MFM
MIRANTE FUND MANAGEMENT

Market Overview

AUGUST 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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GLOBAL GROWTH AND EARNINGS PLAY «THE MARCH FORWARD»

Economist Milton Friedman has observed that «monetary measures affect economic conditions after a lag that is both long and variable». The current market environment seems to confirm this maxim. As central banks implement the most aggressive monetary tightening in history, global economies and corporate earnings are surprisingly resilient and continue to defy experts' expectations.

In the United States, employment and consumption support the economy and the morale of investors. But what has reassured the US financial markets the most is the continued deceleration of inflation. In particular, wage growth continued to slow in the second quarter.

In Europe, growth was also a pleasant surprise. It managed to avoid the recession that seemed inevitable until recently. However, the downside still lies in German industrial production, which remains in contraction. In China, the situation is reversed. China's economic growth recovery continues to disappoint. The real estate market, one of the key drivers, remains inert. More recently, since the reopening relatively buoyant service sectors have slowed considerably. Chinese leaders will be forced to adopt a more flexible approach in implementing stimulus measures to deal with this situation.

Renewed investor confidence translated into broad-based gains across major asset classes. Equities, unsurprisingly, were the big winners, posting particularly strong performances, benefiting from the excellent results of companies. It is obvious that at the start of the earnings season, expectations were relatively modest. Companies capitalized on this cautions sentiment and showcased exemplary success rates. Moreover, the leaders joined the optimism of the investors by affirming that in spite of the rise of the interest rates, a soft landing of the economy is possible. The gains in the stock markets during the first months of the year were mainly generated by the world's largest caps. However, since June, this optimism has spread to most listed companies. This created a feedback loop effect, confirming to investors that the rise in equities since the beginning of the year is based on solid foundations, despite the many uncertainties that persist. In terms of regions, Chinese equities were the best performers this month. Buyers anticipated stimulus measures expected to be announced by the government, which helped China's strong performance. This also positively influenced all of the emerging markets. The United States and Europe recorded similar returns. On the other hand, markets deemed to be more defensive, such as Switzerland and Japan, recorded less impressive performances, although they remained in positive territory. All sectors posted positive performance. Again, sectors considered more defensive, such as utilities, consumer staples and healthcare, were among the worst performers.

With regards to the bond markets, despite further increases in key rates in Europe and the United States, all fixed-income assets recorded solid performances. Convertible bonds benefited from their sensitivity to equities, especially those that had not participated in the rally at the start of the year. In addition, investors' appetite for risk has manifested itself by driving up the price of lower quality bonds. Indeed, corporate credit spreads tightened over the month, with high yield outperforming investment grade. Only bonds with distant maturities were impacted by the rise in rates.

NUMBER OF THE MONTH

37% The Nasdaq has generated a year-to-date performance of +37%, a euphoria fueled in part by the advent of artificial intelligence.

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EUPHORIA: ETYMOLOGICAL OR PSYCHIATRIC MEANING?

The etymology of the word «euphoria» comes from the Greek roots 'eu' (good) and 'phorein' (to carry) and originally meant «to be well». However, within the realm of psychiatry, an excessive sense of euphoria is generally associated with a pathological condition. The upcoming months will tell us which of these two definitions the current market's euphoric trend corresponds to.

The consensus scenario, confirmed by the latest macroeconomic data, anticipates that inflation could return to acceptable levels without further significant interest rate hikes or a major recession. In this scenario, two unknowns remain important:

1. What is the acceptable long-term level for inflation?
2. How quickly do they want to reach this level?

(1) As far as the level of inflation is concerned, the magic number remains 2%. However, some economists are beginning to suggest a much higher target. It is conceivable that some central banks could tolerate inflation of up to 4%, especially if it remains stable. Significantly higher inflation would have significant implications for investment strategies. Indeed, the first objective of a strategy is to beat inflation over the long term. This would impact the construction of portfolios and the expected returns of the different asset classes. (2) When it comes to the speed at which central banks act, each takes a different approach. However, it seems indisputable that central bankers will do everything possible to avoid acting too abruptly, especially if inflation is falling without having a significant impact on employment. They could adopt a patient approach by letting inflation gradually reach its steady state. This is probably the tactic being considered by the US Federal Reserve and the European Central Bank.

