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Global Asset Allocation – Big Uncertainties Warrant Continued Caution

Quarterly Investment Strategy
Fourth Quarter 2022

Summary of Investment Conclusions

UOBAM sees 4 Big Uncertainties that markets are likely to remain nervous over for the coming quarter –
If inflation will improve enough,
central bank reactions,
the resilience of the global economy, and
the market reactions to various combinations of inflation/rates/growth.

Our base case:
Inflation gets below 3% by the end of 2023,
central banks will not pivot to dovishness,
the global economy will slow but not suffer a deep recession, and
markets are likely to remain range bound for the coming quarters before improving in 2023.

We recommend caution and neutral positioning in a highly uncertain environment – Base case is for a 2022 to remain volatile, and for the outlook to start to improve in 2023.

We expect bond yields to range between 2.75% and 3.5% in the 4th quarter of 2022.

We expect the USD to be supported **by stronger economic growth and rising yields and relative tighter monetary policy than other regions.**

UOBAM House View remains cautious

Global asset allocation	--	-	N	+	++
Equities	○	●	○	○	○
- US equities	○	○	●	○	○
- European equities	○	●	○	○	○
- Japan equities	○	●	○	○	○
- Asian ex Japan equities	○	○	●	○	○
Government bonds	○	▶	▶	●	○
Investment grade credits	○	○	●	◀	○
High yield credits	○	●	◀	○	○
Real estate investment trusts	○	○	○	●	○
Commodities	○	○	●	◀	○
Alternatives (hedged strategies)	○	○	●	◀	○
Alternatives (private equity)	○	○	●	◀	○
Cash	○	○	○	●	○

++ Strong overweight + Overweight N Neutral - Underweight - Strong underweight

Note:
*3-6 months horizon
The weights are relative to the appropriate benchmark(s).

Source: UOBAM, 1 September 2022

Investment cycle racing at warp speed

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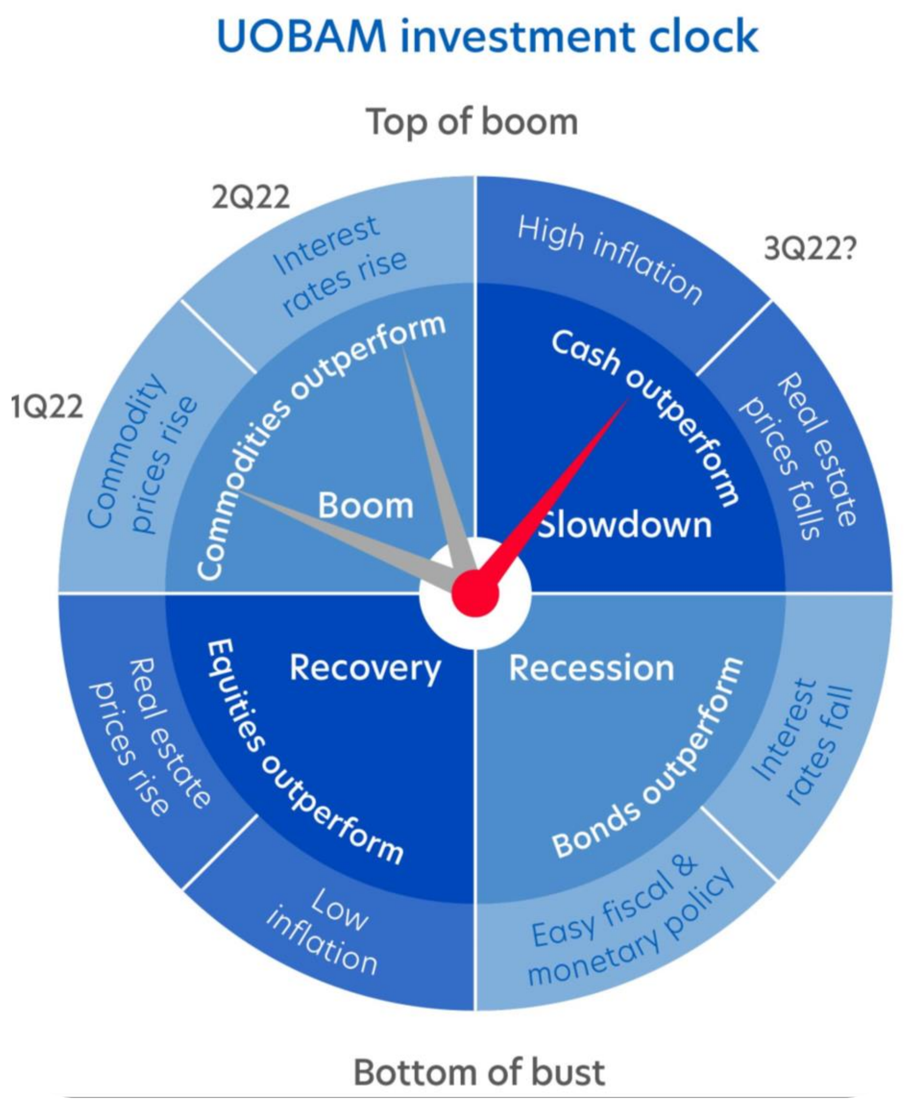
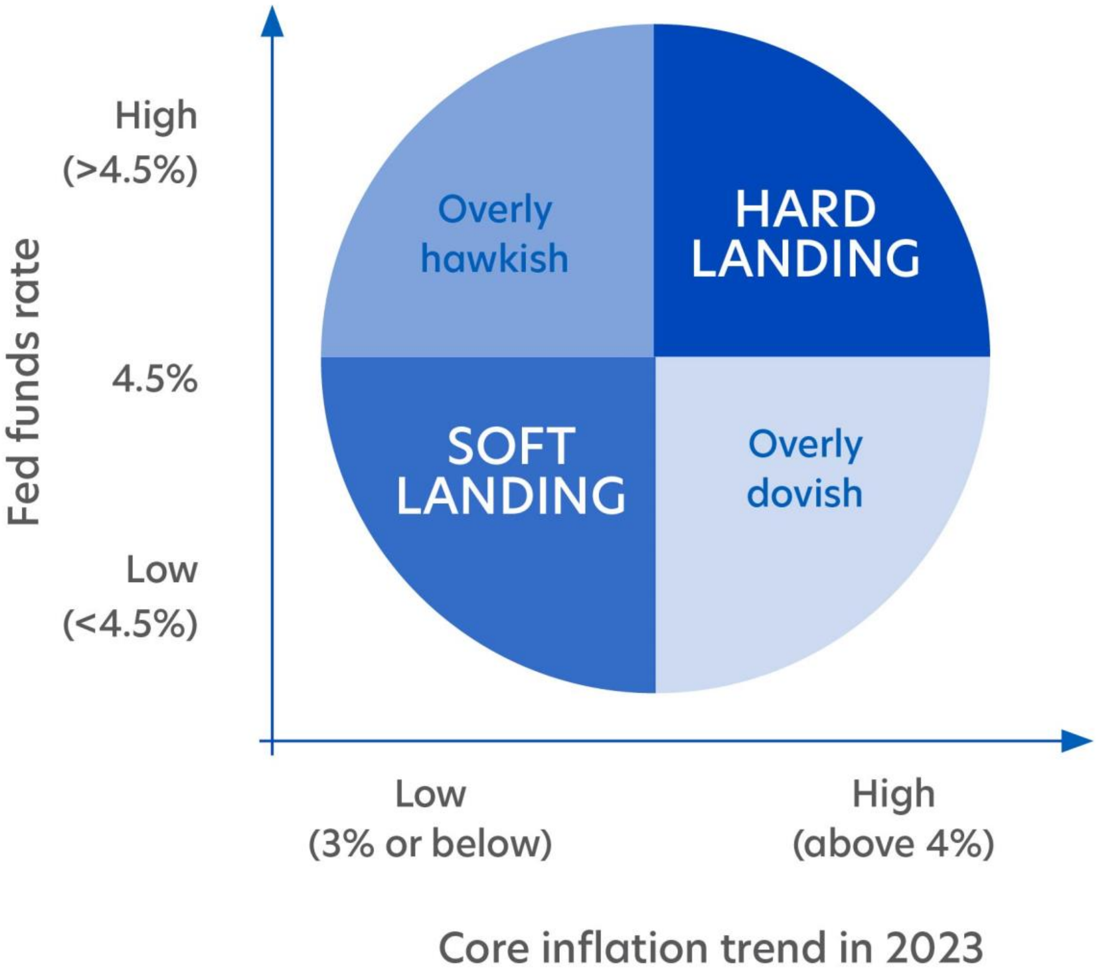
The expansion period when interest rates start to rise can usually last 3 to 5 years. It appears this mid cycle expansion will last less than 1 year.

