Macro Outlook Summary

December 2022

Markets strongly prefer having just one thing to focus on. For this year, as last year, it is the future path of inflation in Western economies and by extension Central Bank interest rate policy. Interest rates have been and always will be the starting reference point for all asset market pricing and last year delivered a brutal reminder of that fact to unwary investors. Post GFC monetary policy, first reducing o/n rates towards zero and then introducing government bond buying (QE) to manipulate yields downwards, made fixed income investing increasingly irrelevant as the years went by. Government bonds at zero yields served no purpose in investment portfolios for those able to choose and from 2014 onwards credit went the same way, paying yields further and further below the fair market return for those risks. There was a growing disconnect from reality and we certainly found it very hard to live with as our starting point for macro economic forecasting – 'interest rates are at zero' - felt completely wrong and made a nonsense of much investment analysis.

The resulting boom in hard assets, bought with financing, was perfectly logical, even as pricing became increasingly surreal. Residential RE was the obvious beneficiary, but importantly auto finance, home furnishings, electronics and luxury items all benefitted massively from zero rates making these goods increasingly affordable to a wider population.

In a world driven by materialistic aspiration, increasingly achieved through 'American style' mountains of consumer debt, this interest rate policy had the same effect as a massive pay rise for those with income. Objects that were previously unaffordable suddenly became very affordable with cheap financing. Luxury cars etc.

The outcome, being where we are now, was surely not the intention or ultimate goal of CB policy from 2012-21. Adjusting to the reappearance of inflation has been slow and a lot of market thinking is still stuck in the past. Central Bankers once said inflation was transient, but retracted.

Many commentators prefer the transient narrative and forecast an imminent pivot in policy. Investors need to consider this very carefully and understand the odds of different scenarios playing out rather than the simplistic view that things are heading back to how they were before. Experienced voices warn that rates will stay higher for longer as the fight against inflation is unlikely to be easily won. That doesn't preclude significant market rallies as we have just witnessed but more importantly requires good anticipation of new trends in price changes likely to emerge this year. On that point we see some exciting and positive investment opportunities materialising in Asia this year.

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