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2023 Market Outlook

Navigating the global reset

Contents

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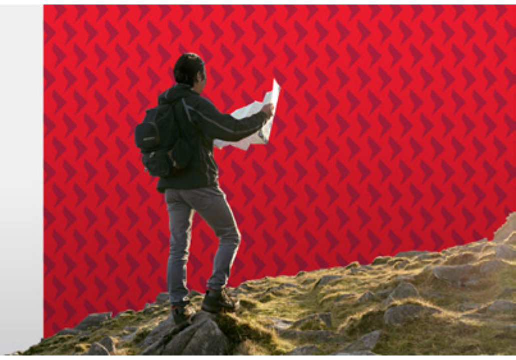
2023 Market Outlook

Foreword



The outlook for inflation and its impact on monetary policy will continue to drive markets in 2023. If the US Federal Reserve (US Fed) succeeds in driving down inflation with determined rate hikes, the ensuing slower growth should favour quality fixed income solutions. This is especially the case for Asian bonds whose yields are at their most attractive in over a decade.

We expect a more benign economic backdrop in the second half of 2023 when we will probably be past peak inflation and peak US Fed hawkishness. This environment should be positive for risk assets including Asia and Emerging Market equities, as well as Asian credit. The second half of the year also coincides with the expected timing of China's full re-opening. As China fine tunes its COVID policy and rolls outs more supportive measures for its beleaguered property sector, we believe that we are past the worst in terms of impact for investors.

Asian and emerging economies have been relatively resilient in 2022 as regional tightening measures have been more moderate on the back of weaker inflation. Going into 2023, we see North Asian markets benefitting from China's gradual re-opening. Meanwhile, India and ASEAN will continue to offer investors opportunities arising from the ongoing supply chain diversification and global decarbonisation cycles. In Japan, decades of corporate restructuring have borne fruit, resulting in greater efficiencies and improved profitability. We see significant upside for Japanese equities in 2023 and beyond.

That said, we expect volatility to remain elevated in the new year. The Russia-Ukraine war reminds us that geopolitical events are hard to predict. A deep US recession and a disorderly re-opening in China are also potential risks that investors may have to contend with. Investors can consider making use of smart beta, multi-factor, and low volatility strategies to build portfolios that are less influenced by swings in market sentiment. Our multi asset portfolio solutions team is also finding creative ways to add resilience to portfolios via tactical overlays and derivatives.

As Asia and the world races towards net zero, we see sustainable investing becoming more entrenched in the region. Increasingly, there is a move away from a pure exclusions approach to one that embraces greater engagement. This encourages us to continue in our efforts to engender change among our investee companies and add value to our stakeholders and the community.

Bill Maldonado
Chief Investment Officer

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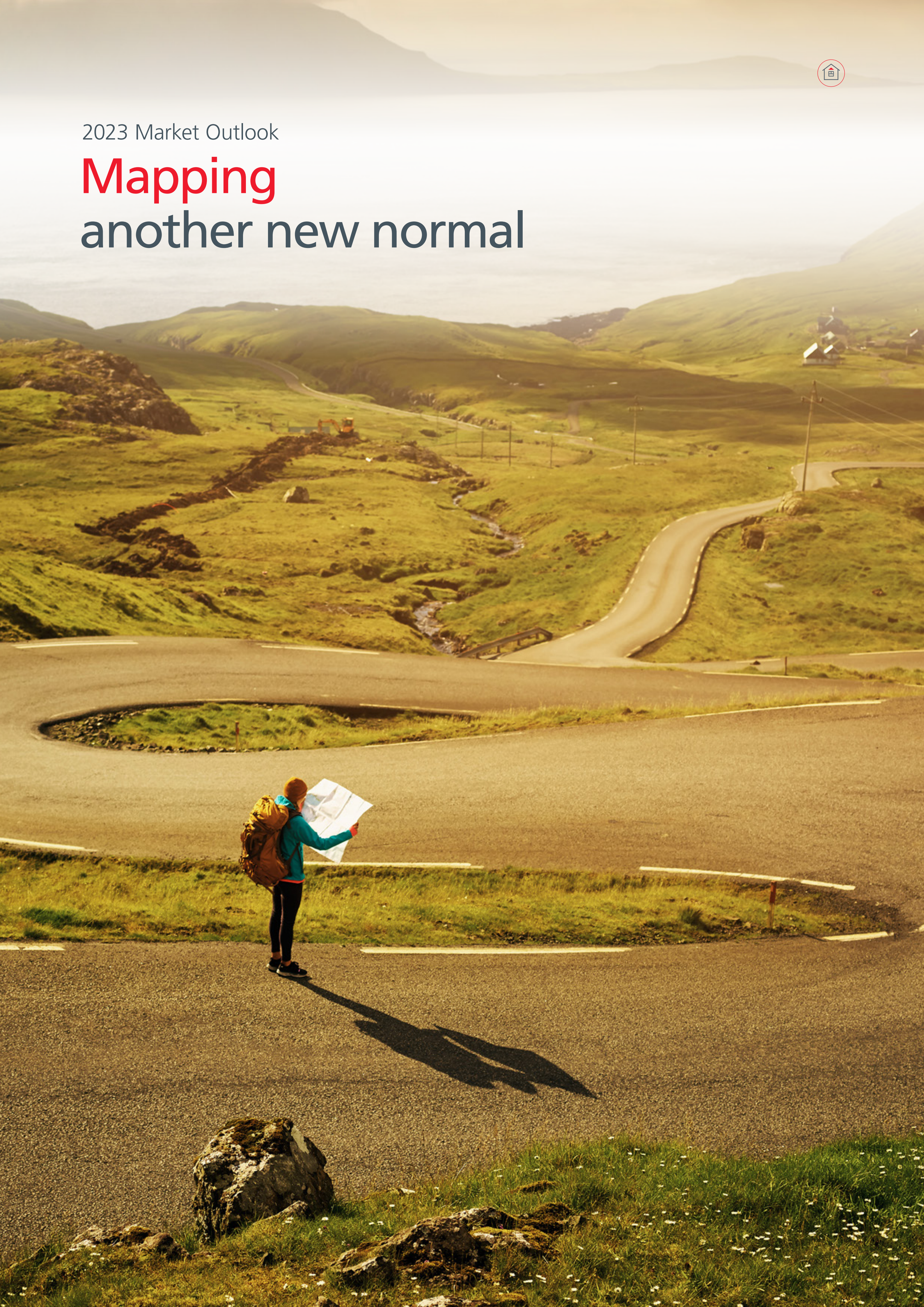
2023 Market Outlook

Mapping another new normal



2023 Market Outlook

Mapping another new normal

As we head into 2023, another new normal confronts us. Just as several pandemic-induced changes have become entrenched, inflation is likely to be higher than what it used to be in the decades prior to COVID-19. Consequently, the era of easy money has ended while geopolitical tensions are at a high across the globe. Against this backdrop it is important to be nimble and proactive in one's portfolio choices and positioning.

