HOUSE VIEWS

SEPTEMBER 2022

Central banks and "whatever it takes" to tame inflation

Even in the best case, inflation will take some time to fall back. Events over the summer seem to confirm inflation has peaked in the United States, but price pressures will only subside fairly gradually. In Europe, fresh jumps in energy and food costs continue to power inflation and raise doubts about whether it is likely to decline short term. All of which encouraged central bankers, gathered at the Jackson Hole symposium in the United States, to reaffirm the priority of the fight against inflation, 'whatever it takes' in terms of economic impact.

This latest trailed tightening of monetary policy poses an additional risk of recession for developed economies. True, a number of support factors are still in play – buoyant labour markets and plentiful savings – but activity should nonetheless slow sharply in coming quarters. In the United States, even without considering monetary policy, high inflation and restrictive budgetary policy are already damping demand. In the euro area, household purchasing power is being particularly hard hit because of the feeble growth in salaries. New pressures on gas and electricity prices raise a real risk that some industries will have to cut production triggering a sharp recession. In further bad news for the global economy, China's outlook is also weakening, as the government sticks to its zero-Covid policy and the real estate market struggles.

Greater prudence in our investment strategy. We have redoubled our prudent approach to equity markets, reweighting towards defensive and resilient sectors. We retain our Underweight to the euro zone in light of the specific risks overhanging the region. At the same time, we are Neutral on bond markets, having done well from our Underweight early in the year. Yields may now look tempting, particularly real yields, but another rate hike would knock performance back again. We are also exiting our euro/dollar Underweight as the cross has already fallen substantially. Finally, we are reducing exposure to Hedge Funds, which are looking less appealing as interest rates rise.

Unless otherwise specified, all statistics and figures in this report were taken from Bloomberg and Macrobond on 09/02/2022.

SOCIETE GENERALE
Private Banking

OUR MAIN CONVICTIONS

Inflation will slowdown only progressively, giving incentives to monetary tightening

Inflation seems to have peaked in the United States, but its spread to different categories of goods and services as well as to wages slows down its decline. The Federal Reserve, just as the other main central banks, will continue to increase its key interest rates up to the year-end.

Global and specific risks on economic activity

The high levels of inflation and the monetary tightening by central banks will dampen economic activity in the main developed economies. Uncertainties on energies supply by Russia are an additional risk on European economies, while the “zero-covid” policy and rapid drop of the housing market are weakening the Chinese economy.

Equity markets could be hit again by a slowdown of the activity

Even though the major part of uncertainties seems to be integrated in the markets, we keep a cautious position, especially in the Euro zone. Emerging equity markets keep being attractive for diversification.

Rates levels are attractive but could still increase.

Real interest rates remain in positive territory, but new surprises in terms of monetary tightening could imply new interest rates increases.

Less attractiveness of hedge funds and the dollar

Recent evolutions of valorizations lead these asset classes to be less attractive.

OUR ASSET ALLOCATION

The table below presents the latest conclusions of our Global Investment Committee (GIC)

			Summary house views					
			UW	Slight UW	N	Slight OW	OW	Variation since last GIC
EQUITY		GLOBAL EQUITY		X				
EQUITY		United States			X			
EQUITY		Euro area		X				-
EQUITY		United Kingdom				X		
EQUITY		Japan		X				
EQUITY		Emerging			X			
FIXED INCOME	SOVEREIGN	GLOBAL RATES			X			
FIXED INCOME	SOVEREIGN	U.S. Treasuries			X			
FIXED INCOME	SOVEREIGN	Bunds			X			
FIXED INCOME	SOVEREIGN	Gilts			X			
FIXED INCOME	SOVEREIGN	EM Govies ($)		X				
FIXED INCOME	CORPORATE	U.S. IG			X			
FIXED INCOME	CORPORATE	U.S HY		X				
FIXED INCOME	CORPORATE	EMU IG			X			
FIXED INCOME	CORPORATE	EMU HY		X				
FIXED INCOME	CORPORATE	U.K. IG			X			
FOREX		EURUSD			X			+
FOREX		USDJPY				X		
FOREX		GBPUSD			X			
FOREX		EURCHF			X			
ALT.		Brent			X			
ALT.		Gold				X		
ALT.		Hedge funds			X			-

