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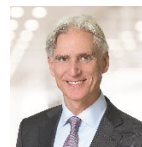
INVESTMENT MANAGEMENT

Transitional year for energy markets

January 2023

CUSTOMISED SOLUTIONS | GLOBAL BALANCED RISK CONTROL TEAM | PATH | 5 January 2023

Following a two-month rally, in December equities across the globe sold off. The S&P 500 Index returned -5.8%¹, whilst the MSCI Europe and MSCI Japan returned -3.5%¹ and -5.2%¹ respectively, in local currency terms. Although the MSCI Emerging Markets (USD) fell 1.4%, a notable exception was the MSCI China (USD) index, up 4.8%¹ due to the accelerated reopening of China's economy with limited setbacks so far. Despite U.S. inflation falling,² the year-end market slump can be attributed to the hawkish tone of the December Federal Reserve meeting. The Fed is worried about inflation not only falling enough but remaining anchored near target levels by 2024. Recessionary concerns, the abrupt rise in government bond yields and reduced liquidity in the second half of the month likely contributed to the decline in markets in December. The U.S. 10-Year yield moved up, ending the month at 3.8%³. The VIX index remained range bound, reaching 21.7 by month end³.



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Energy markets in transition in 2023

We expect a transitional year for energy markets in 2023, with higher oil and gas prices leading to some market rebalancing after disruptions last year. However, sanctions on Russia are likely to result in tight supplies globally and remain a key inflation challenge. Recessionary headwinds are likely to dent oil demand in 2023, but we expect sanctions on Russia, and gas-to-oil switching, to be offsetting factors that could sustain

Notes:

¹ Bloomberg, 1-month returns, as of 31 December 2022.

² Consumer Price Index News Release. November 2022 headline inflation was 7.1% over the last 12 months, before seasonal adjustment, compared with October at 7.7%. U.S. Bureau of Labor Statistics. 13 December 2022. www.bls.gov/news.release/archives/cpi_11102022.htm

³ Bloomberg, 31 December 2022.

relatively high prices. OPEC's announcement⁴ of a production cut in an already tight market, underscores the necessity to keep prices higher, to incentivise the investments in supply needed to rebalance the market. A fall in prices now could disincentivise investment and spell higher prices when demand recovers. Essentially, whether central banks can push inflation down and successfully anchor it is likely to be one of the most important determinants of assets' performance in 2023 and energy dynamics are clearly key to the inflation story.

Investment implications

We remain cautious with respect to U.S. equities, due to the concern that earnings are still likely to fall in the first half of 2023, but we are more optimistic on global equities ex-U.S. However, the recent market retracement after the hawkish Federal Reserve and European Central Bank (ECB) announcements, and the light macro event calendar before year end, provided a window for us to tactically increase risk from defensive levels. Furthermore, investor positioning should provide support to the market, especially if economic and corporate data surprise to the upside. We believe it is prudent to separate our Chinese equities exposure from other Emerging Markets, hence we made the following tactical changes in December:

U.S. and Eurozone Equities

We moved from underweight to neutral Eurozone equities and added to the U.S. equity underweight. Eurozone equities are still trading at a substantial discount to the S&P 500.

Japanese Equities

We moved from overweight to neutral Japanese equities. Often viewed as a safe haven, Japanese equities seem to be moving past their peak and may no longer outperform. However, we are moving overweight Japanese yen relative to the U.S. dollar as there are some biases for further upside.

Emerging Markets ex China equities

We moved from neutral to overweight Emerging Markets ex China equities, as peak inflation in the U.S. and EM suggests that central banks are near the end of their tightening cycles. Markets expecting cuts in EM rates by the second half of 2023 coupled with peak Fed hawkishness, also suggest that the U.S. dollar peak might be approaching, which has positive FX transmission for EM balance of payments. China's reopening could potentially be another positive catalyst that could have a positive impact on its Asian trading partners.

MSCI China equities

In December, we moved overweight MSCI China equities as near-term reopening could boost consumption and support growth in China, earlier than previously anticipated, given a softening of China's zero-covid stance and reprioritisation of economic growth.