2022 was a tough year for most investors. 2023 may be even more challenging. Slower growth and tighter financial conditions in the Developed Markets (especially the US and Europe) are clouding the global economic outlook. There is also a growing acceptance that inflation would be more durable than originally thought and that talks of a US Federal Reserve (US Fed) pivot at this point in time are a bit premature.

GROWTH RISKS TO INTENSIFY

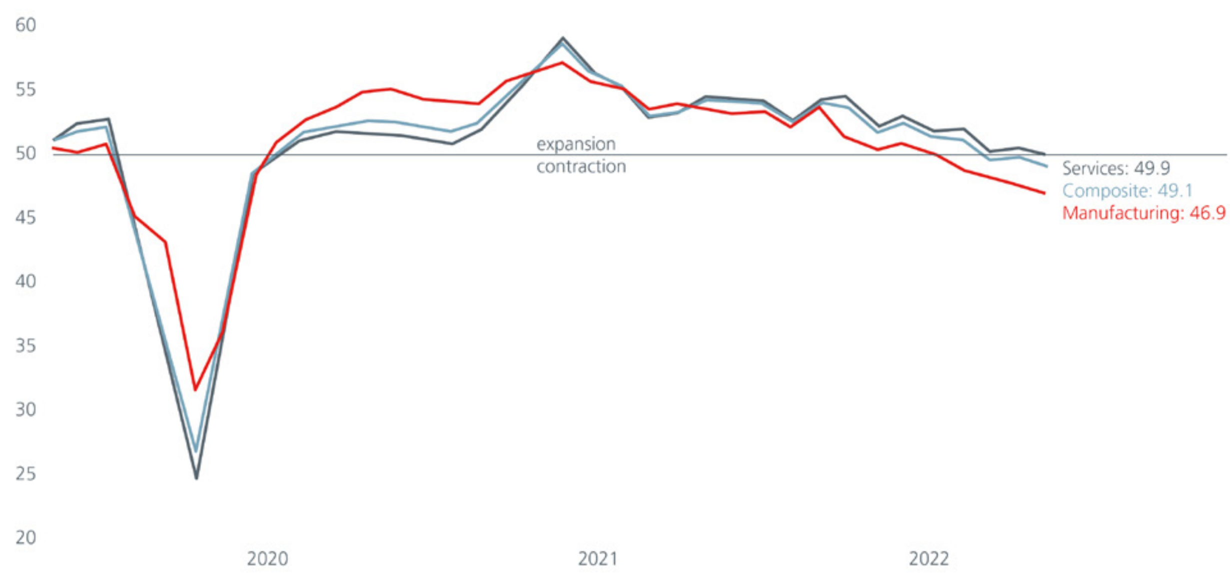
Continued declines in global PMI readings and a broad-based weakening of factory output across regions suggest that the global goods sector is in a recession, prompting comparisons to the 2000-2003 period during which there was a technology-led recession.

Much depends on the inflation trajectory and the consequent impact on monetary policy in Developed Markets (DMs).

While there are signs of inflation peaking, tight US labour markets and strong wage growth may force the US Fed to remain hawkish for longer. Meanwhile, high energy prices which have been another inflation driver will likely face more upward pressure especially as China begins to re-open, and this could prolong central banks' battle against inflation. On the flip side, exogenous factors leading to a decline in commodity prices could bring inflation down rapidly and end the monetary tightening phase earlier than expected.

Nonetheless we believe the current conditions will likely extend into the first quarter of 2023. The US Fed is expected to continue tightening monetary policy into 2023, although the magnitude and frequency will depend on how quickly unemployment rises or how fast consumer prices fall. The median projections from the US Fed currently point to further rate hikes in 2023 before falling in 2024. As it stands, it is likely that the US Fed will only reach its peak of the rate hike cycle mid-2023, barring a tail risk event in financial markets.

Global PMI new orders are falling



Source: Refinitiv Datastream, Eastspring Investments, October 2022.

A better global economy is thus likely to emerge in the second half of 2023 as we navigate past peak inflation and US Fed hawkishness. Any impending US recession will probably be a mild one relative to previous recessions given that the US consumer balance sheets are much more resilient today (even compared to the 2008 Global Financial Crisis).

> **A better global economy is likely to emerge in the second half of 2023 as we navigate past peak inflation and US Fed hawkishness.**

We acknowledge that equities have more room to decline in a recession, especially as US equities represent approximately 63% of global equities and given the large technology representation in key market cap indices. The extent is however contingent on the magnitude of the recession (i.e., the deeper the recession, the larger the equity drawdowns). That said, further easing of financial conditions on the back of the US dollar peaking will lead to better performance returns for risk assets in the second half of 2023.

EMERGING ECONOMIES RELATIVELY RESILIENT

Central banks in Emerging Markets (EMs) have also tightened monetary policy, but generally not to the magnitude and pace seen in DMs. This is because for many emerging economies, domestic demand is typically weaker, wage growth is less robust, and hence inflation dynamics are relatively weaker compared to the US. This can be seen in China, which is experiencing weak domestic demand and weak inflation dynamics, primarily due to COVID restrictions and a weak housing market, among other factors.

Over in Asia, inflation has also been relatively benign partly due to the smaller fiscal stimulus response to the pandemic (unlike the US), less exposure to the energy shocks (unlike Europe), as well as more government subsidies, some of which have been passed onto consumers. Meanwhile Asian central banks have been trying to manage their interest rate differentials to contain currency depreciation and imported inflation. While Asian yields were pressured higher in tandem with higher core DM rates, markets struggled to price in much more tightening from Asian central banks amid a weakening economic backdrop and less sticky inflation.