A «soft landing» scenario is obviously positive for all risky assets. However, two points must be taken into account. The first is the potential lack of positive catalysts. With the surprising performance of the financial markets since the beginning of the year, this scenario seems to have been endorsed by the financial markets. It is therefore more difficult to identify what could create a positive surprise in the coming quarters. The manufacturing sector could be the surprise. In fact, business investment in the manufacturing sector has not been so high for more than 40 years. The second is that the global economy continues to slow. Even if the worst-case scenario of a depression no longer seems relevant in the short term, a slowdown in the economy, combined with high interest rates, should be felt by both companies and consumers. For the time being, the robustness of corporate results is astonishing. Indeed, with the exception of the shocks to the US financial sector this spring, most companies seem to be able to withstand the elevated level of interest rates. One of the explanations is no doubt linked to the extremely low level of interest rates before the start of the hiking cycle. Indeed, most companies had the opportunity to benefit from minimal rates in order to refinance their debts. This has helped indebted companies in particular to keep debt cost low by making them impervious to increases in policy rates. This logically lengthens the transmission belt between monetary policy and the cost of the debt they have to bear, as explained in the introduction by Mr. Friedman. Historically, in the United States, it took on average about two and a half years after the first rate hike by the Fed for a recession to begin.

POSITIONING OF OUR INVESTMENT STRATEGIES

In terms of asset allocation, a cautious approach, which could benefit from positive surprises, seems appropriate to us in a euphoric environment. Our «World Equity Risk Premium» indicator fell sharply during the month. The robust performance of equities, which mechanically lowers their expected long-term returns, combined with the continuous increase in interest rates has pushed this indicator to historically low levels. This justifies a larger allocation to bonds versus equities. It should be noted that in the first half of the year, quality bonds once again fulfilled their role as a shield during equity market corrections. This positive development is beneficial for all multi-asset investment strategies.

In an environment combining high uncertainty and euphoria, it is essential to implement a carefully crafted diversification, both in terms of asset types and investment premiums. This creates resilient approaches to take advantage of certain market opportunities when they offer sufficient returns to offset the associated risks. In addition, these strategies ensure that the portfolios withstand a wide range of possible scenarios, whether positive or negative, both from a macroeconomic point of view and in terms of the performance of the main asset classes.

KEY MARKET DRIVERS

GLOBAL GROWTH

- Developed economies are set to slow; the key question remains the extent of these slowdowns.
- In the US, the Fed now considers the scenario in which the economy avoids recession to be "almost as likely as a mild recession", reflecting the continuing strength of the labor market and consumer spending.
- Europe has managed to avoid the recession that seemed inevitable until recently. However, the shadow is still cast by German industrial production, which remains in contraction.
- Chinese growth is not as strong as expected at the end of the Covid. The government will probably continue to stimulate its economy.

CORPORATE EARNINGS

- The corporate earnings season is excellent, even if expectations were relatively modest.
- Positive surprises are not rewarded by the market, but negative surprises are not punished either.
- By 2024, a large proportion of companies will have to refinance at significantly higher costs.

INFLATION

- Overall, rising service prices are now driving inflation in most countries around the world.
- Some forces driving inflation higher could strengthen, including optimizing supply chains, decarbonization and defense.
- In the longer term, the forces pushing inflation down remain demographic and productivity gains.
- Could central bankers accept interest rates permanently above 2% to avoid destabilizing the economy?

INTEREST RATES

- A slowdown in the economy should mechanically dampen inflation... and thus reduce the pressure on interest rates.
- Probably"higher for longer", the Fed and the European Central Bank continue to raise rates but are nearing the end of their hike cycles.
- QT (quantitative tightening) is likely to create only moderate pressure on long-term rates.

