SEASPRAY PRIVATE
Creating Investment Solutions

Q3
23

QUARTERLY INVESTMENT UPDATE: Q3 2023

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Introduction

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As we enter the fourth and final quarter of 2023, US stock markets are up by 12% YTD, while European indices have appreciated by 10%, both in local currency terms. Equities have mostly benefitted from a more favourable economic backdrop than had been expected this year, and encouragingly we have also seen headline inflation continue to decline across developed regions. These factors have increased the probability of a 'soft landing' for the global economy – i.e. an economic slowdown without a recession. Bond markets, on the other hand, have been mixed over the quarter. A combination of persistent core inflation, aggressive central bank interest rate hikes, and a still robust US economy has caused bond yields to aggressively reprice higher to levels that have not prevailed in over ten years for some regions.

As the quarter ended markets began to feel that perhaps the phase of interest rate hiking might be coming to an end. However, as the Chinese curse goes "may you live in interesting times" none more so than as we write, the sudden escalation in geopolitical risk driven by the recent Hamas attacks in Israel and the corresponding response from Israelis has suddenly heightened tensions in the middle east. The corresponding impact is that in a week the oil price has jumped by over $5. With USA moving aircraft carriers into the region to provide support for Israel, a sharp intake of breath has pervaded the opening week of the fourth quarter. It now looks like this final quarter may well be dominated by raised Geopolitical tensions which were not foreseen at the end of September.

A divergence has remained between regions, with regard to economic growth over recent months. The US economy has shown relative strength compared to Europe and China, but importantly recessions have been avoided in all the main regions, including the UK which was expected to be the weakest G7 region coming into 2023. We believe there have been a number of reasons that a recession has not occurred so far this year, including:

- The possibility that monetary policy is not yet restrictive enough to cause a recession.
- Fiscal policy has been marginally expansionary and is fuelling investment.
- Strong household balance sheets are continuing to support spending.
- The global economy lacks clear excesses that make it vulnerable to a recession.
- Credit conditions have tightened, but they are not overly tight yet.
- Labour demand and supply dynamics are keeping the market tight.
- The pandemic has distorted cycle analysis and made data noisy.
- Sector-specific rolling recessions may preclude a full recession.
- Services dominate the US and European economies, and they are still growing for the most-part.
- The US economy in particular has evolved over time to be less cyclical and recession-prone.

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	1-Month	3-Month	YTD
Equity Indices			
S&P 500	-3.38%	-1.68%	12.92%
Nasdaq	-3.12%	-1.29%	28.83%
DAX	-2.96%	-1.92%	10.12%
EuroStoxx 50	-2.10%	-1.38%	9.79%
ISEQ	-4.39%	-3.60%	14.89%
FTSE 100	0.82%	4.82%	1.43%
Multi-Asset Funds			
Aviva Multi-Asset ESG 3	-2.27%	-1.48%	-0.53%
Aviva Multi-Asset ESG 4	-2.31%	-0.83%	2.35%
Aviva Multi-Asset ESG 5	-2.25%	-0.13%	5.43%
Irish Life MAPS 3	-1.55%	-0.07%	3.66%
Irish Life MAPS 4	-1.82%	0.04%	5.01%
Irish Life MAPS 5	-1.97%	0.06%	5.90%
New Ireland iFunds 3	-1.30%	-0.20%	2.00%
New Ireland iFunds 4	-1.50%	0.30%	4.10%
New Ireland iFunds 5	-1.60%	0.80%	6.60%
New Ireland PRIME 3	-1.40%	-0.20%	2.50%
New Ireland PRIME 4	-2.10%	0.20%	4.90%
New Ireland PRIME 5	-2.30%	0.40%	6.40%
Zurich Prisma 3	-1.09%	0.64%	3.44%
Zurich Prisma 4	-2.19%	0.72%	6.95%
Zurich Prisma 5	-2.26%	1.40%	10.96%
Bonds			
US Government Bonds	-2.54%	-5.19%	-4.76%
US Corporate Bonds	-3.34%	-5.66%	-3.99%
European Government Bonds	-1.64%	-2.99%	0.67%
European Corporate Bonds	-0.45%	-0.68%	-0.89%
Currencies			
EUR/USD	-1.28%	-3.59%	-0.86%
EUR/GBP	0.15%	1.04%	-2.25%
GBP/USD	-1.89%	-4.56%	1.45%
USD/JPY	1.57%	5.36%	13.55%
Commodities			
Gold	-3.88%	-3.09%	2.49%
Brent Crude Oil	-2.86%	13.13%	2.49%

