INDOSUEZ WEALTH MANAGEMENT

Marketing Material

MONTHLY HOUSE VIEW

September 2022

The rebound that wasn't

Architects of Wealth

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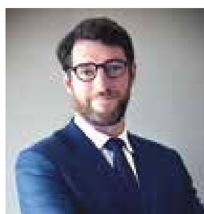
THE REBOUND THAT WASN'T



VINCENT
MANUEL
Chief Investment Officer

Dear Reader,

In the end, it was a calm summer on the markets with a fairly symmetrical rebound to the downside in long yields and to the upside in economic surprises in the United States. This summertime lull ended a few days before the meeting of central bankers at Jackson Hole, where Jerome Powell confirmed his plan to raise rates and prioritise inflation.

There was also something paradoxical and precarious about this summer rebound. The United States benefited from both more moderate-than-expected inflation (the July price index did not rise further versus the previous month and the annual inflation level stabilised) and a healthier-than-anticipated labour market. But the end result of better economic data would be to stop the downward trend in long yields that began in mid-June and thus rekindle fears about the Fed's actions. The very nature of the rebound raised questions about its sustainability in mid-August: low volumes, little or no major flows from traditional investors, and a rise that was ultimately achieved through short term options.

A more complex reality and a more challenging medium-term trend are also hiding behind the window dressing of positive economic surprises. First, a comparison of US and European growth presents a misleading picture of a reality that could reverse: US GDP has been contracting for two quarters while European growth remains entrenched in positive territory. This is expected to reverse, with a short but likely inevitable recession in the Euro Area, and, in contrast, US GDP set to rise in the third quarter after a contraction stemming in part from non-recurring impacts on inventories. Second, despite its reassuring strength, the US labour market will eventually change direction (the Fed has announced and anticipated this) and the business investment cycle should start to be affected by tighter financial conditions.

Europeans should also be sceptical about the European Commission's comments on the reality of gas restocking. Even a full restocking would only cover a quarter of the region's gas needs, with the bulk still supplied daily by the pipeline from Russia despite the diversification efforts already underway.

The positive surprises from companies should also be taken with a grain of salt given the significant risk of short-sightedness. The strong second-quarter earnings season that fuelled the rise in markets this summer was driven largely by the energy sector, while the weak euro and inflation artificially boosted European companies' revenues. Lastly, the scale of the share buybacks in the United States both confirms the importance of the shareholder return theme in a stagflationary period and raises questions about the sustainability of this trend and the reality behind the earnings without the accretion generated through share buybacks. The risk of a reversal of the earnings cycle is therefore always present although it appears it will take place later than expected. And, in the meantime, any risk of a rise in long term yields could weaken the equity market's equilibrium valuation.

Summer hopes for an economy that can avoid recession and of a central bank that would immediately be able to temper its comments in response to stabilising inflation are therefore somewhat premature, and we believe caution is warranted this autumn. Other risk factors could also capture investors' attention, between the upcoming congress of the Chinese Communist Party, tensions around Taiwan, the legislative elections in Italy, the conflict in Ukraine and the mid-terms in the United States.

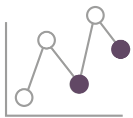
We are therefore ingrained in a structurally higher volatility regime, which investors will have to both get used to and adjust to, without envisaging a rapid return to the pre-pandemic cycle regime. The time is therefore ripe not so much for chasing short term market rebounds, but rather for identifying long term sources of real returns.

CHINA AND JAPAN: WHEN DOVES CRY

The risk of a balance-sheet recession in China echoes Japan in the 1990's, but we would argue that the Chinese recovery is hampered, but not lost and policy-makers still have strong ammunition to kick-start the economy. Japan remains in a world of its own, where inflation is welcome after years of stagflation. Despite the yen free falling, the Bank of Japan (BoJ) appears constrained to dovishness in the face of still strong economic imbalances.

RISKS SKEWED TO THE DOWNSIDE IN CHINA

Chinese retail sales grew 2.7% year-on year (YoY) in July (below the 5% growth forecast by the Reuters poll) and industrial production rose by 3.8% (missing expected 4.6% growth). Although these growth figures remain enviable from a European perspective, they reflect a second economic reopening that has been a lot less impressive than in 2021. Purchase Managers Index (PMI) surveys have fallen into contraction territory in August (at 49.4), while the services PMI (at 52.6) benefitted from the slight easing in the zero-COVID policy.



