PERSPECTIVES

MARKET AND ALLOCATION

Our experts monthly overview

February 2023

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Ofi invest
Asset Management

BACK AND FORTH

Éric BERTRAND

Deputy Chief Executive Officer,
Chief Investment Officer
OFI INVEST

Jean-Marie MERCADAL

Chief Executive Officer
SYNCICAP ASSET MANAGEMENT

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.

How is 2023 shaping up, as seen from Europe and Asia?

Éric BERTRAND : 2022 was a year of great change. In Europe, we estimate that at least one quarter of these changes will continue to play out in 2023, including: geopolitical tensions, with the war in Ukraine; sustained high energy prices, making it necessary to diversify supply sources, pending the switch to decarbonated energy; inflation, which has returned to the fore after vanished for 20 years and will not return to its pre-crisis levels; and the end of the myth of free and unlimited money, which in the long term is posing a threat to the financing of sovereign debt.

Jean-Marie MERCADAL : In Asia, these issues are interpreted as reflecting the fact that Europe is emerging very weakened from this crisis. Many people feel that Germany, for example, has given up its leadership role. But on the whole, Asia is focusing rather on relations between the United States and China, which many regard as far more important for the economy in the two regions and which improved considerably last year, with the resumption of dialogue between the two countries. It is hard to draw any lessons from this for the European market outlook, but the lack of unity within the Eurozone during this crisis year could very well generate tensions on the issue of disparity in the levels of debt.

Is China back as an issue for the markets?

Jean-Marie MERCADAL : The shift in China's Covid policy in late 2022 was surprising in its extent. And it provided a boost to China's economic momentum, which has become desynchronised with the US economy. This is also good news for the European economy.

Éric BERTRAND : Indeed, that does change things! Seen from Europe, until November we had assumed in our forecasts that the Chinese slowdown would have an impact on risky assets, but later in the year we began to revise them upward.

That being said, we are now more cautious, given that if the Chinese economy continues to accelerate, we will have to deal with the return of tensions on the energy and commodity markets. We don't think that investors have priced this in yet.

So, it is worth staying cautious for 2023?

Jean-Marie MERCADAL : The year should be positive on the whole for financial assets, but the market has priced that in, perhaps a little too fast. We therefore believe that caution is the better course for the short term.

Éric BERTRAND : The markets do indeed seem to have anticipated the next six months a little too rapidly. We do expect 2023 to end well, but there may still lie some challenges ahead, particularly in inflation trends and central bank monetary policies, which markets seem to have shrugged off a little too quickly.

What risks should we keep an eye on this year?

Éric BERTRAND : Debt is the elephant in the room. We will have to keep a close eye on it, along with inflation trends. In Europe, we have moved from 200 billion euros in refinancing needs in 2022 to more than 800 billion projected for this year. For the moment, the market seems to want to forget, but this can't go on forever.

The good news is that expected returns are back in investment grade(1) and high yield(1) corporate bonds. These asset classes are once again attractive for asset allocations.

(1) High yield bonds have a lower credit rating (from BB+ to D, according to Standard & Poor's and Fitch) than investment grade bonds (rated from AAA to BBB- by S&P and Fitch), due to their issuers' weaker financial standing, based on research from ratings agencies. They are therefore regarded as riskier by the ratings agencies and, accordingly, offer higher yields.

OUR CENTRAL SCENARIO

Risky assets began the year with a bang, driven in part by a shift in interest rates that we see as partly contradictory. The markets seem to be pricing in key rate cuts by central banks as early as the second half of the year, while assuming that the economy will slow and that inflation will be brought under control, in particular in the US. In that case, we should be seeing downward revisions in earnings forecast for 2023, which would throw cold water on the equity markets in particular. Moreover, the Chinese reopening is likely to continue to drive upward revisions of forecasts of global growth and probably of commodity and energy prices, as well.

With this in mind, we expect the long-dated bond yields to rise a little in the short term, once central banks' target short-term rates are reached (about 5.00% for the Federal Reserve and 3.50% for the European Central Bank) before receding in the second half of the year.

In light of this expected trend in interest rates and given the path already traced since the end of September 2022, we are more cautious in the short term on the equity markets, with a view to taking back on exposure during the bouts of volatility[(1)] that interest rate shifts and revised earnings forecasts could cause in the coming months.

Our allocation as of 07/02/23

Underweight		Neutral	Overweight	
--	-	=	+	++

ASSET CLASSES

The bond markets got off to a robust start this year, even better than the equity markets, driven by an easing of concerns on inflation, monetary policies and growth. The markets seem to have jumped the gun and to be partly contradicting themselves. Accordingly, we are lowering our weighting of both equities and bonds by a notch, in order to take advantage of a likely future bout of volatility[(1)] to take back on exposure.