ECONOMIC OUTLOOK

Further tightening of monetary policy

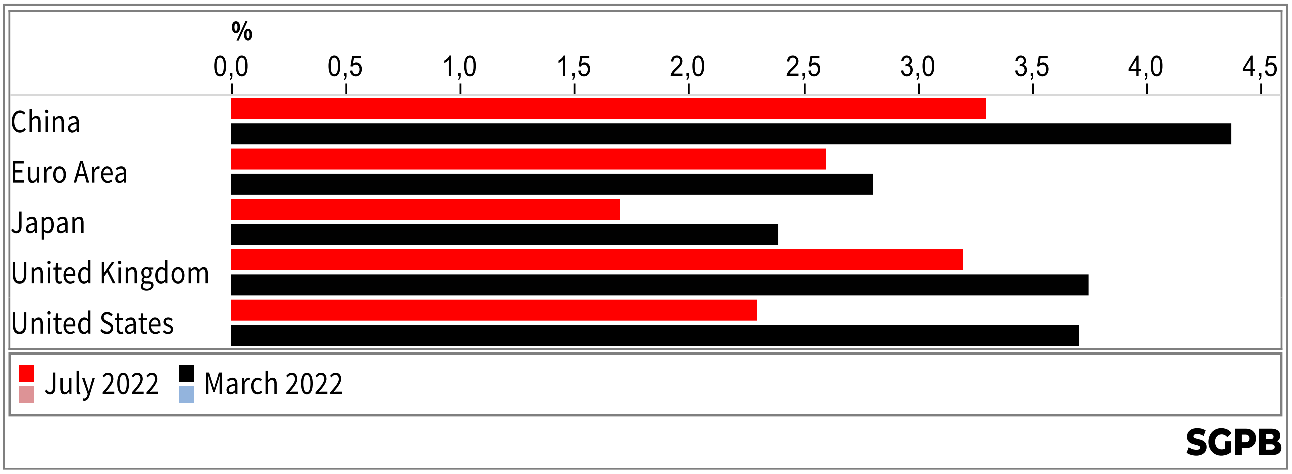
High inflation and monetary policy tightening by central banks will mean economic slowdown for developed economies. The threat to Russian gas supplies poses an additional risk for Europe. China's economy continues to slow and is getting only timid support from economic policy.

At the start of 2022 the global economy was boosted by ongoing normalisation as the world moved out of Covid. The euro area enjoyed a particularly dynamic trend. The post-Covid recovery by service sectors and budgetary support measures went some way to offsetting the outbreak of war in the Ukraine. In the United States, growth slowed in the first half-year, albeit against a booming comparison base from 2021, as supportive economic policies were dialled back to normal and spending power curtailed by rising inflation. In China, however, activity fell sharply in the first six months, hampered by reimposed lockdowns and a struggling property market.

The second half of the year is looking less favourable. Inflation will take some time to fall back. In the United States, inflation seems to have peaked for now, but wage pressures raise fears of possible second-round effects. In the euro area, renewed pressure on energy prices continues to drive inflation. All of which has led central banks to toughen their tone and reiterate their determination to cut inflation 'whatever it takes' in terms of the economic impact. The Federal Reserve is set to raise policy rates a further point by year-end to 3.75%, while the ECB could tighten rates 75bp in September, followed by two 25bp hikes in the rest of the year. With inflation still running high and monetary conditions now tightening, economies are going to feel the drag. Meanwhile, the IMF's end-July forecasts downgraded the global growth outlook for 2022 by 0.4 points from its April projections, to 3.2%, while stressing that uncertainties over full-year growth remain high.

