Macron encore

Monthly Investment Strategy

AXA IM Research

27 April 2022

Summary: April 2022

Theme of the month: E. Macron's re-election does not fully clear the political sky

- Emmanuel Macron won the presidential election, receiving 58.5% of the votes against Mrs Le Pen, slightly higher than predicted by polls. In this rerun of the 2017 run-off, the margin was significantly tighter: Macron's lead halved to c.8pts.
- The election showed a further polarization of the French political landscape. This evolving dynamic brings additional uncertainty to the outcome of the upcoming parliamentary elections in June, key for the governance of the country.
- Our baseline envisages that France's relative GDP outperformance is set to continue. The elections pose one of the main downside risks, namely the risk to governance.

Macro update: Toxic factors challenge the global outlook

- The war in Ukraine continues and while energy markets have been relatively cushioned, commodity prices are elevated, and supply-chain disruptions have risen. This is a clear issue for European economies, but is impacting economies across the globe, with Asian central banks increasingly tightening
- The worsening inflation outlook has seen central bank expectations re-price higher. This includes the Fed where markets now see rates rising to 2.75% this year and 3.25% next. We believe markets are overpriced, with growth set to slow markedly, but regional labour market developments will be critical.
- China's Covid outbreak is adding to risks. Growth slowed markedly in March – even before the Shanghai lockdown. We forecast contraction in Q2 and lower our full-year growth forecast to 4.5%. This slowdown suggests demand headwinds for the rest of the world, but also risks further supply disruption.
- This is a toxic combination of factors and has led the IMF to downgrade its global forecasts to 3.6% for this year and next. Our own outlook is for a weaker 3.0% and 2.9% respectively.

Investment strategy: yields may be peaking as bears for risk awaken

- FX: The sharp inflation repricing post Ukraine war has driven an even sharper repricing of monetary policy normalisation globally. The Fed is leading, as the higher energy prices are adding to already very tight labour market. This is behind the fall in the JPY as markets are pricing no change in BoJ policy.
- Rates: Double-digit drawdowns year-to-date in long duration markets like USD IG, Gilts and GBP IG have become a stark reality for investors. Rising real rates are a risk to equities; together with spread widening, a warning sign for financial conditions which could compel the Fed to dial back its hawkishness.
- Credit: Duration is set to bedevil returns until we reach peak central banks' hawkish expectations. We therefore continue to prefer HY spread risk over IG, the latter being more exposed to duration risk. Default backdrop remains supportive of HY, although rising macro risks merit prudence.
- Equity: Positive surprises for Q1 are consistent with the relationship between US ISM and earnings, but the trend does point to downside risks for the rest of the year. The extraordinary rise in US real yields could prove a catalyst for outflows into fixed-income as relative valuations reach near par.

AXA Investment Managers

Central scenario

Summary – Key messages

Inflation

Ukraine supply-shock extends inflation overshoot. Signs of domestic inflation pressures remain mixed. Uncertainty grows over expectations.

Monetary policy

Fed and ECB to tighten policy as inflation threatens expectations. This has long been the case in EM, but will run further. BoE worries about slowdown and tightening too much.

Fiscal policy

Euro area leads with large fiscal measures to absorb energy shock. UK's response small. US still deadlocked in Congress.

Growth

Growth will slow, but in most areas remain positive given post-COVID momentum. Contraction a risk for some.

Our central scenario:

Ukraine war poses material supply-shock, raising inflation further and slowing COVID-rebound growth

We forecast global growth to rise by 3.0% in 2022 and 2.9% 2023.

Economic slowdown amidst supply pressures and tighter monetary policy. Inflation elevated for much of 2022.

Emerging Markets

Ukraine war to hit CEE hard. Higher inflation, particularly energy and oil to further strain complex. Asia sheltered.

Rates

Rise in rates reflects central bank re-pricing. Flat curves show growth concerns, but may also reflect technical features.

FX

Fed pricing and geopolitics favours dollar for now. Though Fed hikes suggest peak. Commodity currencies bolstered in light of war.

Credit

Volatile spreads in 2022 on central bank and geopolitics concerns but still favour higher beta rather than duration risk.

Equities

Earnings expectations are getting shakier due to inflation & downside risks to growth. Some caution into H2 2022 warranted.

Alternative scenarios

Summary – Key messages

Entrenched supply shock *(probability 25%)*

What could be different?

- Escalation in Ukraine conflict
- COVID outbreaks spreads again: China and/or new mutations
- Post-pandemic structural changes – labour market withdrawal and goods demand – persist. Supply shocks last longer
- Inflation expectations rise, affecting wages and persistence

What it means

- Growth weaker, employment rebound softer, but inflation remains more elevated
- Monetary policy ill-equipped to deal with supply shocks, deteriorating inflation credibility forces still tighter monetary policy in DMs

Market implications

- Risk appetite deteriorates / equities sell off / credit widens
- Safe-haven rates rally resumes
- EM debt to come under pressure

A global boost *(probability 10%)*

What could be different?

- Geo-political tension ease – peace in our time.
- Labour market participation recovers, strong income growth and easing inflation pressures
- Productivity boost following investment rebound and structural post-pandemic adjustments

What it means

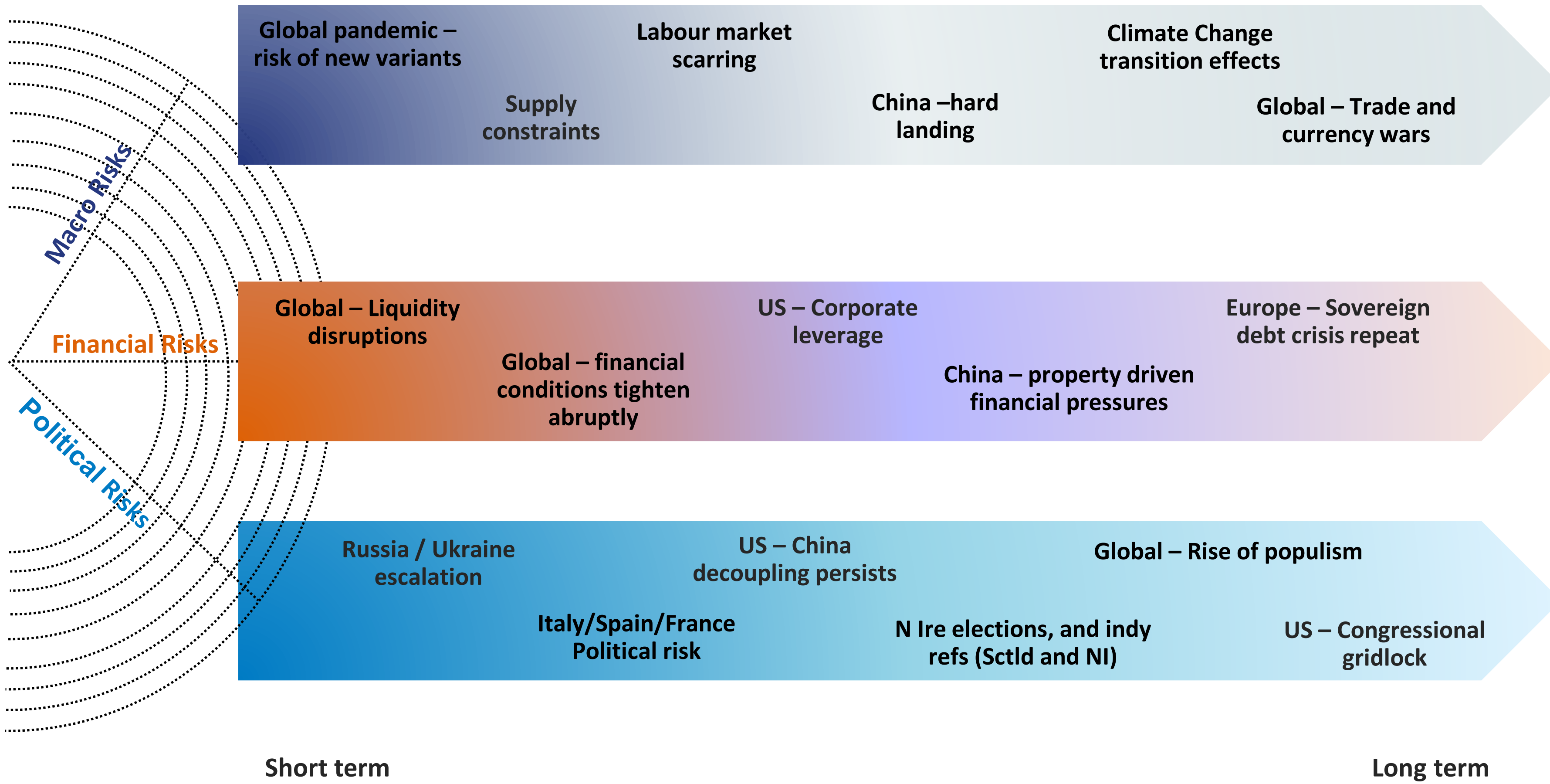
- Growth surprises on the upside in most regions
- Inflation fades more quickly towards and below central bank targets
- Monetary policy proves more patient than expectations

Market implications

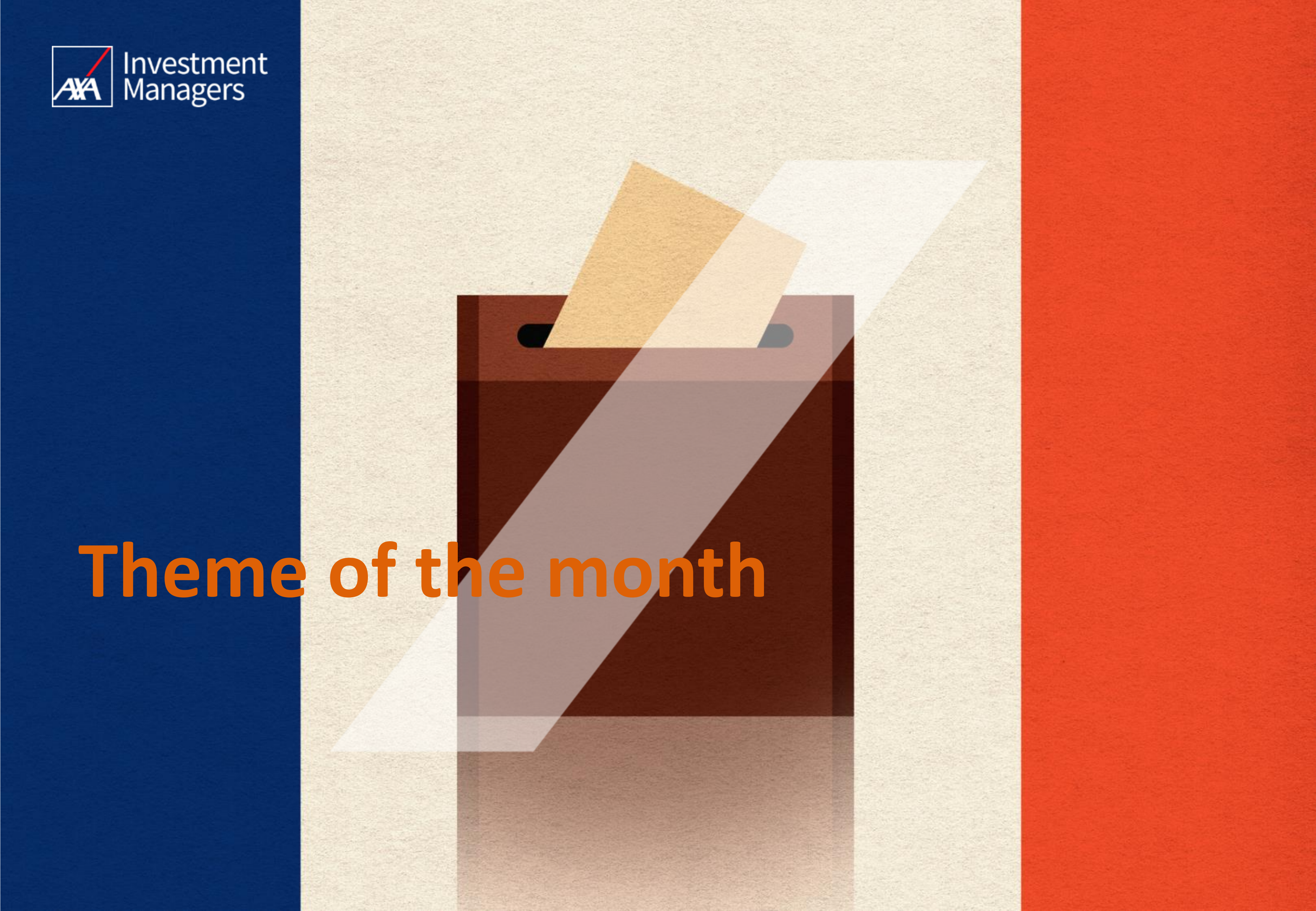
- Risk-on environment, equities make further gains, growth retains lead over value
- UST softens, EUR strengthens
- Spreads grind tighter

