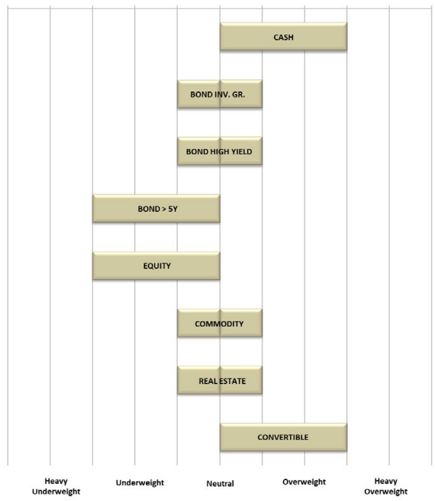
Early 2023 will bring economic slowdown and inflation

This year will be crucial in assessing the extent of the economic slowdown and at what levels inflation will stabilise. These uncertainties could destabilise markets further in 2023, so it may be worthwhile starting the year with a defensive positioning, although not divested.

ASSET ALLOCATION



- Retain a large percentage in **CASH** in order to benefit from any market volatility.
- After the recent further levelling out (or inversion in dollars) of interest rate curves, we remain overweight on the medium/short end of the **GOVERNMENT and CORPORATE INVESTMENT-GRADE BOND** curves, but underweight on the long end.
- The **HIGH YIELD BONDS** sector offers attractive returns, but, given the uncertain macro context, we prefer to avoid significant exposures.
- We remain cautious regarding **EQUITIES** due to the combination of economic slowdown and inflation remaining high.
- **COMMODITIES** are supported by the positive cycle of public investments and geopolitical risks, but we remain neutral due to high volatility. Gold is attractive in view of a macro slowdown, but we are neutral due to interest rate rises.
- We are neutral again when it comes to **REAL ESTATE** as rising interest rates have largely been factored into prices.
- **CONVERTIBLE BONDS** are a valid means of exposure to the equities market, with greater downside protection.

MACRO VIEW

The latest Manufacturing PMIs for 2022 confirm the deceleration of global economic growth. Weakening at the level of services also continues, although not uniformly as some sectors (tourism in particular) remain in the post-pandemic recovery phase. The situation in terms of inflation is quite complex. The 2023 data will be essential to understanding how this variable will affect the markets. From a long-term perspective, the (first?) cycle of rising inflation appears to have reached its peak.

FIXED INCOME

Following sharp rises in interest rates in August and September, the last few months of 2022 were marked by a reduction in rates and levelling out of curves. The fall in nominal yields was accompanied by a decline in breakeven rates and real rates. The main reasons for these are diminished fears regarding inflation and growing fears of a recession, with the awarenes that the central banks will bring policy rates back to a more neutral level in the medium term. A strong pursuit of yield was also noted which favoured narrowing credit spreads, particularly in relation to the high yield component and subordinated issues.

FX VIEW

The final months of 2022 were characterised by a generalised fall in the dollar, attributable to the confirmation that the US inflation peak has passed, while the Federal Reserve's statements seem to indicate a slowdown in the rate of rises. At the same time, the Euro recovered, supported by declarations from ECB members determined to continue with the interest rate rises. As a result, there was a restriction of the US and EU rate differential which supported the EUR-USD exchange rate. The Swiss franc remains strong, with the EUR-CHF exchange rate remaining below parity. In Asia, the fragility of the Chinese economy has weakened the Yuan, while the Japanese Yen has started to regain value.

EQUITY MARKETS

With the recovery in October and November, the equity markets limited the damage in 2022, albeit with marked differences between sectors and styles, with value clearly winning over growth (hence the under-performance of the Nasdaq). We consider this a bear market rally, as we expect further volatility in the equity markets in 2023. However, the extent of any weakness will primarily be determined by the scale of the likely global recession. This could be avoided or mitigated if China proceeds quickly and resolutely with its easing of pandemic containment measures.

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