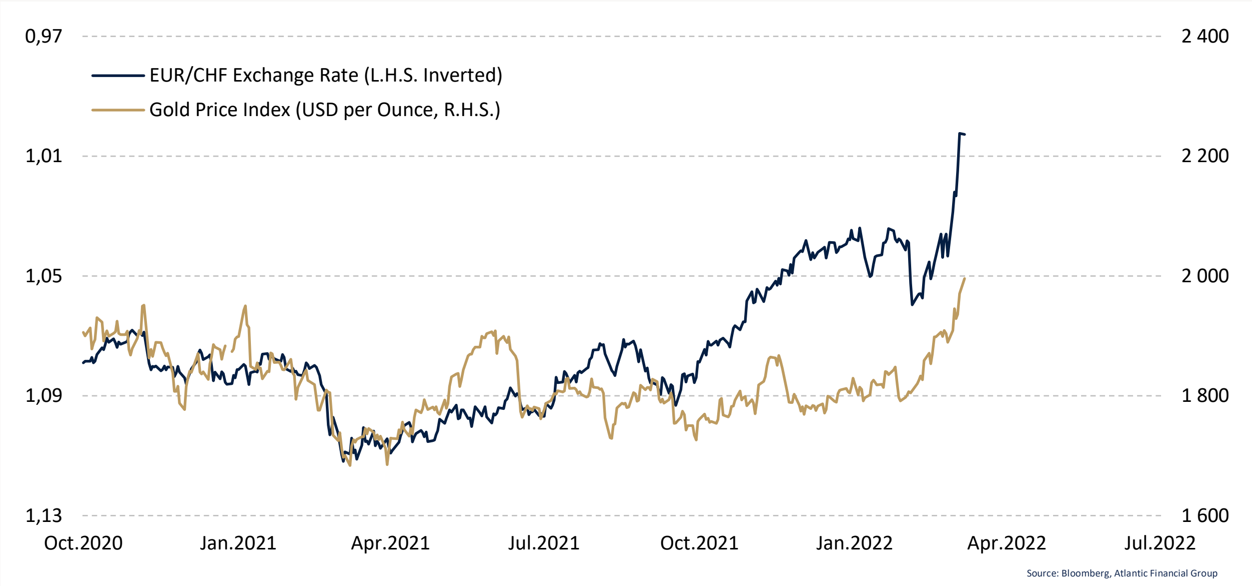
Weekly Investment Focus

7 March 2022

"IN A BARBAROUS WORLD, KEEP SAFE OUR RELICS"

- The exclusion of Russian banks from the Swift system benefits China and its Yuan
- The war in Ukraine should not overshadow other factors that are shaking up financial markets
- Central banks are making a monetary policy mistake
- Gold and the Swiss franc, a barbarous relic and a sound currency, have a bright future

CHART OF THE WEEK: "Even if gold pays more than the franc, it is lagging behind"



FINANCIAL MARKETS ANALYSIS

After weeks of fruitless diplomatic negotiations, Vladimir Putin launched a military offensive in Ukraine on 24 February. The response from Europe and the United States was Swift. For the West, it was not a **question of entering the conflict on military grounds but of imposing economic and financial sanctions on Russia:** stopping gas imports, banning exports of high-end or critical technical equipment and technology components, freezing the assets of political figures and oligarchs, closing airspace, cutting off funding to the central bank, depriving major commercial banks of the Swift international payment system, etc.

This Russian incursion into Ukraine and its weak condemnation by China reshuffles the geopolitical balance, with an American-European Atlantic bloc in the West and a Chinese-Russian bloc in the East. The United States now has a strong argument for strengthening the North Atlantic Treaty Organisation (NATO), which some believed to be brain dead. On the Old Continent, it is historically in crises that the European Union (EU) has been strengthened. Having built the foundations of fiscal solidarity and a common bond market during the pandemic, the EU could emerge as a more powerful and better coordinated military force.

China should also take advantage of the situation by reinforcing its status as a major power in the international financial system. As Russian banks have been excluded from the Swift financial transaction system, they will naturally turn to its Chinese competitor, CIPS. As a historical reminder, Swift replaced TELEX in 1973. For 50 years, it has enabled banking institutions to communicate with each other the essential information they need to carry out transactions. Today, more than 80% of international transactions are carried out via Swift. However, Swift is experiencing increasing competition: more efficient financial technology companies (fintechs) or domestic systems that make it possible to bypass sanctions (SPFS in Russia since 2014 and CIPS in China since 2015). Thus, China should not encounter too many difficulties in developing CIPS, initially created for internal reasons, into a tool compatible with the Russian SPFS, and then into a complete system capable of carrying out cross-border transactions throughout the world.

