

The Year Ahead | 2023

2023: The rainbow after the storm?



Overview

We believe 2023 is likely to be a year of subpar economic performance among developed economies. However, policy support and relatively attractive valuations across many asset classes could facilitate a better year for investors. Some relaxation in COVID-19 containment policy through 2023 should bolster China's economic recovery. A rebound in Chinese demand should help Asian economies reverse contracting exports to the U.S. and Europe.

Near-term economic challenges could still bring elevated volatility in risk assets, including equities. This calls for an emphasis on high-quality fixed income at the start of the new year. Yet, as the year progresses, the peak in policy rates in developed markets and stabilization in economic data should provide an opportunity to increase equity allocations. The early-recovery phase of an economic cycle typically presents the strongest return prospects. In addition to cyclical recovery, there are structural opportunities, such as renewable energy and Asian consumption, which could deliver long-term return to investors.

In our *2023 Year Ahead*, we address the 10 most frequently asked questions on the economy and asset allocation from investors across Asia. These are:

1. Could the global economy go into a recession?
2. Could high inflation in the U.S. turn into deflation?
3. Could the Fed cut rates?
4. Will China's economic recovery benefit Asia?
5. Can Asian economies thrive with a hawkish Fed and strong USD?
6. What can go wrong?
7. Can cash outperform again?
8. Is it growth stocks' turn to deliver?
9. Could Asian equities outperform the U.S.?
10. Time to go long duration in fixed income?

1. Could the global economy go into a recession?

The global economy is entering a period of subpar growth because of reduced fiscal support, synchronized monetary tightening in both developed and emerging markets and the squeeze on household disposable incomes on the back of high inflation. The skew of risk to global growth remains on the downside, and investors should still opt to take a more conservative stance on asset allocation until there are clearer signs of growth bottoming out, as well as for the peak in monetary tightening.

In the U.S., cutbacks to corporate spending and weak housing investment were key ingredients for most of the recessions since the Second World War. There are already signs that business investment and construction activities are decelerating as borrowing costs rise. A divided government following the midterm elections means fiscal support could be more difficult to come by. However, the depth and duration of a recession in the U.S. in 2023 could be mitigated by a number of factors.

A robust job market is supporting consumption. Personal consumption expenditure has traditionally been a more resilient component of the U.S. economy. A healthy balance sheet for both households and the corporate sector, helped by deleveraging since the global financial crisis and fiscal packages in 2020 and 2021, also boosts resilience. If weaker growth helps to cool demand-side inflation, this may also allow the Federal Reserve (Fed) to take a less aggressive stance on monetary policy.

In Europe, the risk of recession is considerably higher with the Russia-Ukraine conflict and the spike in energy and food prices. Survey data shows consumers and businesses are pessimistic, which is already weighing on consumption, business activities and corporate investment. The restocking of natural gas inventory has gone surprisingly well and may help the region through an unexpectedly mild winter. However, fiscal support is still needed to help both households and companies overcome the cost-of-living crisis. Fortunately, European governments have shown their greater willingness to spend during these challenging times.

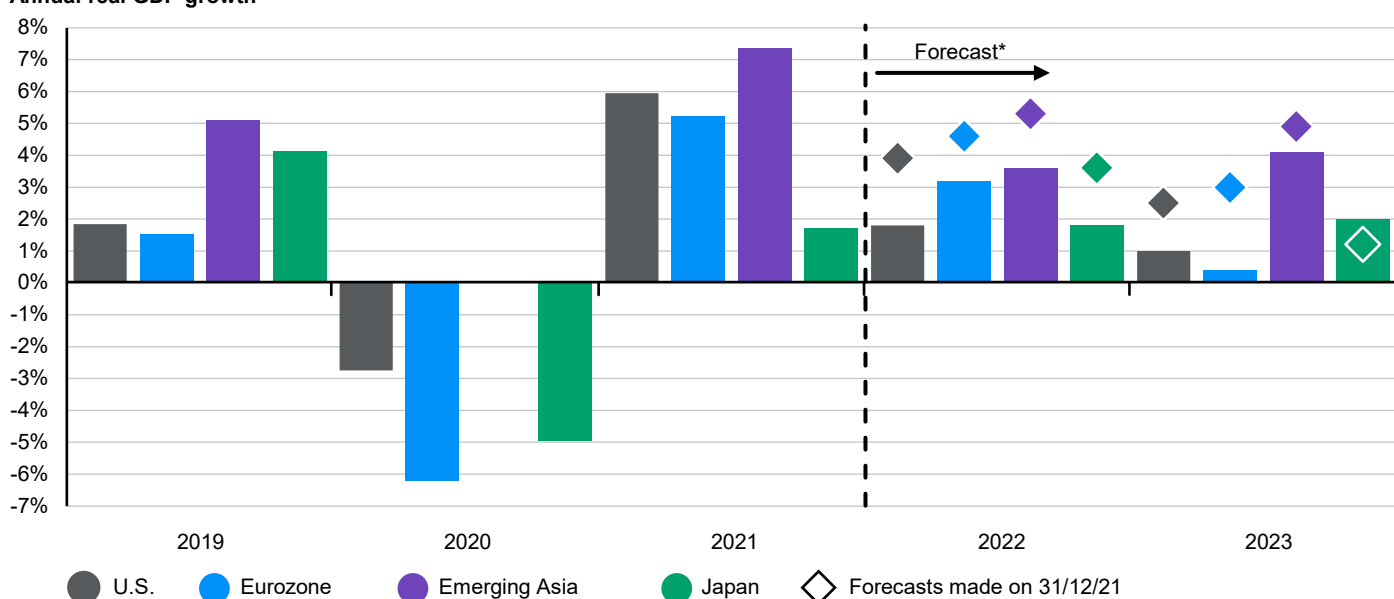
In China, the timing of its economic recovery depends on the adjustments of the current COVID policy approach and how fiscal and monetary policies could complement current economic reopening. With a difficult labor market, subdued consumer and business sentiment and the adverse impact of prolonged weak growth, we expect China to gradually ease its current COVID policy in 2023. This should help enhance the efficacy of policy stimulus and prompt growth acceleration. More optimistic sentiment can also help stabilize the real estate market. China's growth rebound would be a contrast against the risk of recession in the U.S. and Europe.

For Asia, weak demand from the developed world has led to a contraction in exports for economies such as Hong Kong, Singapore, South Korea and Taiwan. This would be partially offset by domestic demand and recovery of the services sector as more economies learn to live with COVID-19 and reopen their borders. Inflation could surge amid pent-up demand from Asian consumers and supply-side challenges.

Subpar growth for the U.S. and Europe, but possible acceleration for China

Exhibit 1: Global growth forecast

Annual real GDP growth



Source: FactSet, J.P. Morgan Economic Research, J.P. Morgan Asset Management. *Real GDP growth forecasts are based on growth forecasts estimated by J.P. Morgan Economic Research. Diamonds represent the real GDP forecasts made on 31/12/21 published by J.P. Morgan Economic Research. Columns and dotted lines in the forecast area indicate the most recent forecasts published by J.P. Morgan Economic Research. Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecast, projections or other forward statements, actual events, results or performance may differ materially from those reflected or contemplated. *Guide to the Markets – Asia*. Data reflect most recently available as of 14/11/22.

2. Could high inflation in the U.S. turn into deflation?

Inflation has put the Fed and other developed market central banks on a difficult journey and will drive the trajectory of monetary policy in 2023. For the U.S., headline inflation is easing and core inflation should have peaked; however, the path toward the Fed's target will be long.

Falling global energy and commodity prices will push headline inflation lower. Energy consumer price inflation (CPI) is on a decline, mainly driven by falling gasoline prices.

Core goods inflation is also slowing. First, there are signs of global supply chains easing and bottleneck pressures improving. Second, continued U.S. dollar (USD) strength will help to contain imported inflation. Other leading price indicators for consumer goods, such as core goods producer and commodity prices, are also showing signs of softening. Lastly, with fiscal impulse reduced, pent-up demand fading and financial conditions tightening, global growth will slow, which will drag on core goods demand.

