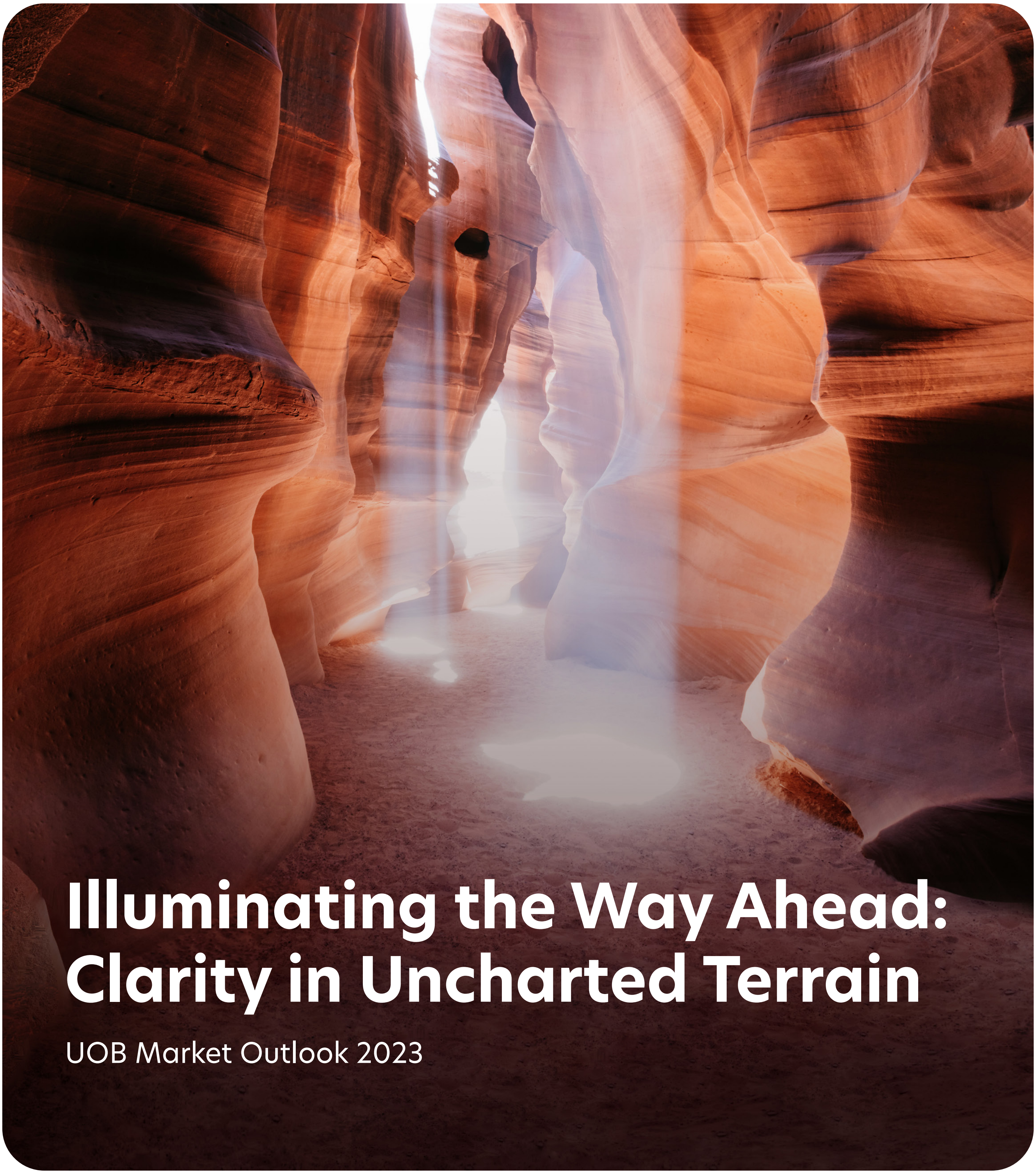

Illuminating the Way Ahead: Clarity in Uncharted Terrain

UOB Market Outlook 2023

Right By You

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Opening Note

2023 is expected to start off on an uncertain note as investors eye a potential recession, inflation trends, and global central banks' monetary policy paths.

Geopolitical tensions will also need to be assessed, with the Russia-Ukraine conflict set to drag on beyond the one-year mark. While things remain fluid over contentious issues such as US-Sino tensions and US semiconductor curbs on China, an amicable meeting between US President Joe Biden and Chinese President Xi Jinping at the November 2022 G20 Summit has raised hopes of an improvement in US-China bilateral ties.

Assuming China continues its re-opening path post-COVID, and global central bank tightening slows, the storm clouds may start to break, resulting in a short and shallow recession in 2023. While there are still many variables at play, a greater sense of clarity may start to emerge as we approach the second half of the year.

As volatility is expected to spill over into the new year, steering your portfolios may be challenging. Let our investment insights help you make sense of the noise and build strong foundations for brighter days ahead.

Winston Lim, CFA
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2023 Macro Outlook

The global economic outlook is set to be weaker in 2023, hampered by high inflation and aggressive monetary policy tightening by major central banks. From a top-down perspective, the main talking point for 2023 is whether global recession risks become reality, and whether the contraction will be shallow or deep, short or sustained. Our view is that any recession will be shallow and short.

2022 was a year of elevated volatility, where simultaneous sell-offs in global equities and bonds left investors with no place to hide from the storm.

Will this continue into 2023, or will we see a return to the negative stock-bond relationship seen in the past two decades?

The long-term trend reveals that stock-bond correlations[1] depend on inflation. Assuming inflation declines over the coming year, a return to a negative correlation should play out, especially if a recession were to hit, as that will benefit bonds. If so, portfolio allocations should become less tricky in the year ahead.

Indeed, we may see some respite in 2023 from surging inflation and aggressive monetary policy tightening. Headline consumer price index (CPI) inflation should generally peak and trend lower owing to a high base of comparison[2], while the pullback in commodity prices will also help. This should then allow central banks to slow and pause their tightening cycle.

Overall, an uncertain first half of the year may give way to more clarity by the middle of the year, and set up a more conducive backdrop for risk assets in the second half of 2023.

As such, investors may be well served by slowly accumulating risk assets, buying on dips to position for the next upward cycle, with an initial focus on defensive and quality growth stocks.

[1]Stock-bond correlation refers to the relationship between stocks and bonds. A positive correlation means that prices of stocks and bonds move in the same direction, while a negative correlation indicated prices of stocks and bonds moving in opposite directions.
[2]Inflation is most commonly described as a year-on-year comparison, and since the 2022 base level is unusually high, the upcoming year-on-year change in prices will be smaller in comparison.

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2023 Outlook

Economic Outlook

Earlier expectations of moderating growth have now morphed into a more uncertain global outlook.

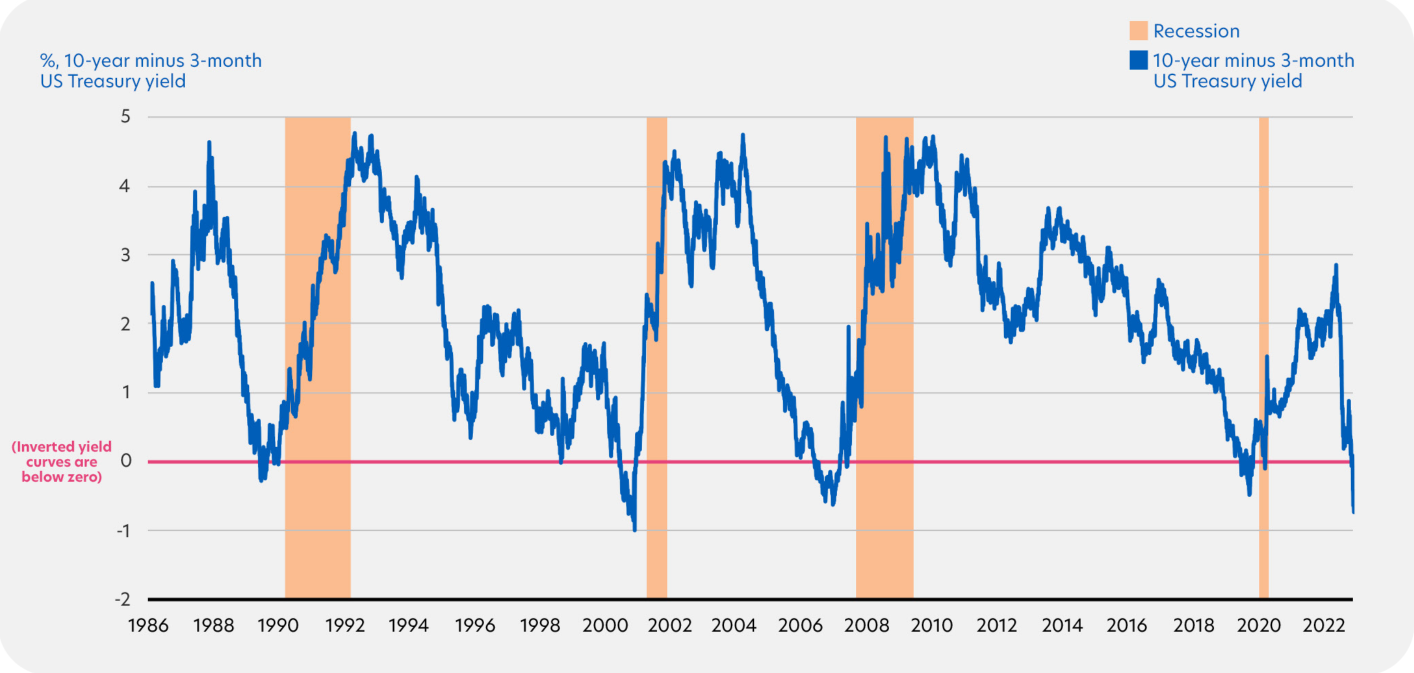
In the wake of the 2008 Global Financial Crisis, central banks played the crucial role of financial market stabilisers, with loose financial conditions laying the groundwork for an unusually long equity bull market. That is no longer the case now, with central banks currently prioritising the fight against inflation, even with the risk of aggressive rate hikes triggering a recession.

