
NAHMANI GRUNDER
WEALTH MANAGEMENT & MULTI-FAMILY OFFICE

NG Market Insights

2022 Review

2023 Outlook

Executive Summary

Asset Allocation

- Carry/Interest income is our new focus.
- Clear preference during 2023 on Bonds over Equities.
- At current levels, risk/return trade-off around equities remains unfavorable.
- Positive on Commodities, while Gold remains a core investment.
- PE/VC lagging to price new regime, such that valuation reset to drag into '24.

Equities

- Developed Market equities with further downside likely in 2023.
- S&P 500 range of outcomes: 3,700 by year-end 2023 in a soft landing and a bottom of 2,800 - 3,000 in a mild US recession.
- Gradually revisiting EM equities, after 12 years of underperformance.
- Sectorally, emphasize Health care, segments of Consumer with strong pricing power, Energy, Metals and US Software.

Fixed Income

- Focus on short-dated USD/CHF/EUR sovereign bonds (up to 2 years).
- Key are Coupon and Quality.
- Position in global IG credit, notably USD/EUR/CHF low A-to-BBB rated within the 2 - 5 years duration bracket. Too early to go longer along the curve.
- Bigger emphasis on credit selection ahead of a potential default cycle.

Commodities

- Still positive on Crude Oil and «green» base metals ahead of China re-opening and the lack of supply growth.
- Gold should continue to benefit from central bank purchases in a period of increased de-dollarization, even despite higher long-dated US real rates.

Currencies

- USD pullback experienced against other developed market currencies (EUR, CHF and GBP) during Q4 2022 should partially reverse.
- Conceivable that BRICS currencies do better against USD, especially those from commodity-rich countries.

2022 Review

Regime shift at the FED led to a truly unique global tightening cycle

- In retrospect, 2021 was the year of economic normalization, after the covid-pandemic driven recession in 2020. The initial health care shock and the resulting government-mandated lockdowns were followed by an unprecedented monetary and fiscal support around the world during 2020 and 2021. In this period, the FED balance sheet ballooned from $ 4.2 trillion by end-2019 to a new peak of $ 9.0 trillion by end-March 2022. This significant liquidity infusion coincided with a re-opening of the global economy during 2021 which brought about significant global supply chain challenges as well as persistent labor shortages especially in the US. Inflation thereby reared its ugly head during 2021, after an extended period of very benign inflation post the great financial crisis (GFC) period of 2010 – 2020 during which US headline CPI averaged only 1.7% (versus the average of 7.1% during Q4 2022).

- The initial post-pandemic inflationary overshoot, which became increasingly sticky and visible as of October 2021, got only compounded by the war in Ukraine from February 2022. The resulting sanctions against Russia by the West as well as the freezing of the country's $ 300 billion in USD reserves not only acted as a major supply shock in key commodity markets augmenting food and energy price inflation, but also became an additional catalyst to accelerate the de-globalization wave which we believe can not be reversed anymore. National security has become a dominant priority.

- The globalization trend especially after China's entry into WTO in 2002 drove just-in-time based global supply chains and was extremely deflationary in the West. The resulting low inflation world in this period had three pillars: cheap immigrant labor keeping nominal wage growth stagnant in the US, cheap Chinese goods raising real disposable incomes amid stagnant nominal wages, and lastly cheap Russian natural gas fueling German industry and Europe more broadly. However, global supply chains work only in peacetime, but not when the prevalent world order is in flux saddled with all forms of war, be it a hot war in Ukraine with Russia or an economic/technology war with China.

- 2022 will go into history books as the year when inflation around the world surged to levels not seen in 40 years since the early 1980s. Headline year-on-year inflation peaked at 9.1% in the US in June 2022 and 10.6% in the euro-area in October 2022, levels that are meaningfully above major central banks' respective price stability mandates at 2.0%.

- The inflationary surge resulted in a truly unique global tightening cycle during 2022 (excluding in Japan and China), kick-started by the FED's lift-off on 16 March. This regime shift at the FED triggered one of the sharpest tightening cycles in its history. Since March 2022, the Fed Funds policy rate has increased from zero to finish the year at 4.25% - 4.50%. Other major central banks were pushed to follow, with the ECB going from -0.50% to 2.0% and SNB from -0.75% to 1.0%.

FED pushing for demand destruction via negative wealth effects

- Alongside the rate lift-off, the FED has also embarked on a journey to reduce the size of its bloated balance sheet through quantitative tightening (QT). After purchasing $ 120bn of Treasuries and mortgage backed securities per month between March 2020 and November 2021, the FED is currently reducing its balance sheet by $ 95bn per month, or $ 1.1 trillion on an annualized run-rate. Its balance sheet closed 2022 at $ 8.6 trillion, still amounting to 36% of US GDP.

