M.M.WARBURG & CO
BANK

ECONOMIC SITUATION AND STRATEGY

January 7, 2022

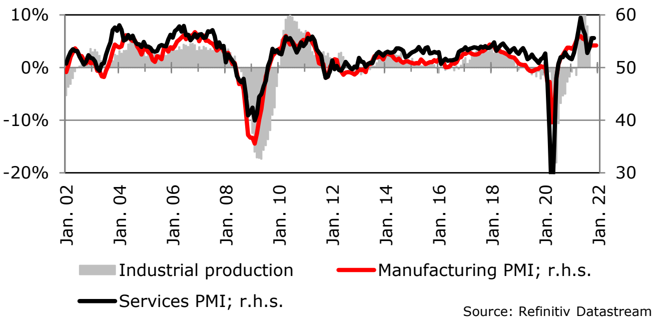
Outlook 2022 (V): Summary and Asset Allocation

In the past weeks we have ventured to look ahead to the year 2022. We examined the economic outlook and asked ourselves what the future holds for inflation. How will monetary policy react and what does this mean for the stock and bond markets as well as for exchange rates? Today we summarise our core statements once again - no easy task, because an outlook for the new year always suggests a certain degree of certainty, which by definition cannot exist on the capital markets. After all, no one knows the future, and the past shows time and again that many things may happen that one did not expect. Nevertheless, plausible considerations can and must be made in order to be able to prepare for the possible challenges of 2022.

We wish all readers a good start to a successful and, above all, healthy year 2022! Please feel free to visit our YouTube channel, where you will find all our videos on the Annual Outlook 2022: https://www.youtube.com/c/MMWarburgCO

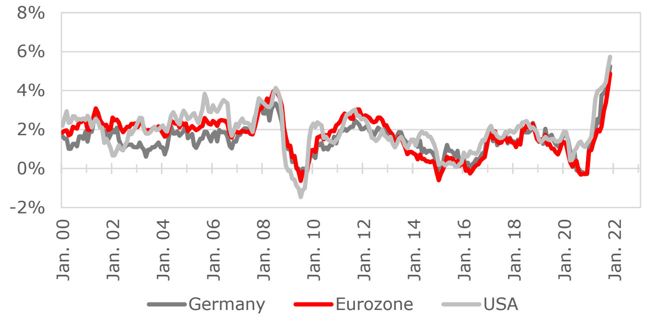
The economic outlook for 2022 remains very positive. Although the Corona virus continues to be a concern and the Omikron variant is causing new infections in many countries and regions higher than ever before, there is increasing evidence that this new mutation is less dangerous than the Delta variant or the original virus. Far-reaching economic restrictions, as at the beginning of the pandemic, are therefore less likely, even if there will be new lockdown measures in isolated cases. The disturbances to the global economy observed in 2021 in the form of supply disruptions or shortages of intermediate goods and the availability of transport capacity should gradually diminish. This could lead to recovery effects in many economies, especially since monetary and fiscal policy are still having expansionary effects. 2022 will thus be a year in which global economic growth will once again be significantly above its long-term trend. In Germany, we expect an increase in real gross domestic product of four percent, after last year's growth was quite disappointing. In the USA and the Eurozone, GDP growth will weaken somewhat this year compared to 2021, but expected growth rates at around four percent will still be significantly higher than potential growth. From 2023 onwards, however, a more "normal" economic development can be assumed.

