

Positioning for a delayed landing

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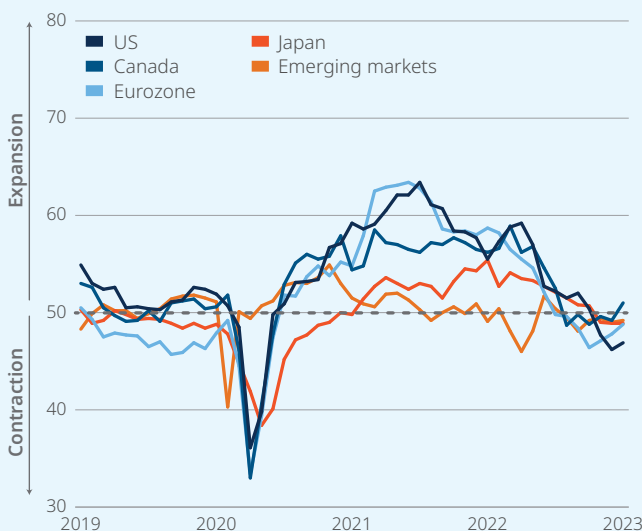
Highlights

- In the US, underlying inflation is stuck above 4%, growth and employment are holding up, and markets have finally begun pricing out a Fed pivot in 2023.
- With China reopening its economy and Europe’s catastrophic energy crisis scenario in the rear-view, global growth is perking up.
- Neither stocks — especially in the US — nor bonds are particularly attractive in this scenario, but we do prefer to take risk through equities than duration.

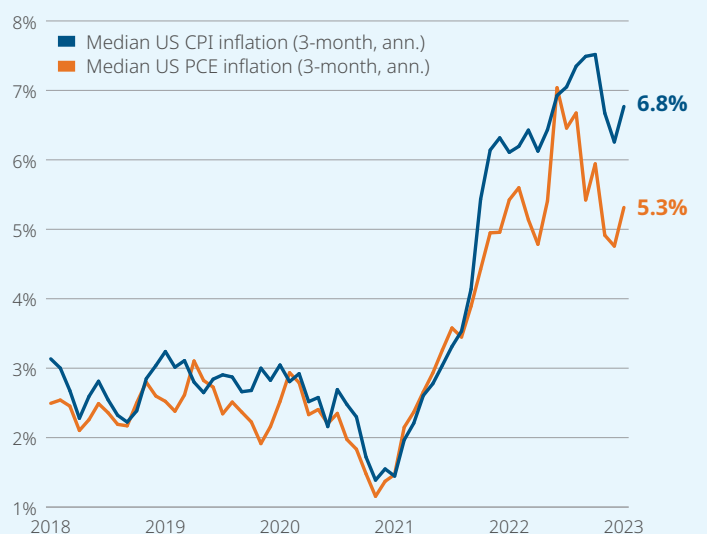
Soft landing, hard landing, no landing... the global economy’s flight has been a bumpy one. A few months ago, [we argued](#) that a Fed pivot in 2023 — priced in by markets at the time — was unlikely. Since then, growth has picked up around the globe, helped along by a warm winter in Europe and the scrapping of China’s zero-COVID policy. US inflation did show signs of easing in Q4 of 2022 but bounced decisively in January. PCE inflation, the Fed’s preferred measure, blew past analyst forecasts last month. Services prices excluding housing, a composite measure on which Fed Chair Powell keeps a close eye, grew by an annualized 7% in January, the hottest number since November 2021. We see trend inflation as having stabilized above 4%, at a significant distance from the Fed’s 2% target.

Figure 1. The post-COVID inflationary boom is not over

Purchasing managers indices (PMIs) reflect the uptick in global growth



US inflation is a long way from 2%



Notes: Via Bloomberg as of March 1, 2023.



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Investments

Over the coming months, we expect the US economy to keep overheating, and the global macro environment to remain one of high inflation and resilient growth. Neither stocks nor bonds are particularly attractive in this scenario, but we do prefer to take risk through equities than duration. Without a Fed pivot or a recession, neither of which we expect in the next few months, it's hard to see longer-term government bonds sustaining a rally. And even with 10-year Treasuries yielding close to 4%, bonds are still slightly too pricy relative to our fair value estimates. On the other hand, even if stock valuations end up getting compressed by higher-for-longer rates, equity earnings have a decent chance of realizing investors' modest expectations. This is especially true for ex-US stock markets, where valuations are much more attractive and profit margins less stretched.

