INDOSUEZ WEALTH MANAGEMENT

Marketing Material

MONTHLY HOUSE VIEW

July 2022

Focus
Gauging the energy price shock

Architects of Wealth

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NORMALISATION RHAPSODY… OR INFLATION TRAGEDY?

"Any act requires oblivion": Excerpts from Nietzsche.

VINCENT MANUEL

Chief Investment Officer, Indosuez Wealth Management

Dear Reader,

Victory is never a home run in real life, nor is it a quick return to normalcy. After having defeated his enemies, it took Ulysses ten years to leave the ruins of Troy and return to his home island of Ithaca. Exactly the time that it took to win the decade-long fight against inflation in the 70s. It also took the same amount of time for central banks to revive inflation expectations; and now that they are here, we only wish they return to where they were before. Is this realistic? What if we were not just in a cyclical moment, but in a more structural shift that could take years to curb?

The ancient Greeks had a sense of temporality and a form of patience that we may have lost. This is probably the reason why forgetfulness - the dual condition for action and happiness for Nietzsche – and our short memory have led us to forget the long dynamic of inflationary cycles. The memory of past time knocks unsuccessfully on the door of our perceptions biased by our hopes, our optimism, our beliefs as well as by our shortened temporal horizon. Our hopes for perpetual peace have made us forget the long history of Russia. Financial market volatility also contributes to reducing our time horizon, while social urgencies and free elections shorten the horizon of governments. These social demands call for rapid action by central banks today. However, this may well be a trap; inflationary cycles take more time to cool than to revive.

The shortened time horizon and perception bias of central banks is one of the explanations behind this major policy error. In 2021, central bankers were still so shaken by the dislocation that followed the pandemic and doubtful on the job market recovery that they continued to provide unjustified monetary accommodation. They recently refused to acknowledge the return of inflation when it was already here, biased by a decade of deflation fears.

Now that inflation is here, central banks are rushing to raise rates and are trying to close their eyes to the aftermath of a sharp normalisation process in an already slowing economy, thereby increasing the risk of recession, with many geopolitical unknowns. The normalisation of policy mix is not a destination, but a journey, with more ups and downs than usual, and many possible surprises along the way. What if this was not a short and happy-ending rhapsody, but a darker and longer Greek tragedy with heroes in the grip of a fate that eludes them and subject to Cornelian choices?

That is the key question asked today by investors to the Fed. Are you confident that these actions can be efficient in controlling a surprisingly strong inflationary path? Are you ready to run the risk of a recession to curb inflationary pressures?

Reading Greek tragedies is useful nowadays to rethink our perception of time and the impact of human and political actions. Contrary to our modern conception of history - viewed as a dialectic path of progress - tragedies teach us that things do not always end well, and that our sometimes vain actions can make things worse. A lesson in humility for us investors. If we cannot predict the future, it is better to adapt to the present, without forgetting history.

GAUGING THE ENERGY PRICE SHOCK

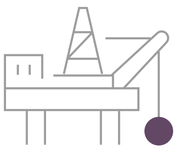
There are many driving forces behind the current energy crisis. Oil prices will remain high, but will face downside risks from the fall in demand. Gas shortages are soon to be a reality in Europe and are the main risk to our GDP growth scenario.

OIL PRICES TO FACE DEMAND DROP

Oil prices fell 10 dollars per barrel (to under USD 110) following the Fed's June meeting that reignited recession fears, despite China's progressive reopening.

Looking ahead, supply side risks remain strong. Thus far, Russian oil (a little under 10% of world production) has been relatively resilient and able to play musical chairs; transferring demand from western to eastern buyers (India has now overtaken Germany as the second-largest importer of Russian oil exports). However, the European Union's (EU) sixth package of sanctions, including a partial ban on Russian oil imports and a ban on insuring transport of Russian oil to third-party countries, was game changer for many analysts with the full impact to come into play in 2023.

In 2022, global oil markets have been relieved by US strategic reserve releases, but these are temporary. OPEC (Organisation of Petroleum Exporting Countries) upped its commitment to increasing production on 2 June, but with recent below target output, markets remain jittery as to OPEC's real spare capacity and ability to stabilise markets (OPEC supply shortfall vs. official output targets widened to 2.8 million barrels per day (M Bbl/d) compared to 2.5 M Bbl/d in April). Non-OPEC producers are expected to lead oil production growth in 2023. According to the International Energy Agency (IEA), US production is expected to continue its growth path in 2023. Brazil is expected to be the largest source of new conventional oil supply projects, followed by Norway, and the US.



NON-OPEC
producers to lead
PRODUCTION
GROWTH
in 2023

All in all, the Oxford Institute for Energy Studies (OIES), which uses a model-based approach to the oil market, calculates that an oil market deficit is to gradually remerge as of Q4 2022, but not enough to maintain prices at current levels. They project the Brent at USD 112.8/Bbl on average in 2022 and USD 102.8/Bbl in 2023. Oil price's downward trend could be more pronounced if recession fears continue to accentuate, leading investors to anticipate a faster rebalancing of the market through weaker global oil demand.

GAS PRICES: A REGIONAL CONCERN

Natural gas is comparatively harder to substitute than coal and oil. Gas prices have risen much more sharply in Europe in both 2021 and 2022, due to supply issues from the Netherlands and now Russia. The recent turn of events (sudden reduction of supply from Russian pipelines, shutdown of a US liquefied natural gas port) has prompted Germany to unveil a new auction system to encourage manufacturers to consume less gas. The EU's RePowerEU plan is scrambling to find new gas sources. Encouragingly, the EU LNG (liquefied natural gas) imports from the US were up 45% in May compared to 2019 (+4.7 billion cubic feet per day (BCF/d) 40% of Russia exports to EU in 2020), but the latter has almost reached capacity. With such extreme levels of uncertainty, and assuming only a partial cut-off in Russian supply, gas prices could increase to EUR 170/MWh in Europe at the turn of the year (according to Crédit Agricole SA specialists), with risks to the upside either from an extension of EU sanctions to Russian gas or Russia pre-empting this risk by intentionally cutting gas supplies to Europe which would propel gas prices to much higher levels and inflict a full-blown Euro Area recession.