However, as demand continues to shift from goods to services, core services inflation will likely remain persistent. Health care and airfare costs should continue to soften as health insurance and fuel prices level off. However, the labor market remains tight and wage growth could still run hot for a while, pressuring companies to raise prices. The cost of shelter, constituting 42% of the core inflation basket, remains strong and continues to be one of the largest contributors to changes in core inflation. Although house prices have peaked, shelter costs can stay elevated as new rental agreements are still incorporating earlier rises in home prices. Thus, we think shelter costs will stay sticky and take time to moderate.

We expect headline inflation to ease toward 3.5% by 4Q 2023, or 2.7% if we use the Fed's preferred measure of personal consumption deflator. This would be close, but still above the Fed's 2% target. Key upside risks to this view include further disruptions to global supply chains and energy and commodity markets, potentially from the Russia-Ukraine crisis.

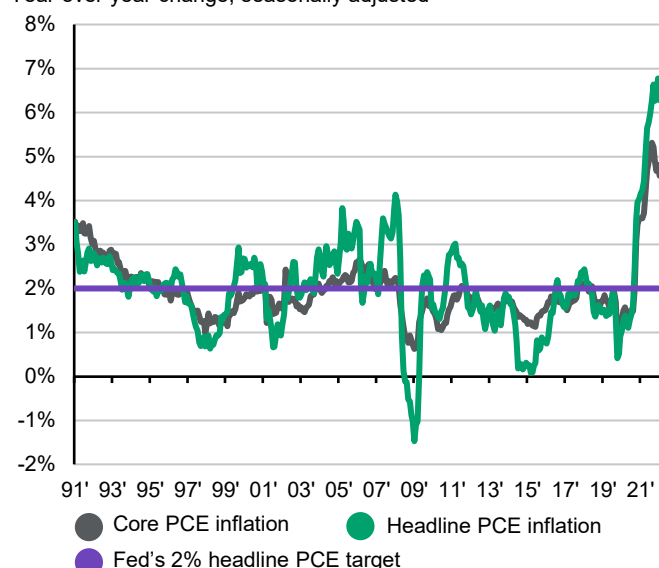
In summary, we expect 2023 to be a year of disinflation as prices rise more slowly, but not deflation where prices fall compared with a year ago. The exception to this potentially being energy markets. The scenarios for prices to fall would require a rapid cooling of the U.S. and global economy. In addition to above-target inflation in 2023, the volatile commodity market and event risks associated with supply chains and extreme weather events could increase the volatility of inflation, and add to the Fed's challenge to respond appropriately.

Inflation will gradually moderate but remains elevated, driven by sticky components of CPI such as shelter

Exhibit 2: United States: Inflation

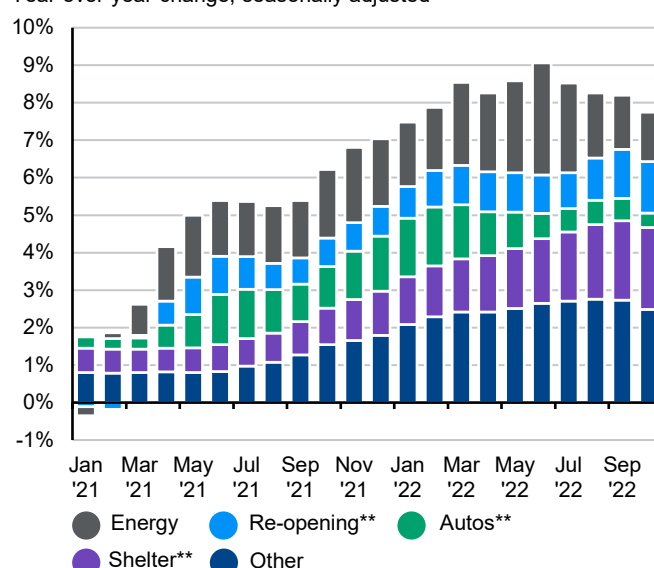
Headline and core PCE* inflation

Year-over-year change, seasonally adjusted



Consumer Price Index (CPI) components contribution

Year-over-year change, seasonally adjusted



Source: Bureau of Economic Analysis, Bureau of Labor Statistics, FactSet, Federal Reserve, J.P. Morgan Asset Management.

*The Fed uses the Personal Consumption Expenditure (PCE) deflator to measure inflation. Core PCE is defined as PCE excluding food and energy prices. In August 2020, the Fed unveiled its Average Inflation Targeting policy, which seeks to achieve inflation that averages 2% over time.

**Re-opening defined as lodging away from home plus transportation services and food away from home, Autos defined as new vehicles plus used cars and trucks, Shelter defined as shelter minus lodging away from home.

Guide to the Markets – Asia. Data reflect most recently available as of 14/11/22.

3. Could the Fed cut rates?

After enacting a record pace in interest rate hikes, the futures market is pricing in a small chance of a rate cut by end of 2023. There is a worry that the Fed is risking overtightening, raising rates to fight inflation but moving too much, too quickly, putting downward pressure on growth, and potentially dragging the U.S. into a recession. Based on the latest commentary from Fed officials and our U.S. economic outlook, policy rates could peak in 1Q 2023. But the bar for the Fed to start cutting rates in 2023 is high.

Our current outlook for the rate path is that the Fed is likely to make a number of smaller rate hikes at upcoming meetings, slowing the pace from its recent 75 basis points (bps) moves, leaving key rates at around 5% in 2023 with upside risk.

Inflation remains uncomfortably above the Fed's target. There has been some improvement on this front where a few major inflation components have begun to recede. Energy prices have now fallen below their peaks, global food commodity prices are easing and supply chain issues appear to be fading. However, the Fed has made no mention about the easing of inflationary pressures recently and until it does, it will mean another factor to show they are not considering a pivot.

The situation on the economy is similar. The Fed has acknowledged slowing economic growth and its own contribution to this situation amid tighter financial conditions. Still, the labor market remains tight. While job growth is likely to slow, the high job opening to job seeker ratio could reinforce the Fed's hawkishness. Fed officials have also reiterated they are willing to tolerate a period of weaker growth to bring inflation down.

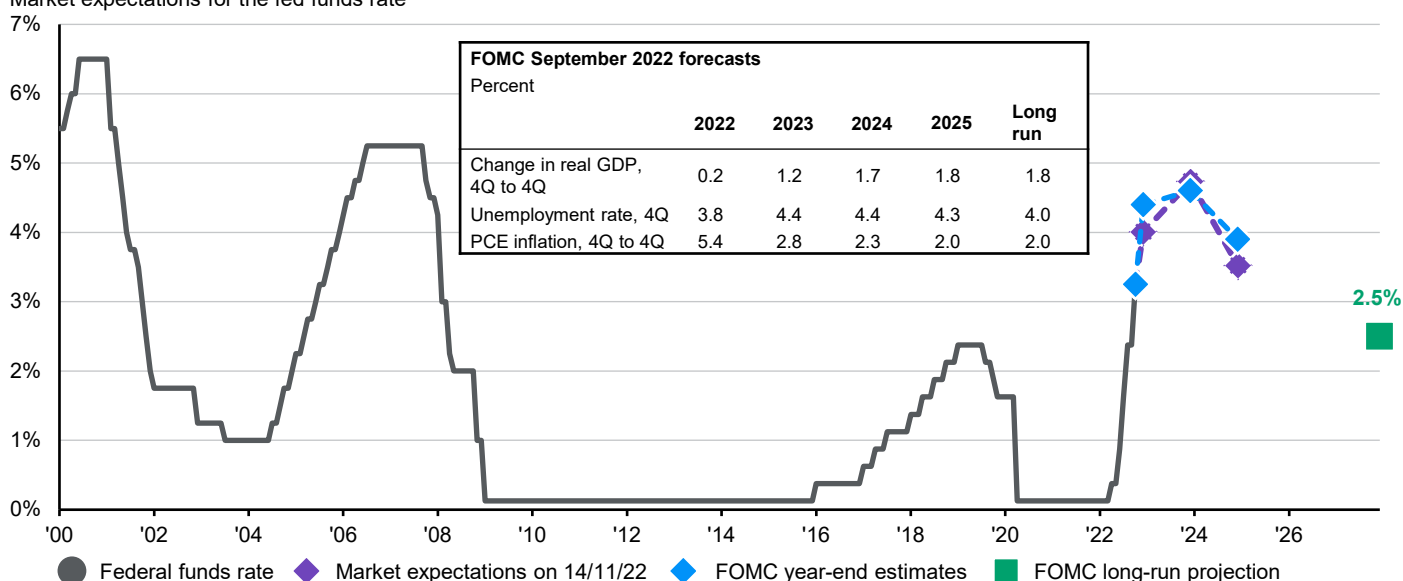
We should keep in mind that the Fed needs to restore policy credibility and also provide transparent guidance for the market. It expects personal consumption expenditures inflation and the unemployment rate to reach 2.8% and 4.4%, respectively, by 4Q 2023. Hence, there still is a long way to go for inflation to reach its projection. It is unlikely the Fed will reverse its current course without ample warning. The conditions needed for a complete reversal in policy would have to involve getting inflation back on track toward returning to the Fed's 2% target, along with weak economic activity and a higher unemployment rate. So far, this does not look likely to happen for much of 2023.

