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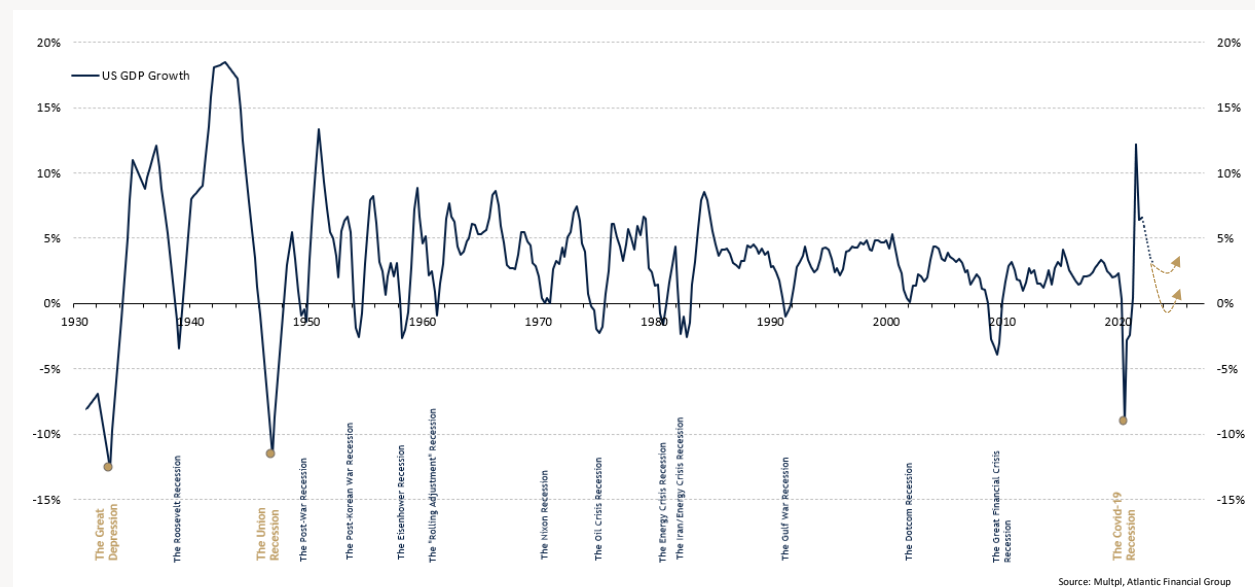
## Weekly Investment Focus

17 January 2022

### "THE HYPOTHESIS OF A MONETARY POLICY MISTAKE"

- ◆ By focusing too much on fighting inflation, the Fed risks triggering the next crisis
- ◆ The current economic cycle could be one of the shortest in history
- ◆ The flattening of the yield curve reinforces this scenario
- ◆ By stabilising their balance sheets, central banks no longer support the bull market

