



2023: Five Investment Trends for the Next 12 Months

Positioning your portfolio for the challenges and opportunities ahead.

March 2023

KEY INSIGHTS

- While returns in 2023 are not anticipated to be as disappointing for most investors as in 2022, we expect elevated levels of uncertainty and volatility to continue.
- We believe five trends will dominate markets over the next 12 months: (1) inflation, (2) policy, (3) recession, (4) uncertainty and (5) opportunity.
- We have identified a range of investment ideas that we believe may be effective in helping to steer portfolios through the period ahead.

Investment outcomes in 2023 are anticipated to be better for most investors than in 2022. After more than a decade of relatively benign markets, benefitting from low inflation, supportive central banks and moderate economic growth, conditions changed in 2022. With global equities falling 18.0% and global fixed income falling 11.2%,¹ investors had only a few places to hide. Historically high inflationary pressures, central banks aggressively raising interest rates and increasing concerns about an economic slowdown or recession weighed on markets. A new regime has come to pass.

We expect more changes in 2023 as the new regime matures, entering a new phase. Inflation is likely to linger at higher levels but recede over time.

This above-target inflation means that many central banks may well have to keep interest rates elevated for a prolonged time. However, while a pivot to monetary easing may be elusive, this tightening cycle is nearing its peak. The global economy is likely to continue to slow down. It is yet unclear whether major economies will slip into recession or manage to avoid it.

Furthermore, geopolitical risks include the ongoing war between Russia and Ukraine, the impact of the post-COVID reopening and the centralisation of power in China and political polarisation in the US ahead of next year's presidential election. Add to this the recent duress in the U.S. and European banking sectors, and these concerns will continue to have a major impact on sentiment and the direction of the



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— Yoram Lustig
*Head of Multi-Asset Solutions,
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¹ Past performance is not a reliable indicator of future performance.

Sources: MSCI All Country World Index (ACWI) measured in US dollars (USD). Bloomberg Global Aggregate Bond Index hedged to USD (see Additional Disclosures).

markets, adding to uncertainty. So much change means volatility could remain elevated, ripe with both risks and opportunities.

Our Multi-Asset Solutions team has identified five key trends that we believe will drive the performance of markets over the coming 12 months, and beyond:

Five Investment Trends for 2023

1. Inflation: A Path to 2%



After surging to multi-decade highs in 2022, inflation is likely to recede erratically in 2023.

2. Policy: Higher for Longer



Monetary policy tightness is likely to peak in 2023, but a pivot to easing may elude markets.

3. Recession: Dodged or Delayed?



Recession in 2023 remains a risk but also an opportunity.

4. Uncertainty: A World in Revolution



Geopolitical events, increasingly polarised politics and continuous change create uncertainty.

5. Opportunity: Make the Most of the New Normal



Change, and more reasonable valuations, mean opportunities for long-term investors.

1.



Inflation: A Path to 2%

After surging to multi-decade highs in 2022, inflation is likely to recede erratically in 2023.

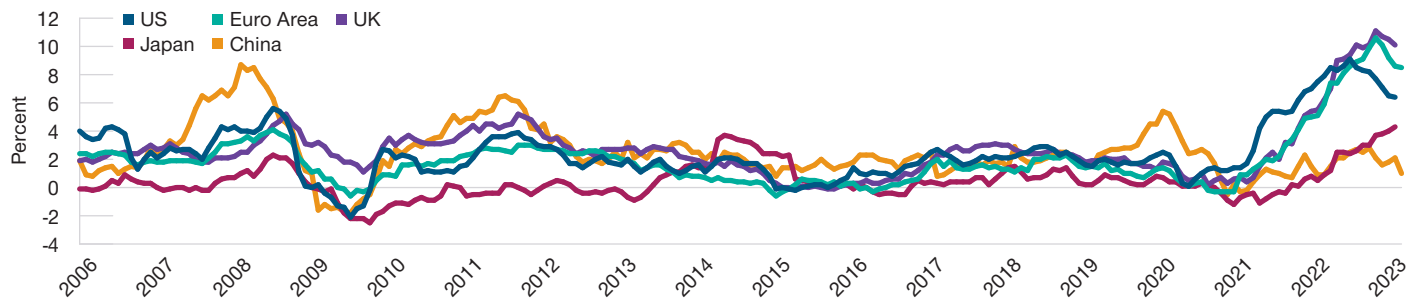
The job of central banks is to manage inflation; for example, the US Federal Reserve has an explicit inflation target of 2%. Inflation in the US and Europe is expected to recede in 2023 because of easing supply-side pressures (e.g., healing supply chains, lower energy and commodity prices), easing demand-side pressures (e.g., normalisation of post-pandemic pent-up demand), base effects (prices will be compared with already elevated

