

Q3 2023 Market Review: Unpacking the Role of Inflation and Geopolitics

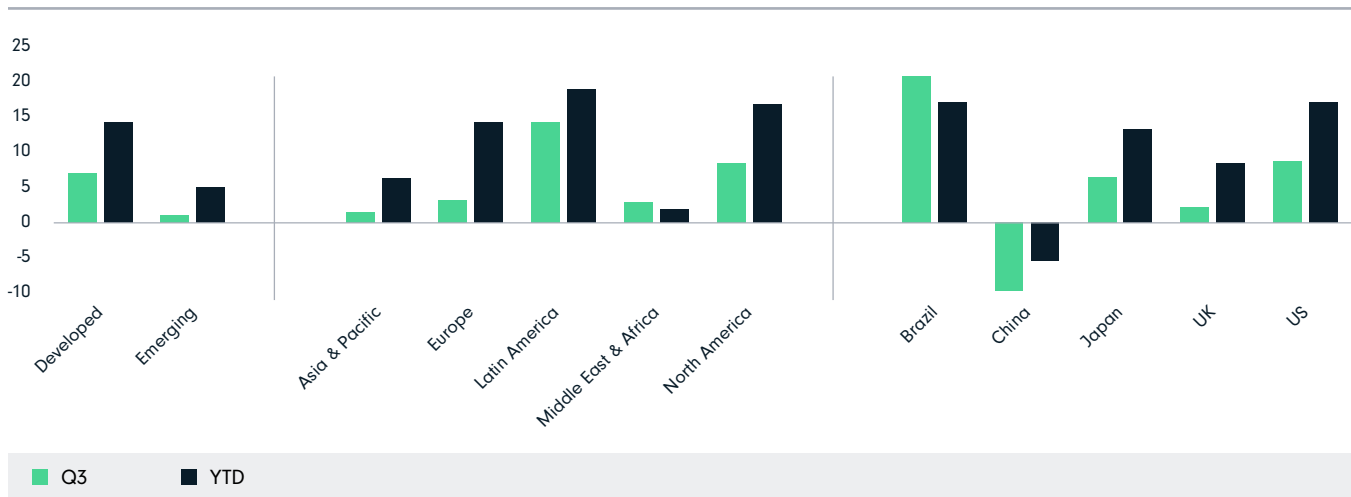
Sep 2023

Markets broadly declined in Q3 2023, with global stocks falling over -3% (as measured by the MSCI ACWI Index), bringing YTD gains to roughly 10%. US dollar-based returns were lower than local returns as the USD strengthened slightly during the quarter relative to major global currencies. Developed markets fell slightly more than emerging markets in Q3, declining more than -3% versus just shy of -3%, respectively, and bringing YTD totals to +11% versus +2%, respectively.

With all major regions in the red in Q3, the Middle East markets fell least, declining shy of -2% on the back of strength in Israel and Egypt. As we write, however, Israel is actively at war as Hamas invaded in early October – a development which bears watching and could impact markets in the region and beyond. The Asia Pacific region also held up moderately better than others, tied partly to resilience in India’s market, which delivered a rare positive return in the quarter (+3%). Meanwhile, Asian markets generally declined, led down by Hong Kong (-11%), Taiwan (-7%) and Korea (-7%), while China fell a more modest -2% but remains mired in economic malaise. However, during the quarter, the country’s government did announce several measures aimed at bolstering the flagging property market and incentivizing economic and trading activity.

In Europe, the biggest economies’ markets – France (-7%), Germany (-8%), the UK (-2%) – all fell as the European Central Bank (ECB) and Bank of England (BOE) continue their bids to rein in inflation and economic data show signs of moderating. Meanwhile, investors had effectively the opposite reaction to Turkey’s similar battle (its market rose +33% in Q3), given its inflation rate had skyrocketed and the country was in desperate need of higher rates, which its central bank finally started delivering over the last several months. Norway was another positive outlier, its market rising just shy of +12% as oil prices have risen.

Exhibit 1 – August and YTD Returns for Major Markets (USD) (%)



Source: FactSet, as of 30 Sep 2023.

From a sector perspective, energy stocks in the MSCI ACWI ex USA Index were the sole positive performers, rising north of 9%. Conversely, technology stocks gave back some of their YTD gains, declining more than -8%, followed by utilities (-8%), which declined amid a rising rate environment. Consumer staples stocks were also in the red (down more than -6%) as investors weigh concerns about the likelihood of an economic downturn and its likely impact on consumers.

Though Q3 marked the year's first negative quarter, the headlines were substantially similar: Inflation, global monetary policy and geopolitical tensions remain front and center in financial news outlets. If there was a shift in Q3, it was arguably investors' seemingly growing recognition the major developed world central banks are likely to maintain higher interest rates for longer than many thought – with US Federal Reserve head Jerome Powell making that very declaration in September. Yet, the Fed, along with the Bank of England and Bank of Japan, held rates steady in September, while the European Central Bank (ECB) raised its benchmark rate to 4% – the highest level since the euro was launched in 1999.

Another of the major 2023 headlines that persisted in Q3 was concerns about China's economic malaise – though the Chinese government announced in Q3 measures aimed at boosting growth and bolstering its property market. Among them are relaxed requirements for down payments and interest rates, as well as steps intended to improve sentiment and increase tax allowances for some demographics. These measures' efficacy remains to be seen, especially in the face of rather stark economic realities, including falling consumer prices and factory activity. Further, China's proverbial sneeze is prompting something of an Asian cold, with markets in Korea, Taiwan, Hong Kong and, more moderately, Japan declining in Q3 amid faltering Chinese demand.

Though there are reasons for optimism – both economically and market-wise – there are ample unknowns, as ever, and there are an equal number of reasons for caution. But such market environments, in our opinion, allow for investors with a time-tested and disciplined investing approach to shine. Particularly as market breadth has narrowed meaningfully – i.e., the majority of positive gains are increasingly concentrated in a small handful of market leaders – those bottom-up investors able to continue doing the fundamental work to identify good companies trading at attractive valuations are relatively well positioned. This is particularly relevant in an international context. Amid ongoing global concerns, well-researched investors can often find some of the most attractive long-term investment ideas in overseas markets. This is why we take the approach we do, and why we believe owning a well-curated portfolio of individual companies (as opposed to a benchmark or index) is critical to long-term, non-US investing success.

MSCI ACWI Index measures the performance of large- and mid-cap stocks in developed and emerging markets. **MSCI ACWI ex USA Index** measures the performance of large- and mid-cap stocks in developed (excluding the US) and emerging markets. The indexes are unmanaged, market capitalization weighted, include net reinvested dividends, do not reflect fees or expenses (which would lower the return) and are not available for direct investment. Index data source: MSCI, Inc. See [diamond-hill.com/disclosures](https://www.diamond-hill.com/disclosures) for a full copy of the disclaimer.

The views expressed are those of Diamond Hill as of October 2023 and are subject to change without notice. These opinions are not intended to be a forecast of future events, a guarantee of future results or investment advice. Investing involves risk, including the possible loss of principal. Past performance is not a guarantee of future results.