After the first month…

Monthly Investment Strategy

AXA IM Research

30 March 2022

Summary: March 2022

Theme of the month: After the first month …

- Russia's invasion of Ukraine has had a profound impact, but the impact on global growth is uncertain. Direct trade links, particularly beyond Europe are small, but broader global demand may weaken. Elevated energy prices and tighter financial conditions look likely to be the key headwinds to growth.
- Ukraine's 2019 output had not recovered 2013 levels – the impact here is huge. But sanctions should also see the Russian economy contract by at least 7% this year. More broadly Europe will see the biggest impact with gas prices rising sharply and supply-chains disrupted for some manufacturers. Europe's impact will be somewhat mitigated by in the main a very proactive fiscal response.
- The impact on the US and China will be more indirect. In the US higher gasoline prices threaten a faster consumer spending slowdown, with little response from domestic oil production. In China, high global prices will weigh, but more uncertainty reflects China's longer-term relationship with Russia.

Macro update: Another supply shock that further complicates central bank outlook

- The Ukraine war weighs adds to broader tensions. Only in the Euro area was the economic outlook 'comfortable' pre-war, with a growth recovery not yet building sustained inflation pressures. The outlook here has deteriorated despite significant fiscal intervention. In the UK, a smaller fiscal response leaves growth more vulnerable.
- In the US, the war is another supply shock to an economy with a robust demand recovery. This has created tensions for the Fed and markets struggle to gauge the Fed's shifting reaction function, responding as the Fed's focus appears to swing to inflation expectations control.
- China also faced challenges before the war. Structural re-orientation of longer-term objectives has created economic headwinds, additionally an outbreak of Omicron threatens activity with China's zero-COVID policy. Yet an ambitious 5.5% government growth target will require significant stimulus.
- Emerging markets also faced challenges before the war, but rising energy and food prices will add to inflationary pressures, while weakening global risk sentiment may also weigh. That is aside from the more exposed CEE region, whose proximity and interconnectedness will see it impacted sharply.

Investment strategy: global yield curves flat and furious but risk assets rebound

- FX: Fed hiking has started, and this may signal that the USD is near its peak, unless this time is indeed different. The rise in Fed hike expectations has hindered JPY as the customary safe haven. Commodity currencies have overperformed USD. CAD and NOK should continue to rise.
- Rates: Bonds have largely disappointed since the start of this year, leaving investors with uncomfortably negative returns. At the same time, market participants are increasingly focussing on the US Treasury yield curve's flattening as a signal of increased recession probability.
- Credit: The impact of the conflict across credit markets has been proportional to their proximity to the conflict. There has been a material improvement in valuations and excess return expectations based on spread mean reversion have increased materially; to 2%+ for EUR IG and to 5%+ for EUR HY.
- Equity: Equity markets have seen a relief after a tortuous start to the year, rebounded by +2.9% over the last month. Our study suggests that the Quality factor seems to offer the best excess return on average (+0.46%) when earnings growth expectations are revised lower.

AXA Investment Managers

Central scenario

Summary – Key messages

Monetary policy

Fed and ECB to tighten policy as inflation threatens expectations. This has long been the case in EM, but will run further. BoE worries about slowdown and tightening too much.

Inflation

Ukraine supply-shock extends inflation overshoot. Signs of domestic inflation pressures remain mixed. Uncertainty grows over expectations.

Fiscal policy

Euro area leads with large fiscal measures to absorb energy shock. UK's response small. US still deadlocked in Congress.

Growth

Growth will slow, but in most areas remain positive given post-COVID momentum. Contraction a risk for some.

Our central scenario:

Ukraine war poses material supply-shock, raising inflation further and slowing COVID-rebound growth

We forecast global growth to rise by 3.1% in 2022 and 2.8% 2023.

Economic growth persists despite supply pressures and tighter monetary policy. Inflation persists for much of 2022.

Emerging Markets

Ukraine war to hit CEE hard. Higher inflation, particularly energy and oil to further strain complex. Asia sheltered.

Rates

Rise in rates reflects central bank re-pricing. Flat curves show growth concerns, but may also reflect technical features.

FX

Fed pricing and geopolitics favours dollar for now. Though Fed hikes suggest peak. Commodity currencies bolstered in light of war.

Credit

Volatile spreads in 2022 on central bank and geopolitics concerns but still favour higher beta rather than duration risk.

Equities

Earnings expectations remain healthy despite downside risks to growth. Some caution into Q1 earnings season is warranted.

Alternative scenarios

Summary – Key messages

Entrenched supply shock *(probability 25%)*

What could be different?

- Escalation
- Coronavirus mutation sees renewed outbreaks
- Post-pandemic structural changes – labour market withdrawal and goods demand – persist. Supply shocks last longer
- Inflation expectations rise, affecting wages and persistence

What it means

- Growth weaker, employment rebound softer, but inflation remains more elevated
- Monetary policy ill-equipped to deal with supply shocks, deteriorating inflation credibility forces still tighter monetary policy in DMs

Market implications

- Risk appetite deteriorates / equities sell off / credit widens
- Safe-haven rates rally resumes
- EM debt to come under pressure

A global boost *(probability 10%)*

What could be different?

- Geo-political tension ease – peace in our time.
- Labour market participation recovers, strong income growth and easing inflation pressures
- Productivity boost following investment rebound and structural post-pandemic adjustments

What it means

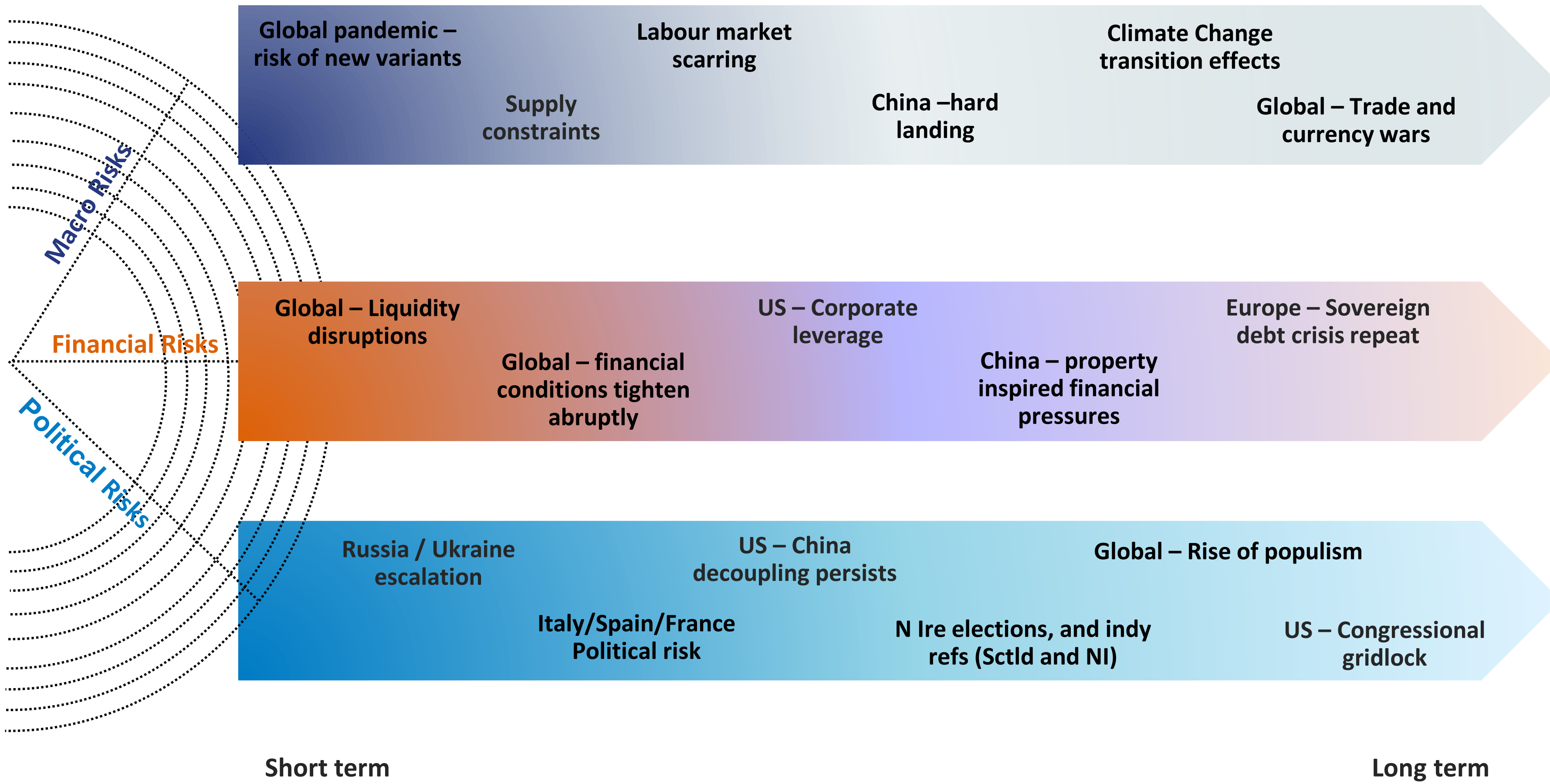
- Growth surprises on the upside in most regions
- Inflation fades more quickly towards and below central bank targets
- Monetary policy proves more patient than expectations

Market implications

- Risk-on environment, equities make further gains, growth retains lead over value
- UST softens, EUR strengthens
- Spreads grind tighter

RISk Radar

Summary – Key messages



Contents

Theme of the month

Russia invasion of Ukraine

Channels of contagion

Direct trade effects

- Direct trade exposure to Russia & Ukraine is relatively small in the larger economies, particularly outside of Europe. However, the net impact of weaker global demand as a result of the full impact of the Russian invasion may be more material.

Energy prices

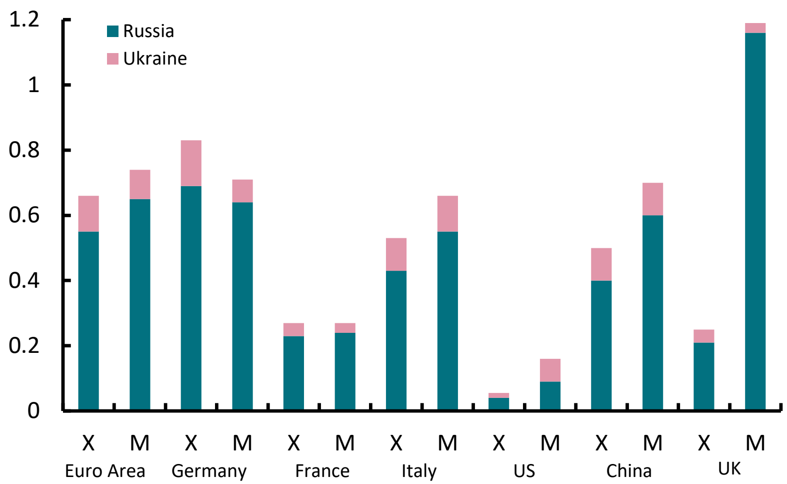
- Higher energy prices – gas for Europe, gasoline for the US - and a further boost to inflation from supply disruption in food, metals and other commodities will further erode household and business real incomes, reducing spending.

Financial conditions

- Financial conditions have also tightened since the start of this year, in part in anticipation of the war.

