Rothschild & Co
Wealth Management

Consensus Outlooks 2022

Mid-year update

Investment and Portfolio Advisory
June 2022

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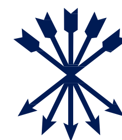


Street View – The Big Picture

A higher, later peak in inflation, China's battle with Covid and the war in Ukraine have shifted the global outlook

What was expected for 2022 in Dec 2021?

- At the end of 2021, consensus expected macro and policy considerations to return to the forefront of investor decision-making, with Covid apprehensions and geopolitics expected to recede from headlines and investor concerns. In politics, only the French elections were cited as a risk.
- Consensus expected the Fed to focus primarily on its goal of full employment, not inflation. Inflation was anticipated to retreat with normalising energy prices and easing supply chain bottlenecks. Consensus predicted that unemployment in the US and Europe would continue to fall.
- Three Fed rate hikes were predicted for 2022, and none for the ECB. Real yields were expected to rise but remain negative in the US and Europe.
- Consensus favoured equities over other liquid assets classes for 2022, with a preference for European and Japanese stock markets over the US.

How has the outlook changed?

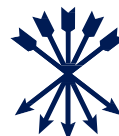
- Russia's invasion of Ukraine shifted the global geopolitical and economic outlook in February 2022.
- The war has exacerbated supply and demand challenges in an already tight commodity market, increasing energy and commodity prices by up to 40% since the start of the year, and pushing inflation to multi-decade highs in the US and Europe.
- Persistently high inflation in H1 2022 has forced the Fed into a faster, sharper rate hiking cycle than was previously expected, prompting fears of recession and stagflation.
- China has closed down large cities, including the world's largest port, Shanghai, in adherence with the country's strict zero Covid policy, further straining fragile global supply chains and the country's growth prospects.

What does consensus expect now for 2022?

- Consensus gives a 25%-35% probability to a global recession in the next 12 months.
- The US is predicted to experience a milder slowdown than Europe. Consensus expects both US and EU 2022 real GDP growth to be 2.7% (vs. respectively 3.9% and 4.2% at the end of 2021).
- Inflation is expected to remain above trend, with lower contribution from energy but higher costs of labour and services adding upward pressure.
- Equities continue to be favoured over other assets for the remainder of 2022, with a regional preference for the US, China and Japan over Europe and a preference for dividend sectors over growth sectors. Investors should focus more on margins than on growth going forward.
- In rates, 10-year yields in the US and Europe should move modestly higher from current levels, with real yields also slightly rising as inflation moderates. Despite the bond sell-off in H1 2022, bond valuations remain unattractive.
- Brokers point to a pickup in global demand for cyclical commodities in H2 2022, especially from China. This should continue support oil, as inventory levels are at multi-year lows, spare capacity is low and falling, and investment remains low.
- Gold faces a muted outlook in the face of rising real yields and a strong US dollar.
- After a very strong H1 for the USD, the horizon for a high USD has lengthened and brokers extend their bullish outlooks.
- The EUR's path will depend on the speed of monetary tightening in Europe in H2 and the ECB's ability to curb inflation whilst continuing to support the European economy through the Ukraine crisis.
- In Japan, brokers expect limited moves in the JPY as long as the Bank of Japan does not change its policy of yield curve control.

Past performance is not indicative of future performance and the value of investments and income from them can fall as well as rise

Street View – United States



Inflation normalisation will determine how H2 2022 will unfold

Macro View

- End-2021, consensus expected the US economy to absorb the Fed's shift toward monetary policy tightening comfortably, supported by strong US growth (2022 consensus end-21 at 3.9%), normalizing inflation (towards 2-4%), healthy consumers and strong corporate earnings.
- Since then, while most of these catalysts remain favorable, the two major downside risks mentioned in late 2021's outlook have unfolded: first, heightened geopolitical risk with the Ukraine conflict exacerbating inflation pressure (food and energy). Second, China's zero Covid policy puts further pressure on supply chains and the global economy.
- As a result, inflation has stayed elevated longer than expected not only prompting the Fed to act faster than anticipated, but also questioning consumers' spending capacity.
- Markets are now faced with higher economic and earnings uncertainty, leading brokers to lower US growth estimates for 2022 to 2.7% while the 12-month average recession risk has increased to around 30% (from 10% end-2021).
- While some brokers are also questioning the Fed's ability to achieve a "soft landing" to support a market rebound, many remain constructive on US equities for H2 2022 relative to other US asset classes.