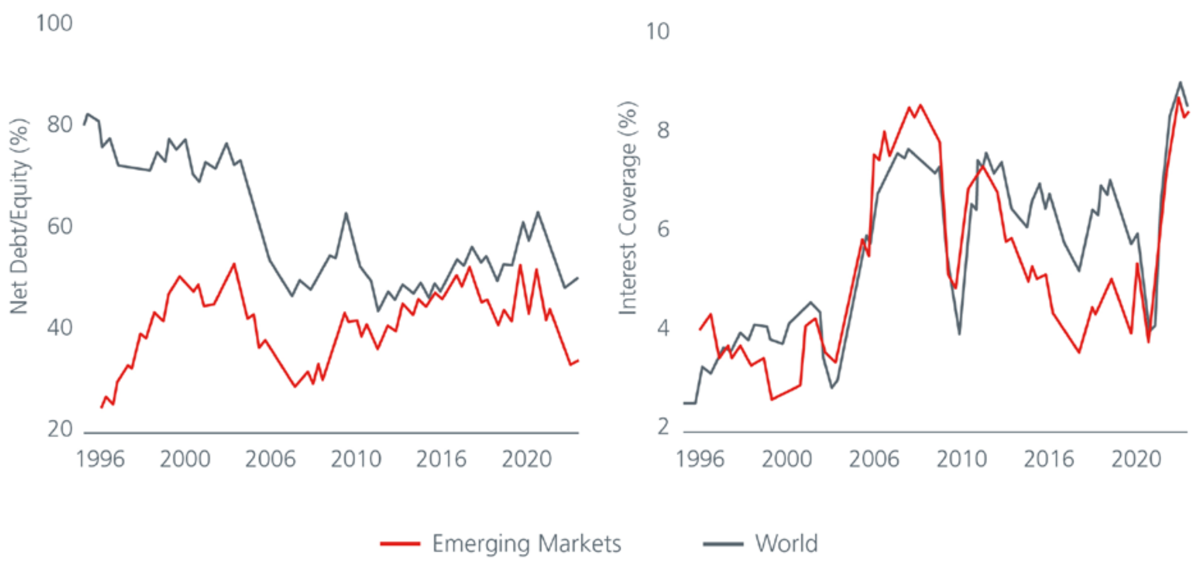
All said, the 2020s have also begun in a very different fashion to the 2010s for EM equities. The 2010s was the perfect backdrop for growth and quality investing as investors were encouraged and rewarded to pay high prices for potential future earnings stability and growth, especially in the e-commerce space. In the early 2020s however, we have seen policy responses to COVID-induced slowdown more focused on investing in the real economy with capital expenditure plans returning and decarbonisation efforts front of mind. Following a volatile year for EMs, we are ending 2022 with a very attractive valuation entry point on a historical context both in absolute terms, but also relative to DMs.

OUR RISK CONSIDERATIONS

We believe the current market environment is quite challenging amid increasing tail risk events and geopolitical tensions (i.e., US-China, Russia-Ukraine, China-Taiwan, Iran nuclear talks). Geopolitical risk is notoriously hard to assess because it is dependent on the unpredictable behaviour of its actors. The Russia-Ukraine conflict in 2022 is perhaps a reminder to investors that following a decade of relatively peaceful geopolitical environment, we may be ushering in a new period of skirmishes caused by rivalry between great powers.

Tighter liquidity conditions and higher borrowing costs are other key risks. As interest rates go up, companies that are not producing reliable profit streams will be most affected and vulnerable. US growth and tech stocks are quite susceptible to deteriorating valuations, and as such have seen some de-rating amid rising rates. Only companies that can produce an economic return from their borrowings are going to be creditworthy institutions.

EM non-financial corporate balance sheets are seemingly healthy



Source: Refinitiv Datastream, Eastspring Investments, October 2022.

Finally, there is a good chance that the US Fed may push the US economy into a recession if inflation persists. Investors need to remain very vigilant to that potential outcome. The US dollar which has strengthened considerably amid rising rates and souring global risk sentiment will likely remain strong in the near term. Emerging and Asian economies may be forced to intervene to reduce the volatility of their currencies. Rapid reserve drawdowns could increase uncertainty.

Ultimately if the US Fed stamps out inflation by crushing aggregate demand, then we are going to see higher unemployment and slower growth, and investors will likely favour fixed income solutions. On the other hand, if more supply-side measures help to ease inflation, then equities are likely to be in demand. In our view, it is very unlikely that inflation is going to be addressed through supply-side measures alone.

Investment implications

Scenarios	Rationale	Equities	Bonds
US Fed continues to raise rates to stamp out inflation which in turn crushes demand, and recession risks grow	Investors typically flock to safe haven assets during these periods.		✓ Long duration Treasuries
US Fed rates peak in mid-2023 as inflation falls due to supply-side measures, and US growth bottoms	Sentiment will turn positive and in a risk-on mode, stocks and credits tend to outperform.	✓ Asia ✓ Emerging Markets	✓ Asian high yield ✓ Asian investment grade
High real interest rates force investors to refocus on company profitability and free cashflows	This is supportive of value stocks which have been under-invested in and mispriced over the past decade.	✓ Value	

Source: Eastspring Investments. November 2022.

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2023 Market Outlook

Tracking China’s re-opening

2023 Market Outlook

Tracking China's re-opening

China's zero-COVID policy and the turmoil in its property sector had weighed on the Chinese economy and equity markets in 2022. We believe that we are past the worst in terms of impact for investors and with valuations, earnings expectations and investor positioning at extremely low levels, the potential upside is attractive as China moves towards re-opening its economy in 2023.

The Chinese government faces multiple policy trade-offs in 2023 as it seeks to create a more balanced and sustainable economy in the long term while ensuring social stability in the near term. This balancing act is further complicated by the country's COVID policy, a slowing global economy and rising geopolitical tensions.

THE CASE FOR CHINA

Despite China's recent macro and geopolitical challenges, we believe that there is still a case for holding Chinese equities in investor portfolios. Over the longer term, economic development remains one of the Chinese Communist Party's top priorities - GDP per capita is targeted to grow by a compounded average growth rate of +5% by 2035 according to the 20th Party Congress report. Higher domestic consumption, more diversified growth drivers and improved resource allocation should result in a more balanced economy.

"There is still a case for holding Chinese equities."

Despite recent restrictions imposed by the US to limit Chinese companies' access to advanced semiconductor chips, we believe that China's pace of innovation will continue as the government focuses on innovation and supply chain security. It is forecasted that over the next five years, China's foundry capacity will grow at more than twice the rate compared to the rest of the world, as China seeks to localise its semiconductor supply[1].

The Chinese A-share market is a large and diverse equity market which offers investors significant portfolio diversification. China A has a correlation of 0.33 with Developed Markets and 0.49 with Emerging Markets[2]. China's bond market is also one of the largest in the

Source: [1]Gartner. [2]Bloomberg. Weekly returns for the period of November 2012 to November 2022.

world. The low correlation between Chinese and global government bonds of 0.24 since 2013 offers diversification benefits to global investors[3]. With investors significantly underweight both these asset classes, the potential upside from a rise in allocations is compelling.

ALPHA OPPORTUNITIES

Within Chinese equities, we believe that there are alpha opportunities in sectors that are aligned with China's strategic goals as well as in sectors that will benefit from China's structural growth trends.

In the near term however, we see the services, industrials and materials sectors benefitting from China's re-opening and recovery. As most global central banks continue to hike rates into 2023, albeit at a slower pace, we expect Chinese policymakers to keep monetary policy accommodative, which would be supportive for Chinese bonds.

We expect China's growth to bottom out in the first quarter of 2023 as the government fine tunes its COVID policy (reduced mass testing and fewer days of quarantine) and provides more supportive measures for the property sector (lowered restrictions for funds in the escrow accounts and financing support for private developers). Fundamentals may remain depressed in the short term given the lagged impact from policy easing. A full re-opening would probably take place around the first half of 2023 and China's GDP growth is likely to rebound to 4-5% in 2023, up from 3-4% in 2022. That said, a disorderly re-opening and a rise in inflation as the economy rebounds would be key risks for China.

