Plot Twists and Portfolios: 2023 surprises that reshaped investor thinking

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As the tumultuous year of 2023 draws to a close, investors have now naturally turned their focus to the coming year and are trying their hands at predicting what might happen over the next 12 months. However, we decided to instead look back at the year that was, to some of the outcomes that were widely predicted, and what has actually transpired. This year, most experts - and consensus forecasts -- were far off the mark for much of the time, which is why at M&G Investments we don't rely on macroeconomic predictions when building our portfolios we rely on actual asset valuations instead. 2023 was a year in which four big macroeconomic forecasts shaping investor thinking all proved to be misguided in the end.

- **A recession was imminent**

  At the end of last year, the prevailing view by far was that a recession in 2023 was practically a given, on the back of high inflation, sharply rising interest rates and slower economic growth. Starting in the US, it would spread to much of the developed world, and spark a string of financial crises in emerging markets and developing economies, with a lasting detrimental effect. A long list of indicators appeared to support this prediction, including a falling stock market, historic lows in consumer sentiment and the inversion in the US Treasuries yield curve. Instead, in the US, the economy defied the pundits, consistently beating even the most optimistic expectations: first quarter real GDP growth was positive at 2% y/y, as was second quarter growth at 2.1% y/y, and in the third quarter, the US economy expanded by an annualised 5.2%.

- **The stock market would suffer**

  At the end of 2022 the outlook for the stock market was bleak, to say the least. Against the backdrop of surging interest rates, high inflation, the Russian invasion of Ukraine and its negative effects, and the recession fears mentioned above, analysts were predicting a negative year for equities. What occurred instead was one of the best starts to a year, with the S&P 500 Index up by nearly 16% in the first six months, albeit with volatility along the way. By the end of November, the S&P 500 had posted a total return of 21% for the year to date, largely the result of technology stocks, in particular the so-called "Magnificent 7" mega-caps that are expected to take advantage of the burgeoning expansion of AI into industry and business. This is particularly impressive given that a US regional banking crisis rattled markets and investor confidence in the second quarter.

- **China would lead the post-Covid recovery**

  As the world's second largest economy, many had hoped that China would be at the forefront of the global post-pandemic recovery. What happens in China has significant implications globally for inflation, growth and trade. But while China's economy has achieved positive growth this year, it has been at a slower pace than initially hoped for. While its actual GDP growth rates of 4.5% y/y in Q1 2023 and 6.3% y/y in Q2 2023 were favourable in absolute terms, they disappointed most pundits who were hoping for 7.3% y/y expansion in Q2, for example. Government policies to boost consumption and support the ailing property market have not had the desired impact, and deflation risks have been growing. Recently, the International Monetary Fund raised its China growth forecast to 5.4% for 2023, but it expects growth to slow to 4.6% in 2024 due to continuing weakness in the Chinese property market, as well as subdued demand from global markets.

- Instead, it was the US – primarily the American consumer – that has been leading the world out of the Covid doldrums.

- **Inflation would continue to rise**

  Investors started the year expecting inflation to continue spiraling upwards, or at least to remain at high levels for all of 2023. After all, many countries experienced their highest inflation rates in decades in 2022 as a result of the widespread economic dislocation and supply chain problems that Covid triggered. Having peaked at 9.1% y/y in June 2022, US inflation declined to 6.4% y/y in January, and the downward trend continued. By the end of October, US inflation was just 3.2% y/y. A similar pattern was seen elsewhere, although inflation did prove more stubborn in certain regions like Europe and the UK before falling in the latter part of the year. Eurozone inflation stood at 2.9% y/y in October, and at 4.6% y/y in the UK.

Uncertainty is undesirable, but inevitable

Of course, as 2023 comes to an end, investors are once again trying to predict what might lie ahead in 2024. Humans do not like uncertainty, and do their best to pin down all the possible future variables. Human nature also inclines us to anchor to the recent past and extrapolate it far into the future. Unfortunately, this is impossible since we never know all of the variables at play. Extrapolation from the past is also futile, given that our previous sense of financial balance was built on 40 years of successful inflation fighting, very low (and negative) real interest rates, rising globalisation, and increasing profit shares of GDP. Since Covid, these trends have started to reverse. As such, in the current environment the right answer to what the new year might bring must be "we don't know". Seemingly far-fetched views of the future have just as strong a chance of being right as some notion of a tweaked version of today.

That is why at M&G Investments we build our portfolios to deliver to investor expectations, no matter what future market conditions may be. The odds of any one macro scenario materializing are low, and it would be irresponsible to bet our clients' hard-earned savings on a prediction. We invest strictly according to asset valuations, applying our time-tested methodology consistently over time to create carefully diversified, well-valued portfolios with potential to outperform the market. Proof of our success can be seen in the strong, long-term track records of many of our unit trust funds, including the M&G Equity, M&G Dividend Maximiser and M&G Balanced Funds.

To invest in our funds today for a more predictable future, speak to a financial adviser or contact our Client Services Team on 0860 105 775 or email us at info@mandg.co.za for more information.