Main Events

EU CPI
Eurozone inflation is expected to climb to another all-time-high of 5.6% YoY

02.03

POWELL SENATE TESTIMONY
Will Mr. Powell use Senate testimony to reveal any upcoming changes in the FED's monetary policy after the Ukraine invasion?

03.03

US PAYROLLS
The US job market is likely to remain solid

04.03

ECB
On the basis of updated predictions from the ECB's economic team, Ms. Lagarde will reveal the future course of interest rates

10.03

Azimut Global Network

- Milan
- Abu Dhabi
- Austin
- Cairo
- Dubai
- Dublin
- Hong Kong
- Istanbul
- Lugano
- Luxembourg
- Mexico City
- Miami
- Monaco
- New York
- Santiago
- São Paulo
- Shanghai
- Singapore
- Sydney
- Taipei

WRONG-FOOT

- **The invasion of Ukraine caught financial market participants off guard, forcing them to reposition themselves for the new scenario.**
- **The best performing asset classes, markets and styles suddenly became the worst performer, and vice-versa.**
- **Because of the conflict, central banks are likely to be more cautious in implementing interest rate hikes and QT.**

As we all sadly know, Putin invaded Ukraine on multiple fronts on February 24, targeting military infrastructure as well as strategic trade and airport targets, justifying military action by citing the need to "demilitarize" Ukraine and halting its path to NATO membership.

Initially, the West reacted by sanctioning some individuals and broadening the perimeter of Russian bonds that cannot be held. Europe accompanied the sanctions with Germany's decision to halt construction of the Nord Stream2 gas pipeline. The pipeline, which is entirely owned by Gazprom, cost € 9.5 billion and was awaiting authorization from Germany.

On February 28th, the EU and US announced their intention to exclude some Russian banks from the SWIFT messaging system, and sanctioned the Central Bank of Russia by freezing its foreign reserves denominated in USD and EUR, of which approximately $300 billion is held offshore. This decision likely exposes Russian lenders to the risk of massive bank runs.

Russia responded by temporarily prohibiting foreigners from selling securities, closing its domestic stock market, raising its benchmark interest rates to 20%, and prohibiting all Russian residents from transferring foreign currency abroad.

(continued)

The invasion of Ukraine lead to a sharp increase in risk aversion and abrupt swings in global financial markets, as most market participants were caught off-guards and had to re-evaluate their expectations against the new scenario.

On the one hand, the outbreak of the conflict will likely lead to a loss of confidence in both businesses and consumers sentiment, which could translate into a more pronounced slowdown in global growth than initially thought as a consequence of the waning fiscal stimuli. Global governments will try as much as possible to implement additional fiscal measures either to support growth or to mitigate the impact of the high cost of living on consumers. However, after the significant weakening of public finances during the pandemic, the fiscal support in some instances may fall short of what is needed.

On the other hand, the continued rise in commodity prices, the increased likelihood of supply shortages and bottlenecks in global trade could translate into further strengthening of inflationary pressures, making inflation a more persistent phenomenon difficult to eradicate.

Central banks will therefore be caught between a rock and a hard place as inflation is already at its 30-year high. They may be at a major tipping point in deciding whether to stay more focused on fighting inflation by holding a hawkish stance, or to maintain a relatively accommodative stance to support global growth, which is expected to slow as a result of recent developments. Central banks understand that a more hawkish stance in their monetary policies during times of heightened geopolitical tensions increases the risk of stagflation in the coming quarters, given that some of the inflationary pressures are due to factors beyond the control of monetary policy. Therefore, there is growing possibility that central banks will not be in a hurry to implement all the hawkish measures they announced just few weeks ago.

As a result, because they are the most sensitive to nominal and real interest rates, technology and growth stocks have benefited the most from the new scenario. Unsurprisingly, the Nasdaq has been the best performing major index since the conflict erupted. The index of “non-profitable tech” which halved since November, increased by as much as 20% since the opening on Thursday 24. On the contrary, Value, because it is the most sensitive to nominal and real interest rates, was the worst performing style. Financials, especially in Europe, were hit by the prospect of a postponement of the interest rate normalization and by the potential write-offs that they could suffer in relation to their exposure to Russia.