It should be remembered that China is several years ahead of the United States and Europe in developing a central bank digital currency (CBDC). The digital Yuan is no longer a project as it was in 2014, but it is used by more than 260 million Chinese since May 2020 for their transactions in the country (see Weekly Investment Focus from 19 Oct. 2020). **Russia's ban from the Swift system should therefore lead to a significant development of CIPS,** notably by backing it up with big data, blockchain and artificial intelligence. This will allow Beijing to offer a CIPS that is faster, more efficient and more secure than the ageing Swift, with the intention of becoming an international standard.

Today, CIPS is used by 1,300 financial institutions, a far cry from the 11,000 that use Swift, but this number is growing exponentially. While the dominance of the US dollar in the international financial system seems unlikely to be challenged in the coming years, no one can deny that the Chinese currency will play a crucial role in the future. **The Yuan exchange rate should therefore continue to benefit from global capital inflows and appreciate** (see Fig. 2).

On the stock market, Chinese companies involved in the development of CIPS are rising rapidly (see Fig. 3). **HyUnion Holding,** whose business includes payment and financial logistics, has risen by 36% in one week. **Beijing Infosec Technologies,** which provides signature server and security services for CIPS, jumped 24% in the same period. **Shenzhen Forms Syntron Information**, which offers IT services to banks, jumped 13%.

Fig 2- Evolution of the Chinese Yuan

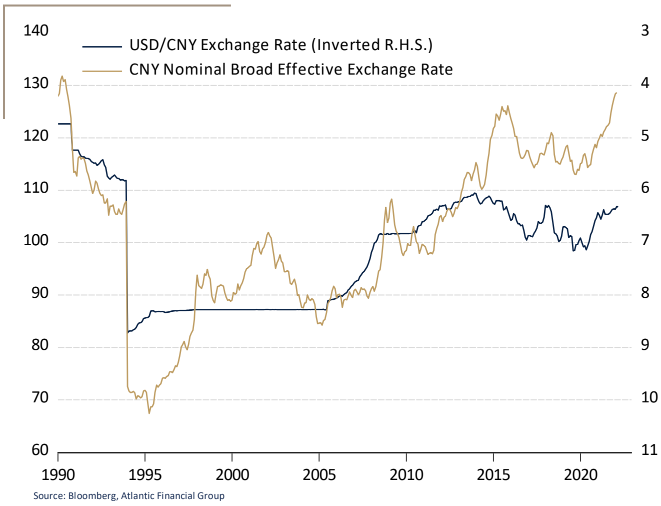
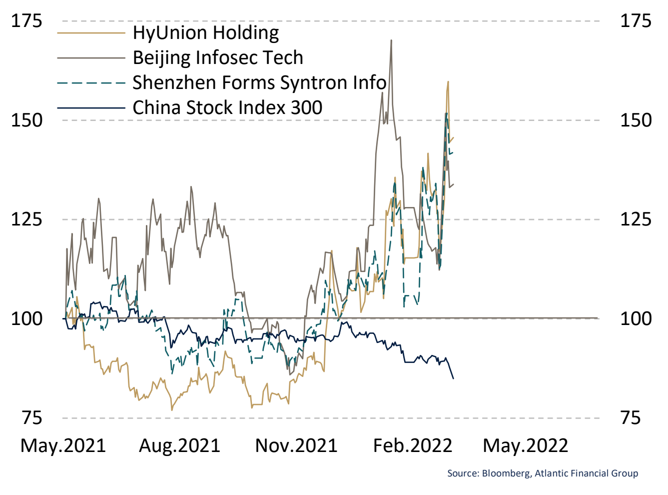


Fig 3- Chinese companies linked to CIPS



Economically, the conflict also has important consequences. In terms of growth, Russia and Ukraine account for less than 2% of global GDP, but the sanctions will bring uncertainty and undermine business and consumer confidence worldwide. In addition, **inflationary pressures inherited from the pandemic will increase** (see Figs. 4 & 5), as Russia and Ukraine are major producers of energy and raw materials for many supply chains: gas, oil and industrial metals for Russia; agricultural raw materials and proteins for Ukraine.

