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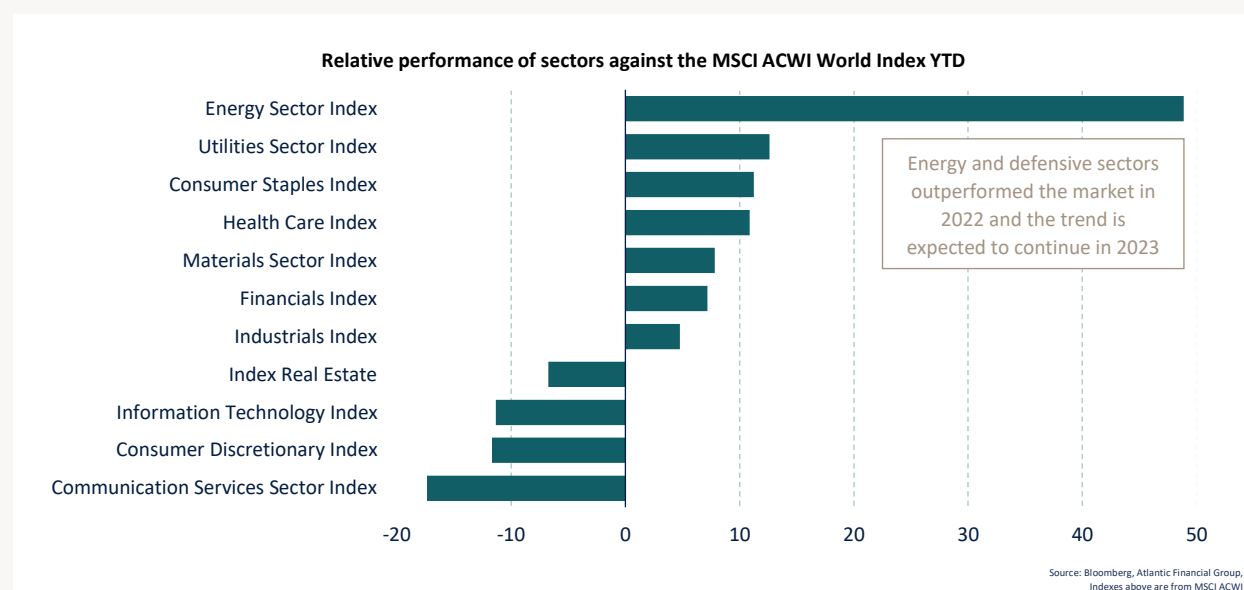
Weekly Investment Focus

12 December 2022

"RESILIENCE AND OPPORTUNITY"

- ◆ Which sectors performed well in 2022?
- ◆ Which sectors have declined?
- ◆ Which themes will maintain their momentum in 2023?
- ◆ And what strategies should be avoided?

CHART OF THE WEEK: "High equity market fragmentation"



STOCK MARKET ANALYSIS

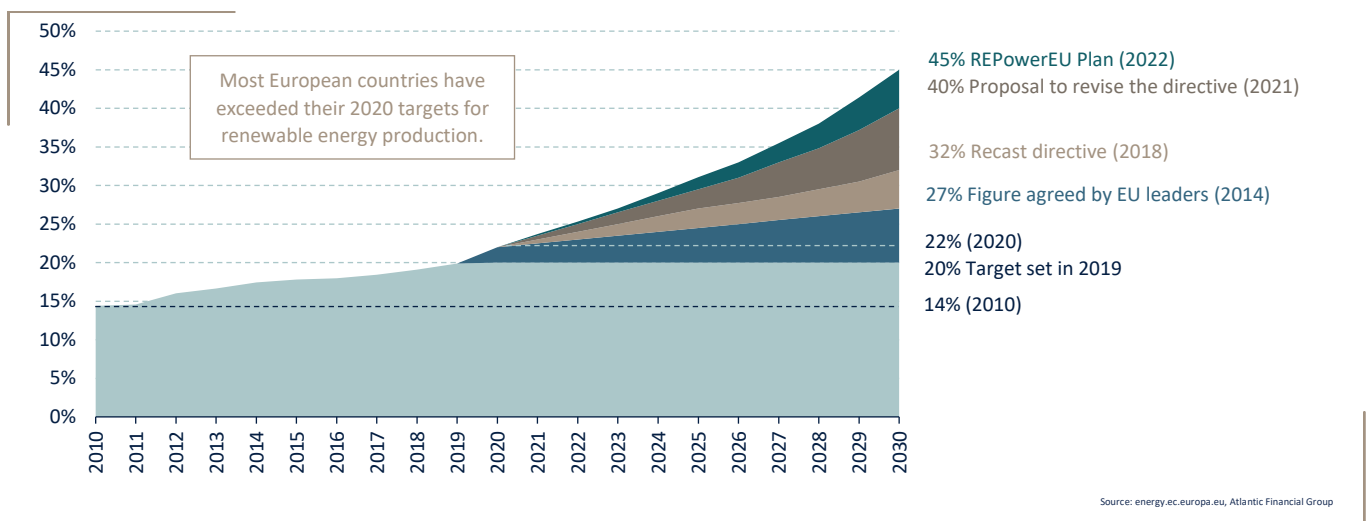
The market has been quite turbulent over the last 11 months (See Chart of the Week). **Geopolitical events have called into question political choices regarding energy and encouraged more industrial protectionism.** The end of the year is an opportunity to take stock and **realign the equity allocation** if necessary, without succumbing to the siren song ... or "bull trap". The latter must **become more resilient in the face of inflation, high interest rates and the coming recession.**



