

2023

GLOBAL MARKET OUTLOOK



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OVERVIEW

REMAINING NIMBLE: CHALLENGING OUTLOOK WITH OPPORTUNITIES AHEAD

In 2023, financial markets will be hard pressed to exceed the challenges that faced investors in 2022. However, following a global pandemic, extreme weather events, a war in Europe and the unwind of a decade of stimulus measures, the year is unlikely to be a smooth ride. While the macro outlook remains challenging, there should be ample opportunity for investors this year. Where and when remains the question.

STAGFLATION BY ANY OTHER NAME

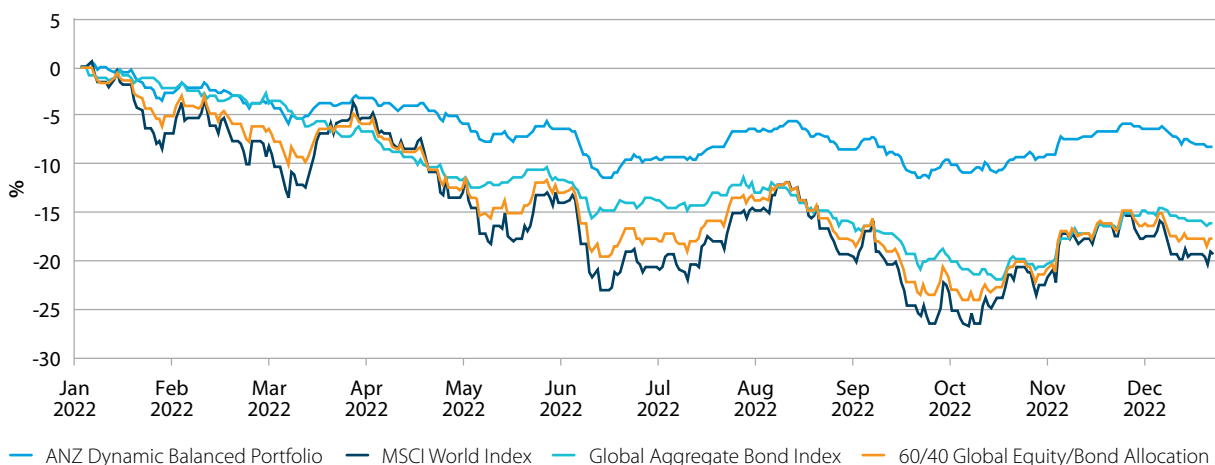
Reflecting briefly on 2022, it was undoubtedly one of the most challenging years on record for financial markets. Central banks had only just removed the word transitory from their vocabulary and seemed poised to tackle inflation when no sooner did Russia's invasion of Ukraine send another supply shock reverberating around the globe. China's insistence on remaining closed provided a headwind for growth, although perhaps in hindsight helped to offset some demand-side inflationary pressures. Being 'behind the curve' turned out to be an understatement for the predicament facing central banks and the subsequent global synchronisation of monetary tightening — the sharpest in decades — saw almost all asset prices head south in a coordinated manner. The MSCI World Index ended 2022 more than 20 per cent lower, and the Global Aggregate Bond Index more than 16 per cent below where it began the year — a calamitous outcome

for multi-asset investors, although those in more diversified portfolios were certainly better shielded from the carnage.

Perhaps the only shining light in a year marred by disappointment was the strength of the labour market — much to the US Federal Reserve's (Fed) chagrin. Here, the great resignation took hold and the roughly two job vacancies for every unemployed person resulted in upward pressure on wages that was vastly inconsistent with the Fed's inflation target.

Soaring inflation and deteriorating growth, coupled with strong unemployment and market capitulation, saw commentators scramble to ascribe the correct terminology to the situation unfolding across the globe. And while technically high unemployment is a condition of stagflation, more simply stagflation is an environment of high inflation and stagnant growth; and one in which neither equities or bonds benefit. In 2022, this was certainly the case.

FIGURE 1: 2022 GLOBAL EQUITY AND BOND MARKET PERFORMANCE



Source: Bloomberg, ANZ PB&A CIO, as at 31 December 2022

FROM INFLATION FEARS WILL COME GROWTH CONCERNS AND EARNINGS DISAPPOINTMENTS

Looking ahead to 2023, we expect inflation to moderate as supply chain pressures further ease, the reopening of China provides some respite for manufacturers, and the full impact of the interest rate rises to date finally catches up with corporates and consumers — denting demand.

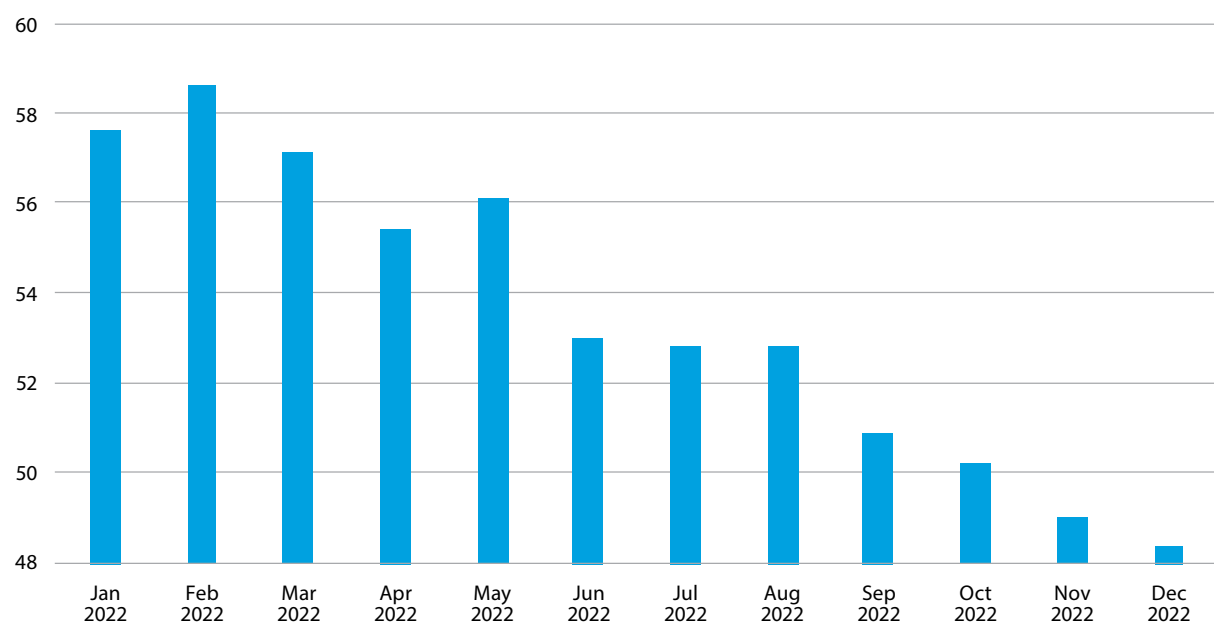
Already in 2023, an expected peak in inflation and hopes of a quicker moderation in price pressures have seen the market begin to shift its focus from inflation towards the outlook for global growth. December's US ISM Purchasing Managers Index (PMI), released earlier this month, showed a steeper fall into contractionary territory, to 48.4 from 49.0 in November. Excluding the decline in April 2020 at height of the pandemic, this was the lowest reading since February 2016 — further evidence of the deterioration in global growth.

It's this focus on waning growth and ultimately earnings that will likely dominate markets this year. We expect global growth to slow to 2.4 per cent in 2023 before a modest recovery the following year. Each of the US, UK and Europe are expected to enter recessions; pleasingly Australia has the chance to avoid such a downturn, thanks

in part to the possible tailwinds from China reopening, sustained demand for commodities and the expectation that headline inflation will moderate and has yet to reach levels experienced elsewhere across the globe. In China, we expect growth to rebound to 5.4 per cent this year. Xi Jinping's attempts to abandon the zero-COVID policy have so far been shrouded in controversy. The success of any reopening there alongside rising tensions surrounding Taiwan are two key risks we will be watching closely.

Last year's equity market capitulation has seen valuations improve on an absolute basis, yet we believe they remain unappealing on a relative basis given the sharp rise in yields. Moreover, the improvement in valuations fails to account for the growth slowdown already underway as analysts' estimates for future earnings appear to remain far too optimistic for the coming recessionary period. Corporates have so far been protected by consumers willing to absorb much of the increase in costs to date. This has enabled margins to remain elevated relative to history and earnings resilient. In 2023, we expect falling demand and rising costs to finally squeeze margins and for earnings to tumble as a result. Unless equities rerate and more accurately reflect the macro environment any rally is likely to be unsustainable until such time as the Fed begins to cut its policy rate.

FIGURE 2: THE US ISM MANUFACTURING PMI HAS BEEN TRENDING LOWER FOR SOME TIME



Source: Bloomberg, ANZ PB&A CIO

BONDS ARE BACK

The equity rally over the latter part of 2022 indicates that some equity investors believe a Fed 'pivot' is nearing or has possibly already come, in the form of the step down in tightening to 50 basis points at the December FOMC meeting. In our opinion this represents a false dawn; at best, the Fed has only stepped down its hawkishness, at worst it's served to lengthen the time required to reach its terminal rate — resulting in a longer tightening cycle than previously expected. Perhaps more perplexing is that many of these same equity investors seem unwilling to accept a recessionary environment will most likely be required for an actual 'pivot' to materialise.

In 2022, the US 2yr/10yr Treasury curve inverted to its deepest level in more than forty years. While it has since flattened somewhat it remains heavily inverted and is suggestive of a bond market that believes a strong pivot (in the form of a cut rather than pause), will be forthcoming from the Fed in the year ahead. Although inflation in the US is expected to moderate from 8 per cent in 2022, to 4 per cent by year-end — it's likely to remain sticky and well above the Fed's 2 per cent target. Already in 2023, the minutes released from the December FOMC meeting have suggested that any cut is some way off, noting, "...a restrictive policy stance would need to be maintained until the incoming data provided confidence that inflation was on a sustained downward path to 2 per cent, which was likely to take some time." Here, 2023 may also provide some false starts. Any initial fall in inflation, that is unaccompanied by a much weaker labour market, is unlikely to be sustainable. Under such circumstances we believe the Fed will be required to maintain its tightening bias and extend the cycle.

The only other logical possibility for a loosening of monetary conditions would be if growth falters to such an extent that a recession looks to be damaging and long-lasting — even here question marks remain as to whether the Fed will blink. Unlike former Fed Chair, Arthur Burns, Powell is yet to truly be

tested as Burns was in the 1970s. Growth, while deteriorating, has yet to collapse and employment remains at record highs.

This year we highlight three broad potential scenarios that may occur with investment markets — the two more probable outcomes suggest bonds should be back in favour this year. It's this outlook that led to changes to portfolios over the back-half of 2022, namely a reduction in the underweight to global bonds and a cut in equity exposure. Moreover, it determines why we are positioned with a mild underweight to equities and overweight to cash as the new year commences.

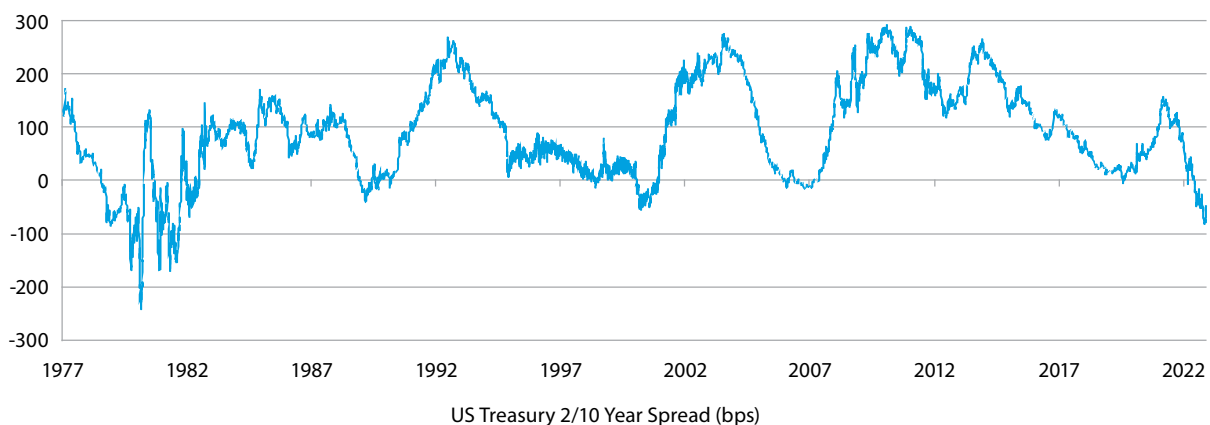
Under the first scenario, the bond market is right, inflation comes off the boil, the slowdown is sharper than expected and the Fed and other central banks have the luxury of being able to cut policy rates to support the economy. If this transpires, then on the balance of probabilities we would expect equity markets to suffer if earnings begin to reflect a recessionary environment.

