JANUARY 2023 | ISSUE # 210106

Habib Investment Limited

Views from the desk

Global Economic & Market Outlook 2023

Habib Investment Limited
Regulated by the DFSA

For Professional Clients Only

Reset & Rebalance

> *With a challenging 2022 for most, we welcome 2023 with cautious optimism and exciting opportunities".*
>
> **- Sajjad Habib, SEO of Habib Investment Limited**

Dear Investor,

The world we live in has dramatically changed in recent years. We often discuss how the change impacts economic growth, inflation, interest rates and various aspects of the global economy.

While Market volatility in 2022 has been exacerbated by external events and changing expectations around the likely size and speed of monetary policy tightening, in the face of high and persistent inflation, central banks have struggled to give consistent forward guidance. Confusion in markets has driven sharp swings in bond yields, and destabilising equity markets.

After facing difficulties on all fronts in 2022, investors are likely to be rewarded with more opportunities in the year ahead, even as the global economy confronts headwinds. If 2022 could be known as the year of policy tightening, perhaps 2023 could be the year of living with it. Companies across the globe are set to announce their full-year corporate results for 2022 in addition to Q4 2022 results over the next few weeks. This earnings season is pivotal as investors will be assessing how the weakening macroeconomic environment and inflationary pressures are affecting corporate earnings, and how that will impact forward guidance.

But by using a cautious non FOMO approach, we can often identify new trends and opportunities that run across geographies and sectors, that can be more long lasting.

For many of us, this approach is more tangible and relatable than looking at economic data. It would reward the brave during such uncertain times and we at Habib Investment Limited, would prefer to be proactive at some point in 2023, but we feel we are not there yet.

In our view, earnings pressures from Q4,2022 onwards are likely to come from (lower) margins as elevated input costs (e.g. wages), financing costs and inventory backlogs weigh on corporate profitability.

Given cost pressures remain prevalent, we expect future outlook to emerge as a key theme during the reporting period. Full-year earnings estimates for 2023 for the MSCI World have already been revised lower.

In our view, markets are likely to focus more on future growth prospects and cost-cutting measures this quarter over actual EPS delivery. Markets would reward those who maintain or even increase their exposure over those that lean toward more cautious or outright negative. The Q4 2022 earnings season unofficially kicks off on 14 January with US banks reporting first, and the busiest week will be 30 January to 3 February.

The overarching theme still remains that while you, the investor, looks up to the potential return expectation, we are happy doing our bit to manage the down side risk to preserve and grow your wealth.

Today, many leading indicators are pointing in foggy directions, and we believe it is important to convey this uncertainty to our clients unequivocally. We strongly recommend staying invested and diversified to capitalize on the opportunities that 2023 has to present,

Thank you & Happy Investing,
Sajjad Habib

Future: Looking Through The Rear View

Welcome to the new year. So the bad news is, nobody has any idea what's going to happen this year. The good news is, the year starts with plenty of data and info that can guide and assist in positioning portfolio bets for the rest of the year.

Investors are hoping for a much happier year than the one that just passed, seeing as 2022 delivered double-digit losses for both global equities and bonds. International Monetary Fund Managing Director Kristalina Georgieva just reiterated reasons for the angst to continue for stocks at the very least. Highlighting expectations that the world's three largest economies — the US, Europe and China — will all sag in 2023, she reiterated the Fund's projection that a world recession is possible.

I think you could make an argument that there are risks in both directions right now.

But at this point in time, there are intelligent people making arguments that this will be a year of stubbornly high inflation, and more rate hikes than expected. And there are smart people warning about recession and a substantial rise in the unemployment rate.

Don't Fight the Fed!" is supposed to be a Wall Street mantra, but these days it is definitely more honored in the breach than otherwise. Markets remain insistent the

Federal Reserve will be cutting interest rates by year's end. They are ignoring a slew of policymakers as they reiterate that the plan is to hike further into restrictive territory and then hold rates there until inflation has been fully tamed. Should that mean brighter times for bonds then? Probably, though they also face headwinds from inflation — which Michael Burry reckons is set to spike again — and from the potential that slowing economies plus central banks which Michael Burry reckons is set to spike again — and from the potential that slowing economies plus central banks trimming balance sheets will create excess supplies of sovereign debt(USD 31.4 Trillion for teh USA as a debt ceiling). Admittedly, getting a better outcome than 2022 is a very low bar, so the chances are stong we will manage that. Restoring a rosy investment environment may take a bit more time though.

