TARENO

INTERNATIONAL ASSET MANAGERS

TARENO VIEW Q3 2022

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MARKET COMMENTARY

Review

The Ukrainian-Russian war continues to hold the world in suspense. Gradually, its international effects are becoming visible and noticeable: for producers and companies as well as for consumers and households. While the Western sanctions against Russia are gradually being intensified and reinforced by new packages of measures, Russia is reducing its gas and oil exports to Europe. As a result, commodity prices are rising, which is not only driving up inflation rates, but is also likely to have negative consequences for the economy as a whole.
The simultaneous invasion of Ukraine, as expected, leads to global famines in developing countries, as the important wheat export via the Black Sea sea route is blocked.
The international markets continue to react with sharp markdowns. At present, a stabilisation is not in sight, mainly due to the high inflation rates, the increased interest rates as well as the threat of recessions in numerous countries.

Bonds

In the last quarter, the Fed decided to make another interest rate move, which was very high at 75 basis points. The last time the Fed took a similarly high interest rate step was in 1994, which again emphasises how serious the current situation is.
The ECB, which so far has been known for its rather lax monetary policy, also raised its interest rate by 25 basis points. ECB President Lagarde announced further interest rate steps for September, if the medium-term inflation outlook remains intact.
Bond yields in the US as well as in the EU area have risen as a result of the interest rate steps. A further dynamic development is to be expected. The risk premiums for bonds with lower credit ratings have increased significantly in some cases.

Equities

Due to the Russian-Ukrainian war, imposed sanctions against Russia, rising inflation rates and higher interest rates, many companies are under pressure. On the one hand, in the area of their supply chains and the strongly increased cost of raw materials, and on the other hand, in the sphere of financial viability and the increase in the cost of possible loans.
Technology companies, growth stocks and interest-sensitive companies in particular reacted with heavy losses. A bottom is not to be expected in the short term. In the course of the quarter, there were repeated countermovements, which, however, did not prove to be sustainable.

Alternative Investments

While the gold price rose to over USD 2,000 at the beginning of the Ukraine war, it settled at around USD 1,800 in the second quarter. Currently, the gold price is trading at USD 1,830 and is living up to its reputation as a stable commodity in turbulent times.

Bitcoin, on the other hand, fell sharply. The all-time high of 69,000 USD from last year is becoming increasingly distant, as Bitcoin is currently trading at around 20,000 USD. The entire crypto market, especially the alternative coins (all except Bitcoin), was hit by the Luna shock, which provoked a massive loss of confidence in cryptocurrencies.

ECONOMY

The current inflation rates, both in the EU and in the US and other Western countries, follow the leading indicators. In particular, the strong increase in producer prices, compared to the previous year, shows an average increase of 37% in the EU and 33% in the US.

In particular, producer prices in the oil-processing sector rose by over 100% and continue to be the driving force behind high inflation rates. These are currently 8.1% in the Eurozone and 8.6% in the US. This is four times the long-term target of 2% for both currency areas.

The interest rate hikes that have already taken place will have a moderating effect on economic development in the short term. Together with the reduced supply of raw materials, supply disruptions and sharply increased oil and gas prices, the global economy could be threatened with a recession, which is likely to pose considerable difficulties for central banks as well as governments and companies. The macroeconomic environment will not get any easier any time soon.

OUTLOOK

Economic growth is slowing across the board. Drastically rising energy and food prices, rising labour costs and supply chains affected by China's zero-covid strategy are taking their toll.
In contrast to past market phases, investors can no longer rely on the support of central banks. It seems no question that fighting inflation is the top priority. Central banks' most important instrument is an interest rate hike, which, however, also carries the risk of slowing down the economy too much. The direct consequence would be a recession. Whether the central banks will succeed in bringing about a soft landing is unclear. However, the possibility that this could happen and that it succeeds certainly exists. We expect economic growth rates to weaken, but to remain positive. The upcoming corporate reports on the first half of the year as well as the outlook for the second half will attract a lot of attention.

Uncertainty in the financial markets and the continuing major geopolitical changes will maintain a continued high volatility in the markets. If volatility were to decrease, inflationary pressure would also decrease and therefore pressure on central banks reduces. Although this is not foreseeable in the short term.

For us as investors, however, the current market situation offers opportunities, too. The higher interest rates open up opportunities on the bond side that we missed in the past years of record low interest rates. At the same time, significant corrections in the equity markets have led to attractive valuations in many areas. We believe that, unlike in past years, the balance between bonds, growth and value stocks will be crucial. Periods of sustained high volatility give rise to the impulse to exit the markets. However, a look at the past shows that remaining in the chosen investment strategy pays off in the long run. We therefore remain invested.

