Investment Outlook 2023

PREPARING FOR LANDING

BIL 1856 BANQUE INTERNATIONALE À LUXEMBOURG

INTRODUCTION

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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.

...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.

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.

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.

Lionel De Broux
Group CIO, BIL

MACRO OUTLOOK

Globally, a broad-based downturn in economic activity is underway as financial conditions tighten while the cost of living remains elevated.

Globally, a broad-based downturn in economic activity is underway as financial conditions tighten while the cost of living remains elevated. On top of that, China – the world's second largest economy – is in the midst of a slowdown, while the armed conflict in Ukraine continues on Europe's doorstep. All of this is leading to subdued business optimism with new order intakes and international trade flows dwindling through Q4, suggesting weaker activity ahead. The notable bright spot in the data docket continues to be the labour market, with firms thus far somewhat reluctant to let staff go given how difficult it was to recruit in the aftermath of the pandemic amid the "Great Resignation".

IMF Growth Expectations *(%)*

		OCTOBER FORECAST		JULY FORECAST		SPRING FORECAST	
	2021	2022	2023	2022	2023	2022	2023
World	6.1	3.2	2.7	3.2	2.9	3.6	3.6
US	5.7	1.6	1.0	2.3	1.0	3.7	2.3
Eurozone	5.3	3.1	0.5	2.6	1.2	2.8	2.3
China	8.1	3.2	4.4	3.3	4.6	4.4	5.1
Japan	1.6	1.7	1.6	1.7	1.7	2.4	2.3

Source: IMF World Economic Outlook, BIL

Purchasing Managers' Indices (PMI) – considered a reliable leading indicator – have largely fallen below 50 for both the manufacturing and service sectors suggesting economic contraction ahead.

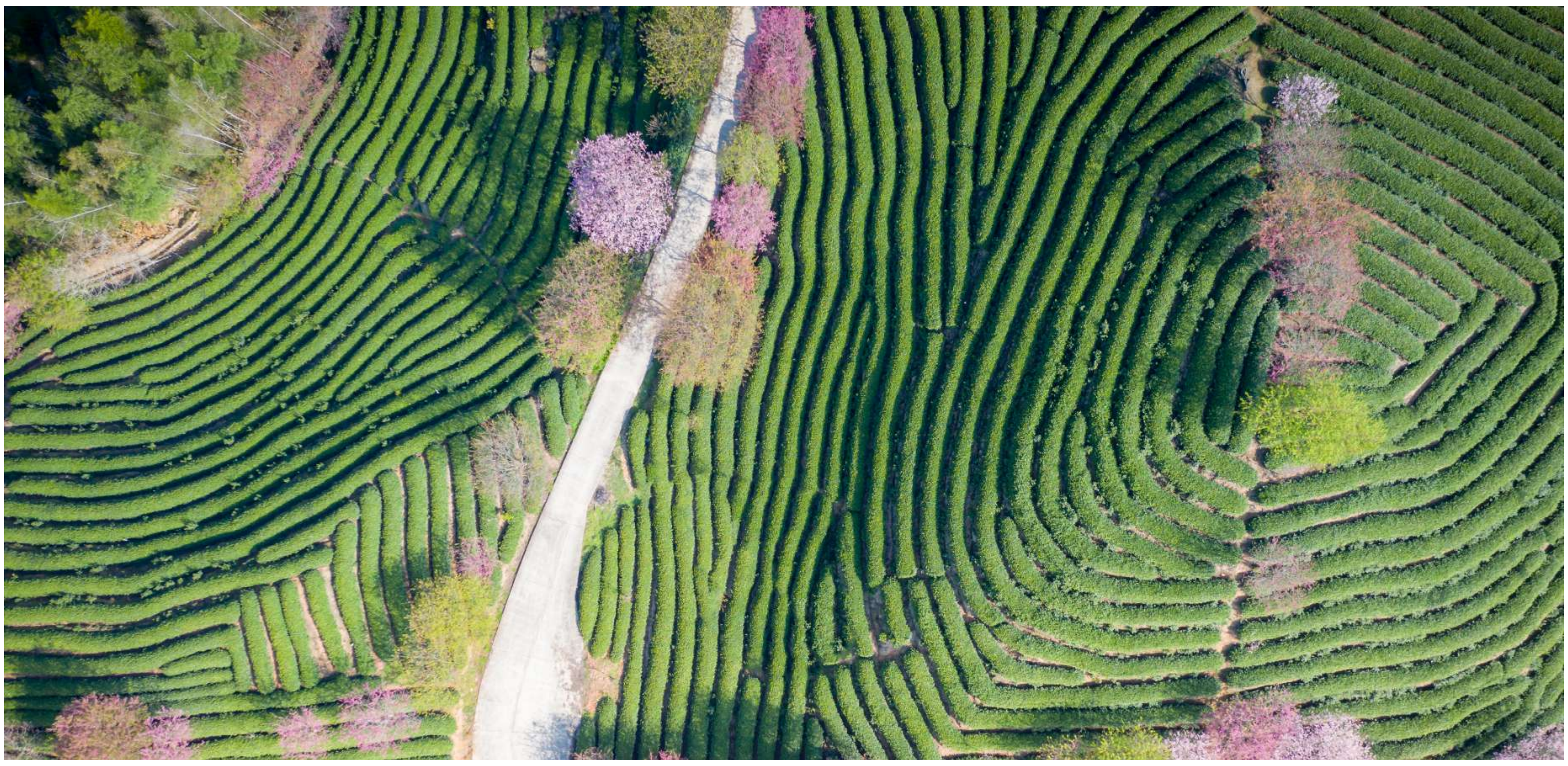
Services PMIs

	05/2022	06/2022	07/2022	08/2022	09/2022	10/2022	11/2022
JP Morgan Global	51.9	53.9	51.1	49.3	50	49.2	
US	53.4	52.7	47.3	43.7	49.3	47.8	46.1
Eurozone	56.1	53	51.2	49.8	48.8	48.6	48.5
China (Caixin)	41.4	54.5	55.5	55	49.3	48.4	46.7
Japan	52.6	54	50.3	49.5	52.2	53.2	50.3
Emerging Markets	47.2	55.5	55.4	54.8	50.7	49.9	

Manufacturing PMIs

	05/2022	06/2022	07/2022	08/2022	09/2022	10/2022	11/2022
JP Morgan Global	52.3	52.2	51.1	50.3	49.8	49.4	48.8
US	57	52.7	52.2	51.5	52	50.4	47.7
Eurozone	54.6	52.1	49.8	49.6	48.4	46.4	47.1
China (Caixin)	48.1	51.7	50.4	49.5	48.1	49.2	49.4
Japan	53.3	52.7	52.1	51.5	50.8	50.7	49
Emerging Markets	49.5	51.7	50.8	50.2	49.4	49.8	49.7

Source: S&P Global, Bloomberg, BIL



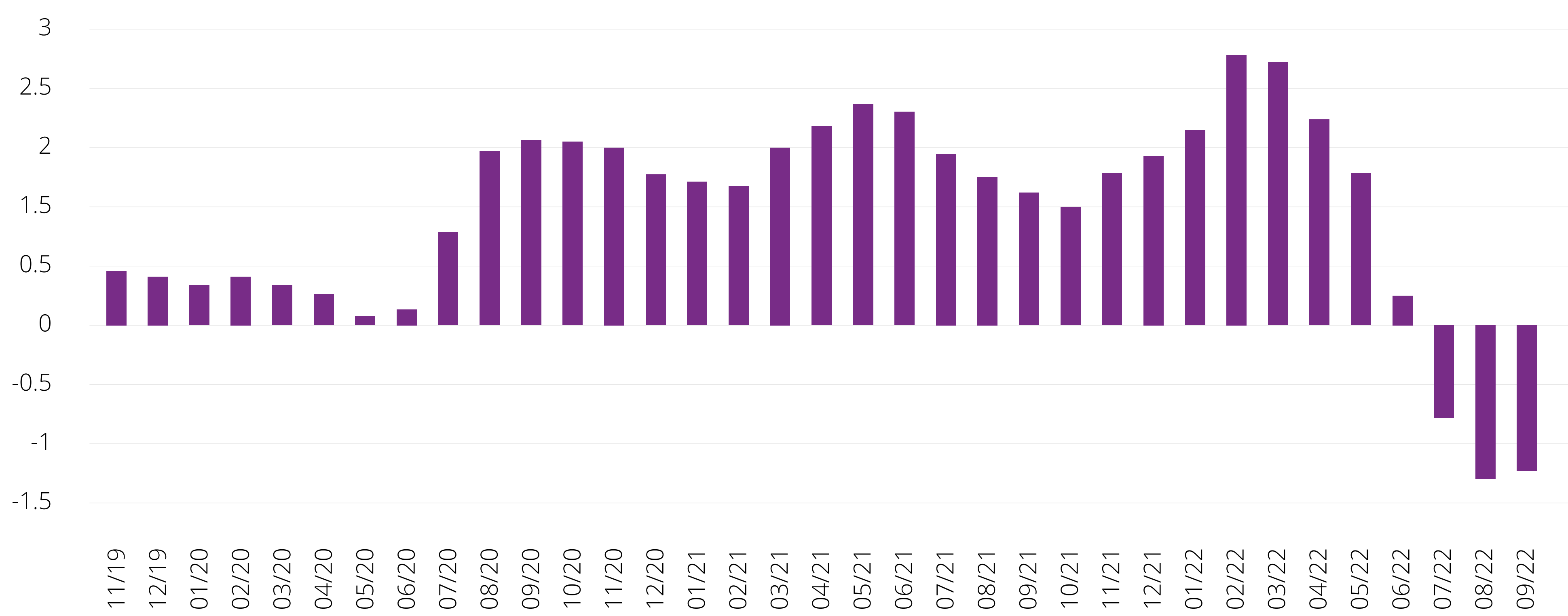
THE US

For inflation to continue its path back down towards target, and thus bring about a softer landing, we need to see a softer labour market and weaker consumption.

At large, the US economy has remained strong in the face of Fed tightening, with Q3 GDP surprising on the upside at 2.6%. Leading indicators suggest that this strength is starting to wane, but this is not exactly an unwelcome development: Every sign of enduring economic strength complicates the Fed's mission to rein in broad-based inflation without raising rates to levels that make a hard landing inevitable. For inflation to continue its path back down towards target, and thus bring about a softer landing, we need to see a softer labour market and weaker consumption.

The interest-rate sensitive housing sector was the first shoe to drop in response to the Fed's aggressive tightening campaign. With mortgage rates[1] rising above 7%, the decade-long US housing boom has come to an end. However, the sector accounts for about 10% of GDP and as such it is possible for the sector to roll over without causing an economy-wide recession. Conversely, the fate of the housing sector will largely depend on whether the Fed can engineer a soft landing. Prices are expected to slip by at least 10% from their June peak through 2023, but in a hard-landing scenario the fall could be much steeper. House prices in the Eurozone are still rising; however, the pace is slowing (see Appendix).

US Housing Recession: Case-Shiller 20 City Home Price Index ***(%, MoM)***



Source: Bloomberg, BIL

1 Average 30-year fixed rate

Companies report increasing headwinds from the rising cost of living, tightening financial conditions and weakened demand...

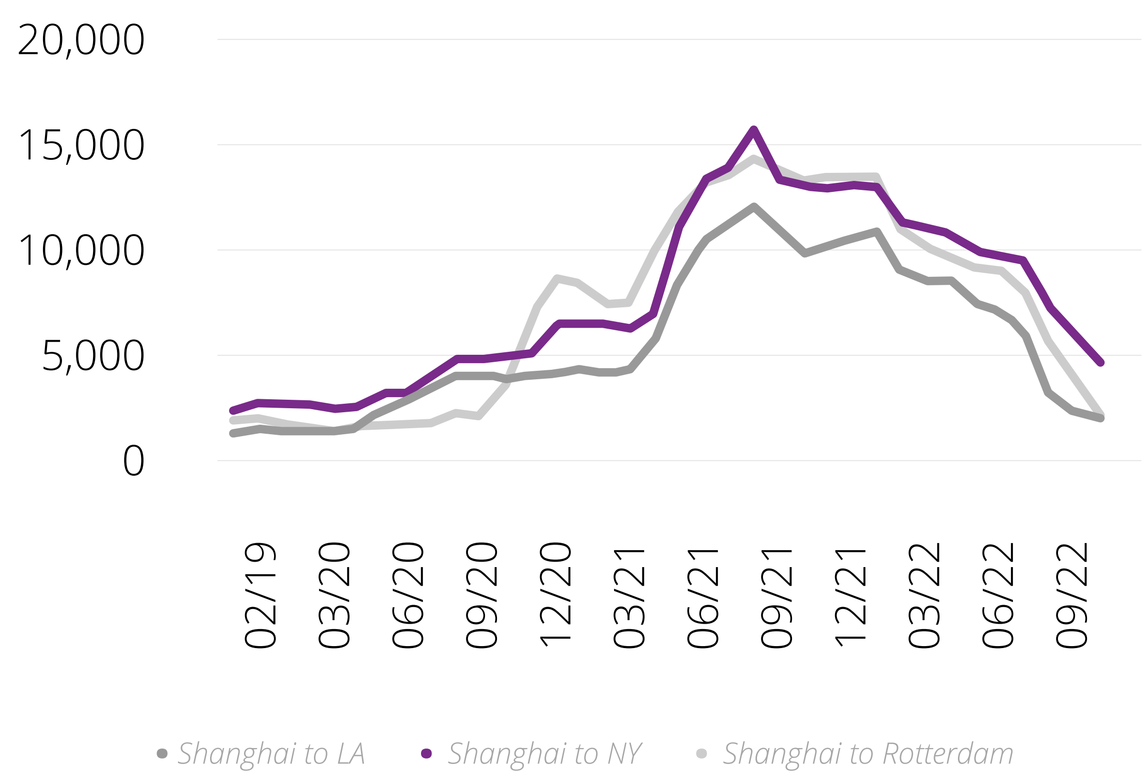
With regard to private-sector activity, PMIs now also indicate that a slowdown is nigh. Companies report increasing headwinds from the rising cost of living, tightening financial conditions and weakened demand in both domestic and export markets – the latter compounded by the strength of the dollar. New sales indicators (which have fallen at their fastest pace since 2009 if we exclude pandemic lockdowns), rising inventories and falling backlogs indicate that a manufacturing recession is probable in the months ahead. Like housing, however, manufacturing only accounts for a relatively small share of the economy at around 11% of GDP.

...pandemic-era supply chain issues are ameliorating and in turn, input cost inflation is subsiding.

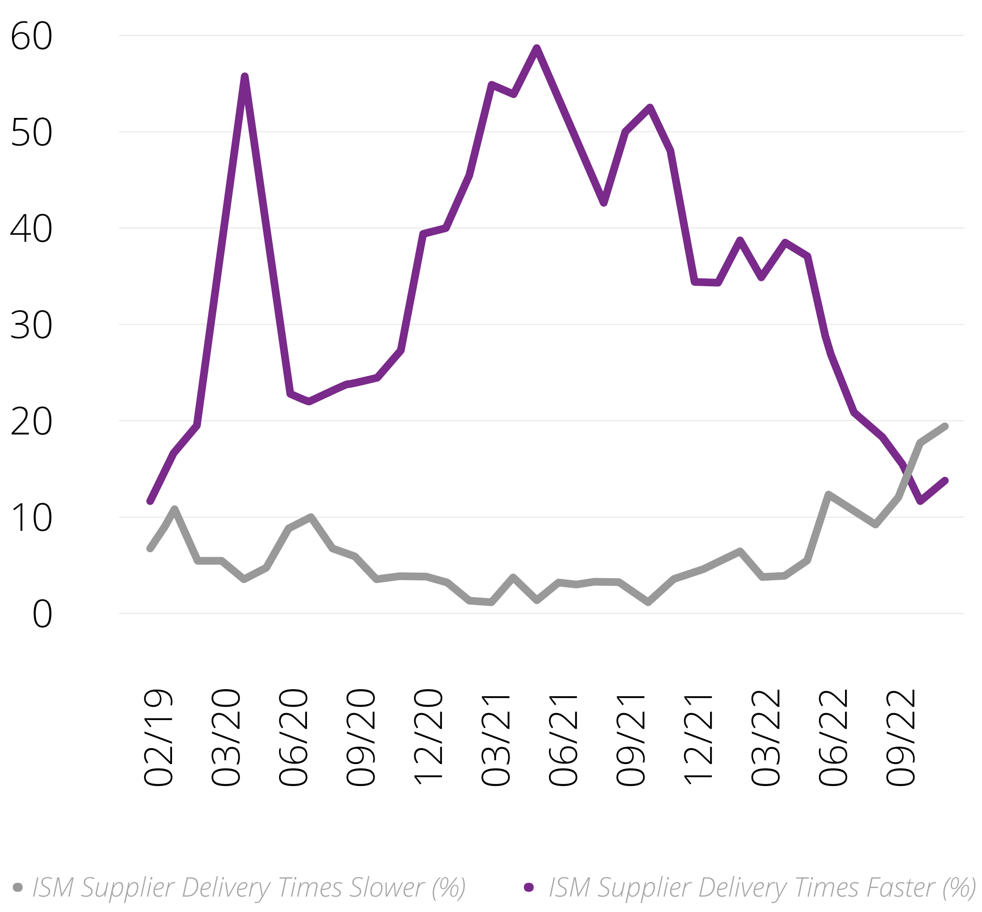
The silver lining for the corporate sector is that pandemic-era supply chain issues are ameliorating and in turn, input cost inflation is subsiding. US firms raised their selling prices at the slowest rate in over two years in November, with some offering discounts to entice customers.