Direct exposure to Russia Ukraine is relatively limited

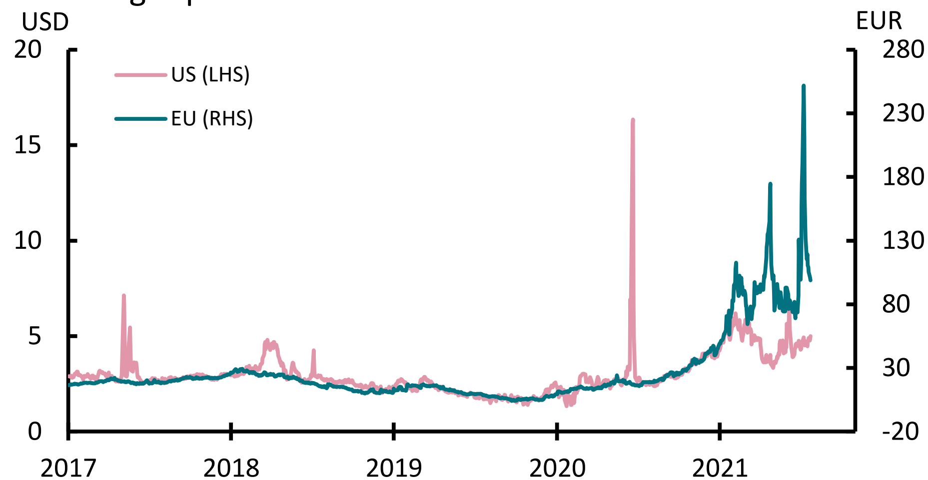
Trade as % GDP



Source: Eurostat, United Nations and AXA IM Research, 2020 data

Energy prices have risen since the invasion – particularly European gas

Historic gas prices



Source: Bloomberg, European Energy Exchange, AXA IM Research, March 2022

Russia invasion of Ukraine

Europe the epicentre of the shock

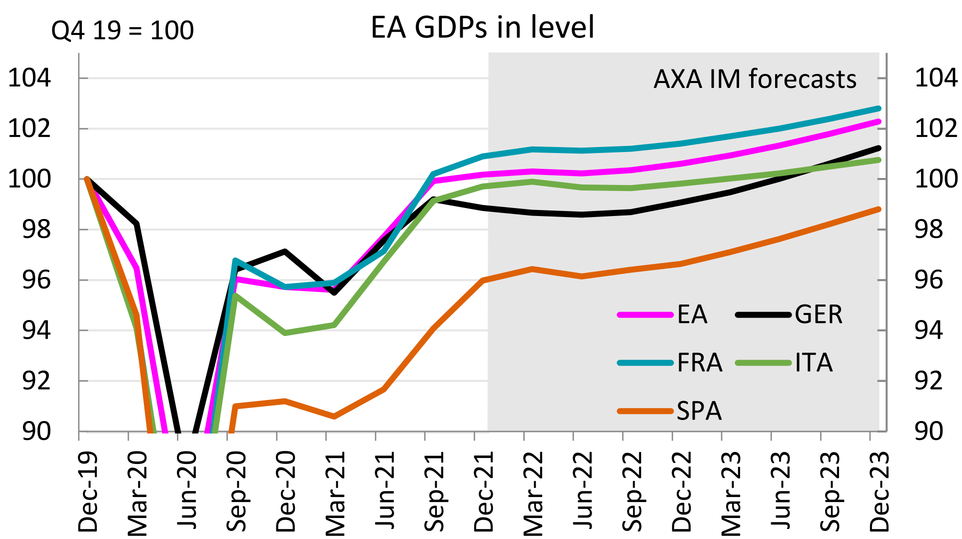
Impact on Europe significant, somewhat offset by fiscal easing

- Energy-driven inflation on the rise, though path is largely dependent on magnitude and type of fiscal measures across countries. We project EA inflation to average 5.3% this year and 2.5% next year, risks skewed to the upside.

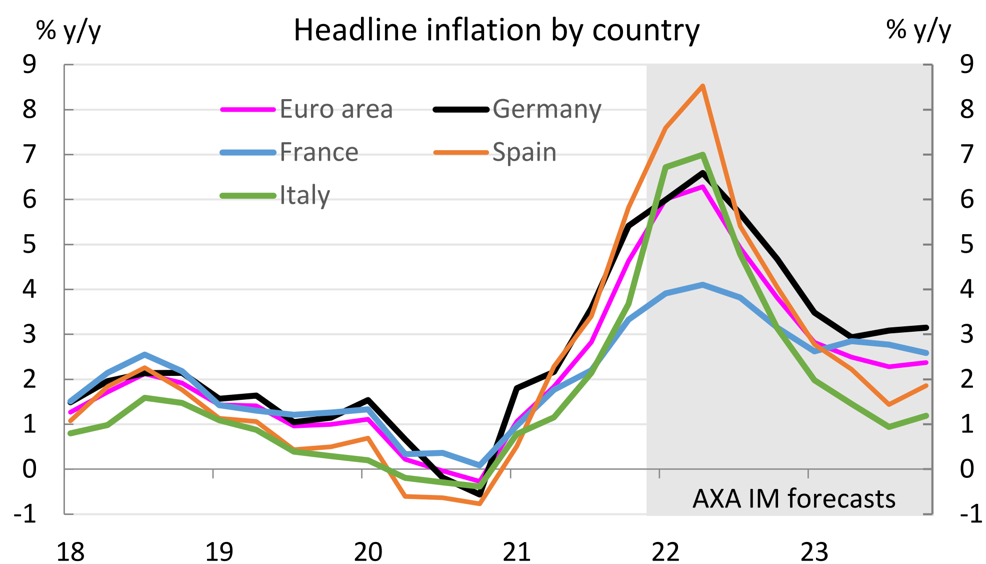
- We forecast Euro area GDP to contract slightly in Q2 22, grow modestly in Q3 22, before recovering strongly led by investment in 2023. All in, we project Euro area GDP to grow by 2.1% in 2022 and 1.2% in 2023 (vs carry over of 1.9% and 0.2% respectively).

- Labour markets should be only moderately affected (no strong reversal, no scarring) – though this will be largely dependent on fiscal response. Consumers' savings behaviour is another key element to the outlook, suggesting downside risks in our view.

- Inflation above 2% target, well anchored inflation expectations, and recovery delayed rather than broken should keep ECB on a gradual normalisation path.



Source: Eurostat, AXA IM Research



Source: Eurostat, AXA IM Research

Russia invasion of Ukraine

US outlook affected by energy and financial conditions

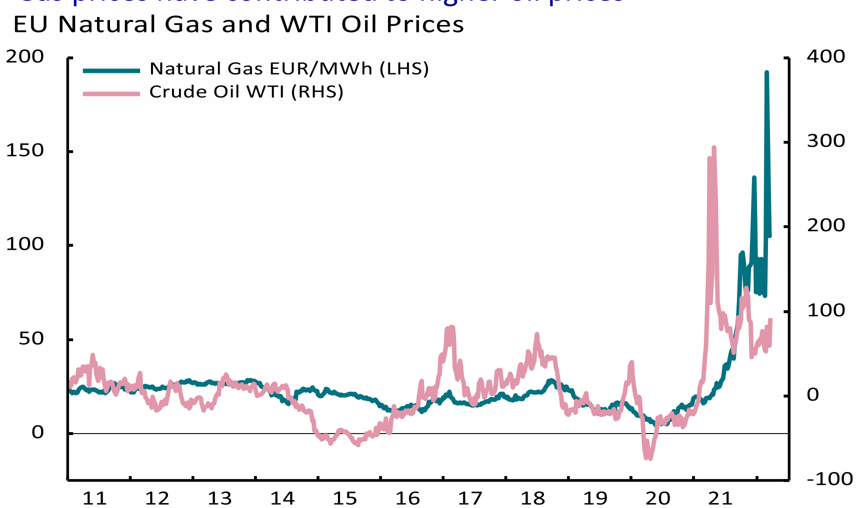
Not gas, but gasoline

- US natural gas prices have not been as affected by the Ukraine invasion, nor is the US as reliant on gas. However, oil prices have also been affected and this has underpinned further increases in gasoline. This will also impact US consumer spending and confidence continues to fall.
- In the past, higher oil prices have boosted US oil production, leaving GDP broadly neutral to rising oil prices. However, the response to higher oil prices has been less than in previous episodes and oil output has not increased over the past six months. We expect the government to try and bolster domestic oil production and clean energy investment, but this is not happening yet.

Financial conditions a drag

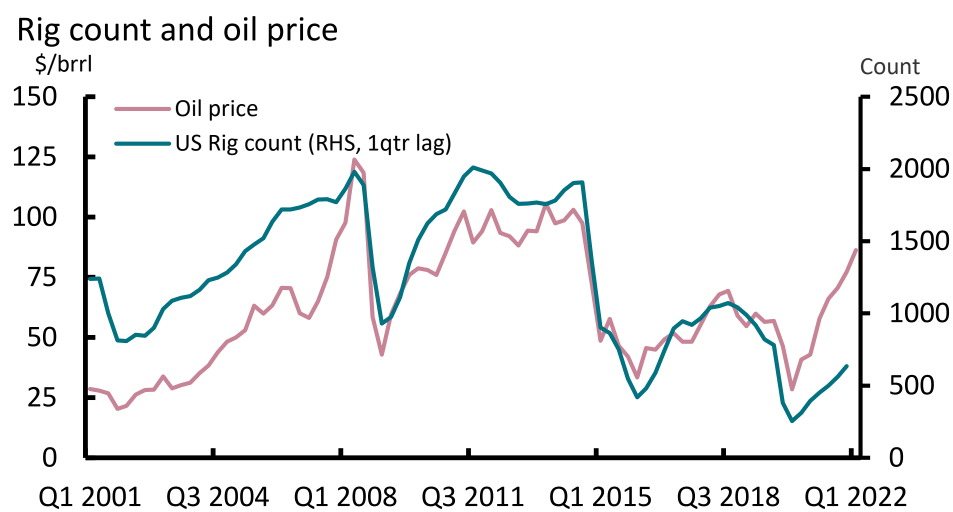
- The US has seen a material tightening in financial conditions in anticipation of the war and in response to signs of Fed hawkishness. These could tighten further as the impact of slowing consumer spending becomes more obvious.

Gas prices have contributed to higher oil prices



Source: European Energy Exchange, Refinitiv, AXA IM Research, March 2022

The US response to higher oil prices has been muted



Source: Bloomberg, Baker Hughes, AXA IM Research, March 2022

Russia invasion of Ukraine

China: manageable near-term impact, but long-term implications are complex

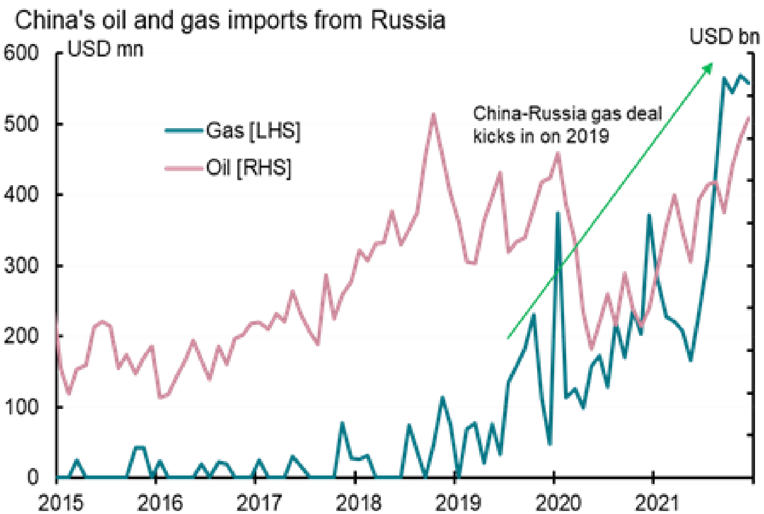
Near-term macro impacts manageable

- China's small trade exposure to Russia and Ukraine should keep the economic fallout from the escalating tensions manageable. Russia and Ukraine account for less than 2% of China's total exports or 0.4% of GDP. But rising oil and commodity prices will revive domestic PPI inflation, even though the passthrough to the CPI could be limited by controlled petrol and gas prices. We do not expect increased price pressure to inhibit policy easing by the PBOC

Geopolitical implications harder to decipher

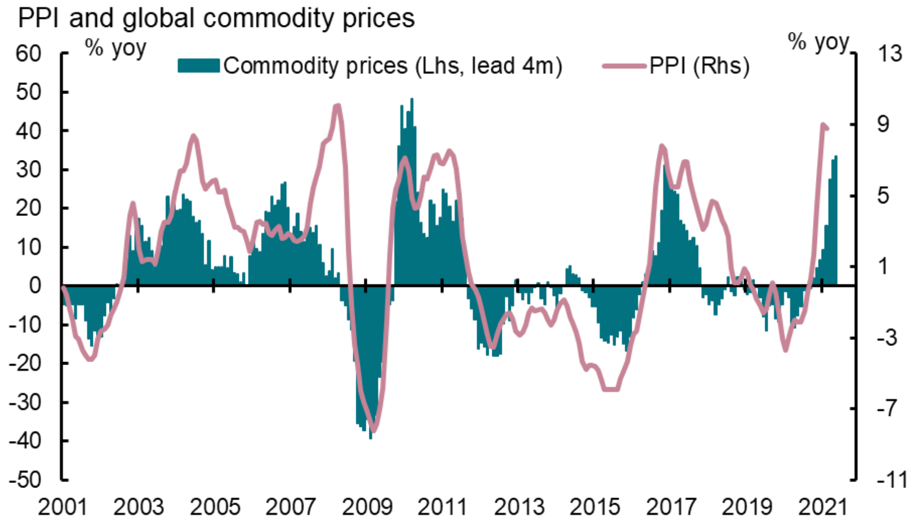
- Beyond the near-term impact, increasing geopolitical tensions are leading to further economic decoupling between Russia and the West, which could prompt the Kremlin to work more closely with Beijing. However, China maintaining a normal relationship with Russia could expose it to sanction risks and confrontation with the West. Beijing therefore faces a complex trade-off with potentially profound ramifications. Higher prices of fossil fuel could also accelerate China's transition to renewable energy

China-Russia energy trade strengthens in recent years



Source: CEIC and AXA IM Research, Mar 22

Rising energy prices will boost PPI inflation



Source: CEIC, AXA IM Research, Mar 22

Investment Managers

Russia invasion of Ukraine

Russia and Ukraine

Russian economy inexorably shrinking now and in the long run

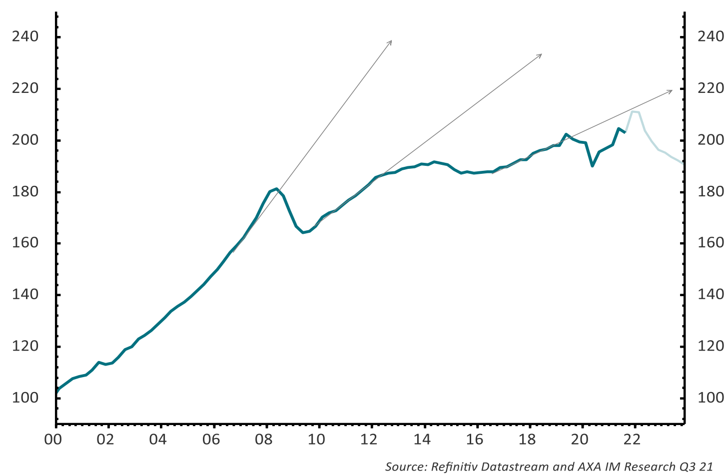
- We expect Russian GDP to fall by at least 7% this year and another 3% in 2023. Yet, these estimates could prove overly optimistic if European sanctions expand to include hydrocarbon imports from Russia.
- Capital accumulation and technological transfers are set to structurally weaken leading to significant cumulative output loss over the long run. Along with adverse demographics and already weak productivity growth, potential growth will continue to fall further below the current estimate of 1.5%.

