2022

OUTLOOK

by SILEX

JANUARY 2022

EDITO_

“When looking at market performance in retrospect, 2021 may look like it was a smooth ride. In fact, it proved another challenging year, with continued uncertainty about the pandemic and its implications. A new world is starting to emerge, with digital trends, the green transition, and a return of inflation as driving forces.

In 2021, we had opportunities to get a better grasp of client needs. For sure, they want performance and we have worked hard to help them deliver it. But increasingly, they want sleep-well portfolios and insurance that erratic markets will not bring them bad surprises. Quantitative tools can help with that. Also, clients want real-time, on-demand access to their investments. Our digital portal my_SPARK aims at addressing these needs; many more features will be added in 2022.

Last April, SILEX Investment Managers Suisse (SA) received its Finma license in Switzerland, as a complement to our agreements in France. We also further strengthened our team, with the arrival, among others, of Emeline Ozhan, Eric Bozzetto, Gerald Sinnasse and Chris Ptak. We now have both the expertise and the regulatory setup for the next stage of our growth trajectory. Onwards!

Today, I am delighted to present the new annual Outlook from SILEX. Our portfolio management team shares their convictions and recommendations for 2022. We hope you will enjoy it and look forward to getting the conversation going!

Happy New Year to all,

Xavier Laborde, CEO

ALLOCATION

ASSET ALLOCATION VIEW_

Maxime Alimi*
Head of
Macro & Allocation

*Maxime has been employed by SILEX IP since 2019 as Head of Macro & Allocation. He is in charge of research and macro analysis. He began his career as an economist at Lehman Brothers then as a multi-asset strategist at Goldman Sachs. Maxime then worked at AXA Investment Managers as Head of Investment Strategy.

. best idea

Don’t be afraid of heights

Three years of extraordinary performance have ignited the debate about equity market valuations and the imminence of a correction into 2022. Simply looking at market levels to infer about valuations is too much of a shortcut in our view. First, valuation multiples have fallen in 2021, even though they remain high from a historical perspective. Second, the equity risk premium, a measure of relative expensiveness of equities to bonds, remains benign. In other words, equities can stay very expensive as long as bonds are extremely expensive. Will a sharp rise in interest rates crush equity valuations in 2022? This can happen to some extent, but probably not enough to offset earnings growth. As a result, staying invested in equities this year looks like the right thing to do, as hiding on the side-line may prove costly once again.

. key risk

Chinese transition

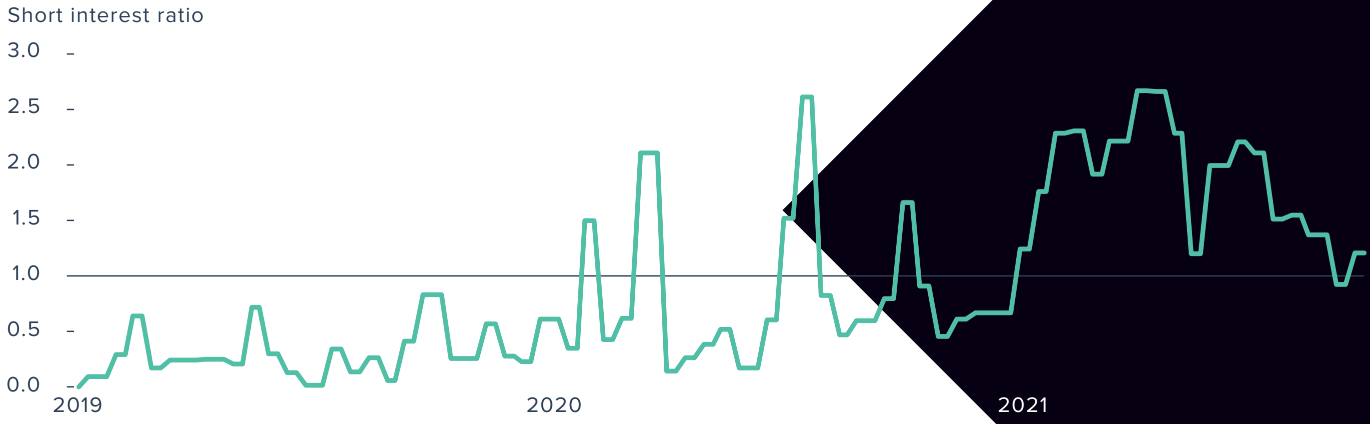
China is going through an unusual period of uncertainty. Last year, a self-imposed crackdown on tech crushed large parts of the equity market. The government made clear that political objectives (‘common prosperity’ and ‘strategic autonomy’) dominate financial performance. At the same time, the collapse of Evergrande initiated the broader restructuring of the real estate sector, a major growth engine over the past decade. In 2022, the impact of these two shocks will compound at a time when China is already engaged in a transition to structurally lower growth. Meanwhile, President Xi will be focussed on the Party’s 20th Congress that should see him re-elected for another term. Unusual economic risk is therefore meeting an unusual need for economic stability. Pressures for successful policy making will be maximal and reasons for policy mistakes abound.

