Vontobel

Investors' Outlook

Do you think of a winter of discontent? Or of taking on challenges?

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Do you think of a winter of discontent? Or of taking on challenges?

Dear readers,

Looking back on 2022 and also previous years, there's no doubt we've been confronted with momentous change, from the pandemic and its overcoming to worries about war, inflation, the climate, and energy security.

Not long ago, the US Federal Reserve unleashed the steepest hiking cycle in decades, and we witnessed the highest inflation since the 1970s. "Deglobalization" suddenly became a buzzword, as did "energy crisis". More bad news came in the form of Russia's invasion of Ukraine, the unravelling of cryptocurrency markets, and China's commitment to a very strict zero-Covid policy and lockdowns.

Meanwhile, on the sunnier side of things, investors can look back on historically low unemployment rates and a resilient global consumer that was spending like there's no tomorrow—keeping corporate profits near record highs. It's also worth noting that some countries, such as Mexico and Indonesia, benefited from the post-pandemic phenomenon of nearshoring, i.e. bringing production capacity closer to western consumers, or moving it away from the dominant Chinese workbench. Moreover, commodity-exporting giants like Brazil reaped the benefits of strong supply disruptions in global agriculture as well as base metals.

Still, 2022 wasn't the plain sailing that markets and investors had grown accustomed to during decades of apparently unlimited money supply by central banks. Global synchronized growth and an artificial suppression of the cost of capital led to frothy asset prices. This period is now definitively over and 2022 is likely to go down in the financial market history books as one when we had to start paying the price for a decade of excess.

→ Webcast
To view our webcast on recent market developments, click **here**

—
Dan Scott
Head of Vontobel Multi Asset, Vontobel

Some fixed-income segments beckon
The sailing will hardly get smoother anytime soon, but as investors, we are tasked with constantly finetuning our asset allocation to balance risk and return. And from our current vantage point, we see a number of things worth considering. Take fixed income, for example. With yields on government bonds having risen to more than 4%, anyone looking for cheap "risk-free" assets may feel intrigued. Pricing and yields on emerging-market debt could seem similarly enticing.

Equities will be challenged as we go into a recession across most of the developed world. But there too are some nuggets waiting to be unearthed by discerning investors, we believe.

The almost unheard-of close correlation between the two asset classes—they both fell in unison in 2022—should unwind, we believe. This means multi-asset investors stand to bounce back from what's been an unusually difficult year.

It is our hope that we won't face a winter of discontent. And even if there should be occasional glitches in, say, our power supply, we as a society and as investors have always found ways to emerge stronger from a crisis. Therefore, let me wish you all the best for 2023.

—
Frank Häusler
Chief Investment Strategist,
Vontobel

—
Mario Montagnani
Senior Investment Strategist,
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Bundle up for Christmas and move closer

Around the turn of the year, people generally expect to find lots of presents around the Christmas tree or in stockings by the fireplace. This time, it may be a humble packet of socks instead—a fitting gift in times of cut gas supplies and turned-down heaters. It is a time to keep warm and move closer.

Investors, too, will find this year's pickings slim, to put it mildly. Gone are the days of effortless gains on financial markets propelled by a flood of central bank money. The biggest two asset classes, equities and bonds, took a simultaneous, massive hit, which is exceedingly rare. By contrast, commodities enjoyed a somewhat unexpected ride, but that was due to extraordinary factors rather than the usual interplay of supply and demand.

Our investment committee has been keeping a steady course for a while, and will in all probability maintain this approach during the festive season. Our positioning in all major asset classes remains unchanged, down to sub-segment level. Equities remain on a slight overweight as we expect them to overcome their weakness sooner or later despite recession worries and prospects of a continued increase in central banks' base rates. In terms of sub-segments, we continue to prefer "defensive" equity markets, such as the US and Switzerland.

Our neutral rating on bonds in place for many quarters still stands. This year's dismal performance notwithstanding, things are slowly looking brighter for the asset class due to higher yields and higher spreads, which both suggest higher returns in the future. Next year, inflation readings should come down amid a probable contraction of western economies, which will present bonds with an opportunity for a rebound. Details of our positioning can be found on the overview page 5 or the asset class-focused items on pages 12 to 15.

	UNDERWEIGHT significantly	UNDERWEIGHT slightly	NEUTRAL	OVERWEIGHT slightly	OVERWEIGHT significantly	
1 Liquidity		→				Cash remains on a slight underweight, a function of a recent increase of our equity position. Still, keeping some money for purchases is a good idea.
2 Bonds			→			Almost all fixed income segments have disappointed this year, but things started looking up in November as market rates edged lower and spreads tightened. Within 12 months, we expect to see lower bond yields, but in our opinion, it would be too early to move to an overweight bond stance. Reaffirming our segment views, we rate government bonds as well as emerging-market bonds in hard currency overweight, investment-grade corporate bonds neutral, and high-yield bonds underweight.
3 Equities				→		Markets have rallied since the beginning of October thanks to falling inflation, solid earnings reports, overly negative investor sentiment, and seasonal effects. We stick with our moderate overweight. Whilst we expect lower economic growth, we think that the combination of falling inflation and a less restrictive US monetary policy could provide enough support for equities to keep them from falling further. We prefer the US and Switzerland, where stocks tend to outperform when global growth worsens, and where companies sport the highest margins and return on equity across markets. We remain neutral on European stocks due to attractive valuations (even when adjusted for a recession scenario), particularly versus those of US equities. The European market has benefited from changes in the index composition during the past decade, such as a smaller proportion of value sectors, for example financials, which now account for less than 12% against 30% in 2008. Likewise, consumer-related sectors, such as discretionary or staples, have doubled their weight to more than 30%, partly thanks to the luxury sector. We maintain our neutral view on Japan, where the weakening yen should boost exports, lift capital expenditures, and improve corporate earnings. Lastly, we retain our underweight on emerging markets given the slowdown in China.
4 Gold				→		Gold remains on overweight. The yellow metal struggled to move higher this year as the interest rate hikes in the US lowered inflation expectations, which in turn worsened gold's prospects as a cushion against rising prices. But once the US Fed changes tack, factors such as abating dollar strength could support gold. Apart from that, the metal remains a hedge against geopolitical risks.
5 Commodities			→			Commodities remain on neutral for the time being. Various leading indicators, such as purchasing managers' indices, suggest a further cooling of the world economy in the months ahead. Oil and other index components won't be able to escape this general downward trend. At the same time, commodity prices would benefit from rising geopolitical tension, declining output in major oil producing nations, or an earlier-than-expected reopening of the Chinese economy.
6 Alternative strategies			→			We maintain our neutral view on alternative investments overall and reiterate all sub-asset class views, i.e. a modest underweight in hedge funds and neutral view on real estate.