### CHART OF THE WEEK: "Growth stabilisation or new recession?"

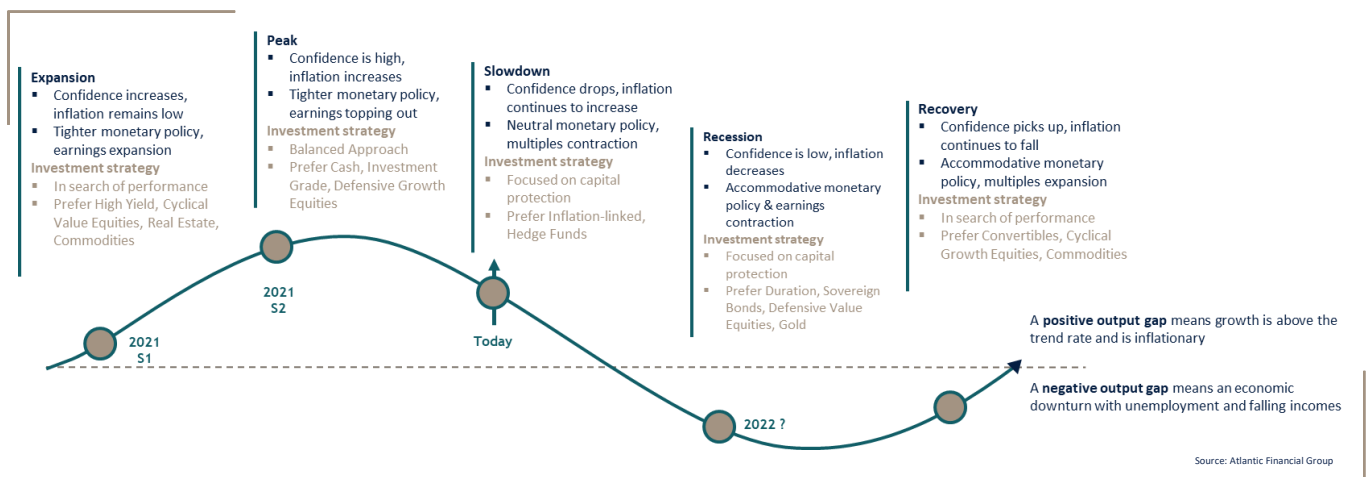


### FINANCIAL MARKETS ANALYSIS

The outline of our scenario for 2022 has already been unveiled (see [Strategy & Themes of 29 November 2021](#)). **Let's take advantage of the beginning of this year to detail a crucial element: the duration of economic cycles.** The one that has just begun could be one of the shortest in modern history. For the record, the economic cycle represents the fluctuations in the pace of activity in a country. It is composed of five phases that repeat in a loop in a precise order: expansion, peak, slowdown, recession, recovery. In each of these phases, specific assets outperform (see Fig. 2).



Fig 2- Economic cycle & asset allocation strategies



Since ancient times, the cyclicity of economic activity has been detailed in the literature. Human beings quickly understood that agriculture, for example, followed the natural cycle of the seasons, making it inevitable that production would fall and then rise. The Pharaohs tried to anticipate the different periods of the cycle in their kingdom, but also the length of the cycle by mentioning episodes of fat and lean cows. This debate is still alive today. **For economists, there are four main types of business cycle, of varying lengths** (see Fig. 3).

Fig 3- Different economic cycles

- **The Kitchin cycle.** Developed in the 1920s by the English economist Joseph Kitchin, it describes a **short cycle of 3 to 4 years**. Based on the stockpiling policy of companies, it is characterised by an expansion phase of about two years, followed by a phase of slower growth, also lasting two years.
- **The Juglar cycle.** Theorised by the French economist Clément Juglar in 1862, **this cycle lasts from 8 to 10 years**. Corresponding to the dynamics of the deployment of corporate capital, it revolves around a phase of sustained investment and then, once all the profitable projects have been completed, by a plunge in growth.
- **The Kuznets cycle.** Theorised by the American economist Simon Kuznets in the 1930s, **it lasts from 15 to 25 years**. It is based on demographic variations that stimulate economic activity in waves.
- **The Kondratiev cycle.** The well-known business cycle was first identified by the Soviet economist Nikolai Kondratiev in the 1920s. It was further developed by Joseph Schumpeter in the late 1930s. According to Schumpeter, innovations appear in "clusters" and drive growth **for 20 to 30 years**. Their positive effects dissipate before other innovations are able to boost the economy.

Source: Atlantic Financial Group

**The downturn in the cycle may be due to a slowdown in demand for goods and services**, both from households and domestic companies, and also via external trade. This fall in demand leads to a slowdown



in production, a rise in the unemployment rate and a fall in inflation. **The downturn in the cycle can also be caused by a bottleneck in production factors**, i.e. a supply shock: an unavailability of capital, a shortage of workers, a lack of raw materials or energy, among other examples. If there is little substitutability between these factors in the short term, it becomes difficult for companies not to reduce production and lay off workers.

