DAVY

January 2023

MarketWatch

Outlook 2023:

Is hibernation over?

Editor's note

Welcome to the latest edition of MarketWatch.

Despite the fourth quarter rally, 2022 was an unusually bad year for stocks and an exceptionally bad one for bonds. Investors, including ourselves, underestimated how aggressively central banks would turn in their fight against inflation, with rising interest rates hitting bonds hard and fear of recession dragging stocks into a bear market (down 20% or more). The natural question now is whether we're through the worst of the damage and can look forward to recovery in 2023.

The good news is that most of the interest rate hikes have already happened, at least in the United States. The negative news is that we're only starting to see the impact on the real economy and corporate earnings. Europe, in particular the United Kingdom, is already close to recession, but the US consumer is still going strong, and a recession there is not inevitable.

As always, markets look ahead, and much of this news, though not all, is already factored into stock and bond prices. This means that more downside is possible, especially if the economy or inflation deteriorate further, but it appears that most of the damage has been done. However, the macro uncertainty will hang over markets, and we expect a bumpy first half of the year as the situation evolves.

Our medium outlook is still positive though, so we are comfortable staying invested, and would view another large dip as a buying opportunity.

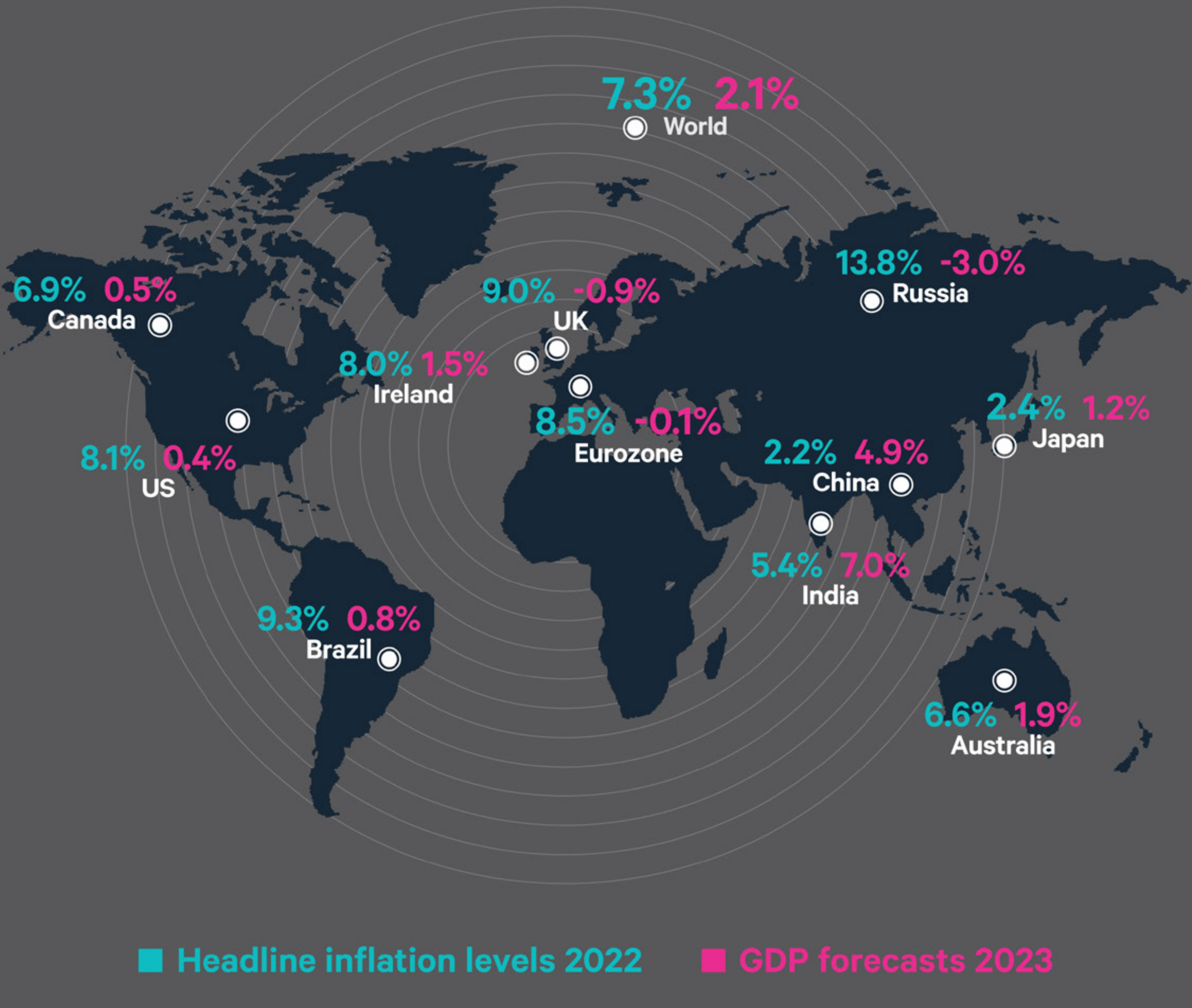
In this edition of MarketWatch, we present our 2023 outlook for the economy and the markets, both global and local. We look at earnings growth from the top-down macro level and the bottom-up company level. We examine what types of investors own the stock market and how sustainable investing has done through the energy crisis. Amongst other topics, we also explore whether the carnage in the crypto world can spill into mainstream markets.

Should you have any questions in relation to the content within this quarter's edition, please contact your Davy Adviser.

Donough Kilmurray
Chief Investment Officer

Warning: Forecasts are not a reliable indicator of future performance.

2022 Headline inflation levels
2023 Economic growth forecasts



Source: Bloomberg consensus as at end of 2022

Warning: Forecasts are not a reliable indicator of future results.

Donough Kilmurray
Chief Investment Officer

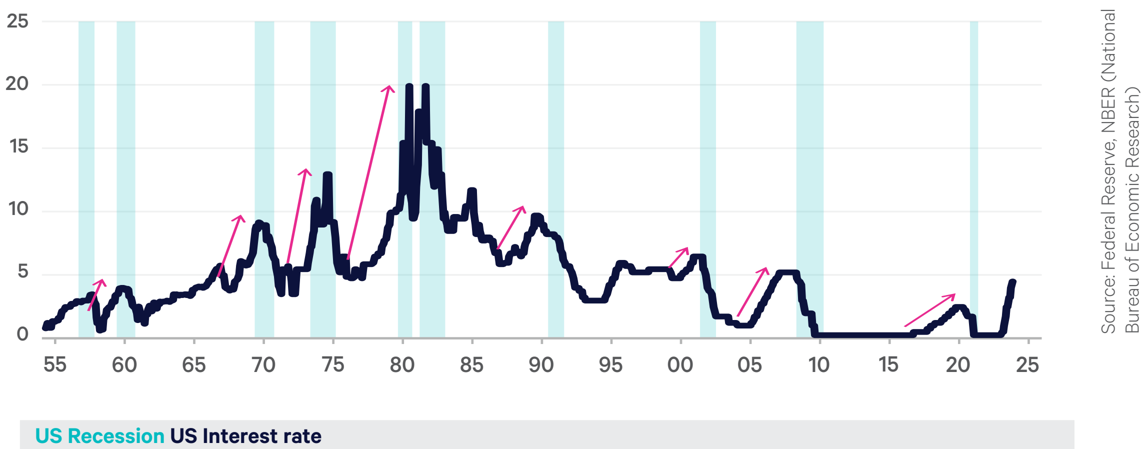
Global outlook -
Time to come out of hibernation?

Looking back on the events of 2022 – double-digit inflation, a spike in borrowing costs, an energy crisis, and a war in eastern Europe – it's hard to believe that the economy and corporate earnings continued to grow. You certainly couldn't tell from the financial markets, where stocks fell into a bear market (down 20% or more) and bonds had their worst year on reliable record.

Of course, the economy and the markets are not the same. Economic data is slow and backward-looking, while markets move rapidly in anticipation of what might happen in the future. Nobel prize winner Paul Samuelson joked that economists have predicted nine out of the last five recessions. The same could be said for markets. If we do get a recession in the United States this year, it will be the most heavily foretold recession ever.

Why are economists and investors so convinced that a recession is imminent? Mainly because we haven't ever gotten out of such a high inflation/interest rate hiking environment in modern times without one. Are we kidding ourselves to think that this time it can be different?

Figure 1: Interest rates and recessions in the United States (1955-2022)



Is inflation deflating?

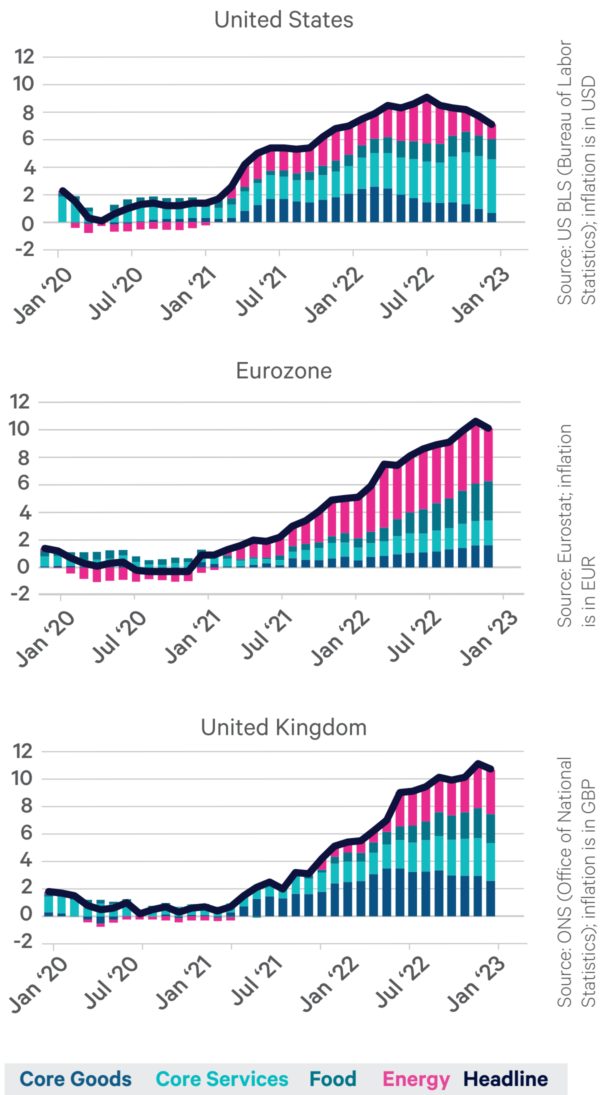
To get a sense of how inflation can be brought down, and what damage that might cause, we look at what's causing the price rises. US inflation is now mostly in services, driven by rent and wages, and here the bears have a strong case. The slowdown in wage growth required to slow down service inflation would historically have been associated with an increase in unemployment which has only been seen in a recession.

Despite almost record-low unemployment, the US workforce is still smaller than it was pre-COVID-19. Higher savings, changing life choices, slower immigration, and an ageing workforce have led to fewer workers and higher wages. The Federal Reserve (Fed) hopes that slowing demand can close the vacancies-workers gap without causing millions of lay-offs. Early evidence is positive, but wages and rents adjust slowly and we would be surprised if core US inflation gets close to the 2% target this year.

The picture is different in Europe, where energy is the dominant driver of inflation, which makes it more political and less predictable. On a positive note, even record low unemployment in the Eurozone is higher than elsewhere. There's also more wage restraint, as seen with IG Metall, Germany's biggest union, trading off lower wage increases for more flexible conditions. So if energy prices do settle down, inflation here should be less of a problem and require a less drastic policy.

