Market Insights

Q2/2022

A consolidated view of the markets, across geographies and asset classes.

PRIVATE BANKING


Between inflation and the current geopolitical tensions, the pandemic already feels like history in investors' minds.

Contents

FOCUS

Q1 Markets Review

After an exceptional 2021, the first quarter of 2022 has been an emotional and difficult one for investors. Russia's invasion of Ukraine, surging inflation and the start of the Fed rate hike cycle weighed on both equities and bonds performance while commodities thrived. Here are 10 stories to remember from an eventful quarter.

STORY 1 —

Invasion of Ukraine

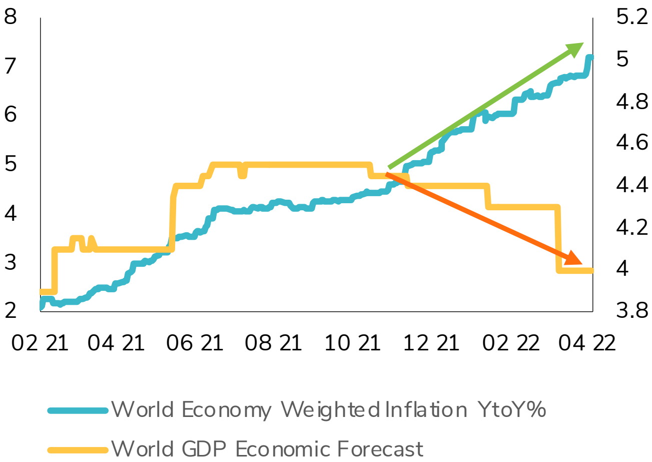
This is without doubt the most dramatic and important development of the first quarter. Although a Russian incursion into Ukraine appeared plausible at the beginning of the year, Russian President Vladimir Putin's decision to carry out a full-scale war beyond the separatist region of Donbass has stunned the world. Beyond the human tragedy of the conflict, the sanctions imposed by the West on Russia have far-reaching consequences for the global economy and monetary order. This episode of history comes at a time when the supply of raw materials is already insufficient to meet demand. Meanwhile, Russia produces and exports the vast majority of them: oil, natural gas, industrial metals, precious metals, agricultural commodities, etc. The global economy is therefore facing a commodity supply shock, with consequences on both growth (downside risk) and inflation (upside risk). At the time of writing, a rapid end to the war, and therefore to the application of sanctions, seems unlikely. Even if an agreement is reached, the normalization of relations between Russia and the West could take years, as long as Putin remains in power.

STORY 2 —

Stagflation fears

From a macroeconomic standpoint, global GDP continues to rise above trend but forecasts for 2022 are being revised downward. Meanwhile, inflation keeps surprising on the upside, hitting multiple decade highs across the globe. U.S. consumer price jumped 7.9% from a year earlier in February to a fresh 40-year high on rising gasoline, food and housing costs, with inflation poised to rise even further following Russia's invasion of Ukraine. In Europe, Germany's inflation jumped by 7.3% in March, the highest CPI YoY print since November 1981. While the conflict's immediate impact on the world economy is expected to be limited (Russia's economy accounts for less than 2% of global GDP), rising commodity prices could fuel greater or at least more persistent inflation, eating into household wages. This has led to rising stagflation fears.

World GDP forecast (orange line) and World Economic Weighted Inflation



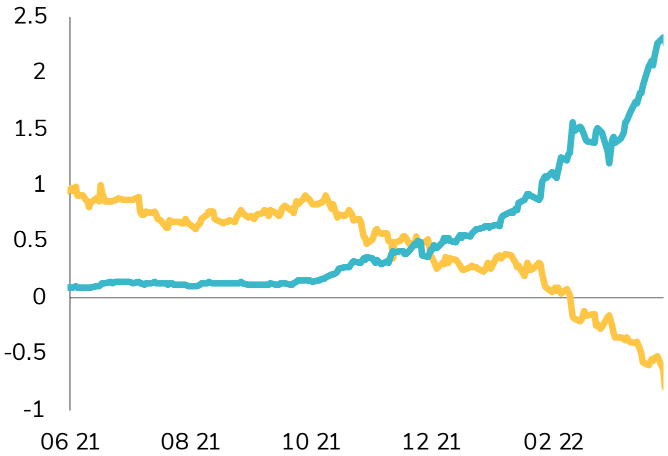
Source: Bloomberg

STORY 3 —

The start of a rate hike cycle by the Fed

On the 16th of March, the Fed's FOMC tightened interest rates for the first time since December 2018. While Chairman Jerome Powell initially called the post-vaccine inflationary pressure "transitory", Fed officials have moved away from that stance and are set to follow central bank peers, like the Bank of England, with multiple rate hikes in 2022. The US continue to face strong rents and wages inflation. In the meantime, sanctions on Russia have led to additional upward pressures on commodity prices, which are likely to push inflation rates to even higher levels. Sanctions and renewed Covid cases in China could both lead to additional supply chain bottlenecks. Investors have been adjusting their expectations accordingly, pricing in a fast and brutal rate hike cycle in the short-term with potential negative consequences on growth (and thus rates) later on. At the short-end of the yield curve, we saw an unprecedented divergence as the market is now pricing in 9 rates hikes in 2022 (vs. 2 hikes a few montsh ago) and 3 rates cuts in 2023/2024 (versus 2 hikes a few months ago).

FOMC rates expectations in 2022 (blue line) vs. 2023/2024 rate expectations (yellow line)



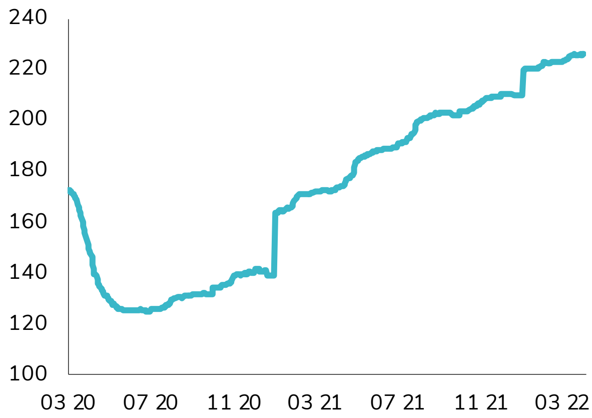
Source: Bloomberg

STORY 4 —

Resilient corporates and consumers

Despite all these negative headlines (war, inflation, etc.), there are some bright spots including two areas of relative strength in the U.S. economy. First, the U.S. consumer remains healthy: unemployment rate fell to 3.6% -- a post-pandemic low – and average hourly earnings are increasing at a solid pace (+5.6% year-over-year). U.S. households overall are entering the year with over $2.5 trillion more in savings than before the pandemic began, which offers some cushion in the face of rising borrowing costs. On the corporate side, balance sheets and earnings growth have been resilient: we continue to see earnings revisions for 2022 edging higher. Typically, analysts revise their earnings growth expectations downward for the year in the face of the events we saw in Q1. But we have not seen this trend yet. Expectations for S&P 500 earnings growth are now at 9.1%, up from 7.0% at the end of last year.

