Marketing material



Monthly Update - April 2022

As at 29 March 2022

Summary: Central banks fight against high inflation

- Global economic growth is slowing down significantly. However, we do not yet see any danger of recession.
- The war in Ukraine has so far had only a limited direct impact on the economy and financial markets, but is causing considerable uncertainty.
- For the second half of the year, we see significantly greater stagflation risks.
- Inflation will remain high for longer than expected. From April onwards, however, we expect a significant decline. The central banks still have the situation well under control, which is confirmed by the flattening of the yield curve.
- The Fed has surprised with the announcement of a stronger than previously expected tightening of monetary policy.
- Financial and currency markets have so far reacted only moderately to the cooling economy and the more restrictive monetary policy in the US and Europe. The global financial system currently remains in balance. Negative developments are priced in.
- A significant easing of monetary policy in Japan and China is also having a balancing effect on the global supply of liquidity.

Significant changes compared to the previous month

- Last week, Fed Chairman Jerome Powell surprisingly announced a much more restrictive monetary policy course than previously communicated in order to combat high inflation.
 A cooling of the economy would be accepted, as the danger of recession is currently very small. According to the Fed, the Ukraine crisis increases uncertainties, but is apparently no reason to forego a tightening of monetary policy.
- Overall, financial markets reacted surprisingly calmly to these monetary changes as well
 as to the ongoing geopolitical tensions. Stock markets were even able to make gains in
 some cases. We interpret this as a signal of strong market technicals.
- Long-term interest rates in the US and Europe continued to rise, but in an orderly manner
 and in line with expectations. The simultaneous further flattening of the yield curves is
 also a signal that inflation expectations remain moderate, the economy is cooling but no
 recession is expected, and central banks thus have the situation under control.

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— Interestingly, monetary policy is currently being loosened again in Japan and China. The Bank of Japan has announced unlimited purchases of 10-year government bonds to keep interest rates low. China is easing due to problems in the real estate sector and declining economic momentum. In a global context, this ensures a balanced supply of liquidity, and thus has a stabilising effect on the financial markets.

 The diverging monetary policy in the US vis-à-vis Japan and China is causing a slight increase in volatility on foreign exchange markets, although the price movements do not yet pose a threat to the stability of financial markets.

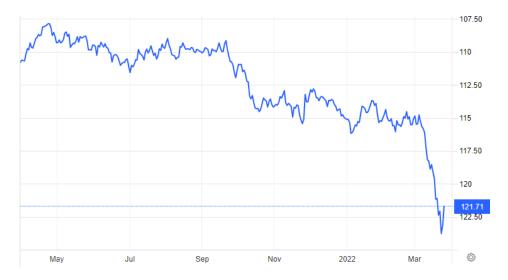
Current situation and positioning

- In our baseline scenario, economic growth expectations have weakened slightly compared to the previous month, as monetary policy in the US and also in Europe is likely to be tightened somewhat more than expected. In addition, high energy prices are causing a temporary time lag in the decline of inflation, and are thus also weighing on consumer confidence. However, we do not expect an actual recession in the next two quarters.
- Historically, geopolitical crises have had little long-term impact on the global economy and financial markets. In addition, a number of factors continue to have a structurally positive impact: high household cash balances, strong industrial order books, diminishing global supply chain problems, low inventories, rebounding US employment rates and strong credit impulses in the private banking system.
- In our view, tighter monetary policy does not change the existing, controlled upward trend in long-term interest rates. Consolidation is possible in the coming weeks. By the end of this year, however, Fed Funds rates in the range of 2% are expected in the US and, derived from this, rates for ten-year government bonds in the range of 2.75% to 3%. This interest rate level would also fit in with medium-term economic growth of 2.5% and an inflation rate of 2.8%. Conversely, in Europe, growth is likely to be significantly lower, but with inflation at a similar level. The ECB, on the other hand, is less restrictive than the Fed. Accordingly, higher interest rates are also to be expected in the eurozone in absolute terms, but they will rise comparatively less than in the US.
- The so-called "Fed put" will remain in place, but with a lower strike price once again. The Fed (but also the ECB) is therefore likely to loosen its more restrictive monetary policy again in the event of a potentially excessive economic slowdown or stock market turmoil. In the current central bank mode, however, a temporarily significantly higher volatility on stock markets will be tolerated.
- Many negative factors are currently priced into financial markets, including higher interest rates and a delayed decline in inflation. In this environment, even positive surprises are possible in the short term. However, a prospective recession in the second half of the year is not yet reflected in prices. Here, potential warning signals need to be watched closely.
- One such example is the strong flattening of the US yield curve in the range between 2 and 10 years. However, the currently very high 2-year rates anticipate the virtual certainty of a Fed Funds hike to 2% by the end of the year. Therefore, the small difference to the 10-year rates is not necessarily a sign of an imminent recession, but an arbitrage-induced reaction to the Fed's communication.

