2pm PERSONALIZED PORTFOLIO MANAGEMENT

Quarterly marketreview

JANUARY 2022

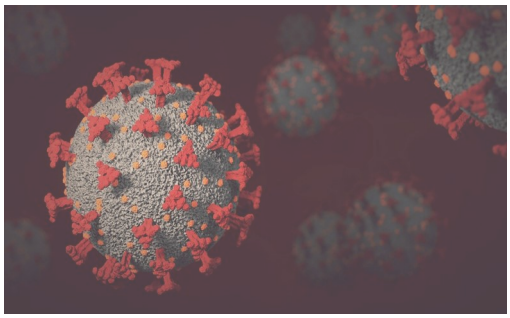
Editorial

Betting on the equity markets in 2021 was a must: the Eurostoxx50 rose by 20.99% and the CAC 40 soared by almost 30%, its best annual performance since 1999, despite the procrastination linked to Covid and its variants, the setbacks of Evergrande in China, and concerns related to the return of inflation. Driven by the strong recovery in activity since the first confinement, the Parisian index is evolving at its highest level ever, like Wall Street. By 2021, the S&P 500 will have erased seventy times its highest mark on Wall Street, ending the year at 4,766.18.

This presumptuous state of affairs enabled the Stock Exchange to fulfill its mission once again truly. Namely, the financing of the growth of companies - through a record number of introductions - and the enhancement of their performance - from which technological stocks have fully benefited, of course, but also other sectors such as luxury goods, for example.

In the United States alone, more than 480 companies have gone public and trading volume broke the 2020 record of $165 billion. And the pipeline of new IPOs already looks well supplied for 2022. Ditto for mergers and acquisitions which reached a record volume of $5 trillion in 2021 (including 1.2 trillion private equity deals which have doubled from year 2020).

Aside from emerging markets, down -4.59% over the year, and Japan, posting a modest +4.91%, other stock markets have grown by more than 20% this year (see table opposite).



And all this despite a virus that is playing havoc with us, as evidenced by the recent explosion of contaminations with this extremely contagious Omicron variant, but fortunately much less lethal than the previous Delta variant. Hospitalizations are far from following the same exponential trend as contaminations and operators seem to be betting on the erosion of the virulence of the pandemic, expecting in 2022 measures limiting economic activity more moderate than in 2020 and 2021. With therefore a lower impact on growth. Thus, even if Covid will undoubtedly not disappear overnight (which will lead us to learn to live with it), the increase in the levels of inflation in the world will certainly constitute in the coming months. main concern for investors.

Is inflation going to fall again in 2022 as the central bankers predicted or, on the contrary, set in for a long time? The answer to this question is not straightforward since some trends observed over the past year are likely to be transitory, while others may well turn into more structural headwinds. Thus, the strong demand for certain goods and services driven by the reopening of economies after the lockdowns is a transitory phenomenon, like the bottlenecks in certain supply chains. On the other hand, the rise in wages linked to the scarcity of human capital, in the United States in particular (see our Special Topic, page 4) or proactive policies relating to climate change could adversely constitute persistent drivers of inflation.

In the second half of 2021, investors took in an increased likelihood of rising interest rates. Rapidly rising inflation figures in the United States and Europe have fueled these expectations and reminded us that policy rates remain the primary tool of a country's monetary authorities. The gradual withdrawal of accommodative monetary measures will also force central bankers to perform a rather delicate tightrope walk exercise, in particular for the FED, whose credibility will be regularly tested by the market. Operators will assess in the coming months the US Federal Reserve in compliance with its commitments and in particular those of its new, more flexible inflation targeting framework if prices were to continue to rise. One thing is certain: the era of ultra-accommodative monetary policies is drawing to a close. We expect interest rates to rise in

