# The Way We See It

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## *Embrace the Summer with a Negroni* ?*

**INSIDE THIS ISSUE**



A brief update report which serves to review recent developments, as well as offering our outlook for the near and medium-term future: ***a bitter cocktail.***

### Review of Developments in Q1

The geopolitical conflict between Russia and Ukraine continued, aggravating an already serious bottleneck problem in the goods' supply chain, as well as raising prices in key energy and agricultural products further.

Despite the above, the global economy continued to grow, albeit at different speeds in Q1. The US continued to lead, along with other commodity-producing countries, which benefit from higher commodity prices and increased production (Australia, Middle East, Africa, Latin America). Next comes China, which just released a better-than-expected GDP 4.8% in Q1 2022 vs Q1 2021 (please note that the month of March, April and May are likely to be quite weak, as the impact of the Shanghai lockdown is felt). At the bottom, Europe, together with other indebted emerging nations which are not well endowed with natural resources, are likely to show the weakest growth rates.

** Negroni – a famous bitter cocktail*

In overall terms, economic growth is not yet an issue. It is inflation. The latter continued to rise at a fast clip, so much so that an annualised headline inflation rate of 7-8.5% is becoming more common.

**Central banks: soon to turn from QE into QT**

The above prompted an increasing number of central banks in the OECD world to raise rates and to soon turn their QE (quantitative easing) into QT (quantitative tightening) programs. These crucial policy changes have already started to impact negatively on global financial markets.

Fears of rising inflation, more restrictive monetary policies together with escalating geopolitical tensions sent both bond and equity markets lower. Global bonds declined by -5.74% and equities by -4.73% in Q1. While the HK-China markets enjoyed a bounce recently, they closed the quarter lower.

The best two performing asset classes included Commodities and Cash. Within currencies, the US dollar and selective commodity-linked ones showed strength.

Style-wise, higher interest rates curtailed the ascent of Growth. Instead, Cyclicals and High Dividend styles led. Cash flow dominated hyper-growth stories.

In terms of funds flows, Commodities and Equities saw significant net inflows, funded by redemptions of Money Market and Fixed Income.

## Bitter Cocktail: Quantitative Tightening + Stagflation

**GOJI: a prudent and defensive approach for the remaining of the year**

Consistent with the main messages outlined in GOJI's 2022 Global Outlook, we continued to advise a prudent and defensive approach to investing for the remainder of the year. This is unless bond and equity markets reach levels which are fundamentally cheap beforehand.

At the global level, stagflation (slowing economic activity and high inflation) and recession are two common concerns amongst investors. In the short term, in Q2 and possibly Q3, depending on the outcome of the Russian-Ukraine conflict and other potential geopolitical, we believe that it does appear potential geopolitical, we believe that it does appear that stagflation will dominate. This is caused by the significant challenges in procuring more supply of natural resources and other goods which are being disrupted by the above conflict and the strict Covid control policy implemented by China.

Stagflation is unlikely to stop the Fed and other central bankers (except the Bank of Japan) to continue to tighten monetary policy at a gradual pace.

Commodity prices, while firm, are unlikely to continue to rise as strongly as in the first two months of January and February. Some, actually, appeared to have peaked (such as Oil at $125/bbl in early March). Hence, while headline inflation remains high, it may have peaked in the short term.

The above backdrop is not conducive towards a sustainable bull market in neither bond or equity markets.

As both asset classes are technically oversold and investors' sentiment has turned more bearish after they have reduced some exposure in the above, it is quite probable that we could see some strong short-covering rallies, from time to time. Nonetheless, the latter are likely to be short-lived.

Hence, until markets reach their estimated lower-term fundamental value, and the Fed is close to relaxing the tight phase of its monetary policy, both bond and equity markets are likely to range trade or drift lower.

## Asset Allocation Directions

We suggest to retain prudence and defensiveness in one's tactical asset allocation. In other words, for the remainder of this year, until long-term equilibrium levels are reached, Cash is preferred to Bonds, which is preferred to Equities.

## P.S. A Word on the Fed

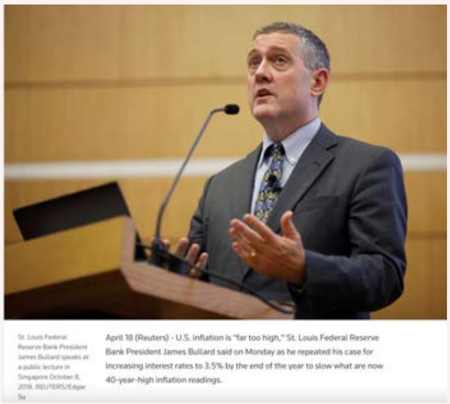
We simply cannot hold ourselves back from writing this postscript on the Fed.

Yesterday (Monday, 18/4/2022), one of the Fed members, well known for his hawkish sentiment, floated the idea of implementing, if and when required, a 75 bps hike in one of the FOMC monthly meetings this year, so that a 3.50% Fed Fund rate can be reached by December.

Our house view is as follows: as the debt leverage has been building up to dangerous levels in the US financial system and economy over the past few years, hypothetically speaking, should the above monetary path be adopted, it would lead to possibly two, not just one, crises. It would not be inconceivable to imagine a severe financial crisis on top of an economic recession in the US, and probably the world too.

Thus, in our view, it is most unlikely that the Fed Chairman and his Board would agree to this. In brief, while we think that it is likely that the Fed will raise rates by 50 bps in the May FOMC meeting, the Fed Fund rate is unlikely to be much higher than 2% p.a. by year end.

### Fed's Bullard wants to get rates up to 3.5% by year end

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