The second scenario, where the bond market is wrong, could be even more damaging for equities. Under this scenario, inflation remains stubborn, and the Fed and other central banks are required to hike further than currently expected. If this transpires, growth would be undermined to an even greater extent — and so too equities. If this occurs, there is scope that bonds might also suffer, but with breakevens now at more reasonable levels, they would remain a more attractive investment across multi-asset portfolios.

The third and most unlikely scenario would see inflation recede somewhat, employment remain healthy, and growth not falter as expected. Under this scenario the Fed may engineer a soft landing while holding the cost of funding at elevated levels. We currently see this as improbable.

Weighing up the likelihood of these alternatives, we believe the risk-reward trade-off is skewed towards bonds, at least in the initial stages of 2023, and that any sustainable rally in equities is likely to come only once a new low has been tested.

FIGURE 3: THE YIELD CURVE RECENTLY INVERTED TO LEVELS NOT SEEN SINCE THE 80S



Source: Bloomberg, ANZ PB&A CIO as at 5 January 2023

IT'S GENERALLY DARKEST BEFORE THE DAWN

While there are several instances of market capitulation being followed by further pain the following year, back-to-back years of negative equity market returns are unlikely based on historical data — and any consecutive fall across both equities and bonds would be unprecedented.

The previous scenarios might be deemed pessimistic, however, positively this year we see the opportunity for almost all asset classes to stage a recovery at some point. Much like 2022, the eventual path for financial assets hinges largely on the reaction function of the Fed. Will it blink in the face of deteriorating fundamentals or is it likely to inflict further pain on economies? This remains unclear, however, regardless of the outcome, for patient investors there is likely to be ample opportunity in 2023.

Over the first quarter, we expect to remain defensive across portfolios until there is greater certainty surrounding the outlook for inflation and growth or there is a noticeable shift in Fed rhetoric. If the Fed does succumb to growth pressures and cuts policy, then we would look for opportunities to add to risk. As noted above, this appears unlikely, particularly in H1.

If the market continues to rally over the first half of this year, we are likely to look at 'selling the rip', cutting equity exposure further to conserve capital across portfolios ahead of an expected rebase in equities and eventual upswing. Conversely, if the market sells off heavily prior to any Fed pivot, then this may well change to a 'buy the dip' mentality and provide an opportunity to build a sizeable overweight to equities in H2. The second half of the year is also likely to see the US dollar fade; this would be supportive of emerging market equities relative to US shares and could provide scope to add to our existing overweight to emerging markets, regardless of overall equity positioning at the time.

Within fixed income we begin the year with a preference for Australian bonds relative to global bonds and sovereign bonds versus credit. Any shift into equities later in the year

would likely be preceded by a shift to investment grade credit first and then possibly high yield. Investment grade credit spreads are attractive and at this point in the cycle a quality bias remains prudent. A softer recession or economic recovery could be conducive to high yield, where the current yield embedded in these assets is appealing to say the least. However, like equities, too many question marks currently remain, and we require more certainty about the outlook before building a substantial position here.

As always, we continue to advocate for a long-term diversified investment strategy. In 2023, investors might be well served by tactical changes as market conditions evolve rapidly and opportunities present.

On a personal note, 2022 was one of the more challenging and volatile periods I've witnessed in my career. Perhaps fortuitously, the resumption of travel afforded me the opportunity to meet with more of you face-to-face and to hear first-hand how you are navigating the current market environment. On behalf of ANZ, I'd like to take this opportunity to thank you for your continued investment and for allowing us to be a trusted advisor during this turbulent period.

We trust this publication provides you an understanding of what we are expecting for the year ahead. In 2023, we look forward to providing you with further investment insights as the year progresses and we continue to assist you with your investment needs in 2023 and beyond.

As always, the team and I will be watching markets with interest.



Lakshman Anantkrishnan
Head of Investment Strategy, ANZ Private

FIGURE 4: A WEAKER USD TYPICALLY FAVOURS EMERGING MARKET EQUITIES



Source: Bloomberg, ANZ PB&A CIO as at 5 January 2023

FIGURE 5: ASSET CLASS RETURNS

Asset class	2013-2022 annualised returns	2022 returns	2022-2032 forecast annualised returns*
Australian equities	8.6%	-1.8%	8.2%
International equities (unhedged)	13.8%	-12.5%	9.1%
International equities (hedged)	10.4%	-18.1%	8.9%
Emerging market equities	5.9%	-14.3%	10.9%
International property (hedged)	4.8%	-26.3%	7.8%
Infrastructure (hedged)	9.6%	-6.2%	8.3%
High Yield (hedged)	N/A	-12.2%	6.8%
Australian fixed income	2.3%	-9.7%	4.2%
International fixed income (hedged)	2.3%	-12.3%	4.4%
Cash	1.7%	1.3%	3.8%

Index information: To 31 December 2022. Australian Equities - S&P/ASX 300 Accumulation| International equities unhedged - MSCI World ex Australia (Net)| International equities hedged - MSCI World ex Australia Net Index (hedged to AUD)| Emerging market equities - MSCI Emerging Markets (Net) in AUD| International property - FTSE EPRA/NAREIT Developed Rental Index ex Australia (hedged)| Infrastructure - FTSE Developed Core Infrastructure Net Hedged to AUD| High Yield - Bloomberg Global High Yield Corporate Total Return Index Hedged AUD | Australian fixed income - Bloomberg AusBond Composite (0+Y)| International fixed income - Bloomberg Barclays Global Aggregate (AUD Hedged)| Cash - Bloomberg AusBond Bank Bill. Source: FactSet, ANZ PB&A CIO.

Past performance is not indicative of future returns.

* Annualised returns are forecast through to September 2032 using Willis Towers Watson (WTW) capital market assumptions (CMA) from September 2022. CMAs are gross of fees and taxes unless otherwise stated.



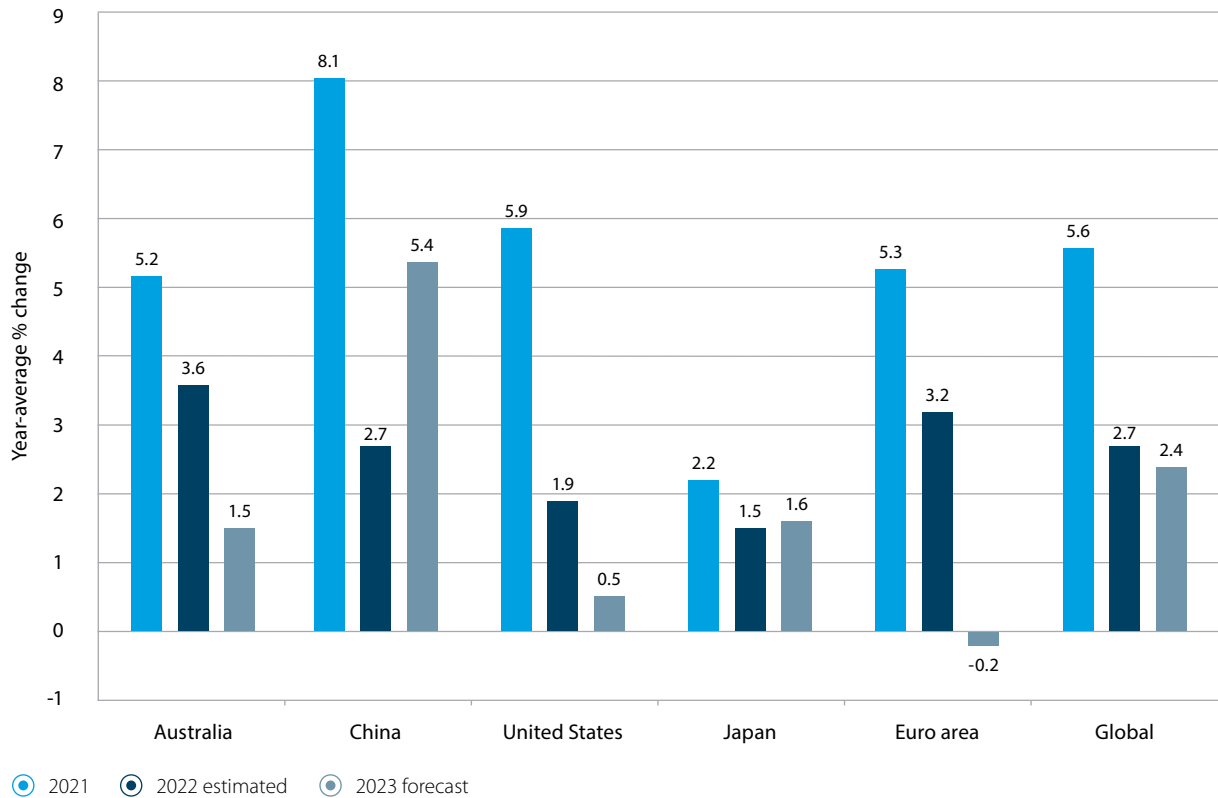
ECONOMIC OUTLOOK

RECESSION TO HIT. THE SEVERITY REMAINS UNCLEAR.

In 2023, we forecast recessions for the UK, EU and the US. While none are expected to be particularly nasty at this time, there are obvious risks to this assessment, and the stubbornness of inflation and the willingness of central banks to inflict further pain on economies will be key.



FIGURE 6: GLOBAL GDP GROWTH



Source: ANZ Research, PB&A CIO, December 2022

In 2022, central banks were caught well behind the curve and forced to sprint rather than jog towards policy normalisation. While growth deteriorated last year, in 2023, investors are expected to finally see just how fragile the global economy is as the full impact of 2022's rate hikes come to pass. With an expectation that the finish line for this tightening cycle is in sight, a recession seems inevitable — but whether central banks are willing to inflict further pain and force the global economy to fully capitulate will be fascinating to watch.

The global growth outlook as usual, hinges a great deal on China. It appears a full reopening could be achievable in Q1 and brings with it the possibility of a 2023 China GDP forecast of 5.4 per cent. The pivot from zero-COVID is likely to bring with it some inflationary pressures for the rest of the globe, but Australia should be a beneficiary if it leads to higher and sustained commodity prices. Whilst policy has tightened sharply in Australia, and growth is expected to slow further over 2023, an Australian recession seems less likely, thanks in part to the possible tailwinds from the China reopening, and an expectation of moderating headline inflation that should provide the Reserve Bank of Australia (RBA) with some optionality to engineer a softer landing.

Of course, the other factor in 2023 will be the US and the Fed. Positively, it appears inflation has reached its peak in the US. Naively, many have taken the stepdown to 50 basis points from 75 basis points at the December FOMC meeting as a policy pivot. With inflation in the US remaining well above target (much like everywhere else globally), further hiking in the first half of 2023 is expected. Moreover, the stubbornness of inflation is suggestive of an extended plateau in the interest rate cycle rather than a sharp peak followed by a decline. How long inflation takes to recede back to acceptable levels — and whether the Fed and other central banks are required to continue to tighten policy into H2 in the face of deteriorating fundamentals — will go a long way to determining how deep any recession is.

It's this uncertainty which makes any forecasting difficult. In 2023, macroeconomic conditions look likely to be more conducive for fixed income assets than equities. If growth capitulates and the Fed blinks, or conversely inflation recedes much quicker than anticipated, then equities could look attractive in H2. For investors, patience will be required again this year, with 2023 more likely to resemble a marathon than a sprint.

Disclaimer: Components of the 'Economic Outlook' section, associated charts and content relating to the Australian dollar on page 35 have been derived from the ANZ Research Quarterly, December 2022.



AUSTRALIA

The outlook for the domestic economy in 2023 is a relatively strong one, with forecast GDP growth of 1.5 per cent this year. This comes against a backdrop of stubborn domestic driven inflation, resulting from sticky wages growth and businesses passing through costs to consumers. Low unemployment, of mid-3s through much of 2023 should result in strong wages growth in the order of 4 per cent until year-end and possibly beyond. Even though employment growth has slowed, it remains ahead of labour force growth and therefore, even as interest rate rises weigh on demand, it's likely to be some time before underutilisation begins to lift.