Expectations are for the Fed to change course sometime in 2023

Exhibit 3: United States: Monetary policy

Federal funds rate expectations

Market expectations for the fed funds rate



Source: Bloomberg Finance L.P., FactSet, U.S. Federal Reserve, J.P. Morgan Asset Management.

Market expectations are derived from market implied policy rates as of 30/09/22. Federal Reserve projections shown are the median estimates of Federal Open Market Committee (FOMC) participants. Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecast, projections or other forward statements, actual events, results or performance may differ materially from those reflected or contemplated.

Guide to the Markets – Asia. Data reflect most recently available as of 14/11/22.

4. Will China's economic recovery benefit Asia?

The COVID-19 resurgence and stringent containment measures continue to weigh on China's economic growth in 2022. These economic challenges will prompt authorities to gradually relax the current COVID policy in 2023. The pre-conditions for this transition would be a higher vaccination rate, especially among the elderly, and for the health care system to be well prepared for an increase in the number of infections. Limiting severe cases and deaths would be an important justification for the government to relax its policy.

Recent data showed that economic activity in China was mainly supported by manufacturing and exports. With the escalation of stimulus measures, the strong momentum of infrastructure construction may be sustained through 2023. In contrast, consumer sentiment remains subdued, and sluggish consumption growth has weighed on overall economic performance. Meanwhile, real estate investment and housing activity have been further depressed by weak consumer confidence. This all points toward the fine-tuning of pandemic control measures as essential in restoring consumer and corporate confidence, and in enhancing the efficacy of policy stimulus. If this happens in the spring of 2023, the synergy between reopening and continued policy stimulus may help stabilize domestic growth and benefit other Asian economies via trade and tourism channels.

Given its pivotal role in regional trade, China's recovery could provide some fresh momentum in Asia's demand, especially at a time when the U.S. and European economies are slowing. During lockdowns, consumers in China became more cautious and saved more. Hence, the import of goods slowed to 3.5% year-over-year in the first 10 months of 2022, compared with 31.4% for the same period a year ago. This is partly the reason for weakness across the electronics supply chain, particularly in semiconductor demand for Korea and Taiwan.

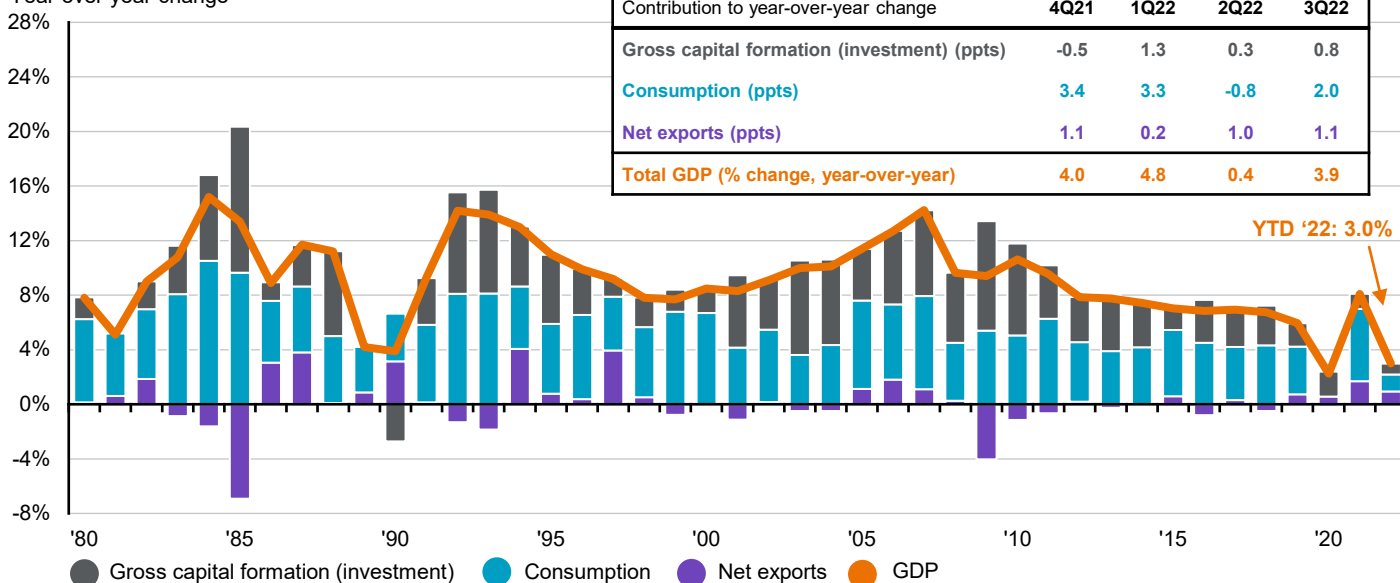
The pent-up demand in China has significant potential. Chinese households are holding RMB 116.5trillion in deposit accounts, 42% higher than the pre-COVID-19 level. Should this demand be released as the economy reopens, the spillover effects to other Asian economies would be a welcome source of growth.

Service trade is another channel for positive regional benefits. In 2019, Chinese tourists spent USD 254.6billion in overseas travel, and Asia is a major destination. This expenditure shrank to USD 105.7billion in 2021 and declined sharply again in 2022 due to even stricter border controls. In addition to tourism, there is potential demand for overseas education, health care and financial services. On the current low base, China's reopening could present opportunities for service sectors across Asia. That said, based on the current gradual easing of pandemic measures, a full recovery is likely only in late 2023.

Chinese consumption has dampened during the COVID-19 resurgence, but this may represent large growth opportunities across Asia
Exhibit 4: Contribution to real gross domestic product (GDP) growth

Contribution to real GDP growth

Year-over-year change



Source: CEIC, National Bureau of Statistics of China, J.P. Morgan Asset Management.

Total gross domestic product (GDP) figures may not sum due to rounding.

Guide to the Markets – Asia. Data reflect most recently available as of 14/11/22.

5. Can Asian economies thrive with a hawkish Fed and strong USD?

As we progress through the current hiking cycle, it is apparent the Fed still sees a bigger risk in hiking too little than in overtightening. As the path to a soft landing in the U.S. gets narrower, investors are naturally also concerned about collateral damage. Historically, a hawkish Fed has generated a number of headwinds for Asian economies, which has translated to weak asset performance. As pressures continue to mount, investors want to know if (1) Asian economies can withstand further pressure from a hawkish Fed and a stronger USD and (2) which economies are most vulnerable.

