AURIS
WEALTH MANAGEMENT

Market Insight

Winter 2023

Economic context

Global manufacturing activity may have been contracting for several months now, but global growth continues to be resilient despite central bank monetary tightening. The good news at the end of 2022 and the beginning of this year is the general decline in inflation, despite the lifting of restrictions in China, which could have presaged a rebound in commodity prices.

In the United States, the first signs of the slowdown so desired by the FED are finally here. While real estate has already been slowing for several months, as has manufacturing, growth in services has come to a screeching halt! What's more, the price components of the ISM are pointing to a substantial drop in inflation statistics, which investors are quick to incorporate. Even the employment report was ideal at this level: job creation was still vigorous, but wage growth was slowing. And the December inflation figure confirmed this decline. If the price of services continues to rise, this is due to the rise in rents. Without this, the fall in inflation would have been more substantial.

In Europe, after months of deterioration, manufacturing activity is beginning to rebound timidly, as is activity in services. The fall in gas and electricity prices - back to their pre Ukraine war levels - is taking the burden off the European economy and points to an acceleration in growth, which could also benefit from falling inflation **#1 & 2**.

In China, the sudden lifting of restrictions has created health tensions and the return to normalcy will only be gradual**#3 & 4**.

Not surprisingly, there will be a sharp short-term drop in activity indicators, but in the long term, the effects of the reopening on consumer confidence, coupled with household savings swollen by months of confinement, will drive growth. Finally, the country has announced a package of measures to end the regulatory clampdown on technology companies and a support plan for property developers. This should lead to an acceleration of growth in 2023. We will have to be careful that this does not become inflationary, in China as in the rest of the World.

Central banks

The monetary tightening carried out by central banks in 2021 and 2022 is historic in its speed and generalised nature. It will have had one merit: the disappearance of debt with negative interest rates. But this process is nearing its end and the markets have doubts about the rates desired by the FED**#5**. While short rates have fallen slightly since the beginning of the year, it is mainly 10-year rates that have fallen significantly, causing a sharp inversion of the US and German yield curves. It is interesting to note that real rates have not fallen because this movement has been accompanied by a fall in inflation expectations.

However, we have to be careful not to be too complacent with the level of rates. The reduction in the size of central banks' balance sheets, coupled with large volumes of issuance, could push them up. But it could also be the

Beginning of the end of ultra-accommodating monetary policy in Japan.

Financial markets

Buoyed by the good news on the inflation front, financial markets have started the year with a bang after a particularly difficult 2022 in both equities and bonds**#6**. Investors were cautiously positioned, and this fuelled the rally even more. However, for this rally to continue in US equities, the FED needs to confirm the fall in inflation and start to soften its rhetoric. It seems to us that it is still a bit early for that.

European equities have had a historic start to the year, buoyed by the dissipation of the risk of the energy crisis, and emerging equities are being driven by Chinese equities, finally freed from the burden of Covid and political risk. Lastly, credit performance is not to be outdone and is benefiting from a more than buoyant environment between falling inflation and an economic soft landing.

