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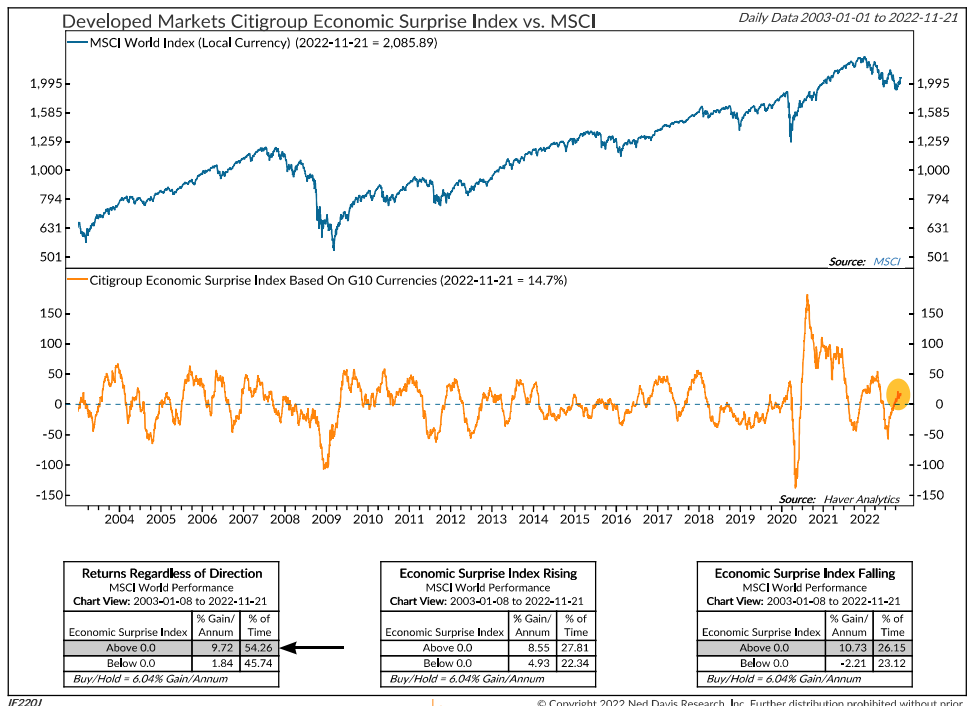
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Are economic surprises telling us the worst is over?

Key Takeaways

- Global economic data has been surprising to the upside, a constructive condition for equities.
- But we find this to be a better tactical indicator, as opposed to identifying broader economic and equity cycles.
- Upside inflation surprises are down from their peak but remain historically elevated.

Positive economic surprises are good for equities



Rising recession risk and stubbornly high inflation is the narrative coming from most economists, including ourselves. The [latest global data](#) and our severe [Global Recession Watch Report](#) are suggesting that even though we may not be in severe recession now, the risk is rising in the near-term. Similarly, although there appear to be signs that [global inflation is close to peaking](#), it will likely stay higher for longer.

Are economists too pessimistic?

But are economists becoming too pessimistic? The Citigroup surprise indexes, which measure economic data relative to expectations, suggest that they probably are.

As shown in the chart, the economic

surprise index for advanced economies has been in positive territory since September, indicating that economic data has, on balance, been surprising to the upside. This comes after a three-month streak of data consistently surprising to the downside.

The positive surprises are [broad-based](#), covering the U.S., eurozone, and the U.K. But the higher readings are coming from smaller developed economies, including Norway, New Zealand, and Australia.

As also shown in the chart, global equities tend to outperform when the surprise index

has been positive, as it is now. One can also notice that the index often bottoms ahead of major equity market bottoms and recession end (e.g., 2009 and 2020).

Does that mean that the worst is behind us from an economic and equity market perspective? Unfortunately, that's not as clear. Although the index has often signaled the end of recession and market bottoms, it's also been in negative territory on many other occasions (almost half the time!). This makes it a better tactical indicator, as opposed to identifying moves in the economic business cycle.

