OUTLOOK 2022

« A silver lining »

19.11.2021

DPAM

DEGROOF PETERCAM ASSET MANAGEMENT

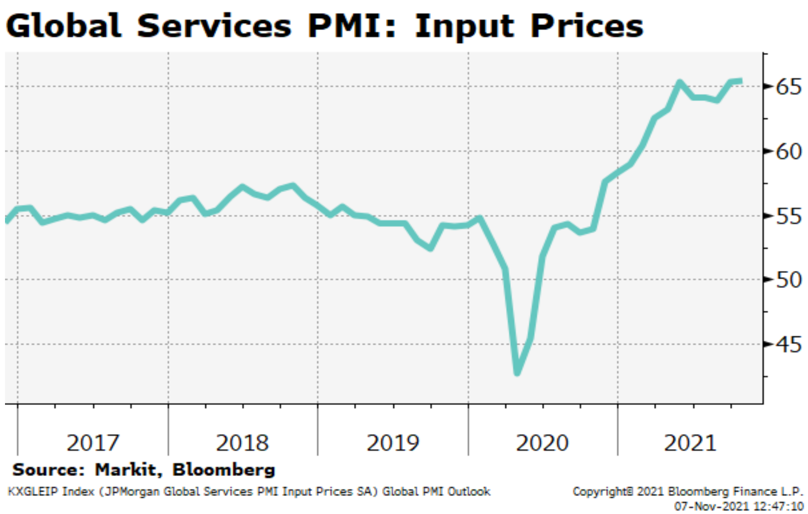
FIXED INCOME OUTLOOK 2022

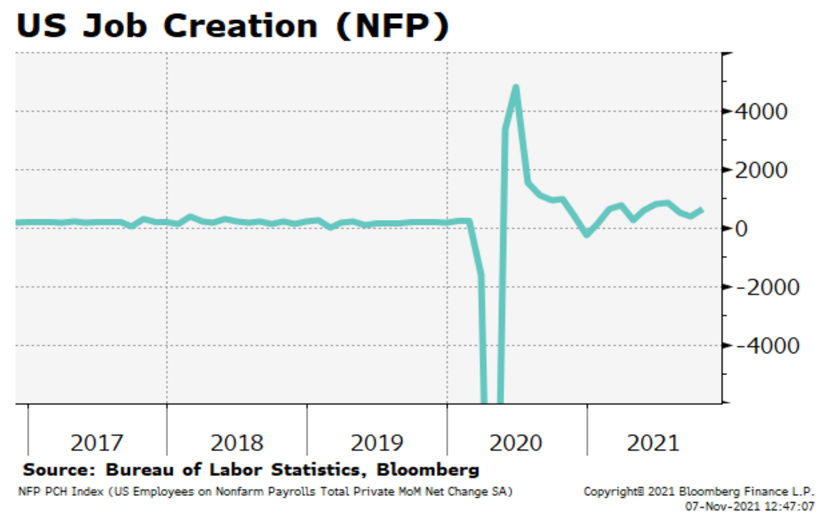
Sam Vereecke

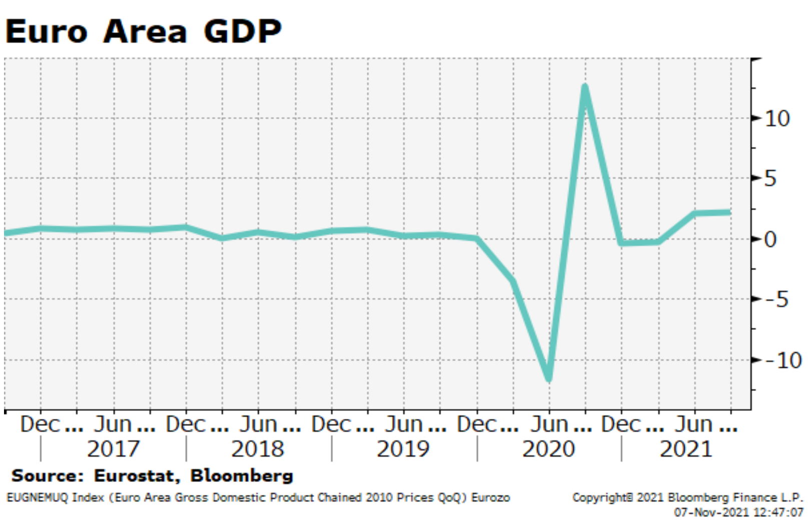
CIO Fixed Income DPAM

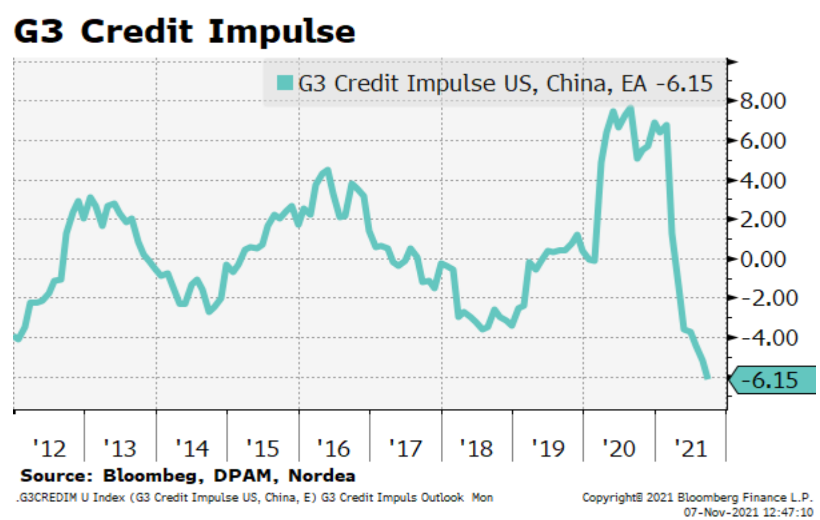
1

RATES: POST COVID VOLATILITY









Source: JP Morgan Global Services PMI Input Prices SA: Markit / Bloomberg, Euro Area Gross Domestic Product Chained 2010 Prices QoQ: Eurostat / Bloomberg

Source: US Employees on Nonfarm Payrolls Total Private MoM Net Change SA, BLS / Bloomberg, ICE Brent Oil Futures: Bloomberg

