Strategy

JefMacro Weekly—Hard Landing Is Base Case; Best Opportunities in Asia & EM

January 8, 2023

Key Takeaway

Aneta highlights that by March, Fed will have lifted rates by nearly 5 points, which creates a drag on growth. Peak pain has not yet been felt, expect margins to get squeezed in 1H by slowing revenues, higher wages, & higher rates. GREED & fear sees China's Covid U-turn as the best chance for Asia & EM equities to outperform given the prospect in '23 for earnings downgrades in US and the reverse in China. Global Strategy opens long position of RUT vs. S&P 500.

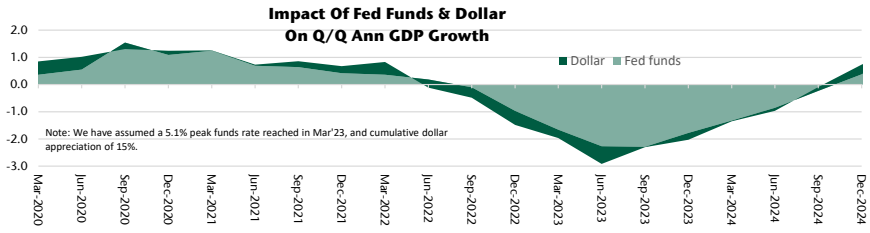
GREED & fear—China's Covid U-turn creates the best chance in many years for Asia & EM equities to outperform given the prospect in '23 for earnings downgrades in US and the reverse in China. The positive implications for commodities of a China reopening, and likely weakening of US dollar in the event of a U-turn by the Fed. If Asia looks better in aggregate on valuations, there is one market where valuations are undoubtedly challenging. That is GREED & fear's long-term favorite, India. However, India remains the best domestic demand story in Asia and emerging market universe.

Aneta Markowska—By March, the Fed will have lifted rates by nearly 5 percentage points which will create an enormous drag on growth. When it comes to consumption and capex, we believe that policy transmission is skewed to the short-end of the curve, given the cash-rich balance sheets and less dependence on credit growth. That means that peak pain has not yet been felt. We expect margins to get squeezed in 1H by slowing revenues, higher wages, and higher interest rates.

Sherif Hamid—This week's headlines will likely help feed both a disinflation story and the "soft landing" narrative. That combined with valuations that on an all-in yield basis still look attractive and conservative positioning continues to create a supportive backdrop. While we think IG looks more attractive than HY and fixed rate bonds look more attractive than leveraged loans, post this rally and amid what looks like a heavy IG primary issuance calendar we would flatten both of those positions tactically.

Global Strategy—Inflation is a much more important driver for equity markets than the fall in earnings because of the changes to the equity-bond relationship in the past four years. The last major period when inflation declined precipitously, the Volcker shock, saw the Russell sharply outperform the S&P 500. We open a long position of the Russell 2000 versus the S&P 500. Our S&P 500 earnings lead indicator is still heading lower.

Impact from rate hikes and dollar begin to impact GDP this year, with biggest hit coming in Q2



Source: Haver, JEF Economics. Based on FRB/US model with VAR-based expectations

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The JefMacro Weekly is the accumulation of this week's best Macro research.

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^Prior trading day closing price unless otherwise noted.

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