

Growth versus value, Europe's cold snap and inflation expectations

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Julius Probst PhD, Nicolas Tremel, Arnaud Lieugaut, Patrick Malm and Karl-Philip Nilsson

As 2022 heads to a close, this week's charts examine the tug of war between growth and value stocks over the past decade, as well as different indicators that predict falling US inflation. China is relaxing the Covid zero policy as cases rise, resulting in an uncertain outlook for its German trading partner. Americans are switching jobs because it pays to do so, while UK housing prices are proving to be a leading indicator for unemployment. And it's not just you – it really is a colder winter than usual in Europe.

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Looking back at winning and losing growth and value sectors

This table ranks winners and losers among US equity sectors for every year between 2015 and 2022. Two distinct eras jump out.

The Covid year of 2020 was defined by recession, anemic inflation, low interest rates, low commodity prices and elevated risk aversion. It was the perfect environment for growth stocks in sectors like IT and communication services. (Interestingly, 2019 equity trends were similar.)

The second era is the 2021-2022 “post-Covid” period: stronger growth, stronger inflation, higher rates and commodity prices, and lower risk aversion. It was the sweet spot for value stocks, such as energy and financials.

The change of leadership from growth to value has been extreme. In 2023, we will probably see more balanced returns from the two investment styles, as both economic growth and inflation expectations are cooling.

S&P 500 Sector Annual Performance Ranking

Rank	2015	2016	2017	2018	2019	2020	2021	2022
1	Consumer Discretionary 8.4 %	Energy 24 %	Information Technology 37 %	Health Care 4.7 %	Information Technology 48 %	Information Technology 42 %	Energy 48 %	Energy 53 %
2	Health Care 5.2 %	Financials 20 %	Materials 21 %	Utilities 0.46 %	Comm. Services 31 %	Consumer Discretionary 32 %	Real Estate 42 %	Utilities -0.53 %
4	Information Technology 4.3 %	Comm. Services 18 %	Consumer Discretionary 21 %	Consumer Discretionary -0.49 %	Financials 29 %	Comm. Services 22 %	Information Technology 33 %	Health Care -2.8 %
3	Consumer Staples 3.8 %	Industrials 16 %	Financials 20 %	Information Technology -1.6 %	Industrials 27 %	Materials 18 %	Financials 33 %	Consumer Staples -2.8 %
5	Real Estate 1.2 %	Materials 14 %	Health Care 20 %	Real Estate -5.6 %	Consumer Discretionary 26 %	Health Care 11 %	Materials 25 %	Industrials -7.2 %
6	Comm. Services -1.7 %	Utilities 12 %	Industrials 19 %	Consumer Staples -11 %	Real Estate 25 %	Industrials 9 %	Health Care 24 %	Materials -13 %
7	Financials -3.5 %	Information Technology 12 %	Consumer Staples 10 %	Financials -15 %	Consumer Staples 24 %	Consumer Staples 7.6 %	Consumer Discretionary 24 %	Financials -14 %
8	Industrials -4.7 %	Consumer Discretionary 4.3 %	Utilities 8.3 %	Industrials -15 %	Utilities 22 %	Utilities -2.8 %	Comm. Services 21 %	Real Estate -26 %
9	Utilities -8.4 %	Consumer Staples 2.6 %	Real Estate 7.2 %	Comm. Services -16 %	Materials 22 %	Financials -4.1 %	Industrials 19 %	Information Technology -26 %
10	Materials -10 %	Real Estate 0.0053 %	Energy -3.8 %	Materials -16 %	Health Care 19 %	Real Estate -5.2 %	Consumer Staples 16 %	Consumer Discretionary -34 %
11	Energy -24 %	Health Care -4.4 %	Comm. Services -6 %	Energy -20 %	Energy 7.6 %	Energy -37 %	Utilities 14 %	Comm. Services -40 %

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Watching Germany as its biggest trade partner relaxes Covid zero

