Marketing Material

MONTHLY HOUSE VIEW

June 2022

Focus
Euro Area: at the crossroads

Architects of Wealth

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BE KIND, REWIND!

"*Loss aversion helps produce inertia, meaning a strong desire to stick with your current holdings*" Richard Thaler, Nudge

VINCENT MANUEL

Chief Investment Officer, Indosuez Wealth Management

Dear Reader,

Many investors would probably like to turn back the clock a few months and retroactively adjust their portfolios to avoid the two major corrections in recent months: one on government bonds and the other on Growth stocks. In hindsight, the lesson learned from this correction is that it is hard to remain clear-eyed on high market prices and resist the idea that the future will be a continuation of the present. This is particularly true in a year when the macro-financial scenario has been seriously undermined by the conflict in Ukraine. Nevertheless, it would equally be a great a risk to think that inflation will continue to increase and that central banks will simply go back to a 1970s-style Fed approach.

The high level of uncertainty and the unease caused by capital losses can lead as much to investor paralysis as to an emotional decision to capitulate. This is what often happens after markets take 20% pitfalls; a famous bear market threshold which aptly reflects the swing from optimism to pessimism. This risk of capitulation in 2022 can be seen as the counterpart to the "fear of missing out" (FOMO) uptrend that dominated the markets in 2021.

To avoid the twin emotional trap of capitulation and impulsiveness, it might be better to try to make sense of the current environment. In the last few weeks, we have seen two alternating and competing narratives that are in fact two sides of the same coin: first, inflation with monetary policy normalisation and, second, fears of a recession.

Up until early to mid-May, the markets were primarily governed by inflation data (which once again exceeded expectations), and by the more determined tone of central banks (which fuelled the rise in long term rates). Paradoxically, future inflation expectations have corrected, reflecting the anticipated impact of the economic slowdown and monetary tightening. This correction has also led to a rise in real interest rates, which affected both Growth stocks and gold.

But in parallel long term rates have eased due to the increase in the likelihood of recession over the past few days.

This clash between the inflationary narrative and the recessionary narrative has also been stimulated by the sharp divergence between signs of a downturn in the business cycle, on the one hand, and surprisingly resilient corporate earnings, on the other. We can see a parallel with the divergence between economic indicators (such as PMIs), which are stabilising at high levels, and depressed consumer confidence indicators, which are affected by the decline in household purchasing power. All this confirms that the current shock is consumer rather than business-driven, but the latter will soon start to feel the effects on their sales volumes.

The rise of the recessionary narrative inevitably leads to changes in market positioning, with a better performance by Defensive sectors at the expense of Growth and Value. It could be tempting to see this as an entry point for Growth stocks after six months of correction. The signal will likely come from central banks. If the Fed were to soften its tone in the coming months in response to the risk of an excessive economic slowdown, investors would likely return to these stocks. The timing could also coincide with the possible and long-heralded weakening of the US dollar, something that is hard to imagine as long as the Fed sticks to its harsh tone. However, the dollar could return to gravity if the Fed signals an inflection point in its tightening cycle and the European Central Bank (ECB) exits negative rates.

The expected exit from negative rates is at least one positive that investors can hold onto in this anxiety-inducing environment, and which signals the return of bond carry. At the same time, the equity market correction could restore more attractive rates-of-return that investors need in order to combat the capital erosion caused by inflation.

EURO AREA: AT THE CROSSROADS

The Euro Area stagflation narrative is progressively becoming reality. The ECB is expected to bring interest rates back to positive territory, while fiscal policy will need to remain exceptionally accommodative for yet another year. European solidarity remains an element to watch, even if sovereign debt sustainability should not be questioned in the short term.

GDP TO HIT THE BRAKES IN THE SECOND HALF OF 2022

The Euro Area economy grew by 0.3% quarter-on-quarter (QoQ) in the first quarter of 2022 in line with market expectations. Growth in Spain (0.3%) and Germany slightly offset the contraction in Italy (-0.2%) and the unexpected standstill in France. Employment in the zone rose for a fourth-straight quarter, pushing the total further above its pre-pandemic level.

Looking ahead, surveys indicate that European consumers are really taking the brunt of the energy price crisis at present. Retail sales begun to slow in March (-0.4% month-on-month (MoM)). Private consumption is expected to contract in H2 2022 in line with the peak in inflation. Uncertainty remains high, especially on energy supplies as well as the knock-on effects of the Chinese lockdowns creating hefty supply bottlenecks for manufacturing states. Car registrations in the European Union (EU) plummeted in April (-20.6% year-on-year (YoY)), in large part due to supply constraints hampering production. The currency bloc can however benefit from two supportive factors. First, service-led economies will profit from the re-opening of the European economy and the prospects for a more "normal" summer tourist season.

