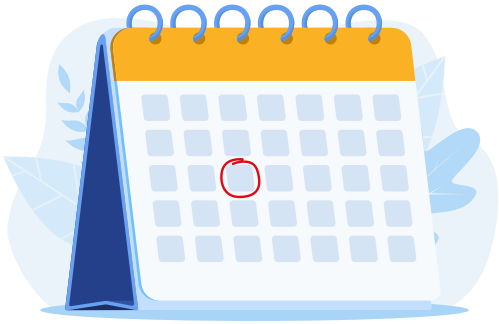
2023 MARKET OUTLOOK



Boom or Bust - Market Outlook for 2023

The global economy experienced some of its biggest shocks in 2022. In Europe, Russia invaded Ukraine, in the continent's biggest conflict since the Second World War. Cryptocurrencies pulled back as Terra and FTX collapsed. In the same period, central banks embraced their most hawkish tone in decades as inflation surged.

Global equities and cryptocurrencies dropped by double digits while the US dollar index surged to its highest point in more than two decades. The Japanese yen and the British pound dropped to their lowest levels in 24 and 36 years while the euro moved below parity for the first time since 2002.

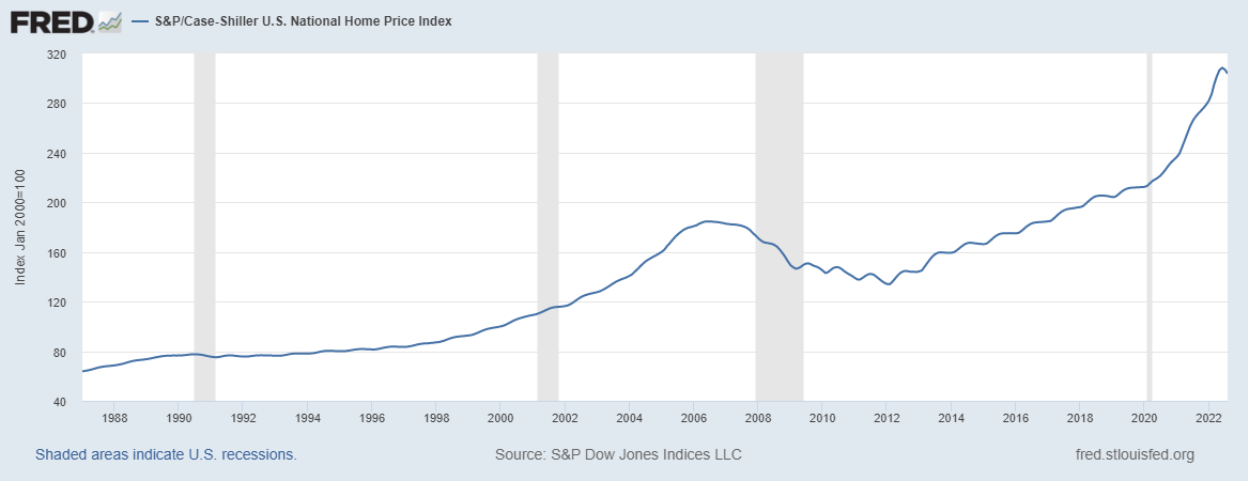
Nasdaq 100, DAX, Hang Seng, S&P 500

Key economic challenges

The world economy enters 2023 facing numerous headwinds. First, most economies are expected to sink to a recession during the year. The OECD expects that the global economy will grow by just 3.1% in 2023 as announced in Fortune, down from 5.1% in 2021. Countries like Russia, the United Kingdom, and China are expected to see some of their slowest growth rates since 2020.

The economy is facing numerous headwinds. Inflation remains stubbornly high in most countries, meaning that many will face stagflation. Stagflation happens when slow economic growth rate is accompanied by high inflation. Further, companies are expected to have mild earnings growth while interest rates are expected to remain at an elevated level.

Another challenge is the housing market seems to be on the verge as mortgage rates soar. In the US, mortgage rates jumped to a multi-decade high of 7%. As shown below, the Case-Shiller house price index seems overstretched, meaning that it is ripe for correction. Home prices have started dropping in countries like the UK and Australia.



Home price index

Worse, the yield curve in the US inverted in July 2022. Historically, yield curve inversion is usually one of the best predictors of a recession. It inverted briefly in 2019 followed by a recession in 2020.

In addition to high-interest rates, the economy faces other headwinds like geopolitics, continued Chinese weakness, and more corporate defaults.