RISk Radar

Summary – Key messages



Contents



Theme of the month

President Macron re-elected for another five year term

French presidential election

2nd term

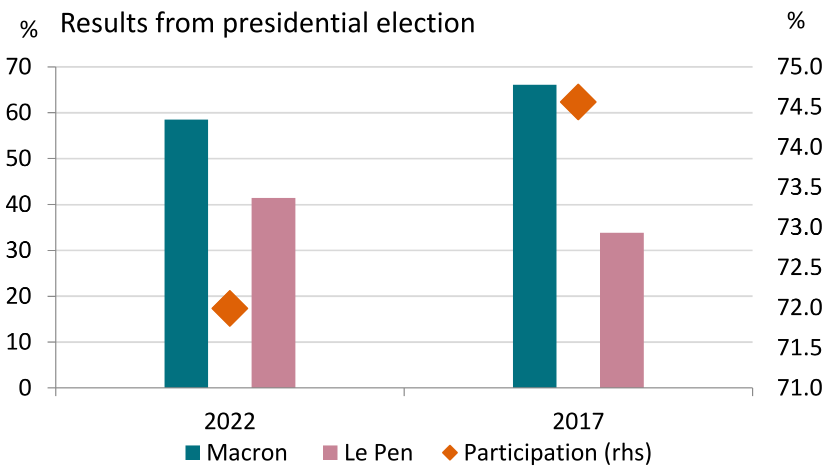
- President Macron won the presidential election for a second time receiving 58.5% of the votes against Mrs Le Pen, slightly higher than predicted by polls. In this rerun of the 2017 run-off, the final margin was significantly tighter: Macron's lead halved to 8pts. Turnout in the second round reached a new low since 2002 at 72%, while the average is c.79%. Similar to 2017 second round, voters casted a high share of blank/nil votes (9% after 12%).

Difficult next steps: governance

- President Macron now faces challenging next steps. First, the nomination of a Prime Minister, allowing for the subsequent formation of a first government (before 13 May).

- Parliamentary elections (12-19 June) where there is significant uncertainty about how complex levels of tactical voting will unfold for the population of parliament.

Outcome of French presidential election



Source: Interior ministry. Note: Participation rate averaged c.79% in all rounds since 2002

Key events ahead

Date	Event
Before 13 May 2022	Transfer of power to new president and appointment of new PM
12-Jun	First round of Parliamentary election
19-Jun	Second round of Parliamentary election
July	First session of New Parliament
End-Sept	Presentation of 2023 budget

Source: AXA IM Research

Elevated uncertainty until summer (1)

French parliamentary election

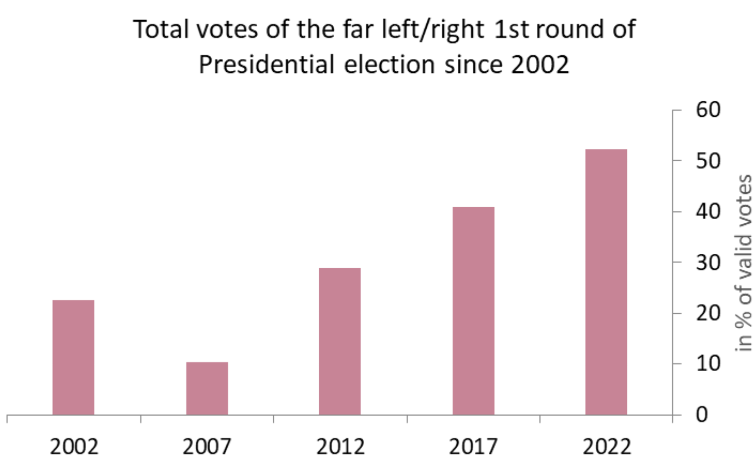
Presidential election showed a further polarization of the French political landscape

- The political landscape is split around four main forces: sovereigntist radical left and extreme right which share strong social economic transfer policies and a more or less formal exit from EU treaties. However, they strongly oppose each other on climate change and immigration. The fall of traditional parties has also benefitted a wider support to Mr Macron centrist positioning. Finally, participation is on a downward trend, non-voters representing about 25% of the population.

Fundamental uncertainty to the outcome of parliamentary elections

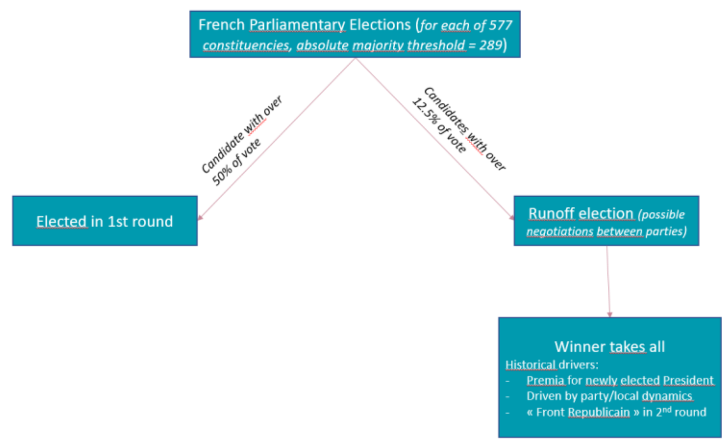
- Lack of valid historical precedents to gain absolute majority in lower house for a re-elected president. The electoral system does not help predictability. MPs are elected with a two round majority voting system, with a 12.5% threshold meaning that more that 2 candidates can qualify for the second round.

Above 50% of votes went to far right or radical left



Source: Interior ministry, as of April 2022

French Parliamentary election process



Source: AXA IM Macro Research

Elevated uncertainty until summer (2)

French parliamentary election

Governance for next five years may prove challenging

- While political fragmentation makes full-on “cohabitation” unlikely, **we think there is a non-negligeable chance for the newly elected President not to have an absolute majority in Parliament, thus requiring him to seek compromise on selected laws and reforms.** While most ‘ordinary’ laws require a simple majority, important bills (such as budget) or material reforms may prove more difficult to pass –making MPs voting presence/abstention critical.

- **There is the possibility of a more complicated governing triangle.** France’s Fifth Republic system can be simplified as the relationships between the three ‘Ps’ - namely president, parliament and the population. Over the past five years, the contention has mainly been dual: the President’s plans have at times been resisted by some significant segments of the population (e.g. the yellow vest movement and with pension reform). In the event of a split Parliament, it could mean protracted, less forceful legislative proposals and reforms.

Better placed than peers

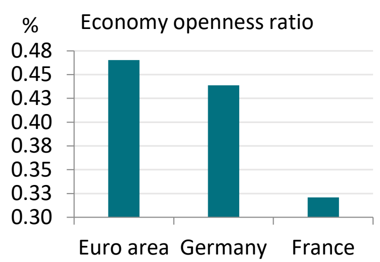
France: outlook and risks

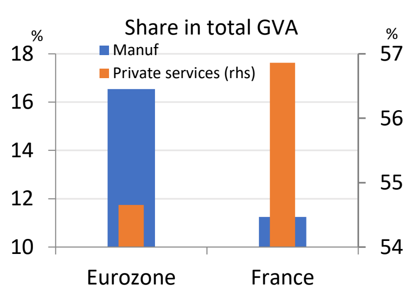
- France was outperforming its peers when exiting the pandemic, as it was the only large country with real GDP at pre-crisis levels (Q4 19) in Q3 21, helped by private consumption and investment.

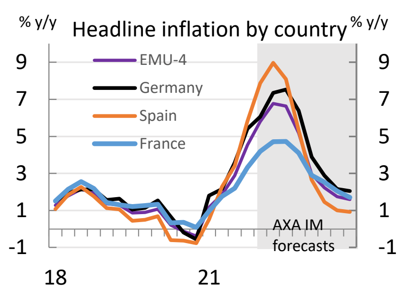
- We think this relative GDP outperformance is likely to continue for three main reasons - its relatively closed services intense economy, thus also less dependent from China, lower dependence on fossil fuels and material fiscal policy mitigation cushioning high energy prices. We project French GDP to grow 2.7% this year and 1.0% next, consistent with real GDP 2.8% above Q4 19 levels in Q4 2023.

- The elections pose one of the main downside risks, namely the risk to governance. If the outcome of these elections is an inability to pass meaningful reforms and an associated increase in social tensions further disrupting supply then this may have a negative impact on activity. The second downside risk is related to further declines in purchasing power, as significant offsetting measures are unlikely to be maintained in the medium-term.

France well placed on key metrics

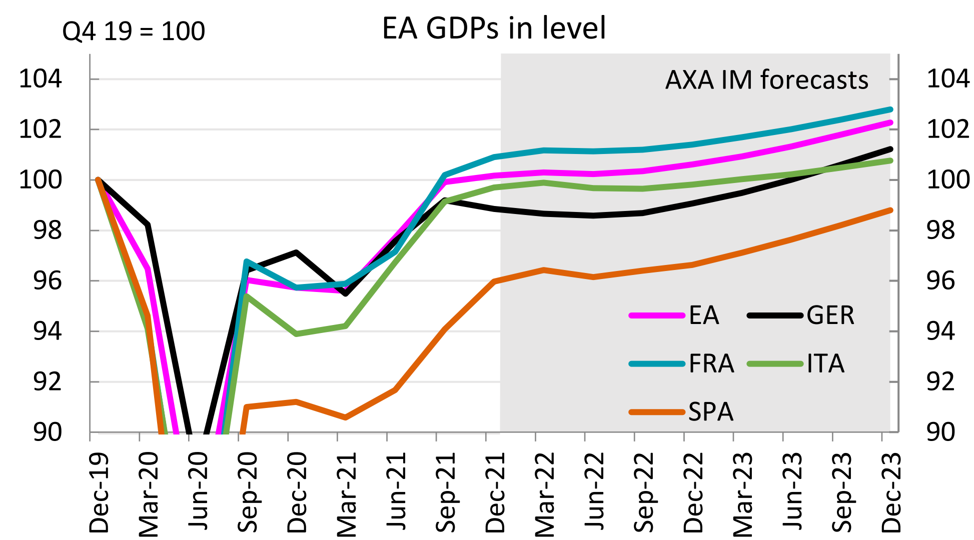






Source: Eurostat, AXA IM Research

France GDP outperformance likely to continue



Source: Eurostat, AXA IM Research

Macro outlook

Inflation fuels Fed's response expectation

US

Peak inflation concern

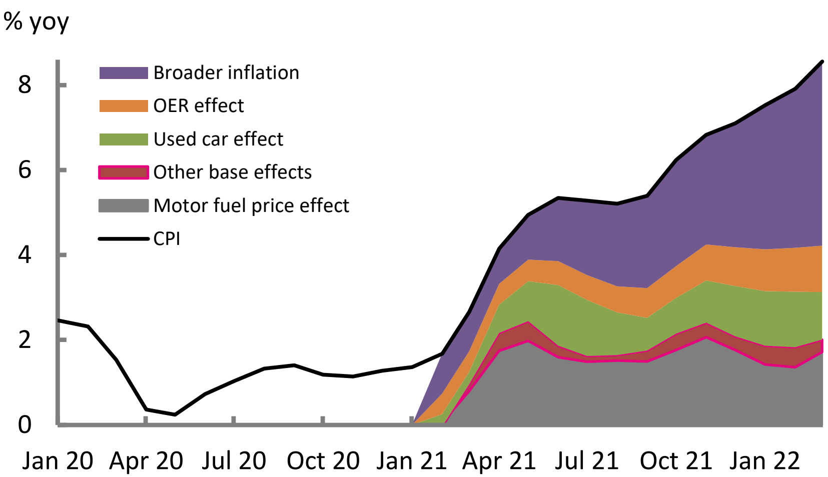
- Inflation set a new 40-year high of 8.5% in March. Successive supply shocks – of which the Ukraine-related oil price rise is the latest – is passing through into broader components of CPI. 5y5y breakeven inflation expectations also exceeded 2.6% - above the 2.4-2.5% range consistent with the Fed's inflation target for the first time since 2014. But core CPI rose by less. Inflation is likely close to the peak, but will take several months to recede meaningfully. We forecast inflation averaging 7.0% and 3.8% this year and next.