PROPERTY TURNAROUND ONLY IN LATE 2023

In the fourth quarter of 2022, the government had announced several measures to help alleviate the liquidity pressure within the property sector. RMB250bn of financing was set aside to support the private developers while the People's Bank of China and the China Banking and Insurance Regulatory Commission issued a "16-point plan" regarding the delivery of completed units, refinancing and risk management. For the first time, the plan acknowledged the importance of supporting companies and not just projects. The grace period for banks to reduce their exposures to the property sector was also lengthened. That said, execution is still key and a recovery in physical property sales is needed for the sector to normalise.

At the point of writing, primary sales and property investment remain weak and it would take time for homebuyers' confidence to return. As such, we are unlikely

Opportunities within Chinese equities

Market/Sectors	Rationale
China A	
High-end manufacturing, new energy, healthcare, semiconductors	Government's strategic goals of self-sufficiency, technology independence and energy security
MSCI China	
Renewables	China's goal to reach peak carbon emissions in 2030 and carbon neutrality in 2060
Hospitality	Structural increase in Chinese spending on domestic and international travel
Smart infrastructure	Digitalisation and data proliferation

Source: Eastspring Investments, November 2022.

Source: [3]Bloomberg. Weekly returns for the period of January 2013 to October 2022.

to see a turnaround in property fundamentals till late 2023. As the government seeks to reduce systemic risks and bolster market sentiment, the property-related sectors may enjoy a re-rating although the upside would be capped by still-weak fundamentals. Against this backdrop, we continue to favour state-owned developers over private developers.

We see the Local Government Financing Vehicles (LGFVs) continuing to play a key role in supporting the economy as infrastructure will be an important growth driver in the near term. LGFVs are fully owned by the respective local governments and are set up to finance, invest in and operate local public infrastructure and social welfare projects. Although the downturn in the property sector has raised concerns over the financial health of these vehicles, their deep linkages with the local governments and the potential damage to the regional funding environment from any default suggest that there will be government support to help resolve LGFV debt issues. In addition, the local governments' fiscal balances are likely to improve in 2023 as China gradually re-opens.

Investment implications

Themes	Rationale	China A equities	MSCI China equities	China onshore bonds (Sovereigns/LGFVs)
Enhancing portfolio diversification	Low correlations with global asset classes suggest that Chinese equities and bonds can help increase portfolio diversification.	✓		✓
Positioning for China's re-opening/recovery	Bottoming of economy in 1Q23 to lead to more stable earnings and market re-rating. Current underweight positioning in portfolios and cheap valuations suggest attractive upside.	✓	✓	
Benefitting from China's accommodative monetary policy	Still low domestic interest rates, amid a global tightening cycle, will underpin Chinese assets.	✓	✓	✓
Achieving China's strategic goals	Alpha opportunities can be found in sectors that support China's strategic goals of self-sufficiency, technological independence, energy security and its net zero ambition.	✓	✓	

Source: Eastspring Investments, November 2022.

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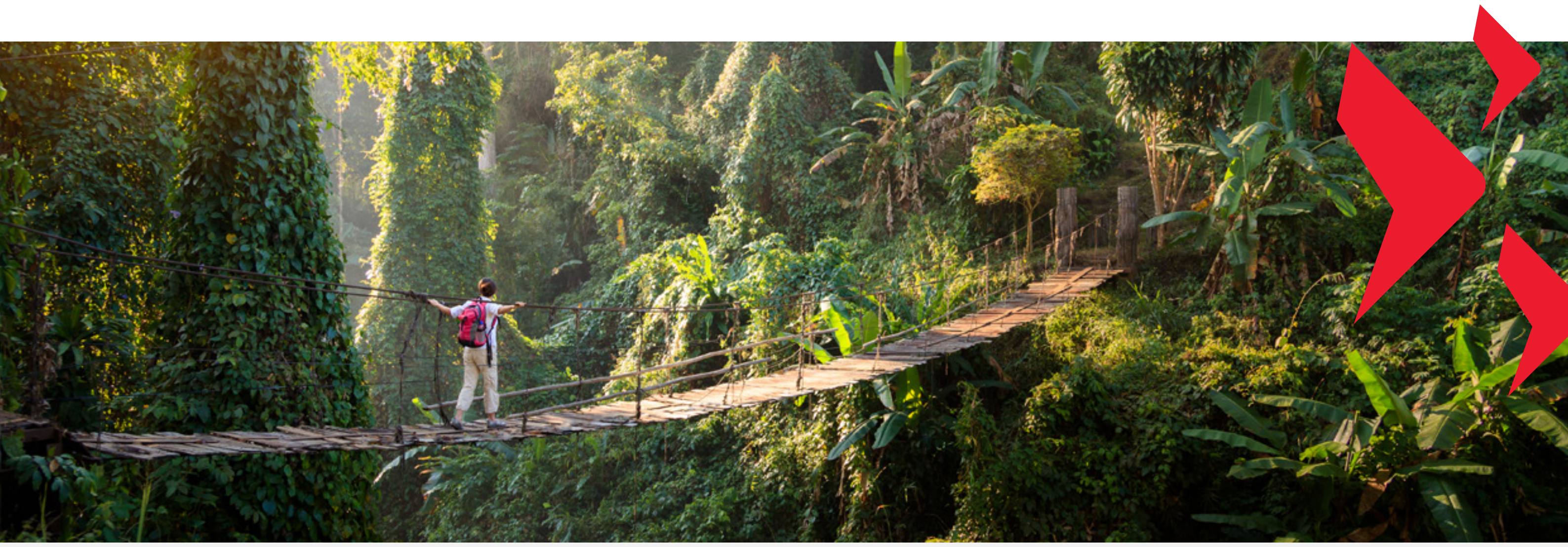
2023 Market Outlook

Embracing a different Asia



2023 Market Outlook

Embracing a different Asia

Asia's long-term investment attributes remain intact despite a reset in the growth trajectory due to the scarring from the pandemic. The investment universe is also becoming more diversified. Various countries are leveraging different competencies in the ongoing supply chain diversification and global decarbonisation cycles, offering opportunities in both developed and emerging Asia.

Growth in Asia Pacific is expected to decelerate to 4.0% in 2022 before rising to 4.3% in 2023 amid an uncertain global environment.[1] Apart from the risks discussed in **"Mapping a new normal"**, the slowdown in China is also a headwind to Asia. Still, there are bright spots and growth drivers in other Asian countries that present attractive opportunities.