Given the backdrop of high inflation and aggressive monetary policy tightening, we see heightened risks of developed economies such as the US, Eurozone and UK slipping into recession over 2023 as financial conditions tighten while consumer and business confidence declines.

Specifically, we expect a US recession to happen in 1H 2023.

The spread between 3-month and 10-year US Treasury (UST) yields, one of the key indicators highlighted by Federal Reserve (Fed)[3] Chairman Powell, has also turned negative (inverted) for the first time since March 2020, serving as a recession warning[4] (Figure 1).

Figure 1: Inverted yield curves between 3-month and 10-year US Treasuries usually precede a recession



Source: Macrobond, UOB PFS Investment Strategists (30 November 2022)

On a brighter note, we think any recession will be of the "average" variety, namely short and shallow, assuming the labour market does not weaken drastically and central bank tightening tapers off.

A quicker than expected COVID re-opening in China will also be a positive factor, helping to offset some of the downside risks for the coming year and benefiting the global outlook.

[3]The Federal Reserve (Fed) is the US central bank.
[4]A negative 3-month/10-year Treasury spread typically precedes a recession.

2023 Outlook

Economic Outlook

Risks to this base case are escalated geopolitical tensions on the Russia-Ukraine front that fuels another surge in food and energy inflation across the world, US-Sino tensions or a further surge in core inflation that necessitates even higher interest rates to cool demand.

Other risk factors include financial stability risks stemming from tightening financial conditions.

With control of the US Congress now divided, there could also be a paralysis of domestic policies, while we also need to be mindful of a potential US debt ceiling crisis around the middle of the year.

Another potential risk will be complications in China's COVID re-opening, as this could trigger a deeper downturn in global demand and worsen supply chain disruptions.

Emerging Market economies (particularly ASEAN) should outperform, as financial conditions there are expected to remain more benign. Specifically, we expect ASEAN economies to avoid a recession.

Inflation

Our view is that headline inflation[5] and core inflation[6] have likely peaked due to high base effects[7], as commodity prices have backed off from their highs, while supply chain disruptions have eased considerably such that the demand and supply relationship adjusts to a new equilibrium.

Even so, there is a worry stemming from persistently elevated core inflation, driven by higher costs of services and higher wages.

This elevated core inflation will be the key factor keeping central bankers awake at night, which also means interest rates will remain high for a while.

Risks to inflation remain on the upside, as we are mindful of potential price shocks arising from labour-employer tensions, a new round of higher global energy prices, and renewed disruptions in supply chains.

As such, we are unlikely to see inflation ease back to the 2% level that central banks target.

[5] Headline inflation is the raw inflation number determined by calculating the prices of a fixed basket of goods, and is typically expressed as a month-on-month and year-on-year comparison.
[6] Core inflation removes the highly volatile components of headline inflation that can cause month-on-month distortions, such as food and energy prices.
[7] Base effects refer to the impact of comparing current inflation levels in a given month against levels in the same month a year ago.

2023 Outlook

Economic Outlook

Central Bank Policies

This is the million-dollar question to which everyone hopes for an answer.

In the near-term at least, more monetary policy tightening looks likely from the major central banks to tame inflation.

Most importantly, we expect the Fed to deliver another 50 basis points (bps) rate hike in February, followed by a 25bps rate hike in March to bring the Fed Funds Target Rate (FFTR)[8] up to 5.00% - 5.25% by the end of 1Q 2023. Thereafter, we expect a pause to the rate hike cycle for the rest of 2023.

The Fed's moves will likely affect what other central banks do, with the exceptions being the Bank of Japan (BOJ), which has kept policy unchanged, and the People's Bank of China (PBoC), which has cut key policy rates.

Interestingly, the idea of a "Fed pivot" has changed dramatically over the past few months, akin to the repeated shifting of central banks' goal posts. The "Fed pivot" was once used to signal a reversal to rate cuts sometime in 2H 2023, before it became a policy pause instead. Now, the idea of a "pivot" is smaller rate hikes.

With the Fed having shifted down to a 50bps rate hike rather than 75bps increments, the pace of tightening is slowing, suggesting we are closer to the end, rather than the middle, of the rate hike cycle. This is particularly so for Emerging Market central banks, which started their policy tightening much earlier at the tail-end of 2021.

[8]Fed Funds Target Rate (FFTR) refers to the key short-term target interest rate set by the US Federal Open Market Committee (FOMC). This is set as a range between an upper and lower limit, and is the rate at which commercial banks borrow and lend excess reserves to one another on an overnight basis, which can also influence short-term rates on consumer loans and credit cards. As such, the FFTR effectively dictates the cost of money in the US economy.

2023 Outlook
Asset Class Views

Equities
Given recessionary risks for the year ahead and downside risks for corporate earnings, equities will likely continue to face headwinds in the near term.

As such, we retain a neutral allocation to equities.

Still, stock market valuations have become attractive following the sharp sell-down (Figure 2), and there are pockets of opportunities in quality growth companies, although we caution against chasing short-term stock market rebounds.

Figure 2: Valuations for broad equity markets are attractive following the sharp sell-down in 2022

Forward Price-Earnings Ratio	US	Europe	Japan	Asia ex-Japan
10-year Average	18.4x	15.5x	17.8x	13.4x
End-2021	22.7x	16.5x	17.7x	15.2x
Current	18.5x	12.3x	15.3x	13.2x

Source: Bloomberg (30 November 2022)

For now, investors may find it hard to look past downside risks, and forecasting the bottom may need to wait until 2Q 2023, when we get more clarity on the scale of any recession. However, the worst of the growth and valuation de-rating is likely behind us, and we expect stock markets to bottom in 1H 2023.

One thing to note is that despite the decline in share prices of mega-cap growth stocks on the back of rising yields, the valuations of growth stocks remain more expensive than that of value stocks, especially amid greater downside risks for growth stocks' earnings. As such, value stocks remain historically cheap when compared to their growth peers.

Focus on relatively defensive sectors for the time being. Further out, investors can start to accumulate quality growth and early cyclical stocks to position for the next upward cycle.

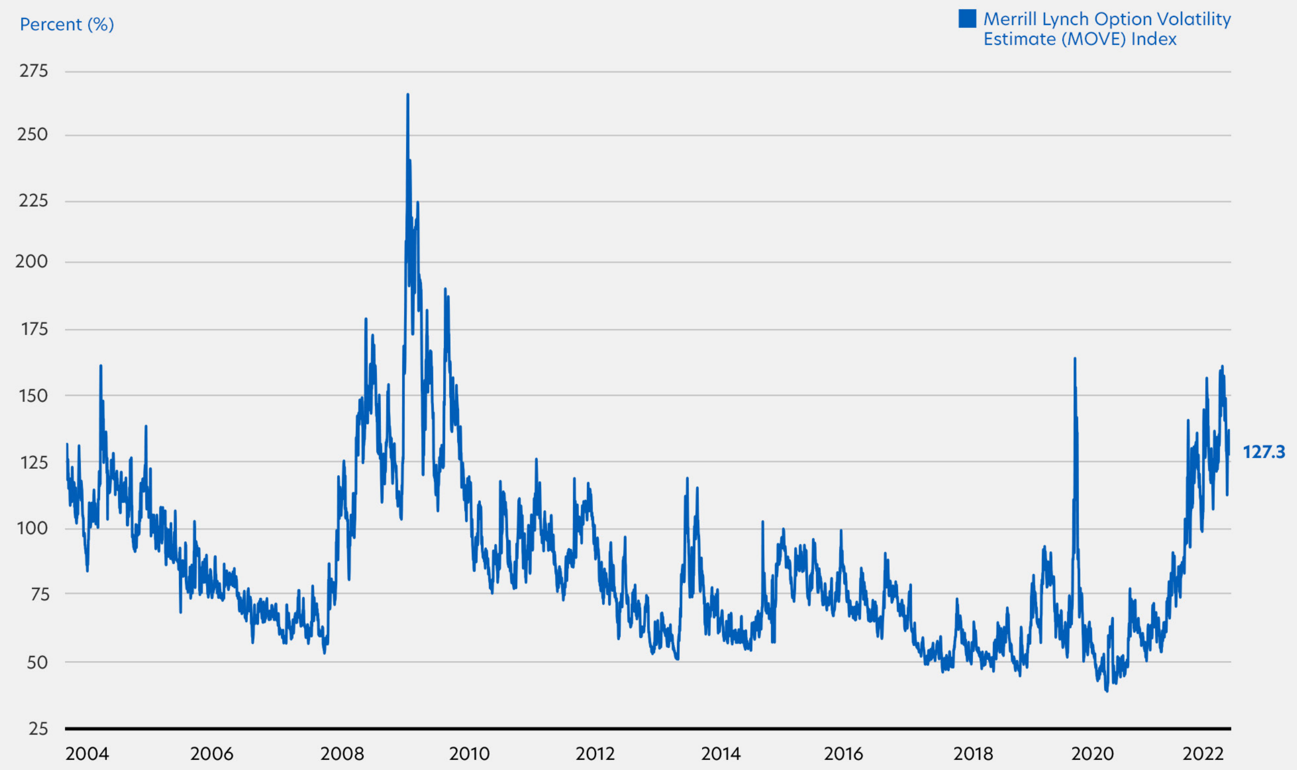
2023 Outlook

Asset Class Views

Fixed Income

2022 was notable for the unexpected volatility in rates. As a reference, 10-year United States Treasury (UST) bond yields surged by as much as 282 bps, while the MOVE Index[9], a measure of interest rate volatility, more than doubled from 77 in end-2021 to a peak of 160 in October (Figure 3).

