MONTHLY COMMENT

January 2022

MARKET REVIEW

Freezing winter wind on the financial markets, which had one of the worst January's in history

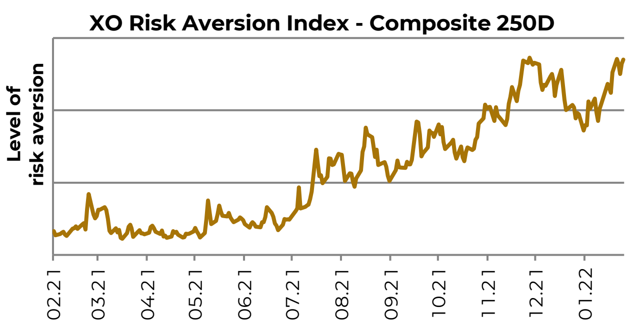
The first month of the year is off to a rocky start. The equity markets had one of the worst January's in their history, worse than the major crises of the last 120 years. Volatility is soaring, topping 40%. Growth markets are the most affected: Nasdaq, technology, biotechnology, solar, environmental technologies, etc. In this slump, Brazil is one of the only countries to post a positive performance. Banks are also spared thanks to the rise in interest rates.

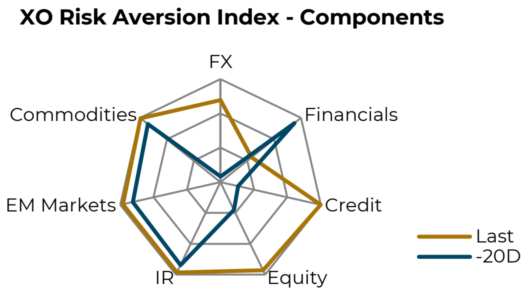
The FED's stated intention to raise interest rates quickly had a very negative impact on bonds, which lost significant ground in the first few weeks of the year. Real estate is less affected. As for currencies, the USD remains strong and the EUR is having difficulty breaking out of the negative trend of recent months.

Oil is up sharply, a symbol of more persistent inflation than expected by the monetary authorities. Precious metals are slightly down for the month.

The overall risk indicator remains high, particularly for all components, but is falling for financials.

	Value	January	2022
Equity markets			
Switzerland (SMI)	12 227	-5,04%	-5,04%
United States (S&P500)	4 516	-5,26%	-5,26%
Europe (Euro Stoxx 50)	9 227	-2,78%	-2,78%
Japan (Nikkei)	27 002	-6,22%	-6,22%
China (Shanghai SE)	3 361	-7,65%	-7,65%
Brasil (Bovespa)	112 144	6,98%	6,98%
Currencies			
USD/CHF	0,930	1,87%	1,87%
EUR/CHF	1,041	0,37%	0,37%
GBP/CHF	1,246	1,00%	1,00%
EUR/USD	1,122	-1,33%	-1,33%
Other asset classes			
Swiss Real Estate		-0,19%	-0,19%
Swiss Bonds		-1,41%	-1,41%
Foreign Bonds		-1,69%	-1,69%
Commodities		11,63%	11,63%
Oil	88,15	17,21%	17,21%
Gold	1 797,00	-1,76%	-1,76%
Rates / Indicators			**Δ**
10 years Swiss rate		0,10%	0,23%
10 years US rate		1,78%	0,27%
US Unemployment		3,90%	0,00%
US GDP		5,50%	0,00%
US CPI		5,50%	0,00%





THE FED HAS GOLD GLITTER IN ITS EYES

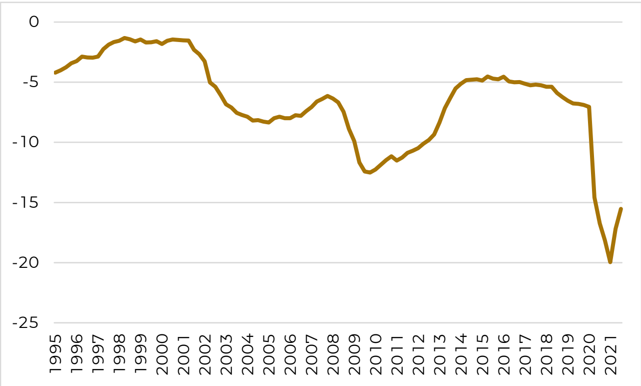
Twin US deficits and negative real interest rates offer the mining sector, particularly gold, good return prospects.

