Outlook
Second Semester
2023

July 2023

SunPartners
Spirit of Independence

Executive Summary

- Markets will less focus on inflation, as peaks are left behind, but rather on growth as regional divergences start to emerge. We expect a period of sub-trend global growth. The US recession odds have fallen, Europe is in a technical recession and China reacceleration is policy dependent. While emerging markets are nearing the start of a new phase of monetary policy (expansion), the Federal Reserve is approaching the end of its tightening cycle, and the Eurozone still has a few more hikes ahead.

- 2023: Investors need to remain cautious, selective, and stick to quality and income as battered and bruised bonds are poised for a comeback. We favor bonds over stocks as volatility is expected to persist due to an impending slowdown. The impact of aggressive tightening is becoming visible in earnings growth, and the “positive” inflation effect on margins is anticipated to diminish. On the equity side, we recommend focusing on quality, income, and defensive options. In the fixed income space, we are overweight on the most protective segments and suggest adding duration as the end of the monetary policy cycle approaches.

- The main risks to our scenario are monetary policy missteps (overtightening or core inflation remains sticky and policymakers go beyond the expected pause), heightened geopolitical tensions (as we move towards “slowbalization” and a bipolar or multipolar world) and earnings estimates correction (to reflect the slowdown in economic activity).

Macro & Asset Class Overview

2023: Weakening growth, financial risks

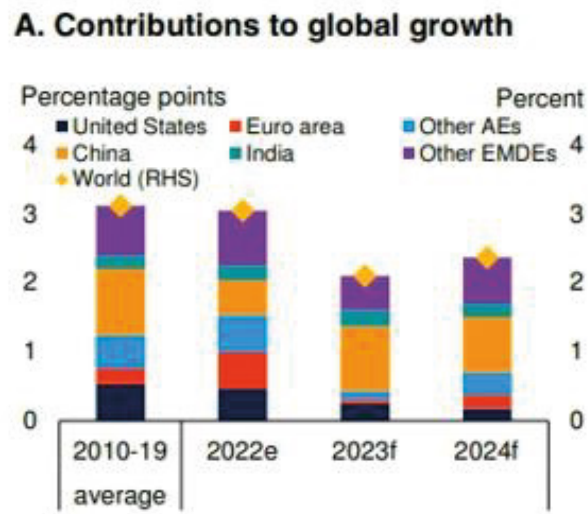
- **The global economy will experience a sub-trend growth period with divergences among regions.** The overlapping negative shocks of the pandemic, the war in Russia and Ukraine, and the sharp tightening of monetary policy to contain high inflation will affect growth. Global growth is projected to slow significantly in the second half of this year, with weakness continuing in 2024.

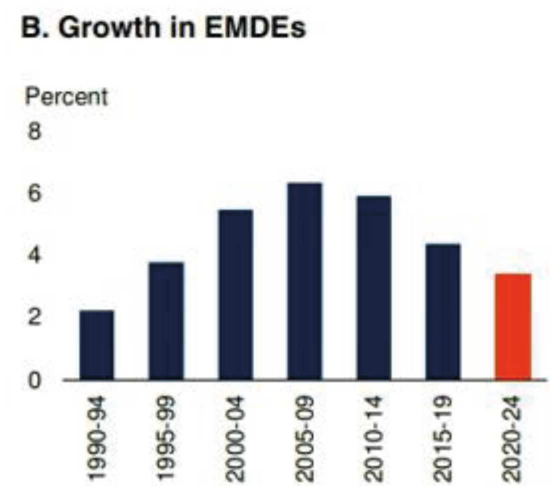
- **Inflation pressures persist, and tight monetary policy is expected to weigh substantially on activity**. Also, recent banking sector stress will put pressure on credit conditions and finally affect growth. Rising borrowing costs in advanced economies could lead to financial dislocations in the more vulnerable emerging market and developing economies (EMDEs).

- Global headline inflation has been decelerating as a result of base effects, abating supply chain pressures, and falling commodity prices, core inflation in many countries remains elevated, and inflation is above target in almost all inflation-targeting economies. Inflation is expected to continue to be above its pre-pandemic level beyond 2024. That said, inflation expectations in most inflation targeting countries have so far not undergone a major shift and appear to remain anchored.

- Global inflation is projected to gradually edge down as growth decelerates, labor demand in many economies softens, and commodity prices remain stable. The slow pace of improvement means that core inflation is expected to remain above central bank targets in many countries throughout 2024.

- **Downside risks to the outlook for all regions include possible further global financial stress and more persistent domestic inflation than projected in the baseline.**





2023: Weakening growth, financial risks

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- **In all, global growth is forecast to slow from 3.1 percent in 2022 to 2.1 percent in 2023, before edging up to 2.4 percent in 2024.** Relative to the January projections, this is 0.4 percentage point stronger in 2023 and 0.3 percentage point weaker in 2024. Greater-than-expected resilience of major economies at the end of 2022 and early in 2023 led to the overall upgrade to growth in 2023. However, the drag on activity from tighter monetary policy is increasingly apparent, particularly in more interest-rate-sensitive activities such as business and residential investment, including construction. Growth over the rest of 2023 is set to slow substantially as it is weighed down by the lagged and ongoing effects of monetary tightening, and more restrictive credit conditions. These factors are envisaged to continue to affect activity heading into next year, leaving global growth below previous projections

- **In EMDEs, aggregate growth is projected to edge up to 4 percent in 2023, almost entirely due to a rebound in China following the removal of strict pandemic-related mobility restrictions.** Excluding China, growth in EMDEs is set to slow substantially to 2.9 percent this year.

