INDOSUEZ WEALTH MANAGEMENT

Marketing Material

MONTHLY HOUSE VIEW

December 2022

The return of time value

Architects of Wealth

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THE RETURN OF TIME VALUE

Vincent MANUEL
Chief Investment Officer

Dear Reader,

During the so-called great disruption to the investment framework, that occurred after negative rates were introduced, investors found themselves at sea and with no north star to guide them. And with good reason: how can you assess the value of and return on financial assets when they can only compare them to zero or negative rate risk-free assets? Having negative rates on 10-year bonds versus a zero-rate on deposits was just as unsettling.

Suddenly leaving this framework behind means returning to a more normal financial order. One manifestation of this return to normal is the return of time value of money, which remains the basis for any bond investment or loan relationship. What is the rationale in macroeconomic theory for the existence of a return associated with a loan or an investment? The preference for the present, i.e. the capacity to consume now and not later (savings are deferred consumption, and the interest rate is in some way the cost of sacrificing immediate enjoyment).

It is therefore a very good thing that deposits and bond investments are once again bearing yield. First, because it might help lower consumption and investment and reduce inflationary pressures. Second, because it reintroduces healthier trade-offs between consumption and savings, but also between asset classes.

Even though time value's comeback remains unfinished (as seen in the inverted yield curves in this monetary adjustment and slowdown phase), it signals a more balanced relationship between savers and borrowers, and makes savings meaningful again... as long as the more persistent-than-expected inflation can be beat. It is starting to show signs of stabilising in Europe and of slowly easing in the United States. This explains the heightened focus on return for all asset classes, setting aside hopes of an increase in the indices.

If time finds new value, then investors have less need to sacrifice liquidity or portfolio quality in order to achieve returns. The other implication of this disruption is the death of TINA (the famous "there is no alternative" to equities) which was still heralded only a couple months ago. First, because the rise in rates has been adversely affecting the present value of future cash flows for a year (another sign that time value is making a comeback). Second, because the return of bond yields may bring the weight of equities to its fair value in a portfolio. Yield is in fact very close to the ratio of net income to share price for US equities. We therefore need further confirmation of attractive growth outlooks and/or a high and growing dividends (or a more significant correction in valuations) before we can justify a high weighting of equities alongside high-quality corporate bonds that are already offering returns.

In 2023, we will likely see the return of the "60/40" portfolio, whose definitive and long term demise we had been a bit too quick to announce. Bonds should therefore return to portfolios in early 2023, before improved earnings and the likely easing of monetary policies provide a long term boost to the equity market in the second half of 2023. Furthermore, as markets will not wait for confirmation from the US Federal Reserve (Fed) to make their judgement, any signs of a fall in inflation should translate into a rebound in equity markets. Only time will tell whether the rise in markets that followed October's inflation was justified but, in our view, it is still too soon to bet on a Fed pivot at the end of the year.

Wishing you an enjoyable read.

INFLATION IS NOT OVER

Bénédicte KUKLA
Senior Investment Officer

Evidence is accumulating that US inflation has peaked and is now receding, while Euro Area prices continue to rise unabated as the pass-through of the energy crisis continues. Nevertheless, prices have proved stickier than expected in the US and run the risk of derailing inflation expectations. Inflation will be harder to bring down than markets anticipate.

ENERGY PRICES take time to fully seep into EURO AREA INFLATION

The US consumer price inflation came in weaker-than-expected in October: 7.7% year-on-year (YoY) compared to 8.2% in September and 8% anticipated by markets. In detail, inflation grew 0.4% month-on-month (MoM) compared to September 2022, with core inflation growing even slower at 0.3% MoM thanks to continued unwinding in used car prices (-2.4% MoM).

In the Euro Area, inflation is still on the rise, breaking record highs to 10.7% YoY in October (higher than market forecast 10.2%). Compared to the previous month, prices are up 1.5% in the monetary zone. All inflation components rose higher, with energy still having the strongest impact followed by food (Chart 1). Core prices (prices of goods and services excluding food and energy) only account for 30% of inflation in the Euro Area, while it accounts for over 60% in the US.

ENERGY STILL AT THE HEART OF EURO AREA INFLATION

Gas prices will remain volatile and event driven in Europe. The Dutch Title Transfer Facility (TTF), Europe's leading trading hub, closed below to pre-Ukraine war levels end of October, but returned to mid-year highs as tensions returned mid-November.

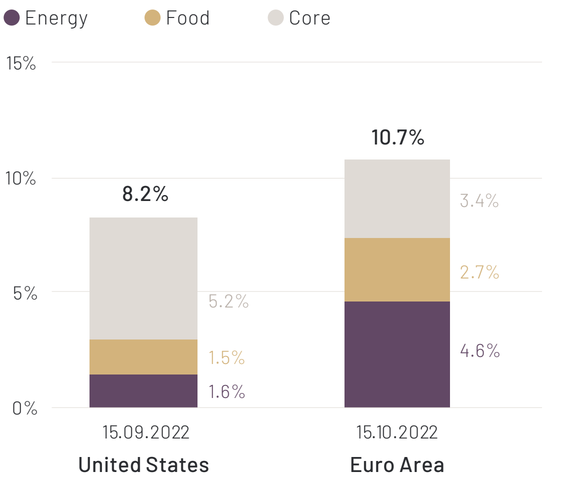
They are the main source of divergence between US and Euro Area inflation drivers, even if the GDP growth gap is also an important factor with the US expected to avoid recession in 2023 (Table 1, page 6).

Oil prices have also proved sticky as OPEC continues to cut supply. Oil prices are expected to remain above 90 dollars per barrel, despite the contraction in global demand. Under this assumption, strong annual oil price base effects will weigh on prices on both sides of the Atlantic in Q2 and Q3 2023.