Ukraine

- The economy was largely dependent on trade with Russia and the weather (agriculture accounts for 40% of exports). Material loss of territory could dramatically reduce fiscal capacity and the export sector: the damage to GDP would be massive and unlikely to be recovered. FDI will not return until a clear resolution to the conflict emerges. End-2019, GDP/capita was still below the 2013 level.

Russian economy shrinking

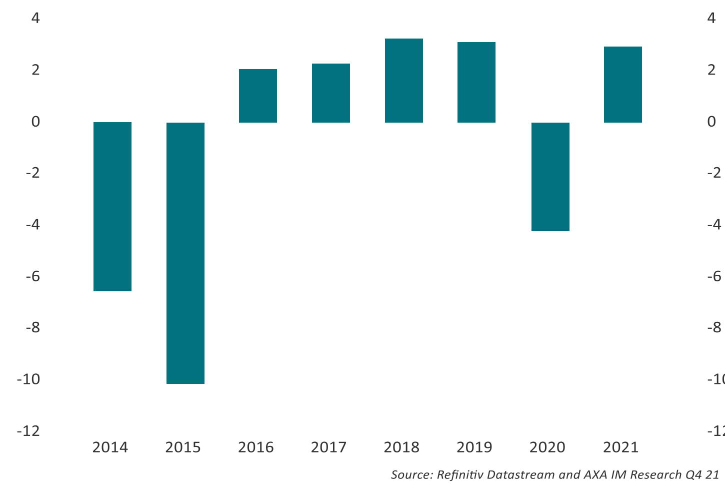
Russia GDP index trend and forecasts (Q1 1995=100)



Source: Datastream, and AXA IM Research, Mar 22

Effects of war will go beyond 2014 Crimea annexation

Ukraine GDP growth (yoy %)



Source: Datastream, AXA IM Research, Mar 22

Macro outlook

War raises inflation and lowers activity outlook

US

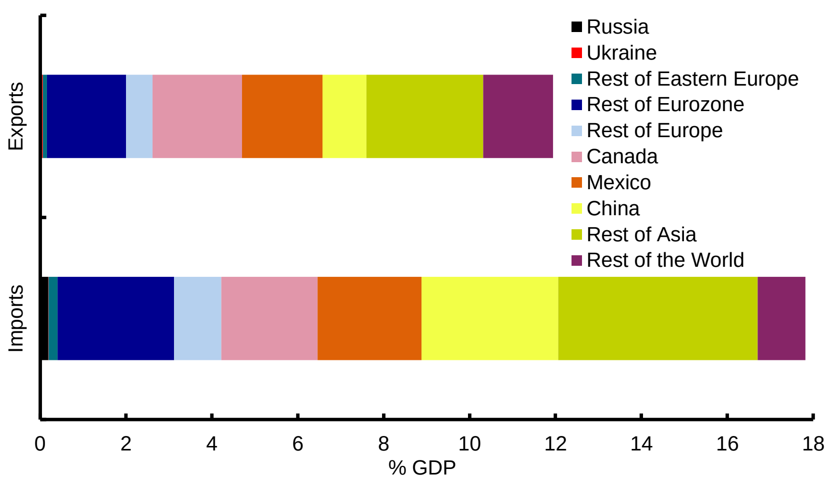
War in Ukraine to impact US growth outlook

- Russia's invasion of Ukraine will have implications for global growth. While Europe will bear the brunt of the fallout, the US is also likely to be affected. The US's direct connections with Russia and Ukraine are small. However, European markets account for a little under 3% of US GDP in exports and a sharp slowdown in the region would have some impact. Financial conditions tightened in anticipation of, and after, the outbreak of the war. Moreover, higher inflation will also impact consumer and business spending. We lower our GDP forecasts to 2.8% and 1.6% (from 3.2% and 2.0%), someway below consensus forecasts of 3.5% and 2.3%.

Inflation

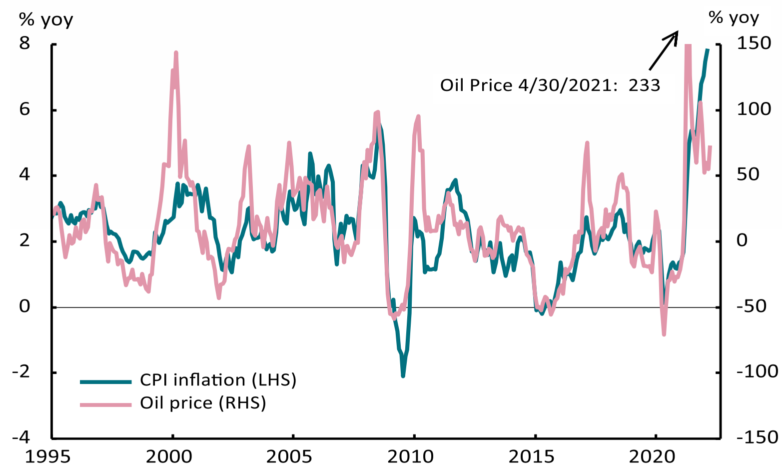
- The war is also another supply shock, impacting energy particularly but also affecting a range of commodities including wheat and corn and a number of metals. This looks set to undo signs of improving supply conditions from end-2021, lift the US inflation peak to above 8% and delay material decline. We forecast inflation averaging 6.8% in 2022 and 3.8% 2023 (6.2% and 2.6% consensus).

Direct/trade impact of war relatively small



Source: BEA, AXA IM Research, March 2022

Another supply shock delays hopes for inflation slowdown



Source: BLS, Refinitiv, AXA IM Research, March 2022

Fed switches to managing inflation expectations

US

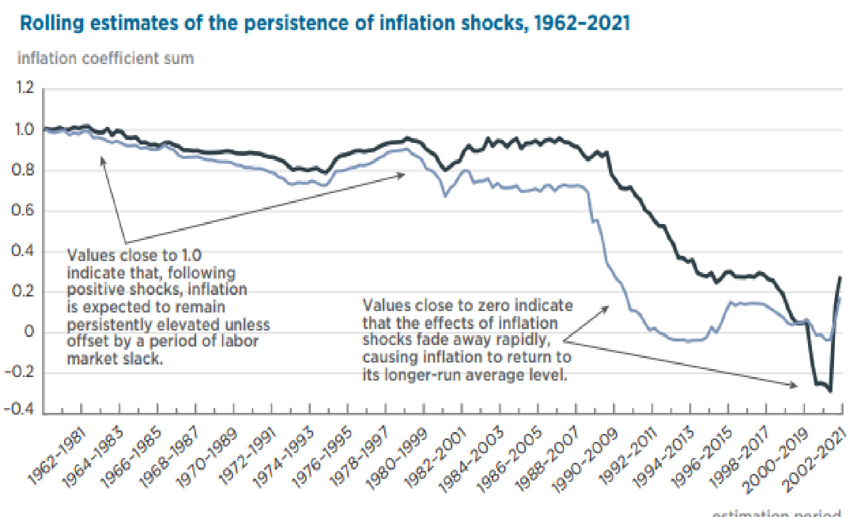
Uncertainty over characteristics of inflation expectations

- Over and above headline inflation concerns, the Fed appears concerned about inflation expectations. Elevated current inflation risks unanchoring expectations. In turn this could disrupt the wage-setting process and lead to an increase in inflation persistence (raising the costs of returning inflation to target). For now, medium-term inflation expectations appear well anchored – both on a market and survey basis. But the Fed looks unwilling to take this for granted.

Fed prepares both barrels – but is it too much ?

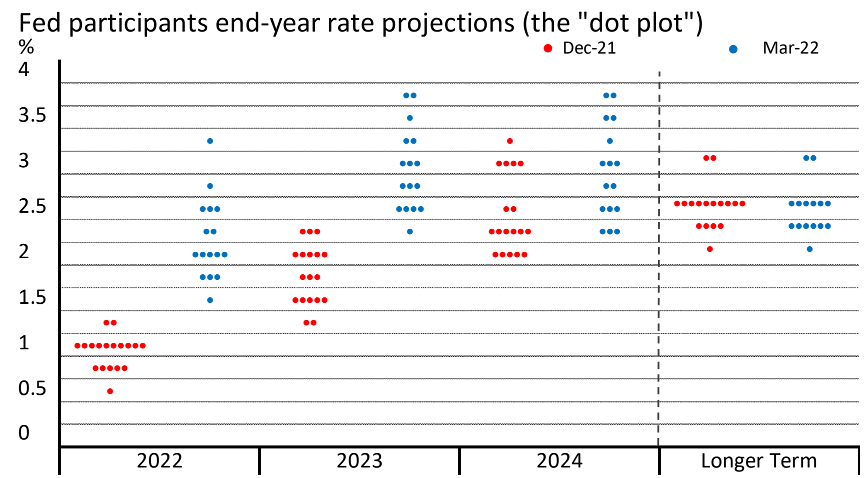
- The Fed began tightening policy with a 0.25% rise in the Fed Funds Rate in March. It also signalled a more hawkish rate outlook. We also now expect it to announce quantitative tightening (QT) in May. But is this too much ? This tightening in financial conditions, potentially alongside a war-related risk-off could slow growth sharply. Markets forecast a 2023 peak in rates at 2.50% followed by a cut in 2024. We forecast a slower hiking path to 1.5-1.75% this year and 2.25-2.5% next.

Doubts rise about persistence of inflation



Source: Peterson Institute, March 2022

Fed plots a more hawkish path



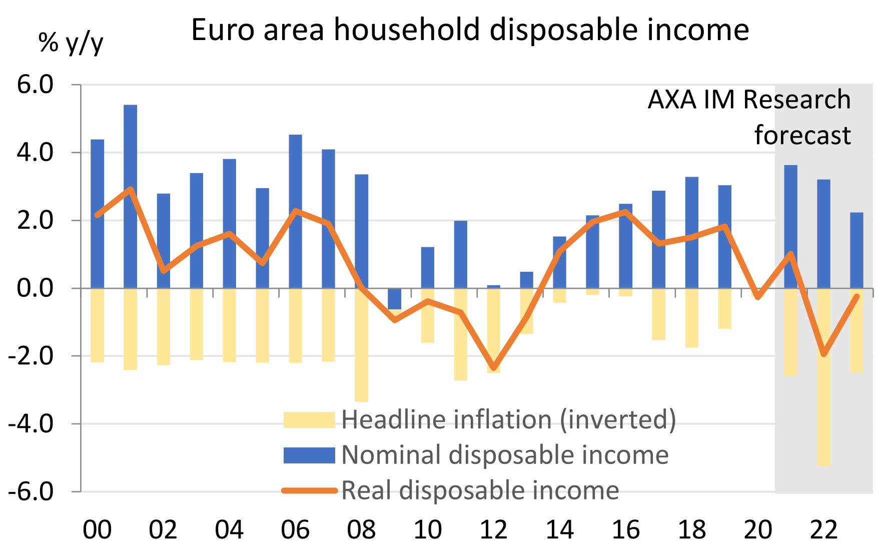
Source: FRB, AXA IM Research, March 2022

Yet another exogenous shock towards stagflation

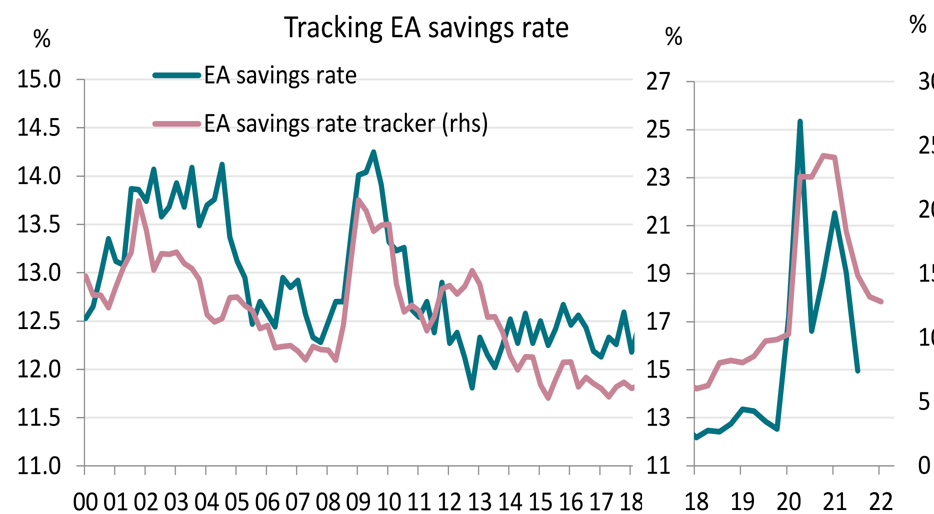
Eurozone

Differentiated growth shock amidst fiscal response

- Deteriorated macro environment due to inflation squeezing households' real income (c.-2% y/y this year) and faltering sentiment. Uncertainty runs high.
- We project euro area GDP to grow by 2.1% in 2022 and 1.2% in 2023 (vs carry-over of 1.9% and 0.2% respectively).
- Labour markets should be only moderately affected (no strong reversal, no scarring) – though largely dependent on fiscal response. Savings behaviour is another key element to the outlook, suggesting downside risks in our view.
- Putting together fiscal support and exposure (manufacturing, energy), France looks well placed to outperform peers.



