MFM
MIRANTE FUND MANAGEMENT

Market Overview

MAY 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

INFLATION (OF PRICES) OR DEFLATION (OF GROWTH)?

Earlier this month, fears of accelerating inflation continued to be the primary concern for investors, with figures showing record levels in all regions. Following the commodity shock generated by the war in Ukraine, investors and economists are trying to identify if the massive price explosion is spreading to wages. In this environment, logically, interest rates continued to rise at the same pace as the previous month. As a result, bond investments mechanically showed strongly negative performances, especially for long maturities.

At the end of the month, the pessimism of bond investors spread to equity investors. Indeed, inflation and rising interest rates made them fear a marked slowdown in the economy and corporate profits. By circular effect, these growth fears slow down the increase of interest rates. If the economy slows significantly or enters a recession, investors tend to sell risky assets, especially stocks, to buy defensive assets, especially bonds. This has resulted in a stabilization of interest rates and a sharp correction in equity indices.

For the month, the impact on the major asset classes was painful. However, it was not the magnitude of the movement that was painful but that the two major asset classes, equities and bonds, declined in near-synchrony. Bonds continued to show strong negative returns, especially long-dated assets. Equities were under pressure at the end of the month. On a regional level, the US was the weakest performer. The technology and consumer discretionary sectors were pressured by the lackluster quarterly results of large companies such as Amazon, Netflix and Google. Only consumer staples managed to achieve a positive performance in the US. Despite the war in Ukraine, Europe was the best performing region. It was particularly supported by its defensive sectors, such as consumer staples and utilities. The energy sector, supported by oil and gas prices, also performed well. In the real estate asset class, all regions suffered except Asia. It practically closed the month in positive territory, supported in particular by the defensive nature of the Japanese real estate market.

MACROECONOMIC OUTLOOK

The monetary tightening of the US and European central banks, the Chinese slowdown and the invasion of Ukraine will inevitably restrict growth. However, fears of rising rates and the invasion of Ukraine should dissipate in the coming months. Indeed, the intense movement on interest rates seems to already integrate future decisions of central banks until the end of 2022 or even 2023. Even if they were to rise further, most of the way seems to have been done. The impact of the war in Ukraine on commodities should also fade. The shock was sudden, especially for energy commodities, but economic and political actors seem to be able to integrate it. The impact on inflation will be felt much longer. However, inflation is likely close to its peak and should decline steadily in the coming quarters (by statistical and economic phenomena). This will be likely if wages do not follow a parabolic path. This does not seem to be the case at the moment. A drop in inflation should also allow rates to stabilize.

The biggest unknown remains Chinese growth. For several months now, it has been hampered by three factors: the zero covid policy, the regulatory crackdown on technology, and its property sector's indebtedness. China's anti-covid measures have led to a further decline in consumer spending and the economy. The impact of these confinements has not been limited internally. It continues to put pressure on all global supply chains. Chinese officials have announced a wide range of measures to offset these disruptions. In addition to tax cuts, the government promises to significantly increase infrastructure spending and end the crackdown on technology companies.

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POSITIONING OF OUR INVESTMENT STRATEGIES.

If it is almost impossible to predict market movements for both bonds and stocks, it is even more perilous during a market correction. Will this correction turn into a major crisis is one of the questions to ask today? Recession indicators have reacted strongly to the rise in interest rates. While the odds of a recession are much higher, the models indicate that it will not materialize for several quarters. Moreover, if China can revive its growth, the medium-term outlook may improve significantly despite many unknowns.

In terms of asset allocation, while interest rates have risen significantly, corporate earnings yields have offset this movement in the short term. It is not earnings expectations that have increased. The earnings season that has just begun confirms that corporate profits have begun to normalize. The strong movement in corporate stock prices has allowed earnings yields to rise. As a result, our «World Equity Risk Premium» indicator fell only slightly. It measures the equity risk premium, i.e. the additional return that investors demand when investing in equities rather than government bonds. This means that it remains relevant to invest in equities in the long term despite the massive increase in interest rates.

In the short term, given the significant correction underway, there should be plenty of opportunities when the dust settles. Valuations have fallen sharply across all asset classes. This should allow active strategies to benefit from higher returns. In the bond world, some bonds considered defensive are becoming attractive for portfolio construction again as their yields are rising. In the equity world, some growth companies (with not-too-distant profitability prospects) and quality companies are available at attractive prices. This should allow us to improve the positioning of our investment strategies.

In the medium term, our economies' structural evolution, including higher inflation and interest rates, underlines the importance of a broad and dynamic approach to asset allocation strategies. Focusing on quality is also crucial in an environment where the risk of recession is more pronounced. Despite the coordinated decline in equities and bonds, we remain convinced that diversified management remains central to cushioning the expected fluctuations in investor risk appetite.

ANECDOTE OF THE MONTH

"La disparition" by Georges Perec, 1969

Like the "e" in Georges Perec's novel, negative returns have disappeared. All global corporate bonds with good credit quality now yield 0% or more.**

(** Indice Bloomberg Global Aggregate Credit IG)

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MAIN DRIVERS

SOURCE: MFM, May 2022

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MONTHLY PERFORMANCE, 29 APRIL

Equities Market (Local currency)	
United Kingdom	1.00
Switzerland	0.33
Japan	-2.65
China	-3.22
Emerging Markets	-3.52
Asia (ex-Japan)	-3.55
Europe	-5.75
World (all countries)	-6.90
United States	-9.09

Equities Sector (Local currency)	
Consumer Staples	2.87
Energy	0.22
Utilities	-1.91
Materials	-2.72
Real Estate	-2.93
Health Care	-3.19
Industrials	-6.23
Financials	-7.24
Consumer Discretionary	-10.75
Information Technologies	-11.32
Telecommunication Services	-13.01

Fixed-Income (USD Hedged)	
Global Aggregate 1-3 Year	-0.41
Global Inflation-Linked Bonds	-0.48
Swiss Bond Index AAA-BBB (CHF)	-1.99
Global Aggregate 5-7 Year	-2.19
Global Treasury	-2.21
Global Aggregate	-2.69
Global High-Yield	-3.51
Global Convertibles	-4.13
Global Corporate Credit	-4.21
Emerging Market Hard Currency Aggregate	-4.68
Global Aggregate Long Duration	-5.80
US Treasury Long Duration	-8.89

Others (USD)	
Commo Global (ThomsonReuters)	4.08
Commo Industrials (CBR)	-0.34
Hedge Funds	-0.70

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