For professional investors and qualified investors only

COLUMBIA THREADNEEDLE INVESTMENTS

GLOBAL OUTLOOKS **2023**

# No more bad news **should be good news in 2023**

**William Davies**
Global Chief Investment Officer

After a dismal year for markets, William Davies gives his thoughts on risks and opportunities in the market as we head into 2023. While there is plenty to be cautious about, a repeat of 2022 seems unlikely

Going into 2022 the market repriced for bad news – and there was certainly no shortage of that. We have seen deteriorating US-China relations and associated tariffs and trade wars; the Covid pandemic and subsequent supply-chain problems; the Russian invasion of Ukraine and intensified pressure on energy resources; and the great resignation and a reduction in the participation rate of workers. In addition, we have seen stickier headline inflation and rising interest rates, expectations for a recession, and in the UK a period of intense volatility as the government and its policies see-sawed.

Issued December 2022

For 2023 we may see many of these macro conditions continue, but in the US in particular we don't necessarily expect these to result in an extended deep recession, and as long as things don't deteriorate significantly investors may begin to feel more optimistic and we might see market conditions improve. We believe the recession in Europe will be deeper than the US, but the unpredictability of the situation around Russia and Ukraine makes it difficult to factor this into a central case. In each instance, however, no more bad news could end up being good news for investors.

## A different story on inflation and interest rates

Headline inflation should come down in the US unless energy prices increase substantially. Core inflation is likely to be stickier, but stable or lower readings mean that the US Federal Reserve might pause interest rate rises in early 2023. We would not expect a looser monetary environment as rates come down, but with some stabilisation 2023 should be a different year.

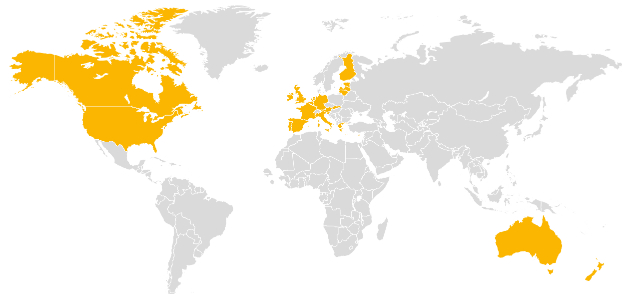
In terms of raising rates, in our view the European Central Bank (ECB) has more work to do than the Fed. The ECB only began to hike in July 2022, so although it is unlikely to raise rates as high as in the US it may have to do so for longer. However, there is a little less clarity on inflation in Europe given both the war and the reliance on imports in the region, particularly of energy. Whereas the US is considerably more self-sufficient, Europe has worked to build up energy inventories[1], but a particularly cold winter could see rationing and additional contribution to an economic slowdown.

[1] Reuters, Mission accomplished? Europe fills gas storage ahead of schedule, 4 October 2022

Interest rates in the UK, meanwhile, remain a little bit unpredictable following a change in government and a reversal in policy.

Overall, although I don't expect global rates to come down in 2023, an end to the guessing game about how high they go has the potential to be a positive catalyst (Figure 1).

**Figure 1: The majority of developed market central banks (in yellow) expect to reach terminal rate in 2023**



Source: Bloomberg, November 2022

## An end to the guessing game about how high interest rates go has the potential to be a positive catalyst

## A recession playbook with a twist

So, it seems inevitable that Europe will see recession, and in the US we will have to watch the Fed and assess how much economic pain it deems necessary to beat inflation. Although I don't think we will see a recession along the lines of 2020 or 2008, given the risks I believe focusing on quality will be essential for success – across asset classes and regions – because there are going to be companies that are able to survive a recession much better, and those that are going to be less well prepared.

In fixed income, credit quality is likely to be a much greater determinant of success in 2023 relative to 2022 when duration was the key driver. There are a lot of companies which built up strong balance sheets during the periods of low interest rates, but the almost indiscriminate fall in valuations has created pockets of opportunity in markets.

In equities it is a similar story with quality of earnings and balance sheets the likely requisites for success. Although we have seemingly emerged from Covid-19 in the west, we are not quite "normal" in terms of activity. We are, however, seeing more spending on services than goods, and areas of recovery that are different to those areas of strength we saw in 2020/21. Usually in a recession you would avoid economically sensitive sectors, and investors should be cautious, but this "return to normal" does create opportunities even with the prospect of recession.

