Banque Richelieu
MONACO

STRATEGY SYNTHESIS
RICHELIEU GROUP
MONTHLY REVIEW
Alexandre HEZEZ, Strategist

February 28th 2022

SUMMARY

"The European Union must become more independent in terms of energy, technology and military power" Emmanuel Macron

INVASION

We are obviously thinking first of all of the populations affected by this war and its devastating human implications. It is now very difficult to establish scenarios that would be favored by the probabilities as Vladimir Putin's reactions remain beyond Western rationalities.

Apart from forecasts concerning the geopolitical situation, **the only conviction we have at this stage is that Western countries will do everything possible to avoid causing a major financial accident in the world that would legitimize the action of the Russian president in his destabilization of the Western world.**

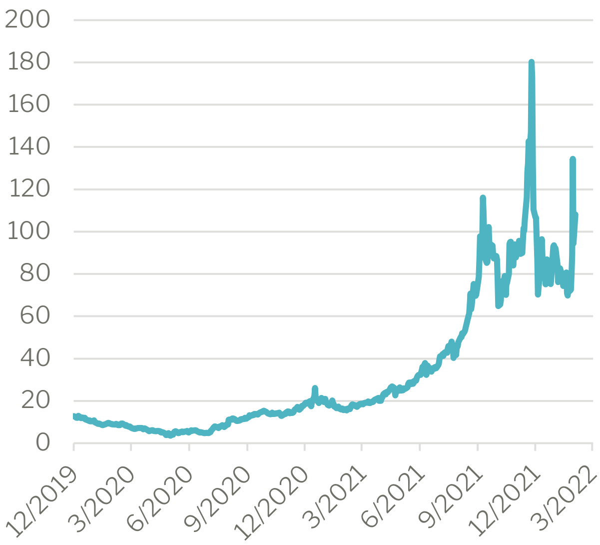
The impact of these various measures remains unclear. **That said, we expect central banks, regulators and governments to act. In some ways, this is reminiscent of the recent pandemic crisis.** The reactions should be equivalent even if there is a notable difference. Let's remember that spot oil prices had plummeted (to a negative price!). **We believe that the authorities have learned many lessons from the recent crises and have learned to act quickly and efficiently.** They proved this during the initial financial turmoil in March 2020 following the advent of Covid-19. Overall, they also handled the initial economic fallout of the pandemic quite well. They showed that they had the tools or could develop them quickly to contain potential financial risks. Even then, heads of state were already talking about war when referring to the pandemic. We are now really there...

If necessary, targeted injections of liquidity will be provided in tight market segments, as well as temporary easing of rules or direct assistance to the most affected firms. A key issue for the authorities will be to provide clear guidance to their own financial institutions.
In recent days, the notion of a "gradual response" by western leaders has become much more credible, and they may be prepared to take massive measures, including those potentially damaging to their own economies.

Overall, the situation will reinforce macro concerns, including commodities, and potentially the Fed's path of monetary policy normalization as the situation evolves.

The inflation factor remained a concern for most central bankers, who tightened their tone at the end of 2021, but the war generated is likely to change the perception of monetary institutions and their aggressiveness in combating rising prices is undermined. Savings are likely to "rebound" at the same time as household confidence is declining. In Europe first of all, even if the current economy is strong, the repercussions will gradually be felt. **Europe, given its geographical proximity and energy dependence, is particularly vulnerable.**

Gas prices in Europe



Sources : Bloomberg & Richelieu Gestion

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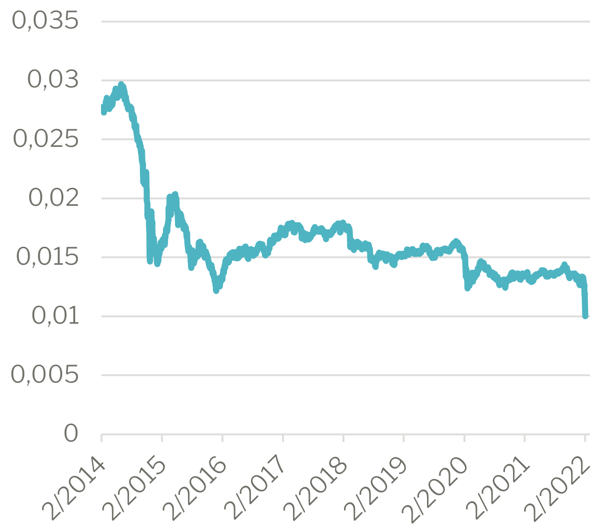
«Today, a French Minister has said that hey declared an economic war on Russia. Watch your tongue, gentleman! And don't forget that in human history, economic wars quite often turned into real ones.
@MedvedevRussiaE

