CURMI & PARTNERS

October 21st, 2022

Monthly Strategy Update

The month in summary:

Financial markets rallied over the summer months as investors positioned themselves for a post-peak inflation environment. An inflation peak could act as a catalyst for the Federal Reserve ("FED") to slow the pace of tightening over the coming meetings, with investors hoping of an increased probability of a rate cut in 2023. Any such hopes were dashed as the FED, European Central Bank ("ECB") and the Bank of England ("BoE") all raised rates during September. Moreover, central banks were clear during press conferences that they would prioritize bringing inflation under control over avoiding a recession.

A combination of rates anxiety and growth concerns led to a bloodbath in financial markets over September. Sovereign and investment grade bonds sold off on the expectation that rate hikes will persist for longer, leading to a re-pricing to a higher terminal rate. The announcement of a surprise big fiscal expansion plan in the UK led to the outsized move in the UK 10-year yield. At the riskier end of the investment spectrum, investors were anxious about both the potential for higher rates and the potentially higher probability of a recession, which drove the steep sell-off in high-yield bond and equity markets.

Commodities are amongst the only asset-class with a positive performance on a year-to-date basis. Yet they were not spared during September. Fears of demand destruction due to a potential recession led to a roughly 10% fall in oil prices. Gold, generally seen as an inflation hedge, fell c. 3%. Iron ore defied the weakness, with a +6% return during September, primarily driven by news that China would support its real estate market and increase infrastructure spending.

The year-to-date performance across financial markets has been among the weakest in history. The performance of the 10-year treasury paper (widely considered as a risk-free asset) over the first 9 months of 2022 is the worst seen on record since the 1900's. This is also true for European Investment Grade and High-yield bonds. As for the S&P 500, the performance YTD is the 4th worst on record, only surpassed (in terms of losses) in 1931 (Great depression), 1975 (Great inflation) and 2002 (Internet bubble).

Sovereign		
	MoM bp	YTD bp
US 10-year yield	64	232
DE 10-year yield	57	229
UK 10-year yield	129	312
Credit		
	MoM %	YTD %
EUR IG	-3.4%	-14.7%
EUR HY	-3.7%	-14.6%
USD IG	-5.1%	-18.6%
USD HY	-2.6%	-13.5%
GBP IG	-10.2%	-25.6%
GBP HY	-5.6%	-15.2%
Equities		
Local currency returns	MoM %	YTD %
S&P 500	-9.2%	-23.9%
Nasdaq 100	-10.4%	-32.0%
STOXX 600	-6.4%	-18.0%
DAX	-5.6%	-23.7%
CAC	-5.8%	-17.1%
FTSE 100	-5.2%	-3.8%
Emerging markets	-11.7%	-27.0%
EM ASIA	-12.8%	-27.7%
EM LATAM	-3.3%	3.0%
EM EMEA	-7.7%	-32.0%
Currencies		
EURUSD	-2.5%	-13.8%
EURCHF	-1.6%	-6.8%
EURAUD	4.2%	-2.1%
GBPEUR	-1.5%	-4.2%
GBPUSD	-3.9%	-17.5%
Commodities		
Oil WTI	-10.7%	12.9%
Oil Brent	-9.6%	16.1%
Gold	-2.9%	-9.2%
Copper	-3.1%	-22.2%
Iron Ore	5.9%	12.6%

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Macro-economic views

At the start of the third quarter, our main concerns from a macro-economic perspective centred around three issues: The first issue was inflation, and whether demand had cooled sufficiently to enable the FED to slow down the rate hike cycle in the second half of 2022; Secondly, the risk that Russia would cut gas flows to Europe during the winter period, and whether the region would have enough gas reserves for the economy to continue to operate at a normal pace; Finally, China's growth had fallen sharply during the second quarter of 2022 and there was some concern around future lockdowns.

Over the course of the third quarter, we note that there were negative developments on all three fronts. The FED hiked rates by 75bp in September, with the hawkish language focusing on taming inflation even at the cost of a recession. In Europe, Nord Stream 1 gas flows came to a complete halt, meaning that Russia is supplying only 25% of its pre-war gas to Europe. Finally in China, several lockdowns were announced during September which will likely weigh on economic growth.

Economists expect global growth to weaken in the fourth quarter of 2022 (Exhibit 1) due to: (1) sizeable growth drags from Russia/Ukraine conflict; (2) tighter financial conditions as central banks continue to hike at an aggressive pace; and (3) substantial slow-down in the housing market. As for inflation, the expectation is for global inflation to peak over the coming months due to: (1) a moderation in global demand; (2) less supply-side constraints; and (3) tighter monetary policy.