Mixed picture for emerging economies. Chinese activity continues to be hampered by zero-Covid measures and the rapid slump in the national property market. Outside China, countries face a mix of situations: high commodity prices are good for some and bad for others which face an increased risk of instability.

Evolution of IMF growth projection (between March and July 2022)



FIXED INCOME

Still limited overall appeal

We remain Neutral on sovereign bond markets. Interest rates look attractive in that they are again paying positive returns, adjusted for inflation hedges, amid rising uncertainty about global growth. Bond markets, however, remain vulnerable to fresh upside surprises on inflation. We remain Neutral on investment grade corporate debt and Underweight high yield.

Fixed Income

US. Sovereign yields remain volatile against a backdrop of slowing growth, only gradually falling inflation and restrictive monetary policy. Having dipped to 2.6% over the summer, 10-year Treasury yields are now back above 3% following the Federal Reserve's Jackson Hole gathering. Jerome Powell used the meeting to stress that underlying inflationary dynamics remained high and would require a lengthier period of higher interest rates in response. His remarks triggered a substantial reset of short-term rates in the United States, with money markets now expecting rates to peak at 3.75%, and real yields now positive across nearly the whole curve. In these circumstances, we remain at Neutral on Treasuries. Fears of recession, ongoing political risks and some tempting carry are all bullish factors for Treasuries. However, any upside surprises on inflation could trigger a fresh jump in yields.

Euro area. Sovereign yields in Europe have also been volatile over recent weeks. The 10-year bund dropped below 0.8% in early August before rebounding back above 1.50%. As in the United States, these movements reflected the market's re-evaluation of monetary policy as inflation continues to accelerate in the wake of the energy shock and fears of second-round effects. Several ECB members have already spoken in favour of accelerating policy tightening, fearing that current levels of inflation could majorly de-anchor the inflationary expectations of households and companies. As a result, money markets are now pricing in a 75bp rise in the ECB's policy rate at its 8 September meeting and a peak rate of 2% in H1 2023. Meanwhile, the ECB has already started using its margin for manoeuvre to counter risks of financial fragmentation among single currency members, switching EUR 15 bn of Bund holdings for an equivalent volume of peripheral sovereign debt. Overall, given the weak growth outlook and an increasingly hawkish ECB, we remain at Neutral on European sovereign debt.

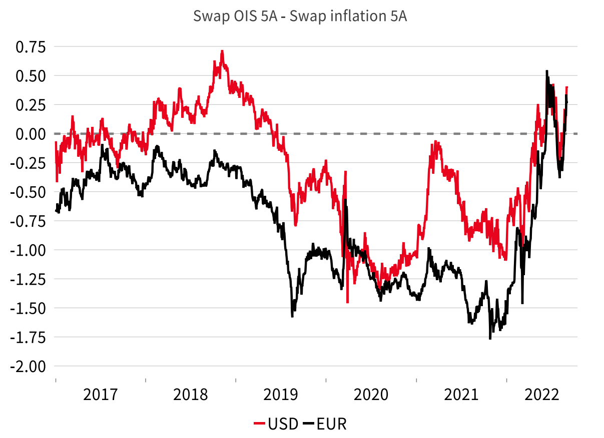
UK. It is a similar story in the UK, where gilt yields have surged in the last week to leave the 10-year bond paying above 2.50%. The Bank of England also announced it would speed up its rate-tightening cycle, expected to peak at 4.25%, and warned of a stagflation scenario for the next few quarters. We remain at Neutral on gilts.

Credit

US and euro area credit. We remain Neutral on investment-grade bonds. The recent adjustment in yields has made carry on these assets attractive given the solid balance sheets of companies. We remain Underweight high-yield corporate bonds. Risk premiums have widened considerably, to pre-Covid levels, as the prospect of recession stokes fears companies may struggle to refinance maturing debt.

Emerging markets. We remain Underweight emerging market debt. Monetary tightening in developed economies is generally bad news for emerging market assets and risks to growth remain high.