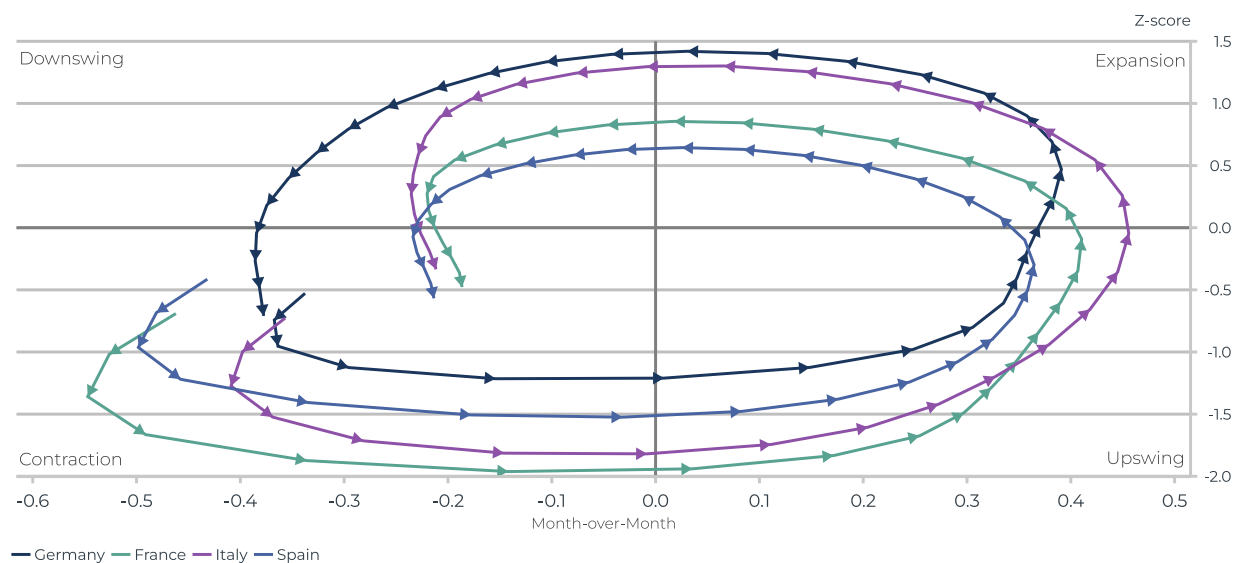
The following chart is [a version of the European Commission “clock”](#) that tracks economic progress through the business cycle, divided into four quadrants: contraction, upswing, expansion, and downswing.

Germany’s economy has deteriorated more quickly than France, Italy and Spain, as our chart shows. That’s due to the knock-on effect of China’s Covid-zero policy and a greater impact from this year’s energy crisis.

Growth in Europe’s largest economy has long been export-driven, and China is Germany’s biggest trading partner. As China loosens the Covid-zero policy, Germany may benefit. But the experience of other countries suggests cases may surge, and it’s not guaranteed that supply-chain and trade disruptions will disappear.

Economic climate clock since January 2020

Source: European Commission (DG ECFIN)



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Cold European winter is as much of an outlier as the warm autumn

After a mild autumn, many Europeans are shivering in a much-colder-than usual winter.

The cold snap is important because of the potential for energy shortages. [German regulators recently warned](#) that firms and households must save much more gas to avoid winter rationing or outages.

