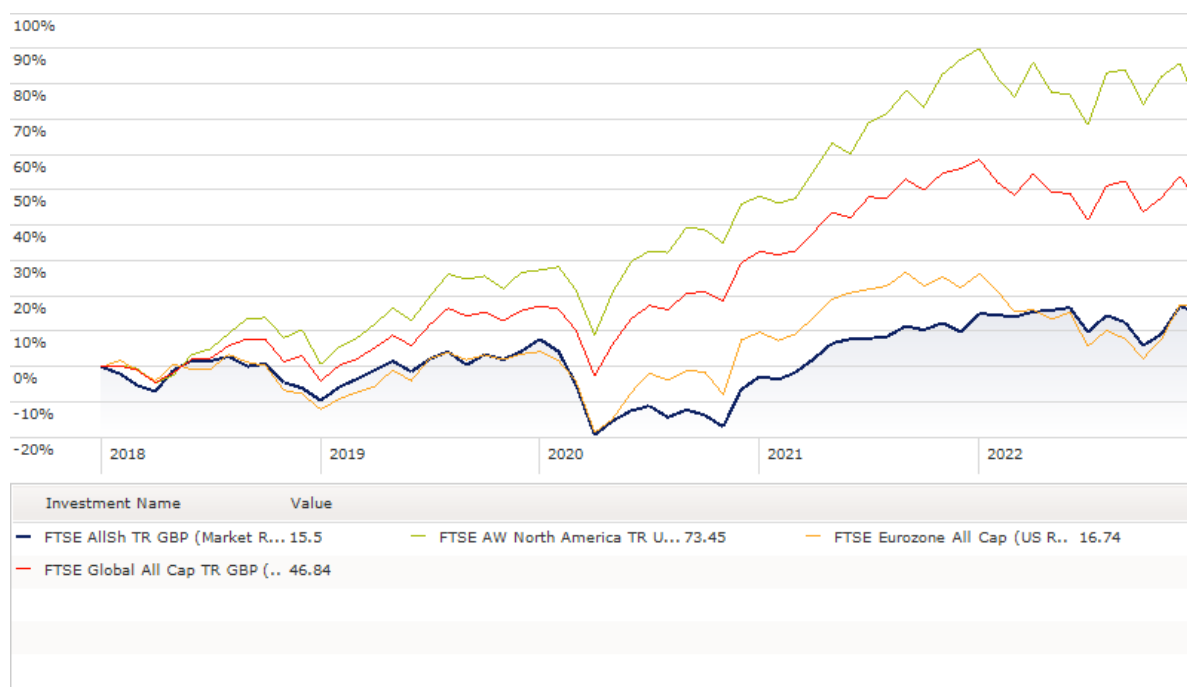
It is worth reflecting on ESG as this can cause some confusion. ESG stands for environmental, social and governance. Effectively it is a set of standards measuring a business's impact on society, the environment and how transparent and accountable they are. ESG is not exclusionary, this means that an oil company can have good ESG standards.

The point with all of this is that we know the direction of travel, but we also know that existing commodities are needed to deliver that eventual outcome. For investors it is about finding good companies across both areas unless they have specific exclusion requirements.

In summary, sustainability and responsible investing is a fundamental shift for investors. But there is room for all investors. ESG is important because it is a measure of how good a company is and it enables investors to invest where they want to but with good companies. How quickly we transition and change is really anyone's guess! The need is there and whether the desire and drive follows is another matter.

## US, EUROPE & UK

Five year returns 1 January 2018 – 31 December 2022



**Special note to graph:** You should note that past performance is not a reliable indicator of future returns, and the value of your investments can fall as well as rise. The total return reflects performance without sales charges or the effects of taxation but is adjusted to reflect all on-going fund expenses and assumes reinvestment of dividends and capital gains. If adjusted for sales charges and the effects of taxation, the performance quoted would be reduced.

With so much happening, trying to find a place to start is challenging. In the last update we talked about the “bonkers”. It seems that the rumours were not that far out. Liz Truss lasted just 49 days in office, and Boris Johnson seemed ready to step back in. In the end it was Rishi Sunak who become Prime Minister.

In the US Trump announced his intention to run for a second term in the 2024 elections. Ron De Santis hasn’t announced his intention to run but many expect him to do so soon. It is important to reflect that the Republicans were expected to take both the Senate and House. As it turned out the Democrats performed significantly better than expected and held the Senate but lost the House. Some saw this as a vote against Trump. Whether this is true or not, we do know that the next two years will be fascinating to watch.

