HOUSE VIEWS

OCTOBER 2022

RATES TIGHTEN

The rise in yields has gathered pace in the last few weeks. And unlike other rises of recent years, it is not being driven by a stronger growth outlook but by a tightening of monetary policy to deal with inflationary pressures. The jump in yields – both nominal and real – has turned up the pressure on developed economies.

Higher rates squeeze activity by making refinance costlier. Real estate and corporate investment alike are set to slow sharply. Central banks are tightening financing conditions in order to stem inflation, but this also heightens the risk of recession. US interest rates have risen particularly steeply. In Europe, the hikes have been less spectacular but the economic agents they target are already reeling from the energy crisis. For many countries, the rise in rates further complicates their economic policy decisions. For one thing, the steeper hikes in US rates have added to pressure on currencies, forcing various central banks, particularly in Asia, to intervene. For another, higher interest rates are undermining European governments' plans for large-scale measures to mitigate the impact of the energy crisis by automatically increasing their funding costs. It was the difficulty of getting the right mix of monetary and fiscal policy in these circumstances that underlay the disruption in UK financial markets over recent days.

Further retrenchment of our investment strategy. We are doubling down on our prudent approach to equity markets by Underweighting nearly all regions and maintaining our ample allocation to defensive and resilient sectors. At the same time, we are adding to our bond market positions, moving to Overweight on United States fixed-income markets. In our view, US bonds are now offering attractive returns, particularly in real terms. Redoubled prudence is also why we are cutting our oil exposure and bolstering our position in the Swiss Franc. Finally, we are taking a defensive view of the pound sterling given the turbulence rocking UK markets, which could continue for some time.

Unless specified, all figures and statistics in this report are from Bloomberg and Macrobond on 03/10/2022.

SOCIETE GENERALE
Private Banking

OUR MAIN CONVICTIONS

Inflation will only gradually decline, prompting central banks to continue tightening their policies

Inflation is likely to have peaked in the United States, but its spread to different categories of goods and services as well as wages is slowing its decline. The Federal Reserve and the main central banks will continue to raise their key interest rates significantly by the end of the year. If this tightening seems already well integrated by the markets on the US side, new adjustments could occur in Europe in case of renew upside surprises on inflation

Attractive yields encourage us to overweight U.S. bonds

The tightening of the Federal Reserve now seems to be largely priced by bond markets with attractive yield levels, including in real terms. In Europe, on the other hand, further adjustments could occur on rates, prompting us to wait.

Rising rates to weigh on economic outlook

High inflation and tightening central banks are penalizing economic activity in developed economies. Energy tensions pose an additional risk to European economies, while the maintenance of health policies and the rapid decline of the housing market pose a specific risk to China’s economy.

Rising rates to reinforce volatility in risk markets

While some of the uncertainties already appear to be embedded in the markets, the recent rise in interest rates encourages us to be more cautious about equity markets. Recession fears also encourage us to reduce our exposure to oil.

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
EQUITY		GLOBAL EQUITY		■				
		United States		■				-
		Euro area		■				
		United Kingdom			■			-
		Japan		■				
		Emerging		■				-
FIXED INCOME	SOVEREIGN	GLOBAL RATES			■			
		U.S. Treasuries				■		+
		Bunds			■			
		Gilts			■			
		EM Govies ($)		■				
	CORPORATE	U.S. IG			■			
		U.S HY		■				
		EMU IG			■			
		EMU HY		■				
		U.K. IG			■			
FOREX		EURUSD			■			
		USDJPY				■		
		GBPUSD		■				-
		EURCHF		■				-
ALT.		Brent		■				-
		Gold				■		
		Hedge funds			■			