Exhibit 1 – Consensus real GDP growth expectations

Consensus expects Developed economies to report slower growth in 3Q22, a trend which is expected to persist till 2Q23

Real GDP, %	*4Q21A*	*1Q22A*	*2Q22A*	*3Q22F*	*4Q22F*	*1Q23F*	*2Q23F*	*3Q23F*
United States	7.0	-1.6	-0.6	1.4	1.0	0.8	0.9	1.2
Japan	3.9	0.2	3.5	1.4	1.9	1.2	1.2	1.1
Germany	1.2	3.5	1.7	0.7	0.2	-0.9	-0.7	-0.3
France	5.0	4.7	4.2	1.0	0.4	0.6	0.2	0.6
Italy	6.6	6.4	5.0	1.8	0.7	0.5	-0.3	0.1
Spain	6.6	6.7	6.8	3.9	1.5	1.5	1.2	1.6
Eurozone	4.6	5.4	4.1	1.8	0.9	0.2	-0.3	0.0
UK	8.9	10.9	4.4	2.2	0.4	-0.5	-0.4	-0.2
Developed Economies	5.9	2.2	2.1	1.8	1.1	0.7	0.7	1.0
China	4.0	4.8	0.4	2.6	1.1	0.6	0.8	1.8
Emerging Economies	4.4	4.3	2.3	3.3	2.7	3.4	5.6	4.5

Inflation, %	*4Q21A*	*1Q22A*	*2Q22A*	*3Q22A**	*4Q22F*	*1Q23F*	*2Q23F*	*3Q23F*
United States	6.7	8.0	8.7	8.3	7.2	5.8	4.0	3.2
Japan	0.5	0.9	2.5	2.8	2.9	2.4	1.7	1.2
Germany	5.4	6.1	8.2	9.4	10.1	8.6	6.7	5.7
France	3.3	4.2	5.9	6.5	6.5	5.9	4.8	3.9
Italy	3.8	6.0	7.4	9.0	9.5	7.6	6.3	4.4
Spain	5.8	7.9	8.9	10.2	8.6	6.9	5.3	3.6
Eurozone	4.7	6.4	8.0	9.3	9.5	7.7	6.2	4.7
UK	4.9	6.2	9.2	10.0	10.5	9.8	6.4	5.2
Developed Economies	5.5	7.2	8.8	9.9	8.7	7.1	5.1	4.2
China	1.8	1.1	2.2	2.7	2.7	2.8	2.2	2.2
Emerging Economies	3.6	3.7	5.3	5.2	6.9	6.4	5.2	4.9

Source: Bloomberg

(Shaded areas represent consensus forecasts as at 14/10/2022)

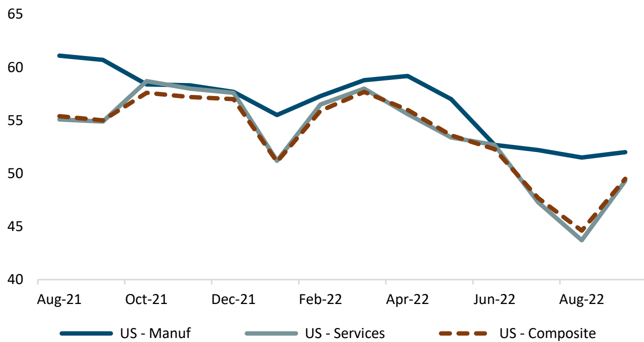
United States

Growth: Economists expect growth in the US to rebound in the third quarter, largely reflecting a significant boost from net exports which is partially set-off by slower consumption growth and weaker investment. PMI's have recovered from the lows seen during August (Exhibit 2) despite the tighter financial conditions seen since the summer lull (Exhibit 3). The drag from surging interest rates and weaker employment growth will keep consumption growth muted. Falling gasoline prices could yet provide some support to real consumption over the coming months but, with the Fed's aggressive tightening still feeding through, GDP growth is expected to remain below trend over the coming quarters.

Inflation: Core CPI rose by the most in 40 years during September, with prices rising 6.6% year-on-year, ahead of economist expectations of a 6.5% (Exhibit 4). Despite this, economists expect inflation to continue to moderate over the coming months. The demand and supply imbalance in the labour market has supported wage growth over the past months. The job-workers gap, which is defined as the difference between job openings and unemployed, peaked in March at 5.9 million and has since fallen to 4.3 million (Exhibit 5). Goldman Sachs note that job opening gap needs to fall to around 2 million for wage growth to fall to a rate compatible with the FED's inflation target.

Exhibit 2 – US PMIs

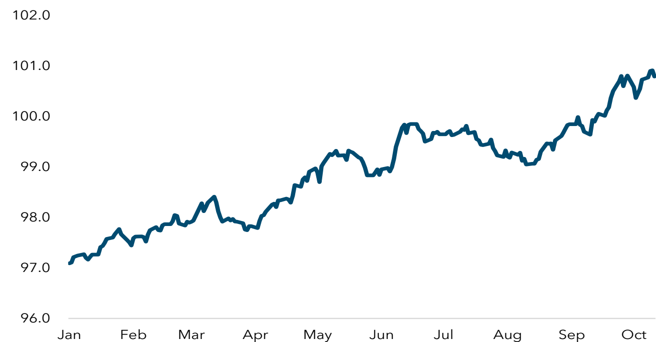
PMIs have recovered in September which should help growth..



