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WWTD - FEATURE

Market Outlook 2023

INSIDE

Soft economic growth

GDP growth could be sub-par in 2023

Sticky inflation

Inflation is expected to be sticky and elevated in 2023

Higher interest rates

We expect interest rates to remain high for a longer period

Political Stalemate

Politics will be a key driver of economic growth for the US in 2023. A split Congress could lead to another debt ceiling crisis in the first half of 2023. This will negatively impact economic growth for 2023.

Inflation is likely to remain sticky and elevated in 2023. So, we do not expect the US Fed to pivot from its hawkish monetary policy.

A hawkish Fed is determined to fight inflation by taking away the liquidity punchbowl. This could drive the US dollar and Treasury yields to a higher level in 2023. Hence, we believe that there is limited upside for US equities in 2023. Further headwinds could also come in the form of a debt ceiling crisis.

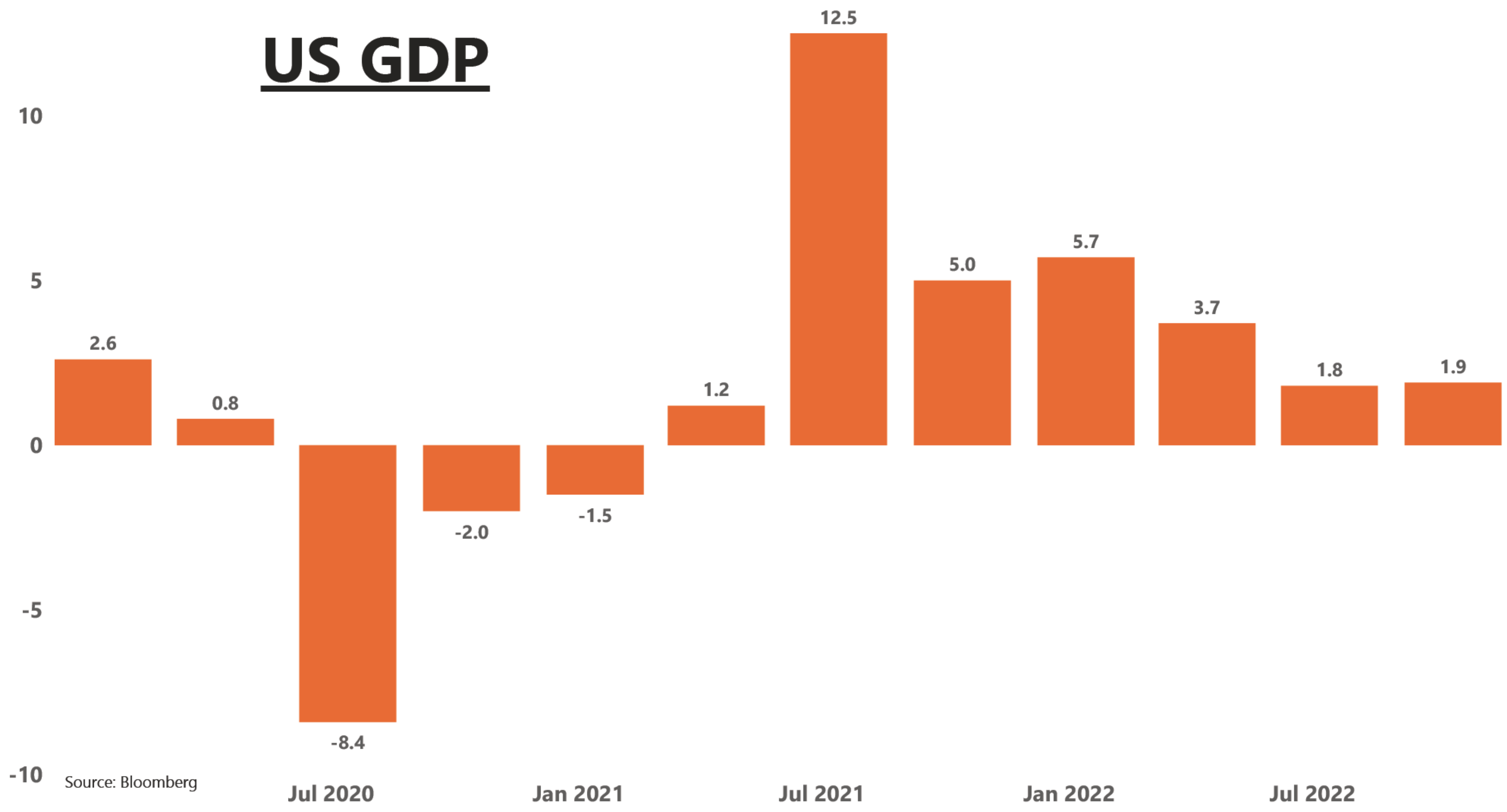
Soft Economic Growth

We expect US GDP to trend at 1.5% in 2023, below its 10-year average of 2.0%.

