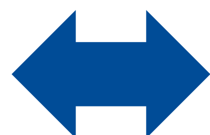
Market Outlook – Asset Class 1Q 2023

Equities



Neutral

- Economic activity continued to normalize lower. The global economy is now closer to contractionary territory against a backdrop of prolonged monetary tightening. Global financial conditions are expected to stay tight.
- Inflation remains centerstage and central banks are unlikely to loosen unless they see a sustained drop in inflation towards policy targets. Inflation may have peaked in the U.S. and the Fed may suspend rate hikes some time in Q1 or Q2, but any talk of a pivot is still premature.
- Pressure on valuations persists as the rise in funding costs and deteriorating economic outlook continue to weigh on corporate profitability.
- While the technical picture remains light and investor sentiment remains bearish, approaching the peak of the rate hike cycle in the U.S. with a potential weakening of the U.S. dollar, investors may start to reposition for an economic recovery. This may support a market rebound towards the end of the quarter.

Fixed Income

Slightly Overweight

- The longer-end of U.S. Treasuries may have peaked with anchored real yields and inflation expectations. With that in mind, investors may want to allocate part of their assets to developed sovereigns while volatilities persist.
- The Fed is expected to continue hiking rate but at a slower pace depending on economic data. Front-end yields could edge higher and the yield curve may flatten further.
- As policy rates may stay in restrictive territories for longer and the economic slowdown continues, default risks may increase modestly. Credit spreads could widen on deteriorations of economic conditions, market sentiment, and corporate fundamentals.

Overweight

Slightly Overweight

Neutral

Slightly Underweight

Underweight

Source: Principal Asset Management Company (Asia) Ltd.

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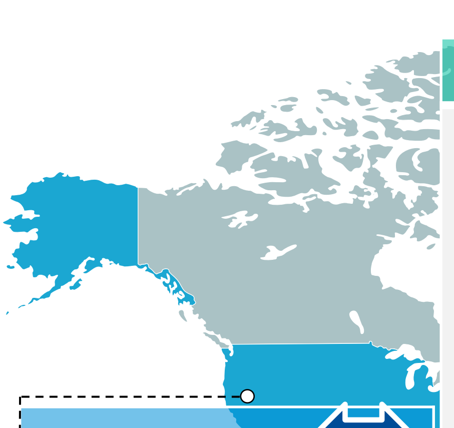
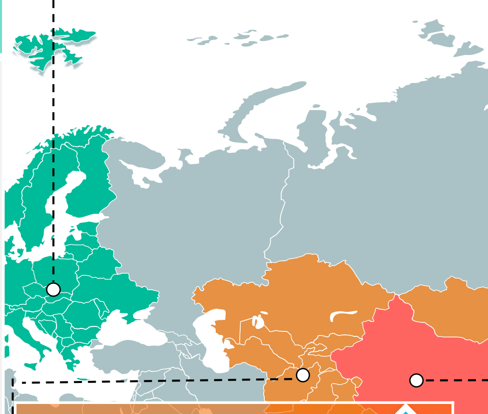




Japan

- Valuation of Japan's equity market remains in a reasonable zone. The large-scale share buyback program may provide support to equity performance.
- Yen weakening has contributed to higher imported prices of energy which has been translated into a rising inflation rate. BOJ may face additional pressure to adjust its ultra-loose monetary policy and move towards a tightening direction.
- The recent rebound of Yen together with weaker external demand may drag earning prospects of the export-oriented companies in Japan.

Eurozone

- Eurozone inflation still hovers at much higher levels compared to the past years. Uncertainty over energy prices continues to be prominent with increasing demand in wintertime, ongoing disputes between Eurozone and Russia, and OPEC+ interventions.
- Given inflation in Europe is not likely to come off anytime soon, ECB may need to stay hawkish and continues to hike, bringing about demand disruption and additional pressures to the already-weak business and investment sentiment.
- Despite relatively attractive valuations, sluggish consumer demand and tightening financial conditions could weigh on corporate earnings further. More upside catalysts are needed to trigger a broad-based re-engagement of investors in the market.

U.S.

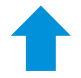
- If inflation continues to decelerate, Fed rate may peak in 1Q or 2Q at 5.25%. Relatively mild recession pressure coupled with a robust labour market creates room for the Fed to maintain rates at restrictive levels for longer. A rate cut may not happen until early 2024.
- The recession in the U.S. may start from 3Q and last for three quarters. U.S. recession is expected to be relatively mild compared to other developed countries. A less hawkish Fed may improve sentiments in the equity market.
- Large caps remain relatively expensive while small and mid caps are now at or slightly below the historical average. Pressures on margin remain especially for small caps that are less capable of passing on rising production costs.