Source: Bloomberg

Exhibit 3 – US Financial Conditions Index

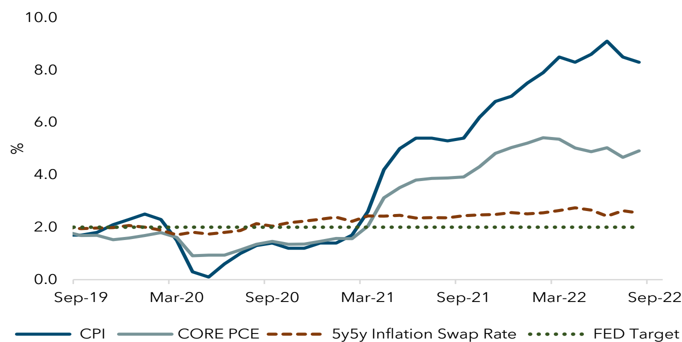
…but tighter financial conditions are likely to act as a drag



Source: Goldman Sachs

Exhibit 4 – US Inflation rate

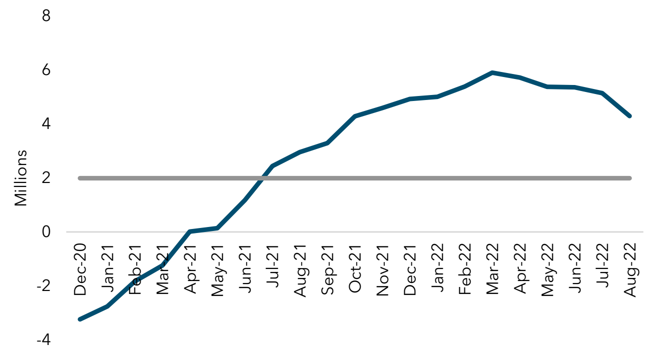
Inflation remains well above target despite aggressive tightening…



Source: Bloomberg

Exhibit 5 – Job-workers gap

…but wage growth should moderate if job-workers gap closes further



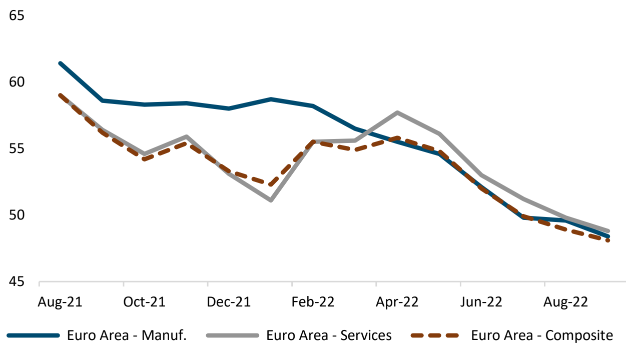
Source: FRED

Europe

Growth: Economists expect economic growth in the Euro-area to slow down sharply in the coming quarters (Exhibit 1). This view is supported by a deterioration in high frequency indicators over the past months, as both Manufacturing and Services PMI are now in contraction territory (Exhibit 6). Additionally, the outlook in Europe is clouded by the uncertainty brought about by the energy crisis. As we approach the peak demand months, gas flows remain well below pre-war levels which could lead to gas shortages during the winter months. A worse case scenario where gas would need to be rationed would have severe repercussions on industrial production. Expansionary fiscal policy aimed at shielding the economy from the surging energy costs should help support consumption over the near-term. The severity of the downturn in Europe's economy will depend on several factors, including the severity of the upcoming winter and potential shocks in consumer confidence (and consequentially on consumer spending) from an escalation of the Russia/Ukraine conflict.

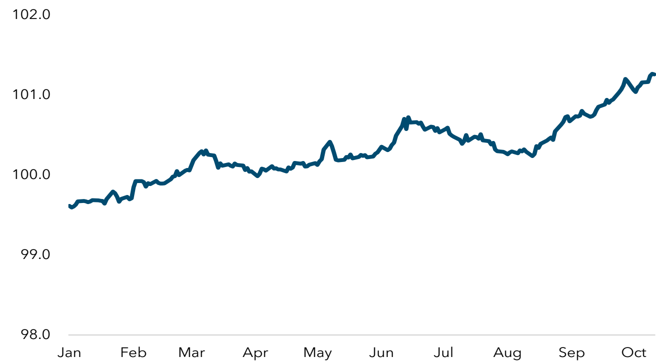
Inflation: Core CPI in Europe came in at 6.1% in September, the sixth consecutive month of rising core inflation (Exhibit 8). Unemployment in the region remains fairly low by historical standards (Exhibit 9), and pent-up savings seem to have supported demand. Yet, we think that the deterioration in the macro-economic backdrop and the tighter financial conditions (Exhibit 7) will likely limit further upside to inflation.

Exhibit 6 – EU PMIs
Europe faces a double whammy of PMIs in contraction territory..