The more difficult situation is in the UK, which suffers from both European energy prices and US-like labour tightness. Energy prices settling down will not be enough to stop inflation if the issues with wages and services cannot be solved, and judging by the the widespread industrial action, this will not be easy.

Figures 2-4: Composition of consumer inflation in United States, Eurozone & United Kingdom



Is recession risk receding?

A genuine concern in Europe several months ago was not the escalating price of energy, but the fear that there wouldn't be enough energy available, at any price. Warmer-than-expected weather and alternative energy sourcing removed this tail risk, causing prices to drop. So much so that the oil cartelOPEC+ decided to reduce production to keep prices up.

However, energy prices are still well above pre-COVID-19 levels. Double-digit inflation will eat into household and corporate budgets across the Eurozone and UK, and sharply higher borrowing costs are a significant drag as the region is highly dependent on variable-rate bank lending. Consumer and business surveys indicate that recessionary declines in spending and investment may be upon us already, despite various government attempts to cushion the blow.

With its own energy resources, longer-term fixed-rate financing, and a more modern sector mix, the US economy is much less sensitive to the problems Europe faces. Although higher rates have hit the property sector, the combination of COVID-19 savings, rising wages, and low unemployment mean that the consumer is well positioned to see out a slowdown. A US recession is not at all inevitable, and if one happens it should be mild.

Higher interest rates don't just slow down growth, they also expose unsustainable business models and economic imbalances. To paraphrase Warren Buffet, "When the tide of cheap money goes out, we see who's swimming naked". The good news is that apart from more speculative sectors, like new technology and crypto, the broader economy is on much firmer foundations than in 2008. This doesn't mean that a recession can't happen, but that it's far less likely to become a crisis.

More stagnation for the bears?

The natural response of market strategists is to look back at similar episodes in the past and map them into the present or near future. We fully acknowledge the weaknesses of this approach, not least due to the small number of relevant examples, but history can still be a useful guide.

So, we lay out all the times since the Second World War that the US stock market (now almost 70% of the developed world market) fell by 25% or more, and measure the real returns, i.e. after inflation, over the next 1-10 years from the point where the market reached -25%.

Table 1: Real Returns after 25% declines in US Stock Market (1946-2022)

Market Peak	25% Decline Date	Total Eventual Decline	Cumulative Real Total Returns (post 25% decline)			
			1 year	3 years	5 years	10 years
May-46	Oct-46	-27%	-5%	12%	72%	312%
Dec-61	Jun-62	-28%	33%	64%	83%	101%
Nov-68	Apr-70	-36%	28%	30%	-7%	-5%
Jan-73	Apr-74	-48%	-9%	-2%	-3%	33%
Nov-80	Aug-82	-27%	57%	86%	218%	305%
Aug-87	Oct-87	-34%	22%	35%	78%	305%
Mar-00	Mar-01	-49%	1%	-4%	9%	9%
Oct-07	Sep-08	-57%	-4%	9%	54%	169%
Feb-20	Mar-20	-34%	59%	49%		
Jan-22	Oct-22	-25%				
Median Real Return (post 25% decline)			22%	30%	63%	135%

Source: Shiller, Davy calculations; All returns are in USD

Table 2: Macro Conditions around 25% declines in US Stock Market (1946-2022)

	Market Valuation*		Macro Conditions **	
25% Decline Date	(Price / Earnings) Peak	at -25%	Consumer Inflation	Corporate Bond Yield
Oct-46	16	11	3.0%	3.5%
Jun-62	22	16	3.2%	6.5%
Apr-70	22	15	7.7%	9.4%
Apr-74	19	12	8.0%	12.0%
Aug-82	10	6	3.7%	11.3%
Oct-87	18	12	3.5%	8.7%
Mar-01	46	31	2.3%	6.1%
Sep-08	28	19	1.4%	4.3%
Mar-20	32	23	4.8%	3.3%
Oct-22	39	26		

Source: Shiller, DataStream, Federal Reserve, Davy calculations; * the Shiller CAPE (cyclically-adjusted price/earnings); ** the average over the 10yr period. Bond yield is BAA corporate yield; All data is in USD

It's encouraging to see that median outcomes are strong, indicating that buying the market after such drops is usually a sound investment strategy. But, there were three periods where real returns were very low, even over ten year periods. Looking more closely, we see that such 'lost decades' were associated with high and prolonged inflation, sky-high market valuations, or financial crisis.

The current environment does feature high inflation, which central banks are fighting hard to prevent from bedding in. However, the financial system is in much better health than in 2008, so the main worry from here is the above-average market valuations (in the US). This means that returns from here are likely to be decent, but at the more modest end of the historical range.

Or springtime for the bulls?

Despite the encouraging medium-term outlook, the problem remains that markets have moved well ahead of the economy, first by anticipating a recession, and more recently by assuming that inflation has been contained and the Fed will relent. Inflation is moving in the right direction, but is still a long way above target. Also, slowing growth and higher input costs mean that corporate earnings are vulnerable, perhaps more than analysts have baked into their forecasts.

At some point this year, we will see whether the US goes into recession or not. A recession would bring interest rate cuts, although probably smaller and slower than in recent crises, as inflation may still be a risk. Ultimately, the lower interest rate and no recession scenarios are both positive for the stock market, but we face a period of economic and earnings uncertainty first, meaning that more market mood swings are likely.

Does the prospect of more volatility mean that we should reduce our equity exposure? Now that interest rates are higher, waiting in cash seems more attractive. But waiting until the uncertainty passes – if it ever really does – means accepting a negative return (after inflation) and assuming that we can pick a better time to re-invest and catch up. Unless valuations are unusually high, or the financial system is dangerously unbalanced, we view dips as opportunities to add, not threats to avoid.

In summary, we are positive on stock markets for 2023, expecting 5-10% returns on the year, and therefore, are staying invested. We expect a bumpy first half of the year, driven by macro data and evolving expectations for central bank policy. But rather than attempt to time the market, we prefer to rely on a solid financial plan, including sufficient liquidity, to cushion our investment journey through the year, whatever it may bring.

Conall MacCoille
Chief Economist

Irish economic outlook

Ireland certainly faces a difficult global economic environment in 2023. Consensus forecasts indicate recessions for key trading partners such as the Euro area and the United Kingdom, brought on by the squeeze on consumers from high Consumer Price Index (CPI) inflation and the uncertainty posed by the war in Ukraine.

However, as was the case during the COVID-19 pandemic, the Irish economy should prove relatively resilient in relation to its peers. Our current forecast is for 3.5% Gross Domestic Product (GDP) growth in 2023, albeit starkly split between a 6% gain in the multinational sector and a more subdued 2% growth amongst indigenous firms.

Export performance should provide some protection

The key factor underpinning Ireland's performance has been the buoyant export sector, concentrated in the areas of information/communications ICT, pharmaceuticals and medical-technology and classic defensive sectors that have proven to be less sensitive to global downturns.

This pattern is once again evident. Despite the challenging international environment, Irish exports in the first three quarters of 2022 were up 15% on the year. It is striking that the Euro area industrial production grew by only 0.7% in 2022, but in Ireland, the industrial sector expanded by an enormous 17%.

The export sector's health is not merely a statistical mirage, with little pass-through onto the domestic economy.

The Industrial Development Authority (IDA) reported that employment amongst multinational firms had grown to 301,000 in October 2022, up 9% on the year. Crucially, 60% of the 24,000 multinational jobs created in 2022 were outside of the ICT sector, allaying concerns that hiring freezes, or job cuts, amongst household names such as Google and Meta would threaten Ireland's performance.

The public finances have also benefitted. The Irish Fiscal Advisory Council (IFAC) amongst others, has highlighted that just ten companies now account for over 50% of corporate tax revenues – a potential vulnerability. However, corporate tax revenues have continued to beat expectations, growing by an enormous 56% in the first eleven months of 2022 to €21bn.

A difficult year for the Irish consumer

Irish energy companies announced a plethora of price hikes during the summer of 2022, effectively doubling the average household electricity and gas bill over a 12-month period to above €4,000 and pushing the CPI inflation rate up to a peak of 9.2%.

At the time of writing, wholesale natural gas prices have fallen back to €76 per megawatt/hour, back to pre-Ukraine war levels, but it will take time for energy companies to pass through lower wholesale prices into household bills.

In the meantime, Irish households face a severe hit to their real incomes. Hence, we expect consumer spending will likely contract through the winter, before recovering later in the year and expanding by a muted 1.8% in 2023.

Thankfully, Budget 2023 put in place a range of income supports for Irish households. These included the €600 electricity price credit, double benefit payments, and tax cuts worth €830 at the average wage. We now expect that the Irish government ran a budget surplus of €4-5bn in 2022, so further support may be likely.

It is also worth pointing out that many Irish households have accumulated savings during the pandemic, which may be used to sustain spending in 2023. The Organisation for Economic Co-operation and Development (OECD) is currently projecting that the Irish household savings rate at 16.8% in 2022 was the highest amongst all the EU countries.

House price inflation starts to slow

Irish house price inflation was in double-digit territory for most of 2022, but it started to slow rapidly in the final months of the year as stretched valuations, economic uncertainty, and the prospect of further European Central Bank rate hikes weighed on sentiment.

Indeed, MyHome asking prices fell by -0.4% in Q4 2022, down for a second consecutive quarter, and up just 6% on the year. This clearly points to the current 9.8% official rate of house price inflation soon slowing into single-digit territory.

We expect modest house price declines may occur during the winter, typically the quietest period of the calendar year for the housing market, and as some of the froth built up during the pandemic unwinds. However, a sharp correction in Irish house prices looks unlikely. The housing market is still extremely tight, with a limited pool of homes available for sale, clearly insufficient to meet demand.

Furthermore, the Central Bank of Ireland's surprise decision to loosen the mortgage lending rules will add momentum to pricing in 2023. The 3.5x loan-to-income threshold for lending to first-time-buyers has been raised to 4x. The Central Bank has itself estimated this loosening of the rules will eventually add 8% to Irish house prices over a three year period.

It could well be the case that our forecast for a 4% increase in Irish house prices could prove to be too conservative if first-time-buyers take on additional mortgage debt at an aggressive pace to compete for the limited pool of housing.

We are currently forecasting that housing completions will fall slightly to 27,000 in 2023, from 28,400 in 2022. Unfortunately, build cost inflation and other constraints such as the planning process have hurt viability and held back housing completions from rising above the 30,000 mark, which we had originally expected to be met this year.

It remains to be seen if recent government efforts to expediate planning processes can bear fruit.

Warning: Forecasts are not a reliable indicator of future performance.

Conall MacCoille
Chief Economist

UK economic outlook

The current consensus forecast is that the UK will see a 1% contraction in Gross Domestic Product (GDP) in 2023, the worst performer amongst the G7 economies, and is accompanied by the strongest rate of Consumer Price Index (CPI) inflation at 7.3%

The UK economy has already slipped into recession. GDP contracted by -0.2% in Q3 2022 and looks set to contract further in the fourth quarter. It is already clear that the UK's double-digit CPI inflation rate at 10.7% in November, brought on by surging energy prices, is hurting household spending. Retail sales volumes fell 2.7% in the three months to November.

Hunt reverses course on the 'mini-budget'

Of course, Kwasi Kwarteng's disastrous 'mini-budget' has exacerbated the UK's problems, eroding confidence, despite new Chancellor of the Exchequer Jeremy Hunt's reversal of the unfunded package of tax cuts. The Autumn Budget statement revealed tax rises on higher earners to help pay for a 10% rise in benefits and an extension of the energy price guarantee.