In focus: supply chain issues have eased

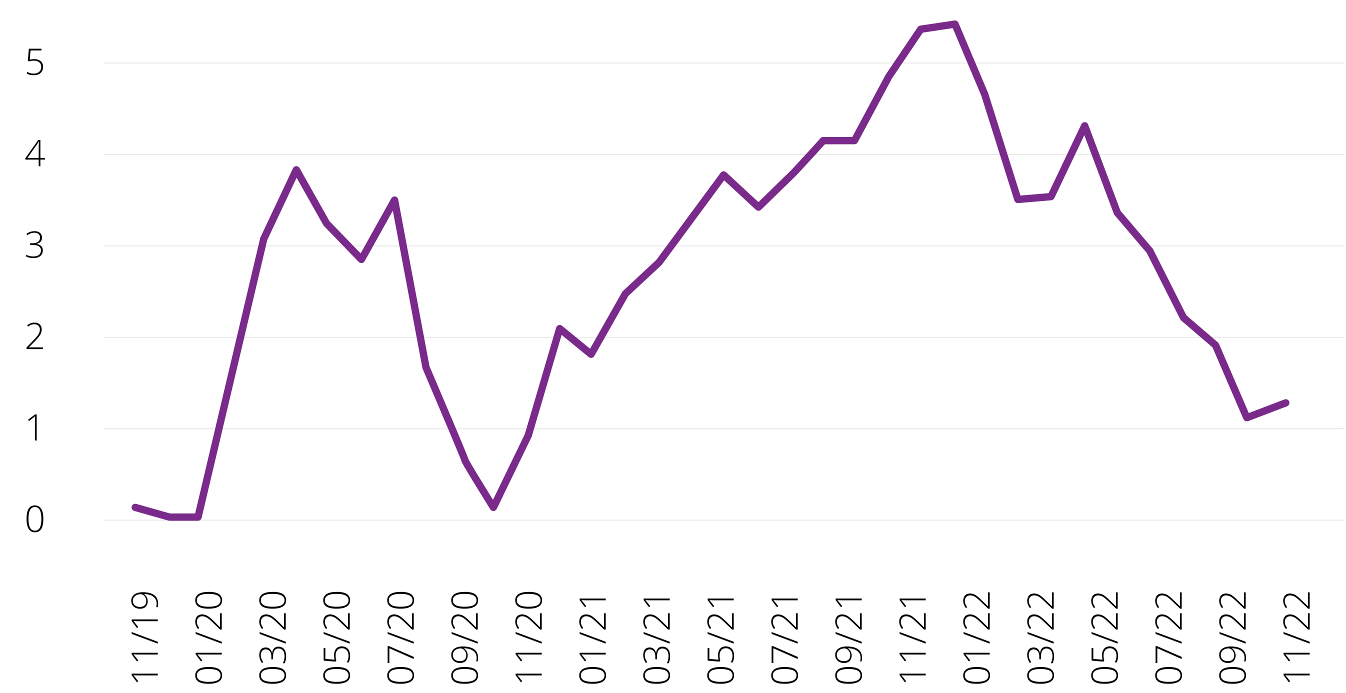
Cost to send a 40-foot container *(USD)*



ISM Supplier Deliveries



NY Fed Global Supply Chain Pressure Index



Source: Bloomberg, NY Fed, ISM, BIL

Utimately, the fate of the US economy hinges on consumer demand given that private consumption accounts for about two-thirds of total GDP.

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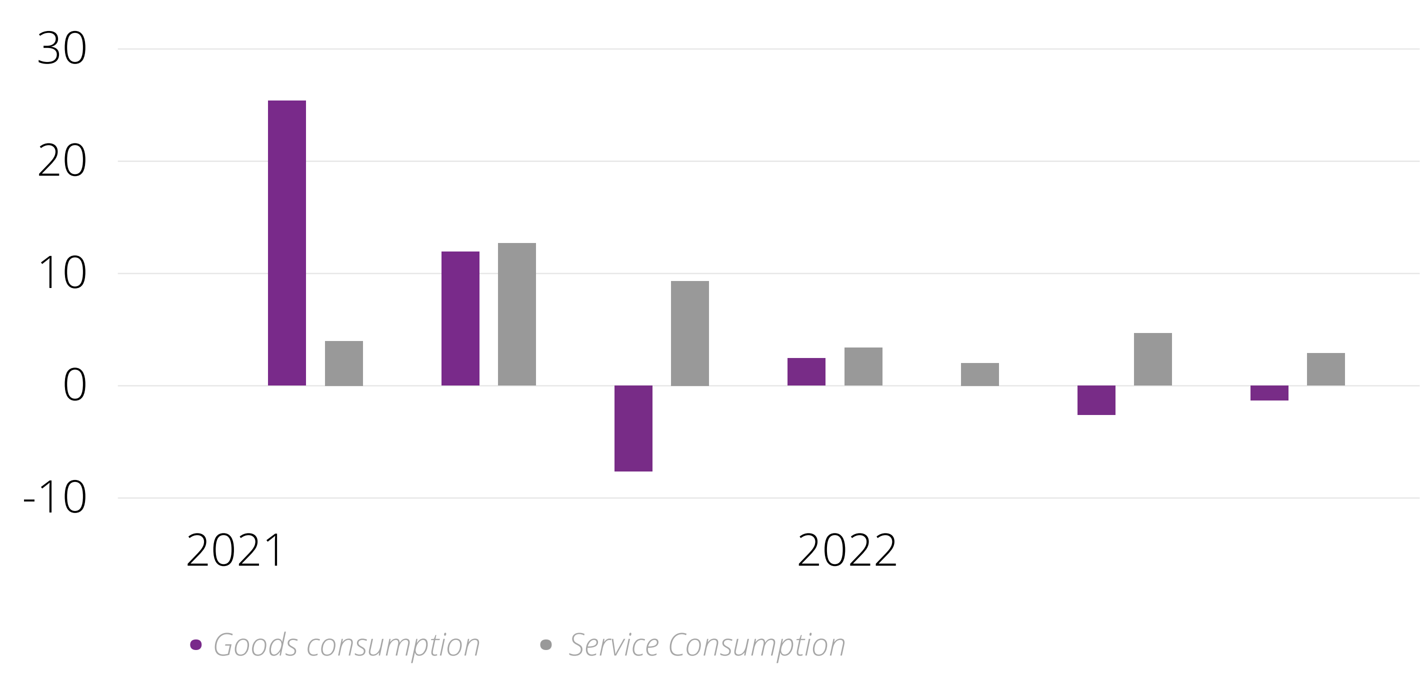
For goods, the old adage that "the cure for high prices — is high prices" has started to ring true, with retailers turning to heavy discounting to clear inventory gluts.

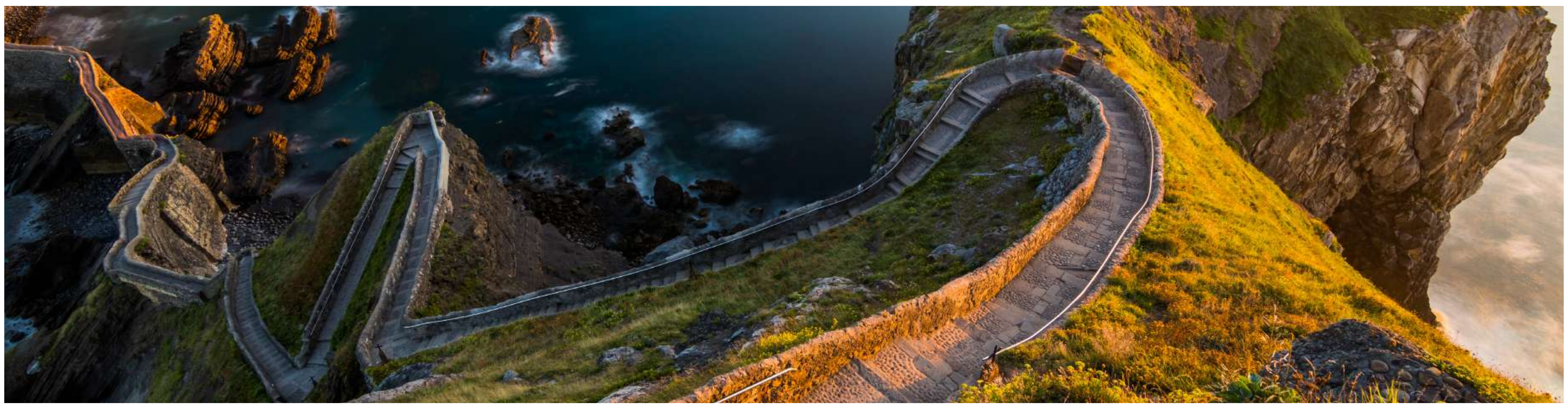
However, the service sector is more important for growth given that it accounts for around two-thirds of consumer spending on things like travel, rent and health care. People have been eager to catch up on experiences missed during the pandemic and are willing, if necessary, to run down their accumulated savings to do so. This pent-up demand was perfectly illustrated by the recent Taylor Swift tickets fiasco: Volumes were so high that the Ticketmaster website crashed and the company later claimed the demand "could have filled 900 stadiums", while prices on secondary sites rose to as much as USD 20,000+. More anecdotal evidence also comes from the travel sector: Despite airfares surging nearly 43% over the past year, major airlines have said that they do not see signs that the pandemic-related travel boom is tapering off[2].

US GDP: Consumption Growth *(%)*

Goods vs Services



Source: Bureau of Labor Statistics, BIL



2 https://www.wsj.com

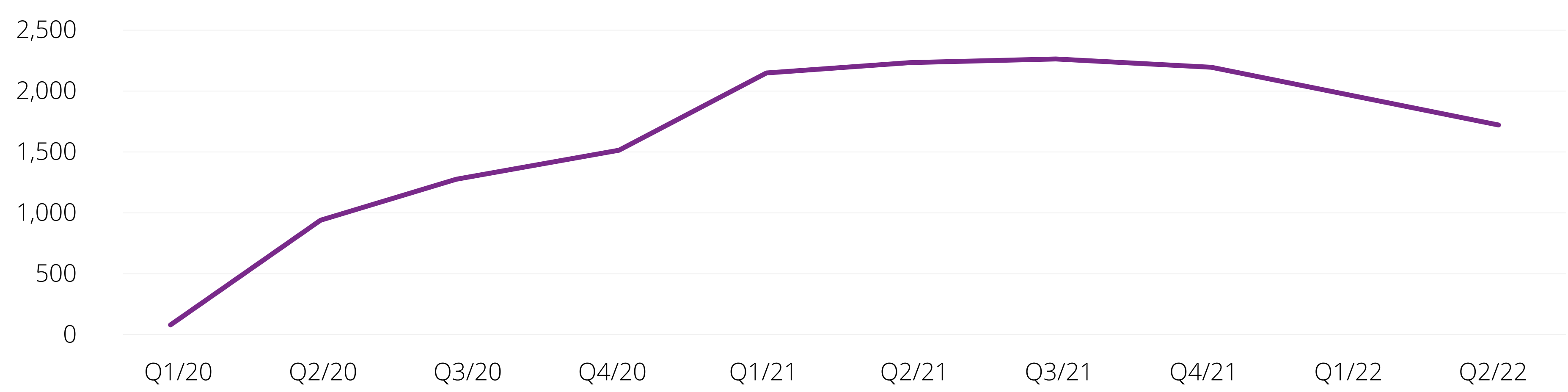
The pillars propping up US spending are looking less sturdy. Those are: excess savings accumulated during the pandemic (subsequently topped up with a series of fiscal stimulus cheques) and a strong labour market.

Softer consumption data would probably be a welcome development for the Fed in its fight against inflation. Given that the pillars propping up US spending are looking less sturdy, we believe it is reasonable to expect modest (we might even say "healthy") demand destruction as 2023 progresses.

The pillars we speak about are excess savings accumulated during the pandemic (subsequently topped up with a series of fiscal stimulus cheques) and a strong labour market.

Excess savings are now gradually in decline. Beyond dipping into savings, consumers have also been leaning on credit cards with balances increasing by USD 38 billion in Q3 (approaching pre-pandemic levels, after sharp declines at the onset of the health crisis). As of now, delinquency rates are low by historical standards; this suggests consumers are managing their finances through the period of increasing prices[3].

US stock of excess savings *(USD billion)*



Source: US Federal Reserve, BIL

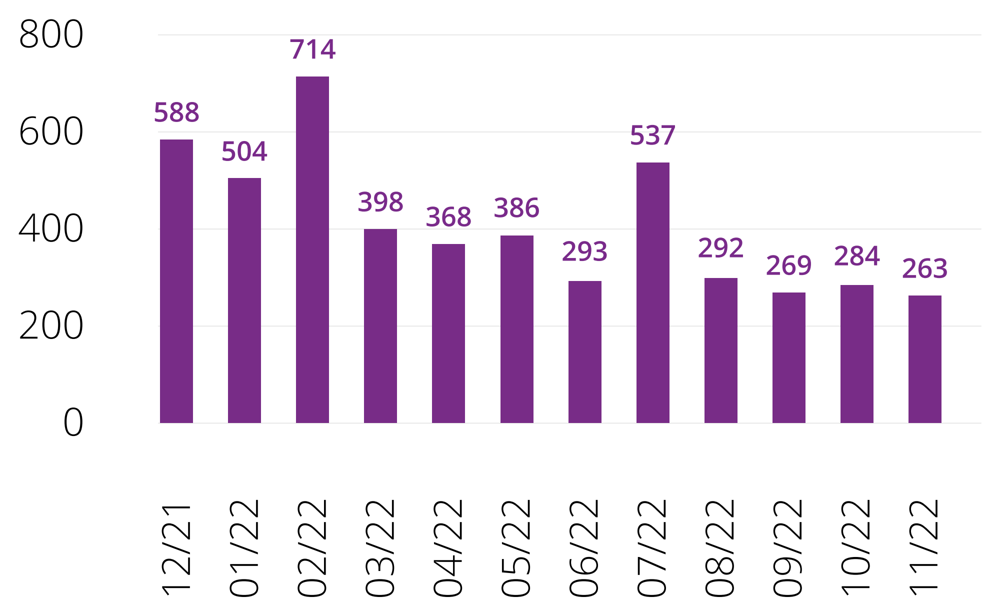
The US labour market has remained incredibly strong until now, with the unemployment rate at 3.7%.

The US labour market has remained incredibly strong until now, with the unemployment rate at 3.7% – just shy of the 50-year low of 3.5%. A key risk for the Fed and the inflation outlook is that if the labour market doesn't slacken up, it could exert renewed upwards pressure on wages - in November, average hourly earnings accelerated to 5.1% YoY, around double the average pace during the 2009-2020 expansion. Recently, Fed Governor Bullard commented "I do think that the fact that the labour market is so strong gives us licence to pursue our disinflationary strategy now and try to get the inflation under control right now so we don't replay the 1970s where the FOMC at that time took 15 years to get inflation under control."

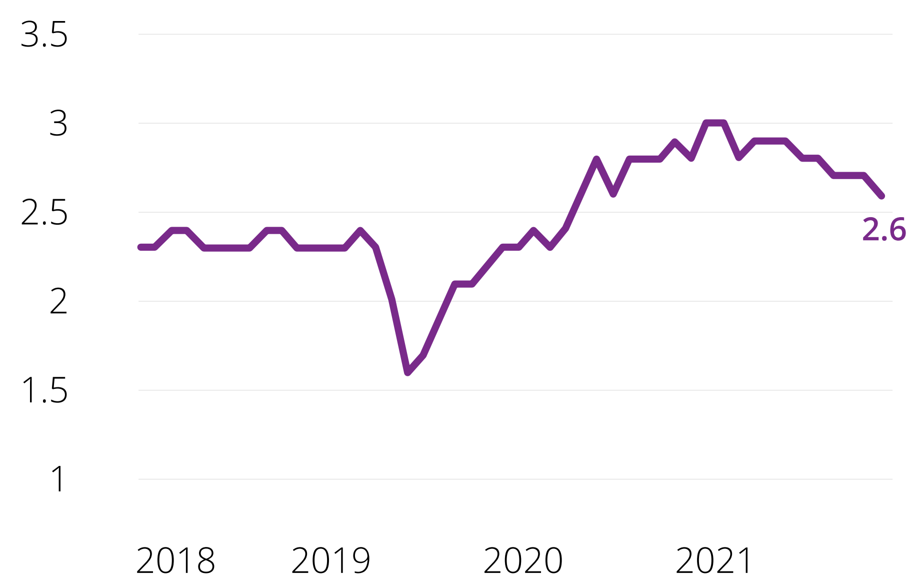
3 https://libertystreeteconomics.newyorkfed.org

Change in nonfarm payrolls *(000s)*

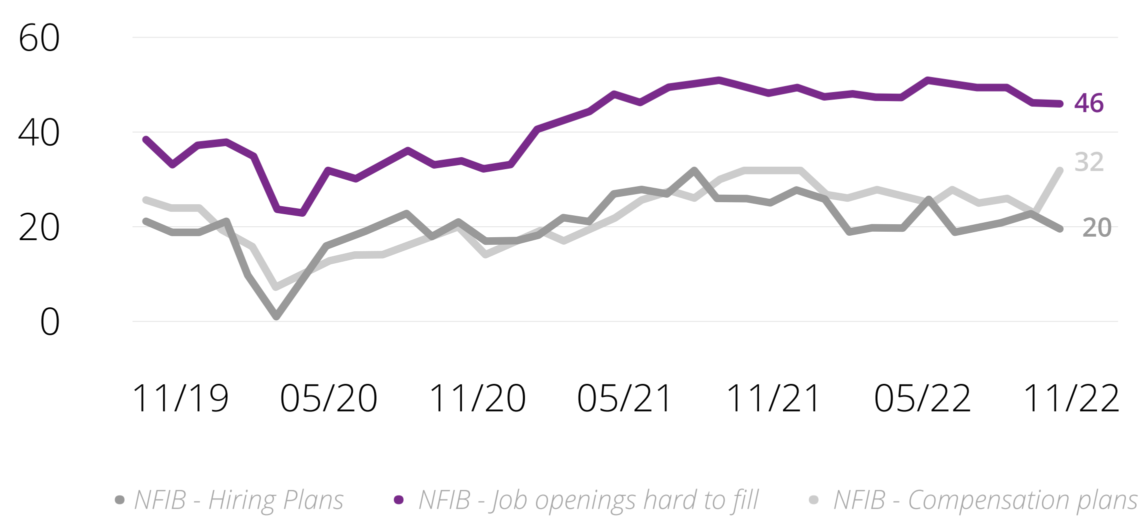
Job growth is slowing but continues to surprise on the upside (263k vs. 200k expected)



