LimmatWealth

Investment Strategy – September 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	2.4	0.6	2.8	1'650	→	↗	0.89	1.00	1.30	-	-	-
Germany	2.8	1.5	3.2	8.0	12'774	→	↗	1.54	1.25	1.30	-	-	-
Eurozone	5.2	2.8	2.6	8.0	3'493	→	↗	-	-	-	0.97	0.98	1.02
United Kingdom	7.2	3.5	2.6	9.3	7'280	→	↗	2.91	2.20	2.00	1.13	1.16	1.18
United States	5.7	1.6	4.7	8.0	3'924	→	↗	3.19	3.10	3.00	0.98	0.94	0.94
Japan	1.7	1.5	-0.2	2.1	27'620	→	↗	0.24	0.20	0.20	143	138	135

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	3.6	1.2	2.8	624	→	↑	-	-	-	-	-	-
China	8.1	3.5	0.9	2.3	65	→	↑	2.63	2.90	2.90	6.93	6.75	6.75

Review – Recovery only short-lived

The friendly market phase from July ended in mid-August and culminated in significant corrections that led to a generally weak investment month in August. As a reminder, said recovery was mainly the result of easing global inflationary pressures and speculation that central banks will become less restrictive in the medium term. However, this disinflationary euphoria was curbed by the US central bank Federal Reserve (Fed) in August, as inflation rates were far too high despite the slowdown. Bond markets took these warnings seriously, as evidenced by interest rates continuing to rise. Global bond markets are now in a bear market for the first time in 40 years. Equity markets, on the other hand, hardly reacted to the risk signals and were firmly caught up in the disinflationary euphoria. However, after Fed President Powell in his Jackson Hole speech warned against further increases in key interest rates and a restrictive monetary policy for a longer period of time, stock markets corrected noticeably. In particular interest-sensitive stocks such as technology and growth stocks have fallen significantly, as they are strongly valuation-driven and react more sensitively to restrictive monetary policy. The hawkish Powell speech boosted the US Dollar and pushed it to a multi-decade high. In general, the US Dollar is currently heavily overvalued, but the short- and medium-term drivers (primarily monetary policy and safe haven demand) continue to point to a strong or stable US Dollar. European equities were also heavily impacted in August. The price volatility on the futures exchanges for natural gas and electricity continued in August after it became increasingly clear that Russia would continue to restrict gas deliveries to Europe in the coming months. The leading economic and sentiment indicators are signaling that a recession in the Eurozone is almost certain in the next few quarters as the high energy prices put a strain on company margins and deprive consumers of real purchasing power. Finally, oil prices fell significantly in August, signaling fundamental risks for the global economy. Surprisingly, despite the weakness in oil prices, the energy sector was the strongest sector over the past month. This sector is currently the only one with noticeably rising corporate profits and is therefore very popular with investors.

Equity markets around the world ended August with negative returns. While the market in the United Kingdom was unchanged over the past month, the markets in Europe (-5.1%), Germany (-4.8%) and the

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United States (-4.2%) fell significantly. The Swiss equity market also ended the past month with a negative return (-3.1%).

Ten-year government bond yields have risen sharply worldwide over the past month, except in China (-0.12% to 2.64%). Yields rose the most in the United Kingdom (+0.94% to 2.80%), Germany (+0.72% to 1.54%) and the United States (+0.54% to 3.19%). Interest rates have also turned around in Switzerland and have risen significantly (+0.40% to 0.84%).

Currency markets moved within normal limits in August. The Swiss Franc weakened against the Euro (-1.0% to CHF 0.98) and the US Dollar (-2.6% to CHF 0.98), while it strengthened against the British Pound (+2.0% to CHF 1.14). The US Dollar continued to strengthen against the Euro (+1.7% to USD 1.01).

Alternative investments ended the past month with mixed returns. Both gold (-3.1% to USD 1,711 per troy ounce) and oil (WTI, -9.2% to USD 89.55 per barrel) ended the month with negative returns, while hedge funds managed to post slightly positive returns (+0.5%).

Outlook – Stagflationary tendencies

The fundamental outlook is becoming increasingly difficult and shows clear stagflationary tendencies. Even if the inflationary momentum should slow down over the course of the year, it is unlikely that the inflation rate will normalize in 2022 and the years that follow. It is already apparent that employees are taking inflationary pressure into account when making wage demands, and that part of the inflation is therefore being permanently cemented. Global market interest rates correctly anticipated this development and implemented a regime shift. As a result, interest rates are likely to remain high and only ease if there are clear fears of a recession, but without sinking to new lows. Since inflation rates are still too high, global monetary policy will remain a significant burden on the markets and real economy in the medium term. While the end of the Fed’s tightening cycle is increasingly in sight (probably mid-2023), the European Central Bank's tightening cycle is still in its infancy. Corporate profit margins are near all-time highs. However, the strong US Dollar, rising labor costs and high energy prices all point to falling profit margins. This circumstance could increase earnings disappointments over the further course of the year and in 2023. 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 hardly makes it into 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. New devastating corona waves in autumn/winter in combination with the Zero-Covid Policy and the weak real estate market pose significant risks for the Chinese economy.

Based on the above statements, we expect the equity 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 should keep market volatility elevated as the year progresses. Corrections in certain markets over the past year and earlier this year continue to offer entry opportunities in select 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 Fed to raise interest rates five more times this year. Things look slightly different in Europe, where seven interest rate hikes by the European Central Bank ECB are priced in. The

Swiss National Bank SNB is also likely to raise interest rates further and end the period of negative interest rates after more than seven years.

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.

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