Marketing Material

MONTHLY HOUSE VIEW

May 2022

Focus

The United Kingdom: a silver lining?

Architects of Wealth

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IN SEARCH OF RESILIENT RETURNS

VINCENT MANUEL

Chief Investment Officer, Indosuez Wealth Management

Dear Reader,

In recent weeks, the markets quickly shifted from worrying about a slowdown caused by the outbreak of the conflict in Ukraine to fearing persistently high inflation, prompting central banks to accelerate their rate hike timetables. Yield curves accurately reflect the risk that an inflationary surge will lead to a slowdown, resulting in a fast, but short-lived rate hike cycle followed by rate cuts from 2024... if not before.

Investors can lose their bearings in this type of environment. First, because they need to learn to move away from thinking about nominal performances and instead focus on the search for positive real returns, net of the inflation expected in the coming years. Second, because these future returns rely on growth and margin assumptions that have been shattered by this new environment. And, lastly, because there is limited value in using benchmarks and passive index management in this context, particularly when the equity and bond markets are sending rather different signals, between growth and margin resilience on the one hand, and recession risk on the other.

Nevertheless, it can be difficult for investors to change their mindset. They may have to walk away from the investment style that has worked the best for the past 10 years (Growth stocks) and bear all the consequences of shifting gears, while stepping back from the framework used in recent years, symbolised by the exit from negative interest rates.

Central banks have changed their models in just a few weeks and made fighting inflation their top priority. The "Greenspan put" is long gone, and central banks will now provide markets with less support. The reduction in the Fed's balance sheet is terra incognita, for which we can find few precedents in monetary history. This makes it difficult to envision long-term rates at very different levels from those of the period that began with the pandemic.

Changing mindsets can also be expensive in the short term, both psychologically (calling into question convictions and habits backed by 10 years of performance) and financially (knowing that it is time to sell losing positions ahead of a repositioning), but profitable in the long term. While this environment differs from that of the 1970s on a number of parameters, the question that remains is how to identify the asset classes that will be better able to withstand a higher inflation cycle than that currently projected by the consensus.

High-dividend equities and high-yield debt appear to be the asset classes whose returns should exceed average inflation over the next five years. However, the companies that are able to ensure the durability, sustainability and growth of these returns, and that are not penalised by weakened margins, excessive debt, or investment needs that are not self-funded, still have to be identified. This screening by resilience and quality should allow portfolios to perform well in all environments, like a ship designed to sail in calm weather as well as choppy seas. In the corporate bond world, selectivity is still necessary in the face of an asymmetrical energy shock that has exposed some countries' and sectors' heavy reliance on Russian gas.

The search for resilient intrinsic returns in the medium term, which can be sustained regardless of the monetary or economic environment, should therefore take precedence over the search for index performance in the short term. The latter is more heavily influenced by the short-term direction of confidence indicators, geopolitical risks and central bank communication. That will be the challenge for the earnings season set to start this month on the heels of a surprisingly positive trend in earnings expectation revisions despite the difficult environment for companies.

THE UNITED KINGDOM: A SILVER LINING?

The UK benefits from its island status with better energy supplier diversification, a central bank free to focus on inflation, but it is far from immune to the energy-price crisis and policy trade-offs between inflation and growth are still exceedingly complicated. However, UK equity performance - largely detached from the domestic economy - should not be overlooked.

Disposable income to fall by

2%

IN 2023

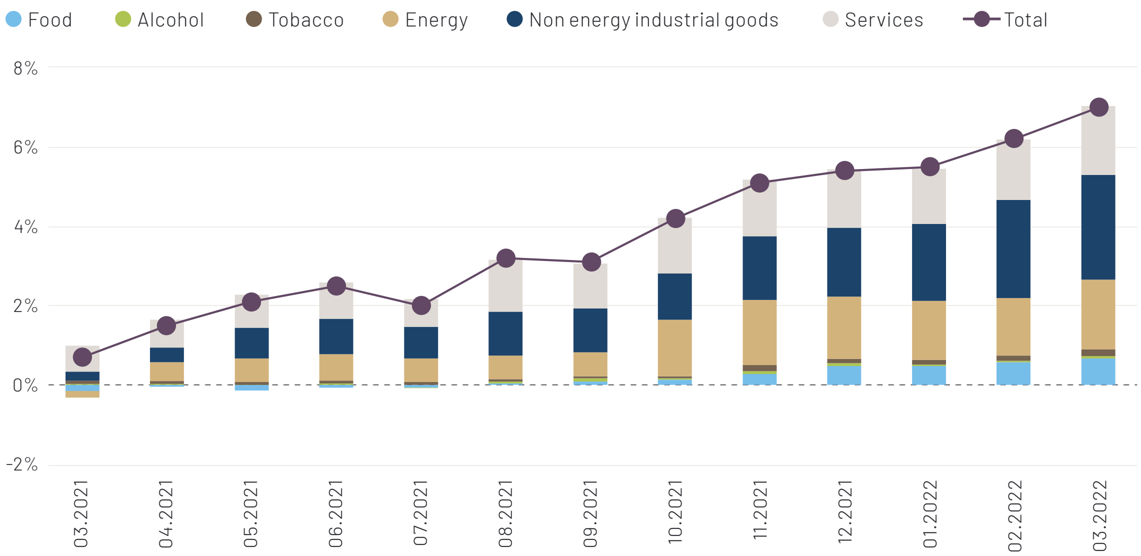
THE UK ECONOMY IS CLEARLY NOT OUT OF THE WOODS

After one of the most severe economic contractions in 2020 (-9.3%) and a solid recovery in 2021 (+7.4%), the UK economy is expected to grow by just under 4% in 2022. As health restrictions are now entirely lifted in the UK, the services PMI rose to 62.6, surpassing even France's stellar services performance in March (at 57.4) and the US (58). However, this recovery will be short lived as UK consumers pay the brunt of the energy crisis. Although the UK is relatively independent from Russia in terms of energy imports (30% of oil and 74% of gas imports come from Norway), a combination of pre-war factors including the impact of COVID-19 lockdowns on maintenance work in the North Sea have resulted in an increase in wholesale costs even before the war.