Source: Seaspray, October 2023

Global Economy & Inflation

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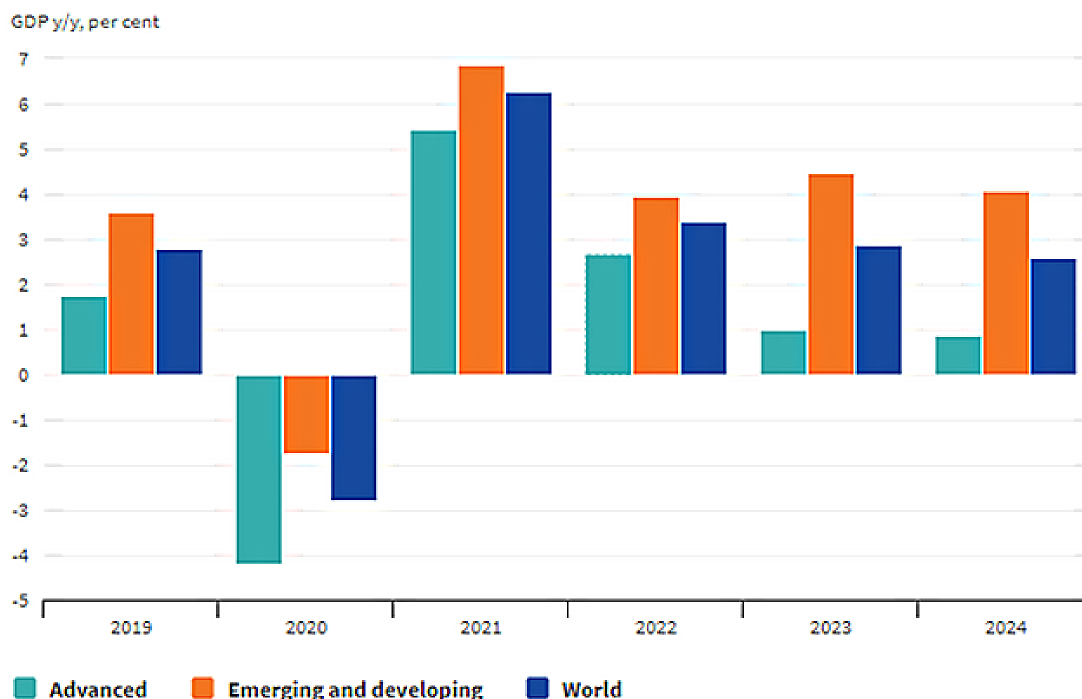
The regional differences in the global economy, which we have spoken about at different stages of this year, have gained further momentum. The US economy has proven to be more resilient than almost anyone was expecting, especially in the second and third quarters. Job creation on both sides of the Atlantic continues to exhibit robustness, providing support to consumption. The most recent US employment numbers which issued at the start of the fourth quarter are particularly robust. It must be noted that the Chinese and European economies are telling a slightly different story, however. In the Eurozone, we have seen a sharp contraction with regard to the manufacturing sector, and although consumption overall remains steady, it has not delivered enough momentum to offset the manufacturing weakness. Economic growth forecasts have been under threat as a result for the Eurozone. Unfortunately, in China, the impact from lifting strict Covid-19 restrictions at the beginning of this year has faded faster than most market commentators had been anticipating. Not only is domestic demand showing signs of decline, but external demand is also suffering. Additionally, there has been a surge in youth unemployment to record highs of over 20%, which was seen by many as a key indication of the country's slowdown. The country's overall unemployment rate however is still at just 5.3%.

As was the case at the beginning of the year, and as can be seen below, consensus forecasts show that emerging and developing economies are expected to do much of the heavy-lifting in terms of global growth this year and next. Advanced regions are now expected to grow by just 1.00% in 2023 and 0.9% in 2024. As a whole, the world economy is estimated to see growth of 2.9% and 2.6% this year and next, respectively.



Source: Aviva Investors

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Global Economy & Inflation contd...

The OECD in its latest update, though, warned that higher interest rates could continue to expose underlying financial vulnerabilities, with potential for rising loan defaults most notably in weaker low-income countries, where signs of debt distress are becoming increasingly evident. Broader financial contagion, though, from recent events has been limited so far, with central banks noting that the banking system remains strong in terms of its capital and liquidity positions. Overall, the group believes that growth in advanced economies will remain subdued in 2023-24. The OECD is forecasting GDP growth of 1.4% in both 2023 and 2024 for the OECD region, with the world economy projected to expand by less than 3% in both years. Most US growth data has come in ahead of expectations year-to-date in 2023, especially in the first half. GDP in the States rose at an annualised rate of 2.0% and 2.4% (or 0.5% and 0.6% in q/q terms for comparison with Europe) in the first two quarters of the year. By contrast, Eurozone data has been sluggish, flat-lining at the start of the year and rising by 0.3% in the second quarter. Meanwhile, although the UK has avoided recession, GDP growth has been very anaemic at an estimated 0.1 – 0.2% in the first two quarters of this year. Indeed, US GDP is now 6.2% above its end 2019 pre-pandemic level. Eurozone GDP is 2.7% higher than that level, held back somewhat by a weak performance by Germany, while the UK's equivalent is still some 0.2% below its pre-Covid 2019 level.

The outperformance of the US economy in recent years can be attributed to several reasons: less stringent Covid measures that were imposed by authorities in most US states, the adoption of expansionary fiscal policies both throughout and after the pandemic, being more resilient against energy price shocks due to their status as a net energy exporter, as well as a less severe inflationary shock overall. Of course, the invasion of Ukraine has also acted as much more of a headwind for the European economy than it has for the US.

	United States	Eurozone
Q1 GDP	2.0%	0.0%
Q2 GDP forecast	1.8%	0.2%
Q2 GDP actual	2.4%	0.3%
Composite PMI (July)	52.0	48.6
Composite PMI (August)	50.4	47.0
Composite PMI (September)	50.1	47.1

Source : Seaspray, October 2023

Global Economy & Inflation contd...

In recent days we have seen the release of the PMI's for both the USA and Eurozone for September. Purchasing Managers' Index (PMI) readings give us a sense of the level of growth that nations have seen over the past few months. Clearly, it is still too early to say whether the global economy will emerge mostly unscathed from the relatively sharp monetary tightening of the past year and a half. Weakening PMIs, which tend to be a good leading indicator of activity, are a concern. August PMIs for the major economies were particularly weak, especially in Europe, whilst September has seen a marginal improvement.

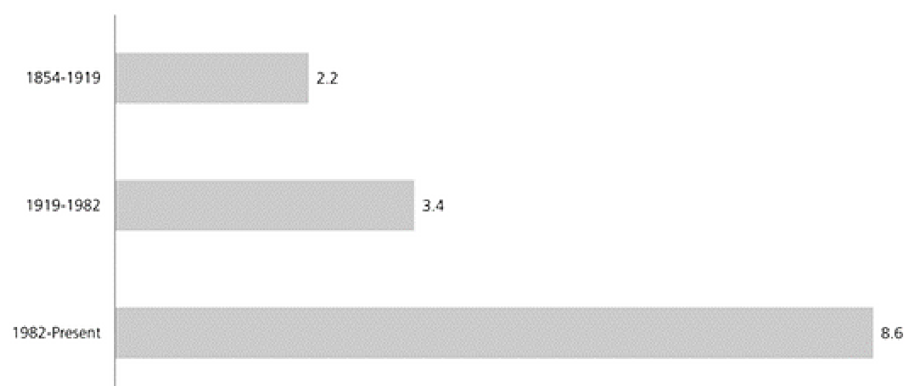
With GDP growth exceeding forecasts for the second quarter, many analysts are now beginning to expect a 'soft-landing' scenario, whereby the economy transitions from a period of rapid growth and inflation to more sustainable and stable levels, without entering a recession. We would agree with this view, but still do acknowledge that interest rate hikes usually act with a lag, with regard to their full effect on the economy. Thus, we may not have seen the full extent of the damage yet, after the sharp monetary tightening of 2022 and 2023.