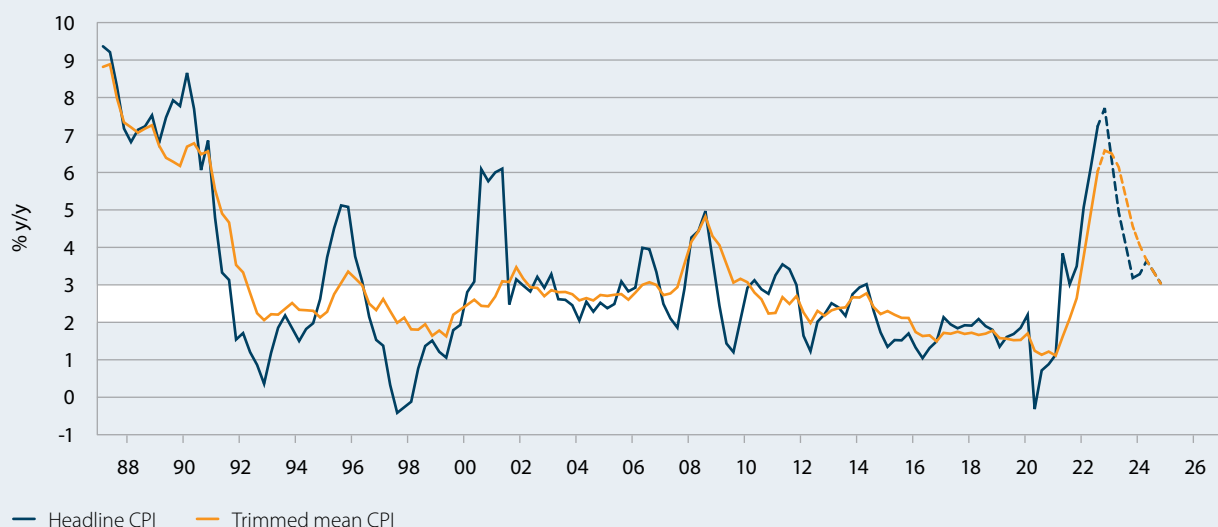
On a positive note, headline inflation is expected to ease materially in the year ahead as supply-side pressures further abate. Less positive is the outlook for trimmed mean inflation; this is likely to remain sticky thanks to domestic pressures including the aforementioned wages growth. The expected sharp decline in headline inflation will give the RBA some breathing room, particularly with respect to inflation expectations. With this will come the opportunity for an extended pause at some stage in 2023 and the possibility of an end to rate rises should the economy and data begin to slow as expected. And while inflation will remain the RBA's focus, activity indicators will be a guide to the extent that demand and hence inflationary pressures are easing.

House prices fell strongly over 2022 and are expected to continue to soften as higher interest rates impact borrowing capacity and mortgage sizes by extension. This reduction in borrowing capacity is important, as it is this, rather than forced sellers, that is leading the downturn. Should employment remain solid further falls are likely to take place in an orderly fashion.

Retail spending has begun to slow, though the extent to which it is a slowdown rather than a shift to services is still unclear. Regardless, consumer spending is expected to slow in the year ahead as the catch up in services spending runs its course, cost of living pressures take hold, and the impact of rate rises is felt more sharply.

In 2023, despite the relatively upbeat outlook for the Australian economy, it may be global developments that impact most acutely. Recessions in the US and Europe will weigh on Australia's external accounts, conversely a Chinese recovery should be a boon. Regardless, any forecasts at this stage remain delicately poised. Should wages growth remain more stubborn or inflation fail to recede as expected, the RBA may be left with no choice than to continue hiking the cash rate. The longer this tightening cycle progresses, the more downside risk there is for the Australian economy.

FIGURE 7: AUSTRALIAN INFLATION TO REMAIN OUTSIDE THE BAND



Source: ABS, Macrobond, ANZ Research, as at December 2022



UNITED STATES

In the US, a significant slowdown in GDP is forecast over the coming year as real rates turn restrictive. We expect GDP growth of 0.5 per cent in 2023 including two quarters of negative growth starting Q2 2023. Of course, this could end up being weaker if the Fed is required to engineer an even sharper slowdown across the labour market.

Numerous indicators have been pointing to a recession, including the inversion of two closely watched yield curves, the spread between the 10y and 3mth Treasury yields and the difference between the six-quarters-ahead forward rate and the 3mth yield. Alongside this, the Lead Economic Index (LEI) fell sharply over the second half of 2022 and several indicators from the National Bureau of Economic Research (NBER) have begun to soften, most notably in manufacturing and employment as measured in the Bureau of Labour Statistics Household Survey. This slowdown is expected to gather momentum and become more broad-based in 2023, as the impact of the monetary tightening to date flows through to the economy and the Fed continues to raise interest rates.

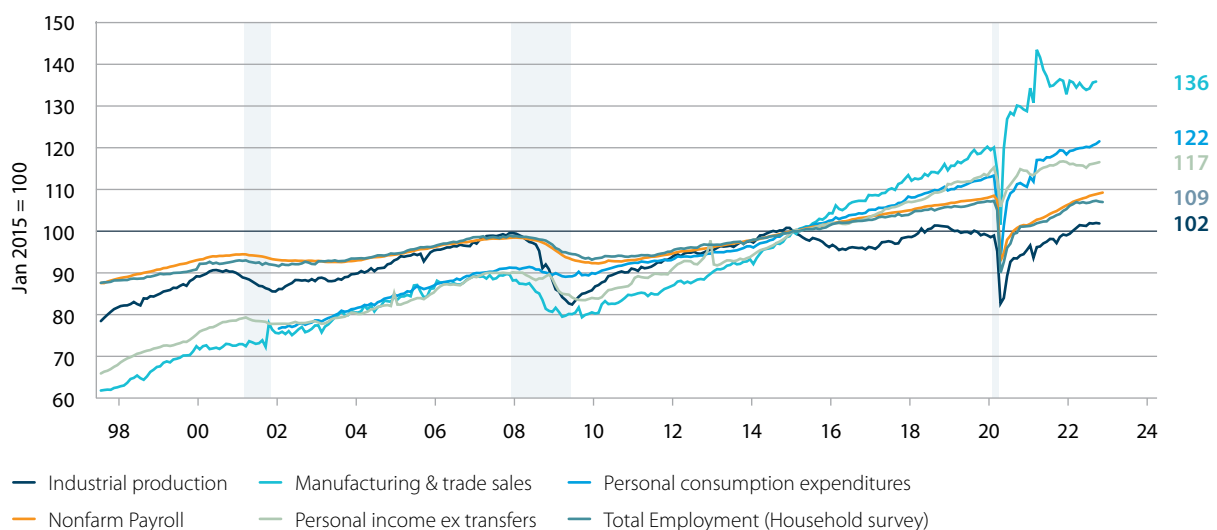
On the inflation front, one might take solace that inflation appears to have passed its peak, though the slowdown towards target will likely be prolonged. Headline inflation has eased materially from an expected peak of 9.1 per cent y/y in June thanks in large part to lower energy prices and core goods prices. A combination of softer domestic demand,

supply bottlenecks easing, and weaker commodity prices should continue this downward trend, with headline CPI expected to land in the mid-4s by year-end. Shelter rent inflation, which accounts for almost 40 per cent of the core CPI, remains challenged, however, it is a lagging price indicator and new rental agreements (a timelier indicator), peaked around mid-way through last year and have since eased.

Core services excluding rent prices are running at above 7 per cent y/y. Given wages are the largest cost in services, labour market trends will be critical to the inflation outlook. Excessive demand for workers is leading to wage growth above levels consistent with the Fed achieving its inflation mandate. Wages in the service sector, where labour market tightness is more extreme, is growing much faster than the aggregate.

The Fed stepped down its pace of tightening from 75 basis points to 50 basis points at its December meeting. While welcome news for some investors, a step-down doesn't infer its job is complete. We expect a terminal rate in the vicinity of 5 per cent, which includes 25 basis point increases at the February and March meetings. Once reached, rates are expected to be held at terminal into 2024 in order to get inflation back to target. With inflation sticky and the labour market tight, a move above 5 per cent can't be ruled out — and with it, heightened risks to the economic outlook in the US and indeed globally.

FIGURE 8: NBER RECESSION WATCH INDICATORS



Source: Fed, BLS, BEA, Macrobond, ANZ Research as at December 2022



JAPAN

Japan is often the outlier amongst developed market economies and 2023 was looking to be no different; that is until late December, when the Bank of Japan commenced what appears to be the first step in policy normalisation by widening its yield curve control (YCC) band. However, price pressures are still largely divergent. As other nations are seeking to quell inflation pressures, Japan is expected to find it challenging to keep inflation above target. The BoJ's preferred measure of core inflation, the CPI excluding fresh food, rose sharply to 3.7 per cent y/y in November last year — driven primarily by energy and other food prices. The CPI measure excluding these items is running at half that pace and with little anticipation that food and energy prices will remain a persistent source of inflation in Japan, overall price pressures should ease too. A meaningful pick-up in wages growth would be the main caveat to this scenario, and the shunto (spring wage offensive) negotiations early this year should attract a lot of attention.

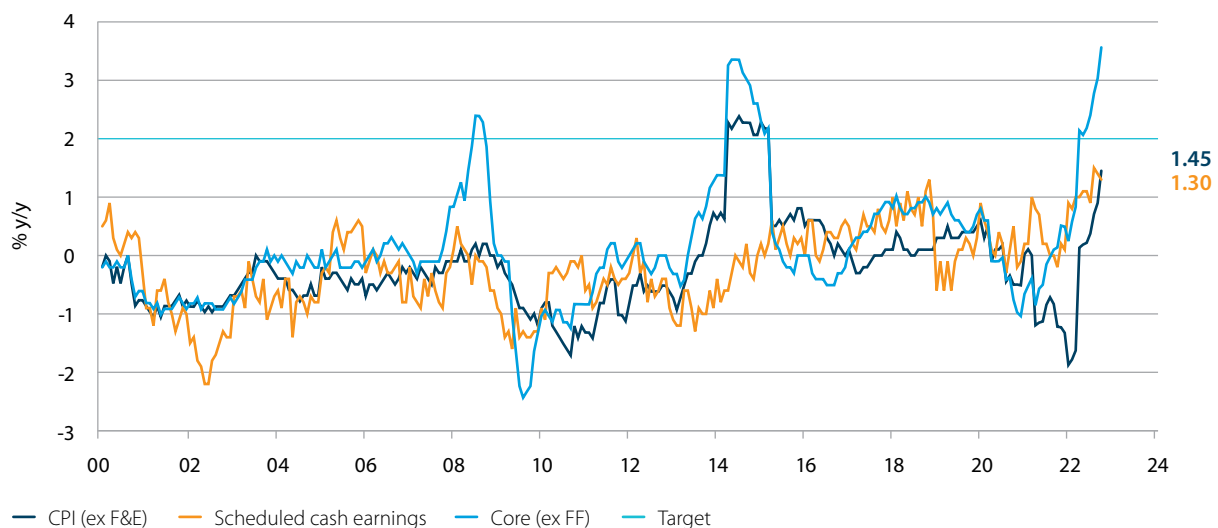
On the growth front, reopened borders and solid domestic spending appears set to provide a positive backdrop in 2023 with anticipated GDP growth of 1.6 per cent. A significant portion of the population is now vaccinated and with a greater understanding of COVID amongst its citizens, the cautious mood of consumers is waning. Combined

with an increasingly reopened economy, optimism is one word to describe the outlook for household spending. Consumption is expected to be ably supported by household savings accumulated since the start of the pandemic and the trend in services spending in particular is positive. Inflation outpacing wages growth does present a headwind though as real disposable income declines.

Since the start of the pandemic there has been limited international tourism. However, given its government lifted travel restrictions in October, tourism exports are expected to boost GDP growth in 2023. For context, in 2019, 32m foreign tourists arrived, which added about JPY4.8trn (0.9 per cent of GDP) to the economy. A weaker yen should also be supportive here, although the changes to YCC and further policy normalisation have already seen the yen strengthen off its lows.

This year will mark the end of Bank of Japan (BoJ) Governor Kuroda's ten-year tenure. The two leading candidates to succeed him are current Deputy Governor Amamiya and former Deputy Governor Nakaso. Prior to the change to YCC in late December, there weren't high expectations for a major shift from the existing framework of negative interest rate policy and yield curve control. That now looks more uncertain; and could even come before April when Kuroda's term finishes.

