DIAMOND HILL

INVESTED IN THE LONG RUN

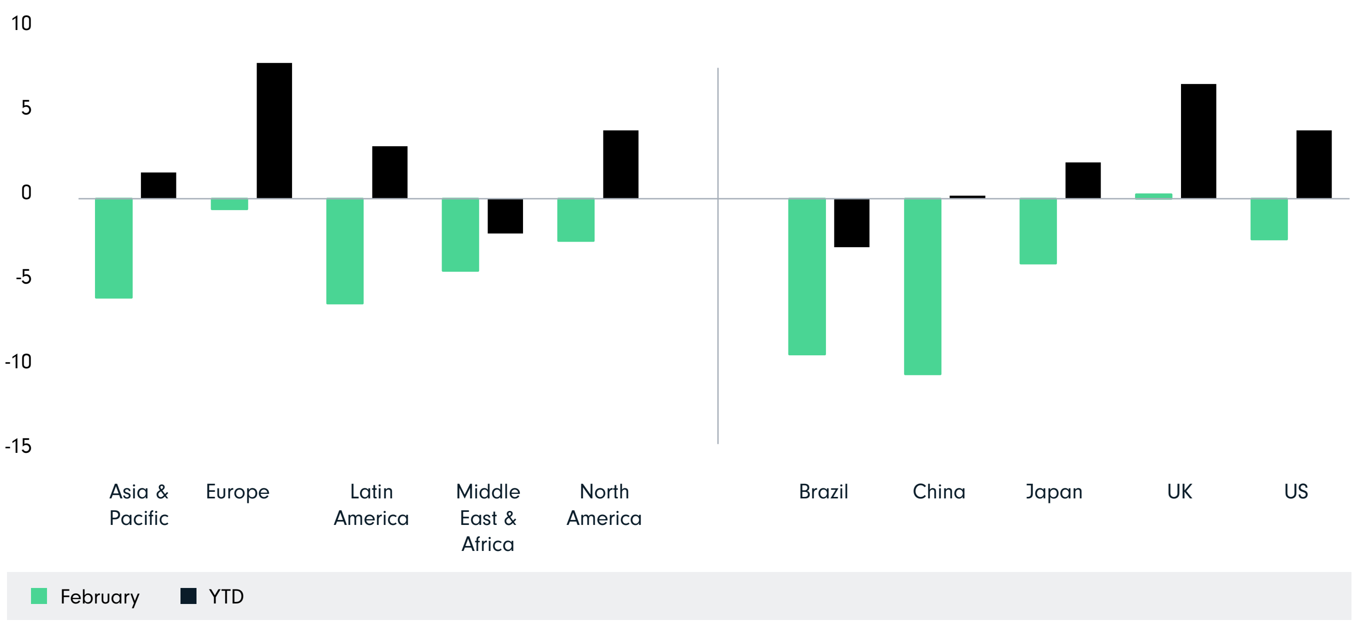
Another Month, Another Data Debate

Mar 2023

Global stocks gave back gains in February — falling -2.8% in USD terms as measured by the MSCI ACWI Index — amid ongoing debate as to the likely direction of both economic data and global central bank reactions to those data.

Regionally, Europe led the way, falling just -0.6%, even as the European Central Bank (ECB) took a more hawkish stance on inflation and expectations for rates at year end rose to 4.0% — implying several more hikes from the current 2.5%, to which the ECB raised the benchmark rate from 2.0% in February. Furthermore, ECB head Christine Lagarde signaled another hike was likely in March. The ECB's renewed enthusiasm for tightening comes against a backdrop of sticky inflation — as evidenced by Germany's, Spain's and France's latest numbers, which increased again after moderating for several months — and signs the region's economy remains relatively robust as energy prices remain largely in check and in spite of the ongoing war in Ukraine.

Exhibit 1 — February and YTD Total Returns for Major Markets (USD) (%)



Source: FactSet, as of 28 February 2023.

Asian markets declined -5.8% in February, led down by China, which fell -10.4%. Following a sharply positive January as China's economy reopened, increasingly tense geopolitical relations with the US and the West more broadly as it continues supporting Russia likely contributed to a sentiment reversal in February and erased all of January's gains. Elsewhere in Asia, Korea fell -7%, and Japan fell a more moderate -3.8%.

Latin American markets also declined in February, falling -6.2%. Brazil declined -9.2%, reversing all of January's positive progress and taking its market into negative territory year to date. On an absolute basis, Colombia was February's worst performer, falling a meaningful -16.3%. Mexico fell a modest -0.2%.

Among relatively few bright spots in the month was the UK, whose market eked out an essentially flat month (up 0.2%) as its economy averted a technical recession at the end of 2022 with GDP growth managing 0.1% annualized growth in Q4. Though the Bank of England has indicated it still expects a recession sometime this calendar year, the combination of moderating inflation — which declined for the third straight month in January and more sharply than expected — and potential signs the labor market is improving could lead the central bank to pause rate hikes. In addition, the recently agreed trade deal, which settles an ongoing dispute over trade between the UK and the EU passing through Northern Ireland, alleviates a source of uncertainty.

All sectors declined in February, led down by materials (-7.1%), consumer discretionary (-5.9%) and real estate (-5.0%), the latter as it faces an increasingly difficult interest rate environment which has challenged affordability for many potential home buyers. Industrials (-1.3%), energy (-1.4%) and financials (-2.2%) declined least. From a style perspective, growth resumed leadership over value as investors returned to some of the world's largest technology and communication services companies.

The US's inflationary environment remains a key focus for many, and markets seem to continue responding on what seems like a minute-by-minute basis to signs of inflation's either cooling or heating up and the Federal Reserve's presumed reaction. The reality is many of the economic data point in conflicting directions — not just in the US, but globally, too — making the value of such an exercise questionable at best. For example, consider some of the following data points:

- Net profits at S&P 500 Index companies declined for the sixth straight quarter in Q4 as input costs rise.
- The yield curve is sharply inverted — which is often considered a signal of impending recession — yet demand for junk-rated debt remains robust.
- The US labor market seems to remain healthy, with unemployment at a 53-year low, but many major companies have announced job cuts, and some private measures show demand for workers may be slowing, even while government data point to a still-hot labor market.
- Retail sales rebounded sharply in January, even while consumer spending seems to be declining, as does manufacturing activity.

The tea leaves seem to be just about anyone's to read right now. As we noted in January's commentary, we may very well be in for a bumpy ride in 2023.

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. **S&P 500 Index** measures the performance of 500 large companies in the US. 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 for a full copy of the disclaimer.