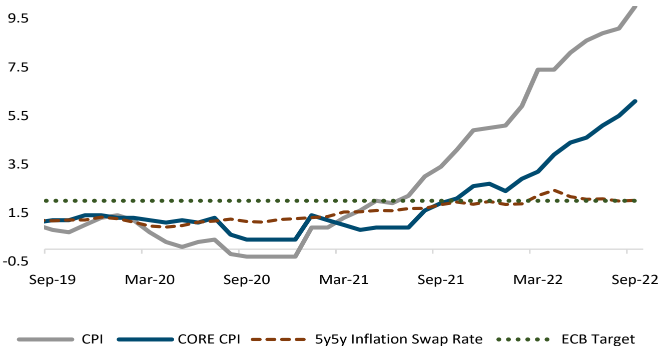
Source: Bloomberg

Exhibit 7 – EU Financial Conditions Index
...and tighter financial conditions



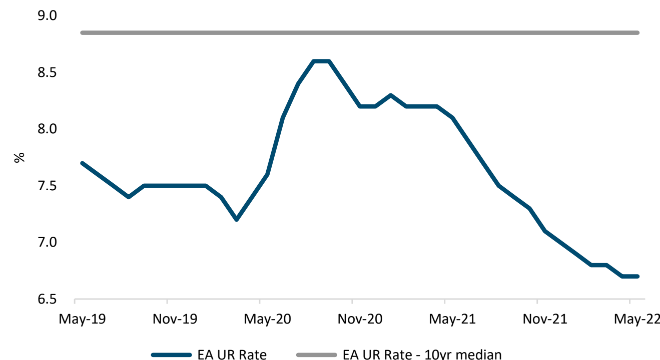
Source: Goldman Sachs

Exhibit 8 – EU Inflation rate
Inflation remains well above the ECB target...



Source: Bloomberg

Exhibit 9 – Euro-area unemployment rate
...with unemployment well below 10-year median

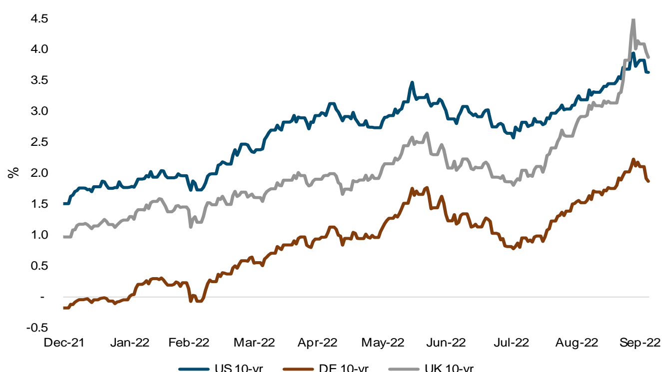


Source: Bloomberg

Rates

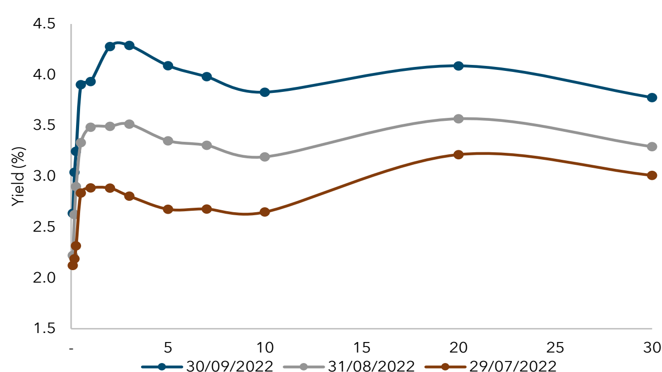
The rising yield environment persisted during September as central banks across developed economies intensified their efforts to tame inflation (Exhibit 10). The BoE, ECB, FED, Norges Bank, SNB and Riksbank all hiked rates last month, and guided to more tightening going forward, at least until inflation is brought under control. Moreover, the market went through a period of volatility after the UK Chancellor shocked the market on the 23rd of September with the announcement of a bigger than expected fiscal expansion plan. Despite the limited read across, volatility spilled over to other markets as evidenced by the volatility seen in US rates. Finally, concerns over global economic growth prospects led to further flattening in the yield curves for the markets we follow, as 10-year yields remain anchored by recession fears.

Exhibit 10 - 10-year nominal bond yield for the US, Germany and UK
Nominal bond yields have continued to climb during September as inflation pressures persisted



Source: Bloomberg

Exhibit 11 – US Yield Curve
The US Yield curve inverted in July, with upward pressure on the short-end of the curve from FED policy



Source: Bloomberg

United States

The hawkish tone adopted by FED's Powell during the September FOMC meeting led to a re-pricing of rate hike expectations. The median dot-plot projections showed an additional 125bp of tightening this year, which implies a 75bp rate hike in November (vs previous market expectation of a 66bp hike) and 50bp in December (in-line). This primarily explains the 64bp rise in the UST10-year yield during September, the steepest sell-off in the 10-year this year.

Yield curve continued to flatten during September (Exhibit 11). However, we see less scope for deeper inversion as the FED is expected to reduce its hiking pace over the coming months. Also, the recent payroll data suggests a gradual labour market rebalancing is more likely, which could reduce the probability of a recession in the US.

Europe

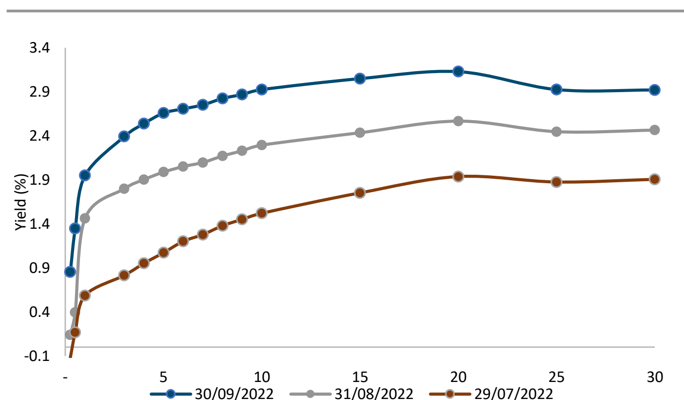
Euro-area inflation continued to surprise to the upside, reaching new all-time highs in August. Inflation pick-up was driven by both core goods and services, excluding volatility in energy prices. Higher inflation and the expectation of more tightening in the coming months led to higher yields across the region (Exhibit 12). Economists expect inflation in Europe to peak in the fourth quarter of 2022 due to a combination of tighter monetary policy and a deterioration in the macro-economic environment. Sovereign spreads in the Euro-area have widened slightly in September, especially in Italy and Greece. (Exhibit 13)