Furthermore, UK inflation was already at historical highs before the Ukraine war and - contrary to the Euro Area - is relatively broad-based (Chart 1). It rose to 7% year-on-year (YoY) in March (1% month-on-month), with the sharpest rise coming from housing costs due to the rise in energy prices, which is set to increase further in April as the UK energy regulator (OFGEM) gas price cap is to rise during the month. Second round effects of these price increases combined with a historically low unemployment rate (at 3.8%), have pushed wages up (+5.4% on a three month moving average growth in February), but pay was unable to keep up with inflation as real wages remain down by 1% over the same period.

According to a study by Euler Hermes the increase in total energy bills per household compared to the pre-war situation represents a loss of disposable income of -2 percentage points in the UK (vs. -1.5 pp in Germany, and -1 pp in France, Italy and Spain). This is particularly the case for low-income earners in the UK that also experienced the sharpest increase in household debt during the pandemic. Private consumption has yet to recover to its pre-COVID-19 levels in the UK.

CHART 1: UK INFLATION (CPI) CONTRIBUTION, YOY, %



Source: Office for National Statistics, Indosuez Wealth Management.

BANK OF ENGLAND: FREE TO ACT

The Bank of England (BoE) is less impacted by potential risk of financial fragmentation than the European Central Bank (ECB) that remains attentive to the impact of tightening too fast on Italy's fragile debt stock. In this context, the BoE has proceeded with its third consecutive rate hike in March, while the market expects rates to reach 2.5% by March 2023. The BoE has also announced that they would not reinvest the proceeds of maturing government bonds as they start their process of quantitative tightening (QT). That being said, after increasing rates to 1% next month, the BoE may choose to pause its tightening policy in order for the Monetary Policy Committee to take note of the impact of its policy on growth. According to the International Monetary Fund (IMF), the UK is expected to have the highest inflation (5.3%), but also the lowest GDP growth in the G7 in 2023 (1.3%) as disposable income weakens and financial conditions tighten.

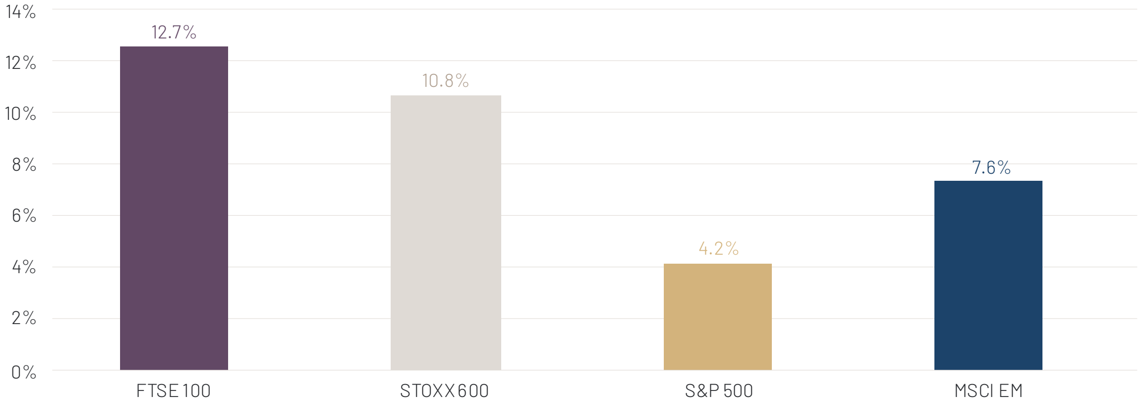
UK EQUITY MARKET: A HIGH YIELDER TILTED TOWARDS ENERGY AND QUALITY

Despite the gloomy UK macroeconomic context, it is interesting to note that UK equities are significantly outperforming their continental counterparts. There are several reasons why investors are attracted to the island. While the UK seems more immune to the Ukraine-Russia crisis and offers a diversifying opportunity within risky assets, the fundamental aspects of this market are even more supportive.

On the one hand, UK equity absolute and relative valuations are trading at historically lows (11.8 vs. 10-year average at 14.8), having never returned to their pre-Brexit levels (this limits the risk of strong repricing in the event of another global sell-off on equity markets). On the other hand, the main equity index, the FTSE 100, benefits from its higher weighting towards the energy sector compared to other major indices (12.2% vs. 5.4% for the EuroStoxx 50 and 4.3% for the MSCI World). This makes it an interesting hedge against rising commodity prices. Furthermore, the inflationary environment has buoyed the case for Quality style positioning and the pricing-power thematic. The healthcare sector, known for its defensive nature and which belongs to these previous thematics, is also well represented in the FTSE 100 (11.7%). Oppositely, sectors the most affected by rising input costs (such as industrials) or by rising interest rates (such as technology) are underrepresented compared to major European indices.