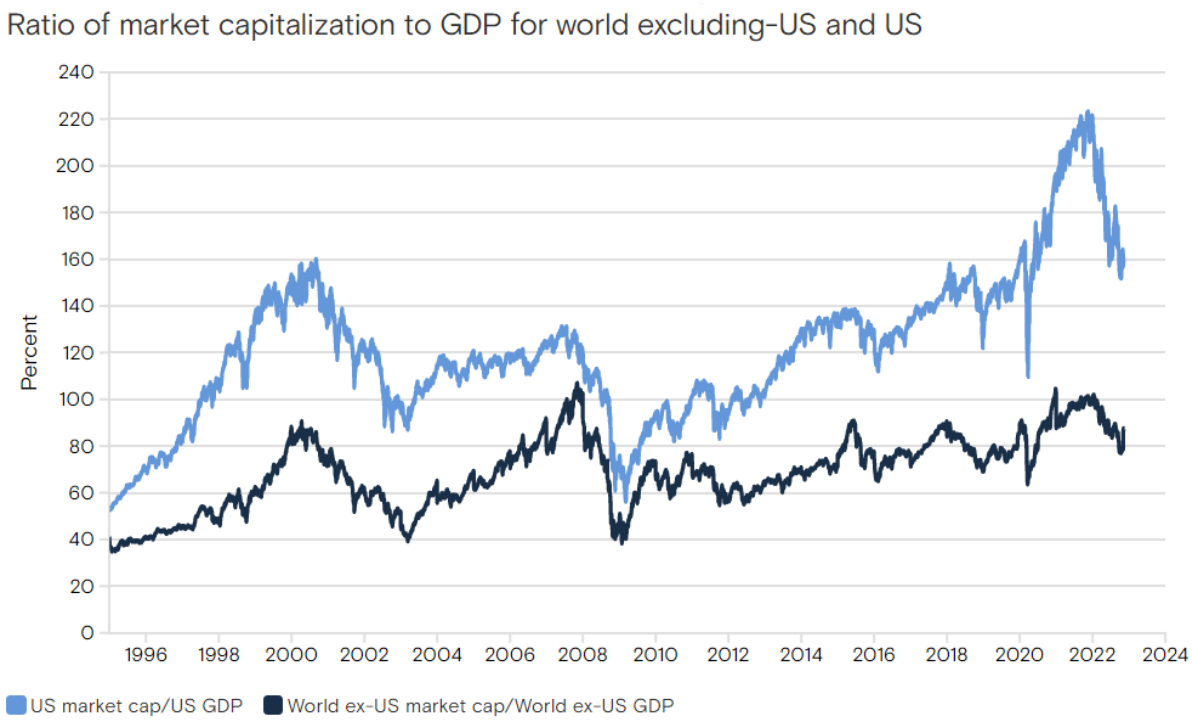
Stock market outlook in 2023

Global stocks plunged in 2022. The closely-watched MSCI All Country Stock Index crashed by over 20% in 2022 as equities faced significant shocks. These shocks will likely continue in 2023 albeit at a slower pace.

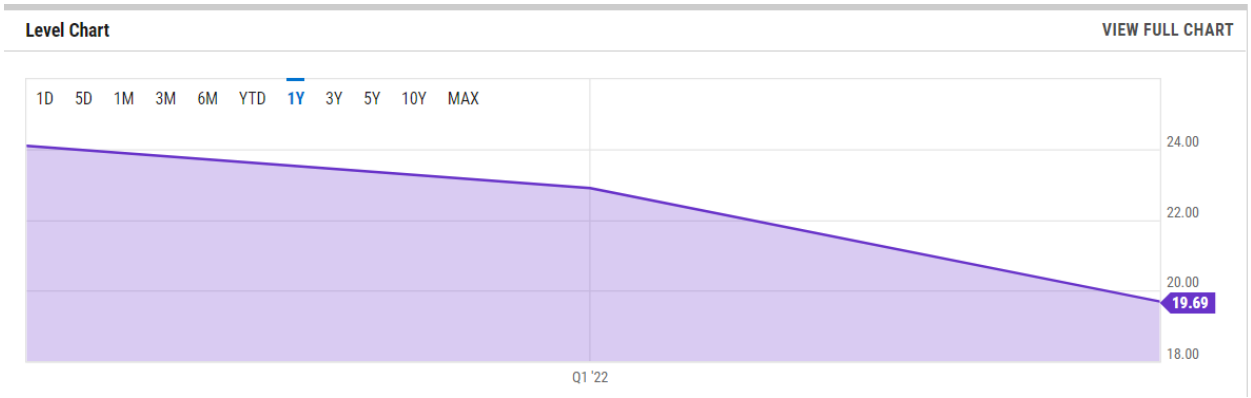
Analysts at Goldman Sachs expect that the bear market in global stocks will continue in 2023 as earnings remain under pressure. In their report, they noted that the slowdown in the stock market was cyclical and historically, such declines last about 26 months.

On the other hand, analysts at Morgan Stanley expect that the US will have a soft landing followed by a steady recovery.

