CITĒ GESTION

Newsletter : Omicron won't derail recovery | January 2022

1. Macro and Rates
2. Fixed Income
3. Equity
4. FX and Commodities

Key Take-Aways

- December was characterized by a high volatility environment, pushing the market to finish the year on a high note and close to historical highs for most of the Global Indexes.

- The persistence of inflation on a higher level was even more accentuated by the volatility regime. Hence the need to raise interest rates, pushing the estimates at 3 hikes, instead of 2, for 2022.

- The threat of Omicron seems to be reduced. Despite new high records of worldwide infections cases, fatalities and hospitalization remain below previous waves. Following this trend, the Omicron impact on the economic outlook could be limited.

- Financial indicators expect a growth in global economy by 4.8% in 2022. Positive consumers sentiment and excess savings could be key for this recovery.

- Still remains specter of inflation, which could peak in the first half of 2022. As seen with a more hawkish Fed policy, major Central Banks could normalize (faster than anticipated) their monetary policy consequently.

- However, the first rate hike of the Fed should occur after the bond-buying program has come to an end. The ECB should follow the same path.

- Opportunities could arise in the Bond market over 2022, as 2021 was one of the worst since decades for this asset class. IG and Govies look now less overpriced versus Equities.

- Equity market outlook for 2022 remains uncertain. After reaching high gains in 2021, the momentum could continue based on historical trends. Concerns of Coronavirus, Inflation and major Government policies could change the game.

- Equities should evolve in a rising interest rate environment across the first half of 2022, which could be beneficial for cyclical value and good quality stocks. Following this trend, financial companies could also benefit from this environment as well as Energy companies.

- EUR could be stimulated by the ECB's tightening policy sooner than expected. Gold and JPY could continue to grow as a result of inflation fear and their respective role of safe haven investments.

Review : December 2021

Omicron, the Fed and the Christmas rally.

This month was marked, like the rest of the year, by high volatility and wide dispersion, mainly due to Jerome Powell's last speech of the year. The latter stressed the persistence of inflation and the need to raise interest rates, pushing estimates to three rate hikes, as opposed to the two initially expected. These hikes are expected to take place in March, while the first hike was planned for June 2022.

But this was without counting on the will of the market to end the year on a high note, which saw the majority of markets end December on a very strong gain, giving us a Christmas rally and indices close to their historical highs. The S&P500 ended the month up 4.47%, taking it to +28.68% for the year, making 2021 one of the biggest gains of over the last 20 years. The Nasdaq finished the month up 1.19% and the year up 27.51%, the Eurostoxx50 up 5.81% and 24.10%, the Nikkei up 3.60% and 6.62% and the SMI up 5.89% and 23.73%.

In terms of US sectors, the best performer was Consumer Staples, which finished up 10.29%, followed by Real Estate, at +10.23% and Utilities at +9.64%. Only Consumer Discretionary posted a negative performance at -0.25%. For the year, all sectors finished up by double digits, led by Energy with an incredible 54.35% appreciation, Financials up 34.87%, Techs up 34.52% and Communication Services up 21.57%.

With the dollar index easing over the month (-0.34%), the EUR/USD rose by 0.28%, the USD/CHF by 0.65% and the GBP/USD by 1.75%. Only the yen depreciated by 1.91%. Over the year, the DXY rose by 6.37%, setting the EUR/USD at 1.1370, down 6.93%. The same was true of the USD/CHF, which rose by 3.13%, and the USD/JPY, which gained 11.46%. As for the EUR/CHF, it fell by 4.04%, ending the year at 1.0375, once again prompting the Swiss central bank to intervene in the currency market.

Unsurprisingly, the US 10-year yield rose by 6 basis points, ending the year at 1.5101%, up 59bps over 12 months. The bund yield rose by 17bps, ending the year up 39bps. The appreciation in government yields pushed bond indices into negative territory, with the Bloomberg Global Aggregate Index ending the year at -4.71%, the JPMorgan EMBI at -1.51% and the Bloomberg Core Government Index at -2.65%.