Source: Eurostat, AXA IM Research



Source: Eurostat, European Commission, AXA IM Research

Investment Managers

ECB: Committed to a gradual normalisation path

Eurozone

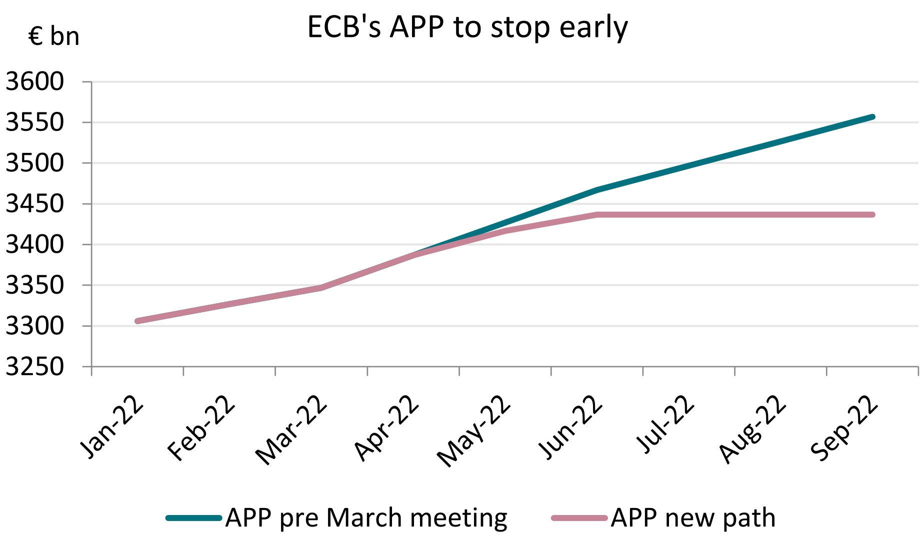
Gradual normalisation with inflation above target, inflation expectations anchored, and delayed not broken recovery.

Keeping the hawkish turn…yet a long normalisation ahead of us

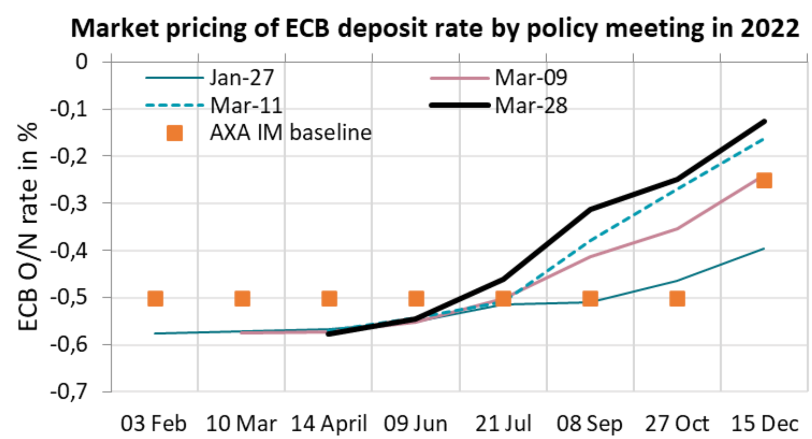
- Finish with APP asap: missing €120bn against previous expectation it would finish in Sep
- De-link end of APP and rate hikes waiting "some time", rate hikes to be gradual
- Put the pressure on fiscal policy to deliver
- ECB keeping options open: data-dependence is paramount

Our baseline:

- Finish APP in June
- Two 25bps rate hikes in Dec 2022, and March 2023. Added another in Dec 2023.



Source: ECB, AXA IM Research



Source: Bloomberg, AXA IM Research, as of Mar 28 2022

Ukraine invasion threatens UK outlook

UK

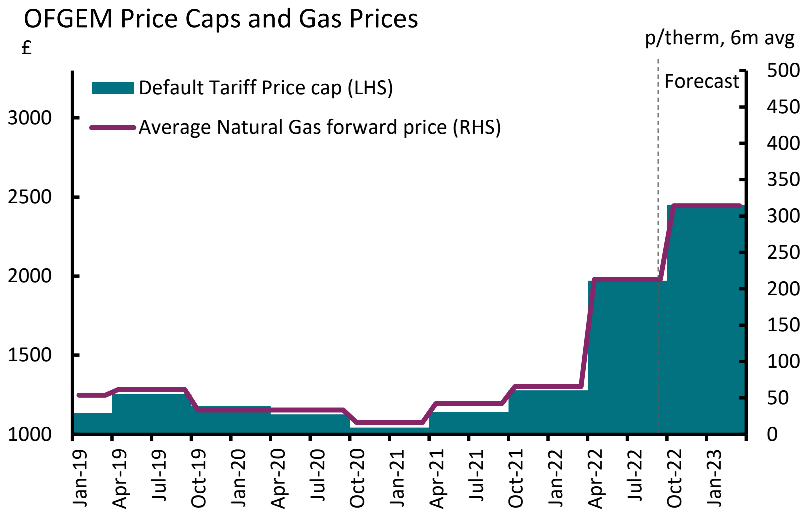
UK to suffer on combination of factors

- Despite small direct exposure to Russia or Ukraine, the UK looks set to suffer from the invasion. Although direct gas imports from Russia are small, the UK is heavily reliant on gas and exposed to European gas prices. It also has a large European trade exposure (46% of exports), so is vulnerable to a European slowdown. Unlike Europe, there has been little fiscal offset to the shock, while the BoE has been tightening monetary policy in the face of elevated inflation.

Inflation up, growth down

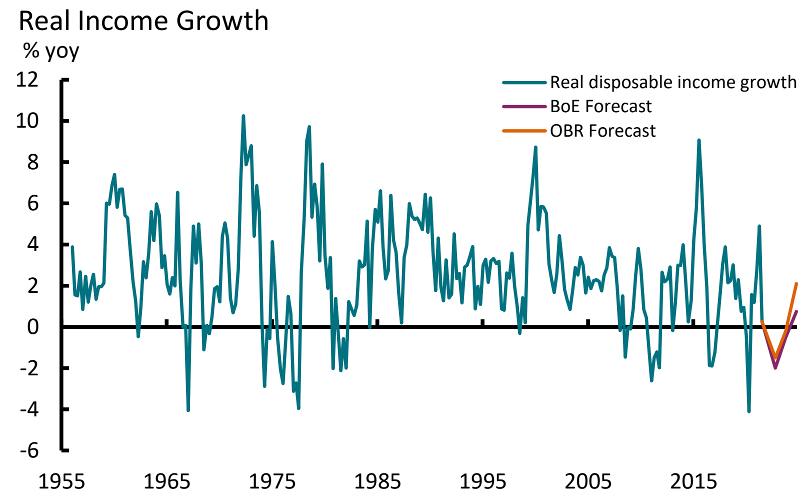
- This further supply shock impacting energy, but other commodities including wheat, corn and metals, is likely to see inflation spike higher (we now expect a peak above 8% in April) and recede more slowly. We raise our inflation forecasts to 6.8% and 3.4% for this year and next (consensus 6.5% and 3.0%). This will exacerbate the real income squeeze, which now looks set to be the worst since the 1970s. As such, we lower our growth forecasts to 3.8% for 2022 and 0.7% for 2023 (consensus 4.0% and 1.8%).

Elevated wholesale gas prices will boost utility prices further



Source: OFGEM, Bloomberg, AXA IM Research, March 2022

UK households face worst income squeeze since 2011



Source: ONS, BoE MPM Feb 22, OBR EFO Mar 22, AXA IM Research, March 2022

Monetary policy to cushion outlook

UK

Fiscal policy falls short on support

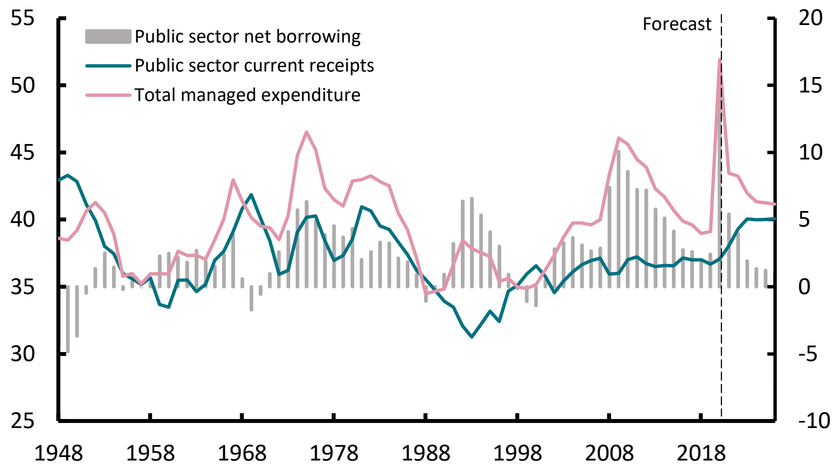
- The Spring Statement added £3bn in direct measures and £6bn/annum indirectly to alleviate the cost-of-living crisis. Adding to the previous £4bn package. This is small by comparison to the estimated £25bn rise in household utility bill increases alone. A pre-announced 1p cut in income tax before the next election is little consolation now. The finances are on track to meet the fiscal rules by a wider margin, providing scope for more relief in the Autumn Budget – but forecast risks could erode this margin quickly.

Monetary policy to take up the slack

- The MPC raised rates by 0.25% in February with 4 members voting for a 0.50% hike. In March it hiked again to 0.75%, but this time guided that "modest further tightening might be appropriate", contrasting with February's was "likely". February's projections had envisaged growth slowing below trend and unemployment rising to 5% by end-2024. This outlook will be worse after the invasion. If the BoE is confident that inflation expectations are well anchored, we see it raising rates to just 1.25% this summer and curring to 1.00% in 2023.