To make that assessment, we look at a range of indicators across key categories such as foreign exchange (FX) reserve coverage, indications from balance of payments and imminence of FX funding needs, as well as overall leverage measures.

Accelerated declines in FX reserves sparked concerns as central banks intervened to stem excessive currency volatility. However, most economies in Asia still have a healthy level of reserves. The situation in Malaysia and China appears to be the most precarious, but we note that the risk of domestic deposit outflows is lower in economies that have a history of effective capital controls. Hence, relying on indicators that just look at the extent of FX reserves coverage versus potential domestic money supply outflows may not be as relevant.

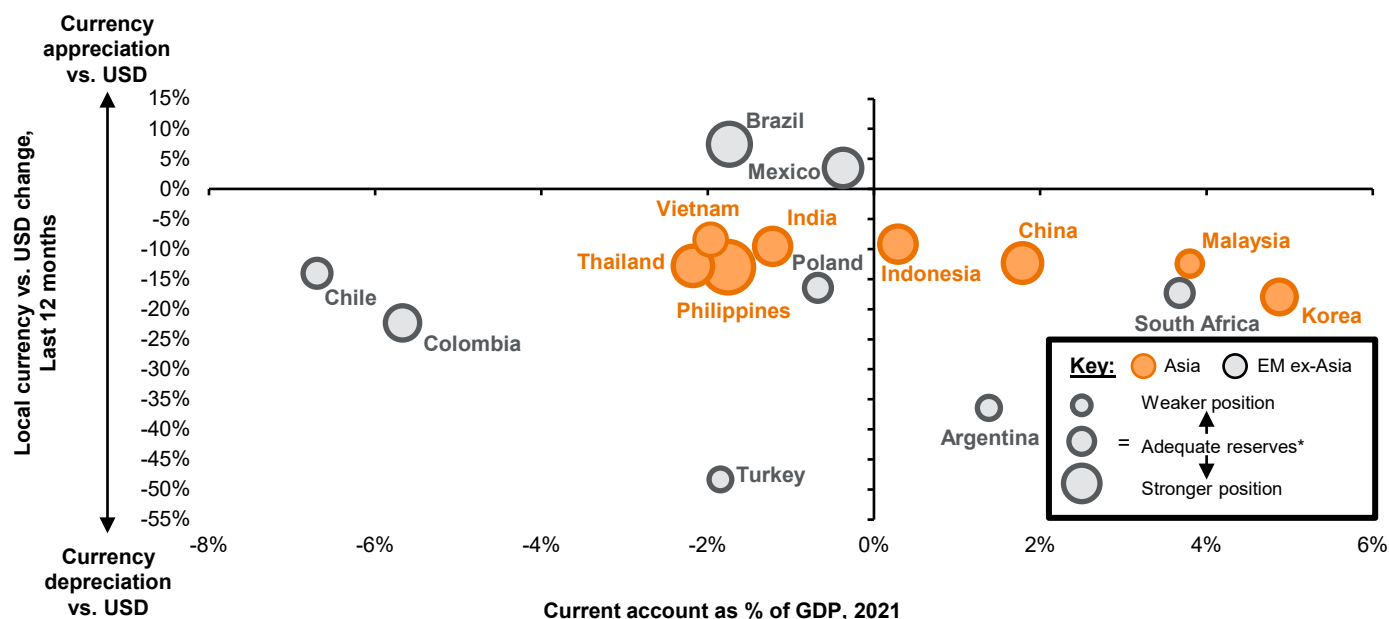
In terms of the current account balance, most Asian economies still have a flat to positive current account as a percentage of GDP. This is true especially for those that gained from goods (China, South Korea, Taiwan) and commodities (Indonesia, Malaysia) exports. India, Thailand and the Philippines, on the contrary, are running deficits due to cost of imports and a decline in tourism. However, tourism trends have been on the mend and commodity prices have come off their peaks.

Real rate differentials have declined but still remain positive across most Asian economies except for Thailand. Debt levels are quite elevated in economies such as China, South Korea and Thailand, but most of the debt is domestically held and in the local currency. This suggests the risk to a rapid stop in external funding is low.

Our assessment shows that while there has been deterioration in external indicators across some Asian economies, there still exists a reasonable buffer to withstand further pressures.

Exhibit 5: Emerging market external positions

Current account positions, currency movements and reserve adequacy



Source: FactSet, International Monetary Fund, J.P. Morgan Asset Management.

*Adequate reserves are stocks of a market's foreign exchange reserves that can cover 3 months of imports (the amount of times available reserves can cover 3 months' worth of imports) and cover short-term debt due in the next year (the amount of times available reserves can pay off debt maturing in the next 12 months and any payments on longer-term debt due in the next 12 months). The larger the bubble, the larger the amount of reserve coverage.

Guide to the Markets – Asia. Data reflect most recently available as of 14/11/22.

6. What can go wrong?

The risk that you don't see coming is the one that is the most dangerous, i.e., the black swan event. However, there are many white swans, or risks that we can see on the horizon, and these can be just as worrying given there are a number of them.

The economic forecasts for nearly every economy have been cut heading into 2023, and global growth may stall in the year ahead. The risks to a gloomier outlook relate to the cost of living and the potential for unrelenting inflationary pressure, such as miscalculation by central banks on how restrictive monetary policy needs to be, the reopening of the Chinese economy and geopolitics with the ongoing Russia-Ukraine conflict and its impact on global energy prices. When economic activity is already weak, a second energy shock would likely have a more significant impact.

The expectation is that inflation rates have peaked in the U.S. and are close to peaking in other developed markets. But inflationary pressures have become increasingly broad beyond food and energy to encompass more categories. The risk is that because these broader pressures are slower to abate, policy makers would once again face rising inflation expectations and an upward inflation spiral. There are clear reasons the pace of inflation would fall in 2023, but the path downward and the end point are still up for debate.

The Fed has opened the door to a policy rate of over 5%, but the persistence of inflation or the need to stem rising inflation expectations may require a return to more aggressive rate hikes. This would certainly drive the U.S. into a recession and undermine the credibility of the central bank, leading to another sharp repricing of both risk and risk-free assets.

Weaker global demand should ease pressures on energy prices, particularly oil, at a time when supply is restricted. But the risk to further disruptions in supply and the uncertainty of increased international sanctions on Russia should the conflict in Ukraine escalate create scope for another energy price shock. Moreover, when it comes to Europe, much of the region's economic outlook may simply boil down to the weather.

The expected reopening of China's economy could spark "animal spirits" in Asian markets, presenting opportunities. The risk is that the vaccine rollout across China is slower than expected and the economy remains sluggish through most of the year. Without more flexibility in its current COVID-19 policy, the sentiment among consumers and businesses is unlikely to improve. This could have knock-on effect to the housing market and generate broader financial stress.