Our macro view of resilient global growth and higher-for-longer rates hinges on the success of China's recent policy U-turn. We argued [back in November](#) that China's reopening would be an inflationary shock for the rest of the world. By scrapping its zero-COVID policy and turning on the liquidity taps, Chinese policymakers hope to jump-start growth in the second largest economy in the world, which had been hurtling towards a serious recession before the government's change of heart. Economic indicators were slow to turn around after the policy pivot was announced in Q4 last year, as COVID rippled through the population. Plus, the combination of a scarcity of transparent economic data and the Chinese New Year interruption makes it hard to discern the strength of the bounce in early 2023. But Chinese flight activity has already tripled since December, and the return of Chinese demand is evident in neighbouring countries' economic data.

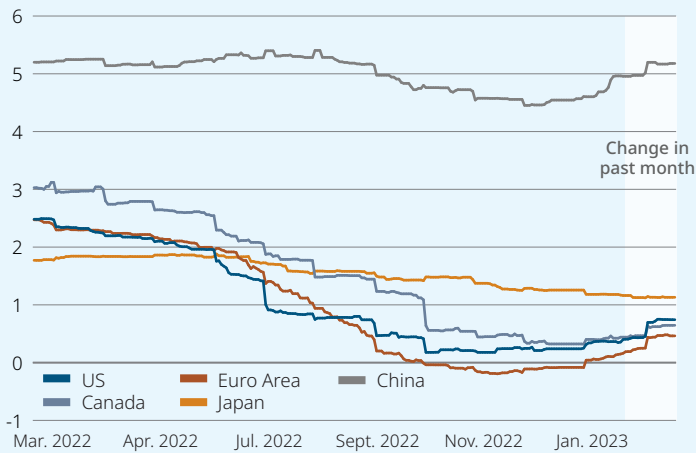
With economic conditions brightening in Europe and Asia, the US dollar is losing its shine. In the [Blue Book](#), Mackenzie's 2023 Outlook, we had highlighted that the US dollar was at its most overvalued since 1985. Even with the USD depreciating sharply over the past two quarters, it remains well above fair value. In fact, out of the 22 currencies in our universe, the USD screens as the least attractive. Surely, it's not all bad news for USD cheerleaders: higher-for-longer interest rates in the US could keep the dollar's value at current highs throughout 2023. But we prefer to express our "no Fed pivot" view by underweighting bonds, rather than overweighting an overvalued US dollar. In that sense, our currency bets help to balance out our bond position.

We don't see the US economy landing anytime soon, in either a soft or a hard fashion; but that doesn't mean it never will. Eventually, inflation will ease towards 2%. We believe central banks have the willingness and the tools to quash inflation. And that will probably come with a marked slowdown in growth, a drop in profits and rise in unemployment. But it will take more time than many expected. For now, the landing is delayed.