Official forecasts see deficit narrowing further in coming years

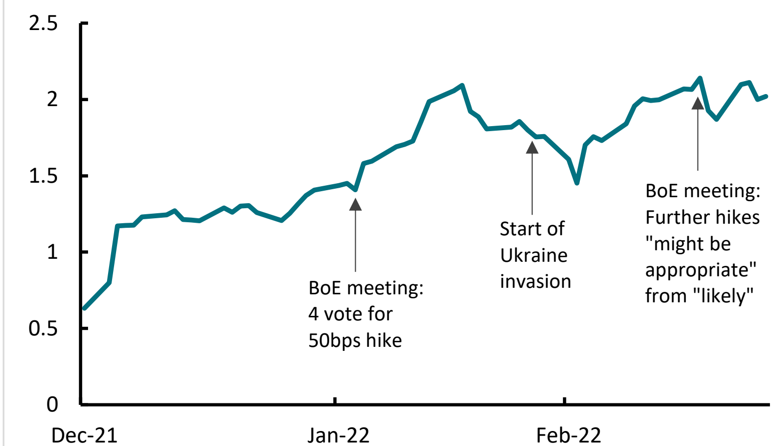
The public finances



Source: OBR, AXA IM Research, March 2022

Markets still price 2% bank Rate by year-end

Expected Bank Rate level Dec 2022



Source: Bloomberg, AXA IM Research, Mar 2022

Strong data likely overstates economic strength

China

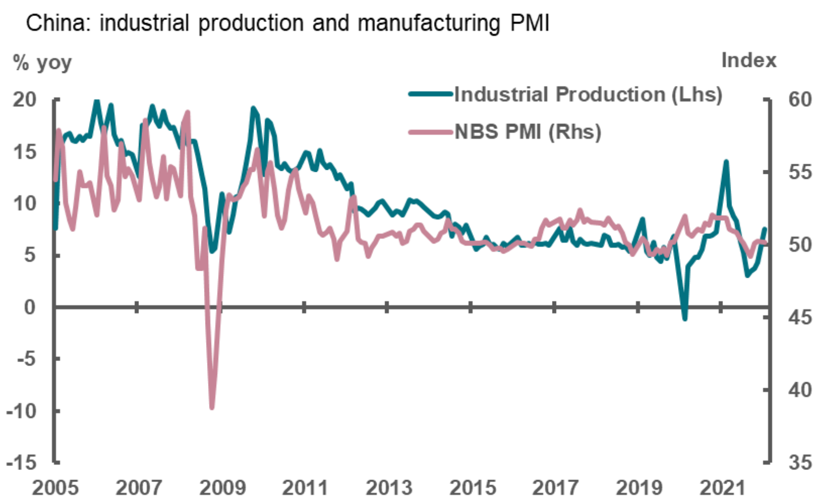
Data inconsistency suggests caution in data interpretation

- The strong January-February activity data came as a surprise. The sharp and broad-based growth rebound appears to be at odds with earlier indications of the economy losing steam at the start of the year. With potential distortions from the lunar new year, we advise caution in reading too much into the official prints. Had the economy really got off to an impeccable start to 2022, there would have been no need for the government to roll out an aggressive stimulus plans to *stabilize* the economy

Rising concerns over a vicious return of COVID-19

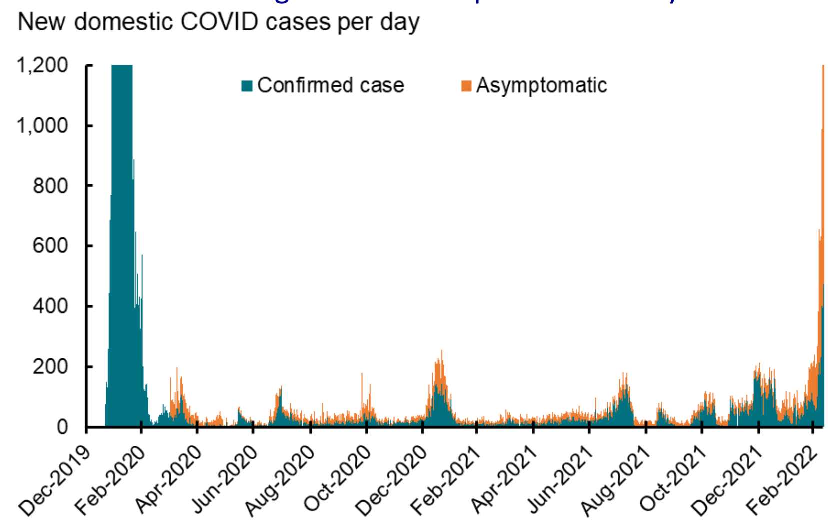
- Markets attention has shifted to worrying about China's near-term outlook in light of a vicious COVID-19 flareup. With case numbers skyrocketing across provinces, China is now battling against the severest COVID outbreak since the onset of the pandemic. Tightened containment measures have put major cities, like Shenzhen and Shanghai, under semi-lockdowns. The shock to consumption, services activity, the labor market and supply chains, will weigh on Q1 growth

Industrial output recovers despite soft PMI



Source: CEIC, AXA IM Research, Mar 22

COVID-19 cases rising at the fastest pace since early 2020



Source: CEIC, AXA IM Research, Mar 22

Urgent policy supports needed to stabilize growth and markets

China

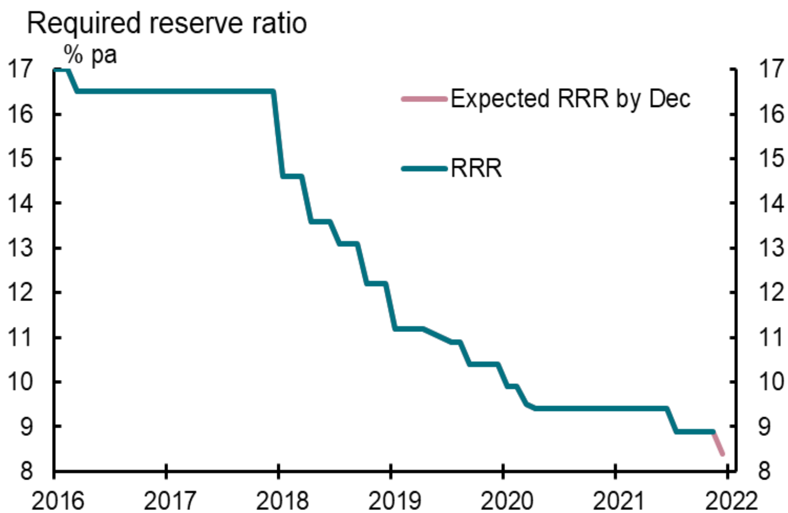
More policy supports underway

- The National People's Congress delivered a clear policy roadmap to stabilize growth at an ambitious rate of 'around 5.5%'. To achieve this, fiscal stimulus worth 2-3 percentage points of GDP will be deployed through increased infrastructure spending and tax/fee reductions. More monetary supports are also underway. We expect a RRR and/or interest rate cut in the coming weeks. This, along with targeted liquidity injections and window guidance, should lift credit growth

Other policies critical for restoring confidence

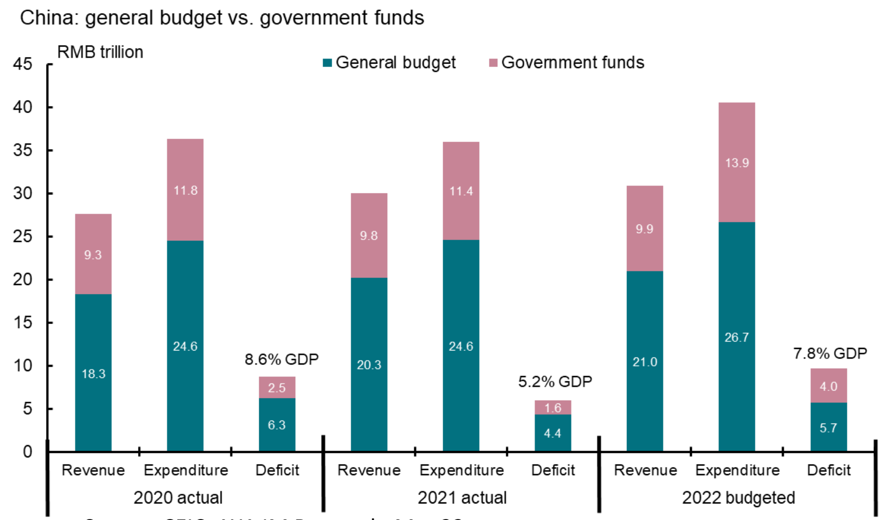
- The recent market declines reflect a lack of confidence in Beijing's policy operation. Apart from underwhelming support from counter-cyclical policies so far, tight property curbs and tech regulations have plagued investors. However, the latest statements from the powerful Financial Stability and Development Committee – pledging greater policy coordination to manage financial risks and stabilize the economy – appear reassuring. These need to be followed by concrete actions to ensure that the positive knee-jerk reaction in the market is sustained

Further RRR cut on the card



Source: CEIC, AXA IM Research, Mar 22

Bigger fiscal impulse to support growth



Source: CEIC, AXA IM Research, Mar 22

Russia/Ukraine war and its possible aftermath

Japan

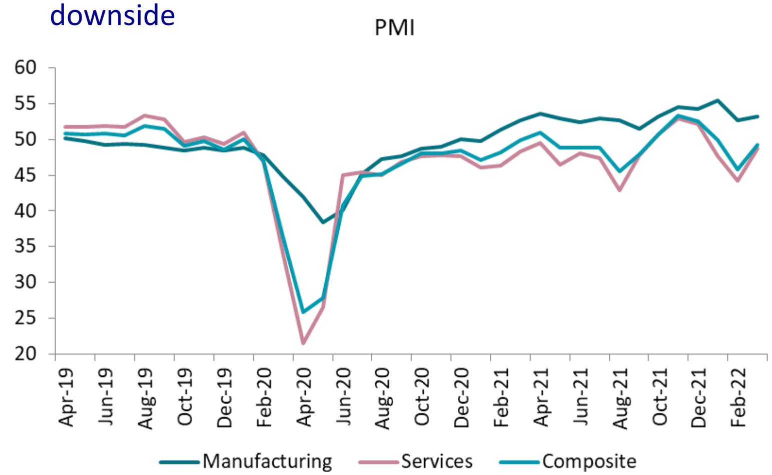
Limited direct exposure

- Japan's most exposed sector is energy imports. Although it is more diversified than Europe with no direct pipeline feeds and just 9% of its natural gas and 4% of oil come from Russia.

Higher global energy prices will weigh on purchasing power

- Current CPI figures remain distorted to the downside by technical factors, including mobile phone charges, but in April CPI inflation is expected to reach at least 2%. Assuming energy prices and the yen stay at current levels, inflation could rise again during the summer. We forecast 2% inflation in 2022 and 1% in 2023. This is not apparent in wage pressures yet, as shown by preliminary data on Spring wage negotiations, which pointed to a small increase in nominal base pay of 2.1% from 1.8% last year.
- Those developments weigh a little on our outlook for private consumption. Excess savings could help, but historical experiences have pointed the other way: in uncertain times, households tend to save more.
- As a result, we have lowered our GDP outlook to 2.5% in 2022 (from 3%); it is broadly unchanged for 2023 at 1.8%.

Unscathed March flash PMI but risks remain on the downside



Source: IHS Markit and AXA IM Macro Research, March 2022

A new scenario with higher energy prices

Scenario (2022 / 2023)	Previous	Current
GDP	3% / 2.2%	2.5% / 1.8%
CPI	1.2% / 0.7%	2% / 1%

Source: AXA IM Macro Research, March 2022

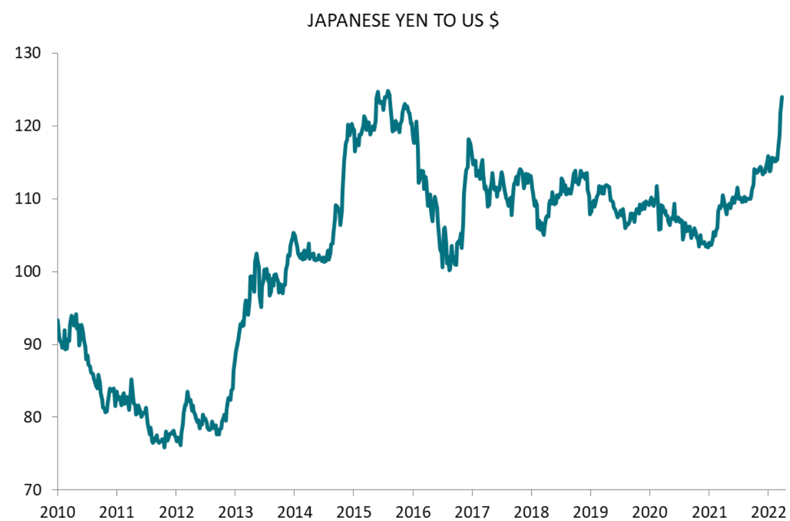
The Bank of Japan is pushed to the limit

Japan

Yield curve control challenged by rising rates

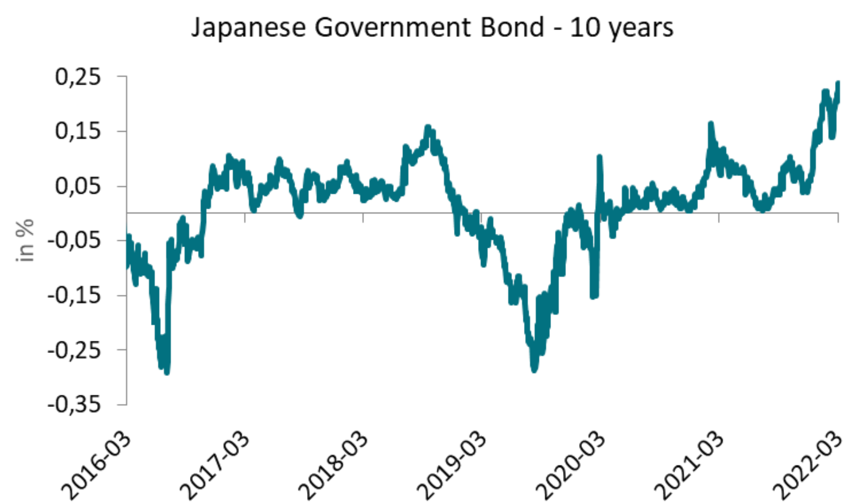
- At its latest monetary policy meeting the Bank of Japan (BoJ)'s rhetoric was more 'dovish' than expected. Governor Haruhiko Kuroda rejected any premature tightening, arguing that inflation was still chiefly driven by energy prices and did not reflect any improvement in economic fundamentals.
- Having said that, the pressure is growing on the BoJ. Inflation is likely to be above its 2% target in April and the 10y JGB is repeatedly closer to it yield curve control (YCC) upper limit.
- We continue to believe that a rate hike is premature, but we can no longer exclude shortening of the YCC or widening of the 10y range. The first option would seems more likely to counter further depreciation.

