MFM
MIRANTE FUND MANAGEMENT

DECEMBER 2021

We believe in active management based on a structured investment process to ensure optimal diversification in terms of asset classes, types of financial instruments and geographic sectors. Risk management is an investment tool fully integrated into the portfolio construction process.

The benefits of this approach are numerous: the reduction of risk against significant market declines, as well as the potential to create increased value over the long term.

Frank Crittin, Chief Investment Officer

GREEK LETTER OF THE MONTH:

OMICRON

Omicron is the name of a virtual currency created at the beginning of November. It saw its price soar by some 1000% following the discovery of the new variant of the coronavirus at the end of the month.

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ROBUST MARGINS

The publication of company results punctuated the beginning of the month. Investors particularly scrutinized corporate margins. Indeed, the robust rise in inflation raised fears of increased pressure on margins. As equity valuations remain high, such pressure would mean a contraction in valuation multiples. Yet, surprisingly, most companies have been able to pass on their increased costs to their customers.

While inflation pressures have been minor for companies, central bankers cannot say the same. Indeed, the inflation figures were spectacular during the month. Average prices in the US market basket rose by 6.2% year on year, the highest since 1990. In Europe, the increase is 4.1%, the highest since 2007. Most have half-heartedly admitted to being wrong about the magnitude of inflation. They continue, however, to assert that inflation remains transitory. It does not convince all the more wary investors, who expect monetary policy to tighten more quickly, especially in the US. Nevertheless, rates remained relatively stable during the month. It was the appearance of the new Omicron variant, on the other hand, that pushed bond yields down sharply at the end of the month.

DIFFICULT END OF THE MONTH

The sudden arrival of the Omicron variant caused considerable turbulence in the financial markets. The unknowns about its transmission speed and its dangerousness have severely shaken investor confidence. All regions were impacted. Europe was the most heavily exposed as it had already been under pressure during the month due to new announcements of confinements in several countries before the new variant appeared. Conversely, Switzerland performed strongly, benefiting from the defensive nature of its stock market indices and the safe-haven status of its currency. At the sector level, technology performed strongly, benefiting from spectacular gains by companies such as Apple and Nvidia.

Surprisingly, as in previous equity market corrections, technology seems to be playing a defensive role, particularly during the resurgence of pandemic fears. The hardest-hit sectors were finance and energy. Financials fell on the prospect of a slower rate hike, as energy suffered from erratic movements in oil prices.

In fixed-income, negative investor sentiment supported long-duration bonds (those offering long maturities). Defensive Swiss franc bonds were a safe haven, as did inflation-linked bonds that benefited from spectacular inflation figures. At the other end of the spectrum, high yield and convertible bonds were negatively impacted by fears of the new variant.

Real estate held up but ended in negative territory. The sector was helped by the excellent performance of companies active in logistics and data centers. Conversely, real estate companies linked to tourism were logically strongly affected. Potential new confinements strongly impacted global commodities.

OUTLOOK 2022 - TOWARDS NORMALIZATION

At this time of year, most economists try to predict the outlook for the next twelve months. However, if this is usually considered a tricky exercise, it is an acrobatic one this year. Indeed, the two most important factors that will influence the macro-economy and the financial markets are inflation and the evolution of the pandemic.

(1) Inflation is undoubtedly the biggest unknown. The fundamental question on all analysts' minds is whether the recent inflationary surge is transitory or whether it heralds a long-term return. Unfortunately, no economic model can describe the behavior of inflation over the last decade, as Janet Yellen pointed out when she was chair of the US central bank. A prediction of its trajectory without a valid explanatory model is therefore complicated. However, some of the factors contributing to the recent inflation surge have begun to fade.

- The boom in consumer demand following the end of the health crisis is fading. In the United States, consumer spending after the Thanksgiving holiday was only moderate.
- Production and supply chain bottlenecks have begun to ease. Delivery times and port delays have decreased. After peaking in early autumn, the median cost of shipping a standard container from China has fallen sharply in recent weeks. In Vietnam, factories in the country's southern manufacturing heartland are running more smoothly than they did several months ago. Even car producers have announced that the shortage of semiconductors is abating.

- The momentum of commodity prices is waning.
- China growth in 2022 will be more moderate due to the delicate situation of its property market and the government's desire to make its economy more balanced.

While most of the above short-term factors weaken, two others remain more equivocal.

