SKYCASTLE
International Investments

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What Happened in 2022?

The **S&P and Nasdaq were down 19.45% and 32.97%** respectively for the year and the JSE top40 was down **0.14%.** This was due to high inflation and aggressive rate hikes from the Federal Reserve coupled with geopolitical concerns.

Major Index Returns for 2022:

	2022
S&P 500	-19.45%
Nasdaq Composite Index	-32.97%
JSE Top40 Index	-0.14%

Reuters

Expected Headwinds in 2023:

Heading into 2023, inflation seems to finally be subsiding. However, analysts and economists are concerned the Central Banks' battle with rising prices is still far from over, and a recession could be on the menu in the first half of the year. The odds of recession at least priced into financial markets have fallen sharply from their 2022 highs.

1. Inflation, Interest rates, Unemployment & the Fed's Statements

Inflation's surge to **40-year highs** led the Fed to an unprecedented series of interest-rate increases raising rates by **4.25%** in 2022 and are currently sitting at **4.50%.**

US inflation rate ended the year at **6.5%** and The Fed has already raised rates by **25bp** this year and indicated it is aiming to keep raising rates another **50bp** until it hits somewhere around **5% to 5.5%,** signalling Fed officials' concern that inflation will prove to be stubborn. The Fed's goal is to restore the rate of inflation to **2%.**

As the Fed assesses the impact of its rate hikes, the U.S. jobs market will remain a key focus, and tight labour conditions show little sign of easing soon. The Fed does not expect the U.S. employment market to weaken substantially in 2023, with the unemployment rate not moving too much until late 2024.

Locally, with the average annual CPI figure for the whole of **2022 at 6.9%,** economists anticipate that inflation will continue to fall as the year progresses, with projections that headline inflation will be back within the SARB's target band by the end of the year. However continued price hikes, specifically in the energy sector may place the SARB in the position of having to manage high inflation for longer. This increases the risk of more interest rate hikes or holding rates at the current levels for longer.

Analysts are already pencilling in room for another **50bp hike in 2023**. The SARB already rates by **25bp** at its MPC meeting last week.

2. Economic Growth

Contrary to the noise around inflation, rising rates and plunging equity valuations, many major economies are expected to deliver decent growth across 2022.

That's not to say that we're out of the woods just yet, with the forecasted low-point being pushed back from 2022 to 2023. The IMF raised its outlook for the global economy for the first time in a year, pointing to resilient US spending and China's reopening. It expects GDP to expand **2.9%** before ticking up to **3.1%** in 2024. As for the rest of the world, it appears investors will have to wait until 2024 to start seeing signs of a recovery.

Locally, load shedding is a major stumbling block to economic growth and remains a noose around South Africa's growth prospects. Treasury has revised the 2022 economic growth forecast downward from **1.9% to 1.6%** and expects growth to average around 1.6% over the medium term (the next three years).

How we are Positioned?

Alternative Portfolio Positioning:

With differing views on the outlook for 2023 by major Investment houses (S&P at 4200 on the upside and 3500 on the downside), this year should provide lots of volatility. With the volatility in mind, it's important to remember that the **alternative portfolio** has the ability to go **has the ability to go short, long and market neutral.**

It's our opinion that **market volatility** will persist in the medium term, where we will still be looking to select **quality stocks** that are **cash generative** with **strong balance sheets producing solid earnings and guidance's**. This is important as earnings will come under pressure on both the top line (Revenue) on the bottom line (EPS) and should be monitored closely.

Bottom Line:

Volatility should persist for the **foreseeable future**. We're expecting **earnings** to bottom out in **2023** and **history** suggests in the bottoming out process, markets could **rally sharply**. The biggest risk to inflation this year will be the **re-opening** of **China** and we have limited knowledge of what lies ahead for both growth and inflation. Only a spate of **deflation** will get us to the Fed's target of **2%.**

The year will be dominated by talks of **recession**, whether shallow or deep. Market **timing** will be critical as there will be **opportunities** to make money on the **downside**, buy the dip, and make money on the upside. In this *environment, one should have exposure to **the Alternative Investment Portfolio**.*

All the Best from the Skycastle International Investment Team
We used sources from JP Morgan, Reuters, Iress and Greg Saffy to compile this report.