Fed responds further fuelling expectations

- Having raised the dot plot in March, FOMC participants voiced support for 50bps hikes, at least in May. Market expectations for the Funds Rate rose to 2.75% this year and 3.25% next. We have shifted our profile (now seeing 2 x 50bps hikes in May and June) to see the FFR at 2.50% by year-end (the Fed's view of neutral) and 2.75% in 2023. We expect signs of labour market easing to manifest before the Fed reaches 3%. While most FOMC participants support a hawkish stance, Bostic and Waller have been more cautious.

Inflation rises and spreads – but close to peak

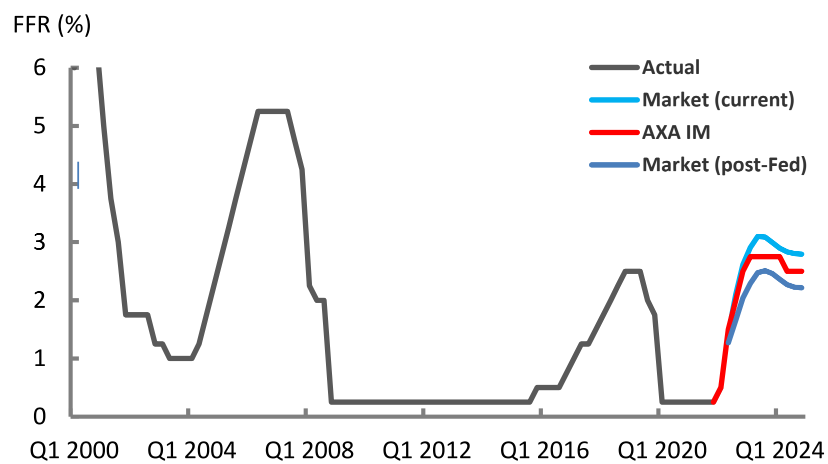
A decomposition of the rise in CPI inflation



Source: BLS, AXA IM Research, April 2022

Hiking expectations rise further

Fed Funds Rate and forecasts



Source: FRB, Bloomberg, AXA IM Research, April 2022

Growth to slow – impact on labour market key

US

Interest-rate sensitive sectors of the economy weaken

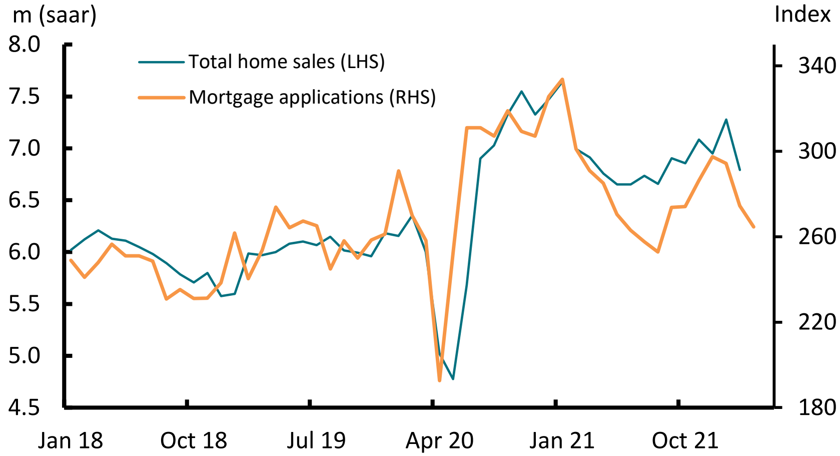
- The 30-year mortgage rate has surged from 3.25% end-21 to >5.5% now. Mortgage applications for home purchase are down 15% over the period and home sales are falling after a buoyant period. Vehicle sales also dropped in March – although it is difficult to differentiate supply and demand effects here. Retail sales more broadly have fallen successively in real terms since October – barring a post-COVID January. Consumer spending is likely to slow as incomes are squeezed, despite some cushioning from savings.

GDP growth to slow

- After 6%+ (saar) growth in three quarters last year this should be obvious. We forecast growth of 1.5% in Q1. But growth volatility caused by large levels of inventory build threaten contraction in one quarter this year. We forecast growth to rise by 2.8% in 2022 and 1.6% in 2023 (consensus 3.2% and 2.1%). The scale of the slowdown leads us to see the Fed hiking by less than current market forecasts. However, it is the impact of this broad slowdown on the labour market that will be key to policy.

Softening in interest rate sensitive sectors

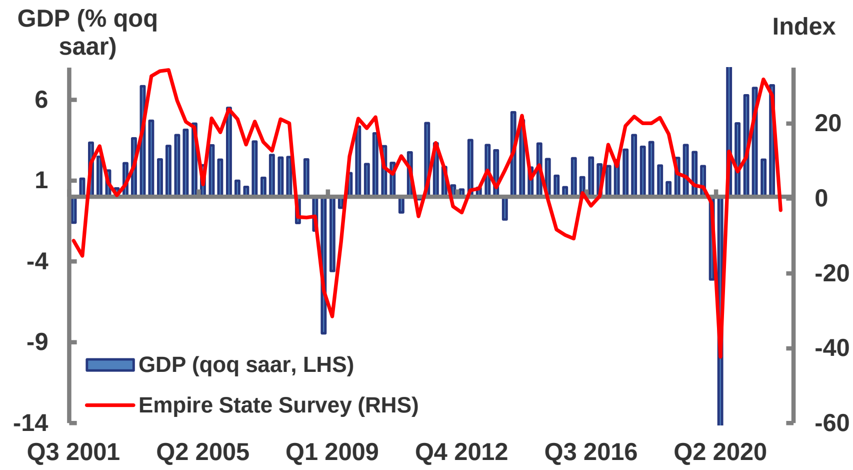
Total home sales and mortgage applications



Source: NAR, MBA, April 2022

Growth to slow

GDP growth and Empire State Survey



Source: FRNY, BEA, AXA IM Research, April 2022

Consumers feeling the heat

Eurozone

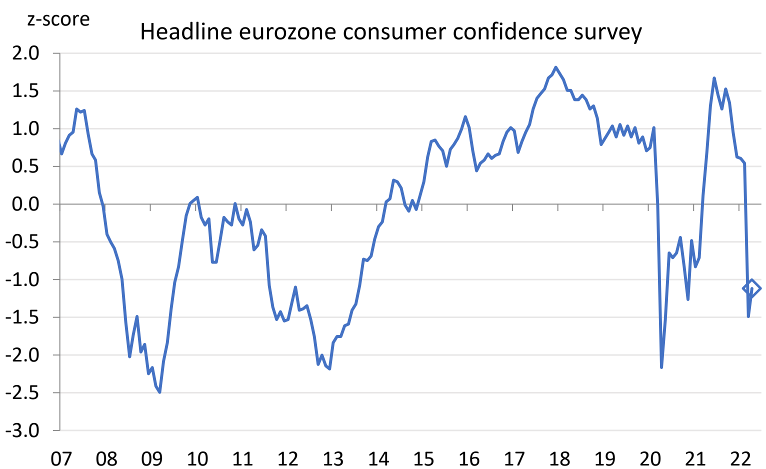
Consumers feel strain even as COVID easing boosts services

- Consumer confidence nose-dived in March and remained at low levels in April. We have revised our euro area inflation forecast up for this year, now projecting 6.1% and 2.1% (+0.7pp, -0.4pp) in 2022 and 2023 respectively.
- Business confidence has remained resilient in April, supported by the removal of pandemic restrictive measures spurring the services sector, more than offsetting manufacturing difficulties. Worries about China's outlook continue.

Eurozone close to stall speed over coming quarters

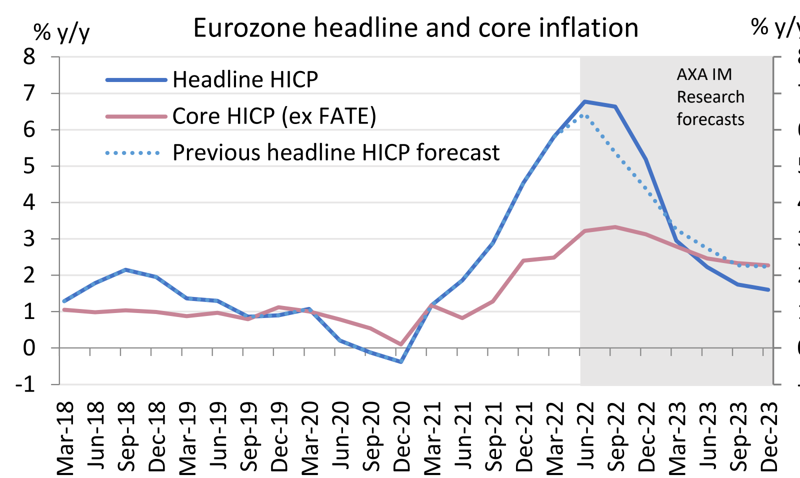
- We maintain our below consensus view that euro area economy should flirt with recession in Q2-Q3, before recovering strongly in 2023 led by investment. Labour markets should be only moderately affected (no strong reversal, no scarring) – though largely dependent on fiscal response. Savings behaviour is another key element to the outlook. Lower income quartile earners display increased precautionary savings behaviour.

Consumer confidence at very low levels in April



Source: European Commission, AXA IM Research, April 2022.
Note: Diamond refers to April data

High inflation for longer



Source: Eurostat, AXA IM Research, April 2022

ECB: High bar to soften monetary policy normalisation

Eurozone

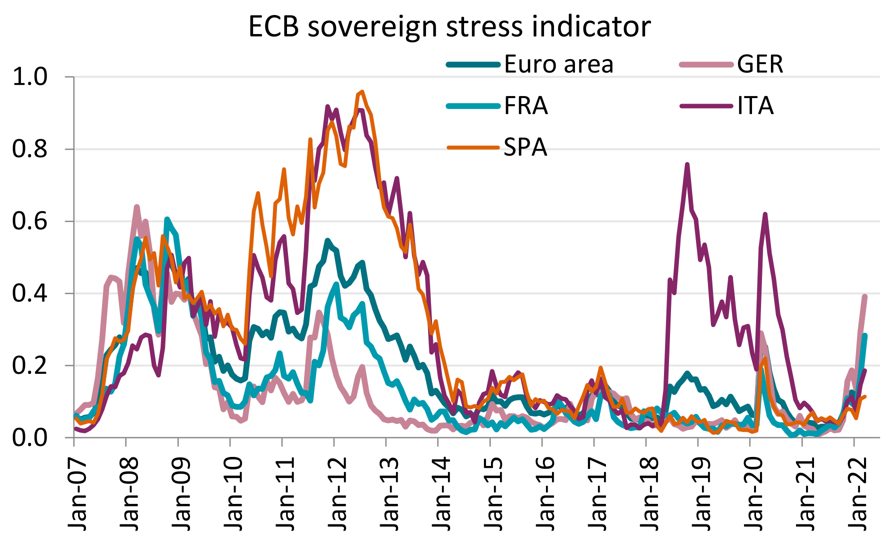
Going through with hawkish tone

- The ECB struck an increased hawkish tone in April (end APP, nervousness on inflation) suggesting a very high bar to avoid a quick unwind of extraordinary measures (asset purchases and negative rates). The ECB running is on faith with its (future) anti-financial fragmentation tool, which is likely to be a mix between SMP (sterilization), OMT (conditionalities), PEPP (flexible, self-triggered). The ECB likely to remain reactive rather than proactive. It also leaves its options open under "optionality, flexibility, gradualism" mantra.

