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October's topic:
„First cracks in the financial system“

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Risks are accumulating

– Important support factors for the economy and equity markets continue to weaken rapidly.
– At the same time, risks to the markets are mounting, while the majority of investors remain carefree.
– We remain cautiously positioned in this environment and have increased the duration to neutral for hedging reasons.

Overall economic situation

Currently, only 22% of analysts expect a recession in the US, compared to 98% a year ago. At the same time, the US labour market is weakening considerably, government aid programmes are coming to an end (student loan repayments) and the surplus savings accumulated during the pandemic have been used up. This threatens a collapse in consumer spending, the only pillar of growth in the US. Europe is also already close to a recession. At the same time, the restrictive monetary policy is having an increasingly strong effect globally and long-term interest rates continue to rise. The foundations of financial markets are thus beginning to crumble.

Recent developments: First cracks in the financial system

— The US labour market still appears strong on the surface, but is lagging the economy and is therefore not a good leading indicator. However, the Kansas City Fed's Labor Market Conditions Index, which is running reliably ahead, has already been weakening significantly since last November and has meanwhile delivered a recession signal (see chart on page 3). We therefore expect consumer confidence to decline further. However, given that consumer spending is currently the main pillar of the US economy, it will lose this support in the foreseeable future.
— Other important positive factors will also disappear: historically unprecedentedly high surplus savings (mostly from the pandemic aid programmes) have been used up, student loans must be paid off again with immediate effect and the large share buyback programmes on the US stock market have come to an end.
— Monetary policy remains restrictive worldwide. At the same time, government debt is rising, which is draining additional liquidity from markets. The first cracks in the US government bond markets became apparent in the second half of September in the form of interest rates that suddenly shot up and then fell back again. Such events are always the result of massive speculation and a simultaneous outflow of liquidity, and thus a warning signal.

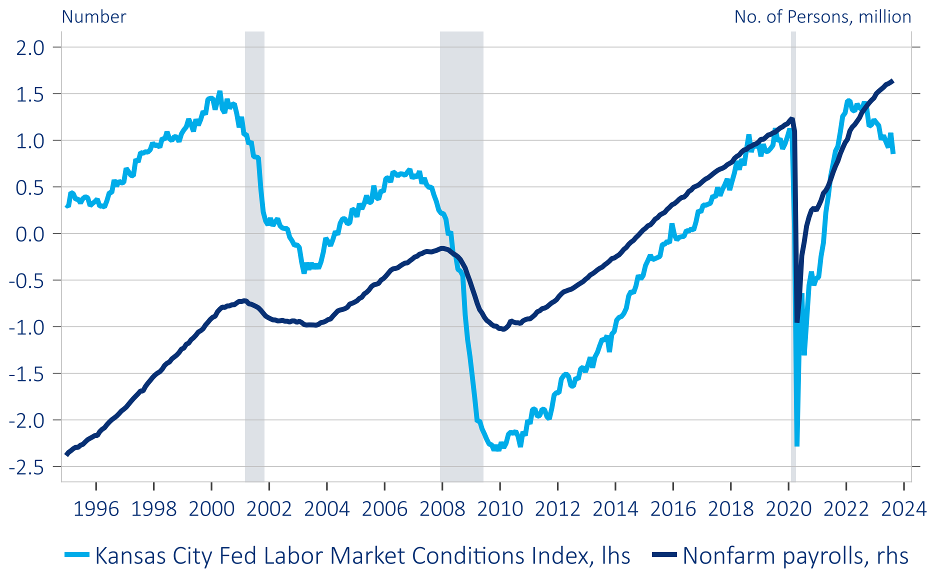
➲ **On the radar:** US households face sharply rising interest burden (page 6)

Overview & outlook: Carefree investors

» Money supply and bank balance sheets are good leading indicators.

- We are currently observing an astonishing lack of concern among analysts and investors. The dangers of a cooling economy and thus lower corporate profits, as well as further increases in long-term interest rates, are mostly ignored, and are not fully priced into the equity and credit markets. The danger of negative surprises is thus growing.
- In addition, money supply continues to fall globally, and US regional banks remain under pressure. The recent sharp rise in long-term government bond yields is causing massive price losses on very large positions here. This is likely to lead to a continuing loss of confidence among customers, combined with a risk of contagion throughout the financial system. Money supply and bank balance sheets have historically always been a good leading indicator for stock markets.
- In this environment, long-term interest rates should fall and thus stabilise the system, but this is not the case due to restrictive monetary policy and excessive government debt. Negative factors and risks are thus accumulating.
- The extent of the negative impact of these factors is still unclear. Overall, however, various indicators provide a clear warning signal. And monetary policy is now starting to have an increasing impact after the usual one-year lag. In addition, risk-free interest rates, which have now risen to 5% (Europe 4%), are a tough competitor for equities and high-yield bonds.

