

Maybank *P*RIVILEGE

**Reset,
Reposition,
Rejuvenate**



Humanising Financial Services.

EDITORIAL



2022 has been a challenging year with most of financial markets posting steep losses. The Russia-Ukraine war, U.S.-China trade tensions, supply disruptions to energy and agricultural products exacerbated the situation and created inflationary pressures.

Our 2022 investment theme – Reopening, Recalibration, Resilience – was somewhat prophetic in capturing the investment landscape over the past 12 months. While the world has benefitted from the “Reopening” of borders for many countries, the “Recalibration” of monetary policies has led to increased risks to the post-COVID recovery and increased market volatility, resulting in the need to build portfolio “Resilience”.

With inflation reaching decade highs in many economies, the U.S. Federal Reserve and other central banks had little choice but to respond with the most aggressive rate hikes since the late 1970s. While we expect the central banks to slow down and pause their monetary tightening once inflation is reined in, the timing remains highly unpredictable.

The contractionary monetary policy has consequently weighed on economic growth, and led to increased financial market uncertainty. This higher-rate environment is a seismic shift from the vicennial of zero-rates, and in some economies negative rates, during which appetite for high-risk strategies to generate returns was quite the norm. It is likely that higher interest-rate, and higher-inflation, will be the business and investment backdrop against which we will operate for a protracted period of time.

Despite the less-than-rosy prospects, we believe there will come a point of inflection in the markets and acceptance of the new norm. This is when, the macro environment will become more conducive for risk assets. We are hopeful that this inflection will happen sometime in 2023.



*Knowing what lies beyond us
is important, maybe even more
so is the preparation to deal
with the uncertainty.*

Therefore, our 2023 investment theme is “Reset, Reposition, Rejuvenate”. We believe the evolving macro landscape will require investors to reset expectations on growth and inflation. By adjusting to the new norms, we can then refocus and reposition accordingly to revitalise and rejuvenate our investment portfolio.

Knowing what lies beyond us is important, maybe even more so is the preparation to deal with the uncertainty. We hope that our investment insights will provide the perspective and ideas you need to navigate the coming year. We look forward to be of service to you.

Thank you for your continued support. On behalf of everyone at Maybank Group Wealth Management, we wish you a healthy and prosperous year ahead!

A handwritten signature in black ink, appearing to read 'Alvin Lee'.

Alvin Lee
Head, Group Wealth Management &
Community Financial Services, Singapore

MACRO ECONOMIC OUTLOOK AND INVESTMENT STRATEGY



MACRO ECONOMIC OUTLOOK

KEY HIGHLIGHTS



Rising global recession risk on the back of tighter monetary conditions.



Recalibration of inflation expectations may lead to higher long-term terminal rates.



Key risks include widespread financial instability, persistently high inflation and rising geopolitical uncertainties.

The economic outlook going into 2023 remains challenging as investors have to deal with slower global growth and tighter monetary policies to combat decades-high inflation, alongside lingering geopolitical uncertainties. For 2023, we expect global GDP growth to slow further to 1.7% from 2.9% in 2022 as tighter financial conditions continue to cool demand.

Notably, the risk of an economic recession has risen sharply, particularly in Developed Markets (DM). Among major DM economies, both the U.K. and Eurozone are facing a risk of a severe downturn. The U.S. may also witness negative GDP growth at some point in 2023 with rising probability of a recession.

Inflation has surprised to the upside in many countries in 2022. While inflation is likely to moderate in 2023, we expect it to remain higher than historical average levels. In the U.S., services inflation could stay elevated marked by a demand shift from goods to services post COVID. The still tight labour market is also pushing up wages, leading to a more sticky inflation. While inflation in Europe may cool with softer energy price increases, the lingering uncertainties related to the Russia-Ukraine war will impose supply constraints

and lead to persistent price pressure. Meanwhile, inflation could remain higher than normal in Asia with external price pressures a key contributing factor.

Given the stickier than expected inflation, central banks may be pressured to maintain a restrictive monetary policy to safeguard price stability even though the pace of tightening may start to slow. Having said that, the central banks are wary of overtightening with several U.S. Federal Reserve (Fed) officials signalling the need to remain data dependent. Hence, we will not be surprised to see an earlier than expected pause in rate hikes or even rate cuts should the economy deteriorate faster than expected.

Looking ahead, we will continue to look for clear and sustained signs of inflation downshift and the need for policy recalibration. In the U.S., we expect the Fed funds rate to peak at 5.00% – 5.25% by 1H 2023 but the 10-year U.S. Treasury (UST) yield to peak well below the terminal rate. Resilience in the labour markets and a still large stock of private sector excess savings are key to our view that global growth bends but does not break.