The policy response will also be something to watch. A spike in energy prices could still be cushioned by fiscal policy. Germany's announcement to raise its defence budget to more than 2% of GDP was a significant gesture. It suggests that even fiscally conservative governments may be open to a new round of fiscal stimulus to deal with the consequences of war.

All eyes are now on the negotiations to be held between Moscow and Kiev on the Belarusian border, as this is one of the few hopes for a short-term de-escalation. For the time being, the hope of reaching a rapid solution seems low. In the medium term, a way out could also be found if a major country were to play the role of mediator, but at this stage Beijing is not sending this type of signal. **The length of the disruption to confidence is therefore still very uncertain, but its extent will also determine the economic impact.**

Parity of the ruble against the dollar



Sources : Bloomberg & Richelieu Gestion

The sanctions against the Russian central bank and banks will deeply destabilize Russian society. This could result in a revolt comparable to that of the late 1980s. Everything is possible.

The geopolitical factor is undoubtedly the element that will generate a real surprise. We feared that geopolitics would return to the forefront of market concerns for 2022. At the center of the structuring geopolitical developments was the confrontation between the United States and China on the one hand and Russia's plans to invade Ukraine on the other. It is the latter that is crystallizing all attention. This risk exacerbates the risk aversion movement that has been at work in the markets since the beginning of the year. Apart from the invasions of Kuwait in 1990 and Iraq in 2003, we have no comparable event. At that time, the S&P 500 fell by 16%, only to regain its level 6 months later.

Diplomatic solutions will be put in place and Russia is becoming more fragile. The Russian public fears that its economic situation will be further weakened. Ukraine's entry into the European Union would be a plausible solution. In order to promote stability in Ukraine, the European Council has adopted an emergency macro-financial assistance operation of 1.2 billion euros in the form of loans. The financial assistance aims to provide rapid support in an acute crisis situation and to strengthen Ukraine's resilience. The European Union, like the health crisis, is showing unwavering solidarity.
The current geopolitical tensions are certainly having a negative effect on the already precarious economic and financial stability of Ukraine, but this is likely to accelerate the process of integrating Ukraine into the EU instead of the NATO !

STRATEGY SYNTHESIS RICHELIEU GROUP CONVICTIONS

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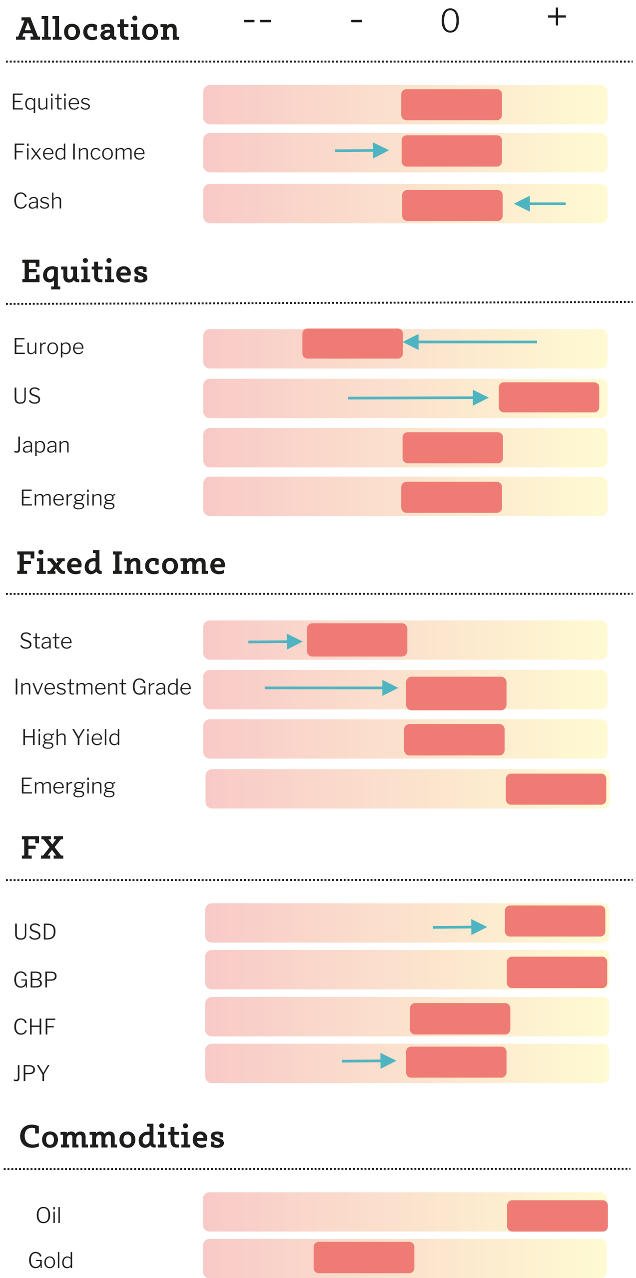
POSITIONING IN RELATION TO RISK CRITERIA



