

## Quarterly Pulse – Friday, 1<sup>st</sup> April 2022

### Economic Outlook

The dominating topic in financial news in the end of the first quarter was the Russia-Ukraine conflict and its consequences not only for the countries involved directly, but also for the rest of the world. While financial markets have quickly recovered after the initial sell-off, longer-term economic effects of disruption in international trade and rising commodity prices are likely yet to be seen. One of the immediate concerns for financial markets, that arises from the situation, is rapidly rising commodity prices that are likely to affect global growth.

#### Tactical Asset Allocation

|                         |            |
|-------------------------|------------|
| Liquidity               | Neutral    |
| Rates                   | Neutral    |
| Credit                  | Overweight |
| Equities                | Overweight |
| Alternative Investments | Neutral    |

#### Macroeconomics

Economic activity in advanced economies has so far been robust this year. Preliminary March PMI figures in the Euro Zone and in the US revealed strong activity both in manufacturing and in services. Preliminary March composite PMI figures were 54.5 in Euro Zone and 58.5 in the US. Labour market dynamics is strong in both regions with unemployment steadily decreasing and labour participation rates increasing.

However, the Russia-Ukraine conflict has triggered a downward revision of 2022 global growth estimates by major banks and official institutions. Namely, JPMorgan lowered their 2022 global GDP growth forecast by 1 p.p. (although it is still expected to be positive, thanks to favourable base effects and the continuing reopening momentum) and notes that near-term growth risks remain skewed to the downside. The bank also notes that, coming amid the constellation of elevated inflation levels and rising interest rates, a shut-off of Russian energy exports to Europe might push Europe into a recession. While Russia and Ukraine are not major players in financial markets and constitute a small part of the global GDP, they are crucial in supplying both hard and soft commodities to the rest of the world. Sanctions and other disruptions to availability of those commodities have already pushed their prices significantly higher. As this inflation get passed on to consumers, consumer purchasing power will decrease, affecting growth. Moreover, central banks might be more inclined to promptly tighten their monetary policies in

an effort to counter rising prices, which also puts additional pressure on growth prospects.

At the same time, pandemic-triggered supply chain issues, which were expected to be transitory, still persist. Together with rising commodity prices in economies, over-stimulated by central banks, they are driving price indexes up across the globe. Year-on-year CPI growth in Euro Zone was 5.9% in February and Core CPI growth in the region was 2.7% over the same period. In the US, March PCE Deflator and PCE Core Deflator readings indicated year-on-year price growth of 7.9% and 6.4% respectively. Thus, price growth rate reached multi-decade highs in both regions. Both the ECB and the Fed target inflation at around 2% on average over some time, thus allowing temporary overshoots. Major central banks still expect that the elevated price growth rate in Western advanced economies is temporary, if more prolonged than was expected last year, as post-pandemic demand growth normalizes and goods and labour supply improve. Financial markets mostly seem to agree with this view. However, rising commodity prices do pose a risk of inflation expectations becoming unanchored from central banks' targets, which would make inflation harder to control and tilt the risk to the upside.

In response to highest inflation levels in decades, the US Fed after its March meeting announced the first post-pandemic rate hike by 25 b. p., bringing the interest rate up to 0.50%, as was anticipated. Powell and other officials have also indicated their openness to hiking further by more than 25 b. p. at a time, if necessary, to tame inflation. Meanwhile, the ECB concluded its Pandemic Emergency Purchase Programme (PEPP) in the end of March and announced a faster pace of unwinding of its Asset Purchase Programme. According to the new plan, net asset purchases will decrease from EUR 40bn to EUR 20bn per month already by the end of June. No rate hikes have been announced so far, and Lagarde also reiterated, that any adjustments to the key rates will only come after the PEPP has been concluded and will be gradual.

#### Fixed Income

The bear market in US Treasuries continued with full speed, mainly driven by a 40-year high inflation, which forced the Fed to start with a more aggressive tightening cycle. Market expectations for further Fed rate hikes have shot up. Expectations for the target range stands now around 2.50 by the end of this year. That is why US Treasuries had their weakest quarterly performance since decades. 10-year yields

have risen around 100 bp. The short end lost even more (2-year +165bps).

The 2-10yr yield curve is now close to inversion which is widely seen as a sign of looming recession risks. It reflects fears that more aggressive rate hikes by the Fed could hurt economic growth or even put the US into a recession. The bond market is giving a warning sign that has correctly predicted almost every recession over the past 60 years. According to research from the Fed Reserve Bk San Francisco (FRBSF), a yield curve inversion has preceded every single recession since 1955.

“A simple rule of thumb that predicts a recession within two years when the term spread is negative has correctly signalled all nine recessions since 1955 and had only one false positive, in the mid-1960s, when an inversion was followed by an economic slowdown but not an official recession. The delay between the term spread turning negative and the beginning of a recession has ranged between 6 and 24 months” (source FRBSF).