REAL GDP FORECAST (%)	2021	2022E	2023E
WORLD	6.0	2.9	1.7
U.S.	5.7	1.7	0.3
EUROZONE	5.2	3.0	0.0
JAPAN	1.7	1.6	1.4
CHINA	8.1	3.3	4.0
ASEAN-6	3.8	5.6	4.3

INFLATION FORECAST (%)	2021	2022E	2023E
WORLD	4.7	8.8	6.5
U.S.	4.7	8.1	4.0
EUROZONE	2.9	8.5	6.0
JAPAN	-0.2	2.5	1.8
CHINA	0.9	2.2	2.3
ASEAN-6	2.2	4.5	4.1

RATES FORECAST (%)	4Q22E	1Q23E	2Q23E	3Q23E	4Q23E
FED FUND TARGET (UPPER BAND)	4.50	5.00	5.25	5.25	5.25
FED FUND TARGET (LOWER BAND)	4.25	4.75	5.00	5.00	5.00
ECB DEPOSIT RATE	2.00	2.50 – 2.75	2.50 – 2.75	2.50 – 2.75	2.50 – 2.75
BOE BANK RATE	3.50	4.00	4.00	4.00	4.00
BOJ TARGET RATE	-0.10	-0.10	-0.10	-0.10	-0.10

Source: Maybank IBG Research | November 2022

The energy crisis in Europe continues to dampen business and consumer confidence, while governments need to provide fiscal support in the face of high inflation. As the negative impact on economic growth becomes more evident and inflation rolls over, both the Bank of England (BOE) and European Central Bank (ECB) would have to consider pausing their rate hike cycle earlier than anticipated.

In contrast with the slowing growth in the U.S. and Europe, China's economy showed signs of recovery with GDP growth expanding stronger than expected by 3.9% quarter-on-quarter in 3Q 2022. Looking ahead, a key driver of China's economy will be developments related to the zero-COVID policy. While the recent easing of the COVID restrictions is encouraging, the reopening process will likely be gradual and bumpy.

Meanwhile, it will take time for China's property sector to show more visible bottoming despite more concerted efforts to support the sector and boost demand. Still, China is one of the few economies where inflation remains benign, allowing room for more accommodative stimulus to support growth. As such, we expect strong measures and implementation to come through if necessary, especially after the National People's Congress in March 2023 with the latest political reshuffling.

For the rest of Asia, the growth outlook will be challenging as well given heightened recession risks in DM, fading reopening benefit, and subdued growth in China. In particular, Asia's export downturn could continue to deepen, while tighter financial conditions weigh on capital expenditure and consumption.

Notably, Southeast Asia (ASEAN) is also not immune and cannot fully decouple from the global downturn. However, we expect their economies to be more resilient, partly supported by increased foreign direct investments (FDI) to

ASEAN as countries reconfigure their manufacturing supply chains away from China. Meanwhile, regional central banks are expected to further tighten their monetary policies to combat inflation and stem further currency weakness, but the pace of tightening could moderate as growth slows.

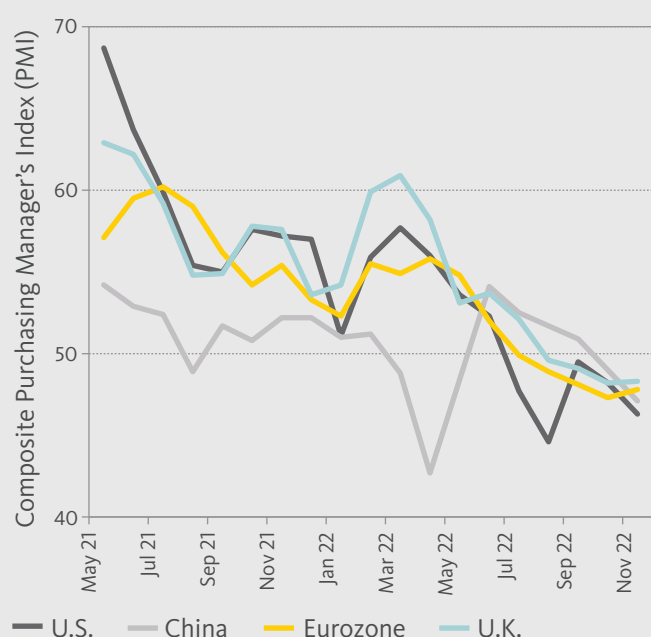
Given the risks to the economic outlook, we believe investors should stay cautious in the near term. In particular, several downside risks to the outlook remain that could shift our baseline view. Firstly, global central banks are treading a fine line between growth and inflation, and any monetary policy missteps could miscalculate the right stance to reduce inflation. The tightening of global financial conditions and/or a sharp U.S. dollar (USD) appreciation could trigger widespread financial instability, resulting in Emerging Market (EM) sovereign default risks or corporate bond market stress.

