AZIMUT
DEFINING INVESTMENT DIRECTION

AZIMUT GLOBAL VIEW

14.02.22

Main Events

CHINESE CPI — 16.02
Inflation is expected to slow down to 1.0%, giving the PBOC ample room to ease monetary policy

US RETAIL SALES — 16.02
Retail sales are likely to rebound after a sharp drop last month. Consumption's resilience would be questioned if this were not the case.

MARKIT EU — 21.02
How has the rise in input costs and tensions in Ukraine affected European companies' confidence?

US PERSONAL INCOME — 25.02
0.3% reduction is expected on a MoM basis, implying that US consumers' purchasing power is fast eroding in real terms

Azimut Global Network

- Milan
- Abu Dhabi
- Austin
- Cairo
- Dubai
- Dublin
- Hong Kong
- Istanbul
- Lugano
- Luxembourg
- Mexico City
- Miami
- Monaco
- New York
- Santiago
- São Paulo
- Shanghai
- Singapore
- Sydney
- Taipei

WAGES ON THE RISE

- **Rising inflation is leading to stronger demand for wage increases**
- **Due to the shortage of labor, companies are forced to accept workers' requests for higher salaries, as record number of companies is having difficulties filling job-opened positions**
- **Wage inflation is having the biggest impact on companies that are unable to pass on increasing labor costs to their customers**

Inflation has been one of the hottest topics in recent months, with the main debate being whether it will be a transitory phenomenon or become more persistent and entrenched in the economy.

Wage growth has always been one of the factors that has made inflation more persistent.

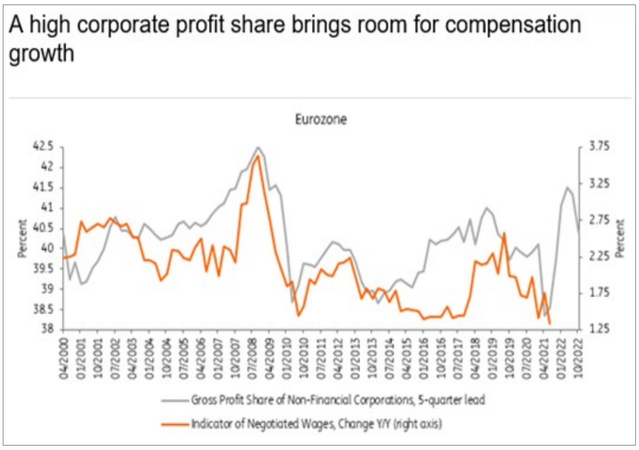
Wages are a laggard indication since inflation always anticipates favorable wage growth patterns with consumer price inflation (CPI) being one of the primary drivers in salary negotiations. Wage increases, both in nominal and real terms, are usually a powerful and healthy contributor to sustained inflationary pressures.

Consider Europe and the link between inflation patterns and wage growth: historically, every sustained increase in consumer prices has been followed by a positive wage growth path, usually with a two-quarter lag (graph on the next page).

Companies, on the other side of the equation, are mostly facing labor shortages, and are unlikely to push back because the impact on their margins will be tolerable given the strong gross profit margins.

(continued)