ECONOMIC OUTLOOK

Financing conditions tighten further

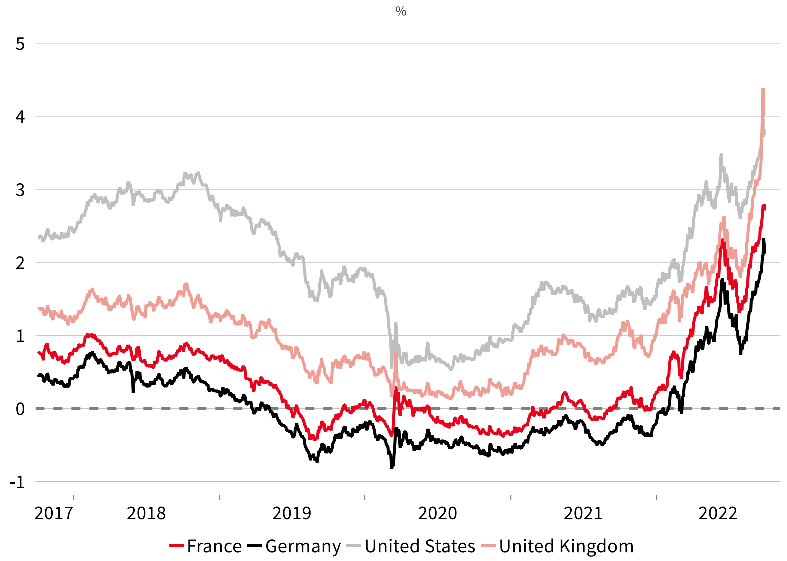
Inflation is still running well above target, encouraging central banks to double down on policy tightening. Interest rates have already risen substantially and should significantly slow economies in coming months. The risk of global recession is high. Europe, beset by the energy crisis, is more fragile.

Inflation remains elevated and rate hikes could tip the world into recession. Inflation will take some time to fall back. In the United States, price rises seem to have peaked for now, but wage pressures are raising fears of possible second-round effects. In the euro zone, renewed tensions on energy prices continue to drive inflation. Aware of this, central banks are striking a hawkish tone. The Federal reserve is expected to raise the Funds rate to 4.25% by Q1 2023, while the ECB's policy rate could hit 2.75%. With inflation still running high and monetary conditions now tightening, economies are going to feel the drag.

Walking the policy tightrope in Europe. The UK ran into serious financial turbulence when it announced what foreign investors saw as incompatible economic policy measures: the central bank continuing to tighten monetary policy while the new government unleashed a major stimulus package. Unless there is a major and lasting policy shift, UK markets will keep sliding downhill, with potentially damaging impacts on the British economy. Euro area countries look less vulnerable to such a shock as they are less reliant on foreign finance. But the tensions that erupted in Britain highlight the difficulty facing the EU in striking the right policy balance between the ECB turning the monetary policy screw and budget-setters seeking to support economies struggling with the energy crisis.

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.

10 years government bond yields



Sources: SGPB, Macrobond, Macrobond, U.S. Department of Treasury 30/09/2022

FIXED INCOME

Increasing exposure in US Treasuries as global risks are on the rise

The current environment with its ongoing recovery is tough for bonds. We are sticking with our strong Underweight on sovereign debt. We are moving back to Neutral on emerging market sovereign debt, offsetting this with a slight Underweight (instead of Neutral) on high-yield debt.

Fixed income

US. With more monetary policy tightening in the pipeline, US sovereign yields continued their rise. August's inflation figures of 8.2% headline and 6.3% underlying confirmed that inflationary trends remain significant and that convergence toward the 2% target will be a gradual process, all else being equal. Given these figures and the still hawkish tone being struck by Fed members, markets continued to adjust and now see rates peaking at 4.5% in Q1 2023 before starting to come down in 2024. Similarly, the yield curve continued its inversion as the risk of a sharper economic slowdown was seen to have grown. As a result, we turned Overweight on Treasuries, which stand to gain from the severe deterioration in global outlook.

