Prime Partners

SINCE 1998

MARKET INSIGHT

AUGUST 2022

CITYWIRE SWITZERLAND TOP50 INDEPENDENT ASSET MANAGERS 2022

Market Analysis

August 2022

The worst is still possible although not necessarily probable.

The combination of a bond rally and the first earnings releases, which in general have shown companies' resilience, have enabled a pronounced rebound in the main stock market indices over the past month.

After the stock market turmoil in June, this has given some reassurance to investors who had suffered from a strong deterioration in sentiment in late spring.

But the economic figures, which still indicate excessive inflation and worsening growth prospects – the latest PMI indices, for example – are not necessarily heartening; however, investors had already largely priced in the idea of a likely recession for the global economy in the near future.

"The worst is still possible although not necessarily probable": in a nutshell, this is how we might sum up financial asset behaviour in July, which bore no relation to that of the month before!

The sharp drop in bond yields over the past few weeks owes much to the outlook for a slowdown in the economy. Moreover, another "significant" development for bond markets should not be ignored: traders are now banking on a return to a more accommodating monetary policy as early as 2023, particularly in the United States.

Behind this phenomenon hides a scenario that can now be discerned more clearly: the slowdown in growth should allow inflation to ebb enough to restore some leeway for the central banks, after the kind of forceful, swift tightening process as was displayed by the Federal Reserve with its second consecutive hike of 0.75% in key rates in July.

In general, visibility on the economic cycle remains poor and, with all due respect to some, we remain convinced that the future of the global economy is a hard one to call decisively.

Thus, as we mentioned last month, we place the scenario of weak growth on par with that of recession in our economic assessment for the coming months.

In this respect, the US GDP figures for the second quarter are indicative of the difficulty that economists are facing; indeed, although it is possible to speak of a "technical" recession, as this statistic has declined for two consecutive quarters, the impact of reduced inventories and still rising private sector demand must temper this judgement. On this point, we coincide with Janet Yellen in our assessment of the economic situation in the United States.

> "In July alone, the markets have factored in the scenario of an about-turn in US monetary policy in the relatively short term."
>
> **FRANÇOIS SAVARY,** CHIEF INVESTMENT OFFICER, PRIME PARTNERS

In the end, as we have been repeating for several months, it is the question of reversing inflation that remains central both for the future of the economic cycle and for the financial markets.

Unless price rises ebb soon, investors will rethink their expectations of a possible end to US rate hikes by the end of the year, let alone their more optimistic expectations of a loosening of the monetary reins in 2023.

This point is essential, because in July alone, the bond and stock markets have factored in the scenario of an about-turn in US monetary

policy in the relatively short term (within 12 months)!

Therefore, even though we are delighted with the improved performance of the financial markets in recent weeks, we have decided not to add extra risk to our allocations.

Our recommendation to strengthen bonds and lengthen the duration of the portfolios in June proved to be sound and we took advantage of it; however, the recent fall in bond yields seems “excessive” and we do not consider this is the right time to be accumulating interest rate risk in portfolios. Similarly, we do not feel that conditions are in place to recommend a more aggressive stance on credit risk.

Given this observation on bond yields, their reduced support for stock markets in the short term and the fact that the earnings season is in full swing, we have not altered our exposure to equities over the last few weeks. Once again, it seemed to us that risk management in the very special circumstances that mark 2022 did not justify taking “bets”, which are hardly warranted by the limited economic visibility.

Here, it should be noted that the results published by companies (still partial at the time of writing) are encouraging, both with regard to the figures for the second quarter and forecasts outlined for the second half.

These developments validate our choice to stay the course plotted for equities over recent months, despite a very turbulent environment for this asset class.

Last month we wrote: “*the levels reached by global stock markets 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.*”

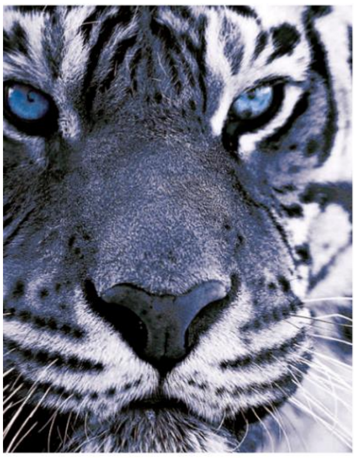
Market performance in July has borne out this observation. Fortunately, it could be said!

This does not mean that the markets are now ripe for a linear advance over the next few months.

The visibility of the economic and financial cycle remains cloudy, particularly on the issue of inflation. Many developments will depend on this crucial factor.

Until there is more clarity on whether price increases can moderate, and at a time when seasonal conditions limit market volumes, we did not wish to raise the risk on our allocations: we are comfortable with this choice.

Geneva,3 August 2022



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IMPORTANT INFORMATION