# HOUSE VIEWS

## DECEMBER 2022

## SEEKING RETURNS IN AN UNCERTAIN WORLD

**Developed economies now look firmly set to slow in 2023.** Inflation continues to erode household purchasing power and rising interest rates are weighting on property markets and corporate investment. On top of which Europe continues to feel the effects of the energy crisis. These headwinds, though, are still partly offset by support factors that limit the risk of an overly sharp slowdown. Household and company finances remain generally solid, with substantial savings and labour markets going from strength to strength. In the euro area, supportive fiscal measures have eased the impact of the energy crisis for companies and the hardest hit households. What is more, ongoing doubts around China's zero Covid policy have helped keep oil prices at moderate levels.

**Central banks are watchful.** Inflation looks to have peaked in the United States and euro area and will fall off steeply in 2023 as the initial surge in energy and durable goods prices comes out of the comparison base. However, these base effects aside, core inflation may take time to follow suit as pressures feed through to salaries and service prices. Central banks will continue to tighten policy in the short term before calling a halt. They are likely to stick to their hawkish tone until sure that inflation has been brought back to near target for the long term.

**Quest for yield.** We retain the broadly cautious tone of our investment strategy and our global equities Underweight. However, we feel the risk of an extreme scenario has receded, leading us to raise exposure in certain markets. For instance, we have increased exposure to high-rated corporate debt to cash in on the higher interest rate environment. We have also added exposure to the euro zone equity market, to play its bias toward rate-insensitive sectors. At the same time, we are slightly Overweighting the euro against the dollar and cutting back our exposure to hedge funds.

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Unless specified, all figures and statistics in this report are from Bloomberg and Macrobond on 02/12/2022, publication completion date.

SOCIETE GENERALE
Private Banking

# OUR STRONGEST CONVICTIONS

## Inflation will only gradually decline, prompting central banks to maintain restrictive financial conditions

Inflation is expected to fall sharply in 2023 due to favourable base effects. However, core inflation will take time to moderate, especially as tensions continue to spread. Central banks will continue to raise their key rates until the first quarter before taking a long pause. While these tightening's already seem to be largely integrated by the markets, further adjustments could occur in Europe on the side of central banks' balance sheet policies.

## Rising interest rates make different types of bonds attractive

The tightening of central banks seems to have been largely taken on board by the bond markets, which have attractive interest rates, including in real terms. We are now Overweight to the Investment Grade corporate debt and US government bonds. In Europe, on the other hand, further adjustments could occur in long-term rates, prompting us to remain neutral on government bonds.

## The economic slowdown is confirmed, but moderating factors contain the risk of an excessive recession

High inflation and central bank tightening are hurting economic activity in the developed economies. However, there are elements that moderate these effects and reduce the risk of an excessive recession.

## Slight reduction in our caution

We remain cautious in our allocation. However, we believe that the risk of an overly adverse scenario has decreased, prompting us to increase our exposure to certain markets. We are therefore slightly increasing our exposure to the euro area equity market, due to its predominance of sectors that are not very sensitive to rising interest rates and attractive yields. At the same time, we are slightly overweight the euro against the dollar.

# OUR ASSET ALLOCATION

The table below presents the latest conclusions of our Global Investment Committee (GIC)

**Summary house views**

| | | | UW | Slight UW | N | Slight OW | OW | Variation since last GIC |
|---|---|---|---|---|---|---|---|---|
| EQUITY | | GLOBAL EQUITY | | ■ | | | | = |
| | | United States | | ■ | | | | = |
| | | Euro area | | | ■ | | | + |
| | | United Kingdom | | | ■ | | | = |
| | | Japan | | ■ | | | | = |
| | | Emerging | | ■ | | | | = |
| FIXED INCOME | SOVEREIGN | GLOBAL RATES | | | ■ | | | = |
| | | U.S. Treasuries | | | | ■ | | = |
| | | Bunds | | | ■ | | | = |
| | | Gilts | | | ■ | | | = |
| | | EM Govies ($) | | ■ | | | | = |
| | CORPORATE | U.S. IG | | | | ■ | | + |
| | | U.S HY | | ■ | | | | = |
| | | EMU IG | | | | ■ | | + |
| | | EMU HY | | ■ | | | | = |
| | | U.K. IG | | | ■ | | | = |
| FOREX | | EURUSD | | | | ■ | | + |
| | | USDJPY | | | | ■ | | = |
| | | GBPUSD | | | ■ | | | = |
| | | EURCHF | | ■ | | | | = |
| ALT. | | Brent | | ■ | | | | = |
| | | Gold | | | | ■ | | = |
| | | Hedge funds | | ■ | | | | - |

