MIRANTE FUND MANAGEMENT

Market Overview

NOVEMBER 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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BAD NEWS IS GOOD NEWS

Macroeconomic data continued to deteriorate during the month. The rise in interest rates, inflation, the energy crisis in Europe, confinements in China, the strength of the dollar is starting to put a heavy strain on economies. In the United States and Europe, the leading growth indicators all point to a sharp slowdown. All this bad news strangely pleased investors. Hopes that central banks would slow the pace of interest rate hikes generated positive sentiment.

Nevertheless, interest rates in the United States and Europe continued to rise until the middle of the month. In the United States, the 10-year rate rose above 4%. However, the rise in interest rates was not accompanied, as we had become accustomed to, by a marked fall in the equity markets, on the contrary. Equities have indeed benefited from positive investor sentiment and the start of the corporate earnings season.

For now, profits are lower than in previous periods, but some investors were expecting much worse. That being said, investors severely punish companies that miss their target, especially in terms of guidance. Even though this earnings season is not over, a few trends seem to be emerging:

(i) Online spending continues to slow along with the global slowdown. This obviously weighs on big tech companies like Alphabet, Microsoft, Meta (Facebook, Instagram, ...) and Amazon. Most of them have posted disappointing results with the exception of Apple, which is posting disconcerting health.

(ii) Consumption, although slowing down, remains at high levels. However, it has shifted from goods to services. Indeed, most societies are seeing strong demand for travel and leisure spending at the expense of consumer goods.

(iii) Corporate earnings seem to be holding up against the overall increase in costs. They seem able to offset these increases with price increases. Additionally, supply chains continue to normalize.

In this environment, equity markets posted positive performances, with the exception of China. In the United States, the Fed received «good» news pointing to a rapid slowdown in the economy. The only indicators showing persistent strength are those related to the labor market. Indeed, applications for unemployment benefits remain at their lowest level for several years. In China, Xi JinPing has been reappointed as head of the country for another five years. However, investors were surprised and disappointed by his appointments to the party's Politburo. In the new team, no member seems clearly favorable to the financial markets. This surprise, combined with the announcement of new confinements in many Chinese cities, weighed heavily on Chinese equity markets.

At the sector level, communication services posted weaker performances following the disappointing results of the dominant companies in the field. The energy sector benefited from OPEC+'s decision to cut oil production as Europe finds itself in a major energy crisis. The financial sector achieved a notable performance by benefiting from higher margins linked to appreciation of interest rates.

At the bond level, duration (sensitivity to interest rates) was once again the main asset class driver. Despite the Bank of Canada's surprise to raise rates less than expected (0.5% instead of 0.75% expected), assets with long duration were under pressure. Convertible bonds benefited from the good performance of equity markets by posting the best performance of bond assets.

The real estate sector continues to endure the consequences of the rise in mortgage rates. In most regions, rising borrowing costs lead to a decrease in existing housing sales and lower demand for new real estate projects. While the asset class is relatively immune to long-term inflation (most rents being indexed to inflation), it is highly exposed to rising short-term interest rates. However, it benefited from the relative optimism of investors and ended the month in positive territory.

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OUTLOOK

Rising interest rates and adjustments in central bank policies will remain the main drivers of the performance of financial assets in the coming months. While interest rates are likely to continue to rise in the short term, it seems likely that most of the rate hike has been effected. Inflation still needs to show a clear downward trend so that central bankers temper their inclination to raise rates. The first signs of a clear economic slowdown are pointing in this direction. If this decline is marked, it is likely that investors' fears will shift from inflation to growth, with the potential consequence of lower interest rates and an increased involvement of states in supporting their economies.

At the company level, on the negative side, the decline in profits should be confirmed in the coming quarters. The central question for investors will be whether the magnitude of this fall is already priced into current company valuations. On the positive side, if supply chains normalize and transport costs decrease, this should support company margins. In this framework, profits could be boosted by inflation, as companies appear to be able to pass on price increases to consumers. Finally, companies seem ready to invest some of their cash. Indeed, capital expenditures are increasing significantly (which has not been the case for many years) which could in turn stimulate economies.