Interest rates will continue to rise to slow the cycle but at some point, soon bond yields may peak and create an opportunity in fixed income.



Source: UOBAM, March 2022

The New “Clock” – we are monitoring the critical intersection between inflation and policy



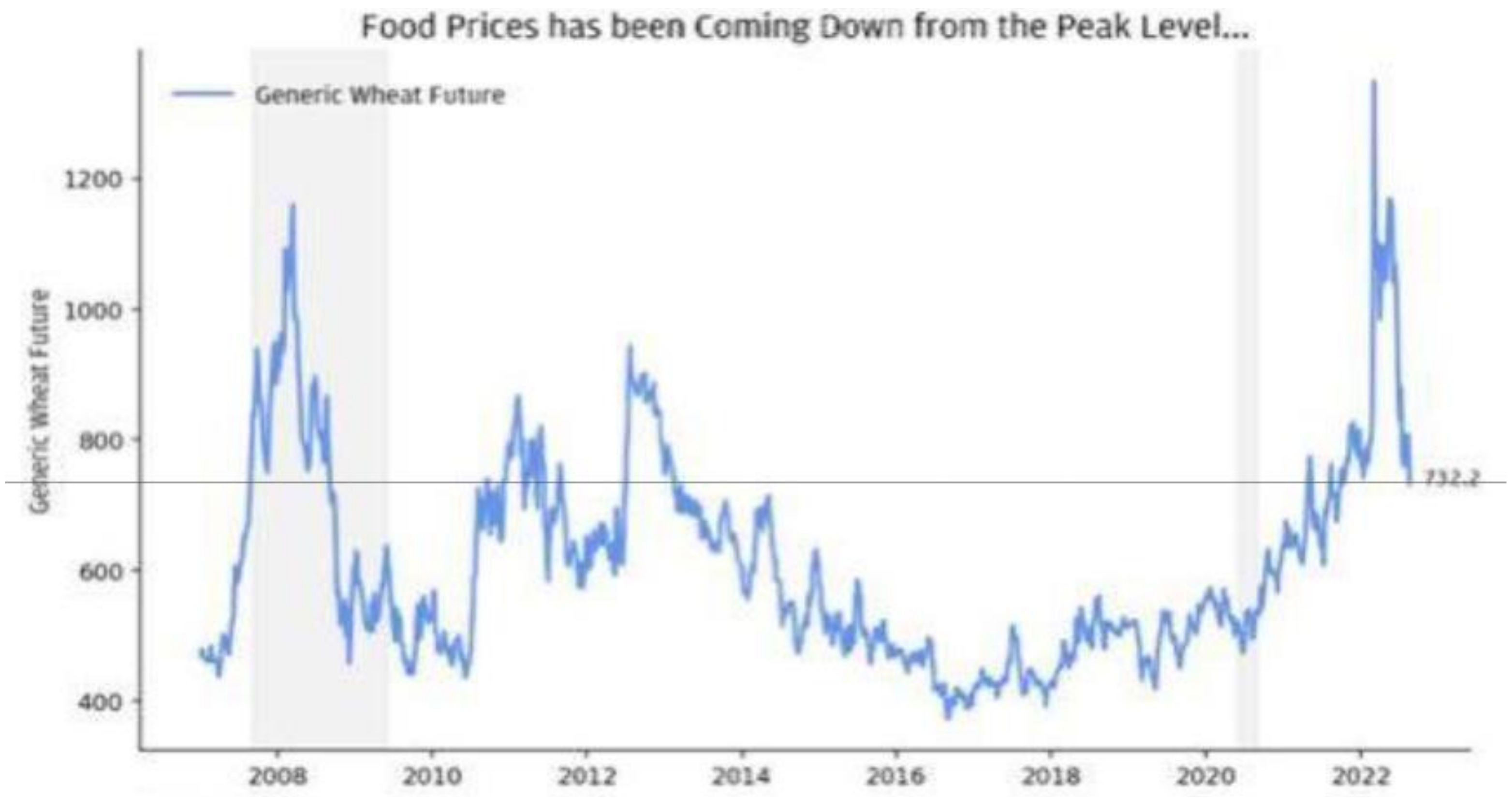
Source: UOBAM, September 2022

The 4 big uncertainties

The 4 big uncertainties

Inflation outlook	How long will it take for inflation to get back under control? (which we define as <3%, a level seen in past expansions)
Central bank outlook	Given the inflation outlook, what will the central bank reactions be, and will they pivot to a more dovish path in 2023?
Economic outlook	Everyone expects the global economy to slow into the fiercest rate hiking cycle in 50 years – but will this be a soft slowdown like 1990 or a hard recession like 2008?
Market reaction to inflation/rates/ economy outlook	The pricing of rates, credit and equities remains very complicated under many of the potential outlook conditions. We do not have a lot of market history on many of the potential scenarios and it remains unclear how markets are going to react.

