The Difficulties of Macro Investing – Market Commentary

December sees the end of 2023 and a good time to take stock of global markets' performance. The year saw a stunning +55.1% for the Nasdaq, and a more muted but still strong +25.7% for the S&P 500.

Perhaps surprisingly Growth outperformed Value +37.0% to +11.5%.

The US was a driver for the MSCI World which returned +23.8%. Emerging Markets underperformed returning +9.8% and within this South Africa underperformed returning only +1.7%.

The various market returns are summarised in Table 1 below.

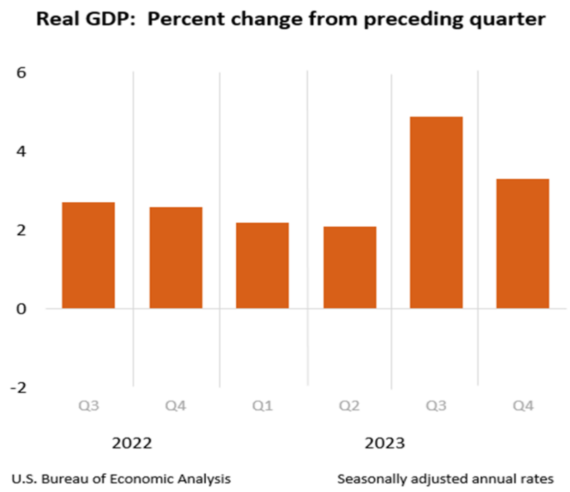
Table 1. South African and global equity returns (USD) for December 2023*

	Dec-23	YTD 2023
FTSE/JSE ALSI (ZAR)	2.0%	9.3%
FTSE/JSE ALSI (USD)	5.7%	1.7%
MSCI World	4.9%	23.8%
MSCI EM	3.9%	9.8%
MSCI Value	5.4%	11.5%
MSCI Growth	4.4%	37.0%
S&P 500	4.5%	25.7%
Nasdaq 100	5.6%	55.1%

*Total return indices, Source: Factset

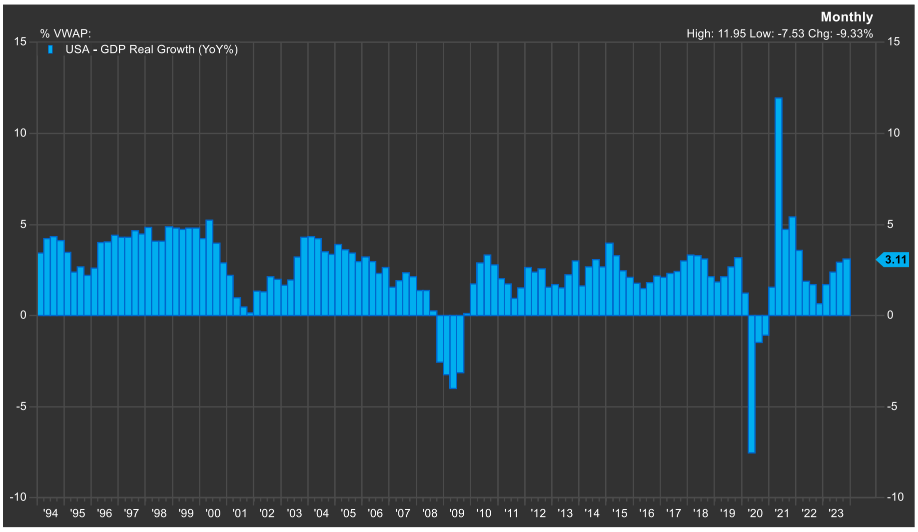
At the time of writing in January 2024 real US GDP growth has just printed at an annual rate of +3.3% for Q4 2023, down from +4.9% for Q3. The recent readings from the Bureau of Economic Analysis are set out in Chart 1 below.

Chart 1. Quarterly Annual Real US GDP Growth



This latest GDP data underscores consistent strength in the US economy. Year-on-year growth for the last 4 quarters, presented in Chart 2 below, has been accelerating. Economists tell us this is explained by strength in consumer spending underpinned by a strong job market.