In both equities and fixed income, however, you need a really thorough analysis capability to find the winners with strong balance sheets that can survive a recession, and we pride ourselves on that at Columbia Threadneedle.

We must also be aware that this is a different environment to the past few decades: low inflation goes back to the 1970s and 1980s, so we must be careful about extrapolating from those periods which companies and sectors will do well over the next few years. In a time of cheap money, weaker companies perhaps survived for longer than they would in an environment where money is more normally priced, and they are about to be tested in ways they haven't previously experienced.

**In fixed income, credit quality is likely to be a much greater determinant of success in 2023 relative to 2022**

The same focus on quality applies to relative opportunities across regions. Europe is cheaply valued compared to the US but is facing greater headwinds; emerging markets, dominated by China, are also relatively cheap but are experiencing uneasy geopolitical relationships and trade restrictions; while the US looks pretty reasonable in terms of valuations and is the broadest market. Again, research and analysis will be key in finding the right opportunities.

## Trials for the energy transition

Turning to renewables, the Russian invasion of Ukraine has created a dichotomous outcome in Europe. The increase in fossil fuel energy prices will accelerate the energy transition, with a desire to be self-sufficient paramount. However, the energy crisis has also seen the extended use of coal and nuclear plants that were scheduled to close[2]. So on the one hand we are taking a step back in terms of carbon reduction policies – out of necessity – but on the other we are seeing increased investment in renewable projects[3]. This also brings a sensitivity we must be aware of from an ESG (environmental, social and governance) point of view. This crisis has highlighted that if we reduce the supply of fossil fuels, it drives their price higher. Environmentally that may be good, with less energy being consumed because it is expensive. Socially, however, it is problematic because those that are less well-off spend a greater proportion of their income on energy. So we have a huge social negative for what environmentally is a positive.

I do believe, however, that rather than this reversing the opportunities in ESG because fossil fuel production keeps taking place, it will actually increase the opportunity for renewables because the increased investment should accelerate future growth.

## The Russian invasion of Ukraine has created a dichotomous outcome in Europe

[2] IEA, Global energy crisis, June 2022

[3] IEA, Record clean energy spending is set to help global energy investment grow by 8% in 2022, June 2022

Higher inflation and interest rates will remain part of the economic backdrop in 2023, **but stability on these measures should provide some support**

## Conclusion

It is difficult to recall a year in which news has been so sustainably negative as 2022. Looking forward and seeking to make a central case is challenging given the difficulty in calibrating the risk of escalation of the war in Ukraine and its impacts on Europe, or even regime change in Russia. Meanwhile, rising tensions between China and the US have introduced heightened risks for emerging markets and added caution. We believe higher inflation and interest rates will remain part of the economic backdrop in 2023, but stability on these measures should provide some support. The markets did not anticipate the Russian invasion as we entered 2022; it's possible a similar blind spot occurs heading in to 2023.

In our view we are well-placed to navigate this uncertainty. At Columbia Threadneedle we are globally connected with more than 650 investment professionals based in Europe, North America and Asia[4] sharing perspectives across all major asset classes and markets. We look to continuously improve our analysis and research, and our investment approach is underpinned by a culture that is dynamic and interactive, and by processes that are team-based, performance-driven and risk aware. This has allowed us to perform well over the long term, and as we head into 2023 we believe this will continue.

[4] As at September 2022

To find out more visit **columbiathreadneedle.com**

**Important Information**

**For use by professional clients and/or equivalent investor types in your jurisdiction (not to be used with or passed on to retail clients).** This is an advertising document. This document is intended for informational purposes only and should not be considered representative of any particular investment. This should not be considered an offer or solicitation to buy or sell any securities or other financial instruments, or to provide investment advice or services.

**Investing involves risk including the risk of loss of principal. Your capital is at risk.** Market risk may affect a single issuer, sector of the economy, industry or the market as a whole. The value of investments is not guaranteed, and therefore an investor may not get back the amount invested. International investing involves certain risks and volatility due to potential political, economic or currency fluctuations and different financial and accounting standards. Risks are enhanced for emerging market issuers.