◆ Which sectors performed well in 2022?

In this unstable environment, **the Energy sector** (MSCI ACWI Energy Index), up +29.2% since the beginning of the year, **is the only sector to post a positive performance. It marks the great comeback of fossil fuels but also the acceleration of the commitment to renewable energies** (see Fig.2). In Europe, the "Green Deal" aims to make the continent carbon neutral by 2050. A package of measures should enable European households and businesses to benefit from a sustainable green transition. The use of renewable energy has many advantages, including the reduction of greenhouse gas emissions, diversification of energy supplies and, above all, a reduced dependence on fossil fuels (in particular, oil and gas). The growth of renewable energy sources can also boost employment in the EU.

Fig. 2 - Evolution of renewable energy production targets for the European Union



Defensive strategies, which are not very sensitive to economic cycles, held their ground: the healthcare sector (-4.6%), **consumer staples** (-4.9%) **and utilities** (-3.6%). The same applies to **the insurance sector** (+0.6%). The population still needs to eat and care for itself and increasingly wants to protect its health and property through insurance products. Although growth is weaker than the rest of the market, these companies are generating good cash flows and have strong balance sheets.

The material sector experienced choppy performance (-8.3%), sometimes praised following the invasion of Ukraine, and sometimes punished in the face the Chinese real estate sector failure and the maintenance of the zero-covid policy by Xi Jin Ping. **The war in Ukraine has pushed up the price of energy, agricultural commodities and natural resources to levels not seen since the great financial crisis of 2008.**

◆ Which sectors have declined?

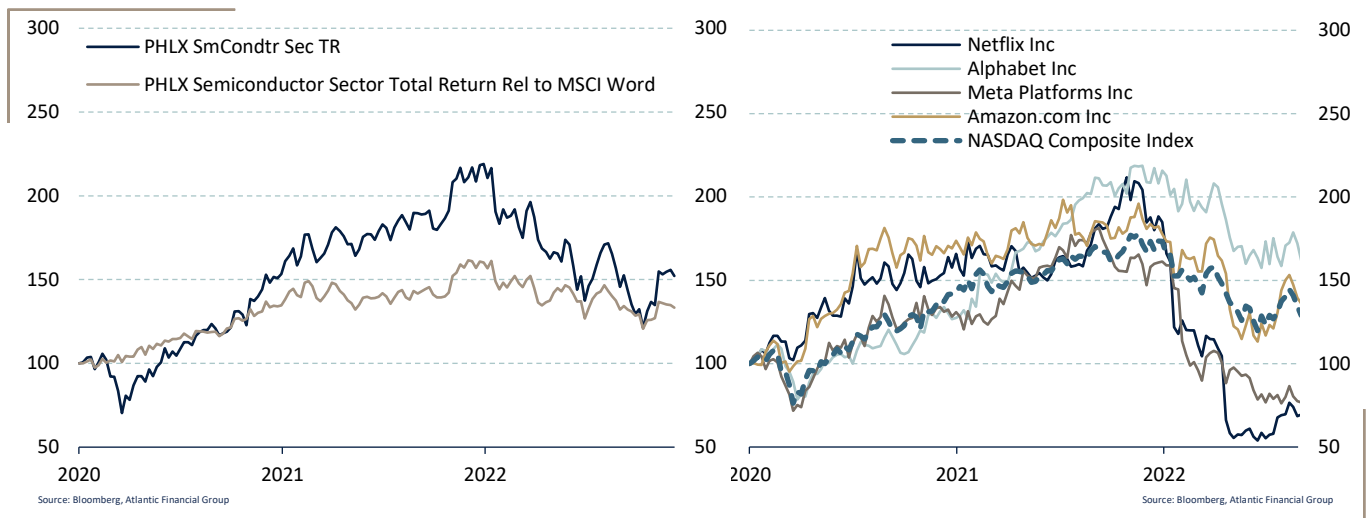
The technology sector (-27.2%) **has seen its valuation multiples compressed by rising interest rates. Within the sector, semiconductors** (-32.1% - see Fig. 4), **after trying to make up for more than a year of supply shortfall due to the Covid-19 pandemic, is experiencing a counter-shock from slowing demand.**



