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Wealth Management Chief Investment Office
16 December 2022

Outlook 2023 (in-brief)

Playing it SAFE

In 2023, we expect recessions in the US and Europe, a recovery in China, a slowdown in global inflation, and a pause in Fed rates in H1 23, followed by cuts in H2 23. In this fast-changing environment, sequencing asset class preferences is likely to be key.

We prefer a SAFE approach to building foundation portfolios by: (i) **S**ecuring your yield via income strategies, (ii) **A**llocating to Asian assets that offer long-term value, (iii) **F**ortifying against surprises via defensive assets, and (iv) **E**xpanding through alternative strategies.

We see opportunities in consumer-focused equity sectors in China as economic activity gradually normalises. In FX, we are bullish on the EUR and JPY on a 12-month horizon.

This contains the highlights of our Outlook 2023 views. Please contact us for the full Outlook 2023 which contains our detailed macroeconomic and asset class views.

Letter from the CIO

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As I look forward to the year ahead, if there is one piece of advice I can give, it is this: beware of the recency bias – placing too much emphasis on the freshest experiences… Public markets have gone on sale, and for yield-seeking investors, there is a significant opportunity in high-quality bonds.

2022 was a year to remember, and to forget! On the one hand, it was an opportunity to reconnect with family and friends across the world for the first time in over two years. It is amazing how something so simple, once taken for granted, can suddenly be so precious.

Once you turn your mind to investments however, it is likely that those memories will be replaced by less pleasant emotions. In some ways, 2022 has been the toughest year for investors in my 25+ year career. It is only the fourth year in 150 years that US equities and bonds have both lost value. The decline in equities is not extreme from a historical perspective, but the sharper decline in technology shares, which had outperformed for so long, made it feel a lot worse for a lot of investors. Meanwhile, for bonds, this year's performance was among the four worst years in 150 years.

While it is important to reflect on the year past, if there is one piece of advice I can give, it is this: beware of the recency bias – placing too much emphasis on the freshest experiences. The growing narrative is that the 60:40 stock-bond portfolio is dead. To be honest, this has been true for a long time. For over 10 years, we have allocated to alternative assets including commodities and hedge fund strategies. Last year, we released updated strategic asset allocation models that included a 25% allocation to private assets. The good news is these are becoming more accessible to investors.

However, we should not take the outperformance of private assets in 2022 as an indication that public, listed asset markets are becoming less relevant to investors. The benefit of public markets is that there is almost always a price at which you can transact. You can take it or leave it, but it is there, although returns can be more volatile. This raises the potential for much greater opportunities as markets swing from greed to despair, but also increases portfolio volatility.

For private assets, liquidity is generally lower. However, this illiquidity can reduce price volatility, helping smoothen portfolio returns. Neither is better than the other; they are just different. A blended allocation is suitable for most investors.

As we head into 2023, it is important to remember that market corrections create opportunities. Public markets have gone on sale, and for yield-seeking investors, there is a significant opportunity in high-quality bonds where prices have fallen. For equities, we acknowledge that the risk of a recession is high and volatility is unlikely to dissipate quickly. However, markets are forward looking and much of this will be priced in soon; so, look for opportunities, especially in Asia.

Steve

Steve Brice
Global Chief Investment Officer

Investment strategy and key themes

Steve Brice
Global Chief Investment Officer

Manpreet Gill
Chief Investment Officer, AMEE

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Chief Investment Officer, North Asia

Our top preferences
(12-month outlook)

Foundation overweights

- Bonds – both government and corporate
- *In equities:* Asia ex-Japan
- *In bonds:* Asia USD

Sector overweights

- *US:* Healthcare, Staples, Energy
- *Europe:* Energy, Financials
- *China:* Comms. Services, Consumer Discretionary

FX views

- EUR, JPY top beneficiaries of a weaker USD

Structural macro trends*

- A digital tomorrow
- Preparing for an aging world
- From unipolarity to multipolarity
- Investing in a climate-constrained world

*Individual reports available

Playing it SAFE

- In 2023, we expect recessions in the US and Europe, a recovery in China, a slowdown in global inflation, and a pause in Fed rates in H1 23, followed by cuts in H2 23. In this fast-changing environment, sequencing asset class preferences is likely to be key.
- We believe it will pay to be **SAFE**: (i) **S**ecure your yield via income strategies, (ii) **A**llocate to Asian assets offering long-term value, (iii) **F**ortify against surprises via defensive assets, and (iv) **E**xpand beyond the traditional via alternative strategies.
- We see opportunities in consumer-focused equity sectors in China as the economy reopens. In FX, we are bullish on the EUR and JPY over a 12-month horizon.

