Market Commentary on the Q3'2022 Results Season:

Towards a New Pivot of Economic Decoupling?

While most of the world has learnt to get on with life after Corona-related disruptions,[i] with the notable exception of China and its zero-Covid policy, there are a number of **seismic shifts in international relations that have impacted the global economy in 2022** – particularly the previously unthinkable industrial scale of Russian conventional military warfare in the Ukraine but also the **more recent US trade assault on China** which might accelerate a military confrontation over Taiwan.[ii] This politically enforced decoupling of the Western world from Russian energy supply and the Chinese manufacturing base has pushed **Europe to the brink of recession**, with a growing fear among investors and analysts that European companies are in **structural disadvantage due** not only **to high energy and personnel costs, but also a strong US dollar**, with the increasing need for "relocation" if they want to remain competitive.[iii]

Against this backdrop companies have largely reported a **"normalisation" of previous Corona-related economic dislocation**, notably in terms of order patterns implying shorter delivery lead times and a "sequential easing of component shortages" (ABB) but also **massive destocking as both raw materials prices have fallen significantly** (and often on short notice) and **consumer demand has softened** (AkzoNobel).[iv] With the highest inflation since 40 years continuing,[v] the discussion on **pricing power has now shifted towards timing and price elasticity** (Nestle),[vi] with a number of companies in Retail & Apparels reporting profit warnings in the run-up to the Q3'2022 reporting season as they faced a strong US-dollar and high energy bills (H&M), lower consumer demand in Greater China and Western Europe (adidas) or even had to liquidate inventory (Nike).[vii] When it comes to high inflation there are **two other new discussion themes**: i) apart from energy, the interest of investors and analysts has now also started to **focus more strongly on personnel** (and potential competitive advantages in terms of productivity);[viii] and ii) in their attempt to improve efficiency, companies have started to **implement organisational changes and structural "realignments"** (Goldman Sachs, Credit Suisse, Ericsson).[ix]

As professional fund managers turned their scrutiny increasingly to **corporate debt and companies' ability to refinance under high inflation**,[x] we start our market commentary with a short discussion on quantitative tightening. Then we turn our attention to Taiwan in the context of the latest saber-rattling between China and the US while taking a closer look at emerging markets afterwards. As recent efforts of the energy transition have been significantly disrupted by Russia's military aggression in the Ukraine, we will then focus predominantly on European companies in their effort not only to **cope with gas shortages and shutdowns, but also to speed up their own green transition**. Finally, to get a better understanding about **changing consumer behaviour** (including downtrading and demand destruction), we prepared a **special case study on Retail & Apparels** as this sector not only suffered from a multitude of profit warnings in recent weeks, but also provides an excellent insight into how companies try and fend off inflationary pressure and recessionary fears.

QUANTITATIVE TIGHTENING

Much has been written about "quantitative easing" following the global financial crisis in 2007-08, but the recent attempt to reverse previous rescue efforts by central banks and shrink their balance sheets ("quantitative tightening") gave grounds to speculation among fund managers whether this removal of liquidity might lead to another financial crisis.[xi] What had been a concern for many market observers before, notably whether central banks have too large a footprint in financial markets following massive purchases of not only Treasuries and mortgage-backed securities, but also of corporate bonds and municipal debt – essentially pushing institutional investors into taking ever greater risks to deliver returns as they were crowded out of the world's safest assets. This has now become the unchartered territory as professional fund managers will need to re-price risk. The big question mark remains about the market's ability to absorb the new debt launched into the market as central banks started to sell Treasuries and mortgage-backed securities.

First strains in the US Treasury market were observed in September, when the Federal Reserve started to shrink its nearly $9 trillion balance sheet by $95 billion a month, with bid-ask spreads reportedly reaching the widest levels since May 2020 and leading to more market volatility.[xii] In the UK, the need for the Bank of England and the Treasury to work closely together to lengthen the maturity of UK government debt had already been discussed in summer,[xiii] but the latest episode of unorthodox economic policy by the Liz Truss government has not only brought the UK gilt market to the brink of collapse, but also forced the Bank of England back into quantitative easing.[xiv] Similarly, the ECB started discussions on shrinking its balance sheet in early October, but it remained largely undecided as any attempt to reduce reinvestments of maturing bonds is likely to increase long-term borrowing costs for eurozone governments, notably Italy.[xv]

TAIWAN TENSIONS

Following the speed and scope of Russia sanctions earlier this year, multinational companies are now drawing up contingency plans in case China attacks Taiwan and US and EU authorities were to impose sanctions on China.[xvi] Following the visit of Nancy Pelosi, the Speaker of the US House of Representatives, in Taiwan in early August, China launched an unprecedented series of military exercises around Taiwan, blocking airspace and one of the world's busiest shipping lanes, further disrupting supply chains for global exports which were already under strain from the zero-Covid policy in China.[xvii] While this is not the place to speculate what kind of Western response might follow, the fact that China is such an important market for US and European companies has just raised the corporate risk perception to a completely new level.[xviii]

