Vontobel

Investors' Outlook

Don't ditch your 60 / 40 portfolio, but do pause for thought

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Don’t ditch your 60 / 40 portfolio, but do pause for thought

—
Dan Scott
Head of Vontobel Multi Asset,
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Dear readers,

With consumer price increases nearing double-digit percentages and the war in Ukraine moving elevated energy prices even higher, it’s now clear to everyone that inflation is anything but transitory.

Central banks led by the US Federal Reserve now are in inflation-fighting mode. It’s unclear what the economic cost of their about-turn will be. Some investors facing prospects of markedly higher interest rates, and losses on their bonds, are asking themselves whether this may be the end of the 60 / 40 portfolio.

An allocation of 60 % to equities and 40 % to fixed income (or the other way round in some countries) used to be the bedrock of investing. For generations of investors, such a portfolio combined the perks of equities—the possibility of capital appreciation—and the solidity of bonds including loss protection as well as solid yields.

Looking ahead, it seems clear that even with rate hikes, real yields (the nominal yield minus inflation) will remain negative in many segments of the fixed income universe. Moreover, the prospect of central banks unwinding trillions in debt on their balance sheets, thus selling the government bonds they hold, is hardly an enticement to buy such securities either. Meanwhile, equities can cushion portfolios against inflation, but with aggressive rate hikes looming, the prospect of higher prices has dwindled.

→ Webcast
To view our webcast on recent market developments, click **here**

A hearty “jein” to a fresh look at portfolios
Does the definition of a balanced portfolio need a fundamental rethinking? In German, my answer for you would be “jein,” which roughly translates to “yes but no”. The year 2022 has taught us so far that balanced portfolios with diversification across all liquid asset classes and currencies actually work well for investors. While bonds and equities sold off in tandem at the start of the year, commodities and gold held their own. Investors with proper risk diversification will have been shielded from the worst of this year’s downturn.

Despite the scant protection and the negative real returns of government bonds, constructing a balanced portfolio without them would be unthinkable. Still, fixed income investors will want to pause for thought. We believe that owners of balanced portfolios should embrace actively managed strategies that exploit higher rates and pricing inefficiencies in segments ranging from low-risk, investment-grade bonds to high-yield corporate paper as well as emerging-market debt.

Keep in mind that inflation is the friend of an indebted government, as it reduces the cost of servicing existing debt. It is also a stealth tax on your cash, as its purchasing power is steadily declining. In this context, fixed income can provide an answer with asset-backed security strategies that can deliver attractive income along with a focus on capital preservation.

So while the future may not be as simple as a 60 / 40 mix between equities and government debt, the basic principle of diversification is more relevant than ever. Balanced portfolios need to be finely tuned, carefully calibrating return potential, capital preservation qualities, as well as risks, across all asset classes. The upshot, from our point of view: don’t give up on fixed income, just rethink your fixed income.

—
Frank Häusler
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—
Mario Montagnani
Senior Investment Strategist,
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We move to a neutral stance on equities due to euro zone doubts

In the midst of a crisis, it sometimes feels wrong to be worrying about portfolios. But such an argument doesn't hold water if we acknowledge that investors have every right to see their concerns addressed in times like these.

The one certainty of Russia's attack on Ukraine, apart from the catastrophe it represents for the people affected, is that it will have an inflationary effect via higher energy, metal, and grain prices. Regarding the possible consequences for investors, it is useful to remember how markets developed during past international crises. Looking at the moves of the S&P 500 index in times of major conflicts starting with the Japanese attack on Pearl Harbor in 1941 and ending with Russia's annexation of the Crimean peninsula in 2014, there are clear signs of stock market resilience. Most of the time, after six or 12 months, equity markets were clearly in positive territory. There were, however, three periods during which the S&P 500 remained in the red for longer: Egypt's nationalization of the Suez Canal in 1956, the oil embargo by a Saudi Arabia-led coalition of petroleum producers in 1973, and the 9/11 terror strikes in the US. Some of these events pulled the global economy down, and stock prices with them. It was a global recession that made the difference.

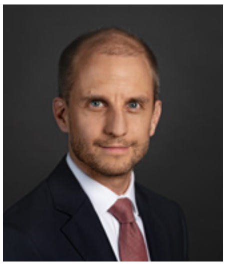
We have moved to a neutral stance on equities, mainly because of concerns that western sanctions and Moscow's counter-measures will hamper economic growth in the euro zone. At the same time, the war in Ukraine has thrust commodities and gold into the spotlight, and we confirm our overweight. Bonds remain a negative, but we are slightly more sanguine regarding the prospects of investment-grade corporate bonds. For details, see the overview page 5 or read the asset class-focused items on pages 12 to 15.