# ECONOMIC OUTLOOK

## Central banks remain vigilant despite peak inflation

**The slowdown in activity is confirmed, with a risk of recession (particularly in Europe) in the coming months. However, the shock absorbers will help to avoid too sharp a slowdown. Inflation is expected to decline in 2023, but underlying tensions will remain high, prompting central banks to exercise caution.**

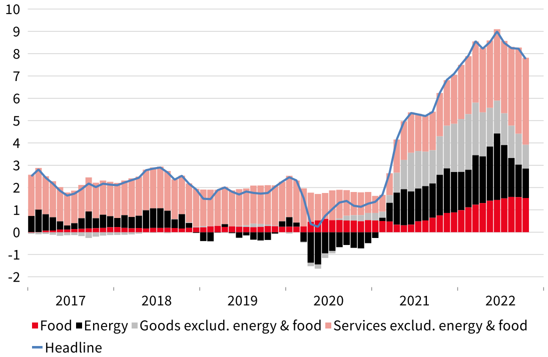
**Economic activity: negative factors moderated by shock absorbers.** Activity will continue to slow down due to high inflation, rising interest rates and the energy crisis in Europe. These negative forces remain partly counterbalanced by supporting factors, notably the generally favourable financial situations of households and companies, labour markets that remain dynamic, and fiscal policies that remain accommodating in the euro zone.

**Central banks' vigilance in the face of falling inflation.** Inflation may have passed its peak, both in the United States and in Europe. It will fall sharply in 2023 due to favourable base effects on energy and durable goods prices, with the normalization of production chains and a decrease in goods consumption in favour of services. However, underlying inflation will take time to decline, illustrating the continued spread of pressures. These findings will encourage central banks to maintain a firm stance in their fight against inflation, even if they will gradually moderate the speed of their tightening. Financial markets expect the Federal Reserve to raise its key rate to the upper limit of 5% in the first quarter of 2023, while the ECB could raise its rate to 2.75% (deposit rate). In terms of "unconventional" policies, the Federal Reserve will continue its gradual reduction of its balance sheet, while the ECB could begin its own in the first half of the year. In the absence of a sharp recession or significant financial turbulence, the central banks will then stabilize their policies until they have confirmation that inflationary pressures are easing. A lesser sensitivity of economic actors to monetary tightening could encourage central banks to maintain a more restrictive tone for longer.

**Heterogeneity in emerging economies.** Uncertainty remains high for the Chinese economy, due to the complicated exit from the zero-COVID measures and the persistent difficulties of its real estate market. Outside of China, very different situations will persist, depending on the ability of the authorities to manage rising inflation.

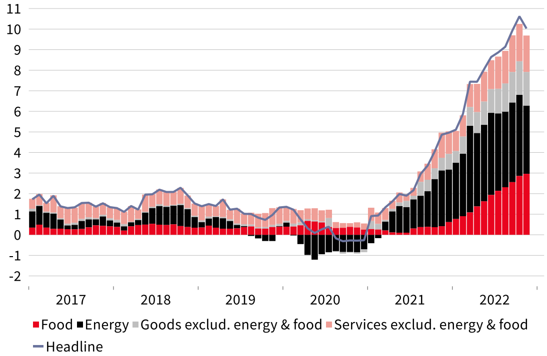
### Inflation rates

**United States: inflation and components**




Sources: SGPB, Macrobond, Eurostat, BLS 10/2022

**Euro area: inflation and components**




Sources: SGPB, Macrobond, Eurostat, BLS 11/2022

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# EQUITIES

## Modestly increasing our exposure to European markets

**In a still uncertain environment, we remain generally cautious on equity markets. This mainly takes the form of an overall Overweight position on equities and a preference for defensive and value styles. Risks remain high but we consider markets have now priced in the likely recession, at least in the euro area. We have taken advantage of this to slightly reduce our cautious stance.**

**United States.** We remain Underweight United States equities. US stock market indices continued their October rallies in November, helped by good inflation figures and broadly accommodative statements from Federal Reserve chairs. However, we think substantial risks continue to overshadow US equity markets. The consensus expects the United States economy to grow 0.4% in 2023, but risks are mainly on the downside and corporate earnings are showing the first signs of slowing. We have therefore opted to remain cautious.

