For Professional Investors Only

RBC BlueBay
Asset Management

Macro markets - seven key investment themes for 2023

This year kicks off with macro markets bang in the middle of a difficult transition phase. Positive price action in fixed income markets and stocks in October and November last year could be interpreted as the market front running a more benign outlook for macro data and central bank policy. But after the final round of major central bank meetings in December, our fear is that the Federal Reserve (Fed) and the ECB have other ideas and are not yet ready to sanction any kind of pivot. It would need inflation and economic activity indicators to continue to weaken. As we move into this new phase, we have identified seven key macro market themes for 2023:

1. All eyes on the pivot

A meaningful pivot from the Fed becomes more realistic if labour markets soften materially (US payrolls declining towards flat, job openings falling rapidly and the claimant report showing a meaningful increase). And then financial assets can continue to rally. However, the counterfactual also applies. If the US labour market does not soften, then the Fed will continue to hike the US base rate well above 5% and will not cut rates towards the end of the year. Currently, the market is dismissing the concerns of the Fed, and pricing a fairly benign path for interest rates over the next 12-18 months: the terminal rate below 5% in Q1 and then at least two cuts of 0.25% before year-end.

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2. China's reopening is the real pivot

Forget the Fed pivot, this is the real pivot. One of the strongest themes right now in global macro is China's reopening which is gathering pace. The most obvious implication is a return of cross-border travel from the Chinese. And the timeline for this seems to be even more accelerated than previously expected, as evidenced by the scrapping of all quarantine measures for inbound travellers to China. Furthermore, domestic demand in China should step up as activity and mobility rise. This will have important implications for oil and energy and will benefit commodity exporters: Australia, Brazil, and Chile, to name a few. And while the China reopening theme is a few months old we don't believe it is well positioned because it only started to gather steam towards the end of the year-end when investors were reluctant to allocate in size to new themes. And more importantly, there has been skepticism on this theme at every stage. There's more to go here.

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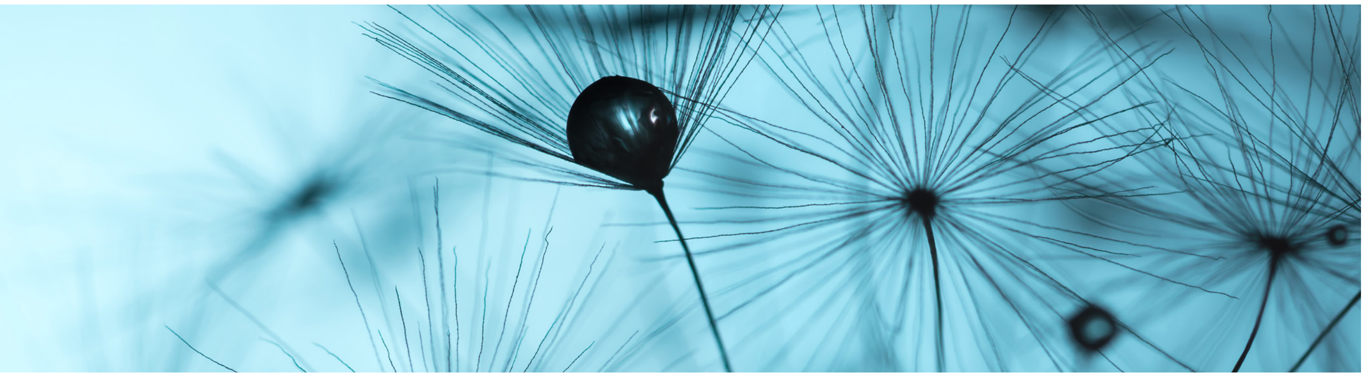
3. Moderating Inflation

When we look at the macro data points that came out in December, there are nascent signs that inflation is moderating in many parts of the global economy and the latest CPI data out of the US was most encouraging. The burden of proof has shifted heavily to macro data points in the first quarter to justify the more positive tone and the benign path for monetary policy that has emerged in recent months. There is an open question of whether inflation falls back to target in a relatively short time, and there is a myriad of macro factors that present crosswinds to the macro outlook. We have doubts that these headwinds will be superseded by the prospect of the major central banks shifting to a rate-cutting mode. Aside from the strong labour market, the energy crisis and demands that climate change put on economic structures will remain important and will present new threats and opportunities. There are also heightened geopolitical tensions and uncertainty over how the conflict between Russia and Ukraine will play out.

4. Tight labour markets headwind

When we focus on inflation, we observe there are new factors at play in the US that have the potential to keep wages rising and the labour market tighter than has historically been the case. We believe that it is in one significant area, the labour market, that there are worrying signs that slaying the inflation dragon might take longer and require more drastic action from monetary policy than is currently priced. Labour markets in many key economies remain concerningly tight. There is no doubt unemployment is a lagging indicator, however, there are structural factors at work that potentially point to labour markets remaining tighter for longer. These factors include labour hoarding, skills shortages, reduced labour market mobility, and declining immigration.



5. Alternatives should provide resilience

We continue to find a strong focus on alternatives through multiple channels (wealth management, LDI, private banking and general financial institutions). While there has been an appreciation of the degree of value creation in the long only space, given where core yields are, and with spreads also historically attractive in some areas, alongside that, we also find a healthy amount of scepticism that we can revert to a pre-Covid world. Alternative strategies are often more flexible and offer more diversified sources of returns than traditional long only strategies. In particular, proven absolute return macro strategies will remain in high demand.

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6. Quantitative tightening risks heighten

Market volatility is likely to remain high. But perhaps the most important driver, however, will be the fact that monetary policy across the globe will remain in restrictive territory for an extended period. With many central banks also embarking on quantitative tightening, liquidity will continue to be drained out of the system. This global tightening of financial conditions, at a time of slowing growth (even recessionary conditions) and rising default rates, will result in greater dispersion in macro conditions. Good policy making will be rewarded, bad policy making will be punished.

7. A bottom-up approach

With uncertainty high, and crosscurrents buffeting the global economy, we are reluctant to take big-macro directional bets, but on balance are more disposed to back the Fed. In our global macro strategy, this makes us negative on the outcome for core rates and we are short US duration in the 10-year part of the curve. We are also cautious about risk in general and running credit and FX exposure close to neutral. At the current juncture, picking winners and losers at an idiosyncratic, bottom-up level makes more sense.

Author

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Russel is the lead portfolio manager for BlueBay's global macro strategy. He joined BlueBay in September 2010 as a Portfolio Manager responsible for the firm's European government and aggregate bond portfolios. Prior to BlueBay, Russel worked at Invesco Asset Management from 2000 to 2010, where he was responsible for managing multi-currency global fixed income portfolios for retail and institutional clients. He was also Co-Head of Global Alpha (ex US). Prior to joining Invesco, Russel worked at Citigroup Asset Management. Russel was born and raised in Zimbabwe, he attended University in South Africa where he earned a Post Graduate Diploma in Management from the University of Cape Town in 1996 and a Bachelor of Arts degree in Economics and Journalism from Rhodes University in 1995.

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