Baseline forecast more modest tightening than consensus

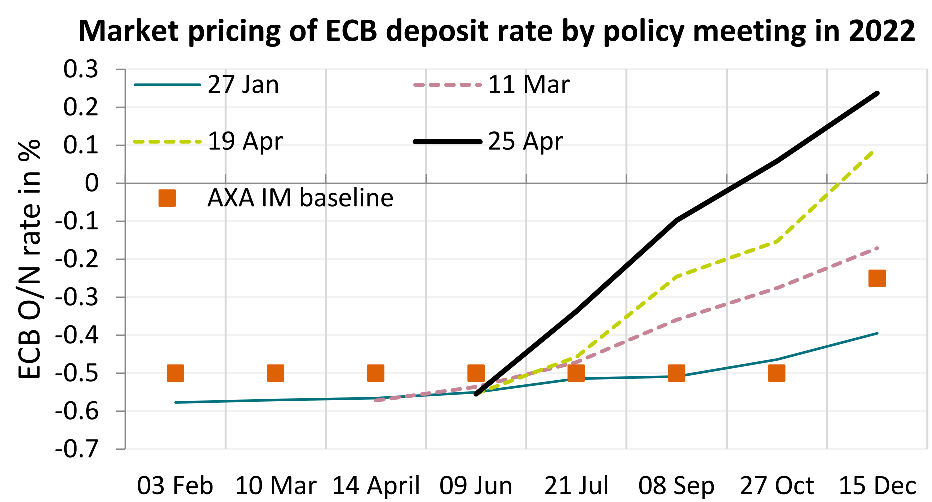
- We expect the ECB to finish APP in June. We then forecast two 25bps rate hikes in Dec 2022, and March 2023 and for now envisage another 25bps hike in Dec 2023. We think that the macro impact from the Ukraine crisis is likely to delay the ECB's normalisation versus market expectations. However, we cannot rule out a first lift off in September 22.

Sovereign stress materially up in March



Source: ECB, AXA IM Research

Resilient economy has pushed ECB rate expectations materially higher



Source: Bloomberg, AXA IM Research, as of 25 Apr 2022

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Inflation driving cost of living squeeze

UK

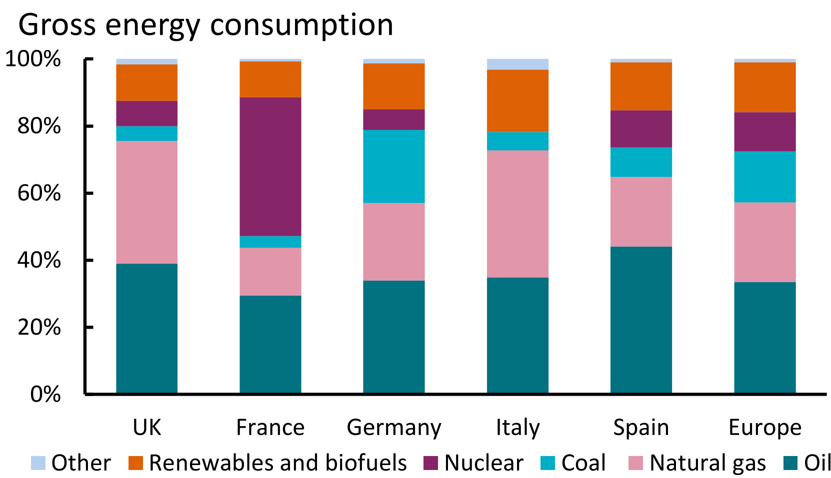
Inflation nears a peak of ~9%

- Inflation rose to 7% in March with prices rising in most sectors, the spread of inflation appears to be broadening, a development which may unsettle the MPC. Inflation is on track to peak around 9% in April driven by utility price rises. The UK is particularly vulnerable to oil and gas prices driven higher by the war in Ukraine due to their dominance in energy consumption. We have raised our inflation outlook to 7.3% for 2022 and 3.5% for 2023 up from 6.8% and 3.4%, respectively (consensus 7.0% and 3.3%).

Cost of living faces historic falls

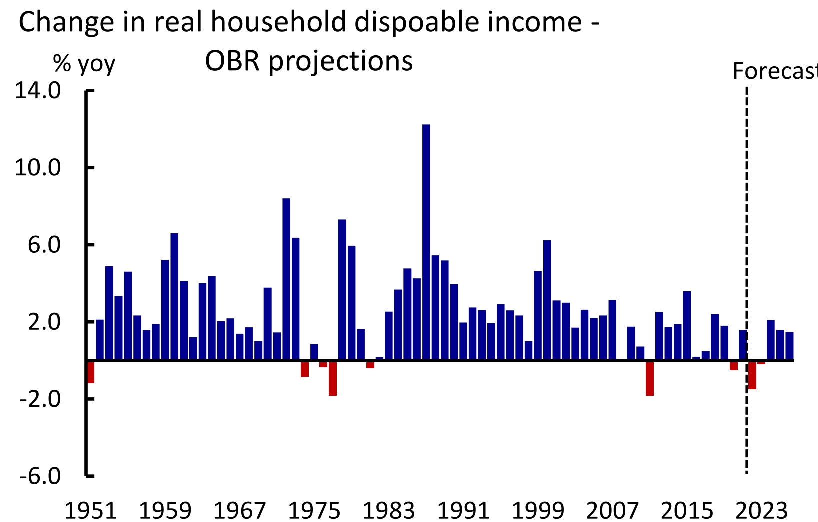
- We expect growth to begin to slow materially as the real income squeeze impacts households - some measures point to the worst real income fall on record. Retail sales have already begun to show signs of softness, falling by -1.4% in March after the -0.5% falls recorded in February. Consumer confidence has also continued to weaken reaching levels last seen during the 2008 GFC. We forecast GDP growth of 3.8% for 2022 and have downgraded 2023 to 0.6% from 0.7% (consensus 3.8% and 1.7%).

Dominance of oil and gas in UK energy mix leaves it vulnerable



Source: Eurostat, OBR, AXA IM Research, April 2022

Real income is set to suffer sustained falls as inflation surges



Source: National Statistics, OBR, AXA IM Research, April 2022

MPC set to hike in May

UK

May Monetary Policy Report will be key

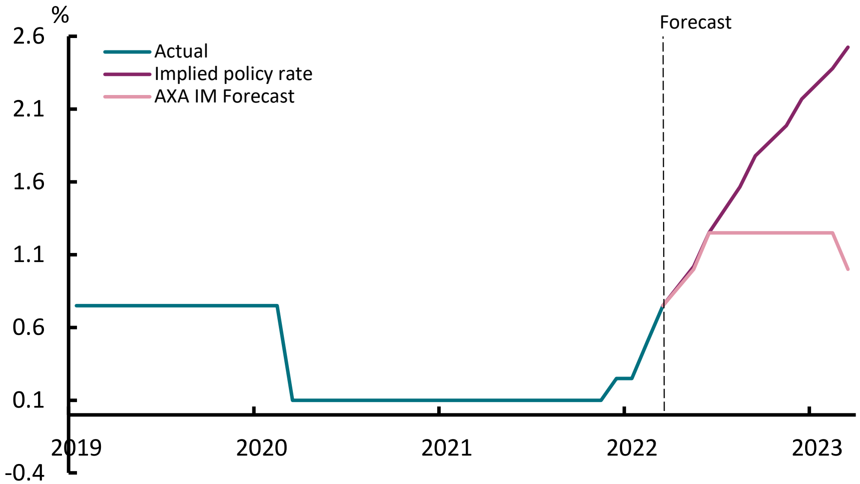
- The Bank of England (BoE) is expected to hike rates again to 1.00% in May. It will also publish updated economic forecasts which we expect to show a material slowdown in UK growth and a worsening inflation outlook as a result of the war in Ukraine. We see this as triggering an easing in market rate expectations, with markets currently expecting rates to reach 2% by end-2022. We forecast just one more rise to 1.25% in June, with the BoE likely to end their hiking cycle as the growth outlook deteriorates.

Higher wage and price expectations risk further hikes

- Medium-term indicators of inflation expectations have generally been stable and Governor Bailey suggested longer-end expectations did not point to an unanchoring; however, some indicators remain above past averages. The latest Bank/Kantar and YouGov/Citi surveys both showed five-to-ten years household expectations higher recently. Further increases in expectations could see the BoE have to hike more to secure expectations remain anchored, regardless of the growth consequences.

We expect fewer hikes than markets

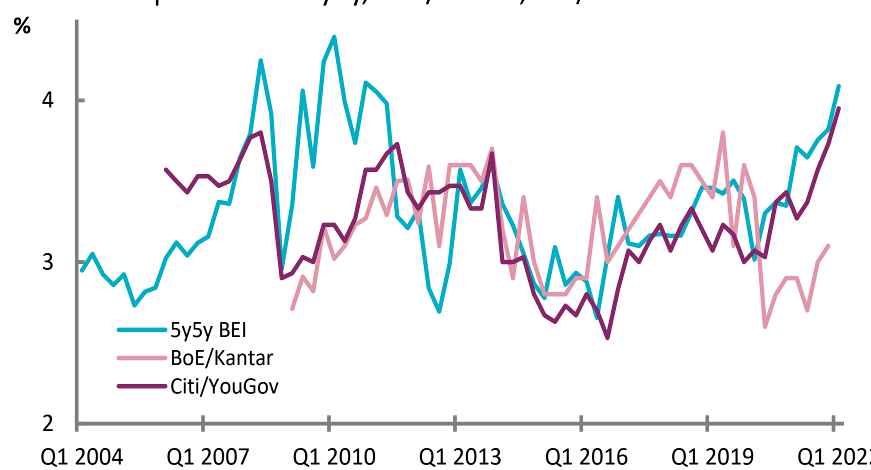
UK Policy Rate



Source: BoE, Bloomberg, AXA IM Research, April 2022

Measures of inflation expectations have picked up slightly

Inflation expectations: 5y5y, BoE/Kantar, Citi/YouGov



Source: BoE, Citi, Kantar, YouGov, AXA IM Research, April 2022

Omicron takes a severe toll on the economy

China

Growth slows even before Shanghai lockdown started

- March data showed a severe economic shock from the latest Omicron outbreak even before Shanghai went into a full lockdown. Industrial output and investment growth all slowed notably from the start of the year, but it is services and consumption activity that bore the brunt of the shock, contracting for the first time since Q1-2020. Mobility and travel metrics fell sharply as COVID restrictions were tightened nationwide in response to the worst outbreak since the onset of the pandemic

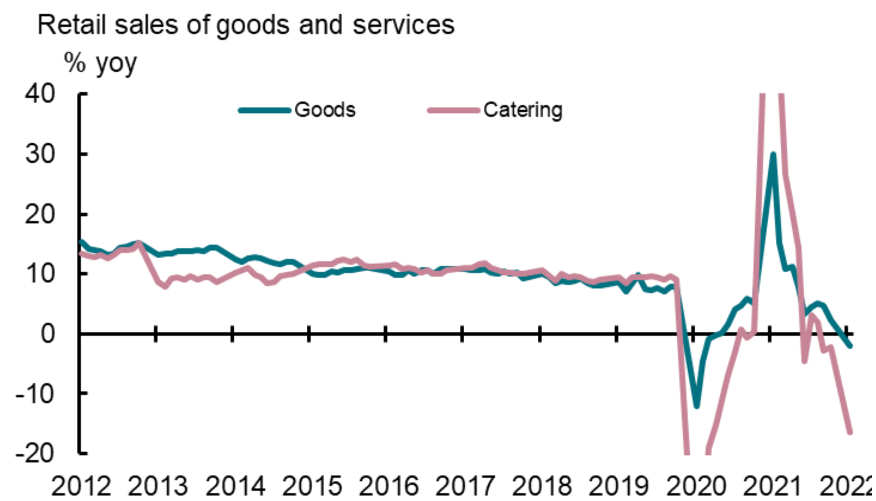
Conditions deteriorate further in April

- The Shanghai lockdown is a pivotal moment in the current outbreak. The impact of halting activity in a city that accounts for 3.5% of China's GDP is already non-negligible, before considering the spillover effects. But the latter has become a bigger concern, as the city's lockdown disrupts the nation's supply chains and logistic networks. Proactive, and sometimes excessive, tightening of COVID controls by other local governments – to avoid repeating Shanghai's fate – have also exacerbated the contagious effect

