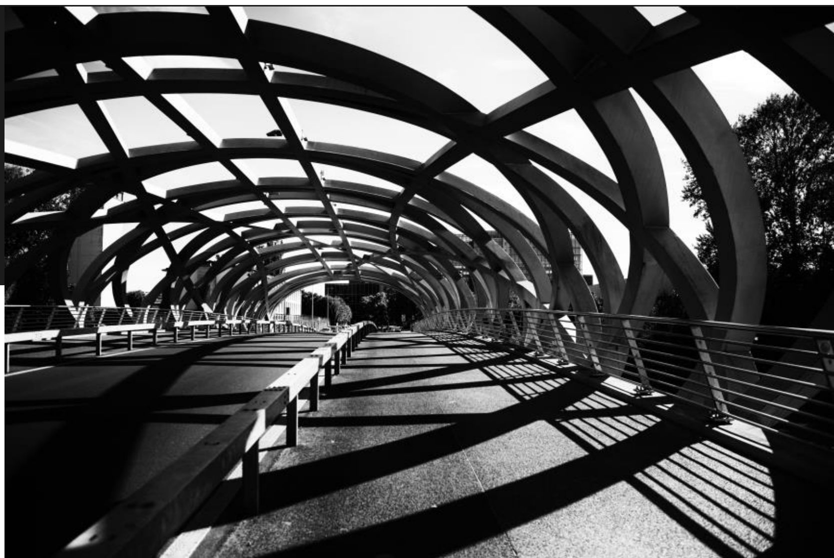

Investment Review

January, 2023

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Environment: 2022 in a few words

2022 was most probably one of the worst years for financial markets with equities and bonds declining significantly. We were faced with the highest inflation in 40 years driven by supply chain disruptions, soaring energy prices and tight labor markets. At the same time, the world was facing the prospect of slower growth and the early consequences of the war between Russia and Ukraine.

In 2021, most of the investment community thought that interest rates would remain near zero for a very long time. From an ultra-accommodative monetary policy to a post pandemic demand surge due to supply chain disruptions and to the Ukraine War's impact on commodity prices, multiple forces drove inflation to 40-year highs. After viewing the changes as "transitory", the U.S. Federal Reserve initiated an about-face. The Federal reserve started one the swiftest tightening cycle raising its target range for its benchmark interest rate by more than 4 percentage points. In Europe, inflation was even more acute amid energy shortages, and this pushed the European Central Bank to start its tightening program. Rates were on the move on a worldwide basis. In parallel, stock markets started their descent and finished down between 32% for the Nasdaq, 18% for the S&P, 10% for the Euro Stoxx 50 and 18% for the MSCI World. Bonds on a

Environment: 2022 in a few words

worldwide basis collapsed, falling by an average of 16%. The world had been flushed with capital as Central banks quantitative easing programs, which started during the financial crisis of 2008 to stabilize the markets, increased dramatically during the Covid years. It is estimated $11 trillion were pumped into the western economies during the years of quantitative easing. Today, liquidity is scarce and capital abundance has turned into scarcity. At the end, the fierce tightening of monetary policy was the trigger for much of the turbulence that rocked finance in 2022.The collapse in tech share prices was violent and the bond market rout was merciless. In the crypto world, the market value of all crypto currencies fell from a high of $ trillion to $800 billion.

Outlook

The world as we know it is changing. The shape of the global economy and the policy prescriptions necessary to address post pandemic challenges are likely to be different than they were in the past decades. The unrelenting rise in energy and food prices and a reordering of economic and political alliances have accelerated some of these trends. Geopolitical shifts are putting issues as supply chain resilience and greater economic self-sufficiency in particularly sharp focus and will likely accelerate a process of partial deglobalization. Destabilization is underway, changing bilateral relationships, and the rise of conflict is likely to shake up trade patterns and reorder alliances.

We believe inflation will almost certainly retreat further from peak levels, although it is likely to remain well above norms throughout the year and into 2024. Central banks understand the need to maintain tight conditions to tame pricing pressures. For this reason, we think that U.S. short term rates are likely to stay high for some time. The world of zero interest rates that was so prevalent after the Global Financial crisis is likely over. We already see the signs of a slowdown in the housing market in the United States impacted by higher mortgage rates. Construction will weaken, spending on household durable goods will fall and declining house prices could weigh on consumer spending. The decline in activity should have the

Outlook

intended effect of taming inflation. In Europe, the cut in the dependence on Russian gas was a major concern for its economies this winter. Good management and a bit of luck with the mild weather allowed Europe to avoid energy rationing so far.

China's economy which had greatly been impacted by its prolonged period of lockdown decided to end its zero Covid policy. China should experience an acceleration in its economic activity in the coming months and, as direct result, the normalization of the Chinese economy could significantly ease the supply chain disruption that have contributed to rapidly rising goods inflation.

Outside of unforeseen geopolitical events, our investment thesis for 2023 will be very much tied to the final inflation outcome. Many believe that we have returned to a 1970s inflation problem, which will require a much deeper recession and a much larger rise in unemployment than we expect to drive inflation away. We are more in the camp that we are or will enter a moderate recession and that inflation will stabilize and decline to more acceptable levels. We do not believe that it will go back to the 2% target that many Central Banks around the world are aiming for. Giving the decline already seen in the price of

Outlook 2023

Outlook

both stocks and bonds, we believe that while 2023 will be a difficult year for economies, the worst of the market volatility is behind us and opportunities in the fixed income and equity markets look increasingly attractive.

Outlook 2023

Portfolio construction

In this environment, we decided that we should continue to proceed cautiously. We are currently underweight in equities but plan to increase the exposure during the year especially if we clearly see that inflation numbers confirm a more durable decline which will lead to a decline in interest rates.

The sectors that we favor remain Energy, Commodities and Healthcare. On the energy front, many factors such the end of the release of strategic reserves in the USA, the dismantlement of the zero-Covid policy in China and the decline in the Capex budget of oil companies make us reiterate our bullish stance on Oil prices. In commodities, we are convinced that we are in long term secular bull market for industrial commodities driven again by the structural lack of Capex investments for many years and the reopening of China. Healthcare is tied to a growing aging population and the increase in new medicine and treatments.

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