Investmenttrends 1st quarter 2023

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Market outlook from ONE Asset Management AG

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ONE® Asset Management

01/ Equities

Inflation and, in its wake, the lagging central banks remain the topic on the international capital markets at the start of the new year 2023. For too long, the monetary watchdogs led by the Federal Reserve in the United States had underestimated the problem of rising prices and considered it to be temporary. Now they are still trying to make up for this shortfall with more aggressive rate hikes.

In view of the complex and, in some cases, delayed effects of the central banks‘ jerky course, a major slowdown in the global economy seems inevitable. Economists even expect a sharper economic decline in the USA over the winter than in Europe. After all, the Fed had started to raise key interest rates earlier than the European Central Bank. Nevertheless, Germany in particular is likely to suffer in the euro zone, due to its previously strong dependence on Russian energy. But lately some leading indicators even surprised on the upside. Europe could even manage a softer landing than feared. On the stock market, this could favor a relatively robust development of the regional exchanges.

Meanwhile most central banks slowed the pace of their interest rate hikes somewhat in December. The Fed hiked rates by „only“ 0.5 percent. But its new projections show an even higher interest rate peak compared to September. They fear wage growth and see only partially cooling inflation. The curve could therefore be overstretched. Driven by this concern, price data and the upcoming job reports in particular will continue to be carefully dissected on the stock markets.

Just before Christmas, the Bank of Japan also caused a sensation. Unexpectedly by economists, it softened its ultra-expansive monetary policy somewhat and became the last major central bank to de facto abandon its promise of low interest rates. Although BoJ Chair Haruhiko Kuroda changed the monetary policy framework only minimally, the signal effect was enormous.

Currently, there is an astonishing consensus among strategists for the stock markets in the new year. After a very rough first half of the year, the outlook is expected to brighten noticeably. The capital markets could then move into a strong recovery in the second half of the year. We take a rather critical view of such strong unanimity among the experts. In our view, this could even tend to trigger a friendlier environment right at the start of the year as professionals seem to be underinvested.

Another positive could be China that is starting to relax its Corona-related regulations. Admittedly, the zero-covid policy of the huge country is thus far from history. But the path seems clear. In our view, China‘s economy should slowly open up again from the first quarter into the second half of the year, with clearly positive implications for the global economy. We see the fact that policymakers have recently reacted less radically to setbacks from covid easing as a mildly positive signal. Thus, China could become a positive trigger for the international equity markets.

Visibility in the Ukraine war, on the other hand, remains low. Russia‘s forces seem to be waning. However, it is difficult to predict how a battered and unpredictable Kremlin leader Putin will react. Without a solution, the war will therefore take a back seat on the stock markets for the time being.

In economic terms, the result could be a mild recession followed by a weak recovery. On balance, this is a stagflation scenario that the markets will have to deal with. However, this is not unexpected and should be coped with. Especially since not all sectors will be hit equally hard. For example, providers of non-discretionary products traditionally hold up better in this environment. This means that the solid performance of value stocks should continue for the time being.

By contrast, the stock market engine of recent years – the tech stocks and above all the megacaps from the USA – already had the red lantern in their hands in 2022. The Nasdaq indices performed far worse than all other leading stock indices up to Christmas Eve, with an annual minus of around 30%. Otherwise, the stock markets went hand in hand, without major outliers on the downside. The major indices in the USA, Asia and Europe all lost a little over 10% in value.

Technically speaking, the German Benchmark index Dax40 was ultimately able to defend the 12,000-point mark, which was not only psychologically important last year – a key level also for the new trading year to watch. If prices fall below this level again, the fresh technical sell signal triggered this way could force further selling pressure. On the forward-looking stock market, however, we believe that prices should hold their ground rather well and ultimately be able to crack the December high at 14,675 points in the course. Then the chances for further gains on the stock market are not bad. With the right selection, a reallocation of stocks – regardless of the consensus expectation of a weak start to the year – seems an option to us. After all, the masses are rarely right on the stock market.

02/ Bonds

The bond markets were shaken to the core by the knee-jerk policy of the international central banks, which in some cases took on panicky features and brought with it an aura of excessive demands. In recent months, however, the situation has already started to calm down. In view of the reduction in the pace of interest rate hikes in December, the nervousness should ease further in the coming weeks, despite the Fed's continued hawkish stance. The Fed made it clear: „Higher for longer."

Looking back, the 2022 U.S. Treasury yield had peaked at 4.24% in mid-October, up from 1.5% at the beginning of the year. Now it's paying around 3.5%. The market had been reassured by the rate of inflation, which had stopped rising and then actually declined. Only the monetary watchdogs do not want to lower their admonishing finger. As described, they are currently taking an even more critical view of price developments than before. This is where the risk for interest rates lies.

On the bond market, the interest rate peak has already been overlooked, and the Federal Reserve may consider a first rate cut as early as the end of 2023. The central bankers could stall the economy with their aggressive policy and then start to counteract it. However, with the last Fed meeting in 2022, such speculation received a strong damper. Supporting indicators such as core inflation, to which the Fed is guided, are now expected to remain elevated for longer.

Madame Lagarde in Europe has now also moved on to resolutely defying inflation. With its inflation forecasts, which have been revised upward once again, the ECB has followed in the footsteps of its U.S. counterpart with even more hawkish tones than before. Even though the causes of inflation in the two regions are different. In the USA, it is mainly driven by huge Corona stimulus programs and a strong labor market, in the euro zone much more by very high energy prices.

