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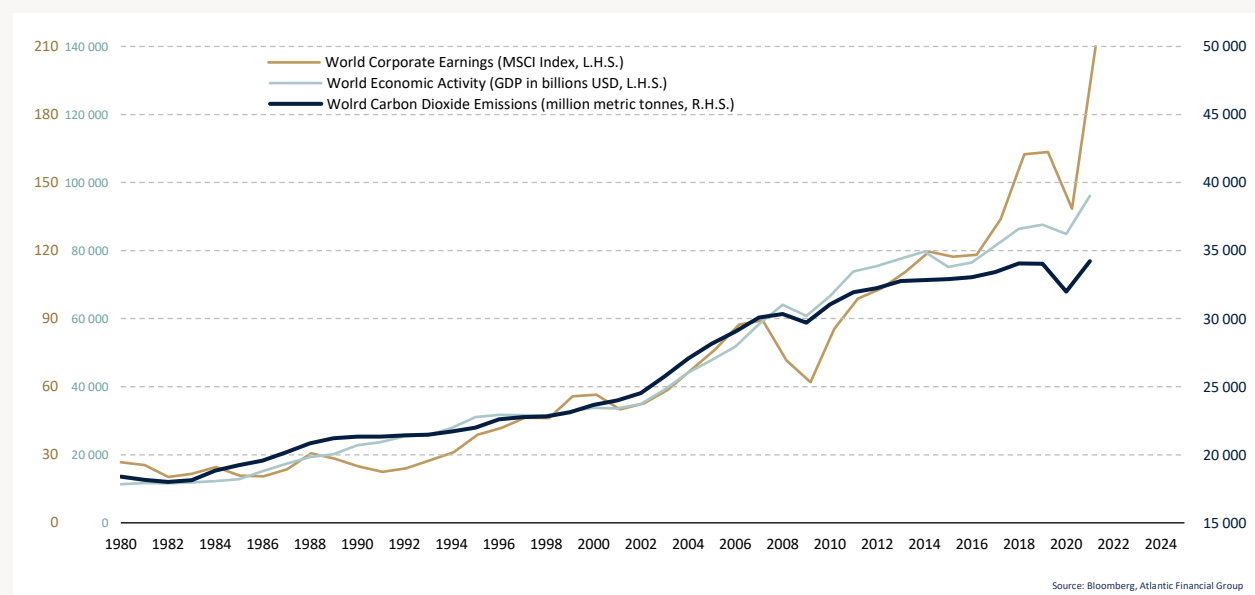
Weekly Investment Focus

10 October 2022

"CLIMATE & FINANCE ARE NOT GAMES, BUT GAME THEORY CAN HELP"

- ◆ Climate and finance are linked by a Nash equilibrium
- ◆ A long-term strategy would be preferred, but short-term gains prevail
- ◆ Thus, the climate imbalance increases as economic activity and profits grow
- ◆ Good news, macroeconomic policies can provide an exit from this sub-optimal situation

CHART OF THE WEEK: "Carbon emissions follow earnings trend, but less than before"



