

Global Multi-Asset Viewpoint

2023 Global Multi-Asset Team Outlook

GLOBAL MULTI-ASSET TEAM | MACRO INSIGHT | JANUARY 2023

After one of the toughest years for both stocks and bonds in decades, there is a pervasive sense of cautiousness and apprehensiveness on the part of investors and asset owners: is the nightmare over? Or will 2023 bring more of the same?

In this piece, we lay out 8 key macroeconomic and investment themes we expect will materialize over the coming year. Some are a continuation of existing trends, others are new trends we expect to be established in coming quarters, and yet others are reversals of prior trends. However, we do see all these 2023 themes occurring in the context of a broad multi-year regime shift driven by the end of free money and end of low-inflation, structural trends we have been writing about for nearly three years.

1. The Most Anticipated Recession Ever

The consensus expects an imminent (2023), short and shallow US recession. By contrast, we expect a soft landing in 2023, followed by a deep recession in 2024.

A year ago, we expected the trifecta of a doubling in mortgage rates, skyrocketing gasoline prices and a fiscal cliff to drive the US into recession. But the fiscal cliff did not materialize: the effect of the 2020-2021 stimulus continued because nearly half of the \$6trn COVID stimulus was saved. In 2022, households drew down nearly \$1.2trn of excess savings, which helped offset

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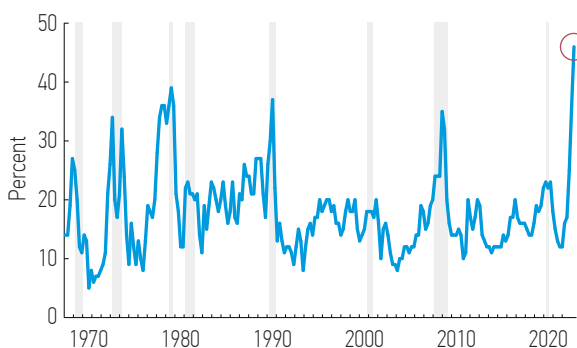


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Display 1: Highest Recession Probability Ever Forecast

Survey of Forecasters: Probability of Decline in Real GDP Over Next Three Quarters



Source: Federal Reserve of Philadelphia Survey of Professional Forecasters. Data as of January 12, 2023. Forecasts/estimates are based on current market conditions, subject to change, and may not necessarily come to pass.

the hit from \$5.00 gasoline and 7% mortgage rates. Ultimately, the US economy bent but did not break.¹

However, with the Fed raising rates by the most in thirty years, most economists and market participants expect a recession in 2023. In this respect, it is likely to be the most anticipated recession ever (see *Display 1*). This is interesting from a contrarian point of view.

We are intrigued by the possibility that, after skirting recession in 2022, the US economy avoids one again in 2023 as gasoline prices have collapsed 35% from last June, supply-shortage-driven inflation is reversing, mortgage rates appear to have peaked, and the COVID fiscal stimulus is still coursing through the economy in the form of excess savings. In addition, the shift from goods to services demand, which is still not complete, is favorable for the US economy as more services than goods are domestically produced. And our proprietary recession indicator, which anticipates recessions by an average of eight months, has still not yet triggered, though it is getting close.

Of course, it's not all sunshine and roses as job growth has more than halved from 600,000 new jobs per month a year ago to 250,000 today, wages are decelerating, and the Fed is likely to bring rates to 5% while inflation drops to around 3% by year-end. But until the COVID stimulus/excess savings are spent, probably by the end of 2023, the economy is likely to keep growing with 2024 being a bigger recession risk, especially if inflation falls but not all the way to 2%, which could cause the Fed to resume rate hikes. In summary, after eighteen months of growth disappointments, there is a good chance that the US economy surprises and does better than the current consensus expectation of growth of near zero growth in 2023. Better US growth and improving growth from Europe, Japan, China and many emerging markets should help global economic growth rebound in 2023.²

In concert with expectations of a recession, there is a near universal consensus by investors and strategists that bottom-up earnings forecasts for 2023 are still egregiously high. The bottom-up forecasts are for global EPS growth of 2% (US +3%, EAFE +1%, EM +2%), the lowest expected growth in thirty years except for four months in 2008-09 and two months in 2020 (see *Display 2*).

