AXIOMA
Wealth Management AG

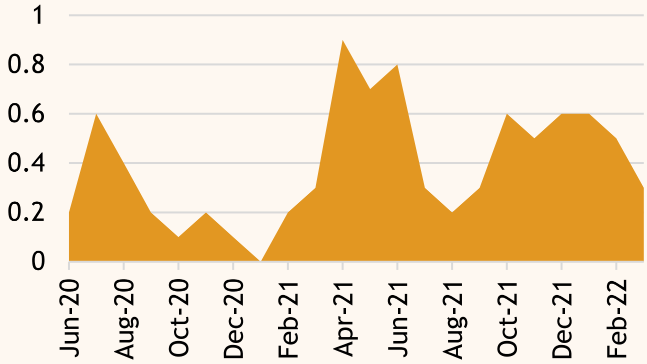
2022 Investment Strategy
1st Quarter Update

Market Overview

The global economy has started the year slowly as the Covid-era emergency stimulus packages were removed by that time and the Omicron variant caused the new wave. The services sector, in particular, operated under significant restrictions that hampered its growth. Meanwhile, manufacturing "escaped" with slight impacts by the Omicron variant. Eventually, partial relief has been seen as countries lifted most of the covid-restrictions, and supply in labour markets rebounded from the pandemic period's low level. More and more people started coming back to the labour market although their participation level stays below the pre-pandemic level. Labour market has been under close watch as prolonged strong demand in labour markets may augment inflation pressure and it may take excessive steps, for monetary operations, to increase unemployment rate till necessary levels. On the other side of the room, rising inflation has been accompanied later by the geopolitical risk that jolted cross-asset markets. The geopolitical shock has added pressure on inflation, and supply chains. Expectedly, disturbed supply chains have tilted towards knotty. Consequently, the symbiosis of these factors has begun to slow down economies around the world, yet nonuniformly. Notably, economic growth revision is greater for Europe than for the US.

Inflation, another newsmaker, remains elevated. In March, headline CPI in the US hit four decades of reading as it reached 8.5% YoY. High energy prices have contributed significantly which has created not only economic pressure, but also socio-political ones. Therefore, fight with high oil prices has started being carried out by all available tools. The US has announced to release of oil from strategic reserves. In addition to energy prices, prices of food that are explicitly and implicitly related to Russia and Ukraine have soared. Yet, the monthly development of core CPI has demonstrated a "slowing pattern" which has been accepted by markets with a certain level of ease and has sparked discussions related to a peak of it. As a result, readings of inflation have driven repricing of instruments aggressively as markets believe that monetary authorities will have to tighten at faster pace and continue until the tumble of stock markets stall them according to selective opinions.

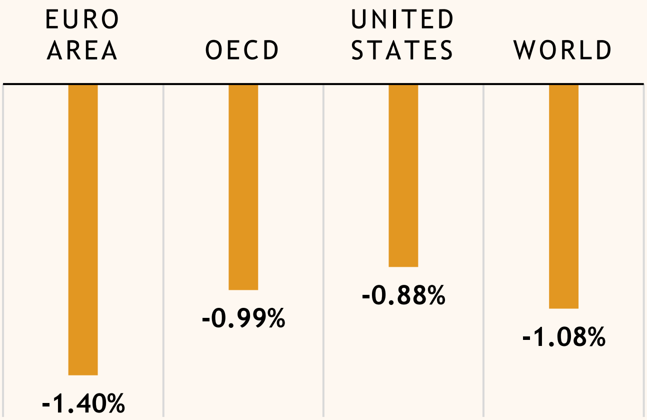
Fig. 1: Monthly development of core inflation in the US (%)



**Source: U.S. Bureau of Labor Statistics*

Geopolitical tectonic tremors took place in February when the conflict between Russia and Ukraine started. Given Russia's role in commodity markets, prices started soaring immediately. Namely oil prices have kept swinging as markets have been filled with mixed signals from oil-producing countries, negotiations of the USA with Venezuela and Iran, and progress on the peace talk between Ukraine and Russia. Volatility intensified also on the back of talks on a potential embargo of Russian oil and gas, payment of gas in Rouble, and limited supply from other producers. Alternative producers are either restricted technically in the short term or reluctant to increase their volumes. Yet, supply-side concerns are not the only in the market, as the latest data across countries show that consumers' sentiment has started to depict "relative pessimism". Global inflationary environment has brought down the sentiment.