SUPPLY-SIDE PRICE PRESSURES TO REMAIN IN EUROPE

The producer price index (PPI) can serve as a leading indicator for the goods component of CPI. In the US, the gap between the PII and the goods component has been narrowing fast. In the Euro Area producer prices moderated for the first time in September to 42% YoY, but the gap with the goods CPI component remains excessively wide and increasing (32 percentage points in June to 36 in September). Supply-side factors will remain a consumer price pressure in 2023 Euro Area energy prices, even in the context of a Ukraine ceasefire.

CHART 1: WHICH COMPONENTS HAVE CONTRIBUTED THE MOST TO INFLATION[1], %



Source: BEA, Eurostat, Indosuez Wealth Management.

1 - Total inflation YoY, components in percentage points contributions to inflation.

UNITED STATES
shelter prices to
FUEL
INFLATION
until
Q2 2023

FOOD PRICES TO IMPROVE AFTER YEAR END

Consumer food prices are over 10% YoY in both the US and Europe. Certain global food price pressures will moderate in 2023, such as lower energy prices, the impact of the Ukraine war on supplies of fertilizer, wheat and other crops and price spikes that stem from pandemic supply-chain disruptions. However, costs "after the farm" are less likely to fall, as confirmed by Coca-Cola and General Mills who both expect price increases to continue through the end of the year. Furthermore, in the context of climate change, bad weather has led to poor harvests a factor that will continue to bring volatility on this component.

CORE PRICES THE 2023 GAME CHANGER

Core inflation may surpass headline inflation in 2023 in the US. We expect to see prices recede on goods that were particularly in demand during the pandemic. The normalisation in US used car prices is only just beginning to normalise (remaining 42% higher than pre-pandemic). The main expenditure item to US inflation remains shelter prices (33% of the fixed basket of consumer goods and services on which inflation is based) that are impacted by the rise in rent prices and the lagged impact of housing prices on the shelter consumer prices component.

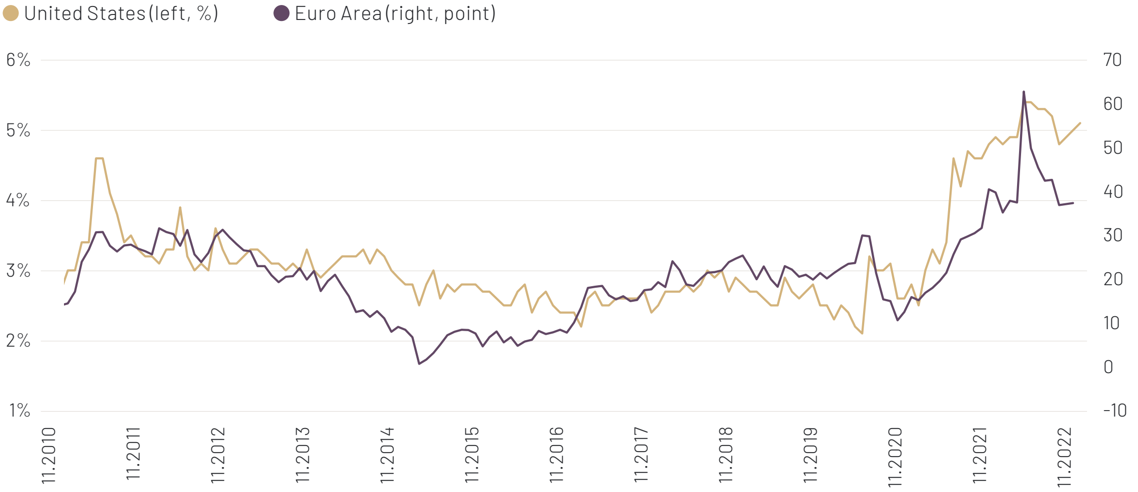
All in all, core inflation will continue to rise on a YoY basis in the US until the shelter component starts to moderate in Q2 2023. In the Euro Area, the energy crisis will continue to pass through to core prices into 2023.

EXPECTING HIGHER INFLATION CAN MAKE IT REALITY

Resilience in Euro Area demand in Q3 was not helpful in abating pass-through, but should moderate going forward. In this respect, the divergence in fiscal support will be a key determinant to inflation in 2023 increasing the inflation differential among Euro Area members.

Finally, the risk of wage increases and second-round effects may increase inflation persistence. The US labour market is beginning to soft, but wage increases continue to be broad based. Furthermore, consumer 12 month inflation expectations continue to rise in the US, contrary to the Euro Area, and is key element to watch, notably to see if the wage price spiral will continue (Chart 2). All in all, in 2013 inflation should moderate, but remain considerably above central bank targets in the US (4.1%) and even more so in the Euro Area (7.5%).

CHART 2: CONSUMER INFLATION EXPECTATIONS IN THE NEXT 12 MONTHS



Source: University of Michigan, European Commission ESI Surveys, Indosuez Wealth Management.

WEAKENING MACRO MOMENTUM

Bénédicte KUKLA
Senior Investment Officer

Global economic growth is expected to slow in 2023, as the Chinese recovery disappoints and is unable to compensate the drag on growth in the US and recession in the Euro Area. Our main worry for 2023 is whether the robustness of consumer spending will endure in the context of high inflation and tightening financing conditions.

UNITED STATES: BUFFERS WILL FADE

After two quarters of contraction, the US economy steered away from recession in the third quarter with a quarterly annualised growth rate of 2.6%. Growth was driven by: exceptional foreign trade, resilient consumer spending and an unexpected rise in government spending. The two factors weighing on GDP were the plunge in residential investment (-26.4% in Q3) and inventories. Looking ahead our main worry for 2023 is the robustness of consumer spending in the context of high inflation and a potential hard landing in the real estate market. On the production side, manufacturing stalled in October, but represents only small share (11% of GDP) of the economy compared to consumption (approximately 80%).