	UNDERWEIGHT significantly	UNDERWEIGHT slightly	NEUTRAL	OVERWEIGHT slightly	OVERWEIGHT significantly	
1 Liquidity			→			We remain neutral on cash, reflecting our view that there are no exaggerated risks in the financial markets.
2 Bonds		→				Given the upward trend in inflation rates, and our own higher estimates (we now expect inflation to reach a yearly average of 5.7% in the euro zone, and 6.2% in the US), our bond underweight remains in place. Meanwhile, declining bond prices and rising yields also present buying opportunities. Corporate bonds with an investment-grade (IG) rating, for example, are on an attractive entry level, and we have purchased selected securities using proceeds of our equity divestment. As a result, our view on this bond sub-segment is no longer a “strong negative”, despite the still low yields. Our positioning remains the same for all other segments. We stay neutral on government and high-yield bonds, and we still like emerging-market debt in hard currency for yield reasons.
3 Equities			↘			The war in Ukraine, and the possibility of escalation, continues to dampen the sentiment in financial markets. The path ahead for equity investors has become more arduous amid higher inflation and lower economic growth. We currently expect the euro zone’s gross domestic product to increase by 2.8% (previous estimate: 4.0%) and the US figure by 3.1% (3.5%). While we don’t foresee a recession this year, we acknowledge that the risk has risen, particularly in Europe given its dependency on Russian energy. Consequently, we have reduced euro zone equities from neutral to negative, which results in an overall neutral stance on equities as an asset class. Our view on all other regions remains the same. US equities are on overweight with their peers in Switzerland, Japan, and emerging markets rated neutral.
4 Gold				→		A situation where economic growth is slowing and inflation rising should benefit the precious metal. Our unchanged slightly positive view on gold reflects its diversification and hedging qualities. A position in gold should help to shield portfolios against market turmoil tied to Russia’s aggression, or the effect of both inflation and stagflation. The latter development isn’t our base case, though.
5 Commodities				→		It seems we were right to put commodities on overweight in January 2022, citing their cushioning effect against inflation and geopolitical risks. The asset class has since lived up to expectations. We reiterate our rating because the scarcity value of commodities will only increase the longer the war in Ukraine drags on. Moreover, prices may climb because many companies have in the past few years failed to invest in new or existing sources. Another price-supportive aspect is the continued shift to a “green” economy, which heightens demand for certain commodities.
6 Alternative strategies				→		We retain an overall overweight rating on alternative strategies, exclusively stemming from our gold and commodities overweight. Within the asset class, hedge funds remain on a slight underweight. Other types of alternative investments such as insurance-linked securities are on neutral.

Changes month-on-month: same → higher ↗ lower ↘

No recession seen but lower growth and more inflation

Vladimir Putin's crossing of the Ukraine Rubicon has thrown markets into disarray. Many assumptions regarding growth, commodities and inflation started looking wobbly. We don't expect a recession but have lowered our growth forecasts and increased our inflation estimates substantially.



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At the beginning of the year, we expected a global growth rate substantially above those seen in the decade before the pandemic. Our erstwhile confidence wasn't diminished by already elevated energy prices, supply chain problems, or central banks that were tightening their ultra-loose monetary policy. The Russian invasion of Ukraine, and the subsequent sanctions against Russia and a Kremlin-friendly elite, changed the picture. It pushed energy and food prices even higher while weighing on business as well as consumer sentiment, and disrupting supply chains even more. Although we are no military strategists and cannot forecast the outcome of the war, we assume in our baseline scenario that most sanctions will be maintained for longer. Energy prices will stay elevated in the first half of the year but are expected to decline slowly at some stage because Russia will find additional ways to export its energy via global markets after all. This led to a downgrade of our growth forecasts and a significant upgrade of our inflation estimates. According to our forecasts, global growth, albeit lackluster, will remain firmly above a critical level at which a "recession" sign could start flashing, for this year (3.2%) and next (2.9%). Our forecasts could obviously be compromised by any further escalation of the war, but also the risks that would come with a hard-to-control inflation and a subsequent stronger demand destruction. Central banks could react in the form of faster-than-expected and more forceful monetary policy tightening, at least during the next few months, which would deal financial markets another blow.

Europe: Holding up but shaky

The war on Europe's doorstep prompted us to significantly lower our 2022 forecast for the euro zone's gross domestic product (GDP) from 4% to 2.8%. We assume that higher energy prices, less trade with Russia, a weaker business and consumer sentiment as well as supply chain disruptions will weigh on growth. We don't expect the euro zone to fall into recession but any additional shock such as a loss of energy supply (see chart 1) would most probably have this undesired effect. More public spending will help to partially cushion the war-related shock. Relaxed pandemic-era restrictions on mobility should also support economic activity in the coming months. At the same time, the re-opening of the economy, the globally rising costs for energy and food, and the disruption of supply chains, will lead to even more price pressure. We have raised our inflation outlook for the current year from 4.1% to 5.7%. The European Central Bank (ECB) finds itself between a rock and a hard place, weighing up the benefit of measures to curb inflation and the negative effect on growth these may have. Fighting inflation seems to be the current priority. We expect the monetary authority to stop all net asset purchases in the third quarter and to start increasing its key rate, setting a first hike in the last quarter of 2022. No such move is expected from the Swiss National Bank (SNB) this year, but the Bank of England is likely to continue its rate hiking cycle with at least two more key rate increases in 2022, we reckon.

US: Lower growth amid rate hikes and higher prices

As widely expected, the US Federal Reserve raised the benchmark rate by 25 basis points to 0.5% in March, the first increase since 2018. While the rate liftoff was no surprise, a sense of panic is coming through in the recent statements by some US Federal Reserve members. With inflation already running at a 40-year high and surging energy prices implying a possible further rise, the central bank is expected to raise rates much faster in the coming months. Chairman Jerome Powell has mentioned the possibility of large increases of 50 basis points at the US Fed's next meetings, and we anticipate that the hiking cycle will indeed be front-loaded and aggressive (see chart 2).