The FED finances twin deficits

The US Federal Reserve has begun the perilous exercise of normalising its balance sheet at the very end of 2021. With assets reaching USD 9 trillion, it will be a long and bumpy road.

One of the main problems the FED will face is US political pressure as the US is running huge deficits on both its current account and public accounts. This phenomenon known as "twin deficits" is particularly important in the US where it has a deficit of almost 15% of GDP.

Twin deficits US

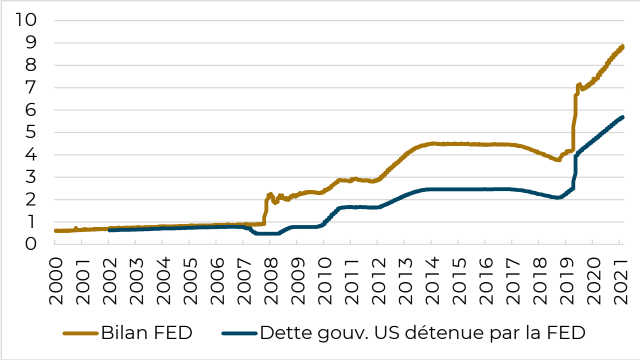


Source : Bloomberg, XO Investments SA

This is the largest amount of debt in decades and implies increasing financing. Every year for nearly 20 years, the US government has had to borrow 10% of GDP in addition to interest payments and considering that the debt is rolled over (or extended). With a US GDP of approximately USD 23 trillion, an additional USD 2.3 trillion will have to be borrowed in 2022.

For the past two years, the vast majority of this new government borrowing has been financed by the FED. The Federal Reserve now holds USD 5.6 trillion in government debt, an increase of USD 3.4 trillion in two years, while the FED's total balance sheet has grown by USD 4.7 trillion over the same period. 75% of the growth in the FED's balance sheet therefore comes from government deficits. The FED is not only the US central bank in charge of currency and price stability, but it has become the government's commercial bank.

FED balance sheet

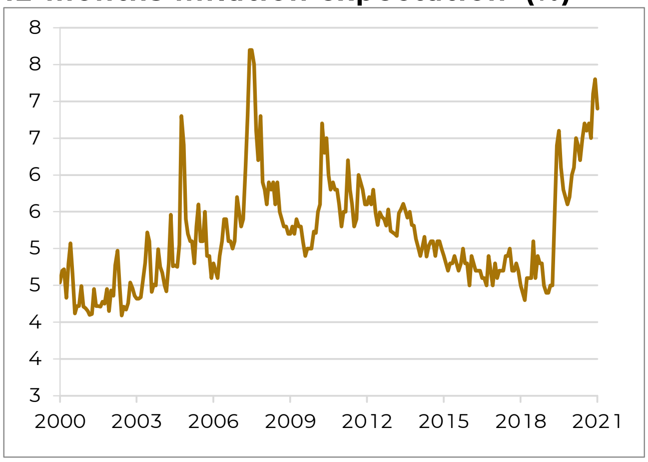


Source : Bloomberg, XO Investments SA

Inflation and real interest rates

These massive injections of liquidity have triggered a significant inflationary rebound in 2021. With inflation expectations of around 7% per annum, the fears of FED members are understandable.

