



# Climate Report

February 2023

**The long goodbye ...to Zero Interest Rates!**

# Investment Themes

- **‘The pace of Disinflation’** is the new inflation theme.
- A new market theme **‘Early economic recovery’** has emerged based on China/EU hopes
- **‘The Long Goodbye to zero interest rates’** limits the scope for an early recovery.
- **FED action is still a main theme.** The market does not expect a +5% Fed Fund rate but without clear evidence that the tightening medicine is effective, FED might continue to tighten.
- **Deglobalization** is ‘full speed ahead’. The split in a **Red and a Blue planet** indicate that there are more adjustments to be made by investors in the coming years.
- **Permacrisis** – a word used to describe 2022. The crisis has created new and reinforced old Long-Term investment themes in financial markets.
- **ESG.** No one seems satisfied with the current development. Investors and Companies are ‘Between a Rock and a Hard Place’



## Adapting to the new Positive Interest Rate regime .....in slow motion

- Real Estate.** Prices are still too high
- Borrowing & Lending.** Growth is still too high
- Corporates.** Investment plans: Freeze but no cancellations
- Job market.** Job lay-offs are too few.
- Household spending.** Still too high.
- Equity market.** Earnings expectations are too positive
- Credit market.** Default expectations are too low.
- Investors.** Still too growth driven.

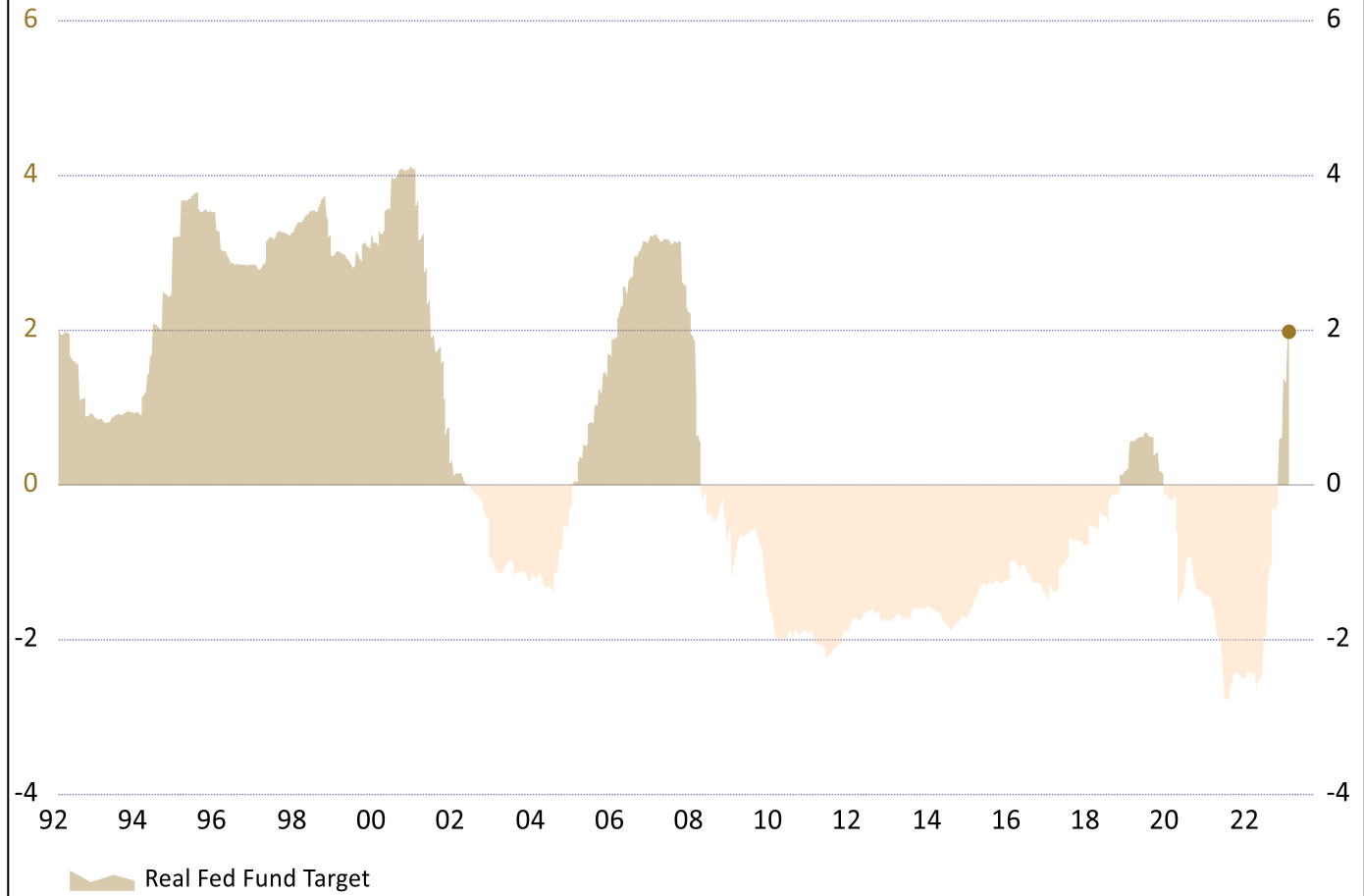
### Our Take:

Returning to the 'zero rate' low volatility regime?  
There are preconditions that we do not expect will be fulfilled in 2023:

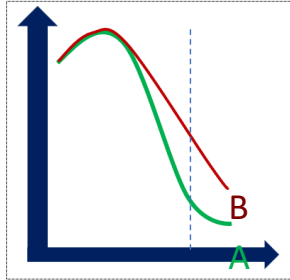
- Central Banks will very soon pivot on interest rates
- Inflation will quickly return to below 3%