While the US economy is solidly growing and the labor market remains buoyant, this monetary tightening is restricting financial conditions. The US has relatively few ties to Ukraine, but rising global commodity prices will hit the economy, nonetheless. We expect private consumption to slow as people will start feeling the higher cost of essential goods and fuel. This could delay the demand recovery for services that we had in our books, expecting a re-orientation of money flows after consumers focused on goods during the pandemic. Another headwind will be higher rental and housing costs, as mortgage reference rates have started to increase in line with other borrowing costs. We have, therefore, lowered our US GDP forecast to 3.1% from 3.5% for 2022, which is still above trend growth.

Japan: Eyes on surging energy costs

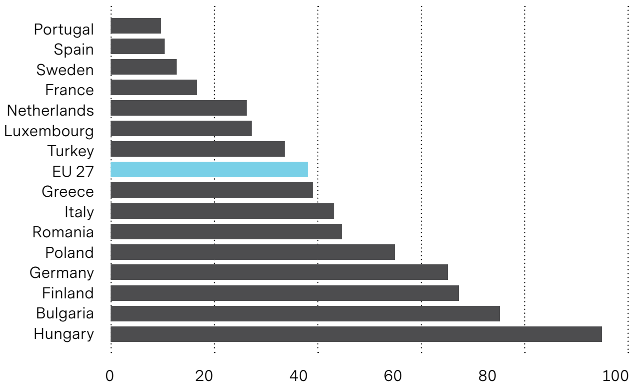
Covid cases have come down and emergency measures have been lifted. This should give the consumer sentiment and the services sector a boost. On the negative side, Japan as a major importer of energy will be hit by the consequences of the war in Ukraine on commodity markets. Given the still fragile economy, we expect the Bank of Japan to stay supportive.

Emerging markets/China: Commodity importers hit

Russia and Ukraine will face a deep recession due to the war, with the Russian economy seen contracting by nearly 10% in 2022. High-frequency data shows that since the start of the invasion of Ukraine, the number of ships entering major Russian ports has halved versus the normal rate. The strongest contagion effects are likely to be felt in neighboring Central Eastern European (CEE) countries via trade disruptions. Other emerging economies, particularly those that rely on grain, metal and energy imports, will suffer from higher prices of these commodities, which undermines disposable incomes. In this regard, CEE, China, India, Turkey, and South Africa, are probably more affected by the war than others (see chart 3). This is an unwelcome development for China in particular, where the growth dynamic started picking up in February. We downgraded our 2022 growth outlook for emerging markets as a whole from 4.4% to 3.6%. Inflation pressure is generally on the rise, but higher agricultural prices will impact Eastern Europe more than Asia, where food prices are rather driven by regional developments.

Chart 1: Some European countries import almost all their gas from Russia

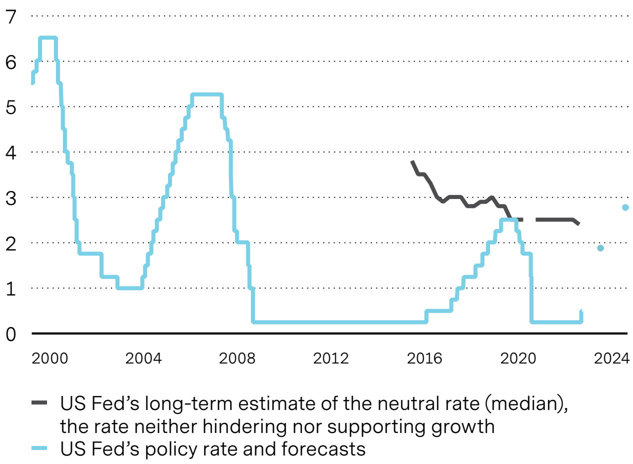
In % of total natural gas imports in 2020



Source: Refinitiv Datastream, Vontobel

Chart 2: We expect the US Fed to hike rates aggressively, taking the target rate above long-term estimates

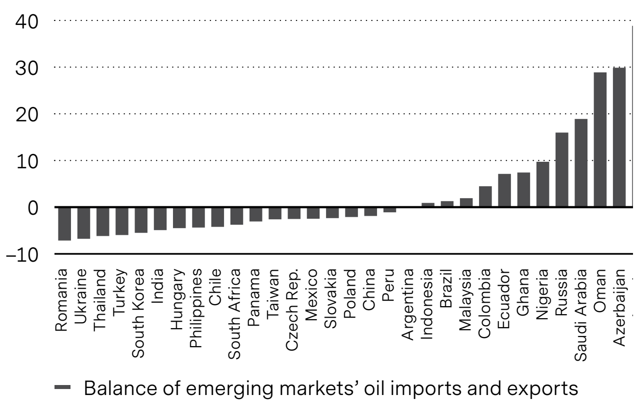
In %



Source: Refinitiv Datastream, US Federal Reserve, Vontobel

Chart 3: Most emerging economies are net energy importers, but exporters now benefit from price rise

In % of GDP



Source: Refinitiv Datastream, Bureau of Economic Analysis (BEA), Vontobel

Emerging-market debt remains a key strategic asset for well-diversified portfolios

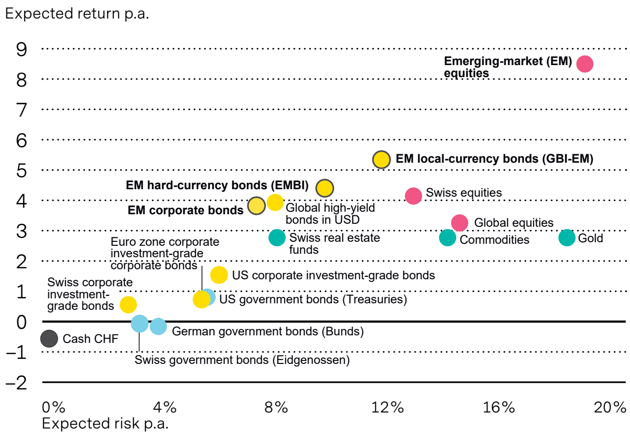
—
Sandrine Perret
Senior Economist,
Fixed Income Strategist,
Vontobel