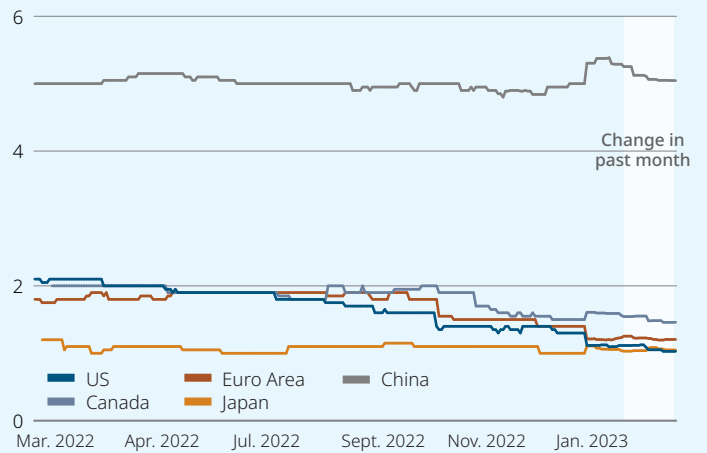
Global macro update

- **Global growth forecasts** clearly inflected in February, as the stark improvement in European economic indicators and China's reopening chased away global recession clouds. In its most recent World Economic Outlook, the IMF revised up its 2023 growth forecast for global GDP from 2.7% to 2.9%. This growth impulse reduces the odds of large cuts in global policy rates in both developed and emerging market economies. Plus, the rebound in ex-US GDP growth should favour rest-of-world equities relative to US stocks.
- **Forecasts for 2023 Japan inflation** are now well clear of the Bank of Japan's 2% inflation target. In our [December commentary](#), we advocated for the BoJ to begin unwinding its unconventional cap on 10-year government bonds, which it timidly did at its meeting on December 20. With inflation and inflation forecasts still on the upswing, growth prospects improving from China's reopening, collapsing liquidity in the Japanese bond market, and a new BoJ governor set to take over in April, signs point to the BoJ taking additional steps to tighten monetary policy.

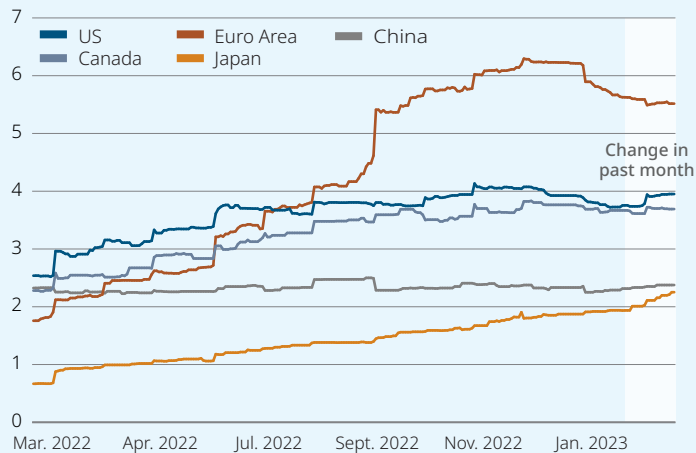
2023 real GDP growth forecast (% , consensus)



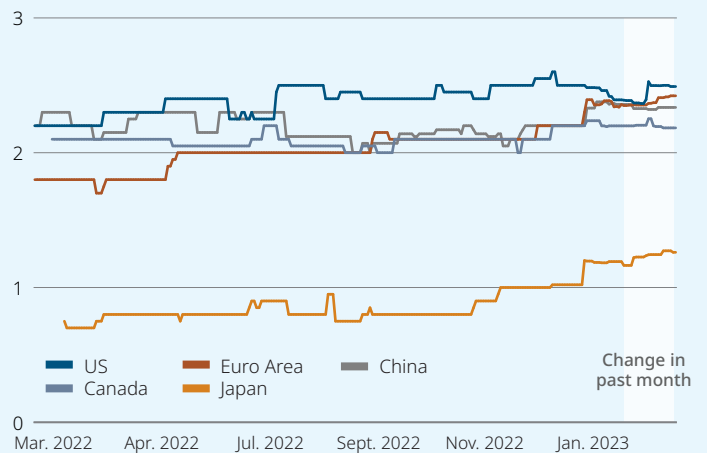
2024 real GDP growth forecast (% , consensus)



2023 inflation forecast (% , consensus)



2024 inflation forecast (% , consensus)

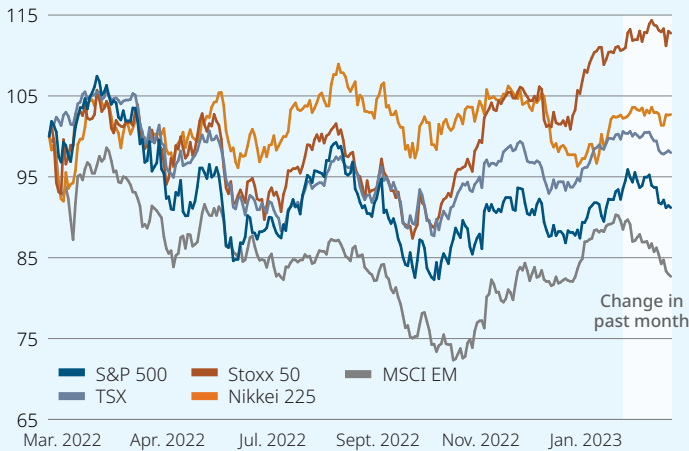


Notes: Average growth and inflation forecasts from Consensus Economics as of January 31, 2023.

