LimmatWealth

Investment Strategy – July 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	2.3	1'639	→	↗	0.84	1.10	1.10	-	-	-
Germany	2.8	1.8	3.2	7.3	12'512	→	↗	1.22	1.20	1.30	-	-	-
Eurozone	5.2	2.7	2.6	7.2	3'382	→	↗	-	-	-	0.99	1.04	1.07
United Kingdom	7.2	3.5	2.6	8.4	7'051	→	↗	2.09	2.00	2.00	1.16	1.22	1.24
United States	5.7	2.5	4.7	7.5	3'759	→	↗	2.83	3.10	3.20	0.97	0.97	0.96
Japan	1.7	1.7	-0.2	1.9	26'423	→	↗	0.22	0.20	0.25	140	132	132

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	4.6	1.2	2.6	647	→	↑	-	-	-	-	-	-
China	8.1	4.1	0.9	2.2	75	→	↑	2.83	2.80	2.80	6.72	6.70	6.60

Review – Higher than expected inflation data weighs on markets

Global equity markets fell across the board in June, even marking the weakest month of the year. At the beginning of the month, higher than expected US inflation data weighed on the financial markets. Market participants expected declining inflation dynamics and thus a confirmation of the peak inflation thesis, but unfortunately this did not happen. As a direct result of the inflation problem, financial markets have priced in an even less friendly policy by the US Federal Reserve. This means that the Fed is forced to accelerate the already significant monetary tightening and thereby give the markets another liquidity shock. A short time later, the Fed confirmed these expectations and raised the key interest rate by 0.75%. That was the biggest rate hike in decades. The European Central Bank (ECB) and the Swiss National Bank (SNB) also tightened and announced a key interest rate hike for July and an immediate one for the SNB (+0.50%), respectively. The hikes can be significantly higher if inflation data shows no signs of stabilizing. In response to this unfriendly macro environment, interest rates have risen while company valuations have come under pressure. As a result, both bond and stock markets have fallen noticeably. The markets had barely digested the first wave of corrections when new selling pressure emerged in the second half of June, which was primarily focused on stock markets. This time it was not interest rate and inflation concerns that were the trigger, but increasing risks of recession. To put this in perspective: The global economy is fundamentally negatively affected by supply chain disruptions (caused by the Ukraine war and the lockdowns in China) and high commodity prices (which are slowing down private consumption). Due to the very tight expected monetary policy in the next quarters, another negative driver is materializing that could finally push the global economy into recession. Numerous leading economic indicators are already pointing downwards and the markets priced in the increased recession risks in the second half of June. As a result, stock markets generally sold off, with cyclical segments losing disproportionately. Consequently, commodity prices fell significantly in June, while the US dollar benefited from the uncertainty.

Most equity markets around the world ended June with negative returns. China (+6.7%) was the only major global market to post positive returns, while markets in Germany (-11.2%), Europe (-8.8%), and the United States (-8.4%) fell the most. The Swiss stock market also corrected heavily last month (-7.3%).

Global 10-year government bond yields continued to rise over the past month. They increased the most in Germany (+0.21% to 1.34%), Switzerland (+0.18% to 1.07%), and the United States (+0.17% to 3.01%).

The currency markets moved relatively strongly in June. The Swiss Franc strengthened against the Euro (+2.9% to CHF 1.00) and the British Pound (+4.0% to CHF 1.16) but remained unchanged against the US Dollar (CHF 0.96). The US dollar strengthened significantly against the Euro (+2.4% to USD 1.05).

Alternative investments also ended the past month with negative returns. Gold (-1.6% to USD 1,807 per troy ounce), oil (WTI, -7.8% to USD 105.76 per barrel), and hedge funds (-1.8%) ended the month with negative returns.

Outlook – Stagflationary tendencies

The fundamental outlook is becoming increasingly difficult and shows stagflationary tendencies. The current war in Ukraine and China's lockdown-related economic weakness are not only burdening the global economy, they are also having an inflationary effect. It is already foreseeable that employees will take inflation into account in their wage demands and that part of the inflationary pressure will therefore be permanently cemented. As a result, the general interest rate rise momentum should remain intact for the time being, but could ease over the course of the year if fears of a recession prevail. In particular, the declining fiscal stimulus and the tighter monetary policy will significantly slow down economic growth. In addition, the rapid liquidity throttling by the global central banks and the associated exit from the strongest monetary expansion phase of modern times should ensure regular withdrawal symptoms on the financial markets. 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. China is likely to increase the pace of stimulus over the course of the year in order to ensure fragile stabilization in the second half of the year.

Based on the above statements, we expect the stock markets to continue trending sideways in the short term before they pick up again. Although we continue to expect positive global economic and earnings growth, this will be lower than expected at the beginning of the year due to rising interest rates and geopolitical events. This is likely to lead to more volatility on the markets as the year progresses. The corrections in certain markets last year and earlier this year offer entry opportunities in selected areas/sectors (e.g. China and biotech). We continue to favor Switzerland and the United States over Europe, while maintaining our focus on good quality companies that 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 seven times over the course of the year. The situation looks extreme in Europe now, where markets are pricing in 14 rate hikes by the ECB until the end of the year. The Swiss National Bank SNB did not follow suit as expected but instead increased interest rates ahead of 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.

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Limmat Wealth Ltd.