December 2022

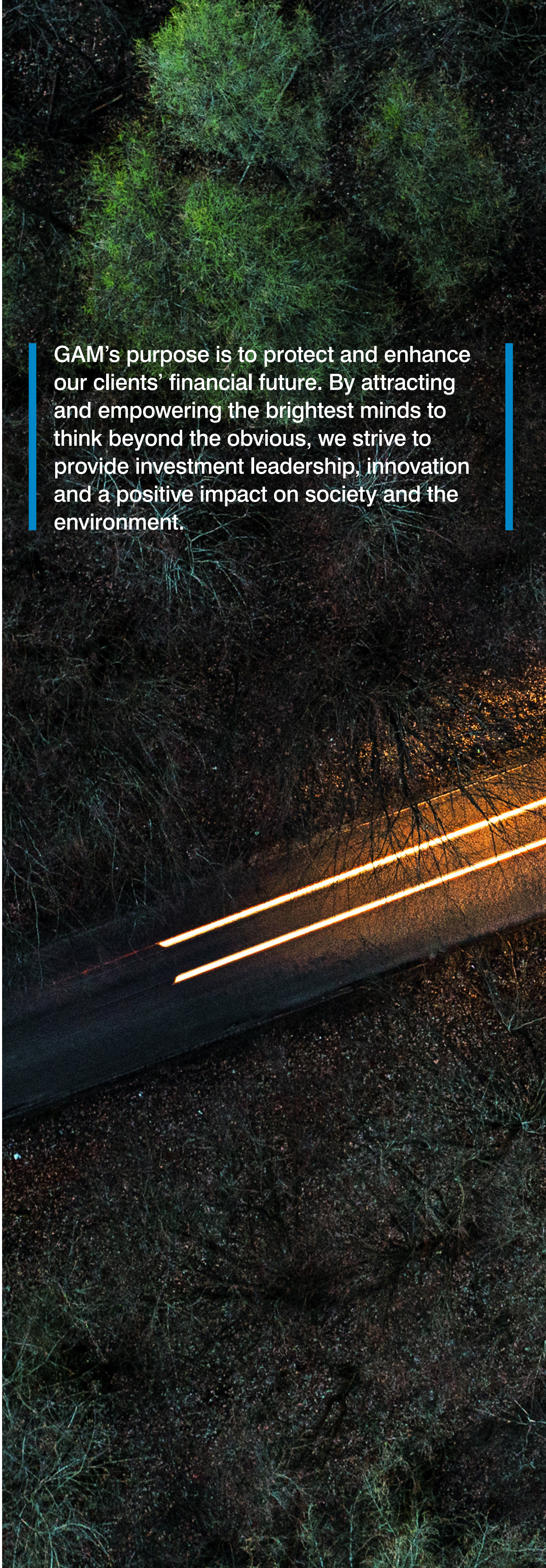
THE YEAR AHEAD – INVESTMENT OUTLOOKS FOR 2023 AND BEYOND

INTRODUCTION

In our 2023 Outlooks David Dowsett, Global Head of Investments, highlights eight charts he thinks may signal the direction of markets in 2023, and a number of our investment professionals across our key capabilities give their outlook for 2023, including Stephanie Maier on sustainability.

We take pride in actively serving our clients with distinction, drawing on the diversity of thought across investment teams globally; their expertise and experience enables them to provide you with their individual take on what investors should look out for next year and what potentially the year might have in store for their respective asset class.

Online Edition:



GAM's purpose is to protect and enhance our clients' financial future. By attracting and empowering the brightest minds to think beyond the obvious, we strive to provide investment leadership, innovation and a positive impact on society and the environment.

MARKET SIGNALS

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David Dowsett, Global Head of Investments

Eight Charts for 2023

David Dowsett, Global Head of Investments, picks out eight charts for investors to watch which may give some guidance on the direction of markets in 2023.

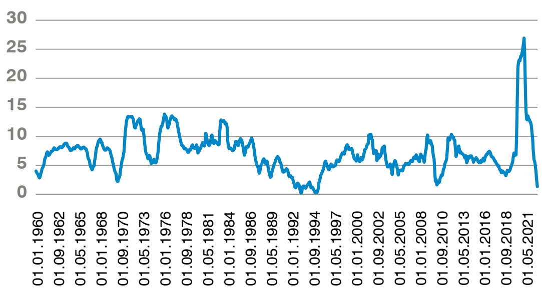
2022 has been a brutal year for investors. The war in Ukraine, followed by an "interest rate shock" and then an "inflation shock" have overturned many pre-existing assumptions about the natural investment order. As central banks have hastily abandoned 15 years of zero interest rate policy and quantitative easing experimentation, virtually all asset classes have experienced steep losses.

We have explained previously that we regard many of the changes in the investment environment to be structural. The post-2008 environment of low inflation, low interest rates and low volatility is now consigned to history. Government policy is now focused on rewarding domestic labour and achieving resiliency, rather than the previous orthodoxy of supporting capital and efficiency. This is likely to be the prevailing doctrine for the rest of the decade - an era of ongoing global uncertainty.

However, even within this structural reality, there can be cyclical opportunity. The following article is not designed to be an "outlook" that will forecast exactly what is going to happen in markets in the forthcoming 12 months. The unexpected events of the past year illustrate the challenges of such exercises. Nonetheless, it would be right to acknowledge that the market declines of 2022 have created significant opportunity in many asset classes.

We highlight eight charts which we think will act as good signposts towards the direction of markets in 2023.

Chart 1: Could money supply actually contract?

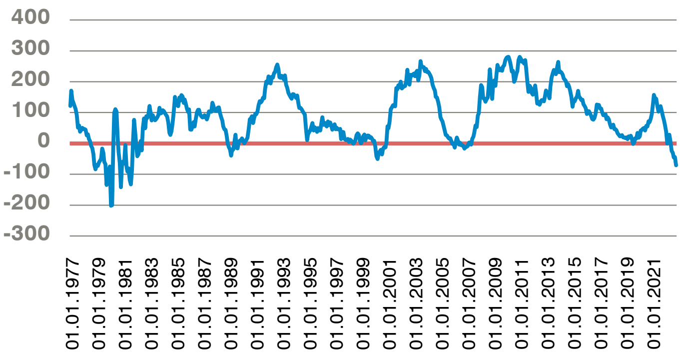


Source: Bloomberg. Past performance is not an indicator of future performance and current or future trends.

David Dowsett
Global Head of Investments

In the words of Milton Friedman "Inflation is always and everywhere a monetary phenomenon." Despite Covid-induced supply constraints and skyrocketing energy prices, this may also prove to be true in 2023. The accompanying chart shows that M2 money supply growth in March 2021 was growing more than twice as fast as any time in the past 60 years as the US was already emerging from Covid lockdowns. The March 2021 USD 1.9 trilllion fiscal stimulus proved highly inflationary. The consensus moving into 2023 is that inflation will prove sticky. Supply constraints remain in energy and labour markets. Nevertheless, will Friedman's dictum remain accurate? Just as we have never witnessed money supply growth at anything like the rates experienced in 2021, so we have never experienced money supply actually contracting, and yet this seems a realistic prospect for early 2023.

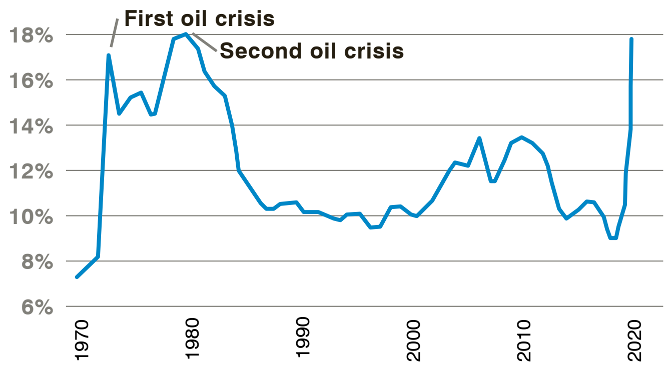
Chart 2: The shape of the US Treasury curve will give a guide to whether the US could enter a recession



Source: Bloomberg. Past performance is not an indicator of future performance and current or future trends.

As the economist Paul Samuelson once joked, "the US stock market has forecast nine out of the last five recessions." The US Treasury curve has a much better forecasting record. Every time since 1970 that 10-year yields have fallen below 2-year yields, a recession has followed. A consequent re-steepening of the yield curve tends to occur just as the recession begins, when the Federal Reserve (Fed) begins to loosen. US equities historically commence the next bull market within three months of the peak in 2-year yields. As we enter 2023, consensus is for a shallow US recession. The IMF forecasts a global growth outturn for 2023 of 2.7%. This would be the weakest since 2001 excluding the global financial crisis (GFC) and Covid. There are clearly significant uncertainties around these outcomes; we believe watching the shape of the US Treasury curve closely will give a strong guide as to how to navigate.

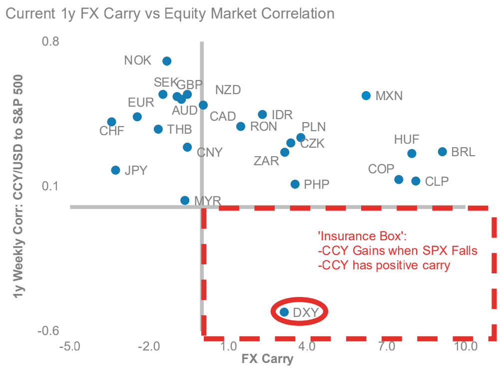
Chart 3: The world is coping with a massive energy price shock - Estimated share of global GDP spent on energy end-use



Source: OECD Economic Outlook (Edition 2022/2). Past performance is not an indicator of future performance and current or future trends.