Changes month-on-month: same → higher ↗ lower ↘

After three years to forget, we hope 2023 will be remembered for the right reasons

—
Michaela Huber
Cross-Asset Strategist,
Vontobel

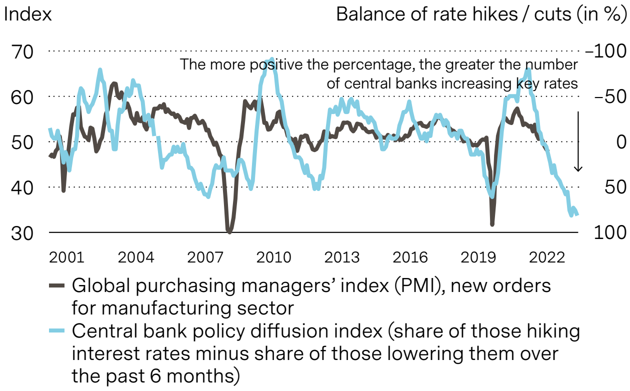
—
Stefan Eppenberger
Head of Multi Asset Strategy,
Vontobel

Some of us would like to forget the past three years, each of which conjures up bad memories: first Covid-19, then inflation, then war in Europe. Will 2023 finally be better? Pessimists point to recession worries in many developed markets whilst optimists pin their hopes on central banks becoming much more pro-growth. Having named our base scenario "multi-asset for a multi-challenging world", we lean towards the latter camp.

What will 2023 have in store for us? Our global economic baseline scenario is built on three pillars: an economy entering a recession, an inflation on a (temporary) downward path, and central banks with a newly found "dovish" bias.

Several factors have made us pencil in a recession for next year. The US yield curve, considered a pretty reliable harbinger of economic pain if inverted, recently moved to the most extreme levels since the 1982 recession. Other important yardsticks, such as purchasing managers' indices (PMIs) for the manufacturing industry, have fallen further, and remain well below the critical 50-point line separating economic expansion from contraction. It's worth noting that purchasing managers' indices, so-called leading indicators predicting economic development, are themselves typically "led" by central bankers' actions. If the past ten years are any guide, we should see a much weaker economy going forward (see chart 1).

Chart 1: When central banks act, PMIs follow with 15-month lag—which now points to a weaker economy



Source: Refinitiv Datastream, Vontobel

We also shouldn't forget that central banks' actions have left their mark on so-called rate-sensitive sectors, such as the housing market. US house prices, as depicted by the Case-Shiller Home Price Index, recently fell for the first time since 2012, while lending standards, as tracked by the Federal Reserve's Senior Loan Officer Survey, have become as strict as before previous economic downturns (see chart 2).

Add to that a stuttering Chinese growth engine. At the time of writing, the world's second-largest economy remains stuck between a rock (read: strict zero-Covid policy) and a hard place (read: simmering real estate crisis). It will take some time before the Chinese economy roars back to life, we believe.

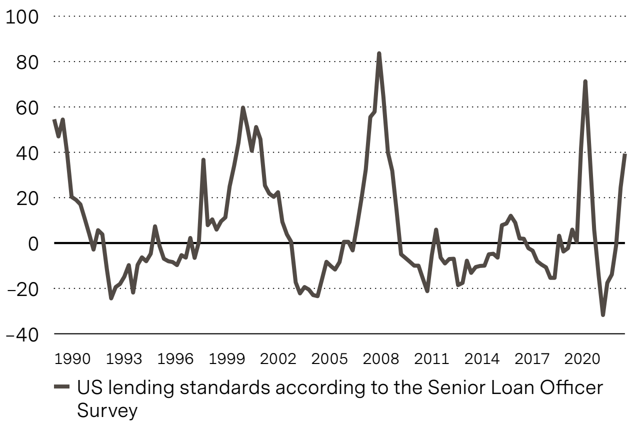
The combination of restrictive monetary policy, likely to remain in place until the second quarter of 2023, and the eventual start of a global recession put the spotlight on our second pillar: falling inflation. Here, we predict an ongoing normalization of global supply chains (container freight rates, which already started to decline this year, should fall further), lower prices for certain goods (especially for used cars), stable energy and food prices (barring unexpected supply shocks), and a cooling labor market (which should ease both wage pressure and service price inflation).

This leads us to our third pillar: central banks adopting a growth-friendly policy again. Whilst timing the "Fed pivot" is tricky, experience shows the central bank usually hikes key rates to a level above headline inflation before adopting a more accommodative stance again. If this rule of thumb proves to be right, the upward trend in US key rates could stop in the first quarter of 2023. Looking back at what the Fed did in the 1970s and 1980s, a period of high inflation often likened to today's situation, we notice a lag of roughly one to two months between the last rate hike and the first rate cut (see chart 3). At the very latest, the Fed should lower the key rate once the unemployment rate starts to move up.

