MFM
MIRANTE FUND MANAGEMENT

Market Overview

FEBRUARY 2024

Arolla, Switzerland

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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GROUNDHOG DAY

Like Bill Murray in the film «Groundhog Day», stock markets began 2024 with a sense of déjà vu, replicating the dynamics observed in 2023. The month of January turned out to be positive for the most part equity indices, with the technology sector once again taking center stage as the main driver of performance. One of the catalysts was the announcement of Taiwan Semiconductor Manufacturing Company's results. Its optimistic outlook not only reflects the company's strong position, but also signals the anticipated growth of the technology sector as a whole given its fundamental role in semiconductors. This was confirmed at the end of the month, leading technology companies showed high growth and profitability. This good performance comes largely from demand driven by artificial intelligence and "cloud" technologies. In sectoral terms, it is therefore no surprise that the technology and communication services sectors outperformed the others. Real estate remained under pressure at the start of the year with new weaknesses coming from China and American commercial real estate which remains highly exposed to the impact of the home office.

Regionally, in the United States, high exposure to large technology caps pushed stock indices higher. Separately, Japanese stocks hit a 34-year high, supported by the Bank of Japan's unwavering commitment to its monetary policy. Conversely, China has once again disappointed investors. Despite Beijing's efforts to implement stimulus measures, the Chinese economy is anemic. It is faced with weak consumption and persistent problems in its real estate sector exacerbated by the liquidation of Evergrande in Hong Kong, one of the main players in the sector.

The bond world did not benefit from the optimism observed on the equity markets. Most central banks have been cautious, managing investors' expectations of possible interest rate cuts. The consensus among central bankers is clear: interest rate cuts during the first half of 2024 seem unlikely. In the United States, the Federal Reserve's task is made easier by the resilience of the economy and the strength of the employment sector. This robustness gives the Fed room to maintain its current policy without immediate pressure to cut rates. Europe barely managed to escape a recession, with slightly positive growth in the fourth quarter. This result gives the European Central Bank the luxury of being patient. Investors have therefore logically adjusted their expectations. The market indicates that investors do not expect a rate cut until the summer. As a result, long-dated bonds have been under pressure. In contrast, short-term bonds and high-yield securities saw renewed interest, with the latter benefiting slightly from investors' appetite for risk.

OUTLOOK: RATES LIKELY TO FALL, BUT WHEN?

Economists and financial analysts are convinced that monetary policies should be less restrictive this year. This is good news, as it is expected to boost economic activity and improve financial market dynamics. However, the decisive question relating to these cuts is not their implementation, but their timing.

The debate over the timing of these adjustments divides economists into two camps. On one side, the «dovish» camp advocates rapid action, urging central banks to cut rates quickly to avoid excessive economic deceleration. Conversely, the hawkish camp warns against precipitous rate cuts, arguing that such measures could reignite inflationary pressures, thereby reversing the progress made in recent quarters. Central banks must therefore play tightrope walkers. The challenge is to find a balance that does not stifle economic growth and keeps inflation in check. This exercise carries many risks of missteps. The latest forecasts from economists, following recent clear statements from central bankers, point to declines not arriving before the start of summer. However, the ability to accurately determine the timing of rate cuts is unlikely to play a significant role in the performance of large asset classes, particularly when considering a long-term investment horizon and a well-diversified approach.

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WHAT IMPACTS FOR OUR INVESTMENT STRATEGIES?

Global growth is expected to remain the main driver of asset class performance. Unfortunately, it is difficult to anticipate. It depends on the timing of central banks to cut rates, which is closely linked to the trajectory of inflation and the strength of the slowdown in their economies. For the moment, global growth is supported by the United States and a slight recovery in global demand; this allows us to remain cautiously optimistic.

In terms of allocation to main investment premiums, our "MFM World Equity Premium" indicator remains at historically low levels. This premium measures the excess return expected by investors for holding stocks rather than bonds considered less risky. It therefore confirms that it is essential to be exposed to bond investment premiums such as duration (sensitivity to interest rates, also called «bond premium») and credit (sensitivity to bankruptcy risk, also called « premium credit»). This also results in an increase in the expected return of diversified approaches combining bonds and stocks, while making these strategies less risky. Indeed, bonds should perform better if the likelihood of a global recession increases, while stocks could outperform with resilient growth.

The honorable performance of the stock markets in recent months comes from two anticipations. (1) On the one hand, investors' expectations regarding more flexible monetary policies. Historically, rate cuts rhyme with positive returns on the stock market. However, these periods are also associated with jumps in volatility, highlighting the need for robust portfolio construction. (2) On the other hand, in the longer term, expected stock returns remain closely linked to the growth of corporate profits. The anticipation of higher earnings estimates for was the second driver of stock performance. Attention is therefore logically focused on the ability of companies to meet these expectations. They remain mixed today. Although some sectors should benefit from reduced inflation, overall, business leaders are exercising caution.

