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MARKET INSIGHT

OCTOBER 2022

CITYWIRE SWITZERLAND TOP50 INDEPENDENT ASSET MANAGERS 2022

Market Analysis

October 2022

Currency volatility further complicates the situation.

“We have raised the probability of a global recession from 45% to 50% for the next few quarters.”

FRANÇOIS SAVARY, CHIEF INVESTMENT OFFICER, PRIME PARTNERS

The return from the summer break has in no way meant a return to tranquility for investors (to say the least!). This has mainly been because of renewed weakness on the bond markets and geopolitical uncertainties that show no signs of diminishing.

Granted, market traders were unnerved by the US inflation figures in August. And admittedly, these figures still allowed for the possibility of a slowdown in price increases, but the decline (on the global index) did not happen as quickly as expected.

Moreover, aggressive rhetoric from the Fed following its decision to raise rates another 75 basis points in September reinforced the feeling that the risk of a rapid US economic recession had significantly increased. In this context, the double blow of the rate hike (multiple compression) and the increased likelihood of recession (doubts on profit growth) logically led to a sharp fall in the stock markets last month (-9.5% on the MSCI World AC Index).

Already confronted by high volatility in interest rates and equities, investors have been forced to absorb far wider currency fluctuations, for instance in the pound and yen, which have suffered severe depreciation in recent weeks.

Then, Russian threats of using tactical nuclear weapons increased fears, which was evidenced by shrinking liquidity on the markets.

The Bank of England's decision to intervene on the bond market through major purchases confirms the disturbances affecting the markets on this front.

As we have said, the US Federal Reserve has toughened its language since its recent meeting. It no longer hesitates to evoke the possibility of a recession to induce a sharper decline in prices.

Another 75 basis point rate hike has almost been announced for next month and the scenario of a “long” period without a rate cut seems increasingly likely, once the monetary tightening process is complete.

The risk of a monetary policy error is growing. As a result, we have raised the probability of a global recession from 45% to 50% for the next few quarters. This choice is all the more justified since other central bankers are on the same wavelength as their US counterparts, such as the European Central Bank which is facing inflation of 10%, and the Swiss National Bank, actively engaged in preventing inflation from slipping out of control (it currently stands at 3.3%).

This combination of economic and geopolitical factors has not encouraged investors to buy ~~low~~ the dip! It is true that any enthusiasm was quickly squashed by the impending publication of corporate earnings, where medium-term prospects are highly doubtful since some companies' early announcements have failed to be reassuring (Carnival, Nike, FedEx).

Additionally, the strength of the dollar and disruptions in the pound and yen have revived fears of serious upheavals in the international monetary system – yet another development hardly conducive to risk taking!

In a nutshell, the month of September has, firstly, increased the lack of visibility on the economic cycle, and secondly, fuelled serious fears on the financial markets.

So, in view of the overarching uncertainties, we have

adjusted our allocations in a more defensive direction.

We have reduced equity exposure and increased bond exposure. Indeed, the sharp increase in yields in just a few weeks seemed to offer opportunities in an environment where we still anticipate that inflation will return to normal levels over the coming months.

These changes to the bond compartment complete the purchases we made last month. In doing so, we reduced our underweight in fixed-income assets, confirmed a more defensive stance in equities and increased the cash in the portfolio.

We have not altered the preferences that we have been applying for several months on the bond market. We favoured short to medium durations and "safe" segments (government debt, US in particular, and corporate debt with higher ratings).

The reduced equity component is chiefly the result of selling positions in the small and mid-cap segment. We still opt for solid exposure to stocks with visible growth in the current context, such as pharma, or stocks with high dividends.

Foreign exchange developments are disturbing in many respects, as is the rising volatility recorded in recent weeks. In addition, the persistent strength of the US currency is a source of justified concern, since raw materials are largely paid for using the greenback.

The dollar has safe haven status, which it shares with the Swiss franc in this case, nevertheless we feel that it is overvalued compared to its fundamentals from a medium-term perspective. This is all the more true as investors priced in the additional rate hikes by the Federal Reserve during September.

However, we have revised our price targets against the euro; we have lowered the Euro/USD fluctuation range to 0.95-1.00 for the next three months and we are considering a target of 1.05 on a 12-month horizon.

To conclude, the market configuration in September (stocks down almost 10% and bonds down 5% – Global Aggregate index in USD) has been difficult!

The emergence of "reasonable" alternatives to equity investments over the past few months has been confirmed in our view, which justifies our recent additions to the bond component.

The looming earnings season and company outlooks will be of particular importance.

We have reinforced our more defensive stance on equities that we had initiated in the "euphoric" summer phase. We consider that, in view of the complicated circumstances for international stock exchanges in the short term, this is a rational move.

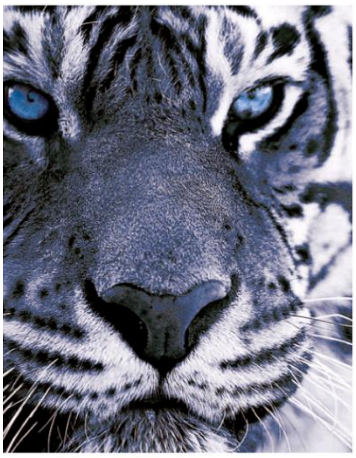
As we mentioned above, the double blow of interest rates (multiple compression) and uncertainties regarding profit growth is wreaking havoc on the stock markets!

Has the issue of earnings risk been sufficiently priced in by the markets? Company announcements will answer this question in the coming weeks.

Is the process of finding a new interest rate balance, which has been in progress since January 2022, now in its final phase? This question depends on figures showing a clear decrease in inflation over the next few months. Is it still relevant? We believe so.

In this situation, giving ourselves the time to wait for more visibility on these two essential factors seemed to be the right solution for now, even if we consider the recent market decline overdone in the short-term.

Geneva, 3 October 2022



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