



# Outlook for 2023

Worse macro, better markets

## Core Offerings

Our latest view of markets and insights  
into our latest strategic and tactical  
asset allocation positions

December 2022 / January 2023



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# Outlook for 2023

## Worse macro, better markets

AN UPDATE FROM LGT CRESTONE'S CHIEF INVESTMENT OFFICER



Scott Haslem  
Chief Investment Officer

"Bear markets reveal bad investments made during bull markets..."

"...bull markets reveal good investments made during bear markets."

Author unknown

"Again, if we over-tighten—and we don't want to—but if we over-tighten, then we have the ability with our tools, which are powerful, to—as we showed at the beginning of the pandemic episode—...support economic activity strongly if that happens..."

Fed Chair Jerome Powell,  
November 2022

Change and volatility have dominated the macro environment in 2022. But despite the prospect of a material slowing in global growth and elevated inflation and interest rates, 2023 has the potential to reveal a more stable market backdrop. Much of the painful valuation adjustment journey across bonds and equities will reside in 2022. We continue to favour allocations to income opportunities and alternative investments. For equities, we are staying focused on quality, favouring defensive sectors and some non-US regions. Further disinflation and earnings adjustments could lead us to upweight equities during H1 2023.

### 2022's regime change delivered a difficult year for economies and markets

Looking back, 2022 has proved to be a year of significant volatility and change in the economic landscape. Central banks were found to be well behind the curve in withdrawing their uber-low interest rate stimulus which, in tandem with an unanticipated (and now prolonged) Russia/Ukraine war, unleashed a significant uplift in demand- and supply-led inflation in just about every corner of the globe. Multi-decade high inflation led central banks to embark on the most aggressive tightening of policy since the early 1980s. This portends, with the usual lags of policy, a material slowing in world growth in 2023. But that demand destruction will ultimately see inflation slow and interest rates peak too.

This 'regime change' was also reflected in a difficult year for financial markets and portfolio returns. The rapid rise in interest rates underpinned a sharp reassessment of valuations, with listed equities and fixed income returns, domestically and offshore, experiencing double-digit declines in the first half of the year (and with little progress thereafter). Indeed, for the US, it now seems highly likely that 2022 will only be the third year since 1926 (the others being 1931 and 1969) that equity and bond returns have both been negative. Alternative assets have been one of the few, if only, places to shelter. Thankfully also, there have never been two consecutive years where US bond and stock returns were negative.

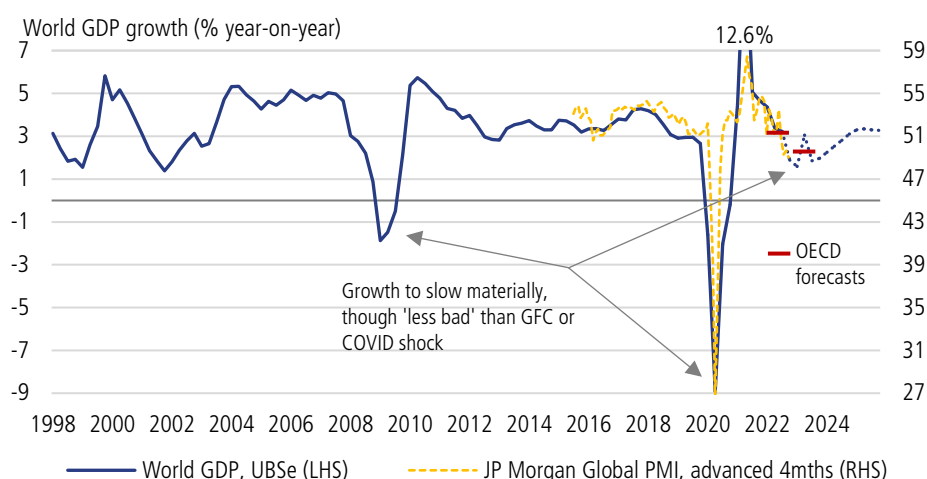
### Macro to get worse in 2023, but peak rates and easing inflation come into view

There is little doubt that published measures of growth will deteriorate significantly as we traverse H1 2023. Financial conditions have tightened sharply, consumers' excess saving balances will dwindle in the face of rising energy and debt servicing costs (despite support from rising wage growth), business' capex plans will wane, and unemployment will rise.

Yet, as 2022 draws to a close, developments in recent weeks have challenged the view that the task of reversing inflation without a deep global recession is insurmountable:

- **Inflation pressures are peaking**—US inflation has peaked, easing from 9.1% in June to 7.7% in October, while upstream producer prices confirm this downtrend should continue in H1 2023. Moreover, while supply-chain pressures have eased in H2 2022, there is now clearer evidence weaker demand is weighing on services prices as well. Still high inflation in Europe, the UK, and Australia should also peak around year-end.

### Global growth outlook—A material slowing in growth lies ahead in 2023

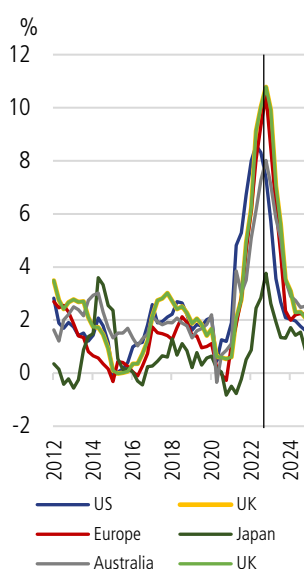


Source: LGT Crestone, UBS, FactSet.

"2022 witnessed remarkable synchronicity of monetary policy rate hikes...We expect central bank policy rate paths to start to diverge over the coming quarters, with some ending, or at least pausing, tightening, while others march on for some time yet."

Société Générale,  
November 2022

Global inflation to moderate through 2023



Source: UBS.

Much of the painful valuation adjustment journey across bonds and equities will reside in 2022...

...we continue to favour allocations to income and alternatives, while further earnings adjustments could lead us to upweight equities during H1 2023.

- **Central banks will pause hiking in or around Q1 2023**—Interest rates globally have already risen sharply in 2022. The well understood lags between hikes and slowing growth argue that central banks should pause to assess the impact. Over the past few months, the US Federal Reserve (Fed) has joined other central banks in Europe, Canada, and Australia to indicate that this is likely. The recent peaking of US inflation suggests this is probable. In early February, we expect the Fed, now at 4.0%, to signal a pause at around 5%, and the Reserve Bank of Australia (RBA), now at 2.85%, to signal a pause at 3.35%. European and UK central banks will likely pause during Q2. We don't expect policy to be eased before late 2023, as inflation (while falling) proves sticky.
- **China has signalled moderately easier COVID and property policy**—In November, China eased and refined its COVID restrictions, while also easing policy around the property sector to provide credit support. Recent outbreaks add near-term uncertainty, but the direction of policy remains clear. This should aid further easing of supply-chain pressures, while supporting growth in Europe, Asia, and Australia during 2023.

Forecasts by both UBS and the Organization for Economic Development (OECD) suggest the world economy will slow to about 2% growth in 2023 (from 3.2% in 2022), before UBS sees a modest pick-up to 2.7% in 2024 (see chart on previous page). This suggests the world will be in a mild recession, or thereabouts, over the coming year (albeit without the loss of activity evident in the GFC or pandemic).

However, there will be more macro divergence than in the recent past. We expect the US economy to slow to around 'flat' growth in mid-2023, but narrowly avoid recession. Less positively, the UK is likely already in a recession, and Europe will be in one by the end of its winter. More positively, Asia and Australia will slow to 'half speed' but avoid recession this cycle (see pages 9-12 for more detail). Strength in the US dollar is expected to fade through 2023, as the Fed peaks, a better 2024 global growth outlook comes into view, and energy prices ease. The Australian dollar is seen pushing through USD0.70.

### Three out of four signals suggest a more constructive outlook for 2023 and 2024

We have maintained a relatively defensive portfolio position through 2022, closing our overweight to equities in January, and moving progressively more in favour of fixed income through the year as central banks lifted interest rates. Outcomes for 2023 will largely be conditioned by the pace at which inflation peaks and central banks pause, so as to minimise the future impact on economic growth, unemployment, and earnings.

With growth slowing, and elevated inflation and interest rates, it remains a challenging near-term backdrop for equities. However, we should be wary of extrapolating the lagged impacts of 2022's policy tightening (the valuation adjustment) onto market outcomes for 2023, since a significant correction has already played out during 2022. We believe a significant amount of the macro journey of rising rates is now in the past. However, more earnings adjustment (to be in line with the macro) still lies ahead. It will be key to assess if and when sufficient adjustment has occurred to warrant a positive inflection during 2023.

**For equities**, three of our four signals for becoming more constructive have recently turned from amber to 'green'. While price/earnings (P/E) valuations have returned to 'fair', earnings still appear too high relative to the macro outlook and long-term trend. This suggests near-term caution for now. However, as discussed in the equities outlook (below) further adjustment in earnings in the coming reporting season could see equities more confidently trough through Q1 2023 ahead of a modest recovery during H2 2023.

**For fixed income**, history suggests bond yields peak one to four months before the peak in the US Fed rate. As we expect this to be during Q1 2023, this supports our recently more positive outlook on both bonds and credit.

**For alternatives**, hedge funds, real assets, and private debt remain well positioned to provide near-term defence. In private markets, as with public equities, company earning adjustments, combined with the further potential for lagged revaluations due to higher interest rates, will be important to monitor.

### Four key signals for turning more constructive risk – still waiting on equity earnings

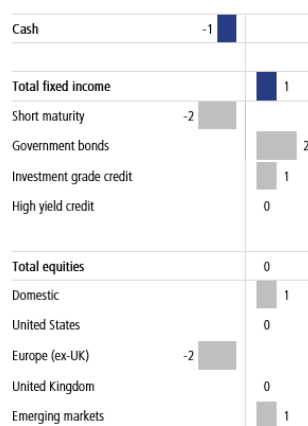
	Jul	Aug	Sep	Oct	Nov	Now
Inflation shows clear signs of trending lower	Negative	Negative	Neutral	Neutral	Neutral	Positive
Central banks reveal less hawkish tone	Negative	Negative	Negative	Neutral	Positive	Positive
China property shows signs of stabilisation	Negative	Negative	Negative	Neutral	Neutral	Positive
Equity earnings adjust to align with macro	Negative	Negative	Negative	Negative	Neutral	Neutral

■ Negative
 ■ Neutral
 ■ Positive

Source: LGT Crestone.



## Tactical asset allocations (% weights)



Source: LGT Crestone Wealth Management. Units refer to the percentage point deviation from strategic asset allocations. Investment grade credit includes Australian listed hybrid securities.

Portfolios should benefit from adding some duration in H1 2023 by allocating to fixed rate assets. This is before the RBA is expected to slow the increase in interest rates or lower rates later in 2023.

"US 10-year Treasury yields typically peak within a 0–4-month window of the last Fed rate hike for the cycle, which could be as early as now or as late as the end of March 2023."

BCA Research November 2022

## Tactical asset allocation—Position for a peak in rates

In this month's 2023 outlook, we have made some tactical asset allocation changes to position for the year ahead. See page 18 for more detail:

- **We have reduced cash** from +2 to -1 to reflect an improving investment outlook, and a more favourable view toward fixed income returns for the year ahead.
- **We add to credit.** We have maintained our current +2 overweight to government bonds but add to both investment grade (from 0 to +1) and high yield (from -2 to 0) credit. While we expect a default cycle and pressure on spreads to widen, we see investors as now adequately compensated through elevated yields.
- **We maintain our neutral equities position.** However, given a likely peak in the US dollar, valuations now appear compelling in emerging markets. Reflecting this, we trim our overweight to Australia (+2 to +1), reallocating to emerging markets (0 to +1).