S&P 500, 2022 EPS Forecasts ($)



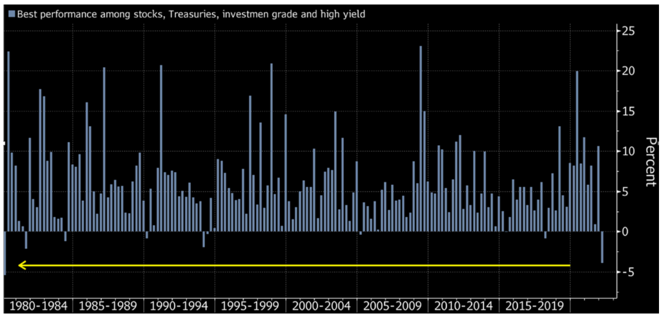
Source: Edward Jones

STORY 5 —

Nowhere to hide for multi-asset investing

Across equity & fixed-income markets broadly, the 'least-bad' quarterly performance among US assets were declines of 4.9% (price return) in S&P 500. They were followed by a 5.6% fall in Treasuries. A model portfolio made of 60% US equities / 40% Aggregate US bonds recorded its 1st quarterly loss in 2 years. With the exception of commodities (see next story), there was no place to hide for investors. European equities were hit by the Russia-Ukraine conflict as the MSCI Europe ex-UK is down -8.1% over the quarter. Europe is a huge importer of oil and natural gas from Russia, which makes the area highly vulnerable to the sanctions. Despite some bright spots (see story 8), the MSCI Emerging Markets index also recorded a quarterly decline (-6.9%). A new round of Omicron cases and lockdowns in China weighed on Chinese markets on top of the broader geopolitical concerns. Japan is down -1.2% over the quarter.

Stock and bond investors just had their toughest quarter in decades



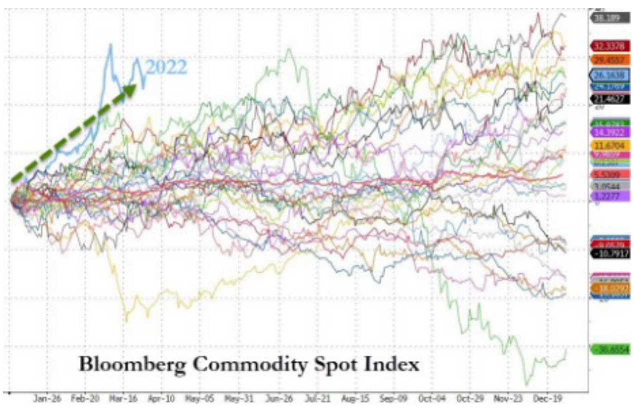
Source: Bloomberg

STORY 6 —

Best to start to a year ever for Commodities

Commodities were all up in Q1 with Bloomberg's Commodity Spot Index having its best start to a year ever, up 26% in Q1. Oil was the standout for many, with WTI up around 40% - which is oil's best start to a year since 1999. US Natural Gas soared to its best start to a year since 1990 but European Natural Gas spiked even higher. Copper and Precious metals rose around 6% in Q1. This was gold's best start to a year since 2016 as the yellow metal was seen by many investors as one of the few remaining “safe havens”. Russia is a major commodity exporter, accounting for 13% of global crude oil production and 17% of global natural gas production. Russia accounts for nearly a fifth of the world’s wheat exports, together with Ukraine. As a result, an interruption in the supply of energy and other agricultural goods creates a significant upside risk for Commodities.

Bloomberg Commodity Spot Index yearly performance



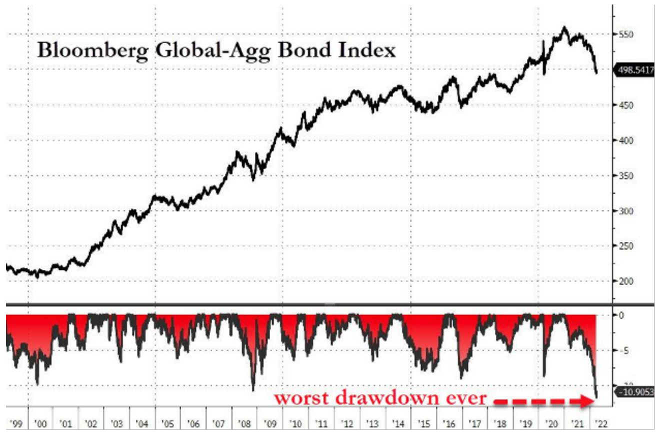
Source: Bloomberg

STORY 7 —

Greatest drawdown on record for global bonds

Based on Bloomberg's data, the global bond market just suffered its greatest drawdown on record. Indeed, the Bloomberg Global Aggregate Bond index is down -6.2% over the quarter. US Treasuries are down -5.6%. Since the US Civil War, the 10-year US Treasuries have only seen a worse total return quarter in the early 1980s and in Q4 1931 after the peak of the Depression-based rally. In Q1, US 2Y yields soared 156bps while the long-end also rose by 'just' 55bps. This was the biggest flattening to start a year ever. From a sub-sector point of view, Inflation-linked (-4.4%) and US High Yield (-4.5%) outperformed the Aggregate index. Euro Government bonds were down -5.3% while Emerging Markets debt were down -9.3%.

Bloomberg Global Aggregate Bond Index & drawdowns



Source: Bloomberg

STORY 8 —

2nd worst start to a year for US stocks since 2008

Most major equity markets ended the first quarter of 2022 lower, with the S&P 500 down about -5.0% (total return -3.4%), while the Nasdaq ended down around 8%. This is the 2nd worst start to a year for stocks still since 2008 (only the COVID crash was worse). March was a bit of a bright spot, however, as the major averages enjoyed a solid two-week rally during the second half of the month. Nasdaq rallied a stunning 17% off the mid-March lows (in 10 days) and the S&P was up almost 12% during the same period, thanks to a massive short squeeze. We note the great rotation between fixed income funds and equity funds is finally underway as investors believe that stocks are a much better hedge against inflation than bonds. As such, fixed income funds suffered major outflows in Q1 (-$80bn) while equity funds recorded inflows despite the negative news flow (war, inflation, Fed, etc.).