A SAFE approach to foundation portfolios

Financial markets in 2022 left investors with unusually few places to hide, with stocks and bonds both down for only the fourth time in the last 150 years. The experience raises the risk of investors falling prey to the recency bias and extrapolating recent trends into the future. However, history suggests that an unusually bad year for investors is rarely, if ever, followed by yet another poor year. Thus, we believe a fresh perspective based on current market conditions will best serve investors from here.

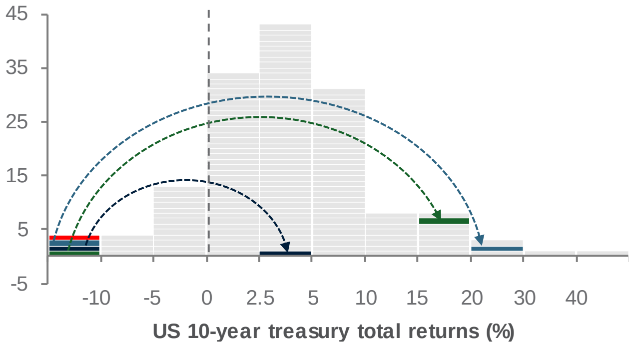
We expect the economic growth backdrop to remain challenging in 2023. One of the fastest Fed interest rate hiking cycles on record makes a US economic recession very likely. We also expect a recession in Europe due to the energy price shock. An economic slowdown should help inflation cool significantly, but not all the way back to 2%. We expect growth in China to be the exception as a gradual removal of mobility restrictions and a policy focus on growth stabilisation improve consumer and business sentiments.

This backdrop is useful for investors because the historical behaviour of major asset classes through a recession can offer a guide to asset class performance. On average, high-quality bonds bottom first, usually not far from the last Fed rate hike in a cycle. Equities usually bottom later – but typically well before an economic recession ends – once the ensuing rate cutting cycle improves the growth outlook.

Against this backdrop, we see a **SAFE** strategy as a prudent way to build Foundation allocations in 2023 by: **S**ecuring your yield, **A**llocating to Asian assets offering long-term value, **F**ortifying against further surprises and **E**xpanding beyond the traditional.

Fig. 1 Bond returns have historically been very positive in the years after very negative returns

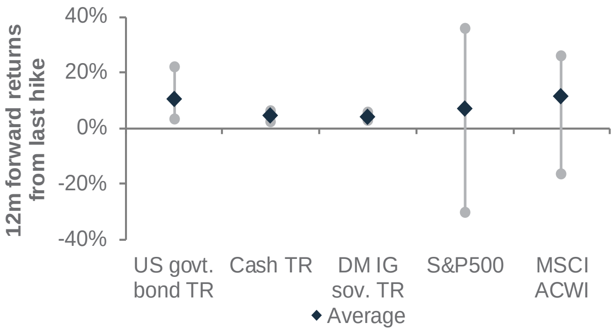
Calendar year US bond returns distribution over 150 years



Source: Alpine Macro, Standard Chartered; 2022 YTD returns in red

Fig. 2 High-quality bonds offer the best chance of positive returns 12m after the last Fed rate hike

Range of asset class returns after last hike of a Fed cycle



Source: Bloomberg, Standard Chartered

Secure your yield

We see today's bond yields as one of the best opportunities of 2023. We are Overweight bonds – including government and high-quality corporate – relative to equities and cash.

Corporate Investment Grade (IG) bond yields are not far from peaks last achieved in the cycle prior to 2008. We also expect the Fed to reach the peak of its current hiking cycle in H1 2023. In our view, this has created an attractive opportunity to lock in an attractive long-term yield.

