INVESTMENT COMMENT February 2022

- **Rates will rise**

  The U.S. just reported the highest consumer inflation in 40 years. Earnings reports that largely beat forecasts revealed strong economic growth despite supply chain bottlenecks and Covid-induced restrictions on consumption. It looks increasingly likely that the Fed will raise rates by 50 basis points in March and by another 50 basis points by the summer. We recommend short duration debt to avoid the upcoming volatility.

- **Avoid the High Yield Trap**

  Higher interest rates will make it increasingly difficult for lower quality issuers to meet their debt servicing obligations. We would prioritize quality over yield and expect downgrades across the curve and more defaults.

- **A Correction – Not a Bear Market**

  U.S. households have reduced their indebtedness significantly. Household debt service as a percentage of disposable income has fallen from 13% in 2007 (financial crisis) to 9%. This frees up significant sums for consumption.

  Stronger demand for goods and services are driven by increased buying power (fueled by generous government hand-outs and a rapidly improving employment situation) and pent-up demand for goods and services that were put on-hold for two years due to Covid. This was met by supply chain constraints and has led to higher prices. We see the January correction as a healthy pullback from stretched valuations. Provided the Fed does not raise rates too fast and by too much, we expect the market to reverse course and resume an upward trend in the medium-term.

- **Commodity Boon?**

  More commodities contracts are in backwardation than at any point since 1997, an indication of scarcity. Heightened political tensions, continued lackluster investment in exploration and the supply-demand imbalance have pushed prices to levels where buyers are willing to pay huge premia for the immediate availability of goods. Investors can benefit from the commodities rise by investing in selected stocks, ETFs or dedicated commodities funds.

- **Asset Allocation**

  Equities are at an inflection point. Geopolitical tensions and rising interest rates are detracting value, while an improving economy and better corporate fundamentals would suggest to buy on the dip. Barring an exogenous shock, we expect markets to calm down once the magnitude and the time table of the rate hikes becomes clearer. We remain neutrally weighted in equities, albeit shifting some exposure from growth to value and taking advantage of an economic reopening that should benefit the leisure and travel sectors.

  We keep our underweight in fixed income and lower our gold exposure marginally to add to our position in commodities.

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