EFG

INVIEW

MONTHLY GLOBAL HOUSE VIEW & INVESTMENT PERSPECTIVES

JANUARY 2023

DISCIPLINED BY NATURE. FLEXIBLE BY DESIGN.
The icons alongside represent our investment process. Through a disciplined provision of investment policy and security selection at the global level, regional portfolio management teams have the flexibility to construct portfolios to meet the specific requirements of our clients.

HIGHLIGHTED IN THIS PUBLICATION:

- GLOBAL STRATEGIC ASSET ALLOCATION
- GLOBAL SECURITY SELECTION
- REGIONAL ASSET ALLOCATION
- REGIONAL PORTFOLIO CONSTRUCTION

Editorial

Welcome to the January edition of *Inview: Monthly Global House View*. In this publication we consider significant developments in the world's markets, and discuss our key convictions and themes for the coming months.

Moz Afzal
Chief Investment Officer

Financial markets remained nervous into year-end, as they had been throughout 2022. Central bank actions were again the key factor in December, with the more hawkish-than-expected tone after the December monetary policy meetings adding to volatility and pushing share prices down. Furthermore, in the eurozone, the general level of bond yields rose while sovereign and corporate spreads widened. This reflected the spike in risk aversion triggered by the European Central Bank's (ECB) aggressive messaging and the announcement that from March 2023 balance sheet reduction will commence.

Inflation remains, according to central banks, too high and continues to warrant further tightening in monetary policy. The ECB was particularly hawkish, indicating that further moves of 0.50% are likely in early 2023. The extent of central banks' concerns is surprising given the strong decline in commodity prices, the progressive normalisation of global supply chains, and the slowdown in global growth which, inevitably, will result in an increase in unemployment rates and reduce inflation. Central banks at this point do not have any incentive to sound dovish given the criticisms they have faced throughout the year. However, markets are now not as hawkish as central banks and this is a reversal from earlier in 2022.

The trend in inflation will therefore remain the key factor for future monetary policy and financial markets. We believe that inflation could fall faster than central banks expect in 2023, prompting a rethink on the need for further severe monetary tightening.

The Federal Reserve will likely be the first to take note of an improved inflationary picture as it is more advanced in the policy normalisation cycle than other developed market central banks. Thanks to the expected recovery of the Chinese economy following the progressive easing of anti-Covid measures, the US dollar is expected to depreciate, including against the yen and the other currencies most sensitive to developments in the Chinese economy.

In this context, the portfolio allocation should see a moderate overweight in equities and bonds at the expense of cash. Within equities, it seems advisable to reduce the exposure to the US market in favour of Asia, Japan and the eurozone, all of which will benefit from China's recovery as well as more reasonable valuations versus the US.

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Global Allocation

Based on a balanced mandate, the matrix below shows our 6-12 month view on investment strategy

	Positioning relative to neutral benchmark	Weighting change from last month*
FIXED INCOME	+	↔
EQUITIES	+	↔
ALTERNATIVES	–	↔
CASH & MONEY MARKET	–	↔
FX	●	↔

– Underweight + Overweight ● Neutral

↔ No change ↑ Increase ↓ Decrease

*Note that arrows reflect any adjustment to allocation weighting and is not necessarily a full upgrade or downgrade.

Fixed Income

No changes were made to our overall fixed income positioning, maintaining a small overweight which we will review again in January. We noted that over the past month investors have become more bullish on this asset class, with bonds no longer being an underweight, according to the Bank of America Fund Manager Survey.[1]

The rally in US investment grade bonds continued in December, making it one of the best performing assets in fixed income. This tightening of spreads has been favoured by the weakening of the US dollar. However, spread levels remain supportive of our overweight stance at this point. In Europe, investment grade bonds appear more attractive on a spread basis than the US.

		Positioning	Weighting change from last month
	Rates	+	↔
USD	Investment Grade	+	↔
	Sovereign	●	↔
EUR	Investment Grade	+	↔
	Sovereign	–	↔
GBP	Investment Grade	+	↔
	Sovereign	–	↔
CHF	Investment Grade	+	↔
	Sovereign	–	↔
	Credit	–	↔
USD	High Yield	●	↔
EUR	High Yield	●	↔
	Hybrids	–	↔
	Asset-backed Securities	–	↔
	Insurance	●	↔
	Convertibles	+	↔
	EM Local Currency	–	↔
	EM Hard Currency	●	↔

– Underweight + Overweight ● Neutral

↔ No change ↑ Increase ↓ Decrease

[1] Bank of America Fund Manager Survey – December 2022

Equities

We maintain a slight overweight equity position relative to the benchmark. Despite the November rally, the EFG valuation scores have not changed significantly compared to the previous month, with most markets continuing to look attractive from a valuation perspective. In particular, non-US markets such as Europe, Asia, Japan and China look attractive from a valuation point of view.

The macro situation in the US has deteriorated, with growth starting to show signs of deceleration. Therefore, we have downgraded our macroeconomic outlook for North America, and consequently reduced the equity allocation to a small underweight. From a sector point of view, utilities are the only sector that looks particularly expensive in relative terms. Healthcare continues to perform well among defensives, while within cyclicals industrial stocks have outperformed.

