SEASPRAY PRIVATE

Creating Investment Solutions

INTERIM INVESTMENT UPDATE

May 2023

Introduction

Q2.... As We Move to Peak Interest Rates... A Robust and Resilient World Economy...

As we make our way through the second quarter, US equities are up by just over 8% year-to-date, while European markets have appreciated by 15%, both in local currency terms. The S&P 500 and the EuroStoxx 50 indices have each seen one of their strongest starts to a year in over a decade. Recently it has been a case of the larger you are the better you have performed, at least with regard to US stocks. The ten largest holdings in the S&P 500 have contributed heavily to its return YTD and now account for approximately 25% of the index. It is worth noting that so far, 2023 has largely been a mirror image of last year, with both equity and bond markets making, and holding on to, most of the gains made early in the year.

Of course, certain new risks have become apparent in 2023, and we will explore some of these later on in this document. However, investors for the most-part have remained positive and risk assets have remained resilient, even in the face of higher interest rates and the prospect of a US recession towards the back end of the year. Corporate earnings have been stronger than expected, Europe has avoided a winter recession that was forecast and feared by many, and policymakers have been quick to step in when concerns were growing around US bank deposits.

Globally, the disinflationary process is well underway, though we believe continued service price pressures may require central banks to sustain higher rates for longer than is currently expected by the market. The rapid rise in interest rates over the past year or so has undoubtedly prompted stresses in the financial system to appear, in the form of failing US regional banks. As we have recently highlighted in our Q1 Update, monetary policymakers are indeed in a difficult position whereby they need to maintain the focus on price stability and reduce inflation back towards 2%, but without causing lasting negative effects to the economy in the process of doing so.

We would like to state that we believe any potential recession seen in the US or beyond during the second half of this year would be mild in nature. Q1 real GDP results for both the Eurozone and US came out in positive territory, employment still remains close to full across developed markets, and households still have excess cash savings left over from the pandemic era despite the higher cost of living seen over the past 12 months.

	1-Month	YTD	1-Year
Equity Indices			
S&P 500	0.1%	8.3%	6.6%
Nasdaq	2.8%	19.4%	9.8%
DAX	1.9%	16.4%	16.7%
EuroStoxx 50	-0.5%	15.3%	20.1%
ISEQ	4.0%	22.5%	21.6%
FTSE 100	-1.8%	4.2%	6.3%
Multi-Asset Funds			
Aviva Multi-Asset ESG 3	-0.3%	2.0%	-2.5%
Irish Life MAPS 3	0.2%	2.7%	-0.4%
New Ireland iFunds 3	0.3%	2.1%	-1.0%
New Ireland PRIME 3	0.4%	2.1%	-1.7%
Zurich Prisma 3	0.6%	2.8%	-0.7%
Aviva Multi-Asset ESG 4	-0.1%	2.9%	-1.4%
Irish Life MAPS 4	0.3%	3.3%	0.3%
New Ireland iFunds 4	0.4%	2.9%	-0.3%
New Ireland PRIME 4	0.5%	3.1%	-1.1%
Zurich Prisma 4	0.8%	4.5%	-1.1%
Aviva Multi-Asset ESG 5	0.1%	3.9%	0.1%
Irish Life MAPS 5	0.2%	3.7%	-0.3%
New Ireland iFunds 5	0.4%	3.6%	0.3%
New Ireland PRIME 5	0.4%	3.6%	-0.3%
Zurich Prisma 5	0.9%	6.3%	-0.2%
Bonds			
US Government Bonds	0.5%	2.4%	-2.1%
US Corporate Bonds	-1.4%	1.7%	-3.6%
European Government Bonds	0.6%	2.8%	-8.4%
European Corporate Bonds	0.5%	1.8%	-5.4%
Currencies			
EUR/USD	-1.3%	1.1%	2.2%
EUR/GBP	-1.3%	-1.7%	2.3%
GBP/USD	0.0%	2.9%	-0.1%
USD/JPY	2.3%	5.1%	7.8%
Commodities			
Gold	-1.1%	8.2%	7.4%
Brent Crude Oil	-7.8%	-10.8%	-31.6%

Source: Seaspray Financial, May 2023

Global Economy

"At Seaspray we remain optimistic that consumer inflation can and will see a sustained moderation over the next year..."

One of the impressive features of the past quarter has been just how robust the world economy has shown itself to be, despite fears to the contrary. Yet, while the much talked about recession hasn't arrived, growth has weakened. First quarter GDP for the United States was mildly disappointing, coming in at an annualised 1.1% versus market expectations for 2.0%. This was the weakest pace of expansion that the nation has seen since Q2 of last year, as business investment growth slowed down, inventories declined and rising interest rates continued to hurt the housing market. Still, consumer spending growth rose from 1.0% in Q4 to 3.7%, despite stubbornly high inflation. Public spending also increased at a faster pace of 4.7%.

First quarter GDP was also recently released for the Eurozone. Much the same as the US, while it turned out better than feared six months ago, the result marginally disappointed with regard to analysts' expectations. As can be seen in the table below, the region's economy expanded by 0.1% q/q against a consensus view for 0.2%. Germany saw no growth in the first quarter, while the Netherlands and Ireland experienced contractions. France, Italy, and Spain saw expansion during the period. The bloc's economy has clearly had to deal with quite a lot, including but not limited to the ongoing war in Ukraine as well as sticky core inflation and an ECB who have plans to hike rates further. While 0.1% q/q was the figure that made the headlines, if we look at Q1 growth from a year-over-year perspective we can see that the Eurozone in fact registered a 1.3% result, slightly below expectations of 1.4%.