- Despite its dual mandate, the FED has now reverted to a singular mission to curb inflation, with subsequent painful effects on financial and housing markets. With current inflation meaningfully above target, the FED will lean on the side of extra caution and possibly even over-tighten in our view. It is crucial that current inflation does not start to creep into higher mid-term inflation expectations, especially as the US labor market continues to be very tight. By November 2022, the open jobs-to-available workers ratio still stood at an incredibly high 1.7x, versus sub-1.0x as late as April 2021, despite FED's ongoing efforts to cool the economy.

- Since the FED has little influence on Food, Energy as well as overall Goods prices, the FED has turned its full focus on the Services sectors, and has been aiming to cure the ongoing labor shortages and wage pressures via demand destruction. Monetary policy works through financial conditions with a lag. Thus, asset prices are the channel through which FED can control overall demand in a domestic consumption driven economy. In other words, since Q2 2022, the FED has been targeting overall demand destruction through negative wealth effects on the US household balance sheets (whereby their largest single assets are US housing and US public equities).

- In a USD-centric global monetary system, the FED almost always gets what it wants (hence the notion of "don't fight the FED" for investors). It should not be a surprise that 10-year US real rates aggressively re-priced upwards from -1.08% at the end of 2021 to finish 2022 at +1.58%, thereby indirectly also tightening US financial conditions by a sizeable 320bps during the year with a cyclical peak so far in US financial conditions index (FCI) reached in mid-October. The rule of thumb is that the peak drag on real GDP growth from a tightening in financial conditions typically occurs after 2-to-3 quarters, which implies that FCI-related drag on US economic growth will peak by mid-2023. With the US economy continuing to generate jobs and the unemployment rate at a historically low 3.5%, we think the FED will continue to pushback against any premature FCI easing during 2023, as long as inflation remains uncomfortably high.

- Net net, 2022 marks the year during which we went through a distinct regime shift. This new market regime is here to stay with the resurgence of an appropriate hurdle rate (i.e. cost of capital) not seen since 2006/2007.

… with long-dated US real rates re-pricing to more than +1.5% and FCI tightening

US Core CPI, 2000 - 2022

FED Funds policy rate, 2010 - 2022

US 10-year real rates, 2016 - 2022

US Financial Conditions Index (FCI) tightened during 2022

Financial markets in 2022: Year of reckoning with the initial normalization in rates

- We see 10-year US nominal and real rates as the anchors which dictate valuation multiples in equity and overall yield levels in credit markets. As discussed earlier, 10-year real rates moved up sharply by +266bps during 2022 to the highest level since September 2009 resulting in a very tough backdrop for financial markets.

- For only the third time since 1926 (the other years being 1931 and 1969), both equities and bonds finished the year with negative returns in 2022, such that global equity and bond markets cumulatively shed $35 trillion in value during the year.

- Within global equities, MSCI World lost -19.5% in value in USD terms in 2022, with MSCI EM underperforming again at -22.4%. For the first time in the last decade, there was no meaningful deviation among developed market returns, unlike recent years which experienced marked US outperformance. S&P 500 was down -19.4% in USD terms, with a high realized volatility of 24%. The Nasdaq-100 lost -33.0% in value during the year, while lagging the S&P 500 by 14 percentage points which was the worst year of underperformance since 2002! The current year P/E multiple of the S&P 500 declined from 22.4x at end-2021 to 17.2x by end-2022, however still implying a rather too tight equity risk premium of only 190bps. The valuation reset which started in 2022 should continue during 2023, in our view.

- Bloomberg Global Credit index (total return) was down -17.0% in 2022, after a decline of -3% already in 2021. Not only did corporate credit spreads widen during 2022, but the 10-year US Treasury also returned -16% in 2022, the worst return on record, with the 10-year nominal rate increasing from 1.51% to 3.87% in this period.

- Physical Gold closed 2022 nearly unchanged at $ 1,826 per ounce (after -4% in 2021), on the back of heavy central bank buying especially on the part of Russia and China. Physical Gold prices are typically inversely correlated to long-dated US real rates, but this negative impact was offset during 2022 through the FX reserve diversification and de-dollarization efforts of these foreign central banks. Despite losing some ground in H2 2022, WTI Crude Oil gained +6.7% during the year, but well below the peak of $ 122 per barrel in early June.