**In the past, business cycles were shorter.** Fluctuations were more frequent. In recent decades, thanks to efficient monetary policies, recessions have been spaced out (see Chart of the Week). On 15 December, Jerome Powell testified that *"what we need is another long expansion, like the ones we've been having over the last 40 years"*.

Smart observers, admittedly a little sarcastic like Ben Bernanke, believe that economic expansions never die of old age but are murdered by central banks. The provocation of the former Fed chairman sounds like a warning, at a time when the institution is reducing its liquidity injections (QE) and is preparing to raise its key interest rates. Inflation, which is higher and more sustainable than expected, is putting political pressure on central banks whose mandate is to contain price pressure. **By focusing too much on fighting inflation, central banks could trigger the end of the economic growth cycle. The risk of a monetary policy mistake increases sharply.**

Fig 4- Fed policy rates & recession periods

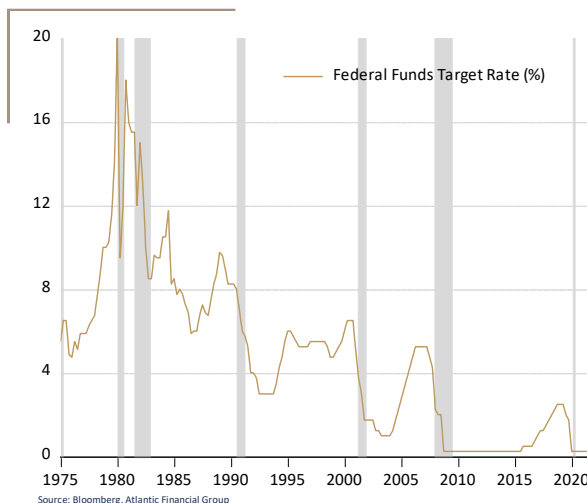
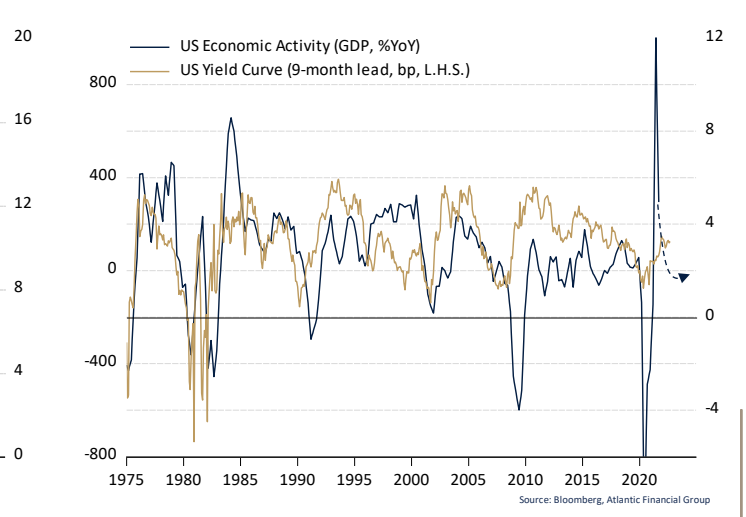


Fig 5- Yield curve & business cycles



Economists note that since 1975, **the majority of Fed rate hike cycles have been followed by a recession within 18 months** (see Fig. 4). This argument is partly misleading because the US central bank raises rates when the economy is growing too fast, precisely to avoid overheating. To put it candidly, it is not the sunscreen that causes the burns but the sun's rays. However, central banks can sometimes tighten their monetary policy with the wrong timing, as in 2008 with Jean-Claude Trichet's ECB, or too aggressively, as in the early 1980s with Paul Volcker's Fed.



In this respect, the yield curve is a key indicator for forecasting the economic cycle (see Fig. 5). If bond investors believe that the rise in short-term rates is a good idea and that it will therefore be sustainable, long-term rates will rise further, allowing the yield curve to steepen. Conversely, if they believe that the rise in the cost of money is a mistake or exaggerated, long-term yields will rise less, if at all. The yield curve will flatten.

