The Way We See It

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Will 2023 Shine? January certainly did.

A brief update report which serves to review the recent market development and to offer our outlook for the rest of the year and beyond.

Review of Developments

- Global Economies

Key US, European, Japanese and Chinese data economic releases continued to show that all major economies continued to grow, albeit at a decelerating pace. In G7 nations, goods prices have seen a welcome mild decline, but wages' inflationary pressures in the services and manufacturing sectors persisted.

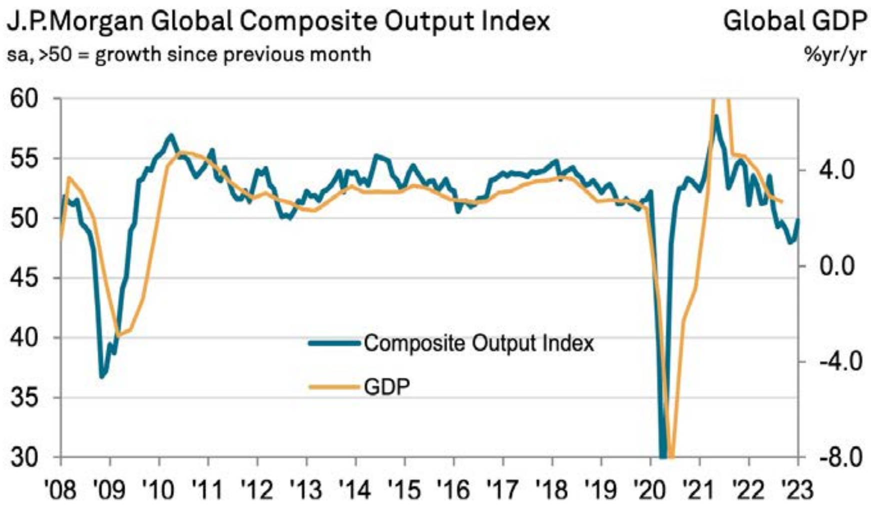
The overall global macroeconomic setting shows a mixed picture.

First, from a growth perspective, the strong pent-up demand trend in OECD countries experienced an unexpected decline in December. Consumption growth appeared to be normalising and heading towards their long-term lower equilibrium path. In the short-term, it appears that the positive employment and wage gains trends have been, to a large extent, offset by the rising cost of living, including higher mortgage payments. On the capital expenditure side, one should expect a mild pick-up of activity as companies are likely to spend more on automating their workflow process in order to reduce the fast-rising wages bill.

Second, China's more relaxed Covid measures, together with its economic reopening and a less restrictive policy towards the property sector, have resulted in a modest pick-up In economic activity.

Negative newsflows include a persistently high cost of living for many, a hawkish US Federal Reserve (Fed raised cash rates by 25bps in their February FOMC meeting to 4.50-4.75% p.a., as expected), continuing downgrades in global GDP and corporate sales and earnings, and no let up in the war between Russia and Ukraine.

J.P.Morgan Global Composite PMI™



Source: J.P.Morgan, S&P Global

- Global Markets

Investors added in risky assets - expecting inflation and interest rate to peak

The month of January was blessed with a strong rally in almost all risky assets. Compared to the month of December, January is the right hand side of the V-shape of risky assets : equities, non-USD currencies, Emerging Market and low quality corporate bonds all performed well.

Investors were very underweight equities and many other risk assets at the end of last year. Portfolio rebalancing, together with a renewed confidence of peak inflation and interest rates, drove risk assets higher in January.

In Global Equities, with the announced reopening of China and the better-than-expected growth newsflows in Europe, the US underperformed the rest of the world.

Global Fixed Income markets performed well, led by the riskier corporate and emerging counterparts. Investors continued to accumulate bonds, based on their perception that inflation has peaked, growth is in a slowdown phase and nominal yields are attractive. Cash underperformed bonds.

Commodities ended at the same Index level at the end of the month.