Activity slows as Omicron strikes

Source: CEIC, AXA IM Research, Apr 22

Consumption contracts on tightened COVID restrictions



Source: CEIC, AXA IM Research, Apr 22

Urgent policy changes needed to stabilize the economy

China

Less draconian COVID controls to lessen economic shocks

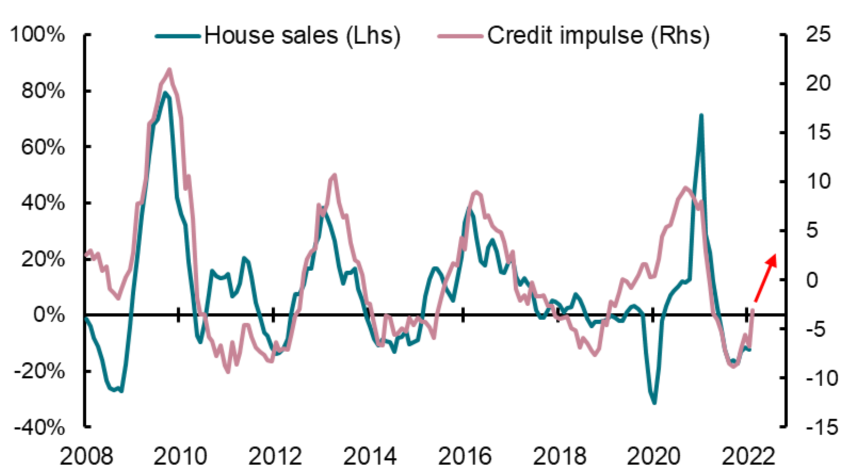
- China's COVID policy requires urgent recalibration as its sustainability has been called into question by the current Omicron outbreak. We think Beijing will be forced to move away from an excessive focus on administrative controls to a strategy that relies more on vaccines, self-quarantine and treating the vulnerable. This would not be a full liberalization straightaway due to public-health and political considerations, but would aim at a middle approach – between 'Zero COVID' and 'Living with COVID'. This could happen as soon as the Shanghai's situation stabilizes

More macro policy easing to revive growth

- Besides lessening COVID-related restrictions, macro policy easing also needs to step up. While the pace of policy announcements has quickened lately, the measures so far remain inadequate to put a stop to the growth slide. We think more policy easing is required, along with changes in the COVID strategy, to pave the way for a growth rebound after the outbreak is contained. To reflect the severe Omicron shock and tepid policy easing so far, we have cut our 2022 growth forecast to 4.5% from 5%

Credit impulse continues to improve

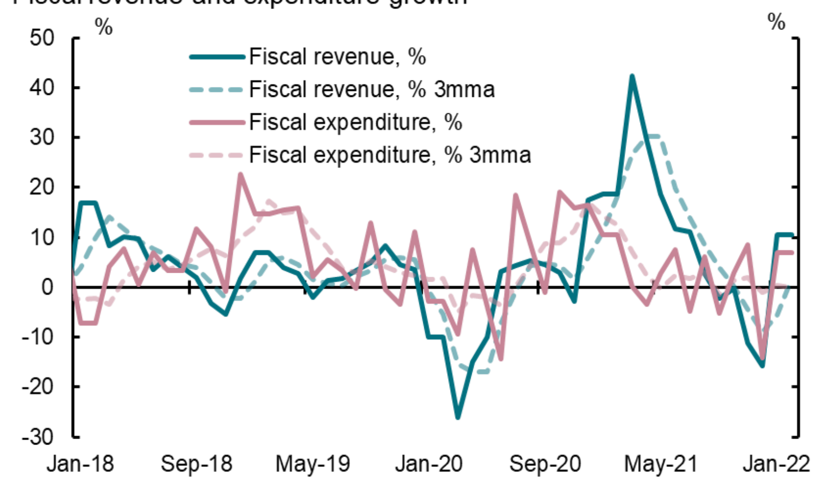
Credit impulse and house sales



Source: CEIC, AXA IM Research, Apr 22

Fiscal spending quickens

Fiscal revenue and expenditure growth



Source: CEIC, AXA IM Research, Apr 22

Mixed economic environment in Japan

Japan

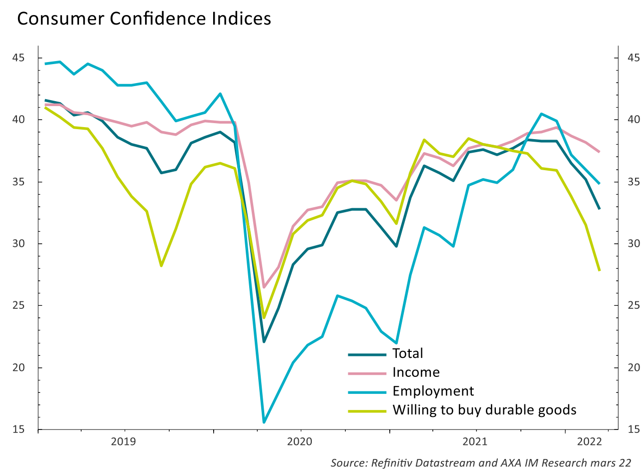
Rebound in services sector, weakness in manufacturing

- April's flash manufacturing PMI dropped to 53.4 after the output, new orders and employment indices declined. In contrast, the services PMI benefited from a rebound in some sectors after the end of COVID-19 restrictions.

CPI rose to 1.2% in March, likely to exceed 2% from April

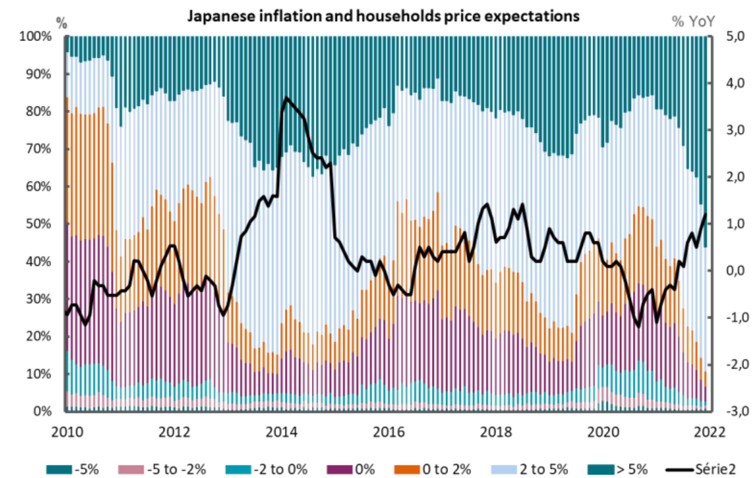
- CPI inflation should exceed 2% in April for the first time since 2015's VAT hike driven rise. This should reflect the impact of the large cut in mobile phone charges last year falling out of the comparison and second-round effects from higher energy prices. On the supply side, domestic manufacturers face surging energy prices and yen depreciation is raising the risk of a higher pass-through of costs to prices.
- 52% of households believe inflation is currently above 5%. Discrepancies between observed and perceived inflation have always been high but rarely on this scale. This is likely to dampen private consumption, despite new government stimulus expected soon (around 1% of GDP).

Increasingly risk-averse households…



Source: Cabinet Office, AXA IM Macro Research, March 2022

… and inflation has a lot to do with it



Source: Cabinet Office, Ministry of Internal Affairs and communications AXA IM Macro Research, as of March 2022

Another headache with yen depreciation

Japan

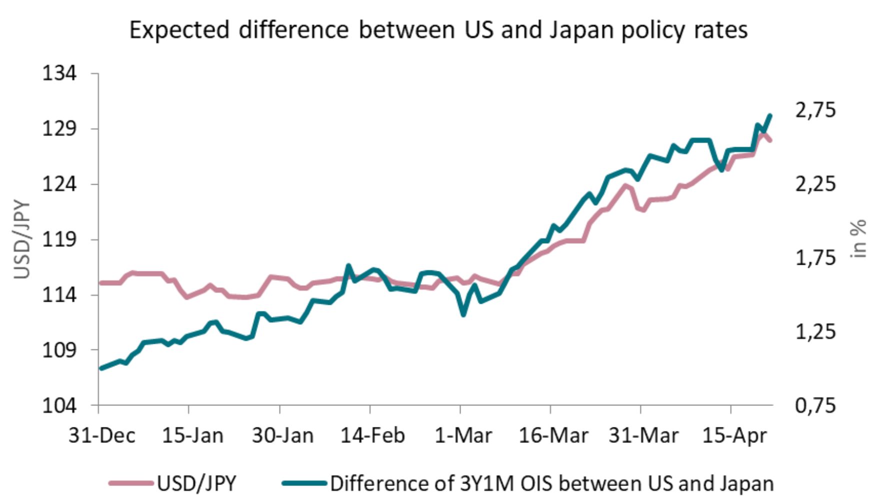
Yen fell to a two-decade low against the dollar at ¥129

- The huge advantage a cheap yen has provided Japan in the past is less prevalent - Japan imports 90% of its energy needs so the import price increase hurt households and companies which are unable to pass on costs. Japanese exporters have also partially outsourced production, so the competitive advantage of a weaker yen is waning

Pressure on the Bank of Japan is likely to grow in coming weeks

- There is a strong and obvious correlation between the US/Japanese expected rate differential and yen depreciation. But the BoJ has stuck to its policy and has recently increased net purchases to defend its 10-year target at +0.25%. We believe the BoJ will keep the status quo at next week's policy meeting, arguing that insufficient core inflationary pressure and an incomplete recovery require further support.

The yen lost 11% against the dollar since the beginning of the year



Source: Datastream, AXA IM Macro Research, as of April 21

The BoJ defends its Yield Curve Control by increasing JGB net purchases

Source: Refinitiv Datastream and AXA IM Research mars 22

Investment Managers

Tight conditions contribute to inflation peak

Canada

Inflation risks on several fronts

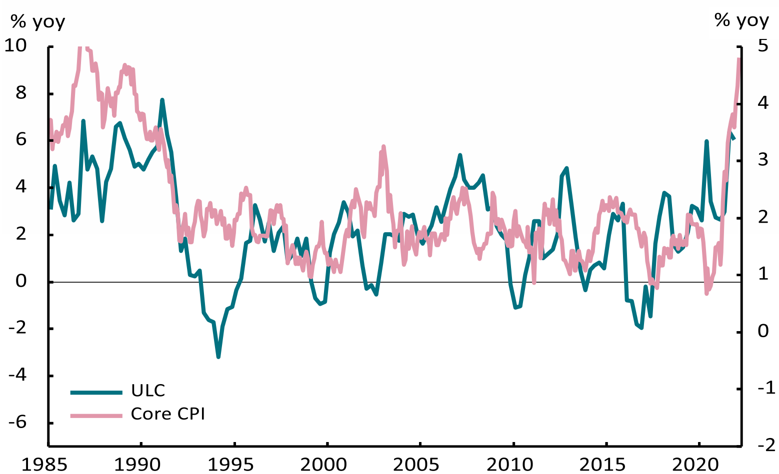
- Inflation reached a 31-year high of 6.7% in March. The proximate cause was the further rise in energy prices – the CPI common core rate was unchanged at 2.7%. More generally, elevated inflation is a mix of high energy (and other commodity) prices, supply constraints and tight domestic conditions. March's inflation should be close to a peak and we forecast inflation averaging 5.9% in 2022 and 3.2% in 2023 (consensus 4.9% and 2.5%). Upside energy and supply disruption risks persist.

Labour market tight

- Employment has picked-up swiftly – recovering its pre-COVID level in November 2021. Unemployment has fallen to 5.3% - a new record low. Low unemployment has been helped by a less-than-full recovery in participation. However, it is persistent weakness in productivity that has driven the labour market so tight. We expect employment growth to slow. Unemployment is likely to drop below 5% by year-end, but should stabilise thereafter. Wage growth looks set to peak in H2 2022, but remain elevated in 2023.

