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Quarterly Market Review

Review of markets over the first quarter of 2023

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Global growth has generally surprised positively during the first quarter of 2023. This stronger growth is perhaps best illustrated by the rebound in the US and European composite purchasing managers' index (PMI) business surveys since the start of the year. Lower energy and oil prices have probably played an important role in the improvement in business sentiment, along with the reopening of China. Against this backdrop, developed market stocks returned nearly 8% over the quarter.

Exhibit 1: Asset class and style returns

2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Q1 '23
Global Agg 5.6%	Global REITS 23.0%	Small cap 32.9%	Global REITS 22.9%	Growth 3.5%	Small cap 13.3%	MSCI EM 37.8%	Global Agg -1.2%	Growth 34.1%	Growth 34.2%	Global REITs 32.6%	Cmdty 16.1%	Growth 15.2%
Global REITS 2.3%	MSCI EM 18.6%	Value 27.5%	Growth 6.5%	Global REITS 0.6%	Value 13.2%	Growth 28.5%	Global REITS -4.9%	DM Equities 28.4%	MSCI EM 18.7%	Cmdty 27.1%	Value -5.8%	DM Equities 7.9%
Value -4.9%	Small cap 18.1%	DM Equities 27.4%	DM Equities 5.5%	Small cap 0.1%	Cmdty 11.8%	Small cap 23.2%	Growth -6.4%	Small cap 26.8%	DM Equities 16.5%	Value 22.8%	Global Agg -16.2%	Small cap 4.4%
DM Equities -5.0%	Growth 16.6%	Growth 27.2%	Value 4.4%	DM Equities -0.3%	MSCI EM 11.6%	DM Equities 23.1%	DM Equities -8.2%	Global REITs 24.4%	Small cap 16.5%	DM Equities 22.3%	DM Equities -17.7%	MSCI EM 4.0%
Growth -5.1%	DM Equities 16.5%	Global REITS 2.3%	Small cap 2.3%	Global Agg -3.2%	DM Equities 8.2%	Value 18.0%	Value -10.1%	Value 22.7%	Global Agg 9.2%	Growth 21.4%	Small cap -18.4%	Global Agg 3.0%
Small cap -8.7%	Value 16.4%	MSCI EM -2.3%	Global Agg 0.6%	Value -4.1%	Global REITS 6.5%	Global REITS 8.0%	Cmdty -11.2%	MSCI EM 18.9%	Value -0.4%	Small cap 16.2%	MSCI EM -19.7%	Global REITs 1.7%
Cmdty -13.3%	Global Agg 4.3%	Global Agg -2.6%	MSCI EM -1.8%	MSCI EM -14.6%	Growth 3.2%	Global Agg 7.4%	Small cap -13.5%	Cmdty 7.7%	Cmdty -3.1%	MSCI EM -2.2%	Global REITs -23.7%	Value 1.1%
MSCI EM -18.2%	Cmdty -1.1%	Cmdty -9.5%	Cmdty -17.0%	Cmdty -24.7%	Global Agg 2.1%	Cmdty 1.7%	MSCI EM -14.2%	Global Agg 6.8%	Global REITs -10.4%	Global Agg -4.7%	Growth -29.1%	Cmdty -5.4%

Source: Bloomberg Barclays, FTSE, MSCI, Refinitiv Datastream, J.P. Morgan Asset Management. DM Equities: MSCI World; REITs: FTSE NAREIT Global Real Estate Investment Trusts; Cmdty: Bloomberg Commodity Index; Global Agg: Barclays Global Aggregate; Growth: MSCI World Growth; Value: MSCI World Value; Small cap: MSCI World Small Cap. All indices are total return in US dollars. Past performance is not a reliable indicator of current and future results. Data as of 31 March 2023.

The geopolitical backdrop remains challenging, with no end in sight to the war in Ukraine and renewed tensions between the US and China. On the inflation front, headline inflation continued to ease over the quarter on the back of low energy prices, but core inflation generally remained stickier, forcing global central banks to tighten monetary policy further.