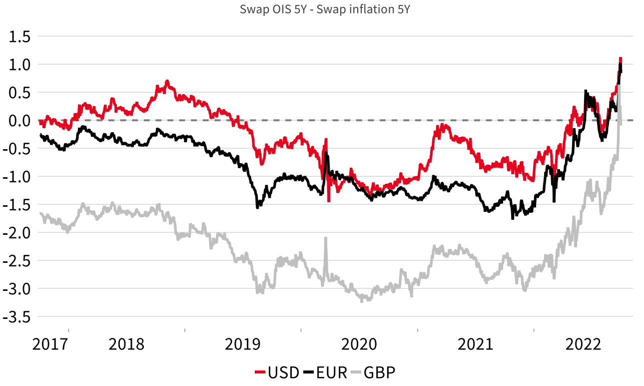
Euro area. Sovereign yields in Europe also rose as inflation accelerated and the pace of monetary policy tightening quickened. Euro area inflation topped 10% in September, still being driven by energy and food prices. Meanwhile, the price of services began to show symptoms of second-round effects. Several governments announced various fiscal measures to mitigate energy inflation. While such measures may bring down the overall rise in prices, as in France, they also run the risk of stoking underlying inflation. In these circumstances, the ECB is likely to accelerate its monetary tightening, opting for a second 75 bp hike at its end-October meeting, while markets foresee a terminal rate of 2.75%. As inflation does not yet seem to have peaked, we remain Neutral on sovereign debt.

UK. Gilts suffered a surge of volatility, including record jumps in yields, following the monetary and budget announcements of late September. Statements by the government, setting out an economic stimulus package that would massively drive-up public-sector debt, and by the Bank of England announcing a rise in its base rate and sharp reduction in its balance sheet triggered a bond market crash. Yields on the 10-year Gilt rose from 3.20% to 4.60% the next day, before steadying at 4% after urgent intervention by the Bank of England to forestall a wave of pension fund defaults. The bulk of the adjustment now seems to have happened and the Bank of England seems willing to continue acting as lender of last resort in the event of further strong rises. All of which suggests yields could stabilise around current levels. However, the risk of new policies perceived as inconsistent and the continuing pressures on sterling are negative factors for UK sovereign indices and we therefore remain Neutral on Gilts.

Credit

US and euro area credit. We maintain our slightly Underweight to Neutral on US and European high-yield debt. Besides, the still resilient nominal growth outlook and resilient balance sheets support IG debt. Yields on risky US bonds (rated BBB) remain above 4,5% with a spread that has widened to 200bp.

Real rates have adjusted markedly



Sources: SGPB, Bloomberg, 03/10/2022

EQUITIES

Cautiousness reinforced

The rise in interest rates adds to recessionary risks and financial pressures. While these risk now seem to be partly priced in, we think equity markets will remain vulnerable. We are doubling down on our prudent approach to equity markets by Underweighting nearly all regions and maintaining our ample allocation to defensive and resilient sectors.

United States. We are moving to Underweight on US equities. The market had a generally good summer, boosted by strong corporate earnings and expectations of an upcoming pivot by the Federal Reserve. But hopes were quickly dashed by Fed Chairman Jerome Powell. The dominant sentiment is now fear of a global recession while inflation remains stubbornly higher than forecast. Mr Powell made it clear that monetary tightening would continue until inflation was brought back down to its 2% target, while also stressing that the Fed was looking to have positive real rates across all maturities. All of which strengthened the hand of market bears. The S&P 500 recently hit levels unseen since December 2020. Accordingly, with a shift in real yields and worsening prospects for global growth, we have moved from Neutral to Underweight on this market.

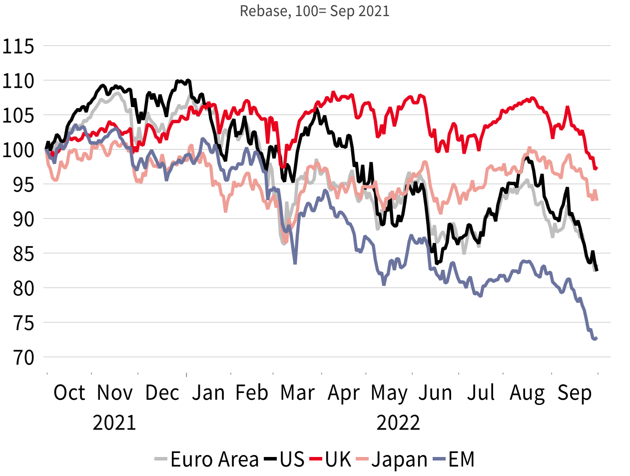
Euro area. We remain at Underweight to euro area equities. Driven by the same winds as US markets, euro area markets have now completely wiped out the summer's gains, which had in any case been more modest than those across the Atlantic. Fears of recession loom larger in Europe because of the energy crisis, currency pressures and the risks of second round inflation brought on by persistent energy inflation and the zone's economic support plans. Geopolitical risks remain high and are affecting household and business sentiment as well as the growth outlook. All of which suggests the European Central Bank is likely to stick with its cycle of monetary tightening for several months yet against a backdrop of an already lacklustre economy. We remain prudent and are staying at Underweight.

