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This fraught environment is a tricky one for investors to maneuver. (UBS)

Investing in a multi-speed world

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The global economy seems poised to operate at multiple speeds in the months ahead.

Last August we noted that in most of the past episodes of elevated inflation in developed and emerging markets, central bank policymakers have historically had to raise interest rates above the rate of consumer price inflation to sustainably bring inflation back to target. The Federal Reserve's most favored price gauge—personal consumption expenditures or PCE inflation—came in at 5.4% in January. With policy rates at 4.75% today, it looks like the Fed still has work to do. Considering that it has already delivered the fastest pace of monetary tightening in 45 years—plus the additional tightening likely ahead of us—we are staying with our baseline scenario of a meaningful slowdown in the US economy in the coming months.

At the same time, the pace of China's turnaround from zero-COVID toward a full reopening has been astounding. This will continue to support domestic growth, and in turn the economies that are closely linked to that of the Asian giant—from manufactured-goods exporters in North Asia, to commodity exporters in Latin America, to tourist destinations across Southeast Asia. In addition, Europe has shown an ability to weather the energy crisis better than anticipated.

Adding complexity to the analysis is the fact that geopolitical tensions remain high. The war in Ukraine has entered its second year, and the current situation on the battlefronts and in the diplomatic arena does not point to an end to hostilities any time soon. US-China tensions also remain high, and we expect a regime of increasing restrictions on technology transfer and capital flows between the two nations.

This fraught environment is a tricky one for investors to maneuver. Blanket "risk-on" or "risk-off" calls are unlikely to work. We think investors will need to take a more nuanced and regionally selective approach to risk decisions, while making the best of what an environment of higher interest rates has to offer. At CIO, we are diversifying beyond the US and growth stocks in our portfolios, and actively seeking income opportunities. Emerging market assets can help investors achieve these goals.

In emerging market equities, we think the effect of the Fed's tightening and China's reopening will be net positive. Earnings momentum and estimate revisions have bottomed both in absolute terms and in relation to developed markets,

and we believe valuations remain relatively attractive. We therefore rate the asset class as most preferred in our global portfolios. We have a tactical preference for China and other North Asian markets over India; expect high-quality earnings growth leaders such as internet and ecommerce companies to outperform; and continue to like environmental, social, and governance (ESG) leaders for their ability to mitigate downside risks and their appealing pricing.

In fixed income, we expect spreads on emerging market bonds to remain overall supported in the coming months; see value in sovereign bonds, where the high yield segment offers room for spread compression; and believe that Latin American corporate bonds present attractive income opportunities spanning countries and industries.

In another challenging year for financial markets, we believe adding emerging markets to the opportunity set will better help investors achieve returns and manage portfolio risk.

For more information:

- Take a look at this five-minute Deep Dive video on the outlook for emerging markets.
- In Spanish: Listen to our latest podcast on Apple or Spotify.
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