Bottom line, this tilt towards Value, especially energy, and Quality, translates into higher earnings prospects for UK equity markets in 2022 (+13.7% expected in 2022, revised 8.9% up over the past month) and should continue to support the market as long as there is no monetary policy derailment or further drastic revision of UK growth. High dividend yielders have generally been greatly rewarded during period of rising stagflationnary risk. With one the highest free-cash-flow yields in the world (Chart 2), UK equities look even more appealing, which could further attract investors if the stagflationnary risk materialises at a global scale. From this point of view, the grass may actually look greener across the Channel.

CHART 2: UK EQUITY MARKETS RECORDING A HIGH FREE-CASH-FLOW YIELD AGAINST OTHER MAJOR INDICES, %



Source: Bloomberg, Indosuez Wealth Management.

NEARING TIPPING POINT?

Inflation is still the key concern for investors and consumers across the globe. After the surge in commodity prices in the beginning of the year, inflation is expected to remain high, but for different reasons.

INFLATION has reached NEW HEIGHTS IN MARCH

COMMODITY PRICES VS. CHINA SLOWDOWN

Commodity prices began to moderate in April while remaining still at historically high levels: oil prices averaged 106 USD per barrel in the first 15 days of April compared to 112 in March, while gas prices have fallen 19% since early March, but remain 40% higher than prices as of 31.12.2021. It is indeed early days to speak of an inflexion point as commodities remain very event sensitive to the Ukraine war. This will also be little comfort for consumers that are progressively discovering the extent of the impact on their energy bills.

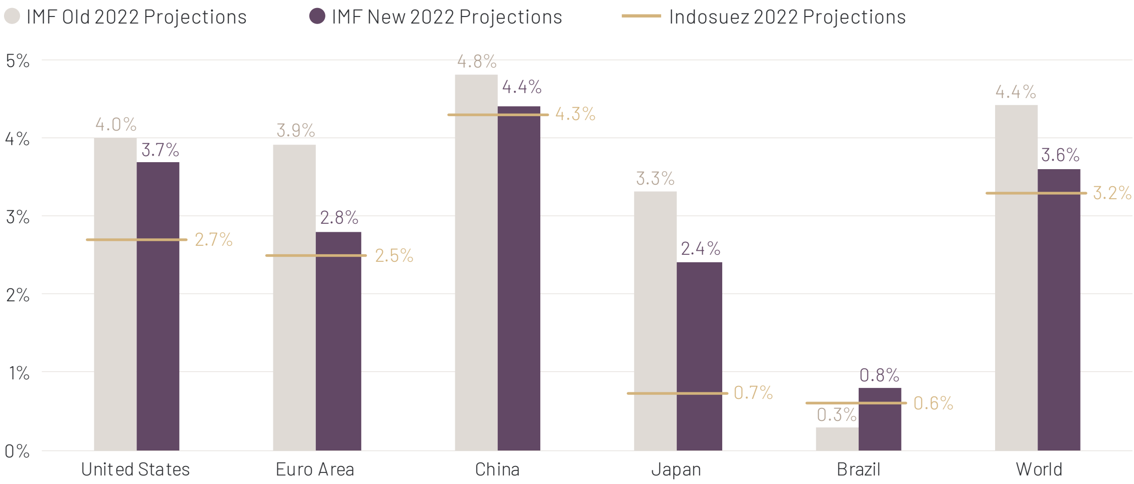
Nevertheless, with growth forecasts being revised down around the globe (Chart 3), it is increasingly possible that commodity prices will begin to adjust down with demand, notably for oil. This is particularly possible due to the recent slowdown in China as the zero-COVID policies proves to be longer than expected, making the Chinese government's 5.5% GDP growth target virtually impossible to attain in 2022 (Indosuez forecast 4.3%). Chinese retail sales fell back 1.9% month-on-month (MoM) in March and industrial production rose by only 0.4% MoM. This has strong ramifications for other emerging markets and especially commodity exporters, such as Brazil.

The latter has benefitted from the increased oil and soya prices, but Brazilian exports will suffer from lower Chinese demand. In total, China imports 32% of total Brazilian exports, of which almost 80% of soya exports and 65% of petroleum oil. Japan's trade balance recorded a sharp deficit in March (four times wider than market forecasts), as China-bound exports decelerated (from 26% in February to 3% in March) and surging energy prices raised the price of imports (the latter rose 31% compared to a rise in total exports of 15%).

INFLATION TO CONTINUE PRESSING FORWARD

Overall, we expect some commodity price relief, but prices are expected to remain under pressure globally for multiple reasons. Firstly, the recent Chinese lockdowns in key manufacturing trade hubs will likely renew supply chain disruptions and push prices up again. Secondly, labour markets remain tight in the US (unemployment rate is at 3.6%), the UK (3.8%) and to a lesser extent in the Euro Area (5.8%).

CHART 3: GDP GROWTH FORECASTS, %



Source: International Monetary Fund, World Economic Outlook, Indosuez Wealth Management.

This tightness is mostly linked to low-paying jobs leading to increased nominal wages in these sectors. But, thirdly, inflation has reached new heights in March and has now risen for over six consecutive months in both the US and the Euro Area (while remaining modest in China). Given the length of this high inflationary period, workers are expected to start demanding pay raises to compensate for fast-rising prices, which according to a recent IMF report could intensify inflation pressure more so than the tightness thus far of the labour market. Finally, the increase in food prices is more "sticky" than energy prices and unusual weather conditions have added to food shortage fears: wheat prices have risen an extra 12% since the beginning of April (a risk for emerging markets in particular).