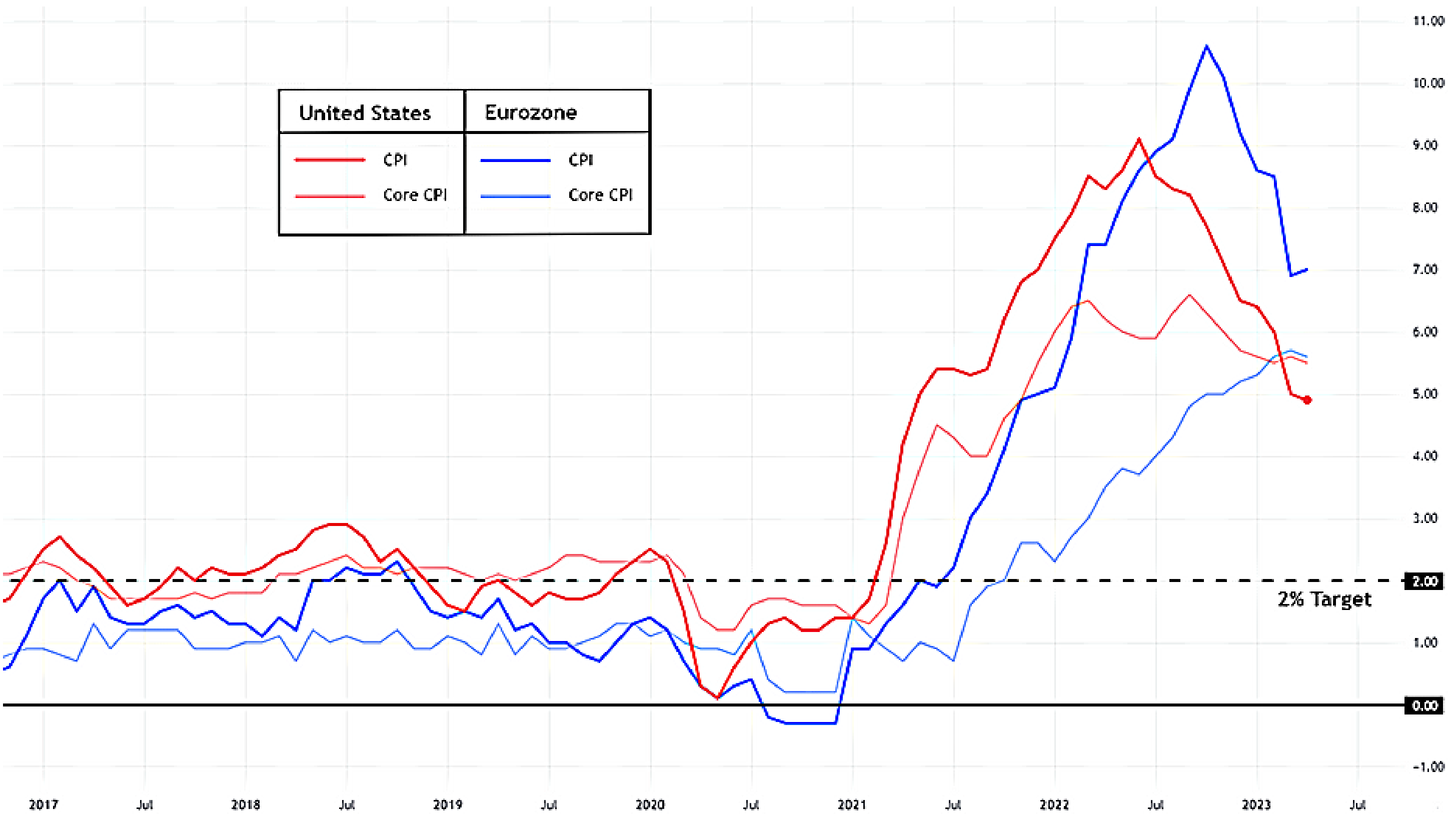
	United States	Eurozone
Q4 GDP	2.6%	0.0%
Q1 GDP forecast	2.0%	0.2%
Q1 GDP actual	1.1%	0.1%
Composite PMI (March)	52.3	53.7
Composite PMI (April)	53.4	54.1

Source: Seaspray Financial, May 2023

In terms of slightly more up-to-date growth data, we do have PMI (Purchasing Managers' Index) figures for the month of April. PMI data gives us an indication of what companies are intending to do, and when these results expand it is normally a strong indicator the economy will follow. As highlighted in the table above, both the Eurozone and United States saw their composite results come out stronger than in March. Encouragingly, this reading for the US showed a solid upturn in private sector business activity which grew at its fastest pace since May 2022. However, price pressures did regain momentum across the US economy, as both input and output costs rose at sharper rates.

The Eurozone composite PMI has now seen six consecutive higher results, and has been above the 50.0 expansion/contraction line now for four months. Much like in the US, it is the services sector that is far outperforming manufacturing. If we take a look at the Euro area's services PMI for last month, it increased to a 12-month high of 56.2, while the manufacturing PMI fell deeper into contraction at a depressed 45.8. With high levels of savings still somewhat intact from the pandemic period, consumers who had been spending on goods are now increasingly spending on services despite an apparent falloff in consumer confidence. Also, supply lines that had been damaged in the Covid-19 period are now mostly restored and the reopening of China has given the world another source of demand so far this year.

Regarding inflation, we have not seen a huge amount of new data since the release of our Q1 Investment Update document and podcast in early April. The main point to note here is that the stickiness of core inflation (which excludes the volatile food and energy price changes) has become a central policy issue for the likes of the Federal Reserve, ECB, and BOE. As can be seen on the chart below, the US core CPI (Consumer Price Index) reading for April moved only marginally lower to 5.5%, while the Eurozone's figure came in at 5.6%. As we have alluded to in past updates, these data points will be very closely watched by investors over the coming months, and will be key factors in determining the near-term direction of monetary policy.



Source:Seaspray Financial, May 2023.

At Seaspray we remain optimistic that consumer inflation can and will see a sustained moderation over the next year. On the producer side, we are seeing inflation decline rapidly, and this often acts as a leading indicator for consumer prices. This is because when producers face input inflation (or in this case, disinflation), the increases (or decreases) in their costs are usually passed on to consumers. In the US, the headline PPI (Producer Price Index) rate has fallen for ten consecutive months and is now back down to just 2.3%.