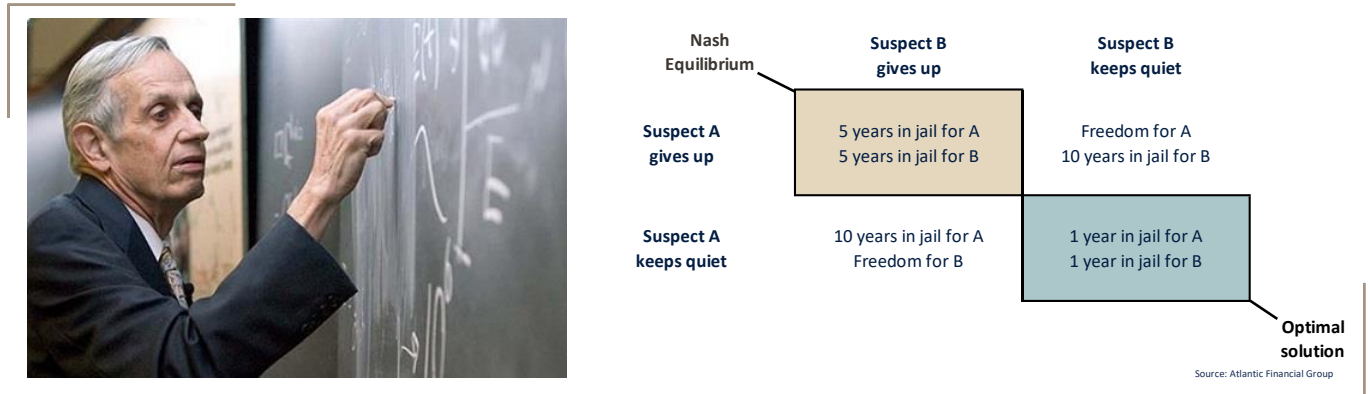
STOCK MARKET ANALYSIS

At a time when finance is trying to limit its negative impact on the climate, literature and film lovers will enjoy reading the biography of John Nash, *A Brain of a Nation*. This book, written in 1999 by Sylvia Nasar, a former business journalist for the New York Times, was adapted for the big screen two years later by Ron Howard. Investors will also find it interesting insofar as **climate and finance form a Nash equilibrium: the needs of the former (long-term sustainability objective) are opposed to those of the latter (short-term profitability objective). For finance to become green, intermediate macroeconomic policies are needed.**



For the record, John Nash (cf. Fig. 2) was interested in non-cooperative situations and demonstrated that individual interests are opposed to collective utility. A Nash equilibrium is a sub-optimal situation in which none of the players (called players in game theory) can find a better strategy, given the strategies chosen by the other players.

Fig. 2 & 3 - John Nash & the prisoner's dilemma



The prisoner's dilemma is the most common example (cf. Fig. 3). Two individuals who have committed a theft are arrested. They are held in two different cells without being able to communicate and are presented with the following choice: "If you report your accomplice and he does not report you, you will be released and the other will get the maximum sentence (ten years in prison); if each of you reports his accomplice, you will both go to prison for a reduced period (5 years); finally, if neither of you reports the other, you will be sentenced to a short term (one year) for lack of evidence. So how do you make the best decision, regardless of what the other person does? From a collective point of view, it would be in the interest of both to deny and only do one year in prison each. Unfortunately, on a personal level, it is rational to denounce one's accomplice in order to go free or go to jail for five years and avoid the worst-case scenario. To get out of this sub-optimal balance, accomplices must be allowed to discuss and give credibility to their intentions.

This dilemma applies perfectly to finance and the climate: investors know that if they want to achieve sustainable returns on their investments, they must preserve the planet and think long-term, but as long as macroeconomic policies do not constrain them, they will prefer short-term financial gains... a rational but sub-optimal decision. **The good news is that in recent years the policies implemented have been delivering positive effects: carbon emissions followed economic and earnings trend, but less than before** (cf. Chart of the Week).

Here are some macroeconomic policy options for extending the time horizon of finance, so as to restore climate balance and maximise future gains:

- **States:** Their role is central to this issue of common interests. It is at the core of their very reason for existing. A few hundred years ago, states set up police and judicial institutions to ensure that human



beings abided by common rules rather than killing each other at every disagreement. States could impose incentives or constraints to do things differently in terms of investment so as not to damage the climate balance. This fiscal policy of subsidies, ex-ante taxes or ex-post financial penalties would favour climate-friendly investments... and move towards an optimal situation.

- International institutions: Globalisation of decisions would make previous rules more effective. There is no shortage of examples. The creation of the World Trade Organisation (WTO) in 1995 accelerated the globalisation of trade, allowing for the development of world growth, the containment of inflation and the reduction of poverty. A World Climate Organisation (WCO) would make national decisions more harmonious and those taken at the Climate Conferences (COP) more effective. It could even be integrated into the World Trade Organisation, in order to define common objectives for trade, finance and climate.
- Financial intermediaries: Investors are becoming more comfortable with long-term investments. In recent years, as bond yields have fallen, financial intermediaries have sought to make dated bond funds or unlisted investments more accessible, whether in mergers and acquisitions or private equity. They could now seek to develop investments in listed equities where exit costs are inversely proportional to the length of the holding period. Like unlisted and at the opposite extreme to high frequency trading, these strategies would seek to invest in listed companies, without concern for immediate profitability.
- Scientific community: Most economic theories and risk models focus on the short term. Academic research could use econometrics and constrained optimisations to try to arrive at theorems that would optimise performance in the very long term. In the same way, researchers in behavioural economics could focus their efforts on these climate issues.
- Central banks: Monetary policies currently aim to keep inflation close to 2% and, for some, a second objective of maximising job creation. Both targets are set with a relatively short time horizon. It could be envisaged to lengthen it or to include a very long term parameter. This would allow central bankers to pay more attention to the problem of climate change in advance. They could then adapt their key rates and the money supply by taking this long-term criterion into account. Imagine a central bank setting a different policy rate for commercial banks, depending on whether they lend to climate-friendly companies or not.

