Marketing Material

MONTHLY HOUSE VIEW

March 2022

Focus

Emerging markets in a normalising world

Architects of Wealth

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THE PRICE OF INFLATION

VINCENT MANUEL

Chief Investment Officer, Indosuez Wealth Management

Dear Reader,

Inflation continues to surprise to the upside. This trend is perhaps not all that surprising given the spike in energy prices, and it is not hard to make the connection between inflation, rising oil and gas prices, and geopolitical tensions. This could once again drive the temporary inflation narrative, namely that it is caused by energy and will decline quickly.

Looking at the latest US inflation figures, we believe this is a risky misconception for several reasons. First, because these figures show that the rise in prices is distributed across the vast majority of components. Second, because one might expect a mechanism where wages react to inflation and vice versa. This would bring us closer to a sustained inflation scenario, or at least one that lasts longer than expected. With more moderate wage growth in Europe, we are still a long way off, but the old continent's low level of unemployment could lead to an acceleration in the coming quarters. So we need to be cautious about the dynamic nature of this process and monitor the chain reactions at play.

This inflationary phenomenon could have an impact on growth. The middle classes' actual purchasing power challenges the theory of the COVID-19 savings glut. Low-income households are bearing the brunt of higher fuel prices, which leads to higher wage demand and changes in consumer choices. This is what is currently missing from the relatively consensual and optimistic scenario for global growth, which assumes GDP is not to be affected at this stage by inflation and rate hikes.

This concern has likely been factored into the central bank equations and they might not move forward with all the rate hikes the market is currently expecting.

The Fed and the European Central Bank (ECB) diverge in many areas, due to both the differences in their economic environments and the specific nature of their missions. But what they seem to have in common is the desire to not trigger a recession or sharp downturn in the markets through massive normalisation, especially if growth were to show signs of weakness.

Monetary policy is, however, anything but neutral for the markets, yet a paradox remains. While there is some recognition that actions by the central banks helped financial asset prices recover strongly starting in the spring of 2020, it is less commonly agreed that monetary policy leads to an adjustment in the equity markets and corporate bond spreads, even if that is exactly what has happened since January.

Some signs of weakness due to inflationary pressure are also starting to emerge at company levels. Until now, they had continued to beat growth and profitability records, responding to higher costs with higher prices to shore up their margins.

Fourth-quarter results were a high point, but business leaders are cautious about the trend for 2022, while margins are falling for industrial stocks.

We therefore need to be humble and pragmatic as we start the year in the face of an ever-shifting reality, in which trends are not as well established, and a higher-risk regime.

March will be packed with challenges and should provide some answers regarding the strategy adopted *vis-à-vis* the central banks. If the economy holds, the Fed will start its announced rate hikes. Conversely, if the international environment, market volatility or economic trend worsen, then it will be time to check whether the Greenspan put[1] still exists.

1 - The idea is that the Fed becomes accommodative again when financial conditions worsen (an expression that was coined after the 1987 crash when Alan Greenspan came to the markets' rescue).

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EMERGING MARKETS IN A NORMALISING WORLD

As the US begins its tightening path, it will be key to segregate between emerging markets by looking at the reactiveness of their economic policy and the strength of their key fundamentals. Furthermore, it's not all about the Fed, oil prices, the residue of the pandemic and managing macro-imbalances will be determining factors for emerging markets in 2022.

3 MAIN CHANNELS
impacting emerging markets

The Fed's intentions to raise rates in March and also end its bond purchases that month may complicate the crisis-exit plans for certain emerging markets.

There are three main channels[2] through which an increase in US interest rates can impact emerging economies.

- **The financial channel:** Fed tightening has historically led to capital outflows from emerging markets as investors begin moving dollars to now more attractive yielding risk-free US treasuries. Back in 2013, the "taper-tantrum" struck emerging markets by drastically reducing capital inflows particularly in the then "fragile five" markets (South Africa, Brazil, India, Indonesia and Turkey) and again to a lesser extent when the Fed started to reduce its balance sheet in 2018.
- **The exchange-rate and monetary channel:** these outflows in turn weigh on emerging market currencies with flexible exchange rate regimes, particularly the case for vulnerable countries with structural current account deficits and/or low currency reserves. For countries with fixed exchange rate regimes (or pegged currencies), the impact is a lot more sudden and central banks in these countries will have to raise rates in tandem with the Fed, thus weighing on their economy.
- **The trade channel:** a spill over effect from a decrease in US domestic demand on the exports of the largest US trading partners.

THIS TIME IT'S DIFFERENT?

While times have changed since 2013 (the "fragile five" now have an average current account deficit of 1.3% of GDP compared to 4.4% of GDP in 2013), the world economy is only just recovering from an unprecedented shock that has heavily deteriorated balance sheets making it particularly important to segregate between emerging markets. Thus far, their currencies have not been significantly impacted by the Fed's hawkishness and some have even been buoyed by higher commodity prices (South Africa). Several emerging central banks have also started to hike rates before the Fed, and therefore US normalisation should not reduce the carry differential. Furthermore, although numerous in quantity, the expected US rate hikes may not lead to an interest rate differential that is attractive enough for portfolio managers to turn away from emerging markets. Finally, on the trade front, US import demand will also be impacted by the expected demand shift of US consumers from goods (especially imported goods) back to the consumption of services (mostly local as tourism will take time to reopen).

In this changing context, we identify four emerging market groups with different degrees of risk attached in the current US monetary tightening environment (Table 1, page 5).

The "lucky ones" which we divide into two subgroups. First the Middle-eastern countries with US dollar pegs, these countries will experience monetary tightening, but at a convenient time where gas and oil prices are surging and therefore should absorb the increasing financing costs and improve fiscal balances. The second subgroup gathers the ASEAN countries (Thailand, Indonesia, Malaysia and the Philippines) where the impact of US monetary tightening is limited to the constrained US dollar appreciation as their macro-fundamentals remain relatively sound.