What could derail our baseline scenario? As for upside risks[1] that suggest a better-than-expected outcome, the Chinese economy could roar back to life after a sudden reopening or government-sponsored measures to stimulate and deregulate the economy, for instance. Moreover, strong US consumer uptake could throw the economy a lifeline. Regarding downside risks, one important event could be the bursting of the Chinese property bubble, which would send shock waves through the Chinese or even the global economy. Other negative factors could include a sudden breakdown of energy supply (either due to developments linked to the Russia-Ukraine war or tensions in the Middle East), a European debt crisis (either in the so-called periphery or in the UK), or escalating tensions, for instance in the form of another round of US/Chinese sanctions. Naturally, we are more in the optimists' camp, so let's hope 2023 will be remembered for the right reasons.

Chart 2: Lending standards are as strict as before previous recessions

In % (net share)*

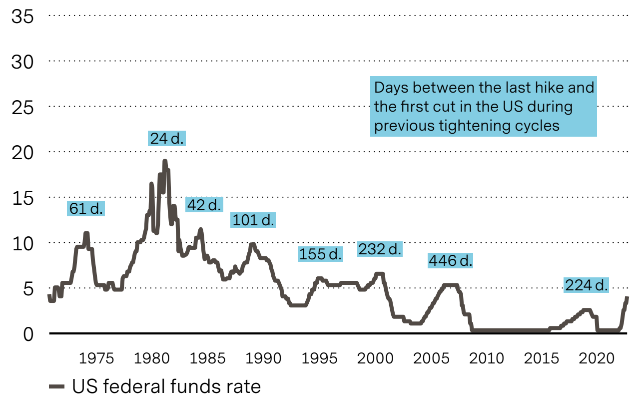


* Percentage of banks that reported having tightened minus percentage of those that reported having eased.

Source: Refinitiv Datastream, Vontobel

Chart 3: In times of high inflation, a rate-cutting cycle quickly follows a tightening one, as a rule

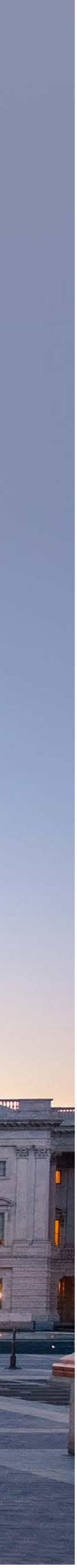
In %



Source: Refinitiv Datastream, Vontobel

[1] We define important upside and downside risks as those with at least a 10% probability of occurring.

The US mid-term elections: short-lived news with long-term implications



—
Reto Cueni, PhD
Chief Economist,
Vontobel

Elections of US state governors or members of Congress rarely scream from front pages outside America. Yet this short-lived news has long-term implications impacting the inner workings of US politics, thus bearing on the rest of the world. So what has changed after the recent mid-term elections? Joe Biden's Democrats, though retaining—even extending—control of the upper house of parliament, the Senate, will find it harder to push through their agenda, as they are now part of a divided government for the next two years. The Republicans, though regaining the majority in the House of Representatives and winning some gubernatorial seats, haven't achieved what they were hoping for. This holds especially true for candidates endorsed by Donald Trump, whose own re-election prospects in 2024 have worsened.

In US midterm elections, which take place halfway through a president's four-year term, all 435 members of the House of Representatives and a third of the 100-strong Senate face the verdict of voters. Now that the Congress is split along party lines, how will it affect political decision-making and the economy?

How the mid-terms can affect the economy
A divided government will slow down or even compromise the legislative process. We saw cases of a so-called government shutdown around the turn of the year 2018/19, when then President Donald Trump, a Republican, tried to pass the budget in a divided Congress only to see the Democrats block it. Usually, like at the end of 2018, a government shutdown temporarily weighs on financial markets due to increased uncertainty about the changes to public spending and the furlough of federal workers, which naturally reduces public services as well as consumption.

If the US economy slips into a recession (also see chapter Market highlights, page 6), which could well happen given the current tightening of the Federal Reserve's monetary policy and the elevated prices that keep consumers on edge, a quick response from the government in the form of more public spending to support the economy would be particularly important. However, a divided government means unlocking state coffers will be tricky. If the US economy starts to weaken significantly, it's reasonable to expect that a divided government will lead to fewer rapid and substantial support measures than a unified (Democrat) one. This is what could make these midterms economically crucial in the current environment, as the economic outlook for the US and the world continues to deteriorate.

That said, it's worth noting that one of the Republican wings in Congress seems to be demonstrating reduced fiscal frugality. This was already evident during the Trump presidency, when the pandemic prompted a shift towards more support for the working class through federal funds. This could mean that a divided Congress could push through fiscal packages to mitigate the effects of a recession. As a rule, US presidents grappling with a recession one or two years before presidential elections face poor re-election prospects (see chart 1). Hence, with the onset of a broad recession, Republicans may be caught in a conflict of interest between supporting the economy and increasing their likelihood of helping a Republican president win the race in 2024. Remember Democrat Bill Clinton's successful campaign against George H.W. Bush (a one-term Republican president) in the early 1990s, using the catchphrase "it's the economy, stupid" in reference to the Bush administration's handling of the recession at the time.