Signs that inflation outlook is improving



Source: Bloomberg, JPM US Market Intelligence

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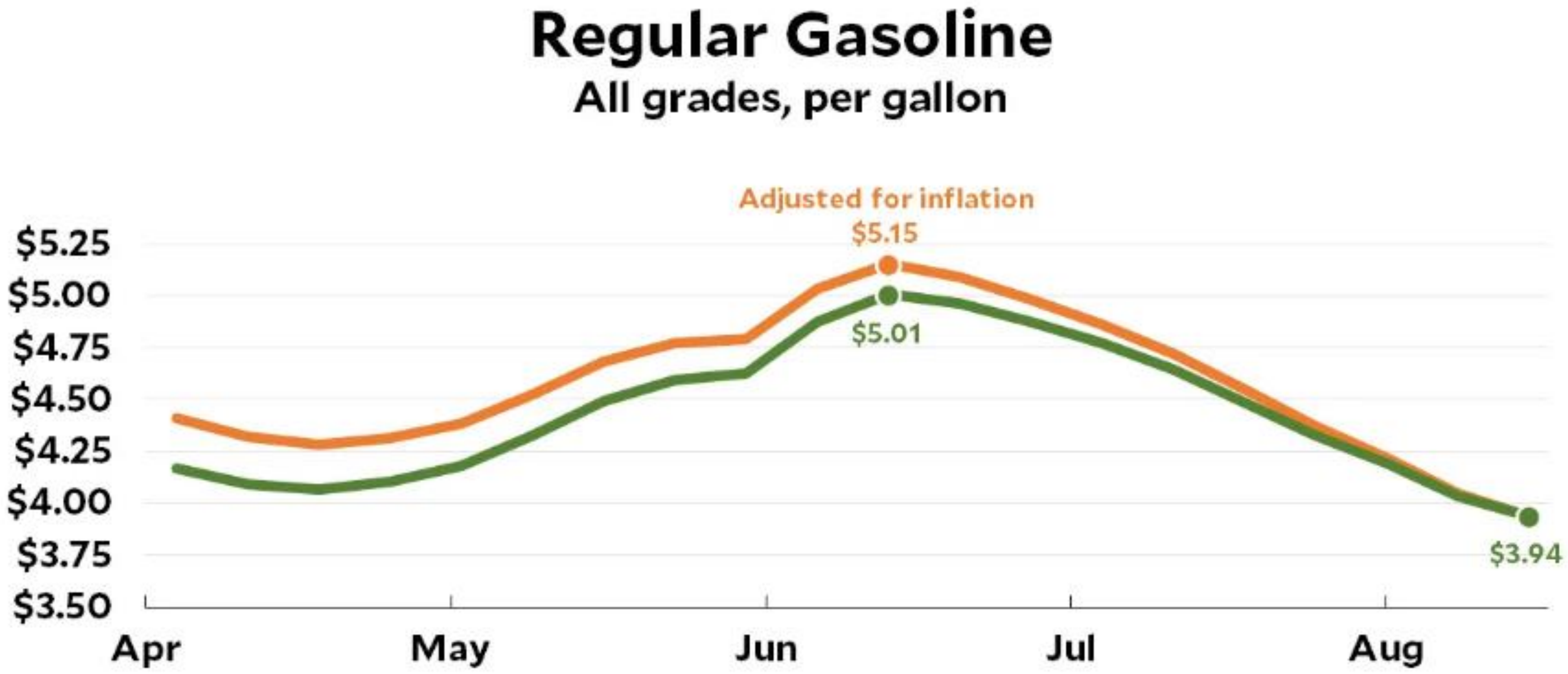
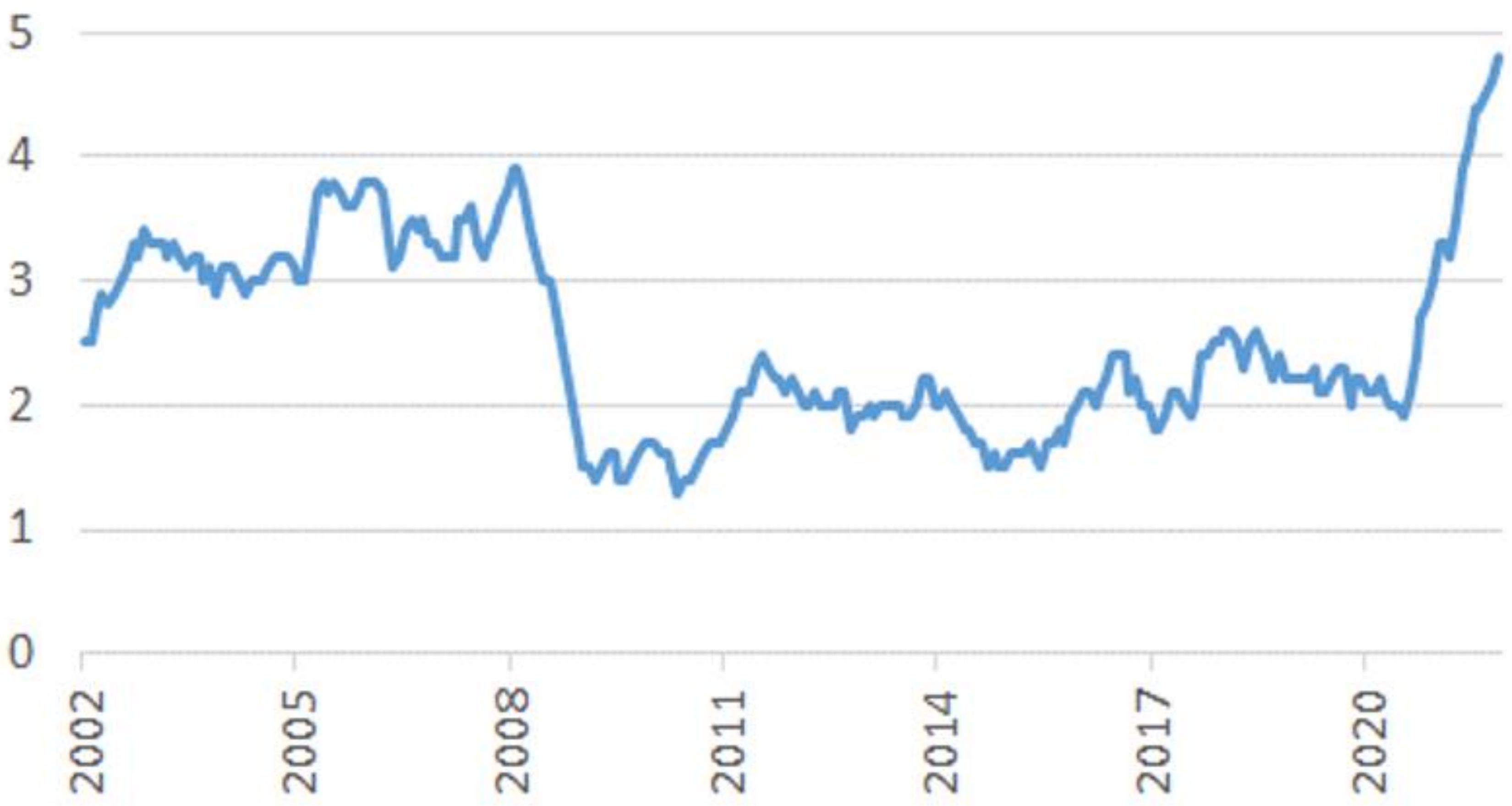