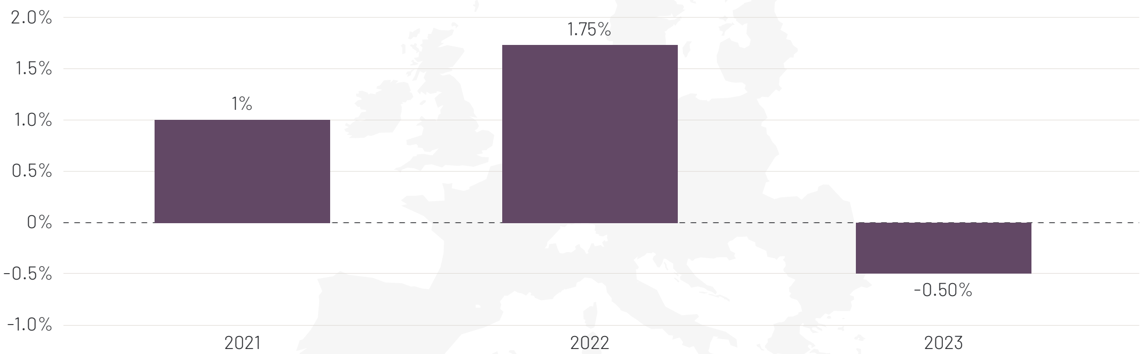
%

DOWNSIDE RISKS
prevail in the short term

Secondly, the slowdown in private investment due to higher uncertainty and anticipated rising rates, will be partially offset by an increase in public consumption and investment. The fiscal impulse in 2022 is indeed estimated to be stronger in 2022 than 2021 (Chart 1) with the implementation of the NextGenerationEU (NGEU) envelopes and new national measures to help households and firms to cope with the surge in energy prices. However, this will not fully compensate the impact from slowing demand and we therefore expect growth to come to a standstill in the Euro Area in the second half of the year.

All in all, GDP is expected to progress by 2.5% in the Euro Area in 2022, this figures is supported by a strong carry-over effect from solid growth end 2021. In H2 2022, the zone will see a stagnation in growth with the peak on inflation. In 2023, growth is projected to remain modest (to 1.5%) as consumers gradually retrieve some purchasing power. According to European Commission fore-casts, wages are expected to progress by 3.2%, above projected inflation at 2.7%. National fiscal spending is no longer expected to be supportive in 2023. Downside risks prevail in the short term, notably from a Russian gas cut off; the European Commission estimates that such a scenario would lead to recession (writing off 2.5 percentage points of growth in 2022 and 1 in 2023).

CHART 1: EURO AREA ESTIMATED FISCAL IMPULSE ON GDP GROWTH, %



Source: European Commission, Indosuez Wealth Management.

RISING RATES: ANOTHER HURDLE

Core inflation (excluding energy prices) in the Euro Area went up by 3.5% in April (vs. 2.9% in March). It is expected to continue rising in the coming months, as wages begin to tilt up with workers demanding higher wages in a still solid labour market. Euro Area headline inflation is expect to reach 7% in 2022 and remain above the ECB target at 2.7% in 2023. Faced with rapidly rising inflation and the weakness in the euro implying imported inflation, the ECB is set to normalise monetary policy (cf. Fixed Income, page 8), but only modestly given the weakness in domestic demand. Deposit rates should return to positive territory by end 2022.

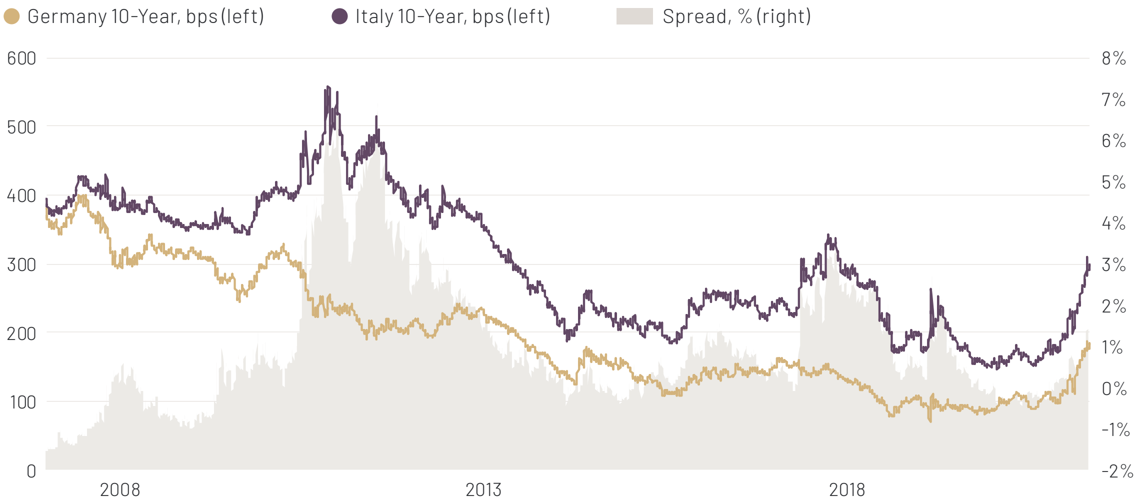
European FISCAL RULES likely to be KEPT ON ICE FOR ANOTHER YEAR

With an ECB mid-summer hike looking inevitable and European fiscal rules likely be kept on ice for another year, debt sustainability fears appear to have crept up again for high-debt European countries such as Italy (Chart 2). Along with the fiscal balance, the interest rate-growth differential ($i - g$) is indeed an important determinant of government debt dynamics and sovereign sustainability analysis. Effectively these two factors tell us, everything else held constant, how much government spending and revenues will naturally evolve. In the short term, the Italian debt-to-GDP ratio will actually be positively impacted from both sides thanks to still historically low average yields on bond issuances (at 0.4% today compared to 3% in 2012), a lengthening of the average maturity of debt and higher inflation.

The recent increase in 10-Year Italian yields to the 2018 post-election stress levels of around 3% does not constitute a risk of financial fragmentation in the zone as nominal GDP growth this year remains significantly higher than interest rates. Furthermore, Italian credit default swaps are nowhere near past stress levels.

