The Wealth Report: *Outlook 2023*

Using data from our annual Attitudes Survey of more than 500 private bankers, wealth advisors and family offices combined with in-depth conversations with industry experts, we bring you our assessment of the key themes for wealth in 2023

by Flora Harley

A TRIUMVIRATE OF SHOCKS

Four in ten ultra-high-net-worth individuals grew their wealth during 2022, despite a year of 'Permacrisis'. Here, we delve into the results of our Attitudes Survey and assess how investors are adjusting their approach to a new era.

Every time lexicographers choose their 'word of the year' they provide a signal as to how the world is changing. This year, *Collins English Dictionary* chose 'Permacrisis', defined as an "extended period of instability and insecurity".

It's a fitting choice. The Covid-19 pandemic ended a long period of relative stability. Global economic growth has for more than a decade been underpinned by relatively benign geopolitics, globalisation and the widespread availability of cheap credit. The triumvirate of shocks that defined 2022 across geopolitics, energy and economics marked a turning point, prompting the majority of equity and bond markets to fall in tandem, culminating in the worst performance for the traditional blended portfolio since the 1930s.

For many investors it's been a difficult year, but others have made gains despite the headwinds. Four in ten respondents to our Attitudes Survey said their clients had grown their wealth during the year, while 16% said they'd seen no change. The drivers of this performance were cited as: real estate, currency trades, market timing, and, for the first time in more than a decade, the return on cash.

Indeed, despite significant headwinds annual price growth in prime global residential markets is likely to hit 5% for 2022, according to our *November Forecast*. The MSCI All Property Index – an index that measures commercial property performance – was 7% higher in September compared to the end of 2021. We will reveal the full results for 2022 property performance in March.

Those that saw their wealth shrink attributed declines to equity markets, financial markets more broadly and interest rate moves. Many interviewees pointed out that the traditional diversified portfolio offered no safety amid a unique set of circumstances. The MSCI World Mid & Large Cap index was down 18%, the S&P 500 by 19%, the FTSE 250 by 17%, the Nikkei by 9% and China's CSI 300 22%, by way of example. Longer term investors have largely been shielded due to declines by the exceptional performance of the preceding years, as pointed out by our panellist David Bailin, CIO at Citi Global Wealth Management Investments. The S&P 500, for example, was up almost 20% between 1st January 2020 and 31st December 2022.

We will delve deeper and examine the magnitude of wealth shifts through a tracker of asset performance in the March edition of *The Wealth Report*. We will reveal how the new investing landscape has altered the population of high-net-worth (HNW) and ultra-high-net-worth individuals (UHNWI) in May once full year data is more readily available.

Five big themes for 2023

1 **The rate of inflation** will dictate when central bankers can end the current cycle of rising interest rates. The results will reverberate through borrowing costs and global asset prices

2 **There will be opportunities to reset** as we enter a new investment environment, despite recessions across many major economies

3 **Real estate** is the top cited opportunity among our Attitude Survey respondents seeking diversification and a hedge against inflation

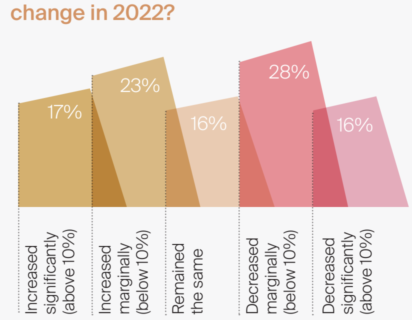
4 **Geopolitical tensions** were dominant in 2022 and will continue to weigh on sentiment through 2023. Many will be familiar, but there will undoubtedly be surprises

5 **The big three** will have an outsized impact: the reopening of the Chinese mainland, India's rise and the agility of the US economy

Resilience tested

Attitudes Survey

On average, how did your clients' total wealth change in 2022?