Europe was the most affected region-wise, owing to its proximity to the conflict zone, reliance on supplies of several commodities from Russia and/or Ukraine (particularly gas, oil, and wheat), and the fact that European indices are much more vulnerable to value than other markets. Emerging markets have also suffered, weighed down not only by the collapse of the Russian stock market, but also by the Chinese government's renewed crackdown on some technology companies, which resumed shortly before the conflict erupted.

US and Japan confirmed their safe haven status during periods of heightened uncertainties. Japan in particular is benefiting from lower valuation, its energy independence thanks to its nuclear power plants, the strength of the yen during market turmoil.

Interest rates paused their uptrend towards mid-February as fears of a possible escalation in Ukraine became more concrete, but they failed to retrace until at least the last trading day of February. The fear of surging inflation and rising rates probably counterbalanced the search for safety.

In credit market, investment grade bonds fared quite well during the last week of February, as duration no longer had a negative impact on their prices. Conversely, high yield bonds continued to be under pressure because of increased risk aversion, reduced liquidity and worsening expectations on global economic growth. Emerging market bonds, which largely outperformed developed market bonds YTD, were those most impacted by the Russian developments, with both local currency and hard currency strategies dropping by about 5% in dollar terms during the last week.

(continued)

To summarize, since the start of the Ukraine conflict, the dynamics on financial market has turned upside down from the pre-war period. We can expect that these new dynamics will remain in place until the conflict ends, unless central banks will surprise the markets by confirming their original stance on monetary policy, or inflation numbers continue to surprise to the upside.

Additional recommendations on single asset classes are provided in the following section.

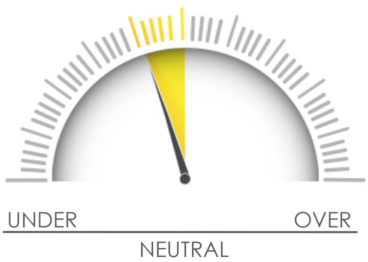
Asset Allocation View

	−	=	+
Equity			
Developed Markets	Downgrade		
Emerging Markets	Downgrade		
Fixed Income			
Developed Markets Sovereign			
Developed Markets Corporate			
Emerging Markets		Downgrade	
Commodities			
Currencies		*Commentary below*	

− UNDER = NEUTRAL + OVER

Equity

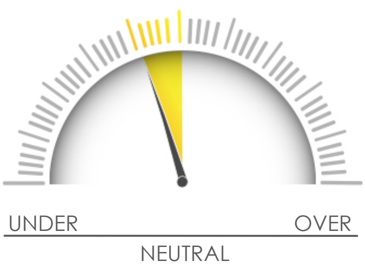
Developed Markets



We downgraded our recommendation on Developed Markets Equities to **Slightly Underweight**. While we continue to maintain a relative preference for equities in the long term due to the more inflationary environment, we prefer a more cautious stance in the short term due to the conflict in Ukraine. Recent developments indicate that the bear case is now more likely to materialize than it was prior to the invasion. As stated in the prologue, under this new scenario, we prefer US and Japan, while Europe may continue to lag behind. In term of styles, we are now cautious on Value, and more constructive on Growth stocks in light of less hawkish central banks.

US	+	**Europe**	−	**Japan**	+

Emerging Markets

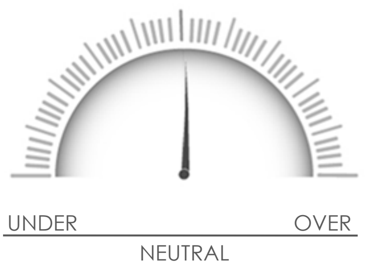


We decreased our recommendation on Emerging Markets Equities to **Slightly Underweight**. Even if Emerging markets continue to trade at much lower multiples than developed market equities, the escalation in Ukraine will likely divert investors from the asset class in the short to mid term. We recommend not to be scared about the recent developments and to stick with the gradual accumulation plan in order to take advantage of the lower entry point, we recommend avoiding the Emerging Europe region until the conflict ends.

