INDOSUEZ
WEALTH MANAGEMENT

MONTHLY HOUSE VIEW

Marketing Material - December 2021

Focus
Brazil: stagflation or land of opportunity in 2022?

Architects of Wealth

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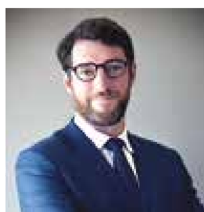
01 • Editorial

FROM THE FEAR OF INFLATION TO THE FEAR OF A SLOWDOWN



VINCENT MANUEL

Chief Investment Officer, Indosuez Wealth Management

Dear Reader,

As we approach the end of the year, with investors asking questions about the investment outlook for 2022, it's worth taking a look back at the principal risks surrounding the growth scenario. In this highly unusual recovery phase, characterised by severe imbalances, the forecasting risk remains high. This could be amplified by a effervescence in the field of economic forecasting, which has become more reliant on high-frequency activity indicators since the pandemic.

The first risk of uncertainty concerns US growth trend, for which the regional central banks' forecasting models are giving mixed signals. Among the least optimistic indicators is the New York Fed's model, which predicts growth at 1.7% for the fourth quarter of 2022; this would imply a significant slowdown compared with the trend anticipated for the fourth quarter of 2021. Looking at the forecasts from major international institutions, differences in forecasts are greater for the United States than for Europe, with the OECD forecasting 3.9% growth in the United States in 2022, compared with 5.2% according to the IMF. Multiple factors are at play in this deceleration, including the disappearance of base effects, bottlenecks, supply chains issues, and the reduction of the Biden plan. Although the economic debate is now focused on inflation, the growth trend will be a key issue for monetary policy decisions next year.

The second macroeconomic risk relates to the speed of landing in the Chinese property sector and macroeconomic management. Faced with a bloated property sector that could have a significant impact on Chinese growth, we might have expected a stronger economic response from the Chinese authorities, who could have sought to counterbalance the restructuring of the sector with monetary and fiscal support for the rest of the economy. For the moment, the authorities are showing a degree of cautiousness that is at odds with the strength of the response seen in 2009 and 2015. With the IMF and OECD forecasting growth of between 5.6% and 5.8% in 2022, the idea that Chinese real estate could cost the Chinese economy one to two points of growth could be retained.

The third risk concerns the resurgence of the pandemic in Europe, with responses that could diverge even further between the countries, reflecting not only different healthcare strategies but also specific political contexts, that could delay the return to remote working that is already emerging in Germany. Faced with this trend towards a resurgence of the pandemic, the growth figure of 4% to 4.5% forecast for 2022 could also be revised downwards.

The final hazard is global and relates to supply chain problems, the effects of which could continue well into 2022. In the third quarter, this factor probably cost one to two points of growth, as evidenced by the disappointing US growth in the third quarter (2%) or industrial production in China, which remained subdued in September compared with the previous month. There is no doubt that these issues should eventually be resolved, but it is difficult to predict how long this will take, and scenarios for 2022 only partially integrate this.

If we add all these risks together, we could see a shift from a scenario of global growth well above 4% to a scenario in which it is barely above the 3% threshold that is considered by investors as the point below which it is generally advisable to reduce investments in risky assets.

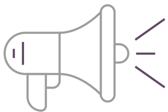
This is not our scenario today, but after increasing the probability of reflationary acceleration, we should take into account the risk of disappointment over growth.

The other key implication concerns the central banks. In the face of strong growth and inflation above target, the normalisation of the Fed's interest rates would not usually be in question.

However, with inflation remaining high and a growth rate that could be disappointing, a dilemma is emerging. Perhaps this explains Jerome Powell's cautious approach, as his future at the Fed hangs in the balance.

BRAZIL: STAGFLATION OR LAND OF OPPORTUNITY IN 2022?

While stagflation currently appears as an alternative scenario in the US and Europe, the risk seems more concrete in Brazil where double-digit inflation is combined with sluggish growth prospects. The Brazilian context is also shrouded in uncertainty with one year to go before the elections, while fiscal sustainability is a concern for investors and monetary policy is on the restrictive side.



Auxilio Brasil announcement signals the risk of a de-anchoring of FISCAL POLICY in Brazil

A FALTERING RECOVERY

Brazil's growth stumbled less than that of its South American neighbours in 2020 (-4.1% vs. -6.6%, IMF) but is also expected to see a weaker recovery in 2021 (5.3% vs. 6.3%, IMF) and beyond. In its October 2021 report, the IMF again revised down its 2022 growth forecast for Brazil to 1.5% (Chart 1) from 1.9% in July and 2.6% in April. Note that the consensus on Brazil's growth is quite scattered, with some economists predicting flat to negative growth in 2022.

