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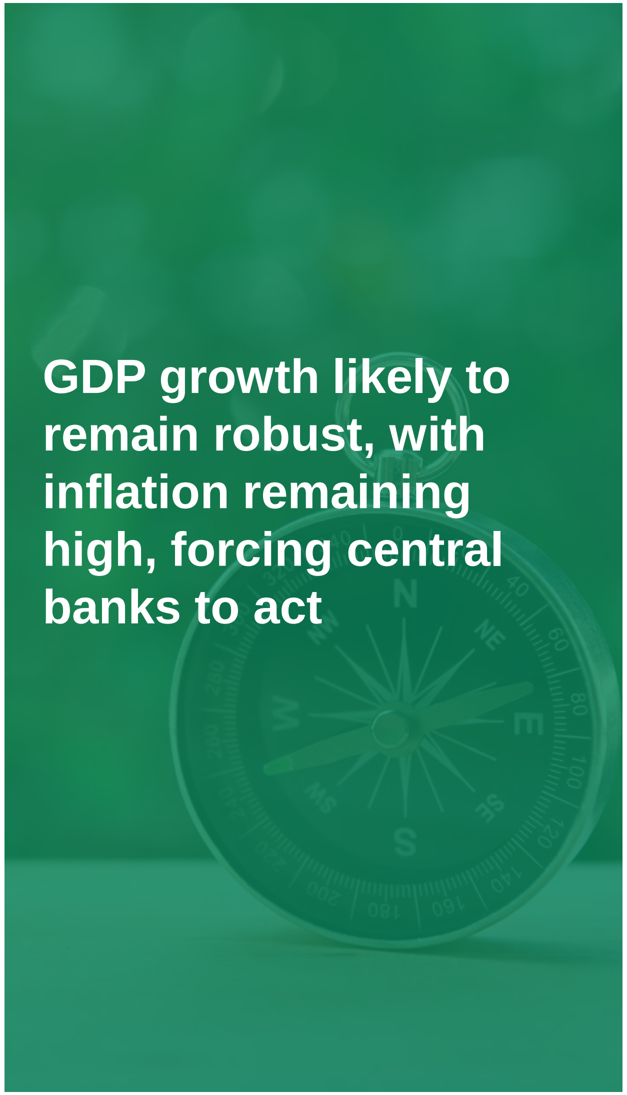
Macro and Fixed Income Outlook 2022

February 2022

Vontobel

Main macro and investment themes for 2022



- The disconnection between Monetary policy, Economic fundamentals and Asset prices need to converge
- We believe this convergence is likely to lead to headwinds to performance and an increase in volatility
- We expect GDP growth to slow, but to remain above historical averages, however we also expect high inflation to linger above central bank targets
- In the US, we think the Federal Reserve will be forced to act more aggressively if the unemployment rate continues to fall
- Main risk to markets is policy error from the Fed, they must tread a fine line, but unlikely to cause cycle to end prematurely
- Ultimately, a convergence should result in a healthier balance, and we think will likely lead to an intra-cycle dip that will present buying opportunities

