

EDOUARD CARMIGNAC'S LETTER

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

Dear investor,

Three months ago, I wrote that the prevailing investor pessimism seemed unjustified as per our analysis of the primary factors behind the uncertainties revealed many underlying opportunities.

As a reminder, these factors were – and still are – the following:

Central banks' fight against inflation. The effects of Russia's invasion on food and energy prices made it imperative for central banks to introduce highly contractionary monetary policies, just after the pandemic created an unprecedented increase in global liquidity. Now that fiscal stimulus is winding down in the US, an economic slowdown is looking more probable. How deep will this slowdown need to be in order to ease the tight US job market and significantly reduce inflation expectations? Several leading indicators already suggest the American economy is weakening. We continue to rule out the risk of a severe recession, as political tolerance for a sharp rise in unemployment is low. On the other hand, in Europe, fiscal stimulation plans and the diminishing risk of an energy shortage have reduced the risk of a recession. We thereby believe the movement into European assets and out of US assets will continue, and in particular that the euro will gain further ground against the dollar.

Geopolitical risks and Europe's energy crisis. As we expected, and with the help of clement weather, the risk of an energy shortage in Europe has subsided – at least for this winter, but probably also for the future. The failure of Russia's invasion should push Putin to make mistakes. A new Russian offensive is expected no later than during the spring thaw, or perhaps as early as the end of February, to mark the anniversary of the hostility outbreak. Another failure by the Russian army would further weaken Putin's authority and make a revolution in the Kremlin likely. Less talked about is the Iranian threat. Supplier of a variety of weapons, including drones to Russia. Iran appears to be close to developing a nuclear weapon. With a right-wing party now back in power in Israel, the chances of a preventive strike have increased, and with it the risk of a blockade in the Persian Gulf.

The reawakening of China's economy. In my previous letter, I expressed the view that the lifting of China's zero-Covid policy in the near term was inevitable since the damage caused by this policy had become too burdensome for the country's economy, society in general, and its youth in particular. The policy was first called into question just after Xi Jinping was reappointed at the Party Congress in October, and the speed with which it is being lifted has come as a surprise to our Western minds. Once the shock of widespread contagion has passed, China's economy should quickly recover its dynamism. Consumer spending in particular looks set to flourish after nearly two years of very harsh restrictions.

In conclusion, while some of the uncertainties that weighed on the investment outlook in October have abated, they still harbour promising opportunities.

On this cautiously optimistic note, I wish you all the best for a happy and prosperous new year.



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