Commodities were highly volatile during the year, ending relatively scattered, but with the Bloomberg Commodity Index up +27.05%. Led by the WTI, up 13.64% in December and 55.01% for the year, while gold, which rose 3.08% in December, ended the year at -3.64%.

Volatility contracted by 36.67% in December, ending the year at -24.31%. This does not reflect the differences seen during the year, seeing it oscillate between 15.01 and 37.21, a difference of over 147%.

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	4,793	0.14	3.09	4.95	11.27	27.61	21
Nasdaq	15,850	0.53	2.11	2.01	9.70	22.98	31
Russell 2000	2,270	0.93	2.17	3.24	2.98	14.95	25
Euro Stoxx 50	4,297	0.29	0.73	5.76	6.15	20.96	15
Stoxx 600 EUR	489	0.20	1.23	5.61	7.51	22.53	16
FTSE 100	7,419	-0.02	1.67	5.09	4.69	14.83	12
SMI	12,961	0.27	1.95	6.59	11.33	21.09	18
NIKKEI 225	28,792	-0.40	-0.02	3.49	-2.24	4.91	16
CSI 300 China	4,922	0.78	-0.55	1.85	1.13	-5.56	15
MSCI EM Index	1,218	-0.75	-0.14	0.45	-2.81	-5.68	11

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	4,793	0.14	3.09	4.95	11.27	27.61	21
UTILITIES	360	-0.24	1.67	8.37	11.04	12.96	21
ENERGY	425	0.13	1.71	3.51	7.39	48.57	11
TELECOM	272	0.67	1.68	4.35	1.57	22.68	20
CONS STAPLES	800	-0.13	2.14	9.39	12.02	14.96	21
REAL ESTATE	323	0.11	2.87	9.27	16.29	41.90	51
CONS DISCRET	1,627	0.33	2.68	0.69	13.80	24.90	30
MATERIALS	571	0.28	3.80	7.53	14.90	25.22	17
HEALTH CARE	1,652	0.24	2.02	9.35	11.30	24.75	18
INFO TECH	3,102	0.35	2.58	4.91	18.23	35.39	27
FINANCIALS	655	0.36	1.86	3.90	4.86	33.54	15
INDUSTRIALS	895	0.10	3.02	5.28	8.30	19.46	20

Currency % Change	Price	1 day	5 days	MTD	QTD	YTD
DXY	96.188	0.27	0.12	0.20	2.08	6.95
EUR-USD	1.1301	-0.42	-0.23	-0.33	-2.41	-7.49
USD-JPY	115.16	0.18	0.67	1.73	3.36	10.34
USD-CHF	0.9180	0.36	-0.05	-0.10	-1.49	3.57
EUR-CHF	1.0375	-0.04	-0.27	-0.40	-3.96	-4.22
GBP-USD	1.3462	-0.21	0.40	1.23	-0.09	-1.52
EUR-GBP	0.8395	-0.21	-0.61	-1.55	-2.36	-6.46
JP EM FX Index	52.47	-0.32	-0.65	0.08	-5.02	-9.42

10 yr Yield Bps Change	Price	1 day	5 days	MTD	QTD	YTD
US	1.53	-2	4	8	4	62
Germany	-0.19	-0	6	16	1	38
UK	0.99	-2	7	19	-3	80
SWITZERLAND	-0.14	-1	4	9	2	41
Japan	0.07	1	1	1	-0	5
US IG Spread	100	-1	-5	-8	8	-2
US High Yield spread	262	-3	-23	-70	6	-65
EUR High Yield spread	353	0	-6	-39	26	3

Commodity % Change	Price	1 day	5 days	MTD	QTD	YTD
BBG Commo Index	100.1	-0.09	1.38	4.48	-0.66	28.23
Gold Spot $/OZ	1801.2	-0.20	-0.42	1.50	2.52	-5.12
Crude Oil WTI	76.6	0.76	5.08	15.68	2.04	57.79

Volatility	Price	1 day	5 days	MTD	QTD	YTD
VIX	17.1	0.18	-1.50	-10.06	-25.97	-5.62

Source: Bloomberg 31.12.2021

Macro and Rates : Omicron won't derail recovery

With more than 2.5mn daily cases worldwide well above the 1mn daily cases from previous waves, Omicron leaves investors with concerns about the economic fallout in part of the world. While these numbers are alarming, fatalities and hospitalizations remain below previous waves.