Chart 2. Year-on-year Real GDP Growth



Source: Factset

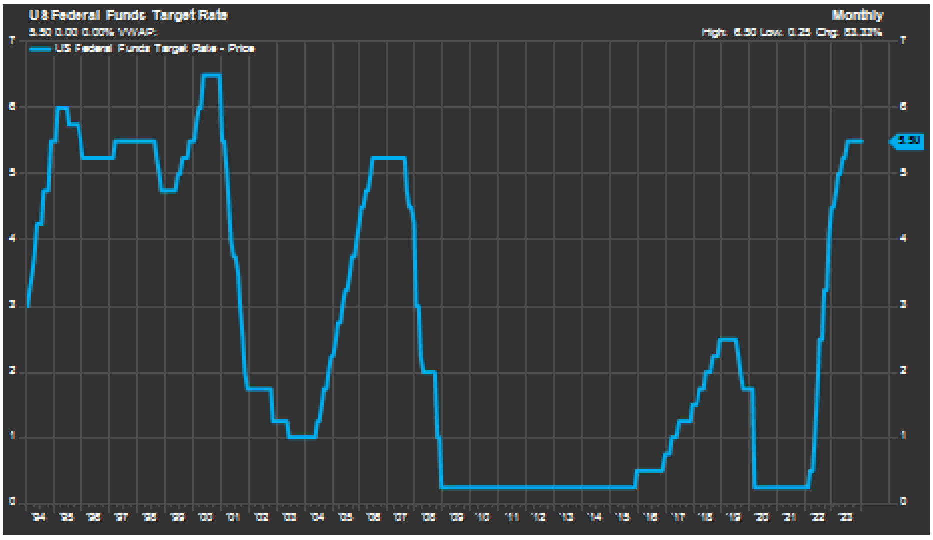
So what happened to the recession?

The problem is that 2023, like 2022, was another year with seemingly never-ending debate, discussion and expectation of a recession in the US with an inverted yield curve and contracting lending. We have been waiting for the recession for at least 18 months. 2024 is now here and the recession still hasn't arrived.

Of course, this is not to say it will not come – long and variable lags mean that a slowdown, should there be one, is expected 12-18 months following the peak in interest rates. It is likely the peak was reached at mid-year in 2023, per Chart 3 below. So we are still waiting for the recession in 2024 with one popular current debate being whether this will materialise in the first or second half of the year.

But what if it doesn't arrive at all?

Chart 3. Fed Funds target rate



Source: Factset

Macro investing

Which brings us to macro investing and the point of this writeup. An entire category of hedge funds uses macro investing as a primary strategy. George Soros, a renowned personality and investor, was a macro investor. Long only investing also often employs this strategy, and in many cases it is at least an input into some other approach.

As a quick recap macro investing relies on formulating views of macroeconomic developments and attempting to profit by positioning a portfolio accordingly. Macro investors might take views on the future movement of various macroeconomic variables – GDP being one, but others include Treasury yields, exchange rates, commodity prices etc.

A recent conversation with an asset management colleague included the comment "tell me what happens to the macro and I'll tell you which shares to buy".

