2023 MARKET OUTLOOK

Balancing short-term volatility with long-term opportunity

NEI

At NEI Investments, we believe markets will likely be volatile in the first half of 2023 as central banks continue their path of tightening and will likely not reach their peak rate until closer to the middle of the year. Regardless of when and where rates do top out, they will be firmly in restrictive territory and that will impact economic growth. Earnings growth has already been revised down, but likely don't reflect a recessionary scenario.

While the old economic environment was supported by a 30+ year trend of low inflation and decreasing interest rates, the new economic environment will have structurally high volatility as higher rates take affect. This increased volatility provides an ideal environment for active managers like NEI and its global roster of sub-advisors.

For our 2023 Market Outlook, we have identified 10 key opportunities:

1 Bonds are back

Following the 30-year trend of falling interest rates, a rising rate environment marks a great opportunity for fixed-income investors in 2023 and beyond. Higher yields can provide more predictable income and starting yields are an important predictor of future returns. In the likely event of a recession, credit spreads could widen further, which could provide more opportunity for fixed-income investors to generate excess returns over the long run. Between high income and price appreciation, some parts of the high-yield markets could provide equity-like returns for patient investors with a long-time horizon.

2 Equity valuations are attractive

On a valuation basis, equities are even cheaper than they were at the beginning of 2021. The final rate hike in the tightening path will be an important inflection point for equities and provide an attractive entry point.

3 The 60/40 portfolio is not dead yet

The 60/40 portfolio has had one of the worst years of real return performance in decades due to the positive correlation in fixed income and equities, as both saw significant declines. The portfolio is well positioned for recessionary environment as fixed income could outperform in a risk-off environment while equities typically hit a bottom three months before a recession begins.

4 Clean energy

The long-term thesis for secular growth in renewable energy remains as demand for electricity is stronger than ever. Renewables are the electricity technology with the lowest cost in most places around the world, uncorrelated to the economic cycle and expected to grow much faster than the broader market at a time when growth is scarce.

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5 Emerging markets growth

Expectations are for global growth to rebound in late 2023 and into 2024 with emerging markets to outpace developed markets. As China's economy reopens, it will provide a boost to its own economy and other emerging markets.

6 Sustainable stocks

Sustainable companies tend to provide goods or services that fulfil an essential need, leading to more durable earnings growth less reliant on the macro environment. As bond yields have risen, these companies have come under significant pressure creating an attractive entry point to invest in companies with strong, long-term prospects that deliver positive outcomes for society.

7 Low volatility equities

The Minimum Volatility Index has been low since 2019 and provides significant upside potential and downside protection in the event of an equity market downturn.

8 Dividend payers

Over the past 50 years, dividend payers have outperformed non-payers with lower risk but in the past decade of zero-interest rates, payers fell to a 20-year low versus non-payers. Inflation is expected to remain elevated in the next decade and a decade of zero-interest rate policy (ZIRP) is unlikely to repeat, creating a favorable outlook for dividends in the next decade.

9 Canadian equities

Earnings yields for equities remain well above Canadian bond yields and through pricing power, can help to offset inflation. Attractive earnings potential provide enhanced valuation support amidst a volatile market backdrop.

10 Defensive equity strategies

The last decade had fewer downside events, but investors may need to prepare for more market volatility and be ready to sacrifice some return in very strong markets—less upside capture. The good news is that a strategy that loses less than the market in downturns can beat the market over time even if it doesn't capture all of the market's rallies.

Talk to your advisor today about how responsible investment solutions from NEI can help you achieve your goals.

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