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CIO Newsletter Asia

The Truman show

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Jean-Louis Nakamura
CIO for Lombard Odier Asia-Pacific

The New Year is starting amidst macroeconomic data, policymakers' stance and potential public health developments sending mixed signals about the possible markets' dynamics over the next few months. In Western economies, still-robust business conditions will have to digest a significant drag from fiscal policies, while reflation will be at work in China and to some extent in Japan. Emerging economies should remain under pressure from possible successive Covid-19 waves, strong dollar and, for some of them, toppish/declining commodity prices later in the year. Ultimately, the pace and horizon of normalization of economic conditions and reversing inflationary pressures will remain at the mercy of Omicron and future variants, and the level of resilience of global health systems, which is, however, increasingly supported by vaccines' diffusion and anti-viral therapeutic developments.

In the absence of any major policy mistakes, **2022 should remain supportive for equities but with returns discounted by downwards revisions in earnings growth and weaker risk appetite.** Bonds may suffer as Fed accelerates its tightening, but lower yields emerge as a likely outcome by end of 2022. **Asia credit could make a comeback later in the year, once China would have stabilized its own domestic situation.** Within commodities, energy prices remain a major source of risk in the first months of the year but should then recede facing decelerating demand. Investors who feel able to bear a high level of noise and volatility over the next few months should **stick to secular-themed stocks (sustainability, asset-light business models, high quality brands, large caps...)**. Others should seek refuge in diversification, including in long-duration bonds, **while cautiously accumulating equities from economies likely to reflate and de-correlate in 2022 (China and to some degree Japan) at the expense of the ones tightening their financial conditions (the US).**

We continue to argue that the main risk for markets remains a confusion between the economic imbalances induced by the pandemic, likely to persist for longer but with incrementally smaller impact, and a structural regime shift in terms of growth and inflation. Recent history suggests investors frequently underestimate the initial pace of a tightening move from the Federal Reserve but also that US central bankers systematically overestimate their capacity to rise policy rates. This conviction gap might be even wider in the present case as inflation has surged to spectacular levels while the pandemic has likely cut further potential growth and equilibrium interest rates in major economies. **In this context, the main impact from Omicron might consist in further blurring the visibility as to who is right and wrong in this debate.**

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Should such risk materialize, there is little doubt that markets, and in particular risky assets, will be hit by a significant sell-off and rise in volatility. However, this sell-off should remain short-lived, as the Fed would have no alternative than to capitulate (again) and signal a premature end of its tightening efforts, liquidity and assets' high valuation being the main shields protecting consumption and growth in the US and preventing large-scaled liquidity and credit tensions, with potential systemic implications. **Ultimately, this dynamic would prove positive for both bonds and equities.**

The start of a new year is usually the period when we step back and look at the key developments that took place over the last 12 months, assessing how they matched or deviated from the scenario published one year ago. We will follow this ritual with this first newsletter of the year, focusing more specifically on the unexpected developments that may have hit our portfolios, and **trying to draw some lessons to frame our views for 2022.**

In the first weeks of 2021, we anticipated pent-up demand fueled by renewed fiscal stimulus plans, leading to a likely reflationary boom in the course of the year, with small and mid-cap stocks, cyclical industries, energy and industrial commodities as well as a few export-led emerging economies as the main beneficiaries. **We were, however, also of the opinion those reflationary trades should reach some limits in the year's second half, capping de facto any sustainable rotation from growth to deep value assets.** The key risk to this scenario was resulting from a possible confusion by investors between cyclical developments and structural changes [1].

At this level of generic description, this scenario matched quite well with the broad developments witnessed last year. Some of the trades it inspired – for instance switching in January 2021 from China equities for European and US small caps as well as cyclical Asian exporters - did perform nicely in the first part of the year. **At a more granular level, however, we faced multiple shocks we did not see coming, at least not at the pace at which they materialized**. The rapid surge in long-term interest rates during the first quarter of last year did surprise us but we proved right in seeing the 1.75% yield reached in March by 10Y Treasury bonds as the likely top over the medium-term.