Source: Energy Information Administration

Core services remains a problem…

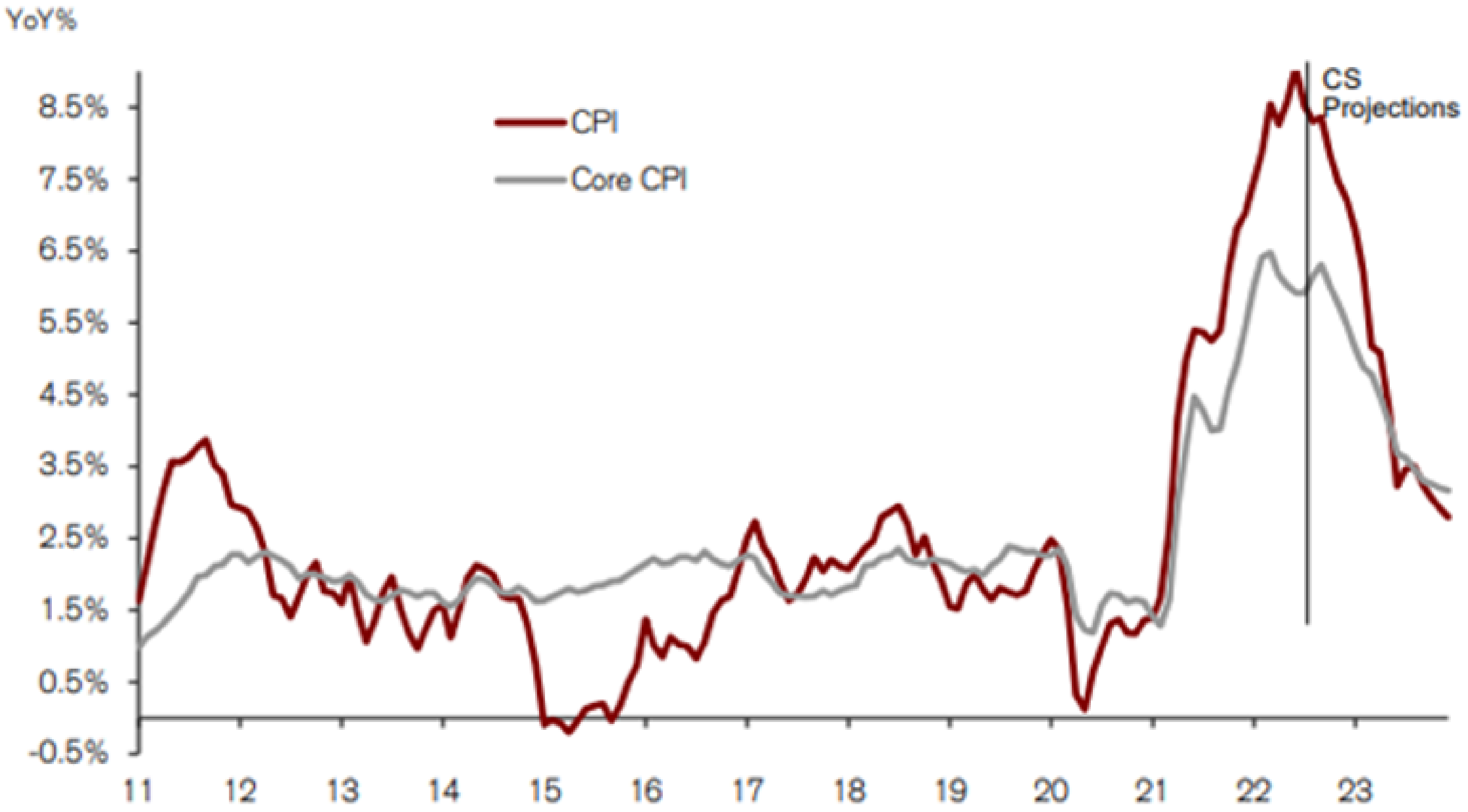
Reaching multi-year highs.



Source: Bloomberg, July 2022

Economic forecasts are looking much better

Consumer Price Index (CPI) inflation
peak inflation supports a slower pace of tightening, but persistent strength should prevent rate cuts.



Source: Credit Suisse, Bureau of Labor Statistics

Inflation conclusion

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Base Case	Bull Case	Bear Case
Inflation comes down slowly but does get below 3% by end of 2023.	Inflation steadily improves and gets below 3% by mid 2023.	Pandemic inflation retreats but rents and wages remain high and fail to get down to Fed “comfort zone”.

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Central bank guidance

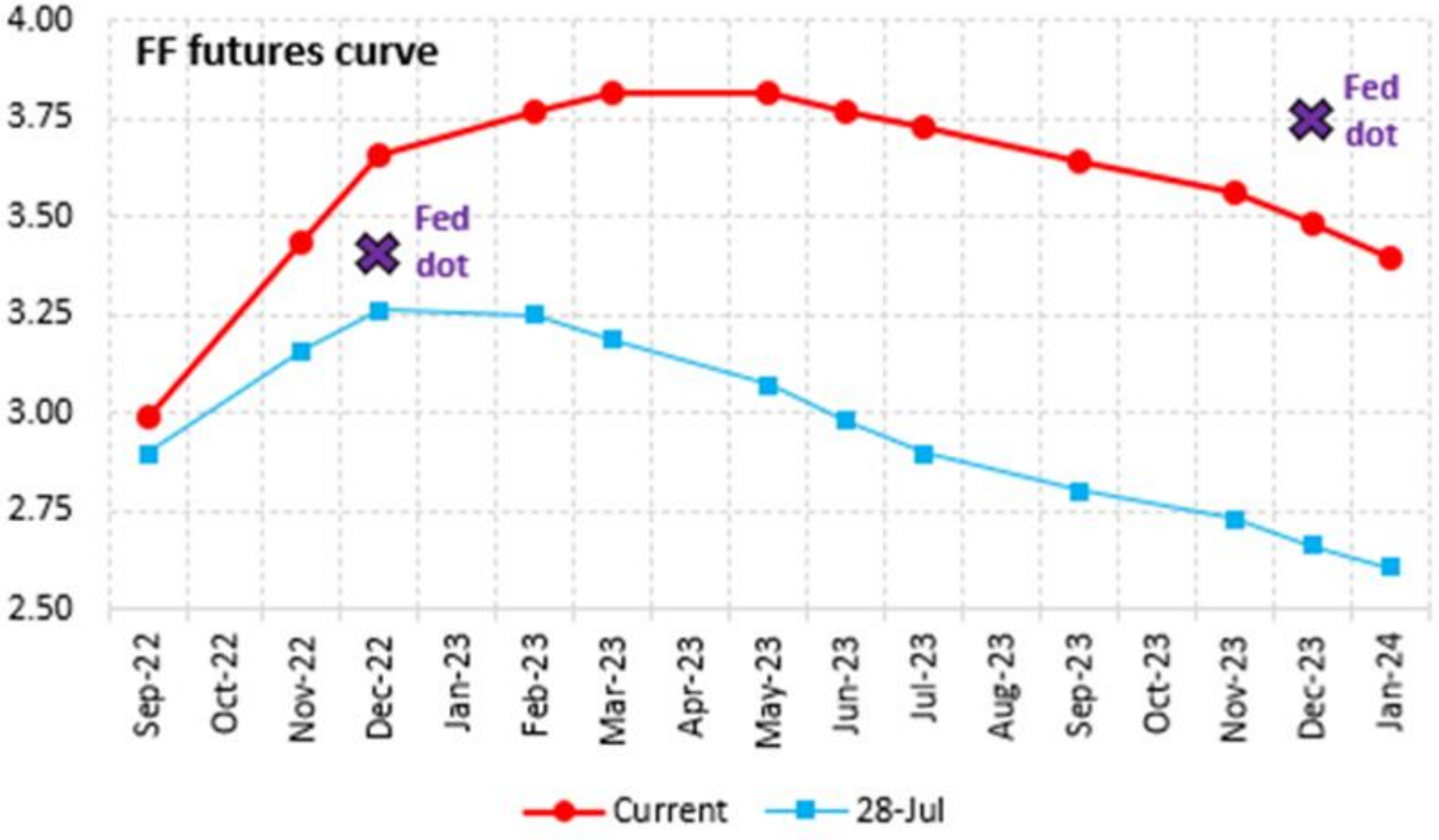
For all the comments by central banks we think the most important one was that they "will do whatever it takes to get inflation back down to target range".