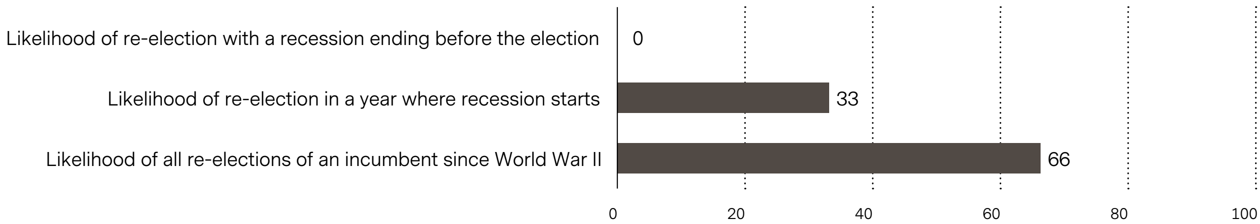
Biden v. Trump: the sequel in 2024?

Generally, mid-term election results are a poor guide to presidential elections. Even so, we can draw several conclusions ahead of the big showdown in two years' time. The Republicans, still in many ways beholden to their most recent president, will undergo some soul-searching following the poor showing of Trump-backed candidates for state governors and members of Congress. Moreover, after the resounding victory of Florida governor and former Trump protégé Ron DeSantis, Trump looks set to face a strong contender for the presidency from his own party.

With Donald Trump now throwing down the gauntlet, the Democrats have a strong incentive to select President Biden again, who has already prevailed over Trump once before. However, the incumbent will turn 82 in 2024, and some critics have started putting in doubt his ability to bear the demanding presidential burden. There are many other potential candidates among the Democrats, such as Transportation Secretary Pete Buttigieg and Vice President Kamala Harris. Some contenders, whether Democrat or Republican, may not even be on the radar yet – neither was Barak Obama, by the way, whose star rose in the two-year period before the 2008 presidential election.

Chart 1: State of the economy is crucial for an incumbent US president's re-election prospects

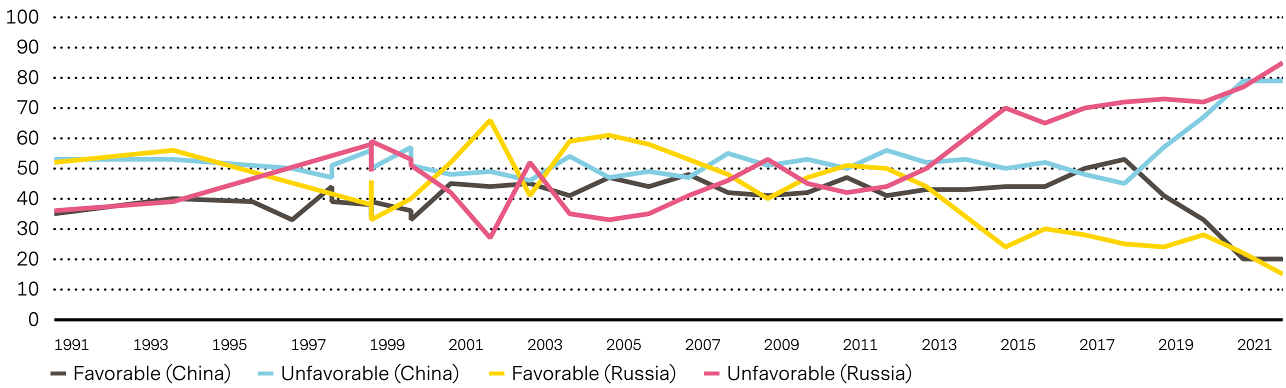
Probability in %



Source: NBER, Federal Election Commission, Clerk of the House of Representatives, Vontobel

Chart 2: Americans' views of China and Russia got more unfavorable

In % of total answers to Gallup survey*

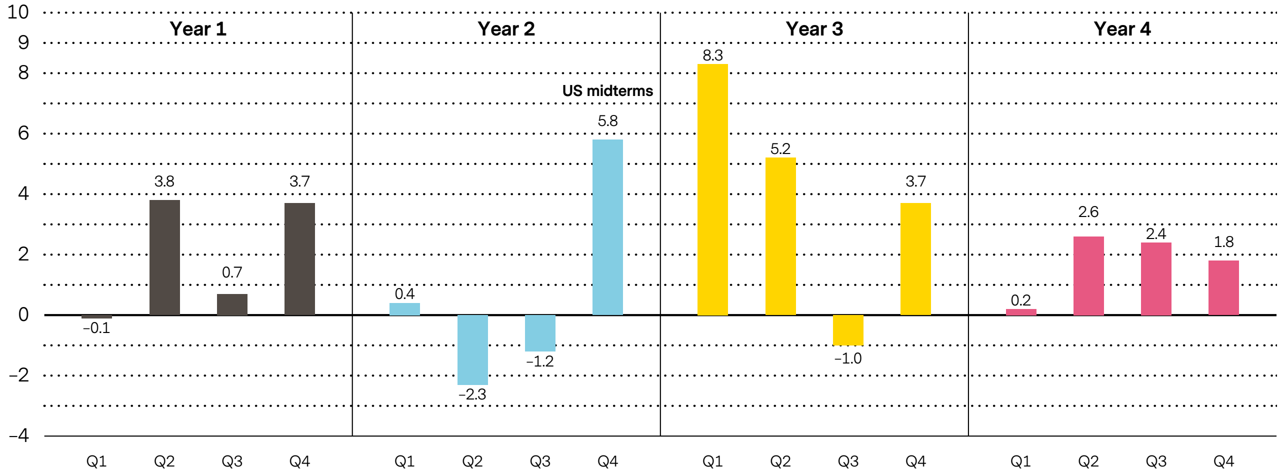


* Question regarding views on a specific country

Source: Gallup, Vontobel

Chart 3: Midterm elections are usually a good time to buy US equities, but there's a caveat

Performance of the S&P 500 index across the four-year presidential cycles 1968 – 2020, average quarterly returns in %