2 - M. Iacoviello and G. Navarro (May 2018), *Foreign Effects of Higher US Interest Rates.*

The "early movers" that were constrained to be hawkish. These countries have launched the normalisation process in advance to fight inflation and stabilise their currencies, at the possible expense of short term GDP growth. These include South Africa, Brazil and Russia all of which moved early and aggressively signalling their determination to manage inflation expectations. Mexico, Hungary, Chile and Poland, adjusted their monetary policy later, but have since accelerated their hikes in order to chase inflation.

Those at risk of a US trade downturn. Here we ring fence emerging markets with a strong dependence on US imports representing over 15% of total trade, the impact will be mostly felt in Latam countries (notably Mexico). China could also feel the impact of an import contraction from the US this year, but we would argue that it is in a world of its own - no longer treated like an emerging economy by financial markets – and focused on easing its policy to offset the recessive impact of its real estate deleveraging.

Those with significant macro-imbalances. In a context of rising oil prices, countries with strong oil imports as a percentage of total imports are at risk of currency sanctions in 2022 due to a swelling in their current account balance. This is the case for India, who despite having strong currency reserves and a limited current account deficit thus far, runs a real risk of deterioration in its trade balance (oil accounts for 30% of total merchandise imports) and inflation in the case of a prolonged oil price surge. Finally, at a significantly riskier level, the twin deficit situation[3] and low vaccination levels in Egypt and the hyperinflationary issues in Turkey push investors to be cautious on these markets, where existing vulnerabilities can be accentuated especially in times of US policy normalisation.

TABLE 1: EMERGING MARKET VULNERABILITY HEAT MAP, %

	EMERGING MARKETS	GENERAL GOVERNMENT BALANCE, 2022, % GDP	GENERAL GOVERNMENT DEBT, 2022, % GDP	CURRENT ACCOUNT, 2022, % GDP	INFLATION, 2022, %	% OF US IMPORTS IN TOTAL EXPORTS	% OF OIL IMPORTS IN TOTAL MERCHANDISE IMPORTS, 2020
THE LUCKY ONES	Indonesia	-5%	43%	-1.0%	3.4%	11%	11%
	Kuwait	1%	11%	13.3%	3.0%	0%	0%
	Malaysia	-4%	70%	3.7%	2.0%	11%	12%
	Philippines	-6%	62%	-1.8%	2.9%	15%	9%
	Qatar	6%	53%	11.6%	0.1%	2%	1%
	Saudi Arabia	-2%	31%	3.8%	2.2%	1%	3%
	Thailand	-3%	60%	2.1%	0.8%	15%	14%
	UAE	0%	39%	9.4%	2.2%	2%	17%
THE EARLY MOVERS	Brazil	-7%	90%	-1.7%	4.0%	10%	10%
	Hungary	-6%	76%	0.9%	3.6%	3%	6%
	Poland	-2%	53%	1.6%	2.6%	3%	5%
	Russia	0%	18%	4.4%	4.3%	3%	1%
	South Africa	-7%	72%	-0.9%	4.5%	8%	14%
	Chile	-2%	37%	-2.2%	3.4%	14%	13%
SIGNIFICANT MACRO-IMBALANCES	Egypt	-6%	89%	-3.7%	7.0%	5%	12%
	India	-10%	89%	-1.4%	4.9%	18%	28%
	Turkey	-6%	38%	-1.6%	14.5%	6%	5%
HIGH US TRADE EXPOSURE	Colombia	-6%	68%	-4.0%	3.1%	30%	5%
	Mexico	-4%	60%	-0.3%	3.1%	79%	6%
	Peru	-4%	37%	0.1%	2.6%	16%	9%

Note: Countries included in the MSCI emerging markets excluding China and South Korea.
Source: IMF World Economic Outlook, ITC Trade Map, World Bank, Indosuez Wealth Management.

3 - Twin deficit: government budget deficit simultaneous with a current account deficit.

INFLATION: A CAUSAL DILEMMA

As prices rise sharply in the US and the Euro Area, economists appear to be propping up their inflation forecasts while growth projections remain rather stable. Indeed the rise in prices is in part explained by the recovery in demand, but it is also due to exogenous effects (temporary supply-chain effects and commodity prices) and therefore could dampen consumption going ahead after a strong surge in goods demand in the US in the beginning of the year.

US average hourly earnings up

5.7% YOY

INFLATION ON BOTH CONTINENTS

January inflation figures surpassed consensus expectations in both the US (7.5% year-on-year vs. 7.3%) and the Euro Area (5.1% year-on-year vs. 4.4%). The rise in prices was however much less widespread in the Euro Area, limited to the increase in food and energy prices, whereas in the US inflation also hit core goods and service sectors. The beginning of a wage-price spiral is also starting to emerge in the US (average hourly earnings grew 5.7% year-on-year in January), while the increase in unit labour costs remain modest in the Euro Area (2.5% in Q3 2021).

Looking ahead, we see the increase in oil prices and supply shortages continuing to have an impact in the first quarter of 2022.

Thereafter, inflation should moderate, but remain at high levels in the US mainly due to ongoing pressure from: strong commodity prices, shelter prices, wages in a tight labour market (US unemployment rate at 4%) and capacity utilisation which is back to February 2020 levels.

In the Euro Area, spare capacity is also being reabsorbed, but with limited pressures from the labour market (unemployment rate at 7% in the Euro Area and ranging from 13% in Spain to 3% in Germany) implying that the rise in prices is expected to be temporary and inflation should return to the ECB target in 2023. Furthermore, housing prices are rising sharply in the Euro Area 8% year-on-year in Q4 2021, but, in contrast to the US, the latter is not integrated in the consumer price index.

WHAT IMPLICATIONS FOR CONSUMPTION AND GDP GROWTH?