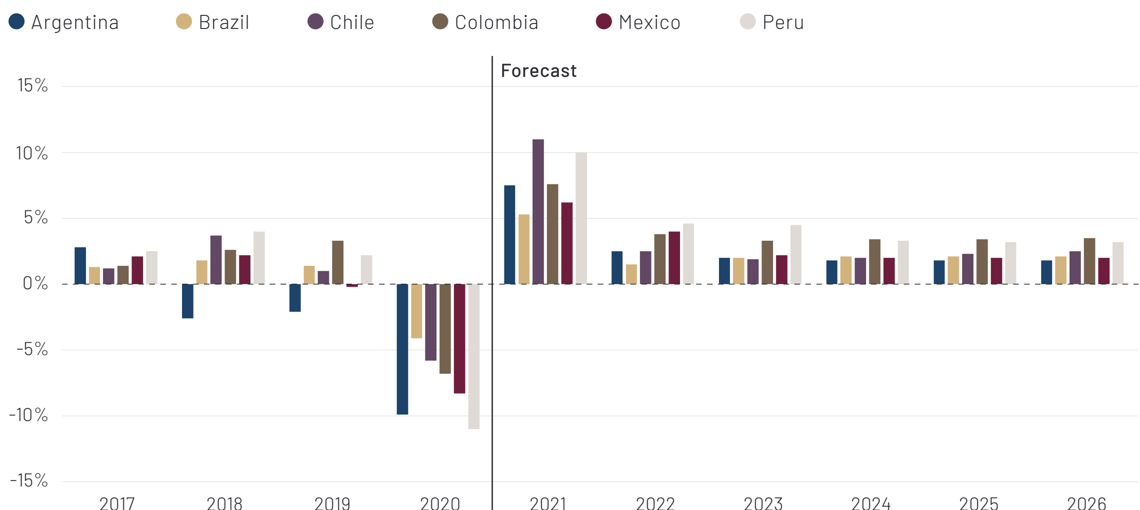
Economic activity improved in Q2 2021 with a notable recovery in services driven by improved demand, the reopening of businesses, and the acceleration of the vaccination campaign, with the percentage of fully vaccinated Brazilians increasing from 10% to 58% since June.

However, the Brazilian economy is expected to face many headwinds with high inflation (10.7% in October) driven by soaring energy prices, an unemployment rate still well above its pre-pandemic level (13.2% in August 2021 vs. 11.9% in 2019), a gradually restrictive monetary policy, the uncertainty surrounding the elections in Q4 2022, and the slowdown of Chinese growth which should weigh on Brazilian exports. If this ambiguity persists, could this combination of factors lead the Brazilian economy to stagflation? Our scenario foresees a moderate growth of 1.2% in 2022 and 1.6% in 2023 while inflation should remain high in 2022 at 6.2% before falling to 3.5% (just above the central bank's 3% inflation target).

DEBT SUSTAINABILITY AT RISK

As the growth outlook has deteriorated and with President Jair Bolsonaro concerned over voting intentions for 2022, the current government has announced its intention to create a new social spending program (an extension of the already existing Bolsa Familia plan) for low-income citizens: Auxilio Brasil. The plan includes expanding the number of recipients from 14.7 million to 17 million and increasing the monthly allowance from 190 to 400 Brazilian *reais*. The issue is that this plan implies exceeding the spending cap, which is the guarantor of the sustainability of the Brazilian debt, which currently stands at 92% of the GDP (IMF).

CHART 1: HEADWINDS CHALLENGE BRAZIL'S GROWTH OUTLOOK, %

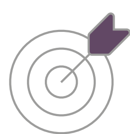


Source: IMF, Indosuez Wealth Management.
Past performance does not guarantee future performance.

This announcement highlights the risk of a deanchoring of fiscal policy which could trigger rising inflation expectations in Brazil, while the current favourite for the presidential election, Lula, plans to replace the spending cap with a spending target that would de facto lead to an acceleration of the debt dynamics in Brazil.

To pass Auxilio Brasil, President Bolsonaro plans to use accounting tricks by changing the inflation rate to which the spending cap is indexed. The measure was validated by the Chamber of Deputies at the beginning of November, but it still needs to be voted on by the Senate.

AN INCREASINGLY RESTRICTIVE CENTRAL BANK



The Selic rate is expected to reach
11%
in 2022

The latent risk around the fiscal framework forced the Brazilian central bank to become even more restrictive by raising its benchmark rate by 150 basis points at the end of October, the sixth increase in a row as the Selic rate rose from 2% to 7.75% in 2021. The committee said that the doubt surrounding fiscal policy implies a higher risk premium and has increased the risk of inflation expectations becoming unanchored. The consensus forecast for the Selic rate is to reach 11% in 2022.

The restrictive policy of the Brazilian central bank should make it possible to attenuate the dynamics of inflation from 2022 onwards (inflation is expected to be around 3.8% at the end of 2022), but the dilemma will be to find the right balance, as it also significantly lowers the growth prospects for Brazil.

ELECTIONS YEAR. MORE UNCERTAINTY

While the fiscal framework and the tightening of financing conditions are worrying investors, the key issue for next year will be the presidential election that will take place in October 2022. Currently, former president Lula is leading in the polls, benefiting from a strong support base among low-income workers.

However, he is also benefiting from the low popularity of Jair Bolsonaro, who has been penalised by his mishandling of the COVID-19 crisis, high inflation eating into workers' real wages, high unemployment, and poor growth prospects. Recent polls also show that the economy is emerging as the key issue for voters. The Auxilio Brasil plan is a response to Bolsonaro's unpopularity in order to appeal to low-wage workers, currently affiliated to Lula.

That said, with less than a year to go before the election, the hypothesis of a third candidate emerging in 2022 is not excluded, as the rejection rates of Lula and especially Bolsonaro appear high. In early November, the former Justice Minister Sérgio Moro, currently credited with 8% of voting intentions in the polls, mentioned his intention to return to politics.

Against this backdrop of worsening growth prospects and the risk of fiscal imbalance, Brazilian markets corrected sharply, with the Bovespa index losing nearly 18% between the beginning of June and the end of October, while the USD/BRL rose by 8.5% during the same period reflecting poorer investor sentiment to the political noise and uncertainties around the fiscal framework. Meanwhile, the central bank's restrictive policy has resulted in an inversion of the Brazilian yield curve as the risk of a recession in Brazil becomes more pressing.