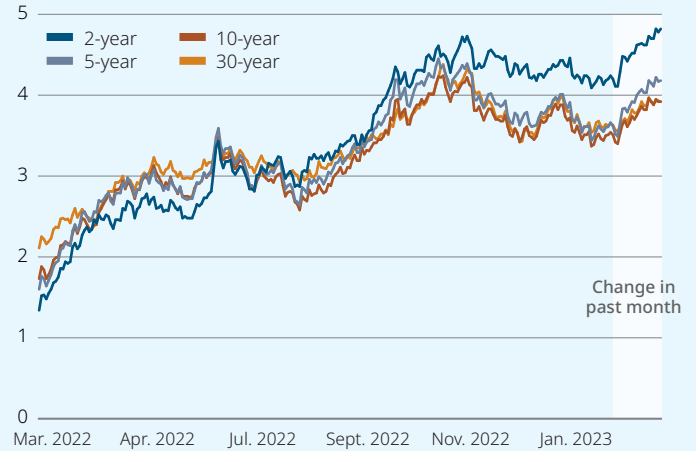
Capital markets update

- February was a positive month for the “inflationary boom” trade, with **bonds down more than stocks**, both outright and, especially, on a risk-adjusted basis. Just about every US economic data release last month screamed of a still-overheating economy. The US economy created 517k jobs (vs. 200k expected), US CPI inflation for January came out at 6.4% year-on-year (vs. 5.9% expected) and US retail sales grew 3% (vs. 2% expected).
- Oil prices** have been trading in an uncharacteristically tight range since November, oscillating between US\$72 and US\$82 per barrel. The US government has a standing plan to refill its Strategic Petroleum Reserve around US\$72, which sets a soft floor under oil prices. China’s reopening has not yet resulted in a surge in oil demand from the largest global petroleum consumer, with only jet fuel consumption having rebounded sharply in China over the past few months. But as the Chinese economy heals, oil demand from industry and ground transportation should firm as well.

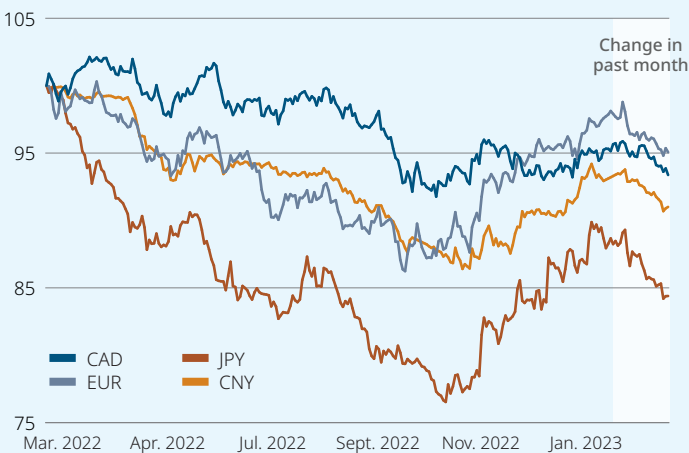
Equity indices (one year ago=100)



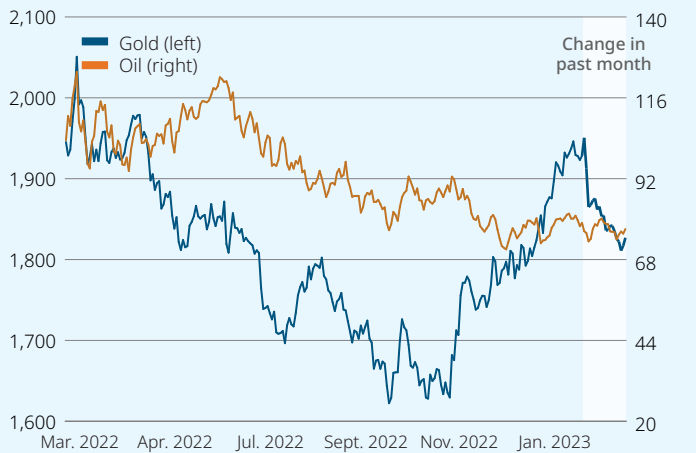
US Treasury yields (%)



Currencies (relative to USD, one year ago=100)



Commodity prices (in USD)



Notes: Financial data from Bloomberg as of February 28, 2023. Total return equity indices are in local currencies, except MSCI EM, which is denominated in USD.