Even in the event of a further slowdown over the coming quarters, we believe that we should not expect a standard recession in what has definitely been an unorthodox cycle. For example, the manufacturing sector has already been contracting and may even start its recovery by the end of the fourth quarter, just when other sectors could be entering their contractions. One possibility over the next year is that the global economy may instead experience 'rolling recessions' across different sectors at different times. The net result could be a very modest recession overall with unusually low job losses, an outcome very similar to a soft landing. Such a recession is unlikely to start long before the end of the year.

The economy has evolved to be less cyclical and recession-prone

...and as a result, economic activity is less volatile and expansions can last longer

Economic expansions have grown longer
Average length of economic expansions (in years)



Source: Bloomberg, UBS

Global Economy & Inflation contd...

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Essentially, we believe it has become quite unlikely that we will see a recession begin this year, and furthermore it is impossible to accurately predict whether we will see a recession or not next year. We would also like to point out that recent history has shown us that it is not wise to invest according to economic forecasts. So even though the next recession may well be on the horizon, and there will always be another recession in the future at some stage, trying to predict and time it is less useful than constructing a portfolio that can weather different economic conditions.

Moving on to employment data, tight labour markets have been the common theme this year across major developed regions. In the US in September, Nonfarm payrolls increased by 336,000, considerably better than Dow Jones consensus estimates of 170,000. Average hourly earnings rose by 0.2% for the month and 4.2% for the year. The unemployment rate was steady at 3.8%. Overall, very strong employment data for the end of the third quarter. While in the Eurozone saw its average unemployment rate at 5.9% but the region did record a small increase in those employed of 0.2%.

Looking at the issue of inflation, falling commodity prices this year have been a key driver in headline CPI rates declining across most economies. Oil, gas, and global food commodity prices most notably, have fallen sharply. Furthermore, economic activity across many sectors is slowing, with clear signs of a marked easing in inflationary pressures especially in the manufacturing sector. Nonetheless, price pressures have become more broad-based, and this is particularly evident in the services sector, resulting in core inflation rates remaining quite sticky. Policymakers at the main central banks have been closely monitoring wage growth given how tight labour markets still are, while also noting that profit margins have widened too.

In recent months, central banks and other institutions, such as the OECD, have warned that signs of “persistent” inflationary pressures are present in many cases, which could necessitate a more aggressive monetary policy response, with rates remaining higher for longer than was initially thought. However, inflation is generally still expected by most market participants to continue to decline, albeit more slowly than may have been anticipated earlier in the year. The most recent forecasts are for core inflation rates to average 4.0-5.5% in many of the large advance economies this year, with core rates remaining above target at 2.5-3.5% in 2024.

Global Economy & Inflation contd...

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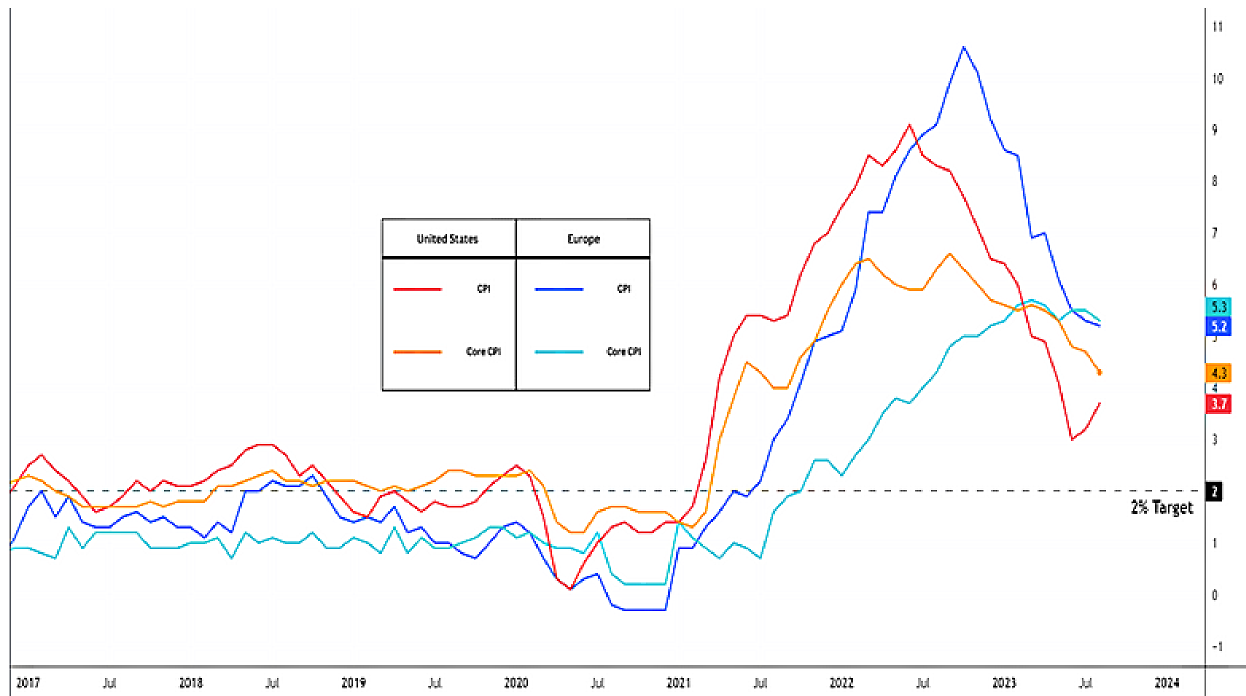

Source: Seaspray , October 2023

As can be seen in the chart above, headline CPI rates in the US and Eurozone have now fallen to 3.7% and 4.3%, their lowest point in 18 months. August/September's declines came as energy prices came in broadly flat q/q. Meanwhile, core inflation for the Eurozone fell from 5.3 to 4.5% and in the US fell from 4.7% to 4.3%.

As we have highlighted in past investment updates, we feel confident at Seaspray that over the next 12 months developed regions will see a continued reduction in inflation. However, what is less clear is the ability of central bankers to achieve this goal without simultaneously causing a recession or at least a market correction. All long-term asset classes should eventually benefit from easier monetary policy in the medium to long-run. However, with broad equity market valuations now slightly elevated, it is more important than ever that investors be active, selective with regard to regions and sectors, and well-diversified as they build portfolios designed to meet the challenges of a decade with higher inflation levels than were seen during the pre-Covid decade.