- With the aggressive FED rate lift-off, USD appreciated against all major currencies in 2022 for the second year in a row, although there was a general USD pullback during Q4 as markets started to prematurely bet on peak FED hawkishness. EURUSD was down -6% during the year, closing 2022 at 1.0705.

2022 Global Risk Radar

NG RISK RADAR

GLOBAL EQUITIES	S&P 500	SMI	EuroStoxx 600	MSCI DM	MSCI EM
30-Dec-22	3,839.5	10,729.4	424.9	2,602.7	956.4
31-Dec-21	4,766.2	12,875.7	487.8	3,231.7	1,232.0
In local currency	-19.4%	-16.7%	-12.9%	-19.5%	-22.4%
FX impact	*0%*	*-1.3%*	*-5.8%*		
% change (USD terms)	-19.4%	-17.8%	-18.0%	-19.5%	-22.4%

GLOBAL BONDS	Global Credit	US BBB spread	US HY spread (BarCap)	10-year Treasury	US yield curve 3m/10y
30-Dec-22	244.3	1.83%	5.10%	3.87%	-0.55%
31-Dec-21	294.2	1.21%	2.70%	1.51%	0.78%
% change (USD terms)	-17.0%				

	10-year inflation breakeven	10-year US REAL yield	US FCI	Fed Funds rate, end-23e
30-Dec-22	2.30%	1.58%	100.20%	4.40%
31-Dec-21	2.59%	-1.08%	97.05%	1.25%

CURRENCIES	EURUSD	CHFUSD	GBPUSD	USDJPY	BTCUSD
30-Dec-22	1.0705	1.0817	1.2083	131.12	16,579
31-Dec-21	1.1370	1.0962	1.3532	115.08	46,334
% change	-5.8%	-1.3%	-10.7%	13.9%	-64.2%

COMMODITIES	Global BBG index	Gold	Copper	Iron ore	WTI Crude Oil
30-Dec-22	112.8	1826.2	8372.0	108.6	80.3
31-Dec-21	99.2	1828.6	9720.5	114.1	75.2
% change	13.8%	-0.1%	-13.9%	-4.8%	6.7%

Source: Bloomberg, Nahmani Grunder.

2023 Outlook

"Price stability and well-anchored inflation expectations are the bedrock of the US economy"

-- FED Chairman Jay Powell

Great moderation is over; US inflation likely to stabilize above 3.0% into 2024

- Despite the aggressive rate hike cycle and the meaningful FCI tightening so far, the US economy has remained surprisingly robust with little signs of let-up in the tight labor market during Q4 2022. Core CPI (excluding Food & Energy) has been moderating since reaching a peak of 6.6% in September 2022, but still finished last year at an uncomfortably high 5.7%. This moderation has been solely due to sequential declines in Goods prices, while Services inflation (73% of core CPI) has continued to be red-hot with an average +0.5% month-on-month (MoM) increase per month during Q4.

- With Oil and Gas prices retreating from the highs experienced during mid-2022 and markets believing that it is only a matter of time until Services inflation subsidizes as well due to the lagged effects on shelter/housing prices, investors have increasingly started to treat their growing conviction in the ongoing forward deceleration of inflation back to 2.0% as a given. We contest this view. What matters most for the terminal Fed Funds rate is what level inflation ultimately settles at and becomes sticky, not whether inflation has peaked.

- Our macro framework is now based on the thesis that we have reached the secular end of the low-inflation period of 2010 - 2020, such that the great moderation is over. To us, this means that, despite further declines during H1 2023, US core CPI will finish 2023 above 3.0%, with considerable upside risks, and remain there for the foreseeable future.

- There are two main reasons to this view: US labor markets and the negative effects of increasing de-globalization.

- US labor market continues to be historically tight, with an unemployment rate at 3.5%, a jobs-to-workers ratio above 1.7x and a labor participation rate stuck 500bps below levels seen in early 2000s. Wage inflation has remained at an annualized run-rate of 4.5% - 5.0% which we believe is historically consistent with core CPI between 3.5% - 4.0%. The employment cost index (ECI) was +5.0% YoY in Q3 2022, the highest level since its inception in Q1 2001. In our view, a recession will likely be needed as the end-game to bring the unemployment rate back above 5.0% so that wage pressures ease appropriately. US recession has historically led to an increase of 200–500bps in the unemployment rate.