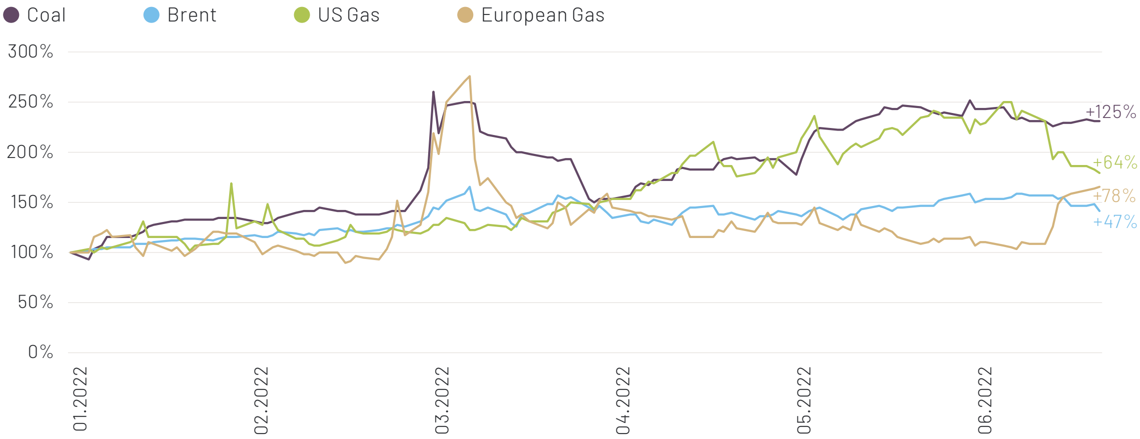
IMPACT ON GROWTH TO BE FELT HARDEST IN EUROPE

Contrary to the 1970's, we are in the unique situation where all energy prices are on the rise (Chart 1). Higher gas prices have fuelled higher electricity prices (22% fuelled by gas in Europe, 38% in the US), while coal prices have surged as governments scramble to find energy substitutions.

Some net-importing emerging markets can benefit from cheaper Russian energy, but this will be more complicated logistically and politically going ahead and the rise in other commodities is a growing threat to growth. The US market is often depicted as immune to the gas and electricity shortages and is set to benefit from greater investment in the LNG and oil sector.

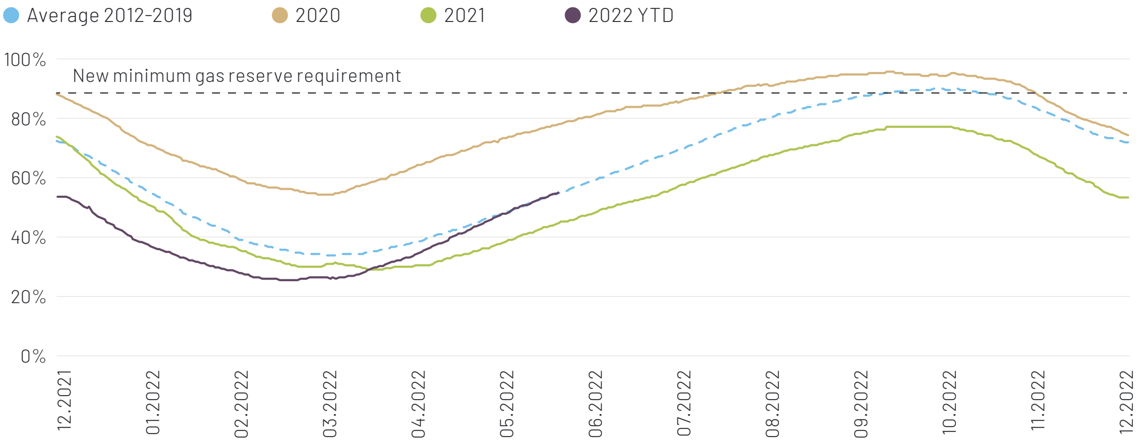
However, the rise in oil prices has exasperated the inflation phenomenon in the US, which should moderate as of Q3 2022 and possibly be cushioned by the proposed suspension of the federal fuel tax. The European continent has been and will remain the worst hit by the energy crisis. Higher gas prices/shortages will also reduce efficiency by increasing temporary reliance on alternative/outdated energy sources and creating supply disruptions. We expect consumption and investment prospects to falter in the current environment bringing Euro Area GDP in slight negative territory in the second semester (-0.2%), with risks skewed to the downside. The adjustment in domestic demand should weaken pressure on prices, but the need to maintain reserves (Chart 2) and logistical costs as well as increased investment needs should keep energy prices high in 2023.

CHART 1: ENERGY COMMODITY PRICES, 100= 31.12.2021, %



Source: Bloomberg, Indosuez Wealth Management.

CHART 2: NATURAL GAS RESERVES, % WORKING GAS IN STORAGE



Source: Bloomberg, Indosuez Wealth Management.

THE R-WORD

Nobody among international institutions wants to predict a recession, especially not Jerome Powell who may have helped to create it. Words can matter indeed and impact reality, but the blunt picture of stagnation in the West is already visible in the numbers. China looks forward after the fall back in activity in the first semester, while Europe dreads the winter with gas shortages clouding its post-COVID recovery.

