SARASIN
& PARTNERS

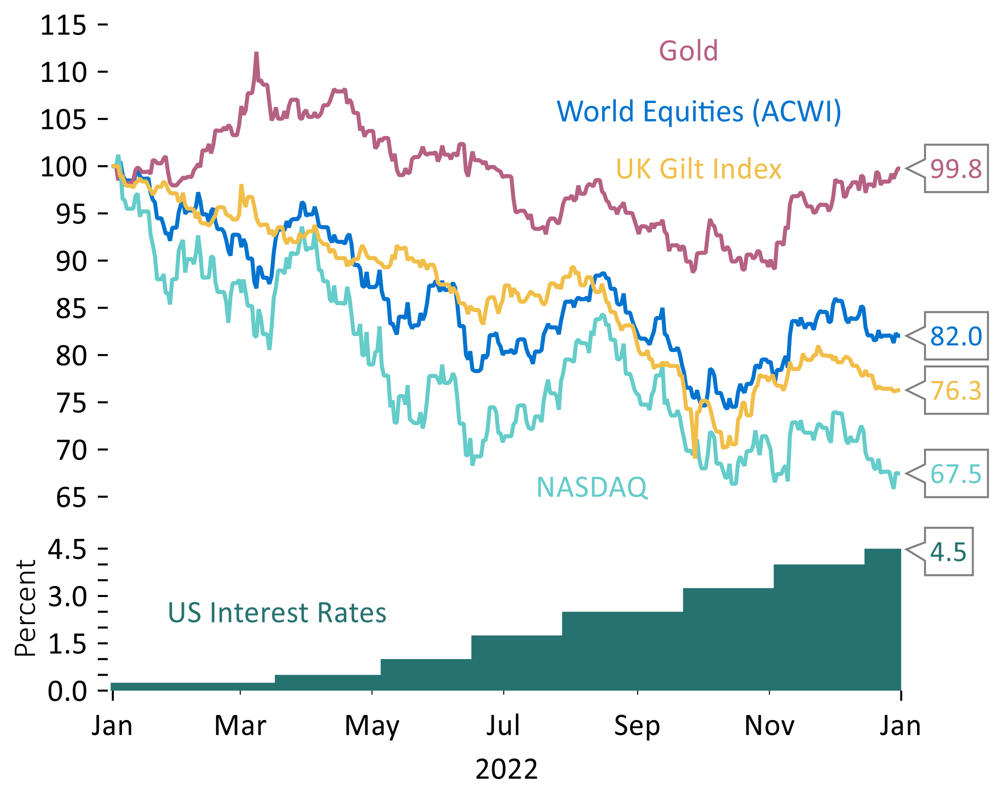
Six minute strategy
Patience please – central banks are not quite finished

9 January 2023

A return to monetary normality was never going to be easy

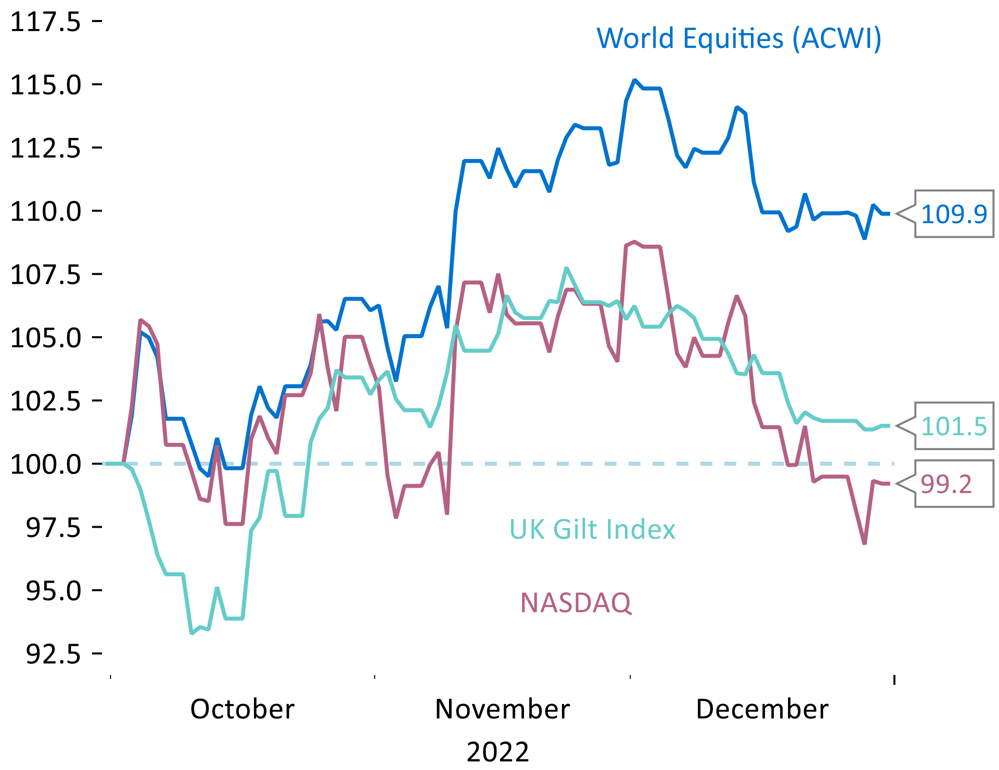
Market returns in 2022 bear the scars of the fight against inflation