The collapse of Silicon Valley Bank (SVB) in March (the second largest banking failure in US history) led to a major sell-off in the US and European financial sectors. For more detail, please see our latest On the Minds of Investors article **"Answers to the key questions raised by the recent stress in the banking sector."**

Markets started the year with a strong January rally for equities. Fixed income markets also reacted positively to the decline in inflation and the prospect of easier monetary policy. In February, equity and fixed income markets were weighed down by strong economic data, which together with sticky core inflation forced investors to reassess their interest rate expectations and price in higher-for-longer interest rates. In March, the collapse of SVB and broader concerns around the financial sector hit bank shares hard, while government bonds rallied. The global aggregate bond index returned 3% over the quarter. The fall in bond yields also led to a rally in growth stocks, which rallied by more than 15% over the quarter. The hit to bank shares weighed on the performance of value stocks, which only delivered around 1% over the quarter.

US

US economic data published since the beginning of the year suggests that the largest economy in the world continued to grow in the first quarter.

The labour market remains resilient as February non-farm payrolls grew by a stronger-than-expected 311,000. Average hourly earnings rose by just 0.2% month on month, and 4.6% year on year, which shows that wage pressures are gradually decelerating.

The February consumer price index (CPI) report showed that headline inflation fell to 6.0% year on year, an eighth consecutive monthly decline and now well down from its 8.9% peak in June. It is also worth noting that inflation is now dominated by shelter costs, accounting for over 70% of the increase in prices. Changes in rents and house prices tend to feed through into shelter inflation with a lag though. So much of the current inflation data is reflecting prior rent gains, whereas more recent data show rent increases have generally slowed and house prices are coming under pressure.

Exhibit 2: World stock market returns

2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Q1 '23
US S&P 500 2.1%	MSCI Asia ex-Japan 22.7%	Japan TOPIX 54.4%	US S&P 500 13.7%	Japan TOPIX 12.1%	UK FTSE All-Share 16.8%	MSCI Asia ex-Japan 42.1%	US S&P 500 -4.4%	US S&P 500 31.5%	MSCI Asia ex-Japan 25.4%	US S&P 500 28.7%	UK FTSE All-Share 0.3%	MSCI Europe ex-UK 10.5%
UK FTSE All-Share -3.5%	Japan TOPIX 20.9%	US S&P 500 32.4%	Japan TOPIX 10.3%	MSCI Europe ex-UK 9.1%	US S&P 500 12.0%	MSCI EM 37.8%	UK FTSE All-Share -9.5%	MSCI Europe ex-UK 27.5%	MSCI EM 18.7%	MSCI Europe ex-UK 24.4%	Japan TOPIX -2.5%	US S&P 500 7.5%
MSCI Europe ex-UK -12.1%	MSCI Europe ex-UK 20.0%	MSCI Europe ex-UK 24.2%	MSCI Europe ex-UK 7.4%	US S&P 500 1.4%	MSCI EM 11.6%	Japan TOPIX 22.2%	MSCI Europe ex-UK -10.6%	UK FTSE All-Share 19.2%	US S&P 500 18.4%	UK FTSE All-Share 18.3%	MSCI Europe ex-UK -12.2%	Japan TOPIX 7.2%
Japan TOPIX -17.0%	MSCI EM 18.6%	UK FTSE All-Share 20.8%	MSCI Asia ex-Japan 5.1%	UK FTSE All-Share 1.0%	MSCI Asia ex-Japan 5.8%	US S&P 500 21.8%	MSCI Asia ex-Japan -14.1%	MSCI EM 18.9%	Japan TOPIX 7.4%	Japan TOPIX 12.7%	US S&P 500 -18.1%	MSCI Asia ex-Japan 4.4%
MSCI Asia ex-Japan -17.1%	US S&P 500 16.0%	MSCI Asia ex-Japan 3.3%	UK FTSE All-Share 1.2%	MSCI Asia ex-Japan -8.9%	MSCI Europe ex-UK 3.2%	MSCI Europe ex-UK 14.5%	MSCI EM -14.2%	MSCI Asia ex-Japan 18.5%	MSCI Europe ex-UK 2.1%	MSCI EM -2.2%	MSCI Asia ex-Japan -19.4%	MSCI EM 4.0%
MSCI EM -18.2%	UK FTSE All-Share 12.3%	MSCI EM -2.3%	MSCI EM -1.8%	MSCI EM -14.6%	Japan TOPIX 0.3%	UK FTSE All-Share 13.1%	Japan TOPIX -16.0%	Japan TOPIX 18.1%	UK FTSE All-Share -9.8%	MSCI Asia ex-Japan -4.5%	MSCI EM -19.7%	UK FTSE All-Share 3.1%