	Position	Trend
Money market	+	↑
Bonds	-	↓
Convertibles	-	↓
Equities	-	↓
Commodities	=	→
Alternatives/Absolute return	+	→

BONDS

The market are guessing that central banks will lower their rates shortly after they have peaked. But the banks could remain restrictive for longer, which would push long-dated bond yields upward. Movements in both investment grade and high yield risk premiums have been strong and fast, which calls for some caution in the short term. Carry[(2)] is still favourable in a medium-term view.

	Position	Trend
Euro core sov. debt	-	↓
Euro periphery sov. debt	-	↓
Euro Investment Grade	=	↓
High Yield	=	↓
Inflation-linkers/Breakeven	+	→
Emerging debt, hard currency	=	→
Emerging debt, local currency	=	↓

EQUITIES

We believe that the volatility[(1)] expected on the bond markets should lead to a slight consolidation on the equity markets in the short term, but without calling into question our full-year objectives, even though these are only very marginally above current levels. With this in mind, the US could hold up better in relative terms, thanks to its status as a safe haven, but not in absolute terms.

	Position	Trend
United States	-	↓
Eurozone	-	↓
UK	-	↓
Japan	-	↓
Emerging markets	-	↓
China	-	↓

EQUITIES BY SECTORS / STYLES

Growth stocks could take a hit from higher interest rates, but, on the other hand, they tend to be defensive during market consolidations. That's why we see no divergence coming in performance vs. cyclicals and value stocks. Only financials, which benefit from higher interest rates, could outperform them.

	Position	Trend
Growth	-	↓
Value	-	↓
Small / Mid caps	-	↓
Cyclicals	-	↓
Financials	=	→

CURRENCIES

In the run-up to the end of monetary tightening, the euro, sterling and the dollar could neutralise one another. The yen will probably wait for a change in governance at the Bank of Japan before moving back up.

	Position	Trend
USD	=	→
Yen	=	→
Livre sterling	=	→

(1) Fluctuations in the price of a financial asset. The higher volatility is, the riskier the investment is considered..
(2) Carry consists of holding bonds in a portfolio, possibly even till maturity, in order to tap into their yields.
Notice: the allocation policy presented applies to multi-asset funds managed by Ofi Invest Asset Management (including profile funds). The investment horizon of this allocation policy is short term and subject to change. This investment policy therefore does not constitute an indication for building a client's long-term allocation.

MACROECONOMIC VIEW

SOME GOOD SURPRISES TO START THE YEAR

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

The market euphoria on the year to date is due to encouraging signs being sent out from Europe. The Eurozone has held up better than expected to the energy price shock, thanks to several factors, such as the substitution of Russian gas by other supply sources, energy efficiency gains, mild temperatures, and state assistance to households and companies. Macroeconomic data even point to a mere stagnation in the Eurozone this winter, rather than a moderate recession. China's reopening, one of the market catalysts in early 2023, is an additional factor that could in part offset the weakness of developed economies. For, we mustn't overlook the fact that most developed countries could still very well be driven into recession by the consequences of inflation and monetary tightening. Global growth is therefore likely to dip in 2023 before taking off again, while remaining below its son potential in 2024.

TOWARDS A RECESSION IN THE US

One key point for investors is whether the US will slip into recession and, if so, when. Given the transmission times of monetary policy, recession remains the most likely scenario, in our view, as more than one year is needed for monetary tightening to have its maximum impact on the real economy.

Until now, the real-estate sector alone has slowed significantly, but the main business surveys are pointing to a coming contraction, something that has been confirmed by the volume decline in industrial output and retail sales. Regarding households, the surplus savings from the Covid crisis, half of which we calculate has already been exhausted, will be less able to support consumption. As for companies, productive investment is likely to suffer from a credit squeezes and companies' are likely to be less able to maintain their margins, which would ultimately hurt employment.