## Fed Fund Target Rate

in real terms using inflation expectations



Source: Refinitiv Datastream



**A. Commodities**

suggest a speedy normalization of CPI

CPI- Total:  
Est. 3% y/y% Q3 23

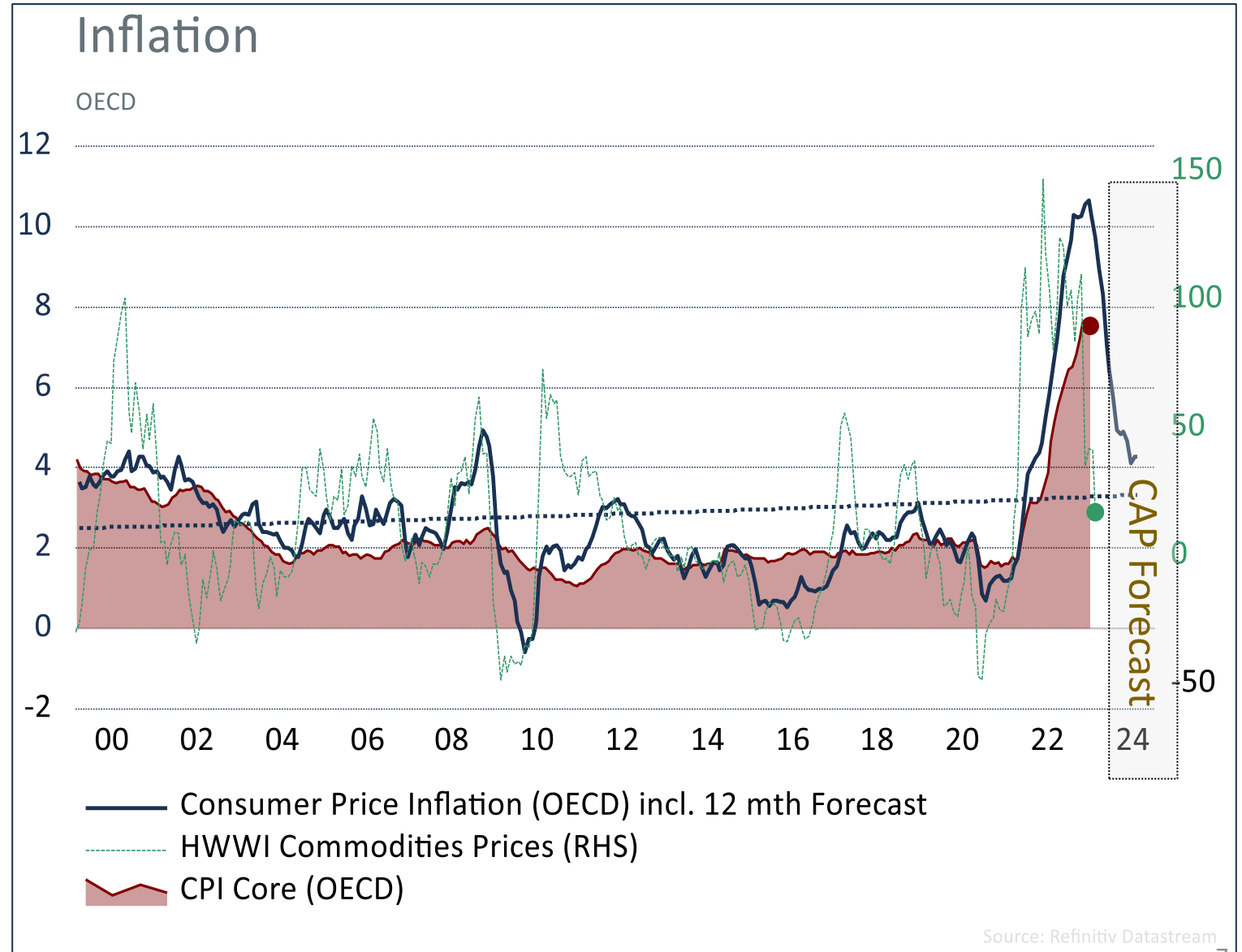
**B. Core CPI**

points to a longer time to normalize  
Laggards: Rental, Hospitality & Wages

CPI – Total:  
Est. 4.5% y/y% Q3 2023

**Our Take:**

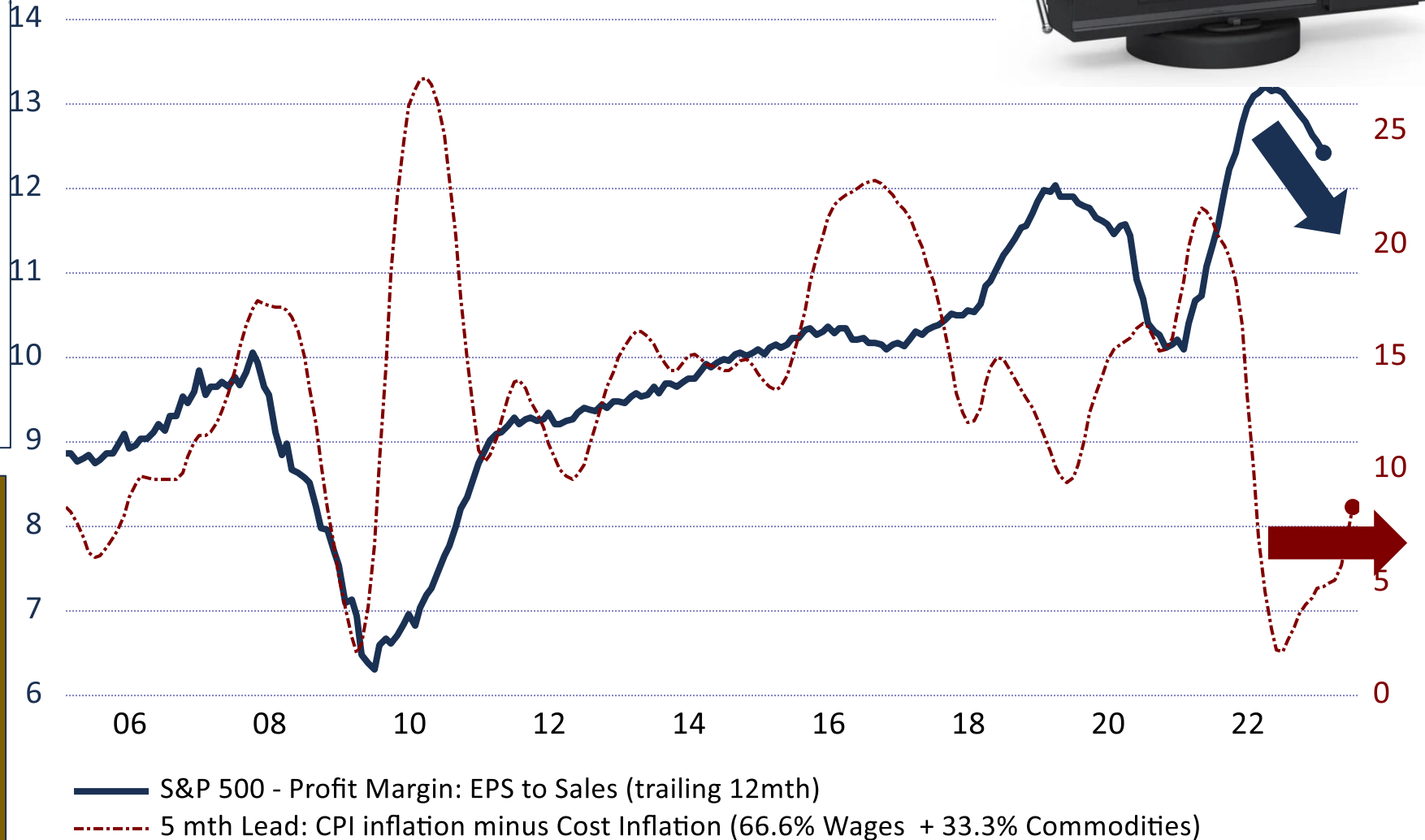
It will be almost impossible not to disappoint financial markets as consensus is clearly in the A camp.



# Profit Margins - finally moving south



S&P500 profit margins & Lead



## Mounting Margin Pressure

- Delayed effects of soaring input costs
- Labor Cost inflation is on the rise.
- Labor productivity is weak
- EPS revisions are negative

## Our Take:

- Lower margins will be welcomed for Fixed Income and 'Inflation negative' stocks as it will stimulate disinflation.
- The problem is, however, that the overall profit cycle, at the same time, will most likely weaken more than expected by consensus (IBES)



# The Phillips Curve – Coming back to life?

Wage/CPI Inflation %

## Return to 1950-80?

- De-globalization & Homecoming
- Sustainable (shorter) supply chains
- From Neoliberalism to Piketty
- Restoring workers' bargaining power
- Service needs people
- Mature China
- Climate change

## Stay the course 2000-20?

- Job lay-offs in 2023-24
- Robotics/AI
- From Analog to Digital
- 'Blue Planet' supply chains
- Raising India
- Corporate key objective: Profitability (incl. margins)

## Our Take:

- No matter the shape of the Phillips curve, the US job market is so tight, that it will be almost impossible to get wage inflation down below 4% in 2023 without layoffs. In the ugly scenario, the Philips curve 1950-80 will slowly be reinforced over the coming period.



Unemployment %

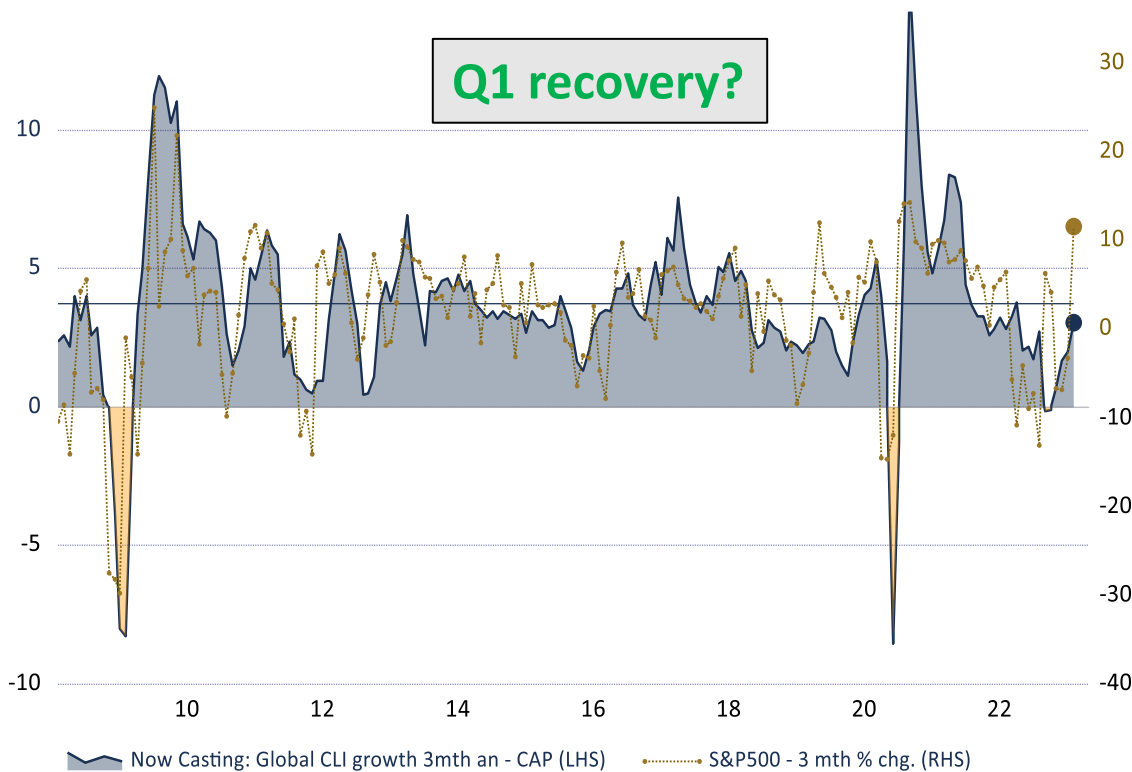
# Avoiding Hard Landing? Data is still (too) strong!

**NowCasting Macro:**  
 Industrial Metals (+), EU Service (+), Germany (+),  
 China Consumer (+), Financial Conditions (+)

**Long Term Macro + Lead 6Mth:**  
 General business conditions(--), Inflation(--), Liquidity (-), Funding Rates (--), China (+), G10 Economic Surprise(+)

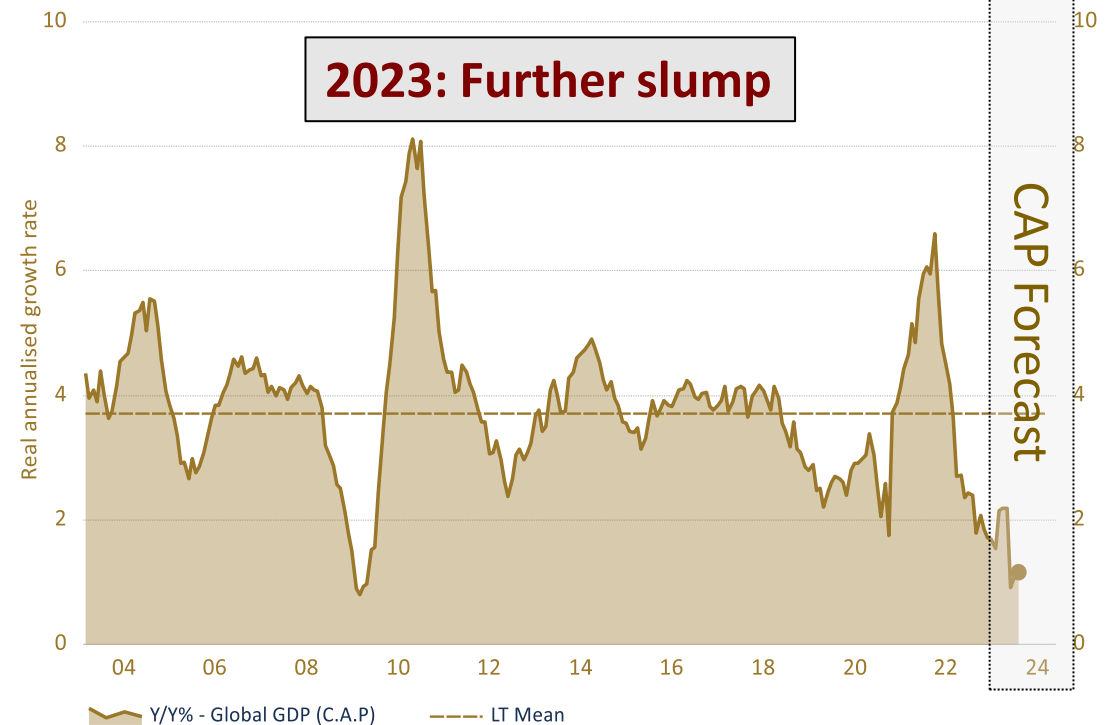
QQ% an. Global Growth

Now Casting Model & S&P500



Y/Y% Global Growth incl. 6 mth lead

CAP Model incl. forecast



Source: Refinitiv Datastream, C.A.P

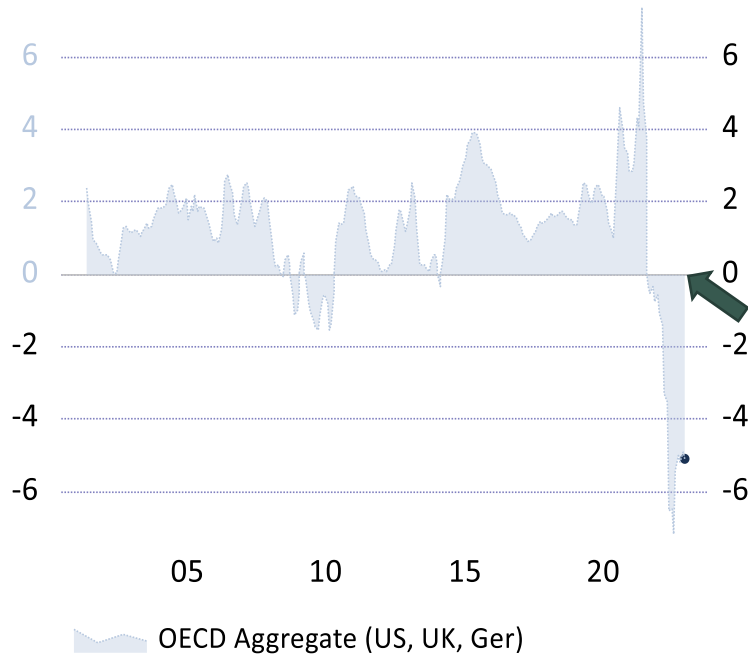
**Our Take:**  
 For 2023: Higher Interest rates will slowly filter through to global GDP and become a serious headwind from mid-2023.  
 Q1: We anticipate the slowing in the US to counterweight the positive recovery signs from especially China.



