Richelieu Harmonies ESG

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Recent real activity indicators show economies holding up well despite high inflation, refinancing rates and the recent energy crisis. Labor markets are showing strength with employment levels well above pre-Covid levels. The rebound in equity markets also sends a signal of improving macroeconomic expectations (China reopening, employment, consumption) and microeconomic expectations at the corporate level (rather reassuring results and outlook). The tightening of monetary policies already in place will start to slow down activity. Central banks have already significantly tightened their monetary policy either by raising key rates or by reducing their balance sheets. Recent inflation data releases have reminded investors that the fight is far from over. Central banks, as a whole, will have to continue to "scare" the market to avoid any attempt to improve credit conditions that would be inflationary. Dynamic labor markets encourage wage growth, which spreads price pressures. **Central banks will finalize their rate hike cycle in the first part of the year before pausing to assess the effects of their policies.** While headline inflation will continue to fall in 2023, core inflation pressures will persist and encourage central banks to remain vigilant and aggressive in their rhetoric. However, they would not cut rates in 2023 or well into 2024. Even if we accept that policy rates are near their peak, it is unlikely that the central bank will want to take risks with inflation, especially if labor markets remain buoyant.

We continue to favor a soft landing scenario. We remain confident that the economies will be able to avoid a recession. Indeed, the strength of the labor markets and the fall in inflation will be real supports for households. Covid savings are still available to cushion a shock and have not yet delivered their consumption capacity in China. Maintaining tight monetary conditions should limit overly vigorous growth that would be harmful to financial markets. The rate hikes that have already taken place have halted activity in most real estate markets and are weighing on corporate financing capacity. In terms of equity allocation, given the latest figures published, the coming weeks are likely to crystallize fears about the attitude of central banks to a surprisingly resilient job market. Eurozone and US PMIs continue to rebound in February to hit 4-month highs thanks to lower energy prices in Europe and improved consumer purchasing power due to easing inflation. The rise in PMI's adds fuel to the fire ignited by strong US employment numbers and retail sales. These statistics imply persistently higher interest rates. Monetary tightening affects growth with about a 10-month lag. With the FED having started its rate hike cycle 11 months ago, the effects will start to be felt in the economy (tightening credit conditions, deteriorating credit flows, slowing money supply growth).

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While we are confident that the monetary effects will have the expected impact for the year, we should have a correction phase to build on. Investor sentiment has returned to a zone of optimism (as shown by the Bull-Bear indicator) marking a zone of volatility in the face of uncertainty.

We are once again maintaining our overexposure to the European equity market, which continues to benefit from valuation differentials and favorable macroeconomic factors. The proven easing of the energy crisis and the resilience of the European economies lead us to favor this market as it appears particularly attractive in terms of valuation; moreover, its sectoral composition (more value, more dividends) is less sensitive to higher rates. The small and mid cap segment could benefit from this craze in the coming months, helped by a catch-up effect and historically very low valuations compared to large caps. The reopening of China remains favorable to the local market as well as to those of its trading partners. The persistent tensions between China and the US could create favorable entry points in the coming weeks. As for Japan, we are downgrading our view to focus on emerging Asia. The change of governor at the BoJ (Bank of Japan) creates a lot of uncertainty. The accommodative policy will be difficult to maintain given the impact on the currency. The next measures will have to be from a perspective of supporting the yen. Wages are still struggling for the moment. This is the main reason for the deteriorating market outlook. Japanese companies, many of which depend on exports, are particularly benefiting from an improving situation in China, which will pick up in the second half of the year. We remain underweight the U.S. segments as the U.S. central bank could show it can go much further and make investors fear stronger action at its next meeting. Growth stocks, which have largely outperformed since the beginning of the year, could suffer from the pressure on valuations. The flows of the last three years have been concentrated in this region and should continue to undergo some arbitrages in the months to come. Some themes seem interesting to us: dividend growth, relocation and digitalization.

In the short term, we are also downgrading bond investments to neutral in order to reposition ourselves more strongly once the housing and services sector has marked a decline in terms of inflation (particularly on the sovereign parts but also corporate credit on the long parts). Interest rate markets are starting to integrate a re-acceleration of the economy and could lead the FED and the ECB to act more against inflation. Spread declines should moderate or even reverse in the short term. The riskiest segments should suffer in these conditions. We remain positioned in the BBB-/BB segment, which we believe is the most resilient (with a preference for the Euro segment). The number of bankruptcies is increasing significantly in the United States. **This phenomenon is largely linked to the deterioration of credit conditions for the most vulnerable companies in terms of their balance sheets.**

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The context of higher interest rates encourages us to maintain our exposure to the debt of highly rated companies. In the short term, doubts about inflation and the attitude of central banks wanting to maintain their credibility at all costs in defending price stability have led us to temporarily increase the levels of cash in portfolios. Credit spreads have narrowed far too quickly for our taste and without any real discernment. Selectivity will be the order of the day. As far as the **euro/dollar exchange rate** is concerned, the rate differential anticipated by the markets and concerns about the European economic outlook in 2022 had largely contributed to the fall of the euro, before fading and allowing the single currency to rise. These two factors had been well integrated into prices until now, but the persistence of US inflation, a higher than expected FED terminal rate and above all the resurgence of geopolitical tensions between China and the US have allowed the dollar to regain strength. We believe that the FED remains ahead of the cycle and that the euro should continue to strengthen in 2023, starting with the next ECB monetary policy meetings.

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