# More clarity and opportunities in 2023

Quarterly Investment Strategy
First Quarter 2023

# Summary of Investment Conclusions

# “When” not “if” for a rebound in 2023

**The trajectories on the key market drivers for 2023 remain difficult to assess:**
Will inflation improve enough?
Will the global economy remain resilient?
How will markets react to different combinations of inflation and growth?

**Our base case:**
Inflation gets below 3% by the end of 2023,
central banks will near the end of their rate hiking cycle,
the global economy will slow but a classic recession is not likely, and
markets are most likely to rebound in 2H 2023, with a rebound in 1H 2023 possible if unemployment does not rise significantly

**We are overweight fixed income, neutral on equities, commodities and alternatives, and underweight cash.**

**We expect bond yields to range between 3.5% and 4%** in the 1H 2023.

We expect the USD to be supported **as the US Fed maintains its hawkishness, and the US economy remains a relative safe haven.**

# UOBAM House View is more positive for 1Q2023

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| 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 | ○ | ● | ◀ | ◀ | ○ |

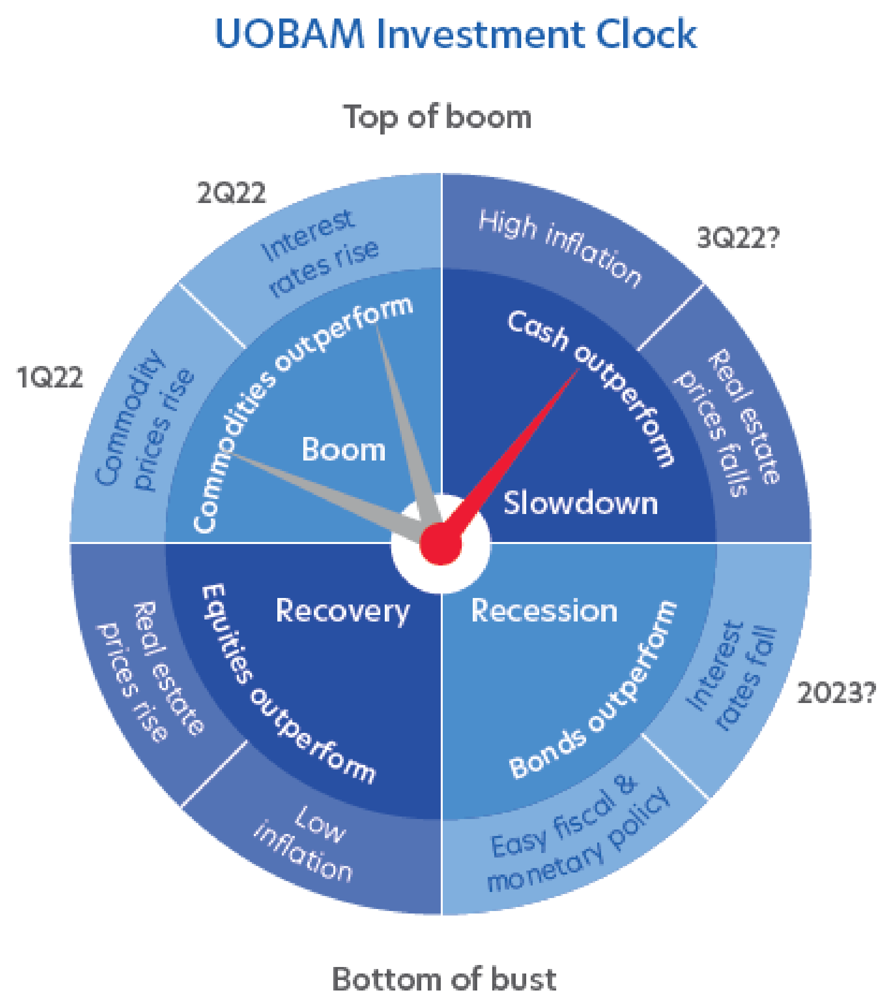
++ Strong overweight + Overweight N Neutral - Underweight - Strong underweight

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

Source: UOBAM, 1 December 2022

# The global economy has clearly slowed, now we just have to see the shape of the bottoming process.

The economy has followed a classic cycle so far. It remains to be seen if inflation and interest rates will moderate before the economic slowdown becomes too sharp.




Source: UOBAM, March 2022

# Inflation and growth will be key drivers in 2023

## Inflation outlook

- Inflation will moderate in 2023, but will it be enough?
- Will it fall to the 3% or less level by the end of 2023? (a level seen in past expansions that the Fed will likely accept)

## Economic outlook

- The global economy will slow in 2023, but will this be a mild slowdown like 1990 or a classic recession with a drawn-out period of unemployment?

Source: UOBAM, September 2022

# Inflation outlook for 2023

# Inflation pressures are easing

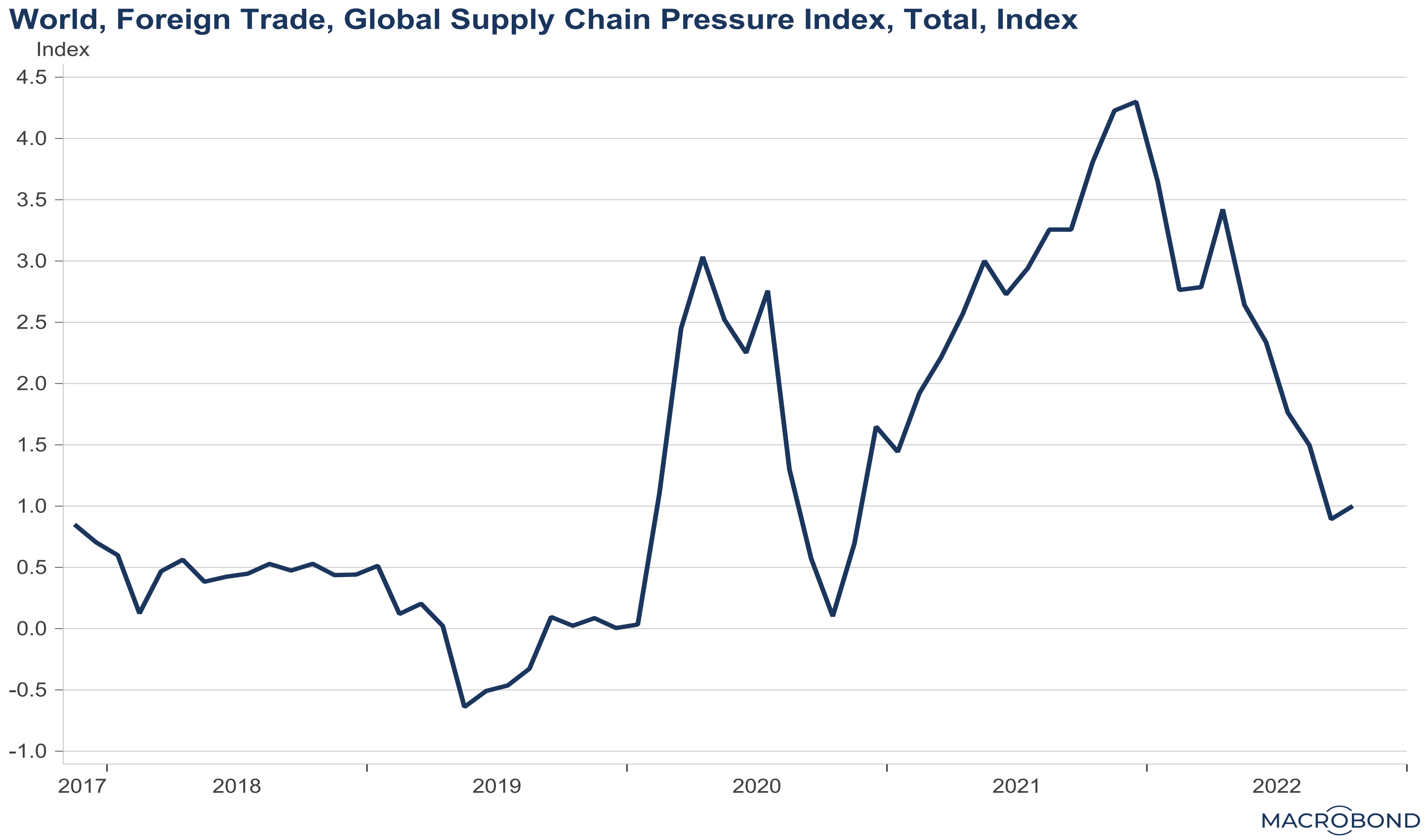
Most of the underlying economic drivers of inflation in 2022 are now easing e.g. fuel prices and freight rates are moderating.