The Russia-Ukraine conflict has shattered previous orthodoxies around European security and the geopolitical balance. Europe faces a long period of reassessment of defence capability, economic vulnerabilities and its security architecture. Nowhere has this been more obvious than in the energy space. As the chart shows, this is actually a global phenomenon, to which Europe is particularly vulnerable. Security of energy supply, which has largely been taken for granted in the West, with consequent underinvestment, will now become a key focus of government policy. For 2023, the chart shows how the global economy will continue to be leveraged to the Russia-Ukraine conflict. Any attempts to forecast the course of the war from here are likely to prove as inaccurate as most previous attempts, but the conflict's continuing importance to the world's energy (and food) supplies should not be overlooked. Importantly, if hopes of a settlement to the conflict increased, the effect on prospects for global growth would be immediate.

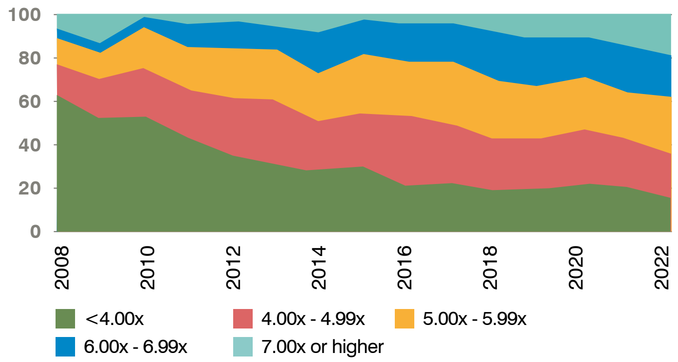
Chart 4: US dollar strength has been boosted by the perception of the dollar as a safe haven



Source: Morgan Stanley, as at 30 November 2022.

In the long term, one can build a convincing case for US dollar weakness due to building twin deficits, and mounting concerns about non-discretionary fiscal outlays. The recent weaponisation of the dollar through use of financial sanctions will also encourage other countries to reduce financial vulnerability. In the shorter term, the chart above shows that recent dollar strength has been boosted by the perception of the US dollar as both a safe haven and a high carry currency. If this perception at least somewhat reverses in 2023, the implications for non-US asset performance are significant. Equally, stronger local currency performance would mitigate domestic fears about inflation pass through and hard currency repayment risk, two factors that have been significant drags on emerging market (EM) and Asian asset price performance in 2022. A world with less fear of continued US dollar strength is a less threatening one financially.

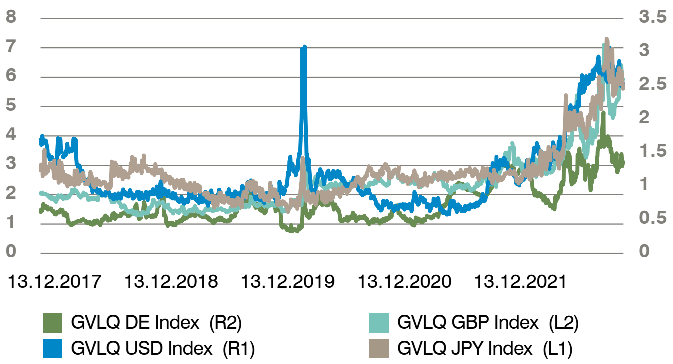
Chart 5: Credit quality is deteriorating, with the share of highly leveraged deals accelerating since the peak of the pandemic - Leveraged loan issuance by Debt-to-EBITDA Ratio (percent)



Source: IMF Global Financial Stability Report – Navigating the high-inflation environment, October 2022. Past performance is not an indicator of future performance and current or future trends.

However 2023 progresses, we can be sure that there will be no return to zero interest rate policies. That period of financial market history is definitively over. As the global tide of liquidity recedes, we should remain vigilant for further examples of those who have been swimming naked. In 2022, the crypto meltdown, LDI implosion and SPAC crash were three examples of asset price misvaluation based on an expectation of low interest rates forever. By definition, these "liquidity landmines" are hard to spot ahead of time, but we would highlight that most of this year's financial pain has occurred only in the public market space. The transfer of assets to private markets may make sense from a strategic and managerial perspective, but eventually the pricing mismatch between the two must be resolved. The repricing of global interest rates, together with the deteriorating quality of highly levered loan issuance as evidenced above, suggests a reckoning to come. Private market firms have projected a significant amount of "dry powder" they have to continue to put to work, but validation of deals through a market priced exit needs to be eventually achieved. Of course, the follow on question is whether any unpredictable market events quickly mushroom to present systemic risk. The chances of this seem relatively low given the strong provisioning of banks and relatively light repayment schedule for high yield debt in 2023. Next year's liquidity events will, like this year's, be extremely painful for those directly exposed, but the damage should remain localised.

Chart 6: Expect continued liquidity scares

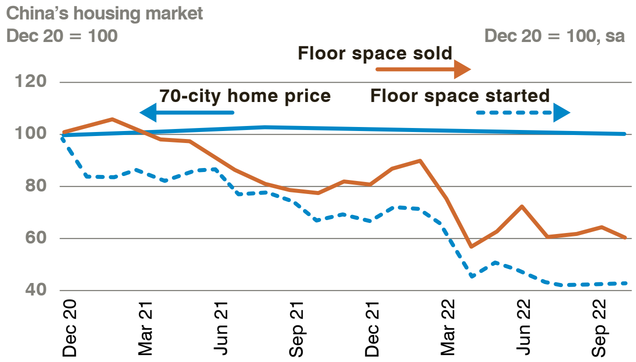


Source: Bloomberg. Past performance is not an indicator of future performance and current or future trends.

Of course, liquidity events are not the same as liquidity risks. As central banks continue to reduce the size of their balance sheets, so they can potentially add to volatility in core government bond markets, and by extension all other riskier asset classes. This reduction in central bank liquidity provision occurs while markets are still adjusting to the reduction in investment bank market making capability as a result of regulatory change and the growth of both the traditional buy side and shadow banks. This is likely to cause ongoing stresses associated with the transfer of risk and consequent market pricing. Watch for repeat episodes in 2023.

Uncertainties, therefore, abound about the outlook for 2023 in developed markets, but perhaps even these pale into comparison with those associated with China. Will the world's second largest economy finally emerge from its Covid hibernation? Can this be positive for global growth and actually serve as a counterbalance to Western recession risk? Can renewed export performance from China mitigate supply chain pressure that has acted as an inflation driver, particularly in the US? These questions are still subject to significant policy risk, and only now are we beginning to gain some idea of how Xi will order his domestic priorities now he has achieved unchallenged power. It is likely, however, that how China copes with its real estate bubble will be the key determinant of domestic growth.

Chart 7: The housing market is a key economic variable to watch in China

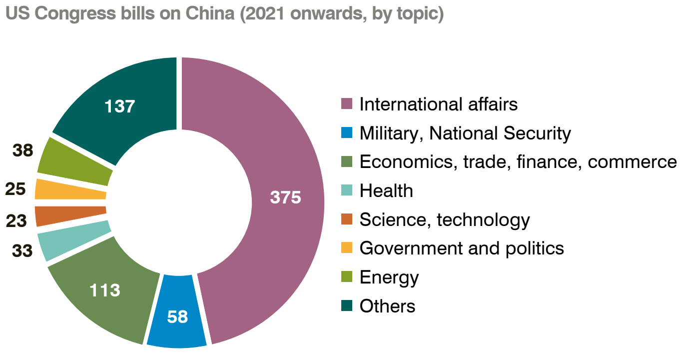


Source: NBS, CEIC, JP Morgan. Past performance is not an indicator of future performance and current or future trends.

As the chart shows, China has taken the approach of maintaining prices and letting new housing formation collapse. This protects against near-term financial spillover but the lack of a market clearing mechanism surely has a detrimental effect on consumer confidence and consumption as well as depressing investment. The Chinese authorities believe eventual urbanisation will clear excess housing stock, but this is a long-term process. Developments in the housing market may still be the key economic variable to watch in China in 2023.

Politically, recognition that China and the US have now entered a phase of strategic competition has been the most significant factor to speed the end the era of globalisation. Notably, the sea change in attitudes has occurred most dramatically in the West. The chart above shows the number of bills in US Congress concerned with the China rivalry.

Chart 8: Taking the temperature of US-China relations



Source: US Congress, JP Morgan.

This is a dramatic shift from the attitude of constructive engagement followed by all presidents from Nixon to Obama. The varying temperature of US-China relations will remain the most important geopolitical signpost for 2023. There is still a wide gulf between Washington and Beijing in strategic thinking about Taiwan and spheres of influence within the South China Sea, but both countries still have many challenges that require a common approach. Climate change, food and health security require global solutions, even in a more regionalised and localised world. As personal dialogue between world leaders resumes and President Xi begins to travel from China again, there is scope for hope of an improvement in relations. This can surprise those positioning themselves for a new Cold War.

SUSTAINABILITY

SUSTAINABILITY

Stephanie Maier, Global Head of Sustainable and Impact Investment

Sustainable finance regulation – starting to redirect capital

The impact of EU Sustainable Financial Disclosure Regulation (SFDR) and associated Taxonomy regulation continued to gather pace in 2022, as the 'level 2' guidance (regulatory technical standard) introduced more specific disclosure requirements including the consideration of principal adverse impacts (the most significant negative impacts of investment decisions on sustainability factors). From January 2023, we will see the start of the publication of the first periodic reporting (prescribed templates covering fund level environmental and/or social characteristics, PAIs and sustainable investments as relevant) for so-called 'Article 8' and 'Article 9' funds. This, coupled with the changes to MIFID II introduced in August now requiring the incorporation of sustainability preferences into the suitability assessment, will provide significantly enhanced disclosure regarding the sustainability profile of different funds.