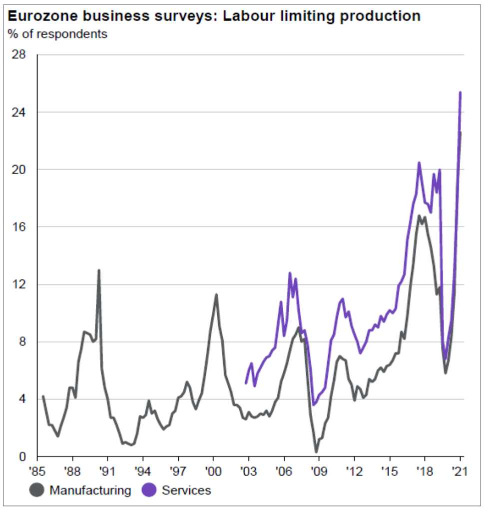
Source: Eurostat, ING Research

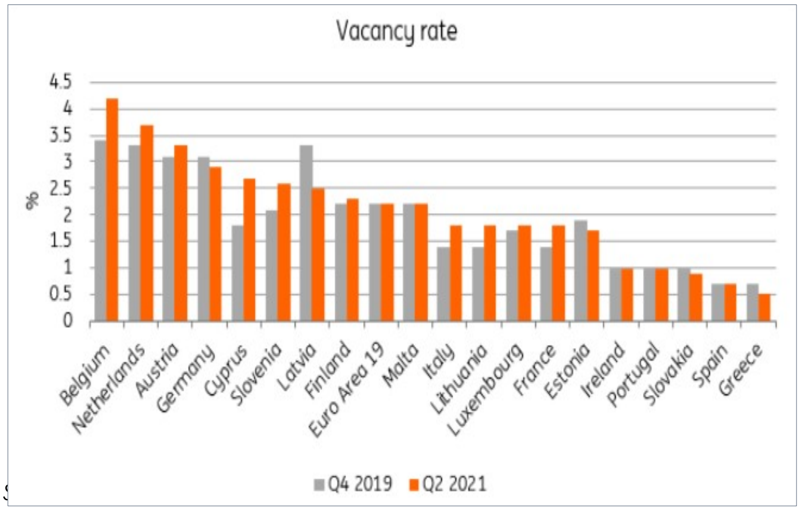


Source: Eurostat, ING Research

According to recent surveys, several companies in the Eurozone, especially in the manufacturing and construction sectors, are mentioning labor shortages as a key factor limiting production. Aside from manufacturing sector, the hospitality, IT, and administrative support sectors are seeing the most worker shortages.

Moreover, despite the severe economic damage caused by the pandemic, most European countries are reporting higher levels of job vacancies than they were prior to the start of the pandemic (job vacancy is defined as a paid post that is newly created, unoccupied, or about to become vacant).





In the US, the labor conditions and wage increase pattern has become much more pronounced.

2020 was one the most extreme global employment shock ever experienced, notably in the USA. The USA, where social safety nets have traditionally been less important, the shock was met with unprecedented stimulus payments and unemployment assistance. The result was that a lot of workers, especially in the low-income cohort, were able to accumulate savings over this period and increase their leverage and ability to quit their jobs or ask for wage increases.

The rally of equity markets, which has historically represented a large portion of consumer savings, along with rising real estate prices, contributed to a widespread increase of consumer wealth among all income brackets. The positive change in net consumer wealth gave more negotiation power to the US workforce, regardless of the income bracket.

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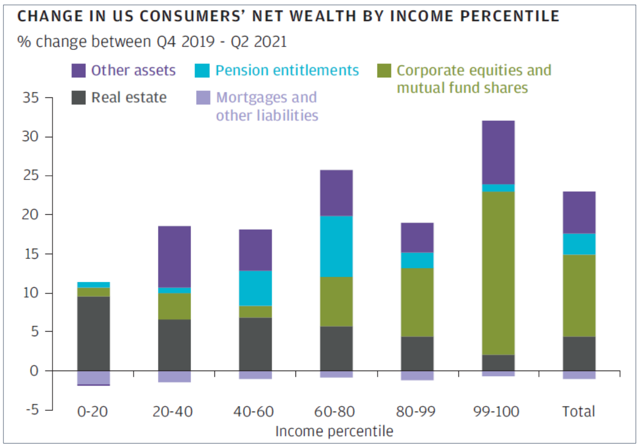
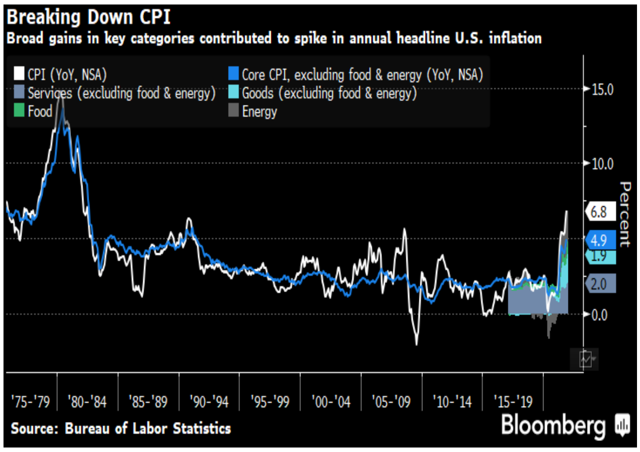




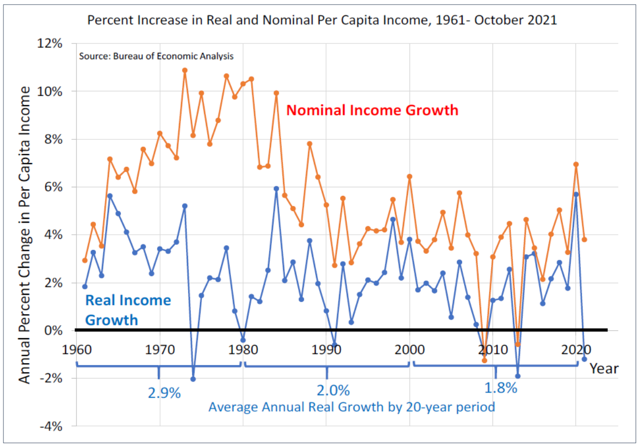
Source: US Federal Reserve, J.P. Morgan Asset Management