TABLE 1.1 Real GDP[1]

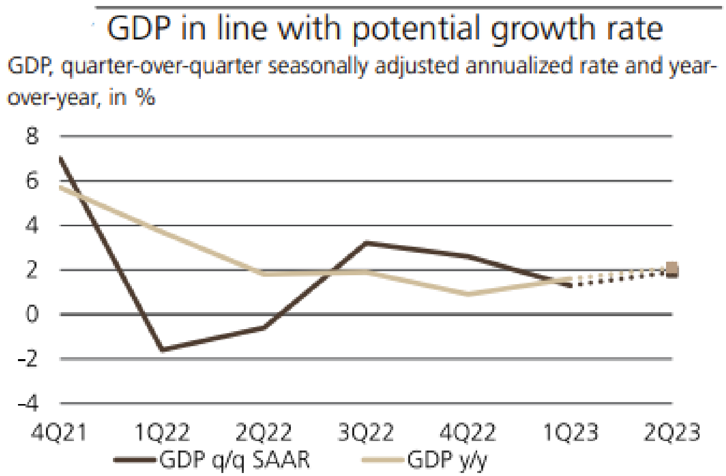
(Percent change from previous year unless indicated otherwise)

							Percentage point differences from January 2023 projections	
	2020	2021	2022e	2023f	2024f	2025f	2023f	2024f
World	**-3.1**	**6.0**	**3.1**	**2.1**	**2.4**	**3.0**	**0.4**	**-0.3**
Advanced economies	**-4.3**	**5.4**	**2.6**	**0.7**	**1.2**	**2.2**	**0.2**	**-0.4**
United States	-2.8	5.9	2.1	1.1	0.8	2.3	0.6	-0.8
Euro area	-6.1	5.4	3.5	0.4	1.3	2.3	0.4	-0.3
Japan	-4.3	2.2	1.0	0.8	0.7	0.6	-0.2	0.0
Emerging market and developing economies	**-1.5**	**6.9**	**3.7**	**4.0**	**3.9**	**4.0**	**0.6**	**-0.2**
East Asia and Pacific	1.2	7.5	3.5	5.5	4.6	4.5	1.2	-0.3
China	2.2	8.4	3.0	5.6	4.6	4.4	1.3	-0.4
Indonesia	-2.1	3.7	5.3	4.9	4.9	5.0	0.1	0.0
Thailand	-6.1	1.5	2.6	3.9	3.6	3.4	0.3	-0.1
Europe and Central Asia	-1.7	7.1	1.2	1.4	2.7	2.7	1.3	-0.1
Russian Federation	-2.7	5.6	-2.1	-0.2	1.2	0.8	3.1	-0.4
Türkiye	1.9	11.4	5.6	3.2	4.3	4.1	0.5	0.3
Poland	-2.0	6.9	5.1	0.7	2.6	3.2	0.0	0.4
Latin America and the Caribbean	-6.2	6.9	3.7	1.5	2.0	2.6	0.2	-0.4
Brazil	-3.3	5.0	2.9	1.2	1.4	2.4	0.4	-0.6
Mexico	-8.0	4.7	3.0	2.5	1.9	2.0	1.6	-0.4
Argentina	-9.9	10.4	5.2	-2.0	2.3	2.0	-4.0	0.3
Middle East and North Africa	-3.8	3.8	5.9	2.2	3.3	3.0	-1.3	0.6
Saudi Arabia	-4.3	3.9	8.7	2.2	3.3	2.5	-1.5	1.0
Iran, Islamic Rep.[2]	1.9	4.7	2.9	2.2	2.0	1.9	0.0	0.1
Egypt, Arab Rep.[2]	3.6	3.3	6.6	4.0	4.0	4.7	-0.5	-0.8
South Asia	-4.1	8.3	6.0	5.9	5.1	6.4	0.4	-0.7
India[2]	-5.8	9.1	7.2	6.3	6.4	6.5	-0.3	0.3
Pakistan[2]	-0.9	5.8	6.1	0.4	2.0	3.0	-1.6	-1.2
Bangladesh[2]	3.4	6.9	7.1	5.2	6.2	6.4	0.0	0.0
Sub-Saharan Africa	-2.0	4.4	3.7	3.2	3.9	4.0	-0.4	0.0
Nigeria	-1.8	3.6	3.3	2.8	3.0	3.1	-0.1	0.1
South Africa	-6.3	4.9	2.0	0.3	1.5	1.6	-1.1	-0.3
Angola	-5.6	1.1	3.5	2.6	3.3	3.1	-0.2	0.4

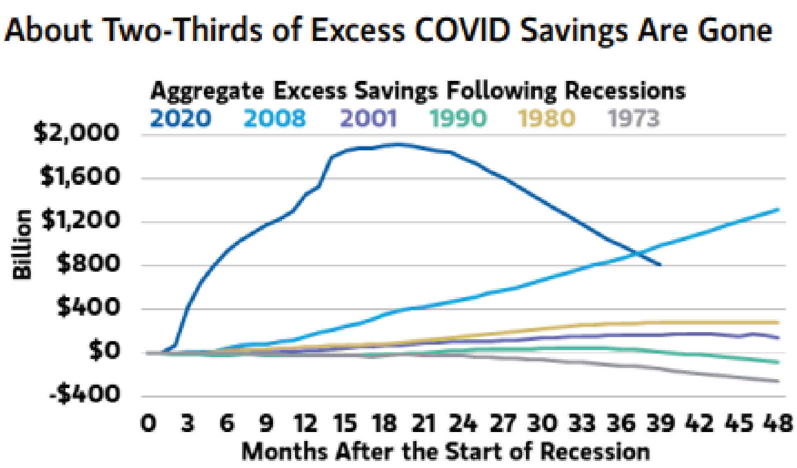
World Bank – Global Outlook June 2023

H1 in review: where is the US recession?

- **Resilient growth, persistent inflation and monetary tightening define H1.** Households have been spending down the excess savings they built up during the pandemic and a strong labor market (solid job growth and rising wages) is also giving support to consumers. **Unfortunately, robust demand from consumers is also contributing to inflation which remains above the 2% target even after 10 straight interest-rate increases.**
- **Recent data provides mixed signals.** The Atlanta Fed's leading economic index estimates for 2Q23 stands at 1.9%, which is in line with the economy's potential growth rate, as payroll gains remain strong, surveys suggest that hiring intentions remain solid, and the unemployment rate remains at historically low level. Striking is the relative resilience of the housing sector, despite housing affordability measures at record lows on the back of a sharp rise in mortgage rates. On the other hand, the conference board leading indicator has declined for the last fourteen months and continues to point to weaker economic activity ahead. The Manufacturing PMI has been below 50 since November -levels that correspond with near-zero growth. The slope of the yield curve has been inverted for ten months and is the most inverted since the 1980s. A Fed survey shows that the demand for credit is as low as it usually is during a recession, and credit standards are as tight as they usually are during a recession.
- The economy is expected to slow as household's savings are below long-term average, companies face tighter lending conditions, and the lag effect of monetary policy works its way through. A period of below trend economic growth and a softer labor market will likely be required to get inflation back down to target as core measures hover around 0.4% m/m since December. The Fed latest forecasts showed that 16 of the 18 policy committee members expect another interest-rate hike, and a majority expect two more this year. Powell said the Fed will decide "meeting by meeting," based on incoming data and implications for economic activity, inflation, and risks.