We can expect further changes as regulation expands its focus from disclosure to labelling as regulators look to bring greater clarity and consistency to the market. Additional guidance and proposals on fund labelling and underlying requirements were issued by ESMA in the EU, the FCA in the UK and the SEC in the US. This will likely lead to changes not just in fund names and classifications, but also in investment approaches in some cases.

The impact of taxonomies will also increase; following on from the EU Taxonomy there are now reportedly 30 different taxonomies globally in development or being implemented. While most are grounded in common principles, there is undoubtedly a political context for national taxonomies seeking to use them to channel financing to meet the needs for that economy, whether with a focus on the green or on transitioning activity. As taxonomies expand and reporting on taxonomy-aligned activities improves, this will increasingly impact investment decisions.

While the proliferation of these templates, tags and taxonomies will present implementation challenges, they are increasingly likely to make a meaningful change to how and where capital is invested.

Looking ahead to COP28

As we head out of what can be considered a somewhat lacklustre cover agreement from COP27 in Egypt at the end of November, we are already looking ahead to what is on the agenda for COP28. While COP27 arguably did little to accelerate the response to climate mitigation at a political level, we did see a greater focus and some progress on climate adaptation. The main 'win' at COP27 was the agreement "to establish a fund for responding to loss and damage" to aid vulnerable countries to deal with the impacts of climate change. This has long been a contentious issue and, while the details are still to be determined, it was an important milestone. At the G7, taking place in parallel, there was a joint statement between Indonesia and the International Partner Group (comprising among others Japan, the US, EU and UK) on the Indonesia Just Energy Transition Plan to accelerate the expansion of renewable energy and phase down on coal.

The limited outcomes at COP27 puts further focus on COP28; the UN Secretary General has already indicated a climate summit in 2023, before COP28, to address the continued 'ambition' gap between the intent and action to keep the rise in global temperatures to 1.5°C. The next COP, set to take place in the UAE, will also present the first 'global stocktake' on progress, likely to underscore this gap and bring even greater emphasis on climate finance.

Given the continued conflict in Ukraine, heightened inflation concerns and the ongoing energy crisis, accelerating the transition to a net zero economy remains a major focus for governments. While we saw a significant policy package in the US, with the Inflation Reduction Act catalysing new climate technologies and speeding the roll out of renewable energy and electric vehicles, other governments are looking to policy measures with lower price tags. The need to manage the social cost and implications of the net zero transition will come into greater focus.

Stephanie Maier
Global Head of Sustainable and Impact Investment

For investors, the transition to a lower carbon economy, alongside the increasing adaptation needs, continues to shape the investment landscape. However, if appropriate policy measures fail to be implemented and the social dimensions are ignored, the likelihood of what is already looking like a somewhat disorderly transition increases.

Nurturing nature as an asset

Nature is rapidly rising up the agenda for investors. This is due to both the growing recognition of "the interlinked global crises of climate change and biodiversity loss, and the critical role of protecting, conserving and restoring nature and ecosystems in delivering benefits for climate adaptation and mitigation". At COP27 there were important discussions on oceans, forest and agriculture. The scale and rate of biodiversity loss we are experiencing – a rate not seen since the last mass extinction – is prompting a greater focus on nature loss as a systemic risk. As we write, we have not yet seen the conclusion of COP15 on the Convention on Biological Diversity taking place in Montreal, Canada in December. Hopes are high that COP15 will result in an agreed framework setting out key targets to be achieved by 2030, including protection of land and sea globally, prevention or reduction of the introduction and establishment of alien species and utilisation of ecosystem-based approaches to contribute to mitigation and adaptation to climate change. This framework could potentially be to nature what the Paris Agreement was for climate.

Regardless of the COP15 outcomes, we expect biodiversity to increasingly shape investor and corporate priorities. The Taskforce on Nature-related Financial Disclosures (TNFD), modelled on the better-known Taskforce for Climate-related Financial Disclosures (TCFD), aims to provide a risk management and disclosure framework for evolving nature-related risks. As these risks become more evident, nature's resources are likely to be valued more explicitly.


ACTIVE EQUITIES

ACTIVE EQUITIES

Jian Shi Cortesi, Investment Director, Asia/China Growth Equities

In 2022, Asian equity was hit by the combination of rising interest rates, the strong dollar and China's Covid restrictions. In 2023, all three factors could improve, with interest rate hikes expected to end, the dollar expected to peak, and China expected to further relax Covid restrictions. This should lift economic growth and corporate earnings and will be positive for Asian equities.

Among countries, after the strong outperformance of India and Southeast Asian markets, for 2023 we believe Asian regional leadership could shift to Northern Asian markets such as China and South Korea, given the stretched valuation gaps and potential macro drivers such as China's reopening. On India, we are bullish on the long-term growth outlook but cautious on the high valuations.

We see opportunities in:

1. Asian technology stocks in semiconductors and hardware, following inventory rationalisation
2. Beneficiaries of China's reopening, such as travel and entertainment
3. Asian renewables, including companies in solar, wind, electric vehicles and batteries
4. China's technology industry security theme, particularly companies that could offer import substitutions in the technology supply chain
5. Beaten down Asian growth names with a positive reversal in earnings, such as internet companies.

Key risks include a slower-than-expected Covid reopening in China, higher-than-expected US inflation and worse-than-expected geopolitical tension.

Jian Shi Cortesi
Investment Director

ACTIVE EQUITIES

Niall Gallagher, Investment Director, European Equities

2022 proved a tumultuous year with energy prices in Europe reaching unprecedented levels following Russia's invasion of Ukraine, and where inflation returned after a prolonged hiatus. While these dual headwinds have not been fully resolved, we would argue that equity markets have already adjusted significantly with Europe now trading on 11x forward earnings versus a long-term average of 14x. This sharp de-rating of the market, combined with the already significant rise in bond yields and adjustments in currencies, suggests much of the adjustment needed may have already occurred.

In our view, markets have entered a new environment where both inflationary pressures (and therefore interest rates) and energy prices, particularly in Europe, will remain higher for longer. However, the resilience of European company earnings was evident in earnings reports throughout 2022 and while we expect some pockets of weakness in 2023, overall we see this resilience continuing in large part driven by the exposure to the global growth of European companies (more than 50% of revenues are generated outside of Europe). Financials remain a key sector for us, as higher interest rates feed through into improved profitability and where a mix of well-capitalised balance sheets benefiting from post-GFC regulation and a less indebted consumer mean we forecast little erosion to loan books in aggregate. The energy sector also remains a focus given our view of higher energy prices in the medium term and where we look for those companies transitioning from fossil fuels to alternative sources of energy as key to moving the energy story forward.

Technology continues to disrupt; we continually look for companies benefiting from the structural shifts occurring. This includes the offline to online switch, positive both for select disrupting retailers as well as for the fintech sector. Digital 4.0 will continue to drive growth in cloud computing, Internet of Things, 5G and digital factories, for example, and semiconductors will remain at the heart of powering this growth where European companies are global leaders.

And last, Asia appears to finally be emerging from the severe Covid lockdowns which should once again allow for the continued growth of the middle class where Asia is on track to represent two thirds of the global middle class population by 2030. We believe this is perhaps best captured through the best-in-class luxury companies headquartered in Europe.

Niall Gallagher
Investment Director

ACTIVE EQUITIES

Mark Hawtin, Investment Director, Disruptive Growth Equities

We have long observed that while growth stocks can perform well in periods of rate rises, they tend to perform poorly in periods of heightened uncertainty about the rate and exit level for rates; this was borne out for most of 2022. Our focus during this period was to mitigate the risks by recognising the pattern of market activity and moving down the duration curve. The significant rise in bond yields over the year, and the similarly large moves in equity markets and currencies, suggest to us that much of the adjustment to a new rate environment needed may have already occurred. This, coupled with increased visibility on the path and level of US interest rates should allow the market to refocus on fundamentals. We continue to believe that the outlook remains extremely positive for disruption and the onslaught of an ever more digital world. This will as ever emphasise the divide between the winners and the losers, thus increasing the alpha generation both through finding those winners but also by avoiding underperforming losers.

Moving into 2023, we will remain focused on the biggest opportunities for technology to challenge established incumbent businesses such as those within Digital 4.0, which remains a key theme for us. In the connectivity sub sector, concerns of weakening demand in the industry and an imbalance of supply/demand have caused much downward volatility in the semiconductor industry but we see significant upside for some of our key picks into 2023 as these imbalances stabilise.

The metaverse and its adoption has become a significant area of debate given it is still in relative infancy. While we see the metaverse adoption as a longer-term theme, we believe the cash flow generation from metaverse infrastructural technologies such as ARVR and blockchain will be a near-term benefit, underpinning our long-term positive stance overall while remaining mindful of short-term sentiment shifts.

Cybersecurity also remains an active investment opportunity theme with the needs of consumers to protect their online privacy, home network and devices driving continued growth. We look for companies well positioned with cross selling opportunities to be increasingly connected online.

China experienced a challenging year but will remain a focus; we have historically generated significant alpha in China and see current macro trends as supportive for equity markets where valuations remain at deep discounts to history. We like high quality consumer internet names on attractive valuations and with visible earnings trajectories, as top ecommerce players deepen penetration and reemphasise profitability. Our research focus will continue to be on the best opportunities there.