Potential for further steepening as ECB risk management shifts. The ECB's risk management arguments have tilted to the hawkish side since the start of the year. With inflation looking stickier than expected, we see a possibility for the ECB to continue to hike rates even if this means a deterioration on the macro front. Yet, last week's warning from the European Systemic Risk Board highlighting that the combination of rising rates, high inflation and weaker growth presents a substantial risk to financial stability by putting pressure on private sector balance sheet, could likely impact the ECB's tightening cycle. The current market pricing is of 70bp and 60bp respectively for the October and December meeting. An ECB disappointment could lead to curve steepening. Yet, the ECB's hand could be forced bearing in mind the current high level of inflation.

The account of the September Governing Council meeting struck a cautious tone on the growth outlook. Members noted that the tailwind to growth from reopening effects was fading and headwinds from gas supply disruptions and weakening global demand were building. It was highlighted that a further shutdown of gas supplies from Russia—which has since materialised—could turn the stagnation embedded in the baseline forecast of the staff projections into an outright recession. It was also noted that the impact of the war in Ukraine and the pandemic on the productive capacity of the economy was turning out to be bigger and longer-lasting than expected.

Exhibit 12 - EUR OIS Spread

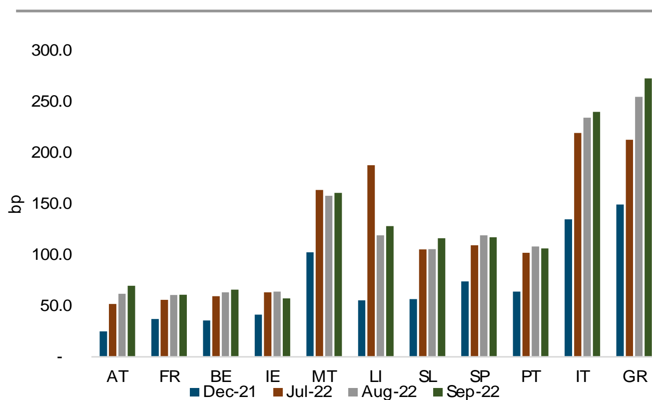
Re-pricing of terminal rate expectations led to a change in curve shape



Source: Bloomberg

Exhibit 13 – 10-YR Sovereign spreads vs German 10-YR

Basis points



Source: Bloomberg

Exhibit 14 – Summary of views

Duration	
United States	We believe that with inflation still well above target, pressure will remain on the front-end of the curve with room for further upside in the event of firmer inflation than expected. Yet, we believe that the gradual slowdown seen in the labour market could imply a lower probability of recession, hence lower probability of a rate cut, which should also exert some pressure on the long-end.
Europe	The higher-than-expected inflation which is likely to persist for longer supports the view that the ECB will continue to tighten policy over the next months and increases the risk of an upward revision of the terminal rate. Additionally, the possibility of higher debt issuance will support fiscal policy programs to address the energy crisis. This will likely lead to more rate hikes which presents upside risk to the short-end of the curve, whilst the debt issuance could also present some upside risk to the long-end of the curve. At the other end of the spectrum, growth concerns are rising rapidly, as gas flows remain well below normal levels. Although reserves have been replenished, the risk of gas shortages is rising and this could have implications on industrial production as well as the wellbeing of the European population. The growth concerns will likely weigh on the longer-end of the curve. Yet, with inflation at such elevated levels, we see little incentive for the ECB to change its policy over the short-term. At this stage it looks unlikely to see a material decline in yield for 10-year yields for individual EU countries.

Curve	
United States	Scope for further inversion in 10s30s relies on much higher front-end yields. Whilst not close to the extremes seen in the 80s (max -70bp in February 1980) it seems to be close to sustainable "flats". The curve is also looking too flat versus its historic relationship with the 2yr yields
Europe	Goldman Sachs expect a front-loaded ECB hiking cycle, with two additional 75bp rate hikes in 2022 to maintain a relatively flat 2s10s. The risk is earlier than expected QT which would put pressure further out on the curve. We note that in the last week of September the shape of the curve changed with the 10s30s inverting by as much as 60bp. This change in shape was brought about primarily by the volatility seen in the rates market post-UK mini budget announcement.

Source: Curmi & Partners, Bloomberg, Goldman Sachs

Credit

For the majority of September, volatility in the rates market remained intense, with a wide range of negative catalysts impacting the space and driving global credit spreads wider overall. September was the fifth-worst month in history for Euro Investment grade, continuing this year's credit rout, with 3.32% total-return and 0.79% excess-return losses. A 57 bp rise in the bund yield coupled with a 23bp spread rout made for a painful month and the worst 1Q-3Q on record with a 14.6% loss. Investment grade returns will likely continue to be at the mercy of inflation, central bank headlines and the related rates and commodity-price moves, though with that said, spreads at +225bps are screening attractive relative to year end forecasts. Expectations are for October net supply to be below the decade average, in line with September, as the ECB halted QE and most companies either don't need to issue or are deterred by higher interest costs.