Unfortunately, two key developments diverged from our scenario much more significantly. The first one was the emergence of the Delta variant during the summer, **which drastically transformed the perspectives of evolution of the pandemic**. The perturbations it generated conflicted openly with our view of a faster normalization of economic conditions, and in particular the easing of some inflationary pressures in the late part of 2021. **The second one was the much deeper than expected transformation of China's policy playbook**, on the macro as well as on the regulatory sides. While we had rightly anticipated a severe slowdown in China's domestic activity through 2021, we thought that fast-deteriorating conditions in the third quarter would force a much quicker reversal in credit conditions as well as a pause in the regulatory crackdown on web-based giants. By contrast, support for mortgage financing and easing of credit rules and distribution only started to materialize during the last weeks of 2021, amplifying the scale and contagion of a largely self-induced liquidity crisis among property developers, while policy pressures on e-platforms continued until the end of the year.

Since April 2020, policymakers in most advanced economies have staged their own version of the *Truman show*, a virtual world that could have been a pure fantasy notwithstanding the dramatic human toll from the pandemic. Indeed, in this early version of a global economic Metaverse, the full-blown depression that should have normally resulted from the initial pandemic shock, was replaced by a stage where households' balance sheet improved, private consumption increased, jobs (and in some cases wages') growth accelerated and asset prices ballooned.

From here on, the similarities with the 1998 US comedy-drama start mirroring. Unlike Christof, the Truman Show's producer in the movie, policymakers – at least in the US and to a smaller extent in Europe – are the ones willing to end the program today, considering the characters at play (consumers, entrepreneurs and investors) mature enough to understand the necessity to return to the shores of economic "reality". In the movie, Christof is trying to prevent Truman Burbank, the lead character played by Jim Carrey, from leaving the stage, first by triggering a storm while Truman is sailing towards the edge of his world, then by describing a frightening picture behind the scenes. In today's situation, investors – because they are not sharing the same perception of the economic reality – may try forcing the Fed not to drop the set, possibly through a storming sell-off in markets.

Hence, two key questions for 2022: How solid will the global economy be to absorb the prospect of a significant withdrawal of policy support? How far apart are the perceptions between investors and central banks about the long-term economic "realities" (i.e. growth and inflation regimes and equilibrium level of interest rates) and who is likely to be right?

At present, the momentum in global economic conditions still appears robust. As expected, activity is logically not as strong as during the first half of 2021 but it has been improving globally since the end of last year's third quarter when the Delta variant-induced global disruptions, as well as other idiosyncratic supply-side shocks in China, hit the hardest. In

[1] See « A confederacy of dunces – Winners and losers under the Pandemic rule », Asia CIO Newsletter, 15 January 2021.

the US, recent business surveys for both the manufacturing and services sectors have rebounded materially while various proxies for private consumption remained strong. In China, where growth choked and almost stalled during the summer, supply and private investment stabilized/improved somewhat, in spite of the drag of the property market where transactions and new projects continue to contract.

Other economies as diverse as India, Vietnam or Japan who had to face either an early and dramatic Delta-variant spread (India), unexpected supply-side disruptions (Vietnam) or a mix of mild/prolonged social restrictions and supply bottlenecks (Japan) have all demonstrated continuous or more recent yet rapid bounces after the Delta wave receded or when the prospects of re-opening took place. By contrast, European economies, which have gone through the Delta wave with minimal disruptions, have decelerated significantly in the last months of 2021.

In other words, fluctuations in business conditions over the last six months have been mainly echoing the tide from the previous Delta spread, more or less amplified by local public health policies. Impact from endogenous factors (stronger labour markets, higher wages, lower saving rates...) and other exogenous factors (higher energy prices...) as well as policy support drivers has remained relatively unnoticed over the last few months. **For the first months of 2022, at least, we might face a more complex overlaps of these different categories of drivers, whose net consolidated impact points toward a risk of growth deceleration.**

2022 should indeed mark another milestone in the process of global growth normalization as the production gap in most advanced economies has been substantially reduced (Europe) or even almost fully-bridged (US). After surging by more than 6% (annualized) during the first half of 2021, the US GDP has probably grown at a pace below 4% over the last 6 months. It should decelerate further in the first half of 2022. The situation might be slightly different for some developed economies (such as Japan) and emerging countries, especially in Asia, lagging in terms of cyclical catch-up and likely to benefit from the launch of the Regional Comprehensive Economic Partnerships on 1 January, the largest free trade agreement in the world. Those economies might enjoy slightly higher GDP growth in the early months of 2022, **in the absence of any additional interference from the Omicron variant (see below)**. China, by contrast, is struggling not to generate a negative output gap, with domestic consumption, property market and fixed assets investments still weakening before recovering partially in the course of the year, under the benefit of higher credit growth.

