MFM
MIRANTE FUND MANAGEMENT

Market Overview

FEBRUARY 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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JANUARY 2022: WILD !

The beginning of 2022 has been a bumpy ride for investors, with several factors combining to increase volatility across all asset classes.

As expected, global growth continues to normalize. Most macroeconomic indicators have confirmed its slowdown. However, it remains above the average growth expected in the long term. As an illustration, the International Monetary Fund predicts that the global economy will grow by 4.4% this year, compared to a previously estimated expansion of 4.9%. The slowdown is evident in the United States and China. In the U.S., consumption is slowing as the boom in demand driven by the economic stimulus and containment continues to fade. In China, the crisis in the real estate market continues to put pressure on the economy. The Chinese government has already initiated economic stimulus, notably by lowering key interest rates.

Inflation remains at high levels in all regions of the world. Moreover, it will remain mechanically high in the months to come.

In the United States, the strength of inflation, combined with a strong labour market, has prompted the central bank to announce a faster rise in interest rates. In this environment, investors revised their expectations and pushed rates up sharply. This interest rate hike is being felt across all asset classes.

Under these conditions, the equity markets have been under severe pressure. The year-to-date decline in global equities is close to -5%. Growth companies have been hit harder as higher rates reduce the present value of future earnings. The effect is pronounced for high-growth companies valued based on long-term earnings growth. The only sectors that closed the month in positive territory were energy and financials. Energy companies were propelled by strong oil prices supported by threats of an invasion of Ukraine. Financials benefited from relatively strong earnings reports from major banks and rising interest rates. Indeed, automatically, higher rates allow banks to increase their gross margins.

The strength of interest rates has mechanically pushed bonds into strongly negative territory. Long-dated bonds (bonds with long maturities) were logically the most affected. Investors' strong risk aversion could not offset the impact of rising rates on bonds considered defensive, such as government debt. On the other side of the spectrum, the negative performance of convertible and high yield bonds illustrates investors' fears about riskier assets. Convertibles suffered from their exposure to high-growth companies. With credit spreads (the yield differential with government bonds) coming under pressure, the riskier high yield bonds were sold.

Commodities benefited enormously from the surge in oil prices. As for alternative strategies, those whose behavior is not correlated to the equity markets posted decent performances, while the others ended the month in negative territory.

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ANECDOTE OF THE MONTH

Please don't shoot the pianist. He is doing his best.*

President Erdogan fired the head of statistics in Turkey after inflation data hit 36.1% in December 2021, a 19-year high.

* In his essay Impressions of America (1896), Oscar Wilde reported that in the Leadville saloon, a sign had this inscription.

OUTLOOK: CORRECTION OR CRISIS ?

Market corrections represent sharp movements in the prices of risky assets. They hurt equity valuations. The current correction reflects investors' fears about inflation, rising interest rates and a potential war in Ukraine. However, for the time being, it does not seem to indicate a significant crisis linked to a possible recession or a destabilization of the financial system. Indeed, even if it slows down, global growth remains above its long-term potential. Companies should benefit from this—the start of the earnings season points in this direction, with companies reporting robust sales and margins. The more fundamental question is the pace of this slowdown.

In China, the government has begun to stimulate the economy to offset the impact of the new Omicron wave and the violent turbulence in its real estate market. In the U.S., although rates will rise, it is clear that the U.S. central bank will be looking «at all costs» to avoid derailing its economic recovery. The two engines of the global economy should logically avoid seizing up global growth. As for interest rates, they should continue to rise inexorably. Indeed, inflation will remain at high levels pushing central bankers to action.

In this context, investors will reassess their expectations. This should continue to generate volatility in bonds and equities. On the positive side, the modest effects of the latest pandemic wave, the significant reduction of problems in production and supply chains and the satisfactory results of companies should support stock prices.

In terms of our investment strategy positioning, the increased volatility of the main asset classes does not justify a change in strategic allocations for the time being. Our major challenge remains to mitigate inflationary risks in the short term while integrating the normalization of the global economy in the medium term.

Our «World Equity Risk Premium» indicator has increased slightly. 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, as rising corporate profits have offset rising interest rates. It means that it remains relevant to invest in equities for the long term. Indeed, equities should be supported by above-trend economic growth and earnings growth.

The high valuations of most asset classes mean that expected returns over the long term are lower than in the past. Despite this outlook, there are still many opportunities for investors who advocate active management based on highly diversified portfolios. The persistence of inflation combined with the reduction of accommodation by central banks pleads for an asset allocation linked to the real economy and inflation and to remain short on duration. Therefore, diversified management remains central to cushion the expected fluctuations in risk appetite.

Equity performance will be driven primarily by earnings growth despite increasing pressure on margins. On the positive side, equities should be able to benefit from significant revenue growth and dividend yields. As a result, allocation and stock selection should focus on earnings, pricing power and quality.

At the bond level, excluding the impact of equity market corrections, sovereign bonds could post negative returns as central banks reduce their support. Overcoming the temptation to go long after the first phase of rising nominal yields will remain crucial.