Display 2: Near Lowest Ever Forecasts for Earnings Growth

Bottom-Up Consensus 12-month Forward EPS Growth for MSCI ACWI Index



Source: MSIM Global Multi-Asset Team Analysis and Haver Analytics. Data as of January 12, 2023. Forecasts/estimates are based on current market conditions, subject to change, and may not necessarily come to pass.

Top-down strategists are predicting 10-20% misses in 2023. Our estimate is for a more modest 7% miss which will result in earnings shrinking -5% in 2023—this ought to have only a modest impact on equities given that the average miss over the past thirty years has been about -5%.

When the recession eventually arrives, likely in 2024, it is likely to be deep, not short and shallow as the consensus expects: for inflation to fall to 2% either requires zero growth for nearly three years or a 2% decline in economic activity in one year.³ A normal recession is thus much more probable, most likely in 2024, when excess savings run out and the Fed is still tight.

2. The Reversal of the Great Inflation of 2021-2022

2022 saw core inflation skyrocket to a peak of 6.7% on CPI and 5.4% on PCE in the US. That was more than a 400 bp acceleration from the lows of 2021. This inflation tsunami occurred in most developed and emerging markets. For example, the Eurozone saw headline inflation hit nearly 11% in December (core 5.2%) from less than 2% in 2021.

¹ GDP did shrink about 1% in the first half of 2022 but Gross Domestic Income, judged to be a better indication of economic growth than GDP, and another measure, Final Sales of Domestic Product, were both flat. All three rebounded into positive territory in the second half.

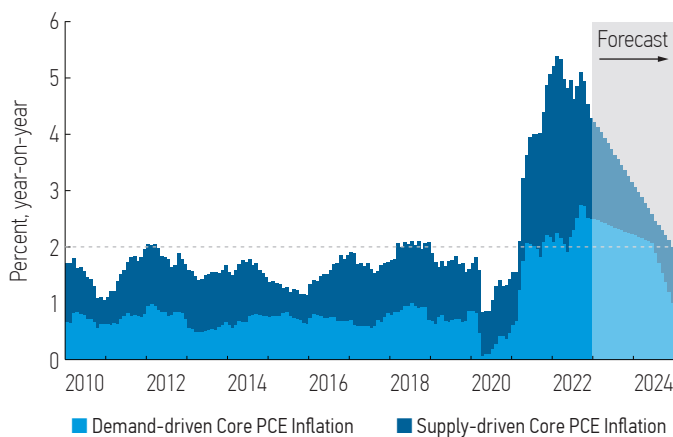
² Since the Eurozone, UK, China and EM ex-China either had actual recessions, multiple deep one-quarter potholes or subpar growth in 2022, the rebound in the rest of the world's growth in 2023 is likely to be stronger than in the US. The result will be better global growth in 2023, though not quite at trend and not quite as high as the consensus expects.

³ Historically, every 100 bps decline in core inflation has necessitated a 2.5% widening of the output gap. If demand-driven inflation is 1.5% above normal, then a nearly 4% widening of the output gap will be required for demand-driven inflation to drop 150 bps and bring overall inflation back below 2%.

Our framework has been that inflation has shifted structurally higher from the 2010s (see May 2020 Viewpoint “*Stars Aligned for Higher Inflation*”) and that 2% could turn out to be a floor, rather than the ceiling that it has been in the prior couple of decades. However, a combination of cyclical supply and demand factors drove the acceleration in inflation in 2022 to much higher levels than the structural trend would imply. Our work, partially based on research from the Federal Reserve of San Francisco, indicates that about half of the acceleration in core inflation was supply-driven and the other demand-driven, and that most of the supply-driven component will recede, as it has already started to, over the coming year (see Display 3 below).

Display 3: Supply-Driven Inflation to Decline but Demand Side Sticky

Core PCE Inflation: Supply- vs. Demand-Driven



Source: MSIM Global Multi-Asset Team Analysis, Federal Reserve of San Francisco, Haver Analytics. Data as of January 12, 2023. Forecasts/estimates are based on current market conditions, subject to change, and may not necessarily come to pass. Past performance is no guarantee of future results.

If supply-driven inflation (in dark blue above) goes from contributing 2.6% to its historical norm of 1.0%, we expect overall core inflation will fall to 3.5%. Demand-

driven inflation (in light blue below) is also slowing from 2.5% due to sub-par growth in 2022 but will likely require a deeper economic downturn to drop back to its 0.8% historic contribution to overall inflation. Historically, it has taken a nearly 4% output gap widening for inflation to drop 150 bps. So, without a recession, overall core inflation could drop to 3% or modestly below, but getting to the Fed’s 2% target will likely require a recession.