Elevated wage pressures might only be cured by a US recession

Employment cost index (ECI), which measures changes in direct & indirect labor costs, shows current US wage pressures

Higher structural inflation means persistently higher rates in the West…

- The post-WWII world order is currently being challenged with an equally important shock to the inflation outlook. For two entire generations as investors, we did not have to discount geopolitical risks but it is clear that 2022 marks the year during which this has structurally changed as well. As we transition from a US-centric unipolar to a multipolar world order, geopolitics will supersede economic interests over the next 5+ years.

- Since the conclusion of the Cold war, the US was the undisputed superpower and globalization was the economic order. We believe globalized supply chains will increasingly be dismantled as the G20 increasingly separates into two spheres: "G7 + Australia" on one side, and "BRICS +" on the other, with the potential addition of Saudi, Turkey, UAE and Argentina. The drive to de-dollarize intra-BRICS+ trade will speed up, and resource nationalism around commodities will only grow. With the freezing of Russia's USD reserves post the Ukraine invasion, the G7 signaled to the BRICS+ that it is "our currency, your problem". BRICS+ seem to be gearing up to respond by saying "our commodity, your problem". The drive to de-dollarize by settling China's crude oil purchases from Russia in renminbi and India's purchases from Russia in dirhams, while increasingly rallying around the Shanghai Cooperation Organization (SCO) with new member states should be watched carefully.

- Sustained and structural deglobalization on the back of a new multi-polar world order can only be incrementally inflationary to the West. Industrial reshoring/friend-shoring in the Western semiconductor value chain, or Saudi's drive to move up in the petrochemical value chain with Chinese investment to retain more of the value-added and thus gross margins are just two examples of this wave.

- As a result, it is time to start pricing the secular end to the low inflation period, and we see US inflation remain comfortably above 3.0% for the foreseeable future, unless we get a deeper US recession. In contrast, with the 5-year US breakeven currently priced at 2.25%, markets seem to widely underestimate the risk of persistently higher inflation in the US (and the West) into 2024 and over the mid-term, especially with meaningful risks from deglobalization to Goods and Energy prices. It is optimistic to expect a normalization of inflation back to the target 2.0% together with a soft landing in the US economy and decline in rates.

... 10-year US real rates between +1.5%-to-2.5% into 2024

- Structurally higher inflation in the West should also directly translate into a higher terminal Fed Funds rate as well as higher long-dated real rates. On the Fed Funds rate, we see it getting to a peak of 5.0% - 6.0% during 2023 and subsequently remaining there well into 2024.

- This view is in contrast to current market pricing of a peak policy rate at 4.9% by June 2023 with a subsequent 50bps rate cut in H2 to finish 2023 at 4.4%. We do not see the FED cutting rates during 2023, and think this gap in market expectations will need to be resolved by mid-year once markets realize the level at which inflation stabilizes is above 3.0% even with a very shallow recession.

- The market is wrongly questioning FED's inflation fighting credibility and resolve in this instance *("We will stay the course until the job is done. We need to see inflation come down decisively, and we are strongly committed to bring inflation down to 2.0%"* – Powell, 14 Dec. 2022).

- Our framework now hinges on:
  - A new market regime under which 10-year US real rates will continue to price within a higher range of +1.5% to +2.5% over the next 3 years, after having increased from -1.08% to +1.58% during 2022. In contrast, 10-year US real rates averaged only +0.32% between 2010 – 2020, aiding the valuation of long-duration assets in this period. Ultimately, long-dated US real rates are the key driver of equity valuation multiples, credit spreads, Gold prices and FX pairs.

  - The investing environment has now changed radically. Valuations printed across public and private markets during 2019 – 2021 will most probably never be re-visited again.

... with a changed investing environment where Carry is the new focus

- Unless the FED adjusts its mid-term inflation target to 3.0% from 2.0% which we doubt, we see the FED Funds rate moving towards 6.0% in this cycle. This would most likely result in a US recession. As also stated by FED Chair Powell during December 2022, while FED continues to push ahead with rate hikes during 2023, *"the path to a soft landing in the US economy has narrowed considerably"* due to persistent inflation.

- Despite our base case scenario of a mild US/European recession, we forecast 10-year Treasury rates to be between 4.0% - 5.0% by mid-2023 and remain in this range into 2024 (versus 3.40% on 18 Jan.) as inflation remains FED's primary focus. While Treasuries do attract safe-haven flows during a US recession pressuring down rates, we believe these incremental flows should this time be easily offset by further declines in Chinese Treasury holdings as well as the potential end to the ongoing yield curve control policy by the Bank of Japan (BoJ) during Q1 2023. JGB rates can move much higher to 1.0% - 1.5% (from 0.40% currently).