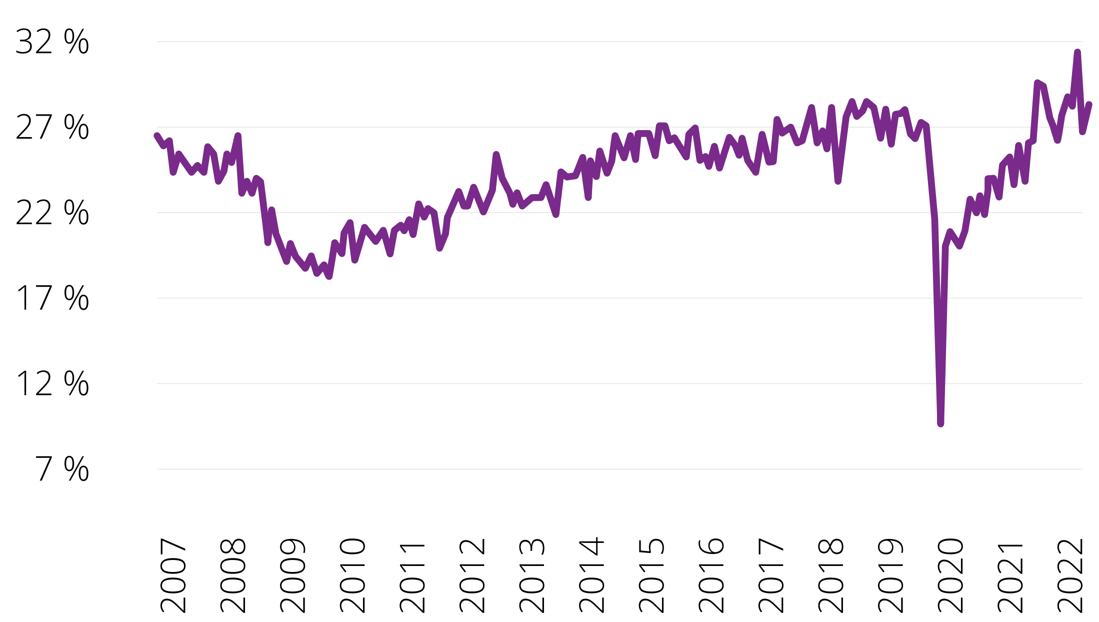
US quits rate *(%)*



NFIB - Labour Market Survey



Monthly flow of «not in the labour force» to unemployed as a share of unemployed hit a record in August and the trend looks set to continue

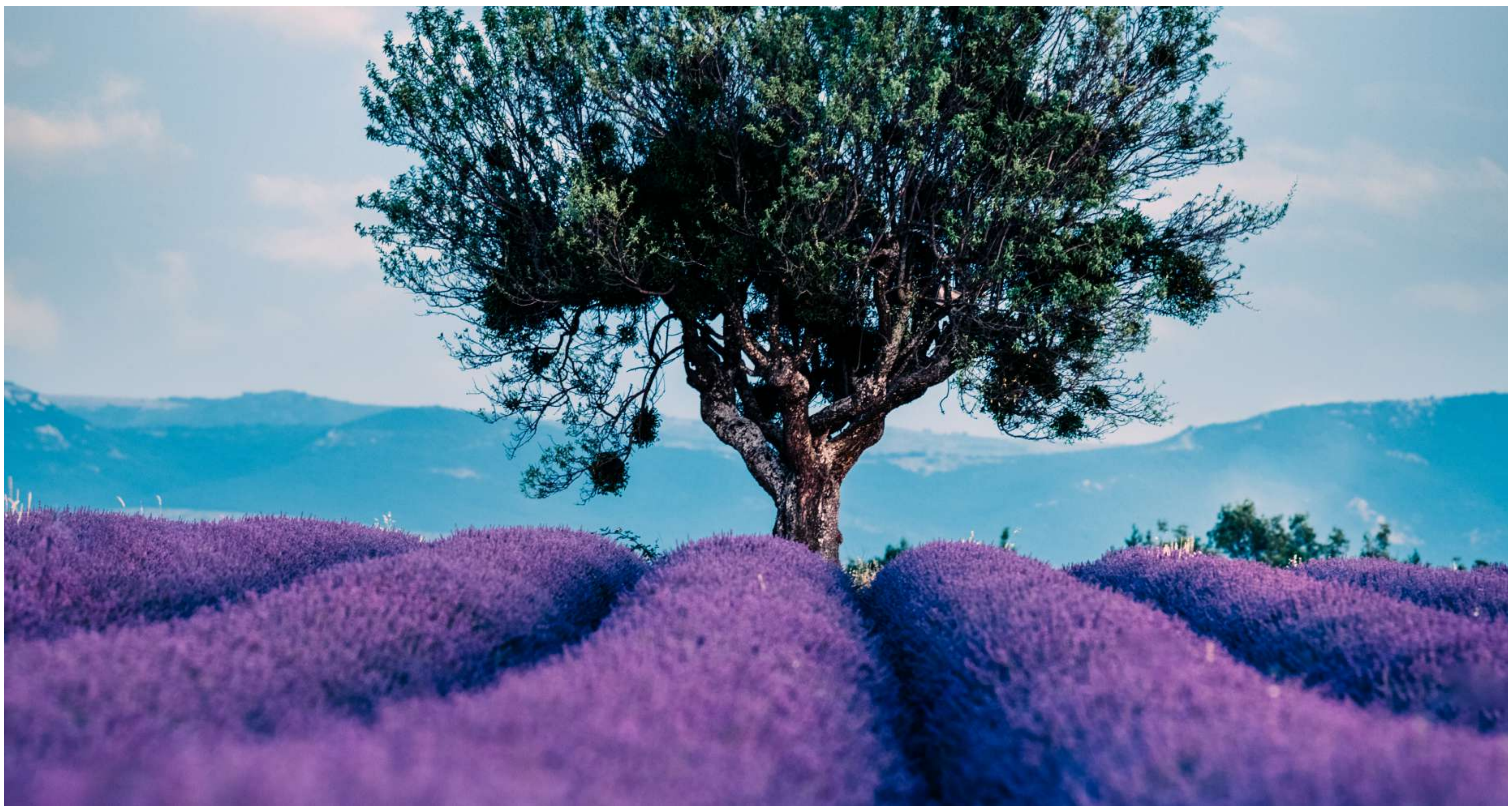


Source: Bloomberg, BIL

...faint cracks are beginning to appear in the labour market. The ratio of openings to unemployed people dropped to 1.7 from 1.9, but remains quite far above the pre-Covid level of 1.2.

It is therefore somewhat welcome news that faint cracks are beginning to appear in the labour market. Job openings fell from 10.7 million to 10.3 million in October, while the quits rate (a good indicator of tightness) fell to the lowest level since May 2021 – although it remains above pre-pandemic levels. The ratio of openings to unemployed people dropped to 1.7 from 1.9, but remains quite far above the pre-Covid level of 1.2. We expect the moderation in demand for workers to continue as private-sector firms scale back hiring activity in response to falling customer demand. At the same time, the supply of workers appears to be on the rise.

While encouraging, the labour market is yet to cool in an "obvious" way, as Powell himself has put it, and the Fed still has a significant amount of work to do in terms of taming inflationary pressures emanating from the job market. In a "soft landing" scenario, we would probably see the unemployment rate rise towards the 4.5% range, with companies able to avoid a spike in layoffs.



A US recession is likely but we believe the downturn will be shallow and short-lived.

Overall, as the Fed approaches its terminal rate and tighter policy works its way through the economy, a US recession is likely. However, given the starting point from a place of relative economic strength, a still-strong labour market, as well as its energy independence, the US has the capacity to absorb more monetary tightening. Accordingly, we believe the downturn will be shallow and short-lived. Bank balance sheets are robust and a downturn today is less likely to seriously disrupt lending – the hallmark of financial recession and systemic damage. Rather, we will probably see economic pain hitting the weakest links across sectors: companies and consumers with too much leverage.

EUROPE

The Eurozone is probably already in a recession – a downturn that will span across Q1 2023. Any potential rebound in 2023 is expected to be muted.

The key factor holding back the Eurozone is its dependence on imported oil and gas. While rationing has been avoided this winter, problems will arise when it comes to refilling storage facilities for winter 2023.

Growth in the Eurozone slowed to just 0.3% in Q3 and the bloc is now probably in recession – a downturn that will span across Q1 2023. With the slowdown expected to be broad-based across demand components and countries, any potential rebound in 2023 is expected to be paltry, with the European Commission anticipating full-year growth of 0.3% followed by 1.5% in 2024.

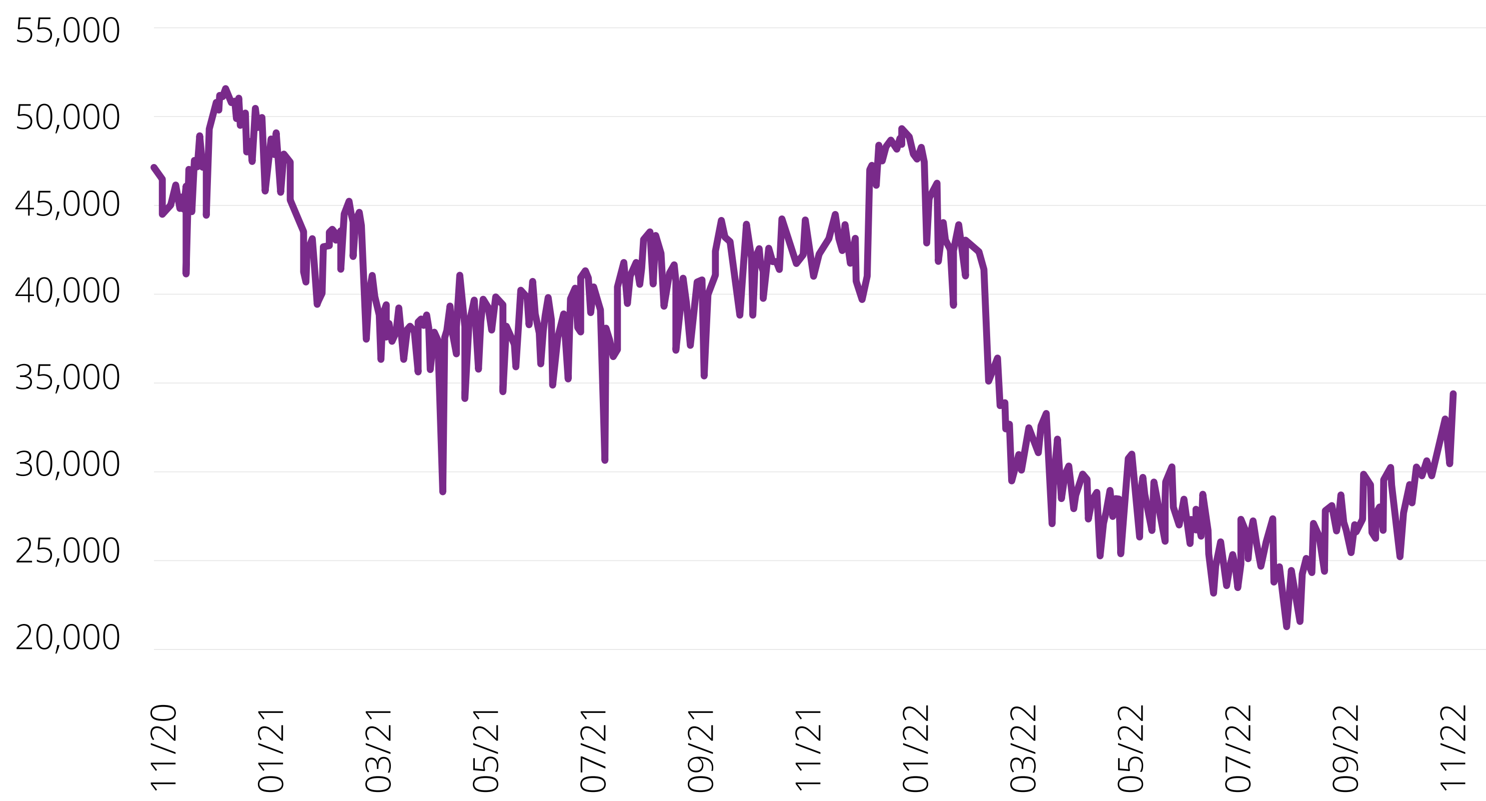
The key factor holding back the Eurozone is its dependence on imported oil and gas. High energy costs as the bloc weans itself off of cheap Russian energy are taking a huge toll on energy-intensive sectors[4] (probably meaning industrial activity will detract from Q4 GDP) and stoking inflation. Maintenance at 26 of France's 56 nuclear power plants has not helped matters, having turned to country into a net power importer while it is usually a net exporter. The good news is that pay deals have been reached with staff at 18 reactors where labour unrest was delaying restarts.

4 Chemicals, metals, refining, paper, minerals

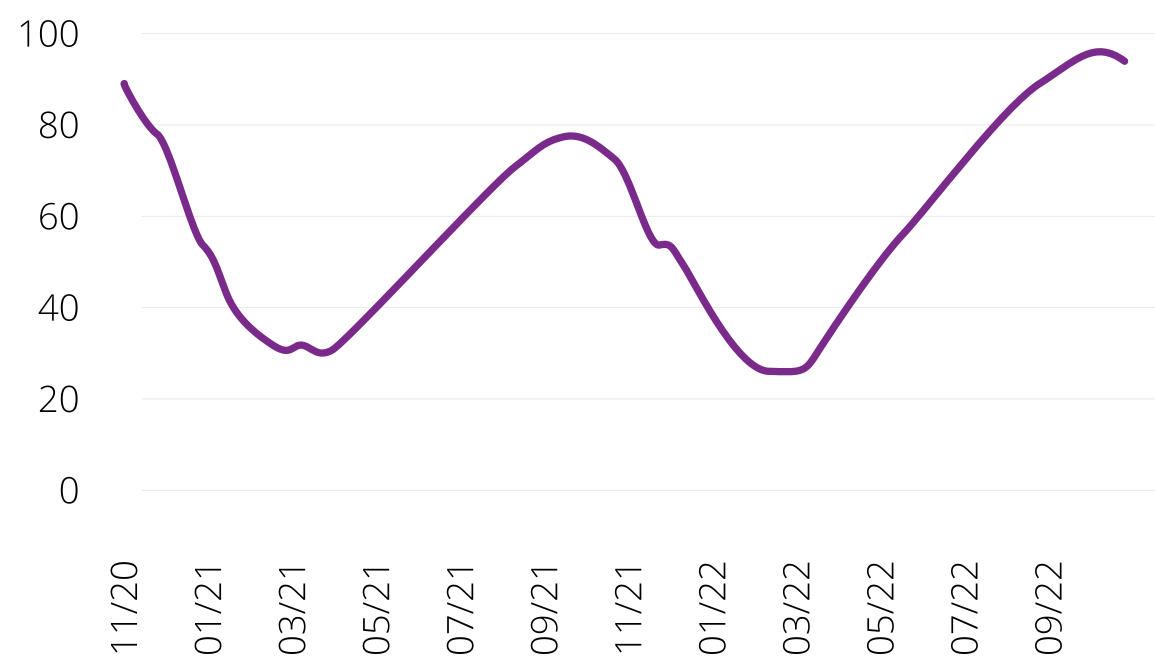
While EU governments have done well in substituting Russian gas with liquefied natural gas (LNG), they have not been able to plug the hole entirely. Floating storage and regasification units (FSRUs) will provide Europe with an extra 49.55 billion cubic metres of new LNG import capacity annually. This is only a fraction of the 155 billion cubic metres of Russian piped gas imported in 2021; however, an increase in other imported piped supplies and renewable capacity, as well as a reduction in gas demand, will also be part of the toolbox. The race is now on to build FRSUs, with Germany aiming to construct five of them by the end of 2023.

In all, the worst-case scenario of energy rationing has been avoided this winter, with gas reserves almost full and warm weather delaying the start of the heating season. The can has nevertheless been kicked down the road, in that problems will arise when it comes to refilling storage facilities for winter 2023, absent Russian gas and considering that China's reopening will increase competition for LNG imports. Europe's energy crisis will persist for years, not months, as it shifts towards alternative sources of energy.