POSITIONING OF OUR INVESTMENT STRATEGIES

The continued rise in interest rates combined with the slowdown in corporate profits pushed our "World Equity Risk Premium" indicator down sharply. It measures the risk premium of equities, i.e. the additional return that investors demand when they invest in them rather than in government bonds. For the first time in a long time, this indicator fell below its historical average. This means that the difference in expected returns on stocks and defensive bonds has narrowed sharply. It justifies an increase in the allocation to defensive bonds rather than equities. This is why tactically, we continue to increase exposure to this type of asset with short maturities in order to take advantage of higher yields while protecting ourselves from potential upward rate movements.

On the one hand, the American and European economies will enter into recession. This will induce increased demand for bonds considered defensive and mechanically lower rates, which could benefit equities despite the economic slowdown. In this contradictory environment, accurately predicting the behavior of financial assets is a challenge. The potential scenarios are many, but none lends itself to strong conviction. That's why we try to build portfolios that are likely to withstand or benefit from all plausible scenarios. Heightened nervousness in the financial markets increases the instability of the system and could exacerbate some news, good or bad. A defensive and cautious approach therefore remains in order. A robust and diversified asset allocation strategy should maintain the expected return while reducing the magnitude of losses in the event of a prolonged bear market. In addition, it allows you to seize longer-term opportunities as they arise.

PRICE OF THE MONTH

-16 euros/MWh

At the end of October in Europe, the spot price of a MWh of natural gas was for a few moments -16 Euros, a negative value!

In August, this same MWh was trading at more than 300 Euros. This is due to the continuous arrival of liquefied natural gas while storage capacities are full and demand (economic slowdown and summer temperature) remains low.

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MAIN DRIVERS

Main markets' drivers

GLOBAL GROWTH

- US and Europe are slowing strongly ⇒ the main question remains "Major recession or mild slowdown?"
- China stimulates its economy but covid related lockdowns weight
- No positive catalysts: war in Ukraine, lockdowns in China, energy crisis in Europe and accelerated central banks tightening

EARNINGS GROWTH

- Current season is not great but less catastrophic than anticipated. Online spending has been transferred to leisure & travel
- Margin are resilient but risk level remains high
- Increasing capex
- Revenues could be driven by inflation if pricing power is sufficient

INFLATION

- US inflation seems to stabilize; Europe energy crisis will sustain inflation at a high level, but both regions should be close to their inflation's pic
- Anchoring: Inflation expectation is the focus, if inflation could stay high if workers and firms come to expect rapid price increases, this will have a strong impact on long-ter expected return

INTEREST RATES

- Rates are likely to continue to rise until inflation is clearly under control but conversely, a recession will induce increased demand for bonds considered to be defensive and mechanically lower rates
- 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, November 2022

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MONTHLY PERFORMANCE, 31 OCTOBER

Equities Market (Local currency)

United States	7.91
Europe	7.17
World (all countries)	7.14
Japan	5.73
Switzerland	4.81
United Kingdom	2.80
Emerging Markets	-2.63
Asia (ex-Japan)	-5.44
China	-16.39

Equities Sector (Local currency)