In the medium term things are less rosy, Italian average interest payments on debt will be gradually impacted by higher rates as debt gradually rolls over and assuming Italian nominal growth returns to pre-crisis levels, this would imply the need for more fiscal discipline (in the form of a primary budget surplus) to maintain a stable debt path; a skill that the Italian government has maintained with few exceptions over the past 20 years. The rise in spreads can therefore be attributed more to a repricing of Italian high indebtedness after periods of extremely low rates, especially as the ECB purchasing program winds down and new buyers will need to be sought out. Continued EU debt mutualisation will be required as the ECB takes the backseat (Italy has already subscribed for the maximum amount of NGEU funds); the June election is an element to watch as the risk of more euro-sceptical figures (M5S and Lega Nord) may increase at a time when Italian consumers begin to pay for Draghi's tough stance on Russian energy.

CHART 2: MARKETS REPRICE ITALIAN GOVERNMENT DEBT



Source: Italian Department of the Treasury, Indosuez Wealth Management.

MIND THE GAP

The Bank of England (BoE) certainly knows how to make itself heard. By announcing double-digit inflation and possibly a more realistic growth trajectory than the Fed and the ECB, the BoE managed to shake global markets early May. Europe is in the eye of the Ukraine storm and the UK has uniquely compounded a purchasing power crisis with Brexit, but will the US muster a soft landing when even China is slowing the global growth trajectory?

THE BoE SHOWS ITS CARDS

Early May the Bank of England (BoE) raised rates to 1%, while flagging recession risks and increasing inflation forecasts to 10% in 2022 (with its peak pushed back from April to Q4 2022) and 3.5% in 2023. In April, inflation hit a 30-year high of 9%, more than triple the BoE's target. Energy bills are due to have increased by 54% in April, with a further increase scheduled in October.

Retail sales dropped 4.5% over the year in April, albeit less than the consensus forecast (-7%). They may have been cushioned by total wages (including bonuses) growing 9.9% over the year in March, but excluding bonuses this figure is brought down to 4.1% and adjusting for inflation regular pay actually fell by 1.2%. In this context, the BoE projects GDP to fall in Q4 2022 and be broadly flat in 2023.

A CHINA mRNA VACCINE
upside risk
for global growth
IN H2 2022

THE FED IS FIGHTING A DIFFERENT TYPE OF INFLATION

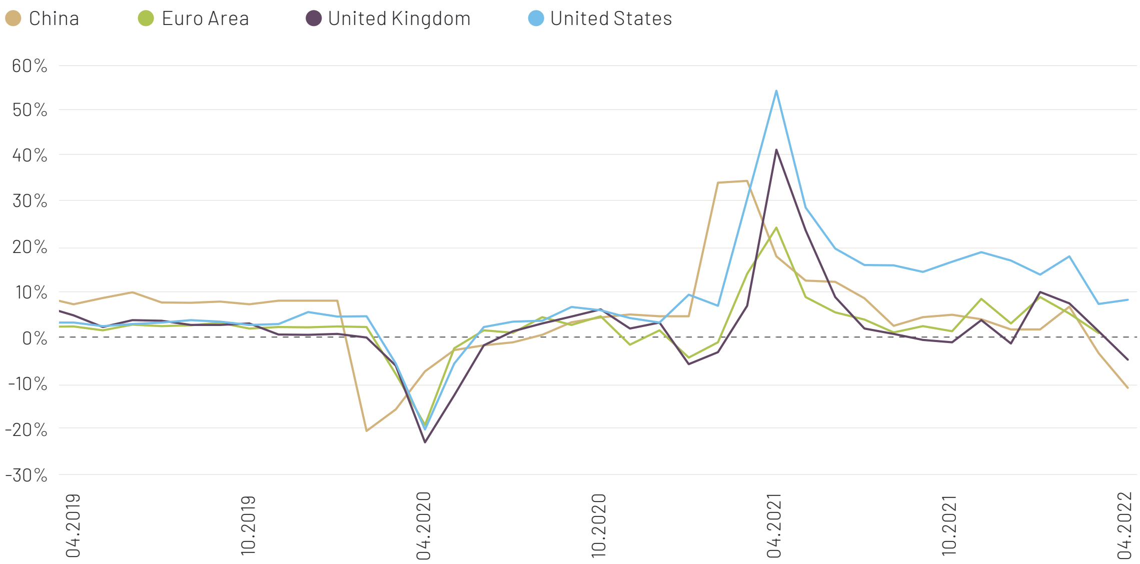
In contrast, the Fed announced more hikes in a more upbeat environment, as US consumers appear to be more resilient thus far, which can in part be explained by the very tight labour market and a lower exposure to the energy price rises caused by the war. After a first quarter rise of 2.7% in consumer expenditure, retail sales continued to advance in April (0.9% MoM and 8.2% YoY), despite an almost 3% decrease in sales at gasoline stations (Chart 3). This provides an upside boast for Q2 2022 GDP and pushes back the expected impact of Fed hikes until the end of the year.

Nevertheless, inflation is now engraved in consumer minds and will prove to be slow to decline, while double-digit producer price inflation is expected to weigh on the manufacturing sector. We also continue to monitor the US housing market as the first impacted by the Fed's actions. Mortgage rates have hit a 12-year high in three months (at 5.3% in May, up 43 basis points (bps) over the month, albeit less than the 78 bps rise in April). In this context, the National Association of Home Builders (NAHB) index shows a sharp decline in prospective buyers; house prices are lagged, but remain upward pointing. All in all, despite better performance, consumer confidence surveys remain clear that consumption will slow towards the end of the year. A more sober outlook is portrayed for 2023 (1.7%), which could warrant for a less hawkish Fed next year.

