AZIMUT
DEFINING INVESTMENT DIRECTION

AZIMUT GLOBAL VIEW

18.07.22

Main Events

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

20.07 — EXISTING HOME SALES
Will US existing home sales continue to remain strong despite surging mortgage payments?

21.07 — ECB MEETING
The focus will be on the path of interest rate hikes and details on the anti-fragmentation tool

22.07 — S&P GLOBAL CONFIDENCE
Will confidence indexes indicate that growth is resilient after a sharp decline in recent months?

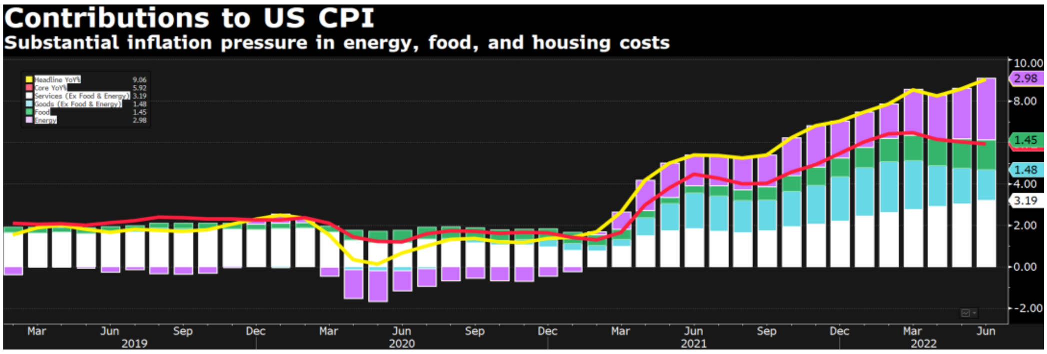
27.07 — FED MEETING
Will the Fed continue to raise rates at a sustained pace, or will it open the door to a more moderate stance in light of the risk of an economic slowdown?

DIVERGING INFLATION

- **Falling commodity prices in the United States may result in a favorable July inflation reading**
- **However, in Europe, energy supply issues are causing an increase in electricity prices, which could lead to double-digit inflation**
- **This could cause the Fed to be more cautious in tightening monetary policy, while the ECB becomes more aggressive. As a result, US growth stocks may rebound, while Europe could be the weakest region**

Inflation has been the dominant theme of the past year, and it is a phenomenon that has almost uniformly affected western countries, as evidenced by YoY changes that are all close to +9%. Inflation rates, however, are expected to diverge significantly in the near future, at least between the United States and Europe.

In the United States, inflation reached +9.1% YoY, driven by a monthly increase of +1.3%, the sixth highest monthly increase in 50 years. According to the chart below, the energy and food components alone account for roughly half of the current inflation rate.



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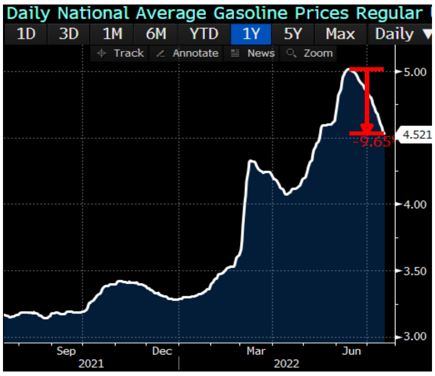
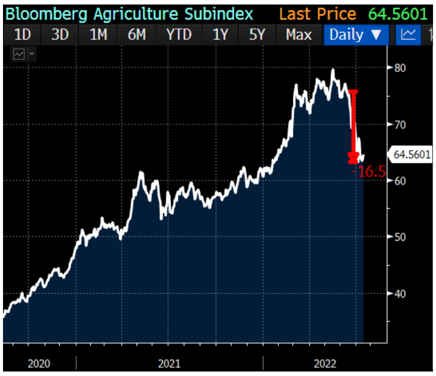


Source: Bloomberg



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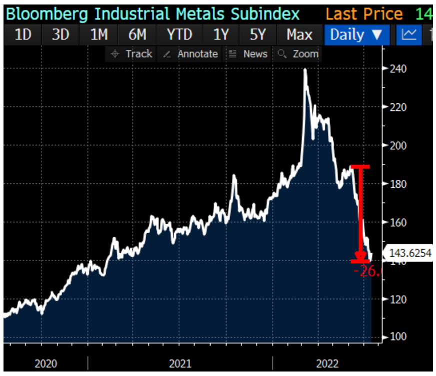


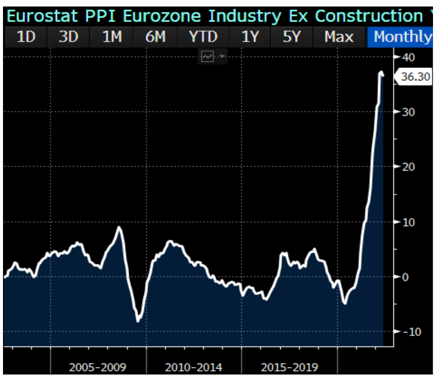
Source: Bloomberg

Given how much commodities have recently corrected (in dollar terms), the July CPI set to be released on August 10 could come out much lower than the last reading (+9.1% YoY). This is because the inflation figure for each month reports the change in prices between the middle of the reference month and the middle of the previous month. As a result, the price change from mid-June to mid-July will be published in August. Over that time period, gasoline fell by 10%, oil by about 20%, and agricultural commodities by 15%.