While we remain defensively positioned at the start of 2023, staying overweight fixed income relative to equities, we have now put some additional cash to work in credit to recognise an imminent peak in policy tightening. Should inflation continue to moderate, and equity earnings rebase, we will look to reallocate toward equities through H1 2023.

The key headwinds to a more constructive outlook on equities remains renewed concerns about the inflation and rates outlook, as well as a broadening of geo-political risks, that point to an ongoing adjustment lower in the equity earnings outlook through 2023.

## Fixed income—We expect positive returns in 2023

**Duration risk has largely been removed:** For most of 2022, we witnessed bond yields rise and credit spreads widen to incorporate the aggressive hiking cycle from global central banks in response to rising inflation. Most fixed income asset classes, which had a level of duration at the start of the year, would have shown negative returns due to the speed of central bank rate hikes, aimed at curbing inflation. For 2023, we are expecting a much better environment for investors seeking returns from this defensive asset class.

**Bond yields should rally as central banks pause:** Our base case scenario is that markets have all but priced in the future rate rises expected in Q1 2023. Economic data is showing that demand is weakening, a likely precursor to reduced corporate pricing power over the coming year. With signs that inflation has peaked, we believe central banks will continue to tighten, but at a much slower pace. And we anticipate the Fed will signal a pause in Q1 2023. As growth slows in Australia and the US, we expect to see some fall in bond yields and short-term money market rates in 2023, particularly at the front end of the curve (between one and five years). We also expect some negative moves in the UK and Europe.

**Fixed income should provide return and income in 2023:** Given interest rates are now much higher than during quantitative easing, we believe the risk-return to the asset class has been restored. While we expect volatility to continue into 2023, especially in global equities, fixed income should provide a level of return and income for investors. Our preference is for portfolios to increase duration over 2023 via high-grade government bonds and investment grade credit. Investors should be highly selective within high yield credit, despite the attractive yields, as the cycle is likely to see an increase in defaults to more normalised levels and higher refinancing costs to weaker rated corporates.

**Domestically,** the banks will continue to issue senior unsecured notes for their wholesale funding requirements and the repayment of AUD 188 billion they borrowed from the RBA via the Term Funding Facility. The major banks will also need to continue to issue subordinated Tier II bonds, which will keep spreads elevated in this sector, but will likely return over 7.00% for the year as we expect interest rates to come down and the yield and credit curve to steepen once again. We expect a lower pipeline of Additional Tier I hybrid supply in 2023. However, with hybrid issues pricing tighter in the Australian market versus offshore and relative to subordinated Tier II, we may see some issuers taking advantage of the tighter spreads and consider further hybrid issuance in 2023.

## Equities—Macro was the topic de jour for 2022...in 2023, it will all be about earnings

**Global markets to re-base lower before possibly having a stronger H2 2023:** The lagged impacts of almost 500 basis points (bps) of rate increases are yet to be reflected in corporate earnings. The MSCI World index is trading at a 12-month forward P/E of 15.7x. Although this is well off the 21x it traded at in the early part of 2021, it is worth noting that

We have turned more constructive on emerging market equities. With US dollar strength likely closer to a peak than a trough, the risk-reward trade-off looks more attractive from a macro perspective for emerging markets than it has looked for some time.

Within private markets, history tells us that vintage years following periods such as the one we are currently working through, tend to be some of the best performing, and we have already seen meaningful declines in valuations.

this level is only one point from the prior decade peak. Furthermore, the competitiveness of fixed income as an asset class is likely to remain a headwind for equity flows, since we believe interest rates are likely to be structurally higher relative to the past decade.

**Equity markets are yet to reflect a material macro slowdown:** To date, this year's fall in equity markets appears to have been largely driven by a fundamental revaluation due to sharply higher interest rates. Despite this, markets have not yet become 'cheap' in an historical context, and appear unprepared for major earnings disappointments. This leaves considerable downside risk in place near term, ahead of some further adjustment in earnings in the months ahead.

**Significant price adjustment already in the past, but stay cautious:** Despite our near-term caution, we are cognisant that once equity markets fall 25%, forward-looking returns (i.e., greater than one year) are typically positive. In light of this, the view as we enter 2023 can be best characterised as positioning cautiously (for now) but thinking constructively.

**Regionally, Australia is a relative outperformer:** Australia's corporate earnings will likely be relatively resilient. The bottom-up consensus outlook is for 2% earnings-per-share (EPS) growth for the S&P/ASX 200 in both the 12 months to June 2023 and June 2024. Anaemic growth rates like this are consistent with a 'soft landing' for corporate profits, likely supported by a 'less bad' macro backdrop. Combined with a 4.5% dividend yield (the second highest in developed markets), a modicum of EPS momentum and less upside pressure on discount rates should mean domestic equities post positive gains in 2023.

**We have moved overweight emerging market equities:** Emerging markets were one of the worst performing markets in 2022. We turn more constructive. Equity managers are very underweight and at 11.3x P/E multiples, valuations are screening less onerous than other parts of the world. China is making tentative steps towards a more pragmatic approach to COVID-zero, and there has been greater policy support for its beleaguered economy. Recent outbreaks add uncertainty, but the more positive direction of policy is clear. With the US dollar likely closer to a peak than a trough, the risk-reward looks more attractive from a macro perspective for emerging markets than it has looked for some time.

#### **Alternatives—Real assets remain preferred, while volatility will support hedge funds**

2022 proved a strong testing ground for alternative assets and while we expect this test to continue through 2023, the return outlook arguably looks more attractive, given a meaningful recalibration in broad valuations and long-term interest rate expectations.

**Heightened volatility should continue to provide a ripe hunting ground for diversified hedge fund programs** and offer strong risk-adjusted returns into 2023. At a strategy level, we expect discretionary macro strategies to continue their renaissance, given ongoing geopolitical uncertainty. Idiosyncratic credit-orientated strategies could excel, given current and ongoing dislocations in credit markets. We still caution against high-beta, equity-orientated strategies, but market neutral may benefit from more focus on earnings in the year ahead.

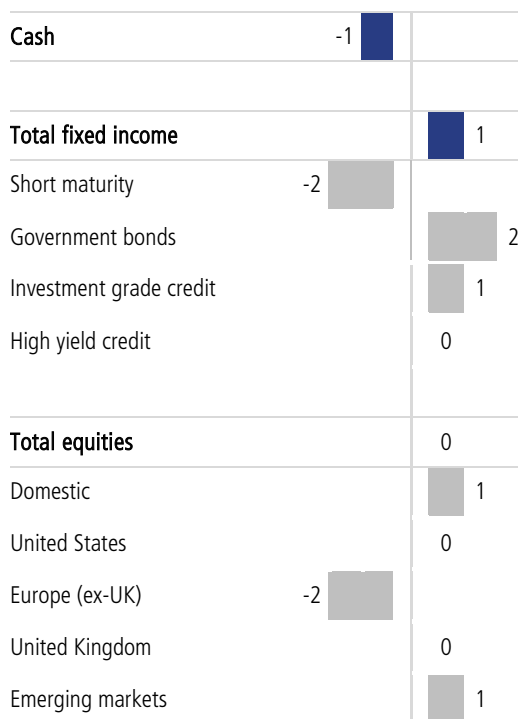
**Further valuation impacts are likely still to be felt within private markets,** so we are not deploying heavily into fully-invested strategies at this juncture. However, history tells us that vintage years following periods such as the one we are currently working through, tend to be some of the best performing, and we have already seen meaningful declines in valuations. We are, therefore, encouraging deployment into new primary and secondary opportunities across both private equity and venture capital through 2023.

**Higher quality property and infrastructure have fared particularly well in 2022 and we expect this to continue through 2023.** Many of these assets have embedded inflation linkages and/or are able to increase net operating income, which can and has played a significant role in offsetting the impact of rising interest rates on valuations. We continue to focus on more defensive assets to act as a further portfolio ballast to public and private equity positions. However, we anticipate that the time for more opportunistic investments in the space may not be too far away.

**The transition to a net-zero economy as a long-term structural investment theme only continues to grow in relevance for portfolios.** Gaining exposure through private markets and/or real assets presents a significant growth opportunity, while also diversifying risk away from industries and assets that may fail to adapt and thus threaten portfolio returns.

# What's driving our views

## Tactical asset allocations (% weights)



Source: LGT Crestone Wealth Management. Units refer to the percentage point deviation from strategic asset allocations. Investment grade credit includes Australian listed hybrid securities.

## Policy tightening expectations are ebbing

It appears that both inflation and growth are slowing more clearly now as the impact of recent interest rate increases by central banks take effect. We remain cautious about how central banks will react through to end-2022 and are of the belief that the peak in market interest rates globally will be around Q1 2023.

**Focus on diversification**—As always, it is important to maintain portfolio diversification, avoiding over-exposure to individual markets, sectors and other specific return drivers. We are not making significant tactical bets.

**Rising interest rates**—After two years of near-zero interest rates, most key central banks are expected to continue to hike rates this year. How the interest rate outlook evolves into 2023 will be key to market performance.

**Slowing growth**—Risks around inflation, policy normalisation and geo-politics have seen odds of a global recession rise. While we expect growth to slow significantly in H2 2022, possibly to below trend we continue to believe a broad global recession can still be avoided in the year ahead.

**Avoid timing the market**—Sharp market swings proved challenging in 2020 and 2021 but demonstrate the importance of staying invested rather than trying to time markets. We expect current volatility to moderate into 2023 as inflation recedes and central banks pause their policy tightening.

## Structural thematic

**Decarbonisation**—An ongoing push towards sustainability means decarbonisation will continue to be a focus for corporations, governments, and investors, and a key opportunity (and risk) for markets.

**Sustainable investing**—As the world becomes more connected, it is also becoming more socially aware. The intersection of finance and sustainability will govern a reallocation of capital.

**The future of finance**—Decentralised finance will allow users to interact as peers using algorithms rather than through traditional intermediaries, such as banks, brokerages and insurance companies.

**Rising inequality**—Income and wealth inequality have very significant implications for government redistributions (and taxation), central bank policy settings, economic growth and investments.