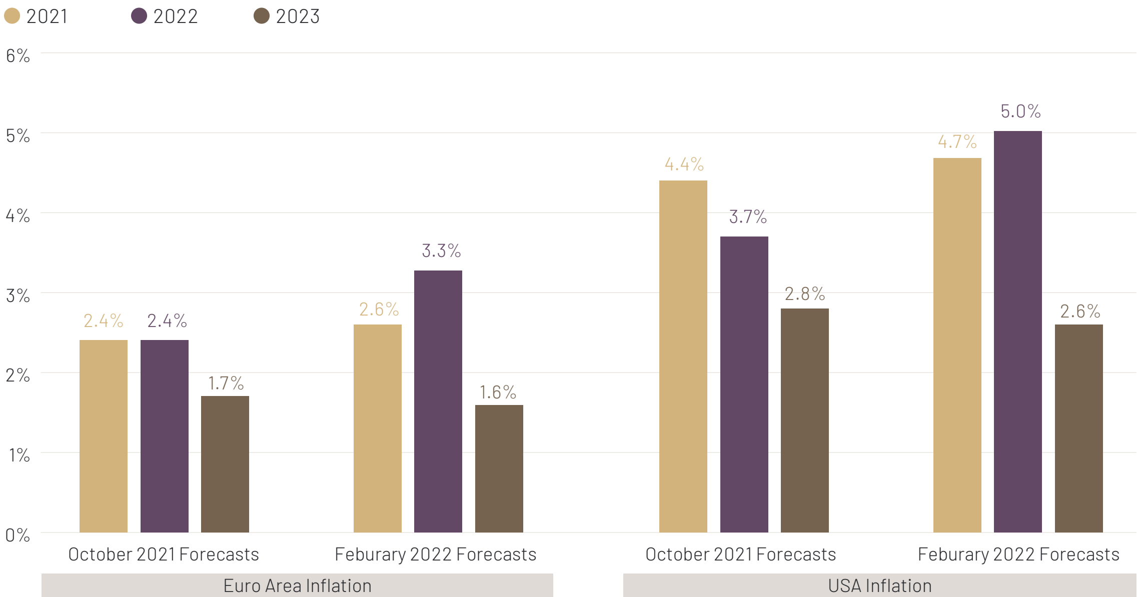
Inflation has weighed on consumer sentiment; down sharply in the US in February 2022 and in the Euro Area in January. In the US, we expect workers to demand wage increases to regain purchasing power, especially with such a tight labour market. Nevertheless, the change in real wages (taking into account the impact of inflation) in the US will remain negative in 2022.

The expected rate hikes in the US should also weigh on credit-driven consumption, even if the accumulated savings and wealth effect from house prices and stock markets could cushion the impact on high-income individuals. The fiscal impulse is expected to be less supportive in 2022 in the US, while in Europe it remains strong (at 1% of GDP according to the European Commission). EU consumers will also benefit from a still comparatively high savings buffer (15% of income vs. 7.5% in the US) and lower inflation in 2022 (Chart 1).

All in all, consumption is expected to rebalance between goods and services in 2022, with the beginning of the year still widely focused on goods (US retail sales up 3.8% over the month after -2.5% in December). We expect US consumption to moderate after Q1 2022 and return to pre-crisis levels in the Euro Area in the second quarter. Risks to our scenario are balanced with an upside risk in the US in the case of additional fiscal stimulation and downside risks from geopolitical/energy and pandemic factors that cannot be entirely ruled out at this stage.

In this macroeconomic context, with diverging inflation pressures in the US and the Euro Area, central bank agendas will also differ with the ECB having a plethora of reasons to take its time compared to the Fed, including the need to continue supporting excruciatingly high public sector debt-to-GDP ratios (125% in Portugal, 150% in Italy and 175% in Greece).

CHART 1: UPDATED INFLATION FORECASTS, %



Source: Amundi, Indosuez Wealth Management.

A HISTORIC START TO THE YEAR

The global fixed income markets are feeling the effects of the change in the major central banks' tones. In response to publications showing persistently high inflation, they are fast-forwarding the end of the ultra-accommodative monetary policies they implemented in 2020. In doing so, they are giving short shrift to bond investors whose portfolios have had their worst performances since the beginning of the 2000s.

The current uncertainty creates INVESTMENT OPPORTUNITIES

CENTRAL BANKS

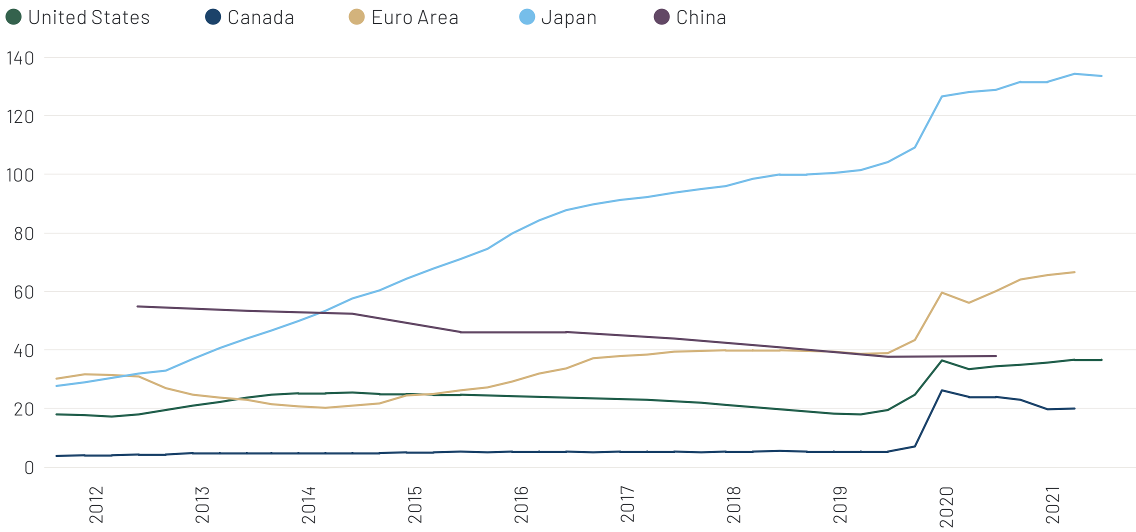
Is the nearly 14-year period of central banks artificially supporting bond markets coming to an end? Starting in September, the Bank of England (BoE), the Fed, and most recently the ECB, announced an end to the ultra-accommodative policies they had implemented at the height of the financial and economic turmoil of 2020 (Chart 2). With inflation figures persistently higher than the monetary institutions' medium-term targets, a monetary response was needed.

