BELVÉDÈRE
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OUTLOOK 2023 - THE IMPOSSIBLE SEEMS POSSIBLE

MARKET INSIGHTS

OUTLOOK 2023 – THE IMPOSSIBLE SEEMS POSSIBLE

2022 was an "annus horribilis" for investors. All asset classes closed in the red for the year: equities, bonds, real estate investments. And in Switzerland deposit rates were still negative until recently. Even crisis-proof gold closed slightly in the red. This development was owed to the constellation of a "perfect storm": a surge in inflation, restrictive central banks, rising interest rates, a slowdown in growth, the Ukraine conflict. The situation will calm down in 2023, but there will be hardly any cause to be euphoric. What exactly does 2023 hold in store?

Recession or no recession? Opinions couldn't be more divided over this question. A majority of analysts are convinced a recession in the US this year is practically a given. The probability of a recession, calculated on the basis of a survey among economists, is at its highest level since the surveys began in 1968. The inverted yield curve – usually a harbinger of a downturn – backs up these fears. While we expect a further slowdown in growth, overall we are not as pessimistic as the market (see Economy section below).

Inflation, the key concern last year, will continue to keep us on our toes in 2023, although markets feel it might lose some of its scare. US inflation has already come down from its peaks last summer and will continue to recede. It may not fall to the targeted level of 2%, but in the course of the year it should slow to 3–4%. Europe is lagging the US development by a few months, although inflationary pressure will eventually ease here, as well. This will be mostly due to slower demand, weakening supply-side price drivers and some base effects.

Should our growth and inflation scenario prove accurate, the US Federal Reserve (Fed) might actually succeed in bringing about a soft landing, i.e. curbing inflation without triggering a recession as a result of a tighter monetary policy. That would indeed be extraordinary, but for once the impossible seems possible. Our view on interest rates is in line with current market consensus that they will cease to rise by mid-2023. However, we do not share the overall market expectation that the Fed might start cutting interest rates again as early as in the second half of the year. At the long end of the yield curve, there should be significantly less movement this year than in 2022. We do not expect last year's highs to be substantially and sustainably exceeded.

No recession, monetary policy taking a breather, inflation and capital market yields turning the corner – all this sounds quite positive for equities at first. While this scenario does support equity markets, it is hardly enough to boost them. And although valuations have come down, equities are not exactly cheap. Compared to bonds, they are even expensive. Consequently, no big leaps are to be expected on equity markets in 2023. There is simply nothing there that might spark off a substantial rise in prices. The "annus horribilis" will not be followed by an "annus mirabilis".

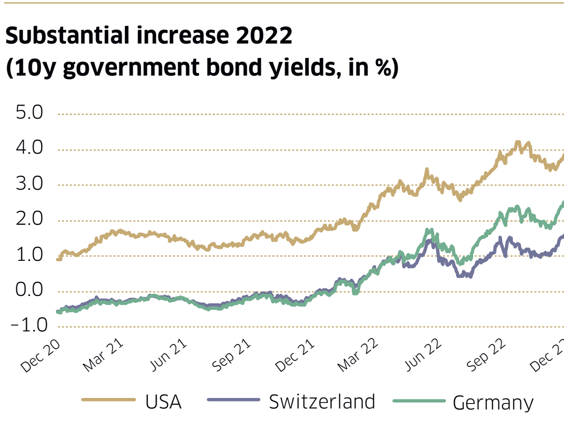
Thomas Heller
CIO, Belvédère Asset Management

INTEREST RATES

In 2022, inflation was more tenacious than expected and determined the course of fixed income markets. At the short end, central banks were compelled to raise key interest rates sharply, first and foremost the US Federal Reserve (Fed) with a hike from practically 0% to 4.5%. The European Central Bank (ECB) and the Swiss National Bank (SNB) followed suit shortly, as inflation was getting out of hand here, as well. At the long end, interest rates kept rising sharply until October due to inflation fears. But then things turned as concerns about an economic downturn superseded those about inflation. As a result, the situation on the fixed income markets eased a little.