CONCLUSION

As the repricing of Brazilian risk continues, Brazil could be a case to watch next year. While the high carry alone does not currently justify exposure to Brazilian local currency debt, with inflation moderating from 2022 onwards, BRL is expected to be very volatile in 2022 and election developments will be a key theme to watch next year, while the emergence of a white knight could represent an attractive opportunity in this segment of the Brazilian markets.

SHIFTING FROM A DEMAND-DRIVEN TO A SUPPLY-DRIVEN ECONOMY

The year 2021 will have seen several phases in the economy: from recovery to acceleration and now to normalisation of activity. But beyond this transition, it is the engine of growth that has changed: if demand has long been the supporting factor, in early 2022, it is the agility of economies to adapt and to absorb supply shortages that will enable activity to rise.

SUPPLY ISSUES should continue to be a drag on growth next year

UNITED STATES

Across the Atlantic, the economy continues making progress but remains hampered by supply-side issues, as evidenced by activity surveys: the US manufacturing PMI kept decreasing, reaching a 10-month low in October (58.4). US economic growth slowed to an annualised 2% quarterly rate in Q3 (compared to 6.7% in Q2). In addition, despite an improving labour market and better-than-expected non-farm payroll figures (+550 thousand vs +450 thousand expected), underlying data still points to a shortage of workers, with a record level of jobs unfilled and a participation rate remaining at low-levels (61.6% compared to 63% one year and half ago). If this is spreading some uncertainty as regards to wages outlook, it is above all raising questions about the ability of companies to attract workers to respond to demand, adding concerns to growth prospects for 2022.

Therefore, if latest macroeconomic indicators point towards a rebound in Q4 (+4.8% according to the consensus), supply issues and bottlenecks should continue to be a drag on economic activity, as reflected by analysts who revised down their 2022 GDP forecasts from 4.3% in early September to 3.8% by mid-November. However, replenishment of stocks, household consumption, and public spending, most recently via the approval of the USD 1'200 billion infrastructure bill (although less than the initial amount), should all help growth remain above the long-term average.

Besides, ongoing restraints on oil production and continued high energy demand pushed inflation above estimates in October (6.2% vs. 5.8% expected on a yearly basis, +0.9% month-on-month). Looking well into 2022, contributors to inflation should nevertheless differ as it diffuses into various sectors of the economy (shelter, services, transport), as demonstrated by the last print of core inflation.

Thus, if higher inflation should persist longer than expected - as we highlighted in our previous *Monthly House View* - and second round effects do not manifest too significantly, as is the case currently, inflation should gradually revert by mid-2022 and gradually approach central bank targets by 2023.

EURO AREA

THE EUROPEAN RECOVERY is rather scattered

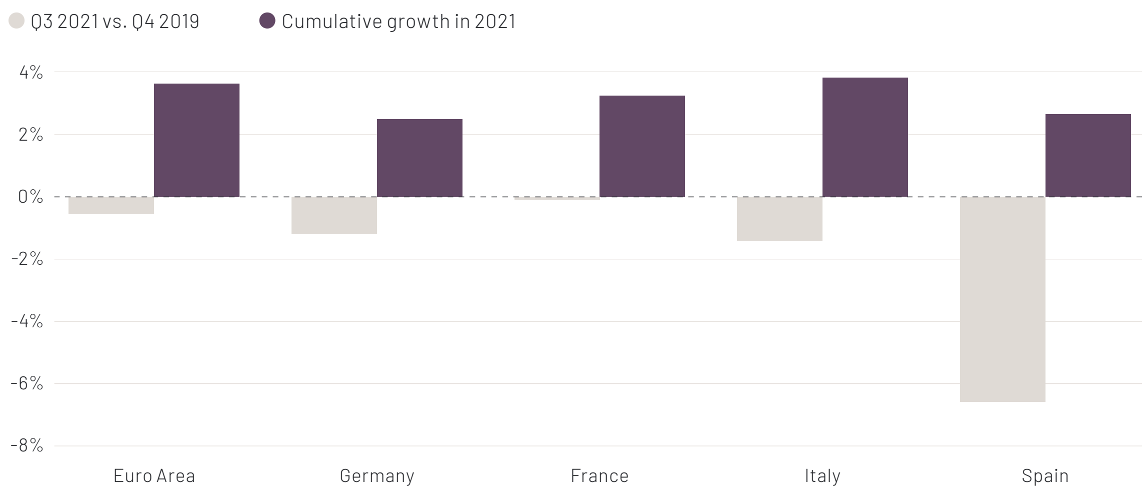
In Europe, the picture is broadly similar but with a relative time lag: inflation accelerated to 4.1% and should continue pushing upwards, while the pace of economic activity slowed. Nevertheless, the European economy is doing well and is almost back to its pre-pandemic level even if the recovery is rather scattered (Chart 2). France and Italy are progressing at a higher pace than expected, while Spain is 6.6% below its Q4 2019 GDP level.

Globally, European households dissaving, combined with the support of fiscal policies, should allow consumption to remain a powerful engine for growth in the coming quarters. We expect growth to print at 3.9% in 2022, still well above potential growth. However, the evolution of supply constraints and a resurgence of the COVID-19 epidemic, as can already be observed in Germany or in Austria, where the government implemented restrictive measures for unvaccinated people, are likely to impact demand and should be monitored closely.

