IMT Asset Management AG
Austrasse 56 · P.O. Box 452
9490 Vaduz, Liechtenstein
asset@imt.li · www.imt.li

INVESTMENT OUTLOOK 01.2022

19 January 2022

Another demanding year has gone by. In 2021 the Corona pandemic once again severely restricted our activities, confronting us with challenges in both our personal and working life.

At the beginning of last year, there were high expectations that an unprecedented global vaccination campaign would make the Covid virus manageable. In fact, 4.7 bn doses were administered, reaching 62% of the world population. Despite that achievement, the recent outbreak of the Omicron variant disappointed our hopes and resulted in an even stronger spike of new cases and many new restrictions.

All those challenges notwithstanding, 2021 proved to be an exceptionally good year for equity and commodity markets. However, ongoing supply chain disruptions, a sharp increase of inflation, and more hawkish central banks are providing strong head winds for markets and, in our view, will make 2022 very challenging for investors.

As in recent years, we are reviewing last year's predictions and make some predictions for 2022.

Thomas Trauth
CEO – IMT Asset Management AG

REVIEW OF LAST YEAR'S PREDICTIONS

What happened in 2021?

After the pandemic caused a massive downturn in the economies in 2020, we observed a very dynamic economic recovery in 2021. The growth spurt was driven by exorbitant fiscal and monetary measures as well as by high pent-up demand. This gave an especially powerful boost to the equity and commodity markets, with many stock indices reaching new record highs in the year. The MSCI World Index rose by 20%, the S&P500 by as much as 27%. The price of oil soared 50%. The emerging markets, however, were unable to profit from these developments, their stock markets losing 4.6% on average.

Manufacturers and service providers could not keep up with the high demand for goods, not least because of many supply chain disruptions. The result of these developments was a sharp rise in inflation, which climbed as high as 7.0% in the USA. As a consequence bond yields increased, in the case of US 10-year government bonds from 0.9% to 1.5%.

In view of the particularly dynamic economic growth in the USA and the increased interest-rate advantage, the US dollar appreciated 7% on average in 2021. The Swiss franc weakened at the beginning of 2021 but then increased in value especially in the fourth quarter, gaining 4% against the euro over the year.

Last year's predictions

In the following, we review last year's predictions. For the details, we refer you to our Investment Outlook 01.2021.

Our growth predictions were about right, though we underestimated the dynamic growth impulse, especially in the US and Europe. Similarly, we did not foresee the inflation spike.

We are quite happy with our financial market predictions, which were right with only two exceptions: the performance of emerging market equities was not positive and the USD did not weaken. For a detailed overview, we refer to the table below.

Last year's prediction	Actual outcome	
1. Growth (real GDP)		
US: 3.2%	6.0%	(✓)
Eurozone: 3.6%	5.0%	(✓)
Japan: 2.3%	2.4%	✓
China:8.0%	8.0%	✓
Note that GDP growth for 2021 is based on the latest estimates since official figures are not yet available.		
2. Inflation (end of period)		
US: 1.5%	7.0%	☹
Eurozone: 1.0%	5.0%	☹
Japan: 0.3%	0.6%	✓
China: 2.5%	1.5%	(✓)
3. Central Banks		
Policy rates to remain unchanged in 2021.	This assessment was correct.	✓
4. Rates (10-year yields)		
US: 1.5-1.8%	1.5%	✓
Eurozone: (-0.2)-0.0%	-0.18%	✓
Real rates to stay low.	US 10-year real rates remained unchanged at -1.0%	✓
5. Credit		
Credit spreads to remain stable or even tighten.	Year-on-year credit spreads remained unchanged at 48 bps and 240 bps.	✓
6. Equities		
Positive returns	Correct	✓
with the US outperforming Europe.	Correct	✓

Last year's prediction	Actual outcome	
7. Equities, emerging markets		
Positive returns, led by China.	The MSCI Emerging Markets index lost 4.6% and the Chinese CSI 300 5.2%	☹
8. Commodities		
Positive outlook for oil.	The price for oil rose 50%.	✓
Prices for industrial metals stabilize.	Prices for industrial metals rose 30%.	(✓)
Gold between USD 1,800 and 2,000.	The price for gold was 1,820 at year end.	✓
9. Alternatives		
Positive for REITS	Global REITS returned 32.6%.	✓
10. Currencies		
Weaker USD	The USD strengthened against most major currencies.	☹

OUTLOOK 2022 – TEN PREDICTIONS

1. Growth

Although global growth has slowed down, it will remain clearly above trend growth in 2022. Growth will be driven by large excess savings, positive wealth effects due to rising stock and real estate prices, as well as strong capex as companies need to increase capacity.

