2022: The Year Of The Polycrisis And The End Of An Era

2022 was the year of the polycrisis:

- Run-away inflation, forcing central banks to tighten monetary policy aggressively
- The war in Ukraine, and the ensuing fears about an energy shock in Europe and a food shock in developing countries
- Russia talking about nuclear weapons
- Worries about China invading Taiwan
- Liz Truss became the UK's shortest-serving Prime Minister in history, thanks in large part to the 'mini'-budget, that spooked markets and caused the Pound go tank. A popular video livestream launched by The Daily Star on Oct. 14, as to who would outlast the other, a wilting vegetable, or Prime Minister Liz Truss, had gripped the nation and underscored the chaos at the heart of Britain's government. In the end, the iceberg lettuce won
- The stubbornly tough China Zero Covid Policy
- Climate change and natural disasters, with the 'Niña' phenomenon, still ongoing after over 2 years

2022 was also the end of an era:

- The end of a global fiscal experiment: fiscal stimulus and quantitative easing
- The end of the outrageous outperformance of US mega caps
- The end of investors chasing companies with attractive new technologies that might never turn in a profit
- The end of the belief that the number of subscribers to services and the pool of advertisement might be unlimited
- The end of the belief that the transition to renewable energy might be rapid and cheap
- The end of the quixotic dream about a decentralized financial system, independent from governments and central banks, that offers sky-high risk-free rewards. Questions now abound about the fate of its army of over 20'000 cryptocurrencies and the myriad of non-fungible tokens
- The 1990's post-cold war belief that trade, business and money will replace geo-politics and ideology
- The end of There Is No Alternative (to equities): fixed income securities have regained a level of yield where they recover their role of cushion in a multi-asset portfolio and, particularly for investment grade USD bonds, a real alternative, in net return terms, to equities

Financial Markets

Globally, it was clearly a very disappointing year for financial markets and its classical 'balanced' portfolio, there was nowhere to hide except for cash. Even gold disappointed: it briefly spiked following Ukraine's invasion, and then fluctuated in close correlation with 10-year USD rates, to finish roughly flat for the year.

The sell-off in the fixed income market was very generalized, amidst central banks rising rates, the Bank of Japan being the sole exception. Within equity markets we did find some surprises though:

- Europe outperformed the United States by a wide margin, thanks to the show of unity, both on the fiscal and political front, as well as the energy one. Also, its indices are being dominated by 'old' economy companies
- About 2/3 of the move lower in the S&P 500 can be attributed to just 8 stocks, which include Tesla, Apple, or Microsoft: the end of FANG or FAANMG outperformance
- Non-profitable or highly valued US stocks collapsed. Taking much mediatized Kathie Wood's ARK investment as a proxy: it lost 70% in 2022. It sits now 50% below its pre-pandemic level, having rallied 160% at its peak in early 2021
- The UK's FTSE index closed the year up 5%, despite the domestic political saga and its economic issues, as 75% of the index companies' revenues are derived internationally
- The worst markets in Asia were neither domestic China nor Hong-Kong, they were to be found in Taiwan, South Korea, and Vietnam
- As usual in emerging markets, when citizens are hit by very high inflation, those who can afford it look for shelter in stocks: Turkey is thus up 100% in USD terms. Lebanese real estate company is up 90%, also in USD terms, after rising 150% in 2020 and 71% in 2021
- Despite the continent moving decidedly left politically, Latin America ended the year up 12% in USD
- After the debacle of 'growth' stocks, there have been reshuffles in some indices, that look different than in the past. For example, in the MSCI Europe Growth index, the largest stock is now Nestle

Commodities

In energy commodities, most of the spikes higher, due to the war, have now been retraced: natural gas both in the US and Europe, along with crude oil, are now below their pre-war levels. However, thermal coal and German electricity are still 76% and 63% higher respectively. Global agricultural commodities spiked 30%

higher after the invasion, and they now sit just 10% higher. However, wheat, a key commodity exported by both Ukraine and Russia, rose 80% before falling, and is now 20% lower than pre-war.

CURRENCIES

With various crises crisscrossing the planet, and the US Federal Reserve hiking at a pace not seen since the late 70's, the USD, for the better part of the year, offered shelter to investors. Towards the end of the year though, as it became clear that an energy crisis would be avoided in Europe, that the ECB would no longer be late to the game in its inflation fight, that China would change its ZCP approach, and the BOJ started adjusting its yield curve control ahead of a potential pivot in its policy, under a new governor in the Spring, the USD started to lose some of its shine, falling about 9% into year-end.

