RAYMOND JAMES

"Six Characters in Search of an Author"

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Just as the playwright Luigi Pirandello asked his audience to participate in an immersive experience in his theatrical masterpiece, so we too participate in an equally immersive way in the great drama unfolding in the financial markets. Ours is a performance not being played out on a stage, but about us and in the round, and one in which we are all profoundly engaged. The curtain has risen on 2023 and the action has been explosive from the very start. No slow build this year; from the off, stocks and bonds have seemingly cast the worries of 2022 to one side. The action is enthralling and the plot lines complex. How might 2023 play out? Who, or what, will prove the most compelling actors? Despite the revival, no clear themes are as yet apparent. Guards are up but as yet new commitments are limited. We're enjoying the show, but we wonder what might happen next.

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When casting around for the apparent trigger event serving to propel markets higher, one character emerges as an unlikely deus ex machina: China. Amidst a slew of better-than-expected news pertaining to the global economy, it was the Chinese authorities' abrupt 26th December decision to cast the country's long-held and economically debilitating "zero-Covid" policies to one side that transformed sentiment and lit the blue touch paper. In fairness, Beijing's ability to maintain its aggressive position had long been in doubt, but the timing and extent of the policy U-turn caught everybody by surprise.

Freed from its shackles, the hitherto moribund Chinese economy seems sure to deliver a strong rebound over the next twelve months. Yet this, in turn, poses as many questions as it answers. Yes, the resuscitated economic behemoth will likely transform a previously moribund global economic outlook, but what might the wider implications be? Is China a friend or foe? How serious are fears of economic and geopolitical fragmentation, the converse of earlier globalisation aspirations, stalking the corridors of Davos? Will global supply chains survive intact, serving further to ease already ebbing headline inflationary pressures? Or will Chinese demand fill the void created by slowing economies elsewhere, keeping prices higher and for longer in consequence?

One key battleground will surely be across the commodity complex. This really matters to investors in the UK stock market, given the historically high weighting accorded to energy and other basic resources in the country's benchmark index. The UK's resilient equity market stands in stark contrast to its subdued economic performance. It is noteworthy indeed the extent to which shares in the largest international companies headquartered in Britain have attracted admiring glances from overseas, especially when handy dividend payments are added to the mix.

Might one of those tall, handsome strangers be the United States? For a decade or more, the US dollar's persistent strength on the foreign exchanges has served to support superior returns from domestic financial assets, but with dollar hegemony under attack and economic activity showing clear signs of moderation, might a new era be at hand? Professional investors think they know and speculative bets against the US currency have been piling up, just as they have in favour of the resurgent euro, and Japanese yen.

Is this a significant plot turn or yet another of the red herrings littering the landscape in 2022? US currency weakness is not all bad news after all. Those multinational businesses located in the US are already benefiting from the translation of sales and earnings derived from overseas back into the dollar. This may yet ensure that the headwind thought most likely to derail the stock market's revival proves less destructive than expected.

Pantomime villains or white hat-wearing saviours? The world's most powerful central bankers certainly view themselves as the latter and certainly seem to enjoy their time in the spotlight. Financial markets are not so sure. For months now, this most important of cabals have rolled up their sleeves and got busy pulling levers and pressing buttons (notably not those on the printing presses anymore), raising interest rates the world over in a headlong attempt to head off inflationary pressures in part of their own making. Driving down demand is a painful process and takes time to gain traction. The lagged impact of earlier policy tightening is already percolating into real economies to the extent that Western activity is suffering a pronounced slowdown. The more encouraging counterpoint to this is that the desired effect, slowing inflation, is beginning to feature more prominently on the backdrop.

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How long might it be until central bankers believe that their work is done? Likely not too long now and irrespective of periodic darkly muttered asides, an increasingly restive investor audience is becoming more convinced than ever that they know how this story will end, and that it will end well. Seldom have leading actors had their credibility called into question as now. Gone is the axiomatic belief that one should never bet against the Fed, or its systemic counterparts the Bank of England and European Central Bank. When finally all plot threads are pulled together and the last curtain falls, it will surely be the audience leaving happiest of all.

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