This growth will be possible despite rising interest rates, as a result of more hawkish central banks and a sizeable fiscal drag. Fiscal drag means that government spending will decline as covid-related support payments vanish.

The latest rise in coronavirus infection rates is due to the rapid spread of the Omicron variant, which often leads to less severe symptoms than other variants. At least in the developed countries this will accelerate progress to herd immunity. As a result, we expect that the current lockdown measures will have only a transitory effect on economic growth.

In 2022 we expect US real GDP growth of 5.0% (down from 6.0% in 2021), Euro area growth of 4.5% (down from 5.0%), Japanese growth of 3.0% (up from 2.4%) and Chinese growth of 5.5% (down from 8.0%).

2. Inflation

The rising inflation can be attributed to a large extent to temporary, pandemic-related effects, and it will decrease somewhat in the course of this year. Consumers have been unable to spend on services since lockdown measures prevented people from going to restaurants, to hotels, or on vacations. At the same time many governments provided large-scale monetary support for households. The households used the available cash to buy consumer goods. As a result, manufacturers, who had to deal with pandemic related restrictions, could not meet this rapid increase in demand.

In 2022 we expect US inflation to fall to 3.0%, EMU inflation to 1.5%, Japanese inflation to remain at 0.5%, and Chinese inflation to rise to 2.0%.

3. Central Banks

All the important central banks have begun to normalize monetary policy. We expect the US Fed to raise interest rates three times this year, while the ECB will keep rates unchanged throughout 2022. In addition, the Fed and the ECB will – as already announced - start reducing their asset purchases, which will lead to a reduction of their balance sheets.

4. Rates

In our opinion, bond yields, in particular real interest rates, will continue to rise, the reason being the reduction of asset purchasing by central banks (tapering) and the continuing reflationary environment.

We expect US 10-year yields to be between 2.5% and 3.0% at the end of 2022, US 10-year real yield between 0.0% and 0.5%, and European 10-year yields between 0.0% and 0.5%.

5. Credits

High-grade bonds are priced to perfection. We expect high-grade credit spreads to widen. In contrast high-yield bonds offer better value currently, as we expect solid growth while default rates remain low. In our view, high-yield spreads will remain stable or move a little wider.

6. Equities, developed markets

We anticipate that the equity markets will be more volatile but will nevertheless undergo a positive development. However, the performance will be significantly lower than in the past few years, probably in single-digit figures.

We think that the US will continue to outperform Europe, since Europe is more vulnerable to the decline of the Chinese economy.

We expect cyclical sectors, like industrials and (US) financials to outperform.

7. Equities, emerging markets

Equities in emerging markets are facing various headwinds. Chinese growth is dampened by several structural issues. Many countries are faced with rising inflation, which provoked some central banks to hike rates aggressively. For example, Brazil raised rates from 2% to 9.25%.

Nevertheless, we may see some stimulus measures in China, which could shift equity market performance back into positive territory. Overall, we expect positive returns for the MSCI Emerging Markets index.

8. Commodities

We expect that procyclical commodities will continue to do well in 2022. Examples are certain industrial metals and crude oil. Especially copper and lithium look very interesting since they are widely used for batteries and other purposes which are important for the global energy transition. The oil price is very dependent on how OPEC+ will manage supply. But it looks likely that there is a certain upside for oil from current levels. We expect the price of gold to fall since real rates are likely to rise.

9. Alternatives

REITS enjoyed a strong rally in 2021. We think that there is additional upside, as REITS provide a certain hedge for inflation and dividend yields look attractive. Furthermore, certain sectors of the REITS markets, such as logistics and data centers, are supported by the increased demand for online services.

10. Currencies

The USD looks overvalued. However, the yield advantage and strong relative growth should continue to support the USD. As a result, we expect the EUR-USD exchange rate to remain between 1.12 and 1.18.

The CHF appreciated against the EUR recently. We expect the ECB to become gradually more hawkish in 2022, which should release some upward pressure from the CHF. However, we do not see a massive shift in the EUR-CHF exchange rate. It may rather remain between 1.04 and 1.08.

Review of our strategic asset allocation

As we do every year, we have reviewed our strategic asset allocation and adapted it to the medium-term outlook — the next 3 to 5 years. We assume that the next few years will be significantly more volatile and that there will be an increased risk of market corrections. For that reason we have increased the portfolio weight of volatility strategies from 5% to 7.5%. The volatility strategy we have implemented serves as a tail-risk hedge and should perform especially well in the event of strong market turbulence.

In a countermove we have further reduced interest-rate risks and reduced the proportion of inflation-linked bonds in the portfolio. In addition we have slightly reduced the high-yield bonds and slightly increased insurance-linked bonds.