12-months inflation expectation[1] (%)

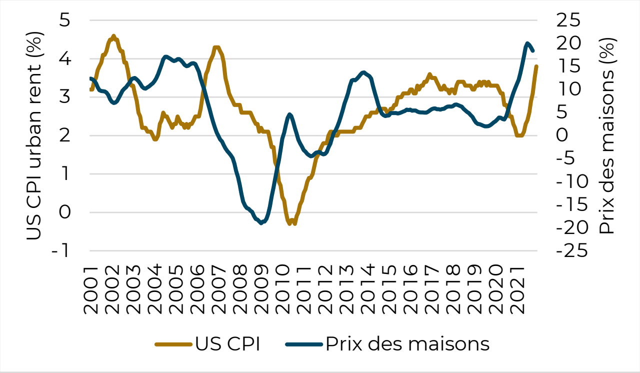


Source : Bloomberg, XO Investments SA

These inflation figures can be found in many sectors. Real estate is at the centre of these considerations. The following graph shows the evolution of house prices in the 20 largest US cities (in blue) and the evolution of the equivalent rental price (in bronze). The two curves follow each other. Even if the last movement on prices is slightly negative, rents tend to rise and will weigh massively on household budgets.

[1] Conference Board Consumer Confidence

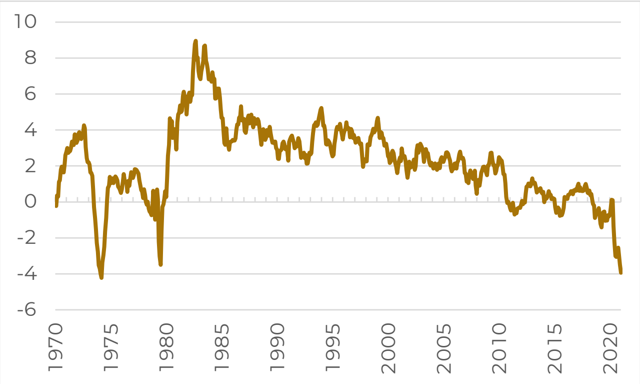
Rental prices and house prices



Source : Bloomberg, XO Investments SA

This context of inflation in a very low interest rate environment leads to a situation of negative real interest rates (base rate minus inflation). Real interest rates are -6% in the US. This value is an estimate of the loss of purchasing power or reduction in the debt burden. The situation is ultimately favourable to over-indebted states.

Real rates (%)

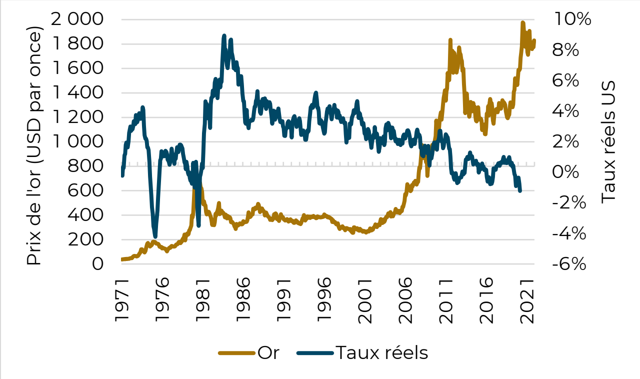


Source : Bloomberg, XO Investments SA

Periods of negative interest rates have occurred in modern history, although they are still rare. The last major period of negative interest rates took place in the 1970s in an economic situation known as "stagflation".

During each period of negative real interest rates, investors, in search of purchasing power protection, massively bought gold, which thus largely benefited from this situation.

Gold and real rates

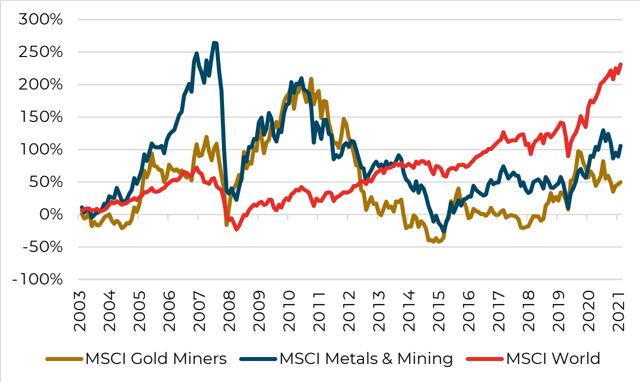


Source : Bloomberg, XO Investments SA

A mining sector to consider

The commodity mining sector should be able to benefit from this inflationary outlook.