The Conference Board's measure of consumer confidence fell to 102.5 in October (market consensus: 106.5) in line with the recent weakening in jobs data (initial US jobless claims rose to 226 thousand from 218 thousand, above the consensus). Although beginning to abate, inflationary pressures (see Focus, page 4) will continue to pose strong headwinds to consumer spending, which could result in a challenging holiday season for retailers. The personal savings rate in the US has dropped from 8.7% in December 2021 to 3.1% in September. In Q3, consumer credit increased at a seasonally adjusted annual rate of 6.8%, down from 8.7% in Q2. This current level of consumer debt growth shows that the Fed's rate hikes have not yet significantly slowed down consumer borrowing.

A CHALLENGING HOLIDAY SEASON ahead for US retailers

In 2023, the US economy is projected to grow by 0.8% after a revised up 1.9% in 2022, as these buffers are gradually removed from consumers and the housing market and manufacturing contract.

EURO AREA: RECESSION AHEAD

Like in the US, Q3 GDP surprised to the upside in the Euro Area, notably in Italy where recent elections only had a moderate impact on consumption. In its autumn forecasts, the European Commission now expects most member states to be in recession in the last quarter of the year under the pressure of mounting energy bills, a weaker external environment and tighter financing conditions (Table 1). The unemployment rate remains at a record-low of 6.6% in September (down from 7.3% a year earlier). Strong nominal GDP growth (boasted by inflation) and the phasing out of pandemic-related support will lead to a reduction in the Euro Area government deficits in 2022, despite new measures adopted to shield consumers from the energy crisis. In 2023, the deficit is expected to increase again as GDP weakens, interest expenditure increases, and governments extend measures to mitigate the impact of high energy prices. Currently fiscal measures to shield consumers from the energy crisis range from 7.4% of GDP in Germany to 0.5% in Ireland.

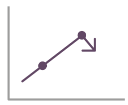
TABLE 1: ECONOMIC FORECAST UPDATES FOR 2022 AND 2023, %

	GDP GROWTH		INFLATION	
	2022	2023	2022	2023
World	3.4%	2.2%	8.3%	6.2%
United States	1.9%	0.8%	8.1%	4.1%
Euro Area	3.2%	-0.7%	8.7%	7.5%
China	3.2%	4.5%	2.1%	2.2%
Japan	1.6%	0.5%	2.3%	1.3%

Source: Amundi (November Forecasts), Indosuez Wealth Management.

CHINA: HIGH UNCERTAINTY CLOUDS IMPROVED SENTIMENT

October activity data pointed to weakness in Chinese growth. Retail sales unexpectedly dropped 0.7% MoM reflecting still very low domestic demand, and industrial production slowed to 0.3% MoM compared to 0.8% in September. While the recent relaxation in the COVID-19 strategy points to more easing ahead, a meaningful shift away from zero-COVID will likely only take place after Q1 2023. Real estate will also continue to weigh on growth, with the house price index falling 1.6% YoY in October (the sharpest since August 2015). As such, China's domestic economy will remain under pressure towards year-end. Meanwhile, exports also unexpectedly fell 0.3% YoY in October, the first drop since May 2020 with a contraction in exports to the US (-13%) and Europe (-9%).



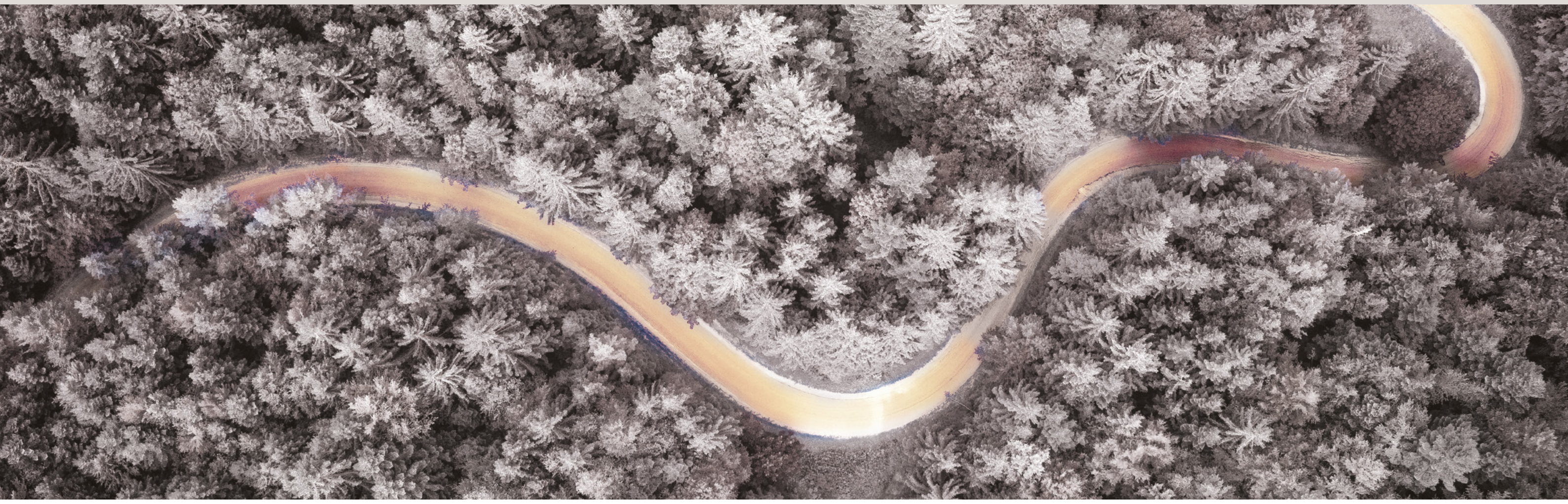
FIRST DROP IN CHINESE EXPORTS since May 2020

Risks remain surrounding China's recovery macro policy in a deleveraging context and liquidity trap risk. Chinese growth could therefore disappoint compared to current expectation of 4.5% GDP growth in 2023, keeping in mind the high sensitivity to any potential relaxation of zero-COVID policy. ASEAN[2] economies have benefitted from investor flows away from China as an appealing alternative, which should not fully reverse. Indeed, when China reopens, the reversal in investor flows may not be a zero sum game, given: investor diversification needs as geopolitical risks have risen in China and ASEAN countries are well positioned to benefit from the reopening, either through tourism (Thailand, Vietnam and Malaysia) and/or commodity demand (Malaysia, Indonesian). Japan should also benefit from its neighbour's reopening, but imported inflation linked to the currency slump is weighing on the economic recovery (GDP contracted by 0.3% in Q3).