Despite some mobility restrictions in some areas, we do not expect Omicron to derail the economic outlook. The global recovery remains resilient thanks to a strong labor market, pent-up demand for services and healthy corporate balance sheets.

Several indicators suggest the global economy in on track to grow 4.8% in 2022 with the US, as the world's biggest economy experiencing a strong recovery in both manufacturing and services. Buoyant consumer sentiment combined with large household excess savings can also cushion an eventual bumpy road to full recovery. The IMF forecasts that the global gross savings ration will hit an all-time high of 28% in 2022.

However, price pressures have been stronger and more persistent than expected. Even after stripping out base effects and bottleneck effects, inflation is running well above major central banks' official target. Combined with the continuing rebound in economic activity and some plausible effects from recent Variant Omicron, inflation could only peak in the first half of 2022.

In this context, Central banks and the US Federal Reserve in particular are becoming more and more vocal, announcing an earlier normalization of their monetary policy. The Fed is turning more hawkish and announced its intention to end asset purchases by March. St. Louis Fed president James Bullard said on January 7th that the Fed could hike rates as soon as March and he is not the first FOMC member that has verbalized such an aggressive timetable in public. That being said, a rate liftoff in March is priced to a significant degree with April Fed Funds implying an effective rate of 0.29% versus current level at 0.08%. At this stage, and given the US economic activity and the rapid progress in the labor market, we believe a faster normalization of the Fed monetary policy is justified.

Regarding Europe, the short-term outlook could be less clear given the economic impact from renewed mobility restrictions. Nevertheless, we still expect the region's economy to grow above 4% this year. Being less active than others, the European Central Bank will likely take its time before any normalization. On top of that, the heavy European political calendar will provide some kind of immobilism.

We see optimism in Japan where macro data has been encouraging. A weaker yen combined with a fresh fiscal stimulus should support the Japan economy in the coming months.

In conclusion, the global economy remains robust and resilient. Inflation appears also more resilient and less transitory than earlier expect. We expect inflation pressures to ease only in the second half of the year. The Fed among other central banks will have to proceed to a faster normalization both on rates and balance sheet. This transition, even gradual could provide some volatility chapters for most rate sensitive sectors for which risk premium for that potential outcome has not been built. Nevertheless, the global recovery is on track allowing us to maintain a constructive view in the medium-term.

We acknowledge three major risks to our scenario:

- Aggressive inflation pressure that would trigger an acceleration in the pace of rate hikes that would not anticipated by financial markets.
- Further building tensions between Russia and Ukraine that would deteriorates relationship between Russia and the rest of the world.
- Emergence of a new variant with higher hospitalizations and fatalities.

Fixed Income: Surprises and Stability

December was a big month for bond markets as several central banks decided on interest rates. The BoE was the first major central bank to hike rates from 0.15% to 0.25%. This surprise hike was the first in 3.5 years and came just as the Omicron variant is raging in the UK.

The Fed, which met in the middle of the month, decided to double the taper by speeding up the reduction of bond-buying. This was largely expected. With this new timetable, bond-buying will end by March 2022.