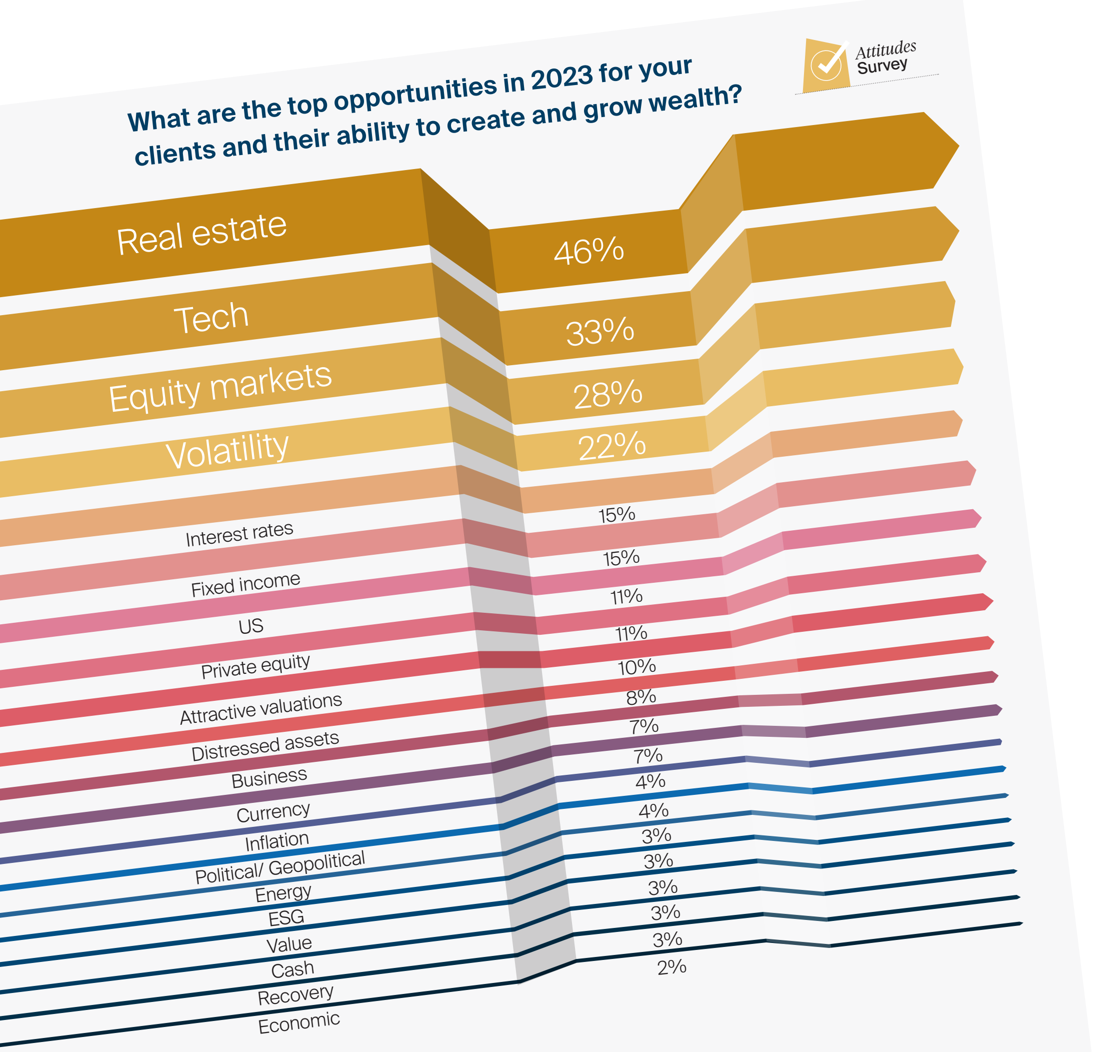


Source: *The Wealth Report* Attitudes Survey 2023

2023 *in five themes*

Our survey respondents and panellists are positive but realistic on the outlook for 2023, despite a backdrop of high inflation and low growth

With disruption comes opportunity. More than two-thirds of our survey respondents expect their clients' wealth to increase either marginally (47%) or significantly (21%) in 2023. To understand what is driving this optimism and what might throw it off course, we asked survey respondents for their top three risks and opportunities for the year ahead – see below and over the page. The results point to **five big themes for 2023 – inflation, reset, real estate, geopolitical tensions and the big three.**



Source: *The Wealth Report* Attitudes Survey 2023
Note: We analysed the amount of times each word was mentioned within the responses as this was a free-text question

1

THE INFLATION QUESTION

The path of inflation will determine the course for interest rates and the results will reverberate through global asset prices. Central bankers, particularly the Federal Reserve's Jerome Powell, were humbled by their error in assuming inflation would be transitory and most are erring on the side of caution. Two thirds of our respondents cited inflation as one of the biggest threats to wealth in 2023, while almost 60% singled out interest rates.