2 - Association of Southeast Asian Nations.

04 • Fixed Income

INVERTED CURVES AND THE RETURN OF CARRY: WHERE TO INVEST?



Thomas GIQUEL
Head of Fixed Income

With the contribution
of the Fixed Income Team

As we enter the last weeks of the year, fixed income investors will remember 2022 as the worst year of performance in their lifetime in most market segments. The performance buffer for 2023 looks appealing, but strong volatility is set to remain.

Spreads:
THE ECB'S CREDIBILITY
remains intact

Central bankers are still on their course to over-tighten. For our readers fond of modern history, the 1970s inflation scheme is not repeating itself entirely. The Nixon administration had initially pledged for wage and price control in 1971, before freeing the nemesis after his reelection. In the early 1980s, previous Fed Chairman Paul Volcker's policy drove: real rates into strong positive territory, the economy into recession and inflation down. Can history repeat itself? The fact that the US debt-to-GDP ratio is today flying above 100% makes a huge difference (see Monthly House View, November edition).

So far markets, specifically Fed fund futures, applauded a softer than expected preliminary inflation figure released in early November. At the time of writing, the US money market is expecting rate cuts as early as next autumn. This looks optimistic to us, or signals a recession not priced elsewhere, excepted on the shape of the US curve: the 2-10 year curve has inverted to an extent not seen in 40 years.

In Europe, hawks have the lead and are pushing for quantitative tightening in addition to raising rates to restrictive territory. The TLTROs[3] (cheap money provided by the European Central Bank (ECB) to the banking system) will no longer prove accommodative starting 23 November.

Banks will most likely withdraw part of their EUR 2.2 billion investment held at the ECB, leading to a drop in money circulating in the Euro Area. Thus far, the ECB's credibility has not been challenged by investors judging from intra-zone spreads: the difference in Italian to German financing costs has remained stable, resisting political turmoil, 2023 budget presentations and 2022 economic noise.

WHAT ABOUT YIELDS AND CURVES?

Yield curves are very flat, as investors balance strong inflation in the short term with low growth or recession around the corner. Hence, there is value to investing in the short parts of the curve for carry investors, and the possibility to deploy flattening strategies in the Euro Area through fund derivatives.

As central banks quickly dry up the excess liquidity provided to markets and economies in 2020, some bubbles have already started to deflate. In the fixed income area, carry is back, as yields recover to levels not seen in more than 10 years.

3 - Targeted longer-term refinancing operations.

UNITED STATES
investment grade
yield briefly tops
6%

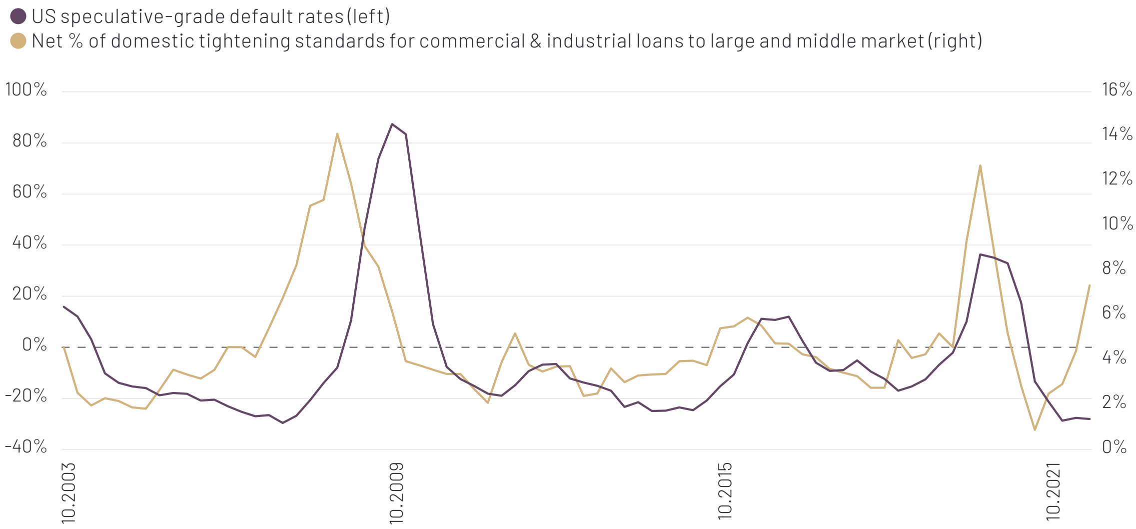
In the investment grade market, the US yield briefly topped 6% while recently Europe almost attained the 4.5% mark. Repricing has been painful for investors already in the market, but a lot of bad news has already been priced-in. Rating downgrades are probable, even though companies are holding cash buffers and EBITDA remain strong so far. Investors have done their homework, too. When yields were low, they had to shift down the risk curve: accepting more duration risk and/or credit risk to maintain a level of yield compatible with their expectations. This year, the high yield and investment grade markets suffered enormous outflows, signaling a reflux from investors (mostly institutional) back to their core investment risk type. We would call this the end of the tourist era: each investor remains within their investment rational, with no run for yield. By extension, this means that markets are pricing risk at the correct level, taking into account credit and duration risks.

THE INVESTOR DILEMMA: WHERE TO INVEST?

From this point-of-view, we consider there is more value on the investment grade market, in relative terms vs. high yield (HY). Regarding subordinated debt, either issued by corporates or banks, the market was extremely nervous about non-calls at the first call date. However, this created an opportunity for issuers to actively manage their balance sheet: issuing longer dated bonds, in exchange for buying back short-dated bonds below par. The new bonds encompassed higher coupons, but the tender price, below par, is an immediate profit for the company in its income statement. It's a win-win for investors and issuers.