STORY 9 —

Commodity-related equity markets and sectors thrived

From a sector standpoint, Energy stocks (+39%) were Q1's massive winner with Utilities the only other sector to end in the green. Communication Services (-11.2%), Consumer Discretionary (-9.4%) and Tech (-8.4%) were the quarter's biggest laggards. Over the quarter, developed market value stocks were only down 0.5% while growth stocks fell nearly 10% on the back of rising bond yields. We note however that growth stocks started to outperform in March as Mega-Cap tech stocks rebounded massively in late-March (but still remain lower in Q1). From a country standpoint, stock markets from commodity-rich countries such as Brazil, Peru & the Saudi Arabia were the main beneficiaries last quarter. Russia's stock exchange was the 2nd weakest with a drop of 36%. Sri Lanka fared even worse, with its stock market nearly halving in dollar terms.

Best and worst performing stock markets in Q1


Region Primary Indices Only Period YTD 12/31/21 - 03/31/22 Total Return Currency USD
Movers All

Groups (92)	Return
Primary Equity Indices	
Best Performing	
1) BRAZIL IBOVESPA INDEX	34.53%
2) FTSE NSX Overall Index	31.86%
3) S&P/BVLPeruGeneralTRPEN	28.05%
4) MSCI COLCAP INDEX	25.24%
5) S&P/CLX IPSA (CLP) TR	24.51%
6) QE Index	20.68%
7) KWSE Premier Mkt	18.94%
8) BB ALL SHARE INDEX	18.64%
9) FTSE ADX GENERAL INDEX	18.52%
10) TADAWUL ALL SHARE INDEX	16.43%
Worst Performing	
11) BUDAPEST STOCK EXCH INDX	-13.38%
12) OMX STOCKHOLM 30 INDEX	-15.11%
13) Kazakhstan KASE Stock Ex	-15.62%
14) AUSTRIAN TRADED ATX INDX	-15.80%
15) ISEQAll-Share	-16.57%
16) MSE Top 20 Index	-16.81%
17) GSE Composite Index	-18.98%
18) EGX 30 INDEX	-19.18%
19) RTS Index	-35.67%
20) SRI LANKA COLOMBO ALL SH	-49.34%

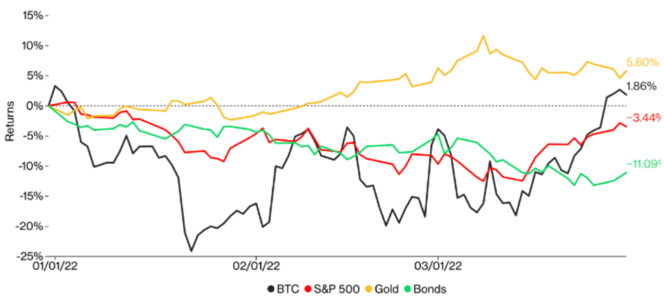
Source: Bloomberg

STORY 10 —

Strong dollar and a volatile quarter for cryptos

The dollar was higher in Q1, trading back into the pre-COVID range and to its highest monthly close since July 2020. Expectations for faster monetary tightening in the US contributed to a rally in the dollar, which finished the quarter up about 3% against both the pound and the euro. FX markets once again reflect the rise and fall of nations. The Ruble is down -9% over the quarter but is not the weakest currency year-to-date as the Turkish Lira did even worse (almost -10%). Brazil Real (+17.6%) and South-Africa Rand (+9%) appreciated on the back of strong commodity markets. Cryptocurrencies had a tough Q1. Bitcoin had one of its worst-ever starts to a year trading as low as $34,000 in February. But thanks to a strong recovery in the last part of the quarter, Bitcoin performance is almost unchanged over the quarter. Note that the correlation between bitcoin and the S&P 500 hit its highest level ever (nearly 0.9). Despite a strong performance in March Ethereum is down over 10% in Q1.

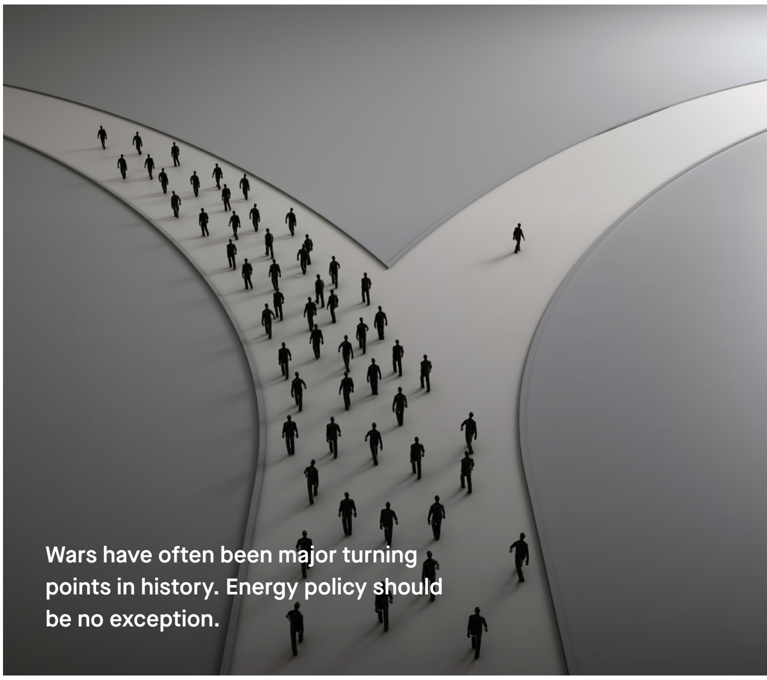
Selected asset class returns in Q1



Source: Coindesk

Major turning points?

The succession of two major crises (the Covid-19 pandemic and then Russia's war against Ukraine) could lead to major and lasting changes to the world order. In this Focus, we review 10 potential macroeconomic and financial trends which could shape the next decade.



Wars have often been major turning points in history. Energy policy should be no exception.