Russia's invasion of Ukraine has affected millions of civilians and the economic future of the country while darkening growth prospects of other neighboring states like Poland and Hungary. Facing volatile markets, high inflation and rising yields globally, investors have started to question their investments in emerging markets (EM)—notably in the bond space where default risks have increased. We revisit our long-term return expectations and thesis for investing in EM debt, and find that investing in actively managed EM debt remains key to provide income and diversification to efficient portfolios over the long term.

Since the beginning of 2022, emerging-market assets have suffered from the tricky combination of rising yields in developed economies and increasing geopolitical worries with Russia's invasion of Ukraine and the start of a military conflict in Eastern Europe. Fears of rising commodity prices globally and lower growth have led more volatile asset classes such as emerging markets to underperform benchmarks, across both equities and bonds. Regionally, the heavy negative impact from the war expected on Russian and Ukrainian economies has raised default fears on their bonds. This has been mirrored by higher credit default swaps (CDS) in the two regions—the price of insurance against a sovereign default. These negative returns of EM assets have worried investors and raised questions regarding future returns and the right level of exposure to emerging-market debt.

Risk-return perspectives: strategically attractive?
To answer this question, we compare emerging-market debt risk-return potential to other main asset classes, taking a long-term approach. Our capital market assumptions help us to estimate the long-term annual return expected in each asset class, for the next seven years. The returns of emerging-market debt in USD (EMBI) and local currencies (GBI-EM) are attractive, with expected annual returns between 4 and 5% (see chart 1), and they compare favorably to global stocks on a risk-adjusted basis. For the same annual risk, these bonds are competing with other major asset classes such as global high-yield corporate bonds, Swiss real estate and Swiss equities. EM local debt also enables investors to take tactical currency exposure, which can be hedged appropriately. Moreover, it is worth noting that developed-world government bonds, like those of the US and the euro zone, provide more defensiveness, but are unable to match this expected level of returns.

Chart 1: Vontobel long-term return estimates by asset class
In %



Source: Refinitiv Datastream, Vontobel. Expected returns in local currencies, as of the fourth quarter of 2021.

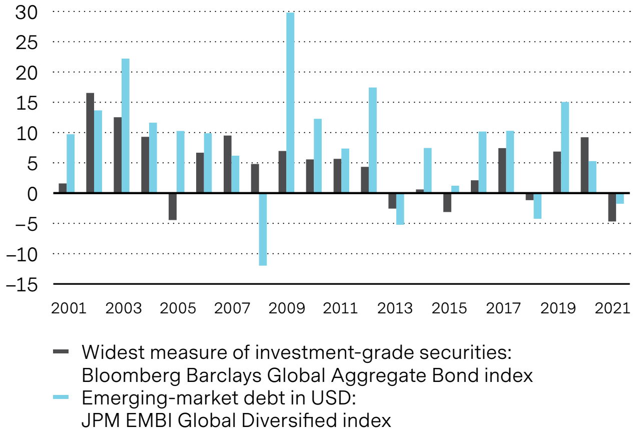
The appealing prospects of EM debt also come from expanded investment possibilities, which have evolved meaningfully over the last decades. This reflects EM economies' larger share in the world GDP, which has increased from 20% in 2005 to 40% in 2020, according to IMF estimates. Areas of EM debt have grown in size and duration, and their investment universe has also become more liquid. Looking at J.P. Morgan debt indices, the most widely followed bond indices aggregating emerging economies' debt—the composition of the index reflects this diversification. The JPM EMBI Global Diversified Index now includes more than 60 countries, compared to only 11 in the mid-1990s. The weighting of large countries such as Brazil, Mexico and Turkey has been cut to increase exposure to smaller regions and has therefore improved its geographical diversification. As of early 2022, no country had a weight of more than 5% in the index. Finally, emerging markets were slower than advanced economies to adopt ESG targets and offer sustainability criteria, a must for investors nowadays. But sustainability considerations have also grown in EM, and many EM debt funds now incorporate ESG criteria into their investment processes to help bondholders meet their sustainability goals.

Negative returns of EM debt are less frequent than most investors think

While exposure to emerging markets can be attractive from a long-term perspective, some investors worry about possible short-term losses. However, negative returns are less frequent than is commonly believed. Looking at annual returns of the EMBI Global Diversified index since 2001, negative annual returns have occurred on four occasions, compared to five for the Global Aggregate index (see chart 2). And while drawdowns in EMBI were larger, the rebounds were also much larger in subsequent years, for example in 2009 and 2019.