Since October 2021 and the Fed's commitment to raise its key rate, the US yield curve has crashed from 130 to 80 basis points. Investors perceive the Fed's decision as an inadequate method to control soaring inflation. Since this rise in prices is linked to a supply shock (exogenous), not to overheating demand (endogenous), putting the brakes on the economy will not change anything. If the world's leading financial institution misdiagnoses and mistakenly tightens credit conditions, then **recession could be in the cards, and sooner than expected by the investor consensus.**

Fig 6- Credit impulse & business cycle

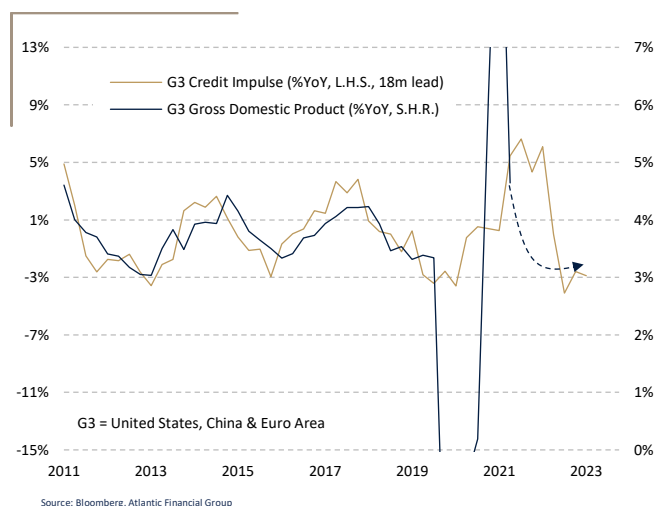
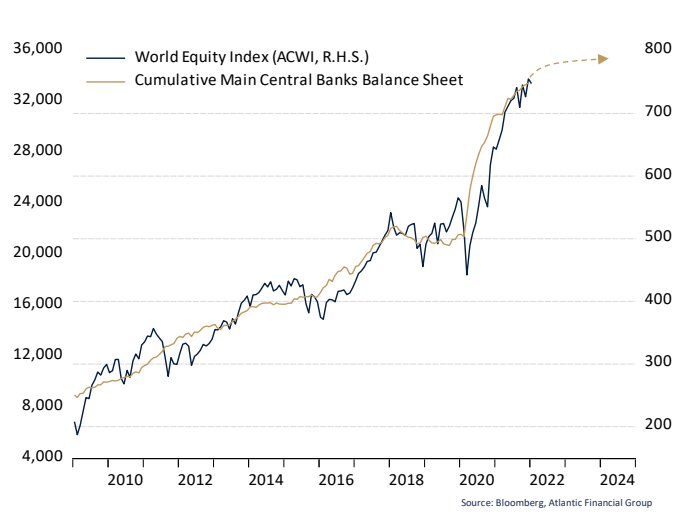


Fig 7- Money printing & stock market



Finally, as in every year since 2009, economic activity and stock markets have moved in step with liquidity injections. Last year, the latter were very favourable. **Over the next twelve months, credit developments will no longer support growth (see Fig. 6) and the levelling of central bank balance sheets will no longer support the bull market (see Fig. 7).**

### Conclusion:

The current economic cycle may be one of the shortest in modern history. After 40 years of long cycles, central bankers are likely to be surprised by such a scenario. Their desire to fight inflationary pressures has led them to stop stimulating credit growth and expanding their balance sheets. The hypothesis of a monetary policy mistake is strengthened. Bond investors are already anticipating this scenario, as the yield curve tends to flatten. Conversely, equity investors could be caught off guard experiencing a bear market.