Figure 3: Interest rate volatility more than doubled in 2022



Source: Macrobond, UOB PFS Investment Strategists (30 November 2022)

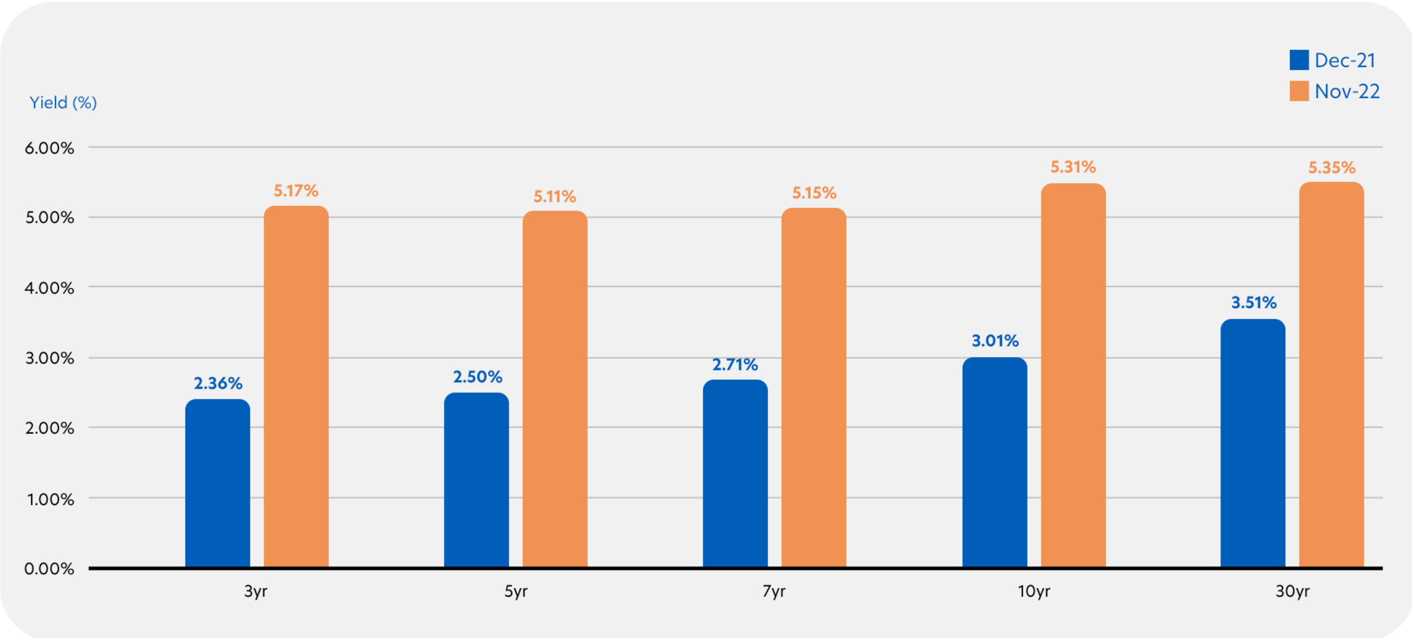
As a result of aggressive central bank rate hikes, even the most liquid parts of the fixed income market such as USTs and sovereign bonds faced a big sell-off. Even so, we believe government bond yields are close to peaking. This is because growth, inflation, and central bank tightening are expected to slow ahead. Given this backdrop, investors need not look beyond Investment Grade corporate bonds to enjoy attractive income, as yields have increased dramatically over the past year to above 5% (Figure 4).

[9]The MOVE Index is the yield curve weighted index of the normalised implied volatility on 1-month UST options.

2023 Outlook

Asset Class Views

Figure 4: Attractive yields across US Investment Grade (IG) bonds



Source: Bloomberg, using the benchmark of the J.P. Morgan US High Grade index (30 November 2022)

If a recession pans out, investors can also benefit from potential capital appreciation from a flight to safe havens. Sovereign bonds and high-quality corporate bonds are defensive assets that can protect portfolios during an economic slowdown or recession.

The takeaway here is that yields for fixed income assets, including government and Investment Grade bonds are now attractive, when considering valuations and potential economic developments. With central bank tightening set to slow ahead, we expect to see bond yields drift lower across 2023.

As such, investors should look to lock in attractive yields and focus on cash flow returns over the coming years.

We however remain cautious on High-Yield corporate bonds as they could remain under pressure if economic activity slows, corporate profitability declines, refinancing costs rise, and default risks increase. This will be magnified for companies that are highly leveraged and with weak balance sheets.

2023 Outlook
Asset Class Views

Foreign Exchange and Commodities

After the relentless and broad-based rally in 2022, US Dollar (USD) strength will likely normalise in 2023. This comes as the Fed slows its rate hike pace and potentially pause their policy tightening cycle, which suggests we could see the USD normalise to lower levels.

Overall, we think the USD will likely peak in 1Q 2023, in line with our projection of the FFTR topping out then (Figure 7).

When this happens, pressure on Emerging Market currencies should start to abate. However, it is still too early to signal the all-clear given uncertainty over China's economy, spill-over effects from a recession in the US, UK and EU, and geopolitical tensions.

The outlier risk is that if geopolitical tensions spike over the coming year, any USD downside may be limited, as the greenback will subsequently benefit from safe haven demand.

Commodity prices require a consumption recovery in China. If China's COVID re-opening is slower than expected or faces unexpected complications, commodities will likely remain under downside pressure. But if China's COVID re-opening proceeds more smoothly than expected, this should unleash pent-up demand and trigger a production recovery, providing support to commodities.

We remain confident in Gold as a portfolio diversifier of risk and a long-term safe haven asset, and a meaningful recovery may start once the FFTR peaks after 1Q 2023.

For crude oil prices, there are contrasting factors in play, with OPEC+ production cuts offset by falling demand and weakening global economic growth.

2023 Outlook

Country Focus

US

US 2023	
GDP (y/y %)	-0.5%
CPI (y/y %)	3.0%

Equities
US equities may see further downward pressure in 1H 2023 as the economy is likely to enter a shallow recession. A broad-based V-shaped market recovery is not expected. Focus on quality growth stocks and defensive sectors amid higher interest rates.

Fixed Income
With the Fed expected to keep interest rates higher for longer, the 10-year UST yield is expected to hit 4.20% in 1Q 2023, before falling to 3.70% by year-end.

Currency
The US dollar index (DXY) is likely to peak alongside US rates at 109.0 by 1Q 2023, and weaken gradually to 102.0 by end-2023.

Eurozone

Eurozone 2023	
GDP (y/y %)	-0.5%
CPI (y/y %)	5.6%

Equities
The Eurozone could fall into a recession in 2023. Stay cautious on equities although valuations are attractive. Heavy energy reliance on Russia remains a long-term risk for the region. European Industrials are a silver lining across the equity markets.

Fixed Income
Following a cumulative 250bps hike in 2022, the European Central Bank (ECB) could raise its refinancing rate by another 25bps to 2.75% in 1Q 2023. Rates are expected to stay high for the entire year thereafter.

Currency
The EUR is expected to bottom at 1.01 against the US dollar (USD) by 1Q 2023, and recover subsequently to 1.08 by end-2023.

2023 Outlook

Country Focus

Japan

Japan 2023	
GDP (y/y %)	1.0%
CPI (y/y %)	2.8%

Equities
The reopening of its borders in 4Q 2022 will continue to benefit reopening-related stocks despite rising recessionary concerns. Japanese Financials might benefit from expectations of changes in monetary policy and higher yields going forward.

Fixed Income
The BOJ is likely to keep its ultra-loose monetary policy, at least until 1Q 2023. That said, Yield Curve Control (YCC)[10] remains in place too.

Currency
An easy monetary policy stance will push the Japanese Yen (JPY) weaker to 142 against the USD by 1Q 2023 before strengthening slightly to 132 by end-2023 as US rates start to peak.

China

China 2023	
GDP (y/y %)	5.2%
CPI (y/y %)	2.8%

Equities
The Chinese government's abrupt shift away from the zero-COVID strategy and policy support for the property sector have boosted market sentiment, skewing equity market expectations towards the upside. What comes after needs to be watched closely, for example, policies stimulating economic growth, the COVID situation, earnings growth recovery, or relief from ADR[11] delisting risk.

Fixed Income
Relatively weak economic growth will be supported by easy monetary policy which benefits the bond market. Avoid highly leveraged property companies and focus on Investment Grade bonds.

Currency
A weak economy together with accommodative policy are putting pressure on the Chinese Yuan (CNY), with the CNY expected to weaken further to 7.30 against the USD by end-2023.

[10] Japan's yield curve control is a strategy aimed at keeping interest rates low, in order to spur the economy and increase inflation to 2%. Specifically, it sets the short-term policy rate at -0.10% and seeks to pin the 10-year Japan Government Bond (JGB) at around 0% while limiting fluctuations to 0.50% either side of 0%.
[11] ADRs are American Depositary Receipts, a US bank-issued certificate that represents shares in a foreign company trading on American stock exchanges.

