PUBLIC

Economic Update

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Equity Markets

Equities mixed in 4Q22; outlook for 2023 affected by uncertain growth, policy prospects

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Highlights

- **Global equity markets, except the GCC, were mostly positive in 4Q22, helped by easing inflation and rate-hike concerns.**
- **The MSCI AC World Index rose 7% q/q, lifted by US and Europe, with the DJIA and Euro Stoxx 50 up 14% and 15%, respectively.**
- **The rally could not reverse deep losses for the year overall, though, with the S&P 500 closing down a steep 19% y/y by 31 Dec.**
- **In contrast, the MSCI GCC lost 6.7% q/q, weighed down by lower oil prices, higher interest rates and global growth concerns.**
- **Equity performance will continue to hinge on growth, inflation and Fed policy prospects.**

Equities remained volatile in 4Q22 amid high uncertainty

Despite some gains, global equity markets were highly volatile in 4Q22, struggling for direction amid conflicting economic data and continued Fed policy uncertainty. Investors mulled a multitude of opposing factors, including hawkish Fed guidance and elevated treasury yields, recession risks, and weaker earnings expectations on the one hand, and easing inflation metrics, the appeal of multi-year low valuations, and a post zero-covid China reopening on the other. Although end of quarter outcomes were mixed, with some developed markets posting notable gains, the overriding trend remained negative, as small rallies failed to reverse deep losses for the year overall.

In the year ahead, the possibility of a recovery will largely depend on Fed policy, global inflation and recession prospects. Equity markets could begin to recover were inflation see a faster than expected moderation, which would allow the Fed to dial back its hawkish stance. While the timeline is uncertain, the above scenario could emerge towards the second half of the year, given that the Fed has signaled on several occasions that rates will be kept high until inflation moves on a sustained path back towards the Fed's 2% target.

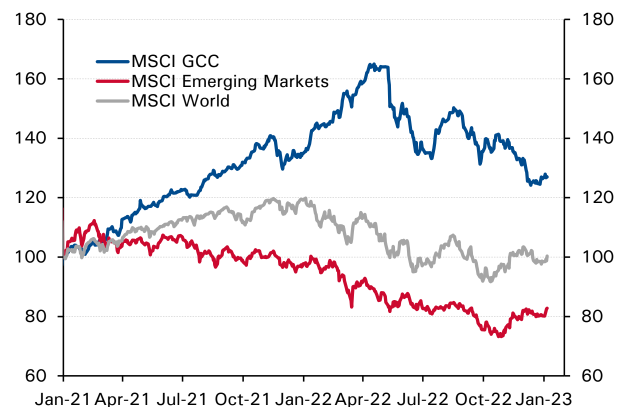
EM losses contrast sharply with developed market gains

Global equity markets were mostly positive in 4Q22, helped by easing inflation and rate-hike concerns, curbing annual losses unseen since 2008. Bearish sentiment in EMs and capital outflows eased in the final quarter of the year, with the MSCI EM closing up 6.1%, helped by gains in its two largest constituents India and China (with a combined weight of 45%), on relatively attractive valuations and improving outlooks especially with the latter's lifting of its zero-covid policy restrictions in December.

In developed markets, gains were led by US and European markets on early signs that inflation may be cooling, implying a sooner than expected Fed pause along with a tight job market that eased recession concerns, though the Fed continued to maintain its hawkish guidance. The S&P 500 and DJIA rose 7.1% and 15.4% q/q, respectively, curbing losses in the year to 19% and 9% y/y as of December 31, while the Euro Stoxx 50 gained a solid 14%, trimming annual losses to 12%.

Chart 1: Global equity markets

(rebased, 31 December 2020=100)

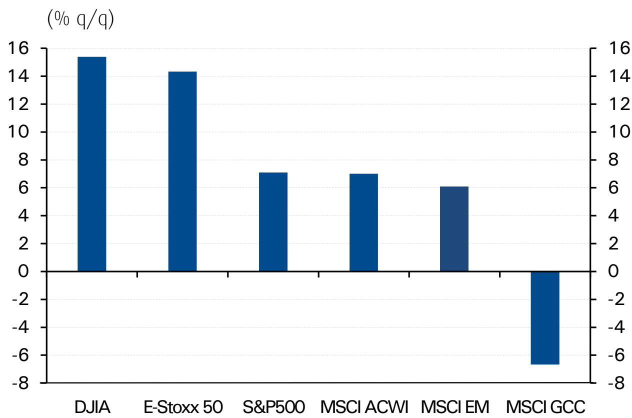


Source: Refinitiv DataStream, as of 6 January 2023

Looking ahead, investors will continue to turn to inflation and labor market data as the two main cues for the equity market. Continued monetary tightening remains a major downside risk, though. That being said, the Fed slowed the pace of rate hikes in its December meeting to 50 bps from 75 bps in its previous four meetings. With ongoing signs of easing inflationary pressures and easing labor market tightness, a further moderation in the pace of tightening could be seen, which would be positive for markets especially given the still attractive valuations. On the other hand, should labor market tightness and inflationary pressure persist, the Fed could remain hawkish, with adverse implications for economic growth and equity markets.

