Core Global/Core International

NCM Monthly Commentary for January 2023

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Review of 2022

2022 was a challenging year for investors. Inflation had been percolating in the background when the year began and then the onset of the war in Ukraine served as a catalyst to drive inflation even higher. In response to inflation reaching levels not seen in 40 years, central banks in various parts of the world started hiking interest rates. Against this backdrop, both stock and bonds lost money in 2022. It is very unusual for this to happen. Since 1926 there have only been three calendar years when stocks and bonds were both down. Those years were 1931, 1969, and 2022. According to Ned Davis Research, 2022 marked the first time on record that both stocks and bonds fell by more than 10%.

As seen in the chart below, the weakness in stocks was a global phenomenon.

Index	Currency	Total return with dividends
Morningstar Global Index	70% USD / 30% Euro	-16.4%
S&P 500	USD	-18.1%
Euro Stoxx 600	EURO	-9.9%
MSCI Emerging Markets	USD	-19.9%

Outlook for 2023

We are cautiously optimistic as 2023 gets underway. Given what transpired in 2022, valuations are much more attractive relative to where things stood one year ago. With a decline of nearly 20% for the S&P 500 during 2022, the Price-to-Earnings (P/E) ratio for this index as of year-end 2022 was trading in line with the 25-year average as seen in chart 2.

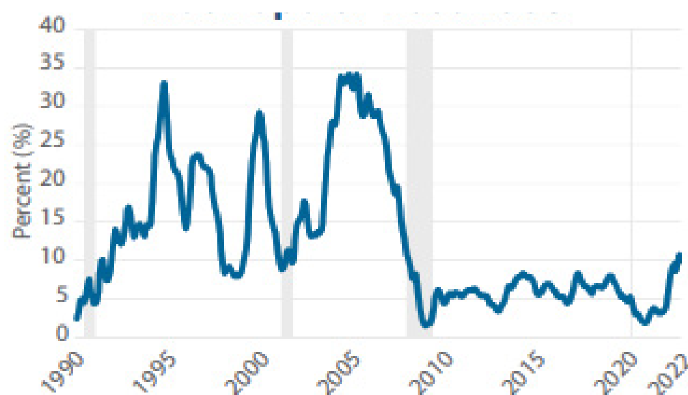
Although there are signs that inflation is cooling, it seems a bit too early for central banks to declare victory. From my vantage point, there are likely to be further interest rate hikes on the horizon and the jury is out as to whether central banks can engineer a soft landing by avoiding a recession. Having said that, if a recession does materialize, I believe it will be a milder garden variety type recession. Global banks have robust levels of capital so a repeat of the 2008-09 Financial Crisis seems highly unlikely. Meanwhile, corporates

CHART 2

Source: JPMorgan - Guide to the Markets

and consumers are less exposed to credit risk and leverage risk than they have been historically. In the United States, debt servicing ratios are near multi-decade lows. As seen in chart 3, approximately 90% of U.S. mortgages are fixed, far below levels seen during previous tightening cycles. Similar to consumers, U.S. corporates have shifted to fixed rate debt. Today, over 75% of S&P 500 debt is long-term fixed versus 40% back in 2007. The average maturity of debt on S&P 500 balance sheets today is 11 years, which compares to 7 years in 2007. For all these reasons, we believe that any recession that unfolds should be shallow one as opposed to a deep, prolonged downtown.

CHART 3



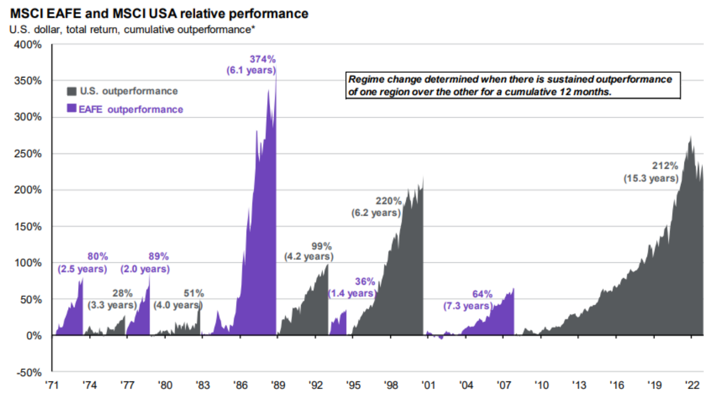
As of December 31, 2022. Sources: Mortgage Bankers Association. Adjustable-rate mortgage (ARM) share of number of loan applications, percent of 3 month average. Grey lines indicate recessionary periods.