We also see a growing possibility of capital gains. Historically, US government bond yields tend to peak around the last rise of a Fed hiking cycle, with bond yields subsequently falling (bond prices rising) as markets start to worry about slower growth and the likelihood of eventual rate cuts. Therefore, we would move to lock in the current yield levels soon, particularly on any spikes in the 10-year US government bond yield to or above 3.75%. We would also lengthen maturity profiles to take advantage of an eventual turn in bond yields. This will help mitigate reinvestment risk if yields move lower by end-2023, as we expect.

High-quality IG bonds, both government and corporate, are one route to earn income. High dividend equities are another, given their history of outperforming mainstream equity indices in current environments. Our multi-asset income strategy seeks to bring these asset classes together to offer an attractive income.

Allocate to long-term value

While today's higher yields offer a more immediate income opportunity, we also believe this should be balanced by exposure to assets offering longer-term value. We currently see attractive value in Asia ex-Japan equities and bonds.

Given likely recessions in the US and Europe, history suggests their equity markets have not yet bottomed. Asia ex-Japan, though, is likely the key exception and we believe the region's equities now offer value. This is best exemplified by P/E valuations on Chinese equities that are not far from the previous crisis lows. Chinese policy has already pivoted towards stabilising growth, but the ongoing gradual easing of extreme mobility restrictions is likely to allow these measures to start having a positive impact. More broadly, a turn in the USD should ultimately be supportive for EM assets, including Asian equities.

Within Asia ex-Japan, we are Overweight Chinese equities as we expect them to outperform the region given their inexpensive valuations and positive catalysts (we, however, expect temporary setbacks, given the reopening experience of other major markets).

Indian equities could struggle to replicate their spectacular regional outperformance in 2022 given elevated valuations, but still-robust earnings growth and the return of foreign investment flows mean we expect them to perform in line with the region and outperform global equities. In India, we are Overweight large-cap equities.

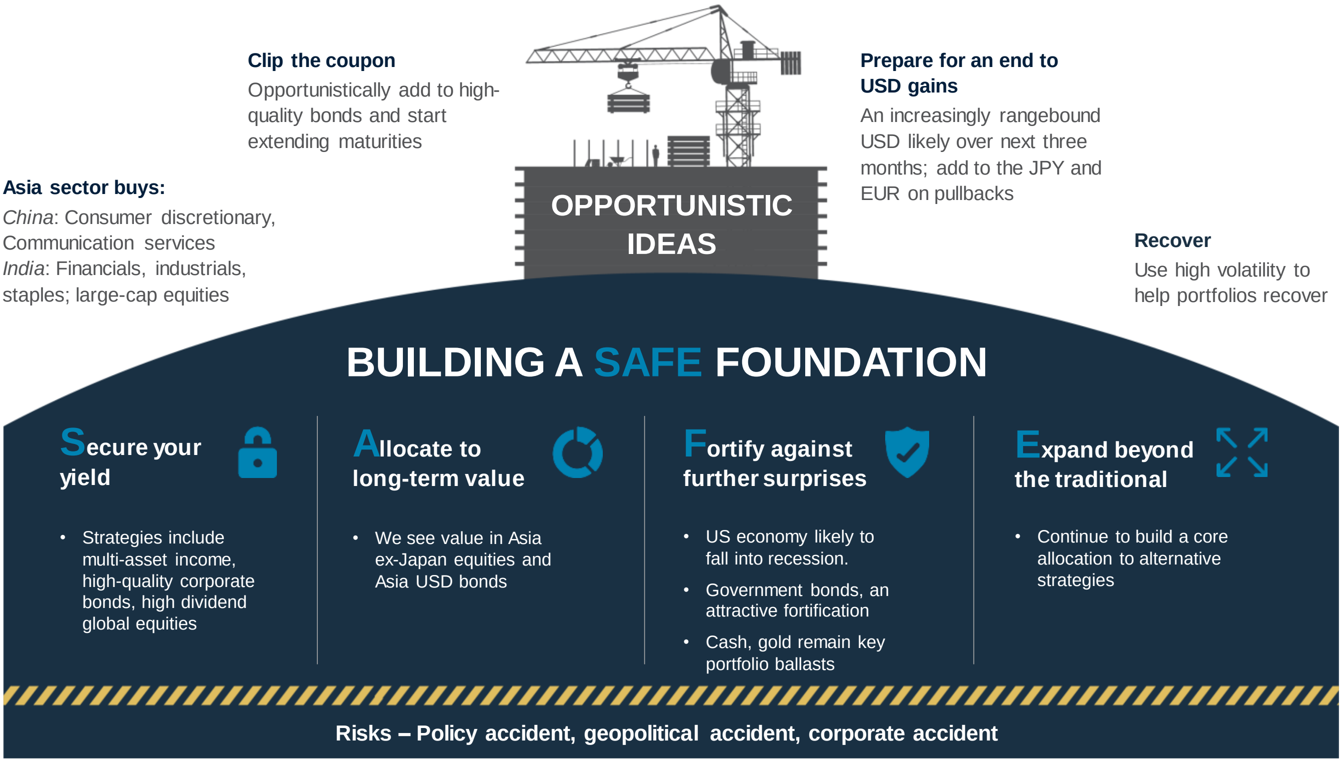
We also see long-term value in Asia USD bonds. While pockets of High Yield bonds could remain under some stress, we believe c.6.5% yield is an attractive value for an asset class where 85% of bonds are Investment Grade-rated.

