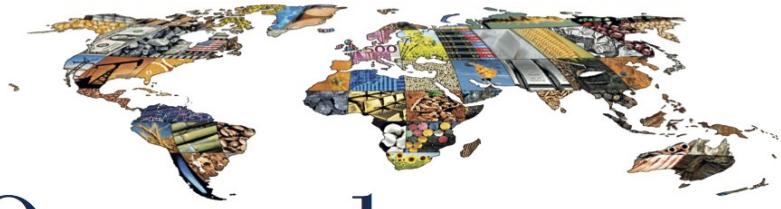
2pm PERSONALIZED PORTFOLIO MANAGEMENT



Quarterly marketreview

APRIL 2022

Editorial

We mentioned it in our last edition at the beginning of January, we started the year 2022 with a degree of vigilance even higher than that which prevailed at the beginning of 2021. A few clouds had indeed accumulated on the horizon, starting with the level of valuations. Aside from emerging markets, China included, and Japan, the equity markets at the start of the year were historically expensive, in particular the American stock market, whose estimated P/E stood at 22.91 for 2022. And we had imagined that at these valuation levels, any bad surprise such as a more ample monetary tightening than expected could lead to significant disengagements on the part of operators. As well as an exogenous event of the type of armed conflict in Ukraine…

As for American markets, it is clear that the corrective movement began well before the start of hostilities on the morning of February 24. Indeed, driven by high inflation figures and the expected tightening of the FED's monetary policy, 10-year Treasury Bond yields began to tighten in mid-December. From 1.40% on December 17, they rose to 2.00% on February 23, resulting in a decline in the equity markets and in particular the segment of growth stocks and technology stocks. Thus, the S&P500 index declined by -11.34% on 02/23 while the Nasdaq posted a worrying -17.22%. Finally a sharp decline in a few weeks, a few people even mentioning a mini-crash on technology. And during this time, a fairly clear rise in the price of raw materials, energy and industrial metals in particular. In Europe, the shock was less, the Eurostoxx50 index falling -7.56% before the first sounds of shell explosions. It must be said that the rise had been less spectacular in 2021 compared to the United States and that the weight of "expensive" stocks, technology top of the list, is less in the European indexes. As for emerging markets, they were the good surprise at the start of the year with a decline of only 2.04% as of February 23.

The start of Russian hostilities on Ukrainian soil on February 24, a major escalation in the crisis that had been simmering since the annexation of Crimea in 2014, will have changed the situation for world stock markets. As early as November 10, 2021, the United States had reported unusual movements of Russian troops near the borders of Ukraine. Three weeks later, nearly 100,000 Russian soldiers could be counted at the gates of the country. On December 17, in the form of two texts entitled "treaty between the United States and the Russian Federation on security guarantees" and "agreement on measures to ensure the security of the Russian Federation and the member states of NATO", Vladimir Poutine proposed to limit the activities of NATO in Eastern Europe, with in particular the prohibition for Ukraine to adhere to the organization of Atlanticist defense. Texts which remained without follow-up, the United States replying that there would be no discussions on European security without the European allies and partners. On Thursday, February 24, around 5:30 a.m. Moscow time, Vladimir Putin announced a "special military operation" in Ukraine aimed at the "demilitarization and denazification" of the country. A few minutes after this announcement, explosions were reported in Kyiv, Kharkiv, Odessa and in Donbass. Cruise and ballistic missiles were launched at airfields, military headquarters and military depots in Kyiv, Kharkiv and Dnipro. And Russian troops were entering from all sides, north, east, south, while many experts expected that the attack would only concern the eastern region of Donbass. That same evening, an extraordinary European Council met in Brussels, adopting a battery of sanctions aimed at having serious consequences on the Russian economy and its political elite.