USD-JPY at record level, betting on looser BoJ



Source: Datastream, AXA IM Macro Research, as of March 28 2022

Energy component remains the more important contribution



Source: Datastream, AXA IM Macro Research, as of Mar 25 2022

Ukraine to impact, but less than elsewhere

Canada

Ukraine impact less than for peers

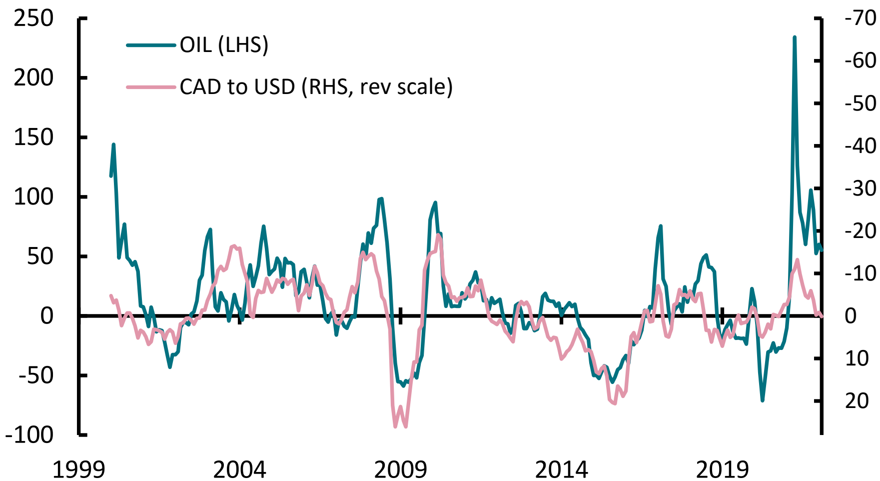
- The nature of the Canadian economy should mean that the impact of the Ukraine war is less negative for Canada than for other developed economies. This reflects Canada exporting similar products to Russia, including oil, gas, wheat, fertilizers and metals. Oil investment has been less responsive to oil price increases than in the past. However, corporate profits and tax revenues should rise, while the current account should be boosted and the currency supported.

Strong end to 2021, but Ukraine developments to weigh

- Despite the omicron impact flattening growth in December, Q4 rose by 6.7% annualised and 2021 rose by 4.6% as a whole. The impact of Ukraine should be negative overall – though not as much as elsewhere – and we edge our GDP forecasts modestly lower to 3.3% and 2.6% (from 3.5% and 2.8%). This is less than consensus forecasts of 3.8% and 3.0%. This is also below the central bank forecasts and we think will ultimately lead to somewhat less tightening.

Oil no longer as supportive for Canada

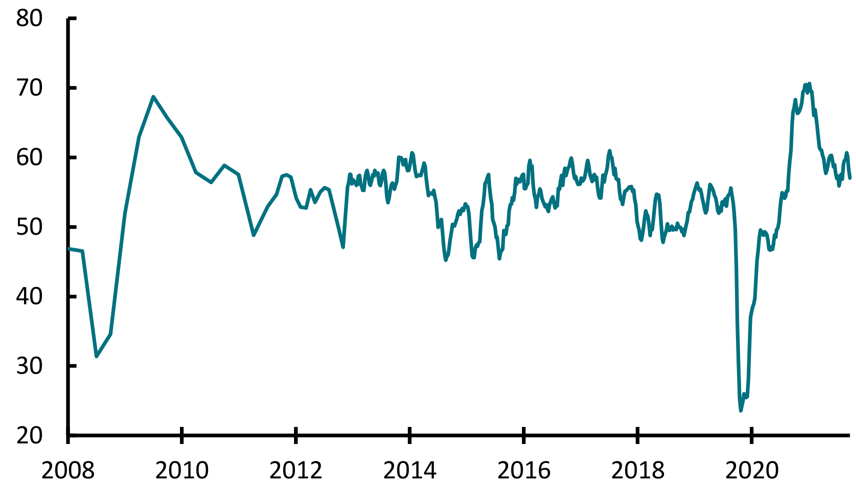
Oil & CAD USD



Source: New York Mercantile Exchange, Refinitiv, AXA IM Research,March 2022

Consumer confidence stats to weaken

National Consumer Expectations Index (NANOS)



Source: Bloomberg, AXA IM Research, March 2022

BoC balances hikes and balance sheet

Canada

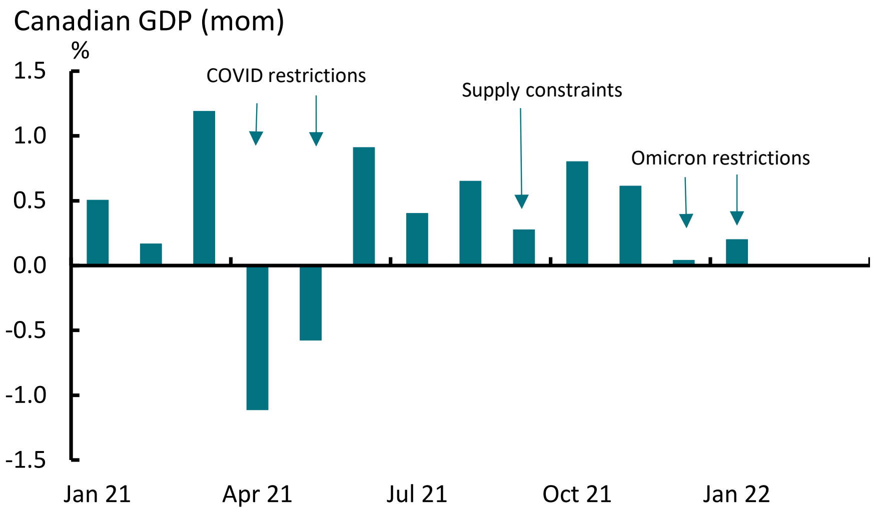
Ukraine forces inflation higher for longer

- Inflation reached 5.7% in February and was relatively broadly based with two-thirds of prices rising in excess of 3%. The impact of the Ukraine war is likely to see inflation peak at a higher rate – now likely over 6% in the coming months – and to recede more slowly than we had previously forecast.

Inflation sees BoC move quicker, weaker growth sees it move less

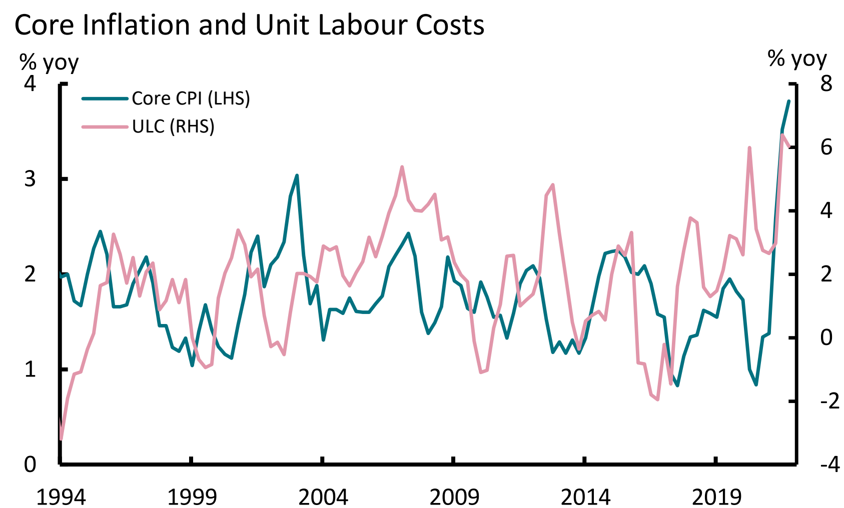
- The BoC raised its policy rate by 25bps to 0.50%, the first hike since 2018. It may soon adjust its balance sheet – plausibly from April. Governor Macklem suggested a “full roll-off” of securities, twice as fast as the Fed’s in 2017-18 by end-2023 and seeing half of assets mature by end-2024. This aggressive unwind should dissuade the BoC of a 0.50% hike in April, although this was not ruled out for the future. We lift our BOC rate to 1.75% for 2022 and 2.25% for next – still shy of market expectations for 2.25% and 2.75%.

Q4 GDP solid before Omicron



Source: CANISM, AXA IM Research, March 2022

Inflation pressures require tighter policy



Source: CANISM, AXA IM Research, March 2022

Inflation and rates higher… still

Emerging Markets

Inflation still pointing higher

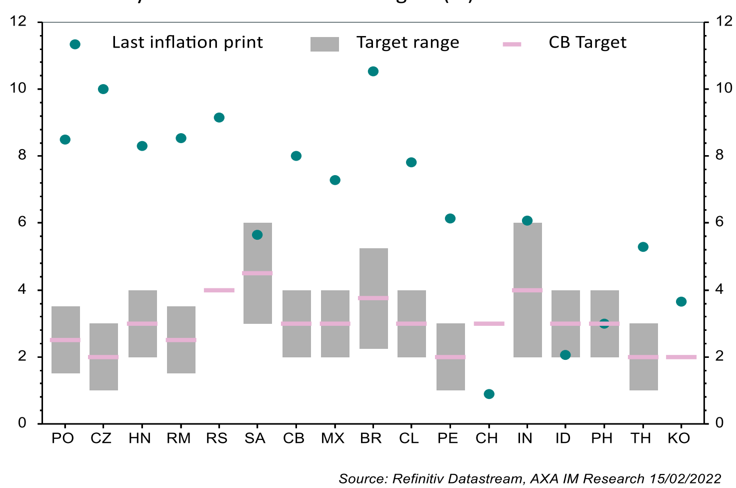
- Inflation rates remain - and will do so for some time - above central banks' targets. The tentative signs of abatement in Brazil and Mexico, where inflation stood for some months around 10% in Brazil/7.25% in Mexico and where central banks were quicker to adjust policy rates, slowing economic growth markedly, may not hold for long given the recent renewed pick up in energy and food prices. Central Europe sees now inflation closer to double-digit territory as the war in Ukraine significantly altered the CEE outlook. Asia remains relatively insulated so far, but not completely.

Hawkish bias remains

- Monetary policy remains still oriented towards a tighter stance. With the exception of Brazil, where the policy tightening is quite mature and where we expect an additional 100bp hike before a pause that may mark the peak in policy rate, hawkishness reigns. Renewed de-anchoring of inflation expectations will push rates higher in Chile, Colombia and Mexico, also very sensitive to the more hawkish FOMC. Even in Asia, where only Singapore, Korea and Taiwan tightened so far, and central banks are typically inclined not to respond to supply-side cost push inflation, there has been an increasing signaling that the lift-off is seen approaching.

Inflation rates higher (and mostly above CB targets)

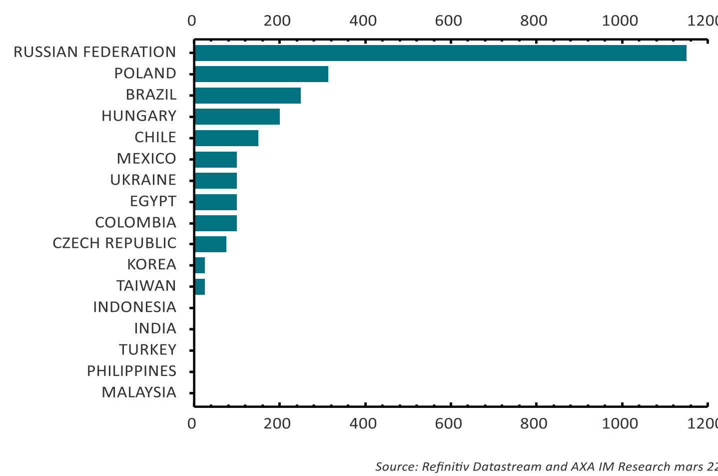
EM ex Turkey inflation rates and CB targets (%)



Source: Datastream, AXA IM Research, March 2022

Policy rates higher

Policy rates (change year-to-date, bps)



Source: Datastream, AXA IM Research, March 2022

Investment Managers

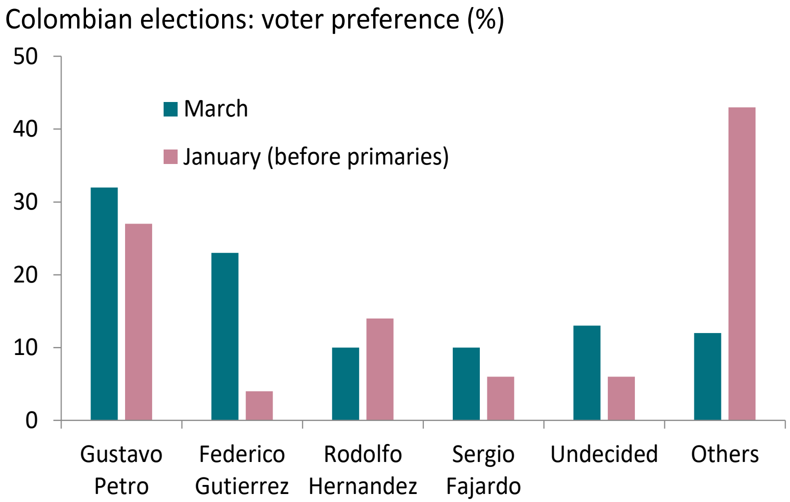
Keeping an eye on local politics and elections

Emerging Markets

Politics back into the spotlight

- In Latin America, Colombia held congressional and presidential primaries. The left Pacto Histórico elected populist Petro by a wide margin of over 80% with a strong participation rate. However, the Congress will remain divided, Pacto Histórico only secured 15% of Senate seats, constraining a radical policy shift from the traditionally market-friendly framework. Political noise is up again in Peru where Congress approved an impeachment trial against President Castillo over allegations of corruption. This is the second attempt to impeach Castillo since he took office in July 2021. Peru has had five Presidents since 2016, including Castillo.
- In Asia, South Korea's presidential election saw conservative Yoon Suk-yeol winning suggesting the people's desire for a change although policymaking may be more constrained for Yoon as the democratic party has a strong majority in the parliament. India state polls show BJP, the ruling party of PM Modi, won four out of five states, suggesting policy continuity and a smooth progression of planned reforms.
- In Central Europe, Hungarian PM Orban runs for a fourth term, facing a grand opposition coalition fo the first time. But but polls still point to Orban winning, which would probably leave Hungary challenging the EU and risking NGEU funds. Presidential, local and parliamentary elections will be held in Serbia where the governing party which has dominated the political scene for nearly a decade faces still a rather fragmented opposition, likely thus to keep a comfortable majority in the one-chamber 250-seat parliament.