Chart 2: EM hard-currency debt returns historically higher than in investment-grade debt

Historical annual performance (in %, total return in USD)

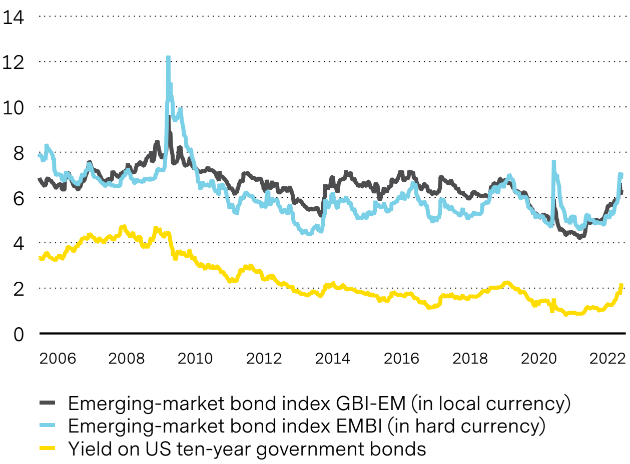


Source: Refinitiv Datastream, JP Morgan, Bloomberg Barclays, Vontobel. Data as of December 31, 2021.

The recent surge in developed-market (DM) yields, particularly in the US, raises the question whether EM debt yields still compensate for the higher volatility that investors face compared to investing in developed-market bonds? Ten-year yields of US government bonds increased to above 2.5% in March, a new local high. But they have also done so in emerging markets, where some countries such as Brazil and Mexico started their post Covid-19 rate hikes well ahead of the US Federal Reserve. As such, the spread of emerging-market debt over their developed-market counterparts remains attractive and has even increased in USD as well as local currency in the current environment (see chart 3).

Chart 3: EM debt offers a substantial yield pick-up over DM global bonds, even with the latter increasing recently

Index yield, in %



Source: Refinitiv Datastream, J.P. Morgan, Vontobel.
Data as of March 28, 2022.

Short-term headwinds highlight the need for an active management

While we believe investing in EM debt is an effective way to enhance portfolio efficiency and achieve the best risk-adjusted returns, Russia's invasion has shown that geopolitical tensions can rapidly escalate into crisis, with important impact for the bond market of affected regions. Central and Eastern European countries' debt now trades at a discount due to their proximity to Ukraine, and spreads have also increased for EM heavy importers of commodities such as Egypt. Other EM bond segments already incorporate a geopolitical risk premium that is likely to compress once volatility drops and investors increase exposure to these segments. The long-term arguments of investing in EM debt are still valid today, but geopolitical events in Ukraine show that active management and a careful selection process is important to select markets with strong fundamentals and solid balance sheets. An active approach can help bondholders to navigate short-term risks while portfolios benefit from a structural exposure to the long-term potential growth of EM debt investments.

Fixed income bear market looking for a new equilibrium

—
Sandrine Perret
Senior Economist,
Fixed Income Strategist,
Vontobel

The first quarter of 2022 will be remembered for how fast the world's attention switched from a global pandemic crisis to a dramatic war in Eastern Europe. Global bond investors may well remember it as the worst start of a year in history with surging yields and falling prices as heavy performance detractors. We remain underweight in fixed income but take some profits.

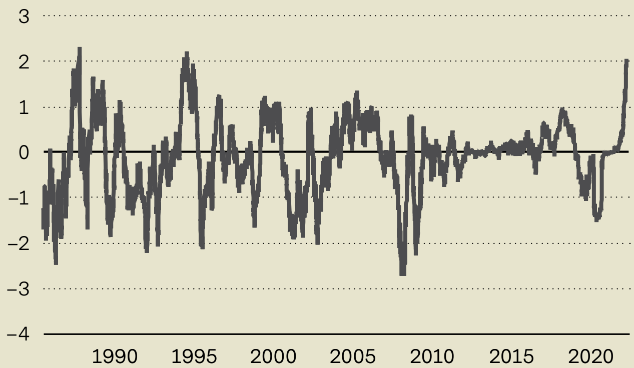
Since Russia's invasion of Ukraine, fears of higher energy prices fueling inflation have accelerated the sell-off in fixed income that started at the turn of the year. The main reason was rising expectations of rate hikes by the US Federal Reserve and other central banks, whose rhetoric changed from mildly to very "hawkish" in a couple of months. US Fed officials have doubled down on their tightening plans and are now openly talking about "expeditiously" increasing the base rate by 50-basis-point steps at the next meetings.

The Global Aggregate index, the most widely used yardstick for tracking global bonds with an investment-grade (IG) rating, was off –7.3% as of March 28. The US Fed's change in tone is also reflected in a rise in two-year US government bond yields above 2.0%, a change over a six-month period last seen in 1994 (see chart 1). The US yield curve—the yield difference between short and long-maturity bonds—has already inverted, suggesting that an economic slowdown is anticipated.

Looking for a new equilibrium: the neutral rate
When will yields stop moving higher? In fact, the market's discounting of a growing number of interest rate hikes mirrors the search for a new equilibrium: the neutral rate. This is the estimated yield level that is neither hindering nor stimulating the economy. When the neutral rate is exceeded, the federal funds rate becomes restrictive (see chart 2). The US Fed Committee's own estimate of the long-term neutral rate is approximately 2.4%, and we believe that short-end yields are unlikely to rise much above that level.

Adding exposure to high-quality corporate bonds
Our negative view on fixed income as a whole has so far been largely expressed via a double underweight in corporate bonds with an IG rating, one of the most battered bond segments this year given its low yield and long duration (i.e. high sensitivity to interest rate changes). Our strong underweight and the recent poor performance of IG paper have benefited our portfolio. Therefore, we were able to take profits by increasing our weight to a mere single underweight. This segment's spreads, i.e. the yield difference to benchmark bonds, have increased, which makes the current valuation more attractive, also given that we see less upside for bond yields after the recent sell-off.

