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MARKET INSIGHT

DECEMBER 2021

CITYWIRE SWITZERLAND TOP 50 INDEPENDENT ASSET MANAGERS 2021

Market Analysis

December 2021

Everything was going so well on the economic front...

Everything seemed to be going so well in the first weeks of November, at least on the economic front. Inflation was still worryingly high in many countries but the economic figures and leading economic indicators were generally pointing towards a strong expansion in 2022.

In this regard, nobody could deny that the rise in economic surprises, particularly in the US, might justify hopes about satisfactory – but evidently more moderate – growth in earnings next year.

Moreover, the confirmation of Jay Powell for a second term as Chair of the Federal Reserve was welcome news, ensuring continuity at the Fed at a "crucial" moment for the US economy, with the implementation of a more restrictive monetary policy on the cards for the next two to three years.

This was before COVID-19 was taken into account, the virus once again causing panic on the markets at the end of the month, this time due to the Omicron variant.

Apart from the fact that it spreads rapidly and has appeared in various parts of the world, little is known for sure about this variant, which is still under analysis at the time of writing.

Is the sharp return of volatility across all financial markets – whether equities, currencies or bonds – here to stay? Or is it a knee-jerk reaction as investors fine-tune their scenarios for the coming quarters?

Certainly, with stock market valuations relatively high there was little room for the sudden rise in uncertainty caused by the Omicron variant. However, the question is difficult to answer given our current knowledge about the nature of the variant.

"The evidence we have doesn't justify reducing the overall risk of the portfolios."

FRANÇOIS SAVARY, CHIEF INVESTMENT OFFICER, PRIME PARTNERS

At the same time, seeing markets behave as they did when COVID-19 first emerged, when the world was entirely unprepared for it, seems excessive at first glance.

Ultimately, developments on the pandemic front raise the question of whether the outlook for 2022 should be revised. However, at present, it does not seem reasonable to change the assumptions we made last month, at least for the broad outline of the scenario.

We remain convinced that the economic expansion will be confirmed next year and that inflation rates will begin to normalise from the end of the first quarter, in developed economies in particular.

The emergence of the new variant makes the task of central bankers even more complicated, if that were possible.

While signs of an accelerated tapering in the US had been building – with the possibility of the Fed raising rates faster than expected in 2022 – that scenario now seems more unlikely.

Moreover, nothing could show more clearly how important monetary policy and related expectations will be for financial asset prices in the coming quarters. This is something we discussed at length in our last issue.

We did not change our investment policy in the weeks leading up to the appearance of the Omicron variant. Our commitment to favor equities at the expense of bonds, which we have reinforced in recent months, remained unchanged.

Recent developments have not led us to change course. In light of the "abrupt" reactions on the markets, which seem more the result of "panic"

than facts on the ground, this approach seems to us the most appropriate, even if the performance of our allocations was affected.

Again, the evidence we have on the virulence of the Omicron variant and its associated risks does not justify any rash decision to reduce the overall risk of portfolios.

The main themes of our investment policy remained in place.

1. While pandemic-related fears, exacerbated by recent news, may weigh on consumption in the short term, we do not believe they cast doubt on a rate rise in the US in 2022. In general, the shift in monetary policy will continue in the major economies, although the pace may remain unclear in the coming months.

2. With the economic expansion set to continue and inflationary pressures insufficiently contained in the short term, the fundamental environment for bonds remains negative.

Against this backdrop, 10-year US treasury yields could reach 2.25%-2.50% in 2022. A policy of underweighting government debt and short duration bonds therefore remains the best course.

Overall, we do not think it wise to bet on a rapid flattening of the yield curves over the next six months.

Even though their return potential is now more limited, we believe that corporate debt – especially high yield corporate debt – should be favoured in bond holdings, especially for less aggressive investors.

3. Equities offer potential in line with expected earnings growth for 2022, which is around 8%-9% for developed markets.

Due to their cheaper valuations, together with the more advanced economic cycle and higher interest rate risk in the US, we see European stocks as more attractive.

4. Our interest rate forecasts, in line with our predictions of a sustained economic expansion, still lead us to favour the more cyclical segments of the stock market, especially financials. Certain, more defensive, sectors offering greater visibility – such as pharmaceuticals – should also be considered.

5. Despite a disappointing performance since June, the euro still has diversification potential for 2022. We maintain our negative outlook for the US dollar, despite its "strong" rebound in recent months.

The twin deficits (fiscal and current account deficits) in the US are a strain on the dollar; moreover, the prospects of a rise in interest rates across the pond have now generally been taken on board by market operators, while the real return on the greenback is not attractive. Lastly, the dollar has the most to lose from the emergence of the Omicron variant, due to a potential downward revision of US rate hike expectations.

While we cannot rule out the dollar rising towards 1.10 to the euro in the short term, we are maintaining a target closer to 1.20 for the end of 2022.

6. The Swiss franc's strength against the euro has been growing since the middle of the year, despite it not really benefitting from the emergence of the Omicron variant lately.

Admittedly, the strength of the Swiss currency caught us off guard and is still a surprise. Certainly, with the doubts about the global recovery expressed over the summer, its safe haven status may have played a role, but the latest economic data seem to show that the fears about global growth were unjustified. Similarly, the muted response from the SNB, which did nothing to counter the trend, may have encouraged the appreciation seen in recent months.

Now overvalued, the franc could return to levels closer to 1.10 against the euro by the end of 2022, thanks both to confirmation that European growth will remain more than satisfactory and to action by the ECB to reduce liquidity injections in the spring.

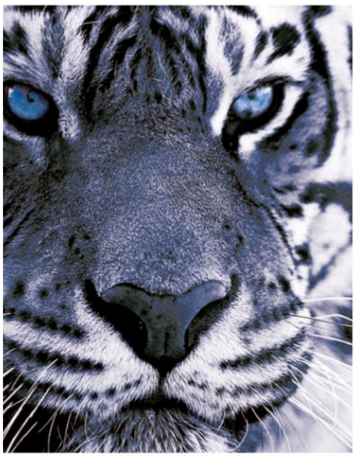
Although the year is not yet over, and notwithstanding the marked gains in the indices, the last few months have clearly been far from smooth. Changes in investor expectations have, as in the last days of November, led to abrupt and sometimes incomprehensible variations in financial asset prices throughout 2021.

With the recent developments in COVID-19, there is every chance that volatility will remain with us over the next few months, especially since phases of monetary policy change often pose many questions within the financial community. In view of this, some consider the new state of play on the fiscal dominance front – which subjects monetary policy to the necessities of fiscal stimulus – to be a

fundamental change, justifying a new assessment of the impact of a more restrictive monetary policy bias on financial assets. This theory will be put to a real test in 2022.

We wish you a very happy holiday period.

Geneva, 30 November 2021



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