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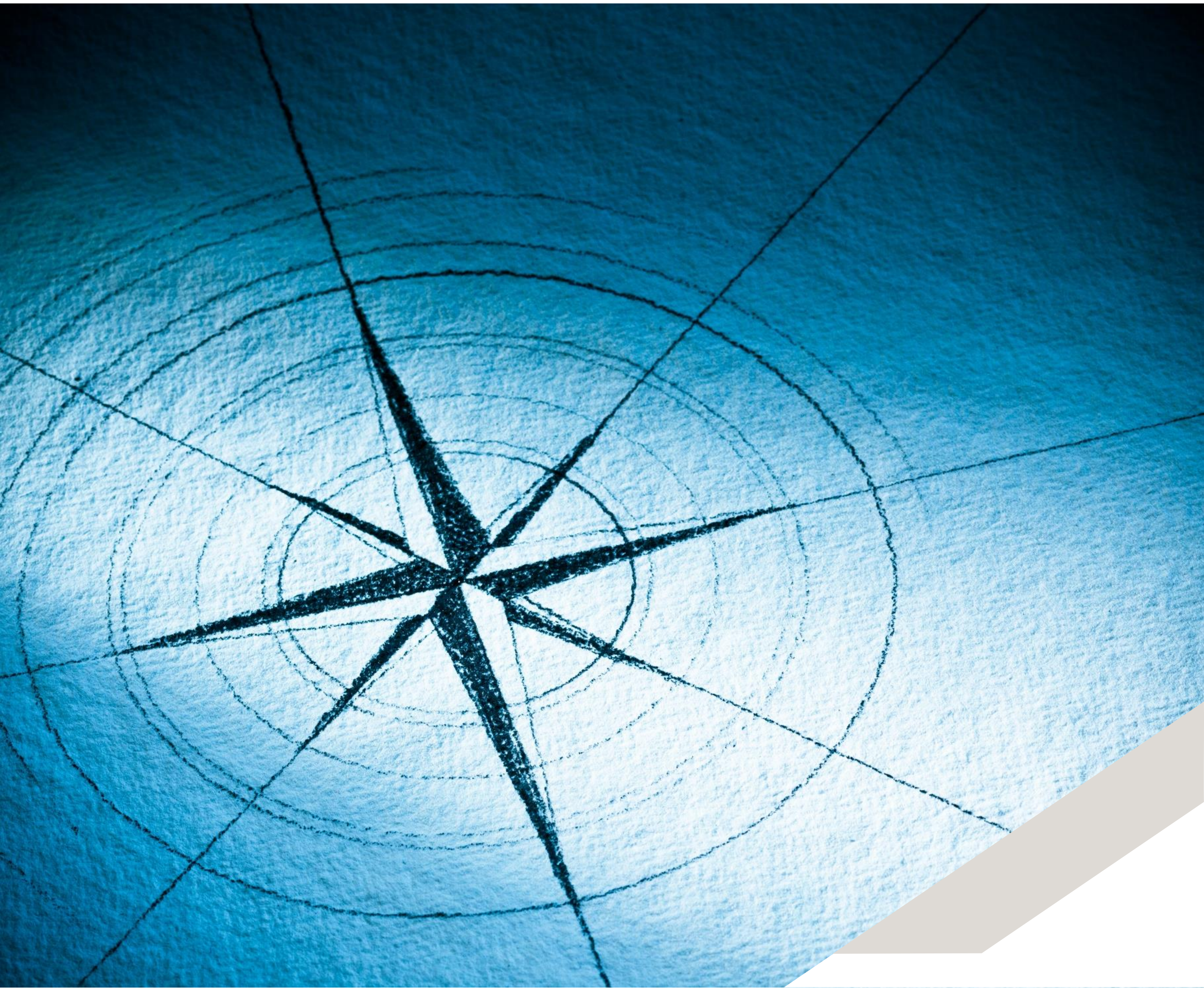

Scenario analysis

What if?

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Foreword

Predicting the economy, and its impact on financial markets, is famously difficult at the best of times. These are not the best of times, and extra humility is in order.

As in the summer's publication, we offer here three plausible mid-term scenarios as an aid to organizing investors' thinking about that uncertain future.