Fortify against further surprises

While yield and long-term value offer room for optimism in 2023, we believe a US recession outlook means investors should be prepared for downside surprises. The Fed has yet to sound the all-clear in terms of its comfort with inflation's path and the market's rate expectations. US or European equities have arguably not yet witnessed a 'capitulation' event often associated with a recessionary equity market bottom.

High-quality government bonds can mitigate such surprises, given yields should move lower (bond prices should rise) in such a scenario. However, maintaining neutral allocations within foundation portfolios towards portfolio ballasts in the form of cash and gold are prudent, in our view. Cash yields continue to rise alongside Fed rates. Gold should also benefit from the eventual turn lower in real (net of inflation) bond yields, though the decline in yields is likely to only come through much later in the year.

Fig. 3 **Our 2023 Outlook**



Source: Standard Chartered

Expand beyond the traditional

We believe the unusual rise in stock-bond correlations in 2022 is unlikely to last into 2023. Nevertheless, the experience means the demand for relatively uncorrelated assets, or less volatile substitutes for traditional asset classes, is likely to sustain.

This is where a neutral allocation to alternative strategies can help. Liquid alternative strategies are one potential route. While many of these tend to be relatively less volatile 'substitutes' for equities, 'diversifiers' such as macro/CTA strategies tend to outperform during recessionary and/or trending markets. Private asset classes can be another route. Private credit strategies, for example, fit well into our preference for income and are a preferred substitute for riskier bonds (such as leveraged loans or High Yield bonds).

Opportunistic allocations – a weak USD

We expect currency markets to offer scope for opportunistic allocations as the USD weakens over the next 12 months.

Over the past year, the USD has singularly benefited from higher US bond yields and rapid upward shifts in Fed policy rate expectations. This could spill over into Q1 23, recent price action notwithstanding, as markets continue to debate when the Fed Funds rate will peak, resulting in a volatile but rangebound USD on a three-month horizon.

Looking beyond this, though, we believe the USD is likely to turn lower over the next 6-12 months as the Fed pauses in its rate hiking cycle. Elevated valuations make the USD more vulnerable as the Fed cycle turns.

History shows that most currencies tend to rise during periods of USD weakness. We are bullish on the EUR and JPY and expect them to be strong performers on a 12-month horizon. We would use any Q1 weakness to add exposure to these currencies. The other beneficiary of a weaker USD is likely to be Emerging Market assets – including our preferred Asia ex-Japan equities – which usually gain significantly from a weaker USD.