The key remaining uncertainty is the price of labour and services. If growth slows and unemployment rises, this will dissipate as well.

Inflation should moderate in 2023, but the uncertainty will persist until inflation gets below 3%.

If inflation fails to get back toward 3%, we expect the US Fed to remain in inflation-fighting mode.

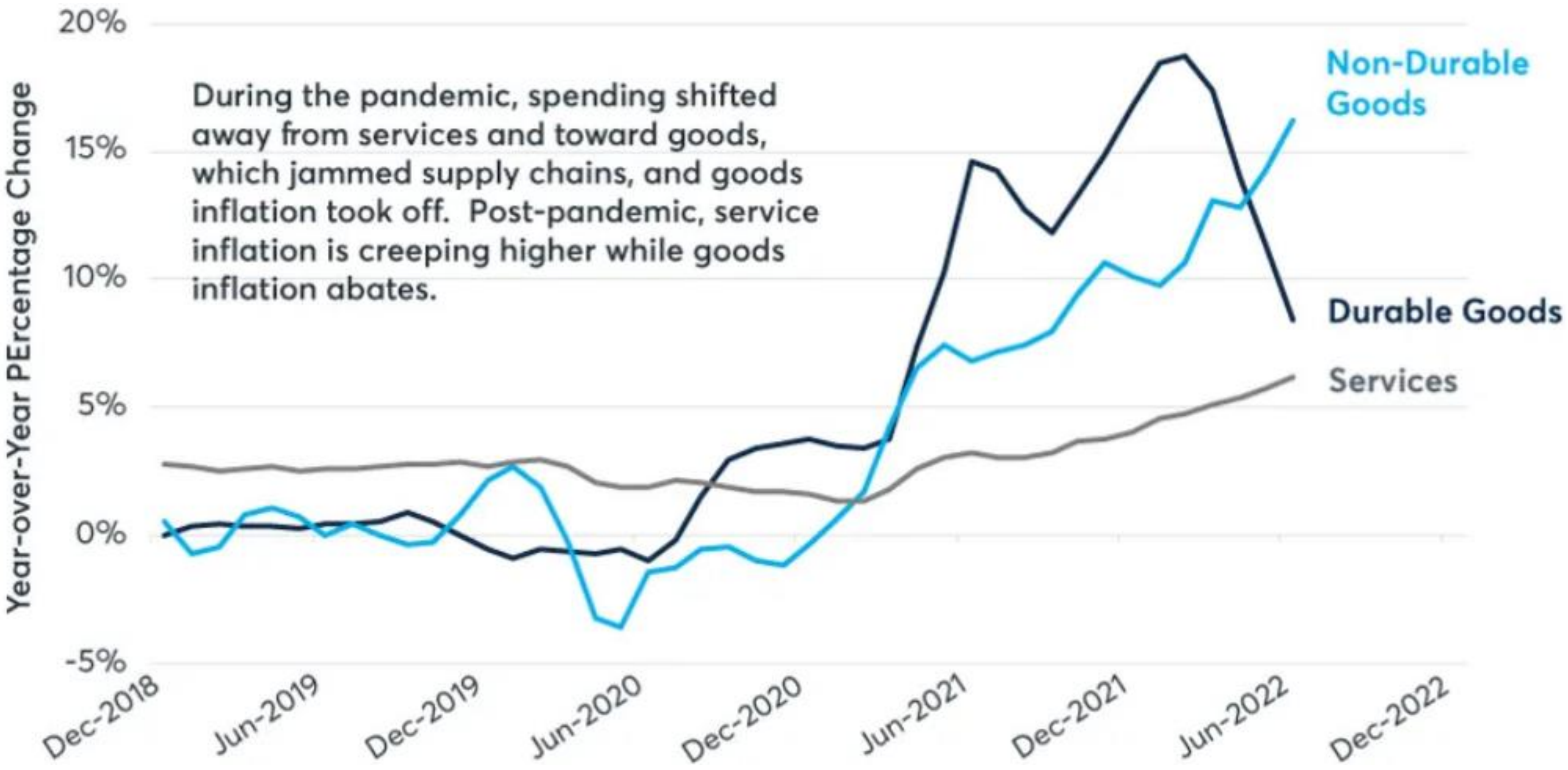
# Signs that inflation outlook is improving: Global supply chains are improving.




Source: Macrobond, 16 November 2022

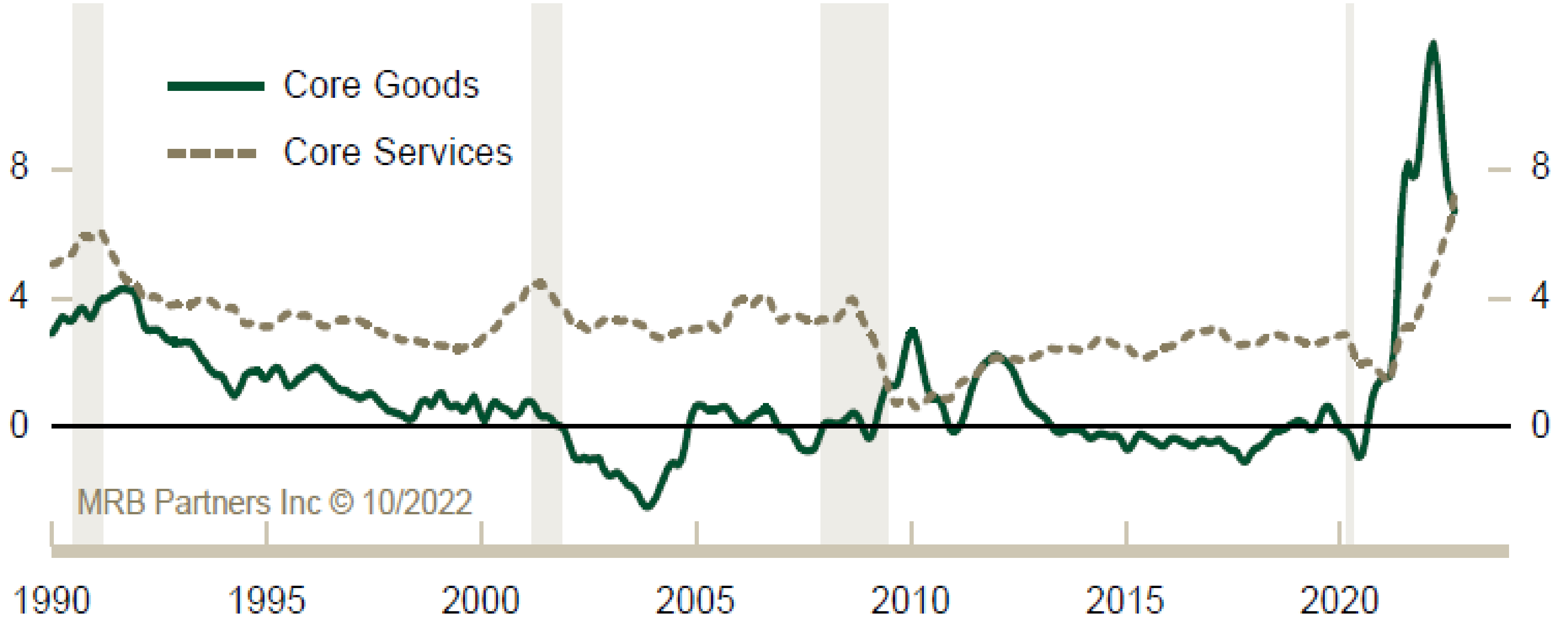
# Post-pandemic, service and non-durable goods inflation continues to trend higher while durable goods inflation abates.

