Authored by:
Investment Forum

Jon Maier
Chief Investment Officer

Michelle Cluver
Portfolio Strategist

Morgane Delledonne
Head of Investment Strategy, Europe

Pedro Palandrani
Director of Research

Rohan Reddy
Director of Research

Date: January 24, 2023
Topic: Macroeconomic

Global X House Views – January

Expectations surrounding China's reopening, potential economic contraction in the U.S., and a weaker U.S. dollar are key points of interest for investors in early 2023. While slowing, inflation remains elevated by historical standards and real economic growth expectations are subdued. Shifts away from excess pessimism are presenting opportunities globally.

Global Macro

Interest rate differentials across the globe have contracted subsequently contributing to the weakening U.S. Dollar. Combined with less concern about energy supplies in Europe, this has created a potential opening for increased interest in global risk assets. We maintained our views on U.S. (overweight), international developed equities (neutral) and emerging markets (neutral).

Regional Macro

U.S. Equities	**Overweight**
International Developed Market Equities	**Neutral**
Emerging Market Equities	**Neutral**

United States: Slower Trajectory, but Restrictive for Longer

Central banks have increased interest rates at the fastest rate on record, and there are signs that higher yields are starting to flow into the economy.[1] Central banks globally are hinting at a deceleration of rate hikes as tighter financial conditions seem to be having an impact on inflation. At their November meeting, the U.S. Fed changed their wording, signaling they may lessen the pace of rate increases while shifting the focus to a potentially higher terminal rate and the length of time that the Fed is likely to remain restrictive. The futures market has priced in a 25 basis point hike in the Fed Funds rate for the February meeting. The Fed is aiming for a soft landing, meaning a desired slowing in the economy, but has admitted a risk of a contraction. We currently expect the terminal policy interest rate to be around 5% by mid-year followed by a stabilization period at that level.

We maintained our overweight tilt toward U.S. equities as the Fed is raising interest rates while the U.S. economy remains in a strong position relative to most other economies. However, we are seeing emerging weaknesses in economic data warranting a cautious approach. Personal consumption remained strong in the third quarter although we've noted the increased reliance on credit card debt for consumption while the personal savings rate is nearing its lowest level since 2005. We are also noting falling house prices and higher borrowing costs. Consumption, increased unemployment and elevated inflation remain key areas of focus as economic fundamentals slow.

The appreciation of the U.S. dollar versus its major peers is supporting U.S. equities and particularly internationally exposed companies, including tech companies. It appears that the Fed is approaching

the end of this tightening cycle, which could trigger a gradual rotation back to growth stocks, also supported by large public spending in infrastructure, tech and clean energy.

International Developed Markets: Potential to Surprise to the Upside

Europe appears to be in a stronger position than expected going into winter. European natural gas prices have now returned to their long-term average as the continent successfully shifted gas sourcing. Valuations are starting to look more attractive for European equities presenting opportunities as pessimism decreases. Given a deceleration in inflation, we expect the European Central Bank to likely adopt a lower pace of rate hikes amid declining headline CPI inflation. All these positive factors have provided a backdrop for the U.S. dollar to weaken, which is a positive factor globally.

The Bank of Japan has decided to raise the bar on the ceiling for the 10-year yield in December as the first attempt to exit its ultra-loose monetary policy. Further tightening is now expected as Japan is experiencing the hottest inflation in decades with price growth in Tokyo, a leading indicator for the nation, running at 4%, double the central bank's target.

Emerging Market Equity: Beneficiary of Lower USD and Possible Gradual Reopening of China

A lower U.S. dollar coupled with growth-supportive measures in China, including easing of COVID restrictions, a real estate rescue plan, and expectations of a continued easing of financial conditions from the People's Bank of China, helped Chinese equities rebound. More broadly, the rebound improved investors' sentiment on emerging markets (EM). Improved sentiment was also supported by dialogue resuming between China and the U.S. following a meeting between President Biden and President Xi at the 2022 G20 summit. Although valuations look attractive, the wave of new Covid cases across China could drive more for the volatility in the near-term.