In the present market environment we assume that stable quality stocks will perform well. Consequently, we have added quality stocks to our strategic asset allocation. In doing so, we are focusing on the "dividend aristocrats", the shares with above-average dividend returns. The companies issuing them must, moreover, have pursued a dividend-payout policy for at least the last ten years which aims at increasing or at least retaining the dividend levels.

ECONOMICS

The big macro-economic themes in 2021 were the slowing of growth, though it remained at relatively high levels, supply chain disruptions, and surging inflation. The pandemic caused several supply and demand shifts. Among other things, consumer demand shifted from services to goods, which caused shortages of supply. China was another notable focus of attention, as growth slowed markedly, the Chinese government implemented harsh new regulatory rules, and Evergrande defaulted.

Fig. 1: PMIs

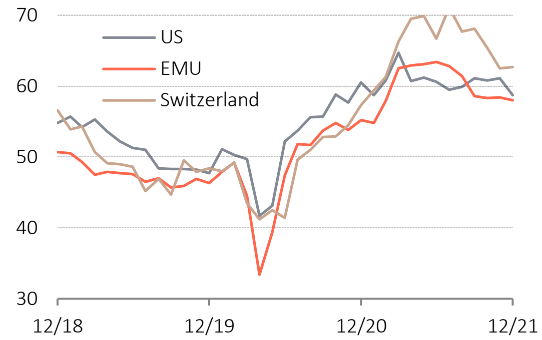


Fig. 2: PMIs

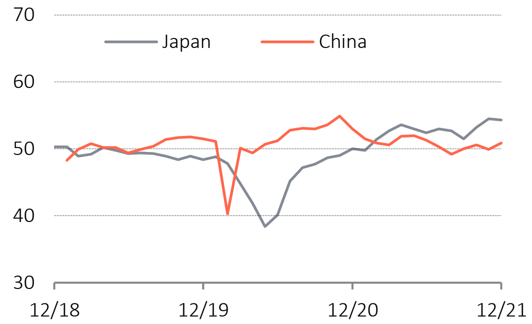


Fig 3: Consumer price inflation, in % YoY

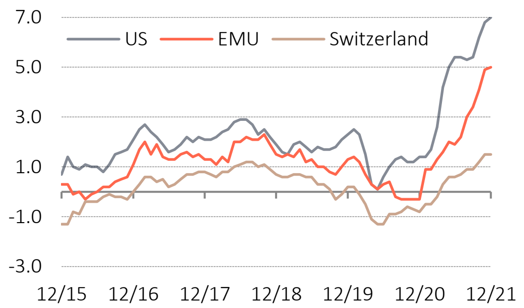


Fig. 4: Consumer price inflation, in % YoY

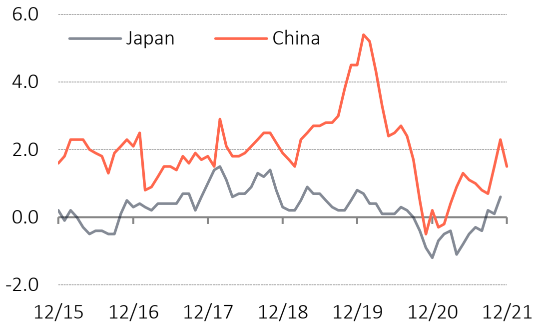


Fig 5: Unemployment rates, in %

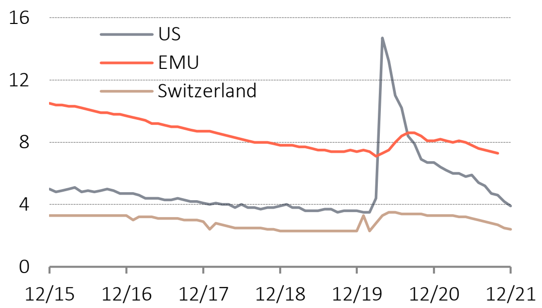
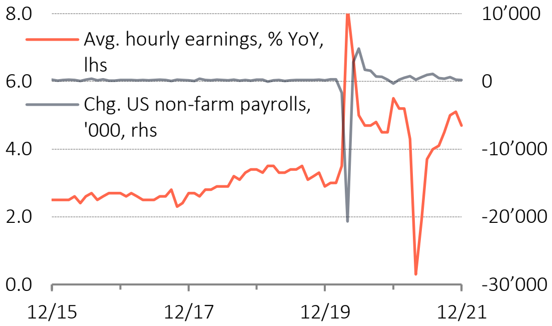


Fig 6: US labor market



FIXED INCOME

In 2021, yields rose across the board, driven by strong growth and rising inflation. That yields did not rise much more than they did, can only be explained by central banks' massive bond-buying programs. Especially real yields remained unusually low for most of the year. Credit spreads did not move much year-on-year as corporate earnings grew and their balance sheets remained healthy.