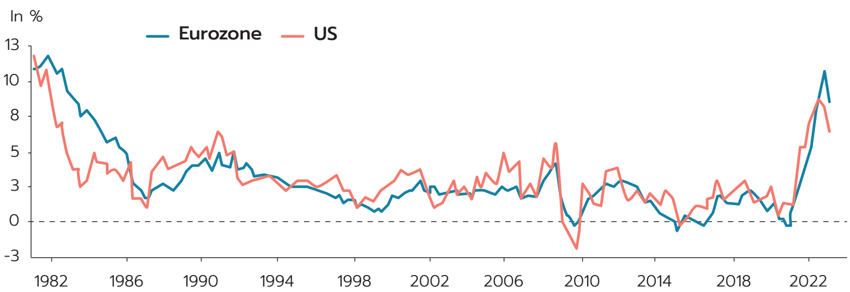
AND SLOWER INFLATION

The good news is that inflation is likely to moderate this year but will take a long time to converge towards the central bank targets. It should remain at levels higher than (or close to) 3.0% at the end of 2023. In the US, total inflation has already slowed considerably, to 6.5% in December, since peaking at 9.1% last June, and downward pressures on it are likely to be driven this spring by the weaking of the real-estate component. In the Eurozone inflation is higher (8.5% in January). In both regions, the main challenge is now in services, which is the least variable and most persistent component in the consumer price basket.

CENTRAL BANKS STILL ON THE MOVE

The US Federal Reserve has said it has two key criteria for the direction of monetary policy in 2023: an easing of job market pressures and a "convincing" slowdown in non-housing services inflation. The second criterion is derived mostly from the first, as wages in non-housing services are the main factor driving prices in these sectors. The job market is still tight, as seen in the main indicators – an unemployment rate below its long-term average, record job openings, and robust wage trends. This context justifies a terminal Fed rate of about 5.00%-5.25% and continued hawkish talk on inflation for some time to come. In the Eurozone, the phase of spreading of input prices into prices paid by households is still underway, suggesting that core inflation should moderate significantly in the second half of the year. Significantly higher wage growth than in 2022 (from +3% to +5%, based on the ECB's baseline scenario) could also support the stance of hawks on the ECB Executive Board. That's why we still see significant tightening to come, with the deposit rate exceeding 3.0% and converging towards 3.5%. In addition, the normalisation of the balance sheet will continue through the redemption of long-term refinancing operations and quantitative tightening.

INFLATION IN EUROZONE AND THE US



Sources: Macrobond, Ofi Invest Asset Management as of 31 January 2023

RENEWED INTEREST IN RATES

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

The 10-year German yield was still close to 0% just one year ago. But then central banks had to quickly raise their key rates in 2022 to address inflationary pressures. The year was thus marked by an exceptional run-up in rates in Europe and the US, making it one of the worst years ever for the bond markets. The Bloomberg Barclays Global Aggregate index fell 16.25% on the year, an unusual showing for bonds.

FIXED-INCOME MARKETS ARE CLOSELY TRACKING CENTRAL BANKS

Inflation appears to have already peaked in the US and Europe, but core inflation (i.e., ex energy) is still high. Central banks will therefore probably continue their monetary tightening cycle before taking a break in 2023.

As 2023 begins, encouraging signs on growth and inflation are the cause of the recent shifts in interest rates. After moving past 2.50% in late December, 10-year German bonds are now yielding about 2.25%, and 10-year US bonds almost 3.50% after hitting 4.25% during the fourth quarter of 2022. In 2023, fixed-income markets are therefore likely to remain particularly sensitive to macroeconomic data, depending on how central banks react to those data.

ARE SOVEREIGN YIELDS (AT LAST) AT ATTRACTIVE LEVELS?

Growth fears continue to confront inflation fears, but risks are now more balanced following the 2022 bond market crash. Sovereign bonds are now trading at long-term valuations that we believe are worth looking into. While we believe that 2023 will probably be a less volatile year(1), many questions remain, and it seems premature to expect yields to continue falling as they have so far this year.

In our baseline scenario, US and European 10-year yields should trade at close to current levels or slightly higher during the year to come. Long bond yields now offer some potential, but core inflation is still high and issuance volumes are still heavy, and the ongoing shrinking in central bank balance sheets will tend to push US and European yields upward.

With no major elections in Europe this year, political risks are likely to remain contained. But an eye will have to be kept on the possible emergence of new societal risks (reforms, purchasing power, etc.) and the trajectories of public debt and deficits, particularly in southern Europe. From this viewpoint, Italian spreads(2) are at levels that may look relatively narrow and could be sensitive to a shift in market sentiment.

CARRY OPPORTUNITIES IN CORPORATE BONDS

In a still-uncertain economic environment, corporate bonds, and in particular investment grade(3) ones, in our view offer good carry prospects(4) (close to 4% early in the year). While volatility could be higher than in recent years (except 2022), particularly with reduced central bank support, this market is relatively well positioned even in a more challenging economic landing context. High yield bonds may also become attractive, with average yields of the main indices exceeding 7.25%. In high yield(3), we are overweighting the top rating category (BB). However, a high tolerance to volatility is necessary, as is selectiveness, as corporate default rates are still very low and will likely move back up. Keep in mind also that a very strong start to the year in corporate bonds, as in equities, calls for some vigilance in the shorter term.