+16.9%
YoY for Chinese exports in May

CHINA: REOPENING 2.0

China's exports rose by 16.9% Year-on-Year (YoY) in May (surpassing market forecasts: 8%). The manufacturing PMI increased to 49.1 in May of 2022 up from 46 in April and beating market forecasts of 48. Domestic activity in China is still struggling, but improving. Retail sales declined 6.7% YoY (+0.5% Month-on-Month (MoM)) compared to market expectations of a 7.1% fall and the unemployment rate fell from its 26-month high in April (6.1%) to 5.9% in May. The still apparent weakness in domestic demand and high unemployment rate has helped to keep inflation below the central bank's target (at 2.1% vs. 3%) compared to other Asian economies (7% in India and 5.4% in South Korea) and despite the rise in commodity prices.

However, in a world full of inflation hawks, the People's Bank of China (PBoC) refrained from furthering lowering rates in June. The rebound in GDP should receive a boast from investment in H2 2022 thanks to the improved outlook, better financial conditions and the government's push for infrastructure projects. The recovery will however be challenged by the global slowdown as well as the risk of further outbreaks.

In this context we expect fiscal policy to step up, while monetary policy remains more muted by an increasing interest rate differential with the rest of the world and an unresolved deleveraging dilemma. China is set to grow by 3.5% in 2022 (down 0.5 percentage points compared to last month) and 5.4% in 2023 (revised up 0.6 points) (Table 1).

US: SHORT-TERM PAIN FOR LONG-TERM GAIN

US retail sales fell 0.3% MoM in May, a first sign in hard data that purchasing power and gloomy prospects were finally breaking consumer purchases. Soft data has indeed been pointing at this slowdown for months, University of Michigan consumer confidence surveys are worse today than at any other time (including during the pandemic and the Global Financial Crisis in 2008). Admittedly, the latter has less predictive power on US consumption than Conference Board survey that has been more resilient thanks to its tendency to follow the job market, but is clearly pointing downwards. The unemployment rate is indeed at 3.6%, which is comforting factor when today's inflation predicament is compared to the 1970s (when the unemployment rate was north of 6%).

TABLE 1: OUR BELOW-CONSENSUS GDP AND INFLATION FORECASTS FOR 2022 & 2023, %

	GDP GROWTH				INFLATION			
	2022	Versus Consensus	2023	Versus Consensus	2022	Versus Consensus	2023	Versus Consensus
United States	2.4%	2.8%	1.8%	2.0%	7.8%	7.3%	3.7%	3.4%
Euro Area	2.4%	2.6%	1.3%	2.1%	7.5%	6.6%	4.1%	2.8%
China	3.5%	4.7%	5.4%	5.1%	2.1%	2.2%	2.2%	2.3%

Source: Amundi, Focus Economics Consensus Forecasts, Indosuez Wealth Management.

Nevertheless, with inflation above 8% and the savings rate now below 5% the risk of a contraction in domestic demand in the second semester is high. Inflation is expected to weigh on private consumption as of Q3 2022, the contraction will intensifies towards year end in line with the deterioration in the labour market. Investment is also expected to take a hard blow from the aggressive monetary tightening now factored in for this year (Fed funds reference rate forecasted by markets at 3.75% by year end). Inventory rebuilding continues to make a lot of noise in the figures, but we believe a technical recession is possible in Q4 2022 to Q1 2023. However, another scenario, probably less likely and less optimal in the long run, would be that the US consumer is further assisted by accommodative fiscal policy and less aggressive monetary policy, but this would not rein in inflation. A difficult trade-off for policy makers, especially as midterms approach in November.

EURO AREA: WINTER IS COMING

Europe's post-COVID recovery has been fogged by war. Industrial production rose 0.4% MoM in April, purely thanks to a strong push in energy production (5.4% MoM). Nevertheless, the service sector has held surprising well as depicted by Google mobility and flight data.

In June, the Purchasing Managers' Index (PMI) for the service sector fell by 3.3 points to 52.8 and dropped by another 2.6 points to 52 in the manufacturing sector. The downturn in confidence indicators is a bad omen for the autumn, past the summer service recovery where higher-income households will have purged into their still solid private savings before entering into a challenging winter. Europeans will of course be able to rely on fiscal buffers; according to Bruegel think-tank, energy tax/VAT cuts have been put into place in 20 of the EU's 27 member states and transfers to vulnerable groups in 25. However, investment will suffer from extreme levels of uncertainty and lower demand prospects going into 2023. The Euro Area is projected to grow by 2.4% in 2022 (with two percentage points worth of growth carried over from solid growth end-2021, stagnation in Q2 2022 and a slight contraction in GDP in Q3 and Q4) and 1.3% in 2023 (revised down 0.5 percentage points since last month), with risks skewed to the downside (the probability of a full Russian gas cut off that would wipe out growth in 2023 is rising). Inflation is expected to peak in Q3 (at 8.3%), but uncertainty is high in the current energy crisis (see Focus).

A RISK OF OVER-TIGHTENING?

Central bankers in the US, Europe and the UK are determined to avoid second round effects on inflation and will tighten monetary conditions. A smooth recession might well exist in theory, but what will happen in real life?

Negative yielding debt down
90%
TO USD
1.8 BILLION

CENTRAL BANKS

Central banks led by the Fed have been tightening monetary conditions very aggressively through forward guidance and rate hikes. Market rates are overshooting neutral levels which puts a drag on the economy. Demand continues to slow and cyclical components are starting to roll over (goods prices, industrial metals) but food and rent prices are still rising. The energy dilemma is giving no relief for central bankers.