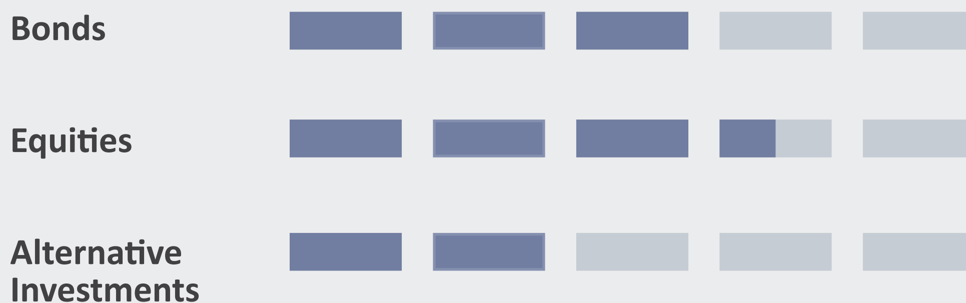
INVESTMENT POLICY

Asset allocation

The rapid rise in interest rates in all investment categories logically leads to an increase in our bond rating. The relative attractiveness of bonds has thus increased in relation to competing asset classes. In the US in particular, 10-year interest rates are once again quoted at 3% following the drastic interest rate hikes by the Fed. For an investment in high-quality corporate bonds, an additional risk premium of approx. 1.5% is added. In CHF and EUR, the investment options are not really interesting „yet“ due to the comparatively more moderate interest rate policy.
Nevertheless, we rate the return potential of equities as much higher, especially due to the current equity market quotations.

As the overshooting of inflation rates put all asset classes, apart from USD liquidity, under pressure, we assume that this will cool down in the coming year, but settle at a higher level than in recent years. Based on this assumption, we see equities as the most appropriate instrument to achieve a satisfactory return.
We also consider alternative investments to be positive, as their lower correlation makes them an ideal tool in order to reduce performance volatility.
With regard to currencies, we continue to maintain an active management. We remain largely in the reference currency of the mandates and keep the foreign currency exposure low.

Positioning



The chart shows the Tareno PM’s current assessment of its relative attractiveness compared to other asset classes. The more blue dots, the more attractive.

Bonds

The consensus of the US Federal Reserve is a target rate of around 3.5% by the end of this year, assuming no sharp drop in inflation. Unfortunately, this is still a long way from the current interest rate range of 1.5-1.75% and there are still several interest rate steps ahead in 50bps, if not 75bps. The Fed's challenge is to decisively counter inflation and provide a soft landing for the economy.
For the ECB, the task is much more difficult. In addition to the aforementioned problem, the tight financial corset of the peripheral countries must be taken into account in order to prevent the gap between the countries within the Eurozone from growing even wider.
Due to the still tense economic situation, our focus remains on first-class corporate bonds. We would only take advantage of interesting investment opportunities in the low investment grade area selectively and with a relatively short duration.

Equities

We believe that the equity markets have already largely anticipated and priced in the economic „worst case" scenarios and are several months ahead of the real economy. Of course, we cannot rule out that the last bout of volatility is over yet. However, the majority of the surprise potential within all current negative news seems to be of positive nature.
Moreover, the economy is still in a much better shape than the media suggest. Of course, this can change, which is why we will subject it to continuous and critical scrutiny.
In summary, however, we currently see good entry points in companies of the highest quality. Due to the sell-off in the markets, we have seen a strong increase in correlation in equities. This means that many top companies were taken to task during the price correction and unjustly suffered heavy markdowns.

Alternative investments

According to various sources, the private equity market shows no signs of slowing down so far. The global pool of lucrative projects is still well filled and the „more expensive" liquidity has not managed to harm demand.
The gold price has been consolidating sideways in recent weeks, which is remarkable considering the very strong USD. On a relative basis, the precious metal has outperformed the broad equity market and once again earned its justification as a portfolio component. Should the USD absorb the steep rise and consolidate sideways or weaken again, the gold price will be fundamentally supported.
In Q2, cryptocurrencies had to face a motion of confidence several times. On the one hand, the asset class took a tumble due to distortions in stablecoins, and on the other hand due to the temporary closure of the Celsius Network trading platform. We believe that the crypto market is in a shakeout phase, which is a healthy development given the highly speculative environment in the past and will consolidate Bitcoin as a leader.

Currencies

We maintain an active currency management, in which we keep the weightings in foreign currencies very moderate. The performance volatility which may be triggered by foreign currencies should not be disregarded.

TARENO

INTERNATIONAL ASSET MANAGERS

Imprint

Tareno Ltd
St. Jakobs-Strasse 18
CH-4052 Basel
+41 (0)61 282 28 00

Tareno Ltd
Claridenstrasse 34
CH-8002 Zurich
+41 (0)44 283 28 00

info@tareno.ch
www.tareno.ch

Responsible

Sybille Wyss
Chief Executive Officer
s.wyss@tareno.ch

Stefan Schütz
Head Equity Research
s.schuetz@tareno.ch

Annina Aeschi
Head of Marketing
a.aeschi@tareno.ch

More authors:
Frank Pfeiffer

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