2022 OUTLOOK

Ostrum ASSET MANAGEMENT

Document for professional investor.
Completed 29/11/2021

Inflation should continue to influence the markets in 2022

After a challenging 2020 and the crisis exit in 2021, the experts at Ostrum Asset Management (Ostrum AM), a subsidiary of Natixis Investment Managers, are anticipating a return to the pre-crisis trend in 2022.

However, the markets are expected to remain under the influence of several risk factors and uncertainties. With inflation expected to increase, Ostrum AM presents its preferred investments in terms of sectors and asset classes.

MACROECONOMY - What are the key issues in 2022?

- The macroeconomic situation is expected to resume the pre-crisis trend from the second half of 2022 onwards.
- This trend will not be accompanied by persistent inflation over the economic cycle
- Central bank interventions will remain limited.

STRATEGY - Tighter monetary policies, persistent inflation continuing to impact the markets

- Central banks: a global change in tack, with a clear tendency towards monetary tightening
- Fundamentals remain strong
- Inflation: changing market sentiment; a risk for equities
- CO_2 emissions: what progress in 2022?

INVESTMENTS - Where to find value in 2022?

- **Sovereign** - exposure to inflationary risks, sustainable bonds and emerging markets.
- **Credit** – taking on credit risk (crossover, high yield) rather than increasing investment maturity.
- **Equities** –exposure to companies capable of generating constant growth and exposure to companies able to resist the inflationary trend.
- What are the potential risks for 2021?

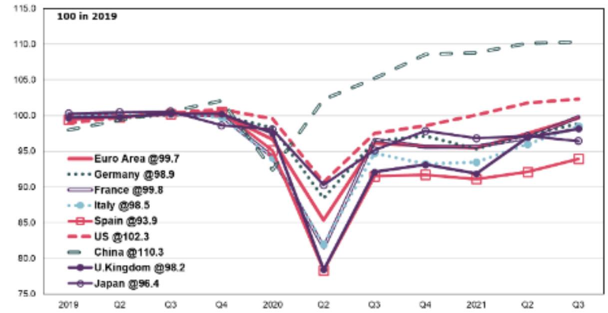
MACROECONOMY

WHAT ARE THE KEY ISSUES IN 2022?

According to Philippe Waechter, Head of Economic Research at Ostrum AM, **most developed economies have rapidly converged towards their pre-crisis levels**, chiefly due to macroeconomic intervention within government economic policies. In Europe, the authorities have acted preventively, with economic policies immediately mutualising the shock and fully assuming risks, in order to avoid any direct impact on households and companies. In the US, the shock occurred at the time of the lockdown and the authorities had to act in order to remedy the situation and mitigate the impact and repercussions by introducing measures to support demand.

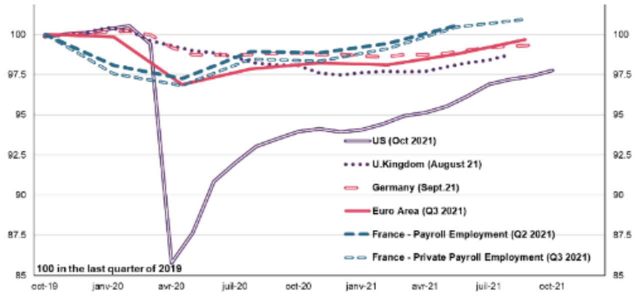
> “In all cases, the jobs market has improved rapidly with the recovery, vindicating economic policy strategies

GDP Profiles at the end of 3rd quarter 2021



Sources Datastream ; Ostrum AM ; ostrum.philippewaechter.com

Employement Level Momentum

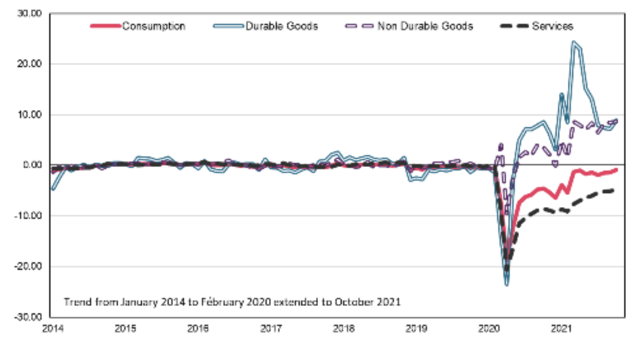


Sources Datastream ; Ostrum AM ; ostrum.philippewaechter.com

The turbulence observed since spring 2021 has been triggered by three factors: a sharp increase in Chinese imports until the summer, followed by the impact of the handouts implemented by President Trump and President Biden from December until March and lastly, as uncertainties abated with the vaccine rollout and health restrictions coming to an end.

The excessively high level of demand took companies by surprise, driven mainly by appetite for goods, whereas company inventories were depleted. This imbalance led to shortages, bottlenecks in ports and higher freight prices, therefore driving inflation higher. Once this excess has been cleared, the situation should return to a more stable trend.

US : Household's Consumption
Deviation from the trend (in%) for each component



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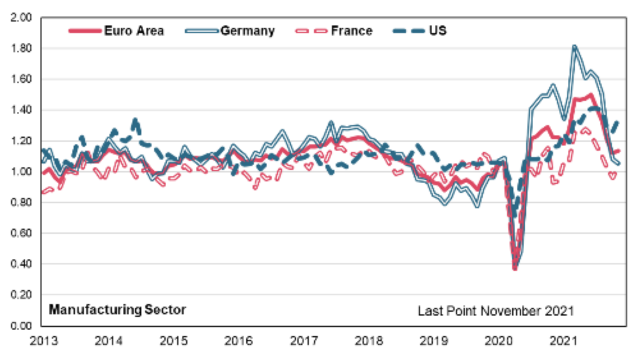
Markit Surveys - New Orders to inventories Ratio



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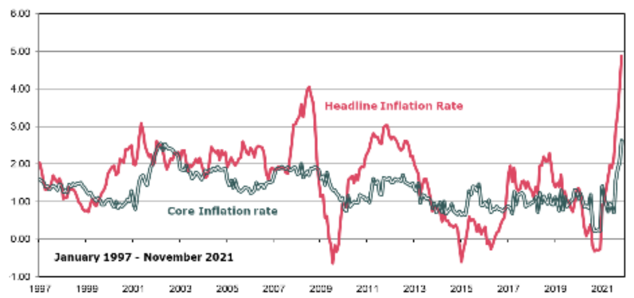
Inflation has reached levels rarely seen in the past 25 - 30 years, driven by surplus demand. Reactions have differed between the US and the eurozone.