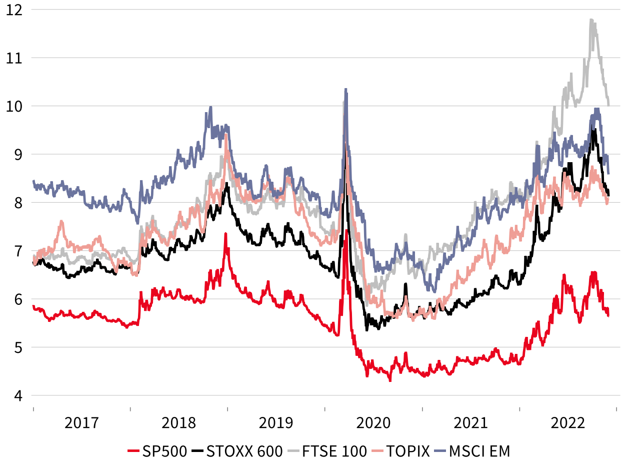
**Euro area.** We are moving to Neutral on euro area equities. The euro area indices did well during the recent rally. In fact the area's market has actually outperformed the United States' over the full year. The consensus projections now see a moderate recession in 2023 and latest data for underlying inflation suggest pressures continue to run high. Also, the Ukraine war remains profoundly uncertain. Having said all that, European economies today are proving remarkably resilient, as evidenced by the recent upgrades to German and Italian Q3 growth. We think this resilience could well persist and force markets to upgrade their earnings estimates for 2023. We are therefore increasing our exposure to euro zone equity markets.

**United Kingdom.** We remain Neutral on British equities. The UK stock market has outperformed all other developed economies in 2022, thanks to its focus on energy and commodities sectors, vindicating our decision to retain a relatively high weighting. While recent political disruption and the easing of pressure on commodity markets have not been good for UK equity indices, the market has still managed to put on nearly 9% so far in Q4. Also, investors are now nearly unanimous in expecting the UK to slip into recession in 2023, which puts a floor under risks of revenues disappointing. We therefore maintain our exposure to this market.

**Japan.** We remain at Underweight on Japanese equities. Revenues from overseas investments remain strong and show no sign of flagging, underlining Japanese companies' ability to ride out the contraction in activity. The yen is likely to remain weak against the euro, however, which leads us to remain cautious about putting money into the Japanese market.

**Emerging markets.** We remain at Underweight on emerging equities. The spike in deaths linked to coronavirus has dashed hopes of any imminent end to the Chinese government's "zero-Covid" policy. EMs remain heavily reliant on Chinese growth, which is unlikely to recover its pre-2010 trend. Emerging market currencies have been further weakened by the Fed's monetary policy tightening. We therefore remain prudent.

**Equity earnings yield (Earnings per Share/Share Price)**




Sources: SGPB, Macrobond, MSCI 30/11/2022

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# FIXED INCOME

## Taking the positive real yield

**We remain Overweight on US government bonds in an environment of deteriorating global growth and positive real rates. We remain Neutral on European sovereign debt given the still high inflation. We are Overweight on highly rated corporate bonds in a search for yield.**

## Rates

**US.** After a period of sustained increases, Treasury yields edged back last month. The 10-year yield fell to 3.7% by end-November from 4.2% in mid-October. The main reason was confirmation that headline and core inflation have indeed peaked over the autumn and are now likely on a slow downward track. This pressure-drop in inflation should give the Fed leeway to relax the pace of its rate hikes, tightening by "just" 50 bp in December to a terminal rate of 5%, expected some time in Q1 2023. Fears of a sharp slump in the US and global economies have also helped drive yields down. We, however, think underlying inflation will take time to diminish, leading the Fed to keep a tight rein on financing conditions throughout much of 2023. Against this backdrop and given the Fed's determination to keep real rates positive across the whole curve we are maintaining our Underweight to Treasuries.