There are several reasons why the stock market will rebound in 2023. First, valuations in the US have dropped sharply in the past few months. The chart below shows the ratio of market cap of stocks compared to GDP. In the US, it has dropped to the lowest level since 2021.

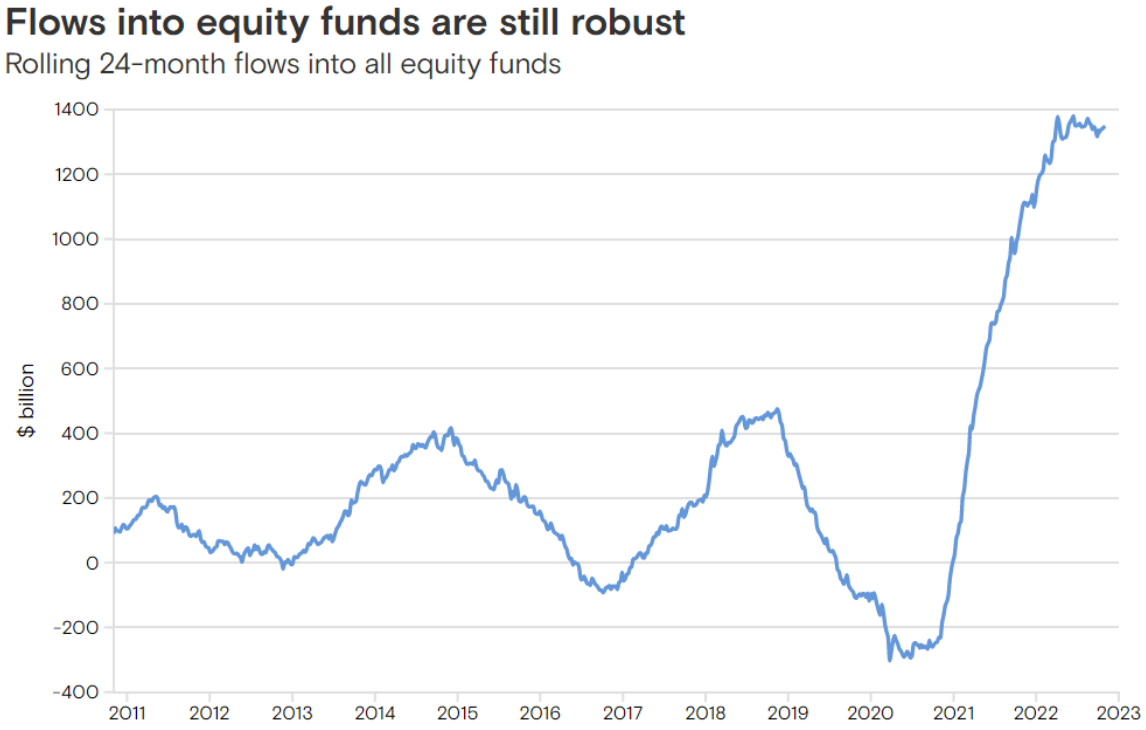


The S&P 500 index PE ratio has also crashed to the lowest level in years. Historically, it has remained above 20.



S&P 500 PE ratio

On a positive note, despite the stock market crash, equity funds continued attracting investments. Flows into funds hovered near its all-time high in 2022.