Two factors could amplify this endogenous deceleration. Ongoing high consumer inflation pressures and a decline in real wages at work over the last few months in the US and a few developed economies, could ultimately act as an indirect tax, trimming consumers' purchasing power. **More fundamentally, households will have to face a dramatic global fiscal cliff in 2022**. Indeed, aggregated fiscal deficit for the G4 (US, UK, Eurozone and Japan), which remained stable at just below USD 6 trillion in 2020 and 2021, is expected to shrink by almost half this year. Even if a large part of this reduction results from stronger tax receipts from 2021 revenues (automatic stabilizers), it shall also reflect much lower net fiscal spending this year. This picture looks worse only now that the US social expenditures package seems nearly dead.

Some positive developments could partially buffer the impact on global growth from this inflation and US fiscal drags. They appear, however, too limited to prevent a faster growth normalization. First, a fall in households' saving rates could further expand the boom in consumption in many developed economies, especially in Europe and Japan, as the saving rates in the US has dramatically contributed already to the surge experienced in personal consumption expenditures last year. Saving rates that had ballooned in early 2020 due to massive fiscal transfers at a time where consumption was constrained by lockdown have indeed already declined by more than 8 pp (percentage points) in the US and 6 pp in the UK in 2021. They could decline by up to 5 pp in the Euro area in 2022.

Second, the move towards fiscal consolidation will not be universal. Some large economies, such as China and Japan will expand public spending at local and/or national levels. After a sharp contraction of its GDP in the third quarter of 2021, Japan's new Prime minister, Fumio Kishida, unveiled a large fiscal stimulus plan of JPY 56 trillion, including JPY 32 trillion of fresh new spending, equivalent to 6% of GDP. Quite unusual measures in the Japanese context, such as a direct cash-out of JPY 100,000 to every young adult, could help to boost domestic demand, supporting Japan's GDP growth in 2022 by a few tenths of percentage points.

In China, the Central Economic Working Conference (CEWC) held on 8-10 December highlighted the priority granted to stability, citing for the first time "the triple pressures of demand contraction, *supply turbulences and weakening expectations*". With the 2021 special bond quota for local government bond issuance being almost fully exhausted at the end of the year, the Ministry of Finance just announced on December 16 a special bond quota of RMB 1.46 trillion just for the first quarter of 2022 (vs. 3.65 trillion for the full 2021 year). **This higher quota should translate by accelerated infrastructure investments in the areas of green transformation, industrial equipment and logistic networks**.

China is the first wild card in our scenario for 2022. We have no doubt that China will be one of the few self-reflating economies this year. **The question is more about how fast and how far these efforts will go and how articulated the various components of the economic policy will be**. In the past, China's usual policy playbook used to translate "the need for stability" to "the opportunity to reverse prior policy course at full speed", involving rapid and large policy swings. However, with the intense prioritization of medium-term societal objectives over short-term economic costs experienced in 2021, we may fear that an excessively gradual policy easing could continue to lag macro deterioration in early 2022. **From this**

perspective, the combination of a front-loading of public investments and recent quicker moves on the monetary side [2] may signal a drastic – and welcomed - acceleration in aggregated macro stimulus.

The risks however remains two-fold: First, a scale-back of those measures as soon as China's GDP growth might have stabilized at or slightly above 5%, the likely official objective for 2022; Second, Chinese equities markets might only partially reap the benefits from this macro reflation if, at the same time, the regulatory stance remains excessively tight. In the housing market, authorities continue to leave the burden of the restructuration on the shoulders of share/bondholders of property developers. In the social media/e-commerce industries, the official stance against the "excessive" profits and other social negative externalities has so far shown no sign of easing - quite the contrary - potentially weighting further on long-term earnings growth assumptions for the sector. **The baseline assumed for 2022 is that policies will ease strongly and rapidly enough to allow China's growth to re-accelerate above 5% and to contain the systemic implications of the property meltdown, but with little/none positive surplus for the rest of the world, and especially commodities markets, unlike the situation that prevailed in 2008-2009.**

Bottom line: Even before the extremely rapid spread of Omicron, global business conditions were expecting significant headwinds in 2022. Real interest rates are still at very negative levels, solid households' balance sheets combined with the prospects of further progress in labour markets, should nevertheless allow global GDP to expand at a pace above or close to potential for most of 2022. However, those factors of resilience also mirror the extreme vulnerability of the current equilibrium to an excessive tightening of financial conditions by central banks, which – if materialized – would awaken fears of a premature recession by early-mid 2023 among investors.

