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Weekly perspective on current market sentiment February 1, 2023

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Last week's S&P 500 Index: +2.5%

Happy new year?

Key takeaways

- How China's economy fares this year as its post-pandemic reopening unfolds should likely have far-reaching ripple effects on the global economy.
- We believe Chinese demand for commodities is likely to be an important driver of global raw material prices in the coming year and beyond.

Our regular readers know the S&P 500 Index has had good start to the year, trading up nearly 5% in the first month of this year. Eight of 11 S&P 500 sectors have also gained ground so far with two of those, Consumer Discretionary and Communication Services, up more than 12% in the early going as of January 30, 2023. So, for equity investors focused on U.S. stocks, it has indeed been a happy new year.

But there is another new year to think about. What are the prospects for the Chinese New Year? It took place on January 22 with the traditional celebration occurring over a 15-day period and ending on February 5. It is the Year of the Rabbit in 2023 according to Chinese zodiac. How China's economy fares this year as its post-pandemic reopening unfolds should likely to have far-reaching ripple effects on the global economy. As the world's second-largest importer of commodities behind the U.S., demand in China, as has been the case over the last quarter-century, will be a key factor in determining the global price of raw materials in our view.

Numerous China-specific indicators such as Purchasing Managers Indexes, retail sales, gross domestic product, and industrial production all jumped noticeably higher in January compared to December, potentially indicating there may be some positive economic momentum. And while there are many opinions as to the pace of economic growth as China reopens, an examination of the Baltic Exchange Dry Index shows, on average, a meaningful upside acceleration around the start of the Chinese New Year (going back to 1986 per data from the Baltic Exchange Information Services Ltd.) and hints that a noticeable economic rebound could be in order over the coming months. Also note that earlier this week the International Monetary Fund slightly increased its estimate for global economic growth due in part to China's anticipated emergence from COVID-19 lockdowns.

We continue to hold a favorable recommendation on commodities, as the supply of many raw materials such as oil and copper has continued to be tight. Keep in mind that for the 10 to 15 years prior to the pandemic, the price of many commodities was low and producers were reluctant to invest in new capacity. Capital investment aimed at just maintaining commodity production was minimal. Now that prices have risen, producers are having trouble increasing supply quickly enough given the underinvestment that occurred prior to the pandemic.

We believe Chinese demand for commodities is likely to be an important driver of global raw material prices in the coming year and beyond. While we expect a recession here in the U.S. and eurozone in the nearer term, we think better economic growth as we move toward the end of this year and into 2024 should continue to buoy commodity prices.

Risk Considerations

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Foreign investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets.

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility.

Investing in commodities is not appropriate for all investors. Exposure to the commodities markets may subject an investment to greater share price volatility than an investment in traditional equity or debt securities. The prices of various commodities may fluctuate based on numerous factors including changes in supply and demand relationships, weather and acts of nature, agricultural conditions, international trade conditions, fiscal monetary and exchange control programs, domestic and foreign political and economic events and policies, and changes in interest rates or sectors affecting a particular industry or commodity. Products that invest in commodities may employ more complex strategies which may expose investors to additional risks, including futures roll yield risk.

Definitions

Baltic Dry Index (BDI) is a composite of the dry bulk timecharter averages and provides a continuous time series since 1985.

Purchasing Managers Index (PMI) is an indicator of the economic health of the manufacturing sector. The PMI index is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

An index is unmanaged and not available for direct investment.

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