Source: Refinitiv Datastrea, Clerk of the House of Representatives, Vontobel

Old and new challenges beyond the US

Clearly, a lot can still happen between now and 2024. President Biden may be tempted to act in areas where the Constitution grants him more power also with a split congress, such as foreign policy and trade agreements. While the current surge in energy prices and high inflation chips away at his popularity, he may be looking to get credit for his handling of geopolitical crises, standing up to Russia much like former US President John F. Kennedy did during the Cuban Missile Crisis in 1962, which underpinned his popularity. As far as US foreign policy is concerned, the American public seems to support a tough line on Russia as well as China, according to recent polls (see chart 2). By contrast, it is unclear how Trump or a Trump-like president would act if the current war between Russia and Ukraine continued. Trump was unable or unwilling to secure strategic alliances with geopolitically important partners like the European Union, nor did he cultivate new alliances during his term as president. A second term for him could see the US withdrawing from global leadership bodies and alliances, and his re-election could create a vacuum for other global players with strong geopolitical ambitions, such as China and Russia.

What investors should pay attention to

If history is any guide, US stock markets usually perform quite well in the US midterm election quarter, as well as the following two quarters, although this should be taken with a pinch of salt as intra-year seasonality also plays a role (see chart 3). However, this time, the economic and monetary policy factors seem to exert a much stronger influence than usual. It is widely expected that central bank tightening and elevated consumer prices will lead to meager growth in the US or even a recession in the quarters to come. So, the usual positive effects of the midterms (which relieve the markets from some uncertainty) might not be as influential on equities this time around.

To sum up, the midterm elections may have removed an element of uncertainty in America's domestic course, but simmering global conflicts may heat up, perhaps more suddenly than in the years before the pandemic. Recent developments in Russia's war against Ukraine, as well as official statements during China's recent Communist Party Congress aren't apt to calm nerves. Similarly, there is strong bipartisan support to preserve the status of the US as the globally leading democratic power, whether it's vis-à-vis Russia or China. That said, even an increased domestic focus of a more inward-looking next US president (remember isolationist tendencies of the Trump administration), and the subsequent vacuum in the wake of America's lesser role on the geopolitical stage, could create rather more than fewer worries. All told, investors are likely to face years of volatility and elevated geopolitical uncertainty that will affect both the global economy and financial markets. This is something to consider in portfolio construction.

Waiting to tear a leaf off the bond market calendar

—
Frank Häusler
Chief Investment Strategist,
Vontobel

The festive season is a good time to take stock. It's safe to say that 2022 will go down as a year with one of the worst bond performances in recent history. Even so, there are signs that things may be on the mend, and prospects of the market starting with a clean sheet are intact.

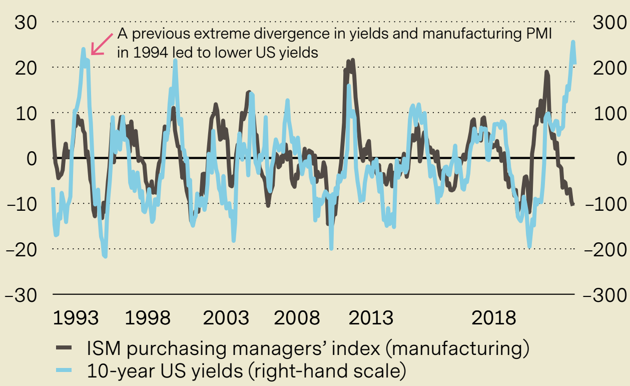
Our overall rating for fixed income remains neutral. Given the diverseness of this asset class, our positioning in the sub-segments shows a wide range. We are overweight in government bonds as well as emerging-market bonds in hard currency, neutral in investment-grade corporate bonds, and underweight in high-yield bonds.

It's easy to lament about 2022, but discerning bond investors also see some hopeful signs. The US Federal Reserve, which spent most of 2022 making up for the time it lost during its botched response to rising inflation, looks set to relax its monetary reins again. Inflation readings have started moving lower here and there, and prospects of an economic cooling or even recession justify a more accommodative stance by the US Fed during the second half of 2023.

Emerging-market hard-currency bonds rebound
The markets have started pricing this in. November saw a retrenchment in market rates, and spreads started narrowing, meaning that prices of certain fixed-income segments have recovered versus those of government paper. This held particularly true for emerging-market issues in hard currency, which ridded themselves of their "loser of the year" stigma.

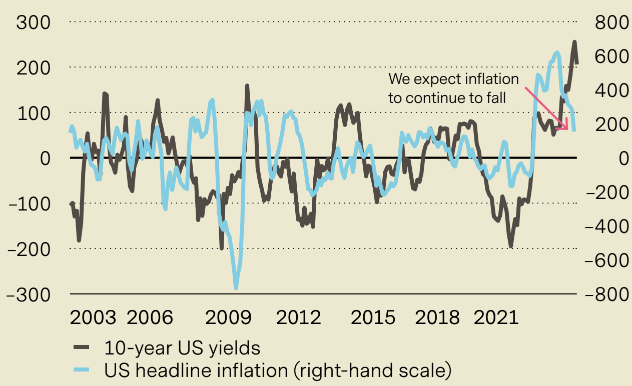
Nowhere to go but up?
We can understand that fixed income investors are itching to tear the last leaf off the calendar. Within 12 months, we expect to see lower bond yields (these move inversely to prices) given our outlook for a weaker US economy (see chart 1) and "peak inflation" (see chart 2). Next year, markets will be able to start with a clean sheet—if you want to call it that after the massive downturn caused considerable pain to bond investors. We believe that 2023 could be an excellent year for active market participants able to navigate the difficult waters.

