# Morgan Stanley says: In an environment of slow growth, lower inflation and new monetary policies, expect 2023 to have upside for bonds, defensive stocks and emerging markets. Investors may find themselves a bit whiplashed in 2023 as inflation and some of this year’s other dominant market trends fully reverse themselves, according to the 2023 Strategy Outlook from Morgan Stanley Research. “For markets, this presents a very different backdrop than 2022, which was marked by resilient growth, high inflation and hawkish policy,” says Andrew Sheets, Chief Cross-Asset Strategist for Morgan Stanley Research. “Overall, 2023 will be a good year for income investing.”

# Morgan Stanley says: Bonds—the biggest losers of 2022—could be the biggest winners in 2023, as global macro trends temper inflation next year and central banks pause their rate hikes. This is particularly true for high-quality bonds, which historically have performed well after the Federal Reserve stops raising interest rates, even when a recession follows. Similarly, emerging market equities and debt, which were early to underperform in this economic cycle, could be early to recover in the next, as was the case after the dotcom bust of the early 2000s and in 2009 following the financial crisis.

# Morgan Stanley says: Other key takeaways from our 2023 Strategy Outlook: 10-year Treasury yields will end 2023 at 3.5% vs. a 14-year high of 4.22% in October 2022. With favorable pricing, securitized products, such as mortgage-backed securities, will offer upside. S&P 500 will tread water, ending 2023 around 3,900, but with material swings along the way. U.S. dollar will peak in 2022 and declines through 2023. Emerging-market and Japanese equities could deliver double-digit returns. Oil will outperform gold and copper, with Brent crude, the global oil benchmark, ending 2023 at $110.

# Morgan Stanley says: Overall, investors will need to be more tactical and pay close attention to the economy, legislative and regulatory policy, corporate earnings and valuations, says Mike Wilson, Chief Investment Officer and Chief U.S. Equity Strategist for Morgan Stanley. “Because we are closer to the end of the cycle at this point,” Wilson says, “trends for these key variables can zig and zag before the final path is clear.  While flexibility is always important to successful investing, it's critical now.”

# Morgan Stanley says: In 2023, with interest rates set to decline, conditions bode well for stable and attractive bonds, as prices move in the opposite direction of yields. Morgan Stanley fixed-income strategists forecast high single-digit returns through the end of 2023 in German Bunds, Italian Government bonds (BTPs) and European investment-grade bonds, as well as in Treasuries, investment-grade bonds, municipal bonds, mortgage-backed securities issued by government sponsored agencies and AAA-rated securities in the U.S.

Morgan Stanley says: However, investors should keep a close eye on quality. U.S. high-yield corporate bonds may look enticing, but they may not be worth the risk during a potentially extended default cycle. “We are wary of unfinished business with high-yield” says Global Director of Fixed Income Research Vishy Tirupattur. Conversely, securitized products, such as mortgage-backed securities, auto-backed securities and collateral debt obligations, could offer income opportunities. Spreads—or the excess yield versus low-risk government bonds with similar maturities—are the widest they’ve been since the pandemic. Meanwhile, rising rates are limiting the supply of new securities coming on the market. This is particularly true for agency mortgage-backed securities. “Not only are they the most liquid asset, they’re also starting from the most attractive valuation. Nominal spreads on mortgages produced today have not been this wide since the fourth quarter of 2008,” says Tirupattur. “Additionally, slowing housing activity will shrink the net supply of these securities.”

Morgan Stanley says: Equities next year, however, are headed for continued volatility, and we forecast the S&P 500 ending next year roughly where it started, at around 3,900. “Consensus earnings estimates are simply too high, to the point where we think companies will hoard labor and see operating margins compress in a very slow-growth economy,” says Wilson. To that end, investors should consider the higher-yielding parts of the equities market, including consumer staples, financials, healthcare and utilities. European equities could offer a modest upside, with a forecasted 6.3% total return over 2023 as lower inflation nudges stock valuations higher. “This should ultimately more than offset the 10% earnings-per-share decline we expect from weaker top-line growth and material margin disappointment,” says Graham Secker, Head of European and U.K. Equity Strategy. Financials and energy are more likely to perform well in this environment, he says.