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Irish Economy

Ireland exited a technical recession in the second quarter of the year after recording a strong rise in GDP. Figures from the Central Statistics Office (CSO) show GDP rose by 3.3% q/q, and by 2.7% when compared with the same quarter in 2022. The CSO noted that the result was driven mainly “by increases in the multinational dominated sectors in Q2 2023”. Since this data, we have seen third-quarter results come out, which show that Modified Domestic Demand, a broad measure of underlying domestic activity covering personal, government and capital formation spending, increased by 1%. Personal spending on goods and services, a key measure of domestic activity, increased by 0.9%. Interestingly exports fell by 4.1% in quarter 2 2023 while imports increased by 0.1%. The fall in exports as previously indicated is linked to the fall in demand for COVID related treatments. Observers are watching to see if this is all it is or is it something more serious.

Despite a ‘technical recession’ occurring at the end of the first quarter in Ireland, the country had full employment coupled with a record high tax intake. Normally, GDP serves as a useful indicator for the economic growth of any given nation. However, in the case of Ireland, we would like to point out that this approach is not as effective. This is because of the significant distortion to our GDP caused by multinational corporations, many of which record sales in Ireland that actually occur in other jurisdictions. For this reason, we prefer to closely watch the Modified Domestic Demand figure, which came in at 1%
Headline inflation which had been falling to 5.8% has seen a marginal increase in September to 6.3% but well down from the peak last October of 9.3%.

As we write, the Irish Minister of Finance is on his feet announcing the annual budget. It is set to be the largest budget ever with over €9billion of positive adjustments. The key areas focussed on, included a €3billion package of climate action items, and the setting up of a Future Wealth Fund with the aim of reaching €100 billion by 2035, to address long term challenges such as our ageing population. The Budget included a substantial reduction in income tax across the board and grants and supports for a range of sectors that have been under pressure since the pick up in inflation. The major ones included SME’s, the rental investor market and households both through increased mortgage relief and increased rent allowances. Overall, this budget is targeted to provide maximum positive impact for the electorate and is only possible because of the buoyant Corporation tax receipts from the many Large Multinationals operating here.

Artificial Intelligence

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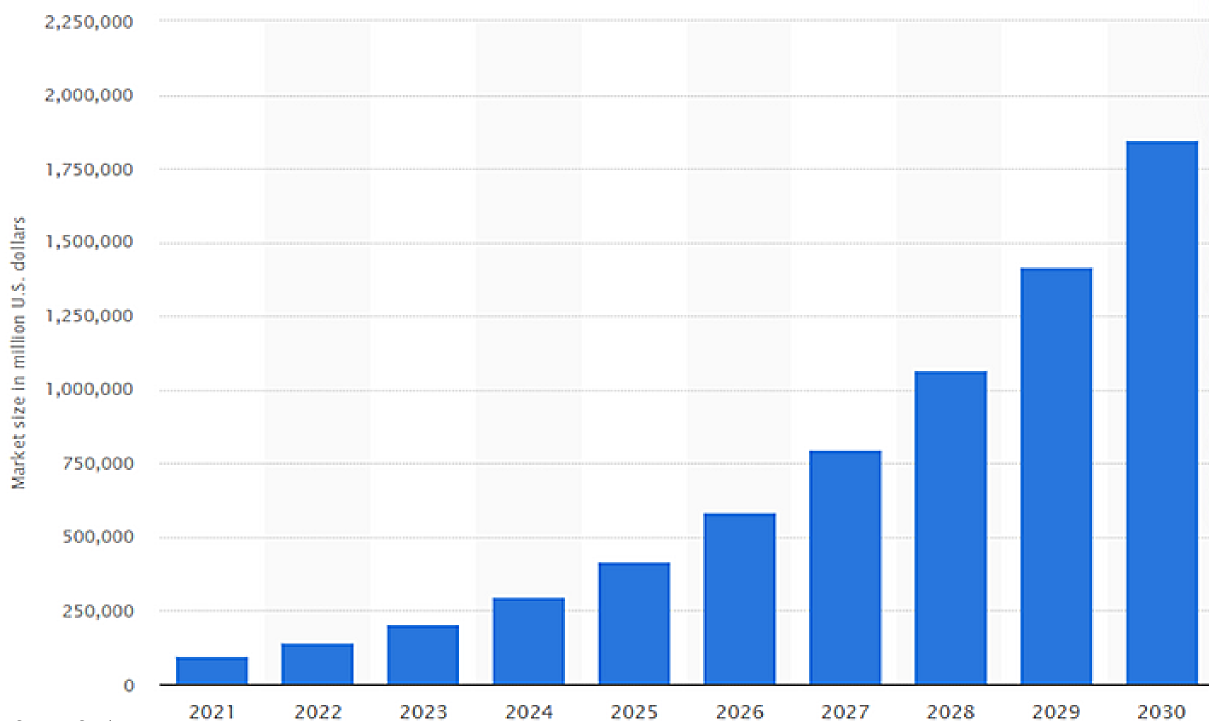
As we highlighted in our Half-Year Investment document, we are firm believers in the longer-term boost that Artificial Intelligence (AI) will give to global growth over the coming years. In fact, we believe AI will soon have the ability to reshape entire industries and redefine the way in which many corporations operate, serving as a catalyst for operational efficiency and elevated customer interactions. We are not alone in stating that the profound impact that AI will have on sustained corporate profitability is undeniable.

According to Statista, consensus forecasts currently show that the market for AI is forecast to see significant growth over the coming decade. As can be seen below, with a 2021 value of just below $100 billion, the AI market is forecast to be roughly $1.85 trillion by 2030, which if accomplished would represent a compound annual growth rate of 32.9%. Forecasters see AI spanning across multiple sectors, covering everything from supply chains, marketing, production, research & analysis, and other fields. In the nearer term, analysts predict that chatbots, image generation AI, and mobile applications will be among the major trends improving AI.