## RETURN ON FINANCIAL ASSETS

Markets Performances (local currencies)	Last Price	Momentum Indicator (RSI)	1-Week (%)	1-Month (%)	2022 Year-to-Date (%)	2021 (%)	2020 (%)
<b>Equities</b>							
World (MSCI)	744.4	47.87	0.2%	1.4%	-1.3%	19.0%	16.9%
USA (S&P 500)	4 663	46.08	-0.3%	0.7%	-2.1%	28.7%	18.4%
USA (Dow Jones)	35 912	47.71	-0.9%	1.1%	-1.1%	20.9%	9.7%
USA (Nasdaq)	14 894	40.26	-0.3%	-2.2%	-4.8%	22.2%	45.1%
Euro Area (DJ EuroStoxx)	474.3	48.69	-0.9%	2.7%	-0.9%	23.5%	0.8%
UK (FTSE 100)	7 543	63.07	0.8%	4.6%	2.2%	18.4%	-11.4%
Switzerland (SMI)	12 526	42.97	-2.1%	0.9%	-2.7%	23.7%	4.3%
Japan (Nikkei)	28 124	43.09	-1.2%	-1.0%	-2.3%	6.6%	18.3%
Emerging (MSCI)	1 257	59.84	1.6%	3.0%	2.1%	-2.5%	18.8%
Brasil (IBOVESPA)	106 928	57.73	1.1%	0.2%	2.0%	-11.9%	2.9%
Russia (MOEX)	3 597	37.11	-4.2%	0.7%	-4.5%	21.9%	14.8%
India (SENSEX)	61 223	68.91	2.5%	5.4%	5.1%	23.2%	17.2%
China (CSI)	4 727	34.85	-2.0%	-6.4%	-4.3%	-3.5%	29.9%
Communication Serv. (MSCI World)	108.13	42.83	0.8%	-0.6%	-1.9%	10.8%	24.2%
Consumer Discret. (MSCI World)	400.8	42.64	-0.6%	-0.3%	-2.4%	9.2%	37.0%
Consumer Staples (MSCI World)	289.1	55.17	-0.4%	1.9%	-0.9%	11.7%	8.8%
Energy (MSCI World)	212.6	78.98	4.9%	15.0%	12.6%	37.5%	-27.7%
Financials (MSCI World)	158.2	68.57	1.1%	7.3%	5.2%	25.1%	-3.1%
Health Care (MSCI World)	350.5	36.78	-0.5%	-1.2%	-5.1%	18.0%	15.4%
Industrials (MSCI World)	328.0	48.34	-0.8%	1.9%	-1.2%	16.6%	11.8%
Info. Tech. (MSCI World)	546.6	40.91	-0.2%	-1.9%	-4.8%	27.6%	46.2%
Materials (MSCI World)	370.6	59.67	1.3%	4.8%	1.4%	15.4%	21.6%
Real Estate (MSCI World)	223.7	37.97	-1.1%	-0.5%	-4.7%	23.6%	-5.7%
Utilities (MSCI World)	159.5	51.48	0.0%	1.8%	-2.0%	11.1%	4.8%
<b>Bonds (FTSE)</b>							
USA (7-10 Yr)	1.78%	33.09	0.1%	-2.8%	-2.2%	-2.4%	9.3%
Euro Area (7-10 Yr)	0.29%	34.97	0.1%	-2.3%	-0.6%	-2.9%	4.5%
Germany (7-10 Yr)	-0.05%	34.41	0.1%	-2.3%	-0.6%	-2.7%	3.0%
UK (7-10 Yr)	1.15%	33.47	0.3%	-3.4%	-1.4%	-4.9%	5.4%
Switzerland (7-10 Yr)	0.03%	33.55	0.2%	-2.2%	-1.0%	-2.3%	0.4%
Japan (5-10 Yr)	0.14%	28.65	-0.2%	-0.7%	-0.5%	0.0%	-0.1%
Emerging (5-10 Yr)	5.16%	21.00	-0.6%	-2.7%	-3.0%	-2.3%	5.2%
USA (IG Corp.)	2.62%	32.01	-0.3%	-2.4%	-2.4%	-1.0%	9.9%