Mark Hawtin
Investment Director

ACTIVE EQUITIES

Swetha Ramachandran, Investment Director, Luxury Equities
Luxury Brands

1. Q3 results confirm a positive trading backdrop for luxury companies

Recent Q3 reports from luxury companies have, in aggregate, broadly surprised on the upside on continued strong demand, as well as companies maintaining their positive outlook going forward, while maintaining the requisite caution on a more uncertain macroeconomic backdrop. As expected, trading in Europe especially benefited from a surge in inbound tourism and a weak currency which helped increase the appeal of shopping on the continent. Consumers are not yet trading down, but continuing to pivot to 'experiences' such as long-haul travel (further supported by the strong US dollar for US consumers). Higher-income consumers are proving to be more resilient in spending than lower-income peers, in evidence at companies whose products span a range of price points – where the higher end of their range is widely seen to be outperforming the mass market exposed offer.

2. What happens next?

US domestic spend has moderated from very high rates in H1, partly because of American tourists shopping abroad during the summer. We continue to see ongoing evidence of polarisation in company results; while the stronger companies in the sector widened their lead over weaker counterparts when the wider environment was very strong, this gap has extended even further against a backdrop of deceleration and potentially more conservative spending behaviour from consumers who are showing signs of concentrating their spend among the very top tier of brands.

3. Rumours of the death of the US luxury consumer are exaggerated

US consumers continue to benefit, in the upper income quartiles, from elevated levels of cash savings with pandemic buffers in many instances likely to take more than 18-24 months to exhaust. We continue to watch the unfolding wave of tech layoffs for signs of high-income consumer fatigue but note that the US consumer, in the wake of the pandemic, is much more diversified geographically. Indeed, recent drivers of growth have been cities such as Miami, Austin and Atlanta, rather than San Francisco/Silicon Valley.

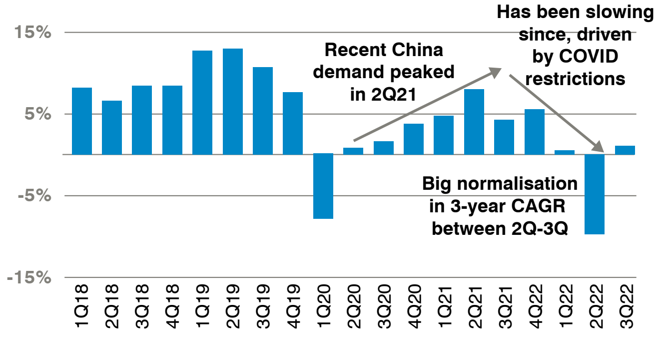
4. Can China pick up the baton from a normalising Europe and US?

The market is keenly awaiting a wider China reopening, which would be a significant catalyst for the luxury sector. We believe the ongoing "stop-start" trading environment in China as a result of rolling lockdowns and interruptions to mobility are priced into the shares at current valuations. We believe there remains a significant recovery opportunity into 2023 especially as we near the one-year anniversary of this year's March-May Shanghai lockdowns, which proved to be quite damaging for luxury businesses in the country, thankfully offset globally by strength in the US, Europe and South East Asia. Into 2023 and a more normalising US consumer environment, we expect China will be the source of demand upside, in the same way that the US consumer has been for the better part of two years now. Comparisons look especially easy into H1 2023 while the underlying consumer appetite for luxury remains strong. We were reassured by the recent party Congress comments which sought to emphasise 'common prosperity' and the targeted doubling of China's middle class to 800 million by 2030, a significant positive for luxury consumption, in our view.

Swetha Ramachandran
Investment Director

Recent China demand peaked in 2Q21, has been weaker since, easy to comp for 2HG22 and 2023

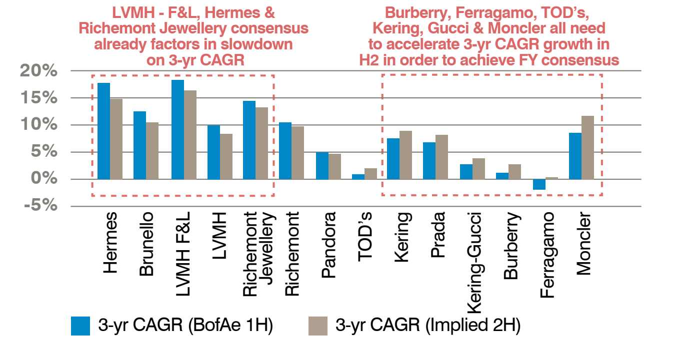
Three year CAGR growth of Chinese consumer vs luxury sector overall



| Source: BofA Global Research estimates

Consensus expectations model in more conservative growth for stronger companies relative to weaker companies – mean reversion unlikely to occur

Implied 3-year CAGR growth rates for 2H (based on consensus FY2022) vs 1H22



| Source: BofA research, consensus estimates.

5. Consensus expectations on a bottom-up basis look too conservative for leading brand companies

Overall, the market has not made adjusted full year expectations for the companies that have, to date, beaten expectations, which has now led to several companies pricing in relatively undemanding top-line expectations for the second half, on a year-on-year as well as three-year stack. We believe this may prove to be excessively pessimistic for companies such as LVMH, Richemont and Hermes. While consensus is rightly assuming an acceleration at Moncler (the second half being its seasonally peak selling period), we believe it is too low considering its exit rate in H1 and could also surprise on the upside. Conversely, for brands where the market seems to be assuming an acceleration in the second half – namely Burberry and Ferragamo – we would be more cautious.

6. Shares remain attractively valued, despite earnings expectations being well underpinned

Despite an uptick following Q3 results, companies have broadly looked through actual trading coming in ahead of expectations to an anticipated slowdown in trading, always seen as around the corner, which has been a significant driver of the sector's sharp de-rating in 2022. Having hit peak revenue and margins in 2021, the luxury sector has derated by circa 30% towards 24 times FY price-to-earnings (P/E), a 20% discount to its five-year average. Considering the net cash positive nature of the sector, which inflates P/E, and with downgrades already priced in, we believe ongoing evidence of much better than feared fundamentals can continue to catalyse a re-rating.

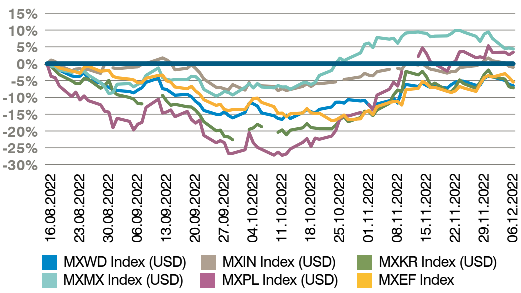
What can the sector offer in these turbulent markets? We consider the following factors for why an investment in luxury stocks can be appealing at this time: (1) A hedge against inflation – from the pricing power at the top-line and; (2) a balance of growth and profitability at attractive valuations – with the sector trading at 30% below its five-year average multiples; and (3) rock solid balance sheets protecting against interest rate rises currently underway – the sector's companies are typically net cash positive, generating significant free cash flow, with growth fully self-funded.

ACTIVE EQUITIES

Tim Love, Investment Director, Emerging Markets Equities

Following a one-third pullback and 21 months of a continual choppy downwards trend, we added to emerging market (EM) exposure in early Q3 2022 on the grounds that both qualitative and quantitative viewpoints strongly suggested EM equities had reached a counter-cyclical buy point. Although we seemed to have been right on a relative basis to developed market (DM) equities, we are only just beginning to see an EM equity absolute upside be realised in mid-November 2022.

MSCI EM indices (USD)



Source: Bloomberg as at November 2022. Indices cannot be purchased directly.

We mentioned that the logic for the realisation of material upside from these coiled spring level EM equity valuations would be a select number of key catalysts:

1. The catalysts

A dollar peak and fresh policy support from China especially for property/banks, combined with at least a partial exit from Covid restrictions in China, following the November 2022 China National Congress of the Chinese Communist Party (NCCCP). Should any of this occur, we believe it would materially drive EM equity upside in 2023, helped by resilient and reformed EM equity earnings leading to strong earnings-per-share (EPS) growth in 2022/23 alongside large potential EM equity multiple expansion.

2. The upside

15 years of choppy sideways performance is comparable to compressing a coiled spring. A series of positive risk return opportunities are now in place (market downturn/Covid/oil shock), which rhyme with the situation in 2003-2008 (post Asian crises/SARS). Relative and absolute returns will encourage re-examination of this enviable cyclical and secular entry point. Light liquidity, low positioning and negative sentiment could drive an attractive prospective risk/return for EM equities in 2022/23, in our view. Playing defence is yesterday's game.

3. Favourable asset allocation themes:

- China – post-Covid opening up and fiscal support themes
- Global growth recovery themes – South Korean and Taiwanese electric vehicle (EV) and IT exports
- Renewable supply chain themes – South African platinum, Chilean lithium, Malaysian rare earth materials.
- Liquid secondary laggards in India, as well as deglobalisation/onshoring beneficiaries in Mexico, Vietnam and Romania. Keep, style agnostic, liquid and high quality ESG.
- Lastly, we believe it could be beneficial to maintain at least market weights in START stocks (Samsung, TSMC, Alibaba, Reliance Industries and Tencent). This index (which was coined by us in our START piece in 2020/21) is now poised to capture upside versus FAANG stocks into 2023, in our view.

Tim Love
Investment Director

ACTIVE EQUITIES

Lukas Knueppel, Investment Director, Japan Equities

We believe Japan should escape recession in 2023 due to the ongoing recovery post-Covid. We expect corporate profits to benefit from a reversal of negative impact factors and we believe the stock market has upside potential not least due to a possible easing of inflation and less interest rate pressure.

Private consumption in Japan has been recovering since autumn last year and should continue to be an important support factor in 2023 due to the government's now relaxed stance on Covid. The re-opening since October 2022 has started to benefit the tourism related industries. As the statistics show, foreign visitors are returning to Japan, although peaks are not being reached as quickly, as the previously so important Chinese tourists are still being kept in check.

