Wall Street's Most Accurate Analyst: "Here's What Happens In 2023" And His Top 10 Trades

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FRIDAY, NOV 25, 2022 - 09:57 PM

If there is a prize for calling not only the market's overall trajectory in 2022, but ever major inflection point, then BofA's CIO Michael Hartnett has certainly won it.

Having repeatedly warned in 2021 that markets are about to take a spill in 2022 (see "BofA Is Bearish On Markets Ahead Of The 2022 "Rates Shock"), at the same time when every other sellside strategist was predicting 5000+ or higher for their 2022 year-end targets, with the possible exception of MS' Michael Wilson, Hartnett not only correctly called the tactical July-August meltup (see "Biggest Wall Street Bear Turns Bullish After "Record Pessimism", "Full Investor Capitulation"), but also top-ticked the peak of the bear market rally to **within half a point** on August 17 (see "Mood No Longer Apocalyptic": Wall Street's Most Accurate Strategist Says Start Shorting S&P Now"), and then, as stocks dumped again, Hartnett was spot on once more when he said as the start of October to "Short Stocks Until Halloween, Then Brace For The Rally."

In other words, anyone who listened to Hartnett (whose every must-read report is dutifully provided in real time and archived for all professional subs), has not only made money in 2022, but made lots of money. And while past performance does not guarantee anything about the future, in Hartnett's case we have a feeling that his winning ways will extend well in 2023 if not beyond.

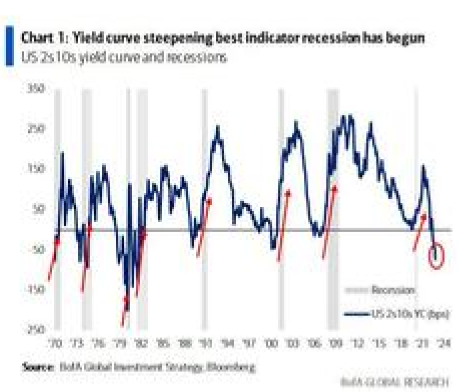
Which is why we are happy to present Hartnett's latest "*Thundering Word*" note (available to pro subs here), which looks at the year ahead 2023 and whose trade advice boils down to the following: **long bonds in H1, long stocks in H2** (this won't be news to those who read our note from last Friday). Going straight to the punchline, Hartnett echoes what he has been saying in his weekly Flow Shows over the past month, and tells clients that he is staying "bearish risk assets in H1, set to turn bullish H2 as narrative shifts from the inflation and rates “shocks” of ’22 to recession and credit “shocks” in H1’23, then bullish “peak” inflation, Fed, US$ in H2’23; recession." In terms of trades:

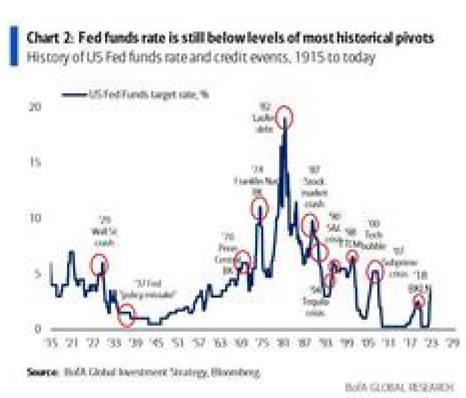
> **"Long bonds in H1, maintain SPX nibble at 3.6k, bite at 3.3k, gorge at 3.0k entry points; Fed rate cuts...long stocks and credit in H2."**

Below we excerpt from his must-read *"Year Ahead"* note, which is available to all professional subscribers in the usual place.

2022 in Words:

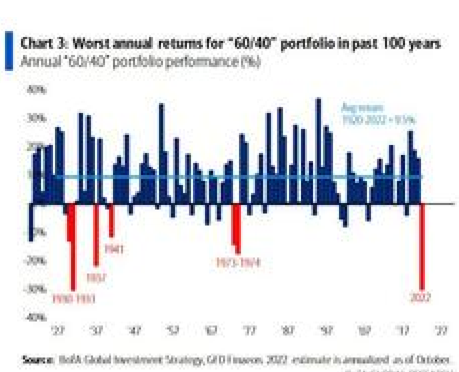
- “**inflation shock”** and ”**rates shock**” caused historic bear market on Wall St but no “recession shock” on Main St; exogenous shocks of Russia/Ukraine, China COVID, UK pension funds, FTX/crypto all negative on Wall St, but were offset on Main St by historically low unemployment rates in US/G7 and ongoing government bailouts; higher rates crushed valuations on Wall St and US yield curve inverted most since 1982, but there was no rates shock on Main St; big outflows from credit funds, big inflows H2 into short-dated Treasuries, but no outflows in equities.