Real rates remain positive



Sources: SGPB, Macrobond, 02/09/2022

EQUITIES

Continue to tread carefully

With growth outlooks deteriorating and inflation still running high, we remain Underweight on this asset class and are picking sectors with even greater prudence.

United States. We remain at Neutral on the American equity market. After the stock market slides of H1, global equity markets mounted a broad recovery during much of the summer. There was good news on corporate earnings and expectations that, faced with slowing economic activity and moderating headline inflation, the Fed might moderate its policy tightening. However, the rally was not enough to wipe out first-half losses and the market was recently hit again by the Fed's return to a hawkish tone. While peak inflation may be behind us, price pressures will take time to abate, and the Federal Reserve will continue tightening policy to achieve its 2% inflation target 'whatever it takes' in terms of economic impact. Amid such uncertainty, we remain Neutral on this market and are bolstering our exposure to defensive sectors.

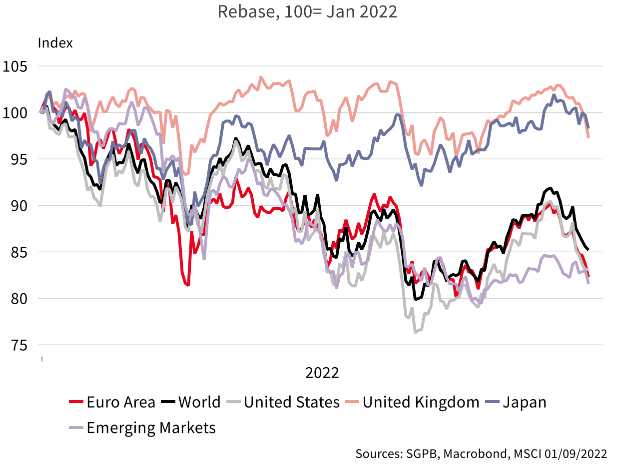
Euro area. We remain at Underweight to euro area equities. The region is being deeply disrupted by tensions emanating from the Ukraine war and by energy costs. Growth prospects for 2022 and 2023 are worsening. Europe's key economies look set to contract between now and year end. Inflation, meanwhile, shows no sign of slowing. Various estimates suggest inflation is unlikely to peak before 2023, raising fears of gas and electricity shortages this winter. Like the Federal Reserve, the European Central Bank is set to raise rates sharply as from September as it pursues its aim of cooling the economy. In these circumstances, we remain Underweight euro area equity markets and are building up our exposure to more defensive sectors.

United Kingdom. We remain Overweight British equities. Despite a grim outlook for the UK economy, set to contract between now and year-end with inflation hitting 10% in July, the British stock market is one of the few sitting on year-to-date gains. It is helped by its sector composition and relative disconnection from the domestic economy. For this reason, we are retaining our Overweight on this market.

Japan. We remain Underweight this market. True, the Japanese stock market has held up well all year, but the sharp depreciation of the yen and the Japanese economy's reliance on China counsel caution.

Emerging markets.. We remain at Neutral on emerging equity markets. Like most stock markets, emerging equity markets have corrected overall since the start of the year. Problems with the Chinese economy could slow recovery in neighbouring Asian economies, while exporters of raw materials should continue to do well out of spiralling commodity prices. We remain at Neutral, having been Underweight earlier in the year, and remain alert to attractive entry points in these markets.

Equity market performances from January, 1st



Sources: SGPB, Macrobond, MSCI 01/09/2022

DEVISES

Still Overweight on the Dollar versus the Euro

The dollar is likely to remain at high levels given the deteriorating economic outlook, the interest rate differential and geopolitical risks. However, we change to Neutral on the euro/dollar exchange rate as a significant part of the euro's depreciation against the dollar has already been achieved.

Dollar index (DXY). The dollar continues to make strong gains against nearly all other floating currencies. In real terms, against a basket of currencies, the dollar has hit its highest since 2002. A worsening growth outlook, expectations for a more hawkish policy tightening by the Fed and ongoing political risks will continue to buoy the greenback.