The midterm elections yielded a split Congress with the Democrats and Republicans taking control of the Senate and House respectively.

In recent years, a fully Democrats -controlled Congress has led to fiscal overspending by the US especially during the COVID pandemic. The budget balance rose to a high of -16.8% in January 2021 from -4.9% in March 2020. Hence, a split Congress could lead to another debt ceiling crisis in the first half of 2023. We expect the Republicans to use the debt ceiling as political leverage in their negotiations with the Democrats.

This could spark economic turmoil similar to the 2011 debt crisis where the US was downgraded to below AAA by S&P. In addition, we expect high inflation to be a drag on the US economy. The longer inflation remains high, the worse the drag on economic activities. So far, inflation has remained sticky to the upside. Hence, we expect GDP growth to be soft in 2023.



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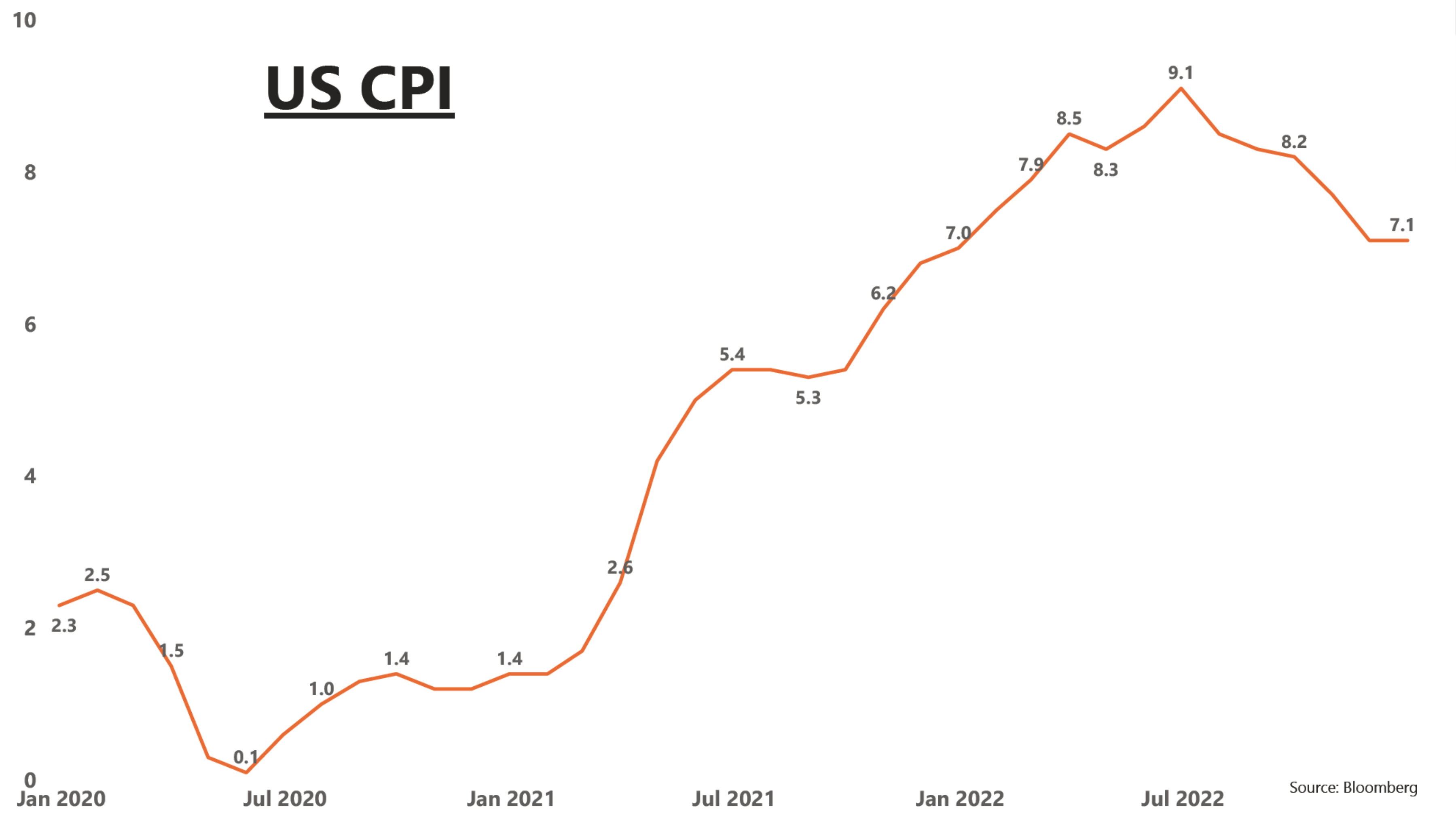