ASIA

The continent has also been affected by supply problems in recent months, as can be seen in Japan where the economy shrank by 0.8% in the third quarter on a quarterly basis, below estimates. Furthermore, while the latest indicators in China, such as retail sales and trade balance, have surprised positively, several risk factors on growth could come into play in the quarters ahead. Self-imposed restrictions like the "zero-tolerance" policy for COVID-19 and production cuts for electricity rationing and environmental purposes, as well as the deleveraging of the real estate sector, have already led analysts to downgrade their 2022 GDP growth estimates (around 5% as of now). As a result, this could lead the global economic activity to normalise faster than expected, help commodity inflationary pressure to abate, and impact some China-sensitive countries. More broadly, however, the improving sanitary situation should support Southeast Asian countries, while helping to ease bottlenecks in the region.

CHART 2: A RATHER SCATTERED RECOVERY WITHIN THE EURO AREA, CHANGES IN GDP, %



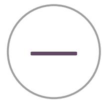
Source: Refinitiv, Eurostat, Indosuez Wealth Management.

LOW LONG-TERM YIELDS: UNDERSTANDING THIS FALL MARKET'S DYNAMICS

As more and more Central Banks are raising their key benchmark rates, along with high inflation figures and persistent robust growth figures, the long term (thirty years) yields across developed countries have not increased as many market participants expected.

CENTRAL BANKS

Recently, some Central Banks decided to withdraw, sometimes abruptly, their monetary support initiated during the economic trough in their respective countries. For instance, the Bank of Canada decided to stop its quantitative easing (QE) program, the Bank of Australia gave up its yield curve control for up to the three years, while the Bank of England refrained from hiking in its last meeting.



Long term yields
NEGATIVE
for an infinite period of time

In a context of sustained growth across countries and high inflation figures not observed for 30 years, long term yields are barely moving upward. This surprises many fixed income investors, starting with veteran hedge funds whose performance in October was the worst since the early 2000s.

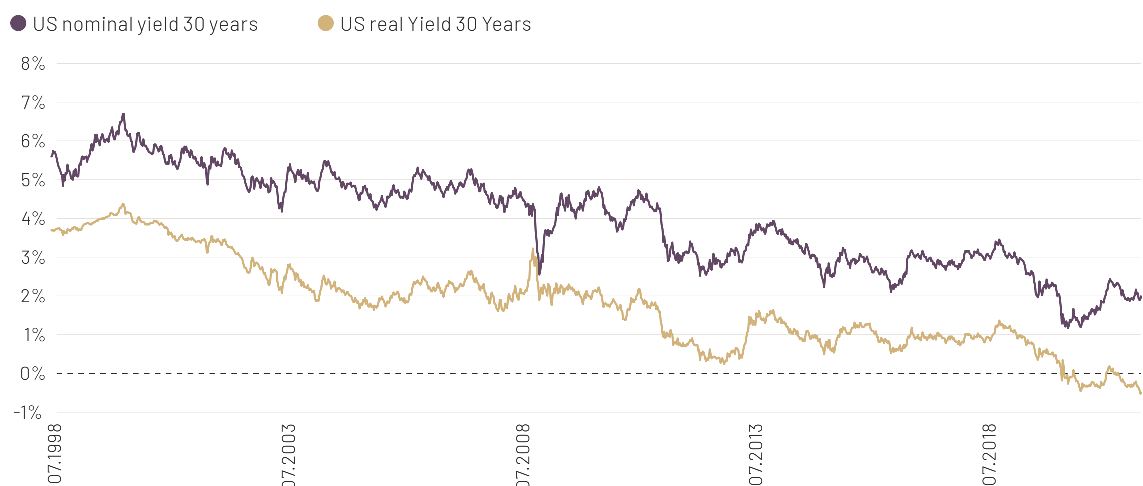
The US 30 years trades, at the time of writing, stand far below the 2% psychological threshold and obviously without measure to a simple Taylor-rule designed implicit long-term rate. Meanwhile, the forex market and some short rates markets are pricing in two hikes in 2022.

Could this derail the long-term rates performance? What are the drivers for long-term rates performance?

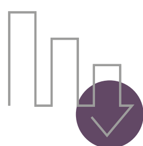
The demand for long duration assets keeps on growing, as more and more savings need to find a place to be invested in. Institutional investors and banks need to hold liquid assets on their balance-sheets to meet regulatory requirements. Central banks in every country hold government bonds as well, as an investment for their euro currency reserves holdings or for QE purposes. Last but not least, long-term studies show the global debt pile tends to weigh on long-term yields, keeping real yields in negative territory. Here we switch from nominal yields to real ones, to introduce the actual stunning -0.5% on a spot basis in the 30 years real yield (derived from the TIPS market) (Chart 3).

Moving back to the current situation, markets strongly bull flattened following the Bank of England (BoE) decision to keep rates on hold, stating that a hike is on the table for December.

CHART 3: US 30 YEARS NOMINAL AND REAL YIELDS, %



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



Fed starts tapering its purchases by

15 BILLION

per month

The Fed starts tapering its purchases by 15 billion per month, while the market is pricing in more than two hikes by the end of 2022. The Fed should engage a rate hike cycle in H2-2022 but is likely not expected to match the magnitude of the spike in inflation. Therefore, whatever happens with short-term rates in the US, real rates will be kept in very negative territory.