FIGURE OF THE MONTH

3%

as in the cumulative ECB rate hikes from the start of July 2022 and to the end of January 2023

PERFORMANCES

Bond indices with coupons reinvested

	January 2023	YTD
JPM Emu	2.35%	2.35%
Bloomberg Barclays Euro Aggregate Corp	2.22%	2.22%
Bloomberg Barclays Pan European High Yield en euro	3.20%	3.20%

Sources: Ofi Invest Asset Management, Refinitiv, Bloomberg as of 30 January 2023.
Past performances are not a reliable indicator of future performances.

(1) Volatility is the amplitudes of price variations of a financial asset. The higher the volatility, the riskier the investment is considered to be.
(2) The spread is the difference in yield between a government bond and a same-dated benchmark bond that is regarded as the least risky (such as the German benchmark government bond).
(3) High yield bonds have a lower credit rating (from BB+ to D, according to Standard & Poor's and Fitch) than investment grade bonds (rated from AAA to BBB- by S&P and Fitch), due to their issuers' weaker financial standing, based on research from ratings agencies. They are therefore regarded as riskier by the ratings agencies and, accordingly, offer higher yields.
(4) Carry consists of holding bonds in a portfolio, possibly even till maturity, in order to tap into their yields.

EQUITIES

DO EQUITIES HAVE ANYTHING LEFT IN THE TANK?

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

After the robust performance by the world's various equity markets in late 2022 and early 2023, particularly in Europe, where the Eurostoxx 50 gained 26% in less than four months, three questions naturally come to mind:

- Is this "rally" deserved?
- Can this headlong pace go on?
- Could the markets' short-term performance sacrifice their medium-term trend?

As to the first question, keep in mind that a fundamental valuation of a company is based on two factors: anticipations of future earnings and the level of long-term interest rates, on which basis those earnings are discounted. It is precisely these two factors that resurfaced in early autumn as the markets had fallen into a deep torpor. After hitting record highs for several years, bond yields pulled back on both sides of the Atlantic, returning to levels that were quite acceptable for the equity markets.

The message being sent out by the equity markets seems to point to moderate inflation in the medium term. It is particularly in such phases that the price-earnings ratio is at its highs. Historically, we see P/E[1] at between 18 and 20 in the US when inflation ranges between 2% and 3%. On the earnings front, to everyone's surprise, financial analysts have kept raising their 2022 earnings forecasts. Despite higher production costs, major companies have managed in part to maintain their margins by passing on some higher prices.

And now? As we mentioned above, the bond markets may have gotten a little carried away. So, if an even moderate correction were to occur, equities would be unlikely to catch any fallout from it. Everything would then depend on how fast, and how much, interest rates moved. Meanwhile, we will have to keep an eye on revisions of global growth forecasts, as corporate earnings are closely linked to them and so far, forecasts are not guaranteeing stable earnings for 2023.

SLIGHTLY HIGHER RATES? SLIGHTLY LOWER EARNINGS?

This could be the trigger of a slight consolidation allowing equity markets to catch their breath, especially if geopolitical tensions fail to ease, which could bring back the spectre of an energy shortage.

Late in the year, the markets will be projecting themselves onto 2024. At that time, we should see global growth reaccelerate, allowing earnings to turn back up, while, at the same time, central banks should be easing their monetary policies. The current P/E(1) (price/earnings) ratios of 12.5 in the Eurozone and 17 in the US leave enough room for a slight downward revision in earnings forecasts, with the possibility for indices marginally higher than they are today, despite possible short-term hiccoughs.

US EQUITIES AS A SAFE HAVEN

In our baseline scenario, a short-term consolidation should see the US market serving as a safe haven, but between now and yearend, the rebound in growth could benefit the most cyclical of the European indices. The same goes for styles. Cyclicals stocks that are at first hit by the economic slowdown could then regain investor favour. We are therefore not overweighting any style or geographical region on the year as a whole beyond the US market in the short term, in the event of passing turbulences. We also like emerging markets, which are a source of diversification that we feel is attractive.

FIGURE OF THE MONTH
Threshold passed
by the EuroStoxx 50 in February

4200
points

PERFORMANCES
Equity indices with net dividends reinvested, in local currencies

	January 2023	YTD
CAC 40	9.51%	9.51%
EuroStoxx	9.31%	9.31%
S&P 500 in dollars	6.25%	6.25%
MSCI AC World in dollars	7.17%	7.17%

Sources: Ofi Invest Asset Management, Refinitiv, Bloomberg as of 30 January 2023.
Past performances are not a reliable indicator of future performances.