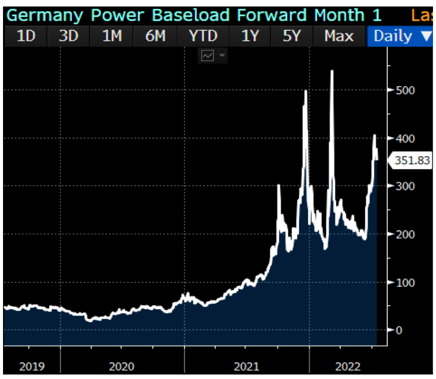
Among non-food and non-energy commodities, industrial metals fell about 25%, returning to early 2021 levels. Only the "sticky" components of inflation (salaries, housing) are likely to sustain inflation. However, the magnitude of the decline in commodity prices is such that the month-on-month change may even be negative.

The dynamics in Europe are very different, and not just because of the euro's weakness, which has offset some of the declines in commodities (which are priced in dollars). Europe unfortunately felt the consequences of the war between Russia and Ukraine the most, as an important part of European imports came from those two countries. As a result, producer prices in Europe increased by 36% year on year, and some of this increase will inevitably be passed on to consumers.

But the main problem for Europe is energy dependence on Russia. Electricity prices, which were already going up in 2021 due to rising commodity prices, have skyrocketed since Russia first became more threatening and then invaded Ukraine. While electricity prices spiked three times but then fell back, starting in mid-June, they began a more persistent rise that appears to be justified by Russia's use of gas as a weapon against Europe. Russia cut supplies from the "Nord Stream 1" pipeline first, then completely shut it down during planned pipeline maintenance. It is unknown whether Russia will resume gas supplies to Europe after maintenance. Electricity prices in Germany have more than doubled since mid-June, before a portion of the increase was reversed. Electricity prices are now ten times higher than they were at the end of 2019. It is unthinkable that this increase will not be passed on to goods and services produced in Europe, having a large impact on European inflation.



Source: Bloomberg



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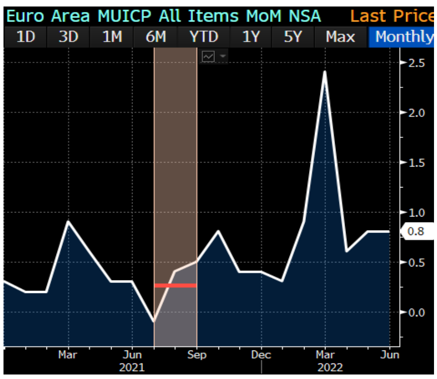

Source: Bloomberg

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These dynamics occur at the worst possible time, as the base effect for the next three months is utterly unfavorable: In Europe, prices rose by an average of less than 0.3% month-over-month from July to September 2021. It is likely that the MoM increase in the coming months will be significantly higher. Given that European inflation is already at 8.6%, the CPI could rise well into double digits in the Fall. The preliminary reading for July will be published on July 29.

These diverging trends will have profound impacts on the decisions that will be implemented by the Fed and the ECB, with considerable implications for financial markets.

The ECB will find itself in the most difficult position as the it will be forced to act more vigorously to try to stem runaway inflation, albeit in an environment where cost inflation will contribute to inducing an economic slowdown and is caused by factors beyond the ECB's direct control. Stagflationary scenario is thus becoming more likely in Europe.

In the United States, a favorable inflation reading in August could trigger at least a temporary rebound in the stock market, particularly by those stocks, sectors and styles that suffered most during the first-half on the expectation that Fed will implement its monetary tightening more gradually. The reduced liquidity characteristic of August could possibly lead to a quite extended move, especially if the reporting season that began recently proves to be better than expected.

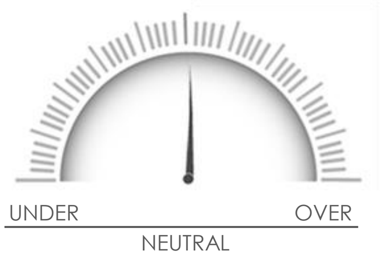
Asset Allocation View

	UNDER (−)	NEUTRAL (=)	OVER (+)
Equity			
Developed Markets		Upgrade	
Emerging Markets	■		
Fixed Income			
Developed Markets Sovereign		■	
Developed Markets Corporate			■
Emerging Markets	■		
Commodities		■	
Currencies		*Commentary below*	

(−) UNDER (=) NEUTRAL (+) OVER

Equity

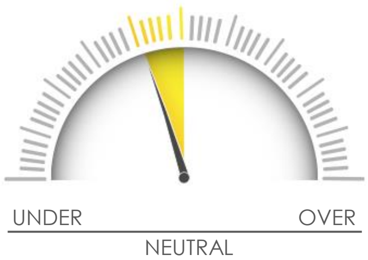
Developed Markets



We upgraded our recommendation on Developed Markets Equities to **Neutral**. Recently, it seems like equity markets are trying to establish a base from which to launch a long-awaited bear market rally. The reporting season will be crucial in this regard, as earnings expectations remain quite high which we had elaborated in the previous report. Equally critical will be the monetary policy decisions and forward guidance of the Fed and ECB when they meet later this month. In terms of regions, Europe is the area over which we maintain the most cautious view.

