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FORUM FINANCE

1994

INVESTMENT PERSPECTIVES 2022
MID-YEAR REVIEW & OUTLOOK

JULY 2022

CONTENTS

EXECUTIVE SUMMARY

In this mid-year publication, we review the first half of 2022 and analyse some current key economic indicators before outlining the asset allocation that we recommend for the second half of the year.

The economy is facing a sharp slowdown, and visibility is poor

The world economy is slowing down, and early-year GDP growth forecasts have been downgraded materially. The war in Ukraine, lockdowns in China, supply-chain disruptions, and restrictive monetary policies have hurt economic activity severely and hopes for the extension of a strong post-COVID recovery period have been crushed. Russia's invasion of Ukraine has exacerbated ongoing strains from the pandemic, such as supply chain bottlenecks and significant increases in the price of many commodities. Inflation pressures have also proved to be much more persistent than those forecasted by central banks. The World Bank now expects global growth to reach only 2.9% for the whole of 2022, from a 4.1% projection six months ago. The economy has had to face even more headwinds than expected so far this year and recession risks have kept on rising.

Financial conditions will continue to tighten

The recent period has seen a most dramatic hawkish shift from central banks. Markets are now anticipating the most aggressive and synchronised tightening cycle since the Volcker era of the early 1980s. It has taken some time for central banks to realize how wrong their inflation forecasts had been, and they are now in catch-up mode. The yields of G-7 sovereign bonds have increased at an unprecedented pace. A rise of yields had been anticipated but the speed at which central banks, especially the Fed, have shifted their monetary policies has shocked the markets. In January, markets were expecting three 0.25% rate hikes only by the Fed in 2022 to a level of 0.75%. A month later, five hikes had been discounted, to a level of 1.25%, and by March this expected level had moved up to 2.5%! Current expectations are for the Fed funds rate to end 2022 close to 3.5% and for the terminal rate to reach 4% in 2023. Rate hike expectations from the ECB have also increased significantly, from none expected in January to five at the time of writing to an end-2022 level of around 1%.

The second half will likely remain volatile for financial markets

The first half of 2022 has been brutal for global equity and bond markets. Despite solid 1Q corporate earnings and, so far at least, an overall positive outlook on future profits, equities have dropped significantly because of the rising hawkishness of the major central banks. The combination of higher earnings and lower equity prices means that the derating of valuations, a trend observed since the end of 2020, has continued throughout 2022. Sovereign debt yields have risen at an accelerated pace and credit spreads have widened significantly. Key broad bond indices are down by around 15%, a staggering drop for the asset class. Investors have had to continuously adjust their expectations relative to the policies of the major central banks, which has triggered outsized volatility. In view of the elevated level of uncertainty, due to economic and geopolitical headwinds, we expect financial markets to remain volatile in the near term.

The positioning of the portfolios has become more defensive

Our portfolio positioning has become more defensive, with a neutral allocation towards equities, an overweight in alternative strategies and a fixed-income allocation which is underweight and has a low level of duration. For non-USD denominated portfolios, the US dollar position was also increased, a defensive move. Our equity exposure remains well diversified and some growth equity strategies have been replaced by more defensive ones, a switch that has worked well so far. Our assessment is that a lot of negative news has already been priced in, and market sentiment has become overly depressed. In the current market conditions, the more defensive strategies, including the less cyclically exposed companies, real assets, healthcare, value equities, and quality growth businesses, are likely to continue outperforming. We also like the decorrelation offered by equities of frontier markets, especially as their valuations remain very compelling.

In the next section of the document, we will evaluate the macro environment and the prevailing financial conditions by highlighting several key indicators that we observe. Following a brief overview of the first half returns of the different asset classes, we will outline our current market outlook and asset allocation.