We assume that the cycle of interest rate hikes is coming to a close. The Fed is likely to raise rates three more times by a maximum of 0.25% each and then call it a day. However, we do not share the market's expectation of any rate cuts for this year. After the recent restrictive course taken by the European monetary watchdogs, we believe the ECB is about to raise interest rates twice by 0.50% at a time. Meanwhile, the SNB should be able to get away with only one more interest rate step of a half percentage point, as inflation in Switzerland is more moderate than in the euro zone. As for long-term interest rates, most rate increases are probably behind us. We do not expect a sustained rise above last year's highs.

Substantial increase 2022
(10y government bond yields, in %)



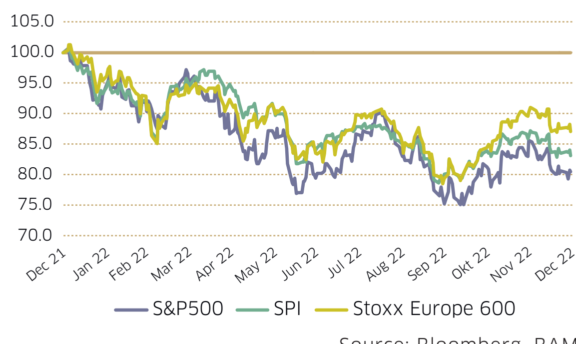
Source: Bloomberg, BAM

EQUITIES

Equity markets had recovered surprisingly well and fast from the pandemic-related slump in the spring of 2020, but then they were hit hard by soaring interest rates last year. Especially the highly rated growth stocks came under pressure. The most prominent losers were the shares of Meta (Facebook), Google, Amazon and Tesla, which had previously been in high demand for years. The biggest winners were the long-shunned energy sector stocks. On a regional level, US markets suffered the heaviest losses, while the defensive Swiss market held up slightly better. Contrary to expectations and as a general surprise, euro zone equities incurred the smallest losses (in the respective local currency).

So, what are the prospects for 2023? Our key scenario (no recession in the US, end of pressure build-up on interest rates) is basically favourable for equity markets. However, despite the correction, valuations are not cheap and risk premiums are very low. With higher interest rates, bonds are once again a real investment alternative to equities. Moreover, earnings expectations for 2023 that have already been priced in are still rather optimistic. Finally, technical market data suggest there has been no real sell-off so far. It cannot be ruled out that such a sell-off lies ahead. We do not expect an outright repetition of 2022, but a catalyst for a significant recovery is nowhere in sight, either. There is no reason to be euphoric.

Equity markets 2022 (indexed, in local currency)

