AHAM CAPITAL
ASSET MANAGEMENT

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FUNDAMENTAL FLASH

Market Outlook 2023 | Looking Beyond the Challenges

Prepared by AHAM Asset Management

After a brutal year which saw almost all asset classes jolted by inflation and rising interest rates, there are reasons to be optimistic about 2023 as market conditions turn more conducive.

But volatility still lays ahead and things are likely to get tough before it gets easier.

Here are the key investment themes for 2023 and what investors should keep an eye for.

Deep or Shallow Recession?

A recession is widely anticipated in US and Europe. Over the past year, the US Federal Reserve (Fed) and the European Central Bank (EBC) have embarked on a series of rapid and synchronised tightening to tamp down on inflation.

The effects of tighter monetary conditions will now be felt in 2023 as businesses cope with higher borrowing costs and shrinking liquidity.

While the timing of the recession is not certain because monetary policy works with a lag effect, economic indicators have begun to show signs of deteriorating as new orders and manufacturing activity gauges fall.

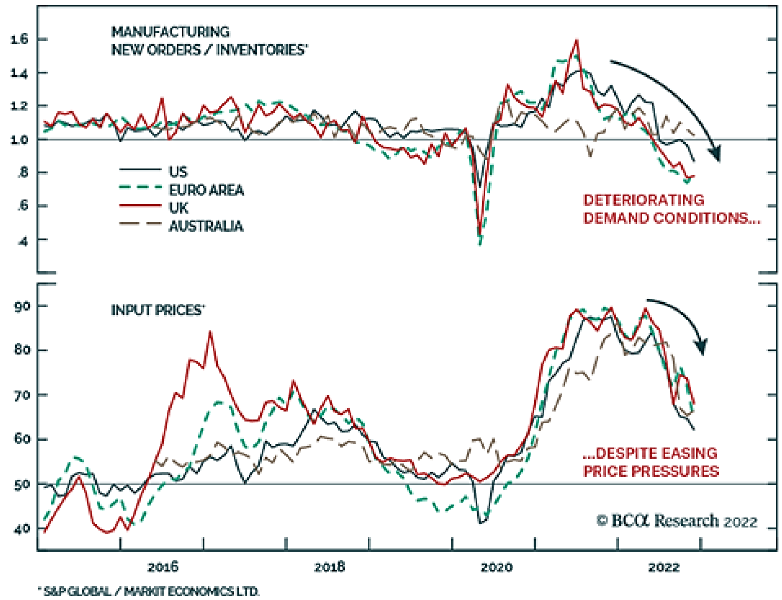
There is also anecdotal news of businesses now having to slash prices aggressively to clear out items which they stocked-up earlier on due to fear of supply shortages.

Flashpoints

- Economic growth will soften with US and Europe likely to fall into recession.
- Inflation seen moderating, though could settle higher than pre-pandemic levels.
- The Fed will similarly ease up on monetary tightening as price pressures cool.
- This bodes well for Asian equities with a weaker US dollar environment and tailwinds from China's reopening.
- Bonds are back as higher yields and cheap valuations provide attractive opportunities.

As operating environments become tougher, we could see more downside to earnings in developed markets (DMs) that could put pressure on stock prices.

Graph 1: Developed economies continue to face significant headwinds



Source: BCA Research, as of 24 November 2022

Fed Slows Down on Tightening

The 'good' news is that a deluge of economic data showing growth weakening as well as fractures in the labour market will bring the Fed closer to the end of its tightening cycle. Greater slack in the labour market and a fall in consumption which makes up to 70% of US GDP may put downward pressure on inflation, thereby allowing the Fed to ease up on tightening.

This may set the scene for a recovery towards the year as the Fed pivots to a pause in tightening. There are already signs of inflation peaking with Consumer Price Index (CPI) gauges showing a broad-based moderation in price pressures that should continue moving forward.

Expectations of a slower pace in tightening could lead to a peak in US Dollar strength which would be a boost for equities especially for emerging markets (EMs) which has historically moved inversely against the greenback.