PREFERENCES

SECTOR: CONSUMER, ENERGY, TECHNOLOGY, DEFENSIVE GROWTH

LARGE CAPS

ASIA PACIFIC EQUITIES

EMERGING MARKETS CORPORATE BONDS ASIA

PATIENCE

The question is how much of the geopolitical risk is already priced into the global asset markets? We believe that the short-term market will sway on marginal geopolitical news (whether it is true or false, by the way). In this uncertain and unusual environment, **the next few weeks will be marked by significant upswings in risk aversion in the markets, followed by very strong rebounds.** Geopolitics has always influenced the financial markets, sometimes for very different reasons. We expected growth to rebound after the Omicron setback and consumption to remain solid once the anxiety passed. However, **we are revising European growth by 0.5%** (3.5% versus 4%). This scenario could be revised downward if oil rises above USD 125/barrel.

Central banks will play a key role in restoring calm and certainly delaying expectations of restrictive monetary movement. In some ways, we are in a similar situation to March 2020. Depending on the sanctions that are taken, the shock to growth could put a dent in the average inflation outlook. **Central banks will have to be flexible and not rule out any policy options.** Real rates are expected to fall significantly in the coming weeks (higher outlook on sovereign rates). The ECB should ignore energy-related inflation in its targets.

We remain relatively less cautious on the fixed income asset class, which could still suffer from the ongoing deleveraging and liquidity, but certain credit spread levels are starting to become interesting. Indeed, opportunities are appearing on companies with solid fundamentals (BB and BBB segment). When the pressure eases, investors will return to the fundamentals. **Credit conditions will deteriorate in the very short term and it will be necessary to take advantage of the spreads levels.**

Against this backdrop of tensions, we are downgrading Europe because of the geopolitical risk and are now overweight US. This change in position is therefore largely tactical. This change in the trend in real rates could benefit defensive growth stocks. The US is partly insulated from Russian oil and Asia is not particularly exposed either.

We remain constructive on the equity segment by acting flexibly. Beyond the current corrections, the central catalyst for significantly increasing our equity allocations will depend on formal statements from the FED, taking into account the geopolitical element and a delay in China. A global runaway is still possible. We will initially favor defensive stocks and large caps.

The Euro should weaken against other currencies but the volatility of the exchange rate will be very high.

Some sectors will regain favor with investors: defense stocks and alternative energies, which should benefit from the desire for autonomy.

Others, such as banks, will be weakened in the short term by retaliatory measures and, above all, the uncertainty of the impact on their balance sheets. We believe, however, that they have demonstrated their resilience during the crisis.