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Topics "on the radar"

Chart: Remarkable weakness of the Japanese yen against the US dollar



Source Trading Economics

The Japanese central bank (BoJ) has surprisingly announced unlimited purchases of 10-year Japanese government bonds in order to keep long-term interest rates low. This expansion of the quantitative easing (QE) programme constitutes a significant loosening of Japanese monetary policy.

As a result, the yen again came under significant pressure against the US dollar. However, the yen's weakness has persisted for some time. The BoJ had already been more expansionary than the Fed before the latest extension of its QE programme. Japan has significantly lower inflation rates and also less economic growth than the US, and can therefore safely afford a loose monetary policy. A correspondingly weaker yen has a growth-promoting effect.

In addition, the easing of Japanese monetary policy partially compensates for the Fed's tightening, and thus has a balancing effect on the supply of liquidity at the global level, thereby reducing stock market volatility.

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Summary of FischView model outputs

	US	Europe	Japan	Asia ex- Japan	LatAm	CEEMEA	Key:	
Equities	0	0	0	0 ↓	+	0 ↓	++	Strong positive
Government Bonds	-	-	-				+	Positive
Credit IG	+ ↑	+ ↑		0 ↓	0 ↓	0 \	О	Neutral
Credit HY	+ ↑	0		0 ↓	+	0 ↓	-	Negative
Convertibles	0	0	0	0				Strong negative
Commodities	Energy	+ ↓	PrecMet	+	InduMet	+		

Notes regarding the table: Changes from prior month are indicated with \downarrow or \uparrow . i.e. "O \downarrow " means that the output has weakened from a prior value of + or ++.

The methodology for calculating model outputs, and how the various pieces fit together to form the big picture, is explained **here**.

Within government bonds, we consider the most important bonds for each region, e.g. German Bunds in Europe, and a representative group of countries for Latin America, Asia ex-Japan and CEEMEA (Central and Eastern Europe, Middle East and Africa).

Cross asset class preferences

This table combines top-down views with bottom-up analysis at the portfolio level.

	Most preferred	Least preferred
Convertible Bonds	 Growth at a reasonable price (GAARP) Stocks related to electrification of economy Cyber security 	 Expensive growth
Global IG Corporates	Financials, energy"Rising Stars"	UtilityCapital goods
Global Corporates	FinancialsMedia"Rising Stars"	Real estateCapital goodsEmerging Markets
Global High Yield	'B' rating segmentTelecomsBasic industryEnergy	BankingTransportation
Emerging Market Corporates -Defensive	IndonesiaLatAm	– Qatar – Taiwan
Emerging Market Corporates - Opportunistic	High yield commoditiesLatAmSub-Sahara Africa	Asia IGBahrainQatar

Note: Preferred sectors/regions may differ between asset classes owing to respective performance drivers. In particular, equity exposure is the key performance driver for convertible bonds and is not relevant for corporate bonds.

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