FIGURE 9: JAPAN — INFLATION AND WAGES



Source: JSB, MIAC, Macrobond, ANZ Research, as at December 2021



EUROPE

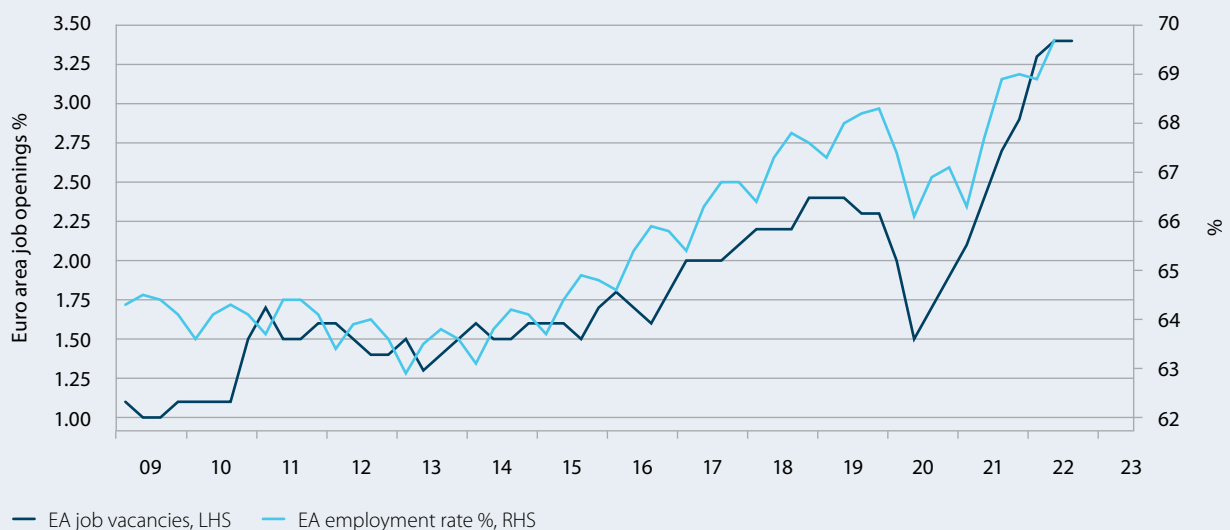
The war in Ukraine, record high inflation and an energy crisis are not insignificant headwinds. All things considered, the euro area (EA) economy held up remarkably well in 2022. In 2023, all three are likely to continue to push against any attempt at a soft landing by the ECB. The industrial sector, which accounts for 26 per cent of European Union (EU) gas consumption and 15 per cent of GDP, has been forced into emergency energy rationing and has transferred production overseas where possible. As a result, contractionary multiplier effects are growing. European gas prices are five times that of 2021, and reduced flow from Russia continues to raise concerns about gas supply and reserves this year. Unless a resolution is reached in Ukraine, it's difficult to see output rebounding sustainably this year.

In 2023, GDP is forecast to fall 0.2 per cent, a modest recession under any circumstances. The main headwind for growth is inflation, which is expected to average 6.3 per cent

this year. Like all central banks, for the ECB, calibrating this next round of tightening will be perhaps the most challenging. A combination of further interest rate rises to somewhere in the vicinity of 3.5 per cent is expected alongside the implementation of quantitative tightening — the latter commencing in Q2 at EUR15bn per month.

On the employment front, growth remains strong, wage settlements in the region are accelerating and many economies are reporting job vacancies greater than available employees — with the EA job vacancy rate recently at a record high of 3.2 per cent. Risks of a wage price spiral remain if policy remains accommodative; and with historically wide inflation ranges across the EA — varying from 6.6 per cent in Spain to over 20 per cent in some of the Baltic states — landing on exactly what is restrictive will be difficult. Regardless, it is imperative that confidence in the ECB's inflation fighting ability remains high in 2023.

FIGURE 10: EA EMPLOYMENT GROWTH IS STRONG



Source: Eurostat, Macrobond, ANZ Research, as at December 2021



CHINA

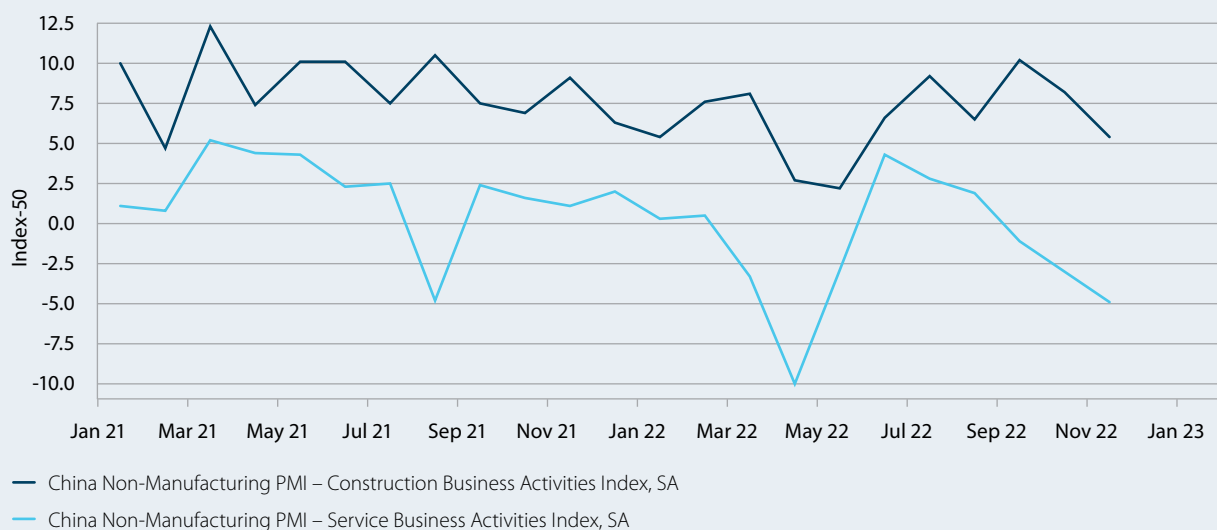
In 2023, GDP growth is forecast to be 5.4 per cent as Chinese authorities shift to a 'living with COVID' stance from the highly restrictive 'dynamic zero' regime, with refinements that are massively easing social mobility.

COVID-zero aside, the other major issue of 2022 was the property sector. Here, the People's Bank of China and China Banking and Insurance Regulatory Commission jointly formalised a package of 16 measures to support property financing. Policymakers want to ensure the continuity of construction projects and restore home-buyer confidence in construction. According to estimates, more than CNY3trn of funds are in preparation to support the package, which could help soften the property downturn. Unlike 2016-17, however, the measures aren't likely to boost demand, rather stem the quantum of defaults by property developers. And with property sales continuing to fall despite recent interest rate cuts, China cannot count on a rebound in property as a growth driver in 2023.

Boosting domestic demand (which has been particularly poor across services most recently), will also be necessary in 2023 to cover falling export demand caused by the rapid slowing of the US and European economies. The pivot from COVID-zero and support for the property sector should see China's economy bottom out in 2023, but external demand is likely to remain weak.

One recent bright spot has been the early signs of a possible thawing of tensions between China and its Western counterparts, including the US and Australia. Despite this, China still faces sanction risks. Alongside falling global demand, geopolitical tension will likely cloud China's economic outlook in 2023.

FIGURE 11: SERVICES SECTOR IS CONTRACTING



Sources: Bloomberg, Macrobond, ANZ Research, as at December 2021



INVESTMENT THEMES IN 2023 & BEYOND

Since the onset of the pandemic, markets have been increasingly turbulent, often making tactical shorter-term trades difficult to implement in a manner that is aligned with a long-term investment strategy.

In this year's Global Market Outlook, we focus on three structural themes that we expect to play out over the longer-term in society and investment portfolios by extension — people and demographics, disruptive technology and the physical world. A fourth — economic forces — has already begun to accelerate post pandemic as the removal of easy monetary policy, the end of the low-inflation era and a shift towards deglobalisation reshapes labour markets, global supply chains and human behaviour. These changes in economic forces, alongside other key structural themes are expected to provide unique opportunities for investors over the coming decade.

Each of these broad themes have numerous underlying thematics and we will cover some of these in further detail as the year progresses. Additionally, this year we discuss a structural shift currently underway in financial markets that should provide better access to these opportunities for high net worth (HNW) investors in the future.

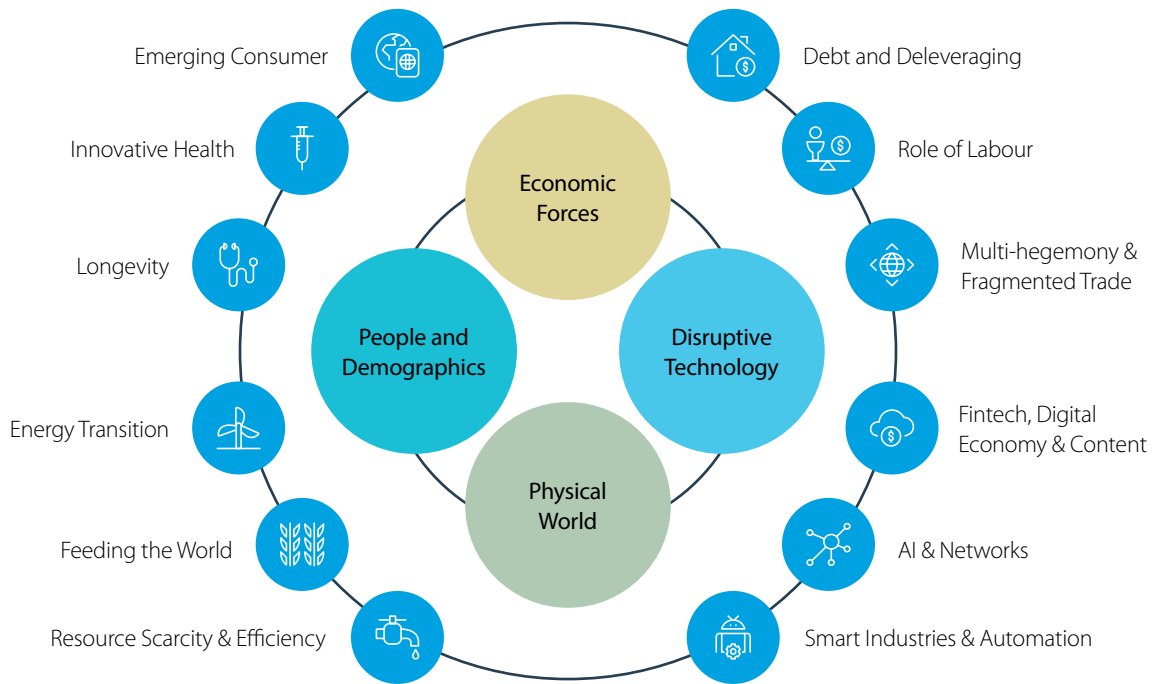
THEMATIC INVESTING

The notion of thematic investing has risen in popularity recently, often associated with the technology sector and disruption. Investing successfully in this manner has been deemed to be as simple as picking a winning theme. Yet what thematic investing is, and the role it plays in a multi-asset portfolio, is much more complex.

Thematic investing isn't just about gaining exposure to a broad area such as technology or renewables, there will be winners and losers here just as there is in everyday investing — 2022 provided plenty of evidence of this. Rather, thematic investing is concerned with identifying structural forces of change that evolve independently of the economic cycle; discerning those companies positively exposed to this change, that are able to harness it for their benefit, and have a sustainable and defensible competitive advantage. We believe that truly transformational shifts tend to unfold at a non-linear pace, often surprising markets. Having exposure to this can benefit investors if the change plays out as expected.



FIGURE 12: KEY THEMATICS



Source: ANZ PB&A CIO

The longer-term nature of thematic investing typically fits well within a high net worth (HNW) portfolio. The important part here is ensuring themes are considered as part of an investor's total multi-asset portfolio, rather than just a standalone opportunity. When investing in themes the aim is to capture sources of return that are not well represented in traditional portfolios, where mean reversion and the influences of the business cycle tend to dominate. On this basis, themes can add further diversification to a portfolio but investors need to remain cognisant of the exposure they hold to sectors, geographies, and factors — just as they would in any other part of their portfolio.

Investors can choose to access thematic investing opportunities through different implementation options, each with their own merits and risks. Exchange-Traded Funds (ETFs) allow you to target preferred themes while efficiently diversifying within each theme. An actively managed fund uses the skill of a professional manager to navigate a range of themes and to target businesses within each theme as they evolve. However, investing in just one theme can leave investors exposed to idiosyncratic risks. Rather, using fundamental and quantitative tools to construct a portfolio

of multiple themes could provide differentiated return streams alongside basic diversification benefits.

The other way to gain exposure to themes is via private markets; the less liquid nature of these markets is more aligned to the capital requirements of companies that are undertaking longer-term infrastructure projects including some of those commonly associated with sustainability. Here, investors can access a true risk-premium from those companies seeking capital, free from the vagaries of short-term reporting in public markets and the potential issue of investor redemptions.