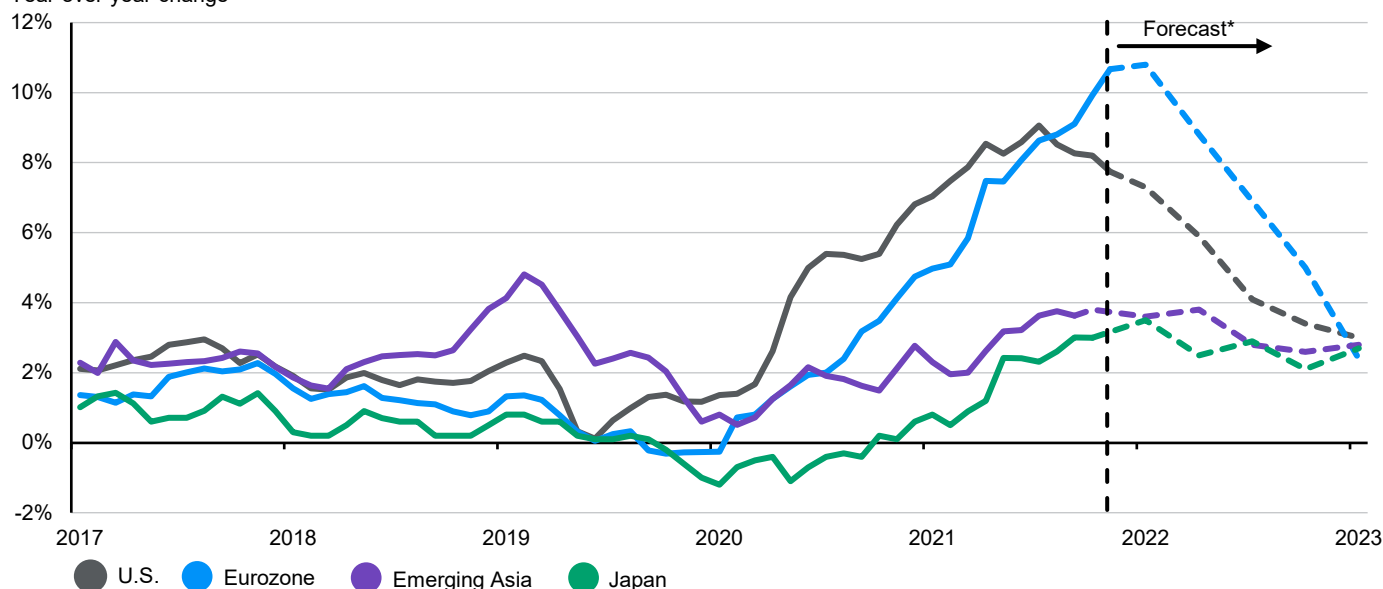
The list of what could go wrong in 2023 may be long, but the positive is that there is a higher degree of visibility on risks. This means investors can be better prepared and positioned to manage the risks should they occur.

Consensus is for inflation to fall gradually, but the actual path poses the greatest risk to the outlook for 2023

Exhibit 6: Inflation will decline in the year ahead, but will it fall fast enough, or far enough?

Headline consumer price inflation

Year-over-year change



Source: FactSet, J.P. Morgan Economic Research, J.P. Morgan Asset Management. *Inflation forecasts are based on consumer price inflation forecasts estimated by J.P. Morgan Economic Research. Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecast, projections or other forward statements, actual events, results or performance may differ materially from those reflected or contemplated.

Guide to the Markets – Asia. Data reflect most recently available as of 14/11/22.

7. Can cash outperform again in 2023?

The rapid rise in interest rates has made cash a viable asset again, particularly given its +1.0% year-to-date return has outperformed many other asset classes. A growing number of Asia Pacific markets have seen a rise in time deposit rates. Following a year of cash outperformance against most assets, particularly defensive ones such as bonds, some investors find this “safer” option appealing. However, we caution against locking up cash in exchange for income at this point.

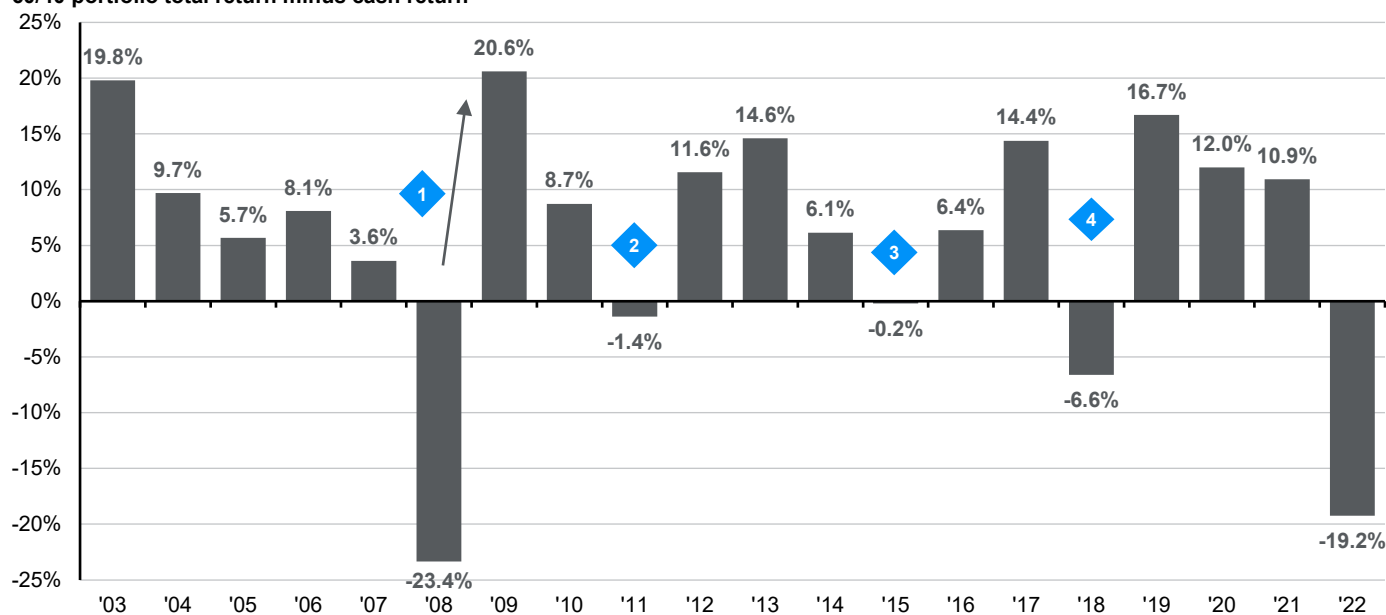
There is a recency bias where investors believe that since an asset class has outperformed over the past few months, that asset class should continue to outperform. This explains why investors may prefer to stay with cash. Cash is the most liquid asset, but to earn income with high conviction, investors may have to give up that liquidity for 6-12 months. The opportunity cost of locking in higher cash rates when the market may turn could prove to be high. If there is an economic turnaround, or when the Fed starts to pivot in the middle to late 2023, investors could miss out on the potential market rebound. The early recovery phase of an economy typically generates the strongest market returns over an economic cycle.

Historically, cash outperformance against a 60/40 portfolio is not long lasting. Since 2003 (excluding 2022), there were four calendar years where cash outperformed a 60/40 portfolio of stocks and bonds. In all four cases, this 60/40 portfolio outperformed cash significantly in the following year. We believe some conditions are in place for this to happen again.

First, the valuation of both fixed income and equities have corrected substantially. Markets such as Europe ex-UK, Asia ex-Japan and emerging markets are trading below their 15-year averages. Corporate credit spreads for both investment-grade and high-yield issues are also wider than their long-term averages. Second, while developed economies are facing considerable recession risk, the subsequent period of recovery typically delivers return with high conviction compared with other phases of the economic cycle. Moreover, the equity market typically bottoms out ahead of economic data and earnings. Hence, we see value in maintaining some dry powder and being ready to re-engage in risk assets once the Fed and other central banks tone down their hawkishness and economic recovery begins.

Over the past 20 years, cash outperformed the 60/40 portfolio four times. In the subsequent year, the portfolio significantly outperformed cash
Exhibit 7: 60/40 portfolio total return vs. cash return

60/40 portfolio total return minus cash return



Source: FactSet, J.P. Morgan Asset Management. Diamonds 1 to 4 indicates the four years since 2003 where cash outperformed the 60/40 portfolio. Cash is based on Bloomberg U.S. 1 to 3 months Treasury Bills. The “60” equity portion of the portfolio is based on MSCI AC World Total Return Index, while the “40” fixed income portion of the portfolio is based on Bloomberg Global Aggregate Index. Past Performance is not indicative of current or future results. Data reflect most recently available as of 14/11/22.

8. Is it growth stocks' turn to deliver?

Growth stocks underperformed in 2022 on the back of multiple headwinds. Expensive valuations were hit by rapidly rising yields. The maturing business model of leading technology companies also led to downgrades in earnings expectations.