Apart from the danger of further military exercises in the Taiwan Strait,[xix] one of the most sensitive issues is Taiwan's leading role in the global semiconductor industry and the implications for the global economy if Taiwan (essentially TSMC) were to be cut off from the rest of the world.[xx] In turn, growing geopolitical tensions and the latest US Chips Act have introduced a major dilemma for global chipmakers, as the decoupling from the large Chinese market may imply "commercial suicide" for some, notably South Korean and East Asian companies.[xxi] When asked about the implications of the latest US semiconductor export controls, Western companies pointed to either "offering Chinese customers alternative products" (NVIDIA) or simply still not being clear who produces what as the technological origin is often in a grey area (ASML).[xxii]

EMERGING MARKETS IN SHATTERS

Higher interest rates, soaring energy and food prices as well as a strong US-dollar have resulted in emerging markets facing a battering in 2022 - both in equity and bond markets - with investors pulling out a record amount of capital since the beginning of this year.[xxiii] While some emerging markets have fared better compared to developed markets in terms of raising interest rates (Latin America) and currency performance (South-East Asia),[xxiv] the most remarkable development this time is that China is not in a position to come to rescue for the rest of the world economy. China's delayed release of third-quarter GDP data – timed after the closing of the 20th Communist Party's Congress – surprised the market negatively as the reported 3.9% growth was way behind the full-year target of 5.5% and laid bare the scale of economic challenges as the country is grappling with a property crisis and zero-Covid controls and lockdowns.[xxv]

Faced with this sudden change of institutional sentiment, the other contentious issue for capital markets was to what extent the US Federal Reserve is willing to risk a recession and, at the same time, to destabilise global financial markets in order to bring inflation down.[xxvi] Higher US rates have bolstered the dollar, exacerbating inflation elsewhere by raising costs for commodities (mostly priced in US-dollars) which might put the world's poorest countries at risk of collapse.[xxvii] In this massive market sell-off, the challenge for professional fund managers now is not only to spot the "bright lights" in emerging markets, but also to scrutinise where Western companies have significant exposure to difficult markets such as Turkey.[xxviii]

ENERGY TRANSITION INTO REVERSE?

With Russia starting to "weaponise" existing long-term gas delivery contracts to Europe after its full-scale invasion of Ukraine, the scope of dependency from cheap Russian gas and the implied structural disadvantage of European companies became blatantly clear over the summer.[xxix] While many companies had already started to switch to alternative energy sources in Spring – often implying a step backwards (fuel oil, coal) from the original green energy ambition – European governments' massive effort to replace Russian pipeline supplies through increased imports of liquified natural gas resulted not only in storage reaching more than 90% capacity, but also in European gas prices dropping below EUR100 per MWh in late October (or 70% below peak levels in August).[xxx]

This has no doubt helped to reduce Russian gas supply from 40% last year to 9% by the time of writing; however, the key challenges going forward will be i) getting enough gas into storage for next winter as LNG is unlikely to cover the gap; and ii) to what extent previous energy transition targets will not only be substantially undermined but climate change might become irreversible.[xxxi] From a corporate perspective - and judging from anecdotal evidence while following closely the Q3'2022 results season - many companies have in fact started to speed up their efforts to transition to clean energy despite short-term bottlenecks and the partial reversal to fuel oil and coal.[xxxii] In addition, high-tech companies reported a growing demand for energy-efficient computing (TSMC, NVIDIA) and new technology for accelerated electrification (ABB), and other specialists for connected energy-efficient lighting (Signify, Fagerhult).

While there is much debate to what extent the EU commission should not only mobilise additional investments through the existing REPowerEU funding programme, but also to use leftovers from the pandemic-related Recovery and Resilience Fund (RRF) to meet green transition targets, there are also a number of interesting new proposals to deploy funding from the ECB's targeted longer-term refinancing operations (TLTROs), which were originally established to prevent European banks from shrinking their loan books after the 2007-08 financial crisis.[xxxiii] The broader discussion though is to what extent has the Russian war in Ukraine triggered a proper re-think about energy overhaul and long-overdue investment in infrastructure in Europe – a topic that institutional investors have become more vocal about in recent months.[xxxiv]

CASE STUDY: RETAIL & APPARELS

As we approach the major shopping seasons for Thanksgiving, Christmas and the Chinese New Year (in early 2023), we have closely followed the Retail & Apparels sector to scrutinise first signs of changing consumer sentiment (including downtrading and demand destruction) in the wake of inflationary pressure and recessionary fears. In this context, recent consumer and retail trade surveys have clearly pointed to declining retail sales volumes in Europe and the US.[xxxv] As in previous downturns, there will not only be winners and losers in the industry, but also the divergence between Luxury Goods and mainstream Retail & Apparels becomes more apparent.[xxxvi]

At this early stage, a few observations are worth highlighting, notably in terms of choice for brands & products, pricing, packaging and special promotions. Nestle was one of the first to admit "gross margin compression in 2021", introducing larger packaging and special promotions in 2022.[xxxvii] In turn, Procter & Gamble most recently admitted minor volume reductions, with some of their customers stretching their purchasing cycles and being careful in terms of dosing while also preferring private labels.[xxxviii] Equally, Beiersdorf did notice downtrading within the last few weeks, mostly within Nivea categories.[xxxix] According to Tesco's CEO, Ken Murphy, their customers have responded very quickly to the changing cost of living and already started trading down during the summer, giving more preference to private labels and frozen food.[xl]

