EDMOND DE ROTHSCHILD

LETTER FROM THE CIO AM

MARKET ANALYSIS
AND PRINCIPAL INVESTMENT THEMES

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MONETARY POLICY: DECISION TIME

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► When reviewing the Fed's recent history, James Bullard, President of the Federal Reserve Bank of St Louis, came to the conclusion that restrictive monetary policies (in 1983 and 1994) had not ultimately led to a recession and that the extinction of underlying inflationary tensions had paved the way for a strong and long-lasting growth cycle. In the 1970s, the 'stop & go' policies neither kept inflation from remaining elevated, nor boosted feeble economic growth, as business cycles have shortened.

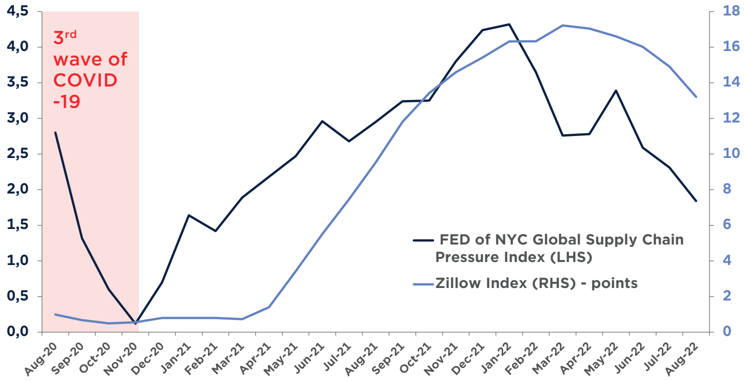
Investors may take this analysis further by comparing stock market performances. Unable to offer protection against inflation in the 1970s, market returns were then particularly strong in the 1980s and the second half of the 1990s.

JACKSON HOLE: CENTRAL BANKS HAVE MADE THEIR DECISION

At Jackson Hole, Jerome Powell put an end to the ambiguous guidance. Key rates must become restrictive and for a sufficiently long period of time to bring inflation down to 2%, even if this causes some pain for the economy. The ECB appears to have adopted a similar model according to many members of the central bank, though Christine Lagarde has remained tight-lipped on the issue. We believe that Jackson Hole has marked a turning point: a return to the 1970s is not an option, though this will require central banks sticking to the path they have set and going the whole way.

Furthermore, several factors signal that inflation could start to abate: production line tensions are decreasing, while in the US, new rents have already begun to slow down and job offers have retreated from the all-time highs reached at the start of the year.

Inflation will end up slowing down...... but not as fast as the markets expect



Source: Bloomberg, Edmond de Rothschild Asset Management. Data as of 24.08.2022. Past performance is not an indication of future performance. It may vary over time.

THE OUTLOOK IS FINALLY LOOKING BRIGHTER FOR THE GLOBAL ECONOMY THOUGH WE PREFER TO REMAIN PRUDENT IN THE VERY SHORT-TERM

Now that central banks have clarified their goal – which appears achievable for the Fed and highly likely for the ECB – and if inflation subsides over the next few months, the environment will be particularly conducive to a strong bull market. With this in mind, we are optimistic over the mid-term.

However, in terms of timing, we prefer not to position our portfolios too early as:

- Short-term rates have factored in the Jackson Hole statement rather effectively, but maybe not fully. Markets might continue to correct as the perception of a durably restrictive monetary policy may wellincrease the likelihood of a recession for investors.
- The Fed's quantitative tightening - the effects of which are unclear but potentially negative for markets - will see its intensity rise two-fold in September.
- We are entering a phase of downward revisions to earnings forecasts.

Our short-term cautious stance is nevertheless expected to be limited and will be revised in the very near future, as the situation evolves.

	Our convictions*	Changes compared to the previous month
ASSET CLASSES		
Equities	-	→
Fixed Income	=	→
Cash	+	→
EQUITIES		
US	=	→
Europe (ex-UK)	-	→
UK	=	→
Japan	-	→
China	+	→
Global Emerging	=	→
Convertibles	=	→
SOVEREIGN BONDS		
US	=	→
Euro Zone	-	→
Emerging Markets	-	→
CORPORATE BONDS		
US Investment Grade	-	→
Euro Investment Grade	-	→
US High Yield	-	↑
Euro High Yield	-	→

*Range of investment committee ratings on the asset class/geographical zone (from -/- to +/+). Source: Edmond de Rothschild Asset Management (France). Ratings at 22/08/2022.

EUROPE LACKS VISIBILITY BUT SHOULD NOT BE UNDULY UNDER-WEIGHT

Energy bills and inflation will rise significantly as the price of gas surges in Europe. The extent of the shock is such that forecasts on European economic growth have been put on hold. The decline of the euro, partly caused by the European energy crisis, is putting the ECB under pressure, and increasing the risk of a recessive trend in monetary policy.

The key problem for investors is that the current challenge for Europe can be summarised as one single factor: the price of gas – which is both highly political and highly volatile. European assets have factored in a great deal of negative news but have not incorporated the scenario of a severe recession.

We therefore prefer to underweight European assets (equities, high-yield bonds), but only to a limited extent. We feel the situation can turn around very quickly and staying away from these listed markets would be costly.

Within equity markets, we appreciate healthcare, which is resilient in periods of economic slowdown, and Big Data. Finally, the very strong run enjoyed by the Indian market has confirmed our long-held faith in this investment theme: India now offers durable growth prospects. The boom of the residential real estate market in the country has supported the long-lasting development of a middle class, accompanied with a high demand for goods and equipment.

KEY POINTS

We are modestly underweight on European assets (equities, high yield)

We particularly appreciate healthcare and Big Data

India offers durable growth prospects

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