Morgan Stanley says: This has been a major bear market for emerging market, but the tide could be turning, says Jonathan Garner, Chief Asia and Emerging Market Equity Strategist.  “Valuations are clearly cheap, and cyclical winds are shifting in favor of emerging markets as global inflation eases more quickly than expected, the Fed stops hiking rates and the U.S. dollar declines,” he says, adding that over the last several economic cycles, emerging markets have recovered before U.S. markets. In particular, investors should keep an eye on Mid and large-cap companies: The MSCI EM, an index of mid and large-cap companies in 24 emerging markets, could see 12% price returns in 2023. Japanese stocks, meanwhile, could benefit from a combination of low valuations and idiosyncratic tailwinds—translating to 11% gains for the Tokyo Stock Price Index next year.

Morgan Stanley says: Emerging market debt: Another potential bright spot, EM debt could benefit from a combination of trends—including declining rates, improving economic fundamentals and a weakening dollar. Fixed-income strategists forecast a 14.1% total return for emerging market credit, driven by a 5% excess return and a 9.1% contribution from falling U.S. Treasury yield. Emerging market local currency denominated debt should see an even stronger total return of 18.3%.

JPMorgan says: 2023 Market Outlook: Stocks Set to Fall Near-Term as Economic Growth Slows . The global economy is projected to expand at a sluggish pace of around 1.6% in 2023 as financial conditions tighten, the winter aggravates China’s COVID policy and Europe’s natural gas problems persist. The global economy is not at imminent risk of sliding into recession, as the sharp decline in inflation helps promote growth, but the J.P. Morgan Research baseline view assumes a U.S. recession is likely before the end of 2023. In the first half of 2023, the S&P 500 is expected to re-test the lows of 2022, but a pivot from the Fed could drive an asset recovery later in the year, pushing the S&P 500 to 4,200 by year-end.

JPMorgan says: There is good and bad news for equity markets and more broadly risky asset classes in 2023. The good news is that central banks will likely be forced to pivot and signal cutting interest rates sometime next year, which should result in a sustained recovery of asset prices and subsequently the economy by the end of 2023. The bad news is that in order for that pivot to happen, we will need to see a combination of more economic weakness, an increase in unemployment, market volatility, decline in levels of risky assets and a fall in inflation. All of these are likely to cause or coincide with downside risk in the near term.

JPMorgan says: 2022 was a shocking year. Against the historic volatility of 2020 and 2021 — which saw the deepest global downturn on record, followed by the strongest rebound — 2022 growth outcomes were far more stable. But this year has been remarkably turbulent, with the global economy hit by multiple adverse shocks — from supply and demand issues spilling into labor markets and a third major wave of COVID-19 to Russia’s invasion of Ukraine.Turning toward 2023, the monetary policy tightening drag is building and central banks remain on the march. Of the 31 countries J.P. Morgan Research tracks, 28 have raised rates. There is likely more to come. Based on its current guidance, the Federal Reserve (Fed) will have delivered a cumulative adjustment of close to 500 basis points (bp) on rates through the first quarter of 2023. Central bank activity is clouding the outlook for next year somewhat as the Fed, followed by other major central banks, is expected to pause hikes by the end of the first quarter of 2023.

JPMorgan says: Global GDP growth in 2023 is forecast to climb 1.6%. Developed Market growth is forecast at 0.8%, U.S. growth is forecast at 1%, Euro Area growth is projected to come in at 0.2%, China’s economy is forecast to grow 4.0% and Emerging Market growth is forecast at 2.9% in 2023. The substantial rise in borrowing costs is already depressing housing activity and the sharp climb in the U.S. dollar is likely weighing on U.S. corporate profit margins. There are also increasing signs that credit conditions are tightening broadly. Tremors emanating from Emerging Market (EM) low-income commodity importers, U.K. pension funds and the U.S. crypto sector are not unrelated: they signal that rapidly tightening financial conditions generate stress that could spill over in ways that threaten macroeconomic stability. With the winter set to aggravate China’s COVID problems and Europe’s natural gas crisis, the global growth outlook remains depressed, but we do not see the global economy at imminent risk of sliding into recession in early 2023. The financial conditions drag is being cushioned by a fading of supply chain and commodity price shocks,” said Bruce Kasman, Head of Economic and Policy Research at J.P. Morgan.