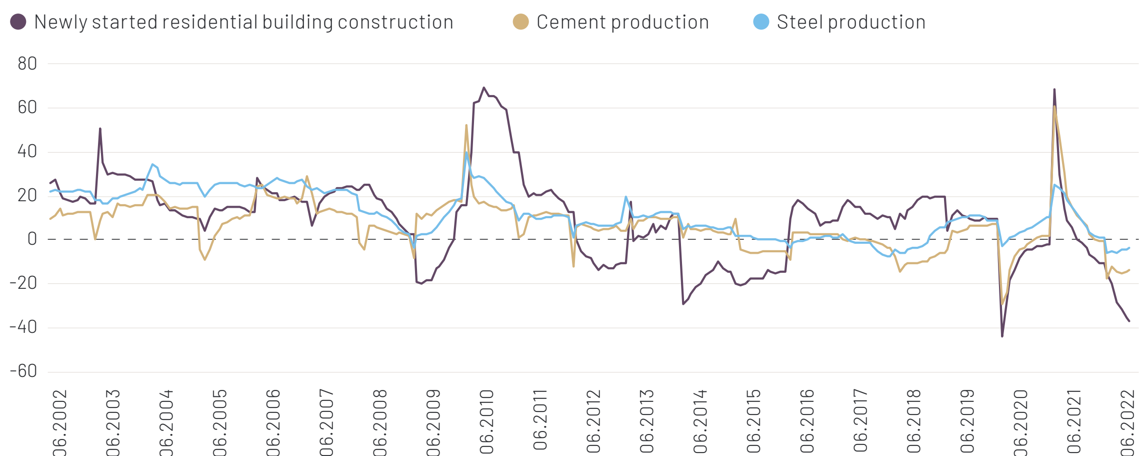
PBoC
has now cut rates twice this year

Authorities have announced further fiscal stimulus in new infrastructure spending (300 billion yuan) and an extension of 500 billion yuan of borrowing to local governments. However, the risk is that much of this extra stimulus will go towards savings and debt repayment in the context of the ongoing real estate downturn (Chart 1). The latter has triggered the debate over the risk of China falling into a "balance sheet recession" similar to that of Japan in the 1990s, when economic agents reduced debt by cutting spending and investment, only further reducing economic activity. Chinese household debt has indeed risen from 28% a decade ago to 62% of GDP, while corporate debt stands at 160% of GDP. Today households are rushing to repay mortgages early as confidence and returns on property investments fall.

RESTORING CONFIDENCE IS KEY

As the 20th National Congress approaches, Chinese authorities cannot afford to U-turn on their tough policy stance on reckless lending in the property market, more than they can significantly go back on their zero-COVID strategy. However, multiple measures have been taken to restore confidence in the real estate sector, including state-owned enterprise guaranteed loans. The loosening monetary policy has been relatively modest, even if the People's Bank of China (PBoC) has now cut rates twice this year signalling its support. Restoring confidence will be key. All in all, we believe there still is some lockdown-induced pent up demand in the Chinese economy, but we expect the real estate downturn to continue weighing on growth in 2023.

CHART 1: CHINA'S HOUSING MARKET SLOWDOWN, YOY CONSTRUCTION RELATED OUTPUT GROWTH, %



Source: Refinitiv, Indosuez Wealth Management.

Chinese GDP growth forecasts have been cut down from 3.2% in 2022 and 5.5% in 2023 to 2.9% and 5.2% respectively. Exports will be hampered by the global downturn, but should continue to benefit from low producer prices (at a 17-month low of 4.2% in July below consensus expectations) and competitive advantages in certain key areas, notably in components for renewables. As for China's own energy dependence, its coal production and ability to rely on Russian energy sources has helped steer the economy away from the global energy turmoil even if the current droughts in the south are hampering energy production.

YEN
-17% YTD
against
the US dollar

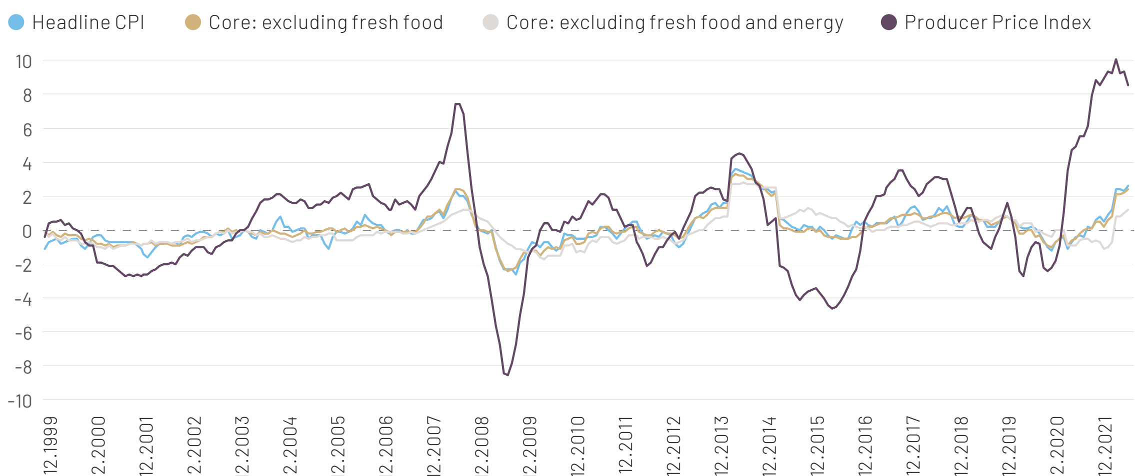
JAPAN: INFLATION IS BACK?

It is most likely too early to tell. Consumer price inflation (CPI) in Japan accelerated higher than expected in July (2.4% year-on-year excluding fresh products after 2.2% in June). This is the highest level since August 2008, if we exclude a period of inflationary surge in Japan in 2014-2015 which was artificially provoked by an increase in VAT (Chart 2). Inflation is broadening gradually, but the majority of price pressures comes from imported products, such as food prices (up 4.4% vs. 3.7% in June) and energy prices (fuel, light and water charges rose 14.7% vs. 14.0% in June). Core inflation excluding fresh products and energy was only 1.2% YoY in July. Encouragingly, producer prices are beginning to cool as commodity prices soften (8.6% YoY in July 2022 vs. 9.4% in June).

Thus far companies have limited the pass through of higher commodity costs to their selling prices. The rebound in domestic demand is strengthening (retail sales rose 2.4% YoY in July, exceeding market expectations of 1.5%). Unemployment remains under its historical average (at 2.5% in July), while nominal wages in Japan rose 2.2% in June 2022 from a year ago, the fastest pace in four years. On the supply side, Japanese manufacturing is suffering from weakened export demand from China as well as the US. Japan's manufacturing PMI fell to 51.5 in August, with the new orders component reducing for the first time in six months pointing to further weakness to come.

July inflation figures are now above the Bank of Japan's forecasts for the current year and exceed the BoJ target of 2%. The extreme weakness of the yen (-17% year-to-date against the dollar) calls for higher rates. However, low financing costs have helped households and companies absorb their higher energy bills. It also helps the government maintain its enormous debt burden (at 270% of GDP), which is set to grow with the effects of the pandemic support programme and planned increased military spending as risks surrounding Taiwan loom. The BoJ therefore remains a clear outlier among the world's central banks. It will need to be more innovative to restrain the fall in the yen, even if the latter could benefit from its safe-haven status in the case of a stronger than anticipated recession in the US in 2023.