Asset Allocation	-	Neutral	+
Government Bonds	✳ GS JPM	MS	
Credit	✳ GS JPM MS		
Equities	MS	✳ GS	JPM

JPM: J.P. Morgan, **GS:** Goldman Sachs, **MS:** Morgan Stanley,
✳ : Rothschild & Co

Reading key

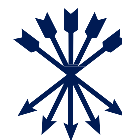
Material underweight	-
Benchmark weight	Neutral
Material overweight	+

Rates & Credit

- 2021 consensus was for the Fed to start hiking interest rates in H2 (3 hikes in total for 2022). Brokers generally expected US 10-year yields to move modestly higher to settle at 2%-2.25% by year-end.
- Brokers entered the year underweight fixed income but were caught by surprise by the Fed's early hawkish turn and shift towards "non-transitory" inflation.
- Not only did the Fed undertake a first hike in Q1 2022, they also announced the start of balance sheet normalisation. The US 10-year yield hit 3% as early as May 2022 (vs. 1.5% in January 2022).
- In the credit space, the majority of brokers expected a modest widening in 2022. While the widening has been more pronounced than anticipated, most of the pressure can be linked to rates and duration versus deterioration of credit fundamentals.
- For the rest of the year, the picture is more mixed. While consensus remains generally underweight the asset class, one broker started to increase allocation to corporate bonds, favouring high yield due to low default rates and reducing government bonds, while another moved up in quality favouring investment grade over high yield.

Equities

- End-2021, consensus favoured equities versus other asset classes with expectation for real rates to rise but to remain negative. Equities were to be supported by elevated household cash balances, a strong labour market and robust corporate profits as well as easing supply bottlenecks, with average upside of 5-10%.
- Geopolitical tensions, continued China lockdowns and higher rates (real rates are now in positive territory) pressured equity markets. While Q1 2022 earnings were better than expected, some companies started reducing their guidance due to sustained input and labour cost pressure. S&P 500 2022 P/E derated from 22x to 17x (just below 10yr average).
- For H2 2022, views are mixed with many brokers having reviewed their S&P 500 target downwards by an average of 10% since the beginning of the year due to slower growth and higher interest rates. Consensus expects volatility to remain high over the next months.
- Style preferences are mixed with one broker favouring defensive stocks as they see further derating in the broader market from here. Another prefers cyclicals as they believe many of the factors supporting the equity market at the beginning of the year are still alive (supportive labour, robust corporate profits, strong consumers). Yet another broker advocated a barbell approach and sees limited upside (+10%) into year-end.
- Consensus agrees that a stabilisation in US monetary policy will drive a rebound in growth stocks.



Street View – Europe

Inflation and geopolitical risk on the forefront

Macro View

- At the end of 2021, consensus predicted low rates, a robust pandemic recovery and cheap valuations versus the US to provide support to the European economy and equity market for 2022. Consensus did not expect the ECB to raise rates this year.
- Since then, Europe is facing the same macroeconomic challenges as the US, intensified by geopolitical risk. The war in Ukraine has highlighted Europe's dependency on Russian fossil fuels and Ukrainian food staples (wheat, oilseeds).
- As a result, inflation is at multi-decade highs, affecting both the household component of European inflation figures with consumer prices escalating and discretionary spending on goods weakening, and also the production component, with pressure on input costs on the supply side. The ECB is now expected to increase rates in July and to conclude its Asset Purchase Programme (APP) in the third quarter.

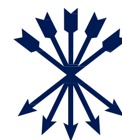
Asset Allocation	-	Neutral	+
Government Bonds	GS JPM MS		
Credit	GS JPM MS		
Equities		MS	JPM GS

Rates & Credit

- 2022 consensus was for the ECB to keep its accommodative monetary policy, with a slow withdrawal of economic stimulus and interest rate hikes not planned until 2023. In credit, consensus predicted spreads to remain stable.
- So far this year, yields have risen sharply (from -0.5% to +1% for the 10-year German Bund) with adverse external shocks putting upward pressure on inflation. Russia's invasion of Ukraine has exacerbated an ongoing energy crisis, whilst lockdowns in China have further disrupted supply chains. Bonds sold off across the European market, with outflows of more than €10bn in investment grade and €5bn in high yield. The environment is expected to remain challenging with investors favouring asset classes with more inflation protection (equities).
- For H2 2022, expectations for euro credit remain weak since broader risk markets are volatile. To have a more positive view on the asset class, analysts would need to see improvements in macro risks.