However, in the long term, chips remain a strategic sector and governments are committed to working with manufacturers to repatriate production capacity to America and Europe.

The communication sector (-33.8%) is also in turmoil as its revenues, largely coming from advertising, are melting under the effect of the central banks' tightening monetary policy. Sales and marketing budgets are indeed the first to be cut during an economic slowdown (see Fig. 5).

Fig. 4 – Weak performance of the Semi Index (XSOX) Fig. 5 - FANGs are also under pressure



The real estate sector (-22.3%) posted one of the worst performances. The speed of the rise in rates led to an almost instantaneous halt in transactions. The CAP RATE (Net Operating Income/Stock Market Capitalisation) represents the return that investors can expect at a given time. It follows the 10-year government bond rate with an average yield spread of 350 bps. If long rates rise too quickly, which has been the case this year, then the CAP RATE rises and property prices fall.

The industrial sector (-11.3%) suffered from supply issues, lockdowns in China, high inflation and rising energy prices. The energy crisis is having a particularly negative effect on European companies, which are sometimes forced to shut down their factories to avoid producing at a loss.

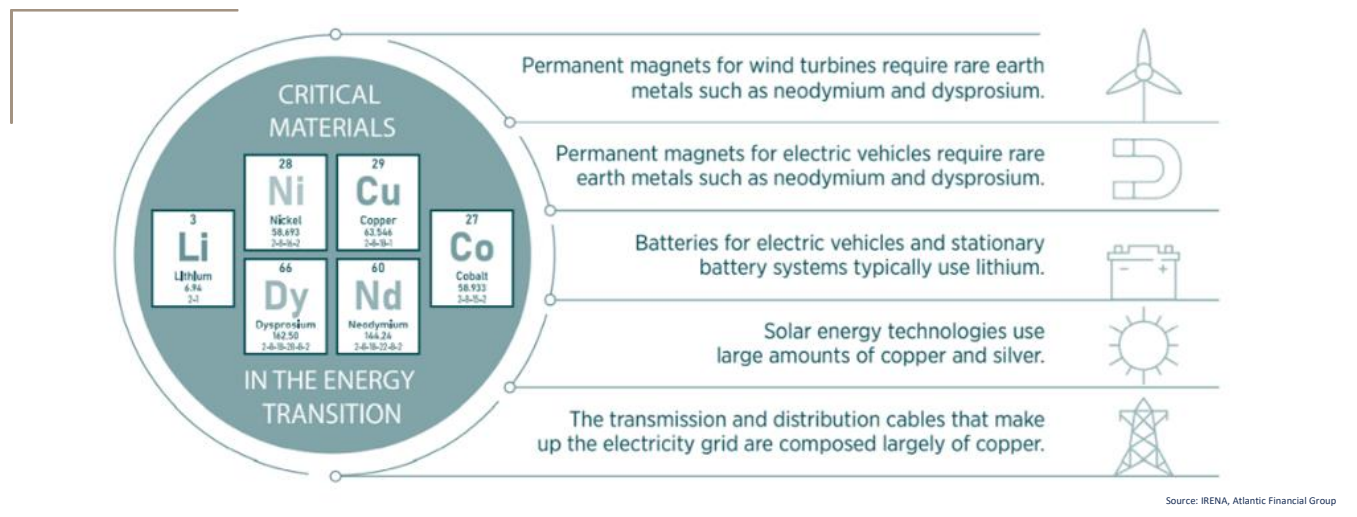
◆ Which themes will maintain their momentum in 2023?