All major asset classes showed negative returns in 2022



Source: Macrobond, 05.01.23

Q4 2022 saw a meaningful recovery in global equities

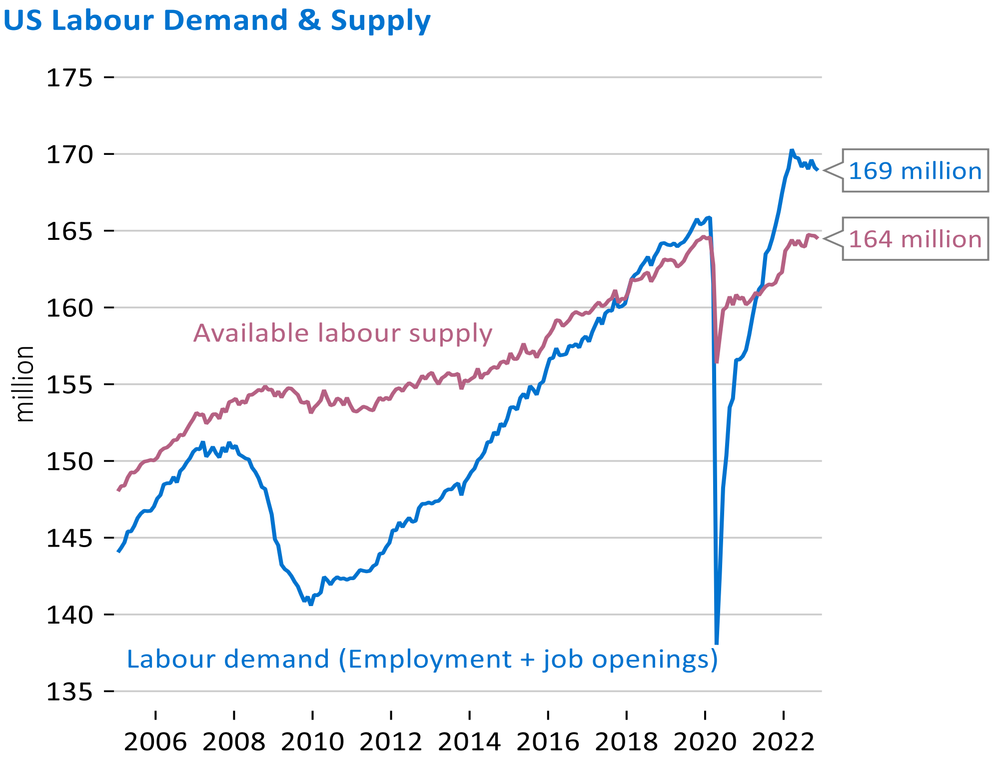


Source: Macrobond, 05.01.23

1. Powell is still facing tight US labour markets…

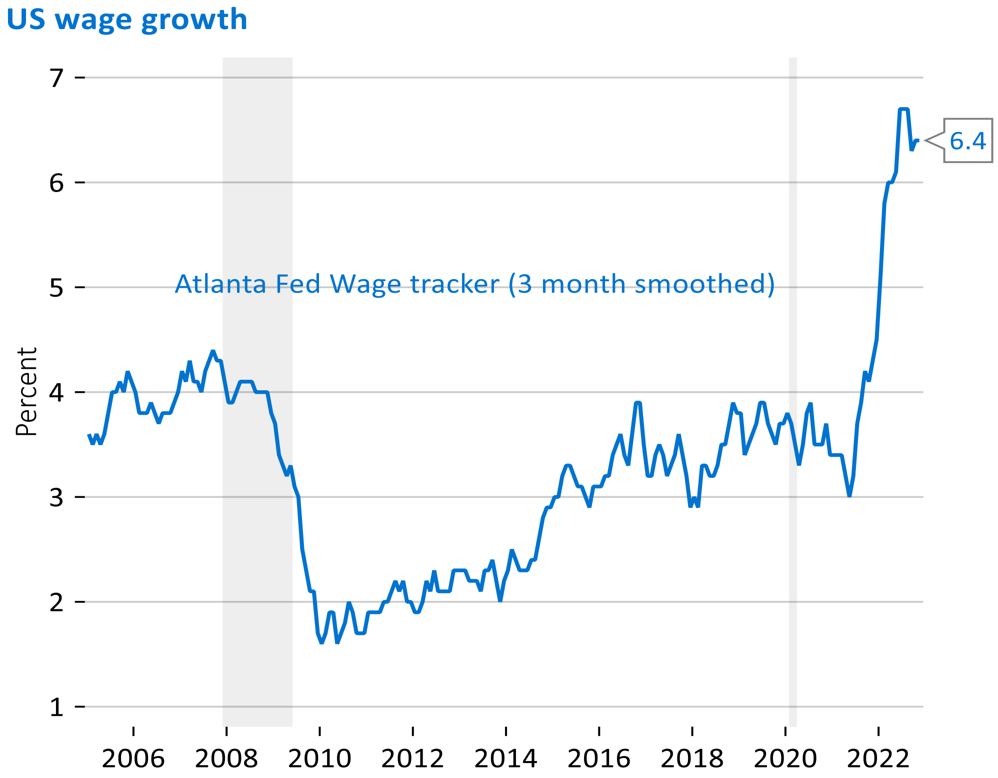
Too many jobs chasing too few people compounded by a Covid reallocation shock

Labour demand *still* needs to decline by at least 5m–6m



