Market Insights

Q4/2022

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Syz PRIVATE BANKING

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INTRODUCTION

Entering the last quarter of a historic year

The first nine months of 2022 will be remembered as one of the most challenging periods ever for asset allocators. For the first time in history, both equity and fixed income are down more than 10% as at the end of September.

Going forward, the main focus remains on inflation and how central banks are handling the situation, as the end of the bear market looks very much dependent on the timing of the "Fed pivot".

In the first part of this publication we review the 10 stories to remember from the past quarter, which was characterized by a wide set of declines across most asset classes.

We then share the investment conclusions of our latest tactical asset allocation committee. Overall, we believe that there are still downside risks for the global economy, amplified by antagonist policies. We maintain an "unattractive" stance on equities and a cautious view on both rates and spreads.

2022 seems to mark a turning point in international relations, with major implications for the global economy and financial markets. In the "East-West" focus note, we discuss the macroeconomic and financial implications of a new world order.

In the last section, we present some attractive investment themes to consider in this challenging environment.

While our forecasts and views are subject to changes, our commitment to serve our clients is not.

We remain at your full disposal for any specific issues you like to discuss, so please do not hesitate to contact us.

Being an entrepreneurial, founder-led boutique business means we're always looking for better ways to deliver great performance and service. Innovation is key to us, but we're always mindful of risks and focused on protecting as well as growing our clients' wealth.

Q3 Review
The “everything down” market

The third quarter was a very volatile quarter for financial markets with an astonishingly wide set of declines across all the major asset classes. Indeed, after a dismal first half of the year, the vast majority of asset classes recorded a negative performance during Q3, as investors grew increasingly concerned about a looming recession due to a combination of hawkish central banks, major disruptions to Europe’s energy supply and looming sovereign debt crisis in the UK and potentially in Italy.

STORY 1 —

All main asset classes ended in the red

The third quarter was a very volatile quarter for financial markets with an astonishingly wide set of declines across all the major asset classes. Indeed, after a dismal first half of the year, the vast majority of asset classes recorded a negative performance during Q3, as investors grew increasingly concerned about a looming recession due to a combination of hawkish central banks, major disruptions to Europe’s energy supply and looming sovereign debt crisis in the UK and potentially in Italy.

In spite of a strong performance in July, the major equity indices all lost ground due to a decline which accelerated towards the end of the quarter. For both the S&P 500 (-4.9%) and Europe’s STOXX 600 (-4.2%), this is the first time since the Great Financial Crisis that they’ve lost ground for 3 consecutive quarters, with their year-to-day losses standing at -23.9% and -18.0%, respectively.

Due to persistent inflation and central banks that were more hawkish than expected, sovereign bonds had another poor quarterly performance. Gilts (-14.0%) were the worst affected given the market turmoil in the UK, although both US Treasuries (-4.4%) and European sovereigns (-5.1%) still lost significant ground. Combined with the losses over Q1 and Q2, that brings the year-to-date decline for US Treasuries to -13.4%, and for European sovereigns to -16.7%.

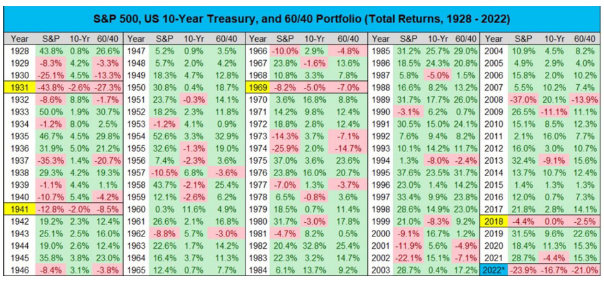
On the credit side, every single credit index we follow lost ground, across each of USD, EUR and GBP – and this for the 3rd consecutive quarter. GBP credit was by far the worst performer, with Investment Grade non-financial down -12.7% over the quarter, compared with -3.2% for EUR and -5.1% for USD.

After a strong first half of the year, there were broad-based declines across different commodity groups in Q3. Both Brent crude (-23.4%) and WTI (-24.8%) saw their worst quarterly performances since Q1 2020 (Covid lockdown). On a monthly basis, Brent Crude has now declined for four consecutive months for the first time since 2017. Both precious and industrial metals also struggled over Q3, with copper (-8.1%) and gold (-8.1%) losing ground as well.

STORY 2 —

A record drawdown for multi-asset portfolios

The “everything down market” continues to weigh on multi-assets portfolio performance. Looking at total return data going back to 1928 for the S&P 500, US 10-year and a 60/40 portfolio, there were only 5 years in which both S&P 500 and 10-Year Treasury Bond went down (1931, 1941, 1969, 2018, 2022). This year is the only year in history in which both S&P 500 and the US 10-year Treasury bond are down more than 10% each.



S&P 500, US 10-Year Treasury, and 60/40 Portfolio (Total Returns, 1928 - 2022)

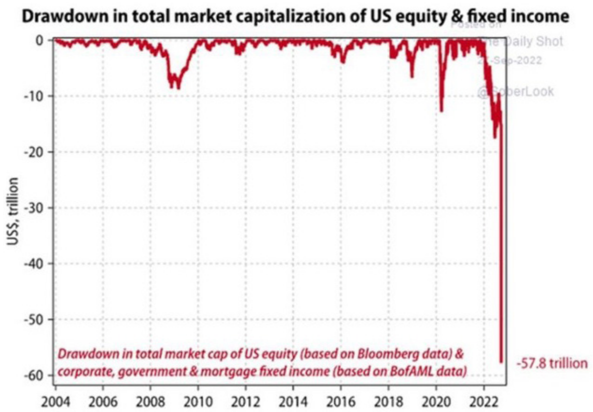
Year	S&P	10-Yr	60/40	Year	S&P	10-Yr	60/40	Year	S&P	10-Yr	60/40	Year	S&P	10-Yr	60/40	Year	S&P	10-Yr	60/40
1928	43.8%	0.8%	26.6%	1947	5.2%	0.9%	3.5%	1966	-10.0%	2.9%	-4.8%	1985	31.2%	25.7%	29.0%	2004	10.9%	4.5%	8.2%
1929	-8.3%	4.2%	-3.3%	1948	5.7%	2.0%	4.2%	1967	23.8%	-1.6%	13.6%	1986	18.5%	24.3%	20.8%	2005	4.9%	2.9%	4.0%
1930	-25.1%	4.5%	-13.3%	1949	18.3%	4.7%	12.8%	1968	10.8%	3.3%	7.8%	1987	5.8%	-5.0%	1.5%	2006	15.8%	2.0%	10.2%
1931	-43.8%	-2.6%	-27.3%	1950	30.8%	0.4%	18.7%	1969	-8.2%	-5.0%	-7.0%	1988	16.6%	8.2%	13.2%	2007	5.5%	10.2%	7.4%
1932	-8.6%	8.8%	-1.7%	1951	23.7%	-0.3%	14.1%	1970	3.6%	16.8%	8.8%	1989	31.7%	17.7%	26.0%	2008	-37.0%	20.1%	-13.9%
1933	50.0%	1.9%	30.7%	1952	18.2%	2.3%	11.8%	1971	14.2%	9.8%	12.4%	1990	-3.1%	6.2%	0.7%	2009	26.5%	-11.1%	11.1%
1934	-1.2%	8.0%	2.5%	1953	-1.2%	4.1%	0.9%	1972	18.8%	2.8%	12.4%	1991	30.5%	15.0%	24.1%	2010	15.1%	8.5%	12.3%
1935	46.7%	4.5%	29.8%	1954	52.6%	3.3%	32.9%	1973	-14.3%	3.7%	-7.1%	1992	7.6%	9.4%	8.2%	2011	2.1%	16.0%	7.7%
1936	31.9%	5.0%	21.2%	1955	32.6%	-1.3%	19.0%	1974	-25.9%	2.0%	-14.7%	1993	10.1%	14.2%	11.7%	2012	16.0%	3.0%	10.7%
1937	-35.3%	1.4%	-20.7%	1956	7.4%	-2.3%	3.6%	1975	37.0%	3.6%	23.6%	1994	1.3%	-8.0%	-2.4%	2013	32.4%	-9.1%	15.6%
1938	29.3%	4.2%	19.3%	1957	-10.5%	6.8%	-3.6%	1976	23.8%	16.0%	20.7%	1995	37.6%	23.5%	31.7%	2014	13.7%	10.7%	12.4%
1939	-1.1%	4.4%	1.1%	1958	43.7%	-2.1%	25.4%	1977	-7.0%	1.3%	-3.7%	1996	23.0%	1.4%	14.2%	2015	1.4%	1.3%	1.3%
1940	-10.7%	5.4%	-4.2%	1959	12.1%	-2.6%	6.2%	1978	6.5%	-0.8%	3.6%	1997	33.4%	9.9%	23.8%	2016	12.0%	0.7%	7.3%
1941	-12.8%	-2.0%	-8.5%	1960	0.3%	11.6%	4.9%	1979	18.5%	0.7%	11.4%	1998	28.6%	14.9%	23.0%	2017	21.8%	2.8%	14.1%
1942	19.2%	2.3%	12.4%	1961	26.6%	2.1%	16.8%	1980	31.7%	-3.0%	17.8%	1999	21.0%	-8.3%	9.2%	2018	-4.4%	0.0%	-2.5%
1943	25.1%	2.5%	16.0%	1962	-8.8%	5.7%	-3.0%	1981	-4.7%	8.2%	0.5%	2000	-9.1%	16.7%	1.2%	2019	31.5%	9.6%	22.6%
1944	19.0%	2.6%	12.4%	1963	22.6%	1.7%	14.2%	1982	20.4%	32.8%	25.4%	2001	-11.9%	5.6%	-4.9%	2020	18.4%	11.3%	15.3%
1945	35.8%	3.8%	23.0%	1964	16.4%	3.7%	11.3%	1983	22.3%	3.2%	14.7%	2002	-22.1%	15.1%	-7.1%	2021	28.7%	-4.4%	15.3%
1946	-8.4%	3.1%	-3.8%	1965	12.4%	0.7%	7.7%	1984	6.1%	13.7%	9.2%	2003	28.7%	0.4%	17.2%	2022*	-23.9%	-16.7%	-21.0%