United Kingdom. We have gone to Neutral on UK equity markets. The composition of the UK equity market gives it a structural bias toward “international value”: commodities, pharma and consumer goods. This distribution has made it pretty resilient since the start of the year. So, despite the recent turbulence, we remain fairly upbeat on the UK market compared to other regions. That said, British equity markets are unlikely to wholly escape the worsening outlook for global growth, leading us to reduce our exposure.

Japan. The Japanese market also corrected on the back of deterioration in global growth prospects. Furthermore, the weakness of the Yen makes returns in Euros or Dollars less attractive. We therefore remain Underweight on the Japanese equity market.

Emerging markets. We are amending our position from Neutral to Underweight on emerging markets. Emerging markets corrected sharply against a background of tightening global financing conditions and still disappointing growth in China, hampered by Covid restrictions and trouble in the property market. While some markets have held up better than others since the start of the year, notably in Latin America, the ongoing tightening by the Fed and poor growth prospects in China have persuaded us to reduce our exposure.

Global Equity Markets corrected in September



Sources: SGPB, Macrobond, MSCI 30/09/2022

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CURRENCIES

Dollar to remain strong

The dollar is likely to remain strong given the deteriorating world economic outlook, the interest rate gap and geopolitical risks. However, we remain Neutral on the EUR/USD cross as the euro has already suffered much of the required depreciation against the dollar.

Dollar index (DXY). The dollar continues to rack up strong gains against nearly all other floating currencies. In real terms, against a basket of currencies, the dollar has hit its highest since 2000. A worsening growth outlook, harder-than-expected policy tightening by the Fed and ongoing political risks will continue to buoy the greenback.

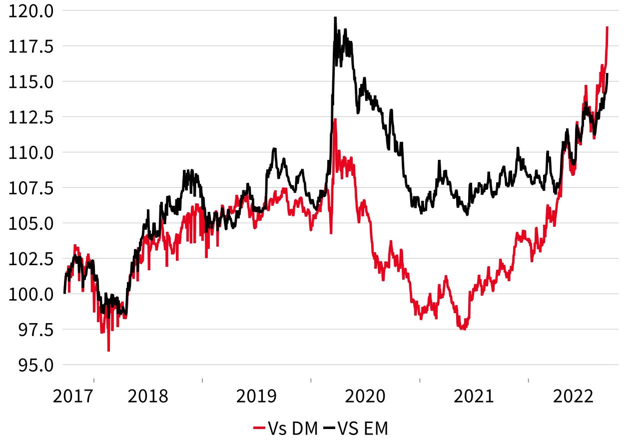
EUR/USD. The euro continued its slide over recent weeks, stabilising below dollar parity. Several factors have fuelled this depreciation: the transatlantic gap in interest rates, a deterioration in Europe's balance of payments and mounting economic and political risks on the old continent. Primarily, 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 worsened the balance of payments, pushing the euro down further. Finally, fears that winter could bring an energy crisis and sharp contraction in the European economy have also hurt the euro's cause. That said, we are sticking by our Neutral position. The ECB has stepped up the pace of its rate-tightening and raised its terminal rate. This, coupled with more similar real rates should support the European currency. In addition, economic slowdown should have the side-effect of improving the balance of payments, also helping the euro.

GBP/USD. In the wake of the Gilts crash, the GBP slumped on announcement of the UK's new fiscal and monetary policy mix. True, the pound has recovered much of its cable losses since, as the bond market stabilised, but the British currency remains fragile. With no sign the government will back down on its budget, downward pressure on the GBP will continue to build. What is more, the United Kingdom's current account balance remains deep in the red and high energy prices will add to pressure on the trade balance. We are therefore moving to Underweight on the EUR/GBP and USD/GBP.