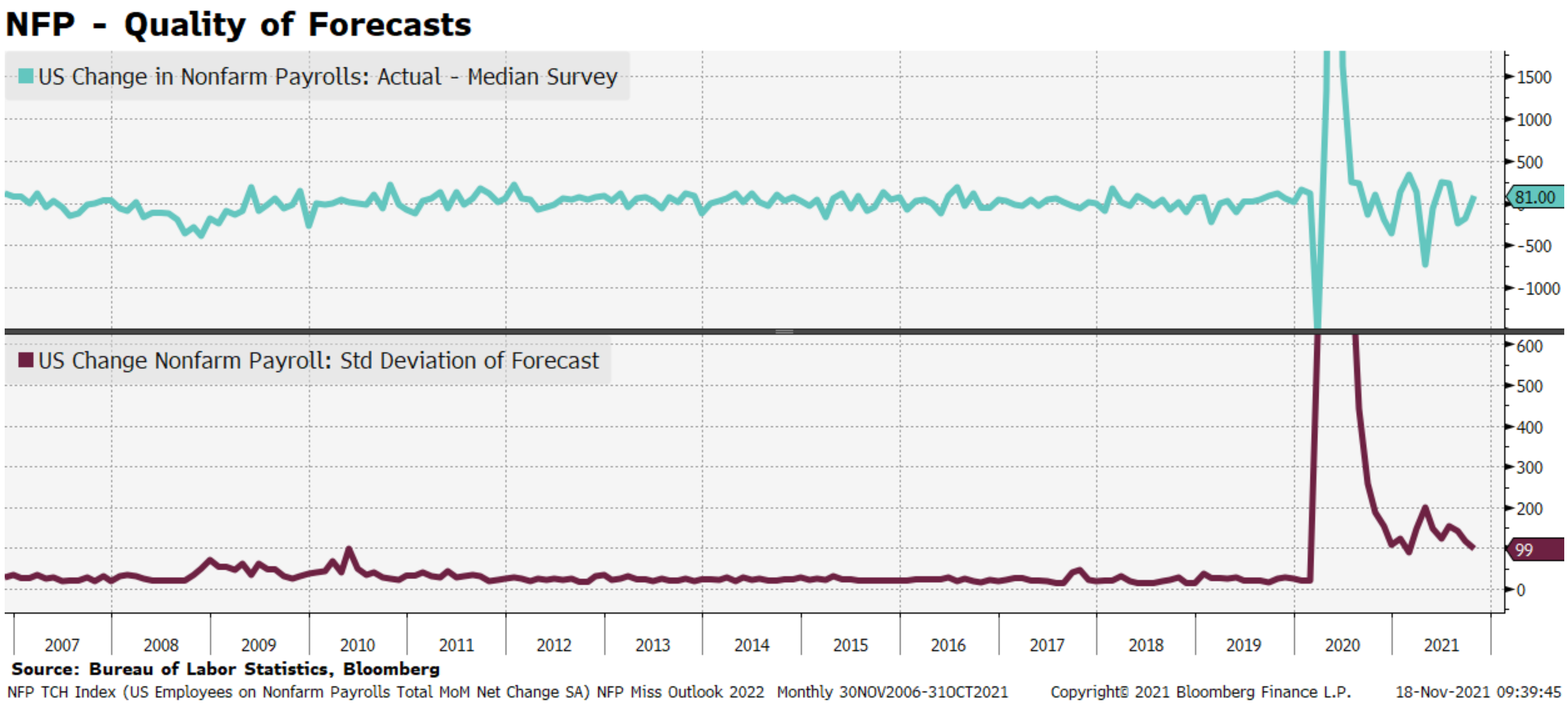
- Rates Volatility -

WILD SWINGS IN ECONOMIC DYNAMICS

- Demand swings
- Fiscal Stimulus
- Monetary Stimulus
- Supply chains
- GDP growth
- Inflation
- Labor supply
- Unemployment

- Rates Volatility -

IT WON'T STOP OVERNIGHT



Source: Bureau of Labor Statistics, Bloomberg - 31/10/2021

DEVELOPED MARKET RATES

1 INFLATION

- **Long term** drivers of inflation remain intact so far
- However, the response to the **Covid shock** in terms of monetary and fiscal coordination stands unique
- Over the **medium term**, some factors might change the inflation trend over the coming years

2 GROWTH

- Cross-region divergence in current growth
- The EU's reaction through the NGEU is unparalleled and could change Europe's structural growth
- Consumer demand and supply bottlenecks will continue to support growth, but might be mean-reverting
- Making a balanced global **underweight duration** exposure appropriate

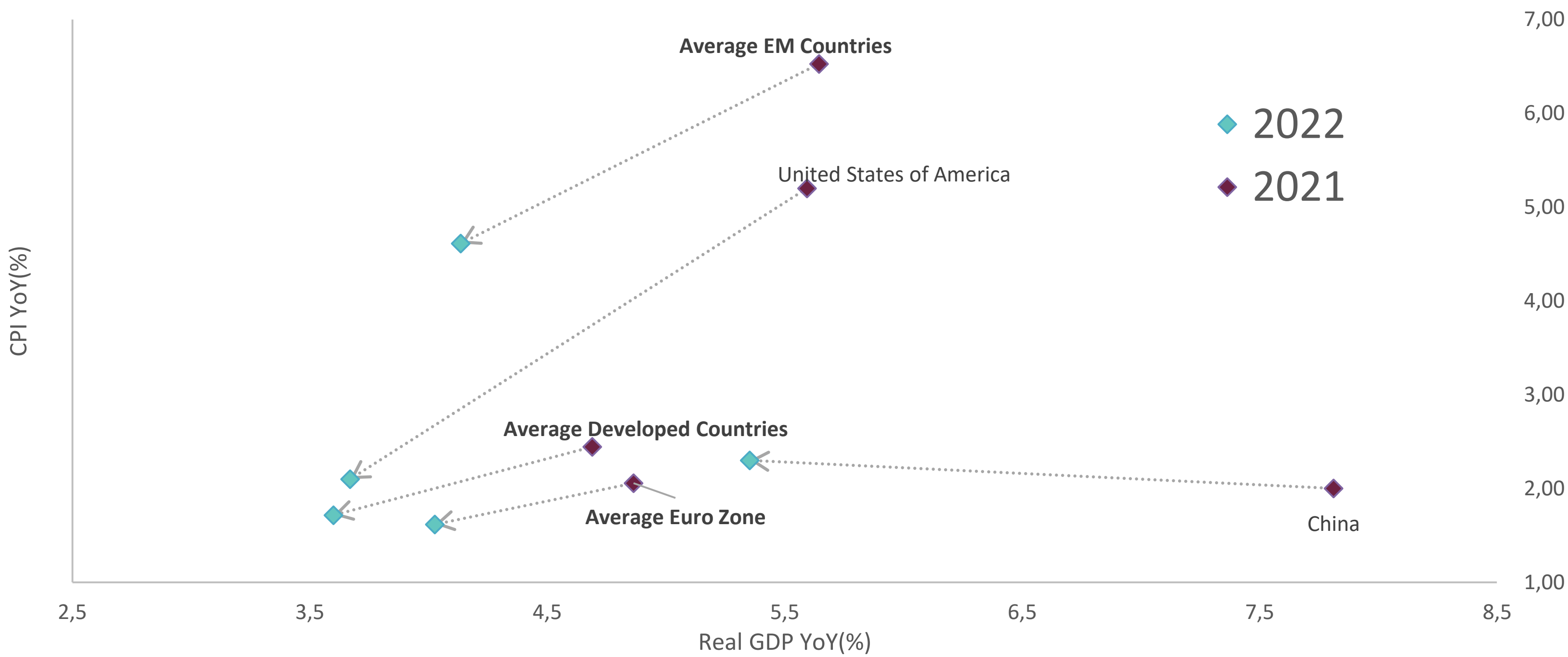
3 CENTRAL BANKS

- A policy tightening path will ensue over the coming years
- But it might continue to be **shallower than during previous cycles**
- From the moment central banks are able communicate their expected policy path with relative certainty, the recently created value in certain curves is there to be unlocked

4 SPREADS

- The removal of central bank support might create **some spread volatility**
- However **reform-based policies** might have changed some countries' fundamental picture thereby providing protection over the medium term

VOLATILITY IS **HIGH**, BUT THE DIRECTION IS **CLEARER**



Source: Fitch forecasts, DPAM, annual averages – 08/11/2021

We have a responsibility to explain that there are powerful reasons to believe inflation will fall next year, and that we have to be sufficiently patient so as not to overreact to a temporary increase in inflation.