CHINA: WAITING TO REOPEN

The continued lockdown in China has led to a revision in growth forecasts for 2022, with domestic demand taking the large part of the contraction. Retail sales indeed fell considerably more than industrial production in April (-11.1% YoY vs. -2.9% respectively). However, we believe the reopening of the economy, thanks to an mRNA vaccine is a key upside risk for global growth in H2 2022. GDP growth is projected around 4% in 2022 given the unavoidable impact of lockdowns on Q2 GDP. In a key election year, we do not believe the Chinese government can let GDP growth diverge heavily from their 5.5% announced target, no more than it can afford losing face on its zero-COVID policy and now increasing food prices. We expect to see additional monetary and fiscal stimulus in the coming month. The return in Chinese activity should maintain pressure on oil prices in the coming quarters, despite the slowdown in advanced economies.

CHART 3: CONSUMERS ON THE FRONT LINE, YOY RETAIL SALES, %



Source: Refinitiv, Indosuez Wealth Management.

MAINTAINING A CONSTRUCTIVE VIEW ON CREDIT SPREADS

Interest rates have risen sharply since the beginning of the year in a context of rising inflation leading central banks to exit their ultra-accommodative monetary policy. Credit markets seem to be pricing in relatively well the slowdown in activity and a moderate rise in default rates. We have a constructive view in the medium term on carry strategies on corporate bonds with solid fundamentals and sufficient visibility in this complex environment. We have a preference for short duration investments.

Subordinated Financial spreads up
100 BP
YEAR-TO-DATE

CENTRAL BANKS

Central banks are in a difficult spot with historically high inflation readings and a global growth slowdown. However, the Fed is in a much better situation than its peers with a tightening of monetary conditions already underway. Its forward guidance and actions are already reflected in the rate markets (mortgages, corporate and treasury rates) and real yields are in positive territory. Cyclical components of inflation are softening (goods prices, metals,…). Fuel, food and rent prices are still rising, but long term inflation expectations are well anchored.

The ECB is caught between a rock and a hard place as growth is threatened by the geopolitical situation and the depreciation of euro is adding fuel to the fire. The ECB's balance sheet is expected to shrink as a consequence of TLTROs repayment. It is also expected to end the asset purchase program and hike rates this summer in an attempt to prop up real interest rates that are still in deep negative territory.

YIELD CURVE

The flattening of the US yield curve was driven by Jerome Powell's hawkish turn last summer. The term structure of interest rates reflects a level of federal fund rates around the neutral rate at the end of 2022. As long as long term inflation expectations stay well anchored, the market could look through further hawkishness from the central bank which should alleviate the pressure on the yield curve. Moreover, risks on GDP growth are rising and could lead central banks to refrain from an overly aggressive tightening.

The consequence would be a bull steepening of the yield curve. Nevertheless, there are also factors that could lead to a bear steepening of the curve. An expansion of the term premium and an inflation risk premium in the case of an aggressive quantitative tightening and/or a deanchoring of inflation expectations.

EUROPEAN PERIPHERAL

In the recent context of rising rates and higher spreads, European peripheral debts have seen an increase in their overall yield. Although these levels can look attractive at first sight, we do not share this point of view. In line with our positioning on the EUR govies curve, we would rather stay away from peripherals for the following reasons: at first the commitment to act from the ECB has gained a lot of traction in the recent weeks and seems inevitable now. The ECB's Negative Interest Rate Policy has come with side effects on banks profitability, bond market distortion, for instance ,and ultimately problematic forex levels. Looking at spreads within the region, the divergences that have formed from the lows observed only weeks ago are logical when compared to actual debt-to-GDP ratios (cf. Focus, page 4). Furthermore, the end of the ECB purchasing programs will probably lead to an upward trend in spreads in our view as new buyers will need more compensation to step in. Current spreads are not discounting a "crisis mode" that would lead the ECB to intervene. We do not consider actual levels as an entry point, but rather a good way to express our neutral/negative view on EUR curve and on peripheral markets.