	What we like	What we don't like
Equities	<ul style="list-style-type: none"> <li>Companies with pricing power and resilient revenues</li> <li>Later-cycle defensive exposures in the consumer staples, telco and utilities sectors</li> <li>Domestic exposures, where valuation risk is more benign and market composition (banks, materials and healthcare) supportive</li> </ul>	<ul style="list-style-type: none"> <li>Sub-market EPS growth companies, which are vulnerable to valuation headwinds</li> <li>Unprofitable, long-duration stocks, where cashflow valuations are vulnerable to rising real yields</li> <li>Continental Europe, where inflationary pressures suggest significant earnings headwinds</li> </ul>
Fixed income	<ul style="list-style-type: none"> <li>Green bonds and ESG-oriented strategies</li> <li>Fixed rate three-five year senior unsecured banks</li> <li>Fixed rate Australian bank subordinated tier II</li> </ul>	<ul style="list-style-type: none"> <li>Short maturity bonds with a preference for more duration in portfolios</li> </ul>
Alternatives	<ul style="list-style-type: none"> <li>Multi-strategy, credit-oriented and discretionary macro hedge funds</li> <li>Domestic private debt and asset-backed securities</li> <li>High-grade, core-plus commercial real estate and infrastructure</li> <li>Private market and real assets exposed to the global energy transition</li> </ul>	<ul style="list-style-type: none"> <li>Carbon-intensive assets and industries with no transition plan</li> <li>Pre-IPO strategies</li> <li>Passive private market and/or real asset strategies</li> <li>Construction and/or junior lending within real estate</li> </ul>

## **Economic and asset class outlook**



# Economic outlook

## Global economy



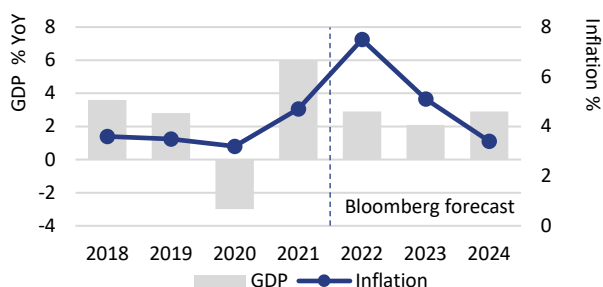
The global economy appears destined for a material slowing in growth in 2023, as a post-pandemic rebound in activity strains under the lagged impacts of rapidly rising central bank rates and sharply higher interest rates. Debate about the extent of any recession in 2023 is likely to be overtaken by an increasing focus on renewed regional divergence. Europe and the UK are increasingly likely to be in recession by early 2023, the US economy is likely to slow sharply into mid-2023 but skirt recession, while Asia and Australia look likely to be relatively resilient, slowing to around half speed in 2023. In contrast, China's recent positive announcements around relaxed COVID and property policies should help growth rebound moderately.

Key to the outlook remains the path of inflation. Despite the impact of the Russian/Ukraine war on energy prices, there is little to rebut the notion that inflation will follow historic trends, retracing lower as policymakers lift rates, consumer spending slows, and recently widened profit margins are forced to contract. In the US, recent data strongly suggest a significant period of disinflation has begun. While still double-digit in Europe and the UK, and still rising in Australia, inflation should also begin moderating in these regions early in 2023.

Together with the recently less hawkish tone from key central banks, as they acknowledge both the lags of policy and risks of over-tightening, the peak in inflation should increase the likelihood that the central banks will cease policy tightening by end-Q1, or shortly thereafter. This should pave the way for a modest recovery in growth through 2024. Peaking US rates, and easing fears of a deep global recession, are likely to reverse some of the US dollar's recent strength. Nonetheless, other risks still cloud the outlook and threaten volatility. These include concerns of a wage-price spiral globally (given tight jobs markets), elevated gas prices in Europe forcing output cuts, while the war in Ukraine remains unresolved. For now, a clear stabilisation in China's property sector remains elusive.

The OECD cut its 2023 growth forecast from 2.8% to 2.2%—a near-recessionary outlook after a likely 3.0% in 2022. UBS expects a similar pace of 2.1% (was 2.5%), rising to 2.7% in 2024. CBA has cut its (recessionary) outlook further from 2.2% to 1.6% for 2023 (before rising to 2.6% in 2024).

### Global GDP growth and inflation



Source: Bloomberg as at November 2022.

## Australia



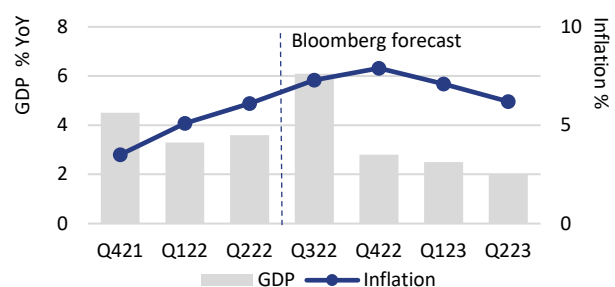
The Australian economy has retained significant momentum in H2 2022, with only tentative signs that growth will slow in the period ahead. The lagged impacts of the rapid increases in the policy rate are forecast to weigh heavily on housing and consumer spending in early 2023, as interest servicing costs escalate. Still, the tempering in the pace of rate hikes toward year-end has added to confidence that while growth is likely to slow materially in 2023, Australia can avoid recession, and will likely outperform growth in other developed economies.

Growth rose by a strong 0.9% in Q2, faster than Q1's 0.7% pace, lifting annual growth from 3.3% to 3.6%. The latest data for Q3, due for release in early December, suggest growth held up during the quarter. Despite renewed weakness in consumer confidence (down 25% year-to-date), retail sales rose by a further 0.6% in September, rising 2.5% over the past three months. According to NAB, business "conditions remained strong in October with demand still elevated and profitability holding up". After several months of a tightening labour market, jobs growth has been flat over four months, albeit unemployment edged lower to 3.4% in October.

Inflation rose a stronger-than-expected 7.3% in Q3 (from 6.1%), its fastest pace since 1990. New monthly data surprised lower, signalling inflation has moderated to 6.9% in October, against expectations Q4 inflation will move higher to an 8% pace. By end-2023, consensus expects a moderation to around 4%. The RBA lifted the cash rate by 0.25% in November to 2.85%, despite some concern of a 0.50% move. The RBA reiterated that it is "committed to returning inflation to the 2–3% range over time" though Deputy Governor Bullock said the "bank wants to hang on to as much of the employment gains made during the pandemic as it can, even as it tries to cool the economy to tame inflation". CBA forecast a terminal (end-2022) rate forecast of 3.1%, while UBS now expects a further final hike to 3.35% in February 2023.

Growth is expected to be around 4% in 2022 (following the strong 4.9% rebound post-pandemic). UBS expects Australia to avoid a recession in 2023, with the lagged impacts of the increase in rates slowing growth to 1.8% in 2023, while CBA forecasts a sharper slowing to 1.3%.

### Australian GDP growth and inflation



Source: Bloomberg as at November 2022.

# Economic outlook

## United States



US data continue to reveal a moderation in the underlying pace of activity during H2 2022. The ongoing and rapid increase in interest rates is now weighing heavily on housing activity, while trends in consumer spending and industrial output have slowed in recent months. A sharper pull-back in growth is likely over the coming year, with the US economy either in or near recession by mid-2023. Household spending is slowing as excess consumer saving balances decline (and credit card balances rise). While any recession is likely to be mild, the lagged impact of rising rates should see unemployment lift in H1 2023, in turn pressuring inflation lower during H2 2023.

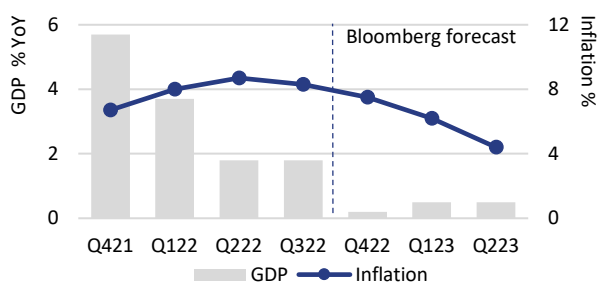
The speculated 'red wave' in the November US mid-term elections failed to materialise, with the Republicans narrowly taking control of the House. The Biden-led Democrats appear on track to maintain control of the Senate. According to PIMCO, the "Democrats had the best midterm of any party in power since 2002". Former President Trump announced his intention to run for President in the 2024 elections.

In Q3, US growth rebounded by 0.6% (2.6% annualised) after a 1% annualised fall in H1 2022. Q4 growth also appears on track to print solidly. However, the US composite purchasing managers leading index (PMI) fell sharply to 46.3 from 48.2 in November, further into contractionary territory (below 50). The jobs market remains tight, though unemployment rose to 3.7% from 3.5% in October. After a flat result in September, retail sales rebounded strongly in October, albeit elevated inflation is likely masking weaker real spending.

US inflation surprised weaker in October, easing from 8.2% to 7.7%. A moderation in key sectors (medical care, rent and used car prices) has increased expectations for further falls. In November, the Fed hiked 0.75%, taking the policy rate to 4.0%. Fed minutes revealed widespread support for slowing the pace of rate hikes "soon". A 0.50% hike is expected in December, followed by 0.25% in February, to 4.75%.

After a post-pandemic rebound of 5.9% in 2021 and growth of around 2% in 2022, UBS expects a further sharp slowing in growth to just 0.2% in 2023. Like UBS, JPMorgan expects a mild recession in 2023, albeit with higher growth of 1.0%.

### US GDP growth and inflation



Source: Bloomberg as at November 2022.

## Europe



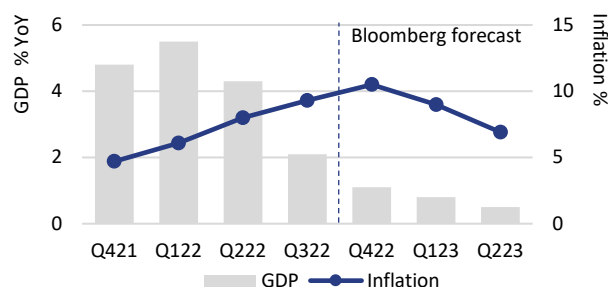
As Europe emerges from a likely brutal winter in early 2023, with elevated energy prices and falling industrial output, the economy is expected to be in a moderate recession. A relatively unimpressive recovery is likely through H2 2023, as the energy crisis continues to weigh. However, as UBS notes, "should rationing of gas occur, the shocks to industrial production, labour markets and broader confidence" would likely lead to another year of negative growth. Fiscal policy has shifted into a new phase of support, working to lower the peak in energy prices. However, with headline inflation only peaking in Q4 2022, policy interest rates may rise through to mid-2023. Rising government debt has also now become a market focus.

Activity in 2022 to date has continued to prove resilient. Q3 growth beat expectations again, up 0.2%, and led by a stronger-than-expected German economy. Annual growth still halved from 4.3% to 2.1%. Retail sales for September also beat forecasts, rising by 0.4%, albeit annual growth is still negative at 0.6%. The latest PMI data for November beat expectations, rising from 47.3 to 47.8, albeit still in contractionary territory. The jobs market remains tight, with unemployment at a record low of 6.6% in September.

Inflation printed at a new record high of 10.6% in October. Once again, the rise reflected higher energy (42%) and food (13%) inflation. In the absence of an inflation peak, the European Central Bank (ECB) hiked its key deposit rate by 0.75% to 1.5% in late October. However, unexpectedly, the meeting delivered a less hawkish tone, with ECB President Lagarde noting, in line with the post-meeting statement, that the ECB has made "substantial progress" in withdrawing policy accommodation. A further 0.5% hike is expected in December, taking the policy rate to 2.0% by year-end. UBS expects two further hikes to 2.75% by mid-2023.

After a post-pandemic rebound of 5.3% in 2021 and growth of a little above 3% in 2022, UBS expects a further sharp slowing in growth to just 0.2% in 2023, a moderate recession. Société Générale (SG) expects higher growth of 1.1% in 2023. Still, most forecasts suggest risks remain tilted to the downside due to developments in the Ukraine/Russia war or production cuts and job losses due to elevated energy prices.

### European GDP growth and inflation



Source: Bloomberg as at November 2022.