However, the Conservatives are still planning to rein in borrowing, only very gradually, from 7% of GDP this budget year to 3% by 2025 and with the debt/GDP ratio rising to a peak of 98%.

Although, the autumn statement was heralded as austerity, promising a squeeze on public spending over the medium-term, most of the difficult decisions have been postponed until after the next election. The task of managing the public finances back towards a balanced budget, amid growing demands for public services, has still to be fully negotiated.

The reality is that the UK government is still planning to run an enormous deficit worth £140bn in 2023. Whilst this borrowing will help protect household incomes, it means that the Bank of England has more work to do to rein in demand and bring CPI inflation back to the 2% target.

Rates up, house prices down

Markets still expect that the Monetary Policy Committee (MPC) will raise official rates to 4.5% by mid-2023, from 3.5% currently.

One concern for the MPC is the risk that persistently high CPI inflation rates will become embedded. In October, private sector earnings were up 6.6% on the year, pushed up by labour shortages which have been exacerbated by Brexit. Surveys of inflation expectations have picked up. Strikes through the winter have also been motivated by workers trying to chase prices via higher wages.

Unfortunately, a downturn in the UK housing market has added another dimension to the downturn. Both the Halifax and Nationwide measures have already declined by 3.2% and 2.4% respectively since the summer, with double-digit declines now expected by many commentators. UK homebuilders have reported collapsing sales rates, with completions set to decline markedly in 2023.

Of course, given frothy conditions through the pandemic, the UK housing market was already vulnerable to a price correction. However, the surge in interest rates on new mortgage lending to above 6.5% in October, following the 'mini-budget' has triggered a sharper correction. At the end of December, Moneyfacts reported that the average 2-year fixed rate was still an eye-watering 5.78%.

At current interest rates and stretched valuations, UK housing affordability has reached breaking point. Something has had to give, for now, falling house prices. The only possible respite for the UK housing market is that signs of disinflation may persuade markets and official Bank of England rates may peak closer to 4%.

Brexit still lurking in the background

Were it not for the COVID-19 pandemic and war in Ukraine, the UK's exit from the EU single market beginning January 1st, 2021 would likely have received far more attention and analysis. The evidence clearly suggests the UK's export performance has been affected.

UK exports in 2022 have remained below pre-pandemic levels, lagging behind the G7 economies where trade flows have fully recovered. The consensus forecast is that UK industrial production will have contracted by 4% in 2022 and will decline by a further 2% in 2023.

There also seems little doubt that Brexit has also weighed on business investment and productivity, and via reduced inward migration, has accentuated labour market shortages and exacerbated pay pressures.

Perhaps the one silver lining is that Rishi Sunak's new government may take a more constructive approach to the Northern Ireland protocol and hopefully, secure an agreement ahead of the 25th anniversary of the Belfast Agreement.

However, it seems less likely that the Conservative party is capable of an objective debate on the merits of negotiating an improved trade deal with the European Union. Speculation in recent months that the UK might pursue a 'Swiss' style relationship with the EU was quickly denied by the government following opposition from back bench MPs. So, there seems little prospect of meaningful progress on EU trade relations until after the next election.

Aidan Donnelly
Head of Equities, Davy Private Clients

Global equities - Earning(s) is caring!!

Well, it is that time of year again when the pressure to dust off the crystal ball ratchets up and for obvious (though questionable) reasons, the focus on 'the next twelve months' intensifies. I don't know why this one-year period is any more important than one beginning in February, May, August, or October for the long-term investor, but such are the ways of the world.

Growth and rates

With that said, let's look at where we are and what major issues are troubling markets. The 'good' news is that the list of concerns to consider is short – in reality there are only two and they have not changed over the last few quarters. Thoughts are anchored on inflation and that central banks – particularly the US Federal Reserve (Fed) – will keep hiking rates until the cycle ends with a deep recession. À la Volcker, a financial accident enroute, or perhaps worse – that they leave the job half done, driving a structural de-rating (à la the 1970s).

The 'bad' news is that we may have to wait a while before we have any concrete answers on either. Therefore, the infatuation with inflation and the Fed's effort to control it may be more prevalent than ever. This is despite the fact that we have just experienced the harshest Fed tightening cycle in 40 years and a historically challenging year for bond returns.

What does it profit?

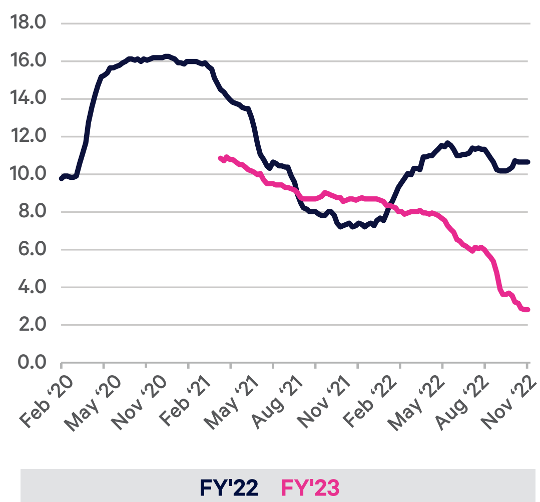
From an equity market perspective, while much ink is spilled about economic growth and inflation, in reality, it is their impact on corporate earnings that matter most. 2022 was a year where the performance of markets was driven by a significant reduction in the valuation multiple even as earnings growth remained positive across all regions. Looking into 2023, the real debate is what happens to those company profits.

Table 1: 2022 Earnings growth across regions

Region	2022 Earnings growth
US	5.3%
Europe ex UK	15.1%
UK	35.9%
Japan	14.7%
Asia	-0.2%
World	10.1%

Source: MSCI

Figure 1: 'Bottom-up' earnings growth rate (MSCI World)



Source: Datastream/S&P as at 5th January 2023

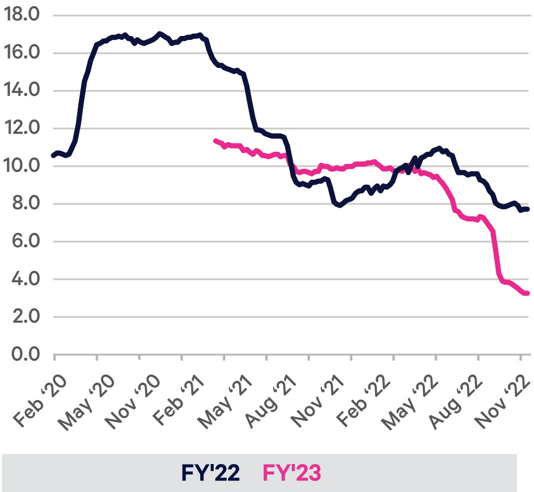
Mind the gap!

Not surprisingly – and for the first time in a few years – there is both a directional divergence and a significant gap between 'Top-Down' (strategist forecasts based on economic models) and 'Bottom-Up' (aggregate analyst forecasts for companies) expectations for corporate profits in 2023.

Nowhere is this more evident than in the US, where the spread of forecasts, even among strategists, remains very wide.

As the chart below shows, while we have seen company analysts trim their forecasts, the growth rates remain positive for 2023.

Figure 2: 'Bottom-up' earnings growth rate (S&P 500)



Source: Datastream/S&P as at 5th January 2023

But as 2022 drew to a close, we also witnessed a 'race to the bottom' as many 'Top-Down' forecasts attempted to 'out-bearish' the consensus expectations in terms of the contraction in profits, with the most bearish now standing at -13%.

What happens now?

With such a wide spread of expectations, it is only natural to ask what will happen next? The 'Top-Down' will argue that it's only a matter of time before 'Bottom-Up' estimates fall in a more accelerated fashion that reflects the kind of downside expressed in their forecasts. The question is one of timing or catalysts. With third quarter earnings season behind us, it's unlikely we are going to see any evidence of this until mid to late January when the next earnings season kicks off.

At that point, the question will be if many companies are forced to reduce their guidance for 2023, or do we see evidence that the consumer sentiment and activity has started to fade post holidays? For much of the second half of 2022, the harbingers of doom have been calling for a major contraction in consumer spending, as pressure from rising prices and interest rates put a halt to their gallop. Concurrently, would this cause a dramatic contraction in corporate profitability?

So far, both have failed to materialise and while, that is no guarantee that it won't happen over the turn of the year, the question of why company managements, in aggregate, would wait this long to reveal bad news if they had it. Particularly when the 'mood music' of 'Top-Down' forecast are so obviously expecting it, warrants some thought. As the old saying goes – "When you are a hammer, all you see is nails" – and maybe that explains the 'Top-Down' point of view.

And the market says...

To add a final wrinkle in the debate, there is the question of what markets are pricing in for growth expectations. Prior to the October/November 2022 rally, market levels implied a contraction in earnings greater than even the most bearish of strategist or analyst. But as we exited the year, the gap has closed, albeit with an earnings recession still priced in.

Whether the bounce in markets early in the fourth quarter reflected the extreme bearish positioning, particularly of hedge funds, or if it was a genuine improvement in sentiment surrounding the growth outlook, will be a topic of great debate – but will be hard to know definitively either way.

But for now, as the table below shows, the companies and analysts remain in the glass half full community – if they move down or get joined by their 'Top-Down' brethren, only time will tell. But chances are the outcome is somewhere in between.

Table 2: 2023 Earnings growth projections across regions

Region	2023 Earnings growth
US	4.2%
Europe ex UK	1.2%
UK	-3.2%
Japan	4.5%
Asia	4.0%
World	3.1%

Source: MSCI

Warning: Past performance is not a reliable guide to future performance. The value of your investment may go down as well as up. These products may be affected by changes in currency exchange rates.

Warning: Forecasts are not a reliable indicator of future performance.

Marie Gillespie
Senior Equity Analyst

Irish equities - No stock is an island

As we know only too well from our experiences with COVID-19, a year can feel like a long time. That was certainly the case with equity and indeed bond markets in 2022. Despite year-end rally in equities, markets still fell strongly overall in 2022, and Irish equities were no exception. However, with the perspective of over twenty years market experience, the rule book hasn't changed and I have no doubt that in the long term, strong management teams and equity markets will flourish.

Of course, like COVID-19, market falls were not fair and equitable to all - some sectors within the market bucked the trend, with Irish financials having a standout year.

'Rate rises are like rocket fuel'

Back in my younger, greener days in the market, one of the more memorable quotes from a senior fund manager sticks in my mind. On wanting to invest in Japanese banks at the time, he pulled up a chart which correlated interest rate expectations (implied from bond yields) and banks' share price performance. He urged, "There's only one thing you need to know about banks - interest rate rises are like rocket fuel".

Many years later, whilst acknowledging the issue is significantly more complex, I have to admit that in 2022,, for several reasons, the share prices of the Irish banks have taken off 'like rocket fuel'. This was accompanied by earnings upgrades from all three banks (AIB, BOI & PTSB) as interest rate rises fed through to profitability. Nonetheless, price performance cannot be simplistically attributed just to the changes in interest rate expectations, albeit the pace of rises did take the market by surprise. A multitude of other factors were specific to Irish banks including the exit of two major competitors from the market (KBC & Ulster Bank), the resumption of dividends, and changes to both lending ('macro-prudential') and staff compensation cap rules to name a few.

Figure 1: Performance of ISEQ and ISEQ financials

Figure 2: Share price correlation of 10-year German government yields vs Eurozone banks

No stock is an island

Even in a tough year for markets, there can be pockets of share price strength. Equally, staring into the barrel of what appears to be an inevitable recession across multiple regions this year, there will be pockets of opportunity. Some of this is simply down to geography– it's fair to say that those Irish companies with significant UK exposure are considerably more cautious in their outlook than those that have US exposure, where the economic outlook is considerably better. Cyclicality also plays a part – some sectors are simply more exposed to cyclical spending than others. However, there are some sectors usually considered cyclical that are not yet seeing evidence of the much-awaited consumer slowdown.