Fig. 2: Ramifications of the geopolitical shock on economic growth



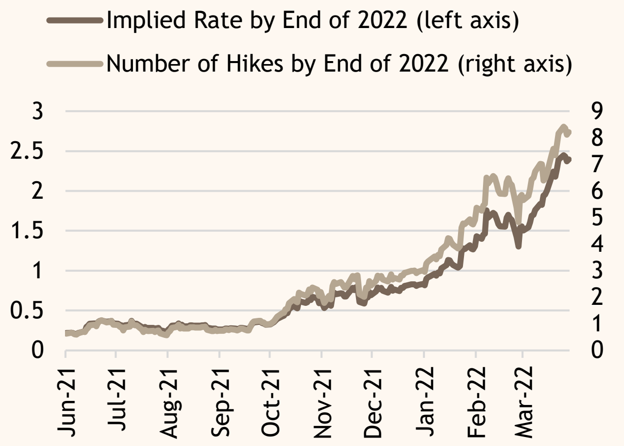
**Source: OECD*

US Monetary Policy

This year started with markets' worries over potential rate hike as the comments of officials at the first Fed meeting in 2022 were more hawkish than what was expected. The Fed was determined to fight inflation as well as start reducing the balance sheet. Further on, additional uncertainty was added to the Fed's agenda as the Russian-Ukrainian events took a place. Therefore, given geopolitical uncertainty, the US central bank lifted the key policy rate by 25 bp in March. Currently, the Fed considers even 50 bp liftoffs possible, and claimed to possibly start the balance sheet unwinding in May, at a much faster pace than in 2017. As for expectations, markets are currently pricing between eight and nine hikes (vs. three hikes at the beginning of the quarter).

The 10-year US Treasury bond yield surged from around 1.50% (end of 2021) to the highest level in the last 3 years: somewhat of 2.30% (end of March) – amid inflation worries. By the very end of the quarter, the 2–10-year part of the curve inverted, providing investors with recessionary concerns as the inversion of the yield curve historically is associated with future economic contraction. With these factors in mind, the Fed will most probably stick to the chosen monetary policy path, soon delivering half-point rate raises along with a rapid balance sheet reduction.

Fig. 3: Fed's stance becoming even more hawkish



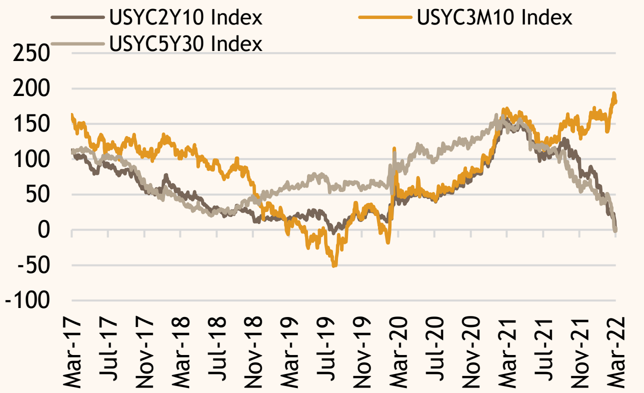
Source: Bloomberg

Credit Spreads

The first quarter of 2022, with inflation concerns, rate hikes, geopolitical events, had a negative impact on bond market. The quarter was the worst one for Aggregate Bond indices. Corporate bonds have had wider spreads than government debt securities.

As for US Treasuries, in the final week of March, both the 2yr10yr and 5yr30yr spreads inverted. The 3m10yr spread normally trends in the same direction as 2yr10y. The former, however, as of end of March was residing at near three-year wides over 200 bps. This is an anomaly which could be a reflection of how far the Fed is behind the curve rather than a leading economic signal.

