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MIRANTE FUND MANAGEMENT

Market Overview

JANUARY 2022

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

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2021 IN REVIEW

The performance of the various asset classes shows that in 2021, investors remained in search of growth. The equity markets generated a spectacular performance of more than 20% overall. But the main surprise came from fixed-income. For the first time in decades, most bond sub-assets finished in negative territory. Prices were driven up sharply; 1) by the explosion in global demand driven by government aid to combat the effects of the pandemic combined with a chronic lack of investment in supply chains; 2) as well as by new constraints on trade and the technology war between the US and China. Cooled investors initiated an interest rate hike in anticipation of future decisions by central bankers.

On the fixed-income side, it is no surprise that long-duration assets were the most severe hit since they mechanically lose more value when interest rates rise. On the other hand, inflation-linked bonds naturally fared much better, offering the best performance. High yield bonds also ended the year in positive territory. They benefited from the tightening of credit spreads linked to the excellent performance of the primary market and interest rates that remain extremely low in absolute terms.

For equities, 2021 has again demonstrated that robust earnings growth supports high valuations, especially when interest rates are near zero. Corporate earnings growth of over 45% on the MSCI World more than offset the compression in valuation multiples. At the end of the year, most companies demonstrated their resilience to inflation by passing on higher costs to consumers and maintaining their margins. Regionally, the main surprise came from China. Chinese equities came under heavy pressure.
On the one hand, China intensified its crackdown on technology companies to promote the «common prosperity» defined by Xi Jinping. On the other hand, at the end of the year, the implosion of the real estate market put investors under tremendous pressure.

The energy sector was the best performer this year on a sector level. Energy prices drove it despite, or partly because of, concerns about the energy transition. Despite the onslaught of Chinese authorities, the technology sector benefited from strong corporate earnings. The financial sector benefited from the expanding economy and significant rise in interest rates.

OUTLOOK 2022

As discussed last month, the two overriding factors that will influence financial markets in the coming year are likely to be inflation and the pandemic.

For the evolution of the pandemic, the health and technological response in vaccines, drugs, and therapies should prevent further pressure on health systems and, consequently, economies. Moreover, as expected, the disease will become endemic.

Regarding inflation, the way it is assessed implies that it will remain mechanically high in the coming quarters, even though some of the factors contributing to its recent surge have begun to fade. They include the explosion in consumer demand, supply chain congestion, raw material prices, etc. However, as no economic model can describe the behavior of inflation, a prediction of its trajectory remains perilous. Among the aggravating factors, the psychology of the consumer in an inflationary environment and the increase in wages could contribute to supporting inflation.

Regarding other critical drivers of financial market performance, the emphasis will be on overall economic growth, corporate earnings growth, and the path of interest rates.

Overall economic growth is expected to normalize due to weakening demand from the post-crisis era, reduced economic stimulus and the Chinese slowdown. It should, however, remain above its long-term trend.

In the longer term, overall growth still driven by demographics, productivity gains and investments.

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NUMBER OF THE YEAR

$12 trillions

Companies raised a record $12.1 trillion in financing in 2021, up by 17% from the previous year

(source : Financial Times based on Refinitv data)

Accelerating population ageing contributes negatively. However, health care needs, environmental issues, and increased attention to supply chain resiliency require greater public and private investment in the coming years. Likewise, with automation and artificial intelligence, productivity could increase, even though technology as a whole likely remains deflationary.

Corporate profit growth is also expected to level off in 2022, with revenues following the overall growth trajectory and margins narrowing significantly. On the optimistic side, companies could spend even more on share buybacks and dividends in the coming year. Their excellent cash position gives them considerable room to reward their shareholders.

In terms of interest rates, central banks will face a dilemma: when and how quickly to raise rates in a world of rising inflation and slowing growth. In absolute terms, interest rates should remain reasonably low but upward. Some regions have already started to raise rates, such as Canada, Norway, and England, while others, such as Europe, Switzerland and Japan, are much slower.

In terms of macroeconomic risks, the confrontation between the United States and China could intensify as these two countries dominate the world economy, accounting for over 40% of the world's gross domestic product.

POSITIONING OF OUR INVESTMENT STRATEGIES

For the coming year, the major challenge for investment strategies will be to mitigate inflationary risks in the short term while integrating this macroeconomic 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 bonds in the long term. Indeed, equities should be supported by above-trend economic growth and strong earnings growth.

The high valuations of most asset classes mean that expected long-term returns are lower than in the past. Despite these lower return expectations, there are still many opportunities for investors. They argue for active management based on highly diversified portfolios in terms of asset classes.

The persistence of inflation combined with the reduction of accommodation by central banks pleads for an allocation to assets linked to the real economy and inflation and to remain short on duration. Diversified management remains central to cushion the expected fluctuations in risk appetite.

Equities remain the asset class with the best return prospects. Their performance will be mainly driven by earnings growth despite likely pressure on margins. On the positive side, equities could benefit from significant revenue growth and dividend yields. Therefore, in this rising cost and interest rate environment, allocation and stock selection should focus on earnings growth potential, pricing power and quality.

In fixed-income, without a significant crisis, sovereign bonds could again post negative returns as central banks reduce their support. Overcoming the temptation to opt for long duration after the first phase of rising nominal yields will remain crucial.