Consumer Price Inflation: Durable goods, Non-Durables, and Services



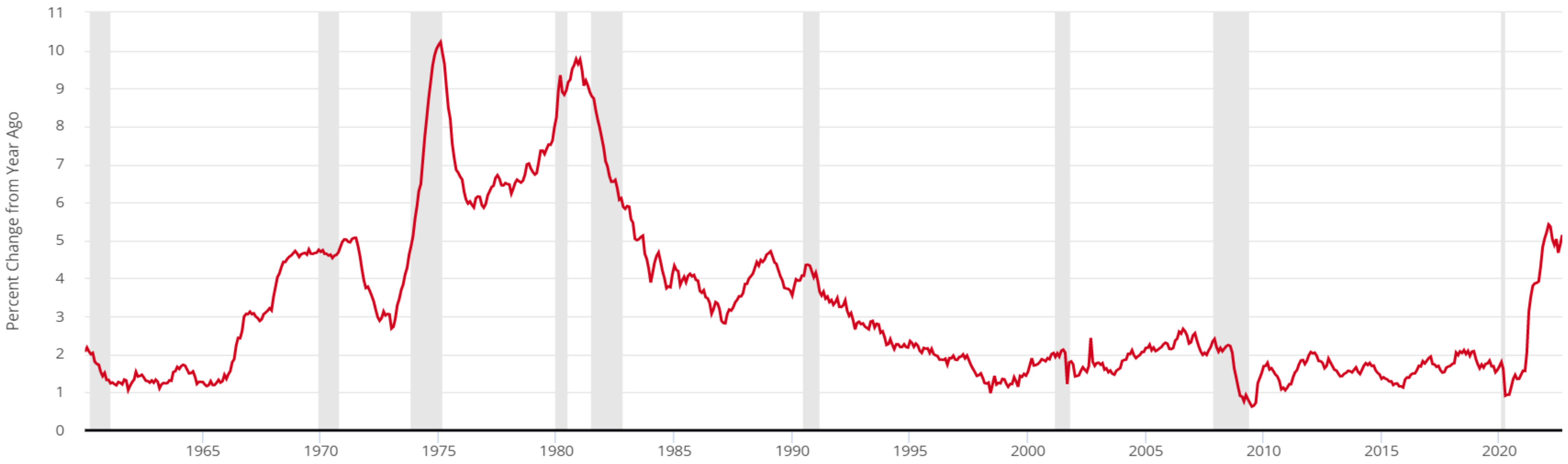

Source: CME Group Economics, Federal Reserve Bank of St. Louis FRED Database

# Long term goods inflation since 2000 has been 0% - but that may be evidence of globalisation benefits that could be reversed in the coming decade.




Source: Bureau of Labor Statistics, October 2022

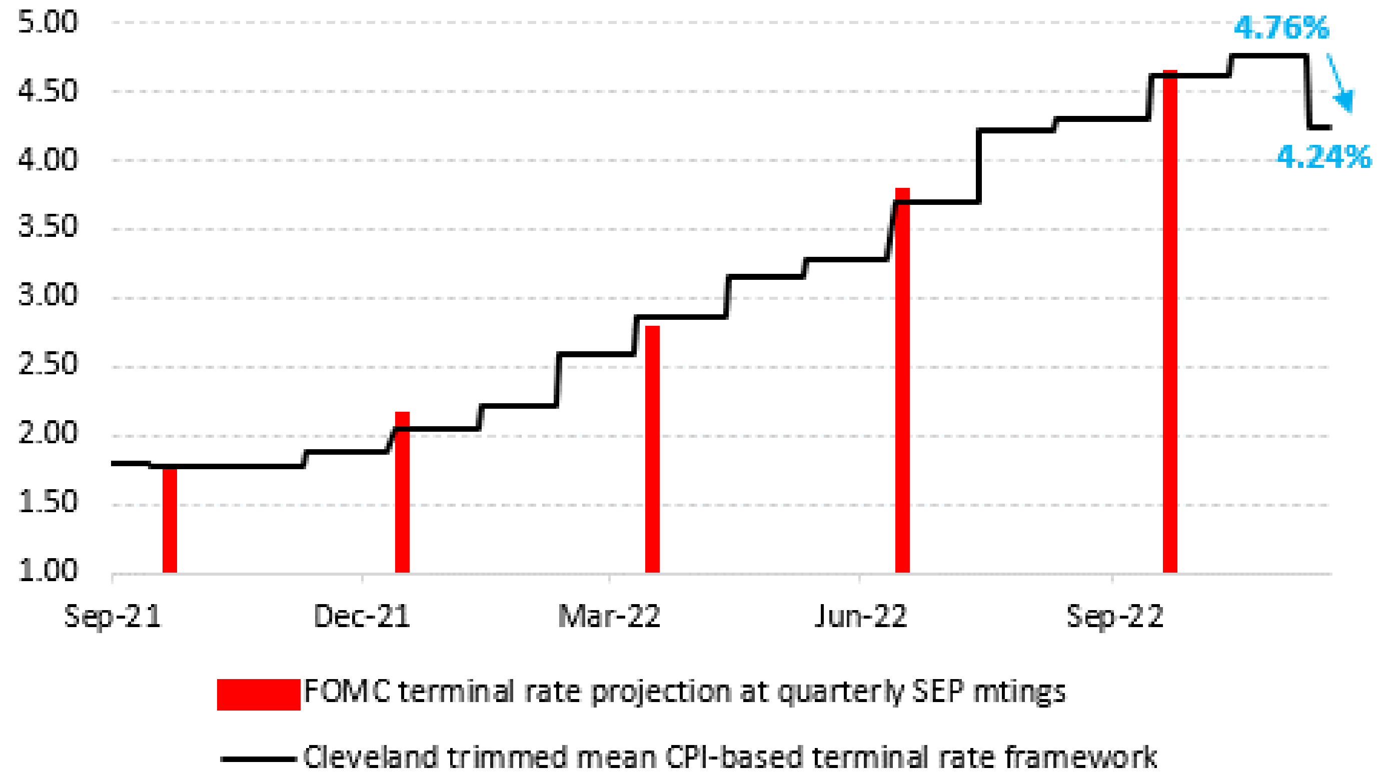
# Multi-year inflation likely to return to the 1990's and 2000's range and not fall back to the disinflationary 2010's.




Source: Credit Suisse, December 2022

# Interest rate implications for 2023

# It “feels” like interest rates have been soaring out of control but there has been a clear framework to the Fed terminal rate targeting – and that framework implies that things are peaking.