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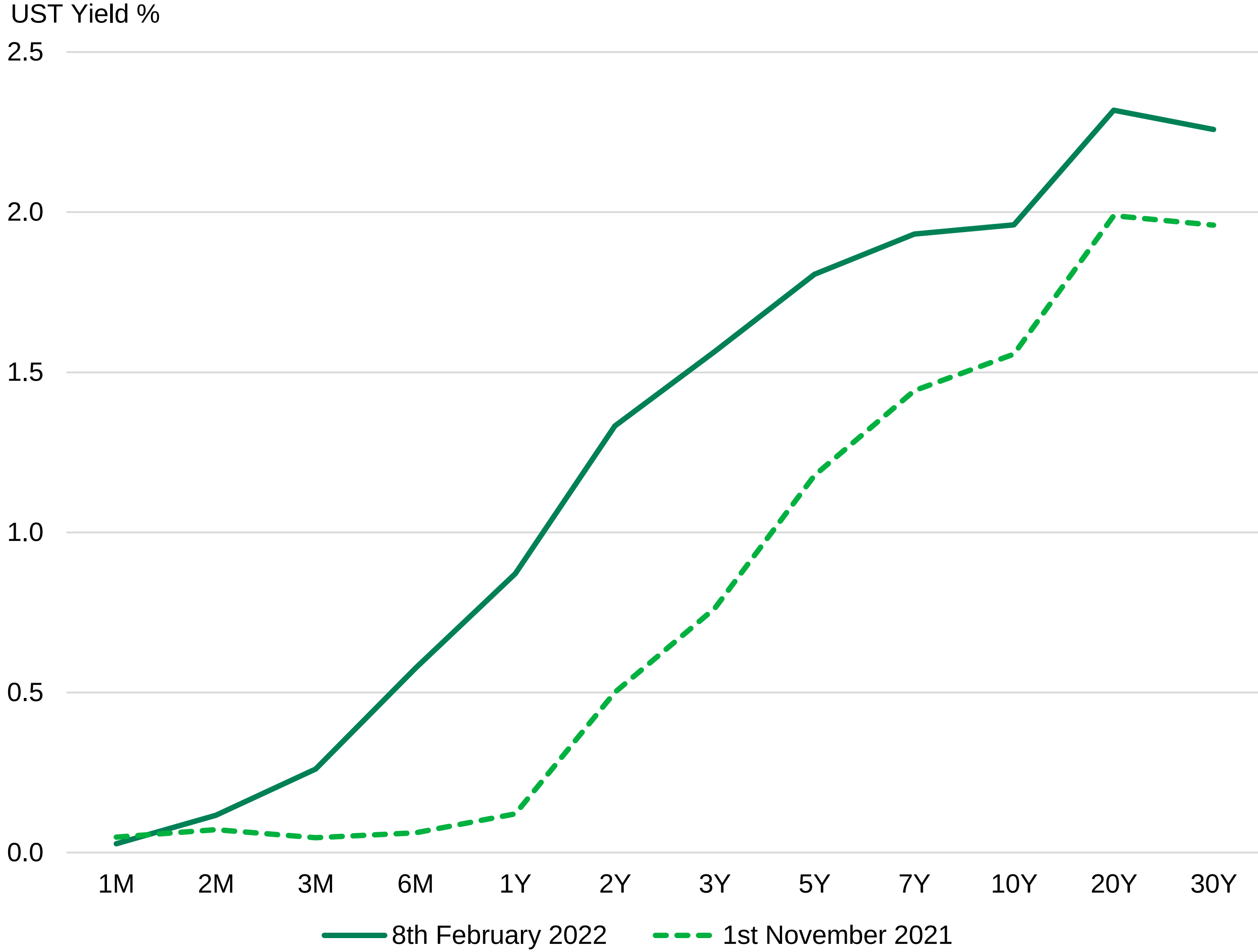
Monetary Policy Repricing

Since November 2021 US Treasuries have repriced to incorporate tighter Monetary Policy, acting as a drag on the rest of government bond markets



Source: TwentyFour, Bloomberg
8 February 2022

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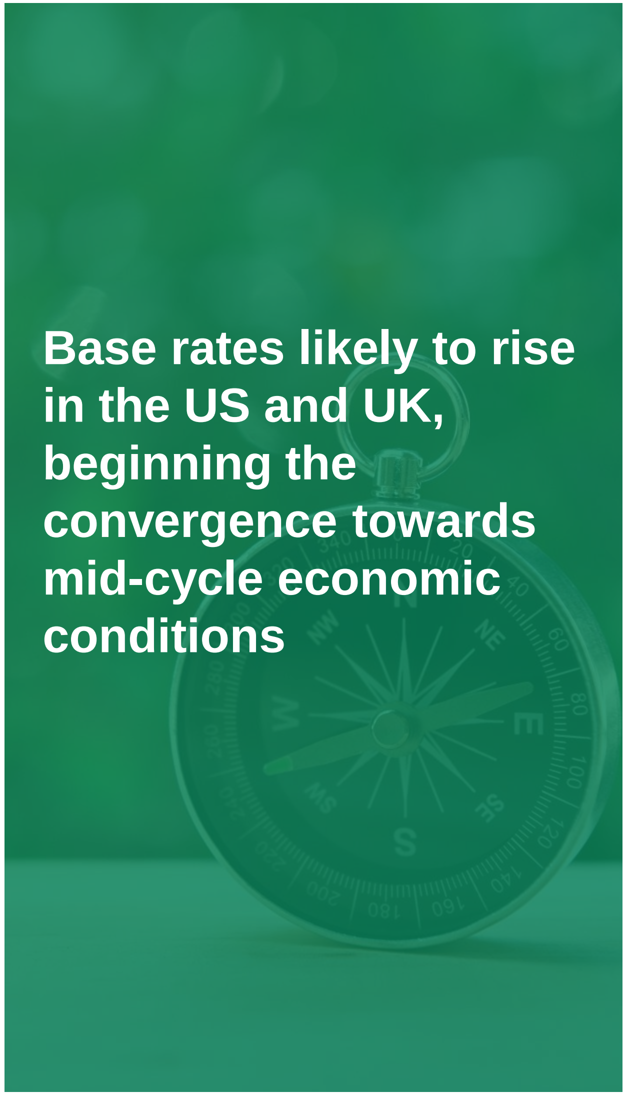
Central banks have a difficult job