Yields are rising in all geographic regions, driven by short yields which have failed to anticipate the pace of the rate hikes and are correcting sharply. Long term yields are rising to a lesser extent, causing curves to flatten significantly.

We have to go back to 2009 to see US government bonds perform this poorly. In the Euro Area, the ECB's gradual withdrawal could cause risk premiums to widen between peripheral countries and Germany, making it more expensive to finance their government deficits.

This flattening reflects both a very hawkish interpretation of the central banks' messages (the markets are now factoring in 6 to 7 rate hikes in the United States, far more than the Fed's dot plots) and the belief that monetary tightening might be relatively short-lived before the end of the cycle. Implicitly, markets are *de facto* integrating into long term yields the risk that widespread and excessive monetary tightening could pose to growth. They might also convey the risk that inflation will have a negative impact on consumption in the medium term.

CHART 2: CENTRAL BANK ASSET-TO-GDP RATIO, % A PAGE IS TURNING?



Source: Bloomberg, Indosuez Wealth Management.

CREDIT

On credit markets, investors are stepping up the pace of their capital outflows, particularly in the Euro Area. The negative performances since the beginning of the year, which are for the most part the result of negative performances in 2021, have not reassured investors. We believe, however, that this is an opportunity to start to build positions on the credit markets. Rising rates are giving the bond asset class new appeal. Spread widening is not justified on a fundamental level: high-quality results have been reported, companies have rebuilt their cash holdings and debt ratios are in line with long term averages (debt/EBITA[4] ratio of approximately 2.7x for the universe of BBB-rated corporates). Lastly, many companies, mainly in the high yield segment, actively managed their debt profiles in 2021: they exercised calls or bought back short-to medium-dated securities, financed by long-dated issues with low coupons. This helps them reduce interest expenses and avoid a "debt wall" in 2022 or 2023. With financial and corporate subordinated debt, we prefer to remain cautious on calls in the medium to long term; however, the current volatility in the markets creates many short term opportunities. A volatility normalisation, notably on the equity markets, will enable the riskiest bond segments to deliver significant performance for the rest of the year, particularly since the possible reversal of the rise in the US 2-year yield would be positive for short-dated corporate bonds.

EMERGING MARKETS

Emerging credit markets weathered the beginning of the year better than their developed country counterparts. The economies of these countries, which are often tied to commodities, began to feel the effects of the central banks' monetary tightening starting in 2021.

The collapse of Chinese real estate actors did not spread to other emerging markets or to other sectors in China. While uncertainty remains, the rates attached to investments in emerging market high yield are protecting investors.

In China specifically, the authorities continue to support the streamlining of the real estate developer market. Asset management companies are now authorised to buy assets directly. Issuers are negotiating with investors to reschedule their debt and thus avoid default.

In conclusion, the corporate bond environment is expected to remain volatile in this monetary transition phase, but also it should present opportunities for investors as long as fundamentals hold up.

4 - Earnings before interest, taxes, depreciation and amortisation.

THE FED TAKES MARKETS BY SURPRISE

The Fed's hawkish tone combined with rising geopolitical risks and a weakening macro momentum have been the drivers for the January market correction, without leading to a widespread revision in earnings. These developments do not call into question our constructive stance on equities for 2022.

%

US EPS just over the 5-year average of

77%

Historically, a rising Fed fund rate cycle is not necessarily negative for equity markets if appropriately sized and accompanied by a positive earnings trend. Beyond the direction of long term rates, which fuels sector rotation, investors will continue to focus on margins and pricing power, as 75% of S&P companies are citing "inflation" during the Q4 earnings calls vs. 30% in 2018-2019.

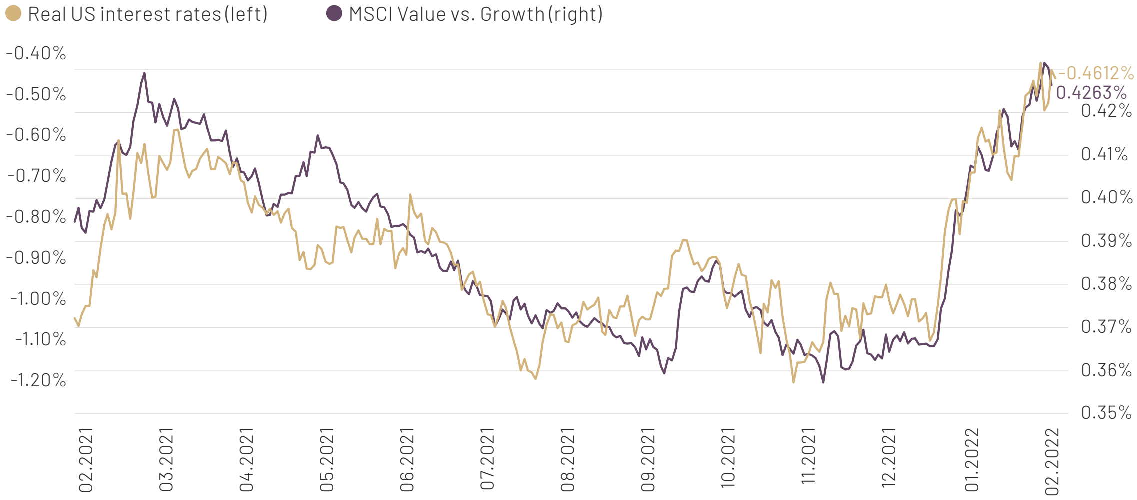
UNITED STATES

US markets have been dominated by two factors: the outlook of US monetary policy and the earnings season. In this context of more permanent inflation and rising rate hike expectations, Value stocks are outperforming (Chart 3) because they benefit more from a recovery in inflation and a rise of the yield curve, as is the case for the energy and banking sectors. This is to the detriment of Growth sectors and, in particular technology companies. Indeed, higher interest rates affect the valuation of the most expensive companies, but also those offering the best visibility on their future earnings.

