

LETTER FROM EDOUARD CARMIGNAC

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EDOUARD CARMIGNAC'S LETTER

Edouard Carmignac writes on current economic,
political and social issues each quarter.

Dear Investor,

I concluded my previous letter with the concern that post-Covid inflation would prove to be resilient. But I tempered this concern by pointing out that secular deflationary forces (demographics, technology) would partially offset the upward pressure on prices.

Has Omicron changed this outlook? Because this variant is so contagious, there's no doubt it will extend the shortages in logistics and supply chains. We'll have to wait a while longer before producer prices start to decline as a result of manufacturers drawing down their safety inventories. And the timing of such a decline could be pushed out even further if the already fragile public-health situation in China takes a turn for the worse.

Beyond these effects of the pandemic, which will last longer than expected but will eventually pass, I believe it's worth looking at what the job market could be like post-Covid. Changes in working conditions, which for some are being accompanied by sudden and at times prolonged bouts of unemployment, are reshaping the job market to an extent which we don't yet fully grasp. The current economic recovery, unlike those following prior recessions, has resulted in a disappointing level of new job creation – even though the new variant is less dangerous and unemployment benefits are being scaled back. The number of job seekers has fallen, reflecting a marked increase in workers taking early retirement, fewer couples with children seeking dual incomes, and the occurrence of post-Covid depression – not to mention millennials whose education has been interrupted and who no longer aspire to a traditional company position.

This decrease in the supply of labour is inevitably putting upwards pressure on wages, especially at the lower-skilled end of the spectrum. In the US, 24 million people quit their jobs between August and September 2021, seeking out more rewarding or better paying employment. At the same time, and as we've mentioned before, higher energy prices are here to stay. Years of under-investment in fossil-fuel extraction, compounded by the move to prioritise green energy, are inexorably pushing up the cost of energy.

Under these circumstances, it's not surprising – and it's even a good omen – that central banks are gearing up to avoid the risk of inflation spinning out of control. As holders of financial assets, we therefore bear the risk of monetary policy mistakes arising from excessive liquidity contractions. While we obviously can't control that risk, it shouldn't be overestimated. Central banks want above all to not derail the economic recovery under way, which is already under threat by diminishing fiscal stimuli. We thus believe equity markets should continue to be buoyed by negative interest rates. And a scenario where a moderate rise in interest rates is accompanied by persistent inflationary pressures should support the growth stocks with good earnings visibility that form the core of our portfolios. These companies have the capacity to absorb higher costs while defending their profit margins, and are less vulnerable to the inevitable slowdown in economic activity that we anticipate for 2022.

As another highly unusual year gets under way, I wish you all the best.



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