All expectations of a Fed "pivot" appear premature until we know inflation is truly coming back down to range.

Jackson Hole speech points to higher for longer.

The new Fed Funds peak rate targets imply rates will go up to 4.7%, a level which looks set to significantly slow economic growth.

Fed Funds' future pricing in increased hawkishness



Source: Bloomberg, Vanda

Central bank policy conclusion

Base Case	Bull Case	Bear Case
Central banks rapidly shift to higher interest rates by 1H2023 and then hold the rest of 2023 (no pivot).	A combination of lower inflation than expected and employment weakness allows Fed to cut rates.	Inflation stays high despite weak economy and central banks hire more (hard landing).

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Recovery GDP growth - 2022 and 2023 moderating towards more average growth rates

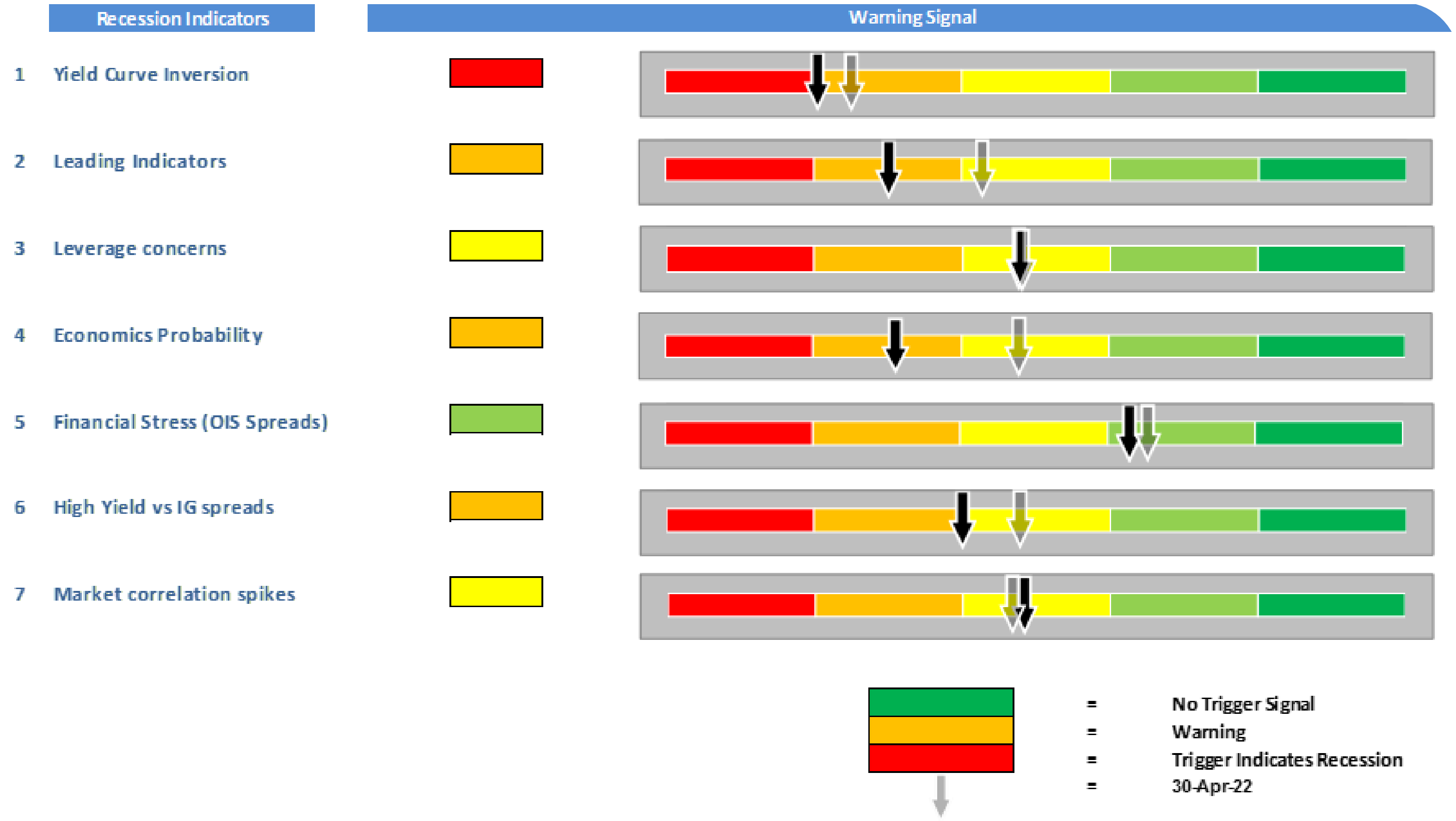
Real GDP Growth Consensus Estimates (%)