prices a year ago) and, eventually, the impact of tighter monetary policy kicking in with a lag. Disinflation is good news: Inflation is a key risk for markets and the driver behind hawkish central banks.

However, the path for inflation in 2023 is likely to be rocky. As China reopens, inflation may rise as it did in other major economies after the pandemic. Core inflation—excluding volatile food and energy prices—has not yet been falling as rapidly as the headline measure. Inflation has shifted from goods to stickier services. As long as labour markets remain tight, the risk remains that the receding inflation trend may pause or reverse.

Realised Inflation Has Surged but Is Showing Signs of Peaking

(Fig. 1) The path lower is likely to be bumpy



As of 28 February 2023.

Source: CPI/Haver Analytics. Analysis by T. Rowe Price. Monthly, for the period January 2006 through February 2023. Consumer price index (CPI).

Investment Idea #1

	Position for Disinflation	Maintain Inflation Hedges	Play Defence
Rationale	<ul style="list-style-type: none"> Balance investments that should fare well in a disinflationary environment with those that do not perform too badly if inflation continues 	<ul style="list-style-type: none"> Include investments that should fare well in an inflationary environment but do not perform too badly if inflation falls 	<ul style="list-style-type: none"> Include positions that should perform reasonably well if sentiment changes quickly between risk-on (disinflation) and risk-off (inflation)
Examples	<ul style="list-style-type: none"> Mix global value and growth equity, tactically leaning into value or growth cycles Blend US growth and value equity Blend growth-oriented emerging market (EM) equity and value-oriented strategies 	<ul style="list-style-type: none"> Natural resources equity and real estate equity (Real estate investment trusts—REITs) Shorter-duration, high-yielding fixed income (global high yield bonds, emerging market debt) Value stocks with exposure to financials 	<ul style="list-style-type: none"> Cash, which is now yielding interest rates not seen in years Diversified tail-risk mitigation derivative overlays to automatically mitigate downside risk Agile and active portfolio management to adapt as conditions change

Source: T. Rowe Price.

2.



Policy: Higher for Longer

Monetary policy tightness is likely to peak in 2023, but a pivot to easing may elude markets.