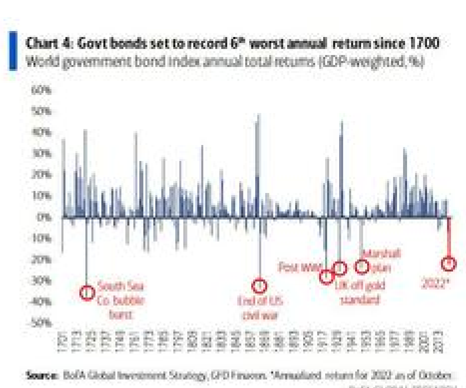




2022 in Numbers:

- World population exceeded 8 billion, US CPI hit 40-year high (9.1%), German PPI hit 100-year high (45.8%), 280 global rate hikes (>1 every trading day), 2-year UST yield hit 4.8% (was 0.2% in 2020), global government bond down 22% (worst since 1949 – Chart 4), 60/40 portfolios down 30% (worst since 1931 – Chart 3), $33tn global equity market collapse, China stocks crashed to lowest level since 2005, best year for US dollar since 2014, crypto $3tn market cap crashed to <$1tn.





2022 Winners & Losers:

- Energy stocks 32%,
- US dollar 12%

- HY bonds -15%,
- IG bonds -18%,
- government bonds -29%,
- China stocks -29%,
- Nasdaq -29%,
- US Treasury 30-year -33%,
- crypto -69%.

Chart 7: Commodities top returning asset class in 2022
Annual cross-asset returns (%) between 2000 and 2022

Source: BofA Global Investment Strategy, GFD, Ibbotson, and Bloomberg. Note: 2022 as of 17 November.
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BofA Macro & Market Forecasts for 2023

BofA economists and strategists forecast mild recession in '23, lower inflation, stronger China, peak rates, yields, spreads, US$, oil prices, flat US stock prices and a very positive year for gold & base metal prices (see Table 2 for details). By the numbers...

- Mild recession...US GDP -0.4% after 1.8% in '22,
- Lower inflation...US CPI 4.4% from 8.1%,
- Higher unemployment...U-rate jumps from 3.7% to 5.5%,
- Stronger China...COVID reopening sees GDP growth 5.5% up from 3.0%,
- Peak Fed funds...peaks 5-5¼% In Mar and then Fed cuts 25bp in Dec,
- Peak yields...US Treasury 10-year yield drops from 4% to 3¼%,
- Peak credit spreads...US IG spreads to tighten to 130bps,
- Peak US dollar...Euro rallies to 1.10, Japan yen to 137, China yuan to 7.00,
- Peak oil prices...WTI oil forecast to peak at $104/bbl in Q3'23,
- Higher gold prices...gold to rally to $2000/oz,
- Flat US stocks...S&P500 year-end '23 target is 4000.

Table 2: BofA Macro & Market Forecasts for '22, '23 and '24
2023 will see the US and Europe top in economic recession with inflation > 4%...but China the wild card

	2022F	2023F	2024F
Macro			
Global real GDP growth (%)	3.3%	2.3%	3.2%
US real GDP growth (%)	1.8%	-0.4%	0.9%
Euro area real GDP growth	3.3%	0.0%	0.9%
China real GDP growth (%)	3.0%	5.5%	6.5%
Global CPI (%)	8.5%	6.4%	4.4%
US CPI (%)	8.1%	4.4%	2.5%
Rates			
Fed Funds*	4.25-4.50%	4.75-5.00%	2.75-3.00%
ECB refi rate*	2.50%	3.75%	3.00%
UST 2-year Treasury*	4.50%	3.25%	2.75%
UST 5-year Treasury*	4.25%	3.25%	3.00%
UST 10-year Treasury*	4.00%	3.25%	3.25%
Credit spreads (OAS, %)			
US Investment-Grade*	145	130	-
US High-Yield**	465	515	-
Euro Investment-Grade*	187	170	-
Foreign-exchange rates			
EUR-USD*	1.00	1.10	1.15
USD-JPY*	144	137	125
USD-CNY*	7.25	7.00	6.80
Commodities			
Gold, $/ounce*	1,710	2,000	1,945
Oil (WTI), $/barrel*	89	94	-