TREND 1 —

From deflation to inflation

The assumption of transitory inflation still seemed plausible in 2021: a stabilization of energy prices and favorable comparison effects could have allowed inflation to normalize. But Russia's invasion of Ukraine and the resulting sanctions are complicating matters considerably. While rising rents and wages are already contributing to an inflationary spiral in the US, the surge of crude oil prices and new supply chain bottlenecks are likely to keep inflation at an uncomfortably high level for much longer.

For the global economy and the financial markets, the shift to an inflationary world implies profound changes, whether in monetary policy, the behavior of the various economic agents or the asset classes and sectors to be favored.

TREND 2 —

From "Quantitative Easing" to "Quantitative Tightening"

As a direct consequence of the previous theme, monetary policy is at a tipping point. Indeed, the Fed has reached the end of its quantitative easing (QE) experiment. There is even talk of QT ("Quantitative Tightening"), i.e. a sale of bonds held by the Fed and/or the non-reinvestment of maturing bonds. For many investors, the transition from QE to QT is a very dangerous move. Indeed, there is a very strong correlation between QE and the increase in many financial assets (stocks, credit but also real estate markets). Will the reduction of the Fed's balance sheet lead to the simultaneous bursting of multiple financial bubbles? This is a risk to consider. But the markets cannot remain under monetary support forever. With a booming job market and an inflation rate well above the Fed's target, it seems logical that the U.S. central bank wants to end this "experiment". QE has created many imbalances (assets overvaluation, over-indebtedness and over-leverage, social inequalities, etc.). With the end of QE, most countries will have to implement the necessary structural reforms. But they will also have to make greater use of fiscal policy, possibly through higher corporate taxes and on their wealthiest citizens.

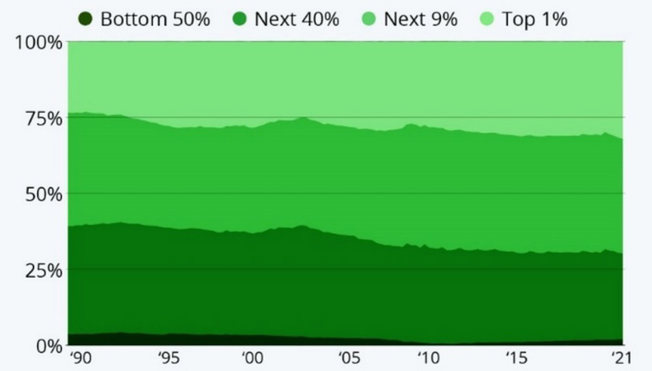
TREND 3 —

From "Wall Street" to "Main Street"

Among the imbalances created by years of QE is the growing wealth and income gap between the wealthiest households and the middle and working class. In the US, the share of total wealth held by the richest 1% has risen from 24% in 1989 to 32% in 2021. The richest 10% are now in possession of almost 70% of the country's total wealth. This is a consequence of the stock market bubble and the rise in property prices. The widening of inequalities is a phenomenon observed in many countries and which has already led to social unrest (yellow vests in France, Arab Spring, etc.) and populist votes (Brexit, rise of far-right parties, etc.). Will the end of QE curb this trend?

Another phenomenon that has been observed over the last few decades - and which also contributes to an increase in inequality - is the fact that labour productivity and wages have not followed the same trajectory. This dichotomy has had a (downward) impact on the rate of inflation and a positive impact on corporate margins, as the share of profits accruing to capital has risen to historically high levels at the expense of the share accruing to labour. One of the reasons for this divergence has been the use of "offshoring". As we shall see in section 8, a change in trend seems to be emerging, with positive consequences for domestic wages and negative consequences for corporate margins.

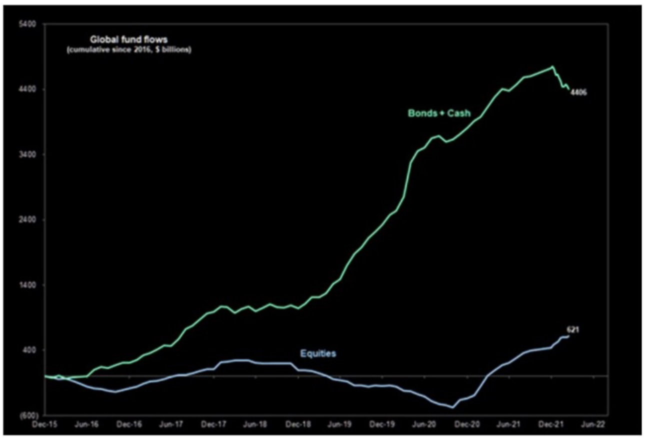
Top 10 Percent Own 70 Percent of US Wealth
Distrobution of Total US net worth 1989-2021 (in %)



Percent of aggregate, not seasonally adjusted.
Source: Federal Reserve Bank of St. Louis

Source: Statista

The Great Rotation



Source: Goldman

TREND 4 —

From bond markets to risky assets

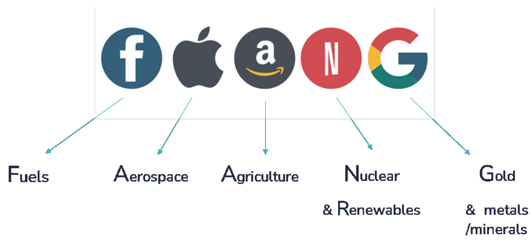
With the return of inflation, are we finally going to see a big rotation between asset classes? It would seem so. A study of the inflows and outflows of investment funds shows that the ultra-expansive monetary policies have essentially benefited the bond markets. By eliminating the remuneration of cash, central banks have generated gigantic buying flows into corporate bonds, emerging market debt, junk bonds, etc. But with the sudden rise in inflation, these bond investments are generating negative real returns, leading to a rapid shift from bond funds to equity funds. For the first time in more than a decade, flows into bond funds are now negative (more redemptions than inflows) while equity fund subscriptions continue to grow. Investors seem to be betting that equity markets will provide a much better hedge against inflation than bonds.

It is also possible to envisage flows into other asset classes, notably commodities and real assets (see point 6), instruments that are currently poorly represented in most portfolios, at best.