We are also seeing this trend play out elsewhere. Spain, Portugal, Norway, Canada, India, China, and Brazil all saw their most recent PPI results come out in negative territory – which means they are officially in the deflation camp. Many of these mentioned countries tend to be leading in the inflation cycle due to their commodity linkage. Commodity inflation leads goods inflation, which then leads services inflation, so while there may be a slight lag, we do anticipate lower CPI readings for the main developed regions over the next few quarters.

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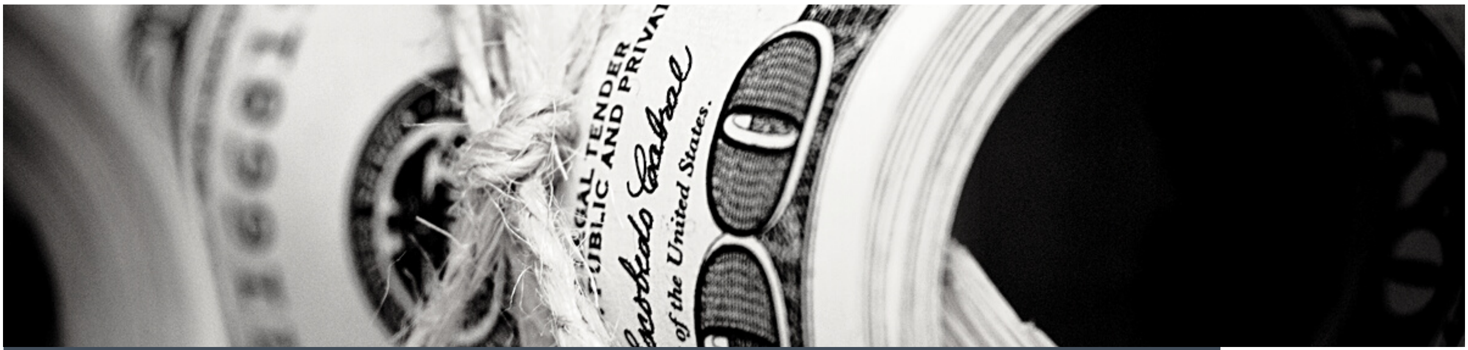


Market News: US Banks... and the Debt Ceiling... Again!

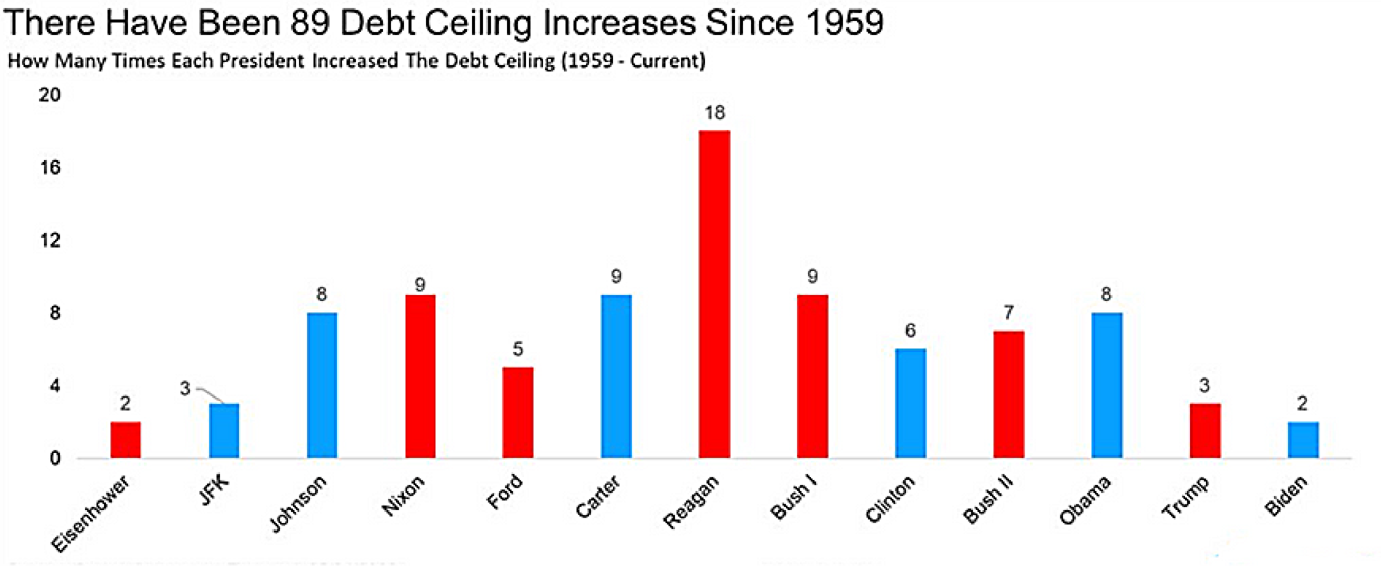
While the risk of a widespread banking crisis faded as we moved through April and into May, we did still see the failure of First Republic, another medium-sized California based lender, who was taken over by JP Morgan. Following this move, market expectations began to grow that this would mark the resolution of the recent uncertainty across the sector. In the meantime however, other regional banks have come into focus with speculation building that some of these are considering strategic options and engaging in acquisition discussions. As a result, America's now-infamous KBW Regional Banks index has now fallen by another 6% since the beginning of the month and is down by over 26% YTD. While overall market sentiment has remained quite resilient, these banking sector developments will likely continue to lead to tighter lending standards, which in turn makes an economic downturn in H2 more probable.

