LimmatWealth

Investment Strategy – February 2022

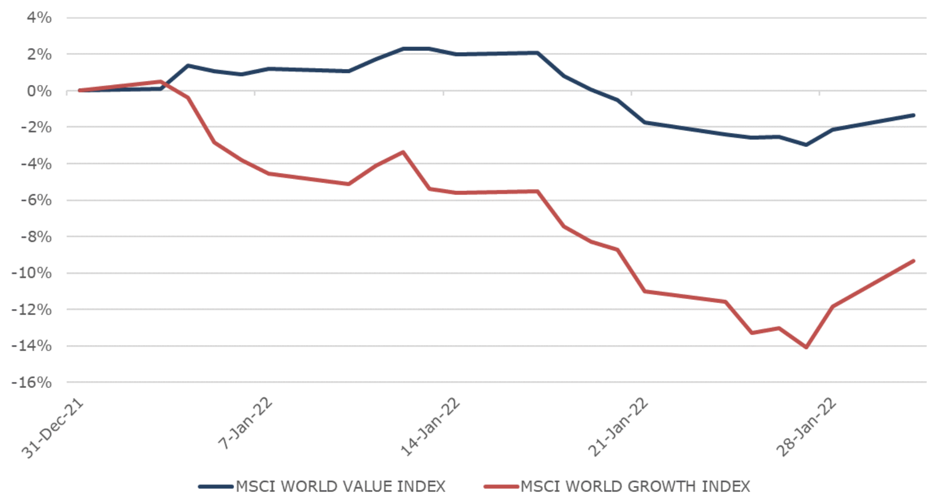
Data & Forecasts

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	3.5	3.0	0.6	1.0	15'616	→	↗	0.10	0.00	0.15	-	-	-
Germany	2.7	3.9	3.2	3.1	15'585	→	↗	0.04	0.00	0.10	-	-	-
Eurozone	5.1	4.0	2.6	3.1	4'207	→	↗	-	-	-	1.04	1.06	1.08
United Kingdom	7.1	4.5	2.6	4.7	7'592	→	↗	1.26	1.30	1.40	1.25	1.27	1.29
United States	5.6	3.8	4.7	4.8	4'589	→	↗	1.77	2.00	2.15	0.92	0.95	0.95
Japan	1.7	2.9	-0.2	0.8	27'241	→	↗	0.18	0.10	0.15	124	123	123

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	7.1	5.4	1.2	2.6	767	→	↑	-	-	-	-	-	-
China	8.1	5.2	0.9	2.3	3'361	→	↑	2.71	2.90	2.95	6.36	6.45	6.50

Review – Expected rate hikes bring volatility to the markets

The good finish last year was followed in January by a rather bumpy start to the new investment year, which was characterized by noticeable corrections and significant sector rotations. After negative inflation data and disappointing comments from the US Federal Reserve, market participants had to adjust their expectations regarding the speed and intensity of monetary tightening upwards again at the start of the year. Market participants are currently assuming that the FED will raise interest rates five times in 2022, while some experts are even anticipating seven rate hikes. The aforesaid adjustment in expectations has led to a noticeable upward pressure on nominal and real interest rates, which manifested itself within a few trading days. As a result, equity markets as a whole came under noticeable pressure, as higher interest rates inevitably lead to an adjustment in valuations given the currently very high valuation levels.



Performance comparison MSCI World Value vs MSCI World Growth, January 2022 (Source: Bloomberg, Limmat Wealth)

As can be seen in the chart above, the highly valued technology segment and the associated growth style sold off disproportionately (red line). Segments with moderate valuations – such as value stocks and sectors that even benefit directly from higher interest rates, such as financial stocks, on the other hand, were penalized much less (blue line). At least in the short term, this corresponds to a trend reversal compared to the past five years (see chart below).

Performance comparison MSCI World Value vs MSCI World Growth, Feb 2017 - Jan 2022 (Source: Bloomberg, Limmat Wealth)

As a result, sectoral return patterns have been highly divergent and have had a clear impact on regional return patterns: the growth-biased US market has shown relative weakness, while value-biased Europe and the UK have shown relative strength. As an interim conclusion, it can be stated that the market fragility and sector rotations in January were largely determined by fears of inflation and rising interest rates. This complex mixture was supplemented by geopolitical risks, which in turn led to uncertainty among investors and also fueled inflation and interest rates. Tensions surrounding Ukraine continued to rise in January and as a consequence, financial markets have started to price in possible military action, which was reflected in the stable gold prices and the very strong crude oil prices. In the future, the latter will increase inflationary pressure and thus also the risk of monetary policy being too tight. A new geopolitical balance between NATO and Russia is likely to emerge over the course of the discussions about Ukraine, which could, however, be quite fragile and uncomfortable.

Equity markets around the world ended January with negative returns. The equity market in the United Kingdom (+1.1%) was the only one of the main equity markets to end the past month with a positive result. The markets in China (-7.6%), Japan (-6.2%), and Switzerland (-5.7%) performed the worst.

Ten-year government bond yields rose sharply around the world last month. They increased the most in the United Kingdom (+0.33% to 1.30%), the United States (+0.27% to 1.78%), and Switzerland (+0.23% to 0.10%). This means that we are back in positive territory in Switzerland for the first time since November 2018. In January, the Chinese central bank lowered interest rates for the first time since April 2020, thereby providing additional liquidity. This is its reaction to the economic developments in China. As a result, interest rates on ten-year government bonds also fell slightly (-0.07% to 2.71%).

Currency markets moved little in January. The Swiss Franc weakened against the US Dollar (-1.6% to CHF 0.93) and the British Pound (-1.0% to CHF 1.25), but remained unchanged against the Euro (CHF 1.04). The US dollar strengthened against the Euro (+1.2% to USD 1.12).

Alternative investments ended the past month with mixed results. Gold (-1.8% to USD 1,797 per troy ounce) and hedge funds (-1.5%) fell slightly, while oil prices spiked (WTI, +17.2% to USD 88.15 per barrel).

Outlook – Markets remain volatile

The fundamental outlook for this year remains complex and challenging. In the first half of the year, an economic slowdown is plausible due to Omicron-related lockdown measures and the increase in sick leave. However, this negative factor should clearly subside in the second half of the year. 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 rapid liquidity throttling by global central banks and the resulting exit from the strongest monetary expansion phase in modern times is likely to cause withdrawal symptoms in the financial markets. At the same time, the inflationary pressure is likely to continue and, if the worst comes to the worst, 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 also 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. As such, earnings disappointments are likely to increase in 2022 compared to 2021, leading to regular bouts of fragility. After all, China will remain an important market driver in 2022. The slowdown in China is already so severe that the Chinese government and central bank are gradually shifting 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 continue to expect equity markets to trend sideways in the short term before they pick up again. We are currently watching cyclical sectors more closely, but have refrained from investing due to the high volatility in equity markets. We continue to focus on good quality companies with strong balance sheets. China should slowly become more interesting as further support measures by the government can be expected.

Market participants expect five interest rate hikes by the US Federal Reserve (FED) 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 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.

February 7, 2022
Limmat Wealth Ltd.