Prime Partners

SINCE 1998

MARKET INSIGHT

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Market Analysis

The earnings season: decisive for the coming weeks

Much has been said and written about the "extreme" conditions prevalent on the markets in June. Recent weeks have seen increased volatility, a bond crash and a slide into bear market territory, with inflation higher than expected in the United States and central banks accelerating the shift in their monetary policy.

In this regard, the Swiss National Bank's decision to raise its key interest rates reflects the clear change in the global economic and financial environment.

In general, the markets remain largely dominated by the inflation issue and the uncertainty surrounding it, which have heightened pressure on bond yields – with the bring calm to the bond market and give investors a clearer idea of the potential for equities over the next 12-18 months.

We are still working under the assumption that the excessive inflation spurt should recede by the end of 2022, especially in the United States.

In the shorter term, the earnings season now getting under way will play a decisive role, after global stock markets looked to stabilise on the low side over the last few days of June.

Will companies be able to report positive earnings growth for the second quarter and meet the expectations of a financial community that hasn't really adjusted its forecasts?

"The Swiss franc should hold firm against all other currencies."

FRANÇOIS SAVARY, CHIEF INVESTMENT OFFICER, PRIME PARTNERS

US 10yr testing 3.50% and European peripheral bond spreads widening significantly – and led to a fresh bout of weakness for stock markets.

An excessive rise in inflation, and central banks' recent response, are fuelling fears of a monetary policy mistake, which could quickly plunge the global economy into recession.

As a result, we have reconsidered the outlook for the coming quarters.

A recession seems just as likely as positive but slower growth (45%) on a 12-18 month horizon.

Not only were oil price movements erratic in June, but signals from the economic and financial world are few and far between. Market jitters have driven brusque changes in the price of all assets over recent weeks.

This takes us back to the question of inflation's ability to stay on the road to normal in the second half of 2022. Only the emergence of visible signs that this is happening could help

Initial announcements raise a degree of hope. We'll just need some confirmation in the coming weeks.

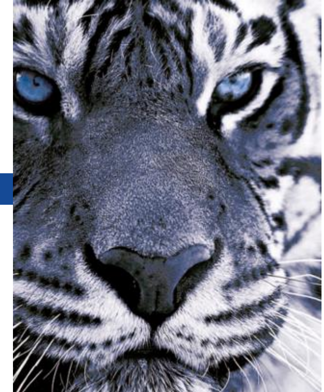
Even more importantly, we'll have to take a closer look at the medium-term prospects that companies are trying to sell to investors.

In such circumstances, we can expect market volatility to remain high.

On the asset allocation front, we took advantage of heavy pressure on yields to adjust our bond exposure.

We increased the weighting of our fixed-income investments at the expense of cash and convertible bonds. However, within a diversified portfolio, we remain underweight bonds relative to our benchmark.

This change in our fixed-income positioning involved strengthening our government bond holdings at the expense of high yield debt. We also increased the duration



of our US and, to a lesser extent, European government bonds.

These adjustments seemed logical given the increased likelihood of recession, as mentioned previously.

We did not alter the weighting of equities in our investment policy. Sharp movements took indices to levels that suggested it was too late for us to be reducing our positions.

Moreover, the levels reached by stocks around the world already reflect the risk of a global recession, with the markets now pricing in future monetary tightening. Jerome Powell's comments on his determination to prioritise the fight against inflation prompted traders to reconsider the number and size of rate hikes to come.

On the foreign exchange front, the recent performance of the US currency was more or less as we expected, with the EUR/USD stabilising at low levels, leaving the greenback in overbought territory.

We still expect the euro to rally over the coming months given the change in the ECB's monetary policy direction (return to zero interest rates by the end of the third quarter) and this autumn's US mid-term elections.

We think the EUR/USD will return to 1.10 over the next six months.

The strength of the Swiss franc following the SNB's unexpected decision to raise its key interest rates has brought the EUR/CHF back to parity. The Swiss monetary authorities seem willing to let their currency gain in value to counter the risk of imported inflation.

In such circumstances, the Swiss franc should hold firm against all currencies over the coming months. This is all the more likely given that the Swiss central bank has left the door wide open for key interest rates to move back into positive territory between now and the beginning of 2023.

The stabilisation of gold prices, which has continued in recent weeks, also seems to pave the way for an appreciation over the coming months. With less volatile rates, a weaker US currency and gold's "protective" qualities, the precious metal should be able to bounce back above USD 1,900 in the medium term.

In conclusion, the reasoning behind financial markets performance in 2022 remains the same: 1) predict future inflation, 2) try to determine the interest rate equilibrium, and 3) assess equities' upside potential on an 18-month horizon, all things considered.

June didn't really change anything, other than that the recession question has become more pressing following the publication of disappointing inflation figures, which forced central banks to run the risk of a monetary policy mistake in prioritising the fight against rising prices.

The importance of the earnings season now under way will be even greater given that, somewhat surprisingly, analysts have barely reconsidered their expectations for the time being.

Announcements will be scrutinised to gauge whether such optimism was justified. In the affirmative, taking bond markets' recent stabilisation into account, we can envision that stock markets will find the resources needed for a better performance in the second half of 2022.

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