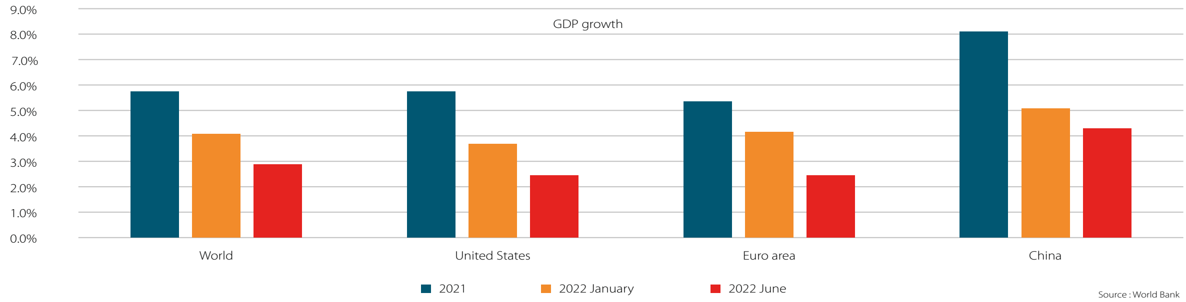
THE MACRO ENVIRONMENT

WORLD ECONOMIC GROWTH

The global economy is slowing down

The global economy is slowing down, and early-year GDP growth forecasts have been downgraded materially. The World Bank now anticipates global growth to reach only 2.9% for the whole of 2022, from a 4.1% projection six months ago. The war in Ukraine, lockdowns in China, supply-chain disruptions, and restrictive monetary policies have hurt economic activity severely and hopes for the extension of a strong post-COVID recovery period have been crushed. Russia's invasion of Ukraine has exacerbated ongoing strains from the pandemic, such as supply chain bottlenecks and significant increases in the price of many commodities. China's zero-COVID policy also means that supply chain issues will take even longer to resolve. The resulting trends of higher inflation and slower growth raise the threat of stagflation, with potentially destabilizing consequences for low-income countries due to the surge of energy and food prices. From a regional perspective, the United States appears to be in a better position than Europe, in view of the latter's reliance on Russian energy, of gas especially. The World Bank now forecasts that euro area growth will slow to 2.5% in 2022, 1.7% less than its January projection. China's economic activity has been badly hurt by COVID-related lockdowns during the first half of the year and the government's 5.5% GDP growth target will not be reached. Several supportive policies should, however, prevent a hard landing of China's economy in the second half.

GDP GROWTH



The chart illustrates the deterioration of the economic environment since the beginning of the year. Back in January, we had commented that "GDP growth forecasts could end up being well off the mark, both on the upside and the downside". It has been to the downside, unfortunately, as reflected by the World Bank's cuts to its January GDP growth projections, with growth in the euro area having been downgraded the most.

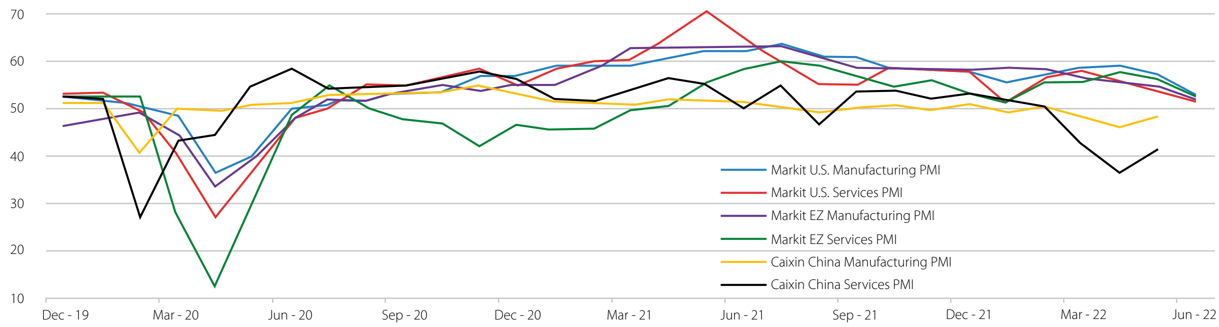
RECESSION RISKS HAVE INCREASED

Since the beginning of the year, the global economy has had to contend with a growing number of headwinds, which have raised the risks of a recession in several regions considerably. Supply shortages were expected to gradually ease, but the opposite has happened. China's strict zero-COVID policy meant that Shanghai was put in a severe lockdown for nearly two months. Shanghai and its surrounding provinces are one of China's industrial heartlands and is the home to the largest port in the world. Other major Chinese ports have also been affected by lockdowns. Suffice to say, global supply chains and logistics have been badly disrupted by these lockdowns and it will take time for the situation to stabilize. The war in Ukraine has only exacerbated this problem. Ukraine was already seen as a major bottleneck for food supply chains before the war due to poor port infrastructure and the large concentration of world maize and wheat supplies moving through. Beyond food, the war's impact on energy and fuel prices has made both production and transport more expensive across the board. Hopes for a peak of inflation during the first half of 2022 have therefore been disappointed and the threat of persistent elevated inflation has driven developed market central banks to tighten their monetary policies most drastically. These headwinds, on top of other issues, mean that the risk of an economic contraction in Europe or in the United States has been increasing, and contributed to weaker business and consumer sentiment.