How fast and how far could some Western central banks – and especially the Fed, tighten financial conditions, before colliding with investors' vision of what the global economy could reasonably absorb? We see the answer to this second key question dependent on two main parameters. First, the level and length of noise/stickiness in abnormal fluctuations induced by Omicron and future variants; second, **the gap in perceptions between investors and central banks about the growth and inflation regimes and equilibrium level of interest rates.**

We will never repeat enough how Delta had been a game changer in 2021 regarding the pandemic-exit scenario most observers (including us) had in late 2020. This variant has shifted the scenario of the end of the pandemic from a linear sequence (vaccines' progressive rollout, global immunity, virus eradication, end of extraordinary economic distortions) to a circular one, **where disturbances will repeat at a rather short frequency - even if milder over time - blurring the perception between "transitory" and structural developments**. This last observation applies especially to the current and future inflation dynamic.

For the time being, markets have bet on a lower hospitalization and fatality rates from Omicron to support a year-end rally that pushed market indices above (the US) or close to (Europe) their historical records. **There are some good reasons for share this optimism**. First, preliminary studies in South Africa, the UK and more recently the US seem to confirm the idea of milder symptoms (from -50% to -80% versus Delta), and lower and shorter hospitalization admissions. Second, while Omicron's level of immunity evasion remains vague, it seems at least that boosters of most existing vaccines continue to provide adequate protection. More importantly, public health policies have learnt in 2020-2021 how to adapt social restrictions to minimize economic disruptions, at least in countries following a "live with the virus" strategy.

It would be a mistake to prematurely rule out any significant interference from this new variant with the economic and financial developments foreseen for 2022. It is worth reminding that the contamination level of a virus is, by far, the most important factor to assess its threat's level for health systems. With daily new cases recently reaching levels three to five times higher than the maximum observed at the peak of the Delta variant in many European countries and the US, there is little doubt the Omicron variant is spreading much faster. Under the current pace of contaminations, it would require Omicron being 80% less lethal than Delta as well as measures reducing social interactions by 10% to 20% to keep pressures on ICUs at manageable levels.

No surprise, then, that many governments resumed with social distancing measures in the last days of 2021. **In the West, mask-wearing mandates, vaccine passports and limitations to public gatherings, frequently completed by restrictive conditions to in- and out-bound travels, have so far formed the bulk of health policies' responses**. This mix may weight somewhat on demand, especially in the service sectors while absenteeism due to illness or contact cases status may reduce further labour force participation, potentially worsening labour shortage issues in countries such as the US. As the extremely rapid spread of the variant suggests its wave's peak could be reached much faster (maybe as soon as the second part of January for the US and many European countries), the resulting losses in revenues/production might be lower/shorter than during previous waves. The subsequent catch-up growth at work once the Omicron tide would recede might also be softer. **Overall, the fluctuations in production/consumption in Western economies could be milder than the ones experienced with previous pandemic tides.**

[2] RRR cut in early December followed by the symbolic but quite unexpected cut in the 1-year Loan Prime rate on December 20, opening the way to a likely rapid cut in the medium-term lending facility.

However, based on what Delta taught us, this might be out of Asia that the disruptions could be the most detrimental to a scenario in which global growth and inflation would have returned "smoothly" to their structural trends within the next few months. Last summer, Delta had triggered serious chaos in global supply chains, with large outbreaks in key manufacturing exporters of IC components (Indonesia, Vietnam, Thailand and, of course, China). Combined with the bottlenecks in energy markets and shipping lines, those disruptions had played a key role not only in the additional contraction in autos' production and sales in the US and Europe, but also in pushing producer and consumer prices even higher, postponing the expected reversal in US, UK and Euro CPI figures by a few months. They started to reverse in November (lower level of congestion in US ports, stronger exports of semi-conductors from South-Asian producers), **raising the probability that a reasonable scenario of extreme inflation reversal would materialize as soon as early 2022.**

For the time being, Omicron's spread in Asia seems very limited and uneven. There has been no new wave experienced in South or South East Asian countries. Vietnam, where Delta-induced cases had bottomed in late October, experienced a brutal spike in daily new cases from mid-November, with a very limited portion linked to the Omicron variant (which is rather worrisome). **China's situation is (again) the wild card**. Not in the absolute number of positive cases, which remains infinitesimal by international standards, but because **the multiplication of sporadic outbreaks combined with the authorities' zero-tolerance towards the virus, regardless its actual lethality, might propagate a succession of supply-shocks for both China's economy and the global manufacturing chain.**