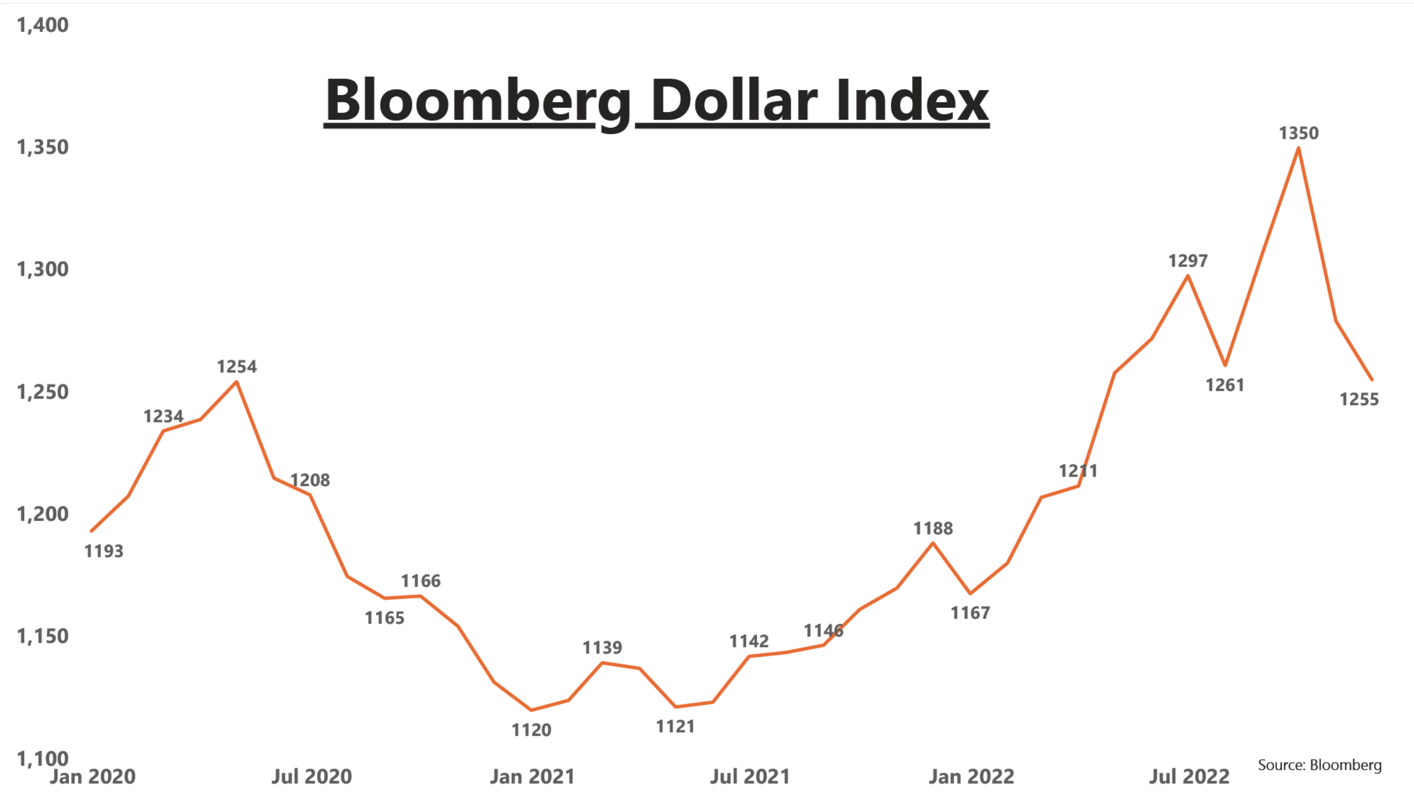
Sticky Inflation

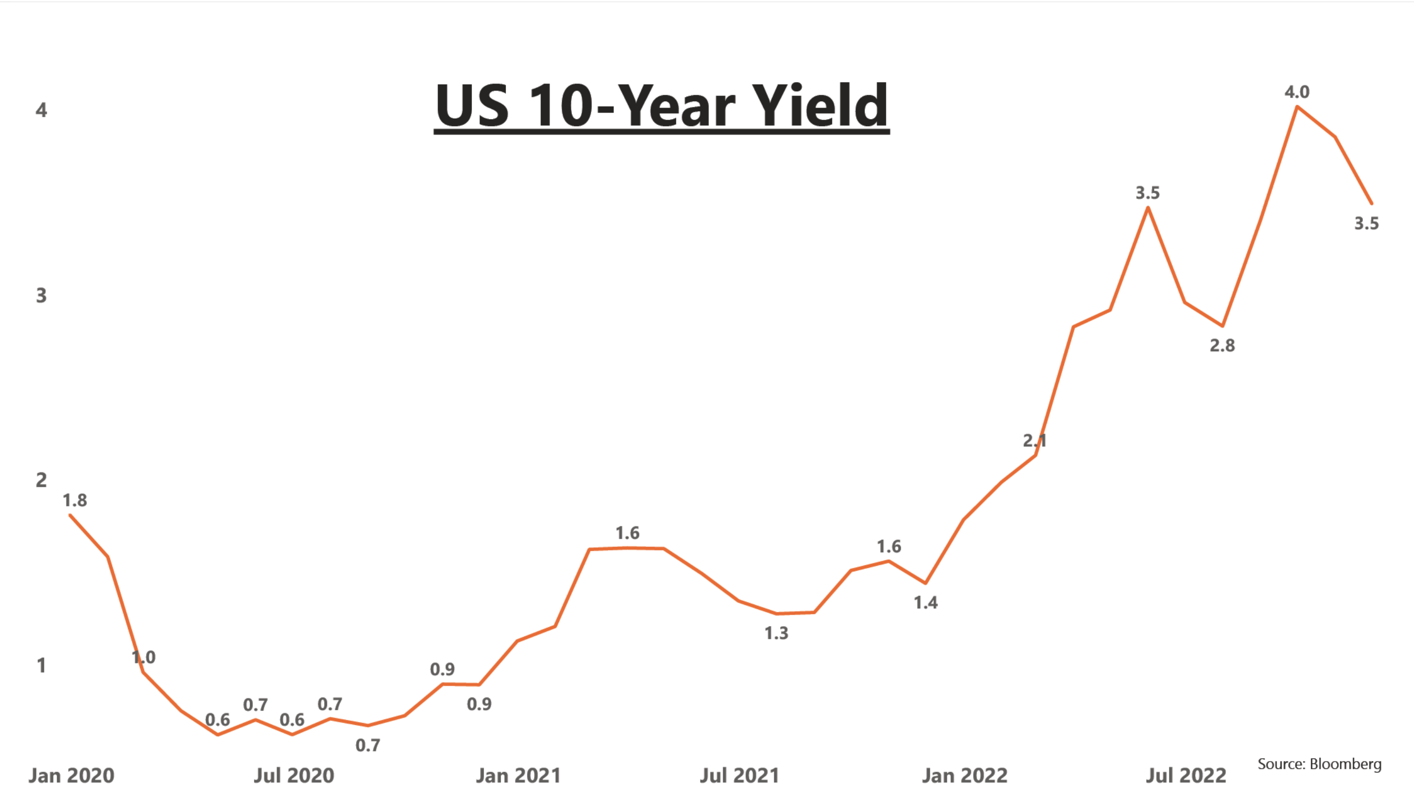
US inflation is still trending above 7% and it is far above the Fed's 2% target.

Furthermore, inflation continues to remain sticky.
A closely watched indicator, November services CPI (excluding Energy) remained elevated at 3.9%.

This is a sign that inflation will continue to trend higher, as these items have more to do with expectations and are unrelated to commodities.

Another indicator is the Cleveland Fed's trimmed mean CPI which remove the volatile times in the CPI reading. It is still showing readings of 6.7%, and this indicates that inflation is sticky and could persist in the near term.





The Killjoy Fed

As a result of hawkish Fed policy actions, the US dollar has registered robust performance in 2022. We expect the strong performance to carry on in 2023.

As inflation is still at an elevated level of above 7%, the US Fed is focused on taking away the liquidity punchbowl. This will continue to drive a stronger US dollar.