However, we believe inflation will drop so dramatically in 2023 from the 2022 peak, mostly from easing supply-driven inflation, that the Fed is unlikely to push the economy into recession until it is clear inflation will stabilize far above target. In addition, policy rates of 5% should be sufficient to trigger a significant slowdown⁴ (though the reservoir of pent-up savings may help offset this). We thus expect a pause starting in Q2 until at least September while the Fed assesses how low inflation drops and whether growth slows enough to reduce inflationary pressures in the labor market. Eventually, if we are correct that demand-driven inflation can only be cured by more slack in the economy and the labor market, the Fed will need to either raise rates even further or at least hold them at 5% for longer than is expected by the market. Most likely the latter, as the delayed impact of the fiscal cliff (i.e., the excess savings running out) could cause as much as a 4% swing in consumer spending in 2024.⁵

This is our baseline case but there are obviously other scenarios which we will be closely monitoring, particularly if our baseline expectation of disinflation becomes increasingly discounted in markets. The two most likely alternatives would be “Immaculate Disinflation” or renewed overheating with the latter most likely in late 2023 or 2024.⁶

3. Bear Market Interrupted but Not Complete

In addition to forecasting an imminent, short and shallow recession, the market consensus generally expects that stocks will have a difficult first half of 2023, with recession and weaker earnings as drivers, but will rebound in the second half on recession exit, bottoming earnings

⁴ 5% policy rates – core inflation of 3% would result in positive 200 bps real rates, which has historically been sufficiently tight to trigger a significant slowdown.

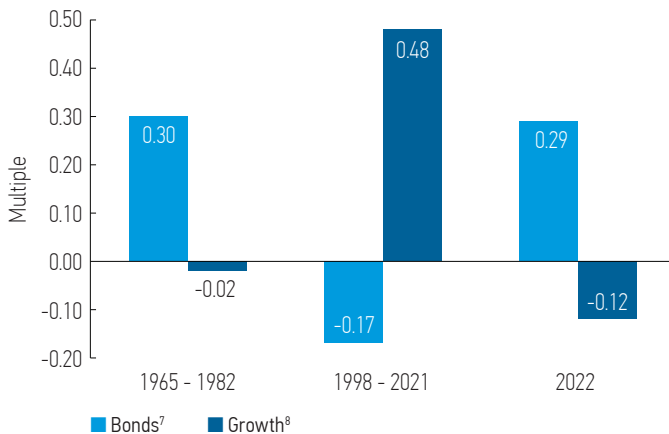
⁵ Household excess savings from unspent fiscal stimulus accumulated to approximately \$2.3trn, about half of which has been spent already. In recent months, households drew these savings down at a nearly \$100bn monthly pace which, if maintained for a whole year, would equate to 6% of disposable income. We expect that 2023 will see approximately \$75bn per monthly of spending from excess savings (approximately 5% of disposable income) leaving a sixth of the original \$2.3trn unspent. Assuming the rest of excess saving remains unspent, starting in 2024, households are likely to have to reduce their excess savings-linked consumption by up to \$75bn a month. Depending on how fast households adjust their spending, the impact on consumption could be from 2.0% to 4% per annum.

⁶ “Immaculate Disinflation,” would see core inflation drop back to 2% without the unemployment rate rising much and without a recession. This would occur if most of the inflation we have observed in the past two years was driven by supply issues, not only in goods but also in the labor market, and/or that prices slide back down very steep supply curves as the overheated demand environment of 2020-2021 cools back to normalcy. This Immaculate Disinflation scenario would enable an economic soft-landing with rate cuts in late 2023-early 2024 and a renewed economic expansion for a few years. This is clearly the most contrarian scenario for markets as it would argue for a continuing rally in stocks (and bonds) and a rebound in commodities. On the other hand, renewed overheating would result from a more vigorous reacceleration in growth than we expect thus preventing demand-driven inflation from declining much or at all. This would bring the possibility of 6% Fed Funds back on the table.

and Fed cuts. However, we believe that this framework is based on the past two decades where inflation was absent and economic/ earnings cycles drove stock market performance. The current market cycle is more driven by inflation, reminiscent of the 1965-1985 era (see *Display 4*).

