

Global Investment Committee's outlook

Good, but not fully smooth sailing, with a rising yen

By John Vail, Chief Global Strategist
23 June 2023

The world held up even better than we expected, especially equities

Our March meeting's overall theme of "**Rocky, but acceptable global returns**" seems to have been, so far, somewhat too cautious, at least for the 2Q, as global equities have surged vs. our estimate of a moderate gain, with few financial accidents occurring and the global economy holding up moderately better than our low, but non-recessionary, forecasts. Specifically, our 2023 GDP forecasts, which were moderately below consensus at the time, are now lower than the current consensus for the US and Japan, while Europe is slightly below, and China matches such. Indeed, China recovered much as we expected in our December and March meetings, with increasing signs of headwinds to consumption after the initial rebound already occurring, also in line with our predictions. The détente in foreign affairs has held up fairly well, although tensions are very high, and much depends upon China's actions regarding its assistance to Russia and the development of the war in Ukraine. The Taiwan situation also remains crucially important.

Globally, our central bank expectations were accurate for the 2Q, but our calls for mild Fed and ECB cuts in the 4Q23 are no longer consensus. Lastly, our positive stance on global equities was correct, but they gained much more than we expected so far through the 2Q. We predicted a small gain for global bonds in USD terms, but they actually lost ground moderately as yields rose. The weakness in the yen played a major role in the global bond index, which is based in USD. Our preference for equities over bonds was quite also correct, especially as we predicted major equity gains on a 9–12-month view, through which intermediate-term investors could ride out the bumps. As for geopolitics, our view that such would be worrisome but not very impactful on markets has been correct so far.

Looking forward, on 22 June our committee unanimously decided on a macro-economic scenario (among the six presented) in which financial accidents in the West (but not in Asian developed markets) continue to play a role in weakening the economy and restraining investment optimism, but not stopping progress. We judge this to be very close to the consensus view in the markets. We do not necessarily expect any bank runs, although such are far from impossible, private lending, private equity, commercial real estate (including CMBS and bank lending to such) are highlighted areas for likely trouble. Markets are now more attuned to the risks in commercial real estate, but given that it is fairly opaque, with booked prices often lagging reality, and that it is one of largest asset classes in Western economies that is deeply entwined with both large and small banks, it is highly likely that the risks are underappreciated, especially as conditions in many of its subsectors are further worsening to distressing levels, at least in the office sector, in the US and Europe. Other sectors' pricing is also hit by higher interest costs as well as higher cap rates that lower prices of buildings. The risks are even more true now that bank regulators will now be more diligent regarding the pricing of assets and the sectoral concentration of risks, while banks will very likely be turning much more cautious anyway and forced to charge higher rates to clients given that funding costs (except perhaps for the largest banks but possibly for them too as investors continue to shift away from low-rate accounts) are rising.

Given this as a backdrop, our scenario predicts that globally, GDP will virtually match consensus in the next four quarters. Thus, we forecast: **US** GDP up 0.0% on a Half on Half Seasonally Adjusted Annualised Rate (HoH SAAR, as used in all references below) in the 2H23 and 0.4% in the 1H24; **Eurozone** GDP at 0.8% and 0.7%, respectively; **Japan**

at 1.0% and 0.9%; and **China** at 4.5% and 4.9%. For CY23 GDP growth, the US, the Eurozone, Japan and China should be 1.1%, 0.5%, 1.3% and 5.7%, respectively with CY24 at 0.6%, 0.9%, 0.9% and 4.7%. Clearly, consensus is quite subdued for the global economy, with quite a few economists predicting recessions, **and indeed, we will likely see one in a technical sense in the 2H in the US, but only a shallow one that could be considered a soft landing.** Meanwhile, Europe and Japan should avoid recession. Economic growth will likely be constrained by inflation and disruption related to strikes, especially in Europe (but not in Japan), and if such occurred a deeply disturbing way, a significant global recession is likely. As for China, we expect much more significant economic stimulus ahead, with the central government also alleviating the debt burden for local governments. We expect that services consumption in China remains quite firm and will increasingly drive economic growth in the quarters and years ahead.

