Prime Partners

SINCE 1998

MARKET INSIGHT

MARCH 2022

CITYWIRE SWITZERLAND TOP 50 INDEPENDENT ASSET MANAGERS 2021

Market Analysis

What new order will arise from the ashes of the war in Ukraine?

By deciding on a full-scale invasion of Ukraine and resorting to attacks on civilians, Vladimir Putin surprised most observers.

However, Europe's firm economic and financial measures in response to the Kremlin's action have been no less surprising, as the moderation of recent years had raised fears of a certain "softness" on the part of European decision-makers.

There can be no doubt that we have emerged from one era – the post-Cold War – to enter a new world whose shape it is still too early to discern; an observation all the more true since at the time of writing the ongoing conflict shows no sign of de-escalation. But one thing seems quite clear: there will be no going back to the world prior to the invasion of Ukraine.

January was complicated enough for risk assets, with the central banks' abrupt about-turn on the question of monetary policy. Geopolitics then triggered a further salvo of volatility on the markets in February.

As shown by certain currencies (USD, CHF, JPY), the decline in long rates, or the rise in gold, investors have sought out safe havens; a logical reaction in the face of current uncertainties.

As was to be expected, questions about economic developments in forthcoming quarters have grown significantly; the price of a barrel of crude crossing the USD 110 threshold helped substantially in fuelling the most pessimistic of fears.

On the back of this, we have factored into our thinking an increased risk of a "stagflationary" deterioration (sluggish growth and persistent inflation) in the global economic outlook. However, we do not feel it warranted to adopt it as our main scenario when making investment decisions.

We remain of the opinion that the global economy should be marked by satisfactory activity in the next few quarters.

As it happens, the latest data we have on the global economic situation (PMI indices, for example) by no means suggest that it was in a phase of rapid deceleration before the events in Ukraine!

Based on the information available to us, drawing definitive economic conclusions without knowing how long the crisis will last cannot be justified.

Jay Powell said nothing different in this regard in his recent testimony before Congress. Pragmatism is the order of the day and we must (try to) judge the facts.

> "Geopolitics triggered a further salvo of volatility on the markets in February."
>
> **FRANÇOIS SAVARY,** CHIEF INVESTMENT OFFICER, PRIME PARTNERS

In our February publication, we restated the main themes of our investment policy: a solid cash position, underexposure to bonds and a neutral position in equities.

In this context, we had mentioned that although we were looking for stock market opportunities, it was not yet time to rush in, given the constant upward revision of rate expectations and price levels that did not look attractive enough for such a move.

Regarding bonds, we do not see the need to shift our stance; in other words, we feel it is wise to maintain a defensive positioning, both in terms of global exposure and (short) duration.

Indeed, we do not picture an economic scenario that could support fixed income assets,

government debt in particular, over the coming quarters.

A drift towards stagflation is certainly not a development that would support bond prices; similarly, a scenario of satisfactory growth should not prevent a rise in interest rates in the months to come, given the desire of central bankers to tighten the monetary reins.

In our recent publications, we had encouraged cutting back on corporate debt, given its less attractive returns. The spread widening caused by the recent geopolitical developments has not led us to change our view or consider strengthening this asset class in our allocations.

Where most questions arise is obviously in equities and the positioning to adopt. The market situation and the price correction that we have witnessed since the beginning of the year have mechanically lowered the weighting of these assets in a diversified portfolio.

Refusing to jump at opportunities in January, because conditions did not seem to warrant doing so, has allowed us to avoid a trap. Of course, we would have preferred to be even less exposed to the markets, but we can't rewrite history.

What is more, rather than raising bond holdings, in recent months we had opted to increase cash positions; this choice was intended to allow us to have readily available resources to benefit from the consolidation in equities that we believed was likely to take place. In doing so, we have limited the negative impact of the material declines recorded on the bond indices since the start of the year.

Beyond the state of a portfolio at a precise point in time, which reflects the occasionally violent fluctuations in asset prices, the question for everyone is whether or not to abandon their stance on medium-term equity exposure; in other words, the question now is whether to go underweight on equities on a medium-term view, or whether to maintain the neutral positioning advocated last month.

History tends to show that making decisions hastily, and especially when dictated by geopolitical uncertainties, is not necessarily a wise choice. Furthermore, we believe that it is far too early to draw economic conclusions about the final impact of the Ukrainian crisis.

We have therefore decided to reaffirm our neutral stance on equities with a 12-month time horizon. There is no inconsistency in such a choice! It is a question of setting a course which, in our opinion, is still one where equities have greater potential than bonds.

We have nevertheless modified our regional objectives, due to a potentially stronger impact of the current crisis on European stock markets compared with their US counterpart; indeed, the Old Continent's greater dependence on Russian raw materials cannot be overlooked.

We have consequently adjusted our allocation by stepping up a rebalancing away from European equities and into US ones.

At the start of the year, we decided to encourage you to add to gold, which had seen a complicated 2021. The yellow metal has benefited from recent geopolitical events, something we welcome.

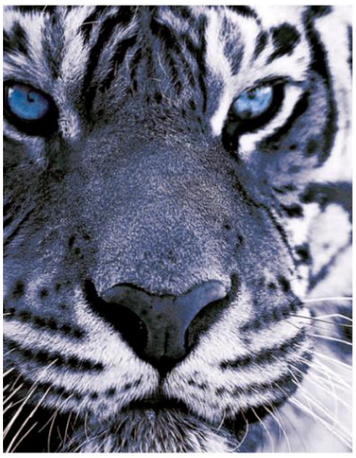
We stick to our advice to remain exposed to gold on a medium-term view, due firstly to the probability of a steadily rising price, and secondly, to lasting shifts in the geopolitical climate that war in Ukraine is likely to bring about. In the shorter term, we do not think that gold positions should be increased at current levels.

The rebound in safe-haven currencies (USD, CHF) in recent weeks is obviously linked to the deterioration in international relations. Does this mean that we need to revise our scenario of dollar depreciation by the end of 2022?

As it stands, we maintain our target of a return to the 1.18-1.20 zone for EUR/USD, although we cannot rule out a test of 1.08 in the very short term, depending on developments on the Ukrainian front. In this context, our choice to rebalance our equity weighting in favour of US securities has increased our portfolio exposure to the greenback.

In conclusion, we will continue to manage facts and events as and when they arise. In light of a situation that will obviously remain uncertain, we do not see any justification for drastically reviewing our core asset allocation weightings. This decision in no way reflects a lack of resolve: it seems to us the most appropriate in the present circumstances.

Geneva, 3 March 2022



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