Display 4: Similar to 1965-1982, Stocks Driven by Yields, Not by Growth as in Past Two Decades

Correlation of Stocks to Bonds and Economic & Earnings Growth



Source: MSIM Global Multi-Asset Team Analysis. Data as of January 12, 2023. The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment. **Past performance is no guarantee of future results.**

During those inflation-driven cycles, the stock market tended to bottom with peaks in inflation, policy rates and bond yields, not with economic activity troughs which tended to occur a few months or quarters later. And a peak in inflation, policy rate expectations and bond yields is what we saw in the fourth quarter: core CPI peaked at 6.7%, terminal Fed Funds expectations peaked at 5.15%, nominal yields peaked at 4.34% and TIPS at 1.79% (intraday). With inflation on its way to 3%, Fed Funds likely to peak around 5%, nominal yields at 3.7% and TIPS at 1.3%, inflation fears and Fed fears have likely peaked, at least for the foreseeable future. As a result, the stock market low in October could prove a lot more durable than the consensus expects, at least until the Fed is forced to reconsider (if inflation turns out to be too sticky) or the economy slips into recession—neither of which we expect until the later part of the year. Net-net, our growth, inflation, and Fed scenarios argue for a stronger first half for stocks but a tougher second half and 2024, as taming inflation remains unfinished business.

As a result of these views, we have been overweight global equities (in the Eurozone) and bonds (mostly US and EM) since October. However, we recognize that global equities, and US equities in particular, have likely not fully adjusted to the higher inflation regime and the end of free money. We have discussed at length our views that the 2009-2022 bull market ended in the type of speculative mania that usually takes years to unwind. Despite a 25% decline in 2022, US stocks never got close to being cheap at the lows and are currently back to expensive levels which are inconsistent with inflation still forecasted to be above target in a year, with positive real interest rates both at the short and the long end, and with a likely recession in 2024. For this reason, we have tilted our global equity overweight to the Eurozone where equities did get cheap in October (10.5x forward EPS), and where the economy is likely exiting an energy-shock-driven recession and underlying inflation is less likely to require severe monetary tightening and a recession.

We would expect to reduce this global equity overweight and move back to an underweight position if our macroeconomic scenario for 2023 plays out. It is worth remembering that, after the late 1990s bubble, it took three years for S&P 500 multiples to compress from 25x to 14x and another six years (and the GFC) to get to outright cheap levels of 10x—and those low multiples were achieved with inflation below 1%, trillions in QE, ZIRP and hundreds of billions in fiscal stimulus. This cycle, US multiples compressed from 23x to 15.5x and are already back to 17x with inflation at twice the target and rates on their way to 5%. In one hundred and forty years, a secular bull market in US stocks has never started with such high earnings multiples—the start of the next secular bull market is likely years away.

Leaders of the Next Cycle Emerging

We have long been of the view that the winners of one decade are rarely winners of the next. This is an easily observable phenomenon over the past 60-70 years for which financial data is widely available. This has applied to stocks and stock market indices, to industries and themes as well as to investment styles and countries. The long stock bull market of the past twelve years saw some very powerful leadership trends which we believe are in the process of changing or reversing (or soon will). In the section below, we highlight five new areas of leadership which will become more visible in 2023 and will likely persist over the coming years.

⁷ Bonds returns: 10-year Treasuries only for 1965-1982, average of 10-year Treasuries and 10-year TIPS for 1998-2021 and 2022.

⁸ Growth: average of correlations with EPS growth (quarterly operating EPS 1965-1982 and 1998-2021; weekly forward EPS 1998-2021 and 2022) and monthly U.S. All-Industry GMA composite PMI (all periods).

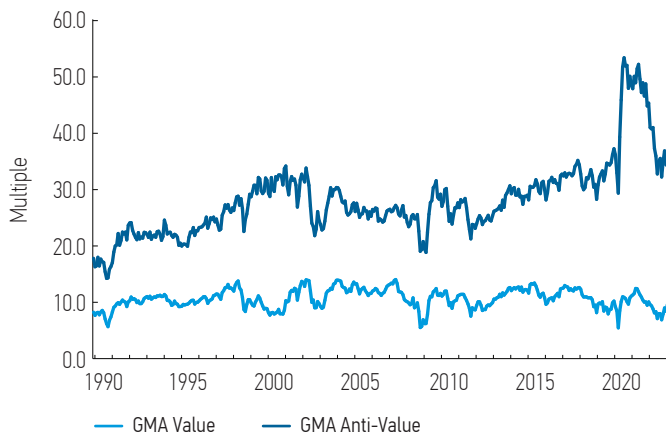
4. Value Bull Market Continues (Has Anyone Noticed?)