2023 Outlook
Country Focus

Singapore

Singapore 2023	
GDP (y/y %)	0.7%
CPI (y/y %)	5.0%

Equities
Advantages of the Singapore equities market include its resilience and exposure to sectors that historically do well in this part of the market cycle and inflationary phase. In addition, Singapore is a relatively defensive market within ASEAN, and its stability is a key draw for many investors. Focus on regional and global economic reopening-related stocks, Financials and Real Estate Investment Trusts (REITs).

Fixed Income
Singapore bond yields could move further upwards in 1Q 2023 but drift lower across 2023 as US rates peak in 1Q 2023, together with a flight to safe havens amid slowing economic growth. The 10-year Singapore government bond yield is expected to reach 3.30% by end-2023.

Currency
The Singapore Dollar (SGD) is expected to stay strong against its Asian peers as the Monetary Authority of Singapore (MAS) could tighten further, but the SGD is still expected to lag against the USD amid a weakening CNY. The SGD will gradually weaken to 1.40 against the USD by end-2023.

Malaysia

Malaysia 2023	
GDP (y/y %)	4.0%
CPI (y/y %)	2.8%

Equities
Malaysian Financials are expected to be key beneficiaries of rising interest rates as net interest margins (NIMs) expand. Meanwhile, continued regional reopening may provide a suitable environment for commodity and consumer-linked equities to gain favour.

Fixed Income
Malaysian Government Securities (MGS) yields have largely reflected tighter policy. Volatility will likely persist but given already elevated yields, a gradual bull flattening[12] of the yield curve may arise in 2023.

Currency
The Malaysian Ringgit (MYR) is expected to stay weak due to the high correlation with the CNY, while the return of confidence in Malaysia's markets post-election remains to be seen. The Ringgit is expected to reach 4.65 against the USD by end-2023.

[12]Bull-flattening of the yield curve occurs when long-term interest rates are declining more than short-term rates as bond prices increase in value.

2023 Outlook

Country Focus

Thailand

Thailand 2023	
GDP (y/y %)	3.7%
CPI (y/y %)	2.7%

Equities
Stock valuations in the Thailand market remain attractive on the back of continued global reopening and a recovery in domestic spending. Focus on Retail, Healthcare, and Tourism-related sectors.

Fixed Income
The Bank of Thailand (BOT) is expected to adopt a gradual pace of policy tightening to support the economic recovery, with another two 25bps rate hikes to 1.75% expected in 1Q 2023. Therefore, a flattening yield curve is likely to persist throughout 2023.

Currency
The Thai Baht (THB) will remain under pressure amid the uncertain global environment but is likely to outperform its Asian peers on a relative basis due to tourism recovery. It is expected to weaken to 36.2 against the USD by end-2023.

Indonesia

Indonesia 2023	
GDP (y/y %)	4.9%
CPI (y/y %)	4.0%

Equities
Earnings growth excluding the Coal sector is expected to remain healthy. The Banking sector should continue to benefit from economic recovery and steady loan growth, while the Consumer sector will benefit from election campaign activities.

Fixed Income
Even though inflationary pressure is likely to ease as the economy slows, Bank Indonesia is expected to continue raising rates to 6.00% by 1Q 2023 to maintain a reasonable spread with the US.

Currency
The Indonesian Rupiah (IDR) is expected to remain weak and volatile amid heightened external risks such as recession in Western economies and a China slowdown. It is expected to reach 16,200 against the USD by end-2023.

2023 Outlook

Economic Forecasts

Figure 5: Forecasts for 2023

	US	Eurozone	UK	Japan	Emerging Markets	Asia ex-Japan	China	India	Singapore
2022 GDP Growth Forecasts	+1.6%	+3.1%	+4.4%	+1.5%	+3.6%	+4.0%	+2.8%	+7.0%	+3.5%
2023 GDP Growth Forecasts	-0.5%	-0.5%	-0.5%	+1.0%	+3.6%	+4.7%	+5.2%	+6.5%	+0.7%
Unemployment Rate Projections by the end of 2023	4.5%	7.0%	4.4%	2.9%			5.2%		2.3%
2023 Fiscal Balance Projections Note: Negative implies deficit.	-4.0%	-3.5%	-5.2%	-6.0%			-5.5%	-5.5%	+0.8%
2023 Inflation Forecasts	+3.0%	+5.6%	+7.0%	+2.8%	+3.6% (Emerging Asia) +19.4% (Emerging Europe) +11.4% (Latin America)		+2.8%	+6.1%	+5.0%
2023 Full-Year Earnings Growth Forecast (EPS)	**S&P 500**	**MSCI Europe**	**MSCI UK**	**MSCI Japan**	**MSCI Emerging Markets**	**MSCI Asia ex-Japan**	**MISCI China**	**MSCI India**	**MSCI Singapore**
	+7.0%	+1.6%	-2.0%	+1.8%	+0.7%	+5.3%	+13.4%	+23.7%	+20.0%
	Russell 2000	**EuroStoxx 600**	**FTSE 100**	**TOPIX**			**CSI 300**	**Sensex**	**Straits Times Index**
	+16.4%	+2.1%	-2.0%	+3.0%			+17.6%	+17.4%	+11.6%
1-Year Forward Price - Earnings Ratio (P/E)	**S&P 500**	**MSCI Europe**	**MSCI UK**	**MSCI Japan**	**MSCI Emerging Markets**	**MSCI Asia ex-Japan**	**MISCI China**	**MSCI India**	**MSCI Singapore**
	17.7x	12.3x	10.0x	12.6x	11.7x	12.8x	10.4x	22.2x	13.4x
	Russell 2000	**EuroStoxx 600**	**FTSE 100**	**TOPIX**			**CSI 300**	**Sensex**	**Straits Times Index**
	21.0x	12.3x	10.0x	12.2x			11.4x	20.6x	10.9x

Sources: UOB Global Economics and Markets Research (December 2022), Bloomberg (30 November 2022), IMF World Economic Outlook (October 2022)

Trending Topics of Interest

20 Does a recession lie ahead? Always focus on the long-term picture.
22 What will central banks' (particularly the Fed's) policy paths look like?
24 Will the stock-bond correlation stay positive or revert to its negative trend?
25 With China's abrupt COVID shift, will headwinds in China lessen?
28 What are the triggers to look for to determine a sustainable market recovery?

Trending Topics of Interest

Does a recession lie ahead? Always focus on the long-term picture.

If history serves as any guide, there are three different types of bear markets:

- Structural: Triggered by structural imbalances and financial bubbles.
- Cyclical: Typically triggered by rising interest rates, impending recessions and declines in profits.
- Event-driven: Triggered by a one-off "shock" that either does not lead to a recession or temporarily knocks a cycle off course.

As things stand, we are likely looking at a cyclical recession in 2023.

Bear markets in a cyclical recession tend to fall by 30% to 35% on average[13]. Since the start of 2022, the S&P 500 has declined 14.4% as at end-November, with a peak drawdown of 27% seen at one stage. As such, if this bear market sell-off conforms to historical trends, the bulk of the drawdown could already be behind us.

Markets are forward looking

Bear in mind that financial markets are forward looking.

Markets have spent the past six months pricing in the possibility of a recession ahead. If a recession becomes a reality, markets will start to ask key questions of how long and how deep the contraction will be.

Assuming the contraction is short and shallow, risk assets may start to bottom out soon after a recession starts. Historically, there is a big range. Based on recent recession examples, the S&P 500 Index can take between one month to 19 months to bottom after a recession.

Focus on the long-term picture

One thing is clear looking at how the S&P 500 and MSCI World indices performed during recessions. Staying invested amid market volatility tends to pay off over the long term.

[13]Source: Goldman Sachs Investment Research, Bear Repair; The Bumpy Road to Recovery (7 September 2022).

Trending Topics of Interest

Does a recession lie ahead? Always focus on the long-term picture.

Stock market losses incurred upon a recession may seem extraordinarily large in the short-term. However, these periods tend to be brief when viewed from a longer-term perspective, as markets stage large rebounds from their bottom until the next recession (Figure 6).

As such, while there are periods of volatility and pain, the time-tested trend is one of rising stock markets over a multi-year and multi-decade horizon. Therefore, we always advise investors to adopt a long-term approach to investing, stay invested through volatility, buy on dips, invest in tranches during downturns, and most importantly, avoid timing the market.

With more clarity by mid-2023, investors could gradually seek out capital appreciation opportunities with greater confidence in the latter half of the year.

Figure 6: Investors have been rewarded by staying invested over the long-term

*"Recovery off the low" indicates the bottom from the past recession into next peak before the next recession.
Source: Bloomberg (30 November 2022)

Trending Topics of Interest

What will central bank (particularly the Fed's) policy paths look like?

More monetary policy tightening looks likely from major central banks in the near-term.

The Fed's moves will likely affect what other central banks do, with the exceptions being the Bank of Japan (BOJ), which has kept policy unchanged, and the People's Bank of China (PBoC), which has cut key policy rates.

The Fed has done a lot in a short timeframe, essentially front-loading aggressive monetary tightening with 425 bps of tightening over the course of 2022, pushing the Fed Funds Target Rate (FFTR) to 4.25% - 4.50%, the highest since November 2007. With the Fed still focusing on fighting inflation, it expects interest rates to rise to 5.1% in 2023.

