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Investment policy Q4/2022

English Version

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ARE WE IN FOR A HOT AUTUMN?

Investment Policy

Fears of economic slowdown and inflation that has reached the highest levels in 40 years weigh on markets, causing uncertainty, given also the difficulty of determining central bank moves in the medium term. However, while critical geopolitical factors remain and the energy crisis conditions the scenario, particularly the European one, there are also positive elements: favorable macroeconomic data in many sectors, probable reinvigoration of the Chinese recovery, attractive corporate earnings, and both fiscal and monetary initiatives that could soon make the investment horizon clearer and full of opportunities, especially on the equity front. In a situation like the present, a cautious but constructive strategy may prove successful and deliver results even sooner than the prevailing consensus seems to indicate. As for the geopolitical aspects of the scenario, financial history indicates how the market turns out to be increasingly "resilient" as time goes on, especially when the acute phase, as in the case of Russian-Ukrainian military operations, or Russian-NATO as you like, is succeeded by a conflict phase "of friction" without extension of the military field. As for inflation, fiscal initiatives and retrenchment, already in place, of some commodities, are capable of leading to the overcoming of the peak in a relatively short time. However, it should be noted how inflation favors debtors, public and private, unfortunately to the detriment of savers, and how debt levels are particularly high at present.

Outlook

The role of central banks, and in particular that of the U.S. Federal Reserve (FED), remains primary. The FED leadership has clearly expressed its intention to counter inflation with an aggressive monetary policy in terms of large and rapid increases in benchmark rates, while showing more caution in managing its balance sheet. The market gives confidence to Jerome Powell and his newfound linearity after a phase of uncertainty, accepting even possible (but momentary) negative repercussions for the labor market and economic dynamics. It should not be underestimated how the Fed's strategy also has a political significance, as it departs from the pressure coming from the Administration and more generally from the Democratic Party, which, in its radical bangs, has come to make quite major accusations against the central bank.

In Europe, where the prospects of the cyclical crisis are compounded by structural ones, exacerbated by divergent positions on anti-Russian sanctions and responses to the energy crisis, the strategy of the European Central Bank (ECB) can only be cautious and delayed, in manner and timing compared to the Fed, even though it is obliged to fight inflation. The difference in economic and financial conditions among member countries are at least partially mitigated by the leveling initiatives that Frankfurt has already defined and could make even more incisive in case of emergency, avoiding, for weak nations, speculative pressures and uncontrollable spreads. European rates are set to return positive by the end of 2022.

All other major central banks are implementing restrictive anti-inflationary policies to a greater or lesser extent, with three exceptions bucking the trend: the People' Bank of China (PBOC), which has lowered benchmark rates to support the economy; the Bank of Russia, partly in view of the strong appreciation of the ruble; and the Turkish Central Bank (TCMB).

The Swiss National Bank, for its part, is initiating a normalization policy (rate up by 0.5 percent), which has resulted in a relative appreciation of the franc, a trend that, on top of everything, curbs imported inflation, keeping it at lower levels than in other countries (3.5 percent compared to 8-9 percent in Europe and the United States).

Macro

As mentioned at the outset, while geopolitical and economic uncertainties remain and, in some cases become more pronounced, there is no shortage of more favorable elements to consider. However, a new global direction in the establishment of trade and financial blocs on the basis of geopolitical "affinities" appears clear, and thus a growing protectionist trend not divorced from reshoring experiences, when and where possible. In the U.S. an economic slowdown is possible, but not such as to unhinge growth. More delicate appears to be the situation in Europe, where structural imbalances, the energy crisis and possible social and political repercussions may lead to delicate conditions. The cyclical slowdown may become recession in the absence of drastic interventions and reforms.

Japan is an area to watch with renewed interest but, in the latter part of the year, it may be China, yet another turning point, that can play a leading role. Today the Asian giant, despite an economic slowdown, recurring lockdowns, and continuing imbalances in real estate, has developed extensive reform plans, holds leadership in various even strategic industries (e.g., rare earths and beyond), and is in a strong position vis-à-vis the United States, while also holding a large share of its debt. The upcoming Communist Party Congress may set new growth programs (still toward 5 percent) and provide enough stimulus to bring about, after a long wait, even a recovery in international and domestic stock markets. The Taiwan issue remains on the table, but it is hoped that Beijing's classic pragmatism will prevail, despite rhetoric and displays of strength, over concrete actions toward the "rebellious" but important partner island.