Global PMIs and OECD-industrial production y/y



Source: Refinitiv Datastream

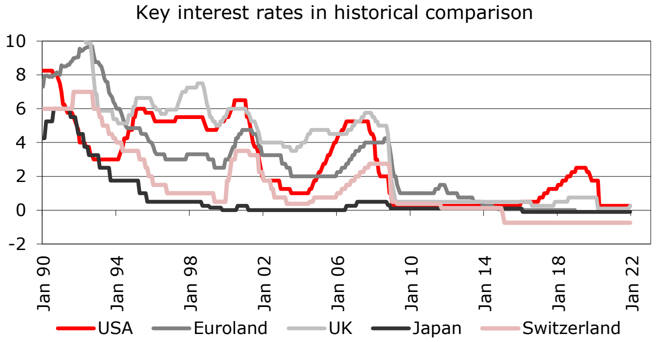
Inflation rates have developed less favourably in recent months. In many countries, price pressure is now stronger than it has been for many years. This is mainly due to the strong increase in global demand in the context of the simultaneous "reopening" of many economies. Global supply, on the other hand, could not expand to the same extent due to existing capacity constraints. Above all, the oil price is responsible for the increase in price growth rates. In addition, there are some special effects, such as the increase in value-added tax and the higher CO2 price in Germany. However, the oil price should stabilise in the next twelve months, and the signal of higher prices should gradually lead to an increase in supply and a reduction in demand for particularly expensive goods and services. Although the inflation rate will fall only slowly in 2022 and will still be above the three percent mark in the first half of the year, the situation will ease thereafter and we expect the inflation rate in Germany to be below two percent again in the final quarter.



source: Refinitiv Datastream

In view of the high inflation rates and the positive economic outlook, monetary policy will become less expansionary in 2022. The turnaround in monetary policy interest rates was already initiated in 2021 as many central banks, especially in the emerging markets, have already raised interest rates. For example, the key interest rate was raised by 575 basis points in Brazil, by 425 basis points in Russia and by 350 basis points in Chile. In contrast, central bank policy in most industrialised countries remained unchanged in 2021. This will change in the USA this year. As a first step, the Federal Reserve will end its bond purchases by March according to the current plan. After that, a first rate hike is on the agenda, which most market participants expect as early as the FOMC meeting on 16 March. Fed funds futures indicate that two more rate hikes are expected this year: one in June and one in September. And as a third step, the US central bank could begin to reduce its balance sheet size later in the year. According to the transcript of the last FOMC meeting, many Fed members are of the opinion that a reduction in the securities holdings could begin shortly after the first interest rate hike. In this respect, it is foreseeable that US monetary policy will become less expansionary in the coming months. However, we do not consider it a foregone conclusion that the first rate hike will take place as early as March and that interest rates will be raised three times this year. On the one hand, the bond-buying programme will not end until March, on the other hand, the Corona incidences in the USA are likely to remain at a very high level until spring. This could induce the central bank not to decide on an interest rate hike until May or June. If, however, the high incidences do not have a major economic impact, this could also lead to a faster reduction of inflation rates, so that the Fed could leave it at two rate hikes this year. US monetary policy thus remains "data dependent".

In contrast, the ECB's monetary policy will hardly change. Although the emergency purchase programme PEPP will expire as planned at the end of March, the purchases of the smaller APP programme will be doubled to 40 billion euros in the second quarter and reduced to 30 billion euros in the third quarter. From October onwards, the pace of purchases will be reduced to the initial level of 20 billion euros and will be maintained for as long as it is necessary to stimulate the economy. In our view, however, the ECB will stick to its zero interest rate policy out of consideration for the high level of government debt, even if the majority of market participants are betting on an increase in the deposit rate by 15 basis points.

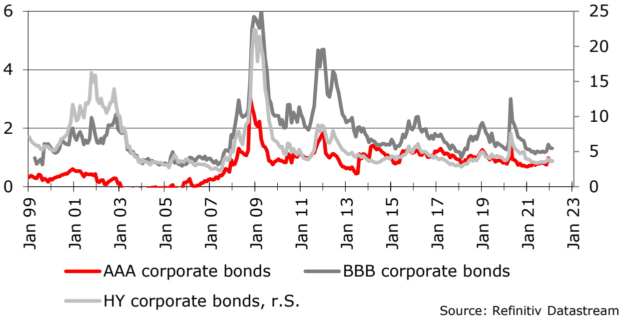


Quelle: Refinitiv Datastream

Due to the less supportive monetary policy, it will again be difficult to achieve a positive performance on the bond market, as it was in 2021. This seems almost impossible with government bonds of good creditworthiness, as yields in the USA and Europe will continue to rise, so that price losses are to be expected. The yield on a 10-year German government bond is likely to be +0.1 per cent at the end of 2022, and we expect the yield on 10-year US Treasuries to rise to 2.0 per cent, so investors must be prepared for a minus of two to three per cent in the performance. A better result is likely to be achieved with corporate bonds, whereby this is primarily influenced by the quality of the respective bond. The inverse relationship applies: the worse the quality, the better the expected performance. On the one hand, this is due to the fact that lower-quality corporate bonds have higher coupons, which offer greater protection against price losses.