Asset Class Views

Both equities and fixed income stand to benefit as the Fed's trajectory slows. While the economic situation is deteriorating, markets typically bottom before the economy. However, with the rates across the U.S. Treasury curve increasingly positive in real terms and rising recession risks, we believe it's increasingly important to incorporate a barbel approach that includes longer-duration income like exposures to long duration U.S. Treasuries.

We prefer commodities over other assets, but with a somewhat more muted outlook that is increasingly tied to the pace of the reopening of China. A global economic slowdown clouds the outlook for economic growth focused commodities. However, commodities stand to benefit from a potential shift away from USD strength.

Product Opportunities

- **Robotics & AI –** Recent breakthroughs in generative artificial intelligence (AI) have made waves, demonstrating wide-reaching potential. These advances, combined with the reopening of China, the largest market for robotics demands, and the growth of capital spending, are set to support the Robotics & AI theme.

- **Lithium & Battery Tech –** Lithium prices reached over $70,000 at the end of 2022, marking a 156% growth relative to 2021 figures and just shy of their all-time high levels.[2] Lithium pricing trends are deeply rooted in the transportation segment's ongoing shift toward electrification. Elevated lithium prices boost the top and bottom lines for relevant miners.

- **U.S. Infrastructure Development –** U.S. Infrastructure Development continues to be a resilient theme. The 2021 "infrastructure trade" may have passed, but the unwind has created a potential buying opportunity. Longer-term, the Infrastructure Bill from 2021 only accounted for $1.2 trillion of the estimated $2.6 trillion in infrastructure spending over the next 10 years, and private sector investment may be positioned to help fund the shortfall.[3]

- **Copper –** Commodity assets like copper is one our top picks in this environment. With China's re-opening underway, assets tied to China's economy, such as copper, could be poised to benefit. A weakening dollar in light of Federal Reserve guidance could begin to spur emerging market demand more broadly as well. A recovery in markets and tight credit spreads may be a catalyst for increasing activity, which by extension would boost copper, would be another positive.

- **Preferreds –** Interest rates rose substantially in 2022 with inflation and the Federal Reserve's aggressive rate hikes causing a jump in bond yields. With the 10-year yield sitting at 3.87% as of December 30th, coupled with comments from the Fed recently, it's becoming increasingly likely that the Fed's rate hiking cycle may start cooling off earlier in 2023 rather than later. Leveling inflation data could also begin to drive bond yields down or at least keep yields range bound. This may make duration sensitive assets like preferreds more attractive after investors largely eschewed higher duration assets in 2022.

- **Covered Calls –** Equity markets trended downwards for most of 2022. For investors, one way to tackle this is by taking a more nuanced approach towards equities. One solution we prefer in this market environment is covered call strategies as a more defensive approach to equity allocations. Depending on earnings data and other corporate & macro outlooks, markets may continue on a volatile path for 2023. The potential income collected from covered call writing could be particularly attractive to play these market moves. Although volatility has been sharply dropping since mid-October, the merits of utilizing covered call strategies amid choppy equity markets still could make for an attractive value proposition for investors.

- **MLPs –** We view the Energy sector favorably in this environment, as inflationary pressures remain sticky and the likelihood of elevated oil prices continues to persist. One pocket of the Energy sector poised to benefit could be Master Limited Partnerships (MLPs), which are usually midstream pipeline companies. MLPs and other midstream equities do well when volumes increase, and given the energy shortfall, along with the potential for higher energy prices, we think MLPs could be poised to benefit. US oil prices also finished December above $80 a barrel, a level where most production companies can comfortably drill at. China's re-opening policies could also be another added positive towards demand for energy.

Footnotes

1. Ross, J. (2022, October 6). *Comparing the speed of U.S. interest rate hikes (1988 – 2022)*. Visual Capitalist.
2. Benchmark Mineral Intelligence. Price Assessment. (Accessed om Jan 17, 2022).
3. American Society of Civil Engineers. (2021, March 3) *ASCE's infrastructure report card gives U.S. 'C-' grade, says Investment Gap Trillion, bold action needed* [Press release].

Global X Investment Forum

Jon Maier
Chief Investment Officer

Michelle Cluver
Portfolio Strategist

Morgane Delledonne
Head of Investment Strategy, Europe

Pedro Palandrani
Director of Research

Rohan Reddy
Director of Research