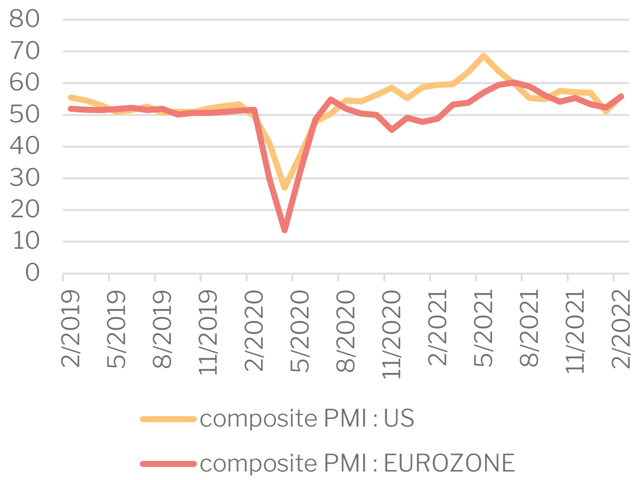
STRATEGY SYNTHESIS
RICHELIEU GROUP
MACROECONOMIC REVIEW

February 28th 2022

AN ACTIVITY THAT WAS STARTING TO RISE AGAIN!

Activity picked up in the euro zone, buoyed by the decline in the epidemic. The improved health situation and the gradual easing of restrictions in the eurozone helped to support activity in February, as evidenced by the release of PMI indicators, which sent a positive message by exceeding expectations on the upside. While activity in manufacturing slowed slightly, although the PMI index remains largely in expansionary territory, buoyed by buoyant new orders, **the lifting of sanitary restrictions and the return of labor benefited above all the recovery in services activity**. In the US and Europe, supply issues are also showing encouraging signs of improvement, while delivery delays continue to decline in intensity. The latter is a major factor in the outlook for growth and, above all, for inflation. Indeed, inflationary risk continues to weigh on household confidence. In the short term, credit conditions are deteriorating, in addition to the rise in energy prices. This will lower our growth expectations for 2022. **An increase in precautionary savings should reduce some of the consumption expected in the first half of the year.**

Leading economic indicators

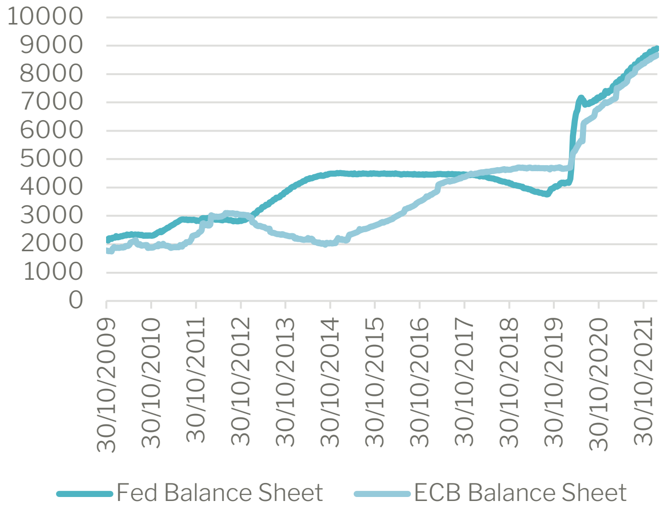


Sources : Bloomberg & Richelieu Gestion

"It is possible, however, that the pace (of monetary policy normalization) is now being somewhat delayed." Robert Holzmann - Governor of the Austrian National Bank

CENTRAL BANKS MUST ALREADY ADAPT

FED AND ECB balance sheet (Bn in local currency)



Sources : Bloomberg & Richelieu Gestion

Faced with the inflationary pressures that the sharp rise in energy prices will continue to fuel in the short term, there was unanimous agreement that the ECB needs to adopt a more cautious tone in terms of its monetary tightening strategy. While the consequences of the crisis are still uncertain, the discussions between Western leaders on major sanctions against Russia will lead to a revised scenario for the global economy. **For now, the choice of economy seems to outweigh the harshness of the response**. On March 10, the ECB will assess the situation and the risks to its scenario in order to take its decisions. In particular, the institution may have to slow down or even delay its exit in order to cushion the shock to growth in the short and medium term, as mentioned by Austrian R. Holzmann, one of its most hawkish members. In the United States, the subject is a little less important, given that the American economy is less exposed to the Russian crisis, and the subject is less central because the effects on growth will be less. Jerome Powell's speech at his semi-annual hearing before both houses of Congress should shed some light on this point and we believe that the normalization of his monetary policy, without being called into question, will be slowed down to avoid too great a deterioration in credit conditions. At the center of the crisis, the euro should weaken.