CHART 2: PRICE PRESSURES IN JAPAN, YEAR-ON-YEAR, %



Source: Refinitiv, Indosuez Wealth Management.

THE WORLD UPSIDE DOWN

This summer's macro data was not all that bad in advanced economies, notably for the US. Quickly, however, good macro news became a bad omen as it gave central banks further confidence to tighten monetary policy. Make no mistake, inflation is today weighing more on growth than rising interest rates. Recession seems now inevitable in Europe as energy shortage fears worsen.

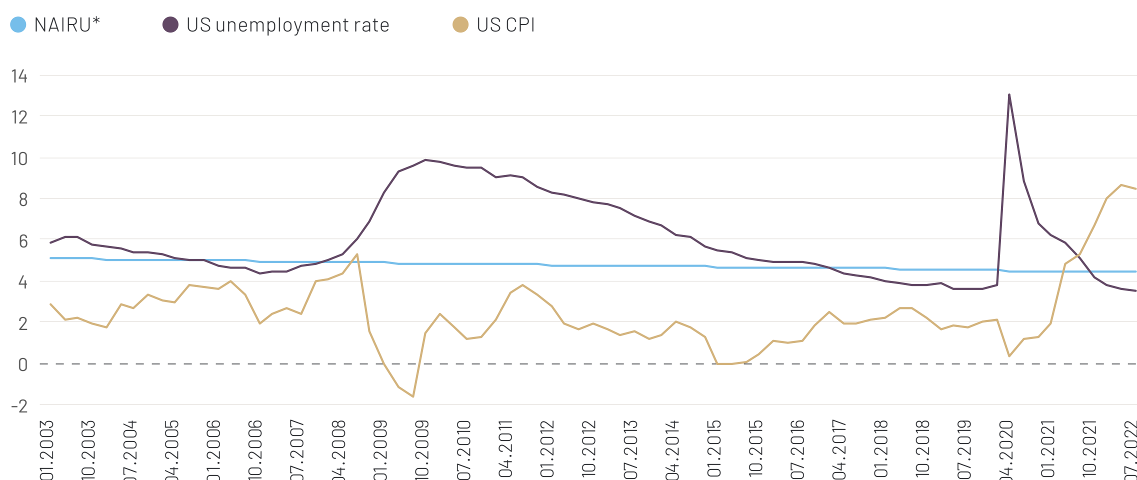
US: THERE IS NO GOING BACK

The slowdown in the second quarter GDP in the US was revised up to -0.6% on a quarterly annualised basis (rather than -0.9% initially estimated), as consumption proved more resilient than expected. Inventories accounted for -2 percentage points of this drop. The headline GDP figure for Q3 may turn out better than expected given the very volatile nature of inventories post-COVID-19. This in part explains why the NBER[1] refuses to declare that the US economy is currently in recession. Overall, this summer saw a strong rebound of the Citi US economic Surprises Index. Despite consumer prices outpacing the rise in wages (at 8.5% YoY vs. 6.7%), consumption has remained relatively defiant (retail sales excluding gasoline prices rose 0.2% in July). Furthermore, the US personal consumption expenditure price index – the Fed's favoured measure for inflation - fell 0.1% month-on-month (MoM) in July of 2022, after leaping up 1% in June. Food prices were up 1.3% MoM, but energy costs fell 4.8% MoM.

US wages up
6.7% YOY

Looking ahead, inflation most likely peaked in July. Some relief is to come, as car prices are expected to weaken as demand softens, but shelter prices (weighing 30% of the total price inflation basket) are stickier (historically lagging house prices by approximately 15 months) and will maintain pressure on prices. The jobs market remains tight (Chart 3), while consumer inflation expectations diminished in July, but remain above 6% (level reached as of November 2021). In this context, the Fed is firmly embarked on the fight against inflation. The collapse in housing demand (housing starts tumbled 9.6% MoM in July) and the plunge in confidence indicators will not derail the Fed's mission. We do not expect US inflation to significantly drop before spring 2023. PMI indices are warning of the slowdown in activity to come, as they dip significantly below the 50-mark threshold for services (at 44.1 in August) and slow in manufacturing (to 51.3). The risk of a recession in the US is now factored into the second half of 2023 when the cracks starting to be apparent in the jobs market today (such as the slowdown in job openings) become deeper and the restrictive level of financing conditions breaks the recovery in domestic demand.

CHART 3: UNEMPLOYMENT RATE VS. INFLATION, %



* NAIRU: Non-accelerating inflation rate of unemployment.
Source: Refinitiv, CBO, Indosuez Wealth Management.

1 - National Bureau of Economic Research.

Euro Area
INFLATION
HAS NOT YET
PEAKED

EUROPE: RECESSION IN THE PIPELINES

European inflation and GDP growth continues to be subject to energy shortages and the confidence shock that it has entailed (Table 1). Inflation is expected to near double-digits towards year-end in the Euro Area as a whole, notably in Germany and Spain. As gas prices continue on an unprecedented path (up 368% YoY in August), inflation cannot yet peak and risks to European inflation remain tilted to the upside (notably the energy and industrial goods component). Nevertheless, and probably because inflation in Europe is almost entirely energy and food price driven, inflation expectations remain anchored thus far. Q2 GDP data surprised to the upside (+0.6% quarter-on-quarter in Q2) with activity supported by easing COVID-19 measures and a stellar summer tourism season. Spain (1.1%), Italy (1%) and France (0.5%) grew at a solid pace while the German economy stalled.

