LimmatWealth

Investment Strategy – May 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	2.5	0.6	2.0	1’863	→	↗	0.81	0.60	0.70	-	-	-
Germany	2.8	2.2	3.2	6.3	14’177	→	↗	0.93	0.60	0.80	-	-	-
Eurozone	5.2	2.8	2.6	6.5	3’782	→	↗	-	-	-	1.04	1.03	1.07
United Kingdom	7.2	3.8	2.6	7.1	7’612	→	↗	1.84	1.65	1.85	1.22	1.24	1.27
United States	5.7	3.2	4.7	6.9	4’300	→	↗	2.95	2.60	2.80	0.98	0.94	0.93
Japan	1.7	2.1	-0.2	1.5	26’819	→	↗	0.23	0.20	0.20	132	128	128

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	5.2	1.2	2.8	679	→	↑	-	-	-	-	-	-
China	8.1	4.9	0.9	2.2	69	→	↑	2.83	2.75	2.90	6.62	6.40	6.45

Review – Expected monetary tightening causes markets to collapse

After the clear counter-movement in the second half of March, financial markets were in weak mode almost continuously in April, with the noticeable USD strength offsetting a significant part of the losses on global stock exchanges (for portfolios with CHF, EUR or GBP as reference currency). As in the previous months, the financial markets are being confronted with the tightening of monetary policy and are attempting to price this in adequately (negatively). In light of the very high inflation rates and the hawkish comments of the US Fed's central bankers, global stock exchanges have priced in a further acceleration of the pace of monetary tightening. In addition, the Fed has announced that it will tackle the balance sheet reduction promptly and make progress here as well, whereby the Fed balance sheet is to be reduced by USD 95 billion a month this year. It is therefore clear that the liquidity environment will deteriorate drastically very soon, putting valuation-sensitive sectors under pressure. As a result, the US technology sector fell significantly in April, which, given the sector's large market capitalization, pushed the overall US equity market lower. The high inflation rates and the foreseeable tough monetary tightening by the global central banks have also further accelerated the bear market in the bond markets (via interest rate increases). The USD, on the other hand, benefited from the hawkish Fed and appreciated by around 5% against the CHF, the EUR, and also the GBP. This is the strongest one-month appreciation in years. Faster pace of Fed tightening and Ukraine's war are factors in favor of a firm USD in the near term. Additionally, as global commodities are traded in USD, commodities and precious metals were clearly positive from a non-USD perspective in April. Structural inflationary pressures are a key driver behind gold's stability. However, the risks are increasing here in light of higher real interest rates. Another negative factor for the markets is the drastic lockdowns in China resulting from the Zero-Covid policy. The Zero-Covid philosophy is based on very tough but time-limited lockdowns to stop the spread of the Corona virus. However, the Omicron virus variant is so highly contagious that the Zero-Covid policy is reaching its limits and the economic costs are spiraling out of control. It is already foreseeable that China will miss the GDP growth targets set for this year.

Equity markets around the world mostly printed negative returns in April. Markets in Switzerland (+0.4%) and the United Kingdom (+0.4%) ended the month slightly positive, while those in the United States (-8.8%), China (-6.3%), and Asia (-5.2%) fell significantly.

Global 10-year government bond yields continued to rise over the past month. They rose the most in the United States (+0.60% to 2.93%), Germany (+0.39% to 0.94%), and the United Kingdom (+0.30% to 1.91%). In Switzerland, interest rates also continued to rise (+0.27% to 0.87%).

The currency markets moved significantly in April, mainly due to the strength of the USD. The Swiss Franc weakened against the US Dollar (-5.2% to CHF 0.97), the Euro (-0.5% to CHF 1.03), and the British Pound (-0.9% to CHF 1.22). The US Dollar strengthened significantly against the Euro (+5.0% to USD 1.05).

Alternative investments ended the past month with mixed results. Gold (-2.1% to USD 1,897 per troy ounce) and hedge funds (-0.9%) ended the month with negative returns, while oil prices (WTI, +4.4% to USD 104.69 per barrel) continued to rise.

Outlook – Markets remain volatile

The fundamental outlook is becoming increasingly difficult. The Ukraine war will continue to weigh on fundamentals and keep upward pressure on interest rates intact. Due to economic interdependence and energy dependency, Europe is more affected than the relatively self-sufficient United States. In addition, there will be overriding normalization effects in 2022, which stem from a slowdown in fiscal stimulus and tighter monetary policy. 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 will require a very tight monetary policy in the medium term. In 2022, it can also be expected that workers will take inflationary pressure into account in their wage demands and that part of the inflationary pressure will therefore be permanently cemented. The aforementioned inflationary factors and rising wage spending will put pressure on historically high corporate profit margins. As such, earnings disappointments are likely to increase in 2022 compared to 2021, leading to regular bouts of fragility. Finally, China remains an important market driver. Beijing is increasingly focusing on stimulating countermeasures, both at the level of monetary and fiscal policy. However, the fundamental structural problems in China are so pronounced that the stimulus is hardly reflected in the macro data. China is therefore likely to step up the pace of stimulus again over the course of the year.

Based on the above statements, we expect equity markets to trend sideways in the short-term before they pick up again. We continue to expect positive global economic and earnings growth, but lower than expected at the start of the year due to rising interest rates and geopolitical events. This is likely to lead to more volatility in the markets as the year progresses. The corrections in certain markets last year and at the beginning of this year offer entry opportunities in selected areas/sectors. We continue to favor Switzerland and the United States over Europe, while continuing to focus on good quality companies that are spared the long-term effects of the pandemic and benefit from long-term trends. We remain positive about Asia and China in particular: there is significant catch-up potential and – as mentioned above – stimuli from the Chinese central bank can be expected.

Market participants expect the US Federal Reserve to raise interest rates eight times over the course of the year. The situation is now similar in Europe, where the European Central Bank ECB is expected to raise interest rates nine times. The Swiss National Bank SNB is likely to follow suit with a slight delay as soon as the ECB raises interest rates.

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.

May 10, 2022
Limmat Wealth Ltd.