# Economic outlook

## United Kingdom



Recent data confirm the UK economy is now contracting in H2 2022, as elevated energy costs, rising inflation, and tighter monetary policy weigh on domestic activity. After months of political turmoil, the UK's new leaders have renewed efforts to re-tighten fiscal policy. With the housing sector also bearing the brunt of higher interest rates, growth is expected to remain weak through H1 2023, albeit somewhat supported by a still tight jobs market before a slow recovery later in 2023.

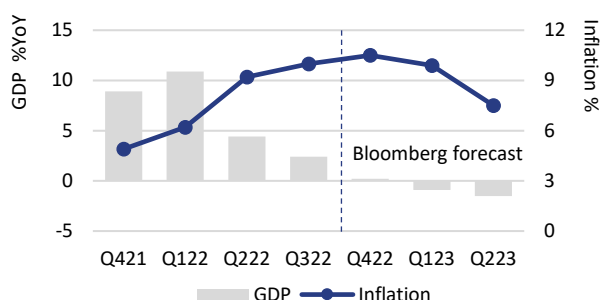
At November's Autumn Statement, new Prime Minister Sunak and his new Chancellor (Treasurer) Jeremy Hunt renewed the tightening of fiscal policy (by about 2.4% of output by 2027). This reflects a combination of spending cuts and tax increases (although near-term energy cost relief was increased).

Growth in Q3 fell by 0.2%, halving the annual pace to 2.4% from 4.4%. Domestic activity deteriorated, led by weaker consumption and business capex, with the statistics agency suggesting lower goods inventories reflected a lack of raw materials. The UK's PMI was little changed in November at 48.3 (below the key 50 mark) and retail sales in September fell 1.4% (after August's 1.7% drop) to be about 7% below year-ago levels. November's jobs report showed ongoing tightness, with unemployment up slightly to 3.6%, still near its lowest since 1974, and wages growth was little changed at 6%.

Price pressures in the UK remain intense, with inflation rising to 11.1% in October. The Bank of England (BoE) hiked rates by 0.75% to 3.0% in October, the largest rise since 1989. As noted by UBS, the BoE reiterated that "further increases may be required" and it stands ready to respond "forcefully" to more persistent inflationary pressures. But dovishly, it pushed back against market expectations, saying the peak would likely be lower than was priced by the market. UBS now sees downside risks to its forecast, which includes another 0.75% hike in December, and further smaller hikes in March and February, taking the peak to 4.5% by end-Q1 2023.

Growth is expected to be around 4% in 2022 (following the strong 7.5% rebound post-pandemic), even with a H2 2022 contraction. For 2023, UBS expects growth to fall by 0.5%. SG also expects a significant slowing to -0.9% for 2023.

### UK GDP growth and inflation



Source: Bloomberg as at November 2022.

## Japan



In contrast to other key advanced economies, Japan looks on track to deliver steady, if not somewhat modest, growth over the next couple of years. The eventual (stop-start) re-opening of the domestic economy following the pandemic, as well as the opening of international borders, a weak currency, and high consumer savings, are all likely to support modest growth. This is despite the likely negative impact on exports and the manufacturing sector from a sharply weaker global economy, which will also likely dent capex.

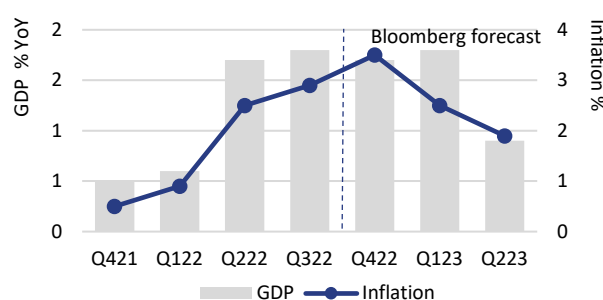
In early November, the Government further eased fiscal policy. While headline announcements look large, in the order of 7% of output, most expect the actual impact to be significantly smaller, consistent with supplementary budgets in the past.

Growth unexpectedly contracted 0.3% in Q3, the first fall since late 2021 (leading annual growth to edge higher to 1.8% in the latest quarter). While consumption proved slower than expected, a sharp rise in imports contributed significantly to the contraction, with demand in the economy proving relatively resilient in Q3. Growth is expected to rebound solidly in Q4, albeit Japan's PMI leading indicator unexpectedly eased to 48.9 in November from 51.8. Retail sales recovered further in September, up 1.1%, its third consecutive increase to be 4.5% higher than a year ago. Wage growth remains subdued at 1.3%,—given rising costs-of-living, this presents a constraint on the future pace of consumption.

Expectations for inflation have recently lifted, driven by the rapidly weakening Japanese yen. However, the peak is expected to be around 3%, well below other economies, and will likely moderate from early 2023 as import prices begin correcting lower. The Bank of Japan (BoJ) remained on hold at its October policy meeting. UBS expects the BoJ to remain on hold until at least the end of 2023, in the absence of wage or political pressures to do otherwise. A stronger global economy in 2024 should be a catalyst for the BoJ to lift rates.

Growth has been relatively steady around a 1.5% pace in 2021 and 2022. UBS expects a moderately slower pace of growth of 1.1% in 2023. SG expects a stronger pace of 1.4% in 2023.

### Japanese GDP growth and inflation



Source: Bloomberg as at November 2022.

# Economic outlook

## China



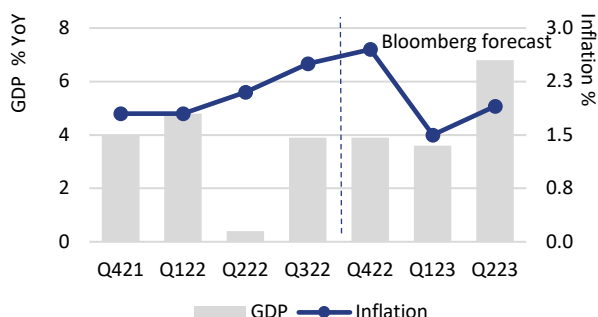
After a moderate rebound in Q3, China's economy should continue to recover through 2023, as COVID restrictions ease and the impact of the property downturn dissipates. Weak consumption should pick up from early 2023 when COVID restrictions are expected to ease. China's government has recently made two significant positive announcements. Firstly, it has eased and refined COVID restrictions; secondly, it has eased policy around the property sector to provide credit support. Even with these modest adjustments, growth is likely to remain relatively contained, as global export demand and manufacturing capex slow, while a stabilising property sector requires less momentum in infrastructure.

Output in China rebounded in Q3, rising from 0.4% to a stronger-than-expected 3.9% pace. However, October's data revealed renewed weakening in the wake of another COVID surge (repeated in November, and likely to damage Q4 activity). October retail sales weakened (-0.5% from 2.5%), industrial production slowed (5.0% after 6.3%), while investment picking turned slower (5.0% after 6.5%). Property activities reversed last month's improvement (with sales easing to -23% from -16%), while export growth slumped (-0.4% after 5.7%). Property prices also continued to fall in October.

Credit growth slowed more than expected in October, easing from 10.6% to 10.3%, led by less lending to households. The Government is expected to provide further moderate credit expansion into year-end, while some further easing of property restrictions should help growth to stabilise around current levels. Positively, inflation cooled to 2.1% from 2.8% as upstream prices eased, particularly for food. This should not present a headwind to any further modest easing.

After 8.1% in 2021, China's growth is expected to have slowed to around 3% in 2022. In contrast to much of the advanced complex, where growth is expected to slow in 2023, UBS expects China's pace of growth to accelerate moderately to 4.5% in 2023. SG recently cut its 2023 forecast from 5.7% to 4.8%, broadly in line with UBS's forecast. Key growth risks relate to COVID restrictions not being removed in early 2023, which could see growth weaken further, closer to 2%.

Chinese GDP growth and inflation



Source: Bloomberg as at November 2022.

## Emerging markets

After slowing sharply into mid-2022, emerging markets growth is expected to rebound in H2 2022, led largely by Asia. The emerging market region, however, will continue to face headwinds from a slowing global economy through 2023, particularly North Asia's export-orientated economies. Inflation has started to broaden beyond just food and energy, albeit remaining low compared to advanced economies. Easing price pressures should see policy rates peak by mid-2023.

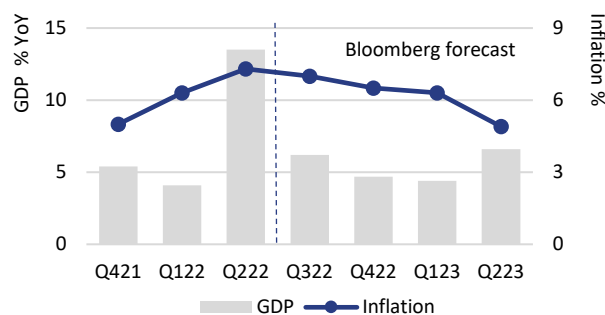
In Southeast Asia, the impact of a slowing global economy is expected to weigh, with growth seen slowing across most economies by around 1% (including Malaysia, Philippines and Indonesia). Inflation has recently been broadening, suggesting further hikes in early 2023, before disinflation becomes more evident in H2 2023. According to SG, "given India's low share in global exports, the impact of the global growth slowdown on output is unlikely to be of any great magnitude, especially as net trade responds less than proportionately [given] imports also slow as commodity prices drop." UBS expects growth to remain solid at 5.5% in 2023, down from a likely 7% in 2022.

In North Asia, the impact of slowing export demand will weigh even more significantly, with Taiwan and South Korea likely to slow from around 3% to 1-2%. In Q3, South Korea's growth edged stronger to 3.1% from 2.9%, led by solid consumer spending, and Taiwan's growth picked up to 4.1% from 3.1%, as strong consumer spending offset weaker capex.

For Latin America, the key headwind will be the slowing global economy, impacting external demand for exports. UBS forecasts growth to slow from around 3% this year to 1.1% in 2023. Disinflation should also see a reversal of some central bank tightening. In Brazil, Luiz Inácio Lula da Silva's (Lula) won a narrow presidential victory. After 3.2% in Q2, growth is now showing clear signs of slowing over recent months, while Brazil's central bank has hinted rates have peaked at 13.75%.

After 7.3% in 2021, UBS sees emerging market growth slowing to 3.8% in 2022. Growth is expected to slow modestly further in 2023 to 3.5% (albeit this masks a pick-up for non-China emerging markets). Growth in emerging Europe is expected to be flat at 0.3% in 2023, easing from 2% in 2022.

India GDP growth and inflation



Source: Bloomberg as at November 2022.

# Asset class outlook

## Short maturity and government bonds

Position: Underweight short maturity, overweight government bonds

### Key points

- We expect central banks to continue to tighten monetary policy into early Q1 2023—but at a slower pace.
- Global bond yields have priced in hawkish tones from central banks, and recent comments signal a pause.
- We expect rate volatility to remain elevated in Q4 2022, but bond yields to fall in Q1 2023.

**Short maturity**—Economic data show consumer confidence and house prices falling in the US, indicating that the recent rapid pace of monetary policy tightening may be starting to reduce demand-led inflation pressures. In response to hawkish tones from central banks to curb this inflation, bond yields and short-term money market rates have all but priced in imminent global rate increases. However, with signs that inflation has peaked, we believe that central banks will continue to tighten but at a much slower pace and expect the Fed funds rate to peak during Q1 2023.