OLD AND NEW GROWTH AREAS

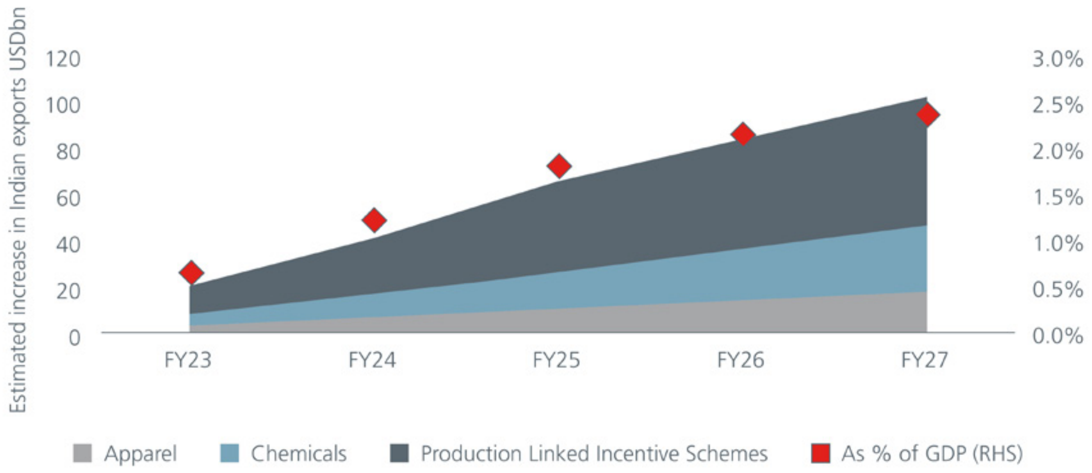
A key theme in recent years has been the diversification of global supply chains out of China, mostly into the rest of Asia. Within ASEAN, countries that have been key beneficiaries of such migration include Vietnam and Indonesia. India is also starting to see the benefits of this move with the electronic manufacturing services and Electric Vehicle (EV) supply chain emerging as high growth areas. Stocks in these sectors are winning market share against competitors outside India. Manufactured exports are thus likely to become an additional growth engine for India. But as of now, Indian exports represent less than 15% of GDP. Thus, the impact of the global slowdown is likely to be lower compared to Asian peers.

> **A key theme in recent years has been the diversification of global supply chains out of China, mostly into the rest of Asia.**

In response to the growing demand for stainless steel and EV battery materials, Indonesia is actively leveraging its rich resource base to develop an EV supply chain ecosystem. There are currently 138 smelters (mostly nickel) and about 6 industrial parks under development. These initiatives have the potential to materially revamp Indonesia's external trade landscape in the coming years.

Source: [1]IMF Regional Economic Report, October 2022.

India's manufactured exports could add 2.4% to GDP in five years



Source: Credit Suisse estimates, January 2022.

Meanwhile, Thailand's economy continues to benefit from the resumption in international travel and tourism. Consequently, tourism and consumer stocks offer attractive investment possibilities. In Malaysia, there will likely be a moderation of growth in 2023, not a recession, as export sectors i.e., oil and gas and electrical and electronic products should continue to do well. Vietnam's economy has recovered strongly post pandemic with GDP growing at 8.8% in the first nine months of 2022. Based on Vietnam's growth drivers, consumer-related and manufacturing sectors present good opportunities.

Across Asia, sustainability is another growth driver. Green infrastructure required to reduce carbon emissions offer many investment opportunities as discussed in **"Charting sustainability pathways"**. With more countries, companies and investors going green, we see opportunities for investors to align their investments with their sustainability views.

IMPACT OF THE TECH DECOUPLING

The global semiconductor chip industry is the latest victim of the US-China rivalry. The recent US semiconductor restrictions will to some extent force major players in the semiconductor supply chain i.e., Taiwan, Korea, and Japan to decouple from China. In Taiwan, however, the impact will be limited as most of Taiwan's semiconductor manufacturers focus on the advanced semiconductor processes and the revenue contribution from China is low.

Short-term geopolitical risks and rising cross-strait tensions with China have caused volatility in Taiwan stocks, but there is no obvious sign of a rise in the risk premium of Taiwan stocks. The competitiveness of the national economy and key industries are the most important factors affecting the evaluation of Taiwan's stock market.

Meanwhile Korean semiconductor companies will face short-term inefficiencies arising from difficulties in upgrading fabs in China. But we see this development as a long-term positive as Korean companies have started to redesign their existing fab location strategy.

WHERE WE SEE OPPORTUNITIES

The risk of a global economic slowdown, higher rates, and higher inflation will present opportunities for stock pickers focused on quality growth at a reasonable valuation. North Asian markets (Korea, Taiwan, China, and Hong Kong) look very cheap given that they have declined some 20% to 30%

in 2022. Moreover, most will experience a positive spill over impact from China's re-opening discussed in **"Tracking China's re-opening"**.

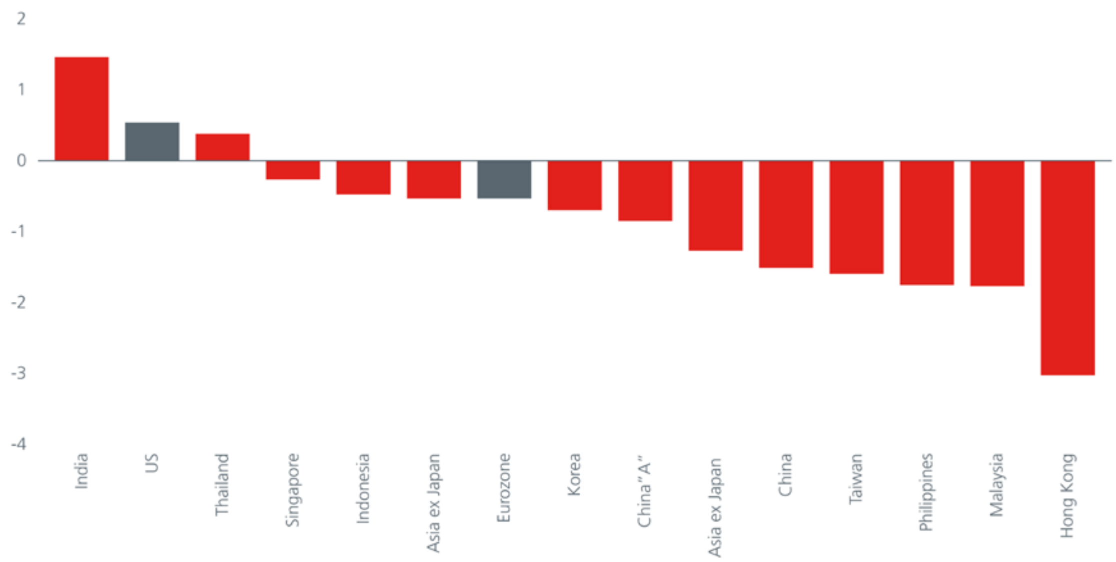
Another area that offers interesting opportunities especially in Taiwan is the Cloud & Hyperscale Data Centre supply chain segment. Companies that make connectors, circuit boards, etc. will benefit from the growing number of such centres. According to Synergy Research Group, there were 728 hyperscale data centres in operation worldwide by the end of 2021. By 2026, this number will reach 1,200. The US will continue to be the largest single market for such facilities.