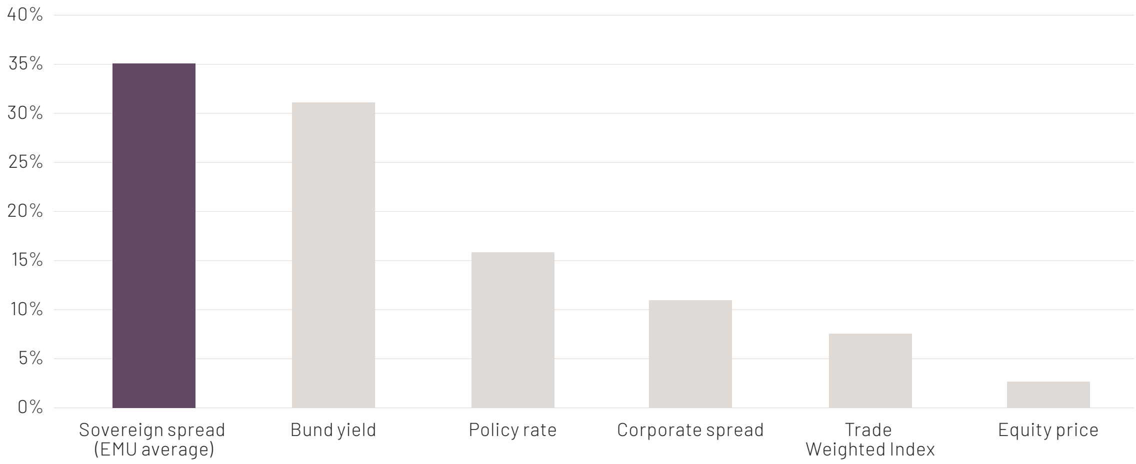
Long term inflation expectations are receding following a sharp correction in cyclical commodities and the aggressive tightening path laid out by the market and delivered by the Federal Reserve.

The Fed is tightening into a cyclical slowdown and this pace of rate hikes could weigh even more on growth. Downside risks on the economy should materialise with a bull steepening of the yield curve. The change of direction in the yield curve slope is a process that takes time as it implies a shift in expectations regarding the strength of the economy and the stance of central banks. An alternative case could be an stagflationnary-driven inversion of the yield curve with markets weighing on long term yields to reflect recession fears, while short term yields could compress less if the Fed remains committed to fight inflation.

The European Central Bank (ECB) is in a much trickier configuration given the sharp depreciation in the euro and the willingness to tighten monetary policy. The central bank sets 25 bps hike in July with one more hike in September while fixed income markets are seeing the deposit rate reaching 1% by end of 2022. Euro rates rose substantially since the ECB pivot in February, but we still see little sign of market fragmentation although absolute levels look attractive on peripherals. Auctions are still taking place in a relatively "normal" way. The widening of peripheral spreads were in line with the rate normalisation of the Euro Area (Chart 3), and some volatility in risk premia is expected in this environment. Nevertheless, two days of widening of the front end of Italian spreads were enough to trigger a reaction from the ECB's Governing Council. The ECB acted pre-emptively and bought itself some time. It had an immediate impact on spreads. Markets are, for now, giving the ECB the benefit of the doubt on the construction of a credible anti-fragmentation tool and volatility has receded in line with peripheral spreads.

To be continued...

CHART 3: SOVEREIGN SPREADS IS THE MAIN RISK FOR EURO AREA* FINANCING CONDITIONS, %



* Euro Area Financial Conditions Index, weights.
Source: Goldman Sachs, Indosuez Wealth Management.

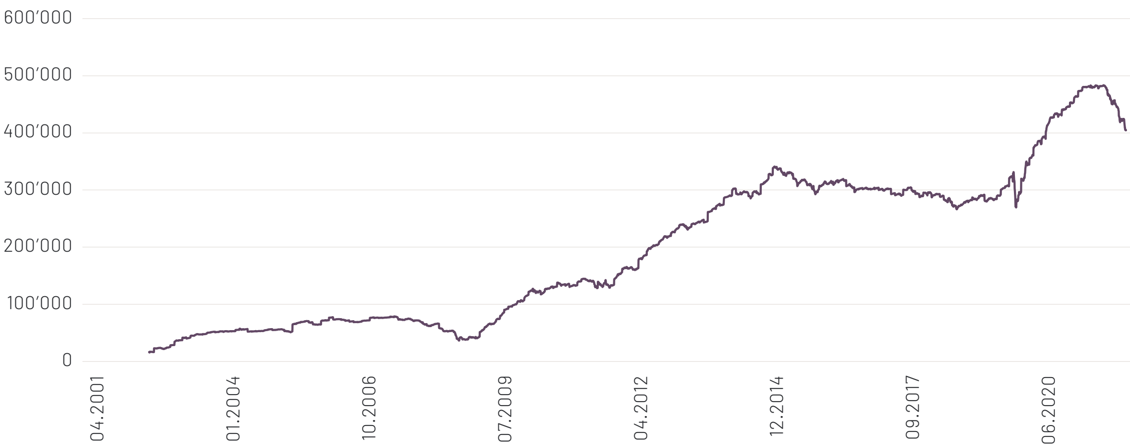
CORPORATE BONDS

Credit markets were roiled by rates uncertainty, measured by intrinsic volatility (at highs not seen since the beginning of the 2000's) and the stock market rout.

Outflows still drive market behaviour: investors pulled out close to 15% of their assets out of the European high yield market, which also cleared 15% in performance year-to-date: this is the sharpest market contraction in nominal terms on record (Chart 4). Nevertheless, credit markets in developed markets already price in recession risks, constrained liquidity for both companies and investors and higher nominal rates. On the fundamentals side, corporates built up cash reserves on their balance sheets and debt inventories encompass very low financing rates. Obviously new financing needs are fulfilled with higher rates and spreads, but it is not enough to erode the very high financial profile at this stage.