Fig.7: 2Y government bond yields

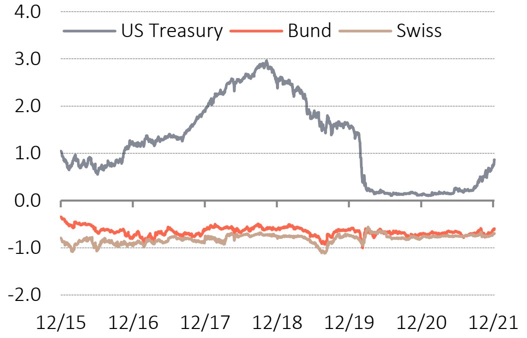


Fig. 8: 10Y government bond yields

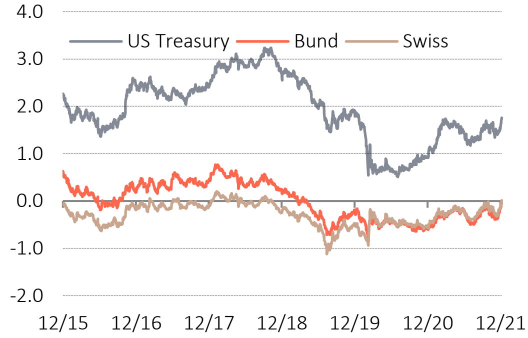


Fig 9: 10Y break-even inflation

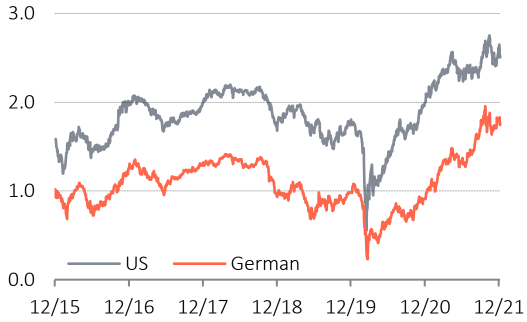


Fig. 10: Credit spreads, 5Y credit default swaps

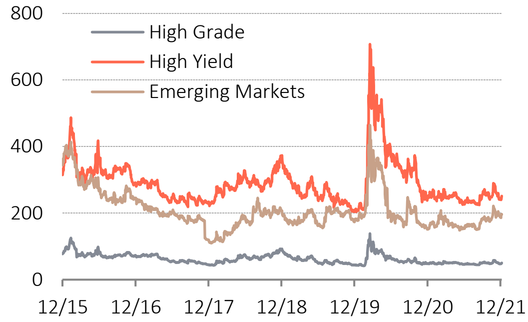


Fig 11: Money market spreads (3M-2Y)

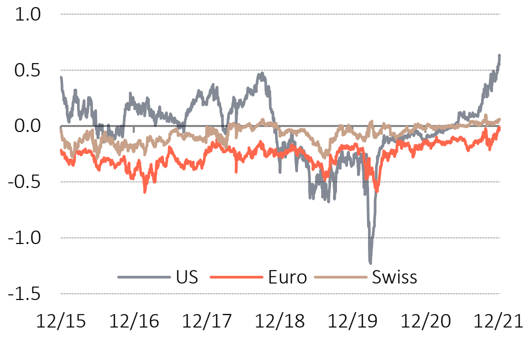
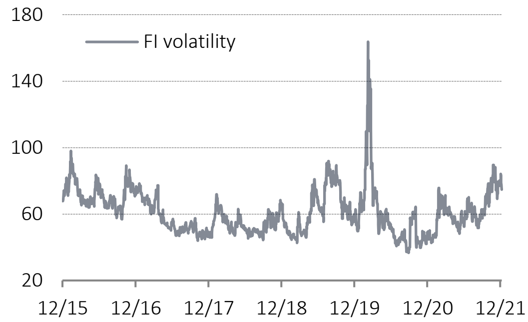


Fig 12: Merrill Lynch volatility index (MOVE)



EQUITIES

Equity markets were buoyant in 2021. The rally was driven by strong growth and ultra-loose fiscal as well as monetary policies. The US outperformed the European equity market, whereas China together with other emerging markets clearly underperformed. The strongest sectors were energy, financials, health, and technology.