On the other hand, the economic environment suggests that the default probabilities of these bonds are decreasing, so that the spread to government bonds tends to narrow. The spread of AAA- to A-rated corporate bonds to government bonds is currently around 100 basis points, while that of BBB corporate bonds is around 130 basis points and that of high-yield corporate bonds is almost 360 basis points on average.

Eurozone: Spread development versus German government bonds in % points

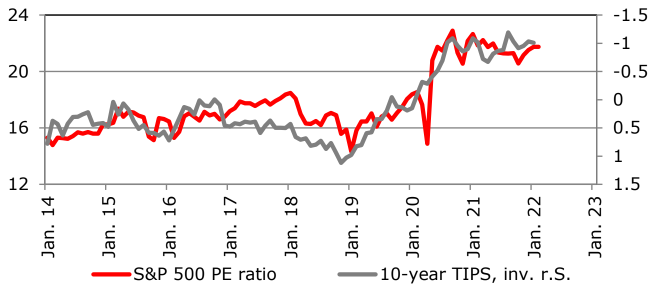


Source: Refinitiv Datastream

On the contrary, stocks once again offer greater upside potential than bonds this year. However, investors must be able to withstand the greater price fluctuations that are likely to occur. We are particularly optimistic about the fact that the economic upswing in many regions of the world is continuing at a fast pace. This should enable companies to further increase sales and profits. Depending on the stock market index and region, we expect almost double-digit percentage growth in corporate profits next year, which leaves room for positive surprises. For the DAX, for example, company analysts only expect an increase in profits of about four percent, which seems too low to us in view of the expected economic dynamics. Due to negative real interest rates, there are still hardly any alternatives to stocks. We expect the DAX to rise to around 18,000 points by the end of 2022. Due to the high cyclicality of German companies, they should benefit particularly from the global economic growth. Moreover, with a price-earnings ratio of around 14 based on expected earnings in one year, the DAX is currently valued lower than many other stock market indices. We also expect a similarly positive performance as for the DAX for the Euro Stoxx 50, which should rise to 4,750 points in the next twelve months. Even though US stocks have already performed above average in recent years and we expect this US dominance of the equity markets to diminish somewhat, we still expect the S&P 500 to end 2022 at around 5,150 points.

The biggest risk factor for the stock markets is US monetary policy, which is likely to create headwinds in the course of the year. Investors will therefore secure profits from time to time. Provided that price pressure eases over the coming months, the Federal Reserve should not be forced to raise interest rates more than currently expected. In this case, the "TINA" argument ("there is no alternative") should once again support the stock markets. For this reason, we continue to recommend an overweighting of stocks compared to bonds for the asset allocation. However, if inflation rates do not ease, monetary policy could become a spoilsport, as significantly higher interest rates would probably lead to a correction of the high valuations.