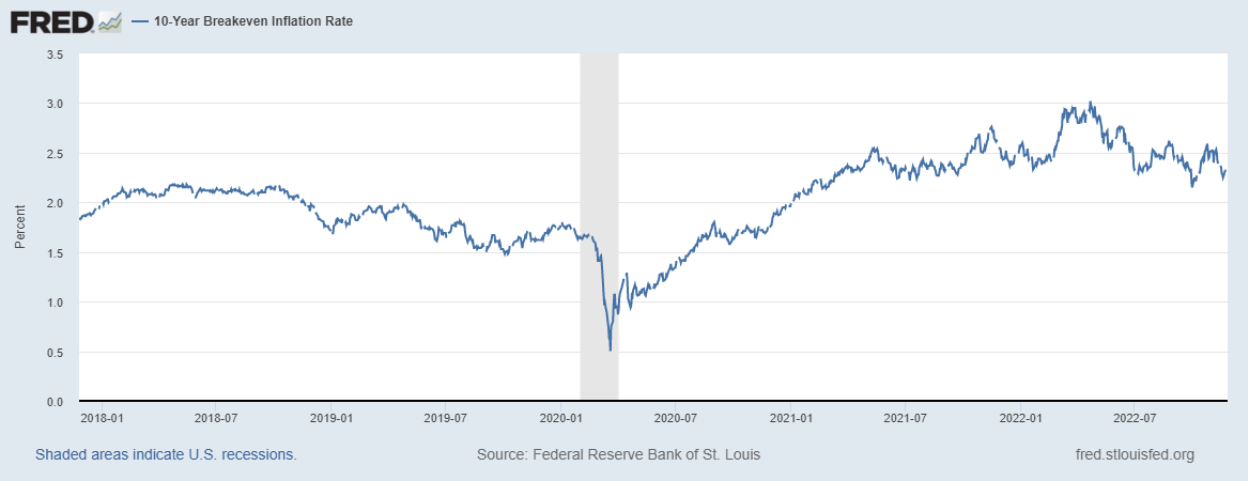


Flows into US equity funds

Second, stocks tend to do well after a major downturn. For example, American equities experienced their biggest rally after the Global Financial Crisis (GFC) of 2008/9. They also had a strong recovery after the Covid-19 pandemic of 2020. This happens since central banks tend to be accommodative in a bid to spur growth.

The Fed has not hinted that it will be accommodative in 2023. Instead, several Fed officials have hinted that they will reduce the size of rate hikes in the coming months. These statements were motivated by the positive reading on inflation numbers published in October.

As shown below, the ten-year breakeven rate, which is a good measure of inflation expectation, has been in a strong downward trend.



10-year breakeven point

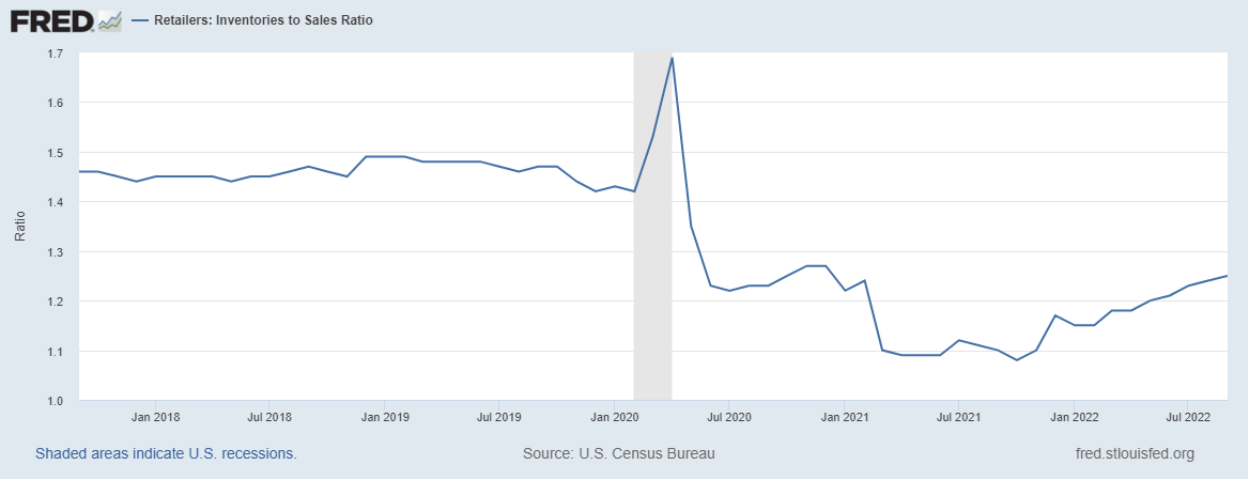
Therefore, there is a possibility that American stocks will rebound in 2023. If this happens, other indices in Asia-Pacific and Europe will also follow suit since stocks tend to have a close correlation.

US dollar outlook for 2023

The US dollar index is a good predictor of other assets in the financial market. In most cases, it tends to have an inverse relationship with other assets like cryptocurrencies and stocks. For example, at its peak, the dollar index was up by over 20% as the bear market in stocks, commodities, and cryptocurrencies continued.

The US dollar index seems to have peaked, which could be a positive sign for other financial assets. It dropped from its 2022 high of $115 to about $105. The decline happened after economic data revealed that inflation had peaked, which will likely push the Fed to become a bit dovish.

There are signs that inflation will continue to fall in 2023. For example, the supply chain challenges that happened after the pandemic has improved. Indeed, CNBC announced sea shipping costs have been dropping as demand eases. Further, retailers like Target and Home Depot which hoarded a lot of inventories have started offering substantial discounts. As shown below, the inventories to sales ratio have been rising steadily.



Inventories to sales

Technical charts also show that crude oil prices have peaked. Therefore, falling inflation will likely push the Fed to relax on rate hikes, which will be a good thing for stocks, cryptocurrencies, and commodities.

Boom or bust

On paper, the outlook for global stocks, commodities, and cryptocurrencies seems to be a bit bearish. Besides, geopolitical risks and tight monetary conditions are expected to persist. Also, companies are expected to report flat earnings growth.

Also, the OECD, World Bank, and the IMF expect that the global economy will have slow growth. However, as mentioned, the year could be a good one for most assets as inflation makes a strong reversal.