Industrial production has been strong recently as Covid-related distortions are mostly resolved, except for the car manufacturers which continue to struggle to procure specific semiconductor chips. However, the situation is not as dire as it was a few months back. Machinery orders in Japan remain at elevated levels for now and only show minor setbacks. Expectations in the market are that there will be a more pronounced slowdown into the early part of 2023 before a recovery is expected towards the end of 2023. As things stand today, the weak demand for PCs and mobile phones is noticeably negatively, impacting machinery demand and related parts. In response to evolving national security issues, efforts to strengthen supply chains have increased, supporting a new wave of capex. For instance, in North America, investment in construction of semiconductor factories is progressing rapidly, and a growth trend has begun in transportation equipment as well, not least due to solid capital investment in electric vehicles (EVs).

Robotics orders overall also show a peeking out of demand for now. Yet, the International Federation of Robotics highlights the fact that despite all global headwinds and China's Covid struggles global installations are expected to grow by 10% in 2022. Looking further out, after a fading out of the "boom after crisis" in the next three years, we believe an average annual growth rate in the medium to upper single-digit range could be anticipated. This growth should be driven by strong demand in Asia. World semiconductor demand has slowed down markedly in Asia since late spring, not least due to the slow PC and mobile phone demand. Other regions have remained stable by trending sideways or marginally down.

Corporate profits reached new highs in 2022, not least due to the net positive effect of yen weakness. However, profit margins have been pressured by the sharp increase in input prices, which have been further pushed up by the yen weakness, as many of the input items are sourced in USD. Nevertheless, the current pre-tax margin of 6.6% is at a record level and well above the previous record set in 2018 and 260 basis points above the level just before the Globalreat Financial Crisis of 2007/08. As core commodity prices have stabilised in recent months, a noticeable positive effect on consumer prices in the US can be expected. As inflation peaks, US interest rates will come under less pressure and markets will adjust to less aggressive monetary tightening by the Federal Reserve (Fed). This potential scenario favours a stronger yen, which, if true, would also reduce inflationary pressures in Japan as import prices will be lower.

Lukas Knueppel
Investment Director

This setup also implies that in 2023 there could be a reversal of the previously negative drivers of Japanese companies' margins, leading to modest earnings growth of around 5%, although sales may be dampened by temporary weakness in demand. The equity market should be positively influenced by lower inflation, lower interest rate pressure and improved margins. In addition, the Japanese dividend yield remains at a historically high level of around 2.5%, which compares favourably with the 10-year government bond yield of 0.25%. The valuation of the equity market is at a historically low level, which is reflected in a comparatively low price-earnings ratio of 13. To some extent, this valuation already considers a potential decline in earnings that investors fear, for example, due to a possible recession in the US next year.

Speculation of Fed tightening coupled with actual rate hikes has led the equity market to favour value stocks over growth stocks, as rate hikes in the US have had a greater impact on the long-range earnings streams of growth stocks than value stocks, which tend to benefit from cyclical earnings increases in the short term. In 2023, a noticeable slowdown in global inflation and stabilisation in interest rates point to a more favourable environment for growths stocks. Moreover, as global economic momentum is expected to slow in 2023 before a recovery starts to materialise in 2024, quality companies with strong margins based on superior pricing power and strong balance sheets led by excellent management teams could do relatively well.

ACTIVE EQUITIES

Adrian Gosden, Investment Director, UK Equities UK Equity Income

The opportunity in UK equities is supported by four key pillars which we have previously highlighted and which continue to hold – the return of dividends, a rise in corporate activity, the unprecedented amount of share buybacks and the composition of the UK market.

Beginning with dividends, they play a fundamental role in the UK, making up half of the return of UK equities over the last 100 years. Following the significant dividend cuts in 2020, we are now operating in a market where dividends are increasing. This not only benefits the shares themselves, but dividend growth is a very useful tool to help investors combat the current inflationary environment.

Secondly, the UK market continues to experience a significant amount of corporate activity. In recent years, we have seen a broad range of UK companies, including Euromoney and Morrisons, bid for at significant premiums by private equity firms. These are not anomalies. Rather, this is happening regularly in the UK market. This reflects both the fall in sterling and the undervalued nature of the UK market. Private equity firms are continuing to buy UK companies and taking them off-market – and they have the potential to make strong returns by doing so.

Further, we are continuing to see an unprecedented amount of share buybacks. UK companies, principally in the financial and energy sectors, having paid their dividends and with healthy balance sheets, are buying themselves. These businesses cannot make acquisitions in the wider market because it is too expensive and therefore, given the low price of their UK shares, they are choosing to buy themselves. We regard this as an attestation to the company's value. Further, share buybacks matter to investors because they reduce the denominator on which dividend per share and earnings per share are calculated. As a result, earnings per share and dividend per share rise.

As well as these three key features – dividends, corporate activity and share buybacks – which represent strong tailwinds for UK equities, the composition of the UK market is also worthy of note. Specifically, 1% of the FTSE 100 is in technology, while technology accounts for almost 30% of the S&P 500.1 The UK market is instead dominated by financials, oil and gas and mining shares, all sectors which, in the current environment where we are seeing a rising yield curve, are likely to respond well.

Having invested in UK equities for the last 30 years, we believe today presents an opportunity akin to that we experienced in 2000, 2008 and 2020. That is, to stick to a robust investment process, adhere to cash flow principles, be nimble, put capital to work at the right time and crucially, be bold enough to make decisions in this investment environment with the aim of delivering on an absolute basis for clients.

Adrian Gosden
Investment Director

ACTIVE EQUITIES

Daniel Haeuselmann, Investment Director, Switzerland Equities
Swiss Equities

2022 was a difficult year for the Swiss stock market. Price movements were mainly determined by macroeconomic factors. The sharp rise in interest rates globally affected the valuations of Swiss equities and led to significant price corrections. In addition, energy prices rose significantly due to the war in Ukraine and some companies suffered from margin pressure due to rising input prices. All these factors led to a global economic slowdown in 2022. Many of the listed Swiss companies are internationally active and most of their revenues are generated outside of Switzerland; therefore, their results are primarily influenced by global economic developments and not by changes in the Swiss economy.

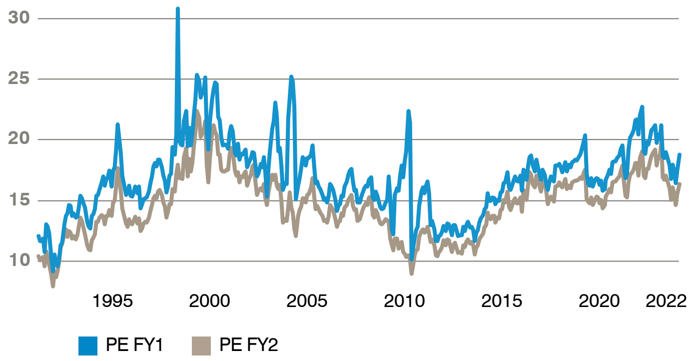
A major challenge for Swiss companies in 2022 was the value chains that were out of balance due to Covid-19. This had different effects on companies. On the one hand, there was a shortage of electronic parts and semiconductor chips or the prices of these increased massively. As a result, lead times for processing orders increased sharply. Order books are actually very well filled at the end of this year and companies are busy reducing their high order backlogs. In recent months we have heard from companies that although not all problems in the value chains have been solved yet, overall the situation has eased considerably. This could lead to a slight decline in orders at the beginning of 2023, because delivery readiness is improving and lead times are shorter, so buyers can order at shorter notice again. For 2023, we see a positive effect on margins due to the easing in value chains.

In 2022, companies also had to increase their prices due to rising input prices. In the short term, this had a negative impact on margins because the increased prices have a delayed effect on margins. In the meantime, the costs for sea and air freight have massively reduced. This will support margins in 2023. Similarly, energy prices or other input prices may be lower next year. Depending on a company's pricing power, prices may have to be lowered in 2023. But our investment style favours companies with high pricing power. This was less relevant in the last two years due to limited supply chains, because practically all companies could raise prices because of limited supply. Now, however, this will become more important again, because depending on their market position and competition, companies are now forced to pass on lower input prices to customers. Companies with pricing power, on the other hand, only have to do this to a limited extent and can achieve a positive margin effect.

It is somewhat more difficult to assess the economy for 2023. Swiss companies are broadly positioned and have strong geographical presence not only in Europe, but also in Asia and the US. We expect some economic headwind in the first half of the year. After that, it is possible that the economic environment will improve again. We are convinced that rising profits are the most important price driver and therefore hold companies in our portfolios that benefit from different structural growth trends.

Daniel Haeuselmann
Investment Director

Price/Earnings - From 29 Dec 1989 to 30 Nov 2022 - Valuations at historical average



Source: GAM Equity Analytics, Bloomberg. Past performance is not an indicator of future performance and current or future trends.

Our portfolios are strongly focused on companies with high earnings growth and high returns on capital, which are able to successfully reinvest capital in their business. We favour profitable, high-quality, well-managed growth companies with healthy balance sheets that gain market share over time and demonstrate sustainable value growth. This is because high profitability enables companies to invest in both research and innovation despite crises, and to enter new markets and expand distribution to enter the upturn stronger. Our portfolios are positioned to benefit from the next earnings cycle. We hold a large number of companies that are market leaders and can grow disproportionately in the next upswing. Valuations are average by historical standards, making them more attractive again for medium- and longer-term investors.

