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»FischView

Monthly Update – January 2022

As at 4 January 2022

Summary: Business as usual

- **Global economic growth is robust, although a slight slowdown seems likely over the course of the year due to more restrictive monetary policy**
- **China is stabilising the real estate sector and the economy, but major uncertainties remain due to a possible strong omicron wave there as well.**
- **Inflation is likely to decline globally soon, but in the long run we expect it to stabilise well above central banks' 2% target.**
- **Currently we do not see any danger of stagflation.**
- **Long-term interest rates are rising worldwide. However, the development will be moderate due to declining inflation over the course of the year, low inflation expectations and a more restrictive monetary policy.**
- **Equity markets still have potential in the short term, but in the medium term various factors will have a dampening effect. The risk/reward ratio is thus declining, but we do not expect a major downturn.**
- **The US dollar appears stable in the short term, but in the longer term potentially negative factors will have an impact. We see moderate upside potential for industrial metals and oil.**

Significant changes compared to the previous month

- The global economy remains robust. The fast-spreading Covid-19 Omicron wave is increasing the immunisation of the population, and could thus accelerate the end of the pandemic.
- Global supply chain problems are moderating. To some extent, scarce goods and commodities are being substituted. Falling freight rate indices (Baltic Dry Index, Harpex/RWI) confirm this easing.
- However, the development in China remains uncertain. The economy and the real estate market are showing first signs of stabilisation due to loosened monetary policy. However, inefficient vaccines threaten a massive omicron wave and comprehensive lockdowns of the economy. This would also have strong negative effects globally. For the moment, however, the situation still appears under control.
- Monetary policy is becoming more restrictive worldwide. In January, around USD 50 billion less money will flow into the financial system from the QE/PEPP programmes compared to the fourth quarter of 2021, and further large reductions in liquidity injections

will follow in February and March. In addition, the first hikes in key interest rates are likely to follow in the US. This monetary tightening will most likely have a dampening effect on stock markets and the economy in the medium term. However, central banks have so far communicated skillfully, and much is already priced in. Therefore, particularly after the recent hints in the Fed minutes of a slightly stronger-than-expected tightening, major negative surprises are unlikely.

— Inflation is likely to peak soon due to lower energy prices, a rising labour force participation rate and base effects. The tighter monetary policy is also dampening inflation expectations, which are already only moderate, and preventing dangerous second-round effects.
— Long-term interest rates are in a moderate upward trend that is likely to continue for the time being. A resulting slightly steeper yield curve in 2-year vs. 10-year yields signals solid economic development, while a tendency to flatten in the 10 vs. 30-year range is a signal of clearly limited inflation expectations and high confidence in monetary stability.

Current situation and positioning

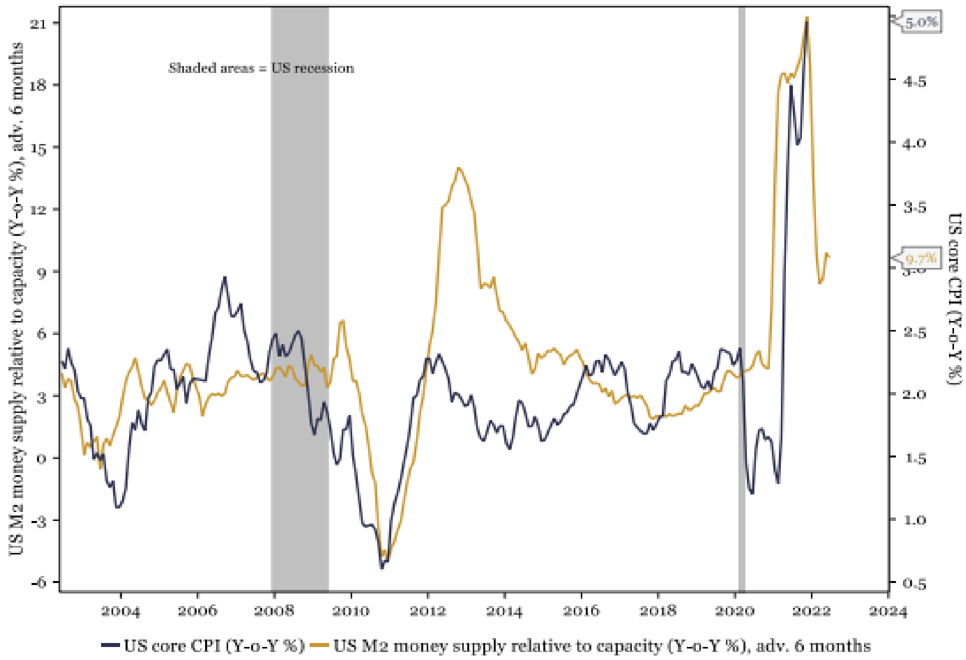
— The global economy continues to perform very well. After a temporary slight slowdown in recent months, it currently looks like a moderate acceleration is under way. In the US, current estimates (GDPNow) by the US Federal Reserve indicate growth of around 7%. This is well above consensus expectations of 6% due to a number of positive factors (labour market, consumer sentiment, high cash holdings of private households, loose monetary policy for the time being and government infrastructure programmes). In our macro model, the global business cycle is in phase B (i.e. better economic activity and simultaneously rising interest rates).
— Long-term interest rates are rising worldwide. However, this rise is likely to remain moderate and controlled in the coming months due to moderate inflation expectations and the deflationary effects of tighter monetary policy. The tighter monetary policy is also likely to lead to an increase in real interest rates, which would be negative for the gold price.
— We assume that inflation has passed its short-term peak and may quickly fall into the central banks' 2% target range (see also chart below in the section "Topics on the radar"). However, the so-called 3D factors are at work in the medium-to-long term: deglobalisation, decarbonisation and demographics. The first two factors directly lead to higher production costs. Demographic factors are also already causing a decline in the working-age population, resulting in labour and skills shortages. This will ensure noticeable wage pressure in the medium term. The 3D factors are therefore likely to keep the inflation level in the range of 3% to 3.5% in the longer term, and thus above the central bank targets.
— Nevertheless, we do not expect stagflation, which would be the worst-case scenario, for the time being. Economic growth is too robust for that and inflation is still too well under control in the short term, despite the 3D factors.
— "TINA" (There Is No Alternative) continues to apply to equity markets, as low interest rates and prevailing high inflation levels make holding cash unattractive. As the year progresses, however, tighter monetary policy, temporarily falling inflation, high valuations and rising interest rates are likely to dampen stock markets. A similar situation can be expected in corporate bond markets. However, a pronounced bear market is unlikely at the moment. Nevertheless, the risk/reward ratio will thus decrease significantly. We also expect strong