Geopolitics

Not only will the Ukraine conflict continue to be a major problem, but North Korea, China/Taiwan and the Middle East require close monitoring. However, we do not expect these issues to roil markets very long, though they will likely cause quite a bit of occasional volatility.

As for US political risk, the country remains mired in conflict and we expect continued turbulence. House Republicans will continue to investigate Democrats, including President Biden, which will likely prove unsettling. The net result of all of this should make risk markets and business leaders somewhat wary, but normally, as long as the economy and corporate profits are not impacted by political turbulence, US markets often overlook such. Fortunately, urgent government action does not seem needed at this time and we expect annual fiscal appropriations to squeak through just like the debt limit did. It's hard to believe, but by the end of this forecast period, we will be deep into the next Presidential election, which will likely be full of surprises and uncertainties.

Our detailed forecasts:

Scenario 3	Jun 16 2023	Sep 2023	Dec 2023	Mar2024	Jun 2024
JP Uncollateral Call	-0.10%	-0.10%	-0.10%	-0.10%	-0.10%
US FF Rate	5.25%	5.50%	5.50%	5.25%	4.75%
ECB Policy Rate	3.50%	3.75%	3.75%	3.50%	3.50%
UK Policy Rate	4.50%	5.00%	5.00%	4.75%	4.50%
JP 10Y Bond	0.41%	0.45%	0.65%	0.70%	0.70%
US 10Y Bond	3.77%	3.80%	3.70%	3.60%	3.50%
Euro 10Y Bond	2.47%	2.60%	2.50%	2.40%	2.30%
UK 10Y Bond	4.41%	4.50%	4.40%	4.30%	4.20%
AUD 10Y Bond	4.03%	4.10%	4.00%	3.90%	3.80%
USD/JPY	141.80	139.00	135.00	133.00	131.00
EUR/USD	1.09	1.10	1.11	1.12	1.13
GBP/USD	1.28	1.29	1.30	1.31	1.32
AUD/USD	0.69	0.69	0.70	0.71	0.71
SPX	4410	4590	4547	4716	4820
Euro STOXX	456	490	505	515	525
FTSE	7569	7900	8200	8350	8500
TPX	2300	2360	2390	2430	2500
Nikkei 225	33706	34500	35000	35500	36500
Hang Seng	20040	22044	23046	23046	23046
ASX	7251	7350	7500	7600	7700
Oil Brent	77	74	74	73	73
Gold	1971	1930	1930	1930	1930
BBG Commod (DJ UBS)	105	99	98	95	95

Central banks: Fed and ECB peak in 3Q and start cuts in 1Q

Our new view on central banks is not too different than consensus, although perhaps a tad more dovish than such in the short term. We expect the Fed to hike 25 bps in the 3Q, and then pause until cutting 25 in the 1Q and 50 in the 2Q. As for the ECB, we expect a similar path, but without the 2Q24 cut. The BOJ will likely increase the YCC band to 75 bps in 4Q, and maintain it there, without hiking policy rates (although it may tinker with the negative interest rate policy's tiering system to make them less onerous to banks). Furthermore, the Fed and ECB will proceed with QT and also, along with the BOJ, reduce their balance sheets by winding down special pandemic-related lending programs.