On the other hand, ASEAN markets (particularly Singapore and Indonesia) and India stayed positive in local currency terms in 2022 and do not look cheap on valuations, both in absolute terms and versus its own history. Active stock selection will be needed to identify the winners. Across ASEAN and even within India, we are seeing selected banks that are looking attractively valued. There is potential here for margins to pick up with strong nominal GDP growth and asset quality improvement coming off a low base in 2021 that can support earnings into 2023. Separately as Asia lagged the rest of the world in opening up post COVID, the full-year benefit of re-opening may only be seen in 2023 for the services sectors across the region.

Japanese corporates warrant a standalone mention as their earnings have remained resilient despite the pandemic. Corporate restructuring over the last decade has resulted in higher operational efficiency and improved trend profitability. The weaker Yen has been a headwind for domestic companies that import raw materials, but a boon for exporters, especially auto names. Domestic and defensive stocks would likely have the most upside sensitivity to any Yen strengthening. Japanese equities are cheap both versus its own history and other Developed Markets and there are many opportunities for double digit returns over the coming years.

Within the Asian bonds segment, we see opportunities in high-quality fixed income as the absolute yields are at their most attractive levels in over a decade. Investors can lock in positive real returns by allocating capital to short-term investment grade securities backed by healthy issuers that are yielding above inflation.

Most Asian markets are cheaper than the US



Source: Refinitiv Datastream and MSCI for all except China"A" as at 31 October 2022. Z scores calculated based on the standard deviation from the 12-year rolling price to book value.

Meanwhile Asian high yield bonds are currently amongst the cheapest of risks assets. However new investors may wish to see if the US Fed is mostly done with its hiking cycle, and for signs of China re-opening. For existing investors shaken by the selloffs caused by the turmoil in the Chinese property sector, we suspect a few things need to happen to bring these investors' confidence back: a) some semblance of a bottoming out or turn in China's physical property market together with supportive policies on the financing front, and b) successful restructuring of some private developers with large offshore bond holdings.

Investment implications

Themes	Rationale	Asian including Japan equities	Asian Bonds
Exploiting higher real rates	There will be higher demand for mispriced and under-invested assets as investors refocus on company profitability.	✓ Value ✓ Growth stocks at reasonable valuations	
Benefitting from supply chain diversification	Greater efforts are being made to transition the economies toward higher-value upstream chains.	✓ ASEAN ✓ India	
Getting to net zero	More companies and investors are committing to ESG considerations.	✓ All Asia	✓ Asia sustainable bonds
Moving towards peak Fed hawkishness	The outlook for high-quality fixed income is favourable as yields are most attractive in over a decade.		✓ Asian investment grade
Positioning for China's re-opening and property sector bottoming	Spill over benefits to trade and tourism. Confidence is restored in the property sector which is 50% of the Asian high yield segment.	✓ All Asia	✓ Asian high yield

Source: Eastspring Investments, November 2022.

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2023 Market Outlook

Charting sustainability pathways

2023 Market Outlook

Charting sustainability pathways

Asia has a big role to play in the global transition to net zero as it accounts for almost half of the world's greenhouse emissions. The rise in green capital expenditure to meet climate challenges will mean significant bond issuances. Asia's innovative companies within the Electric Vehicle and renewables energy ecosystems also offer investors interesting opportunities in the race to net zero.

Asia scored a few wins during COP27 although the failure to agree on greater emission cuts or to put an end to fossil fuel use disappointed many delegates. At the climate summit, it was agreed that a fund will be set up to cover the climate-related losses and damages that "particularly vulnerable" nations experience. This could be good news for some parts of ASEAN, such as Philippines and Thailand, where severe weather events in 2022 had resulted in a significant loss of agricultural output and disruption of livelihoods. In addition, a coalition led by the US and Japan announced that it will provide USD20bn to help Indonesia shut its coal power plants and bring forward its peak emissions date by seven years to 2030.

THE RISE IN GREEN INFRASTRUCTURE

It is estimated that USD4 to 6tr per annum would be needed globally this decade and beyond to transit to a low-carbon economy. Asia has a big role to play given that it accounts for five out the world's ten largest greenhouse gas emitters.

Asia alone would probably need USD1tr per annum to help high carbon emitting sectors such as the power generation, transportation, property, agriculture, and manufacturing industries in their net zero transition. This has multiple implications for investors.

Asia's sustainable bond market will play a pivotal role in funding sovereigns and corporates in their transitions. We expect to see more Green, Social and Sustainability bonds being issued by property companies to build and refurbish energy-efficient buildings. Power generating companies are also likely to raise funds to invest in renewable energy. Meanwhile governments and quasi-governments will seek debt financing to build low/zero carbon transportation infrastructure. Multilateral development banks as well as supranational developmental institutions can support issuances in domestic debt markets by providing guarantees and sponsorships. Meanwhile, the rise in transition capital expenditure (green capex) is extremely commodity intensive, which should benefit the Emerging Markets.

GETTING TO NET ZERO

Asia is leading innovation in the Electric Vehicle (EV) battery and renewable energy ecosystems. China is a world leader in solar manufacturing and dominates the world's EV supply chain. Indonesia is planning to build the world's largest green industrial park in North Kalimantan (solely powered by hydropower and solar), which will house high-tech green industries that will produce solar panels, green aluminium, and lithium-ion batteries. There are also companies within Malaysia's vibrant Automated Test Equipment and Outsourced Assembly and Test industry that are designing innovative systems and equipment to detect abnormalities in production lines. Besides saving manpower and energy, detecting defects early significantly reduces e-waste that ends up in landfills. All these present exciting opportunities for investors.

Climate challenges are also impacting companies that are not operating in zero/low carbon sectors. The energy price hikes in 2022 have led some corporates to review their future energy demands and develop plans to manage these risks. While Asia may have lagged the Developed Markets in terms of Environment, Social and Governance (ESG) policies, investment and reporting, more Asian corporates are making efforts to improve their sustainability roadmaps and policies. The number of ESG policies in Asia has doubled since 2016[1].