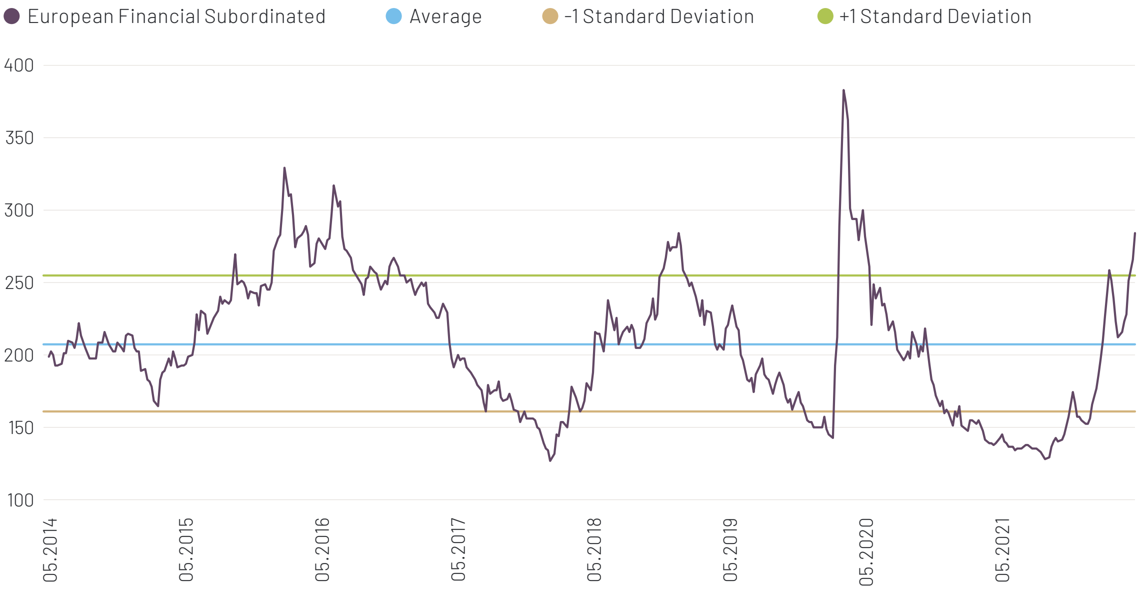
CREDIT MARKETS

The credit markets are still under pressure in a context of decelerating growth and pressure on corporate margins due to higher inflation. While weak credit has been the most affected by recent spread corrections, the negative total return on major indices due to the impacts of both higher rates and wider spreads has led to better entry points for carry perspectives, including among solid credits. Being aware of the lack of catalysts to drive spreads tighter for the moment, with risks of further pressure especially for corporates to be the most affected by rising costs, we remain comfortable with corporate fundamentals overall and believe bondholders are on average well remunerated at current spread levels on a historical basis as compared to government yields.

SUBORDINATED DEBT

The subordinated debt market has suffered from the widening in credit spreads, rates volatility and a general repricing in risk premium. Even though investment grade senior debt offers attractive yield, the spread differential between the two segments of the market still favors subordinated debt especially for high quality corporate hybrid issuers. The financial sector offers also good risk/reward profile. Major European banks - less affected on average than corporates by inflationary pressure - released globally resilient Q1 2022 results, better than expected, only slightly below Q1 2021, driven by solid revenue growth on the back of higher rates. While CET1 ratios have decreased against a combination of regulatory headwinds and distribution catch up post-COVID 19, capital and liquidity ratios remains solid, and capital buffers extremely comfortable. Cost of risk increased due to first Russia/Ukraine impacts; but remains significantly below 2020. The higher rate environment is a positive for banks and inflation costs will weigh more on corporates, thus on a relative basis banks should be more resilient. Another resilience factor is that bank debt has not been part of the ECB purchase program, it is therefore less likely to suffer from the end of quantitative easing programs (Chart 4).

CHART 4: EUROPEAN FINANCIAL SUBORDINATED INDEX, SPREAD VS. GOVERNMENT



Source: Bloomberg, Indosuez Wealth Management.

THE PERFECT STORM

Equity investors have faced a perfect storm of headwinds to start the year: Omicron, inflation, rising rates and the Russia/Ukraine conflict. Against this backdrop, earnings growth expectations have remained steady and provide the main tailwinds for equities. The Q1 2022 earnings season was reassuring with revisions that continue to be pushed to the upside. With the fall in markets, all sentiment indicators are extremely bearish, which from a contrarian standpoint could leave some investors playing on a short term rebound in the stock market.

In Europe,
79%
of the companies
BEAT SALES ESTIMATES IN Q1

EARNINGS AND VALUATION

On the earnings side, results continue to be resilient. Overall, companies have beaten expectations in developed markets. In Europe, 79% companies beat sales estimates (versus the historical average of 60%), with aggregate EPS growth currently coming in at 7% compared to consensus estimates -1%, hence a positive surprise of 8%.

Despite strong reports, management guidance has been cautious about the future as higher input cost-inflation and supply-chain issues are starting to sink in.

On the valuation side, the continuing rise in long term rates has quickly derailed equity market price-earnings ratios, integrating the discount rate to valuation. Meanwhile, real yields deteriorated the equity risk premium, thereby making equity markets less attractive.

UNITED STATES

Earnings season failed to lift equity markets despite some positive surprises: 77% of S&P 500 companies reported positive EPS surprises in Q1 2022. Interestingly, 85% of S&P 500 companies that conducted earnings calls for the first quarter cited "inflation" during the call (the highest percentage since 2010). Nevertheless, at this stage the impact on margins still remains manageable: the current net profit margin estimate reaches 12.5% for the US market in Q2 2022 although below the estimate of 12.7% end of March.

Looking ahead, margins should continue to be under pressure, as reflected by the recent earnings releases of major US retailers. Finally, investors are very concerned about the Fed's more restrictive monetary policy.

We remain cautious with regard to equities that are more sensitive to long term rates and prefer Quality companies. Defensive stocks are also proving to be more resilient in an environment marked by increased fears of recession.

EUROPE

Many headwinds are affecting Europe: the Russia/Ukraine conflict, supply-chain disruptions, inflation, rising rates and repercussions from the China zero-COVID policy. Given the lack of visibility on the path to recovery, we remain cautious on European equity markets even if they are trading relatively cheap in absolute and relative terms. The Q1 2022 earnings season was reassuring for many companies and sectors. Consequently, earnings momentum revisions were positive, but uncertainty continues to prevail for the remainder of the year. Within Europe, we remain constructive on UK and Swiss Markets, as a source of diversification of our European equity exposure, as the two areas should be less directly exposed to the Ukraine crisis compared to the Euro Area and benefit from an attractive sectoral stock market breakdown (tilted towards Energy and Quality/Defensive stocks).

EMERGING MARKETS

Concerns regarding the US current interest rate hike cycle, global stagflation fears as well as the impact of the COVID-19 lockdown on China's domestic demand recovery are weighing on Emerging Markets (EM) investor minds. These concerns are reflected in Chinese stock markets, which are now trading at 11 times earnings and are therefore attractively valued by historical standards. While earnings revisions are still on the downside and warrant caution, we are constructive for the second half of 2022 on the back of progressive relaxation of the strict China COVID-19 measures leading to progressive reopening and expected strong pent-up consumer demand. Moreover, Chinese authorities are keeping their monetary and fiscal easing policies and more measures are to come. We are notably expecting a major ramp-up in infrastructure spending over the year.