Fig. 13: MSCI equity indices – major regions

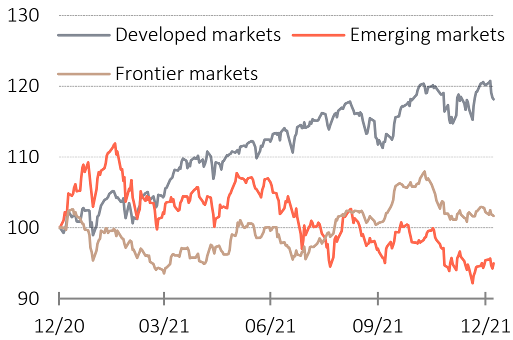


Fig.14: Equity indices – major developed markets

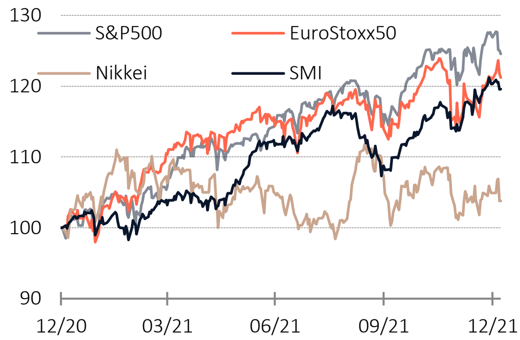


Fig 15: Equity indices – major emerging markets

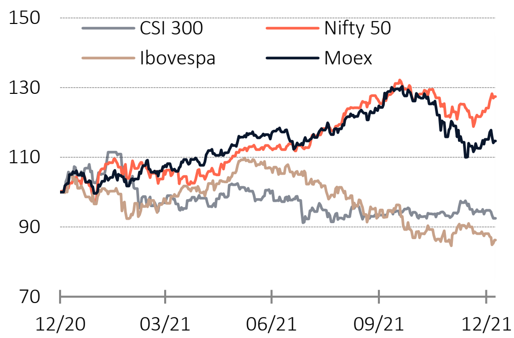


Fig. 16: Sector performance, MSCI Indices, 2021

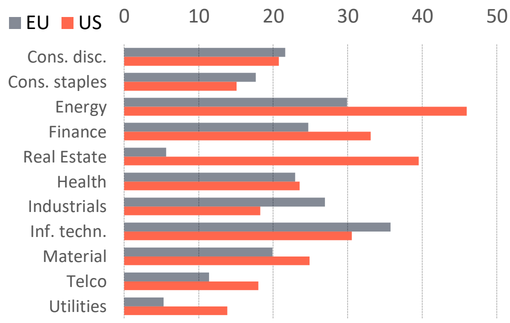


Fig 17: Price-earnings ratios

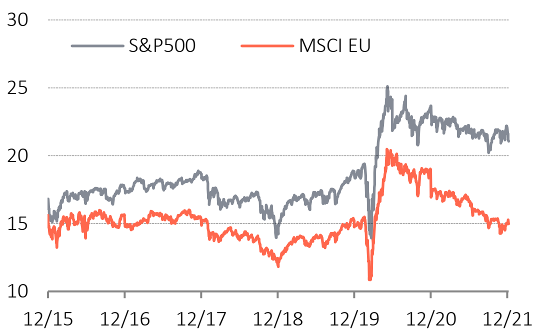
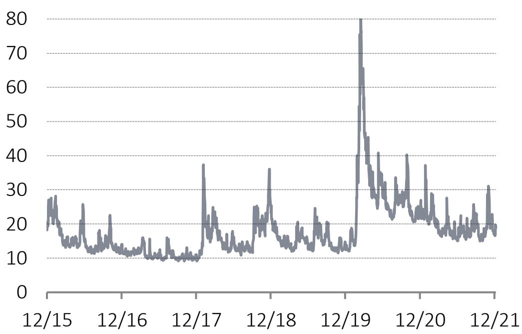


Fig 18: Equity volatility – S&P500 VIX index



ALTERNATIVE INVESTMENTS

Prices for industrial metals and energy rose strongly in 2021. The oil price, for example, climbed by 50%. Despite very low real rates, the price of gold fell by 3.6%. REITS had a very strong year, returning almost 33%. The listed private equity index even surged by 63%.