- Psychology plays a significant role in inflation. Consumer behavior inspired by fears of inflation contributes to the phenomenon by encouraging people to spend more or less, as the case may be.
- Wage growth is also a self-fulfilling phenomenon. Employees negotiate higher wage increases in the presence of inflation, stimulating firms to pass on their costs by raising prices. Sustained wage growth is undoubtedly the major risk to inflation anchoring in the year.

At the investor level, it is relevant to note that the difference between the yield on an inflation-linked bond (TIPS) and the yield on traditional treasury security does not signal an inking of inflation. Indeed, two-year yields have risen above ten-year yields, indicating that investors are betting that inflation will peak in the next few months and then fall. It seems the most plausible scenario: inflation will remain high at the beginning of the year and then, through the base effect and the reduction of the factors described above, should return to its stationary level. This level is determined mainly by demographics and profitability gains. The pandemic has probably not significantly altered these two factors. The world population will continue to age. Productivity gains from the spread of home working and the adoption of new technologies should not accelerate. Artificial intelligence and blockchain technologies could potentially increase productivity, but not short-term.

(2) The evolution of the pandemic with the management of new variants is also very uncertain, as confirmed by the emergence of the Omicron variant. However, the health and technological response in vaccines, drugs, and therapies should avoid increased pressure on health systems and economies. Thus, covid will settle down as an endemic disease, like influenza, and its impact on our lives and economies should reduce and slowly normalize over the next few years.

The other important factors that will dictate the performance of the various financial assets are more straightforward. Without going into details, global growth is expected to normalize as demand weakens in the wake of the crisis, reduced economic stimulus and the Chinese slowdown. Corporate profits are also likely to normalize, with revenues following the trajectory of overall growth and margins narrowing slightly. In terms of interest rates, the speed with which central banks normalize monetary policy will be linked to inflation and investor patience with it. Thus, interest rates should remain reasonably low but on an upward path.

POSITIONING OF OUR INVESTMENT STRATEGIES

For the coming year, the major allocation challenge will be to mitigate short-term inflationary risks while integrating this macro-economic normalization in the medium term. At the strategic level, our World Equity Risk Premium indicator has increased significantly. It measures the equity risk premium, i.e., the additional return that investors demand when investing in equities rather than government bonds. This indicator remains well above historical averages. This means that it remains relevant to invest in equities, and more generally, in growth assets rather than in bonds over the long term.

The high valuations of most asset classes mean that expected returns over the long term are lower than in the past. These low return expectations argue for active management with highly diversified portfolios in terms of asset classes.

On the equity side, to mitigate inflation risks in the short term, it seems wise to invest in quality companies that can pass on certain costs to their clients. However, in the medium term, exposure to companies offering superior and sustainable growth seems reasonable to mitigate the impact of slowing revenues and profits.

In bonds, with the slight rise in interest rates, the expected yield has increased. This is positive in relative terms, but rates remain at very modest levels in absolute terms. In this context, high-quality sovereign bonds offer little appeal with low yields and high duration. Therefore, we continue to prefer to allocate credit risk rather than duration. Most fixed-income asset classes remain at significant valuation levels except for emerging markets and convertible bonds. Moreover, the latter provides robust credit quality, making it an attractive alternative to straight investment-grade bonds. TIPS (inflation-linked bonds) certainly remain attractive in the short term.

During this normalization phase, alternative strategies and real estate offer compelling properties for portfolio construction. Alternative strategies can reduce risk by providing uncorrelated sources of return by monetizing different risk premiums. Real estate remains an attractive asset class despite valuations. It reduces the dangers of inflation while providing an attractive return in a low-interest-rate environment.

The next market corrections might surprise investors by their magnitude, as the very definition of «defensive» assets is changing. However, good diversification and robust portfolio construction can mitigate the impact of these downturns and take advantage of potential market opportunities.