If the story of the 2023 is that the Fed feel confident on the inflation front until we see a "labor market in retreat" then that's a good reason to think labor market weakness is only a matter of time.

Stocks and bonds are expected to re-establish their inverse relationship this year, with prices once again moving in opposite directions. The two asset classes upended their their more normal negative correlation last year and both declined, leading to the biggest loss for traditional 60/40 portfolios since the global financial crisis.

With markets expecting the Fed to cut rates later this year, before we actually get to that, bonds will front-run that. That means bonds do become a diversifier again.

Bonds and stocks remain vulnerable to rapid reversals, with US December payrolls data looming even larger than normal as a result. Upside surprises would bolster Fed hawks who are already way more aggressive than the market expect.

Even results in line with expectations could be enough to spur fresh hawkish commentary, given that persistent bets for the Fed to lower its rate in the second half of 2023 are already helping to make financial conditions the loosest they've been since September.

In the months ahead, we expect new equity market lows as high borrowing costs limit firms' multiple expansion, and earnings estimates keep adjusting to recessions. In this context, we look for quality companies with low earnings volatility and better ability to defend their margins.

Such stocks tend to outperform in recessions or when profits decline. In terms of quality sectors, we prefer healthcare as it enjoys high margins, some insulation from inflation, due to high pricing power, and attractive shareholder returns. Valuations also remain historically undemanding compared with other defensive growth sectors.

As market conditions will remain relatively challenging, we continue to favour resilient hedge fund strategies such as global macro, discretionary and quantitative. These should provide diversification, as they tend to benefit from performance dispersion across asset classes and regions. Their typically convex profiles, designed to perform in more extreme periods, should profit from the volatile environment with limited correlation to underlying markets. Some relative value strategies should also provide attractive returns once rates stabilise.

With inflation eroding real incomes and interest rates rising sharply, recessions are likely in early 2023. But the US, UK, and European economies should all be recovering in the second half of the year. With China likely to accelerate steadily through the year as policy easing steps up a gear, the global economic landscape should be much improved towards the end of 2023.

Debt Markets

With interest rate expectations peaking out, inflation likely to moderate, and the major developed world economies set to enter recession, 2023 should be a good year for debt markets. High-quality sovereigns are our favoured exposure and duration looks attractive. Some caution is warranted for credit and select emerging markets as recessionary conditions could see risk spreads rise in some areas.

Equity Markets

The derating sell-off is mostly behind us, in our view. But earnings could now come under pressure as revenue growth slows in line with the deterioration in global growth in the first half of 2023. But if onshoring continues, as we expect, the beneficiaries will likely be construction and engineering firms, railroads, and consumer discretionary firms. If inflation falls, this would provide an additional boost to consumer-exposed corporates. If it doesn't, highly levered firms and those in regulated industries could be negatively affected.

Real Assets

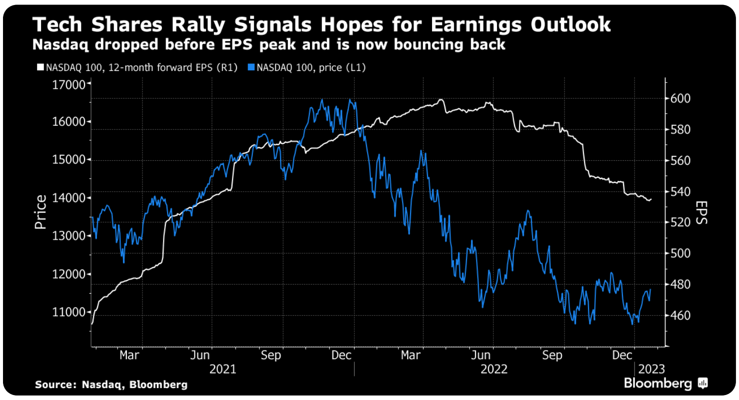
Infrastructure is a standout. It offers inflation protection, defensiveness, high yield, and exposure to structural growth drivers, all of which should be attractive to investors in 2023. Agriculture, with its inflation hedge characteristics and consistent return delivery, also looks attractive to us. The rise in interest rates globally means the near-term outlook for real estate is more challenging. High-quality buildings with healthy cash flows and premium tenants, and assets in attractive locations where there are demand-supply imbalances, should continue to perform solidly.