OUTLOOK

We are moderately positive for the outlook for financial markets in 2023, and particularly for the classical 'balanced' portfolio. 2023 will be substantially different than 2022:

- We believe that inflation has peaked, in early summer in the US and in late 2022 in Europe. In the US, inflation could surprise to the downside this year. We think the market is underestimating the deflationary power of consumer and durable goods, along with falling housing prices, while we acknowledge that services inflation might stay higher for longer. As highlighted in December, the US consumer is not that healthy. It has already spent its pandemic savings and financed its recent spending with credit cards.
- We think central banks are actually much further along their tightening cycle. In the US, the San Francisco Federal Reserve calculates a 'proxy' rate, which considers credit spreads or the balance sheet of the Fed: according to its model current rates are already at 6.1%
- Recent comments from the Federal Reserve - about their resolve in combating inflation - should be taken in perspective: just one year ago the central bank was predicting inflation at 1% in 2023
- In December, we welcomed China abandoning its Zero Covid policy, while worrying about diffusion of the virus and new variants. It looks like the government, while prioritizing the economy to the health, took a gamble: take advantage now of the 'light' omicron version. While there are reports of overwhelmed crematories, it looks like the bet paid off, and that the peak in infections is already behind us: public transport utilization is surging in big cities, and reports from people on the ground, mention a huge number of simultaneous infections at companies. The Chinese thus could have rapidly attained herd immunity, allowing the reopening of its economy, which in turn could particularly

benefit both the rest of Asia as well as Europe. China is also, finally, (and seriously), addressing its housing sector issue, as well as using fiscal and monetary stimuli, to address its economic weakness.

- We are facing one of the most-anticipated recessions, however we think the economy might experience a shallow one or even dodge it. The reopening of China will be of great help, while government spending is likely to increase. On one side, military spending is increasing everywhere, on the other, the US Inflation Reduction Act in the US could actually double in size to 700 billion, while in Europe the Recovery Budget, (1.8 trillion between 2020 and 2026), will likely act as a spending multiplier. If we do have a recession, it is likely to be technical in nature, similar to what we saw in Q1 / Q2 in the US last year
- Expectations on revenues and company earnings will need to come down further in 2023. However, Europe, at 11 times forward earnings, has already priced in a recession, while the US, at 17 times hasn't. In particular, the US market could therefore stagnate, or rise less than others, as the repricing of some parts of the market, such as large cap 'old economy' technology stocks, continues and investors adjust their weightings.
- Stock markets bottom earlier than the trough in the economic cycle, and a peak in unemployment. They also tend to bottom 6 to 9 months before the trough in earnings estimates. It could thus well be that the low in stocks seen in October was the bottom for this cycle
- The positioning towards risk assets, as commented over the last couple of months, continues to be underwhelming
- Geopolitically, it seems that there are also some improvements: China just recently withdrew its ban on Australian coal, while the words 'negotiations' or 'ceasefire' are increasingly used, even by Russia, although admittedly Ukraine is currently ruling out a ceasefire or concessions.

THREATS

We are only moderately positive to start the year, because there are several threats out there, and as usual also potential unknowns, amongst them:

- The US debt ceiling: the negotiations could be particularly hard this year, and a repeat of 2011 cannot be ruled out, along with a longer government shutdown: that is when rating agencies downgraded US debt. Just watch the current chaos unfolding on the US House floor to elect the new GOP speaker. Officially, the government is only 78 billion away from reaching the 31.4 trillion statutory limit, but the treasury has historically employed various measures to delay hitting the ceiling by several months
- Inflation becomes entrenched and the world falls into stagflation: currently markets are implying a return to normal within the next 12 to 18 months
- China stumbles in its reopening
- Russia no longer accepts to fight a proxy-war against the West, and NATO becomes directly involved

- A Covid rerun
- China decides to invade Taiwan
- Risk of policy mistakes for the main central banks remains high
- The West decides to sanction India and China as buyers of Russian commodities, escalating a trade and geo-political war
- A long cold snap in Europe and/or the US causes gas and energy prices to surge to new highs

POSITIONING

Overall Exposure

We are slightly Underweight Equities, and Neutral Fixed Income, with a Gold position, partially USD and JPY hedged

Equity: Underweight

We have a very sizeable Overweight to Continental Europe and a very sizeable Underweight in US equities, Neutral UK, Neutral Japan, Overweight Asia ex Japan

Thematic Equities

Health Improving Technologies and Services, Asian Technology, European Family Holdings, European COVID Recovery, the UN's 17 Sustainable Development Goals, Emerging Markets Healthcare

Fixed Income: Neutral

Underweight High Yield in EUR and USD. Overweight Investment Grade EUR and USD Bonds, Underweight Sovereigns. Long US Municipal Infrastructure Bonds, Long Hybrids, long Financial Credit & Long Asian Bonds.