(1) P/E: Price/Earnings ratio, a market research indicator.

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CHINA ENERGY AND INTEREST RATES: THE TRILOGY THAT WILL STEER THE MARKETS IN 2023...

Jean-Marie MERCADAL
Chief Executive Officer
SYNCICAP ASSET MANAGEMENT

The complete about-face in Chinese political strategy brings changes to the global economy's general outlook. Is it enough to undermine the broad bullish trend on the markets? Against this backdrop, Chinese and emerging assets may outperform.

2023 got off to one of the best starts of any year in recent market history, with the main equity indices rallying by about 5% to 10% in just three weeks. This was driven by the combination of four main factors: the feeling that inflation has peaked and that monetary policies will soon pivot, amidst an ultimately moderate slowdown, and as investors were on the whole overly cautious, which drove gains through adjustments in positions to "track" the markets.

CHINA GIVES THE PRIORITY BACK TO THE ECONOMY

After stepping away from its zero-Covid policy, China is now at opposite ends of the cycle compared to Western countries. The government's priority is now the economy. It has set a growth target of 5%, a target that could be beat. According to the latest mobility figures, activity is starting up very fast during this crucial Chinese New Year period. Moreover, an estimated almost 900 million Chinese have caught the virus, so herd immunity should be reached very rapidly, allowing the economy to move up to cruising speed. The consumption and services sector should be the first beneficiaries of the reopening. Meanwhile, the government has put through support measures to restart real-estate activity. It has eased its famous red lines, measures that it had taken in 2021 to slow down real-estate speculation and head off a financial bubble. Note also that 88 gaming licences have been granted, and the rumour is that President Xi Jinping's inner circle has approached Jack Ma, the founder of the powerful Internet platform Alibaba, which was a victim of the regulatory crackdown in 2021, to get him to come back to China.

This Chinese recovery is already being priced in. The MSCI China has already rallied by more than 50% from its lows of last October. But we still see some potential. Valuations on the whole look undemanding, even after the rally. The market's 2023 P/E(1) (price/earnings ratio) is just 11.5, with scope for upward revisions in earnings forecasts of about 15%. Moreover, many investors have missed out on this rally in Chinese equities and have ended up underweighting this market. So, we still see some upside for this year, although a short-term consolidation cannot be ruled out (which would provide some entry points).

CHINA'S ABOUT-FACE WILL PULL UP THE ENTIRE REGION... AND OTHER EMERGING MARKETS

Asian countries will get a boost from Chinese momentum. Emerging markets as a whole should fare well, particularly the commodity-producing ones. What's more, a less strong dollar would relieve pressure on emerging currencies.

There will also be consequences for the rest of the world. China could cushion the expected global slowdown and push up commodity prices and inflation, which could raise new questions on US and European monetary policies. All this could restart global volatility(2) in the short term... but end up boosting emerging assets on the whole.

FIGURE OF THE MONTHS

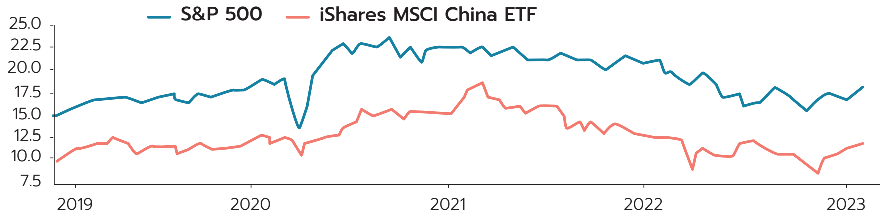
Savings accumulated in 2022 by Chinese households, or the equivalent of French GDP and of 15% of Chinese GDP

USD 2,670bn

Source: People's Bank of China, January 2023

12-MONTH FORWARD P/ES OF THE S&P 500 AND MSCI CHINA

Source: FactSet as of 30 January 2023



Despite a rally in Chinese equities, they look undervalued in both absolute and relative terms, according to the management company, especially as earnings will be revised upward this year with the economic recovery.

The aforementioned companies are cited only for information purposes. They constitute neither an offer to sell, nor a solicitation to buy, any securities.
(1) P/E: Price/Earnings ratio, a market research indicator.
(2) Volatility is the amplitudes of price variations of a financial asset. The higher the volatility, the riskier the investment will be considered.
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Ofi invest

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€173.6bn
In assets under management
(as of end-December 2022)

5th
Largest French asset manager
(source : IPE ranking, December 2021)

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Core portfolio management, asset allocation, and investment solutions
•
Alternative & diversification strategies
•
Real-estate management

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