A Special Report from

SAVVY INVESTOR

2022 Mid-Year Outlook: The balance of power

Discussing the mid-year outlook with leading economists and strategists

Authored by Savvy Investor

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Special Report

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2022 Mid-Year Outlook: The balance of power

SEBASTIAN CULPAN-SCOTT
EDITORIAL DIRECTOR
SAVVY INVESTOR

Sebastian Culpan-Scott is a Chartered Member of the Chartered Institute for Securities & Investment. Prior to joining Savvy in 2020, Sebastian worked as an Investment Manager at Sanlam Wealth and Investec Wealth & Investment.

"MANY MARKET OBSERVERS ARE PREDICTING A U.S. RECESSION WITHIN THE NEXT 18 MONTHS WHICH WOULD HAVE A GLOBAL KNOCK-ON EFFECT."

The first half of 2022 has been challenging for investors due to a number of factors they have to contend with. The war in Ukraine and the disruption to supply chains caused by the lockdowns in China have been key drivers in pushing inflation to its highest level in over 40 years, which has resulted in a slowdown of global economic growth. Central banks across the globe have the daunting task of implementing a contractionary monetary policy that helps to get grip on inflation, while not withdrawing too much liquidity from the market and exacerbating inflation.

Many market observers are predicting a U.S. recession within the next 18 months which would have a global knock-on effect. Global stock markets have already seen a significant pullback in the first half of this year. Despite the current volatility in the markets, investment experts still believe there are opportunities for investors to exploit.

Invesco's '2022 Mid Year Investment Outlook' provides an overview of the current economic environment, and they share their views on the current business cycle and expectations for markets going forward. The paper also discusses central banks' current monetary policy and highlights how the reopening of China could help to accelerate global growth.

SEBASTIAN CULPAN-SCOTT
EDITORIAL DIRECTOR, SAVVY INVESTOR
sebastian.culpan-scott@savvyinvestor.net

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Invesco's Investment Expert

Kristina Hooper
Chief Global Market Strategist

Kristina Hooper is Chief Global Market Strategist at Invesco. In this role, she leads Invesco's Global Market Strategy (GMS) Office, which has strategists on-the-ground in North America, Europe and Asia. Ms. Hooper and her team formulate macro views of the markets and economy, examine the investment implications of those views, and share their insights with clients and the media around the world.

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Featured Paper from Invesco:

2022 Mid-Year Investment Outlook

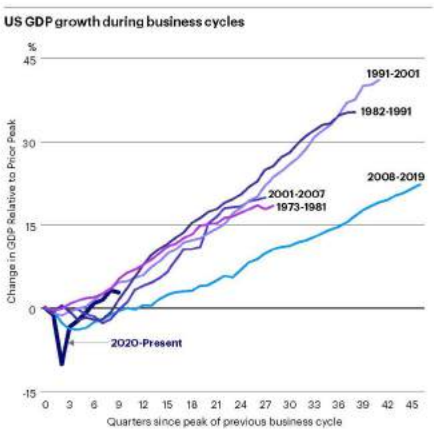
CLICK TO VIEW FULL REPORT

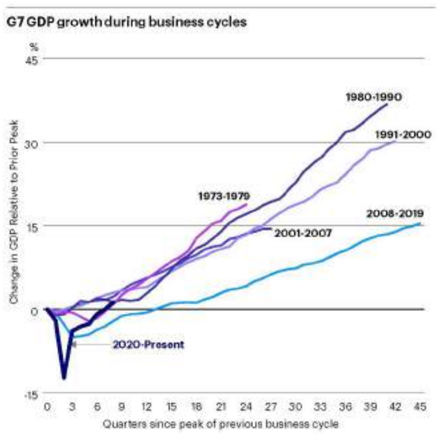
"THE REMAINDER OF 2022 IS LIKELY TO BRING A SLOWDOWN IN GROWTH FOR MAJOR DEVELOPED ECONOMIES."

Much of the world continues to move past the Covid-19 pandemic, but its remarkable effects on economies and policies remain top of mind as a new set of uncertainties enters the picture. Historic pandemic-era moves by both fiscal and monetary policymakers had already reawakened inflation after a multi-decade slumber in most economies. Then Russia's invasion of Ukraine exacerbated these inflationary pressures while also exerting downward pressure on economic growth through a surge in commodity/energy prices.

