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BIL Investment Outlook 2023



Preparing for landing

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Introduction from our Group Chief Investment
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2022 was the year of stickier-than-expected inflation which forced central banks to retire the “transitory” narrative and take decisive action to bring it back down to target.

As central banks continue to tighten policy, the key question for 2023 is whether they will be able to orchestrate a “soft landing” for their respective economies. For those of you who have seen the French movie “La Haine”, as Vinz says, “It’s not how you fall that matters. It’s how you land.” Because all the way down, the feeling is generally “so far, so good.” In today’s context, a soft landing for the economy would constitute a very mild recession, involving slightly higher unemployment and just enough demand reduction to curb inflation.

Under the alternative scenario – a “hard landing” – a full-blown recession and a spike in unemployment would be the price to pay for bringing down inflation.

Given that it takes time for the cumulative effect of tighter monetary policy to work its way through the economy, central banks are not only confined to a rear-view mirror – they are also driving in the dark, in that they must decide how much tightening is still appropriate while previous actions have not yet wielded their full impact. If they don’t tread carefully, they risk overtightening, leading to a hard landing. Contrastingly, if they pivot too soon, the result could be a structural unmooring of long-run inflation expectations and potentially a 1970s-style price spiral. The resounding message from the Fed’s Jackson Hole symposium and the IMF autumn meetings was that central banks should avoid relaxing too soon in their inflation battle – a move that would likely deliver the pain of recession without any of the sustained gains on inflation.

If inflation drivers cool in a convincing manner, less monetary headwinds would be needed. The good news is that headline inflation does seem to be trending downwards in the US and appears close to peaking in Europe. This could allow central banks to take their foot off the gas, adopting a “slower for longer” approach, giving them more flexibility to fine-tune monetary policy with incoming data as the year progresses.

In all, whether we have a hard or a soft landing is yet to be seen. While the Fed has had a mixed record in accomplishing soft landings during past rate hiking cycles, the sheer strength of the US economy probably means the worst-case scenario could be avoided. In Europe, much depends on the ability of governments to effectively manage the ongoing energy crunch. Encouraging is the fact that in several emerging markets, where central banks started hiking rates much earlier, activity has been resilient thus far while inflation is starting to retreat – Brazil being a good example.

Beyond the actual landing process, 2023 might be a more pleasant destination for investors than 2022 has been. Over the past year, markets have had to grapple with accelerating inflation, an expedited rise in interest rates and higher bond yields. Combined, these factors have weighed on equity returns while a breakdown in correlations between stocks and bonds meant that any shock-absorption inside portfolios provided by fixed income assets was ineffective. Looking to the new year, if we are to begin our outlook on an optimistic note, it appears that the bulk of the upward shift in this trifecta of forces is behind us. On top of that, the era of sub-zero yields has come to a close and, once again, bonds provide an income stream.

Nonetheless, we do expect continued turbulence ahead, with volatility arising from incoming macro data and central bank communication as they try to get it right with regard to tightening. We also have to consider that as financial conditions tighten so too do the chances of unforeseen and undesirable side-effects. As such, we enter the new year with a conservative asset allocation, focusing on arising opportunities in the fixed income space. That said, for investors who have an investment time horizon that allows, it is important to remember that cyclical downturns can be seen as an opportunity to build up positions in great companies with sound long-term prospects.

In order to look through market turbulence, we also keep our gaze focused on long-term investment themes which are structural in nature. These include sustainability, with the European energy crunch making the sustainable transition more critical than ever and the US adopting its biggest ever clean energy bill, digitalisation as we move towards a smarter, more connected world, and healthcare innovation, as the sector enjoys a tailwind from demographics, increasing health awareness and medical advancements.

In this outlook, we will discuss all of the above in greater detail with the aim of providing better visibility on the investment landscape in the upcoming year. With that, I wish you an excellent holiday period and a great start to the new year.

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