Defensive sectors should continue to outperform, supported by improved earnings visibility in a highly uncertain macroeconomic and geopolitical environment. The consumer staples sector is benefiting from stable revenue growth due to low demand elasticity. Inflation in agricultural materials, packaging and transport prices have already peaked and are starting to decline. **Companies should therefore be able to improve their margins when the cost increases have already been passed on to customers.** Multinationals such as Nestlé, Mondelez, Diageo or Pernod Ricard have the financial capacity to face the crisis and even to contribute to the consolidation of the sector. There is no shortage of opportunities for external growth as consumer tastes and preferences change rapidly and new markets are opening up.



The energy and commodities sectors are also expected to stay on course, not because of demand but because of **low investment in exploration and production**. Supply is therefore likely to decline. In the longer term, **the energy transition and the digitalisation of the economy will support demand and drive up prices**. The transition to renewable energies requires raw materials (see Fig. 6) such as copper, nickel, lithium or rare earths (neodymium and dysprosium).

Fig. 6 - Critical raw materials for the energy transition



The renewable energy sector should also benefit from the various subsidy programmes. The US Inflation Reduction Act aims to encourage investment in clean energy and the manufacture of technologies such as solar panels, batteries for storage and for electric vehicles, wind turbines, etc. For its part, Europe, spurred on by the ongoing war in Ukraine, has decided to accelerate the transition to clean energy and reduce its dependence on both suppliers such as Russia and volatile fossil fuel prices. A comprehensive policy framework is needed for the energy transition to succeed. **The REPowerEU plan (Joint European Action for More Affordable, Secure and Sustainable Energy) aims to make Europe independent of Russian fossil fuels by 2030.** European utilities, wind turbine, solar panel and LNG terminal manufacturers should benefit from the transformation that will take place.

Pharmaceutical companies continue to benefit from the growing middle class in emerging countries and the ageing population in developed countries. The Covid-19 pandemic has been rather favourable to them, accelerating R&D in certain areas, such as oncology (i.e. mRNA vaccines) with promises of revolutionary new drugs to prevent or cure certain cancers.

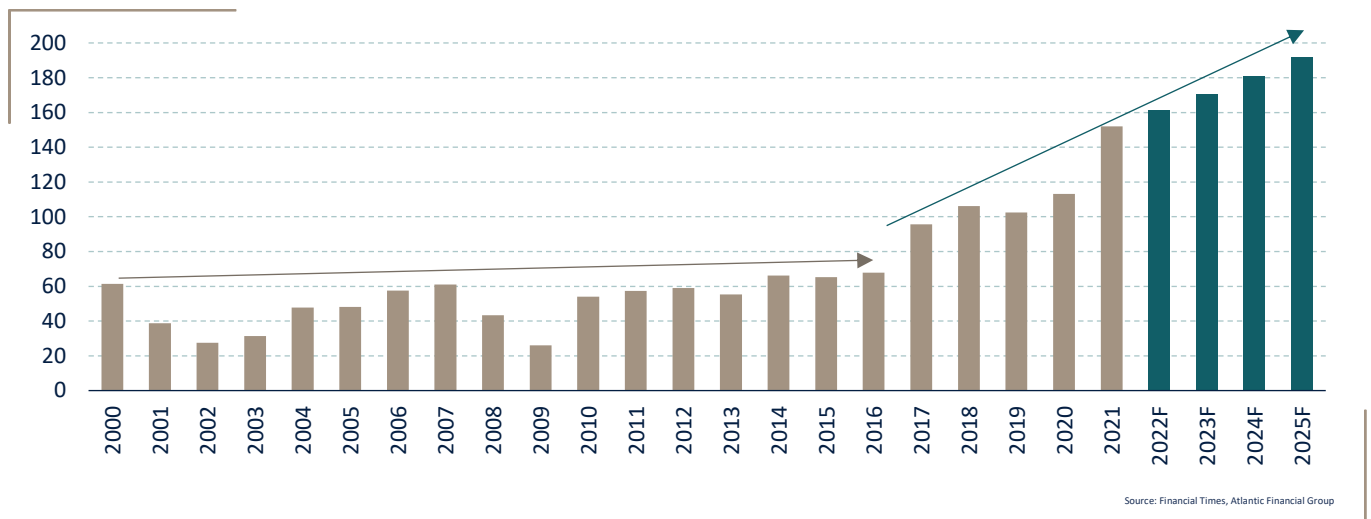
The Industrial Revolution 4.0 is creating megatrends that industry leaders such as Siemens, Schneider Electric, ABB and Eaton have seized upon to further differentiate themselves and drive growth. Companies with pricing power or structural growth drivers could outperform in the coming quarters, especially those selling to utilities, mining companies, energy companies or involved in building digital infrastructure.