Previously, these private market opportunities were primarily accessible by pension funds and institutional investors. However, as more capital is required to drive these longer-term themes and the increasingly integrated role they play in global finance, asset managers have had to find ways to make these opportunities more accessible for investors. And it is this democratisation of private markets that looks set to benefit HNW investors most.



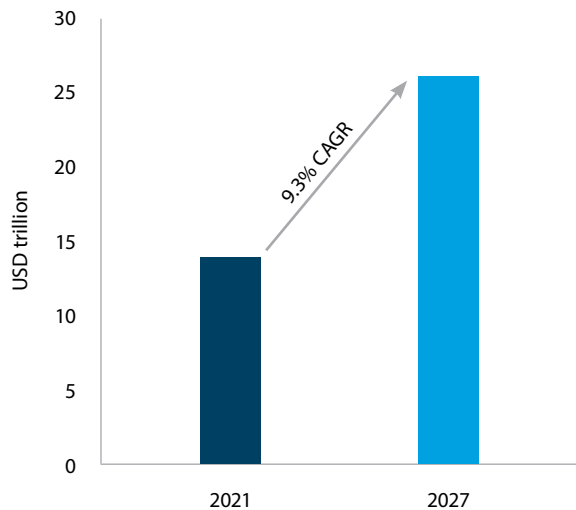
GOLDBLOCKS AND THE DEMOCRATISATION OF PRIVATE MARKETS

By Sameena Nagarwala, Senior Investment Research Manager

Lagom is a Scandinavian philosophy that seeks to apply balance to all aspects of life. In Swedish, it roughly translates to “not too much, not too little.” It’s a concept investors would be well served remembering when allocating capital to private market assets and one that seems particularly apt given the potential ‘goldilocks’ scenario currently unfolding across the industry for HNW investors.

The benefits of private markets have been well accepted within investment circles for some time, with institutional players like superannuation and endowment funds historically benefitting from having the scale required to invest in these assets, either through direct ownership or

via a partnership fund structure. The organic growth of financial markets will continue to provide opportunities for further investment from these larger institutional investors; indeed, research firm Preqin, estimates alternative assets under management will hit USD23 trillion by the end of 2027, up from an estimated USD14 trillion at the end of 2021. However, over the past two decades, institutional investors have significantly increased their exposure to private assets, and with most now nearing or having reached their desired allocation level, private market asset managers — also known as General Partners (GPs) — are now looking to diversify their investor base and require new sources of fundraising.

FIGURE 13: FORECAST GLOBAL ALTERNATIVES AUM

Source: Preqin, ANZ PB&A CIO

The next frontier for private asset providers is the HNW market. Here, the minimum amount of capital available to invest is still reasonable; current portfolio allocations remain relatively undersized; investment time-horizons are long enough to accommodate illiquid or semi-illiquid structures; and perhaps surprisingly, fees aren't as closely scrutinised, given HNW investors tend to focus on net-of-fee returns.

This need for new sources of capital has coincided with a widespread acceptance of the benefits of private assets, an increased investment in technology — such as software and platforms, and a further evolution of products providing different liquidity options for investors. Moreover, last year's capitulation of public market assets only served to accelerate this process as the less frequently priced private market assets held up relatively well by comparison. This led to institutional portfolios becoming skewed with an over-allocation to private assets known as the denominator effect. As institutional portfolios rebalanced back to mandate, a significant increase of deal-flow occurred in the secondary market — a tailwind for GPs looking to structure semi-liquid products for HNW investors.

Furthermore, for investors looking to gain access to the equity risk premium, the opportunity set in private markets

has grown significantly in recent years as compared to public equity markets. More and more companies are choosing to remain private for longer or even indefinitely. The number of public companies in the US has roughly halved to around 4,000 since the mid-90s. This pales in comparison to the estimated number of private companies with more than 100 employees — some 150,000. Moreover, according to alternative investment manager, Hamilton Lane, as at January last year only an approximate 2,800 publicly listed US companies had annual revenues greater than \$100 million as opposed to 18,000 private businesses of that size¹.

Despite the recent democratisation of private market assets, the challenges around how much capital and where to invest remain as important as ever; perhaps even more so than when investing in public markets. Fund and manager information remains relatively opaque, deal flow patchy and the dispersion of manager returns significant — making manager selection and access to the appropriate resources to undertake due diligence critical. Moreover, it's not simply a case of selecting a top manager and job done. Similar to investing in public markets, it's vital that any allocation to private markets is complementary to the entirety of a multi-asset portfolio. Private markets allow an investor to exploit different sources of risk premia such as illiquidity and leverage, however, also come with factors such as concentration risk and a lack of diversification at the geography, sector, liquidity, and vintage level. Consideration must be given to the level of exposure at both the private market and total multi-asset portfolio level to ensure unintended risks or biases are minimised.

For the most part, HNW investors remain significantly underexposed to private market assets, and with liquidity often a bigger factor for individuals than institutional investors, careful consideration also needs to be given to aligning the liquidity profile of investment opportunities to one's investment time-horizon and the potential need for short-term capital. Additionally, while sound opportunities currently exist in private markets, in the near-term particularly, some private assets — which are valued less frequently than public markets — may still need to be repriced as the impact of the past 12 months flows through to underlying assets.

While the seemingly coincidental convergence of factors has created a possible goldilocks scenario for HNW investors; like any investment, working closely with a trusted advisor can help make allocating to this space more seamless, ensuring that one's exposure to private markets within a multi-asset portfolio is not too much, not too little, but rather 'just right'.

¹ [Hamilton Lane 2022, Private Market Investing: Staying Private Longer Leads to Opportunity, Hamilton Lane](#)

PEOPLE AND DEMOGRAPHICS

By Lakshman Anantakrishnan, Head of Investment Strategy

Demographics essentially refers to the statistical characteristics of populations that describe the dynamics and dimensions through which we can understand society. Given the length of a human life, these characteristics vary slowly and their immediate impact on society and economies can often be ignored, but their impact is very real. The good thing about demographics, as opposed to other forecasts, is that their changing nature can be predicted well in advance through some basic calculations, though the impact that such changes have on society can sometimes be open to interpretation. Investors often overlook demographic trends due to the small impact they have on day-to-day events. They shouldn't. We are approaching an inflection point that will see the characteristics of populations change more rapidly, and they are an important trend to stay on top of.

The main demographics of interest today are the ageing global population, the rise of new generations that have lived through very different environments and societal changes, and the rising middle class across once emerging economies — where those who were part of the productive capacity of the world are growing to be a larger part of the middle class and are changing the nature of consumption in society.

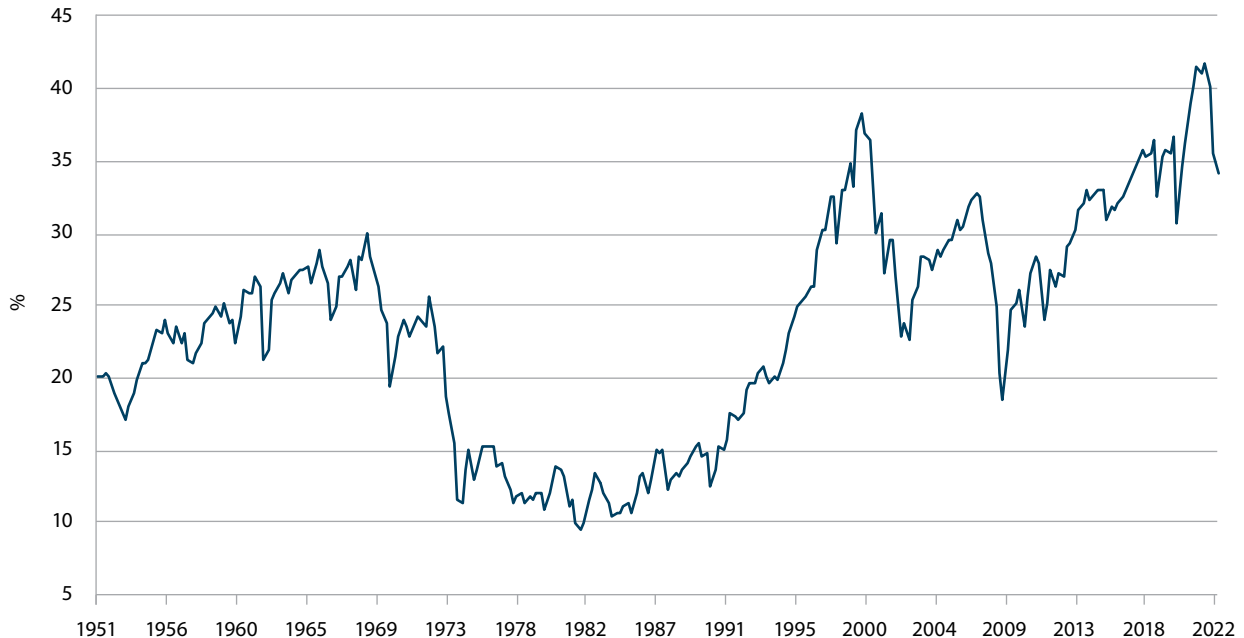
Changing demographics across different countries will have inevitable consequences for labour, supply and demand dynamics, housing needs and financial markets. When we consider this in its simplest form, economic growth is the transformation of labour (human capital) into productive output using financial capital, and its subsequent impact on the value of savings and investment. Therefore, any seismic change in the availability and characteristics of labour can have several knock-on effects to economic growth, and the investments that will thrive in such an environment. For example, even prior to COVID and the additional healthcare spend that resulted, OECD forecasts pointed to healthcare spending (and therefore investment in this sector) in OECD countries as growing by around 2.7 per cent per annum till 2030¹, likely outstripping economic growth over that same period.

Even at its most basic level, as the population ages, there is expected to be an incredible change to the composition of financial markets. As the chart below shows, equities currently account for approximately 35 per cent of financial assets across US households and non-profit organisations. This is likely to unwind over the coming decade as retirees de-risk portfolios.

¹ OECD 2019, Health at a Glance 2019 – OECD indicators, OECD.



FIGURE 14: PERCENTAGE OF US HOUSEHOLDS AND NON-PROFIT ORGANISATIONS FINANCIAL ASSETS; DIRECTLY AND INDIRECTLY HELD CORPORATE EQUITIES AS AT Q3 2022



Source: St. Louis Fed, Board of Governors of the Federal Reserve System (US), ANZ PB&A CIO

Ageing (and compositionally different) populations will also have an impact on government policy and subsequent fiscal spending plans — both to meet the needs of older consumers, as well as to win the vote from a new breed of younger voters, who hold an increasing proportion of voting power, very different life experience and vastly different priorities.

Challenges and opportunities will vary by region as well, as some advanced economies such as Japan, Germany and Italy have greater demographic 'challenges' compared to several emerging economies. Emerging economies, particularly in Asia are expected to account for the dominant share of growth in the middle class, a material shift from the prior dominance of Western economies in this demographic.

These changes have been in play for some time, but with the rapid ageing of the baby boomer generation that has dominated the structure of societies previously, today's demographic shift presents an inflection point in humanity's timeline.

Coupled with the exponential growth in technological innovation transforming societies, the geopolitical move to a multi-polar world, and rising risks around populism and inequality in society, we expect such changes to add to an increasingly volatile world. With volatility and change comes opportunity, and the need for investments that benefit from these secular changes, as well as help to protect portfolios from the subsequent risks that arise.



DISRUPTIVE TECHNOLOGY

By Benjamin McBride, Head of Research and Governance

"Mission: Stop the brain before the brain destroys the world!" exclaims the voiceover to the trailer of the 1967 movie *Billion Dollar Brain*. The movie features Michael Caine as a former secret agent racing to stop the spread of an animal virus to humans, an eccentric American billionaire tycoon whose fervent patriotism serves as cover for his personal ambitions, and the real star of the movie, a supercomputer capable of planning attacks that can change the tide of the Cold War.

The movie was broadly panned after its release. Caine's character was part inspiration for the Austin Powers spoofs and the far-fetched capabilities of the computer stretched the spy genre too far into the realm of fantasy. Move forward to today, and the movie's geopolitical and technological backdrop appears far more realistic.

In 2022, cyberwarfare became a very real part of the war in Ukraine. The impact of cyberattacks became very personal for millions of Australians as sensitive personal data was compromised in hacks on Optus and Medibank, amongst others. Despite ransomware accounting for

less than 1 per cent of all cyber related attacks (see chart below), it remains the most destructive form according to the Australian Cyber Security Centre¹. Businesses are being disrupted by the need for encryption, the reputational damage from stolen data and the resulting impact on the public.