AI market size worldwide in 2021 with a forecast until 2030 (in million US dollars)



Source: Statista

Artificial Intelligence, which was once just the subject of our imaginations and the main plot of science fiction films, is now very real and is improving every day. Statista also point out that the increase in AI investment in recent years is coupled with the increasing need for AI talent. Many large corporations have been seeking workers with AI-related talent for their respective IT departments, as well as in other business areas. But global firms have reportedly been facing challenges in recruiting professionals for roles linked to AI, underscoring the urgent need for individuals with these competencies. The scarcity of AI expertise parallels the broader international trend of increased utilisation of AI and machine learning across various corporate applications. Given the considerable and continuous expansion of the industry, we believe at Seaspray that we will see a lot more of AI in the coming years.

Monetary Policy

The ECB's Governing Council, September meeting, saw the ECB raise rates by a further 25bps, pushing the key deposit rate up to 4.00%. It brings the total amount of rate tightening in this cycle, which began last July 2022, to 450bps. The ECB's decision to hike was not unanimous. Instead, President Lagarde, noted that there was a "solid majority" in favour of a rate increase.

In terms of guidance on the rate outlook, while the ECB was not willing to say that rates have peaked, the text of its meeting statement and President Lagarde's press conference comments afterwards suggested that it has now completed its rate hiking campaign. The statement said that the ECB considers that its key interest rates "have reached" levels, that if maintained for a "sufficiently" long time horizon will have a substantial impact on reaching its 2% inflation target in a timely manner. However, it retained the flexibility to hike again by stating that it remains in a "data dependent" mode and will ensure that rates "will be set at sufficiently restrictive levels for as long as necessary". Post this announcement European markets believe the rate hike in September represents the final one in the ECB's tightening cycle. Looking at future rates it appears that the market envisages rates remaining at their current 4% level through to the end of this year and into the first half of 2024. Futures contracts are pricing a rate cut by June 2024 and see rates ending next year near to 3.25%. This would represent 75bps of rate cuts over the course of 2024. A further reduction of 25-50bps in rates is priced for 2025.

However, in light of the continued focus within the ECB on maintaining a restrictive policy for as long as necessary in the face of sticky inflation, rates may be cut more slowly than is currently envisaged by markets, unless the economy enters recession. The ECB's forecasts envisage a pick up in the pace of activity next year, which if proved to be correct, would seem unlikely to be accompanied by monetary easing.

In the US the Federal reserve is guiding that it will need to maintain a tight monetary policy stance for an extended period of time to return inflation to its 2% target. The latest Fed dot-plot shows that it expects to keep rates at above 5% in 2024. Futures contracts show markets are now pricing in that rates will be cut to 4.75% by end 2024 and to around 4% by end 2025. In early summer, it was expected that US rates would fall back to 3%. This hardening of interest rate expectations has put significant upward pressure on US bond yields in recent months. Two-year Treasury yields have risen to over 5%, while ten-year yields have climbed by 100bps over the summer, hitting 4.88%, their highest level since 2007.

What all of this means for currencies is that although the US dollar has retreated from last year's peaks, which saw it reach its highest point on a trade weighted basis in 20 years, it has remained at elevated levels in 2023. Indeed, it has made gains over the past three months, recovering the ground lost in the first half of the year. EUR/USD has largely moved in a $1.05-1.12 corridor so far this year, but is now testing the lower bound of this trading range. Meantime, sterling has traded in a $1.21-1.31 band versus the dollar since mid-March and is also testing the bottom of this range.

The recent strengthening of the dollar is very much linked to the ongoing impressive performance of the US economy and associated elevated level of US interest rates. US data have generally surprised to the upside in 2023. The anticipated slowdown in the economy has not materialised to date. Indeed, GDP growth this year is on course surpass 2%. Meantime, the labour market remains very tight, with the jobless rate close to fifty year lows amid strong growth in employment. Against this backdrop, the Fed has hiked rates by 525bps to a 5.25-5.5% range, while indicating it could deliver a further 25bps rate increase before the end of the year.

Equities

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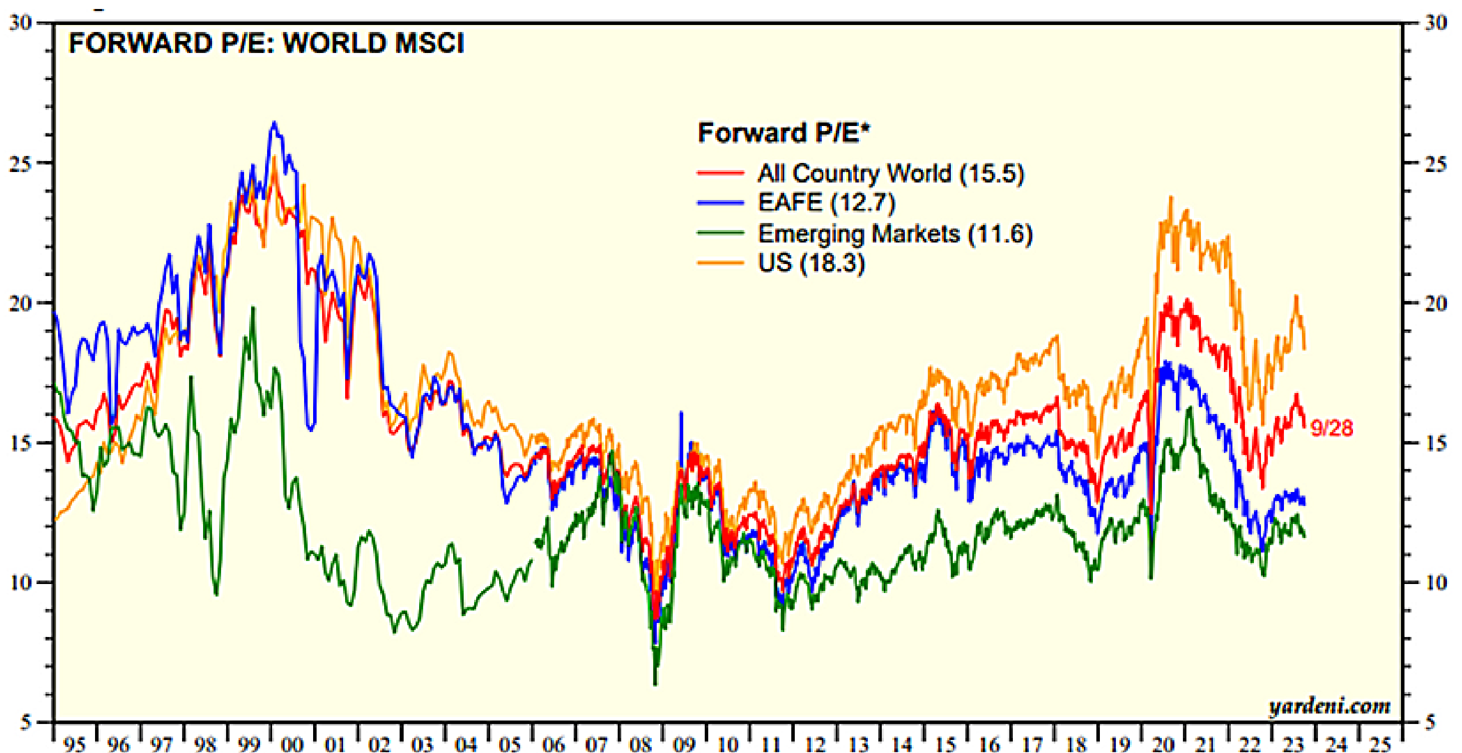
Stocks have pulled back modestly over the last couple of months as overbought conditions met some short-term overhead resistance. Near term cuts to interest rates have become less likely over the past few months, as the prospects of a 'soft landing' economic scenario have increased. While equity markets are still firmly higher on the year, UK aside, there has also been a growing feeling that there may be a little complacency around earnings. On top of these factors, we have also seen the US credit rating and some US banks downgraded by rating agencies, slightly elevated valuations in some markets, and underwhelming economic data in China all weighing on risk appetite.