Source: Macrobond, 05.01.23

5% wage inflation inconsistent with 2% inflation target



Source: Macrobond, 05.01.23

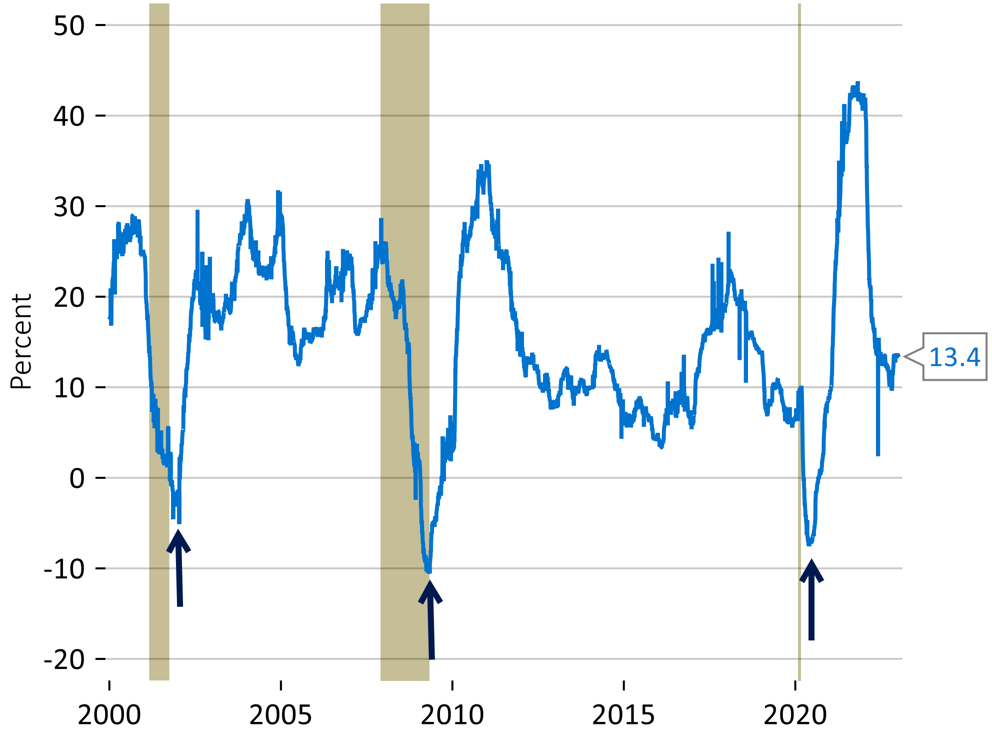
"Participants observed that the labor market had remained very tight, with the unemployment rate near a historically low level, robust payroll gains, a high level of job vacancies, and elevated nominal wage growth." FOMC Minutes December 2022