Looking forward, GDP is to move on a downward trend as the services reopening rebound moderates, global demand weakens and purchasing power remains tight. The German IFO Business Climate Index fell into recession territory at 88.5 points in August (down from 99 in February), while the GFK consumer survey is well below March 2020 levels. Bloomberg recession probability forecast in the Euro Area has now reached 55% compared to 30% in June. Assuming a rationing of Russian gas rather than a total cut off, we assume a mild recession in the Euro Area starting in the second half of 2022 and lasting until spring 2023. The unemployment rate in the Euro Area has remained stable for three months at 6.6%, but with still large disparities (Germany 2.8% unemployed and Spain 12.6%). Public finances are however deteriorating across all member states. The European budget process commences again in October, shortly after the Italian elections, and could be a new source of tension.

TABLE 1: GDP GROWTH AND INFLATION FORECAST UPDATES, %

	GDP GROWTH									
	United States	Euro Area	Germany	France	Italy	Spain	United kingdom	China	Japan	Brazil
2022	1.6%	2.9%	1.5%	2.6%	3.3%	4.5%	3.4%	2.9%	1.8%	2.3%
2023	1.0%	0.3%	0.1%	0.4%	0.4%	1.1%	-0.5%	5.2%	1.5%	1.0%

	INFLATION									
	United States	Euro Area	Germany	France	Italy	Spain	United kingdom	China	Japan	Brazil
2022	8.1%	8.3%	8.5%	6.1%	7.7%	9.3%	9.6%	2.3%	1.9%	9.8%
2023	4.0%	5.7%	6.0%	4.7%	5.3%	4.9%	8.7%	2.4%	0.3%	5.6%

Source: Amundi, Indosuez Wealth Management.

75 IS THE NEW 25!

Economies and financial markets are sailing through the biggest tightening cycle in decades. Remember the good old days, when developed market central bankers were hiking rates by 25 basis points, after a long and cautious market communication exercise. Now forward guidance is a thing of the past and most central bankers are taking the 50 to 75 basis point steps that were once reserved only for emerging markets.

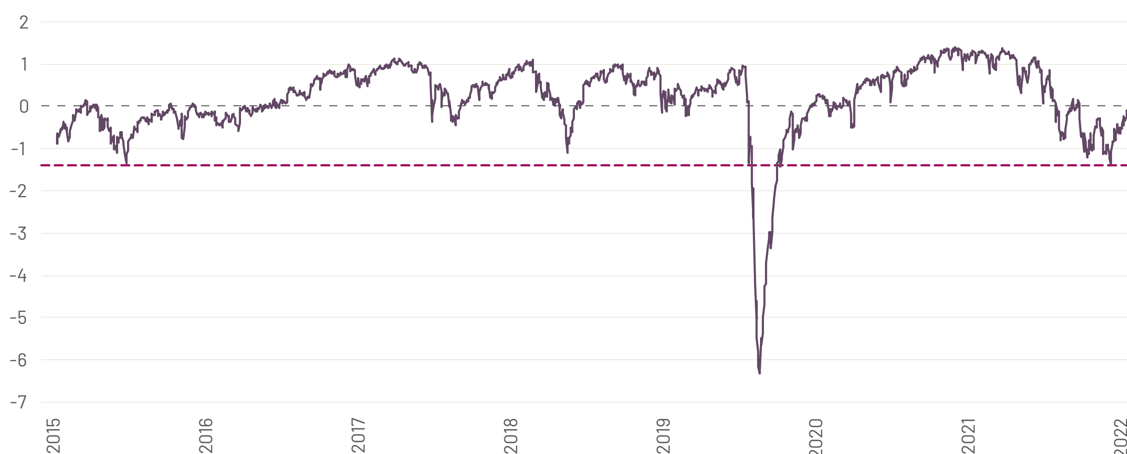
THE ECB in a delicate situation due to EURO DEPRECIATION

It was an eventful summer that saw the market reprice sharply both in the spread and rates markets. This was driven by: strong deleveraging end of June, an increase in reserves due to US treasury spending and a relatively unchanged reverse repo (RRP). Today the rates market has slowly converged back to a more aggressive stance on tightening following the Fed Chair's speech. The reaction post Jackson Hole was fairly muted for US treasuries and the interest rate curve flattening pressures that were in force over the this first half of the year are back in the driver's seat of the US yield curve. On the European Central Bank (ECB) and Bank of England (BOE) front, the situation is dire. Electricity and gas prices are weakening the positon of these two monetary zones, pushing their central bankers to maintain a very hawkish stance despite a growing probability of falling in deep recession. The ECB is in a particularly tricky configuration given the sharp depreciation in the euro.

Finally, even if the widening of peripheral spreads was in line with Euro Area interest rate normalisation as a whole, the ECB reacted this summer by purchasing more Italian treasury bonds through the reinvestment of the Pandemic Emergency Purchase Programme (PEPP).

Given the loosening of financial conditions this summer (Chart 4) and strong jobs market in the US, central bankers are now more likely to continue to tighten fast and it is too early to call for a Fed pivot. Given the monetary policy transmission delays, this should inevitably weigh on an economy that is already in stagnation. However, fighting inflation remains the absolute priority for central bankers that appear convinced that a short term recession is better than a prolonged inflationary environment. In this context the flattening movement is to continue with a possible Fed pivot by year end that could then create some upside pressure on the short end of the curve.

CHART 4: US FINANCIAL CONDITIONS BACK TO ALMOST NEUTRAL, %



Source: Bloomberg, Indosuez Wealth Management.

CREDIT

On credit markets, spreads traded sharply down in investment grades and high yield in both US and European markets. This opened doors for large excess returns on these markets in July, before consolidating in August. While fundamentals remain resilient in Europe, they deteriorate in the US with more debt and less cash on company balance sheets. Realised default rates stood below 1% both in Europe and the US, while rating agencies forecast a limited rise in 2023 consistent with an economic slowdown and just above their long term averages (3.7% in the US and 3% in Europe on an issuer weighted basis). Rating agencies have not yet taken into account this shift as there are still more upgrades compared to downgrades. The exception is the Chinese real estate sector where 40% of issuers are on negative watch. In terms of flows, despite positive momentum this summer, investors withdrew their assets from open-ended funds as year-to-date performances are still negative in a rising yield environment. That being said more and more buy and hold strategies attract investors. Designed to crystallise a yield at inception, these investments offer more visibility as opposed to open-ended funds. In Europe, the continuous widening in swap spreads offer an extra carry for investors, and a potential cushion against rising yields.

