H2 Market Outlook 2023

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H1 2023 in Review

In the US, the S&P 500 index has demonstrated strong performance in the first half of 2023. The index has climbed 13.25% year to date. This robust performance has largely been fueled by large-cap tech stocks, which include major technology companies such as Apple, Nvidia, ASML, Salesforce, and Broadcom.

In the Asian markets, the Nikkei 225 showed strong growth in the first half of 2023. The index gained approximately 20% over the first half of the year, indicating strong growth in the Asian market during this period. During the first half of 2023, the Nikkei 225 outperformed the US market, as represented by the S&P 500. However, both markets showed a positive trend with gains over the period.

Taking Stock

In 2022, the Labour market has shown to be heated. Where the unemployment rate has to increase substantially to bring the labor market back to equilibrium which is ultimately the global consensus. The main cause of it could be related to the high number of job openings instead of the lack of employment such as the 10 million in job openings in comparison to the 6 million recorded unemployment in the US as of Q4 2022 to Q1 2023. Sustainable wage growth from the lowering of job openings has also largely impacted the rate of unemployment which promotes a perspective or consensus for the baseline of the Q2 market to be unlikely headed for recession.

Most narratives in the market would lean towards a worry about inflation and recession. Rate cuts are expected towards the end of 2023 and into the 2024/5 fiscal year. It is possible the pricing in the market is more bearish than what is being priced as a more positive outlook.

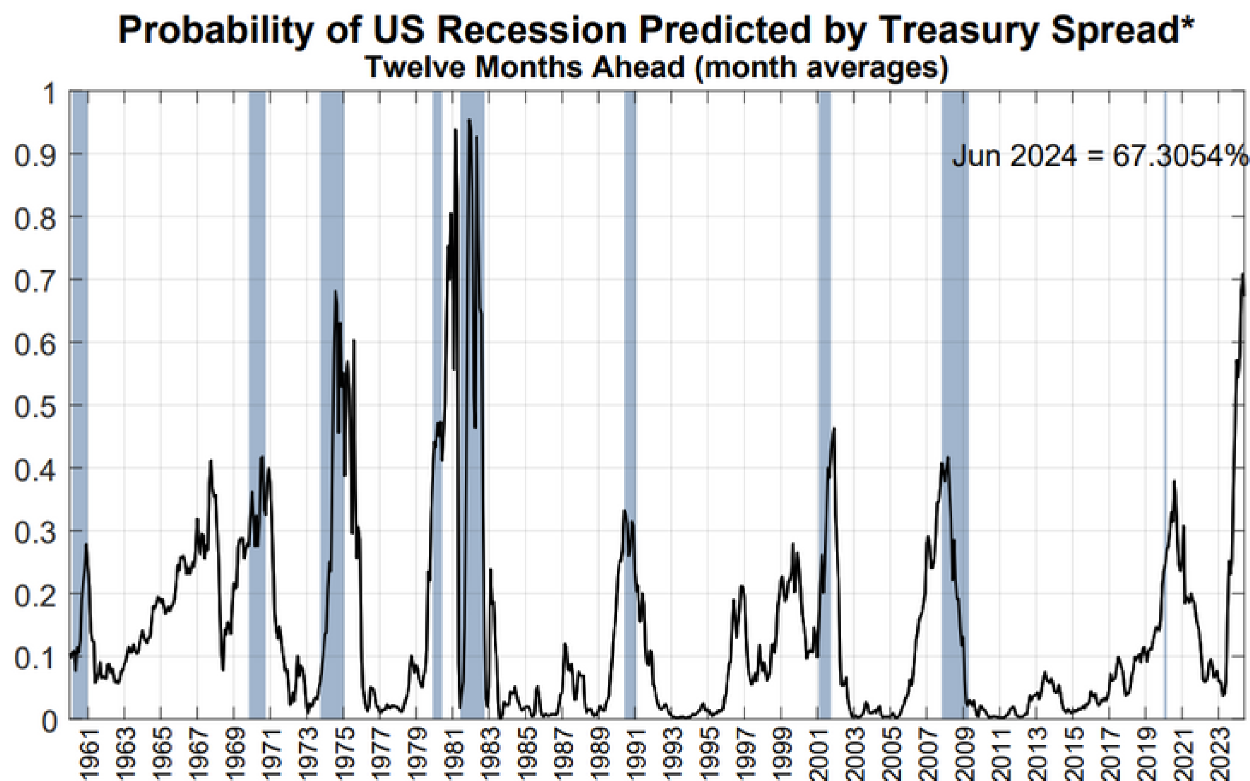
Yield to move higher, growth picture should still hold up and non-US economies should start to pick up in 2023. Possible peaks will unlikely go back as low as the 2022 peak. Risk to the broader asset market is likely to be less intense compared to 2022. Yields of bonds seem to be higher in the overall case of having them in portfolios than supposed stocks.

Equities are cheaper versus 2022, away from the decline but compared to govt bonds and credit yield assets, getting richer, bond curve and long duration equities dominate such as the Cash T bills pricing at 4.65. Valuations overall show that an overall strong bull market is unlikely due to other factors such as exports and imports and consumer consensus. Looking ahead at the rest of 2023, economic growth in the US is expected to move in a bull run, following an overall increase in job employment, services, consumer confidence, and market psychology.