Source: Bloomberg, Atlanta Fed, UBS, as of 20 June 2023



Source: Pantheon Macro as of April 30, 2023

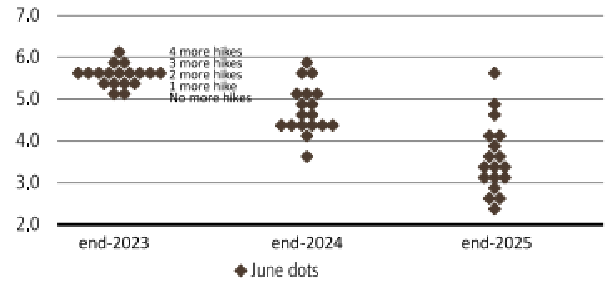
UBS, Morgan Stanley, Julius Baer

H1 in review: where is the US recession?

- **Future Fed policy is key for both the risk of a recession in the next months and its duration. Commercial real estate is another risk to the economic outlook** as the segment is challenged by rising vacancy rates and a wave of debt maturing this year, which will be refinanced at higher rates and tighter credit standards.
- On the fiscal side, a deal was reached to raise the debt ceiling, avoiding a possible default. However, House Republicans are so far refusing to pass a 2024 fiscal budget in line with that deal, so there is still a risk of a government shutdown in the fall. Hence, uncertainty remains not only on the future path of monetary policy but also on the fiscal side.

Fed likely to hike further

Dots from FOMC Summary of Economic Projections, in %



Source: Federal Reserve, UBS, as of 20 June 2023

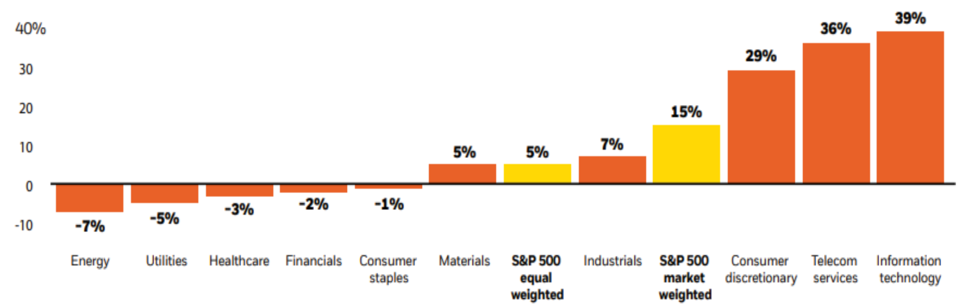
UBS, Morgan Stanley, Julius Baer

H1 in review: stocks defied expectations

- **After a year to be forgotten, equity and fixed income markets staged a comeback in early 2023 despite geopolitical headwinds, a banking crisis and further central bank tightening.**
- **While consensus was expecting a weak first semester in equities followed by a recovery in the second, the playbook turned out otherwise.** Equity markets rallied at the beginning of 2023, driven by beaten-down cyclicals stocks, as recession fears waned. Late last year the leaders were energy, materials, financials, and industrials, while information technology was the big laggard. Today, the technology and consumer sectors are the leaders. **The strong performance of selected large-cap information technology and communications stocks (on the emergence of artificial intelligence as a major investment theme) explains the year-to-date performance of US stocks, as the top ten names account for more than 36% of total value.** The concentration has resulted in divergence between the benchmark and the equal-weighted index (a proxy for the average stock) of a near-record 1,000 bps. The top 10 names are trading at a price/forward earnings ratio nearly twice that of the median large-cap stock and three times that of small-cap. With the exception of the pandemic, the gap between the valuations of the top 10 and the rest is at its widest level since 2000. Added to this, financial conditions are still loose as governments and central banks acted quickly to avoid spillover effects of the banking crisis by providing liquidity and guaranteeing deposits. The VIX index of volatility is at the lowest level since January 2020. Even as stocks rallied over the last quarter, positioning is not stretched, sentiment remains cautious, and earnings growth is in the upper single digits. Evidence of cautious sentiment is fund flows. Data from Morningstar shows USD 37 bn has exited U.S. equity funds this year while bonds have gathered USD 108 bn in assets, even as volatility in fixed income reached 2008 levels. An astounding USD 404 bn flowed into money market funds.

A tale of two markets

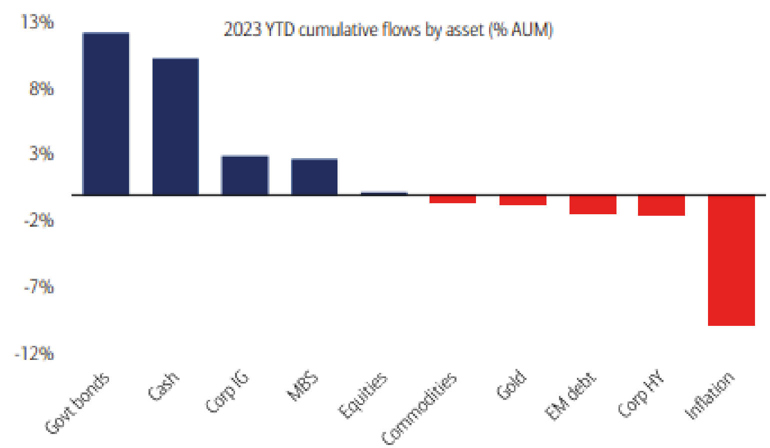
S&P 500 Index performance by sector, year-to-date 2023