As regard to fundamentals, the market expects rating downgrades as rating agencies might react to wider spreads. As such credit risk should increase into 2023 with defaults in the high yield field expected to rise in the near future, although they should remain below past recession levels. On a risk-adjusted basis, there is more value on the investment grade yields than on high yield, which would suffer more if recessionary fears were to materialise. Subordinated debt has attracted investor attention once again as calls are being questioned by the market. We think non-call fears are overdone for most of the issuers, and recommend to stay very selective. Both corporate and financial issuers want to maintain their market access and accept to pay a high price.

CHART 4: EUROPEAN HIGH YIELD MARKET SIZE, EUR BILLION



Source: ICE, Indosuez Wealth Management.

NAVIGATING IN A BEAR MARKET

Equity markets are now in a bear market and investors have to navigate between inflation at historical levels and the risk of a recession. The latter is a key question since the length of equity corrections is correlated to the amplitude of the cyclical downturn.

On the bottom-up side, earnings growth expectations remain steady despite the market storm, but the rise in real yields is a headwind for equity valuations while volatility remains elevated. Therefore, while appreciating the magnitude of the repricing movement already achieved in the past months, we remain cautious on fundamentals before more positive catalysts can signal a bottoming out of the market.

EPS 12 month forward increased by

8%

EARNINGS AND VALUATION

On the earnings side, revisions continue to be resilient... so far. EPS (earnings-per-share) 12 month forward increased by 8% since the beginning of the year when the market lost more than 23%. During the previous bear markets in 2000-2003 and 2007-2009, market prices led the turning point on earnings revisions, but the latter followed quickly. This is still not the case in the current environment. But for how long?

On the valuation side, the S&P 500 is now below its average long term P/E (price/earnings) level (currently at 15.7x compared to 17.1x) (Chart 5).

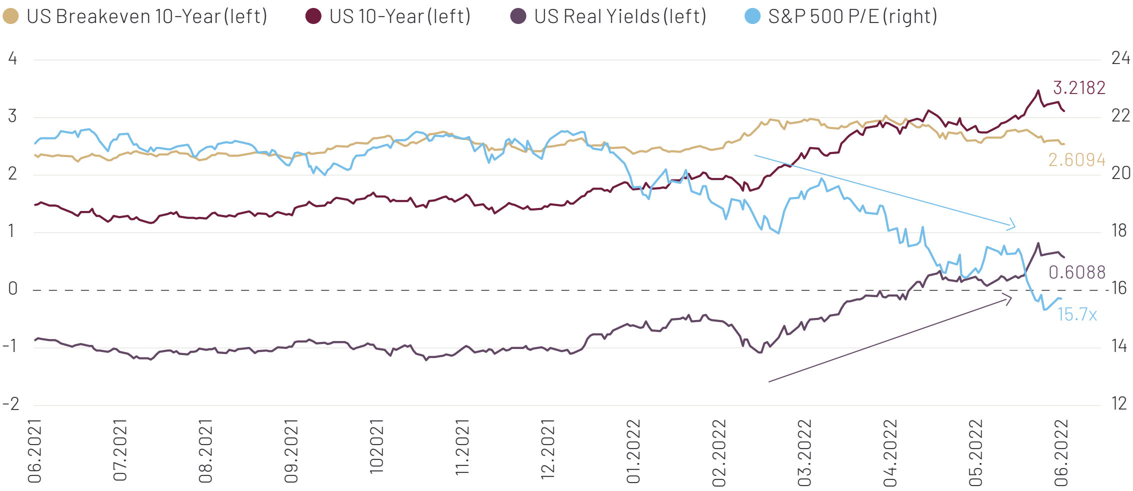
This derating is fully explained by the real bond yields, which deteriorated the Equity Risk Premium, now around at 6%, and affected equity attractiveness. However, after this semester of correction, equity risk premiums are once again attractive in Europe (>10%), moving our focus now to earnings revision risk.

UNITED STATES

The S&P 500 Index closed in a "bear market" (20% decline) territory on 13 June for the first time since March 2020. It is a symbolic and psychological hurdle for investors, usually generating additional pressure on flows.

In recent months, as a consequence of higher US government bond yields, the US market has fallen sharply. Energy is the only sector in positive territory, benefiting from this inflationary context. In such a context, we favour both sustainable dividend stocks and Quality stocks at a reasonable price (QARP), but are more cautious on Cyclical stocks (consumer discretionary and industrials).

CHART 5: S&P 500 PRICE EARNINGS RATIO VS. REAL YIELDS



Note: Since the beginning of the year, the strong rise on real yields (+170 bps) has explained the sharp derating that we have seen on equity valuation (from P/E 22 to 16 for the S&P 500).
Source: Bloomberg, Indosuez Wealth Management.

EUROPE

Headwinds from previous months are still there: the Russia/Ukraine conflict, supply chain disruptions, inflation, rising rates, and repercussion from the China zero-COVID policy.

The brightest spot stays the corporate world, with companies that see no slowdown except for some specific sectors (notably those who benefited the most from the "Stay At Home" trend on the consumer side).

Valuations have compressed significantly, but with a legitimate cautiousness from investors on the rhythm and size of the downward revision on earnings possibly to come. Therefore, despite a significant correction leading to attractive valuation multiples and risk premiums (10.7x for the Eurostoxx 50[1]), we remain cautious on the Euro Area equity markets and still favour the UK and Swiss markets on a relative basis.