There is one key difference between the mid-March mini-crisis and the further banking turmoil seen in recent weeks - it is now the shareholders of these regional banks that are showing signs of concern, not necessarily the depositors anymore. The FDIC (Federal Deposit Insurance Corporation) rescues that we witnessed back in March did importantly protect depositors in struggling US regional banks, but at the cost of wiping out many equity holders. Thus, what we saw in April and May was actually more of an anticipatory sell-off of regional banks' shares, rather than a continued withdrawal of deposits. The most recent news on this topic last week would suggest that deposit levels have in fact been robust, and even grown in some cases, across the regional banks in May.

We would also like to point out that profits in the US banking sector actually reached an all-time high of roughly $80 billion during the first quarter, up 33% y/y, even as the industry contended with the aftermath of two bank failures in March and the most significant stress it has seen since the 2008 financial crisis. Stronger numbers from First Citizens and Flagstar did boost this overall result, after they acquired the remnants of SVB and Signature Bank. However, this jump in profits did also demonstrate that banks in the country experienced positive effects from higher interest rates, minimal loan defaults, and a growing job market – all despite concerns among depositors and investors in March.

Another topic that clients will have come across in recent weeks is that of the US debt ceiling. This is essentially a limit set by the US government itself on the amount it can borrow through the issuance of Treasury bonds. When they approach this limit, which is currently at $31.4 trillion, Congress has to all agree to extend the debt ceiling. In reality, the debt ceiling debate is a political struggle between Democrats and Republicans as election campaigns move into gear. There has been some push-back from Republicans who are against more borrowing, and as a result there may be no chance of an agreement to raise the ceiling unless Democrats offer some concessions.

We have seen comments being made by the US Treasury Secretary Janet Yellen over recent weeks that the limit could be reached as soon as early-June due to the lower than expected levels of tax collection year-to-date. While differences between the Democrat and Republican parties appear to be at historical extremes, we still believe the most likely outcome is a deal to raise the ceiling accompanied by spending cuts and certain tax increases. We are not hugely concerned about a United States default at this point in time. We have been here before many times. Congressional leaders in both parties have always recognized that this is necessary and the debt ceiling has been raised 89 times since the late 1950s, as can be seen below.



Source: Carson Investment Research

"One of the main areas of concern seems to be US office real estate, where vacancies are now at their highest levels in thirty years. Low occupancies and sharply higher rates over the past year, as well as a recent tightening in lending standards, have weighed on these property prices...."

One other risk of note relates to the commercial real estate (CRE) sector. CRE in the US and Europe has become a point of discussion for some market commentators this month, many of whom are anxiously awaiting a potential further sign of vulnerability to show up in the global economy after the collapse of certain US regional banks. This list of commentators included Berkshire Hathaway's Warren Buffett and Charlie Munger, which of course brought the matter to the attention of many.

One of the main areas of concern seems to be US office real estate, where vacancies are now at their highest levels in thirty years. Low occupancies and sharply higher rates over the past year, as well as a recent tightening in lending standards, have weighed on these property prices. We also must note that many CRE loans will need to be refinanced at higher rates over the coming quarters. This year's failures of Silicon Valley Bank, Signature Bank and First Republic have raised some worries about other regional banks that account for the bulk of commercial real estate loans in the States.

This issue may resurface over the coming months for financial markets, and we will continue to remain attentive to it as we move forward.

Monetary Policy

Federal Reserve

As expected, the Federal Reserve raised its benchmark interest rate by a quarter of a percentage point at the beginning of the month, which has brought the Fed Funds target range up to a 15-year high of 5.00 – 5.25%. Policymakers hinted that a pause in rates could be likely at the next meeting on June 14th, with this month's monetary policy statement making no suggestions that another rate increase will be required. ***This comes after the US central bank has raised rates by 5% over ten consecutive meetings spanning fourteen months.***

With this move on rates already well priced into US and global financial markets, investors' main focus was on what the Fed Chair Jerome Powell had to say. Commenting on the ongoing banking mini-crisis, Powell stated that "conditions in that sector have broadly improved since early March, and the US banking system is sound and resilient". Importantly, when asked about reversing policy, the chairman said the Fed's view suggests "inflation is going to come down not so quickly. It will take some time... if that forecast is broadly right, it would not be appropriate to cut rates". We believe the Fed will pause rates at these levels for several months and reassess the state of the US economy over the summer. Inflation figures due out from the region over the next couple of months will be crucial in this regard.

While we did not get updated economic projections from the central bank this time around, the most recent March forecasts showed that most Fed members saw rates of at least 5% by year-end, and none were anticipating a cut in 2023. The labour market remains very strong and even though headline inflation has fallen back since last summer, core inflation is proving sticky and much slower to decline.