Source: BlackRock Investment Institute, with data from Refinitiv, June 14, 2023. Chart shows the year-to-date return of the S&P 500 Index both market weighted and equal weighted (in which each of the index's 500 stocks is proportioned at equal measure) and each sector in the index. **Past performance is not indicative of current or future results. Indexes are unmanaged. It is not possible to invest directly in an index.**

Chart 10: Flow winners & losers YTD

2023 YTD cumulative flows by asset (% AUM)



Source: BofA Global Investment Strategy, EPFR

BofA GLOBAL RESEARCH

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H1 in review: stocks defied expectations

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- Japanese stocks have enjoyed a strong run relative to other regions this year. In addition to the post-pandemic recovery and a cheap currency, corporate reform is in the spotlight. Reopening optimism run out of steam in China and has been the worst performer. It will probably take a more accommodative policy to get on track. Despite the Eurozone economy being technically in recession and the ECB indicating that there is no pause in sight, Eurozone equities performed exceptionally well, ranking among the top 5 performers.
- **After a decade of low-to-negative interest rates, the current bond universe offers more opportunities. The dynamics in interest rates, yields, and credit spreads have resembled a roller-coaster ride so far this year, given the massive repricing of rate-hike expectations and the ongoing banking turmoil**. While the first quarter ended with fears that stresses in U.S. regional banks would escalate into a full-blown crisis and increased odds of a second half recession, the second quarter saw resilient growth and hawkish commitment of the Fed to a higher terminal rate. The macro environment expected for H2 – sub trend growth or mild recession, inflation past its peak, and maturing rate hike cycles – should be a constructive backdrop for fixed income markets. USD-denominated high-yield bonds have benefited from resilient economic activity so far this year. However, their outperformance is in doubt as pressure from tightening credit conditions is likely to lead to rising default rates.
- **After a breakout 2022, commodities markets are reverting**. Rising recession risks and expectations of a reversal of monetary policy pushed gold prices towards record highs during the first few months, making it the only commodity with a positive performance in the first half of the year.

	2019	2020	2021	2022	YTD
Switzerland	29.98%	1.07%	19.51%	-17.50%	4.55%
Eurozone	26.05%	-3.32%	21.54%	-9.94%	7.47%
USA	30.88%	19.70%	25.75%	-20.31%	10.05%
Japan	18.48%	10.23%	12.93%	-6.45%	16.27%
UK	16.37%	-13.93%	15.13%	5.33%	-0.08%
China	24.34%	29.49%	-19.30%	-21.43%	-9.07%
Emerging markets ex. China	16.23%	12.55%	7.87%	-19.65%	5.95%

Developed markets	2019	2020	2021	2022	YTD
US government bonds	6.86%	8.00%	-2.32%	-11.65%	2.01%
US TIPS	8.43%	10.99%	5.96%	-11.38%	2.14%
USD IG corporates	14.54%	9.89%	-1.04%	-15.76%	2.43%
USD high yield	14.32%	7.11%	5.28%	-11.19%	3.12%
USD floating-rate notes	4.28%	1.38%	0.52%	1.33%	2.68%

Emerging markets	2019	2020	2021	2022	YTD
EM hard currency	12.13%	7.02%	-2.48%	-16.24%	1.68%
EM local currency	9.47%	5.29%	-2.53%	-8.23%	1.26%

	2019	2020	2021	2022	YTD
Brent crude oil	22.68%	-21.52%	43.61%	10.45%	-15.42%
US natural gas	-25.54%	15.99%	49.43%	19.97%	-49.36%
Gold	18.87%	24.42%	-5.74%	-0.13%	7.54%
Silver	15.32%	47.38%	-15.61%	2.95%	-1.88%
Platinum	22.05%	10.71%	-14.02%	11.33%	-6.96%
Aluminium	-1.84%	10.61%	34.93%	-16.18%	-4.55%
Copper	3.32%	25.97%	25.65%	-14.10%	-3.50%
Iron ore	28.70%	70.26%	-27.81%	-1.08%	-5.58%

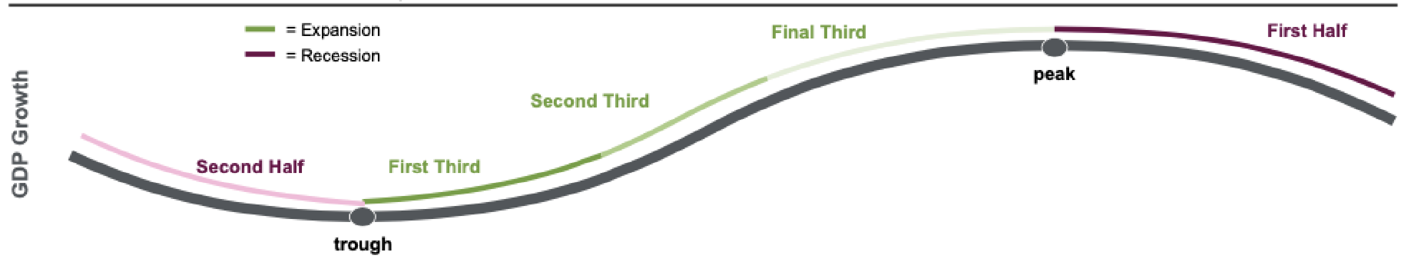
UBS, Morgan Stanley, Julius Baer

How to invest in an economic slowdown?

- During economic slowdowns and also during recessions, bonds tends to provide a stable source of returns. Also in this period with high rates, having and overweight in core fixed income makes sense. In case of a mild recession, high quality bonds will probably outperform equities, commodities and high yield bonds.