The Q4 2021 earnings season is strong, even if it has not reached the record levels observed in the two previous quarters. Companies having reported actual earnings per share (EPS) above estimates is just over the 5-year average of 76%. However, the market is more focused on the earnings outlook and punished companies with guidance below consensus expectations.

Looking at 2022, we identify a rising proportion of negative guidance and a weakening revision momentum on Q1 2022 earnings, notably on industrials. The revision trend by sector supports our preference for Value and technology and our underweight on defensive sectors (real estate, staples, utilities and healthcare). The main risk factor to monitor remains the effect of inflation on profit margins, which have probably peaked in mid-2021, notably within industrials and consumer sectors.

CHART 3: REAL INTEREST RATE AND VALUE RELATIVE TO GROWTH, %



Note: The Value vs. Growth factor is now strongly correlated with real interest rates, benefiting in January from the strengthening of the 10Y yield and real yield.

Source: Bloomberg, Indosuez Wealth Management.

EUROPE

We continue to favour the European equity market as it combines attractive valuation, good EPS growth and resilient revisions trends. Since the pandemic, the valuation gap with the US market has increased, and the stronger exposure of European markets to Value is a source of interest. It is geared to benefit from the rise in nominal and real interest rates. In addition, despite its very good recent relative performance, Value style's discount to the market average is higher than long term averages.

The ongoing Q4 earnings season has so far been reassuring on that front, despite well-known headwinds (input costs and wage inflation, supply chain disruptions,...). In this context, pricing power will likely stay a key investment theme for the months to come.

EMERGING MARKETS

We are turning incrementally more positive on Chinese equities. We believe Chinese equities are well positioned for a substantial rebound later in the year, on the back of macroeconomic support and attractive valuations, and conditional to earnings momentum becoming positive.

Chinese authorities have actually started to ease their monetary policy in the way of cuts in the Bank Reserve Requirement Ratio. The use of Western vaccines could potentially ease the zero-COVID policy later this year.

We also believe that Chinese equities look attractive for 2022 (and A-shares in particular) based on their EPS growth/valuations (highest expected EPS growth for North Asia over the next 12 months) while exhibiting discounts from their historical average P/E ratios.

Lastly, earnings growth is expected at 14% this year, with continued negative revisions in the past quarters, but which could start to stabilise, a catalyst to watch to increase exposure to China.

JAPAN

We are now more cautious on Japanese equities. We expect less positive catalysts for the near term. The Japanese market is more Cyclical than Value compared to other developed countries and positive momentum on EPS surprise is slowing.

Moreover, some political risks remain with the July Upper house election coming. Finally, the spread of Omicron and the low booster vaccination path is going to slow the reopening dynamic of the country.

STYLE : WILL GROWTH AND QUALITY DECOUPLE?

In a context of rising bond yields, valuation of Growth companies, considered as long duration stocks, are under pressure. The market is going to be more and more differentiating between defensive, strong balance sheets and cash generative growth on the one hand, and unprofitable very long duration growth on the other.

In that sense, the correlation between (high and non-profitable) Growth and Quality may be starting to diminish and Quality could finally benefit more from its intrinsic advantages (visibility, resilience, stability, pricing power and low volatility).

The defensive aspect of high Quality and the positive relationship with a rising VIX could favour them against high Growth stocks.

We consider the high and stable margin, strong pricing power, strong balance sheets and stable growth as representative themes of these Quality companies.

CENTRAL BANK VOLATILITY

G10 currencies have been on a roller coaster ride in February, between the ECB's hawkish pivot and rising tensions on the Ukrainian front, convictions have been tested. Regarding central banks' policy tightening, the Forex market seems to have refined its expectations and any dramatic change is very unlikely before the next meetings in March.

€

ECB MEETING reshuffled the cards for EUR

EUR

Even if the horizon is clearing, there are still too many obstacles to be bullish euro.

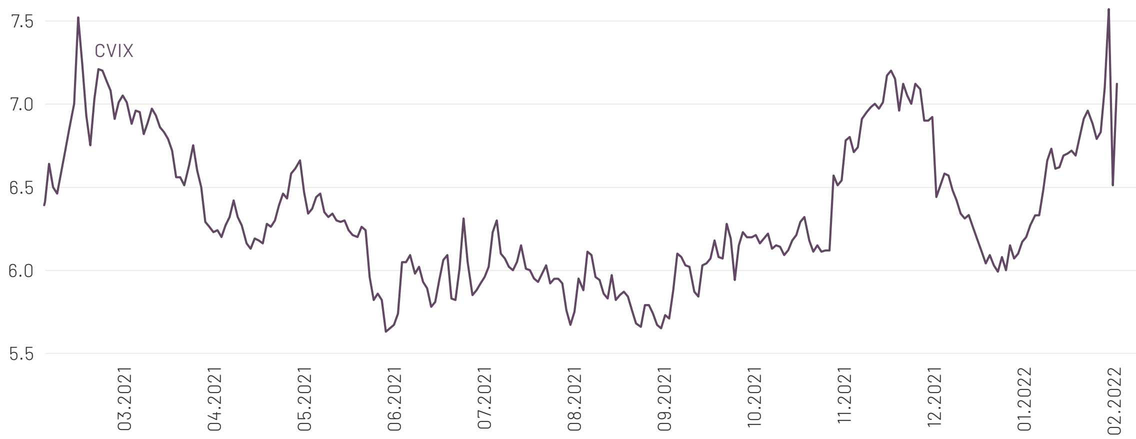
The ECB's January meeting reshuffled the cards for the euro and in particular EUR/USD. Whilst the ECB is not on as strong a tightening path as the Fed, the gap between the two is no longer growing. However, one should not get carried away, as the ECB admitted that persistent inflation has opened the possibility of policy tightening, but did not assure it. Market reaction pushed EUR/USD close to 1.1450, with some expecting as much as 50 bps of tightening. The possibility of interest rates back above negative could significantly reduce the use of the euro as a funding currency, thus supporting it. Whilst the ECB pivot could mean a long term appreciation for the euro, but in the short term a few threats hold it back – the Russia-Ukraine tensions pushed EUR/USD down to 1.1290, as Europe's energy dependency and trade exposure could weaken the Euro Area in the event of sanctions. The French elections also bring uncertainty, as well as the magnitude of the first Fed rate hike. For all these reasons, we remain neutral on the EUR/USD at least until the ECB meeting in March.

