

Monthly Musings

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Whistling Past the Graveyard?

If you just looked at how global equities have started the year you might think everything was hunky dory. The MSCI All Country World Index is up 8% through 5/12/23...and the Nasdaq is up an impressive 18%.¹ Hardly the performance one might expect in the wake of a few high profile and significant bank failures. So, are the collapses of Silicon Valley Bank, Credit Suisse and First Republic just one-offs? Just specific cases of really poor management...or something more systemic? It appears to be more of the former but, if confidence is lost in the inherently leveraged banking system, the repercussions would be significant. At the very least, one could reasonably expect a tighter credit environment, and this could nudge us into the recession that many economists have predicted is coming.

At a 19 P/E on expected 2023 earnings estimates, the S&P 500 is discounting some fairly rosy outcomes, in my opinion.²

- No banking crisis.
- Credit doesn't tighten due to recent banking woes.
- The Federal Reserve is not only done raising short-term rates but, will also cut several times in 2023.
- Intermediate and long-term interest rates stay at this level and then decline.
- Overall profit level and profit margins stay elevated.
- Commercial real estate gets through its re-financing wave swimmingly (\$1.5 trillion of CRE debt is coming due by 2025).³

I would argue that we don't need just one or two of these to hold in order to justify the market at current levels...we need all of them.

The graphs below show that the S&P 500 is not cheap to start with...and, the "E" in the P/E may face some pressure. In fact, Morgan Stanley believes the earnings forecast has 10 – 20% potential downside from current estimates.⁴

Overall, we may just be in a purgatory of sorts...I still believe 2023 will be full of sound and fury, signifying nothing, i.e., global equities might just end up relatively flat after going both positive and negative intra-year. The implication, of course, is that equities get weaker from here.

S&P 500 Historical P/E Ratio

S&P 500 Trailing Price/Earnings Ratio with Historical Median

January 31, 1965, to April 28, 2023



Source: Morgan Stanley ChartBook (See disclosures below)

Cyclically Adjusted P/E Ratio (CAPE)¹ vs. S&P 500 10-Year Trailing Annualized Total Return

As of April 28, 2023



Source: Morgan Stanley ChartBook (See disclosures below)

Where are the Opportunities?

On the equity side, I continue to believe that global value still looks attractive looking out over the next cycle (whenever that may start). Growth stocks, particularly mega cap growth stocks, are simply too highly valued to make any money for investors over the next 12 – 24 months from current levels, in my opinion (see graph below). Let's not forget that, at the end of the day, all companies make the same thing...cash flow. Once adjusted for growth and stability, the cash flow from selling a smart phone or cloud computing services, for example, isn't worth any more than cash flow from selling petroleum products or pharmaceuticals.

Relative Performance of Value vs. Growth

Trailing 10-Year Annualized Total Returns: MSCI World Value Index less MSCI World Growth Index*
Monthly data as of April 28, 2023



Source: Morgan Stanley ChartBook (See disclosures below)

On the income side, BBB & BB rated 2 – 4 year corporate bonds look good with their decent yields and minimal interest rate risk. Energy infrastructure/pipeline companies also look good. Outside of the U.S., emerging market bonds offer above average yields and many of the EM countries are ahead of the US Fed on the monetary policy front and we may actually see interest rate cuts in some countries. Brazil, for example, has an overnight rate of 13.75% and the newly elected president is calling for significant cuts to this rate to help the Brazilian economy.⁵ He may have a point given that the real rate in Brazil (net of inflation) is almost 10%...this compares to a real rate of around 0% for the U.S. federal funds rate.^{6,7}

On the alternative investment side (for qualified investors), the normalization of monetary policy has potentially re-introduced a healthy environment for active investment strategies in general. Quality hedge fund strategies may be able to generate positive returns even if equity indices don't make much headway. Elevated volatility also typically helps active strategies.

See My Previous Investment Commentaries here:

<https://advisor.morganstanley.com/benedict-mcloughlin-group>

***Tactical Allocation Strategies in my Global Growth and Global High-Income Model Portfolios:**

Overweight

Global Value Equities, Long/Short Equity Strategies, Quality Dividend Paying

Underweight

High P/E technology/growth stocks, Mid

Global Equities, Emerging Market
Consumer Equities, Total Return
Strategies, Shorter-term Corporate
Bonds

and Long-Term Fixed Income

* These weightings do not consider each client's unique profile, preferences and/or constraints and therefore may not be applicable to you.

The Benedict-McLoughlin Group always strives to use sound judgment...at every decision point.

We bring experience, credentials, and tenacity which we expect to continue to enable us to help achieve our clients' goals over time.

Regards,
Chris

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The Benedict-McLoughlin Group – “Institutional Caliber Portfolio
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Notes:

1. Bloomberg Markets, 5/14/23
2. Bloomberg Markets, 5/14/23
3. Bloomberg News 5/4/23
4. Morgan Stanley, Daily Positioning, 5/11/23
5. Bloomberg News, 5/4/23
6. Bloomberg News, 5/13/23
7. Bloomberg Markets, 5/10/23

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Chartbook Source: FactSet, Morgan Stanley Wealth Management GIC. (1) The cyclically adjusted P/E ratio (CAPE), also known as Shiller P/E ratio, uses a 10-year average of inflation-adjusted earnings to value the stock market. Historically, cyclically adjusted price-earnings ratios have led subsequent returns with a 10-year lag. Recent price earnings levels suggest equity returns could be better going forward than they have

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