Asset returns vary widely across the business cycle
Bonds tend to outperform in the first half of recessions

Excess returns across the business cycle



Recession Second Half	Expansion First Third	Expansion Second Third	Expansion Final Third	Recession First Half
Equities +22.3%	Equities +12.9%	Equities +11.1%	Commodities +7.7%	Bonds +4.7%
High Yield +11.9%	High Yield +8.8%	Commodities +5.7%	Equities +3.2%	Commodities -4.3% Lorem ipsum
Bonds +10.2%	Commodities 5.1%	High Yield +4.2%	High Yield -0.5%	Equities -26.0%
Commodities -15.0%	Bonds 2.9%	Bonds +1.6%	Bonds -1.7%	High Yield -28.1%

As of 31 March 2023. SOURCE: PIMCO, FRED, Bloomberg, NBER US Business Cycles.
Calculations for excess returns over the cash rate for equities (represented by S&P 500 Index) and bonds (represented by FRED US 7-10 Year Treasury series) based on monthly data from May 1953. Calculations for Commodities (represented by Composite Commodity Index of widely followed indices) and HY (represented by Bloomberg U.S. Corporate High Yield Index) are based on monthly data from July 1959 and August 1988, respectively. Equity, bonds and commodities are in excess of the risk free rate (represented by 3-month Treasury Bill). HY is duration neutral, thus we do not subtract the risk free rate.
Estimates assume the current stage to be an expansion. Recessions and expansions are defined by NBER.
Refer to Appendix for additional index, investment strategy and risk information.

H1 market review

2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	YTD
Real Estate 28.65	USA Equity 32.37	Real Estate 15.89	Japan Equity 9.93	Latam Equity 31.04	Emerging Markets Equity 37.28	UST 0.86	USA Equity 31.47	Gold 25.12	USA Equity 28.68	Commodities 13.75	Europe Equity 21.48
Europe Equity 22.06	Japan Equity 30.55	USA Equity 13.67	USA Equity 1.37	High Yield Corp 17.13	Japan Equity 25.71	Gold -1.56	Europe Equity 26.84	Japan Equity 24.74	Real Estate 27.21	Latam Equity 8.92	Latam Equity 18.12
Emerging Markets Equity 18.22	Europe Equity 28.24	IG Corp 7.46	EM USD Corp + Sov 1.29	USA Equity 11.95	Europe Equity 25.44	High Yield Corp -2.08	Real Estate 23.06	USA Equity 18.39	Commodities 27.05	Gold -0.28	USA Equity 16.94
EM USD Corp + Sov 17.95	Balanced Allocation 14.97	UST 5.05	UST 0.84	Commodities 11.4	Latam Equity 23.74	EM USD Corp + Sov -2.46	Japan Equity 22.41	Emerging Markets Equity 18.31	Europe Equity 15.58	Alternatives -4.41	Japan Equity 16.78
USA Equity 15.99	High Yield Corp 7.44	EM USD Corp + Sov 4.76	Real Estate 0.05	Emerging Markets Equity 11.19	USA Equity 21.82	IG Corp -2.51	Balanced Allocation 19.34	Balanced Allocation 13.22	Balanced Allocation 11.21	High Yield Corp -11.19	Balanced Allocation 8.78
High Yield Corp 15.81	Alternatives 6.72	Balanced Allocation 3.2	IG Corp -0.68	EM USD Corp + Sov 9.88	Balanced Allocation 16.4	USA Equity -4.39	Emerging Markets Equity 18.42	IG Corp 9.89	High Yield Corp 5.28	UST -12.46	Gold 5.23
Japan Equity 12.37	Real Estate 4.39	High Yield Corp 2.45	Balanced Allocation -1.78	Gold 8.14	Gold 13.53	Real Estate -4.74	Gold 18.31	UST 8	Alternatives 3.65	Europe Equity -13.97	High Yield Corp 5.02
Balanced Allocation 11.22	IG Corp -1.53	Alternatives -0.58	Europe Equity -3.6	IG Corp 6.11	Real Estate 11.42	Balanced Allocation -5.71	Latam Equity 17.46	High Yield Corp 7.11	IG Corp -1.04	EM USD Corp + Sov -15.26	Emerging Markets Equity 4.57
IG Corp 9.82	Emerging Markets Equity -2.6	Gold -1.44	Alternatives -3.64	Japan Equity 5.87	EM USD Corp + Sov 8.17	Latam Equity -6.57	IG Corp 14.54	Alternatives 6.81	EM USD Corp + Sov -1.65	IG Corp -15.76	EM USD Corp + Sov 3.07
Latam Equity 8.66	UST -2.75	Emerging Markets Equity -2.19	High Yield Corp -4.47	Balanced Allocation 5.34	High Yield Corp 7.5	Alternatives -6.72	High Yield Corp 14.32	EM USD Corp + Sov 6.52	UST -2.32	Balanced Allocation -17.38	IG Corp 2.67
Gold 7.06	EM USD Corp + Sov -4.12	Japan Equity -4.16	Gold -10.41	Real Estate 4.99	IG Corp 6.42	Japan Equity -8.54	EM USD Corp + Sov 13.11	Europe Equity 6.05	Emerging Markets Equity -2.54	USA Equity -18.13	UST 1.33
Alternatives 3.51	Commodities -9.58	Europe Equity -7.86	Emerging Markets Equity -14.92	Alternatives 2.5	Alternatives 5.99	Commodities -12.99	Alternatives 8.62	Commodities -3.5	Gold -3.64	Japan Equity -18.54	Real Estate 0.96
UST 1.99	Latam Equity -13.36	Latam Equity -12.3	Commodities -24.7	Europe Equity 1.76	UST 2.31	Emerging Markets Equity -14.57	UST 6.86	Real Estate -8.18	Japan Equity -4.39	Emerging Markets Equity -20.09	Alternatives 0.47
Commodities -1.14	Gold -28.28	Commodities -17.04	Latam Equity -31.04	UST 1.04	Commodities 0.75	Europe Equity -15.45	Commodities 5.44	Latam Equity -13.8	Latam Equity -8.1	Real Estate -24.41	Commodities -10.04