Core inflation is not rising as rapidly in Europe as in the US, due to the **Biden stimulus effect.** Despite this factor, goods and services prices indices have not been significantly impacted in the eurozone, while there has also been limited impact on services prices in the US and **only goods prices have been volatile**.

Euro Area - Inflation Rate



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US Inflation Rate CPI Measure

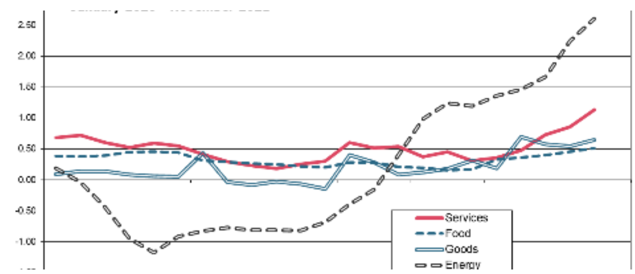
Sources Datastream ; Ostrum AM ; ostrum.philippewaechter.com

The main factor driving the surge in inflation is the impact from energy prices. The contribution from goods and services prices differs on either side of the Atlantic.

> Meanwhile, central banks have limited scope for intervention on the energy market.

Their best policy is to do nothing. The European Central Bank has no reason to intervene as tensions within the intra-eurozone market are limited. In the US, the cash distribution policy (stepped-up form April) has affected the price of goods and services.

Euro Area - Contributions to the Inflation Rate



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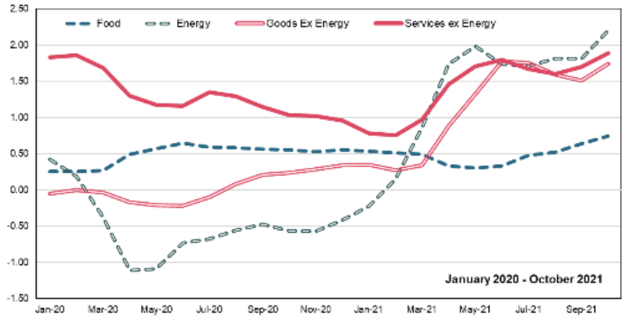
Contributions to the US Inflation Rate



Sources Datastream ; Ostrum AM ; ostrum.philippewaechter.com

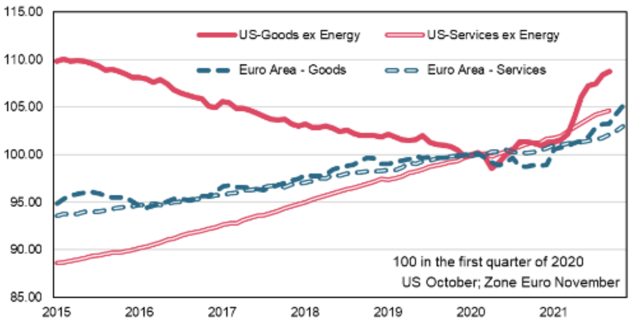
A comparison of goods and services prices indices highlights that there has been no major impact in the eurozone.

In the US, there has also been only a limited impact on services prices, with price volatility occurring only among goods.

Rental prices have been the only persistent inflation factor in the US, which have moved in-line with real estate prices.

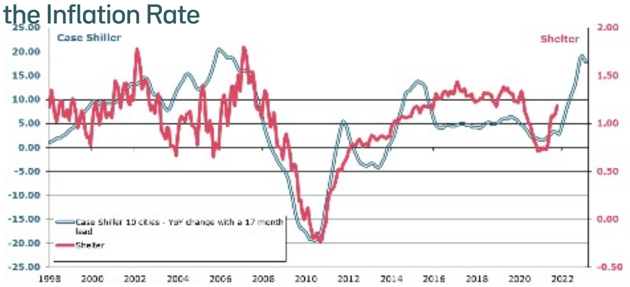
Rents are expected to continue to rise and therefore contribute significantly to the rate of inflation.

Price Indices



Sources Datastream ; Ostrum AM ; ostrum.philippewaechter.com

US - Real Estate Price and the Shelter contribution to the Inflation Rate

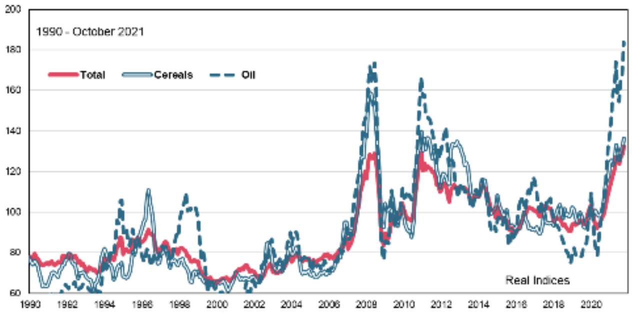


Sources Datastream ; Ostrum AM ; ostrum.philippewaechter.com

To conclude on the topic of inflation, agricultural commodities prices have increased to worrying levels and this factor is jeopardising emerging markets.