At the time of writing, inflation looked to be turning a corner. By way of example, oil had retreated to around US$80 at the end of 2022, from a high of near US$120 earlier in the year. Should we continue to see headline rates of inflation fall, it is likely that central banks will pause and potentially end their hiking cycles during the first half of 2023. Economic downturns are now highly likely, and many forecasters see a pivot to looser monetary policy beginning in 2024 – 15% of our respondents cite that as an opportunity.

2

THE RESET

The saying "a rising tide lifts all boats" aptly described the post financial crisis environment of low cost and readily available debt. The new "higher for longer" rate environment will prompt a psychological shift and an adjustment in expectations.

Interest rates may ease from their 2023 peaks, but not by much – particularly when coupled with the potential for structurally higher inflation.

The message from our panel is clear: take it back to fundamentals. Some economies have already entered a recession so the accurate assessment of long-term fundamentals will be critical. Our panel also highlight the opportunity to generate income via fixed income and cash as interest rates move higher.

3

REAL ASSETS IN THE SPOTLIGHT

Real estate was the top cited opportunity among 46% of our survey respondents, whether for its attributes as an inflation hedge or due to the benefits of diversification. Many panellists highlighted the opportunity to secure enhanced return profiles a key advantage. Plus, when investing directly, real estate enables greater control and value-add opportunities.

One in ten respondents specifically cited looking for attractive valuations and distressed opportunities. That trend isn't limited to real estate either: equities and the technology sector were tipped by around a third of our respondents.

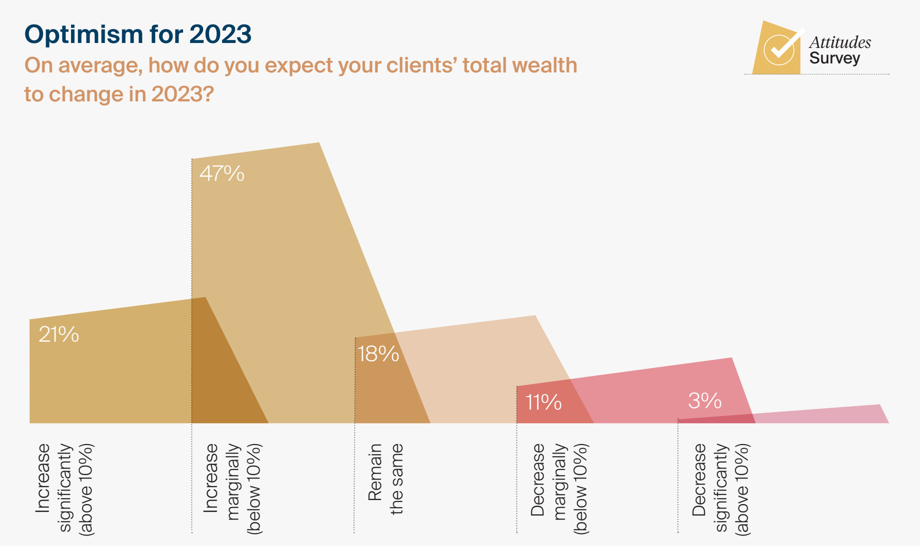
4

GEOPOLITICAL TENSIONS AT THE FORE

More than half of our respondents identified politics or geopolitics as a top risk for 2023. Brexit followed by the US/China trade war followed by the war in Ukraine – geopolitical cracks that emerged in the middle of the last decade have developed into an energy crisis and global food inflation. Just one interviewee last year highlighted the developing situation in Ukraine as a potential threat, but it's impact on the world has been seismic. How the war unfolds will have an impact on many of the themes discussed here.