. key chart

Can a good trend become a good trade again?

No investor has any doubt that the ESG transition will dramatically impact our industry. Changes in the economy will imply new winners and losers. Regulation will steer change, that should only be accelerated by consumers’ changing habits and public awareness. ESG investing policies will also reallocate massive capital flows to green assets. Still, in 2021, a good trend did not make for a good trade. Green assets underperformed amidst unrealistic expectations and heavy speculative positioning. The below chart, showing the short interest on a benchmark green energy ETF, suggests that imbalances have now largely been worked off. We have therefore turned pore positive on green assets in 2022.

Short interest ratio on the iShares Global Green Energy ETF



Source: Bloomberg, SILEX - December 2021

Emeline Ozhan
Thematic Equity
Strategy Manager

Emeline Ozhan joined SILEX in 2021 as a thematic equity manager. She holds a master's degree in Financial Markets from Paris Dauphine and a CFA certification. She started her career at Sycomore Asset Management as an equity analyst, before joining the Pictet Group. She then specialised in sustainability themes at Lombard Odier and contributed to the launch and management of impact strategies.

. best idea

Sustainability-driven capital goods

Driven by energy efficiency, US fiscal programmes and automation, we see sustainability megatrends continue fueling higher-than-usual organic growth for industrial names. We are particularly positive on Capital Goods. On the volume side, there is a significant restocking potential once Covid restrictions abate and supply bottlenecks ease. Large amounts of cash accumulated by capital-intensive companies and low inventory levels should drive volume growth and higher capex. As to pricing, many capital goods companies were able to pass through inputs cost increases in 2021, even though this may take place only partially or with a lag. This environment should allow for mid-single digit organic growth and margin improvements as soon as H1 2022. Overall, we see strong potential into 2022 for sustainability-driven capital goods names, with a preference for companies more exposed to Europe.

