STRATEGY OUTLOOK

January 2023

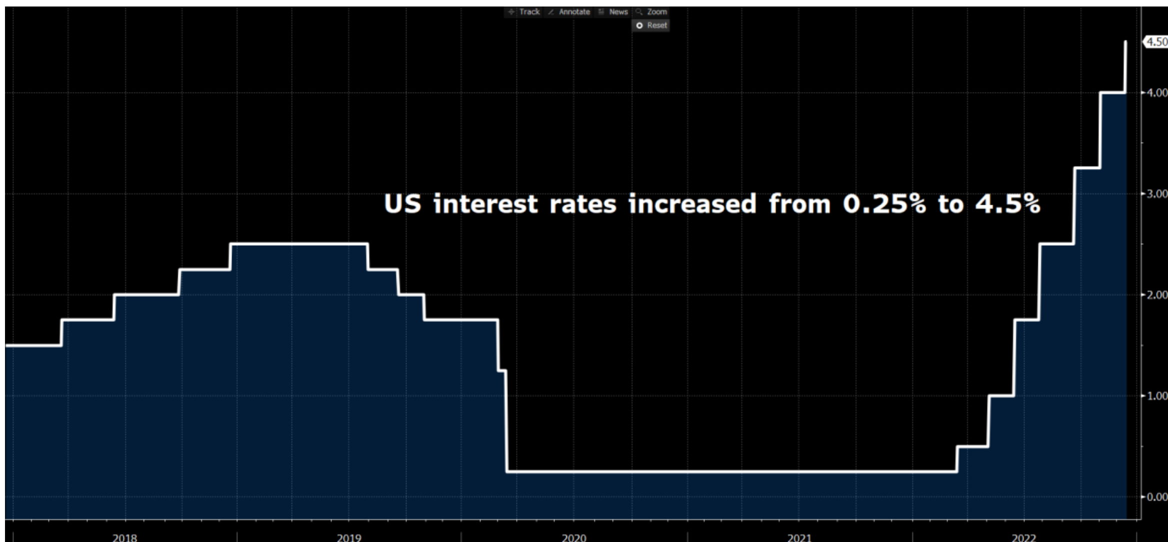
Key takeaways-

- A year to remember or a year to forget? 2022 returns
- 2023 – issues remain but so do opportunities.

A year to remember or a year to forget. Irrespective there are certainly lessons to take away and learn from. The range of drivers, many of which are ongoing, have been from the full gambit of economics, politics, society, and geopolitics. However, as we look into 2023, we are more optimistic on market conditions and hence returns.

In brief: 2022 in terms of asset price performance in USD was:

- +10.5% Brent Crude Oil
- +8.2% USD Index
- -0.3% Gold
- -9.9% FTSE 100
- -12.5% US Government Bonds
- -14.6% Copper
- -15.6% Swiss Market Index
- -16.9% Euro Stoxx 50
- -19.4% S&P 500
- -33.1% NASDAQ
- -64.2% Bitcoin



US interest rates going from 0.25% in Q1 2022 to 4.5% (see chart above) sets the scene for 2023 and indeed 2024. **The financial system has weathered this tightening so far, but it has been close.** The bailout (for want of a better word) of the UK LDI/defined benefit pension scheme is perhaps just one public clue that things were not right.

On top of market dislocations, we believe another reason for increased quantitative easing (QE) and not tightening (QT) at some stage is the **likely collapse going forward in US government tax receipts**. This is at a time when interest expense (with rising interest rates) is near record highs and clearly there is no government desire to cut back on expenses. All this means higher bond issuance and ultimately the Fed back to financing the government with QE.

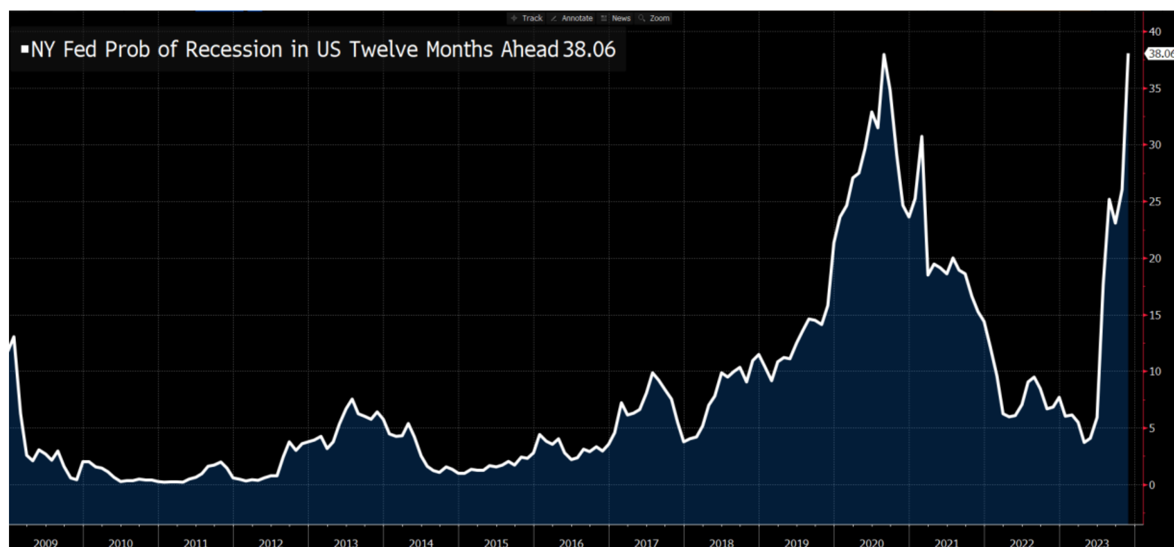
One example is California. California's GDP is 15% of US GDP or the equivalent of the fourth largest economy in the world. The state is looking at its financing having been in $100bn surplus moving to a $25bn deficit. Drill down and 1% of tax returns paid 49% of California's personal income taxes in 2020. That 1% derive a lot of their income from capital gains, stocks, and bonds.