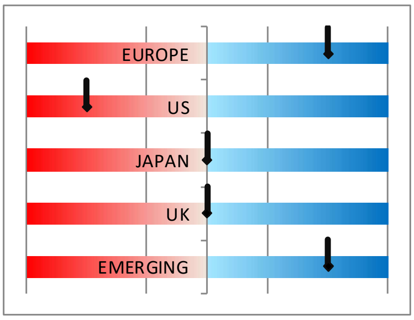
Currencies: Portfolios have a 5% USD exposure

Commodities: Overweight

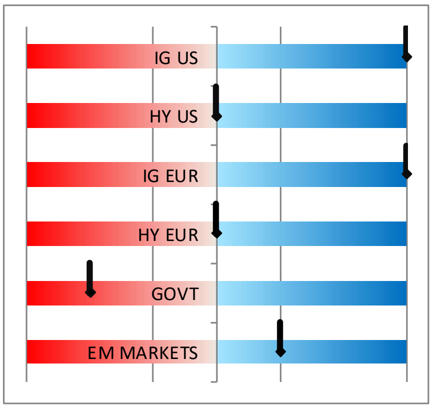
Long Gold

CONVICTION THERMOMETER

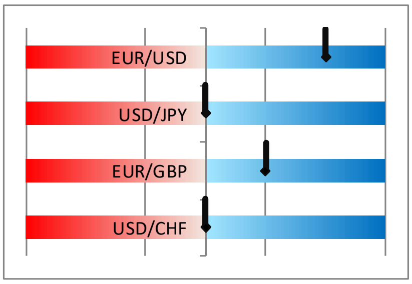
Equities



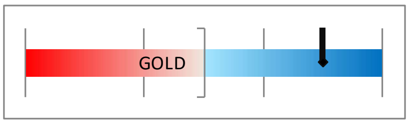
Bonds



Currencies



Commodities



*Negative view / Positive view

Market Overview as of 30th December 2022

EQUITIES (local ccies)	Level	5D	MTD	YTD	2021
MSCI WORLD	2 602,69	-0,06%	-4,21%	-17,71%	22,38%
GERMANY DAX	13 923,59	-0,12%	-3,29%	-12,35%	15,79%
FRANCE CAC40	6 473,76	-0,48%	-3,81%	-6,71%	31,88%
UK FTSE100	7 451,74	-0,28%	-1,49%	4,57%	18,40%
BELGIUM BEL20	3 701,17	-0,66%	0,51%	-11,47%	21,86%
SWISS MARKET INDEX	10 729,40	-0,70%	-3,58%	-14,29%	23,73%
EUROPE EURO STOXX 50	3 793,62	-0,61%	-4,04%	-8,55%	24,10%
US S&P500	3 839,50	-0,12%	-5,77%	-18,13%	28,68%
NASDAQ 100	10 939,76	-0,41%	-9,01%	-32,38%	27,51%
RUSSELL 2000	1 761,25	0,08%	-6,49%	-20,46%	14,78%
JAPAN TOPIX	1 891,71	-0,17%	-4,57%	-2,49%	12,77%
MSCI EMERGING	956,38	0,18%	-1,51%	-19,94%	-2,32%
BRAZIL IBOVESPA	109 735	0,03%	-2,45%	4,69%	-11,93%
MEXICO MEXBOL	48 463,86	-4,15%	-5,65%	-5,77%	24,07%
HS TECH	4 128,79	0,11%	8,74%	-26,66%	-32,47%
CHINA CSI 300	4 563,77	1,22%	0,63%	-19,83%	-3,51%
INDIA SENSEX	60 840,74	1,66%	-3,58%	5,77%	23,23%
KOREA KOSPI	2 663,34	-3,32%	-9,53%	-24,36%	5,56%
HONG KONG HANG SENG	19 781,41	0,96%	6,38%	-12,56%	-11,84%
AUSTRALIA ALL-SHARE	4 075,13	-0,20%	-1,42%	0,23%	18,29%
SAUDI ARABIA TADAWUL	10 478,46	2,57%	-3,73%	-4,96%	33,19%

US: Sectors	Level	5D	MTD	YTD	2021
COMMUNICATION SVCS	159,37	-0,08%	-7,84%	-39,89%	21,57%
CONSUMER DISCRETIONARY	1 005,48	-0,25%	-11,26%	-37,03%	24,43%
CONSUMER STAPLES	779,13	-0,83%	-2,82%	-0,62%	18,63%
ENERGY	672,34	0,60%	-2,99%	65,43%	54,39%
FINANCIALS	569,74	0,72%	-5,27%	-10,57%	34,87%
HEALTH CARE	1 585,54	-0,17%	-1,91%	-1,95%	26,13%
INDUSTRIALS	831,40	-0,15%	-3,00%	-5,51%	21,10%
INFORMATION TECHNOLOGY	2 172,17	-0,15%	-8,37%	-28,19%	34,52%
MATERIALS	489,55	-1,08%	-5,56%	-12,28%	27,28%
REAL ESTATE	232,37	-0,37%	-4,83%	-26,21%	46,14%
UTILITIES	358,48	-0,59%	-0,53%	1,56%	17,67%

