



CIO OFFICE MORNING MARKET WRAP – Friday February 18, 2022. ALSO AVAILABLE ON ALEXA

US equity futures are climbing this morning, and safer assets like gold and treasuries are slipping on the prospect of a meeting agreed late Thursday between American and Russian officials in the attempt to break the current stalemate, while yesterday Wall Street sank, as President Biden said earlier in the day that the probability of an attack is “very high”. Bonds advanced, with the yield on the US 10-year treasury note falling below 2%, while gold and the yen rallied, Brent crude was lower amidst talk of rising odds of an Iranian deal, and bitcoin slumped on spiking risk aversion.

Here we are again, looking into a negative day for equities in 2022, while the exact opposite was true in 2021, when new highs were relentlessly recorded. We hold the view that the withdrawal of liquidity will have longer-lasting impacts versus the more

fleeting geopolitical risks. The CIO Team often mentioned the notion of the 'liquidity impulse' created by the Federal Reserve post covid, lifting all boats. Last year most investors, including meme stock lovers, could make money, whatever was purchased. Few must have wondered what would happen once one was on the wrong side, the descending one, of the liquidity impulse. We are now experiencing it. It will last until the Fed has decided that enough liquidity has been withdrawn for inflation to be tamed, and most likely that will happen also once the wealth effect created by the Fed itself via higher asset prices has been unwound somewhat. Because this is not, unlike the previous ones, a credit cycle, whereby the Fed is trying to tackle a hot economy by curbing excessive credit creation - there is no such thing, private-sector balance sheets are healthy - but rather an asset cycle, whereby excessive euphoria in asset markets must be depressed enough for aggregate demand to be curbed. Indeed, there is a security crisis unfolding making matters worse, and inflation is borne out of supply constraints, a tight labour market and strong demand, but the asset link remains in the backdrop and cannot be neglected, otherwise one would be tempted to consider this tightening cycle as any other one in the past.

The Ukrainian crisis has so far been on autopilot, with President Biden chronicling the lack of progress every day, stating of late that the probability of a Russian invasion is "very high", and President Putin always denying it. We are starting to wonder if consistently keeping focus on the risks of what could happen is going to defuse tensions, or rather be a catalyst for things eventually to come to pass. The crisis has clear winners and losers in asset markets as well. Insofar pressures continue to mount, the rising uncertainty sees equities as the main casualty, and gold the primary beneficiary. These developments should at the same time make clear once for all that Bitcoin, following stocks lower, rather than gold higher, is just a different flavour of a cyclical asset, with volatility magnified by its limited supply, which in this case acts as a curse, rather than a blessing, a detail crypto-evangelists have always failed to take into account.

We have just implemented the TAA Committee decision to proceed to a reduction of our large treasury underweight, triggered by the yield on the 10-year note closing above the 2% threshold in the past sessions. Treasuries are rallying and the current episode of risk aversion could have more to go. Further drops in equities would be equally conducive to gradual risk taking in our portfolios.

The surge in the cost of oil and gas is contributing to inflation and world leaders, pushing for a greener economy to be achieved at greater speed, are now panicking. Higher oil and gas prices should slowly spur investments in renewable energy, but ramping up inflation is not allowing for such smooth transitions. Unless the shift to net zero is slowed down, the tightness in the resource markets to be tapped to build this grand green project are going to magnify the price pressures which already today are a source of big anxiety. Stay safe.

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