The Fed has a communication challenge as it tries to walk the tight rope of balancing potential economic risks and its mandate of controlling inflation. While it has signaled a higher peak in the FFTR, the Federal Open Market Committee (FOMC)[14] has also shifted down to smaller rate hike increments.

This suggests the Fed may be shifting to a "slower for longer" approach of raising interest rates in smaller increments, but for longer. Interestingly, the idea of a "Fed pivot" has changed dramatically over the past few months, akin to the repeated shifting of its goal posts.

The "Fed pivot" was once used to signal a reversal to rate cuts sometime in 2H 2023, before it became a policy pause instead. Now, the idea of a "pivot" is smaller rate hikes.

All things considered, there could be more volatility ahead as investors engage in the dangerous game of deciphering the Fed's intentions.

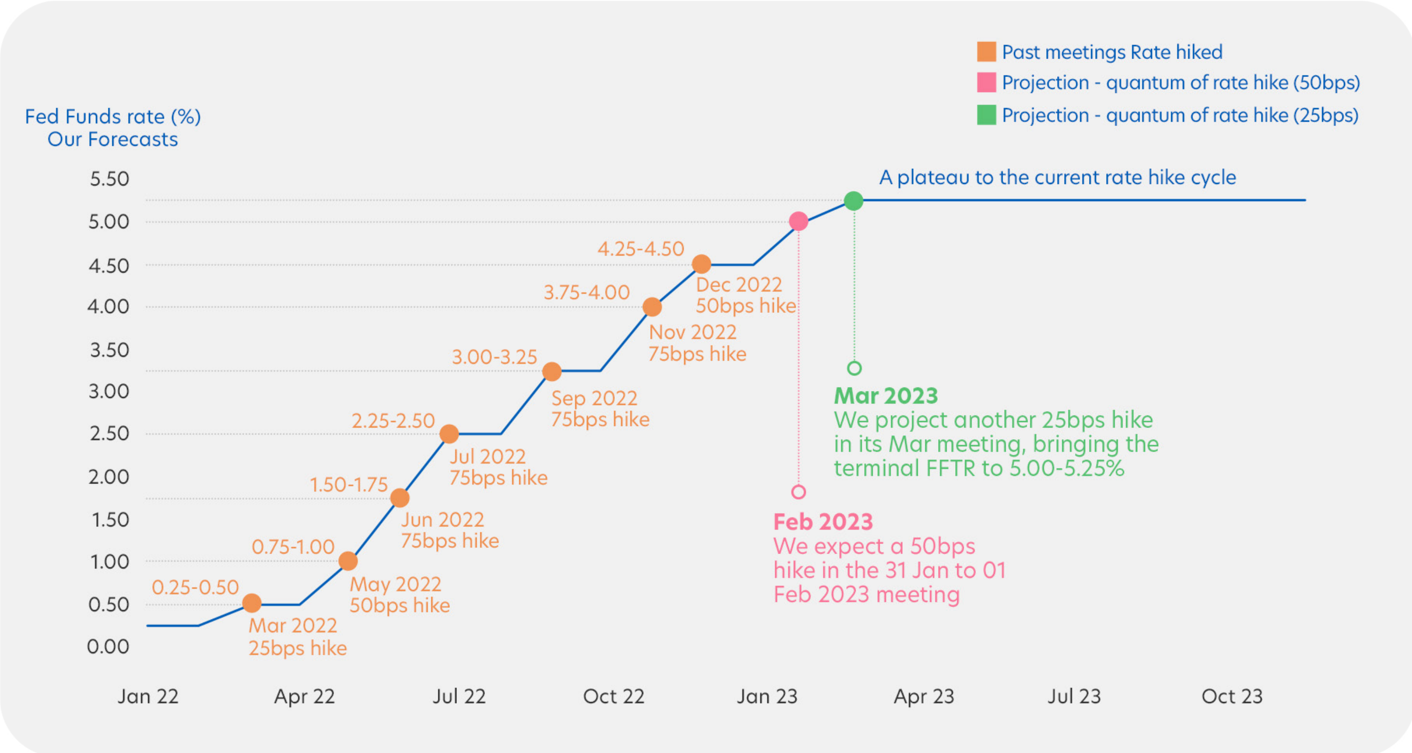
Financial markets are expecting a terminal FFTR of 4.90%. Our house view calls for another 50 bps rate hike in February 2023, followed by a smaller 25 bps hike in March 2023. We are forecasting rates to peak at a range of 5.00% - 5.25% by the end of 1Q 2023. Thereafter, we expect a pause to the rate hike cycle for the rest of the year.

[14]The Federal Open Market Committee (FOMC) holds eight regularly scheduled meetings per year. At these meetings, the Committee reviews economic and financial conditions, determines the appropriate stance of monetary policy, and assesses the risks to its long-run goals of price stability and sustainable economic growth.

Trending Topics of Interest

What will central bank (particularly the Fed's) policy paths look like?

Figure 7: The Fed is expected to tighten policy through 1Q 2023, before pausing the rate hike cycle



Source: UOB Global Economics & Markets Research Estimates (as of 16 December 2022)

While we expect inflation to moderate in 2023 due to high base effects, peaking commodity prices, and a re-adjustment to the demand and supply equilibrium, it will still likely average above the long-term objective of 2% for global central banks.

This means that although the Fed may hit the pause button next year, rate cuts may not be on the cards unless an economic or financial crisis arises. While this not an optimal scenario for a financial market recovery, the Fed slowing its rate hike pace offers hope that we are closer to the end of the rate hike cycle than we are to the middle. This should allow risk assets to stabilise.

For Emerging Market central banks, the likelihood of a policy pause is higher since many started their rate hike cycle much earlier at the tail-end of 2021.

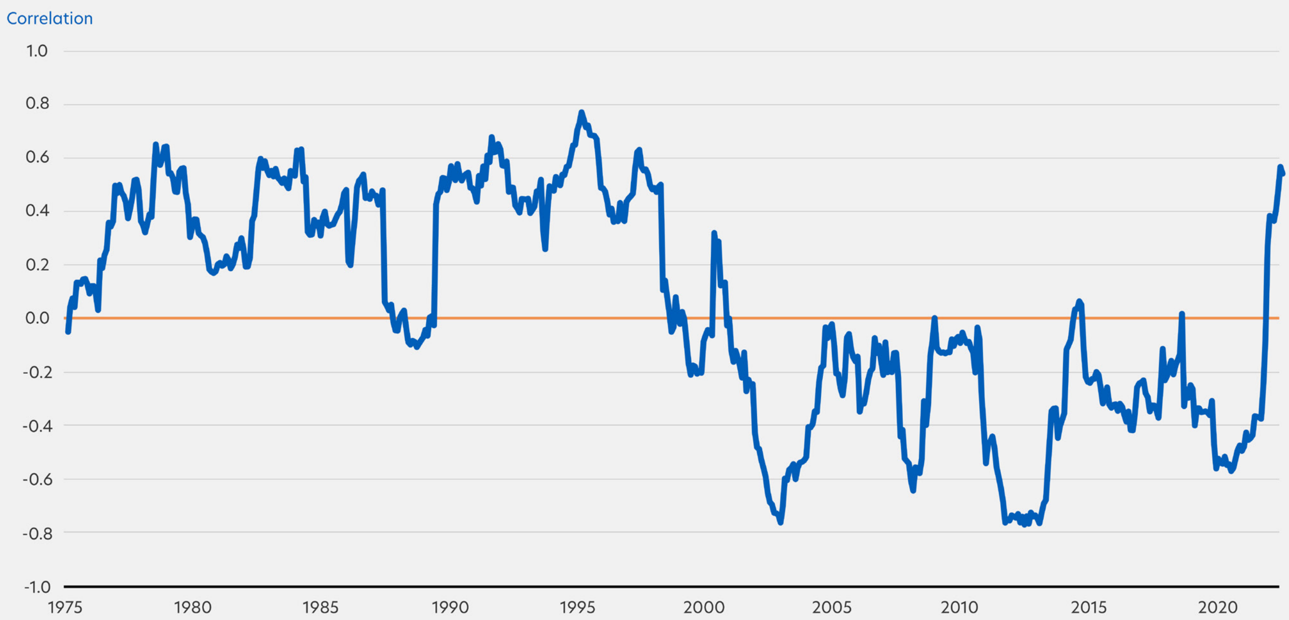
Trending Topics of Interest

Will the stock-bond correlation stay positive or revert to its negative trend?

Over the past two decades, stocks and bonds have been negatively correlated. This means stock prices tended to rise when bond prices fell, and vice-versa.

This allowed investors to build resilient multi-asset portfolios by diversifying across stocks and bonds. However, the stock-bond correlation turned positive in 2022 for the first time since the late 1990s, meaning both stocks and bonds fell, leaving investors with no place to hide from the market storm.

Figure 8: Correlation between US stocks and bonds turned positive after two decades



Stock-bond correlations calculated on a rolling 24 months basis using the S&P500 and Bloomberg US Aggregate Treasury Total Return Indices
Source: JPMorgan Asset Management, Bloomberg (30 November 2022)

If we only consider the trend over the past two decades, a return to a negative correlation trend would appear likely over 2023, especially once inflation declines and central banks ease off from their tightening cycles. Moreover, if a recession occurs, this would benefit safe haven assets such as bonds.

If so, a mixed asset portfolio should see a positive return for the full year 2023.

It is however interesting to note that over the past 150 years, the stock-bond correlation has been fairly dynamic, flitting between negative and positive correlations. Key factors influencing correlations are rising inflation and interest rates. For example, during periods of high inflation, such as in the 1970s, 1980s, and early 1990s, stocks and bonds were positively correlated.