Chart 1: A factor pointing to lower US bond yields: economic slowdown in America



Source: Refinitiv Datastream, Vontobel

Chart 2: Another factor suggesting lower US bond yields: "peak inflation"



Source: Refinitiv Datastream, Vontobel

What to do when profit margins come down

—
Stefan Eppenberger
Head of Multi Asset Strategy,
Vontobel

The recovery following the end of Covid-19 gave companies record profit margins. Since the summer, however, these margins have been falling due to high inflation and the weakening economy. This is likely to continue if we enter a recession. Therefore, it is important to hold stocks of companies with resilient margins.

Profit margins, or revenue minus all costs, are reliable indicators of a company's strength. At present, investors are concerned about their slow fall since last summer. Never mind they were at record highs and even now are well above pre-Corona levels—the direction is clearly downward, meaning companies are earning a little less on every dollar they take in.

The economy isn't helping …
The main reason for the receding margins is the current economic environment of slowing growth and rising inflation, which lowers revenue prospects whilst increasing the cost burden. If the economy weakens further, as we expect (see Market Highlights chapter on page 6), the trend of falling margins will probably continue (see chart 1).

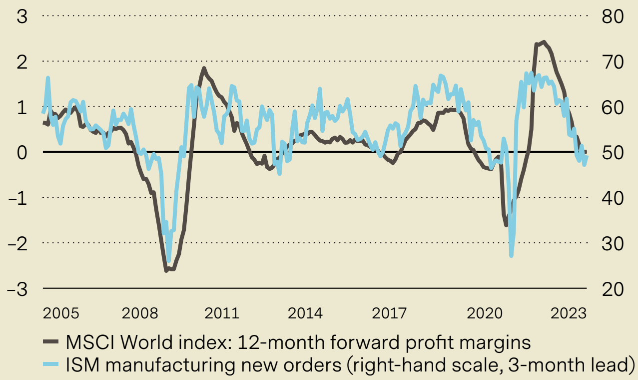
Business cycles aside, the cost side is an important factor. Let's take a quick look at the four most important expenses for most companies: wages, taxes, interest expenses and input product inflation, with the latter having been a major headache for several months now (see chart 2).

… but some relief from inflation trajectory
In the past few quarters, the rising costs of raw material prices due to supply issues and of intermediate products due to global supply chain constraints were huge challenges for companies. Those with a relatively weak competitive position were hit the most in terms of margins because they were unable to pass the costs onto customers. That said, the expected fall in inflation rates should provide some relief to companies, as will the cooling labor market particularly in the US.

At the same time, taxes and interest costs aren't moving in the companies' favor. Tax rates, now at multi-year lows, are likely to rise amid global taxation initiatives by governments. Borrowing costs are already on the rise due to this year's turnaround in central banks' interest rate policies.

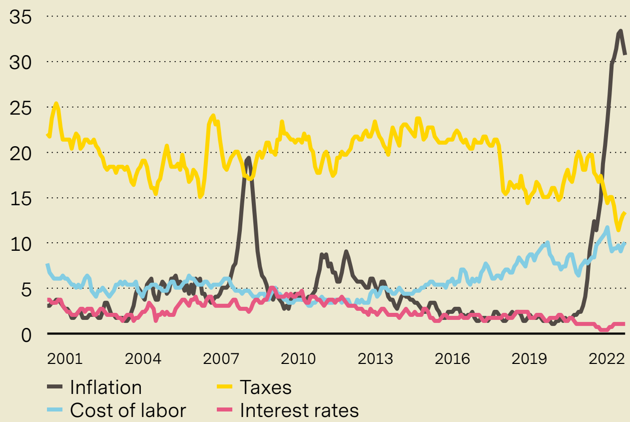
A possible pick: US and Swiss stocks
To sum up, margins for the broad equity market are likely to fall further in the coming months. Investors can try to guard against this by concentrating on specific markets, for instance. We for our part favor Swiss and US equities, where companies on average have been able to protect their margins better in an environment of declining economic activity. Moreover, the Swiss market's attraction lies in a high share of pharmaceutical and food corporations with steady revenues and thus, stable margins.

Chart 1: When business cycles worsen, margins go down as a rule
Index (year-on-year change)



Source: Refinitiv Datastream, Vontobel

Chart 2: Inflation remains the most important challenge for companies
In % of all answers to NFIB survey*



* Question about single most important problem (3-month average)
Source: National Federation of Independent Businesses (NFIB), Refinitiv Datastream, Vontobel

A real gold investor must stand the heat—like the metal

—
Michaela Huber
Cross-Asset Strategist,
Vontobel

As the saying goes, real gold isn't afraid of the melting pot. With one of the highest melting points of any metal —1,064 degrees Celsius or 1,943 degrees Fahrenheit—, gold can certainly withstand a lot. Some gold investors groping for heat-resistant gear in 2022 may now find solace in the prospect of cooler days ahead.

In 2022, things got heated for the yellow metal, mostly due to the US Federal Reserve. In attempting to cool the economy and tame red-hot inflation, the policy watchdog raised rates at the fastest pace in four decades.

This impacted gold in several ways. First, the Fed's moves pushed up real, i.e. inflation-adjusted, yields, thereby increasing the opportunity cost of holding a non-interest-bearing asset like gold. Second, they propped up the US dollar, making the yellow metal more expensive for buyers from outside of the United States. Third, the central bank's actions also brought down inflation expectations, which lowered gold's appeal as an inflation hedge.

The kitchen was too hot for some investors
As a result, many gold investors got out of the kitchen, exiting the precious metal. According to the World Gold Council, investment demand dropped by 47% year-on-year in the third quarter. Outflows were particularly pronounced in exchange-traded funds (227 tons).