Sector buys – the Asia recovery

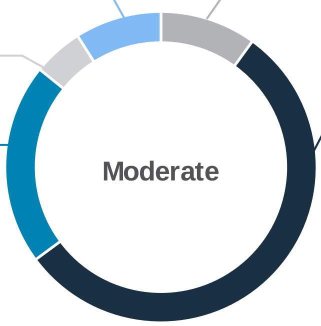
We expect equity sector picks to be a second source of opportunistic returns. Given our Overweight view on Asia ex-Japan, our sector preferences in the region are more pro-cyclical. In China, we would buy the communication services and consumer discretionary sectors, which we expect to benefit from increasingly supportive policies and reduced mobility restrictions. In India, we would buy the financial, industrial and consumer staples sectors, which should benefit from domestic demand.

In the US, our expectation of an economic recession and a lower equity market bottom mean our sector preferences are more defensive. We have a relative preference for the healthcare and staples sectors that have delivered positive earnings in recent recessions. We also favour energy, where we see attractive valuations.

In Europe, we are Overweight financials given inexpensive valuations and improving earnings on the back of higher interest rates. We also prefer the energy sector, given the still-significant sector discount, compared with history.

Foundation: Our tactical asset allocation

Global* allocation for a moderate risk profile



Alternatives	9%
Alternatives	9%

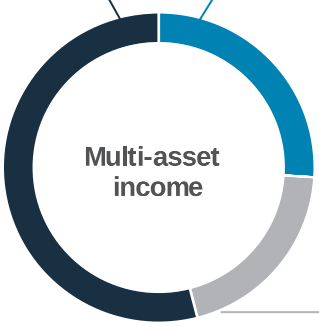
Gold	5%
Gold	5%

Equity	21%
North America Equities	10%
Europe ex-UK Equities	2%
UK Equities	1%
Japan Equities	1%
Asia ex-Japan Equities	6%
Non-Asia EM Equities	2%

Cash	10%
USD Cash	10%

Bond	55%
DM IG Government Bonds	9%
DM IG Corporate Bonds	14%
DM HY Corporate Bonds	8%
EM USD Government Bonds	7%
EM Local Ccy Government Bonds	7%
Asia USD Bonds	9%

Multi-asset income allocation for a moderate risk profile



Bonds	54%
DM IG Govt	7%
DM IG Corp	7%
DM HY Corp	11%
EM HC Govt	10%
EM LC Govt	6%
Asia USD	13%

Equity	26%
Global high-dividend yield	26%

Non-core	20%
Covered calls	8%
Sub financials	9%
Others	3%

	View	Detail
USD cash	◆	+ Safety, now-positive yields || - Risk of missing higher yields elsewhere
Bonds	▲	
DM Govt	◆	+ High credit quality, moderate yields || - Still-hawkish Fed, inflation
DM IG Corporate	◆	+ High credit quality, moderate yields || - Sensitive to rising US bond yields
DM HY Corporate	▼	+ Attractive yield, low rate sensitivity || - Falling credit quality
EM USD Govt	◆	+ Attractive yield, attractive value || - Sensitive to rising yields, falling EM credit quality
EM Local Ccy Govt	◆	+ Moderate yield || - USD strength, rising policy rates in some EMs
Asia USD	▲	+ Moderate yield, low volatility || - Default contagion risks
Equities	▼	
North America	◆	+ Strong labour market || - Faster Fed tightening, rising cost pressures
Europe ex-UK	◆	+ Still-supportive ECB policy || - Ukraine crisis impact, rising cost pressures
UK	◆	+ Attractive valuations, dividend yield || - Policy, Brexit-related uncertainty
Japan	▼	+ China recovery, easy BoJ policy || - US, Europe slowdown; structural deflation
Asia ex-Japan	▲	+ Earnings rebound, China policy support || - COVID-19 risk, weak Chinese demand
Gold	◆	+ Portfolio hedge || - Higher bond yields, stronger USD
Alternatives	◆	+ Diversifier characteristics || - Equity, corporate bond volatility

Source: Standard Chartered Global Investment Committee; Green = Upgrade; Red = Downgrade

Legend: ▲ Overweight | ▼ Underweight | ◆ Neutral

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