PERSPECTIVES

MARKET AND ALLOCATION

Our experts monthly overview

April 2023

Document completed on 05/04/2023

Ofi invest
Asset Management

PERSPECTIVES

Éric BERTRAND
Deputy Chief Executive Officer,
Chief Investment Officer
OFI INVEST

OUR CENTRAL SCENARIO

Fears of a systemic crisis re-emerged in March on both sides of the Atlantic, recalling some bad memories of 2008. We don't believe we are in a situation comparable to the Great Financial Crisis. Global banking regulation has been stepped up markedly, in particular of systemic banks, and balance sheets have been deleveraged considerably. Moreover, prompt and coordinated action by regulators to soothe market concerns shows how much has been learned from 2008, i.e., quick action is needed to keep fears of risks of contagion and liquidity squeezes from becoming self-fulfilling.

Nevertheless, the bout of stress, which is likely to continue receding, does constitute a form of implied monetary tightening that the central banks must now take on board. Accordingly, we expect the US Federal Reserve and the European Central Bank to raise their key rates by less than had been expected one month ago, probably by one or two additional 0.25% hikes.

As combatting inflation remains their priority, we don't see them lowering their rates this year, particularly in the United States. This normalisation is likely to push long bond yields up somewhat.

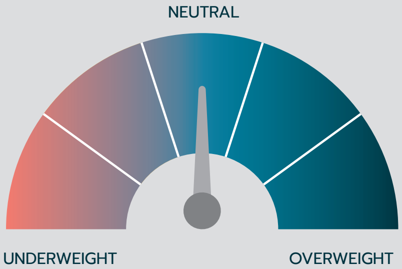
While this episode of banking stress has stoked credit risk, we don't see any major risks and remain constructive on credit spreads, which appear to be pricing in some of the coming economic slowdown and, hence, remunerating the risk assumed.

The equity markets are holding steady at their highs and appear to have already priced in much of the good news and the upside expected for the entire year. We therefore reiterate our slightly negative bias. Other episodes of volatility are likely to occur, reminding us, as they did last month, that such a steep rise in interest rates takes time to spread out into the economy. These episodes are therefore likely to offer more attractive entry points. A close eye should be kept on earnings reporting season and, above all, companies' forward guidance.

The analyses presented in this document are based on the assumptions and expectations of Ofi Invest Asset Management, These analyses were made as of the time of this writing. It is possible that some or all of them may not be validated by actual market performances. No guarantee is offered that they will prove to be profitable. They are subject to change.
A glossary listing the definitions of all the main financial terms can be found on the last page of this document.

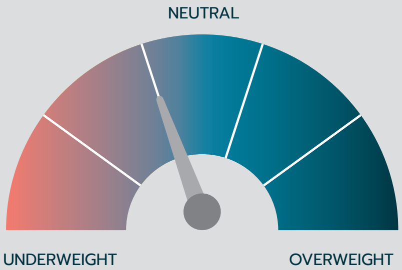
OUR VIEWS AS OF 05/04/23

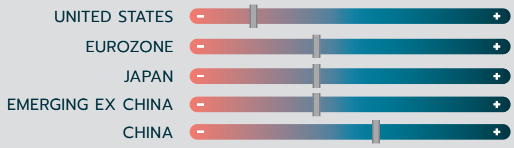
BONDS



We have a neutral stance on euro zone bonds, with a marked preference for corporate bonds over government bonds. We expect government bond yields to rise slightly in the coming months. More tactically, if the 10-year German yield were to rise above 2.50%, we would consider building up long duration positions.
Meanwhile, we believe it is worth exploiting recent market shifts and overweighting corporate bonds for carry purposes. With the rise in key rates and credit spreads, our preference is now for short-duration assets, such as money-market and high-yield instruments. Investment grade corporate bonds and emerging debt also going at attractive levels in most market scenarios.

EQUITIES





Based strictly on fundamentals, equity markets are not overvalued. Even so, the current volatility, uncertainties on central bank policies, and the consequences of the economic slowdown on corporate earnings could create opportunities to take on exposure at lower prices. Hence, our somewhat cautious stance in the short term.
Geographically, Europe is likely to benefit from the fact that it is priced lower than the US. Asia could also fare well with China's reopening.
By sector, the most solid financial stocks, which were bid down in March, may have some catching up to do. Oil stocks could get a boost from higher prices if those prices stay high.

