MIRANTE FUND MANAGEMENT

Market Overview

JANUARY 2023

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

THE YEAR 2022

In 2022, the world economy suffered two inflationary shocks. First, the consumer boom triggered by the lifting of pandemic-driven lockdowns in Europe and the US, combined with fiscal stimulus programs, generated a demand shock. Demand far exceeded supply, causing prices to rise and disrupting most supply chains, driving inflation. Second, Russia's invasion of Ukraine generated a second inflationary shock: a supply shock. Indeed, this war has caused energy prices to soar, yielding an overall price rise. Again, the developed countries have spent a lot to protect households and businesses from this increase. At the same time, the only weapon available to central bankers to fight against this explosion of inflation was to raise interest rates. If this tool works well to fight demand-generated inflation, its effectiveness is questionable for supply-generated inflation. This partially explains why the rate hike cycle, which is not yet over, was the fastest and most robust in US history.

Despite inflationary pressures and rate hikes, the US and European economies have shown strong resilience. It was only in the last quarter that the tangible signs of a slowdown made themselves felt. In Asia, the zero-Covid policy implemented by the government has strongly contributed to the decrease in Chinese growth and, consequently, exacerbated the global slowdown. It was only at the very end of the year that China began to reopen its doors and its economy.

The companies displayed Olympic form throughout the year. The effects of inflation and supply chain congestion did not impact company results. The latter even announced historic profits. It was only during the last quarter that the combined effects of inflation and the rise in interest rates made themselves felt. Companies have become more cautious in terms of outlook. This had the effect of reducing analysts' forecasts and therefore lowering estimates of future profits.

As shown in the annual performance table, all asset classes have been strongly impacted by the rise in interest rates. Global equities lost a fifth of their value, the biggest drop since 2008 on an annual basis. This drop came as companies posted record results. Indeed, most of the underperformance of the equity markets is due to investors' fears regarding the slowdown in the global economy, pressure on margins generated by the increase in costs and the impact of the rise in interest rates. In terms of sectors, the only one that ended the year in positive territory was energy. The shock generated by the invasion of Ukraine sent energy prices soaring. This has allowed oil companies to generate spectacular revenues. All the other sectors ended in negative territory. The least affected were all the sectors considered to be defensive: utilities, consumer staples, healthcare. The worst performers came from growth sectors like technology or consumer discretionary which endured a discount rate shock. Indeed, higher interest rates reduce the value of future income and therefore the valuation of these companies.

Fixed-income's performance was one of the weakest in history. The rise in interest rates mainly explains this poor performance. The yield on 10-year US bonds rose from 1.5% at the start of the year to more than 3.80% at the end of December. Duration, which measures the sensitivity of bonds to interest rates, reflects a painfully mechanical phenomenon: if rates rise, bond prices fall. The longer the duration, the lower the performance. It contributed most of the performance of all fixed income strategies in 2022. As an illustration, as shown in the performance table, one of the long-term US government bond benchmarks lost almost a quarter of its value.

INVESTMENT OUTLOOK

"I don't think anyone knows whether we're going to have a recession or not - and if so, whether it will be deep or not. It's impossible to know." This is a statement by Jerome H. Powell, Chairman of the Fed, during a press conference last month. If this assertion is related to the American economy, it also applies to the trajectory of the world economy. Indeed, two powerful motors will pull in opposite directions. On the one hand, the United States and Europe are heading for a sharp economic contraction. The strength of these downturns, as described above, is impossible to predict. In addition, China should be able to overcome the pitfalls of the Covid. It is therefore conceivable that Chinese growth will regain some of its luster and take the rest of Asia with it.

While many macro-economic signs point to a slowdown in inflation in the United States and Europe, the latter will remain one of the main drivers of the financial markets in the coming months. If the peak has been reached, the fundamental question will be to know at what level it will stabilize. This level will have considerable consequences on the policies of central banks and the positioning of investment strategies.