Governments, businesses and the public are now under no illusion that significant resources will need to be devoted to stopping these threats both now and in the decades ahead. This shift will need to occur despite significant pressures on public spending and a slowing economy. The Australian government has dedicated AU\$9.9 billion over the next decade to support cybersecurity — and the US also announced an 11 per cent increase in spending for fiscal 2023 beyond the current US\$11 billion spent annually on federal cybersecurity². Revenue in the Cybersecurity market is projected to reach US\$156 billion in 2022 growing to US\$262 billion by 2027, an annual growth rate of 10.9 per cent per annum³.

¹ [Australian Cyber Security Centre \(ACSC\) 2022, ACSC Annual Cyber Threat Report, July 2021 to June 2022, ACSC](#)

² [Mueffelmann, K, 2022, Australia and US Pledge More Government Cybersecurity Spend for 2022-23, Archtis](#)

³ [Statista 2022, Cybersecurity — Worldwide, Statista](#)

The growth in importance of cybersecurity is a direct result of the confluence of multiple megatrends in technological disruption. This inexorably prompts structural shifts in many industries and changes the drivers of corporate earnings. The internet of things (IoT) describes physical objects with sensors, processing ability and software that can connect and exchange data. A wide range of ordinary items, from fridges that can order your food to driverless cars are now connected to the internet, collecting data and being controlled remotely.

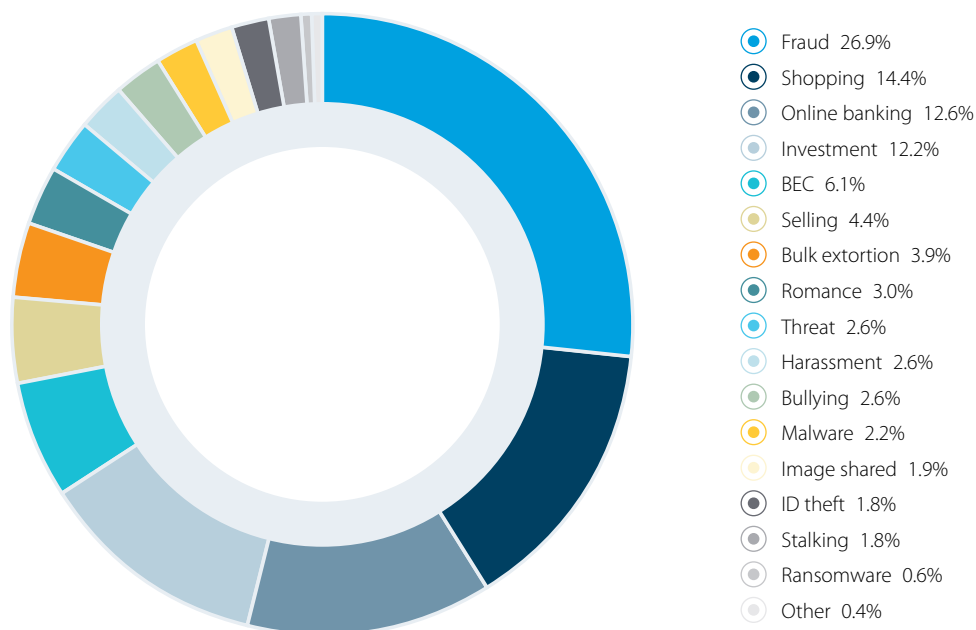
Yet none of the technology in this space can operate safely without appropriate cybersecurity protocols to protect the way they operate and who can access them. The same can be said for Fintech and all parts of the digital economy. As we live more of our lives online through streaming, gaming and the metaverse, we need to be sure we can do it safely. Dystopian tales of robots with artificial intelligence turning on their human masters might still be in the realm of science fiction, but as we know, science fiction can become reality in time.

This is not to say cybersecurity is the only component of the disruptive technology theme we like — far from it. Disruptive technology captures everything from the demise of companies like Kodak that fail to

adapt to changing consumer needs and technological advances, to those such as Netflix that thrive under such conditions. It includes the potential impact to industries as businesses adopt decentralised ledger systems, and involves the creation of new mediums such as Web3 and the metaverse — areas we believe are likely to provide opportunities for investors in the years ahead.

Rather, the rise of cybersecurity is simply just one pertinent example that meets many of the key tenets of an investable theme. It's more than a passing fad; its financial trajectory sits beyond the impacts of the market cycle, it feeds off and into other technological advances and it materially changes the way society functions on a daily basis — all facets we look for when assessing thematic opportunities. Incorporating cybersecurity and other technological disruption themes into a portfolio can help provide important sources of returns that aren't easily captured by traditional index-based approaches which tend to focus on where the world has come from instead of where it is moving to.

FIGURE 15: AUSTRALIAN CYBERCRIME REPORTS BY TYPE FOR FY2021-22



Source: Australian Cyber Security Centre, 2022

THE PHYSICAL WORLD

By Dan Simpson, Head of Portfolio Management

The environmental degradation facing our planet has been a widely accepted phenomena for some time. Yet its causes and impacts are only recently being quantified in financial terms; this is expected to have significant implications for businesses, consumers and investors.

Whilst most of the focus has been on climate change, there is increasing awareness that protecting biodiversity is also imperative for the environment. The World Economic Forum has previously estimated that more than half of the world's gross domestic product (US\$44 trillion¹) is moderately or highly dependent on nature and its ecosystem.

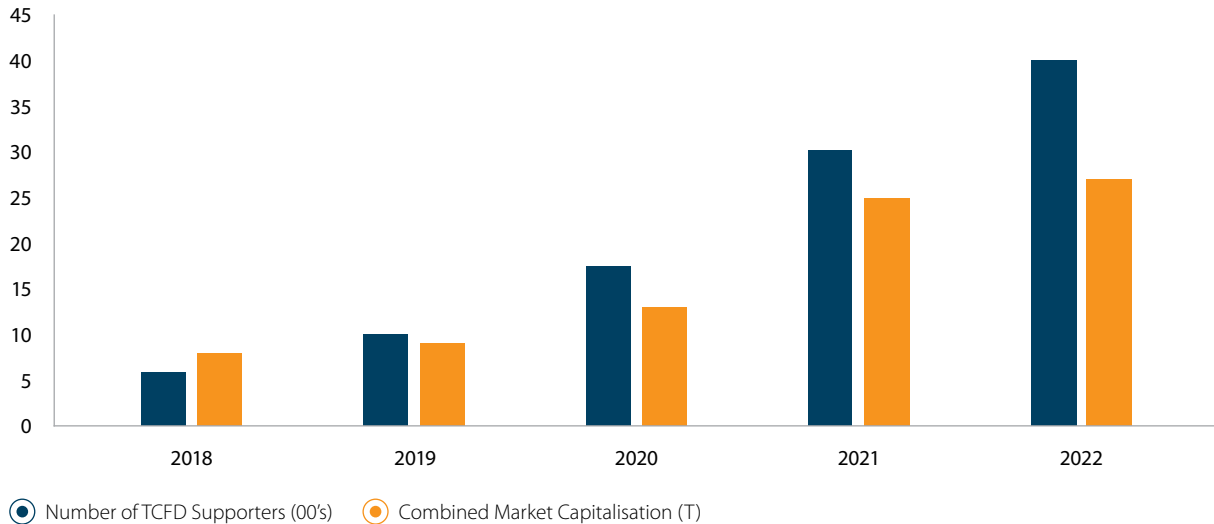
The international Taskforce on Nature-related Financial Disclosures (TNFD) was launched in 2021. It hopes to mirror the success of the Taskforce on Climate-related Financial Disclosures (TCFD), which has driven significant change, influencing companies to consider and tackle climate change. According to TCFD, more than 4,000 organisations now support the TCFD framework — spanning 100+ different countries, with a combined market capitalisation of US\$27 trillion².

¹ [World Economic Forum 2020, Nature Risk Rising: Why the Crisis Engulfing Nature Matters for Business and the Economy, World Economic Forum](#)

² [The Task Force on Climate-related Financial Disclosures \(TCFD\) 2022, TCFD 2022 Status Report, TCFD](#)



FIGURE 16: NUMBER OF TCFD SUPPORTERS AND MARKET CAPITALISATION



Source: TCFD, ANZ PB&A CIO

The establishment of TNFD comes as companies are quickly waking up to the reality that their bottom line will be hit not just by climate change but by the deterioration of nature more broadly. At the same time, sustainability is shifting from being an annoying risk to returns for businesses and investors, to also being recognised as an attractive opportunity. This is being accelerated by the actions of governments and consumers who are rewarding companies who look after the planet and punishing those who don't.

Within the Physical World theme, we identify three main sub-themes we expect to shape markets and drive compelling investment opportunities in the decades ahead:

- **Energy transition** – the race to net zero is fuelling an energy transformation of enormous scale. Most countries and many companies have made net zero pledges. According to the United Nations, a tripling in clean energy investment, to US\$5 trillion per year by 2030, will be required to achieve the 2030 and 2050 energy targets³.

- **Feeding the world** – the UN has forecast that by 2030 our global population will have grown by half a billion. And while the global population is growing at its slowest rate since 1950⁴, that's a lot more mouths to feed.
- **Resource scarcity and efficiency** – compounding the problem of a growing and hungry population is the fact we've also degraded more than 50 per cent of agricultural production land⁵ and over-fished one third of our fisheries (beyond replenishment levels)⁶. The winners in agriculture and food production are likely to be those who regenerate the land and replenish food stocks whilst using water and other valuable resources more efficiently.

³ [United Nations 2021, Proposed global roadmap shows how universal access to sustainable energy can be achieved by 2030, United Nations](#)

⁴ [United Nations 2022, World Population Prospects 2022 Summary of Results, United Nations](#)

⁵ [World Economic Forum 2021, Why Empowering 100 Million Farmers to Transform our Food Systems Matters, World Economic Forum](#)

⁶ [Food and Agriculture Organization of the United Nations \(FAO\) 2022, The State of World Fisheries and Aquaculture 2022, FAO](#)

INVESTMENT STRATEGY

FAVOUR FIXED INCOME WITH SCOPE FOR EQUITIES IN H2

Forecasting is typically a fool's errand. The odds of 'looking silly' 12 months on are high, particularly during periods of uncertainty. So, in looking back on 2022, we do so with a healthy dose of humility — and when considering the outlook for 2023, we do so with similar modesty.

We commenced 2022 cautiously optimistic, with an expectation that volatility would be a dominant theme for the period ahead. In hindsight, perhaps we should have been more cautious than optimistic.

Central banks were correctly assumed to be well behind the curve in their pursuit of policy normalisation. However, after the rapid easing of monetary conditions throughout the pandemic, it seemed central banks would be reluctant to reverse course at speed, let alone with a greater velocity and trajectory than they had on the way down. The fact they did caught markets off-guard — and any investors banking on a 'Fed put' were sorely disappointed.

Inflation was expected to fall and in a meaningful manner, however, a war in Europe and China's self-imposed lockdown only served to fuel inflation, quickly dashing any hopes of a sharp reversion. Even the one factor that was

accurately predicted — volatility — was brought forward and escalated with the advent of Russia's invasion of Ukraine.

As the year progressed it became evident that the Fed, and indeed other central banks, were going to remain forthright in their tightening of financial conditions despite the market deterioration. At this time, we began to adopt a more defensive stance across portfolios — acknowledging the outlook was likely to favour bonds relative to equities over the coming period, at least on a risk-adjusted basis.

So, in 2023, a year where the macroeconomic outlook is perhaps even more bleak and clouded than last, suggesting there is scope for nearly all asset classes to have a renaissance at some stage in 2023 might be considered courageous, laughable or just downright nonsensical. However, it's a view we hold as 2023 gets underway and one that informs our current positioning — namely a mild underweight to



equities and overweight to cash. The moment and size of such opportunities is the more imperative question. In fact, following a year when nearly all asset classes headed sharply south, perhaps forecasting such a possibility isn't that brave after all. Unfortunately for investors, at least at the start of 2023 we believe such opportunities are likely to be considered rather boring and humdrum.

Bonds. It is here we see the greatest likelihood of outperformance over the first half of the year and where we expect to deploy more capital, if as expected, we trim risk positions further in the months ahead. This isn't to say the outlook for fixed income is all blue sky; but as we discuss in the prologue, given we are in the latter stage of this tightening cycle, even if yields do push higher from here we would expect fixed income assets to present a better risk-adjusted return than equities.

As the year progresses, we see scope for more exciting opportunities. And so rather than a 'sell the dip' mindset, we look for opportunities to 'sell the rip' before potentially building back exposure to risk in the latter part of the year (though this will be to a large extent dependent on central bank policy changing from its current trajectory).