Source: Charlie Bilello

STORY 3 —

The biggest wealth destruction ever

The combined decline of equities and bonds just hit a new record: in the US, $57.8 trillion in stocks and fixed income market value have been destroyed since the 2021 peak. The big question mark is whether the housing market will be the next shoe to drop. Indeed, while housing prices stay stubbornly high, U.S existing home sales dropped for a seventh straight month in August as affordability deteriorated further due to surging mortgage rates.

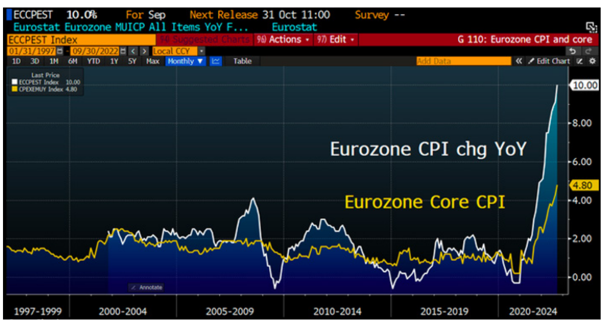


Source: Gavekal

STORY 4 —

Inflation accelerates

To the surprise of many, the US CPI rose 0.1% in August, after being unchanged in July. Prices were up 8.3% year-over-year, down from 8.5% in July, but above analysts' expectations of 8.1%.Core inflation rose 0.6% in August, and was up 6.3% year-over-year, accelerating from 5.9%. A hotter-than-expected inflation reading strengthen the Fed's case for more aggressive interest rate hikes (see next story). Eurozone inflation hit double digits for the first time ever, jumping to record 10% in September. Core CPI accelerates to fresh all-time-high as well. Inflation is broadening on a global scale basis as almost 90% of countries are currently facing headline inflation above 6% on a yoy basis.



Source: Bloomberg

STORY 5 —

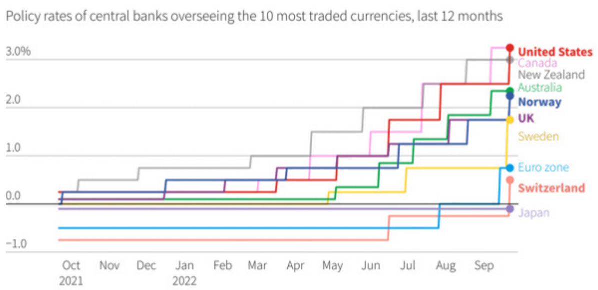
Central banks continue to tighten

The quarter was off to a strong start for risk assets with the S&P 500 being up by nearly +14% in total return terms over July and early-August as a result of a bear market rally. That was supported by a belief in the "peak inflation" narrative, suggesting that we had seen the worst of rapid price gains, and that the Fed would thus be able to pivot towards rate cuts moving into 2023. This narrative was supported by a dovish interpretation of the July FOMC meeting, during which Fed Chairman Jeremy Powell said that as "monetary policy tightens further, it likely will become appropriate to slow the pace of increases". But everything shifted by mid-August in a very hawkish speech from Powell at the Jackson Hole symposium. The Fed then followed through on this hawkish rhetoric, delivering a third consecutive 75bps rate hike at their September meeting. Furthermore, the median dot indicated that officials favored a further 125bps of hikes this year at the two remaining meetings, with the Fed Funds rate still at 4.6% by end-2023.

The story was quite similar at the ECB. At the start of Q3, the ECB was expected to start its tightening cycle in July with a 25bps hike. However, with inflation continuing to rise to new records, they finally hiked by 50bps in July, and followed up with an even stronger 75bps move in September.

For financial markets, the key story of the quarter was thus the fact that central banks became more explicit about how they would be willing to keep policy in restrictive territory, even if growth was to slow. Indeed, September FOMC's meeting showed that policymakers are willing to keep rates in restrictive territory even if that meant a noticeable rise in unemployment.

Central banks ramp up fight against inflation



Source: Refinitiv Datastream I Reuters, Sept. 22.2022

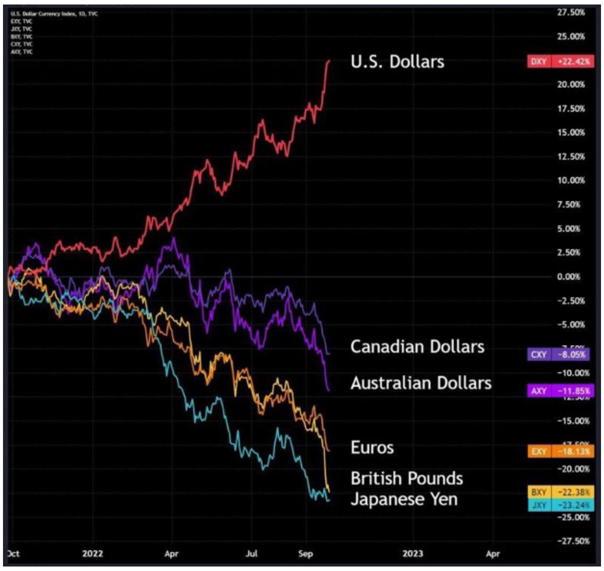
STORY 6 —

Mighty dollar

The only main asset class which was up in the third quarter was the US Dollar, which strengthened against every other G10 currency as the Fed reiterated its hawkishness. Over the quarter as a whole, the dollar index strengthened by +7.1%, marking its strongest quarterly performance since Q1 2015. It also marked the first time since the late-1990s that the dollar has strengthened for five consecutive quarters.

