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MIRANTE FUND MANAGEMENT

Market Overview

AUGUST 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

Cover: «And if my marble was the Moon», sculture by Sara H. - Photo : Armand Khoury

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MAJOR RECESSION OR MODERATE SLOWDOWN?

Despite inflation concerns, aggressive central bank policies, corporate earnings fears and recession risk, it took a slight improvement from the worst-case scenarios to move financial markets into positive territory.

All central banks have demonstrated their determination to control inflation, even if it leads to a severe recession. They continued to raise their interest rates sharply to slow down the economy. The only exceptions are China, Japan and Russia. China continues to contort with its Zero Covid policy and the fragility of its real estate market. As a result, China's central bank is intensely stimulating its economy to offset the impact of repeated lockdowns. Japan continues, ad-aeternam, to boost its economy at the cost of immense yen weakness. Russia is experiencing the effects of sanctions-related capital controls.

Regarding inflation, the slowdown generated by the rise in interest rates to stem the price surge seems to be working. Early signs point to some success. For example, energy and agricultural commodity prices are down while manufacturing input costs have also slowed.

During the month, most economic indicators in the United States and Europe pointed to a sharp slowdown. These figures fueled fears of recession. As a result, since mid-June, interest rates have generally fallen, probably indicating that:

1. investors fear a recession and its effect on the various asset classes and,
2. inflation at long term should not be anchored at too high levels.

While equity market volatility has fallen significantly, that of bonds has logically remained at historic levels. With the fall in interest rates and the renewed appetite for risk, the bond markets logically presented positive performances. Assets offering high yields, convertible bonds and long durations obtained the best performances.

At the stock level, the earnings season was the prominent performance driver. While fears were significant, early results show better-than-expected numbers, especially in technology and payments. Indeed, corporate spending on cloud solutions continues to grow impressively, and credit card provider transaction volumes continue to improve. One of the surprises came from companies that disappoint are not heavily punished in terms of performance. This could indicate that the bad news is already pretty much priced in. Unsurprisingly, the consumer discretionary and technology sectors posted the strongest rebounds. The consumer staples and healthcare sectors lagged. Communication services suffered from the lackluster results of telephone companies. In terms of region, China was the only one to end the month in negative territory. The new lockdowns announced immediately affect the economy and future corporate profits. In real estate, Europe posted the most energetic performance while China and South Korea produced negative returns in Asia.

MACRO PERSPECTIVE AND EFFECTS OF A RECESSION

The probability that the United States and Europe will soon enter (already be) a recession is exceptionally high. Investors rightly worry about recessions because they lead to higher unemployment, lower consumption and business spending, and ultimately lower incomes and, above all, lower expected corporate profits. This last point is central because schematically, share prices boil down to two factors: expected earnings and valuation multiples assigned by investors. This explains why recessions have such a significant impact; they reduce earnings while, at the same time, investor psychology weighs on their valuations.

Therefore, the central question is to determine whether the economy is headed for a major recession or a moderate slowdown. In the pessimistic scenario, the economy and the financial markets are headed for a significant crisis induced

by central bankers breaking the economy too strong to fight inflation which would continue to increase at the same rate. However, the latter may have peaked, especially in the United States. Indeed, inflation was induced by the explosion in energy and raw materials prices and the disruption of supply chains. The momentum for most of these prices seems to be running out of steam. The main unknown remains energy in Europe in connection with the war in Ukraine. In the optimistic scenario, if the slowdown in growth is not too abrupt, the economies seem able to withstand it quite well. As a result, the impact on major asset classes could remain close to historical performance in previous crises, i.e. a decline of around 23% in global equity markets. In this case, a major part of the difficult path would have already been done.

Given inflation uncertainty, recession fears and ongoing political tensions, it seems clear that volatility is set to remain elevated.

POSITIONING OF OUR INVESTMENT STRATEGIES

Regarding investment strategy, we avoid positioning ourselves on a single scenario because the probability of making an accurate prediction in the current environment is minimal. Conversely, we try to develop strategies to navigate these various scenarios with as much resilience as possible. At the allocation level, our indicators show that it remains appropriate to allocate risk to equities compared to bonds. In terms of strategy, we favour a systematic approach to rebalance our portfolios while avoiding being influenced by emotional biases.

At the bond level, we are maintaining a cautious approach. We are taking advantage of the rise in interest rates to invest in sovereign bonds, considered to be defensive, providing attractive returns. If the economy slows down significantly, it is likely that the rise in rates will slow down and will therefore allow defensive bonds to regain their role as portfolio stabilizers. While rising interest rates and slowing economic growth will continue to weigh on short-term high-yield bond prices, long-term investments can capture attractive values.

At the stock level, earnings trajectories will dictate the performance of this asset class. As current corporate results indicate, corporate earnings appear to be holding up against the slowing economy for the time being. Unfortunately, predicting investor psychology is infeasible; however, multiples will contract further if the recession is severe. Tactically, we continue to add exposure to more defensive sectors, which should perform better in the face of substantial declines. The healthcare sector, in particular, combines resilient revenue growth with less exposure to economic fluctuations.

We prefer active management that favours long-term strategic diversification over significant tactical bets. Robust portfolio construction remains paramount to cushioning expected swings in risk appetite across asset classes. This approach enables us to optimize the risk-return profile of all the strategies to better withstand the many possible macroeconomic scenarios.

ANECDOTE OF THE MONTH

Bull or Bear ?

According to Anatoly Liberman, a linguist at the University of Minnesota, the use of the terms "bull" and "bear" to refer to financial optimists and pessimists, respectively, originated in Britain in the early 18th century.