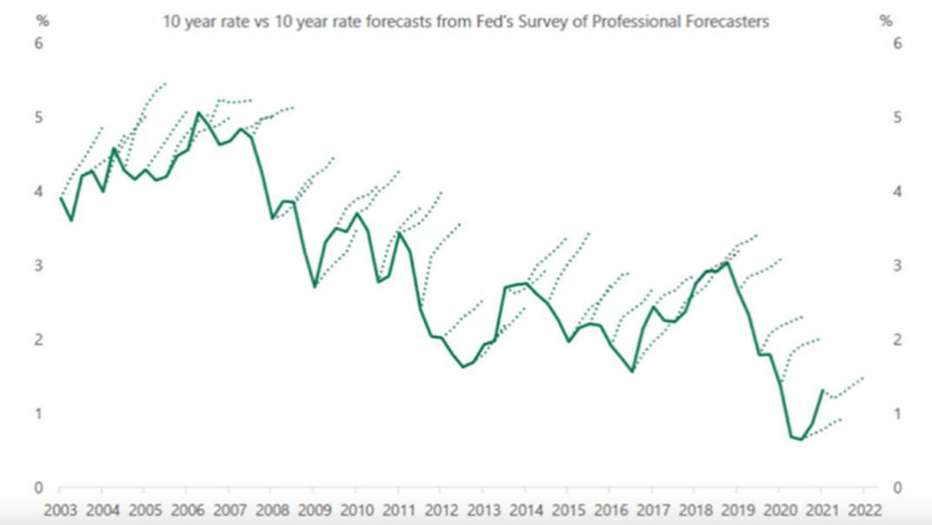
The difficulty of macro investing

A macro forecast needs to be different from consensus and this seems to be as likely to be correct as not. Also, how often is the consensus correct? And what is the consensus anyway? Is it that there will be a recession? If so, it has not been correct for 18 months. And where is the consensus on the start of a slowdown in 2024 – H1 or H2?

How often has one heard a forecaster saying "I forecast a recession in the next 12 months and in the last 5 years x% of my forecasts have been correct"? One thinks of an investment manager who presents no track record.

One example of consistent erroneous macro forecasting is of interest rates and presented in Chart 4 below.

Chart 4. US 10-year Treasury Yield forecasts



Source: Philadelphia Fed Survey of Professional Forecasters, www.philadelphiafed.org

Per Chart 4 above, in the case of US Treasury yields the forecasting record does not look very good. Apart from consistent upward bias in estimates, in 2021 forecasters appear to have *undershot* substantially.

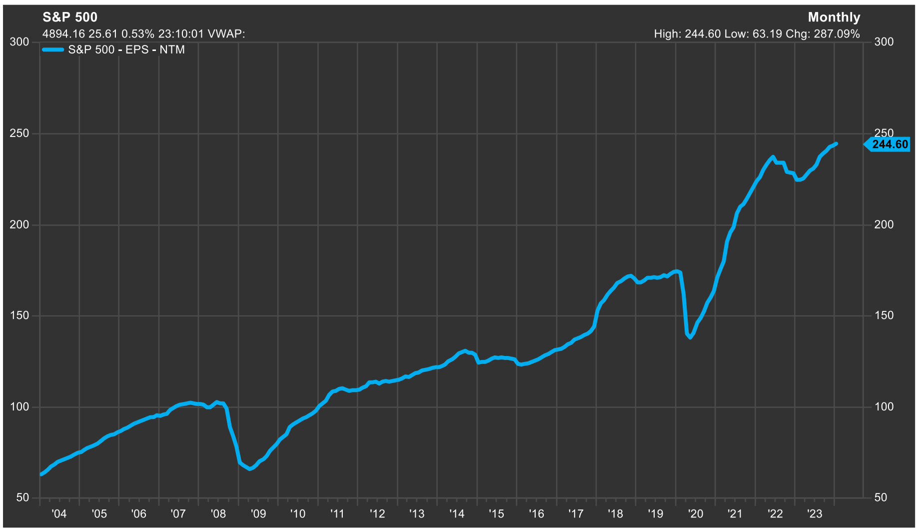
Why are we so obsessed with a recession anyway?

Stock prices are driven by interest rates and profits. A recession would impact profits, depending on the sector and the company being considered, which would then have impact on the stock price.

But profits are expected to rise?

Indeed. Chart 5 presents Earnings per share ("EPS") expectations for the S&P 500.

Chart 5. Next 12 months EPS for the S&P 500



Source: Factset

Per Chart 5 above EPS are expected to rise. An additional possible interpretation is that the earnings recession has *already occurred* and the market has moved on.

So which is it? Profits up or profits down (due to a recession which hasn't arrived) and where is the market going?

If not Macro then what?

These difficulties are the reason why we tend to monitor macro but macro forecasts are not an input into our investment views. For that matter we are also cognisant of valuations but like to think we recognise the very real risks of being overly reliant on these subjective estimates.

In an environment of uncertainty and risk we tend to focus on stability of underlying operating performance as displaying greater predictability over the medium and longer term. As with every approach there will be surprises here too but we like to think these can be better controlled through appropriate portfolio construction.

As a final comment and conclusion, we note that Peter Thiel, of PayPal fame, renowned VC investor and former Meta Board member is also a failed macro hedge fund manager.