In Europe, the ECB is expected to hike once in 2022. Going into year-end, rising rates should not pose a risk for global markets. Nevertheless, we maintain our scrutiny on rising volatility across fixed income segments and swap markets dislocations as markets enter (very early in the season!) into the year end's smooth activity period.

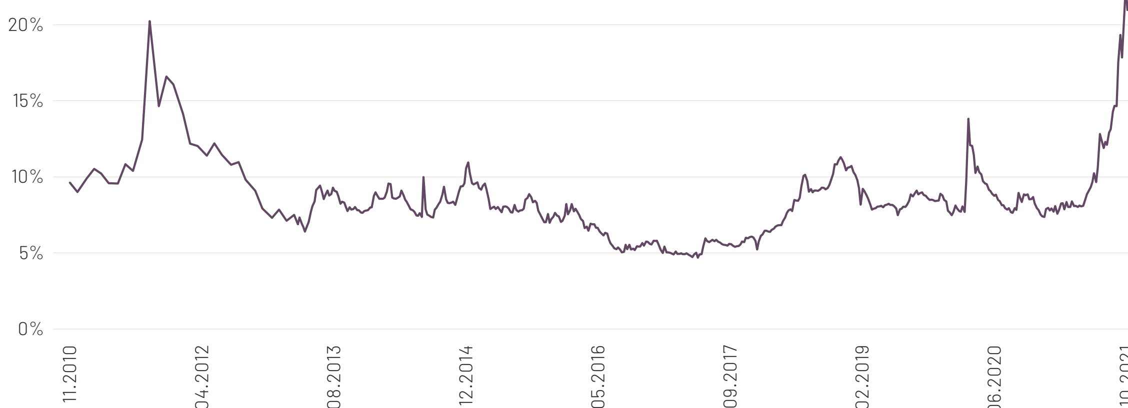
CREDIT

On the credit front, performances have been beaten by the volatility on rates. The risk premia remains very low across developed countries on the investment grade.

On the other hand, the high yield is performing without interruption in Europe and in the US. Euro subordinated debt still offers value in the euro context, as next year bonds are expected to be called, leading to the same amount in new issues.

The Chinese high yield market remains very volatile (Chart 4), shaken by announcements of last-minute coupon payments by Evergrande, and announcements of state support through State-Owned Enterprises (SOE) for real estate. Several real estate companies defaulted over the last couple of weeks, while Sunac raised more than USD 950 million in a stock offering. The exacerbated volatility in this segment reflects both poor liquidity and fundamental risks. Nevertheless, the market does not discriminate between companies when the government is implementing sectoral support measures. Hence, medium-term investors should benefit from high yields and potential high returns for holding positions.

CHART 4: YIELD ON CHINESE HIGH YIELD MARKET, USD DENOMINATED, %



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

YEAR-END RALLY!

We confirmed our positive view on Equity with the conviction that the beginning of the earnings season could be a positive catalyst for the market. Seasonality was entering its best part of the year and sentiment indicators were largely on the cautious side which was a good contrarian indicator. After the recent rebound, the upside potential is more limited, but the current momentum should continue until year end, still driven by positive earnings revisions, flows and seasonality.

81%
of companies reported EPS above estimates

The latest positive development came from the Fed's successful communication regarding the start of tapering. The positive reaction from the market confirms that broad equity indices can tolerate tapering, as the excess liquidity is peaking, but not going away.

EARNINGS SEASON

Q3 has been a positive and reassuring earnings season, notably regarding the margins concerns.

We have confirmation that the key determinants of margins are linked to demand and sales evolution rather than input costs and wages. In fact, margins have continued to increase since the start of the season, and are being revised upwards for 2022-2023.

Investors will now turn their attention to the 2022 earnings outlook. EPS expectations for 2022 remained quite reasonable (+7/8%) notably regarding the expectations that global economic growth should remain above its long-term potential for the coming months.

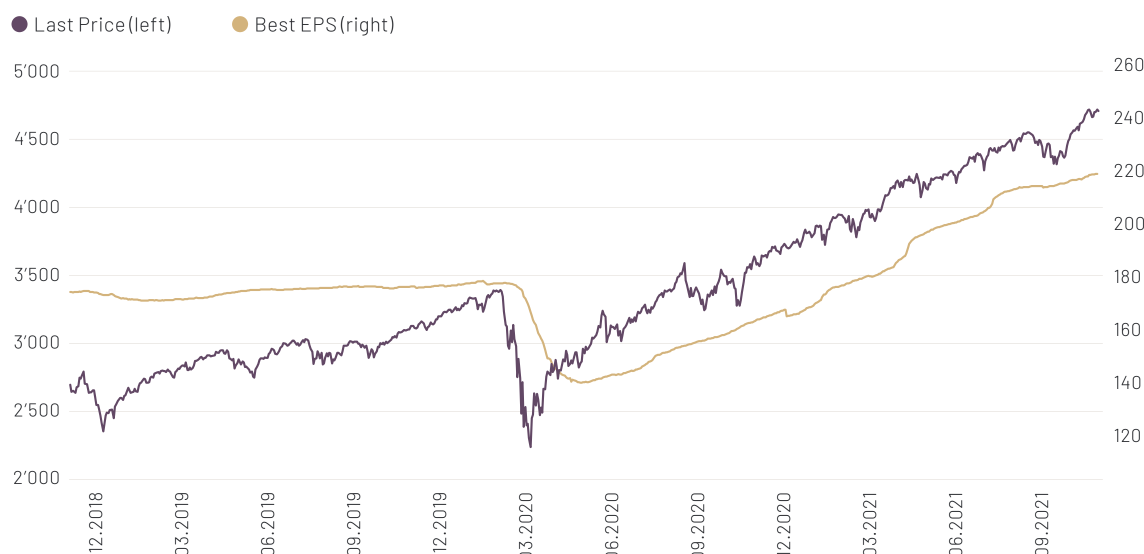
UNITED STATES

Despite concerns about the ability of companies to resist the inflation of raw materials and labour costs, the season of publication of the results for the third quarter have largely reassured.

