AURIS
WEALTH MANAGEMENT

Market Insight

Summer2022

Economic context

The economic slowdown is gaining momentum. Economic data from all three major zones continues to disappoint, fueling a downward revision of growth forecasts, especially in the US. #1

Fueled by fears of recession, all commodity prices have been falling since the beginning of June, which will help to bring inflation down after a few weeks of inertia. #2

Despite the economic slowdown, central banks persist in fighting inflation at all costs! But they seem to be lagging behind the cycle once again.

Inflation expectations are falling significantly and already the markets are predicting, rather cynically, that the FED will have to cut rates in 2023 to fight the recession it caused by raising them! Logically, global interest rates have fallen massively since mid-June.

Economic outlook

It is true that the US slowdown is becoming increasingly evident and that leading indicators, such as the increase in inventory levels or the expected contraction in new orders, lead us to believe that this dynamic will persist. The US economy may even already be in a technical recession (2 consecutive quarters of GDP decline) as suggested by the Atlanta Fed's GDP estimate. #3 For the moment, this is not reflected in the employment report which is a lagging economic indicator. It shows strong job creation inJune, while the leading indicators point at a less favourable dynamic in the months to come.

Finally, inflation rose again in June to 9.1% in annual growth, even though, adjusted for energy and food prices, it is down to 5.9%, which has been falling for the past three months. The anticipated rapid correction in property prices will also help to ease pressure on rents.

Europe is also slowing down and as in the US, this is likely to continue. The big question will be whether or not Nordstream 1 will be restarted after the maintenance operation carried out by Russia. If the Russians decide to cut off the gas supply, then the economic consequences would be major first of all for Germany but also for the whole areawhich is already suffering from high energy prices.

In China, the reopening of the country after the confinements has been promising and economic indicators and mobility have rebounded strongly. Proof that the country has reopened is that the cost of transporting goods from the country is falling significantly.

In order to reach its GDP growth target in the second half of the year, the country has even decided to bring forward infrastructure spending originally planned for 2023 and there has been a resumption of credit distribution. However, developer debt remains a concern as evidenced by Shimao's default on a USD debt.

Financial markets

The FED's monetary tightening has pushed the US dollar to a record high and the massive increase in real rates has caused a major devaluation in equities and credit. But investors already seem to be looking ahead to the next step for the FED. The S&P 500 seems to have found a support level and has stabilized as technical indicators become more favourable. Despitethe bad news on the inflation front, the Nasdaq has not recovered from its lows while European equity markets remain weighed down by the issue of Russian gas supplies. Even if valuations are now attractive #4, the publication season will show how far analysts' forecasts are out of touch with reality. A major point towatch will be the ability of companies to maintain theirmargins which have improved since the Covid crisis. Finally, despite China's good relative stock market performance in June the MSCI EM index failed toadvance.

Credit markets underwent a historic correction in June, particularly in Europe, which seems to be under much more attack from hedge funds than US credit. There is now an aberration in the valuation of some bonds, as suggested by an implicit default rate on investmentgrade or high yield that is totally disconnected from historical reality.

Investment policy

The inflation peak is still to come, but it will be reached through the economic slowdown which is gaining momentum. The markets are already anticipating the next step, i.e. a rate cut to fight the recession. This is not the time to capitulate, we are waiting for a drop in inflation and therefore a future inflection of the FED's discourse to reinforce the exposures.

Equities :

In the US, growth stocks and quality are to be favored as long as recession fears are crystallizing.

In the Eurozone, a disruption of Russian gas supply would be a catalyst to turn negative, otherwise growth in the Eurozone is decent.

In Asia, flows are returning and the desire to support growth is strong. In China however, the Zero Covid policy and developer debt remain problematic.

We maintain our positive view on Latin America, especially as the recent pullback provides better entry points.

Fixed Income :