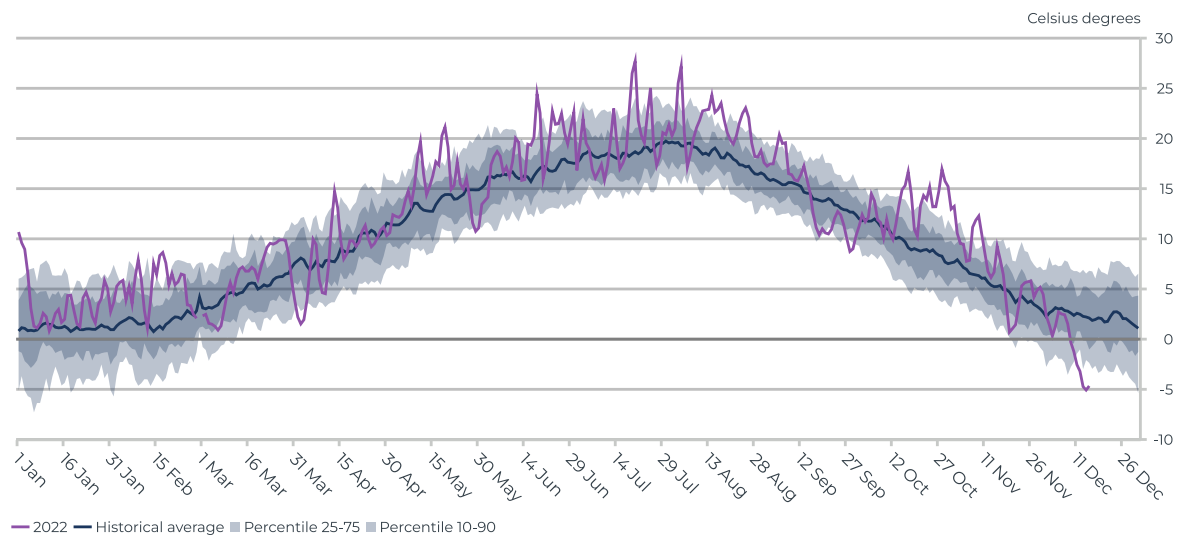
The chart below shows how temperatures in Germany, as tracked by the purple line, have plunged below not just the historic average but the 10 to 90 percentile range of previous years.

The opposite was the case as recently as mid-October – [when we wrote that Europe was taking advantage of balmy temperatures](#) to refill its gas storage facilities.

Europe's energy needs have been in focus this year after Russia slashed gas deliveries, increasing scrutiny of previous German policy to phase out nuclear plants.

Germany: a much warmer fall and much colder winter than usual

Source: Germany's National Meteorological Service (Deutscher Wetterdienst DWD)



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Visualising the growth and value eras

As we pointed out in our first chart this week, value stocks drastically outperformed growth stocks over the past year. The first of the two charts below is a different visualisation of this trend.

Blue areas denote periods of outperformance by growth stocks, as defined by FactSet. Green areas show when the value style outperformed.

The second chart shows that growth, relative to value, is now trading at a valuation discount versus its long-term average (the red line). Not long ago, price-earnings ratios were almost 60 percent higher for growth stocks, a differential last seen in the 2000 dotcom bubble.