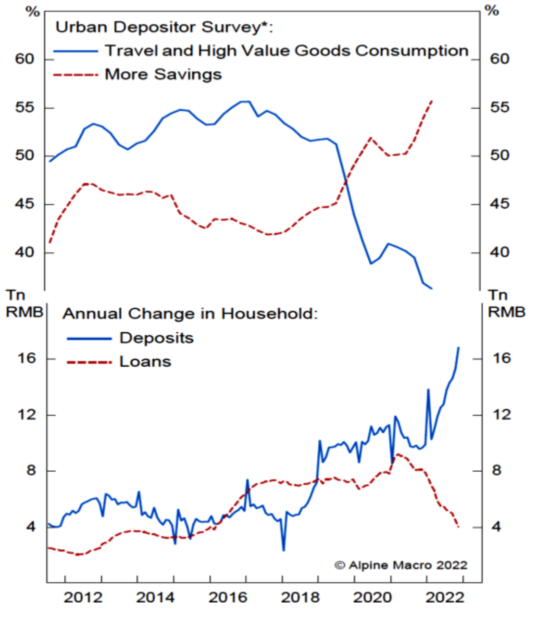
China's Great Reopening

Global recovery will also be supported by China's reopening as authorities shifts away from its strict zero-COVID policy. In an abrupt announcement last December, Beijing announced that it will be unwinding all its COVID restrictions as well as lift its border closures to allow for international travel.

Given extensive pent-up demand, a consumption-led recovery will provide an uplift to growth coupled with the resumption of outbound tourism. Given Asia's proximity and extensive trade ties, the region is seen to be the biggest beneficiary as China fully reopens.

However, its path of reopening is unlikely to be smooth sailing as infections surge. But, once investors are prepared to look past the volatility and the country reaches its peak of COVID, China is expected to be a strong source of growth and returns for Asia.

Graph 2: Massive pent up demand in households



Source: Alpine Macro, as of 20 December 2022

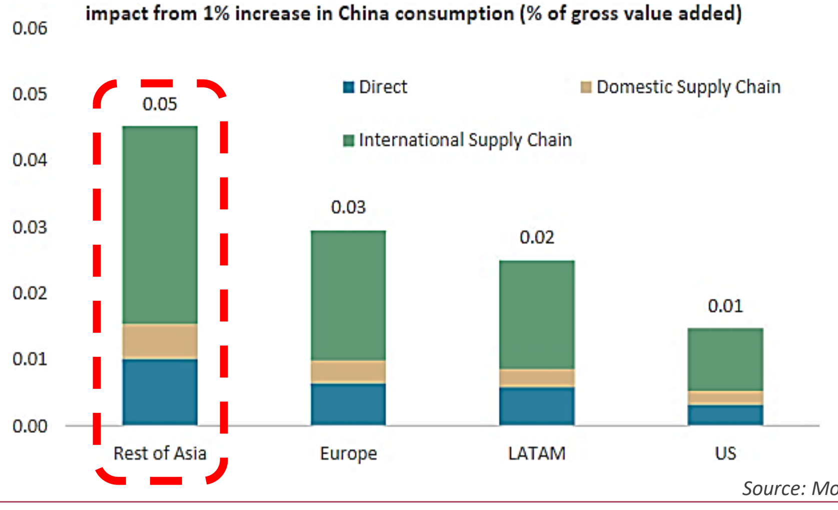
Asia Could Outperform

Against a backdrop of benign inflation and the US dollar strength topping out, Asian equity markets is expected to perform better compared to the US on a relative basis.

US earnings projections still appears too optimistic with EPS forecasts for 2023 only cut by 7%, while Asian markets were revised downwards by over 24%. Tailwinds from China's reopening could also provide a lift to the region as earnings cuts find an earlier bottom.

However, it will be important to monitor how deep or shallow the global slowdown will be as the impact of higher interest rates begin to bite and chip away at growth. There is also a need for more catalysts in order for Asian markets to deliver stronger upside potential.

Graph 3: China's Recovery Benefits Asia



Source: Morgan Stanley, as of 29 November 2022

Malaysia's Recovery Momentum Continues

In contrast to the expected slowdown in the US economy, Malaysia's economic fundamentals remain strong with the gross domestic product (GDP) expected to be one of the strongest in ASEAN this year. Moreover, corporate earnings is forecasted to rebound sharply, after it was dampened by a one-off prosperity tax last year.

From a fund flow perspective, domestic funds are sitting on high cash levels with foreign positioning at near all-time lows. With the return of political stability and a compelling growth story, foreign inflows that could drive markets higher. In every year between 2010 to 2021, whenever there is net foreign buying, our market has been driven positively higher.

Bonds Poised for a Comeback

Bond investors may also see some relief this year after enduring a painful 2022 which saw rates volatility reaching unprecedented highs. The US 10-Year Treasury Yield moved within a range of up to 260 bps last year compared to historical averages of 150-200 bps. In 2023, volatility in rates is expected to temper down as we see a slower pace of adjustment in rates. In addition, a slower growth outlook is beneficial for rates.

On the credit side, valuations are also turning attractive especially with higher yields which give long-term investors an attractive entry point to rebuild exposure. After massive outflows in the fixed income space, we also expect technicals to be more favourable given limited downside risks. A weaker USD environment would also be beneficial for Asian credits as the Fed slows down its pace of rate hikes.

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