Hence, if inflation stays elevated in 2023, leading to continued rounds of aggressive monetary policy tightening, the correlation may remain positive.

Trending Topics of Interest

With China's abrupt COVID shift, will headwinds in China lessen?

The fear after the 20th Chinese Communist Party (CCP) Congress in October 2022 was that China would focus more on ideology and less on the economy.

Recent developments offer hope that this may not necessarily be the case, and suggest that President Xi's attention is slowly turning towards supporting the economy after consolidating his power.

China's three headwinds have been long-standing, namely its zero-COVID strategy, property sector crisis, and souring bilateral relations with the US. Recent policy developments for all three have however been positive, with the risk of a further decline in market confidence seemingly forcing Beijing's hand.

Firstly, China has made an abrupt shift away from zero-COVID, with Beijing looking at reducing the economic and social impact of prior stringent pandemic restrictions.

That said, China's COVID re-opening will invariably face setbacks along the way, and we have seen a big wave of infections across the country after restrictions were eased. The situation may continue to worsen across winter, and it remains to be seen how this affects factory production, supply chains and domestic consumption.

Secondly, a 16-point support plan for China's ailing property sector indicates a growing acknowledgement of the sector's impact on broader economic growth.

Finally, US President Joe Biden and Chinese President Xi Jinping held an amicable meeting at the G20 Summit in November 2022, providing hope that bilateral tensions will soften. The early completion of audit checks by the Public Company Accounting Oversight Board (PCAOB)[15] has also fueled hope of a lower risk of delisting for US-listed Chinese companies facing audit issues.

[15]The PCAOB is a nonprofit corporation established by US Congress to oversee the audits of public companies in order to protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports.

Trending Topics of Interest

With China's abrupt COVID shift, will headwinds in China lessen?

2023 GDP target

It remains to be seen whether China will announce a lower 2023 GDP target or even a definitive target. Clarity will come in the early part of 2023, around the March National People's Congress (NPC).

If there are further positive developments in all three headwinds mentioned above, the market's current 2023 China GDP projections will be on the low side, and there could be upward revisions ahead.

It has been reported that senior Chinese officials are debating a 2023 GDP target of around 5%, while China's Politburo said it will use "targeted and forceful" monetary policy as it aims for an "overall improvement" in the economy in 2023.

Property sector support

Given how China's property sector drives around 26% of the country's GDP[16], Beijing cannot afford a continued slump. Homebuyers boycotting mortgage payments could lead to social unrest, while surging loan defaults by developers could cascade into a banking crisis.

To address this, China recently issued a 16-point plan to support its ailing property sector, with measures ranging from addressing developers' liquidity crisis to loosening downpayment requirements for homebuyers. Overall, the new policies are much more comprehensive than prior piecemeal steps.

Furthermore, the joint statement by the PBoC and the China Banking and Insurance Regulatory Commission (CBIRC) mentioned the "stable and healthy development" of the property sector, while PBoC Governor Yi Gang said he hopes the real estate market will have a "soft landing".

Despite this, Chinese developers still face a mountain of looming debt maturities, with at least USD292 billion of onshore and offshore borrowings due by end-2023[17], which means systemic risk cannot be ruled out.

[16] Rogoff, Kenneth, and Yuanchen Yang. 2022. "A Tale of Tier 3 Cities".: IMF Working Paper 2022/196, International Monetary Fund, Washington, DC.
[17] Source: Bloomberg, China Builders Have $292 billion of Debt Coming Due Through 2023 (1 November 2022).

Trending Topics of Interest

With China's abrupt COVID shift, will headwinds in China lessen?

Shift away from zero-COVID

The biggest policy shift comes from China's abrupt roll-back of zero-COVID. While it has triggered a surge in infections, the hope is that this will eventually lead to herd immunity, and a sustainable recovery in domestic consumption and business sentiment. However, the path ahead is not straightforward.

Investors will likely want to speculate on the re-opening play, with many hoping for a repeat of the boost to consumption and travel-related stocks seen after March 2020. However, we caution that this time may be different, as we do not envisage a quick economic rebound mirroring 2020. Instead, potential waves of infections may mean a slower rebound in consumption and travel spending, and possibly hobble broader economic activity and supply chains.

Closer sectorial focus is needed. While Chinese big-tech companies may struggle with divesting more of their non-core businesses and domestic consumption remains lacklustre, other parts of China's Tech sector may see a respite. President Xi has signalled a focus on building domestic cutting-edge capabilities as the US moves to restrict high-tech semiconductor technology.

Energy security also ranks high on the CCP's priorities in the midterm, with Beijing unlikely to risk a repeat of 2022's brief power shortages triggered by heatwaves and drought. As such, the high-tech and green industries may be big beneficiaries of Beijing's policy priorities.

Sentiment in Chinese markets may start to improve

We may see teething issues in China's COVID re-opening journey. However, if policy developments continue to be positive, the outlook for China's economy and Chinese financial markets could improve more materially in 2H 2023.

If this is the case, China's GDP growth may improve to 5.2% in 2023 (higher than the projected 2.8% in 2022).

The risk to this upbeat scenario is if policy developments disappoint.

Trending Topics of Interest

What are the triggers to look for to determine a sustainable market recovery?

A conclusive turnaround for broader risk sentiment will depend on:

- Moderation in inflation
- Pause in monetary policy tightening
- Peak in US Dollar (USD) strength
- Bottoming in economic activity
- Bottoming in asset valuations

Once these conditions are met, we could see a sustainable market recovery.

Inflation needs to moderate

For a sustainable market recovery to happen, it is crucial that inflation eases further. When this happens, the squeeze on global household disposable incomes will abate. It will also mean that companies face less upward pressure on input and wage costs, allowing them to focus on expansion plans once again.

As such, investors should keep a close eye on both headline and core consumer price index (CPI) data, while staying mindful that central banks are acutely focusing on core CPI and wage trends.

Pause in monetary policy

A decline in core inflationary pressures will also allow global central banks to pause their rate hike cycles. A key reason behind 2022's financial market tumble was aggressive central bank tightening to combat runaway inflation. If price pressures ease and central banks back away from rate hikes, one big headwind for financial assets will be removed.

In this scenario, we will see global bond yields peak and trend lower, while broad USD strength should also abate. For Asian risk assets, capital inflows may gather pace once the USD starts to weaken.

A peak in USD strength

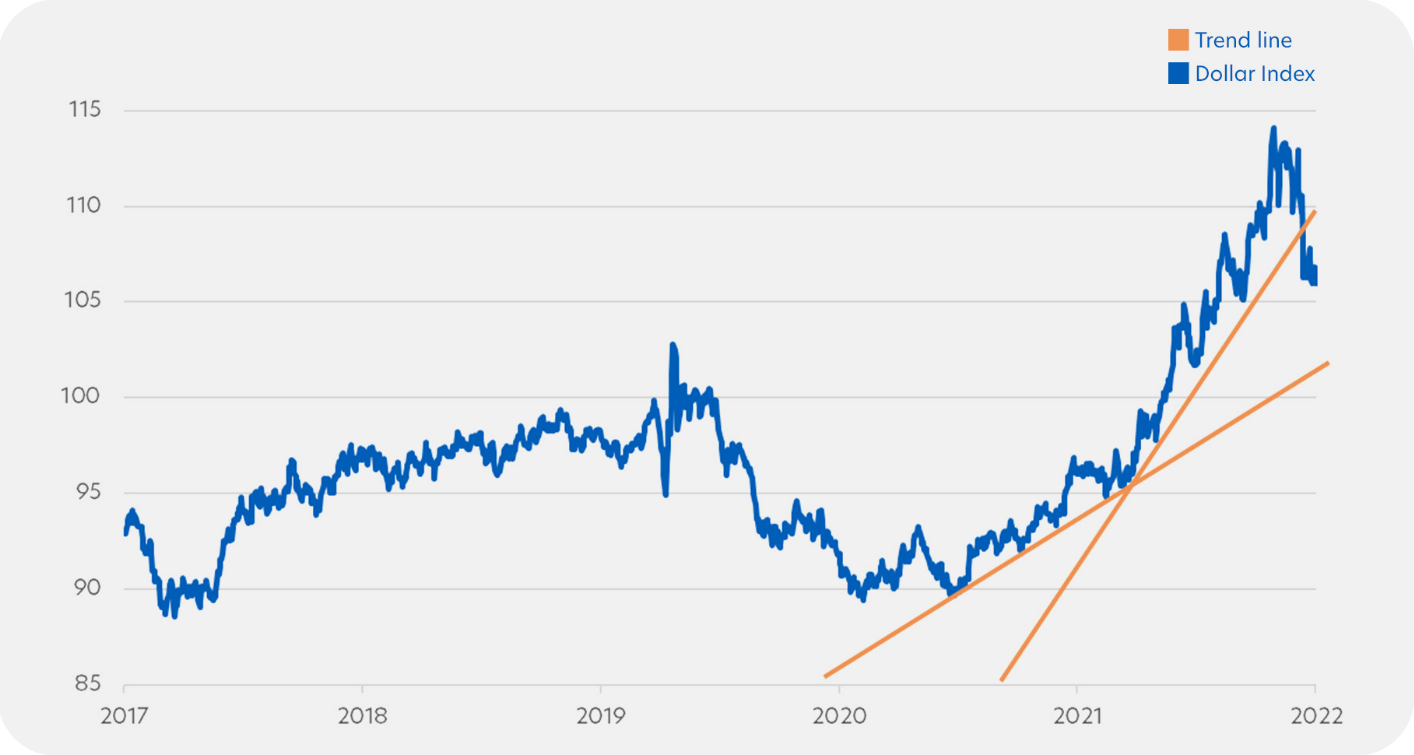
From late September 2022, we have seen USD strength start to abate and enter a consolidation phase, even before the noticeable pullback that started in early November.