Fig 4- Inflation excluding energy and food

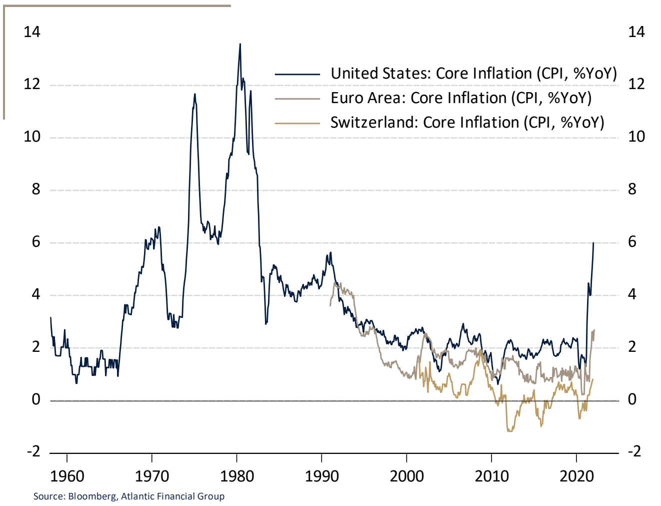
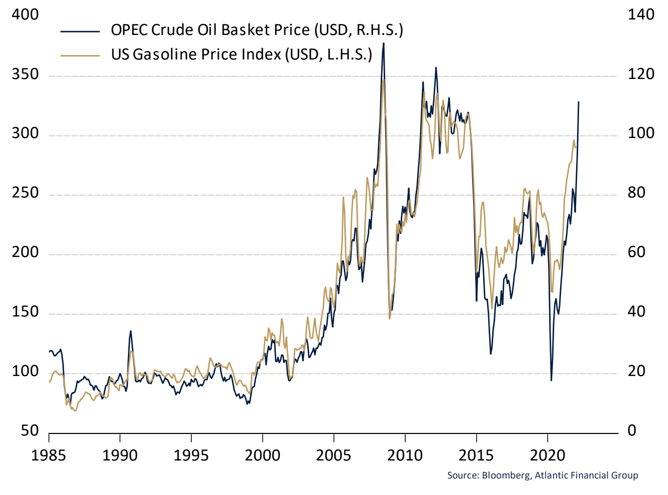
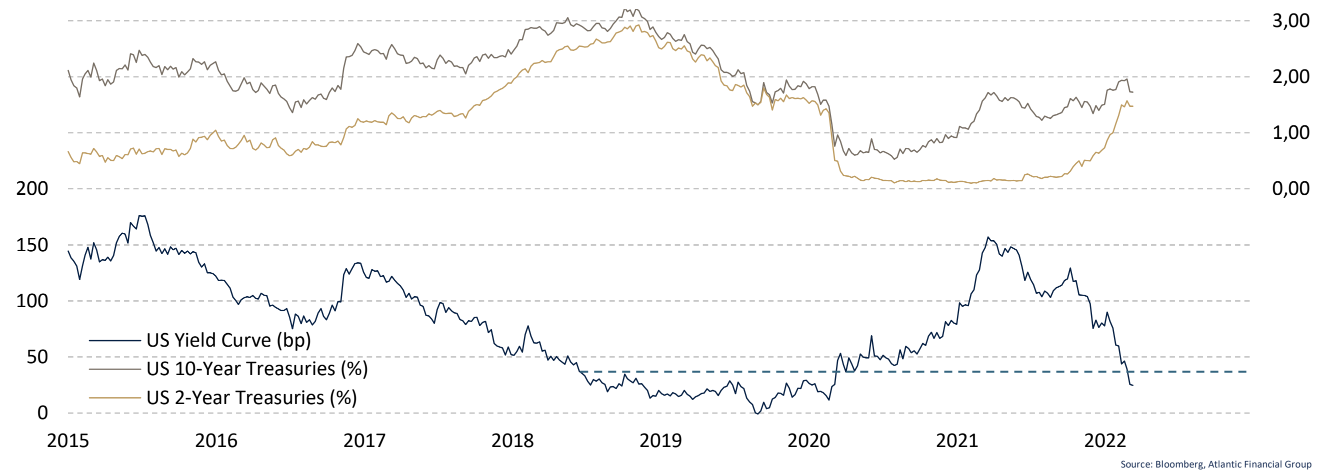


Fig 5- Energy prices



The future decisions of central bankers will be more difficult and unexpected. Should they fight inflation even harder and raise rates or, on the contrary, support growth and leave rates at zero? On Wednesday, Jerome Powell outlined an answer to Congress: the US Federal Reserve is ready to raise its main policy rate by a series of 25 basis points, or even 0.5%, if inflation rises too sharply. However, the economic cycle is in an advanced phase of slowdown and inflation is not "demand pull" but "cost push". It is linked to a supply shock, to an exogenous phenomenon. To be clear, raising interest rates will not bring down the price of a barrel of oil. **The probability is growing that this increase in key rates will end up being considered as a major monetary policy mistake.** Bond investors are not misled. During Jerome Powell's latest statements to Congress on Wednesday, the US yield curve flattened further, falling below the strong technical resistance of 35 basis points for the first time since the pandemic (see Fig. 6). The path to complete flattening is now clear.