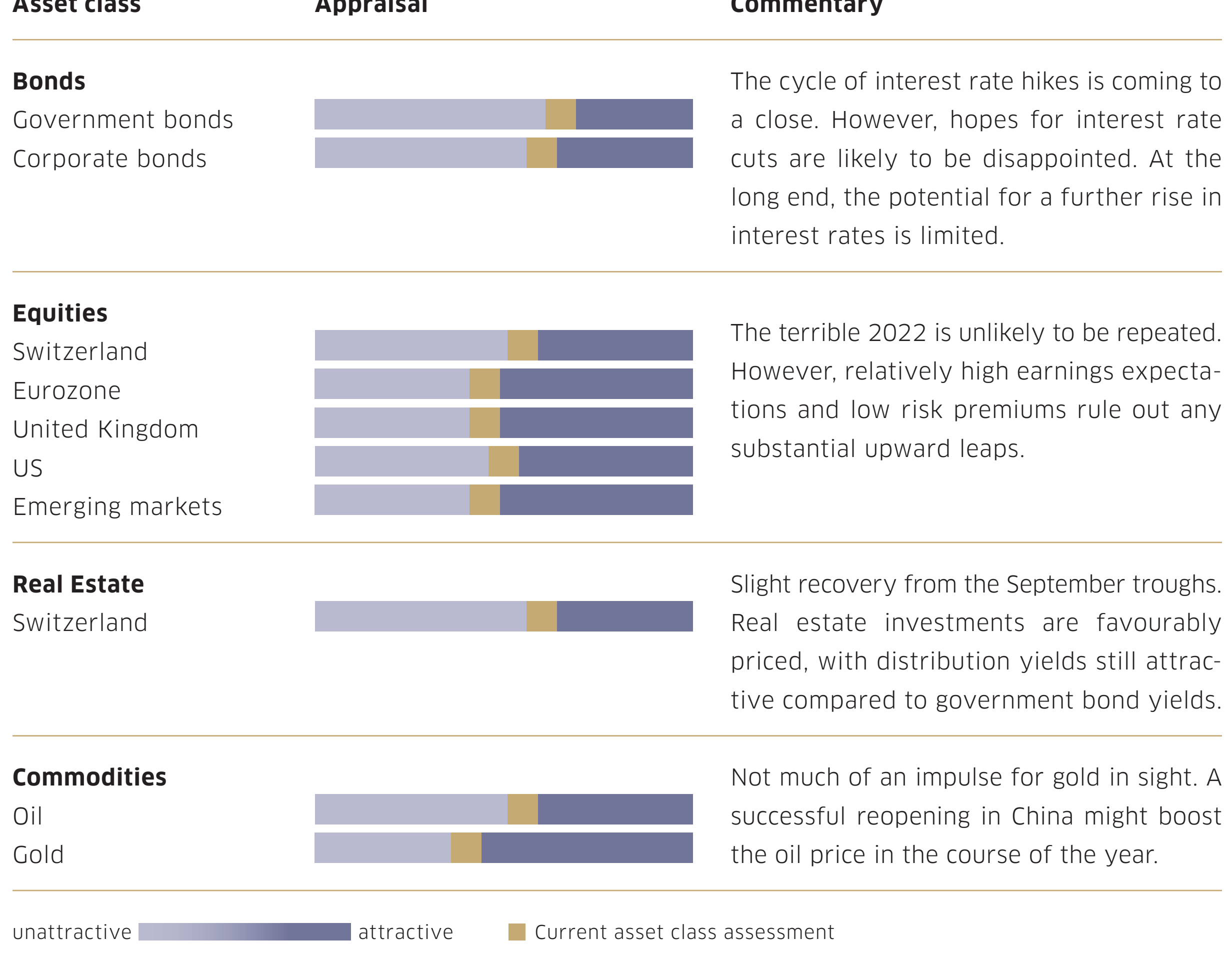


Source: Bloomberg, BAM

ECONOMY

The economic outlook for 2022 may have been still intact at the outset, but then several factors scotched it as the year unfolded. In the US, inflation surged far higher than expected, which weighed down on private consumption. In Europe, it was Russia's unexpected invasion of Ukraine that resulted in sanctions, soaring commodity prices, gas shortages and a breakdown of supplies from Ukraine. All this led to a significant economic slowdown. In China, the restrictive covid policy impacted private consumption and led to recurring supply chain disruptions.

After a disappointing 2022, consensus expectations for 2023 are not exactly optimistic either. A recession is considered certain for Europe and many market participants also expect a contraction for the US. The International Monetary Fund forecasts a worldwide gross domestic product (GDP) growth of 2.7%, which is the lowest figure since 2001, the financial crisis aside. Our take on the situation is not quite so bleak. We do not expect a recession in the US. The labour market is just too strong for that. Even though unemployment will rise, it will remain well below the long-term average. This supports private consumption, which at over 75% is clearly the largest GDP component. Although Europe will probably experience a downturn over the coming months, the worst fears of a deep recession are still unlikely to materialise. A significant recovery is possible towards the middle of the year due to a decline in energy prices among other factors.



Asset class	Appraisal	Commentary
Bonds Government bonds Corporate bonds		The cycle of interest rate hikes is coming to a close. However, hopes for interest rate cuts are likely to be disappointed. At the long end, the potential for a further rise in interest rates is limited.
Equities Switzerland Eurozone United Kingdom US Emerging markets		The terrible 2022 is unlikely to be repeated. However, relatively high earnings expectations and low risk premiums rule out any substantial upward leaps.
Real Estate Switzerland		Slight recovery from the September troughs. Real estate investments are favourably priced, with distribution yields still attractive compared to government bond yields.
Commodities Oil Gold		Not much of an impulse for gold in sight. A successful reopening in China might boost the oil price in the course of the year.

unattractive — attractive | Current asset class assessment

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Belvédère Asset Management AG
info@belvedere-am.com | www.belvedere-am.com