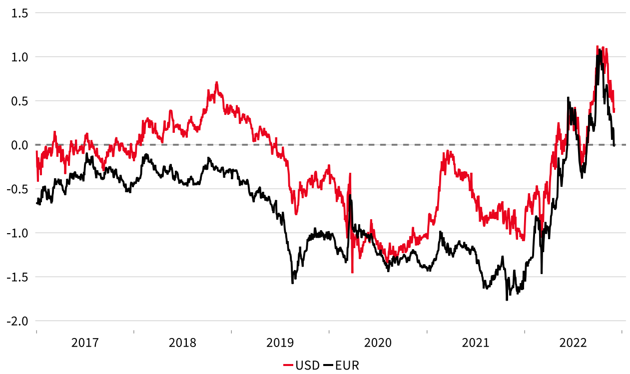
**Euro area.** Euro area sovereign debt yields also declined in November. The Bund 10Y dropped from 2.5% to 1.9% and the OAT 10Y from 3% to 2.4%. The story was similar in peripheral sovereign markets, with Italian 10-year BTP yields down to 3.8% narrowing the spread to the bund to 190 bp compared to 250 bp in September. As in the United States, this is being driven by a better outlook for inflation as energy prices come down. In Europe, natural gas prices have dropped nearly 60% from their summer peak with reserves now at all-time highs and the weather remaining unseasonably mild. The resulting dip in inflation should allow the ECB to slow the pace of its rate hikes, with a 50 bp rise expected in December and a terminal deposit rate of 2.75% some time in 2023. We are maintaining our Neutral stance on European sovereign bonds. Underlying inflation shows no sign of topping out yet and energy risks remain high, increasing the risk the ECB may tighten policy more sharply than is currently being discounted. Also, while nominal rates have risen substantially, real rates remain near zero.

**UK.** Gilt yields have continued to fall back since the fiasco of the September budget, with the 10-year yield down from 4.5% to 3.1%. Rishi Sunak's new government has announced a new and net restrictive budget, freezing spending and leaving taxes unchanged, which has been better received by markets. The Bank of England also announced it was slowing the pace of its rate rises in light of the feeble growth outlook for the British economy and the systemic risk that higher rates pose to households mired in floating-rate debt. Also, as in the euro area, real rates remain close to zero. We remain Neutral on Gilts.

## Credit

**US and euro zone credit.** We are increasing our position in investment grade corporate bonds from Neutral to Overweight. Yields are attractive, at 5.4% in the United States and 3.8% in Europe, and company balance sheets remain healthy against the backdrop of a slowing economy. We remain at Underweight on high-yield credits.

**Real rates**
OIS swap-inflation swap




Sources: SGPB, Bloomberg, 28/10/2021

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# CURRENCIES

## Dollar appreciation slows down

**The dollar should continue to benefit from the deteriorating economic outlook, the interest rate differential and geopolitical risks. Nevertheless, we are moving to Overweight on the EUR/USD exchange rate as a significant part of the deterioration in the Eurozone's trade balance has already passed and the interest rate differential should narrow.**

**Dollar Index.** The dollar continued to decline against the major developed and emerging currencies over the past month. The moderation of inflation in the US, implying the expectation of a slowdown in Fed tightening, supported the currencies of the developed economies. In addition, the decline in commodity prices, traded in USD, also helped the major currencies rebound.

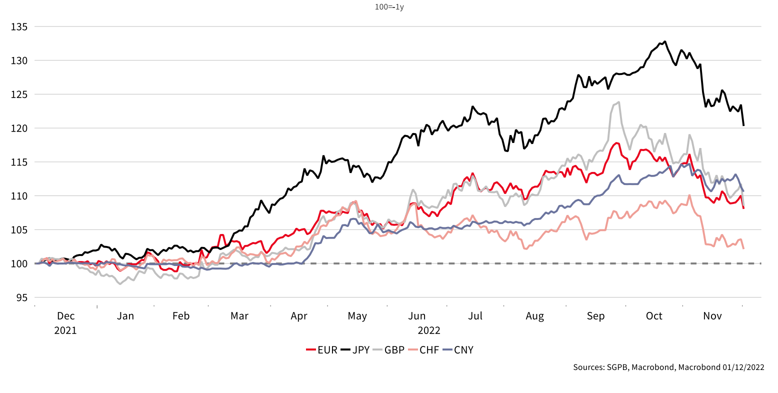
**EUR/USD.** We have upgraded our stance on EUR/USD from Neutral to Overweight. The European currency continued to appreciate against the USD (+5.7% month-on-month), stabilizing at 1.03 against a backdrop of falling energy prices in Europe and an expected slowdown in the pace of Fed rate hikes. We believe that the interest rate differential between the US and the Eurozone will continue to narrow, supporting the European currency further. Furthermore, we believe that the majority of the deterioration in European external accounts has passed, with gas and energy prices expected to remain below their summer peak, given the high level of inventories. Without renewed geopolitical tensions or sharp declines in temperatures, this should support the EUR.