The Fed responded to high inflation numbers by raising rates a further 75bps in October to 3.75-4.00%, and further rate rises are implied by short-term money markets (to a peak of 4.75% in Q1 2023). The RBA has increased rates on six occasions, most recently lifting the cash rate by only 25bps to 2.85% in November. We expect the RBA will continue to increase the cash rate to around 3.35% by Q1 2023. The three-year government bond yield peaked at 3.75% before falling to its current rate of 3.25%.

With early signs inflation may have peaked (e.g., lower commodity prices and easing supply chains) and a greater concern of a global recession led by higher interest rates, we believe markets have now mostly priced in the terminal overnight global cash rates. We are underweight short maturity, which aims to hedge against rising interest rates. High grade and investment grade bond yields now offer a good fixed-rate return. We recommend investors look to implement some duration in portfolios by ensuring a more balanced position between fixed rate and floating rate notes.

**Government bonds**—Our base case is that bond yields are likely to fall over the next six to 12 months as growth decelerates because of tighter financial conditions, higher energy costs, and general uncertainty. The 10-year Treasury yield, now around 3.70%, is already pricing in multiple further moves by the Fed, and fears are growing of an imminent recession, which is characteristically seen in the inversion of the yield curve. Given the balance of risks between high inflation and slowing growth, we believe the asset class presents an attractive asymmetric return prospect. The recent rise in bond yields should offer another opportunity to re-enter this market. Above-target inflation numbers are likely to reverse and drop quickly enough for central banks to take out insurance against a recession, predicting lower energy prices, a weaker labour market, and ultimately lower cash rates. High grade bonds are our most preferred sector.

## Investment grade and high yield credit

Position: Overweight investment grade and neutral high yield credit

### Key points

- Domestic subordinated tier II debt is our most preferred segment within investment grade credit.
- We believe investment grade credit spreads are peaking in line with government bonds.
- We prefer investment grade credit over high yield. High yield spreads are expected to remain elevated and could widen as growth slows and interest servicing costs rise.

**Investment grade credit**—With rising bond yields and equity volatility, US investment grade bond spreads have been vulnerable to higher long-end interest rate moves. Domestically, with the three-month Bank Bill Swap index (BBSW) now around 3.00% and a steeper swap curve at the front end, we recommend investing in fixed rate assets around the three to five-year part of the curve. Senior unsecured bank spreads have remained elevated at around BBSW+120bps, offering a yield to maturity of 5.00% for five years. There have been several new subordinated financial tier II issues, namely from ANZ, CBA and NAB. With historically wide spreads and higher rates, this sector has seen a high level of demand and is currently offering a yield to call of around 6.50%.

Spreads in the hybrid market have been remarkably stable this year, with an average trading margin of BBSW +300bps for major banks that have a first call date greater than five years. CBA and Bank of Queensland have both successfully refinanced maturing capital notes this month with significant demand and heavy investor scaling. On a risk-adjusted basis, we see more value higher up the capital structure in subordinated tier II, where spreads are around BBSW +250bps, yielding 6.50% for five-year fixed rate debt.

**High yield credit**—The culmination of higher rates has led to a sharp rise in high yield spreads (and corresponding fall in bond prices), as high yield bonds are typically fixed rate instruments. We remain cautious about the high yield market and expect a widening of spreads over coming months. This is consistent with less supportive liquidity conditions, an increase in defaults to a more normalised level, and high yield spreads coming under further pressure from likely interest rate rises.

Tactically, before we become more positive on the broader high yield market, we need to see further evidence that inflation is coming under control, which will provide confirmation that central banks do not need to hike as aggressively as anticipated and recession can be avoided.

Yields for US and European high yield debt of around 10% provide a level of protection against falling prices. With a large part of the investment universe now trading at a discount to par, this means there are select opportunities available for investors. Our preference is to be higher up the credit quality curve in investment grade credit.



# Asset class outlook

## Domestic equities

Position: Overweight

### Key points

- Domestic equities rose 6.1% in November, the best back-to-back monthly performance since the pandemic. The S&P/ASX 200 is now down less than 5% from its all-time highs.
- Over the past several months, every sector in the S&P/ASX 200 has advanced higher, although there has been a clear cyclical bias. Materials, financials, and energy have led, while telcos, healthcare and staples have lagged.
- A fall in bond yields from their 4.25% peak to 3.5% has clearly alleviated some of the valuation pressure, especially for rate-sensitive sectors, like real estate.

UBS believes foreign investor apathy towards Australia is set to dissipate, as offshore investors recognise that domestic equities have many of the characteristics required to stand out over the next decade. Near term, Australian strength is a product of the commodity inflation complex and a resilient consumer. Over the coming decade, UBS believes domestic equities hold significant relative appeal due to:

**Australia's population growth**—This has been among the fastest in the world and is expected to continue. In the decade preceding the COVID shock, population growth in Australia averaged +1.5% per annum, which is double the rate of most other advanced economies (even outpacing India).

**Industry structure**—Australia's concentrated industry structure supports high profit margins.

**Dividend yields**—Australian company dividend yields are almost double the global average. The secular shift to a lower growth path over the next decade increases the relevance of income in wealth creation strategies. Australia is an 'income champion', which has allowed total returns from domestic equities to far outpace global and regional equities (9.2% per annum since 1990 versus 7.0% per annum from global equities and 6.6% per annum from Asia Pacific ex-Japan).

**Detachment from the global economic cycle**—The income statements of Australian industrial stocks have proved to be less correlated to oscillations in the global economic cycle. This has been the case for both sales and earnings.

Although there is some uncertainty regarding the February reporting season, over a longer time frame, heading into the H2 2023, the possibility of earnings upgrades should emerge. This would not be through top-line revenue growth, given growth will be slowing, but through margins, which would depend on an easing of input costs (energy, transport, and materials), improving supply chains (something we are already witnessing), the return of immigration (now happening), and Australian dollar appreciation.

## International equities

Position: Underweight Europe, neutral US and UK and overweight emerging markets

### Key points

- Global equity markets have put together their best back-to-back monthly performance since the pandemic, with the MSCI World index rising 4.5% on the back of last month's 7% increase.
- The S&P 500 index, at 17.2x 12-month forward P/E is in the top decile of valuation multiples of the 10-year period prior to COVID.
- This makes the argument for higher P/E markets more difficult and largely rests on the resilience of corporate earnings in the face of lower aggregate demand.

While downbeat sentiment/positioning, easing mobility restrictions in China, and a potential near-term peak in bond yields are positives for equities, downside risks are meaningful and centre primarily around monetary policy (and the impact on earnings outlooks). The Fed has opened the door to a slowing pace of hikes, which is seen as a positive, and the market is prepared to price in cuts before hikes have finished.

A Fed pivot is a material event for US assets, but arguably it is more positive for fixed Income than it is for stocks. With UBS economists forecasting a US recession for Q2 to Q4 2023, the set-up for 2023 is essentially a race between easing inflation and financial conditions (which would be positive) versus a hit to growth and earnings (which is likely negative). History shows that growth and earnings continue to deteriorate into market troughs before financial conditions ease materially (i.e. markets bottom before earnings do).

UBS sees the S&P 500 index at 3,200 (around 15% lower) in Q2 on 14.5x forward EPS of \$220 as a reasonable trough. This is assuming further cuts to estimates are in line with a pre-recession pace. UBS is targeting 3,900 for the S&P 500 at the end of 2023 (which would signal flat returns) based on an EPS of \$215 in 2024. This is in line with trend levels, and a fair value forward P/E of 18x, which assumes a US 10-year yield of 2.65% (from current levels of 3.75%). It has set a target of 4,400 (up 15% from current levels) for end 2024 based on 10% EPS growth and a slightly higher P/E as yields fall more.

The Eurozone remains in the shadow of geo-politics as 2023 gets underway and earnings are key. The extent to which foreign currency weakness can insulate the domestic demand shock from here now seems limited. With revenues and margins under greater pressure, UBS believes the Euro Stoxx index is likely to do worse than the US, bottoming in Q2 at 330 and ending 2023 at 385 (currently 432).

Investor bearishness towards China is very significant, and a structural growth down trend, along with elevated geo-political uncertainty, are significant headwinds. Positively, there is likely to be a re-opening trade that continues into 2023, and investors have welcomed signs from the government of greater support for the property sector.

# Asset class outlook

## Currencies

### Key points

- Inflation concerns, increasing fears of a global recession, and persistent US dollar strength remain the focus points for currency markets.
- The US dollar is likely to sustain its current strength near term as the global growth outlook weakens.

The USD index strengthened significantly in H2 2022 from 102 in June to 114 at its peak in October, driven by broad risk aversion and a deteriorating global outlook. The index retraced towards 106 in November, as signs of price deflation began to emerge, and Fed officials signalled that they may moderate the rate of future hikes. That said, exactly how the Fed's pivot plays out is yet to be seen and will be the key driver of US dollar sentiment in the year ahead. At this stage, the pace of the slowdown in hikes, the level of the terminal rate reached, and the duration at which the Fed chooses to hold at this level before transitioning to a cutting cycle will all be determined by incoming economic data. The risk of that data deteriorating into early 2023 has been on the rise and, given the counter-cyclical nature of the US dollar, we expect it to benefit from safe-haven flows near term. Looking ahead, US dollar sentiment may turn once the Fed signals a pause in hikes, which the market has currently priced for H1 2023.

The Australian dollar weakened significantly in H2 2022, mostly on sustained US dollar strength. It has since rebounded 5% in November as the US dollar weakened but is expected to remain under pressure as the world economy slows and as China's uncertain COVID-19 policies cloud the outlook. Recent developments in China, including a refinement of the rules around COVID-zero controls on one hand and the re-imposition of restrictions on people's movement and activity in several large districts on the other, have meant that it is difficult to determine exactly when we will see a meaningful relaxation in China's COVID-zero policy. Another growing headwind is the two-year interest rate differential between the US and Australia, after the RBA recently stepped down the pace of rate hikes to 25bps, while the Fed remains on a more aggressive path. For end-2023 CBA is now targeting USD 0.67. UBS has the Australian dollar staging a stronger comeback through 2023, forecasting USD 0.78 for end-2023.

After falling to a 20-year low in September, the euro enjoyed an 8% rally above USD 1.03 in November. The Eurozone continues to face the headwinds of surging energy prices and the Ukraine war, which are clouding the region's economic outlook and jeopardising its energy security. Interest rate differentials also continue to pose a headwind for the euro after the ECB flagged a more gradual approach to lifting rates. Forecasts point to a period of weakness ahead with CBA targeting USD 1.01 for end-2023, while UBS targets a stronger rebound in the euro to USD 1.20.

## Commodities

### Key points

- Increasing concerns about a global economic recession and risks around China's COVID policy have been clouding the demand outlook for commodities.
- A softer US dollar and a relaxation of China's COVID zero policy should support commodity prices from Q2 2023.

Iron ore rebounded back above USD 90 per tonne (p/t) in November—however, prices remain around 40% below the peak reached in March 2022. China remains the key driver, where the rise in COVID cases, alongside the first deaths from the virus since May, have raised concerns that a tightening of restrictions may weigh on the economic outlook and steel demand. Still, policymakers have reaffirmed their commitment to stimulating infrastructure spending to restore economic growth. Demand is, therefore, likely to rebound once lockdowns and restrictions become less impactful. However, the risk is that authorities will continue to pursue a COVID-zero policy, depressing China's property sector and demand for commodities. Longer term, the over-arching trends of recovering supply, as well as the decarbonisation of the steel sector (particularly China's efforts to control its carbon emissions), are expected to limit price upside. CBA has recently downgraded its forecasts to reflect ongoing property risks, and now sees prices remaining around USD 90 p/t into end-2022, fading to USD 85p/t in Q1 2023.