S&P 500: Price earnings ratio for the coming 12 month and 10-year TIPS



Source: Refinitiv Datastream

Market data

Stock marktes	As of 07.01.2022 10:28	Change versus 30.12.2021 -1 week	03.12.2021 -1 month	05.10.2021 -3 months	05.01.2021 -1 year	31.12.2021 YTD
Dow Jones	36236	-0,4%	4,8%	5,6%	19,2%	-0,3%
S&P 500	4696	-1,7%	3,5%	8,1%	26,0%	-1,5%
Nasdaq	15081	-4,2%	0,0%	4,5%	17,6%	-3,6%
DAX	16005	0,8%	5,5%	5,3%	17,2%	0,8%
MDAX	35085	-0,1%	4,1%	3,1%	13,0%	-0,1%
TecDAX	3734	-4,8%	-0,7%	1,4%	14,7%	-4,8%
EuroStoxx 50	4318	0,3%	5,8%	6,2%	21,7%	0,5%
Stoxx 50	3817	-0,2%	5,6%	8,7%	22,4%	0,0%
SMI (Swiss Market Index)	12767	-0,8%	4,9%	10,2%	19,4%	-0,8%
Nikkei 225	28479	-1,1%	1,6%	2,4%	4,9%	-1,1%
Brasilien BOVESPA	101561	-3,1%	-3,3%	-8,1%	-14,9%	-3,1%
Russland RTS	1545	-3,2%	-7,4%	-16,0%	8,4%	-3,2%
Indien BSE 30	59668	3,2%	3,4%	-0,1%	23,2%	2,4%
China CSI 300	4822	-2,0%	-1,6%	-0,9%	-10,2%	-2,4%
MSCI Welt (in €)	3185	-1,4%	3,0%	8,3%	28,7%	-1,3%
MSCI Emerging Markets (in €)	1217	-0,3%	-0,8%	1,0%	0,0%	-1,1%
Bond markets						
Bund-Future	170,34	-103	-243	68	-756	-103
Bobl-Future	132,93	-31	-257	-200	-236	-31
Schatz-Future	112,01	-2	-38	-21	-30	-2
3 Monats Euribor	-0,58	0	0	-1	-2	1
3M Euribor Future, Dec 2017	-0,31	0	5	23	26	0
3 Monats $ Libor	0,23	1	4	10	-1	2
Fed Funds Future, Dec 2017	0,08	-69	-55	0	1	-1
10 year US Treasuries	1,73	21	40	20	78	23
10 year Bunds	-0,05	13	33	14	54	13
10 year JGB	0,14	7	9	8	12	7
10 year Swiss Government	-0,01	12	27	12	51	12
US Treas 10Y Performance	685,67	-1,7%	-2,8%	-1,0%	-3,9%	-1,8%
Bund 10Y Performance	658,86	-0,5%	-2,5%	-0,6%	-3,8%	-0,5%
REX Performance Index	488,82	-0,4%	-1,3%	-0,7%	-2,2%	-0,4%
US mortgage rate	0,00	0	0	0	0	0
IBOXX AA, €	0,50	1	14	16	48	1
IBOXX BBB, €	0,90	3	12	20	38	3
ML US High Yield	4,98	12	-12	29	-1	8
Convertible Bonds, Exane 25	8236	0,0%	1,9%	0,5%	-2,1%	0,6%
Commodities						
MG Base Metal Index	467,09	1,4%	5,5%	7,2%	28,2%	1,3%
Crude oil Brent	82,54	4,0%	17,8%	-0,1%	53,8%	5,3%
Gold	1789,86	-1,1%	0,8%	2,0%	-8,1%	-1,8%
Silver	23,13	0,2%	3,1%	2,4%	-15,9%	-0,6%
Aluminium	2913,25	3,0%	10,4%	0,3%	43,1%	3,8%
Copper	9708,25	-0,2%	2,3%	5,8%	21,4%	-0,3%
Iron ore	125,94	12,2%	24,1%	6,9%	-24,2%	11,9%
Freight rates Baltic Dry Index	2296	3,6%	-27,6%	-57,6%	61,9%	3,6%
Currencies						
EUR/ USD	1,1312	-0,2%	0,2%	-2,5%	-7,8%	-0,1%
EUR/ GBP	0,8349	-0,6%	-2,2%	-1,9%	-7,5%	-0,6%
EUR/ JPY	131,06	0,5%	2,4%	1,6%	3,8%	0,5%
EUR/ CHF	1,0415	0,5%	0,3%	-3,1%	-3,6%	0,8%
USD/ CNY	6,3741	0,0%	0,0%	-1,2%	-1,3%	0,3%
USD/ JPY	116,13	0,9%	2,9%	4,2%	13,0%	0,9%
USD/ GBP	0,74	-0,4%	-2,4%	0,6%	0,4%	0,0%

Source: Refinitiv Datastream

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