In this context, US consumer sentiment unexpectedly jumped to 65.7 in April of 2022 from an eleven-year low of 59.4 in March, but consumer inflation expectations were unchanged for both the year-ahead (5.4%) and the five-year outlook (3%). This April survey offers only small improvements in sentiment, which the survey producers admit is still too close to recession levels to be reassuring.

March retail sales in the US were up 0.5% MoM (compared to 0.8% in February), but this increase in consumer spending masks the effect of higher prices on energy (gasoline sales increase 8.9% over the month), food and other goods as retail sales are not adjusted for inflation.

MACRO OUTLOOK TILTED TO THE DOWNSIDE

Risks to the economic outlook remain skewed to the downside including from possible deteriorations from the war and/or escalation of sanctions between Europe and Russia. A cut off of Russian gas appears more feasible according to the Italian Prime Minister (and thanks to Algerian suppliers), but the overall risk of a full cut-off to the economy is estimated at more than a 3% reduction in value added for Germany and almost 4% in Italy given the extent of gas-intensive activities according to the ECB.

Finally, the second half of 2022 will also be filled with important political milestones: after the French elections in April, Australia will be preparing for its federal elections early May, followed by the Japanese Upper House elections in July, the Brazilian elections in October and finally US Midterms in November.

US SHORT TERM YIELD ONCE AGAIN ATTRACTIVE

After the strong repricing of interest rates in a context of inflationary pressures, the expectations of central bank hikes seem to be well integrated by the markets. Credit markets remain attractive with strong fundamentals that should limit the risk of spread widening.

US 2-Year rate up about **100 BPS** over one month to **2.60%**

CENTRAL BANKS

Since the end of 2021, changes in the rhetoric of major central banks to address inflationary pressures have led markets to anticipate significant rate hikes. We consider that these expectations are justified and should be delivered. Thus, by the end of the year, Fed Fund rates should be close to 2.5%. On the European Central Bank (ECB) side, the deposit rate should once again become positive, whereas it has been negative since 2014 (currently -0.50%) even if the uncertainty remains higher for the ECB.

YIELD CURVE

After several months of flattening due to the Federal Reserve's intention to tighten monetary and financial conditions, the US yield curve could steepen in the next months. Here we give a few reasons that could lead to this outcome with bull and bear scenarios for bonds.

Bullish bonds

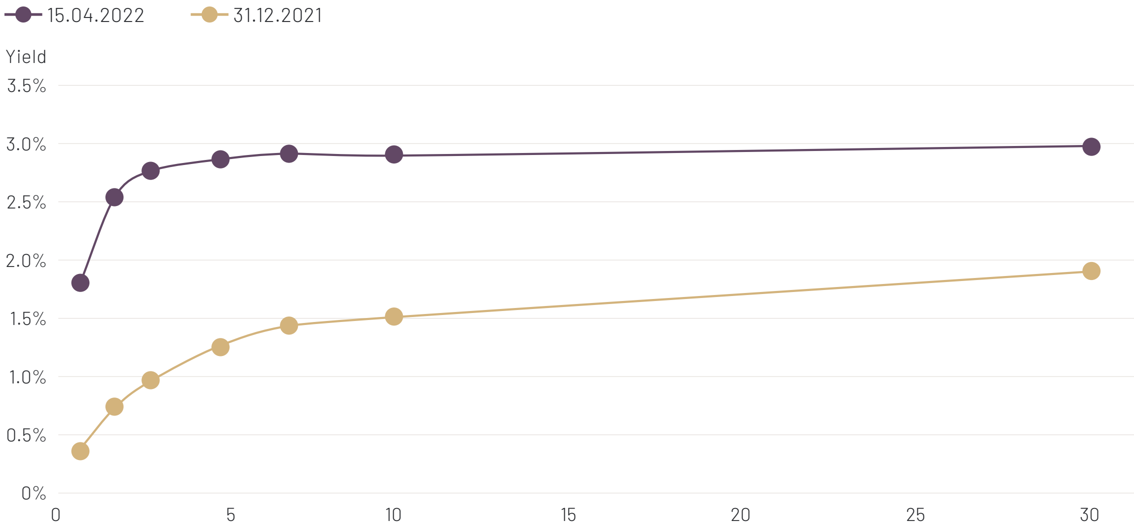
- A deteriorating outlook for the consumer is likely to weigh on growth expectations leading to fewer rate hikes.
- An easing of supply chain pressures and/or a less extreme geopolitical situation would alleviate pressure on commodities and inflation pressures.

Bearish bonds

- Term premium expansion due to aggressive quantitative tightening.
- "Deanchoring" of long term inflation expectations.

When looking at the Treasury market, valuations look more and more appealing (Chart 4). The short end of the US curve currently offers attractive carry levels that provide a good cushion in case rates continue to rise or if the US yield curve steepens as a result of quantitative tightening. On the euro curve, despite the rise in yields since the beginning of the year, breakeven yields remain very low (around 10 basis points at a one year horizon). Thus, they do not offer any protection, especially since the volatility of rates is high.

CHART 4: EVOLUTION OF THE US YIELD CURVE, SINCE THE BEGINNING OF 2022, %



Source: Bloomberg, Indosuez Wealth Management.

INFLATION

Inflation and its components describe fundamental differences between US and Europe. The resulting paths of inflation (observed and forecasted) also explain, in part, our different positioning on their respective interest rate curves. Concerning the US, a consensus exists in the market that we are now close to the peak. In March, US CPI was at +8.5% YoY; indeed very strong with the Atlanta Fed's "sticky-price" inflation index (a weighted basket of items that change price relatively slowly) rising up +4.7% YoY. The acceleration in prices may be beginning to moderate, however, as the core CPI (excluding energy and food prices) grew at a slower pace on a monthly basis in March (+0.3%) than in February (0.5%). In Europe, the story is different, inflation is expected to plateau at its high level in the coming months (7.4% YoY in March). Energy represents a larger contribution as compared to the US and could be a source of adjustment in the near future. The EU's vulnerability regarding energy and the current geopolitical situation induces less visibility for the coming months. Moreover, a more pronounced energy shock cannot be totally ruled out in this context.