Asia ex-Japan

- Economies of ASEAN countries may stay relatively robust and keep expanding with the boost of broad reopening, recovery in consumption and a comparatively benign inflation and interest rate environment.
- The more resilient economic outlook compared to the developed market coupled with a weaker dollar could boost Asian currencies and attract capital inflow.
- Global economic slowdown could further dampen the external demand of the region. Monetary policies may be tightened further than expected if inflation turns out to be more persistent.

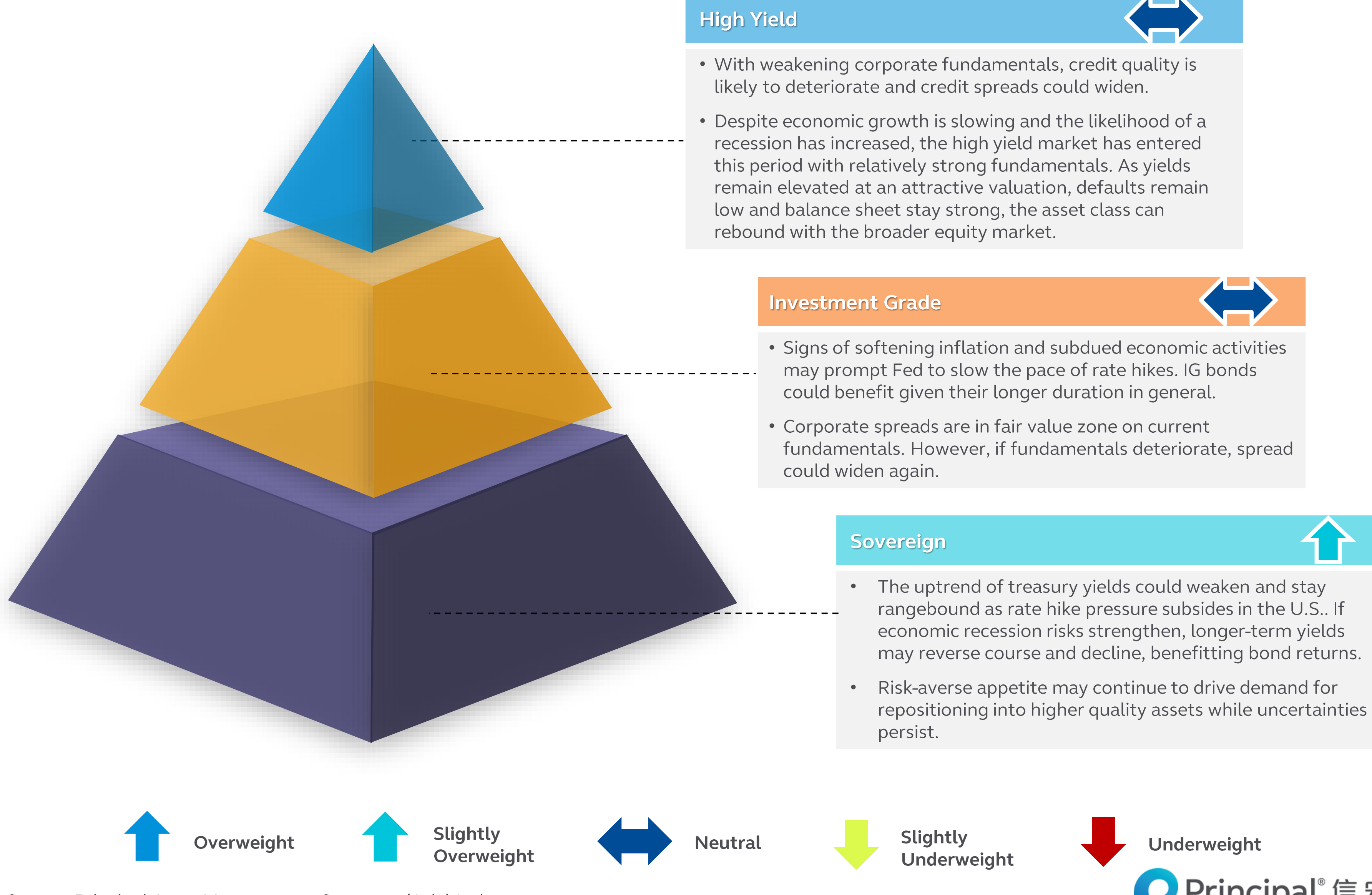
HK China

- Covid cases resurge after the ease of Covid restrictions, shadowing the hope of further relaxation in the near future.
- With the slowdown and gloomier outlook of the real economy, monetary and fiscal policies may turn more supportive, especially in the distressed housing market.
- Expectations on reopening and growth recovery remain the potential upside catalysts for China and HK markets, while the valuation of equities in both markets remain relatively cheap.

 Overweight
Slightly Overweight
Neutral
Slightly Underweight

Source: Principal Asset Management Company (Asia) Ltd.
The geographical classification of above listed equity markets is based on MSCI 2021 annual market classification review. For more information, please refer to https://www.msci.com/market-classification

Market Outlook – Fixed Income 1Q 2023



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