. key risk

Equity rotation

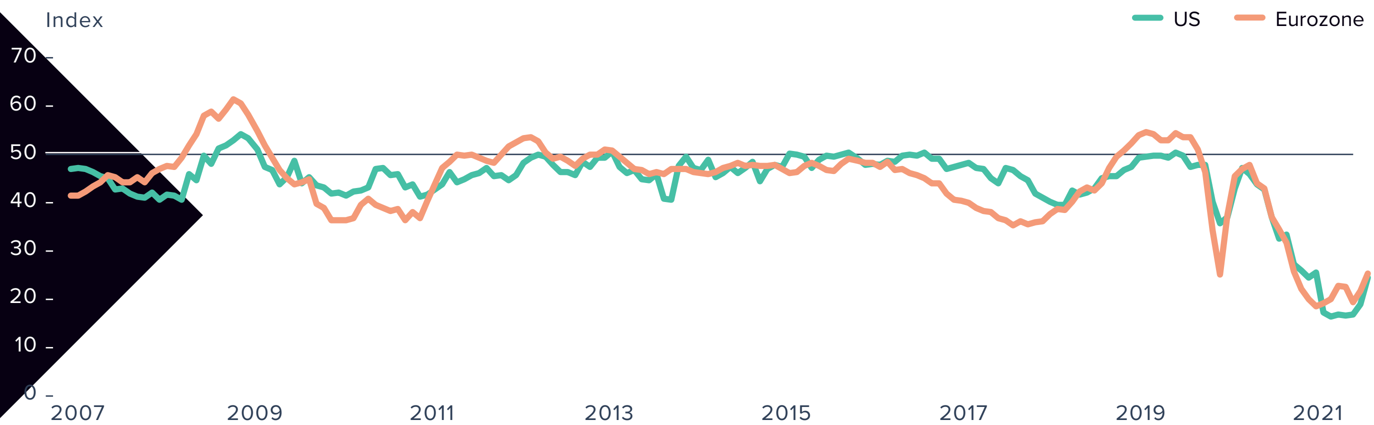
In the same vein as last year, the key risk in 2022 for active equity selection will be rotation. On the one hand, diverging monetary policies could be favorable to Europe while higher interest rates could benefit Value stocks. On the other hand, the reopening trade should continue benefitting cyclical companies capable of weathering inflation and protecting margins. In this environment, we do not expect any complacency: growth stocks not delivering could suffer more than the rest of the market. Overall, we expect the soft P/E multiple compression observed in 2021 to continue into 2022. But earnings growth should allow for upside on consensus projections.

. key chart

Supply chain tensions

Tensions on supply chains and input costs will remain a concern into 2022. The faster-than-expected post-Covid recovery created supply bottlenecks in 2021 and shipping cost and input price components of PMIs are at very elevated levels. Energy prices in Europe may stay higher for longer on the back of geopolitical tensions with Russia. At the same time, suppliers' delivery times are close to their worst ever level and shortages should still weigh on growth in 2022. In some segments of our thematic universe, like automation, supply chain tensions could act as a catalyst, spurred by electrification. We expect headline inflation to soften in H1 2022 on base effects and bottlenecks easing. Such inflexion would be a strong positive for component and equipment manufacturers which were the most impacted by the inflationary environment.

PMI suppliers' delivery times



Source: Bloomberg, SILEX - December 2021

FIXED INCOME VIEW_

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European government debt's spread decompression

In a similar vein to the Fed and Bank of England, the ECB's December meeting signalled a shift in reaction function, along with a humbler description of the inflation outlook. 2022 will see much lower volumes of bond purchases as the PEPP program ends in March while the announced APP volumes are more modest and less flexible. As such, we expect the net supply of European government debt (EGB) adjusted for ECB purchases to be positive for the first time since 2019. As an example, the ECB is expected to absorb around two thirds of BTPs' net supply in 2022 (vs. approximately 120% in 2021).

As a result, we expect technical pressure on EGBs' risk premium to increase in 2022 while valuations remain unattractive after years of heavy ECB bond buying. We think odds of peripheral and semi-core spread widening and volatility are high and spread decompression trades on peripheral or semi-core sovereigns exhibit an attractive risk/reward with limited downside and potential for sizeable gains. Finally, OATs are likely to exhibit excess volatility ahead of the French presidential elections. We expect attractive opportunities to surface in the segment throughout the year.

Philippe Kellerhals
Head of
Fixed Income

. key risk

Central banks back in the spotlight

A faster and harder tightening of monetary policy by the Fed is the risk factor most present in our minds as, in our opinion, odds are high that core inflation settles at a level uncomfortably higher than the Fed's objectives in a context of tight labour markets. This implies that we'll continue to manage duration risk cautiously and actively and that our risk appetite for EM risk will likely remain tentative at best in the first half of the year.

Turning to corporate credit, we expect developed markets' credit metrics to remain very solid and do not expect a default cycle to start in 2022. However, we expect dispersion to continue increasing and will pay particular attention to financial policy risk (LBO, M&A, dividend recaps) and margin risk from rising input costs, especially for industries or issuers with limited pricing power.