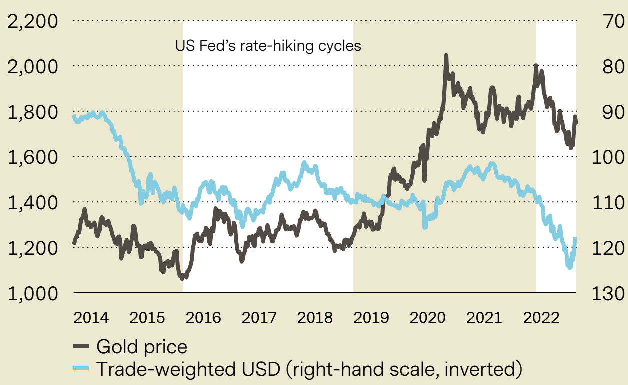
However, we believe that gold is likely to regain its luster in the coming months, as many of the above-mentioned headwinds should turn into tailwinds as soon as the Federal Reserve changes course—real yields should eventually peak, while US dollar strength should abate. This is likely to occur once the US unemployment rate picks up or the economy enters a recession (or both).

Central banks drawn to shiny things
Talking about central banks: they have taken advantage of the lower prices and snapped up the precious metal at the fastest pace since 1967. Emerging-market institutions stood out with Turkey buying more than 31 tons, Uzbekistan over 26 tons, and India over 17 tons. This might be due to a general desire to diversify their dollar-denominated reserves but could also be partly due to what happened to the central bank of Russia, whose foreign reserves were largely frozen by western governments earlier this year after the country's invasion of Ukraine.

Having said that, investors should remember that it's not yet clear when the Federal Reserve might start relaxing monetary policy again. Real interest rates could have some more room to rise, and the US dollar could climb a bit further before the yellow metal ultimately shines again.

Chart 1: The yellow metal has suffered from the US Fed's fight against inflation

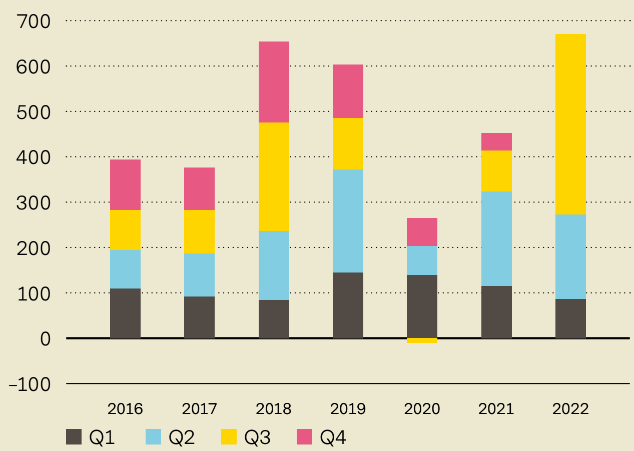
In USD per troy ounce



Source: Refinitiv Datastream, Vontobel

Chart 2: Central banks on a gold buying spree in the third quarter of 2022

Gold demand* in tons



* Central banks and other institutions
Source: World Gold Council, Vontobel

Surprising rally in pound sterling may end soon

—
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Since late September, pound sterling outperformed other major currencies, reaching levels before the UK's recent "fiscal crisis". The pound, highly correlated to global equities, perked up on rebounding stock markets and falling energy prices, but that support may disappear. Meanwhile, the US dollar should recover in the first quarter before losing ground in the course of 2023.

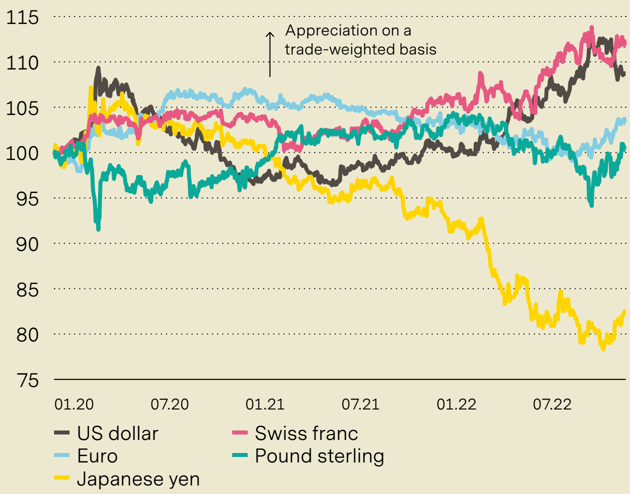
Like "core" Europe, the UK has suffered from higher energy costs. Concerns about its financial stability could resurface if oil and gas prices start rising again given the country's rather poor fundamentals—real yield spreads are pointing to pound weakness, core inflation is currently at 6.5%, and the unemployment rate is at the lowest level since the 1970s.

Start of recession could move US dollar up
This brings us to the US dollar, whose special bond with the pound is known as *Cable* on trading floors. Has the Greenback peaked already (see chart 1)? Possibly yes, but we may first see some USD strength, if the past is any guide. Historically, the US dollar hit a high around the time a recession started in developed markets. And that's where we may be right now. Therefore, we expect the dollar to strengthen somewhat in the first quarter of 2023, but later run out of steam to end 2023 below the currently level.

Yen has further recovery potential
The Japanese yen, a major decliner in 2021 / 2022, should rebound next year, we believe (see chart 2) once the US has entered recession, which will probably result in lower US base rate later in 2023 or in early 2024. This means that the spread between Japanese and US government bond yields will shrink, lending support to the yen. While a possible relaxation of Japan's yield curve control (i.e., massive bond purchases by the central bank) would be a catalyst for additional JPY strength as well, the timing of such a policy shift is less clear.