French nuclear generation Daily average rate in megawatts



European gas storage levels *(% full)*

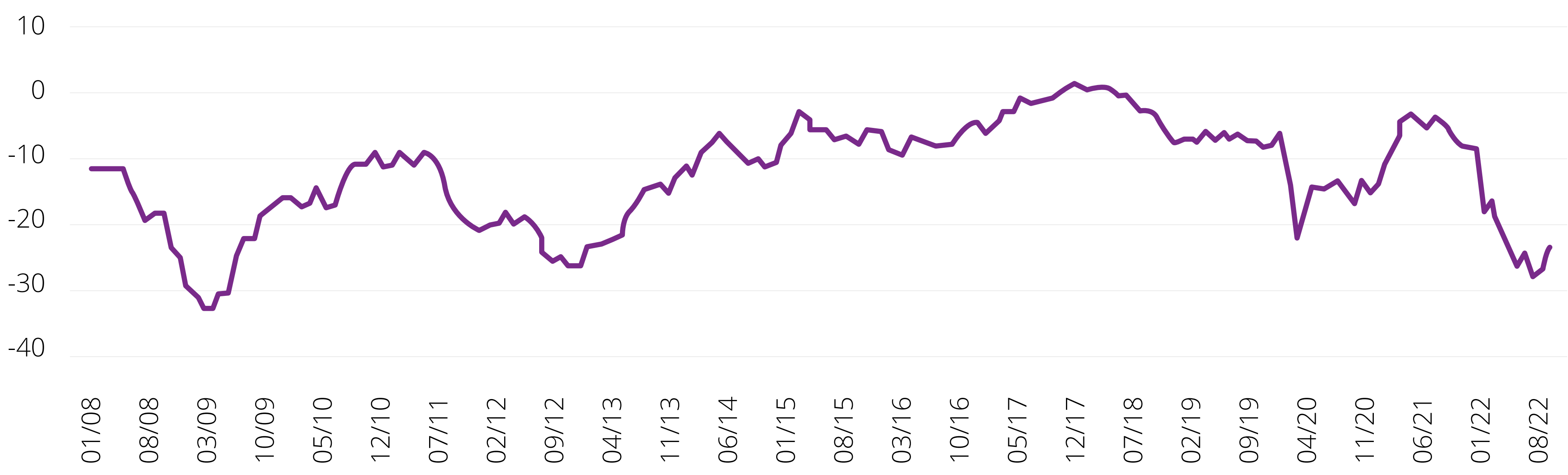


Source: Bloomberg, BIL

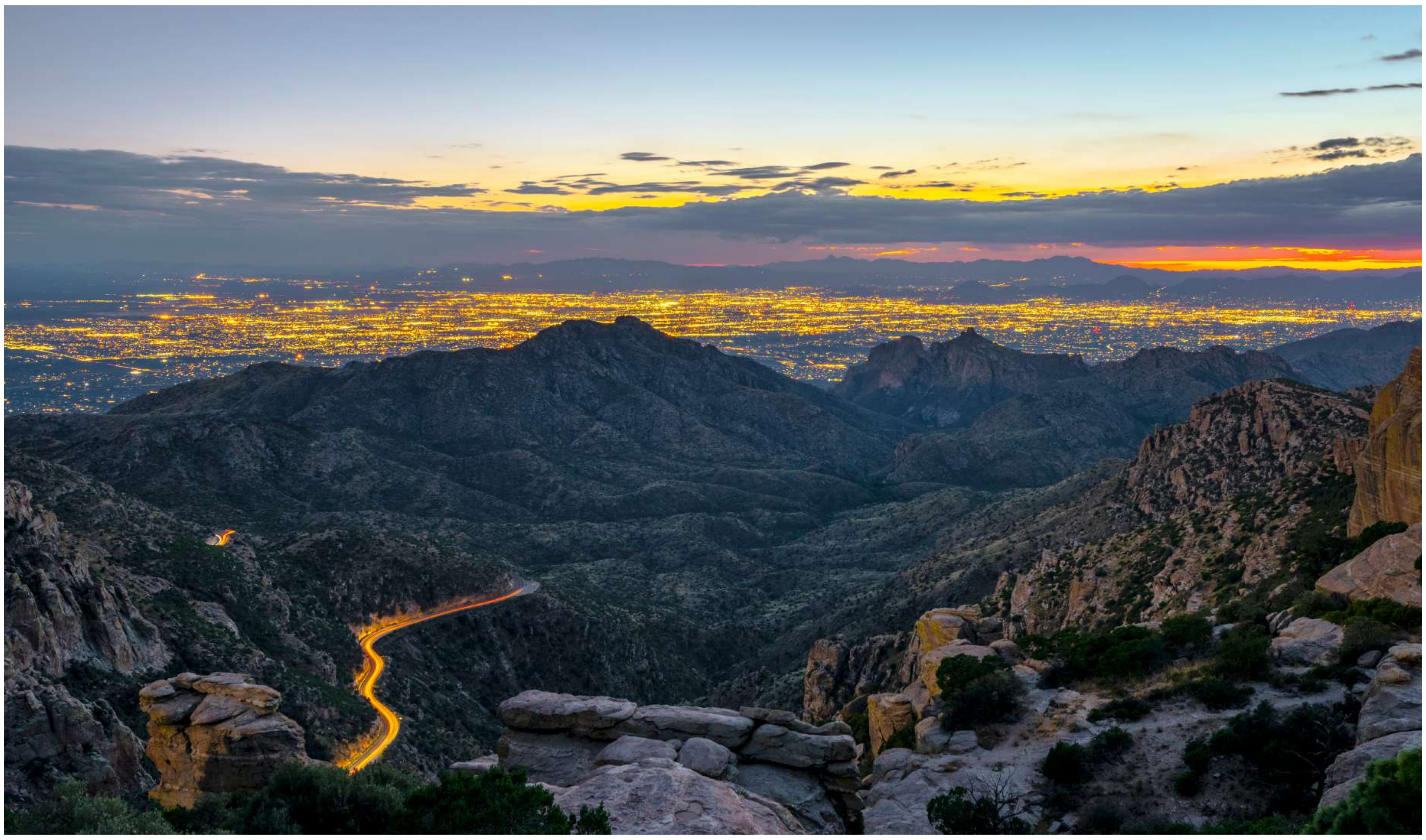
In the consumer sector, inflation is eroding purchasing power and shifting consumer sentiment dramatically. Government actions to shelter households have provided slight relief, but overall, consumer sentiment remains in the doldrums below levels seen during the Eurozone debt crisis.

As such, while there is scope for saving rates to fall (although by less than in the US because European lower-income households have relatively limited excess savings) and while the shift towards more fixed-rate mortgage lending in recent years shields many households from the immediate impact of higher interest rates, we do not expect a marked improvement in spending any time soon; consumption is likely to continue falling through Q4, even if inflation starts to peak.

Eurozone consumer confidence



Source: Bloomberg, BIL

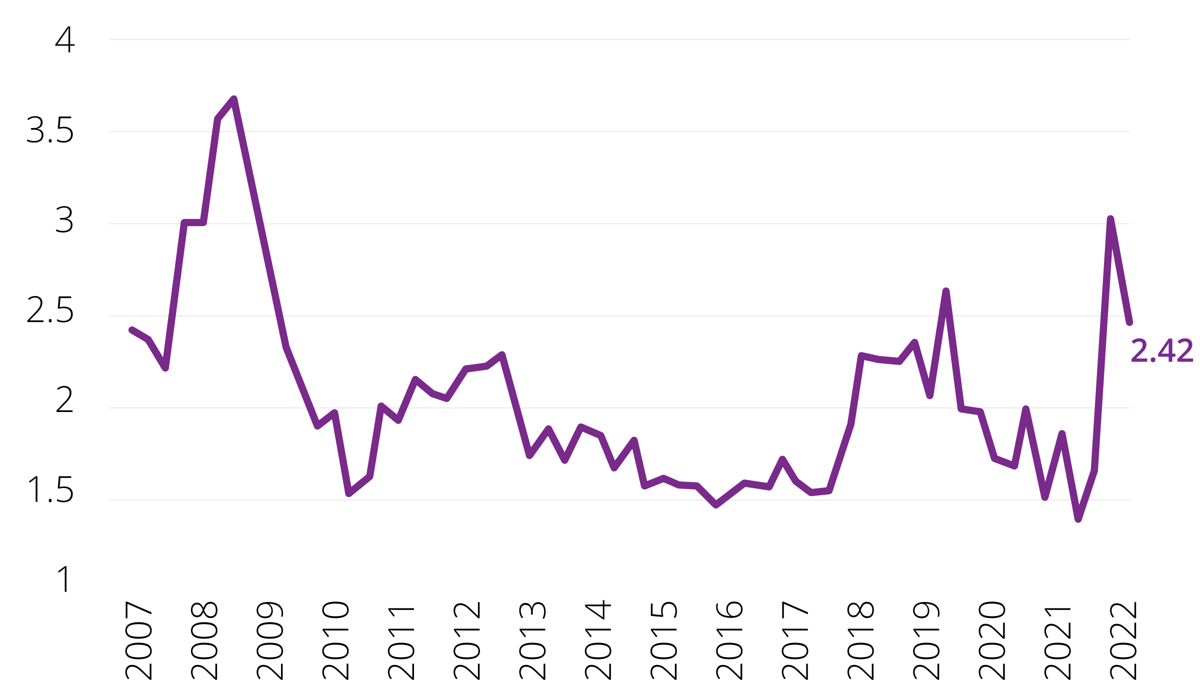


Eurozone wage growth increased to above-average rates in 2022 and is expected to remain strong but to compensate for lost purchasing power only partially.

The bright spot in the data is once again the labour market, which is supporting (though not boosting) household incomes. Although the unemployment rate is sitting at all-time low of 6.5%, we do not yet see significant feedback loops between wages and inflation. As European Commissioner Paolo Gentiloni noted in the Autumn Economic Forecast, wage growth increased to above-average rates in 2022 and is expected to remain strong but to compensate for lost purchasing power only partially.

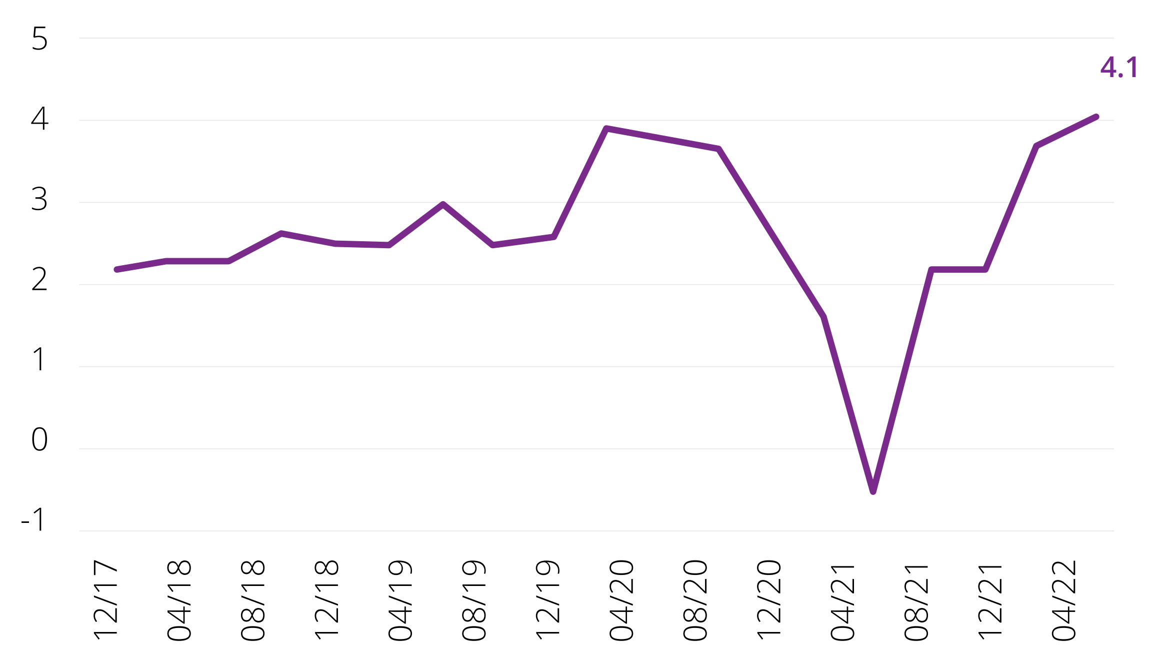
Eurozone

Percentage change in negotiated wage growth – no evidence of wage/price spiral



Eurozone

Labour cost wages and salaries, % YoY



Source: Bloomberg, Eurostat, BIL

Overall, it seems that negotiated pay settlements have been restrained so far or spread out across several years. As a key example, Germany's biggest union, IG Metall, recently reached a deal resulting in pay rises well below Germany's then-inflation rate of 11.6%. Workers will receive a 5.2% rise next year and 3.3% in 2024, plus two EUR 1,500 lump-sum payments.

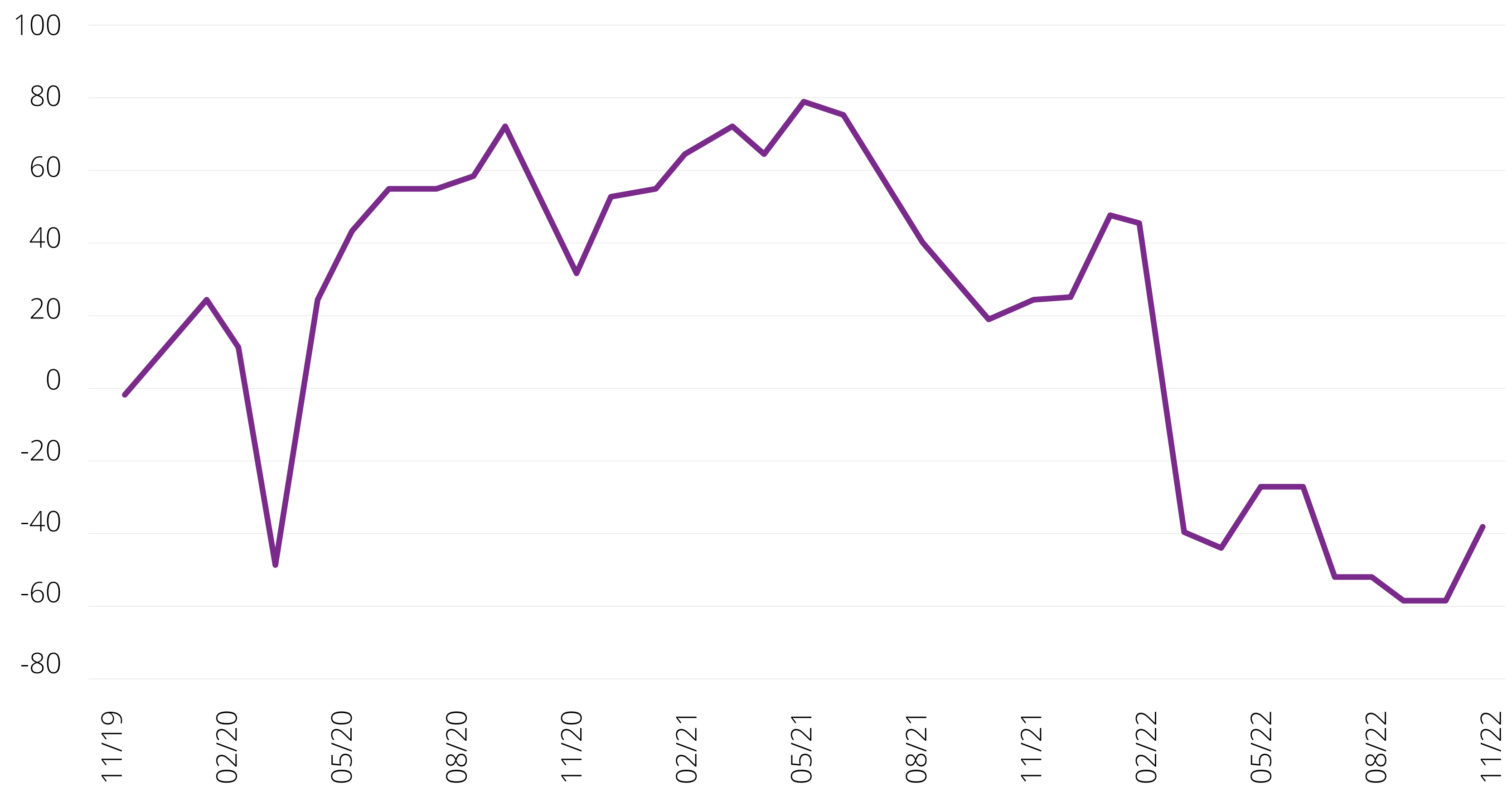
...Europe's landing might not be as hard as one might have expected a few months ago.

The ECB cannot rest on its laurels, however. With eurozone inflation in double digits, the risks of second-round effects on wages have risen.

To finish on a more optimistic note, as seen in the below charts, sentiment has found a floor with energy rationing avoided, government efforts to help with rising utility costs coming into play and with hopes rising that inflation might soon peak, as we have seen in the US. The region is also poised to benefit from China's reopening (a key export market for a swathe of European industries). In light of all this, while a recession now seems inevitable this winter, Europe's landing might not be as hard as one might have expected a few months ago. It is also worth noting that its economy is better insulated going into the downturn with the use of macroprudential policies since 2008 having helped limit excessive household borrowing. Meanwhile, the asset quality of Eurozone banks showed no signs of broad-based deterioration in the first half of 2022, despite a significant worsening of the economic outlook[5].

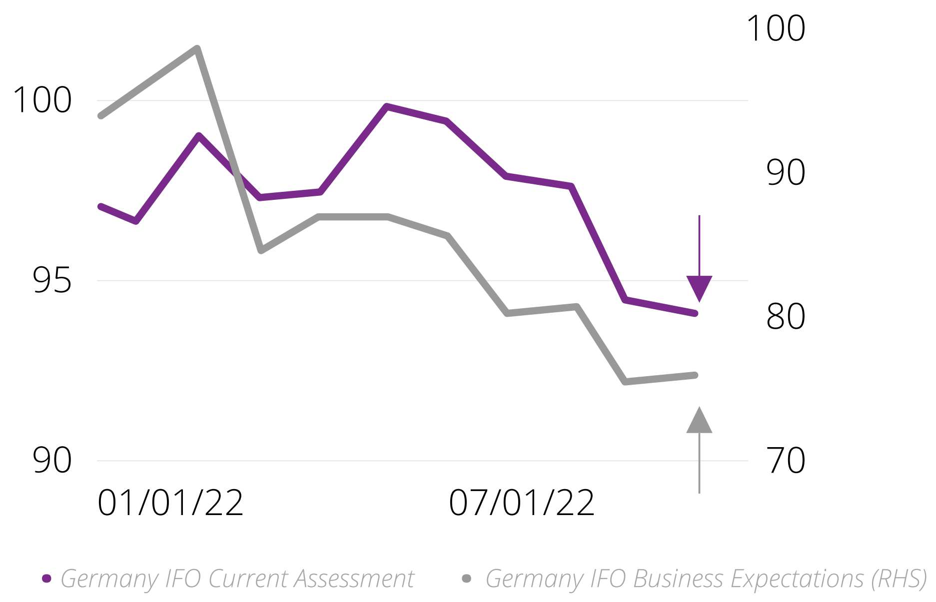
Eurozone

ZEW economic expectations



Germany

IFO current situation vs. expectations



Source: Bloomberg, BIL

5 https://www.ecb.europa.eu

CHINA

China continues to face structural housing market headwinds, lacklustre domestic demand stemming from zero-Covid policies and falling external demand amid a global macro slowdown.

It was once said that when the US sneezes the rest of the world catches a cold. Today the same might be said for China, with its 1.4 billion population making it a key market for various global industries – from materials to industrials, consumer goods to luxury brands, and auto makers to tech.

Its economy grew by just 3.9% in Q3 (versus 4.9% seen over the same period last year), after scraping out just 0.4% growth in Q2. In the short term, China continues to face structural housing market headwinds, lacklustre domestic demand stemming from zero-Covid policies and falling external demand amid a global macro slowdown.

While adjustments to Covid risk management protocols have lathered up a fair amount of investor optimism, evidence from other Asian economies implies that growth will probably remain weak in the quarter following reopening, with cases mounting and caution high.

Longer term, China's prospects look more promising: While the rest of the world will have landed, or will be in the process of coming down from post-Covid highs in 2H 2023, it looks like China will be illuminating the fasten seatbelts sign and preparing for take-off.