CURRENCIES

Monetary policy is likely to provide less support for the dollar, in particular vs. the euro, given that the European Central Bank (ECB) is expected to stick to its hawkish monetary policy in combatting inflation and, hence, counter the dollar's strength. However, the dollar's safe haven status should support it in the event of a hard landing of the economy.
The Bank of Japan looks as though it could end its yield-curve-control policy in 2023, which could mean an appreciation in the yen.

BALANCING OUT FINANCIAL STABILITY AND PRICE STABILITY

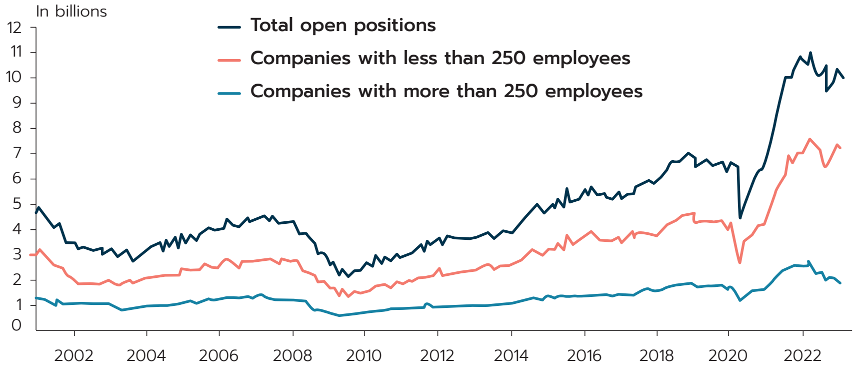
Ombretta SIGNORI
Head of Macroeconomic Research and Strategy
OFI INVEST ASSET MANAGEMENT

Banking "incidents" marked the month of March, but panic and fears of a global banking crisis appear to have been rapidly circumscribed. The failure of two US regional banks – Silicon Valley Bank and Signature Bank – and UBS's takeover of Credit Suisse orchestrated by the Swiss government are completely separate events but the fact that they occurred so close to each other made the markets fear the worst. To head off contagion, US authorities (the Federal Reserve, the Treasury and the FDIC) rapidly set up a mechanism to guarantee deposits and banks' access to liquidity. While each event had its own cause, they remind us that the extent and speed of key rate hikes last year have lagging impacts on the real economy, as households and companies take time to adjust their behaviour. Economic literature estimates that it takes one to two years for the maximum impact to show up in the real economy.

IF FEARS OVER THE FINANCIAL SYSTEM RECEDE, THE FED AND ECB SHOULD BE ABLE TO STICK TO MONETARY TIGHTENING

In March, the central banks were able to manage financial risk and price stability in parallel. The US Federal Reserve raised its key rates by 25 basis points to 5%, and the European Central Bank (ECB) raised its deposit rates by 50 bp to 3%. They are now taking an almost exclusively data-dependent approach, with one eye on (core) inflation and the other on credit condi-tions. We believe that if fears over the financial system recede, the Fed and ECB should be able to stick to their monetary tightening plans and then remain sufficiently in restrictive territory for several quarters. Indeed, the macroeconomic context still justifies a convergence of key rates towards 5.25% by the Fed and 3.50% by the ECB. Recent financial stress terminal rates has lessened the likelihood of terminal rates being in highly restrictive territory.

US LABOUR MARKET:
JOB OPENINGS BY COMPANY SIZE



Sources: Macrobond, Ofi Invest Asset Management as of 03/04/2023

ECONOMIC ACTIVITY IS HOLDING UP WELL, AND CORE INFLATION REMAINS HIGH

On both sides of the Atlantic, the most recent data suggest that economic activity is still holding up well, driven by an expanding services sector and historically low unemployment rates. Total inflation is receding, thanks to favourable basis effects of energy prices. However, core inflation (ex volatile components) remains too high and is still rising in the euro zone (5.7% in March after 5.6% in February). The central banks will probably not have a clearer picture of the speed at which core inflation is moderating until the second half of the year. This will be a key factor in steering future monetary.

That being said, headwinds are blowing on US household consumption, sending savings rates higher since last September, and corporate financing conditions – which were already tight – are likely to undermine business investment in the coming quarters. The US economy is therefore likely to slow and possibly contract later this year. Stress in US regional banks are an additional source of risk that could undermine real estate financing and the business activity of local small and mid-sized companies, which are the biggest cause of excessive demand on the job market. Between now and then, with a slowdown in economic activity that is taking time to materialise in the US and a euro zone that probably (barely) avoided a recession this winter, the fight against inflation hasn't been won yet.