Elevated inflation reflects tight internal and external conditions

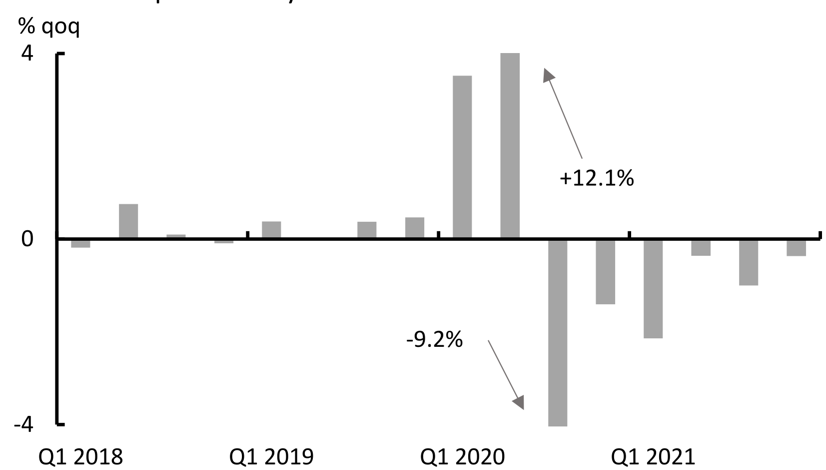
Unit Labour Costs and Core CPI



Source: CANISM, AXA IM Research, April 2022

Weak productivity growth tightens labour market

Total labour productivity



Source: CANISM, AXA IM Research, April 2022

BoC tightening at fast clip

Canada

Growth set to slow

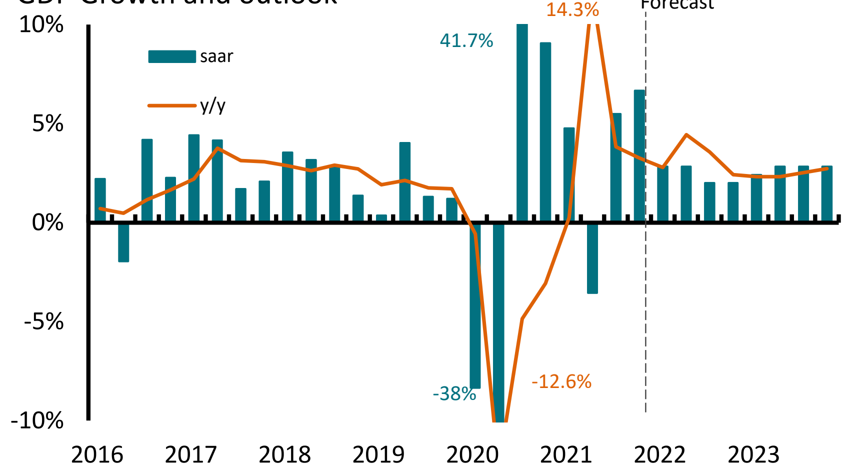
- A combination of slower employment growth and elevated inflation will slow real income growth materially and soften household spending, cushioned somewhat by recent savings. Investment growth should also soften as labour and energy costs are elevated. External demand will be dampened by the Ukraine war, despite a relative boost for Canadian exports, and by slower US activity. We forecast growth slowing to 3.3% this year and 2.5% next (below consensus 3.9% and 2.8% and BoC forecasts 4.2% and 3.2%)

Inflation sees BoC move quicker, weaker growth sees it move less

- The BoC followed its initial 0.25% hike in March with a 0.50% rise to 1.00% in April. It also announced it would allow the full maturity of its GoC holdings from 25 April, something that should see 40% of its bonds mature within two years – a "marked run-off" according to BoC Governor Macklem. Markets now see BoC rates closing the year at 2.75% and rising to 3.00% in 2023. We expect evidence of a faster slowdown to see the BoC raise rates to 2.5%, but risks are to the upside.

Slower growth outlook ahead

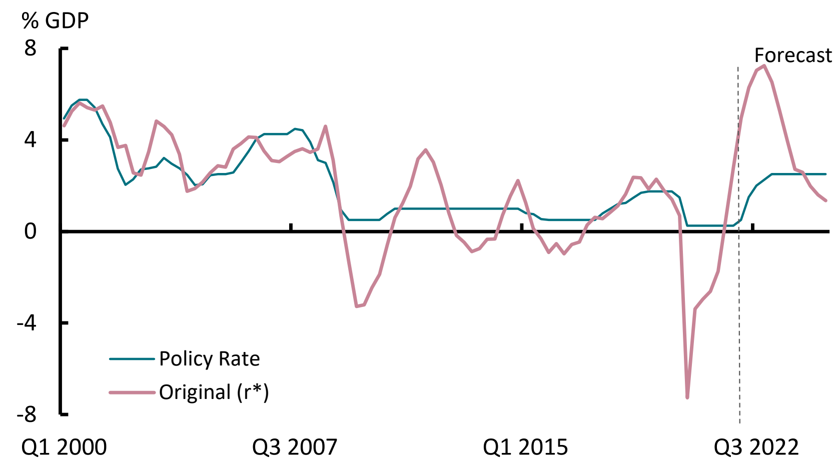
GDP Growth and outlook



Source: CANISM, AXA IM Research, April 2022

BoC front-loading policy tightening

Taylor Rule - original, r*



Source: CANISM, AXA IM Research, April 2022

Asian inflation rising even higher

Emerging Markets

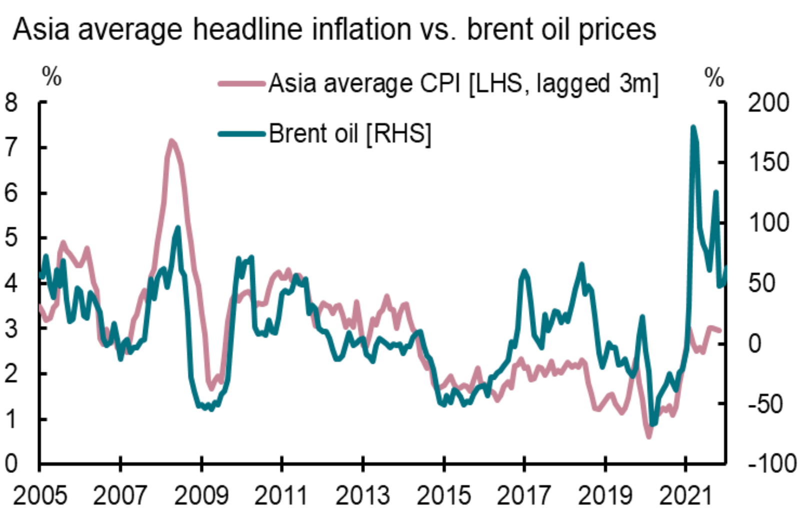
Russia-Ukraine conflicts add uncertainty to growth outlook

- As the Omicron wave gradually subsides in the region, Asia is seeing further easing of local restrictions and entry requirements for travelers. Tourism inflow is expected to recover in 2022, though will still be well below the pre-pandemic levels with mainland China border still shut. As domestic activity and mobility begin to pickup, the service sectors will likely outperform goods-producing sectors. However, looking ahead, geopolitical tension is increasingly posing risks and creating headwinds to the region's growth outlook.

Headline inflation exceeds central banks comfort zones

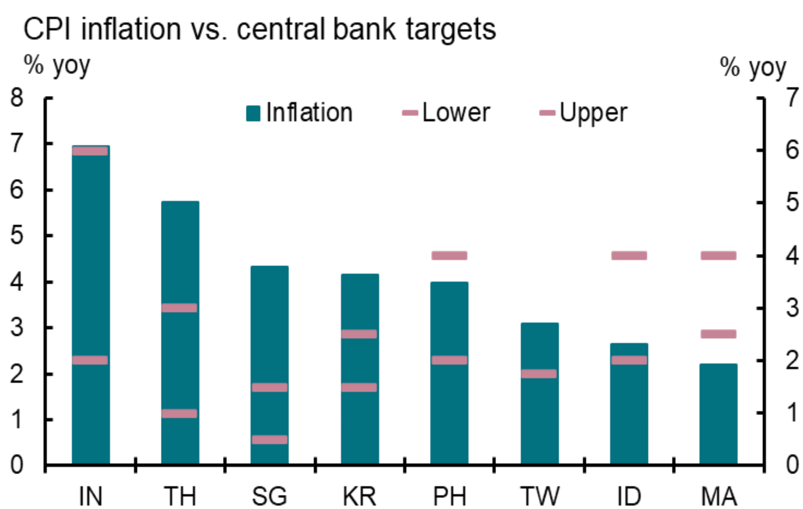
- Rising geopolitical tension between Ukraine and Russia is delivering a series of shocks to commodity prices. The Brent oil price has risen to its highest in eight years, impacting large energy importers in Asia. Meanwhile, food prices have also jumped on the back of interruptions to grain exports from Russia and Ukraine, as well as higher energy costs pushing up fertilizer prices. For Asia, continued gains in commodity prices have added to inflationary pressures which were already building before the Russia-Ukraine conflict.

Inflation rising on soaring commodity prices



Source: CEIC, AXA IM Research, April 2022

Inflation rates surpass comfort zones for many Asian countries



Source: CEIC, AXA IM Research, April 2022

AXA Investment Managers

Asian central banks are collectively beginning to shift hawkishly

Emerging Markets

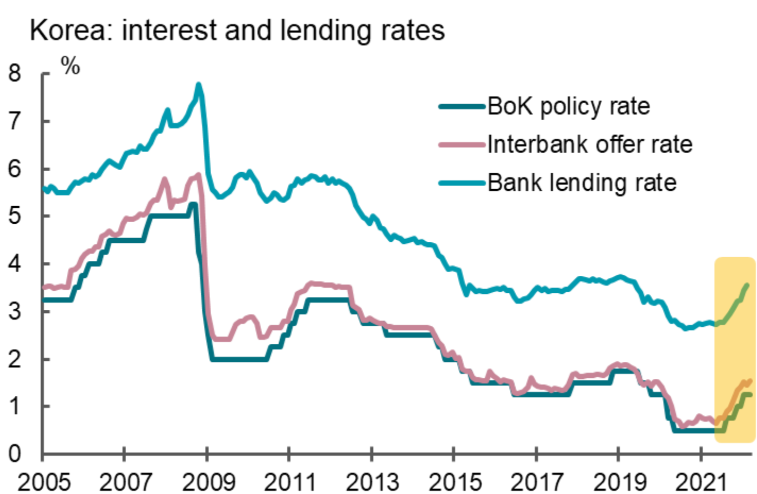
BOK and MAS act more aggressively than market expectation

- Soaring commodity prices have prompted many Asian central banks to recalibrate their monetary policy stances. Both the Bank of Korea (BOK) and Monetary Authority of Singapore (MAS) moved more aggressively than consensus expectations. The BOK raised its policy rate by 25bp to 1.5% - its fourth hike since the COVID-19 outbreak. Meanwhile, MAS announced its first duel tightening since April 2010, the bank's third tightening since October. Both the mid-point and slope of the S$NEER were raised, allowing for faster pace of Sing dollar appreciation.

Other Asian central banks move closer to lift-off

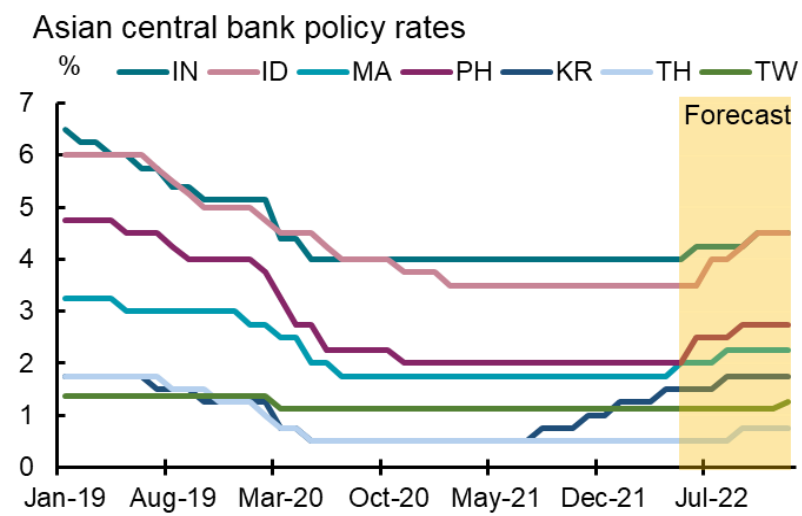
- The highlights in recent central bank meetings were the forecast revisions, reflecting recent developments including a surge in global commodity prices. Many have already upgraded their inflation projections significantly, and at the same time downgraded the 2022 growth forecasts. Overall, while some central banks may not be in a rush to hike, we are increasingly seeing signs suggesting they are moving closer to lift-off.