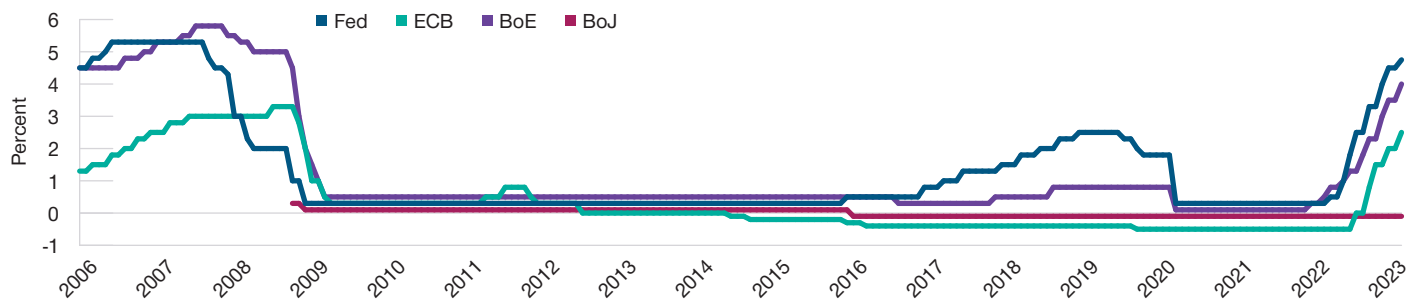
Until they can declare a victory in the war against inflation, central banks are likely to keep policy rates in restrictive territory. The good news is that markets should not undergo the steep tightening of financial conditions experienced in 2022, as central banks move to pause hikes as disinflation sets in. However, many key questions remain. Will US inflation recede to the 2% target or stop at a higher level? What will central banks do if inflation

stops, instead, at around 4%? Will the Bank of Japan (BoJ) change its yield curve control policy, seen as an anchor for rates throughout the world? Will economies slip into recession, forcing a policy pivot from tightening to easing? Will quantitative tightening drain liquidity from fixed income markets? Will the 'central bank put' stage a comeback?

Policy has been a key of markets since the global financial crisis, allowing investment in equities with the implicit safety of a central bank put. Investors need to adapt to the new reality of policymakers focusing on fighting inflation, not soothing markets.

Most Major Central Banks Have Rapidly Tightened Policy Rates

(Fig. 2) Fighting inflation is now the primary focus



As of 28 February 2023.

Source: Central banks. Analysis by T. Rowe Price. Monthly, for the period January 2006 through February 2023. Fed is the US Federal Reserve. ECB is the European Central Bank. BoE is the Bank of England. BoJ is the Bank of Japan.

Investment Idea #2

	Go Global for Bonds	Remain Hydrated	Big in Japan
Rationale	<ul style="list-style-type: none"> Central banks are adopting different policy approaches, while bond yields are at the most attractive levels in years. Global bond diversification could be advantageous if policy eases at different paces 	<ul style="list-style-type: none"> In a volatile environment where central banks are selling bond holdings, maintaining liquidity in portfolios could be an edge 	<ul style="list-style-type: none"> A change of policy by the BoJ may have implications for Japanese assets as well as global rates (Japan's bond market is the second largest after the US in the Bloomberg Global Aggregate Bond Index)
Examples	<ul style="list-style-type: none"> Strategies benchmarked to Bloomberg Global Aggregate Bond Index Global government bonds Diversified, flexible bond strategies 	<ul style="list-style-type: none"> Liquid alternatives, such as multi-asset total return strategies Strategies with daily liquidity Cash and government bonds 	<ul style="list-style-type: none"> Japanese yen may rally if the BoJ changes its policy Japanese equity Dynamic duration management in a global bond portfolio

Source: T. Rowe Price.

3.

Recession: Dodged or Delayed?

Recession in 2023 remains a risk but also an opportunity.

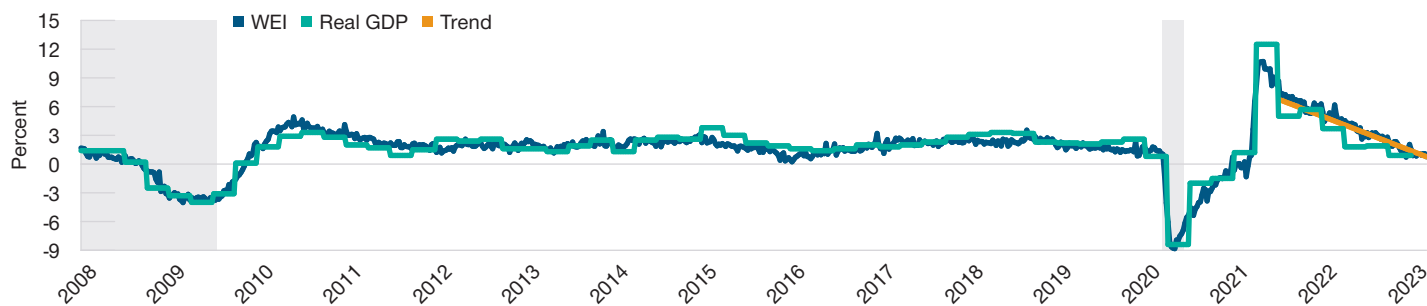
While the global economy has started 2023 in reasonable shape, winning the fight against inflation without a recession is rare. While nobody wants to excessively slow economic growth, central banks may need to push economies into recession to tame inflation. That said, hot labour markets in the US and Europe have been a major obstacle in the path to recession.