US and European bond yields begin downward in 4Q, with yen's major rebound

For bonds globally, weak economic growth, financial sector accidents and a continuing decline in inflation should help restrain yields, although the final ECB and Fed hikes and continuing QT certainly will prove to be headwinds. Due to the financial scares, yields have already dropped substantially, and we see only moderate scope for continuation of such. Thus, for US and German 10Y bonds, we expect rates to be relatively flat through September, but to decline 10 bps in each following quarter, whereas for Japan we expect stability until rising to 0.7% in the 4Q. Regarding forex, we expect the USD to decline ahead with **the yen rising a great amount as 1) the BOP trade deficit in goods and services finally returns to surplus led by increased auto exports, a further surge in tourism receipts as group tours from China (which used to account for about 50% of tourists, but has only slightly recovered so far), 2) a continued surge in foreign investment in Japanese equities and 3) a sharp 4Q narrowing in the USD policy rate differential.**

One should remember that fixed mortgage rates, though down from their highs, have soared globally, and even if they decline a bit, they will continue to cause a major headwind to residential property market prices, which in turn should cause negative wealth effects and also credit problems. Also, in many countries, especially the UK, anyone with a variable mortgage rate will suffer major cost increases that will likely lead to a significant number of defaults. Also, overdue residential rent cases in the US are surging and many tenants will likely exit their apartments, leaving landlords and any securities based on housing (with a similar situation for commercial properties) vulnerable to shocks.

We forecast that the FTSE WGBI (index of global bonds) should produce in USD terms a 1.6% unannualised total return from our base date of 16 June through September, 4.0% at year-end and 9.0% by next June. Thus, we are very positive on bonds. For yen-based investors, however, this index in yen terms should return only -0.5%, -1.0% and 0.7% through those respective periods due to yen strength, with JGBs returning -0.2%, -2.0% and -2.3%, respectively, so bonds should be avoided.

The Brent oil price will likely be volatile occasionally, but decline, in our view, to around USD 74 in each of the next four quarters. Of course, the Russian and Iran questions loom large, both geopolitically and as regards global oil supply, but we think that supply will adjust to any troublesome conditions in relatively short order. Chinese demand should remain quite firm along with its economic growth, in particular the increase in travel abroad stimulating jet fuel demand. Other commodity prices should decline mildly, in our view.

Greatly due to the high base effect caused by the peak of commodity prices in 2022, coupled with deceleration in other prices (but not the oddly calculated medical cost component that will likely rebound after October), we expect the headline and core CPI readings to approximate the consensus estimates of considerable deceleration ahead, with the former at 3.2% and 2.6% in December 2023 and June 2024, respectively, and the latter at 3.8% and 2.7%. As for further details, housing rent will likely decelerate sharply, with airfares, new and used cars, apparel, home furnishings and many services prices softening too due to stagnant demand. Eurozone and Japanese CPIs should decelerate greatly ahead too, although the Eurozone will take even longer to approach the ECB's target, as second round effects and labour strikes are quite pervasive.

Equities should continue rising, with the US underperforming

Obviously, our scenario is quite positive for global equities, so **we have a positive view on global equities for the four quarters ahead.** Aggregating our national forecasts from our base date, we forecast that the MSCI World Total Return Index in USD terms will grow 5.2% through September, 6.0% through December and 13.2% through June (3.1%, 0.9% and 4.6% in yen terms, so Japanese investors should clearly prioritise investing domestically).

In the US, the SPX's PER on its next-twelve-months (NTM) consensus EPS estimate is very high at 19.0, but earnings should bottom soon and then rebound in 2024, buybacks remain strong and the prospect of a dovish Fed should encourage investors despite some financial accidents. Thus, in sum, we expect somewhat moderate gains for the SPX as follows: to rise to 4,590 (4.5% total unannualised total return from our base date) at end-September, to 4,547 in December (4.0% return), then to 4,820 at end-June 2024 (10.9% return), with yen-based returns of 2.5%, -1.0% and 2.5%, respectively. We expect **the US to underperform greatly in the quarters ahead**.