Much like the investment grade space, Euro high-yield is enduring one of worst YTD returns on record at a 14.6% loss, second only to the record high yield defaults of 2001 (23.8% loss) and worse than the financial crisis in 2008. The risk-off sentiment led to a total-return loss of 4.3% and excess-return loss of 2.15% as spreads widened by 68 bps. Primary supply in this space has been dead for the whole year, and we believe that October will be no different as issuers remain reluctant to come to market at current levels.

Exhibit 15 – Spread movements and total returns for Investment Grade and High Yield credit
Sterling credit underperformed during the month as a result of the volatility caused by the mini-budget announcement on 23rd September

	30/09/22	31/08/22	31/12/21	MoM Δ	YTD Δ
Spread Movements (bps)					
USD IG	159.0	140.5	92.4	18.5	66.6
USD HY	552.2	484.1	283.0	68.1	269.2
EUR IG	225.3	201.8	95.0	23.4	130.3
EUR HY	631.0	560.0	318.0	71.0	313.0
GBP IG	234.0	205.3	113.8	28.7	120.2
GBP HY	702.1	635.5	375.7	66.6	326.4
Total Returns Index (%)					
EUR IG	225.2	232.9	263.6	-3.3%	-14.6%
EUR HY	371.7	388.3	437.9	-4.3%	-15.1%
USD IG	2864.1	3023.0	3523.6	-5.3%	-18.7%
USD HY	2098.5	2185.3	2461.4	-4.0%	-14.7%
GBP IG	233.9	256.6	309.6	-8.9%	-24.5%
GBP HY	750.7	799.9	890.4	-6.2%	-15.7%

Source: Bloomberg

Newsflow into the beginning of October was less intense, with two themes both related to the speed of central bank normalisation standing out; namely, the continued fallout from the LDI-led volatility in the UK and "pivot praying". On the LDI-front, the intervention of the BOE has calmed the markets for now, though focus remains on the 14th October, when the BOE is set to cease emergency bond-buying.

Regarding pivot talks, whilst we acknowledge that "at some point" there will need to be a pivot from the ECB and the Fed, it makes sense to consider how that might impact credit markets. The broad assumption is that such a pivot would only happen once inflation is solidly on a downward trend, and this would likely only happen when Europe, and potentially the US, are well into a recession. Significantly reduced uncertainty and volatility around rates in such a scenario, coupled with the ensuing economic downturn, would be a recipe for HY/IG decompression, i.e., IG credit, which is already flirting with year-end targets, will likely benefit from reduced benchmark rate volatility, whilst HY may suffer as a function of weaker fundamentals driven by an economic downturn.

Within the IG Euro Space, we continue to prefer front end curves given wide relative value at the 3-5yr bucket relative to all other tenors. With respect to Sectors, whilst materials continue to trade wide, recent underperformance in the utilities space appears to have created opportunity. Current levels imply that the burden of high energy prices will fall on utilities, despite clear policy action to share the costs across euro area economies. Indeed, the most recent headlines regarding damage to Nord Stream pipelines and the potential for Russian sanctions on the last remaining pipeline to Europe had little impact on credit markets or Utilities spreads - implying that the beta of Utilities to gas prices and related headlines has already fallen. As such, these valuation perspectives, alongside the falling beta of Utilities to the energy crisis, supports an overweight recommendation to the space.

Sterling high grade bonds had a brutal 2022, with a 24.5% total-return loss (gilts 440 bps wider) -- a record. But the key story is the 3.89% excess-return loss as sterling credit spreads blew up all through 2022. Looking at the sterling credit vs. the 10-year gilt-yield differential, we can see a huge move of 133 bps -- to 242 bps from 2021 year-end lows of 109 bps. Of particular interest is the action since August, when Boris Johnson resigned, and the policies of a new Liz Truss government were being discussed in the media. The credit vs. gilts gap has widened by 42 bps since then.

While Sterling high grade total-return losses dwarf Euro high grade, both in Sterling and adjusted for FX in euros, a duration effect could also be partially at play. Looking at spreads to swaps for cross-currency comparison, the sterling/euro IG OAS spread differential hit 90bps soon after Liz Truss became Prime Minister and continues to hover around 77bps after the significant widening following the mini budget. Immediately post the Brexit deal and UK vaccine progress, the differential had tightened to below 40 bps but has drifted now due to significant UK risks -- both fiscal (too much borrowing) and monetary (upcoming BOE corporate-bond sales).