Source: BofA Global Research; note: all macro forecasts are annual averages, except otherwise noted.
*BofA forecasts are quarterly EOP (2024 as of Q4'24 end). **Fair value target for US HY credit spreads.
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BofA Investment Strategy in 2023

The bank stays bearish risk assets in H1, but is **likely to turn bullish H2 as the market narrative shifts from Inflation and rates "shocks" of '22 to recession and credit "shocks" in H1'23,** thereafter more bullish story of "peaks" in inflation, Fed funds, bond yields and US dollar in H2'23.

BofA also recommends going **long US government bonds in H1 as hard landing & credit event risks underpriced;** and it maintains the familiar view of optimal S&P500 entry points: "nibble at 3.6k, bite at 3.3k, gorge at 3.0k."

Hartnett believes the Jun/Jul '23 Fed pivot just before $1.6tn of US corporate refi wall, and only after interest rate tightening visibly hurts Main St (housing and credit markets force unemployment notably higher); to Hartnett **the most bullish outcome for Wall Street is the start of easing financial conditions from mid-year = new bull market stocks and corporate bonds in H2'23 & 2024.**

In that vein, the set-up heading into 2023 is less bearish than into 2022 since **bear market in bonds & stocks means much greater investor pessimism versus year ago;** and it is also ***very*** unlikely central banks hike rates another 280 times in '23; By asset, class, BofA's expected returns are cautiously positive: copper >25%, gold 15-20%, US IG 12-13%, 10-year Treasury 7-8%, oil 5-6%, cash 5%, US stocks 0%, US dollar -6%; ***strongest returns in "peak US$" and inflation hedges of commodities and EM assets.***

Table 1: BofA Research expected returns in 2023
BofA full-year 2023 return forecasts by asset class

Asset class	BofA Asset Return Forecasts 2023
Copper	>25%
Gold	15-20%
US IG bonds	12-13%
US 10-year Treasury	7-8%
US HY bonds	7-8%
Oil	5-6%
Cash	5-6%
German 10-year Bund	2-3%
US stocks	0-1%
US dollar	-6%

Source: BofA Global Investment Strategy.

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Top 10 Trades

- **1. Long 30-year US Treasury** - on recession, unemployment, Fed cuts late'23, history (US Treasury returns have never fallen for 3 consecutive years).
- **2. Yield curve steepeners** - as US yield curve always steepens as recession begins and markets anticipate Fed flipping from hikes to cuts (Chart 1).

Chart 1: Yield curve steepening best indicator recession has begun
US 2s10s yield curve and recessions

Source: BofA Global Investment Strategy, Bloomberg.

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- **3. Short US$, long EM assets** - long EM distressed bonds, Korea won on China reopening, Mexican peso on "nearshoring".
- **4. Long China stocks** - COVID reopening was very bullish for US/EAFE stocks, China has high "excess savings" and China stocks remain v contrarian long trade.
- **5. Long gold & copper** - US$ peak, China reopening, metal inventory shortages, energy transition acceleration, need in 2020s for inflation hedges.

Chart 6: Secular outperformance of US vs EM equities to end in '23
US vs EM equities relative price performance

Source: BofA Global Investment Strategy, GFD Finaeon.

