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Investment policy Q3/2022

English Version

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WILL IT BE RECESSION?

Investment Policy

The scenario facing the investor is particularly complex, and allocation choices require prudence. The post-pandemic phase, assessed in terms of economic recovery perhaps too optimistically, has come to terms with logistical bottlenecks that have exacerbated commodity price increases. This created for businesses supply difficulties, increased costs, delays and operational disruptions of all kinds. Inflationary pressure was reinforced, the accomplice of course being the enormous mass of liquidity that central banks had, for too long, injected into economic systems. At that point, with the start of Russia's military operations in Ukraine, geopolitical upheavals, the imposition of sanctions and embargoes, and Moscow's countermeasures, implemented and threatened, the crisis deepened especially in the energy, oil and gas, and food sectors. The weakest area once again turns out to be Europe, fragile in political as well as economic and financial terms, looking for alternatives to Russian energy sources, but facing recession risks and possible social consequences.

Central banks face the difficult task of countering "bad" inflation, as it originates from costs and not from excess demand, while avoiding recession (and impoverishment) risks as much as possible. It should be noted, however, that inflation, while invisible to central banks, is less so to policymakers, as it eases the burden of debt in real terms, to the detriment of savers and investors. So, the specter of stagflation reappears in Europe within a framework of geopolitical uncertainty whose contours and developments are still hard to define.

Outlook

The role of central banks remains crucial in guiding markets. The U.S. Federal Reserve (FED) has embarked on an aggressive campaign to raise rates, citing the fight against inflation as its primary goal. The 75 basis point increases decided by Jerome Powell, was not seen since 1994, accomplished by then Chairman Alan Greenspan. Less concerned about a possible recession, Powell is challenging a part of the political world, especially Democrats, on this ground, comforted, moreover, by the most recent macroeconomic data, which are also positive with regard to the labor market. It is clear that the economic picture in November will prove decisive in determining the outcomes of the Midterm elections, along with geopolitical developments, starting with Russia, Ukraine and China.

If the FED's bet is challenging, even more so for the European Central Bank (ECB), "obliged" to follow the global restrictive trend, but grappling with political and structural problems (France, Italy, Germany...) that to call complex and delicate is only an understatement. So if it acts on rates in restrictive terms, it is harder to abandon its bond-buying strategy to support those countries otherwise in dire straits, starting with Italy.

The Swiss National Bank (SNB), after its surprise hike in benchmark rates (+0.5 percent), seems to be on its way to a less interventionist strategy in favor of the euro in order not to raise reserves further.

But the central bank to which investors are again looking with particular interest is the People's Bank of China (PBOC): while all its sister banks are engaged in restrictive policies, the central institution in Beijing, in company with the Bank of Japan, is going in the opposite direction, resisting global pressures (since it is also in a position to determine them) and loosening monetary conditions in order to support the economy that now seems to be emerging from a long and troubled tunnel.

Macro

Many are the perspectives of economists who are beginning to see a bleak scenario for the economies of many countries. Certainly, the West is in a position of extreme weakness, including in terms of proactivity, decision-making and geopolitical clout. Looking at the effects of sanctions on Moscow, the damage to the proponents (U.S. and EU) is almost as extensive as that inflicted on the recipient. The US recovery is likely to weaken, making the Fed's monetary policy less aggressive. The evolution of inflation will prove decisive. The same is true for Euroland, where the "imported" inflation component is widening due to the weakness of the euro and the heavy dependence on foreign energy.

The gap between the Western world and the Far East looks set to widen. Compared to levels around 8-9 percent, Chinese inflation stands at 2.1 percent (even 0.9 percent in "core" terms, i.e., excluding energy and food). Producer prices fell year-on-year from 13% to 6.4%. The real estate crisis, which culminated in the Evergrande affair, is being overcome, as is the health crisis that has stalled Shanghai and parts of Beijing. The government has implemented reforms to limit speculation and increase competition and transparency. The PBOC is injecting liquidity and the first positive signs are moving

China's stock exchanges in a positive direction while Western stock exchanges retreat more than 15 percent. The Taiwan issue and possible sanctions from Washington for excessive strengthening of the China-Russia axis remain on the table, obviously troubling minds in the U.S. halls of power.

Fixed Income

For the Euro bond market, this quarter's test by the ECB promises to be an interesting one, with the mix of monetary maneuvering (the first in a long time) and the so-called "anti-fragmentation" program aimed at containing the financing costs of weak countries, such as Italy.

In the U.S., inflationary fears, with levels at the highest in 40 years, lead the Fed's strategy to set rates on the 10-year Treasury above the 3 percent threshold by the end of 2022. A loser in real terms, these yields would shine should monetary policy be reversed in the wake of a heavier-than-expected recession that occurs during 2023.

For emerging market issues, the relative strength of the U.S. dollar and the bullish trend in rates dictates caution and careful selection of issuers, both in terms of reliability and currency choice. Chinese yields are now broadly in line with those of their U.S. counterparts.

Equities

Ukrainian crisis, inflation, rising rates, and corporate difficulties are penalizing European equities, even though valuations are theoretically attractive.

Even on Wall Street, recent corrections have made prices attractive in many sectors, starting with technology, but the prevailing climate of uncertainty seems destined to make the market mostly sideways, at least in the short term.

The outlook for the Swiss market is more positive, with interest in insurance stocks, fairly valued and with good dividends, along with the pharmaceutical sector, still important as a global player.

The Nikkei index back below 27,000 points makes the Tokyo Stock Exchange particularly attractive.

As for China, after sharp corrections, it seems as a good time to re-enter the market: the end of the reforms and lockdowns season and supportive interventions by the PBOC promise a strengthening of the recovery in the Shaghai and Shenzhen listings that has just begun.

Generally speaking, among the dominant themes, always appear those of alternative energy, "green" mobility, and those related to demographic trends.

Alternative Investments

Hedge funds are back in the limelight (albeit in negative terms those linked to cryptocurrencies): interesting, though not immune to some volatility, are those engaged in Merger Arbitrage and Long/Short strategies with limited net exposure.

Oil maintains high prices. Weighing on the Ukrainian crisis, difficult choices and threats on Russian energy imports and exports, but also OPEC+ policy disinclined to increase production (moreover arduous in technical terms) and a possible supply contraction in the medium term. U.S. shale oil is also showing some weakness, the Libyan crisis is festering, talks between the U.S. and Iran are languishing, and the search for alternative sources does not always look easy.

After a very strong rally, most metals are showing signs of weakening, both because of recession fears and because rising interest rates are limiting many non-industrial but financial-speculative transactions. The gold price is also affected by the strength of the U.S. dollar and rising rates, but risks and uncertainties still recommend a share in the portfolio. Strong price increases in the agricultural-food sector are a concern.

Currencies

The U.S. dollar maintains its relative strength given the decorrelation of monetary policies between the FED and ECB, but its weakening is possible in light of Frankfurt's upcoming initiatives.

The Swiss franc appreciated following the +0.5 percent move implemented by the SNB, which also allows it to limit the burden of imported inflation.

The Japanese yen lost, at least for the time being, its status as a safe haven asset due to rate compression.

For investors looking for diversified currency returns, opportunities may come from the Norwegian krone, the Australian dollar (Sydney's economy is highly linked to China) and the yuan itself.

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