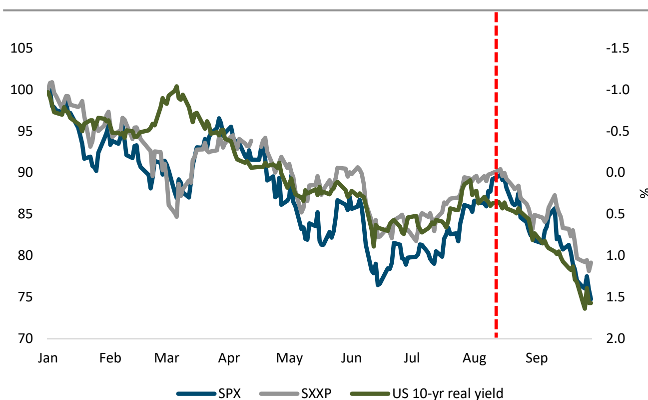
The current 77bp gap is near the widest in the post-Brexit era, at the 90th percentile, though we do not see any immediate catalysts for this to reverse over the medium term.

Equity

Post-summer sell-off has been quite intense but not unexpected. We had highlighted investor complacency in our previous strategy reports, as we thought that investor positioning was consistent with a post-peak inflation environment which had not yet materialised. There was even some excitement over whether the summer rally represented the start of a new bull market. However, such hopes faded quickly, with the FED Jackson Hole symposium signalling the end of the summer rally. The rise in real yields that has followed FED hawkish comments has weighed on risky assets. (Exhibit 16). Global equities rallied 14.6% (US$) during the two months ending in mid-August. Since then, and until the end of September, global equities delivered a total return of -16.1% (US$).

Exhibit 16 – S&P 500, STOXX 600 and US Real yield (RHS)

There is a clear negative correlation between real yields and equity market performance

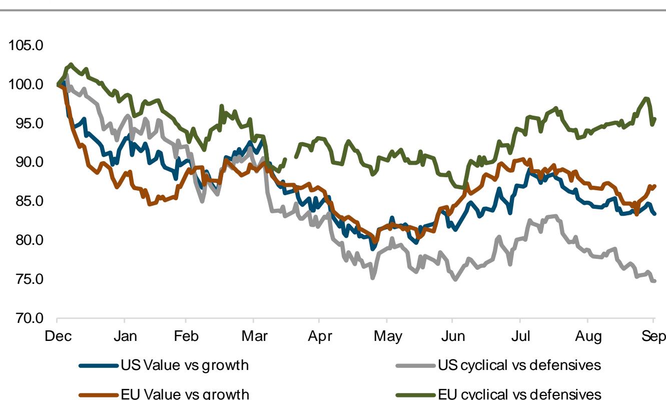


Source: Bloomberg

Performance rebased from 31 December 2021

Exhibit 17 – EU and US performance by strategy

Cyclicals have underperformed defensives by a larger extent in the US compared to Europe



Source: Bloomberg

Performance rebased from 31 December 2021

September has seen heavy, indiscriminate selling in equity markets (Exhibit 17). Global equities lost -9.3% in September, the worst month since March 2020. There was little room for cover, with US stocks shedding -9.2%, European stocks -6.4% and UK stocks -5.2% (all in local currency terms). In terms of strategies, global value strategies (-8.4%) outperformed global growth (-10.1%). It was a similar story in the US (value vs growth), with defensive strategies (-5.8%) outperforming cyclical (-10.5%) as recession concerns increased. Finally, in Europe, investors seemed relatively undecided. Value strategies (-6.1%) and growth (-6.5%) delivered a similar level of performance whilst defensives (-8.5%) marginally underperformed cyclicals (-8.2%).

EM was the hardest hit however after a calm first 8 months of the year. Commodity exporting nations helped performance for the asset class during the first 8 months of 2022. EM equities outperformed DM on 5 of the first 8 months of 2022. Yet, global growth concerns as well as the appreciation of the US$ led to a -11.7% decline for the MXEF index during September. As for performance by region, LATAM was again the outperformer with a total return of -3.3%, followed by EMEA at -7.7% and Asia losing -12.8% (local currency terms). The negative performance seen during September now puts EM equities below DM equities in terms of total return for the first time in 2022.

Equity valuations have come down significantly since the summer months as the sell-off intensified (Exhibit 18). A closer look at the valuation for European equities over the past decade suggests that a lot is priced-in, with the 12-month forward PE around 30% below the 10-year median (Exhibit 17). Monetary tightening is generally a trigger for lower valuations, and we believe that additional downside from rates could be limited. The FED has tightened policy by 300bp since the start of the year, and more tightening is expected in Europe over the coming months, but assuming inflation can be brough under control, the market narrative should soon shift to recession concerns.

A key concern going into FY23 is downward pressure on EPS estimates. The global economy is slowing down (lower demand) and inflation could have a negative impact on margins. Yet, consensus is still expecting EPS growth of 3% in FY23 and 6% in FY24. There is a substantial gap between the survey data (PMI), which moved into contraction, and EPS estimates which have slowed slightly but are still well above levels normally associated with an economic slowdown. As a rough guide, EPS growth in 2012, when PMI levels were close to levels seen today, came in at -9%, a substantial difference to what is being expected today. Therefore, unless there is a significant recovery in economic activity, we see a risk that FY23 EPS estimates could be revised downwards.

Margins are at all-time highs, but this could change over the coming months. Consensus continues to expect flat margins in FY23 despite (1) higher import raw materials cost; (2) higher cost of debt and debt refinancing for the first time since the GFC; (3) taxation is rising in some sectors; (4) labour cost is rising, which could change if unemployment rises.