Inflation markets already price accurately this situation. Inflation swaps, all along the curve, are above the 2% level for both markets and price elevated inflation in the short term. The European swap curve has strongly repriced in the last month and is now inverted. These elements confirm our conviction that inflation breakevens might not have a lot of further upside potential in the US and lot of uncertainty in Europe.

2-Year and 5-Year inflation breakevens even corrected in the US since late March. Consequently, nominal rates could be prone to further volatility on both sides of the Atlantic and could reprice higher in the coming weeks.

CREDIT MARKET

Credit markets have seen elevated volatility in 2022. The two main reasons are extreme repricing of underlying risk-free rates since several months for the US curve and more recently on the EU side. The second reason is the geopolitical crisis in Ukraine which has pushed spreads higher. We reiterate our positive view on "high beta" markets (European high yield and subordinated debt) while being cautious on the long duration bucket.

Arguments in support of this view are both fundamental and technical. At first, yields are at attractive levels notably for the Euro High Yield where indices have reached 4% in the past weeks.

Secondly, issuer balance sheets show robust metrics following the COVID-19 crisis. Looking at leverage, interest coverage or cash balance, indicate that issuers are solid on average and could sustain at least some degree of deterioration of the macro outlook. Moreover trailing default rates over the past 12-months and forecasts by analysts and rating agencies range from 1% to 2.6%. Current default rates implied by spreads are at 5.5% which, in our view, is a good compensation for current risks priced in. However, we note that flows have been negative since the beginning of the year and that high yield markets have not seen a new issuance for eight weeks.

A NEW MARKET REGIME, MORE VOLATILE

Despite the impressive rebound of the MSCI World since the market decline from Russia's invasion, concerns about high commodity prices, higher inflation levels and the growth slowdown are reinforcing the fear of stagflation. Central banks have clearly chosen to fight inflation instead of supporting GDP growth, resulting in higher 10-Year yields. The aggressive Fed cycle combined with the Ukraine War and Chinese COVID-19 lockdowns have placed some potential downside risks on equity markets and should keep volatility structurally elevated.

US expected earnings growth of close to

10%

PER YEAR

EARNINGS AND VALUATION

On one side, earnings estimates surprisingly continue to be revised on the upside, which is a positive driver for the market. On the other side, it seems that these positive revisions are mainly driven by oil and commodity sectors, while industrial and consumer sector earnings expectations continue to slide for Q1 2022. Furthermore, leading indicators like preannouncement ratios or the up/down ratio are pointing to the downside, which implies that the Q1 2022 earnings season should be mixed.

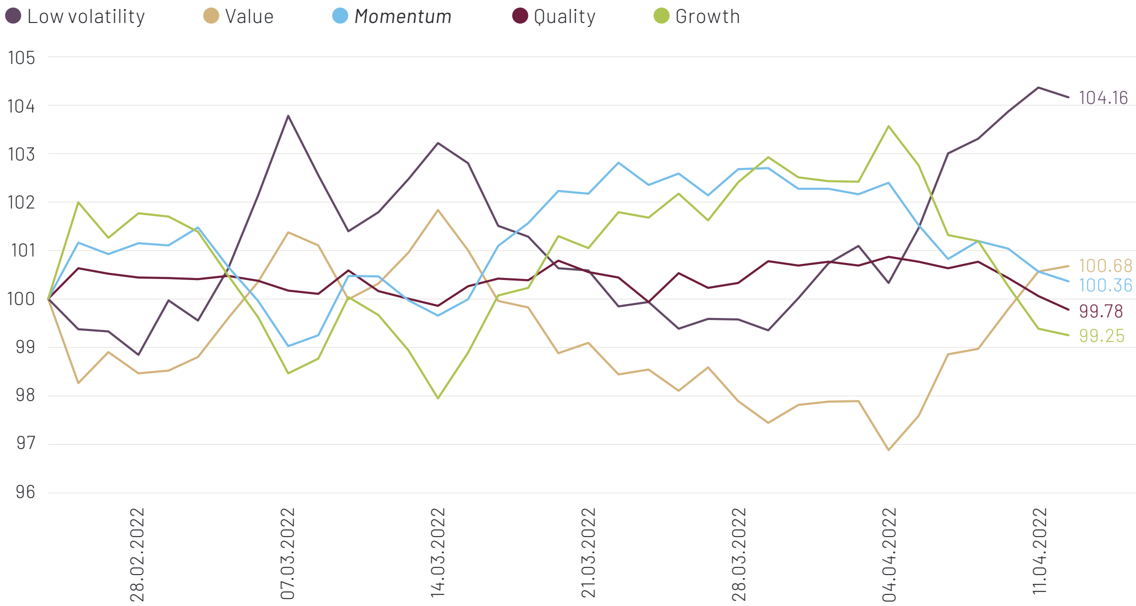
Valuations, which were back to more attractive levels have considerably worsened. The strong rebound of the US 10-Year yield has quickly deteriorated the equity risk premium and real yields, even if the absolute level in terms of P/E are already integrating a non-negligible discount (mainly in Europe and emerging markets).