Philip Lane, ECB

Source: El Pais newspaper – 03/11/2021

HOW WILL THE **INFLATION NORMALIZATION** LOOK LIKE?

Category	Theme
MONETARY POLICY	Inflation targeting mandate
	Monetary policy dominance
DEMOGRAPHY	Ageing population
	Labor market supply shocks (China, baby boomers,…)
FISCAL POLICY	Lack of (infrastructure) investments
	Wealth concentration & inequality

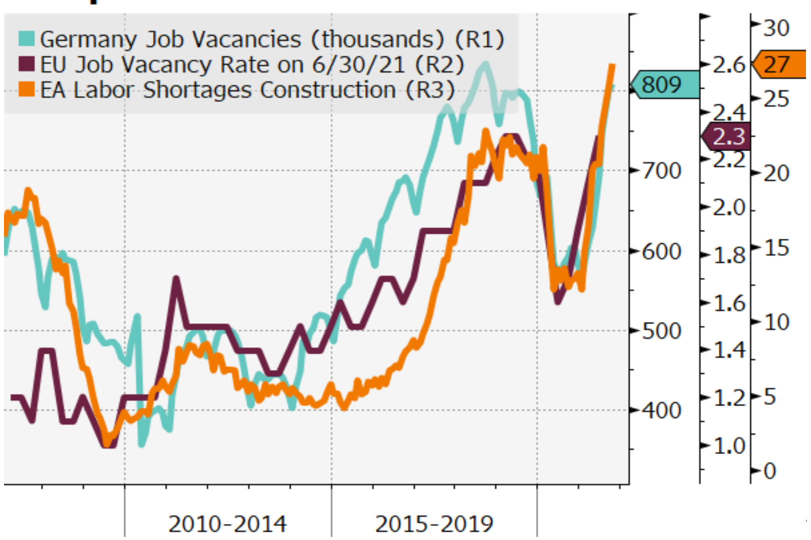
Category	Theme
LABOUR	Declining share of labour versus national income
TECHNOLOGY	Technological disruption (AI, robotics, …)
	Lack of productivity growth
ECONOMY	Reduced economic cycles volatility: Great moderation
	Globalisation
	Savings & investments preferences

Source: DPAM

HOW WILL THE **INFLATION NORMALIZATION** LOOK LIKE?

- The Covid episode has made it difficult to read through standard employment data
- Some indicators are easing, but peak and timing are difficult to forecast

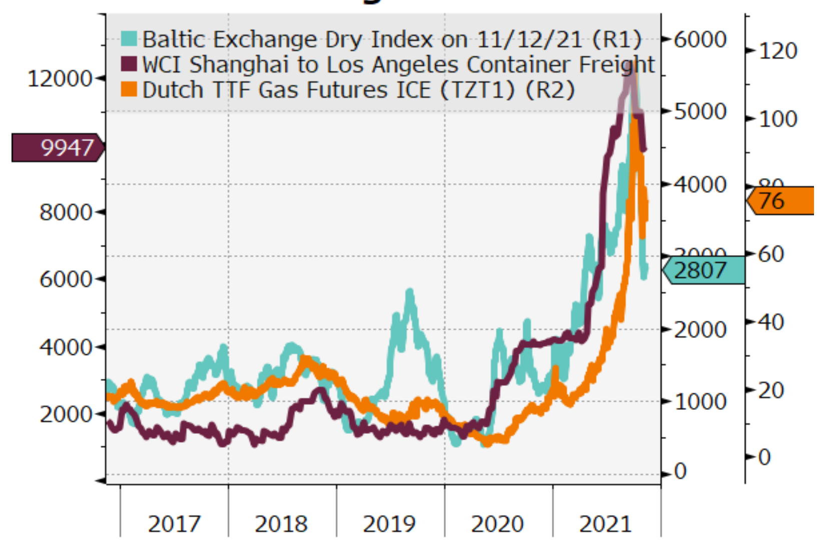
European Vacancies



Source: Bloomberg

GRUFPVAC Index (Germany Vacancies NSA) Outlook 22 Job Openings Monthly 01JAN200

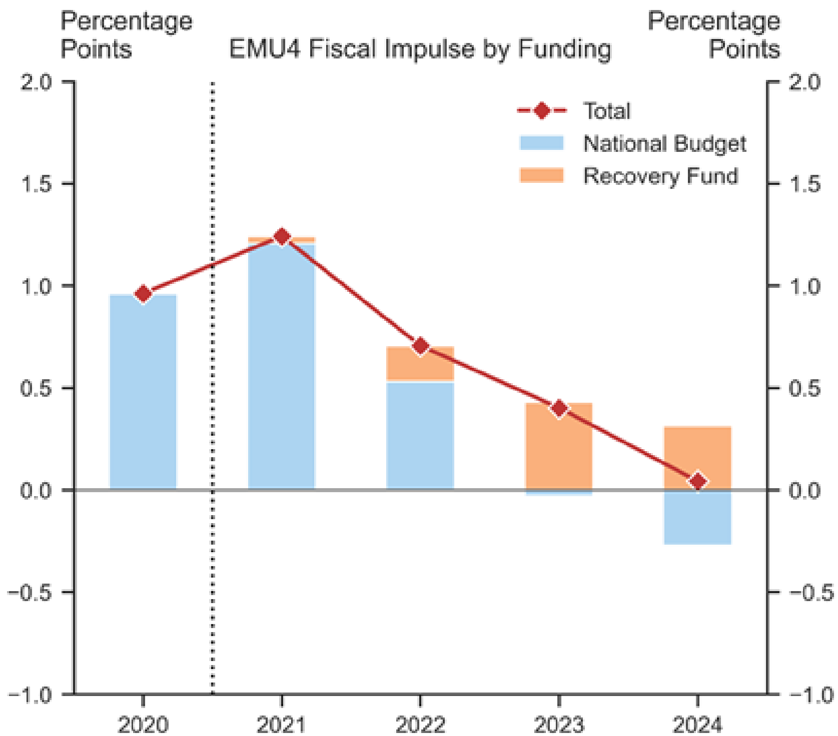
Is Inflation Peaking?



Source: Bloomberg

BDIY Index (BDI Baltic Exchange Dry Index) Inflation peaking Daily 12NOV2016-14

HAS POTENTIAL GROWTH CHANGED?



