

2023 INVESTING PLAYBOOK

THE SET-UP

“The Federal Reserve, as one writer put it, after the recent increase in the discount rate, is in the position of the chaperone who has ordered the punch bowl removed just when the party was really warming up.”

[FEDERAL RESERVE BOARD CHAIRMAN WILLIAM MCCHESENEY MARTIN, ADDRESSING THE INVESTMENT BANKERS ASSOCIATION OF AMERICA, OCT. 19, 1955](#)

“Summertime done, come and gone, my, oh my. I’m Uncle Sam, that’s who I am; Been hidin’ out, in a rock and roll band.”

[GRATEFUL DEAD \(ROBERT HUNTER\), U.S. BLUES](#)

There are times in every investment cycle when playing it safe — or hiding out — just feels like the prudent thing to do.

That’s what history’s longest serving Fed chair might have meant 67 years ago in a legendary speech at New York’s Waldorf-Astoria hotel that referenced the central bank removing the fabled punch bowl. When “risk off” looks more attractive than “risk on.” When it might be time to invoke the English proverb: He who fights and runs away, lives to fight another day.

So it is with financial markets heading into 2023, when the overarching goal might very well prove the preservation of capital rather than the growth of capital. You might well ask yourself, “Why go crazy with my investments, or make myself crazy?”

If the markets are not going to run away from you, maybe the best course for now is to stand back and clip your (bond or CD or Treasury bill) coupons.

Safety. There’s a lot to be said for safety after a year when the parent of Facebook and Instagram lost more than 66% of its value by mid-December. In a world where Tesla, the world’s preeminent electric car maker, tumbled 61%. Where Amazon.com, the world’s premiere e-commerce retailer and cloud computer platform, dropped 48%.

Not to mention a year whose very first week began with U.S. stocks touching all-time highs, but soon saw the biggest European land war since 1945. When gasoline briefly approached a nationwide average of \$5 a gallon before summer even started.

But while the stock market is often a fickle friend, as are commodities such as oil and natural gas, wheat and corn, part of what was so shocking in 2022 was the simultaneous slump in government and corporate bonds, which proved as undependable as stocks.

NEXT YEAR’S PLAYBOOK

To look ahead into how policy and markets might play out in 2023, CNBC PRO spoke with Jan Szilagyi, CEO of Toggle AI, an artificial intelligence-driven research platform

used by hedge funds, institutional traders and overseas banks. Szilagyi, a Yale grad with an economics and finance PhD from Harvard, previously worked with Stanley Druckenmiller at Duquesne Capital, and at Fortress Investment Group and Lombard Odier, where he was co-chief investment officer for global macroeconomics.

Economic conditions are “obviously slowing down” and the outlook deteriorating, despite a “red hot” labor market, Szilagyi said. While the jobs market always turns down last, Szilagyi remains convinced the Fed will continue to brake the economy.

“I just think they that they are going to be more aggressive than what the markets are currently hoping for,” certainly as long as wage growth stays around 5%, Szilagyi said. If the Fed stops tightening and inflation only falls to 5%, and stays there for a year, investors face a period like the “lost decade” of the 1970s, marked by “repetitive tightening cycles.”

Against that backdrop, Szilagyi argues stocks might well bottom in the first quarter of next year in anticipation of a looming recession.

WHAT TO DO: INCOME, INCOME AND MORE INCOME

Perhaps the biggest challenge faced by stocks, however, is competition from fixed income securities in a world with 4%-5% yields. “This I think is where the [stock] market has a problem; the bar for when it becomes attractive is not independent of where yields are trading,” said Szilagyi.

In December 2022, a 3-month Treasury bill yielded above 4%, as did a 1-year issue and a 2-year note. The prevailing wisdom on Wall Street is that that’s a high hurdle for stocks. There’s an alternative destination for cash now that there hasn’t been in a long while, and more investors are looking to allocate parts of their holdings to fixed income. At the very least, that will slow any appreciation in equities, if not restrain prices outright.

Add in the fact that the outlook for corporate profits in 2023 is less than rosy. In fact, a host of strategists assume corporate earnings still have a ways to come down, a reality that’s not yet fully priced in to stocks. To date, analysts’ bottoms up 2023 earnings estimates for individual companies see no contraction, while strategists at the same investment banks can’t see a case where earnings rise dramatically under any reasonable near-term, or perhaps even medium-term outlook.

In early December, bottoms up analysts were still forecasting 4.8% growth in 2023 corporate profits, [while top down strategists called for a 6.5% decline.](#)

The consensus view is that, at best, an earnings downturn might prove shallow but, in any case, the bottom hasn’t yet been reached.

That was the point of a mid-December report out of London from the British bank Barclays: “As [the] market narrative shifts away from worrying about inflation to worrying about growth, owning cash or bonds seems more sensible than owning stocks. There is room for rotation to fixed income.”