While the dollar index continues to appreciate, a detailed analysis shows a significant performance differential between two categories of countries: those in the G10 and emerging countries (excluding China and Russia). It can be seen that, contrary to other periods of crisis, emerging countries are far more resilient than developed countries.

This is due to the euro and the pound, which suggests that it is the European currencies that are weak, rather than the dollar that is strong.



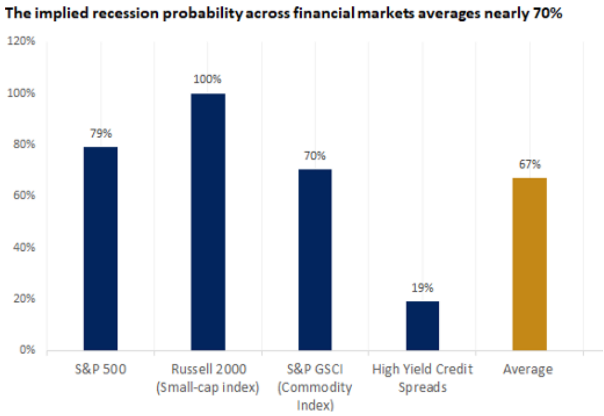
Source: The Market Ear

STORY 7 —

Slumping business activity

On the economic growth front, the data published over the third quarter, continued to point to a global growth slowdown. The J.P. Morgan Global Composite Purchasing Managers' Index (PMI) business survey entered contractionary territory in August for the first time since June 2020. Moreover, the local surveys showed that Europe, the UK and the US are all already teetering on the verge of recession.

The global outlook has indeed deteriorated markedly throughout 2022 amid high inflation, aggressive monetary tightening, and uncertainties from both the war in Ukraine and the lingering pandemic. Full-year US growth forecasts have been downgraded to only about 1.5 per cent in 2022. Financial markets are pricing in higher probabilities that a U.S. recession is on the horizon (see chart below). Growth in China is projected to slow to about 4 per cent in 2022 due to new waves of COVID-19 infections and rising geopolitical risks. European economies have so far proved resilient to the fallout from the war in Ukraine, but strong headwinds and downside risks persist. The region is facing combined pressures from the energy crisis, high inflation, and monetary policy tightening. A recession this winter looks increasingly likely.



Source: Edward Jones

STORY 8 —

EU energy crisis intensifies

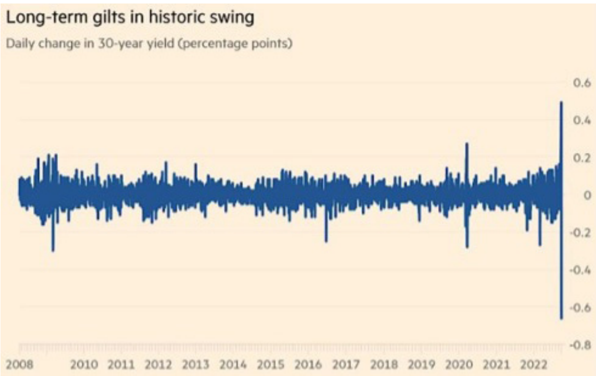
Europe continues to sink into an unprecedented energy crisis. In August, the one-year contract price for electricity in France exceeded €1,000 per megawatt hour for the first time. The German equivalent also reached a record high of €829 per megawatt hour. Of course, these prices are very volatile and did fall sharply in early September (see graph below). Moreover, many countries (France, Greece, etc.) are ready to put support measures in place, particularly for the most financially strained households. Finally, we note that EU natural gas stocks reported in August were in line with the historical average, thanks to increased imports of liquefied natural gas (LNG) and the reactivation of coal-fired power plants.

However, a substantial reduction in gas flows through the Nord Stream 1 pipeline could keep European energy prices high and lead to a very complicated winter. In early September, Gazprom announced that it had "completely stopped" gas transport through Nord Stream until a previously undetected oil leak was rectified. This could take days... or months. This means that Europe will now be forced to rely even more on the much more expensive LNG sold by China. The risks of recession in the EU therefore remain high, as shown by the weakness of the euro, which has fallen below parity with the US dollar.

STORY 9 —

The UK crisis

The UK is in the midst of a financial crisis of rare intensity. During the last week of September, the pound hit an all-time low against the dollar, coming very close to parity, while sovereign bonds saw their yields reach their highest level since 2008. The scale of the crisis is such that members of the Bank of England worked through the night to save the UK's pension fund system. Indeed, the collapse of gilt bonds has led to huge margin calls on UK pension funds, triggering forced sales of gilts, further fueling the decline. The following morning, the Bank of England had to announce the temporary suspension of the Quantitative Tightening and the implementation of a sovereign bond purchase programme in order to curb the rise in yields. Following this announcement, UK 30-year bond yields, which had previously reached a 20-year high (>5%), fell by 0.75% to 4.3%, the largest daily fall in yields on record.



Source: The FT

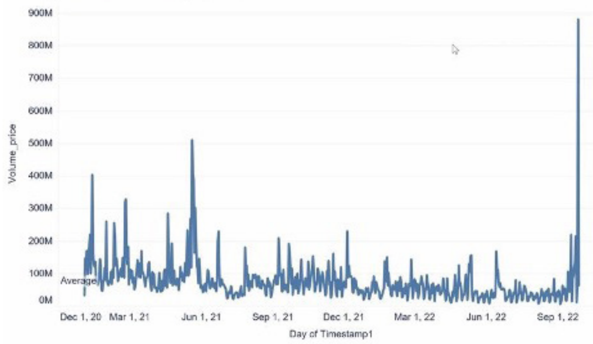
STORY 10—

Cryptocurrencies stabilized

Last but not least, we note that cryptocurrencies sectors outperformed other traditional assets in Q3, recovering from double-digits losses in Q2. Despite a sharp post-Merge pullback, Ether (ETH) managed to close the quarter up more than 20%. After rallying in August, BTC lost most of its gains in September and ended the quarter slightly down following a drop in global risk sentiment.

Interestingly, we note that some brits chose to take refuge in bitcoin during the UK crisis. GBP/BTC trading volume on the Bitstamp and Bitfinex exchanges, which is usually around $70 million per day, reached a staggering $881 million on 26 September (the day of the GBP crisis), an increase of over 1,150%.

Trading volumes in USD (gbp/btc)



Source: Bloomberg

ASSET ALLOCATION INSIGHTS

The good, the bad and the ugly

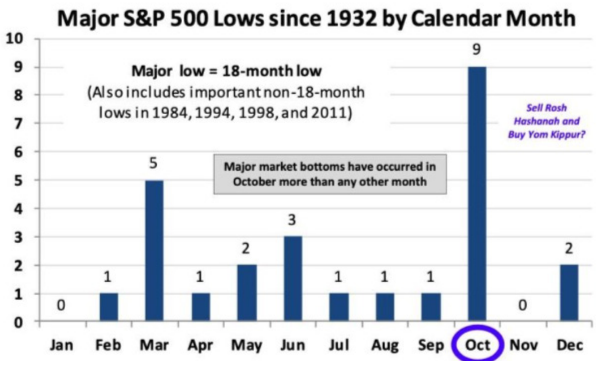
Our main scenario is a rise in downside risks for the global economy, amplified by antagonist policies. There is indeed at the same time a global growth slowdown that governments aim to mitigate through fiscal support, and an inflationary environment that central banks try to contain. This combination spurs macroeconomic volatility which itself keeps asset prices volatility elevated. As a consequence, we maintain an "unattractive" stance on equities and a cautious view on both rates and spreads. We are positive on commodities and have a very attractive view on hedge funds. We remain positive on the dollar against all currencies as the greenback remains the only true inflation hedge at this stage.

The big picture

The "everything down market" continues to weigh on multi-assets' portfolios performance. Looking at total return data going back to 1928 for the S&P 500 and US 10-year Treasuries, there were only 5 years in which both S&P 500 and 10-Year Treasury Notes went down (1931, 1941, 1969, 2018, 2022). This year is the only year in history in which both S&P 500 and the US 10-year Treasury bond are down more than 10% each. Will the "everything down market" continue or are we getting close to a turnaround point for global risk assets?