The 2009-2021 equity bull market saw one of the most powerful advances in Growth stocks of the past half century. Growth stocks outperformed Value by 145% from their trough in 2006, with the last four years (2017-2020) seeing 90% outperformance (using the Russell 1000 Growth and Value Indices). That is even bigger than the 1990's 76% Growth (relative) bull market (with 1998-2000 seeing +65%).

Interestingly, since the summer of 2020, Value stocks have outperformed Growth significantly (+39% on both Russell Value/Growth and our GMA Value/Anti-Value)⁹ but few market participants appear to be viewing this as what we believe it is: the end of the Growth bull market of the 2010s and the beginning of the Value bull market of the 2020s. This is partially understandable since it has been so long since Value stocks have had a sustained period of outperformance—more than fifteen years—and any trend that persists for a decade has a way of becoming entrenched in expectations as the new reality. In practice, this is exactly what gives rise to the tremendous opportunity we see in Value stocks: the Value bull market

Display 5: Value Stocks Still Extremely Cheap Compared to Anti-Value

GMA Value⁹ and Anti-Value⁹ Stocks 12m Forward P/Es



Source: MSIM Global Multi-Asset Team Analysis. Data as of January 12, 2023. The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment. **Past performance is no guarantee of future results.**

has already begun (two years ago), but the valuation gap between Value and Anti-Value remains tremendous¹⁰ (see *Display 5*). For the past decade, “selling the Value rips” and “buying the Growth dips” was the recipe for success—the opposite is now likely true: sell the Growth rips and buy the Value dips. Importantly, Value stocks are cheap and attractive not just in the US but in Europe, Japan and Emerging Markets as well.

We have been overweight US Value vs Anti-Value stocks in our GMA portfolios but also in our [MSIFT US Dynamic Value Fund](#), and recently added EMU Value vs Anti-Value positions to the GMA portfolios as well. We expect to continue to broaden this exposure.

5. The Return of Non-US

US stocks have trounced non-US stocks for so long that many US allocators are starting to wonder: why bother with the trouble of non-US investing? The best and largest economy is right here at home, with the best companies, the most innovation, the deepest capital markets, the best shareholder protections. All true, or at least partially true, but also misleading on two counts: first, that is more of a description of the past decade than the next decade and, second, it does not address the most important driver of future returns, the price being paid.

Since 2009, the US benefited from: an absence of serious crises (having earlier suffered from a housing and banking bust), low inflation, easy money, an appreciating currency, a tech boom, and a corporate tax cut—no wonder US stocks outperformed non-US stocks by 200%! However, the many advantages US stocks benefited from in the 2010s appear to be reversing in the 2020s: the US economy is the most overheated of major economies with inflation most entrenched, the US is also facing the highest policy rates in the developed world, both of which increase the likelihood of an eventual recession. In addition, the US dollar bull market is likely over (see below) and a high index weighting in overpriced tech stocks is no longer an advantage. In addition, US stocks have gone from trading at par with global stocks in 2009 to trading at the biggest premium ever. Expensive valuations and a clear weakening in previously superior fundamentals likely mark the beginning of the end of the US’ outperformance. Unlike the Value bull market which has been in train for two years, international stocks’ outperformance is a nascent

⁹ GMA Value (and Anti-Value) are defined as the cheapest (and most expensive) quintile of stocks in each sector within the S&P 500 and S&P 1500 indices, based on our composite measure of 6 valuation metrics, including forward price to earnings and free cash flow yield. Stocks within each sector are equal-weighted. We believe this is a better definition of Value than most indices offer.