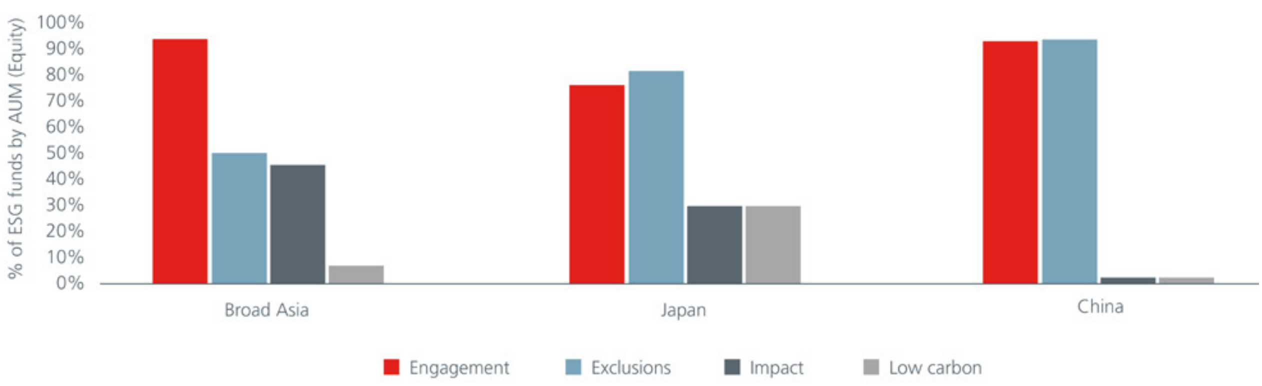
> **The number of ESG policies in Asia has doubled since 2016.**

Within Asia, investors are also embracing a more balanced approach when considering ESG factors, with a move away from exclusions to greater engagement. In particular, we see room for greater engagement especially on environmental and governance issues to drive long-term value amongst Japanese corporates. According to MSCI ESG Research, only 10% of Japanese companies are rated as ESG Leaders (ESG ratings of AAA, AA), far behind European companies.

ASIA'S BIG ROLE IN CARBON TRADING

The demand for carbon credits has increased as more companies make carbon neutral or net zero commitments. According to a McKinsey study, global carbon offset demand is set to grow 15x by 2030 and 100x by 2050. Global initiatives to drive more transparency, standardisation, and detailed verification of carbon credit projects will help develop more robust carbon markets. At COP27, the Global Carbon

Engagement favoured over exclusion policies



Source: Morningstar Direct, Barclays Research. September 2022.

Source: [1]PRI, data compiled by Goldman Sachs Global Investment Research. Cumulative capital market ESG regulations and amendments, January 2000 to August 2021.

Trust agreed to create standardised contracts for carbon credits, embed third-party monitoring and verification of project performance, as well as provide arbitration mechanisms for projects that fail to meet targets.

Asia can play a significant role as a carbon trading hub. There have been efforts to grow Asia's carbon offset ecosystem with the establishment of the Climate Impact X, a Singapore-based global carbon exchange and marketplace, in 2021. Hong Kong also launched a carbon trading platform in October 2022, while Malaysia has expressed similar ambitions. The regulatory environment is also becoming more favourable for growing the carbon offset market with Singapore allowing 5% of carbon tax to be met by carbon offsets.

Meanwhile, Asia's high quality natural ecosystems mean that more than 50% of nature-based carbon offset supply (using plants, trees, soil or the ocean to remove carbon from the atmosphere) resides in Asia, potentially making Asia a key supplier of nature-based carbon offsets. The average price of carbon offsets rose by more than 50% from 2020 to 2021 with high quality nature-based credits commanding more than a 200% premium at USD8/tCO2e . Therefore, Asian companies that are able to supply high quality offsets can benefit from offset price increases although specialised resources and knowledge will be needed to develop nature-based solutions (includes conservation, afforestation, reforestation, forest management, grasslands). Only high-quality carbon offsets can help with offsetting residual emissions that cannot be reduced and enable companies to better meet their net zero commitments. This may help to improve ESG ratings in the long term, although it is still early days.

Investment implications

Themes	Rationale	Asia sustainable bonds	Asian including Japan equities	Emerging Market equities
Getting to net zero	Asia offers innovative companies within the EV and renewable energy ecosystems. More companies are improving their sustainability roadmaps.		✓	
Riding the rise in green infrastructure	Significant capital spend on green infrastructure needed to address climate challenges. This will mean more bond issuance and greater demand for commodities.	✓		✓
Moving towards greater engagement	With still low percentage of companies rated as ESG leaders within Asia and the Emerging Markets, greater engagement can drive change and enhance value.	✓	✓	✓

Source: Eastspring Investments. November 2022.

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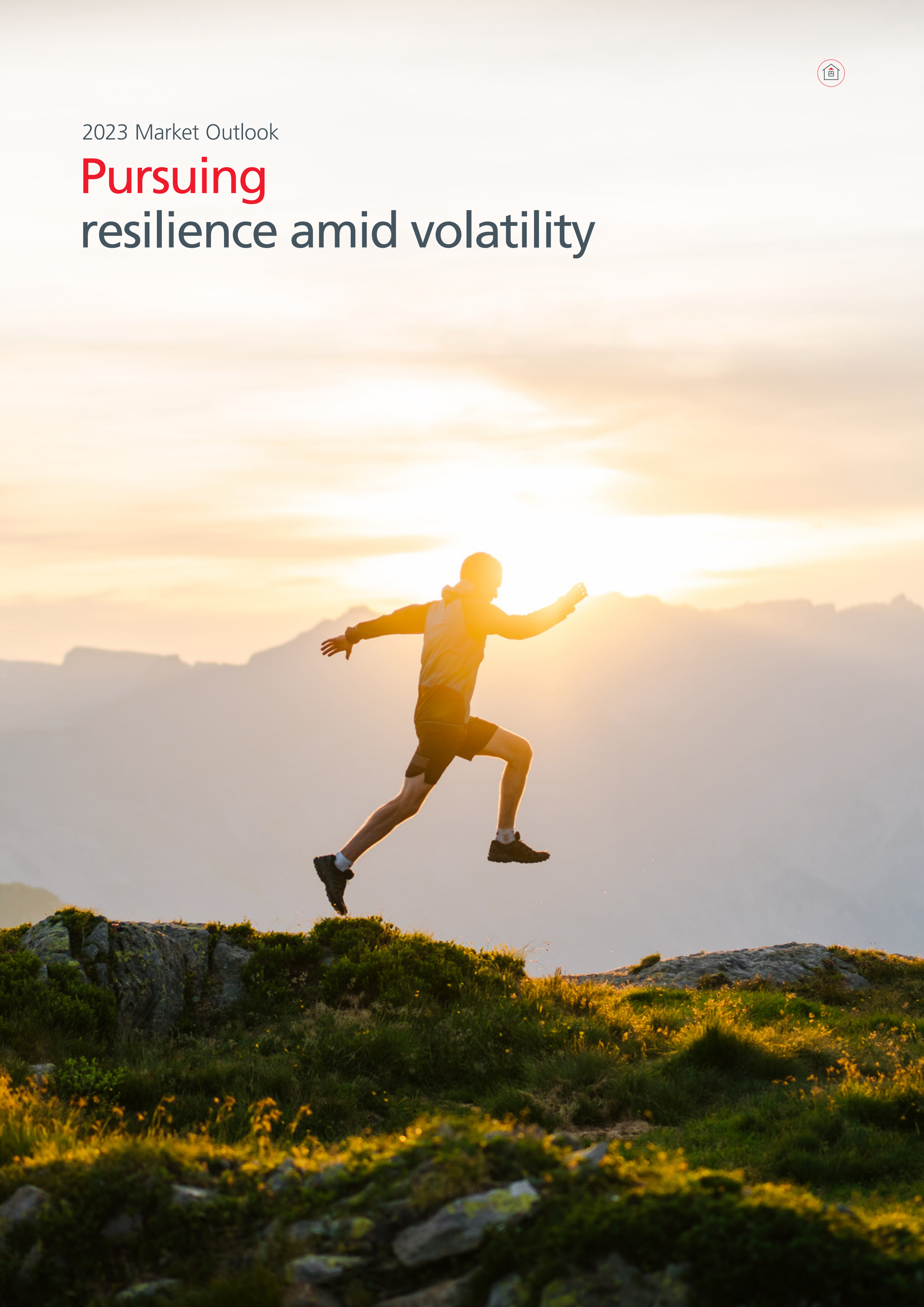
Source: [2]Carboncredits.com live carbon price: https://carboncredits.com/carbon-prices-today/