In the high yield market, valuations look less attractive now and seem at risk considering: the ECB's hawkish stance, the European energy shock weighing on corporate margins, and the broad macroeconomic downturn. Both B/BB and BB/BBB ratios, now below their 5-year average, indicate rich markets at these levels.

Despite challenging primary markets, near term refinancing needs are low. Companies will face higher borrowing costs on new debt, but this will be mitigated by a higher proportion of fixed-rate debt through 2023. Vulnerability comes from B- and below. The strengthening dollar led to a contraction in non-USD debt outstanding of US corporates, while some European corporates benefit from their USD revenue exposure.

In emerging markets, the dollar currency strengthening weighed on local currency returns. The Chinese real estate rout also weighed on global investor's sentiment and the absence of short term solutions prevented any risk taking in the region (Chart 5).

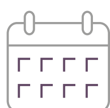
CHART 5: RISING YIELDS ON EMERGING MARKET DEBT DRIVEN BY RISING DEFAULTS IN CHINA, %

Source: Bloomberg, Indosuez Wealth Management.

SUMMER RALLY

The S&P 500 index recorded a strong double-digit gain in eight weeks, buoyed by three factors: the initial feeling that the Fed was not so far from its pivot point; a season of results that turned out to be better than feared; the very bearish pre-summer sentiment of investors that led them to reduce risk ahead of the holiday period.

The Jackson Hole meeting was a massive wake-up call, with inflation remaining the primary concern for central bankers.



EARNINGS revisions: RESILIENT so far, but a CHALLENGE for year-end

EARNINGS SEASON

Q2 earnings delivery was globally supportive with a very positive picture in Europe and a globally reassuring season in the US. The consensus is still expecting sales to grow by 12% in the US and 14% in Europe, which is far above historical average levels. However, profit margins are starting to show some signs of weakness, especially in the US once we adjust from the energy sector. In Europe, margins have been resilient so far thanks to a weaker euro and lower interest rates.

In this context, earning revisions have remained resilient and are even still rising in Europe. Nonetheless, this is one of the main challenges for equity markets looking ahead. The ability for companies to continue to deliver and maintain high margin levels in the current environment will be a key element for year-end stock market performance.

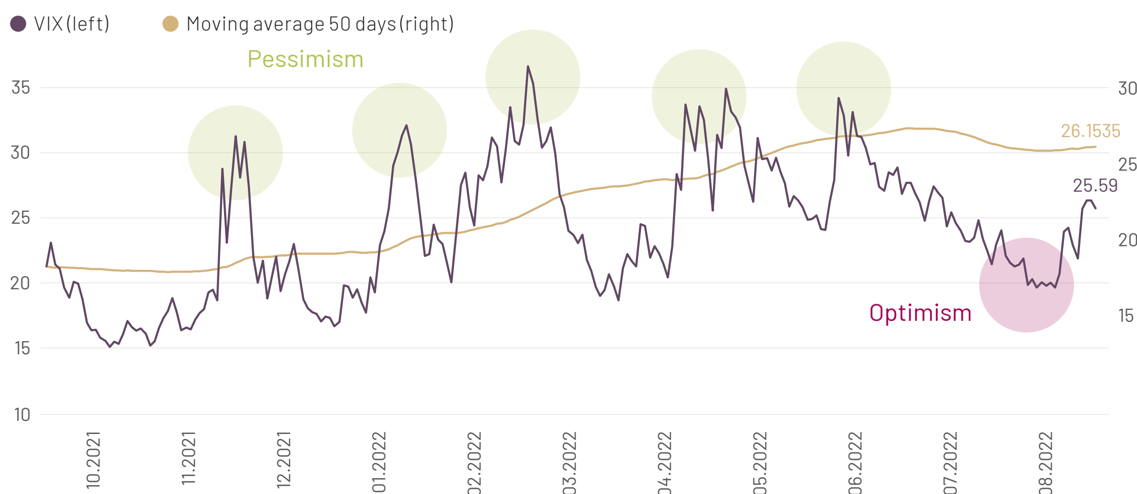
UNITED STATES

The market regain in optimism (Chart 6) was driven by the Fed's change in tone in July (less hawkish than in the past), with Jerome Powell stating that the Fed funds rate was already in neutral, leading to relief In US interest rates and fuelling the equity market rally.

But the Jackson Hole meeting has put away hopes of a near-term Fed pivot to an easier stance. Jerome Powell signalled that the US central bank is likely to keep raising interest rates and leave them elevated for a while to stamp out inflation.

Thus, we remain in a particularly complex macro environment combining geopolitical tensions, high inflation, the risk of recession, monetary policy and the upcoming mid-term elections in the US. All these elements justify our current cautious message on risk positioning even if we still consider the US market as one offering the most resilience with more pricing power and some of the best high-quality companies.

CHART 6: VIX INDEX



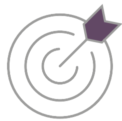
Note: Top bearishness has been reached mid-June before the summer period which has contributed to the summer rally. Now, sentiment indicators are showing some relative optimism, this suggest that markets could be more sensitive to negative news flow.
Source: Bloomberg, Indosuez Wealth Management.

EUROPE

The global situation remains challenging in Europe, despite the relief rally that occurred on the market from the end of July to mid-August.

The potential energy shortage during the winter represents a real headwind for Europe. Some investors even fear that several industries might stop their activities, especially in Germany or Italy. The euro weakness is helping exporters, but increasing inflation pressure on energy/commodity prices will affect profitability of energy-intensive sectors. On the positive side, the earnings season has been stellar for European companies which still drive earning revisions the upside (Chart 7).