In terms of allocation, our "World Equity Risk Premium" indicator is below historical averages. This justifies an increase in the relative allocation of bonds to equities. Therefore, tactically, we continue to increase exposure to defensive bonds with short maturities in order to take advantage of higher yields while protecting against potential upside rate moves.

In terms of portfolio construction, the macro-economic environment prompts us to focus portfolios on finding resilience through investments that are likely to withstand a downturn in the global economy. Indeed, a massive rebound in financial markets, like those of 2020 or 2021, seems unlikely, because a sharp recovery in the short term would trigger an aggressive response from central bankers. This is why we will maintain a defensive approach. Periods of higher volatility will be used to rebalance and diversify portfolios on quality assets offering value creation. These assets could benefit from potential market recoveries.

A flood of forecasts invades the media at the start of each year. If predicting the future represents a risky exercise, the investor who wants to base himself on these predictions to define his strategy faces a second pitfall. Even if predictions of upcoming events are correct, the chances of capturing them as performance in an investment strategy are slim. What is already priced in financial assets? When will the market react to these events? What will be the consequences for all asset classes? All these questions are tough to answer.

That's why we focus on areas we can control, like portfolio construction and robust asset allocation. The macroeconomic environment remains challenging in the short term. In the medium term, the financial markets may no longer focus solely on inflation and interest rates but on a wider variety of investment factors. Despite the disappointing performance of multi-asset strategies last year, we are convinced that a controlled diversification across asset classes, sectors, regions and investment factors makes it possible to design resilient approaches that optimize the risk-return ratio and favor a long-term view, particularly in chaotic macroeconomic environments.

FIGURE OF THE MONTH

3 trillion dollars

The market value lost by the five American technology giants in 2022, namely Alphabet, Amazon, Facebook, Apple and Microsoft.

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.
- US - The turning point will come when interest rate cuts are on the horizon.
- Energy crisis in Europe will remain the main driver.
- China's growth could take the rest of Asia with it.

EARNINGS GROWTH

- Earnings growth will be firmly negative in 1H23.
- Margin are resilient but risk level remains high, as margins could compress once the labor market softens.
- This earnings contraction has been priced in the valuation; the main question is about the strength of the global slowdown.

INFLATION

- Peak reached but…
- US scarcity of worker could sustain high inflation.
- Europe energy subsidies is pure fiscal stimulus and could exacerbate inflation in the mid term.
- If the Chinese economy rebounds in the same way as the Western economies after the pandemic, this could support inflationary pressures.
- Anchoring: The anticipation of inflation is the focus as it will have a strong impact on long-term expected return.

INTEREST RATES

- Global tightening continuing through the first quarter of 2023 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.