The encouraging fact is that with inflation at 1.6%, and therefore below the annual target of 3%, China is a clear outlier in the ongoing tightening cycle. Policy-supported sectors should hold up best over the next months – one example being the boost to auto sales from the waiver of purchase taxes. Meanwhile, fiscal stimulus via infrastructure and the PBOC's guidance for banks to lend for equipment upgrades have fed into capital goods production.

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INFLATION

Hopes are high that global inflation has peaked. This is a fair expectation when it comes to headline figures.

Hopes are high that global inflation has peaked. This is a fair expectation when it comes to headline figures: Beyond lower commodity prices, falling factory gate costs and the easing of supply-chain bottlenecks, central banks are about to receive significant help from base effects. As a good harbinger, headline CPI is already falling in emerging markets such as Brazil, Thailand and Chile, where central banks were quicker in kicking off their tightening campaigns.

In the US, markets warmly welcomed the fall in the October CPI print to 7.7% – the smallest 12-month increase since January. In the Eurozone, the November print ended a succession of "all-time highs" that began in November 2021, retreating to 10% YoY.

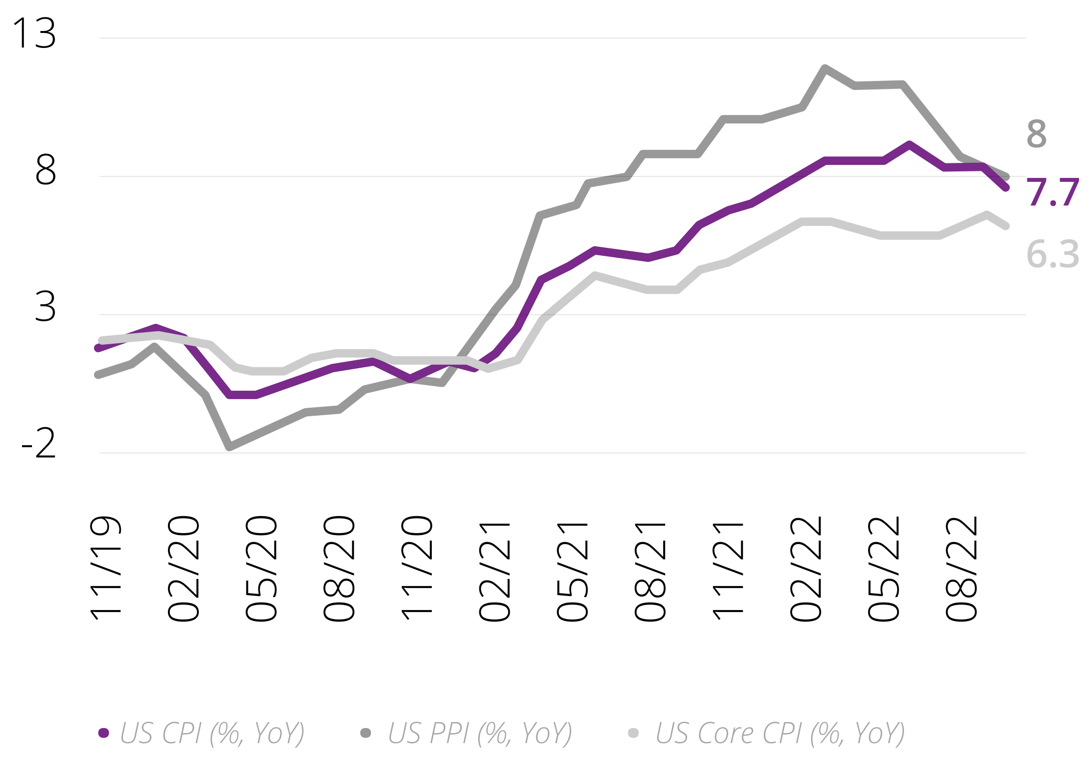
From a glass-half-full perspective there are definitely signs that inflation could continue to soften. The disinflationary impulse from decongestion in supply chains has room to run, China's PPI is in deflation, long-term inflation expectations remain anchored, and falling demand is instigating a wave of discounting.

Core inflation, which excludes energy and food, will take longer to peak due to the lagged effect of high energy prices on the wider supply chain...

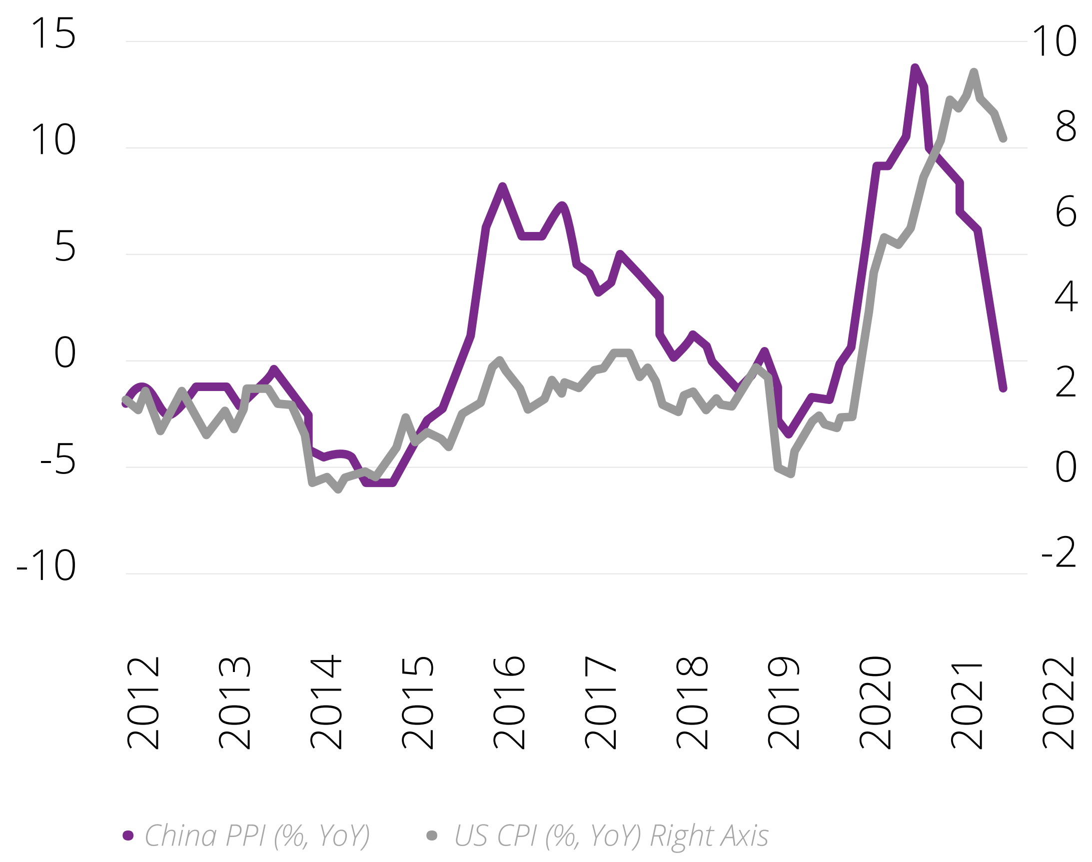
However, core inflation, which excludes energy and food, will take longer to peak due to the lagged effect of high energy prices on the wider supply chain, as well as the fact that inflation has seeped into stickier categories such as shelter costs and wages. As we noted in the macro section, for these to come down we need to see consumption (especially in services) and the labour market soften. In Europe, energy-sector developments could again lead to higher prices, reinforcing inflation.

It's all an expectations game and central banks are afraid to count their chickens before the eggs have hatched: It would be easy for consumer inflation expectations to pick up once more if inflation is slow in coming back towards target or if we see some setbacks.

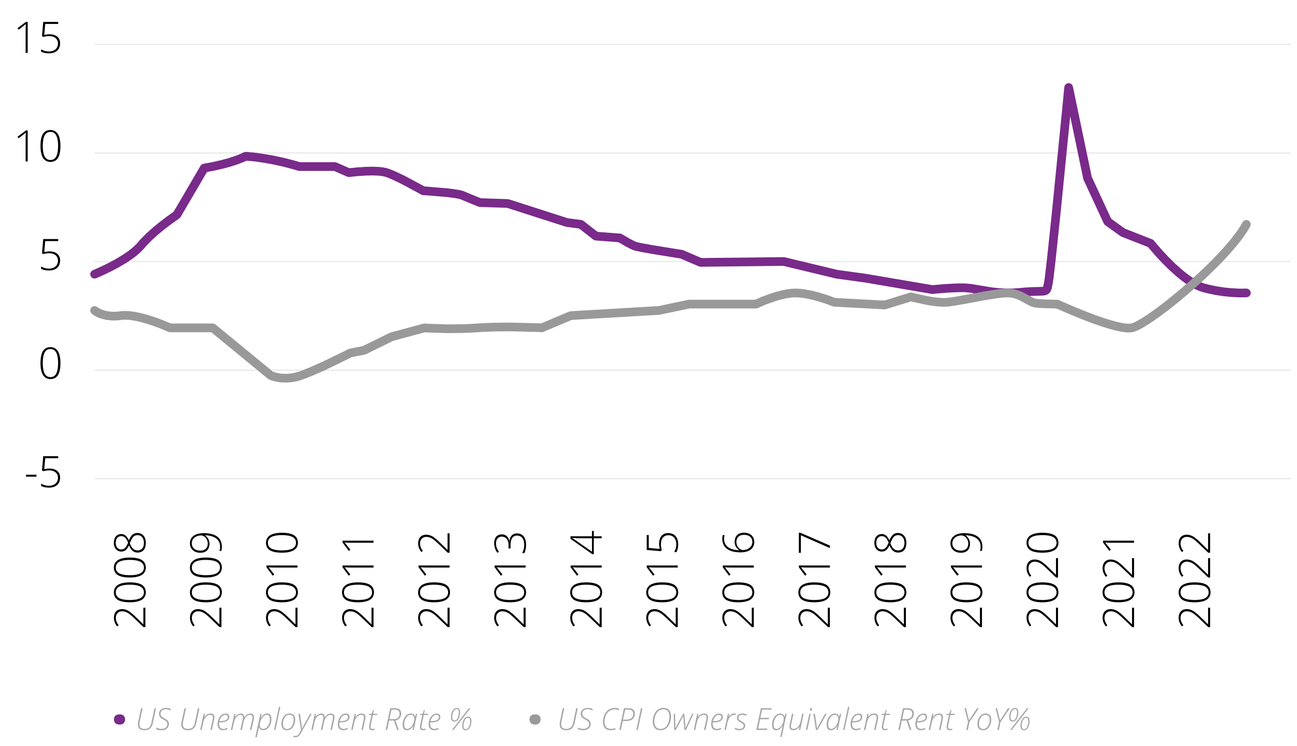
US inflation



China PPI vs. US CPI

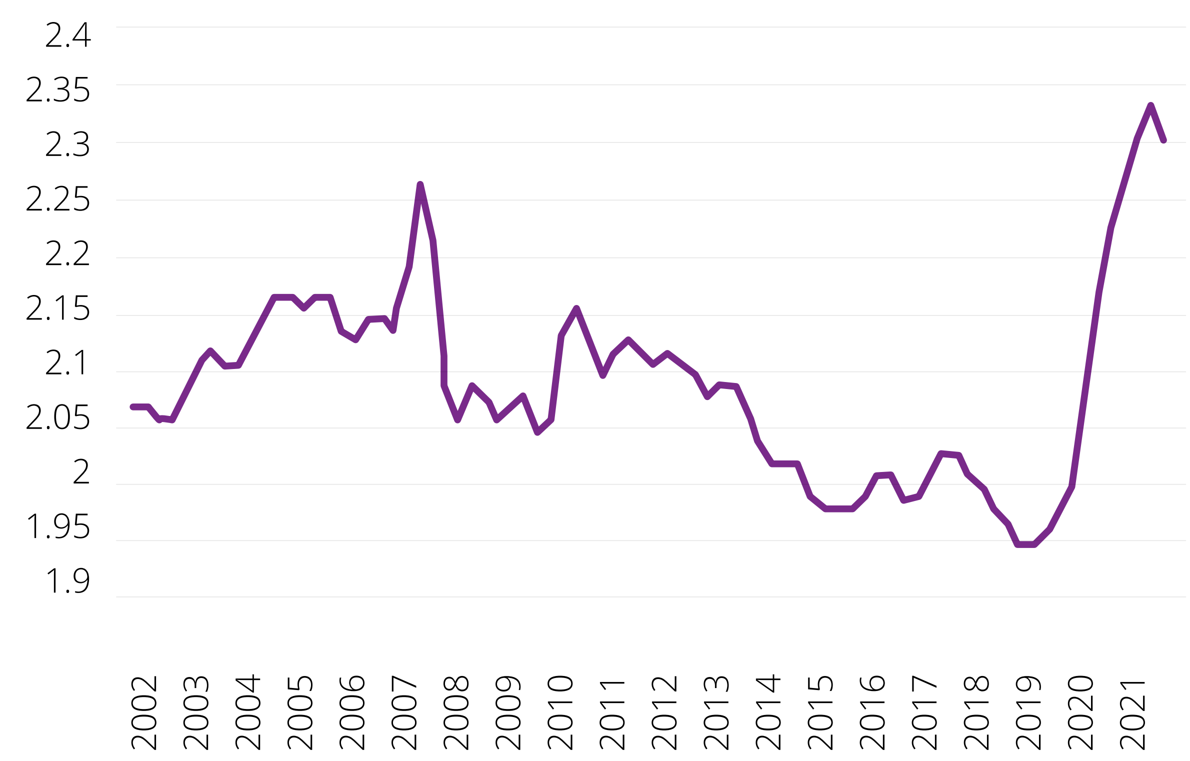


Rent is tethered to the labour market

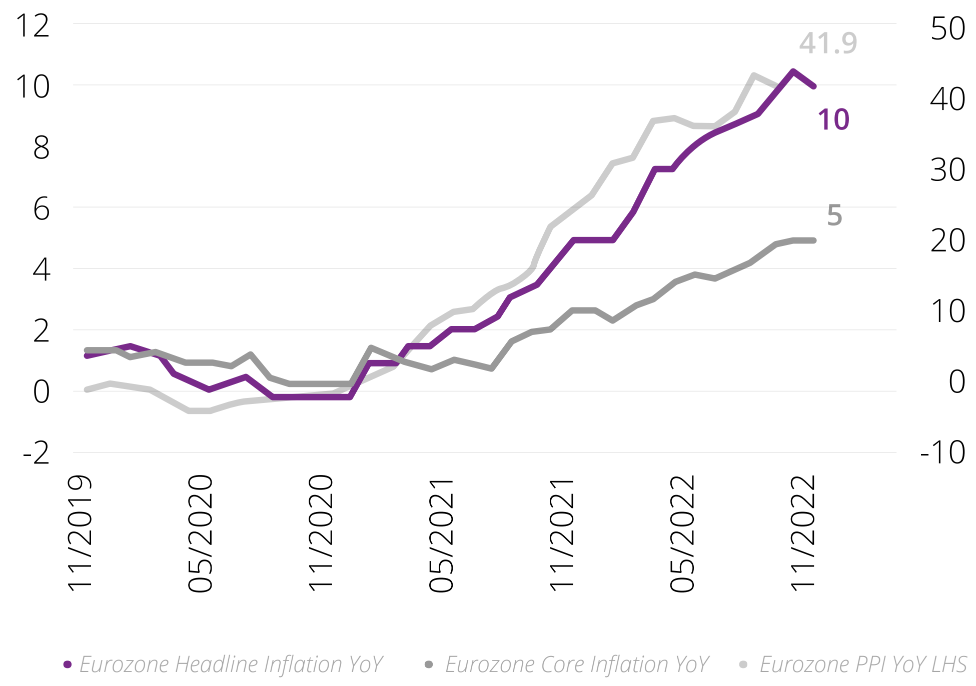


Source: Bloomberg, NY Fed, Bureau of Labor Statistics, BIL

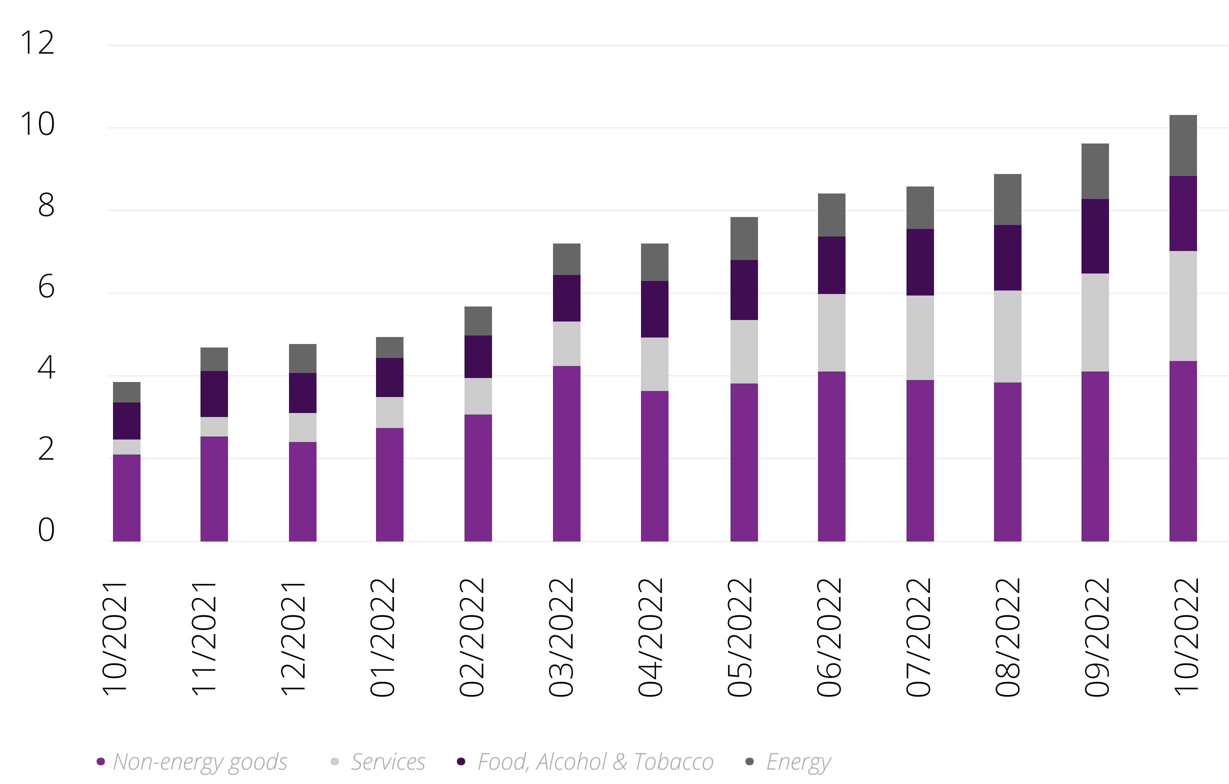
US Federal Reserve Common Inflation Expectations
(blend of 21 indicators)



Eurozone inflation *(%)*



Inflation has broadened beyond energy:
Eurozone HICP contributions to annual inflation in percentage points



Source: Bloomberg, NY Fed, Bureau of Labor Statistics, Eurostat, BIL

CENTRAL BANKS

At some point in 2023, inflation pressures should ease off and give way to growth concerns. At that stage, less monetary headwinds will be required. However, neither central banks nor markets can know exactly when that moment will be.