- The fiscal impulse in Europe should remain significant over the coming years
- Where a large part of it is driven by the NGEU budget which has a large focus on public investment
- The associated fiscal multipliers tend to be much higher than the typical spending multipliers, especially during recessions or with interest rates at the lower bound

Source: Goldman Sachs, DPAM – 24/10/2021

EURO AND GLOBAL RATES

Underweight
But opportunities outside EUR

EUROPEAN PERIPHERY

Overweight

INFLATION LINKED

Overweight
But reducing

2 EMERGING MARKETS

- Slower long-term growth trend ahead -

CHINA **SLOWDOWN**

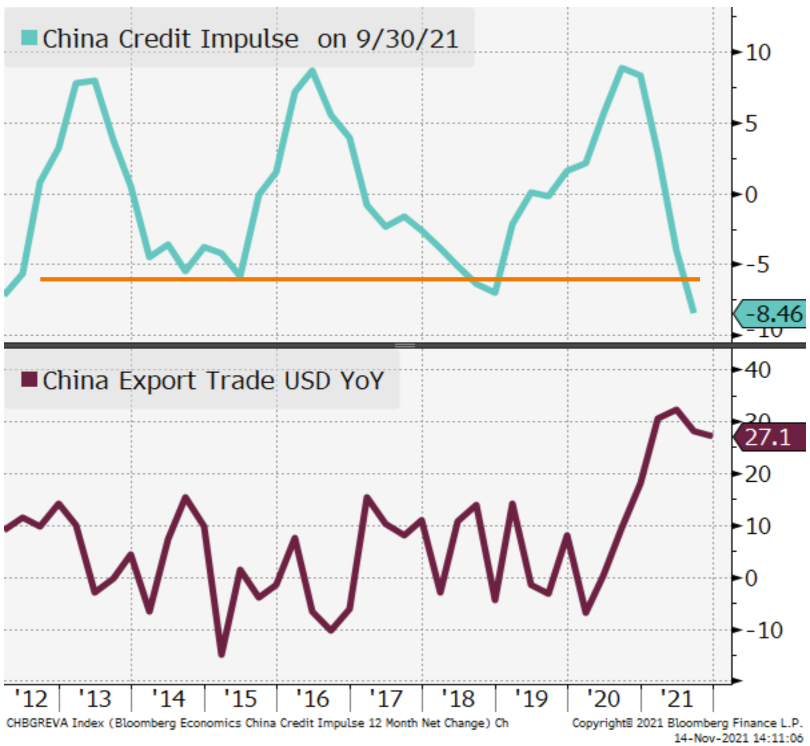
PROPERTY SECTOR CRISIS	regulation and deleverage policy
HEALTH CRISIS	zero covid policy and less effective vaccines
ENERGY CRISIS	bad weather conditions and climate transition

- China growth is expected to be around 5% only in 2022
- Expect strong exports on global demand, despite bottle-necks and ‘onshoring’ trend’
- Looking at the past, a fiscal impulse looks likely, possibly for climate transition purposes
- Despite a very strong currency, depreciation is less likely, given the already strong export momentum