2. Profits could still fall sharply in a true global recession

Bottom-up earnings look optimistic while margins are still close to record highs

Earnings declines of 5-10% are normal in recessions

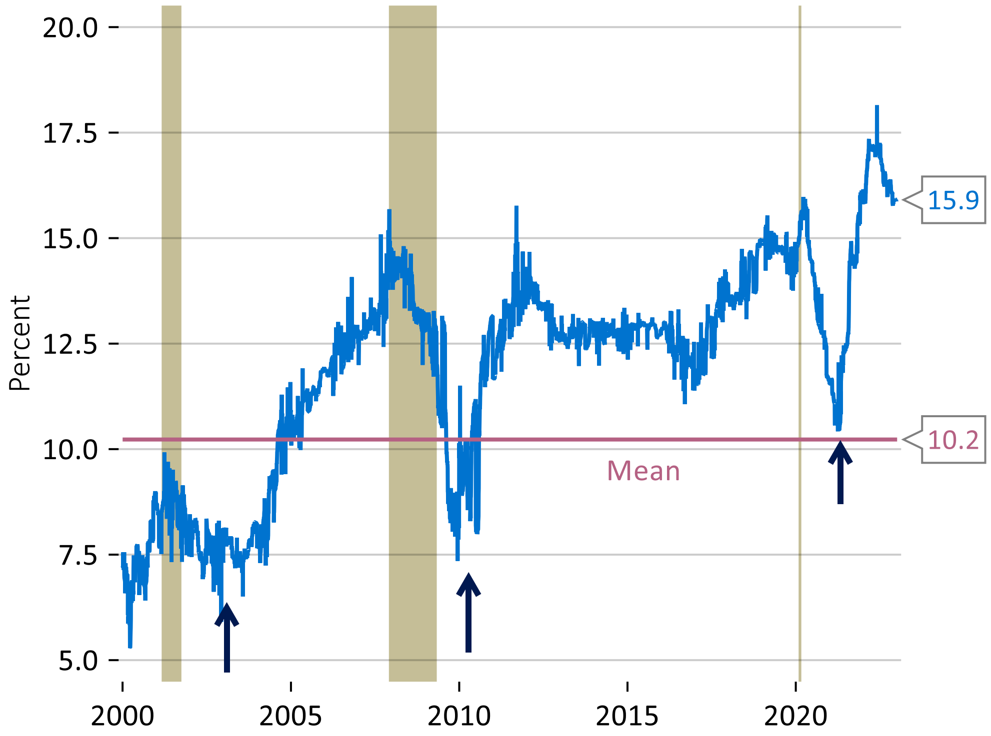
EPS Growth Rate 1 year forecast for World Equities (FactSet)
Shaded bars are US recessions



Source: Macrobond, 05.01.23

Can near record margins survive higher costs forever?