The US dollar also benefits from its safe-haven status as it provides a positive carry for an asset that hedges equities. Hence, we believe the US dollar will remain resilient and has room to reach a new high in 2023.

Slower, longer, and higher interest rates

In the November Fed meeting, Fed Chairman Jerome Powell communicated that the interest rate hike will continue at a slower pace, but it will go on for a longer time and reach a higher peak (or terminal rate). This is in response to sticky inflation that has remained elevated.

Hence, we believe that the US 10-year yield will remain elevated and trend close to 4% in 2023.

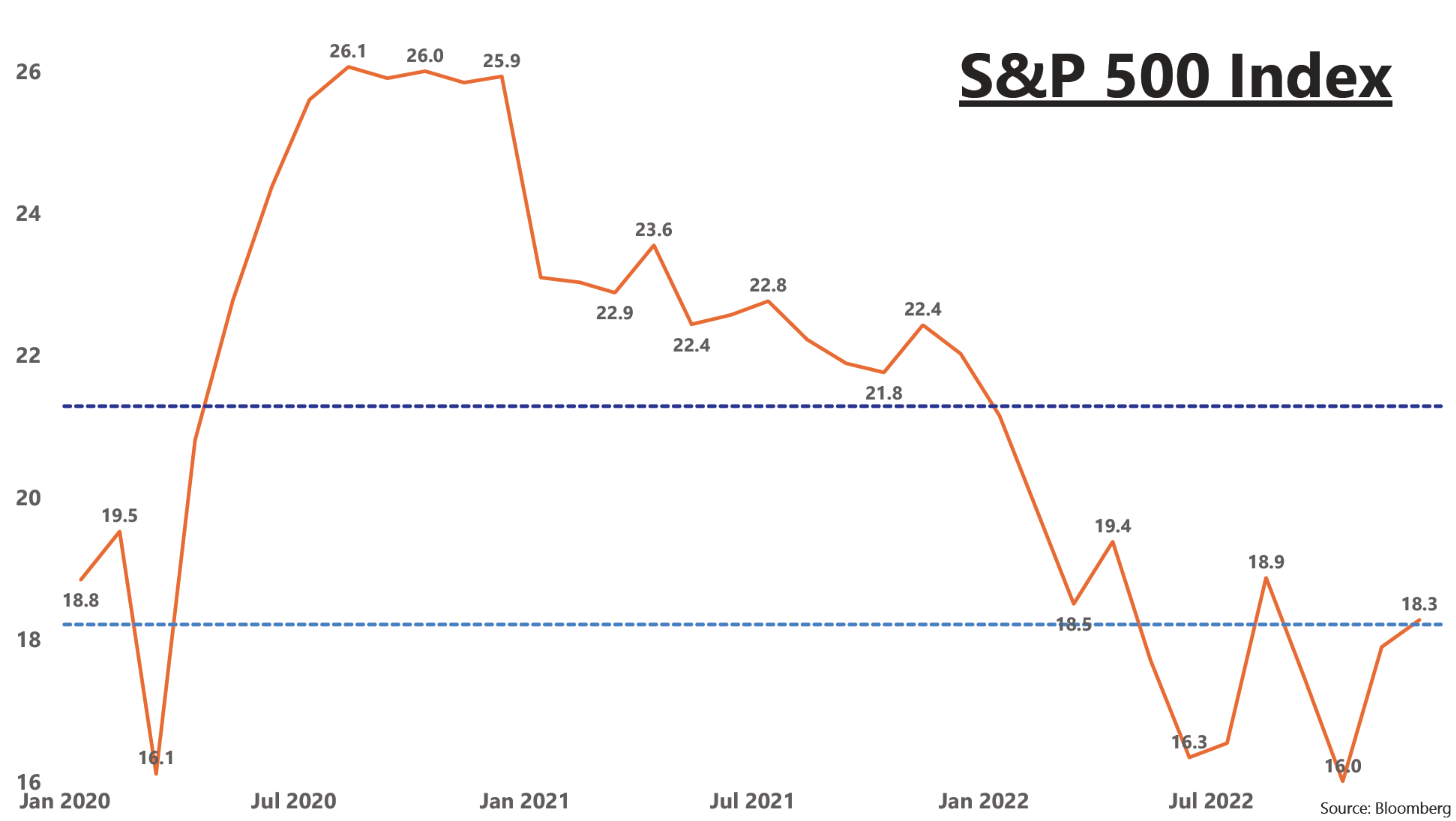
Limited upside for S&P 500 Index

Our 2023 target for S&P 500 Index is 4015. This represents a P/E of 18.3x, 1 standard deviation below its 3-year mean P/E.