EMERGING MARKETS

We are turning even more constructive on Chinese equities from the second half of 2022 on the back of the latest relaxation in lockdowns in Shanghai and Beijing and substantial pro-growth monetary, fiscal policies, as well as a strong infrastructure push. There was also positive development on the regulation front with the resumption of online game approvals after an 8-month freeze. This bodes well for the Chinese gaming sector and internet plays. There has been a steady flow of policy support messages from the Chinese government over recent weeks.

Our bottom-up-induced current positioning is a tactical barbell strategy focusing on China and India/ASEAN (Association of Southeast Asian Nations) as the two main prongs, while being neutral on South Korea and underweight Taiwan.

STYLE: FOCUS ON QUALITY, COMPLETE WITH VALUE

Value has outperformed, mainly driven by the strong rebound in yields and rising commodity prices. After the recent acceleration in bond yields, one can wonder about the remaining potential for that driver, notably if the market begins to focus more on (slowing) growth than on inflation. In that case, the relative performance of Value could gradually fade away, but it seems too premature to play that move.

Quality stocks remain the best option in a market regime of high volatility-low visibility. Stocks with strong fundamentals such as visibility, stability, resilience and growing dividend is something the market is more and more prompt to reward. Moreover, the stabilisation of long term yields should unlock their outperformance potential.

Nevertheless, the persistent inflationary trend justifies keeping an important allocation on dividend strategies, which needs to balance Value/Cyclical sectors with more Defensive sectors (such as healthcare, telecom and utilities).

On the Growth style side, a technical rebound in the market could offer a relief for the style in the short term, notably after the recent sell-off. However, as long as we see rising bond yields, we prefer not to come back on this style, with the exception of optional strategies offering an attractive asymmetry.

1 - Blended Forward 12-month P/E.

CENTRAL BANK DECISIONS REIGNITE FOREX VOLATILITY

Even more central banks have entered the hiking race in the fight against inflationary pressures. Mid-June saw the usually "neutral" SNB make a surprising first step and increase rates by 50 bps. The ECB seems eager to follow the move, and so far, only the Bank of Japan drags its feet in joining the trend, despite the JPY having lost more than 17% against the USD over the past 3 months.

CHF

SNB rises rates unexpectedly

The Swiss National Bank (SNB) unexpectedly rose its rates in June and surprised everyone both with the timing, doing it before the ECB, and with a larger rate hike of 50 basis points to -0.25%. It's a clear message sent to the market that the SNB is committed to keep inflation close to the target and that a depreciation of the CHF is highly undesirable.

Chairman Thomas Jordan said they could intervene in the Forex market and buy foreign currency if "there were to be an excessive appreciation of the Swiss franc". However, in case the Swiss franc weakens, they would also be prepared to sell foreign currency to maintain a strong CHF in addition to more rate hikes if necessary, with the main target being to avoid importing inflation in the country. In this context, CHF should stay strong against EUR in the short to medium term and we could see the pair going toward parity in the next months (Chart 6).

CHF
TO STAY STRONG
against EUR
in the short term

EUR

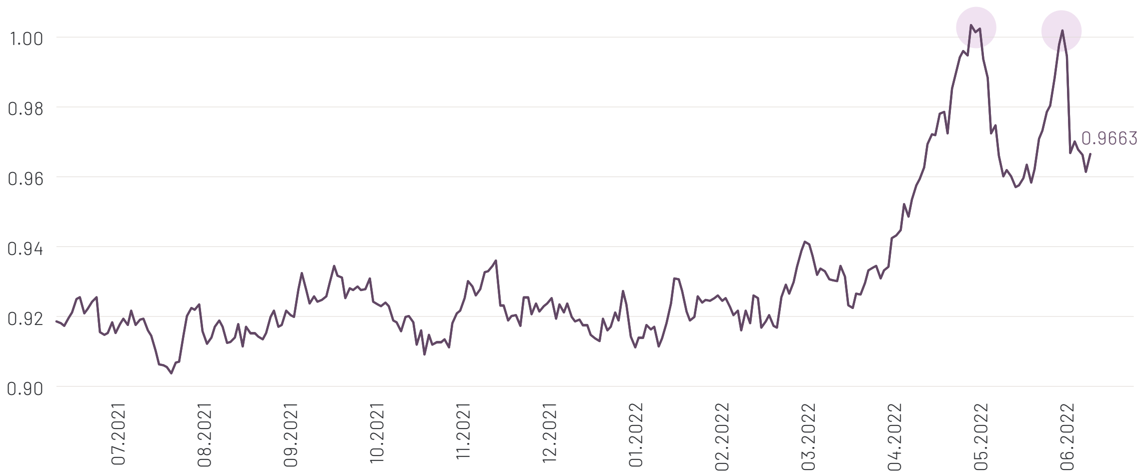
ECB plans to increase rates

ECB president Lagarde had to reiterate the intention to increase rates in July and September amid the increasing spread between German and Italian bonds. Investors worry that an increase in EUR rates could impact peripheral countries, further weakening the euro.

If the risk-off sentiment persists, the EUR should continue to be under pressure against the USD and the CHF in the short to medium term.

The EUR/USD 1.0340 will be a key level to watch.

CHART 6: USD/CHF DAILY CHART – CHF STRONGER AFTER AGGRESSIVE SNB



Source: Bloomberg, Indosuez Wealth Management.

USD

Buoyed by even higher FOMC rate hike expectations

The greenback has left every asset class and foreign currency in its wake following a 40 year high CPI (Consumer Price Index) release. The anticipated Fed rate hike path has climbed even higher, further exacerbating the effective margin call scenario surrounding the dollar. Combined with the still fragile geopolitical backdrop in Ukraine and surging energy and food prices, risk-off sentiment has promptly returned in force.