Bank of Korea hikes for the fourth time since COVID-19 outbreak



Source: CEIC, AXA IM Research, April 2022

Asian central banks to gradually conduct policy normalization



Source: CEIC, AXA IM Research, April 2022

AXA Investment Managers

Investment Strategy

Multi-Asset Investment views

Our key messages and convictions

Moderately constructive on equites

#1

Corporate earnings still expanding; economic activity to decelerate but remain above potential; Valuations improved

#2

Valuations have improved following recent spread widening albeit not attractive enough to warrant being overweight

Neutral on Investment Grade Credit

Positive short-term Sovereign Bonds

#3

Central banks hiking cycle priced in, limiting bond yield upside. Seeking to increase carry

#4

High Yield is now cheap versus default expectations. Pricing at levels consistent with positive returns over short to medium term

Positive Short Duration High Yield

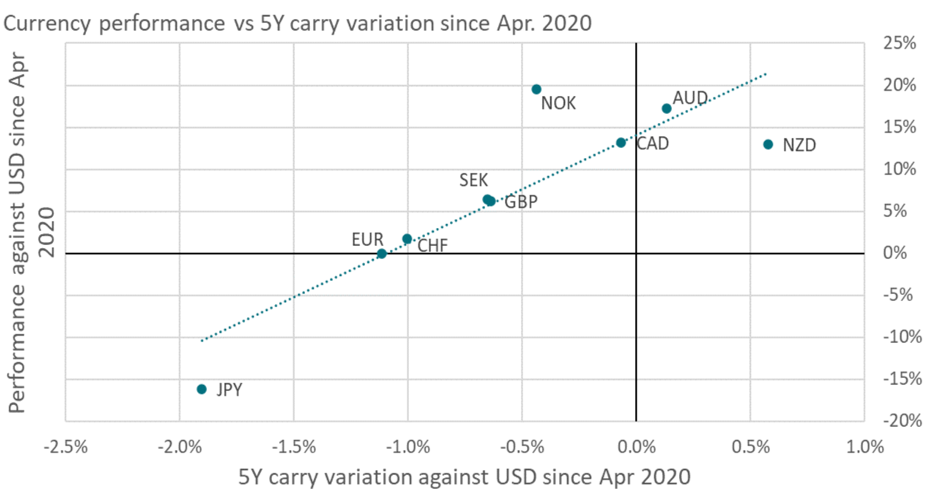
Source: AXA IM as at 25/04/2022

FX Strategy

The monetary policy divergence steamroller – damage to the JPY

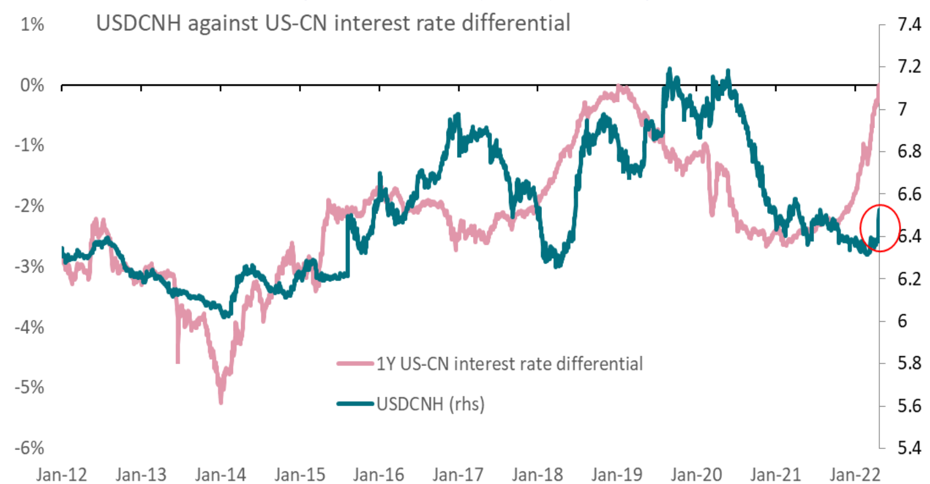
- The sharp inflation repricing caused by the war in Ukraine continues and with it an even sharper repricing of monetary policy normalisation globally. The Fed is leading, as the higher energy prices are adding to already very tight labour market conditions. But expectations for most other central banks have followed and relative monetary policy normalisation continues as the main driver of currencies.
- This is behind the fall in the JPY as markets are pricing no change in BoJ policy, as comments by the BoJ suggest. Japan is an outlier in G10 inflation (remains soft) and higher energy prices are challenging imports. Further rises in global inflation could weaken JPY afresh, and equally, JPY should rebound if global inflation starts to soften, especially if domestic inflation rises and the BoJ has to adjust its policy.
- PBOC also seems to be diverging from the Fed: as it needs to stay accommodative due to the real estate deleveraging, renewed lockdowns, and lower global growth. Yet while carry is anticipated to be lower, CNH has barely reacted yet. But this may be about to change.

Expectations of policy normalisation a key driver in currencies



Source: Bloomberg and AXA IM Research, April 2022

USDCNH also starting to react to policy divergence



Source: Bloomberg and AXA IM Research, April 2022

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Rates Strategy

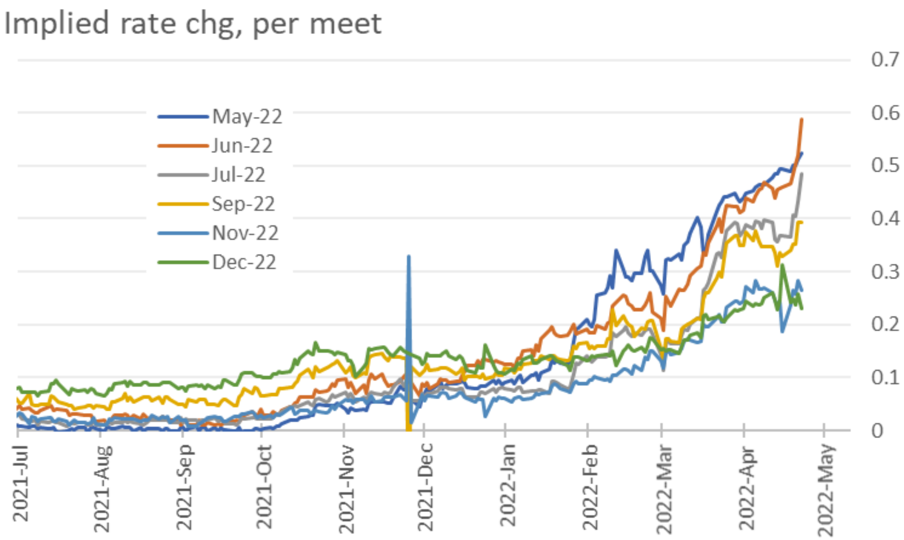
Shock and awe in returns drawdowns but we may be nearing a peak in yields

- The inexorable rise in global yields in Q1 of 2022 has continued in April, making the already dire fixed income returns in Q1 even worse. Double-digit drawdowns year-to-date in long duration markets like USD IG, Gilts and GBP IG have become a stark reality for investors. By contrast, shorter duration markets have held up better, also well into negative territory, but having suffered smaller drawdowns than equity markets.

- With 6 meetings remaining for the US Fed this year, current market pricing implies a 50bp rate hike in each of the next 3 meetings, a 25bp hike in each of the last 2 meetings 25bp, and an 80:20 probability blend of a 50:25bp hike in the September meeting (Exhibit 2). ECB expectations have shifted as well, with the market now pricing the equivalent of 8 hikes of 10bp over the 5 meetings in 2022, starting as early as July.

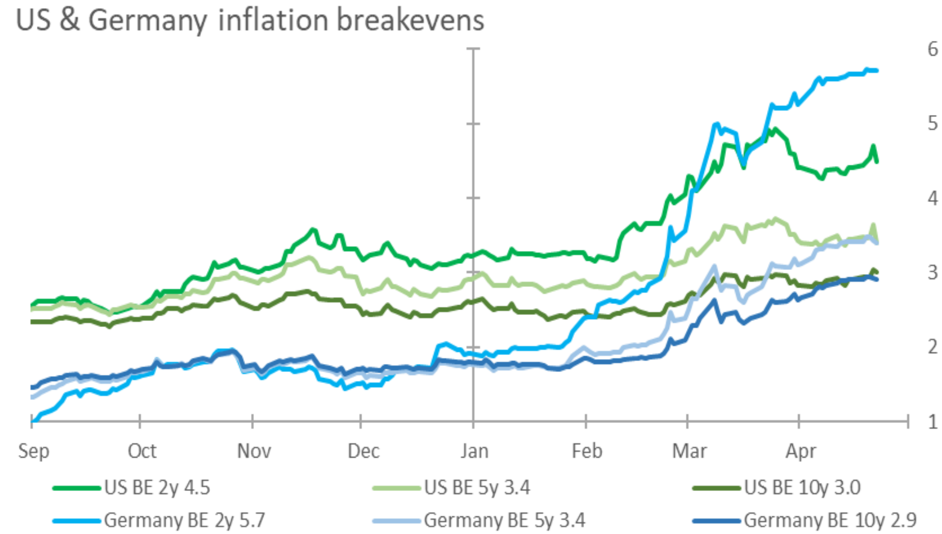
- The hawkish repricing of the Fed has driven US real yields higher, with the 10y tenor now threating to break above zero. Rising real rates are a risk to equities, which have traded down in the past 3 sessions. Together with spread widening, a warning sign of deteriorating financial conditions which could compel the Fed to dial back its hawkishness.

US Fed rate hike calls accelerated in April



Source: Bloomberg and AXA IM Research, April 2022

German inflation pricing exceeds US after Russia invasion



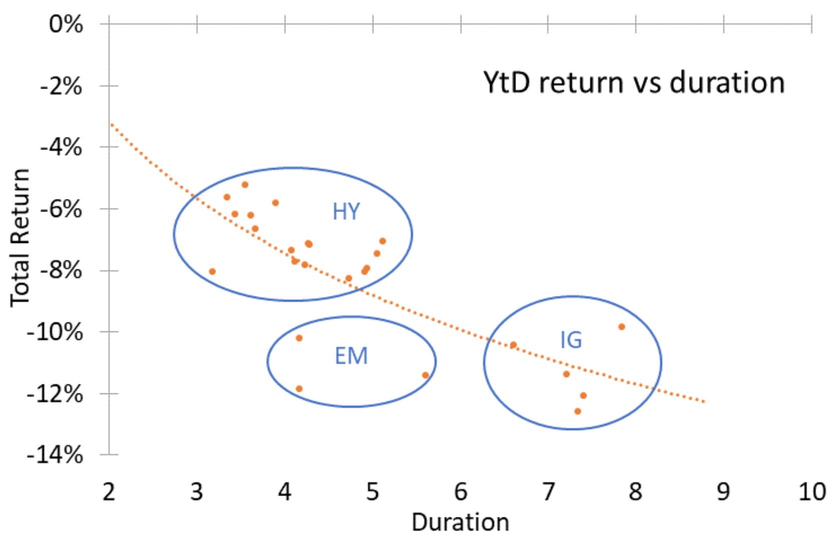
Source: Bloomberg and AXA IM Research, April 2022

Credit Strategy

Negative losses across the board with duration worse off

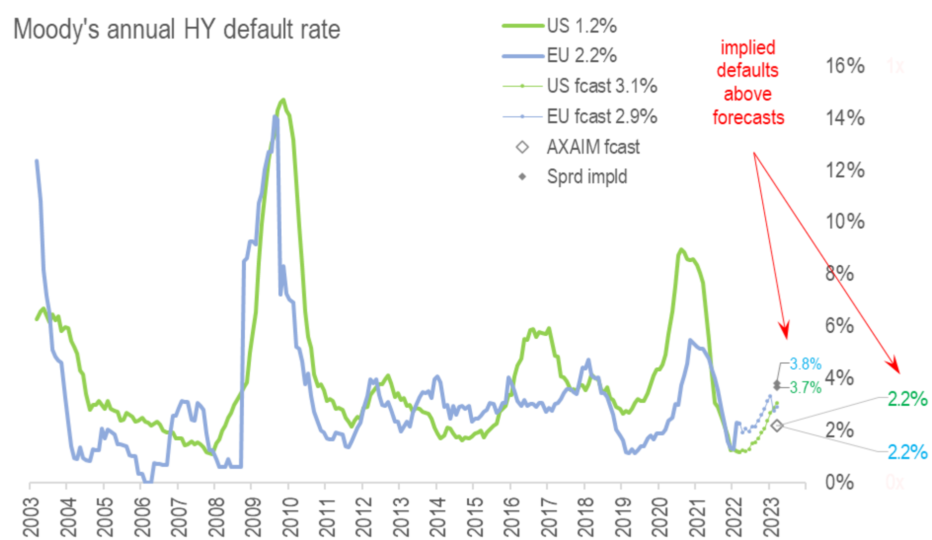
- At best, credit investors have suffered negative losses of 5% year to date . The drawdowns across credit indices have ranged from -5.2% (EUR single-B) to -12.6% (USD BBB), with duration the key driver (3.5yrs for EUR single-B vs 7.3 for USD BBB), aside from EM indices that have been affected by the China property bust, Covid slowdown and the war in Ukraine.
- Duration is set to continue to bedevil returns until we reach a peak in hawkish expectations vis a vis central banks' monetary policy. We therefore continue to prefer High Yield spread risk over Investment Grade, the latter being more exposed to duration risk.
- Default backdrop remains supportive of HY, although rising macro risks merit prudence. Default expectations have ticked up but remain below historic averages and below what is implied by spreads. Some deterioration ahead is likely, but not to the point of wiping out HY excess spreads.
- One consequence from the war in Ukraine has been the notable underperformance in euro risk premia against G7 peers. Our PCA analysis flags BTPs (Italy debt) and Xover (HY credit) as cheap.