Source: FTSE, MSCI, Refinitiv Datastream, Standard & Poor's, TOPIX, J.P. Morgan Asset Management. All indices are total return in local currency, except for MSCI Asia ex-Japan and MSCI EM, which are in US dollars. Past performance is not a reliable indicator of current and future results. Data as of 31 March 2023.

Given the cooler inflation data and the turmoil surrounding Silicon Valley Bank, the Federal Open Market Committee voted unanimously to raise the federal funds rate by just 25 basis points (bps) in March to a target range of 4.75%-5.00%.

Despite the hit to bank shares the S&P 500 rose in March, helped by strong returns from growth stocks that were buoyed by falling bond yields. Over the quarter the S&P 500 rose by 7.5%. US treasuries returned 3% over the quarter.

UK

The UK economy has also fared better than expected so far this year. The preliminary composite PMI for March dropped slightly from 53.1 to 52.2 but remains in expansion territory. Consumer confidence surprised to the upside, increasing from -45 in January to -36 in March.

On the inflation front, the headline CPI and core CPI increased, respectively, to 10.4% and 6.2% year on year in February, which was above expectations in both cases. The Bank of England increased its policy rate by 25bps in March to 4.25% and left the door open to further tightening if necessary to bring inflation down. As more fixed rate mortgages expire this year though, the BOE may not need to tighten much further.

UK equities underperformed global equities over the quarter but still delivered just over 3%. UK government bonds returned just over 2%.

Exhibit 3: Fixed income sector returns

2015	2016	2017	2018	2019	2020	2021	2022	Q1 '23
Euro Gov. 1.6%	US HY 17.5%	EM Debt 9.3%	Euro Gov. 1.0%	EM Debt 14.4%	Global IL 12.7%	US HY 5.3%	US HY -11.2%	Global IL 4.5%
EM Debt 1.2%	EM Debt 10.2%	Global IG 9.1%	US Treas. 0.9%	US HY 14.4%	Global IG 10.4%	Euro HY 3.4%	Euro HY -11.7%	US HY 3.7%
US Treas. 0.8%	Euro HY 10.1%	Global IL 8.7%	US HY -2.3%	Global IG 11.5%	US Treas. 8.0%	Global IL 2.7%	US Treas. -12.5%	Global IG 3.5%
Euro HY 0.5%	Global IG 4.3%	US HY 7.5%	Global IG -3.6%	Euro HY 10.7%	US HY 6.1%	EM Debt -1.5%	EM Debt -16.5%	US Treas. 3.0%
Global IG -3.6%	Global IL 3.9%	Euro HY 6.1%	Euro HY -3.6%	Global IL 8.0%	EM Debt 5.9%	US Treas. -2.3%	Global IG -16.7%	Euro HY 3.0%
US HY -4.6%	Euro Gov. 3.2%	US Treas. 2.3%	Global IL -4.1%	US Treas. 6.9%	Euro Gov. 5.0%	Global IG -2.9%	Euro Gov. -18.5%	Euro Gov. 2.5%
Global IL -5.0%	US Treas. 1.0%	Euro Gov. 0.2%	EM Debt -4.6%	Euro Gov. 6.8%	Euro HY 2.7%	Euro Gov. -3.5%	Global IL -22.9%	EM Debt 2.2%