Within risk assets we believe there is greater upside for emerging market equities over developed market shares this year. We have held an overweight to emerging markets since mid-last year — implemented via a discrete allocation to Chinese shares — and after disappointing through most of 2022, the position began to rebound and outperform over the latter part of 2022, as rumours surrounding China's reopening gathered momentum. In 2023, we see the opportunity for further outperformance from emerging markets, particularly if the US dollar fades in H2 alongside a peak in the Fed Funds Rate. At such time, even if the broader equity market remains unappealing, there might be scope to build a more structural overweight here.

Across developed markets, we see better likelihood of outperformance from the Australian share market in 2023, given its exposure to China, heavy sectoral bias to resources and banks, and the likelihood of the RBA needing to push interest rates higher still. The fact we are currently positioned with a mild underweight to Aussie shares is reflective of our overweight to Chinese shares within portfolios — which somewhat offsets this mild underweight — and our belief that there is little need to rush into such a position given the likelihood of further pain for share markets before any sustained rally can commence. This pain is something we expect to impact the US share market over the first half of the year as earnings finally reflect underlying weakness and margins come under pressure. We have already had two quarters of poor earnings and we expect this trend to continue for now, driven by a slowing economy, higher labour costs and a tightening of financial conditions. If fundamentals continue to deteriorate as expected, then the Fed may be forced to blink — and with this would come another opportunity to increase risk assets.

Sticking with risk assets, perhaps the most interesting asset class as 2023 gets underway is high yield credit. Attractively priced, and with a current macro backdrop that is typically conducive to the asset class, its yield and income characteristics make for a strong investment case. However, in a year where the strength of corporates is likely to finally be tested in a meaningful manner, it's simply too early to increase exposure. Again, should any recession turn out to be duller than expected, then high yield is likely to have an opportunity to outperform and feature prominently across portfolios. Any move here is likely to be preceded by a shift to investment grade credit, where spreads are already trading at attractive levels by historical standards and a preference for a quality bias into 'late cycle' remains.

We commence the year with an underweight to risk assets. With challenges but also potential across most sectors, diversification will be critical again this year. In 2023, remaining nimble while ensuring adherence to a broader long-term investment strategy might be most important of all. Challenging? Yes. Opportunities? Absolutely. And following the calamity of 2022, even the most bearish of investors would be hard pressed to forecast a more difficult year for markets in 2023. Then again, as Warren Buffett once noted, "...forecasters...make fortune tellers look good."

FIGURE 17: ASSET CLASS PREFERENCES

	Current
Growth assets	U
Developed market equities	MU
Australian equities	MU
Emerging market equities	O
Listed real assets	B
High yield	B
Australian dollar	MU
Defensive assets	O
Australian fixed income	B
International fixed income	MU
Cash	MO

 Underweight
  Mild underweight
  Benchmark
  Mild overweight
  Overweight

ANZ PB&A CIO, as at 13 January 2023

ASSET CLASSES

CURRENT STRATEGY AND OUTLOOK



AUSTRALIAN EQUITIES

MU Current

Our current preference is to be **mildly underweight** Australian equities.

Despite the rather uncertain outlook for the global economy, and indeed the domestic one this year, a case can be made in favour of Australian equities in 2023, even as the value trade is likely to come under pressure as the year progresses.

Like last year, the Australian economy is seemingly hostage to opposing forces, however these opposing forces shifted somewhat over the course of 2022. Whilst twelve months ago it was all about the dichotomy between reopening the Australian economy and the return to a more orthodox monetary policy regime; now the fault lines are fighting stubbornly high levels of inflation while protecting the economy from what could be a rather steep cliff in activity. While toxic mixes of opposing forces usually scream trouble for equity markets, the domestic market held up relatively well last year compared to global equity markets — and in 2023 we expect it to be a similar story.

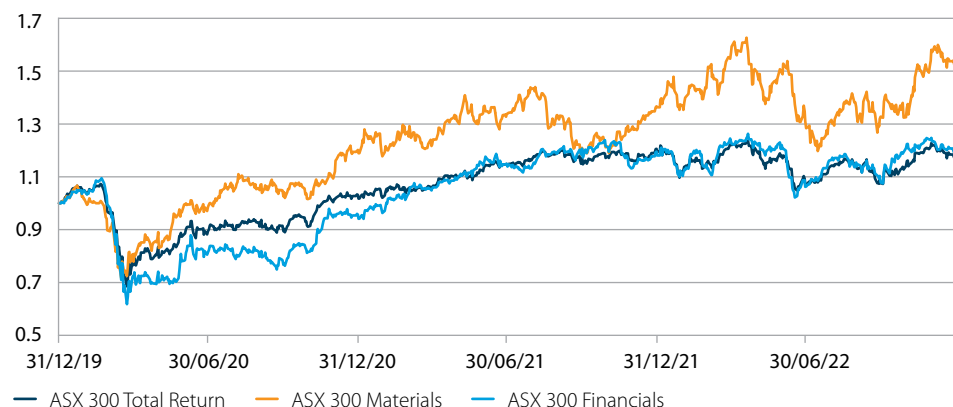
The barbell of financials and resources was the primary reason for this better-than-expected market outcome. The reopening of the global economy paired with the

hostilities between Ukraine and Russia led to a substantial dislocation between demand and supply of commodities, presenting Australian resource companies with lofty windfalls.

So where to from here? The outlook for the global economy and financial markets remains cloudy at best, yet the case for Australian shares remains appealing, at least in relative terms. This is due primarily to the one trump card that couldn't be played in 2022 — China and its reopening. At this time, it's not clear whether the reopening will be a smooth process, but we are willing to assign a higher probability on a continued reopening than the market is currently pricing, which means more demand for resources and the potential for further upward pressure on interest rates — both of which should be beneficial for Australian equity markets given its heavy sector biases.

While we start the year with a mild underweight to the domestic market, this factors in our overweight to Chinese shares and the typical relationship between both markets. With equities expected to stutter over the first half of this year, there is no urgency to increase positioning here. We envisage opportunities to increase exposure throughout the year, particularly relative to other developed share markets.

FIGURE 18: ASX 300 V ASX 300 MATERIALS VS. ASX 300 FINANCIALS



Past performance is not indicative of future returns.

Source: Bloomberg, ANZ PB&A CIO as of January 2022



DEVELOPED MARKET EQUITIES

MU Current

Our current preference is to be **mildly underweight** developed market equities.

The outlook for global developed market equities is more than opaque. While price levels have fallen substantially, the valuation picture remains bleak with a great deal of uncertainty surrounding the upcoming earnings seasons.

There are very few points of reference that one can use to gauge where equities might go from here, so at this time, the Equity Risk Premium (ERP) is one of the most interesting gauges to watch. Given the ultra-low interest rate environment in the past decade, the concept has become less relevant, but has witnessed a small renaissance in the past few quarters. In short, ERP is a valuation framework that looks to estimate the attractiveness of equities relative to bonds. While the bull market in equities prior to last year outpaced corporate earnings meaningfully, the low level of interest rates kept the ERP at reasonable, albeit uninspiring, levels. With the advent of sharply higher bond yields since the start of 2022, the ERP has cratered, even despite corporates operating at peak margins. So, what will happen if margins contract as eventually expected, and earnings do begin to fall? And why does this matter for the outlook for global equities?

The idea that a slower path of interest rate hikes will lift risk assets higher, with equities

a beneficiary, is certainly a valid one but probably only in the short term. Businesses have so far been able to pass higher input costs through to willing consumers. However, this is unlikely to be sustainable as the full impact of last year's rate hikes — and additional increases this year — are eventually pushed through to corporates, and consumer purchasing power is diminished further. At this time, an already vulnerable earnings outlook will be susceptible to margin compression as discounted goods and falling demand — something that has already shown up in the first ISM Manufacturing print of 2023 — weigh heavily on corporate health.

Over the medium-term, investors are bound to start worrying about the valuation dynamics of equities, and if this occurs, other asset classes such as corporate credit are likely to be more appealing on a valuation basis. If the ERP falls further as expected the case for bonds will only be heightened.

Investing in multi-asset portfolios is a process of relative preferences. At least in the first half of 2023, it's difficult to find a compelling case for global developed market shares. Within developed markets, on a 12 month basis, we see greater upside in European and possibly Japanese shares relative to the US. On a sector basis, we see a greater likelihood of outperformance from quality than growth and value.

FIGURE 19: US EQUITY RISK PREMIUM



Past performance is not indicative of future returns.

Source: Bloomberg, ANZ PB&A CIO as of January 2022



EMERGING MARKET EQUITIES

● Current

Our current preference is to be **overweight** emerging markets (EM) equities.

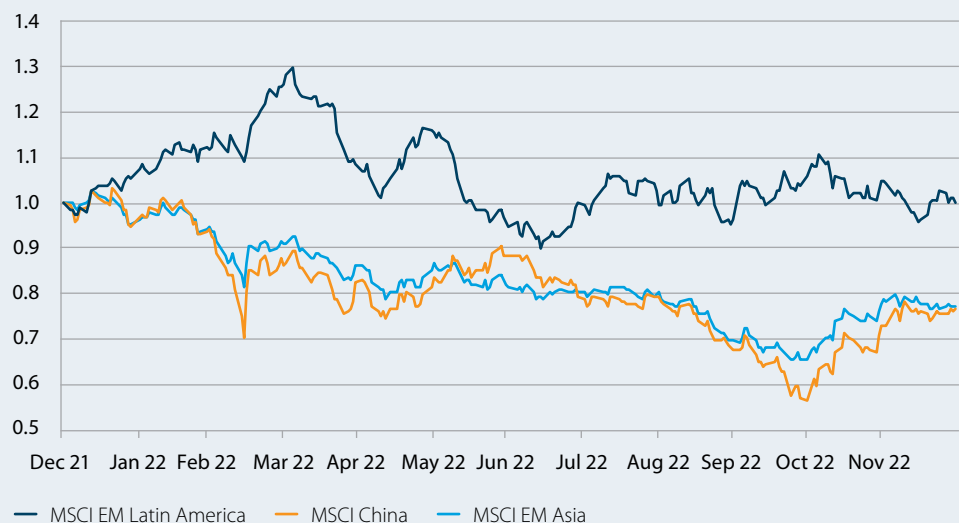
In 2022, like previous years, the performance of emerging market equities as a block was largely beholden to China. 2023 is unlikely to be different. However, where last year news flow from China was dastardly — and issues in its property sector, the political impasse as well as its ill-conceived COVID-zero policy all led to meagre equity performance — this year there is hope that headlines will be more buoyant. In 2023, the growing tension over Taiwan currently appears the most likely tail risk to destroy a positive investment case, at least amongst those risks currently visible.

For much of the second half of 2022, we held an overweight to Chinese shares. This was premised on attractive valuations, financial

conditions that were divergent to most of the developed world — namely continuing fiscal stimulus and supportive monetary policy — and a hope for an end to China's COVID-zero policy. The first two were largely prevalent throughout, however, were trumped by the absence of the third. As rumours of an end to zero-COVID began to gather momentum toward year-end, markets jumped sharply.

Despite, Xi Jinping remaining under criticism for his handling of China's reopening, 2022's most significant headwind (lockdowns) may likely become a tailwind for Chinese shares in 2023. Alongside an expectation of a weaker USD (typically a boon for EM), we are positive on the outlook this year; and after a troublesome period, 12 months without a nasty surprise would be keenly welcomed by investors.

FIGURE 20: EMERGING MARKET PERFORMANCE 2022



Past performance is not indicative of future returns.

Source: Bloomberg, ANZ PB&A CIO as at January 2022



LISTED REAL ASSETS - GREITS & INFRASTRUCTURE

B Current

Our current preference is to be **benchmark** listed real assets, the position a construct of our **benchmark** exposure to Global Real Estate Investment Trusts (GREITs) and **mild underweight** to listed infrastructure.

In a world where stubbornly high inflation seeks to undermine the returns of nominal and fiat money related assets, the case for real assets such as GREITs and infrastructure in particular should be obvious. Unfortunately, in 2022 that was not the case. GREITs performed horribly, while the sell-off in infrastructure was more muted.

The reason for this disappointing outcome? Like everything else in 2022, it was monetary policy and the severity of interest rate rises. In some respects, it shouldn't be surprising that this transpired. After all, besides their 'real' characteristics, they also carry 'duration' qualities and this was not a good trait to have in 2022.