However, this relevant for the most liquid markets. The illiquid buckets, such as CLOs, convey their own specific troubles. LBO deals (such as the USD 13 billion bank funding of the Twitter takeover) difficultly find investors to step in, forcing banks to retain loans on their balance sheets. The developments in this part of the finance industry will be key to weather risks in 2023 (Chart 3).

CHART 3: SENIOR LOAN OFFICER OPINION SURVEY ON BANK LENDING PRACTICES AND HISTORICAL HIGH YIELD DEFAULT RATES, %



Source: FRED, Bloomberg, S&P, Indosuez Wealth Management.

BACK TO COMPLACENCY?

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Since mid-October, all markets rebounded sharply, as the European market was up by 10.7% (MSCI Europe) during the period. This can be explained, firstly, by a better than expected earnings season in Europe and by the switch in investor sentiment from bearish to complacency given the VIX collapse. Even if some concerns seem to soften (US midterms and peak in inflation), some equity indices are now in the overbought zone and so could take a break.

Domestic-based share
INVESTMENT THEME

UNITED STATES

While previous reporting seasons have largely focused on inflation and supply-chain issues, this latest season was more affected by the negative effects of the rising dollar for many US companies. In this context, mega caps suffered the most, as they have a larger exposure to the international market (on average 43%) while small and mid-caps only generating 20% of their revenues outside the US. Thus, at this stage, the domestic-based theme is favoured, of course, due to the forex effects, but also because they benefit, among other things, from fiscal stimulus plans, particularly via the energy transition theme.

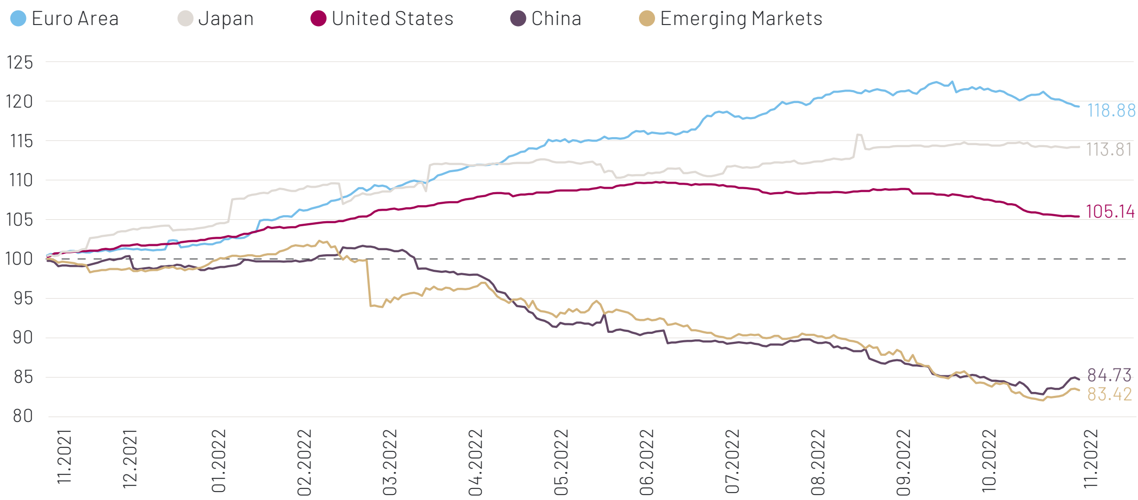
Beyond the earnings season, investors have been reassured by US inflation data that confirms a deceleration of the latter and hints at a less restrictive monetary policy. The midterm election did not bring about a "red wave": democrats retained control of Senate and we are still waiting on House results. However, historically post-midterms election, market seasonality is often positive until the end of the year.

Nevertheless, the sudden rebound of the market seems almost exaggerated, euphoria has abruptly returned, probably too quickly, and this prompts us to be cautious for the coming months.

EUROPE

The outlook remains challenging in Europe, despite the strong rally observed on European equity markets since mid-October. The macroeconomic background is still difficult, with no signs of improvement on the Russia/Ukraine conflict and the ECB trying to fight inflation, while the economy slows. Nevertheless, the Q3 earnings season has been quite good for European companies so far, with 25% YoY EPS growth. Downward revisions for 2023 are just beginning (Chart 4) and even though the valuation of European companies appears quite attractive vs. the historical median, the likeliness of further downward revisions to come could weigh on sentiment after the strong mid-October rally.

CHART 4: EPS MOMENTUM: THE BEGINNING OF THE FALL DOWN, 100 = NOVEMBER 2021



Note: Earnings per share 12 months forward are starting to go down on major developed markets.
Source: Bloomberg, Indosuez Wealth Management.

Therefore, we stay cautious on European equities and favour quality/defensive names and the return to shareholders theme over value/cyclical names, waiting for tangible signs of an inflection of the Federal Reserve's monetary policy stance to increase our exposure on growth names.

Tangible signs of ECONOMIC SLOWDOWN to confirm DEFENSIVE PLAYS

EMERGING MARKETS

Markets are still concerned with Chinese political issues given the negative reaction from global investors as to the conclusion of the recent CCP Congress. Despite some relaxation in COVID-19 measures to start adapting the local Dynamic Zero-COVID (DZC) policy, this will be a long and gradual road to reach full re-opening. As such, high volatility should probably remain through the end of the year. In addition, earnings revisions are still weak and we remain cautious about potential geopolitical risks such as Taiwan. Therefore, we have a cautious tactical, but near term stance, which does not change our medium term positive view on Chinese equities based on the current depressed valuation levels and capitulation signs that were apparent in late October 2022.