Fixed Income

For the time being, the FED is pursuing a highly restrictive anti-inflationary policy with rates expected to reach the 4 percent mark by the end of the year, but, due to fears of a possible recession, the yield on the 10-year Treasury Bond has not yet returned above 3.50 percent. Significant sales of U.S. government bonds by Beijing are worth noting. The situation for U.S. fixed income would change dramatically if macro signals signaled an overshooting of the inflationary peak and/or the FED indicated, more or less explicitly, even a slight change in strategy about the size and timing of the rate maneuver. At the moment, the inversion of the yield curve (higher on short maturities than long) indicates some concern about a recessionary cycle, but in reality the data as it is published are mixed.

For the euro market, economic and structural reasons lead to caution, while the spread widens also due to corrections that have occurred in the stock market. Medium/short duration and particular caution towards "peripheral" issuers are still to be preferred.

Emerging country issues are relatively attractive. New ones have rising yields but some selectivity is necessary given the debt exposure of many issuers to the U.S. dollar, offset, however, by high prices of many commodities.

Chinese bonds are now less attractive as they actually offer yields aligned with those of the U.S. 10-year.

Equities

Wall Street has experienced sharp corrections, particularly in the technology sector, but a possible near-term inflationary cooling, resulting in a less aggressive stance by the FED, satisfactory macro data and good corporate results, result in a more positive sentiment. Given the major corrections, the technology sector is particularly attractive at the moment.

Even in Europe, exercising due caution, selected choices less tied to the regional context are possible. Affordable valuations can be an additional incentive for accurate stock-picking.

The defensive nature of the Swiss list remains a highly topical issue, particularly in the insurance sector, which is attractive for valuations and dividends, and the chemical/pharmaceutical sector.

Japan has been a relatively neglected market for global investors. Now, in light of the government's clear intentions to support the economy by favoring domestic consumption, the country's "resilience" to geopolitical and energy turmoil shaking other regions, a Nikkei index back in the 27,000-point area, and a relatively weakened yen making valuations even more attractive, the Tokyo market looks attractive.

In light of the indications from the PBOC, those that may come from the upcoming Communist Party Congress, and the results of the reforms implemented, as well as given the corrections in values, we think it is time to re-enter the Chinese market.

With a view to portfolio diversification, opportunities that should not be underestimated also come from the so-called "frontier markets," starting with some Arab countries where, according to the International Monetary Fund (IMF), there will be some of the highest growth in 2022.

Alternative Investments

Hedge funds are back in the limelight (apart from falls in cryptocurrency): interesting, though not immune to some volatility, are those engaged in Merger Arbitrage and Long/Short strategies with limited net exposure. Equal interest in the private equity sector.

Oil has corrected on fears of a slowdown in demand due to economic slowdowns and inflation, but OPEC+, in which Russia now leads along with Saudi Arabia, seems geared to support the price. Consuming countries are struggling, not only in their response to Russian maneuvering, and many institutions are predicting a recovery in demand by 2023 that could be matched by limited supply designed to drive up prices. What is apparent is how the utopia of a quick and "easy" energy transition is colliding with a far more complex and diverse reality that, for some time to come, will not be able to do without fossil fuels.

Fears of recession have led to a correction in the price of various commodities, especially in the metals sector.

Gold, despite geopolitical tensions, is volatile, held back by the strength of the U.S. dollar and high rates. However, its presence in the portfolio has a "guarantee" function, and should the dynamics of rates cool, resulting in a relative weakening of the greenback, this could mark the beginning of its new rally.

Currencies

The U.S. dollar maintains its strength, given the delay and less decisiveness with which the ECB operates. Should the signals from Washington change, a weakening phase could open for the greenback, however relative against the euro.

The Swiss franc has appreciated as geopolitical risks have increased, the first moves by the SNB and because of the lower level of inflation from which the country benefits.

Penalized the Japanese yen in the global context due to suppressed rates, which caused it to lose the safe-haven currency status it had enjoyed during previous market phases.

With a view to currency diversification and the search for long-term returns, the Norwegian krone (NOK), the Australian dollar (AUD) and, only partially, the Chinese yuan (CNY) continue to look attractive. It should be noted that, since the beginning of the year, the currency that has seen the greatest appreciation against the major other currencies has been the Russian ruble (RUB).

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Axion SWISS Bank SA
Viale S. Franscini 22
CH 6901 Lugano
Switzerland

Tel: +41 (0)91 910 95 10
Fax: +41 (0)91 910 95 14
Web: www.axionbank.ch
Email: mail@axionbank.ch