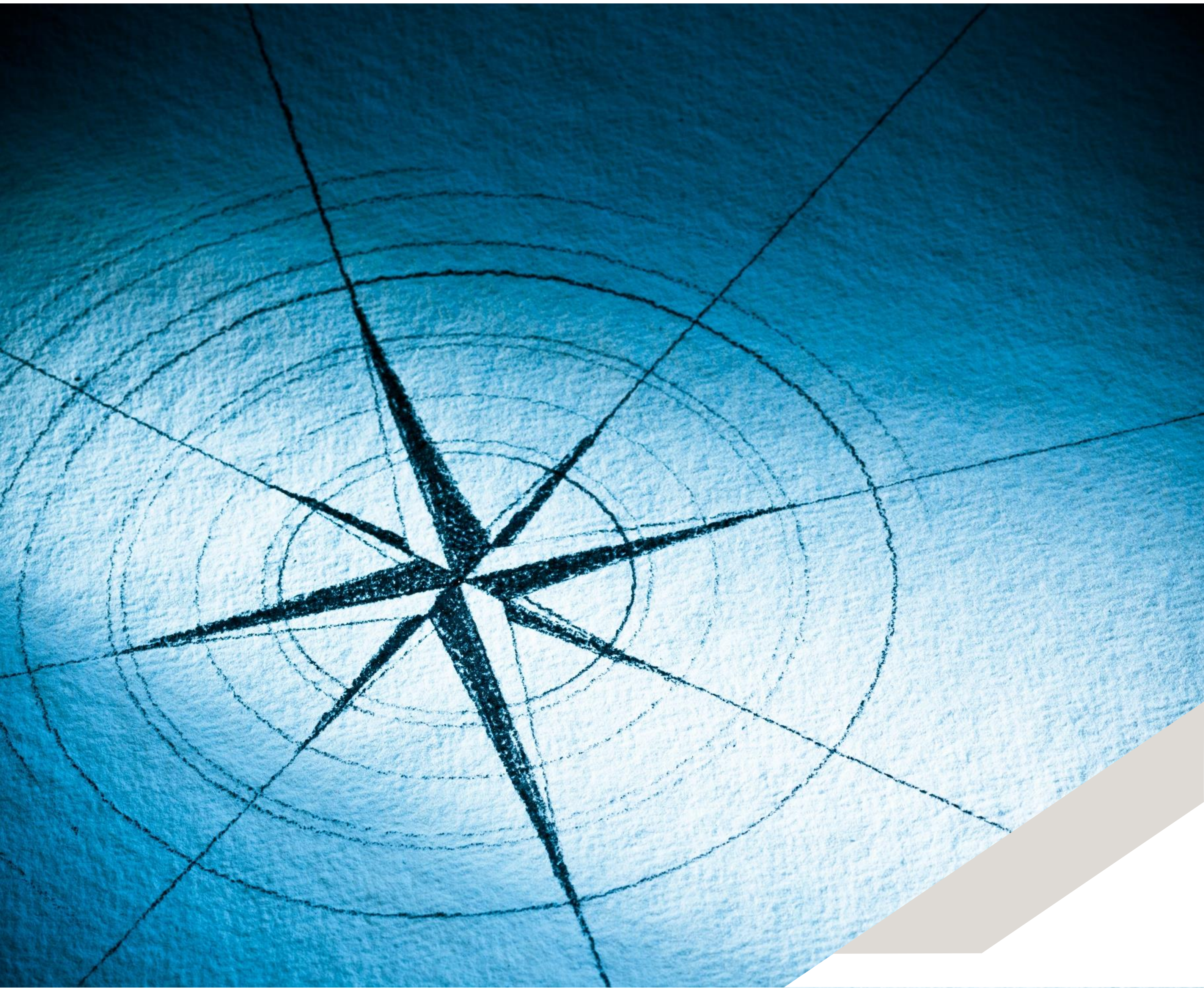

Scenario analysis

What if ?

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Foreword

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The significant economic downturn predicted so confidently, by so many, and for so long, has failed to materialize – so far. There have been technical recessions in the US and eurozone at different times in the last eighteen months or so, but nothing to trouble the history books.

We're not surprised: we have argued that a dramatic economic downturn has been neither necessary nor likely.

This might yet change, of course. But the three scenarios we offer here as an aid to organizing our thoughts about the future differ a little from those we offered at the start of the year. Sticky inflation, and developments in Artificial Intelligence, suggest differently-flavoured "worse" and "better" scenarios than the "Slump" and "Resilient Growth" considered then.

To be clear, our central scenario remains one in which core inflation falls back significantly (though much more slowly than headline inflation) during 2023 and 2024. We think global growth will remain anaemic, but that a major economic downturn is still unlikely. We doubt interest rates will fall back quickly, even as inflation fades.

This scenario remains the base case for asset allocation in Mosaique portfolios. In this scenario, the likely question for 2023 has been when to add to our holdings of stocks and bonds, and we recently moved tactically overweight on stocks, and closed long-standing underweight positions on bonds in European portfolios (we had been neutral on bonds in US portfolios since the autumn).