Bloomberg as of 30.06.2023

Outlook Summary: main providers

Outlook summary: main providers

	Fixed Income										Equities				Alternatives		
	Government			Investment Grade			High Yield										
	US	EU	Focus	US	EU	Focus	US	EU	EM	Focus	US	EU	EM	Focus	HF	CO	Focus
JPM Asset Mgmt	▲	▬	10-year UST on weakness	▲		Short duration	▬		▼	Favour EMD Local Ccy	▬	▬	▬	Favor selectively adding more risk-on positions. OW UK & Japan	-	-	
BlackRock	▼	▬	OW US short duration, US TIPS	▬	▬	OW US MBS	▼	▼	▲	Favour EMD Local Ccy	▼	▼	▲	Neutral Asia. OW China	-	-	OW private credit & infrastructure equity
Julius Baer	▬	▬		▲	▲		▼	▼	▲	EM HC with quality bias	▲	▬	▬	Quality growth (IT & comm)	-	▬	Bullish copper
Wells Fargo	▲	▬	Barebell Strategy: with long and short term	▬	▬	A over BBB. Banks, HC, oil & gas.	▼	▼	▬	Favour BB	▼	▬	▼	Quality with preference for US Large Cap. HC and Energy	▬	▲	Precious Metals and broad commodity
Pimco	▲	▬	Neutral duration	▲	▬	High quality and MBS	▬	▬	▬	Prefer quality issuers	▬	▼	▲		▲	▬	Commodities as diversifier and Nonbank lending

Executive Summary: Overall slight changes have been made since the start of the year despite the unexpected performance of the equity markets. Some UW HY has turned neutral on the back of attractive yields but with focus on securitized bonds. Other change has been the OW of EM equities to neutral due to disappointing Chinese economic data despite reopening. In average neutral views on the equity side remain and the overweight it towards the most protective segments of fixed income.

- **Fixed Income**: Most are overweight fixed income, favoring investment grade, MBS and being neutral duration (vs benchmark). The high yield segment is least favored as spreads widen due to recession.
- **Equity**: Consensus is towards quality, defensive and income segments as the earnings growth forecast correction is still in place.

Our Main Scenario

Our main scenario

Central scenario: a soft and shallow downturn?

Markets will less focus on inflation but rather on growth. At a global level, growth and policy differences are beginning to emerge. The U.S. is perhaps more resilient than expected, Europe has navigated a mild technical recession with little effect on asset markets, and Chinese growth has roundly disappointed.

We expect a period of sub-trend global growth, with some regions falling into recession. In the US recession odds have fallen. The economy faces slightly sub trend growth, but with risks in both directions. Aggressive interest rate hikes and tighter financial conditions keep fears of a contraction alive. A slight recovery in real incomes and resilient corporate and household balance sheets may extend the cycle. The Eurozone is already in a technical recession given the combined impact of the energy crisis, inflation, and interest rates hikes. Emerging markets avoid a recession. The resilience in emerging market growth is leading to a wide growth gap vs. developed markets.

Inflation is trending lower, but the speed of adjustment is slow as core inflation remains sticky and stubborn. Inflation stickiness will also impact how long the central banks send a hawkish message and determine their action going forward. Despite maturing rate hike cycles, rate cuts by year end are not longer a possibility.

Impact to our allocation

As the focus shifts from interest rates to the timing of recession or slowdown, volatility could return to equity markets, particularly as earnings expectations appear out of kilter given the shifting macroeconomic visibility. Investors need to remain cautious, selective and fix to quality.

Cash & equivalents: Cash is providing a positive yield again, and this reserve shall serve as “dry powder” for future investments, coming along with a potential reserve of performance. A larger cash allocation enables greater flexibility by limiting duration, credit, and liquidity risk.

- Fixed income: The macro environment expected for H2 should be a constructive backdrop for fixed income markets. We keep favoring quality over yield as a decelerating economic backdrop might cause default rates from high yield issuers revert to mean from minimum and credit spreads widening. As we approach the end of the hiking cycle, we suggest increasing duration similar to benchmark.
- Equities: As the focus shifts from interest rates to the timing of recession or slowdown, volatility could return to equity markets, particularly as earnings expectations appear out of kilter given the shifting macroeconomic visibility. We suggest focusing on quality, income and defensive bias.
- Diversification: Diversification provide a more defensive stance to portfolios as investors will likely contend with further macro uncertainty in the second half. Therefore, we will keep on adding alternative investments and protection tactically to provide portfolios with volatility cushion to absorb short term shocks.

Main risks to our scenario

Monetary policy missteps

Most of central banks have tighten monetary conditions in the last year to fight persistent inflationary pressures. Nevertheless, finding the right equilibrium between bringing down inflation to its target and achieving a "soft landing" is not an easy task. The question is whether central banks may have already overtightened or if inflation remains sticky and policymakers have to continue the hiking cycle.

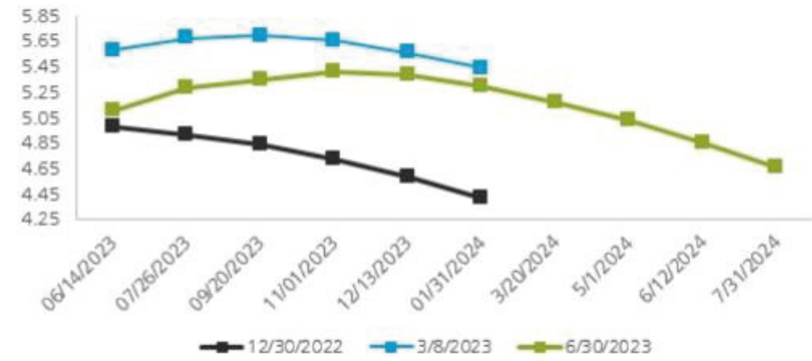
For the US, the greatest support for a soft landing looked to be coming from the resilient household balance sheet. Unemployment is very low, wages are going up, and consumers are able to keep spending. But would this be sustainable? For the Fed to bring core inflation down to 2%-2.5% (which is expected for 2025), wage growth needs to come down, which means unemployment has to go up, which means a (mild) recession is necessary.

Heightened geopolitical tensions

We are living in a fragmented world where geopolitical issues have triggered even more shocks and pitfalls than in recent years. While last year the focus was the conflict between Russia and Ukraine, this year the main highlight is escalation of tensions around the rivalry between the US and China. Tensions between the U.S. and China over access to powerful technology have been rising for months, as US is concerned about Chinese use of artificial intelligence.
Changing geopolitics prompt US manufacturers to diversify away from China, many are looking anew at Mexico.