Finally, **despite a complicated 2022, semiconductors remain the fourth most traded commodity in the world**, after crude oil, auto parts and refined oil products. The market was worth about \$500 billion in 2022 and could reach \$1 trillion by 2030. It is growing exponentially. **Demand is strong and the**



construction of semiconductors plants, or smelters, is accelerating around the world to cope with the shortage (see Fig. 7). Korean, Chinese and Taiwanese, but also American manufacturers are expanding their production lines to increase supply, while new chip designs require more advanced equipment. It is therefore OEMs such as Applied Materials, Lam Research or ASML, which should benefit from the trend first.

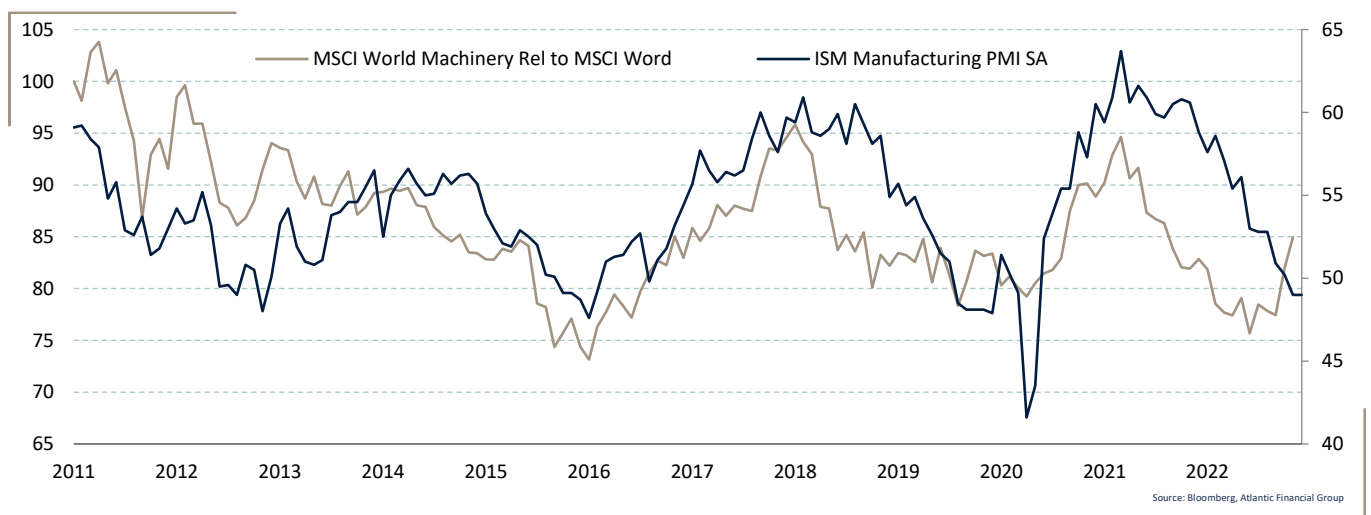
Fig. 7 - Capital expenditure on wafer manufacturer equipment explodes (in billions of dollars)



◆ And what strategies should be avoided?

Cyclical sectors will continue to be volatile and could drag the markets down at least for the first part of next year. **The industrial sector could continue to suffer from the energy crisis in Europe and the slowdown in global demand.** In a context where orders for durable goods had accelerated sharply post-covid-19 thanks to government stimulus packages, the production of manufactured goods has slowed sharply and is beginning to contract (see Fig.8).