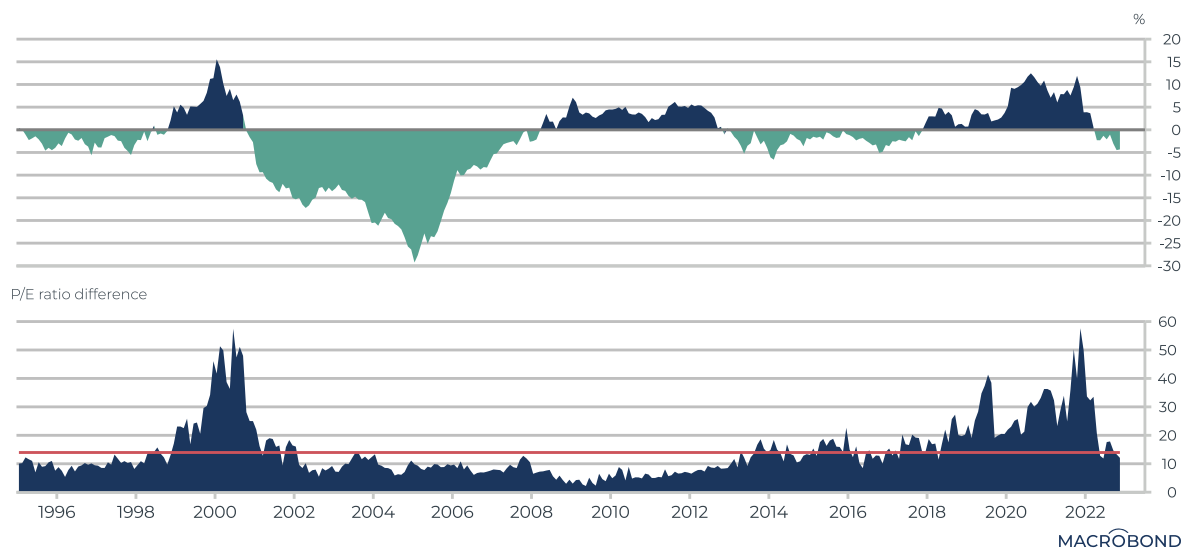
Relative profit expectations for growth stocks have rebounded from their record low in September. As we said previously, 2023 could be a balanced year for growth versus value.

The following chart requires a subscription to the Macrobond/FactSet add-on database.

Tip: this chart allows for the [change region](#) function.

United States: Value stocks outperform growth stocks

Growth-value: 5-year annualised returns difference
Source: FactSet



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US growth and inflation expectations are sliding

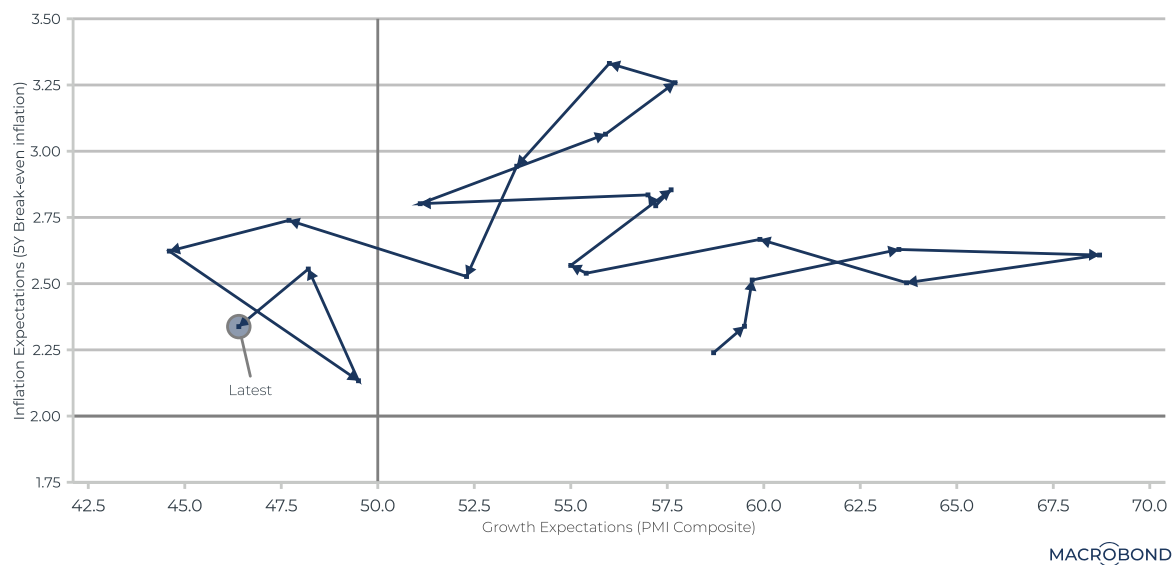
The following chart graphs the progress of US inflation and growth expectations since January 2021, as measured by the [five-year breakeven rate](#) (inflation) and the composite Purchasing Managers Index (growth).

