

Short Macro Outlook Summary

April / May 2023

There is a trader's rule of thumb that a strong USD forewarns of a risk-off market meaning equities go down. In 2022 this rule worked well as the DXY Dollar Index strengthened from 96.0 to 114.5 by 30Sep22 which also marked the equity market low. From there the index fell back to 100, the first time on 1Feb23 and again mid-April. The point is that in the past week DXY has rallied towards 103 and broken out of its bearish downtrend channel. The bearish forces on the USD from US debt ceiling tensions, the US regional banking crisis and the longer term weaponization of the dollar are clearly being more than countered by other forces driving the USD upwards. With short term interest rates at 5.25% this may be one driver but it doesn't easily fit with the fact that the Fed is nearer to the end of its hiking cycle than the ECB or BoE. Investor sentiment that a global recession is looming may be another driver, but that data remains mixed.

An alternative explanation but which contradicts this rule of thumb is that investors could be focusing on near-term US economic growth and corporate profits. We may be on the verge of the most anticipated recession in history but the real debate has centred around the severity of the recession and the resulting impact on corporate profits. The picture is mixed. Advertising, manufacturing and freight have been in a recession for a year. But the consumer is strong with a tight labour market so we're back to the old story of a recession rolling through sectors and geographies across the US as investors prepare for the recession. The US has made more progress than any other G10 country in bringing down inflation, the economy is firmly underpinned by solvent consumers, corporate earnings may be stronger than analysts predict and allocators are perhaps moving back to the dollar to invest in that economy betting that it will post more growth in the next 12 months than elsewhere.

We are undecided on the DXY message at this juncture but while we heed the note of caution we are inclined to the bull scenario. Investor sentiment has become markedly negative with the Bank of America Global Fund Manager survey reporting sentiment more bearish than at any point in the past 20 years and growth expectations at all time lows with a mere 20% expecting a stronger economy in 12 months time.

Investment factors are also flagging a change. In Feb'20 we saw a factor rotation from growth to value. Now in May the value factor has rotated to momentum. If this indicator is right then a market sell-off is not on the cards unless there's a shock to the system. Central bank policy is resolutely hawkish with Powell expressing his personal view that inflation won't go down as easily as markets think and that rate cuts are not really in Fed thinking. The BoE and ECB are signalling the inflation fight is not over with a particularly hawkish tone now emanating

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somewhat belatedly from Lagarde. But as any student of previous inflation should know it is the monetary aggregates which matter the most. Over the last twelve months US M2 is now encouragingly lower while in the UK it's the same but in Europe it is still 3% greater. More tightening is needed in the latter economies. While bonds are adjusting upwards in yield, albeit slowly, equities appear to be looking well beyond and are maybe betting on that rarest of outcomes, a soft landing in the US.