Inside Europe, we favour Swiss markets, which benefit from a strengthened Swiss currency and a quality-oriented bias.



QUALITY
style remains our
KEY
CONVICTION

EMERGING MARKETS

Asian equity markets have had to deal with heightened worries on China's economy over the last months (see page 6), forcing Chinese authorities to launch another round of monetary easing in late August with interest rate cuts and targeted support measures for the property sector. We are also expecting a major ramp-up in infrastructure spending over the remainder of the year.

Renewed tensions with the US (regarding Taiwan in particular) as well as the strict zero-COVID policy still in place have also increased global investor concerns toward China lately while EPS revisions are still oriented to the downside. On a brighter note, we have seen some encouraging signs from China's leading platform economy companies lately, with overall better than expected earnings results and above all, improving margins.

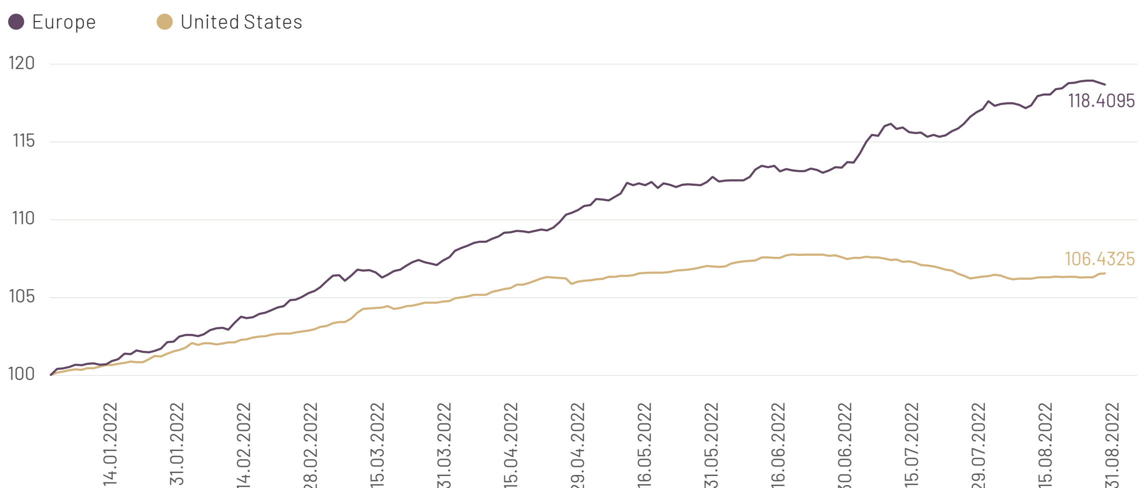
INVESTMENT STYLE

The summer rally has mainly benefited non-profitable Growth stocks as long term yields were reversing over the beginning of the summer. However, after having initially benefited from a drop of 100 basis points (bps) in the US, bond yields have recently firmed up again. As such, we still think it is too early to come back widely on Growth companies (with the exception of renewable and green stocks).

Conversely, we see an opportunity to add a step further on the defensive side by increasing Quality and notably the "growing dividend" theme which focuses on companies able to maintain or increase their dividend in the current context.

Meanwhile, we take advantage of the rebound on Value to take some profits on this strategy. We mainly focus on the reduction of the cyclical part of the Value portfolio which could be impacted by another leg of macroeconomic deterioration.

CHART 7: EPS REVISIONS



Note: The earnings season has been globally reassuring for investors notably with a strong set of results in Europe. Since then, European earning revisions are accelerating on the upside while in the US they are still stabilising.
Source: Bloomberg, Indosuez Wealth Management.

US FED AND US DOLLAR REMAIN IN THE LEAD

USD remains king, Chinese policymakers allow the CNY to weaken in support of a suffering economy, whilst the JPY remains under pressure from attempts to kick start inflation. The AUD is looking an attractive diversifier, whilst Silver is so weak the market is paying to borrow it rather than buy it.

INVESTORS SEEK the safety of the world's reserve currency

USD

Still going strong

The US Dollar reached new heights in August as the Fed dashed market hopes of an early change in its ultra-hawkish monetary policy stance. Propelled not only by recovering interest rates, the USD has also been well supported by the risk-off environment accompanying these higher rates, as investors seek the safety of the world's reserve currency which also happens to be its highest yielding developed market currency. We remain constructive on the USD into the uncertainties of Q3/Q4, but also recognise that the incremental gains in each rally are becoming smaller.

CNY

PBoC bucking the global trend

The slowing growth risk scenario in China was seen as more important than the fight against only gradually rising consumer prices. Hence, the central bank continued easing short term borrowing and mortgage rates to buffer the slowdown and buttress the real estate sector. This ongoing monetary support contrasts with practically all other national Central banks in a rush to regain lost credibility and counter runaway inflation at home. As such, the PBoC is further stimulating by allowing the yuan to drift weaker against their main trading partners also suffering against the USD. Thus, we cannot rule out further CNY weakness towards 7.00 and beyond whilst the FOMC delivers on their hawkish rate rise path and interest differentials widen out even more. Stimulus initiatives are on the way which should contain any deep currency outflows.

AUD

Bottoming out attempt underway

The AAA Australian dollar is attempting to form a bottom versus the surging by default US greenback. Record full employment remains extremely robust whilst CPI runs hot and way above the RBA's tolerance level. RBA hikes have been swift and more remains to be delivered. This "returning" high yielding status is coupled by a growing and record trade surplus. In-demand net exports of wheat, coal, iron ore and even liquid natural gas will continue to buoy the current account and thus support the AUD on dips. The Achilles heel however, remains the sanctioned trade drag with key partner China and the leveraged real estate sector vulnerable to even steeper rate hikes at home. On balance, we remain very constructive on all dips versus global pairs (Chart 8).