Equities

- End-2021, consensus favoured equities versus other asset classes with expectation for real rates to rise but to remain negative. Fading pandemic one-offs (energy price pressures, supply bottlenecks) and accommodative monetary policy, together with inflation falling back below target, were the snapshot for equities with brokers forecasting upside potential around +10%.
- Today, the outlook has changed significantly. Even though companies have reported strong Q1 earnings with 70% beating estimates on sales and 30% on sales and earnings per share; rising and persistent inflation, geopolitical concerns and expected monetary policy tightening have driven the asset class' performance negatively YTD (double digit losses for the Euro Stoxx 50).
- Brokers remain slightly positive on the asset class favoring tactical plays on defensive names, the energy sector, high-dividend stocks, and value vs growth strategies. Major risks for equities include further escalation of conflict, gradual deterioration in economic activity and slowing earnings. On the upside, European equities would be supported by a de-escalation of conflict, a change in China's zero Covid policy and a decline in inflation, which would allow the ECB to tighten monetary policy gradually.



Street View – Commodities & FX

Continued robust momentum for commodities despite a strong USD

Commodity View

- Consensus remains overweight commodities, favouring energy over metals. Drivers for continued strong performance of the energy sector include multiple supply and demand elements. Reduced Russian oil production and exports following European and US sanctions, low inventories, falling levels of spare capacity, and still low levels of investment create supply tightness. A pickup in demand from China when Covid restrictions are lifted, seasonal demand increases from international travel over the summer, and continued investments in energy transition and green infrastructure projects support demand.
- The gold outlook is mixed for H2 2022. Rising real rates and a strong USD are negative for gold. If geopolitical tensions ease, inflation risk moderates and "risk-on" investor sentiment returns, brokers predict a slowdown in gold demand, and possibly some outflows. If recession fears persist and inflation remains elevated, investment and retail demand for gold will likely remain strong. A weaker USD would also support Central Bank demand for gold, especially in Emerging Markets.

FX View

- Brokers started the year with a two-halves view on the USD (a strong H1 and a more muted H2) based on Fed leadership in raising rates. Today, the horizon for a stronger USD has lengthened and brokers extend their bullish outlooks. The greenback tends to outperform in times of turbulence, so brokers are adding USD exposure as they turn more defensive.
- Concerns over the global economy, divergence in monetary policy and safe-haven flows have added to USD performance.
- High valuation remains the only negative point cited by brokers for the USD. However, these valuation concerns do not prevent consensus from making bullish tactical calls and, for instance, forecasting a EURUSD close to parity by the end of the year. Only a de-escalation in Ukraine, a peak in inflation and a return of growth forces would turn the tide and allow some USD depreciation.
- Beyond the USD, the Japanese Yen passed a 20-year low bar of USDJPY130 and brokers expect limited moves as long as the Bank of Japan does not change its policy of yield curve control.
- Finally, the EUR's path will depend on two opposing challenges for the ECB in the face of high inflation: on the one hand, having to raise rates to slow inflation and currency depreciation, and on the other, supporting a European economy already negatively impacted by a war on its territory.

Commodity Forecasts

WTI	Old	New
J.P Morgan	$86.00	$98.00
Goldman Sachs	$78.25	$119.00
Morgan Stanley	-	-

Brent	Old	New
J.P Morgan	$90.00	$101.00
Goldman Sachs	$81.25	$125.00
Morgan Stanley	$85.00	$120.00

Gold	Old	New
J.P Morgan	$1,520	$1,720
Goldman Sachs	$2,000	$2,500
Morgan Stanley	$1,560	$1,700*

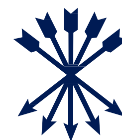
Old Targets as of December 2021, New Targets as of May 2022. Goldman Sachs' 6 month forecast to match Dec'22, *forecast for Q2 2023
Spot prices as of close **27.05.2022: WTI $115.07, Brent $119.43, Gold $1,853.72**