Throughout 2022, much of the turbulence in financial markets was driven by interest rates and the US Federal Reserve was the chief pilot. At some point in 2023, inflation pressures should ease off and give way to growth concerns. At that stage, less monetary headwinds will be required. However, neither central banks nor markets can know exactly when that moment will be. Monetary authorities must decide how much tightening is still appropriate while previous actions continue percolating through different sectors at varying speeds. If it they don't tread carefully, they risk overtightening, increasing the probability of a hard landing. On the other hand, if they loosen prematurely there is a real risk that long-run inflation expectations become de-anchored, igniting a self-fulfilling feedback loop.

Complicating matters is the desire of market participants to look past the tightening to the eventual easing, which is leading to looser financial conditions and thereby increasing the probability that rates will need to go higher and stay there longer.

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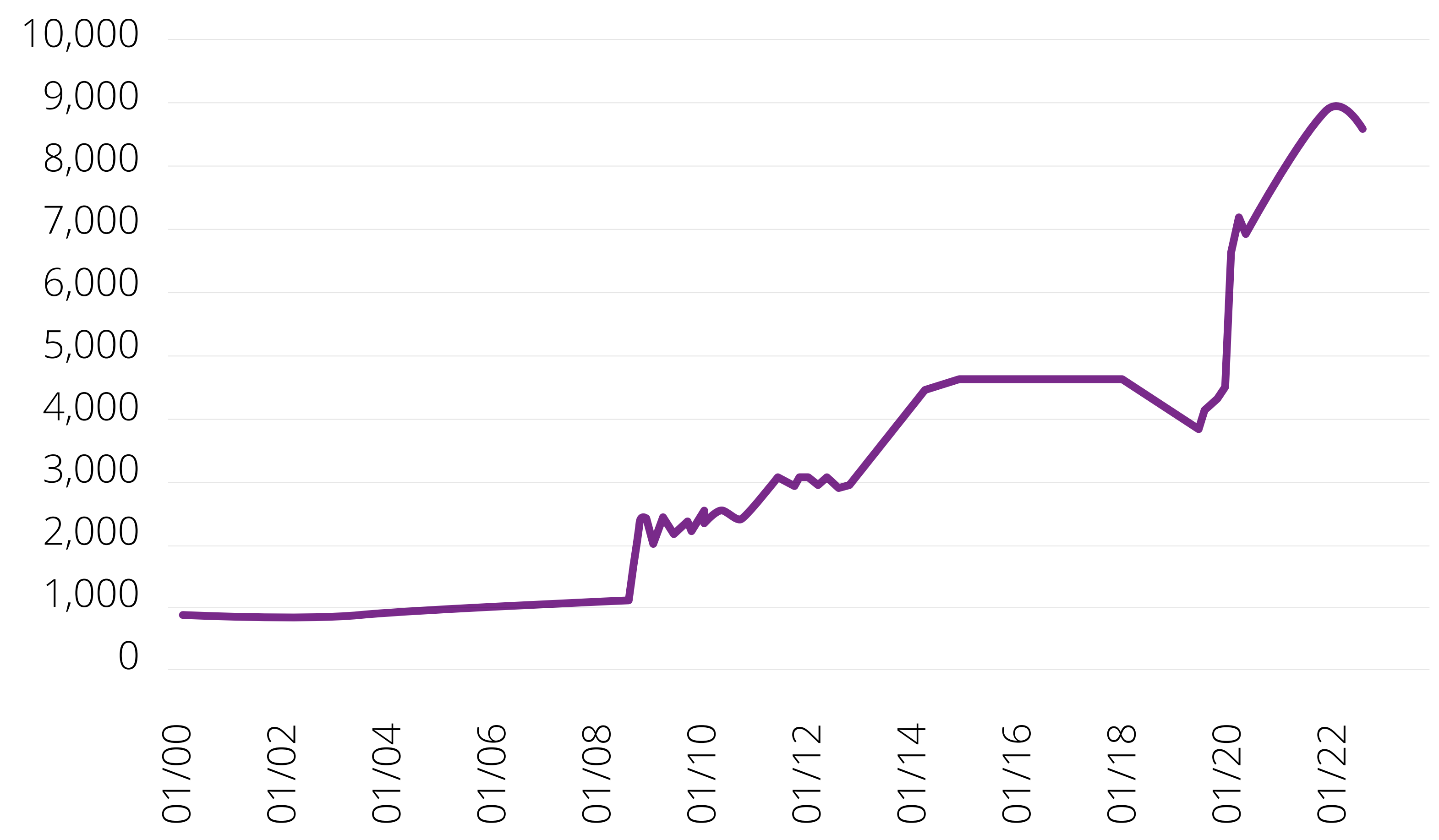
THE FED

Since March, the Fed has increased its key rate by 425 basis points (to 4.25%–4.50% today) and we believe it could now be nearing the end of its hiking cycle, probably reaching the terminal rate late Q1/ early Q2, which we see around 5%.

With CPI coming off the boil, the minutes of the latest Fed meeting showed that "a substantial majority" judged that slowing the pace of hikes "would soon be appropriate". A slower hiking campaign will allow the Fed to better calibrate its actions with incoming macro data (thus reducing the chances of a hard landing).

On top of rate hikes, the Fed is also winding down its USD 9 trillion balance sheet at full speed (a maximum of USD 60 billion per month for Treasuries and USD 35 billion for mortgage-backed securities). So far, the impact has been limited.

Federal Reserve balance sheet
(USD billion)



Source: Bloomberg, BIL

THE ECB

Here in Europe, the ECB has brought the key rate up to 1.50%. It will probably go on autopilot until it reaches its terminal rate, which we see at 3% and expect to happen around mid-2023. Its communication as of late seems to imply that the central bank will continue tightening policy even if the economy falls into recession. This may require taking rates into restrictive territory (a vague concept but widely understood to mean the deposit rate rising well above 2%).

While the market could be underpricing ECB tightening, the ECB is not relying on interest rates alone to tame unruly inflation.

While the market could be underpricing ECB tightening, the ECB is not relying on interest rates alone to tame unruly inflation. It has also altered the terms on more than EUR 2 trillion of TLTRO loans, while it is expected to communicate the details of QT at its 15 December meeting. The key question is whether it will embark on outright selling or if it will take the less hawkish approach of not reinvesting in maturing bonds (we lean towards the latter for now).

With regard to policy differentials, we believe that this will be less of a theme in bond markets during this hiking cycle. The ECB is only a few months behind the Fed and our view is that it will stop hiking soon after its US counterpart, instead playing on balance-sheet reduction to reduce liquidity.

FIXED INCOME

In 2022, the bond market had to learn to walk on its own two feet again as fiscal and monetary support was reduced or even concluded in some circumstances. The consequence is well known by now and can be classified has historical: 2022 marks the first year in the last 150 years where both long term bonds and US stocks both fell by more than 10%.

Uncertainty regarding the extent of the downturn warrants a more prudent/patient stance towards those assets at the lower end of the quality spectrum

The losses of 2022 make it difficult for some to return to fixed income assets which had been a beloved asset class for decades as a source of income and portfolio stability. We think 2023 will be very different from 2022 as headwinds fade while the valuations we start the year with plead for an allocation to bonds.

The big battle in 2023 will be the shifting focus between "recession" and the "terminal rate". 2022 was marked by solid and resilient growth, high-and-sticky inflation and a hawkish central bank policy. 2023 should bring a completely different playing field as we should see weaker growth, disinflation and end to rate hikes. Should investors focus on a hot economy slowing down which is traditionally tough for cyclical assets such as equities and high yield? Or should they focus on the end of the rate hiking cycle which should be supportive?

Investors should consider high quality bonds, which tend to outperform more consistently when central banks stop hiking.

The answer to those questions ultimately depends on how bad the downturn will be. For now, uncertainty regarding the extent of the downturn warrants a more prudent/patient stance towards those assets at the lower end of the quality spectrum (i.e. high yield). Rather, investors should consider high quality bonds, which tend to outperform more consistently when central banks stop hiking.

Until we have more confidence about the end of hiking cycle and clarity on whether we have a hard or soft landing, income will be king. And what better place to achieve this by investing in high quality bonds…

We have begun to top up duration gradually and reduce our underweight to core DM sovereigns.

As such, we have begun to top up duration gradually and reduce our underweight to core DM sovereigns. The US 10-year Treasury is now offering 3.68% (versus 1.6% at the beginning of 2022), while here on the continent (where one does not need to consider currency hedging costs), the 10-year Bund yield is at 2% – again a big improvement on the sub-zero levels we started 2022 with. While the path might be bumpy, we expect the 10-year Bund yield to finish 2023 around current levels and the US equivalent at around 3.5%.

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In Europe, we give preference to core vs. peripheral bonds with higher supply expected (Germany plans a EUR 45 billion net debt increase next year vs. EUR 17 billion in 2022), a weakening macro picture, and the onset of the ECB's quantitative tightening.

We also see attractive opportunities in investment grade segment. The combination of spread widening and rising risk-free rates has created a favourable starting point going into 2023: The average yield for European IG bonds stands at 3.7% – the highest level since 2012. Such attractive levels, from an absolute and relative point of view, provide investors with a healthy buffer against a possible economic downturn. The case for US IG is very similar with a yield of 5.16% – the highest since 2009.

Across the curve, long duration bonds with low cash prices should do well.

Throughout next year, we believe European credit should generate positive excess returns and we forecast that spreads will tighten modestly. Albeit, the early part of 2023 could still be marked by relatively high levels of volatility as risks are still elevated i.e. uncertainty over the depth of a European recession and its inflation path, changes in central bank policy, and weakness in corporate profitability. However, IG credit should receive more support given historically attractive spreads and yields. Across the curve, long duration bonds with low cash prices should do well. Contrastingly, we think high yield and loan spreads could widen further on the back of increasing recession concerns.

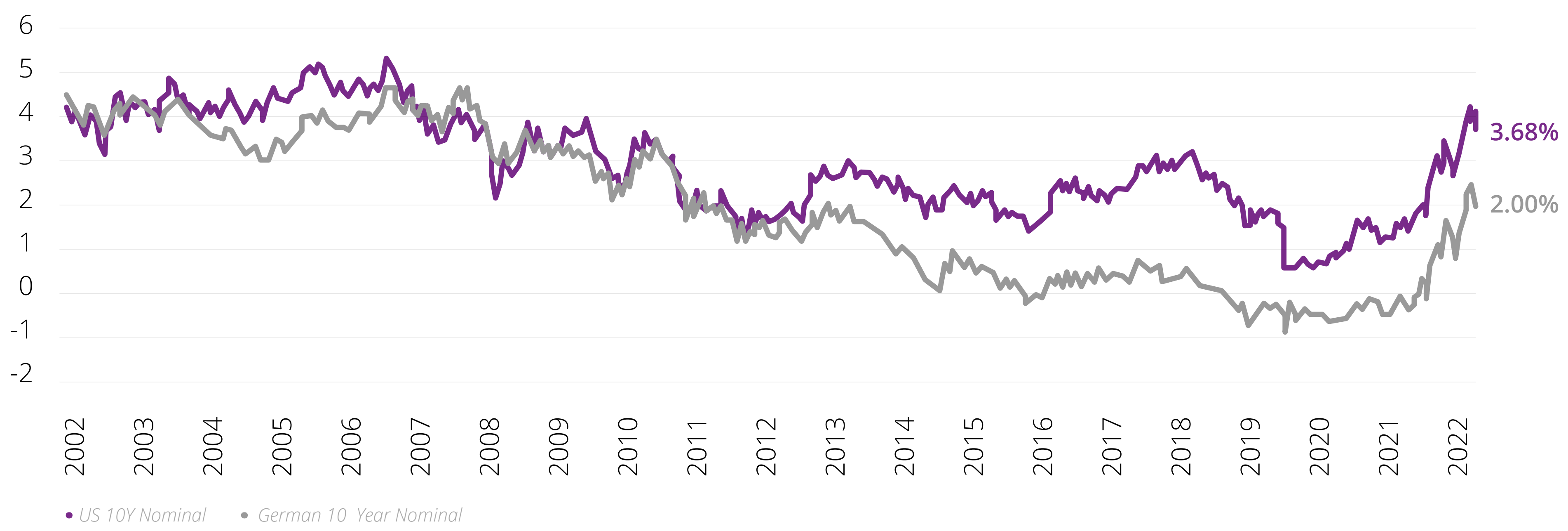
One element that might worry investors though is quantitative tightening (QT), i.e. the reduction central bank balance sheets. With a big buyer out of the market, who will step in to buy the bonds? There is little to no historical precedent for QT so it is difficult to model this impact. However, demand dynamics might actually turn out supportive in 2023 for several reasons: investors are underweight bonds and we expect that the yields offered today are attractive enough to convince them to reengage (indeed, as of now, abundant supply is being well-absorbed by markets with an average coverage ratio of 2.7x)). Further still, the TINA effect that pushed investors out of fixed income into equity has subsided and the flows TINA triggered should reverse in 2023.

For those that do choose to invest in HY bonds, we recommend sticking with the better quality names.

Looking at high yield, issuance remained very low in the second half of 2022 as companies had limited market access or preferred to wait for a less volatile environment. One side effect of this very low supply is distorted pricing and we feel that current spreads don't fully reflect all the fundamental risks that these companies face. We don't see a refinancing wall in 2022 but the subject might become more important as the year goes on. If we were to face a less favourable economic climate in H2 (hard landing), the HY primary market might remain closed (as seen in previous recessions) and even if the market is fully functioning, refinancing costs will be relatively high if we compare the average yield for high yield issuers versus the outstanding coupons. As such, for those that do choose to invest in HY bonds, we recommend sticking with the better quality names.

All of this will be of less concern for IG issuers as they have traditionally maintained market access through turbulent periods. Furthermore, most IG companies seem well funded and we expect less issuance on their behalf. M&A activity, which is often funded with the issuance of new debt, should decrease next year in line with the economic momentum.

10-year yields ***(%)***



Source: Bloomberg, BIL, as of 28 November 2022

While our overall positioning on emerging market debt (EMD) is quite light for now, we give preference to sovereigns (hard currency) over corporates. Yields on EM sovereigns have risen to around 8%, the highest level in around 20 years (outside of the 2008 financial crisis), while they offer slightly higher duration. Meanwhile, corporates are exhibiting their highest default rate in 20 years (7%), largely due to the presence of Russian companies and Chinese real estate firms in the index. The market for EM corporates remains slow, with only USD 15 billion issued since the start of October; the market for EM sovereigns, meanwhile, is fairly buoyant.

EQUITIES

The equity tailwind of "TINA" (There Is No Alternative) has given way to an equity headwind of "TARA" (There Are Reasonable Alternatives), inflation is elevated, interest rates are high and rising, and a slowdown is looming on both sides of the Atlantic.

We are in the midst of a regime change in markets, with the decade-long period of cheap money having come to an end. The equity tailwind of "TINA" (There Is No Alternative) has given way to an equity headwind of "TARA" (There Are Reasonable Alternatives), inflation is elevated, interest rates are high and rising, and a slowdown is looming on both sides of the Atlantic. All of these factors point to more muted returns for equities over the next year and underlie our underweight exposure as we enter 2023.

Where we do hold stocks, we have a clear preference for quality, focusing on companies that have greater visibility on future earnings and strong pricing power. Regionally speaking, we still give preference to US equities, where the macro landscape is more sturdy. Even so, we are starting to reduce our underweight to Europe (albeit cautiously amid high macro uncertainty and the energy crunch). European equities are 30% cheaper than the US, which makes them less vulnerable to earnings disappointment given that a lot of bad news is already in the price.

Where we do hold stocks, we have a clear preference for quality, focusing on companies that have greater visibility on future earnings and strong pricing power.

Towards the latter half of 2023, once policy headwinds start to recede and earnings expectations have come down further, the outlook will become more constructive. China's eventual reopening could also give global equities a leg up, especially cyclical sectors.

EARNINGS AND VALUATIONS

Expectations are finally being diluted, with analysts now expecting a modest 2.9% EPS growth in the US and 2.3% in Europe for 2023. Those numbers still look too optimistic in our view and we do not rule out the possibility of them turning negative.

A key market driver through 2023 will be earnings and how much they are impacted by higher interest rates, slowing growth, and still-high inflation. Mega cap margin compression is already a hot topic: Excluding the five biggest US companies, net income margins dropped 12.9% to 12.2% through summer, while the top five companies saw them drop from 23.8% to 16.9%. On aggregate, margins are expected to fall further before stabilising in 2023 as cost cutting kicks in (IT companies have already reacted to lower earnings and margins by reducing headcounts).

Throughout 2022, earnings expectations defied the pessimistic macro narrative, rising 4.4% YoY in the US over the summer and by a staggering +22% in Europe. Expectations are finally being diluted, with analysts now expecting a modest 2.9% EPS growth in the US and 2.3% in Europe for 2023. Those numbers still look too optimistic in our view and we do not rule out the possibility of them turning negative (for the US and Europe) in the first half.

