MFM

MIRANTE FUND MANAGEMENT

Market Overview

DECEMBER 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 REMAINS THE ENGINE OF PERFORMANCE OF FINANCIAL ASSETS

Inflation remains the central engine of financial markets. Since the beginning of the year, galloping inflation has prompted all central banks to raise their rates. The primary objective was to slow the rate of inflation. This sudden rise in rates had a significant effect on all asset classes. In the short term, it caused bond prices to plummet as investors rushed to price future rate hikes into their prices. Ditto, on the side of equities, those exhibiting increased sensitivity to interest rates were strongly affected, such as technology companies in particular.

For the past few weeks, however, some inflation drivers have been showing signs of running out of steam:

(1) Aggregate demand, which exploded following the lockdowns, is slowing. All economic players see their purchasing power reduced with the increase in prices. They are logically becoming more cautious.

(2) The war in Ukraine, although far from over, takes an unexpected turn. Russia loses the regions conquered at the beginning of the year. Even if the impact of this reversal will not solve the European energy crisis, it gives hope for an improvement in the medium term.

(3) China seems to be easing its zero-Covid policy, suggesting an upturn in global supply chains and a recovery in domestic demand.

(4) Pressure on supply chains has been greatly reduced, leading to lower transport and material cost.

(5) The method for calculating annual inflation should fall mechanically. Months that exhibited high inflation a year ago will begin to disappear from the measure.

All of these bundles have raised hopes that slowing inflation will lead central banks to slow the pace of rate hikes. This was likely the main reason for investor optimism during the month. All asset classes posted positive performances. Interest rates have come down with the decrease in inflation and the significant slowdown in global growth expected in the coming semesters. Bonds with long maturities benefited more than short ones. Investors' appetite for risk also enabled riskier bonds, such as those from emerging countries and those providing high yields, to achieve a robust performance.

In equities, all sectors posted positive returns. At the regional level, China presented a spectacular performance. The strongest monthly performance since 1998. The first signs of easing of the drastic zero-Covid policy and the massive aid to support the real estate sector have been particularly favorably received by investors.

The real estate sector also benefited from the optimistic environment led, unsurprisingly, by the good performance of Asian real estate. Only Europe lagged behind. At the sector level, the healthcare and commercial real estate sectors were the main positive contributors.

INVESTMENT OUTLOOK

In terms of allocation, despite lower rates, the slowdown in corporate profits has left our "World Equity Risk Premium" indicator below historical averages. This justifies an increase in the allocation to defensive bonds. 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. In terms of global growth, 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.

Inflation - coupled with the measures taken by central bankers to bring it down - will continue to drive the markets in the months to come. In the long term, the main contributors to low inflation, such as productivity and demographics, remain valid. They have not evolved because of Covid-19 or the war. However, the invasion of Ukraine, the cost of financing linked to the green energy revolution or the challenge of withdrawing part of the manufacturing industry from China are all elements that could support an increase in medium-term prices. This could mean inflation anchoring at a higher level than in recent decades. Thus, it remains perilous to want to predict the movements of inflation, even if the drivers cited in the introduction tell us that the inflationary peak has probably been reached. This means that we are probably closer to the end of the tightening cycle than to its beginning.

For bonds, this implies that attractive opportunities are available in all bond categories. This provides better diversification with higher potential returns. Quality bonds are attractive, as they should regain their role as shock absorbers during recessions and future shocks. In terms of credit, default rates are now at extremely modest levels. Although they are expected to rise depending on the length and depth of the coming downturn, they offer attractive opportunities.

For equity markets, while it is conceivable that valuations will continue to rise, the coming recessions in Europe and the US as well as reduced corporate earnings growth will be a significant drag on their performance. Indeed, corporate earnings estimates, while still robust, point to a slowdown. It seems unlikely that the latter will accelerate in the next twelve months. This militates for a defensive and quality strategy in order to mitigate the impact of the drop in profits, in particular by avoiding companies that are too indebted, with complex business models or subject to intense competition.

The year 2022 was marked by a strongly negative performance of bonds. However, the resetting of valuations of fixed-return assets, even if the macro-economic environment remains very difficult, makes it possible to envisage better prospects for multi-asset strategies. Rising rates combined with a robust and diversified asset allocation increase expected returns while reducing the magnitude of losses in the event of a prolonged bear market. A diversified strategy also allows to seize longer-term opportunities as they arise.