# Weak consumer spending powers in 2023

## Real Personal Income

Global, Y/Y%

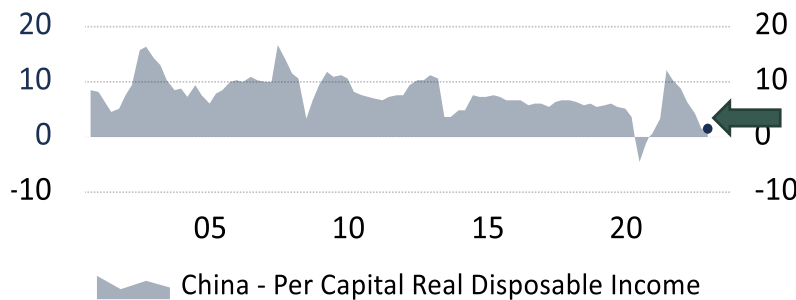


**OECD:**

Our Take: If lucky. Disinflation will drive up real incomes to zero!

**China:**

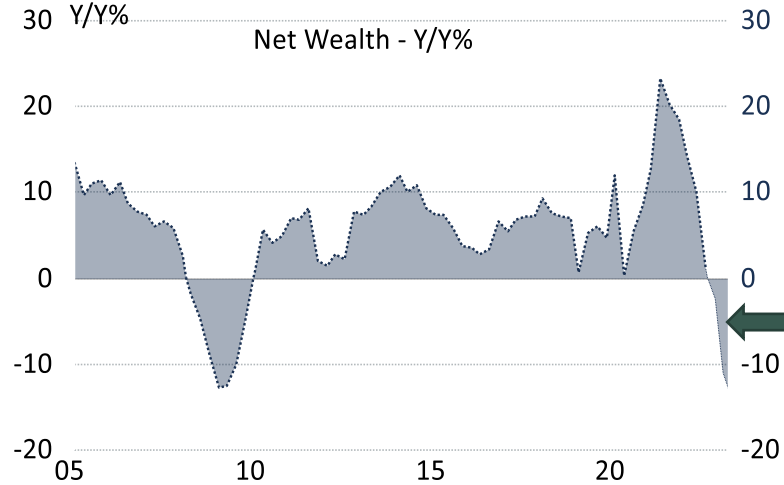
Our Take: Stimulus plans may drive up real incomes to 2-3%!



Source: Refinitiv Datastream

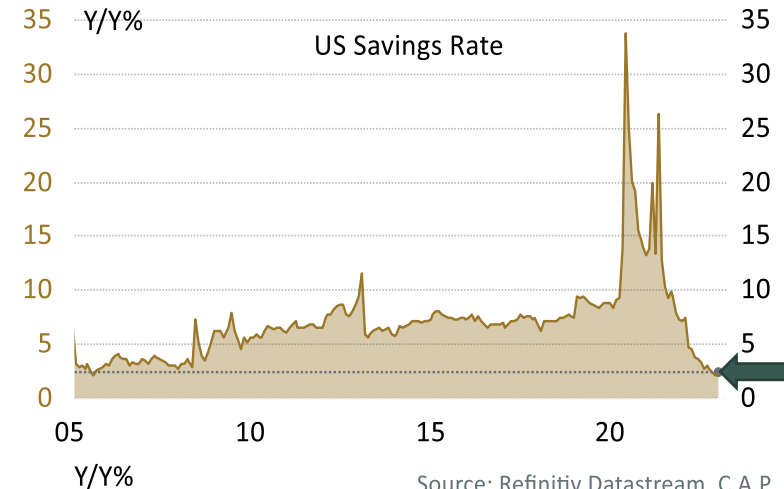
## Savings and Net Wealth

USA



**US:**

Our Take: Net wealth is unlikely to contribute to a further consumption spree in 2023



Source: Refinitiv Datastream, C.A.P

**US:**

Our Take: Savings is unlikely to 'finance' consumption like in 2022

**Positive Activity data surprise:**

- OECD – since end-Q3
- China – Jan 2023

**China Stimulus starts to work:**

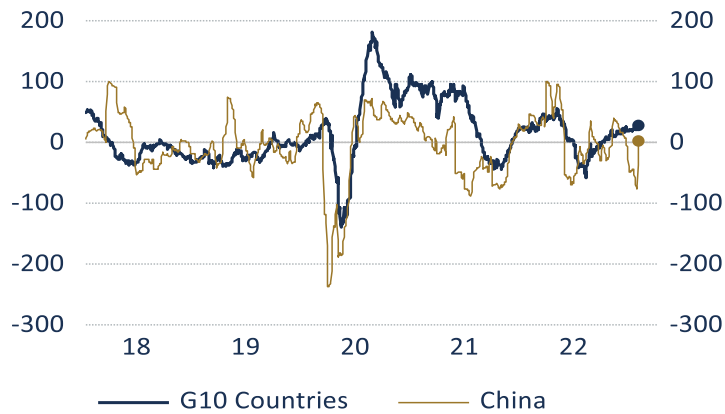
- Consumer confidence at an 18 mth high
- Retail Sales – surprised in Q4 (!)