This date of February 24 also marked a turning point for the markets with very disparate developments. US stocks touched their low point before violently rebounding the next day, so much so that from February 24 to March 31, the S&P500 recovered 7.22% and even 9.84% for the Nasdaq, traders choosing to watch the glass at half-full rather than half-empty, focusing their attention on rather well-made earnings releases from US companies and on diplomatic advances, albeit meager, but progress, nonetheless. Thus, a few weeks after Vladimir Putin's very aggressive speech, the Russian camp no longer spoke of denazification, nor of the overthrow of power in Kyiv and seemed to want to concentrate on taking control of Donbass. On the Ukrainian side, we were now ready to put black on white that the country would never join NATO. And the specter of the nuclear threat, quite present in Russian rhetoric at the start of the invasion, seemed for the moment to be relegated to the rank of bad memories. Once again, it was when the flow of bad news was at its peak that a low point in the markets materialized. We've seen it every time for 30 years. It was true during the first Gulf War in 1991; it was true in March 2003, when the Americans started hitting Baghdad on questionable grounds of weapons of mass destruction supposedly hidden on Iraqi soil; it was true in March 2009, after the subprime crisis, the bankruptcy of Lehman Brothers and the revelation of the Madoff fraud. Who wanted to buy at that time? No one, and yet, in retrospect, it was a good time to add risk to portfolios. Ditto in the second half of 2011 with the Greek crisis. Same thing. When a dictator brandishes the nuclear threat, the small shareholder sells

	FY 2021	Q1 2022	Close 31/03/22
DOW JONES	18.73%	-4.57%	34 678.35
S&P 500	26.89%	-4.95%	4 530.41
FTSE 100	14.30%	1.78%	7 515.68
EUROST.50	20.99%	-9.21%	3 902.52
CAC 40	28.85%	-6.89%	6 659.87
FTSE MIB	23.00%	-8.50%	25 021.26
MSCI EM	-4.59%	-7.32%	1 141.79
CRUDE OIL	55.01%	33.33%	100.28
GOLD	-3.64%	5.92%	1 937.44
EUR/USD			1.1067
EUR/CHF			1.0212
EUR/GBP			0.8424
EURIBOR 1M			-0.532%

and the experienced investor slowly begins to put some risk back into his portfolios. This Ukrainian affair, completely dramatic from a humanitarian point of view, with more than 4 million refugees, mostly women and children, and martyred cities like Mariupol or Boutcha, nevertheless prompted us at 2PM to question our investment philosophy. It didn't change much after all. We remain firmly convinced of the merits of investing in quality assets over the long term, marginally trimming our positions when the markets are expensive, like before last Christmas, and conversely not hesitating to put a little risk back into portfolios when the markets are low like the end of February, trying to keep a cool head with a long-term vision, polluted as little as possible by market "noise" and short-term epidermal movements.

For European stock markets, on the other hand, this date of February 24 will have been the starting point of a downward acceleration over 8 sessions, causing the Eurostoxx50 index to drop suddenly from 4000 to 3400 points, before bouncing back in turn from 8 March. Thus, while the American stock market gained more than 7% from February 24 to March 31, the European index lost -1.78%. Finally a quite logical evolution if we consider that Europe is in the forefront of this conflict which is taking place on its soil, with potentially extremely damaging consequences for its economy if the Russian president carries out his threat and closes the natural gas taps. But it is the emerging stock market index, the MSCI Emerging Markets, which had started the year so well, which takes the prize for the worst post-Ukraine invasion performance with -5.39% from February 24 to 31 March. The fault is mainly China and its surprising policy of zero Covid which is leading it to confine megalopolises of 25 million inhabitants like Shanghai, with all the consequences that one can imagine in terms of activity.

On the interest rate front, the still extremely strong inflation figures in a context of soaring energy prices and full employment led the US Federal Reserve to toughen up its rhetoric. After a first increase of 25 basis points on March 15, operators expect on average 4 or 5 additional rate increases for 2022 to bring them back to the neutral level of around 2.25%. This was fully reflected in the evolution of two-year bond yields. The two-year-old US Treasury, which offered just 0.5% yield last November, is now yielding 2.5%. 10-year rates also continued to rise, rising from 1.8% on March 1 to 2.60% today. Ditto in Europe, with the yield of the German Bund which rose from -0.07% on 03/01 to 0.64% today. This, coupled with credit spreads which have rather widened, explains the poor performance of our bond allocations since the beginning of the year. Even flexible global managers, who can potentially be relatively short in terms of duration, are struggling with declines of at least 3% since the year began.