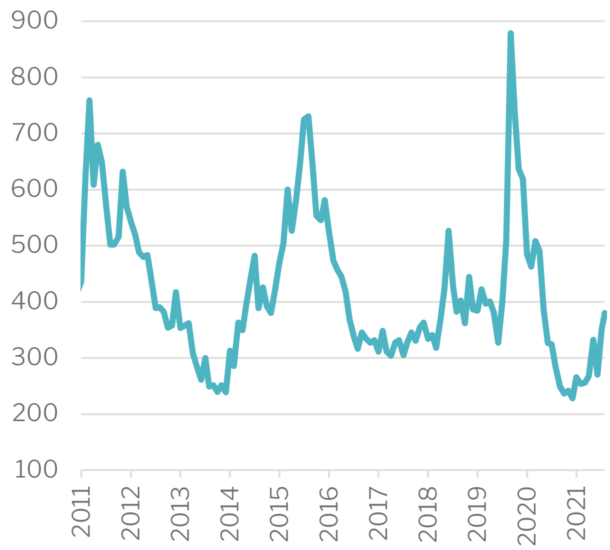
STRATEGY SYNTHESIS RICHELIEU GROUP
MARKET REVIEW

February 28th 2022

CREDIT: SOME OPPORTUNITIES IN THE BBB AND BB SEGMENTS

Less accommodative fiscal policy, inflationary pressures and geopolitical tensions have been the main catalyst for investors to sell corporate bonds since the beginning of the year. Another fundamental headwind, this time longer-term, is emerging, also related to a shift in capital management priorities. **After two years of raising cash and cautious balance sheet management, we expect companies to adopt a more shareholder-friendly stance.** M&A activity (at a new high in 2021) should remain a key ingredient in many companies' growth plans. But unlike last year, strategic deals announced so far in early 2022 have demonstrated a less bondholder-friendly financing mix with increased leverage. We continue to see the highest downside risk among the highest rated Investment Grade companies, as these companies may seek to utilize their significant debt capacity while remaining comfortably in IG territory. **This reinforces our preference for BBB-rated bonds**. Within the High Yield market, we prefer the more conservative BB/BB+ segments with a large portion remaining focused on restoring their IG rating.

US High Yield Credit Spread



Sources : Bloomberg & Richelieu Gestion

China still refuses to use the term "*invasion*", but speaks of a "*military operation*".

CHINA: THE AUTHORITIES IN SUPPORT

CNY versus USD

Sources : Bloomberg & Richelieu Gestion

China's Finance Minister, Liu Kun, announced this month that the authorities will increase tax cuts in 2022 to support economic activity (without mentioning a specific amount at this stage). Beijing also plans to increase payments to local governments to offset falling revenues, allowing them to support investment. Monetary policy has become supportive in recent months, and even more so recently, with a cut in reserve requirements in December and a cut in policy rates in January. The regulatory backlash seems to be behind us. Chinese banks cut property lending rates in nearly 90 major Chinese cities in February. Real estate sales have improved for two consecutive months. This is a positive sign in the all-important real estate sector.

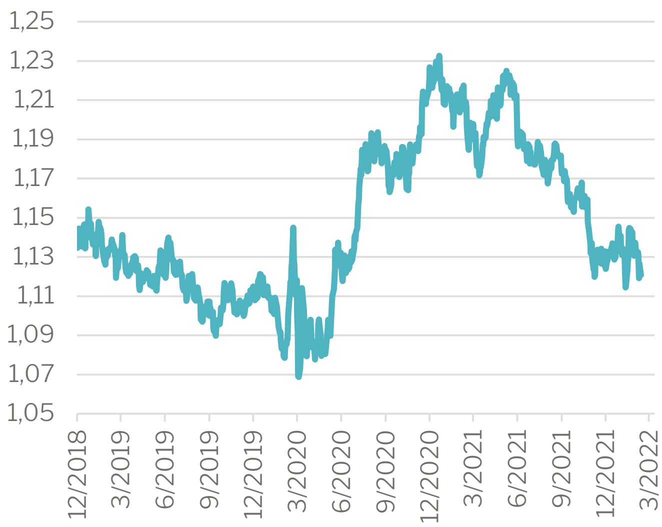
The Chinese authorities' desire to support activity is long-term and, in our view, is aimed at avoiding any accident in economic growth ahead of the Communist Party Congress at the end of the year and in a context where the maintenance of the "zero Covid" strategy remains a brake on activity. Economic growth should be supported in the future by an even more accommodating central bank and should therefore be sustainable