The good

- Despite the current gloomy picture, there are reasons to take a positive and contrarian view on markets.
- First, sentiment is too pessimistic, which is a positive from a contrarian perspective. For instance, hedge funds are running low on leverage. We are now at April 2009 level according to Morgan Stanley. Meanwhile, the 5-day rolling average notional of index puts is $1 Trillion, per day, every day, that's a new record.
- Moreover, a mild recession is already priced in by the markets. Stocks are forward-looking and move ahead of the economy by about six months. The 25% decline in equities since January likely already reflects a mild recessionary outcome. If the downturn doesn't prove to be severe, equity markets could stabilize even as economic data underwhelms. Today, US investment grade yields to worst are the highest in more than a decade. In addition to the higher income potential, investment-grade bonds can potentially serve as a buffer against equity-market volatility.
- Seasonality is turning positive. Indeed, October is historically the month with the highest number of major lows ("The Bear-killer" and "Bargain month").



Source: Oppenheimer

- On the macroeconomic side, some downside surprises in economic reports are raising hopes that inflationary pressures could soon ease. The ISM manufacturing index fell to 50.9 in September, its lowest level since 2020. The ISM manufacturing prices paid fell to their lowest level since soon after the start of the pandemic. Global container freight rates hit a 21-month low early October, down 67% from their peak. It is still over 2x higher than pre-pandemic levels but continuing to move in the right direction. Meanwhile, used car prices are now down year-over-year, the first time we've seen that since May 2020.
- The number of job openings decreased 10.0% in August, the most since April 2020, and the fourth decline in the past five months. The gap between the

number of jobs and the number of unemployed remains high from a historical perspective, but it is starting to narrow. For now, companies are slowing the pace of hiring before cutting jobs, therefore keeping the unemployment rate low.

The bad

- The end of QE and the surge in bond yields continue to drive equity markets lower. As long as we don't get a Fed "pivot", markets will continue to adjust to the reality of tighter liquidity and higher bonds yields. Both are weighing on equity valuations.

Source: Bloomberg

- Other bad news: equity valuations are still not cheap. S&P 500 Enterprise Value to sales got cheaper but we have just arrived at the top of the 2000 dotcom bubble. The old trade -- TINA, or "There Is No Alternative" -- was about to buy everything (meme stocks, unprofitable tech, Miami condos, etc.) as bonds offered 0%. But now, 4.30% on 2-year Treasuries (so no duration risk) is a fundamental game changer for everything you associate with the QE era. This is a market which is more favorable for income types of investments and much less favorable to the old QE winners (tech, speculative stocks, etc.). Hence TARA (There Are Reasonable Alternatives).
- On the macro side, strong oil advance is not a good news for inflation. Early October, WTI Crude oil recorded the biggest weekly gain since March on supply fears (OPEC+ cutting oil supply by 2 million barrels per day) and strong US jobs data. If sustained, this rebound will start pressuring the presumption that headline inflation will maintain its downward trajectory into the end of the year — this at a time when core inflation is still rising. The recent OPEC+ announcement makes Biden's release of 1mb per day look increasingly futile and unsustainable as the SPR (Strategic Petroleum Reserves) are getting depleted to dangerously low levels.

The ugly

- US government securities liquidity is worsening. Central banks around the world are swapping their stockpiles of US Treasuries for cash -- just in case they need to intervene in markets to bolster their currencies. Foreign monetary officials purged $29 billion in Treasury securities in the week ended Oct. 5, bringing the four-week decline in holdings to $81 billion, according to Federal Reserve data. It's the most-extreme outflow since the beginning of the pandemic in March 2020, leaving total holdings at $2.9 trillion.
- Risk gauges in Germany's government debt market rose last week to levels higher than recorded in the 2008 world financial crash. Meanwhile, the spread between the EUR swap and German 10-year yields closed above 1% for the first time ever. UK market borrowing costs continue to surge as quite a few "too big to fail" institutions are heavily exposed to UK Bonds and Gilts.
- Last but not least, the Russia-Ukraine war and the resulting tensions between US/Europe and Russia show no signs of abating. To the contrary, the risks of escalation have been increasing lately. One of the major turning point of 2022 is the growing East-West divide. The countries that have sanctioned Russia over its invasion of Ukraine represent only 16% of the world's population. Two-thirds of the world's population live in countries where the government has declined to condemn Russia's invasion of Ukraine. India, China and the Middle East are keen on cooperating with Moscow. As a consequence, the world has entered into the equivalent of a new "cold war" and this has consequences on structural inflation. Indeed, wars are about control. The control of technologies (chips), commodities (gas), production (zero-Covid) and straits (the Taiwan Strait, the Strait of Hormuz, the Bosporus Strait, etc.). Wars are about alliances: After the BRICS, should we focus instead on Turkey, Russia, Iran, China, and North Korea playing "TRICKs" – an alliance of economies sanctioned by the U.S. getting ever closer economically (and militarily?). Overall, this new geopolitical paradigm is likely to create more macroeconomic and thus volatility on financial markets.
- So where do we go from here?

We keep an “unattractive” stance on Global equities

- The weight of the evidence (i.e. the aggregation of our fundamental and market indicators – see next section) remains “unattractive” on equity markets, i.e we remain underexposed on risk assets.
- From a regional standpoint, we keep a “positive” stance on US equities. We are upgrading UK equities from “unattractive” to “cautious”. We are also cautious on China & EM Asia, Japan and EM Latam. We keep an “unattractive” stance on Eurozone equities. Our least favored market remains EM Eastern Europe equities (very unattractive).
- We keep a “cautious” stance on Fixed Income, credit spreads and rates. We keep a positive view on Commodities (with a “preference” stance on Gold) as well as a very attractive view on hedge funds.
- In Forex, we are positive dollar against all currencies. We keep an “unattractive” stance on the Euro as the Eurozone is facing a major energy crisis which is worsening the fundamentals of the common currency.

Indicators review summary

Our tactical asset allocation process is based on five indicators. The macro and fundamental factors are still tilted towards a negative stance on risk assets. The most dynamic factor of our process - market dynamics – remains neutral. On an aggregated basis, our indicators are pointing towards an “UNATTRACTIVE” view on risk assets.

Macro & Fundamental Factors
(Leading indicators)

→ Macro-economic cycle:
NEGATIVE

→ Liquidity:
NEGATIVE

→ Earnings growth:
NEUTRAL

→ Valuations:
NEUTRAL

Market Factors
(Coincident indicators)

→ Market dynamics (Breadth, Sentiment, etc.):
NEUTRAL

INDICATOR #1

Macro-economic cycle: **Negative**

Economic growth continues to slow down across all large economic areas, except in the United States. Indeed, the US continues to expand firmly, led by domestic demand and services, even if some cyclical and rate-sensitive sectors are slowing down. Consumer spending keep growing (even in real terms), supported by rising jobs and wages (as well as accumulated savings). Investment keeps growing in overall, even if some sectors are already losing steam.

European economies (Continental and the UK) already feel the impact of surging energy prices. And winter is not there yet. The energy-driven surge in inflation and the prospect of energy supply cuts or restrictions through the winter already heavily weigh on consumer and business sentiment, and on spending and investment. Switzerland stands out for the moment but will not be spared by Europe’s woes.

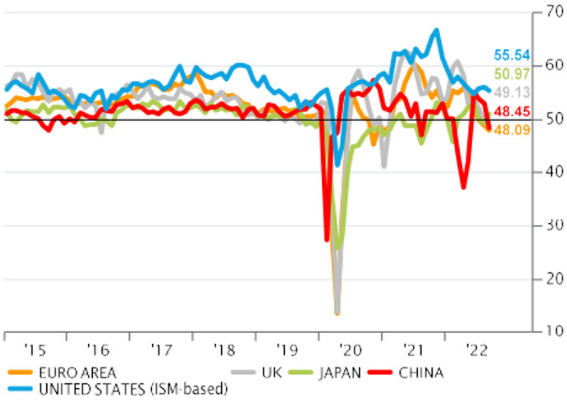
China is struggling with Covid resurgences and real estate market’s turbulences. Monetary policy easing tries to soften the blow ahead of the Party Congress.