As the earnings season nears its end, 81% of these companies have reported actual EPS above estimates. The S&P 500 Q3e[1] EPS growth (Chart 5) is +41% year-on-year, surprising positively by 10%. Mean-while, the proportion of S&P 500 companies making upward revisions to their EPS guidance is nearing decade highs.

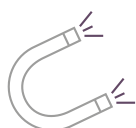
Finally, the most objective conclusion of this season of publications is certainly the reaction of the American indices since its launch in mid-October. Since October 12, the MSCI USA and the Russell 2000 have risen by 9%, the Nasdaq 100 and the FANG by 12%, and finally the SOX (the semiconductor index) which is up a staggering 21%.

CHART 5: S&P 500 VS EPS



Note: The strong EPS growth drove markets up with all time high level for the S&P 500 index.
Source: Bloomberg, Indosuez Wealth Management.
Past performance does not guarantee future performance.

1 - Estimates



Europe provides an
ATTRACTIVE VALUATION

EMERGING MARKETS

We believe that a substantial part of the current regulatory environment in China has been priced in and is reflected in current valuations for some select Asian growth companies.

Finally, Chinese authorities may announce targeted easing measures and policy fine-tuning over the next few months. This could also somewhat ease investor concerns and improve sentiment toward Chinese equities.

The COVID-19 vaccination campaign is progressing all over Asia (China reaching a ratio of approximately 80% of fully vaccinated people). However, China's current "zero-tolerance" policy towards COVID-19 and associated temporary targeted lockdowns seem to be delaying the country's full economic recovery for now, acting as headwind to earnings momentum.

EUROPE

Europe continues to provide an attractive valuation (in absolute and relative terms), a good EPS growth (seen by the consensus at a reasonable +8% for 2022e[2]) and a positive EPS revisions trend (better than the US). The Q3 earnings season was very reassuring on that front despite the well-known headwinds (input cost inflation, supply chain disruptions, and a new round of lockdowns in certain geographies). Indeed, most corporates have been able to demonstrate their ability to cope with this troubled environment. Moreover, the strength of the dollar has been a support for the equity markets too, notably for exporters and international companies.

SECTORS

Rising 10-year bond yields tend to benefit Value sectors and hit Defensives, so we see the same kind of conclusions regarding inflation expectations. Banks, Value, Cyclicals stocks are favoured in a scenario of rising inflation fears which could conversely be detrimental to Defensives, Food and Beverages, and Healthcare.

The Technology segment is immune from inflation and bond yields anticipation as strong pricing power could overcome negative impact on valuation.

2 - Estimates

MIGHTY USD TAKES THE LEAD INTO YEAR-END

As we approach year-end the USD is benefitting from liquidity tailwinds and lack of better news amongst other currencies, although the GBP has been a surprising standout performer. CHF also remains ultra-resilient as the anti-inflation currency, whilst gold found new impetus in November.

DISAPPOINTING GROWTH surprises and DOVISHNESS elsewhere have buoyed the dollar

USD - GREENBACK GAINS DESPITE EVEN DEEPER NEGATIVE "REAL" YIELDS

Surprisingly, the US yield curve flattening on the back of a 30-year high core CPI (Consumer Price Index) release has failed to dent the year-end appetite for the dollar (Chart 6). The FOMC's long awaited dovish taper announcement also failed to hurt the greenback's corrective strength versus the negative yielding CHF, JPY and EUR. Surprisingly disappointing growth and dovishness elsewhere have effectively buoyed the dollar by default. In addition, the worsening COVID-19 backdrop in Europe has exacerbated euro weakness. From a technical perspective, the dollar's upward momentum may have slightly further to run especially if the upcoming debt ceiling standoff can be promptly resolved. However, over the longer term we remain sceptical that this current dollar corrective run up can be sustained beyond Q1 2022, since forex markets price more tightening than fixed income markets and given the rising funding needs implied by the still-debated Build Back Better plan.

XAU - GOLD SHINES ANEW ON RUNAWAY INFLATION FEARS

The yellow metal is enjoying its renewed spotlight status as a portfolio hedge against the less and less "transitory" inflation pressures. The extremely elevated US CPI print has begun to cause market participants to search for "real" hard asset protection. As the crypto world may not be a large enough hiding spot for all, gold may well reprise its traditional role within equity exposed portfolios. Given that speculative gold positioning is quite light after months of endless sideways coiling, the technical shoulders-head-shoulders breakout formation above USD 1'835/Oz will not go un-noticed. Geopolitical migrant border tensions in Eastern Europe may further add to the safe haven appeal in the short term, opening up a potential retest of the initial USD 1'917/Oz high achieved back in June.

CHART 6: USD INDEX DAILY CHART

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

CHF – THE STRENGTH OF SWISS FRANC

After losing almost 2.5% in October and breaking 1.06, the EUR/CHF approached the 1.05 levels at the beginning of November, a level last seen in March 2020. At that time, the Swiss National Bank (SNB) admitted intervening to stabilise the pair amid the pandemic crisis. We could expect the Swiss National Bank to do the same thing today if investors decide to challenge this level again.