Markets are contending with all this, just as some major central banks are tightening policy. Our outlook seeks to assess the balance of geopolitical risks against a backdrop of elevated global inflation and diverging monetary policy.

Where are we in the cycle?





While pandemic-driven factors continue to complicate cycle analysis, we nevertheless see higher inflation and slowing growth, indicating that we are late in the business cycle. The remainder of 2022 is likely to bring a slowdown in growth for major developed economies.

Major Western central banks such as the Fed are in the midst of a delicate balancing act, trying to tighten monetary policy enough to cool the economy and lower inflation, but not tightening so much as to send their respective economies into recession.

What's the direction of economies?

Following large fiscal programs and very accommodative monetary policy, we see economies continuing to slow from their elevated post-pandemic growth rates, with key challenges ahead.

We see the U.S. and eurozone benefiting from a post-Omicron reopening in the second half of 2022, gliding into trend growth rates as we move

"THE EUROZONE IS CHALLENGED BY HIGHER ENERGY PRICES AND POTENTIALLY CURTAILED SUPPLY, AS WELL AS THE LOSS OF EXPORT MARKETS DUE TO THE WAR IN UKRAINE."

through 2022. The eurozone is challenged by higher energy prices and potentially curtailed supply, as well as the loss of export markets due to the war in Ukraine. These effects are likely to be at their most significant in the middle of 2022 as markets assess geopolitical risk premia.

Chinese growth is in what we see as a temporary slowdown driven by Covid-19 related factors. However, we expect a policy-induced reacceleration in the back half of 2022 and a return to potential thereafter.

Inflation expectations are up but concentrated in the near term

Currently, inflation is well above the U.S. Federal Reserve's 'comfort zone', and 1-year inflation expectations are high for the U.S., UK, and the eurozone, both market-based and consumer survey-based. However, longer-term inflation expectations appear better-anchored.

A historical perspective is also encouraging. The U.S. Inflation expectations ahead of the 1980 and 1991 recessions were very elevated for both the 1-year ahead and 5-10 year ahead periods. That is not the case now, as longer-term inflation expectations are not nearly as high. This anchoring may provide the Fed with the cover to not tighten policy so significantly that a recession ensues.

A significant monetary policy pivot

"IN STARK CONTRAST WITH THE END OF 2021, EXPECTATIONS FOR MONETARY POLICY HAVE EVOLVED TO INDICATE A RAPID PACE OF TIGHTENING ACROSS THE FEDERAL RESERVE..."

In stark contrast with the end of 2021, expectations for monetary policy have evolved to indicate a rapid pace of tightening across the Federal Reserve, Bank of England, and even some expectation of ECB tightening. The degree of tightening that is possible is dictated in large part by the health of the underlying economy.

Despite various global growth headwinds, policymakers are nevertheless focused on addressing inflation. For the Fed, we see a tightening cycle in line with market pricing.

As a result, we expect the entire yield curve to flatten by year-end. We have already seen a tightening of financial conditions and a loss of spending power in some major developed economies that should help to cool demand.

China likely to reaccelerate in second half of 2022

COVID-related lockdowns in China have brought with them renewed challenges for growth. While we have seen growth challenged in the first half of 2022, we expect a rebound in the second half of the year driven by a combination of fiscal and monetary policy stimulus, in contrast with many Western developed markets.

To download the full report click here.

Ask the Expert with Invesco:

Where Are We in the Business Cycle?

Kristina Hooper is Chief Global Market Strategist at Invesco. In this role, she leads Invesco's Global Market Strategy (GMS) Office, which has strategists on-the-ground in North America, Europe and Asia. Ms. Hooper and her team formulate macro views of the markets and economy, examine the investment implications of those views, and share their insights with clients and the media around the world.

Kristina Hooper
Chief Global Market Strategist, Invesco

Sebastian Culpan-Scott
Editorial Director, Savvy Investor

"AS WE KNOW, CENTRAL BANKS CAN END ECONOMIC CYCLES WHEN THEY TIGHTEN TOO MUCH AND TOO FAST."

Sebastian Culpan-Scott: What do you consider the biggest risks to global economic growth?

Kristina Hooper: There are so many potential risks, but I will focus on the key risks at this juncture:

1) Central bank tightening.

As we know, central banks can end economic cycles when they tighten too much and too fast. So that is a very significant risk to global economic growth right now given that some major central banks are tightening monetary policy rather aggressively in an effort to fight high inflation.

2) The Russia-Ukraine war.