Secondly, deglobalisation and unexpected supply chain disruptions (e.g. energy, food, and climate shocks) could cause inflation to persist, leading to a deeper and more protracted downturn. Notably, climate change effects (e.g. droughts, floodings, hurricanes, etc.) are already increasing in intensity and frequency.

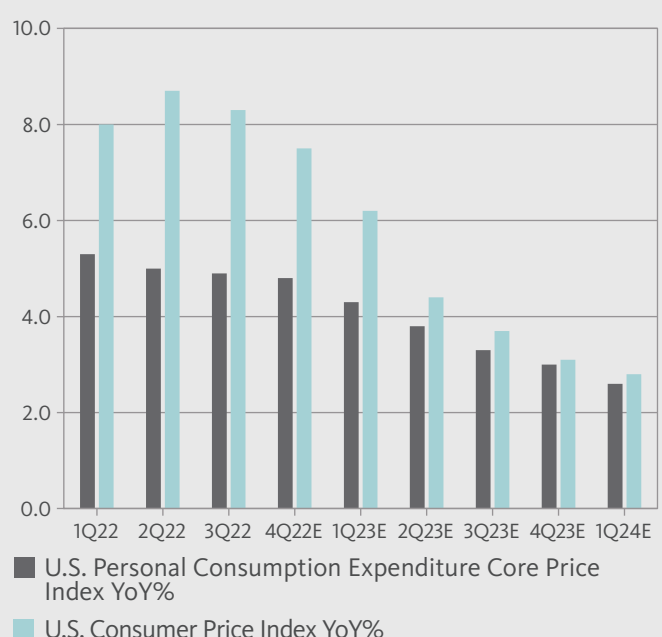
Thirdly, China's reopening remains a wildcard and a resurgence of COVID cases may further curtail growth. In an adverse scenario where COVID-19 restrictions stay for longer, the property sector weakness could persist and be a drag on consumption as well as property-related investments. Meanwhile, the prolonged property sector crisis could also spill over to the domestic banking sector and constrain growth in China and Asia.

Lastly, elevated geopolitical risks in Europe and between the U.S. and China could deter trade and capital flows, as well as delay climate policy cooperation.

HAWKISH CENTRAL BANKS RAISED RECESSION RISKS



U.S. INFLATION LIKELY TO REMAIN ABOVE 2% TARGET



INVESTMENT STRATEGY

KEY HIGHLIGHTS



Stay defensive while waiting for inflection point to turn constructive.



Underweight equities; maintain cash buffer to protect portfolio.



Seek defensive carry opportunities in fixed income; add uncorrelated returns.

The global economy has benefitted from further reopening over the past 12 months. Unfortunately, the recalibration of policies, particularly on the monetary front, has led to a sell-off in risk assets amidst heightened inflationary pressures and geopolitical tensions. In light of these macro headwinds, it highlights the importance of building portfolio resilience.

Downside earnings revision to weigh on risk assets

Looking ahead, the sticky inflation trajectory will force global central banks to maintain restrictive monetary policies that will weigh on the economy. The anticipated slowdown in economy will negatively impact corporate earnings, with further downward revision dampening the performance of risk assets. The tightening liquidity will also result in reduced financial stability and a rise in the probability of a black swan event, further adding to market stress and volatility.

Still, we expect most central banks to pause their rate hikes by 1H 23 as inflation and growth moderates. However, unlike past cycles, we do not expect any aggressive policy easing

soon after the pause. Hence, any growth recovery is also likely to be gradual.