There are "little fires everywhere," our panellist David Bailin said, referring to the global picture. While investors can position for the knowns, there will likely be shocks both on the upside and downside during 2023. Investing based on fundamentals will remain vital to cut out the noise.

Optimism for 2023
On average, how do you expect your clients' total wealth to change in 2023?



Source: *The Wealth Report* Attitudes Survey 2023

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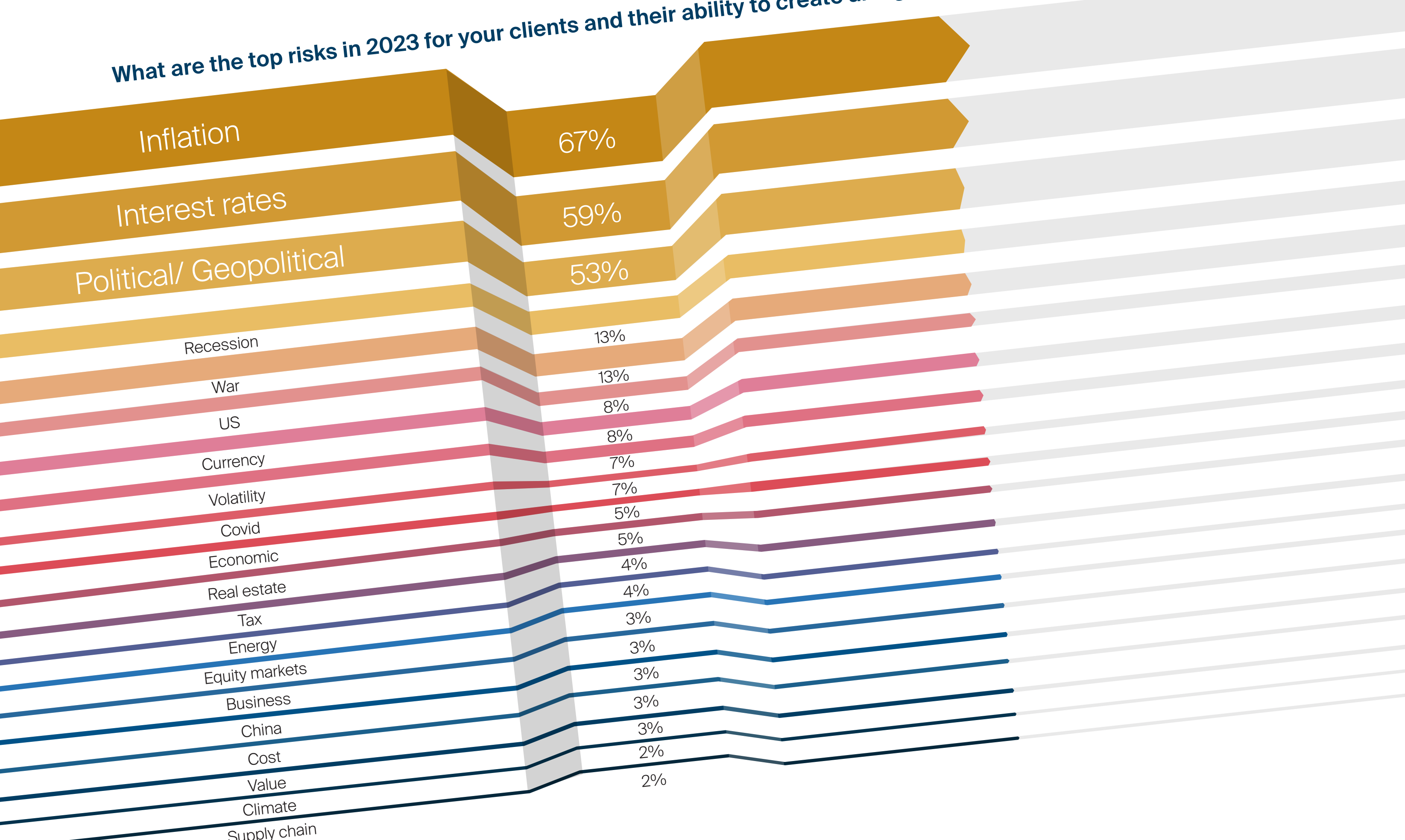
Attitudes Survey

What are the top risks in 2023 for your clients and their ability to create and grow wealth?



