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What could 2023 have in store for investors?

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After a challenging year for financial markets, Janet Mui, our Head of Market Analysis, looks at what the next 12 months could have in store for investors.

2022 proved to be a challenging year for investors. The war in Ukraine, high inflation, rising interest rates and the growing risk of a global recession meant there were many sources of anxiety for financial markets.

Yet with inflation easing, interest rates set to peak and a recession expected to be relatively mild, next year could prove to be a bit brighter.

A mild recession ahead

While a recession in major developed economies looks inevitable, the length and depth of the recession is likely to be mild. Labour markets in developed economies remain in good shape, with job openings in abundance. Financial institutions are well capitalised and are unlikely to experience the kind of liquidity crunch that we saw in the 2008 financial crisis. Governments around the world are shielding the most vulnerable from the surge in energy costs, and there are still plenty of pandemic household savings to cushion the blow of the cost-of-living crisis.

That said, the cost of borrowing has risen significantly. 2022 saw the fastest cycle of interest rate hikes in US history, and this is something that will reverberate more visibly in 2023. There will be inevitable adjustments to the years of excesses and imbalances built up in the economy. That could mean a downturn in the housing market, a reduction in borrowing by households, de-leveraging by corporates, and more fiscal prudence by governments in 2023.

Inflation to ease

The biggest challenge for financial markets in 2022 was arguably the persistence of eye-watering inflation, which had a knock-on effect on monetary policy and economic activity. The good news is that inflation is likely to slow sharply in 2023 for a number of reasons.

Commodity prices, including wholesale oil and gas, have fallen markedly. Inventories of goods are building up and shipping costs are declining rapidly, which are good indications that price pressures will fall.

Historically, interest rate rises impact the real economy and inflation with a lag of 12 to 18 months. Inflation of goods and services typically eases as demand falters in a recession. So, once inflation comes down, we can anticipate better times ahead.

Interest rates to peak and pause

We think that most of the large and rapid interest rate increases are behind us in major developed economies. The Fed funds rate is likely to peak at around 5% in the second quarter, while the UK bank rate will likely peak at between 4% and 4.5% in the third quarter.

The hawkish tone from Federal Reserve officials has softened a bit recently, as they acknowledged there is a time lag between monetary policy and the impact on the real economy. Meanwhile, the Bank of England's governor Andrew Bailey has decisively pushed back against previously elevated market interest rate expectations.

These suggest to us that while central bankers are determined to fight inflation, they know they have already done a lot in a short time span, and they don't want to overtighten and crash the economy as a result. Whether interest rates will be cut in 2023 depends on how quickly inflation comes down. It seems more likely that interest rates will plateau and stay high in 2023, and that cuts are a 2024 story.

China to gradually reopen

There are more concrete signs that the Chinese government is softening its stance towards Covid restrictions after widespread protests. We think the overall direction remains constructive and that the worst of zero-Covid restrictions are behind us. The normalisation of Chinese activity will be incrementally positive for global demand, at a time when recession looms in 2023.

Investors and, indeed, the market will remain very sensitive to Covid developments in China. There is a general sense of FOMO – fear of missing out – in case there is a big rally, which could help Chinese stocks gather momentum.

While the markets may have got ahead of themselves, and before we get overly excited, we should recognise the challenges and complexities involved in the reopening process. Over the longer term, investors are likely to remain concerned about the political, geopolitical, and regulatory implications of the cabinet reshuffle by president Xi Jinping at the National Party Congress.

Long-term investment opportunities

Despite this year's economic uncertainty and market volatility, we believe opportunities for long-term investors are emerging. We think there are pockets of attractive opportunities in bonds after the surge in yields and spreads this year. Investors are now able to lock in decent yields while taking little to no credit risk, with the potential for attractive price returns when interest rates eventually fall.

The outlook for equities is less clear. Weak growth and earnings could drag stock markets lower before a decisive fall in interest rates helps equities reach a bottom. Throughout history, equities tend to deliver superior long-term returns. Timing the market is difficult, but the declines in prices we have seen this year give investors the ability to buy good companies at more attractive valuations. Our preference remains on quality companies with strong balance sheets, pricing power, and sustainable business models.

To conclude, while 2023 is likely to be a year of recession, it could be a better year for market sentiment as central banks slow and then pause interest rate hikes, and inflation eases more meaningfully.



Janet Mui, Head of Market Analysis

Janet Mui, CFA, is Head of Market Analysis at RBC Brewin Dolphin and a voting member of RBC Brewin Dolphin's Asset Allocation Committee. Her role includes analysing and interpreting the markets and conveying investment strategies. Janet has over ten years of experience in macro research and is a frequent guest on the BBC, Sky News, Bloomberg and CNBC. Janet won the best industry commentator award at the 2021 City of London Wealth Management Awards. She has a first-class Economics degree from the London School of Economics and an MBA in Finance from Cambridge University. She holds the CFA Certificate in ESG Investing and the Postgraduate Certificate in Econometrics from Birkbeck College, University of London.

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