The only shadow in the picture, and not the least, is Beijing's attitude towards Taiwan in parallel with the conflict in Ukraine. **China is fluctuating between a neutral and uncomfortable stance.**

Euro expected to be under pressure in the short term

The euro had benefited for a while from the ECB's February meeting, which surprised the markets by adopting more restrictive expectations in the face of the end of the pandemic and favorable economic figures. As we have explained, **the European Central Bank remains the most concerned about the next steps to be taken**. We believe it has no choice but to maintain a more accommodative policy than it anticipated a few weeks ago despite inflation that is expected to continue to rise. The protection of the banking system, the exclusion of some Russian banks from the Swift messaging system and the freezing of the central bank's assets will have serious consequences. European sovereign rates should be under downward pressure as long as the Ukrainian crisis is present.
Conversely, the FED will continue its normalization. Only a deterioration in a global conflict (which is not our scenario) would lead the FED to take a defensive stance and drive the dollar down.
The yen, like the CHF, should also be favored by its safe haven status.

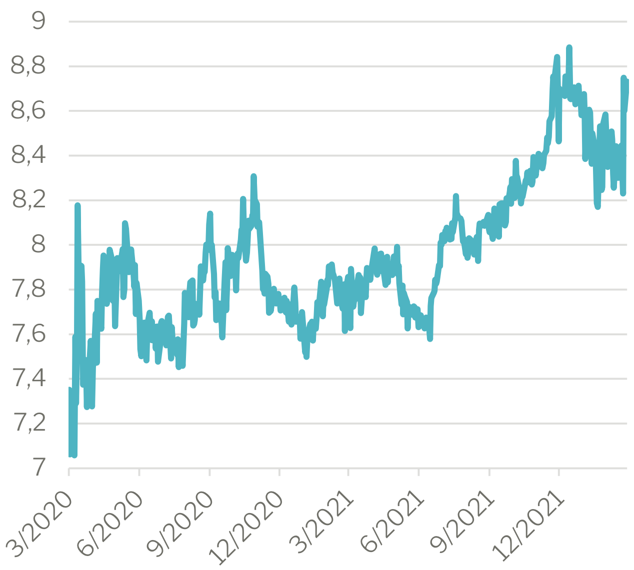
EUR versus USD



Sources : Bloomberg & Richelieu Gestion

"Eurozone trade links are not important outside of energy"

Ratio S&P 500 versus Stoxx



Sources : Bloomberg & Richelieu Gestion

EUROPE: A weakened zone for the time being

For the past few months, we have been positive on value and cyclical stocks, given the rise in interest rates due to inflation, resilient economic growth and valuations. Our overweighting of European markets (structurally more cyclical) did not justify greater visibility and stronger growth. In the short term, this reasoning is challenged. Lower real interest rates should benefit defensive growth stocks. Healthcare, utilities and technology should outperform until the situation is resolved and economic growth potential has adjusted. **We advocate a rebalancing of style in portfolios, as the Eurozone appears to be a risk area. Our analysis shows that 21% of the eurozone's energy imports come from Russia**. We believe that a more cautious stance on European equities may be warranted, but it should be noted that the eurozone's trade links are not significant outside of energy and that fundamentals remain strong. However, in this very volatile and unpredictable environment, **we do not recommend hedging portfolios via indices because the bullish movements could be large in case of good news and impact mainly the major indices.**

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OIL: AN INCREASE THAT SHOULD LEVEL OFF

As Russia is the world's 2nd largest exporter of black gold, the explosive situation in Ukraine raises fears of possible supply disruptions in a market that is already structurally deficient. We maintain a price target of USD 100/110 for WTI this year. However, we do not believe that prices should rise to much higher levels despite increased geopolitical tensions.

