MFM
MIRANTE FUND MANAGEMENT

Market Overview

SEPTEMBER 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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MACRO VIEW: A DIVIDED WORLD

The East-West geopolitical divide, which has become glaring again since the invasion of Ukraine, mirrors the current macroeconomic and financial environment. In the West, the United States and Europe are trying to slow down their economies to moderate runaway Covid-induced inflation and soaring energy prices. In the East, on the contrary, China is stimulating its economy with all the tools at its disposal to combat the impact of confinements and the real estate crisis.

In the West, central bankers have confirmed that they will continue to raise rates as long as employment remains robust. Like every year, just over 100 central bankers and economists worldwide gathered in Jackson Hole to discuss monetary policy. The message was unanimous (except for Turkey). They confirmed that higher rates were necessary to control inflation, even if it induces a recession. This message shook investors who hoped the slowdown in inflation could temper the bullish impulses of central bankers.

As a result, interest rates continued to rise. At the same time, all risky assets were under pressure in anticipation of the impact of the coming recessions. Once again, bonds and equities took the same downward path.

In terms of corporate profits, the earnings season was generally better than anticipated. The expectations were relatively modest, but surprisingly, the companies have been able to absorb the explosion in the price of raw materials and salaries without denting their margins too much.

PERFORMANCE OF FINANCIAL ASSETS

In fixed-income, logically, all assets were strained. The Bloomberg Global Aggregate Total Return Index, which serves as a benchmark for global bonds, fell 20% from its 2021 level, triggering the first bear market since its inception in 1990. Despite increased pressure on the equities side, Convertible bonds managed to limit the damage, particularly compared to assets offering long maturities.

At the stock level, the East-West cleavage was striking. Despite announcements of new confinements, the Chinese indices have drawn other Asian and emerging markets in their wake. The latter posted a positive performance over the month. On the other hand, American and European markets ended the month in strongly negative territory. Europe has been the hardest hit region, the energy crisis is deepening, and the prospect of a severe recession is increasing. At the sector level, growth sectors such as technology, healthcare and communications suffered a new discount rate shock by generating a negative performance. The only sector that closed the month in positive territory was again the energy sector, which benefited from the increase in the prices of energy raw materials.

In terms of real estate, as for equities, Asia presented a positive monthly performance, while Europe and the United States posted negative performances. The asset class suffered the impact of rising interest rates and investors' risk aversion for risky instruments. The office real estate sector was the most affected.

NUMBER OF THE MONTH:

51% **Visa's net margin in 2021, making it one of the most profitable companies in the world.**

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OUTLOOK

The world economy is in a unique situation. One half is entering a recession, while the other half is driving growth. Determining the strength of the coming global slowdown between these two trends remains tricky.

In the West, the annual economic symposium in Jackson Hole did not provide investors with new information. The uncertainty accompanying the decisions of central banks should therefore remain high. Europe is facing the worst energy supply crisis in decades. Soaring energy prices show no sign of abating amid tight gas supplies from Russia. This should support inflation in the coming months by forcing the European Central Bank to significantly raise its interest rates despite the inevitable recession that is looming. The level and speed of this increase will depend on the extent of the coming recession. If it is strong, the central bank does not need to raise rates sharply. In the United States, most indicators point to a sharp slowdown in the economy, except for employment, which remains vigorous. As long as the labor market is resilient, US consumers will consume, and the central bank will continue to raise rates to fight inflation. On the other hand, if unemployment snowballs, consumption will be affected, and the US economy could plunge into a deeper recession.

In the East, China has plenty of leeways to adjust its monetary policy. Indeed, stimulus measures to support the economy have been limited, and inflation is under control. If it manages the endemic nature of the epidemic, China should be able to revive its economy by bringing all the emerging countries in its wake.

In the coming weeks, given the uncertainty about the inflation outlook, fears of recession and the persistence of political tensions, volatility is, in our view, likely to remain elevated.

