Riding slow desinflation

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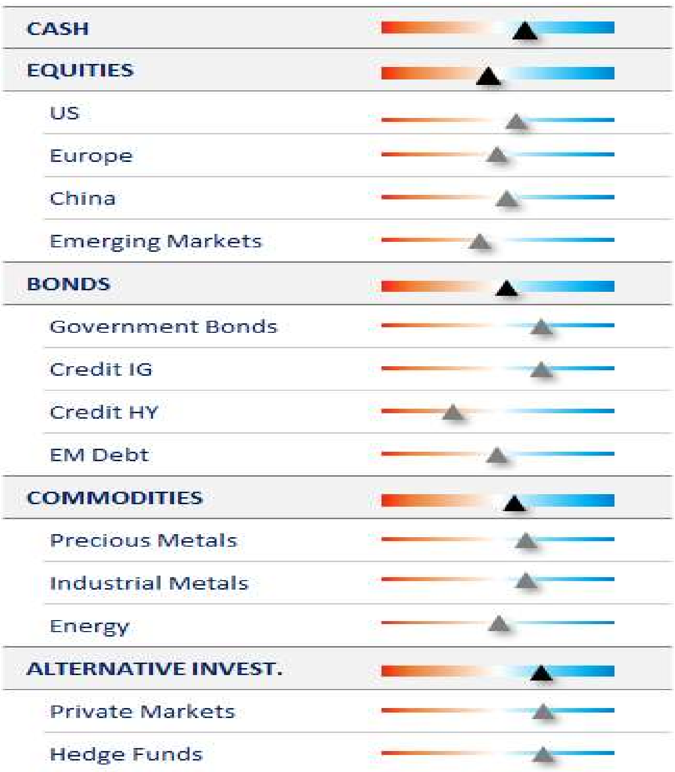
Omega Wealth Management January Investment Committee recognized an improvement in market conditions led by the reduction of headline inflation. Core inflation (5.7%yoy for December in the US) is now central for defining FOMC monetary policy and its acceptance of an economic slowdown. Sticky inflation for the rest of the year can defy predictions of a rapid fall towards a 2% target. OWM asset allocation rests on 3 pillars, firstly, profiting from the positive momentum for non US markets entertained by lower volatility and USD, second, benefiting from attractive yields above 5% in US fixed income investment grade bonds. The third pillar is exposure into commodity markets and CTAs to hedge against sticky inflation. Our overall tactical exposure was shifted (see table 1) in favor of metal commodities and emerging markets bonds & equities. Escalation of conflict in Ukraine is confirming our exposure into gold. Our positive posture on energy alternatives and private assets remain.

Normalization of core inflation not without risks

A decline in core inflation in the US and elsewhere will be slower than what is currently observed with headline inflation. Central bankers need to see reversals in service sectors prices and more generally a decline in addictive price behaviors. No doubt, they will be successful in their policy but neither timing nor the level (above 5% in US) of official interest rate peak make an easy ride. Another particularity is that the corporate earnings guidance have been downgraded over 2022 in synch with higher rate. This is differing from previous cycles when earnings lagged. Effects of high rates on the US economy, residential sector and on cyclical sectors and may be largely discounted. In summary, better investment conditions are constructive for risk taking after the market debacle of 2022. At the same time, a prudent allocation necessitates to take into account the struggle to tame inflation and the escalation in Ukraine.

Table 1: Omega tactical views (1-3 months)



Graph 1: Bond Emerging Market ETF (EMB US – EMLC US)

DAAO: surfing and hedging

The inflection point scenario discussed last December has materialized with a moderation in interest rates expectations driven by a slowdown in inflation. The allocation tilts we suggested back then worked: favor gold over equity, extend bond duration, and more importantly, i.e. more "strategically", gradually re-allocate risk towards balanced strategies. We maintain this view for the quarter to come. We reckon geopolitical uncertainty can be a threat to risk-on assets, and central banks could opt for a "muddling through scenario" while labor markets weaken. But equity markets could perform well and climb the wall of worries. This could sound like a paradox but one should remember US equity markets (and thus global equities) perform well when the labor market is weakening. Besides, this should continue to put a dent on USD, and thus lend support to emerging market bonds (graph1).

Tactical positioning.

Financials, energy and healthcare display defensive features with low valuations multiples. Q4-2022 earnings releases will be moments of truth for the **large tech cap** that are at a crossroad.

Re-affirming the 'old' fossils Energy exposure and concentrate on the 'new' energy solutions to adapt to current spectrum of new solutions.

A **selection of CTA** have demonstrated their diversifying power in the midst of the Ukraine and global energy crisis.