As part of our outlook, we also believe that a changing of the guard may be unfolding in terms of stock market leadership. The United States has had a great run as seen in chart 4 on the next page with about 15 years of outperformance versus international markets.

CHART 4

Cycles of U.S. equity outperformance

GTM | U.S. | 47

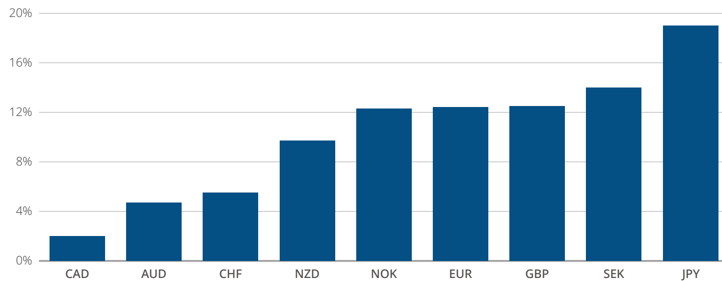


Source: FactSet, MSCI, J.P. Morgan Asset Management. *Cycles of outperformance include a qualitative component to determine turning points in leadership.

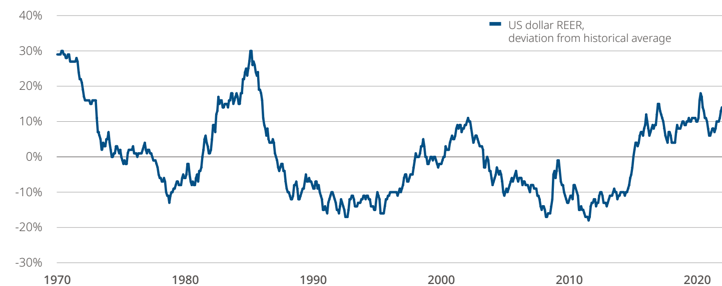
CHART 5

U.S. dollar strength has been one of the main macro themes of 2022

The USD gained vs. all G10 currencies in 2022



The U.S. real exchange rate is well above its historical average



Notes: All data via Bloomberg as at July 31. The chart on the right uses the Bank of International Settlement's version of the real effective exchange rate (REER) for the U.S. dollar against its "narrow" set of peers, minus its average from 1970 to today. Source: Mackenzie Investments.

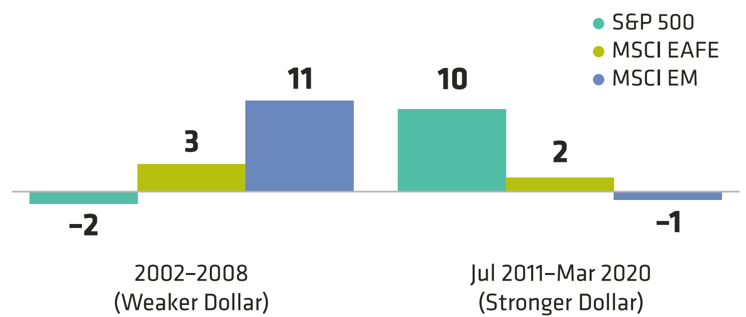
One of the catalysts that will likely play a factor in this potential changing of the guard in the reversal in the strength of the U.S. dollar. As seen in chart 5, the US dollar gained against all G10 currencies during 2022 and it was well above its historical average towards the end of 2022.

Based on history, a reversal in the US dollar could have implications for stock market returns across different regions around the world. As seen in chart 6 below, sustained periods of US dollar weakness have been associated with outperformance from international stocks. The last period of sustained US dollar weakness occurred from 2002-2008. This period coincided with a period of underperformance for US stocks relative to International stocks.

CHART 6

Weaker Dollar Boosts International Equity Returns

Annualized Returns (USD, Percent)



Source: AllianceBernstein: Is It Time To Expand Allocations to International Stocks?

Our portfolios are well positioned for this potential changing of the guard given that we own a large number of companies headquartered throughout Europe and the emerging markets in our Global and International portfolios. In summary, there are many reasons why we have a cautiously optimistic view as the New Year gets underway. First, many of the stocks that we own across our portfolios were caught up in last year's selloff so the valuations for our companies have become more attractive. Second, inflation is finally showing some signs of cooling which leads us to believe that we are getting closer to the end of the interest rate hiking cycle. Finally, we believe that the types of companies we own...with stable earnings, low leverage, and pricing power, will be well positioned for the current environment.

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