An escalation in tensions could be very problematic, especially if it results in an energy embargo. That would push energy costs up even more and result in significantly higher inflation, especially in Europe. We assume this scenario would result in stagflation in Europe and bite into real incomes throughout the globe, resulting in overall lower global growth.

Sebastian: Do you expect the inflationary pressure to continue long-term?

Kristina: Let me put it this way, we are not getting back to 2% overnight. However, I do expect inflationary pressure to moderate; it will just take some time to get back to target inflation. Our expectation is that inflation will be elevated well into 2023, but moving in the right direction.

> **"While pandemic-driven factors continue to complicate cycle analysis, we nevertheless see higher inflation and slowing growth, indicating that we are late in the business cycle."**

Sebastian: Where do you believe we currently are in the business cycle? Is a recession imminent?

Kristina: While pandemic-driven factors continue to complicate cycle analysis, we nevertheless see higher inflation and slowing growth, indicating that we are late in the business cycle. The remainder of 2022 is likely to bring a substantial slowdown in growth for major developed economies.

Sebastian: How have emerging markets fared during this period?

Kristina: Emerging markets in general have performed better than developed markets this year. Chinese stocks have posted particularly strong returns, helped by an improving regulatory environment and stimulus.

Sebastian: Will central banks continue to tighten monetary policy?

Kristina: Yes, Western developed central banks will continue to tighten monetary policy to combat high levels of inflation, and so their tightening cycles are not over yet. It is worth noting that some of the emerging market central banks appear close to ending their respective tightening cycles, while the People's Bank of China will likely continue to ease.

> **"The Russia-Ukraine situation could get worse from here, and I don't believe that has been fully priced in."**

Sebastian: Will the war between Ukraine and Russia continue to affect markets or has all risk already been priced in?

Kristina: The Russia-Ukraine situation could get worse from here, and I don't believe that has been fully priced in. If there is an escalation in tensions, that could have further impact on markets.

Sebastian: What would your advice be for investors when structuring their portfolios?

Kristina: We believe a neutral risk stance relative to the benchmark is appropriate. Given that we anticipate a global slowdown, we expect modest positive returns with narrow dispersion in performance between fixed income and equities.

> **"In this environment, we prefer a slight overweight position to equities relative to fixed income, with equity exposure tilted towards defensive sectors, quality and low volatility stocks."**

In this environment, we prefer a slight overweight position to equities relative to fixed income, with equity exposure tilted towards defensive sectors, quality and low volatility stocks. We also currently favor the U.S. over developed markets ex-U.S., but relatively equally weighted towards both developed markets and emerging markets.

Within the fixed income asset class, we prefer quality credit and are neutral on duration. Fixed rate investment grade and municipal bonds are specific areas of opportunity. Within alternative assets, we are favoring energy, real estate and infrastructure.

Sebastian: Do you see any opportunities in the current market?

Kristina: Yes, of course. There are always opportunities to be found in every market environment. We are currently seeing opportunities in markets where their central banks are not on the monetary policy tightening bandwagon. In particular, risk assets in Japan and China with the exception of the property space look attractive. In my view these assets should be held on a currency-hedged basis because their easier policy stance suggests that their currencies could weaken further against the dollar or major Western currencies.

China stands to benefit from increasing fiscal and monetary stimulus, especially compared to the U.S., where the opposite is underway, as well as the slow reopening of its economy post-Covid shutdowns. Other emerging markets countries also offer opportunities in this environment, given where they are in the tightening cycle.

> **"CHINA STANDS TO BENEFIT FROM INCREASING FISCAL AND MONETARY STIMULUS, ESPECIALLY COMPARED TO THE U.S., WHERE THE OPPOSITE IS UNDERWAY AS WELL AS THE SLOW REOPENING OF ITS ECONOMY POST-COVID SHUTDOWNS."**

Over the medium and longer term, we are seeing opportunities arising from a well-diversified and higher-yielding global portfolio, with exposure to equity, fixed income and alternative asset classes.

Sebastian: Are there asset classes or sectors that you would avoid altogether?

Kristina: There are asset classes and sectors I would tactically underweight, such as very risky assets, given our neutral risk stance. For example, I would be underweight cyclical stocks with the exception of energy given this environment. However, it is my view that in portfolios there should be broad diversification across and within equities, fixed income and alternatives.

