Elston

Elston Insights

16th December 2022

2023 Outlook: Looking for Light

- Yield is back
- Selectivity matters more
- Inflation's getting stickier

2022 proved to be a challenging year with pressure on equities and bonds a like in face of rising rates and soaring inflation.

In our *2023 Outlook: Looking for Light*, we explore three key themes

1. **Yield is back:** for equities, bonds and alternatives - the yield drought is over

2. **Selectivity matters more:** within and across asset classes

3. **Inflation is getting stickier:** getting past the peak, but still a problem

To find out more:

The full version of our **2023 Outlook** report is available to our clients. For UK advisers requesting further information, please contact us.

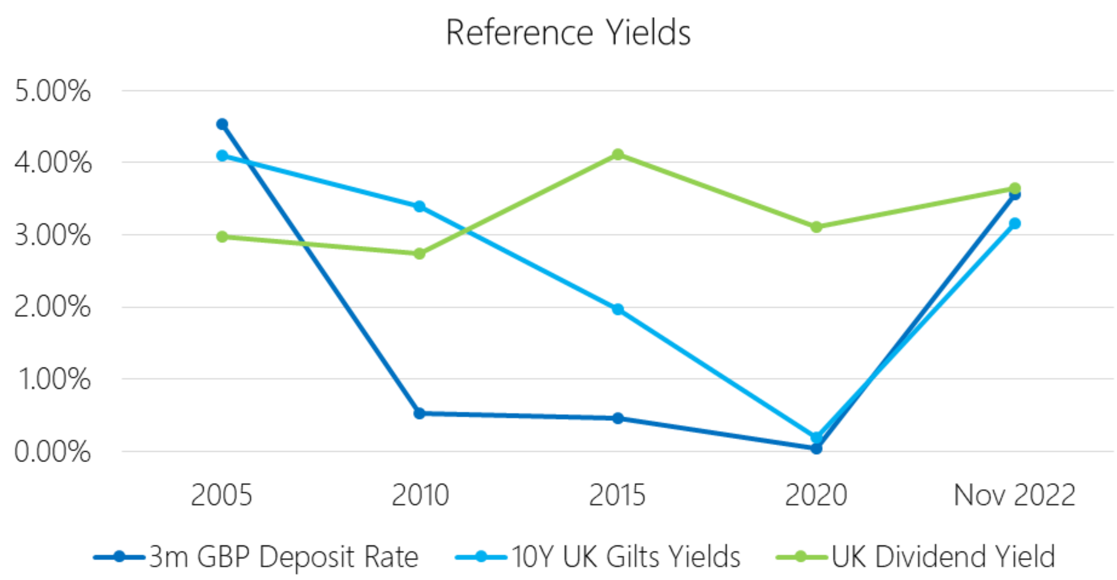
Watch the recent 2023 Outlook webinar discussion with Henry Cobbe, Hoshang Daroga (Elston) and Natasha Sarkaria, CAIA (BlackRock)

Yield is back

For equities, bonds and alternatives, the yield drought is over. Since the Global Financial Crisis, Central Banks' near Zero-Interest Rate Policy suppressed yields. As Central Banks now hike policy rates to fight inflation, interest rates are normalising. As a result, yield is back. Rising policy rates, forces a repricing of yield premia across all asset classes: equities, income-generative alternatives, and bonds.

Yield can help underpin returns in uncertain times. From a portfolio construction perspective, income diversification becomes as important as asset diversification. As investors seek to build up diversified income streams, sizing risk across asset classes is key.

