ODDO BHF
ASSET MANAGEMENT

ODDO BHF POLARIS INVESTMENT STRATEGY AND ASSET ALLOCATION, *Perspectives 2023*

INVESTMENT EXPERTISE – DECEMBER 2022

AFTER A HISTORIC YEAR IN 2022, HOW ARE THE FINANCIAL MARKETS DOING?

The year 2022 is likely to go down in the history books in many respects. Russia's invasion of Ukraine on February 24 has far-reaching consequences not only at the geopolitical level. Rather, the global economy is still suffering the consequences of the resulting supply shock. The sharp rise in energy prices and the supply chains that have been affected have driven up inflation rates massively worldwide. As a result, central banks have had to raise interest rates quickly and massively to adjust demand to the reduced supply. Losses in consumer purchasing power, declines in production and investment as a result of higher inflation and interest rates, and the ongoing problems in China (zero-covid strategy, real estate crisis) have led to a slowdown in growth worldwide.

These developments have also led to significant distortions on the capital markets. The diversification benefit of spreading a portfolio across bonds, equities and other asset classes poorly worked this year, as bonds and equities were highly correlated and fell sharply at the same time. In addition, there was strong differentiation between equity sectors. Energy stocks rose significantly. Interest rate sensitive and highly valued stocks from the technology sector, among others, on the other hand, were noticeably under pressure.

WHAT DO WE EXPECT THE FINANCIAL MARKETS TO DO IN 2023?

We expect further interest rate hikes in the USA and Europe due to high inflation rates. In the U.S.A., monetary policy has already been restrictive with this year's interest rate hikes. In the euro zone, on the other hand, monetary policy remains quite expansionary, as key rates have not yet been raised significantly above the nominal „neutral interest rate" (key rate which is neither expansionary nor restrictive). The magnitude of key interest rates rise depends primarily on a) inflation and b) economic developments. Inflation will probably peak in both regions in 2023. In Europe, it will probably decline more slowly than in the USA due to the energy price component and significantly higher producer prices. A supply shock typically does not subside until core inflation (excluding food and energy) exceeds the broad inflation index.

With interest rates likely to be raised further, we continue to closely monitor duration on the bond side. The good news is that we start to see higher yields in the fixed income space. Currently, with 4% Yield on Investment Grade bonds, we consider to be well paid for the credit risk.

Equities in Europe are currently trading close to their long-term average levels again, looking at price/book ratios and other valuation metrics. U.S. equities, on the other hand, continue to trade above their average, historical valuation levels despite the price declines. The higher valuation of U.S. equities, the strong U.S. dollar and falling profit margins in the U.S. currently argue more in favor of eurozone equities than U.S. equities. We currently consider a further strong increase in the equity ratio to be premature. In the past, it has paid off to increase the equity allocation significantly only a few months before the end of a recession. We currently expect a recession with a probability of 85% in the euro zone and 60% in the USA. We continue to expect the recession in the eurozone and Germany to be mild next year.

IN THIS CONTEXT, WHAT IS THE POSITIONING OF OUR PORTFOLIOS FOR 2023?

Our investment approach remains long-term. The companies we select must continue to meet our high-quality standards. We are convinced that with our consistently pursued quality approach we will continue to succeed in generating added value for our customers in the medium and long term. We continue to focus on stocks with high capital efficiency, low leverage, strong margin, clear competitive advantages and established structural growth. As a consequence, we believe that the ODDO BHF Polaris funds are well-positioned to face the current environment characterized by high inflation and slower growth/recession.