¹⁰ By the summer of 2020, after the monster outperformance of Anti-Value and Growth stocks of the prior few years, US Anti-Value stocks traded at a 265% premium to Value stocks, exceeding the Tech Bubble’s March 2000 premium. Since then, Value stocks have outperformed by nearly 39% but Anti-Value stocks are still trading at nearly a 200% premium vs a historical premium of 100%. Closing that excess premium over the coming two to five years could generate more than 50% outperformance for Value stocks.

trend, having just started in October 2022, but one we expect to last many years. Within “international” stocks, we expect the following to outperform US equities:

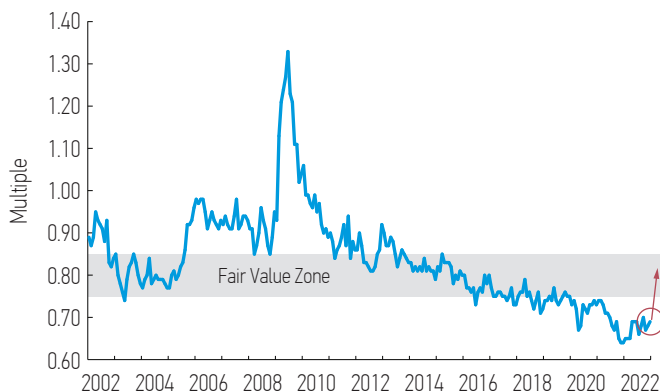
- **JAPAN’S BACK:** after a thirty-year derating, Japanese equities are priced at an attractive 20% discount to US equities and the Yen is now so cheap that manufacturing unit labor costs are lower in Japan than in China. Even though Japan is not experiencing an inflation surge like the US or even the Eurozone, there are indications that Japan is likely exiting its twenty-year deflation nightmare with land prices finally beginning to rise and “true” core inflation approaching 2%. Monetary policy is likely to begin normalizing over the coming quarters but is unlikely to get tight as inflation is not excessive, simply returning to target. In addition, due to thirty-years of underperformance, Japan has been all but forgotten by major asset allocators (remembering that the opposite of love is not hate, but indifference!). All in all, Japan is a cheap equity market, with a competitive economy coming out of deflation, and with very few structural bulls, a very attractive combination.

- **EMU SURVIVES THE SEVEN PLAGUES:** In the 2010s, the Eurozone suffered multiple episodes of sovereign debt panic, with five countries ultimately requiring bailouts or support from the European Union, and just when the peripheral crises began to ebb, Brexit caused another panic in the Eurozone. In the 2020s, just as Europe was about to turn the page on crises, Russia unexpectedly invaded Ukraine causing an energy shock as big as the twin oil shocks of the 1970s. Each of these seven crises took European equities to new lows relative to the US: by October 2022, Eurozone equities had underperformed US equities by a staggering 72% in common currency with the help of the Euro going back below parity for the first time since the early days of the Euro’s founding. At the recent October 2022 low, Eurozone equities were trading at a 36% discount to US equities, nearly twice their normal discount. Even after outperforming by 20%+ from October 2022 to January 2023, EMU equities still trade at a 28% discount to the US (see *Display 6*).

In addition, it is looking increasingly likely that the worst of the energy crisis has passed (after significant energy demand destruction and shift in sources of supply) and that the economy is exiting a mild and short recession. The ECB is normalizing policy rates but, given much lower wage growth, will likely not need to raise rates into restrictive territory (though that is a risk). Most investors are still shell-shocked from the most recent crisis and remain pessimistic. In summary, a cheap market (at least relative to the US), an economy

Display 6: Most International Equity Markets Trading at Big Discount to US Stocks

Eurozone, Japan and EM ex-China 12-Month Forward P/E relative to U.S.



Source: MSIM Global Multi-Asset Team Analysis, Haver Analytics, IBES, Factset. Data as of January 12, 2023. Eurozone, Japan and EM ex-China Forward P/E equal-weighted. Forecasts/estimates are based on current market conditions, subject to change, and may not necessarily come to pass. **Past performance is no guarantee of future results.**

exiting recession and a crisis, with still deep oversold conditions and a very competitive exchange rate. We have thus been overweight Eurozone equities on an unhedged basis (funded by a US equities underweight) and continue to expect outperformance in 2023 and likely beyond.

- **EM EX-CHINA RE-EMERGES:** similar to Japan and Europe, though for different reasons, Emerging Markets have underperformed significantly in the past decade. This was in large part due to the unwind of the EM/China / BRICs / commodities boom of the 2000s. In addition, the dominance of large cap tech—really only present in China, Korea, Taiwan—stranded the rest of EM. Finally, it was also the result of poor economic policy (in Turkey, South Africa, Brazil, etc.). Now, nearly twelve years after the peak of the EM boom in 2010, EM ex-China equities have nearly roundtripped to their post-1998 Asian crisis (relative) lows. Valuations are not quite as low as in 1998 to 2001, but EM ex-China equities recently hit a 44% discount to the US (though are now at a 28% discount). Just like the Euro and the Yen, EM ex-China currencies are the most competitive they have been in thirty years. Inflation in the emerging markets is now only slightly higher than in the US and developed world, with real interest rates in positive territory. In 2023, we expect EM ex-China GDP growth to outperform the US and developed markets. Historically this has been a strong catalyst for earnings and market outperformance, particularly from such a low valuation and FX starting point.