Amid criticism of its past hesitancy to raise rates, the Federal Reserve's tighter policy successfully resulted in falling inflation expectations this year, as our chart shows. But growth expectations are declining too.

The PMI fell to 46.3 in November; numbers below 50 indicate contraction. As investors debate whether the Fed will avoid a hard landing and "pivot" to rate reductions in 2022, the PMI reading suggests a recession in the first half of 2023 is very possible.

US: Inflation and growth expectations since January 2021

Source: S&P Global, Federal Reserve



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M2 suggests US inflation will tumble

Many people got it wrong on inflation over the past two years. In early 2021, some analysts took a micro approach – focusing on used car prices or specific bottlenecks.

In our view, it's become clear that much US inflation is demand-driven and reached all sectors of the economy, caused by excessively easy monetary policy combined with generous fiscal support.

We can consider monetary aggregates like M2 – cash, chequing deposits, and assets that can easily be converted to cash – to examine inflation. (This is appropriate now that the US is no longer in a liquidity trap; the relationship breaks down with interest rates at zero. And to be sure, velocity of M2, not just supply, matters for how inflation behaves.)

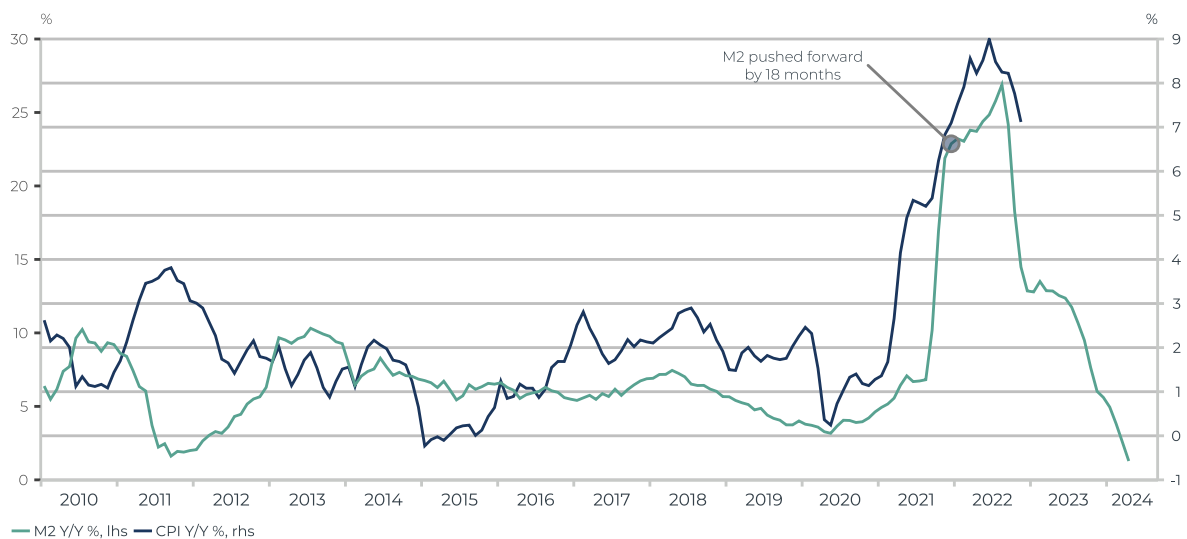
Our chart shows the correlation between M2 money supply, pushed forward by 18 months, and the consumer price index. Excess money growth in 2020-21 contributed to peak inflation this year.

As money growth is falling off a cliff, we can expect inflation to also decline quite substantially in coming months.

Tip: this chart allows for the [change region](#) function.