INVESTMENT STYLE

The softer-than-expected US inflation data and the easing of COVID-19 restrictions in China have triggered a market rotation into Cyclical and Growth stocks to the detriment of the relative performance of Quality and Defensive. This rotation is not confirmed by earnings revisions, as the best performing stocks in the recent movement have generally been those most negatively impacted on the earnings side. The more tangible signs of economic slowdown in the coming months should once again favour the performance of more defensive players. However, if the Fed policy pivot occurs earlier than anticipated, and given the valuation of growth stocks at very low levels (notably for non-profitable tech), we could see a rally on this style. However, we think it is still too early to take that stance.

06 • Forex

THE USD MAY HAVE PEAKED

Davis HALL
Head of Capital Markets, Asia

Hugo DE VASCONCELOS
Active Advisor

USD may finally be peaking although it won't necessarily fall yet as the Fed will retain a hawkish bias for some time to come. There are a myriad of opportunities in Forex as the world adjusts to changing geopolitical and monetary narratives which for now favour safe havens and currencies of countries that can feed and power themselves (as well as others).

Dollar gave back a whopping
6%
in a mere
48 HOURS

USD

Peaking greenback promptly loses momentum

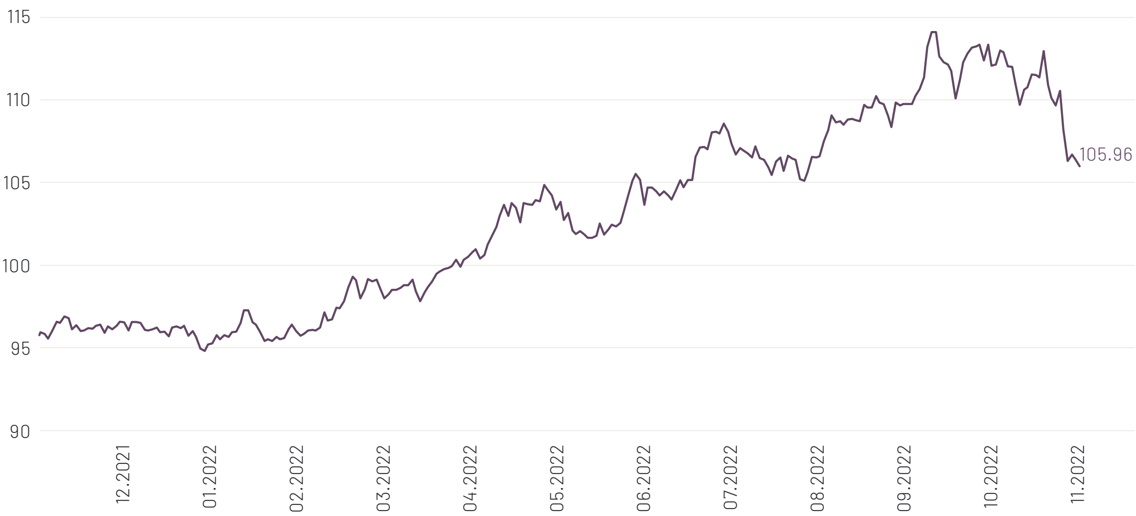
The greenback finally succumbed to a reality check of sorts following a below consensus CPI release for October (Chart 5). Although it is clearly too early to proclaim that the FOMC has slayed the runaway inflation dragon – a more moderated US rate hiking path could now be forthcoming. This softer data combined with a now likely gridlocked US Congress ensures less stimulus legislation ahead just as the US economy softens further. This combination was all it took, as the dollar gave back a whopping 6% in a mere 48 hours to its early July levels. The dollar's correlation with correcting US Treasury bond yields is now as tight as ever. As such, further profit taking of still extensive long positioning on any dollar recovery should lead to a new, lower range into year-end as the Fed ponders the growing risk of overtightening monetary policy.

CNY

Pragmatism hope abounds

What a difference a week can make. Not only the dollar's interest rate hiking overshoot phase appears upon us – but the Chinese authorities further aided risk sentiment by announcing the well rumoured 20 point plan to gradually ease mainland COVID-19 containment rules as well as issuing fresh property sector rescue policies. This was welcomed by immediate yuan currency re-strengthening coupled by very impressive equity index rebounds – notably the Hang-Seng index now up 23% from its end October trough.

CHART 5: USD INDEX – HAS THE USD PEAKED?



Source: Bloomberg, Indosuez Wealth Management.

JPY

Correction time from extreme levels

The Ministry of Finance has so far been successful in its unilateral Forex intervention bouts to smooth out the acute intraday volatility and persistent yen weakness. They have been given some needed respite by the lower than expected US inflation reading – which at least temporarily has brought the tightly linked US yield differentials down slightly. However, one single CPI reading hardly represents a confirmed lower trend. As such, it is premature to conclude that US interest rate hikes will peak soon whilst Japan stubbornly maintains its ever low yield curve control well into April 2023. Ongoing wild daily swings in USD/JPY are thus likely to persist until the Fed pivots – for which we would not hold our breath.

AUD

Recovering despite rate increase disappointment

AAA AUD
establishing a solid base for further recovery

Slowly, but surely, the AAA Australian dollar (AUD) is establishing a solid base for further recovery as a liquid, higher yielding proxy to hopeful China reopening ahead. However, the Royal Bank of Australia has turned somewhat more cautious on rate hikes despite heightened domestic inflation which they must address against the risk of a highly levered and vulnerable property sector. Given the recent events in China and Washington, our favoured AUD is now ideally on it's way to benefit on any bouts of weakness from renewed currency diversification inflows into 2023.

SGD

Still the most resilient in Asia

The Monetary Authorities of Singapore (MAS) continue to fight the ongoing challenge of imported inflation via a steepened slope of SGD basket appreciation.

The currency is specifically used as a tool to anchor price pressures and as such has seen the triple-A Singapore dollar outperform all other Asian peers year-to-date.

This serves to stabilise the economy and attracts even deeper foreign direct investments further buttressing the currency and domestic GDP. We maintain our highly constructive view on this now higher yielding currency allocation as the supportive MAS policies are set to remain into 2023.