Base rates likely to rise in the US and UK, beginning the convergence towards mid-cycle economic conditions

- We anticipate inflation in the US to remain high, and unemployment to fall decisively below 4% as early as Q1 ‘22
- Fed is likely to speed up tapering to avoid being accused of being behind the curve, giving additional time for base rate hikes
  - ➢ Possible that we see four or five rate hikes in 2022
- The ECB will be vigilant to tightening of financial conditions and are likely to bridge the gap between the PEPP and APP
  - ➢ Rates on hold in the short term, but bond yields look vulnerable
- The BoE started hiking rates in December
  - ➢ High inflation is likely to force an active hiking policy. Close call on 50 bps hike in January meeting

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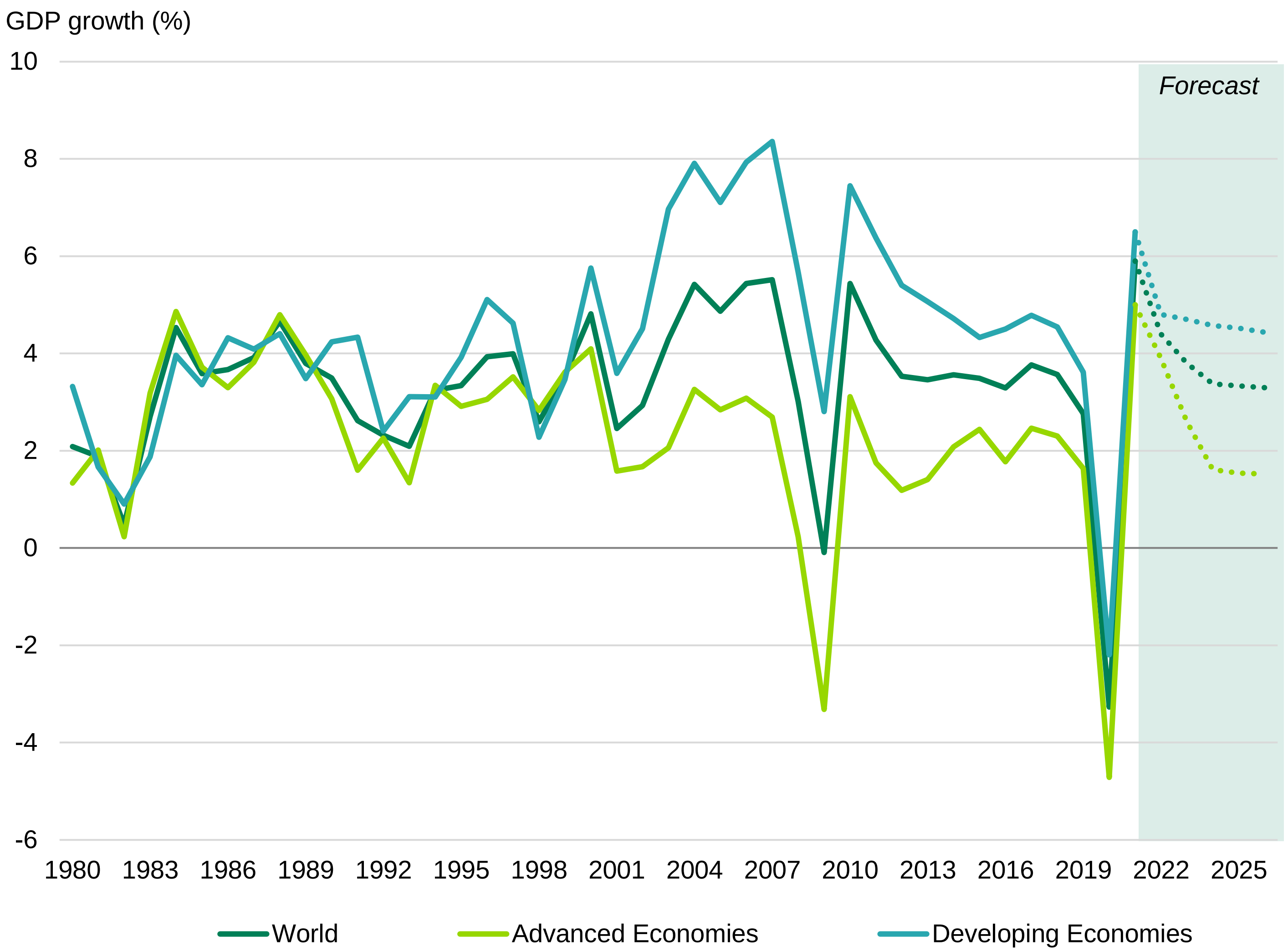
Growth is likely to be above trend in 2022