Even in 2025, the European Central Bank now expects inflation to exceed 2%. Accordingly, „higher for longer" also applies to eurozone yields. However, whether this will bring a renewed rise in yields is questionable in our view. We rather expect a sideways movement of the bond markets in the coming months until new data provide a clear direction again to provoke a new breakout move.

Overall, however, the economic signals from the euro zone are ambiguous. In Germany, the IFO index and ZEW economic expectations recently recovered, as did the purchasing managers' indices. Companies are less skeptical about the future than consumers. If Europe comes through the energy crisis this winter to some extent, the expected recession could be rather mild. By contrast, retail sales have recently performed poorly, acutely burdened by uncertainty about the high cost of energy.

There is still no room for new euphoria with regard to central banks: The Bank of England, as the pioneer of the current key interest rate movement, is also sticking to its aggressive course. With its latest rate hike, it has opened the door wide for a further 0.5% at the February meeting. Recession worries are not coming to a sustained head in the country and wage pressures are continuing. This is hardly likely to dissuade the central bankers from their monetary policy braking course.

In Asia, the surprising softening of yield curve control in Japan suddenly caused unease after the clocks in the region had ticked differently for so long. BoJ chief Kuroda has already achieved the long-term inflation target of 2% before the end of his term in April 2023 anyway. Moreover, Japan continues to keep the monetary floodgates open. Thus, Japan can apparently afford a beginning of the end of ultra-expansionary monetary policy. In the coming months, we expect a test of the new upper limit of 0.5%, which could then be raised even further.

In China, monetary policy continues to steer against an economic slowdown. Among other things, the government's strict zero-covid policy with the resulting lockdowns as well as the still turbulent housing market are weighing on sentiment. Even if China really does loosen its grip further, there are no signs of a turnaround by the central bank. The state will stick to its monetary and fiscal policy support and ensure that the economy starts into a more pragmatic covid approach with strength.

03/ Currencies

On the foreign exchange market, the overall picture of a waning interest rate hike momentum in the US is being played out with a now eagerly following ECB and an initial restrictive move in Japan. The bottom line is a weaker US dollar. At the end of a very strong year for the currency, there is a trend reversal, also favored by profit taking. For even at the beginning of 2022, speculation on a firm dollar had been the strongest crowded bet on the currency market because of the clearer key interest rate path in America. Recently, however, currency analysts increasingly spoke of an overvaluation and compared the movement with the dollar peaks in the mid-1980s and also at the millennium.

For the new year, at any rate, the high air is getting thinner for the Greenback. The euro has already been recovering since the fourth quarter, after the significant tightening of the interest rate climate in Europe, as we anticipated, gave the common currency new strength. After the fall of parity, this brought fresh capital back into the region. On trend, the euro should continue its recovery in the coming months with the tailwind from the ECB. However, the energy crisis remains the key this winter. If it leads to further extensive capital requirements, this will also hamper the euro‘s recovery. Technically, there is clear resistance for the common currency around 1.10 Dollar to the euro. A movement around this level seems relatively likely for the first quarter.

The Japanese central bank breathed new life into the yen once again with its surprising policy move. This sustained impulse should also help the currency to continue its stable development against the dollar. The yen had also already initiated a reaction in the fourth quarter to the extreme weakness in the first three quarters of the year. For the currency pair, we see 131 yen to the dollar as the current key level, which is likely to be fought for initially. Below there would be more chances for the yen.

Cryptocurrencies are coming out of the fourth quarter severely battered. The bankruptcy of the FTX platform, whose founder Sam Bankman-Fried is now facing a media-heavy trial, has highlighted the risks of this form of investment. At the same time, the trading platforms, starting with the bankruptcy of Mt. Gox, has already proven to be a weak point of the crypto system earlier. So far, these shocks have been handled relatively well by the market. For bitcoin, the recent low at 15,479 Dollar – according to Reuters data – is the key support. If this breaks, more crypto investors are likely to pull the ripcord. At the start of the new year, bitcoin is working to stabilize again. Whether this can be successful remains to be seen. For this to happen, the aforementioned support level has to hold.

04/ Commodities

Commodities have been mostly stable in the past year and are moving upwards in an underestimated supercycle, in the view of Goldman Sachs analysts. They see the old economy as structurally underinvested in commodities and expect demand to be further fueled by politics. Add to that tailwinds from the weakening dollar and upward pressure from the inflation side.

The energy complex was among the most dynamic areas in the international capital markets. In the course of the year, crude oil fluctuated between a high of 130.5 dollars for U.S. WTI oil to a low of 70.08 dollars at the beginning of December.

We expect rather positive impulses from a slow and gradual re-opening of the Chinese economy, after it was repeatedly set back by recurring lock-downs from the strict covid policy. This should tend to fuel more positive economic expectations and thus also renewed fantasy for oil demand.

At the same time, OPEC+ is currently putting the brakes on supply to the markets, thus keeping the supply side in check. Accordingly, crude oil should at least stabilize in the coming weeks. After the long underperformance, a recovery is also quite possible.

Meanwhile, the gold price has completely slipped out of focus. For two and a half years, the yellow metal has tended to move sideways in a trading range of 1,700 to 2,000 dollars. Our expectation of a rather weaker dollar should give gold moderate opportunities at the start of the year, also supported by a calmer course on the bond markets. Industrial metals have shone more in 2022. If a deeper economic dip can be averted, then this trend should continue and support metals like nickel.

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