However, as noted, our "worse" scenario now focuses less on outright economic contraction and more on stubborn inflation – a more stagflationary mix than the negative variant last time. High inflation, but unaccompanied by strong growth, would be bad news for both bonds and stocks, and would perhaps favour less conventional assets – and the oldest of them all, gold.

Similarly, the more positive, "better" case scenario we offer now is a productivity-led boom in which growth is stronger, but without runaway inflation. Corporate earnings would surprise positively – and for AI users, not just for AI suppliers – but real policy rates and bond yields might stay higher for a while at least as central banks are reluctant to believe in what might look like a well-known fairy story…

What if…? - Three market scenarios to consider

Setting geopolitics aside, if economies remain resilient, inflation may now feature more in our "worse" case, and central banks may continue to guard against it even in our "better" case

Scenario	***Stagflation***	***Mosaique Asset Allocation***	***Productivity-led boom***
Position	Worse case	R&Co base case	Better case
Definition	Core inflation slows only a little. Economies avoid slump, but growth remains anaemic	Core inflation falls meaningfully, and the associated cyclical slowdown is unremarkable – modest in scale and brief in extent	AI-influenced changes in working practices boost growth: as in previous technological breakthroughs, users benefit alongside suppliers as costs fall
Macro implications			
GDP	Sub-trend global GDP growth continues through 2023 and 2024	Below-trend growth or technical recession in 2023-24, but no major setback	Growth surges to above-trend levels and stays there
Inflation	Core rates stick firmly above target (4-5%?) even in 2024	Falls back to 2-4% range in late 2023/early 2024, but sticks there	Still sticks above target, but not higher than in our base case (2-4%?), as unit costs are kept in check by productivity gains
Monetary policy	Central banks push policy rates above current expectations, and keep them there for longer	Central banks allow rates to start falling in 2024 – eventually	Interest rates stick around current levels: central banks suspicious of productivity growth
Investment implications[1]			
Equities	★☆☆	★★⯪	★★★
Fixed income	★☆☆	★★☆	★☆☆
Cash	★★★	★☆☆	★☆☆
Gold	★★☆	★☆☆	★★☆
Investment positioning			
Equity regions to favour	▪ US may outperform given its safe haven market status ▪ Switzerland may outperform given defensive sector mix ▪ Avoid emerging markets	▪ Developed Market returns to remain driven by sector composition: leadership varies as the cycle evolves ▪ Initial leadership favours US and growth until prospect of cyclical recovery looms closer. Defensive Switzerland/energy intensive UK may mostly underperform	▪ US outperforms strongly as technology leads the way; emerging Asia may return to favour ▪ Europe may outperform given its cyclical characteristics
Equity sectors to favour	▪ Energy ▪ Basic Resources ▪ Industrials	▪ Cyclical rotation to fluctuate with the business cycle ▪ Currently favouring: Healthcare, Information Technology and Industrials	▪ Labour-intensive services may be amongst structural gainers ▪ Information Technology ▪ Media & Entertainment
Other considerations	▪ Value outperforms Growth ▪ Defensiveness (e.g. USD) ▪ Govies over corporate credit	▪ Mid-duration fixed income ▪ Corporate credit over govies	▪ Growth outperforms Value ▪ Long-duration equity ▪ Corporate credit over govies

[1] *Investment implications stars are shown on a relative basis of one asset class vs the overall scenario result. The rankings for the Staglation and Productivity-led boom scenarios have been supported by statistical modelling done with Bloomberg scenario analysis. The rankings for the Mosaique Asset Allocation show our current positioning.*

What if…? - Three market scenarios to consider

Setting geopolitics aside, if economies remain resilient, inflation may now feature more in our "worse" case, and central banks may continue to guard against it even in our "better" case

Equity regions	***Stagflation***	***Mosaique Asset Allocation***	***Productivity-led boom***
North America	★★★	★★★	★★★
Euroland	★★☆	★★☆	★★☆
Switzerland	★★☆	★☆☆	★☆☆
UK	★★☆	★☆☆	★☆☆
Japan	★★☆	★★☆	★☆☆
EM Asia	★☆☆	★★★	★★★
Equity sectors			
Communications	★☆☆	★★☆	★★★
C. Discretionary	★★☆	★★☆	★★★
C. Staples	★★☆	★★☆	★☆☆
Energy	★★★	★★☆	★★☆
Financials	★★★	★★☆	★★☆
Health Care	★☆☆	★★★	★★☆
Industrials	★★★	★★★	★★☆
Information Technology	★☆☆	★★★	★★★
Materials	★★★	★★☆	★★☆
Real Estate	★★☆	★★☆	★★☆
Utilities	★☆☆	★★☆	★☆☆

[1] Investment implications stars are shown on a relative basis of one equity region/sector vs the overall equities result. The rankings for the Staglation and Productivity-led boom scenarios have been supported by statistical modelling done with Bloomberg scenario analysis. The rankings for the Mosaique Asset Allocation show our current positioning.

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