USD

The next Fed meeting in March could be decisive for the dollar's fate.

US inflation hit new record levels which, coupled with super employment data, pushed the market to price 6 to 7 rate hikes in 2022 from the Fed. In the short term, many factors are supporting the dollar: the outperformance of the US economy, Fed rate hike expectations and geopolitical tensions that giving the dollar a safe-haven bid. In the medium term, things could get trickier - a lot of positives are priced into the dollar, following the first rate hike one could expect some classic profit taking related to the old adage "buy the rumour sell the fact". There is also the possibility of the Fed embarking on a more gradual normalisation than that which is currently expected. Coupled with the likelihood that the ECB and other central banks will eventually enter into a monetary policy tightening dynamic, this could negatively affect the USD (Chart 4).

CHART 4: FOREX VOLATILITY IS CLIMBING AS CENTRAL BANKS BECOME MORE UNPREDICTABLE, POINTS



Note: CVIX (composite of Forex volatility produced by Deutsche Bank).
Source: Deutsche Bank, Bloomberg, Indosuez Wealth Management.

GBP

Sterling is hostage to the BoE's struggle between economic growth and inflation control.

The stage is set for a third rate hike at the BoE's next meeting in March: January's employment data is excellent and UK inflation has hit record levels again, raising the threat of stagflation. Although, the prospect of another rate hike is supporting the pound, January's economic data, while slightly better than expected, did not move the sterling much as markets had already been generous in pricing in future rate hikes. The BoE would welcome further appreciation of the pound, as it could help contain imported inflation, but the currency is exposed to a number of downside risks. First, the BoE itself: the UK economic recovery could quickly falter in the face of a number of concerns: soaring energy prices, labour market shortages and continued uncertainty over Brexit. A slowing recovery could hinder the BoE's policy normalisation, which in turn could keep real interest rates and yields negative and weigh on the GBP. Second, it is highly vulnerable to spikes in risk, as long as COVID-19 and Ukraine-Russia tensions are around the pound will be at risk.

GOLD

Geopolitical tensions boost gold's allure.

The yellow metal has been buttressed by two evolving tensions in force simultaneously. The heightened geopolitical uncertainty brewing on the Ukrainian front has buoyed gold's traditional safe-haven demand by investors globally. The knock-on effect of spiking energy prices has further exacerbated runaway CPI levels across most economies. Despite now well telegrammed FOMC rate hikes ahead, US "real" rates however remain persistently negative across the curve which helps gold shine. Gold now poised well above its 200 day moving average is yet again testing key resistance levels of USD 1'877 initially and then potentially USD 1'920 per ounce. As a military conflict can unfortunately not be excluded, gold could swiftly see these higher levels and spike beyond as per the spring 2014 annexation of Crimea. Similarly, if *détente* can be achieved and Ukraine tensions sustainably diffused, gold could give back its recent USD 100 per ounce rally quite promptly.

INVESTMENT SCENARIO AND ALLOCATION

2022 is a transition from a strong recovery with record supportive economic policy, to an economic growth progressively converging towards potential with a normalisation of both monetary and fiscal policies. The convictions of the past years – that were still in vogue in recent months - are being challenged (transitory inflation, low interest rates for long, technology leadership). This implies that investors will need to adapt to a new volatility regime and to rethink allocation, risk-taking and investment themes.

Normalisation of
GROWTH
& economic policy, with a higher volatility regime

- **GDP growth** will be above potential, but progressively decelerating, with a rising risk on consumption.
- **US inflation** dynamics will last for longer and be more broad-based, leading to upward pressures on wages in the US, while Euro Area inflation, mainly driven by energy prices until now, is expected to come back towards 2% in 2023.
- **Volatility** of macro data will remain elevated.
- **Central banks** are determined to normalise their policy, but not to the extent expected by markets. The Fed will probably proceed to four rate hikes this year instead of 6 to 7 currently anticipated by markets. In the Euro Area, we do not expect the ECB to increase rates before Q4 2022 or Q1 2023. Scaling down rate hike expectations could lead to an inversion of the flattening movement of yield curves recorded so far; this could potentially in a second step be reinforced by rising long term yields if markets fear that central banks remain behind the curve, or if markets underestimate the effect of the Fed's balance sheet reduction, which remains largely uncertain so far in terms of technicalities and timing.
- **Corporate fundamentals** are strong, with solid results published by Q4 2021. However, profit margins are peaking and the earnings momentum and corporate guidance seems to weaken in the US. This reflects rising margin pressures on several sectors such as industrials and consumer stocks, while reflation plays (banks, energy) and technology benefit from positive revisions.
- **Corporate defaults** should remain low, but the build-up of corporate leverage has created vulnerability on credit spreads in a context of policy normalisation.