EUROPE: Sectors	Level	5D	MTD	YTD	2021
BASIC MATERIALS	2 933,66	-0,98%	-3,91%	-2,41%	22,50%
CONSUMER GOODS	4 150,89	-0,93%	-3,80%	-7,73%	25,09%
CONSUMER SERVICES	1 274,74	0,23%	-5,06%	-15,22%	22,44%
FINANCIALS	755,71	-0,56%	-1,48%	-1,93%	29,12%
HEALTH CARE	3 312,50	-0,57%	-1,85%	-3,72%	27,58%
INDUSTRIALS	2 961,23	-0,33%	-3,56%	-18,88%	31,32%
OIL & GAS	1 456,02	-1,62%	-4,89%	30,59%	26,63%
TECHNOLOGY	1 281,44	-1,26%	-7,62%	-25,49%	38,92%
TELECOMS	503,52	-0,69%	-5,08%	-13,24%	16,24%
UTILITIES	1 886,00	-0,35%	-1,72%	-6,99%	7,75%

WORLD: Styles	Level	5D	MTD	YTD	2021
QUALITY	3 156,61	-0,22%	-4,38%	-22,21%	25,66%
MOMENTUM	3 216,56	-0,34%	-2,45%	-17,79%	14,64%
VALUE	11 055,50	0,01%	-2,46%	-6,52%	21,94%
GROWTH	6 861,99	-0,15%	-6,11%	-29,21%	21,18%
VOLATILITY	7 652,03	-0,11%	-3,32%	-15,74%	21,77%
SIZE	7 168,54	0,06%	-2,96%	-15,74%	18,02%
DIVIDEND	4 353,16	-0,11%	-2,64%	-9,62%	19,40%

FIXED INCOME	Level	5D	MTD	YTD	2021
Pan-Euro 3-5 yrs IG	192,70	-0,34%	-1,89%	-11,37%	-0,51%
Euro Aggregate	221,57	-0,96%	-3,64%	-17,18%	-2,85%
Pan-Euro HY Hedged Eur	372,52	0,04%	-0,63%	-10,72%	3,46%
Global Inflation hedged EUR	233,10	-0,45%	-2,83%	-18,94%	4,66%
US Corp High Yield	2 264,90	-0,93%	-0,62%	-11,19%	5,28%
EM USD Aggregate TR	1 260,87	-0,28%	0,85%	-15,26%	-1,65%
EM Aggregate TR Local Ccy	136,87	0,21%	2,98%	-8,44%	-1,59%
EUR Banks CoCo Tier 1	136,89	-0,05%	1,15%	-12,63%	4,65%
EU GOVT HEDGED EUR	199,81	-1,05%	-4,46%	-20,38%	-4,21%
Global Aggregate	2 554,99	-0,34%	0,54%	-16,25%	-4,71%

COMMODITIES	Level	5D	MTD	YTD	2021
GOLD	1 824,02	1,44%	3,14%	-0,28%	-3,64%
COPPER	381,05	0,20%	2,17%	-14,63%	26,84%
OIL WTI	80,26	0,88%	-0,36%	6,71%	55,01%
OIL BRENT	85,91	2,37%	0,56%	10,45%	50,15%

CURRENCIES	Rate	5D	MTD	YTD	2021
EURUSD	1,0705	0,83%	2,87%	-5,85%	-6,93%
GBPUSD	1,2083	0,25%	0,21%	-10,71%	-1,01%
USDJPY	131,12	-1,35%	-5,03%	13,94%	11,46%
USDCHF	0,9245	-0,93%	-2,24%	1,27%	3,13%
AUDUSD	0,6813	1,37%	0,37%	-6,20%	-5,60%
EURCHF	0,9841	-0,15%	3,63%	-4,36%	-11,08%
USDCNY	6,8986	0,35%	0,07%	-0,13%	5,28%
USDKRW	1 318,40	0,20%	0,07%	0,07%	4,22%
USDINR	81,43	-0,16%	1,60%	12,66%	9,15%
USDTRY	18,7100	0,27%	0,51%	40,63%	78,81%
BITCOIN	16 579	-1,38%	-3,07%	-64,22%	59,79%

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