**2022 - Investment Outlook**

With 2022 around the corner, there is much to reflect upon, and equally much to look forward to. As we move into the new year, let us take a look at some of our views on the financial markets and where, despite the anticipated volatility, we see the silver linings investors can capitalize on.

Of course, the question on the minds of all investors, and us alike, is what will be the state of inflation? While economists disagree whether inflation is going to remain permanently elevated or is likely to abate over time, there is one thing they can agree on which is that by 2022 year-end, we should have a clearer picture. Lifting a great deal of uncertainty for everyone, this piece of good news will provide investors with a better idea of how to go about their allocations. For fixed income investors, this might mean being prepared to lose money on fixed income positions over a few quarters. Longer-term allocation plans for this asset class will also ultimately be dependent on where inflation settles in comparison to the bond's yields.

Allocation to private assets will, in our opinion, prove popular for 2022. Investors are likely to increase allocations to private assets going forward. Keeping in mind expensive valuations on both public equities and public debt, we anticipate private assets to remain attractive for investors and serve as good diversifiers for their portfolios. Indeed, trading off liquidity for yield is a smart move, especially for private debt which offers more security as well as an earlier exit than private equity.

Finally, another hot topic for many: Cryptocurrencies. We believe 2022 is likely to be a pivotal year for cryptocurrencies and other "digital assets", and their concept will be thoroughly tested through the year. We've already seen early adopters like Tesla, Square, and even the country of El Salvador publicly disclosing their investments. Should the trend get momentum and cryptos become more mainstream, this emerging asset class could potentially have another great year.

With these three predictions to look forward to in 2022, let's now look at some of the numbers and factors to keep a close eye on.

## Interest Rates

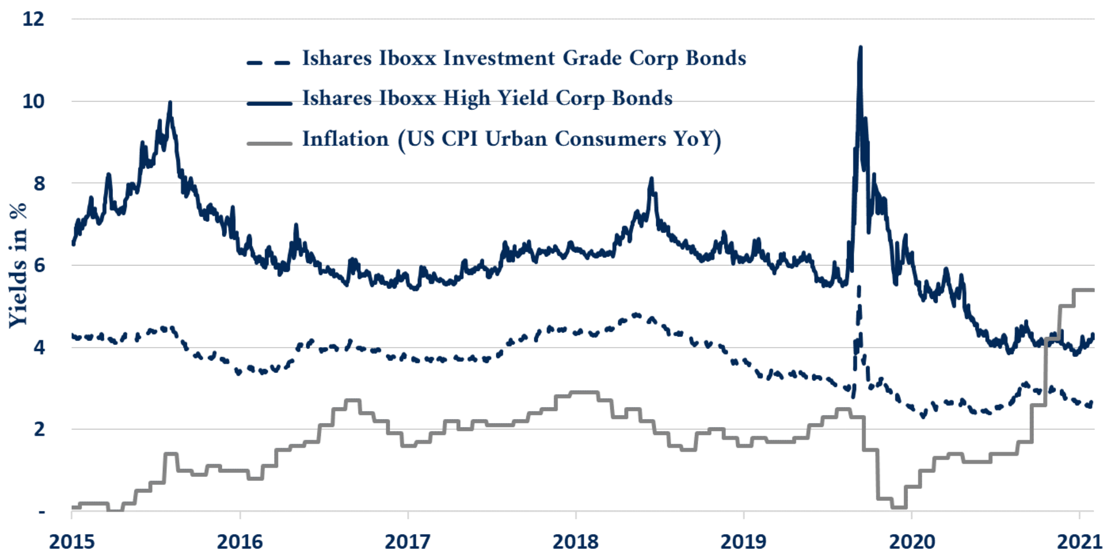
While the recent sets of employment (4.2% unemployment with 61.8% labor force participation, *Source*: *U.S. Bureau of Labor - December* 2021) and inflation data (Core Personal Consumption Expenditure (PCE) at 4.1%) indicate robust economic recovery, the inflation print is clearly outpacing the Fed's 2% target, and this is likely to dominate the headlines in 2022. Powell's testimony to the Senate on December 1st, 2021, was a clear indication of the hawkish tilt the Federal Open Market Committee (FOMC) has. Between containing price rise (inflation) and jobs growth, the recent testimony of Powell confirms that inflation is the Fed's priority, along with the reduction of the monthly asset purchase (tapering).