Chart 2: Global equity market performance in 4Q22

(% q/q)



Source: Refinitiv DataStream

GCC equity markets underperform amid lower oil prices

After outperforming global peers for most of the year as sentiment soared from elevated oil prices and the positive outlook, GCC markets led losses in 4Q22. The MSCI GCC lost 6.7% q/q, weighed down by oil market volatility, hawkish central banks and global growth concerns, erasing all earlier gains and pushing annual performance into negative territory (-6.3% y/y as of 31 Dec.). Quarterly losses were led by Qatar (-15%) and Saudi Arabia (-8.2%), with the latter likely down on profit-taking after greatly outperforming peers in recent years on confidence-boosting business reforms and strong capital investment. In contrast, Kuwait and Abu Dhabi outperformed, up 5.3% and 4.7%, respectively. The mixed results could be due to the varying past performances and relative valuations of the respective markets.

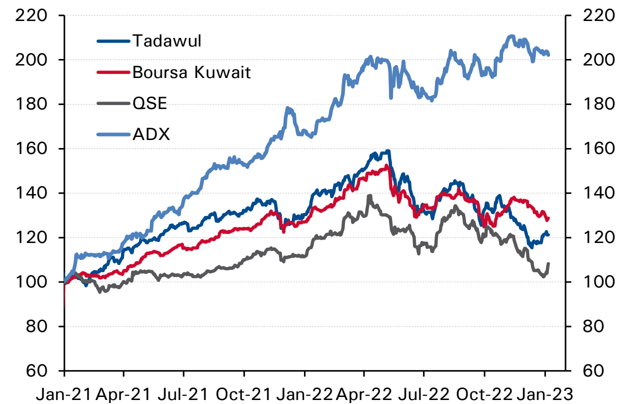
Looking ahead, GCC equities will continue to be influenced by international market developments, including oil, economic growth, inflation and Fed policy. Recent data appears more positive than previously anticipated, but on the whole conditions remain in flux and uncertain. Oil market volatility and rising borrowing costs are additional regional headwinds.

Market risk remains elevated

The outlook for global equities seems to have improved versus early-2022 when the Ukraine war, rising inflation, lofty stock valuations and monetary tightening, presented severe market headwinds. Indeed, inflation is widely believed to have passed its peak, the fog from US midterm elections has faded, the most aggressive rate hikes are seemingly behind us and valuations are at a relatively attractive point. However, continued central bank tightening, the likelihood of a recession in the US and Europe, an uncertain earnings trajectory, and still-high inflation pose notable downside risks. Further risks stem from a still raging Ukraine war (a source of supply chain disruptions and inflationary pressure), still elevated bond yields, as well as dollar strength which has pressured other markets and currencies. While GCC markets will continue to be influenced by global sentiment, the reopening of China and its implications for commodity demand, including oil, will potentially be very positive. EM equities in particular could perform well in 2023 as its largest market, China, stands to benefit from near multi-year low price levels, a potentially weaker USD, and most importantly, the Chinese reopening catalyst.

Chart 3: GCC equity markets

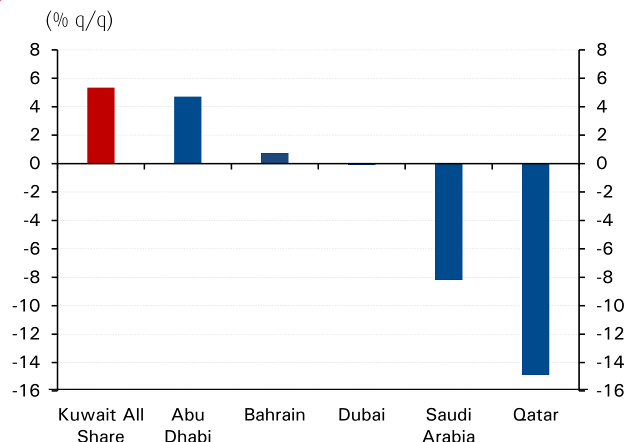
(rebased 31 December 2020 = 100)



Source: Refinitiv DataStream, as of 6 January 2023

Chart 4: GCC equity market performance in 4Q22

(% q/q)



Source: Refinitiv DataStream

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