- *Slower long-term growth trend ahead* -

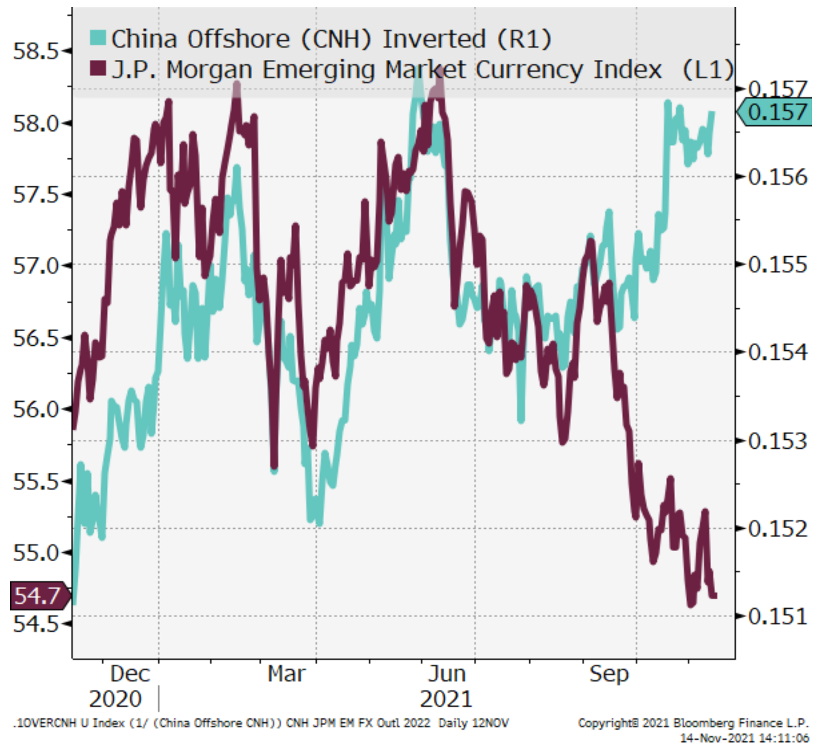
CHINA SLOWDOWN

China Credit impulse



Source: Bloomberg, DPAM

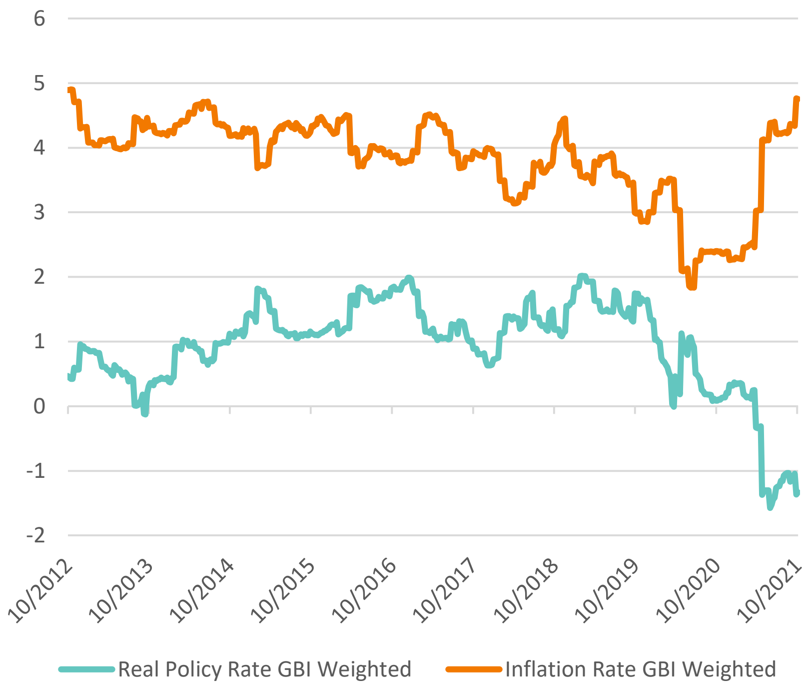
CNH outperformance vs EM peers



Source: Bloomberg, DPAM

- Central Bank's reaction function has an important impact on EMFX -

EMERGING MARKETS POLICY NORMALIZATION



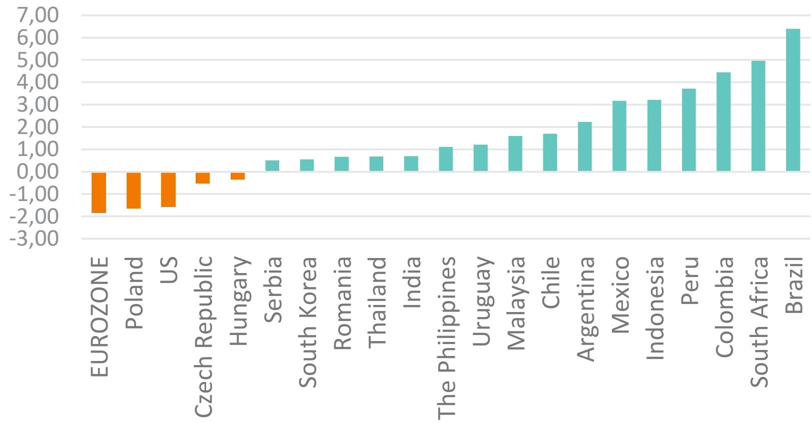
- During the pandemic, EM central banks have cut rates at an unprecedented pace, helped by low inflation
- Policy normalization by EM Central Banks has so far not resulted in more positive real benchmark rates, impacting EM currencies;
- Base effects and continued policy normalization will bring real policy rates back into positive territory during H1 2022
- This process will stabilize EMFX going forward

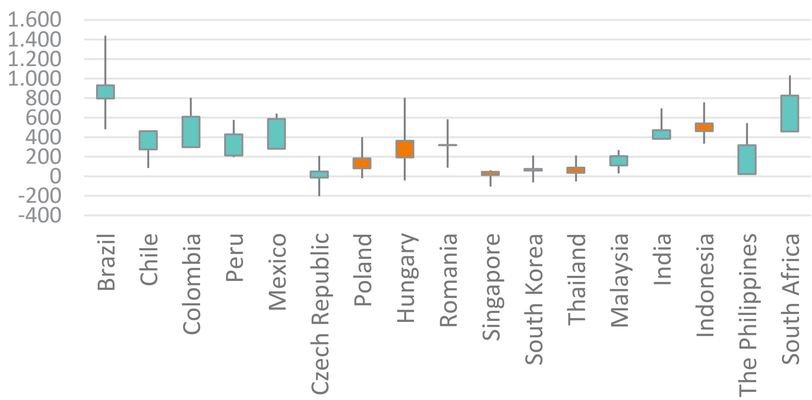
Real policy rate and inflation rate, weighted by GBI-EM Index

Source: Bloomberg, JP Morgan, DPAM – 08/10/2021

- *Low positioning, attractive real rates and a sizeable risk premium in many local markets* -

CHEAP VALUATIONS





- Low positioning (compared to the 2013 taper tantrum) and cheap valuations in many countries make local currency debt **attractive**
- 10-year local yields corrected for 12-month ahead inflation expectations are at multi-year highs in some markets (upper graph)
- Many local currency markets offer an attractive spread over US treasuries (lower graph)

Upper graph: Current 10-year yield on local debt corrected for 12 month ahead inflation ***expectations***

Lower graph: Spread of 10-year local currency sovereign bonds over US Treasuries. Green bars indicate a higher spread relative to 2013, orange bars indicate a tighter spread relative to 2013.

Source: Bloomberg, DPAM, Central Bank Publications – 08/10/2021

EMERGING RATES

Neutral
Looking to go OW

EMERGING FX

Neutral

3 **INVESTMENT GRADE** CREDIT

INVESTMENT GRADE

FROM PRICED FOR PERFECTION TO LOOKING FOR DISPERSION

1 ECB

- Still a **major player** in the corporate bond market universe.
- CSPP purchases comprise approx. 25% of APP purchases.
- ECB is holding around X% of the eligible corporate bonds.

2 CHIPS & LABOUR SHORTAGE

- **Demand-supply mismatches** in the global markets for commodities and manufactured goods.
- Key to determine in **which segments** the companies are located:
  - Manufacturers vs Services ; premium vs. mass market manufacturers; labour-intensive firms

3 INFLATION

- Largest contributor has been the surge in **energy prices**.
- The impact at the sector level is interesting as there are different implications, creating some **winners** and some **losers**.
- From an **operating perspective** how costs and revenues are impacted.

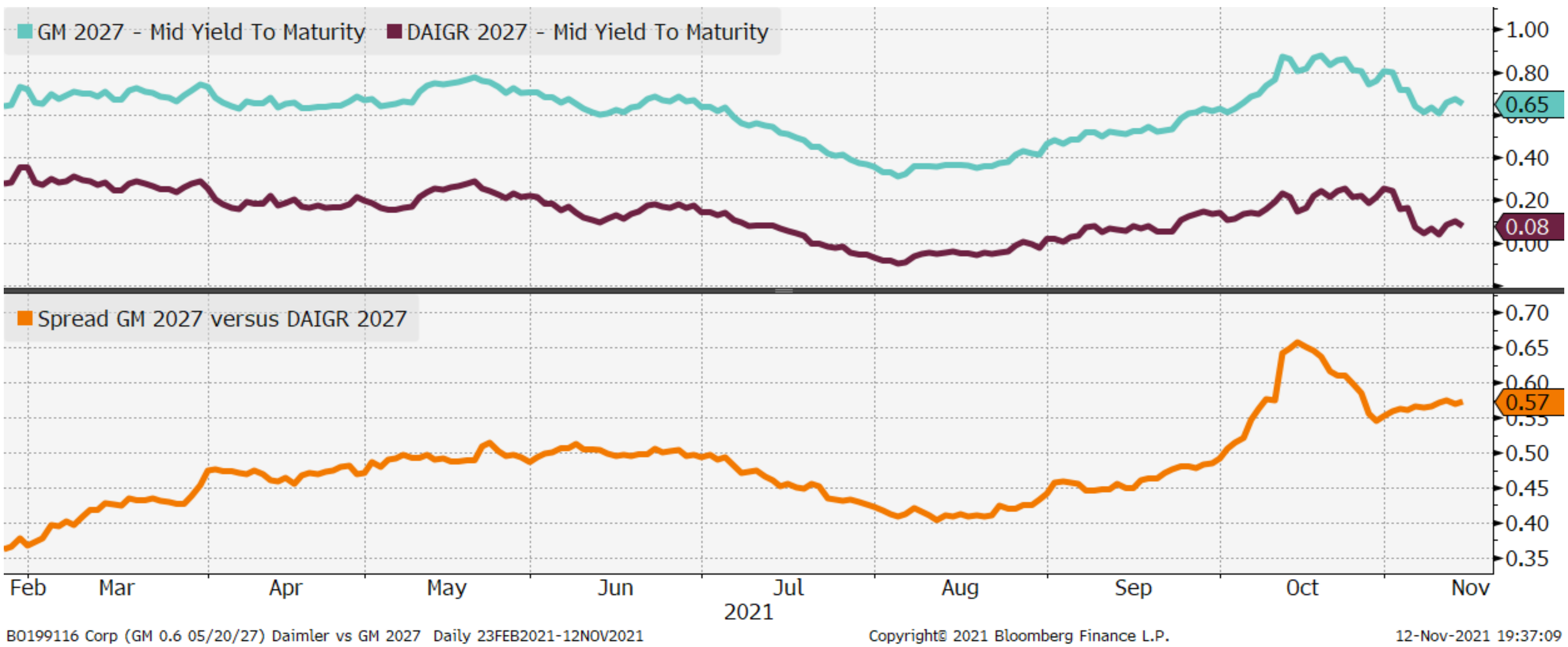
4 ESG

- Investors are looking to **increase their ESG assets** over time, to align with SDG and/or net zero targets
- **ESG-labelled corporate bonds** (sustainability (green and/or social), sustainability-linked, transition bonds …) should continue to find support