**Europe: Disinflation effects kicks-in**

- EU Service sector, Dec
- Germany IFO Business, Dec

**Activity Surprises**

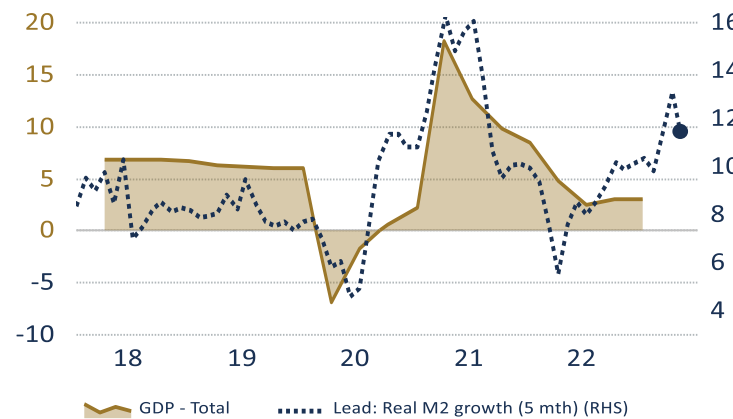
Citi



Source: Refinitiv Datastream, C.A.P

**China GDP**

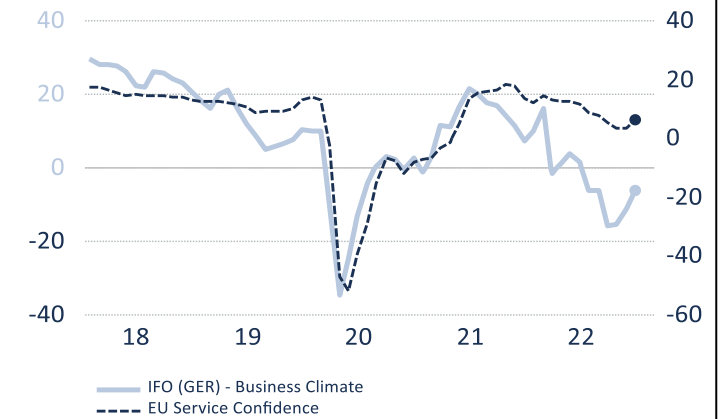
Vs. M2 Lead



Source: Refinitiv Datastream, C.A.P

**Eurozone**

IFO, ECFIN

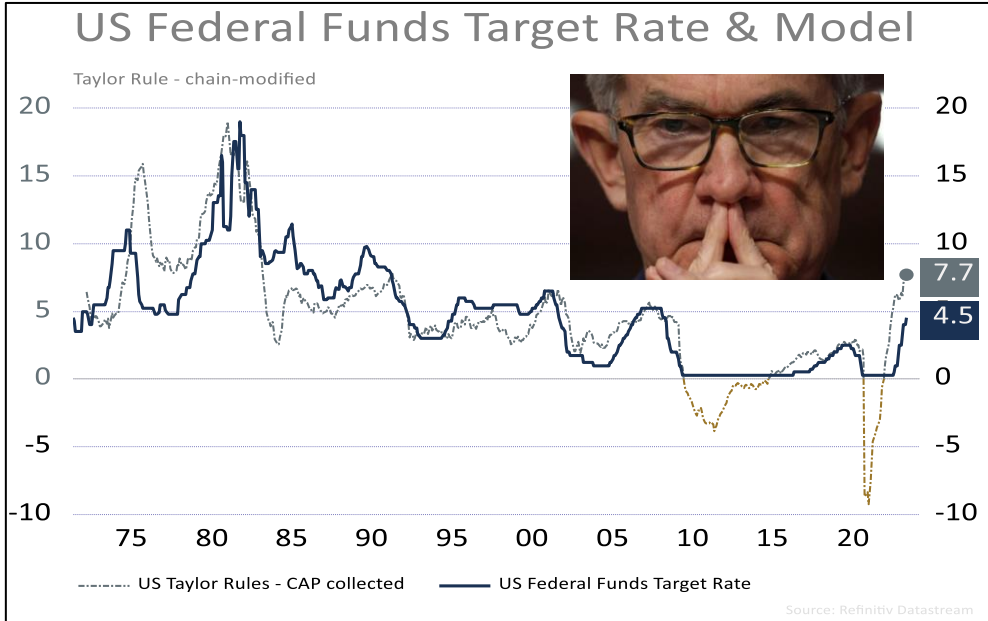


Source: Refinitiv Datastream, C.A.P

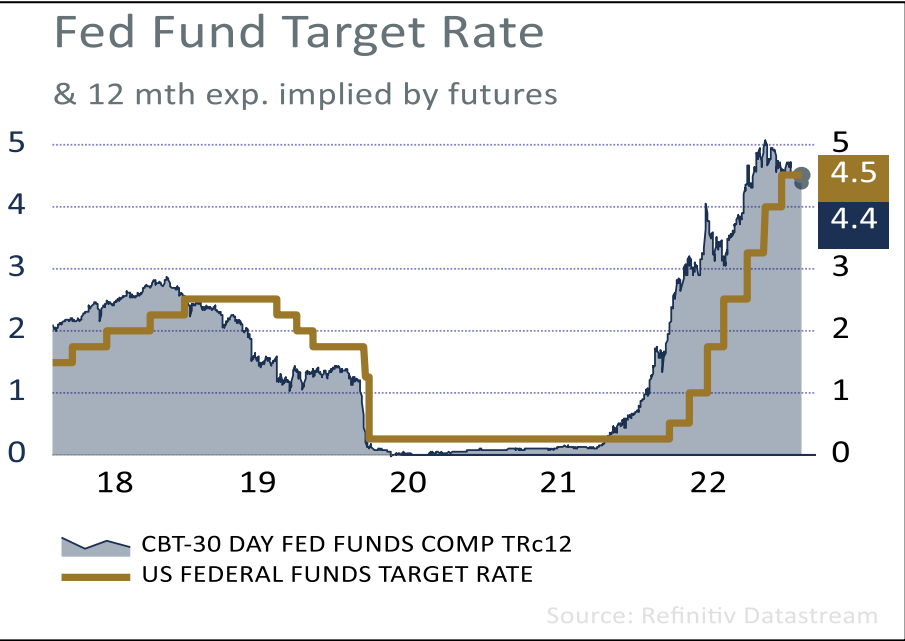
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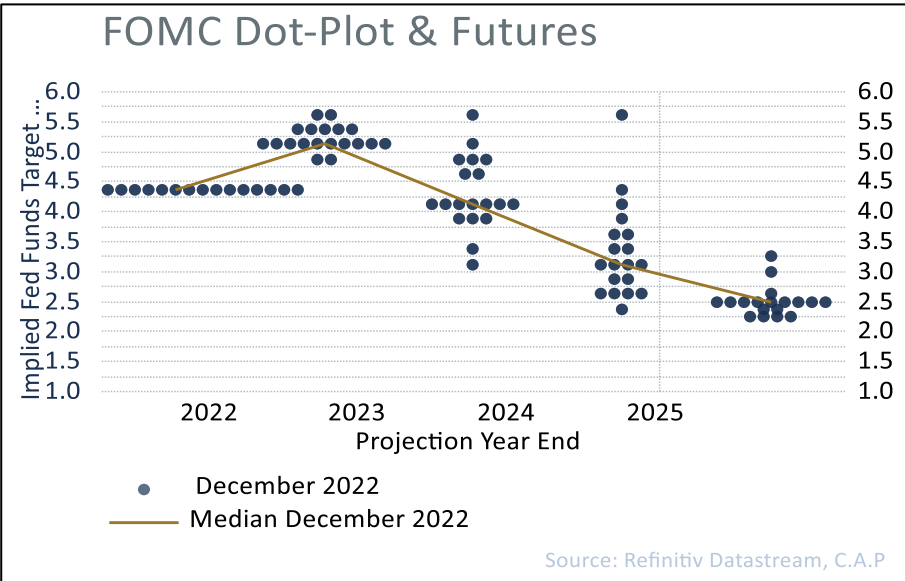
Is Taylor all alone with +7%?



Money market : FED is 'Done'



FOMC members: approx. 5%

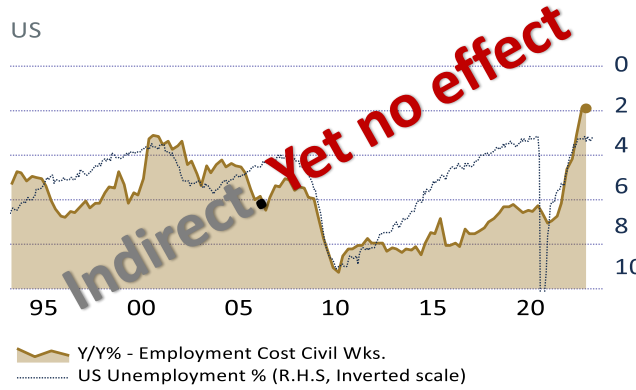


**Our Take:**

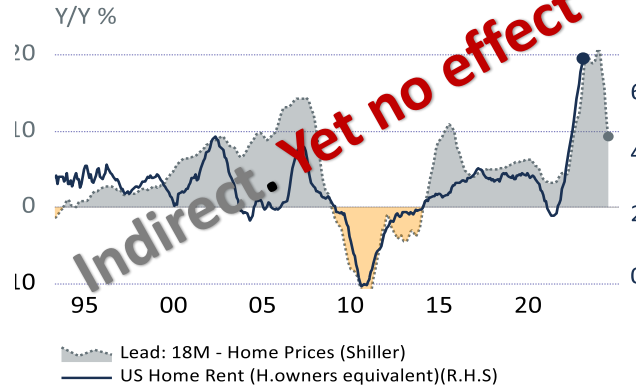
An unexpected +5% Fed Fund rate path would hurt both equities and bonds. We need to see a clear cooling of the job market to agree with both FOMC and the money market assessment of a quick disinflation process.

# Monetary policy: Channels of transmission to fight inflation

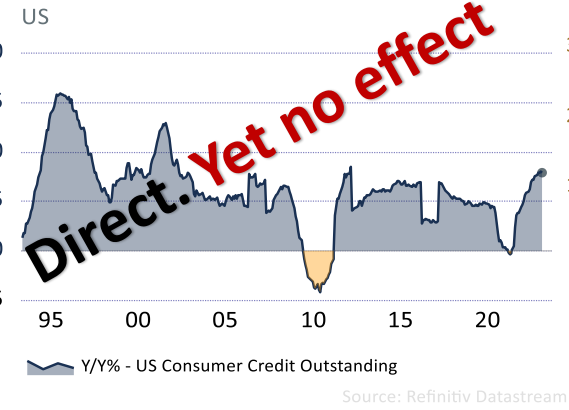
## Job cost Inflation & Mr. Phillips!



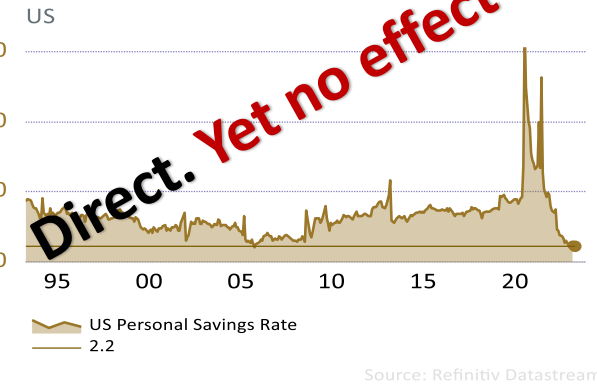
## Home Pricing



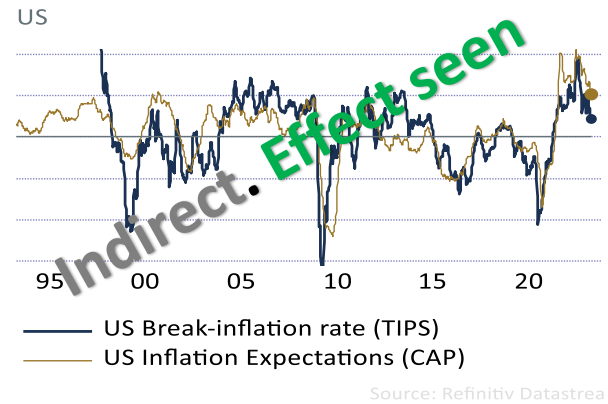
## Consumer Credits



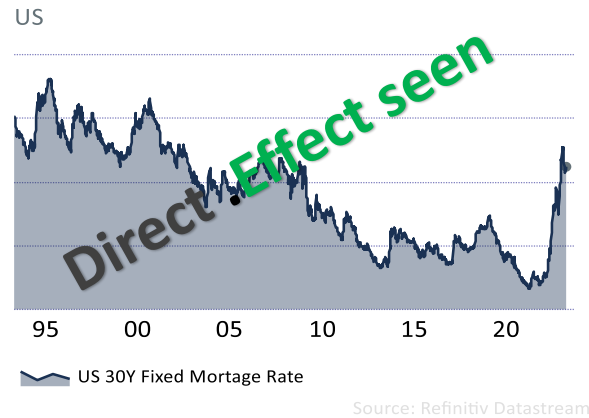
## Attractiveness of savings



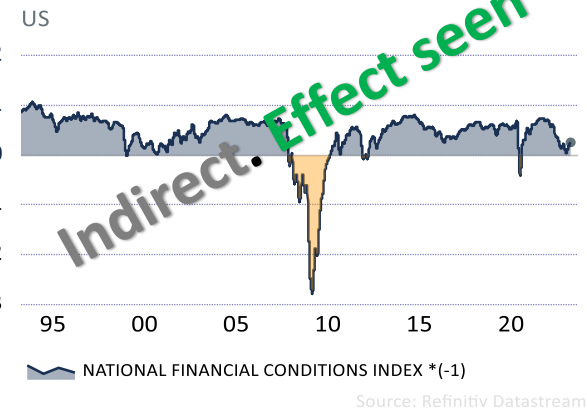
## Inflation Expectations



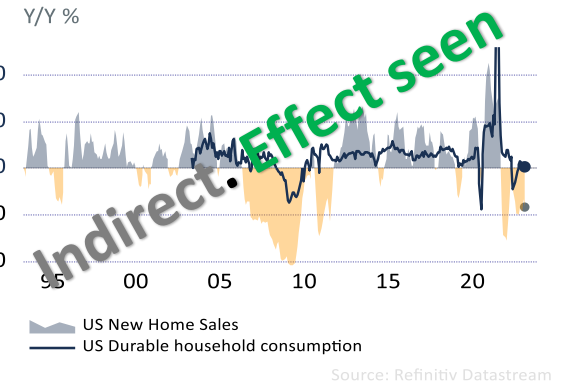
## Funding Rates



## Financial Conditions



## Durable Consumption



## Our Take:

It is difficult for FED to stop tightening before more transmission channels start working!

**Collins** English Dictionary

Definition of 'permacrisis'

**permacrisis**

in British English

(ˈpɜːməˈkraɪzɪs ⓘ)

**NOUN**

Word forms: plural **-ses** (-sɪz ⓘ)

an extended period of instability and insecurity, esp one resulting from a series of catastrophic events

# The Permacrisis and investment themes

An investment theme in 2023?