	Q4 2021	FY 2021	Close 31/12/21
DOW JONES	7.37%	18.73%	36 338.30
S&P 500	10.65%	26.89%	4 766.18
FTSE 100	4.21%	14.30%	7 384.54
EUROST.50	6.18%	20.99%	4 298.41
CAC 40	9.71%	28.85%	7 153.03
FTSE MIB	6.47%	23.00%	27 346.83
MSCI EM	-1.68%	-4.59%	1 232.01
CRUDE OIL	0.24%	55.01%	75.21
GOLD	4.11%	-3.64%	1 829.20
EUR/USD			1.1370
EUR/CHF			1.0375
EUR/GBP			0.8413
EURIBOR 1M			-0.583%

the United States in 2022 (three increases of 25 bp) but as long as we remain in a context of historically low or even negative real rates, equity markets should not normally be too weakened. A negative shock to bonds, then stocks, would only occur if central banks changed their view of long-term equilibrium rates. If, for example, new data led the Fed to consider that its final key rate should not be 2.5%, but something higher, long-term rates could therefore significantly exceed the levels observed in the market over the last two years, which could have an unfavorable effect on equity market valuations.

But that is not our principal scenario at the moment. We want to believe that inflation will be transient, although high levels may still persist in 2022. Therefore, a rise in US short rates of 75 or even 100bp in 2022 would not necessarily be catastrophic for equity investments. History has shown us that a slight rate hike coupled with a slight slowdown in earnings growth in the equity sector does not necessarily equate to declining stock markets. What is more, in this post-Covid cycle that concerns us, the continuation of the economic recovery (we expect 4.2% GDP growth in Europe for 2022 and a little less than 3% in 2023, i.e. levels much higher than those observed over the past ten years), technological innovation linked to climate change and the reorientation of supply chains should constitute support elements for the stock markets for some time to come. Finally, a last element militates for a monetary tightening measured in 2022-2023. It is linked to the growth in public and

private debt, which together reached a record high of $296 trillion last year, or more than 350% of global GDP, according to the Institute of International Finance. Fighting inflation at all costs, as Paul Volker did at the head of the FED forty years ago, is not really a realistic option in 2022. Allowing refinancing costs to rise too much would risk generating a wave of bankruptcies likely to depress economic growth and make the conditions for debt reduction even more difficult, although it should be noted that at the corporate level, the net debt/EBITDA ratio has returned to 2015 levels.

That being said, we are entering the year with an even greater degree of vigilance than that which prevailed at the start of last year. Indeed, even if we remain constructive on the equity markets for 2022, the world stock markets could turn out to be significantly more volatile this year due to a certain number of clouds which have accumulated on the horizon, and it will be necessary to keep a microscopic eye on it. Starting with the level of valuations. Aside from the emerging markets, including China, and Japan, the equity markets are now historically expensive, in particular the US stock market, whose current P/E is 26.33 for 2021 and 22.91 for 2022. Total market capitalization of the United States has gone from 130% of GDP at the end of 2018 to 200% of GDP today. And the weight of equities as a percentage of total US household assets reached a record level of 41.5% against previous highs of 32.8% in 2007 and 38.2% in 2000. At these valuation levels, any bad surprise like more extensive than expected monetary tightening could lead to significant withdrawals on the part of operators. Note, however, that Europe is still paying less than the United States with a P/E of 19.13 this year and 15.55 for next year. This is the area we favor for 2022 in our portfolios.

Among other risks, could be the possibility of a bank or corporate credit crunch, the continued rise in commodities which could lead to a more severe economic slowdown in a context of tightening monetary policy or even a shock of volatility generated by an exogenous event which would have to be found in the geopolitical sphere, in a world subject to multiple tensions. Among them, the risk of an armed conflict in the Ukraine, a possible failure of Iranian nuclear negotiations, US-Russian tensions, the threat of Chinese intervention in Taiwan… and the list could go on.

In this context, we will pay more attention than ever to the quality and liquidity of the assets in our portfolios. Diversification will remain a key element of performance. First of all, stylistic diversification, with a tendency for us this year to slightly increase the share of value style in our allocations to the detriment of growth style, which could be more impacted by rate hikes. Geographical diversification then, with a benevolent gaze on the cheapest territories (Asia, Japan, China), areas that could do relatively well in 2022. Finally, thematic diversification with an increased interest in ESG investments which should benefit from the massive plans implemented by the United States and Europe to accelerate the shift towards a carbon-free economy in the coming years.