Net Margin World Equities (FactSet)
Shaded bars are US recessions



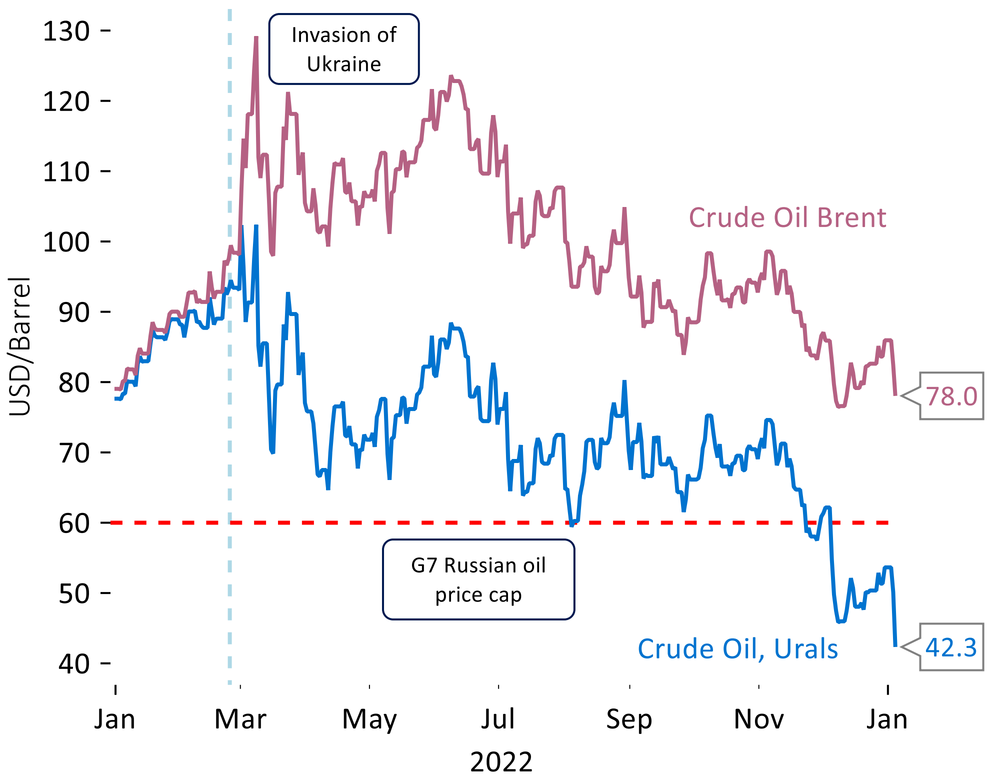
Source: Macrobond, 06.01.23

3. Energy price shock gradually fades in 2022

Energy prices in retreat despite the war – is the de-carbonisation agenda finally left?