2023 Market Outlook

Pursuing resilience amid volatility



2023 Market Outlook

Pursuing resilience amid volatility

Portfolio resilience is going to be very important over the next 12-18 months as we transit from an inflation dominant regime to a more uncertain environment. Can the US Fed engineer a soft landing or is a recession upon us? Regardless, we expect volatility to remain very elevated. The best way to cope with this type of uncertainty is to build a lot more diversification into portfolios.

Predicting precisely which events or themes will drive volatility in 2023 might be challenging. Although markets seem to have priced in balanced views on whether inflation will revert to more tolerable levels quickly or remain at high levels, we expect future market reactions to be strongly news flow driven. The path ahead is thus likely to be choppy but there are options to reduce the overall levels of volatility in investors' portfolios.

BUILDING DURABILITY WITH MULTI ASSETS

Our multi asset team uses a few strategies to optimise risk-adjusted returns in their portfolios over the short-term and long-term horizons and across all market cycles: namely diversification, tactical overlays and risk prudent derivative strategies.

"The path ahead is likely to be choppy but there are options to reduce the overall levels of volatility in investors' portfolios."

Asset class diversification from a traditional perspective consists of combining assets with different correlation profiles. However, as we have seen this year, strong inflation dynamics (and strong initial valuations) have made the equity-bond correlations less negative and less reliable than before. In the current new environment in which inflation (and interest rates) are likely to stay higher for longer, we believe that less traditional diversification methods, such as investment style factor diversification in equities, become increasingly important and valuable.

That said, the team continues to have faith that the historical relationship between equities and bonds will reassert themselves in time. After all, it is when both equities and bonds are reasonably valued that they provide the most diversification benefits.

Tactical overlays are another option. These are typically designed to either limit a certain risk or to take advantage of market sentiment. In the current market environment, investors need to have exposures to defensive assets that can help pre-empt violent reactions in the markets.

Lastly the team believes that risk managed derivative strategies can be beneficial to portfolios. In multi asset portfolios where guidelines permit the use of derivatives, the team has taken advantage of volatility curves to add portfolio hedges. For example, amid this year's downtrend in US equities, the team put on a long calendar put spread strategy in certain portfolios to hedge against a downside scenario in US equities.

GOING DEFENSIVE WITH QUANT STRATEGIES

Smart beta and multi-factor equity strategies have performed well this year relative to broad parent equity indices. Low volatility strategies tend to fare well relative to the broader market during periods of uncertainty and market volatility. By owning stocks and ultimately building a portfolio that is less influenced by the swings in market sentiment, low volatility strategies are by nature more defensive. They also tend to give up less performance as the market falls, and as a result do not need to participate as much in the upside to stay ahead.

A well-diversified approach to low volatility is key though as it will be important to ensure wide representation from all sectors of the market to avoid missing some of the key themes that may take hold in 2023.

A multi-factor strategy is designed to have a similar level of volatility to the broader market and hence less defensive than low volatility. However, by design, this strategy is well diversified across various factors (or styles) and better risk controlled relative to the market benchmark. As a result, it tends to fare well (relative to the broader market) in most environments, regardless of which style is dominant at the time. This should be a useful characteristic to investors in an uncertain environment like we expect in 2023.

BUFFERING VIA AN INCOME APPROACH

As per our narrative in **"Mapping another new normal"**, we expect inflation and interest rates to remain higher for longer. In such conditions, investors will be on the lookout for inflation hedges and higher yields.

Listed real estate is normally seen as good inflation hedge. In general, the overall return and dividend growth have been consistently ahead of inflation over the long term. In some markets such as Australia, UK, and Europe, rentals are linked to an inflationary measure which will provide some earnings buffer for the asset owner.

Asian high dividend yield index returns mostly exceed US inflation

Source: Bloomberg, Eastspring Investments, 30 September 2022. Numbers have been rebased to 100 with starting date 31 January 2001.

Likewise, selecting stocks that have stable dividend payouts will ensure a steady stream of regular income which can result in positive real yields. In Asia Pacific ex Japan, the high dividend total return index usually delivers superior returns to US inflation across most periods.

Asian high dividend yielding equities also have a low correlation to Asian bonds at 0.30 and 0.47 against Asian investment grade and non-investment grade bonds respectively.[1] This is a plus for investors seeking to build a diversified portfolio of income producing assets.

Short-term government securities are another income option for investors. This is especially so if the country enjoys a solid AAA rating; Singapore government securities have hit multi-decade highs this year with yields above 4% compared to the 1% at the start of the year. Investors no longer have to actively seek risk to obtain meaningful returns on their savings. We are likely to see money continuously flock towards short-term government securities with interest rates remaining high.

Furthermore, investors can lock in positive real returns by allocating capital to short-term investment grade securities backed by healthy issuers that are yielding above inflation. The outlook for high-quality fixed income has turned more favourable and their absolute yields are at their most attractive levels in over a decade.

Investment implications

Theme	Rationale	Asset class/Strategy
Building portfolio resilience	These strategies fall less as the market falls, and therefore takes less time to recover.	Low volatility strategies
	There are diversification benefits from combining uncorrelated assets.	Multi asset strategies
	These strategies tend to fare well (relative to the broader market) in most environments, regardless of which style is dominant at the time.	Multi-factor strategies
	Benefit from higher-rated, lower risk bond investments with attractive yields.	Singapore dollar bonds
	The outlook is favourable for high-quality fixed income as yields are most attractive in over a decade.	Asian investment grade bonds
	Regular payouts are a good buffer when capital gains become uncertain.	High dividend Asian equities

Source: Eastspring Investments. November 2022.

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Source: [1]Bloomberg. Weekly data from November 2012 to November 2022. Indexes used: MSCI Asia Pacific ex Japan High Dividend Yielding Net Return Index, JACI Investment Grade Total Return Index, JACI Non-Investment Grade Total Return Index. In USD terms.

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