"IN THE SHORT TERM, WE ANTICIPATE HIGHER VOLATILITY, AS STOCK AND BOND MARKETS CONTINUE TO DIGEST AGGRESSIVE MONETARY POLICY TIGHTENING."

Sebastian: What is your outlook for markets going forward?

Kristina: In the short term, we anticipate higher volatility, as stock and bond markets continue to digest aggressive monetary policy tightening. Once the Fed has finished its 'frontloading' of rate hikes, I suspect the environment will become less hostile for asset prices.

"If we look over the horizon and take the long view as strategic investors and asset allocators, we can also look forward to a realignment of relative valuations across asset classes."

If Western central banks can slow tightening later this year, as they are likely to feel some pressure to keep up with the Fed, it would help the asset price environment. A long-awaited moderating in inflation should also help.

Furthermore, if we look over the horizon and take the long view as strategic investors and asset allocators, we can also look forward to a realignment of relative valuations across asset classes. Bonds are rapidly repricing from yielding next to nothing in the U.S. and UK, and literally less than nothing in Europe, Switzerland and Japan. After this normalization has unfolded, I believe bonds should once again provide coupons that can help investors cushion the volatility in riskier assets. I expect bond-equity diversification to eventually come back into vogue and help provide portfolio balance once again.

Savvy Investor's Top Recent Mid Year Outlook Papers

The following table features 25 of the top outlook papers recently uploaded to the Savvy Investor site.

In their respective papers, Nuveen and Capital Group share their midyear outlooks, comprising a general overview for the first half of the year and forecasts for the second half. They also highlight why a balanced portfolio can perform well in any market environment and why they believe the current volatility should not discourage investors too much.

PGIM Real Estate and M&G Investments provide outlooks for the real estate market and discuss how the asset class can be a resilient inflation hedge. They also explore how investors should look to position their portfolios and share their views on future trends within the real estate market.

Other papers also cover outlooks for fixed income markets, real assets and commodities.

SAVVY INVESTOR'S TOP RECENT MID YEAR OUTLOOK PAPERS (BY DATE)

PAPER TITLE	DATE PUBLISHED
Q3 Outlook: Central Bankers Strike Back (LGIM)	11/07/22
Gold Mid-year Outlook 2022 (World Gold Council)	08/07/22
Municipal Bonds: 2023 U.S. States Outlook (Northern Trust)	08/07/22
H2 2022 Investment Outlook: Life Above Zero (Amundi)	06/07/22
Q3 2022 Investment Outlook (American Century Investments)	06/07/22
2022 Mid-Year Investment Outlook (Invesco)	04/07/22
Q3 2022 Outlook (PGIM Quantitative Solutions)	04/07/22
2022 Global Outlook Investing Through Uncertainty (PGIM Real Estate, 2022)	30/06/22
Mid-2022 Asset Class Outlook (Wellington Management, Jun 2022)	30/06/22
2022 Midyear Outlook: From pain to gain (Nuveen, Jun 2022)	30/06/22
Credit Quarterly Outlook: The mess after the largesse (Robeco, Jun 2022)	30/06/22
Mid-2022 Global Economic Outlook (Wellington Management, Jun 2022)	30/06/22
Mid-2022 Asset Allocation & Investment Strategy Outlook (Wellington Management, Jun 2022)	30/06/22
UK Economic Outlook (KPMG, Jun 2022)	28/06/22
How Could Oil Price and Policy Rate Hikes Affect the Near-Term Inflation Outlook? (FRBNY, Jun 2022)	28/06/22
Midyear Outlook 2022 (Capital Group)	24/06/22
2022 Mid-Year Outlook: Rolling with change (Allspring Global Investments, Jun 2022)	23/06/22
Fixed Income Outlook: The inflation game (Robeco, Jun 2022)	23/06/22
Video: Investment Outlook 2022 – Summer edition with Dan Chornous (RBC GAM)	23/06/22
Global Investment Outlook: Summer 2022 (RBC GAM)	21/06/22
2022 Midyear Outlook: Transitioning to a new paradigm (T. Rowe Price, Jun 2022)	21/06/22
Global Real Estate Outlook: The impact of rising inflation (M&G Investments, Jun 2022)	17/06/22
Midyear Market Outlook: Finding clarity amid complexity (SSGA I SPDR, Jun 2022)	10/06/22
Multi-Asset Monthly Outlook June 2022 (Robeco)	08/06/22
Short-Term Energy Outlook – June 2022 (US EIA)	08/06/22