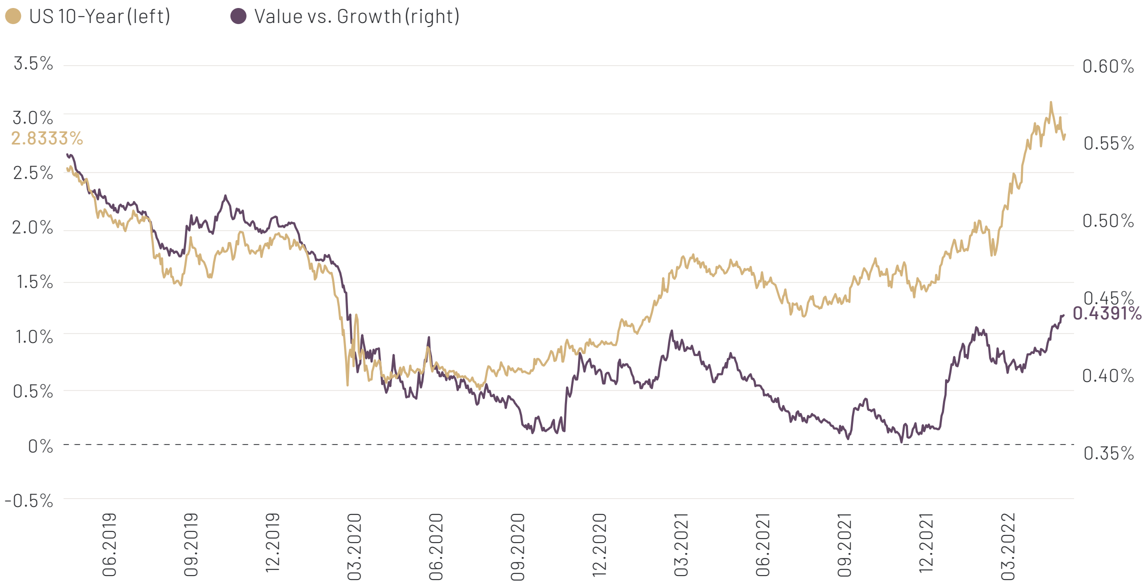
STYLE: WILL GROWTH AND QUALITY DECOUPLE?

The Quality thematic recently had to fight a considerable headwind: the strong rebound in long term yields had a negative impact on their long duration valuations. Nevertheless, this new context of volatility implies a higher premium for the Quality and Return to Shareholders themes, which historically weathered stagflationary periods relatively well.

Value has outperformed thanks to the strong rebound of yields, even if the performance of financials has been a bit disappointing in this context. The positive momentum on Energy and Materials sectors fuelled by the strong earnings revisions is also a solid driver of outperformance, especially as crude oil prices remain supported by the current geopolitical context and low US oil inventories.

On the Growth side, stocks continue to suffer from rising bond yields with some non-profitable tech stocks trading 50% below their 2021 highs, while the tech-heavy Nasdaq has already fallen by 25% year-to-date. Even if this is a good valuation adjustment, it may have further to go if rates continue to rise. As such, we remain cautious on this investment style at this stage until interest rates begin to stabilise, in which case, investors could start to return to the Growth style (Chart 5).

CHART 5: MSCI EUROPE VALUE VS. GROWTH CORRELATED WITH US 10-YEAR, %



Note: The high correlation between US yields and relative performance between Value and Growth stocks is still relevant. Accounting for the last rebound in yields, Value still has some potential to catch-up.

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

FOREX VOLATILITY IS BACK

Diverging monetary trends is a factor that will continue to nourish currency dynamics going forward. In May, forex markets were also impacted by the rollercoaster of risk-on/risk-off volatility, with the USD surging to new twenty year highs. Notable losers were the previous winners – Chinese yuan finally gave up holding onto 6.40, and commodity currencies likely suffered significant position liquidation.

DOLLAR has strengthened beyond our expectations

Forex markets have been very volatile recently driven by risk sentiment and fears of a slowdown in China. The dollar has strengthened beyond our expectations with the US Dollar Index reaching its highest level since December 2002 (Chart 6). Market participants have highlighted growing focus on EUR/USD trading at parity in the near term. Technically, the important support lies at 1.0340 which is the low point last seen in 2017.

WHERE EUR/USD SHOULD TRADE IN THE COMING WEEKS?

Scenario 1: the most negative.

The war between Russia and Ukraine intensifies and gas supplies to Europe are disrupted. The Chinese lockdown continues into year-end. US inflation remains high. In this scenario, EUR/USD breaks through support at 1.0340 and reaches parity.

Scenario 2: our base case.

Our base case scenario is a *status quo*. In this case, EUR/USD should remain in a 1.0350 – 1.0850 range.

Scenario 3: the most optimistic.

ECB rhetoric becomes more hawkish than current trends whilst the Fed starts to soften its message if inflation in the US shows signs of peaking – we see these as a possibilities in H2 2022. It is also worth noting an abrupt end to the war between Russia and Ukraine would lift the EUR. In these scenarios, EUR/USD should trade at 1.10 and beyond.

CHART 6: US DOLLAR AT AN INFLECTION POINT? US DOLLAR INDEX, DXY

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

USD

Surging to heights not seen for two decades.