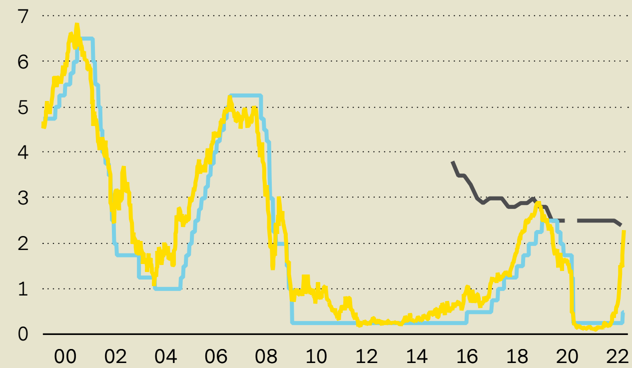
Chart 1: Yields at the short end of the curve are rising very fast, reflecting expectations of steep rate hikes
In %



Change in two-year US yields over a six-month period

Source: Refinitiv Datastream, Vontobel

Chart 2: The neutral rate of around 2.4% will act as an anchor for short-term yields
In %



US Federal Reserve's long-term target rate (median estimate)
US Federal Reserve's target rate
Two-year US government bond yields

Source: Refinitiv Datastream, US Federal Reserve, Vontobel

Time to downgrade equities, without exiting the market

—
Stefan Eppenberger
Equity & Commodity Strategist,
Vontobel

Stocks have enjoyed years in the sun, until a new harsh reality hit home: a war in Europe, high inflation, tighter monetary policy, and a slowing economy. We have decided to exit our holdings in euro zone stocks, which reduces our overall equity position to neutral.

The past decade has been a sort of ideal virtual reality for equity investors. Responding to several crises and record-low inflation, central banks cranked up the economy by pumping liquidity into the system no matter what. Those days are over for now, and equity bulls are scratching their heads.

Only a month ago, we upheld our equity overweight on signals that the US Federal Reserve seemed to follow a cautious rate-hiking path. In the meantime, Fed officials have made it clear that fighting inflation is the top priority, even at the expense of economic growth. In the coming weeks, companies will thus have to digest more (commodity) price inflation as well as higher interest rates.

Diet no longer equity-heavy
This looks like a bleak scenario for equities, but it's worth noting that a lot of the bad news is already reflected in market prices. This explains why equities have gained 8% within two weeks from mid-March (see chart 1), reducing year-to-date losses to not even 5% at the time of writing. We used this rally to say good-bye to our equity overweight. Higher inflation, tighter monetary policy and slower economic growth now justify a neutral equity exposure, in our opinion.

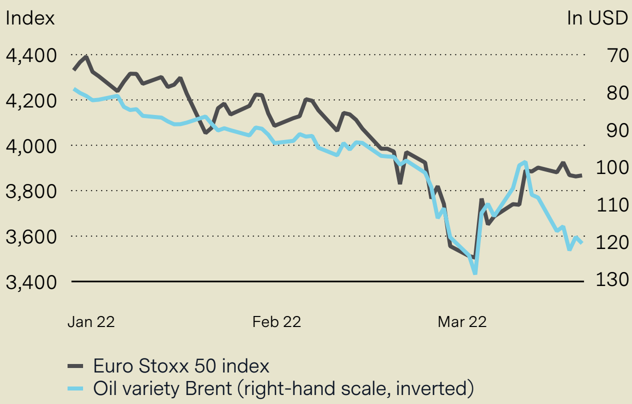
Protracted sanctions would hit European stocks
That said, we still consider the risk of a global recession to be low. Therefore, it makes sense to remain invested in equities despite some uncertainty regarding the market's prospects. Euro zone shares are a different matter, though. The European stock index consists of many industrial and financial companies that are sensitive to the global economic cycle. Slowing global growth, coupled with higher commodity prices, will put pressure on their earnings (see chart 2). Moreover, the exposure of the European Union's economy to Russia means that the 27-member block would be most hit by protracted western sanctions and Moscow's counter-measures. Consequently, we have downgraded euro zone equities to underweight, adopting a neutral view on equities overall.

In terms of geographical preference, we still like US companies, which impress with high profit margins, strong balance sheets and structural earnings growth. True, some US stocks will face headwinds in times of rising interest rates. But as long as global economic indicators are in decline, we believe that investors should favor shares of quality companies like US ones to generate returns without undue risks.

Chart 1: Equities, buffeted by headwinds, rebound to level near all-time highs

Source: Refinitiv Datastream, Vontobel

Chart 2: High oil price weighs on euro zone stocks



Source: Refinitiv Datastream, Vontobel

What happens with Russia’s oil exports?

—
Stefan Eppenberger
Equity & Commodity Strategist,
Vontobel

The day Russia attacked Ukraine, oil prices rocketed to above USD 100 a barrel. Ever since, fewer and fewer countries have touched Moscow’s “black gold”, now offered at a huge discount. We believe high oil prices are here to stay.

There had been rising imbalances even before the war. Higher demand in the wake of the economic recovery after the pandemic met only slowly increasing supply of oil pumped by the Organization of the Petroleum Exporting Countries (OPEC). This led to sharply falling inventories and rising oil prices.

The Ukraine crisis made matters much worse for oil markets. Russia, one of the world’s largest exporters, sends more than 7 million barrels of crude per day abroad. Leaving aside the uptake by China, a loss of these exports would be an unprecedented shock for the world (see chart 1). Such concerns have seen oil prices temporarily reach levels above USD 130 per barrel.