Historically, the US has never entered a recession without weakness in the labour market. A global recession—or an economic slowdown—is still a risk in 2023.

However, recession is also part of the business cycle, and a temporary slowdown also brings opportunities. It clears the market of weaker companies with stronger businesses surviving, leading to more reasonable allocation of capital. Stock markets tend to rally before the recession is over, moving from pessimism to pricing in the ensuing recovery.

Leading Indicators Point to a Slowdown in the US, but Not Yet to a Recession

(Fig. 3) The outlook remains finely balanced




As of 4 March 2023.

GDP = Gross Domestic Product.

Sources: Federal Reserve Bank of New York (Weekly Economic Index—WEI), National Bureau of Economic Research (GDP US Chained 2012 Dollars YoY SA). Analysis by T. Rowe Price. Weekly, for the period 2 February 2008 through 4 March 2023. Grey shaded periods reflect economic recessions.

Investment Idea #3

	Preparing for a Recession	The Day After Tomorrow	Create Your Own Put
 Rationale	<ul style="list-style-type: none"> Include investments that should fare well in a recession 	<ul style="list-style-type: none"> Recession is not necessarily bad news, unless something systemic breaks down. Stock markets tend to rally mid-recession, pricing in the eventual recovery. Companies that survive can come out stronger 	<ul style="list-style-type: none"> The central bank put is unlikely to return until bankers can declare mission accomplished in their fight against inflation. Investors should create their own puts while being conscious of costs and efficacy
 Examples	<ul style="list-style-type: none"> Global government bonds with long, high-quality duration Fixed income strategies benchmarked against Bloomberg Global Aggregate Index Defensive equity sectors (e.g., utilities, health care, consumer staples) 	<ul style="list-style-type: none"> Nimble asset allocation, adjusting positioning for developments Have cash on hand, ready to invest in risky assets as sentiment improves or as liquidity distortions provide rare opportunities Liquid alternative strategies that can deliver returns across market environments 	<ul style="list-style-type: none"> Truly defensive strategies, such as unconstrained, defensive fixed income Derivative overlay to mitigate downside risk and manage volatility Tactical asset allocation for agile portfolio management

Source: T. Rowe Price.

4.



Uncertainty: A World in Revolution

Geopolitical events, increasingly polarised politics and continuous change create uncertainty.