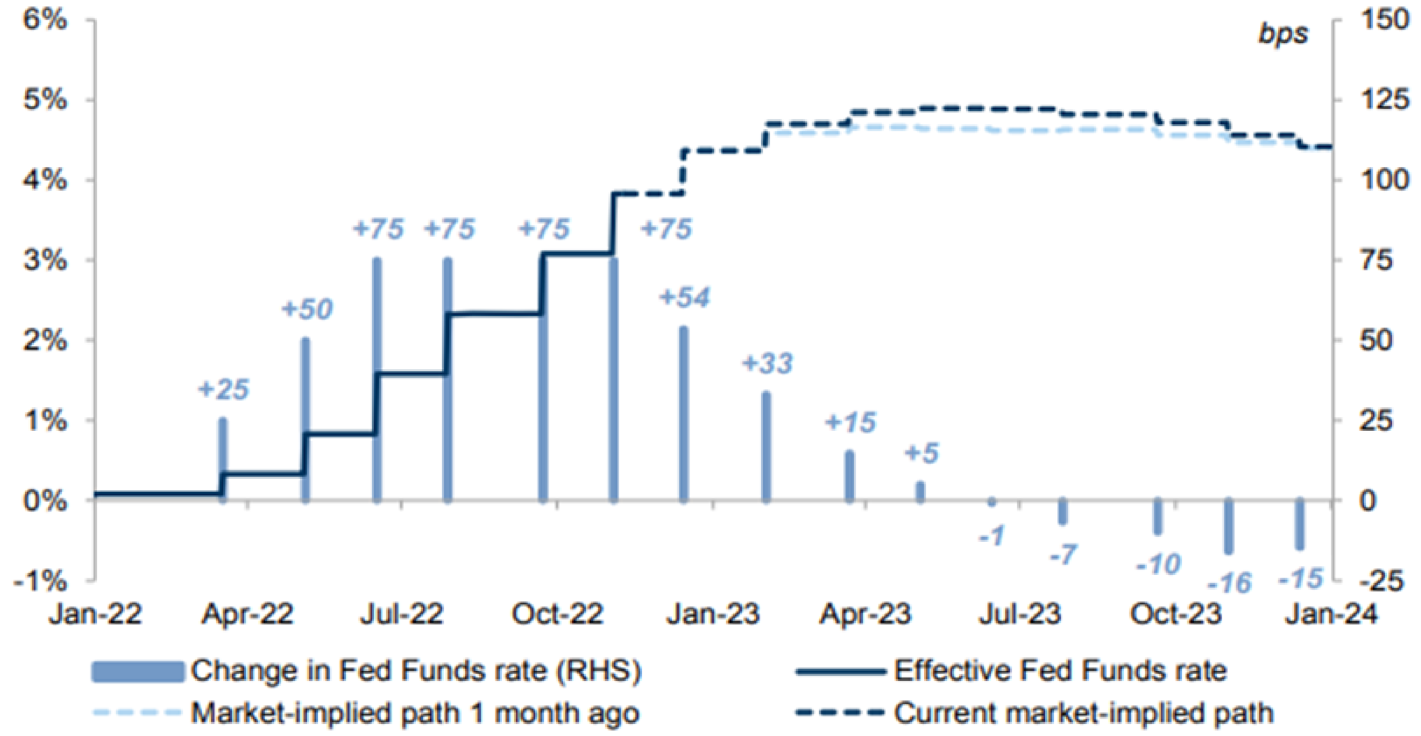



Source: Vanda Research, December 2022

# It is not clear how peaking rates will be interpreted by the markets. While the terminal rate will remain at high levels, the rate of change is expected to shift in 2023.

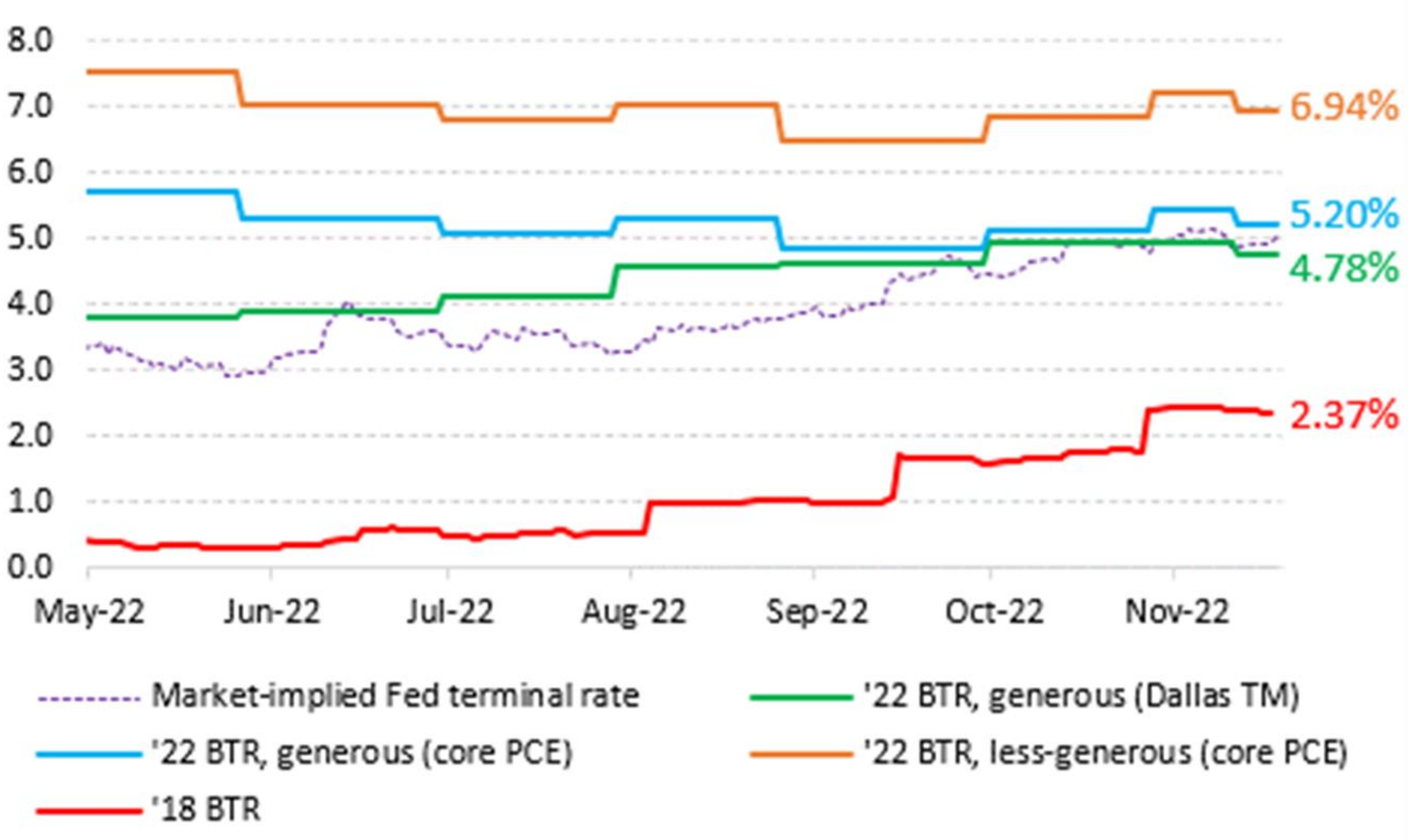
**Exhibit 70: Market-implied path of the Fed Funds rate**