ACTIVE EQUITIES

Christian Munafo, Chief Investment Officer, Liberty Street Advisors Private Shares

A Morgan Stanley analyst note in October said the total private capital market is set to grow at a 12% annual compounded growth rate over the next five years, taking assets under management to USD 17 trillion. As referenced in the note, as private market firms increasingly introduce products and strategies across the risk/return/liquidity spectrum with wrappers and vehicles that cater to different investors, the democratisation of private markets and increased alternative liquidity options may flourish.

Similarly, a recent Preqin report[1] found that total private market assets are estimated to reach USD 18.3 trillion by 2027, doubling its current value. As a subset of the overall private market, venture capital is forecast to demonstrate 19.1% growth per year through 2027, which would make it the fastest growing asset class. We believe this can be attributed to two key factors. First, venture capital can provide investors with access to unique technology, innovation and disruption that is driving the digitisation of, and significant value creation across, the global economy. Second, as global macroeconomic headwinds can create increased public market volatility and uncertainty, many of these technology companies will likely continue staying private for longer, thereby growing into larger market capitalisations in the private market.

Looking into 2023 and beyond, long-term investors seeking private market technology innovation and disruption should continue to benefit from value creation across sectors including fintech, artificial intelligence, cybersecurity, cloud, data storage and analytics, online education, supply chain optimisation, e-commerce, digital health, and the space economy. It is important to acknowledge the record high levels of dry powder (circa USD 300 billion) available to support the venture capital ecosystem and increased maturity of market participants relative to prior cyclical rotations. Furthermore, venture-backed companies rarely have significant debt, if any, in their capital structure which helps mitigate various risks stemming from a rising interest environment. While valuations have retraced and may stay muted in the near-term due to various macro headwinds, we believe there will continue to be a bifurcation across the market where best in class companies continue raising capital without much trouble, while lower calibre or capital constrained companies are at most risk for down rounds, distressed exits and shutting down operations. The companies best positioned for success will be those with differentiated business models, strong operating metrics that balance growth with profitability, seasoned management teams, well-heeled investor syndicates, and healthy balance sheets to help manage through market cycles.

Overall, the bigger implication heading into 2023 may be that private companies continue to delay exit events and thus decide to stay private for longer until the opportune time arises to optimise valuation and liquidity. Historically, periods of increased volatility and macroeconomic uncertainty are often good catalysts for increasing the supply of opportunities in the private markets. In other words, these catalysts may improve supply and demand imbalances in favour of buyers and investors as owners of illiquid assets tend to become more risk averse and prefer liquidity. These types of environments often result in more attractive risk adjusted entry points, and as a result, vintages involving periods of increased public market activity and macro uncertainty typically also generate outperformance.

While no company is immune to macro factors, private companies can often avoid idiosyncratic public market volatility that may otherwise force their management teams to prioritise near-term indicators like quarterly earnings rather than long-term objectives such as new product development, strategic positioning, and overall execution. We believe that well-capitalised venture-backed companies targeting large addressable markets that offer differentiated products and solutions enabling greater efficiencies can be well positioned to thrive even in the most challenging environments.

For these reasons, we believe it becomes increasingly important for all investors to access the potential alpha these companies can generate at the pre-IPO stage, but a longer-term perspective is paramount. As the democratisation of private markets continues, financial advisors and retail investors will likely play an important role in the next stage of growth for the venture capital industry.

Christian Munafo
Chief Investment Officer,
Liberty Street Advisors

[1]Source: Preqin – The future of Alternatives in 2027, October 2022

SPECIALIST FIXED INCOME

SPECIALIST FIXED INCOME

Nelson Seo, Co-Founder and Managing Director, Fermat Capital
Cat Bonds and Insurance-Linked Securities

Catastrophe (cat) bonds and insurance-linked securities (ILS) experienced a tremendous amount of spread widening in 2022, setting up for what we think could be the best investment environment in the history of the ILS market for 2023. This spread widening is due to a large imbalance in the supply and demand of reinsurance which is expected to last at least well beyond 2023. Further, while the hard market has been in place throughout 2022, Hurricane Ian's landfall in late September has pushed the dynamics even more in favour of ILS investors.

Demand for reinsurance from primary insurance companies (particularly in the US) has been dramatically increasing, fuelled by rapid inflation in repair and replacement costs, and is showing no signs of abating. At the same time, supply of reinsurance has been shrinking over the past couple of years due to underwriting losses and trapped collateral, a dramatic reduction of retrocession capacity and the shrinking of reinsurer balance sheets. Brokers are estimating a current gap of USD 40 billion to USD 80 billion in reinsurance supply/demand and do not expect this to be bridged anytime in the medium term.

While Hurricane Ian will cause additional stress to the already hardened Florida hurricane market, we are currently seeing spreads widen significantly across all perils in all layers, a hallmark of a true hard market. And just as importantly, we believe the record high anticipated interest in catastrophe bond issuance for 2023 will create a rare situation where capacity deployment constraints are not the issue they have been in the past for fund subscribers.

As a reminder, cat bonds pay floating rate coupons, so rising interest rates in the US will only add to the total return on the bonds in 2023 (at least for US dollar denominated investors).

Nelson Seo
Co-Founder and Managing Director, Fermat Capital

SPECIALIST FIXED INCOME

Romain Miginiac, Fund Manager and Head of Research, Atlanticomnium
Subordinated Debt

2022 has been a true paradox for subordinated debt of financials. While fundamentals benefit from higher rates, valuations are completely dislocated as the asset class has been impacted by the broader risk-off sentiment. As investors the question is always, what is the catalyst for a recovery? – for example, peaking rates for high grade bonds or an improving macro environment for equities. With high levels of yield in subordinated debt of financials and credit profiles benefiting from the inflationary current environment, even time has become a catalyst of last resort. Even if no other catalysts materialise, capturing this yield delivers the best of both worlds – equity-like returns in fixed income with low default risk.

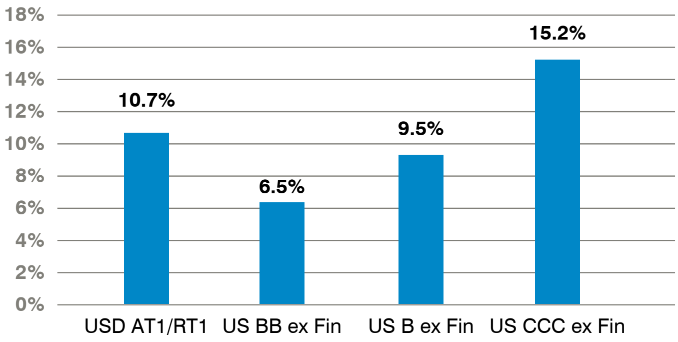
Beyond the obvious macro catalysts that would support price recovery, fundamentals are the key catalyst for subordinated debt of financials. The starting point for the financial sector is rock solid fundamentals, after more than decade of de-risking and capital accumulation driven by stringent regulation. The banking sector is now one of the most resilient sectors, and bondholders have never been as protected, sitting above hundreds of billions of excess capital. Moreover, rising rates is a significant tailwind and financials is one of the few sectors to benefit from the current environment, reinforcing our conviction that earnings alone are sufficient to absorb the impact of a stressed scenario.

Despite the credit strength of the sector, there has been a complete disconnect between fundamentals and valuations, as the asset class has not been immune to negative market sentiment. Looking ahead, despite elevated macro uncertainty, the outlook over the next 12-24 months for subordinated debt is strong. Spreads have widened aggressively so far in 2022, broadly doubling since September 2021 to ~600 bps on AT1 CoCos for example, and yields are now at an eye-watering 10%+ level.

Extension risk has once again weighed on returns, and with more than 80% of the AT1 market priced to perpetuity currently; there is another leg of potential upside as bonds re-price to call. In the high income segment, subordinated debt screens as cheap, with new-style Tier 1 bonds of banks and insurers (AT1 CoCos and RT1s) offering yields of close to 11%. In the high yield market, only CCC-rated corporates offer higher returns, highlighting the strong value in subordinated debt, especially in a time of uncertainty. To illustrate, BNP recently issued a USD-denominated AT1 CoCo with a 9.25% coupon, perpetual with a first call date in 2027. If not called, the coupon would reset to the 5-year US treasury +4.969%; c9%. Even without any price appreciation, 9.25% coupon per year of income (46.25% over five years until the first call date) is a catalyst for bondholders' returns. Finally, subordinated debt offers low sensitivity to rates, a positive in the context of high rates volatility. More importantly, low sensitivity to rates also implies that a decline in rates is not a requirement for strong future performance, as in the investment grade and government bond market where rates is a key driver of returns. Spread tightening and a re-pricing to call are the key drivers of future performance, supported by strong visibility on the high credit quality of the sector.

Romain Miginiac
Fund Manager and
Head of Research,
Atlanticomnium

Subordinated debt offers more attractive higher yields compared to most of the high yield market



Source: Atlanticomnium, Bloomberg, as of 10.11.2022

With yields of up to 10% or above, subordinated debt offers equity-like returns, with a clear catalyst for performance – time. While awaiting a turn in macro that would support price recovery, investors benefit from high income and rock solid fundamentals. For bonds of high quality issuers that are issued at par and repaid at par, high income and pull-to-par mechanically generates performance after a large drawdown. Nonetheless, given dislocations between fundamentals and valuations, we see strong upside potential on top of high income.

SPECIALIST FIXED INCOME

Paul McNamara, Investment Director, Emerging Markets Fixed Income Emerging Market Debt

The key issue for the asset class has been the combination of higher US rates (especially via the stronger US dollar) and higher inflation. A miserable year for emerging market (EM) debt has been driven by currency (-8.7% as of 30 November 2022) and weaker bonds (-11.9%) although higher carry has slightly mitigated the issue (+4.5%).