Selectivity and credit selection will be key

CREDIT CHECKLIST	DAIMLER	GM
CHIP & LABOUR SHORTAGE	The drop in unit sales due to the chip shortage has been offset by positive pricing/mix effects (focus on premium cars) → stable revenue in Q3-21 despite unit sales down by 25% y/y	Weaker pricing power due to the mass-market positioning → Revenue down by 25% in Q3-21, with unit sales down by 36%
INFLATION	Raw materials inflation has been more than offset by positive pricing → EBIT margin up by 40bp y/y in Q3	Strong negative impact from raw materials inflation → EBIT margin down by 400bp y/y in Q3
GREEN BONDS	Inaugural green bonds issued in September 2020 to finance the electric transition (objective: EV share of 50% by 2025 vs. 10% today)	No Green Finance Framework. Weak EV exposure (electric vehicles only represent 3% of total sales) and no targeted mix in the medium term (even if GM wants to accelerate its electrification)
TAX OPTIMIZATION	No tax-related controversy	GM has been flagged by MSCI for involvement in tax-related controversies.

IMPACT ON **SPREAD** IS SIGNIFICANT



Source: Bloomberg, DAIGR 0⅝ 05/06/2027 versus GM 0.6 05/20/27

INVESTMENT GRADE CREDIT

Neutral

4

HIGHER YIELD
CREDIT

HIGH YIELD
FROM CASH PRESERVATION TO BALANCE SHEET EXPANSION

1 POSITIVE EARNINGS GROWTH

- High yield companies have a **positive beta to the economic growth**.
- Higher **earnings growth** has been translated in **lower high yield spread**.
- Risk to earning growth disappointment has recently created additional **volatility**

2 SPREADS

- The focus on **cash preservation** and **government support** has resulted in a low default environment and **more rating agencies upgrades** than downgrades
- **Spreads are now fully discounting these factors**.

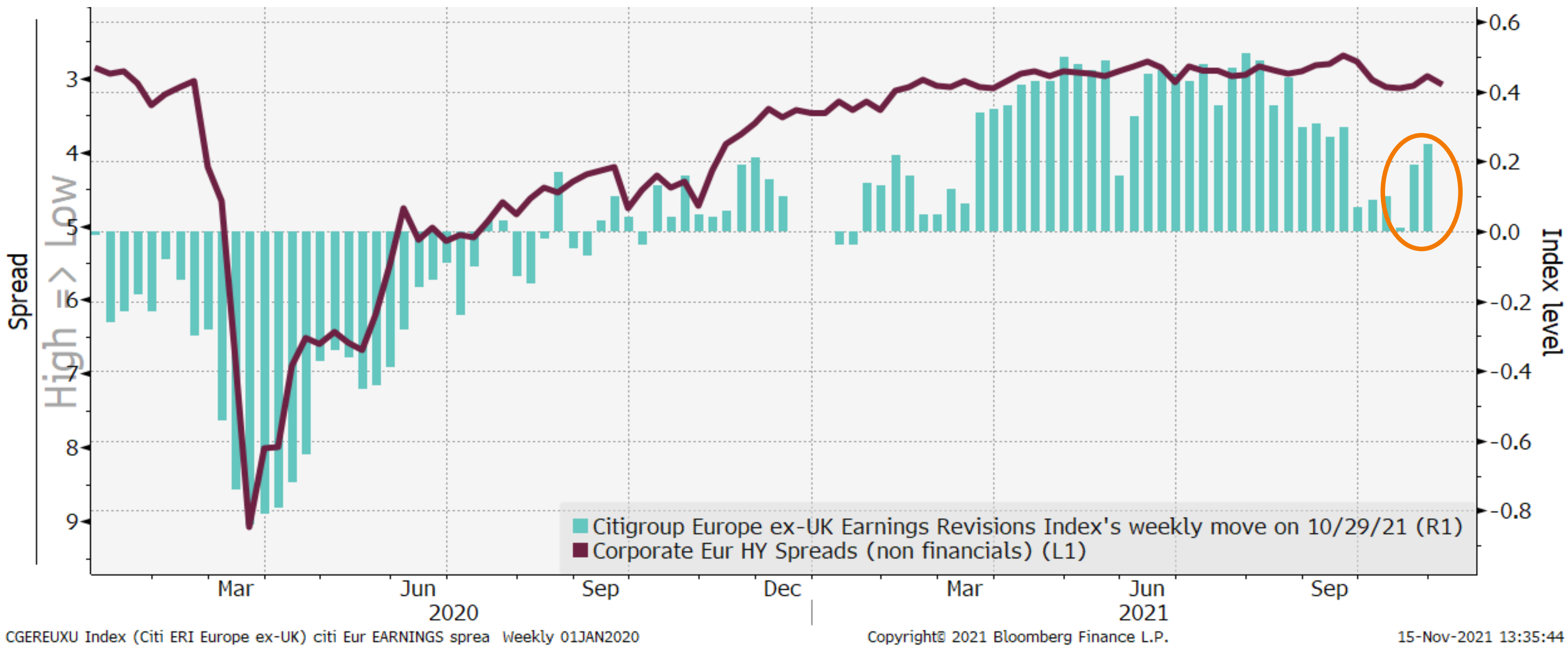
3 PRIMARY MARKET

- In **2020**, management focus was on refinancing to **strengthen the balance sheet**.
- In **2021**, we have seen a **return to M&**A and small tentative to recapitalization
- In **2022**, we expect **more** of both to prevail

4 SUPPORTIVE ENVIRONMENT

- **Credit spreads are strongly related to bank appetite for credit**.
- The current macro environment has been supportive for banks.
- We believe that banks will continue to loosen the credit standards in 2022.