United States: Inflation vs M2

Source: U.S. Bureau of Labor Statistics (BLS), Federal Reserve



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Americans are switching jobs to get big wage increases

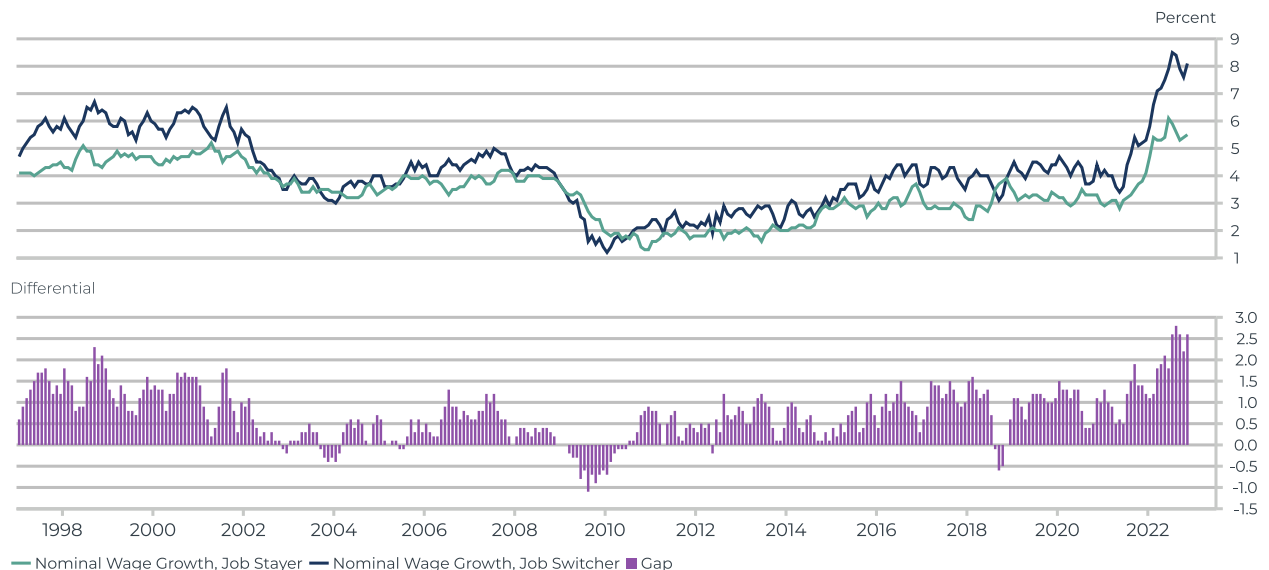
If you want to get a big salary boost in the US, you should switch employers – at least according to data from the Atlanta Fed.

The following chart tracks nominal wage growth for people who stay in the same job versus people who join a new company.

In the US, nominal wages are growing at their fastest pace since the late 1990s. And the differential between job stayers and job switchers recently touched the highest level ever recorded.

US wage growth: Job switchers vs job stayers

Source: Federal Reserve Bank of Atlanta



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The Bank of England has been overly gloomy on unemployment

Britons may well hope the Bank of England keeps up its past record of overestimating unemployment.

The following chart tracks the actual UK unemployment rate against different vintages of the BOE's forecasts for joblessness.