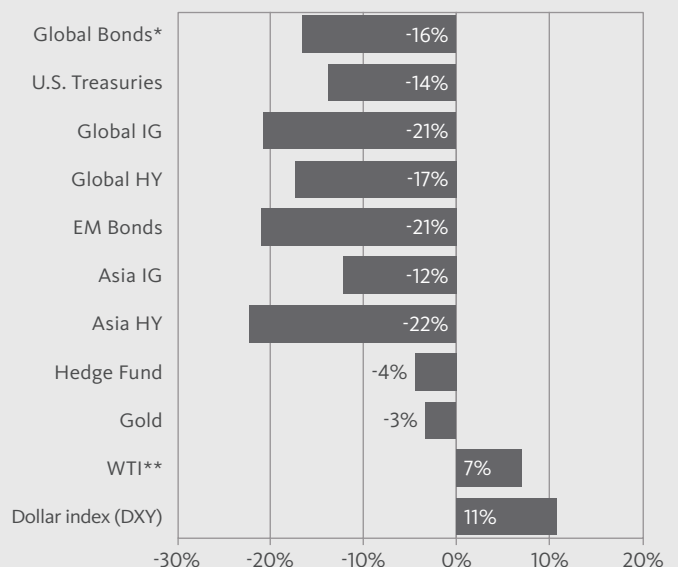
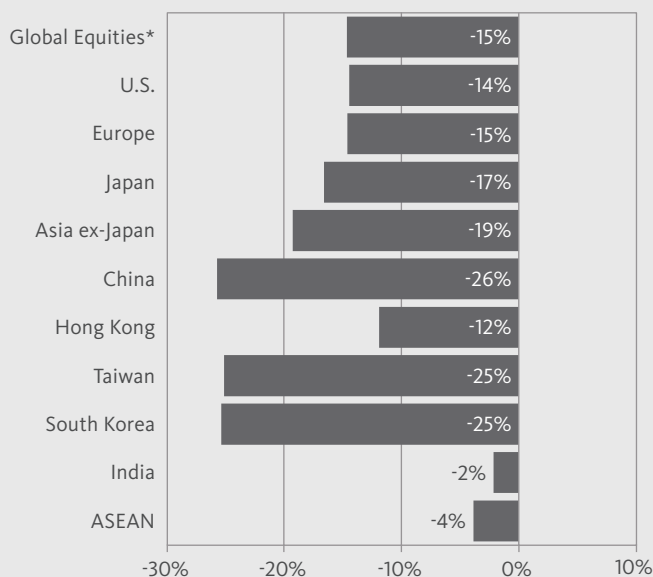
Awaiting the inflection

While the performance of risk assets could remain lacklustre for now, it is likely to improve once we hit an inflection point in terms of inflation, growth and policies. Hence, the evolving macro landscape would require investors to stay nimble and reposition accordingly in order to rejuvenate portfolio returns.

In view of the above, we start the year with a defensive stance in our asset allocation. Given the heightened macro and policy uncertainties, we prefer to maintain a cash buffer to preserve capital while protecting the portfolio against significant drawdowns.

Nevertheless, the increased cash buffer could also serve as ammunition for us to deploy into risk assets once the inflection point is triggered. This could be a peaking of Fed rates, the bottoming of earnings revision and/or distressed market valuation that has more than priced in the negatives.

TOTAL USD RETURNS OF MAJOR ASSET CLASSES (YEAR-TO-DATE AS OF 30 NOVEMBER 2022)



*Global Equities = MSCI All-Country (AC) World; The others are MSCI regional/country equity indices; Global Bonds = Bloomberg Barclays Multiverse

**WTI = West Texas Intermediate

Source: Bloomberg | November 2022

Staying defensive on equities

We are underweight on equities. While global markets are inexpensively valued, we believe earnings risks have not been sufficiently priced in. In particular, we are least sanguine on the U.S. and Europe as they offer less attractive risk-reward compared to global peers. We are neutral on the other markets including Japan and Asia ex-Japan. On a relative basis, ASEAN could be more resilient and acting as a safe harbour within equities, with the region likely to partially decouple from a potential U.S. recession.

Sectors wise, we seek shelter in more defensive Healthcare and Consumer Staples stocks, which are likely to enjoy resilient demand during an economic downturn. We also see select opportunities within the Telecommunications sector to generate steady dividend income. In contrast, the rate-sensitive Real Estate Investment Trusts (REITs) sector could remain under pressure until policy rates peak. We also see headwinds for late cyclical including Industrial and Materials stocks, which would be vulnerable to weakening demand and falling prices if a recession were to hit.

Nevertheless, there may be opportunities to turn more constructive on equities when we hit the inflection point. Early cyclical such as Technology/Semiconductor will be in the limelight again once the economy bottoms out. Tech-heavy markets like South Korea and Taiwan could also start to outperform. In addition, secular growth plays (e.g. HealthTech and FinTech) could regain favour after the significant de-rating, particularly for those pre-earnings growth companies that can achieve their break-even point. Having said that, investors will likely avoid overpaying for such companies again as the risk-free rate is likely to settle at higher than historical average level. Hence, we would prefer to seek growth at reasonable valuation.