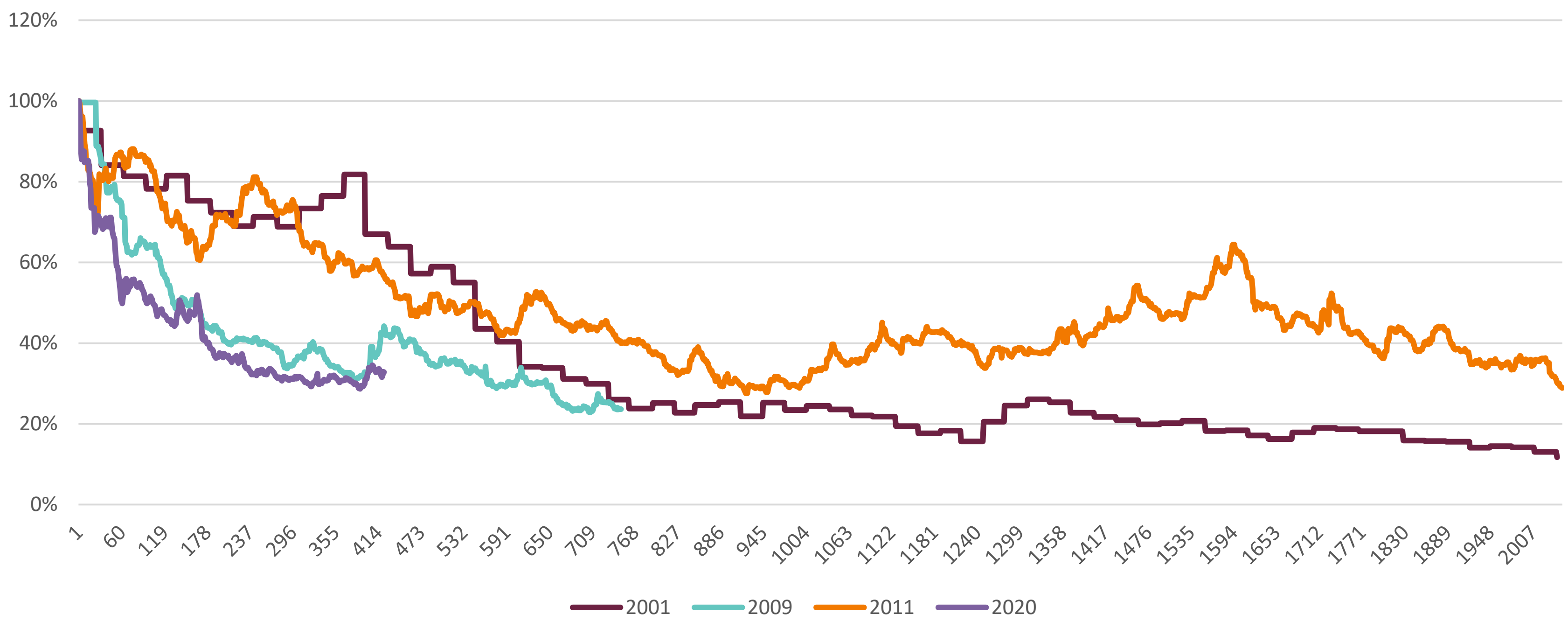
EARNINGS GROWTH AND HIGH YIELD SPREADS



Source: Bloomberg, 15-11-21

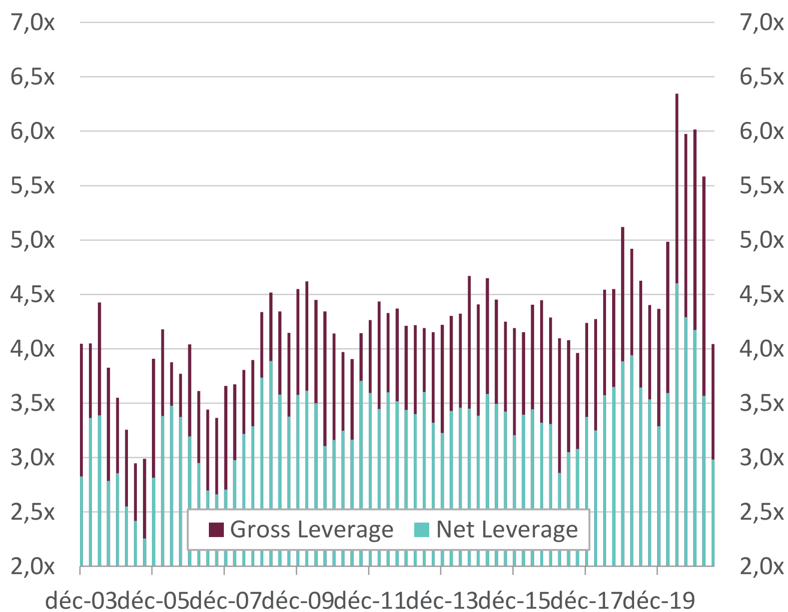
QUICK TIGHTENING –
TRADITIONAL RISK CREDIT FACTORS WILL PREVAIL

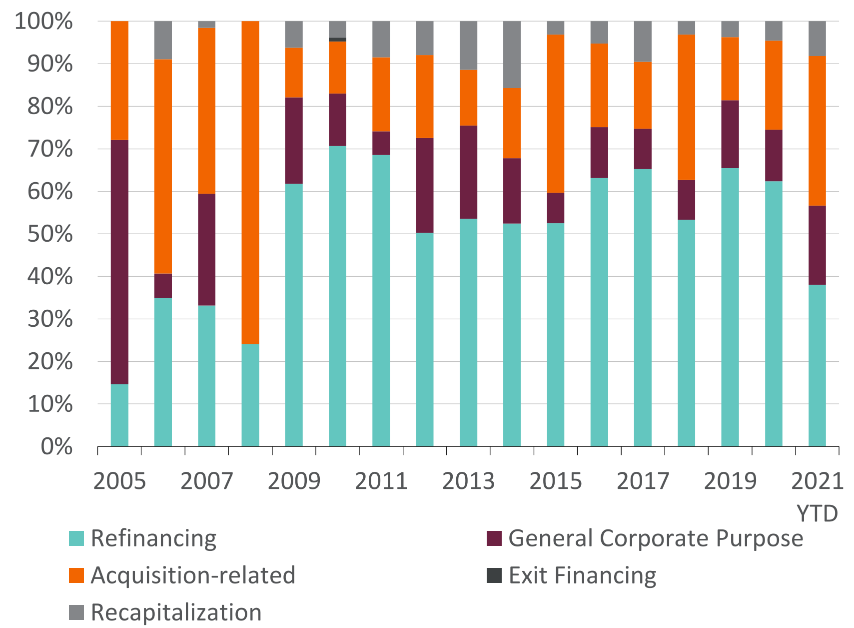
Number of days to pre-crisis level



Source: Bloomberg, DPAM – 03/11/2021

USE OF PROCEEDS – BALANCE SHEET EXPANSION WILL BE THE FOCUS





Source: Morgan Stanley – 29/10/2021

HIGH YIELD

Neutral

CCC

Cautious

5 **CONVERTIBLE** BONDS

KEY TRIGGERS EXPECTED FOR CONVERTIBLE BONDS IN 2022

POSITIVE EQUITY, NEUTRAL ON CREDIT

1 SHARE BUYBACK DIVIDEND

- **Share Buyback & dividends** should boost equity markets especially in the case where operating leverage enhances earnings.

2 REAL RATES

- In a world where inflation could be less ‘transitory’ than expected, negative real rates could be a support for equity valuation.