Crude oil prices unchanged in 2022 – Russian oil collapses

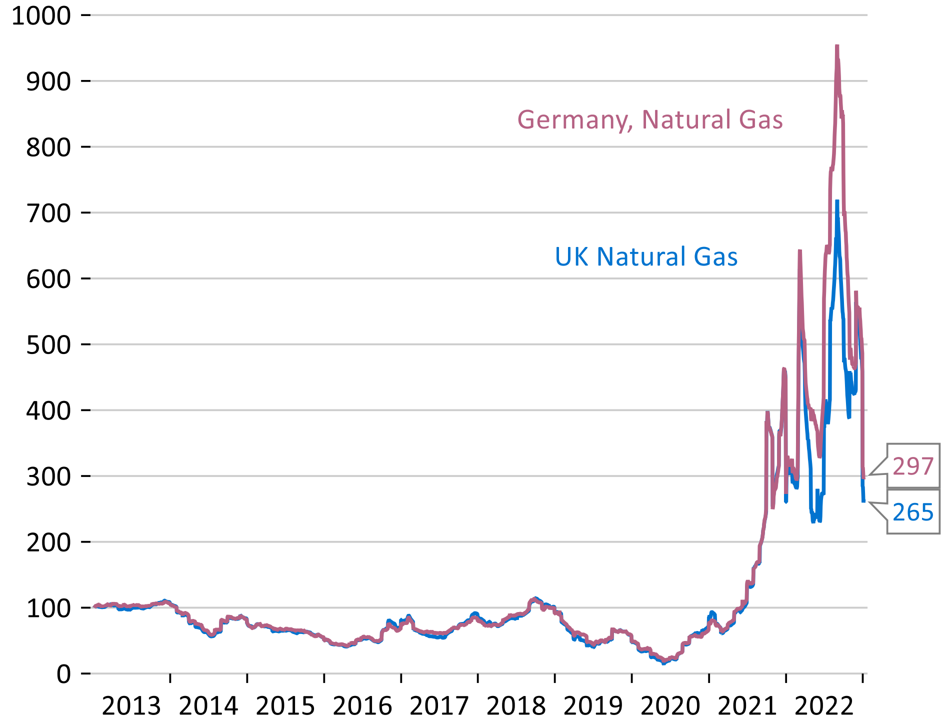
Russian oil impact



Source: Macrobond, 05.01.23

In Europe gas reservoirs are 28% fuller than a year ago.