UNITED STATES

The US economy seems to be more immune to the war in Ukraine because of its geographical distance and its lower dependence on oil and gas imports. Moreover, the analyst consensus continues to expect earnings growth of close to 10% per year over the next two years. However, the US market is suffering from the Fed's increasingly aggressive monetary policy, which is pushing long-term rates to 3-year highs.

This rise in long-term rates creates a lot of volatility in Growth stocks, on which we are more cautious. Thus, Quality stocks should perform better in the event of a downturn in the economic cycle (Chart 5).

CHART 5: MSCI US FACTORS RELATIVE PERFORMANCE



Note: The Fed's hawkish turn has been good for Value stocks. And, since the Russian invasion, unsurprisingly, Quality and Low Volatility has regained some *momentum*.

Source: Bloomberg, MSCI, Indosuez Wealth Management.

EUROPE

The economic uncertainty continues to prevail in Europe due to the consequences of the Ukrainian war (supply chain disruptions, rising energy and raw material costs).

Consequently, we prefer to be more prudent on the European markets: on one side they trade cheap (compared to their own historical averages, compared to the US and/or compared to bond markets), but, on the other side, the likely EPS downgrades are still in front of us as we head into the Q1 2022 earnings season.

In this context, we confirm our relative preference for UK, Nordic and Swiss markets at the expense of Euro Area markets.

EMERGING MARKETS

As China experienced the worst COVID-19 outbreak since Q1 2020, local governments of major cities reverted back to zero-COVID policies and city-wide lockdowns. This zero tolerance policy to COVID-19 has impacted the 2022 Chinese outlook with a downgrade in growth forecasts.

At this time, Chinese authorities are keeping their monetary and fiscal easing bias. We are expecting further monetary easing from the Chinese government over the next few weeks (possibly interest rate cuts).

Despite high volatility on Asian equity markets at this time, we are keeping our focus on actual corporate fundamentals and keep a positive stance for 2022.

STYLE: WILL GROWTH AND QUALITY DECOUPLE?

Volatility is going to stay high in the new market regime which implies a premium for Quality and low volatility stocks. We consider high stable margins, strong pricing power, strong balance sheets and stable growth as representative themes for this Quality universe. However, we equally consider "stable and growing dividends" as another source of alpha in this environment; we integrate this theme in our global Quality approach.

On the Value side, we still want to keep a significant part of our exposure on Oil/Commodity stocks, driven by the strong earnings revisions. But, we remain concerned about some cyclical industries in the Value area.

The Value style will remain very volatile as long as geopolitical risks dominate, but it can offer attractiveness, notably when combine with Quality stocks on a Barbell Strategy.

INFLATION IN THE DRIVING SEAT

The Japanese yen weakens to multi-decade lows driven by a central bank determined more than ever on re-inflating the economy. The Chinese yuan has started to ease back, whilst the EUR remains pressured by war with any recovery delayed at best to H2. Gold breaks correlations with real yields, and there is nothing on the horizon to stop commodity currencies going higher.

€

EUR remains stubbornly WEAK

JPY

Falling off a cliff without a parachute.

The Japanese yen has fallen off a cliff, and is still falling at the time of writing. The cause is low inflation preventing the Bank of Japan (BoJ) from tightening policy. The problem, however, is not higher costs - soaring energy prices (which Japan imports a lot of) and a tanking JPY are increasing wholesale prices at the fastest rate in 40 years. However, two decades of ultra-low inflation have destroyed the ability of Japanese firms to pass on higher costs to consumers.

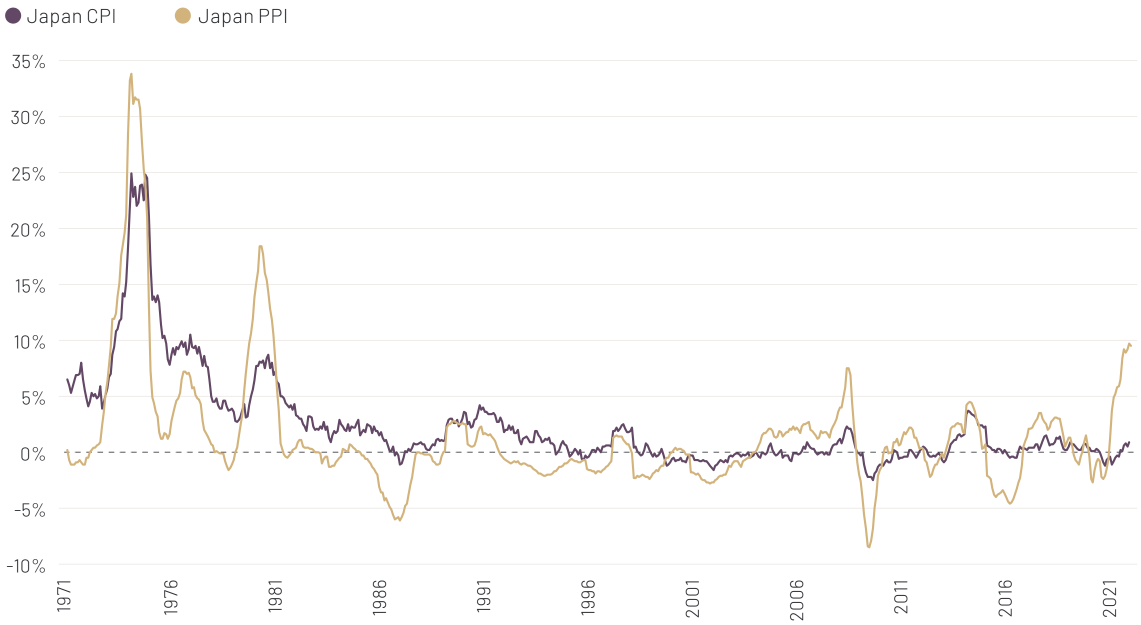
The result? A soaring producer price index (i.e. costs to companies), but a stubbornly tame consumer price index. Until Japanese companies break their habits, there will be few incentives for the BoJ and the government to put a parachute on the falling JPY (Chart 6).