JPMorgan says: Global consumer price index (CPI) inflation is on track to slow toward 3.5% in early 2023 after approaching 10% in the second half of 2022. “Circumstances warrant considering a range of scenarios. The dominant event across different scenarios presented is a U.S. recession…but the timing of this break, the path of Fed policy and the reverberations for the rest of the world vary,” added Kasman.

JPMorgan says: Stock Market Outlook.After a year of macroeconomic and geopolitical shocks, investors responded by derating the S&P 500 price to earnings (P/E) ratio as much as seven times, while some speculative growth segments crashed 70-80% from highs.

Although fundamentals have been resilient throughout these shocks, this year’s constructive growth backdrop is not expected to persist in 2023. Fundamentals will likely deteriorate as financial conditions continue to tighten and monetary policy turns even more restrictive. The economy is also likely to enter a mild recession, with the labor market contracting and unemployment rate rising to around 5%.

JPMorgan says: “Consumers with a cushion of savings from lockdown have mostly exhausted their post-COVID excess cash and for the first time are getting hit by a broadening negative wealth effect from all assets simultaneously — whether that’s housing, bonds, equities, alternative/private investments or crypto,” said Dubravko Lakos-Bujas, Global Head of Equity Macro Research at J.P. Morgan. “This proverbial snowball should continue to gain momentum next year as consumers and corporates more meaningfully cut discretionary spending and capital investments.”

JPMorgan says: In the first half of 2023, we expect the S&P 500 to re-test the lows of 2022 as the Fed overtightens into weaker fundamentals. This sell-off combined with disinflation, rising unemployment and declining corporate sentiment should be enough for the Fed to start signaling a pivot, pushing the S&P 500 to 4,200 by year-end 2023. In light of these factors, J.P. Morgan Research is reducing its below consensus 2023 S&P 500 earnings per share (EPS) of $225 to $205 due to weaker demand and pricing power, further margin compression and lower buyback activity. Upside and downside to this base case will largely depend on the depth and length of the recession and the speed of the Fed’s counter-response. Market volatility is also set to remain elevated (with the Volatility Index or VIX averaging around 25).

JPMorgan says: The convergence between the U.S. and international markets should continue next year, both on a USD and local currency basis. The S&P 500 risk-reward relative to other regions remains unattractive. Continental European equities have a likely recession to negotiate and geopolitical tail risks, but the eurozone has never been this attractively priced versus the U.S. Japan should be relatively resilient due to solid corporate earnings from the economy’s reopening, attractive valuation and smaller inflation risk compared with other markets.“Within developed markets, the U.K. is still our top pick. As for EM, its recovery is mostly linked to China. Tactically, the Asia reopening trade led by China is overdue and the activity hurdle rate is very easy, with further policy support likely. We expect around 17% upside for China by the end of 2023,” said Mislav Matejka, Head of European and Global Equity Strategy at J.P. Morgan.

JPMorgan says: Commodities Outlook. Entering 2022, the view was the global oil market would remain tight but balanced, with Brent averaging $90 per barrel (bbl) for the year. With the [onset of the war in Ukraine](https://www.jpmorgan.com/insights/research/europe-energy-crisis), J.P. Morgan Research opted to raise its 2022 average Brent price to $104/bbl and 2023 price to $98/bbl, with prices peaking in the second quarter of 2022 at $114/bbl. “After maintaining our price view for eight months, we now opt to shave $8 off our 2023 price projections, on our expectations that Russian production will fully normalize to pre-war levels by mid-2023. Despite more pessimistic expectations for balances over the next few months, we find the underlying trends in the oil market supportive and expect global Brent benchmark price to average $90/bbl in 2023 and $98/bbl in 2024,” said Natasha Kaneva, Head of Global Commodities Strategy at J.P. Morgan.