BRL

New president, carry on

Brazilians re-elected President Lula is to lead the country with a moderately positive reaction from Brazilian financial markets - the BRL appreciated to near 5,00 real to the USD. A very centrist congress and senate are likely to help restrain spending, thus the BRL is an attractive allocation thanks to its high carry and relatively insulated economy (versus the multiple crises affecting the rest of the world). In the short term President Lula is likely to make policy announcements that could provoke volatility, offering entry opportunities to interested investors.

GOLD

Temporarily lost lustre shines once again

The yellow metal (XAU) has suddenly benefitted handsomely off its triple USD 1'615/ounce low trough from the confluence of events and correcting US real yields. Coupled by the underlying backdrop of record central bank buying of the bullion since 1967 for reserve diversification purposes, gold recovered 10% in a mere seven trading sessions. Technically speaking, provided XAU can now hold above the USD 1'700 support zone, further upside attempts near key August resistance at USD 1'808 /ounce may lie ahead.

Numerous hotspots and geo-political tensions are still highly acute despite the Bali G20 reunion providing further support for the ultimate safe haven shock absorber on any dips. In addition, and not to be forgotten, the most seasonally supportive three month period for gold consumption (notably in India) now lies ahead whilst speculators are positioned net short or underweight gold.

Nevertheless, beyond seasonality issues and technical factors, gold could remain vulnerable in the short term without a Fed pivot before year-end 2022 and in a context marked by the return of yield on certain asset classes, notably investment grade corporate bonds.

07 • Asset Allocation

INVESTMENT SCENARIO AND ALLOCATION CONVICTIONS

Vincent MANUEL
Chief Investment Officer

INVESTMENT SCENARIO

- **Growth:** recession remains the key risk in 2023 in Europe (highly probable recession in H1); quasi stagnation in the US (GDP growth below 1%). Chinese growth could disappoint vs. current expectations of approximately 4% GDP growth in 2023, keeping in mind the high sensitivity to any relaxation of zero-COVID policy.
- **Inflation:** world inflation should remain around 5% in 2023 (4% in the US and 6% in the Euro Area). In the US, core inflation should remain elevated until the shelter component starts to revert, which should likely happen by late Q1/early Q2 2023. In the Euro Area, services inflation continue to build up while headline inflation remains supply driven due to the ongoing energy crisis.
- **Fiscal policy:** supportive in Europe, more neutral in the US with a divided government (Democrat President and Senate, but Republican House) but increasing scrutiny regarding debt sustainability if interest rates remain at elevated levels whilst nominal GDP growth fades.
- **Central banks**: focused on inflation and not very sensitive verbally to recession risk, especially in the US. Markets are playing an early Fed pivot that we still see this as unlikely (we rather see slower and smaller rate hikes and no pivot before H2 event if the Fed is getting nearer the terminal rate.
- **Earnings:** as expected, the Q3 2022 earnings season led to negative revisions for Q4 2022 earnings-per-share (EPS) and we keep a cautious view on earnings in 2023, where we could see a contraction in profitability notably in Europe.
- **Volatility:** the volatility regime has reset itself to a higher range in 2022, and recently compressed towards the low 20s range after exceeding 30 in October, suggesting a more complacent market, vulnerable to technical corrections.

EUROPEAN EXPORTERS
benefit from strong USD

ALLOCATION CONVICTIONS

EQUITIES

- In a stagnation scenario with central banks raising rates and a high risk of negative revisions on 2023 earnings, the fundamentals are not pushing for an overweight of equities, but valuations started to be more attractive notably in Europe and China.
- We view 2023 as a year in two parts, where the focus on quality and carry on dividend should prevail in the first months, with renewed volatility, until a signal of a Fed pivot could lead to a renewed bull trend in the second half.
- We keep a preference for US equities and global thematic equities, as we continue to see more resilience in the American economy and corporates.
- We have continuously increased the exposure on dividend strategies in the past months and keep our focus on quality at the expense of the most cyclical sectors and notably industrials. We remain long term investors in energy transition and climate solutions.
- Despite remaining relatively cautious on Europe, we highlighted recently that European equities had reached a record level of discount vs. US Equities and that European exporters should benefit from a strong USD. These companies performed well in the past month, driven by a mix of positive earnings, a strong dollar and a more encouraging political and geopolitical backdrop. Tactically, this rebound is vulnerable, but we highlight the attractive equity risk premiums in Europe.
- We had highlighted last month the discounted valuation metrics of Chinese equities reflecting a limited visibility; after a very negative market reaction to the Chinese NPC we are starting to see signs of relaxation of zero-COVID policy and more supportive measures on the real estate sector. We therefore believe that investors should keep their existing exposure in the short term.

FIXED INCOME

- 2023 should be a year of strong performance on bonds, and we already witnessed this trend emerging, with rising flows, curve flattening and spread compression in October.
- We keep the view adopted in the past two months on government bonds unchanged, with a barbell between very short maturities (which integrate well the upcoming rate hikes) and the ultra-long part of the curve (which could act as a macro hedge as recession looms). The exposure to duration was rewarding, beyond expectations in the past month, as markets have reacted vigorously to weaker than expected inflation data in the US and to an expected (probably too much) near term Fed pivot.
- We continue to favour investment grade over high yield bonds that have relatively unattractive spreads compared to investment grade bonds. We however keep a relatively constructive view on financial debt as we see financial balance sheets as relatively solid.
- We remain relatively cautious on emerging market debt in hard currencies and acknowledge that local currencies bonds represented an interesting diversification in 2023 for EUR investors.