EUR

Recovery delayed to H2 2022.

Despite multiple attempts to break back above 1.12 in EUR/USD, fuelled by the ECB's reluctance to turn dovish and failed attempts at a negotiated peace in Ukraine, the euro remains stubbornly weak and is threatening to test the lows of the last 20 years at 1.06 and 1.03. As markets give up hope for a Ukrainian ceasefire, it seems any potential for recovery is pushed back to the Q3/Q4 2022, when the prospect for ECB deposit rates returning to zero may bring back the tide of cash, which left when rates first went negative in 2014.

CHART 6: JAPAN CONSUMER PRICE INDEX (CPI) VS. PRODUCER PRICE INDEX (PPI), YOY, %



Source: Bloomberg, Japan Ministry of Internal Affairs and Communications, Indosuez Wealth Management.

CNY

Outperformance dissipates.

At long last, the yuan has succumbed to overdue profit taking after its ongoing phase of regional strengthening. The People's Bank of China (PBoC) has recently pushed back against daily fixing pressure, whilst the Japanese yen has been pummeled and become a clear cause for concern *vis a vis* export competitiveness in Asia.

Given the lockdown-induced Chinese GDP growth slowdown fears, stimulus in the form of RRR (required reserve ratio) monetary policy easing is now soon in the cards.

As such, the once attractive 10-Year government bond yield premium over US 10- Year yields has fully narrowed to zero.

From a technical chart perspective, the recent catch up retracement orchestrated on USD/CNY above 6.3850 now suggests a deeper correction towards the 6.50 resistance zone at a minimum whilst the FOMC instead hikes aggressively.

COMMODITY CURRENCIES

Unstoppable.

Fragmentation in global energy and raw materials markets, trade barriers getting raised through sanctions or tariffs, and a renewed drive for "self-sufficiency" can only mean higher commodity prices are here to stay, even if Russia and Ukraine make peace. On that basis, and given that they are still trading 20% below their trade-weighted peaks in the previous commodity boom of 2012/2013, AUD, CAD and NOK are likely to continue strengthening.

High inflation and healthy economies are further spurring hawks at their central banks to raise rates, meaning monetary support is coming hand in hand with trade flows. It may be a while yet before we can call a top in these currencies.

GOLD

Breaking correlation with real yields.

The correlation between the gold price in USD and US long term real yields appears to have broken, for now. Whilst US 10-Year real yields climbed to 0% for the first time since the start of the pandemic (from a low of -1.2%). Gold has sustained gains above USD 1'900 and even tested USD 2'000 USD this month. We see two factors supporting it, starting with a geopolitical risk premium of about USD 200 per ounce from the war in Ukraine.

Secondly, and more importantly, it's likely that current very negative real yields in cash terms (where US inflation is soaring at 8.5% YoY whilst 1 month cash is still yielding less than 1%) are provoking a "re-rating" in the gold price. In other terms – real yields are a ranged metric, whilst gold prices can climb interminably with actual real economy prices, so a break such as this one should naturally happen. How high it can go in the foreseeable future is hard to say, indeed it is more likely even to correct, but if investors believe (or fear) inflation is more likely than disinflation, prudence argues against being short.

INVESTMENT SCENARIO AND ALLOCATION

Global growth should end between

3 - 3.5%

IN 2022

INVESTMENT SCENARIO

- **Growth:** revised on the downside in most geographies, reflecting both the inflation of commodities and geopolitical uncertainties affecting business and consumer confidence, as well as zero-COVID and deleveraging in China. Global growth should end between 3 and 3.5% in 2022, with quasi-stagnation in some Euro Area economies in H2 2022, and the US faring better on the back of a more robust domestic economy and less dependency on energy. Fiscal policy will remain lose while investment plans on security, defence and energy transition accelerate.
- **Inflation:** in the region of 6% in the US and Europe in 2022, with a risk of a longer plateau and slower decrease than expected, putting at risk the assumption of 2.5% core CPI in 2023. With inflation high for longer, we expect a higher probability of second round effects on wages (notably in the US).
- **Central Banks:** accelerating rate hikes to fend off inflation pressures: the ECB expected to exit negative rates in H2 2022 while Fed funds rates should reach 2.5% by year end, with a 0.5% increase in May. Emerging market central banks to continue hiking, but may end as advanced economies begin. Balance sheet reduction is set in the US which will begin early summer putting at risk the long-end part of the curve.
- **Earnings and margins:** EPS growth should logically be revised on the downside due to slower growth and higher margin pressures, but the earnings revision *momentum* was paradoxically resilient so far. We anticipate EPS growth stagnating in the Euro Area while being more resilient around 5% in the US. Negative revisions continue in China, versus re-rating of commodity exporters in the emerging world.
- **Geopolitical risks:** elevated risk levels, with a conflict in Ukraine that could last, and high electoral uncertainties in the Euro Area. Institutional investors favour US equities over Europe in this context. H2 will see the return of political risk in Japan and the US with Midterm elections. Within Europe, UK and Switzerland are seen as a sweet spot of diversification.