Developments in the mining and gold sectors

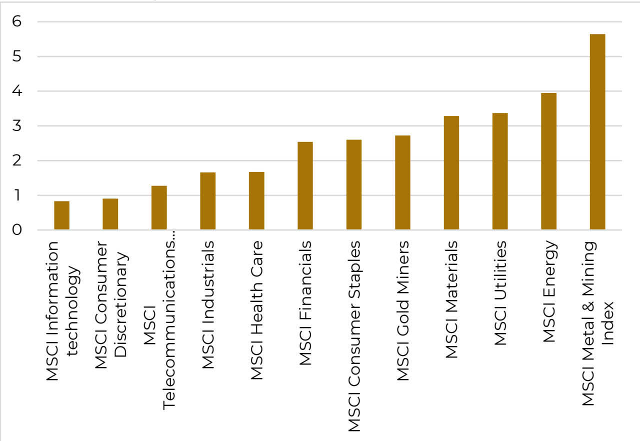


Source : Bloomberg, XO Investments SA

Since 2011 the mining and gold sectors have underperformed the global equity index. However, the situation is now very different.

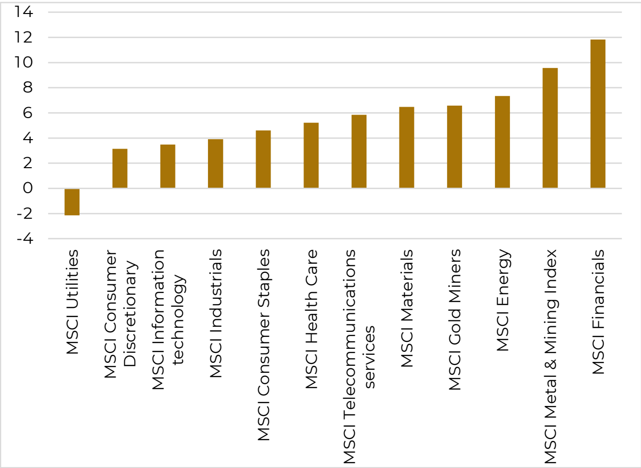
Indeed, these two sectors, to which we can add energy, offer the best 12-month dividend yields, much higher than technology or telecommunications.

Dividend yield



Source : Bloomberg, XO Investments SA

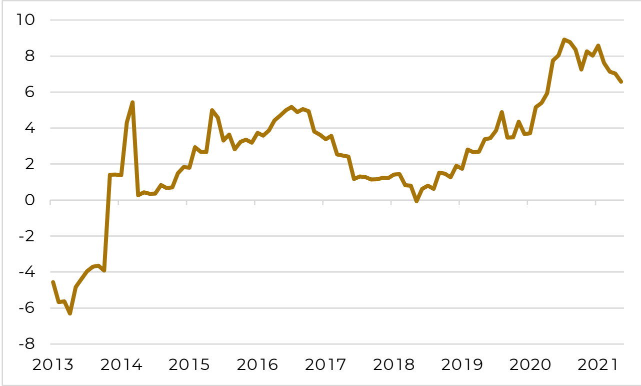
Free Cash Flow



Source : Bloomberg, XO Investments SA

Cash flows are also higher than what is generally generated by other sectors. These good figures are the result of improved company management over the last 10 years. Gold mines had a negative return in 2013 but the removal of some unprofitable projects, the change in financial management of the major groups and the willingness to pay a dividend to shareholders have largely contributed to the improvement in financial figures.

Evolution Free Cash Flow Yield MSCI Gold Miners Index



Source : Bloomberg, XO Investments SA

A mining sector to consider

The beginning of the third decade seems to coincide with the return of inflation after forty years of deflation.

Even if the US Federal Reserve says it wants to reduce the size of its balance sheet, it will have to deal with the US government and its twin deficits at historic highs. It will have to trade off buying US debt to avoid further increases in interest rates against its desire to contain inflation and reduce its balance sheet.

In this context, mining, and in particular gold mining, could emerge from a long slump and benefit from a combination of negative real interest rates and attractive returns.

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