Based on 30-day Fed Funds futures




Source: Haver Analytics, Goldman Sachs Global Investment Research

# The main risk to the framework is if the Fed changes their definitions of key variables.




Source: Vanda Research, December 2022

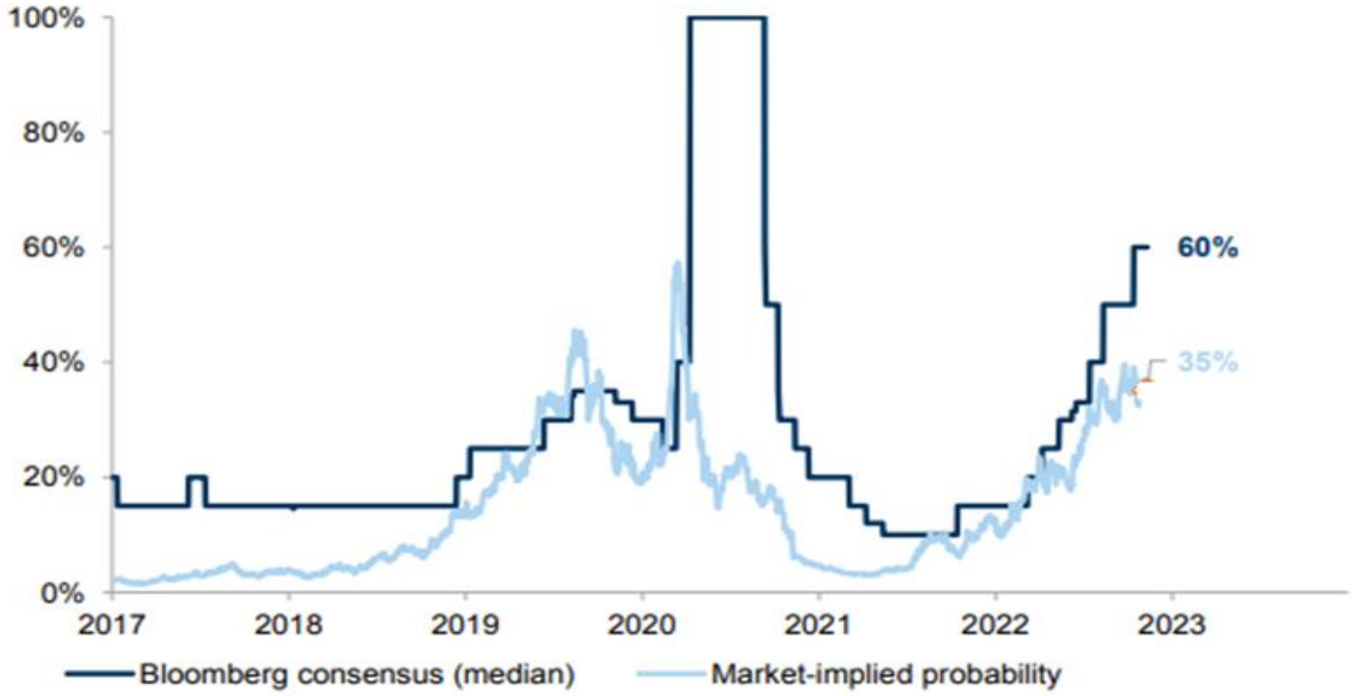
# Economic outlook for 2023

# A mixed picture for global growth

| | |
|---|---|
| US | The US Federal Reserve appears determined to cool the overheated economy.<br><br>As the world's largest economy, a US recession will likely trigger a global downturn. |
| China | COVID and other policies dampened growth this year.<br><br>Easing of COVID-19 restrictions looks set to boost growth in 2023. |
| Europe | Energy crisis and rising interest rates are likely to slow growth.<br><br>Region appears most at risk of recession. |
| Asia | Slowing global growth notwithstanding, local economies seem more resilient to rising interest rates.<br><br>Rates have historically been higher than other regions. |

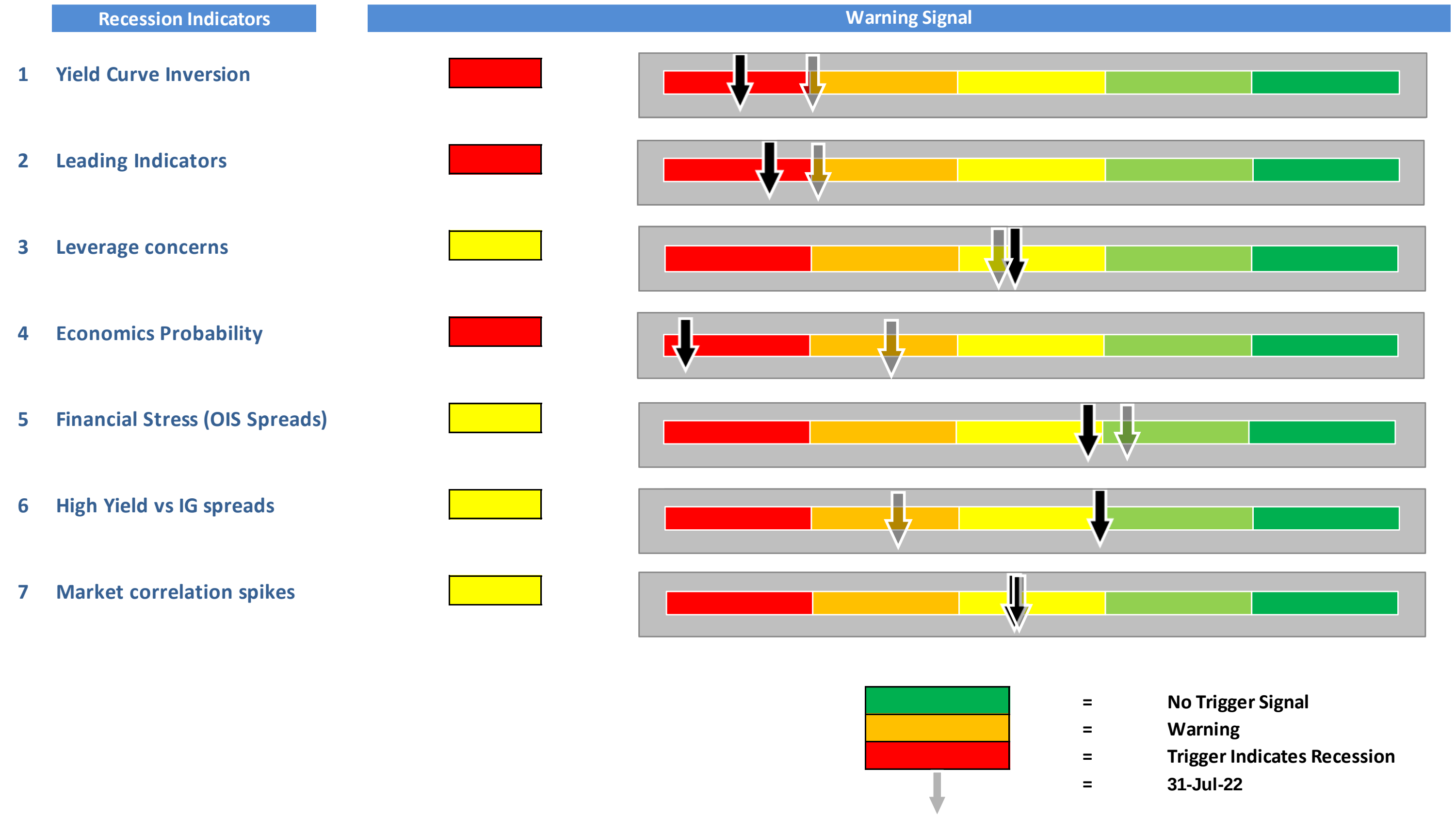
# Market probabilities of a US recession are rising…

**Exhibit 69: Probability of a US recession in the next 1 year**




Source: Haver Analytics, Datastream, Worldscope, Bloomberg, Goldman Sachs Global Investment Research