JPY

Still the underdog

Whilst inflation has picked up in Japan the market is nowhere near being convinced that the Bank of Japan is likely to change policy any time soon – and you can see why from past experience. Previous attempts to kick start inflation in Japan were so short-lived that policymakers will likely want to see fully entrenched inflation before indicating they might abandon their policy.

Investors need to watch the BoJ and Japanese government body language closely for signs of this turn, but with inflation still well below other developed markets this is likely to take a few months yet.

SILVER

Supports give way

Silver has broken back below USD 20/Oz given a particularly strong USD. The price has accompanied the general drop in precious metals prices, which have seen Gold, Platinum and Palladium all fall in August. The USD strength comes from the USD Fed monetary policy stance which is increasingly firm in its fight against inflation, with markets now considering USD interest rates reaching close to 4% by the end of 2022. Interestingly Silver (XAG) funding prices have also moved higher, allowing holders of XAG to generate up to 2% p.a. on their Silver cash holdings by lending them to the market – this could be a sign that markets think the metal will continue to fall, whilst there is still solid demand to use it in the short term, as essentially the high Silver interest rate shows participants are more keen to borrow the metal than buy it outright for their uses.

CHART 8: TRADE-WEIGHTED AUD REMAINS SUPPORTED

Source: RBA, Bloomberg, Indosuez Wealth Management.

INVESTMENT SCENARIO AND ALLOCATION CONVICTIONS

INVESTMENT SCENARIO

- **Growth:** we maintain in our central scenario a high probability to enter a recession, notably in Europe, with a variety of sub-scenarios ranging from a temporary GDP contraction of one or two quarters, to a more severe recession. Beyond energy shortage risks for the industry, European consumer confidence remains low as they are paying most of the price of this stagflation context. Outside Europe, US GDP growth should rebound in Q3 after two consecutive quarters of technical contraction, but should be impacted by the Fed's rate hike cycle thereafter. Chinese data remains lacklustre, and far from the government's growth targets.
- **Inflation** will remain elevated in 2022 (around 8%) and more broad based, beyond the effect of energy prices which have started to correct, while social tensions caused by eroded purchasing power fuel rises in wages. Inflation in 2023 could be a mix of lower (or negative) contributions to inflation from energy due to base effects, whilst core inflation should remain between 3% and 4%, well above central banks' target.
- **Central Banks:** our scenario is unchanged, with hawkishness in the West and easing in China. The Fed has reconfirmed its commitment to fight inflation, but with a question mark on the resilience of this stance in the coming quarter. The Fed will likely signal a pivot at year-end and end rate hikes in Q1 2023. Recession fears fuel expectations of rate cuts in H2 2023 that the Fed discards for now. The ECB has also confirmed an accelerated normalisation. After exiting negative rates, it could walk in the Fed's footsteps in terms of rate hike calibration, while bringing more clarity on the Transmission Protection Instrument (TPI) programme to limit the widening of peripheral spreads in a context of lose fiscal balances. The Chinese central bank has confirmed and accentuated its accommodative policy (with now neutral real rates for the first time in five years).
- **Long term bond yields:** this mix of weak macro forecasts and hawkish central banks maintains our view of a flat or inverted yield curves in the US and also in the Euro Area.
- **Corporate earnings:** we continue to observe a strong divergence between depressed macroeconomic data and upbeat analyst forecasts translating confident management guidance. However, despite a strong earnings season on Q2 boosted by the energy sector, profit and losses should finally start to reflect a worsening environment, either through lower growth or through lower margins.
- **Default rates and liquidity conditions:** default rates will undoubtedly rise in a stagflation context, but not to the implicit level reflected by this year's widening of credit spreads. Credit markets had been rebuilding more attractive liquidity and volatility premiums during the spring before rallying this summer. As the refinancing wall will mostly occur in 2025/2026, carry remains attractive on short duration Quality bonds. However, the summer spread tightening on high yields is to be short lived, as macro risks have not evaporated in the summer heat.
- **Market regime:** we are back to positive correlations between equity and bonds as monetary normalisation dominates again, prompting correction simultaneously in bonds and equities. This contributes to a higher volatility regime where safe havens are endanger species beyond cash in USD.

SELL THE SUMMER RALLY and KEEP QUALITY in portfolios

ALLOCATION CONVICTIONS

- **Equities:** we remain underweight and used the summer rally to reduce the recommended exposure. As expected Growth stocks were the main beneficiaries of this rate-driven market rebound. Our cautious view mainly relies on a dual context of a macro slowdown and monetary normalisation which will ultimately lead to negative earnings-per-share (EPS) revisions. We keep on increasing our preference for Quality assets and sustainable dividends, while reducing our conviction on Value in face of higher macro risks. We remain underweight on Europe while remaining neutral on the US. Chinese equities still suffer from macro headwinds and zero-COVID policy, but could benefit from a more supportive monetary policy, a resolution on US listings and better earnings from tech giants.
- **Corporate bonds:** a constructive view is maintained on Quality corporate bonds offering the most attractive spreads since the pandemic climax. More cautiousness on high yield in the short term as credit spreads can continue to widen notably in the case of energy shortages and higher recession risks. However, patience will be rewarding for long term investors with a buy and hold selective approach.
- **Currencies:** we had reiterated in the recent months that it was premature to become negative on the dollar against euro, as it means fighting the Fed normalisation path or ignoring Euro Area challenges. While this view was validated with USD crossing parity with EUR, we think that the upside is now limited, but costly forex hedges and Euro Area challenges limit the downside risk. We keep our lack of enthusiasm on the CNY in view of the monetary easing in China, and diversification remains to be found in commodities currencies, before a winter Fed pivot paves the way for flows in emerging markets currencies.
- **Macro hedges:** we became more constructive regarding duration on June's peak on government bonds yields, but have recently cut our conviction on this asset class in early August. We came back to our underweight duration strategy, before seeing more clarity on the timing of a Fed turning point.
- **Risk positioning:** overall, we prefer to maintain a moderate risk approach, with both some cash buffers in the riskiest investment profiles and higher macro hedges so as to reduce volatility and have the capacity to seize the opportunities that the market will offer.

