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MARKETS AND ECONOMY | OUTLOOK

# 2023 Investment Outlook: Multi-Asset

*By: EV Forward | December 14, 2022*

**Rebalancing Acts**

**KEY POINTS**

1. The global economy should normalize as pandemic pressures ease.
2. Imbalances in labor and energy markets pose a greater inflation risk for Europe than the U.S.
3. China is redoubling efforts at structural reform to put its economy on a path of long-term stability.

**Labor Pains**

With pandemic-related pressures beginning to wane, global rebalancing may be a principal market driver in 2023. We foresee three key areas of rebalancing: labor markets, the energy crisis and China's structural reform shift.

In developed markets, post-COVID employment conditions have favored workers over employers. Even as growth is slowing, the labor market remains resilient. In the U.S., for example, job openings still sit at high levels, but the number of new positions has come down by 1.15 million from a peak of 5.1 million in March 2022. U.S. wage growth is also normalizing, with the rate running at roughly one-half of its 6.6% high in January 2022.[1]

Labor market rebalancing is likely to be slower in Europe, and risks of a wage-price spiral are higher. Compared to prepandemic levels, indicators such as total employment numbers, hours worked and participation rates have risen more in the eurozone than in the U.S. Labor shortages in the industrial sector should sustain tight employment markets, raising risks that wage increases continue to exert upward price pressures.

**Evolving Energy Landscape**

We expect a transitional year for energy markets. Higher oil and gas prices should combine with slowing economic activity to dampen demand. However, sanctions on Russia are likely to result in tight gas supplies globally. As Russian gas exports look set to fall more sharply next year, we expect that some buyers may switch their energy mix with a move to oil from gas.

OPEC's recent decision to cut production quotas underscores the role that high prices play to incentivize investment. A fall in prices now could disincentivize investment and spell higher prices when demand recovers. In 2023, we expect prices to be supported in the $90 to $100 per barrel (p/b) range. If China achieves a successful reopening from its zero-COVID policy, normalization of demand could push prices above $100 p/b.

**Change in China**

Global supply chain realignments, demographic change, debt deleveraging and a structural shift toward a consumption-led economy will be key trends for China in 2023. Manufacturing and trade are becoming less important in driving economic activity partly because of reduced offshoring by Western companies and rising wage costs in China.

The debt-fueled investment boom has weak foundations, with the country's corporate debt-to- GDP ratio at 218% in 2021,[2] and the property market now saturated. The Chinese government is aware of the urgency for change, which will entail reducing inequality and expanding access to the middle class through its "common prosperity" agenda. These transitions will need to be managed in tandem with the near-term challenge of navigating a COVID reopening.

**Investment Implications**

Economic rebalancing may be tricky in 2023, following a period of profound disruption. Policymakers must carefully weigh their options as they attempt to suppress inflation without harming the economy and financial markets. Labor market and energy challenges will not facilitate a smooth walk across the tightrope for Europe, but the region does appear to be more surefooted than China. The U.S. economy, more

flexible and energy independent, has a slight advantage in unwinding its imbalances.

Overall, we expect fixed income assets to outperform equities in the first half of 2023. Ultimately, the range of potential macro scenarios is wide and dependent on how central banks proceed, particularly the U.S. Federal Reserve. We expect to see a shallow recession and moderate, but still largely restrictive monetary policy. In our view, the paths to rebalancing, and not simply the macro outcomes alone, will matter for markets in 2023. Staying nimble and adjusting investment positions as events unfold will remain key.

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[1] U.S. Bureau of Labor Statistics, Morgan Stanley Investment Management, November 30, 2022.

[2] Bloomberg Economics, December 31, 2021.

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"Staying nimble and adjusting investment positions as events unfold will remain key."

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