# But our recession checklist is mixed




**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, Nov 2022

# Conflicting economic signals

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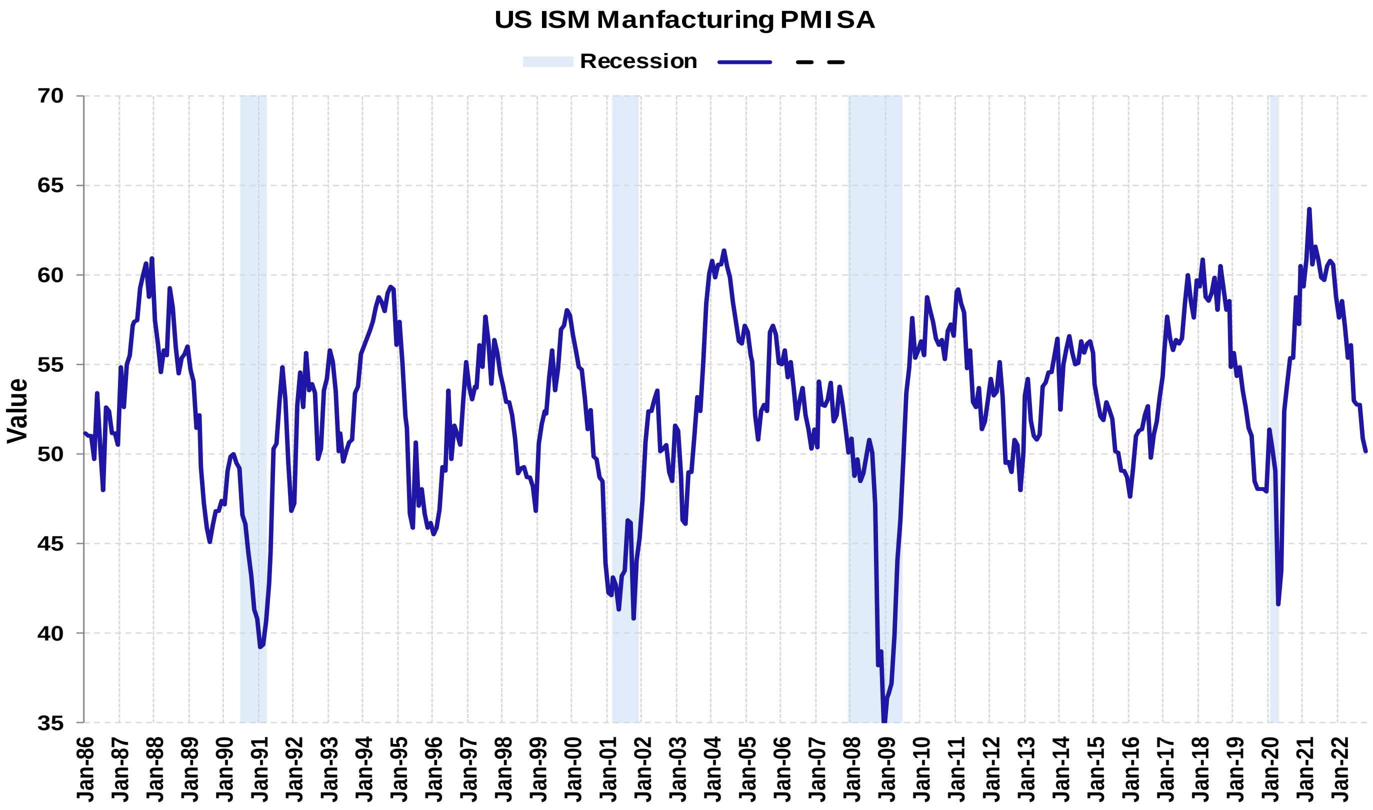
## Indicators pointing to a US recession

- Yield curve inversion
- Declining manufacturing Institute of Supply Management (ISM) index
- Sharp rise in interest rates
- Housing market correction

## Indicators pointing to a milder slowdown

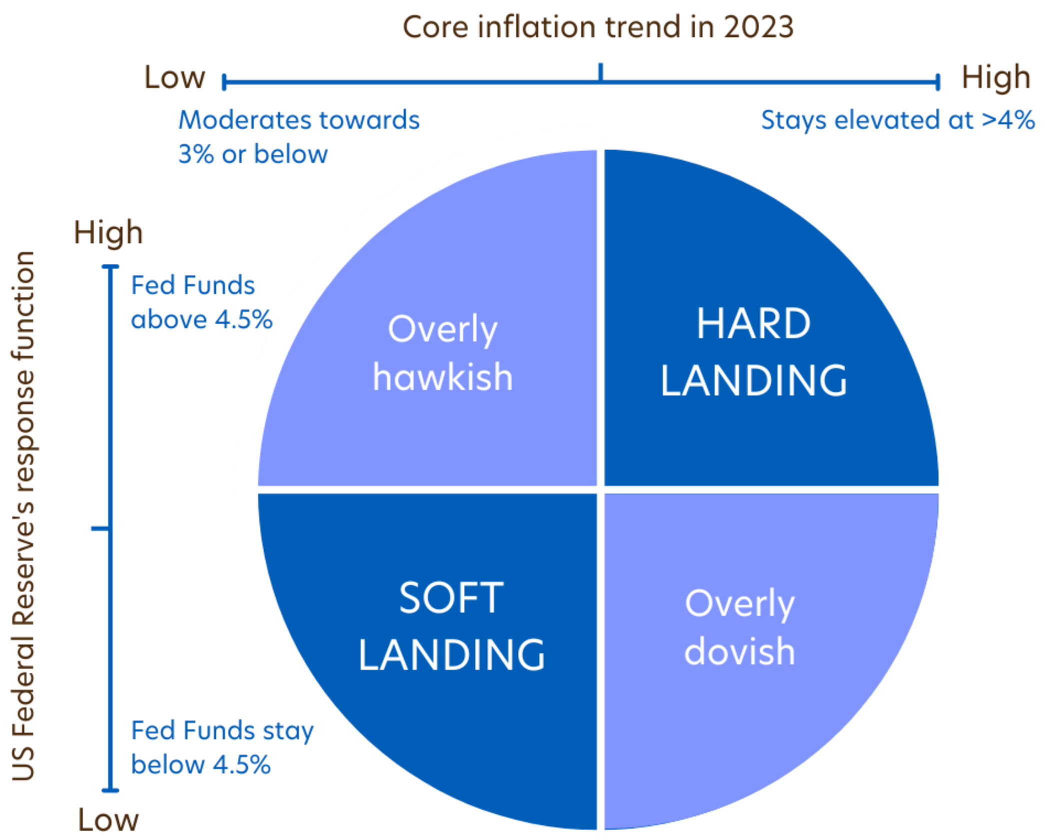
- US consumer spending remains robust
- Strong jobs market; employers reluctant to lay off workers they just rehired
- Easing inflationary pressures
- Greater interest rate clarity