We forecast that earnings will be supressed, and labour market will weaken along with wage growth creating an environment of massive opportunities across the globe. We see **significant divergences in valuations and earnings prospects that calls for a selective approach**. In addition, we like value, quality and dividends stocks which should be complemented by strong bottom-up analysis.

We remain neutral Equities with a preference for U.S. Equities relative to International, and maintain our slight overweight to high-quality Fixed Income. We continue to believe that market volatility will be elevated for most asset classes and expect the "grind-it-out" environment to persist for markets over the next several months before stabilizing later in 2023. Portfolio diversification, including Alternative Investments* for qualified investors, can help mitigate volatility and allow for participation in a renewed bull market

However, there is a new asset class that has entered the competition and that is CASH deposits at a 4% - 5% per annum. It comes with its own inherent embedded risk of reinvestment, but can help a tad bit to mitigate the risk of inflation.

Remember, Stay diversified within acceptable leveraged risk portfolios and taking fresh positions via structured products or hedging via options. Booking profits along the way in 2023 will prove advantageous that will provide dry powder to capitalize on opportunities.



Market Definitions 101

PMI

Purchasing Manager's Index (PMI) is a survey-based economic indicator which allows us to understand the performance of private sector companies.

For example, US ISM Manufacturing PMI is at a current level of 48.40, down from 49.00 last month.

CPI

Consumer Price Index (CPI) measures the average change in consumer goods and services. It is used to predict cost of living and economic growth.

For example, The Consumer Price Index (CPI) increased 6.5 percent over the last 12 months in the year 2022 to an index level of 296.797.

Core CPI

Core Consumer Price Index measures the average change in consumer goods and services excluding food and energy. It is used to understand purchasing trends and inflation.

For example, US Core CPI YOY is at 5.69% compared to a 5.96% in the month of November. This indicates that people are spending less on their "wants" and saving more.

Asset Class Views - 2023

Asset Class	Sub-Class	View (FY 2023)	Rationale
Main Asset Class	Equities	=	We, at an Index level, expect a high degree of volatility and uncertainty for global equities in 2023, as stubbornly high inflation and interest rate rises lead to a rough landing for large parts of the global economy. However, earnings expectations are diverging across different economies, allowing investors to capitalise on select opportunities.
	Fixed Income	= ▲	Yields have backed up and now provide diversification. Current bond yields are fairly close to levels that have historically been associated with a moderately high inflation environment. Yields and quality are now no longer mutually exclusive. Slower Inflation growth, peaking interest rates. We prefer quality over returns and IG over Govt or HY with medium term maturities.
	Commodities	= ▲	We remain positively tilted towards commodities from a consumption perspective & supply side could provide the alpha and the hedge to portfolios. Copper joins the energy-transition-related metals & commodity super cycle
	Currencies	= ▲	We believe we have moved from a strong, trending US dollar to more of a rangebound trade in USD. Our catalysts for a broad turn in the dollar are for the Fed to stop hiking interest rates, China's zero-COVID-19 policy to end, and energy pressures in Europe stemming from Russia's invasion of Ukraine to subside. None of these have fully happened yet, but all three appear to be getting closer. A more rangebound dollar coupled with a global economy that is still growing, but slowing, could provide a very positive backdrop for high carry, commodity-linked currencies