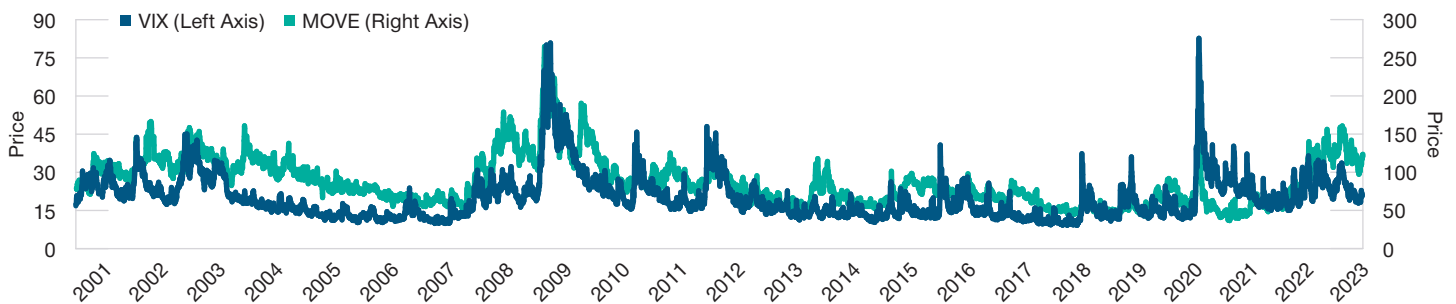
The world is in the midst of a number of secular revolutions: the ongoing information revolution, the green revolution and the remote working revolution. Transitions between regimes means adaptation, and adaptation brings uncertainty. At present, it feels like the world is fraught with even more unsettling events than usual. Some highlights include the war in Ukraine raging on; China’s reopening making

waves across the world; the US debt ceiling meaning a standoff between Republicans and Democrats, attempting brinkmanship in a divided nation; and the tensions between China and the US further escalating. These are the known unknowns, while unknown unknowns may bring new black swans.

When geopolitical events drive sentiment, markets can oscillate between risk-on and risk-off, challenging logical, fundamentals-based investing. Nevertheless, while we tend to focus on ‘what can go wrong,’ uncertainty should also prompt us to look for ‘what can go right.’ When sentiment is fragile, positive developments may lead to a melt up.

Elevated Equity and Fixed Income Market Volatility, But Not Yet at Panic Levels

(Fig. 4) Uncertainty will remain a feature, but not all sources are bad



As of 28 February 2023.

Past performance is not a reliable indicator of future performance.

Sources: Chicago Board Options Exchange Volatility Index (VIX), and ICE BofA MOVE Index (MOVE). Analysis by T. Rowe Price. Daily, for the period 31 August 2000 through 28 February 2023.

Investment Idea #4

	China Reopens	Diversify the Diversifiers	Make Volatility a Friend
Rationale	<ul style="list-style-type: none"> Chinese assets have lagged since the pandemic as the impact of continued lockdowns has been felt. A reopened China has the potential to boost not just its own economy, but countries throughout the region 	<ul style="list-style-type: none"> After failing to diversify portfolios in 2022 due to single risk factors driving markets (e.g., inflation, policy), government bonds may become a diversifier of equity risk again in 2023. However, investors should rely on more than a single diversifier 	<ul style="list-style-type: none"> Volatility could create opportunities for skilled active management. Active managers can thrive on dispersion among investments. Volatility can separate prices from intrinsic values, creating convergence opportunities
Examples	<ul style="list-style-type: none"> Chinese equities with a focus on domestic consumption Asia ex Japan equities Asian credit strategies 	<ul style="list-style-type: none"> Global government bonds, focusing on high-quality duration Safe-haven currencies (e.g., US dollar, Japanese yen, Swiss franc) Defensive strategies and liquid alternatives 	<ul style="list-style-type: none"> Active security selection Tactical asset allocation Managed volatility overlays to maintain overall risk at acceptable levels

Source: T. Rowe Price.

5.



Opportunity: Make the Most of the New Normal

Change, and more reasonable valuations, mean opportunities for long-term investors.