# The most important leading indicators, such as the US ISM appear to be pointing toward a recession.



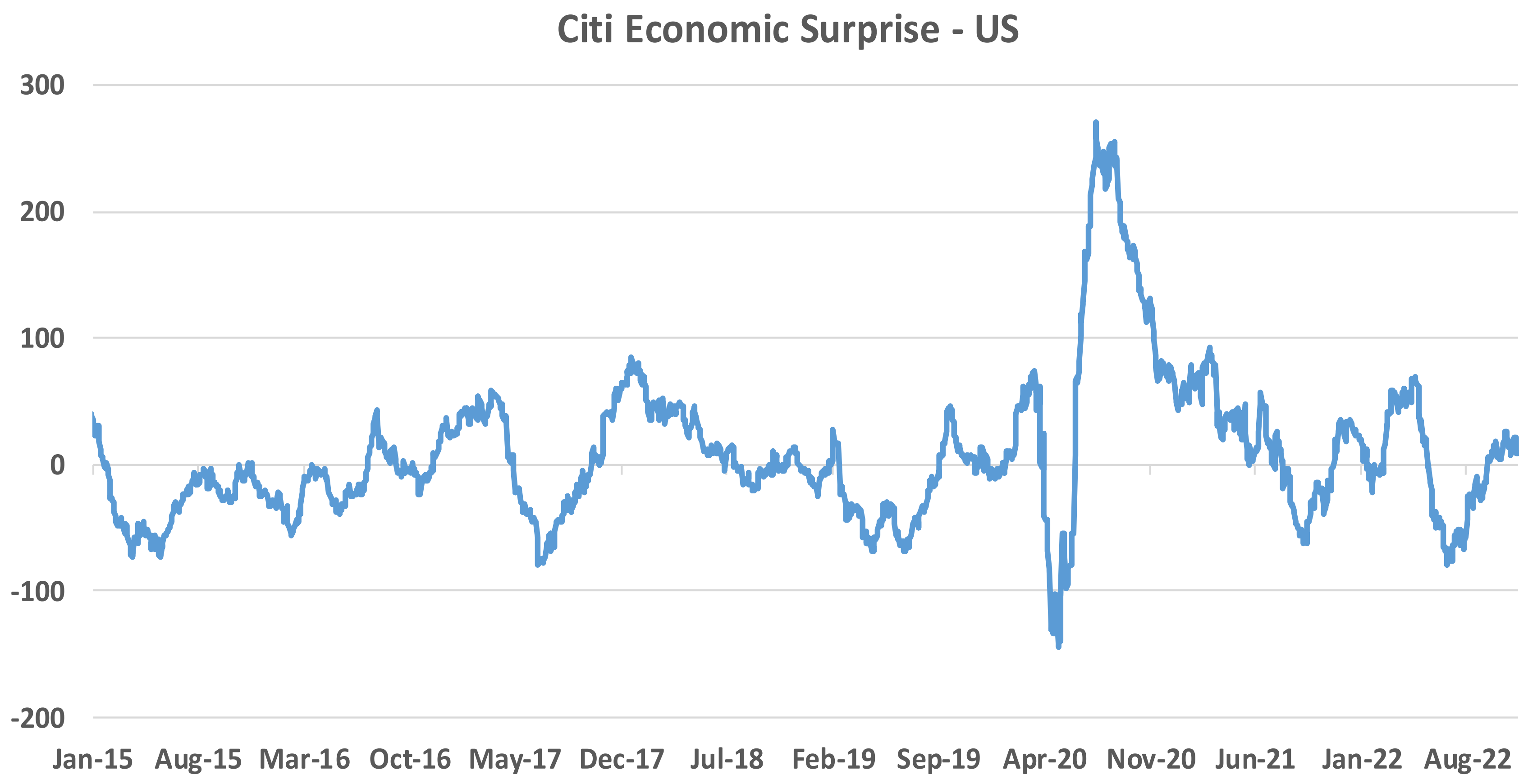

Source: Bloomberg, November 2022

# Our framework highlights hard landing risks if inflation stays above 4% and the Fed funds rate stays above 4.5%.




Source: UOBAM, September 2022

# However, US economic trends are rebounding




Source: Bloomberg, 17 November 2022

# Forecasts suggest a below-trend growth for 2023, not a classic recession.

Real GDP Growth Consensus Estimates (%)

| | 2018 | 2019 | 2020 | 2021F | 2022F | 2023F |
|---|---|---|---|---|---|---|
| Global | 3.6 | 2.8 | -3.0 | 6.0 | 2.9 | 2.3 |
| United States | 2.9 | 2.3 | -2.8 | 5.9 | 1.8 | 0.4 |
| Eurozone | 1.8 | 1.6 | -6.1 | 5.3 | 3.1 | -0.1 |
| Japan | 0.7 | -0.4 | -4.7 | 1.8 | 1.6 | 1.4 |
| Asia ex. Japan | 6.0 | 5.4 | 1.3 | 5.6 | 3.5 | 4.8 |
| China | 6.7 | 6.0 | 2.2 | 8.1 | 3.3 | 4.9 |

Previous 2022 forecasts: Global 2.9, US 1.6, Asia 3.5, China 3.3

Source: UOBAM, 16 November 2022

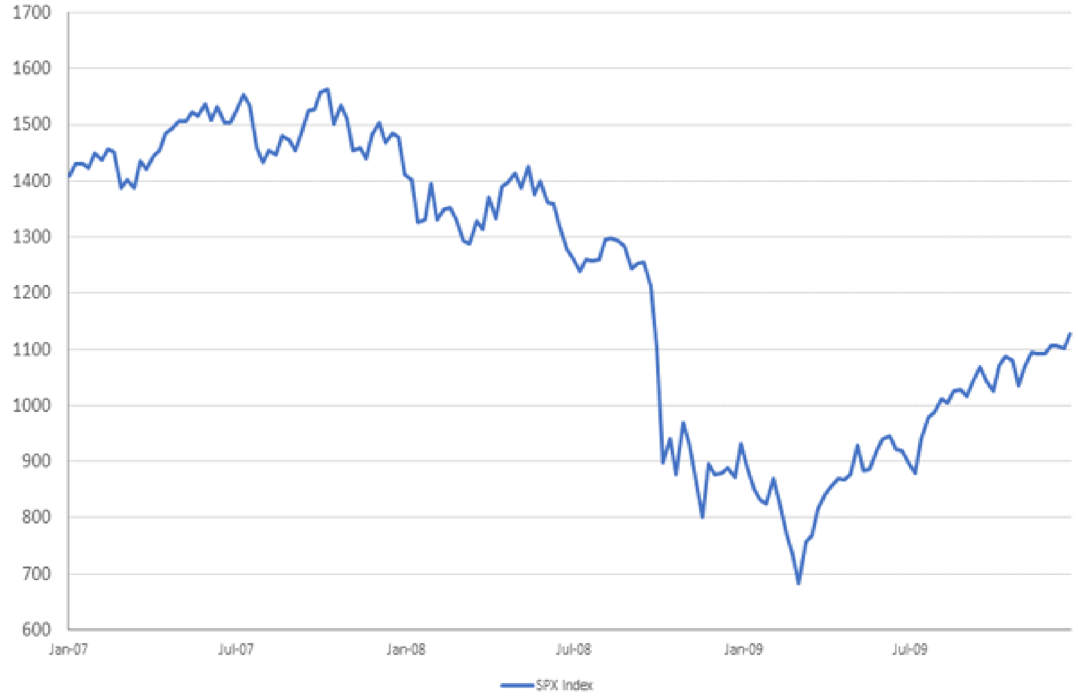
# Soft vs hard landing in pictures (S&P500 performance through the downturn)

## 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



# A US recession is not our base case

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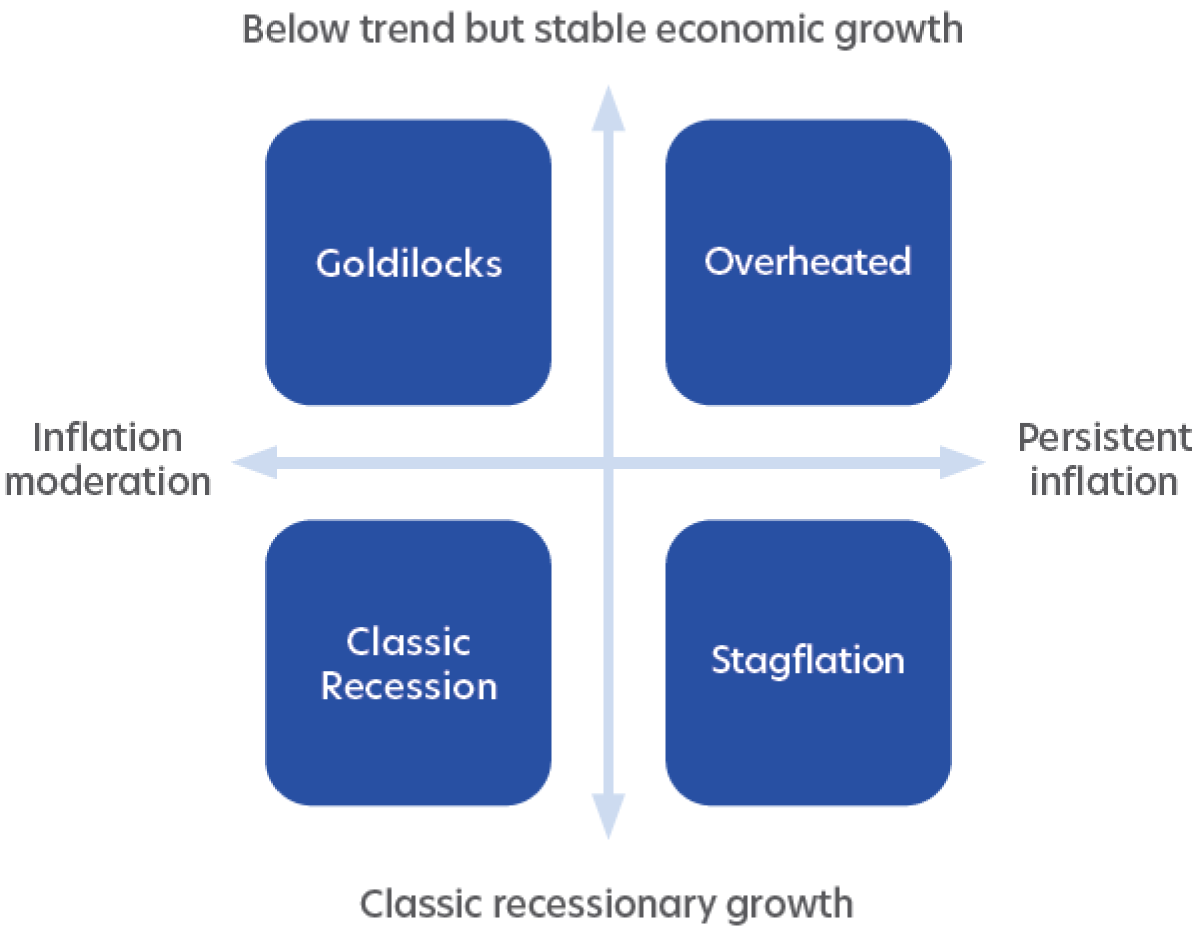
While economic growth is likely to slow in 2023, a recession is not our base case unless the US sees a significant jump in unemployment.