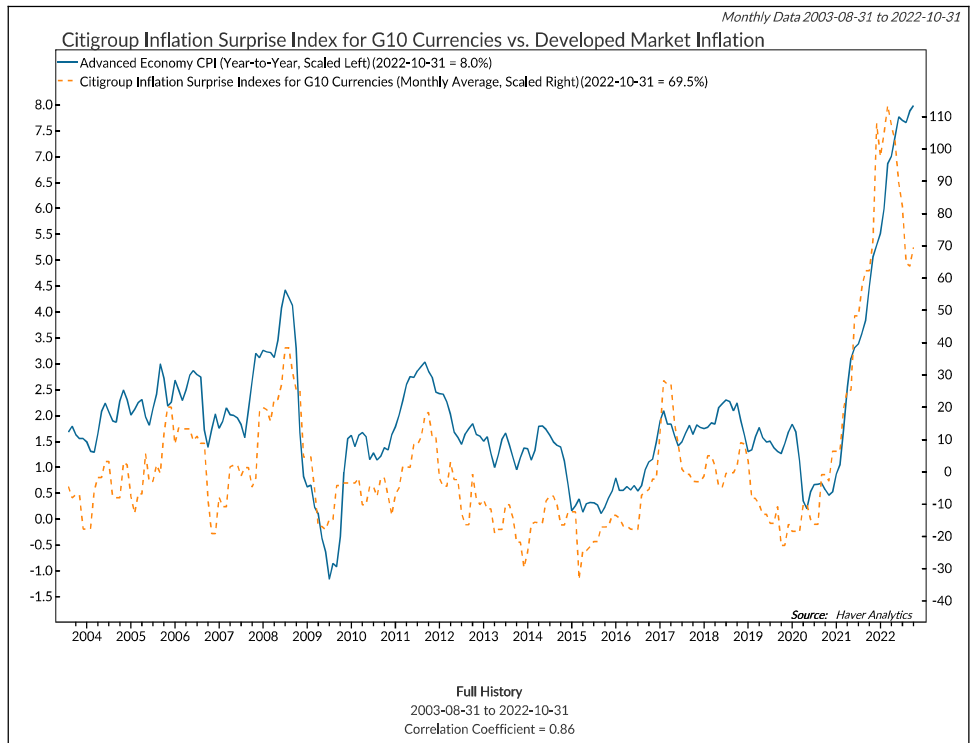
What about inflation?

The Citigroup Inflation Surprise Index for developed economies is shown in the chart at right. As one can see, inflation data has been consistently surprising to the upside since the beginning of 2021. Almost every economy has been experiencing upside surprises in inflation, with the greatest coming from Europe.

The good news is that the surprise index peaked in April and given its high correlation to CPI growth, it suggests a near term peak in the inflation rate among advanced economies.

The bad news is that the index remains well above any level observed before the pandemic and has ticked up over the past month, driven by almost every major economy.

Inflation surprises have peaked but remain very elevated

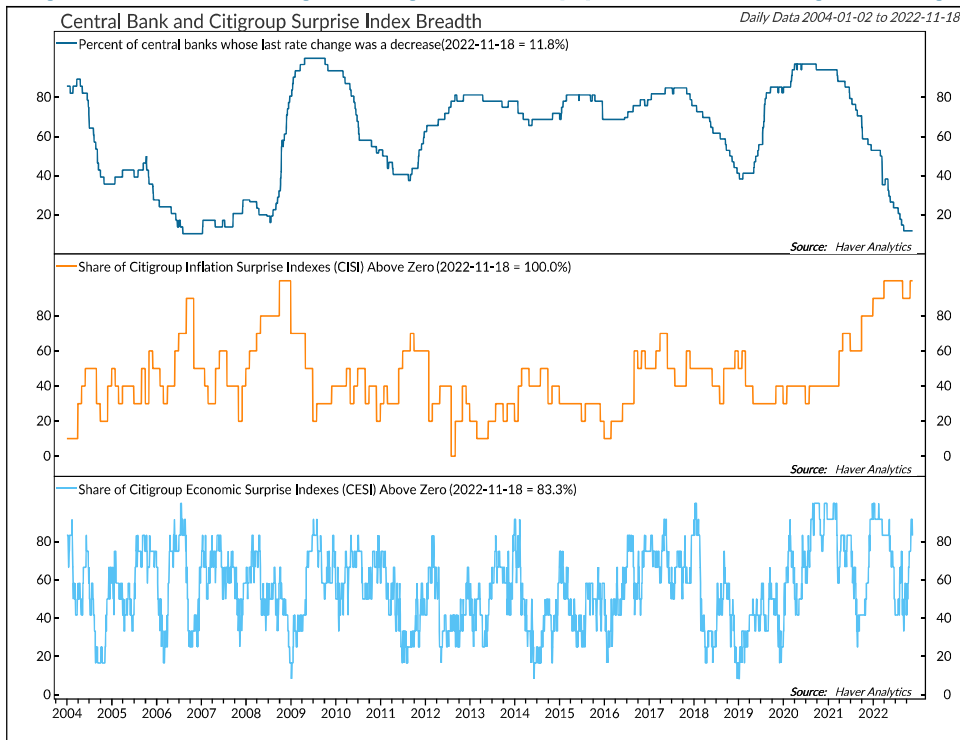


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High inflation and growing economy points to CB tightening



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CBs to remain hawkish

The chart at left shows the breadth of the economic and inflation surprise indexes among economies, while the top clip shows the share of the world's central banks that are in easing cycles.