Fig. 19: Gold price, USD/oz

Fig.20: Brent oil price, USD/bl

Fig 21: Bloomberg commodity indices

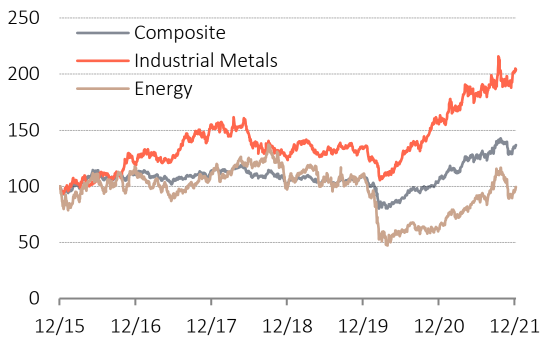


Fig. 22: HFRU hedge fund indices

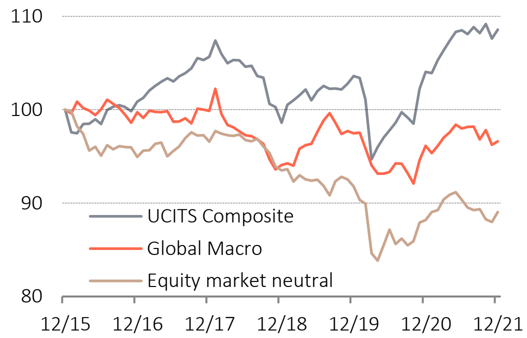


Fig 23: FTSE EPRA/NAREIT global REITS index

Fig 24: LPX global listed private equity

CURRENCIES

It was a strong-USD year. On average the USD strengthened by 6.5%, and by 7% vis-à-vis the EUR. The JPY, a typical safe haven currency, weakened and lost about 11% against the USD. In contrast, the Chinese CNY continued to strengthen, by 2.5% vis-à-vis the USD. While the CHF initially weakened against the EUR it strongly rebounded in Q4 when the EUR-CHF exchange rate fell from 1.09 to 1.04.

Fig. 25: EUR-USD exchange rate

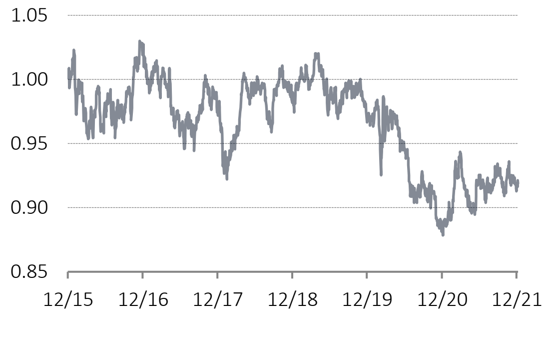
Fig. 26: GBP-USD exchange rate

Fig 27: USD-JPY exchange rate

Fig. 28: USD-CNY exchange rate

Fig 29: EUR-CHF exchange rate

Fig 30: USD-CHF exchange rate



COVID-19

The number of global cases has almost reached 340 m. More than 5.5 m people have died of Covid. 4.7 bn vaccine doses have been administrated during an unprecedented global vaccination campaign. Roughly 62% of the global population has received at least one vaccine dose. Despite all that, the Omicron variant has led to the strongest spike in new cases since the pandemic started. The hope for 2022 remains that Omicron may have stimulated a faster move towards herd immunity.

Fig. 31: Total Covid-19 cases (x 1000)

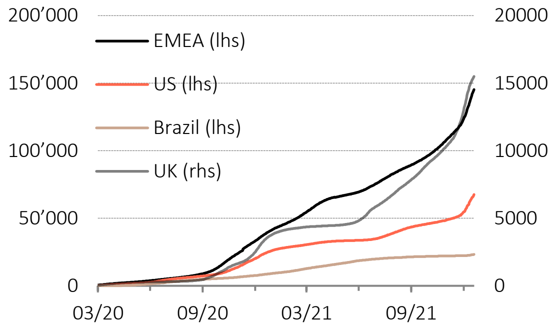


Fig. 32: New cases per day (7-day average)

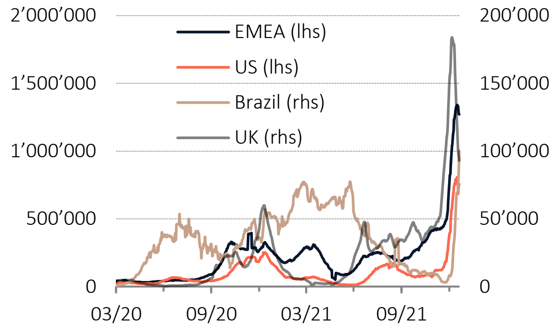


Fig 33: Global vaccination campaign
(doses per 100 people)

