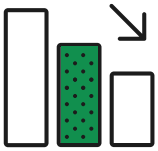
LGIM

Countdown to 2023

2022 was a rollercoaster ride investors may hope to forget, but what does 2023 have in store? As we optimistically set our new year's resolutions, our attention has turned to what's next. Here are 10 themes our Asset Allocation team will be mulling over before welcoming in the new year.

10 months of war in Europe

The war in Ukraine continues. Vladimir Putin has attempted to leverage Russia's supply of energy to Europe to stem the flow of Western weapons into Ukraine, culminating in a near two-thirds reduction in gas exports to Europe. However, a glut of seaborne LNG imports and a mild autumn means European gas prices are down some 65% from their August peak.[1] We believe a Eurozone recession is highly likely over the next few quarters; it now looks to be a question of how deep and prolonged it will be.



9 twinkling red lights

The Asset Allocation Christmas tree twinkles with a garish mix of green, amber and red lights, each representing a recession indicator for the year ahead. Alas, there are no comforting green lights this year; indeed, 12 of the 20 are now red, with the remainder amber. Recession is coming, in our view.

We are not alone in playing The Grinch, with most economists predicting a recession in 2023. Typically, investing in equities isn't well rewarded in this part of the cycle, and our economics score for the asset class is deeply negative, although relatively cheaper valuations and bearish sentiment offset that caution somewhat.

But Mr Grinch does eventually change, and by next Christmas we expect the number of reds will be down from 12 to nine.

1. Trading Economics 2022
2. UN, July 2022
3. Unicef, 2017
4. Bloomberg, November 2022

8 billion... and a bit

The world's population recently surpassed 8 billion people and isn't predicted to peak until the 2080s, at around 10.4 billion.[2] Increased life expectancy and high birth rates, particularly in developing countries, will fuel growth for the next 50 years. By 2050, Africa will be home to 40% of the world's children.[3]

The developed world will be beset by ageing populations and significant challenges to healthcare and social systems; solutions may involve a hard sell with the public and so government borrowing is likely to rise until financial markets force governments to face tough choices. We reject the idea that demographic changes are strictly, inflationary as some would claim, with the case made for both demand and supply side impacts on inflation from changing populations.

7 rate rises

After the realisation in late 2021 that inflation was not transitory, central banks started to fight inflation with interest rate hikes.

In seven* of its eight meetings in 2022, the US Federal Open Market Committee raised interest rates, for a combined increase of 4.25%.[4] Markets now sense the Fed is nearly at the top of the hill, and that it may even start the descent next year. The path of interest rates in turn impacts the bond market. One key question for 2023 is whether the defensive qualities of bonds will start to shine through in a recession. We believe the negative correlation between bonds and equities, which has deserted investors in 2022, should return if growth falters.

*Assuming that in the final meeting of the year they hike by 50 basis points as is currently priced.

6 sixty percent pension gap

The gloomy reality at retirement age is that a woman's pension will, on average, be just under 60% of her male counterpart's. There is a divide from the start of women's careers (on average 17%)[5] that only grows. The pension gap is prominent throughout most industries including female-dominated industries (e.g. healthcare at 59%).[6] Schemes such as auto-enrolment help but do not solve the issue. LGIM has put together an equality task force to raise awareness and help its members enact change, reflecting its commitment to gender equality and inclusive capitalism.

5 months to May

It is five months to May, when we'll see the coronation of King Charles III in Westminster Abbey, and Liverpool host the Eurovision song contest a week later. Both will attract a worldwide audience, feature elaborate costumes and choreography, and perhaps have a soporific effect on viewers. The late Queen's coronation in 1953 was the first live test broadcast of the new 'Eurovision' TV network of Western European broadcasters, which subsequently founded the song contest. The war in Ukraine broadly tightened the bond between European countries but issues remain. As well as idiosyncratic challenges with countries like Hungary and Italy, Europe may find itself 'stuck in the middle' of an increasingly multipolar world led by the US and China.

4 seasons within Number 11

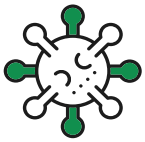
The shocks to global food and energy markets have made life as chancellor of the exchequer something of a headache.

Rishi Sunak tried to stimulate the economy and protect households with a price cap on bills, and Nadhim Zahawi maintained this approach during the summer leadership election.

Kwasi Kwarteng took a radical, and ultimately unsuccessful, approach to stimulating the economy, whereas Jeremy Hunt returned to orthodoxy with tax rises and spending cuts to dampen demand.

Hunt seems to have called time on the conga line of chancellors; however, the worst of the winter remains before us, and we will see how effective the approach has been.

LGIM has responded through close engagement with our partners across the business to stay abreast of the Bank of England's plans and will respond tactically whenever possible, with the aim of protecting clients' assets.



3 a historic 3rd term

Xi Jinping secured a historic third term as Chinese president, consolidating his personal power over the party with a reshuffle of the Politburo that resulted in all seven standing committee members filled by Xi loyalists. Chinese assets fell in the immediate aftermath, with investors concerned there would be little change to the aggressive COVID containment policy and oversight of property developers and the technology sector.

However, markets have rebounded significantly since as COVID restrictions have loosened, providing hope of a full reopening later in 2023. That said, there are question marks over the country's medium-term outlook, particularly in retail and construction investment. And the near-term path remains rocky as officials battle the conflicting objectives of the economy and virus containment.

5. The analysis is based on LGIM's proprietary data on c4 million defined contribution members as at 6 April 2021
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2 too soon to tell

While most central banks were in rate-hiking mode throughout 2022, Japan kept its main policy rate below 0%. Japan's yield curve control (YCC) policy, a measure adopted back in 2016 to keep price stability at 2% year-on-year change, dictates this.

It is likely that inflationary pressures will be so strong in 2023 that Japan will be forced to either abandon the YCC policy, or only apply it for shorter-term maturity bonds.

The end of YCC should see a stronger yen and lower prices, so investors who consider Japanese government bonds will need to keep a close eye on this in the coming months. In the meantime, we have taken a more positive outlook on Japanese equities as the country re-opens and its government has added fiscal stimulus too, boosting growth and the domestic consumer.

1 first time for a 10% decline

At the time of writing, 2022 is the first time ever that we have seen a decline of 10% or more in the Bloomberg Global Aggregate Index in a calendar year.[7] Established in 1990, the index consists of developed and emerging market government and corporate bond assets.

After a year of rising yields and falling equity valuations, we believe long-term return prospects for all assets look better today than they did at the beginning of the year. We would also expect bonds and equities to provide greater diversification against each other in the future, but in the short term we take a more cautious view as markets stumble into 2023.

7. Bloomberg, November 2022

Contact us

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Key risks

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