The S&P 500 and EuroStoxx50 are currently down circa 5% and circa 6% respectively, from their July peaks, with the largest pullbacks seen in the Utilities, Real estate and technology sectors. We are not concerned about August and September's lower trade in equity markets - pullbacks are normal, even during years with above-average returns. History would suggest that a 5 – 10% drawdown around Q3 would not be uncommon. However, even with a pullback, developed market equity indices have still historically generated positive average returns into year-end.

While we would not be surprised to see a continued move higher into Q4, we accept it is also possible that we may have seen the bulk of this year's index returns already at this point. The impact of heighten Geo-political risk with the Israel / Hamas situation causing considerable stress in the middle East may destabilise equity markets in the short term. However, as we have already seen, if the eventual economic landing is once again postponed, the equity market can continue to rally. Also, much of this year's returns in the United States have come from a very narrow range of stocks. While such narrow rallies have usually been followed by reversals in the past, today's valuations are mostly fair outside of the US mega-cap leaders, and therefore there is still plenty of room for other sectors outside of technology and consumer discretionary to grow from here.

Equities contd...

Despite the recent pullback, global equities have indeed proven resilient so far this year, as recession fears have receded and a peak in central bank policy rates has come into view. Following the gains seen year-to-date, global equities are now slightly expensive, trading on a 12-month forward price-to-earnings (P/E) multiple of 15.8x compared to their long-term average of 16.3x (seen below). The 12-month forward P/E for the S&P 500 is currently 19.1x against a long-term average of roughly 17x. As we have alluded to in recent investment updates, equities outside of the US offer better value at this juncture. Eurozone equities trade at a multiple of 11.4x against a long-term average of 13.1x, Japanese equities trade at 14.5x versus a long-term average of 15.8x, and in the UK we can see markets trade at 10.3x against a long-term average of 12.2x.



* Price divided by 12-month forward consensus expected operating earnings per share. Monthly through December 2005, weekly thereafter.
Source: I/B/E/S data by Refinitiv.

Source: Yardeni research, Inc, I/B/E/S, MSCI, Refinitiv Datastream.

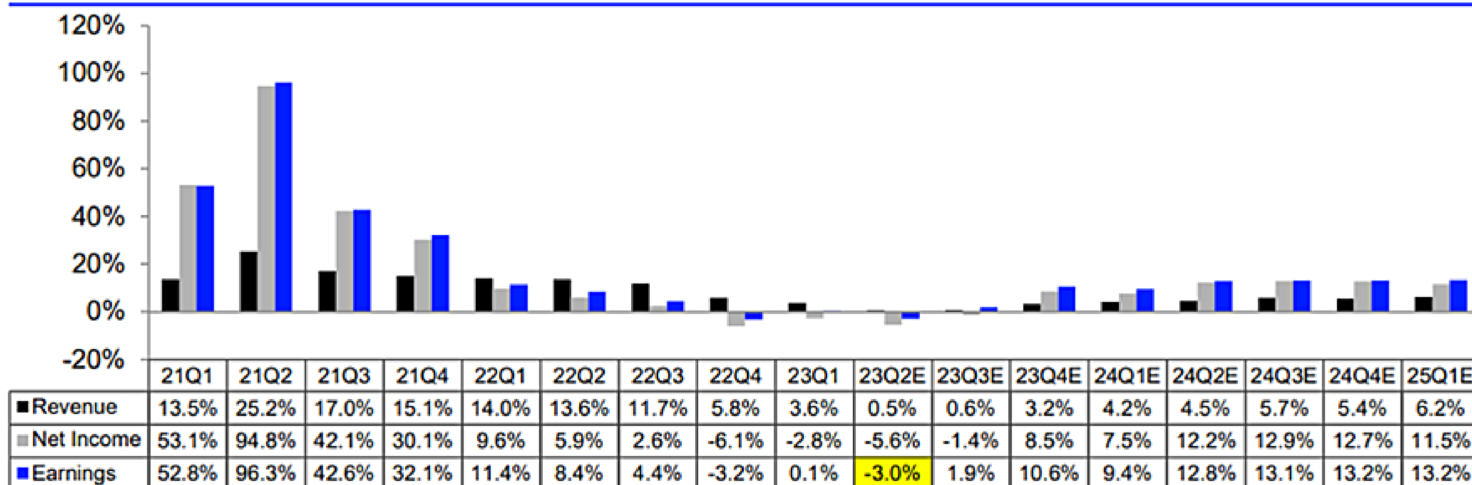
Equities contd...

The considerable valuation gap currently seen between US and Eurozone stocks is not justified in our view, given the backdrop of similar macroeconomic risks and similar consensus long-term earnings growth rates across both regions. In addition, Eurozone equities continue to offer a spread in yield over the US of 1.7% including dividends and buybacks, and this spread is close to all-time-high.

