Market Overview

APRIL 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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INFLATION SOARS AND RATES RISE

The war in Ukraine and its impact on commodity prices remains one of the major concerns of investors. At the same time, the U.S. Federal Reserve, as widely expected, initiated the increase in its key rates. This is the first-rate hike since 2018. In terms of global growth, the slowdown in China has been confirmed. The Chinese government has also announced essential measures to stimulate its economy. The Chinese party's target remains ambitious, with growth expected to be 5.5% this year. At the corporate level, given the geopolitical uncertainties, corporate earnings estimates have changed little.

In this environment of rising interest rates combined with high inflation, the financial markets show very contrasting performances.

The mechanical impact of duration, which measures the sensitivity of a bond's price to a change in interest rates, combined with historically low yields, particularly on a real basis, has resulted in all bond assets falling. Logically, long-dated assets were the most heavily impacted. Emerging market bonds also remained under pressure due to their exposure to commodity prices and weak Chinese growth. On the other side of the spectrum, convertible bonds logically managed to limit the damage in this environment.

While nominal rates have started to rise, the increase in inflation has kept real yields, i.e. adjusted for inflation, at historically low levels. This probably justifies the excellent performance of equity markets, which benefit from exposure to growth in a low-interest-rate environment. Over the month, it is worth noting that all sectors ended the month in positive territory, while China and the emerging countries posted a strongly negative performance. The Chinese market was impacted by the significant slowdown of its economy generated by the confinements announced to control the new wave of Covid and the turbulence of its real estate market. Emerging markets were impacted by tightening global liquidity and slowing economic growth. Japan was the strongest performer, supported by its central bank's promises to stimulate its economy. The U.S. also performed strongly in this turbulent environment. On the other hand, Europe ended the month in negative territory due to its direct exposure to the war in Ukraine and commodity prices, particularly energy.

Real estate had a robust performance for the month. The sector benefited from its defensive nature relative to inflation, with many rents indexed to inflation. In addition, the U.S. contributed to the excellent performance of the asset class, and at the sub-sector level, logistics was the main positive contributor.

NUMBER OF THE MONTH:

13,8 trillions

For the International Monetary Fund, the economic losses related to Covid since its apparition are expected to be ~$13.8 trn by the end of 2023.

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IS THE RISK OF RECESSION INCREASING SIGNIFICANTLY?

At the beginning of the year, overall growth and corporate profit growth remained above their long-term trends. However, a few weeks later, rising inflation, the Ukrainian war, and a slowing Chinese economy are weighing on the growth outlook.

The Chinese slowdown is more substantial than expected. Leading indicators are showing alarming signs. The zero-covid policy and the resulting restrictions severely disrupt the Chinese economic machine. The real estate market, which has contributed to Chinese growth for years, is in a delicate situation. External demand, shaken by the consequences of the war in Ukraine, is weakening. However, the party and the central bank have announced a series of dramatic measures to stimulate the economy. China is aiming for growth of around 5.5% this year. This seems ambitious in the current environment, but the Chinese government may have the means to achieve its ambitions. At a global level, the Chinese slowdown should not derail the world economy.

Inflation, exacerbated by the war in Ukraine, will be more persistent than expected. Its impact will vary from region to region. In the United States, it is already seeping into the price of rents and wages. This justifies the abrupt nature of the interest rate hike initiated by its central bank. In Europe, inflation is crystallizing mainly in commodities and energy. In China, it remains moderate for the moment. Its impact on overall growth should stay under control. Clearly, the rise in interest rates could constitute an obstacle to growth. The inversion of the yield curve in the United States (with short rates higher than long rates) is a reliable historical indicator of a potential recession. However, in terms of the region, fundamentals in the US remain positive with solid household and corporate balance sheets. The prospect of a recession in the next twelve months thus seems unlikely. The Fed Chairman will do everything to prevent rate hikes from derailing the economic recovery.

The main recession prediction models indicate probabilities below historical averages. The inversion of the yield curve means a coming recession relatively reliably, but sometimes several years in advance. Moreover, as this indicator is now heavily scrutinized by macroeconomists and central bankers, it is not inconceivable that it has lost some of its predictive power. The global recession risk has increased but remains at levels that justify continued exposure to financial markets.

Regarding the positioning of our investment strategies, while nominal rates have started to rise, the increase in inflation has kept real yields, i.e. adjusted for inflation, at historically low levels. This is still a strong argument for allocating to risky assets, especially equities, rather than bonds.

At the bond level, even though central banks have started to normalize their monetary policy and raise their rates, financial markets have probably already priced in most of these movements. However, investors will likely continue to demand a significant risk premium for holding fixed-income assets when inflation remains high. Over the medium term, even if the capital losses incurred on bonds are painful in the short term, higher rates mean more attractive expected returns. We continue to favour low durations in our overall investment strategy. If duration is short enough for investors to hold their investments, the increase in expected returns will help to offset the decline in prices. Finally, government bonds should continue to act as diversifiers in asset allocation, especially during crises. This remains valid, even though in recent weeks the correlation between defensive bonds and equities has been strongly positive.