USD/JPY. Downside pressures on the yen, now at its lowest since 2014, remain significant. The Bank of Japan has left monetary policy unchanged as underlying inflation remains weak. To address downside pressures on the yen, the monetary authorities are instead intervening directly in currency markets by selling dollar assets. Given this discrepancy in monetary policy, we remain Underweight the EUR/JPY.

EUR/CHF. The Swiss franc has made further gains against the euro, stabilising below parity. CHF gains mainly reflect its status as a safe haven in interesting times and the fact that Switzerland's inflation rate is well below the EU's. The SNB has continued its tightening cycle, hiking its policy rate by 75 bp to 0.50%, so bringing an end to negative rates. It has also started to reduce its portfolio of foreign exchange reserves. In light of these developments, we have opted to move from Neutral to Overweight on the Swiss franc.

Evolution of the dollar index (100= -5y)



Sources: SGPB, Macrobond, Fed 23/09/2022

ALTERNATIVES

Seeking diversification

Fears of a global recession should be less favourable to oil prices in the coming months. Gold, on the other hand, would benefit from this more chaotic period, regaining a role of refuge value.

Commodities

Oil. We are underweighted on oil. Brent price continues to fall from its first-half highs as recession fears build. The barrel of Brent is traded by the hour indeed around 87 dollars, losing about 25% in 3 months. OPEC, which has not yet reacted to the adjustment of the outlook, could do so at its next meeting on 5 October by reducing its supply, as stated in particular by Saudi Arabia. However, in the context of a widespread economic downturn, we are moving from Neutral to Underweight.

Gold. We maintain our overweight position in gold. The ounce of gold is currently trading at $1640, close to its two-year lows. With recession fears, investors continue to favour the dollar, explaining the decline in price since the highs of the first half. In addition, central banks in developed economies continue their rate-hike cycle, increasing the opportunity cost of holding gold. However, in the context of a general economic slowdown, we are encouraged to remain overweight, with gold remaining a timely source of diversification should risks materialize.

Hedge Funds

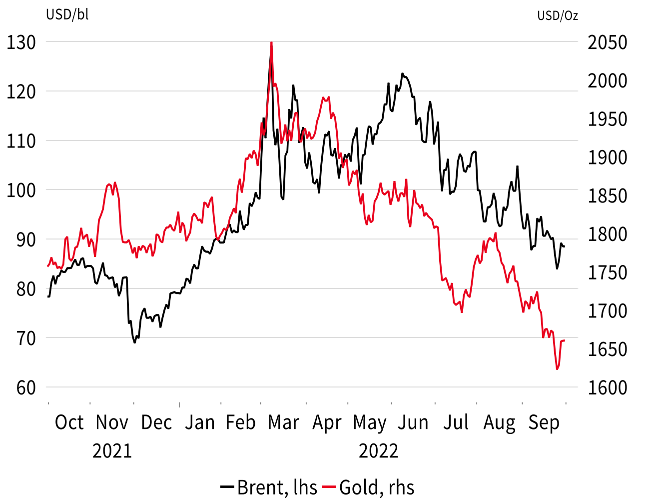
Long/Short Equity. Equity funds (L/S Market) are playing a particularly strong “performance protection” role as they are able to manage dispersion, particularly high in the current phase of high volatility on equity markets.

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 and gold prices



Sources: SGPB, Macrobond, Macrobond, ICE, EIA 30/09/2022

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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.

This document has not been authorized or reviewed by the JFSC or FCA.

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.

Kleinwort Hambros is part of Societe Generale Private Banking, which is part of the wealth management arm of the Societe Generale Group. Societe Generale is a French Bank authorised in France by the Autorité de Contrôle Prudentiel et de Resolution, located at 4, Place de Budapest, CS 92459, 75436 Paris Cedex 09 and under the prudential supervision of the European Central Bank. It is also authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

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

http://www.privatebanking.societegenerale.com