In Europe, the bulk of the downward revisions to earnings expectations thus far has come from the energy sector. Energy was the driver of earnings this year, thanks to high oil and gas prices. As we move into 2023, oil prices have come off their highs in anticipation of a (mild) recession in the US and Europe; logically, therefore, it will be impossible for the energy sector to continue supercharging overall earnings as it has done during 2022. Materials and consumer discretionary are the other big drags on earnings revisions for Europe. Energy and materials are the only sectors where an earnings recession is foreseen.

While a downturn seems to be reflected on the bond side, equities still holding onto too much optimism, leaving room for disappointment.

In the US, we see the same evolution for earnings expectations in the energy sector. Plummeting profit forecasts for tech stocks have become another major drag on the S&P 500 EPS outlook. Consensus expectations for the tech sector have fallen from 3.8% to -1.3%. An earnings recession is also expected for energy, health care and materials. Looking to the second half of 2023, US earnings are expected to improve with cost cutting and a cyclical recovery leading a turnaround mid-year.

Under normal circumstances, we have seen an average earnings decline of 26% from peak to in past recessions. The GFC of 2007-09 saw S&P 500 earnings decline by 57%! We do not expect an earnings decline anywhere near these proportions.

The key question is whether a recession is already baked into prices. While a downturn seems to be reflected on the bond side, equities still holding onto too much optimism, leaving room for disappointment.

In the US, the S&P 500's valuation has come down from 22x earnings to 17.5x (a level that is not cheap, rather it more or less signifies "overbought" levels).

In the US, the S&P 500's valuation has come down from 22x earnings to 17.5x (a level that is not cheap, rather it more or less signifies "overbought" levels). In prior recessions, the S&P 500 has bottomed out at roughly 18.5x. If we were to have a relatively small decline in earnings, say -15%, and given a 18.5x P/E, the S&P 500 would sit at roughly 3500 versus its 4000 level today. While this is -16% YTD, it is still equal to levels seen in May, despite all the bad news since then: multiple rate hikes, elevated inflation reports, tech earnings disappointments, and higher long-term bond yields.

The picture in Europe is slightly different, as the market is cheap compared to historical levels with a valuation of 12x. This cheapness gives a security buffer to Europe, with markets now pricing in an earnings recession of 20%.

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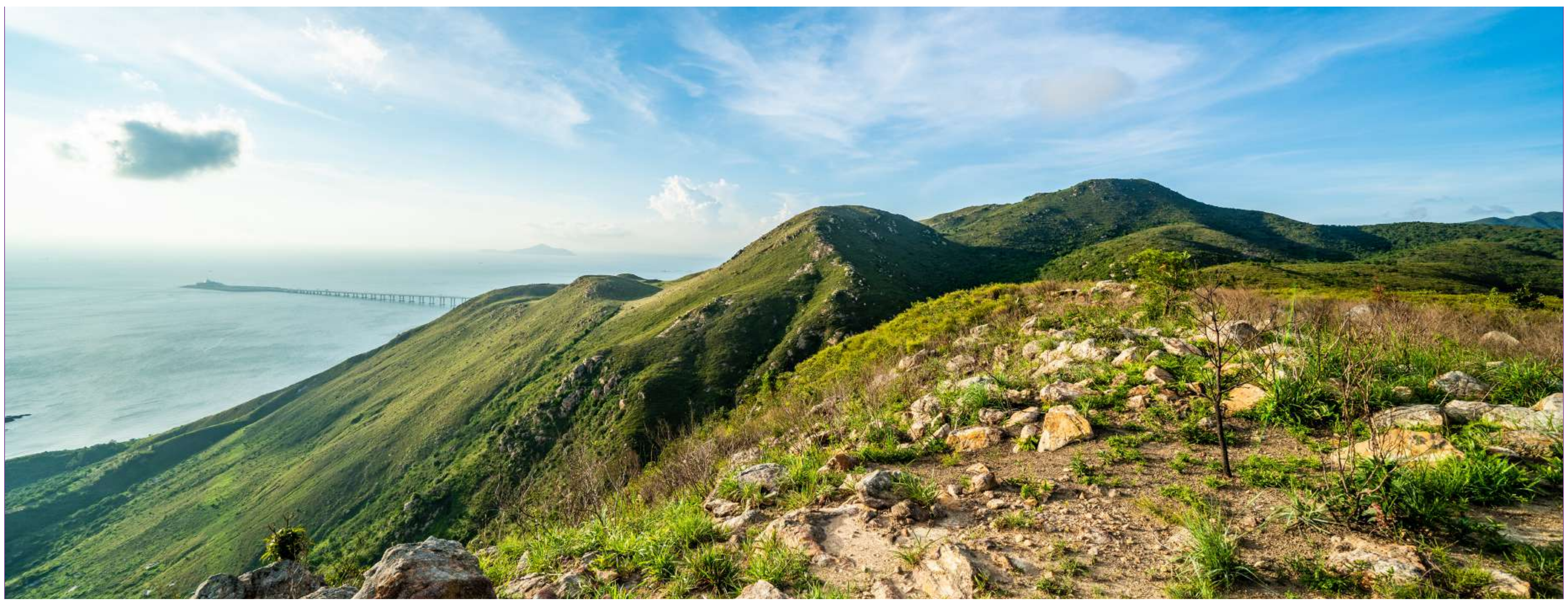
One positive point to note is that when flagging economic momentum (recession) starts to weigh on equities, falling inflation and lower yields should push P/E ratios higher and offset part of the EPS decline.

RECESSION RISK?

The moment a recession is confirmed is usually a good time to start buying equities.

Given that we expect a (mild) recession in both Europe and the US, it is also important to consider how equities normally behave in a downturn. The S&P 500 has surprisingly risen by an average of 1% during all recession periods since 1945. That's because markets usually top out before the start of a recession and bottom out before their conclusion. In other words, the worst is over for stocks before it's over for the rest of the economy. In almost every case, the S&P 500 has bottomed out roughly four months before the end of a recession, and the index typically peaks seven months before the start of a recession. So, the moment a recession is confirmed is usually a good time to start buying equities. One might jump in too early, but it makes sense to start small and gradually build up positioning.



STYLE

With the new year promising volatility, we think a barbell approach – that is, a more neutral style allocation – is best.

Value was in vogue through 2022, outperforming growth by one of the widest margins seen in years. However, should inflation start to come down meaningfully, or should the Fed adopt a more dovish tone, value stocks are at risk of being wiped out as growth comes back into the limelight. Sticking with low volatility stocks has also been a winning strategy, but recently, high-vol has made a comeback on softening inflation numbers. We do not perceive this as a regime change; rather, we take it as a warning signal about the dangers of being invested along one singular style axis (whether it be defensives versus cyclicals, or value versus growth). With the new year promising volatility, we think a barbell approach – that is, a more neutral style allocation – is best.

It is certainly good to prepare for a recession by having defensive stocks such as healthcare in the short term. However, agility is key, knowing that once the opening of the Chinese economy becomes clearer, or, PMIs bottom out, cyclical sectors will come back. Taking a 12-month view, we would expect cyclicals to outperform defensives, assuming economic prospects start to brighten towards the end of next year.

INVESTING THEMATICS

In the coming years, we believe there are three prominent megatrends that will have a profound impact on the investment landscape and capital allocation decisions: sustainability and the energy transition, digitalisation and healthcare innovation.

In the current volatile environment, sector leadership is subject to change like the wind. Amid this turbulence, it helps to focus on the bigger picture and on secular shifts that transcend the ups and downs of the economic cycle. In the coming years, we believe there are three prominent megatrends that will have a profound impact on the investment landscape and capital allocation decisions: sustainability and the energy transition, digitalisation and healthcare innovation.

SUSTAINABILITY AND THE ENERGY TRANSITION

Policymakers have a trilemma: how to achieve security of supply, keep prices low and protect the environment.

2022 catapulted energy security to the fore – not just in Europe but globally. As Europe strives to replace lower-cost Russian piped natural gas, it creates new competition in international energy markets, especially for LNG, and puts upward pressure on the long-term price of global gas. Policymakers have a trilemma: how to achieve security of supply, keep prices low and protect the environment. While the situation has been beneficial for classical energy, it also opens up huge possibilities for the renewable energy sector – especially solar.

Driven by necessity, we think governments will become more committed to the transition away from fossil fuels. Electric and hydrogen-based solutions will be key.

Driven by necessity, we think governments will become more committed to the transition away from fossil fuels with a promising future for hydrogen fuel cell. Objectively, we will become ever more dependent on clean electricity generation: Wind, solar and tidal generation are all set to play their part and – more controversially – nuclear power may also have to play a role (we have already seen Japan re-embrace this energy source).

The utilities sector is well poised to benefit from the sustainable shift. In the US, companies in this field will be key beneficiaries of the US Inflation Reduction Act (IRA), a ground-breaking bill that proposes USD 369 billion for clean-energy and climate programs. The rebates and credits included in the IRA will likely spur greater adoption of energy efficiency improvements in homes and businesses, as well as boost the adoption of EVs. This means that utilities are likely to see a substantial impact on demand in these sectors and will need to be prepared to support customers who are transitioning to efficient, electrified technologies. Given the uncertain regulatory environment, we are cautious about playing this theme via the European utilities sector for now.

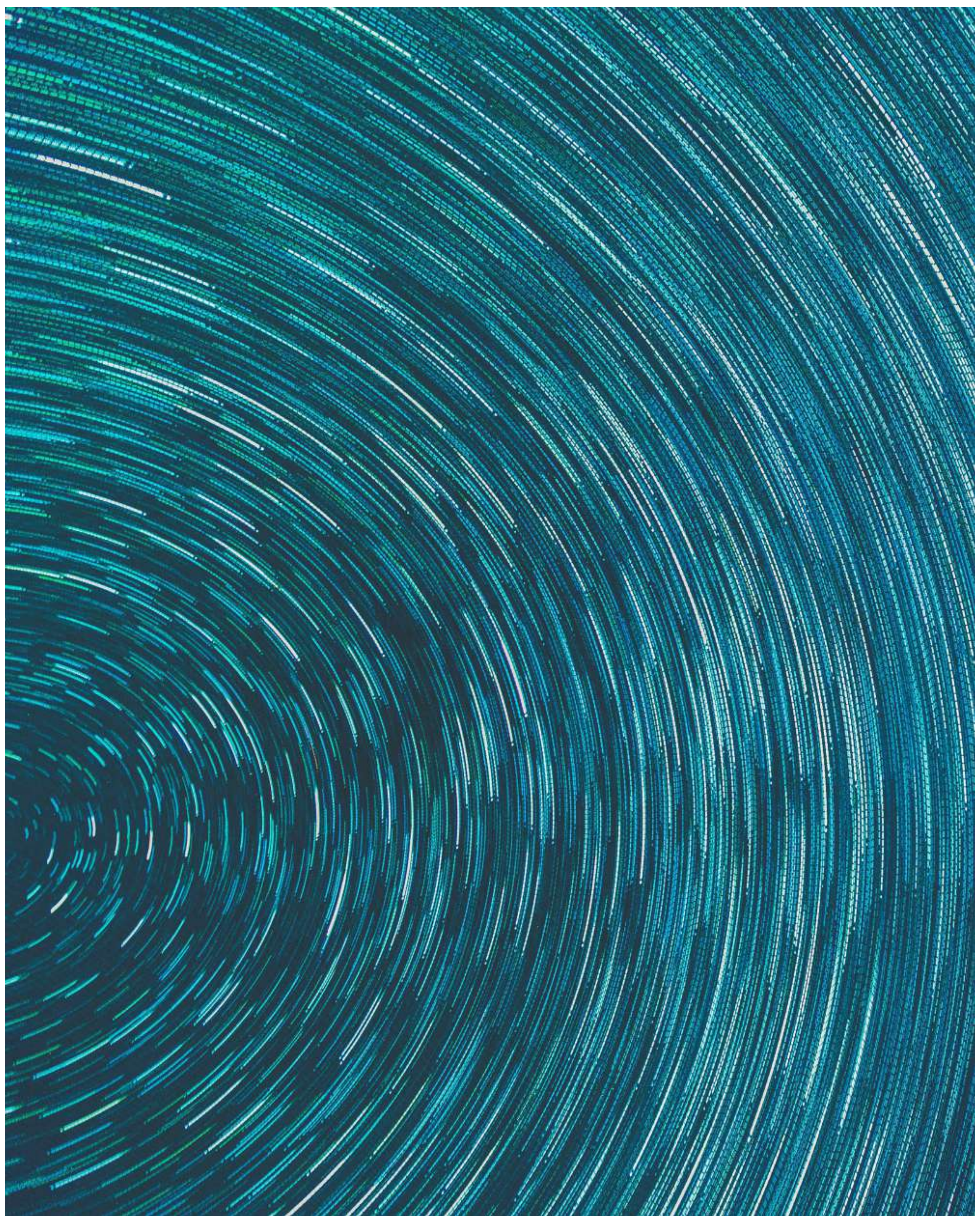
...investments linked to the circular economy are the next frontier for investors looking to make their money matter.

Beyond energy supply, being sustainable is no longer enough if the objectives set out in the Paris Climate Accord are to be met; accordingly, there are now growing calls for us to adopt the new buzzword "regenerative". This involves moving away from a linear economy – in which we extract natural resources, use them in various applications, and then dispose of the waste – towards a more circular model that changes the way in which value is created and preserved. This takes account of all stages in the lifecycle of goods, while promoting more sustainable consumption practices. With this in mind, we believe that investments linked to the circular economy are the next frontier for investors looking to make their money matter.

DIGITALISATION

...core technologies of the fourth industrial revolution are becoming increasingly indispensable: 5G, blockchain, big data and robust cloud-based infrastructures.

We are moving towards an era of "smart everything" – a smarter, more connected world encapsulating machine-to-machine communication, IoT, Artificial Intelligence (AI), as well as virtual and augmented reality. As we move forward, core technologies of the fourth industrial revolution are becoming increasingly indispensable: 5G, blockchain, big data and robust cloud-based infrastructures.



Digitalisation is producing winners in every sector, with first movers realising new efficiencies and competitive advantages.

...adults in the US spent an average of 485 minutes (eight hours and five minutes) with digital media each day in 2021: that's half of their waking lives...

Initially, one might assume that having exposure to the theme of digitalisation automatically entails being overweight tech. This is not necessarily the case. Digitalisation is producing winners in every sector, with first movers realising new efficiencies and competitive advantages.

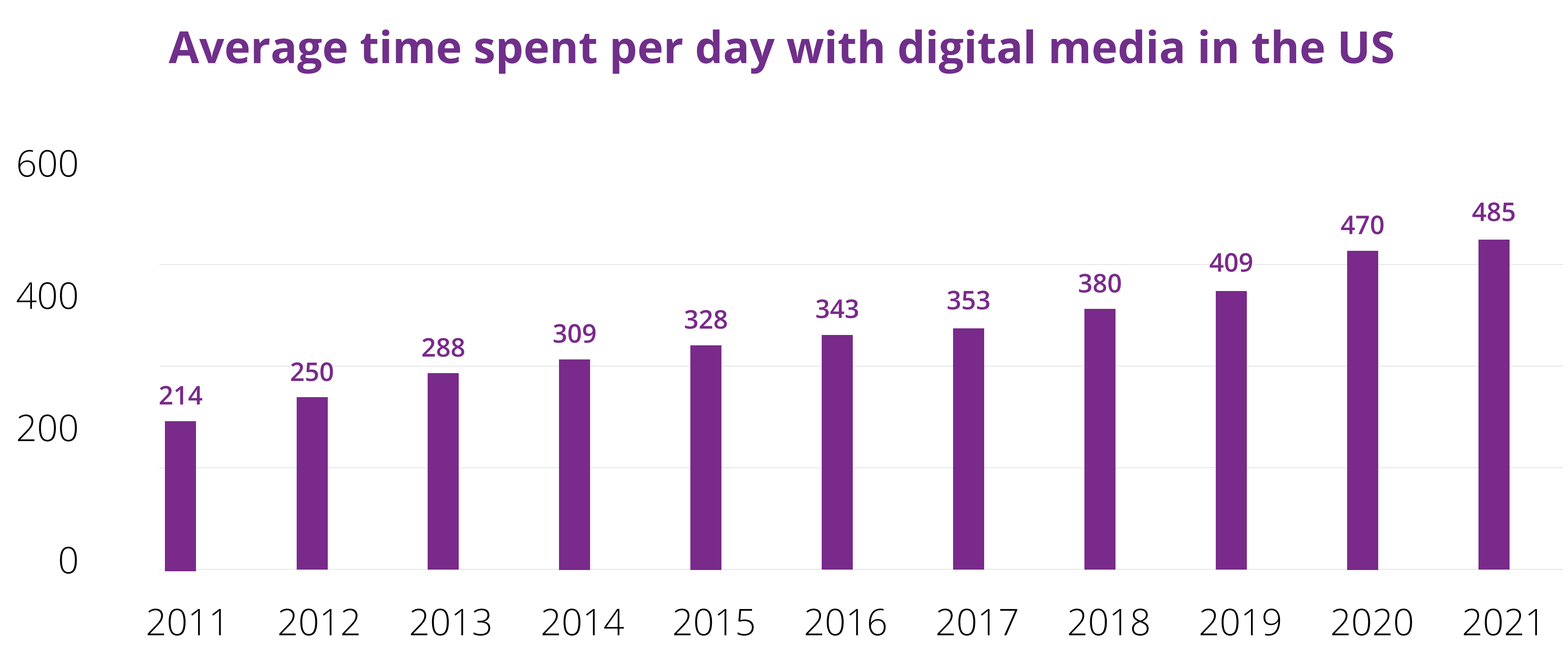
With so much of our lives online, cybersecurity is becoming indispensable...

In the so-called "app economy", people seek to be constantly connected for communication, information, work or entertainment purposes. In fact, according to Statista, adults in the US spent an average of 485 minutes (eight hours and five minutes) with digital media each day in 2021: that's half of their waking lives if we account eight hours of sleep.

...data is the new oil, and companies who can harness its benefits will have deeper insights and a clear competitive advantage.

With so much of our lives online, cybersecurity is becoming indispensable, while at the same time companies have vast amounts of valuable information at their fingertips, including credit card purchases, habits, preferences, locations visited... However, to make sense of this abundance of information, AI is a vital tool. It has been said that data is the new oil, and that companies who can harness its benefits will have deeper insights and a clear competitive advantage.