TREND 5 —

The new FAANGs

The years of sluggish growth, low inflation and monetary easing have benefited growth stocks, especially the digital giants - the so-called FAANGs. Their very high growth rate, superior business models and aggressive share buyback policies are among the factors that have driven years of stock market outperformance. It is interesting to note that the prospects of the end of QE already seem to be weighing on the relative performance of the FAANGs, as other market segments are now attracting investors' favor. We are now talking about the new FAANGs: Fuels (oil stocks), Aerospace and Defense (upcoming increase in military spending, particularly in Europe), Agriculture (shortage of agricultural commodities), Nuclear and New Energies (to reduce dependence on fossil fuels) and the G of "gold" (precious metals but also metals needed for the energy transition). While capital expenditures have been directed for decades towards the fields of technology, biotech or clean energy, raw materials and certain parts of the "old economy" are nowunderinvested. And a return to more balanced situation will certainly take many years because this shortage does not only concern current resources. For example, the world is currently facing a shortage of geologists, who would be very useful to work on new oil and gas drilling and the identification of new mines. These are all elements that could prolong the current outperformance of these sectors.

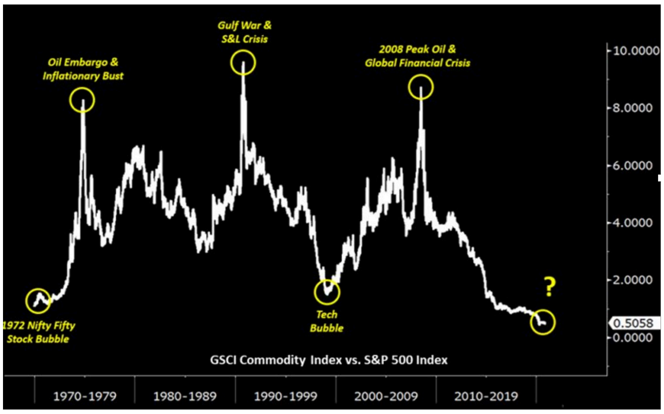


TREND 6 —

From "paper" to "real" assets

An analysis of the asset allocation of most portfolios (both private and institutional) seems to show an over-representation of "paper" assets (stocks, bonds) to the detriment of real assets (real estate, infrastructure, natural resources, etc.). But rising inflation should encourage investors to increase their exposure to real assets and alternative products. Commodities are often seen as the best hedge against inflation. Assets such as real estate and infrastructure have returns that are often indexed to inflation. Some of these assets also benefit from a scarcity effect that supports valuation levels.

Commodities to equities ratio



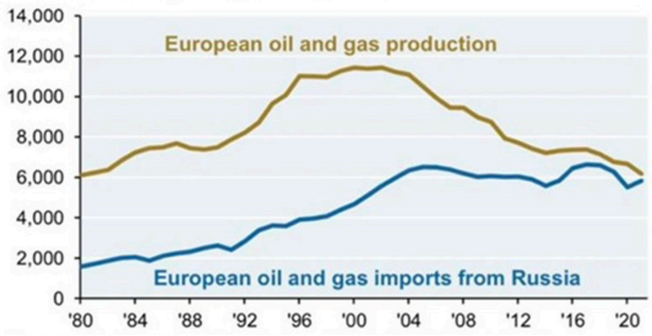
Source: Incrementum AG, Crescat Capital, Bloomberg

TREND 7 —

National security becomes a priority again

Wars have often been major turning points in history. Energy policy should be no exception. Over the past decade, Europe has pursued a noble goal: carbon neutrality by 2050 with the development of renewable energies, the rejection of shale gas investments and a phasing out of nuclear power. Meanwhile, President Putin has anticipated the growing need for energy imports from Europe. Russia has increased its oil and natural gas production capacity and doubled its nuclear power capacity. The figures speak for themselves: in 2016, 30% of the natural gas consumed by the European Union came from Russia. In 2021, this figure will be around 47%. This dependence on Russian gas has certainly given wings to Putin's belligerent ambitions. And it will force Europeans to rethink their energy policy. Of course, renewable energies are a long-term solution. But in the medium term, ecological priorities could be put on hold somewhat in order to secure and diversify energy sources. American and Qatari gas imports are one option. Nuclear power is another.

European reliance on Russian energy
Thousand barrels per day of oil equivalent



Source: BP, Gazprom, Eurostat, Perovic et al, Russia Federal Customs Services, JPMAM calculation. 2021.

TREND 8 —

From globalisation to relocalisation

The accelerating phase of globalisation that began in the 1990s has led to de-industrialisation and the export of supply chains of physical goods from developed countries to the rest of the world. But globalisation has its limits. An interconnected world becomes more efficient and productive but also less resilient. For example, the blockage of a major port in China due to the discovery of a positive case of COVID-19 can have an impact on dozens of other countries. Similarly, the production of high-tech devices consisting of thousands of parts may be delayed because a few parts are not available from a foreign supplier.

In the wake of the pandemic, governments in developed countries have become aware of their vulnerability to the risks associated with globalisation and the delocalisation of supply chains. As a result, the next decade may be characterised by a reshoring of manufacturing. This trend should improve the resilience of processes, but could also have consequences for labour costs and thus inflation. Emerging economies could suffer from a possible de-globalisation.

TREND 9 —

US Treasury bonds lose some of their reserve currency status

The fact that the West has chosen to freeze the dollar (and euro) reserves of the Russian central bank may prompt some central bank governors to rethink the logic of reserve accumulation and also the wisdom of investing part of the balance sheet in US Treasury bonds. If Washington can decide overnight to freeze the dollars that a sovereign country thought were its own, won't central bank governors in China, Pakistan, India, Turkey, Kazakhstan or Saudi Arabia be prompted to sell all or part of their dollars and re-anchor their local currencies in assets that are less likely to be influenced (or confiscated) by Western governments? Possible candidates include the yuan, gold and even bitcoin, three 'currencies' that are now accepted by Russia as a means of payment and thus potentially accumulated on its balance sheet.

TREND 10 —

From maximising wealth to maximising health and well-being

As a result of the pandemic and the ageing of the baby boomers, the lure of maximum wealth have become less important. Indeed, the current labour shortage in the US is partly due to this shift in priorities. Many households have developed a taste for life at home and have enough savings to leave the workforce. This megatrend is leading to new consumer behaviour with an increase in demand for services and goods related to quality of life, sports, leisure, wellness and of course health. This shift in emphasis is also having an impact on property markets around the world. For example, the trend towards teleworking and self-employment has reduced the demand for real estate in some megacities.

ASSET ALLOCATION INSIGHTS

Not out of the woods yet

Our leading indicators (macro & fundamental) continue to point towards challenges for equity markets. From a technical standpoint, the long-term equity bull market trend is being challenged while market breadth is not showing much signs of improvement. In Fixed Income, we remain cautious on rates and keep a disinclination stance on credit spreads. In Forex, we keep a disinclination stance on the EUR. Our "core" scenario for 2022 is adjusted towards weaker growth and higher inflation.