	2018	2019	2020	2021F	2022F	2023F
Global	3.6	2.9	-3.1	6.1	2.9	2.7
United States	2.9	2.3	-3.4	5.7	1.7	1.1
Eurozone	1.8	1.6	-6.3	5.3	2.8	0.9
Japan	0.7	-0.4	-4.7	1.8	1.6	1.6
Asia ex. Japan	6.0	5.4	1.3	5.6	3.8	5.2
China	6.7	6.0	2.2	8.1	3.8	5.3

Previous 2022 forecasts: Global 3.0, US 2.1, Asia 4.6, China 4.1

Source: Bloomberg, UOBAM, 17 Aug 2022

Recession checklist



Note:
The Recession indicator checklist sets out UOBAM house views on the respective recession indicators. They are based upon certain assumptions, management forecasts and analysis of information available and reflects prevailing conditions and our views as of the date of this publication.

Source: UOBAM, Aug 2022

Conflicting economic signals

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Global economic data that is pointing to a slowdown

- Global consumer confidence down sharply.
- US housing starts/pending home sales dropping.
- China home sales falling sharply.
- China mfg PMI below 50 again.
- Germany retail sales dropped sharply.
- Small Biz confidence/ CEO optimism fading.
- Productivity dropped sharply in 1Q and 2Q.

Global economic data that is pointing to stability

- US consumption continues to expand.
- US employment remains very strong.
- Asian exports remain healthy.
- Global PMIs mostly resilient.
- 2nd Quarter Corporate profits resilient.

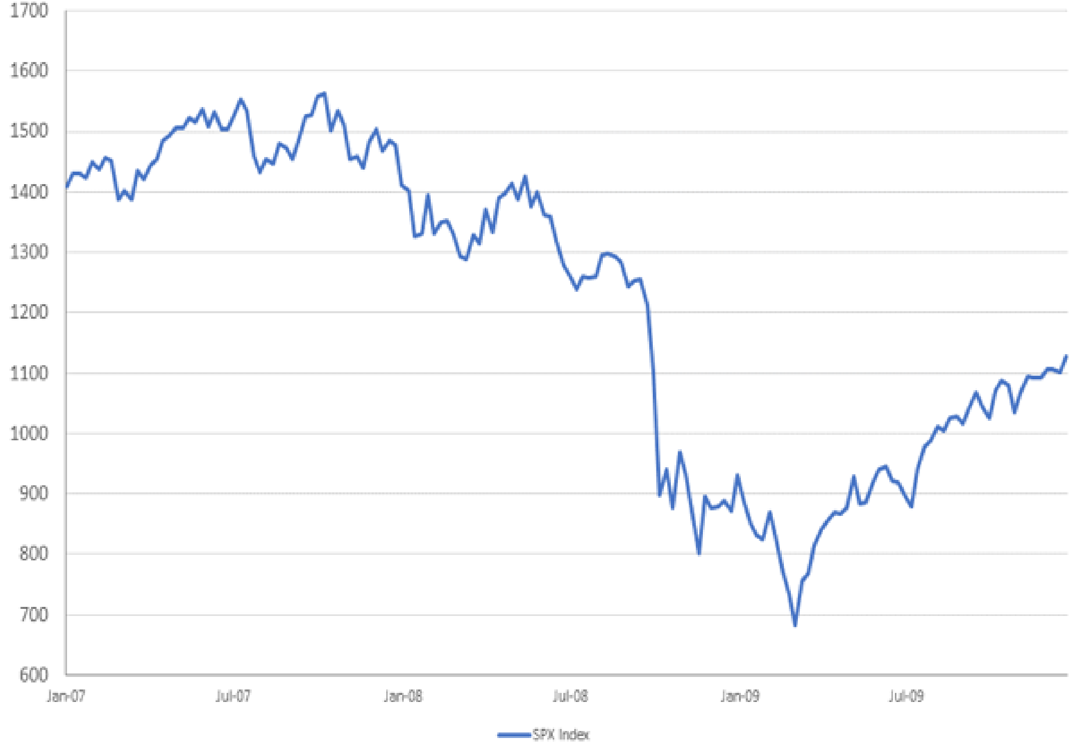
Soft vs hard landing in pictures (S&P500 performance through the downturn)

Soft Landing – 1990 recession

20% drawdown that lasted less than 1 year before recovering

Hard Landing – 2008 recession

50% drawdown that lasted less than several years before recovering



Economic outlook conclusion

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Base Case

If the US Fed and other central banks hit their expectations of rate rises we think it is likely to slow growth enough to cause recession in the US and Europe.

Bull Case

The economy avoids a recession; unemployment stays at historic lows and earnings continue to grow each year.

Bear Case

A classic recession unfolds that results in high unemployment and a significant drawdown in earnings while inflation remains stubbornly high.

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3 Key potential market outcomes

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The Bull Case

- Inflation comes down to below 3% by 3Q23.
- Fed Funds peak at 3.75% and either stay there or is reduced slightly.
- The global economy and the US economy slows but does not go into a real recession and does not experience job losses.
- Earning growth declines from 10% growth expectation at the start of the year but does not decline YoY. 2024 earnings return to growth.
- Household and corporate balance sheets remain healthy.
- Jobs and wages remain robust – real wages grow more strongly than seen in decades.
- Normal credit grows at healthy levels not seen since 2008.
- Investors get comfortable that this growth environment looks better balanced and is not supported entirely by easy monetary policy. Monetary policy normalized and the economy and markets have held up ok.
- Long-term returns outlook has improved.