- **"Bull"** evoked the bellow of an impatient buyer.
- **"Bear"** seems to come from the phrase, "sell the bear's skin before you catch it" - a metaphor for a short sale, in which a trader sells borrowed stocks in the hope of buying them back at a lower price.

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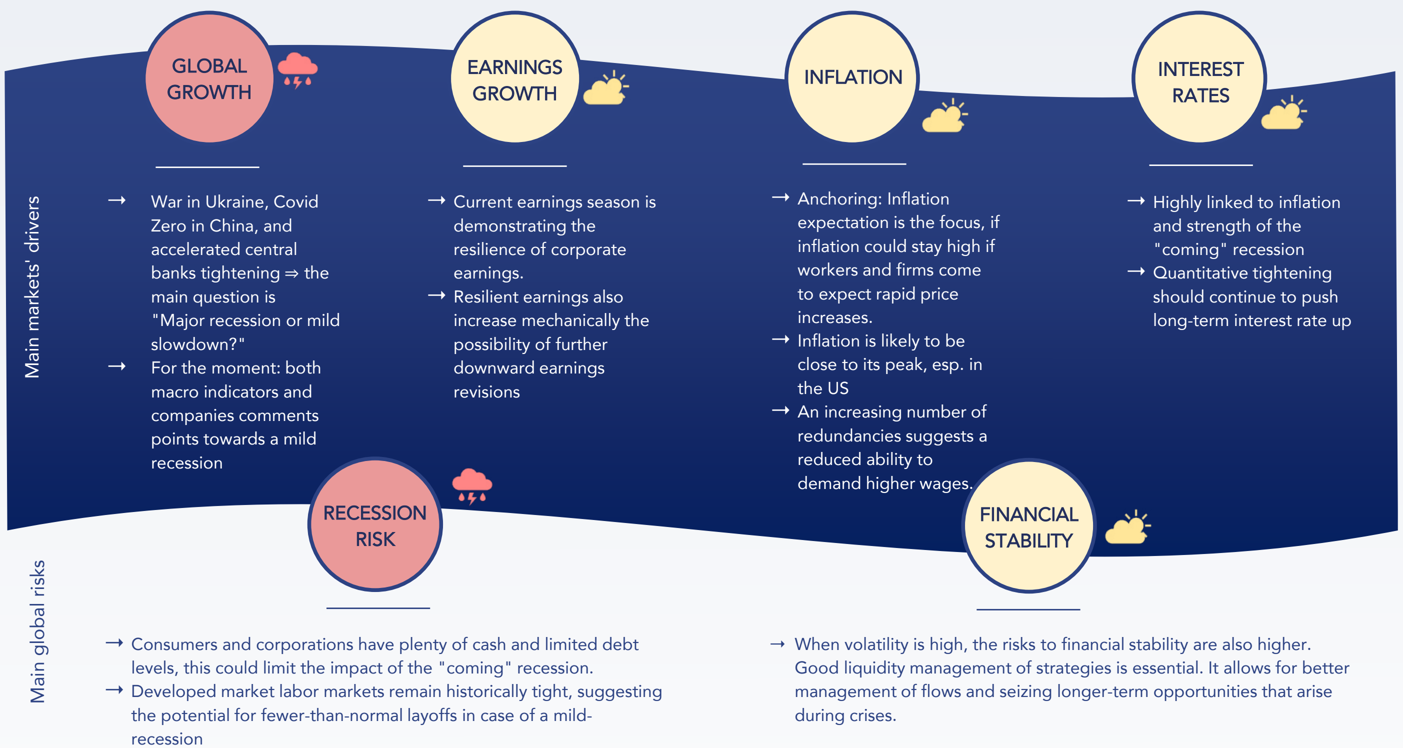
MAIN DRIVERS



- Consumers and corporations have plenty of cash and limited debt levels, this could limit the impact of the "coming" recession.
- Developed market labor markets remain historically tight, suggesting the potential for fewer-than-normal layoffs in case of a mild-recession

- When volatility is high, the risks to financial stability are also higher. Good liquidity management of strategies is essential. It allows for better management of flows and seizing longer-term opportunities that arise during crises.

SOURCE: MFM, August 2022

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MONTHLY PERFORMANCE, 29 JULY

Equities Market (Local currency)	
United States	9.29
World (all countries)	7.98
Europe	4.95
Switzerland	4.16
Japan	3.98
United Kingdom	3.53
Emerging Markets	0.11
Asia (ex-Japan)	-0.93
China	-9.36

Equities Sector (Local currency)	
Consumer Discretionary	15.59
Information Technologies	13.16
Industrials	9.54
Real Estate	7.56
Energy	6.89
Utilities	5.62
Financials	5.02
Materials	3.98
Consumer Staples	3.92
Health Care	3.33
Telecommunication Services	3.15

Fixed-Income (USD Hedged)	
Global High-Yield	4.52
Global Aggregate Long Duration	4.46
Global Convertibles	4.24
Global Inflation-Linked Bonds	3.49
Swiss Bond Index AAA-BBB (CHF)	3.36
Global Corporate Credit	3.35
US Treasury Long Duration	2.67
Global Aggregate	2.55
Global Aggregate 5-7 Year	2.50
Global Treasury	2.20
Emerging Market Hard Currency Aggregate	1.94
Global Aggregate 1-3 Year	0.62

Others (USD)	
Commo Global (ThomsonReuters)	4.08
Hedge Funds	0.54
Commo Industrials (CBR)	-1.35

CONTACT

Lausanne

Rue Etraz 4
CH-1003 Lausanne

T. +41 58 590 10 00

Zürich

Beethovenstrasse 41
CH-8002 Zürich

T. +41 58 590 10 00

info@mirante.ch | www.mirante.ch