With the above in mind, we believe that the probability of a rate hike in 2022 has increased significantly and expect a rate hike of 25 bps sometime in H2 2022, most likely in December. We also expect the 10Y UST to be anchored around the 2% mark, thanks to longer-term growth as well as the flattening of the US Yield Curve. Risks to our view will be a sudden drop in core inflation figures (Core PCE) as this would provide the Fed with more time to evaluate the macro backdrop and calibrate rate decisions appropriately.

## Credit

We believe that generating performance holding corporate bonds will remain a difficult mission next year. The iShares iBoxx Investment Grade Corporate Bonds ETF (high grade) returned -1.25% YTD (as of December 6$^{th}$, 2021) while the iShares iBoxx High Yield Corporate Bonds ETF has returned +2.6% YTD (as of December 6$^{th}$, 2021), barely compensating investors for holding junk credit. With negative real yields (bonds yields lower than inflation) across both high grade and high yield (junk), bonds are likely to remain unattractive in 2022 (Graph #1). Should inflation turn out to be stickier than anticipated, an upward shift of the US yield curves may potentially turn a poor performance into a very bad one. The best-case scenario for bondholders would be if inflation rates were lower next year which seems very unlikely at this point, except in the case of a recession. We reiterate our views that defensive & balanced investors, generally heavily invested in bonds, should diversify their portfolio away from fixed income into the alternative space, which can deliver higher performances than bonds at a fraction of the risk.

**Graph #1 – Negative Real Yields across US Corporate Bonds**




*Source*: *Bloomberg*

## Equities

Unsurprisingly most banks remain pro-risk (over-weight equities), supported by continued strong growth and low real yields. Since bonds are likely to disappoint again next year and considering that many investors are not fully invested yet, most banks forecast 2022 to be another positive year for equities. There Is No Alternative (TINA) seems to be, once again, the only game in town. More specifically, we've seen a consensus amongst banks around Japanese and European exporters, which are expected to benefit from their weaker currencies as well as a strong global growth next year (projection: +4.9%, source IMF).

**S&P 500 targets for 2022 (Index Points)**

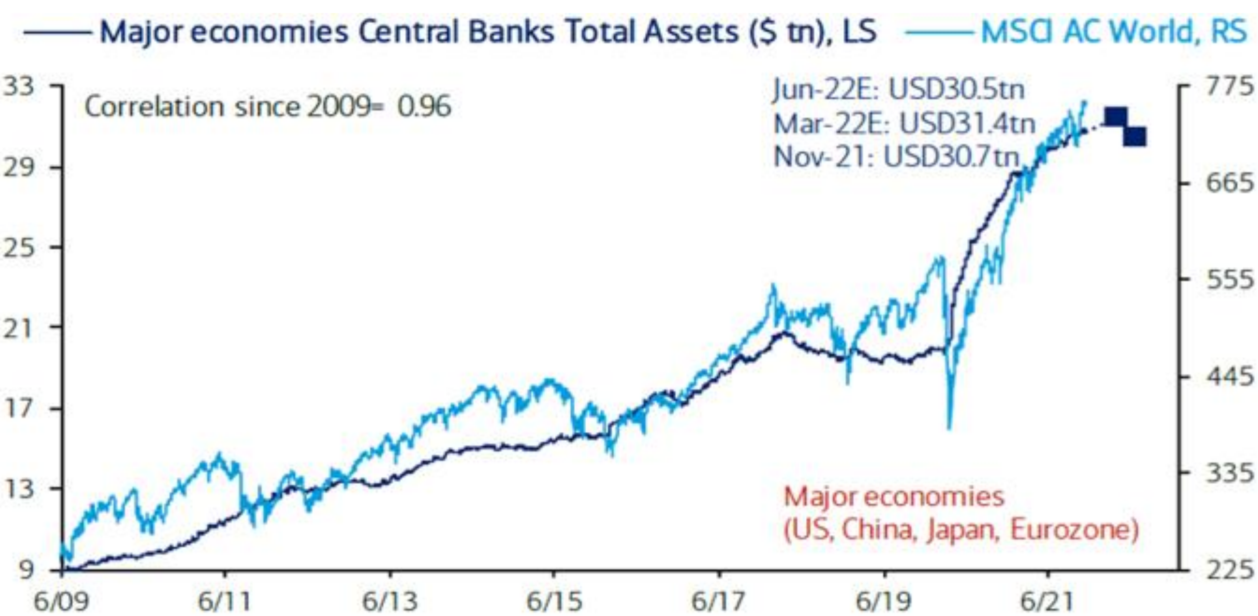
| | |
|---|---|
| Morgan Stanley | 4,400 |
| Bank of America | 4,600 |
| UBS | 4,850 |
| Jefferies | 5,000 |

