Market Overview

OCTOBER 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

MFM is 20 years old, founded on 6 October 2003

Take a moment to immerse yourself in this video interview with Giuseppe Mirante (Joe), founder and CEO of MFM.

In this 1st part of the interview, Joe talks about how his years of study and professional experience have shaped his personality, his financial expertise, and ignited his passion for convertible bonds.

Click on the Youtube link or scan the QR code

MFM
MIRANTE FUND MANAGEMENT

CENTRAL BANKERS' PREDICTIONS CAUSE INVESTORS TO LOSE CONFIDENCE

By the end of September, most global central banks redefined their monetary policy. Most have decided to keep interest rates at their current level as inflation appears to be fading and economies are starting to slow. This decision seems logical and this pause in the rise in rates should have been well received by investors. However, some comments have shaken them. Indeed, most central banks have repeated the same message: "higher, longer". Predictions that inflation will remain higher than expected and therefore interest rates could remain high for a long time have had a strongly negative impact across asset classes. Interest rates have resumed their rise. Ten-year rates in the United States have reached 4.60%, while in Germany they are closer to 3.5%. Stocks have undergone a correction.

In terms of bond assets, long-duration bonds were mechanically and immediately impacted by the rise in interest rates. Only short-maturity bonds managed to remain in positive territory during the month. In regard to credit, it is important to note that its quality remains relatively strong because companies benefit from a robust economy. This results in spreads between quality assets and the most speculative ones which remain at low levels. Stocks were under significant pressure, particularly assets with long duration, such as technology companies. The valuations of the latter have fallen due to the discount rate effect which reduces the future value of company profits. Likewise, sectors of activity exhibiting high levels of debt, such as utilities, were also heavily sold. The real estate sector has also been affected by persistently higher interest rates, putting pressure on their balance sheets. The only sector to post a positive performance was energy. It benefited from the rapid rise in oil prices following announcements of production reductions and the impact of the slowdown in the Chinese economy on demand. At the regional level, England and Japan were the only ones to show positive performances. England benefited from positive surprises in terms of inflation, which seems to be falling more quickly than expected. It also benefited from the type of sectors present in its benchmark index. Japan remains one of the only developed countries in which the central bank continues to stimulate its economy. The United States recorded the least favorable performance. The economy continues to show signs of robustness, particularly in employment and real estate, sparking fears of further rate hikes.

QUOTE OF THE MONTH

The only function of economic forecasting is to make astrology look respectable.

John Kenneth Galbraith, economist and diplomat, 1906-2008.

ON THE VALUE OF PREDICTIONS...

The strong reaction of financial markets to central bankers' predictions is quite surprising for two reasons.

(i) On the one hand, predicting the behavior of inflation, and therefore interest rates, is a difficult task. Following its meetings, the Fed publishes a diagram called a «dot plot», representing each member of the Federal Reserve's projections for interest rates in the coming years. Each "point" corresponds to the expectations of a committee member. Looking back at the past, we see substantial changes from one meeting to the next, highlighting how volatile economic forecasts can be. During a recent speech, Jerome Powell, the current chairman of the Fed, affirmed that: «the points (the rate predictions) are not an excellent indicator of the future evolution of interest rates, as the evolution of the situation is highly uncertain. There is no crystal ball to predict the future - so the 'points' should be taken with a pinch of salt.» The Fed has the humility to admit that these predictions are not necessarily better than others and that it is fully aware of its limitations. It insists that it remains ready to revise its forecasts when economic data evolves.

(ii) On the other hand, the fact that interest rates could remain higher for longer is not something new. This scenario could have been integrated into the prices of different asset classes for several months. Investors probably did not believe this scenario was plausible. The strong reaction of all asset classes in September provides proof of this.

Monetary policy decisions in the coming quarters will inevitably be linked to economic data that measures inflation and growth. Indeed, the recent strength of employment in the United States has once again pushed American and global interest rates upwards. In this context, for several weeks, many clients have been asking us what our forecasts are for interest rates over the next twelve months. The question is certainly valid, because this will strongly condition the performance of the different asset classes. However, without a crystal ball and without being able to rely on the predictions of economists and central bankers, it is perilous to respond. So, how should we position our investment strategies? We are taking into account the fact that we are in a period where these predictions are even more difficult than usual and that there are many possible scenarios. The goal is not to bet on just one, but to be able to support or benefit, in a probabilistic manner, from the different potential scenarios both in terms of allocation and security selection.