[1] The failure of SVB can be put down to the lack of diversification in its customer base, made up almost exclusively of tech companies, and to ALM mismanagement. Signature Bank was one of the few US banks to accept deposits by businesses in crypto. Credit Suisse had been under the markets' radar for some time, owing to weak profitability and the postponed release of its results in December.

INTEREST RATES

VOLATILITY ON YIELDS HITS A NEW HIGH

Geoffroy LENOIR
Co-CIO, Mutual Funds
OFI INVEST ASSET MANAGEMENT

Bond yields were especially volatile in March. The Ice BofA Move Index, an indicator of volatility in US Treasury bonds, approached 200 basis points on 15 March, a level not seen since late 2008. This spike in volatility was due mainly to the emergence of risks on the stability of the US banking system, with, among other things, the failure of Silicon Valley Bank (SVB) then, in Europe, the downfall of Credit Suisse, taken over urgently by UBS. Against this backdrop, the 10-year German yield dropped from 2.75% in early March to 2.10% in mid-March, ending the quarter at about 2.30%. The US 10-year yield fell from 4.05% to 3.38%, ending the month at about 3.50%. Swings were even wider in the short section of the yield curve, as the markets expected that central banks would have to rapidly call off their monetary tightening cycles.

MARKET SENTIMENT HAS TURNED SHARPLY DOWNWARD

In early March, when the macroeconomic environment was more favourable, the level of short-term yields suggested that the US Federal Reserve was likely to raise its key rates to 5.50% before pausing. These expectations look justified in light of the outlook for inflation and growth. Similarly, in Europe, the markets were pricing in the ECB's raising its main key rates as high as 4%. Even so, in light of excessive market exuberance, we urged some caution on the trajectory of yields. The SVB and Credit Suisse episodes did not keep the Fed and ECB from raising their rates, respectively, by 25 and 50 basis points this month. Still, at the worst of the crisis the bond markets were thinking that not only would these hikes be the last ones but that central banks might well pivot by yearend. So the markets shifted from excessive optimism to excessive caution in just two weeks. In reaction, we once again began to slightly underweight European sovereign debt. As of early April, the markets were pricing in two further rate hikes by the ECB in 2023.
Just like in bond yields, inflation expectations fell sharply on the month. We expect uncertainties on the levels of inflation to continue offering opportunities in the coming months

THE CREDIT MARKET HIT BY CREDIT SUISSE

The credit market got a boost from falling bond yields on the month but took a hit from the widening in spreads. These conditions hit bank bonds and high yield bonds in particular. The iTraxx Cross-over indicator, which gives the credit market's take on a basket of bonds ranging from investment grade to high yield, spiked from 413 to 513 basis points during the episode of banking stress. Notably, during the Credit Suisse downfall, holders of subordinated debt known as "Additional Tier One" (AT1) were wiped out, whereas shareholders managed to salvage a little something, which is unusual for this type of event. Based on reassurances from the European authorities, this unusual treatment of investors should remain consigned to Switzerland, especially as European regulations (Bâle III) provide lots of support to the sector, and Credit Suisse does not look systemic. The markets could, however, continue to test the banking sector, as they did with the subsequent widening that occurred in Deutsche Bank spreads with no real fundamentals to back it up. While remaining alert on certain banking stocks, we believe that the current yields and spreads once again offer an opportunity to overweight the asset class.

FIGURE OF THE MONTH

2.90%

Ester, the euro zone's interbank rate, a benchmark for the money market.

PERFORMANCES

Bond indices with coupons reinvested

	March 2023	YTD
JPM Emu	2.34%	2.40%
Bloomberg Barclays Euro Aggregate Corp	1.00%	1.75%
Bloomberg Barclays Pan European High Yield in euro	-0.41%	2.89%

Sources: Ofi Invest Asset Management, Refinitiv, Bloomberg as of 31/03/2023.
Past performances are not a reliable indicator of future performances.

BANKING STRESS WITH NO IMPACT?

Éric TURJEMAN
Co-CIO, Mutual Funds
OFI INVEST ASSET MANAGEMENT

For a minute there in early March, it was looking like a remake of 2008. Back then, after the failure of Lehman Brothers, the equity markets plunged by more than 60% in less than six months. We haven't forgotten! But we did learn from our mistakes and, this time, the central banks and governments decided to take drastic measures to keep the conflagration from spreading from the US and Switzerland. Even so, banks' higher financing costs will inevitably increase business financing costs. And, if so, global growth is likely to be penalised and pull down long-term interest rates. It is this last possibility that makes equity markets happy. After all, lower rates mean higher discounted future earnings.

