Letter from the CIO

BANQUE HERITAGE

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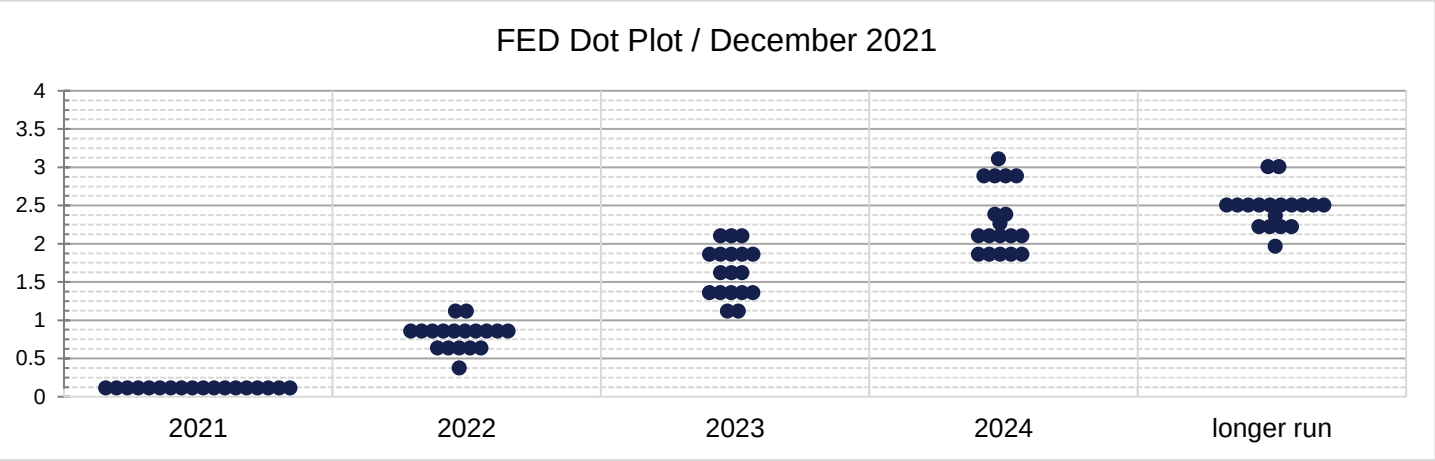
Normalization

It could have been named Nu or Xi, but the WHO chose otherwise in a bid to avoid any confusion (and irritation). The World Health Organization chose the fifteenth letter of the Greek alphabet, Omicron, to name the emerging COVID 19 variant which largely replaced its Delta predecessor as of today. The 5th contaminations wave propagated during the year-end holiday season, among Europe, the United States and Asia. Rapidly, studies showed that Omicron is much more contagious than the Delta variant but also more benign. To counter this wave, many countries strongly recommend (or impose) a third vaccine shot. Other sanitary measures such as teleworking or temporary confinement (Netherlands) are rapidly emerging.