Slowing global growth and a rising US dollar weight on most Emerging Market economies’ growth prospects, even if some (Brazil, India, commodity exporters) show signs of resilience.

With regards to inflation, the increase in prices hits double-digit in Europe due to the energy crisis. Peak inflation is (probably) behind in the US, but not in Europe where energy could push inflation rates in double digit territory. Going forward, we expect inflation to be significantly above central bank’s target in the US and Europe. Upward wage dynamics still on in the US and Europe and central banks need to see some inflexion here to be able to consider a “pivot”. Asia is facing a milder inflation environment.

Overall, medium-term expectations are declining on global growth slowdown expectations and determined central banks. Nevertheless, we still view the mix of declining growth and still elevated inflation as being negative for risk assets.

Economic growth continues to slowdown across all large economic areas... except in the United States !



Source: Banque Syz, FactSet

INDICATOR #2

Liquidity: **Negative**

Central banks remain firmly on the path of hike. To regain control on inflation dynamic, and preserve its credibility, the Fed has no choice but to tighten monetary policy until there are clear and tangible signs of a reversal in inflation dynamics.

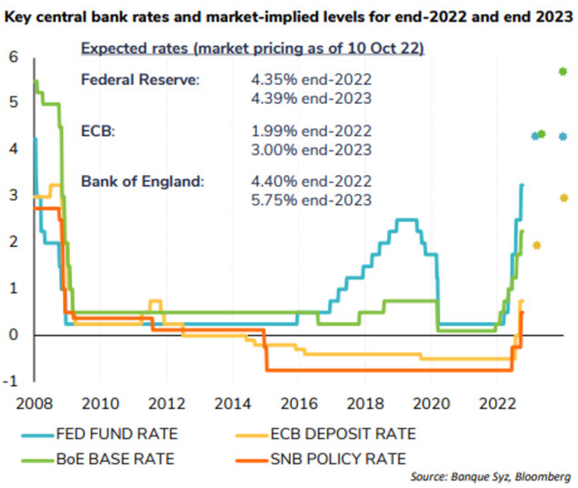
If there is to be a pivot, it could rather be in Europe given the looming recession. Indeed, a recession (and corresponding fall in domestic demand) would dampen underlying inflationary trends. It seems imminent in Europe, not yet in the United States.

Still, despite the elevated recession risk in Europe, the ECB has to hike for the moment. Indeed, wage dynamics are also on the rise in Europe, indirectly supported by fiscal intervention. And monetary policy normalization has barely started yet as the ECB is behind the curve.

Central banks are, at the same time, fighting existing inflationary trends and trying to offset the impact of fiscal interventions. Monetary policy is getting tighter across all economies, with higher rates and withdrawn liquidity. As seen in the UK, the more the government support its economy with fiscal spending, the more the central bank has to hike rates.

Overall, the liquidity environment remains negative for risk assets as most developed markets are facing more rate hikes, quantitative tightening and global liquidity reduction.

Central banks are firmly on the path of hike



Source: Banque Syz, Bloomberg

INDICATOR #3

Earnings growth: **Neutral**

In the second quarter of 2022, 75% of S&P 500 companies reported a positive earnings per share surprise and 70% of S&P 500 companies surprised positively on the revenue front (source: Factset). However, growth momentum is weakening. For the quarter, the aggregate earnings growth rate for the S&P 500 is 6.3%. This is the lowest earnings growth rate since Q4 2020 (4.0%).

After reaching a record high of 13.5% in Q2 2021, S&P 500 profit margins have fallen back to 10.9% in Q2 2022 as sales growth has slowed and companies find it harder to pass on higher costs to their customers. On the positive side, we note that balance sheets remain solid as well and companies have room for more share buybacks. Earnings revisions in Europe are holding up much better than PMIs would suggest. But for how long?

While Q3 US earnings estimates have been revised downward quite aggressively over the last few weeks, 2023 expectations remain too optimistic. As such, we continue to see earnings growth as being a mild tailwind for equities but still believe that some downward earnings growth revisions should act as a headwind for equities in the months ahead.

US 12 month forward EPS during past recessions

MSCI US 12m Fwd. EPS

Recession year	Peak date	Trough date	Peak to trough move
1990	Jan-91	May-91	-14%
2001	Aug-00	Nov-01	-23%
2008	Oct-08	Apr-09	-40%
2020	Mar-20	Sep-20	-15%
Average			-23%
Median			-19%
Current	At peak		

Source: J.P. Morgan

INDICATOR #4

Valuations: **Neutral**

Global equity valuations have de-rated this year. The S&P500 multiple has de-rated by the same magnitude as seen in previous recessions. The 10Y real yield is critical, because for the S&P 500 P/E ratio to rise, the 10Y real TIPS yield must fall. On a relative basis, Equity Risk Premium is a headwind now, as it has probably reached a bottom. Overall, this indicator remains NEUTRAL. Equity markets are less expensive than last year but they are not cheap either.

The S&P500 multiple has de-rated by the same magnitude as seen in previous recessions

US 12m forward P/E during past recessions

Recession	Peak	Trough	MSCI US peak to trough move	12m Fwd P/E at MSCI US peak	12m Fwd P/E at MSCI US trough	Move in MSCI US 12m Fwd P/E from peak to trough
1990	Jul-90	Oct-90	-20%	12.8	10.4	-19%
2001	Mar-00	Oct-02	-51%	25.7	13.8	-46%
2008	Oct-07	Mar-09	-56%	15.4	10.4	-32%
2020	Feb-20	Mar-20	-34%	19.6	13.2	-33%
Average			**-40%**	**18.4**	**12.0**	**-33%**
Current	**Dec-21**	**Sep-22**	**-25%**	**22.4**	**15.8**	**-29%**

Source: J.P. Morgan

INDICATOR #5

MARKET DYNAMICS: **Neutral**

Our market dynamic indicators remain neutral. The S&P 500 trend remains negative with the 200-day moving average falling and the price lower. This signal continues to show that the long-term bull trend has been broken and that we remain in a bear market of lower lows and lower highs. The rate of change is very negative as well. Market breadth (e.g percentage of stocks trading above their 200 days moving average) hasn't improved recently. The US Bull-Bear ratio is negative as well. There is a high percentage of bears but we don't see any turnaround yet. The picture is roughly the same with MACD and Put-Call ratio: there are oversold but there is still no signs for these ratios to revert their trend. We note that volatility has been picking up lately but hasn't reached extreme levels. From a geographic point of view, indicators are more favorable for US equities than for European stocks.

Asset Class Preferences

Equity allocation

Unattractive

Risk assets are facing several headwinds; high inflation and rising rates which are weighing on global growth (with Europe already into an energy crisis), China reopening hampered by Covid and geopolitical tensions and high political uncertainty (US Mid-term elections, shockwaves in Europe from the war in Ukraine and sanctions on Russia). Meanwhile, fiscal intervention tries to cushion the blow from rising energy prices but given the high level of indebtedness of most developed countries, it seems that the market is less willing to finance fiscal deficits. As mentioned earlier, seasonality is becoming a positive for the rest of the year. But overall, the weight of the evidence leads us to keep our "unattractive" view on equities.

From a regional point of view, we are upgrading the UK to cautious (from Unattractive). We believe UK large cap Equities (FTSE 100) are attractive despite the recent turmoil caused by the new government's fiscal policy announcements. This segment is essentially composed of exporters, as 70% of FTSE 100 earnings are derived from outside the UK. Therefore, these exporters are not as impacted by the policy uncertainty and benefit from a weaker GBP. Besides, UK equities are trading at a record discount to other Developed Markets regions which we believe more than compensate current troubles. Our stance on the other regions remain unchanged.