Source: Bloomberg Barclays, BofA/Merrill Lynch, J.P. Morgan Economic Research, Refinitiv Datastream, J.P. Morgan Asset Management. Global IL: Barclays Global Inflation-Linked; Euro Gov.: Barclays Euro Aggregate Government; US Treas: Barclays US Aggregate Government - Treasury; Global IG: Barclays Global Aggregate - Corporates; US HY: BofA/Merrill Lynch US HY Constrained; Euro HY: BofA/Merrill Lynch Euro Non-Financial HY Constrained; EM Debt: J.P. Morgan EMBIG. All indices are total return in local currency, except for EM and global indices, which are in US dollars. Past performance is not a reliable indicator of current and future results. Data as of 31 March 2023.

Europe

In Europe, despite rapidly rising interest rates and the turmoil in the banking sector in March, economic activity also surprised on the upside throughout the quarter on the back of falling energy prices and the resilience of services activity. The euro-area composite PMI for March rose to a 10-month high of 54.1, which was well above expectations. This strong momentum was almost entirely driven by the service sector, where the PMI increased from 52.7 in February to 55.6 in March, while the manufacturing sector continued to struggle as shown by the drop in the manufacturing PMI to 47.1 in March.

At a country level, the two main growth engines of the euro-area, Germany and France, both posted strong activity data in the first quarter. In Germany, all sub-components of the IFO index (business climate, business situation and business expectations) improved substantially over the quarter. In France, even though the country has been confronted with several days of national strikes to protest against pension reforms, the composite PMI jumped from 49.1 in January to 54 in March. Euro-area consumer confidence, though slightly down in March, improved over the quarter.

Exhibit 4: Fixed income government bond returns

2015	2016	2017	2018	2019	2020	2021	2022	Q1 '23
Italy 4.8%	UK 10.7%	Global 7.5%	Spain 2.5%	Italy 10.6%	Global 9.7%	Japan -0.2%	Japan -5.4%	Italy 3.7%
Spain 1.7%	Spain 4.1%	US 2.3%	Germany 1.9%	Spain 8.3%	UK 8.9%	US -2.3%	US -12.5%	US 3.0%
Japan 1.2%	Germany 3.4%	UK 2.0%	Japan 1.0%	UK 7.1%	US 8.0%	Germany -2.9%	Global -16.8%	Global 3.0%
US 0.8%	Japan 3.2%	Spain 1.1%	US 0.9%	US 6.9%	Italy 7.9%	Italy -3.0%	Italy -17.2%	Japan 2.4%
UK 0.5%	Global 1.7%	Italy 0.8%	UK 0.5%	Global 5.6%	Spain 4.3%	Spain -3.0%	Germany -17.4%	Spain 2.3%
Germany 0.4%	US 1.0%	Japan 0.2%	Global -0.7%	Germany 3.1%	Germany 3.0%	UK -5.3%	Spain -17.5%	UK 2.2%
Global -3.7%	Italy 0.8%	Germany -1.0%	Italy -1.3%	Japan 1.7%	Japan -0.8%	Global -5.8%	UK -25.1%	Germany 1.8%

Source: Bloomberg Barclays, Refinitiv Datatsream, J.P. Morgan Asset Management. All indices are Bloomberg Barclays benchmark government indices. All indices are total return in local currency, except for global, which is in US dollars. Past performance is not a reliable indicator of current and future results. Data as of 31 March 2023.

On the inflation front, although headline CPI continued to decrease throughout the quarter from 9.2% year on year in December to 8.5% in February, core inflation increased from 5.2% to 5.6% over the same period.