Consumers prioritising experiences over products

One example is the travel/tourism industry, where months of lock-downs had given consumers a new perspective when it comes to experiential spending. Evidence from European airlines points to strong yields in recent months and decent levels of bookings into this year. Thus far, it seems European consumers are still prioritising travel over other spending. And whilst it's entirely possible that price sensitivity could increase over time, this may arguably benefit some industry players more than others.

Looking across to the hotel industry, demand so far has also remained robust in Ireland and larger UK cities. In Ireland, this is underpinned by the reported minimum of 15% of hotel capacity being given over to refugees from Ukraine and elsewhere – a situation unlikely to change imminently.
An added layer of complexity for the travel industry overall is that corporate and other travellers are increasingly focusing not just on times and prices when making bookings, but also how their travel and accommodation needs are feeding into their overall carbon footprint.

There's no place like home

I dedicated considerable column space to the Irish love affair with the property market in our last edition of MarketWatch. Hence, readers will be familiar with my argument that unlike the UK, where house prices are under pressure, the demographic and economic situation in Ireland is somewhat different. To begin with, whilst there are warnings about the possibility of a year-long recession in the UK, Irish Gross Domestic Product (GDP) is still set to expand in 2023, bolstered admittedly by foreign direct investment.

Furthermore, not having had Brexit to contend with, Ireland remains a country with inward migration. With an existing shortage of housing and years of chronic under supply, it seems we will see prolonged housing demand for some time – something recognised by the government. In addition, we have recently seen changes to the macro-prudential lending rules in Ireland, increasing the loan-to-income multiple for buyers from 3.5x income to 4x from January 2023. When these rules are combined with the Help to Buy and Shared Equity Schemes, it could arguably put further inflationary pressure on house prices.

Table 1: Buying power increases for first-time buyers

Salary 81,584

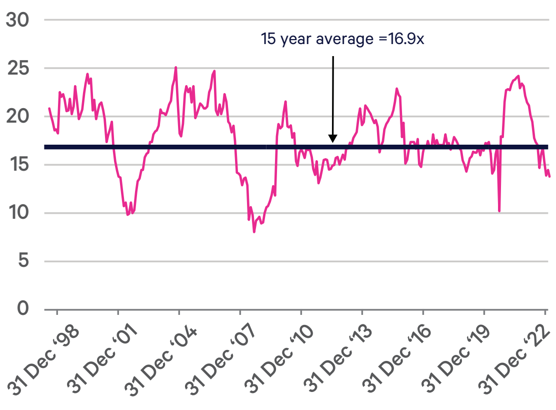
Before shared equity/ CB changes			***First Home* Impact**			**Central Bank Rules Impact**			**After Shared Equity & CB Changes**		
Deposit	31,727	10%	Deposit	40,792	10%	Deposit	36,259	10%	Deposit	46,619	10%
Shared Equity	0	0%	Shared Equity	81,584	20%	Shared Equity	0	0	Shared Equity	93,238	20%
Mortgage	285,543	90%	Mortgage (3.5x)	285,543	70%	Mortgage (4x)	326,335	90%	Mortgage (3.5x)	326,335	70%
House Price	317,270	100%	House Price	407,918	100%	House Price	326,594	100%	House Price	446,192	100%
Increase in buying power					**29%**			**14%**			**47%**

Source: Davy Research; CSO as at 11th November 2022

Earnings growth – beware of averages!

Having established that even in a tough overall market and macro-economic environment there can be pockets of growth, I'm wary of looking at averages – particularly for a very concentrated market like the ISEQ. However, it should be noted that whilst global valuations at the time of writing are back above long-run averages, in Ireland valuations are still below long run averages.

Figure 3: Price/earnings of ISEQ



Source: Davy as at 6th January 2023

Looking towards earnings, ISEQ earnings are set to grow 34.5% in FY23, (down from 42% in FY22). However, these earnings per share (EPS) growth figures are heavily upwardly skewed by financials and some larger names. There are expectations amongst several Irish listed companies for a fall in earnings, particularly for those with strong UK exposure. Furthermore, with analysts often being behind the curve, it seems reasonable to expect that there may be further downgrades to earnings for some names. Nonetheless, even factoring in some earnings cuts, many names in Ireland still represent good long-term value.

Finally, even for companies where earnings are not set to grow, the oft-mentioned strength of Irish balance sheets comes to the fore, with many stocks choosing to buy back shares. Also, numerous stocks outside of the traditional realm have become yield plays, with yields of >3% not uncommon. Hence, in an environment where yields from savings are still low, risk-averse investors with a long-term view may decide that there are still plenty of opportunities for investment in Ireland in coming years.

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Warning: Forecasts are not a reliable indicator of future performance.

Stephen Grissing
Investment Strategist

Glimmers of sunlight through the storm clouds

2022 – a dark year for bonds

For government bonds, years like 2022 are rare. To put the year into perspective, if we go back as far as 1977 using the Bloomberg US Aggregate Bond Index, in its 45 years of existence, there have only been five years of negative returns. The most significant annual decline prior to 2022 was in 1994 when the index was down close to 3% (in US dollar terms).

2022 was a standout year (for the wrong reason) - US government bonds were down 17% at their lowest point before recovering to end the year down 13% (in US dollar terms).

Traditionally, multi-asset investors have relied on developed economy government bonds to provide a stable source of return that helps to smoothen their investment journey. Bonds have tended to provide diversification benefits, helping to dampen the negative impact when risk assets like equities sell-off. During 2022, these tendencies were upended, bonds behaved in a similar manner to equities, both falling in tandem.

However, there was one positive for the euro and sterling based investors, favourable currency moves provided some shelter from the storm. The US dollar appreciated by 6 and 11% versus euro and sterling respectively.

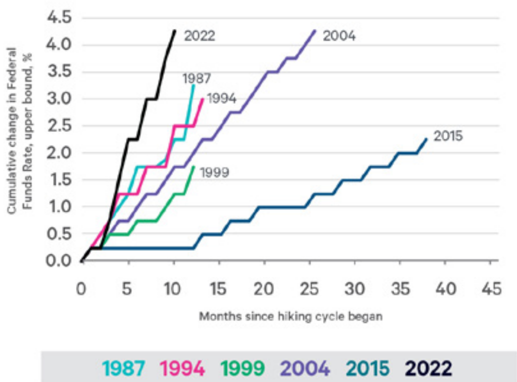
Central banks play catch up

To suppress inflation, central banks of many emerging economies began increasing interest rates in 2021. Central banks of developed economies on the other hand, albeit less accustomed to dealing with inflation outbreaks, were slower out of the blocks. Inflation gained a foothold, leaving these central banks to play catch up.

Jerome Powell, Federal Reserve (Fed) Chair, admitted in November 2021 that the characterisation of inflation as 'transitory' had been an mistake. Despite this, US interest rates did not increase until March 2022, when US headline and core inflation were 8.5% and 6.5% respectively, close to their peak levels. The ECB (European Central Bank) then joined the global rate hiking cycle in July 2022, at a time when Eurozone headline inflation was already 8.9% and rising.

Falling behind the curve with inflation meant that an aggressive frontloading of interest rate hikes was inevitable. The Fed proceeded to deliver 4.25% of rate increases in just 10 months – the fastest pace of any US rate hiking cycle in the past thirty years.

Figure 1: Aggressive pace of interest rate increases

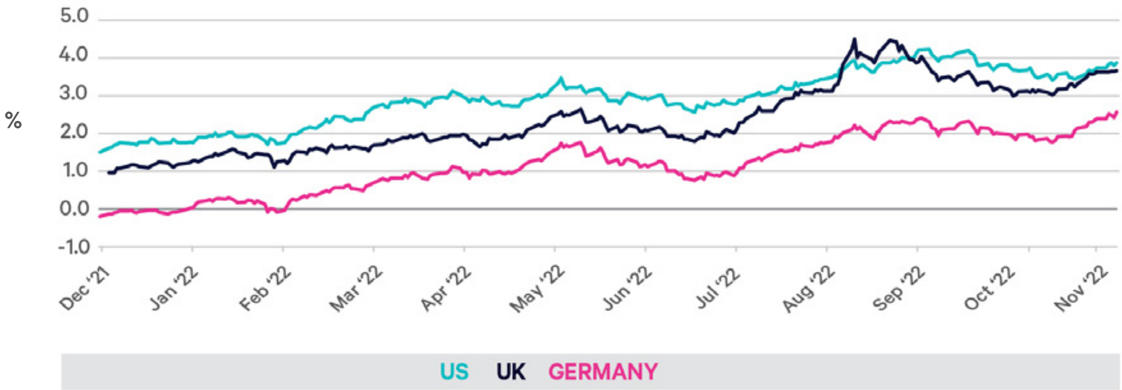


Source: Bloomberg as at 31st December 2022

The aggressive approach by central banks, along with a low level of starting yield in 2022, resulted in the dramatic sell-off in developed economy government bonds. The US 10-year Treasury yield moved from 1.5% at the beginning of the year, before reaching a peak of 4.2% in October. While the yield on the Germany 10-year Bund started the year in negative territory (-0.2%), before reaching a high of 2.6% in December.

The low level of yield at the start of 2022 meant that the income portion of the overall return for bonds was overshadowed by the extreme negative price change as yields increased over the course of the year (bond yields and prices move in opposite directions).

Figure 2: Nominal 10-year yields moved significantly in 2022



Source: Bloomberg as at 31st December 2022

A summit within sight

Following such a negative year, we anticipate 2023 will deliver positive returns. Similar to a mountain climber approaching their summit, sighs of relief could be heard from investors last November as the end of interest rate hikes appeared to be within sight in the US and Europe. Supporting signals included softening US inflation data, along with Federal Reserve meeting minutes that pointed to a near-term slowdown in the pace of rate hikes. In addition, the most recent dot plot projections suggest a terminal level of 5.1% for US interest rates.

If the end of rate hikes proves to be a reality, what will it mean for bonds in 2023? In the seven US rate hiking cycles since the early 1980's the US 10-year Treasury yield has peaked in the months prior to the last interest rate hike of the cycle. With US interest rates currently in a range of 4.25 - 4.50%, history indicates that a peak in US Treasury yields may not be far away, if it has not already been reached. The question of whether central banks go as far as to reverse course and cut rates will be determined by inflation data in coming quarters.

There is an additional glimmer of light. In contrast to the beginning of 2022, bond yields are trading well above their ten year averages. Bonds now provide a considerable yield cushion. In a scenario where bond yields do move higher, the higher level of starting yield will help to dampen the negative impact from moves in the bond price.

Davy positioning

For the first time in several years, government bonds have become a more attractive investment prospect. In Davy discretionary model portfolios, the long standing underweight position to fixed income duration was reduced in the fourth quarter of last year in response to the significant move higher in yields.

Following the change to the fixed income allocation, bond yields then softened late last year when expectations grew for a pause in Fed rate hikes. Following the softening we decided not to proceed with the additional duration to our discretionary model portfolios. We continue to monitor developments closely for an opportunity to add long duration bonds if yields return to a more attractive entry point.

Uncertainties do remain however. The level and persistence of terminal policy rates will depend on inflation developments in coming quarters. The Fed are determined to avoid a 1970s style policy error – cutting rates too early and allowing inflation to re-accelerate. There is a chance that interest rates may be kept higher for longer or increased further than the market is currently anticipating. Having said that, we do not expect a repeat of the dark year that was 2022.

