MFM
MIRANTE FUND MANAGEMENT

Market Overview

MARCH 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

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A STRONG ECONOMY INCREASES THE RISK OF RECESSION

Investor optimism at the start of the year has faded. Data assessing the level of inflation indicated a slower-than-expected slowdown. But surprisingly, the main news that weighed on investor sentiment is that the US and European economies are resilient in many areas and show no sign of slowing down. Indeed, employment and consumption remain at high levels. This is «bad news», as persistent inflation and a strong economy are prompting central bankers to maintain their aggressive monetary policy. Indeed, the objective of central banks is to slow down the economy and consumption sufficiently to attenuate inflationary pressures. Thus, an economy that does not weaken makes it possible to continue to raise interest rates.

Consequently, since the end of January, interest rates have continued to rise. As a result, equity markets misplaced some of the gains generated in January. This return of volatility in both equities and bonds is not a surprise. Indeed, historically, bond market volatility remained at high levels until central bankers clearly signalled a halt to the cycle of rising interest rates.

At the stock level, investors tried to adjust valuations in a high-interest rate environment, with companies continuing to deliver relatively solid results and relative optimism for the quarters ahead. Indeed, fears of a sharp slowdown or recession increase when rates regain altitude; therefore, the equity markets show negative performances. In terms of sectors, the most sensitive to interest rates were logically the most affected, such as real estate and utilities. The materials and energy sectors also ranked at the bottom of the hierarchy. The latter have been affected by fears over China's recovery. Indeed, in January, Chinese equity markets performed strongly following the lifting of Covid-19 restrictions and the potential rebound of its economy. In February, however, macro data cast doubt on this scenario. The real estate crisis shaking the Middle Kingdom could prevent it from reacting as positively as the European and American economies at the end of the pandemic. The Chinese market thus underwent a substantial correction. As this country remains the primary consumer of energy and raw materials, these two sectors of activity have also been under pressure.

At the bond level, investors adjusted their rate hike scenario while reducing the level of risk of their investments. As a result, all bond assets posted negative performances. Logically, those with distant maturities presented the weakest performances, particularly in the United States. Similarly, bonds considered riskier, particularly those exposed to emerging countries or convertible bonds, also ended the month in negative territory despite short durations.

FIGURE OF THE MONTH:

4 billion

More than half of the world's population, or 4 billion people, could be overweight or obese by 2035, according to a new report from the World Obesity Federation, an NGO.

HIGHER RATES... WHAT IMPACT FOR OUR INVESTMENT STRATEGIES?

In the coming months, investors' attention will be focused on the strength of the coming slowdown. If modest, unemployment rates will likely remain historically low, particularly in the United States. This should enable companies to sustain their profit. In this case, equity markets could present positive performances. Obviously, in the event of a severe recession induced by the continuation of the rise in rates, this scenario would be reversed. While it is clear that economies will slow down (or, more precisely, that central bankers will rein in economies), the magnitude of that slowdown is impossible to predict. That's why we focus on an investment approach that can weather the various scenarios most resiliently. This approach combines asset allocation adjusted to current market conditions, robust portfolio construction and careful selection.

Significantly higher interest rates for longer imply a significant adaptation of allocation and investment strategies. Risk-free rates, i.e. the returns investors can expect to obtain by investing in safe assets, have risen sharply. For example, the interest rate on ten-year bonds in the United States is close to 4%; in Germany, it flirts with 2.7%, and even in Switzerland, it approaches 1.5%. This "risk-free" level of return forces investors to reassess the premium needed to justify a riskier investment. Moreover, our «World Equity Risk Premium» indicator continued to fall significantly during the month. The increase in interest rates was not compensated by the weakness of the equity markets (and therefore the increase in its expected return). As a result, this indicator continues to warrant an increased allocation to bonds versus equities. With most of the rate hike cycle likely behind us, bonds should generate favorable returns. This is why tactically, we continue to increase the defensive bond exposure providing short maturities. The goal is to take advantage of these higher yields while protecting against potential upward rate movements. They could even generate positive real returns in the event of a sharp slowdown in the global economy and again play their role as shock absorbers in multi-asset strategies.

In terms of equities, expected returns are more attractive following the fall in February. They could benefit from renewed optimism. However, we remain cautious by maintaining exposure to the most defensive investment factors, such as quality, which offers good visibility of future earnings, while avoiding exposure to highly indebted companies.

Finally, in terms of portfolio construction, we continue to focus on building resilience through investments that can withstand a sharp downturn in the global economy. In an environment of higher inflation, staying invested is crucial to preserve purchasing power over the long term. This is why we remain convinced that controlled diversification across asset classes, sectors, regions and investment factors makes it possible to design resilient approaches while optimizing the risk-return trade-off. The objective is to remain invested by controlling risks and using periods of higher volatility to rebalance and diversify strategies to generate value over the long term.

Read article :
Convertible bonds: a well-rewarded risk

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MAIN DRIVERS SUMMARY

GLOBAL GROWTH

- Global growth is slowing. The main question for each region is “major recession or mild slowdown?”
- Mild weather has helped avert the energy crisis in Europe.
- China is a reason to be optimistic: the reopening of its economy should support global growth, even if real-estate remains under pressure.

EARNINGS GROWTH

- Earning season was not great, but stock reacted positively, and the outlooks given by the management were cautiously optimistic
- Earnings growth remains negative, but are likely to recover by the end of 2023.
- Margins are resilient, but risk level remains high, as margins could compress once the labour market softens.

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.
- With the rebound of Chinese economy, it could generates inflationary pressures.
- Anchoring: Inflation expectation is the focus as will have a strong impact on long-term expected return.
- The long term drivers of low inflation, like profitability and demography remain in place.