The US Dollar continued to weaken slightly as investors are pricing in the near-peak of US Fed Fund rates, together with the expected new shoots of growth elsewhere in the rest of the world, as China took steps to reopen, and Europe recovers.

Near-term performance of various asset classes

as at 31/1/2023

Asset Class	US Equities	Global Equities	GEM Equities
Index	MSCI USA	MSCI World	MSCI EM
1 month	6.58%	7.10%	7.91%
3 months	5.77%	9.78%	22.25%
FY 2022	-19.46%	-17.73%	-19.74%

Asset Class	US Corporate	US Treasury	US Aggregate
Index	Bloomberg US Corporate	Bloomberg US Treasury	Bloomberg US Agg
1 month	4.01%	2.51%	3.08%
3 months	8.91%	4.71%	6.39%
FY 2022	-15.76%	-12.46%	-13.01%

Asset Class	Global Govt Bonds	Global Aggregate	Global Commodities
Index	Bloomberg Global TSY	Bloomberg Global Agg	CBR
1 month	3.08%	3.28%	0.12%
3 months	8.79%	8.73%	1.44%
FY 2022	-17.47%	-16.25%	19.53%

Asset Class	Asia ex Japan Equities	China Offshore	China A
Index	MSCI AC AxJ	MSCI China	MSCI China A Onshore
1 month	8.22%	11.78%	10.40%
3 months	28.40%	52.54%	24.72%
FY 2022	-19.35%	-21.80%	-27.09%

Source: GOJI, MSCI, Bloomberg

Most asset classes had a good start in the near year.

Market Outlook
- Global Economy

While there are both positive and negative factors operating in the US and the world economy, the potential growth positives are likely to narrowly win potential growth positives are likely to narrowly win out, but not by much, in the first half of 2023. The second half may feel the adverse impact of past monetary tightenings and a potential normalisation of consumption to a more modest growth path.

Positives in the first half include: solid employment is likely to continue to boost GDP growth in the US, together with modest increased spending by the government and corporates. In China, the gradual re-opening of its major commercial cities and potential easing of Covid rules, combined with a modest easing of fiscal and monetary policies should help to modestly boost its GDP in 2023. In addition, as the majority of countries have started to re-open and encouraged tourists and foreign workers to return, this will add to GDP growth and help to alleviate the shortage of labour in many countries.

On the negative and risk side, should the Fed continue to tighten too aggressively in order to tame inflation within a short time frame, the US economy may not escape a recession scenario in the coming 6-12 months. Other negative factors again focus on still-elevated inflation, still-tight global monetary policy tightening, and continuing selective supply bottleneck issues on certain specific production components, in particular labour. High inflationary pressures are likely to force central banks in major OECD countries to continue to raise rates in coming months. In addition, while supply-side bottlenecks appear to ease a little, the complete suspension of gas and oil exports from Russia to Germany and other European countries would continue to hurt their economies. Lastly, the difficulty in finding workers to fill low-skilled services jobs in major economies continued to cause unfavourable imbalances in demand and supply.

From QE to QT - world economy remains fragile

In brief, the world economy is expected to grow modestly in the first half. Having said that, one must acknowledge that, after a decade of almost zero interest rates and trillions of QE and fiscal pumping, the abrupt reversal of these super-easy monetary and fiscal policies could cause unexpected financial crises and/or recessionary conditions. The world economy, in our opinion, remains fragile (financial accidents can happen).

Fed Tightening Cycles Always "Break" Something

Source: BofA Global Research

The Way We See It
- Global Markets and Investment Thematics

The above economic, monetary, and geopolitically unbalanced backdrop is expected to prevail in 2023. Please refer to our 2023 Annual Investment Outlook document for a more comprehensive discussion, analysis and scenario-building.