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China's early hibernation

China's economy and markets entered hibernation earlier than the rest of the world due to a multitude of factors...

The impact of China's economic, political and regulatory environment affected investors towards the end of 2022.

Promisingly, the lifting of COVID-19 restrictions and the refocus on growth has already improved the outlook for the region in 2023, with MSCI China Index having had its best start to the year since 2009.

After such a concerning position for tech and real estate primarily, we thought it important to assess the state of play for those sectors in particular.

Also, to keep things in context, the Chinese stock markets (on and offshore) are still small versus the US. To illustrate this, we looked to compare what's happened in the Chinese offshore* tech market and the onshore** real estate market with their equivalents in the US to see how significant the moves were.

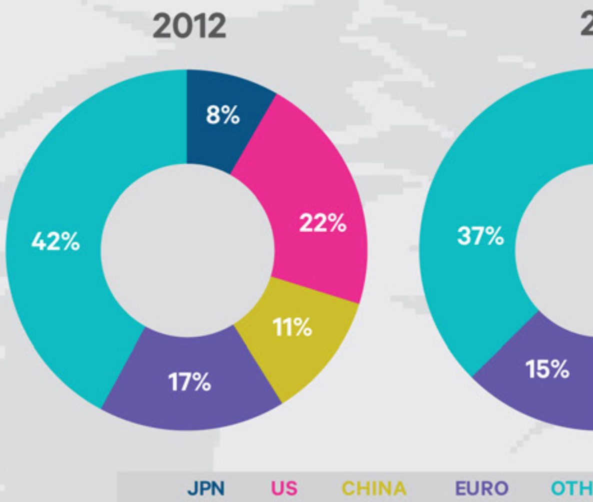
*offshore refers to stocks listed outside mainland China

**onshore refers to stocks listed in mainland China

Is China's economy taking

Economists often predict the eventual surpassing of China and Inc
end of the century. The data shows there is still long to go before t
economic growth was propelled by heavy domestic investment and
past decade.

This significant growth has begun to moderate due to structural c
and COVID-19, whilst US growth remains robust and Europe is losi



**With another shift in governance and policy occurring in the 20t
Chinese Communist Party, many feared Xi Jinping would neglec
of nationalist and protectionist policies.**

However, the aim for this government is to achieve a medium-leve
This implies an annual growth rate of 3.7% to 4.5% every year for th

18%

China % global GDP 2021

Up from 11% in 2012

24%

US % global GDP 2021

Up from 22% in 2012

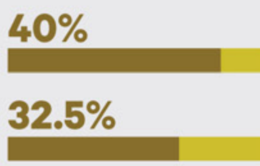
50% ↓

What happened with China's Real Estate crash?

Policy makers had to take action to shield the historic property market downturn. Declines of almost 50% in property market valueswere witnessed in October 2022 from the previous peak in February 2021.

GDP - Gross Domestic Product

**The bubble burst. In Ch
real estate companies r
2022 marked by distres
questionable state inte**



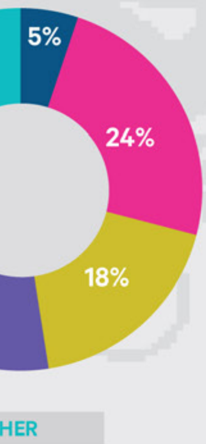
**Resultingly, in Novembe
an unspecified amount
their outstanding prope
40% of total loans and**

over the U.S.?

ndia's economy of the U.S. before the
this may occur. China's surge in
nd high growth in exports over the

constraints, diminishing investment,
sing share.

2021



0th National Congress of the
ct economic growth in favour

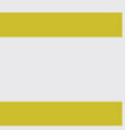
el developed market by 2035.
the next ten years.

15%

Eurozone % global GDP 2021

Up from 11% in 2012

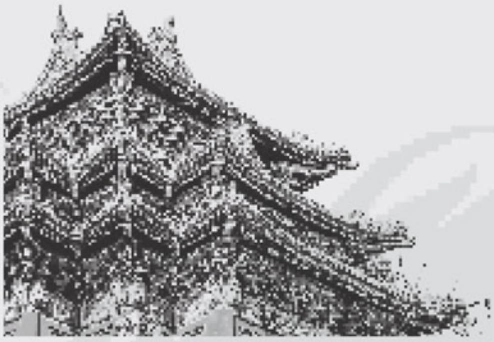
hina, very few privately-owned remain after a tumultuous essed developers and ervention.



ber last, investors were given t of time to cap the portion of perty loans at big banks. outstanding mortgages at 32%

Real estate 2022

Source: Bloomberg as at 31st December 2022; percentage change rebased from 100 from beginning of 2022



Zero-COVID?

Following swathes of protests, COVID-19 restrictions were finally eased in December, bringing an end to its zero-COVID policy and restrictions which lasted almost three years

Tech crack down

The Chinese government pulled tech and fintech firms under scrutiny with antitrust probes in 2021, including fining Alibaba an eye-watering $2.8bn amongst other crackdowns.

There was increased oversight of Chinese tech firms seeking to list abroad, no doubt emphasising the friction between China and the U.S. China wanted to limit private enterprise power in the country, which the government saw as becoming too powerful.

While top officials say this crackdown will ease in 2023, the fundamental motivator of reducing private enterprise power in China is likely to stay, meaning the government's approach to tech companies is unlikely to shift drastically.

72%

China Tech Peak to Trough Decline
China's returns plummeted a staggering 72.11% from February of 2021 to October of 2022.

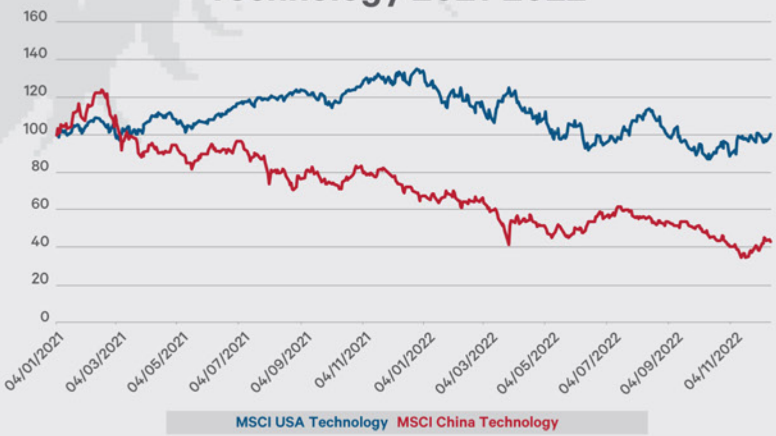
“

Comparing returns for both MSCI China Technology and MSCI USA Technology, there is a significant gap in performance over the past two years.

35%

US Tech Peak to Trough Decline
The % drop from previous peak for MSCI USA Technology of 35.51% occurred from December of 2021 to its lowest level in October of 2022.

Technology 2021-2022



Source: Bloomberg as at 31st December 2022; percentage change rebased from 100 from beginning of 2021

Conor Lacey
Financial Planning Associate

Time to rejig your financial plan

Last year was a volatile time for markets due to hiking interest rates, record inflation, and the war in Ukraine - to name just a few challenges. This geopolitical and financial uncertainty has resulted in fluctuations in investment portfolios worldwide.

The good news is that difficult years in the market such as 2022 don't necessarily mean that the chance of you meeting your long-term objectives has gone up in flames. Growth assets, such as equities are expected to be volatile and fluctuate in value. They also tend to bounce back and reward investors over the long-term for being able to withstand such bouts of volatility, which is a key aspect of financial plans.

How can a financial plan help?

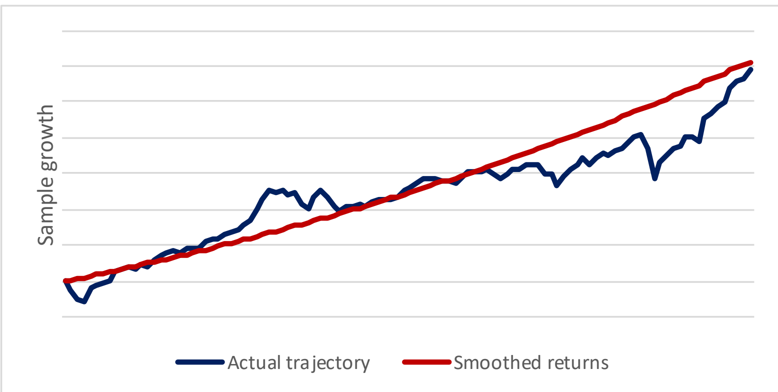
A financial plan can be an invaluable tool and a core for driving your decisions in respect of structures and portfolio positioning, to give you the best chance of meeting your financial objectives. One key element of a financial plan is the ability to allocate your wealth into appropriate investment strategies across your short, medium, and long-term objectives. Simply speaking, growth assets such as equities are allocated against long-term goals, while safer liquid assets such as cash and bonds are set against short-term needs. This positioning is especially important during periods of volatility as you can remain confident that growth assets have a long-time horizon and time is on your side to weather any storm. This avoids any knee-jerk reactions and allows you to focus on what you can control.

Financial plans are not designed to be set-and-forget exercises, so a review of your plan is always worthwhile to ensure you remain on track to meet your goals, carrying out any 'tweaks' as needed. This review can factor in any update in your circumstances and will also incorporate revised forecasted investment returns in the cashflow modelling on the back of a year such as 2022, which will capture our most up-to-date asset class growth assumptions.

Taking account of volatility in financial plans

While market returns do fluctuate like in 2022, a financial plan generally uses smoothed long-term expected returns when assessing the chance of

Figure 1: Sample smoothed vs actual returns over time



Source: Davy. Please note that this graph is not based on market data, rather illustrative to highlight a volatile market period.

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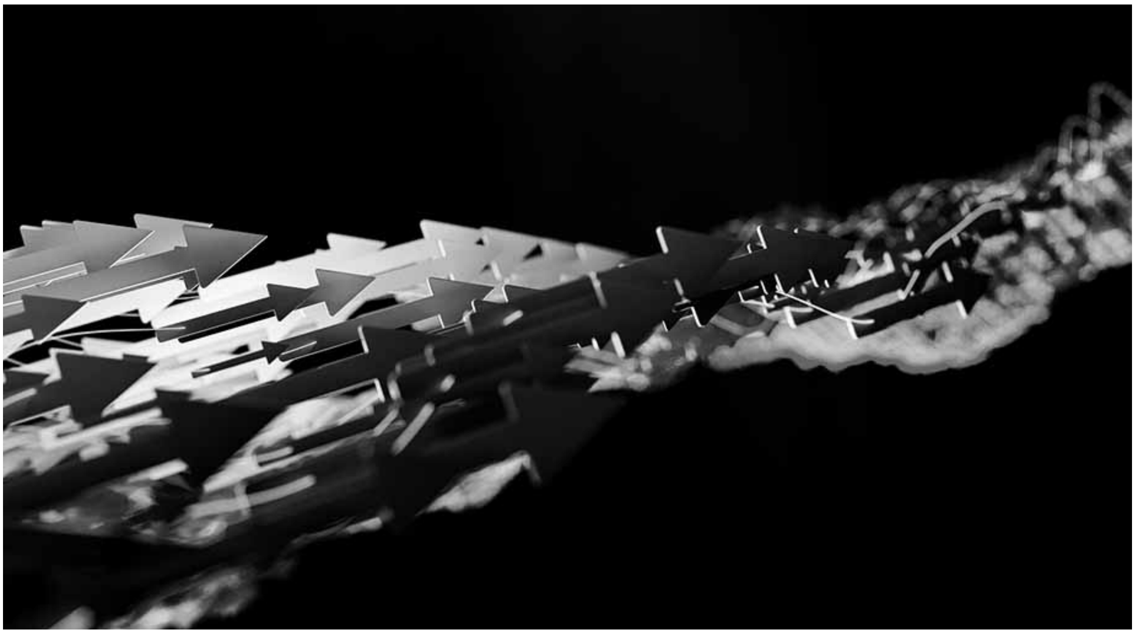


you meeting your long-term objectives. While the assumptions used in financial plans are unlikely to be reflected over the short term, the plan works on the basis that expected returns are more predictable over the longterm. This can provide helpful guidance as to how portfolios may perform over longer periods and indeed how likely you are to meet your objectives over your specific time horizon.