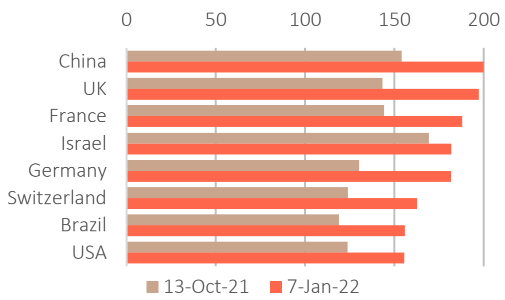


Fig.34: Central bank total assets, indexed

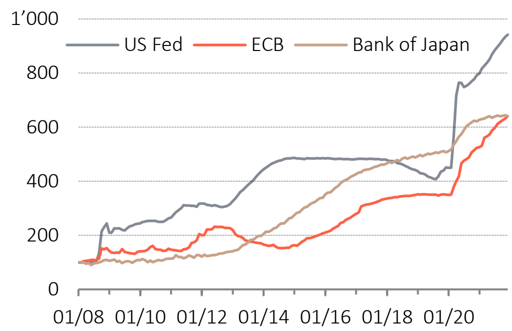


Fig 35: US bankruptcy index

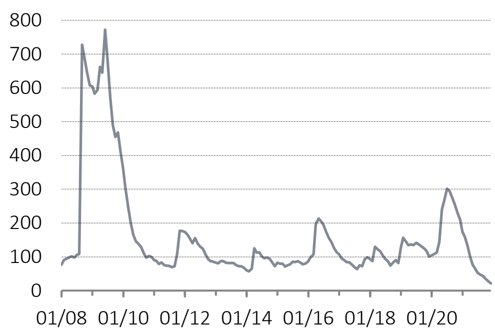
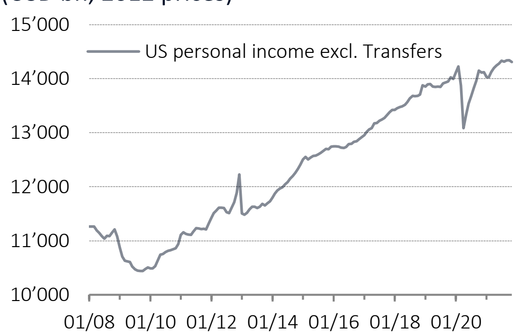


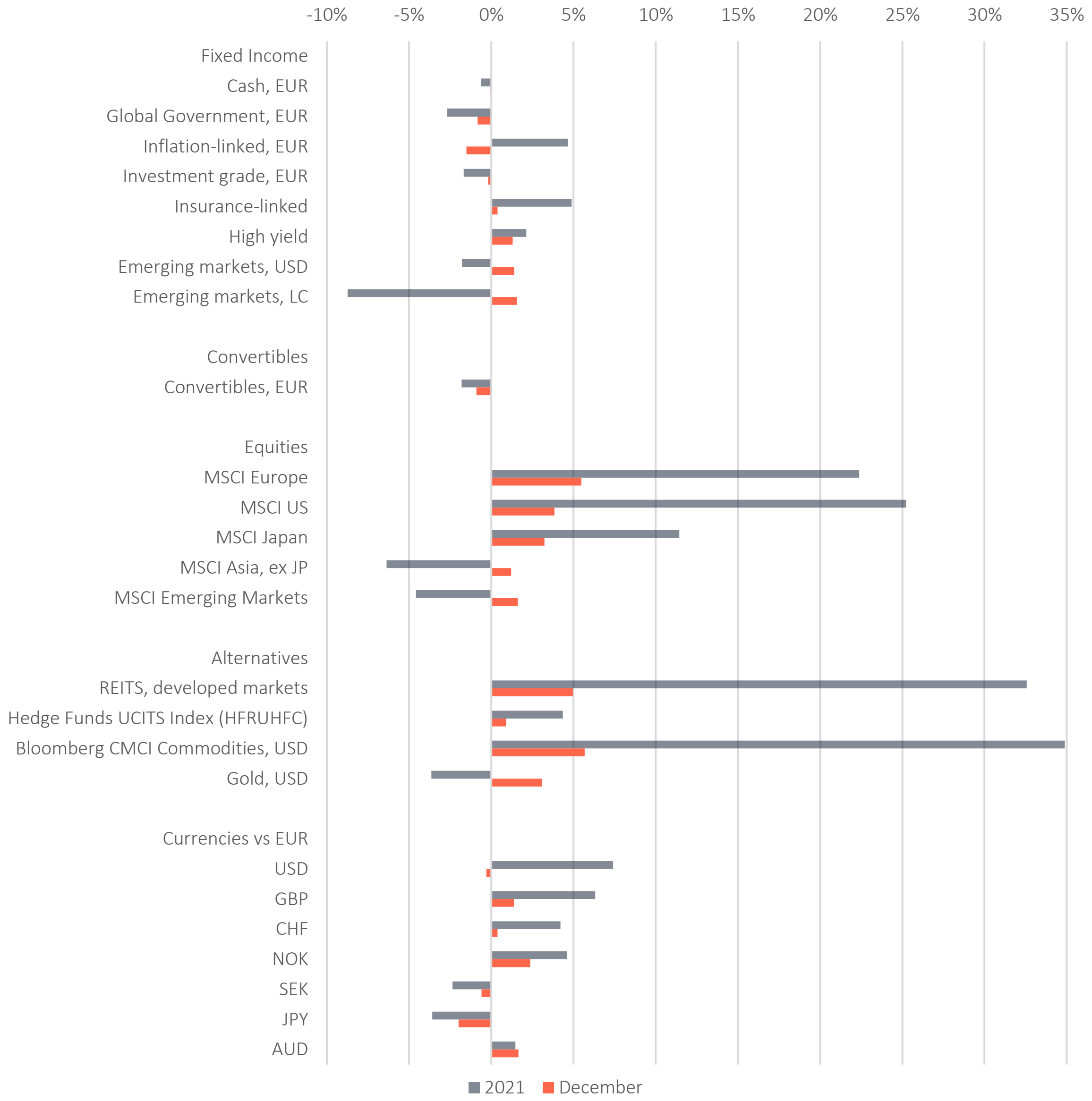
Fig 36: US personal income, excl. transfers
(USD bn, 2012 prices)