Oil prices weakened in November and are now down more than 30% since early June, having erased all gains made after Russia's late-February invasion of Ukraine. Oil markets are set to face turbulence in the months ahead. On the demand side, the stronger US dollar and rising concerns over a potential global recession, as well as China's uncertain COVID policy, have weighed on oil since mid-year and threaten to keep applying downward pressure to prices. Meanwhile, OPEC+ agreed to cut its production quota by 2 million barrels (bbl) per day (around 2% of global supply), and the Eurozone's sanctions on Russian oil supply are set to come into effect in December, which will add upward pressure to prices. UBS has recently lifted its Brent oil price forecasts for end-2022 and end-2023 to USD 81/bbl and USD 80/bbl respectively, on expectations that supply disruptions linked to European sanctions can outweigh a weaker global growth outlook.

Base metal prices lifted in November as sentiment turned more optimistic after China policymakers signalled a less restrictive COVID-zero policy. However, over the near term, the complex is likely to face continued headwinds of further tightening in monetary policy, a near-recessionary 2023 growth outlook, a strong US dollar, and an ongoing war in Ukraine. Longer-term, de-carbonisation trends are bullish for most metal and mineral demand profiles as the world transitions away from fossil fuels. Nickel, copper, aluminium and lithium graphite all face significant under-supply, which should support prices over the longer term.

## Asset allocation views

# Strategic asset allocation views

## Why do we believe in strategic asset allocation?

We believe that the central component of successful long-term performance is a well-constructed strategic asset allocation. Empirical evidence suggests that a disciplined strategic asset allocation (SAA) is responsible for around 80% of overall investment performance over the long term<sup>1</sup>. Diversification plays a critical role within SAA. By diversifying your portfolio among assets that have dissimilar return behaviour, lower overall portfolio risk can be achieved, and your portfolio can be better insulated during major market downswings.

## Why do we advocate SAAs to our clients?

We believe that SAAs encourage a disciplined approach to investment decision-making and help to remove emotion from these decisions. A thoughtfully designed SAA provides a long-term policy anchor for clients. Over the long term, we believe clients are best served by identifying the risk they can bear, then adjusting their return expectations accordingly. Return expectations may be anchored unrealistically. However, risk tolerance tends to remain more consistent throughout the cycle.

## Why strategic asset allocation?

Strategic asset allocation is an important part of portfolio construction as it structures your portfolio at the asset class level to match your specific objectives and risk tolerance.

Furthermore, history has shown that a disciplined strategic asset allocation is responsible for around 80% of overall investment performance over the long term.

## Strategic asset allocations in models

	Yield (%)	Balanced (%)	Growth (%)	Endowment (%)
<b>Cash</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>
<b>Fixed income</b>	<b>53</b>	<b>35</b>	<b>17</b>	<b>14</b>
Short maturity	8	6	3	3
Government bonds	32	15	7	5
Investment grade credit	11	11	4	4
High yield credit	2	3	3	2
<b>Equities</b>	<b>24</b>	<b>42</b>	<b>60</b>	<b>38</b>
Domestic	12	19	28	11
United States	6	11	16	13
Europe (ex-UK)	3	4	5	4
United Kingdom	2	3	4	3
Emerging markets	1	5	7	7
<b>Alternatives</b>	<b>20</b>	<b>20</b>	<b>20</b>	<b>45</b>
Hedge funds	6	6	5	14
Private markets	7	7	9	17
Real assets	7	7	6	14

Source: LGT Crestone Wealth Management. Investment grade credit includes Australian listed hybrid securities.

<sup>1</sup> Ibbotson, Roger G., and Paul D. Kaplan. 2000. Does Asset Allocation Policy Explain 40, 90, or 100 Percent of Performance? Financial Analysts Journal, vol. 56, no. 1 (January/February).

# Active portfolio weights and tactical asset allocation views

## Our current tactical asset allocation views

Near-term risk factors remain elevated, though we are starting to see signs that inflation is tempering, and that policy is supporting China's property sector. Corporate earnings remain a risk and there remains some risk that equity markets reset lower into early 2023.

Within equities, we remain neutral, but have reallocated some of our risk from Australia (still overweight) to emerging markets (now overweight). We have moved overweight fixed income, reflecting an increase in yields and its relative value versus cash (now underweight). We acknowledge that risks remain, but at current yields, investors are being reasonably compensated for these risks, particularly within investment grade and high yield credit where we have increased our exposure. The next three to six months will be important. If we see a sharp change in economic and market conditions, we will likely increase our exposure to risk assets, including equities.

### Cash

We have moved to underweight cash, reflecting the stronger risk adjusted income opportunities in fixed income.

### Fixed income

At the asset class level, we have moved overweight fixed income. Within the asset class we remain underweight short maturity and overweight to government bonds and have moved overweight investment grade and neutral high yield, where yields have risen.

### Alternatives

We favour increasing allocations to hedge funds and real assets, with deployed private equity least preferred.







## Why tactical asset allocation?

Tactical asset allocations have a six to 12-month investment horizon and are reviewed monthly. They can be considered an interim strategy where the aim is to provide a smoother investment journey without altering the end goal.

### Equities

We are cautious equities overall, with a preference to better-valued non-US markets. We are underweight Europe ex-UK (on a weak earnings outlook) and have moved to a less overweight position in Australia. While we are positive Australia, this shift captures some of the market's relative outperformance and funds our move overweight emerging markets. Emerging markets, given stronger growth (and a peaking US dollar), have an opportunity to outperform in 2023. Relative to history, they have stronger balance sheets and stronger domestic spending, so are less reliant on developed markets.

## Active portfolio weights and active tactical asset allocation tilts

	Active tilt	Yield (%)	Balanced (%)	Growth (%)	Endowment (%)
<b>Cash</b>	-1 	2	2	2	2
<b>Fixed income</b>	1 	54	36	18	15
Short maturity	-2	6	4	1	1
Government bonds	2	34	17	9	7
Investment grade credit	1 	12	12	5	5
High yield credit	0 	2	3	3	2
<b>Equities</b>	0	24	42	60	38
Domestic	1 	13	20	29	12
United States	0	6	11	16	13
Europe (ex-UK)	-2	1	2	3	2
United Kingdom	0	2	3	4	3
Emerging markets	1 	2	6	8	8
<b>Alternatives</b>	0	20	20	20	45

 Decreased weight this month       Increased weight this month

Source: LGT Crestone Wealth Management. Investment grade credit includes Australian listed hybrid securities.



# Our view on fixed income

## Short maturity

**We are underweight short maturity.** We now favour a more balanced position in duration-related bonds and credit securities, as aggressive monetary policies from central banks have sufficiently repriced bond yields. Market pricing for easier monetary policy through next year could also see short-dated floating rate returns underperform in the period ahead.

## Government bonds

**We are overweight government bonds.** With expectations for significant central bank rate hikes over the next three months largely priced into markets (both domestically and offshore), and yields rising, we remain overweight government bonds. Although it is difficult to forecast the absolute peak, government bonds have largely incorporated an aggressive rate hiking cycle (which we expect to peak around Q1 2023).

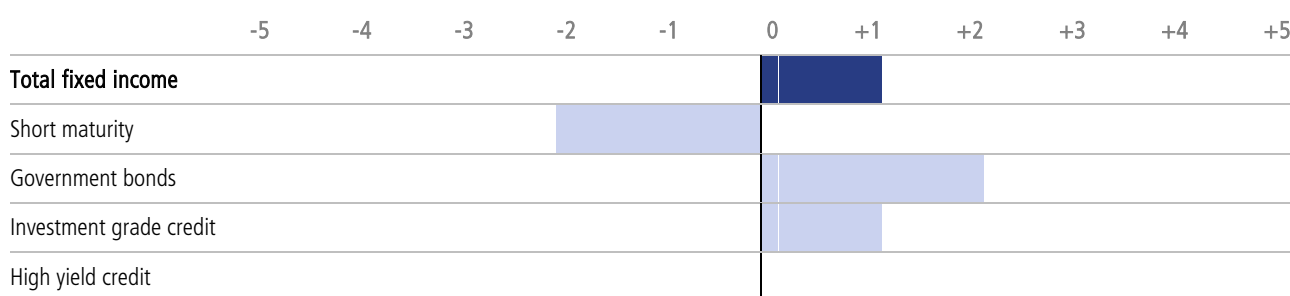
## Investment grade credit

**We are overweight investment grade credit.** Investment grade credit spreads have moved closer to fair value, and we have now moved overweight. We are comforted by higher outright yields, and helped by a wider swap curve, they now provide a reasonable cushion to any further spread widening.

## High yield credit

**We are neutral high yield credit.** This month, we have closed our underweight position to high yield credit, but still prefer investment grade credit relative to high yield. We believe high yield credit spreads have not widened sufficiently enough to compensate for a liquidity premium and for a potential acceleration in defaults as an expected material slowing in the global economy unfolds. The risk of a recession in 2023 also suggests a selective positioning toward high-yield credit.

## Active fixed income weights (%)—We have moved overweight fixed income relative to equities



## Fixed income market summary

Fixed income indices	Current	One month ago
Australian iTraxx	90.79	136.81
Australian 3-year yield	3.24%	3.28%
Australian 10-year yield	3.63%	3.74%
Australian 3/10-year spread	38.0 bps	44.0 bps
Australian/US 10-year spread	-11.3 bps	-28.1 bps
US 10-year Bond	3.74%	4.01%
German 10-year Bund	1.92%	2.10%
UK 10-year Gilt	3.10%	3.48%
Markit CDX North America Investment-Grade Index	81.0 bps	87.5 bps
Markit iTraxx Europe Main Index	91.0	112.1
Markit iTraxx Europe Crossover Index	459.0	547.6
SPX Volatility Index (VIX)	21.9	25.8

Source: LGT Crestone Wealth Management, Bloomberg as at 29 November 2022. Pricing based on UBS Global Research. Active fixed income weights sourced from LGT Crestone Wealth Management. Units refer to the percentage point deviation from strategic asset allocation.

# Our view on equities

## Domestic equities

**We are overweight domestic equities.** In a relative sense, Australia remains a preferred regional allocation. Although the S&P/ASX 200 index has outperformed other regions year-to-date, its 14x P/E ratio is still sufficiently attractive versus the 15.5x pre-COVID five-year average.

## US equities

**We are neutral US equities.** Earnings expectations are beginning to fall, a pre-requisite to becoming more positive on the US market over the long term. However, UBS believes it is premature to expect a dovish pivot from the Fed, with Q4 earnings in early Q1 2023 likely to be the focus for earnings correction. Additionally, EPS expectations for calendar year 2023 have likely not fallen enough. They are now at \$235 per share for 2023 versus \$249 in July (-5.6%).

## European (ex-UK) equities

**We are underweight European (ex-UK) equities.** Despite remaining resilient so far, the outlook for European corporate earnings is deteriorating as weakening consumer sentiment is compounded by higher interest rates. Much of the recent strength in European equities can be attributed to warmer

weather (and thus lower energy prices), which is a difficult basis on which to justify a more positive view.