While we don't react to short-term volatility in our plans due to their long-term nature, we do reassess our inherent expected return assumptions on an annual basis to reflect any changes in the long-term outlook. The good news is that forecasted expected returns for both equity and bonds have increased, as markets are expected to revert in the coming years. This pick-up is not guaranteed and is difficult to time, but is our central expectation, and we will incorporate an increase in our forward-looking portfolio return assumptions accordingly. That is, our plans will reflect our view that the losses of the last year will be recovered if clients remain invested. We always complement our central projections with stress scenarios to highlight what the path will look like if a more difficult market environment was to endure over the medium to longterm.

A similar approach to inflation

A similar approach is taken when accounting for inflation. Although inflation rates are currently in the headlines, we focus on long-term expectations in line with a client's time horizons. Inflation rates are anticipated to revert towards the European Central Bank target in the coming years. It will take time to get there, however, so our long-term inflation assumption is expected to notch up slightly.

A plan focuses on what matters

The purpose of a financial plan is not to achieve an exact target return on your investments, but instead, it is focused on the likelihood of it meeting your goals. Whether that is being able to have the lifestyle in retirement you envisage or being able to gift your loved ones. While we don't expect 2022 to have put long-term investors significantly off track, a financial plan review will highlight if any pivots are needed, along with any areas where there could be a risk of falling short of meeting your goals.

If rebalancing is required in terms of allocation of your wealth, or if investment of your portfolio has been stalled, the review of your plan may be very timely.

For our clients with no plan, we believe there has never been a better time to start your financial planning journey. A conversation with your Davy Adviser is the first step in the process of creating or updating your financial plan. This can be as simple as ensuring your investment strategy aligns with your long-term financial goals and risk preference, along with ensuring the structures you have in place are appropriate for you, especially given the current market environment.

As we enter into 2023, the New Year can be full of opportunity if you look in the right place.

Pete McGuigan
Investment Strategist

Crypto collapse... Should I be worried?

The world of cryptocurrency is no stranger to the headlines, nor is it uncommon for certain elements of the cryptosphere to fall from grace and disappear into the digital ether.

That being said, now and again a perfect storm is created within the digital asset space that spills over into the rest of the crypto universe and, unsurprisingly, pushes digital coin volatility to astronomical levels rarely seen in other assets. Remember Black Monday in 1987 where the US Stock Market dropped 22.6% in a single day? Well crypto has experienced five such trading sessions since 2011 already (not including the most recent FTX Exchange collapse).

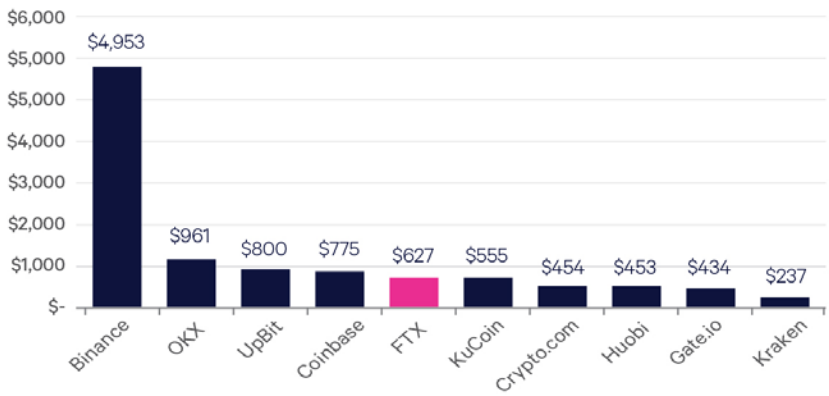
This poses some questions for the rest of us that are based in the more traditional stocks, bonds and alternatives investment world. What exactly happened and why; how much money was lost; and could such events impact my investment holdings in the future? Unlikely, but it's hard to say.

Looking back...

The longer answer focuses on that last point, can the crypto fallout affect other investment holdings? A plethora of analysts, fund managers, academics and pundits that have been scrambling for years to decipher whether cryptocurrency has any significant correlation to any other asset classes. While there have been limited points of interest such as recent price movement relationships with stocks & stablecoins pegged to USD or commodities, more broadly though, limited meaningful statistical robustness exists over the longer term.

Indeed, it is much harder to pin down instances where a solid cause-and-effect relationship exists between an incident in the crypto world and a material effect on the price of any other asset class. That said, it is a fair line of investigation as there may be instances where the crypto 'tail' might wag the global market 'dog'. A good place to begin is the most recent FTX exchange collapse which took place in November as it has been one of the most notable crypto shocks in a few years.

Figure 1: Top crypto exchange by volume (USD billion)



Source: Reuters as at 9th November 2022

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The road to zero
FTX was one of the largest cryptocurrency exchanges in the world (by volume) this year before solvency concerns leading to a liquidity crisis drove the $32 billion company into bankruptcy within a matter of days.

The collapse rattled digital asset markets, shaving billions off coin values and dropping the entire global crypto market capitalisation by 10.6% overnight.

Too big to collapse... what happened that?
Cast your memory back to 2008 to the midst of the Global Financial Crisis and to what became one of the most infamous years in the recent central banking history (at least for the public anyway). Secretary of the Treasury at the time, Hank Paulson, the Federal Reserve (Fed) and the US Congress passed a controversial 'Emergency Economic Stabilisation Act' or as it was commonly known, the 'Bank Bailout of 2008'. It was deemed by Paulson et al. that following the collapse of major financial institutions like Lehman Brothers and AIG, a comprehensive strategy was needed to stabilise the economy and prevent further financial institution failures.

So where was the same central bank and governmental intervention to be seen following the collapse of one of the largest crypto exchanges globally (which arguably had the potential to further derail the entire cryptocurrency environment)?

In short, it wasn't there and is unlikely to be witnessed in the foreseeable future. This is primarily because cryptocurrency, at least when compared to 'traditional' assets is stateless and of course decentralised. It is probable, because of this, that even if central banks deemed fallout from the crypto-sphere as a threat to the wider macro-environment, they would still be reluctant to get directly involved with such a murky market.

Going nuclear... not likely
The US Fed stated at a recent policy setting meeting that the implications of the FTX collapse were "significant among other crypto lenders and exchanges but was not seen to pose broader market risks to the financial system." In addition to this, exposure to FTX was almost entirely on the retail side, while systemic market participants appeared to have little or no exposure to the exchange. Lastly, institutional investors, amid a higher rate environment, are seeing more investment opportunities arising in conventional assets like bonds, that have become more attractive and as such have reduced, at least for the time being, their crypto exposure.

What next?
Downsizing? Regulation? Centralisation? All likely, but of course it's hard to pin down when exactly it will happen and in what magnitude. The downsizing has already begun with many major coins down more than 75% from peaks seen back in 2021. In terms of regulation, President Joe Biden has already approached several federal agencies to address crypto risks. Centralisation remains slightly more elusive, however as Binance has now become an even more dominant market leader within crypto exchanges, one can't help but notice that it bears all the hallmarks of a more monopolistic controlling market incumbent, a far cry from the ethos of a market that preaches decentralisation.

Eileen Rowsome
Senior Investment Selection Analyst

Responsible investing, the good, the bad and the admirable

Some might say that 2022 was the year of reckoning for responsible investing. Performance struggled given the inherent lack of exposure to commodity heavy sectors (such as non-renewable energy e.g. oil) which, due to global shortages, outperformed significantly in the year. Debates around exclusion of certain sectors like weapons came under scrutiny because of the war in Ukraine and a nation's right to defend themselves. We've also seen many politically charged headlines about the backlash towards asset managers for being more vocal about responsible investing, much to the distaste of some US states.

On the positive side, and despite the backlash, we have seen a shift in rhetoric from many large investment firms to set net zero ambitions, who are in turn looking at the companies they invest in to do the same. Diversity, equity, and inclusion is a topic that is discussed not just by staff but by shareholders who want to be investing in companies with fair and equitable employment practises.

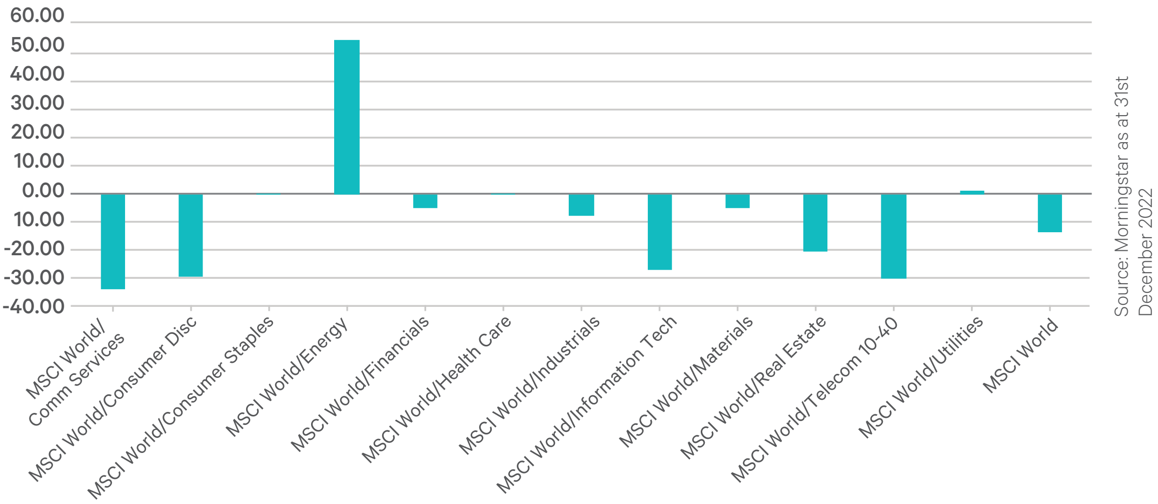
I also believe that the debate and inconsistencies highlighted in recent years by naysayers will only move to improve standards and communication.

> *291 signatories with USD 66 trillion in Assets Under Management have signed up to the to net zero asset managers initiative*

Issues with jargon

The responsible investment industry hasn't helped itself in recent years with the endless array of acronyms and approaches, from ESG (Environmental, Social & Governance) to SRI (Socially Responsible Investment) and Impact. This issue has been compounded to a certain degree by recent regulation that has introduced more terms and more dreaded acronyms, be that SFDR, Article 8, EU Taxonomy*. The confusion all this has created is worthy of criticism but overall should be welcomed to help drive improvements as the industry matures as these terms need more concrete explanation.

Figure 1: Sector performance variation over 2022



Growth towards better outcomes

The spirit of the new regulation, however, is admirable as are most investors motivations when investing in the space. The regulation aims to direct more capital into sustainable investments benefitting all stakeholders, not just shareholders. It does this whilst also aiming to provide more clarity and transparency to investors on what “good” looks like when it comes to a sustainable approach.