So far, local and limited outbreaks have been more or less contained, at the usual cost of zero Covid-19 policies: Complete shutdown of Xian (capital of Shaanxi province, city of 13 million inhabitants, and place of one of the largest Samsung Electronics memory chip complex); tight mobility restrictions in 20+ districts from other provinces; full closure of flights and roads heading to Beijing from Ningbo (Zhejiang, third largest container port in the world); almost complete blockage of the trucks in-bound traffic at the Vietnam border... Given the high level of virulence of Omicron, in the context of a Chinese population with a rather low level of immunity, **the risk of seeing a systematization of those anecdotal experiences at a large scale is rising, and this under a very unfortunate timing**. The combination of the Lunar New Year festivities – scheduled for the first week of February, with the Winter Olympics in Beijing, indeed raises the fear of even tighter and prolonged restrictions, for most of the first quarter.

Should this risk scenario materialize, **Omicron would ultimately weight more on China's growth, pushing up costs further for Western importers and retailers than it would suppress demand in Western advanced economies**. The perfect storm would be a combination of Omicron and energy markets stressed by exacerbated geopolitical tensions in Eastern Europe. Global CPI that was expected to reverse from nearly 5% at the end of 2021 to close to 3% by mid-2022, before converging further towards 2% by year-end, may then be stuck around 4% for a little while longer. More fundamentally, this asymmetric impact on demand and supply in the West might force the hand of the Fed and convince it to definitively accelerate not only its quantitative tapering, but also the timing and pace of its Fed funds tightening cycle, as signaled during its December meeting.

When Jerome Powell conceded, during his testimony in the US Congress in early December, that it was time to drop the adjective "transitory" to characterize US inflation, many described this move as a complete capitulation at a time when consumer prices' "explosion" became a top political issue. Rather than the result of the observation that Covid-19 disruptions may last longer or a tactical move aiming at anchoring long-term inflation expectations at a level close to 2%, this shift in communication emerged as a reflection of a growing conviction, among many FOMC members, that the US economy could be characterized in the medium-term by higher inflation and wages regimes.

Current monetary conditions are still very accommodative, at least for the US economy, with real rates in deep negative territory. There is some space for the US Central bank to further tighten liquidity (keep in mind monetary growth has already substantially decelerated over 2021) and increase policy rates. **The question is more on how large is that space and how fast can the Fed fill it before choking growth and markets**. This is why the discussion about the diverging perceptions on the economic reality behind the "Covid-19-stage" matter so much. **Markets, and especially bond investors, might underestimate the willingness of the Fed to tighten quicker and further than expected to keep inflation and inflation expectations under control**, partially because they do not share the same view on how robust the US economy looks over a medium/long term horizon. **Reciprocally, US central bankers may overestimate their capacity to raise rates before breaching the level of the equilibrium interest rate (R*).**

There is no consensus about the precise measure of this equilibrium interest rate level, which in real terms is supposed to allow full employment with no inflation pressures, or alternatively to equalize savings with investments levels. **Most economists agree on the idea it has fallen to a very low level, with the most pessimistic seeing it as already negative** (as in Japan or Europe). Interestingly, the last time the Fed committed to the 'excessive' hike, which led to an equities market sell-off and a yield curve inversion (Fall 2018), real fed funds rates were almost exactly at zero. Could it be different this time and, if so, in favor of a higher (explicitly positive) or lower (explicitly negative) level of R*?

We will not repeat all the reasons why we do not believe in any significant regime changes induced by Covid-19[3]. **It does not mean the US and global economies did not experience**

[3] See for instance "Froth on the Daydream", Asia CIO Newsletter, July 8, 2021.

some "structural" mutations in the recent past, but most of them are the continuation of pre-existing trends and do not lean towards higher potential growth/higher inflation regimes, quite the contrary. A shrinking labour force, higher saving excess, prospects of a public spending detox cure over the next 2-3 years, and higher dependency on technology should continue to weight on US growth potential and long-term inflation regime. At the global level, re-organization of supply chains and the increasing decoupling between US and China (first in technology, today in the capital markets) as well as the ideological shift in Beijing that is likely to survive current reflation efforts should translate to lower growth spillover benefits for the world economy.