Despite rising interest rates occurring elsewhere in tandem, no currencies have so far been able to withstand the perfect storm pushing the USD higher. However, beyond this current short squeeze which will likely persist until US CPI peaks or until the FOMC blinks, factoring in the rising possibility of a potential policy mistake in the form of an induced recession. Raising rates aggressively just as the US consumer adjusts spending dramatically lower will inevitably lead to a full re-think over dollar outperformance. Stronger for now, but certainly vulnerable in the medium term given current market positioning and in case the Fed start to pass a less hawkish message at the end of 2022.

AUD

Politics to turn the tide for the AAA currency down under

The Labour party struck victory and a majority government results from the longstanding Liberals in a significant policy shift. In turn, the Royal Bank of Australia (RBA) raised interest rates higher than anticipated as full employment reigns in Australia.

The AAA rated currency has since stabilised and begun an uptrend versus regional Asian pairs as the current account surplus swells to unseen levels. The enviable commodity-driven Australian trade status will earn significant foreign currency that will support the AUD. On a cross-basis, the now widening interest rate differentials versus peers will support the AUD on any dips. Its high yielding currency status bodes well ahead for the resurging carry trade currency plays.

CNY

Lockdown or not to lockdown?

The Chinese yuan saw a considerable give back of its top performing world currency status since late April relinquishing its crown to the resurging USD. On a regional basis within Asia, China appears unwilling to face relative appreciation pressures as competitor Japan effectively devalues their yen aggressively via manipulated yield curve control. The PBoC 8% peak to trough push back apparent versus USD should be seen in this light in line with their trading partner Forex basket management regime. Stability has since returned as the USD/CNY pair has held below 6.80 since mid-May. We cannot yet rule out a weaker CNY beyond this point as interest rate differentials to the US widen further in the months ahead. However, some gradual and long-awaited relaxation of the strict lockdown zero-COVID policies in key coastal Chinese cities will certainly help lift the current economic gloom surrounding GDP. We remain cautiously optimistic that over time on such bouts of weakness, the Chinese yuan will continue to provide Central Bank reserve diversification stability and further outperform lower yielding G7 competitors.

INVESTMENT SCENARIO AND ALLOCATION

MACRO-ECONOMIC cycle is expected to continue DECELERATING

MACRO AND MARKET OUTLOOK

- Global narratives continue to balance inflation surprises with recession fears. The inflation peak is extended until year end in the Euro Area, and expected to reach more that 7% on a financial year basis, before receding towards 4% next year.
- The macroeconomic cycle is expected to continue decelerating further, close to recession in the second semester and low growth in 2023 below potential. While the Euro Area is the most affected by the energy crisis and conflict in Ukraine, fiscal spending should limit the recession risk to a technical recession. In the US, it is largely the tighter financial conditions that will drive a slowdown both on the corporate and consumer side, with the latter also being affected by lower purchasing power.
- Monetary normalisation continues to accelerate with the Fed front-loading higher rate hikes. J. Powell seems to be ready to generate a slowdown and increase unemployment. The ECB will exit negative rates, while spread widening crystallises anxiety on debt sustainability, pressing the ECB to intensify discussions on a backstop facility to limit fragmentation risks.
- Corporate fundamentals which remained sound so far should start to bear the marks of this slowdown. Earnings growth has been revised on the upside after the Q1 2022 earnings season, but revision risk is looming. Credit risk should increase into 2023, but remains contained below past recession levels, with high yield default rates expected to reach 4% (far from 2009 records).
- The market regime has embarked on a bear market configuration without a stabilisation point as of yet and under a higher volatility regime. So far, the market correction has been essentially driven by a rise in long term bond yields. Now that recession fears are on the rise and earnings revisions could resurface, investors are increasing their exposure to Defensive sectors and Quality stocks.

INVESTMENT STRATEGY

- Equities: we remain moderately exposed with a neutral approach to risk and a preference for Value and Quality/Defensive stocks offering attractive dividend yields, which remain a good hedge against inflation. We stay underweight on Growth stocks and highly valued companies. We reduced tactically Value and increased Quality in a context of rising recession fears. We remain underweight on the Euro Area, neutral to slight underweight on the US and overweight on China. We observe renewed traction on Chinese equities, which outperformed US markets in the past month, rewarding our patience on this market, which will remain uncertain and volatile in the coming months. Strong drawdown on Quality stocks year-to-date may offer good entry levels.
- Fixed Income: we have kept an underweight position on duration, but recently increased our positions on very long duration government bonds to limit the drawdown in a recession case. We remain constructive on buy & hold on strategies of corporate bonds of moderate duration. We remain constructive on subordinated debt, and increase our focus on ESG (Environmental, Social and Governance) and green bonds.
- Currencies: all factors are in favour of the dollar today against most currencies: rate differentials, macro fundamentals, geopolitical risks as well as sovereign / fragmentation risks. Nevertheless, these factors are relatively well priced and the dollar seems to be peaking, capped by a normalisation that is generalising to a wider number of countries.
- We generally consider real assets as a good hedge against inflation. We think that infrastructures are well-placed to benefit from this role, notably in the context where investment on infrastructure and climate transition are intensifying. Real estate used to outperform equities in the 1970s, but we think that it enters this monetary normalisation cycle at elevated valuation levels, with a higher vulnerability for the US residential market (as the 30-Year mortgage rate exceeds by far rental yields). We remain more constructive on commercial real estate and logistics in Europe. Finally, private equity will probably reflect partly and more gradually valuation multiples adjustments seen in public markets. However, this segment keeps on attracting large inflows as founder exits and carving out of non-core businesses will continue to provide interesting opportunities in this environment.