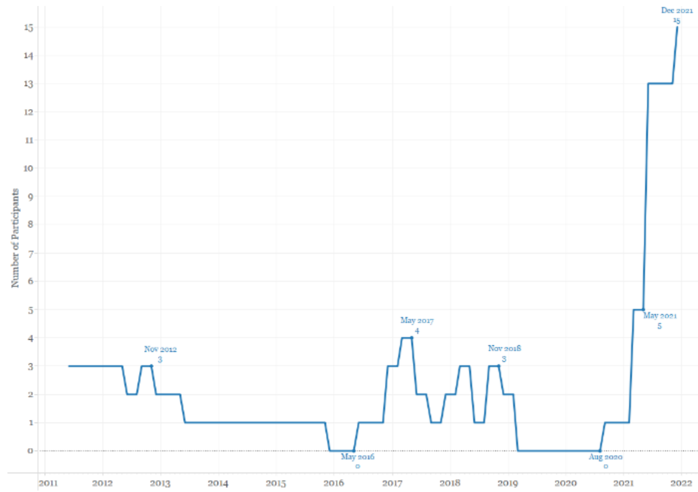
More important is the fact that the Fed's statement was overall hawkish. A majority of FOMC members reported being worried by upside risks to Core PCE. PCE is expected to be 2.6% in 2022 and should fall to 2% in 2023. Above-target inflation, while still "transitory", should last for about one year. The median forecast for rates in 2024 nudged up only a bit from 1.75% to 2%.

In the press conference following the Fed's decision, Powell struck, however, a rather dovish tone. Markets liked the combination of policy certainty and a certain confidence in the economic outlook.

In summary, the Fed sticks to its view that inflation is transitory. Moreover, the first rate hike will happen only after the bond-buying program has come to an end.

The ECB followed the Fed and confirmed that it will continue to buy bonds, continue to re-invest the proceeds and not hike until bond-buying ends.

FOMC Members reporting upside risks to Core PCE Inflation



Source: Bianco Research L.L.C.

For bond investors 2021 was a difficult year. Major indices ended the year in negative territory on a total return basis. For the Ryan 10-year Index and the Barclays Aggregate Bond index, the year was one of the worst since the 1970s.

As core bond yields widened and credit spreads tightened in December, there are also some opportunities arising. Firstly, in relative terms, Govies look now less "overpriced" vs equities, especially if a "policy mistake" scenario should materialize. The shorter-end of the US Treasuries curve (3-7years) as well as the very long end offer some value.

Finally, while real interest rates continue to be negative and favor risky assets, the overall amount of bonds with negative yields is decreasing which is a positive.

Interest Rates in the Developed World as of 7.1.2022

Country	Policy Rate	6-Month	1-Year	2-Year	3-Year	4-Year	5-Year	6-Year	7-Year	8-Year	9-Year	10-Year	15-Year	30-Year
Switzerland	-0.75	-0.77	-0.82	-0.73	-0.52	-0.38	-0.30	-0.24	-0.20	-0.12	-0.06	-0.01	0.11	0.09
Germany	-0.50	-0.66	-0.66	-0.59	-0.57	-0.47	-0.38	-0.32	-0.27	-0.20	-0.12	-0.04	0.11	0.28
Netherlands	-0.50	-0.64		-0.65	-0.54	-0.41	-0.34	-0.27	-0.20	-0.10	-0.02	0.06	0.28	0.39
Denmark	-0.60	-0.68		-0.58			-0.15			0.00		0.13		
Finland	-0.50		-0.73	-0.59	-0.53	-0.41	-0.28	-0.21	-0.10	-0.02	0.09	0.17	0.42	0.59
Austria	-0.50		-0.62	-0.64	-0.54	-0.43	-0.28	-0.23	-0.14	-0.02	0.09	0.18	0.50	0.73
Japan	-0.10	-0.10	-0.12	-0.08	-0.08	-0.07	-0.04	-0.02	0.01	0.04	0.08	0.14	0.34	0.72
France	-0.50	-0.64	-0.64	-0.66	-0.53	-0.41	-0.18	-0.19	-0.05	0.08	0.19	0.29	0.55	0.97
Belgium	-0.50	-0.63	-0.64	-0.64	-0.57	-0.42	-0.30	-0.18	-0.13	-0.01	0.11	0.28	0.41	0.97
Ireland	-0.50		-0.63		-0.53	-0.39	-0.27	-0.13	-0.05		0.00	0.35	0.58	0.96
Spain	-0.50	-0.60	-0.59	-0.57	-0.36	-0.31	-0.10	0.11	0.18	0.35	0.51	0.65	1.09	1.46
Portugal	-0.50	-0.72	0.00	-0.58	-0.48	-0.27	-0.18	0.04	0.13	0.23	0.41	0.58	0.86	1.47
Italy	-0.50	-0.67	-0.54	-0.06	0.08	0.25	0.50	0.67	0.83	0.95	1.19	1.32	1.70	2.16
United Kingdom	0.25	0.22	0.65	0.82	0.90	0.91	0.99	0.96	1.00	1.06	1.12	1.18	1.34	1.29
Australia	0.10	0.03	0.43	0.68	1.18	1.45	1.48	1.62	1.69	1.77	1.82	1.86	2.14	2.51
New Zealand	0.75			1.99			2.30		2.41			2.52	2.76	
Canada	0.25	0.54	0.90	1.09	1.28	1.43	1.53		1.57			1.74		1.97
United States	**0.13**	**0.23**	**0.42**	**0.87**	**1.16**		**1.52**		**1.72**			**1.79**		**2.14**