Conclusion:

Macroeconomic policies can be used to modify the decisions and behaviour of individuals, particularly investors. These policies, whether incentive or repressive, are gradually being adopted to take account of climate balance and long-term objectives. Good news.



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)	563.0	37.01	1.8%	-7.2%	-24.0%	19.0%	16.9%
USA (S&P 500)	3 640	37.73	1.6%	-8.4%	-22.7%	28.7%	18.4%
USA (Dow Jones)	29 297	38.61	2.0%	-7.1%	-18.1%	20.9%	9.7%
USA (Nasdaq)	10 652	36.54	0.7%	-9.6%	-31.5%	22.2%	45.0%
Euro Area (DJ EuroStoxx)	369.4	40.93	1.3%	-4.7%	-20.5%	23.5%	0.8%
UK (FTSE 100)	6 991	39.97	1.4%	-3.3%	-2.4%	18.4%	-11.4%
Switzerland (SMI)	10 309	41.85	0.4%	-4.5%	-17.7%	23.7%	4.3%
Japan (Nikkei)	27 116	48.08	4.5%	-0.4%	-4.0%	6.7%	18.3%
Emerging (MSCI)	898	37.86	2.5%	-6.0%	-25.1%	-2.3%	18.8%
Brasil (IBOVESPA)	116 375	61.67	5.8%	6.0%	11.0%	-11.9%	2.9%
Russia (MOEX)	1 945	31.79	-0.4%	-18.6%	-47.1%	21.9%	14.8%
India (SENSEX)	58 191	49.65	1.3%	-1.4%	1.0%	23.2%	17.2%
China (CSI)	3 805	28.43	-1.3%	-6.7%	-21.4%	-3.5%	29.9%
Communication Serv. (MSCI World)	69.82	34.40	1.5%	-9.8%	-36.0%	10.9%	24.2%
Consumer Discret. (MSCI World)	281.0	34.66	0.4%	-9.4%	-30.9%	9.2%	37.0%
Consumer Staples (MSCI World)	240.0	29.54	-0.6%	-7.2%	-16.0%	11.7%	8.8%
Energy (MSCI World)	228.1	58.77	10.5%	2.9%	25.9%	37.5%	-27.7%
Financials (MSCI World)	118.1	38.07	1.8%	-5.9%	-19.3%	25.1%	-3.1%
Health Care (MSCI World)	307.4	42.00	1.4%	-3.4%	-15.6%	18.0%	15.4%
Industrials (MSCI World)	248.1	38.93	2.5%	-7.3%	-23.9%	16.6%	11.8%
Info. Tech. (MSCI World)	379.7	36.46	2.1%	-8.8%	-33.3%	27.6%	46.2%
Materials (MSCI World)	276.1	43.21	2.6%	-4.5%	-21.5%	15.4%	21.6%
Real Estate (MSCI World)	159.8	26.67	-2.3%	-14.9%	-30.1%	23.6%	-5.7%
Utilities (MSCI World)	135.6	26.98	-1.8%	-14.7%	-14.4%	11.1%	4.8%
Bonds (FTSE)							
USA (7-10 Yr)	3.88%	34.65	-0.5%	-4.1%	-15.3%	-2.4%	9.3%
Euro Area (7-10 Yr)	3.01%	33.84	-0.8%	-5.2%	-18.1%	-2.9%	4.5%
Germany (7-10 Yr)	2.19%	33.23	-0.5%	-4.4%	-15.8%	-2.7%	3.0%
UK (7-10 Yr)	4.24%	28.52	-0.8%	-9.0%	-21.4%	-4.9%	5.4%
Switzerland (7-10 Yr)	1.40%	37.39	-1.3%	-3.8%	-12.6%	-2.3%	0.4%
Japan (5-10 Yr)	0.25%	48.12	0.1%	-0.1%	-1.3%	0.0%	-0.1%
Emerging (5-10 Yr)	8.74%	30.44	-0.3%	-6.2%	-23.5%	-2.3%	5.2%