The total sight deposits were slightly higher in November but there was no clear sign of the central bank intervening. The fact that inflation was still much lower in Switzerland than in the Euro Area (1.2% in Switzerland versus 4.1% in the Euro Area) at the end of October can partly explain the strength of the Swiss franc.

GBP – THE BANK OF ENGLAND DISAPPOINTS

The outcome reached by the Bank of England surprised markets in November, as they left interest rates unchanged while investors were expecting a first rate hike. The deception pushed the cable down, from 1.38 back to 1.34.

Pressures on the cable could persist as inflation expectations remain high and the rate hikes will be more gradual. Today, the Bank of England is divided between managing inflation and supporting the economy as uncertainties remains. In this context, we stay prudent on the pair.

CNY- STEADY AS EVER

Surprisingly, the renminbi has continued its uninterrupted ascent across the board, defying US dollar strengthening versus the negative G3 yielding counterparties. The deeper the US "real" rates descend into negative territory, the more capital is deployed on an unhedged basis into the relatively high "real" yields on offer in China, despite the domestic slowdown in growth. In fact, the RMB has just posted a five-year high versus the ailing euro. However, following this appreciation which has admittedly been helpful in reducing imported commodity prices, it appears the People's Bank of China (PBoC) is now addressing the current overshoot by requesting that banks cap their speculative proprietary trading limits and for volumes to stem the inflows.

INVESTMENT SCENARIO AND ALLOCATION

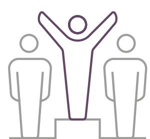
INVESTMENT SCENARIO

MACRO TRENDS

- GDP growth in 2022 should return to more normal levels than FY 2021 growth, still above potential but threatened by higher energy prices and supply side imbalances.
- Confirmed softening of GDP growth in the US in Q3 2021 with simultaneous supply side constraints and demand-side incomplete recovery due to remaining restrictions.
- China's pronounced slowdown was also confirmed in Q3, but external balance and retail sales are resilient; concerns have shifted from regulatory pressure towards the real estate sector.

INFLATION AND CENTRAL BANKS

- In the past months, we expected inflation to accelerate at elevated levels in the second half of 2021 towards 5%. The recent news flow has validated that view and we maintain it for the first quarter of 2022 on the back of supply side constraints and energy prices. Inflation is expected to decrease thereafter but will remain above central banks' target in FY 2022.
- Nevertheless, we think that central banks will stick to their plan of a progressive tapering or recalibration of their policies with a reduction of asset purchases starting at year-end in the US and in March in Europe, and potentially two US rate hikes from September to December 2022.



Preference for
DEVELOPED MARKETS
within the equity space

PROFIT CYCLE AND CORPORATE FUNDAMENTALS

- The earnings momentum continues to surprise on the upside despite headwinds on margins in various sectors, Q3 season led to positive revisions and confirms companies pricing power.
- Default rates will remain limited in developed markets and represent a support for spreads.
- The restructuring process of the Chinese property sector as well as rating downgrades has widened significantly credit spreads; the environment will remain volatile and liquidity quasi absent into year-end, but valuations remain attractive.

RISK FACTORS

- Further deceleration and restructuring of the real estate sector in China.
- Surprise on inflation lasting longer and putting central banks under pressure.
- Slower GDP growth due to supply side constraints.
- Geopolitical risk resurfacing in Eastern Europe and uncertainties on French 2022 elections.

ALLOCATION CONVICTIONS

EQUITIES

- Still constructive view on equities in a year-end bull market phase but less upside for the beginning of 2022 with indicators currently in euphoria territory and lower earnings growth next year.
- Preference for developed markets with a bias towards Euro Area in EUR portfolios. We remain relatively constructive in the long term on China, but with limited catalysts for a rapid recovery given weak earnings revisions, regulatory uncertainties, and real estate restructuring.
- Positive view maintained on Value and Growth as secular growth stories still offer an appealing shelter against inflation impact on margins while the value style should continue benefiting from a strong rerating of earnings growth and still offer attractive valuations. Within value, preference for energy, banks, and autos. We remain underweight on defensive sectors.

FIXED INCOME

- Underweight maintained on government bonds; the expected rise in long term rates has materialised and has probably still further to go, but the pace is slowing and giving way to more upward pressure on the short end of the curve.
- We are more cautious on inflation breakevens which progressed significantly in two months and now accurately price the rebound of realised inflation and the increase of inflation expectations.
- Constructive view maintained on credit in mature markets, notably on subordinated debt and corporate high yield.
- Emerging debt: selectivity is key as attractive valuations being offset by very weak sentiment and regulatory uncertainty. Dislocation in Chinese credit offering opportunities.

CURRENCIES AND PRECIOUS METALS

- The expected strengthening of US dollar was confirmed below 1.15; the greenback could remain supported on the short term given the divergence of monetary policies and Euro Area political uncertainties.
- Japanese yen is still seen as a good macro and volatility hedge notably in EUR portfolios.
- Besides, we remain constructive on the renminbi on the longer run, but the recent appreciation (particularly against EUR) offers less potential and could be vulnerable in the short term against the euro.
- Other emerging markets currencies will remain volatile in this temporary high inflation regime but could start to offer opportunities in 2022 as the horizon clarifies.
- Gold has recently benefited from inflation surprise but could be capped by Fed normalisation process.

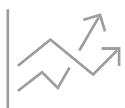
KEY CONVICTIONS

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

Source: Indosuez Wealth Management.