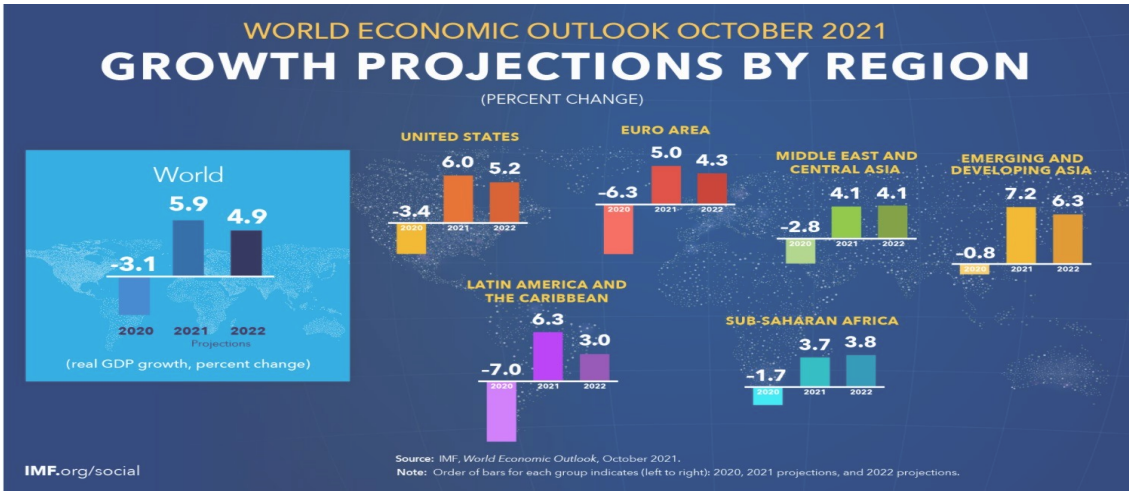
Christophe Carrafang

S&P500 INDEX OVER THE LAST 5 YEARS

Macro-economy

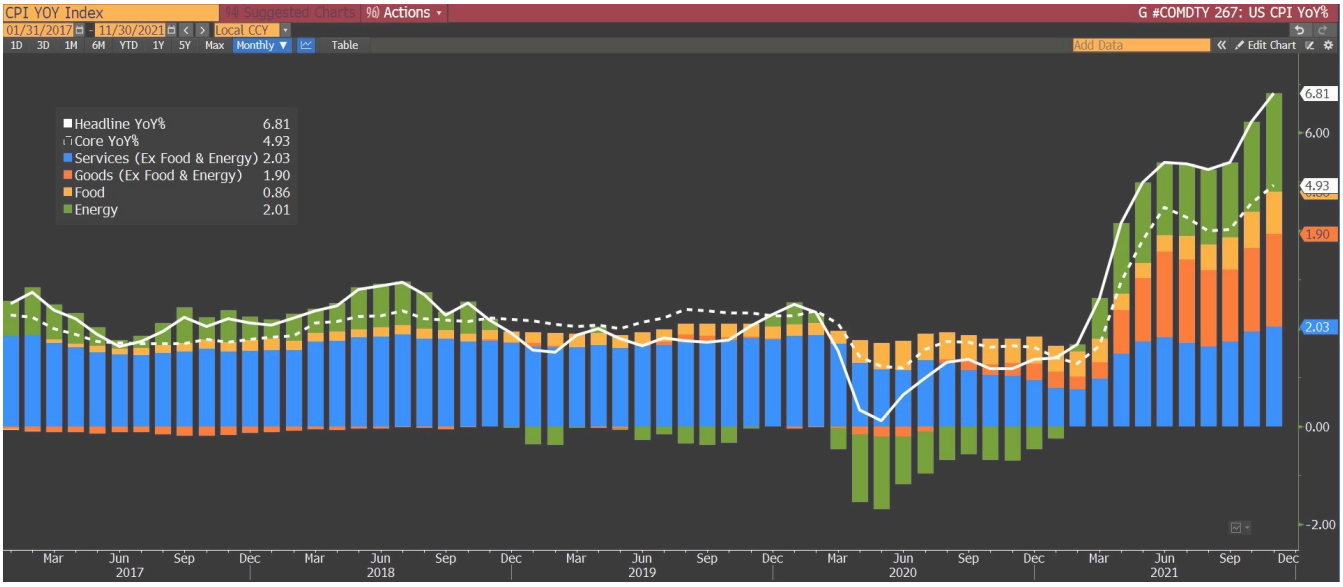
Growth projections 2021-2022

- The economic recovery will continue in 2022, growth in developed countries will remain above the average of the last decade.
- We now know that the negative effects of the latest restrictions should quickly be offset as soon as the Omicron wave has passed.



Inflation: the indicator mostly observed

- Inflation in the United States accelerated further at the end of the year to +6.8%, +4.9% if the cyclical elements are removed.
- In the illustration below, we note that this acceleration is mainly due to the prices of energy and manufactured goods.
- For the moment, the evolution of the price of services is relatively stable.
- This situation is comparable in Europe with an inflation rate for the month of November at +4.9% (+2.6% for the core index).
- In China, on the other hand, inflation remains contained at +2.3%, which will allow authorities to implement a less restrictive mo netary policy in 2022.



December 2021

- The services activity declined everywhere at the end of the year, disrupted by the latest restrictions and contraints linked to the umpteenth wave of Covid. Germany, the only major country below level 50, plummets the European indicator in December (53.1).
- Manufacturing activity, despite shortages, remains positive. The producer price component will be particularly monitored over the coming months. The overall indicator has remained very stable since last summer (54.2).

Damien Liegeois

Special Topic

USA: Human capital

It is common to say that no crisis is the same, because certainly the causes differ, but the consequences are often the same. So, if we refer to the last American recessions, after the crisis the consumer is often in debt, he experiences a high level of unemployment, he can forget about wage increases and therefore remains clinging to his job. Generally also the value of his assets has fallen (portfolio + real estate) and will take time to recover.

The current crisis is special. A little over a year after the shock of the shutdown of the world economy due to the health crisis and in the midst of yet another wave of Covid, American households (European consumers are in a relatively comparable situation) are in a particularly favorable environment, despite the rather negative opinion polls synonymous with a more political than material skepticism.

