Prime Partners

SINCE 1998

MARKET INSIGHT

JANUARY 2023

Market Analysis

Positive signs on inflation should not be ignored.

Overall, the trends noted throughout 2022 continued in December, with volatility, doubts and uncertainty again dominating.

2022 will go down as the worst year for a diversified portfolio in over 50 years! So we're obviously happy to see the back of it.

We are all starting 2023 with very many questions as to how the economic and financial cycle will develop. However, there was no real change in the underlying problems on the evening of 31 December. Inflation remains a key issue, as does the length of the cycle of monetary tightening by the major central banks. Similarly, investors continue to be confronted with a range of uncertainties when trying to assess the likely strength of the economy in 2023. This inevitably leads to questions about corporate earnings growth for the coming 12 months.

As we leave behind a difficult year, it is tempting to get carried away on a wave of pessimism. However, we should not ignore certain more positive signs that have appeared over the course of the last few months. Some indicators appear to point to a turnaround as regards price rises, with the trend slowing, at least in the US.

We believe that this current move is likely to continue over the coming quarters, bringing inflation back to much lower levels by the end of 2023.

This should, at least partially, remove what was one of the main burdens for financial markets in 2022. This point is all the more important, since we anticipate an end to the process of monetary tightening in the US by the start of spring 2023, following on from confirmation of better inflation numbers.

Such a development would certainly have a favourable impact on bond markets, where we have significantly increased our weighting since summer 2022. In addition, it should support our scenario of a decline in the US dollar in the medium term. However, the extent of decline is likely to be limited. In other words, we are not anticipating a decline in the dollar so abrupt as to cause turbulence in the financial markets.

A weaker dollar should also bolster both our emerging equity and gold positions. Despite the erratic performance of these investments over the last 12 months, we have held onto our positions, in anticipation of more favourable behaviour in the coming quarters.

> "2023 will move towards a turnaround in the economic and financial cycle with the end of monetary tightening."
>
> **FRANÇOIS SAVARY,** CHIEF INVESTMENT OFFICER, PRIME PARTNERS

Whilst we are keen to highlight these more positive economic developments coming into play, this is not to diminish the challenges facing us, not least that of economic growth.

Indeed, it is bound to slow in the short term, following on from the hikes in key rates over recent quarters, the pressure on the real cost of capital that we are facing and/or given the clearly less favourable financial conditions.

For several months, our assessment of the economy has been based on the strong likelihood of a recession in 2023. The most recent data available is unlikely to change this assumption.

However, there are several important factors that make it difficult to categorise the type of recession that is coming. Firstly, there is the war in Ukraine, even if the resulting energy crisis has recently taken a positive turn; next, is China's decision to abandon its zero-Covid policy, which could result in a significant recovery in activity in the spring providing a boost for the global economy; lastly, there is the issue of whether the

decline in inflation mentioned above is sustainable, without which any hope of a modest recession will be in vain. In contrast, given the data at our disposal, it seems unreasonable to rule out the possibility of serious economic pain in the coming months.

As we previously stated, we have increased our bond holdings in recent months. Meanwhile, our equity exposure has been reduced to an underweight position, following the rally in October and November.

Our underexposure is in line with our expectations of downward pressure on corporate earnings, particularly during the coming two or three quarters. However, we are sticking to our scenario of a contained decline in earnings growth, in line with our economic scenario.

Whilst we believe that the strong pressure on valuations that took place in 2022 is drawing to a close, the earnings issue is clearly crucial to the stock market outlook for 2023. We do not consider our target of 4,050 for the S&P 500 index by year-end to be overly optimistic, particularly as our general scenario is that significant volatility will continue in the short term and we do not rule out a return to levels of around 3,600-3,550 during the current quarter.

In such an environment of high short-term risk and limited potential on a 12-month horizon, we are comfortable with a defensive position in risky assets for the start of 2023.

In conclusion, the start of this new year has not done anything to alter significantly the difficult climate prevailing in 2022. However, some recent developments seem to signal a reduction in uncertainty, which we cannot but welcome.

These developments are behind our decision to stick with our positive stance on gold, bonds and emerging assets. In addition, they support our cautious stance on the US currency.

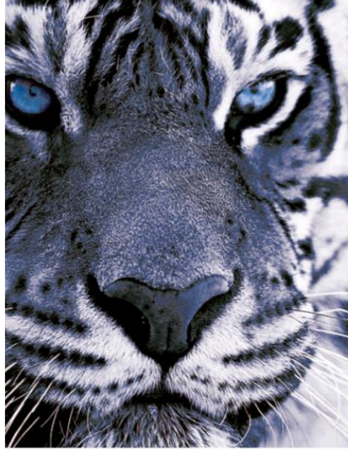
On the other hand, restricted visibility on the economy and earnings growth justifies maintaining a defensive approach to risky assets, at least in the short term.

2023 should be characterised by a turnaround in the economic and financial cycle, with the end to the process of monetary tightening playing an important role in this. This is highly likely to provide us with opportunities to adjust the direction of our investment policy, particularly as we are not convinced that bonds will remain attractive over the medium to long term.

For the time being, we maintain the same strategic orientation as at the end of 2022 whilst awaiting greater visibility on the major issues facing all investors.

Once again, we wish you a happy and prosperous year, and thank you for your renewed confidence during this highly challenging period.

Geneva, 8 January 2023



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