The extremely negative sentiment that flourished in early May led to the strongest USD in twenty years. The strength was probably fuelled by demand for liquidity in markets that were clearly unwinding significant amounts of risk, with the added comfort of climbing USD cash yields as the Fed embarks on 50 bps hikes, at least for the next few meetings. When multi-decade highs are broken it pays to take a very long term view, in which case, with USD at current highs, it's likely longer term investors will start taking profit on USD-overweight positions; however for shorter term money it's worth bearing in mind that the reasons behind the negative risk sentiment (rate hikes and inflation, China's zero-COVID policy and the Russia-Ukraine war) have not gone away and the USD is the haven of choice. All in all, the USD remains supported for now, but upside potential feels increasingly capped by technicals and recession risks.

GOLD

Real yields or geopolitics?

US real yields took another leg higher, the 10-Year rate breaking firmly into positive territory at 0.27% where it sat before the pandemic hit. At the same time the war in Ukraine continues without reprieve and unfortunately looks increasingly likely to drag on for some time.

Of these two opposite forces on the gold price, climbing real yields seem to be the dominant factor as gold was pressured back down to the USD 1'800-1'850 range at which it traded before Russia invaded. We still believe there is a geopolitical risk premium in the price (probably now around USD 50-100/Oz), and that "support levels" have been permanently raised by Western financial sanctions on Russia's currency reserves, but for now we expect gold to underperform.

CNY

Pushing back.

The USD/CNY is at its highest level since 2020, as US yields are above Chinese yields for the first time since 2010. However, China's solid trade surplus should limit the CNY's downside. In a context of the zero-COVID induced slowdown, the People's Bank of China (PBoC) is pushing back against CNY strength, testing the waters via daily fixing. Should the zero-COVID policy persists, USD/CNH could keep pushing higher.

INVESTMENT SCENARIO AND ALLOCATION

THE EQUITY
REPRICING TREND
may not be over yet

MACRO & MARKET SCENARIO

- **Global growth:** our scenario of a slowdown without recession (with a strong cut of our macro forecast at the end of January, worse-off in Europe than in the US) has been confirmed by the Q1 GDP in the Euro Area at +0.3% QoQ. The US Q1 2022 GDP was negatively impacted by the trade balance offsetting a stronger than expected resilience of private consumption and investment which could weaken in the coming quarters. China is experiencing the bottoming of its macro data and PMIs due to lockdowns which are expected to ease going forward while policy mix should become more supportive.
- **Inflation:** the peak has been pushed back as the continued rise in core inflation suggests a more widespread inflation, while the energy price effect should dissipate in the coming quarters. Wage pressure could start to cool in the US, but should rise from lower levels in the Euro Area. Tensions on food prices will continue to nourish rising inflation in emerging markets, which could translate into rising social tensions going ahead.
- **Corporate earnings:** Q1 2022 earnings have surprised on the upside with top line growth bearing no scars of slower growth and with a better resilience of corporate margins, confirming what 2021 hinted: companies have pricing power, and therefore we have more an inflation problem than a margin problem so far. As expected, consumer discretionary suffered the most while healthcare, energy and materials delivered strong results. Overall, this has led to an upward revision of 2022 EPS growth above 10% in the US. Going forward, we expect margins to adjust and revenue growth to slow.
- **Central Banks:** these past weeks have been characterised by an acceleration in the tightening calendar and more hawkish rhetoric that markets are buying without discount. The ECB may remain behind the Fed, but the contemplated exit of negative rates remains a radical change of perspective compared to 2021. This has contributed to fuel anxiety on debt sustainability in the Euro Area, with a widening of sovereign spreads. Two divergences need to be highlighted in the current context. First, the Bank of England's inflation and GDP growth forecasts that are bleaker than those of the Fed and the ECB, as both remain optimistic on their capacity to curb core inflation to 2.5% next year while avoiding stagnation. On the other hand, the PBoC which continues to ease its policy progressively and cautiously.
- **Valuations:** the recent correction on equities and credit has rebuilt risk premia to more attractive levels, but the repricing trend may not be over yet and will continue to be influenced by rising long term rates and slower growth prospects. Investors will be monitoring catalysts coming from central banks and lockdown/vaccination policies in China, as markets already integrate an elevated level of pessimism.

INVESTMENT CONVICTIONS/ALLOCATION

- **Equities:** continued preference for a balanced view between Value, Quality and Defensive stocks in this context. We had cut our conviction on Growth several months ago, while increasing recently both Value plays (US Value and financials) and our exposure to dividend stocks and Quality/Defensive sectors, such as healthcare. Although Value outperformed indices since we initiated this investment style in November 2020, we prefer a tactical reduction in this current context of stagnation fears that are expected to weigh on the style. From a geographical standpoint, we keep a strong diversification, with a focus on developed markets while keeping our longstanding position on Asia, which seems heavily discounted and could outperform if China rolls out a mRNA vaccine.
- **Fixed Income:** we remain underweight on duration and consider that it remains probably too early to come back on government bonds. We keep a constructive stance on corporate bonds and financial debt, where spread normalisation is more a matter of flow-induced repricing in a global movement of reset in returns, than a fundamentals-driven trend explained by higher default rates.
- **Forex:** we wrote recently that it was too soon to become short on the dollar. USD is probably close to its peak at current levels, pricing in the accelerated tightening of the Fed policy, while the reduction in political uncertainty in France and the rate hikes expected by the ECB has not been enough to help the EUR fight off USD strength thus far. Risk aversion and liquidity tightening may also contribute to the greenback's strength. USD weakening could therefore be postponed to the second half of 2022, notably if the Fed starts to soften its hawkishness or if US GDP growth slows further. This could be an entry point for emerging currencies.