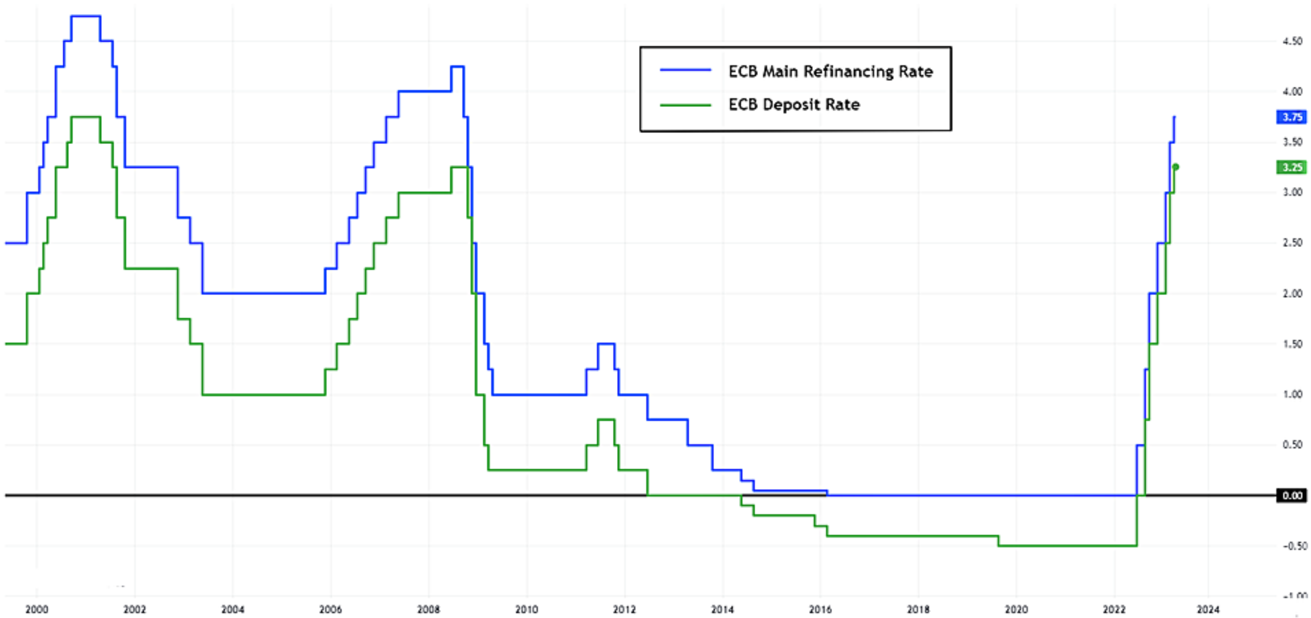
However, investors are at odds with policymakers at present, and the market is currently pricing for the first rate cut to come in Q4 with a series of 25bp cuts to come thereafter. The stresses that have emerged in the US regional banking system are expected to result in a tightening of credit conditions, suppressing growth and reducing inflation. This, in turn, has added to the belief that the US central bank will ease monetary policy before the year is out. It is worth pointing out that the average time between the final Fed hike in the cycle and the first cut over the past 50 years has been 6 months.

"....the central bank likely has more ground to cover and will not be pausing at this juncture."

ECB President Christine Lagarde

European Central Bank

Similar to the Federal Reserve, the European Central Bank raised its interest rates by 25 basis points in early May, bringing the region's Deposit rate to 3.25%, Main Refinancing rate to 3.75%, and Marginal Lending rate to 4.00%. This was the ECB's seventh consecutive rate hike, and comes after the last three increases which were 50bp each. As things stand with the headline Eurozone CPI increasing to 7% in April and the core rate still at 5.6%, it is looking like this will not be the last hike.

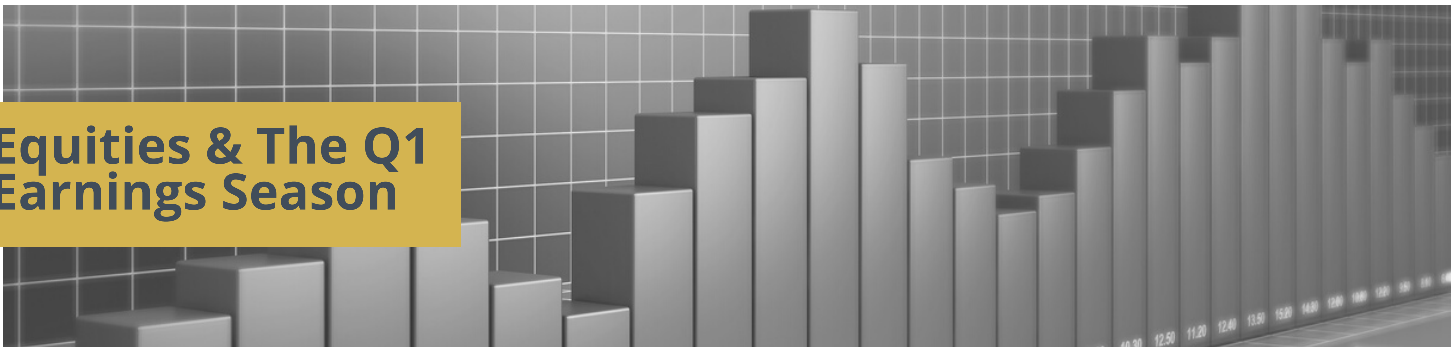


Source: Seaspray Financial, May 2023.

Unsurprisingly, ECB President Christine Lagarde reiterated the messaging that the central bank will need to be data-dependent and await further economic releases before they can give any meaningful forward guidance. However, she did also state that the central bank likely has more ground to cover and will not be pausing at this juncture. Clearly, ECB officials are firmly focused on their fight against inflation, and in particular, core inflation. The ECB also made it clear that future decisions will ensure that policy rates will be brought to levels sufficiently restrictive to cause significant disinflation.

The ECB also said it will stop reinvesting cash from maturing debt in its €3.2 trillion Asset Purchase Programme from July onwards. This means it will allow its balance sheet to reduce over time, which is a direct form of quantitative tightening.