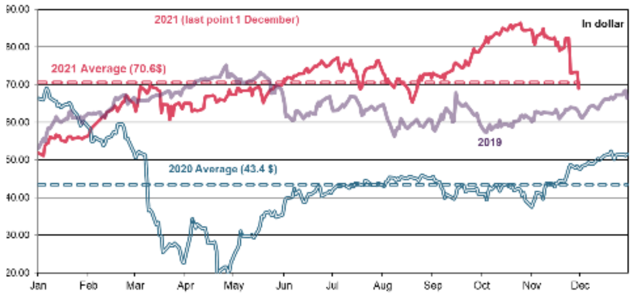
The economic recovery could also drive oil and industrial metal prices higher.

Food Price Indices (FAO)



Sources Datastream ; Ostrum AM ; ostrum.philippewaechter.com

Oil Price Indices (Brent) in 2019, 2020 et 2021

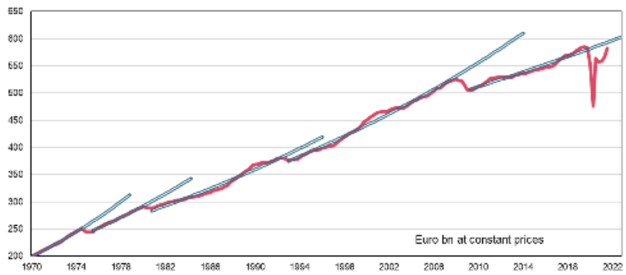


Sources Datastream ; Ostrum AM ; ostrum.philippewaechter.com

Regarding the crisis exit, Philippe Waechter concludes by reminding us of past observations:

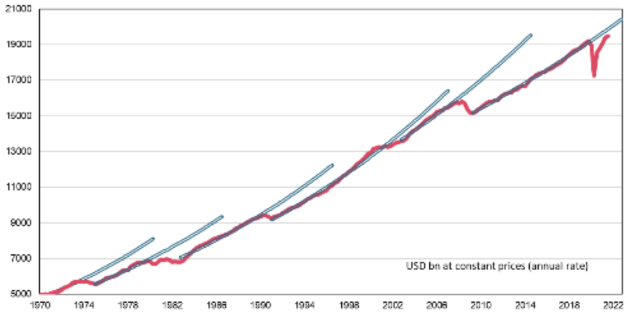
> After every recession, the growth rate in the new cycle is slightly lower than during the previous cycle.
> We should therefore not expect a sharp sustainable increase in growth.

French real GDP, Business cycle trends and their extrapolation



Sources Datastream ; Ostrum AM ; ostrum.philippewaechter.com

US real GDP, Business cycle trends and their extrapolation



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CATCH-UP EFFECTS WILL ONLY BE TEMPORARY:

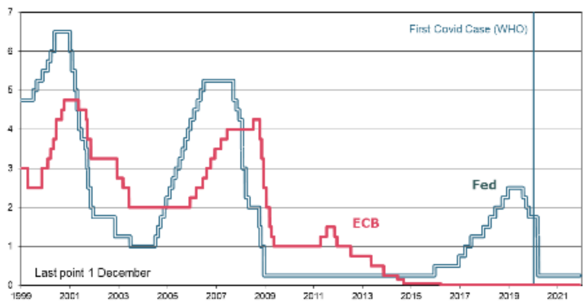
- if the pace of growth in economic activity is at best in-line with the profile of the preceding cycle.
- if the pace of inflation is driven by energy prices and goods prices, boosted by economic policies.
- In the past, we noticed that the persistence of inflation over the cycle was linked to the indexation mechanism of wages to consumer prices. Current increase in wages will not continue over time if there is no indexation clause. That's why the inflation rate should slow down in the second part à 2022

Consequently, central banks are not required to act sharply. If they decide to act, it is difficult to know what the size of the move will be.

We must keep in mind that, after December 2015, the increase in Fed funds was reduced.

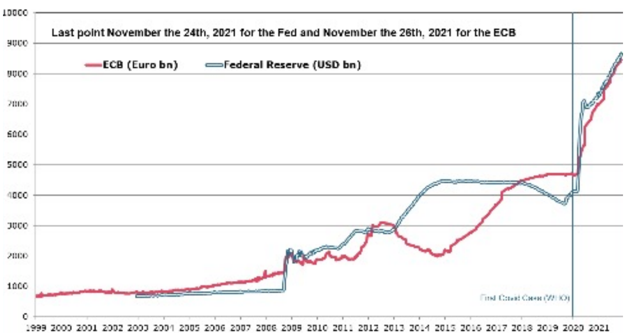
Is it able to go further? This is doubtful ●

US Federal Reserve and ECB main rates



Sources Datastream ; Ostrum AM ; ostrum.philippewaechter.com

Size of Central Bank's Balance Sheet : ECB and Fed



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2022 MACROECONOMIC OUTLOOK

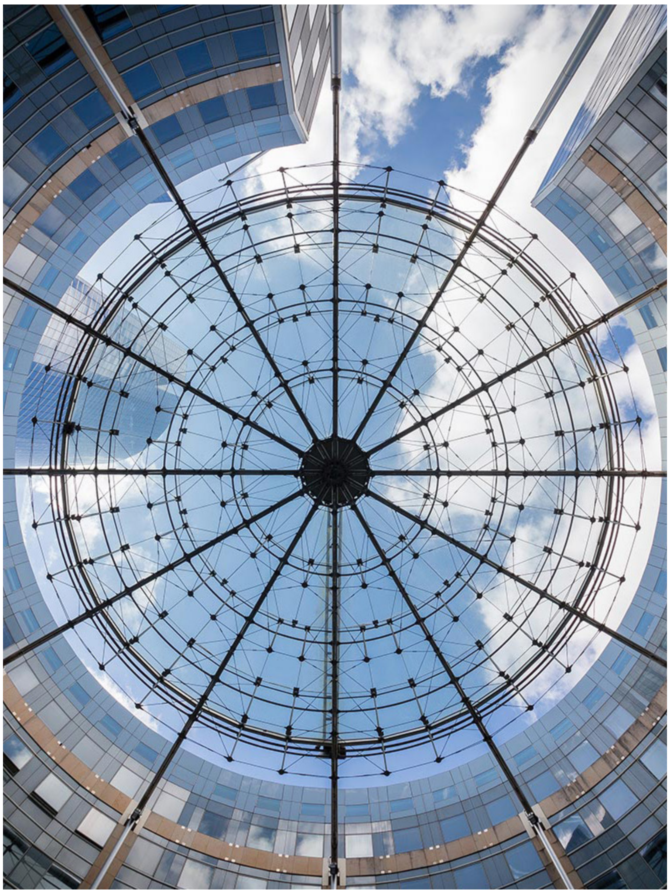
Ostrum AM's macroeconomic forecasts rely on the hypothesis of a situation back to the pre-crisis trend in the second part à 2022. There should be no persistent inflation on the long run and central banks should maintain moderate policies ●