3 Key potential market outcomes

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The Base Case – rangebound markets

- Inflation comes down to below 3% by end of 2023.
- Fed Funds peak at 4.75% and market is anxious that the Fed will do more.
- The global economy and the US economy slows and likely tilts into a recession.
- Earning growth declines and turns modestly negative in 2023.
- Jobs and wages start to weaken and unemployment rises.
- Equities struggle in a year of slowing economic growth and declining earnings outlook – rangebound with downside risks.
- Fixed income under pressure but higher yields provide downside protection.
- Long-term returns outlook improved, but a difficult year first.

3 Key potential market outcomes

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The Bear Case

- Inflation does not come down to below 3% by end of 2023.
- Fed Funds has to be raised more and over 4%.
- The global economy and the US economy slows more sharply, and higher rates make it worse.
- Earning growth declines and turns negative in 2023.
- Jobs and wages weaken in line with a normal recession.
- Equities price in a hard landing recession of 20%-30% down (vs 13% down YTD).
- Fixed income under pressure as Fed has to keep fighting inflation.
- Long-term returns outlook improved, but a difficult and very bad year first.

Conclusion

Key questions – implications

With the recent rally, is the worst over and is it time to invest? –
No, not yet. We think markets remain rangebound in 2022, and probably can invest more confidently by the middle of 2023.

When should we invest? –
Exact timing is hard, but on our base case outlook, 2Q23 looks likely.

Should existing portfolios just shift to cash? –
While we target 1H23 as a likely entry point, we do not recommend current portfolios go to all cash. Rebounds can happen suddenly, such as occurred in July. For existing portfolios, participating in the recovery will be important and it could come earlier than expected.

Is the worst over for fixed income? –
Probably. The upside/downside risks and the long-term returns look favorable. But near-term price and rate volatility likely to remain high.

Can the 2022 losses be recovered? –
Equity losses likely to be recovered when growth resumes. Fixed income losses can be recovered from higher yields but will take more than a year.

Key questions – implications

How do our views compare to the market consensus?

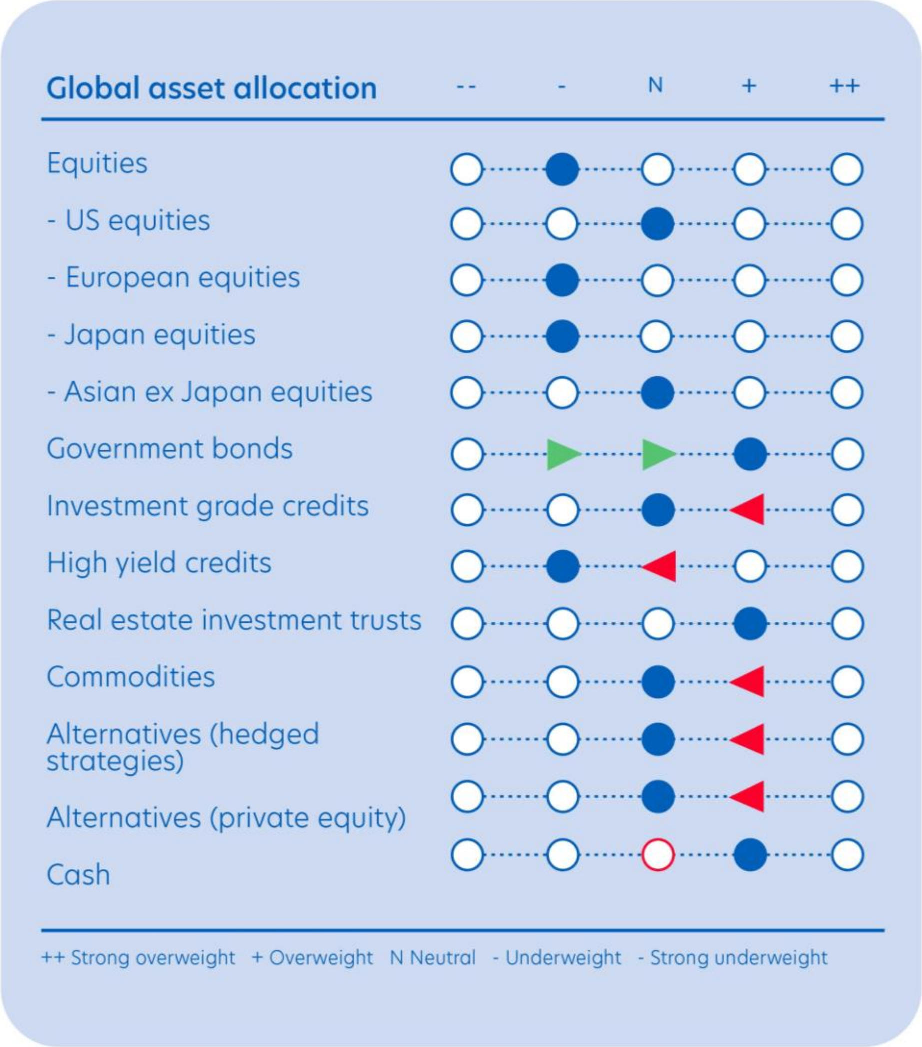
On inflation we believe consensus is more pessimistic that inflation can decline without a hard landing in the economy.

On central bank expectations the market seems to believe that they are naturally dovish and will not hold firm to fight inflation – we think we have to brace for a tough year of central bank policy.

On the economy we think the market is equally divided between a soft landing and a hard landing view.

On the overall market outlook, we think the market has many camps – those that see the bear case, those that think markets can rally like they did sooner than expected after COVID, and those that think it will take more time (like we do).

UOBAM House View remains cautious



Note:
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Source: UOBAM, 1 September 2022

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