Asset Class Views - 2023

Asset Class	Sub-Class	View (FY 2023)	Rationale
Equities	USA	=	Despite the sharp deceleration in core CPI inflation, we maintain our call for a long but manageable US recession ahead and weakness in earnings. As a result, valuation, earning multiples may struggle to advance in the medium-term. While we do expect near-term upmove, we believe 4Q2022 earnings season starting January 2023 could again create downward pressure in the market. As a result, we remain neutral in US Equities
	EU (Ex UK)	▼	Amidst ongoing Russia-Ukraine war, but manageable levels in energy prices, we continue to remain underweight European equities. In Europe, higher commodity & electricity prices, along with geo-political risk can keep the earnings multiple depressed. Record-high inflation has forced the ECB to keep benchmark interest rates higher for longer. ECB rates had been below 0% for eight years until it hiked in July 2022. Though fiscal spending likely to increase but ECB likely to remain hawkish. Limited long term catalyst for earnings growth. Valuations are compelling, but we still expect Eurozone to grown well below 1% in 2023
	UK	=	We maintain neutral view on UK with inherent risks of inflation increasing at a fast pace, cost of living crisis. The UK faces large current and fiscal account deficits, inflation near 40-year highs, and a certain recession in 2023. This is a tough economic outlook that could worsen as 2023 progresses. One upside to this outlook is that the UK has often emerged from crisis periods with strong growth, a healthier current account balance, and lower unemployment.
	EM (Ex MENA)	▲	Selective EM selection remains a key. Drivers such as domestic demand, monetary policy & fiscal prudence. India's economic activity is back to pre-pandemic levels, structural growth drivers like reforms, demographics, FDI flows are in place. This further gives confidence in the long term prospects of the economy. For China, the reopening boost suggests that policy may need to stay accommodative in the first half of 2023 before normalizing in the second half once consumption and services rebound sharply. It also leads us to project above-consensus GDP growth for 2024 (5.3%) as the reopening tailwind lingers through 2024H1. Recent policies and accommodative stance to stimulate growth in China is a clear over weight
	MENA	= ▲	The World Bank's latest Global Economic Prospects report forecasts growth in the MENA region to decline to 3.5% this year and 2.7% in 2024, following 5.7% growth in 2022. In the GCC, GDP is projected to grow by 3.7% and 2.4% in 2023 and 2024 respectively. Scaling of capital markets by divesting PSU, Range bound Oil prices, Rising USD IR and key structural reforms make GCC a key low beta, attractive return allocation specially RSA & UAE.

Asset Class Views - 2023

Asset Class	Sub-Class	View (FY 2023)	Rationale
Fixed Income	US Treasuries	=	FED Hawkishness fully priced into the treasuries. Demand for duration will grow from these levels as portfolios flow back to rebalance and safe havens. The curve inverted & yields peaked is now less attractive relative to IG credits
	Euro (Bunds)	▼	Bund yields at highest levels but gradually pricing in rake hikes. Yields still not peaked out and uncertainty remains
	UK Gilts	▼	We are underweight UK gilts following the UK government's fiscal splurge. The Bank of England will need to hike rates higher to rein in price pressures, and we believe the move raises serious questions about the UK's fiscal credibility.
	US IG	=▲	Sluggish corporate earnings for 2023 and likely FED rate hikes priced in; prefer IG companies with high interest coverage ratio, and tilt towards cautious stance over HY or UST whilst gradually increasing duration
	US HY	=	Based on majority analyst consensus, neutral high yield. We prefer up-in-quality credit exposures amid a worsening macro backdrop and potentially increasing default rates. We assume HY with strong corporate balance sheets should limit default risks even in a recession.
	Europe IG	▼	Economic and political struggles to weigh on EU credits whilst ECB remaining hawkish.
	EM	=	We are neutral with a positive tilt in few selected EM including GCC fixed income amid a recovering macro-outlook. Valuations are not compelling enough yet to turn more positive on the asset class, EM local ccy could prove a good play based on tactical risk allocation. Some caution is warranted for select emerging markets as recessionary conditions could see risk spreads rise in some areas.
Commodities	Oil	=▲	With Global supply disruption easing, while supply reduction to support Oil and potentiallyimproved demand due to China easing Covid Zero policy faster than anticipated neutralizes the impact of bearable winter in EU
	Precious Metals	=▲	Heightened geopolitical risks amidst recessionary fears, Russia-Ukraine and market volatility to drive safe haven demand, however, Lunar New year seasonal demand & weakening USD could hold the metal higher.

Asset Class Views - 2023

Asset Class	Sub-Class	View (FY 2023)	Rationale
Currencies	USD	▼	Good news on inflation has resulted in bad news on USD and any reversal will have an impact on the USD. USD remain the safe haven global currency but still will consolidate lower as expectations of jumbo rate hikes subside.
	EUR	=	Weak economic outlook but technically overvalued USD and valuations can give an upside lift in the mid-term
	GBP	=	Weak economic outlook, and anticipation of aggressive BOE rate hike could support the GBP strength;
	EM	=	Weaker USD, compelling currency valuations, consolidating energy/commodity prices may support EM currencies.

