SOCIETE GENERALE
Private Banking

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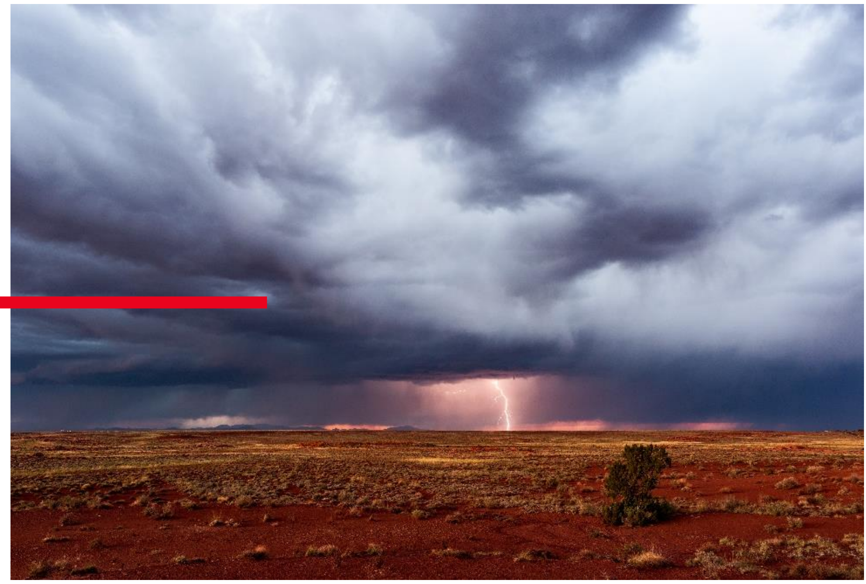


CIO VIEWS

Of two evils, choose the lesser

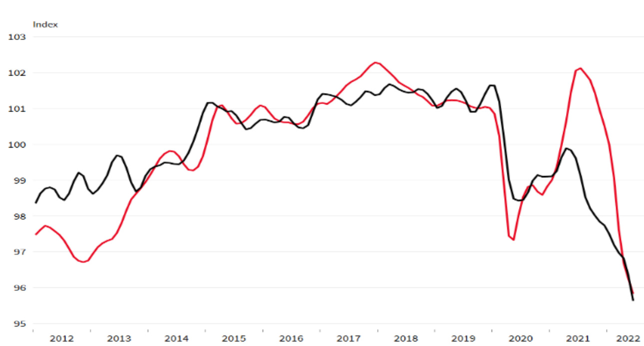
Of two evils, choose the lesser. Central bankers have recently become convinced that a marked slowdown in the economy is necessary to reduce imbalances between supply and demand and to curb inflation. The scenario of vigorous growth anticipated at the beginning of the year has therefore been radically challenged and a recession seems inevitable.

In this environment, and after a deleterious first half of the year on the markets, what positioning should we adopt?

« A rarely seen volte face in monetary policy »

The late recognition by central banks of the strong and continuing tensions on the inflation front has led to a rarely seen volte face in monetary policy. Over the past six months, the Federal Reserve's policy rate expectations have risen by more than 300bps, drastically tightening financial conditions. The real estate market, which is by nature very sensitive to financing conditions, is experiencing a sharp slowdown, and real estate prices are having to adjust to this new paradigm, as has already been observed in the listed markets. Household consumption is suffering from the effects of inflation on purchasing power and consumer confidence. The labor market remains well oriented and wage pressures could therefore fuel the risks of a second round of inflation. The question is now centered on the strength and duration of the recession rather than its probability.

Consumer confidence index



Source: Societe Generale Private Wealth Management, Macrobond, June 2022
Past performances are not a reliable indication of future performances.

« The US money supply grew by nearly 42% »

While the inflation shock initially arose from the tensions associated with the recovery from the health crisis, the monetary component is not unrelated to it. The US money supply grew by nearly 42% between April 2020 and December 2021, whereas nominal GDP growth only was 14% over the same period. The reduction of central banks' balance sheets is necessary to reduce excess liquidity. In Europe, the tightening of monetary policy will logically be more gradual given the risks to the financing costs of peripheral countries. In this environment, the dollar should remain strong against the euro.

« Caution and patience are the watchwords »

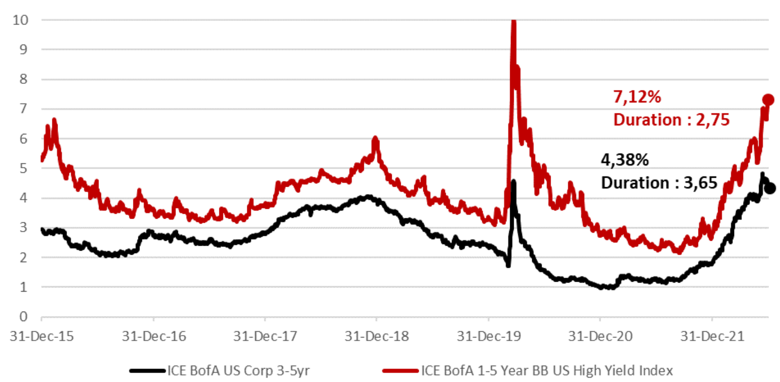
In the equity markets, the dual effect of rising interest rates and falling earnings prospects will weigh on valuations. In this respect, the US markets remain more exposed due to a significant valuation premium. Caution and patience are the watchwords in a bear market. At the other end of the spectrum, Asian markets, particularly China, are benefiting from a reversal of economic momentum, after the confining phases of the beginning of the year, as well as strong support from monetary and fiscal authorities. The Chinese market will have given up 52% in the 15-month bear market that began in March 2021 and is now at a particularly discounted valuation.

« Attractive yield prospects »

In a cautious approach, opportunities are once again opening in the fixed-income markets, particularly on the short end of the dollar yield curve. In the corporate bond segments, risk premiums are already reaching the levels observed during the recession. A selection of good quality issuers offers attractive yield prospects, at more than 5% in dollar terms for high quality credit issues.

The risk of recession will therefore be the focus in the second half of the year. In contrast to developed countries, the equity markets of emerging countries, like Asia, are showing improving dynamics and offer a positive outlook. This is also the case for certain segments of the fixed income market which, after the correction, are benefiting from high yields, ensuring an attractive performance potential. Maintaining a prudent and diversified approach remains the key in these turbulent times.

Evolution of bond yields in US



Source: Societe Generale Private Wealth Management, Bloomberg, July 2022
Past performances are not a reliable indication of future performances.

Written in July 2022 by
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