S&P 500 Index is currently trading at 18.2x forward P/E, close to 1 standard deviation below its 3-year mean P/E.

We believe that the lackluster performance of US equities will continue.

Key drivers include:
1) Higher Inflation
2) Weaker-than-expected economic growth
3) Stronger US dollar
4) Higher US interest rates



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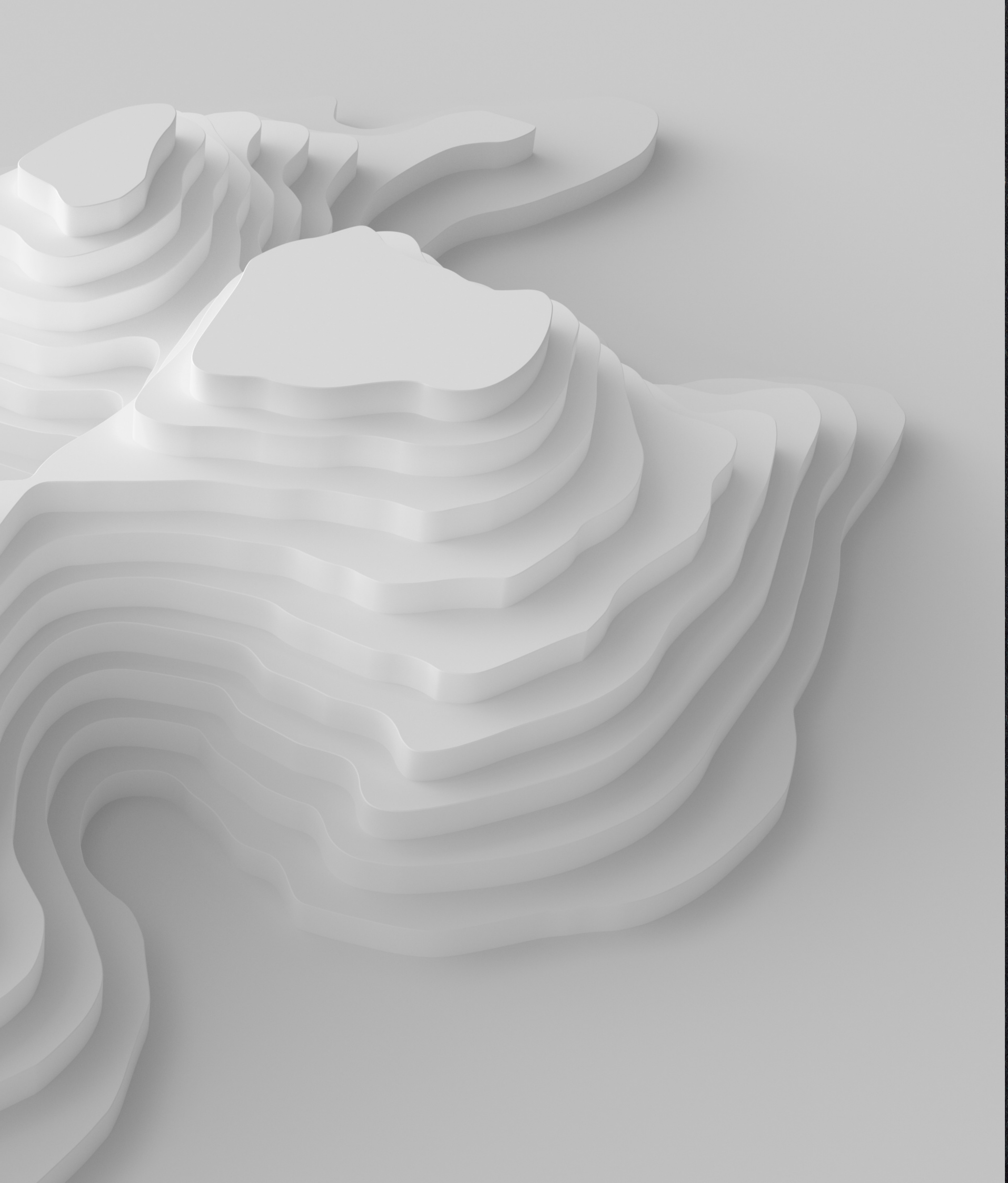

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