Within the Apparels sector, there was a massive inventory build-up in the wake of Corona-related supply chain disruptions as well as a dramatic change in consumer confidence within a short period of time, leading to a number of profit warnings in recent weeks (Nike, adidas). In the fashion industry, H&M was also forced to a profit warning in September, pointing to currency effects, energy and input costs having peaked, with customer sentiment being "very much focused on pricing" and "affordable sustainable fashion in high demand" (CEO of H&M, Helena Helmersson).[xli]

In terms of promotions, Tesco has run discount actions on Toys and clothing, as well as a beer and wine event as they expect Christmas gifts to be smaller this year with people buying them much earlier in advance (anticipating higher inflation).[xlii] One important element of the recent inventory winddown were distribution channels as they expected "consumer confidence to drop fast" and "negative stock revaluations going forward" (AkzoNobel Q3 Update, 27 September 2022).

Peter and Irina Kirkow
31 October 2022

APPENDIX

High macro-economic uncertainty in Europe and China

AkzoNobel

	North America	Latin America	EMEA	North Asia	South Asia
Paints			Europe: Weakening consumer confidence; Deterioration in economic outlook; Proactive destocking across channels	China: COVID restrictions; Declining real estate market; Weakening consumer confidence	
Industrial	Continued supply chain constraints				
Powder					
Automotive and Specialty					
Marine and Protective	Sequential recovery				

Source: Company estimates. **End market demand (y-o-y):** Strong Medium Weak

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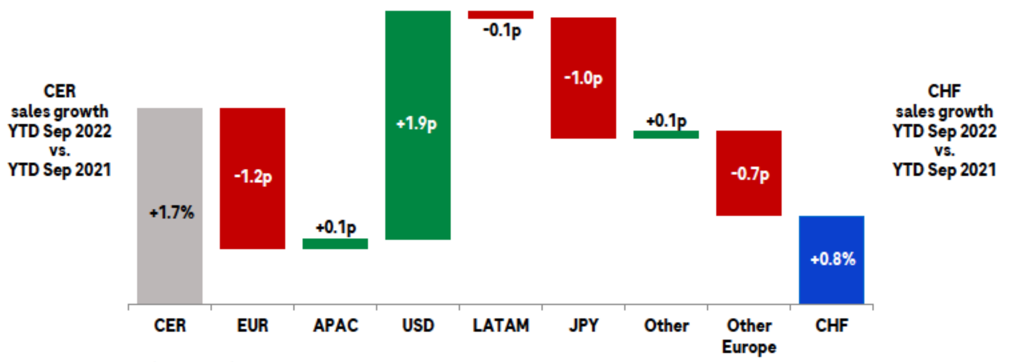
YTD exchange rate swings

Negative impact driven by the EUR, JPY and other Europe, partially offset by USD

Roche

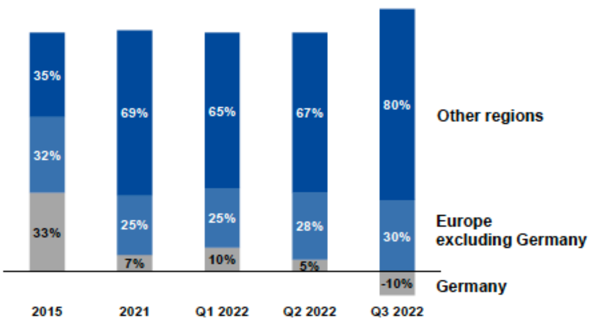


CER = Constant Exchange Rates (avg full year 2021)

47

Operational earnings in region Europe and in Germany under pressure due to various challenges

EBIT before special items of BASF Group[1]



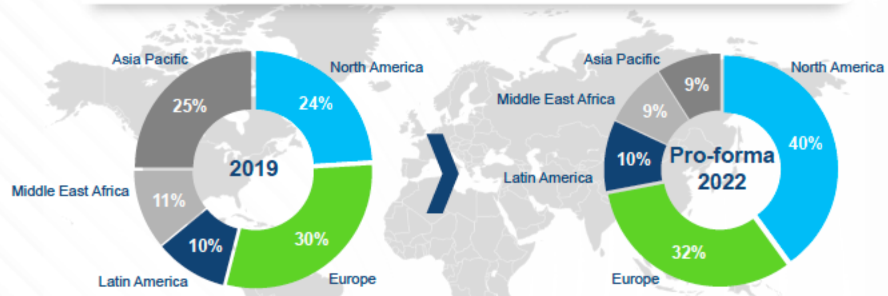
- **Weak average growth** of the European chemical market in the past decade
- **Structurally higher natural gas prices** in Europe to be expected in the longer term
- **Regulatory uncertainty** (e.g., E.U. Green Deal and Chemical Strategy for Sustainability) puts parts of the portfolio at risk and, together with **CO_2 price increases**, leads to higher costs