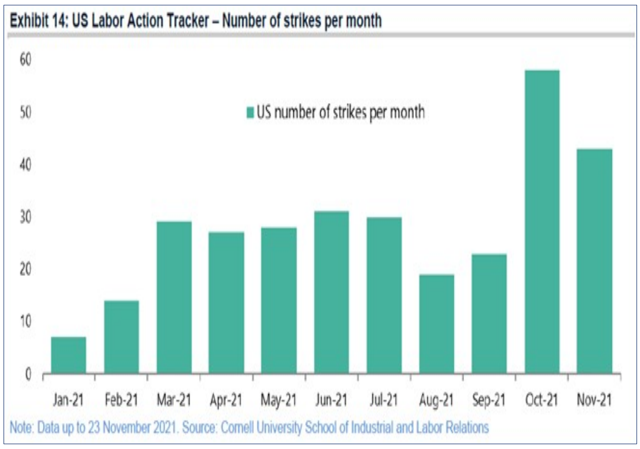
Source: Bureau of Labor Statistics, Bloomberg

Wage increases are usually common in period of huge gaps between nominal and real wages.

The year 2021 represents the perfect example of this, with Consumer Price Index surging to a level not seen in decades. Despite wage negotiations, this huge and rapid surge in CPI has led to a huge gap between nominal and real income growth.

This gap is the biggest determinant behind huge strikes that occurred across several industries in the US. The request has always been the same: higher wages.





Source: Jefferies

Source: Cornell University School of Industrial and Labor Relations

"Deere & Company just an example, with 10,000 of its unionized workers achieving a lot following a nearly month long strike. Aside from an immediate 10% pay rise and a generous increase in retirement benefits, the most significant detail is that, going forward, wages will be adjusted each quarter based on inflation. These cost-of-living adjustments were a major feature of the 1970s. (reworded from Greed&Fear). Source: Jefferies"

On top of these chronic problems, the US economy is experiencing a problem that has rarely occurred before; the Great Resignation. The Great Resignation is a term coined by Anthony Klotz (a psychologist and professor at Texas A&M) and based on the rapid rise in voluntary turnover, caused by a variety of factors. Klotz highlights four drivers of The Great Resignation: 1) backlog of people who would have quit pre-pandemic, but had to postpone their plans, 2) burnout, 3) identity shifts, and 4) the work from home movement.

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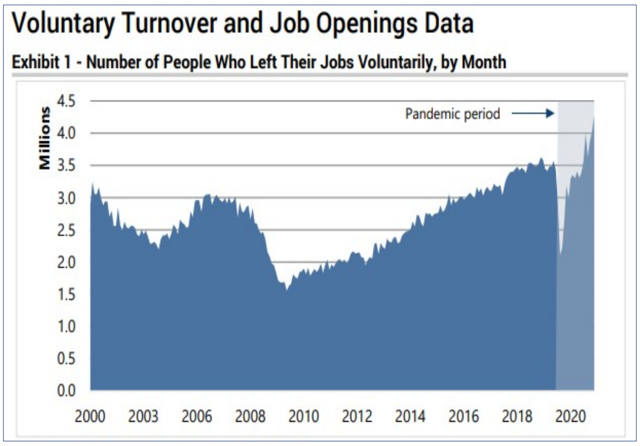
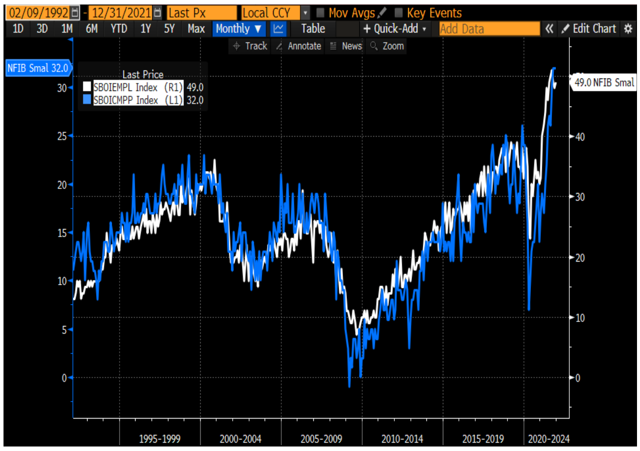
This phenomenon has led to rapid increase in voluntary resignation, as shown below. This phenomenon has also been helped by the rapid surge in net wealth, as shown before.