All this does not mean that a recession is inevitable. Even if the odds are rising, the economy is still benefiting from tailwinds, including robust US consumer spending, and very low unemployment levels on both sides of the Atlantic. In the US, lower consumer confidence has not yet hit spending and the strength of payroll employment growth, which is averaging close to 400'000 new jobs per month, is hard to reconcile with claims that a recession is imminent. Admittedly the eurozone appears as more fragile, due to less resilient consumer spending and the more pronounced spill over effects from the war in Ukraine. The region's high level of dependency on energy imports from Russia and the knock-on impact of economic sanctions are hurting economic activity, as are tighter financial conditions. The probability of any positive developments relative to the war appears small at this stage, but the strong post-lockdown rebound in some sectors most hurt by the pandemic should still support the eurozone economy in the near term. Strong labour markets and corporate robustness represent other pockets of strength.

LEADING INDICATOR

PURCHASING MANAGER INDEXES



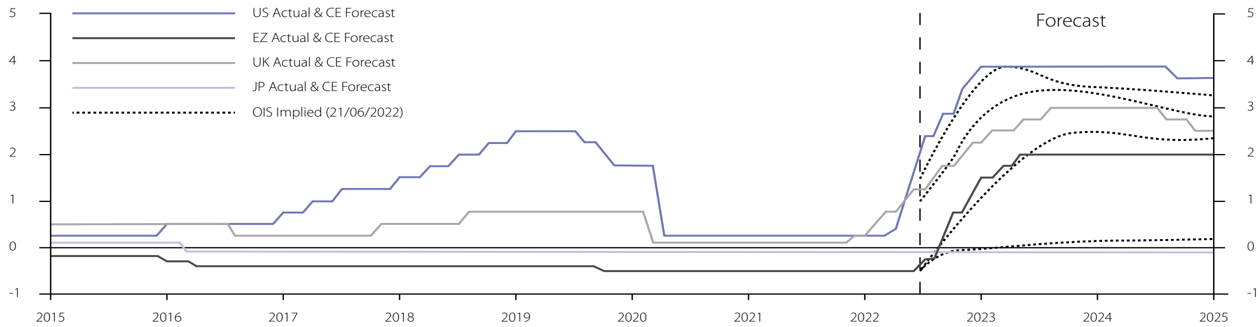
The chart above shows that Purchasing Manager Indexes (PMIs) are trending lower in both the eurozone and the United States. Following a strong rebound of Services PMIs from February onwards, as COVID restrictions were gradually lifted, recent numbers have weakened. In the eurozone, rising costs of living, slowing pent-up demand and a scaling back of hiring plans are some of the reasons for the slide of the index. In the US, a sharp fall in new orders and weaker new export orders had the biggest impact on the latest data. The rate of job creation also softened, while sentiment was at its lowest since September 2020. One must note, however, that the indexes remain in expansion territory, above a level of 50. In contrast, China's PMIs are indicative of a contraction, but they are picking up as the economy is reopening following extensive lockdowns. Economic activity in China should progressively recover in the second half as targeted monetary and fiscal measures will contribute to stabilize growth.