Indeed, the USD Index has now broken below the shorter-term trend line from early 2022, undermining the previously bullish picture (Figure 9).

Trending Topics of Interest

What are the triggers to look for to determine a sustainable market recovery?

Figure 9: USD strength starting to abate



Source: Bloomberg (30 November 2022)

The downturn was triggered by a weaker-than-expected US October CPI report, and helped by the Fed raising interest rates in smaller increments. This is a good signal, as a reversal of USD strength should boost stock market sentiment, as evidenced by the negative correlation between the USD and equities.

Figure 10: Correlation between USD, S&P500 and MSCI World Index

	S&P500	MSCI World Index
USD	-0.425	-0.532

Source: Bloomberg (30 November 2022)

Trending Topics of Interest

What are the triggers to look for to determine a sustainable market recovery?

For Asian risk assets, a weaker USD is an important pre-requisite for capital outflows to end, and for fund flows to return to the region. A weaker USD will also help diffuse the high imported inflation faced by many Emerging Market economies, and reduce the stress on countries with a large proportion of sovereign debt issued in the USD. Lastly, a weaker Dollar also reduces the pressure on Emerging Market countries to run down their foreign exchange reserves to support their local currencies.

A bottoming in economic activity

Another key trigger required is for economic activity to bottom out. Watch for higher frequency data such as Purchasing Managers' Indices (PMI) and corporate guidance updates, followed by lagging indicators such as trade, employment data, and GDP reports.

Still, note that when economic data confirm a bottom, financial markets would already have rallied in anticipation, so these are more of confirmatory signals of a sustainable market rally, rather than leading indicators.

A bottoming in asset valuations

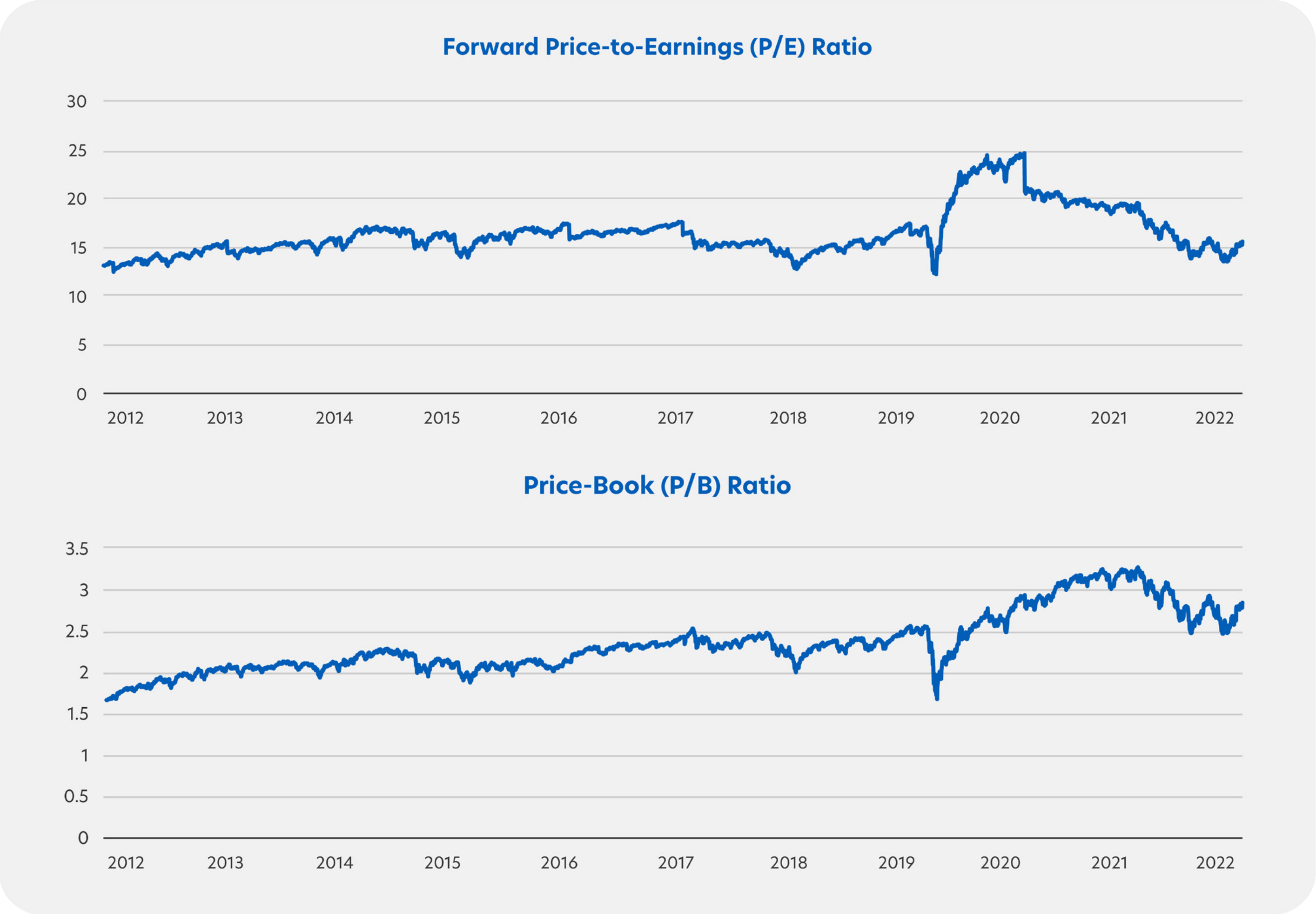
A definitive market recovery traditionally happens after investor capitulation, where fear takes centre stage and panic selling ensues without consideration for valuations. Once this capitulation is complete, the rationale is that there is no one left looking to sell; hence the market can find a bottom. This is difficult to call in real-time, and will only be apparent in hindsight a few weeks or months down the road.

What investors should focus on instead are historical valuation trends, such as forward price-to-earnings (P/E) ratios and price-to-book (P/B) ratios. A lower P/E ratio indicates better value. A P/B ratio below one indicates that a stock is trading for less than the value of its assets.

Trending Topics of Interest

What are the triggers to look for to determine a sustainable market recovery?

Figure 11: MSCI World index valuations corrected significantly in 2022



Source: Bloomberg (30 November 2022)

What Investors Can Do

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What Investors Can Do

Introduction

2022 has been a challenging year for investors, with central banks across the world raising interest rates aggressively to fight inflation, leading to an inevitable correction in financial markets.

Although inflation is expected to retreat from multi-year highs in 2023, due to high base effects, it is unlikely to return to the Federal Reserve's (Fed) target inflation of 2% soon. For inflation to fall to that target level, the Fed may need to maintain interest rates at current high levels for some time.

Our base scenario is a shallow recession in mid-2023 in developed economies, namely US and Europe. Financial markets are expected to remain volatile in the meantime.

UOB's Risk-First Approach is built on the foundation of investing based on one's risk appetite before considering returns. Investors are encouraged not to chase market rallies. Instead, stay defensive and build Core investments to position for slower economic growth and continued volatility in stock markets entering a recession. Core investments include defensive assets such as Investment Grade bonds and lower-volatility solutions such as multi-asset strategies.

What Investors Can Do

Core Allocation

Multi-asset Strategies

Multi-asset strategies provide flexible and diversified asset allocation. They allow investors to capture opportunities across market cycles, as well as asset classes such as equities, bonds, and alternatives. Many multi-asset strategies also provide consistent cash flow in the form of monthly dividends.

As inflation and interest rates moderate alongside growing recession risk, the stock-bond correlation may return to its negative trend, meaning stock prices fall when bond prices rise and vice versa. This could reverse some of the losses suffered by multi-asset strategies in 2022.

Ultimately, multi-asset strategies, being lower risk in nature, form a solid foundation in Core portfolios to help investors build portfolio resilience and meet financial goals in the long-term.

Investment Grade Bonds

With yields at cyclical highs, investors standing by for opportunities to enter the stock market can wait out in Investment Grade bonds, and lock in higher yields.

Investment Grade bonds can now provide investors with attractive yields of above 5% across all durations, compared to a year ago when yields were between 2.4% - 3.5% (Figure 4).

As such, investors should look to lock in attractive yields and focus on cash flow returns over the coming years.

Investment Grade bonds are also an important portfolio stabiliser, especially amid recessionary concerns. With strong fundamentals, we expect them to be resilient under a slow growth scenario or even benefit from potential capital appreciation in the event of a recession.

What Investors Can Do

Tactical Allocation - Top Ideas

Top Ideas are investment opportunities the UOB Personal Financial Services Investment Committee identifies through a rigorous process of research and deliberation using our VTAR framework. This framework provides a holistic view of financial markets and identifies investment opportunities across asset classes, sectors, geographical regions and time periods.

- US Financials
- Asia/China
- Global Healthcare

US Financials

We retain US Financials as one of our Top Ideas. This boils down to higher interest rates boosting net interest margins, while bank earnings remain healthy overall. Long-term fundamentals remain strong as banking remains a core business with a high barrier to entry. It would take time for digital banks to build up their presence and compete with brick-and-mortar incumbents.