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MAIN DRIVERS

Main markets' drivers

GLOBAL GROWTH

- → Normalizing, above long-term trends
- → China slowdown but stimulus
- → Potential for synchronized growth with slightly higher productivity

EARNINGS GROWTH

- → Earnings growth normalizing, remains high in absolute
- → Potential pressure on margins linked to raw material prices, salaries, and supply chain congestion

INFLATION

- → Disconnection between short and long term views
- → Investors and central bankers' patience tested
- → Beyond transitory factors, such as base effects and supply/demand imbalances, focus on durable sources of inflation such as wages
- → Mechanically will remain high at least until 3Q22

INTEREST RATES

- → Interest rate will increase, central banks will try to avoid to impact the economy
- → Key factor to push up long-term bond yields is the long-term inflation outlook
- → Structurally low due to demographics & low productivity gains

Main global risks

RECESSION RISK

- → Tightening monetary policy, especially from the US Fed
- → Inflation explosion

FINANCIAL STABILITY

- → Banks balance sheets are more robust than in the past
- → Volatility is increasing significantly for equities and bonds
- → Combination of low liquidity and automatic trading (ETF & algorithmic) increase potential sharp drawdowns

SOURCE: MFM, February 2022

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MONTHLY PERFORMANCE, 31 ST JANUARY

Equities Market (Local currency)

United Kingdom	1.86
Emerging Markets	-1.79
Asia (ex-Japan)	-2.72
China	-2.89
Europe	-4.58
World (all countries)	-4.93
Japan	-5.02
United States	-5.69
Switzerland	-5.79

Equities Sector (Local currency)

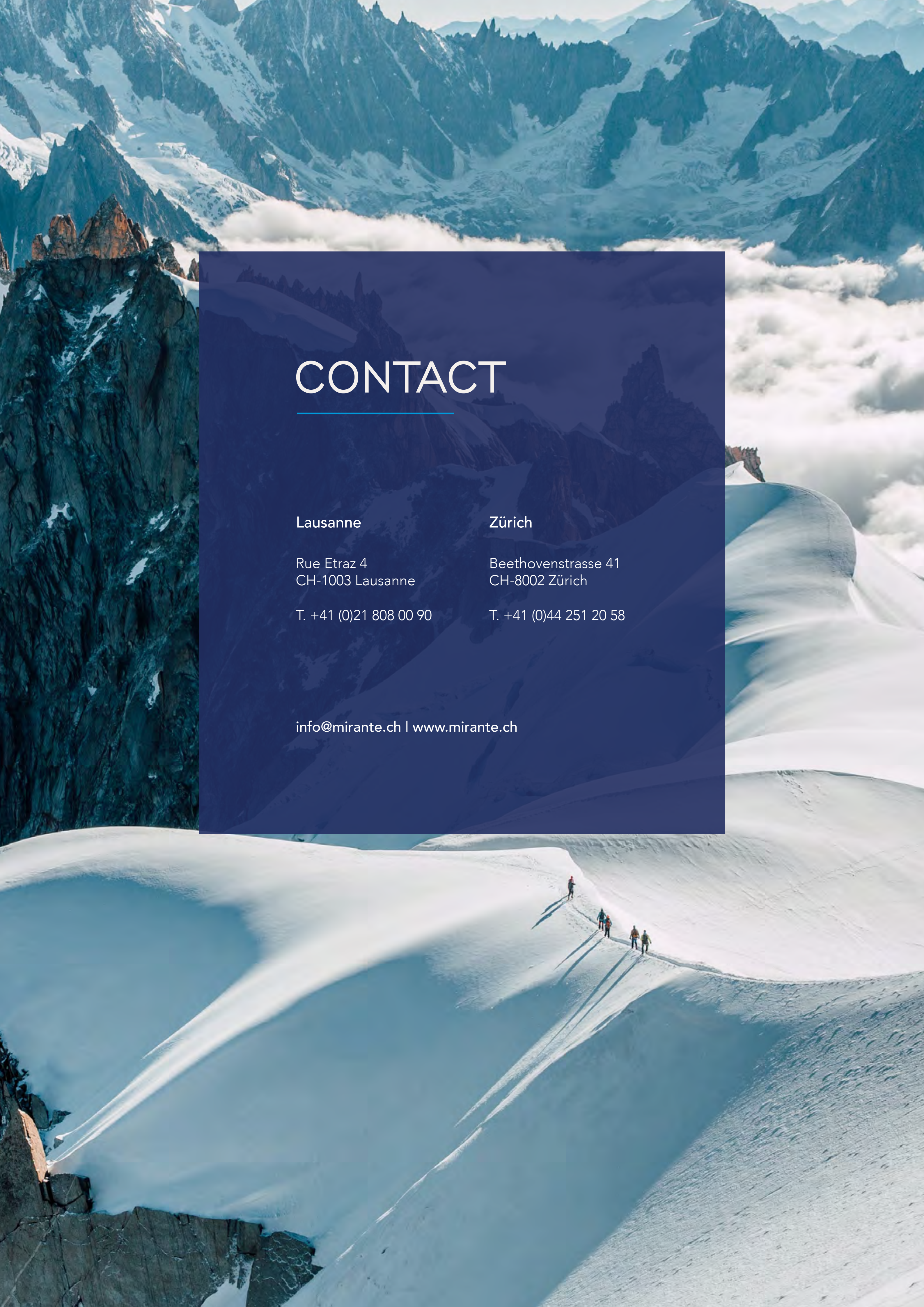
Energy	16.02
Financials	1.19
Consumer Staples	-2.50
Utilities	-2.68
Materials	-3.73
Telecommunication Services	-5.93
Industrials	-6.29
Real Estate	-6.78
Health Care	-7.00
Consumer Discretionary	-8.15
Information Technologies	-8.37

Fixed-Income (USD Hedged)

Global Aggregate 1-3 Year	-0.38
Global Inflation-Linked Bonds	-0.74
Global Aggregate 5-7 Year	-1.27
Global Treasury	-1.35
Swiss Bond Index AAA-BBB (CHF)	-1.41
Global Aggregate	-1.57
Global High-Yield	-2.24
Global Corporate Credit	-2.65
Emerging Market Hard Currency Aggregate	-2.74
Global Aggregate Long Duration	-3.30
Global Convertibles	-4.07
US Treasury Long Duration	-4.14

Others (USD)

Commo Global (ThomsonReuters)	8.77
Commo Industrials (CBR)	-0.40
Hedge Funds	-1.47



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