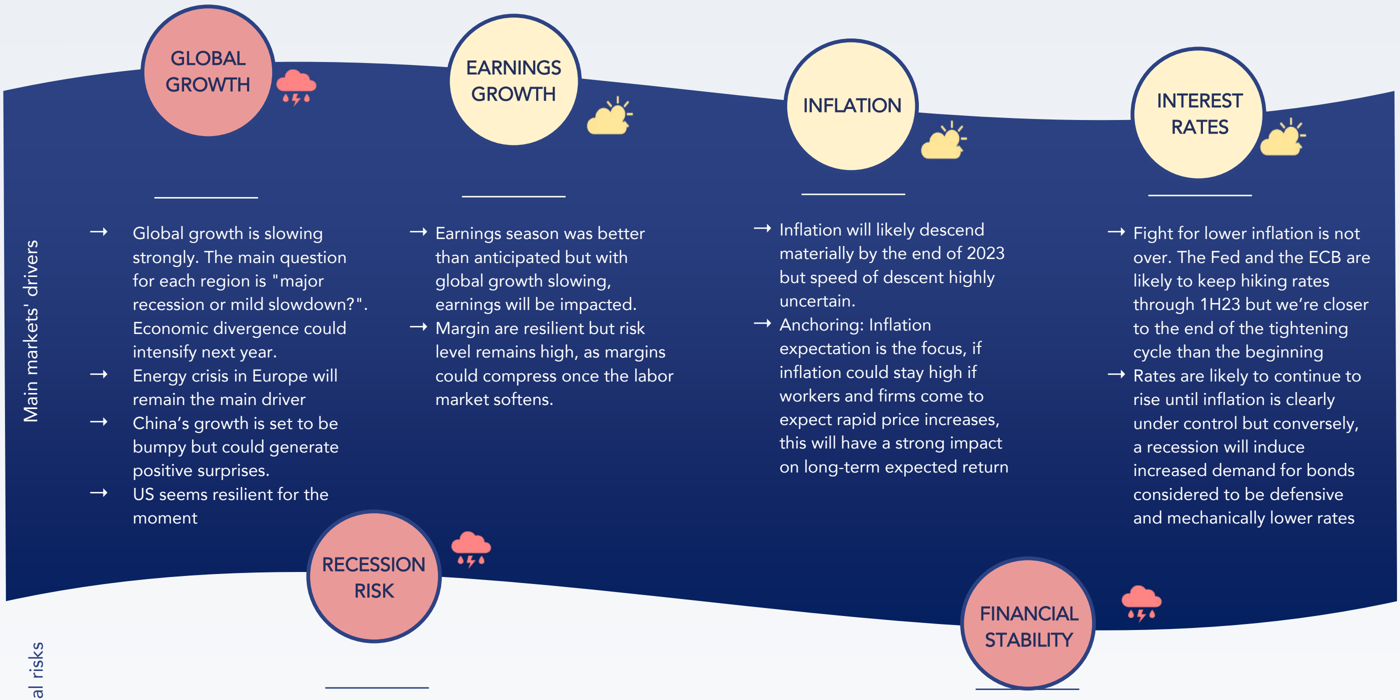
FIGURE OF THE MONTH

10 DAYS

Highest-grossing movie of the year so far, "Top Gun: Maverick", grossed $1 billion in its first month.

Biggest game, "Call of Duty: Modern Warfare II", brought in the same amount in just ten days.

MAIN DRIVERS



Main markets' drivers

GLOBAL GROWTH ⛈

- Global growth is slowing strongly. The main question for each region is "major recession or mild slowdown?". Economic divergence could intensify next year.
- Energy crisis in Europe will remain the main driver
- China's growth is set to be bumpy but could generate positive surprises.
- US seems resilient for the moment

EARNINGS GROWTH 🌤

- Earnings season was better than anticipated but with global growth slowing, earnings will be impacted.
- Margin are resilient but risk level remains high, as margins could compress once the labor market softens.

INFLATION 🌤

- Inflation will likely descend materially by the end of 2023 but speed of descent highly uncertain.
- 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-term expected return

INTEREST RATES 🌤

- Fight for lower inflation is not over. The Fed and the ECB are likely to keep hiking rates through 1H23 but we're closer to the end of the tightening cycle than the beginning
- 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

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 ⛈

- Will remain higher due to risks induced by higher rates
- 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, December 2022

MONTHLY PERFORMANCE, 30 NOVEMBER

Equities Market (Local currency)

China	28.39
Asia (ex-Japan)	15.48
Emerging Markets	11.68
Europe	11.35
United Kingdom	7.09
World (all countries)	5.65
United States	5.38
Japan	2.97
Switzerland	2.69

Equities Sector (Local currency)

Materials	11.62
Financials	7.32
Industrials	6.99
Real Estate	6.81
Utilities	6.61
Consumer Staples	5.65
Information Technologies	5.63
Telecommunication Services	5.09
Health Care	4.37
Consumer Discretionary	3.42
Energy	2.11

Fixed-Income (USD Hedged)

US Treasury Long Duration	7.07
Emerging Market Hard Currency Aggregate	6.18
Global Aggregate Long Duration	4.97
Global Corporate Credit	4.39
Global High-Yield	4.27
Global Convertibles	3.49
Global Aggregate	2.55
Global Aggregate 5-7 Year	2.35
Global Treasury	1.84
Global Inflation-Linked Bonds	1.49
Swiss Bond Index AAA-BBB (CHF)	1.48
Global Aggregate 1-3 Year	0.60

Others (USD)

Commo Industrials (CBR)	3.84
Commo Global (ThomsonReuters)	2.38
Hedge Funds	0.03

CONTACT

Lausanne

Rue Etraz 4
CH-1003 Lausanne

Zürich

Beethovenstrasse 41
CH-8002 Zürich

T. +41 58 590 10 00

info@mirante.ch | www.mirante.ch