MFM
MIRANTE FUND MANAGEMENT

Market Overview

JUNE 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

CLEARLY UNPREDICTABLE

Uncertainty - when it comes to discussing the financial markets in recent months, this word has a strong resonance. Predicting macroeconomic data and its impact on the markets is a perilous exercise. It is even more so today. The end of the pandemic and the war in Ukraine have led to an explosion in inflation and a sharp rise in interest rates. These events have had a massive impact on the economy and the health of societies, and have rendered macroeconomic models based on historical data useless. The level of uncertainty is therefore logically high. But how can we measure this uncertainty? One way was proposed by US economists in 2015 [1]. The idea is to quantify macroeconomic uncertainty by assessing the quality of economists' forecasts. If the forecasts are close to the true value, uncertainty is low. If the forecast errors are substantial, it is high. Not surprisingly, by this measure, we are now at levels rarely seen in history.

Moreover, this uncertainty finds a striking echo in the performance of the major asset classes, which was surprising during the month. In equities, Japan was the strongest performer as it continued its impressive rise. The Nikkei index reached its highest value since 1990. The optimism surrounding the country of the rising sun stems from the potential end of Japanese deflation combined with the weakness of the yen and excellent corporate results. The latter has notably promised to increase share buybacks, which is always well-received by investors.

Conversely, China remained at the back of the pack. The flagging rebound in the Chinese economy continues to be confirmed by the apparent weakness in economic data. As a result, some analysts are predicting massive measures to support the economy politically and financially. In terms of sectors, technology presented the most robust performance. The stunning results and sales forecast announcement of Nvidia, the largest company active in microprocessors, intensified the artificial intelligence euphoria. It expects to see its sales reach $11 billion in the second quarter of 2023 due to the explosion in demand for chips used in generative artificial intelligence. This figure is 50% higher than the most optimistic analysts (still uncertain, but this time positive).

At the bond level, as interest rates continued to rise during the month, assets with high sensitivity to rates, i.e. with high duration, were under pressure. Emerging markets, particularly local currency bonds, also performed poorly. Convertible bonds fared well, taking advantage of their sensitivity to equities. They benefited from the good performance of companies exposed to growth sectors, bolstered by their excellent results.

NUMBER OF THE MONTH

2 million

Following the official announcement of Lionel Messi's departure, almost two million of the Argentine's fans decided to "unfollow" PSG on social networks.

[1] Kyle Jurado, Sydney Ludvigson, and Serena Ng, 2015, "Measuring Uncertainty", JLN uncertainty index.

CERTAINLY UNCERTAIN[2]

For some time now, central bankers and most economists are not seeing the same world as traders and investors. The degree of disagreement is at an exceptionally high level. While US and European central bankers have pledged to keep raising interest rates to fight inflation, investors anticipate rate cuts by the end of the year. The objective here is not to guess which of the two camps is right but to consider the magnitude of these differences. Uncertainty should therefore remain high. Whatever the scenario that prevails, it should contribute to maintaining the volatility of the financial markets in the long term. Historically, macroeconomic uncertainty tends to persist over quarters or even years.

When the level of uncertainty is high, predicting the future performance of major asset classes is even more difficult than usual. So how do we take it into account in our investment strategies? Diversification remains the best way to guard against positive or negative surprises, which are likely to materialize in the coming months. Indeed, historically in this type of environment, a diversified approach to all investment premiums delivers a risk-adjusted performance that is superior to strategies focusing on just one of these premiums. Moreover, our «World Equity Risk Premium» indicator again fell significantly during the month. The rise in interest rates has not been offset by sufficient weakness in equity markets (and therefore, an increase in its expected return). As a result, this indicator justifies an allocation to bonds versus equities. Tactically, we are thus continuing to increase 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 global economic slowdown while acting as shock absorbers during equity market corrections. In this context, we favour short-dated, high-quality sovereign bonds, as well as emerging market securities. At the equity level, we are maintaining an exposure that could benefit from renewed optimism on the part of investors. We, therefore, remain exposed to all of the «alternative risk premia» but by focusing on the most defensive factors such as quality, offering good visibility of future profits while avoiding exposure to highly indebted companies.

In a highly uncertain environment, diversification mastered at the level of asset classes and investment premiums allows the designing of resilient approaches that optimize the risk-return trade-off. Moreover, such strategies ensure that the portfolios withstand a wide range of possible scenarios both at the macroeconomic level and at the level of the performance of major asset classes.

QUOTATION OF THE MONTH

Computers are useless. They can only give you answers.

Pablo Picasso

[2] The title of the paragraph and the article are strongly inspired: Brooks, Jordan. 2023. "Certainly Uncertain" AQR Capital Management White Paper.

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MAIN DRIVERS SUMMARY

GLOBAL GROWTH

- Developed economies will enter a slowdown; the critical question is how deep it will be.
- In the United States, unemployment remains extremely low, consumers are continuing to spend, and the housing market is beginning to stabilize; for the time being, a deep recession is not on the agenda.
- Chinese growth is less intense than expected following the exit from Covid. As a result, the government is likely to stimulate the economy, even if the 5% growth target seems achievable.

EARNINGS GROWTH

- A better-than-expected earnings season and optimistic corporate forecasts have prompted analysts to revise their estimates for the months ahead, with some even raising them for the end of the year.
- Growth is slowing, well below nominal interest rates. As a result, corporate financing costs are set to rise in relative terms.
- Many companies will have to refinance in 2024 at significantly higher costs.

INFLATION

- Overall, rising service prices are now driving inflation in most countries worldwide.
- In the USA, however, the slowdown in the job market has a positive side insofar as the slowdown in wage growth will be a crucial factor in the continued fall in inflation over the rest of the year.

INTEREST RATE

- A slowing economy should mechanically reduce inflation and thus relieve pressure on interest rates.
- Despite falling inflation, the European Central Bank will likely continue raising its key interest rate. As a result, futures markets expect two further 0.25% hikes from the European Central Bank in the months ahead.
- QT (quantitative tightening) will likely create only moderate pressure on long-term rates.
- Long-term drivers of low inflation, such as profitability and demographics, remain in place.

SOURCE: MFM, June 2023

MONTHLY PERFORMANCE, 31 ST MAY

Equities Market (Local currency)	
Japan	4.52
United States	0.60
World (all countries)	-0.22
Emerging Markets	-0.99
Asia (ex-Japan)	-1.51
Switzerland	-1.97
United Kingdom	-5.25
Europe	-5.87
China	-8.19

Equities Sector (Local currency)	
Information Technologies	8.52
Telecommunication Services	4.01
Consumer Discretionary	0.90
Industrials	-1.49
Health Care	-3.33
Financials	-3.42
Real Estate	-4.64
Utilities	-4.85
Consumer Staples	-5.76
Materials	-5.86
Energy	-9.40

Fixed-Income (USD Hedged)	
Swiss Bond Index AAA-BBB (CHF)	1.33
Global Convertibles	0.24
Global Aggregate 1-3 Year	0.08
Global Aggregate 5-7 Year	-0.21
Global Treasury	-0.29
Global Aggregate	-0.39
Global High-Yield	-0.48
Global Inflation-Linked Bonds	-0.63
Global Corporate Credit	-0.93
Emerging Market Hard Currency Aggregate	-0.99
Global Aggregate Long Duration	-1.24
US Treasury Long Duration	-2.79

Others (USD)	
Hedge Funds	-0.46
Commo Industrials (CBR)	-2.43
Commo Global (ThomsonReuters)	-6.08

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