

I asked, what should we expect in 2023?

2023 is almost upon us and I asked our CIO James Penny, for his brief thoughts on what we can expect from markets next year.

It's no secret that many portfolio managers in Q4 2022 have been kicking back their 2023 outlooks for as long as they can.

Some seasoned advisers might chalk this up to investment procrastination of which the industry is famous for but alas, in this instance, I think it's more to do with the velocity of change in headlines and the markets' sequential and often volatile reaction to that change in news. Indeed, the narrative around the markets for 2023 has already altered from when I started writing this note to our clients to now.

Markets have been horribly volatile this year, especially in the bond market which has been truly unprecedented in the scale of its losses. This year will go down as one of, if not the worst, year for clients invested into "protected" portfolios of government and high-quality corporate bonds. Sadly, the 2022 losses in bonds are arguably a simple reversal of the massive gains these clients saw from the huge rally in

government bonds since 2008. Alas that is no comfort for many clients facing a difficult retirement picture because of this year and to them I would say, this market will come back.

Looking back at equities, much like the bond market, this year has been a story of what goes up comes down and often with a bump. Indeed, it was the first quarter which saw markets suddenly lurch from what started out as a positive year to suddenly running for the hills when central banks finally let the cat out of the bag that inflation was a serious problem which they were going to have to control aggressively. Diversification as a portfolio strategy was still not too much of a concern for many portfolios in Q1 and many managers seemingly still owned huge piles of growth stocks walking into that early 2022 bear market.

The apparent intransigence to begin selling these stocks in Q1 was mainly a mixture of past performance hubris and an unwillingness from investors to accept that the landscape had turned against a growth trade which had delivered so much, for so many, for so long, and with little need to own anything else. Hence the lack of alternative diversification walking into 2022.

It's no surprise then that almost all my client meetings this year have focused on "alternative" investments and TAM's focus on "diversification" investments. We have always maintained that "diversification isn't just for bear markets, it deserves to be held across all market cycles and held through thick and thin". Why? Because trying to diversify one's portfolio in the middle of a bear market can be a thankless task because the horse has, on average, already bolted. More importantly, owning a portfolio with lower volatility through diversification helps deliver clients a smooth and stable set of results.

Of course, in a boiling hot equity rally a low vol diversified strategy will lag those going "all in" and so it should. However, on average, most clients are not looking to shoot the lights out with a strategy swinging from one big call to the next. Predominantly they want a steady reliable investment portfolio to get them to their end goal of financial stability, without being up in the stratosphere one minute then deep in the red the next. Sadly, it can take a full bear market like this to be an uncomfortable reminder that high risk, high concentration portfolios go down as well as up!

So back to the task at hand, 2023 and what we think it holds for markets.

Medicine first; corporate earnings are still too optimistic in our minds. We are anticipating Q4 company earnings to begin to show a more negative set of corporate growth numbers and forecasting earnings for 2023 to be lower from here. This scenario usually spells more negativity for markets in the short term so not quite time to call an end to volatility just yet.

Another risk is the potential for inflation to remain stickier than many think, resulting in central bankers having to keep interest rates higher for longer. Predominantly the longer they stay high the higher the chance of an economic contraction. We see global GDP contractions continuing in the UK and Europe, and potentially in the US over most of 2023, and this appears to be the consensus of the market right now.

Don't discount the potential for the US market to actually remain strong over Q4 and surprise markets

with a very good set of corporate earnings numbers. This, combined with lower inflation, will likely cause the market to remain positive, which is certainly a good thing in the short term.

Longer term this picture clouds as fears that high inflation will need to be controlled, and if the economy is strong then that's only more impetus for central banks to keep raising rates until they break inflation, and history tells us this is where recessions occur.

As we move into Q4 2023, we expect to see stock markets, despite recession probabilities, to begin to price in an inevitable economic recovery. This is less of a hope and more of a reliable and sequential response from markets historically which usually prices forward of the current economic condition by six to nine months.

This could be a very exciting time as investors start to "buy the dip" ahead of what could be a strong bull market in which clients can expect to return back to an environment where gains are seen each year, as opposed to losses… hurrah!

TAM's investment team is spending considerable time evaluating areas of the market which have been heavily sold and are now at prices well below their fair value. Some of these are the likes of emerging market stocks, including China, which have suffered this year at the hands of their zero COVID policy. We also see the potential for UK small and mid-cap stocks to shine, as prices for quality companies are at generational lows. TAM's expertise in the UK sector has positioned us very well to identify the opportunities in the UK, as well as the funds to invest into to capture the full rally back in this market.

Finally, as a result of the terrible war in Ukraine, we see a huge level of potential coming from European value stocks which are, like UK mid-caps, now at generational lows in some areas. ESG sectors are setting themselves up for a strong rally. Specifically, in areas linked to sovereign energy independence and particularly green energy independence. There's nothing like having your nation's fuel held to ransom by Russia to make you realise things have to change. This positivity should manifest itself in the green energy transition and green energy infrastructure sectors, to name two. Again, TAM's decade of running ESG portfolios has put us in a fantastic position to be able to isolate the best funds in these areas to put into client portfolios ahead of that influx of attention.

So, all in all a negative start to the year as we continue to digest a developing recessionary narrative which we believe will progress into a positive latter stage of the year as the market begins to anticipate the green shoots of economic growth moving into 2024.

If you would like to speak with us about our approach to investing, model portfolios, or to discuss how our discretionary investment management services could benefit your clients, please get in touch today.

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