## Crisis themes in 2022

## Investment themes in 2022

**Russian aggression in Ukraine. A new security threat!**

Investments in **Defense stocks** +12% in 2022



**Energy Security – a new uncertainty**

Investments in **Energy Producers** +41% in 2022



**Food Crisis. Climate & Conflict-related.**

Investments in **Food Engineering**



**Climate hazards are increasing in frequency and severity**

Investments in **Stable Climate Environment**



**Green Energy Transformation – reinforced!**

Investments in **Alternative Energy** +18% in 2022



**The long goodbye to zero interest rates.**

**Value-over-Growth** Investments +25% in 2022



**Aging populations that need care services.**

Investments in **Healthcare Providers** -2% in 2022



**Inequality Crisis. Rising demand for wealth distribution.**

Corporate Taxation



**Political Crisis. Red vs. Blue Planet**

Investments in **Blue Planet EM** Latin America +21% in 22





# Asset Allocation Strategy

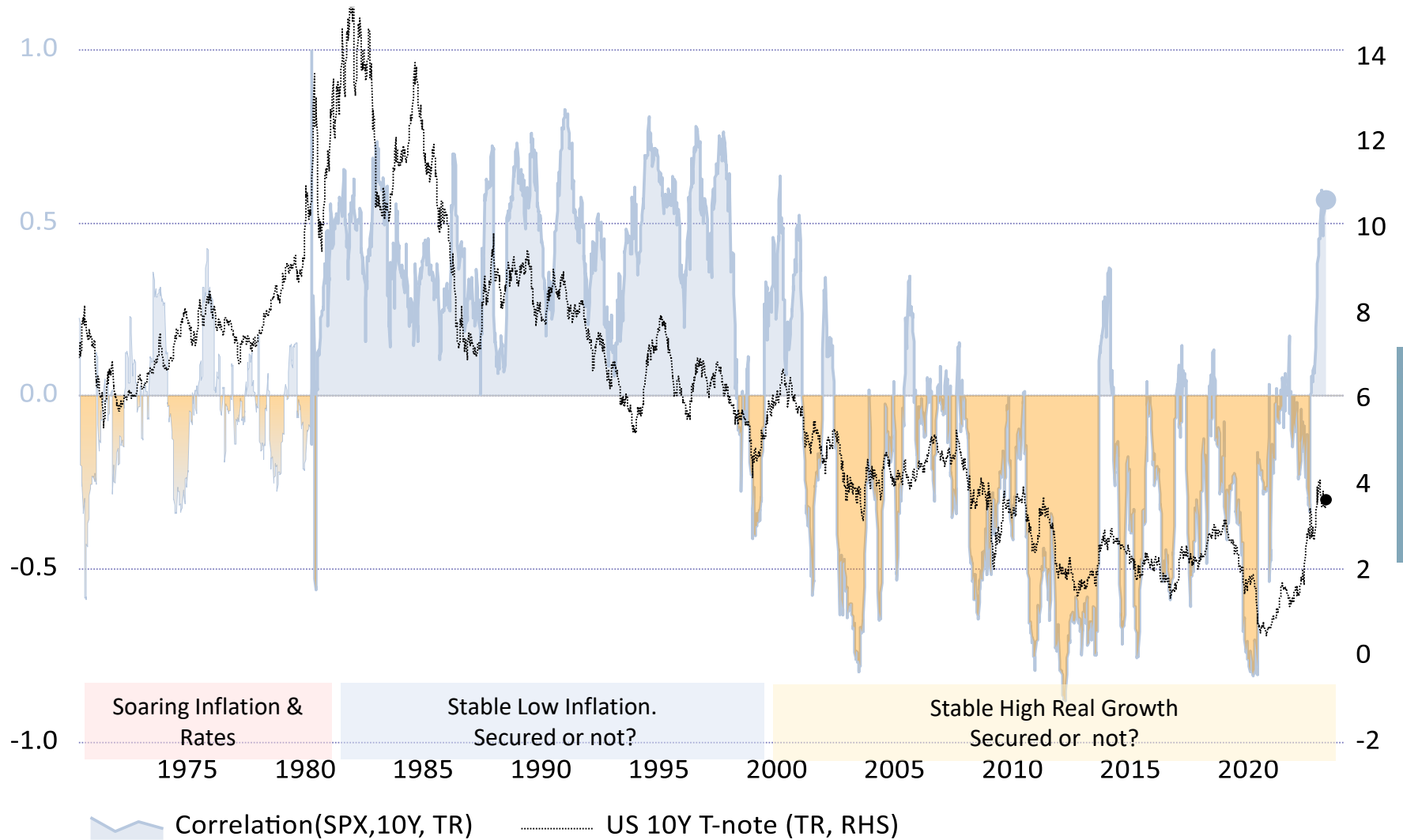
**Bond-Equity Return Correlation depends on the market theme.**

**A. Key Theme is 'Inflation':**  
Bonds and equities will move in the same direction

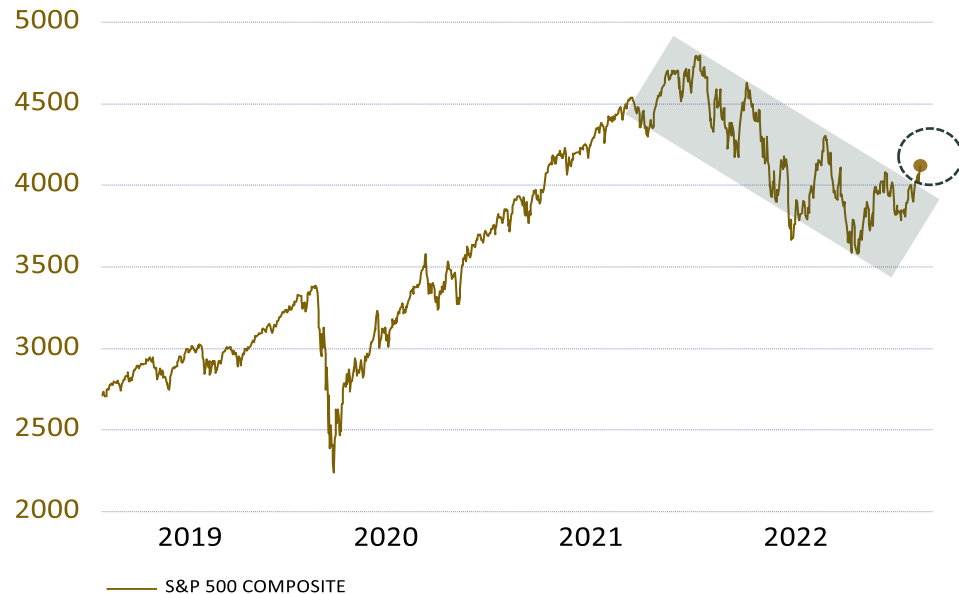
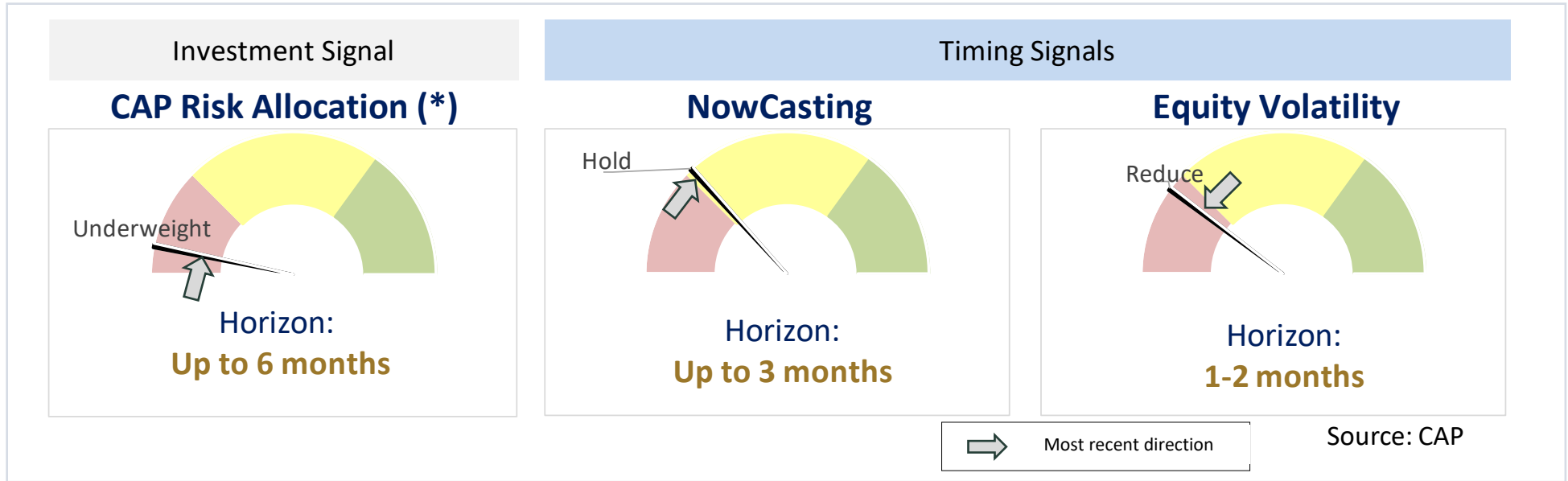
**B. Key Theme is 'Growth':**  
Bonds & Equities will move in different directions.

S&P500 & 10Y T-Bond

Total Return Correlations (weekly pct.chg. over 26 weeks)



# Tactical Risk Signals



Source: Refinitiv Datastream

**Out Take**

‘The Long Goodbye’ makes Risk Investing hard but Risk Trading more interesting.