This means that timing is everything. We are close, but not there yet. Economic indicators are still solid with a low unemployment rate and elevated consumer spending.

After the selloff in bonds, resulting in higher yields, we feel more comfortable to lengthen our portfolio duration a bit. New money (redemption etc.) we are going to put into longer maturities with a better credit quality. Step by step we are going to extend our duration- at the expense of credit risk. Current positions we are not going to touch.

We are going to implement the change in our strategy carefully, as the 10-year UST yield still has some momentum to the upside. With approximately USD 500 bn in Treasuries to roll off Fed’s balance sheet this year, there is some further potential for market weakness in rates..

## Equities

Since the escalation peak at the beginning of the second week of March, market participants have pushed the Russia-Ukraine conflict further and further into the background. Most equity market indices are already trading above the level they reached immediately before the outbreak. And this, despite the fact that the central banks have neither intervened nor deviated from the tighter monetary policy announced at the beginning of the year. The easing escalation dynamics and the willingness for dialogue between Ukraine and Russia just managed to prevent a bear market for now and those who kept their nerve were rewarded for holding the position in the risky assets. But even if the negotiations between Ukraine and Russia have a de-

escalating effect, the sword of Damocles of a renewed escalation is still hovering over commodity prices and the question arises as to what investors should focus on next. One thing is certain: growth is declining, inflation remains high, and persistent supply bottlenecks must now overcome a deglobalization hurdle in addition to the pandemic. The economic outlook for the next quarter is not gloomy, but the constructive signals, that supported a more confident economic scenario at the beginning of the year, have dimmed due to the Russia-Ukraine conflict and the associated sharper slowdown in growth accompanied by a pickup in inflation. Analysts still expect a global recession to be averted, but high inflation is ensuring that central banks will have to tighten monetary policy amid a growth slowdown.

### Equity Indicators

|                 |          |
|-----------------|----------|
| Valuation       | Neutral  |
| Momentum        | Positive |
| Seasonality     | Neutral  |
| Macro-Economics | Neutral  |

Whenever political risks are among the main drivers of financial markets, it makes sense to work with scenarios and isolate the economic impact channels. From an economic perspective, a base scenario focuses on higher commodity prices, persistent supply bottlenecks, increased inflation, and thus tighter monetary policy. While higher inflation directly increases companies' production costs and thus margin pressure, tighter monetary policy makes financing conditions more expensive and/or increases the discount factor for future cash flows. A combination that usually leads to a valuation adjustment in equities. The stock markets have already compensated for the effect of the escalation of the conflict, and most of the valuation correction due to monetary policy had already taken place before the war. However, analysts expect headwinds to profit growth due to increasing margin pressure and the more uncertain economic outlook. However, equities remain the better investment - especially commodity-related sectors and industrial groups - than bonds, especially in an inflationary environment.

The earnings are still supportive for stocks, though analysts reduce the S&P 500 EPS forecast for 2022 to USD 235.5 from USD 242, and 2023 EPS comes down slightly to USD 250.5 vs USD 252 previously. S&P 500 forward P/E have tracked real yields since 2014, and a 10Y real yield of just below zero would support a P/E of roughly 19x. While margins remain the key focus, analysts see sales beats supporting EPS upgrades. A rise in energy prices is a risk for margins. However, energy related costs as % of sales for the S&P 500 are roughly 2.6%. Every 5% increase in energy related prices would be a ca. 0.7% drag on S&P 500 earnings assuming no

pricing is passed through. Relative region and country exposures are likely to become a bigger factor for earnings given potential impacts from the Russia-Ukraine conflict and geopolitical uncertainty. Analysts estimate that 70% of S&P 500 revenue comes from the USA. All in all, the geopolitical uncertainties are subsiding and the monetary policy path on the part of the Fed is currently given. From this side, there are no surprises for the time being, which allows us to reclassify our general equity stance from neutral to overweight. However, the Russia-Ukraine conflict is very likely to bring a recession in Europe, which leads us to favor the U.S. relatively speaking, with a tilt to Quality in order to maneuver well through higher volatility environment.

## Alternative Investments

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The March FOMC decision to start the rate hike cycle, and a surprisingly hawkish expectation by the members of the committee for the future rate path, have supported the USD. Analysts think currency markets will carry the USD rally further over the coming months. The Fed's signal that it sees little risk for a recession and on balance worries more about inflation than about growth is very important, particularly in light of the Russia-Ukraine conflict. Its commitment to hike rates and potentially go above the long-run neutral rate of 2.4% makes the USD the most preferred safe haven, even relative to the negative-yielding CHF. Eventually, we also expect the EUR to pick up against the USD, but this needs some change in the conditions in Europe. The conflict and the sanctions pose downside risks to Europe that go beyond the impact in the US. A rally in the EUR, which we expect later this year, will need a political and economic setting that convinces the ECB to start its own rate hike cycle. On the other hand, USD rate hike path is very much priced in for this year that every "less hawkish" stance from the FED would weaken the USD and to start a reversal of the EURUSD weakness from last year up until beginning of March. Hence, we prefer to buy on dips in EURUSD for the next months to come.