European equities' PER is only 12.9 times NTM EPS consensus estimates, which is around its historical average. A key factor for performance (along with, of course, the Russia-Ukraine situation) will be how pervasive labour strikes (and the resulting wage increases) are. We are a bit pessimistic on that front, given the confrontational socialist backdrop there, but we believe this problem will likely peak soon. Meanwhile, there could be some problems associated with Europe's commercial and residential property sectors will likely cause some banking troubles, but given that EPS expectations will likely increase further due to the stable global backdrop, we expect the Euro Stoxx index to rise to 490 at end-September and FTSE to 7,900, which translates to a total return of +8.3% (unannualised from our base date) for MSCI Europe through then in USD terms (with the euro rising moderately for this and later periods). Thereafter, we expect 13.7%, through December and +21.8% through March, which **argues for an overweight of the region**.

Japanese equities have performed quite well in USD terms year-to date, with TOPIX rising about 20% in yen terms and about 10% in USD terms, but the latter lags the SPX and Eurostoxx returns of around 14%. Corporate profit margins remain very high with sales rebounding nicely in yen terms. Given the full re-opening of the economy (including inbound tourism), consumer optimism is rebounding. High inflation, which has worried consumers, looks set to decline ahead, especially given our anticipated rebound in the yen. Notably the import price index is now solidly negative YoY and we expect commodity prices to fall further, so this index should be even more negative ahead. The auto sector, which is a major portion of the stock market and economy, is finally recovering, but exports have lagged because there was so much pent-up domestic demand to fulfil. But we expect auto exports to accelerate further ahead. Meanwhile, global tech sector demand is widely predicted to recover ahead, which would be a boon to Japan's exports. China's economic rebound is also helping Japan's exports and its factories there. As noted above, tourism will likely be boosted by increased numbers from the crucial origin of China. Meanwhile, Japan has low political risk and structural reform is continuing, especially in digitalization and alternative energy. Japan's low exposure to Russia is fortunate, and it has secured its natural gas supplies from Sakhalin for the intermediate term. Meanwhile, the country will benefit greatly from lower commodity prices. TOPIX's PER is now up to 15.1 times its NTM consensus EPS, which is likely a bit too low. Also supporting the market are strong share buybacks and the market's dividend yield, which at 2.3% remains extremely attractive vs. bonds. Thus, with a fairly stable global backdrop, especially from China, we forecast TOPIX to rise to 2,360 at end-September, 2,390 at end- December and 2,500 next June for total unannualised returns of 5.4% in USD terms (3.3% in yen terms), 10.4% (5.1% in yen terms) and 20.2% (11.1% in yen terms), respectively, from our base date through those periods. As for the Nikkei, it should hit 34,500, 35,000 and 36,500, respectively. **Thus, returns are decent in yen terms, but very attractive in USD terms for both domestic and global investors, so we have an overweight stance on the market**.

Developed Pacific-ex Japan MSCI: Australia will likely be hurt by declining commodity prices and lower global growth. Meanwhile, the domestic downturn in property prices is a headwind for many consumers due to the wealth effect, and for banks and construction firms too. Improved demand from China and more tourists from there and elsewhere are tailwinds, however, as is the decline in domestic bond yields after the 3Q. Hong Kong's stock market, which is dominated by PRC firms, rebounded sharply in the 4Q when China pivoted, but has softened since then. Hong Kong is certainly benefitting from a revival in tourism and the rebounding local property market certainly helps too, as will dovish central banks after the 3Q. The positive global market trend is bound to weigh on local stocks too, so we expect very strong gains from Hong Kong. Thus, we expect the region's MSCI index returns in USD terms (total unannualised) at 5.7% through September, 10.9% through December and +15.9% through June. Thus, **developed Asia is highly evaluated in the quarters ahead, but not the top choice**.

Investment strategy concluding view

We expect occasionally quite volatile, but positive trends for the global economy, financial system and markets in each of the next four quarters. Regionally, we prefer the European market for the next two quarters, and also include Japan's on a 9–12-month view. Overall, this clearly leads to an overweight view for equities during the year ahead. As for bonds, we are also quite optimistic globally, excluding Japan, for USD based investors over the each of the next four quarters. Our stronger yen scenario means, however, that Japan's investors should overweight their own stock market, not only vs. JGBs and global bonds, but vs. overseas equities, as well.