What we'll be watching in March

March 8: Bank of Canada rate decision

- We expect the Bank of Canada to stand pat at its March rate-setting meeting, in line with consensus.
- However, the odds of an insurance rate hike in April or June are far from zero. While GDP was flat in Q4, there are signs that growth has picked up in the new year. The Canadian economy created 150k jobs in January, blowing past forecasts for the second month in a row. Statistics Canada's preliminary GDP growth number for January came out at 3.6% annualized, buoyed by commodity-linked sectors, which potentially benefitted from the growth impulse from China's reopening.

March 22: Federal Reserve rate decision

- While most analysts expect a 25bps hike at the next Fed meeting, we see a 50% chance of the Fed front-loading its hiking plans by going for 50bps. Inflation, jobs and retail sales all blew past expectations in January, enough to make some of the voting members have nightmares of the 1970s.

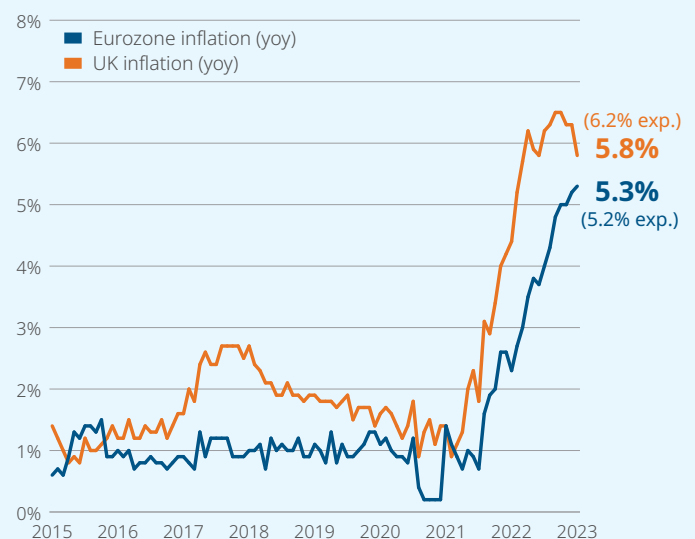
March ??: Canada 2023 budget

- There is no fixed date for the release of Canada's budget yet, but it will very occur sometime in March. Odds are that the deficit forecast as a percentage of GDP for 2023-24 will once again be slashed, even after accounting for new measures announced since the 2022 Fall Economic Statement. High inflation and solid job growth will likely result in higher tax revenues and lower outlays on welfare programs.
- Overall, even with the sharp drop in the federal government's deficit since 2020, fiscal policy remains much too loose — that is to say, the deficits too large — given the macro environment. Last time the Canadian economy overheated as intensely as it did in 2022 was back in the late-1980s.