- 2023 is the year when we get a return to again investing in a world with higher yields after more than a decade. Carry/Interest income is our new focus, with a clear preference during 2023 on Bonds over Equities. Our relative pecking order for 2023 therefore is sovereign bonds before credit, with equities being the least attractive. The S&P 500 implied equity risk premium (ERP), which is the gap between the earnings yield of S&P 500 and the 10-year Treasury rate, stood at only 1.7% on 18 January, half the historical average. In our view, this level of ERP is way too tight, making equities unattractive relative to Treasuries.

- In this new market regime with long-dated USD hurdle rates between 4% – 5%, the "buy the dip mantra" around the thinking that FED will always blink with a pivot at the first sign of trouble will be wishful thinking. The best thing that can happen from here is that the FED eventually engineers an "unlikely" soft landing during 2023/24, which will limit downside for equities and credit from here. In other words, equities and credit are currently far from pricing an eventual US recession, which would lead to even lower equity valuation multiples and wider corporate credit spreads.

Global Equities: Further downside likely during 2023…

- We use S&P 500 as a global barometer for Global equities, since the US macro trends and FED policy continue to be the major drivers of markets in a USD-based global monetary system. Moreover, similar to 2022, we believe current valuation differentials do not justify meaningful regional performance differences within developed markets (DM) in 2023e.

- In our base case scenario of a mild recession, we expect S&P 500 EPS to decline by -10% year-on-year (YoY) in 2023e on revenue growth of +3.2%, such that net margins drop by -150bps to 10.1% (versus a drop of 150-160bps in 2008 and 2020). As a reminder, S&P 500 EPS has historically declined by 15 – 20% during past US recessions. We thus forecast an S&P 500 EPS of $ 201.0 for 2023e, compared to bottom-up market consensus at $ 229.5 by 13 January 2023 (down from $ 255 in June '22). In other words, despite the ongoing corporate earnings downgrade cycle, the market is still expecting earnings growth of +4.6% YoY in 2023e. This is unrealistic, with further earnings downgrades to materialize over the next 2 quarters as margin expectations are brought down.

- Moreover, the equity valuation reset which started in 2022 should continue during 2023. The P/E multiple of the S&P 500 declined from 22.4x at end-2021 to 17.2x by end-2022. However, this multiple still implied an equity risk premium (ERP) of only 1.9% over the 10-year Treasury rate, which as discussed should remain above its closing level at the end of last year. The historical average ERP is above 3.0%. Moreover, we know that S&P 500 P/E multiples have bottomed at 14x – 15x during previous US recessions. Equity valuation multiples should drop further.

Implied Equity Risk Premium (ERP) for S&P 500

	P/E	10-year Treasury	Implied ERP	10 yr Real rates
2011	12.8	1.88%	5.9%	-0.07%
2012	13.7	1.76%	5.5%	-0.67%
2013	16.8	3.03%	2.9%	0.80%
2014	17.6	2.17%	3.5%	0.49%
2015	17.3	2.27%	3.5%	0.73%
2016	18.8	2.45%	2.9%	0.55%
2017	20.1	2.41%	2.6%	0.44%
2018	15.4	2.69%	3.8%	0.98%
2019	19.6	1.92%	3.2%	0.15%
2020	26.0	0.91%	2.9%	-1.08%
2021	22.4	1.51%	2.9%	-1.04%
2022	17.2	3.87%	1.9%	1.58%
Average 15 - 19	18.2		3.2%	0.57%
2023, current	19.5	3.40%	1.72%	1.25%

Source: Nahmani Grunder.

... with S&P 500 seen at 2,800 – 3,000 in a recession and 3,700 in a soft landing

- Thereby, under a mild US recession scenario, it is likely that S&P 500 would bottom in a range of 2,800 – 3,000 during 2023, compared to the closing price at 3,929 on 18 January. This would imply a potential decline of -25% during 2023, after the -19% drawdown already experienced in 2022. Under the unlikely scenario of a US soft landing, we would see a year of flat EPS around $ 223, translating into a year-end 2023e S&P 500 level of 3,700 using a P/E multiple of 16.5x. The average P/E multiple between 2015 – 2019 was 18.2x, albeit during a period with average 10-year real rates at +0.57%. Based on our view that 10-year real rates will remain between 1.5% - 2.5% over the next years, a minimum discount of -10% is certainly warranted.