Fig.1. Indicative reference yields for GBP cash, bonds and world equities



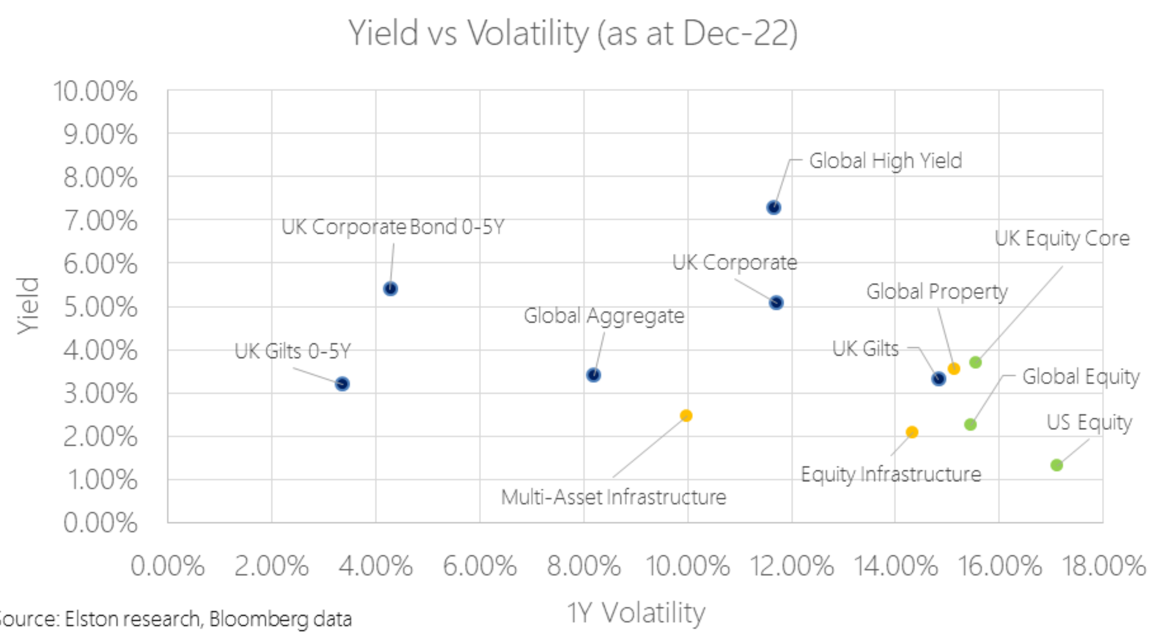
Source: Elston research, Bloomberg data

Selectivity matters more

2022 was a year of dislocation and dispersion. As recession risk, higher interest rate posture and inflation pressures continue into 2023, selectivity matters more, both across asset classes and within each asset class.

Within Equities, higher dispersion from a sector or factor perspective, relative to a regional approach, requires selectivity. But also creates opportunity.

Fig.2. Current Yield vs 1Y Historic Volatility



Source: Elston research, Bloomberg data

Within **Alternatives**, striking the balance between inflation resilience and income- vs non-income generative exposures involves some trade-offs.

Within **Bonds**, selectivity around duration/term, credit and currency remains essential with varying outlooks on interest rates, inflation and currency.

