

April 2022

## Interest rates & bonds

Rates go parabolic

### USA

- US 2-year Treasury yields skyrocketed as they climbed almost 90 basis points (bps) in March. The spread to the 10-year point inverted for the first time since 2019.
- Although the US Federal Reserve delivered a cautious 25 bps hike in March, subsequent speakers became ever more hawkish, calling for more hikes including 50 bps step-ups at some of the upcoming meetings.

### Eurozone

- Despite the war in Ukraine and the associated negative effects on the European economy, inflation is in the driving seat as seen by the sharp increase in the yield curve. The short end advanced almost 70 bps while the 30-year yield increased 56 bps.
- With the pandemic purchase programme about to end and the APP (asset purchase programme) set to wind down over the next few months, rate hikes were again priced into the market as the ECB needs to rein in inflation.

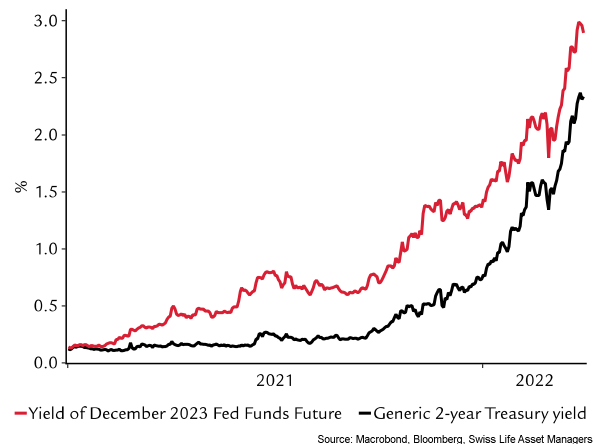
### UK

- While UK rates also increased, the range was a more modest 20-30 bps across the curve.
- The Bank of England delivered another 25 bps policy rate hike in March as prices continue to surge.

### Switzerland

- In solidarity with European rates, Swiss government bond yields also increased by around 40 bps across the curve.
- While the latest consumer price inflation numbers in Switzerland were a relatively modest 2.2%, a sharp contrast to global peers, production and import prices continued to accelerate and now stand at 5.8%.

### USA: bond yields surge amid rising rate hike expectations



Rates have gone parabolic amid surging inflation and central banks that have shifted their views on inflation from a transitory problem to fighting it however they can. Just six months ago the market priced in only two rate hikes by the Federal Reserve until the end of 2023 despite ever-increasing inflation numbers. Fast forward to today and the market sees 12 hikes (by 25 bps each) and attaches a 70% probability of a 50 bps increase in May. So far, the credit market has taken it surprisingly well although we view the latest tightening of credit spreads as a more technical-driven recovery of corporate bonds. The macroeconomic backdrop has been deteriorating for some time, and the ongoing high inflation paired with rapidly tightening financial conditions will continue to squeeze consumers and corporate profits. With central banks also withdrawing stimulus and thus the backstop for credit markets deteriorating, we expect spread volatility to remain elevated and see higher credit spreads going forward. In addition, we still see elevated risk on the geopolitical front, which is why we prefer a defensive positioning. On duration we have become more neutral on USD rates given already elevated expectations, but still see higher government bond yields in Europe.

## Equities

Equities rebounded in March

### USA

- In March, the US market gained 5.1%. The year-to-date performance is -4.1%.
- The US market outperformed other markets in March as the US economy is much less affected by the war in Ukraine and the sanctions against Russia, especially compared to Continental Europe.
- The US market remains far more expensive than the other markets. However, the forward price-to-earnings ratio declined from 24 in March 2021 to currently around 20.

### Eurozone

- The Eurozone equity market gained 0.6% in March and has lost 8.1% so far in 2022.
- Due to the Ukraine war, the Eurozone is once again the weakest main market, and the outperformance from earlier this year has reversed. The economic impact of the war and the sanctions are yet to be fully understood and felt in the Eurozone.
- The valuation looks quite attractive, the forward price-to-earnings ratio is around 14, and the dividend yield is 2.8%. Remarkably, earnings and revenue growth estimates have increased since the start of the year.

### UK

- After several weak years, the UK market is outperforming its peers this year. It gained 2.9% in March and 5.3% since the beginning of the year. It is the only major market in positive territory.
- The UK market still has the lowest valuation of the major developed markets.

### Switzerland

- The market gained 3.2% in March but has lost 4.8% since the start of the year.
- In terms of valuation, the Swiss market is the second most expensive. Its current forward price-to-earnings ratio is 19, and the dividend yield is 2.4%.

### Emerging markets

- Emerging market equities have had a performance of -5.7% since the start of the year, underperforming developed markets by 1.7%. In March, the performance was -4.2%.
- The valuation is attractive, and the Chinese authorities have announced several measures that should support the equity market (China represents 32% of the MSCI Emerging Markets Index).