One of the concerns for the US was policy error and the speed of change from the Fed was unprecedented. In 2020 we saw economic stimulus and enormous amounts of liquidity flooding the market. In 2022 this was effectively turned off over night as the Fed opted for aggressive monetary policy to tackle inflation risks. There is some debate on where this all leads, but it is expected that inflation will peak and decline this year, and rates are expected to reach around 5%.

There are perhaps three things to focus on this year: recession, dollar, and mega tech / stock market valuations.

To some extent these are all interlinked. In terms of currency 2022 favoured the US dollar because of the relative outperformance compared to other economies. However, 2023 is different. The consequences of the Fed tightening is likely to feed through into growth figures, and US household savings have dipped below Pre-Covid 19 levels essentially meaning households have used much of the excess savings built up in 2020 and 2021.

There is some debate on whether the stock market is overpriced and whether it is reflecting a recession. Mega tech makes up near 25% of the S&P 500 and there is a feeling that this may decline as companies come under greater regulatory scrutiny, and there is already a slowing in acquisitions which have boosted sales growth over the last 10-years. On the other side of the argument is that the S&P has declined by 25% from its peak and historically this level of decline has seen a higher stock market the following year (except for 2000 and 2008).

We are probably closer to a 2000 scenario, especially with mega tech, and there is a feeling that these areas remain too expensive. So could we be in a place where markets are negative in 2023? The answer is potentially yes. Nothing is simple and it is important to consider that although earnings have declined around 5%, this figure is likely to move towards 10 to 20%. The general feeling is that the market has already priced this in. We could therefore see a decline in some stocks in 2023 but others coming more to forefront.

When we turn to recession risks it is likely the US will fall into recession in 2023, but the extent is very much debated. The US housing market is in recession but only 5% of US mortgages are on variable rates. The reason for the recession is that people with fixed rate mortgages are unwilling to move and therefore secure a mortgage at a higher rate. Having said that other sectors like autos are rebounding and this is where the uncertainty comes. Other factors include reducing energy prices and potentially a rapid decline in inflation and the impact on interest rates.

In summary, the picture for the US (and with other economies) is complicated. History indicates that potentially after the declines we have seen the markets should rebound. However, whether this is lead by mega tech or other areas is clearly one for debate. There is some debate on whether the S&P is still overpriced and therefore could come down further. A recession is likely but the depth of this depends on many factors and there is a feeling that this will not be severe. A weakening dollar may benefit other economies. We do expect the markets to be volatile and we know there is a chance this year could be positive, but it is a complicated environment and nothing is guaranteed.

Living in the UK I am sure we all have a view and we can be swayed by what is written across the press. We suspect that we will enter a more stable political environment until the next election (scheduled for 24 January 2025). What happens beyond that will be much debated. Rishi Sunak has an uphill task and probably, like Gordon Brown, has inherited a poison chalice.

The real focus for the UK is recessionary. Households are facing higher costs and the Bank of England expect a more prolonged recession. Inflation is high and the approach has been to

raise rates to combat this, but again this puts more pressure on households as fixed rate mortgages come to the end of their terms.

The UK is consumer driven and if the consumer stops spending then that is more likely to drive us into a recession. The question is whether it will be a mild or deep recession. A deep recession is the worst scenario with job losses. Where we currently stand is slightly mixed. Mortgage applications are at their lowest levels since June 2020, house prices are starting to slow and even fall, at the same time an extra £5.7 billion has been added to savings and consumer credit has come in higher than expected but UK consumers are not overburdened by credit card debt compared to history.

There are therefore mixed signals as to the type of recession we may get. Other factors to add to the mix are that the labour market remains strong. We are seeing energy prices coming down from the peaks and therefore there is an expectation that inflation will peak and start to fall. If we see falling inflation and slowing growth this may lead the Bank of England to slow, stop or reverse rate rises.

In summary, the focus for the UK should be on recessionary risks. The wind seems to be blowing more towards a long and shallow recession mainly due to the strength of the job market, falling inflation and costs, but things can change, and a deep recession would not be good for the UK. In terms of markets the UK is undervalued, and political stability and a weaker dollar could be good for markets as investors focus on company fundamentals and cash flows.

For Europe the focus is on energy. Given that Russia contributed 40% of Europe's gas supply and switched this off in the summer weighs heavily on Europe's ability to grow.

As with other economies the Europe is expected to fall into recession due to a mix of higher energy prices and rising inflation impacting the ability for consumers to spend.