Source: Bianco Research L.L.C.

Equity: The battle for transitional inflation is not over and remains at the center of the stocks market's uncertainties

For early 2022, uncertainties on growth caused by the Omicron variant and the US fiscal situation are expected to limit market direction. After the markets recorded some of the biggest gains of the last 20 year in 2021 what can investors expect ?

The S&P ended 2021 up 27% (29% with dividends) with a volatility of 13%. The strongest drawdown on the 2021 S&P was only 5%... Except for 2017 it is the lowest in 25 years. Another important fact is that S&P outperformed Nasdaq by 120 bps.

For over a year now, markets have moved into an uptrend channel. History suggests that momentum should continue in 2022, but investors may also face more stress in the coming year due to a series of concerns about coronavirus, inflation, and interest rates, as well as foreign and national policy. Last week S&P rose to an all-time high (4818) before closing down 3% in the first week of the year. Historically a negative return first-week of the year is rare and always has been followed by negative returns throughout the year.

Will investors really act that inflation has become more structural ?

Inflation in Europe continue with provisional German figures for the month of December which accelerate again year-on-year to 5,3%, confirming the thesis that inflationary pressures will remain strong in the coming months. In the United States, the situation remains the same. The supply chain situation will continue to be a problem for some time yet with no consensus on whether the situation will continue or improve. Investors are cautious about the US central bank's decision to tighten monetary policy faster.

Since the end of September, there has been a considerable divergence in the NASDAQ Composite. The index soared, while profit estimates for 2022 and 2023 fell sharply. This divergence has led the index price-to-earnings ratio to its highest levels last year and put the NASDAQ in a precarious position.

We are now entering the profit season period for the next two weeks, during which analysts generally update their valuation and pricing targets on individual companies. It is likely that sales analysts are starting to update their models and therefore their targets scores and objectives. This could lead to a drop in profit estimates if analysts start to lower their expectations and add additional pressure on NASDAQ profits, which are already on a downward trend.

For the time being, The index is trading at a PE ratio of approximately 30 times the profit estimates for 2022. This PE ratio is up from the beginning of October. Meanwhile, profit estimates have fallen by 5% compared to a peak at the end of August. The most complex is the Fed and its plans to end quantitative easing, raise rates and begin the process of balance sheet reduction.

The last minute FOMC of the December meeting revealed that the process could start much earlier than planned. This caused nominal and real yields to skyrocket, a blow to the bullish narrative based on the history of low yields, which contributed to the excessively exuberant rise in many of the technology and growth values that NASDAQ encompasses.,

We remain constructive on the equity markets, with a value bias for European market and cyclical values of good qualities. Financial companies (SX7E) as well as Energy companies (SXEP) offer an important beta in this economic context we have. We remain cautious in emerging market for the next month in the scenario of rising interest rates.