As with many things in finance, the industry evolves before the structure of standardisation and regulation comes in. This is good for innovation but not so good for investors, who are not involved in the day to day, to understand what they may be investing in. As the regulation beds down, it should meet its aim of standardisation and transparency too.

Our approach at Davy

We use the term Socially Responsible Investing when referring to a more socially conscious approach to investment activity that puts the method of investment on par with the financial outcome measured in risk adjusted return i.e., the ‘how’ we invest is as important as the ‘why’. We believe this is an appropriate term as it encompasses the key areas of an investment approach namely:

- exclusion on harmful activities and products
- integration of environmental, social and governance (ESG) factors into investment analysis
- engagement to affect change
- measuring impact

For fear of consigning myself to the band of acronym junkies, I’ll refer to the activity as this approach as responsible investing throughout the rest of this article but note it can also be referred to as SRI.

While a base level of exclusions is necessary to avoid harm (think tobacco, human rights violators), thankfully the market has moved on in recent years from focusing on exclusions only, to assessing the risk and opportunities ESG factors represent to an organisation as well as how their products and services contribute to a greener, safer, and more equitable world. In addition, engagement to improve laggards is increasingly coming to the fore.

By encouraging all companies and countries to improve practices, responsible investing will really meet its non-financial aspirations.

But what are these ESG factors I mention?

Environmental, Social and Governances factors are important considerations when looking at the operations of an individual company or country. This could be assessing the carbon footprint of a company, its labour practises or how company management are incentivised. ESG factors may be considered in a traditional investing approach also, but their importance is given a higher level of consideration with a responsible investing approach.

Sustainable investing is another term used quite widely. For us, the focus here is more on the products and services provided by companies and countries and what needs they might meet. This type of approach can have a narrower scope for investments, particularly under new EU regulation, but there are also some exciting thematic developments here. For example, energy transition investment funds, that look to invest in companies aiding the energy transition, they may have a high carbon footprint now but the change they can affect will be noteworthy. It would be amiss of me not to touch on the performance debate.

Does a responsible investment approach lead to a better financial outcome?

In theory, investing in companies and countries that are repositioning themselves for a more sustainable world should do well in the long term, but it shouldn’t be seen in isolation without a traditional assessment of what makes an investment attractive.

In practise, it really is too early to tell. There are numerous indices out there that show returns superior to the market for various responsible investing approaches, but caution should be exercised when looking at these. Many indices with a responsible investing angle have been created in recent years, and while they may show years of history, this is a hypothetical or back test of returns rather an experienced return.

There will be times when a responsible investing approach outperforms, like in 2020 and when it underperforms, like in 2022. For investors the key question is whether they believe investing in companies which are contributing to or changing to contribute to a greener, safer, and more equitable world is aligned with their financial and non-financial aspirations. It should be noted however, that progress is not linear, and there will be times, like this year, when patience is needed.

*SFDR: Sustainable Finance Disclosure Regulation. Article 8: Funds filing under article 8 of SFDR are funds that promote environmental or social characteristics. EU Taxonomy: classifies economic activities as either environmentally sustainable or not.

Anna Heaney
Investment Associate

Financial freedom – The next feminist endeavour

It's fair to say that the world of finance has historically been predominantly male dominated. Not just from a career perspective, but also in terms of investing. You'd even be forgiven for saying that the typical image that springs to mind when you hear the word 'investor' is more than likely a man in a suit, but it's time for that image to change.

When we think about the evolution of the female, the strides that have occurred in the past 50 years alone have been phenomenal i.e. the ongoing attempts to dismantle the patriarchy, the feminist movement, and more recently the 'me too' movement as well as the push for equality in the workplace and in the boardroom.

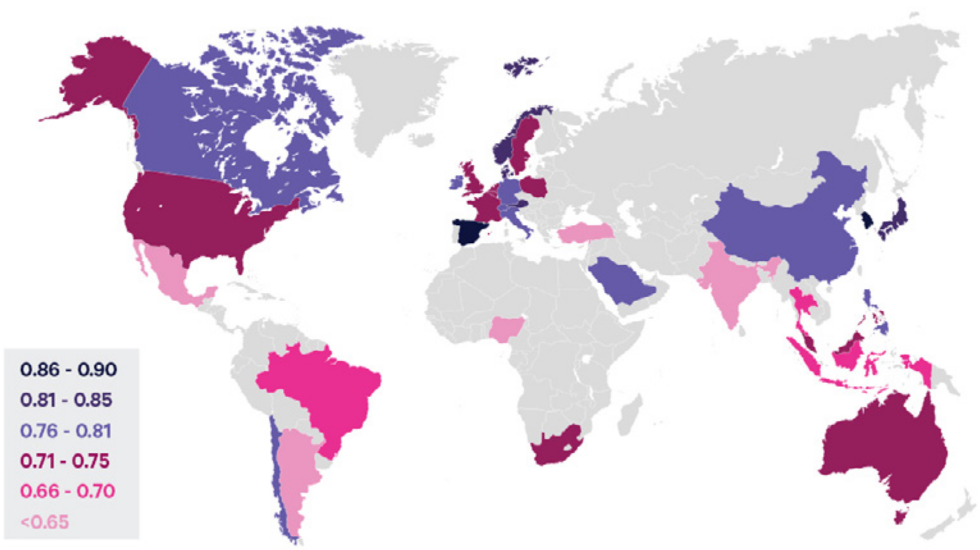
Gender roles continue to evolve, but unfortunately systemic issues of the past are still creating gender gaps and obstacles to investing and wealth accumulation remain for many women. Close to home, one such example is Ireland's marriage bar, which was introduced in the 1920s and required women to resign from work once married and disqualified married women from applying for job vacancies. It was finally lifted in 1973, but many women are still feeling the effects, receiving a reduced pension today as a result.

Though major advances have occurred in the professional and personal lives of the women of the world, investing is an area where females are still vastly under-represented. Women are considered to be less likely to have an investment portfolio and are also still behind when it comes to pension contributions.

The gender wealth gap

Despite women living longer, women are expected to have lower levels of wealth then men by the end of their careers and it's been estimated by Scottish Widows that it would take an average woman in her twenties in the UK, 37 years more than a man to achieve retirement parity. A recent global study carried out by Willis Towers Watson for the World Economic Forum supports this, discovering that globally, by retirement age, women on average will have accumulated 74% of the wealth of their male counterparts.

Figure 1: The global wealth equity distribution for 39 markets



Source: WTW 2002 Global Gender Wealth Equity Report

The study also found that even though variation of wealth equity across regions is significant, the underlying drivers are consistent, namely; pay gaps, delayed career trajectories, family responsibilities and lower financial literacy levels.

The first three listed can be referred to as a 'motherhood penalty', which unfortunately is still estimated to affect generations to come, with it often making more sense to work part-time or step out of the work force temporarily due to high childcare costs etc., which in turn will mean lower pension contributions and slower career advancement during that period. Family responsibilities also impact the amount of time women have to dedicate to things such as investing.

Poor financial literacy in general is something that needs to be tackled, across both genders and from earlier ages as the lack of knowledge acts as a disempowering force.

All that being said, positive change is ongoing and the drives towards full gender equality have never been more in focus.

Why investing is important

There is a myriad of reasons to invest, beyond what you're putting away for retirement. From the base levels of hedging against inflation to building financial security for oneself and family. Investing allows us to grow wealth over time and its importance varies depending on the individual but it comes down to what it can do for you and the lifestyle it enables you and your family to have.

In generalised terms, the drivers can differ between genders, and it is often suggested that when it comes to investing, women prioritise security, independence and lifestyle. The drive for financial independence is natural, for the factors mentioned before, it's something that has been relatively newly attained and is invaluable. Security is hard to define, but we feel out of balance without it and our financial status has a huge effect on it. A comfortable lifestyle is what we work hard to be able to enjoy and this advances as we grow our wealth.

Although in recent years, financial independence and success has become paramount for women across the world, the data on female investing is mixed. Promisingly. according to Fidelity's 2021 Women and Investing Study, 67% of women in the US are now investing aside from retirement only, compared to 44% in 2018. Broken down by generation 71% of Millennials, 67% of Gen X and 62% of boomers were found to be investing outside of their pensions. Whether it is due to intrinsic or extrinsic factors, things seem to be improving, but women are still behind men in this area, despite evidence that they produce higher risk adjusted returns.

Living with uncertainty

One reason for this could be down to the typecast of women being nervous around investing. An interesting factoid that's often quoted and was supported by the 2021 Fidelity study is that whilst women are often the ones managing the household finances, confidence lacked when it came to long-term planning and investing.

Investing has an inherent risk involved and that can be difficult to get fully comfortable with. With the potential for both good and bad outcomes present, it can lead to inaction. When investing over the short-term, risk is enhanced due to the speculative nature. Making our money work in a portfolio over the long-term means that we can have wealth that grows over time and avoids approaching investing from a transactional stance.

This longer-term view is something that a study by German Bank, N26 found that women prefer. This can be achieved through a diversified portfolio with multiple different asset classes working in different ways, with your money compounding away in the background, with adequate time allowed to weather short-term storms.

Language around investing can sometimes be alienating and act as another barrier to entry for some women. As mentioned previously, financial literacy across genders is still not where it could be. When we break it down in the simplest of terms, money is a resource and wealth is what you can create over time through investing. There is an array of different ways we can invest, but the first and only criteria is that we put our resource into something that we expect will increase in value over time.

Naturally, trying to do this yourself is where the hard part begins as predicting future outcomes is increasingly impossible as we become blindsided by global events and their subsequent impacts on markets on a yearly basis, 2022 being one such example. The thing is, we never have the full picture of future events, therefore we can never have all the information before getting started, instead, like most things in life we often learn our biggest lessons along the journey, but first we have to begin.

A nervous approach does not have to be viewed as a bad thing. Being cautious can in fact make you a better investor because willingness to stay a course, avoid overtrading and not make drastic and reactive decisions which can hurt portfolio outcomes.

Wealth equity - where to start

You can start small in your journey to financial security through investing. Small steps like increasing pensions contributions at a younger age can improve your long-term savings outlook. Risk is inevitable, but you can select the risk you are comfortable with and investing over the long-term softens the blows of any short-term volatility that will inevitably arise.

Feeling financially disengaged is understandable with the obstacles mentioned but making decisions today could hurt or help your future self and the path to financial empowerment doesn't have to feel like a cause of stress. The idea is to prevent future stress, creating security and peace of mind. Financial literacy and independence is a lifelong endeavour and all that's required is taking the first step.

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Who owns the market?

"The stock market mostly dipped Tuesday, as it took a breather from recent gains."

Barron's, 29th November 2022

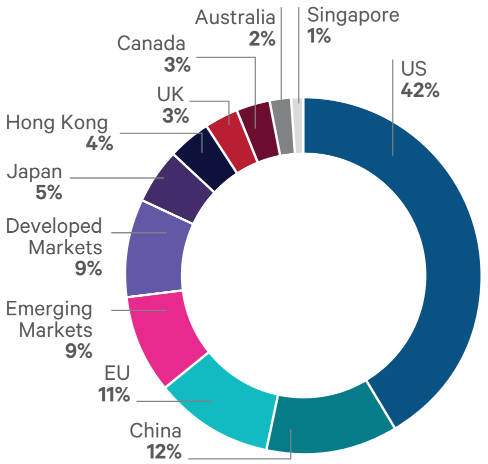
The sentence above from Barron's is an example of the standard commentary across financial media. News articles report movements in the main stock market indices often attributing a reason as to why the market has risen or fallen on a particular day. The "market" is frequently referred to as if it were a single entity with price movements that can be explained succinctly. Legendary investor, Warren Buffet, has used the term "Mr. Market", characterised as someone whose outlook alternates daily between euphoria and excessive pessimism.