POSITIONING OF OUR INVESTMENT STRATEGIES

Regarding allocation, the MFM World Equity Risk Premium indicator fell significantly with the rapid rise in interest rates. This indicator measures the attractiveness of investing in stocks rather than bonds. Even in decline, it remains above historical values, which indicates that it is still appropriate to allocate risk to equities rather than bonds. Overall, in this macroeconomic context, we advise investors not to position themselves on a single scenario, none of which lends itself to solid conviction. Instead, we recommend adjusting portfolios to withstand various scenarios by relying on a diversified and resilient strategy. That should maintain the expected return while reducing the risk and magnitude of losses in a prolonged bear market. In a turbulent environment, effective cash management can help mitigate the risk of forced selling to meet obligations and enable investors to capture longer-term opportunities.

At the bond level, yields will probably continue to rise if inflation is not clearly under control. The Fed Chairman summed it perfectly: "While rising interest rates, slowing growth and easing labor market conditions will be painful for some households and businesses, these are the unfortunate costs of reducing inflation." Conversely, the economic slowdown will induce increased demand for bonds considered defensive and mechanically lower rates. As these two engines are opposed, the trajectory of rates will remain turbulent. This is why we maintain a cautious approach by increasing exposure to high quality bonds without increasing the duration (the average bond maturity). However, while rising interest rates and slowing economic growth could weigh on short-dated high-yield bonds, long-term investments can capture attractive values.

At the equity level, it is likely corporate earnings, rather than the path of interest rates, that will determine the next moves in the stock market. So far, they've held up pretty well. Investors seem to be expecting solid earnings if the economy faces a mild recession. At the regional level, Europe is in a delicate situation with many short-term negative bundles: a major energy crisis, a war in Ukraine, a delicate political situation, etc. At a sector level, tactically, we continue to increase exposure to defensive sectors which should perform better in a severe downturn. The healthcare sector, in particular, combines resilient revenue growth with less exposure to economic fluctuations.

Overall, we prefer active management that favors long-term strategic diversification over major tactical bets. Robust portfolio construction remains central to cushioning expected swings in risk appetite across asset classes.

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MAIN DRIVERS

Main markets' drivers

GLOBAL GROWTH

- → Macro data already show that US and Europe are slowing significantly
- → China stimulates its economy
- → War in Ukraine, lockdowns in China, energy crisis in Europe and accelerated central banks tightening ⇒ the main question remains "Major recession or mild slowdown?"

EARNINGS GROWTH

- → It's likely to be earnings, rather than the trajectory of interest rates, that hold the key to the next moves in the stock market
- → Latest earnings season is demonstrating the resilience of corporate earnings but risk level is increasing

INFLATION

- → Anchoring: Inflation expectation is the focus, if inflation could stay high if workers and firms come to expect rapid price increases.
- → Inflation is likely to be close to its peak, esp. in the US. In Europe with a deep energy crisis it is more complicated

INTEREST RATES

- → Jackson Hole summary: "higher rates were necessary to control inflation, even if they lead to a recession"
- → Quantitative tightening should continue to push long-term interest rate up

Main global risks

RECESSION RISK

- → 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

FINANCIAL STABILITY

- → 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, September 2022

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MONTHLY PERFORMANCE, 31 AUGUST

Equities Market (Local currency)

Emerging Markets	1.21
Japan	1.07
Asia (ex-Japan)	0.85
China	0.57
United Kingdom	-1.32
Switzerland	-3.12
World (all countries)	-3.46
United States	-3.97
Europe	-6.23

Equities Sector (Local currency)

Energy	2.82
Utilities	-0.94
Financials	-1.57
Consumer Staples	-1.63
Materials	-1.86
Industrials	-2.92
Consumer Discretionary	-3.86
Telecommunication Services	-3.86
Health Care	-5.39
Real Estate	-5.45
Information Technologies	-5.70

Fixed-Income (USD Hedged)

Global Convertibles	-0.49
Global Aggregate 1-3 Year	-0.67
Emerging Market Hard Currency Aggregate	-0.77
Global High-Yield	-1.15
Global Inflation-Linked Bonds	-2.13
Global Treasury	-2.48
Global Aggregate	-2.61
Global Aggregate 5-7 Year	-2.71
Swiss Bond Index AAA-BBB (CHF)	-2.84
Global Corporate Credit	-3.05
US Treasury Long Duration	-4.43
Global Aggregate Long Duration	-4.52

Others (USD)

Hedge Funds	0.95
Commo Global (ThomsonReuters)	-0.15
Commo Industrials (CBR)	-0.69

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