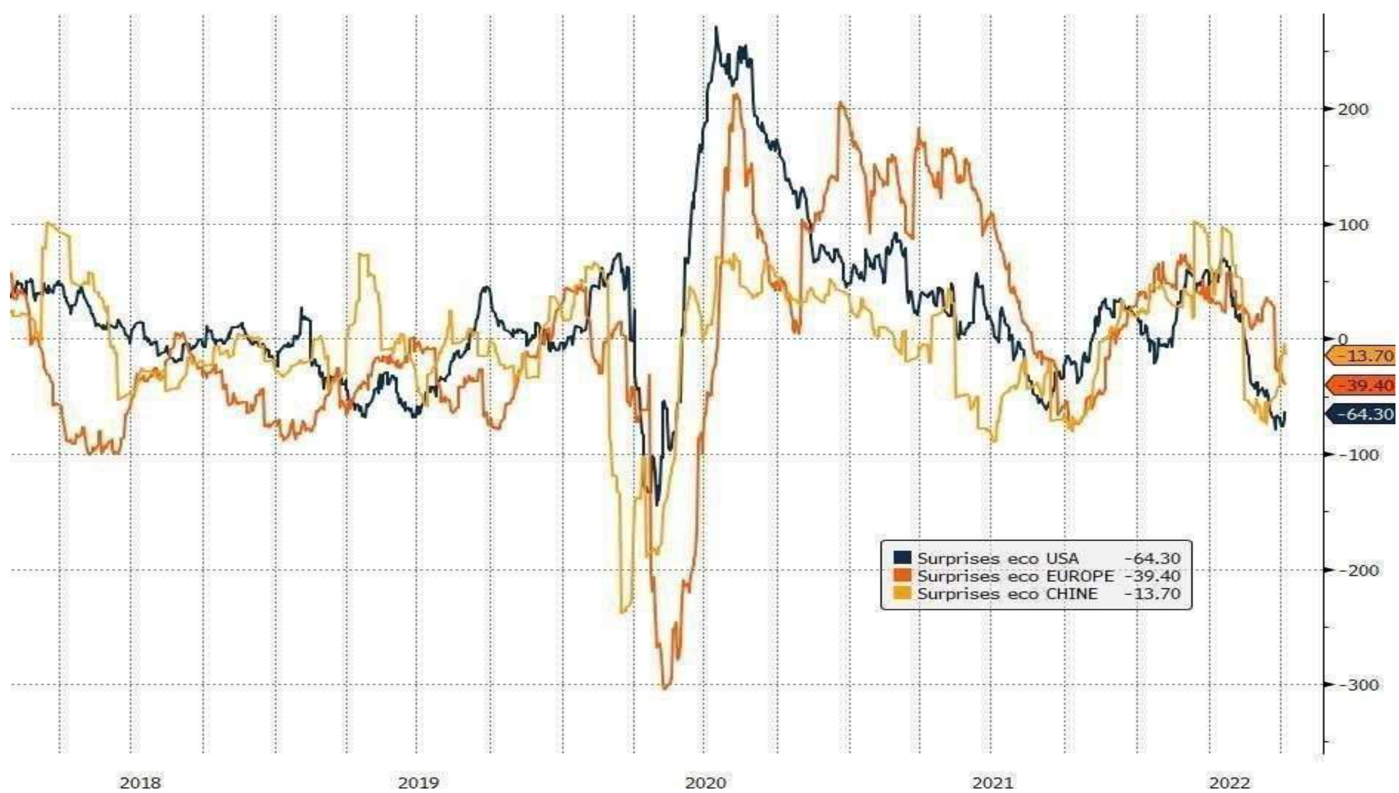
For core rates, the potential for rate hikes is limited, especially as inflation expectations are falling and fears of recession are rising. Their recent decline has been too rapid.

The ECB had better come up with a credible plan soon so as not to cause a new sovereign debt crisis.

Spreads have widened for investment grade bonds. The asset class is regaining interest in diversification.

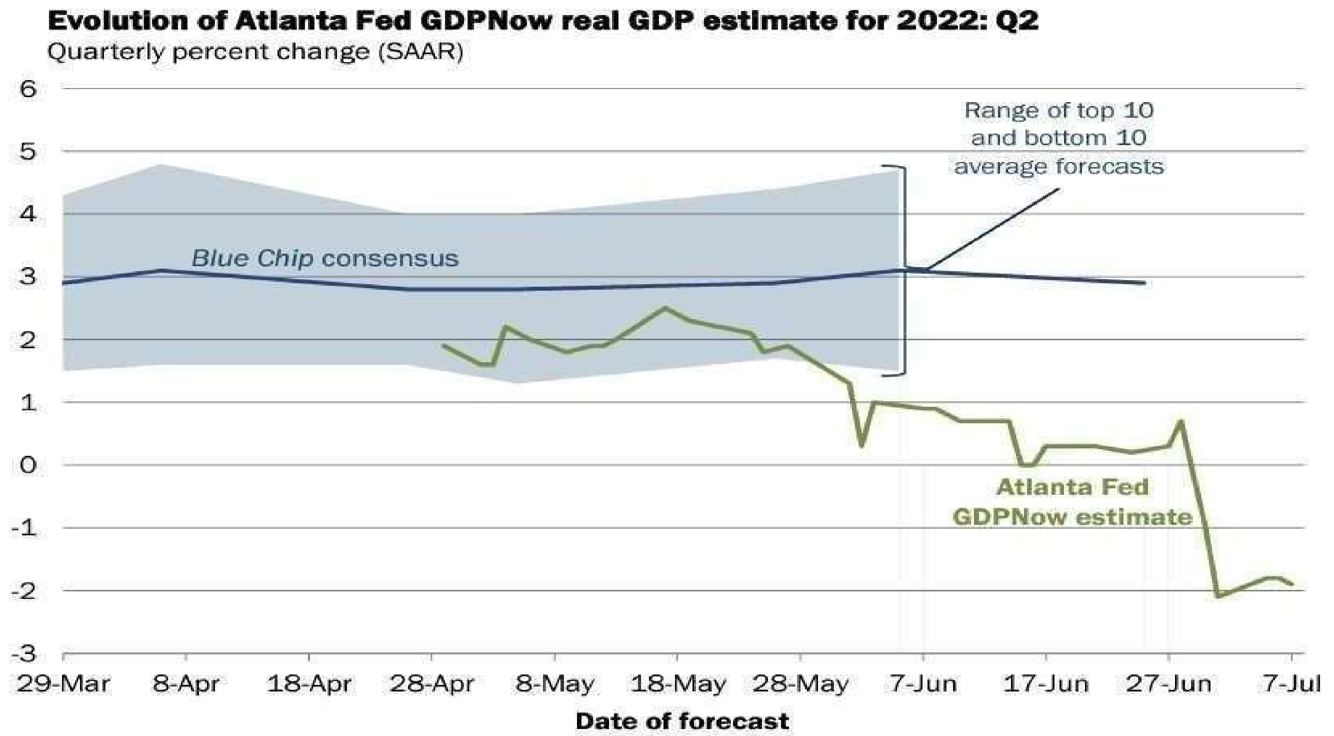
The implicitly inferred defaults of High Yield bonds are out of line with the economic and historical reality and show good value.

#1 Economic Surprise Indicators in the US, Europe and China



#2 Inflation Surprise Indicators

#3 Atlanta FED Q2 GDP Estimate



#4 Valuation of equity markets

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