AZIMUT
DEFINING INVESTMENT DIRECTION

AZIMUT GLOBAL VIEW

14.03.22

Main Events

FOMC MEETING
The FED is expected to deliver its first rate hike in more than three years. Will it be of 0.25% or 0.50%?
16.03

EUROZONE CPI
The preliminary reading for February, which should not yet include the effects of the war in Ukraine, is expected to reach 5.8% YoY
17.03

BANK OF JAPAN
Japan is the only major country where inflation is still below the policy target, hence no changes are expected at this meeting
18.03

MARKIT PMI
Markit PMI will be the first sentiment indicator to be released for March and will help gauge the impact of the war on global confidence
24.03

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

COLLATERAL DAMAGES

- **Chinese stocks suffered severe corrections in the last ten days, dropping by about a quarter.**
- **Several factors contributed to the move, from renewed crackdowns by the Chinese government and the SEC, to the rumors about China potentially supplying weapons to Russia**
- **Although valuations are at an all-time low, some caution is still required in light of recent events.**

In our previous report, we had indicated that the first and direct casualty of the commencement of the war in Ukraine would be European stock markets due to the close economic ties existing between Western Europe and Russia. Surprisingly, two weeks later, the epicenter of the issue appears to have shifted to China.

This Monday, the Hang Seng China Enterprises Index (HSCEI) posted its biggest drop since November 2008, declining by over 7% on the day, while the Hang Seng Tech Index tumbled 11% in its worst decline since the gauge was launched in July 2020. Since the beginning of March, the HSCEI and the Hang Seng Index (HSI) of Hong Kong companies are down about 24% and 19% respectively. The rout was even worse for the Chinese stocks listed in US markets, with the Nasdaq Golden Dragon index tracking American depository receipts of Chinese firms dropping by a third in just three days.

A combination of several factors contributed to the selloff that affected the Chinese stock markets, but the most relevant and troublesome one is the last one. On Friday, a rumor started to circulate that Russia had asked China for military assistance in its war in Ukraine. The United States immediately warned China that if confirmed, there would be severe consequences and sanctions for China and Chinese companies. So far, the Asian giant has tried not to offend either side, and has tried to maintain a neutral position by refraining from supporting any of the contenders.

(continued)

Source: Bloomberg

The sentiment further soured on Monday following an article from the Financial Times reporting that the US has told allies that China has responded positively to Russia's request for military equipment, without specifying if China has provided help or just told Moscow that it would provide support.

For the moment, such claims seem to be just rumors, but even a remote doubt that China or Chinese companies could be exposed to sanctions is leading investors to reduce their exposure, regardless of the fundamentals. These fears add to a series of other negative catalysts that have arisen in the preceding days.

The first one is that the Chinese government revamped its crackdown on some technology names. The planned Hong Kong listing of Didi Global was stopped after the company failed to meet Chinese regulators' demands that it overhaul its systems for handling sensitive user data, and Tencent is facing a possible record fine for violations of anti-money-laundering rules.

The US regulator also contributed to creating a headache for Chinese stocks. Last week, the SEC provided the first list of Chinese stocks that may be subject to delisting should the companies refuse to open their books to US regulators. Currently, the US regulator cannot have access to documents of Chinese companies, not even request them from audit firms (this applies also to western audit firms). Companies that fail to comply within 3 years of their inclusion in the SEC lists may be subject to forced delisting from US exchanges.

Source: Bloomberg

(continued)

