



## Market Compass

October 2022

### MARKET OUTLOOK

- The fast-track monetary tightening and the EU energy crisis are powerful headwinds for the global economy: recession forces are set to grow over the turn of the year.
- The depth of the EA recession will partly depend on winter temperatures. Europe's large negative terms of trade shock are already damaging its competitive position and may persist for years.
- The worst scenarios are getting more likely. The Fed's pivot and eventual opening of the diplomatic route in Ukraine are great bullish triggers, but unlikely in the near term.
- We are still focused on the downside for now, as risk assets fail to price enough bad news. We see cracks in the global financial plumbing, in part due to a shortage of low-risk assets and extreme policy uncertainty.

Edited by  
**MACRO & MARKET RESEARCH TEAM**

A team of 13 analysts based in Paris, Cologne, Milan and Prague runs qualitative and quantitative analysis on macroeconomic and financial issues.

The team translates macro and quant views into investment ideas that feed into the investment process.

#### US

- + Q3 GDP set to rebound on solid consumption
- + Tight labour market ensures support to wages...
- ... but the Fed raising rates by 125 bps by YE increases risks of recession in H1 2023
- Sticky core inflation does not allow the Fed to relax soon

#### UK

- Unfunded fiscal package caused strong market trouble
- BoE raised Bank Rate to 2.25%, more to come
- BoE postponed QT to stabilise long-term yields

#### EUROZONE

- Key sentiment indicators further down heralding recession
- Inflation should have peaked in Sept. at 10% but climbdown will be slow
- Hawkish ECB set to continue hiking rates despite economy slows down
- + Labour market remains strong, governments maintain measures to cushion inflation fallout

#### CHINA

- China's August data recovered but volatility likely to remain high
- Amid fresh lockdowns the Caixin manufactory PMI fell back again
- Real estate sector continues to be weak, causing worries
- Headline inflation rising, but core inflation low

#### EMERGING MARKETS

- EM assets remain on a back foot
- ! LatAm and CEE central banks finishing their hiking cycle
- + Inflation surprisingly edged down, activity is resilient

- + Positive
- Negative
- ! Topics to watch

# DIRECTION OF TRAVEL

- Too early to unwind underweight (UW) in Equity
- Despite repricing, HY credit remains unattractive
- Overweight (OW) in IG credit, Financials preferred over non-Financials
- Neutral in sovereigns, US preferred over EA
- OW Cash

## Equities

- War escalation, sanctions and energy crunch are causing negative growth revisions and high inflation to linger.
- CB's hawkishness will trigger further deterioration in financial conditions, raising firms' cost of capital while lowering PEs.
- Within the UW, we are slight more optimistic on China, UK and Japan, neutral US and EA.

## Bonds

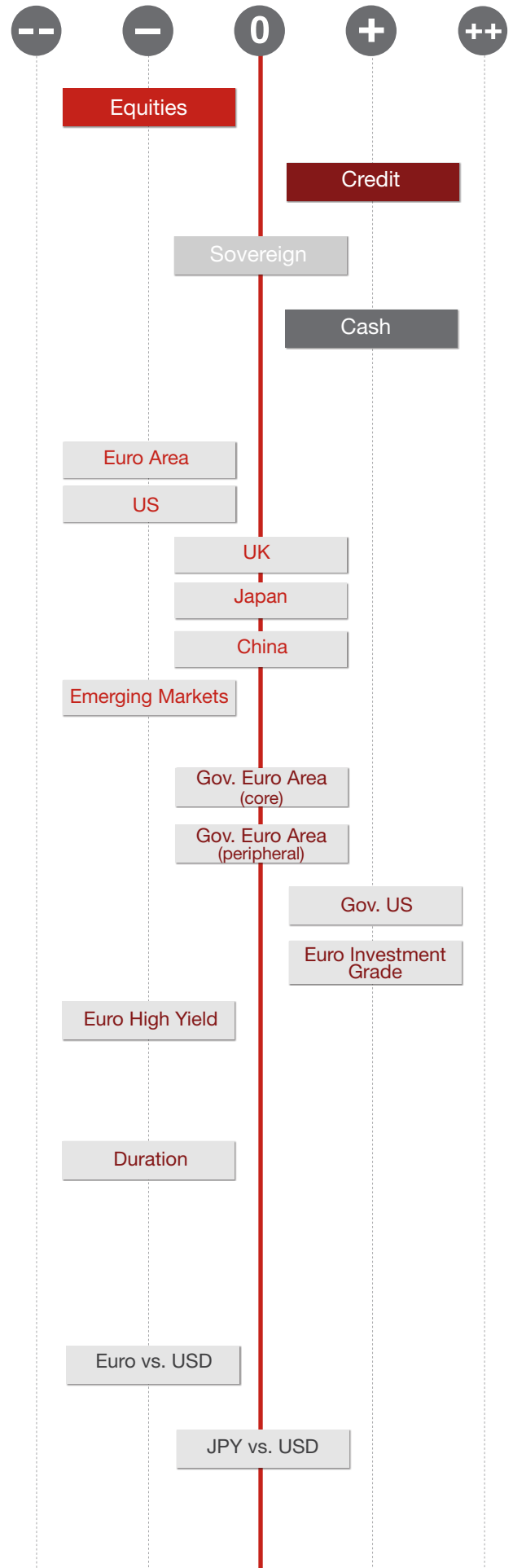
- The trend for international yields is seen to remain upwards short term amid the hawkishness of central banks. Peak in US yields is getting closer.
- Combination of higher yields, hawkish ECB, and a looming recession is seen to trigger a further widening of EA non-core bond spreads.

## Duration

- Moderately short duration.

## Currencies

- Geopolitical worries, a global growth slowdown and higher risk aversion underpin the USD, despite stretched levels already reached.
- The EUR remains burdened by the energy crunch and the looming recession.
- Japan's attempts to stabilize the JPY via FX intervention look futile as long as a policy reversal by the BoJ is not in sight (yet).



## TOPICS TO WATCH

- More sanctions, hard winter, gas rationing → RISK-OFF  
Mild winter, partial resumption in gas supply → RELIEF
- Two-sided inflation risks tilted towards the upside (even faster policy tightening)
- Mutations challenging vaccine effectiveness and requiring new shutdowns
- Russia goes nuclear or new geopolitical tensions (China/Taiwan, N. Korea)

Probability	Impact

Probability: High ← → Low

Impact: High ← → Low

## GLOSSARY

### Terms of trade

Terms of trade (TOT) represents the ratio between a country's export prices and its import prices. When it falls a country has a harder time in financing its import.



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