Fig 6- US rate curve



Investors should not forget that the major stock market indices were already falling before Russia invaded Ukraine. There were several reasons for this and they remain valid today:

- The economic cycle has been slowing down in the major economies (US, EU, China) for several months and contrary to the consensus made by major brokers and private banks.
- Valuations are extremely high despite their fall over the last 12 months. The situation is comparable to that of the bursting of the internet bubble.
- Earnings growth is too low, although positive, and no longer compensates for the contraction in multiples, as it did last year.
- Inflation is very high, despite slowing economic growth and profits. It is dampening business investment spending and household purchasing power.
- Central banks are making a monetary policy mistake. In an attempt to curb inflation, they want to raise their key rates and stabilise their balance sheets.

On the financial markets, stock market indices are falling (see Fig. 7)**, growth stocks are underperforming value stocks, corporate bonds are suffering a little, Treasury bonds are appreciating slightly, oil and commodity prices are rising, the Swiss franc is reaching record levels and gold is starting to rise again** (see Chart of the Week). These movements may seem abrupt, associated with high volatility, but they are quite usual in times of stress.

Fig 7- Stock market developments

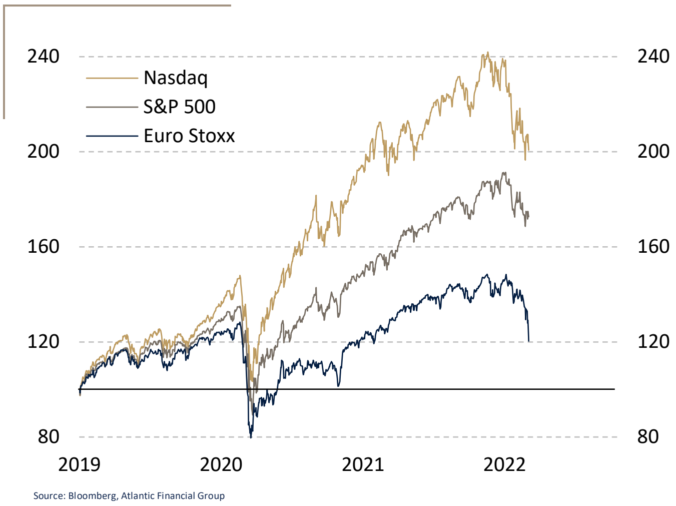
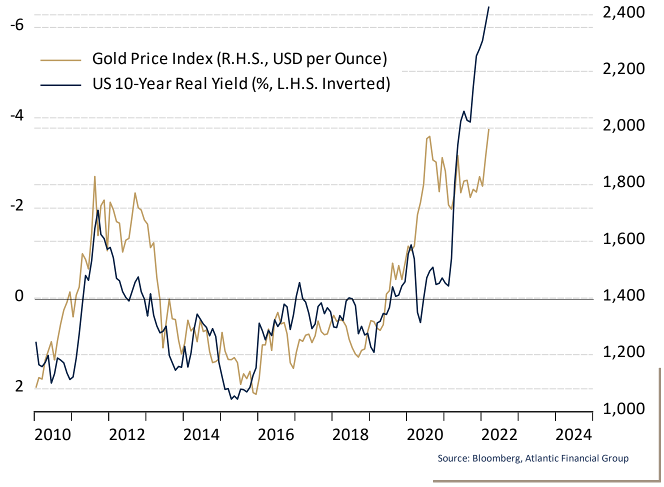


Fig 8- Gold prices and real rates



The situation could become even more critical, passing through phases of exaggerated euphoria and pessimism, with high volatility, which would support defensive assets. In particular, as yields fall and inflation expectations rise, real rates could reach new record lows (see Fig. 8). These two arguments are strong supports for **gold, whose price could easily exceed USD 2,200 per ounce in the near future** and whose decorrelation properties are regularly overlooked by investors.