US	(=)	**Europe**	(−)	**Japan**	(=)

Emerging Markets

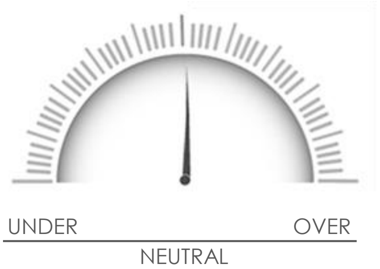


We maintained our **Slightly Underweight** recommendation on Emerging Markets Equities. Emerging countries abruptly halted the period of outperformance experienced in the previous quarter. The Chinese stock market was affected by the government's announcement of a new change in stance on Covid containment policy, while countries most reliant on commodity exports suffered from raw materials' violent correction.

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

Fixed Income

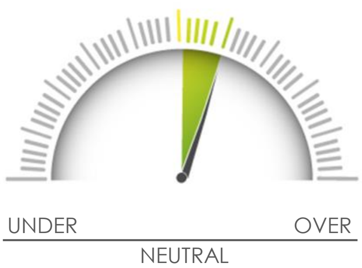
Developed Markets Sovereign



We left our recommendation on Developed Markets Sovereign Bonds unchanged as **Neutral**. The recent rise in interest rates has pushed the entire yield curve, from short-end to the long-end, back to unappealing levels. Given the risk of an economic slowdown, an outright short position is not recommended, but the possibility of a further acceleration of inflation, especially in Europe, suggests that long positions are not that recommended either. Only the very short segments of the curves (up to 6 months of maturity) are relevant and can be used as a safe haven.

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

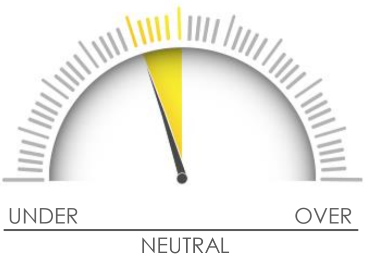
Developed Markets Corporate



We maintained our recommendation on Developed Markets Corporates as **Slightly Overweight**. Among corporate bonds, investment grade and particularly European hybrid bonds have reached level of spreads and YTM that are worth restarting to accumulate, even if an economic slowdown materializes. Conversely, caution is still advised on high yields, which may still have some downside in the event of a downturn in global growth.

IG Europe **IG US** **HY Europe** **HY US**

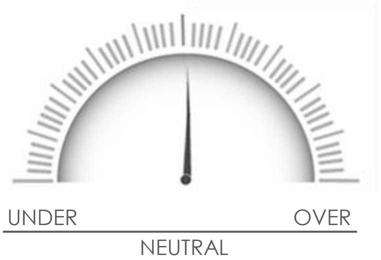
Emerging Markets



We maintained our **Slightly Underweight** recommendation on Emerging Market bonds. Despite spreads reaching high levels, it is reasonable to expect developing market bonds to remain under stress as long as Western central banks continue to release progressively hawkish statements, as well as in case of a global economic slowdown.

Local Currency **Hard Currency IG** **Hard Currency HY**

Commodities



We maintained our **Neutral view** on Commodities. We are more cautious on precious metals in light of Western central banks' increasingly restrictive monetary policies. Precious metals, with no ability to generate cash flow, are facing increasing competition from the US government bonds. The deep correction in commodities is creating a tactical buying opportunity, specifically in industrial metals, which have in some cases returned to early 2021 levels. The view on agricultural commodities remains positive as well.

Precious **Energy** **Industrial** **Agricultural**

Currencies

The Committee confirmed its **Neutral View on the US dollar**. After the strong appreciation of recent weeks, the Dollar may be entering a phase of temporary consolidation. Nevertheless, in the medium term it is still believed that the dollar has further room for appreciation considering that the Federal Reserve is proving to be the most aggressive central bank in tightening monetary policy, and that in case of global economic slowdown or increased risk aversion the Dollar tends to appreciate.

The view on the **Euro is Neutral**. Despite weakening in recent months, energy supply difficulties and the risk of snap elections in Italy continue to weigh on the currency.

The view on the **Chinese Renminbi** is confirmed to **Neutral, but with a bearish bias**. The unpredictability of government decisions, the never-ending slump in the real estate sector, and China's dubious stance regarding the conflict in Ukraine are weighing on investors' willingness to invest in Mainland China.

Similarly, on **other emerging market currencies** we maintain a **Neutral** stance, **but with a bearish bias** in view of the heavy correction in commodities and the possibility of an economic slowdown in the second half of the year.

Euro	=	**USD**	=	**CNY**	=	**Other EM**	=