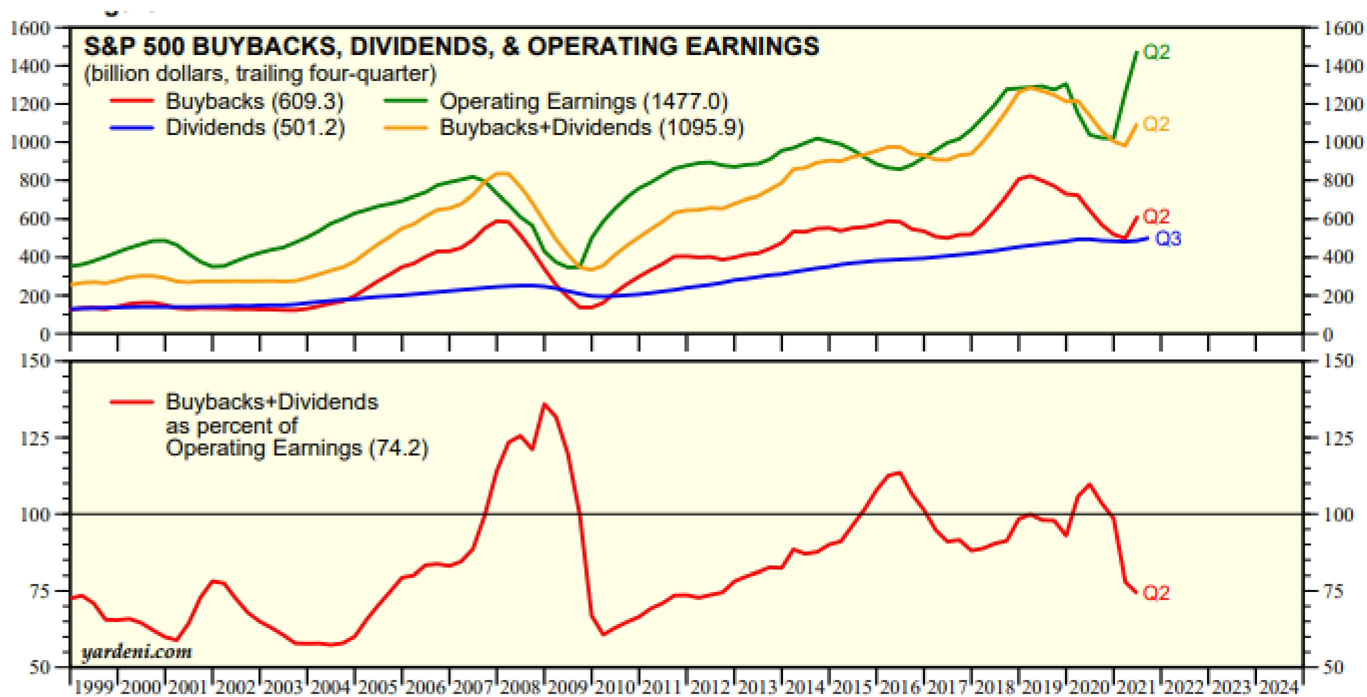
3 M&A

- **Ratchet clauses** could be the cherry on the cake to add specific value to convertible bonds.

4 STABLE SPREADS

- Historically, default rate remains low.
- For convertibles, the **equity upside is more attractive** than the credit component

BUYBACK & DIVIDENDS AS % OF OPERATING EARNINGS

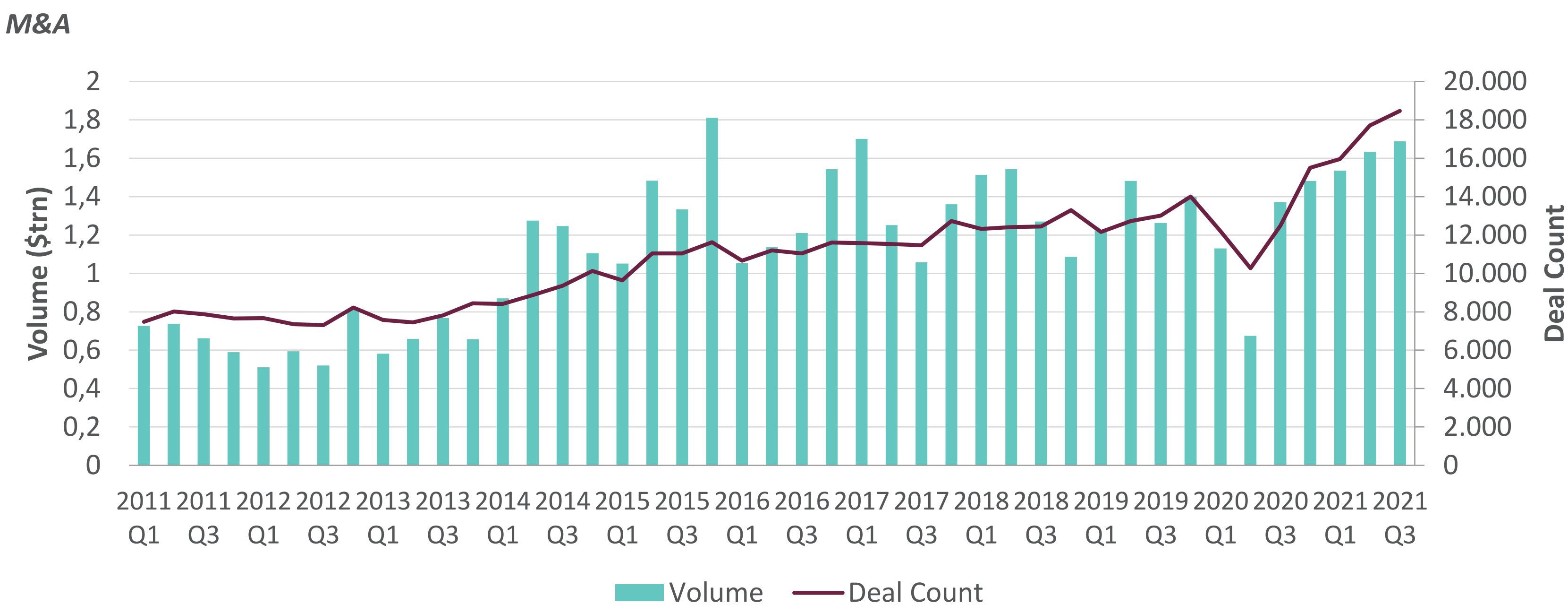


Source: Standard & Poor's.

The % of SBB & Dividends is lower compared to the historical average. If the operating leverage continue to work in 2022 like we have seen on the Q3 2021 results, we could expect board of directors increase the return to shareholders.

Source: Yardeni,26th October 2021, [S&P 500 Buybacks & Dividends (yardeni.com)]

M&A



2021 has been a strong year for M&A with more than $5tr of deal. With equity markets all time high & better economic outlook, we can expect further deals to come next year.

Source: Bloomberg, as of 15/11/2021

CONVERTIBLES

Neutral

THANKS TO YOUR PARTICIPATION TO OUR OUTLOOK 2022: A SILVER LINING,

DPAM WILL DONATE THEIR GOODIE-BUDGET TO "**THE OCEAN CLEANUP**"

The Ocean Cleanup, a non-profit organization, is developing ***advanced technologies to rid the world's oceans of plastic****.*

CLEAN UP what is already polluting our oceans

INTERCEPT plastic on its way to the ocean via rivers

SCIENTIFIC RESEARCH
to understand the problem and develop cleanup solutions

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