ASSET ALLOCATION

The overall good performance in 2021 was driven by stellar performances of commodities, except for gold, REITS, US and European stocks. For EUR investors, foreign currencies gave an extra booster. Government bonds, bonds and equities of emerging markets, however, were clear performance detractors.

Fig. 31: Performance of major asset classes, based on our EUR portfolio strategy

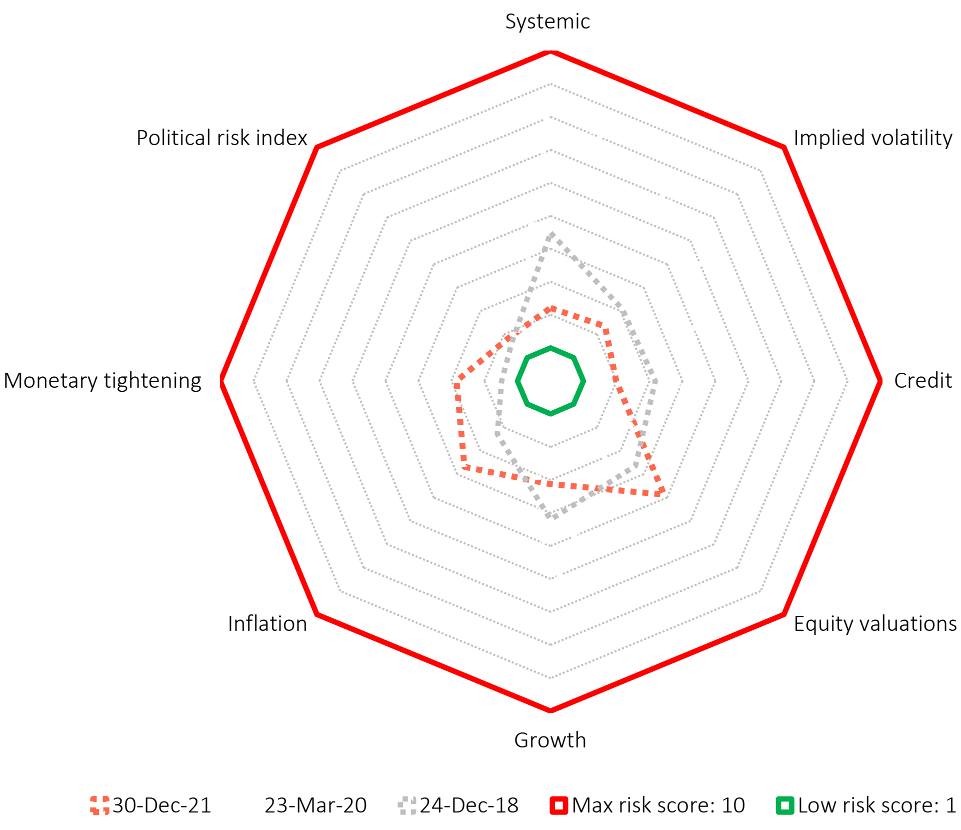


RISK MONITOR

In 2022 equity valuation risks, inflation and monetary tightening risks have increased. The risk indicators of implied volatility and credit spreads remain at historically low levels. As the financial sector currently looks healthy, systemic risks remain low. Geopolitical risks, i.e., the risk of military conflicts, remained quite low in 2021.

Fig. 32: IMT Risk Monitor

24-Dec-2018: Growth and monetary tightening fears
23-Mar-2020: Global pandemic



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