Despite some equity regions and sectors appearing slightly expensive, the outlook for the asset class on a 12-month view remains positive, in our view. Central banks are likely to pause relatively soon and then pivot towards more accommodative monetary policy in 2024 as inflationary pressures reduce further. We believe the growing prospect of a soft economic landing this year and next followed by a rebound in growth and earnings should also provide the asset class with support going forward. In the years ahead, it is becoming more and more clear that the integration of AI into several different sectors will enhance efficiencies and earnings across the entire market, likely allowing stocks to trade at higher average valuation levels.

We have just seen the third-quarter corporate earnings season begin with PepsiCO the first out of the traps. The soft drinks giant lifted its annual profit forecast for a third time this year banking on multiple price increases and resilient demand for its snacks and beverages. Other stocks due to report in coming days include Delta Air Lines, JP Morgan Chase, Citigroup and Wells Fargo.

Looking back at second-quarter earnings season, we saw a generally stronger-than-anticipated set of results for both Europe and the United States. The broad S&P 500 and EuroStoxx 600 indices both witnessed less severe EPS declines than were expected at the beginning of the Q2 reporting season back in July. As can be seen below, S&P 500 companies registered an earnings decline of -3.0% y/y for the April to June period, against analysts' -6.4% y/y forecasts. Furthermore, analysts believe the index underwent a trough in earnings in the second quarter, with a pickup expected to be seen from this point on. Interestingly, 79% of names within the index exceeded analysts' expectations, with the majority of company earnings beating forecasts, coming from the technology, healthcare, consumer staples, and consumer discretionary sectors. This compared to the index's 5-year average of 77% of its companies beating forecasts, and 10-year average of 73%.

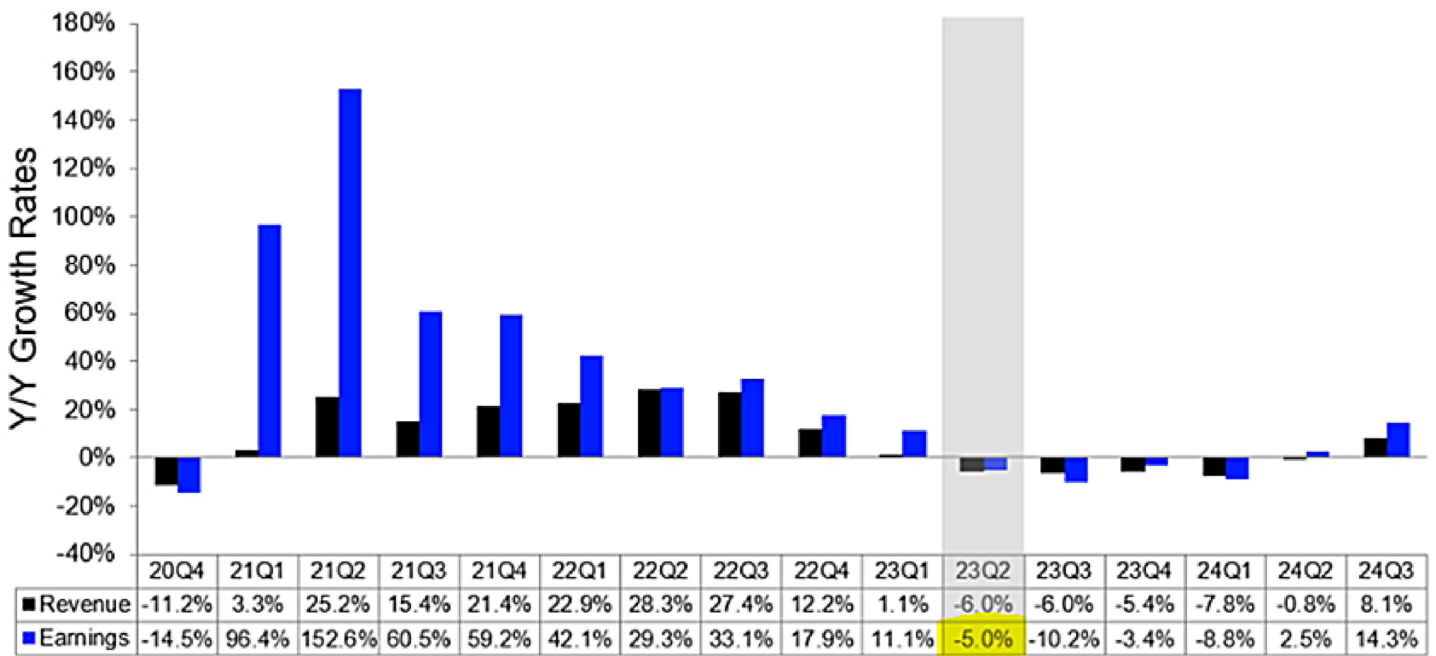


	21Q1	21Q2	21Q3	21Q4	22Q1	22Q2	22Q3	22Q4	23Q1	23Q2E	23Q3E	23Q4E	24Q1E	24Q2E	24Q3E	24Q4E	25Q1E
Revenue	13.5%	25.2%	17.0%	15.1%	14.0%	13.6%	11.7%	5.8%	3.6%	0.5%	0.6%	3.2%	4.2%	4.5%	5.7%	5.4%	6.2%
Net Income	53.1%	94.8%	42.1%	30.1%	9.6%	5.9%	2.6%	-6.1%	-2.8%	-5.6%	-1.4%	8.5%	7.5%	12.2%	12.9%	12.7%	11.5%
Earnings	52.8%	96.3%	42.6%	32.1%	11.4%	8.4%	4.4%	-3.2%	0.1%	-3.0%	1.9%	10.6%	9.4%	12.8%	13.1%	13.2%	13.2%