In equities, the risk premium - the compensation investors require to hold equities compared to risk-free assets - remains very high in historical comparison. It justifies a significant allocation to this asset class. The consequences of the war in Ukraine will be more assertive in Europe than in other regions. For this reason, we maintain a quality bias for stock selection in Europe. In the United States, the economic slowdown could be offset by corporate profit growth. We maintain a cautious allocation to China, which could benefit from economic stimulus and the easing of constraints related to the current wave of the pandemic.

An investment process that combines robust portfolio construction with active risk management seems ideal in the current environment. We believe it is wise to take advantage of particular opportunities by mitigating risk through strong diversification across asset classes, regions and sectors.

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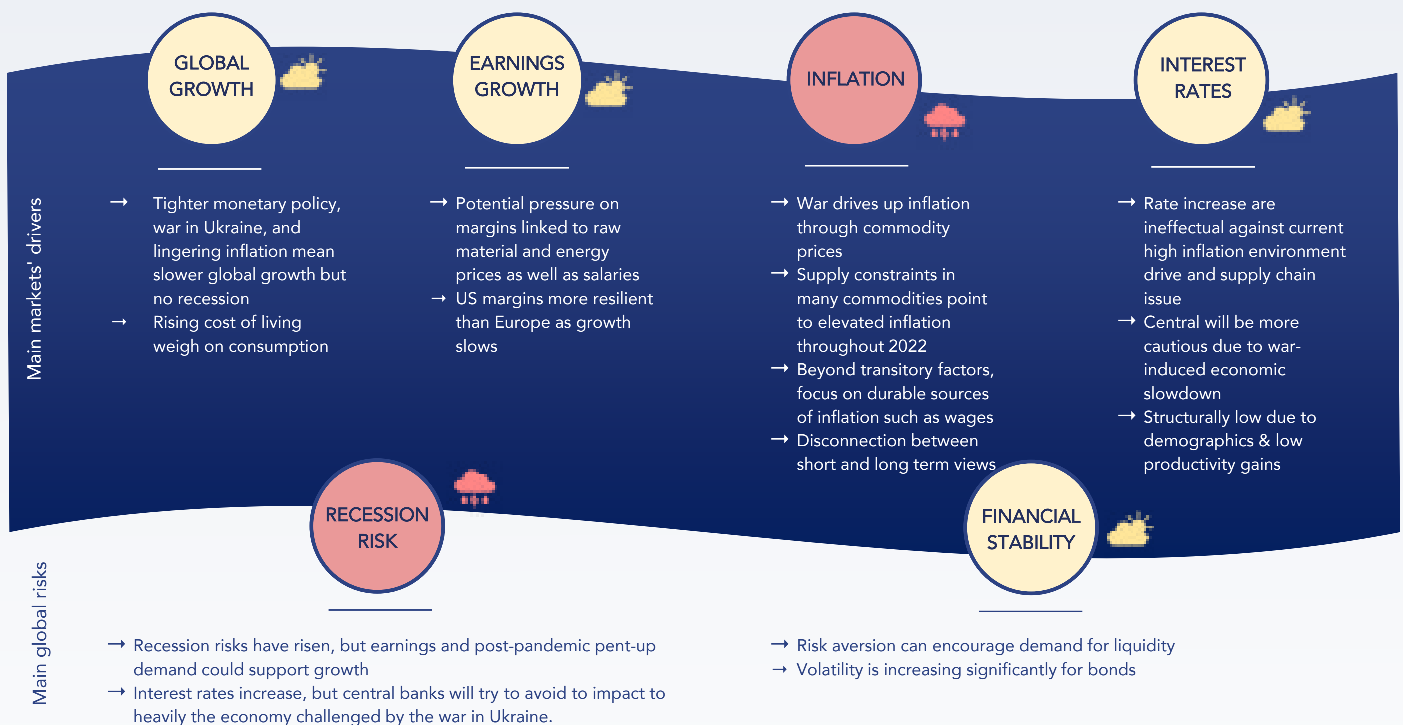
MAIN DRIVERS



SOURCE: MFM, April 2022

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MONTHLY PERFORMANCE, 31 MARCH

Equities Market (Local currency)

Japan	4.85
United States	3.48
World (all countries)	3.11
Switzerland	2.28
United Kingdom	2.04
Europe	-0.10
Asia (ex-Japan)	-2.03
Emerging Markets	-2.06
China	-7.73

Equities Sector (Local currency)

Energy	7.80
Utilities	5.52
Materials	5.49
Real Estate	5.35
Health Care	5.18
Information Technologies	3.22
Industrials	3.11
Consumer Discretionary	2.71
Telecommunication Services	1.14
Consumer Staples	0.73
Financials	0.67

Fixed-Income (USD Hedged)

Global Convertibles	-0.49
Global High-Yield	-0.62
Global Inflation-Linked Bonds	-0.69
Global Aggregate 1-3 Year	-0.97
Global Treasury	-2.10
Global Aggregate	-2.16
Global Corporate Credit	-2.16
Global Aggregate 5-7 Year	-2.43
Emerging Market Hard Currency Aggregate	-2.49
Swiss Bond Index AAA-BBB (CHF)	-2.73
Global Aggregate Long Duration	-2.92
US Treasury Long Duration	-5.34

Others (USD)

Commo Global (ThomsonReuters)	8.61
Commo Industrials (CBR)	4.90
Hedge Funds	0.63

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