| | |
|---|---|
| Credit Suisse | 5,000 |
| JP Morgan | 5,050 |
| BNP Paribas | 5,100 |
| Goldman Sachs | 5,100 |

*Source*: *Strategist research notes*

We remain cautious on equities. The research at Bank of America shows that there is a 0.96 correlation between global equities (MSCI World) and the size of the major's Central Banks' balance sheets since 2009 (Monthly Observations) (Graph #2). In other words, equities have been primarily driven by the liquidity provided by central bankers as opposed to companies' fundamentals (earnings, margins, growth). This is potentially dangerous since the Fed has started reducing the size of its balance Sheet (tapering). For that specific reason, we believe that equities are likely to be volatile in 2022 and present a larger potential downside than potential upside.

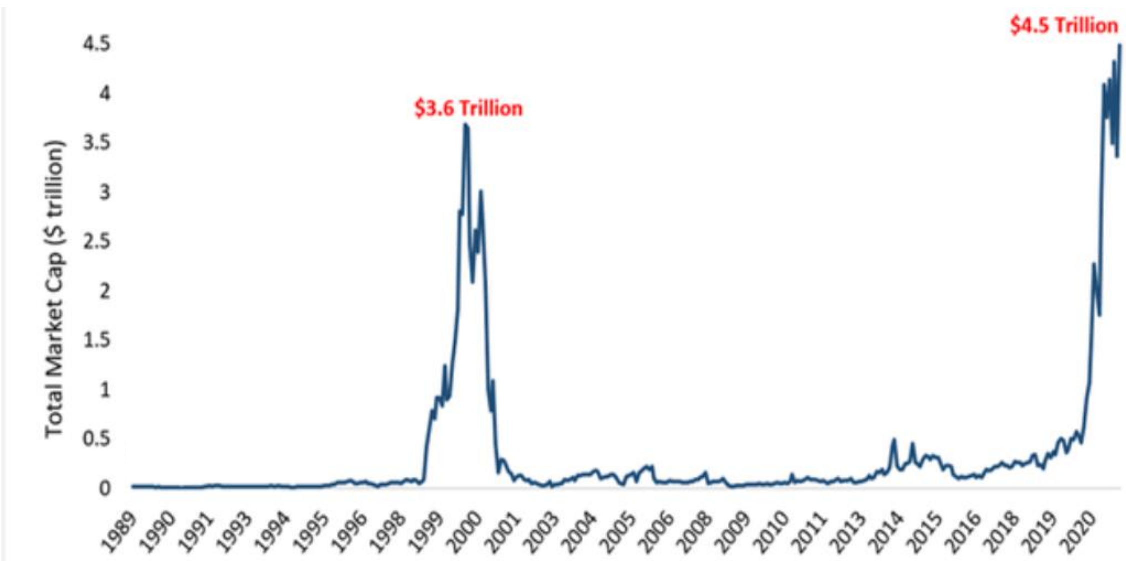
**Graph #2 – Major economies Central Banks Total Assets Vs MSCI World**