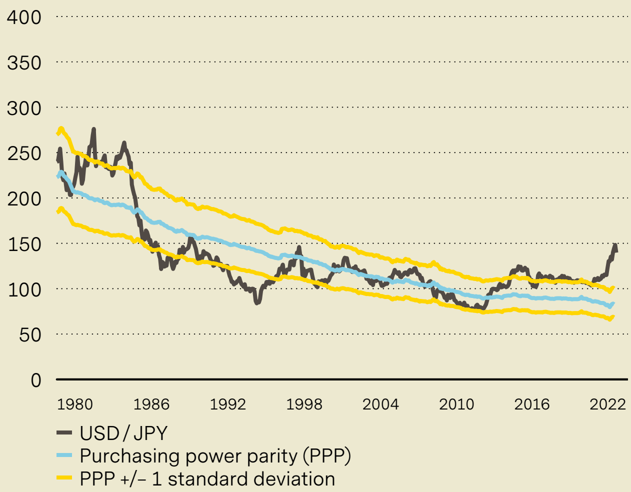
Swiss franc set to remain strong
The recent decline in energy commodity prices and US inflation has boosted investor sentiment in Europe and lowered the risk of a severe recession. But winter will still bite amid closed-down Russian pipelines. The Swiss franc seems relatively shielded against the drag from higher European energy prices due to the country's well-diversified energy mix. Rising recession risks in the US and Europe early next year should increase demand for safe-haven currencies such as the franc. But even without a recession, stronger fundamentals, such as Switzerland's sizable current-account surplus, should justify a continued strength of the currency (see chart 1).

Chart 1: The US dollar appears to have hit a ceiling, Swiss currency keeps the momentum
Trade-weighted exchange rate index (rebased to 100 January 2020)



Source: Refinitiv Datastream, Vontobel

Chart 2: The Japanese yen is extremely cheap in terms of purchasing power parity
Exchange rate



Source: Refinitiv Datastream, Vontobel

Economy and financial markets 2020 – 2023

The following list shows the actual values, exchange rates and prices from 2020 to 2021 and consensus forecasts for 2022 and 2023 for gross domestic product (GDP), inflation / inflationary expectations, key central bank interest rates, ten-year government bonds, exchange rates and commodities.

GDP (IN %)	2020	2021	CURRENT[1]	2022 CONSENSUS	2023 CONSENSUS
Global (G20)	–2.6	5.2	2.5	2.5	1.9
Eurozone	–6.3	5.3	0.2	3.2	–0.1
USA	–3.4	5.7	1.8	1.8	0.4
Japan	–4.7	1.8	1.8	1.5	1.3
UK	–9.3	7.2	–0.2	4.2	–0.8
Switzerland	–2.5	3.8	2.5	2.2	0.7
Australia	–2.1	4.9	0.9	3.9	1.9
China	2.2	8.1	3.9	3.3	4.8

INFLATION	2020	2021	CURRENT[2]	2022 CONSENSUS	2023 CONSENSUS
Global (G20)	1.7	3.3	7.9	7.4	5.2
Eurozone	0.3	2.6	10.6	8.5	5.9
USA	1.2	4.7	7.7	8.1	4.3
Japan	0.0	–0.3	3.7	2.4	1.6
UK	0.9	2.6	11.1	9.0	6.9
Switzerland	–0.7	0.6	3.0	2.9	2.0
Australia	0.9	2.9	7.3	6.5	4.9
China	2.5	0.9	2.1	2.2	2.3

KEY INTEREST RATES (IN %)	2020	2021	CURRENT	CONSENSUS IN 3 MONTHS	CONSENSUS IN 12 MONTHS
EUR	–0.50	–0.50	1.50	2.51	2.53
USD	1.75	0.25	4.00	5.00	4.65
JPY	–0.10	–0.10	–0.10	–0.10	–0.09
GBP	0.75	0.25	3.00	4.10	4.00
CHF	–0.69	–0.76	0.50	1.42	1.43
AUD	0.75	0.10	2.85	3.40	3.45
CNY	4.35	4.35	4.35	4.30	4.30

GOVERNMENT BOND YIELDS, 10 YEARS (IN %)	2020	2021	CURRENT	CONSENSUS IN 3 MONTHS	CONSENSUS IN 12 MONTHS
EUR (Germany)	–0.6	–0.2	1.93	2.35	1.96
USD	0.9	1.5	3.64	4.01	3.52
JPY	0.0	0.1	0.25	0.24	0.22
GBP	0.2	1.0	3.12	3.64	3.28
CHF	–0.5	–0.1	1.03	1.55	1.38
AUD	1.0	1.7	3.52	3.94	3.41

FOREIGN EXCHANGE RATES	2020	2021	CURRENT	CONSENSUS IN 3 MONTHS	CONSENSUS END OF 2023
CHF per EUR	1.08	1.04	0.98	0.98	1.01
CHF per USD	0.88	0.91	0.95	0.98	0.95
CHF per 100 JPY	0.86	0.79	0.68	0.68	0.73
CHF per GBP	1.21	1.23	1.14	1.11	1.14
USD per EUR	1.22	1.14	1.04	1.00	1.05
JPY per USD	103	115	138	142.5	131
USD per AUD	0.77	0.73	0.67	0.65	0.70
GBP per EUR	0.90	0.84	0.86	0.88	0.89
CNY per USD	6.51	6.37	7.20	7.20	7.00

COMMODITIES	2020	2021	CURRENT	CONSENSUS IN 3 MONTHS	CONSENSUS IN 12 MONTHS
Brent crude oil, USD per barrel	52	78	81	95	92
Gold, USD per troy ounce	1,898	1,822	1,750	1,737	1,800
Copper, USD per metric ton	7,749	9,740	8,008	7,200	8,200

[1] Latest available quarter
[2] Latest available month, G20 data only quarterly
Source: Vontobel, respective statistical offices and central banks; as of November 28, 2022

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