With growth more resilient than expected and core inflation stubbornly high, the European Central Bank (ECB) increased its deposit rate by 50bps in March despite the banking turmoil caused by the collapse of Silicon Valley Bank in the US and the subsequent issues for Credit Suisse in Europe. The ECB also updated its macroeconomic projections and now expects higher growth and lower inflation this year. While the door remains open to future rate hikes, these will be data dependent.

Despite the hit to bank shares in March, European stocks outperformed over the quarter delivering just over 10%. European government bonds returned 2.5%

China

China's surprise abandonment of its zero covid policy at the end of last year has led to a strong rebound in its economy since the beginning of the year, while inflation has so far remained surprisingly low, allowing the People's Bank of China (PBOC) to maintain an easy monetary policy. The non-manufacturing business surveys are showing a strong rebound in the domestic service sectors.

The better-than-expected credit growth in January and February undoubtedly contributed to this better economic momentum. Total social financing (TSF) grew by 9.9% year on year in February and the credit impulse (the gap between TSF growth and nominal GDP growth) rose to 5.6%, the highest since January 2021.

Despite this strong economic momentum and credit growth, China's February CPI print came in below expectations, rising only 1% year on year, while the producer price index stayed in deflation territory, falling 1.4%. Against this backdrop, the PBOC announced a 25bps cut to its reserve requirement ratio for banks in March, which was earlier than expected.

Emerging market stocks returned 4% over the quarter.

Exhibit 5: Index returns for March 2023

Index	GBP	USD	JPY	EUR	LOC
Equities (MSCI)					
MSCI World Index	1.0	3.2	0.8	0.7	2.6
MSCI USA	1.4	3.6	1.2	1.1	3.6
MSCI Europe ex-UK	1.3	3.4	1.1	1.0	1.1
MSCI United Kingdom	-2.7	-0.6	-2.9	-3.0	-2.7
MSCI Japan	2.0	4.1	1.8	1.7	1.8
MSCI AC Asia ex-JP	1.4	3.5	1.1	1.0	2.9
MSCI EM Latin America	-1.2	0.9	-1.4	-1.5	-1.6
MSCI EM (Emerging Markets)	0.9	3.1	0.7	0.6	2.2
Bonds					
Bloomberg Barclays Global Aggregate	1.0	3.2	0.8	0.7	
Bloomberg Barclays US Aggregate	0.4	2.5	0.2	0.1	2.5
Bloomberg Barclays Japan Aggregate	1.7	3.8	1.4	1.3	1.4
Bloomberg Barclays UK Aggregate	2.2	4.4	2.0	1.9	2.2
Bloomberg Barclays Euro Aggregate	2.3	4.5	2.1	2.0	2.0
Currencies					
Sterling		2.1	0.0	0.1	
US dollar	-2.1		-2.3	-2.4	
Yen	0.0	2.3		-0.1	
Euro	-0.1	2.4	0.1		

Source: Bloomberg Barclays, MSCI, Refinitiv Datastream, J.P. Morgan Asset Management. Past performance is not a reliable indicator of current and future results. Data as of 31 March 2023.

Conclusion

As we enter the second quarter, we expect China's economy to continue to be supported by its Covid reopening, but we see more downside risks in developed economies.

The recent events in the banking sector are likely to lead to a further tightening of bank lending standards, which could further slow growth in developed economies, possibly leading to a moderate recession over the course of the year. However, with little evidence of extreme excess in the real economy and with better capitalised banks, we see a repeat of 2008 as unlikely.

If the commercial banks tighten lending standards, the Federal Reserve and other central banks will need to do less to bring about the desired slowdown in activity and reduction in inflation.

At this stage, there are considerable uncertainties – in both directions - over the extent to which the recent turmoil will affect sentiment and activity. This uncertain backdrop argues against extreme positioning between or within asset classes. We believe that investors should maintain balance in their portfolios with a focus on quality within both equity and bond allocations.

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