	GDP annual growth rate				
	Average 2015-2019	2020	2021	2022	2023
United States	2.3	-3.4	5.6	4.1	2.5
China	6.7	2.3	7.7	4.5	4.5
Eurozone	1.9	-6.5	5.0	4.1	2.0
Germany	1.5	-4.9	2.7	3.6	1.6
France	1.5	-8.0	6.8	4.6	1.6
United Kingdom	1.9	-9.7	6.9	4.3	1.5

Source: ostrum.philippewaechter.com

	Inflation annual growth rate				
	Average 2015-2019	2020	2021	2022	2023
United States	1,9	1,2	4,6	3,0	2,0
China	2,0	2,5	0,9	2,0	2,0
Eurozone	1,2	0,3	2,5	1,9	1,5
Germany	1,3	0,5	3,1	2,0	1,5
France	1,0	0,5	1,6	1,8	1,5
United Kingdom	1,9	0,9	2,3	2,2	2,0

Source: ostrum.philippewaechter.com



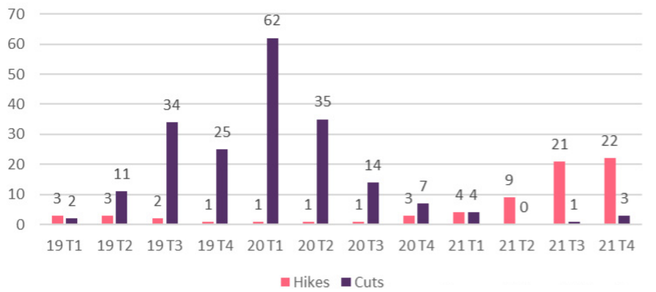
TIGHTER MONETARY POLICIES, INFLATION CONTINUING TO IMPACT THE MARKETS

Stéphane Déo, Head of market strategy at Ostrum AM, believes that the markets will focus on three core themes in 2022: central bank decisions, fundamental strengths continuing to impact credit yields and inflation which should remain a key topic. As a responsible investor, Ostrum AM also focuses on CO_2 emissions as a fourth theme.

THEME #1
CENTRAL BANKS: A GLOBAL CHANGE IN TACK, WITH A CLEAR TENDENCY TOWARDS MONETARY TIGHTENING

The Fed President, Jerome Powell, closed the door to a "transitory inflation". Inflationary pressures are increasing across the board due to restricted supply, rather than a stronger upswing in demand. Wages increases have also accelerated. Household inflation outlook is at levels which are potentially incompatible with the price stability goal set by the Fed. Lastly, the assumption of resurgent disinflationary pressures due to globalisation will be challenged by energy transition issues.

53 central banks around the world: number of rate increases and decreases by quarter



Sources : Ostrum & Bloomberg

Hike in 2021

COUNTRY	RATE	HIKE (bp)
Brazil	7,75%	575
Russia	7,50%	325
Venezuela	11,97%	293
Ukraine	8,50%	250
Czech Repub.	2,75%	250
Chile	2,75%	225
Peru	2,00%	175
Pakistan	9,75%	175
Hungary	2,10%	150
Iceland	2,00%	125
Poland	1,25%	115
Mexico	5,00%	115
Colombia	2,50%	75
South Korea	1,00%	50
New Zealand	0,75%	50
South Africa	3,75%	25
Romania	1,75%	25
Norway	0,25%	25
Singapore	0,08%	5

Sources : Ostrum & Bloomberg

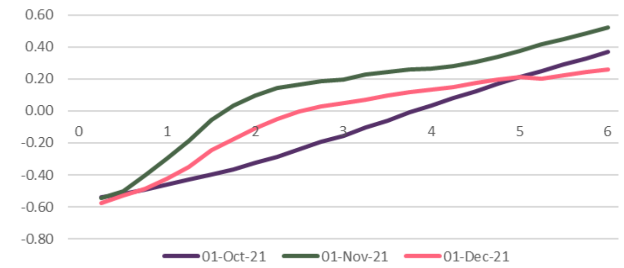
In mid-December, three major central banks will be taking key decisions. The Fed should resume *tapering*[1], the European Central Bank (ECB) is expected to provide details of the on 16 December of the new programme which will replace the *PEPP*[2], with the Bank of England (BoE) announcing a rate hike, although it surprised the markets this month by leaving its policy unchanged, contrary to previous guidance and undoubtedly reflecting its concerns over Brexit. Meanwhile, the Bank of China (BoC) suddenly halted its quantitative easing programme *(QE)*[3].

The central banks are therefore facing a global change in tack by tightening their monetary policies, introducing a high degree of uncertainty.

Fed Funds, implicit rate derived from future Dec 2022 contract

Sources : Ostrum & Bloomberg

Futures Contrats Euribor (horizontal axis = years)



Sources : Ostrum & Bloomberg

Despite these very sharp swings in the curve, certain aspects remain perplexing. The markets are expecting relatively rapid rate hikes, particularly by the Fed and also by the BoE.