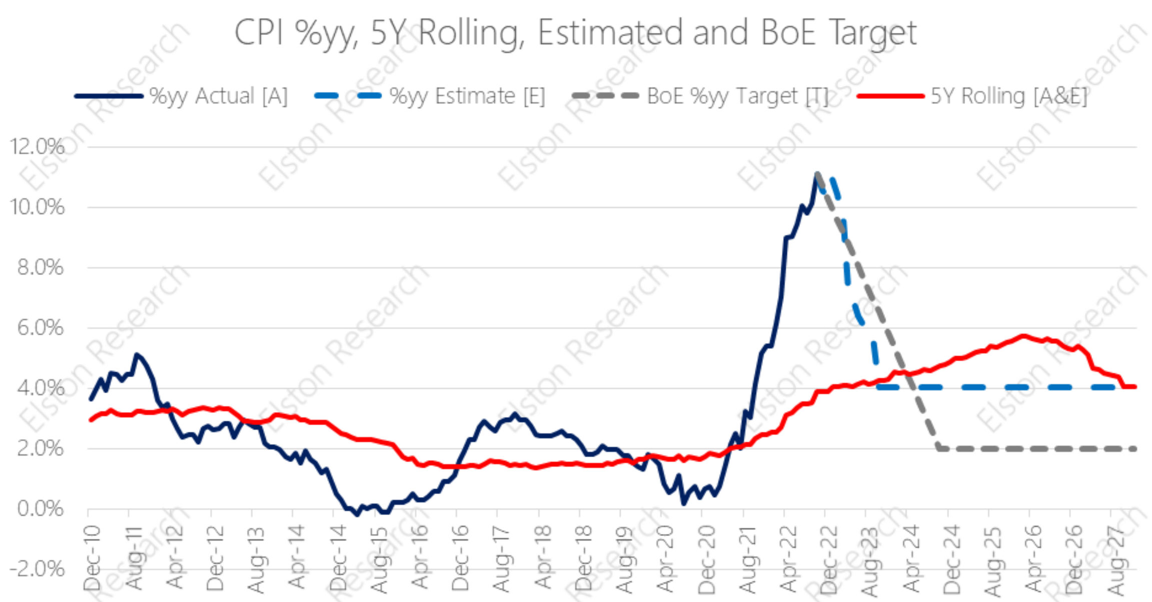
Inflation is getting stickier

We may be getting past the peak, but inflation is still a problem. It's getting stickier as it spreads from supply side inflation shock, to wage-price pressure (unions and strikes). Soaring UK energy costs remain embedded for producers, even if consumers are insulated following intervention.

Longer-term, structural remapping of European energy supply, transition to Net Zero, increased defence expenditure, and re-shoring are all examples of drivers that will keep inflation more persistent for longer. If we assume the next 5 years inflation averages 4%, then 5 year rolling inflation will peak in the UK in 2026, before decelerating.

So whilst we can celebrate getting past the peak, it is essential to ensure that portfolios remain inflation resilient.

Fig.3. UK CPI, and 5 year rolling inflation



Source: Elston research, Bloomberg data

To find out more:

The full version of our **2023 Outlook** report is available to our clients. For UK advisers requesting further information, please contact us.

Watch the recent 2023 Outlook webinar discussion with Henry Cobbe, Hoshang Daroga (Elston) and Natasha Sarkaria, CAIA (BlackRock)

Henry Cobbe, CFA

Head of Research, Elston Consulting

For all our Research & Insights, visit:

https://www.elstonsolutions.co.uk/insights

Find out more

For more insights and information on research, portfolios and indices, visit:

www.elstonsolutions.co.uk or NH ETF<Go>

www.elstonsolutions.co.uk

ABOUT ELSTON

We research, design and build investment solutions with and for asset owners, managers and advisers.

Our Research & CPD focuses on multi-asset strategies, index funds and ETFs.

NOTICES

With reference to the European Union Directive 2014/65/EU on markets in financial instruments ("MiFID II"): this Report does not provide a recommendation for an action, provides information freely available for public consumption and does not therefore constitute "Research" as defined by MiFID II. This is because this report contains purely factual information on one or several financial instruments or issuers and does not explicitly or implicitly recommend or suggest an investment strategy. It does not therefore constitute an investment recommendation as defined within the meaning of Article 3(1)(35) of EU Markets Abuse Regulation ("MAR"), in conjunction with Article 3(1)(34) of MAR. For further information, please refer to ESMA guidance ESMA70-145-111 Version 12.

With reference to the European Union's Market Abuse Regulation (Regulation (EU) 596/2014): we warrant that the information in this report is presented objectively, and the following commercial interests are hereby disclosed: Elston Consulting Limited creates research portfolios and administers indices that may or may not be referenced in this report. If referenced, this is clearly designated and is to raise awareness and provide purely factual information as regards these portfolios and/or indices.

An "Index" is a Regulated Benchmark. An "Index Portfolio" is not a regulated benchmark but a research portfolio of index-tracking investments with a periodic rebalancing scheme.

All company, product and service names and trademarks used in this article are for identification purposes only and are the property of their respective owners, and their usage does not imply endorsement.

This document is not an advertisement or financial promotion. It is provided for informational purposes only and is not intended to be an offer or solicitation, or the basis for any contract to purchase or sell any security or other instrument, or for Elston Consulting Limited to enter into or arrange any type of transaction as a consequence of any information contained herein.

This document is issued by Elston Consulting Limited registered in England & Wales, registration number 07125478, registered office: 1 King William Street, London EC4N 7AF.

© Elston Consulting Limited. All rights reserved No unauthorised reproduction.