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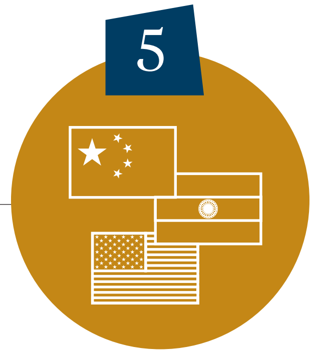

THE BIG THREE – CHINA, INDIA, AND THE US

After two years of strict zero-Covid policies there are clear attempts by the government to reopen the Chinese economy. That should offer a boost to the world economy, though a large, coordinated reopening could prove inflationary. The outlook will remain uncertain while policy is driven by politics rather than economics, as noted by our panellist Jonathan Fenby, Author and China analyst.

China's policy challenges have fuelled the trend of businesses 'regionalising', 'localising', or more simply diversifying supply chains away from the Chinese mainland. There are opportunities here for real estate investors as new destinations emerge, particularly in distribution and industrial.

Longer term demographic shifts will continue to reshape global economics. In the first half of the year, India's population will overtake that of the Chinese mainland, where the population is declining. The Indian economy will continue to rank among the world's fastest growing economies, with 6.1% growth forecast in 2023, according to the IMF, up from stellar growth of 6.8% in 2022. India now has the world's fifth largest economy after displacing the UK in 2022.

While the US will have its resilience tested, investors remain bullish. Some 11% of our survey respondents cited the US as an opportunity to grow wealth, as did many interviewees. While political divisions remain entrenched and the country has witnessed one of the fastest rate hiking cycles in history, the US has confirmed the fundamental strength of its economy and depth of its markets.

It is still too early to know exactly how these rate cycles will impact the global economy and the time lag between hikes and their real-world effects suggests that we'll see more volatility during the first half of 2023. However, with dislocation and disruption come opportunities, particularly for the well informed.

> **In the first half of 2023, India's population will overtake that of the Chinese mainland**

Americas
Asia
Australasia
EMEA

Inside wealth

A panel of ten leading wealth advisors from around the world give their view on the key economic and investment trends they'll be tracking in 2023

WHAT ARE THE BIGGEST TRENDS AND OPPORTUNITIES FOR WEALTHY INVESTORS IN 2023?

DB 2023 is likely to present many investment opportunities after a mild recession. We see the next 12 months as a sequence of events, although we cannot predict the precise order of them. First, active cash management will increase portfolio wealth. Then, as we believe interest rates will be lower in 18 months, comes the demand for intermediate bonds. As stocks bottom, different sectors, first growth then cyclicals will become attractive. Finally, we see alternatives – real estate, private equity, and venture capital – as being more attractive post-recession. 2023 will also provide a broader opportunity for non-dollar assets.

AB We think recessions will broadly be shallow and short-term, and aggressive interest rate hikes from central banks should ease off. For investors, it won't be plain sailing but there's reason enough for longer-term optimism.

RB If inflation is going to be structurally higher, not at the current elevated level but around 4-5%, then equities are attractive, especially for companies with pricing power, i.e. ability to raise prices to cover costs without losing demand. However, you are unlikely to find the top performers of the last decade, such as certain tech companies, being the top performers of the next.

JF I don't believe a decoupling between China and the West will happen in a full dramatic way. However, there is, and will continue to be, a shift to China+1 strategies, where companies have production capability in the Chinese mainland and another country, or a reconfiguring of supply chains to prevent vulnerability.

SH There is a lot of noise, but boiling it down to the fundamentals we have developed four I's. Infection, which is largely moot now apart from in the Chinese mainland. Inventory, where global supply chains have been disrupted and are gradually improving but shifting geographically. Inflation, which has been surging and is now peaking and, by consequence, interest rates, which have risen aggressively but will peak in Q2 2023. Investors need to position with these in mind.

KL 2022 provided a notable shift from a tech centric high growth strategy to more traditional methodologies around value and quality of business management. I said last year that "a good PowerPoint deck doesn't make a good investment" and many experienced a significant drawdown, especially in venture capital and private equity investments valued at high multiples. With the sudden higher-rate environment, there is a need to review investments on a longer-term approach and lower down the risk curve.