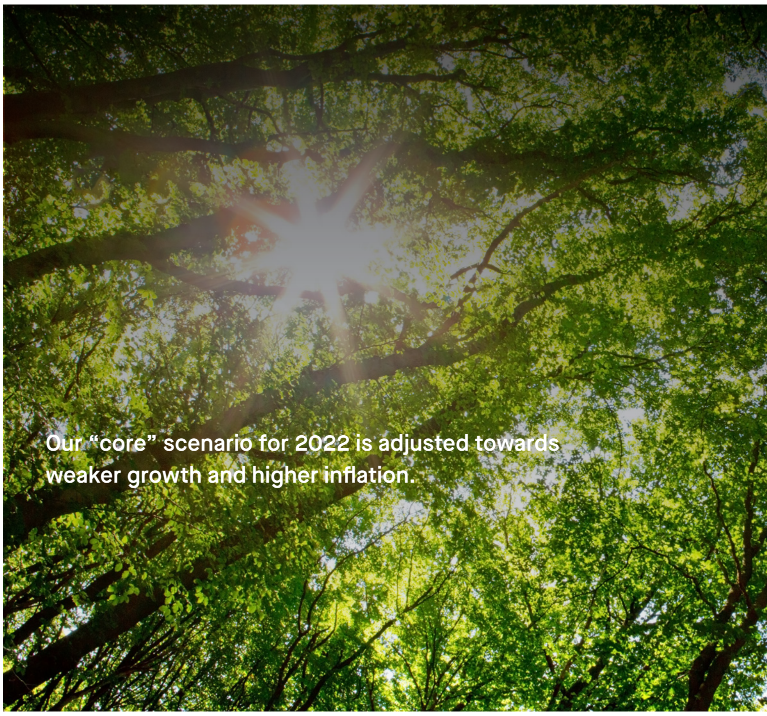
Executive summary

- Despite challenging headlines (Ukraine invasion by Russia, roaring inflation, Fed hiking rates, etc.), US stocks performance has been diverging from bonds since the second half of March. With real rates still in deep negative territory, the US consumer being in a strong shape, growth expectations remain fairly strong and earnings growth estimates showing signs of resilience, the overall impact of persistent inflationary pressures and rising interest rates on risk assets has been relatively mild.

- However, there are still some reasons to lean on the cautious side. Global financial conditions are starting to tighten significantly. Inflationary pressures are likely to rise further on the back of the commodity supply shock we are currently experiencing. Although stagflation is not our core scenario, a macroeconomic context characterized by lower economic growth and higher inflation often results in poor real returns for risk assets. While equity valuations look more attractive, there is an elevated risk for earnings growth estimates being revised downward in the near-term. Indeed, top-line growth should benefit from higher nominal GDP but in the current context of higher inflation, profit margins are likely to suffer in some specific sectors. Overall, our leading indicators (macro & fundamental) continue to point towards challenges for equity markets. Our coincident indicators (market factors) are not positive enough to change this view. On the contrary, the long-term equity bull market trend is being challenged while market breadth is not showing much signs of improvement.

- The weight of the evidence (i.e the aggregation of our fundamental and market indicators) remains negative. As such, we maintain a disinclination view on equity markets in general while we remain positive on US and Japanese equities. Our least favored market remains Eurozone equities (strong disinclination) and we maintain a cautious view on UK and Swiss markets.

- In Fixed Income, we remain cautious on rates and keep a disinclination stance on credit spreads. In Forex, we keep a disinclination stance on the EUR. We remain cautious on the Sterling and are downgrading the Japanese Yen to cautious. We remain positive on the Swiss Franc. We are upgrading Commodities from cautious to positive. We keep our preference stance on Gold.



Indicators review summary

On an aggregated basis, our indicators are pointing towards a DISINCLINATION on risk assets.

Macro & Fundamental Factors
(Leading indicators)

→ Macro-economic cycle:
NEGATIVE

→ Liquidity:
NEUTRAL

→ Earnings growth:
NEUTRAL

→ Valuations:
NEUTRAL

Market Factors
(Coincident indicators)

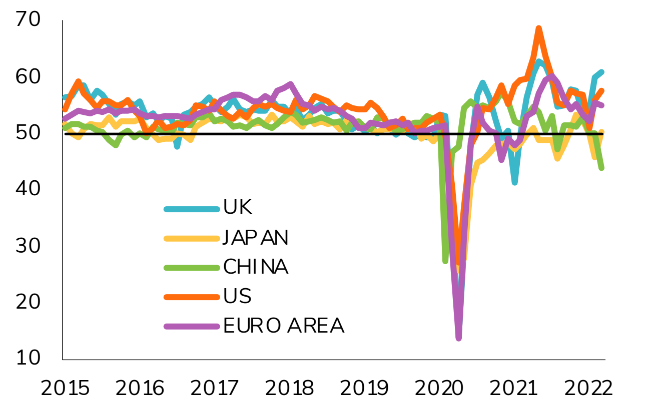
→ Market Technicals (Breadth, Sentiment, etc.):
NEUTRAL

INDICATOR #1

Macro-economic cycle: Negative

We believe that the macro perspective has deteriorated compared to last year. Our "core" scenario for 2022 is adjusted towards weaker growth and higher inflation. Global growth was expected to be above trend before the conflict. Currently, global growth remains firmly positive and the impact of Omicron on the US and Europe has dissipated. However, the Ukraine/Russia war is likely to decrease global real GDP growth by at least 1 per cent due to rising energy prices, negative impact on global trade, deteriorating consumer and corporate sentiment and the risk of worsening financial and liquidity conditions. Meanwhile, inflation keeps rising in the US and in Europe and exceeds expectations. The Russia-Ukraine war is creating a supply shock with moderate to severe effects – depending on the extent and length of the sanctions. This should lead to higher inflation than expected. As such, our macro indicator is NEGATIVE. However, stagflation is not our core scenario as global growth in developed countries remains above trend – see PMI composites below.

