Prime Partners

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MARKET INSIGHT

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CITYWIRE SWITZERLAND TOP 50 INDEPENDENT ASSET MANAGERS 2021

Market Analysis

Under the influence of a good earnings season

For the financial markets, and particularly the stock markets, October could not have been more different from the preceding month.

After the return from the summer break, investors had their doubts about the economic and financial outlook. Heightened fears of stagflation in the economy saw a sell-off in equities in September (-4.6% for the S&P 500).

However, the last few weeks have seen a return to optimism thanks to solid corporate results, particularly in the US and Europe. In this context, New York's flagship index, the S&P 500, returned 7%, a monthly gain not seen since November 2020, when the COVID-19 vaccines were announced.

On the other hand, several factors justify the view that a slowdown in price increases is possible in early 2022. Firstly, a change in monetary policy should be confirmed at the Federal Reserve's November meeting; secondly, the Biden administration's fiscal stimulus plan will be on a much smaller scale than initially envisaged (USD 1.75 trillion instead of USD 3.5 trillion), which should limit the risk of lasting inflation; lastly, while wages are clearly on the rise, it should be borne in mind that labour markets have not yet returned to normal and that productivity gains may at least partly offset wage rises.

In a nutshell, it seems difficult to argue that the economic data is responsible for the return to optimism in the financial markets.

"Periods of monetary policy change are often more complicated for equity markets."

FRANÇOIS SAVARY, CHIEF INVESTMENT OFFICER, PRIME PARTNERS

However, on the economic front, nothing changed greatly in October, meaning a (logical) slowdown in growth and insufficient control of inflationary pressures in the short term are still on the cards.

Despite this, market participants have taken some comfort from the fact that recent economic surprises – particularly in the US – have been favourable, paving the way for continued satisfactory growth over the next six to 12 months.

We are pleased to see that investors have adopted a more "reasonable" outlook for medium-term activity and we still believe that growth will slowly return to quite satisfactory levels over the coming quarters.

The situation is less certain on the inflation front, where the sharp rises of the last few months remain a major cause for concern. The past few weeks have not improved visibility in this regard, with bottlenecks in the supply chains of raw materials and other components of final products still significant.

The boost to the stock markets did not come from interest rates either; with 10-year USD bond yields at almost 1.70% in recent weeks, pressures on the long-term cost of capital instead proved to be a drag on equities in October. In addition, the month ended with a strong rebound in 2-year yields, signalling that investors are increasingly convinced the Fed will be forced to make several rate hikes in 2022. In other words, the above would suggest an outlook for stocks that is far from positive.

On this basis, there's no denying it: the new lease of life enjoyed by equities is due to the strong corporate results in Q3 2021, even if the earnings season has not yet drawn to a close.

Although general forecasts on this front had been revised downwards beforehand, the figures posted for both sales and margins have allayed fears of a marked decline in profitability

It should be noted, however, that while some indices (S&P 500) broke all-time

records, performance was not uniform across and within sectors.

Generally speaking, the recent stock market surge has been part of the more general trend in 2021 of strong sector rotation and differentiation in the performance of individual stocks.

As regards our investment strategy, no major changes were made. We continue to prefer equities to bonds, particularly government bonds.

The increased positioning in equities from the end of September proved to be judicious, especially since financial stocks continued to rise on the back of strong results and interest rate conditions more favourable to them.

Despite stocks being pricey, bonds and cash are clearly not very attractive alternatives in the current environment.

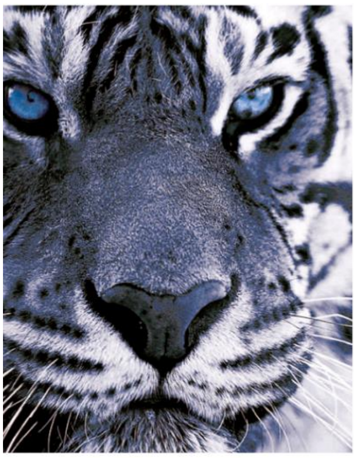
In this regard, since the Fed is likely to be cautious and pragmatic when tapering, the risk of a massive and rapid reduction in liquidity – used by some to justify a cautious stock market outlook for the next six to twelve months – should not be overdone.

The combination of sufficient liquidity, despite the gradual reduction, and a solid earnings outlook (EPS growth of 7%–10% in 2022) could well offset the adverse effects of upward pressures on long-term rates over the coming quarters. At the same time, we still do not see the conditions for a return to positive real interest rates being in place in the next 15 months.

Periods of monetary policy change are often more complicated for equity markets. More volatility in the latter's performance is therefore to be expected in the coming quarters. However, this does not mean that equities cannot perform well in 2022 let alone that a negative performance is on the cards.

Admittedly, any increases are likely to be much more moderate than those achieved so far in 2021, but economic developments that reduce fears of stagflation should leave room for progress in the main indices. Moreover, we still believe that a correction is unlikely, provided that there is a gradual economic deceleration and a reasonable normalisation of monetary policies in 2022.

Geneva, 5th November 2021



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