Source: Bloomberg

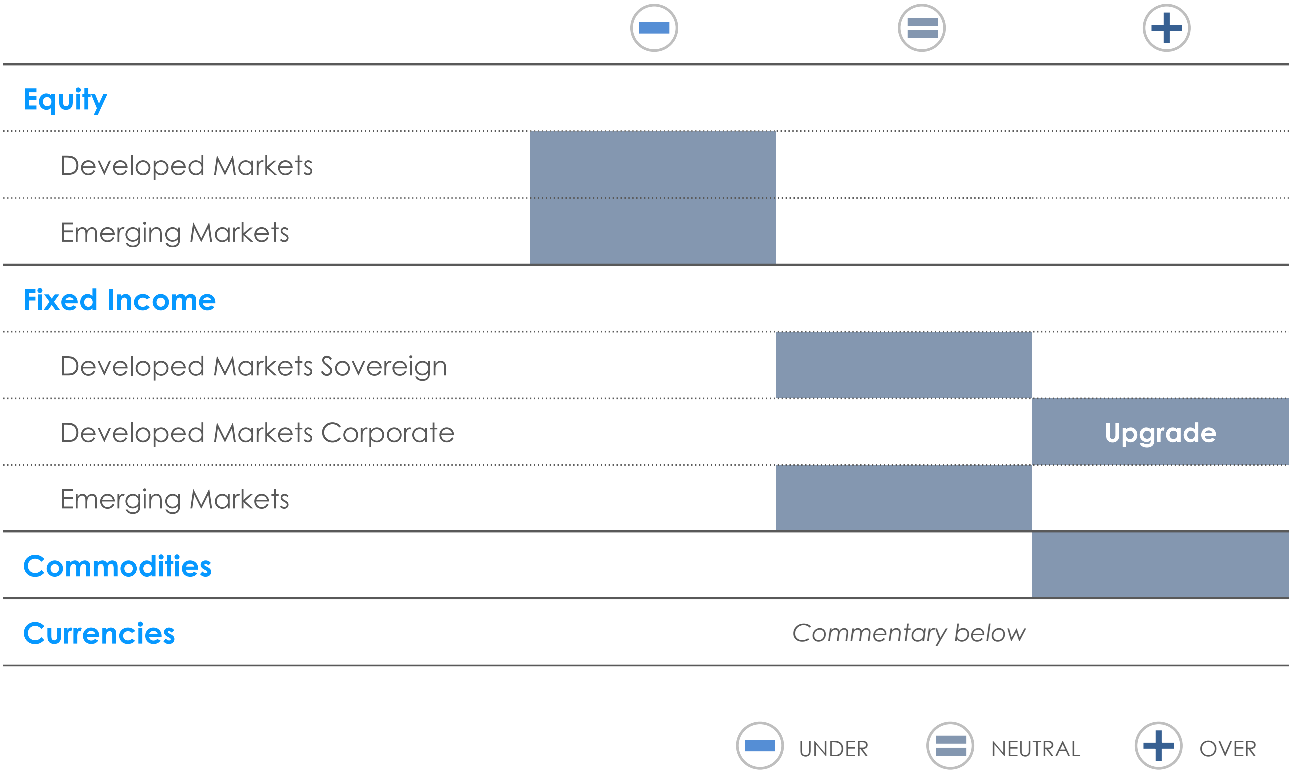
The last factor negatively impacting Chinese stocks has been the rapid increase in COVID-19 cases, which has doubled nationwide in the past week. The lockdown of Shenzhen for at least a week, as well as the possibility of three major Chinese ports closing for an extended period, particularly impacted sentiment.

Brokerage and investment firms reacted to the wave of unexpected bad news all at once by lowering their recommendations on Chinese stocks. For example, on Monday, JPMorgan Chase & Co. analysts downgraded Chinese internet stocks to sell-equivalent ratings, calling them "uninvestable" in the near-term "due to rising geopolitical and macro risks, which "lead to significant fund outflows."

In order to provide a recommendation on what to do, we must compare the set of negative catalysts outlined above against the indications of fundamental analysis. The graphs above show the Price/Earnings ratio for the next 12 months and the Price/Book Value, both for the Hang Seng index of Hong Kong companies, and for the Hang Seng China Enterprise Index of Chinese companies listed on the Hong Kong stock exchange. It can be easily appreciated how both multiples for both indices are currently at, or near the lowest level in history.

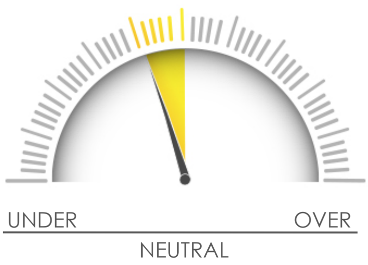
Our suggestion to clients who are underweight or correctly exposed to China is to keep accumulating it, as we suggested earlier this year. For those who are overweight, it is preferable to continue accumulating emerging markets, focusing on those that are not or only marginally exposed to China (like, for example, Latin America and ASEAN), while waiting for greater clarity and visibility on recent developments, particularly those involving Russia.

Asset Allocation View



Equity

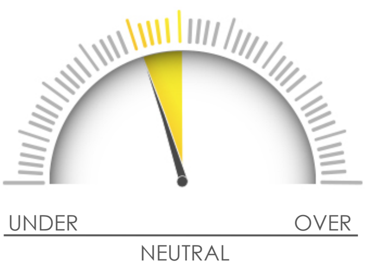
Developed Markets



We reaffirmed our **Slightly Underweight** recommendation on Developed Markets Equities. While we continue to maintain a relative preference for equities in the long term due to the more inflationary environment, we prefer a more cautious stance in the short term due to the conflict in Ukraine and the spike in commodity prices. Recent developments suggest that the bear case is now more likely to materialize than it was prior to the invasion. We concluded that the relative underweight suggestion on European equities was no longer necessary, owing to the strong underperformance since the start of the war, as well as the fact that the current higher rates may act as a headwind for growth firms.

