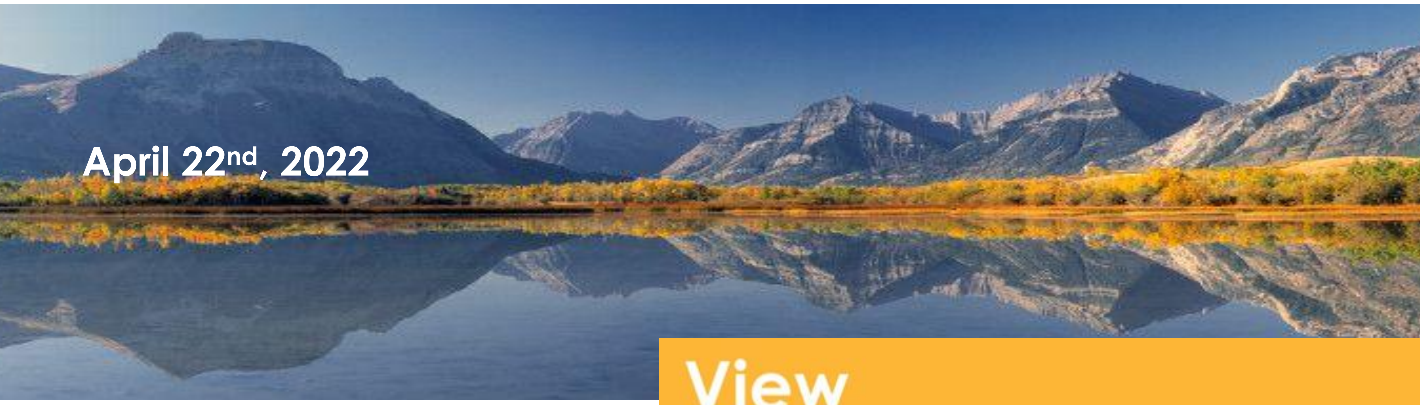

April 22nd, 2022

View
Fideuram Asset Management

Macroeconomic Scenario

The data released in recent weeks show a greater resilience of economic activity compared to expectations (particularly in the Euro Area and especially in the services sector) and reduce the risks on growth in response to Russia's invasion of Ukraine, despite the uncertainties arising from the lockdowns in China.

However, the further acceleration in inflation (and, especially in the case of the US, the risks associated with very sustained wage growth) is leading the main central banks of advanced economies (except for the BoJ) to adopt an even more aggressive stance: the Fed is expected to increase rates by 50 bps in the next three meetings and we now believe it will be likely that the ECB will proceed with the first rate increase as early as in July.

Equity Markets

While in the background the war in Ukraine continues to escalate with Russia's announcement of the beginning of Phase 2, the earnings season got under way in the US.

The first data appear reassuring and analysts are revising upwards estimates on profits and sales for the rest of the year thanks, almost entirely, to the contribution of the oil and commodity sectors.

However, there are still signs of concern over the remainder of the economy and, in geographical terms, signs of weakness are expected both in Europe, due to the sanctions against Russia, and in China, due to Covid-19 restrictions.

This leads us to change our view on equities to a position closer to neutral. Specifically, **we prefer a low volatility style, infrastructure and IT security themes and the biotech sector**. **In regional terms, we maintain a fairly positive view on US, UK and Chinese equities, while we remain neutral on the remaining areas.**

Bond Markets

In a context where the revision of monetary policy expectations appears to be at an advanced stage and where geopolitical instability remains high, we are bringing the exposure to the government component both in the US and in Europe back to neutral, after a long time.

On the credit market, while recognising that spreads have changed significantly in some cases, we continue to maintain a cautious approach with a neutral and slightly underweight positioning.

The central banks' exit from QE leaves room to a less favourable technical aspect and a higher point of balance in terms of valuations.

We confirm our neutral view on the high yield and emerging market, where we are reducing the overweight on Chinese debt in local currency to reflect the greater uncertainty on short-term exchange rate performance.

Macroeconomic scenario

US: the Fed is in a rush to increase rates

Given the strong drive of energy components (and also the food component), **inflation reached 8.5% in March, which is expected to be the peak for this cyclical phase**.

Excluding energy and food, the increase in prices was decidedly more limited (0.3% mom, compared to 1.2% of the total index), however upward pressures on the prices of services and goods (excluding cars) continue to appear high.

Therefore, it is not surprising that **the Fed continues to point out the need to rapidly bring interest rates back towards neutrality**, also in view of the clear imbalance in labour market conditions. It therefore appears likely that a 50-bp rate rise will be decided at the next meeting on 4 May and in the subsequent meetings in mid-June and at the end of July.

The reduction in the Fed's balance sheet will also begin in early May.

Euro Area: the ECB was quicker in increasing rates

Similarly to March, business confidence surprised on the upside in April as well, despite the shock of the war in Ukraine and the new lockdowns in China.

Although the manufacturing sector is weakening, **the services sector remains supported by the post-Omicron reopenings**, the savings accumulated during the pandemic, the support from tax authorities and the strength of the labour market.

Therefore, the indications confirm a recovery in GDP growth in the second quarter, following the stalemate in the first quarter.

However, the growth scenario remains exposed to strong downside risks, especially if the EU decides to penalise gas imports from Russia.

After reaching 7.4% in March, inflation will increase further and exceed 8% in the coming months.

At its April meeting, **the ECB** confirmed its intention to end the purchases of the APP in the third quarter and **continues to be geared towards speeding up the monetary policy normalisation process**.

We now expect the first rate rise in July, followed by another two increases by the end of the year.