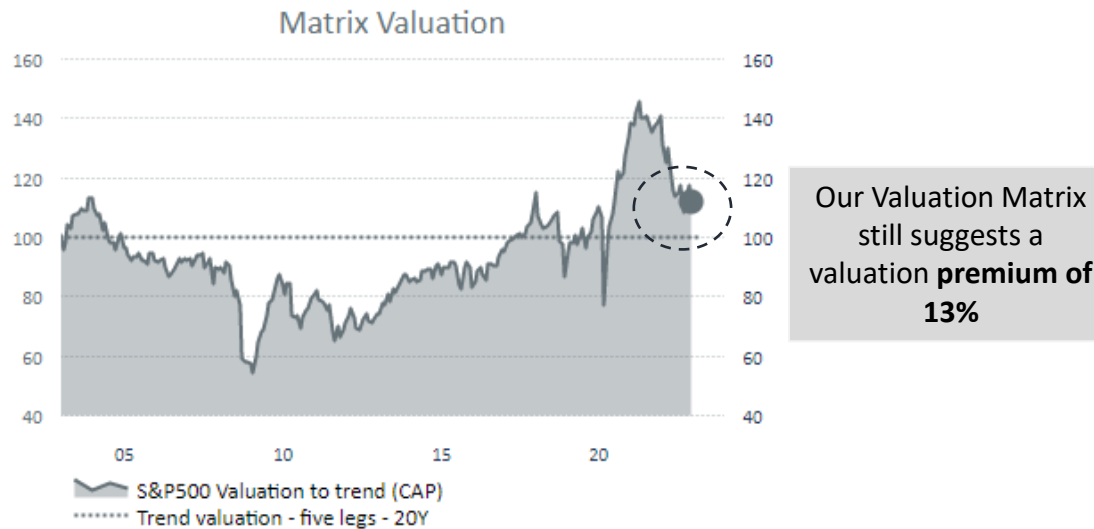
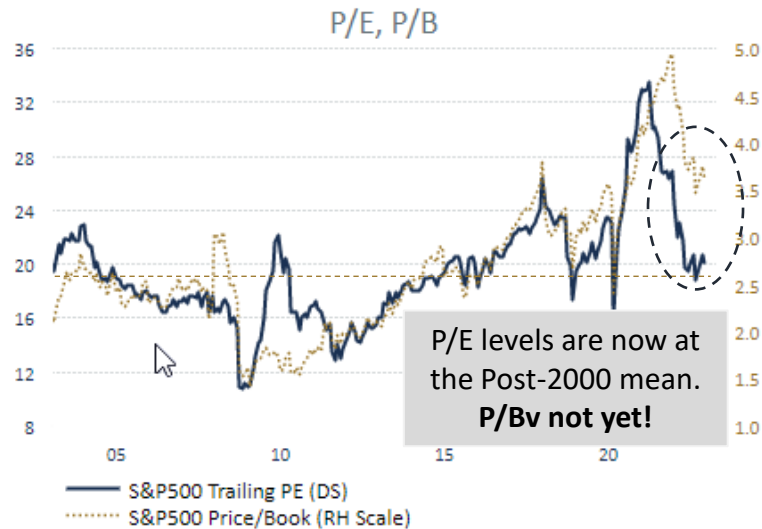
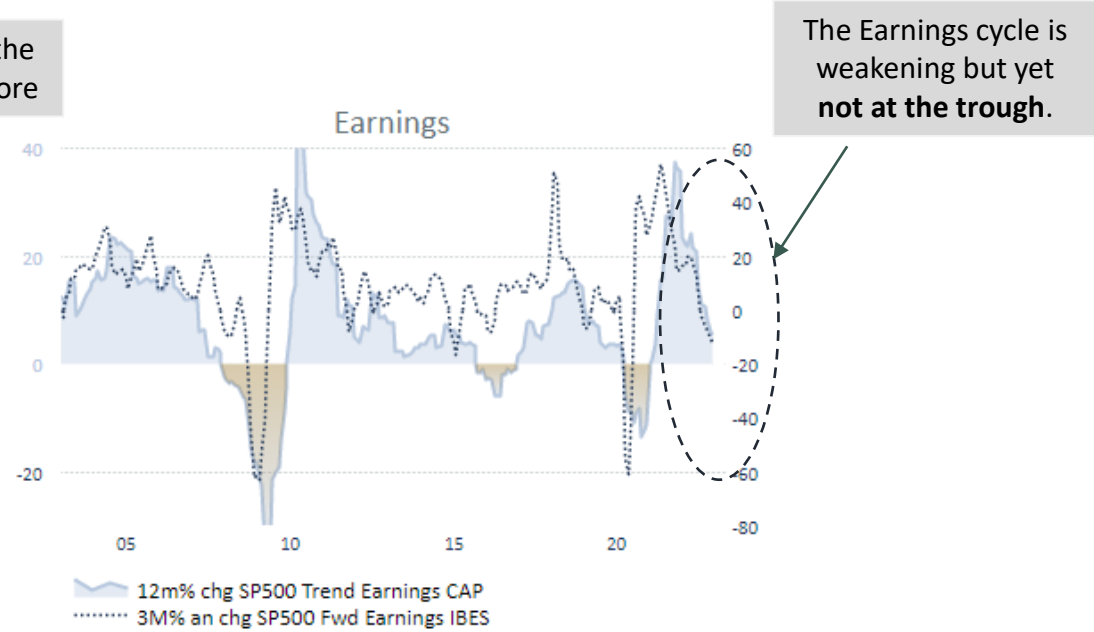
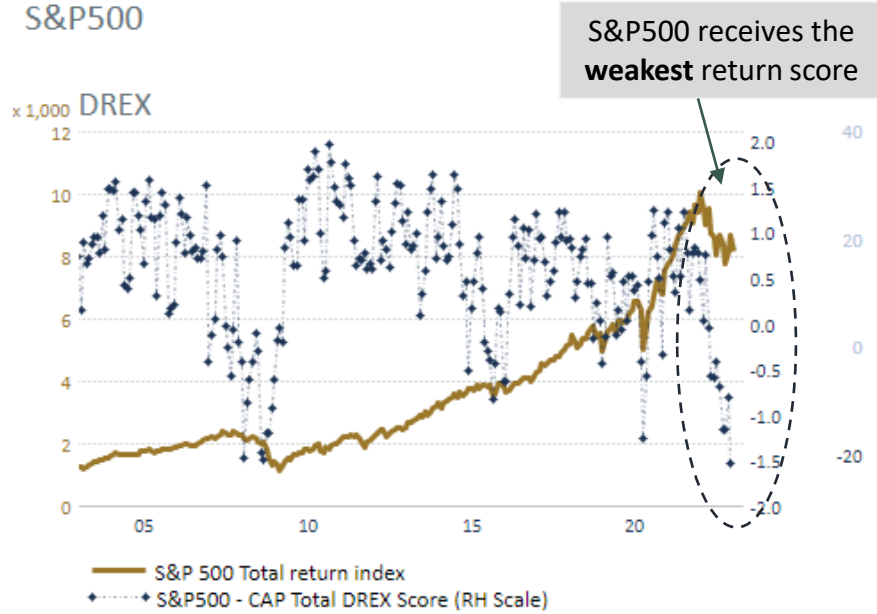
Our Timing Signals indicate that the window for trading-longs in Risk-assets is now closing. Still, we are puzzled by the market’s obvious disinflation optimism e.g. reflected in SPX

# The Great Mean Reversion of US Equity Market Valuation

More downward valuation adjustment is likely for S&P500

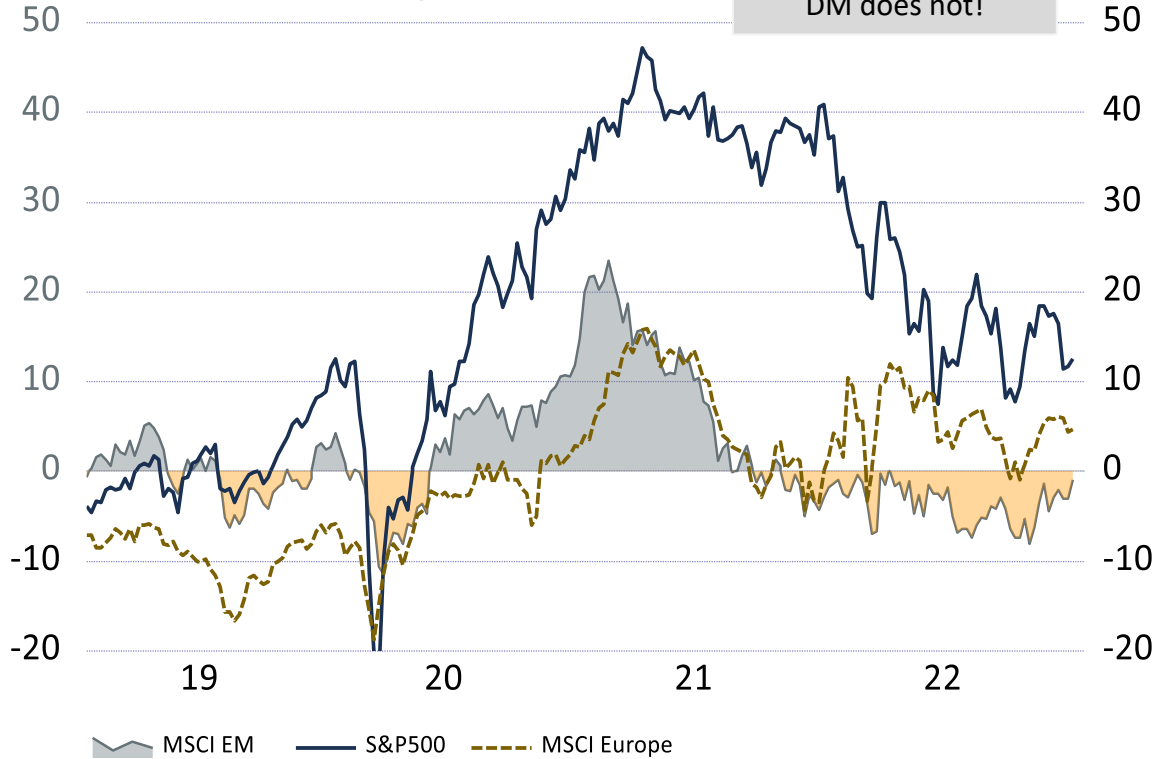
Also, further down-revision of Corporate earnings should be expected.

## US Equities S&P500



### Equity Market Valuation

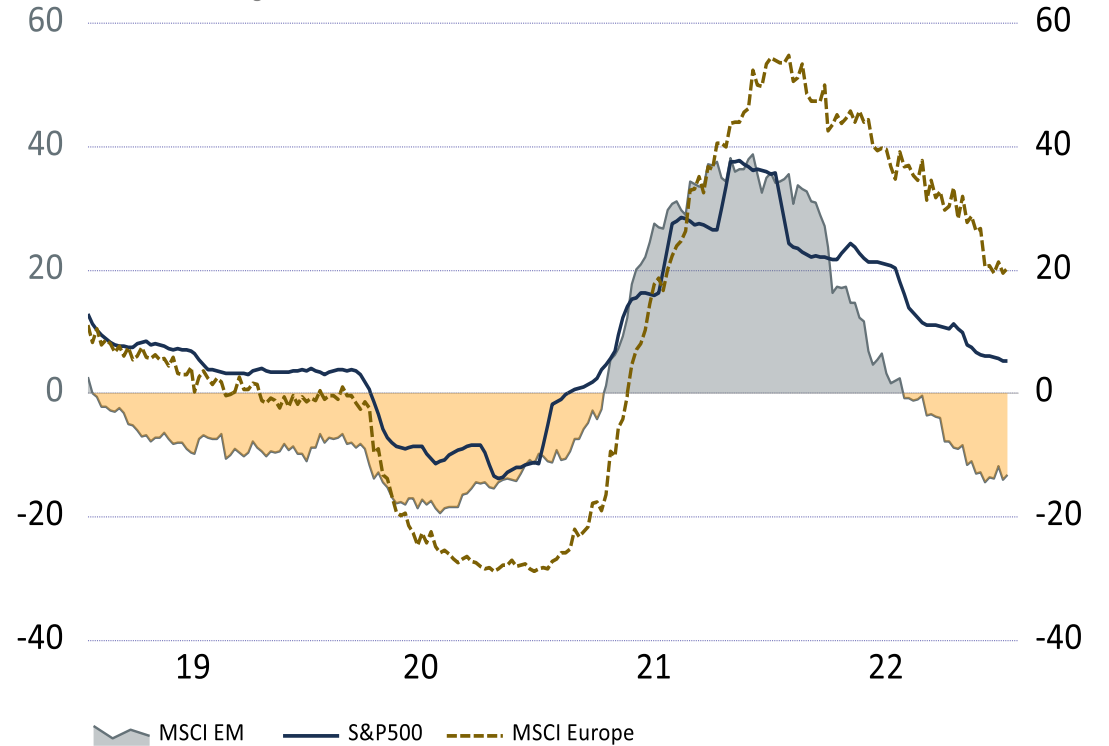
CAP Valuation calculated vs. Long Term Trend