SOURCE: MFM, January 2023

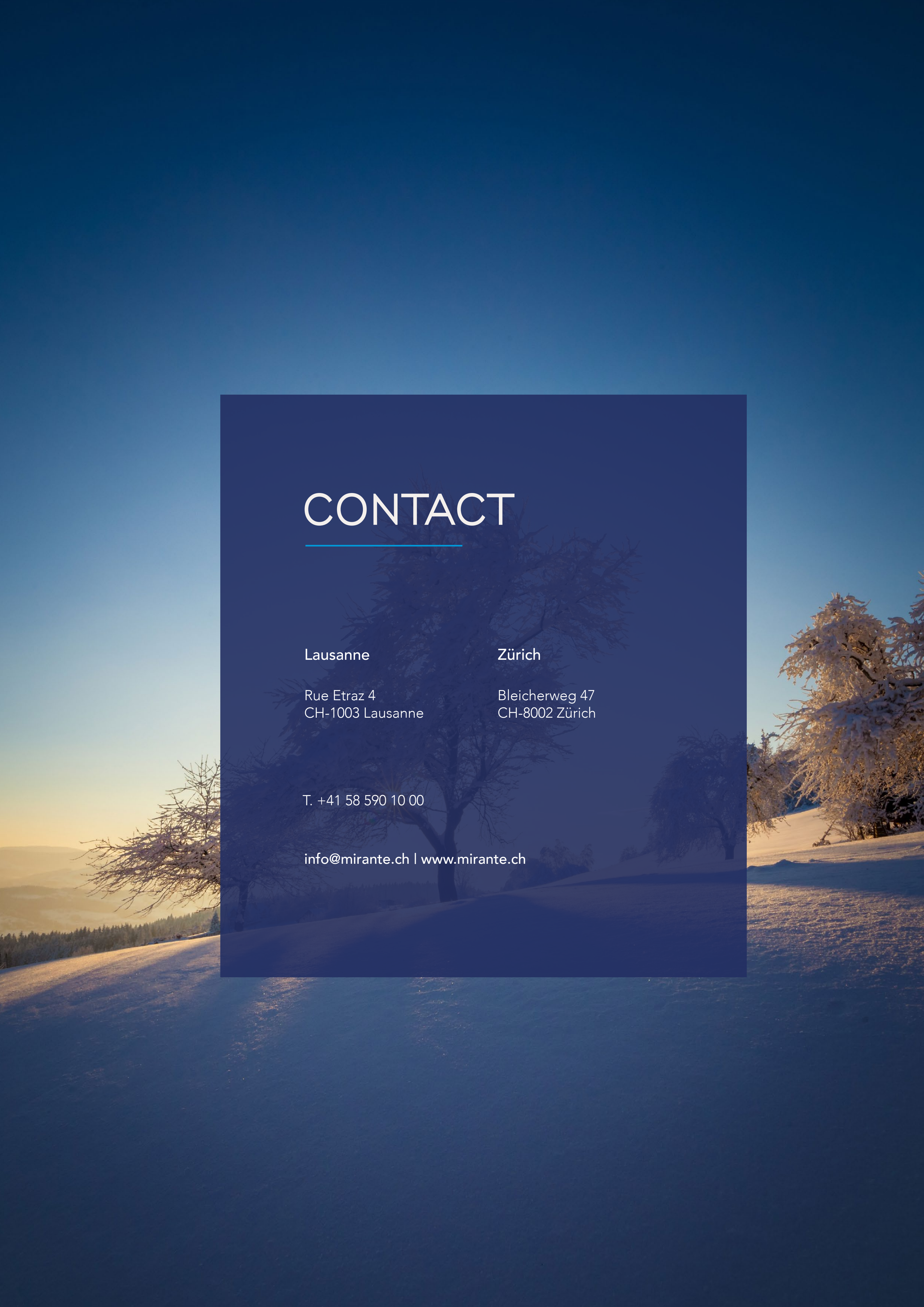
PERFORMANCE 2022

Equities Market (Local currency)	
United Kingdom	5.31
Japan	-1.14
Asia (ex-Japan)	-14.55
Emerging Markets	-15.06
Europe	-15.56
World (all countries)	-15.70
Switzerland	-16.81
United States	-19.56
China	-21.06

Equities Sector (Local currency)	
Energy	45.64
Utilities	-2.79
Consumer Staples	-3.11
Health Care	-3.61
Materials	-5.88
Financials	-8.90
Industrials	-9.04
Real Estate	-23.02
Information Technologies	-28.28
Consumer Discretionary	-29.58
Telecommunication Services	-35.60

Fixed-Income (USD Hedged)	
Global Aggregate 1-3 Year	-2.20
Global Inflation-Linked Bonds	-4.46
Global Aggregate 5-7 Year	-8.23
Global Treasury	-9.20
Global Aggregate	-9.64
Global High-Yield	-10.33
Swiss Bond Index AAA-BBB (CHF)	-10.83
Global Corporate Credit	-12.45
Global Convertibles	-15.23
Emerging Market Hard Currency Aggregate	-16.74
Global Aggregate Long Duration	-19.47
US Treasury Long Duration	-24.88

Others (USD)	
Commo Global (ThomsonReuters)	13.00
Hedge Funds	-4.34
Commo Industrials (CBR)	-12.25



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