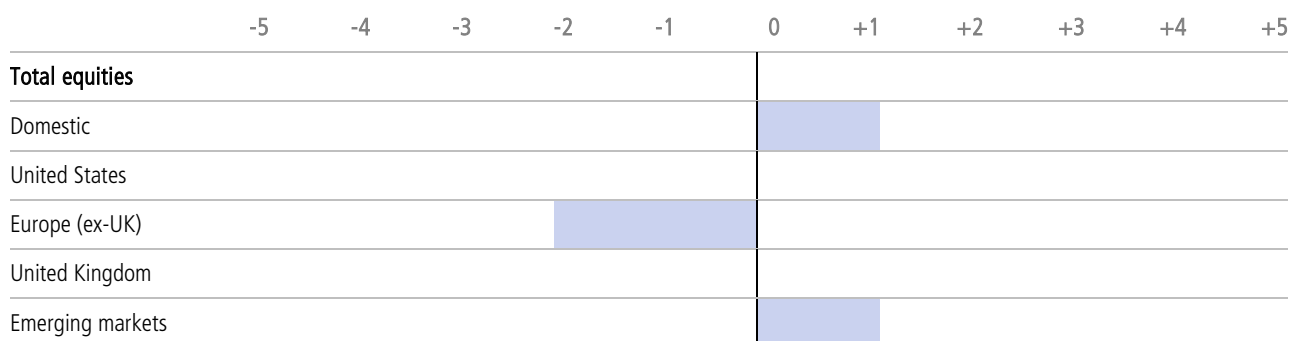
## United Kingdom equities

**We are neutral UK equities.** Resolving the UK's political turmoil with a balanced hand should be welcome for local business (even as the economy enters recession). However, the real key to the FTSE 100 has little to do with domestic segments of the market. The index's unique composition skews toward two groups (key cyclicals, energy and financials, and global defensives, such as healthcare and consumer staples) that should fundamentally benefit from today's economic and secular dynamics of elevated commodity prices, rising interest rates and a depressed currency. There is little direct exposure to domestic problems and valuations are historically low, even if partially due to structural factors.

## Emerging market equities

**We move overweight emerging market equities.** Earnings gains in China and India may stand out next year in a world where growth is shaping up to be a scarce commodity. Consensus expects both markets to post double-digit 2023 EPS growth, which can extend across the region and into broader emerging markets.

## Active equity weights (%)—We are overweight domestic equities and emerging markets



## Equity market summary

Region	Index	Latest price	Consensus 1 yr		Next year P/E <sup>1</sup>	Next year D/Y <sup>2</sup>
			Target	Upside		
Australia	S&P ASX 200	7,253.3	7,577.7	4.5%	14.4	4.34%
New Zealand	S&P NZ 50	11,395.4	12,615.5	10.7%	22.5	3.32%
United States	S&P 500	3,957.6	4,502.2	13.8%	16.9	1.67%
Europe	Euro Stoxx	422.2	499.4	18.3%	11.8	3.44%
United Kingdom	FTSE 100	7,512.0	8,818.5	17.4%	9.8	3.97%
China	CSI 300	3,149.7	3,804.9	20.8%	10.1	2.85%
Japan	Nikkei 225	28,027.8	32,374.0	15.5%	15.4	2.15%
India	Sensex	62,681.8	69,476.5	10.8%	22.7	1.32%

Source: Bloomberg. Data as at 29 November 2022; 1 P/E = Price to earnings ratio; 2 D/Y = Dividend yield. Active equity weights sourced from LGT Crestone Wealth Management. Units refer to the percentage point deviation from strategic asset allocation.

# Our view on alternatives

## Hedge funds

**Low beta hedge fund strategies are preferred, but credit is now also looking attractive.** Market volatility continues to provide a ripe hunting ground for hedge funds, where mis-pricing has created opportunities across asset classes for skilled managers. Heightened macro-economic and geo-political uncertainty is also presenting attractive opportunities for discretionary macro strategies, while idiosyncratic credit strategies should provide increasingly attractive risk-adjusted return opportunities in 2023. We are, therefore, focusing on satellite exposures in those areas, alongside diversified multi-strategy solutions that can take advantage of the wider investment universe.

## Private markets

**This year's re-calibration should present an attractive deployment opportunity for private equity and venture coming into 2023.** While private equity is least preferred on a relative risk-adjusted basis when compared to other alternative asset classes, we believe 2023 will be an attractive year in which to deploy new capital. 2022 has served as a re-calibration with regards to private market valuations, particularly within the venture sector. As such, entry valuations are now starting to re-adjust, while secondary (fund) market activity is beginning to pick up. When partnering with the right private markets platform, the latter is a compelling option for private clients. In summary, we recommend maintaining exposures to private equity and venture capital. However, investors should consider new primary and secondary fund commitment structures through early 2023, rather than growing exposures in evergreen strategies where they are already fully invested.

**Private debt looks increasingly attractive as yields reset higher on the back of interest rate increases.** If investors do not compromise on credit quality and cater for increased debt servicing costs, private debt should be attractive due to wider spreads, credit protections relative to public market equivalents, and their floating rate structures. We prefer direct lending versus broadly syndicated strategies, as loan terms can be negotiated directly, offering greater protection to the end investor. We also prefer corporate and sponsor-backed transactions relative to real estate lending strategies that are often heavily focussed on construction. Increased input costs arising from supply-chain disruption are further impacting builders and their contractors, alongside rising rates.

## Real assets

**We favour core-plus, high-quality real estate.** Real estate continues to be one of our favoured asset classes within alternatives, but we see a meaningful dichotomy across different assets, sectors, and investment approaches. We prefer high-grade commercial assets where there is some ability to add value through up-leasing, repositioning, or marking rents to market, for example. When in the right assets, these initiatives can and have been able to offset and exceed valuation declines, resulting from interest rate increases. We also like high-quality, overseas, multi-family accommodation. This can benefit during periods of higher inflation, as shorter lease terms allow rents to mark to market more often.

**Investors should seek to build infrastructure exposure.** Infrastructure has been notably absent from private client portfolios in the past, yet can provide more defensively positioned core assets on long-term, typically inflation-linked contracts. This can provide both a defensive ballast and inflation protection. With most COVID-19 related travel restrictions likely behind us, volume-based transport-related assets, such as airports, and contracted assets should play a key role in diversified portfolios. Further, we see attractive investment opportunities focussed on energy transition. According to Brookfield Asset Management, the next 30 years will require in excess of USD 100 trillion of investment, presenting an unprecedented commercial opportunity.

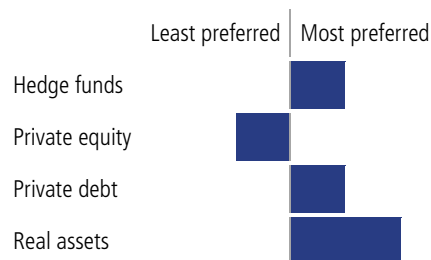
**Our most preferred and least preferred exposures—We continue to favour core real assets and private debt, while maintaining private equity and low-beta hedge funds exposures**

### What we like

- Multi-strategy, credit-oriented and discretionary macro hedge funds
- Domestic private debt and asset-backed securities (excluding real estate)
- High-grade, core-plus commercial real estate and infrastructure
- Private market and real assets exposed to the global energy transition

### What we don't like

- Passive private market and/or real asset strategies
- Pre-IPO strategies
- Construction and/or junior lending within real estate
- Carbon-intensive assets and industries with no transition plan



## **Direct equity opportunities**

# Recommendations: Domestic equities—Best sector ideas

## Objective of this list

The objective is to identify the best business models or best in breed by GICs Industry Group for longer-term investors. While we also overlay valuation, companies are included based on anticipated three to five-year performance. When analysing companies to add to the list, some metrics we consider are:

- **Profitability measures**—Return on net operating assets, return on invested capital, free cashflow and return on equity
- **Liquidity and leverage**—Net debt to equity, Altman Z-score, net debt to earnings before interest, tax, depreciation and amortisation (EBITDA)
- **Efficiency**—Capital expenditure to sales
- **Valuation**—Price/earnings ratio, price/book ratio, enterprise value to sales and EBITDA, private equity screens

Code	Company	Sector	Market price	Consensus upside	P/E 1yr fwd (x)	Dividend yield	ROIC	ROE	1yr EPS growth	MSCI ESG rating
NEC	Nine Entertainment Co	Com. Services	\$2.15	30%	11.3	6.2%	16%	17%	6.8%	A
ALL	Aristocrat Leisure Ltd	Cons Discret	\$35.45	19%	18.8	1.8%	22%	19%	7.8%	AA
TLC	Lottery Corp Ltd/The	Cons Discret	\$4.56	5%	29.4	3.0%	21%	187%	8.4%	AA
MTS	Metcash Ltd	Cons Staples	\$4.21	7%	13.9	5.2%	20%	27%	-1.7%	AA
ALD	Ampol Ltd	Energy	\$28.51	23%	8.9	6.9%	23%	23%	-17.9%	AA
MQG	Macquarie Group Ltd	Financials	\$178.00	8%	16.1	3.6%	--	14%	2.4%	AA
CBA	Commonwealth Bank	Financials	\$108.09	-12%	17.8	4.1%	--	14%	1.2%	A
RMD	ResMed Inc	Health Care	\$33.55	10%	34.8	0.5%	28%	26%	7.0%	AA
CSL	CSL Ltd	Health Care	\$302.58	8%	38.8	0.8%	15%	16%	26.8%	A
MND	Monadelphous Group Ltd	Industrials	\$13.56	-1%	22.5	3.9%	17%	14%	23.0%	AA
VNT	Ventia Services Group	Industrials	\$2.65	15%	13.5	5.8%	23%	37%	10.7%	--
ALU	Altium Ltd	IT	\$37.71	2%	51.0	1.2%	34%	23%	24.4%	A
IGO	IGO Ltd	Materials	\$14.71	7%	7.3	2.4%	28%	35%	2.4%	AA
JHX	James Hardie Industries	Materials	\$29.40	31%	13.4	0.8%	43%	43%	-9.4%	AA
GMG	Goodman Group	Real Estate	\$18.69	15%	20.0	1.6%	10%	10%	8.5%	AA
CHC	Charter Hall Group	Real Estate	\$13.59	14%	14.4	3.1%	15%	13%	-4.8%	AAA
ORG	Origin Energy Ltd	Utilities	\$7.97	-2%	27.7	3.8%	8%	5%	69.1%	A

Source: UBS Global Research, Bloomberg Analyst consensus and MSCI Research. Data as at 29 November 2022. ESG is environmental, social and corporate governance.

## Trade opportunities

Please note the following opportunities may not fully satisfy metrics for the above table.

**ResMed (RMD)—Buy.** As major sleep apnoea competitor Philips falls to GFC and Eurozone crisis lows (-75%), the product recall that will limit its ability to sell its products, and may negatively impact customers' longer-term perception, paves the way for ResMed to take permanent market share.

**Nine Entertainment (NEC)—Buy.** NEC remains exposed to divisions with structural growth, including 9Now, DHG and Stan, with current trading levels presenting a very undemanding entry point (P/E of 10.5x and a dividend yield of around 6.5%).

**Altium (ALU)—Buy.** ALU's business strategy has been confirmed not only by external sources (via a failed take-over attempt) but by also by a reiteration of its medium-term targets at its annual general meeting.