Due to last year's strong performance in real estate, the expected yield has decreased, but the asset class as a whole remains very attractive. The logistics sub-sector could benefit from investments in strengthening supply chains. In addition, real and infrastructure assets help diversify portfolios due to their traditionally low volatility and potential inflation protection characteristics.

In terms of alternative strategies, while bond returns are higher, they will remain anaemic by historical standards. In this environment, alternative approaches provide attractive, uncorrelated returns based on various risk premiums.

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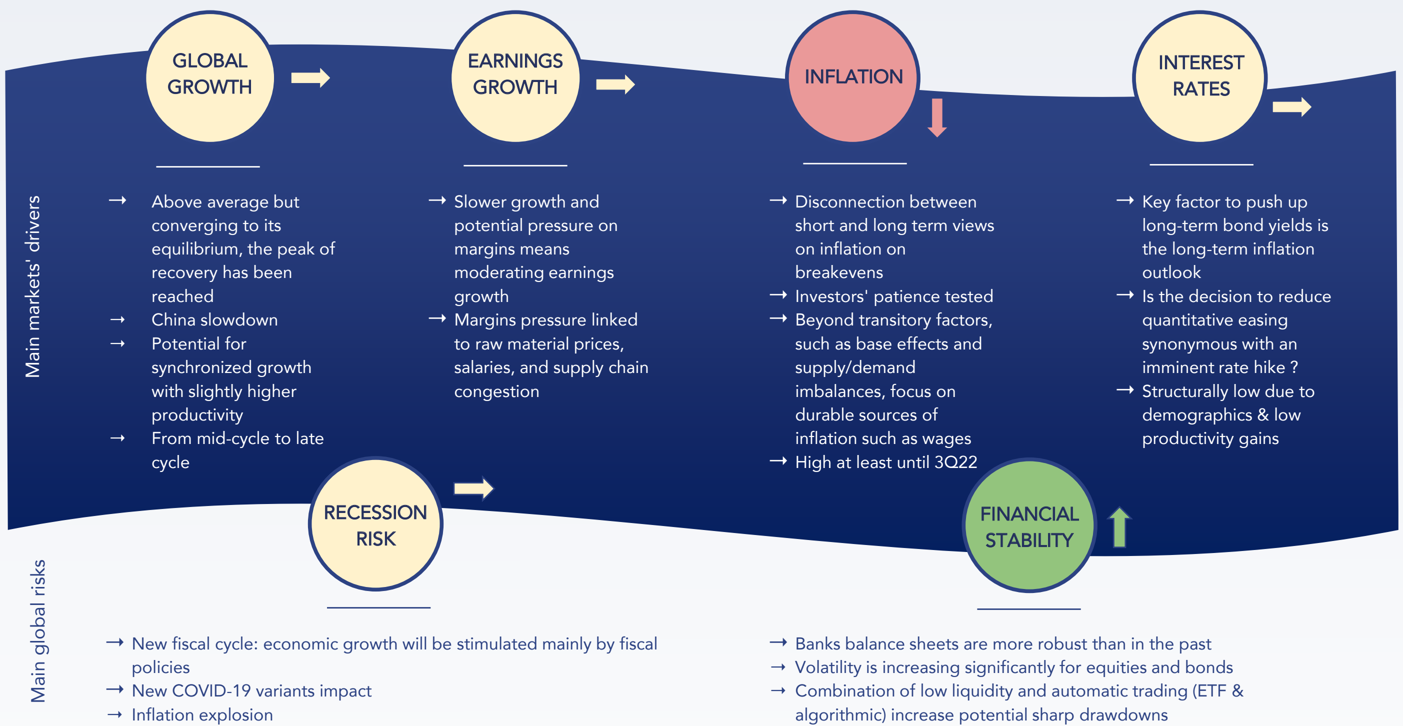
MAIN DRIVERS



SOURCE: MFM, January 2022

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PERFORMANCE 2021

Equities Market (Local currency)	
United States	26.45
World (all countries)	24.17
Switzerland	22.97
United Kingdom	19.59
Europe	16.30
Japan	13.44
Emerging Markets	-0.19
Asia (ex-Japan)	-3.06
China	-21.66

Equities Sector (Local currency)	
Energy	41.97
Real Estate	31.20
Information Technologies	31.19
Financials	30.45
Health Care	21.90
Consumer Discretionary	20.88
Industrials	20.52
Materials	19.79
Telecommunication Services	15.81
Consumer Staples	15.57
Utilities	12.28

Fixed-Income (USD Hedged)	
Global Inflation-Linked Bonds	5.65
Global High-Yield	2.53
Global Aggregate 1-3 Year	-0.06
Global Corporate Credit	-0.79
Global Convertibles	-1.11
Global Aggregate 5-7 Year	-1.28
Global Aggregate	-1.39
Global Treasury	-1.86
Swiss Bond Index AAA-BBB (CHF)	-1.97
Emerging Market Hard Currency Aggregate	-2.65
Global Aggregate Long Duration	-3.14
US Treasury Long Duration	-4.65

Others (USD)	
Commo Industrials (CBR)	26.83
Commo Global (ThomsonReuters)	26.70
Hedge Funds	3.69

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