INTEREST RATE

- Inflation is not going away fast.
- Central banks have a long way to go before they can be sure inflation is under control.
- Global tightening continuing through the first quarter of 2023 but we’re closer to the end of the tightening cycle than the beginning.
- QT (quantitative tightening) will likely create only moderate pressure at the long end.

SOURCE: MFM, March 2023

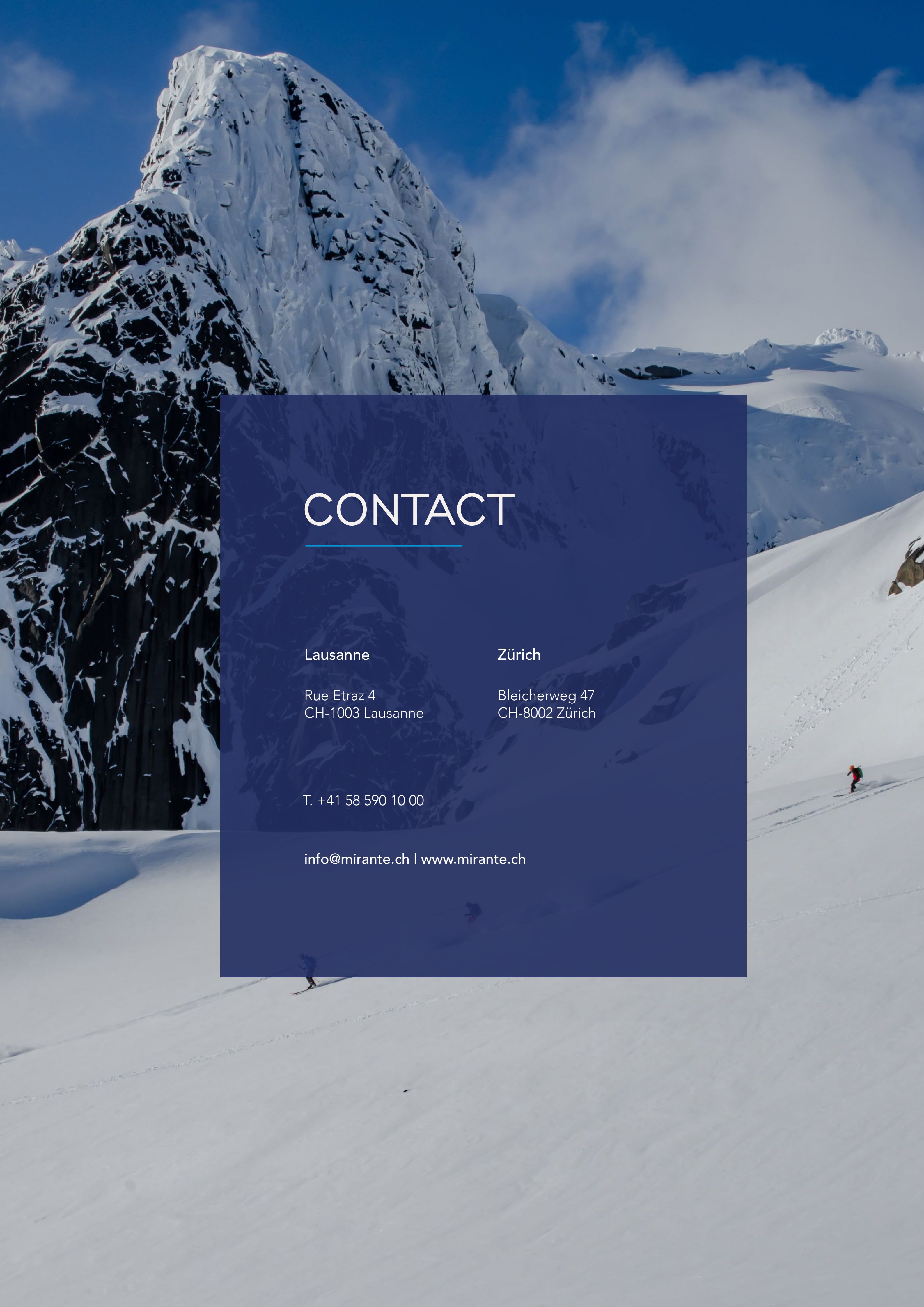
MONTHLY PERFORMANCE, 28 FEBRUARY

Equities Market (Local currency)	
United Kingdom	1.94
Japan	0.72
Europe	-0.62
Switzerland	-1.45
World (all countries)	-1.57
United States	-2.44
Emerging Markets	-4.65
Asia (ex-Japan)	-5.00
China	-9.87

Equities Sector (Local currency)	
Industrials	0.41
Information Technologies	0.35
Financials	-0.79
Consumer Discretionary	-1.20
Consumer Staples	-1.36
Health Care	-3.38
Telecommunication Services	-3.59
Utilities	-3.75
Materials	-3.86
Energy	-3.88
Real Estate	-4.95

Fixed-Income (USD Hedged)	
Global Aggregate 1-3 Year	-0.38
Global Inflation-Linked Bonds	-0.66
Global Treasury	-1.23
Global High-Yield	-1.40
Swiss Bond Index AAA-BBB (CHF)	-1.41
Global Aggregate	-1.60
Global Aggregate 5-7 Year	-1.74
Global Convertibles	-2.06
Global Corporate Credit	-2.41
Emerging Market Hard Currency Aggregate	-2.48
Global Aggregate Long Duration	-2.66
US Treasury Long Duration	-4.74

Others (USD)	
Commo Industrials (CBR)	-0.01
Hedge Funds	-0.36
Commo Global (ThomsonReuters)	-0.92



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