Fig. 8 - The US manufacturing index





The growth sectors, after having experienced the sharp contraction of their valuation multiples, could see a significant downward revision of their net results. Large companies in the sector have already started to take cost-cutting measures through massive layoffs. They are likely to continue to downsize and reduce spending on non-priority projects.

The real estate sector may struggle to find a support as the world enters a recession and households lose purchasing power. In the long term, however, real assets remain a good hedge against inflation.

Attention should also be paid to the **financial sector, which, even if it is experiencing a certain euphoria linked to the return of positive interest rates, may have to take reserves for bad debts.**

Conclusion:

Inflation and high interest rates are expected to have a strong impact on household purchasing power and corporate operating margins. Energy, materials and defensive sectors could help stabilise portfolios in the coming months. Finally, value sectors or those with good fundamentals will also remain safer havens.



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)	619.4	54.39	-2.2%	6.6%	-16.1%	19.0%	16.9%
USA (S&P 500)	3 934	49.28	-3.3%	5.2%	-16.2%	28.7%	18.4%
USA (Dow Jones)	33 476	51.01	-2.7%	3.3%	-6.0%	20.9%	9.7%
USA (Nasdaq)	11 005	47.81	-4.0%	6.4%	-29.1%	22.2%	45.0%
Euro Area (DJ EuroStoxx)	423.6	61.48	-0.9%	5.0%	-8.6%	23.5%	0.8%
UK (FTSE 100)	7 477	58.97	-1.0%	2.9%	4.8%	18.4%	-11.4%
Switzerland (SMI)	11 068	53.75	-1.2%	1.5%	-11.5%	23.7%	4.3%
Japan (Nikkei)	27 842	51.87	0.4%	0.7%	-1.1%	6.7%	18.3%
Emerging (MSCI)	978	62.75	0.5%	8.9%	-18.2%	-2.3%	18.8%
Brasil (IBOVESPA)	107 520	41.06	-3.9%	-5.3%	2.6%	-11.9%	2.9%
Russia (MOEX)	2 178	49.46	-0.1%	0.5%	-37.8%	21.9%	14.8%
India (SENSEX)	62 101	55.10	-1.1%	1.9%	8.1%	23.2%	17.2%
China (CSI)	3 953	67.24	3.3%	7.7%	-17.8%	-3.5%	29.9%
Communication Serv. (MSCI World)	72.07	51.81	-3.1%	8.9%	-33.8%	10.9%	24.2%
Consumer Discret. (MSCI World)	293.6	54.14	-2.1%	9.2%	-27.5%	9.2%	37.0%
Consumer Staples (MSCI World)	270.8	64.01	-1.2%	6.8%	-4.8%	11.7%	8.8%
Energy (MSCI World)	231.7	34.44	-6.5%	-3.8%	29.2%	37.5%	-27.7%
Financials (MSCI World)	132.2	52.84	-2.1%	4.3%	-9.1%	25.1%	-3.1%
Health Care (MSCI World)	346.6	62.27	-0.9%	6.0%	-4.6%	18.0%	15.4%
Industrials (MSCI World)	288.3	59.40	-1.8%	6.0%	-11.8%	16.6%	11.8%
Info. Tech. (MSCI World)	413.7	51.41	-3.1%	8.7%	-27.2%	27.6%	46.2%
Materials (MSCI World)	321.8	62.35	-1.2%	9.0%	-8.3%	15.4%	21.6%
Real Estate (MSCI World)	177.0	58.63	-0.5%	8.7%	-22.8%	23.6%	-5.7%
Utilities (MSCI World)	152.0	62.00	0.1%	7.8%	-3.8%	11.1%	4.8%