PMI Composite by country



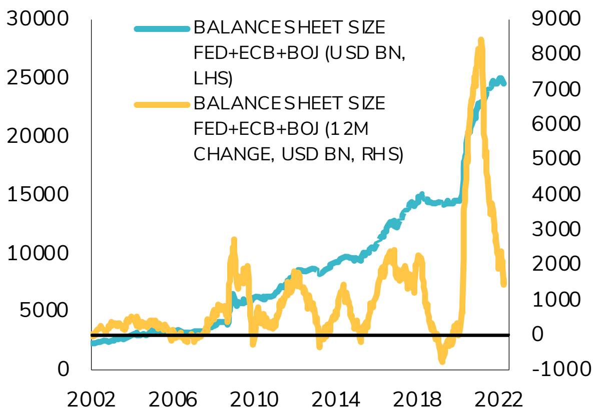
Source: Banque Syz, FactSet

INDICATOR #2

Liquidity: Neutral

In the US, Monetary policy is unlikely to provide much support to the economy and financial markets. On the back of a strong job market and the highest inflation number over the last 40 years, the Fed will stick to its plan to hike rates and tighten liquidity despite the conflict. On the other hand, the European Central bank may be more cautious than expected regarding rate hikes and QE tapering. Should the geopolitical and financial crisis deepen, fiscal and/or monetary policy should come as a support not only in Europe but also in the US. For the time being, we view the liquidity conditions as NEUTRAL.

G3 Central banks balance sheet size & rolling 12m change



Source: Banque Syz, Bloomberg

INDICATOR #3

Earnings growth: Neutral

To the surprise of many, we continue to see analysts revising earnings upwards for 2022. Expectations for S&P 500 earnings growth are now at 9.1%, up from 7.0% at the end of December 2021. The historical norm has analysts lowering annual earnings estimates on average during this period. Balance sheets remain solid as well and companies have room for more share buybacks. As such, we continue to see earnings growth as being a tailwind for equities but still believe that some downward earnings growth revision could happen later this year. Indeed, after a very strong earnings rebound in 2021, base effects are no longer very favorable. While profit margins have been resilient until now, high input cost pressures can hurt individual companies and some specific sectors. That being said, we still expect high single digit earnings growth. Share buybacks provide strong support while value / cyclicals sectors benefit from rising commodities prices. In Europe, banks are suffering from Russian exposure and flattening yield curve. We expect low single digit growth for European earnings this year.

Expected EPS growth

	2022e	2023e
MSCI Word	9.5%	7.9%
S&P 500	9.9%	9.8%
Stoxx 600	9.8%	6.3%
Euro Stoxx	7.6%	7.9%
FTSE 100	9.7%	3.1%

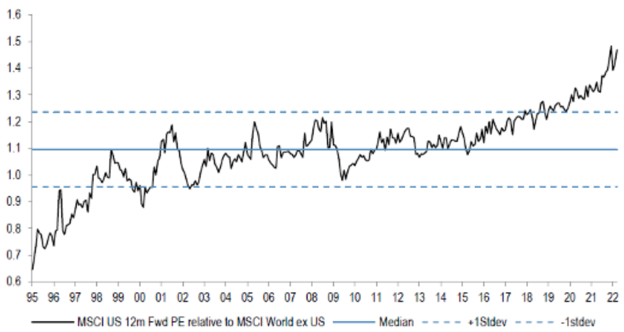
Source: IBES

INDICATOR #4

Valuations: Neutral

Global equity valuations have eased but are still above historical average in the US. Relative valuations of the US versus the rest of the world are a clear challenge as the region is trading extremely expensive versus peers, on most measures. One rational explanation is the fact that strong US earnings delivery supported this outperformance. Compared to bonds, equity markets remain attractive as real bond yields remain in deep negative territory. That means that investors are incentivized to keep investing into risk assets. We also note that with the return of inflation, investors consider stocks as being a much better hedge against inflation than bonds. As such, asset allocators are rotating from fixed income funds into equity funds. This can push equity valuations higher. On a more cautious note, we feel that increased geopolitical risk, growing economic sanctions to Russia and downgrades in earnings are not fully priced yet. As such, this indicator remains NEUTRAL.

MSCI US 12m forward Forward P/E relative to MSCI World ex-US



Source: IBES

INDICATOR #5

Market technicals: Neutral

Our market indicators are NEUTRAL but have been deteriorating recently and show that the recent market rebound is weakening. The low frequency / long-term indicators show that the long-term bull trend (price above 200 days moving average) has been broken – albeit by a small margin. Volume signal is becoming a headwind, i.e market advance is not confirmed by rising volume while correction are confirmed by rising volume. We also note that market breadth keeps deteriorating. Unlike the US, our European indicators give a negative signal on an aggregated basis.

Asset Class Preferences

Equity allocation

Disinclination

Based on the weight of the evidence, we keep a disinclination stance on equities. The U.S. economy has moved into the late cycle 'slowdown' phase, after spending the last 18 Months in Mid-Cycle 'Expansion'. Late-cycle 'slowdown' is consistent with below-average equity market performance, owing to slower earnings growth and multiple compression. Earnings growth remains a tailwind but we expect macro uncertainty and volatility to weigh on valuation multiples. From a regional perspective, we do have a positive stance on US and Japan equities. Our least favored market remains Eurozone equities (strong disinclination). There is significant geopolitical risk and energy dependency. Moreover, the upcoming French elections could create some volatility as well. Outside Eurozone, we maintain a cautious view on UK and Switzerland.

Fixed income allocation

Disinclination

On the fixed income side, we stay cautious on rates. A huge bear flattening of USD and EUR yield curves has been observed over the last few months as surging inflation increases the pressure on central banks. Medium and long-term inflation expectations rose to multi-year highs due to the surge of energy and commodity prices and rising wages. In the Eurozone, the rates curve acknowledges a coming exit of the ECB Negative Interest Rate Policy, with sovereign spreads amplifying the move. Overall, we see some divergence across government bonds markets. US short rates are now set on a very aggressive path while the EURs still have work to do. We thus find some value in the short-end of the US Government curve. We are however downgrading the EUR Peripheral curve to disinclination due to a potential PEPP (Pandemic emergency purchase program) /APP (Asset purchase program) early exit (July) and French election as possible headwinds. In credit, we keep a disinclination stance. The recent revaluation of credit spreads has added some value to the segment, especially in the short duration bucket. However, Investment Grade and High Yield are still not cheap compared to current volatility, poor liquidity and the lack of support stemming from central bank. A bright spot is the 0-2 year segment in Investment Grade / High Yield. Emerging markets debt recorded their worst start of the year ever (-10%). We remain cautious on this segment but believe the overall context is improving. First, valuations are attractive overall. Moreover, Chinese real estate added positive color in recent days which underpinned our Asian High Yield attractive valuation thesis. Another positive is the sharp rebound of capital flows into

Emerging Markets bonds in the last few weeks. We are thus carefully monitoring this segment. Last but not least, we are upgrading subordinated debt to positive from cautious. This matured and resilient asset class is still offering some attractive yield premiums and this despite solid capital position.