EUR/USD. The euro steepened its slide over recent weeks, touching parity with the dollar. Several factors have fuelled this depreciation: the transatlantic gap in interest rates, a deterioration of Europe's balance of payments and mounting economic and political risks on the old continent. Primarily, the euro's weakening reflects the yawning gap between European and American real short rates, at its widest since 2012. Second, the sharp rise in energy prices has led to a deterioration in the balance of payments, dragging down the euro. Finally, fears that winter could bring an energy crisis and sharp contraction in the European economy have also hurt the euro's cause. Having said all that, we are nonetheless moving from Underweight to Neutral on the EUR/USD cross. The ECB's decision to tighten rates faster, stepping up the pace of hikes and setting a higher final target rate, should help support the single currency. In addition, economic slowdown should have the side-effect of improving the balance of trade, also helping the euro. Finally, gas stocks have risen significantly alleviating fears of major energy restrictions.

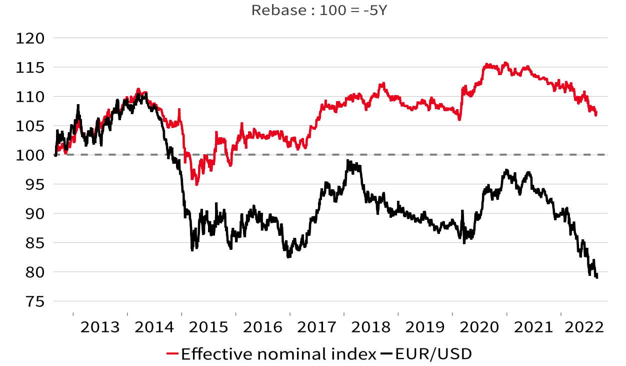
GBP/EUR. Sterling has strengthened slightly in recent weeks amid fears of energy crises in continental Europe. We remain Neutral on the cross, as the gap between nominal rates in the two regions is likely to remain stable.

JPY/EUR. Despite having steadied in recent weeks, the yen remains under serious downside pressures, which have taken it to its lowest since 2014. The Bank of Japan has left monetary policy unchanged, continuing to control the yield curve with underlying inflation still minimal, resulting in a significant increase in JGB purchases over recent weeks. Given the discrepancy in monetary policy, we remain Underweight the euro/yen cross.

EUR/CHF. The Swiss franc continued to appreciate against the euro, stabilising below the parity threshold. This appreciation of the CHF mainly reflects the safe haven status of the Swiss currency as well as an inflation rate which is well below European inflation (3.5% in August). The SNB is expected to continue the tightening cycle started in July, with the terminal interest rate expected to be 1.20%. In addition, the SNB's foreign exchange reserves also started to decline by CHF 57bn in 2Q22. Overall, in a high energy price environment, the SNB should be more comfortable with a strong CHF.

EM FX (vs USD). Emerging currencies remain on a downward trend. On the one hand, the larger than expected Fed tightening cycle is increasing the downward pressure on major floating currencies. The only exceptions to this trend are the currencies of the Latin American economies which benefit from improved terms of trade, very restrictive monetary policies, and low risk of an energy crisis.

Evolution of the EUR (100= Nov 2019)



Sources: SGPB, Macrobond, BIS, Macrobond 29/08/2022

ALTERNATIVES

Seeking diversification

Uncertainties concerning global economy continue to weigh on the oil price, while they confirm the safe haven position of gold. Nevertheless, recent valorisation evolutions lead Hedge Funds to be less attractive. We retain our Neutral allocation to oil and Overweight gold and get Neutral to hedge funds.

Commodities

Oil. We remain Neutral on oil. The cost of a barrel of Brent crude has continued to fall from its H1 highs, dragged down by a slowing global economy, in which weaker growth will mean less demand for oil. That said, the decline is likely to remain modest given the OPEC+ cartel's determination to cut production if there is any major slump in demand. Brent is currently trading at USD 93/bbl, down by around 20% on 3 months ago. We therefore maintain our prudent approach and our position in this market.