IMF World Economic Outlook projections were revised down slightly but growth is still very strong, particularly in DM



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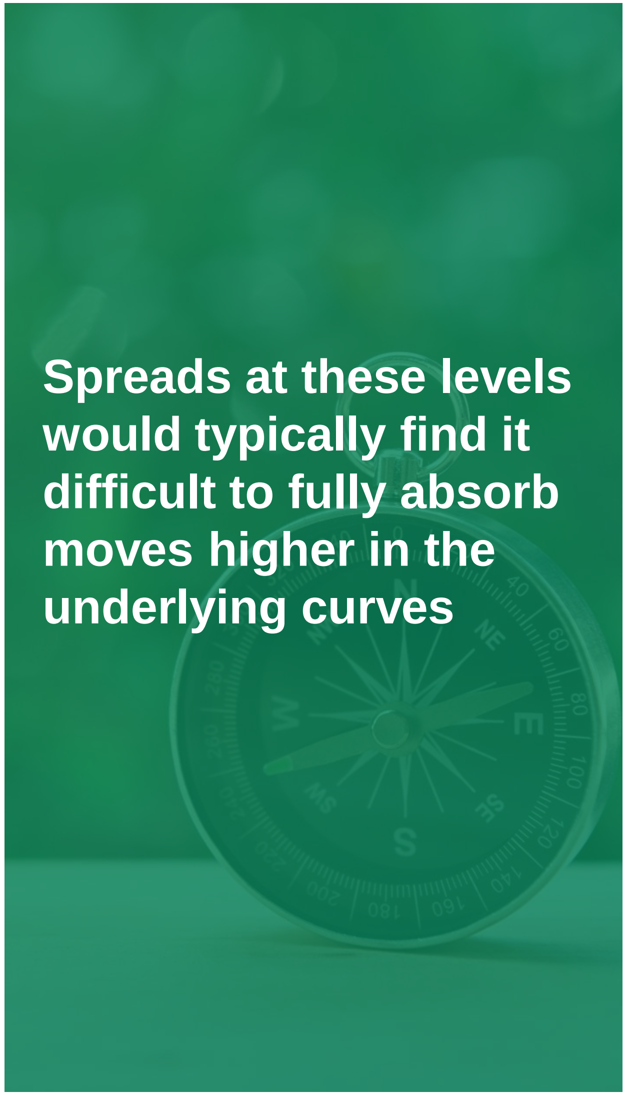
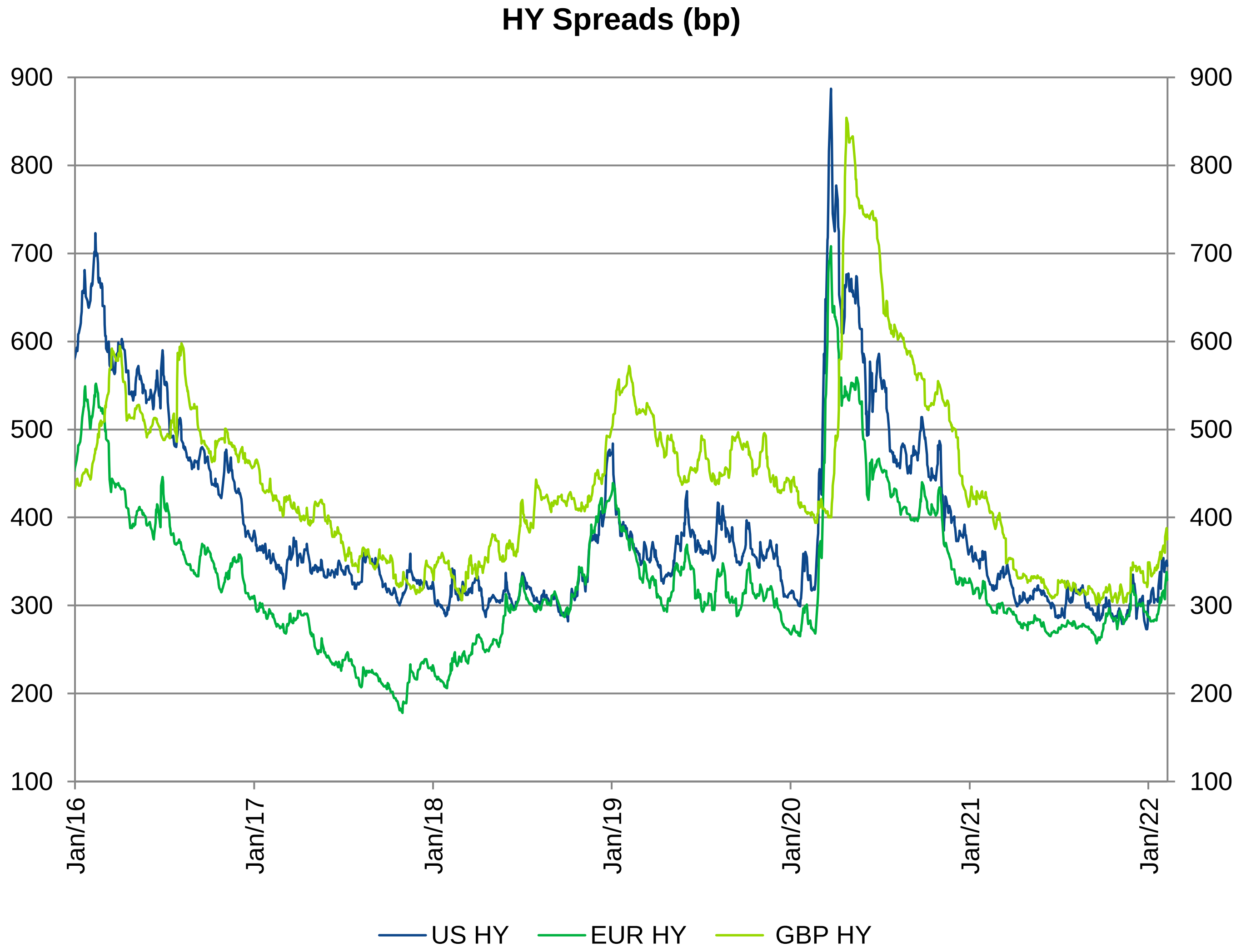
Spreads have sold off from lows