Anticipating two hikes in 2022, perhaps three in the case of the Fed, is perhaps slightly jumping ahead, given that QE will only come to an end in the middle of next year. On the other hand, the Fed is likely to increase its rates only marginally.

For example, 1 and 3-year Treasury yields are close to 1.5%. This is therefore much lower than the 2.5% Fed funds yields during the last rate-hike cycle

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[1] *Tapering*: progressive reduction in the pace of massive bond repurchases

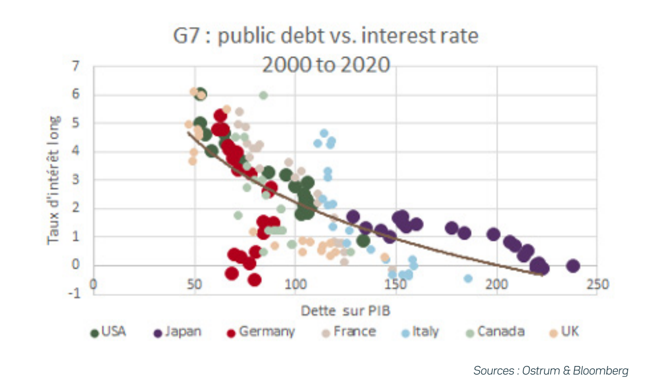
[2] PEPP: the ECB's Pandemic Emergency Purchase Programme

[3] Quantitative easing (QE) is a monetary policy mechanism used to combat the risk of deflation and recession, involving massive, widespread and protracted intervention in the financial markets financiers through securities purchases.

MODERATE RATE HIKES

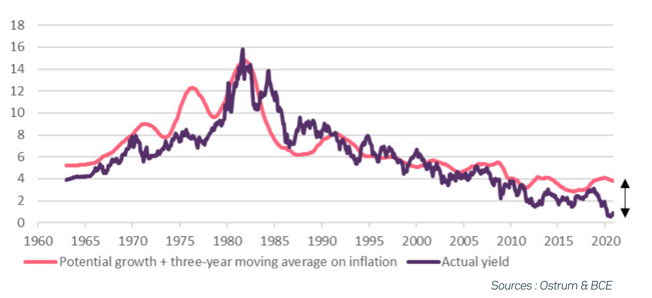
Our interest rate forecasts are 0.25% for the Bund at the end of 2022 and 2.25% for US Treasuries. The pace of rate hikes remains highly limited.

When we compare several countries, the ones with the most important debt have the highest interest rates: for example, Italy has rates higher than French sovereign rates which are themselves above German rates. Paradoxically, if we consider the historical evolution, the relation is inverted as shown by the below graph.



This debt accumulation goes alongside with lower interest rates in the G7 countries over the past two decades. Interest rates should remain at a low level to ease debt servicing, financial repression will remain

USA: 10-year yield



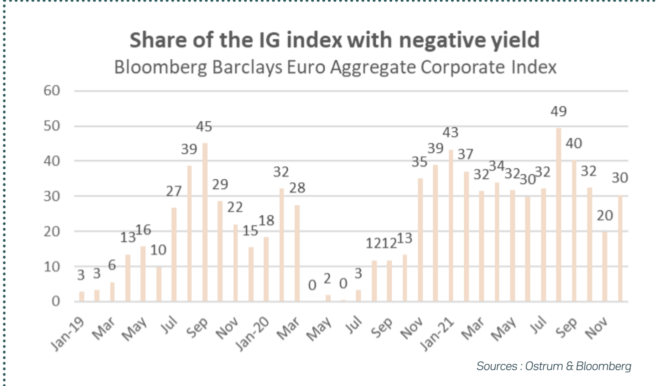
Germany: 10-year yield

THEME #2
FUNDAMENTALS REMAIN STRONG

Low credit yields: one third of the investment grade index rates remains negative

29-nov.-21	[0;2[	[2;3[	[3;4[	[4;5[	[5;7[	[7;10[	[10;15[	All Maturities
	Maturities in years							
AAA		-0.28			0.07	0.11	0.62	0.24
AA+	-0.41	-0.28	-0.03	0.15	0.20	0.40		0.06
AA	-0.36	-0.19	-0.06	0.08	0.26	0.34	0.92	0.00
AA-	-0.21	-0.02	0.10	0.25	0.40	0.62	0.89	0.34
A+	-0.32	-0.11	0.02	0.11	0.28	0.44	0.73	0.12
A	-0.26	-0.05	0.07	0.25	0.41	0.71	0.92	0.34
A-	-0.21	-0.02	0.10	0.25	0.40	0.62	0.89	0.34
BBB+	-0.14	0.02	0.18	0.29	0.48	0.74	1.04	0.52
BBB	-0.12	0.05	0.24	0.44	0.58	0.90	1.21	0.56
BBB-	-0.01	0.17	0.40	0.55	0.82	1.14	1.48	0.89
BB+	0.19	0.31	0.69	0.81	1.06	1.29		1.25
All ratings	-0.19	0.00	0.18	0.32	0.51	0.77	1.03	1.30

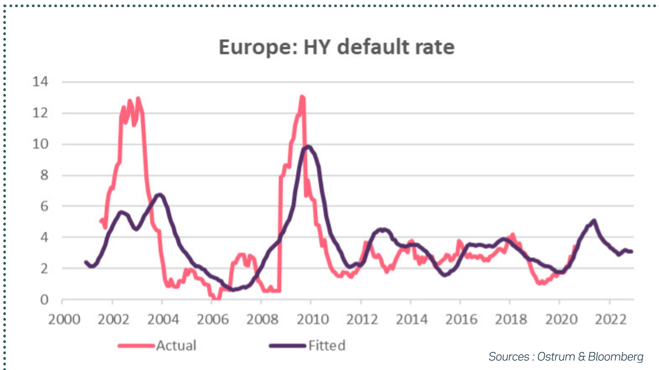
Source : Ostrum & Bloomberg
*index: Bloomerg Barclays Euro Aggregate Corporate, Yield to Worst, weighted average per issue sizes.