Turning off the tap completely would cause a recession
Could there be more trouble brewing for the oil market? We remember that during similar crises, e.g. the Arab world’s oil embargo in the 1970s, the price of the barrel tripled. A similar move by Moscow would certainly cause a global recession, which is in nobody’s interest. Moreover, almost two-thirds of Russia’s oil shipments go to Europe, and the continent has no choice but to take what it can get, at least in the short term. Finally, Russia needs the oil revenues in times of harsh economic sanctions and huge military expenses.

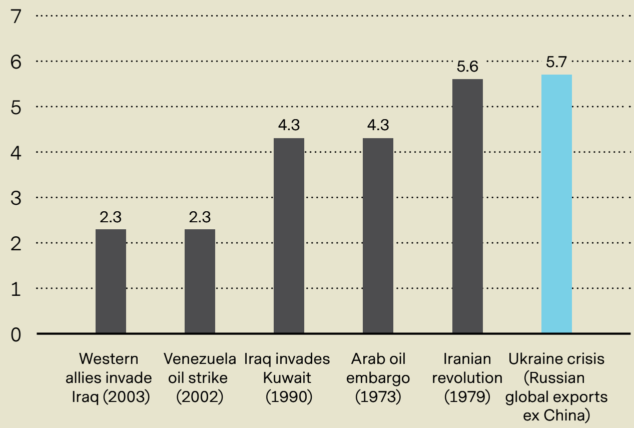
But the situation is more complicated. While Europe hasn’t agreed on direct sanctions against Russian oil, western shipping companies, banks, or ports, are shying away from earning money with Russian oil. The country has reacted by lowering selling prices dramatically (see chart 2).

Where have all the tankers gone?
Thanks to high-frequency data, we can see that a large number of oil tankers are still leaving Russian ports. However, this is probably also due to the fact that exporters are fulfilling contracts from before the crisis. One can also observe that more and more vessels carrying Russian oil no longer indicate their destination, and that their numbers are rising. This is a sign that ships are looking for markets elsewhere because their cargo is being rejected in Europe.

It is difficult to estimate how much of this Russian oil will be lost. Most of it will find buyers in Asia. It’s evident that the longer routes become, the larger the strain on global supply chains. As seen elsewhere in the aftermath of the Corona crisis, this leads to supply shortages and price increases. Until supply chains are reorganized, oil prices are likely to remain high.

Chart 1: The world cannot do without Russian oil in the short term

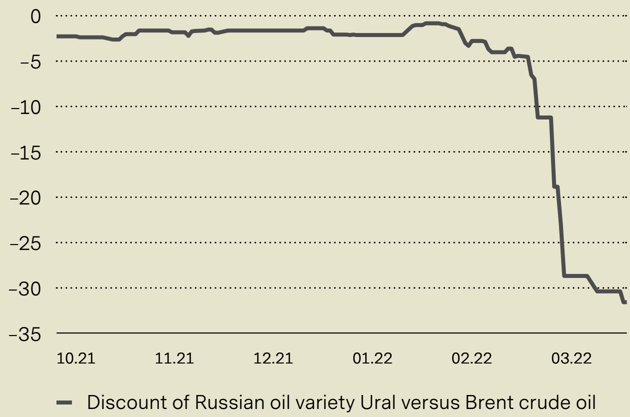
Largest post-war oil supply disruptions (in million barrels per day)



Source: Goldman Sachs, Refinitiv Datastream, Vontobel

Chart 2: Russian oil prices indicate lack of demand

USD per barrel



Source: Refinitiv Datastream, Vontobel

Safe havens in demand, Swiss franc set to remain strong

—
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While the Russian ruble has dropped like a stone, safe haven currencies such as the US dollar and the Swiss franc have taken wing, albeit temporarily. Cyclical currencies like the euro are currently struggling while emerging-market currencies hold their own. Both are likely to recover this year, we believe.

Russia's invasion of Ukraine and the subsequent rise in commodity prices triggered a flight to safe havens such as the US dollar and the Swiss franc in late February and early March. Surprisingly, these flows have partially reversed since mid-March, but it's worth noting that the US dollar has been on an upward trajectory since last autumn. This is limiting the greenback's allure. However, a further escalation in Ukraine could give the US currency another boost.

Swiss central bank not alarmed

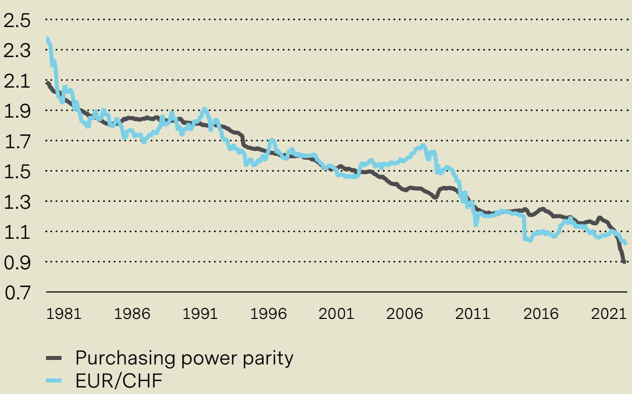
The Swiss National Bank's (SNB) market interventions to weaken the franc at the end of February and early March suggested that EUR/CHF parity is a red line for the monetary authority (see chart 1). But the SNB appears to be rather relaxed regarding the currency's upward drift, which has even picked up speed lately. This comes on the back of higher inflation readings in the euro zone compared to those in Switzerland that undermine the euro's relative standing. Moreover, the euro zone's economic outlook is somewhat muddy in the short term, which is weakening the euro by extension, because most western sanctions targeting Russia probably won't be lifted fast. European prospects may brighten only a little later this year, we reckon. The franc could also rise versus the US dollar because the latter tends to lose ground once a US rate-hiking cycle starts—and we saw the beginning of it mid-March.

