
In 2022, US stocks underperformed the global stock market by 2 percentage points. (UBS)

# 2022: What worked, what didn't, and what's next?

25 January 2023, 8:14 pm CET, written by UBS Editorial Team

**2022 was one of the most challenging years for diversified portfolios in recent memory: bonds had their worst year ever, it was the seventh-worst year on record for US large-cap stocks, and it was the third-worst year for 60/40 portfolios since 1926.**

However, this does not mean that diversification stopped working: an underweight to duration helped to bolster returns within the fixed income portfolio, and overweight to value versus growth helped to add value within the stock allocation, and alternative investments and commodities also helped to provide diversification benefits at the portfolio level.

With this backdrop in mind, here are a few lessons from 2022, and how they relate to the 2023 outlook, according to our colleagues in the UBS Chief Investment Office (CIO):

- **Bonds are not risk-free**

Bonds experienced their biggest drawdown in history in 2022, as inflation surpassed expectations and the Federal Reserve rose rates at the fastest pace in modern history. We do not expect a repeat in 2023. After the reset in bond yields, we expect better returns and more "safe haven" behavior going forward—especially if CPI inflation falls to 3.2%, as we expect. In the past, bonds have always staged a rally after a simultaneous stock/bond loss, delivering an average return of 11%—and 60/40 stock/bond portfolios have posted a gain 81% of the time, with an average return of 12%.

In the near team, CIO maintains a least preferred view on intermediate-duration Treasuries, and a most preferred view on agency MBS and investment grade corporate bonds.

- **Commodities can provide value**

2022 was only the third calendar year in history in which stocks and bonds have fallen at the same time (the other two years were 1931 and 1969). In this environment, commodities were a potent portfolio tool, rallying 16% in 2022. For investors positioned with a tactical overweight to commodities, even a small allocation helped to offset stock and bond losses.

As we head into 2023, CIO continues to hold a most preferred view on commodities and crude oil due to supply-demand dynamics.

- **Beware "home bias"**

In 2022, US stocks underperformed the global stock market by 2 percentage points, -20% to -18%—the first calendar year of international stock outperformance since 2017—even though the US dollar rallied 8% versus global currencies, acting as a direct headwind to US investors' returns. The US stock market has become increasingly concentrated in a handful of stocks and sectors, and faces US-specific challenges such as the US debt ceiling, and domestic tax and regulatory policy risks. Moreover, many of the factors that helped to fuel US stocks' outperformance since 2008—such as anemic global growth, subdued inflation, and low and falling interest rates—appear to be behind us. With this in mind, CIO believes that this is a good time to take this opportunity to rebalance your stock portfolio to right-size your allocation to international stocks. Diversification does more than simply add to return potential; it also helps to reduce the risk that one market will underperform over a given time period.

Over the long term, CIO recommends that investors keep a globally diversified allocation to stocks, with about 60% allocated to US stocks, 28% allocated to international developed market stocks, and 12% allocated to emerging market stocks.

The US stock market has become increasingly concentrated in a handful of mega-cap stocks and a couple of sectors, creating a significant "growth" bias when compared to international peers. These characteristics make the US stock market more vulnerable in inflationary environments, because growth stocks are more interest rate-sensitive than value-oriented strategies. This is one reason why CIO has a least preferred view on US stocks, and a most preferred view on value-oriented UK and Australia stocks, as we start 2023.

**Content is a product of the Chief Investment Office (CIO).**

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