- **Equities:** slight overweight on equities, with a preference for Europe over the US and for Value stocks over Growth stocks as repricing could continue if long term yields continue to increase. Rotation within Value from Cyclicals towards reflation sectors is expected to continue. A cautious view on so-called "Defensive" sectors, which are vulnerable to rising bond yields, and on sectors weakened by pressures on margins such as industrials. In a context of normalisation of valuations, preference for companies generating strong returns to shareholders. Constructive long term view maintained on profitable US tech leaders as well as on Chinese equities, which could be both reinforced when their earnings momentum stabilises.
- **Government bonds:** moderate duration maintained on government bonds, while the underweight can be progressively reduced as bond yields normalise, notably as a hedge against a weaker macro trend or rising geopolitical tensions.
- **Corporate bonds:** greater value than in year-end 2021 after the recent spread widening, notably on the short dated bonds, but a repricing trend that reflect more volatility and sensitivity of leveraged names to higher rates ; this trend could continue in the coming weeks or months towards more mid-range levels recorded in previous cycles.
- **Emerging assets:** probably a good contributor of performance and source of diversification in 2022, notably in countries offering a mix of growth, controlled inflation, solid external fundamentals and sustainable economic policies. Asian countries score well on that perspective and could benefit from a greater reopening. Investors could wait for the first Fed rate hike before increasing their allocation.
- **Exchange rates:** US dollar still benefiting from the Fed normalisation expectations, but the scale-down of rate hike expectations could signal the reversal of the greenback against the euro and emerging currencies. Commodity-driven currencies still favoured by markets in this reflationary context.
- **Liquidity:** increased cash buffers in portfolios to seize opportunities offered by rising volatility.

KEY CONVICTIONS

	TACTICAL VIEW (ST)	STRATEGIC VIEW (LT)
FIXED INCOME		
GOVERNMENTS		
Core EUR 10Y (Bund)	=	=
EUR Periphery	=	=/-
US 2Y	=/+	=
US 10Y	=	=
EUR Breakevens Inflation	=	=
US Breakevens Inflation	=	=/-
CREDITS		
Investment grade EUR	=	=
High yield EUR/BB- and >	=/-	=/+
High yield EUR/B+ and <	=	=
Financials Bonds EUR	=/-	=/+
Investment grade USD	=	=
High yield USD/BB- and >	=/-	=/+
High yield USD/B+ and <	=	=
EMERGING DEBT		
Sovereign Debt Hard Currency	=	=/+
Sovereign Debt Local Currency	=/-	=
Latam Credit USD	=/-	=/-
Asia Credit USD	=/+	=/+
Chinese Bonds CNY	=	+
EQUITIES		
GEOGRAPHIES		
Europe	+	=
United States	=	=/+
Japan	=	-/=
Latin America	-/=	=
Asia ex-Japan	-/=	=
China	=/+	+
STYLES		
Growth	=	+
Value	+	=
Quality	=/+	=
Cyclical	-/=	=
Defensive	-/=	-/=
FOREX		
United States (USD)	=	=/-
Euro Area (EUR)	=	=/+
United Kingdom (GBP)	=/-	=
Switzerland (CHF)	=/-	=
Japan (JPY)	=	=
Brazil (BRL)	=/+	=
China (CNY)	=/-	+
Gold (XAU)	=	=

Source: Indosuez Wealth Management.

08 • Market Monitor (local currencies)

OVERVIEW OF SELECTED MARKETS

DATA AS OF 17 FEBRUARY 2022

GOVERNMENT BONDS	YIELD	4 WEEKS CHANGE (BPS)	YTD CHANGE (BPS)
US Treasury 10Y	1.96%	15.75	45.14
France 10Y	0.70%	33.90	50.70
Germany 10Y	0.23%	25.60	41.10
Spain 10Y	1.21%	55.30	65.10
Switzerland 10Y	0.27%	22.70	40.40
Japan 10Y	0.22%	7.70	15.50

BONDS	LAST	4 WEEKS CHANGE	YTD CHANGE
Governments Bonds Emerging Markets	40.09	1.67%	2.22%
Euro Governments Bonds	213.84	-1.68%	-2.16%
Corporate EUR high yield	207.55	-2.64%	-2.85%
Corporate USD high yield	317.99	-3.04%	-4.34%
US Government Bonds	313.36	-0.90%	-2.16%
Corporate Emerging Markets	49.09	-1.90%	-3.75%

CURRENCIES	LAST SPOT	4 WEEKS CHANGE	YTD CHANGE
EUR/CHF	1.0456	0.78%	0.78%
GBP/USD	1.3616	0.12%	0.62%
USD/CHF	0.9204	0.38%	0.82%
EUR/USD	1.1361	0.43%	-0.08%
USD/JPY	114.94	0.73%	-0.12%

VOLATILITY INDEX	LAST	4 WEEKS CHANGE (POINTS)	YTD CHANGE (POINTS)
VIX	28.11	2.52	10.89

EQUITY INDICES	LAST PRICE	4 WEEKS CHANGE	YTD CHANGE
S&P 500 (United States)	4'380.26	-2.29%	-8.10%
FTSE 100 (United Kingdom)	7'537.37	-0.63%	2.07%
Stoxx Europe 600	464.55	-3.89%	-4.77%
Topix	1'931.24	-0.38%	-3.07%
MSCI World	3'009.09	-2.37%	-6.89%
Shanghai SE Composite	4'629.17	-4.03%	-6.30%
MSCI Emerging Markets	1'242.92	-1.02%	0.89%
MSCI Latam (Latin America)	2'378.06	5.73%	11.65%
MSCI EMEA (Europe, Middle East, Africa)	290.66	1.83%	5.43%
MSCI Asia Ex Japan	787.79	-1.80%	-0.19%
CAC 40 (France)	6'946.82	-3.44%	-2.88%
DAX (Germany)	15'267.63	-4.05%	-3.89%
MIB (Italy)	26'669.27	-3.27%	-2.48%
IBEX (Spain)	8'671.10	-1.63%	-0.49%
SMI (Switzerland)	12'075.27	-3.86%	-6.22%

COMMODITIES	LAST PRICE	4 WEEKS CHANGE	YTD CHANGE
Steel Rebar (CNY/Tonne)	4'784.00	1.18%	5.19%
Gold (USD/Oz)	1'898.43	3.22%	3.78%
Crude Oil WTI (USD/Bbl)	91.76	5.59%	22.01%
Silver (USD/Oz)	23.88	-3.40%	2.24%
Copper (USD/Tonne)	9'929.00	-0.61%	2.14%
Natural Gas (USD/MMBtu)	4.49	17.99%	20.27%

Source: Bloomberg, Indosuez Wealth Management.
Past performance does not guarantee future performance.