S&P 500 EPS per calendar year with P/E bands, 2015a - 2023e

	2015a	2016a	2017a	2018a	2019a	2020a	2021a	2022a	2023e
Operating EPS	118.20	119.08	132.95	162.91	164.58	144.6	212.5	223.4	201.0
growth (YoY)		*0.7%*	*11.6%*	*22.5%*	*1.0%*	*-12.2%*	*47.0%*	*5.1%*	*-10.0%*
Price low	1867.6	1829.1	2257.8	2351.0	2447.9	2237.4	3700.7	3577.03	
Price high	2130.8	2271.7	2690.2	2930.8	3240.0	3756.1	4793.1	4796.56	
Price close	2043.9	2238.8	2673.6	2506.9	3230.8	3756.1	4766.2	3839.5	3928.86
P/E low	15.8	15.4	17.0	14.4	14.9	15.5	17.4	16.0	
P/E high	18.0	19.1	20.2	18.0	19.7	26.0	22.6	21.5	
P/E close	17.3	18.8	20.1	15.4	19.6	26.0	22.4	17.2	19.5
P/E range	15.8 - 18.0	15.4 - 19.1	17.0 - 20.2	14.4 - 18.0	14.9 - 19.7	15.5 - 26.0	17.4 - 22.6	16.0 - 21.5	

Source: Nahmani Grunder.

- As such, given the range of outcomes of a potential bottom at 2,800 – 3,000 in a recession and 3,700 by year-end 2023 in a soft landing, risk/return dynamics around S&P 500 continue to be unfavorable at current levels. We would also generalize this view to broader DM equities.

- On a sectoral basis, given our macro framework, we continue to like defensive sectors with low exposure to inflation and growth risk (Healthcare and parts of Consumer with strong pricing power such as luxury goods), and structural growth sectors with recurring revenues and resilient growth/margins such as US software. In terms of the latter, these being long-duration assets, even higher real rates can be seen as a detriment to their valuations. We, however, believe that the compression in multiples back to 2015 levels experienced in US Software (started in Nov. 2021) has now mostly run its course. As long as growth/margins remain somehow resilient, current stock prices should present attractive long-term buying opportunities, We are also still bullish on crude oil and base metals such as copper, which will incrementally benefit from the China re-opening and lack of supply growth. China accounts for 50-70% of global demand in iron ore, copper, nickel and zinc. As such, Energy and diversified Commodity stocks are still preferred too.

No meaningful regional differences in DM equity markets in 2022e

- Regionally, we have had a preference on US equities over the last 7 years since 2015, and the S&P 500 has indeed outperformed Europe (DJ Stoxx 600) and Emerging Markets (MSCI EM) by +6% per annum in USD terms, respectively, over this period, driven by much superior EPS growth, higher ROIC and attractive starting relative valuation multiples. 2022 was the first year during which most DM equity indices performed in line with each other, with similar declines. Similar to 2022, we think the performance dispersion within DM equities during 2023 will be quite limited, due a convergence in near-term EPS growth trends and the US valuation premium currently at the high-end of its historical range (see below).

Year-End P/E multiples for Major Equity Indices				
	S&P 500	Europe Stoxx 600	MSCI EM	Discount SXXP/SPX
2015	17.3	16.9	13.2	-2.3%
2016	18.8	17.0	12.8	-9.6%
2017	20.1	16.0	15.2	-20.4%
2018	15.4	12.9	12.9	-16.2%
2019	19.6	16.2	14.7	-17.3%
2020	26.0	22.3	20.6	-14.0%
2021	22.4	16.1	13.2	-28.3%
2022	17.2	12.1	11.5	-29.5%
2023e	19.5	15.0	12.1	-23.2%
Average 15 - 19	18.2	15.8	13.8	-13.4%

Source: Nahmani Grunder.

- Lastly for investors with a higher risk appetite, we think the time to gradually revisit EM equities might have finally come. S&P 500 outperformed MSCI EM by +10% per annum between 2010 – 2022, a period durich which the MSCI EM index remained basically unchanged with high realized volatility. At the initial stages of the globalization period during 2000 – 2005, MSCI EM actually generated a return of +19% per annum, so this was not always the case historically. With a current P/E of around 12x (at least 10% discount to its historical average) and China re-opening disproportionately aiding Chinese equities (35% of MSCI EM index) and commodity prices generally, 2023 should be the year during which EM equities finally have their place under the sun. With China currently experiencing outright deflationary tendencies, its monetary and fiscal policy will be completely out of sync with the tightening bias in Western developed economies. (At the WEF 2023 in Davos, China's Vice Premier Liu He stated last week: *"China will continue to implement a proactive fiscal policy and a prudent monetary policy…focus on expanding domestic demand…welcome more foreign investment to China, and prevent and defuse economic and financial risks."*)

Fixed Income: Further FCI tightening calls for higher rates and wider spreads

- Rates markets are most advanced to price the new monetary policy regime and the potential looming recession, in our view. While we still see a further upward shift in the US Treasury yield curve, the majority of this process should be behind us after the move already experienced during 2022. This is also the case for European sovereign rates, with the 10-year Bund and Swiss nominal rates having risen from -0.2% to +2.6% and -0.1% to +1.6% respectively last year. During 2022, we were already warming up to short-dated USD, CHF and EUR (Bunds) sovereign bonds (up to 2 years) and we continue see them as attractive cash alternatives.