Longer-term, the various issues arising from the COVID-19 pandemic have made the world more aware of the importance of being self-reliant. We may witness further deglobalisation that will have implications on supply chain, food, energy and technological security. While a more polarised world may not be good for overall growth, it may still drive investment opportunities for specific businesses including alternative/renewable energy, agricultural/alternative food and defence/cybersecurity as governments strive for self-reliance.

A better time for fixed income

In contrast to equities, we are more sanguine on fixed income with an overweight stance. While upward pressure on government bond yields could persist in the short-term, we believe the increase is limited with the tightening cycle nearer to the end than the beginning. This suggests a favourable risk-reward for sovereign bonds, with U.S. Treasuries acting as an effective tool against recession risk.

In addition, we see defensive carry opportunities in DM Investment Grade (IG) credit which will likely offer more resilient returns even during a downturn. In contrast, we would avoid High Yield (HY) credit in both DM and EM given the risk of significant credit spread widening. Nevertheless, once the risk environment improves, we will be prepared to take on more credit risk.

China as a wildcard

While we are neutral on China assets, the reopening of the economy is a wildcard. An earlier than expected pivot away from the stringent zero-COVID policies could bolster the economic recovery. Notably, sectors that could benefit and outperform from the reopening include travel, hospitality and gaming. In addition, China property stocks and bonds would also benefit as the reopening would support the recovery momentum of property sales.

TACTICAL ASSET ALLOCATION

	OVERWEIGHT	NEUTRAL	UNDERWEIGHT
Overall Positioning	Cash/USD Fixed Income	Alternatives	Equities
Equities		Japan Asia ex-Japan	U.S. Europe
Fixed Income	U.S. Treasuries Developed Market Investment Grade		Developed Market High Yield Emerging Market Bonds
Alternatives		Hedge Funds Gold	

Source: Maybank Group Wealth Management Research | December 2022

Alternatives

The weak performance of both equities and bonds in 2022 highlights the importance of adding uncorrelated returns through alternatives, including hedge funds and private assets. Notably, the resilient performance of these alternative investments have helped reduce the drawdown and volatility of the overall portfolio.

Nevertheless, hedge funds and private assets can be less liquid and more opaque hence investors would need to consider their respective preferences and requirements when pursuing such investments. In addition, the performance disparity among different alternative investment managers is typically very wide. Hence, careful due diligence and selection of managers are paramount to achieve the desired investment outcome.

Separately, we expect gold prices to remain range-bound for now. However, the precious metal could see stronger demand with a softening of the USD on peaking Fed rates.

Strategic Asset Allocation (SAA) as an anchor

While we are tactically cautious on risk assets, there is no doubt their valuation has become appealing for investors with a longer-term investment horizon. Still, it remains critical for investors to adopt a multi-asset approach for better risk diversification and a smoother investment journey.

To this front, we are introducing our SAA framework, to serve as a guidance for investors in building their portfolios according to their respective investment objectives and risk profiles. The allocation in each model portfolio is designed to reflect the optimised risk-return outcome for the respective profile.

Using the SAA framework, investors will be able to build a core portfolio to serve as anchor to reflect their longer-term investment views. A tactical overlay could then be applied (via satellite ideas) to the core portfolio to benefit from short-term mispricing opportunities in assets. By doing so, it would help to enhance overall portfolio returns through this core and satellite approach.

STRATEGIC ASSET ALLOCATION

	Conservative	Moderate Conservative	Balanced	Moderate Aggressive	Aggressive
Equities	0%	22%	42%	62%	83%
U.S.	0%	10%	18%	27%	33%
Europe	0%	4%	7%	10%	15%
Japan	0%	4%	5%	5%	5%
Asia ex-Japan	0%	4%	12%	20%	30%
Fixed Income	65%	63%	53%	30%	10%
U.S. Treasuries	30%	23%	10%	0%	0%
Developed Market Investment Grade	35%	30%	23%	8%	0%
Developed Market High Yield	0%	5%	10%	12%	5%
Emerging Market Bonds	0%	5%	10%	10%	5%
Alternatives	0%	0%	0%	5%	5%
Hedge Funds	0%	0%	0%	2%	2%
Gold	0%	0%	0%	3%	3%
Cash	35%	15%	5%	3%	2%

Source: Maybank Group Wealth Management Research | December 2022

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