FINANCIAL CONDITIONS

THE MAIN CENTRAL BANKS HAVE ADOPTED AGGRESSIVE TIGHTENING POLICIES

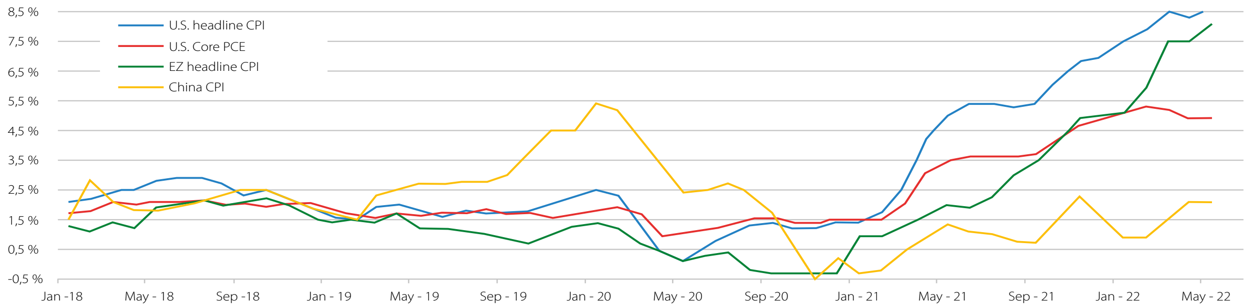
The recent period has seen a hawkish shift from central banks due to persistent price pressures. Markets are now anticipating the most aggressive and synchronised tightening cycle since the Volcker era of the early 1980s. It has taken some time for central banks to realize how wrong their inflation forecasts had been, and they are now in catch-up mode. The Federal Reserve is leading the way and is hiking interest rates at a fast pace, while at the same time starting to shrink its balance sheet; a fast ramp-up of interest rate expectations has already had a major impact on yield curves and credit spreads, but the fallout from quantitative tightening is more difficult to predict. Investors are also closely monitoring whether the European Central Bank will be able to reconcile a more restrictive monetary policy, including interest rate hikes and an end to its asset purchases program, with stability in the eurozone bond markets. It has already had to reassure investors that it would prevent peripheral spreads from widening too much, but questions remain about how it will proceed and what spread levels will be considered acceptable by the central bank. Whereas developed market central banks are playing catch-up in their fight against inflation, emerging market central banks have already been much more proactive. Significant rate rises have been undertaken in countries including Brazil, Chile, Poland, and Mexico, meaning they have already addressed at least some of the concerns related to inflation pressures.

MAJOR ADVANCED ECONOMY INTEREST RATES



The chart shows the actual interest rates and the forecasts by Capital Economics. After initially rising interest rates by 0.25% in March, the Federal Reserve has since accelerated the pace of its tightening; a 0.5% increase in May was followed by a 0.75% move in June, with another 0.75% hike fully expected for the upcoming July meeting. From the current range of 1.5% to 1.75%, markets are expecting the Fed funds rate to reach 3.5% by the end of 2022 and a terminal rate of 4% next year. The ECB is expected to start increasing rates in July. From the current rate of - 0.5%, markets are now anticipating the ECB's policy rate to end 2022 at around 1% as they have been scaling back their expectations recently.

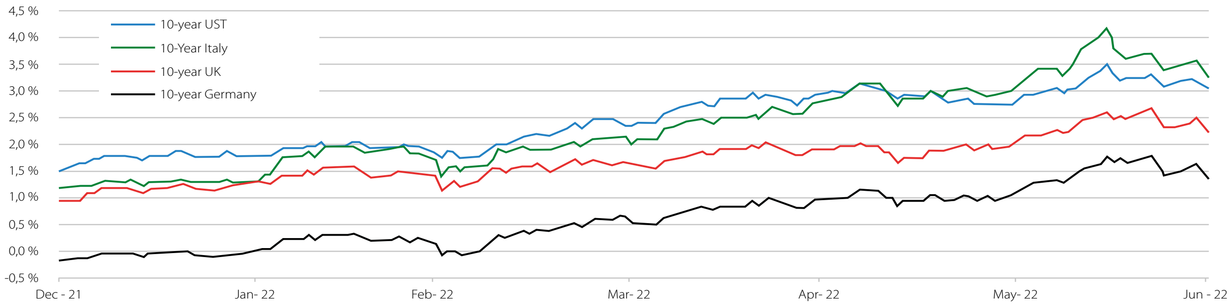
INFLATION HAS RETURNED WITH A VENGEANCE



Source : Bloomerg L.P.

Central banks' long-lasting argument that inflation would be transitory only has proven to be well off the mark. The chart shows that inflation pressures have continued to build at a fast pace and reached levels not observed since the 1980s. Up to now, higher commodity prices and transport costs, supply disruptions at a time when demand for manufactured goods exploded, and rising wages have all contributed to push inflation to the current levels. From now on, pressures are likely to shift to food and services sectors, with higher wage demands amid tight labour markets presenting a source of upside risk. On a more positive note, inflation is likely to peak in the months ahead and could significantly decline thanks to supportive base effects and hopes that supply disruptions could abate. Questions remain over the risks related to wage demands. In the US, the wages of lowly qualified workers have been ramped up, but shortages remain across several sectors as companies continue to struggle to hire new workers. A similar situation can be observed in the UK, with job vacancies reaching a record. In Europe, labour markets are also buoyant, with high vacancy rates and low unemployment. Wage pressures are building due to high inflation and unions in different countries have been increasingly pushing for pay rises.