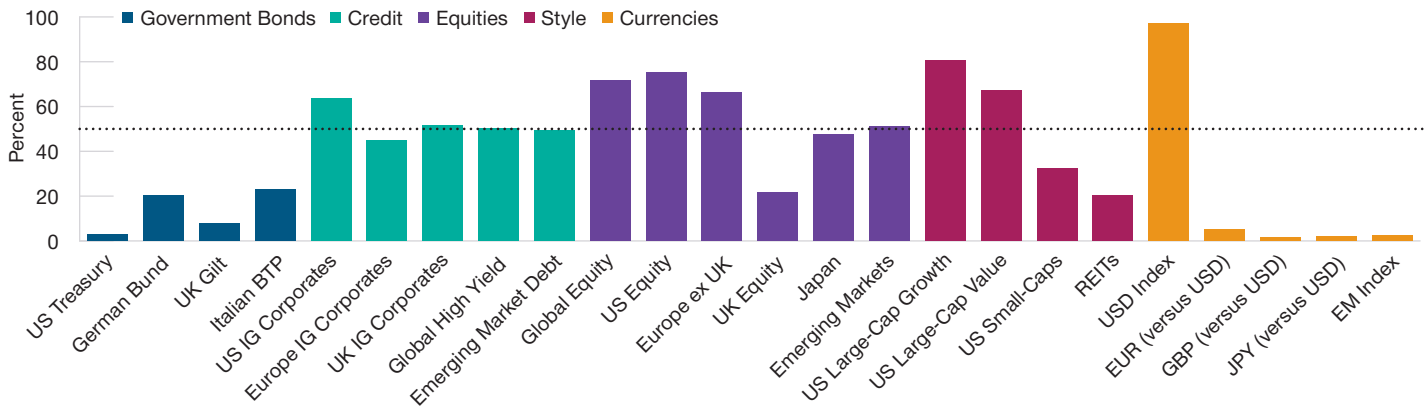
After more than a decade of negative bond yields and cash interest rates at zero, we are getting back to reality. This transition is painful, as we saw in 2022. However, normality can be good. After a brutal 2022, valuations are more

reasonable. Although valuations directly impact returns over the long term, not over the short term, lower valuations today mean higher expected returns in the future.

One theme woven across all others is change. Some existential risks, such as wars, climate change and social transformation, create uncertainty. However, they also bring opportunities for investors who can lean into the change and benefit from its disruption.

Valuations Have Become More Reasonable Across Markets and Asset Classes

(Fig. 5) Opportunities to lean into change for potential long-term reward



As of 28 February 2023.

Sources: T. Rowe Price analysis using data from FactSet Research Systems Inc. All rights reserved. Indices: US 10-year Treasury, German 10-year bund, UK 10-year gilt, Italian 10-year BTP, Bloomberg US Corporate Aggregate, Bloomberg Euro Agg. Corporate, Bloomberg Global Aggregate Corporate—United Kingdom, Bloomberg Global High Yield, Bloomberg EM USD Aggregate, MSCI AC World, S&P 500, MSCI Europe ex UK, MSCI UK, MSCI Japan, MSCI EM, Russell 1000 Growth, Russell 1000 Value, Russell 2000, FTSE EPRA/NAREIT Developed, US dollar index, EUR spot, GBP spot, JPY spot, JPM EM currency index. Monthly, percentile rankings versus past 15 years.

Investment Idea #5

	Time Is on Your Side	ESG and Impact	The Right Side of Change
Rationale	<ul style="list-style-type: none"> Investing when valuations are reasonable has translated in the past to higher long-term returns. For those who can, invest for the long term 	<ul style="list-style-type: none"> The transition to sustainable energy is gaining pace. Leaving a liveable world for the next generation is one of humanity’s greatest challenges 	<ul style="list-style-type: none"> Each decade has seen the largest companies in the world change. This decade is not likely to be different. Disruption is ever present. Investors who identify the trends and surf the wind of change can benefit from emerging opportunities
Examples	<ul style="list-style-type: none"> Small-cap equities European corporate bonds Enter the market over time using dollar cost averaging 	<ul style="list-style-type: none"> Investing in selected sector strategies, such as technology Sustainable and ESG-aware strategies Impact strategies 	<ul style="list-style-type: none"> Growth equity Global equity strategies with a focus on innovation and being on the right side of change Emerging market and frontier market equity

Source: T. Rowe Price.

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