OVERVIEW OF SELECTED MARKETS

DATA AS OF 17 NOVEMBER 2021



GOVERNMENT BONDS	YIELD	4 WEEKS CHANGE (BPS)	YTD CHANGE (BPS)
US Treasury 10Y	1.59%	-6.78	67.57
France 10Y	0.11%	-10.20	45.20
Germany 10Y	-0.25%	-12.10	32.40
Spain 10Y	0.49%	-1.80	44.20
Switzerland 10Y	-0.12%	-4.50	42.80
Japan 10Y	0.07%	-1.50	5.70

BONDS	LAST	4 WEEKS CHANGE	YTD CHANGE
Governments Bonds Emerging Markets	41.46	-2.06%	-8.38%
Euro Governments Bonds	219.79	0.33%	-1.07%
Corporate EUR high yield	213.64	0.42%	3.18%
Corporate USD high yield	328.93	-0.15%	3.38%
US Government Bonds	320.12	-0.09%	-1.77%
Corporate Emerging Markets	51.22	-0.70%	-3.54%

CURRENCIES	LAST SPOT	4 WEEKS CHANGE	YTD CHANGE
EUR/CHF	1.0508	-1.86%	-2.82%
GBP/USD	1.3487	-2.44%	-1.34%
USD/CHF	0.9286	1.06%	4.90%
EUR/USD	1.1319	-2.85%	-7.34%
USD/JPY	114.08	-0.20%	10.49%

VOLATILITY INDEX	LAST	4 WEEKS CHANGE (POINTS)	YTD CHANGE (POINTS)
VIX	17.11	1.62	-5.64

EQUITY INDICES	LAST PRICE	4 WEEKS CHANGE	YTD CHANGE
S&P 500 (United States)	4'688.67	3.36%	24.83%
FTSE 100 (United Kingdom)	7'291.20	0.94%	12.86%
Stoxx Europe 600	489.95	4.23%	22.79%
Topix	2'038.34	0.53%	12.95%
MSCI World	3'221.03	2.33%	19.74%
Shanghai SE Composite	4'885.75	-0.50%	-6.25%
MSCI Emerging Markets	1'286.87	-1.10%	-0.34%
MSCI Latam (Latin America)	2'113.63	-5.17%	-13.79%
MSCI EMEA (Europe, Middle East, Africa)	291.47	-2.59%	20.81%
MSCI Asia Ex Japan	826.90	-0.59%	-1.90%
CAC 40 (France)	7'156.85	6.73%	28.92%
DAX (Germany)	16'251.13	4.69%	18.46%
MIB (Italy)	27'824.94	4.68%	25.15%
IBEX (Spain)	8'993.40	-0.27%	11.39%
SMI (Switzerland)	12'600.15	4.89%	17.72%

COMMODITIES	LAST PRICE	4 WEEKS CHANGE	YTD CHANGE
Steel Rebar (CNY/Tonne)	4'362.00	-21.73%	3.36%
Gold (USD/Oz)	1'867.48	4.79%	-1.63%
Crude Oil WTI (USD/Bbl)	78.36	-6.57%	61.50%
Silver (USD/Oz)	25.17	2.95%	-4.71%
Copper (USD/Tonne)	9'406.50	-7.65%	21.12%
Natural Gas (USD/MMBtu)	4.82	-6.85%	89.68%

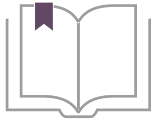
Source: Bloomberg, Indosuez Wealth Management.
Past performance does not guarantee future performance.

MONTHLY INVESTMENT RETURNS, PRICE INDEX

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

	AUGUST 2021	SEPTEMBER 2021	OCTOBER 2021	4 WEEKS CHANGE	YTD (17.11.2021)
BEST PERFORMING (+)	3.26%	3.54%	6.91%	4.23%	24.83%
	3.14%	1.26%	5.59%	3.36%	22.79%
	2.90%	0.30%	4.55%	2.33%	20.81%
	2.42%	-0.47%	2.43%	0.94%	19.74%
	2.35%	-3.41%	2.13%	0.53%	12.95%
	2.08%	-4.25%	1.32%	-0.50%	12.86%
	1.98%	-4.29%	0.93%	-0.59%	-0.34%
	1.24%	-4.36%	0.87%	-1.10%	-1.90%
	0.21%	-4.76%	-1.43%	-2.59%	-6.25%
WORST PERFORMING (−)	-0.12%	-11.39%	-5.38%	-5.17%	-13.79%

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.

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.

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.

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.

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.

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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The banks of the Indosuez Wealth Management Group are preparing for the replacement or restructuring of interbank interest rates, such as the LIBOR, EURIBOR and EONIA, the fixing terms of which will be strengthened significantly, as decided by the financial market authorities and banking agents. At the European level, the European Central Bank began publishing the €STR (Euro Short Term Rate) in October 2019, which will sit alongside the EONIA until December 2021 and will replace it in January 2022. Concerning the EURIBOR, the European Money Markets Institute confirmed in November 2019 that the transition phase for the Hybrid EURIBOR has been completed, paving the way for full restructuring between now and December 2021. Each IBOR interest rate (e.g. the LIBOR US Dollar) will also be overhauled between now and the end of 2021. Accordingly, the Swiss National Bank announced in June 2019 the introduction of its own policy interest rate in Swiss francs, calculated based on the SARON (Swiss Average Rate Overnight) with the goal of creating forward rates that will also be calculated based on the SARON.
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