GOVERNMENT BOND YIELDS

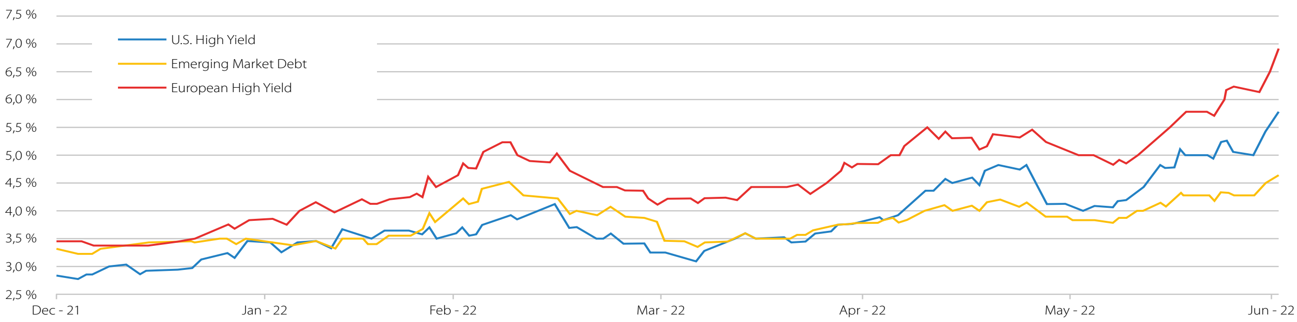


Source : Bloomberg L.P.

The yields of G-7 sovereign bonds have increased at an unprecedented pace. A rise of yields this year had been anticipated but the speed at which central banks, and especially the Federal Reserve, have shifted their monetary policies has shocked the markets. At the beginning of the year, markets were expecting three 0.25% rate hikes only by the Fed in 2022 to a level of 0.75%. By the end of January, five hikes had been discounted, to a level of 1.25%, and by March this expected level had moved up to 2.5%! Current expectations are for the Fed funds rate to end 2022 close to 3.5% and for the terminal rate to reach 4% in 2023. Rate hike expectations from the ECB have also increased significantly, from none expected in January to five at the time of writing to an end-2022 level of around 1%. Suffice to say, these dramatic changes have pushed yield curves much higher. 2-year Treasury yields have jumped from 0.73% to a peak of 3.43% in June, with 10-year yields rising by 2% to 3.5% recently. As shown in the chart, UK and Bund yields have followed the same trend, while peripheral spreads in the eurozone have widened because of concerns over debt sustainability, once again.

BONDS' SPREADS

HIGH YIELD AND EMERGING MARKET DEBT SPREADS



Source : Bloomberg L.P.

As shown in the previous chart, high yield credit spreads on both sides of the Atlantic have widened significantly. Spreads proved to be resilient to rising risk-free rates initially. The beginning of the war in Ukraine then pushed spreads higher, but for a limited time only, as they quickly dropped back close to early-year levels. Spreads have widened considerably since, in view of much more hawkish central banks, and concerns over a fast-slowing economy and recession risks. From a fundamental point of view, however, corporate balance sheets are generally solid as debt levels have tended to decline and interest rate coverage levels have improved. Most companies have taken advantage of low rates to refinance during the past years and the peak year for maturities is far away; US dollar company high yield bonds maturing by the end of 2024 represent only 7% of outstanding notes, according to Bloomberg data. This should give companies breathing space and limit default risk in the near term. The spread of emerging markets sovereign debt has behaved in a quite similar fashion to high yield ones. A spike was observed in March in a risk-off environment, but the recent widening has been quite contained, in part because no tightening took place for this asset class in 2021, contrarily to a significant contraction of high yield spreads.

THE MACRO ENVIRONMENT/FINANCIAL CONDITIONS: CONCLUSIONS

The economy is facing serious headwinds when it should have been enjoying a strong post-COVID recovery. Even if COVID headlines have disappeared from the European media to a large extent, the severe lockdowns that have taken place in China are a reminder that the pandemic and its economic consequences have not gone away. While the risks related to China's zero-COVID policy remain a factor that is difficult to quantify, we are, however, not expecting any new variant to have any significant impact on the eurozone or US economies. At this stage, no one is expecting any positive development relative to the war in Ukraine so the fallout for the world economy has most likely already been largely discounted. The ability of European countries to manage their gas supplies in a satisfactory way is a major concern, but plans to source alternative energy sources, increase LNG capacity, delay nuclear phase-outs, and provisionally switch from gas to coal show that the issue is being addressed urgently.