Important information: This document is prepared by Nikko Asset Management Co., Ltd. and/or its affiliates (Nikko AM) and is for distribution only under such circumstances as may be permitted by applicable laws. This document does not constitute personal investment advice or a personal recommendation and it does not consider in any way the objectives, financial situation or needs of any recipients. All recipients are recommended to consult with their independent tax, financial and legal advisers prior to any investment.

This document is for information purposes only and is not intended to be an offer, or a solicitation of an offer, to buy or sell any investments or participate in any trading strategy. Moreover, the information in this document will not affect Nikko AM's investment strategy in any way. The information and opinions in this document have been derived from or reached from sources believed in good faith to be reliable but have not been independently verified. Nikko AM makes no guarantee, representation or warranty, express or implied, and accepts no responsibility or liability for the accuracy or completeness of this document. No reliance should be placed on any assumptions, forecasts, projections, estimates or prospects contained within this document. This document should not be regarded by recipients as a substitute for the exercise of their own judgment. Opinions stated in this document may change without notice.

In any investment, past performance is neither an indication nor guarantee of future performance and a loss of capital may occur. Estimates of future performance are based on assumptions that may not be realised. Investors should be able to withstand the loss of any principal investment. The mention of individual securities, sectors, regions or countries within this document does not imply a recommendation to buy or sell.

Nikko AM accepts no liability whatsoever for any loss or damage of any kind arising out of the use of all or any part of this document, provided that nothing herein excludes or restricts any liability of Nikko AM under applicable regulatory rules or requirements.

All information contained in this document is solely for the attention and use of the intended recipients. Any use beyond that intended by Nikko AM is strictly prohibited.

Japan: The information contained in this document pertaining specifically to the investment products is not directed at persons in Japan nor is it intended for distribution to persons in Japan. Registration Number: Director of the Kanto Local Finance Bureau (Financial Instruments firms) No. 368 Member Associations: The Investment Trusts Association, Japan/Japan Investment Advisers Association.

United Kingdom: This document is communicated by Nikko Asset Management Europe Ltd, which is authorised and regulated in the United Kingdom by the Financial Conduct Authority (the FCA) (FRN 122084). This document constitutes a financial promotion for the purposes of the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the FCA in the United Kingdom, and is directed at professional clients as defined in the FCA Handbook of Rules and Guidance.

Luxembourg and Germany: This document is communicated by Nikko Asset Management Luxembourg S.A., which is authorised and regulated in the Grand Duchy of Luxembourg by the Commission de Surveillance du Secteur Financier (the CSSF) as a management company authorised under Chapter 15 of the Law of 17 December 2010 (No S00000717) and as an alternative investment fund manager according to the Law of 12 July 2013 (No. A00002630).

United States: This document may not be duplicated, quoted, discussed or otherwise shared without prior consent. Any offering or distribution of a Fund in the United States may only be conducted via a licensed and registered broker-dealer or a duly qualified entity. Nikko Asset Management Americas, Inc. is a United States Registered Investment Adviser.

Singapore: This document is for information to institutional investors as defined in the Securities and Futures Act (Chapter 289), and intermediaries only. Nikko Asset Management Asia Limited (Co. Reg. No. 198202562H) is regulated by the Monetary Authority of Singapore.

Hong Kong: This document is for information to professional investors as defined in the Securities and Futures Ordinance, and intermediaries only. The contents of this document have not been reviewed by the Securities and Futures Commission or any regulatory authority in Hong Kong. Nikko Asset Management Hong Kong Limited is a licensed corporation in Hong Kong.

New Zealand: This document is issued in New Zealand by Nikko Asset Management New Zealand Limited (Company No. 606057, FSP22562). It is for the use of wholesale clients, researchers, licensed financial advisers and their authorised representatives only.