VM We see 2023 as the year of consequential pivots. For long-term investors, we emphasise the need for sustainability as a key factor for equity investments because consumer choice and regulation will favour companies that are making adjustments and investments to thrive in this transition to a carbon neutral, more sustainable economy.

AT Cash now provides 4-5% return, which hasn't happened in years, meaning there is greater consideration on risk versus return, but high-quality debt and the traditional 60/40 portfolio is making a resurgence.

Meet our *panel*

DB **David Bailin**
CIO at Citi Global Wealth Management Investments

AB **Annabelle Bryde**
Head of UK Private Bank & Crown Dependencies at Barclays

RB **Rosie Bullard**
Partner at James Hambro & Partners

JF **Jonathan Fenby**
Author and China analyst

SH **Sheldon Halcrow**
CEO of Caleo Capital North America

KL **Kunal Lakhani**
Director, Family Office & Major Family Groups at NAB

VM **Vincent Magnenat**
Limited Partner, Global Head of Strategic Alliances & Asia Regional Head, at Lombard Odier Group

AT **Alexandre Tavazzi**
Global Strategist & Head of the CIO Office, Pictet Wealth Management

GW **Graham Wainer**
CEO Investment Management, Stonehage Fleming

JW **James Wey**
Head of Singapore and Southeast Asia, Wealth Management, JPMorgan Chase & Co

GW We are extremely bullish on the US. Policy is at a higher level of competency and determination than anywhere else in the world – the Federal Reserve is much more resolved to get it right. The economy has benefitted from this as well as globalisation, deep capital markets, a diverse labour market and technology.

JW The reopening and economic recovery of the Chinese mainland is of particular interest. Economic growth will likely bottom this winter, and cyclically recover in 2023 and 2024. Meanwhile, valuation looks attractive to long term investors. We like consumption and tech names which should benefit from the service sector recovery. But we note in the near term price actions could remain quite choppy. We also see some tactical opportunities for investors who are more nimble.

WHAT RISKS ARE YOU WATCHING OUT FOR IN 2023?

DB There are little fires everywhere – any one of which could be big. The biggest two risks we see are a self-reinforcing global recession that prolongs the downturn and a credit crisis caused by an absence of liquidity due to the Federal Reserve over tightening.

RB There are so many unknowns. When and where inflation and interest rates will peak, the pace of reopening of the Chinese mainland and the ongoing impact that has on supply chains, whether labour markets loosen, the war in Ukraine. People are taking longer to make decisions because of it.

JF China is more of a risk because there are an increasing number of politically driven decisions being taken that affect businesses and investors, which are expected to contribute to the political aims of the leadership. Some underlying societal challenges are also surfacing. Property became the main channel for savings in China, particularly for the burgeoning middle class, and the continual increase in property prices was part of the economic/political bargain. But, the fall in property prices raises problems.

KL Geopolitical. There are so many geopolitical risks currently impacting global investments as we have seen from trade wars to the energy crisis in Europe. Will there be pullback from global companies in certain regions?

AT Inflation and central banks. Inflation will be structurally higher in the next five years than the past five making the costs of doing business higher. If central banks insist on bringing inflation back to 2%, they will need to hike interest rates well above what is currently priced in markets.

GW Long term, its ensuring that returns are matched against personal inflation. Inflation varies person to person due to spending habits, e.g. holidays, private school, homes etc. Higher levels in these discretionary areas means a need for riskier assets, but with that comes a higher degree of volatility.

JW The well documented ones – such as inflation continuing – we can prepare for. However, it can be challenging to predict geopolitics. We must be acutely aware of trends and developments and be nimble in cycles that are compressed and can change quickly.

REAL ESTATE IS OUR CORE, HOW DOES THE SECTOR FACTOR FOR YOU IN 2023?

DB Real estate and alternatives will be where wealth is grown over the coming decade. With the rapid rise of interest rates, we have witnessed the value of these assets change, but the fundamentals for many sectors have not. We are bullish on residential, industrial and warehousing. The 'onshoring' trend is seeing the building of capacity as companies move production closer to home in the US and across Europe.