 [1] Data excluding oil & gas business and construction chemicals business

BASF
We create chemistry

SUCCESSFUL TRANSFORMATION – GEOGRAPHIC PROFILE
FAST EXPANSION IN THE MOST ATTRACTIVE NORTH AMERICAN MARKET

NET SALES BY REGION



Net Sales in mature markets from 59% in 2019 to 77% pro-forma in 2022

 Net Sales to external customers; figures exclude trading

HOLCIM

ENDNOTES

[i] The outgoing CEO of Roche, Severin Schwan, reported a sharp decline in government orders for both Corona-related drugs and tests and observed that the post-Covid 19 world "moves into endemic scale" (Roche Q3'2022 results call, 18 October 2022). Indeed, while companies at the Q3'2022 results season referred to sporadic labour shortages in various regional clusters, the frequent Corona-related lockdowns in China have caused much more disruption, resulting not only in establishing alternative supply chains – including "friendshoring" – but also a decline in consumer demand (AkzoNobel, adidas) and ongoing logistics constraints (Tesla). In this context, the CEO of Tesla, Elon Musk, singled out the Shanghai-Europe shipment route and claimed that "there are just not enough transport carriers for our cars" (Tesla Q3'2022 results call, 19 October 2022). The truth is that Tesla faced margin headwinds not only from transport but also raw materials and FX during Q3'2022, with the additional complication that there was an issue of delivery towards the end of the quarter. In their second profit warning for this year on 20 October 2022, adidas also blamed "a further deterioration of traffic trends in Greater China as well as a significant inventory build-up as a result of lower consumer demand in major Western markets since the beginning of September", with China declining by a "strong double-digit rate", see: https://www.adidas-group.com/en/media/news-archive/press-releases/2022/adidas-reports-preliminary-q3-results-and-adjusts-full-year-guid/.

[ii] This relates specifically to the new semiconductor export controls announced by the Biden administration on 7 October 2022 in its attempt to decouple the Chinese high-tech sector – and implicitly its military - by political force. While there are still many open questions, notably the implications of prohibitions for US citizen and green card holders working in China's semiconductor industry, the US Chip Act implies the risk for retaliation as China might block exports to the US of critical materials like rare earth (Alan Beattie, *"Biden goes it alone in his trade assault on China"*, Financial Times, 20 October 2022). When specifically asked about the implications of the US export controls, the CEO of ASML, Peter Wennink, estimated that this will have an "indirect impact" of about 5% of current backlog, with China accounting for 15-16% of global sales, and the main complication remaining US-origin spare parts and citizen (ASML Q3'2022 results call, 19 October 2022). Not surprisingly, the CEO of Taiwan-based TSMC, C.C. Wei, refrained from any reference to the US Chip Act and simply stated that "there is the possibility of adjustments on the road" (TSMC Q3'2022 results call, 13 October 2022). For a good analysis of the current US-China trade dispute, see also: Edward Luce, *"Containing China is Biden's explicit goal"*, Financial Times, 20 October 2022. History seems to repeat itself as there was a similar attempt by the US to restrain the Japanese semiconductor industry in the 1980s, see: Chris Miller, *Chip War. The Fight for the World's Most Critical Technology*, Scribner, New York, 2022, pp. 85-90.

[iii] The CEO of TotalEnergies, Patrick Poyanne, emphasised at their Investor Day in New York on 28 September 2022 that "Russian gas was the source of competitiveness for the European industry". At the same time, he announced a strategic shift towards the US, moving into the centre of commercial attention as "it is located between Europe and Asia". In the European banking industry, the CEO of UBS, Ralph Hamers, announced that the US will be their key focus in terms of technology investment and new digital products (UBS Q3'2022 results call, 25 October 2022). To our knowledge, the first time a European company was asked about the "structural shift to relocate the chemical industry outside Europe" was BASF at their Q2'2022 results call on 27 July 2022 (Goldman Sachs analyst). Senior management of BASF remains most outspoken about "deteriorating framework conditions" in Europe – i) a weak European chemicals market; ii) higher gas prices; and iii) high regulatory requirements – leading to a "question mark over the business case in Europe" (Martin Brudermüller, CEO of BASF) given low growth, surging inflation and high regulation (BASF Q3'2022 results call, 26 October 2022). When asked about this structural shift for its Chemicals division, the outgoing CEO of Shell, Ben van Beurden, said that the "shift to America will take years" (Shell Q3'2022 results call, 27 October 2022). In the construction and buildings materials industry, the CEO of Holcim, Jan Jenisch, was equally very explicit about their strategic intention to move more to North America as there are "high margins to be achieved" – in sharp contrast to the "troubled markets" of China (down by 5-10%) and Europe with a demand decline of 5% for the last five months (Holcim Q3'2022 Trading Update, 28 October 2022). For a more conceptual outline of the implications of the decoupling from China, notably the "fragmenting and doubling up of supply chains" resulting in additional inflationary pressure, see: Diana Choyleva, *"The great decoupling with China will reshape markets"*, Financial Times, 28 October 2022. In terms of doubling and/or diversifying supply chains, it was interesting to hear from the CEO of Lufthansa, Carsten Spohr, that they noticed additional travel exactly for this reason (Lufthansa Q3'2022 results call, 27 October 2022). The new CEO of Volkswagen, Oliver Blume, outlined in his opening remarks that "new barriers of technology transfer from West to East" forces them to apply various risk scenarios (Volkswagen Q3'2022 results call, 28 October 2022).