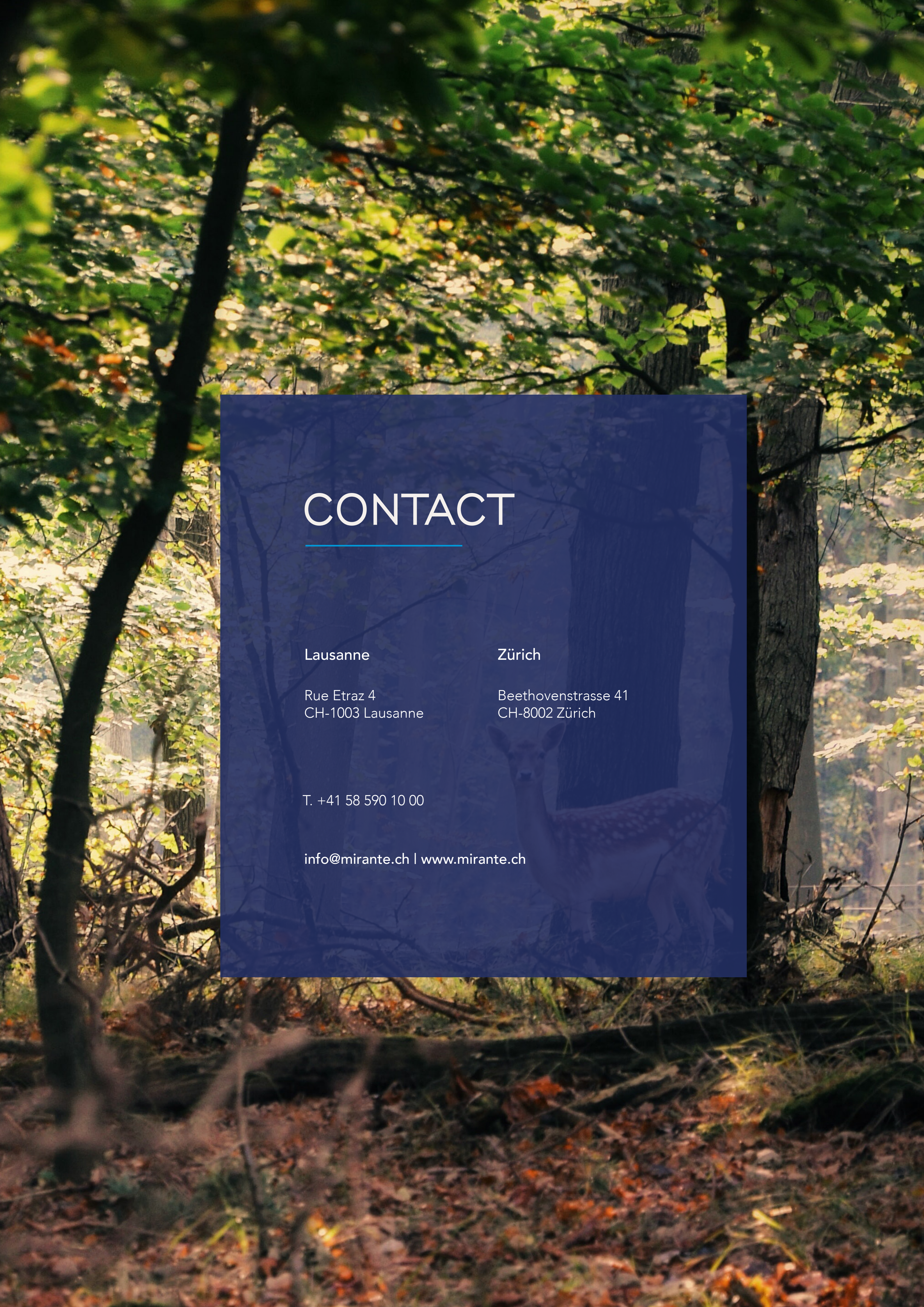
Energy	19.39
Industrials	10.45
Financials	9.01
Health Care	8.48
Information Technologies	7.65
Consumer Staples	5.58
Materials	5.41
Utilities	2.40
Consumer Discretionary	1.90
Real Estate	1.32
Telecommunication Services	1.19

Fixed-Income (USD Hedged)

Global Convertibles	2.26
Global High-Yield	1.98
Global Inflation-Linked Bonds	1.54
Swiss Bond Index AAA-BBB (CHF)	0.67
Global Aggregate 1-3 Year	0.14
Global Aggregate 5-7 Year	-0.01
Global Treasury	-0.12
Global Aggregate	-0.34
Global Corporate Credit	-0.58
Emerging Market Hard Currency Aggregate	-1.08
Global Aggregate Long Duration	-1.23
US Treasury Long Duration	-5.55

Others (USD)

Commo Global (ThomsonReuters)	1.67
Hedge Funds	0.02
Commo Industrials (CBR)	-3.58



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