In terms of sectors, we are reducing Information Technology to Neutral. We confirm our overweight stance on Energy and Health Care, and we are still underweight in Utilities and Real Estate.

Fixed income allocation

Cautious

We keep a cautious "cautious" stance on Fixed Income, including on rates. Indeed, sovereign bond yields are rising across the board, as markets price higher central bank rates (i.e higher real rates) amid continuing inflationary pressures. Inflation expectations edge lower as the Fed and the ECB appear credible in their anti-inflation stance, and downside risks on growth reduce concerns of a sustained inflationary dynamic. Absolute yield levels remain supported by inflation and hawkish central banks; the bright spot remains the short end as the U.S. yield curve is deeply inverted. Within Government bonds, we do have a preference for USD over EUR where ECB needs to catch-up and energy-driven inflation is surging.

As for credit, we keep our cautious stance. Investment Grade offers attractive absolute yields in USD and already prices a lot of bad news in EUR, but macroeconomic headwinds on growth and rates balance the improvement in valuations. The situation is similar for High Yield credit, that offers attractive yields but where spreads are not at extreme levels of cheapness.

Emerging Market Debt in USD are attractive in relative terms. Emerging Market Debt in local currency are not far from attractive levels. Nevertheless, we remain cautious on Emerging Markets bonds. Overall, valuations are attractive but flows remain negative. Emerging market companies are used to dealing with high inflation and a strong dollar (2013 experience). EM Local debt has become more attractive as EM central banks tighten their monetary policy. Their aggressive strategy is starting to pay off (see lower inflation in Brazil).

We remain positive on subordinated. This matured and resilient asset class offers premiums despite solid capital position. Valuations remain cheap due to growth concerns. Fundamentals benefit from rising interest rates.

Commodities

Positive overall. Keep a preference stance on Gold

Over the last few months, commodities have moved from being overbought to oversold as recession fears now dominate all markets. We remain positive on the asset class and sees commodities as an attractive macro hedge. After years of capex underinvestment, many commodities are facing a supply shortage while demand is firm. The invasion of Ukraine by Russia and the sanctions are worsening the situation. Energy and commodities are needed for virtually everything, and Russia exports both massively. And unlike in 1973, it's not just the price of oil, but the price of everything that is surging. Furthermore, the supply shock might be a long lasting one. Indeed, despite ongoing negotiations between Russia and Ukraine, a stalemate with prolonged economic impacts looks likely. We are thus positive on broad commodities. We keep our preference stance on Gold. Rising USD real rates continue to weigh on Gold prospects, but it can remain a potential inflation hedge and a safe haven in a highly uncertain environment.

Hedge Funds

Very attractive

Alternative strategies grab their chance to deliver value. After the pandemic, economies are adapting to the changing cost of capital. Investors need a more selective and active approach to investing. As interest rates rise, hedge funds are providing positive returns. Alternative strategies are benefiting from lower liquidity and higher interest rates.

In terms of hedge funds strategies, we are positive on equity hedge with low net exposure and a trading approach. We are also positive on macro and CTA.

Forex

The US dollar remains supported by yield differentials

Euro remains in a downward trend due to the ongoing energy crisis in Europe and the Fed resolute hawkish stance. The surge in energy prices and concerns around winter supply weight on EUR prospects from several angles: macroeconomic growth prospects, inflation, interest rate differentials, external balance, flows of funds. The ECB is between a rock and a hard place, and fast rate hikes might not even be sufficient, especially as the Fed keeps hiking

The Swiss Franc is temporary overwhelmed by the USD strength, but the downside is nevertheless limited due to real rate differential and sound fundamentals. Fundamental drivers plead for a firm Swiss Franc over the medium term. Flight to safety from European assets is a powerful support. But faster Fed rate hikes than the SNB are supporting the USD in the short-run.

The sterling faces continuing downside risk as inflation surges and fiscal policy gets wild. The surge in energy prices and concerns around winter supply weights on GBP prospects from several angles: macroeconomic growth prospects, inflation, interest rate differentials, external balance, flows of funds. The recent hawkish stance of the BoE is more than counterbalanced by the program of new PM Liz Truss, a huge fiscal support to households and businesses

From a fundamental standpoint, the Yen additional downside risk is limited. However, the yen remains under pressure as long as the BoJ does not move. Growth momentum and monetary policy differentials continue to weigh the yen vs the US dollar, the peak «rate differential» depends on the Fed as the BoJ is not inclined to move for the moment.

Cross-asset correlations and volatility

The bond/equity correlation is in positive territory, implying no diversification in multi-asset portfolios. Volatility creeps higher in equity markets, without large spikes. Volatility remains high on bonds markets.

Rolling 120d correlation between S&P 500 and 10 year Treasury yield has fallen to lowest (most negative) since 2006, i.e correlation between #bonds and equities is at the highest level since 2006

Source:Bloomberg

Tactical positioning: our asset allocation matrix

	Very Unattractive	Unattractive	Cautious	Positive	Attractive	Very Attractive
Portfolio risk		Equities	Credit Spreads Rates			
Equities	EM Eastern Europe	Euro zone	**United Kingdom** → Japan China & EM Asia EM Latam	United States Switzerland		
Fixed Income		EM Local	Government Bonds HY Credit IG Credit EM Hard	Subordinated debt		
Yield curves		EUR “core” EUR “peripheral” CHF GBP	USD			
Forex (vs USD)		EUR	CHF EM currencies GBP JPY			
Commodities				Commodities	Gold	
Alternative Investments						Hedge Funds

Source: Investment strategy group - 12 October 2022

Change from last month

→ More attractive

← Less attractive

Like all family owned and managed businesses we can take a genuinely long-term view. We're never hostage to the need to deliver short-term quarterly returns.

THE LONG VIEW

The East-West divide

2022 seems to mark a turning point in international relations, with major implications for the global economy and financial markets.

Last week, the Shanghai Cooperation Organization (SCO) summit took place in Uzbekistan. This alliance, which initially involved China, Russia and four Central Asian states (Kazakhstan, Kyrgyzstan, Uzbekistan and Tajikistan), now includes India, Pakistan and Iran. Two new guests also attended, Turkey and Azerbaijan, offering further proof that an alliance is being forged in the East that increasingly resembles an anti-Western coalition.

THE VIRTUES OF GLOBALIZATION

A few years ago, globalization was the order of the day, thanks to the formidable impetus given by two major geostrategic blocs.

On the one hand, there is the relationship between China and the United States, labelled "Chimerica" by historian Niall Ferguson. By relocating many activities to China, American companies have greatly increased productivity at the expense of nominal wages. But Chimerica still benefited the American consumer. First, China exported deflation by supplying the US with cheap goods, increasing the purchasing power of Americans. Second, the dollars earned by the Chinese through their exports were partly recycled into US Treasury bills, keeping bond yields low and encouraging borrowing in the US.

In parallel to Chimerica, another geostrategic bloc has played a crucial role in international trade: the Eurussia alliance. As Credit Suisse strategist Zoltan Poszar explains, Europe benefited for years from a cheap source of energy, namely Russian gas. In return, Russia recycled some of the euros it earned into European assets such as real estate or government bonds.

Like Chimerica, this was a "win-win" alliance. Without becoming allies, each economic partner benefited from commercial and financial exchanges and therefore had no interest in entering into conflict.