In terms of allocation, our «MFM World Equity Premium» indicator remains at extremely low levels, close to the 2008 crisis record. Comparing the earnings yield of global equity markets with the yield of government bonds, it measures the excess expected return that investors require to own stocks rather than bonds. He indicates that it is essential to have exposure to bond investment premiums such as duration (sensitivity to interest rates) and credit (sensitivity to bankruptcy risk). Indeed, bonds once again offer attractive expected returns compared to stocks. They also constitute protection in the event of a decline in stock markets and a source of decorrelation in relation to premium shares. In this context, we favor sovereign bonds with short maturities and high quality, as well as securities exposed to emerging markets. When it comes to equities, we maintain a cautious stance with a focus on high-quality assets, while avoiding overly speculative investments. Indeed, for the moment, most companies are resisting the rise in interest rates.

Although investors should expect significant fluctuations in the markets, these sometimes provide opportunities offering sufficient returns to offset the associated risks. We are firmly convinced that controlled diversification approach across asset classes, sectors, regions and investment factors makes it possible to design resilient strategies that optimize the risk-return and encourage a long-term vision, especially needed in macroeconomic environments offering so little visibility.

KEY MARKET DRIVERS

GLOBAL GROWTH

- In the US, the Fed now considers that the scenario in which the economy avoids a recession is "almost as likely as a slight slowdown", reflecting the continued strength of the labour market and consumer spending.
- In Europe, economic activity continues to decline, as does inflation. The likely consequence is that the European Central Bank has finished raising interest rates.
- China's economy showed some signs of improvement in August, notably in industrial production and retail sales. However, the outlook remains uncertain amid weak global demand and a slowdown in real estate.

COMPANY PROFITS

- The results season will begin at the beginning of October.
- Investors will need reassurance about the trajectory of corporate profits in a world where interest rates will remain high for longer. Signs of weakness could have a significant impact on stock valuations.
- In 2024, many companies will have to refinance at significantly higher costs. Some of them are still benefiting from the low rates they contracted a few years ago.

INFLATION

- Inflation data continues to improve significantly, except for everything related to energy and, more specifically, the price of oil.
- Overall, the rise in prices linked to services is now the driver of inflation in most countries.
- In the medium term, specific forces pushing inflation upwards could strengthen, notably optimizing supply chains, decarbonization and defense.
- In the longer term, demographic growth and productivity gains remain the forces pushing down inflation.
- Could central bankers accept interest rates permanently above 2% to avoid destabilizing the economic balance?

INTEREST RATE

- Rates will likely stay "higher for longer." This could have a notable impact on highly indebted countries and companies.
- A slowdown in the economy seems to mechanically attenuate inflation... And thus reduce pressure on interest rates.
- The American Central Bank continues to raise rates but is approaching the end of its hiking cycle. The European Central Bank, too, has probably finished its cycle.

SOURCE: MFM, Octobre 2023

MONTHLY PERFORMANCE, 29 SEPT. 2023

Equities Market (Local currency)

Japan	-0.02
Switzerland	-1.71
United States	-1.74
World (all countries)	-1.76
United Kingdom	-2.53
Europe	-3.97
Emerging Markets	-4.68
Asia (ex-Japan)	-5.16
China	-8.30

Equities Sector (Local currency)

Energy	2.58
Health Care	-0.22
Telecommunication Services	-1.18
Information Technologies	-1.66
Industrials	-2.12
Consumer Discretionary	-2.19
Real Estate	-2.47
Consumer Staples	-2.59
Financials	-2.78
Materials	-3.15
Utilities	-4.83

Fixed-Income (USD Hedged)

Swiss Bond Index AAA-BBB (CHF)	0.62
Global Aggregate 1-3 Year	0.46
Global Aggregate 5-7 Year	0.11
Global Treasury	-0.05
Global Aggregate	-0.13
Global Inflation-Linked Bonds	-0.15
Global High-Yield	-0.17
Global Corporate Credit	-0.39
Global Aggregate Long Duration	-1.13
Emerging Market Hard Currency Aggregate	-1.39
US Treasury Long Duration	-2.79
Global Convertibles	-2.92

Others (USD)

Industrials (CBR)	-0.80
Global	-1.22

CONTACT

Lausanne

Rue Etraz 4
CH-1003 Lausanne

Zürich

Bleicherweg 47
CH-8002 Zürich

T. +41 58 590 10 00

info@mirante.ch | www.mirante.ch