Axion | SWISS Bank

Excellence and performance
in Private Banking

Investment Policy Q1/2023

English version

Da sempre parte del Gruppo BancaStato

FIXED INCOME RE-ENTERS THE SCENE

Politica d'investimento

The era of zero rates and accommodative policies is coming to an end. The year 2023 opens with lingering uncertainties on both the geopolitical and economic fronts, with inflation levels still high in many countries, and with doubts about the path that the major central banks will take in the conduct of their monetary policy. However, there is no shortage of positive notes, among which, in light of the increased interest rates that will hopefully benefit from the rapid inflationary peak and the reversal of the restrictive policies adopted so far, the renewed interest in bond investments stands out. This after a decidedly negative 2022 that saw, for the first time since 1932, a heavy simultaneous fall in both bond and equity markets, rewarding only those who invested in commodities. Now, with the revival of fixed income, there is an opportunity for greater portfolio diversification.
While the tone of fixed income is on average positive, equity markets have also marked the beginning of 2023 with a good, if cautious, performance, awaiting signals from economic data, inflation in particular, and related guidance from central banks. However, in light of the lingering factors of uncertainty, the criteria of caution and selectivity remain crucial in every asset class.

Outlook

While the focus is mainly on inflation, the risk of economic slowdown and recession is present. Much will depend on the evolution of the energy crisis and the dynamics of commodity markets, with the risk that these, as has already happened with oil and gas, may also become the object of "weaponization". Political and strategic pressure may create challenges for the West and Europe in particular, in the current delicate phase of the energy and ecological transition. The labor market remains an important indicator that may significantly affect price dynamics.
Signs of revival, on the other hand, are coming, after a turbulent year, from China, which, having abandoned its Covid-zero policy and rehabilitated some economic sectors, could see a return of interest from global investors, especially from the second quarter of the year.

Macro

Thus, the shadow of the economic slowdown weighs on economies especially in the West, partly as a result of the anti-inflationary policy implemented by central banks, as well as the unfavorable income dynamics for many consumer segments in several countries. On the other hand, debt levels and, as in the case of the European Union, budget constraints, do not allow for further extensive fiscal support maneuvers. High indebtedness, in Italy but not only, is leading, as rates rise, to a very high cost of debt service, and, just during 2023, many government bonds will reach maturity and new ones will have to be issued, with higher yields. Also, central banks will no longer be bond buyers as in the past, and this may signal imbalances between supply and demand.
The focal point, in Europe as in the United States, will be inflationary developments and especially whether it reaches its maximum level. In this regard, the situation is different between the two sides of the Atlantic. In Europe, in fact, inflation proves to be particularly resilient in its "core" component, that is, depleted (albeit erroneously) of the energy share. The most typical case is the sharp rise in food prices in Italy and other Mediterranean countries.

Fixed Income

At the end of December 2022, the Bloomberg Global Aggregate bond index, comprising both government and corporate quality issues, closed with a historic negative performance of -16.25% after a year that, on the whole, is only an understatement to call "horrible".
It is worth recalling the reasons that triggered the panic: galloping inflation, logistical and production bottlenecks, exploding government deficits and debts, and aggressive central bank policies.
Now there seems to be a glimpse of some brightening. After years of zero and negative rates, there are growing numbers of issuers offering attractive rates of return, albeit in nominal terms and to be measured against inflation. There remains, if anything, the issue of even higher volatility than equity markets, awaiting a stabilization that is hopefully near. In the meantime, investors with a higher risk profile can begin to gradually lengthen the duration of their positions to take full advantage of the reversal phase. However, it is necessary to be judicious in choosing issuers because default risks are increasing.
In Euroland, the European Central Bank will maintain monetary tightening perhaps regardless of the choices of the U.S. Federal Reserve, which is likely to implement two more hikes in the first part of 2023. Still, long government yields already discount future cuts linked to retreating inflation. However, the average recommended duration is 5 years, and even shorter positioning for Swiss franc bonds due to uncertainties shrouding the policy of the National Bank (SNB), fresh from an "annus horribilis" with operating losses at all-time highs. A SNB that nevertheless lets the exchange rate run more casually than in the past for the purpose of not importing inflation. Still in the U.S., the inverted yield curve signals all the concern investors have about future growth, so durations may not go beyond 7 years.
In high-yield sectors, spreads and yields are attractive, but default risks induce selectivity and caution.

Equity Markets

Caution is also in focus on equity markets, despite many cheap valuations. Volatility may remain high, even bringing new corrections. Despite the sell-off that took place in 2022, many prices are still high, so in making stocks selection, it's essential to consider corporate fundamentals, "true" operating profits and not the result of contingent situations, pricing capacity and the ability to absorb and pass on higher costs.

That being said, markets offer opportunities, including in Europe, supported by the positive phase of the euro. In the U.S., the turbulence associated with waiting for Federal Reserve decisions is greater. "Value" stocks are to be preferred, as well as those in the technology sector, oversold and now buyable at attractive prices. Rate developments also favor the financial sector.

The Swiss index is attractive because of its defensive characteristics, as well as the dividends offered by many solid companies on the Zurich exchange.

In Japan, the Nikkei returned below 27,000 due to the Bank of Japan's aggressive policy, and is further penalized by the strengthening of the yen, but the real bet in 2023 is the restart of China and its drag on other Asian markets, which are already starting a moderate recovery.

Among our favorite themes we suggest the energy transition, starting with hydrogen technology, areas related to demographics and food security.

Alternative Investiment

They may prove important in an uncertain phase such as the current one, being fairly decorrelated to the performance of the main asset classes. Products with Merger Arbitrage and Long-Short strategies with low net exposure are interesting, although some volatility can be expected.

With a weakened dollar and a potential drop in rates, gold, already revitalized at this early stage in 2023, returns to full play. Industrial and "specialty" metals of strategic importance and use in new technologies are bound to appreciate, as are food products, whose demand is growing and whose supply is subject to bottlenecks of various kinds.

As for oil, its market is affected by increasing ESG standards and growth in alternative energy sectors, at least in some Western countries. On the other hand, the energy transition is proving to be more complex, slower, and more expensive than initially expected and will be a real challenge in many areas. In addition, 2022 showed the clear position of OPEC+ and its leader, Saudi Arabia, who is increasingly close to Moscow, in wanting to support its interests and the price of crude oil even against U.S. pressure, going so far as to cut supply. Moreover, the U.S. itself, which calls for production increases when prices rise, is unable to fill the gaps through its shale oil industry. Russian flows previously destined for Europe are diverted to Asia with sanctions remaining an issue in the world trade.

Currencies

The U.S. dollar may remain relatively weak, as it has already manifested in recent months, and could lead it toward exceeding 1.10 against the euro. But with a change of course by the Federal Reserve, its further weakening is almost marked against other currencies as well. Swiss Franc maintaining momentum of strength due to its solid fundamentals and the change in approach by the SNB. For those who want to seize opportunities for higher yields among secondary currencies, diversification may include the Norwegian krone, the Australian dollar and, to a lesser extent, the Chinese yuan, which with China's significant trade surplus remains a currency that can attract increasing interest.

Disclaimer

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