Lazard Dynamic Portfolio Solutions

Commentary

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Market Outlook – March

The global economic outlook has grown more uncertain as a result of Russia's invasion of Ukraine, which has sparked the most serious security crisis in Europe since World War II and prompted many countries to impose harsh economic sanctions on Russia in retaliation. The escalating geopolitical risks clearly makes even short-term forecasts subject to extreme exogenous factors. With that in mind, the following are our usual commentaries by category:

Canada: Higher commodity prices and stronger immigration from Ukraine should benefit Canada, home to the world's largest Ukrainian diaspora. However, higher inflation could mean that GDP growth in real terms disappoints. Despite higher global volatility and energy prices increasing inflationary pressure, the Bank of Canada raised interest rates 0.25% (to 0.50%) at its 3 March meeting . The expectation is for a further increase in the April meeting. Nevertheless, we would expect Canadian assets to outperform on a relative basis in the near term despite this liquidity headwind.

United States: Daily new COVID-19 cases have fallen to their lowest level since last summer, prompting a number of communities to roll back restrictions and lift mask and vaccine mandates. However, vaccine and booster hesitancy still remain high. February's jobs report reinforced the continuing strength of the recovery and of labour demand: payroll jobs increased by 678,000 and the unemployment rate fell to 3.8%. The Russia-Ukraine conflict compounds inflation concerns because of its impact on commodity prices and supply chains. However, the economic impacts may be less severe in the US than in Europe and other economies more dependent on energy imports. As a result, expectations for Fed policy tightening remain high, with the first interest rate hike widely anticipated on 16 March 16.

Europe: As the epicentre of the geopolitical crisis, the region will face significant headwinds in terms of consumer confidence in the face of significantly higher energy prices and the logistical issue of dealing with millions of Ukrainian refugees. However, in the face of such negative feedback shocks, the continent's sovereign and corporate solvency is stronger than during the 2008-11 crisis period, so barring an escalation of military activity beyond Ukraine's borders, the medium-term outlook may be better than is currently being priced into markets. The political cohesion and coordination around sanctions against Russia and both lethal and non-lethal support for Ukraine also bodes for a more constructive environment going forward. In the near term, volatility and further downside may be expected, however. Meanwhile, the ECB was monitoring any impact on growth forecasts, as well as inflationary pressures, in the eurozone, and the Bank of England imposed back-to-back interest hikes for the first time since 2004, with some of its policymakers advocating for even more forceful action to combat higher inflation expectations in the UK.

Asia: China's Premier, Li Keqiang, told the annual session of parliament that targeted growth for this year will be 5.5%. This is dependent on global growth not taking a sustained negative hit as a result of the geopolitical situation, as well as the country's local property market holding together. This does suggest more aggressive provincial and federal stimulus however, which could be supportive for local markets later in the year. India is vulnerable to higher oil prices and is braced for a substantial terms of trade shock, though domestic consumption has some momentum as the country reopens after COVID. The election in South Korea is a potential domestic market driver for South Korea this month, with a positive reaction expected should the more market-friendly People Power Party take control from the incumbent Democratic Party. The threat that China poses to Taiwan will be an ongoing factor following the Ukrainian invasion, though export and growth numbers continue to look firm.

Emerging Markets ex Asia Russia has been removed from major equity and bond indices as foreigners have pulled exposure from the country in the wake of the action in Ukraine. Russia's sovereign bond interest payments have been continuing, though the possibility of a default is rising giving the political tension and the central bank's now restricted access to US dollar reserves. Trade with China will be one of Russia's few avenues to earn foreign currency and they will look to maximise this. Brazil's economy has been strengthening after two quarters of decline in 2021, driven by agricultural output, which is likely to see further upside given the new demand and pricing environment. The cyclical boost to mining revenues will also be helping South Africa from a trade and budget perspective.

Commodities: The geopolitical crisis and associated sanctions activity have been most clearly expressed in skyrocketing commodity prices, which are likely to continue. With inventories already well below average across the energy complex, Brent crude oil's move toward $130/barrel looks sustainable, with a possible move higher should countries stop buying Russian oil or Russia stops

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supplying export markets (outside of China and Belarus). Natural gas in the UK at one point hit GBP4.7 a therm, equivalent to $360/barrel of oil, indicating the extreme relative tightness of this market. OPEC+ have also reaffirmed its commitment to its previous schedule of increasing production by 400,000 barrels a day in April, capping potential growth in supply. With all grain exports halted out of Ukraine, and the spring sowing season around the corner, further strong rises here can be expected to be sustained, despite the 66% increase in wheat prices since mid-February. Gold's traditional safe-haven status has been affirmed with a convincing move through the $2,000 per ounce level, though—in percentage terms—lagging more directly-impacted commodities substantially.

Currencies: The market has found safe havens in the US dollar, Swiss franc, and Japanese yen. The euro has taken the brunt of G7 currency selling activity, trading down 4.5%. The Canadian dollar will likely be more volatile (between CAD$1.25–$1.30 per US$1) as the market assesses the benefits from higher commodity prices on the current account balance, versus inflationary pressures in the system eroding purchasing power. The British pound initially held ground but subsequently sold down due the higher inflation-sensitivity of the economy as well as the negative impact on Russian sanctions on its key financial sector. In emerging markets, we've seen a bifurcation between commodity importers and exporters: the Indian rupee trading down 3% versus the US dollar and the Brazilian real up 5%, for example. Local rates in Moscow increased to 20% (from 9.5%) to try to halt the collapse of the ruble, though it had fallen 46% against the US dollar as of 7 March. The Taiwan dollar is 1.7% weaker on geopolitical concerns, which is a relatively large move for this currency.

Views are as of 8 March 2022