More hints are coming from **the housing market that all is not well**. New York office space bid-offer is widening. Average weekday occupancy remains below 50%. Blackstone have just gated their $68bn property fund (REIT) and announced the sale of its 49.9% interest in MGM Las Vegas and Mandalay Bay casinos. Other REITS (Starwood) have followed suit. **This is, however, not 2008/2009;** just some signs of stress given the rapid rise in interest rates this year. Again, we do not believe the Fed will blow up the system, they will instead follow their tried and tested methods and re-ignite QE.

Gold remains king in this environment. Gold in USD terms is -0.3% for the year. However, in EUR terms it is +5.9%, in GBP terms +11.5% and in JPY terms +13.6%.

Portfolios remain long the asset both in the underlying asset and in gold miners. As we noted in previous strategy outlooks the big takeaway from the Ukraine/Russia/US war is the clear message for nation states to have a plan B. Rightly or wrongly the US can and will shut down a nation's ability to transact via its controlled monetary systems and seize assets without legal recourse. It's therefore not surprising at all to see **massive central bank gold buying** in Q3. This spiked to 400 tonnes over the quarter against an average of around 100 tonnes per quarter going back to 2010. In that same period central banks sold $424bn in US Treasuries – again another reason to think someone has to buy US debt i.e., the Fed via QE.

As we discussed last month, the prospect of a recession in 2023 is a base case, but we really do not know how deep and for how long it will last. It is also widely discussed and



factored in that it is **more likely that the reality is shallow and brief**. The chart above shows the New York Fed's probability of a recession in 12 months, now sitting at 38%.

China is expected to **reopen** its borders and ease Covid-19 restrictions on January 8, 2023. The news had a positive initial impact on markets. Many companies will switch back to full production. Increased consumer spending will result in higher global growth. With the reopening, China's demand for commodities will push prices higher. **Copper** is likely to surge as buyers start restocking again. Goldman Sachs increased its price expectation for copper from USD 9,000 to USD 11,000 per tonne within the next 12 months. Exporters will benefit from higher commodity prices while energy importing countries will suffer. Hence, inflationary pressure is likely to endure.

The path of inflation really is key for 2023. Once inflation is falling, the market can ignore the Fed's hawkish rhetoric as it looks forward. This ushers in a pause from central banks. However, political/career concerns start driving decision making in each central banker as they will be wary of what history will write about them. However, the lags and drivers involved today are significant; from global supply chains to Covid-19 responses to volatility in energy prices. A nice quote from former Fed Chair Ben Bernanke does a good job -

"If making monetary policy is like driving a car, then the car is one that has an unreliable speedometer, a foggy windshield, and a tendency to respond unpredictably and with a delay to the accelerator or the brake "

As we look into 2023, we remain cautious on Europe. Indeed, if rates do not fall, we could also see big hits to consumption in Australia, the UK and Canada where mortgages are typically floating or short duration with overleverage commonplace.

Europe, not Russia, is paying the price for sanctions. In a recent comment from the Brookings Institute "it outsourced its security to the US, its export led growth to China, and its energy needs to Russia ". They are being forced to buy US energy at 4-5x the price and are now in a forced deindustrialization. As time and narrative march on, combined with the bombing of the Nordstream pipelines, the stances deepen with negotiation sadly looking more and more unlikely.

BASF Chief Executive Martin Brudermuller announced the firm would downsize in Europe "as quickly as possible, and also permanently." **The chemicals industry in Germany employs 350,000 people**. Indeed, a recent poll by the main business lobby found that nearly one in four Mittelstand companies (small to medium sized enterprises) were considering moving production abroad. **Another issue is EU regulation** which is creating "great uncertainty "according to Mr Brudenmuller**.** Moreover, **the plan to derive 80% of Germany's electricity from renewables by 2030** is another item on the list. One report describes that to meet this target Germany needs to put up six wind turbines a day, requiring 3,300 tonnes of steel per day or nearly half an Eiffel Tower. Between January and June of 2022, Germany managed less than one turbine a day. Coal still makes up 30% of Germany's power and this is increasing.

Germany now plans a 33% windfall tax on gas, coal, and oil firms. The economic theory the author learnt at university had an underlying principle that began with the premise that economic actors are rational. How far from reality were those economic textbooks? A great quote from twitter of all places -

"History is the long cycle of societies oscillating between self-harm and self-help"
D. Grice.

Opportunities in 2023

Our medium-term themes are energy transition, the future of food, digitalization, de-dollarization, global compartmentalization, and hard money. For 2023 we like gold (and other precious metals), emerging markets, copper, oil, and bonds. We are focussed on value where there are good stocks with solid businesses and dividends that will double the investment in 5-10 years based on a flat share price.

Ultimately, the **outlook continues to point towards a defensive stance on markets.** We go into the new year long bonds, short stocks with gold and alternatives unchanged. A year is a long time, and we will be guided by our themes which will come in and out of vogue.

We would like to take this opportunity to wish you all a happy and relaxing New Year and leave you with a quote

"Time is the most valuable asset you don't own "
M. Cuban.

J.Loudoun

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