Asset Class Returns

2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Total
HG Bnd 5.2%	EM 79.0%	REIT 28.0%	REIT 8.3%	REIT 19.7%	Sm Cap 38.8%	REIT 28.0%	REIT 2.8%	Sm Cap 21.3%	EM 37.8%	Cash 1.8%	Lg Cap 31.5%	Sm Cap 20.0%	REIT 41.3%	Cash 1.6%	Lg Cap 254.6%
Cash 1.7%	HY Bnd 57.5%	Sm Cap 26.9%	HG Bnd 7.8%	EM 18.6%	Lg Cap 32.4%	Lg Cap 13.7%	Lg Cap 1.4%	HY Bnd 17.5%	Int'l 25.6%	HG Bnd 0.0%	REIT 28.7%	EM 18.7%	Lg Cap 28.7%	HY Bnd -11.2%	Sm Cap 182.2%
AA -22.4%	Int'l Stk 32.5%	EM 19.2%	HY Bnd 4.4%	Int'l Stk 17.9%	Int'l Stk 23.3%	AA 6.9%	HG Bnd 0.6%	Lg Cap 12.0%	Lg Cap 21.8%	HY Bnd -2.3%	Sm Cap 25.5%	Lg Cap 18.4%	Sm Cap 14.8%	HG Bnd -13.0%	REIT 162.5%
HY Bnd -26.4%	REIT 28.0%	HY Bnd 15.2%	Lg Cap 2.1%	Sm Cap 16.4%	AA 11.5%	HG Bnd 6.0%	Cash 0.0%	EM 11.6%	Sm Cap 14.7%	REIT -4.0%	Int'l Stk 22.7%	AA 9.8%	Int'l Stk 11.8%	Int'l Stk -14.0%	HY Bnd 137.3%
Sm Cap -33.8%	Sm Cap 27.2%	Lg Cap 15.1%	AA 0.3%	Lg Cap 16.0%	HY Bnd 7.4%	Sm Cap 4.9%	Int'l Stk -0.4%	REIT 8.6%	AA 14.6%	Lg Cap -4.4%	AA 18.9%	Int'l Stk 8.3%	AA 10.9%	AA -16.5%	AA 104.0%
Lg Cap -37.0%	Lg Cap 26.5%	AA 13.5%	Cash 0.1%	HY Bnd 15.6%	REIT 2.9%	HY Bnd 2.5%	AA -1.3%	AA 7.2%	REIT 8.7%	AA -5.6%	EM 18.9%	HY Bnd 7.5%	HY Bnd 5.4%	Lg Cap -18.1%	HG Bnd 48.3%
REIT -37.7%	AA 24.6%	Int'l Stk 8.2%	Sm Cap -4.2%	AA 12.2%	Cash 0.1%	Cash 0.0%	Sm Cap -4.4%	HG Bnd 2.7%	HY Bnd 7.5%	Sm Cap -11.0%	HY Bnd 14.4%	HG Bnd 6.1%	Cash 0.0%	EM -19.7%	Int'l Stk 40.5%
Int'l Stk -43.1%	HG Bnd 5.9%	HG Bnd 6.5%	Int'l Stk -11.7%	HG Bnd 4.2%	HG Bnd -2.0%	EM -1.8%	HY Bnd -4.6%	Int'l Stk 1.5%	HG Bnd 3.5%	Int'l Stk -13.4%	HG Bnd 8.7%	Cash 0.6%	HG Bnd -1.5%	Sm Cap -20.4%	EM 16.0%
EM -53.2%	Cash 0.1%	Cash 0.1%	EM -18.2%	Cash 0.1%	EM -2.3%	Int'l Stk -4.5%	EM -14.6%	Cash 0.3%	Cash 0.8%	EM -14.3%	Cash 2.2%	REIT -5.1%	EM -2.2%	REIT -24.4%	Cash 9.8%