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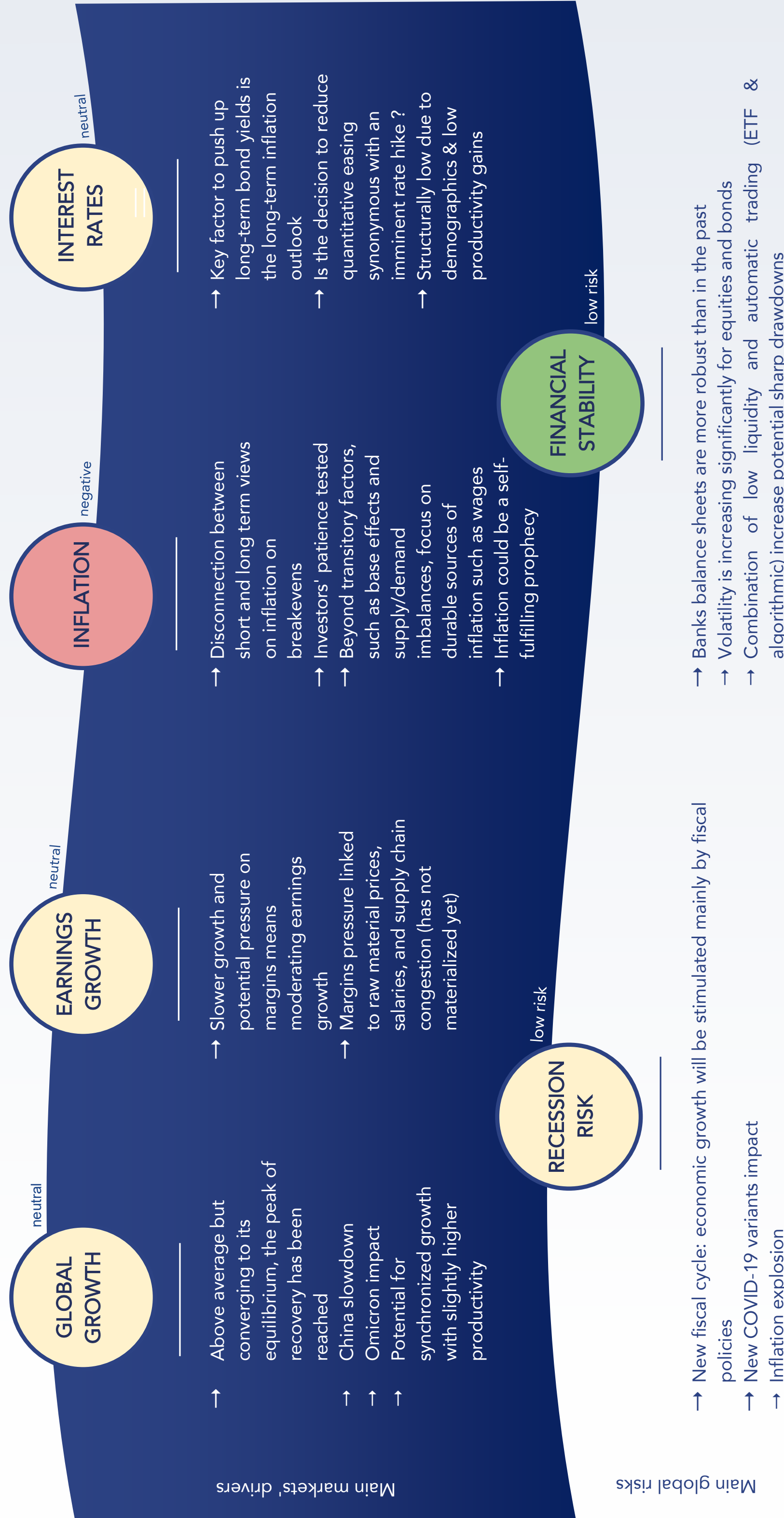
MAIN DRIVERS



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MONTHLY PERFORMANCE / NOVEMBER 30TH

Equities Market (Local currency)	
Switzerland	-0.21
United States	-1.05
World (all countries)	-1.47
United Kingdom	-1.95
Japan	-2.88
Emerging Markets	-3.22
Asia (ex-Japan)	-3.45
Germany	-3.90
Europe	-5.16

Equities Sector (Local currency)	
Information Technologies	2.91
Consumer Discretionary	0.30
Materials	-0.36
Consumer Staples	-1.27
Utilities	-1.30
Health Care	-2.98
Industrials	-3.09
Telecommunication Services	-4.52
Financials	-5.22
Energy	-5.48

Fixed-Income (USD Hedged)	
US Treasury Long Duration	2.65
Global Aggregate Long Duration	1.76
Swiss Bond (SBI / AAA-BBB) - (CHF)	1.42
Global Treasury	1.09
Global Inflation-Linked Bonds	0.71
Global Aggregate	0.71
Global Aggregate 5-7 Year	0.38
Global Corporate Credit	0.17
Global Aggregate 1-3 Year	0.08
Emerging Market Hard Currency Aggregate	-1.17
Global High-Yield	-1.40
Global Convertibles	-2.63

Others (USD)	
Real-Estate (FTSE NAREIT)	-0.67
Hedge Funds	-0.96
Commodities (BCOM)	-7.31

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