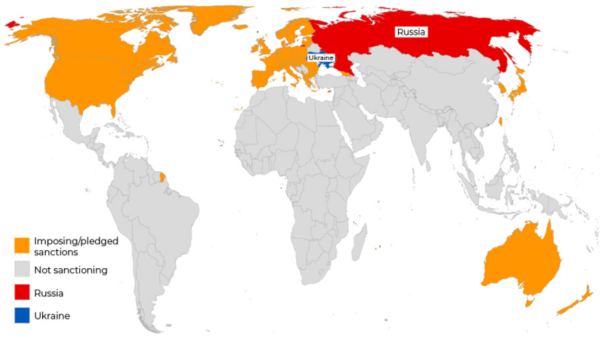
With the arrival of Donald Trump in office, the trust between China and the United States began to erode, giving way to a trade war. The Biden administration has not reversed the trend, and the pandemic has further complicated the trade relationship between America and Asia.

Russia's invasion of Ukraine in February was the endgame for the Eurussia alliance. The two big geostrategic blocs that have been in place for many years are now in an advanced state of decay.

A NEW WORLD ORDER?

The sanctions taken by the West against the country led by Vladimir Putin were supposed to plunge Russia into great financial difficulties. However, this ignored that sanctions were applied only by a small number of states. As the map below shows, the countries that voted for the sanctions (countries in orange) represent only 18% of the world's population, while two-thirds of the planet (countries in grey) did not vote in favour of the sanctions.

Countries imposing sanctions vs. Russia & those not backing sanctions



But above all, the two great Asian powers - China and India - immediately saw the window of opportunity opened by the

Russian crisis: accessing its natural resources - from energy to agricultural commodities and metals - in abundance and at an advantageous price. China has avoided being too vocal about its ties with Russia, perhaps to avoid offending its two major export customers, the US and Europe (during the SCO, Russian President Vladimir Putin himself said he understood that Xi Jinping had questions and concerns about the situation in Ukraine but praised China's leader for what he said was a "balanced" position on the conflict).

India, on the other hand, has made no secret of its intention to strengthen its strategic ties with Russia. India's oil minister, Hardeep Singh Puri, has said he wants to buy as much oil from Russia as possible, stressing that he has a moral duty to his citizens. The nation's Prime Minister, Narendra Modi, has a clear message to the West: "We are keen to strengthen ties with Moscow."

Warm handshakes between the Russian, Indian and Chinese leaders illustrate what may be the new geopolitical face of the world; an alliance between the major Asian countries, through which China and India secure access to raw materials thanks to imports from Russia. Such relations allow President Putin to compensate for the end of trade with the West. For Russia, it is not only a question of replacing the destination of its raw material exports but also of being able to import goods and services that are no longer accessible because of the sanctions, such as semiconductors.

For these three giants, it is a question of accessing and controlling the raw materials and technology necessary for their survival and development, as well as control or access to strategic shipping routes such as the straits of Taiwan, Hormuz, or the Bosporus.

As mentioned by Mr Pozsar in his study "War and Interest rates," wars are both about control and alliances. In recent months, many countries under Western sanctions have strengthened their ties.

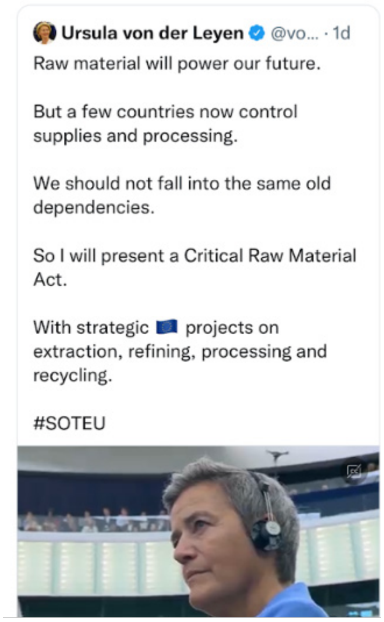
For example, Russia and China are conducting naval exercises with Iran around the Strait of Hormuz. Iran recently hosted talks between Russia and Turkey on grain shipments through the Bosporus. Despite US pressure, India has decided to participate in Russian military exercise "Vostok-2022."

For Mr Pozsar, we have not only entered a world where "the enemy of my enemy is my friend," but in which the "friends of my enemy" are attacked or put under pressure. This includes, of course, China's pressure on Taiwan, but also its pressure on South Korea to end all forms of military cooperation with the US. Mr Pozsar even suggests replacing the BRICs (Brazil, Russia, India, China) with TRICKs (Turkey, Russia, Iran, China and North Korea) as a sort of alliance of US-sanctioned economies that is becoming increasingly close both economically and militarily.

There is of course a parallel between these new alliances and the rapprochement between China and Saudi Arabia (see our recent FOCUS note "The end of the petrodollar?"). The use of currencies other than the dollar in trade is another tangible sign of a new world order.

A COUNTER ATTACK BY THE WEST?

The countries to the east of the globe could enter a new era of growth outperformance. The West must therefore react on several levels. The first priority is access to raw materials, whether through new trading partners or through investments in refining, exploration and production, for example. On 14 September, European Commission President Ursula von der Leyen said that she would soon present a "Critical Raw Material Act."



Ursula von der Leyen @vo... · 1d

Raw material will power our future.

But a few countries now control supplies and processing.

We should not fall into the same old dependencies.

So I will present a Critical Raw Material Act.

With strategic 🇪🇺 projects on extraction, refining, processing and recycling.

#SOTEU

The second priority is to repatriate or "reshore" some of the production capacities that were previously relocated to countries where labour is cheap (see our FOCUS note "On the way to slowbalization"). This is now a matter of national security. Another priority is to strengthen the electricity grid through a more pragmatic energy transition, in particular by further developing nuclear power. The last priority is rearmament. "Our army must become the pillar of conventional defence in Europe," German Chancellor Olaf Scholz said on 16 September.

These lines of development require massive purchases of raw materials, which constitutes a shock to demand, even though supply is limited and highly coveted by the alliances in the East.

It should also be noted that these various projects constitute gigantic investments, which will require major loans, even though the West is already over-indebted. For the great Eastern powers of China, Russia and India, there is less and less appetite to finance the West's debt for geostrategic reasons. Borrowing costs could therefore increase.

MACROECONOMIC AND FINANCIAL IMPLICATIONS

This new world order may have important repercussions for the global economy and financial markets.

- An inflation rate above central bank targets on a sustainable basis

As mentioned at the beginning of this article, the low-inflation world (also called "the great moderation") had two geostrategic pillars: Chimerica and Eurussia. The weakening, or even the end of these alliances, means that the days of cheap labour, goods and gas imports are over.

Many commodities are experiencing structural shortages while demand is expected to continue to grow. The asset class may therefore have entered a super-cycle with bullish implications for inflation.

Re-shoring puts upward pressure on wages - which is also inflationary.

- The end of the dollar's hegemony?

The US dollar has been the world's reserve currency since the 1970s. However, the rift between the West and the great powers of the East (Asia, Russia) may challenge this supremacy. The rise of China as a major world power, the exclusion of Russia from the SWIFT banking system and the implicit disagreement between the US and Saudi Arabia may accelerate the trend towards de-dollarization. Last week, world leaders of the Shanghai Cooperation Organization (SCO) agreed to use national currencies in trade between their countries, setting the stage for a potential future reserve currency to rival the US dollar.

- Higher interest rates and bond yields for longer?

Inflation rates that remain above central bank targets for an extended period, a continued rise in debt and a reduced appetite for G7 debt on the part of Russia, China and Saudi Arabia point to higher interest rates and bond yields.

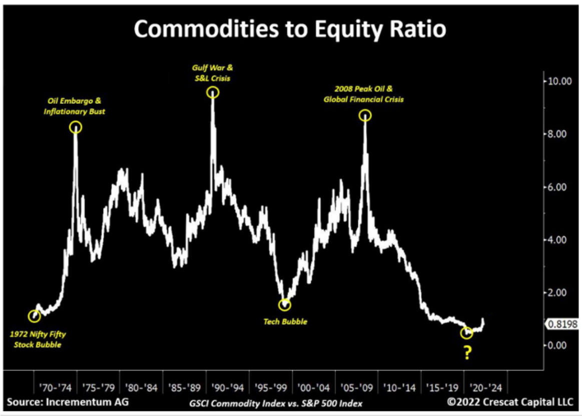
- A new leadership in the financial markets?