But it would be unfair to attribute the stubborn bullishness of the equity markets to falling bond yields alone. For, with the first quarter just ended and with earnings reporting season set to begin within about 10 days, financial analysts see no reason to lower their earnings forecasts, either for 2023 or 2024, at least in Europe. This is less so for US companies, which, among other negative factors, are suffering from the strong dollar, although the dollar has weakened a bit recently.

Inflation appears to have peaked, but it's not over yet. It will be crucial to see how companies have managed (or not) to protect their margins by passing their higher costs onto their customers. They have managed to do so until now. Can they continue to do so in the future? Another thing to keep in mind will be wage trends. Naturally, employees want raises to deal with the run-up in the cost of living, and, since the "post Covid" period, the balance of power has shifted in their favour.

EUROPEAN AND ASIAN MARKETS ARE MORE ATTRACTIVE THAN THE US

Geographically, we remain cautious on US equity markets, mainly because of valuations that leave little room for bad surprises. And seldom have there been so many uncertainties, whether the extent of the ongoing economic slowdown, the landing point of inflation, or the outlook for companies' margins, which are at record levels. At almost 18 times forecast earnings for 2023, the S&P 500 is already above its long-term average.

Our relative preference is for European and Asian markets. European markets have already been riding a steep drop in energy prices over the past several months. Robust end-demand in Europe and the easing in intermediate costs are boosting the earnings outlook. Meanwhile, China's reopening will provide additional growth to its trading partners, led by European countries and Japan.

Lastly, **in terms of investment style,** concerns over the banking sector – combined with falling bond yields – have naturally boosted growth stocks.

BUT CAUTION IS STILL IN ORDER FOR THE EQUITY MARKETS

In January we had decided to lower our equity market recommendation by one notch, exiting our neutral stance, as we felt the headlong rally had been a little too fast. Without calling into question our yearend forecasts of double-digit gains in the indices, European ones in particular, we believe that the many prevailing uncertainties justify this very slightly negative bias. If volatility persists, there will no doubt be opportunities to change tack.

FIGURE OF THE MONTH

-13.85%

The slide of European banking stocks during the month

EuroStoxx Banks Index

PERFORMANCES

Equity indices with net dividends reinvested, in local currencies

	March 2023	YTD
CAC 40	0.83%	13.32%
EuroStoxx	0.38%	11.83%
S&P 500 in dollars	3.62%	7.36%
MSCI AC World in dollars	3.08%	7.31%

Sources: Ofi Invest Asset Management, Refinitiv, Bloomberg as of 31/03/2023.
Past performances are not a reliable indicator of future performances.

ASIA: THINK CHINA AND EX CHINA...

Jean-Marie MERCADAL
Chief Executive Officer
SYNCICAP ASSET MANAGEMENT

China's sheer size makes it a must-have in Asia and worldwide. Its weight in regional market indices has become overwhelming. But China has also come under some controversy in the West... That's why we now feel it is worth reasoning in terms of two dimensions for investments in Asia: China and ex China.

An international equities portfolio naturally includes a portion of Asian stocks. Asia accounts for almost two thirds of the global population and is one of the biggest contributors to global growth. And China's size makes it, by far, the economic, market and political driver of Asia. The MSCI Asia Pacific ex Japan, a regional index, is dominated by Chinese equities, with a weighting of almost 44%. The same goes for the MSCI Emerging Market, at 27.5% for continental Chinese stocks and 2.0% for Hong Kong-listed ones, amounting to a total of almost 30.0%.
China's development has been driven mainly by burgeoning globalisation in trade of goods and capital in recent decades. But, now the reverse is being promoted for reasons of supply security (cf. Covid) and politics (cf. the presence of Chinese components in highly sensitive materials used, for example, in the defence and healthcare sectors). Moreover, China's positions on Russia and Taiwan are felt to be ambiguous. In reaction, the United States has levelled trade sanctions, including embargos on key products (semiconductors) and drawn up a sanctions list of Chinese companies. **China, meanwhile, seems to have embarked on a path that would ultimately lead it to focusing on its domestic economy and its huge domestic market.**