Those developments are hardly consistent with the view of a US real equilibrium rate higher than in late 2018. At best, it is still close to zero, at worst it has already moved towards the negative territory. If bond investors are right in expecting long-term inflation still close or slightly above 2%, the scope for policy rates tightening is somewhere between 6-8 hikes at best, versus 9 to 10 in the long-term median resulting from the FOMC dots chart in December. **This leaves enough room for the Fed to tighten 2 to 3 times in 2022 after ending its tapering by March**. Markets have so far aligned on this perspective, pushing the USD further, yields edging higher, with little volatility on the equities side. **Things could be radically different in the second part of 2022 if the FOMC were to signal an acceleration of its policy tightening by late 2022/early 2023, precisely when the global and US economy would start decelerating faster**. Under that risk scenario, the expected dynamic would look quite familiar: brutal sell-off in risky assets and inversion of the yield curve with UST 10 yield potentially converging toward 1%. Ultimately, with asset prices being the last line of defense for US households and corporates' balance sheet, **the Fed would have no alternative to signal a pause or even a reversal in its policy, a move that would open a more sustainable window of positive return for both equities and bonds.**

Bottom line: The main risk associated with Omicron would consist in blurring the lines further between transitory distortions induced by the pandemic and structural regime changes, making the Fed's task in 2022 even more complicated. There is some room for Fed policy tightening (and USD appreciation) but probably less than what policymakers think and communicate. A potential clash between the Fed's and investors perception by late 2022 would translate to a severe but short-lived market correction, paving the way for a policy reversal ultimately positive for both bonds and equities.

2022 shall be a year of complex overlaps between multiple risk factors, whose impact is extremely difficult to predict, **leading to an extremely wide range of possible outcomes.** Beyond the usual humility this exercise involves, **we suggest unscrambling those centrifugal forces along the following lines that would support our investment recommendations:**

1. Global growth should remain close or even slightly above long-term potential, in spite of a sharp deceleration relative to 2021 "extraordinary" pace. **Equities prices should progress further but returns would be capped by lower earnings expectations and overall weaker risk appetite**. Bond yields might rise in the first part of the year before declining again in the second half.
2. With milder and milder cyclical mini-cycles induced by Covid-19 variants, **the scope for value/cyclical outperformance should decrease further**. Progressively, secular-themed stocks (quality, asset-light and strong growth companies as well as large caps) should prevail over energy, financials, cyclicals and mid/small caps.
3. **Domestic economies would follow diverging trajectories, under contrasting macro policies, leading to higher currencies' volatility**. In the US, business conditions will have to absorb a very significant fiscal cliff and a rapid monetary tightening, **pushing the USD higher initially**. In contrast, China and Japan would be the two major economies trying to reflate, with the risk China's policy remains behind the curve in the initial months of the year.
4. The environment would remain difficult for most non-Asian emerging economies, forced to keep monetary conditions tight, at least during the first half of the year. Asian economies might benefit from a cyclical catch-up, potentially amplified by the new regional trade agreement. Provided China stabilizes its domestic situation, Asian credit markets should make a comeback.
5. **Omicron is a first wild card in this scenario**. If it strikes China and its zero Covid-19 policy, it may translate into a new round of global supply bottlenecks, delaying a reversal in global consumer inflation by a few more months. Persistently high energy costs, due to strong weather-related demand during the winter or extreme geopolitical confrontation in Eastern Europe, would entail similar consequences.
6. Potential additional supply-side shocks would make the task from central banks even more complicated. The Fed has some room to tighten but probably less than it communicates. A clash with the markets' perception should not be immediate but might come later in 2022 when growth would decelerate faster.

7. A policy mistake-induced sell-off in risky assets might be brutal but would remain probably short-lived, as the Fed will have to rapidly pause or even reverse its previous policy course. This would open a longer and more sustainable window of equities and credit performance.

8. Finally, we cannot rule out the definitive mutation of Covid-19 into a low-lethality endemic. Such a positive outcome would support a last and spectacular bout of value/cyclical rally and a re-steepening of the yield curves, but it would also translate to an even more aggressive monetary tightening, **with the Fed hitting the wall of a very low US equilibrium interest rate quicker**.

9. Investors who feel able to bear higher level of volatility over the next few months should **stick to secular-themed stocks (sustainability, asset-light business models, high quality brands, large caps...)**. Others should seek refuge in diversification, including in long-duration bonds, **while accumulating cautiously equities from economies likely to reflate and de-correlate in 2022 (China and to some degree Japan) at the expense of the ones tightening their financial conditions (US).**

Jean-Louis Nakamura
Chief Investment Officer for Asia-Pacific
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Rue de la Corraterie 11 · 1204 Genève · Suisse
geneva@lombardodier.com
Lombard Odier Asset Management (Switzerland) SA
Avenue des Morgines 6 · 1213 Petit-Lancy · Suisse
Support-Client-LOIM@lombardodier.com
Management Company regulated by the FINMA.