Meanwhile Gold was seeing a high of USD 2'050 as a safe haven, but now slowly retreating to USD 1'930. Correlation between precious metals and equity markets finally decreased back to their historic levels. The most volatile precious metals was Palladium recovering from their lows in December below USD 2'000. Russia is one of the biggest commodity producer in the world dominating commodities such as Palladium, Natural Gas, Nickel, etc. It seems that the current situation to continue and therefore see further price volatility in most of the commodities. For Oil the only way to go seems to be up: already existing supply scarcity has been

exacerbated by Western sanctions on Russia. The world is still short on energy, especially Europe. Therefore balancing the equation leads either to less demand by higher prices or by slower growth. In Natural Gas, the US agreed to supply an extra 15bn cubic meters of LNG to Europe by the end of 2022, which does not even closely meet the supply of more than 100bn cubic meters supplied by Russia. Other sources will be hard to find as LNG capacities are limited before 2026. We are holding a strategic position of commodities in Gold as well as general exposure in order to hedge current equity risk and to diversify the equity allocation.

Private Markets also retracted as the risk-on environment cooled down. However the demand for private markets is still strong and will further increase. Market participants are willing to harvest the liquidity premium of 2-5% depending on the different investment approaches. We still see further upside on private debt as well as private market and further increase the allocation to it.

Hedge Funds further deteriorated the trust put in them. They were not able to mitigate the losses compared to balanced mandates and therefore do not deserve their higher fees and low transparency. We see only limited potential in Hedge Funds and keep a small allocation invested in.

## Market Overview as of Friday, 1 April 2022, 5:14 PM

### Fixed Income

|                 | Rate  | Δ 1m   | Δ 3m  | Δ ytd |                     | Δ 1m  | Δ 3m  | Δ 6m  | Δ ytd |
|-----------------|-------|--------|-------|-------|---------------------|-------|-------|-------|-------|
| USD Overnight   | 0.33  | 0.25   | 0.27  | 0.27  | USD Deposit 1m      | 0.2%  | 0.5%  | 0.9%  | 0.9%  |
| USD 1y Swap     | 2.02  | 0.95   | 1.47  | 1.48  | USD Aggregate 1-3y  | -1.6% | -2.5% | -3.1% | -2.5% |
| USD 3y Swap     | 2.76  | 1.17   | 1.54  | 1.59  | USD Aggregate 3-5y  | -2.9% | -4.5% | -5.4% | -4.5% |
| USD 5y Swap     | 2.63  | 0.96   | 1.18  | 1.26  | USD Aggregate 5-7y  | -3.5% | -5.2% | -5.9% | -5.2% |
| USD 10y Swap    | 2.48  | 0.68   | 0.80  | 0.90  | USD Aggregate 7-10y | -4.0% | -6.6% | -6.9% | -6.6% |
| EUR Overnight   | -0.51 | -0.02  | -0.01 | -0.01 | EUR Overnight       | 0.0%  | -0.1% | -0.2% | -0.1% |
| EUR 1y Swap     | -0.07 | 0.33   | 0.41  | 0.41  | EUR Aggregate 1-3y  | -1.0% | -1.3% | -1.6% | -1.3% |
| EUR 3y Swap     | 0.85  | 0.76   | 0.97  | 0.99  | EUR Aggregate 3-5y  | -2.5% | -3.5% | -4.2% | -3.5% |
| EUR 5y Swap     | 1.03  | 0.71   | 0.98  | 1.01  | EUR Aggregate 5-7y  | -3.5% | -5.2% | -6.0% | -5.2% |
| EUR 10y Swap    | 1.23  | 0.57   | 0.89  | 0.93  | EUR Aggregate 7-10y | -4.4% | -6.6% | -7.5% | -6.6% |
| CDX Xover 5y    | 3.75% | -0.06% | 0.81% | 0.82% | US Corp. HY         | -1.2% | -4.8% | -4.2% | -4.8% |
| iTraxx Xover 5y | 3.37% | -0.42% | 0.95% | 0.95% | EUR HY              | -0.3% | -4.1% | -4.1% | -4.1% |