U.S. Health Care equities

We initiated an overweight to U.S. Health Care equities in a bid to lower our exposure to U.S. equity beta. We see continued downside to overall U.S. equities and together with its defensive characteristics, Health Care possesses structural, higher-quality growth characteristics over other defensive sectors such as Consumer Staples and Utilities.

Notes:

⁴ Announcement made on 5 October 2022. www.opec.org/opec_web/en/press_room/7021.htm

Duration

We shortened U.S. duration as we are concerned that at current levels, the market is underestimating the impact of the resilient labour market, with strong wage growth and potentially misinterpreting the seemingly dovish tone of the Fed from the November FOMC meeting. At the time of our reduction in duration, the market was discounting 2-3 25bps rate cuts towards the end of 2023 and another 100bps worth of cuts in 2024. While this is certainly a plausible outcome, we believe it is premature to price this with certainty given persistent, core inflationary pressures and little visibility on the level at which inflation will ultimately settle over 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. See Disclosure section for index definitions.**

Tactical Positioning

We have provided our tactical views below:

Asset Class	--	-	=	+	++
Equity					
US	■				
US Health Care		■	■		
Eurozone		■	■		
Eurozone Banks					■
Global Energy				■	■
UK			■		
Japan			■	■	
Asia ex Japan			■		
Emerging Markets			■	■	
Global Growth		■			
Global Infrastructure			■		
Global Property			■		

■ Latest view ■ Previous view

Source: MSIM GBaR team. Previous view is as of 30 November 2022 and current view is as of 31 December 2022. For informational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy. The tactical views expressed above are a broad reflection of our team's views and implementations, expressed for client communication purposes. The information herein does not contend to address the financial objectives, situation or specific needs of any individual investor. The signals represent the GBaR team's view on each asset class. A negative signal indicates a negative or underweight relative view, a positive signal indicates a positive or overweight relative view.

Asset Class	--	-	=	+	++
Fixed Income					
IG Credit			■		
European IG Credit				■	
US High Yield	■				
EU High Yield			■		
EM Sov Debt (LC & HC)				■	
EM Corporate Debt			■		
LatAm Short Duration Debt				■	
US Treasuries			■		
EU Core Gov. Bonds			■		
EU Peripheral Gov. Bonds		■			
UK Gilts		■			
JGBs		■			
Commodities					
Gold			■		
Oil			■	■	
Currencies					
Euro				■	
GBP			■		
JPY			■	■	

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There is no assurance that the Strategy will achieve its investment objective. Portfolios are subject to market risk, which is the possibility that the market values of securities owned by the portfolio will decline and that the value of

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Consumer Price Index: The Consumer Price Index (CPI) is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.

MSCI Emerging Markets Index: The MSCI Emerging Markets Index (MSCI EM) is a free float-adjusted market capitalization weighted index that is designed to measure equity market performance of emerging markets.

MSCI Europe Index: The MSCI Europe Index captures large and mid-cap representation across 15 developed markets (DM) countries in Europe.

MSCI Japan Index: The MSCI Japan Index is designed to measure the performance of the large and mid-cap segments of the Japanese market.

MSCI China Index: This free-float adjusted capitalization-weighted index is designed to measure the performance of China-based equities.

S&P 500 Index: The Standard & Poor's (S&P) 500 Index tracks the performance of 500 widely held, large-capitalization U.S. stocks.

VIX®: This is a trademarked ticker symbol for the Chicago Board Options Exchange Market Volatility Index, a popular measure of the implied volatility of S&P 500 Index options. Often referred to as the fear index or the fear gauge, it represents one measure of the market's expectation of stock market volatility over the next 30-day period.

OPEC (Organisation of the Petroleum Exporting Countries): Intergovernmental organisation of 13 countries whose purpose is to co-ordinate and unify petroleum policies among Member Countries.

Federal Open Market Committee (FOMC): It is a 12 member committee within the Federal Reserve System that makes key decisions about interest rates and the growth of the U.S. money supply.

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