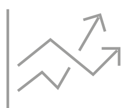
KEY CONVICTIONS

	TACTICAL VIEW (ST)	STRATEGIC VIEW (LT)
FIXED INCOME		
GOVERNMENTS		
Core EUR 10-Year (Bund)	=/-	=
EUR Periphery	=	=/-
US 2-Year	=/+	=/+
US 10-Year	=	=
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.

OVERVIEW OF SELECTED MARKETS

DATA AS OF 1 SEPTEMBER 2022



GOVERNMENT BONDS	YIELD	4 WEEKS CHANGE (BPS)	YTD CHANGE (BPS)
US Treasury 10-year	3.25%	56.50	174.32
France 10-year	2.17%	82.30	197.80
Germany 10-year	1.56%	75.80	174.00
Spain 10-year	2.76%	86.40	219.60
Switzerland 10-year	0.88%	45.60	101.80
Japan 10-year	0.24%	6.60	17.20

BONDS	LAST	4 WEEKS CHANGE	YTD CHANGE
Governments Bonds Emerging Markets	33.77	-1.76%	-13.91%
Euro Governments Bonds	200.34	-3.80%	-8.33%
Corporate EUR high yield	190.37	-2.45%	-10.89%
Corporate USD high yield	293.64	-4.59%	-11.66%
US Government Bonds	298.72	-2.12%	-6.73%
Corporate Emerging Markets	43.06	-1.51%	-15.57%

CURRENCIES	LAST SPOT	4 WEEKS CHANGE	YTD CHANGE
EUR/CHF	0.9764	-0.23%	-5.90%
GBP/USD	1.1545	-5.06%	-14.68%
USD/CHF	0.9818	2.76%	7.55%
EUR/USD	0.9946	-2.93%	-12.52%
USD/JPY	140.21	5.51%	21.84%

VOLATILITY INDEX	LAST	4 WEEKS CHANGE (POINTS)	YTD CHANGE (POINTS)
VIX	25.56	4.12	8.34

EQUITY INDICES	LAST PRICE	4 WEEKS CHANGE	YTD CHANGE
S&P 500 (United States)	3'966.85	-4.46%	-16.77%
FTSE 100 (United Kingdom)	7'148.50	-4.02%	-3.20%
STOXX 600	407.66	-7.15%	-16.43%
Topix	1'935.49	0.25%	-2.85%
MSCI World	2'610.26	-5.48%	-19.23%
Shanghai SE Composite	4'043.74	-1.41%	-18.15%
MSCI Emerging Markets	976.14	-1.86%	-20.77%
MSCI Latam (Latin America)	2'124.59	0.15%	-0.25%
MSCI EMEA (Europe. Middle East. Africa)	194.28	-3.53%	-29.53%
MSCI Asia Ex Japan	628.92	-2.17%	-20.32%
CAC 40 (France)	6'034.31	-7.36%	-15.64%
DAX (Germany)	12'630.23	-7.56%	-20.49%
MIB (Italy)	21'302.16	-5.93%	-22.10%
IBEX (Spain)	7'806.00	-4.35%	-10.42%
SMI (Switzerland)	10'663.44	-4.81%	-17.18%

COMMODITIES	LAST PRICE	4 WEEKS CHANGE	YTD CHANGE
Steel Rebar (CNY/Tonne)	3'901.00	-3.94%	-14.23%
Gold (USD/Oz)	1'697.52	-5.23%	-7.20%
Crude Oil WTI (USD/Bbl)	86.61	-2.18%	15.16%
Silver (USD/Oz)	17.55	-12.78%	-24.84%
Copper (USD/Tonne)	7'597.00	-1.69%	-21.85%
Natural Gas (USD/MMBtu)	9.26	14.04%	148.31%

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

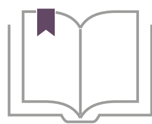
MONTHLY INVESTMENT RETURNS, PRICE INDEX

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

	JUNE 2022	JULY 2022	AUGUST 2022	4 WEEKS CHANGE	YTD (01.09.2022)
BEST PERFORMING (+)	8.79%	9.11%	1.18%	0.25%	-0.25%
	-0.42%	7.86%	0.03%	0.15%	-2.85%
	-1.38%	7.64%	-0.04%	-1.41%	-3.20%
	-2.70%	4.22%	-0.22%	-1.86%	-16.43%
	-6.46%	3.71%	-1.04%	-2.17%	-16.77%
	-7.10%	3.54%	-1.88%	-3.53%	-18.15%
	-7.20%	3.18%	-2.19%	-4.02%	-19.23%
	-7.43%	-0.69%	-4.24%	-4.46%	-20.32%
	-8.07%	-1.66%	-4.33%	-5.48%	-20.77%
WORST PERFORMING (−)	-16.81%	-7.02%	-5.29%	-7.15%	-29.53%

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

09 • Glossary



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.

Cyclicals: Cyclicals refers to companies that are dependent on the changes in the overall economy. These stocks represent the companies whose profit is higher when the economy is prospering.

Defensives: Defensives refers to companies that are more or less immune to the changes in the economic conditions.

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.

Growth: Growth style refers to companies expected to grow sales and earnings at a faster rate than the market average. As such, growth stocks are generally characterised by a higher valuation than the market as a whole.

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 5-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.

Quality: Quality stocks refers to companies with higher and more reliable profits, low debt and other measures of stable earnings and strong governance. Common characteristics of Quality stocks are high return to equity, debt to equity and earnings variability.

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.

Stagflation: Stagflation refers to an economy that is experiencing simultaneously an increase in inflation and stagnation of economic output.

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.

Value: Value style refers to companies that appear to trade at a lower price relative to its fundamentals. Common characteristics of value stocks include high dividend yield, low price-to-book ratio, and a low price-to-earnings ratio.

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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