Source: Refinitiv Datastream

### Equity Market Earnings Cycle

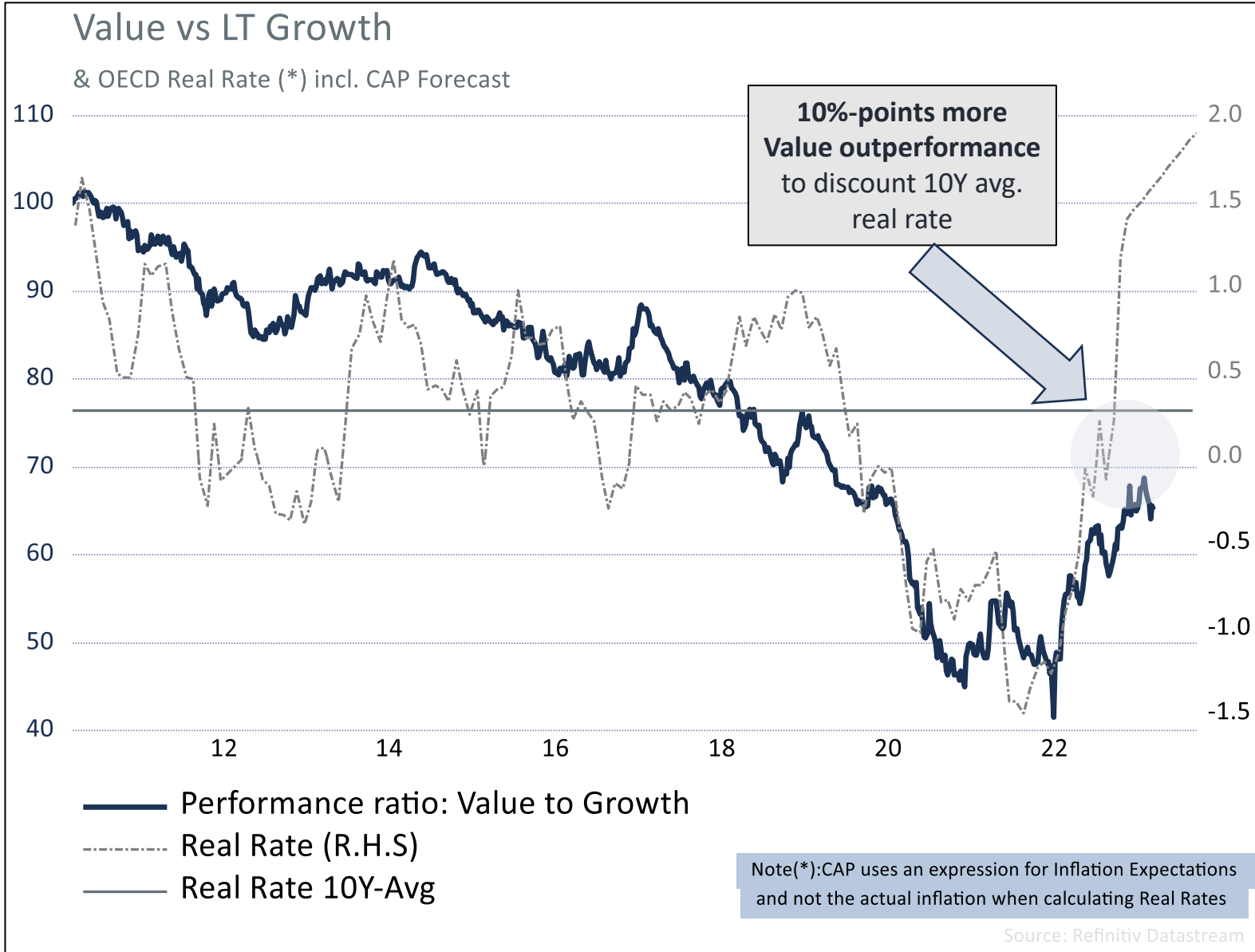
CAP Trend Earnings



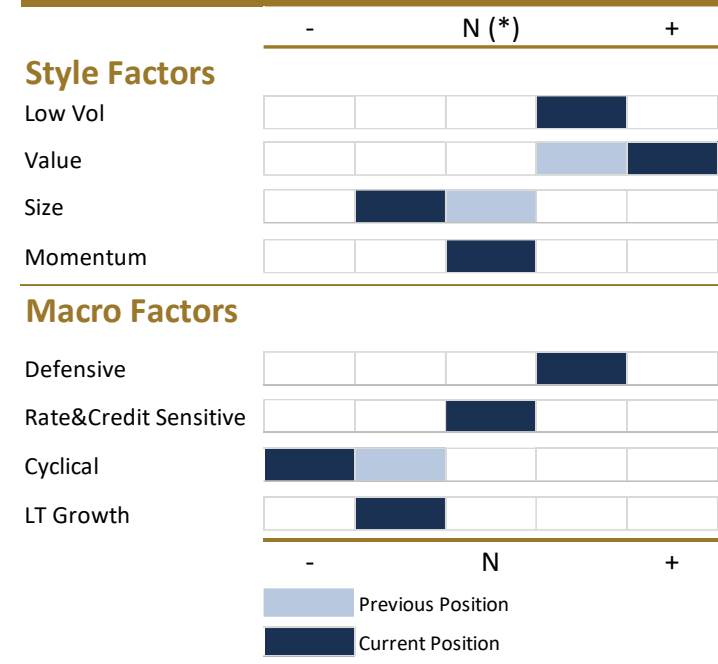
Source: Refinitiv Datastream

**Our Take**  
**We prefer EM to DM as both valuation and earnings now look better for EM.**





### Equity Factor Allocation

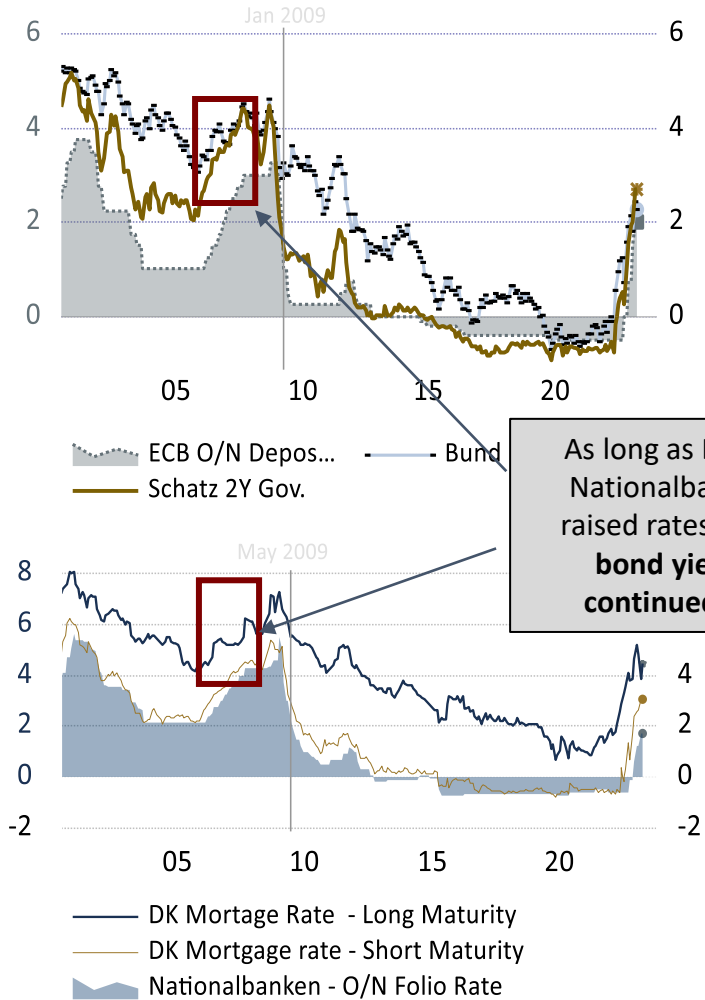


**Value** is back as an important factor for equity markets as well as in stock selection.

**Growth stocks** will, for some time, continue to be challenged.

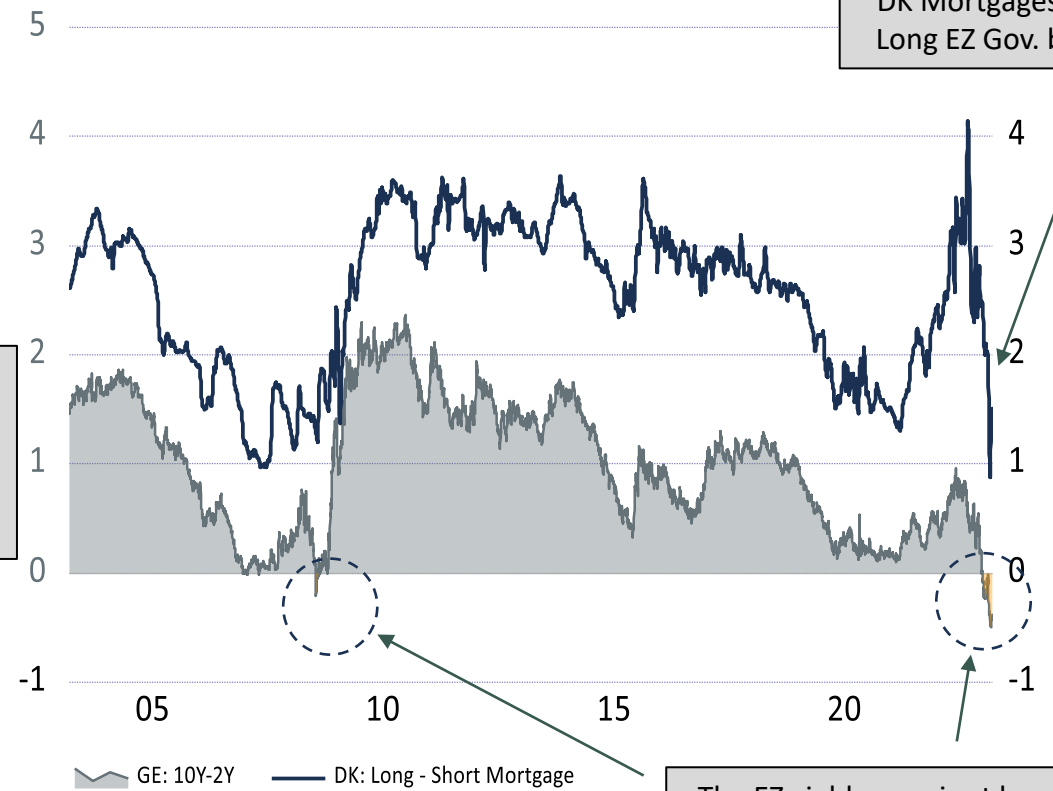
We need recession and CBs to pivot, to justify the current inverted yield curves.