We think that in one important respect the outlook for the global economy may now be a little clearer than it was (but again, see paragraph 1). Europe is learning to live with its energy shortfall, and central banks are belatedly but determinedly tightening policy: as a result, both supply and demand-side threats to inflation have faded somewhat, and we no longer include a scenario in which inflation stays especially high.

Our central scenario is one in which core inflation falls back significantly (though much less quickly than headline inflation) during 2023. We think global growth is likely to continue to slow – a technical recession is possible – but that a major downturn, an economic slump, is neither necessary nor likely. As a result, we doubt interest rates will fall back quickly, even as inflation fades.

This scenario is effectively the base case which underpins asset allocation in Mosaique portfolios. In this scenario, the likely question for 2023 is when to add to our holdings of stocks and bonds. We are tactically neutral on stocks currently, and in European portfolios retain ongoing but reduced underweight positions in bonds (we closed an underweight in bonds for USD portfolios in late 2022).

However, should growth undershoot and a slump materialize – which it could do if economies prove more sensitive to the normalisation of interest rates, for example – then we might face a scenario in which corporate earnings fall more sharply, but in which interest rates also start to fall sooner. Stocks would be more at risk, and bonds would do better – though those lower policy rates would point to an eventual cyclical rebound.

Equally, we can imagine a more positive scenario for the economy in which (say) a collapse in energy costs boosts growth even as inflation falls. Corporate earnings would surprise positively, but there would be less room for policy rates and longer-dated real yields to fall.

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Global Investment Strategist

What if? - Three market scenarios to consider

Setting geopolitics aside, with inflation rolling over, the main uncertainty facing investors is the outlook for growth, and the speed with which interest rates eventually begin to subside

Scenario	***Slump***	***Mosaique views R&Co central scenario***	***Resilient growth***
Position	Worst case	Base case	Best case
Definition	Inflation subsides decisively, but at the cost of a very hard landing for the economy	Inflation subsides meaningfully, and the associated cyclical slowdown is unremarkable – modest in scale and brief in extent	Inflation subsides without a significant impact on the real economy
Macro implications			
GDP	Global recession, including a material fall (2-3%?) in US GDP growth during 2023-24	Clearly below-trend growth or technical recession in 2023-24	Growth stays firmly positive and returns to trend during 2023-24
Inflation	Falls back to target (2%) in 2024	Falls back to 2-4% range in late 2023/early 2024, but sticks there	Sticks around 4-5% from late 2023, long-term expectations stay firm
Monetary policy	Central banks respond to monetary "overkill" by starting to cut rates during 2023	Central banks leave rates at 2023 highs for longer	Interest rates stay at or close to 2023 highs – resemble plateaus, not peaks
Investment implications[1]			
Equities	★☆☆	★★☆	★★★
Fixed income	★★★	★★☆	★★☆
Cash	★★☆	★★☆	★★☆
Gold	★☆☆	★☆☆	★☆☆
Investment positioning			
Equity regions to favour	▪ US may outperform given its safe haven market status ▪ UK and Switzerland may outperform given their sector mixes ▪ Avoid emerging markets	▪ Developed Market returns to remain driven by sector composition: leadership varies as the cycle evolves ▪ Initial leadership favours US and growth until prospect of cyclical recovery looms closer. Defensive Switzerland/energy intensive UK may mostly underperform	▪ Developed Market returns to remain driven by sector composition, with more of a cyclical tilt ▪ Eurozone may outperform the US; emerging Asia may return to favour
Equity sectors to favour	▪ Consumer Staples ▪ Pharmaceuticals ▪ Utilities	▪ Cyclical rotation to fluctuate with the business cycle ▪ Currently favouring: Healthcare and Information Technology	▪ Industrials ▪ Consumer Discretionary ▪ Financials ▪ Mining
Other investments to consider	▪ Defensiveness (e.g. USD) ▪ Longer term debt ▪ Govies over corporate debt	▪ Direct real estate ▪ Shorter term debt ▪ Corporate credit over govies	▪ Direct real estate ▪ Shorter term debt ▪ Corporate credit over govies

[1] *Investment implications range from returns below inflation rates (one-star), similar to inflation rates (two-star) to above inflation rates (three-star)*

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