[iv] The outgoing CEO of AkzoNobel, Thierry Vanlancker, described the rapid reduction in inventory levels in terms of "what has been built in one and a half years is now flushing out in 4-5 months". Similarly, the deflation in raw materials prices implies a "lag effect due to the elevated level of inventory", with price quotations changing almost at a daily basis (AkzoNobel Q3'2022 results call, 20 October 2022). Others also reported "a better situation at supply chains though not entirely over yet" (CEO of Fagerhult, Bodil Sonesson, 28 October 2022). In the semiconductor industry, demand still remains above supply capacity, although customers appear to revise their capex plans being faced with the "largest backlog ever" (Peter Wennink, CEO of ASML, at the Q3'2022 results call, 19 October 2022). In this respect, TSMC was even more explicit by anticipating the "inventory correction" to have its worst impact in the first half of 2023, which resulted in their own capex adjustment in Q3'2022 due to "capacity optimisation and delivery difficulties" (C.C. Wei, CEO of TSMC, at the Q3'2022 results call on 13 October 2022). In turn, the CEO of Intel, Pat Gelsinger, highlighted the inventory correction for Q3'2022 from their perspective given an "abrupt and pronounced slowdown since June 2022" and a generally "unpredictable environment" with the potential for a global recession (Intel Q3'2022 results call, 27 October 2022).

[v] The three major elements of companies' response to inflation have been neatly summarised by the CEO of Ericsson, Börje Ekholm: i) pricing; ii) product substitution and technology leadership; and iii) simplifying operations and reducing costs including redundancies (Ericsson Q3'2022 results call, 20 October 2022). While there has been much discussion about "value-based pricing" over the last few weeks (CEO of ABB, Björn Rosengren, at the Q3'2022 results call on 20 October 2022), the new tweak in companies' presentations is the issue of "timing" of price increases (Nestle) as companies need to find new ways of "cost sharing with customers" (ASML). In this context, the CEO of Nestle, Mark Schneider, explained their approach of cutting the number of "low rotation, underperforming SKUs" (stock keeping units) to achieve better on-shelf visibility, in his words "cutting the tail to push the head" (Nestle Q3'2022 sales call, 19 October 2022). Given the huge inventory level many companies face right now, and the high prices raw materials and components were acquired for before, there is naturally a desire to sell through shorter cycles (CFO of ABB, Timo Imahuotila, at the Q3'2022 results call on 20 October 2022) before price pressure sets in. This perhaps also explains the sense of urgency in destocking during Q3'2022 – combined with an adverse FX impact, negative hedging and high comparables with the same period last year – with senior management admitting that there are structural changes under way which might lead to higher working capital in future (CEO of Signify, Eric Rondolat, 28 October 2022).

[vi] The CEO of Nestle, Mark Schneider, saw price elasticity particularly in diary and food, where people switch to "less brands" while Nestle's CFO, Francois-Xavier Roger, remains specifically concerned about "downtrading in Europe" (Nestle Q3'2022 sales call, 19 October 2022). In turn, the CEO of Tesco, Ken Murphy, observed "subtle changes" in consumer behaviour, "switching from fresh to frozen" and his CFO, Imran Nawaz, added "from branded to own-brand products" (Tesco Interim Results 2022/23, 5 October 2022). As always there are big differences when it comes to luxury goods, where the CFO of LVMH, Jean Jacques Guiony, claimed that their industry is "not a proxy for the general economy", although even he conceded that "gold is preferred to silver in recessionary times" and that watches are selling more as people are trying to preserve value under high inflation (LVMH Q3'2022 results call, 11 October 2022).

[vii] Nike's President and CEO, John Donahoe, reported that 10% of inventory is currently going through "accelerated liquidation" in North America, with the difficulty of "a few seasons landing in the marketplace at the same time" (Nike Q1'2023 results call, 29 September 2022). Others outlined in great detail to what extent they are trying to simplify their stock and replenishment routine, review supplier contracts and expand their digital offering to improve inventory management (Tesco Interim Results 2022/23, 5 October 2022). Interestingly, both Nestle and Tesco made a great ESG emphasis about "responsible and affordable" prices (Nestle), with Tesco announcing to "freeze prices for over 1,000 products until April 2023". On several occasions, the CEO of Tesco, Ken Murphy, claimed that they are trying to "hold back inflation wherever possible" and "inflate a little bit less and a little bit later".

[viii] It is unusual but perhaps a sign of the time that analysts ask about labour productivity at insurance companies, but this was exactly where Andrew Ritchie from Autonomous Research intervened in the Q&A at Hannover Re's Investors' Day 2022, asking how the company could possibly achieve premium growth going forward given the relative low employee base and lower salaries compared with major peers, which would require massive investments at a time of high inflation (Hannover Re Investors' Day 2022, 6 October 2022). In this respect, the CEO of AkzoNobel, Thierry Vanlancker, emphasised that the "wild card will be wage costs in 2023" (AkzoNobel Q3'2022 results call, 20 October 2022). Equally, the CEO of Trelleborg, Peter Nilsson, conceded that "labour in Europe has become more challenging" (Trelleborg Q3'2022 results call, 26 October 2022). The CEO of KPN, Joost Farwerck, pointed to "labour capacity (being) a challenge for the entire industry" (KPN Q3'2022 results call, 26 October 2022).