Source: I/B/E/S, Refinitiv

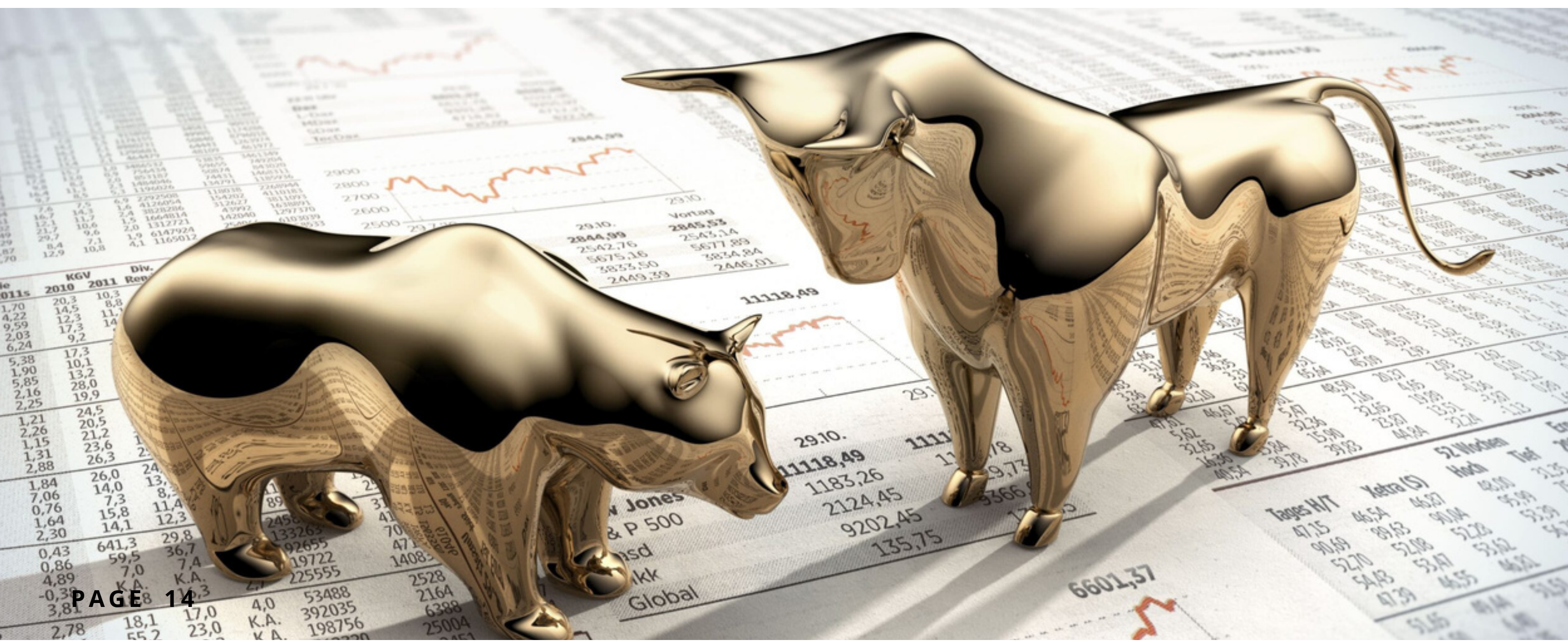
Equities contd...

Similarly, European firms fared better during the Q2 reporting season than had been initially feared. The EuroStoxx 600 index saw an EPS decline of -5.0% y/y, versus the consensus forecast going into that earnings season of -8.2% y/y. 53% of names within the index beat market expectations with regard to their Q2 releases, which is in line with historical average for the EuroStoxx 600. We saw positive earnings growth from five of the sixteen countries represented in the index index. Ireland and Italy had the highest earnings growth rates, while Norway and Portugal had the sharpest declines.



	20Q4	21Q1	21Q2	21Q3	21Q4	22Q1	22Q2	22Q3	22Q4	23Q1	23Q2	23Q3	23Q4	24Q1	24Q2	24Q3
Revenue	-11.2%	3.3%	25.2%	15.4%	21.4%	22.9%	28.3%	27.4%	12.2%	1.1%	-6.0%	-6.0%	-5.4%	-7.8%	-0.8%	8.1%
Earnings	-14.5%	96.4%	152.6%	60.5%	59.2%	42.1%	29.3%	33.1%	17.9%	11.1%	-5.0%	-10.2%	-3.4%	-8.8%	2.5%	14.3%

Source: I/B/E/S, Refinitiv



Fixed Income

Q3
23

Since our Half-Year Investment Update was released in July, our house view on bonds has not changed. With what would appear to be the final increase in central bank interest rates and with the increase in Geopolitical risk we have seen a short term spike in Yields. The 10 Year US is trading at a near 5 year high of 4.761% and the 10 year German Bund reaching 3.02%.

While we acknowledge that equities may indeed have further room to rise as we move through the fourth quarter, we believe fixed income markets now look more attractive on a risk-adjusted basis than stocks in the near-term.

At Seaspray, we have a preference for short-duration government bonds, as well as high quality investment grade corporate debt. The likely higher-for-longer rate scenario that we now find ourselves in has helped to strengthen the argument for short-dated bonds in our view. We are maintaining a lower allocation to longer-term nominal government bonds on both horizons, as we anticipate that investors will require greater compensation for bearing the risk associated with holding such bonds in a high-for-longer rate environment. With regard to high yield credit we are still somewhat cautious, as we see this asset class as more vulnerable to recession/downturn risks at present. We are also overweight inflation-protected government bonds.

Historically, whenever the Federal Reserve has finished increasing its interest rates this has usually been supportive for markets – and we think the relationship with high grade bonds is especially notable. Since 1984, there have been five times that the Fed has ended interest rate hiking cycles after multiple increases. Each time it did so, the yield on the US Aggregate Bond index amazingly peaked within one month of this final hike. Essentially, the Fed pausing its rates has historically been a positive for investment grade bonds in the region. And we can see the logic to this – if the Fed has stopped hiking interest rates, one of two things may very well be true.

1)The central bank has stopped at the correct level to support growth while also reducing inflation, and that stability with less inflation is welcomed by bond investors.
2)It has paused because rates are now too high, and are set to slow growth and inflation much more sharply than was initially anticipated.

Ultimately, we see a greater likelihood of gains in the bond market over the next year than of losses. To put it simply, if the Federal Reserve and other central banks end up cutting rates in 2024, bond market risk should be modest, as rates should quickly adjust downward. If that consensus on rate cuts turns out to be wrong, but the economy still continues to slow down, rates are also likely to fall. It's only if both inflation and economic growth show a surprise increase that bond markets could be at material risk of capital losses.

SEASPRAY PRIVATE
Creating Investment Solutions

Q3 23

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