It is difficult at this stage of events to decide on the duration that this conflict could have particularly in Donbass, so coveted by the Czar of the Kremlin. It is a safe bet that volatility will remain in place for some time to come, which leads us to maintain a certain degree of caution for the moment on our investments in "risky" assets in our portfolios. Indeed, this Russian-Ukrainian war is not without consequences from an economic point of view. It generates upward pressure on energy prices, having a strong impact on growth and global inflation. Pressure also on food prices, given the importance of Russia and Ukraine in the world of wheat and corn exports. Not to mention disruptions in supply chains. The main risk for us to monitor in the coming months is that of the inflation rate coupled with the global growth rate. The scenario of stagflation (high inflation, very weak growth) has already been mentioned by some economists. To avoid stagflation, Western countries will have to work in cooperation with OPEC+ to avoid the persistence of energy prices that remain too high for too long, which could lead to a stronger than expected global slowdown. And central banks will also need to steer their monetary policies carefully, torn between the need to raise rates significantly to fight inflation while supporting economic growth. This scenario of stagflation is not our central scenario for the time being. On the longer term, this war on our doorstep could also undoubtedly lead to less globalization. This movement began after the 2008 financial crisis, was reinforced with the trade war waged by Donald Trump against China, then with the Covid episode. The risk of a protracted conflict could cause a further decline in world trade as a percentage of GDP, less competition, less productivity gains and therefore ultimately lower global growth. This conflict could also bring a little more geopolitical risk. European sanctions are irremediably pushing Russia towards its Chinese neighbor. Tensions are likely to build up again between the United States and the Middle Kingdom with the Taiwan issue in the crosshairs.

A positive point to note that we will develop in our Grand Angle: this Ukrainian tragedy could give additional impetus to freeing ourselves from dependence on fossil fuels. The European Union plans to be independent from Russian fossil fuels before 2030 with energy saving measures and a greater role for solar, wind…and nuclear. And China, for its part, could, with Russian natural gas at a reduced price, begin to reduce its dependence on coal. The energy transition theme will become a real long-term growth theme for our portfolios.

Last positive point, the foreseeable slowdown in the global economy is probably widely anticipated by global investors, with levels of pessimism equivalent to those of 2008 and the end of 2018. The stock markets have certainly weakened but they have held up, thanks to the deflation of valuations for several months, in Asia and in major growth stocks in particular. Today, global P/Es have mostly normalized, helping to make equities more attractive relative to bonds.

C.Carrafang

The Big Picture

The conflict in Ukraine: an accelerator of the European energy transition

The conflict in Ukraine has highlighted Europe's heavy dependence on Russian oil and natural gas. This dependence, on gas in particular, has accelerated in recent years with the intention of moving away from fossil fuels and nuclear (especially in Germany), because it presents a more measured ecological impact. Faced with this unprecedented situation, and in order to prevent this energy dependence from being used as a geopolitical weapon in the future, Europe must react.

Today, the priority of the European Union is to ensure its energy independence. Indeed, around 45% of European gas imports come from Russia. The European Union can no longer continue to be dependent on a supplier who flouts its values and peace in Europe. But it cannot, as the United States has done, announce a total embargo on Russian gas and oil. This scenario would lead to severe shortages and a new surge in prices.

The war in Ukraine has added additional pressure on energy prices, while for several months, the European continent has already been suffering from a raw materials crisis due to the recovery of post-pandemic economies. Last fall, Europe started the winter season with the lowest gas stocks in a decade. According to Bloomberg, European reserves only had a filling rate of 77%, whereas they are usually around 90% each year. The reason: low gas deliveries precisely from Russia, an increase in Chinese energy demand, and unfavorable climatic conditions for renewable energies.

These various shocks have weakened the European energy context. Each country will have to find alternative solutions to improve their energy mix. France, which structurally can already count on its domestic sources of nuclear energy, has chosen to build new next-generation reactors. But it will take years before the project is validated and put into service. Germany, where dependence on Russian gas is particularly strong, had drawn a line under nuclear power, which is considered a danger for the human species given the risk of accidents, its waste and its treatment. However, a few days after the outbreak of the conflict, Germany reconsidered its choice by announcing a possible use of this source of energy in the near future.

The debate on the use of nuclear power, which is often opposed to renewable energies, is very current today if we think of the European imperatives of a guarantee of electricity supply and carbon neutrality in 2050 - not to mention this recent desire to achieve energy independence. Countries realize that even if nuclear energy cannot be considered as a renewable energy (because uranium, used today for fission, remains a limited resource), it constitutes a complementary and more competitive mode of production. Wind, hydro, solar, biomass or geothermal energy are less expensive in absolute value but include variables, such as not operating 24 hours a day (intermittent energies, not controllable). Comparing one mode of production to another is very complicated. It would be interesting to know the average price of electricity according to the different production methods that make up the energy mix, in a logic of overall planning of the electrical system.

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Macro-economy

An environment of restrictive monetary and unbridled fiscal policies

Macroeconomic indicators should be disturbed by the geopolitical situation in the coming months. Let us list together the uncertainties that the global economy must face, but also the positive points that will support activity.