Asia ex-Japan	=	**EEMEA**	−	**LATAM**	=

Fixed Income

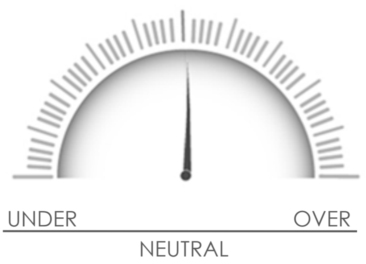
Developed Markets Sovereign



We kept our **Neutral** recommendation on Developed Markets Sovereign Bonds. The outbreak of the conflict in Ukraine is likely to benefit sovereign bonds as investors seek safe havens and central banks may delay implementing the rate hikes and QT preannounced few weeks ago. On the other hands, the increased inflationary environment caused by the spike of commodity prices may put additional pressure on central banks to stick to their original plans. Among sovereign curves, we no longer expect the BTP-Bund spread to compress as a result of the heightened risks, and thus we have removed our preference for EU Periphery.

EU Core	=	**EU Periphery**	=	**US Treasury**	=	**Japanese JGB**	=

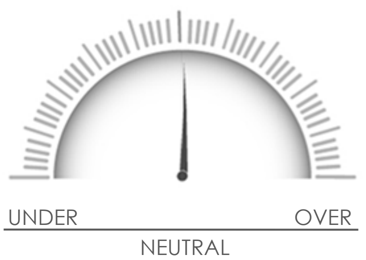
Developed Markets Corporate



We maintained our Neutral recommendation on Developed Markets Corporates. Recent developments in Ukraine may cause risk-free rates to remain stable or lower until the conflict ends, unless there is a further material spike in inflation. As a consequence, investment grade bonds may no longer be exposed to the downside risk linked to the interest rate normalization and may once again become a viable investment solution. Instead, we remain cautious on high yield bonds, as their weaker fundamentals, together with increased risk aversion and decreasing liquidity, suggest that further downside is still possible.

IG Europe	=	**IG US**	=	**HY Europe**	−	**HY US**	−

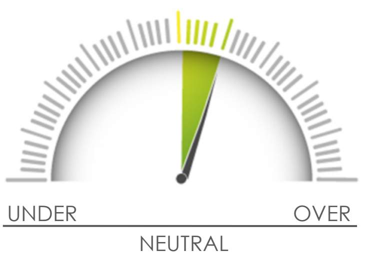
Emerging Markets



We reduced our recommendation on Emerging Market bonds to **Slightly Underweight**. The war in Ukraine suddenly resulted in an interruption and reversal of the outperformance that emerging markets bonds had achieved over developed market bonds during the first half of the year. Increased geopolitical risks directly linked to one of the emerging market countries are likely to continue to have an impact on both hard and local currency bonds.

Local Currency	=	**Hard Currency IG**	−	**Hard Currency HY**	−

Commodities



We maintained our **Slightly Positive** view on the Commodities. We continue to prefer precious metals, particularly because of thei safe haven status amid the current developments in Ukraine. Additionally, precious metals continue to be supported by deeply negative real interest, and may serve as an inflation hedge if inflation is not temporary. We have maintained a more cautious view on the other commodities.

Precious	+	**Energy**	=	**Industrial**	=	**Agricultural**	=

Currencies

As a result of the events in Ukraine, the Committee turned positive on the US dollar. Because of its status as a safe haven and the fact that margin calls must be paid in US dollars, the greenback typically outperforms during periods of market turbulence.

The view on the Euro is negative, considering that Europe will be the hardest hit by the war in Ukraine because of higher commodity prices, disruption in the supply chain, greater exposure of financial companies to Russia, geographical proximity to the area of conflict and an increased risk aversion towards Europe. Furthermore, the ECB may be the central bank most likely to deviate from its previous stance on interest rate normalization.

The view on the Chinese Renminbi remains neutral. On the one hand, the currency is trading near multi-year highs against most developed and emerging market currencies, and the interest rate differential against the US dollar and other currencies is shrinking, leaving the Renminbi vulnerable to correction. On the other hand, it could remain strong thanks to the continuous inflows due to the progressive increase of China's weight in international benchmarks and portfolios.

We have turned cautious on the other emerging market currencies as the conflict in Ukraine will likely lead to increased risk aversion and outflows from emerging market countries.

Euro	−	**USD**	+	**CNY**	=	**Other EM**	−