Conclusion:

The war in Ukraine has made an already complicated situation worse, especially if central bankers make an error in judgment. Portfolios based on a robust strategic allocation will be negatively impacted, but they are conceptually designed to withstand such crises. Tactical allocation, which is more dynamic and takes into account the short-term environment, requires a temporary reduction in risk taking. For investors who want to do this, this is the right time to act. If they wait, decisions will be even more difficult to make in a few weeks.

However, even if the trough of the stock market has not yet been reached, the recent correction and the increase in volatility make it possible to build very attractive investment structures, particularly using value stocks. When tensions ease, the investment horizon will be clearer but the structuring conditions will be less favourable.

RETURN ON FINANCIAL ASSETS

Markets Performances (local currencies)	Last Price	Momentum Indicator (RSI)	1-Week (%)	1-Month (%)	2022 Year-to-Date (%)	2021 (%)	2020 (%)
Equities							
World (MSCI)	679.3	35.61	-2.7%	-5.3%	-9.8%	19.0%	16.9%
USA (S&P 500)	4 329	43.34	-1.2%	-3.7%	-8.9%	28.7%	18.4%
USA (Dow Jones)	33 615	41.37	-1.2%	-3.9%	-7.2%	20.9%	9.7%
USA (Nasdaq)	13 313	40.64	-2.8%	-5.5%	-14.8%	22.2%	45.1%
Euro Area (DJ EuroStoxx)	382.4	25.24	-10.0%	-12.7%	-17.2%	23.5%	0.8%
UK (FTSE 100)	6 857	32.82	-6.7%	-6.6%	-4.9%	18.4%	-11.4%
Switzerland (SMI)	10 920	29.56	-5.7%	-6.9%	-12.2%	23.7%	4.3%
Japan (Nikkei)	25 221	38.33	-1.9%	-5.3%	-9.7%	6.7%	18.3%
Emerging (MSCI)	1 145	31.58	-2.3%	-6.2%	-7.0%	-2.3%	18.8%
Brasil (IBOVESPA)	114 474	59.89	1.2%	2.0%	9.2%	-11.9%	2.9%
Russia (MOEX) as of 25.02.2022	2 470	31.35	-27.2%	-24.2%	-34.4%	21.9%	14.8%
India (SENSEX)	52 776	34.28	-2.7%	-7.2%	-6.6%	23.2%	17.2%
China (CSI)	4 353	37.08	-1.7%	-1.5%	-9.0%	-3.5%	29.9%
Communication Serv. (MSCI Worl	95.33	32.83	-3.3%	-7.6%	-13.5%	10.9%	24.2%
Consumer Discret. (MSCI World)	338.7	29.36	-5.3%	-10.5%	-17.4%	9.2%	37.0%
Consumer Staples (MSCI World)	275.0	37.15	-2.4%	-2.8%	-5.5%	11.7%	8.8%
Energy (MSCI World)	222.0	59.14	3.0%	1.0%	18.4%	37.5%	-27.7%
Financials (MSCI World)	141.5	30.36	-5.6%	-8.9%	-5.7%	25.1%	-3.1%
Health Care (MSCI World)	338.7	48.02	-0.4%	-1.1%	-8.1%	18.0%	15.4%
Industrials (MSCI World)	298.9	39.51	-1.4%	-3.2%	-9.8%	16.6%	11.8%
Info. Tech. (MSCI World)	485.4	37.43	-3.5%	-6.7%	-15.4%	27.6%	46.2%
Materials (MSCI World)	358.9	49.22	0.5%	1.8%	-1.3%	15.4%	21.6%
Real Estate (MSCI World)	214.6	46.16	0.0%	-1.8%	-8.4%	23.6%	-5.7%
Utilities (MSCI World)	155.1	50.68	0.1%	-1.0%	-4.2%	11.1%	4.8%
Bonds (FTSE)							