Commodities

Positive overall (upgrade). Keep a preference stance on Gold

We believe that commodities might be short-term overbought but remain long-term under-owned. After years of capex underinvestment, many commodities are facing a supply shortage while demand is firm. The invasion of Ukraine by Russia and the sanctions are worsening the situation. Energy and commodities are needed for virtually everything, yet Russia exports everything, and unlike 1973, it's not just the price of oil, but the price of everything that is surging. And the supply shock might be a long lasting one. Indeed, despite ongoing negotiations between Russia and Ukraine, a stalemate with prolonged economic impacts looks likely. We are thus upgrading our view from cautious to positive. We keep our preference stance on Gold. The yellow metal is one of the few portfolio diversifier remaining. It benefits from lower real bond yields, geopolitical uncertainty and tight supply.

Forex

Positive on the dollar and the Swiss franc; disinclination stance on the euro; downgrading the yen

In Forex, we keep our disinclination stance on the euro. The Ukrainian War weights on EUR prospects from several angles: macroeconomic growth prospects, interest rate differentials and flows of funds. We stay cautious on the Sterling and positive on the Swiss Franc. Fundamental drivers plead for a strong CHF over the medium term. Flight to safety from European assets is a powerful support. We stay cautious on GBP/USD. We are downgrading the Japanese yen from positive to cautious. Growth momentum and monetary policy differentials are weighting on the yen.

Tactical positioning: our asset allocation matrix

	Strong Disinclination	Disinclination	Cautious	Positive	Preference	Strong Preference
Portfolio risk		Equities Credit Spreads	Rates			
Equities	Euro zone EM Eastern Europe		Switzerland United Kingdom	United States Japan China & EM Asia EM Latam		
Bonds		HY Credit IG Credit	Government Bonds EM Hard EM Local	**Subordinated debt** →		
Yield curves		**EUR "peripheral"** ← CHF GBP	USD EUR "core"			
Forex (vs USD)		EUR	EM currencies GBP **JPY** ←	CHF		
Commodities				**Commodities** →	Gold	

Source: Investment strategy group - 07 April 2022

Change from last month

→ Preference

← Disinclination

How we go about thematic investing

Gold

In a context of very low USD interest rates, gold has been an attractive alternative for storing value recently. The yellow metal is currently still supported as real USD interest rates (rates adjusted for inflation) remain negative in a high inflation context.

The prospect of monetary policy tightening in the US, and the inflation slowdown that is expected to follow, may ultimately weight on gold prices: it will gradually push real interest rates higher and raise the opportunity cost of holding a non-yielding asset compared to positive yields on USD cash and government bonds.

Nevertheless, gold can be valuable in a portfolio as a hedge against a scenario of persisting inflationary pressures that would keep real rates negative for longer. It can also benefit from an unexpected deterioration in market sentiment, if geopolitical developments or economic growth slowdown prevent the Fed from rising rates.

Thus, even if the environment could be slowly turning less supportive for gold in 2022, the yellow metal will continue to provide considerable potential for portfolio diversification and will act as a hedge against potential tail risks going forward.

Pricing Power

As inflationary pressures mount, we identify "pricing power champions" as those companies that can sustain their profit margins by passing the cost increases onto consumers without losing them.

The main characteristics of pricing power champions are to be in a dominant position or market segment or to be in a niche market or in a sector with high barriers to entry. The management team usually demonstrates operational excellence and a bias toward action and innovation.

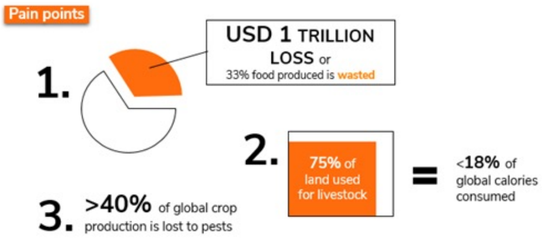
Such companies have the flexibility to pass input costs such as commodities, labour and transportation to their customers, and thus preserve their margins. The scarcity, quality or value added of their products or services are the main advantages the pricing power champions can depend on, they help them provide stable potential returns over time as they are in a position to sustain their margins.

Agri-Technology

The world's growing population inexorably increases demand for agricultural products but at the same time reduced land availability, while climate change has reduced supplies.

Demographic change has spurred new consumer demand, and advancements in food science is creating new opportunities on the industry, cellular and consumer fronts.

Agritech is about automating, reducing waste, improving controls, change how we produce food, and leverage technologies such as AI and ML to better connect consumers to a more sustainable food future.



Next Era Metals

Base metals' demand should continue to benefit from higher demand growth in the coming decade due to the need for clean energy transition, which will require colossal amounts of raw material, which is critical for the renewable energy transition (for the production turbines, batteries, etc).

The macro backdrop for base-metal demand should become more supportive in the future as China continues its loosening on liquidity in order to support its tired domestic demand. We also expect demand to remain elevated on the back of global infrastructure spending in power and transports as well as the development of electric vehicles.

Copper, zinc, cobalt and nickel have the most attractive near term fundamentals and should continue to benefit from higher intensity of use in Evs due to the additional wiring demand and their use in electric motor and the battery.

Inventories are shrinking and the lack of any production projects expected to deliver material supply increases any time soon are exacerbating the supply demand imbalance.

Uranium

Longer-term, nuclear may be the only affordable way of producing reliable carbon free energy. Currently, nuclear is the world's second largest source of low-carbon power.

Globally, utility companies use about 180 mn pounds of uranium per year but only 125 pounds are being mined (mostly in Kazakhstan), this is due to the lack of investments in new deposits. Until now, the deficit was compensated by the existing stockpiles and decommissioned military warheads however, we expect uranium prices to appreciate as above ground stockpiles will shrink and utilities will need to restock at a time where uranium production is in deficit and demand is growing.

Nuclear power capacity is increasing steadily worldwide, with about 55 reactors currently under construction mostly in Asia and Russia. The trend could accelerate in the future as a commission of advisors on EU taxonomy is studying the possibility of considering nuclear power as a green transition fuel under the existing EU Taxonomy Climate Change Mitigation Plan.

Find out more

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Tell us about the future you're looking forward to and we'll get back to you with a team that understands your challenges, speaks your language, and is fluent in your region.

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