Colombia: opinion polls ahead of Presidential elections



Source: Centro Nacional de Consultoria and AXA IM Research, March 2022

Hungary: the risk of remaining EU defiant

	GDP weight (%)	RFF (bn EUR)	MFF (bn EUR)	% GDP
Hungary	1.0%	7.2	34.4	28.5%
Czech	1.6%	7.1	29.6	16.3%
Poland	3.8%	23.9	106.2	24.4%
Romania	1.6%	14.3	51.3	29.4%
EU-27	100.0%	339.0	751	7.5%

Source: EU, AXA IM Research, 2019 nom.GDP current EUR, March 2022

AXA Investment Managers

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Investment Strategy

Multi-Asset Investment views

Our key messages and convictions

Moderately constructive on equites

#1
Corporate earnings to expand further ; economic activity to decelerate but remain above potential; Valuations improved

#2
Valuations have improved following recent spread widening albeit not attractive enough to warrant being overweight

Neutral on Investment Grade Credit

Neutral on Sovereign Bonds

#3
Central banks hiking cycle fully priced, limiting bond yield upside in the short term

#4
High Yield remains cheap versus default expectations. Following recent market dislocation, pricing at levels consistent with positive returns over short to medium term

Positive Short Duration High Yield

Source: AXA IM as at 30/03/22

AXA Investment Managers

FX Strategy

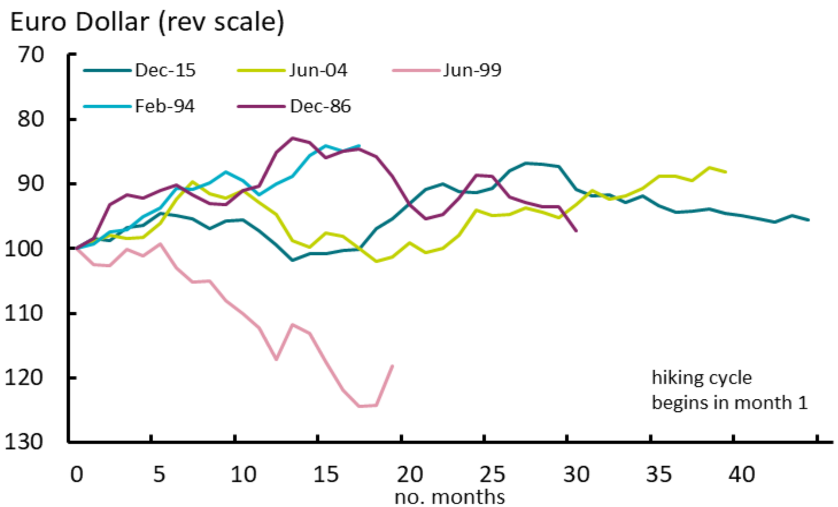
False start for the EURUSD post ECB meeting

- The Fed delivered its first rate hike in March as expected and this may signal that the USD may be near its peak, unless this time it is indeed different to previous cycles. The Ukraine conflict has brought more than just temporary risk-off support to the USD, as renewed pressures on energy prices are pushing Fed to accelerate policy normalization.

- The rise in Fed hike expectations has hindered JPY as the customary safe haven, with USDJPY surging above 120. Much further JPY depreciation looks unlikely, as Fed expectations are high and BoJ expectations are low. But JPY may remain under pressure as long as BoJ remains the dovish outlier amid central banks.

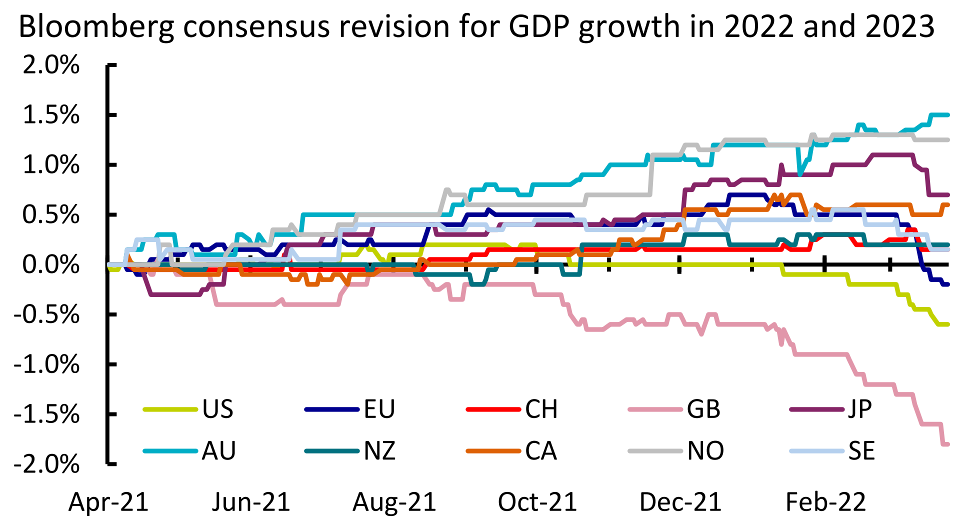
- Commodity currencies have overperformed USD. CAD and NOK should continue to rise as both currencies still look reasonably cheap. Their respective domestic tight labour market and inflation pressures were already supportive of further policy normalization by BoC and Norges Bank. Their boosted Oil & Gas exports is bringing additional support.

USD to peak now that Fed hikes have started?



Source: Bloomberg and AXA IM Research, March 2022

Ukraine conflict hits growth expectations, UK underperforms



Source: Bloomberg and AXA IM Research, March 2022

Rates Strategy

Bond returns have hurt year to date; UST curve causes recession concerns

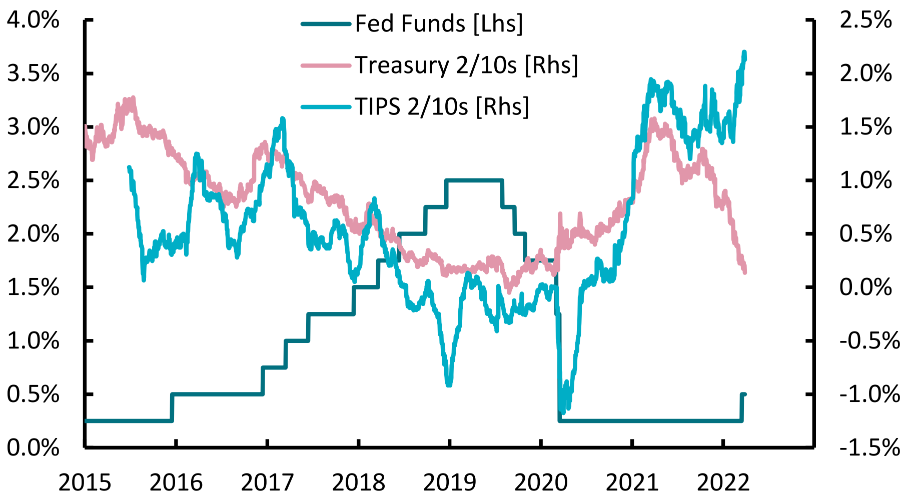
- Bonds have largely disappointed since the start of this year, leaving investors with uncomfortably negative returns. Duration has been in the driving seat. The outlook for bond returns has not improved substantially, at least not in the near term: High levels of inflation won't disappear overnight and might even risk becoming entrenched into expectations, thus begging for a firmer and more decisive central bank reaction.

- At the same time, market participants are increasingly focussing on the US yield curve's flattening as a signal of increased recession probability over the coming twelve months. But one should not overlook, however, factors that tend to bias the signals we extract from Treasury universe. For example, the fact that the TIPS curve has recently decoupled from the nominal curve and is trading in excess of 200bp between 2s and 10s.

- The cost of hedging USD rates risk is set to rise over the coming months. Indeed, the futures strips are indicating another 100bp increase in FX-hedging costs by the end of the year . Interestingly, FX-hedging costs are implied to drop substantially again in 2023, probably reflecting the belief that the Fed might be close to a neutral rate by then, while the ECB will be in the midst of its own tightening cycle.

Different signals from the Treasury market

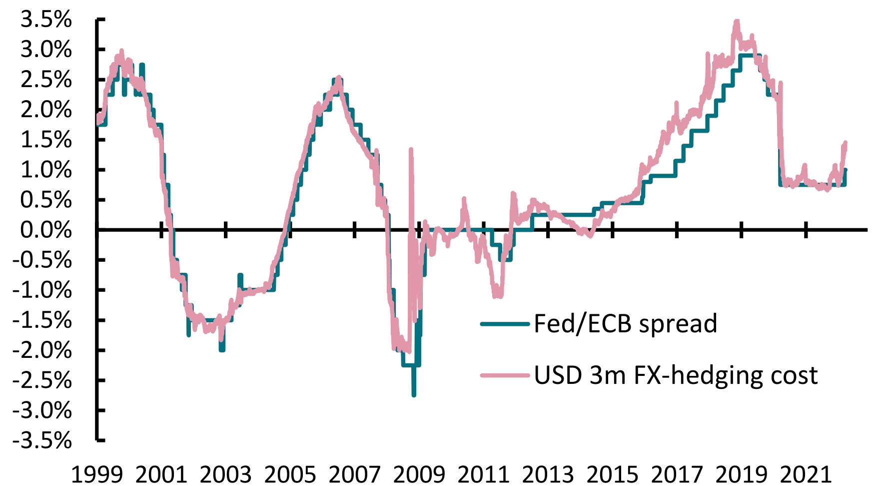
US Yield Curve and Monetary Policy



Source: Bloomberg and AXA IM Research, February 2022

Hedging USD rates risk is set to become more expensive

Monetary Policy and FX-Hedging Costs



Source: Bloomberg and AXA IM Research, February 2022

Credit Strategy

Valuations improve and implied excess returns ahead appear attractive

- Credit spreads widened further in March, driven by the latest market shock of Russia's invasion of Ukraine and the ever-ratcheting hawkish expectations for central banks' policy. The impact of the conflict across credit markets has been proportional to their proximity to the conflict, in geographic and economic terms. USD spreads have remained insulated, especially in HY where Energy is the largest sector.
- In addition to the widening in spreads, the epic rise in government bond yields year-to-date has pushed credit yields towards the top of their 5-year range. This makes for a material improvement in valuations. Excess return expectations based on spread mean reversion have increased materially. Over 12 months, EUR IG is expected to return over 2% and EUR HY over 5%.
- Using spreads as a 'nowcast' for GDP, we see the repricing in credit reflecting a steeper drop for the Eurozone. Average weekly spreads over Q1 imply 1.3% in Q2 GDP YoY for the Eurozone vs 2.8% for the US. This from a nowcast peak of 2.1% and 3.2% respectively at the end of 2021.

