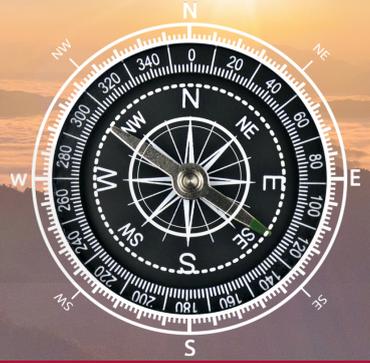


Market Compass

March 2022



MARKET OUTLOOK

- Russia's invasion of Ukraine adds to the series of tectonic shifts from Covid, the return of inflation and central banks' search for a smooth exit.
- Energy supply is the key vulnerability. Sanctions have thus far largely spared Russia's energy sector, but actions against the Russian Central Bank and selected financial institutions may gravely hamper trade while sending Russia deeper into recession.
- We see no rush to buy the dips, waiting for more stability in the geopolitical and energy complexes. We further trim our prudent pro-risk bias, reducing both the Equity exposure in favour of Cash and the Cyclical and Value bias.

Edited by
**MACRO & MARKET
 RESEARCH TEAM**



A team of 13 analysts based in Paris, Cologne, Trieste, Milan and Prague runs qualitative and quantitative analysis on macroeconomic and financial issues.

The team translates macro and quant views into investment ideas that feed into the investment process.

US

- ⊖ Higher energy prices will keep inflation above 7% in the short term...
- ⊖ ...further pressuring weak consumer confidence
- ⊕ Yet a strong labour market and health income position will favour a demand rebound in Q2
- ⚠ Geopolitics will not derail monetary normalisation. We see consecutive rate hikes over the next Fed meetings

UK

- ⊕ Consumer confidence dropped but retail sales rose
- ⊕ Government removed all Covid restrictions in England
- ⊖ Inflation likely to prompt series of BoE rate hikes

EUROZONE

- ⊖ War in Ukraine lifts energy prices further and dampens sentiment
- ⊕ Mitigating fiscal policies against high energy prices likely
- ⊕ ECB stands ready to again launch supporting measures if needed

CHINA

- ⚠ China to try a low profile stance in Ukraine war
- ⊖ Covid-19 waves weigh on consumption
- ⊕ More monetary and fiscal support will help stabilise the economy



EMERGING MARKETS

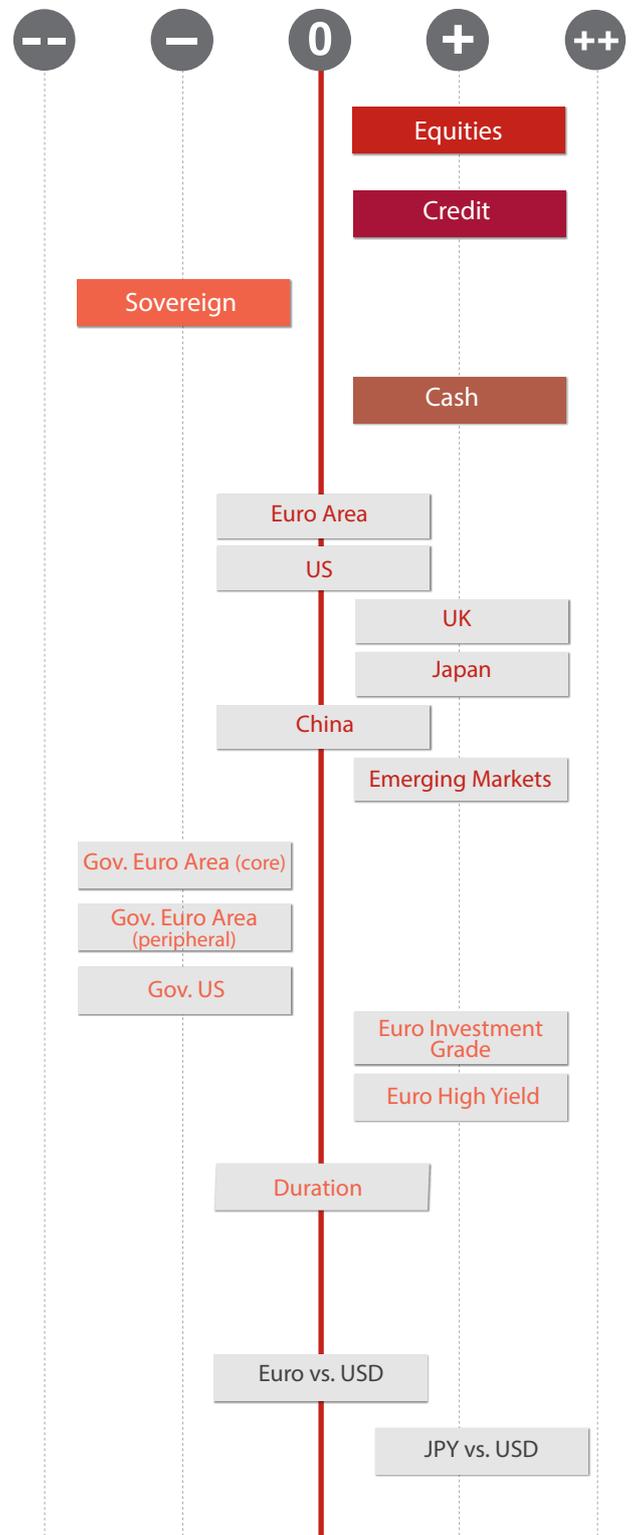
- ⊖ Higher oil prices and heightened risk aversion will likely hurt growth and capital inflows...
- ⊕ ...but the impact will be heterogenous
- ⚠ LatAm is the least vulnerable thanks to large commodity exports, while Turkey is at risk given large trade deficit and exposure to Russian tourism