Shaky in the West

The US Core PCE Prices have come in below consensus at 4.1%, suggesting that the Fed's hawkish monetary policy stance is having an impact. Since early last year, the Feds have been adjusting their monetary policy to a target range of 5.25% to 5.5%, up 25 basis points last quarter. While the Fed and the banks have been cautiously optimistic about the future economic outlook for the US markets, we believe that there are still significant uncertainties. The US GDP growth rate for the next quarter is forecasted to be 1.8%, a slight decrease from the previous rate of 2%. We believe that the US markets are sensitive to these economic indicators and may react adversely to changes in the second half of 2023. Although the Fed and the banks have been optimistic about the future economic outlook for the US markets, we believe that the US recession's probability is still significant enough to shake investor's confidence.

The Fed is predicted to continue its hikes later this summer for another 1-2 times, with rates remaining for the medium term(1-2 years). We believe that the US markets have not priced in the anticipated hikes and are expected to continue to pull back in the next half of 2023, possibly inducing the market into a stressed configuration.



*Parameters estimated using data from January 1959 to December 2009, recession probabilities predicted using data through Jun 2023. The parameter estimates are α=-0.5333, β=-0.6330.

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Figure 1. New York Fed | Probability of US Recession Predicted by Treasury Spread

Rising in the East

Japan's economy, which struggled to rebound in the latter half of 2022, has shown notable signs of recovery in 2023. After a contraction in 2022's third quarter and a marginal 0.1% growth in the fourth, economic momentum has picked up since January 2023. The service sector, in particular, has been gaining momentum thanks to a rebound in consumer spending and the reopening of borders. This overall improvement bodes well for the first quarter real GDP growth. The labor market remains relatively tight, and wage acceleration is expected to continue in H2 2023.

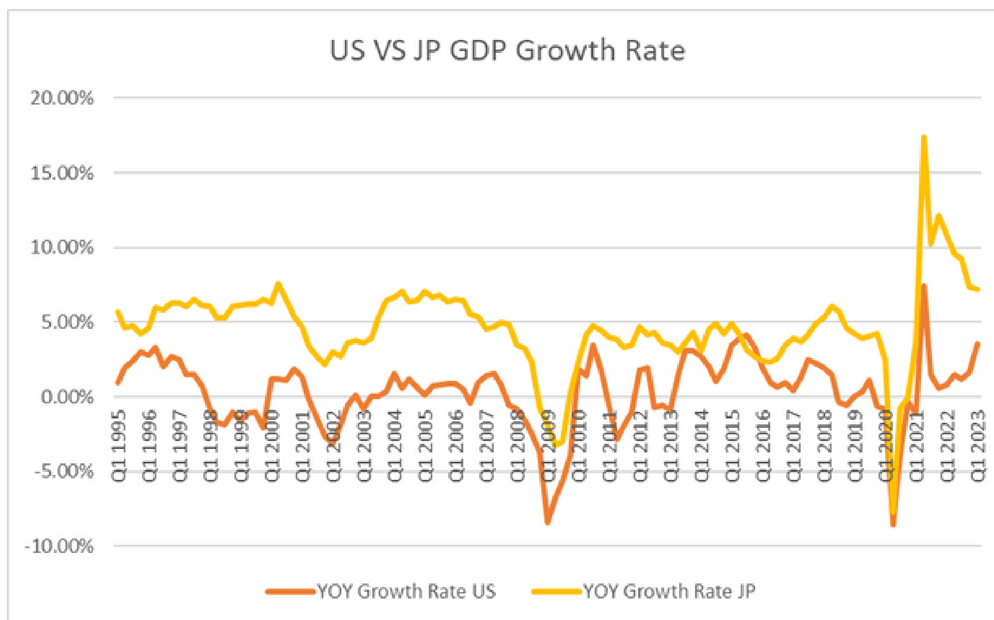

Figure 2. FRED | Comparison of US & JP GDP Growth Rates

The rebound in economic activity has led to inflation exceeding the Bank of Japan's (BoJ) 2% target. Despite the rising inflation, the BoJ has kept its -0.1% short-term interest rate target and a 0.5% cap on the 10-year bond yield under its yield curve control policy. This highly accommodative monetary policy stance aligns with market expectations and positions the BoJ as a dovish outlier among global central banks. However, there may be a need for modest tightening due to inflationary pressures. Factors such as changes to the supply chain, which could lead to increased costs of moving production lines, may also contribute to these pressures. Even though inflation has exceeded the 2% target for BOJ, we believe that inflation levels may start to decrease in 2H 2023; BOJ most likely will not adjust its monetary policy.

In July, the BOJ loosened its yield curve control, causing the 10-year JGB yield to increase to as much as 0.57%. These higher interest rates could signal confidence in the economy's strength, which could boost investor sentiment and support stock prices.

The economy showed more robust growth than initially projected in the first quarter of the year. A post-pandemic pickup in domestic spending and company restocking offset the impact of slowing global demand on exports. The gross domestic product (GDP) expanded at an annualized rate of 2.7% in the January-March period, significantly higher than the preliminary estimate of 1.6% growth.

Private consumption, which accounts for more than half of Japan's GDP, grew by 0.5%. This figure was slightly revised down from an initial estimate of a 0.6% increase but still indicates a resilient economy driven by domestic demand, which contributed 1.0 percentage points to the revised first-quarter GDP growth, more than initially estimated.

Thus, with our increased required rate of return for U.S. equities, the risk-reward profile of Japanese equities has become even more appealing. Japanese equities offer a compelling alternative, given our assessment of the comparable return potential with what we view as a lower-risk profile. Therefore, we recommend an overweight position in Japanese equities relative to U.S. equities. We believe that this positioning will allow us to capture the growth potential in Japan while minimizing our exposure to the risks we currently see in the U.S. market.

Sources: Deloitte, Reuters, FRED, Nikkei Industry Research Institute, New York Fed

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