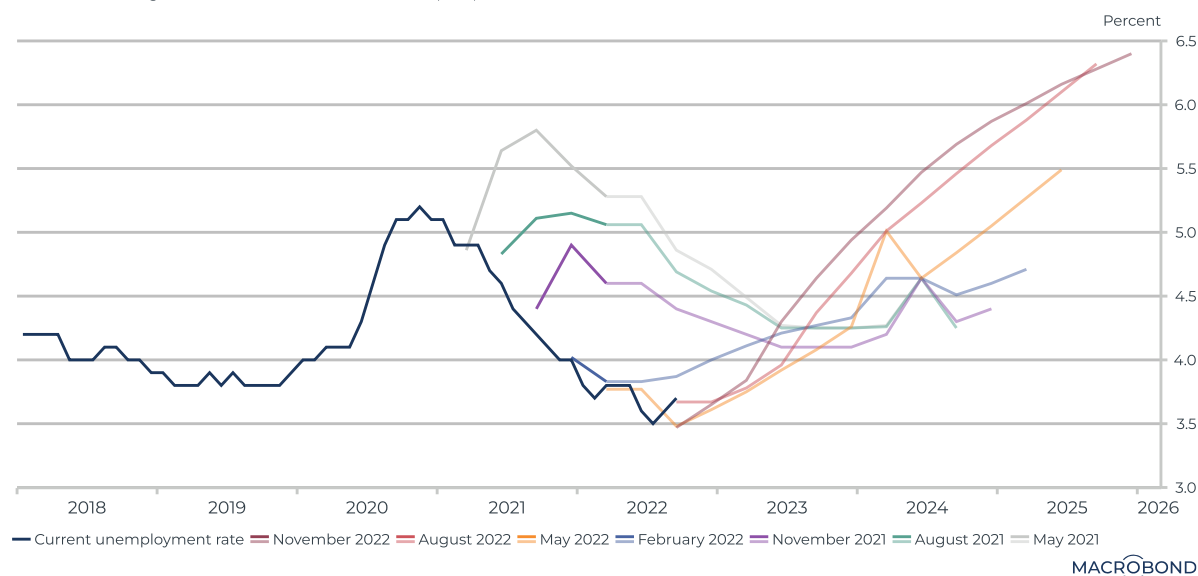
In 2021, the BOE initially expected unemployment to be much stickier than what actually occurred post-lockdown. And it overestimated unemployment throughout 2022 by one to two percentage points; the rate plunged to 3.5% this summer.

However, the outlook is considerably less bright as the BOE forecasts a brutal recession that lasts from early 2023 until potentially mid-2024.

The BOE recently revised its unemployment forecast upwards. Amid a darkening outlook, the BOE expects the jobless rate to almost double, reaching 6.5 percent by early 2026.

UK unemployment rate vs forecast revisions

Source: Bank of England, U.K. Office for National Statistics (ONS)



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The correlation between UK house prices and unemployment

Perhaps unsurprisingly, UK house prices and unemployment are tightly correlated.

Several economists, most notably Roger Farmer, have examined this relationship. Asset-price declines affect private-sector confidence and induce a negative wealth effect, both of which are obviously detrimental to the labour market.

The causality goes the other way, as well. A negative shock to the labour market hurts house-price fundamentals.

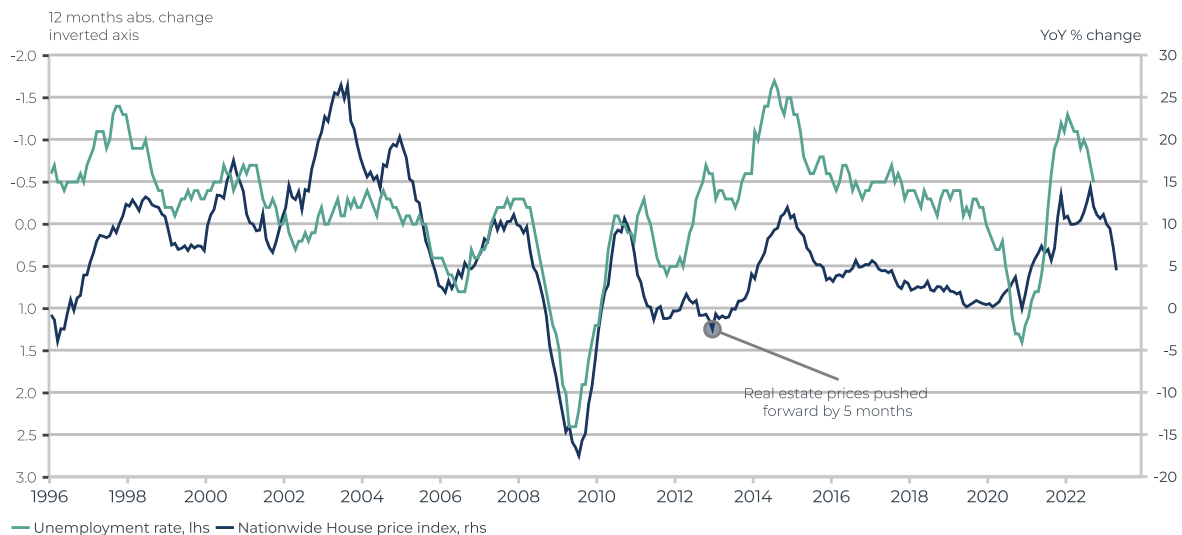
As our chart shows, UK house-price growth slowed markedly over the course of 2022. And unemployment is edging up as the UK recorded negative third-quarter growth.