However, Europe managed to fill its gas tanks over the summer largely replacing Russian gas with liquified natural gas from the US. A mild autumn has also helped to keep the tanks nearly full. The fear of energy rationing seems to be subsiding unless we head into a deep, long and cold winter.

The consensus is that the recession will be shallow due to the resilience within the manufacturing sector, the build up of gas storage, decline in gas prices, weakening dollar and significant fiscal support.

But there are risks. The gas supply remains fragile and the fiscal support is likely to be a drag on growth in 23/24, although the Recovery Fund may cushion some of this. There are also political risks: in Italy rising sovereign yields, high debt, and weak growth expose its economic vulnerability, European fiscal rules are likely to be introduced in 2024, some Scandinavian countries have high levels of household debt, and the French Government has struggled to get legislation through and has used Article 49.3 which ensures no votes are needed.

In summary, the key focus for Europe is the energy market. Being quick to replace supplies and being lucky with a milder autumn has helped but they will face the same challenge to replace in 2023. Governments have largely shielded consumers from rising prices and this may not be sustainable. Politics will always be challenging and Italian debt is not something new but will their path clash with the European fiscal rules? In France do they push for another election to get a majority?

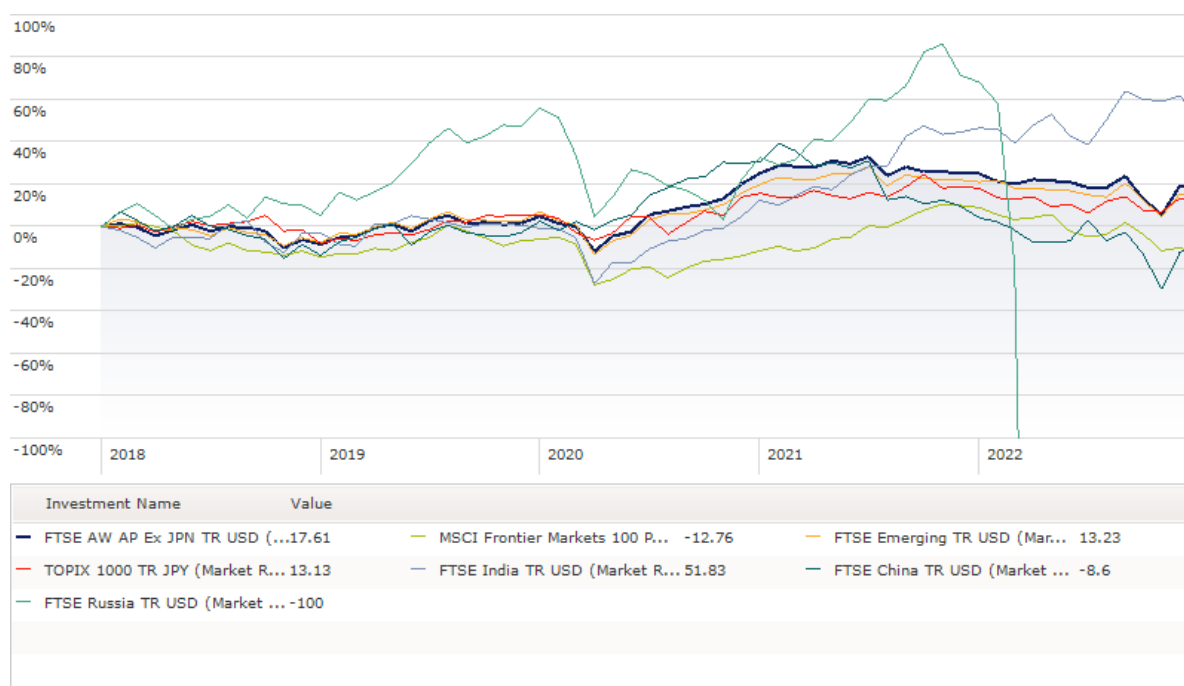
It is important to reflect that Europe is at the forefront of the drive to sustainable energy and has some of the best technology in the world. The Recovery Fund includes provision for fair climate and digital transition via the Just Transition Fund and the Digital Europe Programme and ensures that 30% of the EU funds go to tackle climate change. So amongst the challenges there are significant positives.

As an overall summary, the UK, Europe, and US all face different challenges and outcomes. In terms of investing, we believe that it is high quality, cash generative businesses with strong liquidity that will come out stronger in periods such as this. Heavily indebted businesses or businesses burning cash are likely to struggle without changing their business models. The easy ride for mega tech is likely over as they find it harder to generate growth through acquisition and more legislation impacts how they operate. If economies can avoid a severe recession then this should enable markets to recover sooner.