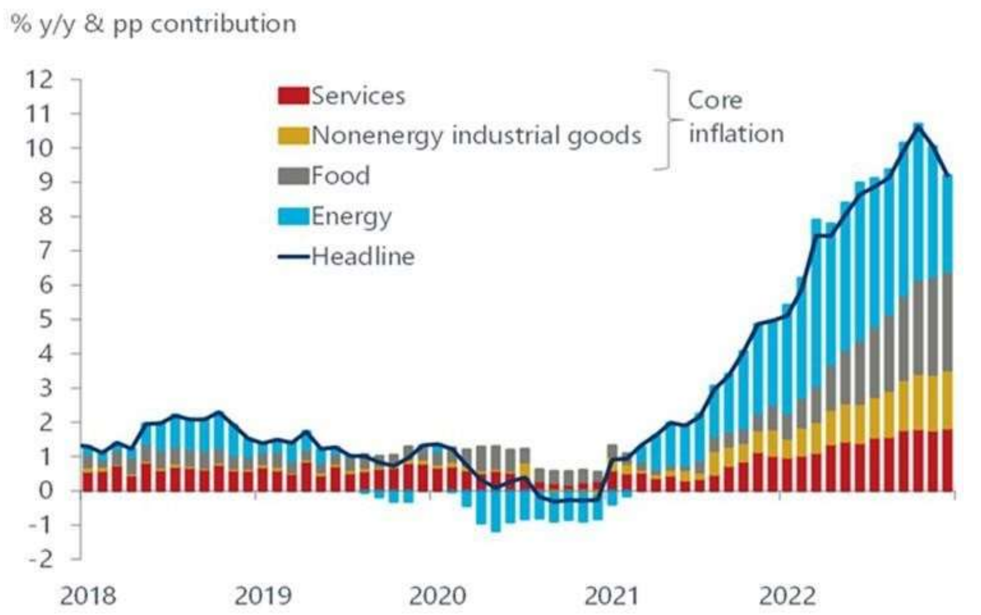
Investment policy

The decline in global inflation is undeniable and investors are already anticipating a pivot by the FED. But will central banks be satisfied with these positive surprises? Nothing is less certain, given that just a month ago they made very aggressive speeches and that in the meantime China has reopened its economy.

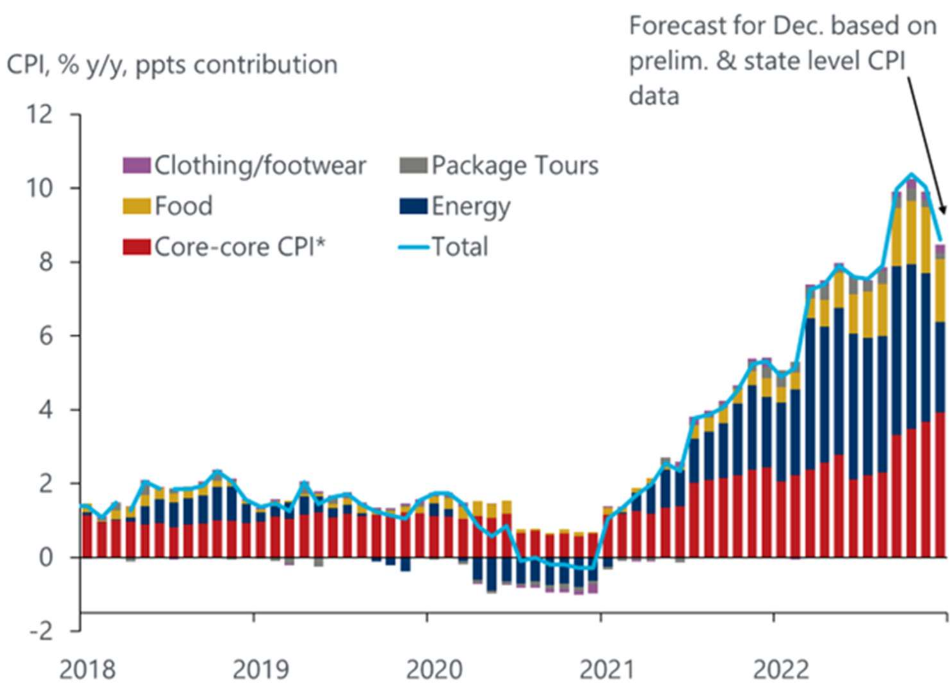
- In order for the market to break its downward trend, the FED must give credence to the idea of a pivot. We doubt it will do so soon.
- The mild winter will further fuel the decline in inflation and take the burden off the economy.
- Reopening, accommodating monetary and fiscal policy, support for real estate at a time of low valuations. What more could one ask for? This should be very favorable for China and Asia.
- We focus on Asia in the emerging world.
- In fixed income, 3.8-4.0% on the US 10-year seems to be a ceiling level at the moment while European rates could continue to rise towards 2.50%.

