Investment Review

January, 2022

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Environment: 2021 in a few words

While the year was a positive one for asset classes, disparity was very high. Some commodities showed strong increases: oil rose over 50% (its best year since 2009) yet precious metals underperformed while iron ore lost close to 40%. In equities, the S&P ended up 28% but here again disparity was high: only 1% of the index contributed to half of the performance and over a third of the companies finished the year in negative territory.
Fixed income had a difficult year, US Treasuries returned -2.3%, their first negative performance since 2013, and European sovereigns were down 3.5%.

In currencies, the US dollar saw its best performance since 2015, while the Yen and the Euro lost close to -10%. Against the pound, the dollar finished the year pretty flat and stayed throughout the year within a 1.42-1.32 range.

Environment: 2021 in a few words

While the recovery from the pandemic set an overall positive tone for risky assets, the performance of different investment strategies was often thrown off by new Covid-19 waves leading to market volatility, changes in the steepening of the yield curve and style rotations.

Early in 2021, cyclical assets posted strong returns amid the vaccine rollout and optimism that the pandemic would soon be over. However, the rotation stalled when the Delta variant appeared in the second half.

During the last 2 months of the year, markets experienced high volatility and a new phase of doubt gripped market participants. Indeed, a new Covid variant was discovered, Omicron, and it dampened the general optimism among investors.

In addition, the FED announced that it would be aggressive on tapering bond purchases and forecasted several rates hikes for 2022.

Environment: 2021 in a few words

In a few words, here below the key elements to remember for 2021:

- **Inflation significantly higher than expected**

US inflation rose in November at an unprecedented rate in nearly 40 years. The price increase reached 6.8%. Many factors contributed to this surge, whether transitory or more structural. At the same time, inflation in the Euro area hit a record high in November at 4.9%, still propelled by steadily rising energy prices. It reached a level not seen since the launch of the Euro.

- **Bond markets under pressure**

The 10-year government bonds yields have globally increased. Continued asset purchases by the main central banks prevented a more pronounced bond correction given the level of inflation. In the US, 10-year Treasury government yields have risen to 1.5% today from 0.9% at the start of the year. Yields have risen in the euro area and in Switzerland as well, but to a lesser extent. Given these developments, bond markets remained in negative territory during most of the year, except for high yield bonds.

Environment: 2021 in a few words

- **Equity markets hit new records**

Global equity markets have followed on their 2020 momentum. Regional markets, including Switzerland, hit new highs, driven in large part by strong corporate earnings and TINA (There Is No Alternative) investor mindset.

The appearance of the Omicron variant has caused trouble, causing a sharp rise in global financial markets volatility.

American technology companies have once again outperformed. They posted nearly twice the performance of the market.

The price of gold has been falling steadily since August 2020, briefly dropping below $1,700 an ounce in March 2021. It has since recovered and then moved sideways.

Environment: 2021 in a few words

- **Paradigm shifts**

2021 will have been a turning point for the auto industry. All groups have announced that they want to turn the page on the combustion engine when until recently they wanted to replace gasoline and diesel with biofuels. But it is too late. Concerns about the climate, China (again) and its market have imposed a radical technological shift. There will still be a lot of talk about the electric car in 2022.

Beijing is becoming more authoritarian in business matters. The authorities are hunting down bosses who are too extroverted and critical of power. In addition, conflicts with foreign investors are increasing. A form of "cold war" is taking hold between Beijing and Washington. Internally, President Xi Jinping lectures the youth and threatens Western firms that refuse to comply with the specific rules laid down by Beijing. Chinese stocks showed the worst performance among the major markets.

2022 Outlook

What a difference a new year makes! The rhetoric for much of 2021 was that the FED may keep rates hikes on hold for multiple years - this now seems like a distant past. At the start of 2022, the market has priced in a quicker than initially anticipated tightening in monetary policy. The main culprit for this change is a shift from describing inflation as “transitory” to something that is more permanent. A combination of a tight labor market, accelerating wage growth and the continued above-run rate of price inflation confirms the need for the FED to finish tapering and start hiking rates over the next couple of months.

In the developed world, demand is firing on multiple engines. The outlook for consumer spending appears particularly strong. Households are still sitting on considerable savings that they accumulated during Covid lockdowns, although the rise in savings pales in comparison to the improvement in household balance sheets which has arisen from the strong asset price increases in the last few years. Governments will also continue their multi-year spending plans. While short-term forms of stimulus are being removed, spending on infrastructure will expand, not least to facilitate the transition to low carbon technologies.

2022 Outlook

2022, however, will have many political events that could derail our constructive outlook. President Macron will be looking to secure a second term in the spring and in the United States, it seems highly likely that President Biden will lose control of the House, Senate or both at the midterm elections in November. Losing legislative control proved a pivotal moment under both the Obama and Trump administrations.

Elevated energy and raw materials prices are here to stay for a while longer. For renewable energy to replace fossil fuels in the energy mix, global investment in clean energy and energy efficiency will need to triple by 2030. Until renewables can play a greater role, there will still be significant demand for oil, and especially gas, because many of the countries that are shifting from coal are turning to natural gas to temporarily bridge the gap. As a result, energy is one of our favorite sectors this year.

We believe stock selection will be a key element this year. We cannot discard Growth companies entirely in favor of Value or Cyclical companies. The leading companies in the Growth sector will continue to outshine the competition.

2022 Outlook

We must, however, be extremely disciplined and choose companies which are cash rich and with strong balance sheets. Some of the biggest technology names will be supported by structural trends, such as digital and technological transformation. Quality in our selection will be more than ever an important element as stocks trading at high valuations have been primarily driven by plentiful liquidity conditions that central banks have provided. In a world where the tide in liquidity begins to turn, these names are likely to struggle the most.

Financials and Energy, two of the biggest value sectors, have strong positive correlations with rising Treasury yields. We also believe that CAPEX expenses which had been reduced during the pandemic will increase substantially. This will favor the infrastructure, IT hardware, chemicals and transport sectors. Metals such as copper should continue to shine as its demand in the construction and energy transition fields will remain strong.

2022 Outlook

We remain prudent on Emerging markets but are watching closely China as its markets have fallen sharply and make a compelling investment opportunity for long term investors. The new goal of "Common Prosperity" aim to insure that Chinese growth over the coming years is more inclusive and sustainable which could be good for the economy, corporate profits and the stock market in the long run.

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