SOURCE: MFM, August 2023

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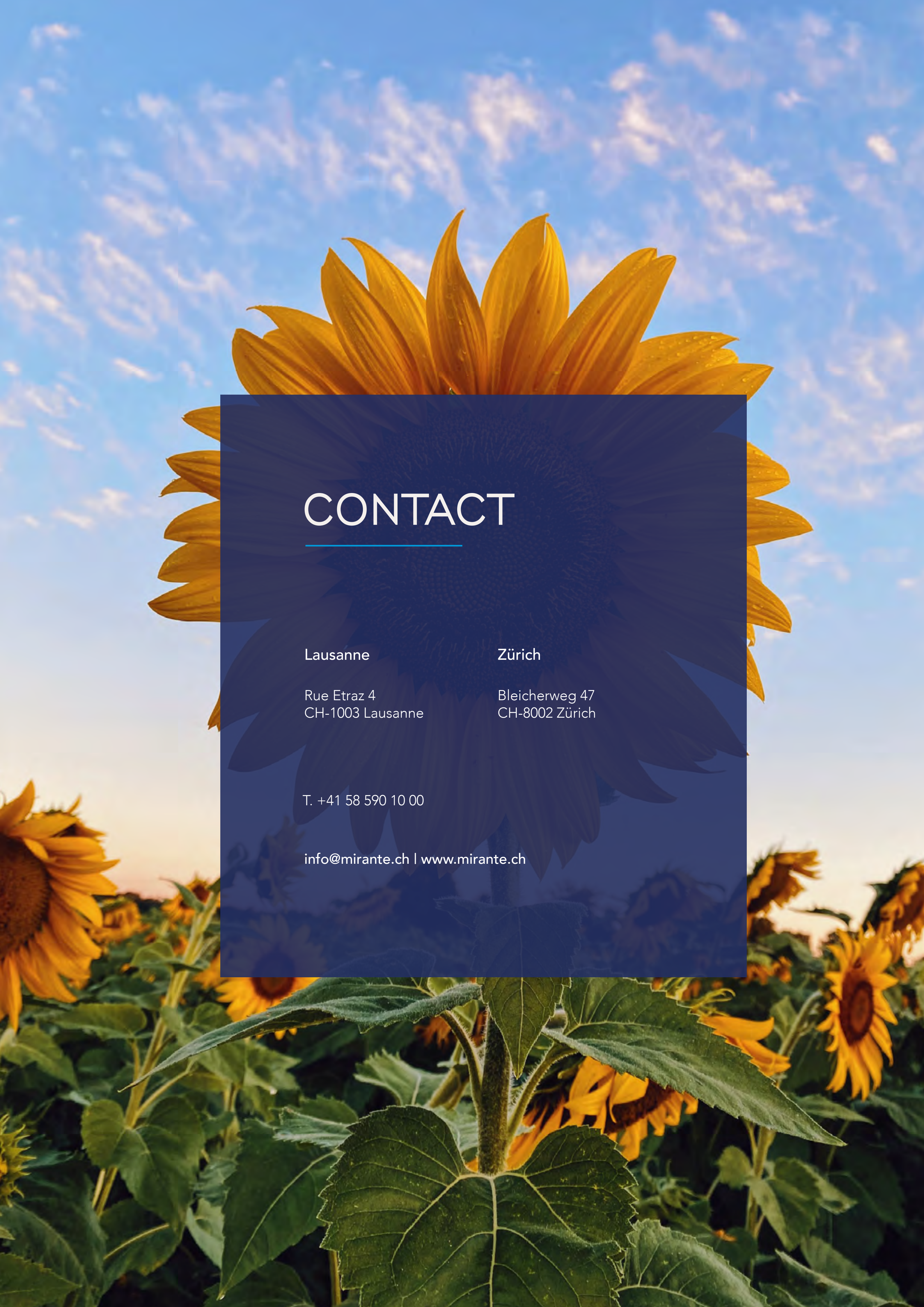
MONTHLY PERFORMANCE, 31 ST JULY 2023

Equities Market (Local currency)	
Japan	7.69
United States	6.63
World (all countries)	5.69
Europe	4.79
China	4.40
Emerging Markets	3.45
Asia (ex-Japan)	2.91
United Kingdom	1.25
Switzerland	0.41

Equities Sector (Local currency)	
Consumer Discretionary	10.28
Industrials	8.73
Materials	7.07
Information Technologies	6.14
Financials	5.87
Energy	5.50
Real Estate	3.90
Health Care	2.77
Telecommunication Services	2.70
Consumer Staples	2.58
Utilities	1.78

Fixed-Income (USD Hedged)	
Global Convertibles	3.79
Global High-Yield	2.12
Emerging Market Hard Currency Aggregate	1.29
Global Aggregate Long Duration	0.78
Global Corporate Credit	0.13
US Treasury Long Duration	-0.02
Swiss Bond Index AAA-BBB (CHF)	-0.03
Global Aggregate	-0.06
Global Treasury	-0.07
Global Aggregate 1-3 Year	-0.14
Global Inflation-Linked Bonds	-0.35
Global Aggregate 5-7 Year	-0.48

Others (USD)	
Commo Global (ThomsonReuters)	2.30
Hedge Funds	0.44
Commo Industrials (CBR)	0.04



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