In reality, the market is made up of transactions entered into by millions of participants across the world from a wide variety of backgrounds. These market participants have very different objectives and investment time horizons and in aggregate their activities combine to determine the returns on the "market". In this article we highlight some features of global equity markets and outline the main categories of market participants to shed some light on the question of, "Who owns the market?".

How large is the stock market?

The global stock market was estimated at $124.4 trillion as at the end of December 2021, with the US representing 42% of this total as highlighted in Figure 1. This is well ahead of the next largest markets of China (11.6%) and the EU (11.1%). Market values change on a real-time basis due to share price movements, changes in the number of companies issuing shares through an initial public offering (IPO) and the value of these IPOs. When public companies are acquired or taken into private ownership, it reduces the outstanding value of publicly listed stocks.

Figure 1: Global equity market cap 2021 - $124.4 trillion



Source: World Federation of Exchanges as at year end 2021

The total market capitalisation is the aggregate of an estimated 40,000 stocks listed on stock exchanges throughout the world. Of this total, there is a concentration of value within a small number of stocks, with seven companies at one point each reaching a market capitalisation of $1 trillion. Apple was the first company to hit the $1 trillion market capitalisation milestone and was subsequently followed by Aramco, Microsoft, Alphabet, Amazon, Tesla and Meta.

Market ownership

This brings us to the question of who owns the market. Clearly with over 40,000 stocks listed at a combined value of over $100 trillion, ownership is widely dispersed. Many publicly listed companies started out as private companies with a single person or family as founder. Ownership is diluted when a company issues shares but these insiders often retain significant ownership stakes well after a company goes public. As an example, US retailer Walmart first issued shares to the public in 1970 but the family of founder Sam Walton still owns about half its market value of circa $400 billion.

Other holders of stocks are wide and varied, ranging from sovereign wealth funds, public and corporate pension funds, hedge funds, asset management firms investing through pooled funds, as well as direct investors who purchase stocks directly. The proportion of each broad category varies by country, to give an example, in China about 80% of stock market trading is estimated to be transacted by retail, or non-professional investors. In contrast, in the US, only about 10% of trading is done by retail investors, with the balance of 90% transacted by investment professionals.

The total amount of transaction activity conducted on a daily basis across all stock markets globally was estimated at $774.8 billion in 2021.

Active to passive

The most significant change in the structure of equity markets this century has been the growth in assets managed on a passive basis, a trend that accelerated post the global financial crisis of 2008. Passively managed strategies simply look to build a portfolio of the constituents of a particular benchmark to match the returns of that benchmark – for example simply matching the list of stocks in the S&P 500 at weights corresponding to their market weights. Active managers, on the other hand, aim to outperform a benchmark through selecting securities they believe will generate superior returns vs the benchmark. They seek to do so through the analysis and interpretation of publicly available information to determine which stocks, bonds or other traded instruments will outperform.

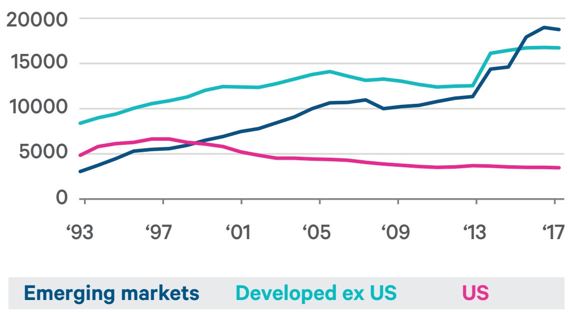
Arriving at a precise figure for assets managed passively is difficult, as investors invest across a variety of different vehicles including index funds, Exchange Traded Funds (ETFs) as well as separately managed accounts favoured by large pension funds and sovereign investors. Institutions that have sufficient scale in terms of the assets they manage often set up internal passive strategies and do not need to delegate these assets to an external manager.

Notwithstanding these challenges, the growth in assets managed passively has been substantial. According to Morningstar data compiled by trade association, The Investment Company Institute, assets in index funds alone grew to $11.4tn to the end of 2019, from $2.3tn a decade prior. This rapid growth in passive assets means that the answer to the question of, "Who owns the market?" changes over time, with active fund managers such as hedge funds now representing a much smaller proportion of the overall market.

Changes in publicly listed stocks

Another notable change within equity markets has been the decline in publicly listed stocks in the US, the largest and most liquid stock market. This however has been more than offset by growth in listings elsewhere, particularly in Emerging Markets as highlighted below.

Figure 2: Public stocks by region (1993 to 2020)



Source: Acadian Asset Management

In the US, the number of listed stocks grew from 4,530 in 1975 before peaking at over 7,000 in 1997. This has declined steadily since then and the number of US listed stocks now represents about half of the 1997 figure and still well below the number from almost 50 years ago. There are many views as to why US listings have declined, but a key factor has been the growth in private equity, allowing companies to continue to grow without the need to raise capital through an IPO process.

Implications for investors

The composition of the stock market changes over time as the largest stocks and sectors change when some industries go into secular decline, whilst others gain in importance. Investors should also be aware that the ownership of the stock market also changes and this has implications for market behaviour. In this article we have highlighted two major changes in market structure over the past quarter-century alone. It is worth remembering that stock market returns are not determined by a homogenous group, but instead represent the actions of a diverse group of global investors that together combine to determine the overall market return.

Warning: Past performance is not a reliable guide to future performance. The value of your investment may go down as well as up. These products may be affected by changes in currency exchange rates.

Warning: Forecasts are not a reliable indicator of future performance.

Market data

Total Return (%) in local currency	2018	2019	2020	2021	2022
Equities (local currency)					
MSCI All Country Local	-7.7	26.2	14.2	20.9	-16.0
MSCI World Local	-7.4	27.3	13.5	24.2	-16.0
MSCI Emerging Markets Local	-10.1	18.0	19.1	-0.2	-15.5
S&P 500	-4.4	31.5	18.4	28.7	-18.1
MSCI USA	-5.0	30.9	20.7	26.5	-19.8
MSCI USA Small Cap	-10.4	26.7	18.3	19.1	-17.6
MSCI Eurozone	-12.2	25.1	-2.2	23.6	-11.8
MSCI UK	-8.8	16.4	-13.2	19.6	7.1
MSCI UK Small Cap	-15.0	30.0	-4.9	14.5	-22.4
MSCI Ireland	-21.5	40.0	5.6	16.7	-21.4
ISEQ	-22.1	31.1	2.7	14.5	-15.8
ISEQ Financials	-31.8	-9.6	-27.3	38.7	69.3
Eurozone Banks	-33.3	11.1	-23.7	36.2	-4.6
MSCI Japan	-15.1	18.5	8.8	13.4	-4.5
MSCI Germany	-18.2	23.0	2.3	13.3	-17.3
NASDAQ Composite Index	-3.6	37.8	44.9	22.2	-32.5
MSCI Hong Kong	-8.5	10.8	5.3	-3.4	-4.6
MSCI China A Share	-29.3	39.5	31.5	0.9	-20.2
MSCI China	-20.3	20.4	26.7	-22.4	-23.5
MSCI USA Technology	-1.4	47.4	44.5	30.6	-30.6
MSCI China Technology		36.0	110.3	-30.4	-30.4
MSCI USA Real Estate	-8.6	20.9	-11.1	38.8	-27.3
MSCI China Real Estate	-30.3	29.6	-5.1	-14.6	-20.9
Global Equity Sectors					
MSCI World Energy	-13.4	10.3	-32.9	42.0	51.5
MSCI World Materials	-14.1	22.7	15.2	19.8	-6.4
MSCI World Industrials	-13.5	27.6	8.2	20.5	-9.4
MSCI World Consumer Disc	-4.9	26.4	33.8	20.9	-31.7
MSCI World Consumer Staples	-8.4	22.3	4.6	15.6	-3.0
MSCI World Health Care	3.6	22.9	11.0	21.9	-3.5
MSCI World Financials	-14.9	24.9	-5.4	30.4	-7.1
MSCI World Info Tech	-2.4	47.5	42.4	31.2	-30.1
MSCI World Comms Services	-8.2	27.2	21.6	15.8	-35.9
MSCI World Utilities	3.8	22.5	1.9	12.3	-2.2
Government Bond Yields					
US 10 Year	2.68	1.92	0.91	1.51	3.87
US 2 Year	2.49	1.57	0.12	0.73	4.43
German 10 Year	0.24	-0.19	-0.57	-0.18	2.57
German 2 Year	-0.61	-0.60	-0.70	-0.62	2.76
UK 10 Year	1.28	0.82	0.20	0.97	3.67
UK 2 Year	0.75	0.55	-0.16	0.69	3.58
Ireland 10 Year	0.90	0.12	-0.30	0.25	3.13

Warning: Past performance is not a reliable guide to future returns and future returns are not guaranteed. The value of investments and of any income derived from them may go down as well as up. You may not get back all of your original investment. Returns on investments may increase or decrease as a result of currency fluctuations.

Total Return (%) in local currency	2018	2019	2020	2021	2022
Bond Indices					
EUR Government Bonds	0.9	6.3	4.7	-3.4	-18.2
EUR Corporate Bonds	-1.3	6.2	2.8	-1.0	-13.6
UK Government Bonds	0.5	7.1	8.9	-5.2	-25.1
UK Corporate Bonds	-2.7	10.9	7.5	-1.5	-15.4
US Treasury Bonds	0.9	6.9	8.0	-2.3	-12.5
US Corporate Bonds	-2.5	14.5	9.9	-1.0	-15.8
Central Bank Rates					
European Central Bank	-0.40	-0.50	-0.50	-0.50	2.00
Bank of England	0.75	0.75	0.10	0.25	3.50
US Federal Reserve	2.50	1.75	0.25	0.25	4.50
Interest Rates					
EURIBOR 3 Month	-0.31	-0.38	-0.55	-0.57	2.13
LIBOR GBP 3 Month	0.91	0.79	0.03	0.26	3.87
LIBOR USD 3 Month	2.80	1.91	0.24	0.21	4.77
Currency Exchange Rates					
EUR-USD	1.15	1.12	1.22	1.14	1.07
EUR-GBP	0.90	0.85	0.89	0.84	0.89
GBP-USD	1.28	1.33	1.37	1.35	1.21
GBP-EUR	1.11	1.18	1.12	1.19	1.13
USD-CNY	6.88	6.96	6.53	6.36	6.90
Commodities					
Bloomberg Commodity Index	-11.2	7.7	-3.1	27.1	16.1
Gold	-2.8	18.0	20.9	-4.3	-0.7
Silver	-10.2	13.9	42.5	-12.3	2.6
Platinum	-14.8	21.6	8.5	-11.4	14.0
Brent Crude Oil	-15.3	37.7	-35.1	63.0	36.5
WTI Oil	-20.5	34.1	-60.3	62.2	27.6
Natural Gas	4.8	-32.3	-45.9	35.1	19.8
Copper	-16.8	4.7	25.3	26.0	-11.2
Wheat	3.5	9.4	10.3	14.1	-2.7
Corn	-4.1	-5.5	13.8	40.4	24.9
Soybeans	-9.9	0.1	33.5	13.9	28.1
Crypto					
Bloomberg Galaxy Crypto Index	-81.1	7.1	276.7	153.4	-70.2
Bitcoin	-74.3	94.8	305.1	59.8	-64.2

Source: Data is sourced from Bloomberg as at market close 31st December 2022 and returns are based on price indices in local currency terms, unless otherwise stated.
*Figures are price return as total return unavailable for certain indices.

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