Euro and emerging market currencies seen up

Cyclical currencies like the euro have been under pressure, if we disregard some oddities like the strength of the Norwegian krone, which benefits from the country's oil exports. We expect European currencies to gain ground, but the recovery should be a rather shallow one, as we assume most Russia-targeting sanctions to remain in place in 2022.

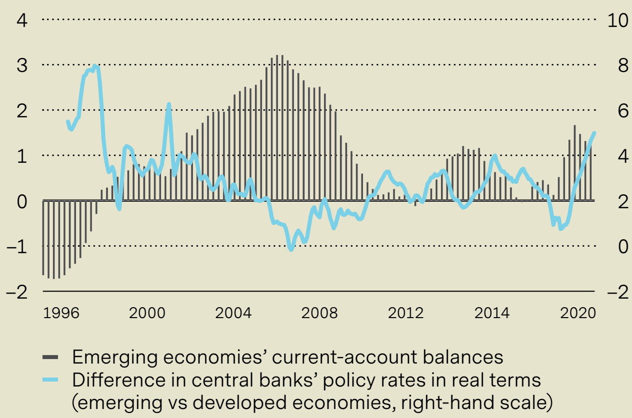
Apart from the Russian ruble and the Turkish lira, emerging-market (EM) currencies have remained resilient. This isn't really surprising given the much-improved fundamentals. Currency valuation is moderately attractive, many emerging economies have accumulated current-account surpluses, and policy tightening by many Eastern European and Latin American central banks has moved interest rate differentials versus developed countries to levels not seen in many years (see chart 2). Therefore, we think EM currencies can appreciate in 2022 against a moderately weaker dollar.

Chart 1: The Swiss franc's "fair value" is even below a 1:1 parity to the euro



Source: Refinitiv Datastream, Vontobel

Chart 2: Emerging economies have done their homework



Source: Refinitiv Datastream, Vontobel

Economy and financial markets 2020 – 2023

The following list shows the actual values, exchange rates and prices from 2020 to 2021 and our forecasts for 2022 and 2023 for gross domestic product (GDP), inflation / inflationary expectations, key central bank interest rates, ten-year government bonds, exchange rates and commodities.

GDP (IN %)	2020	2021	CURRENT[1]	FORECAST 2022	FORECAST 2023
Euro zone	–6.5	5.3	4.6	2.8	2.2
US	–3.4	5.7	5.6	3.1	2.1
Japan	–4.5	1.7	0.5	2.4	1.8
United Kingdom	–9.4	7.5	6.5	3.7	2.0
Switzerland	–2.5	3.7	3.9	2.5	1.6
China	2.3	8.0	4.0	5.1	5.3
INFLATION (IN %)					
Euro zone	0.3	2.6	5.9	5.7	2.2
US	1.2	4.7	7.9	6.2	3.1
Japan	0.0	–0.3	0.9	1.5	0.7
United Kingdom	0.9	2.6	5.5	6.4	2.7
Switzerland	–0.7	0.6	2.2	1.9	0.6
China	2.5	0.9	0.9	2.5	2.1

KEY INTEREST RATES (IN %)	2020	2021	CURRENT	FORECAST 3 MONTHS	FORECAST 12 MONTHS
EUR	–0.50	–0.50	–0.50	–0.50	0.00
USD	1.75	0.25	0.50	1.00	2.00
JPY	–0.10	–0.10	–0.10	–0.10	–0.10
GBP	0.75	0.25	0.75	1.00	1.25
CHF	–0.69	–0.76	–0.75	–0.75	–0.50
CNY	4.35	4.35	4.35	4.35	4.35
10-YEAR GOVERNMENT-BOND YIELD (IN %)					
EUR (Germany)	–0.2	–0.6	0.3	0.3	0.5
USD	1.9	0.9	2.2	2.1	2.3
JPY	0.0	0.0	0.2	0.3	0.3
GBP	0.8	0.2	1.5	1.6	1.7
CHF	–0.5	–0.5	0.4	0.4	0.5
EXCHANGE RATES					
CHF per EUR	1.09	1.08	1.04	1.05	1.00
CHF per USD	0.97	0.88	0.94	0.93	0.87
CHF per 100 JPY	0.89	0.86	0.79	0.81	0.76
CHF per GBP	1.28	1.21	1.23	1.24	1.19
CHF per AUD	0.68	0.68	0.69	0.68	0.66
USD per EUR	1.12	1.22	1.11	1.13	1.15
JPY per USD	109	103	118	115	115
USD per AUD	0.70	0.77	0.74	0.73	0.73
CNY per USD	6.95	6.51	6.86	6.45	6.50
COMMODITIES					
Crude oil (Brent, USD/barrel)	66	52	107	110	100
Gold (USD/troy ounce)	1,521	1,898	1,943	2,000	2,200
Copper (USD/metric ton)	6,149	7,749	10,232	11,000	12,000

[1] Last officially available quarterly data year-over-year
na: not yet available
Source: Thomson Reuters Datastream, Vontobel; closing prices for all data: March 17, 2022, forecasts as of March 24, 2022

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