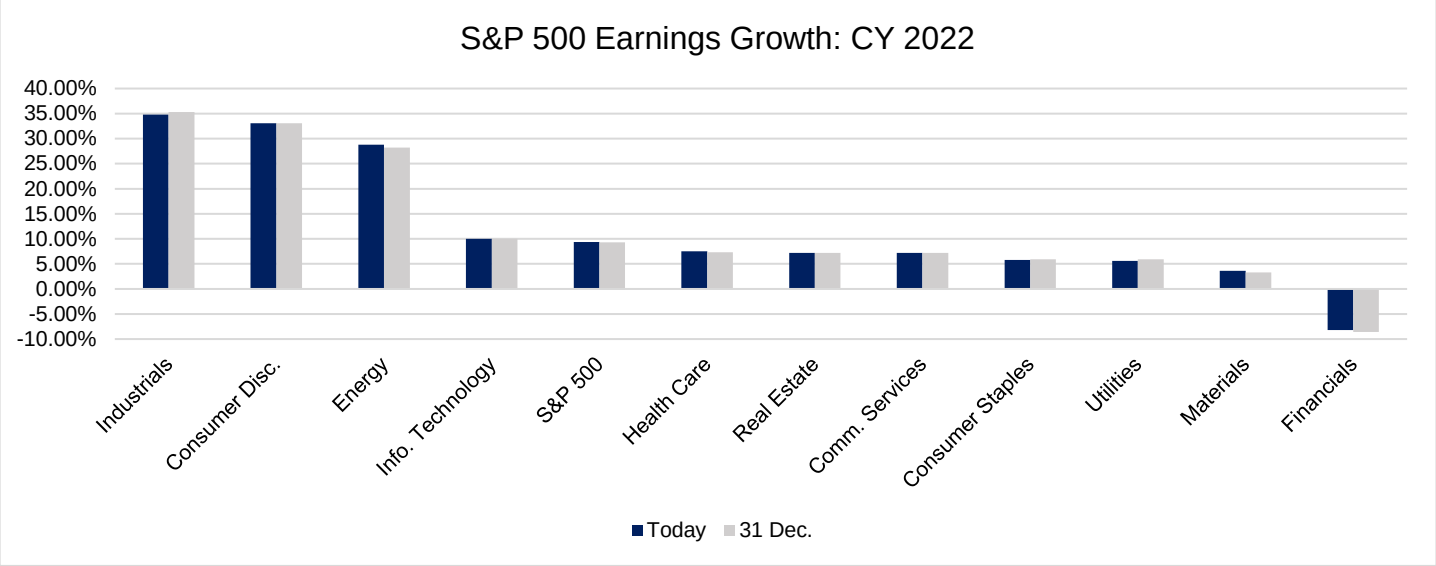
Another major event in December was the FED confirming its willingness to halt bond purchases starting March 2022 and open the way for three rate hikes by the end of the year. Thus, inflation is no longer considered as transitory and the American Reserve intends to act rapidly to bring back inflation to its 2% target. In light of this, one could have expected a negative reaction from equity markets but it all turned out quite differently. On the contrary, markets ended December 2021 on a high note. The S&P500 closes the year up by +27% (+4.7% over the month)! This is the 3rd consecutive year that the main US index ends in positive territory, despite the pandemic! Defensive stocks led the pack in December, the MSCI USA Defensive index finishing up by +8.4%. In Switzerland, equities also held their own, the SMI closing up by +5.9%. The two index heavyweights, Novartis and Nestlé, are amongst the best contributors, gaining respectively +9.3% and +8%. In Europe, the DAX closed up by +5.2% while the French CAC40 gained +6.5%. Finally, lagging but still positive, emerging markets finished last, Shanghai appreciating by +2.8%. On the commodities front, oil once again registered a strong increase with US crude skyrocketing by 16%. Gold further rebounded by +2.4%. Rates curves remained broadly stable over the period, despite the change of tone from central banks as well as encouraging economic data.

Year-end macroeconomic publications confirmed the strength of the economic recovery. In the United States, unemployment figures stand at +3.9%, 0.3 points lower than in November. The average hourly wage increased by 0.6% in December compared to the previous month, beating expectations and corresponding to the strongest rise since April. On an annual basis, wages increased by +4.7%. Inflation-wise, figures published last week in the United States show price increases over December of +0.5%, bringing inflation to +7% over the course of 2021. One has to look back to 1982 to witness such a surge in prices, consequence of the 1979 oil crisis which followed the Iranian Revolution. There is no doubt left in the FED's motivation to fight this overheating, as was recently expressed the newly elected Vice President of the Federal Reserve, Lael Brainard. While it took two years over the last tightening cycle for the institution to reduce its balance sheet, last FOMC minutes from December point to a reduction as early as 2022, following the buyback program's complete halt being brought forward to mid-March. Even though monetary policy will be data dependent, we expect the normalization rhythm to keep its pace in the US over the coming months, combining three rate hikes (or more?) as well as a massive reduction of liquidities. And what about Europe? Inflation also beat new records, consumption prices increasing by +5% on an annualized basis in December. In light of this, the ECB adopted a more cautious stance (or maybe rather less), arguing that inflationary pressures remain transitory and should dissipate by year end. In the end: it will stop its € 1'850 billion buyback program (PEPP) by March 2022 but, contrarily to the FED or BoE, no rate hikes in sight… for now !



Source: FED / Banque Heritage

Markets are rather chaotic since the beginning of the year, with the FED's tightening as a main catalyst. In parallel, earnings season will kickstart the week and should give some direction to otherwise rather disoriented market participants. After the third quarter's slowdown in growth, the economy rebounded nicely over the fourth. According to Factset, Wall Street anticipates S&P500 earnings to be up by 22% year-on-year over the period. This remains higher that historical averages but significantly lower than as of recent. However, investors' attention will surely by turning towards outlooks. They should evidently come as lower after a record year, companies facing heightened consumer demand, margin pressures and a less accommodative financing environment. In our opinion 2022 will surely be a year marked by normalization, and not solely on the monetary policy front. We anticipate strong global growth, supportive of equity markets over the first six months at least. Alpha generated from stock picking should dominate Beta, hence our positioning in companies with strong pricing power, whether in Europe or the US.



Source: FactSet / Banque Heritage

The combination of tighter monetary policy, global growth normalization and inflation stabilization lead us to anticipate a flattening of the US curve (Bear flattening). We thus remain underweight in sovereign bond, favoring exposure to quality credit, high yield and Asian credit.

Diversification further translates into an alternative pocket offering uncorrelated returns, some gold (neutral) and a cash buffer slightly above our neutral stance.

The Asset Management team joins me in wishing you a happy new year!

Stay in good health!

Jean-Christophe Rochat, CIIA
Chief Investment Officer

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