Elevated inflation, a hawkish Fed and further earnings downgrade could still pose some headwind to growth companies going into 2023. During a period of depressed economic growth, defensive sectors and quality companies with strong balance sheets and ample cash flow are still preferred. The subsequent economic recovery would benefit companies whose earnings are closely related to the economic cycle, which would include financials, consumer discretionary and industrials.

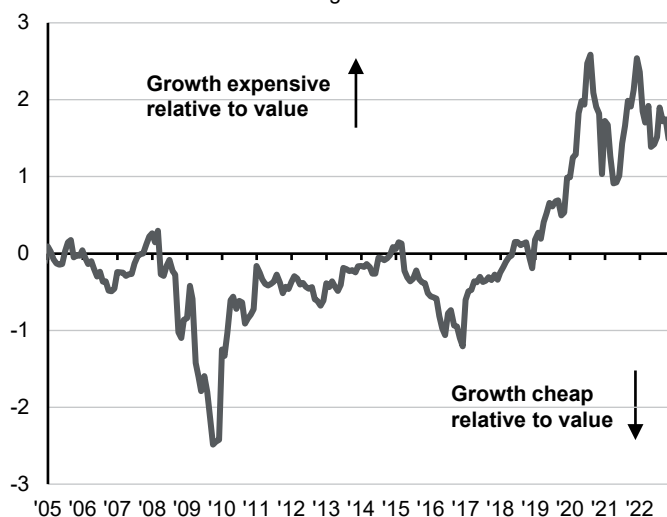
Nonetheless, we see opportunities in growth companies for investors with a long-term investment horizon. Historically, growth companies are able to generate the strongest earnings performance over a longer time period. Their valuations are now more reasonable following significant de-rating in 2022. One important catalyst for better growth stock performance would be for U.S. government bond yields, or discount rates, to peak. This could well come in mid-2023 once the Fed stops raising rates. Nonetheless, we believe investors should focus more on profitable growth companies in this early stage of rebound, while companies that have yet to turn a profit would only regain investor interest once the discount rate falls materially.

Growth is still expensive relative to value. But over a longer time period, growth has outpaced value stocks in earnings

Exhibit 8: Global equities: Growth vs. value

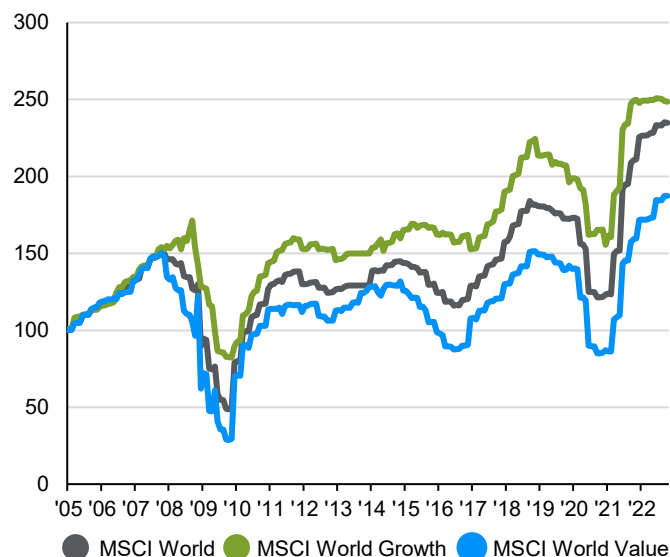
Growth vs. value valuations*

MSCI World growth / value fwd. P/E ratio,
of std. dev.** over / under average



Trailing 12-months earnings per share

Indexed, 31/12/04 = 100



Source: J.P. Morgan Asset Management; (Left) FactSet, MSCI; (Right) Bloomberg L.P.

*Growth is the MSCI World Growth index and value is the MSCI World Value index. **Std. dev. stands for standard deviation.

Past performance is not a reliable indicator of current and future results.

Guide to the Markets – Asia. Data reflect most recently available as of 14/11/22.

9. Could Asian equities outperform the U.S.?

2022 was a tough year for Asian equities. While domestic reopening provided fodder for Asian equities, this was offset by the sharp appreciation of the USD, COVID-19 restrictions in China and deteriorating external economic conditions in developed economies. The performance of Asian equities relative to the U.S. in 2023 will depend on a combination of these factors.

A challenge to Asian equities has been the extraordinary strength of the USD because historically, a strong USD correlates with weaker Asian equity returns. However, the peaking of U.S. Treasury yields may lead to a more stable relationship between the USD and Asian currencies, supporting Asian equity market returns and inward capital flows to the region. Additionally, the relative growth outperformance in Asia over the U.S. should also support Asian currencies. Capital flows into Asian assets from investors looking to take advantage of cheap valuations will also help.

Another positive trigger will be improving prospects from China's reopening. China's market rebound in June and early November 2022 illustrated what a combination of cheap valuations and potential economic recovery could deliver. A rebound in demand from China would help counterbalance the slowdown in Asian exports to the U.S. and Europe, as well as mitigate current supply chain disruptions.

A key headwind will be the impending recession in Europe and the U.S. export growth has been key in driving Asia's economic rebound over the past two years. Demand for Asian exports has already shown some signs of a slowdown, and this is likely to be exacerbated by the normalization in consumption habits and excessive inventory built up during the COVID-19 lockdowns.

Asian equities de-rated significantly in 2022, with a handful of the region's equity markets now trading below their long-term averages of 12-month forward price-to-earnings range. With much of the bad news already discounted, valuations are looking more compelling and earnings expectations more realistic relative to the U.S.

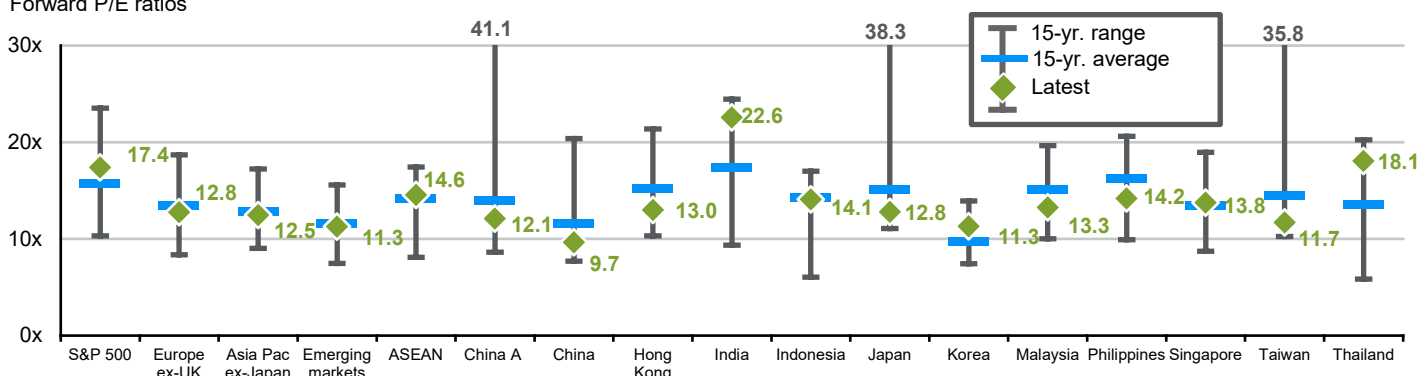
Additionally, some Asian economies will be capable of weathering slower U.S. and European growth, particularly those with greater exposure to intra-regional trade and a strong domestic consumer base. The USD should be less of a headwind in 2023. That said, an improvement in sentiment is likely dependent on China's reopening, which would provide a positive boost to the region as a whole.