Spreads at these levels would typically find it difficult to fully absorb moves higher in the underlying curves



Data source: ICE Indices

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Credit spreads could struggle in H1 ‘22

- Credit fundamentals are likely to remain supportive; positive rating migrations and default rates remaining at or below historical averages
- However, rising government bond yields, tightening financial conditions and policy error concerns increase credit spread pressures
- We expected spreads to retrace wider in H1 2022, but some of this has been accelerated by the Omicron variant
- *We think this is likely to be an intra-cycle dip that presents a buying opportunity*
- Some sectors are worth a closer look in our view;
    - Floating rate European ABS, especially CLOs, could provide strong returns
    - Banks still look compelling to us, and spreads have already widened
    - Emerging Markets will likely see further volatility but a good entry point could emerge later in 2022

CLOs can provide very interesting risk adjusted yield opportunities

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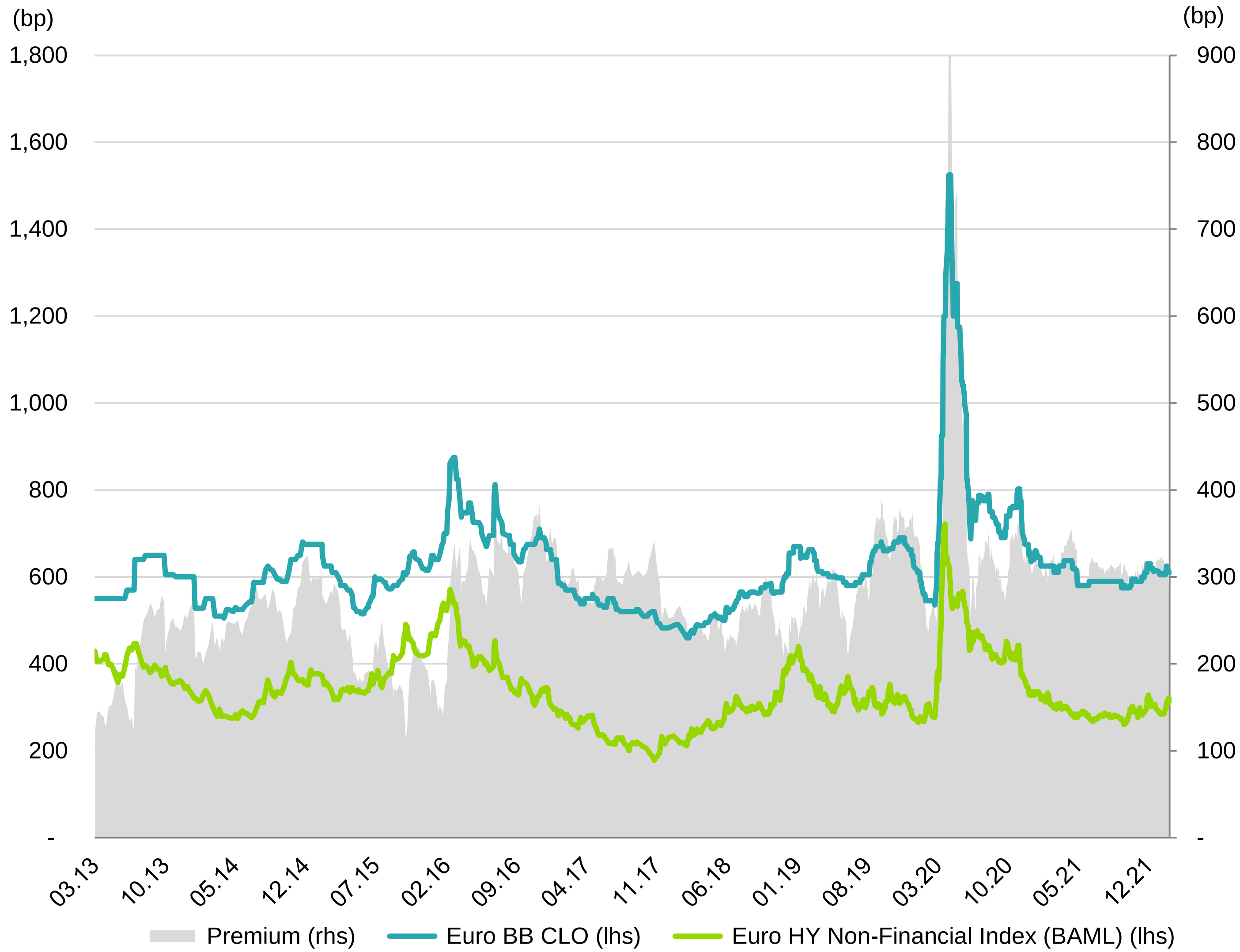
We do not expect the gap to HY to close. But in 2022 we think carry is likely to be the most important component of total returns



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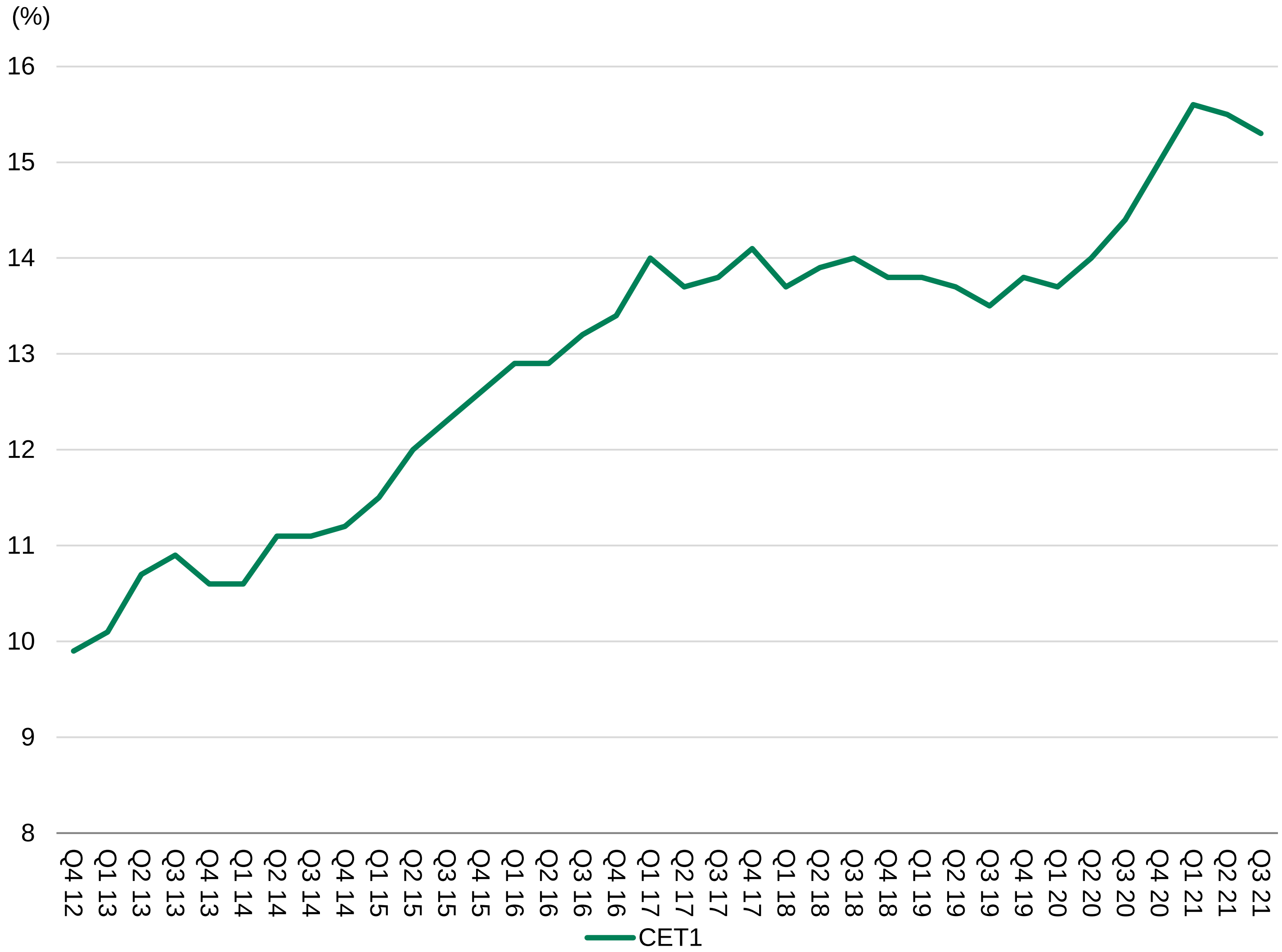
Data source: TwentyFour, ICE Indices

