LimmatWealth

Investment Strategy – October 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	2.3	0.6	2.9	1'599	→	↗	1.02	1.00	1.30	-	-	-
Germany	2.8	1.5	3.2	8.2	12'670	→	↗	1.92	1.25	1.30	-	-	-
Eurozone	5.2	2.9	2.6	8.2	3'484	→	↗	-	-	-	0.98	0.97	1.00
United Kingdom	7.2	3.5	2.6	9.0	7'086	→	↗	3.88	2.70	2.40	1.12	1.13	1.16
United States	5.7	1.6	4.7	8.0	3'791	→	↗	3.66	3.20	3.10	0.98	0.98	0.94
Japan	1.7	1.6	-0.2	2.2	27'121	→	↗	0.25	0.25	0.25	147	139	134

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	3.5	1.2	2.8	563	→	↑	-	-	-	-	-	-
China	8.1	3.3	0.9	2.3	57	→	↑	2.75	2.70	2.70	7.12	6.90	6.80

Review – Interest rate worries persist

The weak market environment continued in September and led to significant losses across the board. The main drivers of the September performance were again interest rate concerns, which had a negative impact almost the entire month and, in some cases, even resulted in panic-like waves of liquidations that affected all asset classes. Interest rate-sensitive equity segments, such as the United States as a region and highly valued technology stocks, lost disproportionately in September. However, the US Dollar has again benefited from hawkish Federal Reserve policy and safe haven demand and has shown strength. Concerns about interest rates were mainly fueled by inflation data, which was more tense than expected. In response to the unfavorable data on the inflation front, global central banks have continued to accelerate interest rates hiking while at the same time holding on to the prospect of further tightening measures. This further accelerated the interest rate shock on the financial markets. At the end of the month, the United Kingdom put another damper on the markets. Despite record inflation and recession, the British government has announced new fiscal stimulus, which should be mainly financed by new debt. This did not go over well in the markets and prompted investors to flee the British Pound and UK government bonds. London is a central hub of the global financial system. As a result, this flight of capital has further increased the uncertainty on global equity markets and led to new selloffs. Due to the steep rise in interest rates, bonds have increased their losses for the year to new record levels. Since real interest rates also rose in September (flanked by a strong US Dollar), the price of gold also fell significantly. After all, there were not only concerns about interest rates in September, but at the same time the signs of a potential recession increased and thus weighed on cyclical commodities across the board. In summary, it can be stated that this September will go down in financial history as one of the worst months ever for equity markets.

Equity markets around the world ended September with significantly negative returns. The markets in Asia (-12.9%), the United States (-9.3%), and Japan (-7.7%) lost the most. The Swiss equity market also ended the past month with a negative return (-6.0%).

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Yields on ten-year government bonds again rose significantly globally last month. They rose the most in the United Kingdom (+1.29% to 4.09%), the United States (+0.64% to 3.83%), and Germany (+0.57% to 2.11%). Interest rates have also risen significantly in Switzerland (+0.40% to 1.23%).

The currency markets moved unspectacularly in September. The Swiss Franc strengthened against the Euro (+1.6% to CHF 0.97) and the British Pound (+3.1% to CHF 1.10), while weakening slightly against the US Dollar (-1.0% to CHF 0.99). The US Dollar continued to strengthen against the Euro (+2.6% to USD 0.98).

Alternative investments also ended the past month with negative returns. The price of gold (-2.9% to USD 1,661 per troy ounce), oil (WTI, -11.2% to USD 79.49 per barrel), and hedge funds (-1.0%) fell significantly in the past month.

Outlook – Stagflationary tendencies persist

The short-term market outlook is quite positive, since September was characterized by isolated panic-like selloffs that were not exclusively based on fundamentals. The correction of these irrational price movements has already started and should lead to a more friendly market trend in October, especially compared to September. The fundamental outlook, on the other hand, is becoming increasingly difficult and shows clear stagflationary tendencies. Despite the currently high inflation rates, the inflationary pressure is likely to ease over the course of the year and the peak of inflation should therefore be behind us. However, a real normalization of inflation rates in 2022/23 is unlikely. We can already see that workers are taking inflationary pressures into account in their wage demands and as a result some inflation is becoming persistent, particularly in the United States. Global market interest rates correctly anticipated this development and implemented a long-term regime shift. As a result, global interest rates are likely to correct their recent exaggeration but remain generally high. Since inflation rates remain high, global monetary policy will remain a significant burden on the markets and the real economy in the medium term. While the end of the Fed's tightening cycle is increasingly in sight (expected in mid-2023), the tightening cycle of the European Central Bank (ECB) is still in its infancy. Corporate profit margins have already started to decline. The strong US Dollar, rising labor costs, and high energy prices create the perfect breeding ground for declining profit margins. This circumstance could make profit disappointments increasingly likely in 2022/23. 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 and macro burdens in China are so pronounced that the stimulus is hardly visible in the macro data. China is therefore likely to keep the stimulus intensity high over the course of the year in order to at least ensure economic stabilization. However, new damaging corona waves in winter in combination with the Zero-Covid Policy and the weak real estate market pose risks for the Chinese economy.

Based on the above statements, we continue to expect positive global economic and earnings growth. However, due to rising interest rates and geopolitical events, both are likely to be lower than expected at the beginning of the year. The corrections offer entry opportunities in selected areas/sectors (e.g. China and biotech). We continue to favor Switzerland and the United States over Europe, with a focus on high-quality companies that benefit from long-term trends. We remain positive about Asia and China in particular: there is significant catch-up potential and stimuli from the Chinese central bank can be expected.

Market participants expect five to six further rate hikes by the Fed over the course of the next six months. The situation is similar in Europe, where seven interest rate hikes by the ECB are currently priced in. The Swiss National Bank (SNB) is also likely to hike rates further, having already done so in September, ending the period of negative interest rates after more than seven years.

Trade policy disputes and geopolitical developments can continue to lead to strong movements on the currency markets. The Swiss Franc always serves as a safe haven during such periods.

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

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Limmat Wealth Ltd.