[ix] The CEO of Goldman Sachs, David Solomon, somewhat downplayed the planned "realignment" as being "nothing

dramatically different" and just an attempt to "rationalise on customer acquisition costs" (Goldman Sachs Q3'2022 results call, 18 October 2022). However, in the wake of high inflation and recessionary developments the main focus points for a number of companies remain market share gain, cost control and margin improvements (AkzoNobel, Ericsson, Goldman Sachs). Other efforts to improve efficiency and cut additional costs include not only office closure and headcount reduction as a reaction to post-pandemic changes at work but also the attempt to optimise payment terms and the timing of invoices as well as to simplify customer interface (KPN Q3'2022 results call, 26 October 2022).

[x] In anticipation of a recession, it is interesting to see to what extent some professional fund managers are betting against corporate defaults through holding credit default swaps. This gloomy market outlook is often brought into context with quantitative tightening as central banks are selling back bonds into the market. In this context, for a fairly pessimistic view by the founder of hedge fund Saba Capital, Boaz Weinstein, see: Laurence Fletcher, *"Global stocks face Japan-style bear market, warns hedge fund manager"*, Financial Times, 24 October 2022.

[xi] Katie Martin and Colby Smith, *"The mystery of how quantitative tightening will affect markets"*, Financial Times, 11 July 2022.

[xii] Ethan Wu and Kate Duguid, *"Fed's faster 'quantitative tightening' adds to strain on bond market"*, Financial Times, 14 September 2022. In the run-up to this year's annual Jackson Hole symposium of the Federal Reserve, an academic paper prepared by Viral Acharya of the NYU Stern School of Business and several other co-authors was widely distributed as they looked at several previous attempts of quantitative tightening and easing in 2019 and 2020 and to what extent this affected market liquidity, see: Viral V. Acharya et.al, *Liquidity Dependence: Why Shrinking Central Bank Balance Sheets is an Uphill Task*, 15 August 2022.

[xiii] Jagjit Chadha, *"Time to tackle the UK's quantitative easing problem"*, Financial Times, 4 August 2022.

[xiv] Megan Greene, *"UK market turmoil is a harbinger of global events to come"*, Financial Times, 12 October 2022.

[xv] Martin Arnold, *"ECB to start talks on shrinking its balance sheet"*, Financial Times, 9 September 2022. One major concern for the ECB is that long-term rates will remain too low if it continues with bond reinvestments while, at the same time, pushing up short-term borrowing costs through rate increases which might lead to an inverted yield curve. See also more recently, Martin Arnold, *"ECB to start talks on shrinking balance sheet amid bond market turmoil"*, Financial Times, 27 October 2022.

[xvi] Edward White, Tom Mitchell, Kana Inagaki and Hudson Lockett, *"Taiwan tensions force multinationals to rethink China risk"*, Financial Times, 17 August 2022. Given the massive slowdown in the Chinese construction industry, the CEO of Holcim, Jan Jenisch, was very explicit that this is a "very tough market" and that it will continue to "be disrupted weill into 2023" (Holcim Q3'2022 results call, 28 October 2022). On the negative global market reaction the next day after the appointment of the new Politburo Standing Committee, essentially passing over pro-market candidates, see: Hudson Lockett and Mercedes Ruehl, *"No 'adults in the room': Xi Jinping catches global investors off guard"*, Financial Times, 28 October 2022.

[xvii] Kathrin Hille, *"China's military response to Pelosi visit raises escalation fears"*, Financial Times, 3 August 2022.

[xviii] Suffice to say that China's re-elected President, Xi Jinping, has just reiterated at the latest Communist Party Congress that "the resolution of the Taiwan issue is a matter for the Chinese people themselves" and that they "will never renounce the use of force and will take all necessary measures to stop all separatist movements", see: Tom Mitchell and Primrose Riordan, *"Xi Jinping heralds 'critical time' in history as he prepares for third term in power"*, Financial Times, 17 October 2022.

[xix] Kathrin Hille, *"Taipei accuses Beijing of trying to take control of Taiwan Strait"*, Financial Times, 9 August 2022.

[xx] Taiwan (essentially TSMC) accounts for 20% of global wafer fabrication capacity and 92% of capacity for the most advanced chips as the efficiency and cost savings of the foundry model have convinced other chipmakers to outsource fabrication to TSMC. For the difficulty the US is currently facing to rebuild chip manufacturing at home, see: Kathrin Hille and Demetri Sevastopulo, *"TSMC: the Taiwanese chipmaker caught up in the tech cold war"*, Financial Times, 24 October 2022. For a more critical view about TSMC's ability to keep its leadership position, see: Kathrin Hille, Song Jung-a and Richard Waters, *"TSMC battles to stay ahead as world demands ever-smaller chips"*, Financial Times, 25 October 2022.