Robust fundamentals will continue to impact credit yields, with a very low level of default rates which tends to narrow the risk premium, while continued strong intervention by the ECB through quantitative easing absorbs more than the equivalent of net investment grade supply.

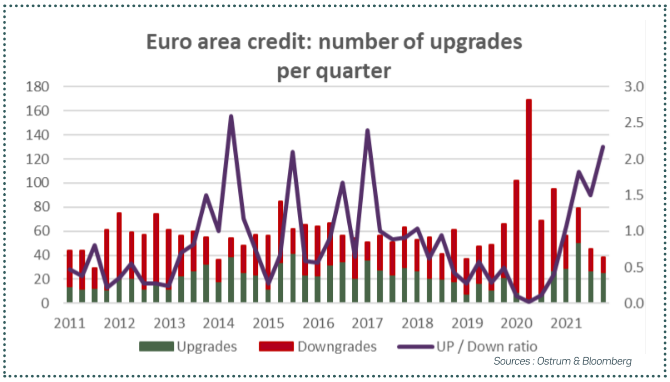
In return, risk is limited as yields remain very low, which creates favourable borrowing capacity among companies, which have restored their margins and cashflow to pre-crisis levels.

Lastly, balance sheets are healthy, particularly in terms of cash positions, which remain robust.



The default rate in the high yield universe remained below 4% in 2020, compared to 13% in 2009. Macroeconomic variables suggest a default rate of close to 3% in 2022, whereas a bottom-up analysis would place the level even lower, at around 2%.

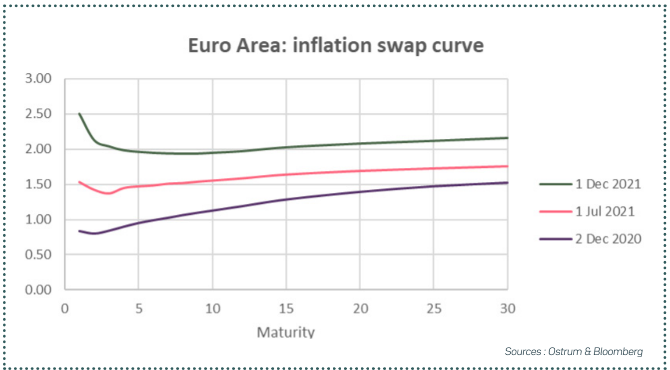
[4]Bloomberg Barclays Euro Aggregate Corporate



THEME #3
INFLATION: CHANGING MARKET SENTIMENT REGARDING INFLATION

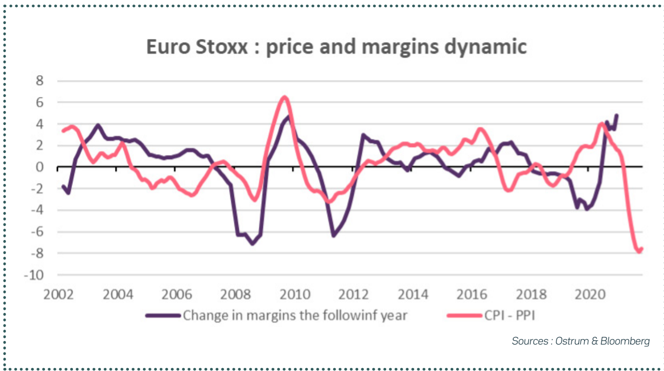
Market sentiment appears to have changed significantly since the summer, extending the trend observed over the past year, and outlook is now similar in the US and in Europe. The markets are anticipating inflation of significantly above 2% in the near term, followed by a rapid easing and ultimately stabilising at around 2%, or closer to 2.5% in the US, which corresponds to the targets set by the two central banks.

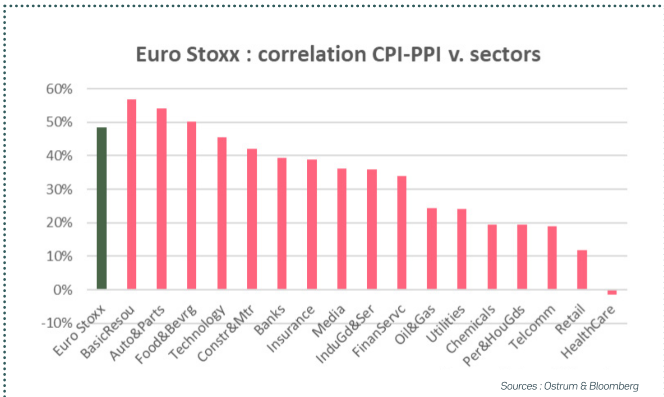
> According to the markets, a return to normal is expected after the purely temporary current inflationary shock.



A RISK FOR EQUITIES

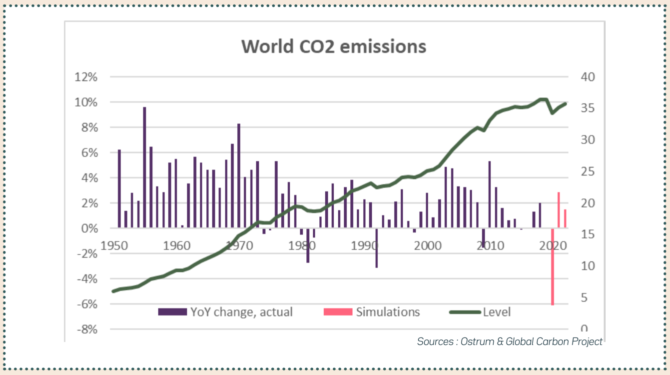
Inflation in the Consumer Price Index (CPI) reflects higher sales prices by companies, whereas the Producer Price Index (PPI) represents the cost of production for companies. The difference between the two therefore reflects margin dynamics. As the chart shows, the difference between the two is effectively closely correlated to margin trends over the ensuing quarters. Price momentum is observably strong enough to have a significant impact on corporate margins. **Potential sector rotation** appears to be the key issue however, beyond the aggregated risk of price swings weighing on the index. **Divergent reactions can lead to sharp performance dispersion.**