USA (7-10 Yr)	1.74%	60.60	2.2%	1.7%	-1.5%	-2.4%	9.3%
Euro Area (7-10 Yr)	0.45%	59.92	2.4%	2.0%	-1.5%	-2.9%	4.5%
Germany (7-10 Yr)	-0.06%	66.54	2.8%	2.4%	-0.1%	-2.7%	3.0%
UK (7-10 Yr)	1.24%	60.63	2.3%	2.2%	-1.3%	-4.9%	5.4%
Switzerland (7-10 Yr)	0.17%	51.58	1.2%	0.9%	-2.4%	-2.3%	0.4%
Japan (5-10 Yr)	0.15%	58.32	0.4%	0.3%	-0.5%	0.0%	-0.1%
Emerging (5-10 Yr)	6.54%	20.81	-2.1%	-6.7%	-10.3%	-2.3%	5.2%
USA (IG Corp.)	3.12%	44.88	-0.1%	-1.0%	-5.4%	-1.0%	9.9%
Euro Area (IG Corp.)	1.08%	50.83	1.1%	0.6%	-2.7%	-1.0%	2.8%
Emerging (IG Corp.)	6.46%	8.22	-1.4%	-5.3%	-8.1%	-3.0%	8.1%
USA (HY Corp.)	5.77%	37.34	-0.4%	-1.0%	-4.1%	5.3%	7.1%
Euro Area (HY Corp.)	5.09%	28.60	-0.2%	-1.1%	-4.5%	3.4%	2.3%
Emerging (HY Corp.)	9.71%	16.40	-2.8%	-6.8%	-8.9%	-3.2%	4.3%
World (Convertibles)	398.8	36.04	-2.2%	-3.1%	-9.0%	2.4%	38.8%
USA (Convertibles)	535.8	40.73	-1.8%	-2.5%	-9.6%	3.1%	54.5%
Euro Area (Convertibles)	3 698	22.86	-3.0%	-5.0%	-9.9%	-0.3%	6.1%
Switzerland (Convertibles)	181.8	39.67	0.3%	-0.4%	-2.2%	-0.5%	0.5%
Japan (Convertibles)	196.1	40.06	-0.4%	-0.8%	-2.3%	3.3%	2.8%
Hedge Funds (Crédit Suisse)							
Hedge Funds Indus.	726.7	69.55	n.a.	-0.7%	n.a.	8.2%	6.4%
Distressed	966.8	70.76	n.a.	-1.0%	n.a.	12.5%	3.8%
Event Driven	812.3	61.69	n.a.	-2.0%	n.a.	12.9%	7.0%
Fixed Income	393.5	76.28	n.a.	-0.1%	n.a.	5.2%	3.6%
Global Macro	1 205.0	73.50	n.a.	3.4%	n.a.	9.6%	6.5%
Long/Short	927.5	57.72	n.a.	-2.4%	n.a.	8.3%	7.9%
CTA's	341.6	64.91	n.a.	1.4%	n.a.	8.2%	1.9%
Market Neutral	290.1	48.79	n.a.	-0.8%	n.a.	6.2%	1.7%
Multi-Strategy	696.9	66.92	n.a.	-1.2%	n.a.	7.0%	5.6%
Volatility							
VIX	35.59	59.34	15.9%	37.7%	85.7%	-24.3%	65.1%
VSTOXX	56.62	70.03	54.6%	88.7%	157.6%	-17.6%	67.5%
Commodities							
Commodities (CRB)	623.0	n.a.	2.7%	5.5%	7.7%	30.3%	10.5%
Gold (Troy Ounce)	1 999	76.77	4.7%	9.8%	9.3%	-3.6%	25.1%
Oil (WTI, Barrel)	115.68	79.63	20.9%	25.3%	50.3%	58.7%	-20.5%
Oil (Brent, Barrel)	131.44	82.95	26.5%	29.5%	59.5%	51.4%	-23.0%
Currencies (vs USD)							
USD (Dollar Index)	99.049	75.39	2.4%	3.8%	3.5%	6.4%	-6.7%
EUR	1.0860	22.70	-3.2%	-5.1%	-4.5%	-7.5%	9.7%
JPY	115.04	50.91	0.0%	0.1%	0.0%	-10.2%	5.1%
GBP	1.3165	28.85	-1.9%	-2.7%	-2.7%	-1.0%	3.1%
AUD	0.7401	70.11	1.9%	3.9%	1.9%	-5.6%	9.6%
CAD	1.2723	48.67	-0.4%	-0.4%	-0.7%	0.7%	2.1%
CHF	0.9245	46.01	-0.8%	-0.1%	-1.3%	-3.0%	9.4%
CNY	6.3186	58.53	-0.1%	0.7%	0.6%	2.7%	6.7%
MXN	21.225	28.91	-3.6%	-3.0%	-3.3%	-3.0%	-5.0%
EM (Emerging Index)	1 717.2	32.93	-1.4%	-1.3%	-1.0%	0.9%	3.3%

Source: Bloomberg, Atlantic Financial Group

Total Return by asset class (Negative \ Positive Performance)

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