- ⊕ Positive
- ⊖ Negative
- ⚠ Topics to watch

DIRECTION OF TRAVEL

- Cut equity overweight (OW) to minimal, just above neutrality, increase defensive stocks vs. cyclicals
- Keep credit OW thanks to ongoing ECB support
- Underweight (UW) core sovereigns as inflation will bite
- Increase Cash OW

Equities	<ul style="list-style-type: none"> • The downside in the short term is limited to ca. 5%, but we don't buy the dips yet. • Currently, earnings and margins are safe but at risk mid-term due to higher energy prices and inflation hurting sentiment. • Recommend a minimal OW and lower cyclical exposure also due to rising real yields and spreads ahead. • Prefer UK and Japan to still expensive US and EA.
Bonds	<ul style="list-style-type: none"> • As long as central banks continue on the rate cycle path mapped out there is leeway for government yields to raise medium term as growth concerns will be balanced by higher inflation expectations. • In case of a further geopolitical escalation - delaying key rate hikes - no sustained yield increase is expected.
Duration	<ul style="list-style-type: none"> • Keep duration neutral.
Currencies	<ul style="list-style-type: none"> • Short term, Russian invasion will keep weighing on European FX while safe havens incl. USD, JPY are enjoying strong demand. • Barring a severe further escalation in Ukraine, the ECB's recent hawkish pivot will unlikely be reversed. Thus we see renewed upside for EUR/USD further into the summer.



TOPICS TO WATCH!

- War in Ukraine further escalates disrupting global energy supplies
- War driven plunge in sentiment triggers a global recession
- Geopolitical tension spills over to Asia (Taiwan) disrupting global trade
- Need to hedge high oil prices might trigger large inflows into brown assets

Probability:	Impact:

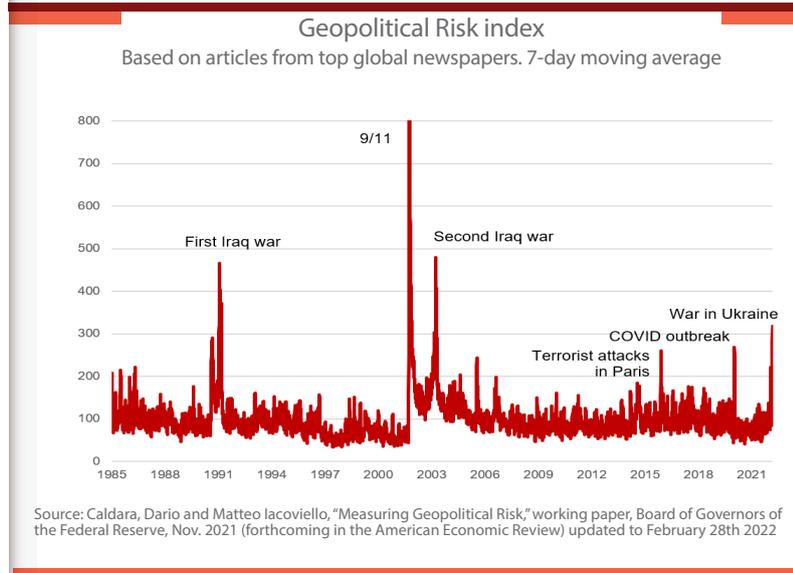
Probability: High \longleftrightarrow Low
 Impact: High \longleftrightarrow Low

SPECIAL FOCUS

Energy induced stagflation risk calls for cutting cyclicality

The conflict and potential sanctions are likely to drive energy prices higher for longer. We then have materially raised our inflation forecasts and moderately trimmed our growth expectations for the euro area and the US. The war in Ukraine will amplify price pressures, but may also depress confidence, complicating the central banks' task. We still see the Fed sticking to a March lift-off, followed by a series of rate hikes - but stressing caution. The ECB will probably not reverse its hawkish pivot either. But in the upcoming meeting on March 10, Lagarde will likely flag data dependency and optionality regarding the looming tightening steps: the QE tapering may be slower. With inflation constraining central banks, expect governments to use the fiscal lever again, to soften the blow on consumers and corporates from higher commodity prices.

In dealing with the high degree of uncertainty, investors need to differentiate between risk premia (temporary risk aversion) and cyclicality (more durable risk via tighter financial conditions and energy prices). Equity multiples have sharply retrenched already, and another 5-7% decline would push EU and US risk premia to potentially attractive levels. Yet risks are tilted towards a more protracted rise in energy costs, which may threaten the growth and earnings outlook. So, buying the dips looks premature in this highly volatile environment. Increase cash positions for now with the aim of redeploying risk when we get more geopolitical and energy price stability. Intensifying stagflation worries suggest reducing the cyclicality of portfolios. We maintain a favourable view on Credit, considering that the ECB will cautiously consider CSPP tapering in the view of keeping funding conditions healthy. The flight to safety status of Bunds and Treasuries is partially offset by rising inflation worries.



GLOSSARY

BUYING THE DIPS

Buying the dips refers to going long an asset or security after its price has experienced a short-term decline, in repeated fashion. The belief here is that the new lower price represents a bargain as the «dip» is only a short-term blip and the asset, with time, is likely to bounce back and increase in value. Buying the dips can be profitable in long-term uptrends, but unprofitable during tougher secular downtrends or protracted periods of uncertainty.



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