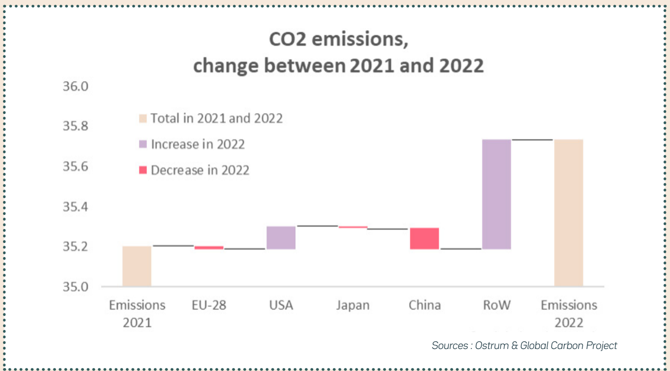




THEME #4
CO_2 EMISSIONS: WHAT PROGRESS IN 2022?

Forecasts for 2022 indicate that the increase in global CO_2 emissions should slow but remain on a positive trend. Emerging markets are the main contributors to the increase.





The following formula is used to calculate the increase:

Increase in CO2 emissions in 2022

$$= \frac{CO2_{2022}}{CO2_{2021}}$$

$$= \frac{GDP_{2022}}{GDP_{2021}} \; \frac{CO2_{2022}/GDP_{2022}}{CO2_{2021}/GDP_{2021}}$$

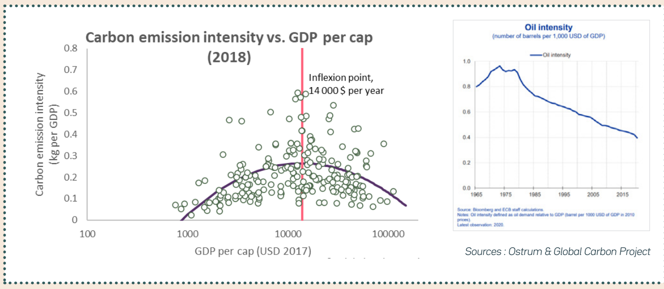
$$= \frac{GDP_{2022}}{GDP_{2021}} \; \frac{Carbon\ intensity_{2022}}{Carbon\ intensity_{2021}}$$

= Increase in GDP. Increase in carbon intensity

RESULTS : emissions are expected to increase by around 1.5% in 2022 but stabilise in developed countries.

However, the European area – which is at the end of its post-covid normalisation period - slightly slows down its emissions, despite a high increase of its GDP. China should see its CO_2 emissions decrease, due to the economy slowing: gains in "environmental productivity" should be more important than economic growth which is slowing down. This situation should bring emissions onto a downward path. The increase is attributable to other developing countries.

These changes can be explained by the fact that the relationship between growth and CO_2 emissions is far from linear. The Kuznets environmental curve demonstrates that emission decline beyond a given level of development.



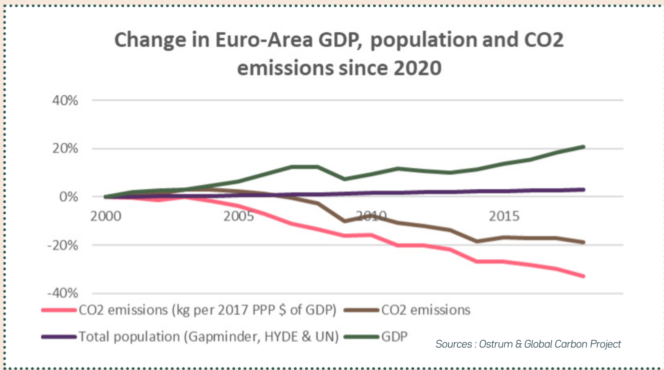
The Kuznets curve demonstrates the relationship between a country's level of development and its degree of inequality.

A bell-shaped curve reflects inequalities increasing with economic development and then decreasing once a given level has been reached and as a middle class emerges.

The Kuznets environmental curve also follows the same pattern with regard to emission intensity and also produces a bell-shaped chart for several different reasons:

- The growth rate among the most developed countries is driven chiefly by services and deindustrialisation. Growth is therefore driven by less energy-consuming sectors.
- Despite prices among certain low-carbon technologies decreasing significantly, the overall cost remains high in many cases. Only wealthy countries can therefore afford decarbonisation. Climate and environmental concerns are more prevalent among developed countries.
- Emissions have also been partially exported to poorer countries, through the delocalisation of the most highly-polluting industries to these nations.

Applying this logic to Europe, there has been economic growth AND a reduction in emissions since the beginning of the century.



> The moral of the story is that growth does not necessarily produce more greenhouse gases.

On the contrary, beyond a given level of development, empirical data appears to show that emissions reduce, particularly through the adoption of more efficient technologies.

Shrinking the economy is not therefore necessarily the ideal solution.

The reality is more complex than a simple Malthusian analysis would suggest ●

WHERE TO FIND VALUE IN 2022?

According to Ibrahima Kobar, CIO at Ostrum AM, there will be value to be found in the various markets in 2022, sovereign bonds, corporate bonds (credit) and equities, by precisely identifying selectivity axes.

SOVEREIGN
- Inflation
- Sustainable bonds
- Emerging markets

CREDIT
- Fundamentals improving further
- Prefer seeking yield by taking credit risk
- Interest rate risk management

EQUITIES
- Further promising growth outlook: financials, media, tech stocks, travel & leisure

SOVEREIGN
exposure to inflationary risks, sustainable bonds and emerging markets

Inflation should remain a key theme, at least during the first half of 2022. The market has adopted the highly optimistic view of European inflation returning rapidly to 2%. Despite exposure to inflationary risks, the market appears over-optimistic regarding European inflation.

