June 6, 2023

Marketing Material

Little growth, much uncertainty, decent returns

Over a twelve-month horizon, we expect decent overall returns across many asset classes despite lackluster economic growth and sticky inflation.

“ The next twelve months do not look bad for investors. We expect modest but positive real returns in several asset classes. But there is unusually large scope for surprises to both the upside and the downside in a very unfamiliar economic environment. ”

Björn Jesch
Global Chief Investment Officer

The outlook is neither rosy nor gloomy. Uninspiring sideways movement looks likely. Whether one sees this positively or negatively depends on one's expectations. On the positive side, the downturn in Europe and the U.S. will likely be mild, in our opinion. Less positive is the outlook for the subsequent upswing, which is also expected to be muted. Globally we expect growth of 2.8% for the current year and 3.0% for next year. For the Eurozone, the U.S. and Japan, the figure in 2024 will likely be below 1%, and therefore quite tepid.

We foresaw a similarly anemic economic picture in 2015 to 2020. Back then we called it the “turtle cycle” – but being a turtle was not unattractive from an investor's point of view. There was no risk of overheating and low interest rates benefitted most asset classes. Today's situation is quite different. Although we expect inflation rates to fall – to 4.3% and 2.5% in the U.S. in 2023 and 2024, respectively, and to 5.7% and 2.5% in the Eurozone over the same period[1] – inflation will remain above the central banks' target of 2% in 2024, preventing the central banks from giving the markets, or even the economy, as generous a helping hand as in the past. Another difference is that today’s central bankers and investors lack experience of the economy they now face, beset by both high inflation and high interest rates and yet cooling very slowly, mainly due to atypically strong labor markets.

It is therefore unsurprising that the inflation-averse bond markets are much more nervous than the equity markets.[2] There is much disagreement about the direction of bond yields next year. Will inflation or growth concerns dominate in twelve months' time? Or will the European and American economies muddle through the next one or two years without major damage?

These assumptions also determine whether a steepening or flattening of the yield curve can be expected. In line with our macroeconomic outlook, we assume that the inversion of the yield curve will end, with interest rates rising at the long end. This means that shorter maturity government bonds remain attractive. In the case of corporates, high-yield bonds are the most appealing under this scenario as they could yield 6% in Europe and 7.5% in the U.S., though our preference is for Europe, as credit quality here is higher.

This, in turn, also highlights the dilemma of equities. We expect mid-single-digit returns over the next 12 months, but these returns will largely come from dividends. Tepid economic growth, relatively high bond yields, still relatively high profit margins and also relatively high valuations limit the upside potential of equities in our opinion. However, they have again shown their suitability for a high inflation environment.

[1] Coming from more than 8% in 2022
[2] As expressed in the volatility indices of the S&P 500 (Vix) and U.S. treasuries (Move).

In addition, they offer the opportunity to share in innovation, as artificial intelligence shows again now. We like European small & midcaps, as they still have some catching-up to do and offer great niche players, and the global telecom sector.

We expect oil supply to be sufficient to meet moderate demand growth over the next 12 months and see oil therefore only climbing to $85 a barrel for Brent in twelve months' time.

Gold should continue to benefit from geopolitical tensions, a peak in interest rates soon and further central bank buying, and so our target is $2,200 an ounce.

Our overall outlook is no more than mildly optimistic. But in our view investors can still choose between several asset classes that are likely to offer positive returns – and position them well for different economic and market scenarios.

GLOSSARY

The Eurozone is formed of 19 European Union member states that have adopted the euro as their common currency and sole legal tender.

High-yield bonds are issued by below-investment-grade-rated issuers and usually offer a relatively high yield.

Inflation is the rate at which the general level of prices for goods and services is rising and, subsequently, purchasing power is falling.

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