Financial conditions will become even more restrictive under the actions of the central banks, but markets appear to be having some doubts already about how far rate hikes can go. The acceleration of the Federal Reserve's tightening path means that it could have a little more leeway later this year to pause were economic conditions to deteriorate too quickly or if inflation trends improved in a totally unforeseen way. Bond markets have experienced a torrid period as they have had to adjust to a very hawkish shift of monetary policy, and the rise of bond yields has been breath-taking. The most reassuring observation is that credit and emerging market spreads have evolved in overall smooth market and liquidity conditions. Current investment-grade credit spreads in the EU and the US have already priced in a significant level of recession risk; they provide breakeven compensation for a five-year cumulative default rate which is almost eleven times the average realised default rate for any 5-year period between 1970 and 2021. As always, the European Central Bank has struggled to put out a clear message, with a broad dispersion of views between board members, and it will likely continue to be tested by markets. Inflation is expected to start declining from the third quarter onwards, but the past year has shown how difficult it is to be overly confident of forecasts.

In conclusion, the economy has had to face an increasing number of headwinds so far this year and recession risks keep on rising. Financial conditions have tightened considerably and will continue to do so in the near term, but a lot of bad news has already been priced in the markets and there is still a possibility that the current level of pessimism will turn out to have been overdone.

FINANCIAL MARKETS

	End 2021	May 2022	June 2022	MTD	2022
EQUITIES					
S&P 500	4'766.2	4'132.2	3'785.4	- 8.4%	- 20.6%
Euro Stoxx 50	4'298.4	3'789.2	3'454.9	- 8.8%	- 19.6%
MSCI EM	1'232.0	1'077.7	1'000.7	- 7.2%	- 18.8%
YIELDS					
UST 10-year	1.51%	2.84%	3.02%	+ 18bps	+ 151bps
Bund 10-year	- 0.18%	1.12%	1.33%	+ 21bps	+ 151bps
BBB EU	0.95%	3.02%	3.73%	+ 71bps	+ 278bps
CURRENCIES					
EUR/USD	1.137	1.073	1.048	- 2.3%	- 7.8%
USD/CHF	0.913	0.960	0.955	- 0.5%	+ 4.6%
EUR/CHF	1.038	1.030	1.001	- 2.8%	- 3.6%
USD/JPY	115.1	128.7	135.7	+ 5.4%	+ 17.9%
GBP/USD	1.353	1.260	1.218	- 3.3%	- 10.0%
COMMODITIES					
CRB Index	232.4	316.5	291.1	- 8.0%	+ 25.3%
Oil, WTI	$ 75.2	$ 114.7	$ 105.8	- 7.8%	+ 40.7%
Gold	$ 1'829	$ 1'837	$ 1'807	- 1.6%	- 1.2%

Global equity markets have been under intense pressure, and have derated significantly

The first half of 2022 has been brutal for global equity markets, reflected by a 21% plunge of the MSCI World Index. Despite solid 1Q corporate earnings and, so far at least, an overall positive outlook on future profits, equities have dropped significantly because of the rising hawkishness of the major central banks, with the Federal Reserve leading the way. The rapid rise of bond yields initially hurt growth stocks the most before a drastic shift of the Fed's policy triggered a widespread correction of stocks, except for markets heavily exposed to commodities, and especially to energy. The Technology, Consumer Discretionary and Communication Services sectors have underperformed the most, with small caps also underperforming large caps. The Russian invasion of Ukraine only added to ongoing concerns over elevated and persistent inflation, the overwhelming driver of financial markets in 2022. The combination of higher earnings and lower equity prices means that the derating of valuations, a trend observed since the end of 2020, has continued throughout 2022.