# Recommendations: Domestic equities—Sustainable income

## Objective of this list

This objective is to generate 'sustainable income' over time. Historically, companies that grow their dividends consistently can offer superior long-term performance. While we also overlay valuation, companies are included based on anticipated three to five-year performance. When analysing companies to add to this list, some metrics we consider are:

- **Profitability measures**—Return on assets, cashflow, return on invested capital and return on equity
- **Liquidity and leverage**—Net debt to equity
- **Efficiency**—Change in revenue, EBITDA and margins
- **Management signalling**—Dividend growth and pay-out ratios

Code	Company	Sector	Market price	Consensus upside	P/E 1yr fwd (x)	P/B 1yr fwd (x)	Franking	Grossed up yield	1yr DPS growth	MSCI ESG rating
IAG	Insurance Australia Group	Financials	\$4.80	12.7%	12.7	1.92	70%	5.1%	17.0%	AA
MQG	Macquarie Group Ltd	Financials	\$178.00	7.9%	15.7	2.10	40%	3.6%	4.0%	AA
WBC	Westpac Banking Corp	Financials	\$23.83	4.8%	11.1	1.18	100%	5.9%	5.9%	A
QBE	QBE Insurance Group Ltd	Financials	\$12.96	23.8%	8.5	1.51	10%	1.8%	120.2%	AA
COL	Coles Group Ltd	Cons Staples	\$17.06	0.3%	20.8	7.27	100%	3.8%	3.5%	AA
MTS	Metcash Ltd	Cons Staples	\$4.21	7.2%	14.2	3.76	100%	5.2%	-0.5%	AA
SGR	Star Entertainment Grp	Cons Discret	\$2.70	23.3%	17.5	0.75	100%	3.2%	32.2%	A
TAH	Tabcorp Holdings Ltd	Cons Discret	\$1.05	-0.5%	24.4	0.86	100%	2.2%	13.0%	AA
TLS	Telstra Corp Ltd	Com. Services	\$4.00	12.3%	21.7	3.01	100%	4.2%	42.3%	A
NEC	Nine Entertainment Co	Com. Services	\$2.15	29.8%	10.5	1.95	0%	6.2%	5.3%	A
RMD	ResMed Inc	Health Care	\$33.55	10.5%	32.6	9.52	100%	0.5%	0.0%	AA
PME	Pro Medicus Ltd	Health Care	\$59.28	-10.1%	85.4	60.77	100%	0.5%	24.8%	BBB
REP	RAM Essential Services	Real Estate	\$0.74	30.7%	0.5	1.37	0%	7.8%	--	--
SGP	Stockland	Real Estate	\$3.80	3.6%	12.1	0.87	0%	7.1%	-3.3%	AAA
IRE	IRESS Ltd	IT	\$9.61	23.1%	22.2	3.86	25%	4.6%	5.5%	AA
DBI	Dalrymple Bay Infra.	Industrials	\$2.43	12.7%	14.4	1.14	0%	7.8%	6.8%	--
ALX	Atlas Arteria Ltd	Industrials	\$7.05	-3.4%	17.9	2.13	0%	5.6%	1.5%	AA
VNT	Ventia Services Group	Industrials	\$2.65	15.4%	12.2	5.81	80%	5.8%	8.5%	BBB
ORG	Origin Energy Ltd	Utilities	\$7.97	-2.1%	16.4	1.37	75%	3.8%	3.0%	A
ALD	Ampol Ltd	Energy	\$28.51	23.2%	10.8	1.82	100%	6.9%	-18.8%	AA
BHP	BHP Group Ltd	Materials	\$44.82	-5.1%	12.1	3.37	100%	4.4%	-11.7%	A
AMC	Amcor PLC	Materials	\$17.98	-0.9%	14.6	--	0%	2.7%	2.9%	AA

Source: UBS Global Research, Bloomberg Analyst consensus and MSCI Research. Data as at 29 November 2022. ESG is environmental, social and corporate governance.

## Trade opportunities

Please note the following opportunities may not fully satisfy metrics for the above table.

**QBE Insurance (QBE)—Buy.** The premium rate environment is now more positive than it has been for a decade. Combined with the benefits of higher investment portfolio yields due to higher interest rates, QBE stands to be a significant outperformer in 2023.

**RAMS Essential Services (REP)—Buy.** Year-to-date, REP has outperformed the S&P/ASX Property index. This is a trait that is expected to continue, given its multiple defensive characteristics—essential services orientated, long WALE (weighted average lease expiry), and a low level of gearing.

**Ampol (ALD)—Buy.** ALD is trading at 9.6x 2023 earnings, a 37% discount to its historical average (of 15.3x) and largely in line with global peers (at 9.7x). The business is now structurally better positioned and recent weakness presents a buying opportunity.

# Recommendations: International equities—Best sector ideas

## Objective of this list

The objective is to provide a list of large-cap international companies across sectors with sustainable business models that generate compounding returns on investment and capital over the longer term. While we also overlay valuation, companies are included based on anticipated three to five-year performance. When analysing companies to add to the list, some metrics we consider are:

- **Profitability measures**—Return on net operating assets, return on invested capital, free cashflow and return on equity
- **Liquidity and leverage**—Net debt to equity, Altman Z-score, net debt to EBITDA
- **Efficiency**—Capital expenditure to sales
- **Valuation**—Price/earnings ratio, price/book ratio, enterprise value to sales and EBITDA, private equity screens

Code	Company	Sector	Base CCY	Market price	Consensus upside (%)	P/E 1yr fwd (x)	Yield (%)	Market cap (USD bn)	MSCI ESG rating
LSEG LN	London Stock Exchange	Financials	GBP	8220.00	11.9	22.7	1.4	53,943	AA
LLOY LN	Lloyds Banking Group PLC	Financials	GBP	43.52	42.3	6.6	6.0	34,606	AA
WFC US	Wells Fargo & Co	Financials	USD	47.55	12.8	9.2	2.8	181,189	BB
2318 HK	Ping An Insurance Group	Financials	HKD	39.45	63.2	4.6	6.6	99,027	BBB
939 HK	China Construction Bank	Financials	HKD	4.59	43.0	3.1	8.7	148,046	A
2330 TT	Taiwan Semiconductor	IT	TWD	441.50	38.5	11.7	2.8	366,955	AAA
MA US	Mastercard Inc	IT	USD	339.29	16.0	27.8	0.6	326,214	A
GOOGL US	Alphabet Inc	Comm Services	USD	96.41	32.5	15.4	0.0	1,249,924	BBB
UMG NA	Universal Music Group NV	Comm Services	EUR	21.88	15.8	24.9	2.1	41,128	A
DIS US	Walt Disney Co/The	Comm Services	USD	95.01	40.6	17.0	1.7	173,209	A
9988 HK	Alibaba Group Holding Ltd	Cons Discret	HKD	70.80	91.6	8.7	0.0	191,317	BBB
NKE US	NIKE Inc	Cons Discret	USD	106.09	2.6	27.7	1.3	165,987	A
SBUX US	Starbucks Corp	Cons Discret	USD	97.38	0.9	24.6	2.4	111,734	BBB
AMZN US	Amazon.com Inc	Cons Discret	USD	100.79	38.0	34.3	0.0	1,028,225	BBB
RACE IM	Ferrari NV	Cons Discret	EUR	209.80	5.3	34.6	1.0	39,628	BBB
BA US	Boeing Co/The	Industrials	USD	177.49	7.6	58.8	1.3	105,781	BBB
DSV DC	DSV A/S	Industrials	DKK	1114.00	24.3	18.7	0.7	36,324	A
MSFT US	Microsoft Corp	IT	USD	247.11	19.8	21.9	1.1	1,842,075	AAA
ILMN US	Illumina Inc	Health Care	USD	242.74	3.9	72.9	0.0	38,183	AA
NOVOB DC	Novo Nordisk A/S	Health Care	DKK	801.10	12.3	26.4	1.8	254,512	AAA
ISRG US	Intuitive Surgical Inc	Health Care	USD	265.08	-4.9	48.9	0.0	93,675	A
EL US	Estee Lauder Cos Inc/The	Cons Staples	USD	228.22	7.0	31.3	1.2	81,432	A
COST US	Costco Wholesale Corp	Cons Staples	USD	515.47	7.5	32.0	0.8	228,149	A
288 HK	WH Group Ltd	Cons Staples	HKD	4.57	61.0	5.4	1.1	7,481	BBB
SHW US	Sherwin-Williams Co/The	Materials	USD	237.24	7.4	23.2	1.0	61,479	A
SHELL NA	Shell PLC	Energy	EUR	26.92	26.9	5.5	4.2	197,711	AA
EQIX US	Equinix Inc	Real Estate	USD	660.60	5.7	75.0	2.0	61,131	AA
ORSTED DC	Orsted AS	Utilities	DKK	666.80	19.1	29.5	2.2	39,059	AAA
Average Yield:							2.0%		

Source: UBS Global Research, Bloomberg Analyst consensus and MSCI Research. Data as at 29 November 2022. ESG is environmental, social and corporate governance.

# Recommendations: Thematic investing—Climate change

## Objective of this list

Thematic investing is an approach which focuses on predicting long-term trends rather than specific companies or sectors. As it is also often associated with secular forces, this means it can provide investors with exposure to themes that are expected to grow at rates above economic growth over the longer term. Thematic investing is best suited to longer-term investors and those looking for opportunities beyond the comparatively smaller investment universe that exists in Australia. Some key themes that investors are exploring include:

- Climate change
- Cryptocurrency and blockchain
- Demographics
- Electric vehicles
- Healthcare and genomics
- Inflation
- Metaverse
- Security and safety
- Supply chain disruption
- Sustainable investing

## Climate change—Select exposures

As the world grapples with how, when, and where to tackle climate change, a range of risks will almost certainly impact governments, industries, and companies. The transition to a lower-carbon economy is expected to present opportunities across a broad range of industries.

Code	Company	Sector	Base CCY	Market price	Consensus upside (%)	P/E 1yr fwd (x)	Yield 22E (%)	Market cap (USD bn)	MSCI ESG rating
KRX	Kingspan Group PLC	Industrials	EUR	\$54.04	29.2	16.6	0.9	10,142	AA
ALO	Alstom SA	Industrials	EUR	\$24.56	23.8	12.6	1.8	9,544	AA
ORSTED	Orsted AS	Utilities	DKK	\$604.20	30.9	27.9	2.4	35,277	AAA
NEE	NextEra Energy Inc	Utilities	USD	\$82.49	12.3	26.6	2.3	163,921	AA
EAF	GrafTech Int'l	Industrials	USD	\$5.17	12.5	7.2	1.4	1,327	B
VWS	Vestas Wind Systems	Industrials	DKK	\$176.08	6.1	102.9	0.1	24,697	AAA
HON	Honeywell Int'l	Industrials	USD	\$216.72	-1.2	23.6	1.9	145,706	AA
APD	Air Products & Chem	Materials	USD	\$302.18	1.7	24.1	2.4	67,043	BBB
KNEBV	Kone Oyj	Industrials	EUR	\$48.50	-3.8	25.8	3.8	26,520	A
ILMN	Illumina Inc	Health Care	USD	\$208.57	20.6	68.9	0.0	32,808	AA
RWE	RWE AG	Utilities	EUR	\$41.86	23.6	13.7	2.2	29,238	A
ENPH	Enphase Energy Inc	Info Technology	USD	\$303.39	4.3	58.6	0.0	41,238	A

Source: UBS Global Research, Bloomberg Analyst consensus and MSCI Research. Data as at 29 November 2022. ESG is environmental, social and corporate governance.

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