Going forward, expect further pain for property prices and unemployment. Perhaps counter-intuitively, real estate is the leading indicator – by about five months, as our chart shows.

Tip: this chart allows for the [change region](#) function.

United Kingdom: Unemployment and house prices

Source: Nationwide, U.K. Office for National Statistics (ONS)



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China relaxes Covid zero as cases rise

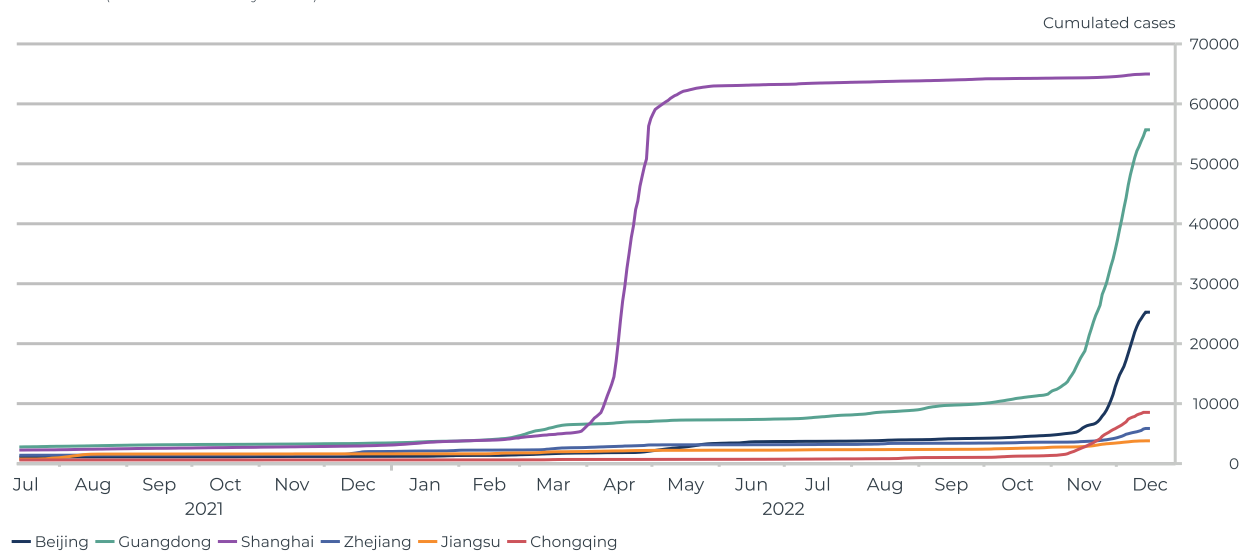
At long last, China is relaxing the Covid-zero policy, which saw regional lockdowns constrain economic growth and disrupt global supply chains.

Coronavirus cases are on the rise, as our chart tracking notable Chinese regions shows.

It is notable that Shanghai experienced an earlier surge and plateau of cases than the other regions.

China Covid confirmed cases surge with relaxed Covid-19 rules

Except for Shanghai whose already surged early this year
Source: DXY (Lilac Garden Family Clinics)



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