The worst year-to-date performance for sovereign and investment-grade corporate debt on record

As for equities, this year has proven to have been a most challenging environment for the fixed income asset class. Sovereign debt yields have risen at an accelerated pace and credit spreads have widened significantly. Year-to-date, 10-year US Treasury yields have jumped from 1.51% to a peak of 3.48%, while those of 2-year ones have rocketed from 0.73% to a peak of 3.43%, as expectations of Fed rate hikes have ramped up at a breath-taking speed. Key broad bond indices are down by around 15%, a staggering drop for the asset class. Investors have had to continuously adjust their expectations relative to the Fed's actions, which has triggered outsized volatility, with the terminal Fed funds rate being priced at around 4% in 2023.

The US dollar has appreciated strongly on the back of the Fed's hawkish shift

The main trend observed in the currency markets this year has been the appreciation of the US dollar. The very hawkish shift of the Federal Reserve has underpinned the dollar as has the risk-off environment, which usually drives the greenback higher. The stark contrast between the very accommodative policy of the Bank of Japan and the very restrictive one of the Fed has led to a 15% depreciation of the yen versus the dollar this year. The euro has also lost ground, with the EUR/USD parity dropping by 7.5%. The ECB is struggling to find the right balance between its fight against inflation and the maintenance of stable eurozone bond markets, due to the threat of excessive widening of peripheral debt spreads. Finally, the Swiss National Bank has just shocked the markets by unexpectedly hiking rates by 0.5%, pushing the franc closer to parity with the euro.

The prices of most commodities have continued to rise

The rally of commodities has continued in 2022. The prevailing rising trend has accelerated for a range of commodities since the beginning of the war in Ukraine; energy and food prices have been heavily impacted in view of the significant weights of exports from both Russia and Ukraine. The reluctance, and to a certain extent the inability, of OPEC countries to increase oil production, on top of the EU sanctions on Russian oil, have also contributed to push oil prices higher. The price of gold is trading close to its early-year level as the benefit of its haven status has been countered by rising real interest rates and a stronger dollar.

MARKETS' OUTLOOK

Central banks will continue their fight against inflation

It took a long time for central banks to admit they had underestimated the threat of inflation pressures, but recent communication shows that they no longer have any doubt about the action required. The Federal Reserve's 0.75% rate hike in June to a range of 1.50-1.75% was its biggest move since 1994 and another 0.75% rise in July is fully anticipated. The markets are currently expecting the Fed funds rate to end 2022 at 3.5%, and to reach a terminal rate of close to 4% in 2023. In view of the constant repricing of market expectations since the beginning of the year, we are hopeful that current forecasts will not need to be raised further. A stabilisation of bond markets would represent a major step towards the reestablishment of stronger market confidence. For the European Central Bank, the period ahead will be very challenging, and it remains to be seen whether it will be able to successfully fight against inflation while preventing unwelcome stress in eurozone bond markets. The question of when the Bank of Japan will have to change tack from its current very accommodative stance remains unanswered and could represent a further source of market volatility.

Inflation concerns to dominate markets in the near term

Central banks' fight against inflation is the dominant factor driving the markets currently. As for many other key issues, it is very difficult to predict the path of inflation with a high degree of confidence, unfortunately. For certain inflation components, base effects are likely to become more supportive as the past year's rate of price rises is unsustainable. Some pandemic-era disruptions, including supply issues, low inventories, and higher shipping rates, should start to abate, and central bank tightening will begin to slow economic activity by impacting the level of demand for goods and services. The behaviour of markets in the second half of the year will depend to a large point on the central banks' ability to slow the economy without pushing it into recession. This represents a huge challenge and market volatility is here to stay.

DEBT INSTRUMENTS

The rise of G-7 sovereign debt yields to slow

We would expect G-7 sovereign debt yields to continue rising during the rest of the year, but at a much slower pace. We can well imagine a scenario where 10-year US Treasury yields eventually trade within a peak range of 3.75% to 4% before starting to fall, as the 10-year yield has typically peaked during tightening cycles at a level close to the peak in the Fed funds rate; that explains why we are not considering increasing the allocation to sovereign debt at this stage. Credit spreads have already widened considerably even if they are still well-off peaks observed in previous crises. We feel that credit offers value at the current levels and that spreads compensate for the risk of defaults, especially in view of solid corporate fundamentals; we are therefore happy to hold our current positions.

EQUITIES

The outlook for equities remains uncertain but a lot of negative news has already been priced in

The outlook for equity markets remains challenging; a further rise of real yields should remain a headwind and the forecasts for corporate earnings growth could prove to be over optimistic. However, a lot of negative news has already been priced in, and market sentiment is overly depressed, according to us. Some segments of the market have gone from being overvalued to being undervalued, and investors' market positioning has become quite underweight, so any improvement of sentiment could trigger a relief rally. That is why our equity allocation is neutral and remains well diversified.