2023 :
FOREX
DIVERSIFICATION

FOREX MARKETS

- We view 2023 as a year of forex diversification as dollar strength should fade.
- We wrote recently that the US dollar was rich, but that fundamentals were limited for the rebound potential of euro and other currencies. Weaker than expected (but still elevated) US inflation led to profit taking on the greenback. We expect a weaker dollar in the medium term, but we do not anticipate the current weakening trend to go far in the short run, unless: i.) the Fed confirms a pivot ii.) geopolitics start to clear out and/or iii.) Washington politics weaken the USD.
- Gold was also a strong beneficiary of the weakening of the dollar, but could be vulnerable in the short term in a world where investors continue to focus on yield generating assets.
- Meanwhile we continue to see commodity currencies as good diversifiers for USD investors, and CHF as the best hedge outside the dollar, notably for EUR investors.

KEY CONVICTIONS

	TACTICAL VIEW (ST)	STRATEGIC VIEW (LT)
FIXED INCOME		
GOVERNMENTS		
Core EUR 10-Year (Bund)	=/-	=
EUR Periphery	-	=/-
US 2-Year	=/+	=/+
US 10-Year	=/-	=
US 30-Year	=/+	=/+
EUR Breakevens Inflation	=	=
US Breakevens Inflation	=	=
CREDIT		
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	+	=/+
Yield	+	=/+
Cyclical	-	=
Defensive	+	=/-
FOREX		
United States (USD)	=	=/-
Euro Area (EUR)	=/-	=
United Kingdom (GBP)	=/-	=
Switzerland (CHF)	=/+	=
Japan (JPY)	=	=/-
Brazil (BRL)	=	=
China (CNY)	=	=
Gold (XAU)	=/-	=
Commodity currencies (NOK, NZD, CAD)	=/+	=/+

Source: Indosuez Wealth Management.

OVERVIEW OF SELECTED MARKETS

DATA AS OF 17 NOVEMBER 2022

GOVERNMENT BONDS	YIELD	4 WEEKS CHANGE (BPS)	YTD CHANGE (BPS)
US Treasury 10-year	3.77%	-46.26	225.56
France 10-year	2.49%	-46.50	229.60
Germany 10-year	2.02%	-38.40	219.70
Spain 10-year	3.03%	-49.50	246.80
Switzerland 10-year	1.06%	-28.20	119.40
Japan 10-year	0.24%	-0.90	17.60

BONDS	LAST	4 WEEKS CHANGE	YTD CHANGE
Government Bonds Emerging Markets	33.62	4.93%	-14.28%
Euro Government Bonds	197.15	1.82%	-9.79%
Corporate EUR high yield	192.10	4.02%	-10.08%
Corporate USD high yield	295.62	3.03%	-11.07%
US Government Bonds	294.36	1.97%	-8.09%
Corporate Emerging Markets	41.79	4.08%	-18.06%

CURRENCIES	LAST SPOT	4 WEEKS CHANGE	YTD CHANGE
EUR/CHF	0.9868	0.50%	-4.89%
GBP/USD	1.1864	5.60%	-12.33%
USD/CHF	0.9517	-5.18%	4.25%
EUR/USD	1.0362	5.89%	-8.87%
USD/JPY	140.20	-6.63%	21.83%

VOLATILITY INDEX	LAST	4 WEEKS CHANGE (POINTS)	YTD CHANGE (POINTS)
VIX	23.93	-6.05	6.71

EQUITY INDICES	LAST PRICE	4 WEEKS CHANGE	YTD CHANGE
S&P 500 (United States)	3'946.56	7.66%	-17.20%
FTSE 100 (United Kingdom)	7'346.54	5.80%	-0.51%
STOXX 600	428.38	7.43%	-12.18%
Topix	1'966.28	3.74%	-1.31%
MSCI World	2'642.34	8.77%	-18.24%
Shanghai SE Composite	3'818.66	1.70%	-22.70%
MSCI Emerging Markets	942.36	8.97%	-23.51%
MSCI Latam (Latin America)	2'154.41	-3.36%	1.15%
MSCI EMEA (Europe. Middle East. Africa)	194.81	2.74%	-29.34%
MSCI Asia Ex Japan	603.04	11.77%	-23.60%
CAC 40 (France)	6'576.12	8.04%	-8.07%
DAX (Germany)	14'266.38	11.74%	-10.19%
MIB (Italy)	24'339.67	12.16%	-11.00%
IBEX (Spain)	8'040.70	5.18%	-7.72%
SMI (Switzerland)	10'917.88	4.24%	-15.21%

COMMODITIES	LAST PRICE	4 WEEKS CHANGE	YTD CHANGE
Steel Rebar (CNY/Tonne)	3'734.00	1.03%	-17.90%
Gold (USD/Oz)	1'760.44	8.13%	-3.76%
Crude Oil WTI (USD/Bbl)	81.64	-5.05%	8.55%
Silver (USD/Oz)	20.98	12.23%	-10.18%
Copper (USD/Tonne)	8'110.00	7.27%	-16.57%
Natural Gas (USD/MMBtu)	6.37	18.87%	70.75%

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 (+)

AUGUST 2022	SEPTEMBER 2022	OCTOBER 2022	4 WEEKS CHANGE	YTD (17.11.2022)
1.18%	-3.37%	9.59%	11.77%	1.15%
0.03%	-5.36%	7.99%	8.97%	-0.51%
-0.04%	-6.48%	7.11%	8.77%	-1.31%
-0.22%	-6.57%	6.28%	7.66%	-12.18%
-1.04%	-6.72%	5.09%	7.43%	-17.20%
-1.88%	-8.19%	4.17%	5.80%	-18.24%
-2.19%	-9.34%	2.91%	3.74%	-22.70%
-4.24%	-9.46%	-3.15%	2.74%	-23.51%
-4.33%	-11.90%	-6.13%	1.70%	-23.60%
-5.29%	-12.94%	-7.78%	-3.36%	-29.34%

(−) WORST PERFORMING

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

09 • Glossary

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.

TPI : An addition to the Eurosystem's toolkit that can be activated by the ECB to counter unwarranted, disorderly market developments if these pose a serious threat to the smooth transmission of monetary policy across the euro area. The ECB Governing Council approved the instrument on the 21 July 2022.

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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