*Source*: *Bank of America, November* 2021

Even more concerning, the amount invested in firms where Price / Revenue exceeds 20x is larger today (4.5 Trillion USD) than during the dot.com bubble (3.6 Trillion USD) which ended poorly for most speculative investments (Graph #3). For public equities, we reiterate our recommendation to avoid loss-making companies, a majority of which have already underperformed in 2021. As a matter of fact, half of the IPOs with an initial market capitalization above USD 1bn in 2021 are trading below listing price according to the Financial Times.

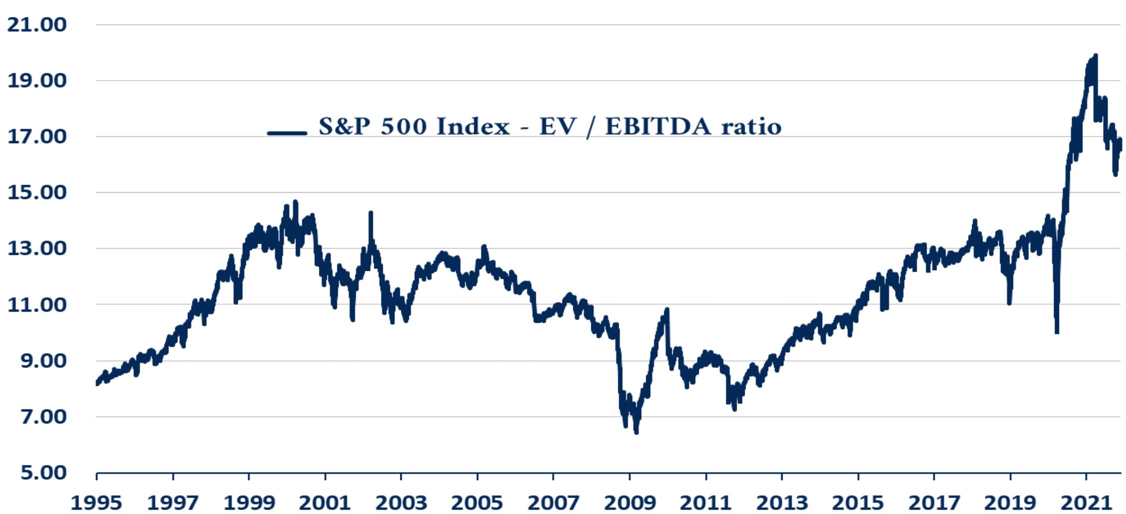
**Graph #3 – Total Market Capitalization of stocks with Price / Revenue > 20x**




*Source*: *Kailash Capital, LLC, Data from* 4/30/1989-6/30/2021

Managers focusing on innovative businesses (most of which are early-stage / loss-making companies) like the Ark innovative ETF (-23.7% YTD as of December 6th, 2021) have performed poorly compared to the S&P index so far this year (+ 23.8% YTD as of December 6th, 2021). Since average valuations on equities look expensive as per historical standards, we believe such underperformance is likely to persist next year. In such a particular context, we recommend reducing the portfolios' Beta by allocating primarily to Long/Short managers and "arbitrages" (Volatility Arbitrage, M&A Arbitrage, etc.)

**Graph #4 – S&P 500 Index EV / EBITDA multiple**




*Source*: *Bloomberg*

Chinese equities are likely to remain complex in 2022, especially for foreign investors. The risk of delisting from US exchanges, ongoing regulatory concerns, and defaults in the real estate sector are just a few of the challenges that investors will face next year when looking at China. While the long-term picture is still favorable, China is expected to become the world's largest GDP over the next 10 years, the amount of uncertainty around Chinese stocks might persuade the bravest investors to skip China for the moment. Since timing the market is difficult, we recommend investors to either stick with high-quality assets or to outsource their selection of Chinese stocks to long-biased managers.