Banks proved their resilience

The COVID crisis was one of the most acute in history. No AT1 coupons in Europe were suspended, no bonds were converted into equity and banks continued to lend throughout the crisis



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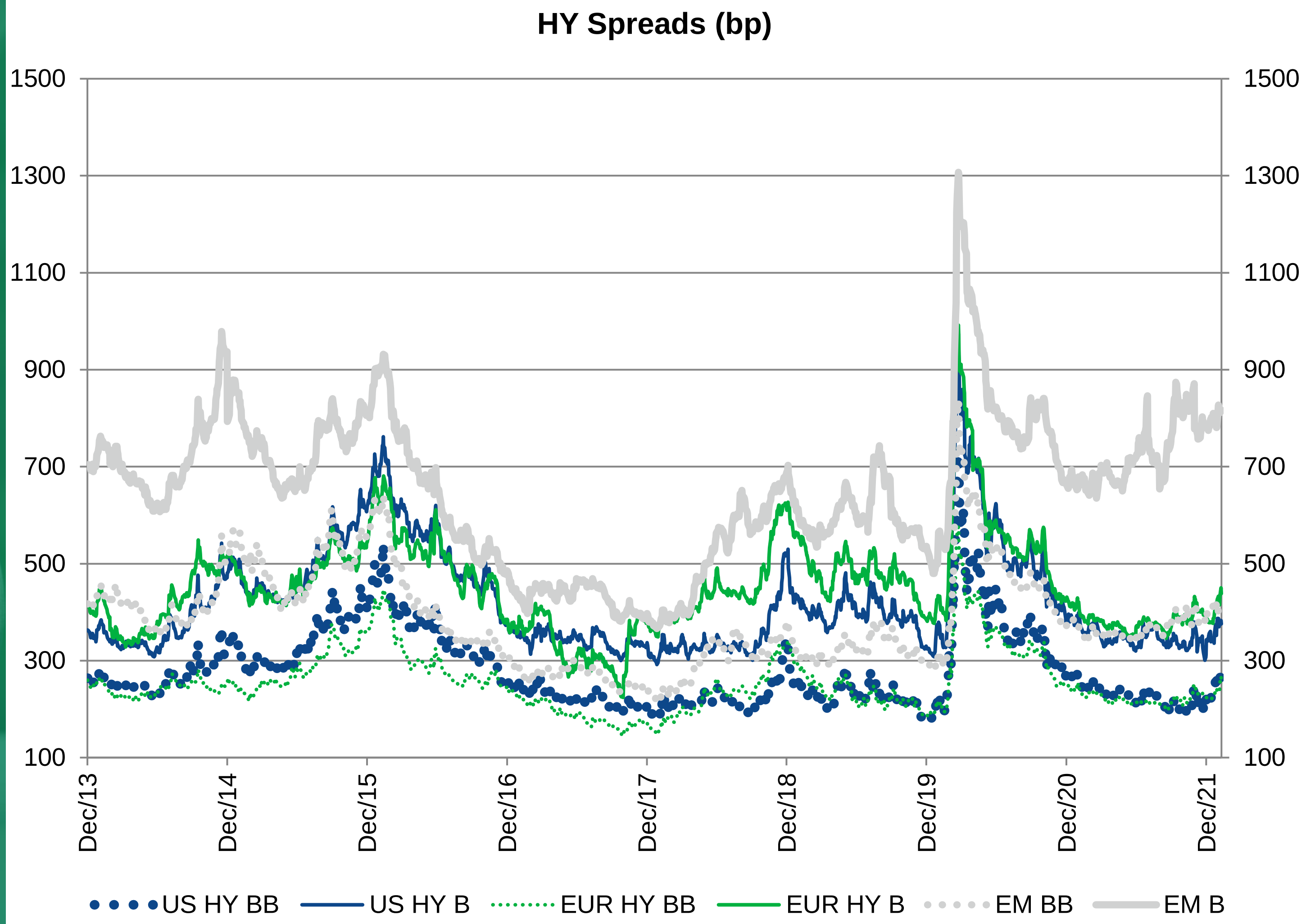
Data source: Bloomberg