Euro Area (IG Corp.)	0.63%	29.22	-0.1%	-1.3%	-0.6%	-1.0%	2.8%
Emerging (IG Corp.)	5.06%	13.10	-0.9%	-2.7%	-2.4%	-3.0%	8.1%
USA (HY Corp.)	4.58%	44.26	0.3%	-0.1%	-0.9%	5.3%	7.1%
Euro Area (HY Corp.)	3.36%	50.22	-0.1%	0.0%	0.0%	3.4%	2.3%
Emerging (HY Corp.)	7.73%	18.54	-1.0%	-2.5%	-2.7%	-3.2%	4.3%
World (Convertibles)	425.1	35.23	-0.3%	-1.2%	-3.0%	2.4%	38.8%
USA (Convertibles)	568.5	34.11	-0.7%	-2.0%	-4.1%	3.1%	54.5%
Euro Area (Convertibles)	4 046	37.91	-0.8%	-0.8%	-1.5%	-0.3%	6.1%
Switzerland (Convertibles)	185.1	31.73	0.1%	-0.9%	-0.4%	-0.5%	0.5%
Japan (Convertibles)	200.5	50.01	0.2%	0.3%	-0.1%	3.3%	2.8%
<b>Hedge Funds (Crédit Suisse)</b>							
Hedge Funds Indus.	713.0	68.87	n.a.	-2.2%	n.a.	6.2%	6.4%
Distressed	959.5	73.50	n.a.	-0.8%	n.a.	11.6%	3.8%
Event Driven	810.2	73.84	n.a.	-1.8%	n.a.	12.6%	7.0%
Fixed Income	388.4	72.35	n.a.	-0.5%	n.a.	3.9%	3.6%
Global Macro	1 164.3	48.35	n.a.	-3.1%	n.a.	5.9%	6.5%
Long/Short	900.6	60.55	n.a.	-3.0%	n.a.	5.2%	7.9%
CTA's	340.9	62.38	n.a.	-3.9%	n.a.	8.0%	1.9%
Market Neutral	284.6	44.56	n.a.	-0.5%	n.a.	4.2%	1.7%
Multi-Strategy	682.4	69.87	n.a.	-1.4%	n.a.	4.7%	5.6%
<b>Volatility</b>							
VIX	19.19	49.78	2.3%	-12.3%	11.4%	-24.3%	65.1%
VSTOXX	21.40	51.34	3.7%	-12.4%	11.0%	-17.6%	67.5%
<b>Commodities</b>							
Commodities (CRB)	585.3	n.a.	0.6%	2.9%	1.2%	30.3%	10.5%
Gold (Troy Ounce)	1 818	54.75	1.2%	2.7%	-0.6%	-3.6%	25.1%
Oil (WTI, Barrel)	83.82	69.85	0.2%	18.5%	8.9%	58.7%	-20.5%
Oil (Brent, Barrel)	86.34	70.64	0.4%	18.7%	11.5%	51.4%	-23.0%
<b>Currencies (vs USD)</b>							
USD (Dollar Index)	95.165	41.36	-0.6%	-1.5%	-0.5%	6.4%	-6.7%
EUR	1.1413	56.74	0.5%	0.7%	0.4%	-7.5%	9.7%
JPY	114.16	56.49	1.2%	-0.4%	0.8%	-10.2%	5.1%
GBP	1.3678	67.53	0.7%	2.7%	1.1%	-1.0%	3.1%
AUD	0.7221	50.82	0.6%	0.5%	-0.6%	-5.6%	9.6%
CAD	1.2541	60.39	0.8%	1.9%	0.8%	0.7%	2.1%
CHF	0.9125	55.46	0.7%	0.7%	0.0%	-3.0%	9.4%
CNY	6.3527	59.94	0.4%	0.2%	0.1%	2.7%	6.7%
MXN	20.300	67.47	0.5%	2.6%	1.1%	-3.0%	-5.0%
EM (Emerging Index)	1 742.7	68.86	0.6%	1.0%	0.5%	0.9%	3.3%

Source: Bloomberg, Atlantic Financial Group

Total Return by asset class (Negative \ Positive Performance)



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