6. US Dollar Bear Market Has Begun

Similar to US equities and for some of the same reasons, the US dollar has performed spectacularly in the past decade. The combination of the housing and banking bust of 2008-2009 and multiple rounds of QE/ ZIRP took the US dollar to its weakest level in real effective terms since Bretton Woods. From this record low starting point in 2011, the US dollar exploded into a spectacular eleven-year bull market supported in the last two years by an overheating economy and an increasingly hawkish Fed. We expect that the US dollar bull market has ended and that a US dollar bear market has begun. The catalyst for the turn was the triple peak in inflation, Fed expectations, and bond yields in the fourth quarter. The trend towards a weaker USD will continue as non-US growth improves over 2023 and non-US central banks tighten monetary policy. A recession in late 2023 or 2024 would seal the deal for the US dollar. Until then, multiple dollar bear market rallies will likely play out in the coming year, but the tide has turned on the US dollar and the past decade's USD strength is in the process of reversing.

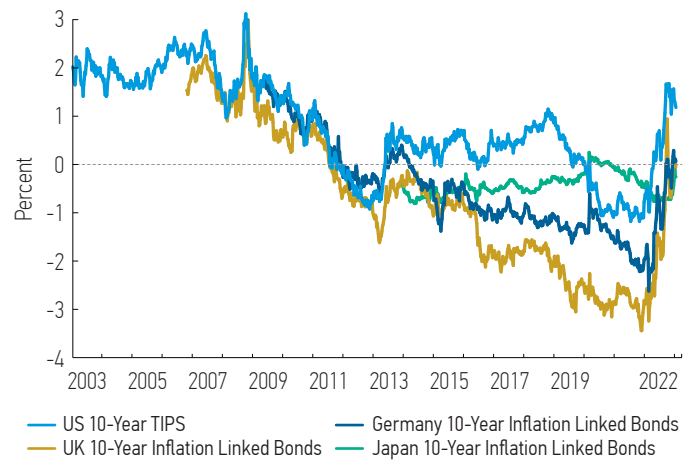
7. Light at The End of the Tunnel For Bond Holders

For more than a decade, as central banks fought one deflationary crisis after another (housing, banking, peripheral eurozone, COVID), real yields collapsed further and further into negative territory, culminating in an average negative 2% real yield across the US, Germany, Japan and the UK in early 2022. Never had governments paid so little to bondholders. As one pundit described it: return-free risk for bond holders. The inflation shock of 2021-2022 and the tardy monetary policy response caused a huge backup in policy rates and market yields resulting in the worst drawdown for government bonds in history. One small silver lining is that one developed market now offers real yields high enough for some potential return and some deflation protection: the US, with real yields between 1.35% (10-year TIPS) and 2.25% (2-year TIPS) (see *Display 7*).

With cash rates heading to 4.5% and above, longer maturity bonds have some competition but, at least, offer positive real yields and have room to rally 100-200 bps to hedge portfolios in case of a deflationary accident. Over the medium term, the end of the low inflation regime will likely prevent the return of nominal yields to the last decade's low levels. However, secular downward pressures

Display 7: Partial Normalization in G-7 Inflation-Linked Bonds

US, Germany, UK and Japan 10-Year Inflation Linked Bonds



Source: MSIM Global Multi-Asset Team Analysis, Haver Analytics. Data as of January 12, 2023. Past performance is no guarantee of future results.