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**Graph #5 – CSI Overseas China Internet Index tracker (KWEB US)**

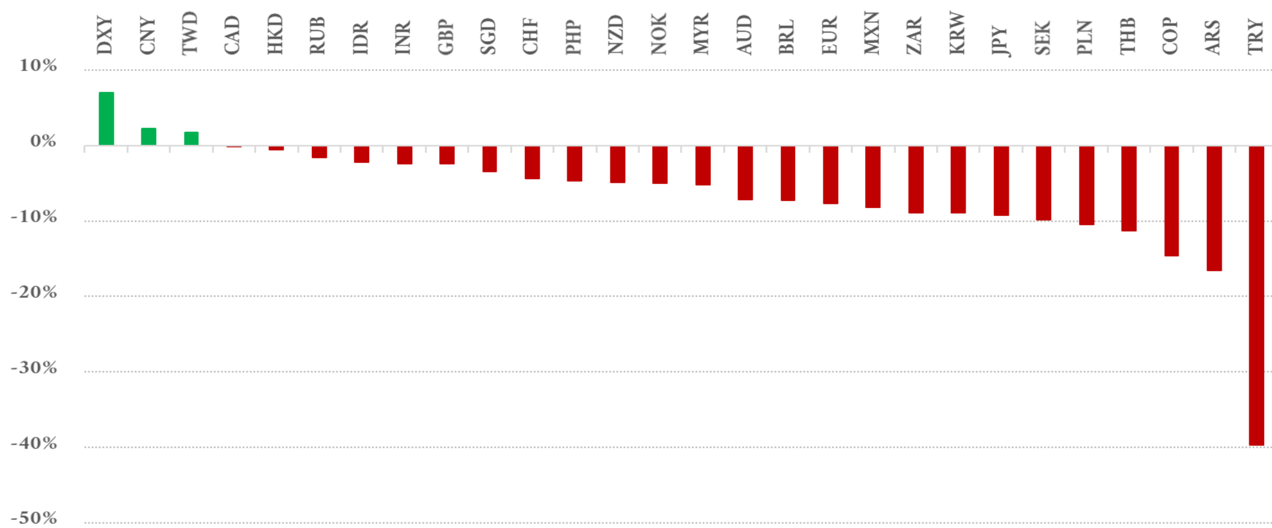

*Source*: *Bloomberg*

On the opposite, we expect themes like Decarbonization (Energy transition), ESG, Digitalization, and Metaverse to keep on being preponderant amongst investors next year.

**Currencies**

The USD, that many economists expected to weaken at the start of the year because of the US twin deficit (Economies that have both a fiscal (or) budget deficit and a current account deficit (a measure of country's trade and financial transactions with other countries) are often referred to as having "twin deficits."), is the best-performing currency so far this year (+7.0% YTD as of December 6th, 2021), supported by its safe-haven status as well as rates moving higher in the long-term part of the yield curve (10Y-30Y). Interestingly the only two currencies which are also positive in 2021 are the Chinese Yuan (+2.2% YTD as of December 6th, 2021) and the Taiwanese Dollar (+1.8% YTD as of December 6th, 2021), thanks to the strength of their economies relative to the rest of the world. Other currencies (G10 and emerging) are all negative YTD in disparate performances. We anticipate currencies to remain volatile and hard to predict in 2022.