Labour conditions could become less overheated without triggering unemployment.

Many employers may be reluctant to lay off workers they just re-hired after COVID lockdowns; Small businesses report labour shortage as their biggest business challenge.

# How will markets react to different combinations of inflation and growth?

# Potential market outcomes




Source: UOBAM, September 2022

# Potential market outcomes

## Classic recession

High interest rates weigh on the economy
COVID buying frenzy cools off
The Fed successfully tames job growth

**Likelihood that fixed income performs: 95%**
**Likelihood that equities underperform: 70%**

## Goldilocks

Inflation declines as COVID shortages in goods and services improve
Economic data continues to remain resilient
Employers are reluctant to fire workers they just hired back

**Likelihood that fixed income performs: 85%**
**Likelihood that equities underperform: 80%**

# Potential market outcomes

## Overheated

Economy expands as robust job levels keep wages and spending up
Inflation improves modestly but stagnates at about 4%, implying long term structural problems
The Fed continues raising rates to bring inflation down to target levels

**Likelihood that fixed income declines: 70%**
**Likelihood that equities decline: 60%**

## Stagflation

Inflation fails to improve
The economy slows to a recession and unemployment rises
Recovery is seen as a long multi-year process

**Likelihood that fixed income stays flat to down: 60%**
**Likelihood that equities stay flat to down: 60%**

# Market implications of combined probabilities

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- Likelihood that fixed income provides current yields or better: 75%+
- Likelihood that equities provide high single digit returns or better: 50%

**For 1Q 2023, we recommend investors focus on bonds and hold stocks based on a neutral weighting.**

# Conclusion

# Key questions – Implications

## With the recent equity rally, is the worst over and is it time to invest?

Probably not. Even under our optimistic scenario, we expect an economic slowdown and a period of below-trend growth. This is not a conducive environment for equities, with corrections expected along the way. However, signs that the economy may avoid a sharp recession and improvements in inflation could stabilise equities earlier than expected.

## How likely is a global recession?

Economic growth is likely to slow, and while a classic recession is a possibility, it is not our base case unless the US sees a significant jump in unemployment.

## When should we invest in equities?

Exact timing is hard, but on our base case outlook, 2Q23 looks likely. But if inflation improves ahead of schedule and the economy merely slows without rising unemployment, equities could rally in 1Q23.

# Key questions – Implications

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### Fixed deposit (FD) rates are attractive at 3% to 4%. Should we just stick to FDs and give up on stocks and bonds?

FDs are representative of the entire market pricing now but we don't think you should be overly impressed with FDs. Good quality corporate bonds can yield 5% to 6% without taking much credit risk and their gains could rise significantly if credit spreads and bond yields moderate in 2023. One may miss some attractive valuations in these markets sticking to FDs.

### Is the worst over for fixed income?

Most likely. The upside/downside risks and the long-term returns look favorable. Inflation is likely to peak, and the Fed is approaching its terminal rate.

### 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

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## How do our views compare to the market consensus?

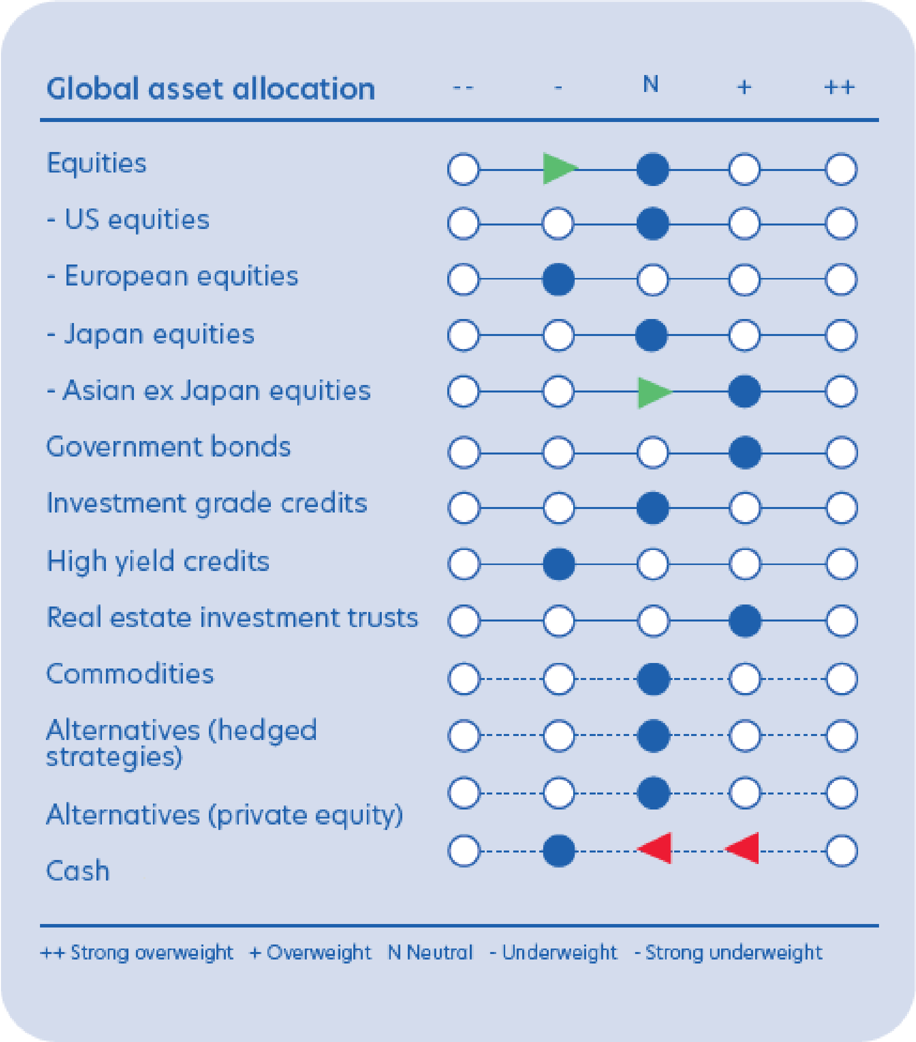
**On inflation,** we believe consensus is more pessimistic that inflation can decline without a hard landing in the economy.

**On central bank expectations,** the market seems to believe that they are naturally dovish and will not hold firm to fight inflation – we think the Fed will hike rates close to 5% and then hold to see if inflation declines.

**On the economy,** we are mostly convicted that there will be a slowdown and period of below-trend growth but are less convicted that it will result in significant unemployment.

**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 is more positive for 1Q2023




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

Source: UOBAM, 1 December 2022

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