Fig. 1: Easing priced into the curve at the start of the year has now been pushed out to 2H24

In %



Source: Bloomberg, UBS, as of 30 June 2023

Chart 4: Reshoring

US construction spending on manufacturing ($bn)

Source: BofA Global Investment Strategy, Bloomberg

BofA GLOBAL RESEARCH

Main risks to our scenario

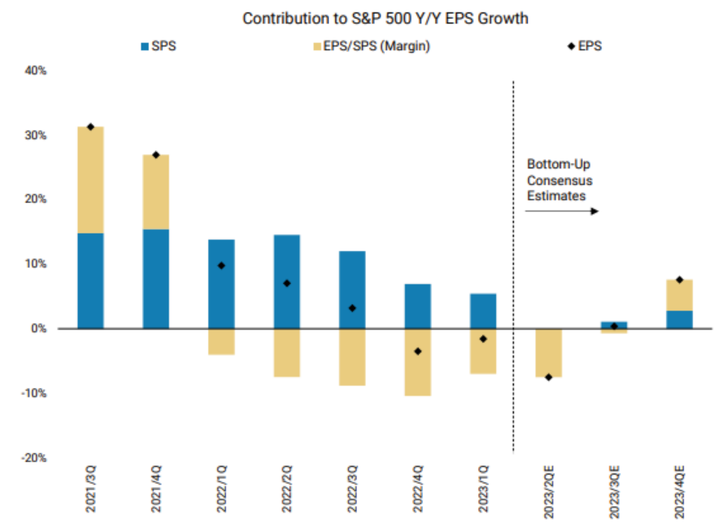
<u>Downward earnings revision</u>

Multiples have expanded due to improving liquidity and excitement around AI´s potential impact on productivity and earnings growth. However, is probable that liquidity will start to fade with tighter financial conditions and a restrictive monetary policy . According to Morgan Stanley Research, while 2Q results are unlikely to solidify the bull or bear earnings case for 2H, stocks will need more confirmation of the turn in growth than they have over the past six months given higher valuations and deteriorating liquidity.

Morgan Stanley doesn't expect 2Q earning to disappoint expectations in aggregate given how much 2Q estimates have now been revised lower (-7.5% YTD with half of that coming since 1Q earnings season) but believes the deteriorating trend will continue until the end of the year.

On that front, 3Q is where their forecast really starts to diverge from the consensus so **the key for stocks will come via company guidance for the out quarter rather than the 2Q results themselves.** On this score, they expect some companies will begin to walk down the estimates while others will continue to tell a more optimistic story.

Exhibit 2: Consensus Now Expects 2Q to be the Trough EPS Growth Quarter (Pushed Out from 1Q)



Morgan Stanley, July 2023

Main Asset Classes

SunPartners

Asset Class	UNDERWEIGHT		NEUTRAL	OVERWEIGHT		RATIONAL
Cash				●		Cash is king: absorbs volatility, positive yield and dry powder
Fixed Income				●		Favour Investment Grade bonds as default rate and credit spread will probably increase. In HY we prefer high quality issuers and short duration
Equities		●				Equites have increased a lot and we prefer to be slightly underweight with a diversified position
Commodities			●			We remain neutral in Commodities as a hedge to geopolitical issues and to increase diversification in portfolio
Alternatives			●			Overall liquid alternative investments should keep on helping portfolios specially during volatility spikes, but we are cautious with illiquid strategies

Current	Previous
●	

Sub Asset Classes – Fixed Income

SunPartners

Sub Asset Class	UNDERWEIGHT		NEUTRAL	OVERWEIGHT		RATIONAL
US Government bonds				■ ●		Yields in US treasuries are really attactive and as we expect low growth or a mild recession we prefer quality. Good way to increase duration in a portfolio
US Credit				■ ●		IG becomes a priority in portfolios to provide stable returns and income
US High Yield		■ ●				Expecting default rates to rise and credit spreads to increase, be selective. We prefer BB, short duration and senior secured bonds
EUR Government bonds		■ ●				Europe is earlier in the cycle, with persistent inflation pressures and we expect more interes rate hikes
EUR Credit			■ ●			While yields are more attractive today, be selective in credit
EUR High Yield		■ ●				Expecting default rates to rise, be selective. There are opportunities in specific sectors
EM Bonds		■	●			Emerging markets offer an interest spread in comparisson with advanced economies. There are opportunities in both local and hard currency
Perpetuals / Convert			●	■		Perpetuals could provide an extra cashflow, be selective in the quality of the issuer and resset terms
Alternative bonds			●	■		Still providing diversification within a traditional fixed income allocation

Current	Previous
●	■

Sub Asset Classes – Equity and Alternatives

SunPartners

Sub Asset Class	UNDERWEIGHT		NEUTRAL	OVERWEIGHT		RATIONAL
US Equity		●				We remain slightly underweight on equities and expect further volatility
EUR Equity		●				Europe remains exposed to the Ukraine war and commodity shocks. Inflation is persistent and macro data is deteriorating
EM Equity			●			Valuations are more attractive than other regions and there are opportunities
Alternative Equity			●			Help to manage Beta of portfolio and provide diversification and partially absorb volatility
Commodities			●			Reopening of China will be one of the main drivers of returns. It work as a hedge to geopolitical tensions and provide diversification
Alternative			●			We favour liquid strategies and is important to focus on the underlying liquidity
PE / Real Estate		●				High rates do not contribute to leverage in Private Equity and Real Estate markets. There will probably be a good entry point in next half.