### Eurozone: more earnings downgrades than upgrades



Over the past few months, forecasts for economic growth were adjusted downwards while inflation forecasts were adjusted upwards. At the same time, equities corrected, market estimates for future central bank rates increased, and the war in the Ukraine has been factored into market expectations. Earnings forecasts and revisions have mirrored these developments only partially. At the end of last year, 2022 earnings for the US and European markets were expected to grow by 9.2% and 7.7%, respectively, while expectations for 2022 revenue growth were 7.3% in the US and 5.0% in the Eurozone. Currently, the market consensus for 2022 earnings growth is 10.9% in the US and 14.5% in the Eurozone, i.e. earnings growth expectations are now higher than at the end of last year. The earnings revision ratio (upgrades minus downgrades divided by total number of rating changes), however, has declined substantially and turned negative in March (see chart). This suggests that earnings expectations might be revised downward in the coming months.

If company earnings manage to grow this year, there is still potential for equity markets to end the year in positive territory. From current levels, this would imply returns of 5-15% for the remainder of the year. However, the Ukraine war and spiralling inflation remain major risks which call for caution and point to a high likelihood of declining earnings expectations. We feel that markets have become a bit too optimistic in that regard. On the other hand, valuations have, as we outlined in detail last month, come down markedly and are now around historical averages for most markets. We remain constructive on equities, but we are cautious in the short term due to the war in Ukraine.

## Currencies

### Moving to a neutral view on USD

#### USA

- The risk sentiment on the financial markets deteriorated in the first week of March due to developments in the Ukraine war, supporting the USD. As risk sentiment improved somewhat in the following weeks, reflected by a remarkable improvement on the US equity market, the USD stabilised for the rest of the month.
- We decided to move from a positive to a neutral view on the USD against the EUR, GBP and JPY. Interest rate differentials are still supportive of the greenback, but we think that expectations regarding US monetary policy tightening may have gone a bit too far.

#### Eurozone

- After the initial correction at the beginning of March, EUR/USD recovered and ended the month almost unchanged.
- With inflation surging in the Eurozone, we have brought forward our expectation for ECB policy rate hikes from early 2023 to the fourth quarter of this year. Contrary to the US, we also see further upside potential for long-term bond yields. This should limit the downside on EUR/USD despite elevated risks emanating from the Ukraine war. We have thus changed our view on EUR/USD from negative to neutral for the next three months.

#### UK

- GBP/USD weakened in March as the Bank of England surprisingly moved to a less hawkish tone.
- We have a neutral view on both GBP/USD and GBP/EUR for the next three months.

#### Switzerland

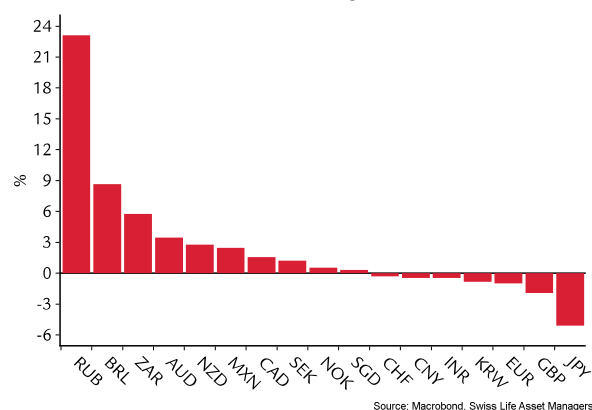
- EUR/CHF briefly touched parity on 7 March but subsequently recovered and stabilised in the 1.02-1.04 range.
- As the CHF is likely to remain a sought-after currency in the current geopolitical environment, we have a negative three-month view on EUR/CHF.

#### Japan

- USD/JPY gained 6% in the month of March, reaching the highest level since early 2016.
- At these elevated levels, we have moved from a positive to a neutral view on USD/JPY.

### Yen loses most in March, rouble with spectacular rebound

Performance of selected currencies against USD in March 2022



The month of March brought a surprising pattern in FX markets. The Russian rouble staged a spectacular rebound after the currency sold off in the wake of Russia's invasion and the implementation of sanctions. Even though the extent of the rebound remains disputed due to weak market liquidity, it has become clear that Russia's capital control measures as well as continuously high inflow of foreign exchange due to gas and oil exports managed to support the rouble. High energy and raw materials prices are also a boon for other commodity-related currencies such as BRL, ZAR, AUD and NZD, which all managed to appreciate against the USD in March (see chart). The big outlier was sterling, which probably suffered from a mood swing at the Bank of England, where the tone has lately become a bit less hawkish. JPY meanwhile sold off, with Japan's central bank reiterating its very dovish tone amid still relatively weak inflation numbers. Also, Japan continues to suffer from a major shock to its terms of trade (ratio between export and imports prices) as the country is fully reliant on fossil fuel imports.

For the next three months, we have moved from a positive to a neutral view on the USD. Interest rate differentials are still supportive of the greenback, but we think that expectations regarding US monetary policy tightening may have gone a bit too far. We are, however, sticking to our negative view on EUR/CHF, as the stubbornly high inflation differential between Switzerland and the Eurozone is driving the "fair" value of the EUR/CHF exchange rate lower and the CHF is likely to remain an attractive currency in the current geopolitical risk environment.

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