Spreads and more so yields have moved well off their lows

5yr Sigma score normalised (Spread)

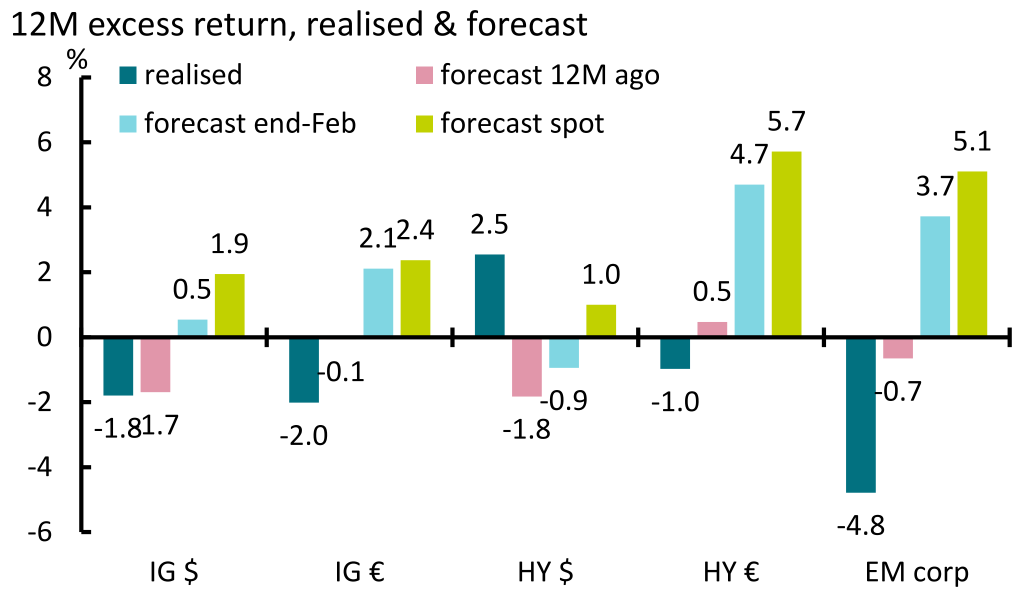
	Level					
	spot	min	1st quartile	median	3rd quartile	max
EUR IG	0.42	0	0.16	0.24	0.41	1
GBP IG	0.41	0	0.20	0.29	0.39	1
EUR HY	0.31	0	0.14	0.18	0.24	1
GBP HY	0.24	0	0.13	0.19	0.26	1
USD IG	0.22	0	0.10	0.14	0.24	1
USD HY	0.19	0	0.11	0.17	0.32	1

5yr Sigma score normalised (Yield)

	Level					
	spot	min	1st quartile	median	3rd quartile	max
EUR IG	0.90	0	0.25	0.32	0.52	1
GBP IG	0.72	0	0.19	0.26	0.33	1
USD IG	0.48	0	0.21	0.29	0.46	1
EUR HY	0.41	0	0.13	0.18	0.24	1
GBP HY	0.37	0	0.16	0.22	0.28	1
USD HY	0.31	0	0.18	0.22	0.32	1

Source: ICE, and AXA IM Research, Mar 2022

Mean reversion-implied excess return ahead appear attractive



Source: ICE, and AXA IM Research, Feb 2022

Investment Managers

Equity Strategy

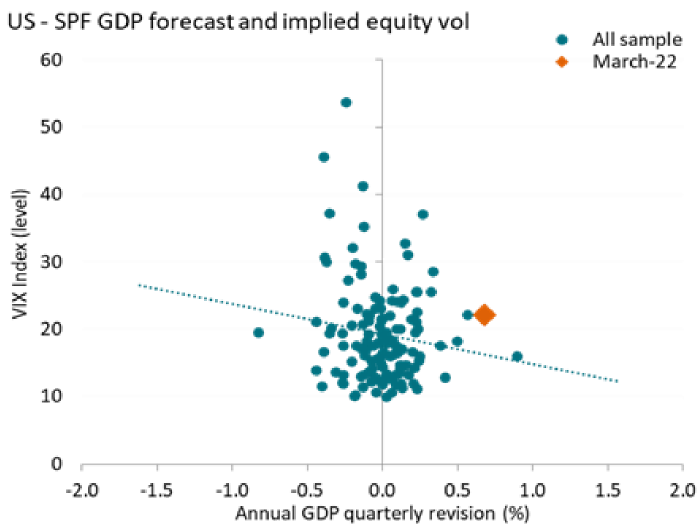
Playing with a bad hand

- Equity markets have seen a relief after a tortuous start to the year. Over the last month, the global stock market rebounded by +2.9%. Across sectors, healthcare (+6.5%) and energy (+5.8%) outperformed, reflecting a market sentiment shift toward stagflation risk – hedging low growth with defensive stocks and inflation with commodity beta assets.

- At a level of 22, the VIX implies a 0.6% decline in annual GDP growth in 2022 in the US. Adjusting the consensus of +3.6% for in real US GDP, takes us to +3% year-on-year growth, in line with our forecast (+2.8%).

- The prospects for economic growth in the developed world are not good, suggesting a downside risk to earnings growth forecasts, which remain elevated. Our study suggests that the Quality factor seems to offer the best excess return on average (+0.46%) when earnings growth expectations are revised lower.

Market risk is consistent with our lower than consensus growth forecast



Source: CBOE, SPF and AXA IM Research, March 2022

Navigating negative earnings revisions via the Quality factor

	Value	Growth	Low Vol	Quality	Size	Momentum	Yield
FY1-1m	-0.30%	0.30%	-0.10%	0.52%	0.08%	-0.05%	-0.16%
FY1-3m	-0.21%	0.25%	-0.16%	0.48%	0.03%	-0.03%	-0.04%
FY1-6m	-0.29%	0.31%	-0.17%	0.39%	0.01%	-0.02%	-0.21%
Average	-0.27%	0.29%	-0.14%	0.46%	0.04%	-0.03%	-0.13%

Source: IBES, MSCI and AXA IM Research, March 2022, Monthly excess return relative to MSCI World. 1 year forward fiscal period.

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Asset allocation stance

Positioning across and within asset classes

Asset Allocation

Key asset classes	Negative	Neutral	Positive
Equities			■
Bonds			■ ▲
Commodities		■	
Cash	■		

Equities

Developed	Negative	Neutral	Positive
Euro area	■ ▼		
UK		■	
Switzerland		■	
US			■ ▲
Japan		■	
Emerging & Equity Sectors			
Emerging Markets		■	
Europe Cyclical/Value		■	
Euro Financials		■	
European Autos		■ ▼	
US Financials		■	
US Russell 2000		■	

Fixed Income

Govies	Negative	Neutral	Positive
Euro core		■	
Euro peripheral		■	
UK		■	
US		■	
Inflation Break-even			
US		■	
Euro		■	
Credit			
Euro IG		■ ▲	
US IG		■	
Euro HY			■
US HY		■	
EM Debt			
EM Bonds HC		■	

Legend Negative | Neutral | Positive **Change** ▲ Upgrade | ▼ Downgrade

Source: AXA IM as at 30/03/22

Forecasts & Calendar

Macro forecast summary

Forecasts

Real GDP growth (%)	2020	2021*		2022*		2023*	
		AXA IM	*Consensus*	AXA IM	*Consensus*	AXA IM	*Consensus*
World	-3.1	5.2		3.1		2.8	
Advanced economies	-5.0	3.4		2.0		1.2	
US	-3.4	5.5	5.6	2.8	3.7	1.6	2.5
EMU-4	-7.4	5.0		2.1		1.2	
Germany	-4.9	2.8	2.7	1.2	3.5	1.7	2.7
France	-8.0	7.0	6.6	2.7	3.8	1.0	2.1
Italy	-9.0	6.5	6.3	2.3	4.1	0.6	2.3
Spain	-10.8	5.0	4.7	3.5	5.7	1.6	3.6
Japan	-4.9	1.7	1.8	2.5	2.8	1.8	1.8
UK	-10.0	7.2	7.0	3.8	4.3	0.7	2.0
Switzerland	-2.5	3.5	3.5	2.0	2.9	1.3	1.9
Canada	-5.2	4.4	4.6	3.3	3.9	2.5	3.1
Emerging economies	-1.9	6.3		3.8		3.8	
Asia	-0.8	6.8		5.1		5.0	
China	2.3	7.9	8.0	5.0	5.0	5.0	5.2
South Korea	-0.9	4.0	4.0	2.0	3.0	2.0	2.6
Rest of EM Asia	-4.6	5.8		5.6		5.3	
LatAm	-7.0	7.0		2.5		2.5	
Brazil	-3.9	4.8	4.7	0.9	0.5	1.9	1.9
Mexico	-8.5	4.8	5.6	2.4	2.3	2.2	2.3
EM Europe	-2.0	6.6		-0.3		0.9	
Russia	-2.7	4.7		-7.0		-3.0	
Poland	-2.5	5.8	5.3	4.2	4.7	3.3	3.8
Turkey	1.8	11.5	9.9	3.9	2.9	3.4	3.2
Other EMs	-2.1	4.2		3.0		3.0	

Source: Datastream, IMF and AXA IM Macro Research – As of 29 March 2022

* Forecast

Expectations on inflation and central banks

Forecasts

Inflation Forecasts

CPI Inflation (%)	2020	2021*		2022*		2023*	
		AXA IM	*Consensus*	AXA IM	*Consensus*	AXA IM	*Consensus*
Advanced economies	**0,7**	**3,2**		**5,4**		**2,9**	
US	**1,2**	**4,7**	4,6	**6,8**	5,2	**3,8**	2,6
Eurozone	**0,3**	**2,6**	2,5	**5,3**	3,9	**2,5**	1,7
Japan	**0,0**	**-0,2**	-0,2	**2,0**	1,0	**1,0**	0,7
UK	**0,9**	**2,6**	2,5	**6,8**	5,4	**3,4**	2,7
Switzerland	**-0,7**	**0,5**	0,5	**2,0**	1,0	**1,0**	0,6
Canada	**0,7**	**3,4**	3,4	**4,2**	3,7	**2,8**	2,3

Source: Datastream, IMF and AXA IM Macro Research – As of 29 March 2022 * Forecast

Central banks' policy: meeting dates and expected changes

Central bank policy

Meeting dates and expected changes (Rates in bp / QE in bn)

		Current	Q1-22	Q2-22	Q3-22	Q4-22
United States - Fed	Dates	0-0.25	25-26 Jan 15-16 Mar	3-4 May 14-15 June	26-27 July 20-21 Sep	1-2 Nov 13-14 Dec
	Rates		+0.25 (0.25-0.5)	+0.50 (0.75-1.00)	+0.50 (1.25-1.50)	+0.25 (1.50-1.75)
Euro area - ECB	Dates	-0.50	03 Feb 10 Mar	14 April 9 June	21 July 8 Sep	27 Oct 15 Dec
	Rates		unch (-0.50)	unch (-0.50)	unch (-0.50)	+0.25 (-0.25)
Japan - BoJ	Dates	-0.10	17-18 Jan 17-18 Mar	27-28 April 16-17 June	20-21 July 21-22 Sep	27-28 Oct 19-20 Dec
	Rates		unch (-0.10)	unch (-0.10)	unch (-0.10)	unch (-0.10)
UK - BoE	Dates	0.75	3 Feb 17 Mar	5 May 16 June	4 Aug 15 Sep	3 Nov 15 Dec
	Rates		+0.5(0.75)	+0.5 (1.25)	unch (1.25)	unch (1.25)

Source: AXA IM Macro Research - As of 29 March 2022

Calendar of 2022 events

2022	Date	Event	Comments
	Q3-Q4 2022	Chilean Constitutional Referendum	
April	6 April	UK National Insurance contributions increase 1.25ppt	
	6 April	UK Dividend Tax increase by 1.25ppt	
	6 April	UK Super-deductibility for UK investment begins	
	6 April	US FOMC minutes	Details of QT expected
	10 & 24 April	French Presidential Elections	
May	May	Philippines Elections	
	4 May	US FOMC announcement	Announcement of QT expected
	5 May	Monetary Policy Report & MPC Summary and minutes	
	5 May	UK Elections in Scotland, Wales, and Northern Ireland and UK Local Elections in England	
	29 May	Colombian Presidential Elections (first round)	
June	12 & 19 June	French Legislative Elections	
	15 June	FOMC meeting	
	16 June	MPC Summary and minutes	
	19 June	Colombian Presidential Elections (second round)	
July	1 July	UK border checks on EU imports scheduled to resume	
	25 July	Japan Upper House election	
	27 July	FOMC meeting	
August	August	US Federal Reserve Jackson Hole Symposium	
	4 August	Monetary Policy Report & MPC Summary and minutes	
September	15 September	MPC Summary and minutes	
	21 September	FOMC meeting	
October	October	China's 20th National Congress- President Xi to be re-elected (expected)	
	2 October	Brazil General Elections	
	30 October	Brazil Presidential Elections (second round)	
November	2 November	FOMC meeting	
	3 November	Monetary Policy Report & MPC Summary and minutes	
	8 November	US Midterm Elections	
December	14 December	FOMC meeting	
	15 December	MPC Summary and minutes	

AXA Investment Managers

Latest publications

China's property sector: This time is different

9 March 2022

Russia Ukraine: Frozen conflict heats up

25 February 2022

February Global Macro Monthly - Frozen Conflict

23 February 2022

Omicron update: Boon or Bust?

1 February 2022

January Global Macro Monthly - Omicron to a Russian Rubicon

26 January 2022

2022 emerging market elections: The who's who and the so what…

19 January 2022

December Global Macro Monthly - Omicron- the ghost of Christmas past?

17 December 2021

2022-2023 Macroeconomic Outlook: Pandemic effects to recede, policy starts to tighten

1 December 2021

Tapering, profit and equity prices

15 November 2021

China: Riding the green wave

3 November 2021