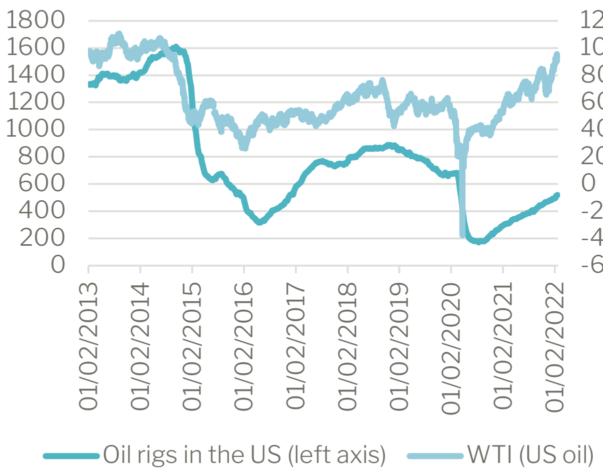
We believe that 3 elements are key:

- An agreement on the Iranian nuclear program, allowing Iranian supplies to return to the world markets ;
- A steady increase in the commissioning of oil rigs in the United States ;
- The ability of some Middle Eastern countries to increase their production to cope with the difficulties of other producers and especially the geopolitical context.

According to the IEA, global demand should increase by 3.2 million barrels per day (mb/d) this year to reach 100.6 mb/d, with the easing of restrictions to contain the Covid-19 pandemic.

Prices should therefore remain high without causing a surge that would undermine economic growth. This should continue to benefit US oil stocks and to a much lesser extent European majors investing in Eastern Europe.

Oil prices and active oil platforms in the US



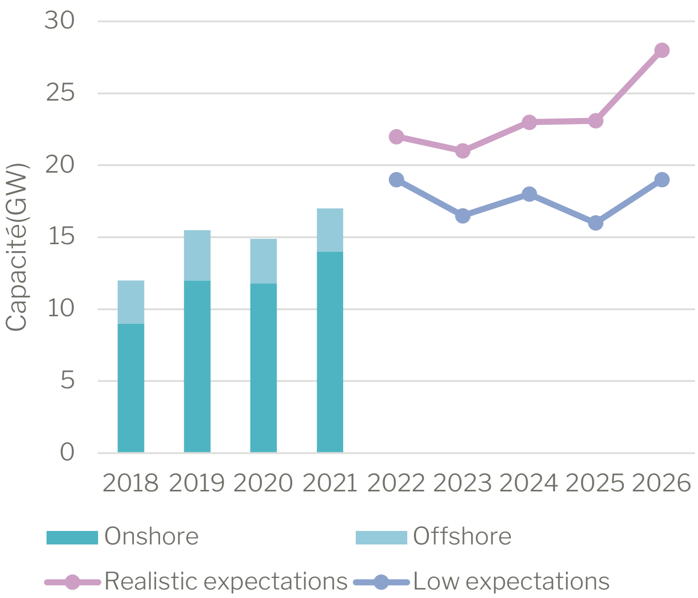
Sources : Bloomberg & Richelieu Gestion

RENEWABLE ENERGY: AN ALTERNATIVE TO THE INCREASE IN CARBON-BASED ENERGY

Although wind equipment manufacturers' margins have been under pressure since 2016 and continue to suffer with the current cost inflation environment, the future of this thematic remains definitely promising.

Investments in this theme should accelerate due to an increased need for alternative sources to gas and oil. The wind equipment segment has historically lacked pricing power, due to a low cost of capital combined with aggressive price competition. However, there is no doubt that the future looks attractive for European utilities and OEMs as the EU moves toward its "Net Zero" goal by 2050, which implies nothing less than a doubling of total electricity volumes during that time. The same is true for the US market, which could benefit from a very significant boost as Joe Biden promised his constituents to decarbonize the US electricity system by 2035. This is why **we advise to start taking progressive portfolio positions in renewable energy in a gradual way from the end of the first quarter with the monetary tightening of the Fed and the ECB which should lower the inflation costs.**

Onshore and offshore wind power installations in Europe



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