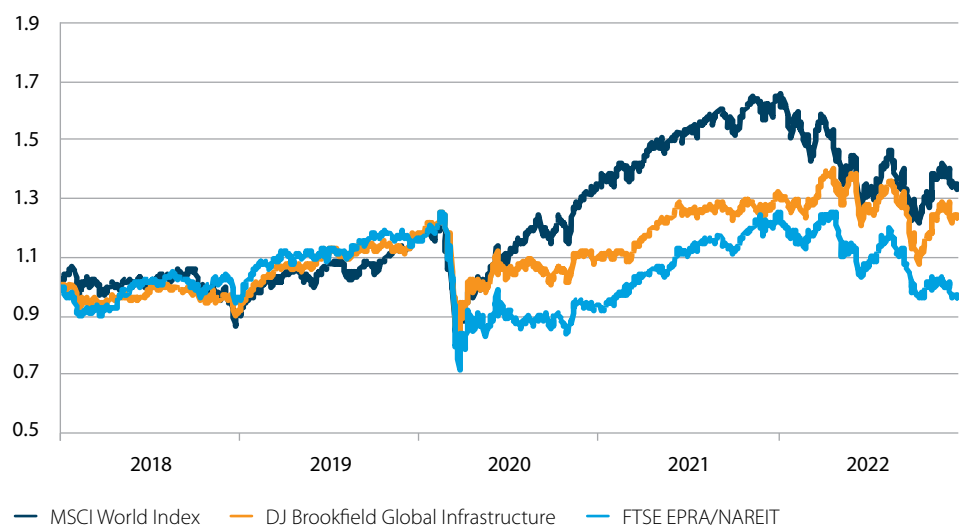
In 2023, as most global central banks approach the latter stage of their hiking cycles, one can argue that some of these

pressures should eventually abate. That said, the next six to 12 months remains shaky, particularly in real estate. Refinancing will be done at much higher levels than 12 months prior, economic activity is expected to slow meaningfully and with this comes an increased risk of tenants failing to meet commitments. All up, this could result in some deep discounts in 2023, meaning an investment opportunity is possible, but the timing remains questionable.

The opportunity is less pronounced in infrastructure. Here, governments have a great deal of incentives for private investors to help with the maintenance of their ageing infrastructure portfolios. However, in a world where governments are leaning increasingly left, any infrastructure investment brings with it regulation risk, curtailing the potential upside in some segments.

For this reason, we favour GREITs to listed infrastructure on a 12 month basis as well as within portfolios currently.

FIGURE 21: GLOBAL REITS VS. INFRASTRUCTURE VS. MSCI WORLD



Past performance is not indicative of future returns.

Source: Bloomberg, ANZ PB&A CIO as at January 2022



HIGH YIELD

B Current

Our current preference is to be **benchmark** high yield.

In a year where the investment outlook has been described as muddled, cloudy and opaque, high yield has perhaps the greyest prospects of them all. The asset class looks reasonably attractive, and at the time of writing the market and the economic environment appear conducive to potentially strong returns from the asset class (certainly above those of equity markets).

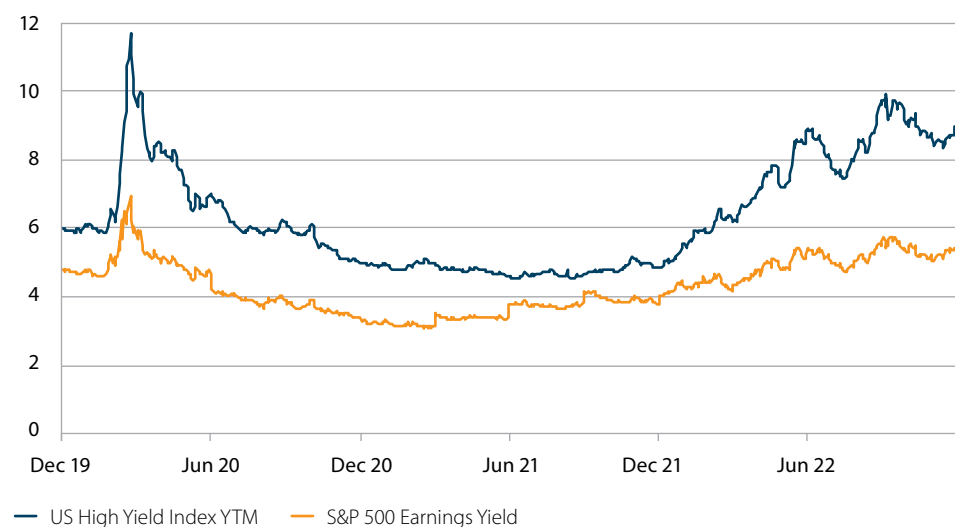
High yield flourishes in an environment where the business cycle is lukewarm, and growth is modest. Currently, central banks are beginning to get anxious about inflicting too much damage on the economy. In this environment the yield embedded in these assets and the continuous compounding effect of coupons is a powerful mix for investors. However, should this muddling environment turn out to be more than a shallow recession then the risks of default start to rise substantially, and the outlook for the asset class is no longer so appealing.

Like most asset classes in 2023, the severity of any recession, rather than whether it will occur, is most pertinent for high yield. Just how hard corporate earnings and margins are hit, and whether default rates — which have remained low so far — rise sharply, will be key.

The resilience of corporate profit margins has been remarkable so far. Investor demand for long duration assets has allowed corporates to issue comparatively longer debt maturities, which have shielded them from the current rise in interest rates. Moreover, corporates have been able to increase their selling prices much more than the rise in labour costs. However, these tailwinds could easily reverse course and become headwinds going forward.

Regardless, we believe there should be ample opportunity for further investment in high yield over the coming year.

FIGURE 22: US HIGH YIELD RELATIVE ATTRACTIVENESS



Past performance is not indicative of future returns.

Source: Bloomberg, ANZ PB&A CIO as at January 2022



AUSTRALIAN FIXED INCOME

B Current

Our current preference is to be **benchmark** Australian fixed income.

As it is the case for all high-quality sovereign bond markets, Australian government bonds are highly correlated with US Treasuries and German Bunds, meaning that global factors are generally more important than local factors when it comes to sovereign bond markets. However, there are obviously some idiosyncratic factors that matter too. The Australian economy and its dependence on resources, as well as the fact that the RBA has a looser inflation target, make Australian Government bonds generally more volatile than their developed market counterparts. Additionally, the fact that the Fed is much more advanced in its tightening cycle than other central banks, brings the possibility

that the strong correlation between high quality global bond markets might not be as pronounced as it has historically. So, some dispersion is possible.

For Australian government bonds in 2023, much like the domestic equity market, it is once more China that might have the most substantial impact. A reopening of the Chinese economy should bring with it a great deal of stimulative effects for the Australian economy. Strong demand for iron ore, copper, nickel, gas, coal and oil as well as food might possibly push Australia into an economic sugar rush, at a time when the RBA is hoping to put its inflation fighting efforts to bed. This could bring with it further upside for yields as bond prices retreat.

FIGURE 23: RELATIVE AUSTRALIAN FIXED INCOME PERFORMANCE



Past performance is not indicative of future returns.

Source: Bloomberg, ANZ PB&A CIO as at January 2022



INTERNATIONAL FIXED INCOME

MU Current

Our current preference is to be **mildly underweight** international fixed income.

'Annus Horribilis' is a Latin term brought to prominence by Her Royal Highness, the late Queen Elizabeth II, in 1992 — a year that amongst many things saw a fire devastate Windsor Castle. Some 30 years on, its translation of 'horrible year' might be best placed to describe another fire, that which devastated the global bond market in 2022.

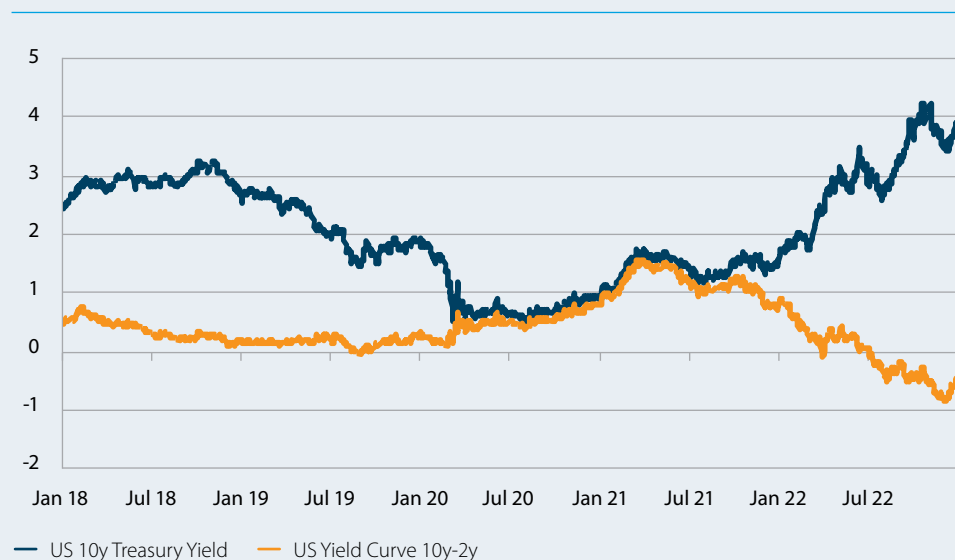
Broad based and upward grinding inflation was exacerbated by the conflict in Ukraine, as well as the stubbornly persistent post-COVID stimulus hit that literally bullied central bankers and in particular the Fed into hiking interest rates with extraordinary speed. The rapid hiking cycle has obviously left global bond prices in tatters, and the global business cycle is starting to slow down as well, sparking hope amongst some that the hiking cycle might almost be complete. Yet, when thinking of the long awaited and widely celebrated 'pivot' by the Fed, one must ask the question — what does 'pivot' actually mean? The definition in the Oxford dictionary is "to change direction; to

change the way in which something is done." On that account one might argue that the 'pivot' is only half complete.

Some market participants have become so obsessed about monetary policy, that anything less than a 75 basis point hike by the Fed at its December meeting was seen as the real deal, the full pivot. But even if the hiking increments become smaller, it doesn't change the fact that rates are still rising, and monetary conditions are still being tightened. Whether this monetary tightening induced, global economic slowdown turns what was a 'Annus Horribilis' for bond markets into a 'Annus Mirabilis' — or 'marvellous year' — in 2023 remains to be seen.

We commence the year with a mild underweight to international fixed income, and after making purchases of global sovereign bonds throughout 2022 to reduce our underweight, we look for further opportunities to increase our allocation over the year ahead and believe there may be favourable conditions for fixed income as the year progresses.

FIGURE 24: US SOVEREIGN BOND PERFORMANCE VERSUS US YIELD CURVATURE



Past performance is not indicative of future returns.

Source: ANZ PB&A CIO, as at January 2023



AUSTRALIAN DOLLAR

MU Current

Our current preference is to be **mildly underweight** the Australian dollar (AUD).

Volatility dominated currency markets in 2022. US dollar exceptionalism was the standout as the Fed set about embarking on one of the steepest hiking cycles on record, and risk-off sentiment swept markets.

In 2023, with inflation easing, and the Fed seemingly well-progressed in its tightening cycle, USD momentum that was experienced across 2022 — as the Fed led most other central banks in normalising policy — is likely to moderate, and alongside it demand for the USD.

With the USD now likely past its peak, macroeconomic fundamentals including current account balances, fiscal positions and foreign exchange reserves, should play a larger role in influencing exchange rate movements of global currencies going forward, particularly as the year progresses.

The RBA wants to remain on the “narrow path” to a soft landing, keeping the economy on an “even keel” if it can. As a result, we expect the domestic cash rate to peak somewhere in

the high-3s and remain there for some time. This higher-for-longer story is a key reason why some upside opportunity exists over the medium-term for the AUD against currencies with more aggressive central banks, like the NZD and GBP, which are likely to face pressure to cut sooner.

Like bond and equity markets, global factors such as recession risks and geopolitical threats will likely remain key drivers of the local currency in the first half of 2023, as the market shifts its attention from inflation to growth. While the AUD may struggle against this early, overall we expect 2023 to be a better year than 2022 for the Aussie dollar, and some broad-based USD weakness in H2 2023 should help lift the AUD and other cyclical into year-end.

With the outlook unclear, particularly for the first half of 2023, within portfolios we are very mildly underweight the AUD, favouring developed market, foreign currency exposure — particularly the US dollar. Given its status as a premier risk currency, this underweight to the AUD should provide some downside protection to portfolios in risk-off scenarios.

FIGURE 25: DXY HAS FALLEN FROM ITS RECORD HIGH



Past performance is not indicative of future returns.

Source: Bloomberg, ANZ PB&A CIO as at January 2023

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