LimmatWealth

Investment Strategy – March 2022

Data & Forecasts

Developed Markets	Growth (%)		Inflation (%)		Equities			Bonds (10 Years)			Currencies (vs CHF)		
	GDP 21	GDP 22	CPI 21	CPI 22	Actual	3 Mths	12 Mths	Actual	3 Mths	12 Mths	Actual	3 Mths	12 Mths
Switzerland	3.6	2.9	0.6	1.0	1’847	→	↗	0.19	0.20	0.50	-	-	-
Germany	2.8	3.6	3.2	3.9	13’698	→	↗	0.02	0.20	0.45	-	-	-
Eurozone	5.2	4.0	2.6	3.9	3’742	→	↗	-	-	-	1.01	1.06	1.08
United Kingdom	7.2	4.2	2.6	5.5	7’239	→	↗	1.30	1.45	1.60	1.23	1.26	1.28
United States	5.7	3.7	4.7	5.1	4’363	→	↗	1.79	2.00	2.30	0.92	0.94	0.93
Japan	1.7	2.8	-0.2	0.9	25’985	→	↗	0.16	0.20	0.20	126	124	125

Emerging Markets	Growth (%)		Inflation (%)		Equities			Bonds (10 Years)			Currencies (vs USD)		
	GDP 21	GDP 22	CPI 21	CPI 22	Actual	3 Mths	12 Mths	Actual	3 Mths	12 Mths	Actual	3 Mths	12 Mths
Asia ex Japan	7.0	5.4	1.2	2.6	741	→	↑	-	-	-	-	-	-
China	8.1	5.2	0.9	2.1	78	→	↑	2.83	2.70	2.85	6.32	6.40	6.50

Review – Escalation in Ukraine leads to falling equity markets

The market weakness continued in February, with the military escalation in the Ukraine conflict becoming the most important market driver in the second half of the month. Contrary to the expectations of numerous observers, Russia's President Vladimir Putin has launched a war of aggression across Ukraine, thereby changing the geopolitical structure for the long term. This new level of escalation was an exogenous shock for the markets, which until recently had hoped for a diplomatic solution to the conflict. Consequently, the markets are very unsettled, which is evident from the decreasing liquidity. Due to the economic proximity to Eastern Europe, European equity markets lost disproportionately in the past month, while the US equity markets did better, at least in relative terms. Due to the high weighting of energy stocks, the UK equity market was the only important equity market to even show a positive performance in February. Russian equities and Russian assets in general have sold off massively in recent weeks. The Ukraine war and the associated risk aversion are also clearly visible at sector level. Energy and commodity stocks benefited from rising commodity and gold prices. At the same time, defensive sectors (e.g. consumer staples) were in demand as safe havens and were able to show significant relative outperformance.

The US Federal Reserve (and partially the European Central Bank ECB) is currently in a real dilemma. In light of the high inflationary pressure, the month of March was originally supposed to be the beginning of a noticeable turnaround in monetary policy. The war in Ukraine and the associated rise in commodity prices have further intensified the inflationary pressure and thus the urgency of raising key interest rates. On the other hand, the financial markets are heavily burdened by this war and threaten to swing into a real bear market. In addition, Western sanctions cut off the largest Russian banks from the international payments system, leading to tension in the interbank market. Under normal circumstances, the negative factors outlined would be sufficient to postpone the turnaround in interest rates. However, given the very high inflationary pressures, this shift does not seem likely. The FED is therefore likely to initiate the turnaround in interest rates in March, but will probably combine this with dovish communication.

Equity markets around the world ended a very volatile February with negative returns. China (+3.0%) was the only one of the main markets to close the past month with a positive result. The markets in Germany (-6.5%), Europe (-6.0%), and the United States (-3.1%) performed the worst. The Swiss equity market was also unable to escape the volatility and ended the past month also with a negative result (-2.2%).

Global 10-year government bond yields continued to rise over the past month. They increased the most in Switzerland (+0.16% to 0.26%), Germany (+0.12% to 0.14%), and Great Britain (+0.11% to 1.41%). Interest rates in Switzerland are now at their highest level since the end of 2014.

The currency markets moved little in February despite the Ukraine war. As expected, the Swiss franc served as a safe haven and strengthened against the US dollar (+1.1% to CHF 0.92), the Euro (+1.2% to CHF 1.03), and the British Pound (+1.3% to CHF 1.23). The US Dollar was unchanged against the Euro (USD 1.12).

Alternative investments ended the past month with mixed results. Gold (+6.2% to USD 1,909 per troy ounce) and oil rose sharply (WTI, +8.6% to USD 95.72 per barrel), while hedge funds fell slightly (-0.4%).

Outlook – Markets remain volatile

The fundamental outlook for 2022 is becoming increasingly complex and challenging. The current Ukraine war is ostensibly a burden for market psychology, but over time it will also weigh on the fundamentals and make the interest rate environment even more unfriendly. On the positive side, the Omicron burden will largely ease from the second quarter. Nevertheless, a significant post-Corona boom is not to be expected because in 2022 the dampening normalization effects resulting from a slowdown in fiscal stimulus and tighter monetary policy will have a greater impact. In particular, the swift throttling of liquidity by the global central banks and the resulting exit from the strongest monetary expansion phase of modern times should ensure regular withdrawal symptoms on the financial markets. At the same time, the inflationary pressure will continue and, at worst, will result in an even less friendly monetary policy. In 2022 it is also to be expected that employees will take this inflationary pressure into account in their wage demands and that part of the inflationary pressure will therefore be permanently cemented. On the other hand, the global economy is expected to grow moderately above potential in 2022 (and 2023) despite a loss of momentum and Omicron braking. The positive growth in corporate profits should therefore continue. However, the aforementioned inflationary factors and rising wage spending will increasingly put pressure on profit margins. Hence, earnings disappointments are likely to increase in 2022 and ensure regular bouts of fragility. After all, China will remain an important market driver in 2022. The slowdown in China is already so severe that Beijing is gradually turning towards stimulus. However, the positive effects of a change of course in China are only likely to take effect in the second half of 2022.

Based on the above statements, we expect equity markets to trend sideways in the short term before they pick up again. We continue to monitor cyclical sectors more closely, but as volatility in equity markets remains high, we have refrained from investing so far. We continue to focus on good quality companies with strong balance sheets. China is slowly becoming more interesting as further government support measures can be expected.

Market participants expect the US Federal Reserve Bank to raise interest rates six times over the course of the next 12 months. Things are a bit different in Europe, where only two to three interest rate hikes are expected from the European Central Bank ECB. The Swiss National Bank SNB is likely to follow suit with a slight delay as soon as interest rates are raised by the FED and the ECB.

Trade policy disputes and geopolitical developments will continue to lead to strong movements from time to time in the currency markets. The Swiss Franc will serve as a safe haven during these periods.

Hedge funds continue to benefit from a normalization of correlations, volatilities, and dispersion. They typically thrive when dispersion is high and correlations are low, because then they can take full advantage of their trading techniques.

March 4, 2022
Limmat Wealth Ltd.