Key triggers will realize Asian equities' favorable valuation proposition

Exhibit 9: Global equities: Valuation

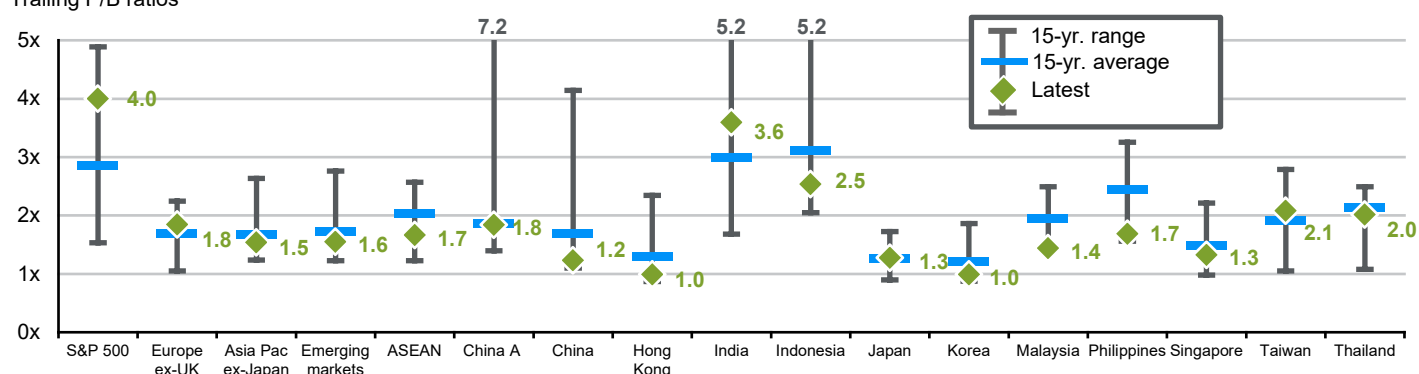
Equity market valuations – Price-to-earnings

Forward P/E ratios



Equity market valuations – Price-to-book

Trailing P/B ratios



Source: Bloomberg Finance L.P., China Securities Index, FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management.

Emerging markets is represented by the MSCI Emerging Markets Index. Price-to-earnings (P/E) and price-to-book (P/B) ratios are in local currency terms. 15-year range for P/E and P/B ratios are cut off to maintain a more reasonable scale for some indices. Past performance is not a reliable indicator of current and future results.

Guide to the Markets – Asia. Data reflect most recently available as of 14/11/22.

10. Is it time to go long duration?

Bonds have two roles within a portfolio—to provide a reliable source of income and to help lower volatility through diversification¹ and uncorrelated returns. For a long time, the potential of bonds to deliver either of these was severely hampered by very low, if not negative, yields. However, a painful 2022 for bond investors has changed this and we can finally say goodbye to negative yields.

2022 saw the largest drop in bond prices in recorded history. During the year, the benchmark Bloomberg Global Aggregate Bond Index (USD hedged) of government bonds fell by 11% at its lowest point, as of October 10, and the index yield tripled, rising from 1.09% in January 3, to 3.15%, as of October 21.

The persistent inflationary environment and commitment of central banks to drive inflation back toward target created the dramatic repricing across bond markets and the rise in market volatility.

As the saying goes, “no pain, no gain.” The experience of 2022 means bonds could be set for strong gains given the better valuations that come with higher yields. Certainly, the relative attractiveness of the bond market compared to equities has improved as yields have risen. The earnings yield spread, or the difference between the yield on BBB-rated U.S. corporate bonds and the earnings yield on the S&P 500, has become negative for the first time since 2009.

The higher yield means that core government bonds can once again fulfill those two roles of income and diversification¹. The higher yield means that income levels have improved and yields have room to fall if the economic outlook deteriorates further.

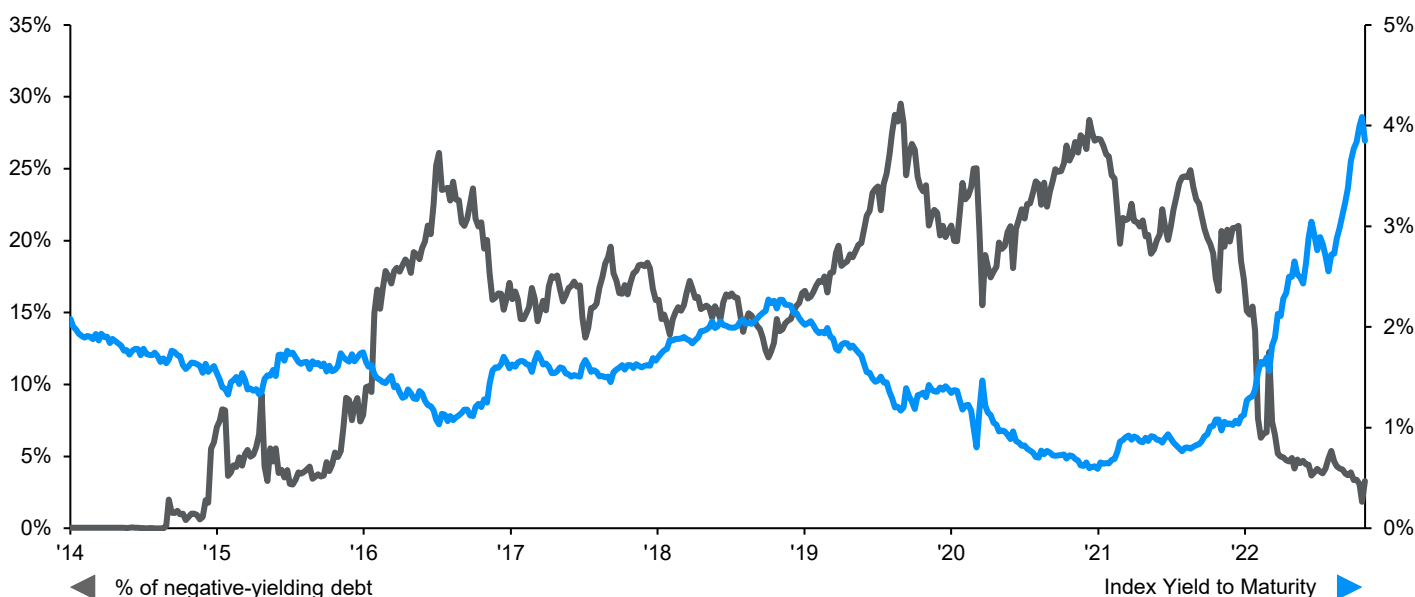
The rising recession risk in the U.S. and the Fed being closer to the end of its rate-hike cycle suggest that there is more downside risk to yields than upside in 2023.

However, the uncertainty over the peak in interest rates and how fast inflation rates will fall in 2023 mean that the correlation between stocks and bonds remains positive. A better growth and inflation mix will mean that this correlation once again becomes negative. In the meantime, bond markets could stay more volatile than investors would have liked. We believe investors should gradually increase duration exposure as the market gains more clarity on the inflation and rates outlook in 1H 2023.