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 Hard Currency	=	=
Sovereign Debt Local Currency	=	=
Latam Credit USD	=	=
Asia Credit USD	=/-	=
Chinese Bonds CNY	=/-	=
EQUITIES		
GEOGRAPHIES		
Europe	=	=
United States	=/+	=/+
Japan	-	-/=
Latin America	-/=	=
Asia ex-Japan	=	=
China	=/+	+
STYLES		
Growth	-/=	+
Value	=	=
Quality	+	=
Cyclical	-	=
Defensive	=/+	-/=
FOREX		
United States (USD)	=	=/-
Euro Area (EUR)	=	=/+
United Kingdom (GBP)	=/-	=
Switzerland (CHF)	=/+	=
Japan (JPY)	=/-	=/-
Brazil (BRL)	=	=
China (CNY)	=/-	=/+
Gold (XAU)	=	=

Source: Indosuez Wealth Management.

08 • Market Monitor (local currencies)

OVERVIEW OF SELECTED MARKETS

DATA AS OF 23 JUNE 2022

GOVERNMENT BONDS	YIELD	4 WEEKS CHANGE (BPS)	YTD CHANGE (BPS)
US Treasury 10Y	3.09%	34.01	157.69
France 10Y	1.97%	45.50	177.10
Germany 10Y	1.43%	42.90	160.70
Spain 10Y	2.51%	45.80	194.80
Switzerland 10Y	1.23%	51.00	136.70
Japan 10Y	0.23%	-0.50	16.40

BONDS	LAST	4 WEEKS CHANGE	YTD CHANGE
Governments Bonds Emerging Markets	34.16	-2.76%	-12.90%
Euro Governments Bonds	202.33	-2.02%	-7.42%
Corporate EUR high yield	188.09	-4.01%	-11.95%
Corporate USD high yield	290.13	-5.36%	-12.72%
US Government Bonds	300.55	-1.45%	-6.16%
Corporate Emerging Markets	43.19	-3.51%	-15.31%

CURRENCIES	LAST SPOT	4 WEEKS CHANGE	YTD CHANGE
EUR/CHF	1.0114	-1.73%	-2.51%
GBP/USD	1.2260	-2.70%	-9.40%
USD/CHF	0.9609	0.10%	5.26%
EUR/USD	1.0523	-1.88%	-7.45%
USD/JPY	134.95	6.16%	17.27%

VOLATILITY INDEX	LAST	4 WEEKS CHANGE (POINTS)	YTD CHANGE (POINTS)
VIX	29.05	1.55	11.83

EQUITY INDICES	LAST PRICE	4 WEEKS CHANGE	YTD CHANGE
S&P 500 (United States)	3'795.73	-6.46%	-20.36%
FTSE 100 (United Kingdom)	7'020.45	-7.20%	-4.93%
STOXX 600	402.4	-8.07%	-17.51%
Topix	1'851.74	-1.38%	-7.06%
MSCI World	2'549.05	-7.10%	-21.12%
Shanghai SE Composite	4'343.88	8.79%	-12.07%
MSCI Emerging Markets	995.34	-2.70%	-19.21%
MSCI Latam (Latin America)	2'040.53	-16.81%	-4.19%
MSCI EMEA (Europe, Middle East, Africa)	193.61	-7.43%	-29.78%
MSCI Asia Ex Japan	647.69	-0.42%	-17.94%
CAC 40 (France)	5'883.33	-8.22%	-17.75%
DAX (Germany)	12'912.59	-9.27%	-18.71%
MIB (Italy)	2'1615.00	-11.94%	-20.96%
IBEX (Spain)	8'106.4	-8.80%	-6.97%
SMI (Switzerland)	10'453.31	-9.04%	-18.81%

COMMODITIES	LAST PRICE	4 WEEKS CHANGE	YTD CHANGE
Steel Rebar (CNY/Tonne)	4'289.00	-7.60%	-5.69%
Gold (USD/Oz)	1'822.77	-1.51%	-0.35%
Crude Oil WTI (USD/Bbl)	104.27	-8.61%	38.64%
Silver (USD/Oz)	21.042	-4.10%	-9.89%
Copper (USD/Tonne)	8'409.00	-10.09%	-13.49%
Natural Gas (USD/MMBtu)	6.24	-29.96%	67.27%

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

MONTHLY INVESTMENT RETURNS, PRICE INDEX

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

BEST PERFORMING (+)

MARCH 2022	APRIL 2022	MAY 2022	4 WEEKS CHANGE	YTD (23.06.2022)
12.25%	0.38%	6.46%	8.79%	-4.19%
3.58%	-1.20%	1.87%	-0.42%	-4.93%
3.15%	-2.40%	0.84%	-1.38%	-7.06%
2.52%	-3.79%	0.69%	-2.70%	-12.07%
0.77%	-4.89%	0.20%	-6.46%	-17.51%
0.61%	-5.23%	0.14%	-7.10%	-17.94%
-2.52%	-5.75%	0.01%	-7.20%	-19.21%
-2.93%	-8.43%	-0.16%	-7.43%	-20.36%
-6.84%	-8.80%	-1.56%	-8.07%	-21.12%
-7.84%	-13.86%	-4.29%	-16.81%	-29.78%

(−) WORST PERFORMING

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

IPPC: The Intergovernmental Panel on Climate Change.

IRENA: International Renewable Energy Agency.

ISM: Institute for Supply Management.

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

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

OECD: Organisation for Economic Co-operation and Development.

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

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

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

PMI: Purchasing Managers' Index.

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

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

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

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

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

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

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

SRI: Sustainable and Responsible Investments.

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

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

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

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

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

WTO: World Trade Organization.

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