Exhibit 18 – Valuations – Developed markets

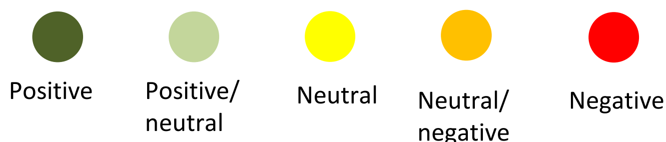
Valuations have come down significantly since the start of the year

Historical Data	SPX	SXXP	SX5E	DAX	CAC	FTSE100	FTSE250
Current Forward PE ratio (FPE)	14.8x	10.3x	9.7x	9.4x	9.5x	8.2x	9.3x
Forward PE ratio (31/12/2021)	21.1x	15.7x	15.3x	13.2x	14.6x	12.1x	14.8x
10 Year data							
Highest	22.1x	17.5x	18.0x	15.7x	18.2x	15.4x	17.9x
Highest (date)	31/12/2020	29/12/2020	29/12/2020	28/12/2020	04/12/2020	02/12/2015	29/12/2020
Lowest	11.8x	10.0x	9.0x	8.4x	9.1x	8.2x	8.3x
Lowest (date)	08/01/2013	18/03/2020	18/03/2020	18/03/2020	18/03/2020	29/09/2022	23/03/2020
Median	15.9x	13.7x	12.8x	12.1x	13.3x	12.8x	13.8x
95th percentile	20.4x	16.0x	16.2x	14.4x	15.9x	14.9x	15.3x
5th percentile	12.7x	11.2x	10.2x	10.2x	10.5x	10.4x	11.2x
Historical rank (since 2006)							
Percentile	54.0%	19.1%	22.8%	9.8%	13.2%	1.9%	9.0%
Current FPE, % above/ (below) 10-YR median	-6.8%	-24.5%	-23.9%	-22.7%	-28.3%	-35.8%	-32.5%
Current FPE, % above/ (below) Dec 21	-29.6%	-34.2%	-36.5%	-28.9%	-34.4%	-32.3%	-37.3%

Source: Bloomberg

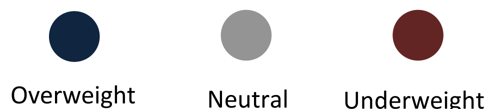
Asset class views

Key – Our view



Positive | Positive/ neutral | Neutral | Neutral/ negative | Negative

Key – Allocation



Overweight | Neutral | Underweight

Asset Class			Positioning
Developed Market Sovereign Bonds			Our negative view on Government bonds remains unchanged given inflation pressures on central bank's commitment to fight inflation. We continue to see upside risks to terminal rates as inflation pressures remain elevated. We also continue to see little scope for shift in policy given sticky inflation which means that central banks are less likely to tolerate easier financial conditions any time soon, unless the risk of a deep recession increases significantly.
Investment Grade Corporate Bonds			Investment grade returns will continue to depend on movements in benchmark rates and corporate spreads, though following the material widening since the onset of the Ukraine conflict, the asset class has begun providing reasonable opportunities to add risk on a selective basis. At current levels, the asset class offers a significantly better cushion against adverse movements in benchmark bond yields than we have seen for a number of years. The default and rating environment for global credit is beginning to show signs of weakness, reinforcing our preference to move further up in credit quality where possible. Whilst we acknowledge the risks for benchmark rates to move higher, we prefer to increase our exposure to IG corporate bonds, though maintain a preference for a low-to-neutral duration stance versus the broader corporate market.
High Yield Corporate Bonds			The elevated uncertainty on the growth outlook and higher inflationary forces as a result of the war in Ukraine has led to a substantial widening in credit spreads. We continue to like the asset class at current valuations, though as we begin to see signs of weakness in the outlook for global credit quality, we are becoming all the more selective in the names we choose to hold on portfolios. The focus remains on identifying positions on a name-by-name basis, screening for issuers based on resilience of cash flow and strength of balance sheets that should see limited drag on operational performance as finance costs and input costs increase in the face of slowing growth. We place additional focus on names and sectors less exposed to a potential slowdown and on issuers at the upper end of the HY rating scale to avoid downgrades into distressed territory.
Developed Market Equities			Equity markets have been hit by a combination of rate volatility and economic growth concerns so far this year. While equity valuations in most regions we follow have normalised, bonds have re-priced lower too. The equity risk premium for equities is at the lowest it has been over the past decade. Therefore, fixed income instruments are now offering a viable alternative to equities. Furthermore, the total return of bonds and equities on a YTD basis is fairly similar, which is unusual when considering the rising recession risk. Normally, as economic activity slows, bonds tend to outperform equities as investors look to cut their exposure to the riskier asset classes. Equities have probably held up better this year due to their status as an inflation hedge. However, once inflation peaks there will be less scope for bond sell-off and the market narrative will shift to recession concerns, which could provide more downside.
Emerging Market Equities			We have downgraded Emerging market equities to underweight as we believe that the strengthening of the US Dollar and the deterioration in the global macro economic prospects will likely weigh on the asset class. There has been a significant outperformance in LATAM (where we were o/w until recently) relative to Asia and EMEA, which is mostly explained by the rally in commodity prices. We think that this performance could reverse the closer we get to an inflation peak in developed economies, and we get a better understanding of that damage suffered by the global economy.

Disclaimer

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