Prime Partners

SINCE 1998

MARKET INSIGHT

APRIL 2022

CITYWIRE SWITZERLAND TOP 50 INDEPENDENT ASSET MANAGERS 2021

Market Analysis

April 2022

The geopolitical factor vanishes as suddenly as it appeared

The performance of the markets over the past month does not necessarily tie in with the results one might have expected when Russian troops first crossed the border into Ukraine. As of 28 March, the performances of the main stock market indices were flat or positive compared with a month ago, while the Global Aggregate Bond Index had fallen by 4%.

Offloading equities in a hurry and opting either to increase exposure to the safest debt or to increase duration were not the right tactical choices at the end of February. This is evidenced by 10-year Swiss government bond yields, which are at their highest levels since 2014. This shows clearly that government debt is far from being a safe haven for most investors.

Given the opinions expressed in our last publication, we can only be pleased with these developments, even if holding the line we set ourselves has not been easy, bearing in mind the daily, sometimes "tense" developments in the conflict between Moscow and Kiev.

The aforementioned market developments were helped by the fact that the conflict in Ukraine did not ultimately see a new and lasting escalation, and by a certain stabilisation in energy prices, after moves towards USD 135 per barrel during the period.

Similarly, the US Federal Reserve's decisions to begin monetary tightening and to adjust its rate outlook to market expectations helped "convince" the market that the fight against inflation would be resolute.

Despite this, it must be admitted that visibility on the economic cycle and on the new international order that will emerge from the Ukrainian crisis is hardly better than last month.

"The speed of the recovery in equities over the last few weeks has clearly been impressive."

FRANÇOIS SAVARY, CHIEF INVESTMENT OFFICER, PRIME PARTNERS

On the economic front, the question is not whether growth will be more moderate and inflation higher than expected at the beginning of the year, since both developments are very likely in the coming months.

Instead, the main question is whether stagflation, or even worse, a recession, is unavoidable in the near future. As things stand, we do not think it possible to decide on this matter based on the economic indicators; for example, certain leading economic indices (PMI) remain good despite a logical downturn.

In this context, we are maintaining our central scenario of satisfactory global activity in 2022 and expect inflation to slow down in the second half of the year.

We can now try to outline how the new international order created by the Ukrainian crisis may look: a retreat from globalisation, with production chains tending to become regionalised and a strengthening of political blocs, which the common ground between the US and Europe in the management of the current crisis seems to foreshadow; the agreement on the delivery of US liquefied gas to Europe is symbolic in this regard.

All of this points to an environment where the "peace dividend" of the last three decades will no longer apply. The main effect we foresee is without doubt an upward trend in inflation compared with the last 10 years. Once again, though, in such an uncertain global context, it is not a good idea to draw conclusions too quickly with regard to the long term. There are times when pausing to reflect is particularly justified.

Now to return to the outlook for the financial markets in the coming months.

As noted above, the recovery in the stock markets across all sectors, with energy and commodities outperforming by a wide margin, is quite remarkable. Even from a historical perspective, which shows that geopolitical shocks tend not to have a lasting influence on the markets, the speed of the recovery over the last few weeks has clearly been impressive.

In this highly unusual context for the stock markets and in view of the tension observed on nominal and real interest rates, the earnings season for the first quarter of 2022 will provide clarity for investors.

Margin changes will be under close scrutiny but investors should also, if not above all, focus on the outlook for the coming quarters announced by companies. It is likely that disappointments on this front will, if anything, fuel market volatility, and the recent downturn in volatility should not be considered final.

Earnings estimates, in an environment where valuations – particularly in the US – are far from cheap, are now subject to downward revisions that we consider justified and which can only lead us to play down the potential of equities over the coming months.

The limited upside potential of equities and uncertainties that are likely to fuel continued volatility have led us to refrain from increasing our exposure to the stock markets in recent weeks. This is not to say that we have been inactive on the portfolio side; indeed, we have continued to focus on adjusting certain exposures, and have not shied away from disposals when deemed necessary. This will continue in the coming weeks as we await the earnings season and the clarity it should bring.

As for bonds, should the marked pressure on yields for the safest debt be considered a buying opportunity? This question is all the more relevant given the firmly defensive and underweight policy on fixed income assets we have been following in recent months.

Given the current economic situation and the non-negligible risk of a slide into stagflation, we do not feel the time has come to change our bond strategy.

On the other hand, the sharp rise in yields on the short end of the US yield curve may offer attractive entry points, particularly for the most conservative investors. This option seems all the more justified given that the repricing resulting from the monetary tightening process has been largely factored into this section of the curve.

On the long end of the curve, we would need to see US 10-year yields approaching 2.70% before reconsidering our positioning, as the case may be.

Given the strong overall portfolio risk management warranted by the economic and political environment, together with our choice to maintain a solid exposure to equities, it does not seem wise to increase our positions in corporate debt. This is especially true given our strong exposure to convertible bonds.

The recent sharp fall in the Japanese yen, particularly against the US dollar, was due to a monetary cycle shift that has been reinforced by the actions of policymakers in recent weeks. We have no exposure to this region in our portfolios.

The euro remains weak against the dollar, although it has recovered somewhat since the first week of March. We believe that sideways trading between 1.08-1.12 is still on the cards for the next three months. However, we consider that the euro is undervalued and that certain risk factors in the US (mid-term elections, monetary policy mistakes) justify remaining positioned for a recovery in the single currency over the next six to nine months. Our target for the EUR/USD by the end of 2022 is 1.15-1.18.

In the wake of the recent geopolitical tensions, the Swiss franc temporarily broke the symbolic 1.00 mark against the euro. In general, the ongoing political and economic uncertainty are supportive of a strong franc; this assumption would remain valid even if it were to return to levels of 1.06 against the euro over the next six months, as we believe it will.

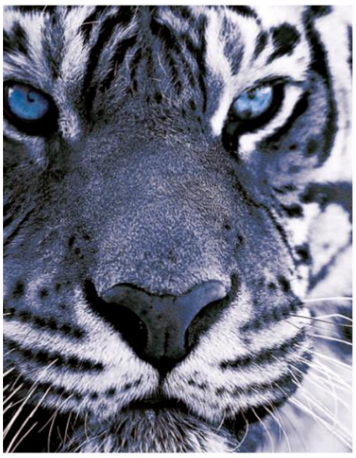
In conclusion, the markets' resilience in March has justified our decision to stay calm last month. On the other hand, we are fully aware that the economic and political situation is far from offering strong visibility on the developments to be expected in the coming months.

Moreover, the earnings season is now fast approaching. It could provide some clarity on the consequences of both the ongoing change in monetary policy and the recent geopolitical shock.

While we have chosen to continue favouring equities over bonds in our investment policy, we

do not feel it would be justified to double down in this regard at present.

Geneva, 28 March 2022



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