Digitalisation is also being supercharged by the ongoing trend of deglobalisation. With large economies racing to build their own domestic semiconductor, technology and infrastructure hubs, strong potential growth opportunities are emerging.



Source: Statista, BIL

HEALTHCARE INNOVATION

Demographics, an increasing global population, the expanding aged population, lifestyle diseases and increasing health awareness will continue to provide tailwinds as well.

While the pandemic might be drawing to a close, healthcare remains in the spotlight. On a short-term basis, the sector is receiving impetus from "pent-up demand", with delays in diagnosis from 2020/21 extending into 2023. Meanwhile, European pharma is one of the rare beneficiaries of a stronger dollar given that about 30% of its customer base is in the US.

On a more structural basis, scientific advancement is resulting in new targeted treatments that can significantly prolong life or cure patients. Indeed, it has been written that if the 19th century was all about chemistry, and the 20th century was about physics, the 21st will be a century of biology, in which we will vastly expand our capacities in reengineering biological systems to meet our needs. The intersection of biotechnologies, with AI, big data and computer science, present innumerate opportunities in the healthcare sector, including allowing a transition from generalised medicine to precision medicine to predictive medicine.

Demographics, an increasing global population, the expanding aged population, lifestyle diseases and increasing health awareness will continue to provide tailwinds as well. We are particularly interested in oncology – currently the biggest therapeutic area.

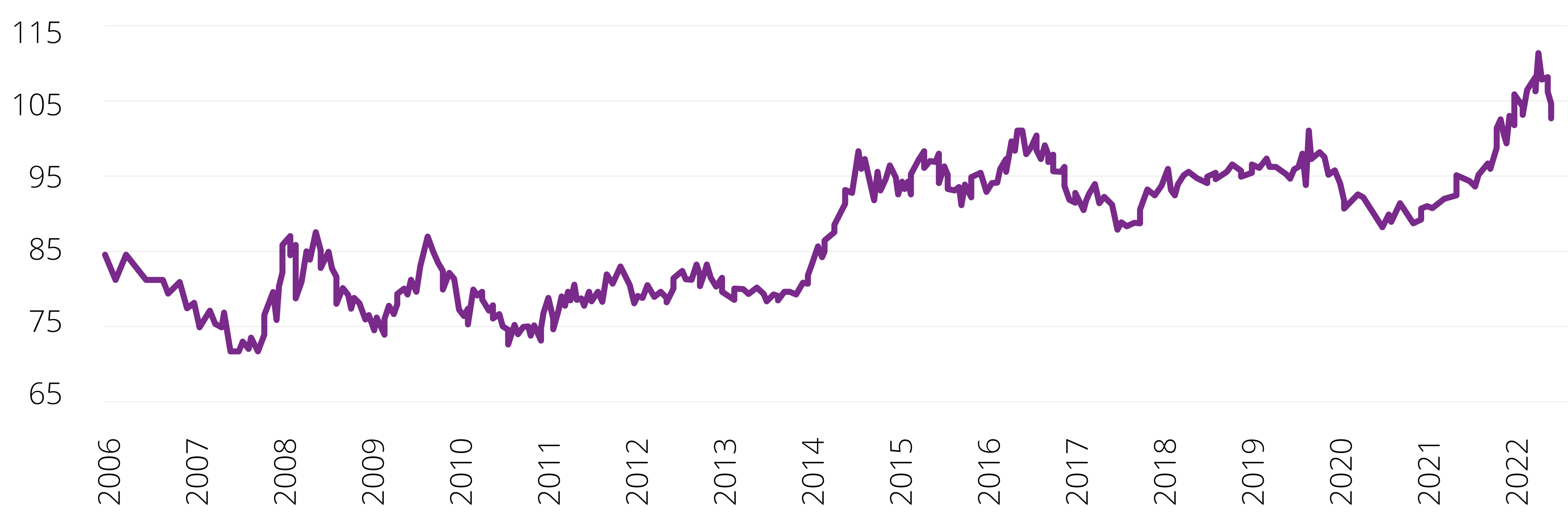
CURRENCIES AND COMMODITIES

...the final quarter of 2022 has seen a breakdown in the dollar's bull trend. However, it is premature to call the onset of an orderly dollar bear market...

2022 was the year that the dollar became a green monster in global FX markets. Policy differentials, as well as a "flight to safety", led the greenback to appreciate against several major currencies to levels unseen in decades. A stronger dollar has had detrimental effects the world around, stoking inflation in other countries (because commodities are largely priced in USD) and raising debt servicing costs (especially for EM). It also began to weigh on the competitiveness of US firms' exports.

On hopes of peak US inflation, the final quarter of 2022 has seen a breakdown in the dollar's bull trend. However, it is premature to call the onset of an orderly dollar bear market with the US currency still susceptible to bouts of strength in the short term on any upside inflation surprises, hawkish Fed talk or geopolitical flare-ups. We are keeping a neutral stance (versus the euro) going into 2023, but with a more bearish view in the second half of 2023 with a 1Y target of 1.10 versus the euro.

DXY: USD vs. major world currencies



Source: Bloomberg, BIL as of 5 December 2022

For investors, it is never a bad idea to have some gold in a portfolio – a proverbial life jacket under the seat.

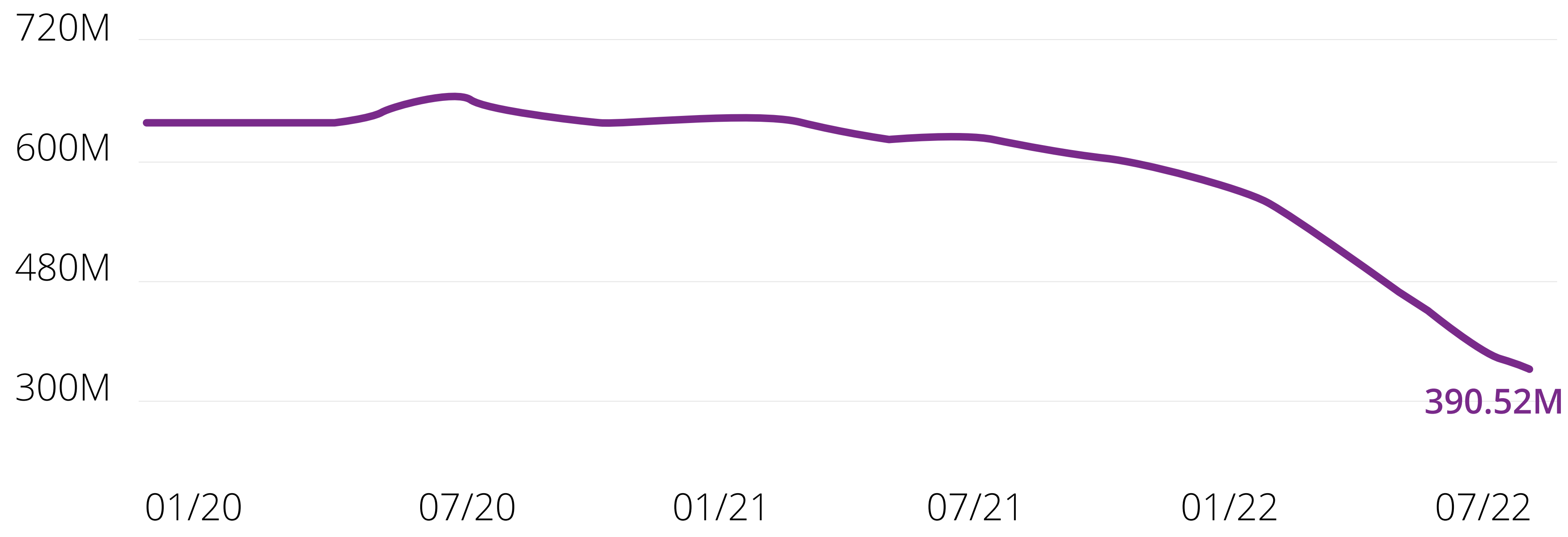
We enter 2023 with a neutral allocation to gold. Investment demand for the precious metal was soft through 2022 as the Fed tightened policy, pushing the dollar and real rates higher, denting the relative attractiveness of this non-yielding asset. Ultimately, when the Fed decides to ease off its tightening campaign, falling bond yields and a weaker dollar would probably allow gold to shine again.

The outlook for oil is constructive as we move into the new year. While slowing global growth will continue to cap prices early 2023, three factors should combine to provide a floor.

For investors, it is never a bad idea to have some gold in a portfolio – a proverbial life jacket under the seat. Gold boasts important functions as both a store of value and a diversifier, and it's glitter really starts to become apparent when considered over the long-term inside a well-diversified multi-asset portfolio. With this in mind, current valuations might present an attractive entry point. It is also worth noting that demand from central banks has been strong as they continue to diversify their foreign reserves. In Q3, global central banks purchased an unprecedented 400 tonnes, according to the World Gold Council. That's 115% more than in Q2 and nearly double the previous record of 241 tonnes set in Q3 2018.

The outlook for oil is constructive as we move into the new year. While slowing global growth will continue to cap prices early 2023, three factors should combine to provide a floor: OPEC+ has reaffirmed that the supply cut of two million barrels per day will continue until the end of 2023, Europe's ongoing energy crunch and embargos on Russian oil, and the fact that the US Department of Energy is now focused on rebuilding American strategic oil reserves. We do not invest directly in oil as a commodity; rather, we play our view via targeted equity holdings in the energy sector.

US crude oil in strategic petroleum reserve stocks ***(million barrels)***



Source: Ycharts, EIA, as of week of 18 November 2022

ALTERNATIVES

...it makes sense to maximise the investable universe to include non-traditional strategies that offer lower correlations, potentially with higher duration.

Last year saw a break down in the negative correlation between traditional asset classes, namely equities and bonds. In such circumstances, it makes sense to maximise the investable universe to include non-traditional strategies that offer lower correlations, potentially with higher duration. As such, we have stepped up our activity across an array of alternative investments from UCITs hedge funds to private equity.

With regards to the latter, in 2023, investors in private markets face a complex mix of challenges and risks. Private markets are not immune to recession environments, giving reason for caution, but because they are long-term in nature, it's more appropriate to assess the medium-to long-term outlook before making any investment decision. From this lens, 2023 might present an interesting entry point: Recession years tend to be particularly attractive vintage years, according to some analysis. This is because structurally, private equity funds can benefit from "time-diversification", whereby capital is deployed over several years. This allows funds raised in recession years to pick up assets at depressed values as the recession plays out. The asset manager can then pursue an exit later on, in the recovery phase, when valuations are rising.

...private equity funds can benefit from "time-diversification", whereby capital is deployed over several years.

Even though private asset valuations tend to correct to a lesser degree than listed markets, they are not immune to an increase in nominal and real interest rates. However, the private asset market has grown hugely and has become very diverse. There are specialised strategies in each asset class that should be resilient to even a prolonged and deep recession. For example, on the secondaries side in 2023, we expect attractive opportunities to acquire LP stakes from distressed sellers will arise throughout the year.

Overall, there is a great deal of data to suggest that investors can expect comparative resilience from private asset valuations. We believe that by targeting a steady investment pace and focusing on long-term trends, investors have numerous ways to position their private asset portfolios well.

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CONCLUSION

The constellation of macro data that we have at hand does imply that headline inflation should begin to cool.

Global growth slowed through 2022 on a diminishing reopening boost, fiscal and monetary tightening, China's Covid restrictions and property slump, and the Russia-Ukraine war. As central banks continue their fight against inflation, it will continue to come down. The key question is whether central banks can deliver a soft landing for the economy, as opposed to a deeper, more prolonged downturn.

This is no easy feat. Central banks don't exercise nearly the same control over the course of the economy as a pilot has over aircraft; monetary policy is a relatively blunt tool that affects different areas of the economy at different speeds and intensities, meaning the risk of overtightening is high. Jerome Powell himself has admitted "I do continue to believe that there's a path to a soft or soft-ish landing… Although you know, if you look at history, it's not a likely outcome, but I would just say, this is a different set of circumstances."

The constellation of macro data that we have at hand does imply that headline inflation should begin to cool. With that said, it has seeped into stickier components and we cannot rule out some false dawns before central banks finally back off from their fight.

Markets are complicating the task further, eager to look past the landing to the eventual recovery. In turn, this is boosting liquidity at a time when central banks would like to see conditions tightening. Turbulence is expected ahead as central banks try to manage dovish expectations while waiting for confirmation that inflation is indeed headed downwards.

…the signs we are seeing in the US seem to point to a softer landing and to a short and shallow downturn. In Europe, it's more difficult to say.

How hard will the landing be? For the moment, the signs we are seeing in the US seem to point to a softer landing and to a short and shallow downturn. In Europe, it's more difficult to say. The ECB is priming markets for rate hikes into restrictive territory, even if a recession comes. Meanwhile, the energy crisis remains a wild card and its impact will probably persist as a complex issue for years rather than months, thus presenting further upside risk to inflation.

Though we do believe the bulk of the northbound journey in rates and yields is behind us, it is not yet complete and the destination (terminal rates) is still subject to change, with higher for longer seemingly the new paradigm.

The fixed income space is where we see the brightest horizons for now, with yields having ascended to much more attractive levels.

Our investment strategy in the current context is therefore a conservative one, consisting of an underweight on equities, at least until we have more visibility on an eventual central bank pivot. Where we do hold them, we give preference to the US (where we see the most macro resilience) and high-quality stocks. The fixed income space is where we see the brightest horizons for now, with yields having ascended to much more attractive levels. We are slowly increasing duration and exposure to core sovereigns, while already being overweight on investment grade.

...after central banks refocus on growth, the outlook for risk assets should become more constructive as markets start preparing for a growth recovery and with China's economic activity likely beginning to normalise.

Towards the latter half of the year, after central banks refocus on growth, the outlook for risk assets should become more constructive as markets start preparing for a growth recovery and with China's economic activity likely beginning to normalise. Until then, investors should sit tight, collect coupon income and wait until a better entry point presents itself in risk assets.

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APPENDIX

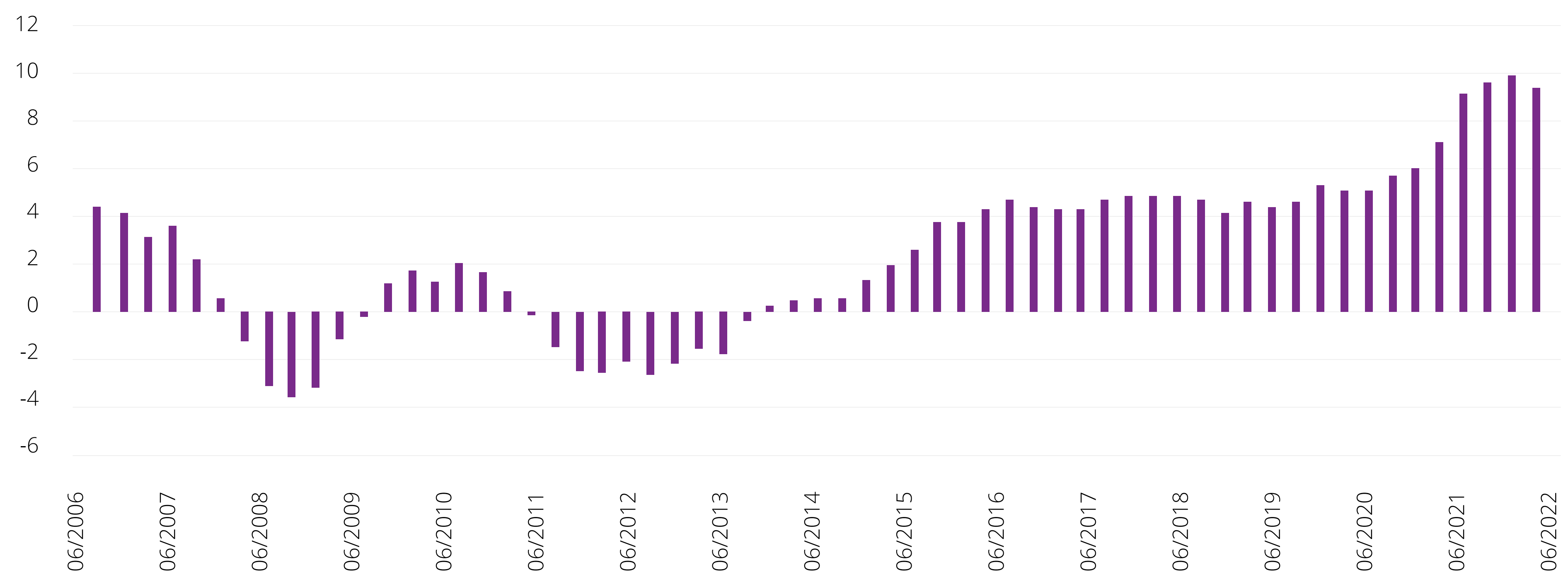
IMPORTANT DATES

JAN. 1	Croatia will adopt the euro and become the 20th member state of the Eurozone
JAN. 1	Luiz Inácio Lula da Silva will be sworn in as the next President of Brazil
JAN.Y 12-13	Czech presidential election
JAN. 22	Chinese New Year
JAN. 31-FEB.1	FOMC
FEB. 2	ECB monetary policy meeting
MARCH 16	ECB monetary policy meeting
MARCH 21-22	FOMC*
MAY 2-3	FOMC
MAY 4	ECB monetary policy meeting
JUNE 13-14	FOMC*
JUNE 15	ECB monetary policy meeting
JUNE 18	Turkish general election
JULY 25-26	FOMC
JULY 27	ECB monetary policy meeting
SEPT. 14	ECB monetary policy meeting
SEPT. 19-20	FOMC*
OCT. 26	ECB monetary policy meeting
OCT. 31 - NOV. 1	FOMC
NOV. 7	US gubernatorial elections
NOV. 12	2023 Polish parliamentary election
DEC. 12-13	FOMC*
DEC. 14	ECB monetary policy meeting
DEC. 15	Next Spanish general election for the Cortes Generales
DURING 2023	India is projected to surpass China to become the world's most populous country

*Meeting associated with a Summary of Economic Projections.

EUROZONE HOUSE PRICE GROWTH

Eurostat House Price Index (%, YoY)



Source: Bloomberg, BIL as of 5 December 2022

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