A recent 72-page look-ahead to 2023 from UBS Global Wealth Management chief investment officer Mark Haefele in Zurich favored “defensive sectors, income opportunities, safe havens and alternatives” to stocks and bonds. UBS’s base case assumes the S&P 500 falls to 3700 by June of 2023, with a smaller chance it drops to 3300 and even lighter odds the index rises to 4400.

A 63-page 2023 outlook report from 27 strategists and analysts at Morgan Stanley was entitled “The Year of Yield,” told investors to “embrace income,” and predicted “a good year for ‘income’ investing.” Morgan Stanley said “opportunities for ‘income’ abound, especially in high-quality bonds,” such as Treasuries, German Bunds, investment grade corporate bonds, agency mortgage-backed securities, AAA-rated collateralized loan obligations and municipal debt, all of which could return in the high single digits in 2023.

Jim Besaw, chief investment officer at \$3 billion GenTrust, said to buy more Treasury Inflation-Protected Securities (TIPS), especially at the short end of the yield curve. Besaw co-founded GenTrust in 2011 after a career at Element Capital, a \$4 billion global macro hedge fund, and after leading teams of fixed income options traders at Barclays Capital and JPMorgan Chase.

For several years before 2022, investing during a period of zero interest rates “was very difficult...so we’re very, very happy to see higher rates. It gives us the ability to build more balanced portfolios that have a higher expected return over the long run,” the Yale economics and math graduate said.

Besaw’s case for short-dated TIPS is this: the market is pricing inflation “to come back down to the mid- twos pretty quickly and stay there...but if you own a TIP and that happens, on the front end you still earn your 4% yield because the real yields are one and a half to one and three quarters. And if you’re wrong, and inflation turns out to be higher, then returns on those TIPS will be even higher.”

OTHER IDEAS: BIOTECH AND... NORWAY

What’s more, TIPS also offer attractive diversification, since they’re likely to move in the opposite direction of stocks in the event inflation stays stuck around 4-5% and the Fed needs to hike further.

A small move Besaw and GenTrust have recently taken that’s further diversified the portfolio has been investing in Norway, buying the market through exchange-traded funds.

The thesis is that “Norway will be the main beneficiary of Europe’s restructuring of where they get their energy from, if they’re no longer buying energy from Russia,” Besaw said, and not only in fossil fuels. While Norway is [the world’s 12th largest oil producer](#), it’s also a big exporter of alternative energy. GenTrust’s view is there’s already a decent amount of risk premium built into Norwegian stocks after the sabotaging of the Nord Stream pipeline between Russia and Germany last September, but that Norway represents “a pretty attractive asset” over the next 5-10 years.

Plus there are two other attractions: Norwegian stocks sell at a significantly lower price-to-earnings multiple to the U.S., and offer a way to play a possible depreciation of the strong U.S. dollar versus the Norwegian krone. The dollar's risen 11% against the krone in 2022 but had been 19% higher in September, at the time of the Nord Stream blasts.

A dollar-based investor would see positive returns in Norwegian stocks if the krona appreciates, even if the equities don't move.

Other segments of the market where GenTrust looked in the second half of 2022 to add a little more risk and diversification to the portfolio heading into 2023 were taking a position in biotechnology and small cap stocks, and uranium miners. It also took some money off the table in bank stocks.

BEWARE BUYING THE DIP IN TECH

In raising its stock positioning back to neutral at various points in 2022, up from an underweight, GenTrust avoided tech stocks. It was "a bubble," and the firm has been cautioning clients "that just because something is down 70% or 80%, doesn't necessarily mean it's cheap, because a lot of these assets were three to four times more expensive than they should have been... Looking at peak to trough drawdown is not necessarily a good indication of current cheapness. And I think that a large part of the technology sector would fall into that camp," Besaw said.

Instead, shifting a little money into small caps, where valuations "are about as cheap as they've been in decades," is one way to add equity exposure, a little more beta, a little more risk to a portfolio.

Another is biotechs. "Because we thought at some point, that with so large a percentage of the companies actually trading at lower enterprise value than the cash on their balance sheet, that there was a lot of upside optionality to holding those names," said Besaw.

Despite investors' conditioning over the past decade, buying the dip when stocks crack, or certainly buying the dip as quickly as possible, is no longer necessary under a new investment regime dominated by higher rates. "We're in a different environment now, where that's not the case, because the Fed isn't going to support markets," Besaw said.

Investors now are laser focused on guessing the point in 2023 or early 2024 when the Federal Reserve pivots, or shifts to a looser policy from a tighter one, "but if you look historically, equity markets don't really bottom until after the Fed has already started to ease," said Besaw. "So I'm not sure that the pivot is the right time to go long or overweight. You might want to be even more patient than that."

And until then, collect your stock dividends. Or clip your bond coupons.

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