Gérald Sinnasse
Senior portfolio
manager

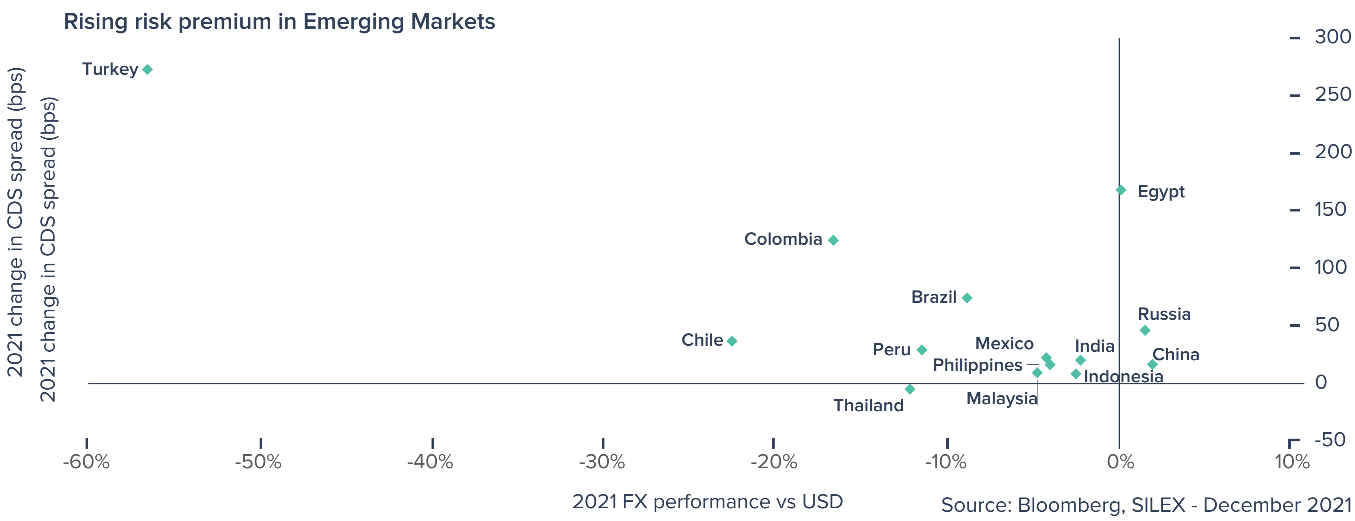
. key chart

Rising EM risk premium

Emerging markets have underperformed developed markets across asset classes in 2021. Global inflationary pressures, a stronger US dollar and a more hawkish Fed reaction function have been important drivers and, if anything, they are likely to remain in place in 2022. Local political risk has also resurfaced in various countries, including Turkey (monetary policy interference) and some Latin American countries (socialist victories in Chile and Peru). EM bonds and stocks are particularly exposed to a faster-than-expected Fed tightening in 2022. The Brazilian election should also be key to watch.

Chris Ptak
Senior research analyst
Fixed Income

Rising risk premium in Emerging Markets



Source: Bloomberg, SILEX - December 2021

> A faster and harder tightening by the Fed is our key risk factor

Philippe Kellerhals

CONVERTIBLES VIEW_

MTU 2027 convertible bond

. best idea

Our best idea for 2022 is to get exposure to the airline sector by investing in the German MTU 0.05% 2027 convertible bond. This convertible bond offers a positive yield of around 1% and is trading just 2 points above the bond floor. The stock is trading 40% below its pre-Covid level following disappointing 2021 performance. The consensus view on the stock is turning up, with 90% of analysts having a positive or neutral opinion. The company is strong with a market cap of €10bn, positive free cash flow generation, debt of only €1.4bn and EBITDA margins above 15%. In terms of valuation, the convertible bond is trading at a discount of around 2% to its fair value.

Equity market reversal

. key risk

In the current interest rate environment, most of the performance of directional convertible funds will once again come from equities. If these markets were to turn down, the impact on performance could be significant for convertible bonds. Nevertheless, the diversity and depth of the market (more than 500 billion euros in 2021), the nature of the security itself, and a primary market that we expect to be active with an expected volume of new issues of more than 140 billion euros, should act as buffers in the event of a downturn.