ALLOCATION STRATEGY

- Neutral approach on risk assets in portfolios.
- Equity exposure partly reallocated from Euro Area towards UK, Switzerland and US Equities.
- Preference for Quality, Value and dividend plays over Growth and long duration stocks in this context; cyclical stocks such as industrials remain vulnerable due to higher input costs.
- Moderate duration maintained as quantitative tightening could re-steepen yield curves; preference for short-end part of the US curve where carry can compensate adverse movement on rates.
- Within credit, idiosyncratic risk is rising, but no wall of defaults and refinancing in sight. We keep our constructive view maintained on short duration high yield and financial bonds.
- Still early to become bearish on USD against EUR and to buy emerging debt in local currencies, but USD strength should fade, as well as the CNY start to weaken moderately to reflect macro headwinds and further accommodative monetary policy.

KEY CONVICTIONS

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

Source: Indosuez Wealth Management.

OVERVIEW OF SELECTED MARKETS

DATA AS OF 21 APRIL 2022

GOVERNMENT BONDS	YIELD	4 WEEKS CHANGE (BPS)	YTD CHANGE (BPS)
US Treasury 10Y	2.91%	53.77	139.94
France 10Y	1.40%	42.30	120.70
Germany 10Y	0.95%	41.60	112.70
Spain 10Y	1.90%	48.50	133.30
Switzerland 10Y	0.89%	38.50	102.60
Japan 10Y	0.25%	2.30	18.20

BONDS	LAST	4 WEEKS CHANGE	YTD CHANGE
Governments Bonds Emerging Markets	36.27	-0.68%	-7.52%
Euro Governments Bonds	207.49	-2.02%	-5.06%
Corporate EUR high yield	202.55	-0.75%	-5.19%
Corporate USD high yield	309.71	-1.75%	-6.83%
US Government Bonds	301.63	-1.86%	-5.82%
Corporate Emerging Markets	45.35	-1.97%	-11.08%

CURRENCIES	LAST SPOT	4 WEEKS CHANGE	YTD CHANGE
EUR/CHF	1.0329	0.97%	-0.44%
GBP/USD	1.3030	-1.19%	-3.71%
USD/CHF	0.9533	2.48%	4.43%
EUR/USD	1.0834	-1.48%	-4.71%
USD/JPY	128.38	4.93%	11.56%

VOLATILITY INDEX	LAST	4 WEEKS CHANGE (POINTS)	YTD CHANGE (POINTS)
VIX	22.68	1.01	5.46

EQUITY INDICES	LAST PRICE	4 WEEKS CHANGE	YTD CHANGE
S&P 500 (United States)	4'393.66	-2.80%	-7.82%
FTSE 100 (United Kingdom)	7'627.95	2.15%	3.30%
STOXX 600	461.57	1.88%	-5.38%
Topix	1'928.00	-2.70%	-3.23%
MSCI World	2'959.92	-2.68%	-8.41%
Shanghai SE Composite	3'995.83	-6.01%	-19.12%
MSCI Emerging Markets	1'086.93	-4.40%	-11.78%
MSCI Latam (Latin America)	2'571.06	-2.53%	20.71%
MSCI EMEA (Europe, Middle East, Africa)	230.40	-1.52%	-16.43%
MSCI Asia Ex Japan	686.84	-5.09%	-12.98%
CAC 40 (France)	6'715.10	2.43%	-6.12%
DAX (Germany)	14'502.41	1.60%	-8.70%
MIB (Italy)	24'805.62	1.66%	-9.29%
IBEX (Spain)	8'814.60	6.13%	1.16%
SMI (Switzerland)	12'301.33	1.40%	-4.46%

COMMODITIES	LAST PRICE	4 WEEKS CHANGE	YTD CHANGE
Steel Rebar (CNY/Tonne)	5'159.00	4.33%	13.43%
Gold (USD/Oz)	1'951.62	-0.31%	6.69%
Crude Oil WTI (USD/Bbl)	103.79	-7.61%	38.00%
Silver (USD/Oz)	24.62	-4.94%	5.43%
Copper (USD/Tonne)	10'285.00	-0.62%	5.81%
Natural Gas (USD/MMBtu)	6.96	28.81%	86.51%

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

	JANUARY 2022	FEBRUARY 2022	MARCH 2022	4 WEEKS CHANGE	YTD (17.03.2022)
BEST PERFORMING +	7.29%	4.73%	12.25%	2.15%	20.71%
	2.43%	0.39%	3.58%	1.88%	3.30%
	1.08%	-0.08%	3.15%	-1.52%	-3.23%
	-1.93%	-0.47%	2.52%	-2.53%	-5.38%
	-3.12%	-2.40%	0.77%	-2.68%	-7.82%
	-3.88%	-2.65%	0.61%	-2.70%	-8.41%
	-4.84%	-3.06%	-2.52%	-2.80%	-11.78%
	-5.26%	-3.14%	-2.93%	-4.40%	-12.98%
	-5.34%	-3.36%	-6.84%	-5.09%	-16.43%
− WORST PERFORMING	-7.62%	-10.33%	-7.84%	-6.01%	-19.12%

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

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

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

BLS: Bureau of Labor Statistics.

BNEF: Bloomberg New Energy Finance.

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

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

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 five-year inflation expectations will be in five years' time. It provides a window into how inflation expectations may change in the future.

IPPC: The Intergovernmental Panel on Climate Change.

IRENA: International Renewable Energy Agency.

ISM: Institute for Supply Management.

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

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

OECD: Organisation for Economic Co-operation and Development.

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

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

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

PMI: Purchasing Managers' Index.

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

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

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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