In this new paradigm, the best performance may come from regions, asset classes and sectors that are different from those of the past ten years.

For example, commodity-rich countries may be the big winners over the next few years - as could the basic resources and energy sectors.

After years of underperformance relative to equities (see chart below), the commodity asset class could experience a period of prolonged outperformance.

GSCI Commodity index vs. S&P 500 index



Source: Incrementum AG

The Defense & Aerospace industry, agriculture-related businesses, those that help to strengthen the power grid and uranium miners may also benefit from this new era. Finally, "re-shoring" will create new opportunities for local small and medium-sized enterprises, as well as for the technology and robotics sector, which is necessary for productivity gains.

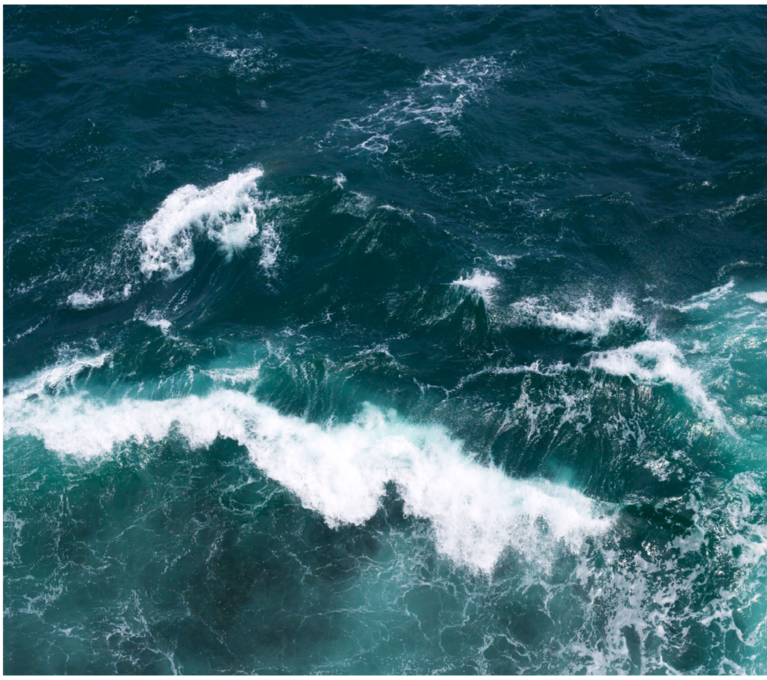
These themes are investable through both listed securities and private markets.

Who would lose from this new paradigm? G7 government bonds are likely to face some tough years. Europe could be the big loser in the East-West divide.

INVESTMENT THEMES

Investing in choppy waters

Market turbulences are highly stressful periods that may however reveal some positive outcomes, if one knows how to navigate them. Some will have no other choice than to see the glass half empty, others can be more fortunate and see a glass half-full... of opportunity. Warren Buffet is one of those who believe that “great investment opportunities come around when excellent companies are surrounded by unusual circumstances”.



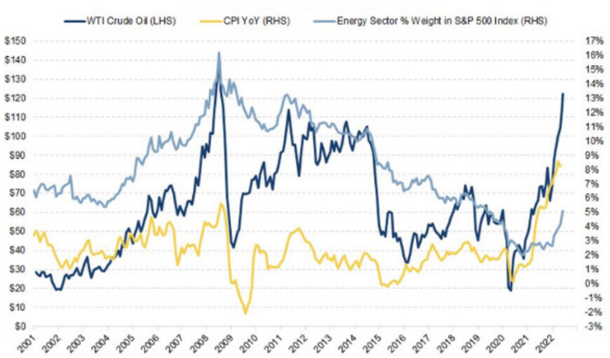
1. Oil stocks...there is still oil in the tank

And the elevated price of oil looks set to last despite fears of falling demand due to the recession. But the main concern is mainly on the supply side.

Early October, OPEC+ decided to cut its production by 2 million barrels per day. In reality this cut will only result in a decrease of 700’000 barrels per day, as for months now, the oil organization was unable to produce in line with its objectives. For the past 8 years, the industry has reduced fossil spending, the capex being invested in renewables in order for the companies to transition toward cleaner energy sources. As a result, production has been slowing down and inventories have been drastically reduced in both Europe and the US. However, the winter has not yet begun, and Russia has not - yet - decided to use oil as a "weapon".

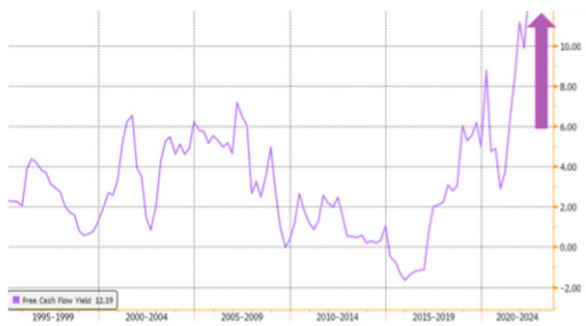
The immediate beneficiaries of high oil prices are the oil companies. Their profits allow them to post record cash-flow-yields (nearly 12%). Investors are not mistaken: the US energy sector has gained more than 40% since the beginning of the year, despite historically bad markets across most asset classes. However, expectations of profit growth have continued to rise, making these companies even more attractive, especially in Europe (at the time of writing, the STOXX Sector 600 Energy P/E is trading at 9.3x current year EPS est.). In the past 10 years, the share of energy in stock market indices has been reduced by more than half, however, in the current supportive environment, oil companies are overtaking some US tech companies. Is this the beginning of a greater rotation?

Oil vs. Energy Sector Weight vs. CPI



Source: Bloomberg

Setting new records on Free-Cash-Flow yields



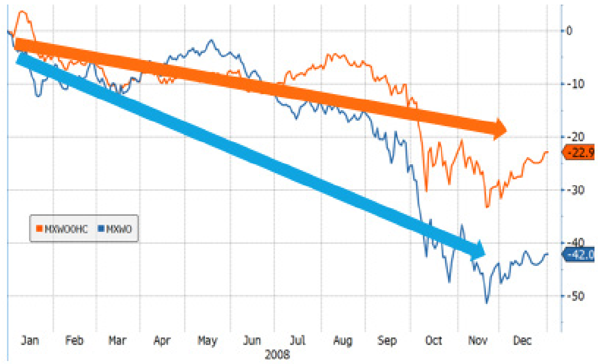
Source: Bloomberg

2. Healthcare, time for a treat(ment).

In the current tumultuous market context, it is good to focus on the fundamentals: we find that the Healthcare sector offers attractive investment opportunities over the next decades thanks to: an aging global population, better access to healthcare in emerging markets and above all, innovation. Healthcare companies are also very important from a public health perspective, as they try to serve unmet medical needs or help reduce healthcare costs. Finally, we like the sector as it tends to have lower sensitivity to macro trends in general. Despite a rally since June, healthcare equity valuations continue to be attractive in particular within the big pharma sub-sector.

The healthcare sector tends to have lower sensitivity to macro trends in general

The Great Financial Crisis of 2008 : Healthcare outperforms



2022 Central Banks pivot / inflation / growth concerns : Healthcare outperforms

Source: Bloomberg

3. UK, the next contrarian play? Proof is in the pudding.

From a regional point of view, we are warming up to the UK market despite the risk of stagflation and the political uncertainties facing the country. We are particularly keen on the UK large cap Equities (i.e. FTSE 100) which we believe are attractive following the recent turmoil caused by the Truss government's fiscal policy announcements. This segment is essentially composed of exporters (70% of the FTSE 100 earnings are derived from outside the UK). Therefore, these exporters are not as impacted by the policy uncertainty and benefit from the weaker GBP.

Besides, UK equities are trading at a record discount vs. other Developed Markets which we believe more than compensate for the current concerns faced by the economy.

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