Bonds (FTSE)							
USA (7-10 Yr)	3.54%	61.46	0.0%	5.7%	-12.7%	-2.4%	9.3%
Euro Area (7-10 Yr)	2.58%	53.00	-0.5%	2.4%	-15.1%	-2.9%	4.5%
Germany (7-10 Yr)	1.92%	55.34	-0.4%	2.4%	-13.8%	-2.7%	3.0%
UK (7-10 Yr)	3.18%	54.28	0.0%	2.3%	-14.8%	-4.9%	5.4%
Switzerland (7-10 Yr)	1.16%	53.30	-0.4%	1.0%	-9.1%	-2.3%	0.4%
Japan (5-10 Yr)	0.25%	46.15	0.0%	-0.1%	-1.4%	0.0%	-0.1%
Emerging (5-10 Yr)	7.74%	74.77	0.0%	5.8%	-16.5%	-2.3%	5.2%
USA (IG Corp.)	5.20%	65.25	0.5%	4.3%	-14.2%	-1.0%	9.9%
Euro Area (IG Corp.)	3.78%	62.94	-0.2%	2.3%	-11.5%	-1.0%	2.8%
Emerging (IG Corp.)	8.07%	83.22	0.2%	6.9%	-15.0%	-3.0%	8.1%
USA (HY Corp.)	8.52%	66.80	0.0%	2.5%	-10.0%	5.3%	7.1%
Euro Area (HY Corp.)	7.68%	68.88	-0.4%	1.3%	-9.9%	3.4%	2.3%
Emerging (HY Corp.)	11.07%	77.14	-0.2%	5.9%	-12.7%	-3.2%	4.3%
World (Convertibles)	361.8	54.67	-1.4%	4.0%	-17.4%	2.4%	38.8%
USA (Convertibles)	481.0	49.93	-2.0%	3.2%	-18.9%	3.1%	54.5%
Euro Area (Convertibles)	3 550	62.24	-0.6%	1.9%	-13.5%	-0.3%	6.1%
Switzerland (Convertibles)	175.0	70.13	0.3%	1.5%	-5.8%	-0.5%	0.5%
Japan (Convertibles)	198.9	51.98	0.3%	0.1%	-0.9%	3.3%	2.8%
Hedge Funds (Crédit Suisse)							
Hedge Funds Indus.	725	63.89	n.a.	0.6%	n.a.	8.2%	6.4%
Distressed	930	55.34	n.a.	-0.7%	n.a.	12.5%	3.8%
Event Driven	750	49.81	n.a.	0.9%	n.a.	12.9%	7.0%
Fixed Income	382	51.36	n.a.	0.4%	n.a.	5.2%	3.6%
Global Macro	1420	77.93	n.a.	-0.9%	n.a.	9.6%	6.5%
Long/Short	852	46.94	n.a.	1.7%	n.a.	8.3%	7.9%
CTA's	405	79.94	n.a.	0.3%	n.a.	8.2%	1.9%
Market Neutral	287	51.68	n.a.	0.4%	n.a.	6.2%	1.7%
Multi-Strategy	687	61.34	n.a.	1.4%	n.a.	7.0%	5.6%
Volatility							
VIX	22.83	49.68	19.8%	-12.5%	32.6%	-24.3%	65.1%
VSTOXX	21.40	47.07	10.7%	-7.9%	11.0%	-17.6%	67.5%
Commodities							
Commodities (CRB)	558.0	n.a.	-0.8%	-0.6%	-3.8%	30.3%	10.5%
Gold (Troy Ounce)	1 791	61.88	1.3%	1.1%	-2.1%	-3.6%	25.1%
Oil (WTI, Barrel)	71.02	29.06	-7.7%	-17.3%	-7.8%	58.7%	-20.5%
Oil (Brent, Barrel)	75.75	28.45	-10.7%	-18.2%	-2.1%	51.4%	-23.0%
Currencies (vs USD)							
USD (Dollar Index)	104.99	37.48	-0.3%	-1.2%	9.7%	6.4%	-6.7%
EUR	1.0525	64.25	0.3%	1.9%	-7.4%	-7.5%	9.7%
JPY	136.68	62.21	0.1%	2.3%	-15.8%	-10.2%	5.1%
GBP	1.2257	64.37	0.5%	4.3%	-9.4%	-1.0%	3.1%
AUD	0.6781	58.54	1.2%	1.2%	-6.8%	-5.6%	9.6%
CAD	1.3645	41.70	-0.4%	-2.4%	-7.4%	0.7%	2.1%
CHF	0.9353	64.84	0.8%	0.9%	-2.4%	-3.0%	9.4%
CNY	6.9742	62.96	-0.2%	1.4%	-8.9%	2.7%	6.7%
MXN	19.765	41.63	-0.1%	-2.1%	3.9%	-3.0%	-5.0%
EM (Emerging Index)	1 650.5	67.19	0.2%	2.9%	-4.8%	0.9%	3.3%

Source: Bloomberg, Atlantic Financial Group

Total Return by asset class (Negative \ Positive Performance)



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