**Graph #6 – Currencies Performance Year-to-Date (Date: 29/11/2021)**

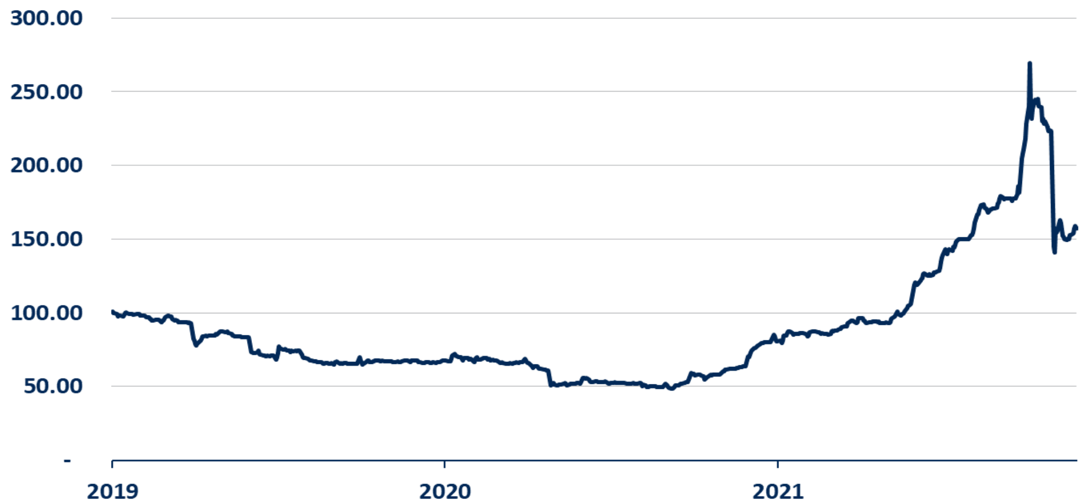



*Source: Bloomberg*

## Commodities

The commodity rally is losing steam. We witnessed sharp reversals in commodities where the supply eventually managed to adjust to the rising demand, in the context of reopening economies. With the resumption of production, we have seen speculation reduce and the price for metals (Gold, Silver, Coal, Iron Ore, Aluminum), Lumber as well as soft commodities (Corn, Wheat, Soybean) begin to correct. This is good news as far as inflation and consumers are concerned but we remain watchful as the situation can evolve rapidly and, in any direction. For that specific reason, we take any 2022 forecasts on commodities with a pinch of salt. The only clear consensus is Oil, where most banks forecast the black gold to move higher next year. As OPEC+ members have agreed to leave the door open to a change at short notice, producers will be able to adjust the output quickly if demand falls. This effectively puts a floor under prices.

**Graph #7: Coking Coal price (ICE Futures – USD / Metric Ton)**




*Source*: *Bloomberg, ICE Exchange*

**Conclusion**

"The line separating investment and speculation, which is never bright and clear, becomes blurred still further when most market participants have recently enjoyed triumphs. Nothing sedates rationality like large doses of effortless money". Warren Buffet, Berkshire Hathaway's 2000 Annual Meeting.

We believe that market participants have more important things to worry about than omicron, namely Fed tapering and US rates going higher. We predict that all asset classes will remain volatile next year as Central Bankers start pulling out liquidity from financial markets. Inflationary pressure can also pressure the Fed to tighten quicker than expected which could keep investors on their toes.

As far as portfolios are concerned, since both bonds and equities look expensive and vulnerable (Graph 2-4 above), portfolio managers will need to start looking elsewhere for new sources of diversification. Less liquid alternatives such as private equity and private debt, are likely to be favored as they act as true diversifiers for portfolios that are mainly comprised of bonds and equities. We believe cryptocurrencies could gain traction with investors allocating a small portion of their portfolio into digital assets.

We believe 2022 will be another interesting year. Higher volatility should provide opportunities for long-term investors across all asset classes, provided that wealth is protected. As usual, the ability to deploy capital quickly and efficiently, with a proven risk management process is paramount. Current valuations on public markets (bonds and equities), as well as the Fed's tapering, are clear warnings for the educated investors. For that reason, we believe our approach which combines alternative strategies, to deliver attractive risk-adjusted returns with low correlation to equities should perform well, especially during periods of higher volatility.