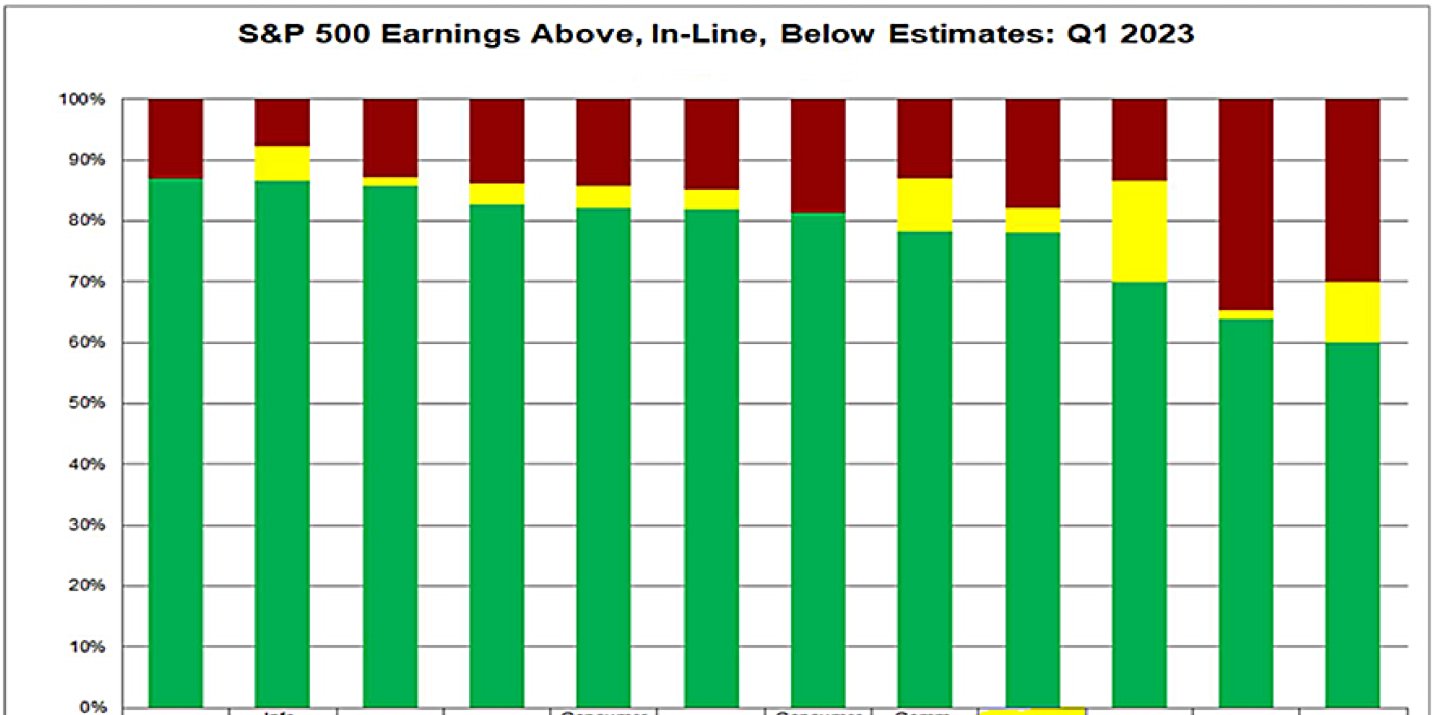
The next monetary policy report from Lagarde and her team will come on June 15th, when we will also get the quarterly release of the ECB's latest macroeconomic projections. March's forecasts, which were compiled before the emergence of tensions in the banking sector, showed an upwards revision to the Eurozone 2023 GDP projection from 0.5% to 1.0%. The ECB reduced its inflation forecast for 2023 from 6.3% to 5.3% in the same report. For 2024, the inflation forecast was revised down from 3.4% to 2.9%. Nonetheless, there is an upside risk to these projections due to the persistence of core inflation.



Equities & The Q1 Earnings Season

As we come to the end of the first quarter earnings season, it is worth reviewing where corporates currently stand, and which sectors have beaten or missed market expectations. One of the main risks for equity markets that we have highlighted over the past 6+ months has been the possibility for disappointing Q4 2022 and indeed Q1 2023 earnings seasons. So far, corporates have generally held up well during this economic slowdown, with developed-market equity indices beating EPS and revenue forecasts in most cases.

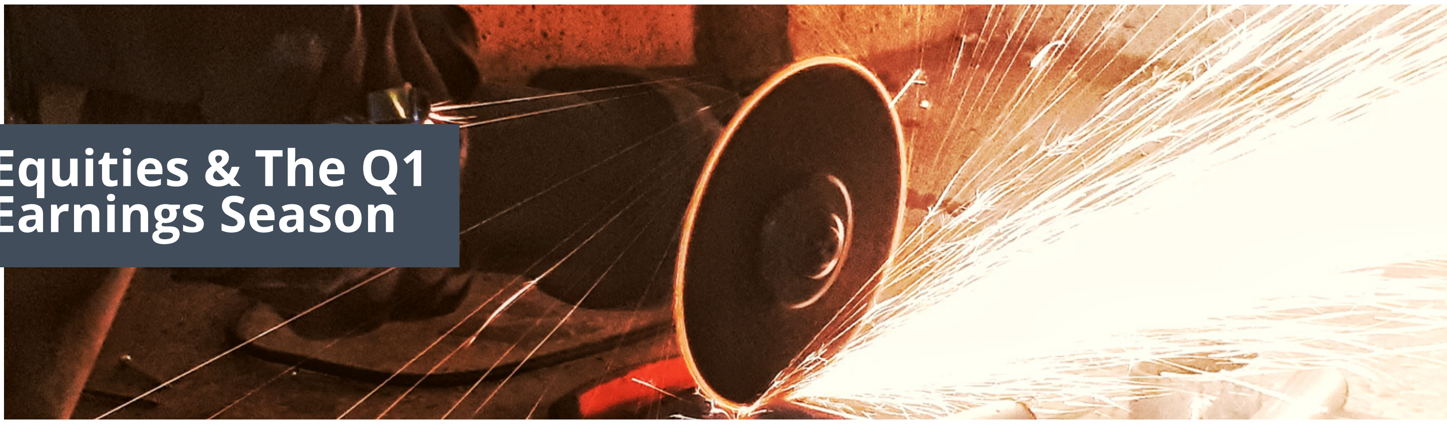
As can be seen on the graph below, 78% of names within the S&P 500 (highlighted, fourth from the right) have actually reported a positive earnings surprise, with 4% in line with analysts' estimates (as shown by the yellow part of the bars) and 18% of companies missing forecasts (red bars). This 78% result compares with the index's 10-year average of 73%, and is the best performance relative to analyst expectations since Q3 of 2021. The largest contributors to the positive earnings surprise were JP Morgan Chase, Microsoft, Pfizer, Apple, Exxon Mobil, Amazon, Bank of America, Ford, General Motors, Moderna, and Alphabet. In general, banks have fared much better over the first quarter, large-cap technology names have delivered outstanding results against analysts' expectations, and consumer-focused businesses are showing they still have pricing power.