Abbr.	Asset Class – Index	Annual	Best	Worst
Lg Cap	Large Cap Stocks – S&P 500 Index	8.81%	32.4%	-37.0%
Sm Cap	Small Cap Stocks – Russell 2000 Index	7.16%	38.8%	-33.8%
Int'l Stk	International Developed Stocks – MSCI EAFE Index	2.29%	32.5%	-43.1%
EM	EM Stocks – MSCI Emerging Markets Index	0.99%	79.0%	-53.2%
REIT	REITs – FTSE NAREIT All Equity Index	6.70%	41.3%	-37.7%
HG Bnd	High Grade Bonds – Bloomberg Barclays U.S. Agg Index	2.57%	8.7%	-13.01%
HY Bnd	High Yield Bonds – ICE BofA US High Yield Index	6.02%	57.5%	-26.4%
Cash	Cash – S&P U.S. Treasury Bill 0-3 Mth Index	0.62%	1.66%	0.0%
AA	Asset Allocation Portfolio*	4.87%	24.6%	-22.4%

Past performance does not guarantee future returns. The historical performance shows changes in market trends across several asset classes over the past fifteen years. Returns represent total annual returns (reinvestment of all distributions) and does not include fees and expenses. The investments you choose should reflect your financial goals and risk tolerance. For assistance, talk to a financial professional. All data are as of 12/31/22.

*Asset Allocation Portfolio is 15% large cap stocks, 15% international stocks, 10% small cap stocks, 10% emerging market stocks, 10% REITs, 40% high-grade bonds, and annual rebalancing.

Not for the Faint Hearted:

Policy Matters

Markets, have declared the battle is already over as they rally on expectations that Fed hikes are almost done. That's helped to raise US financial conditions to neutral for the first time since April, from the deeply restrictive territory reached after the Fed hiked 75 basis points in September for a third-straight meeting. Gains for equities and junk bonds — the latter up a sizzling 2.8% this month — have been key. The danger for investors is that, with inflation likely to still be very elevated even as it slows down, the Fed will look askance at the countervailing impact of markets. That would add to reasons for policymakers to hike higher and keep rates high for longer than investors are expecting. Whatever US inflation comes in at in January, the Federal Reserve is already facing some major difficulties in pursuing its stated aims. Fed speakers have been saying they made settings restrictive and will need to keep them there for some time in order to tame inflation.

> **There is something for everyone across the adventure spectrum...**

Central bankers want desperately to bring down inflation before it becomes sticky. That's why they've hiked rates at -- in the case of the Federal Reserve -- a pace not seen since the hyperinflationary 1980s.

But if they possibly can, they'd like to do so without killing off growth. They'd like to bring demand down just enough to keep prices in check without seeing millions lose their jobs. In short, they're trying to achieve the fabled soft landing.

Is a soft landing in the cards for the US economy? After December's Jobs Report which saw job growth come in better than expected, and wage gains come in cooler than expected,

The debate will now pick up about whether the dream scenario is actually possible. Jobs growth was faster than expected; the labor participation rate increased; and wages, measured in average-hourly earnings, came down. Don't look now, but it looks like the green just became a little larger and the bunker a little smaller.

There's a **choose your own adventure element** to the economy right now.

You can start by asking "Is a sustained fall in inflation even possible without a sustained deceleration in wages?" Then from there you can ask "Is a sustained deceleration in wages possible, without a meaningful increase in the unemployment rate?" And then from there you can ask "Can the Fed feel confident that any decline in wages and inflation is possible, if the unemployment rate doesn't weaken?"

This last question is something that keeps coming up over and over again. To some extent, the theoretical possibility of a soft landing is contingent on the Fed believing one is possible. If the Fed's worldview is premised on the idea that labor market weakness MUST take place in order to fully vanquish inflation, then a soft landing is virtually impossible. On the other hand, the Fed could just be saying that about the labor market in order to pre-empt what it sees as an unhelpful loosening of financial conditions.

Economists expect core inflation to drop from 6.0% on a YOY basis to 5.7% for the month of December. The stakes are high for this one.

Meet the Team

Sajjad Habib
SEO

Masroor Zaidi
Managing Director

Mohammed Abu Ali
Executive Director

Sandeep Jadwani - ACSI
Head of Investment Advisory

Rohit Sahijwani
Director

Fatima Nasir
Human Resources

Fermina S. Antonio
Operations Assistant

Raina Shahzad
Marketing & Operations Assistant

Denzyl Dsouza
Finance Director

Source and Sighting: Goldman Sachs Asset Management, Bloomberg Research, Blackrock BII, Pimco Outlook, Sys Group, HSBC Asset Management, Amundi Asset Management