In the short-term, after a vigorous rally in the month of January, we continue to think that it would be sensible for investors to continue to adopt a modestly defensive to neutral-risk strategy. This translates into a strong focus on quality and lowly-geared assets that can deliver predictable cash flows, and, until the Fed's Chairman, Jerome Powell, truly pivots from tight to pause/ease, investors could consider holding a mild overweighting in US-dollar-denominated Treasuries and Investment Grade corporate bonds.

GOJI's view remains - modestly defensive to neutral-risk strategy.

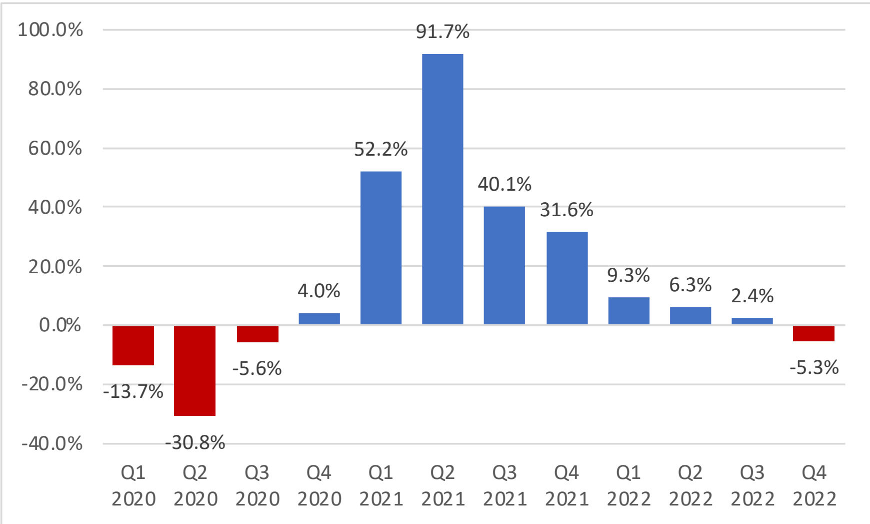
In terms of geographical diversification, it appears that it may pay to be neutral in the US versus other global equities. This is based on the differing growth and liquidity trends across the globe, which favour the rest of the world over the US.

The two charts below show the falling trend of US corporate profits and the valuation of the US stock market. Based on the still falling US PMI leading economic indicators, and the persistent increase in the cost of doing business, it is sensible to expect that the trend of US sales and profits will continue to fall incoming quarters.

As far as the valuation of US equities is concerned, it is not cheap, against the backdrop of higher and still rising interest rates, and a current P/E of 21X (cheap would be at 16-18X).

US Corporate Profits Are Set To Fall

Year-on-year change in S&P 500 earnings (%)



Source: EEAGLI, The Financial Times
Q4 2022 figure captures reported and estimated results

US equities : Valuation from a long-term perspective

S&P 500 PE Ratio

Current S&P 500 PE Ratio: 21.80 -0.06 (-0.28%)
4:00 PM EST, Fri Feb 17

Mean: 15.99
Median: 14.91
Min: 5.31 (Dec 1917)
Max: 123.73 (May 2009)

Source: multpl.com

From an investor's sentiment and positioning perspective, while they have recently increased their equity' and other risk assets' weighting based on the expectation of peak inflation and interest rates, both Quantitative- and Algorithm-focused and Fundamental investors remain modestly underweight risk assets.

Discretionary vs Systematic Equity Positioning

*Wtd average of Z-scores for positioning indicators, weights based on explanatory power in regression of equity performance on indicators

Source: CFTC, Haver, Bloomberg Finance LP, Deutsche Bank Asset Allocation

To summarise, it remains our strong belief that a sustainable bull market in equities and corporate bonds will return at some stage. But it would only occur when valuations fall further to reflect the US and global sluggish growth trend, and, more importantly, when the US Fed and other major central banks switch from the current tightening to a pause, or an easing mode. In the meantime, due to continuing macroeconomic uncertainties in the global economy, markets are likely to remain volatile. Consequently, a modestly defensive and quality-focused investment strategy should remain the foundation of risk-averse investors.

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