### Equity

|                      | Price  | P/E  | D. Yield | FCF yield |                      | Δ 1m  | Δ 3m   | Δ 6m  | Δ ytd  |
|----------------------|--------|------|----------|-----------|----------------------|-------|--------|-------|--------|
| MSCI World           | 9 253  | 17.9 | 1.9%     | 5.3%      | MSCI World           | 4.4%  | -5.2%  | 1.7%  | -5.2%  |
| S&P 500              | 4 530  | 20.1 | 1.4%     | 4.1%      | S&P 500              | 5.2%  | -5.0%  | 4.0%  | -5.0%  |
| NASDAQ               | 14 887 | 26.2 | 0.7%     | 3.1%      | NASDAQ               | 6.3%  | -8.8%  | 0.6%  | -8.8%  |
| Euro Stoxx 50        | 3 918  | 13.2 | 3.3%     | 13.3%     | Euro Stoxx 50        | 4.0%  | -8.8%  | -2.9% | -8.8%  |
| SMI                  | 12 187 | 17.9 | 2.8%     | 11.6%     | SMI                  | 2.7%  | -5.4%  | 5.3%  | -5.4%  |
| FTSE 100             | 7 539  | 11.3 | 4.0%     | 12.6%     | FTSE 100             | 2.8%  | 2.1%   | 7.3%  | 2.1%   |
| DAX                  | 14 445 | 12.6 | 3.2%     | 8.9%      | DAX                  | 3.9%  | -9.1%  | -4.7% | -9.1%  |
| MSCI Asia Pacific    | 180    | 13.7 | 2.7%     | 5.8%      | MSCI Asia Pacific    | -1.6% | -6.6%  | -7.5% | -6.6%  |
| FTSE China A50       | 14 010 | 12.3 | 2.7%     | 8.0%      | FTSE China A50       | -2.8% | -10.5% | -9.5% | -10.8% |
| MSCI Emerging Market | 1 142  | 12.4 | 2.9%     | 7.0%      | MSCI Emerging Market | -2.9% | -7.3%  | -8.4% | -7.3%  |
| PH Semiconductor     | 3 387  | 18.5 | 1.2%     | 3.6%      | PH Semiconductor     | 2.5%  | -14.2% | 3.8%  | -14.2% |

### Commodity

|           | Price  | FCST 21 | FCST 22 | Δ Future |           | Δ 1m  | Δ 3m  | Δ 6m  | Δ ytd |
|-----------|--------|---------|---------|----------|-----------|-------|-------|-------|-------|
| Gold      | 1 925  | 1798    | 1827.5  | 0.2%     | Gold      | -1.0% | 5.3%  | 9.6%  | 5.3%  |
| Silver    | 24.86  | 25.1    | 23.14   | 0.8%     | Silver    | -2.7% | 6.3%  | 10.0% | 6.3%  |
| Platinum  | 999    | 1091    | 1055    | 1.0%     | Platinum  | -5.1% | 3.4%  | 2.2%  | 3.4%  |
| Palladium | 2 293  | 2410    | 2236.88 | 2.3%     | Palladium | -9.6% | 19.9% | 20.3% | 19.9% |
| Crude Oil | 99.96  | 68.12   | 90.4    | 0.8%     | Crude Oil | -0.2% | 35.2% | 37.3% | 35.2% |
| Brent Oil | 105.00 | 70.95   | 92.54   | -1.1%    | Brent Oil | 3.8%  | 37.5% | 39.4% | 37.5% |

### Foreign Exchange

|         | Price  | FCST 21 | FCST 22 | Δ Spot |         | Δ 1m   | Δ 3m   | Δ 6m   | Δ ytd  |
|---------|--------|---------|---------|--------|---------|--------|--------|--------|--------|
| EUR/USD | 1.1037 | 1.14    | 1.14    | 3.2%   | EUR/USD | -0.8%  | -2.3%  | -4.8%  | -2.9%  |
| GBP/USD | 1.3108 | 1.35    | 1.35    | 2.9%   | GBP/USD | -1.6%  | -2.8%  | -3.2%  | -3.1%  |
| USD/CHF | 0.9263 | 0.93    | 0.94    | 1.5%   | USD/CHF | -0.8%  | -0.8%  | 0.5%   | -1.4%  |
| USD/JPY | 122.84 | 114     | 117.5   | -4.4%  | USD/JPY | -6.4%  | -6.1%  | -9.6%  | -6.3%  |
| EUR/CHF | 1.0224 | 1.06    | 1.06    | 3.6%   | EUR/CHF | 0.0%   | 1.6%   | 5.5%   | 1.5%   |
| USD/RUB | 118.69 | 71.19   | 102.23  | -14.9% | USD/RUB | -36.8% | -38.2% | -38.3% | -37.1% |
| EUR/RUB | 93.12  | 80.7    | 109     | 15.7%  | EUR/RUB | 30.1%  | -9.5%  | -9.5%  | -8.2%  |

Source: Clarus Capital Group, Bloomberg

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