## EMERGING, ASIA AND FRONTIER MARKETS

Five year returns 1 January 2018 – 31 December 2022



**Special note to graph:** You should note that past performance is not a reliable indicator of future returns and the value of your investments can fall as well as rise. The total return reflects performance without sales charges or the effects of taxation but is adjusted to reflect all on-going fund expenses and assumes reinvestment of dividends and capital gains. If adjusted for sales charges and the effects of taxation, the performance quoted would be reduced.

I feel I have banged the drum for emerging markets for many years and yet it has significantly underperformed developed markets, especially the US over the last decade, so should we just focus on developed markets?

Now may well be the time to look at emerging markets. If we start with China, the reaction to China's 20<sup>th</sup> Communist Party Conference was fascinating but not unexpected. The reporting was negative focusing on Xi Jinping becoming Head of State for a third time, the new hard-line team, a desire to safeguard China's sovereignty and see state owned capital enterprises get stronger and bigger.

What was not reported were some key phrases from the report and this again highlights the theme of common prosperity. Bring people up, keep them happy and you keep power. Anything that disrupts that will cause unrest and could fundamentally change the balance of power. Therefore we think an invasion of Taiwan is highly unlikely because simply it would cause significant unrest.

Some of the key phrases that came out were:

“focused on promoting high-quality development”

“bring per capita disposable income to new heights”

“substantially grow the middle-income group as a share of the total population”

“development is our Party’s top priority”

“we will provide an enabling environment for private enterprises”

This is a very different picture to that which is painted. The biggest is social unrest and when we read these words we can see where the focus is. Clearly the zero Covid policy was deeply unpopular and this perhaps reflects an opportunity lost. The protests likely forced the hand of the government to change tact and at the same time provide more stimulus to the economy. This shift is important because it will ease supply chain disruption and boost the demand for global commodities. China is the second largest economy and to effectively shut that down will have a global impact, and the reverse is true when it opens.

But emerging markets is not just about China. There are many economies across Asia and Latin America. A weaker dollar, lower commodity prices etc will be a tailwind for emerging markets in 2023.

It might be a surprise to see that countries such as Brazil, Mexico, India, Indonesia, and the Gulf Cooperation Council (GCC) outperformed both the MSCI EM Index and S&P 500 Index in 2022.

Much of what is holding back developed markets are tailwinds for emerging markets.

Morgan Stanley sums up well what underpins the growth story:

- Post-COVID recovery led by credit creation after a period of deleveraging
- Manufacturing revivals in certain markets led by the “China plus one” strategy that drives reshoring and friend shoring
- Commodity boom driven by resource-intensive decarbonisation, which benefits resource-rich economies
- Boosts to productivity and growth led by digitalisation across most EM regions
- Favourable political cycles in several pockets of EM

When we consider the tailwinds, we see that...

- Relative growth differentials favour EM equities
- EM sovereigns are healthier compared to developed markets (DM) governments due to better public debt and fiscal situations
- EM corporates are in better shape compared to DM corporates due to deleveraging
- EM external balances have improved relative to DM