### JPMorgan says: Commodity price forecasts 2023. Commodity price forecasts for 2023, with Brent averaging $90 per barrel, WTI averaging $83 and gold averaging $1,860 in the fourth quarter of 2023. There are strong reasons to expect a relatively robust 1.3 million barrels per day (mbd) of oil demand growth next year, despite expectations for the global economy to expand at a sub-par 1.5% pace in 2023. There is still substantial room for a cyclical rebound, driven by a continued normalization of demand for mobility fuels like gasoline, diesel and jet fuel to pre-COVID levels.“Our forecast of a $90 Brent in 2023 centers on the view that the OPEC+ alliance (Organization of the Petroleum Exporting Countries and allies) will do the heavy lifting to keep markets balanced next year,” added Kaneva. On the structural side, expansion of the world’s oil supply growth is expected to slow in 2024, reviving the need for OPEC’s crude. Growth from U.S. shale producers, traditionally the most responsive to changing market conditions, is expected to more than halve from 1.1-1.2 mbd this year and next to 0.5 mbd in 2024.

JPMorgan says: For base metals, 2023 will be a transitional year, with prices once again re-testing the lows approached earlier this year around mid-2023. “After bottoming over mid-year, a more sustained recovery in base metals prices is set to unfold in the last few months of the year,” said Greg Shearer, Head of Base and Precious Metals Strategy at J.P. Morgan. Relative to base metals, the outlook for precious metals is more positive, with all but palladium expected to end 2023 higher. With the Fed on pause, decreasing U.S. real yields will drive the bullish outlook for gold and silver prices over the latter half of 2023. Gold prices are forecast to push up to an average $1,860 per troy ounce in the fourth quarter of 2023. “Even with a bullish baseline gold and silver forecast, we think risk is skewed to the upside in 2023. A harder-than-expected economic landing in the U.S. would not only attract additional safe haven buying, but the rally could become supercharged by more dramatic decreases in yields if the Fed more rapidly unwinds tighter fiscal policy,” added Shearer.

## JPMorgan says: The Forecast for Rates and Currencies. Over the past year, the Fed has been forced to tighten aggressively, outpacing every tightening cycle over the last three decades.

For 2023, it is no surprise that inflation and Fed rate policy remain top of mind for investors: in the J.P. Morgan Research 2023 Outlook Survey, respondents ranked these two factors as the most important for U.S. fixed income markets in 2023, followed by U.S. recession risks. With inflation already showing signs of softening, the Fed is expected to deliver a 50bp hike in December, before dialing down the tightening pace further and delivering 25bp hikes at both the February and March meetings. It is expected to pause rate hikes thereafter. “The almost 500bp of expected cumulative hikes is already delivering a commensurate tightening of financial conditions, which we believe will tip the economy into a mild recession later next year. With a slowing in aggregate demand, we project the unemployment rate will rise to 4.3% by the end of next year,” said Jay Barry, Co-Head of U.S. Rates Strategy at J.P. Morgan.

JPMorgan says: 10-year U.S. Treasury yields are expected to fall to 3.4% by the end of 2023 and real yields are expected to decline.Investors expect the Fed to be on hold through early 2024 or beyond. 55% of investors polled by J.P. Morgan in its 2023 Outlook Survey expect the Fed to be on hold through the first quarter of 2024 or beyond. 2023 should deliver the completion of one of the fastest and most synchronized Developed Market (DM) central bank tightening cycles on record, with most of them expected to be done by the first quarter of 2023. The growth profile will show divergence: the Euro area will likely face a mild recession into late 2022/early 2023, while the U.S. is expected to slide into recession in late 2023.

JPMorgan says: In currency markets, further dollar strength is still expected in 2023, but of a lower magnitude and different composition than in 2022. The Fed pause should give the dollar’s rise a breather. Additionally, unlike in 2022, lower-yielding currencies like the euro are expected to be more insulated as central banks pause hikes and the focus shifts to addressing slowing growth — but this in turn makes high-beta, emerging market currencies more vulnerable. Weak growth outside the U.S. should also remain a pillar of USD strength in 2023. “Some growth signals suggest an improvement outside the U.S., but we are skeptical of the longevity of this theme,” said Meera Chandan, Co-Head of Global FX Strategy at J.P. Morgan.