Job creation is at its highest, and the number of job openings in companies, at 11 million, is much higher than the number of job seekers: 1.7 million. The job search is not a problem, and on the contrary the ability to negotiate is on the side of the employees.

Unlike other recessions, on the financial side, debt to disposable income has never been lower. The savings rate as a result of the massive aid incentives and consumption constraints is 7%, which corresponds to a massive savings excess of $2 trillion. Ultimately, very sensitive to the value of assets, the wealth effect is in full swing, with stock market indexes at their highest as well as favorable property prices.

One of the unintended consequences of this financial comfort and the desire for a change of life after months of confinement/ restrictions, is that the number of people who have retired prematurely is much higher than the trend observed in recent years: 2.4 million Americans have made this choice in recent months, a record in such a short space of time..

These elements are obviously positive for an economy which depends 70% on household consumption, but this could pose serious problems in the medium term. Indeed, this is starting to create the scarcity of an asset fundamental to the economy: human capital. This scarcity generates a sharp rise in wages, particularly in the least qualified jobs and in sectors where arduousness and working hours are less and less accepted. While waiting for the partial robotization of certain sectors such as restaurants and transport, the pressure on wages and prices could continue and add weight on the economy.

To encourage these inactive people to re-enter the labor market, stopping aid related to the health situation is a step in the right direction, but it will not necessarily be sufficient. It would either require another recession, unlikely in the short term, or a new wave of immigration, which remains politically complex in an America that has never been so divided on the subject.

In the meantime, this shortage will probably take longer to resolve than those of semiconductors and certain raw materials.

Damien Liegeois

FED FUNDS TARGET RATE PROJECTIONS