**GBP/USD.** We remain neutral on GBP/USD. In the wake of the EUR, the GBP has also gained 5% over the past month against the USD, benefiting from lower energy prices and the prospect of a less aggressive Fed. In addition, the easing of financial tensions following the new budget announcement also helped the GBP gain ground.

**EUR/JPY.** The downward pressure on the JPY has diminished significantly over the past few weeks, with the Japanese currency even appreciating by 6% against the USD. As with the EUR, lower energy prices coupled with an improvement in the external accounts has allowed the currency to appreciate. Nevertheless, in a context where the Bank of Japan is only expected to gradually increase sovereign rate targets as part of its curve control, we remain underweight the Japanese currency.

**EUR/CHF.** We remain Underweight on the EUR/CHF. Inflation in Switzerland remains well below European inflation (3% in November for total inflation against 10% in the Eurozone) supporting the Swiss currency. Moreover, the SNB is also continuing its tightening cycle - with the monetary policy rate at 0.50% and expected to reach 1.25% in 2023 - and a further reduction in its foreign exchange reserves.

**USD against main currencies**

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# ALTERNATIVES

## Seeking diversification

**Oil remains weakened by the risks of recession, particularly in China where growth is expected to slow significantly in the coming years, while gold should continue to play its role as a safe haven. Although hedge funds remain a valuable diversification tool, they are now less attractive than fixed-income products.**

## Commodities

**Oil.** We remain Underweight oil. Fears of a recession in 2023 have pushed the price of oil down 5.4% since the beginning of the fourth quarter. The asset also remains highly dependent on decisions by the Organization of the Petroleum Exporting Countries (OPEC) and revisions to growth forecasts for 2023. The evolution of Chinese activity will be particularly important, and a stronger-than-expected slowdown could weigh on the price of oil.

**Gold.** We maintain our Overweight position in gold. The ounce of gold is currently trading at €1750, up 5% since the end of October, which reinforces our position. Traditionally, gold is an important safe haven in a context of high inflation and slowing growth. The dollar also seems to be reaching a high point, which would be favorable to gold. Thus, we maintain our overexposure to this market.

## Hedge Funds

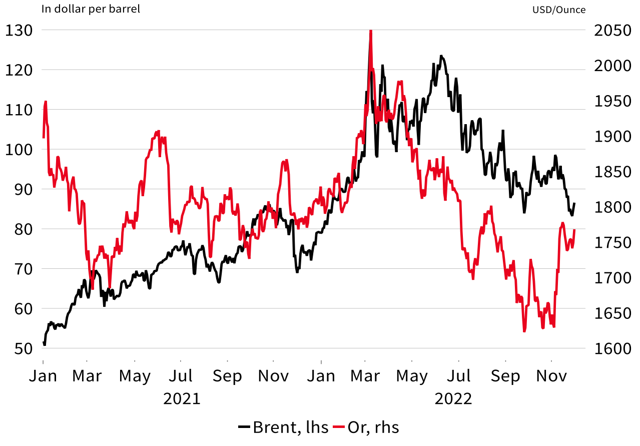
**Long/Short Equity.** Higher volatility and dispersion, combined with an end-of-cycle environment, should continue to favour this category, provided that non-directional strategies are favoured.

**Event Driven.** The rise in interest rates does not favour Merger/Acquisition operations and makes this category of funds less attractive.

**Fixed Income Arbitrage.** The backdrop of rising rates offers opportunities for funds positioned in the sovereign bond market. We continue to show relative interest in funds positioned on the credit side.

**Global Macro / CTA.** While Commodity Trading Advisors (CTA) funds still benefit from their traditional property protection against market volatility, the current period does not appear to be the best entry point.

**Price of Brent Barrel and Ounce of Gold**




Sources: SGPB, Macrobond, ICE, EIA 30/11/2022

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