Energy Prices, Re-based 2013 = 100

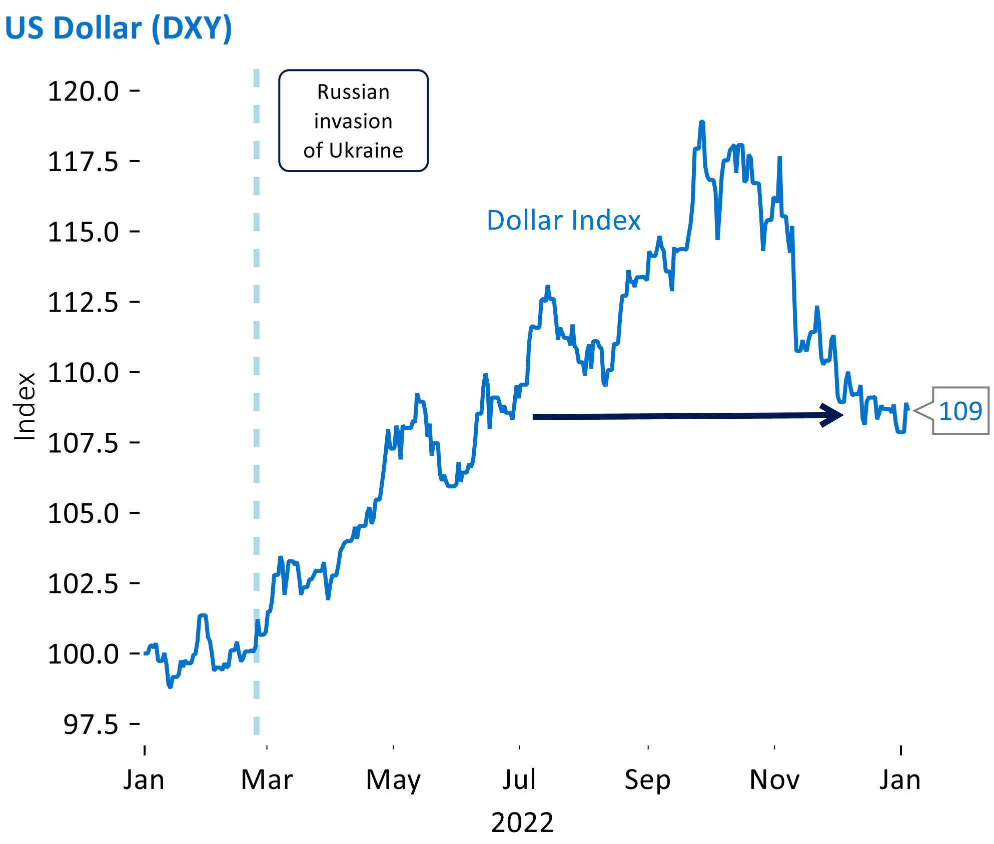


Source: Macrobond, 06.01.23

4. The dollar correction begins – who are the winners?

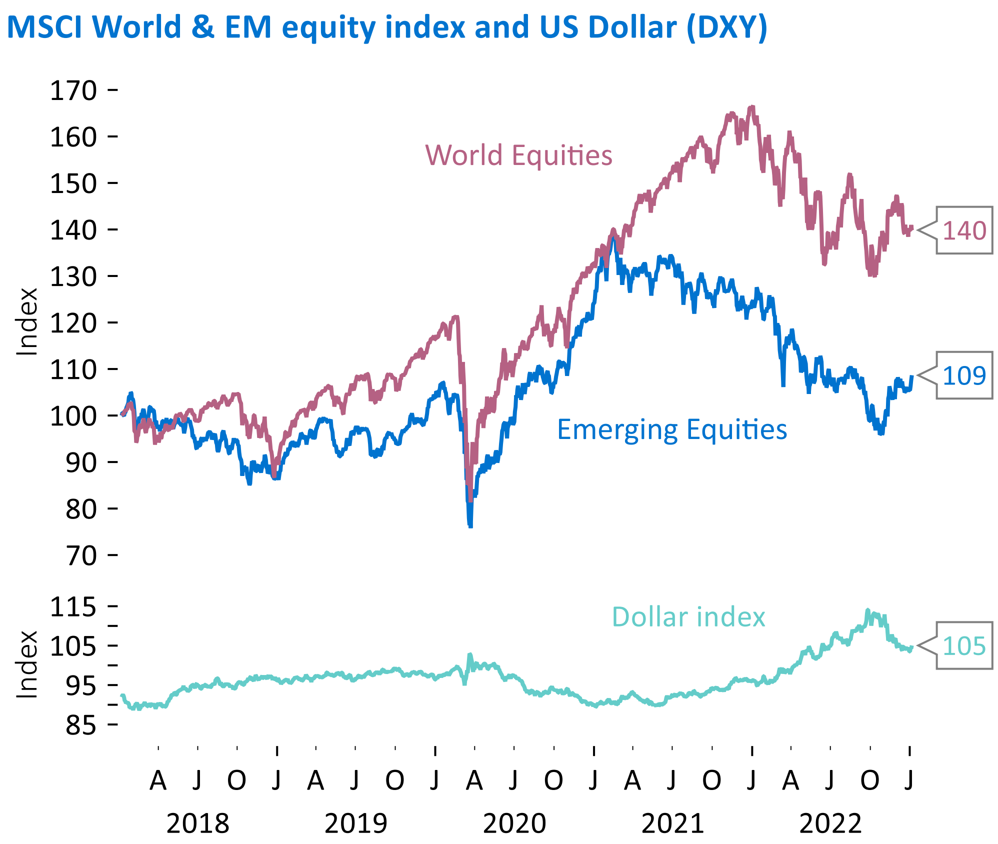
A strong rally across assets in Q4 – a weaker dollar lifts Asia and EM

The US dollar uptrend may now have broken



Source: Macrobond, 05.01.23

A weaker dollar is good for emerging world liquidity



Source: Macrobond, 06.01.23

Patience please – Central banks are not quite finished

Stickier inflation and hawkish central banks leave us cautious a little while longer

Global strategy update – January 2023

Bonds	Neutral • Neutral Government Bonds – global inflationary pressures remain elevated but rates are close to peaking • Neutral Investment Grade Credit – yields attractive – corporate balance sheets healthy
Equities	Underweight • Near record corporate margins clearly exposed in a global recession – a strong thematic overlay needed • Equity valuations are vulnerable if inflation is stickier than the market expects • **Emerging markets** offer opportunities in 2023 as China reopens and US dollar strength ebbs • **Equity insurance** attractive
Alternatives	Overweight • Underweight Correlated Alternatives – higher discount rates and worries over liquidity argues for caution on private equity, infrastructure and renewables • Strong Overweight Uncorrelated Alternatives as effective diversification • Overweight positions in Gold as dollar surge fades
Cash (tactical)	Neutral – no currency preference
Risks	1. Inflation shock not yet abating: US Core inflation remains high in 2023 meaning higher rates for longer 2. Shrinking central bank balance sheets: QT triggers tighter liquidity and volatility issues. Central bank losses intensify budget crisis 3. Military challenges worsen: China-Taiwan reunification risks accelerate – Putin escalates with tactical nuclear 'event'

Source: Sarasin & Partners, December 2022.

Important information

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