Graphics

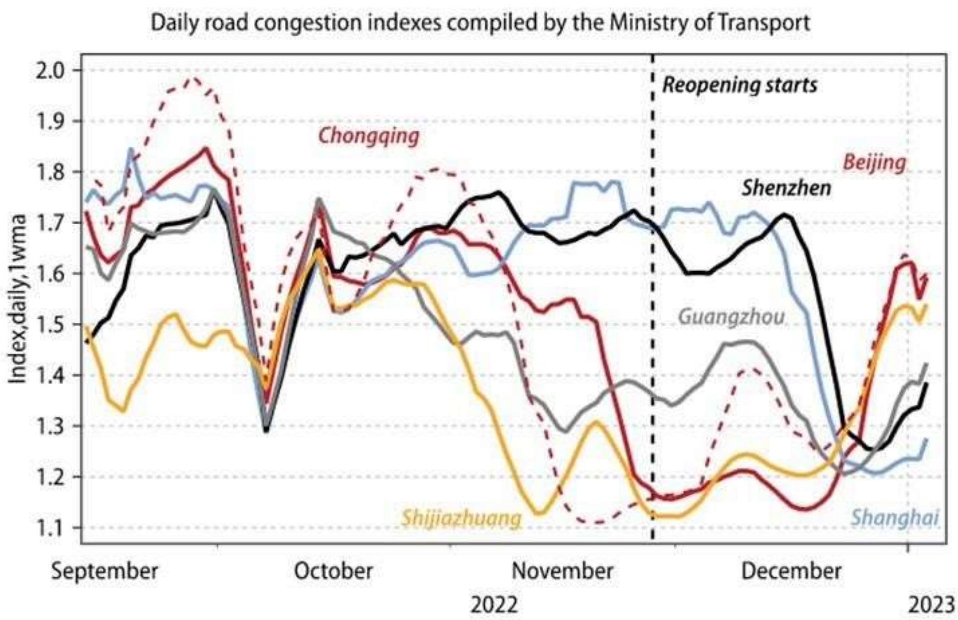
#1 Decomposition of inflation in the euro area