EM assets have underperformed

EM $ Corporate Debt valuations look attractive to us but we want to see a catalyst. Firstly, a solution to the China property saga. Secondly, more clarity on how quick the Fed is likely to tighten monetary policy



Data source: TwentyFour, ICE Indices

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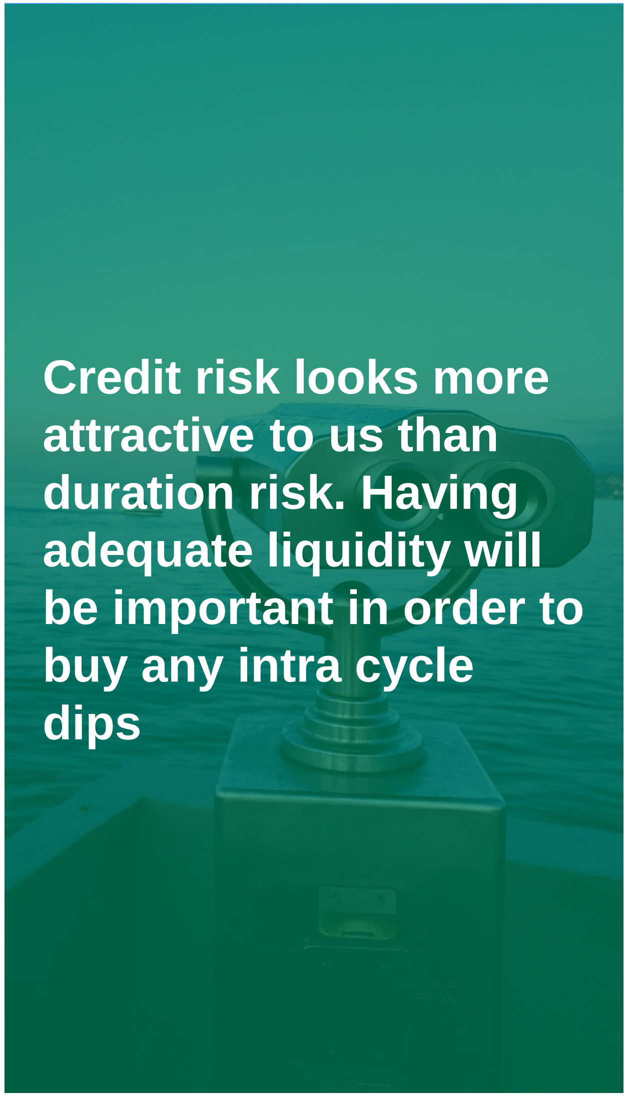
Strategy for managing 2022 headwinds



- Avoid unwanted government-bond yield curve risk though portfolio construction, supplemented with an Interest Rate Swap if needed
- Credit fundaments look supportive to holding credit and moving down the curve
- Lower rated, shorter dated credits benefit from roll down and are preferable to higher quality longer dated names, which have more duration risk
- Important to maintain a liquidity buffer to take advantage of any intra-cycle dip to try and improve portfolio yields
- Ultimately, spread plus roll down, plus good security selection should trump the modest widening in overall credit spreads
- We think reasonable returns can still be generated, but volatility will be higher than seen in 2021

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