



## CIO OFFICE MORNING MARKET WRAP – 6th January, 2022. ALSO AVAILABLE ON ALEXA.

The volatility we expect throughout 2022 seems to have already started. US stocks fell by -2.2% on Wednesday, with technology leading the rout as shown by the Nasdaq index losing an impressive -3.3%. Europe and Japan were flat. Stocks in emerging markets were down by -0.9%. Causes are to be found in the continuous rise of interest rates. The 10-year Treasury yield added 6 basis points to 1.71%, while the 5-year maturity added 7 basis points to 1.43%. The price of Brent crude oil was slightly up to \$80.2.

The current narrative is simple: market participants are back from holidays and realize that the Fed is more hawkish, interest rates are too low, and that higher interest rates should affect the valuation multiple of long-duration assets, which includes widely owned tech stocks. The minutes from the December FOMC unambiguously confirmed their hawkish turn yesterday. Members of the committee emphasized that rate hikes could happen sooner or at a faster pace than earlier anticipated. In the very diplomatic Fed wording, this is quite aggressive. A new stage of the tightening sequence was also brought to the table: after the taper process, which is now expected to conclude in March, and the rate hikes, which could follow and start in the first half of the year, some members called for starting to reduce the bank's balance sheet. This is not just about ending the new purchases and reinvesting the proceeds anymore, it's about taking back the "magic money" from the system. Against this backdrop, market action is very logical. Having said that, policy normalization is not a surprise given the current growth/inflation mix and the strength of the job market. It's clearly justified. Importantly, the Fed meeting took place at a time when the omicron breakout was relatively benign in the US. And finally, we all know

by experience that the Fed doesn't only care about inflation, jobs and growth, but also about stock market, diplomatically referred to as "financial conditions". The Fed would not fuel a potential market rout, should it happen. Starting the year with an aggressive roadmap actually reconstitutes ammunition for them to help, should a market storm happen. Next week's inflation numbers, the US CPI, will be important to gauge the next policy step, as will Friday's monthly US job report. Ahead of it in the meantime, the ADP jobs report came in much stronger than expected yesterday, with an addition of 800k private sector job, which is close to twice the median forecast. Friday's change in non-farm payrolls is expected to be +425K, which now looks a bit low.

Our Tactical Asset Allocation Committee was held Tuesday, and we decided to reduce our absolute and relative risk, by cutting our exposure to developed market equities from overweight to neutral and to keep the proceeds in cash. We also cut our overweight in gold to neutral, which was reallocated to hedge funds. Timing was not unlucky but this wasn't of course short-term speculation: we want to start the year with a neutral stance, as we believe that 2022 will reward reactivity more than proactivity. Proactivity requires a high level of confidence in a central scenario which provides a superior risk-return profile. Criteria are not met yet to take aggressive active positions. Yes, our central scenario is reasonably constructive, as we believe in the continuation of the economic recovery. However, the upside potential to our year-end fair values, especially in DM stocks, doesn't pay for the elevated levels of volatility we expect. Our own level of confidence is also lower. Visibility is simply low, while vulnerabilities are material. Neutrality sounds wise, as it may allow us to take advantage of any material correction to add to risk when it's better rewarded. Our positioning remains underweight in fixed income, especially the most defensive segments. We are very modestly overweight in emerging market stocks, which includes the UAE and India, and neutral on developed. We are not overweight on DM stocks anymore. We are overweight on hedge funds, now neutral on gold and global listed real estate.

All news are actually not that bad today. On the virus front, while infection numbers are raging and alert levels are raised in Japan and China, a positive statistic came from South Africa, where excess deaths ticked lower in the last week of 2021, giving hope that the omicron wave could be shorter than the delta one. In the UAE, the Central Bank updated yesterday their growth forecast for 2022, and the number is strong at +4.2%, close to our own in-house expectation. Finally and importantly, the Caixin China PMI Services index was released this morning for December: at 53.2, it is firmly in expansion territory, and materially higher than both the 51.7 median forecast and the November 52.1 level.

Staying in Asia, stock markets are logically down as we write this morning, with the technology sector being materially hit. Japan is down -2.2%, Korea and onshore China are currently losing -0.8% while Hong-Kong is only modestly in the red, down -0.3%. Interest rates are marginally firmer, and oil prices are down by one percent, with the Brent future contract currently just below the \$80 mark. Future contracts on Western stock markets are fluctuating without a clear direction.

Tonight we will get the US ISM Services Index at 7PM Dubai time, expected to be as high as 67. Friday will provide retail sales and inflation numbers in Europe as well as the important US job report at 5.30PM Dubai time.

Stay safe.

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