sector rotations, especially if the Omicron wave results in a high level of herd immunity in the population, and thus an early end to the pandemic.

— The Chinese central bank intervenes in favour of the US dollar: This should dampen the yuan's nascent strength, while the euro is likely to remain weak for the time being due to the relatively loose monetary policy of the ECB vis-à-vis the Fed. In the medium term, however, a strongly negative trade balance in the US, lower purchasing power parity and falling energy prices will have a negative effect on the US dollar.

Topics “on the radar”

Chart: Inflation at its peak



Source Longview Research

The chart shows US core inflation (black line) compared to US money supply dynamics (=money supply M2 in relation to the maximum production capacity of the US economy). A stable lead time of the money supply dynamics to the inflation trend is clearly visible.

Accordingly, a decline in inflation is to be expected soon in the US, but also worldwide. This expectation is currently also confirmed by the flattening of the US yield curve at the long end (difference between 10- and 30-year interest rates). This development could also create somewhat more leeway for central banks in the further course of the year and reduce the pressure to raise interest rates excessively.

However, due to the aforementioned 3D structural factors, inflation is expected to stabilise in the range of 3% to 3.5% in the medium term, and thus well above central banks' 2% target.

Summary of *FischView* model outputs

	US	Europe	Japan	Asia ex-Japan	LatAm	CEEMEA
Equities	+ ↑	+ ↑	+ ↑	o	o	o
Government Bonds	- ↓	- ↓	- ↓			
Credit IG	o	o ↓		o	o	o
Credit HY	o	+ ↑		+	+	+
Convertibles	o	o	o	- ↓		

Commodities	Energy	+	PrecMet	o ↓	InduMet	+

Key:

++	Strong positive
+	Positive
o	Neutral
-	Negative
--	Strong negative

Notes regarding the table: Changes from prior month are indicated with ↓ or ↑. i.e. "O ↓" means that the output has weakened from a prior value of + or ++.
The methodology for calculating model outputs, and how the various pieces fit together to form the big picture, is explained **here**.
Within government bonds, we consider the most important bonds for each region, e.g. German Bunds in Europe, and a representative group of countries for Latin America, Asia ex-Japan and CEEMEA (Central and Eastern Europe, Middle East and Africa).

Cross asset class preferences

This table combines top-down views with bottom-up analysis at the portfolio level.

	Most preferred	Least preferred
Convertible Bonds	– Recovery names – Growth at a reasonable price (GAARP) – Stocks related to electrification of economy	– Expensive growth
Global IG Corporates	– Financials – Spread duration 5 years – “Rising Stars”	– Real estate, capital goods – Spread duration > 15
Global Corporates	– Financials, healthcare – Spread duration 5 years – “Rising Stars”	– Real estate, telecoms – Spread duration > 15 – Emerging markets
Global High Yield	– ‘B’ rating segment – Telecoms – Basic industry – Energy	– Banking – Transportation
Emerging Market Corporates -Defensive	– Indonesia	– Singapore – Taiwan
Emerging Market Corporates - Opportunistic	– High yield commodities – LatAm – Sub-Sahara Africa	– Bahrain – Qatar

Note: Preferred sectors/regions may differ between asset classes owing to respective performance drivers. In particular, equity exposure is the key performance driver for convertible bonds and is not relevant for corporate bonds.

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