MONTHLY INVESTMENT RETURNS, PRICE INDEX

FTSE 100 · Topix · MSCI World · MSCI EMEA · MSCI Emerging Markets
Stoxx Europe 600 · S&P 500 · Shanghai SE Composite · MSCI Latam · MSCI Asia Ex Japan

	NOVEMBER 2021	DECEMBER 2021	JANUARY 2022	4 WEEKS CHANGE	YTD (17.02.2022)
BEST PERFORMING (+)	-0.83%	-0.83%	7.29%	5.73%	11.65%
	-1.56%	-1.56%	2.43%	1.83%	5.43%
	-2.30%	-2.30%	1.08%	-0.38%	2.07%
	-2.46%	-2.46%	-1.93%	-0.63%	0.89%
	-2.64%	-2.64%	-3.12%	-1.02%	-0.19%
	-3.40%	-3.40%	-3.88%	-1.80%	-3.07%
	-3.64%	-3.64%	-4.84%	-2.29%	-4.77%
	-3.92%	-3.92%	-5.26%	-2.37%	-6.30%
	-4.14%	-4.14%	-5.34%	-3.89%	-6.89%
WORST PERFORMING (−)	-7.05%	-7.05%	-7.62%	-4.03%	-8.10%

Source: Bloomberg, Indosuez Wealth Management.
Past performance does not guarantee future performance.

Basis point (bp): 1 basis point = 0.01%.

Blockchain: A technology for storing and transmitting information. It takes the form of a database which has the particularity of being shared simultaneously with all its users and generally does not depend on any central body.

BLS: Bureau of Labor Statistics.

BNEF: Bloomberg New Energy Finance.

Brent: A type of sweet crude oil, often used as a benchmark for the price of crude oil in Europe.

CPI (Consumer Price Index): The CPI estimates the general price level faced by a typical household based on an average consumption basket of goods and services. The CPI tends to be the most commonly used measure of price inflation.

Deflation: Deflation is the opposite of inflation. Contrary to inflation, it is characterised by a sustained decrease in general price levels over an extended period.

Duration: Reflects the sensitivity of a bond or bond fund to changes in interest rates. This value is expressed in years. The longer the duration of a bond, the more sensitive its price is to interest rate changes.

EBIT (Earnings Before Interest and Taxes): Refers to earnings generated before any financial interest and taxes are taken into account. It takes earnings and subtracts operating expenses and thus also corresponds to non-operating expenses.

EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortisation): EBITDA takes net income and adds interest, taxes, depreciation and amortisation expenses back to it. It is used to measure a company's operating profitability before non-operating expenses and non-cash charges.

ECB: The European Central Bank, which governs the euro and Euro Area member countries' monetary policy.

Economic Surprises Index: Measures the degree of variation in macro-economic data published versus forecasters' expectations.

Economies of scale: Decrease in a product's unit cost that a company obtains by increasing the quantity of its production.

EPS: Earnings per share.

ESG: Non-financial corporate rating system based on environmental, social and governance criteria. It is used to evaluate the sustainability and ethical impact of an investment in a company.

Fed: The US Federal Reserve, i.e. the central bank of the United States.

FOMC (Federal Open Market Committee): The US Federal Reserve's monetary policy body.

GDP (Gross Domestic Product): GDP measures a country's yearly production of goods and services by operators residing within the national territory.

Gig economy: system characterised by flexible, temporary or freelance jobs.

IEA: International Energy Agency.

IMF: The International Monetary Fund.

Inflation breakeven: Level of inflation where nominal bonds have the same return as inflation-linked bonds (of the same maturity and grade). In other words, it is the level of inflation at which it makes no difference if an investor owns a nominal bond or an inflation-linked bond. It therefore represents inflation expectations in a geographic region for a specific maturity.

Inflation swap rate 5-year, 5-year: A market measure of what five-year inflation expectations will be in five years' time. It provides a window into how inflation expectations may change in the future.

IPPC: The Intergovernmental Panel on Climate Change.

IRENA: International Renewable Energy Agency.

ISM: Institute for Supply Management.

Japanification of the economy: Refers to the stagnation the Japanese economy has faced in the last three decades, and is generally used to refer to economists' fears that other developed countries will follow suit.

Metaverse: A metaverse (portmanteau of meta and universe) is a fictional virtual world. The term is regularly used to describe a future version of the internet where virtual, persistent and shared spaces are accessible via 3D interaction.

OECD: Organisation for Economic Co-operation and Development.

Oligopoly: An oligopoly occurs when there is a small number of producers (supply) with a certain amount of market power and a large number of customers (demand) on a market.

OPEC: Organization of the Petroleum Exporting Countries; 14 members.

OPEC+: OPEC plus 10 additional countries, notably Russia, Mexico, and Kazakhstan.

PMI: Purchasing Managers' Index.

Policy-mix: The economic strategy adopted by a state depending on the economic environment and its objectives, mainly consisting of a combination of monetary and fiscal policy.

Pricing power: Refers to the ability of a company or brand to increase its prices without affecting demand for its products.

Quantitative easing (QE): A monetary policy tool by which the central bank acquires assets such as bonds, in order to inject liquidity into the economy.

SEC (Securities and Exchange Commission): The SEC is an independent federal agency with responsibility for the orderly functioning of US securities markets.

Spread (or credit spread): A spread is the difference between two assets, typically between interest rates, such as those of corporate bonds over a government bond.

Secular stagnation: Refers to an extended period of little or no economic growth.

SRI: Sustainable and Responsible Investments.

Uberisation: Term derived from the name of US company Uber which develops and operates digital platforms that connect drivers and riders. It refers to a new business model that leverages new digital technologies and is part of the sharing economy, insofar as it puts customers in direct contact with service providers, at a reduced cost and with lower prices.

VIX: The index of implied volatility in the S&P 500 Index. It measures market operators' expectations of 30-day volatility, based on index options.

WTI (West Texas Intermediate): Along with Brent crude, the WTI is a benchmark for crude oil prices. WTI crude is produced in America and is a blend of several sweet crude oils.

WTO: World Trade Organization.

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