In the current market conditions, the more defensive strategies are likely to continue outperforming. These include the less cyclically exposed companies, real assets, healthcare, value equities, and quality growth businesses. We also like the decorrelation offered by equities of frontier markets, especially as their valuations remain very compelling.

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The appreciation of the US dollar is likely close to its end

In the near term, the US dollar should remain well supported in view of elevated market volatility and the Federal Reserve's determination to bring inflation levels down by slowing the US economy significantly. A lot of supportive factors have been priced in, however, the dollar is well above its purchasing power parity, and the market is already very long the dollar, so its upside potential appears somewhat limited from the current levels. Our allocation to the dollar for non-USD portfolios was increased in March but remains underweight.

ASSET ALLOCATION 2ND HALF 2022

CASH (4%)

Neutral

The allocation to cash has risen to neutral from underweight at the beginning of the year. This level of cash reflects a more cautious outlook on risk assets as we trimmed some equity exposures in the spring

DEBT INSTRUMENTS (27%)

Underweight

Our allocation into debt instruments has been underweight since last year. We had cut the exposure to the asset class due to historically low yields, tight spreads, and a rising duration risk. Our exposure to investment-grade bonds has been very underweight for some time but we have maintained some exposure to the most highly rated part of the market for portfolio construction reasons. It is striking that investment-grade funds have underperformed during the stressful environment observed so far this year.
The recent period has been very testing for bond managers who have never had to face such a rout of rates before. Our overall low duration risk at the portfolio level helped a little, as did the ability of some managers to actively reduce this risk even further. We remain exposed to emerging market corporate debt, high-yield bonds, and senior secured loans. The managers of these funds have solid track-records of managing risk and of capturing market opportunities following market stress. We have confidence in their ability to navigate the upcoming period, especially as market dispersion is likely to increase even further.
We have maintained our allocations towards convertible bonds and to unconstrained funds. Despite being overall defensive in their positioning and duration, these unconstrained strategies have been badly impacted by the widespread drawdowns observed across all market segments.

EQUITIES (51%)

Neutral

The exposure to equities is now neutral following the trimming of some exposures in March and because of market price action. We also switched from growth strategies in emerging markets and global equities to increase our allocation to more value-orientated ones. This has proved helpful as the new positions have outperformed the ones we exited significantly. On a less positive note, we must report that some of our most active strategies have underperformed following years when outsized alpha had been generated. Our long-term investment approach means we remain confident that renewed alpha-generation will be reproduced. In relative terms, we see significant value across several equity pockets. European, UK, Japanese, emerging market, and Frontier equities appear attractive compared to their historical averages, and US small caps now trade at a discount to large caps, a rarely observed pattern. So, while it is difficult to be overly confident in a second-half equity rally, we think that the downside risk for these positions should be limited. Our key message is that we invest for the long term and that our equity allocation remains well diversified across regions, investment styles and market capitalisations.

COMMODITIES (3%)

Neutral

Our direct exposure to commodities consists of physical gold only. The main reasons for this holding are portfolio diversification and as a portfolio tail hedge. Even if gold prices could continue to face headwinds in the form of higher real interest rates, we are comfortable with this strategic position.

HEDGE FUNDS (15%)

Neutral

The allocation to hedge funds is overweight since 2021 following the addition of market neutral strategies. In a period where bonds have not been able to offer their traditional protection against falling equities, hedge funds have provided diversification benefits and, in some cases, positive contributions.

ASSET ALLOCATION GRID 2ND HALF 2022

For our balanced accounts, we apply the following grid:

	ALLOCATION	JULY 2022
SHORT-TERM DEPOSITS	**0 – 20%**	**4%**
DEBT INSTRUMENTS	**15 – 55%**	**27%**
Investment grade bonds	5 – 45%	7%
EM & high-yield bonds	0 – 20%	11%
Specialist bonds	0 – 15%	9%
EQUITIES	**20 – 60%**	**51%**
Developed markets	15 – 50%	42%
Emerging markets	0 – 30%	9%
COMMODITIES	**0 – 15%**	**3%**
Physical gold	0 – 5%	3%
Other commodities	0 – 10%	0%
HEDGE FUNDS	**0 – 25%**	**15%**
		100%

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