> Sustainable bonds represent a sound investment opportunity: almost 900 billion euros were issued in 2021.

Investors could benefit from the greenium (sustainable bonds premium) trend by continuing to support sovereign issuers in their energy and social transition.

Emerging markets have been impacted this year by steeper Treasury yields and a rise in the dollar. Conditions should be more favourable in 2022 and the asset class offers a high level of carry and improved risk resilience.

CREDIT
taking on credit risk (crossover, high yield) rather than increasing investment maturity

Fundamentals should continue to improve in the credit market and the experts at Ostrum AM are anticipating the advent of more rising stars than falling angels in 2022.

Despite this factor, interest rate risk management will provide a strong performance source and our teams suggest seeking yield by taking credit risk in the high yield segment, in Europe for example, rather than increasing investment maturity.

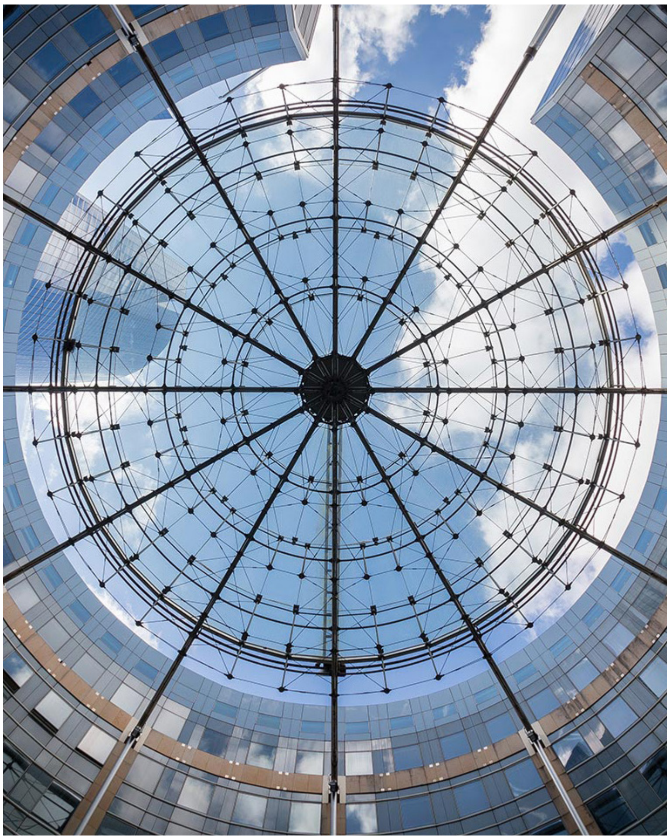
We believe that the remuneration for credit risk is superior to duration risk and we also consider the investment grade segment to be overpriced and that US high yield is too expensive compared to Europe.

EQUITIES
prefer companies capable of generating constant growth and exposure to companies able to resist the inflationary trend

Equities should benefit from economic growth, which helps improve margins.

We prefer sectors which, despite the 2021 rally, **harbour further strong growth outlook:** financials (rate hikes, quality assets), media (sector recovery), tech stocks (megatrends, digitalisation) and travel & leisure (excluding airlines).

Beware of the risk of rising prices however. **Increasing inflation and therefore costs** may have a significant impact on margins. We prefer healthcare (resistance to inflation), energy & basic resources (exposed to commodities), luxury /high-end products (strong pricing power). We are avoiding the automotive sector, air transport, food & drink (other than spirits) and the discretionary consumer segment



Source: Ostrum AM & Bloomberg, November 2021. The analysis and opinions in this document represent the viewpoint of the referenced author at the date indicated and may change and cannot be interpreted as having any contractual value

Our views for 2022

Sovereign bonds	-	Neutral	+
USA	X		
Bund	X		
OAT	X		
Emerging			X

Credit	-	Neutral	+
Investment Grade	X		
High Yield			X

Equities	-	Neutral	+
EUR			X
USA	X		

Relative views	-	Neutral	+
Equities vs. Souvereign bonds			X
Equities vs. Credit			X
Credit vs. Souvereign bonds			X
Equities EUR vs. US			X

Asset class outlook

Sovereign bonds		18/11/2021	End-2022 outlook
USA	Fed Funds	0.25	0.25
	10 years	1.59	2.25
Eurozone	ECB, deposits	-0.50	-0.50
Germany	10 years	-0.28	0.25
France	10 years	0.07	0.65
	Spread	35	40
Italy	10 years	0.92	1.45
	Spread	120	120
Spain	10 years	0.44	0.90
	Spread	71	65
Portugal	10 years	0.35	0.80
	Spread	62	55

Sovereign bonds		18/11/2021	End-2022 outlook
USA	Fed Funds	0.25	0.25
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	Spread	71	65
Portugal	10 years	0.35	0.80
	Spread	62	55

WHAT ARE THE RISKS OVER THE COMING YEAR?

According to Philippe Waechter, we are expecting to face several types of risk in 2022.

The cycle returning to a normal pace should slow inflation. The impact on long-term interest rates should therefore be limited. If inflation persists due to durably higher wages, an inflation premium would be priced into long-term interest rates. This factor would weigh on indebted economic players and the hierarchy among financial investments.

The second risk factor is **rising commodities prices, notably** agricultural commodities which have reached disconcerting levels, with potentially hazardous consequences for emerging markets.

The economic situation in China, as the country faces a slowdown (particularly in real estate) and the fragility of local governments represents a third risk factor.

Lastly, **the need to adapt to climate change** could lead to major turbulence in coming months.

Ibrahima Kobar
CIO

Philippe Waechter
Head of Economic Research

Stéphane Déo
Head of market strategy

LEGALS MENTIONS

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Completed 29/11/2021

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