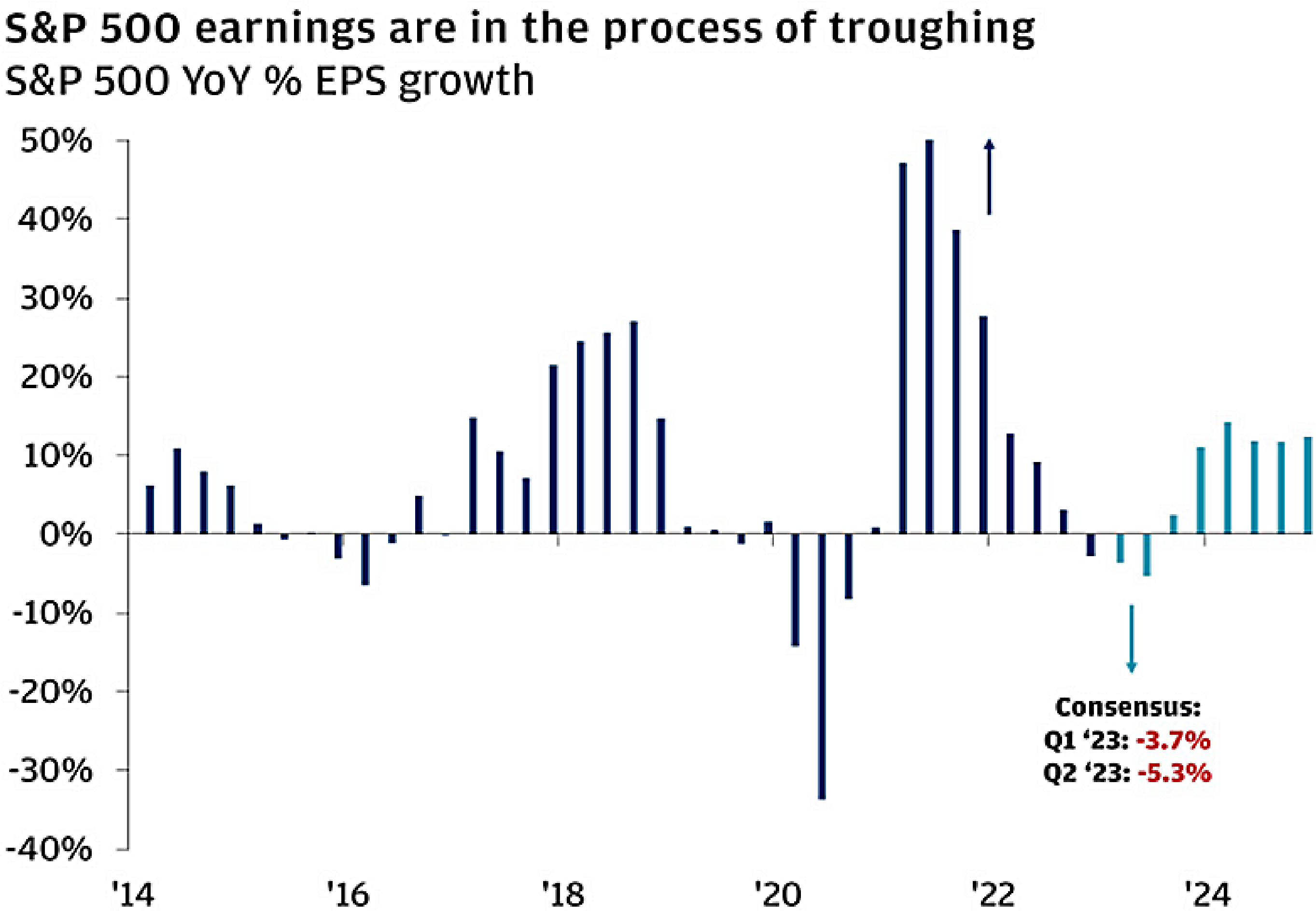
	Energy	Info. Technology	Industrials	Materials	Consumer Staples	Health Care	Consumer Disc.	Comm. Services	S&P 500	Real Estate	Financials	Utilities
Below	13%	8%	13%	14%	14%	15%	19%	13%	18%	13%	35%	30%
In-Line	0%	6%	1%	3%	4%	3%	0%	9%	4%	17%	1%	10%
Above	87%	87%	86%	83%	82%	82%	81%	78%	78%	70%	64%	60%

Source: Factset

Equities & The Q1 Earnings Season



The S&P 500 is currently reporting a less severe EPS decline than was expected at the beginning of this earnings season. The blended growth rate (combines actual results for companies that have reported along with expected results for the few firms yet to report) for the three-month period stands at -2.5% y/y today. This is well ahead of forecasts at the end of Q1 for an earnings decline of -6.8%, and ahead of the -3.7% that was expected just a couple of weeks ago. This would mark the second consecutive y/y EPS decline for US companies, with a -5.3% EPS trough currently forecast for Q2 earnings (as can be seen below) before we rebound during H2 back into positive territory.



Source: JP Morgan Private Bank, Morgan Stanley, FactSet

Equities & The Q1 Earnings Season

Taking a look at European first-quarter earnings: the EuroStoxx 600's blended earnings growth rate is currently at a positive 7.3% y/y, with the financials, technology, and utilities sectors all registering robust growth. 65% of the firms that have reported so far have exceeded analysts' expectations, compared to a typical quarter when only 53% would beat estimates. The market is looking for European companies' earnings to pull back to circa -3.7% y/y in the current quarter, followed by a recovery and a return to positive territory by Q4.

We believe European equities will likely continue their outperformance versus the US over the next few months. Fundamentals and valuations have further room to normalize in Europe, in our view. For example, the S&P 500's 12-month forward-looking P/E ratio stands at 18.0x at present, between its 5-year average of 18.6x and 10-year average of 17.3x. Conversely, the EuroStoxx 600 index currently has a forward-looking P/E of 12.7x, which even after the region's strong performance YTD is still below its 10-year average of 14.4x.