Rates and yields are high at present, and at a minimum, currencies are cheaper than they have been for years, at least versus the US dollar. Emerging currencies have traded against a strong dollar in line with the historical relationship – when the dollar rises 1% against developed markets, it rises 1.4-1.5% against EM.

There are a number of reasons for the dollar's extraordinary strength this year: the Federal Reserve moving more aggressively than its peers, a defiantly robust US economy, fallout from the Russian attack on Ukraine that falls disproportionately on Europe and a Chinese economy which has suffered from a series of strict lockdowns in pursuit of zero Covid. EMs tend to do best in a world with broad strength in economic growth, whereas a "unipolar" world with only the US prospering tends to simply mean a strong dollar. Commodity exporters are especially reliant on China.

In 2023, we expect to see a change in these relationships, but it is far from clear yet exactly how. The best case would be a soft landing in the US, with inflation coming down without a serious recession, combined with a mild winter in which Europe does not run out of gas and a relaxation of China's draconian interest rate policies. In such a case softer oil and global food prices could take the sting out of EM inflation while a weaker dollar would allow EM currencies to claw back lost ground.

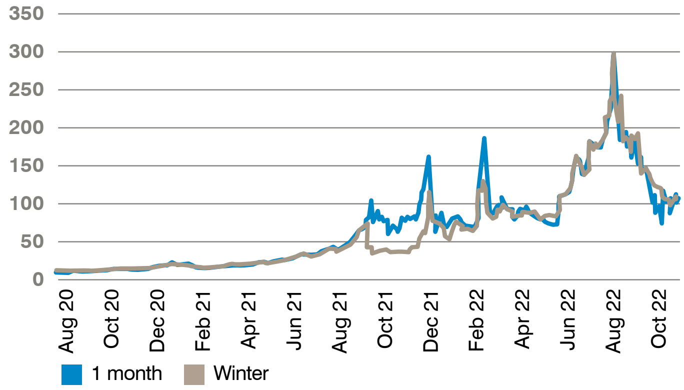
The fall in commodity prices at the end of 2022 offers hope for EM inflation into 2023, but the lags have historically been short and the failure to respond so far causes concern. Some of this can be explained by coverage – the index does not cover the natural gas prices which are so important in Europe and which have fallen more recently than most other prices. But it is a struggle to depict this as more than merely the most likely of a number of possible scenarios. Similarly with external trade, the higher oil price has weakened external balances and the retracement will help.

However, when EM does best (see 2000-2006 or 2009-10) the balance of payments surplus is such that governments usually intervene in currency markets to prevent excessive appreciation. This is not the case at present. While EM weakness or strength tends to be self-sustaining, it is hard to be optimistic with such a trend.

Overall, the outlook is very dependent on the winter in Europe. Gas prices have retraced most of their autumn panic, but at least part of this drop is because Europe has successfully filled its storage, and demand will be weak until the gas has been drawn down. Much of Europe has very limited storage relative to usage, and a number of countries will likely run out of gas if there is a cold winter. This would have serious consequences for the European economy (and would likely result in sharp dollar strength and EM weakness). The consequences for Central Europe could be especially bad.

Paul McNamara
Investment Director

Europe: Gas Price Futures



Source: Bloomberg

In summary, we are cautious about pushing an all-round bullish view on EM. This would involve a 'soft landing' in the US, where the tightening done to date, plus a very small number of further hikes, is sufficient to take the momentum out of inflation without tipping the US into a serious recession (a technical recession of two quarters of negative growth looks very likely nonetheless). In case of a soft landing in the US, and a benign recovery in the rest of the world, EM currencies begin to look rather attractive. Absent such certainty, and with our usual metrics of EM currency demand and valuation (current account/trade balances, growth in currency reserves) looking fair value at best, we are neutral on EM currencies.

However, EM bonds look far more compelling. Rates have risen as much or more than in developed countries; inflation is more sensitive to volatile commodity prices and looks well placed for a sharp drop. EM bond prices have been far more likely to decouple from currency rates – most clearly seen in 2008, when yields fell sharply (amid the collapse in oil and other commodity prices) despite weak currencies.

Our particular favourites are the countries where central banks have hiked rates relatively aggressively. Chile and Brazil have already demonstrated the returns from bonds as the cycle turns can be large. Hungary and Colombia are the two most likely candidates to follow, though both have serious question marks (policymaker commitment in Hungary, fiscal and balance of payments vulnerabilities in Colombia). We also continue to like long-time preferred markets like Mexico, South Africa and Brazil. We are cautious about countries we regard as vulnerable (Turkey, Egypt, Ukraine) and also generally in Asia, where rates have risen less and inflation has been suppressed by expanding (expensive) subsidies.

Turning more bullish, the best scenario for EM is trend or better growth across the world. This means, apart from avoiding US recession, avoiding persistent zero Covid lockdowns in China and a gas-related accident in Europe. The best confirmation signal would be stabilisation or even recovery in EM reserve levels. Some combination of these factors would allow us to turn more bullish on EM currencies, which would support the appeal of bonds as well as generating returns in its own right. When the market turns, the returns may be strong – technicals are positive, sentiment is bearish and investors are underinvested (whereas investors are long the US dollar while lacking conviction).

SPECIALIST FIXED INCOME

Tom Mansley, Investment Director, Asset Backed Fixed Income Mortgage Backed Securities

Tom Mansley
Investment Director

The Federal Reserve (Fed) has been very loose in terms of monetary policy for a long time and now it needs to tighten by raising rates and shrinking its balance sheet. However, not only does the central bank have to compensate for its own overshoot in policy but it also must account for government fiscal policy which was also very stimulative. When Fed monetary policy and government fiscal policy are simultaneously stimulative, they are very powerful and have caused high inflation, which the Fed now has to counter.

We believe the US consumer is in a strong position to withstand Fed rate rises. The household debt-to-income ratio has fallen significantly over the last 15 years, meaning there is less debt versus income. Debt to income today has returned to where it was prior to the early 2000s. The other factor to consider is that consumers took advantage of a period of low rates to refinance debt and lock in low rates. For example, many in the US have 3% 30-year fixed rate mortgages, meaning they have locked in a low interest rate on a low debt level. We can see this through the debt service ratio, the proportion of income that services debts, which is sitting near all-time lows. Additionally, the savings rate spiked to 30% during the pandemic. According to the Fed, households have accumulated USD 1.7 trillion in excess savings since the beginning of Covid through a combination of government stimulus programmes and reduced expenditures. This will likely give consumers a lot of power to get through a recession. The combination of low debt levels, low debt servicing payments and excess savings means consumer credit will likely remain strong through a downturn.

There are two big powers fighting each other in the housing market right now. One is the low supply versus high demand imbalance which puts upward pressure on prices. The other is that home prices have risen and mortgage rates are higher, so it is difficult for new home buyers to afford houses which puts downward pressure on prices.

The millennial generation has a large influence on what goes on in the economy and society. The switch a few years ago from millennial renting to millennial buying meant a lot of homes were needed and the market was consequently very short of homes.

The big question is where house prices go from here. The last time we saw a steep increase in prices, they started to go down significantly following the Global Financial Crisis (GFC). However, there were too many homes at that time and the home ownership rate was high, leading to more supply than demand. Today, it is very different. As soon as prices decrease, there are a lot of millennials that missed out previously who will likely look to buy. We believe we may see home prices go down moderately (maybe 10%), increasing their affordability so that millennials can again purchase homes.

Given that background, we prefer very seasoned mortgages and own a large proportion of mortgages that were issued prior to 2008. With 15-year-old mortgages, prices would have to decrease a lot more than during the GFC to get back to the cost basis in terms of home price. Additionally, the mortgage balances are lower than when they were initially issued. A 15-year old mortgage therefore has a large equity buffer, and the borrower has demonstrated an ability to pay, which only gets easier as time goes on. As a result, these types of mortgages will be resilient to a recession and to home prices falling, in our view.

ALTERNATIVES

ALTERNATIVES

Adrian Owens, Investment Director, Global Macro & Currency Fixed Income

Adrian Owens
Investment Director

Central bankers are looking to the future and how current policy is likely to impact future inflation. In terms of action to date, the Federal Reserve (Fed) has done more, having hiked rates by 375 bps at the time of writing, while the Bank of England (BoE) has raised rates by 290 bps. Real 10-year yields in the US are 1.8% while real yields in the UK remain negative (real yields based off 10-year inflation-linked bonds). Further, sterling, which is key for an open economy like the UK, has performed very differently to the US dollar. According to JP Morgan's broad effective exchange rate, so far this year sterling is down 5.5% while the US dollar has strengthened by 12.3%. As if monetary conditions were not already tightening at a much slower pace in the UK than the US, the UK's quantitative tightening programme has also been delayed with its first gilt sale only taking place on the first of November.

At the BoE press conference, which followed the latest rate decision, the Governor was asked directly by a journalist from CNBC why the BoE was behaving so differently from the Fed. Bailey deferred to Deputy Governor Ben Broadbent who emphasised the different growth outlooks, drawing particular attention to the latest PMI data. Broadbent said that the US outlook, based on these indicators, was far better than the UK's. He stated that the PMIs in the UK and the US were 58 and 57, respectively, at the beginning of the year but the UK was now closer to 47, while the US was much higher at 58. Looking at the latest data, we can see that the US PMI is, in reality, 48.2 (S&P Global US Composite PMI) - exactly the same as the latest reading for the UK. The deterioration of the UK and US has, on this basis, been in line.