Uncertainties:

Restrictive monetary policies in 2022 and 2023 in the Western world.
The duration of the conflict between Ukraine and Russia.
The duration of sanctions even if military operations were to stop.
The negative impact of oil and agricultural commodity prices on growth.
When will inflation peak? And at what level will it stabilize?
The management of Covid in China.
The increase in the absolute level of state debts.
Declines in consumer confidence.

Positives:

Low to very low unemployment rates in the developed world.
High savings rates.
The almost total reopening of the European and American economies.
Post Covid recovery plans in progress.
Accelerated investment plans in energy transition and what is new in energy independence (in Europe).
The sharp increase in defense-related investments.
All budget spending announcements in Europe to counter energy price increases.
The amelioration of semiconductor shortages.
Very accommodative monetary policy in China and Japan.
The mechanical reduction in the relative weight of public debts with the increase in inflation.
A priori, there are still enough positive points to ensure a correct level of growth in the coming quarters. The duration of the conflict remains the most determining variable in this equation.Les taux de chômage bas voire très bas dans le monde développé.

D. Liegeois

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Special Topic

The politics of sanctions

Russia's attack on Ukraine took everyone by surprise, but Western reactions were not long in coming; a wave of sanctions swept over Russia and its population. Besides punishing members of the government and those close to Putin, Western politicians, beginning with the US and followed by Europe, have also (prompted by a hefty media campaign) put pressure on Western companies. The latter found themselves urged (forced in some cases) to give up the Russian market overnight. The idea of a boycott of all Russian energy supplies (coal, oil and gas) is even gaining ground, which would be very detrimental to the European economy and companies that will have to change suppliers, thus see their energy bills soar. Some even doubt the real impact on Russian suppliers who have access to easy outlets in Asia and Africa. We are faced with sanctions of American origin which penalize the companies of the old continent the most, by strengthening their American and Asian competitors.

Without waiting for Russia's aggression on Ukraine, Sino-American tensions under the presidency of Donald Trump had already led to economic sanctions against China with reprisals from Chinese leaders. A dangerous protectionist escalation for which American and Chinese companies, especially in technology, had to suddenly change their business practices. As an asset allocator, we were in the habit of retaining political risk at the time of important elections, by measuring the risk of a change of orientation of a new government vis-à-vis economic freedom; risk of nationalization, tax increase... This risk has always been greater in emerging countries, where entrepreneurial freedom was more likely to be restricted. This is no longer the case, even companies in so-called developed countries can now suffer the consequences of sudden political decisions.

The policy of systematic sanctions which often replaces or is the prelude to military interventions has become widespread. The idea is to economically weaken an enemy to force him to give in or push the people to change leaders. In recent years, these policies have multiplied: North Korea, Sudan, Venezuela, Iran, China. They are mostly initiated by American politicians, but have only caused economic distress for the people in question (excluding China), without the leaders of the countries concerned having been led to give up their place. This has often led to strengthening their determination and their grip on the population and sometimes, even internally, to strengthening the feeling of national cohesion.

For companies and their managers, how can a group's activities be serenely weighed outside national borders? Is de-globalization the answer, or are we underestimating the capacity and flexibility of our companies to withstand these shocks, as they managed to do perfectly during the health crisis?

For the investors that we are, how do we integrate this risk in the choice of securities, how to integrate essentially short-term political elements in allocation decisions? The answer is perfectly in line with our traditional investment method, namely geographical diversification of portfolios.

D. Liegeois

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In conclusion, a new energy mix must emerge and the European Commission has proposed a new plan, called REPowerEU, which aims to:

- *Diversify gas supply sources by increasing imports of liquefied natural gas (LNG), but this will require the construction of additional terminals.*
- *Accelerate the installation of electrical capacity of both solar and wind origin and reduce the time required to obtain permits (from 30 months on average to 12 months).*
- *Decarbonize the industry by accelerating the transition to electrification and renewable hydrogen.*
- *Develop infrastructures around green hydrogen produced from "green" electricity (neither gas nor coal, but nuclear, solar and wind power).*

Many investments will have to be deployed in order for Europe to disengage from its close energy ties with Russia. The renewable energy sector should fully benefit. After having been neglected by investors since November 2021 – in question, the rise in interest rates as well as the rise in inflation of raw materials – it has experienced a strong rebound since the appearance of the conflict and the various energy announcements from European decision-makers. This is a theme that is part of our convictions for the years to come.

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