Kingdom of Bahrain: The document has not been approved by the Central Bank of Bahrain which takes no responsibility for its contents. No offer to the public to purchase the Strategy will be made in the Kingdom of Bahrain and this document is intended to be read by the addressee only and must not be passed to, issued to, or shown to the public generally.

Kuwait: This document is not for general circulation to the public in Kuwait. The Strategy has not been licensed for offering in Kuwait by the Kuwaiti Capital Markets Authority or any other relevant Kuwaiti government agency. The offering of the Strategy in Kuwait on the basis a private placement or public offering is, therefore, restricted in accordance with Decree Law No. 7 of 2010 and the bylaws thereto (as amended). No private or public offering of the Strategy is being made in Kuwait, and no agreement relating to the sale of the Strategy will be concluded in Kuwait. No marketing or solicitation or inducement activities are being used to offer or market the Strategy in Kuwait.

Kingdom of Saudi Arabia: This document is communicated by Nikko Asset Management Europe Ltd (Nikko AME), which is authorised and regulated by the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the Financial Conduct Authority (the FCA) in the United Kingdom (the FCA Rules). This document should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko AME.

This document does not constitute investment advice or a personal recommendation and does not consider in any way the suitability or appropriateness of the subject matter for the individual circumstances of any recipient. In providing a person with this document, Nikko AME is not treating that person as a client for the purposes of the FCA Rules other than those relating to financial promotion and that person will not therefore benefit from any protections that would be available to such clients.

Nikko AME and its associates and/or its or their officers, directors or employees may have or have had positions or material interests, may at any time make purchases and/or sales as principal or agent, may provide or have provided corporate finance services to issuers or may provide or have provided significant advice or investment services in any investments referred to in this document or in related investments. Relevant confidential information, if any, known within any company in the Nikko AM group or Sumitomo Mitsui Trust Holdings group and not available to Nikko AME because of regulations or internal procedure is not reflected in this document. The investments mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors.

Oman: The information contained in this document neither constitutes a public offer of securities in the Sultanate of Oman as contemplated by the Commercial companies law of Oman (Royal decree 4/74) or the Capital Markets Law of Oman (Royal Decree 80/98), nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in the Sultanate of Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market law (issued by Decision No. 1/2009). This document is not intended to lead to the conclusion of any contract of whatsoever nature within the territory of the Sultanate of Oman.

Qatar (excluding QFC): The Strategies are only being offered to a limited number of investors who are willing and able to conduct an independent investigation of the risks involved in an investment in such Strategies. The document does not constitute an offer to the public and should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko Asset Management Europe Ltd (Nikko AME). No transaction will be concluded in your jurisdiction and any inquiries regarding the Strategies should be made to Nikko AME.

United Arab Emirates (excluding DIFC): This document and the information contained herein, do not constitute, and is not intended to constitute, a public offer of securities in the United Arab Emirates and accordingly should not be construed as such. The Strategy is only being offered to a limited number of investors in the UAE who are (a) willing and able to conduct an independent investigation of the risks involved in an investment in such Strategy, and (b) upon their specific request.

The Strategy has not been approved by or licensed or registered with the UAE Central Bank, the Securities and Commodities Authority or any other relevant licensing authorities or governmental agencies in the UAE. This document is for the use of the named addressee only and should not be given or shown to any other person (other than employees, agents or consultants in connection with the addressee's consideration thereof).

No transaction will be concluded in the UAE and any inquiries regarding the Strategy should be made to Nikko Asset Management Europe Ltd.

Republic of Korea: This document is being provided for general information purposes only, and shall not, and under no circumstances is, to be construed as, an offering of financial investment products or services. Nikko AM is not making any representation with respect to the eligibility of any person to acquire any financial investment product or service. The offering and sale of any financial investment product is subject to the applicable regulations of the Republic of Korea. Any interests in a fund or collective investment scheme shall be sold after such fund is registered under the private placement registration regime in accordance with the applicable regulations of the Republic of Korea, and the offering of such registered fund shall be conducted only through a locally licensed distributor.