While clear challenges remain in the near-term, such as rising loan-loss provisions in preparation for a recession and lower investment banking fees amid an uncertain economic backdrop, these are short-term headwinds. If the potential recession proves to be short and shallow, loan-loss provisions will also be marked lower sometime in 2023, which should then provide a tailwind for bank stocks.

Furthermore, if interest rates remain high but the yield curve inversion abates, the combination of lower front-end funding costs and higher back-end lending revenues will boost bank earnings.

US Financials remain relatively attractive compared to the broader S&P 500 Index. The sector will continue to benefit from a high interest rate environment even if loan growth slows. Risks include recessionary concerns and rising competition from alternative payment platforms putting pressure on traditional banking revenues.

What Investors Can Do

Tactical Allocation
- Top Ideas

Asia/China

Asian stocks could pick up momentum as economic reopening continues to play out and as economies such as China adopt supportive policies to boost economic growth. Recent easing of pandemic policies and fresh stimulus for the Property sector were also welcomed by investors.

While Asian markets are not immune to recession risk in Developed Markets, they have become less reliant on export demand from Developed Markets. The growing Asian middle class is driving global consumer trends and spending, creating prospects for domestic and foreign companies to capitalise on. Furthermore, structural drivers such as urbanisation and digitalisation continue to be key drivers for sustainable domestic consumption. This ensures that Asia's growth will become less dependent on Developed Market economic growth.

Within Asia and aside from market drivers, Chinese stocks offer compelling opportunities given their attractive valuations. Much of the negative news has likely been priced in, and earnings growth expectations have been trending downward. At such a low level, we believe that expectations can be easily surpassed, which would deliver an upside surprise to the market.

Valuations for Asia ex-Japan remain relatively attractive compared to historical averages. Economic reopening and normalisation of activity continue to have a positive effect on the region's recovery. A slowdown in Developed Markets, on the other hand, may impact Asian businesses that rely on export revenue.

What Investors Can Do

Tactical Allocation - Top Ideas

Valuations for Chinese equities are attractive compared to historical averages. Supportive policies and the COVID re-opening may also boost investor confidence in the China market. A rough economic transition could compound current difficulties and risks, slowing China's economic growth.

What Investors Can Do

Tactical Allocation - Top Ideas

Global Healthcare

We continue to see opportunities within the Global Healthcare sector as we enter the third year of the COVID-19 pandemic. We believe that this industry has both a defensive and long-term growth profile, with inelastic demand and compelling long-term structural drivers.

Pharmaceutical revenue is less affected by the economic cycle than that of other sectors, making it one of the most defensive industries. In a slow growth environment, we expect pharmaceutical stocks to hold up better compared to other sectors.

On top of its defensive characteristic, the Global Healthcare sector also benefits from structural tailwinds such as an ageing global population, which gives rise to the need for healthcare services. The pandemic has also accelerated digital transformation within the healthcare industry. We see long-term structural growth in themes such as health tech, which enables remote healthcare services at reduced costs.

Global Healthcare valuations are at a discount compared to broader global equities, while the sector's earnings growth prospects remain strong. The sector also demonstrates defensive characteristics, such as lower volatility. US drug pricing and policy dynamics remain risks, although these may diminish over time with more clarity.

Our Strategies

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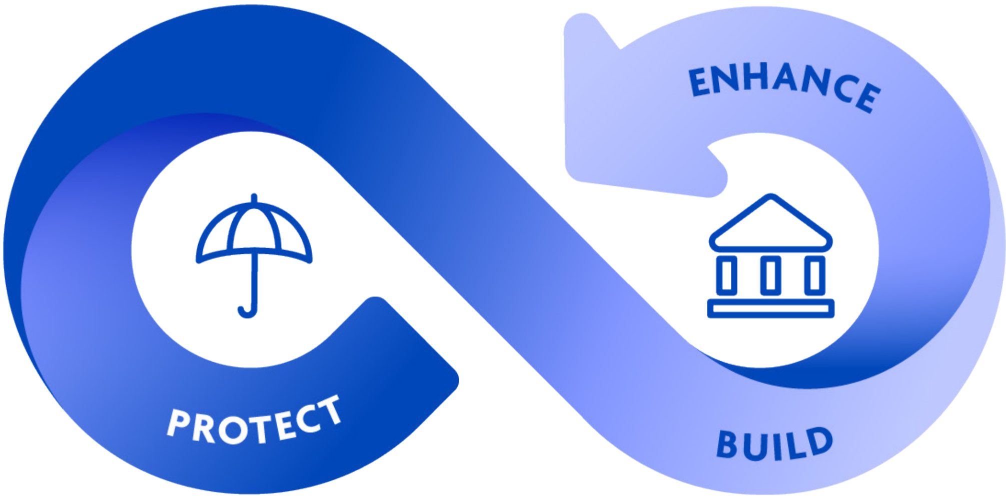
Our Strategies

UOB's Risk-First Approach

Investors may face uncertainties in their investment journey, as financial markets will likely stay volatile with heightened recession risks in 2023.

Our proprietary Risk-First Approach ensures that investors understand their risk appetite as the starting point in their wealth journey, before considering the returns they would like to achieve. This way, investors avoid taking excessive risks in their journey towards their financial goals.

Protect the wealth you have worked hard to accumulate, then Build and Enhance your wealth with the appropriate asset allocation.



Optimal portfolios are recommended according to your Client Risk Profile (CRP). A maximum of 30%, 40% or 50% is allocated to higher-risk Tactical investing while the rest is anchored in Core investing.

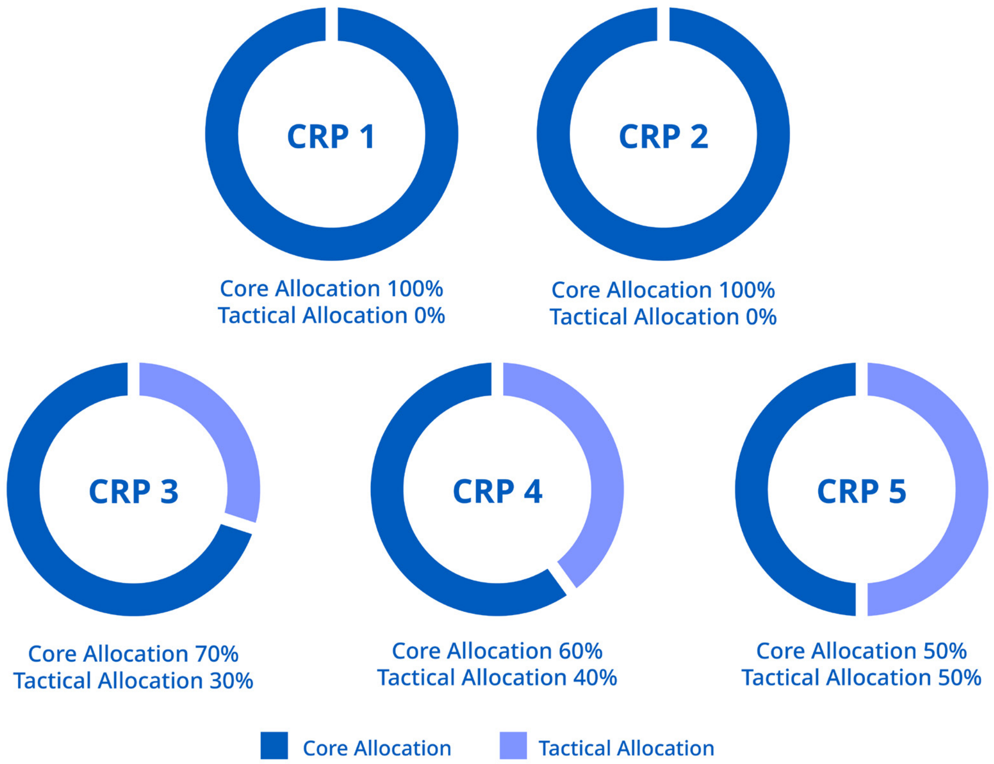
Core allocations are relatively lower risk in nature, yet able to generate reasonable returns. They tend to be less volatile than the broader market to help investors meet longer-term financial goals. By nature, they are less dependent on market cycles and can provide regular income. They tend to be diversified across asset classes, sectors and regions.

An allocation to Core solutions helps to lower downside volatility which is much needed during challenging markets.

Tactical allocations are higher-risk in nature and focus on capturing targeted, short-term opportunities. These aim for capital growth but can also incorporate income.

Our Strategies

UOB's Risk-First Approach



Our Strategies

Our VTAR Methodology

Our award-winning VTAR framework focuses on analysing large volumes of financial data in the four components of Value, Trend, Activity and Risk (VTAR). This framework provides a holistic view of financial markets and identifies investment opportunities across asset classes, sectors, geographical regions and time periods.

The UOB Personal Financial Services Investment Committee examines these insights based on market and asset class views from our Chief Investment Officer, in tandem with key risks, and comes to a consensus to determine the attractiveness of each potential investment idea.

	Purpose	Common Indicators
Value	Identifying investments with attractive valuations and earnings potential.	• Price-to-Earnings Ratio (P/E Ratio) • Earnings Growth (EPS Growth) • Option-Adjusted Spreads (OAS)
Trend	Understanding the trend of the investment.	• Simple Moving Averages (MAs) • Relative Strength Indicator (RSI) • Fund flows
Activity	Understanding the macro environment and business activities that may affect performance.	• Central bank policies • Composite Purchasing Managers Index (PMI) • Industrial Production (IP) and Retail Sales
Risk	Identifying key market risks and potential mitigating factors.	• Geopolitical events • Industry- or region-specific events • News flows

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