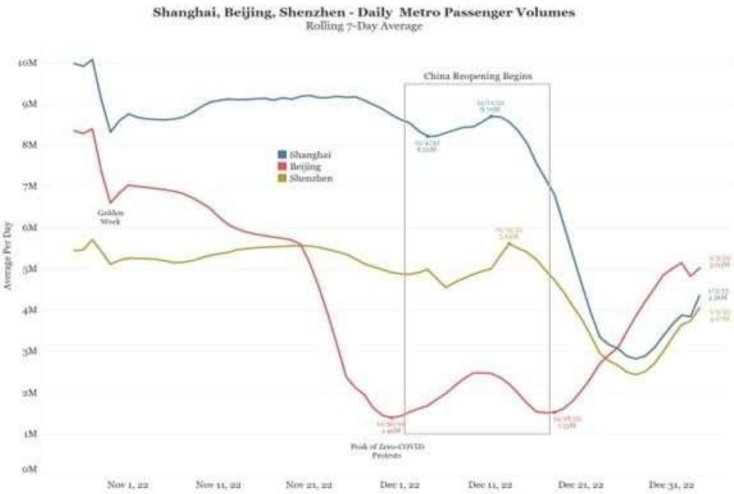
#2 Decomposition of the German CPI

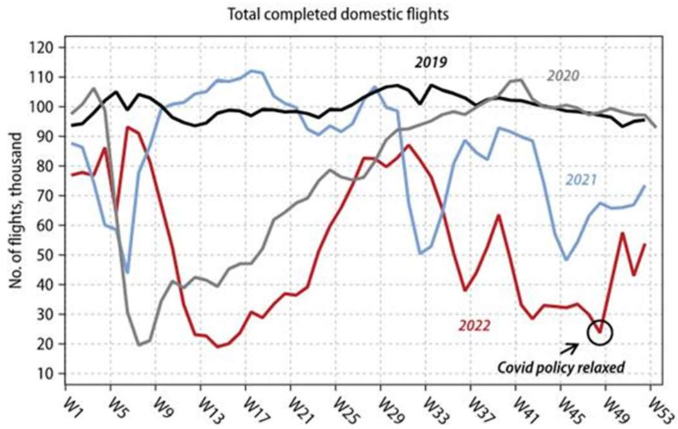


#3 Daily traffic jams in major Chinese cities

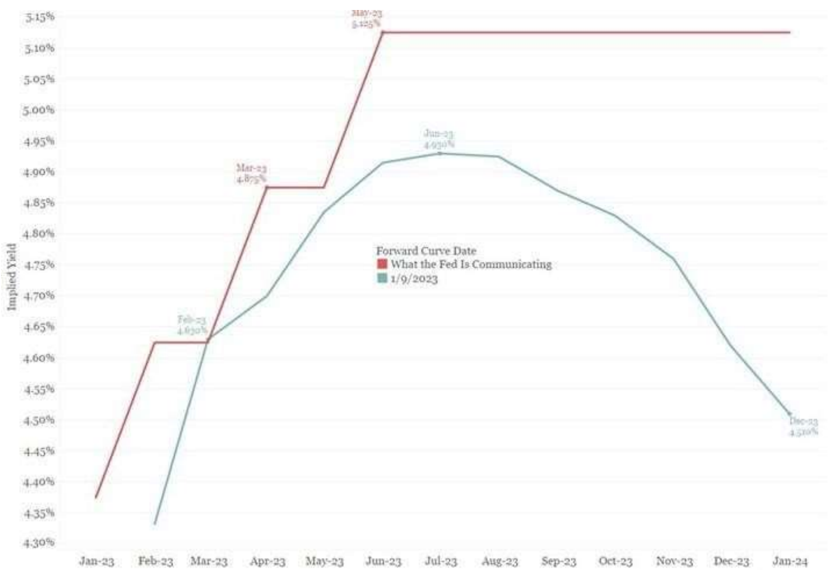


#4 Metro passenger numbers and air traffic

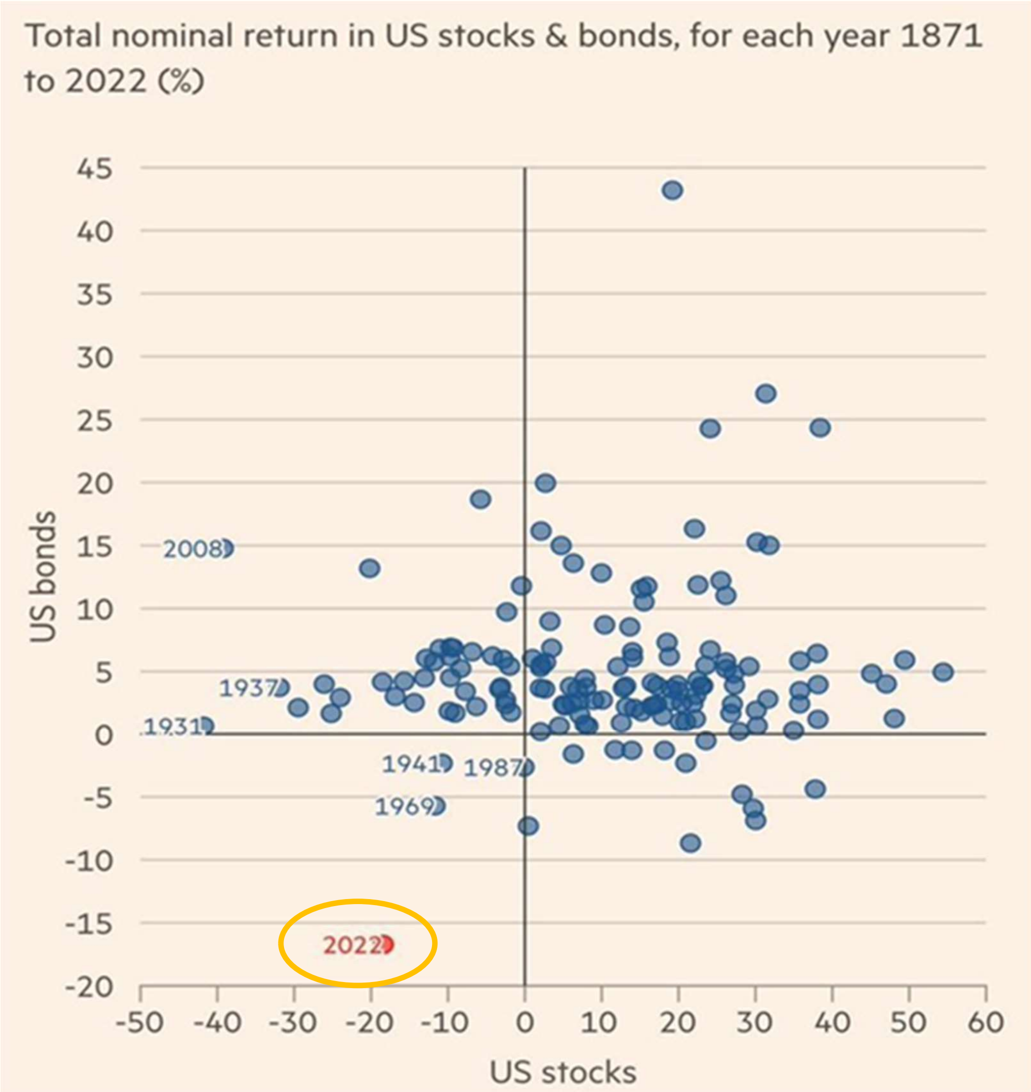




#5 What the FED says vs. what the market thinks



#6 Annual performance of US stocks and bonds



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