- We would not extend the maturity profile yet, especially given the volatility and compression seen so far in early 2023 in an environment where yield curves remain inverted even in Germany. We remain negative on long-dated JGBs. We think the Bank of Japan (BoJ) will need to give up its yield curve control (YCC) policy latest by April 2023 when current governor Kuroda's term expires. As discussed, any further large volatility in the JGB space will have potential negative spillover effects into long-dated Treasury rates.

- BBG Global Credit index generated two straight years of negative returns in 2021 and 2022, losing a hefty -19.6% cumulatively in this period. While incrementally becoming more constructive on shorter-dated high quality corporate credit as a viable carry complement to our rates positioning, our bearish bias on the long-dated credit spectrum remains in place.

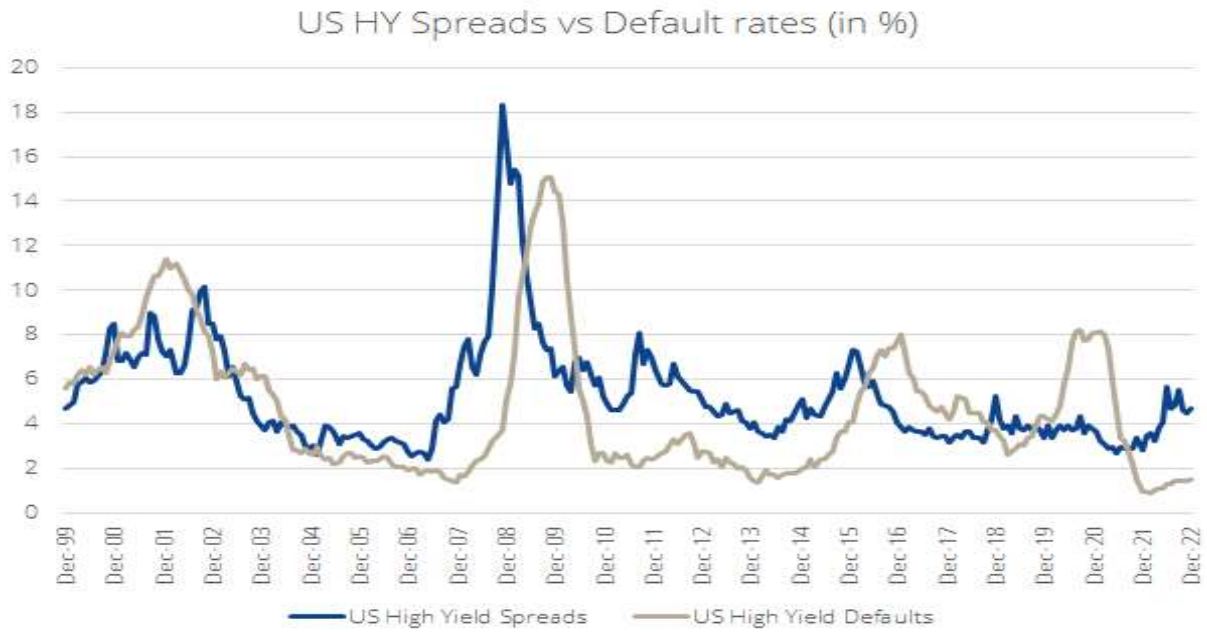
Index (Local CCY)	2022 Return %	YTW %	OAD (YRS)	OAS (BPS)
China Aggregate	3.4	2.89	5.7	23
US High Yield	-11.2	8.96	3.9	467
Pan European High Yield	-11.3	8.32	3.1	512
Global High Yield	-12.7	9.42	4.1	546
US Aggregate	-13.0	4.68	6.2	51
Global Aggregate	-16.3	3.73	6.7	53
Global Credit	-16.7	5.18	6.1	147
Euro Aggregate	-17.2	3.46	6.3	89
Global Treasuries	-17.7	3.04	7.5	14

Source: Nahmani Grunder, Bloomberg.