The uncertainty of macroeconomic and geopolitical conditions combined with the diversity of corporate profit projections calls for caution. The disparity in performance between regions and sectors generates very different risk-return ratios. A disciplined strategy and a long-term perspective allow you to avoid emotional reactions and take advantage of attractive investment opportunities in turbulent times.

Although the yield on cash, known as the risk-free rate, is higher than in the past, other asset classes should help generate attractive investment returns. At the bond level, in a context of falling interest rates and low inflation, bonds should regain their role of protecting portfolios. The "premium bond" in particular should benefit from possible rate cuts and play its role as a shock absorber in the event of a sharp contraction in the economy. Although spreads (the compensation investors demand for holding riskier bonds than government bonds) have tightened in 2023, the "credit premium" remains an attractive source of return. Indeed, bankruptcy rates remain low and higher coupons should translate into higher returns.

In the coming months, despite cautious optimism in macroeconomic fundamentals, investor sentiment will be heavily influenced by elections in more than 70 countries and ongoing tensions in the Middle East and Ukraine. The impact of these events on financial markets is unpredictable. This highlights the importance of structured portfolio construction and diversification. They should enable strategies to cope with different scenarios, allowing, in periods of turbulence, to benefit from interesting investment opportunities.

CITATION OF THE MONTH

Listen to the forest that grows rather than the tree that falls.

Georg Wilhelm Friedrich Hegel, 1770-1831, German philosopher.

MAIN MARKET DRIVERS

GLOBAL GROWTH

- Growth will likely be the determining factor in the performance of financial assets in the coming quarters.
- The United States remains in great shape, particularly consumption and employment which seem little affected by interest rates.
- Europe narrowly avoided falling into recession, but economic activity is contracting, as is inflation.
- Despite the upheavals caused by the numerous economic and monetary stimuli, the Chinese economy remains shaky. The real estate sector, still under pressure, represents more than 20% of the country's GDP.

CORPORATE PROFITS

- So far, the earnings season has been rather encouraging, with companies generally doing better than analysts' expectations. Margins do not appear to have been excessively impacted by inflation.
- Many companies are accelerating their cloud/data/AI spending.
- For the coming quarters, company executives anticipate a modest increase in profits. This outlook seems plausible given the high absolute level of inflation and interest rates, as well as the likely slowdown in the world's major economies.

INFLATION

- In the short term, the spectacular increase in shipping costs, a consequence of the unrest in the Middle East, could stimulate inflation.
- In the medium term, certain forces pushing inflation upwards are likely to strengthen, notably the optimization of supply chains, decarbonization and geopolitical unrest specifically in Ukraine and the Middle East could increase oil prices. energy.
- In the longer term, the forces pushing down inflation remain demographic growth and productivity gains.

INTEREST RATE

- Most central banks in developed countries have reached the peak of their upward cycle. When will they decide to reduce their rates? This will essentially depend on the trajectory of inflation and the strength of the slowdown in their economy.
- Two camps clash over timing. The "dovish" think that central banks should lower their rates promptly, in order to avoid a significant impact on the economy. On the contrary, the "hawkish" argue that cutting rates too quickly could reignite inflation.
- Interest rates remain high in absolute terms. This could have a notable impact on highly indebted countries and companies.

SOURCE: MFM, February 2024

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MONTHLY PERFORMANCE, 31 JAN. 2024

Equities Market (Local currency)

Japan	8.47
World (all countries)	1.79
Switzerland	1.61
United States	1.53
Europe	-0.12
United Kingdom	-1.23
Emerging Markets	-3.49
Asia (ex-Japan)	-4.36
China	-10.43

Equities Sector (Local currency)

Telecommunication Services	4.64
Information Technologies	4.29
Health Care	3.23
Financials	2.23
Consumer Staples	1.19
Industrials	0.74
Energy	-0.53
Consumer Discretionary	-0.84
Utilities	-2.69
Materials	-3.60
Real Estate	-4.80

Fixed-Income (USD Hedged)

Global Aggregate 1-3 Year	0.36
Global High-Yield	0.13
Global Aggregate 5-7 Year	0.10
Global Inflation-Linked Bonds	0.06
Global Corporate Credit	-0.05
Global Aggregate	-0.20
Global Treasury	-0.26
Swiss Bond Index AAA-BBB (CHF)	-0.56
Emerging Market Hard Currency Aggregate	-0.70
Global Aggregate Long Duration	-1.31
Global Convertibles	-1.38
US Treasury Long Duration	-2.20

Others (USD)

Global	-0.09
Industrials (CBR)	-0.10

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