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

Emerging Markets

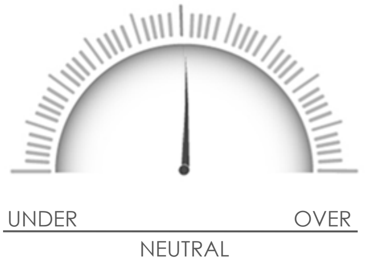


We kept our Emerging Markets Equities rating unchanged at **Slightly Underweight**. As argued in the prologue of this report, in China the resurgence of the government crackdown on tech companies, the renewed threat of delisting Chinese companies from American stock exchanges and the fear of sanctions against China due to the suspicion of collaboration with Russia caused a sharp sell-off in Chinese stocks. None of these things could have been predicted in advance. Because of the potential of sanctions, despite the extraordinarily low valuations, investors should exercise caution when it comes to China and emerging markets, as they may reduce their exposures. Given these circumstances, it is appropriate to continue with the accumulation plan but only if there is an underweight to EM countries.

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

Fixed Income

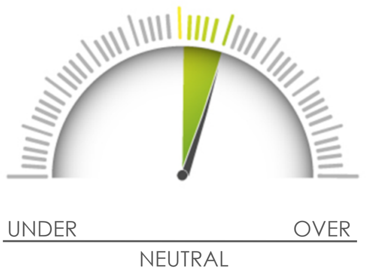
Developed Markets Sovereign



We kept our **Neutral** recommendation on Developed Markets Sovereign Bonds. On one hand, sovereign bonds may benefit from their safe-haven status if the conflict escalates, but on the other hand they are exposed to considerable downside should rates start to normalize to higher level as a result of runaway inflation. We believe that these two risks as balanced in the short term. In the medium term, much will depend on the forward guidance of central banks. The ECB already hinted at tighter monetary policy, and the Fed is expected to do the same at its meeting on Wednesday.

EU Core	=	EU Periphery	−	US Treasury	=	Japanese JGB	=

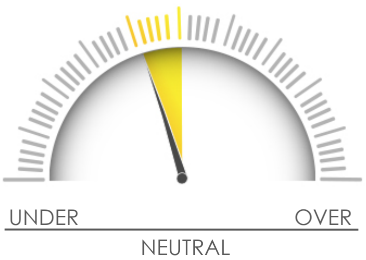
Developed Markets Corporate



We upgraded to **Slightly Overweight** our recommendation on Developed Markets Corporates. The decision to increase the recommendation stems primarily from a generally cautious view on all the risky assets, which could have further downside due to an escalation of the conflict and/or an increase in rates. Among the various asset classes, short-dated, high-grade corporate bonds are seen as the best solution for weathering the storm. The recent rise in risk-free rates together with the widening, albeit modest, of the spreads on companies with good fundamentals allows for a decent return with limited volatility. The outlook for high yield and short-term corporate bonds remains negative.

IG Europe	=	IG US	=	HY Europe	−	HY US	−

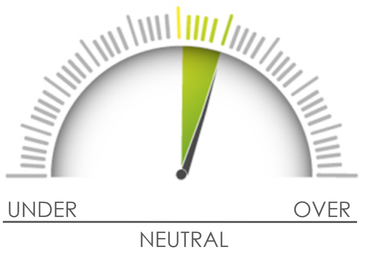
Emerging Markets



We maintained our **Slightly Underweight** recommendation on Emerging Market bonds. The invasion of Ukraine resulted in a sharp reversal of flows into emerging market bonds seen in the first weeks of this year, causing spreads to widen significantly mainly in the hard currency space. The recent developments in China discussed in the prologue have prompted investors to further reduce their exposure to the asset class. As long as these negative developments persist, it is reasonable to expect emerging market bonds to remain under stress, despite spreads reaching high levels. We prefer local currency bonds issued by commodity exporting countries.

Local Currency	=	Hard Currency IG	−	Hard Currency HY	−

Commodities



We maintained our **Slightly Positive** view on the Commodities. We continue to prefer precious metals, particularly because of their safe haven status amid the current developments in Ukraine. Additionally, the precious metals continue to be supported by deeply negative real interest rates, and may serve as an inflation hedge if inflation proves to be not temporary. We have maintained a more cautious view on the other commodities.

Precious	+	Energy	=	Industrial	=	Agricultural	=

Currencies

The Committee confirms its Positive view on the US dollar, owing primarily to its status as a safe haven, which typically outperforms during periods of market turbulence. Furthermore, given the expectation of higher inflation rates and the US economy's relatively limited exposure to Russia, the Fed may maintain its hawkish stance at this week's meeting.

The view on the Euro is Negative, considering that Europe will be the hardest hit by the war in Ukraine due to higher commodity prices, disruption in the supply chain, greater exposure of financial companies to Russia, geographical proximity to the area of conflict and an increased risk aversion towards Europe.

The view on the Chinese Renminbi has been downgraded to Negative, for all the reasons explained in the prologue of this report.

We have raised our recommendation for other emerging market currencies as a group to Neutral, as commodity exporters in emerging markets will benefit greatly from the significant increase in raw material prices. On the contrary, commodity-importing countries' currencies remain vulnerable to further depreciation.

Euro	USD	CNY	Other EM
−	+	−	=