## Euro & DK Rates

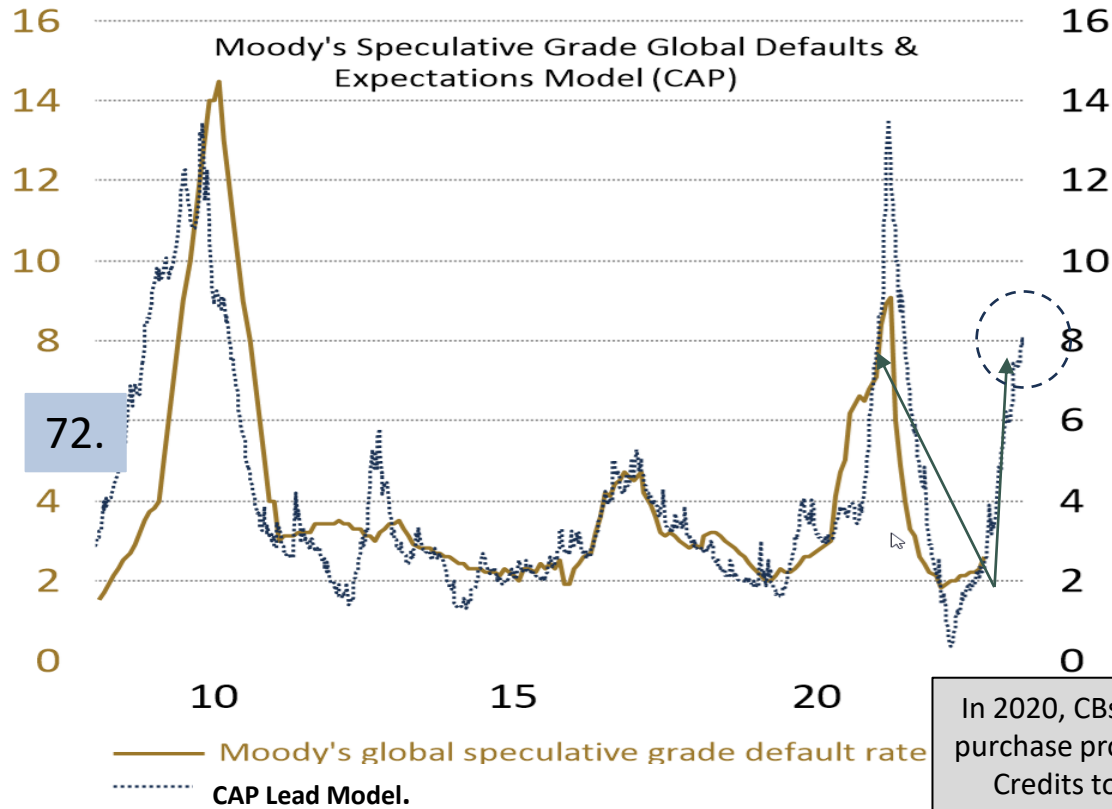


Source: Refinitiv Datastream

## EU/DK Yield curves



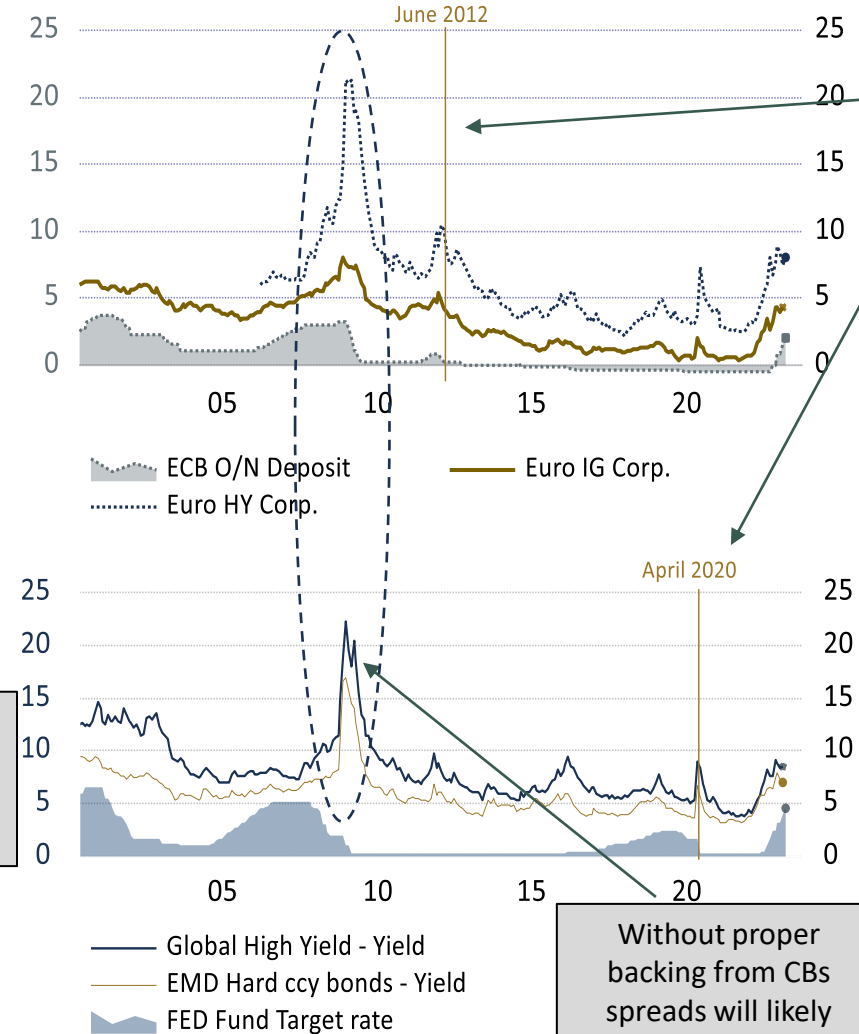
The EZ yield curve is at levels last seen pre-GFC (June 2008). **JUSTIFICATION:** If ECB starts a fast-paced easing cycle in 2023, then OK!



In 2020, CBs opened purchase programs in Credits to avoid soaring credit rates.

The risk of higher default rates is not sufficiently priced in HY

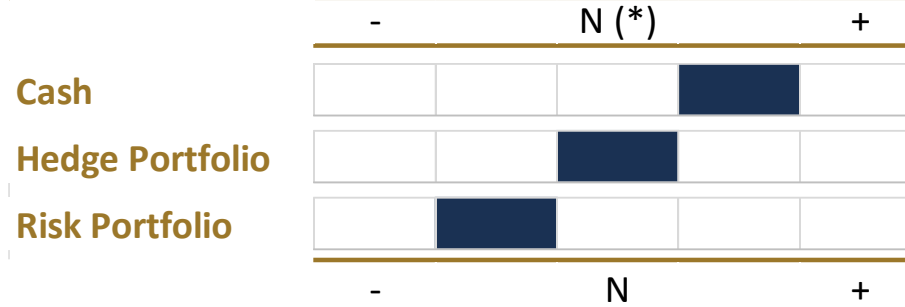
Euro & Global Credit Rates



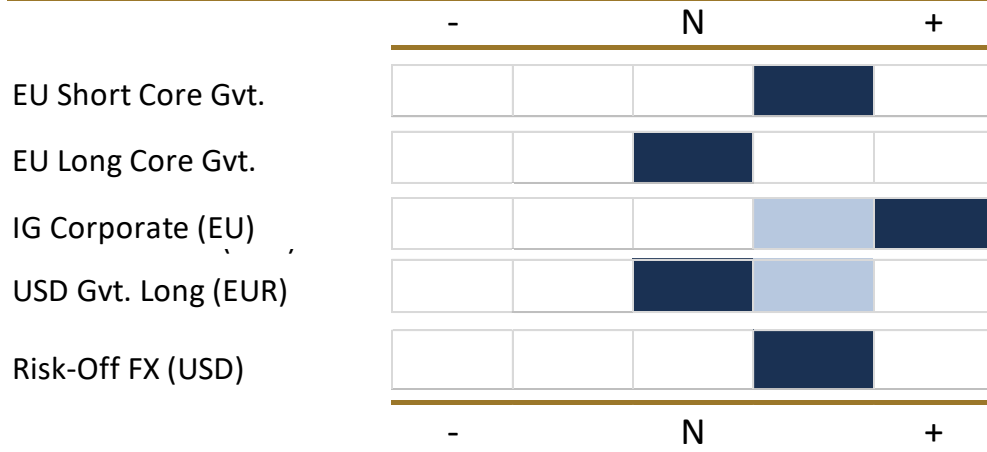
Euro Credits look more attractive!

Without proper backing from CBs spreads will likely mirror defaults.

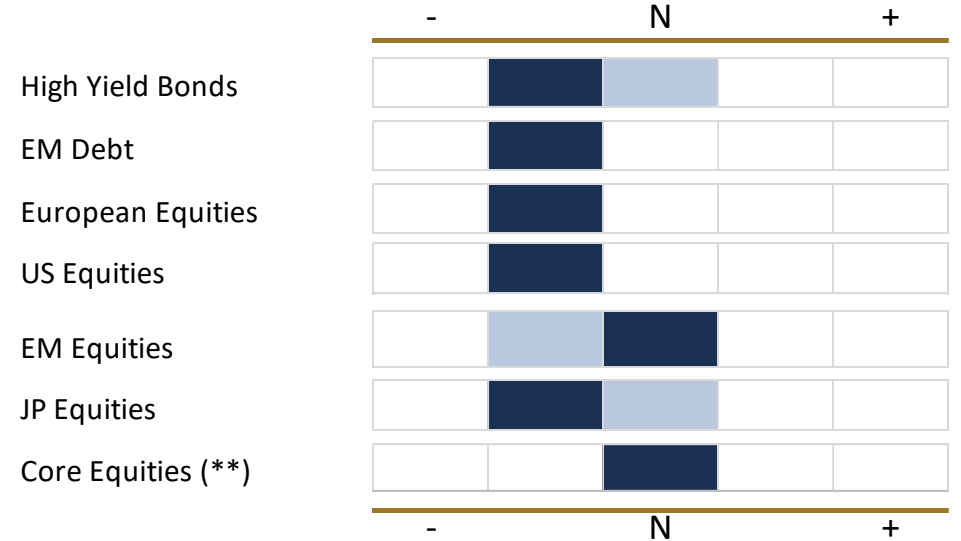
## Cross Asset Portfolio



## Hedge Portfolio



## Risk Portfolio



(\*\*) Our Factor&Sector Portfolio