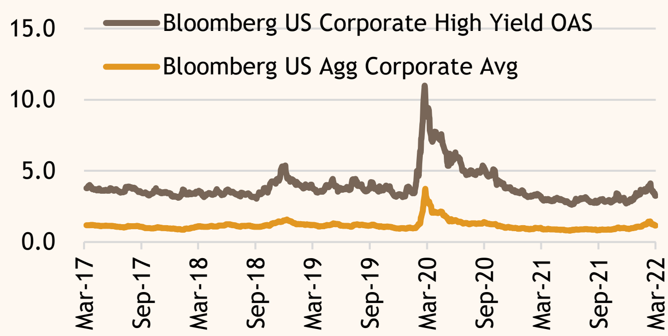
Fig. 4: Anomaly observed in the spreads



Source: Bloomberg

Right after the start of Russian-Ukrainian events, both IG and HY spreads have climbed to the levels which they were at prior to 2021. Before the conflict HY bond spreads widened to a similar degree, regardless of rating. However, since the beginning of the Ukrainian events, BB-rated issuers have outperformed B- and CCC-rated ones. As for BBB-rated corporate bonds, 1Q22 spread widening (around 40 bps) is the most considerable since 1Q20. The tight US labor market, persistent inflation, current and future rate hikes are very likely to weigh on the growth, while driving spreads even wider.

Fig. 5: Geopolitics affecting the spreads (%)



Source: Bloomberg

Strategy

Q1 was not the best quarter for the Aggregated Bond Indexes, as inflation, central bank tightening and Ukraine conflict with Russia drove yields sharply higher. Chairman of Federal Reserve indicated that the focus is on the near-term forward curve which is still steep, but it may temper the amount of tightening the Fed can do. Nevertheless, the selloff and tightening policies can be viewed as an income opportunity to find attractive fundamentally companies in terms of business model and financial soundness. The recent surge in yields means there is income in fixed income, particularly in EM. However, some risks are on the rise. Corporate profit growth slowed in 4Q21, and high inflation and supply chain bottlenecks pose a risk for lower-rated companies that may have volatile cash flows even when growth is strong. As geopolitical instability has been persisting, markets are still facing heightened uncertainty and extreme volatility, we believe the approach 'wait and see' will take place until we see the bond market unsettlement worries are over.

Performance Forecast

- **Optimistic scenario:** UST yields reach levels around 2.96% and credit spreads recover 49bps on average
- **Base scenario**: UST yields reach levels around 2.7% and credit spreads stay as they are.
- **Pessimistic scenario:** UST yields reach levels around 2.5% and credit spreads widen over 150bps on average where assumed a default rate is 1.5%.

Table 1. Strategy performance forecast, 2022

5 years UST yield to maturity										
	UST Yield	1.7%	2.0%	2.2%	2.5%	2.7%	3.0%	3.2%	3.5%	3.7%
Spread (bp)	-65	14.7%	13.4%	12.0%	10.7%	9.3%	8.0%	6.6%	5.3%	4.0%
	-49	13.8%	12.5%	11.1%	9.8%	8.4%	7.1%	5.8%	4.4%	3.1%
	-32	12.9%	11.6%	10.2%	8.9%	7.5%	6.2%	4.9%	3.5%	2.2%
	-16	12.0%	10.7%	9.3%	8.0%	6.6%	5.3%	4.0%	2.6%	1.3%
	0	11.1%	9.8%	8.4%	7.1%	5.7%	4.4%	3.1%	1.7%	0.4%
	51	8.4%	7.1%	5.7%	4.4%	3.0%	1.7%	0.3%	-1.0%	-2.3%
	101	5.7%	4.4%	3.0%	1.7%	0.3%	-1.0%	-2.4%	-3.7%	-5.0%
	152	3.0%	1.7%	0.3%	-1.0%	-2.4%	-3.7%	-5.1%	-6.4%	-7.8%

Table 2. Strategy performance forecast 9 months: 1 April 2022 - 31 December 2022

Strategy return for the next 9 months	Optimistic scenario	Base scenario	Pessimistic scenario
Coupon component	3.3%	3.3%	3.3%
Price change due to change in UST yield	-2.7%	-1.3%	0.03%
Price change due to spread narrowing or widening	5.4%	2.7%	-5.4%
Default	0.0%	0.0%	-1.5%
Total:	**6.1%**	**4.7%**	**-3.5%**

Source: AXIOMA

We hope you find this information useful and will be glad to answer your questions

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