As one can observe, our breadth reading for the inflation surprise index is at a record-high 100%, indicating that all economies are seeing upside surprises in inflation. Moreover, the breadth reading for the economic surprises is at its highest level since the beginning of the year. High inflation and positive economic surprises are a recipe for continued central bank tightening, which will create headwinds to the economy.



NDR HOUSE VIEWS (Updated November 17, 2022)

For global asset allocation, NDR recommends marketweight allocation to stocks, bonds, and cash. We are in line with our Global Balanced Account Model estimate.

Equity Allocation

U.S. | We have a modest underweight to stocks in our asset allocation recommendation but are neutral on an absolute basis. The hawkish Fed has overwhelmed the positive tape development in the summer, but sentiment is extremely pessimistic. We favor small-caps over large-caps and Value over Growth.

INTERNATIONAL | We are overweight Europe ex. U.K. and marketweight on all other regions.

Macro

ECONOMY | The global economy is in a sustained slowdown due to waning monetary and fiscal support, stubbornly high inflation, and rising geopolitical risk. While the slowdown remains moderate, the risk of severe recession increases in 2023. Global inflation pressures are easing but will remain historically elevated in the foreseeable future.

FIXED INCOME | We raised our bond exposure to 100% of benchmark duration and are neutral on the yield curve. We are overweight Treasurys, MBS, and CMBS and underweight high yield and TIPS. We are marketweight everything else.

GOLD | We are currently neutral but will be watching our Gold Watch Report for a bullish signal for a potential upgrade.

DOLLAR | We are bearish due to worsening momentum and model readings.

Economic Summary

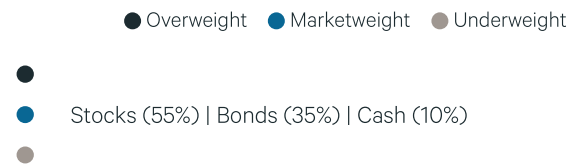
November 21, 2022

Near term activity: ● Accelerating ● Neutral ● Decelerating



Economic gauges reflect changes in near-term economic activity. Numbers in parenthesis refer to NDR 2022 forecasts.

Global Asset Allocation



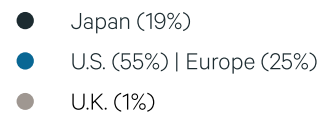
Benchmark: Stocks (55%), Bonds (35%), Cash (10%)

Equities — Regional Relative Allocation



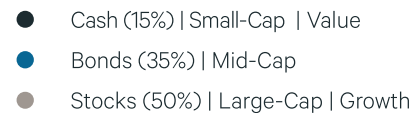
Benchmark – U.S. (61.5%), Europe ex. U.K. (12%), Emerging Markets (11.2%), Japan (5.5%), U.K. (3.8%), Pacific ex. Japan (3%), Canada (3.1%)

Global Bond Allocation



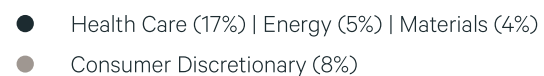
Benchmark: U.S. (57%), Europe (25%), Japan (15%), U.K. (4%)

U.S. Allocation



Benchmark: Stocks (55%), Bonds (35%), Cash (10%)

Sectors



Benchmark: Technology (27.4%), Health Care (13.8%), Financials (10.7%), Communication Services (9.3%), Consumer Discretionary (12.1%), Consumer Staples (7.0%), Industrials (7.9%), Energy (4.0%), Utilities (2.7%), Real Estate (2.7%), Materials (2.5%)

U.S. Bonds — 100% of Benchmark Duration

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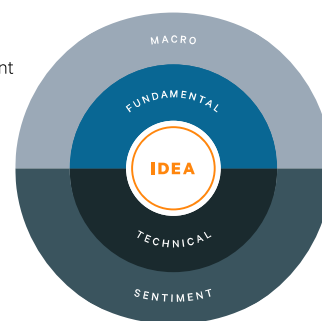
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