[xxi] Christian Davies and Song Jung-a, *"Chipmakers caught in crossfire of rising US-China geopolitical tensions"*, Financial Times, 1 September 2022. For a more positive view on this new "silicon shield" leading to a "fresh wave of global government investment" and stimulating broader innovation, see: John Thornhill, *"The 'chip choke' on China may breathe air into semiconductor industry"*, Financial Times, 29 September 2022.

[xxii] Jensen Huang, CEO of NVIDIA, at the GTC Financial Analyst Q&A on 20 September 2022 and Peter Wennink, CEO of ASML, at the Q3'2022 results call on 19 October 2022. At the latter, it was remarkable to hear from the analyst of

New Street Research how "refreshing" he found the CEO being open and honest about this very difficult and in many ways still unclear situation.

[xxiii] For emerging market bonds, this is estimated at a record $70 billion between January and the end of September 2022 alone (Jonathan Wheatley, *"Emerging market bond slump creates opportunities for investors"*, Financial Times, 24 October 2022).

[xxiv] A number of Latin American countries are outlined for their proactive interest rate policy and monetary prudence, notably Brazil, Chile, Colombo, Peru and Mexico (Michael Stott, *"Latin America's inflation lessons for the G7"*, Financial Times, 18 October 2022), while Indonesia, Singapore, India and Malaysia are often mentioned as having better managed to fend off the strong US-dollar (Hudson Lockett and Chloe Cornish, *"South-east Asian currencies weather market storm better than international peers"*, Financial Times, 19 July 2022).

[xxv] Thomas Hale, Hudson Lockett and Edward White, *"China's GDP growth falls short of target as property and zero-Covid woes mount"*, Financial Times, 24 October 2022. Given a shrinking population and declining productivity growth it has been argued that economic growth rates seen over the last two decades are not sustainable any more as China will not be able to inject the huge amount of capital (largely for physical infrastructure) it did in the past due to the huge debt ratio to GDP (Ruchir Sharma, *"China's economy will not overtake the US until 2060, if ever"*, Financial Times, 24 October 2022).

[xxvi] Jonathan Wheatley, *"Emerging markets hit by record streak of withdrawals by foreign investors"*, Financial Times, 1 August 2022. For the spillover effects from the surge in US borrowing costs for the rest of the world, see: Claire Jones, *"A global backlash is brewing against the Fed"*, Financial Times, 22 September 2022.

[xxvii] IMF bailouts are reported to have hit a record high in 2022 ($140 billion) as Zambia and Sri Lanka defaulted during the pandemic and Lebanon, Russia and Suriname are in IMF bailout talks to restructure their debts. Ghana, Egypt and Tunisia are in early talks for similar support while Pakistan and Argentina have already received substantial bailout packages of $1.1 billion and $3.9 billion, respectively (Jonathan Wheatley, *"IMF bailouts hit record high as global economic outlook worsens"*, Financial Times, 26 September 2022).

[xxviii] Ruchir Sharma outlined Vietnam, Indonesia, India, Greece, Portugal, Saudi Arabia and Japan in a combination of emerging and developed markets, although for some of these "bright lights" growth is more of a catch-up story given previous economic depression (Greece, Portugal, Japan), see: Ruchir Sharma, *"The seven economic wonders of a worried world"*, Financial Times, 26 September 2022. In turn, Turkey has been outlined for its unorthodox economic policy through continuing state intervention to curb inflation, with the CPI up to 83.45% in September while the benchmark interest rate was brought down to 12% (Laura Pitel, "*Turkish inflation tops 83% as Erdogan promises more rate cuts"*, Financial Times, 3 October 2022). While AkzoNobel has switched to hyperinflation accounting in Turkey, this was not only cited for the "negative stock revaluation going forward" but as one example for a "big dislocation in end markets" (Thierry VanLancker, CEO) when publishing the profit warning on 27 September 2022.

[xxix] For various efforts to save energy across different industrial sectors but also the need for production shutdowns and fear of a forced shift of production from Europe, see: Peggy Hollinger, Sarah White, Madeleine Speed and Marton Dunai, *"Will the energy crisis crush European industry?"*, Financial Times, 19 October 2022. The extent of naivety or simply disbelief by European senior management that Russia would ever stop supplying gas was illustrated by the Chief Risk Officer of Austrian bank Erste Group, Alexandra Habeler-Drabek, presenting their risk model at the Q2'2022 results call on 1 August 2022, with the "base case" that a gas stop is unlikely based on "expert assessment", which was subsequently heavily questioned by analysts in the Q&A up to the point whether the dividend would be at risk (KBW analyst). Given that by then Russia had already started to use all kinds of excuses to slash down gas deliveries to Europe, Erste Group's claim that gas flowing from Russia would remain "adequate" – in the words of the CRO "as long as industry keeps operating" - was equally questioned (Concorde analyst).

[xxx] David Shephard and Shotaro Tani, *"European gas slumps below €100 for first time since Russia cut supplies"*, Financial Times, 25 October 2022. With a more jubilant assessment of Western markets being resilient to the Russian gas war, see: Chris Giles, *"The end of Europe's energy crisis is in sight"*, Financial Times, 28 October 2022.