However, in thinking about inflation and the implications for monetary policy, it would have been more informative if Broadbent had talked about growth relative to trend - or relative to the rate of growth at which the economy can expand without creating inflation. There is much uncertainty about where exactly trend growth is but what we can say with some confidence is that in both the US and UK it has been declining over recent years. Various estimates suggest US trend growth was around 3% in the 1980s and is probably closer to 1-2% today. The UK, in contrast, is likely witnessing a trend growth rate somewhere between zero and 1% (which also calls into question former UK Prime Minister Liz Truss' claim that she wanted to see UK growth at 2.5% at a time of high inflation). We would not be surprised to find that it is currently much closer to zero or negative. Why? As the Office of Budget Responsibility (OBR) highlights, the key determinants are productivity, population growth and hours worked. Evidence suggests that UK productivity remains very weak, labour market participation is low and as Bailey highlighted, inactivity has been on a rising trend.

So, the relative growth outlooks in the US and UK, adjusted for their respective potential growth rates, may not be quite as different as Broadbent implied. In fairness, he also highlighted the impact of the war in Ukraine which has resulted in a much larger shock to UK energy prices than seen in the US. However, this is a double-edged sword, not only affecting growth, but also likely to have a negative impact on the trade-off between UK growth and inflation, implying higher inflation for a given level of growth than would have occurred prior to the war.

In summary then, the US has seen more monetary tightening coming from rates, currency and quantitative tightening than the UK. The growth differences, relative to potential, may not be as large as the BoE suggests yet the Monetary Policy Committee has argued that an unchanged rate path is more likely to get inflation back to target than current market pricing! In contrast Chairman Powell at the Fed believes that the peak in interest rates will be higher and stay higher for longer. We are more convinced by the arguments presented by the Fed and do not think that the UK is in such a different position that the BoE will be able to go its own way. After all, if UK rates diverge too much from the US, we believe sterling is likely to be impacted, adding further to the already troubling inflation dynamic.

In our view, Bailey and team do not appear to have the appetite to tackle inflation purely through tighter monetary policy. The one thing they do have on their side that may differentiate the UK from the US could be future fiscal policy. The Bank of England bailed out former Prime Minister Liz Truss. Perhaps the government of Prime Minister Rishi Sunak and Chancellor Jeremy Hunt can bail out an overly dovish bank.

ALTERNATIVES

Chris Longworth, Investment Director, GAM Systematic Core Macro

Systematic macro styles such as trend-following saw renewed interest in 2022 after delivering strong performance in a year when many traditional investments underperformed. The ability to benefit from declines in both equities and fixed income, as well as strong trends in commodities and FX, all contributed to strong performance.

Chris Longworth
Investment Director

We should note that making confident speculation about the future is somewhat antithetical to a systematic approach. However, looking forward to 2023, we think many of these key themes are likely to stay relevant. The invasion of Ukraine continues to play out in higher and more volatile energy prices and the outlook for rates and equities going forward remains uncertain. These uncertainties generally favour the strengths of a systematic approach, which can react incrementally to market developments as they emerge and manage positioning and risk appropriately. The ability to identify and harvest opportunities across a broad and diverse traded universe will also be important.

Differences in funding mechanics are also likely to see increased scrutiny as global rates continue to rise. Since systematic macro investments are typically paid on margin, it is helpful to hold the majority of AUM in cash or other instruments that will benefit from increases in the risk-free rate, in contrast to styles that require full funding.

MULTI ASSET

MULTI ASSET

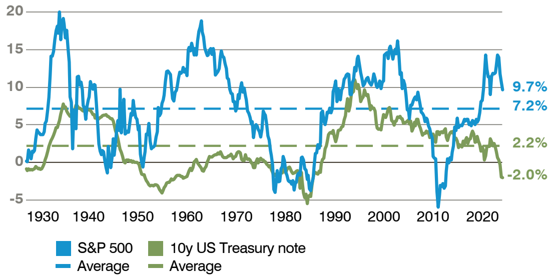
Julian Howard, Lead Investment Director of Multi Asset Solutions

The well-worn expression, 'It's always darkest before dawn' seems especially prescient as 2023 looms. The real issue is whether it is 5am or still 2am. Developed equity and bond markets continue to face a perfect storm of high inflation, tight labour markets and a slowing economy. Added to this, there is growing evidence in some quarters that raising rates is having no effect anyway, beyond inducing economic pain. Chile is a case in point, having started its monetary policy tightening cycle in 2021 and now sporting a high 11.25% discount rate, but with CPI seemingly undeterred at fully 12.8% in the year to October. However, we believe that relief for policymakers is on its way from another source and that the cornerstones of long-term investment remain unaltered by the recent turmoil.

This relief can be seen in palpable signs of 'naturally' easing price pressures. In the US, headline CPI has started to slow its ascent. Oil and commodity prices are easing off as supply chains adapt to the war in Ukraine. Similarly, there is now evidence of wage hikes cooling amid rising labour market participation in many advanced economies, particularly by more senior cohorts. It should also be noted that for all the determination apparently on show by the Fed, the monetary policy response to this round of inflation has been relatively muted when compared with previous instances such as in the early 1980s under chair Volcker. The Fed still appears to be looking for an off ramp and we believe that a cooling in inflation would be well received and, if proved durable, should result in a less aggressive policy tightening path in the coming year.

For long-term investors of course none of this should matter too much, though we accept that the current turbulence is unedifying and self-doubt is only natural on the more extreme days. And a 2023 characterised by the same challenges as 2022 is still possible. But it is worth remembering that the Siegel Constant of 6.5-7% is the real return net of dividends generated by equities over a period of many decades and so remains the fundamental tenet of portfolio construction. That stated, real return over time already includes the wars, inflation spikes and policy errors of the past, many of which were far more extreme than we are seeing this year. This alone should provide justified confidence to investors that markets have seen all of this before and should recover, just as before. The real surprise may be just how soon this recovery begins to occur.

Siegel Constant' shows US stocks prevailing despite 100 years' worth of crisis: 10-year annualised returns 1 Sep 1922 to 1 Sep 2022



Source: Shiller, Yale. Past performance is not an indicator of future performance and current or future trends.

Julian Howard
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OUTLOOK 2023

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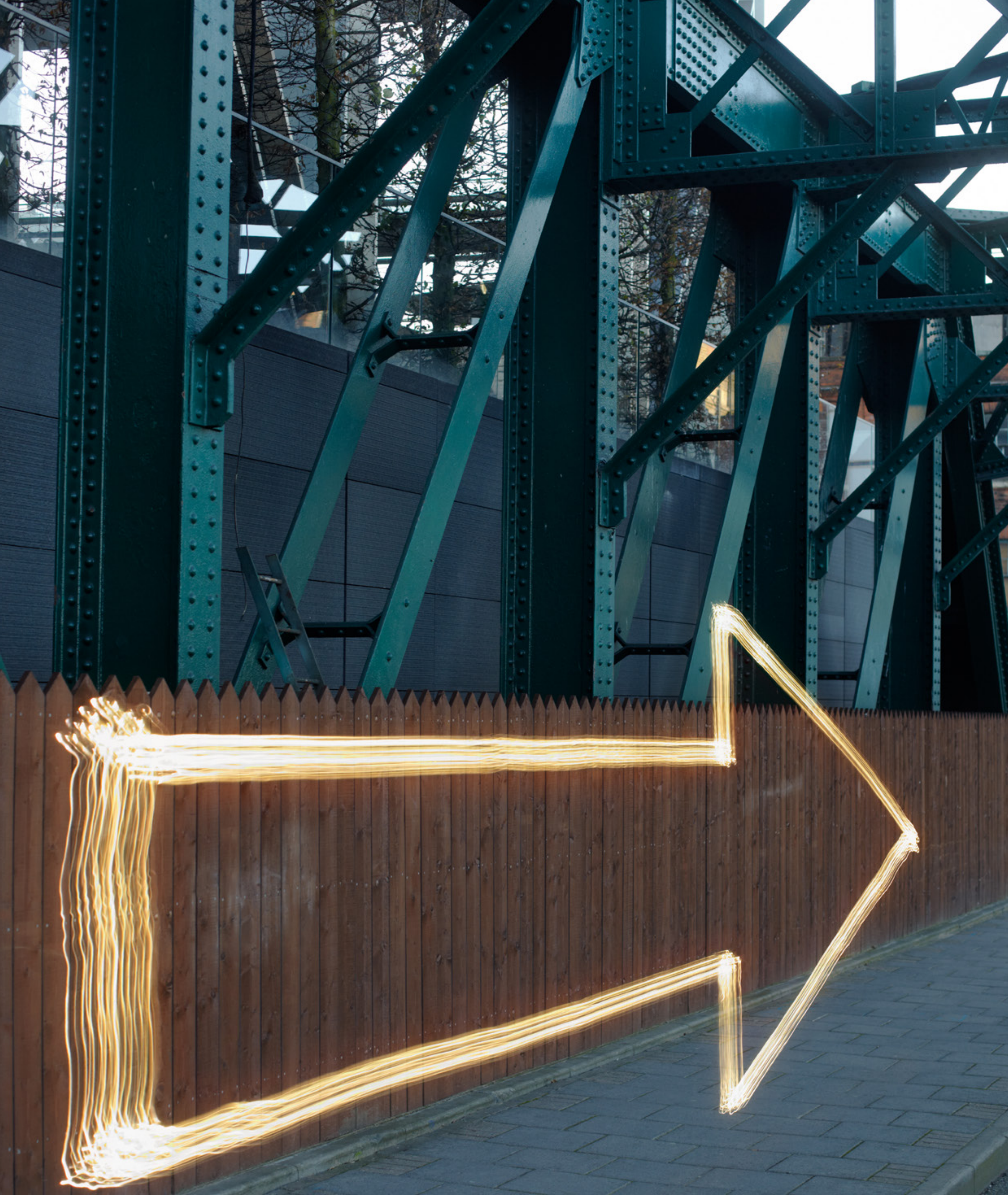

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