Gold. We remain at Overweight on gold. Gold is now changing hands at USD 1,700/oz, close to its annual low. As fears of recession mount, investors continue to turn to the dollar, which explains why the gold price has dropped back from the highs seen in H1. Also, central banks in developed economies have been busily raising rates and should continue their tightening cycle going forwards, increasing the opportunity cost of holding gold. That noted, as political and economic risks stack up, we still see gold as a safe haven and are therefore retaining our exposure.

Hedge Funds

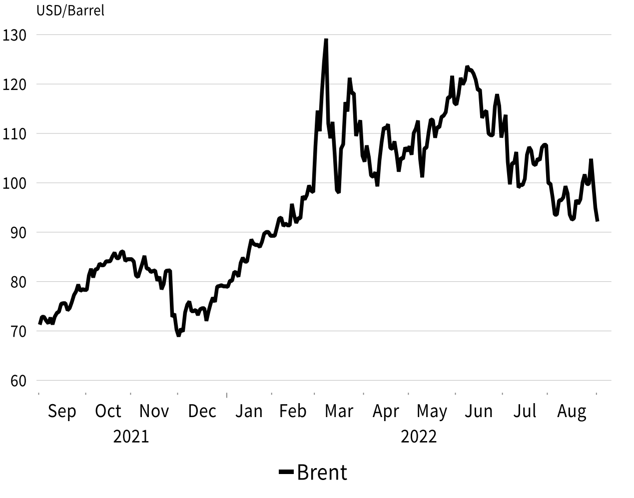
Long/Short Equity. Equity funds (L/S Market) are playing a particularly strong "performance protection" role as they are able to manage dispersion, particularly high in the current phase of high volatility on equity markets.

Event Driven. M&A transactions may moderate in the current context of tightening financing conditions, making this category of funds less attractive.

Fixed Income Arbitrage. The context of rising interest rates already underway is beginning to offer opportunities for funds positioned in sovereign bonds. We continue to show an interest in funds positioned on the credit side.

Global Macro / CTA. Commodity Trading Advisors (CTAs) offer traditional protection against market volatility, which looks set to persist. As for Global Macro funds, managers will have to pick particularly carefully amid ongoing uncertainty about the economic recovery

Oil Price evolution



Sources: SGPB, Macrobond, Macrobond, ICE, EIA 01/09/2022

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SG Kleinwort Hambros Bank (CI) Limited – Guernsey Branch is regulated by the Guernsey Financial Services Commission for banking, investment and money services business. Its address is PO Box 6, Hambro House, St Julian's Avenue, St Peter Port, Guernsey, GY1 3AE.

The company (including the branch) is also authorised and regulated by the UK Financial Conduct Authority in respect of UK regulated mortgage business and its firm reference number is 310344. The Company (including the branch) is not authorised or regulated by the UK Financial Conduct Authority for accepting UK bank deposits nor is it permitted to hold deposits in the UK.

Kleinwort Hambros is the brand name of SG Kleinwort Hambros Trust Company (CI) Limited, which is regulated by the Jersey Financial Services Commission in the conduct of trust company business and fund services business and by the Guernsey Financial Services Commission in the conduct of fiduciary services business. The company is incorporated in Jersey under company registration number 4345 and its registered address is SG Hambros House, PO BOX 197, 18 Esplanade, St Helier, Jersey, JE4 8RT. Its address in Guernsey is PO Box 86, Hambro House, St Julian's Avenue, St Peter Port, Guernsey, GY1 3ED.

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Gibraltar: SG Kleinwort Hambros Bank (Gibraltar) Limited is authorised and regulated by the Gibraltar Financial Services Commission for the conduct of banking, investment and insurance mediation business and its firm reference is 419436. The company is incorporated in Gibraltar under company registration number 01294 and its registered address is 32 Line Wall Road, Gibraltar.

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Further information on the Kleinwort Hambros Group including additional legal and regulatory details can be found at:
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