Percentage of negative yield bonds and yield of global aggregate bond index

Exhibit 10: Share of negative-yielding debt vs. yield to maturity of index

ICE BofAML Global Broad Market Index



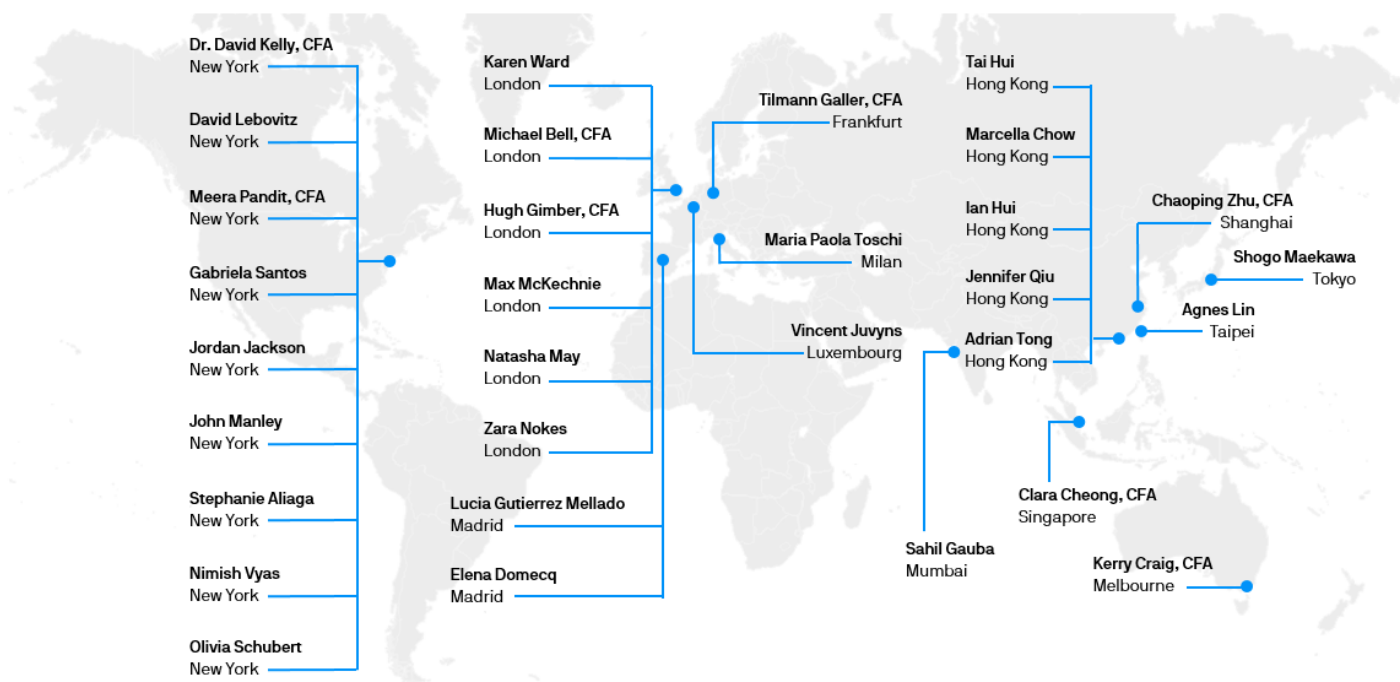
Source: Bloomberg Finance L.P., ICE BofA Merrill Lynch, J.P. Morgan Asset Management. Yield is not guaranteed. Positive yield does not imply positive return. Data reflect most recently available as of 14/11/22.

Conclusion

2023 could be a year of greater variations in economic performance and policy response after the synchronized inflation surge and monetary tightening of 2022. Active management and diversification¹ continue to be important investment principles to restart our investment journey after a year of hurt. We could see a rainbow in our investment landscape in 2023. Being ready to capture the moment will be key.

¹Diversification does not guarantee investment returns and does not eliminate the risk of loss.

GLOBAL MARKET INSIGHTS STRATEGY TEAM



AUTHORS



Tai Hui
Managing Director
Chief Market Strategist, Asia
Hong Kong



Marcella Chow
Vice President
Global Market Strategist
Hong Kong



Clara Cheong, CFA
Executive Director
Global Market Strategist
Singapore



Ian Hui
Vice President
Global Market Strategist
Hong Kong



Kerry Craig, CFA
Executive Director
Global Market Strategist
Melbourne



Shogo Maekawa
Vice President
Global Market Strategist
Tokyo



Agnes Lin
Executive Director
Global Market Strategist
Taipei



Jennifer Qiu
Associate
Global Market Strategist
Hong Kong



Chaoping Zhu, CFA
Executive Director
Global Market Strategist
China



Adrian Tong
Analyst
Global Market Strategist
Hong Kong

The Market Insights program provides comprehensive data and commentary on global markets without reference to products. Designed as a tool to help clients understand the markets and support investment decision-making, the program explores the implications of current economic data and changing market conditions.

For the purposes of MiFID II, the JPM Market Insights and Portfolio Insights programs are marketing communications and are not in scope for any MiFID II / MiFIR requirements specifically related to investment research. Furthermore, the J.P. Morgan Asset Management Market Insights and Portfolio Insights programs, as non-independent research, have not been prepared in accordance with legal requirements designed to promote the independence of investment research, nor are they subject to any prohibition on dealing ahead of the dissemination of investment research.

This document is a general communication being provided for informational purposes only. It is educational in nature and not designed to be taken as advice or a recommendation for any specific investment product, strategy, plan feature or other purpose in any jurisdiction, nor is it a commitment from J.P. Morgan Asset Management or any of its subsidiaries to participate in any of the transactions mentioned herein. Any examples used are generic, hypothetical and for illustration purposes only. This material does not contain sufficient information to support an investment decision and it should not be relied upon by you in evaluating the merits of investing in any securities or products. In addition, users should make an independent assessment of the legal, regulatory, tax, credit, and accounting implications and determine, together with their own financial professional, if any investment mentioned herein is believed to be appropriate to their personal goals. Investors should ensure that they obtain all available relevant information before making any investment. Any forecasts, figures, opinions or investment techniques and strategies set out are for information purposes only, based on certain assumptions and current market conditions and are subject to change without prior notice. All information presented herein is considered to be accurate at the time of production, but no warranty of accuracy is given and no liability in respect of any error or omission is accepted. It should be noted that investment involves risks, the value of investments and the income from them may fluctuate in accordance with market conditions and taxation agreements and investors may not get back the full amount invested. Both past performance and yields are not reliable indicators of current and future results.

J.P. Morgan Asset Management is the brand for the asset management business of JPMorgan Chase & Co. and its affiliates worldwide.

To the extent permitted by applicable law, we may record telephone calls

and monitor electronic communications to comply with our legal and regulatory obligations and internal policies. Personal data will be collected, stored and processed by J.P. Morgan Asset Management in accordance with our privacy policies at <https://am.jpmorgan.com/global/privacy>.

This communication is issued by the following entities:

In the United States, by J.P. Morgan Investment Management Inc. or J.P. Morgan Alternative Asset Management, Inc., both regulated by the Securities and Exchange Commission; in Latin America, for intended recipients' use only, by local J.P. Morgan entities, as the case may be. In Canada, for institutional clients' use only, by JPMorgan Asset Management (Canada) Inc., which is a registered Portfolio Manager and Exempt Market Dealer in all Canadian provinces and territories except the Yukon and is also registered as an Investment Fund Manager in British Columbia, Ontario, Quebec and Newfoundland and Labrador. In the United Kingdom, by JPMorgan Asset Management (UK) Limited, which is authorized and regulated by the Financial Conduct Authority; in other European jurisdictions, by JPMorgan Asset Management (Europe) S.à r.l. In Asia Pacific ("APAC"), by the following issuing entities and in the respective jurisdictions in which they are primarily regulated: JPMorgan Asset Management (Asia Pacific) Limited, or JPMorgan Funds (Asia) Limited, or JPMorgan Asset Management Real Assets (Asia) Limited, each of which is regulated by the Securities and Futures Commission of Hong Kong; JPMorgan Asset Management (Singapore) Limited (Co. Reg. No. 197601586K), this advertisement or publication has not been reviewed by the Monetary Authority of Singapore; JPMorgan Asset Management (Taiwan) Limited; JPMorgan Asset Management (Japan) Limited, which is a member of the Investment Trusts Association, Japan, the Japan Investment Advisers Association, Type II Financial Instruments Firms Association and the Japan Securities Dealers Association and is regulated by the Financial Services Agency (registration number "Kanto Local Finance Bureau (Financial Instruments Firm) No. 330"); in Australia, to wholesale clients only as defined in section 761A and 761G of the Corporations Act 2001 (Commonwealth), by JPMorgan Asset Management (Australia) Limited (ABN 55143832080) (AFSL 376919). For all other markets in APAC, to intended recipients only.

For U.S. only: If you are a person with a disability and need additional support in viewing the material, please call us at 1-800-343-1113 for assistance.

Copyright 2022 JPMorgan Chase & Co. All rights reserved.

Material ID: 09dd222811092331