Current	Previous
●	

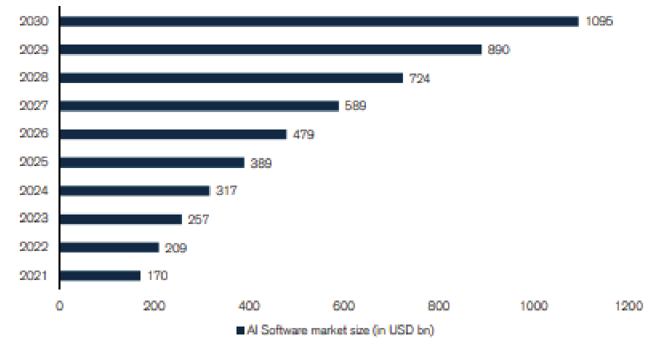
Investment ideas

Artificial intelligence in the spotlight

SunPartners

- Artificial intelligence (AI) has been THE word of the first half of the year as the recent hype around ChatGPT, a programme that optimizes language models for dialogue, has further fueled the debate about the impact of AI on the economy. **AI** is a general-purpose technology that is being applied in many areas, from healthcare to finance, advertising, to name a few. It **is not only creating innovations that are generating new markets but is also helping various industries to reduce their cost base as digital innovation can lead to higher productivity.** McKinsey had estimated that about 60%-70% of worker hours worldwide were spent on tasks that could be automated. Hence, AI implementation may add between 0.1% and 0.6% in annual labor productivity growth for 20 years, depending on how the technology is adopted and implemented. About 75% of the potential value from applied generative AI will come in four business functions: customer operations, marketing and sales, software engineering, and research and development.
- According to research done by PricewaterhouseCoopers, **AI could contribute USD 15.7 trillion to the global economy, adding over 1% per year in global GDP growth by 2030**. Morgan Stanley conducted an informal poll, asking 40 CIOs and PMs for their view and positioning on the major themes of the moment, including AI. Nearly 50% of respondents thought "AI will change everything", with roughly another 30% saying they expect "wholesale change but are yet to understand its full potential".
- According to industry research (Precedence Research), the AI software market is expected to grow at a compound annual growth rate (CAGR) 2021 – 30E of 23%, starting with an expected size of USD 170 bn in 2023 and reaching USD 1.09 trn in 2030. Software companies with proprietary data, data-centre hardware, the semiconductor value chain, and cloud infrastructure providers are seen as the best places to benefit.

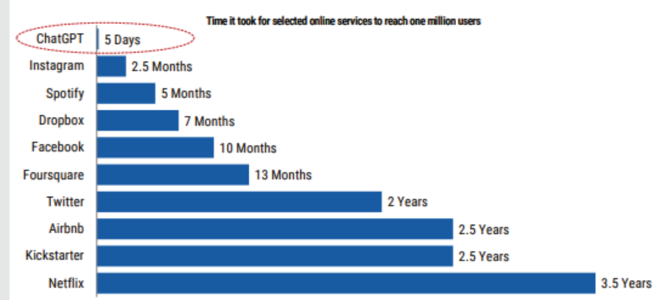
AI software market size – 2021 to 2030



Source: Precedence Research (report from Dec 2022), Credit Suisse

ChatGPT reached 1 million users in just five days and 100 million two months after launch: An average of about 13 million unique visitors used ChatGPT per day in January, more than double the levels of December. TikTok took about nine months after its global launch to reach 100 million users and Instagram 2½ years.

Exhibit 1: ChatGPT – the fastest growing user base of all time



Source: Company data, Statista, Morgan Stanley Research

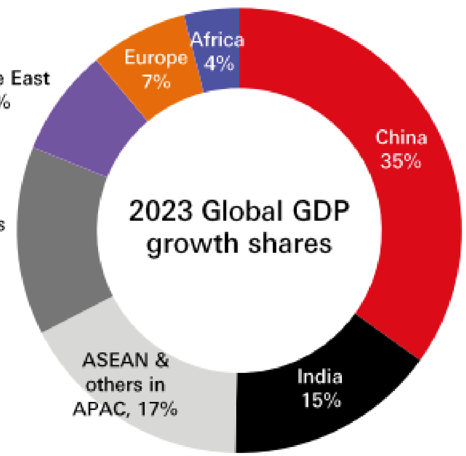
Emerging markets: waiting for a sign

- **The resilience in emerging market growth is leading to a wide growth gap vs. developed markets. Around 70% of global growth is expected to come from Asia this year.**

- Attractive valuations, an end to Fed tightening and a weaker USD bode well for emerging markets assets. China's post-Covid recovery was expected to provide support for the broad emerging market region, although after a very strong first quarter, economic data has more recently underwhelmed investor expectations.

- Emerging market stocks already trade at close to a 30% discount to developed markets on a 12-month forward earnings basis, and many currencies screen as cheap relative to the US dollar. Added to this, several emerging market central banks had frontloaded their hiking cycles in 2021 and disinflationary trends this year is now opening the potential for the start of cutting cycles. Meanwhile, forward earnings prospects for emerging markets equities should continue to improve and drive positive performance and rerating over twelve months. EM bonds offer higher starting yields and appealing valuations. UBS expects emerging markets sovereign debt in USD may deliver a 6.2% annual return with 9.5% annual volatility over the next 15 years (with an average rating between BBB- and BB+ vs B+ of US high yield). Also foresee emerging markets equities delivering annual returns of 9.3% (with volatility of 19.3%) over the next 15 years, the highest potential of their equity universe.

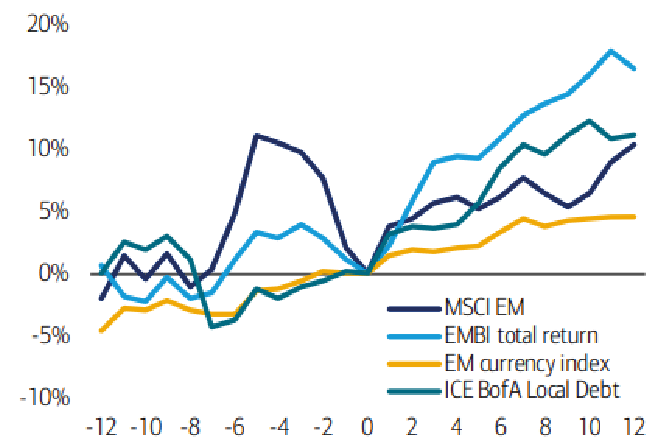
Figure 3: Nearly 70% of 2023 global growth will come from Asia and the Pacific



Source: HSBC AM, IMF, June 2023.

EM asset classes – total average returns around last Fed hike

Return in the 12 months after the last hike are pretty consistently positive



Note: last 5 hiking cycles since 1995 as available. **Source:** Bloomberg, BofA Global Research

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Spirit of Independence

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