Emerging theme

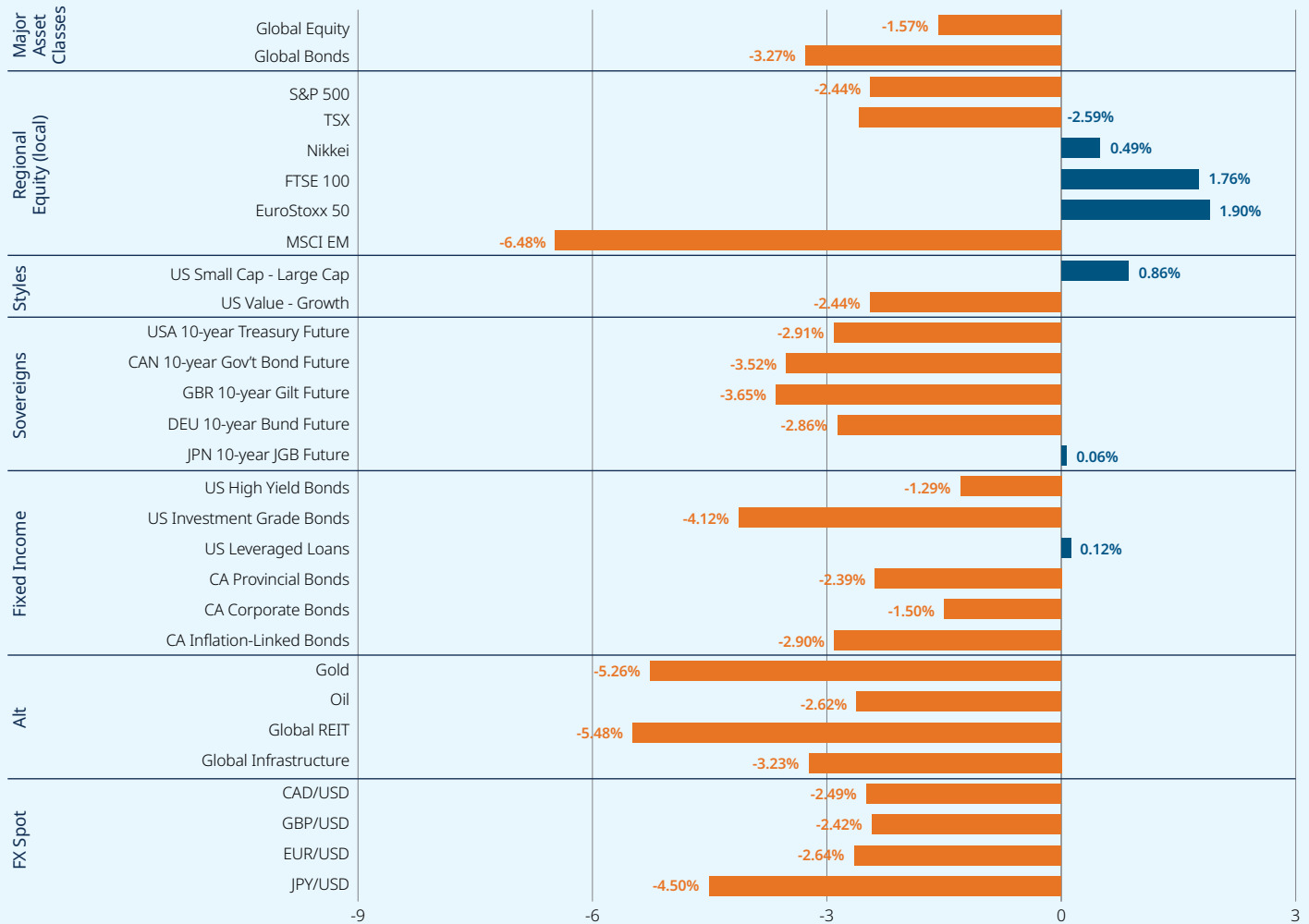
- Last week saw the release of the final January inflation numbers for the eurozone, which once again exceeded economists' forecasts. A striking contrast with the macro situation across the pond, where UK core inflation came in well below expectations, sliding from 6.3% in December to 5.8% in January.
- A warm winter has kept Europe's gas reserves plentiful, likely putting the catastrophic energy crisis scenario in the rearview. We've seen a few signs that growth has gotten its second wind across the euro area. With rebounding industrial production, solid employment and stubborn inflation, the European Central Bank is not about to take its foot off the brake. Energy prices have eased, but kinder macro conditions are pushing core inflation — the kind central banks care about — higher. More rate hikes are coming in Europe.
- The euro is well positioned to gain against the British pound, with Bank of England rates nearing their peak. For the same reasons, we prefer UK government bonds to German bonds, where we still see downside in price.

Sticky Eurozone inflation will force the ECB's hand



Notes: Via Bloomberg as of February 28, 2023.

Capital market returns in February



Notes: Market data from Bloomberg as of February 28, 2023. Index returns are for the period: 2023-01-01 to 2023-02-28. In order, the indices are: MSCI World (Ici), BBG Barclays Multiverse, S&P 500 (USD), TSX Composite 60 (CAD), Nikkei 225 (JPY), FTSE 100 (GBP), EuroStoxx 50 (EUR), MSCI EM (Ici), Russell 2000 - Russell 1000, Russell 1000 Value - Russell 1000 Growth, USA 10-year Treasury Future, CAN 10-year Gov't Bond Future, GBR 10-year Gilt Future, DEU 10-year Bund Future, JPN 10-year JGB Future, BAML HY Master II, iBoxx US Liquid IG, Leveraged Loans BBG (USD), Provincial Bonds (FTSE Canada), BAML Canada Corp, BAML Canada IL, BBG Gold, BBG WTI, REIT (MSCI Local), Infrastructure (MSCI Local), BBG CADUSD, BBG GBPUSD, BBG EURUSD, BBG JPYUSD.

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