Forex And Commodities:

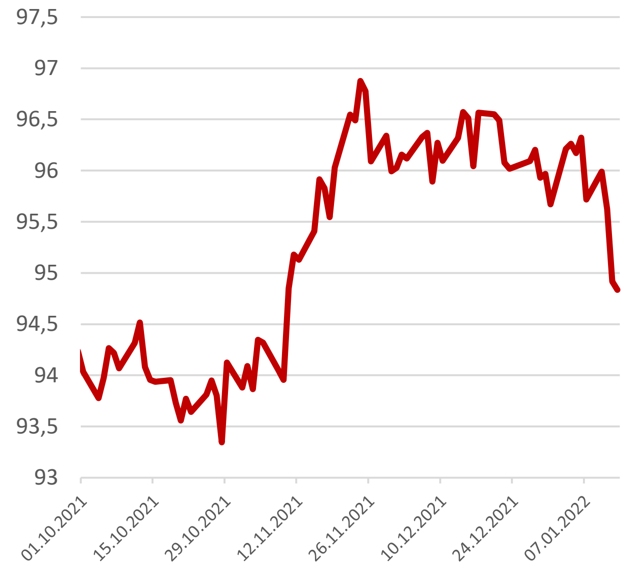
After a good performance in the 2nd quarter of 2021, what can we expect from the USD in 2022 ?

In 2021 the DXY index found its bottom around 89 – 90 in the first part of the year and seems to have taken off. However, he was under pressure after December's non-agricultural employment in the US grew less than expected.

In this contest the Yen has progressed in its role as a safe haven.

In addition, the strength of the EUR/USD weighed on the dollar as signs of faster inflation in the euro area put pressure on the ECB which is likely to tighten its policy sooner than expected, which stimulated the euro. EUR/USD also found support after euro area retail sales in November increased unexpectedly by +1.0% monthly, exceeding expectations by -0.5% and the largest increase in 5 months.

Dollar Index under pressure for 2022 ?



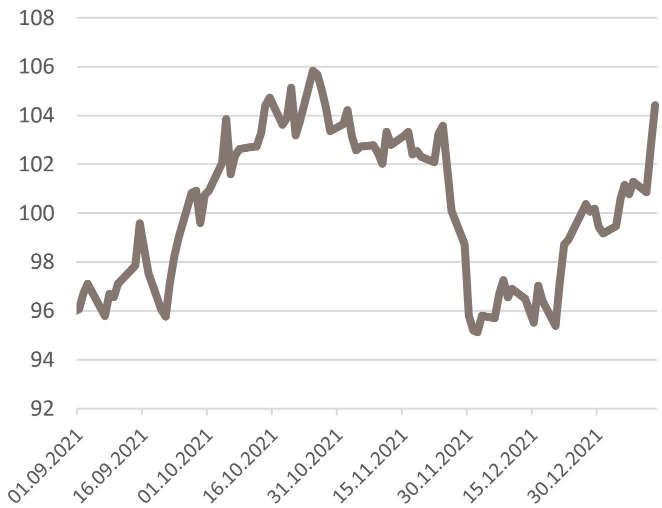
Source: Bloomberg.

Good end of year for base metals

Gold and silver rose 3% and 2% respectively last month as a result of inflation fears and concerns about the outlook for global economic growth as a result of Omicron's rise. The US CPI jumped to 6.8% in November, the strongest acceleration since 1982. But overall, Gold just recorded its worst year since 2015.

Non-ferrous metals also performed well (e.g., LME 3M Zinc and Aluminum +10.4%/+7.0% resp.). Zinc was stimulated by concerns about production capacity (Nyrstar will slow down its Auby smelter next month due to soaring electricity prices, while Glencore will soon place its Portovesme smelter on maintenance). The idling of the two foundries effectively reduces the supply of primary refined zinc on the European market by c. 13%. Soaring European energy costs have also forced large smelters like Aluminium Dunkirk to reduce production

Bloomberg Commodity Index, good start for 2022



Source: Bloomberg.

After the huge correction in recent months of 50%, Iron ore was stimulated by rumours that reductions in steel production could be mitigated in December and after the Chinese authorities committed to prioritizing economic stability in 2022. (Dalian May22 futures +9.2%).

LME 3M Copper prices also rose 2.9%. Roadblocks led to stops in Las Bambas and Cerro Lindo in Peru (the second largest copper miner in the world)

Palladium was one of the top performing +12% thanks to early signs of stock replenishment in China after a year of extremely low imports, while the global shortage of chips seemed to ease.

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