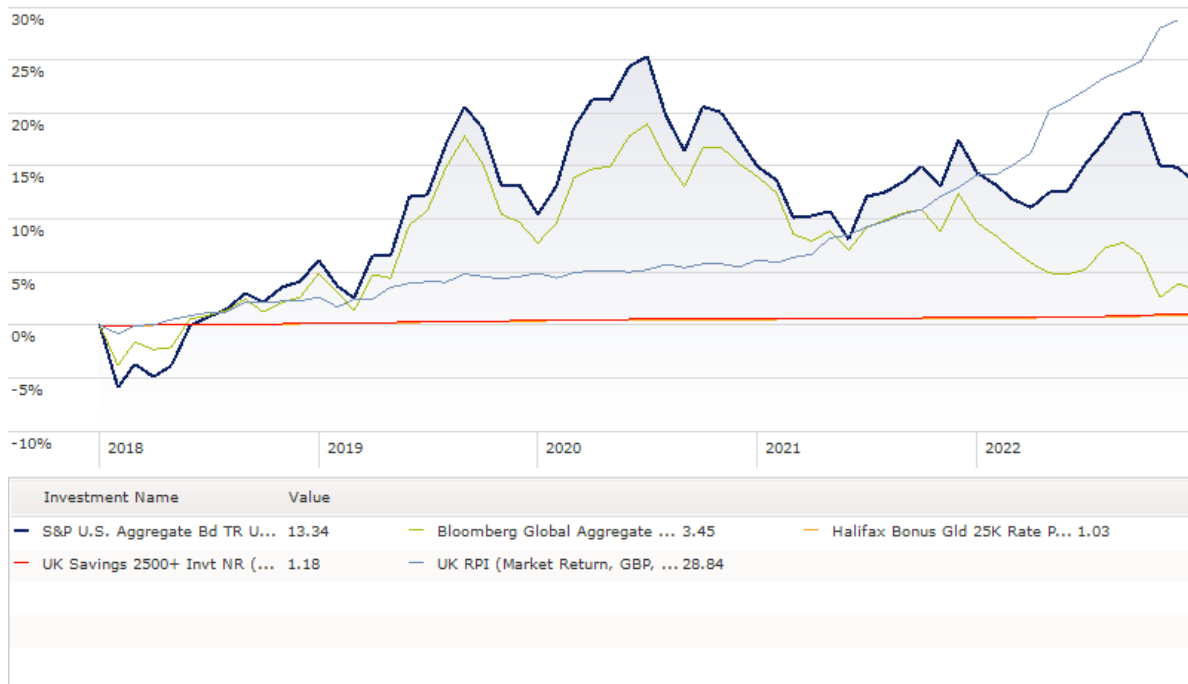
- EM equities and currencies are trading at decade-low valuations

Political risk will always be a factor of emerging markets but the big shock was Russia / Ukraine. Beyond that we are starting to see stability. Brazil's elections saw Lula da Silva elected President with a focus on economic development and stability, poverty, education, and housing. In Japan opening the economy, political stability and reform makes the country an interesting investment opportunity. Then with China opening and a clear road map over the next five years we can start to see positives across the political arena.

In summary, many emerging market economies are in a better shape than western developed market economies. There is also a greater desire for change and innovation. A weaker dollar combined with economies such as China and Japan opening will be seen positively. Politics will always play a part, but the big shock is now reflected within emerging markets. The consensus seems to be that the next few years could be beneficial for emerging markets, and although China will always be seen at the head of this, the opportunities are much wider across different regions.

## CASH

Five year returns 1 January 2018 – 31 December 2022



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With interest rates rising cash comes back into focus for investors. It is that safe haven in times of market uncertainty. However, the risk is always on what the aim of holding cash is. If it is to time markets then all research indicates this is almost impossible to do.

If holding cash is a safety net and for immediate needs, then having extra interest is beneficial. Like any investment it is about managing the asset in the right way.

## CONCLUSION

2022 was a challenging year and there were many things for us to grapple with, whether it was Fed Policy, Russia / Ukraine, China's Zero Covid Policy, energy prices, inflation, interest rates etc.

To some extent we have a clearer path in 2023 unless we get another "Black Swan" event. We should expect a recession and this seems to point towards a shallow one, but it could differ across regions. Inflation is likely to peak and come down, the speed of which we don't know. Interest rates are likely to rise but if inflation comes down fast and growth slows, does this mean rate rises stop, slow or come down?

In terms of markets, it really is hard to guess where they go from this point. History would point to the fact that in most cases, after a negative year, the following year is positive. But there have been years when this has not happened. History also shows us that markets recover before economies. There is also an argument that the mega tech that has driven the US market will not do the same over the next decade, so then what takes its place?

We think that because there is more "certainty" this might be better for markets. Any better-than-expected news will help. We are not out of the water by any means but if the global recession is shallow, if inflation comes down faster than expected and if interest rates peak and even come down, all of this could be positive. Adding into the mix is that a weaker dollar could be beneficial especially for EM economies, and also the re-opening of China is really important.

In summary, there is the potential for markets to return positively this year but the journey will not be smooth and there will be many factors to watch and observe.

*General disclaimer: The data has been sourced from external sources (the charts for example are from Morningstar) and although we have looked to ensure this is as accurate as possible, we are not responsible for data they supply.*

*The view on markets is written in a personal capacity and reflects the view of the author, it does not necessarily reflect the views of LWM Consultants. Individuals wishing to buy any product or service because of this update must seek advice or carry out their own research before making any decision. The author will not be held liable for decisions made because of this paper (particularly where no advice has been sought).*

*Please also note past performance is no guide to future performance and investments can fall as well as rise.*

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