Reducing our US exposure allowed us to increase the allocation in other regions. The European equity exposure was raised to a slight overweight. In our view, positive technical indicators, the strength of the euro versus the US dollar and the positive impact from a reopening of China will offer support to European equities. We also increased our allocation to Asia ex-Japan, with countries in the region also expected to see a positive spill over effect from China's change in Covid policy, as well as the seasonality around Chinese New Year. Finally, we also added to the allocation in Japanese equities. There, we expect to continue to see robust corporate earnings despite a low-growth environment.

	Positioning	Weighting change from last month
North America	–	↓
Europe	+	↑
UK	–	↔
Switzerland	•	↔
Asia ex-Japan	+	↑
China	+	↑
India	+	↓
Indonesia	+	↔
Korea	•	↓
Malaysia	–	↔
Philippines	–	↔
Taiwan	–	↓
Thailand	–	↔
Other	–	↓
Japan	+	↑
Latin America	+	↔
EMEA	•	↔
Thematic/Global	•	↔

– Underweight + Overweight • Neutral
↔ No change ↑ Increase ↓ Decrease

Equity Sector Views

UK

Industrials is the largest sector overweight in UK stocks, taking advantage of the de-rating seen across the sector this year to pick up quality companies. We continue to hold a bias towards defensive compounders over more cyclical industrials for now. Energy is also a preferred sector as we continue to see support for energy prices remaining high over the next year, particularly as economies begin to re-accelerate, China reopens, and demand for aviation fuel recovers to pre-pandemic levels. Additionally, large UK energy companies trade at more attractive valuation levels than their international peers. High levels of cash generation will allow them to invest in their renewables business, while also supporting large scale buybacks and dividend increases going forward. There is more caution on consumer staples as we expect companies in the sector to be tested as consumer purchasing behaviour changes, downtrading increases, and volumes weaken. This is likely to affect margins in a sector where valuations look expensive given investor moves into defensive assets this year.

US

We remain defensively positioned given the macro backdrop. The lagged effect on demand of financial tightening, the erosion of consumer purchasing power and the pressure on margins are a downside risk to corporate earnings. We are therefore overweight in defensive sectors, including healthcare and consumer staples and are also holding higher levels of cash than usual. Within cyclical sectors, we remain overweight consumer

Equity Sector Views *(cont.)*

discretionary, but this is largely driven by our position in Amazon which is more of a technology company than a consumer company. So far US consumers are still holding up thanks to pandemic savings, low unemployment rates and limited energy price shocks compared to Europe. This strength will be tested by ongoing financial tightening. It is uncertain at this point to what extent, and the possibility of a soft landing is non-negligible. We are also overweight technology – due to our quality growth bias and the concentration of such stocks within tech.

Asia ex Japan

Within Asian stocks, we maintain a bias to the Chinese re-opening trade, with positions in travel, hotels, and general consumer discretionary sectors. We remain defensively positioned with overweight positions in healthcare and staples given current weak demand trends ex India/Indonesia. We are underweight in the property sector, largely due to China's real estate market, as we believe that home sales will remain weak and will take a long time to recover from improved financing support. We also have a small underweight in information technology, which is showing some early signs of downstream inventory destocking. However upstream semiconductor inventories continue to rise, gradually pressuring pricing and demand.

Europe

Technology has moved to our biggest overweight in European stocks. Up to the end of third quarter the sector had performed poorly, and overall market positioning had been very underweight. Coupled with the recent move down in European bond yields, we see it as a good time to be adding exposure given attractive valuations and expectations of resilient earnings through the current macroeconomic slowdown. We remain underweight in industrials despite adding into capital goods to take advantage of the recent market rally and the attractive valuations in some companies with quality short-cycle business models. We maintain a neutral position on financials given interest rate tailwinds in the region. However, positioning could be reduced if rate expectations top out or if the macro environment deteriorates more than expected.

Alternatives

Commodity prices have declined in recent weeks, in line with the OECD leading indicator. Given the correction in prices since the peak, we have become more comfortable with valuations but will continue to monitor the leading indicator for any pivot in the months ahead. Within commodities, the low levels of copper inventories could be supportive of prices alongside the China reopening, but we still see it as too soon to make any moves yet. On gold we maintain a more neutral view, although prices have picked up amid US dollar weakness.

We are growing more cautious on the real estate sector which has been reaffirmed following negative developments across some real estate funds. There are liquidity concerns, particularly around investments in office spaces, which has seen over-supply and declining demand after the Covid pandemic. However, other sub-sectors such as residential or commercial properties are less of a concern at this point.

	Positioning	Weighting change from last month
Hedge Fund	●	↔
Carry / RV	●	↔
Market Neutral	+	↔
Long / Short	●	↔
CTA	+	↑
Private Markets	●	↔
Real Assets	●	↔
Commodity	●	↔

− Underweight + Overweight ● Neutral
↔ No change ↑ Increase ↓ Decrease

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