Actively positioned in global IG credit with 2 – 5 year duration

- Credit returns should be driven by spreads, and less by the rates outlook, from here. Given our base case scenario of a global recession, we think a negative credit cycle during 2023/24 is likely. US high-yield (HY) default rates peaked above 10% during 2002 and 2009, whereas it was 8.2% post covid in September 2020 despite the shortest recession in history at that time. HY default rates finished 2022 at only 1.5% (see below). Despite some initial corporate spreads tightening in both the investment-grade (IG) and HY spectrum in this current cycle (US BBB +50bps, US HY +190bps), credit spreads still remain tight versus past down cycles. Investors seem to price current low default rates to persist during 2023.

- Net net, given our views on rates, spreads and equities, we have also become more actively positioned in global IG credit, notably USD/EUR/CHF low A-to-BBB rated within the 2 - 5 year duration bracket (with a targeted average duration of 3 years) as an alternative to holding cash. Moreover, an even bigger emphasis on credit selection is warranted. Single issuer yield gaps even within BBB should become a usual occurrence in an illiquid overall market. We stick to greater credit quality.



Source: Nahmani Grunder, Haver Analytics.

Commodities: Positive on Oil and Copper; Gold to still be driven by CB demand

- Gold clearly outperformed rates, equities and credit in 2022, as the sizeable upward move in long-dated real rates was offset by incremental central bank (CB) demand. Countries with current account surpluses, such as China and Russia, have been channeling these surpluses into gold, rather than USD/Treasuries, in recent years. Russia's invasion of Ukraine and the subsequent freezing of their USD/EUR reserves were a clear catalyst for CB gold purchases to even accelerate last year. Within our de-globalization framework which would imply further de-dollarization, it is conceivable for this trend to persist into the mid-term, especially as OPEC+ oil exports increasingly get settled in non-USD currencies (renminbi, dirhams, rubles etc.) with these flows subsequently being recycled into physical gold. In other words, the Gold-to-Brent Crude Oil ratio could potentially rise further in the mid-term from 23 barrels per ounce today, even in a rising oil price scenario. Thus, net net, despite our overall call of a further upward move in long-dated US real rates to between 1.5% - 2.5% during 2023, it is also difficult to become bearish at $ 1,900/oz., especially if one believes in the risk of a gradual end to the current USD reserve currency-based monetary system. Gold clearly has its place in a global balanced mandate with a core position which we currently peg to 10%.

- Similar to Gold above, all commodities are spot assets, driven by demand levels relative supply levels, and one would remain bullish on commodities as long as demand levels are above supply in absolute terms. For Crude Oil, the rise of ESG investing in recent years has coincided with an unbalanced climate policy program in the West, with little focus on managing the decline in hydrocarbon supply. Along similar lines, after years of underinvestment, overall supply growth in various base metals has also become curtailed, creating questions on how tight demand/supply will become in those commodities even in a milder recession scenario as the China re-opens its economy and the world re-arms, re-shores its industrial base and re-stocks as the West – global East/South divorce goes into over-drive. As a reminder, China accounted for 70% of iron ore, 50% of copper and nickel and 15% of crude oil demand globally in 2021. We remain positive on Commodities in 2023, with a potential catch-up in Oil, which has underperformed Copper by 30% since Nov.

FX: USD pullback since Q4 2022 to partially reverse

- On FX pairs, the USD pullback experienced against other developed market currencies (EUR, CHF and GBP) during Q4 2022 should partially reverse, as the market has been too prematurely betting on peak FED hawkishness with expectations that real interest rate differentials will tighten during 2023. We thus think USD should remain FX strong versus other DM currencies, even as the ECB takes its deposit rate to 3.25% by May 2023. We also still prefer CHF over EUR with the potential to revisit the 0.95 level from September 2022. Reaching a clear conclusion regarding USD against BRICS currencies is more difficult, given the risk of further de-dollarization as well as higher commodity prices.

Trade-weighted USD index, 2019 - 2023

Summary Outlook 2023

Asset Classes	Positive	Neutral	Negative
Fixed Income & Cash	Treasury (up to 2 years) Sov. EUR/CHF (up to 2 years) Global IG Corp (2 - 5 years)	US Treasuries	EU Sov. Bonds EU HY Corp US HY Corp Global IG long dated
Equities (sectoral view)	Healthcare Consumer Staples Energy Metals&Mining US Software	Internet Telecom	Industrials Consumer Discretionary Chemicals Financials
Commodities	Crude Oil Copper	Nickel Iron ore Gold	

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