CHINESE EQUITIES ARE LIKELY TO BECOME INCREASINGLY DECORRELATED FROM OTHER INTERNATIONAL MARKETS

Regarding investment in Chinese equities, it is worth focusing on the two priorities that the state wants to promote: the green economy and "common prosperity". The themes of green technology, domestic consumption, with the emergence of local brands on this market of more than 1 billion consumers, healthcare, and so on are likely to benefit from these social objectives. The Chinese equities market was already relatively well decorrelated from other international markets; it will probably become more so, making it intrinsically attractive for portfolio diversification. Keep in mind that China has the world's second-largest equities market, with a total capitalisation of almost 16,000 billion dollars and more than 7000 listed stocks. In short, it's an investment zone in and of itself.
The rest of Asia is highly diverse, with many countries at various stages of development. Although some of them are small, they are also a way to construct rather robust diversified portfolios. They also offer opportunities for investing in growth companies, some of which are priced rather low in absolute terms and, above all, in comparison with companies in other countries. Asia's main markets, other than China, are India, Korea, Taiwan, as well as attractive countries like Indonesia, Malaysia and other, less mature countries that are among the main recipients of Chinese capital, such as Vietnam, which is still in the frontier country index. We are indeed seeing more and investment from China in its neighbouring countries. There are three main reasons for this: (1) entrepreneurs' wish to leave China; applications for expa-triation by families who are among the richest have risen considerably in recent months; (2) as a corollary, producing outside China helps create new supply chains that bypass China and the embargos levelled by Western countries; and (3) production costs, particularly wages, are highly competitive.
To sum up, both zones (China and Asia ex China) are attractive and, while interconnected economically, are different, especially politically. We are therefore thinking of creating an "Asia ex China" strategy. This would allow investors to carve out their investments and better control their allocations while discretely managing the sometimes controversial "China" parameter.

FIGURE OF THE MONTH

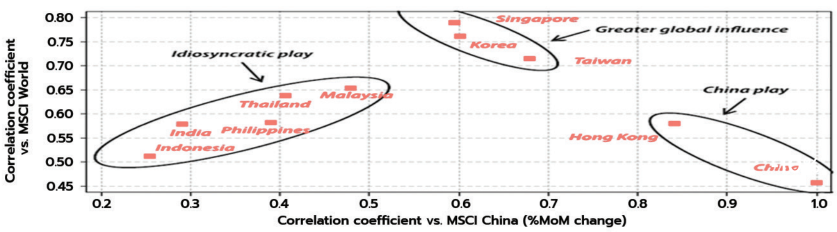
44%

Weighting of Chinese equities in the MSCI Asia ex Japan index.

Source: Bloomberg as of end-March 2023

CORRELATION COEFFICIENTS MSCI CHINA VS MSCI WORLD

Sources: Gavekal Research/Macrobond as of end-March 2023



Asian equities cover two types of countries – those that are more sensitive to the Chinese economy and its equity market and others that are more closely tied to international growth and the international equities indices.

Syncicap AM is a portfolio management company owned by Ofi Invest (66%) and Degroof Petercam Asset Management (34%), certified on 4 October 2021 by the Hong Kong Securities and Futures Commission. Syncicap AM specialises in emerging markets and provides a foothold in Asia, from Hong Kong.

Glossary

Breakeven inflation : difference between the yield on a traditional bond (nominal yield) and the yield on its inflation-indexed equivalent (real yield).

Carry: a strategy that consists in holding bonds in a portfolio, possibly even till maturity, in order to tap into their yields.

Duration: the weighted average life of a bond or bond portfolio expressed in years.

Inflation: the loss of a currency's purchasing power, translating into a widespread and lasting increase in prices. Core inflation refers to inflation excluding energy and food.

Investment Grade / High Yield credit: Investment Grade bonds refer to bonds issued by borrowers that have been rated highest by the rating agencies. Their ratings vary from AAA to BBB- under the rating systems applied by Standard & Poor's and Fitch. Speculative High Yield bonds have lower credit ratings (from BB+ to D, according to Standard & Poor's and Fitch) than Investment Grade bonds as their issuers are in poorer financial health based on research from the rating agencies. They are therefore regarded as riskier by the rating agencies and, accordingly, offer higher yields.

PER: Price to Earnings Ratio. A stock market analysis indicator consisting in dividing price by earnings.

Spread: difference between interest rates. Credit spread is the difference in interest rate between a corporate bond and a same-dated benchmark bond that is regarded as the least risky (benchmark government bond). Sovereign spread is the difference in interest rate between a sovereign bond and a same-dated benchmark bond that is regarded as the least risky (German benchmark government bond).

Volatility: a measure of the amplitudes of price variations of a financial asset. The higher the volatility, the riskier the investment is considered to be.

Important notice

Ofi Invest Asset Management • 22, rue Vernier 75017 Paris - FRANCE • Portfolio management company • RCS Paris 384 940 342
Certified under N° GP 92-12 • S.A. with a board of directors and share capital of €71,957,490 • APE 6630 Z • FR 51384940342

Printed on PEFC paper (sustainable forest management)