AB Property is a passion for many and will remain so, however, decisions are typically driven not only by returns, but sentiment and need. Whether looking for family use or a specialist asset that drives diversification and yield across a broader range of investments, our clients like the idea of combining passion with practicalities. This becomes more important, and a driver, as global leverage funding costs increase.

RB Clients are thinking about their properties and operation costs, particularly in Europe. Property has a well-founded place in the portfolio, but there is now more scrutiny over liquidity and, for example, who the tenants of commercial properties are.

SH Real estate is still favourable. Whether it's the desire to have the 'plan B' residence or sophisticated investors looking for opportunities among assets that have repriced due to the pandemic and increasing rates.

KL We see prime offices as strong. Big corporates are committing to floorspace and increasing amenities to incentivise workers to return to offices. Also, on a smaller scale, we are seeing families seek out safe havens in regional areas and island retreats to escape their cities. Prime residential is also still very strong.

VM Interest in alternative assets is on the rise, but investors are cautious. Findings from our recent HNWI study show that APAC investors believe that private assets are a way to capture future structural changes in a regulated and risk-managed way. We are currently cautious on the property sector, but once the dovish pivot in interest rates arrives, we believe it will start recovering more substantially.

JW In an inflationary world, real assets provide some hedge and uncorrelated returns from financial markets. Investors are increasingly thinking about direct investment as there is more predictability and control. We are also looking at sustainable forestry as returns are attractive and not correlated with other markets and assets. Another area is investment in food technology and responsible agritech, particularly given the focus on food security.

Attitudes Survey

Attitudes survey: At a glance

Ten findings from our annual Attitudes Survey. We will publish the full results and delve into the implications for property markets in *The Wealth Report* 2023, to be released in March

1

Global movement has been tempered by the pandemic, but the desire to be mobile is proving resilient. Some 13% of UHNWIs are planning to apply for a second passport or new citizenship, down from the 15% recorded in last year's report.

2

Globally, a third of total wealth is allocated to UHNWI's primary and secondary homes. More than a quarter is held outside their country of residence, on average. UHNWIs in the Middle East (41%) have the highest global footprint.

3

The average UHNWI owns 4.2 homes globally. UHNWIs in Asia have the greatest appetite, owning an average five homes each. This demonstrates the unwavering global appeal of residential property.

4

Higher interest rates will temper demand for residential property in 2023. Some 15% of UHNWIs are looking to purchase a residential property this year, down from 21% in the previous year's survey. Appetite is highest amongst Middle Eastern UHNWIs.

5

The US, UK and Spain are the top three locations for purchasing homes. Australia and France round out the top five.

6

UHNWIs are increasingly diverse, both by geography and asset class. More than a fifth of our respondents' investable wealth is directly invested in commercial property and a similar proportion is held overseas.

7

Real estate was identified as a top opportunity, both for direct and indirect investment. One in five UHNWIs are planning to invest directly in 2023, with 13% looking for indirect opportunities. This is broadly in line with the 20% of last year's survey, indicating the attraction of property as a haven during economic uncertainty.

8

Healthcare, logistics/industrial and offices are the top target sectors for UHNWIs in 2023. The private rented sector (PRS) and hotels/leisure complete the top five. Around a third of respondents are interested in each of the top five sectors in 2023.

9

Energy source (57%), opportunity for refurbishments (33%) and materials used/the embodied carbon footprint (30%) are increasingly being looked at by UHNWIS when purchasing investment property.

10

Art is set to remain the most sought-after investment of passion in 2023 with 59% of UHNWIs likely to make a purchase. Watches come in second, with 46% looking to purchase, followed by wine with 39%. In terms of how much they will spend – art is again at the top, followed by classic cars and wine.

Source: *The Wealth Report* Attitudes Survey 2023

THE WEALTH REPORT

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Flora is a Partner within Knight Frank's Global Residential Research team. Having contributed to *The Wealth Report* for the past five year's, Flora has been deputy editor for the past two. She leads on economic and geopolitical analysis, assessing how this influences wealth levels and movement.

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