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MARKET INSIGHT

SEPTEMBER 2021

CITYWIRE SWITZERLAND TOP 50 INDEPENDENT ASSET MANAGERS 2021

Market Analysis

September 2021

As quickly as possible, but as slowly as necessary

The question of whether central bankers, and the Fed in particular, would reduce their asset purchases was the subject of much debate on the financial markets throughout August, although this was far from the only phenomenon to challenge investors.

In the end, Jerome Powell's speech at the Jackson Hole Symposium provided the answer investors had been waiting for regarding the Federal Reserve's stance in the months to come.

Following the example of the Swiss politician Alain Berset, the US central bank intends to carry out its tapering process "as quickly as possible, but as slowly as necessary", although this may disappoint those who were hoping it would act as swiftly as it could.

> "The Chinese question is now a source of much debate"
>
> **FRANÇOIS SAVARY,** CHIEF INVESTMENT OFFICER, PRIME PARTNERS

The Fed Chair's choice came as no surprise to us, insofar as it is hard to see why he would risk rushing things at a time when one would have to be naive to ignore the prevailing uncertainties.

First of all, there is the economy, which is showing signs of weakness as the Delta variant continues to spread.

Given this context, it is very difficult to determine how much of the economic inflection is due to a natural tendency for growth to normalise and how much is linked to the latest wave of COVID-19 spreading around the world.

Acting too suddenly on liquidity could therefore prove to be "dangerous" in that business activity levels could take a turn for the worse – something that is by no means desirable.

For several months now we have been arguing that global growth will return to normal gradually and slowly over the next few quarters.

We still do not believe that the current wave of the pandemic is likely to send the economy off the course we foresee, in part because governments are expected to balk at implementing drastic lockdown measures; the European and US governments continue to focus the fight to control the current pandemic on their vaccination strategy. This means that the types of measure applied in the first waves of COVID-19 would only swell the ranks of antivax protesters, and assuredly raise questions about the financial costs of such an option.

The Chinese question – because we now have to refer to it in these terms – is another source of much head-scratching.

For some months now we have been witnessing what looks quite simply like the Communist Party speedily regaining control of Chinese society. Xi Jinping is increasingly asserting himself as the new "Red Emperor" and there are some who no longer hesitate in comparing him to Mao! The return to (communist) orthodoxy can now be seen in all its forms: political, economic, financial and above all, ideological. Under the pretext of discourse on equality and difference, there lurks the distinct threat of totalitarianism, according to some.

Imagining China barricading itself against external influences is no longer a flight of fancy, even though the last twenty years have led to its integration in global economic and financial flows.

The consequences of such a phenomenon for both the Chinese and world economy are difficult to appreciate; in other words, they may give ample cause for concern in the years to come.

We must face facts: it is unrealistic to believe that the events of recent months, imposing

regulations and asserting an ideology of "power", will be challenged any time soon.

Some people believe that the election of a new Politburo Standing Committee in 2022 is what is motivating the actions of Xi Jinping, who is eager to surround himself with as many like-minded members as possible ahead of this process.

This theory has as much to recommend it as any other, but should certainly be viewed in a wider context: the will to assert Chinese power over the forthcoming years.

What will this mean for economic growth? This is a question we need to bear in mind for the medium term. Was Jerome Powell taking this into account when seeking to "postpone" the reduction in the Fed's asset purchases? There is nothing to confirm this, although nobody can overlook the fact that reduced growth in China in the short term is likely to hamper the global cycle or even increase inflationary pressures over the next few quarters.

Against this backdrop, we feel comfortable with our recent choice to sell our investment in Chinese equities, given the lack of clarity as to the situation there at present.

Similarly, we decided to divest from Japanese stocks in August; this choice was prompted by the government's difficulties in managing the COVID-19 epidemic and an economic outlook hampered by weaker-than-expected global growth resulting from developments in China. However, we have not reduced our exposure to equities, as we reinvested the proceeds of this sale in the US and European stock markets.

Granted, valuations are higher in Europe and higher still in the United States. And yet we view economic and earnings prospects as more favourable and at least clearer over the six- and twelve-month horizons.

In general, we continue to favour equities over bonds in a diversified allocation and with a European bias in our regional stock market selection.

In the same vein, we are maintaining relatively balanced sectoral exposure, although we must admit that the more cyclical market listings have proved disappointing over the last few quarters. Finally, it is important to remember that we are not overexposed to the stock markets in what is proving to be a very positive year for equities.

We have certainly erred on the side of caution in recent months while waiting for a market consolidation to increase our equity exposure.

We are well aware of this, but it is water under the bridge. Still, we do not find it warranted to use up all our ammunition on the stock markets at present. We therefore feel that our neutral weighting is appropriate, as is our distinct underexposure to unattractive government debt, especially if inflation turns out to be less transitory than expected.

In short, our overall allocation has changed little in recent weeks in the face of the developments discussed above; nevertheless, certain key details have been changed (Chinese and Japanese equities, increase in high yield short-maturity debt, strengthening of passive investments at the expense of their active counterparts).

We are maintaining a cash component so as to seize any opportunities on the stock markets while our bond allocation remains largely focused on high yield debt.

In conclusion, doubts about the conduct of monetary policies have certainly been an important factor for investors in recent weeks although, in the end, the decisions announced have failed to produce a significant impact.

Jerome Powell certainly managed to say the right things to reassure market participants. Not taking a decision is sometimes a perfectly valid option, especially when the situation is uncertain.

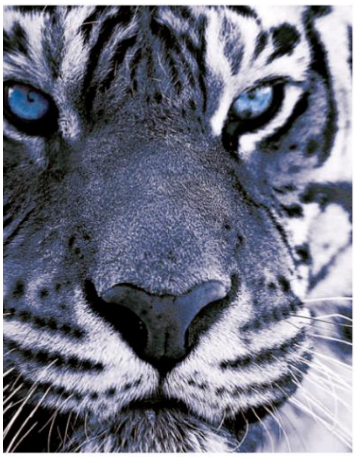
It is true that the next few months should give us a better idea of what the future holds for the global economy, as regards both growth and inflation.

In the current situation, developments in China should not be swept under the carpet, because like it or not, what is taking shape in Beijing is unlikely to strengthen the outlook for the global economy. In turn, is it liable to change our central thesis on the global economy for the next twelve months? We do not believe so, although we remain vigilant in this regard; we have to consider the risk of a sharper-than-expected economic slowdown when managing our asset allocation.

When it comes to economic forecasts and/or asset allocation, Alain Berset's famous formula could serve as good advice. This does not mean that inaction should prevail; on the contrary, adaptation is still of paramount importance, like

the adjustments made in recent weeks to our investment policy.

Geneva, 31 August 2021



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