USA (IG Corp.)	5.70%	34.24	-1.0%	-4.3%	-18.6%	-1.0%	9.9%
Euro Area (IG Corp.)	4.29%	31.33	-1.0%	-3.2%	-14.7%	-1.0%	2.8%
Emerging (IG Corp.)	8.83%	25.53	-0.2%	-4.3%	-19.5%	-3.0%	8.1%
USA (HY Corp.)	9.28%	40.91	0.9%	-3.7%	-13.5%	5.3%	7.1%
Euro Area (HY Corp.)	8.58%	32.49	0.5%	-3.3%	-14.1%	3.4%	2.3%
Emerging (HY Corp.)	12.47%	33.29	0.2%	-5.7%	-20.1%	-3.2%	4.3%
World (Convertibles)	349.6	40.15	1.5%	-3.8%	-20.2%	2.4%	38.8%
USA (Convertibles)	473.3	42.39	2.1%	-3.8%	-20.2%	3.1%	54.5%
Euro Area (Convertibles)	3 399	36.18	1.6%	-3.6%	-17.2%	-0.3%	6.1%
Switzerland (Convertibles)	168.6	35.27	-0.6%	-2.2%	-9.3%	-0.5%	0.5%
Japan (Convertibles)	198.8	53.55	1.0%	0.5%	-1.0%	3.3%	2.8%
Hedge Funds (Crédit Suisse)							
Hedge Funds Indus.	733	65.84	n.a.	0.5%	0.8%	8.2%	6.4%
Distressed	940	56.28	n.a.	1.7%	-2.8%	12.5%	3.8%
Event Driven	763	54.24	n.a.	0.7%	-6.0%	12.9%	7.0%
Fixed Income	384	57.94	n.a.	0.0%	-2.3%	5.2%	3.6%
Global Macro	1469	79.23	n.a.	2.1%	21.9%	9.6%	6.5%
Long/Short	851	40.34	n.a.	-1.3%	-8.3%	8.3%	7.9%
CTA's	407	76.99	n.a.	3.1%	19.2%	8.2%	1.9%
Market Neutral	287	56.58	n.a.	1.5%	-1.2%	6.2%	1.7%
Multi-Strategy	694	58.80	n.a.	0.8%	-0.4%	7.0%	5.6%
Volatility							
VIX	31.36	60.36	-0.8%	27.3%	82.1%	-24.3%	65.1%
VSTOXX	29.92	55.62	-2.6%	10.3%	55.3%	-17.6%	67.5%
Commodities							
Commodities (CRB)	559.1	n.a.	-0.1%	-2.3%	-3.3%	30.3%	10.5%
Gold (Troy Ounce)	1 695	50.23	2.1%	-1.4%	-7.3%	-3.6%	25.1%
Oil (WTI, Barrel)	92.64	61.82	16.5%	13.1%	20.3%	58.7%	-20.5%
Oil (Brent, Barrel)	98.54	60.96	14.4%	12.9%	27.2%	51.4%	-23.0%
Currencies (vs USD)							
USD (Dollar Index)	112.80	61.09	0.6%	2.7%	17.9%	6.4%	-6.7%
EUR	0.9737	41.42	-0.7%	-3.0%	-14.4%	-7.5%	9.7%
JPY	145.33	35.76	-0.4%	-2.0%	-20.8%	-10.2%	5.1%
GBP	1.1090	41.62	-0.7%	-4.3%	-18.0%	-1.0%	3.1%
AUD	0.6376	32.62	-0.4%	-6.8%	-12.2%	-5.6%	9.6%
CAD	1.3729	35.87	0.7%	-5.1%	-8.0%	0.7%	2.1%
CHF	0.9939	38.61	-0.7%	-3.3%	-8.1%	-3.0%	9.4%
CNY	7.1160	33.13	0.2%	-3.2%	-10.7%	2.7%	6.7%
MXN	20.037	51.83	0.5%	-0.7%	2.5%	-3.0%	-5.0%
EM (Emerging Index)	1 596.7	38.16	0.3%	-1.6%	-7.9%	0.9%	3.3%

Source: Bloomberg, Atlantic Financial Group

Total Return by asset class (Negative \ Positive Performance)



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