FX Forecasts

Old Target	EUR/USD	GBP/USD	USD/CHF	USD/JPY
J.P Morgan	1.01	1.32	0.92	116
Goldman Sachs	1.18	1.37	0.92	111
Morgan Stanley	1.18	1.38	0.93	113

New Target	EUR/USD	GBP/USD	USD/CHF	USD/JPY
J.P Morgan	1.01	1.15	1.00	132
Goldman Sachs	1.10	1.22	0.91	126
Morgan Stanley	1.05	1.24	0.98	132

Old Targets as of December 2021, New Targets as of May 2022. Goldman Sachs' 6 month forecast to match Dec'22,
Spot prices as of close **27.05.2022: EUR/USD 1.07, GBP/USD 1.26, USD/CHF 0.96, USD/JPY 127**



Forecasts for the end of 2022

United States

Current allocation	-	Neutral	+
Government Bonds	✳ GS JPM	MS	
Credit	✳ GS JPM MS		
Equities	MS	✳ GS	JPM

Forecasts	Rates – UST 10 Year		Equity – S&P 500	
	Old	New	Old	New
J.P Morgan	2.25%	3.20%	5,050	4,900
Goldman Sachs	2.00%	3.30%	5,100	4,300
Morgan Stanley	2.10%	3.00%	4,400	3,900*

Old target as of December 2021 for end-2022, new target as of May 2022 for end-2022,
*Morgan Stanley target for Q2 2023
S&P 500 level as of close 27.05.2022: **4,158**

Sector allocation	-	Neutral	+
Consumer Disc.	MS	GS JPM	✳
Consumer Stap.	GS JPM	✳ MS	
Energy	✳	MS	GS JPM
Financials		✳ MS GS	JPM
Real Estate	✳ JPM	GS	MS
Health Care			✳ GS JPM MS
Industrials		✳ GS JPM MS	
Technology	MS	JPM	✳ GS
Materials		GS JPM MS	✳
Communication	GS	✳ JPM MS	
Utilities	✳ JPM GS		MS

Europe

Current allocation	-	Neutral	+
Government Bonds	✳ GS JPM MS		
Credit	✳ GS JPM MS		
Equities		✳ MS	JPM GS

Forecasts	Rates – Bund 10 Year		Equity – EU Indices	
	Old	New	Old	New
J.P Morgan	0.10%	0.75%	307	275
Goldman Sachs	0.30%	1.25%	530	460
Morgan Stanley	0.00%	1.35%	2,080	1,760

Old target as of December 2021 for end-2022, new target as of May 2022 for end-2022,
Spot prices as of close **27.05.2022**
J.P. Morgan uses MSCI EMU Local Index, spot price = **243**
Goldman Sachs uses STOXX Europe 600 Index. Spot price = **444**
Morgan Stanley uses MSCI Europe Local Index. Spot price = **1780**

Sector allocation	-	Neutral	+
Consumer Disc.	GS	✳ JPM GS	
Consumer Stap.	GS JPM MS	✳	
Energy	✳		GS JPM MS
Financials	✳	MS	GS JPM
Real Estate	✳ JPM	MS	GS
Health Care	JPM		✳ GS MS
Industrials		✳ GS MS	JPM
Technology	MS	JPM	✳ GS
Materials		MS	✳ GS JPM
Communication	GS	✳	JPM MS
Utilities	✳	GS JPM	MS

JPM: J.P. Morgan, **GS:** Goldman Sachs, **MS:** Morgan Stanley, ✳ : Rothschild & Co

Reading key	
Material underweight	-
Benchmark weight	Neutral
Material overweight	+

Notes and terminology

FED = Federal Reserve
ECB = European Central Bank
OPEC = Organization of the Petroleum Exporting Countries
EM = Emerging Markets
DM = Developed Markets
EPS = Earnings per Share
GFC = Global Financial Crisis
QE = Quantitative Easing
ESG = Environmental, Social and Governance
PEPP = Post Pandemic Purchasing Program
APP = Asset Purchase Programme

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Note: We select, when available, the closest target to the end of 2022, depending on the counterparty (stated as *end of 2022, 4Q2022, 6-month forecast* or, alternatively, *2H2022*). Forecasts might be changed by counterparties depending on market circumstances

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