## JPMorgan: Emerging Markets Outlook. At 2.9% in 2023, EM growth looks to remain well below its pre-pandemic trend, slowing modestly from 2022. EM excluding China is expected to slow to a below-trend 1.8% with wide regional divergences. In China, the full-year 2023 growth forecast is 4% year-over-year, where two quarters of below-trend growth are assumed as the economy loosens COVID restrictions. The global and U.S. economic cycles will remain the primary drivers for EM assets in 2023. The worst moves for EM risky asset classes are seen in U.S. recessions with large widening in credit spreads and lower equity prices.Dwindling private sector savings will test EM’s ability to withstand continued tightening in global financial conditions and weaker global growth. 2022’s geopolitical stresses remain unresolved and represent two-sided risks for EM in 2023, while some key domestic political events will be followed closely — most notably the elections in Turkey and Argentina. JPMorgan says: Disinflation is expected in 2023, but with few rate cuts across EM central banks and focused mostly in Latin America. EM ex-China and Turkey inflation is expected to halve to 4.3% by end-2023 compared with 7.9% in end-2022. “Inflation is expected to remain a problem for central banks in roughly half of the core EM countries. Some EM central banks may start easing next year but most look set to keep rates high for longer,” said Luis Oganes, Head of Currencies, Commodities and Emerging Markets Research at J.P. Morgan.JPMorgan says: Stubbornly high inflation, continued USD strength and a broader tightening in global financial conditions mean easing cycles are only expected to get underway in Latin America, Czechia and India. The rest of EM Asia, having lagged its EM peers in lifting off, is expected to stay on hold next year. “The global and U.S. economic cycles will remain the primary drivers for EM assets in 2023. The worst moves for EM risky asset classes are seen in U.S. recessions with large widening in credit spreads and lower equity prices. EM has historically followed these patterns and we expect higher risk premia into a U.S. recession, although the moves may be mitigated by the selloff already seen in 2022,” added Oganes.

JPMorgan says:  As investors navigate increasingly complex markets, J.P. Morgan Global Research is looking forward to continuing our partnership, providing investment insights and ideas in 2023 and beyond.

Goldman Sachs says: US Economics Analyst 2023 US Economic Outlook: Approaching a Soft Landing. The key macroeconomic question of the year has been whether inflationary overheating can be reversed without a recession. Our analysis suggests that the answer is yes—an extended period of below-potential growth can gradually reverse labor market overheating and bring down wage growth and ultimately inflation, providing a feasible if challenging path to a soft landing. The initial steps along this path have been successful, but there is much further to go in 2023. We expect another year of below-potential growth and labor market rebalancing to solve much but not all of the underlying inflation problem. Unlike consensus, we do not expect a recession.

Goldman Sachs says: The first step in keeping the adjustment process on track is ensuring that GDP growth remains below potential. The fiscal tightening that helped to slow the economy this year has mostly run its course, but the large tightening in financial conditions engineered by the Fed should keep GDP growth near 1% in 2023. Consumer spending should grow a bit more firmly as income begins to rise again, but this is likely to be offset by weakness elsewhere, especially in housing.

Goldman Sachs says: The second step requires soft GDP growth to further reduce labor demand. So far, the speed and composition of labor market rebalancing have been encouraging. Our jobs-workers gap has shrunk substantially, driven by a decline in job openings rather than employment. In 2023, we expect a further large decline in job openings coupled with a ½pp rise in the unemployment rate to shrink the jobs-workers gap from the historical peak of 5.9 million reached earlier this year to the 2 million threshold that we estimate is necessary to dampen labor market overheating.

Goldman Sachs says: The third step requires labor market rebalancing to slow wage growth. Wage growth has begun to moderate in recent months, and we expect it to fall to 4% by the end of 2023, not far above our 3.5% estimate of the pace compatible with 2% inflation. If so, this intermediate step would provide crucial early support for the view that overheating can be reversed without a recession.

Goldman Sachs says: The fourth step requires softer wage growth to bring inflation back to target. This should get underway in 2023 but will take longer. We expect core PCE inflation to fall from roughly 5% to 3% by December 2023, driven largely by goods categories where supply chain recovery is now reversing pandemic shortages. Services inflation is likely to fall meaningfully in the official data only with a longer lag, especially in the largest categories, shelter and health care. n We expect the FOMC to slow the pace of rate hikes as it shifts to fine-tuning the funds rate to keep growth below potential, but to ultimately deliver a bit more than is priced, with a 50bp hike in December and three 25bp hikes next year raising the funds rate to a peak of 5-5.25%. Our recession odds are below consensus even though our Fed forecast is slightly more hawkish than consensus because we expect demand to prove more resilient than expected next year