FRIBOURG
Banque Lombard Odier & Cie SA · Bureau de Fribourg[1]
Rue de la Banque 3 · 1700 Fribourg · Suisse
fribourg@lombardodier.com

LAUSANNE
Bank Lombard Odier & Co Ltd[1]
Place St-François 11 · 1003 Lausanne · Suisse
lausanne@lombardodier.com

VEVEY
Banque Lombard Odier & Cie SA · Agence de Vevey[1]
Rue Jean-Jacques Rousseau 5 · 1800 Vevey · Suisse
vevey@lombardodier.com

ZURICH
Bank Lombard Odier & Co Ltd[1]
Utoschloss · Utoquai 29-31 · 8008 Zürich · Schweiz
zurich@lombardodier.com

EUROPE

BRUSSELS
Lombard Odier (Europe) S.A. Luxembourg · Belgium branch[2]
Avenue Louise 81 · Box 12 · 1050 Brussels · Belgium
brussels@lombardodier.com
Credit institution supervised in Belgium by the National Bank of Belgium (NBB) and the Financial Services and Markets Authority (FSMA).

LONDON
Lombard Odier (Europe) S.A.· UK Branch[2]
Queensberry House · 3 Old Burlington Street · London W1S 3AB · United Kingdom ·
london@lombardodier.com
The Bank is deemed authorised in the UK by the Prudential Regulation Authority ('PRA'). Subject to regulation by the Financial Conduct Authority ('FCA') and limited regulation by the Prudential Regulation Authority. Financial Services Firm Reference Number 597896. Details about the extent of our authorisation and regulation by the Prudential Regulation Authority and regulation by the Financial Conduct Authority are available from us on request.
Lombard Odier Asset Management (Europe) Limited
Queensberry House · 3 Old Burlington Street · London W1S 3AB · United Kingdom ·
london@lombardodier.com
Investment firm authorised and regulated by the Financial Conduct Authority (FCA register No.515393).

LUXEMBOURG
Lombard Odier (Europe) S.A.
291, route d'Arlon · 1150 · Luxembourg · Luxembourg
luxembourg@lombardodier.com
Credit institution authorised and regulated by the Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg.
Lombard Odier Funds (Europe) S.A.
291, route d'Arlon · 1150 · Luxembourg · Luxembourg
luxembourg@lombardodier.com

MADRID
Lombard Odier (Europe) S.A. · Sucursal en España[2]
Paseo de la Castellana 66 · 4ª Pl. · 28046 Madrid · España · madrid@lombardodier.com
Credit institution supervised in Spain, by the Banco de España and the Comisión Nacional del Mercado de Valores (CNMV).
Lombard Odier Gestión (España) S.G.I.I.C, S.A.U.
Paseo de la Castellana 66, 4ª Pl. · 28046 Madrid · España · madrid@lombardodier.com
Management Company supervised by the Comisión Nacional del Mercado de Valores (CNMV).

MILAN
Lombard Odier (Europe) S.A. · Succursale in Italia[2]
Via Santa Margherita 6 · 20121 Milano · Italia
milano-cp@lombardodier.com
Credit institution supervised in Italy by the Commissione Nazionale per le Società e la Borsa (CONSOB) and la Banca d'Italia.

MOSCOW
Bank Lombard Odier & Co Ltd · Representative Office Moscow
Letnikovskaya st.2, bld.1 · 115114 Moscow · Russian Federation · moscow@lombardodier.com
Under the supervisory authority of the Central Bank of the Russian Federation.

PARIS
Lombard Odier (Europe) S.A. · Succursale en France[2]
8, rue Royale · 75008 Paris · France. RCS PARIS B 803 905 157 · paris@lombardodier.com
Credit institution supervised in France by the Autorité de contrôle prudentiel et de résolution (ACPR) and by the Autorité des Marchés Financiers (AMF) in respect of its investment services activities. Business permit No.23/12. Registered in Luxembourg - No.B169 907. Insurance intermediary authorised by the Commissariat aux Assurances (CAA) No.2014 CM002. The registration with the CAA can be verified at www.orias.fr.