Losses of 5-13% year to date with duration a dominant factor



Source: ICE, and AXA IM Research, Apr 2022

Default expectations have risen modestly but we may have more to go



Source: ICE, and AXA IM Research, Apr 2022

Investment Managers

Equity Strategy

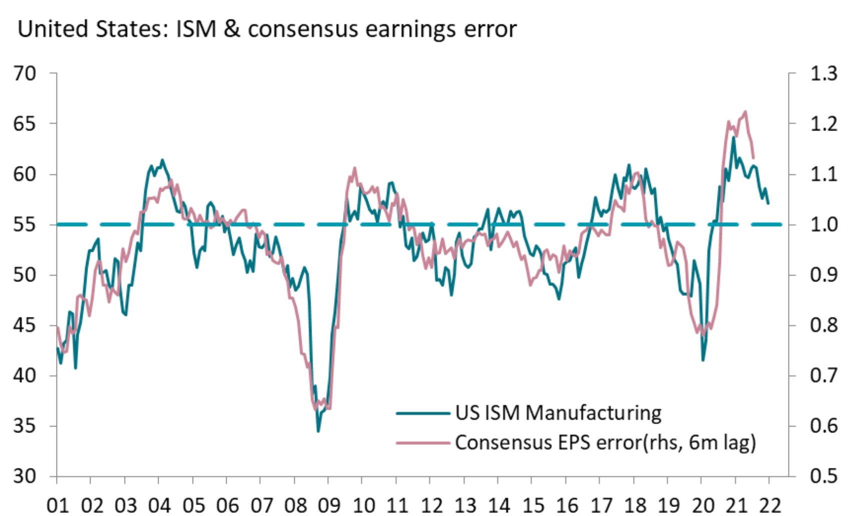
Hardly better

- The current landscape remains a demanding one for equities - the duo of downward growth and rising inflation is harmful. World equities have declined slightly (-0.8%) over one month. Thanks to high commodity prices, the energy sector (+4.8%) outpaced the other sectors (again). Lastly, in this difficult macro backdrop, the defensive factor (+4.2%) keeps delivering.

- The earnings season has kicked off and at the time of writing sales (+1.1%) and earnings (+7.2%) surprises are positive for the 19% of the S&P500 companies that have reported. Positive surprises this quarter across the board are consistent with the relationship between US ISM Manufacturing and earnings surprises. Although the trend clearly points towards downside risks for the rest of the year.

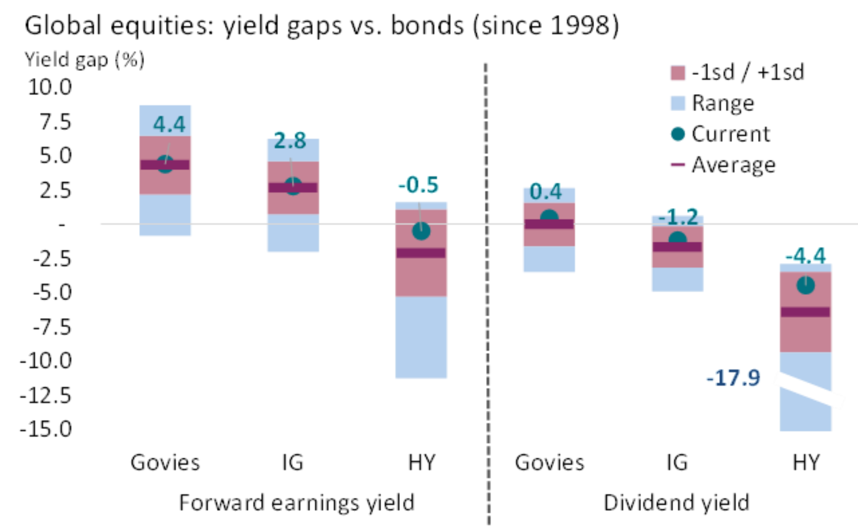
- The extraordinary rise in US 10-year real yields (+40bps over the past month), reaching zero for the first time post-Covid, could prove to be a catalyst for outflows into fixed-income as relative valuations reach near par. Despite that risk, our equity allocation remains mildly constructive; we still favour utilities renewables and digital-payment themes.

US ISM implies positive earnings surprises, but trend points down



Source: ISM, IBES and AXA IM Research, April 2022

Equity relative value advantage starting to erode as real rates rise



Source: MSCI, ICE and AXA IM Research, April 2022

Asset allocation stance

Positioning across and within asset classes

Asset Allocation

Key asset classes	Negative	Neutral	Positive
Equities			■
Bonds			■
Commodities		■	
Cash	■		

Equities

	Negative	Neutral	Positive
Developed			
Euro area	■		
UK		■	
Switzerland		■	
US			■
Japan		■	
Emerging & Equity Sectors			
Emerging Markets		■	
Europe Cyclical/Value		■	
Euro Financials		■	
European Autos		■	
US Financials		■	
US Russell 2000		■	

Fixed Income

	Negative	Neutral	Positive
Govies			
Euro core		■	
Euro peripheral		■	
UK		■	
US			■ ▲
Inflation Break-even			
US		■	
Euro		■	
Credit			
Euro IG		■	
US IG		■	
Euro HY			■
US HY		■	
EM Debt			
EM Bonds HC		■	

Legend Negative | Neutral | Positive   **Change** ▲ Upgrade | ▼ Downgrade

Source: AXA IM as at 25/04/2022

Forecasts & Calendar

Macro forecast summary

Forecasts

Real GDP growth (%)	2020	2021*		2022*		2023*	
		AXA IM	*Consensus*	AXA IM	*Consensus*	AXA IM	*Consensus*
World	**-3.1**	**5.4**		**3.0**		**2.9**	
Advanced economies	**-5.0**	**3.4**		**1.9**		**1.2**	
US	**-3.4**	**5.5**	5.6	**2.8**	3.3	**1.6**	2.4
EMU-4	**-7.4**	**5.0**		**2.2**		**1.2**	
Germany	**-4.9**	**2.8**	2.7	**1.2**	2.4	**1.7**	2.6
France	**-8.0**	**7.0**	6.6	**2.7**	3.3	**1.0**	17
Italy	**-9.0**	**6.5**	6.3	**2.3**	3.4	**0.6**	2.0
Spain	**-10.8**	**5.0**	4.7	**3.5**	5.1	**1.6**	3.4
Japan	**-4.9**	**1.7**	18	**1.8**	2.3	**2.1**	18
UK	**-10.0**	**7.2**	7.0	**3.8**	3.9	**0.6**	16
Switzerland	**-2.5**	**3.5**	3.5	**2.0**	2.7	**1.3**	17
Canada	**-5.2**	**4.4**	4.6	**3.3**	3.8	**2.5**	2.9
Emerging economies	**-1.9**	**6.6**		**3.6**		**4.0**	
Asia	**-0.7**	**6.8**		**4.8**		**5.1**	
China	**2.2**	**7.9**	8.0	**4.5**	5.0	**5.2**	5.2
South Korea	**-0.9**	**4.0**	4.0	**2.0**	3.0	**2.0**	2.6
Rest of EM Asia	**-4.2**	**5.9**		**5.5**		**5.2**	
LatAm	**-7.0**	**6.9**		**2.6**		**2.6**	
Brazil	**-3.9**	**4.8**	4.7	**0.9**	0.5	**1.9**	16
Mexico	**-8.5**	**4.8**	5.6	**2.4**	19	**2.2**	2.3
EM Europe	**-2.0**	**6.7**		**-0.2**		**1.0**	
Russia	**-2.7**	**4.7**		**-7.0**		**-3.0**	
Poland	**-2.5**	**5.8**	5.3	**4.2**	4.0	**3.3**	3.5
Turkey	**1.8**	**11.5**	9.9	**3.9**	2.3	**3.4**	2.9
Other EMs	**-2.5**	**5.4**		**3.0**		**3.0**	

Source: Datastream, IMF and AXA IM Macro Research – As of 25 April 2022   * Forecast

Expectations on inflation and central banks

Forecasts

Inflation Forecasts

CPI Inflation (%)	2020	2021*		2022*		2023*	
		AXA IM	*Consensus*	AXA IM	*Consensus*	AXA IM	*Consensus*
Advanced economies	**0.7**	**3.2**		**5.9**		**2.8**	
US	**1.2**	**4.7**	4.6	**7.0**	6.6	**3.8**	3.0
Eurozone	**0.3**	**2.6**	2.5	**6.1**	5.7	**2.1**	2.1
Japan	**0.0**	**-0.2**	-0.2	**2.2**	1.4	**1.0**	0.9
UK	**0.9**	**2.6**	2.5	**7.3**	6.7	**3.5**	3.6
Switzerland	**-0.7**	**0.5**	0.5	**2.0**	1.8	**1.0**	0.7
Canada	**0.7**	**3.4**	3.4	**5.9**	5.1	**3.2**	2.6

Source: Datastream, IMF and AXA IM Macro Research – As of 25 April 2022

* Forecast

Central banks' policy: meeting dates and expected changes

Central bank policy

Meeting dates and expected changes (Rates in bp / QE in bn)

		Current	Q1-22	Q2-22	Q3-22	Q4-22
United States - Fed	Dates	0-0.25	25-26 Jan 15-16 Mar	3-4 May 14-15 June	26-27 July 20-21 Sep	1-2 Nov 13-14 Dec
	Rates		+0.25 (0.25-0.5)	+0.50 (1.25-1.50)	+0.25 (1.75-2.00)	+0.25 (2.25-2.50)
Euro area - ECB	Dates	-0.50	03 Feb 10 Mar	14 April 9 June	21 July 8 Sep	27 Oct 15 Dec
	Rates		unch (-0.50)	unch (-0.50)	unch (-0.50)	+0.25 (-0.25)
Japan - BoJ	Dates	-0.10	17-18 Jan 17-18 Mar	27-28 April 16-17 June	20-21 July 21-22 Sep	27-28 Oct 19-20 Dec
	Rates		unch (-0.10)	unch (-0.10)	unch (-0.10)	unch (-0.10)
UK - BoE	Dates	0.75	3 Feb 17 Mar	5 May 16 June	4 Aug 15 Sep	3 Nov 15 Dec
	Rates		+0.5(0.75)	+0.5 (1.25)	unch (1.25)	unch (1.25)

Source: AXA IM Macro Research - As of 25 April 2022

Calendar of 2022 events

2022	Date	Event	Comments
	Q3-Q4 2022	Chilean Constitutional Referendum	
May	May	Philippines Elections	
	4 May	US FOMC announcement	Announcement of QT expected
	5 May	Monetary Policy Report & MPC Summary and minutes	
	5 May	UK Elections in Scotland, Wales, and Northern Ireland and UK Local Elections in England	
	29 May	Colombian Presidential Elections (first round)	
June	12 & 19 June	French Legislative Elections	
	15 June	FOMC meeting	
	16 June	MPC Summary and minutes	
	19 June	Colombian Presidential Elections (second round)	
July	1 July	UK border checks on EU imports scheduled to resume	
	25 July	Japan Upper House election	
	27 July	FOMC meeting	
August	August	US Federal Reserve Jackson Hole Symposium	
	4 August	Monetary Policy Report & MPC Summary and minutes	
September	15 September	MPC Summary and minutes	
	21 September	FOMC meeting	
October	October	China's 20th National Congress- President Xi to be re-elected (expected)	
	2 October	Brazil General Elections	
	30 October	Brazil Presidential Elections (second round)	
November	2 November	FOMC meeting	
	3 November	Monetary Policy Report & MPC Summary and minutes	
	8 November	US Midterm Elections	
December	14 December	FOMC meeting	
	15 December	MPC Summary and minutes	

AXA Investment Managers

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13 April 2022

[The real story behind the value/growth rotation]

7 April 2022

[French elections: Wait until summer]

5 April 2022

[March Global Macro Monthly – After the first month]

30 March 2022

[China's property sector: This time is different]

9 March 2022

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25 February 2022

[February Global Macro Monthly - Frozen Conflict]

23 February 2022

[Omicron update: Boon or Bust?]

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19 January 2022

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