Chart: Leading indicator for US labour market (Kansas City Fed LMCI) weakens



Sources: Federal Reserve Bank of Kansas City, BLS, Macrobond, Fisch Asset Management

Positioning: Continued focus on risks

» We are identifying opportunities in corporate bonds

- As the risk of negative surprises in financial markets remains high, we continue to be defensively positioned overall, especially in our convertible bond strategies. Here, we favour lower equity sensitivity (delta) and higher credit quality compared to the benchmark index. In addition, we are focusing on convex bonds with high asymmetry.
- However, since the inflation trend and inflation expectations are under control overall, despite a temporary delay in the downward trend (due to the absence of base effects, rising energy prices and increasing wage pressure), we expect lower interest rates again in the medium term. This is already creating initial opportunities, especially for corporate bonds issued by interest-sensitive borrowers.
- We are moderately defensively positioned in our high-yield strategies. Due to the high current interest rate and a favourable maturity structure of the market, high-yield bonds offer an attractive risk premium (also compared to equity markets) despite recession risks. In the investment grade as well as the emerging market segment, we are also slightly more defensively positioned than the benchmark, but with a neutral duration. Here, too, the market offers an overall interesting yield and, due to the increased interest rate sensitivity, partial protection against recession risks.
- In the case of long-dated government bonds, we see short-term risks due to rising debt and correspondingly rising interest rates. In the medium term, however, the strongly deflationary monetary policy and a cooling economy should lead to lower interest rates again. In our multi-asset strategies, we are therefore neutrally positioned in terms of duration.

	US	Europe	Japan	Asia ex-Japan	LatAm	CEEMEA
Equities	-	-	+	o	o	o
Government Bonds	- ↓	o	-			
Credit IG	o ↑	o ↑		-	-	-
Credit HY	-	-		o	o	o
Convertibles	-	-	+			

	PrecMet	InduMet	Energy
Commodities	- ↓	-	o

Key:

++	Strong positive
+	Positive
o	Neutral
-	Negative
--	Strong negative

Notes regarding the table: Changes from prior month are indicated with ↓ or ↑. i.e. "O ↓" 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	– Energy – CBs with high convexity – CBs with positive yield	– Utilities, REITS – Unprofitable and expensive technology – Weak credit quality and/or liquidity
Global IG Corporates	– Healthcare, energy – 5-10 year maturities	– Real estate – Maturities >10 years
Global Corporates	– Healthcare, energy – Investment grade – Developed markets	– Real estate, transport – High yield – Emerging markets
Global High Yield	– Capital goods, energy – Basic industry	– Retail – Technology – ‘CCC’ rating segment
Emerging Markets - Defensive	– Middle East – Indonesia, South Korea – Maturities <10 years	– LatAm – China, Hong Kong – Maturities >10 years
Emerging Markets - Dynamic / Opportunistic	– High yield energy, gold miners – LatAm (esp. Mexico and Colombia), Indonesia	– Deeper credit B/CCC segment

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.

On the radar: US households face sharply rising interest burden

The importance of consumption for the US economy is well known, yet investors do not always afford it the attention it deserves. At the same time, there is a lot going on in this area at the moment. It therefore makes sense for us to take a closer look this month at the factors that are likely to influence consumption in the coming months.

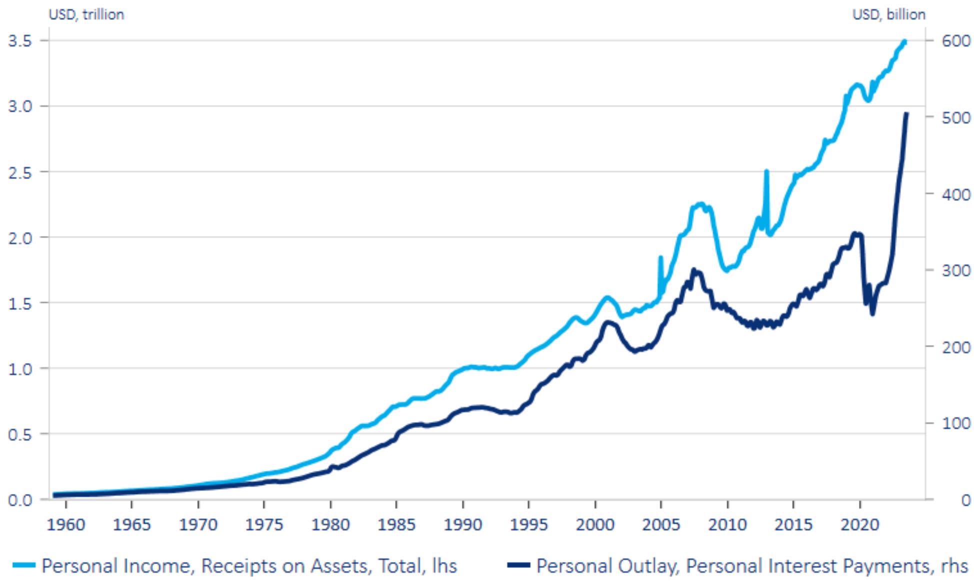
» US consumers are coming under increasing pressure

For example, the restrictive monetary policy and the 18 months of rising key interest rates are having an increasing effect on consumers. The chart accordingly shows a drastic jump in the interest burden on private households in the US. At the same time, the surplus savings from the pandemic aid programmes have now been spent.

This means that an important impulse for private consumption will disappear in the coming months. This is dangerous because the manufacturing sector is already in a downturn. Consumption and services have been the pillars of the economy so far.

As long-term interest rates are rising at the same time (including mortgage rates) and liquidity in the banking system is decreasing, we expect additional pressure on consumers in the coming months. Contributing factors are the continued weakness of the US regional banks, which are likely to practice more restrictive lending, while at the same time raising lending rates. Another warning signal in the US government bond market is the repetition of brief (within a few minutes) jumps in yields followed by a subsequent drop. In the past, such "flash crashes" were always harbingers of a liquidity crisis.

Chart: Interest payments of private US households explode



Sources: BEA, Macrobond, Fisch Asset Management

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