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ABU-DHABI
Bank Lombard Odier & Co Ltd · Abu Dhabi Global Market Branch
Al Maryah Island · Abu Dhabi Global Market Square · Al Khatem Tower · 8th floor · P.O. Box 764646 · Abu Dhabi · UAE · abudhabi@lombardodier.com
Arranging Deals in Investments · Advising on Investment or Credit · Arranging Credit. Regulated by the ADGM Financial Services Regulatory Authority.

BERMUDA
Lombard Odier Trust (Bermuda) Limited
3rd Floor, Victoria Place · 31 Victoria Street · Hamilton HM 10 · Bermuda · bermuda@lombardodier.com
Licensed to conduct Trust, Investment and Corporate Service Provider Business by the Bermuda Monetary Authority.

BRASIL
Lombard Odier (Brasil) Consultoria de Valores Mobiliários Ltda.
Avenida 9 de Julho No. 3624, Torre DGN 360, 6° andar Jardim Paulista · CEP 01406-000 · São Paulo · Brasil
sao.paulo.office@lombardodier.com
Supervised by the Comissão de Valores Mobiliários of Brasil.

DUBAI
Bank Lombard Odier & Co Ltd · Representative Office Dubai
Conrad Business Tower · 12th Floor · Sheikh Zayed Road · P.O. Box 212240 · Dubai · UAE ·
dubai@lombardodier.com
Under the supervisory authority of the Central Bank of the UAE.

ISRAEL
Israel Representative Office · Bank Lombard Odier & Co Ltd
Alrov Tower 11th floor · 46 Rothschild Blvd. · Tel Aviv 6688312 · Israel · telaviv@lombardodier.com
Not supervised by the Supervisor of Banks in the Bank of Israel, but by Swiss Financial Market Supervisory Authority which supervises the activities of Bank Lombard Odier & Co Ltd.

JOHANNESBURG
South Africa Representative Office · Bank Lombard Odier & Co Ltd
4 Sandown Valley Crescent · Sandton · Johannesburg 2196 · South Africa · johannesburg@lombardodier.com
Authorised financial services provider Registration number 48505.

MONTEVIDEO
Lombard Odier (Uruguay) SA
Luis Alberto de Herrera · Torre 2 · Oficina 2305
11300 Montevideo · Uruguay
montevideo@lombardodier.com
Supervised by Banco Central del Uruguay.

NASSAU
Lombard Odier & Cie (Bahamas) Limited
Lyford Cay House · Western Road · P.O. Box N-4938 · Nassau · Bahamas · nassau@lombardodier.com
Supervised by the Central Bank of the Bahamas and the Securities Commission of the Bahamas.

PANAMA
Lombard Odier & Cie (Bahamas) Limited · Representative Office in Panama
Oceania Business Plaza Torre 2000 · Oficina 38-D · Blvd. Pacifica · Urb. Punta Pacifica · Corregimiento de San Francisco · Panamá · panama@lombardodier.com
Supervised by the Central Bank of the Bahamas and the Superintendencia de Bancos de Panamá.
Lombard Odier (Panama) Inc.
Oceania Business Plaza Torre 2000 · Oficina 38-D · Blvd. Pacifica · Urb. Punta Pacifica · Corregimiento de San Francisco · Panamá · panama@lombardodier.com
Supervised by the Superintendencia del Mercado de valores de Panamá. Licensed to operate as an Investment Adviser. Res. SMV No.528-2013.

ASIA - PACIFIC

HONG KONG
Lombard Odier (Hong Kong) Limited
1601, Two Exchange Square · 8 Connaught Place · Central · Hong Kong · hongkong@lombardodier.com
A licensed entity regulated and supervised by the Securities and Futures Commission in Hong Kong.

SINGAPORE
Lombard Odier (Singapore) Ltd.
9 Raffles Place · Republic Plaza #46-02 · Singapore 048619 · singapore@lombardodier.com
A merchant bank regulated and supervised by the Monetary Authority of Singapore.

TOKYO
Lombard Odier Trust (Japan) Limited
Izumi Garden Tower 41F · 1-6-1 Roppongi, Minato-ku · Tokyo 106-6041 · Japan · tokyo@lombardodier.com
Regulated and supervised by the Financial Services Agency (FSA) in Japan. It holds a trust business license (FSA No.208) and is registered with Kanto Local Finance Bureau for Financial Instruments Business Operator (No.470).

[1] *Private bank and securities firm authorised and regulated by the Swiss Financial Market Supervisory Authority (FINMA).*

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