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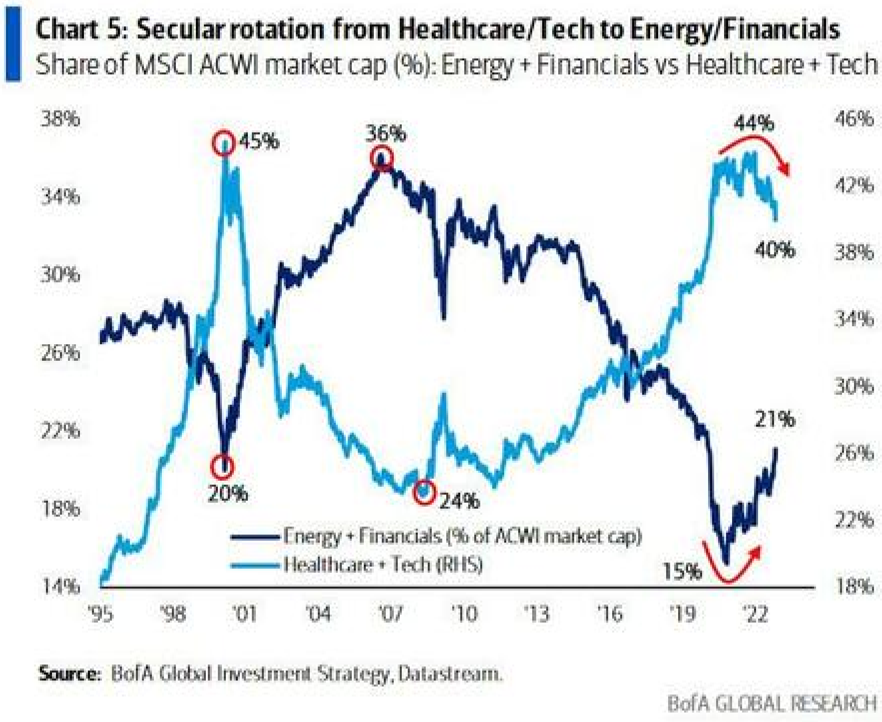
- **6. Barbell credit** - long credit too consensus in '23, we barbell long IG tech bonds (>5% yield + strong balance sheets) with distressed HY debt in Asia (17% yield).
- **7. Long global industrials and small cap stocks** - secular leadership shift in 2020s from deflation to inflation assets, driven by globalization to localization, monetary to fiscal excess, inequality to inclusion and so on just beginning; capex set to be new macro bull story.
- **8. Short US tech** - the old leadership, still over-owned, era of QE is no longer, era of globalization no longer, plus peak penetration and regulation risks (Chart 5).



- **9. Short US private equity** - the old leadership, redemption risks given shadow banking exposures to housing & credit risks.
- **10. Long EU banks, short Canada/Aussie/NZ/Sweden banks** - EU fiscal stimulus to wean Eurozone off Russian energy dependence, Chinese export dependence, US military dependence vs real estate market busts in Canada/Australia/NZ/Sweden

The Big Surprises of 2023

Three "Botox Bull" surprises

- **1. "Botox bull" returns;** investors discount monetary/fiscal policy capitulation at 1st sign of recession pain on Main St to **coddle new electoral expectations of stimulus checks, rebates, debt forgiveness...**to ease slightest economic pain; ultimately means higher-for-longer inflation **but if Fed signals openness to higher 3% Inflation target in '24/'25, nominal returns in assets to remain superficially high**.
- **2. "1975 redux":** Dec'74 saw "Great Pivot" as Fed funds dropped from 9.25% to 4.75% despite inflation being 12% as GDP turned deeply negative, stock market losses reached 40%, unemployment rate leaped from 5.6% to 6.6% in Dec'74; following 12-months S&P500 rose 31%; unemployment key catalyst.
- **3. "Geopolitics":** geopolitics flip from negative to positive as China-Taiwan static, Russia-Ukraine stalemate, Saudi-US quid pro quo (higher Saudi oil supply for bigger Mid-East geopolitical sway), all aid big fall in oil prices <$70/bbl allowing European & Asian cyclical assets to significantly outperform.

Three "Detox Bear" surprises

- **1. "Detox bear" continues:** 12 years of hubristic monetary excess and abnormal credit/equity returns require more than 6 months to detoxify; hard-core investor beliefs ("Fed always blinks", "stocks always go up", "tech always leads stocks up") need to end via Fed policy so asset prices can lead inflation lower.
- **2. "US dollar super spike":** markets continue to punish policy mistakes (BoJ persistence of yield curve control (YCC), belligerently slow China reopening, Russian oil embargoes worsen G7 budget deficits); bond yields fail to fall, credit events mutate from peripheral to core credit markets and consensus '23 trade of "long IG credit" fails; bear market ends with classic liquidity panic and rush to US dollar safe haven.
- **3. "Geopolitics":** inflation engenders social unrest and negative geopolitical repercussions in countries with strategic importance and/or nuclear power, e.g. Iran (CPI currently >50%), Pakistan (>25%), Turkey (>80%), Egypt (>15%).

Much more in the full report available to pro subs.