



FRANKLIN TEMPLETON

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Dear Investor,

And just like that another year has passed by. As we draw the curtain on 2022, in this letter, we would like to look back on 2022 and evaluate some of our decisions, and then take a deeper dive into key themes that we believe will impact the global economy and capital markets in 2023. Our aim is to provoke thought and debate and, as always, we welcome your feedback.

Looking back at 2022

Our global market strategy team had offered five forecasts for 2022. We got a couple right and a few wrong. Here's a summary:

Our first forecast, which we nailed was that 2022 would see a surge in demand for electronic vehicles (EVs), with worldwide EV sales topping total automobile output of General Motors. Already in the first half of 2022, global sales of electric vehicles rose to 4.3 million units, nearly double GM's half-year car production of 2.8 million. That's testimony to the technology that is making EVs viable forms of transportation, as well as the subsidies and tax breaks that make them increasingly affordable.

Our second successful prognosis was the collapse of cryptocurrency prices. We felt the market value of cryptocurrencies would tumble 20% in 2022 as hype about digital money cooled off. In the end, we were too cautious. Based on our calculations, cryptocurrencies lost roughly 60% of their value in the past twelve months.

With the third and fourth forecast, we thought US core personal consumption expenditures inflation would drop below 3% by the end of 2022. Inflation proved to be much stickier than we thought and will probably finish the year above 5%. We also thought that declining inflation would push stock markets up 20% this year. Major stock indexes are likely to finish 2022 more than 10% in the red.

Finally, on one 2022 forecast, the jury remains out. We said a year ago that "sustainable assets" (i.e., those managed according to Environmental, Social and Governance [ESG] criteria) would increase from one third to 40% of US assets under management. While it does appear that ESG investing continues to expand, the data we need to validate our view remains unavailable at the time of publication.

Looking ahead to 2023

So much for last year's picks. What are we willing to stick our necks out for in 2023? To begin, we will make a slight departure from last year's approach. While we normally want to have a benchmark to measure our forecasting successes and failures, we also feel it is important to highlight key themes that will occupy investors over the next 12 months (or longer). Our choices for 2023 are therefore more thematic in nature. But we will fairly judge what we get right and wrong this time next year. We are not shy about admitting failure or claiming success.

India in 2023

India is one of the largest and most dynamic economies in the world. Franklin Templeton believes India's economy currently benefits from catalysts for growth, both cyclically and structurally. This in turn creates opportunities for investors. India enjoys several structural growth drivers which could keep the economy on a reasonably strong upward trajectory in the long run. Such drivers include a domestically oriented economy with increasing internal demand and investment, a low but expanding export share, a rapidly expanding middle class and a high savings rate in the population. The convergence of these megatrends is driving three themes - Rising Incomes, Local Consumption and Global supply chain diversification.

We expect domestic demand to be the key driver of economic growth in the next couple of years, both from a consumption standpoint and capital expenditure (capex) standpoint. We are seeing self-sustaining drivers emerging from India, led by a resurgence of manufacturing, strengthening government finances with better quality of public spending, and massive infrastructure investments. Such measures, combined with the cyclical improvement in demand and capacity utilization, and cleaner balance sheets, should boost the private capex cycle, with positive effect on productivity. A succession of one-off events (demonetization, Goods and Services Tax, COVID-19) delayed a cyclical recovery, but we believe the economy is lifting off after a prolonged period of adjustments.

World in 2023

1. Blockchain goes mainstream

Our first 2023 forecast is that the proponents of blockchain financial technology will seek regulatory frameworks under which they can offer their innovations. That outcome seems increasingly likely given the November 2022 implosion of the FTX exchange. Regulation of blockchain finance was always probably going to happen. After all, regulation of financial markets is a fact of life. Quasi-libertarian ideals for a parallel set of unregulated and unsupervised currencies, assets and securities have always been fanciful.

2. Balanced bounces back

2022 was a dreadful year for so-called "balanced" portfolios comprised of stocks and bonds. High inflation undermined both asset classes via rising interest rates and soaring risk premiums.

But no investment strategy can be judged, much less discarded, based on one year's performance. That is particularly true if—as we believe—the 2021-2022 inflation surge proves to be temporary. Already tighter monetary policies are slowing growth and cooling price pressures. Bond yields have tumbled nearly a full percentage point from their cyclical peaks. Expected rates of inflation are receding and ought to decline in the course of 2023 toward the norms of the past two decades.

Bond returns are already improving. But it will likely take longer for stock markets to find their footing. After all, weaker economic growth also implies weaker profits, for which stock market analysts and investors may not yet be fully prepared.

But the key point is this: as inflation falls back toward central bank desired levels, bonds will provide ballast in portfolios, diversifying the risk of a possible profits' recession. Once equity market valuations more appropriately discount future profits growth, we believe both stocks and bonds will likely offer attractive returns. We think those preconditions will fall into place by mid-2023. "Be balanced" is a key theme for 2023.

3. A new-new normal

Prior the pandemic, the "new normal" described a world of moderate growth, low inflation, and low interest rates. The successful restoration of inflation from its 2022 highs, however, will not result in a restoration of the "new normal." Rather, a "new-new normal" is likely to emerge.

Some things may look similar. Inflation will likely recede to more desirable levels, drawing interest rates down. But recessions in the United States, the United Kingdom, the European Union, perhaps Japan, and many emerging markets are likely to mark the first half of 2023. Downturns already underway in capital expenditures, housing, construction, and many goods-producing industries are foreshadowing that outcome.

But the new-new normal will exist beyond a brief period of recession. Aging societies, falling labor-force participation rates, and the growth of informal employment in the gig and hybrid-work sectors will become durable hallmarks of the new-new normal. Skills shortages will continue to push up real wages for some workers. Worker shortages will spawn innovation and investment in labor-saving technologies. We believe those trends will extend well beyond 2023—they will become decade-long stories.

4. Putting energy into energy

Our final theme to watch in 2023 is energy transformation. In key respects, of course, the energy transformation is well underway, as countries, industries and individuals worldwide shift away from carbon sources of energy toward renewables. But other factors—above all geopolitics—compound the need for all actors to put more energy into energy.

Interesting reads

- Franklin Templeton recently hosted an investment forum in Singapore, and much of the dialog pointed to a growing gap in growth outlook emerging between Asia and the West. [Click here for the key takeaways from Stephen Dover](#), Chief Market Strategist and Head of Franklin Templeton Investment Institute.
- A Perspective from Franklin Templeton Emerging Markets Equity on [“Ready for India’s growth recovery: Powered by domestic demand”](#).
- The Franklin Templeton Investment Solutions team’s capital market expectations (CME) note titled [‘Brighter times ahead’](#)

Hope you find the above insights useful.

As always, you can directly write to me at avisatwalekar@franklintempleton.com for any questions. I value your questions, and feedback and look forward to the opportunity of continuing to meet your investment needs in future.

2023 has the potential to begin the pivot toward what the next few decades might look like. May you all have a wonderful holiday season!

Sincerely,

Avinash Satwalekar
President, Franklin Templeton Asset Management (India) Pvt. Ltd.

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