Marketing material



# Monthly Update - July 2022

As at 28 June 2022

**FISCH** » Asset Management

### Summary: Monetary headwinds

- The economy in the US and Europe continues to cool down considerably. However, various indicators are not yet pointing to a recession, but instead to a "soft landing".
- Inflation rates are still high at present, but we expect a significant easing soon.
- Meanwhile, stable or even slightly falling inflation expectations are already having a positive impact on financial markets and the path of monetary policy.
- The Fed therefore seems to us to be proceeding too aggressively at present. We feel there is a danger of a "policy mistake".
- The ECB, on the other hand, is only tightening the reins very moderately and has announced an "anti-fragmentation tool" to support peripheral eurozone countries. This is having a positive impact on the government bond markets for the time being.
- Market sentiment has reached extremely negative levels in historical terms. A technical recovery in equity and credit markets is therefore likely. In the medium term, however, the reduction of the Fed's balance sheet remains a major drag.
- A strongly asymmetrical opportunity/risk ratio thus remains. Moreover, there are still no signs of an easing in the Ukraine war.

### Significant changes compared to the previous month

- After a brief stabilisation, the economy in the US and the EU is currently cooling down considerably. However, various indicators do not yet signal a recession.
- In contrast, the situation in China and Japan is improving. On a global level, this is having a partially offsetting effect.
- The Fed has surprisingly tightened its monetary policy further. It raised interest rates by 75 basis points and confirmed the planned balance sheet reduction. In the medium term, this could prove too restrictive, and constitute a so-called "policy mistake".
- Although the ECB will raise key interest rates from the end of July, it will remain much less restrictive than the Fed. China and Japan, on the other hand, are continuing to loosen

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their monetary policy, and are thus having a globally balancing effect not only on the economy but also in terms of monetary policy.

- In addition, the ECB has announced an "anti-fragmentation tool". With this, it wants to prevent interest rates in the peripheral eurozone countries from rising further. Already the announcement of this plan has led to a steadying of long-term interest rates in Italy and Spain, which proves a high degree of effectiveness for the time being. The money invested in government bonds of the peripheral states via this method is also "sterilised". This means that the ECB sells or issues other securities so as not to increase the money supply overall. This should have a positive overall impact on the euro.
- Currently, the cooling economy, more restrictive monetary policy, lower money supply dynamics, base effects and decreasing supply-chain problems in China due to the easing of the Covid measures are having a dampening effect on inflation. Overall, we could therefore see positive surprises in the inflation trend in the coming months.
- The Ukraine war remains a stress factor for financial markets. There is still no sign of an
  easing of the situation. On the contrary, Belarus could intervene in the conflict in the
  foreseeable future, and thus create additional uncertainty.

### Current situation and positioning

- We do not expect a recession for the time being. Current and leading economic indicators such as new orders, consumer spending and the continuing steepness of the yield curve structure are pointing to sufficient economic momentum at present. Moreover, corporate profits are growing robustly, despite the economic slowdown. Even in a mild recession, this should at least provide some support to equity and corporate bond markets.
- In the US, the labour and real estate markets are weakening slightly. However, this does not yet negatively impact the economy to any great extent, but it does dampen inflation and especially inflation expectations. The real estate market has been overheated for some time. But the situation is in no way comparable to the subprime crisis of 2007 and 2008. Today's market structure is more solid and the cooling is healthy.
- Rising interest rates are weighing on goods consumption, but falling inflation rates are easing the burden on consumers, which further dampens the risk of recession.
- Central banks continue to retain control over inflation expectations and thus also in respect of confidence in long-term monetary stability and economic growth.
- The yield curve structure remains the most important and reliable leading indicator. A
  further flattening would be a recession signal, while a steeper curve at the long end would
  constitute a dangerous indicator of rising inflation expectations.
- In the short term, risky assets could recover, as much negativity is priced in (e.g. a mild recession) and hence there is room for positive surprises given partly favourable valuations. Long-term interest rates are likely to consolidate. In the medium term, however, the Fed's balance sheet reduction will remain a negative factor that is underestimated by many market participants. A potential market recovery in the coming weeks therefore remains "a calm before the storm".

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## Topics "on the radar"

#### Chart: Equity markets have already corrected sharply (example EuroStoxx 600)



Source Tradingeconomics

Global stock markets have corrected sharply in recent weeks, with some retreating to their 2016 levels (see chart EuroStoxx 600). This means that a strong technical market support zone has been reached.

However, corporate earnings are much higher today than they were back then. The P/E ratio of the S&P 500 Index is currently a moderate 19, and 13 when excluding technology stocks, which means that a mild recession is already priced in.

Since expectations are thus low and, at the same time, equity market valuations are moderate, a technical recovery is possible in the coming weeks. However, the reduction of the Fed's balance sheet ("quantitative tightening") remains an extremely strong monetary drag, which is likely to lead to a significant lack of oxygen for stock markets from the fourth quarter of this year onwards at the latest.

In the event of a market recovery in the coming weeks, a very similar environment would therefore arise in the US as it did in 1987. Back then, the Fed had raised interest rates significantly from March to October due to high inflation. At the same time, stock markets rose. The resulting monetary tension erupted in a stock market crash, with the Dow Jones plunging 22% on "Black Monday". The Fed reacted with massive liquidity injections and thus prevented further problems. There was also no recession.

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## Summary of FischView model outputs

	US	Europe	Japan	Asia ex- Japan	LatAm	CEEMEA	Key:	
Equities	0	0	0	0	0	0	++	Strong positive
<b>Government Bonds</b>	-	-	-				+	Positive
Credit IG	0	+		0	0 ↓	О	О	Neutral
Credit HY	0	0		0	o <b>↓</b>	0	-	Negative
Convertibles	0	0	0	0				Strong negative
Commodities	Energy	0 1	PrecMet	- 1	InduMet	- 1		

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	<ul> <li>Cyclicals with reasonable valuation and convex CB structure</li> <li>Stocks with positive long term outlook (renewables, cyber security)</li> </ul>	<ul> <li>Weak credit quality &amp; liquidity</li> </ul>
Global IG Corporates	<ul> <li>'A' rating segment, rising stars</li> <li>Banks, DM IG Energy, TMT</li> <li>5-10 year maturities</li> </ul>	<ul> <li>'BBB' rating segment</li> <li>Consumer goods, capital goods</li> <li>Maturities &gt;10 years</li> </ul>
<b>Global Corporates</b>	<ul><li>DM IG, Rising Stars</li><li>TMT</li><li>EUR IG hybrids</li></ul>	<ul><li>Capital goods</li><li>Maturities &gt;10 years</li><li>High yield (particularly EM)</li></ul>
Global High Yield	<ul><li>'B' rating segment</li><li>Telecoms, energy</li><li>Basic industry</li></ul>	<ul><li>Banking</li><li>Transportation</li></ul>
Emerging Markets - Defensive	<ul><li>Indonesia, Brasil</li><li>LatAm</li><li>7-10 year maturities</li></ul>	<ul><li>Asia</li><li>Taiwan, Saudi Arabia</li><li>Maturities &gt;10 years</li></ul>
Emerging Markets - Dynamic / Opportunistic	<ul><li>High yield commodities</li><li>LatAm</li><li>Sub-Sahara Africa</li></ul>	<ul><li>Asia IG</li><li>Bahrain</li><li>Qatar</li></ul>

**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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