KEY CONVICTIONS

	TACTICAL VIEW (ST)	STRATEGIC VIEW (LT)
FIXED INCOME		
GOVERNMENTS		
Core EUR 10Y (Bund)	=/-	=/-
EUR Periphery	=	=/-
US 2-Years	=/+	=/+
US 10-Years	=	=
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 Local Currency	=	=
Latam Credit USD	=	=/-
Asia Credit USD	=/-	=
Chinese Bonds CNY	=/-	=
EQUITIES		
GEOGRAPHIES		
Europe	-/=	=
United States	=	=/+
Japan	-	-/=
Latin America	-/=	=
Asia ex-Japan	=	=
China	=	+
STYLES		
Growth	-/=	+
Value	=	=/+
Quality	+	=
Cyclical	-	=
Defensive	=/+	-/=
FOREX		
United States (USD)	=	=/-
Euro Area (EUR)	=	=/+
United Kingdom (GBP)	=/-	=
Switzerland (CHF)	=	=
Japan (JPY)	=/-	=/-
Brazil (BRL)	=/+	=
China (CNY)	=/-	=/+
Gold (XAU)	=	=

Source: Indosuez Wealth Management.

08 • Market Monitor (local currencies)

OVERVIEW OF SELECTED MARKETS

DATA AS OF 20 MAY 2022

GOVERNMENT BONDS	YIELD	4 WEEKS CHANGE (BPS)	YTD CHANGE (BPS)
US Treasury 10Y	2.78%	-11.76	127.10
France 10Y	1.47%	4.80	127.30
Germany 10Y	0.94%	-2.80	112.30
Spain 10Y	2.08%	14.30	151.40
Switzerland 10Y	0.70%	-20.10	83.80
Japan 10Y	0.24%	-0.80	17.30

BONDS	LAST	4 WEEKS CHANGE	YTD CHANGE
Governments Bonds Emerging Markets	34.88	-2.87%	-11.07%
Euro Governments Bonds	206.37	-0.25%	-5.57%
Corporate EUR high yield	195.85	-3.25%	-8.32%
Corporate USD high yield	296.94	-3.61%	-10.67%
US Government Bonds	303.88	0.72%	-5.12%
Corporate Emerging Markets	44.16	-2.43%	-13.41%

CURRENCIES	LAST SPOT	4 WEEKS CHANGE	YTD CHANGE
EUR/CHF	1.0295	-0.41%	-0.78%
GBP/USD	1.2480	-2.80%	-7.77%
USD/CHF	0.9746	1.79%	6.76%
EUR/USD	1.0564	-2.09%	-7.09%
USD/JPY	127.88	-0.48%	11.12%

VOLATILITY INDEX	LAST	4 WEEKS CHANGE (POINTS)	YTD CHANGE (POINTS)
VIX	29.43	1.22	12.21

EQUITY INDICES	LAST PRICE	4 WEEKS CHANGE	YTD CHANGE
S&P 500 (United States)	3'901.36	-8.67%	-18.14%
FTSE 100 (United Kingdom)	7'389.98	-1.75%	0.07%
STOXX 600	431.10	-4.90%	-11.62%
Topix	1'877.37	-1.46%	-5.77%
MSCI World	2'655.91	-7.86%	-17.82%
Shanghai SE Composite	4'077.60	1.60%	-17.46%
MSCI Emerging Markets	1'035.31	-3.75%	-15.97%
MSCI Latam (Latin America)	2'376.10	-3.62%	11.56%
MSCI EMEA (Europe, Middle East, Africa)	208.37	-8.77%	-24.42%
MSCI Asia Ex Japan	663.33	-2.76%	-15.96%
CAC 40 (France)	6'285.24	-4.50%	-12.13%
DAX (Germany)	13'981.91	-1.13%	-11.98%
MIB (Italy)	24'095.00	-0.76%	-11.89%
IBEX (Spain)	8'484.50	-1.94%	-2.63%
SMI (Switzerland)	11'308.98	-7.74%	-12.17%

COMMODITIES	LAST PRICE	4 WEEKS CHANGE	YTD CHANGE
Steel Rebar (CNY/Tonne)	4'817.00	-6.16%	5.91%
Gold (USD/Oz)	1'846.50	-4.41%	0.95%
Crude Oil WTI (USD/Bbl)	113.23	10.93%	50.55%
Silver (USD/Oz)	21.67	-10.68%	-7.21%
Copper (USD/Tonne)	9'422.00	-6.81%	-3.07%
Natural Gas (USD/MMBtu)	8.08	23.71%	116.70%

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

BEST PERFORMING ⊕

FEBRUARY 2022	MARCH 2022	APRIL 2022	4 WEEKS CHANGE	YTD (20.05.2022)
4.73%	12.25%	0.38%	1.60%	11.56%
0.39%	3.58%	-1.20%	-1.46%	0.07%
-0.08%	3.15%	-2.40%	-1.75%	-5.77%
-0.47%	2.52%	-3.79%	-2.76%	-11.62%
-2.40%	0.77%	-4.89%	-3.62%	-15.96%
-2.65%	0.61%	-5.23%	-3.75%	-15.97%
-3.06%	-2.52%	-5.75%	-4.90%	-17.46%
-3.14%	-2.93%	-8.43%	-7.86%	-17.82%
-3.36%	-6.84%	-8.80%	-8.67%	-18.14%
-10.33%	-7.84%	-13.86%	-8.77%	-24.42%

⊖ WORST PERFORMING

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 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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