Source: US Bureau of Labor Statistics, Jefferies



Source: Bloomberg

The graph on the right shows the natural result of the voluntary employment termination. A record number of USA small-mid cap companies (800 companies in the sample) is having difficulties filling job-open positions (blue line) in a context where the majority of companies that plan to raise wages (white line) is at record-setting levels.

During the fourth quarter of 2021 reporting season, most CEOs rang the alarm about "wage inflation everywhere" in the US economy. Among them were David Solomon of Goldman Sachs and Jamie Dimon of JPM, both of whom have cast a shadow on profit margins in the coming years due to wage hikes.

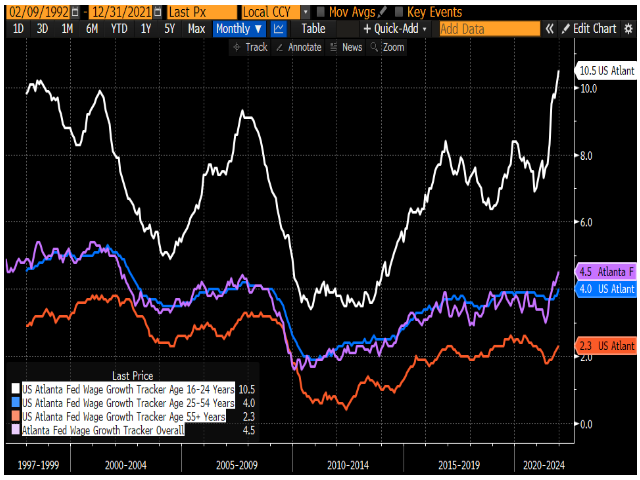
Wage increases are particularly evident in the population's youngest group, as shown below (16-24y). The aggregate growth wage tracker by the Atlanta Fed (purple line) shows the strongest wage increase pressure since the early 2000s.

Labor shortages, both in Europe and across the Atlantic, increased retirements and decreased labor supply (with the consequent need to retain talent and pay them competitively), supply chain disruption and need to make the supply chain "shorter" (less reliance on low-income countries),

Robust economic growth, surging inflation and higher capital spending are all indicators that wage negotiations will continue into 2022, at least in the developed markets countries.

The big question remains as to how long companies could cope with higher input prices and labor costs without hurting profits and earnings.

So far, the reporting season has revealed a divergence between companies in the IT, Communication services and Financials, which have been able to maintain strong gross profit margins, and those in the Industrials, energy, and Materials, whose margins are under pressure.



Source: Bloomberg

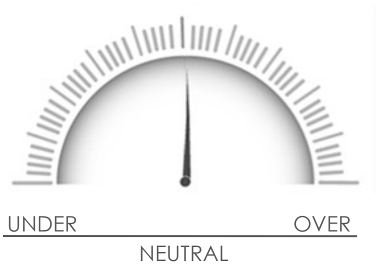
Asset Allocation View

	−	=	+
Equity			
Developed Markets		Downgrade	
Emerging Markets		■	
Fixed Income			
Developed Markets Sovereign		Upgrade	
Developed Markets Corporate		■	
Emerging Markets			■
Commodities			■
Currencies		*Commentary below*	

− UNDER = NEUTRAL + OVER

Equity

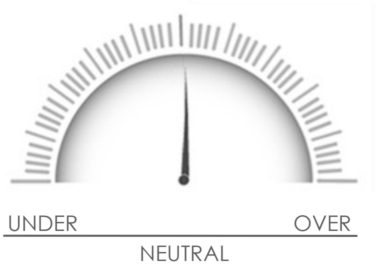
Developed Markets



We have reverted our recommendation on Developed Markets Equities back to **Neutral**. Following last week's upgrade, equity markets began to recover in line with expectations, but ECB's much more hawkish posture, the highest CPI print in the US in 40 years and the mounting tensions in Ukraine suggest that a more cautious view is now warranted. The expectation of several interest rate hikes by various central banks as well as the run-off on central banks' balance sheets may lead to lower multiples. Given the rising tensions in Ukraine, we'd prefer to downgrade Europe to neutral.

US	=	**Europe**	=	**Japan**	=

Emerging Markets

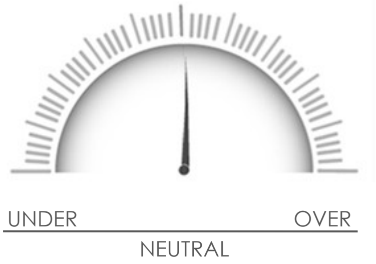


We kept our **Neutral** recommendation unchanged on Emerging Markets Equities. Emerging markets continue to show signs of resilience during this volatile period, thanks to the much lower valuation of developing Nations versus the developed ones. This is encouraging and reinforces the view that emerging markets could represent one of the most interesting opportunities in 2022. As a result, we continue to recommend gradually accumulating them. Within the EM space, our preference remains for the Asian region, and China in particular.