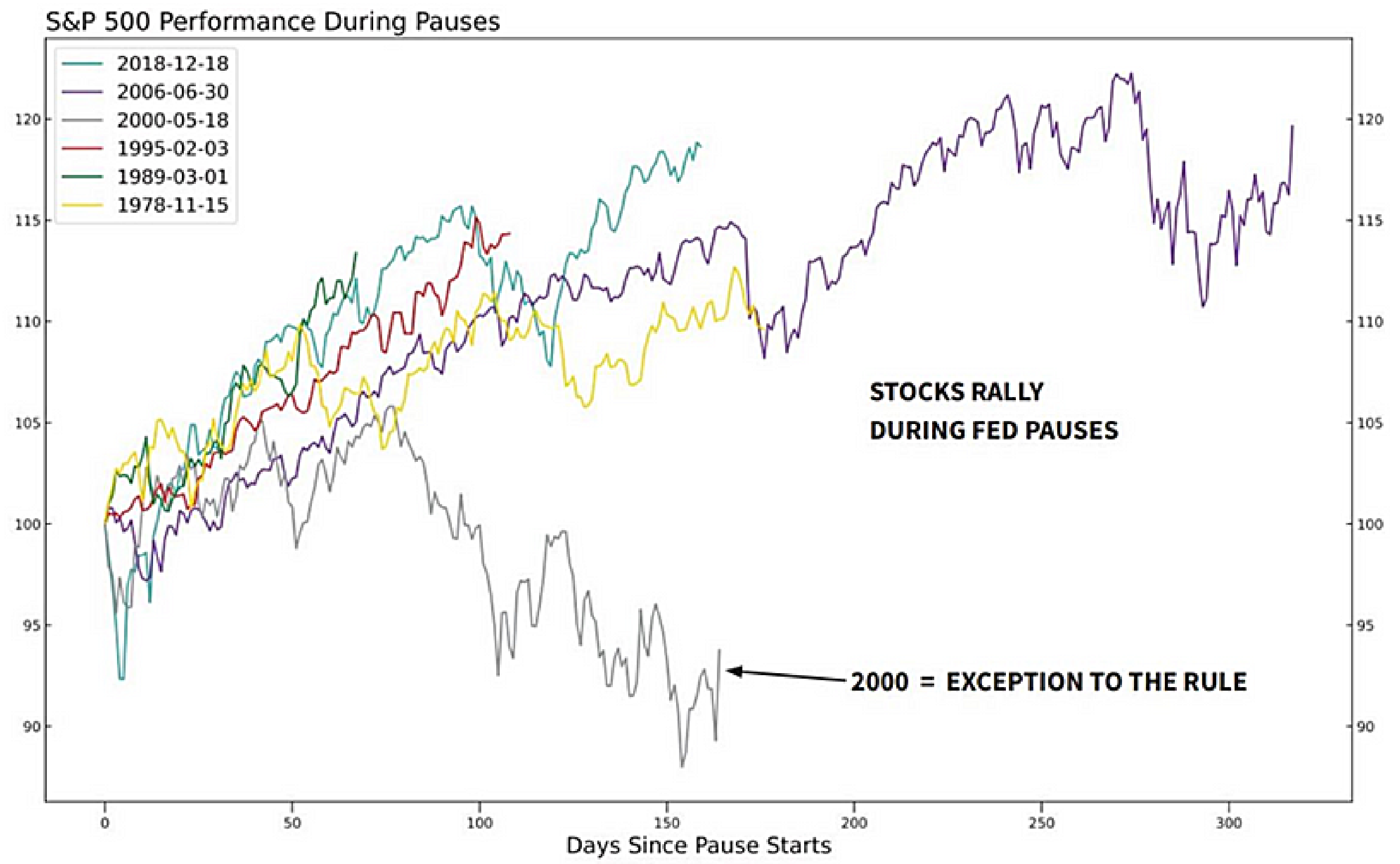
We also see two major macroeconomic supports for Europe at this point in time. Firstly, we see less downside risk to the European economy over the remainder of this year than we do for the US – where many of the traditional economic leading indicators are approaching or are down near recessionary levels. In contrast, similar metrics for Europe such as consumer confidence have actually been rising lately. In addition, a healthier and more resilient banking sector in Europe would suggest to us there is potentially less risk of a credit crunch developing here than we see in the States.

Secondly, Europe is also seen as an alternative way to get exposure to the broad economic recovery in China, given that the region has stronger economic ties as well as greater stock market exposure to China than most of its developed-market peers would have. In recent months we have clearly seen this theme benefitting certain industries within Europe such as luxury goods – which have arguably become one of the most popular ways to express a positive view on China globally. Notwithstanding these relative advantages, we do acknowledge that there is also the potential for some small pullbacks in European equities over the next few months, after what has been such a robust first four and a half months of the year. Negative risks from the US could possibly outweigh the positive risks from China and Asia in the short-term, but we would see this as an opportunity to allocate further capital to the region.

Equities & The Q1 Earnings Season

In our '2023 Investment Outlook', we spoke about the likelihood for an interest rate pause from the Federal Reserve at some stage this year, and we explored the positive effects that this should have on the bond market. For context, core bonds since 1984 have generated average 6-month and 1-year returns of 8% and 13%, respectively, after the Fed stopped raising rates. Below, we take a look at how equity markets tend to perform during this same scenario.

While stocks will typically soften during the hiking cycle itself, the chart below demonstrates that they generally rally post-pause. It relates to the last six times the Federal Reserve has paused after a rate hiking cycle, with each performance on the chart beginning at the 100 mark and playing out for as long as the pause lasted. Clearly, five times out of six, the asset class traded higher under these circumstances as investors began to price in less aggressive monetary policy and probable rate cuts to come at some subsequent stage. The year 2000 is the only exception here, back when the S&P 500 traded at an elevated 28x price-to-earnings.



Source: 3Fourteen Research

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