Eric Bozzetto
Senior portfolio Manager
Convertible bond

Eric joined SILEX in 2021 as a convertible fund manager. Starting at Société Générale in Paris in 1997, he went on to spend much of his career in London, being appointed co-head of European Convertibles at Lehman Brothers in 2007. After joining Nomura in 2008, he decided to join the asset management industry by moving to SPGP in Paris in 2012.

Heterogeneous performance of convertible bond funds in 2021

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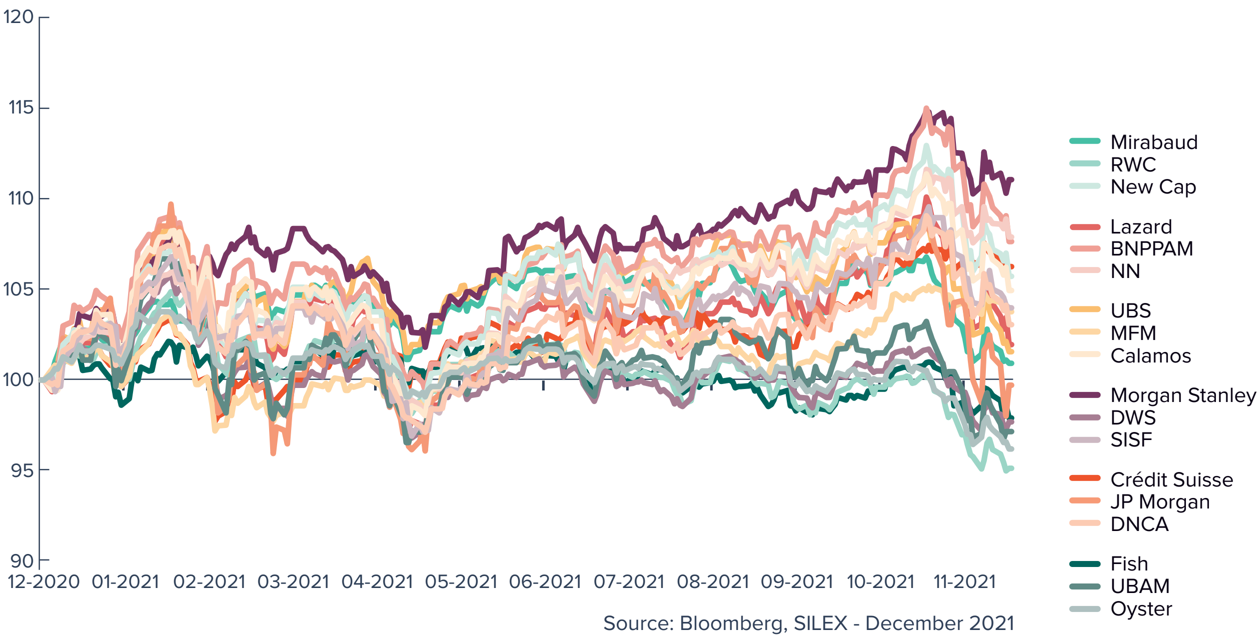
In 2021, the performance of the largest global convertible bond funds is highly dispersed. The best funds are posting returns of more than 10%, while some remain in negative territory despite a buoyant equity market environment.

The capital inflows into the asset class have led to a large number of issuers coming to finance themselves opportunistically on extremely advantageous terms, with premiums of more than 60% and yields to maturity close to zero or even negative. Not all of those will be attractive though, and stock selection remains essential to avoid accidents. As an illustration, Cineworld succeeded in issuing a convertible bond in April 2021 at 100% which is currently trading at 50%.

Performance of global convertible bond funds in 2021

index, 31 Dec 2020 = 100



Source: Bloomberg, SILEX - December 2021

This article was finalised on 11 January 2022.

Data on the careers and experience of SILEX employees are provided for information only and are only current as of the date mentioned on this page. The employees mentioned may no longer necessarily be employed by SILEX.