**The securities included herein are for illustrative purposes only, subject to change and should not be construed as a recommendation to buy or sell. Securities discussed may or may not prove profitable.** The views expressed are as of the date given, may change as market or other conditions change and may differ from views expressed by other Columbia Threadneedle Investments (Columbia Threadneedle) associates or affiliates. Actual investments or investment decisions made by Columbia Threadneedle and its affiliates, whether for its own account or on behalf of clients, may not necessarily reflect the views expressed. This information is not intended to provide investment advice and does not take into consideration individual investor circumstances. Investment decisions should always be made based on an investor's specific financial needs, objectives, goals, time horizon and risk tolerance. Asset classes described may not be appropriate for all investors. **Past performance does not guarantee future results, and no forecast should be considered a guarantee either.**

Information and opinions provided by third parties have been obtained from sources believed to be reliable, but accuracy and completeness cannot be guaranteed. This is an advertising document. This document and its contents have not been reviewed by any regulatory authority.

**In Australia:** Issued by Threadneedle Investments Singapore (Pte.) Limited ["TIS"], ARBN 600 027 414. TIS is exempt from the requirement to hold an Australian financial services licence under the Corporations Act 2001 (Cth) and relies on Class Order 03/1102 in respect of the financial services it provides to wholesale clients in Australia. This document should only be distributed in Australia to "wholesale clients" as defined in Section 761G of the Corporations Act. TIS is regulated in Singapore (Registration number: 201101559W) by the Monetary Authority of Singapore under the Securities and Futures Act (Chapter 289), which differ from Australian laws.

**In Singapore:** Issued by Threadneedle Investments Singapore (Pte.) Limited, 3 Killiney Road, #07-07, Winsland House 1, Singapore 239519, which is regulated in Singapore by the Monetary Authority of Singapore under the Securities and Futures Act (Chapter 289). Registration number: 201101559W. This advertisement has not been reviewed by the Monetary Authority of Singapore.

**In Hong Kong:** Issued by Threadneedle Portfolio Services Hong Kong Limited 天利投資管理香港有限公司. Unit 3004, Two Exchange Square, 8 Connaught Place, Hong Kong, which is licensed by the Securities and Futures Commission ("SFC") to conduct Type 1 regulated activities (CE:AQA779). Registered in Hong Kong under the Companies Ordinance (Chapter 622), No. 1173058.

**In Japan:** Issued by Columbia Threadneedle Investments Japan Co., Ltd. Financial Instruments Business Operator, The Director-General of Kanto Local Finance Bureau (FIBO) No.3281, and a member of Japan Investment Advisers Association and Type II Financial Instruments Firms Association.

**In the USA:** Investment products offered through Columbia Management Investment Distributors, Inc., member FINRA. Advisory services provided by Columbia Management Investment Advisers, LLC.

**In the UK:** Issued by Threadneedle Asset Management Limited. Registered in England and Wales, Registered No. 573204, Cannon Place, 78 Cannon Street, London EC4N 6AG, United Kingdom. Authorised and regulated in the UK by the Financial Conduct Authority.

**In the EEA:** Issued by Threadneedle Management Luxembourg S.A. Registered with the Registre de Commerce et des Societes (Luxembourg), Registered No. B 110242, 44, rue de la Vallée, L-2661 Luxembourg, Grand Duchy of Luxembourg.

**In Switzerland:** Issued by Threadneedle Portfolio Services AG, Registered address: Claridenstrasse 41, 8002 Zurich, Switzerland.

**In the Middle East:** This document is distributed by Columbia Threadneedle Investments (ME) Limited, which is regulated by the Dubai Financial Services Authority (DFSA). For Distributors: This document is intended to provide distributors' with information about Group products and services and is not for further distribution. For Institutional Clients: The information in this document is not intended as financial advice and is only intended for persons with appropriate investment knowledge and who meet the regulatory criteria to be classified as a Professional Client or Market Counterparties and no other Person should act upon it.

**Columbia Threadneedle Investments is the global brand name of the Columbia and Threadneedle group of companies.** Valid from 12.22 | Valid to 6.23 | 5195778 | WF274657