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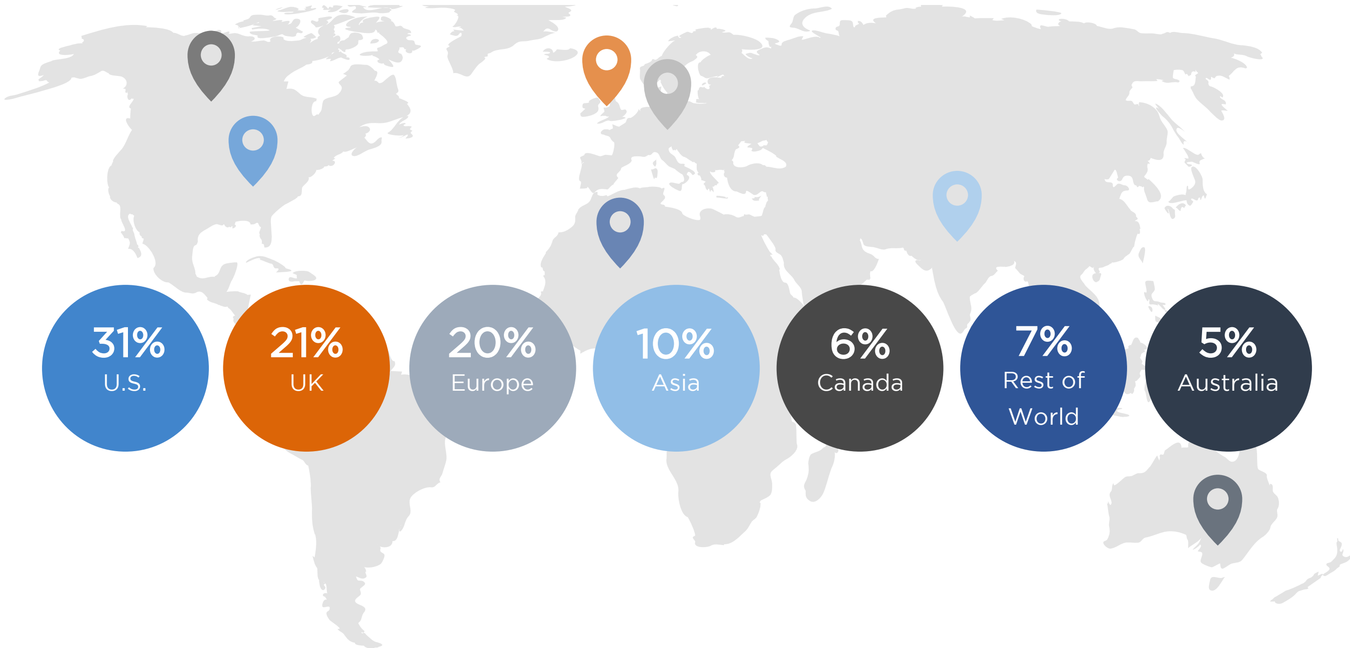

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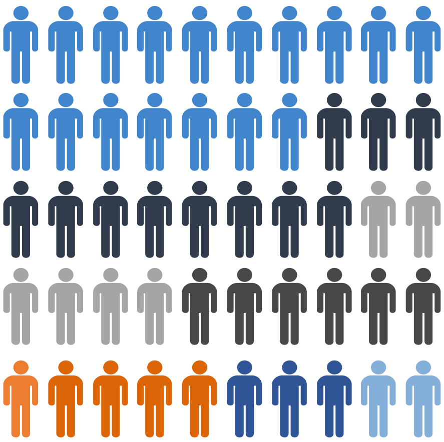

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- 9% Others
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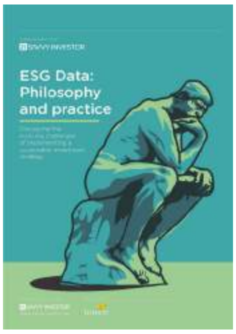

August 2022

Inflation Portfolio Implications

Fixed Income Outlook

September 2022

ESG Investing

Retirement Solutions

October 2022

U.S. Outlook

Megatrends

November 2022

Real Assets Outlook

COP 27 Implications

Subject to demand (at any time)

The Business of Asset Management

Insurance Asset Management

Asset Allocation Quarterly

Fund Management Technology

Quant Strategies

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Authored by Savvy Investor

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