Asia ex-Japan	+	**EEMEA**	=	**LATAM**	=

Fixed Income

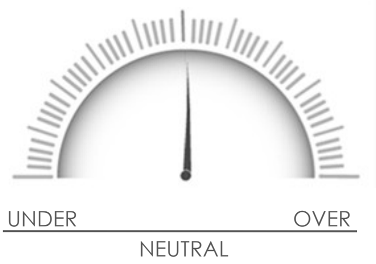
Developed Markets Sovereign



We upgraded Developed Markets Sovereign Bonds to **Neutral**. The Bank of England and the ECB have joined the Fed in forecasting a faster exit from the ultra-loose monetary policies of the past years. Additionally, the highest inflation in 40 years in the US has further exacerbated the expectation for higher rates. As a consequence, the short-end of the curves now discount up to 7 hikes in the US in 2022, and up to two in the EU. Rates on the long-end of the curves were more stable, but the US 10-year rates managed to reach our first target for a temporary consolidation, hence our upgrade to neutral for the asset class. Our long term view, however, remains that rates should continue to rise.

EU Core	EU Periphery	US Treasury	Japanese JGB

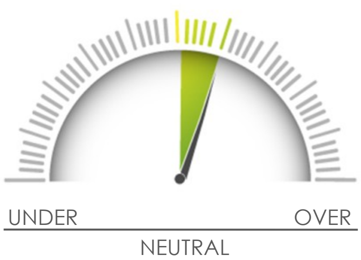
Developed Markets Corporate



We maintained our Neutral recommendation on Developed Markets Corporates. The recent widening of both investment grade and high yield bonds spreads is not considered extended enough to merit an upgrade. Corporate bonds in developed markets are anticipated to continue to be pressured by a faster-than-expected tapering and a more consistent pace of rate hikes. Furthermore, we are starting to see outflows from fixed income funds and ETFs, which could lead to additional pressure on the asset class. We continue to recommend taking a cautious stance on the asset class and favoring strategies that actively manage the duration and/or are focused on short maturities.

IG Europe	IG US	HY Europe	HY US

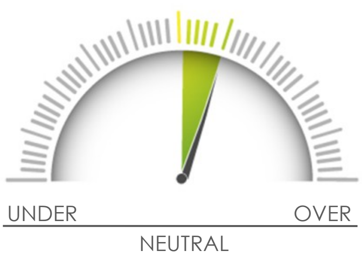
Emerging Markets



We reiterate our **Slightly Overweight** recommendation on Emerging Market bonds. During the second half of January emerging market bonds began to shows signs of strength, which persisted in the first half of February. We maintained our favorable outlook on high yield bonds, and particularly Asian high yields which are trading at spreads near to the highest levels in decades as a result of Chinese government crackdown and of the Evergrande crisis. Furthermore, the fact that EM central banks are significantly further along in their hiking cycle than their DM peers, there is minimal downside left on EM bonds, at least in terms of the duration risk.

Local Currency	Hard Currency IG	Hard Currency HY

Commodities



We kept our **Slightly Positive** view on the Commodities. We continue to prefer precious metals, given that the real rates are still deeply negative and have lagged other commodities. Additionally, precious metals are one of the few asset classes that may serve as a hedge in the event of a market turbulence or geopolitical crisis, or as an inflation hedge if inflation is not temporary. We have maintained a more cautious view on the other commodities.

Precious	Energy	Industrial	Agricultural

Currencies

The committee's view on the US dollar is neutral as a result of two opposing forces. On the one hand, the rate differential is growingly supporting a stronger US Dollar, while on the other hand the prospect for a balance sheet run-off by the Fed in the second half of the year and the increased US Treasury funding needs could lead to a weaker greenback.

The Euro is also viewed as neutral, considering the more hawkish stance by the ECB and the increased tensions surrounding Ukraine.

The view on the Chinese Renminbi is has been upgraded to neutral. The Chinese government does not appear to be in a rush to bail out the real estate sector, and the People's Bank of China's rate cut was only symbolic with no further easing provided or announced. Lacking supportive measures, the currency could remain quite strong.

Other emerging market currencies have finally started to rebound thanks to the several interest rate hikes enacted by several central banks.

Euro	USD	CNY	Other EM
=	=	=	+