The Year 2023 and Our Outlook for 2024

Newsletter for January 2024

The year 2023 for global markets was a reversal of 2022. Risk appetite came back with a bang and as sharply as risk appetite had corrected downwards in 2022. The only market which continued its downward correction was China, where the policy-induced restructuring continued to have an impact.

We take this opportunity to review the year 2023 and make our predictions for 2024. Broadly, the long term trends highlighted from 2022 continued in 2023, though some, like inflation and interest rates, normalised. A few new trends and micro trends emerged, which we will try to capitalise on going forward.

1. **Higher for longer is the theme for rates and inflation**: The conjoint twins "interest rates and inflation" both lost steam in 2023. Inflation came off significantly, while rates peaked out and are expected to slowly come down over the next few years. But the new norm is potentially a structurally higher level of inflation and rates over the next many years. As we mentioned in our November write-up, the impact of this will initially be felt only slowly and then accelerate.

2. **Geopolitical uncertainty is the new norm**: From the end of the Cold War all the way to about 2014, geopolitics was always a tailwind for global investors. Increasing globalisation grew potential markets, improved supply chains, reduced costs across products and services, increased access to capital, helped keep inflation and interest rates low and created large pools of corporate profits. This was good for economies and corporate profits across the board. This windfall has clearly reversed. With wars in Europe and now the Middle East too, the overt signs of this reversal are clear. But the larger reversal has happened in the slow unravelling of the symbiotic relationship between the US and China. As the two largest economies in the world increasingly look at each other as rivals, the overall global wealth creation slows. This is potentially not going to reverse, though we hope the fall out will be managed.

   Adding to the uncertainty on this front is the fact that a few pivotal elections are happening across the world this year. The most important one is the presidential election in the US. The results of this will throw more light on the pace and degree of the unravelling of the global economic order of the past. The other important elections in markets that matter to us are Indonesia, India (both of which should not throw many surprises) and Taiwan (happening as we write) where the outcome has geopolitical implications.

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3. **China settles into a slower but steadier economic rhythm**: China's policy-induced restructuring of its economy now enters the fourth year. The market has sharply underperformed global markets since 2021 (underperformed MSCI world by 73% and S&P by 80%). This has happened in an environment of weak corporate earnings in China and strong earnings in the rest of the world (especially the US). Our view is that this is now reversing. Chinese corporate earnings growth will now track and outperform global numbers. This is primarily because the two largest reasons for the slow down are bottoming out. These two reasons are the property sector rebalancing and the tech sector restructuring. Hence, we agree that China's growth is going to settle down now in the 3-5% range. But remember that China is still a middle income country (with per capital GDP in the same range as a Mexico or Malaysia). It still has a dynamic, well educated work force, large savings rate, low interest rates, high forex reserves, etc. This economy has more legs for sure. How this converts to corporate profits, especially in the listed space, is where the primary uncertainty lies.

4. **Indonesia is a structural opportunity**: This market is where we have a structural positive bias. This is India with a lower valuation and lower drive at the corporate level. Growth is chugging along at 5% p.a., inflation and interest rates are under control, corporate and government balance sheets are underleveraged, it benefits from our structurally positive view on commodities, etc. Also, valuations remain attractive. This can be broadly extrapolated to the rest of Asean too. Selectively, good companies continue to emerge and do well in markets like Singapore, Thailand, Philippines and Malaysia too. Remember this is a region with a combined economy the size of India, per capital GDP about 2.5 times that of India and a growth of about 4.5% (compared to India at about 6%). So opportunities there are aplenty.

5. **'Rest of US' markets will do relatively better:** We define this narrowly as S&P ex the "magnificent seven" stocks (Microsoft, Apple, Alphabet, Nvidia, Amazon, Meta and Tesla). Broadly it means S&P ex the tech sector. This part of corporate America has not done as well as the tech sector. Also, its balance sheet, competitive environment and profitability are more cyclical and weaker. As the impact of higher rates gets fully absorbed and behind us, this universe will slowly rebound. The magnificent seven make up about 28% of the S&P index and have had a disproportionate impact on performance and earnings growth. This should start to wane.

These are some of our thoughts and predictions for 2024. Our portfolio is a play on exposure primarily to HK/China, Asean and a bit to India (in that order). We have invested against strong headwinds from China in the past three years and done relatively well compared to the Asian benchmark index. Valuation in China remains at multi-decade bottoms in both absolute and relative terms. We hope to see assets there being repriced up and for macro risks and corporate earnings to improve.

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