[xxxi] The unusual hot and dry summer in Europe has additionally dried up hydropower resources while various nuclear power plants in France and elsewhere (Belgium, Switzerland, Germany and Finland) faced either widespread maintenance closure or had been forced to lower capacity due to a lack of water to cool the reactors (Alice Hancock, *"Europe's new dirty energy: the 'unavoidable evil' of wartime fossil fuels"*, Financial Times, 6 September 2022).

[xxxii] Fatih Birol, *"Three myths about the global energy crisis"*, Financial Times, 6 September 2022. In this context, it is interesting to see that the EU plans to lower regulatory barriers to mining and production of critical materials such as lithium, cobalt and graphite needed for wind farms, solar panels and electric vehicles, arguing that so far we not only

ignored the environmental and social impact in third countries but also the carbon footprint of importing (Sam Fleming, Alice Hancock and Peter Wise, *"EU seeks homegrown lithium, cobalt and graphite in green energy push"*, Financial Times, 16 August 2022). BASF reported to have substantially substituted natural gas with heating oil while, at the same time, reducing gas consumption through internal measures by 40% (BASF Q3'2022 results call, 26 October 2022). In turn, KPN has been well hedged for its energy exposure in 2022 but expects overall energy costs for 2023 to increase by 50-60%, with 77% currently being hedged (KPN Q3'2022 results call, 26 October 2022).

[xxxiii] Megan Greene, *"Europe must use all its financial firepower to fund the green transition"*, Financial Times, 19 August 2022. In the aftermath of the Russian military aggression against the Ukraine, the debate on the EU's green taxonomy has gained a new dynamics, with some pointing to the need of "encouraging the greening of 'grey industries', rather than just backing the development of the greenest-of-green technologies" (Huw Van Steenis, *"Time to destigmatise 'khaki finance'"*, Financial Times, 18 July 2022) and others highlighting the need for more transparent disclosure standards to "harness the power of capital markets" (Emmanuel Faber, *"The power of capital markets can be harnessed to drive the green transition"*, Financial Times, 23 August 2022).

[xxxiv] Katherine Neiss (Chief European Economist at PGIM Fixed Income), *"Germany needs it very own Marshall Plan"*, Financial Times, 25 August 2022, and on the importance of European derivatives markets, clearing houses and exchanges, see: Gillian Tett, *"Brussels ignores derivatives at its peril amid energy crisis"*, Financial Times, 9 September 2022. While the CEO of BASF, Martin Brudermüller, was most critical about the "EU not having a Plan B", resulting in a weak competitiveness of European industrials (BASF Q3'2022 results call), the CEO of Shell, Ben van Beurden, hopes that the Russian gas war will help to "accelerate the energy transition", being a "wake-up call for policy makers" (Shell Q3'2022 results call, 27 October 2022). In the context of financing the energy transition, it was interesting to see how a number of energy companies opted for announcing special dividends in Q3'2022, what some analysts perceived as a proactive attempt to avoid windfall taxes, see for a lively debate on that: Shell Q3'2022 results call on 27 October 2022 and OMV Q3'2022 results call on 28 October 2022.

[xxxv] Eurostat Euro-indicators: *Volume of retail trade in August 2022 compared with July 2022 down by 0.3% in the euro area and by 0.2% in the EU*, 6 October 2022. Colby Smith, *"US economy rebounds in third quarter"*, Financial Times, 27 October 2022. See also, McKinsey & Company, *European consumer pessimism intensifies in face of rising prices*, 27 October 2022 and IRi (Information Resources, Inc. https://www.iriworldwide.com/en-gb), FMCG Demand Signals Report, *A return to 1970s and 1980s behavior as inflation fatigue deepens*, October 2022. FMCG Demand Signals looks at the impact of changing consumer demand on 230 FMCG categories, 2000+ product segments and over 10 million SKUs across 14 major markets in Europe, the US and Asia Pacific.

[xxxvi] While the CFO of LVMH, Jean Jacques Guiony, claimed that "luxury is not a proxy for the general economy" he conceded, among other things, that they have currently excess stock for cognac in China due to the pandemic (LVMH Q3'2022 results call, 11 October 2022). He also admitted that Tiffany's silver business was weaker than gold in Q3, possibly in response to inflation.

[xxxvii] Back in those days, the CEO of Nestle, Mark Schneider, insisted that "margin pressure is transitory" and that "demand elasticity is still quite limited" (Nestle Q2'2022 results call, 28 July 2022), something he had to revise only three months later when he conceded that they are "still in the process of catching up" with gross margins, pointing to high comparables in the prior year, supply chains and pricing (Nestle Q3'2022 sales call, 19 October 2022).

[xxxviii] At the same time, Procter & Gamble addresses it by providing different value tiers to consumers. The company expects a slowdown in categories growth from 5% to 3-4%, with most of the growth coming from price increases (Procter & Gamble Q1'2023 results call, 19 October 2022).

[xxxix] Beiersdorf Q3'2022 results call, 27 October 2022.

[xl] Tesco Interim Results 2022/23, 5 October 2022.

[xli] H&M Q3'2022 results call, 15 September 2022.

[xlii] Tesco Interim Results 2022/23 call, 5 October 2022.