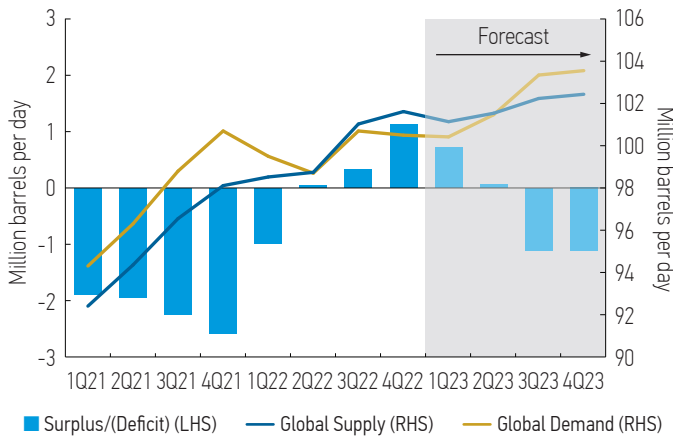
on real interest rates, such as slowing trend growth in most major economies and large aggregate debt burdens will ultimately lead to lower medium- and long-term real yields. Structurally stickier inflation in the context of constrained or suppressed real rates will eventually force medium-term inflation breakevens higher. Current levels price in a return to lowflation (though, in light of the disinflation that we expect this year, this repricing will likely play out with some delay). Most other markets outside the US have real yields that are still too low, close to zero, and are not offering any real return and not much deflation protection. In a world of modest growth but no recession, Emerging Markets local currency bonds are somewhat attractive with decently high real yields, cheap currencies, peaking/ falling inflation.

8. Commodities Back in Favor as EMU, UK, China Exit Recessions

After a decade of dismal performance, commodities sprang back in the aftermath of the pandemic, posting substantially above-average returns in 2021 and 2022 of 40% and 26%, respectively. While this leaves many commodities trading above the high end of their cost curves, this overvaluation is likely to persist and even extend, despite modest global growth in 2023.

Display 8: Oil Market Deficits Likely as Demand Recovers and Supply Growth Moderates

Global Oil Supply vs. Demand



Source: MSIM Global Multi-Asset Team Analysis, Haver Analytics. Data as of January 12, 2023. Forecasts/estimates are based on current market conditions, subject to change, and may not necessarily come to pass. **Past performance is no guarantee of future results.**

First, demand for oil is likely to improve this year as a result of continued reopening and normalization of travel in China and much of the rest of Asia (see *Display 8*).

Second, overall commodity demand will likely be higher than expected as global growth will be more commodity-intensive than in the past (with the exception of China). An extended period of underinvestment in equipment and structures in most advanced economies has left capital expenditures at depressed levels, and a period of catch-up investment spending has begun. Large energy infrastructure spending in Europe in the middle of near-recessionary conditions is just one such example. Reconfiguration of global supply chains, rising defense spending and decarbonization-driven rebuilding of energy infrastructure are likely to continue to lift demand this year. Third, commodity production costs are likely to be higher, driven largely by political, rather than economic, factors, such as decarbonization and security of supply concerns. The strong performance of commodities that we expect in 2023 would nicely rhyme with two of the other major themes discussed above: sticky demand-side inflation (after supply-driven disinflation) and a weak US dollar.

DEFINITIONS

The **Russell 1000® Growth Index** measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000® Index companies with higher price-to-book ratios and higher forecasted growth values. The Russell 1000® Index is an index of approximately 1,000 of the largest U.S. companies based on a combination of market capitalization and current index membership.

The **Russell 1000® Value Index** is an index that measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values.

The **S&P 500 Total Return Index** is an index that consists of 500 stocks chosen for market size, liquidity and industry group representation. The S&P Index is a market value weighted index with each stock's weight proportionate to its market value. The S&P Index is one of the most widely used benchmarks of U.S. equity performance. The performance of the S&P Index does not account for any management fees, incentive compensation, commissions or other expenses that would be incurred pursuing such strategy. Total return provides investors with a price-plus-gross cash dividend return. Gross cash dividends are applied on the ex-date of the dividend.

The **S&P GSCI®** is a composite index of commodity sector returns representing an unleveraged, long-only investment in commodity futures that is broadly diversified across the spectrum of commodities. The returns are calculated on a fully collateralized basis with full reinvestment. The combination of these attributes provides investors with a representative and realistic picture of realizable returns attainable in the commodities markets. Individual components qualify for inclusion in the S&P GSCI® on the basis of liquidity and are weighted by their respective world production quantities.

The **Sharpe ratio** was developed by Nobel laureate William F. Sharpe and is used to help investors understand the return of an investment compared to its risk. The ratio is the average return earned in excess of the risk-free rate per unit of volatility or total risk. Volatility is a measure of the price fluctuations of an asset or portfolio.

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The **MSCI USA Energy Index** is designed to capture the large and mid cap segments of the US equity universe. All securities in the index are classified in the Energy sector as per the Global Industry Classification Standard (GICS®).

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