China: uncertainty over growth

GDP growth in the first quarter was very robust (5.3% annualised), despite the interruption of production activities during the Chinese New Year period and the Winter Olympics.

However, **the sudden increase in infections and the implementation of the "zero tolerance" strategy against Covid-19** have put short-term growth prospects and the likelihood of reaching the 5.5% target by 2022 at risk.

The March data already show an initial impact on consumption and services, which should become even more significant in April.

We have therefore revised our GDP growth expectations for the current quarter (to 2.0%), but with further downside risks, with the average growth for this year down to 4.9%.

Equity Markets

The first quarter earnings season is under way

The first quarter earnings season has got under way with good earnings and turnover in the US, driven above all by the sectors that most benefited from the effects of the war in Ukraine and the consequent sanctions imposed by Western economies on Russia, i.e. energy and commodities.

The profit estimates for the current year have been significantly revised upwards for securities in these sectors, but this does not mean that signs of weakness cannot be observed in cyclical sectors linked to consumption and economic growth, such as consumer discretionary and financials, whose estimates have been revised downwards since the beginning of the year.

The performance of the technology sector appears to be still solid, although large caps still need to publish their data, and despite the fact that profit margins are expected to be compressed during the first half of the year following sales growth estimates above profit estimates.

On the other hand, the behaviour of the Chinese authorities, which continue to pursue a zero tolerance strategy against Covid-19, is a serious source of concern.

The almost total stoppage of operations in Shanghai and the consequent collapse of import-export flows from and to the city is having a strong impact on the equity markets of the Asian giant, which have lost more than 20% since the beginning of the year. At this point, however, most of the bad news appears to have been factored into prices and we expect economic support from the government.

In general, we bring back our view on equities close to neutral, with a slight overweight on the US, UK and China.

We maintain a neutral view on the remaining areas.

Specifically:

- we maintain a relative preference for the **US** market, where the fundamentals are more solid than in other countries even in relation to the ongoing geopolitical risks. In terms of profits, the first quarter is not expected to yield any negative surprises. The first published figures show a reporting season in line with the previous ones in terms of the percentage of upside surprises on profits and turnover. Guidance on the coming quarters will be crucial. **Therefore, we maintain a modest overweight**;

- in **Europe**, geopolitical and inflationary developments pose downside risks to Euro area earnings, estimated to grow to 9% in the current year. On the other hand, thanks to energy independence and the index composition, UK earnings are subject to upward revisions, which are probably more sustainable. Relative valuations continue to provide support. This leads us to **confirm our neutral view in the Euro area and to maintain a slight overweight in the UK area**;

- on the **Japanese market**, **we maintain a neutral view** due to the pressure on input costs that points to a downward revision of corporate profits for the entire 2022. The market seems to have anticipated the deterioration, while the yen depreciation did not result in an improvement in equity prices and profit expectations, due to the supply chain issues which do not allow the usual increase in exports;

- **we maintain a neutral view on emerging markets**, but our preference lies in the Chinese market despite the increase in Covid-19 cases and disappointing monthly data, since more incisive expansionary measures are expected to come from Chinese policy makers in order to try to reach the ambitious 5.5% real growth target at the end of the year. The overall scenario remains challenging, but profit valuations and estimates seem to already reflect the risks identified.

Bond Markets

The revision of monetary policy expectations continues, while geopolitical pressures and uncertainty surrounding zero-Covid policy developments in China remain high

The need for central banks to contain medium/long-term inflation expectations on the one hand and, on the other, geopolitical tensions and the effects of the higher cost of living on consumer sentiment continue to create a complex scenario. The market is currently pricing in an increase of around 75 bps in Europe and around 225 bps in the US between now and the end of the year, highlighting a sharp adjustment of expectations, while growth expectations are being revised downwards, whilst remaining positive.

Government bonds

The rise in bond yields leads us to **close the underweight position on European and US government bonds** and to bring the duration of the portfolios back to neutral. The current rate rise has led valuations to more correctly reflect macroeconomic conditions and monetary policy developments.

In addition, the contribution of equity risk diversification from government bonds is higher, especially in the US where we expect inflation to be close to record highs. We bring our exposure back to neutral in Europe where the Bund went beyond our valuation estimates in line with the reference scenario, driven by expectations of monetary tightening and the reduction of the scarcity effect.

For **peripheral securities**, geopolitical risks **and the only generic reference to flexibility margins to achieve the financial stability target, reduce the compression effect due to monetary policy** and bring the spread closer to the credit risk premium (which we estimate at around 180 bps for Italy).

Spread products

We confirm our neutral view on IG credit, which is still vulnerable to rate rises, especially in Europe where the ECB confirmed its intention to end the QE in the third quarter and announced a gradual lifting from July of the easing of the rules on collaterals introduced during the pandemic. This could impact the credit risk in the segment at a time when the downgrade process could get underway once again.

We continue to prefer exposure to bonds in the financial sector, although the overweight has been reduced.

Despite preferring risk-taking in the equity segment over investment in HY securities, we note, however, that default rates remain low and, in the US component, the expected longer term yields have once again become more attractive.

However, uncertainty surrounding the landing point of interest rates and the economy's ability to continue expanding at healthy rates keeps the asset class volatility high and the risk asymmetric in the event of further rate rises or a more marked cyclical slowdown.

This leads us to confirm our neutral view.

We remain neutral on the weight of emerging debt. US financial conditions, albeit still favourable, are undergoing a clear tightening process, while growing geopolitical tensions require an additional risk premium that we do not believe is likely to ease in the short term.

Finally, we have reduced the overweight on Chinese debt in local currency to reflect greater uncertainty over the performance of the renminbi in the short term.

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