Prime Partners

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MARKET INSIGHT

SEPTEMBER 2022

CITYWIRE SWITZERLAND TOP50 INDEPENDENT ASSET MANAGERS 2022

Market Analysis

September 2022

Feeling the effects of another shift in investor psychology

We have grown accustomed to swift and substantial changes in investor sentiment over the past nine months, both on the economic front and with respect to financial markets.

August was no exception in this regard; after July's euphoric atmosphere, doubts gradually wormed their way into operators' minds in the weeks that followed, building to outright concern in the wake of Jerome Powell's speech to the world's leading central bankers at Jackson Hole.

It is clear that the Chair of the US Federal Reserve extinguished all hope of an abrupt change in monetary policy direction under his leadership.

determination to bring inflation in the United States back under control as quickly as possible.

It is easy to see why these developments did nothing to improve visibility as regards the economic cycle in the medium term, thereby facilitating a sharp resurgence in volatility on the financial markets in the second half of the month. The complacency that took hold in July left little room for the slightest bad news.

The conditions were already right for volatility to set in, given erratic movements in energy prices – for oil and natural gas in particular – and multiple sources of geopolitical tension.

> "The Chair of the Federal Reserve extinguished all hope of an abrupt change in monetary policy direction."
>
> **FRANÇOIS SAVARY,** CHIEF INVESTMENT OFFICER, PRIME PARTNERS

In so doing, he only strengthened our view that investors had become too optimistic in this regard in July, given that economic data in no way justified such expectations.

Clear trends for the economic outlook remain hard to discern; for example, inflation figures are still soaring despite a dip, whereas employment figures seem to suggest that the economy is booming.

Jerome Powell wasted no time in nailing his colours to the mast, however, stressing his determination to stop compromising on monetary policy and stating that his priority was to curb demand, at the risk of making a major economic downturn in the United States more likely.

In short, it was definitely not a speech written to please the financial markets. In fact, it should be understood as a concerted effort to halt the easing of financial conditions seen in recent months, which could jeopardise the work the Fed is doing in its (increasingly strong)

We are holding fast to our scenario of a probable normalisation in inflation over the coming quarters, although we do not think that bringing it back to 2% in developed economies by the end of 2023 is realistic. For that matter, the question of inflation is and will remain central to economic and financial developments over the next few months.

Only normalisation and a lasting stabilisation of rising prices will allow for the right level of real interest rates to be determined, and these will affect the economic outlook and reasonable expectations as regards returns on financial assets. Such a process is sure to prove long and erratic.

In this respect, it is obvious that if a reduction in price pressures is to be achieved through demand destruction, the latter must not get out of hand if we hope to avoid a major global recession with unknown economic and financial consequences. Strong statements from central bankers are welcome, as they demonstrate a clear intention to regain

the credibility that has been lost over the last 18 months, but that does not mean that their work is now easy – far from it!

In fact, we believe that we have entered the most turbulent phase of monetary policy adjustment, where decisions taken today must be based on an unavoidably patchy understanding of the consequences recent rate rises will have on the economic outlook in the near future. The major central bankers are walking a tightrope and the odds are that investors will remain highly responsive to monetary policy statements and decisions made over the coming months. This is likely to fuel ongoing market volatility.

In light of what we viewed as overly optimistic expectations on the question of a possible pivot in US monetary policy, continued progression on the stock market early in the month, and an excessive drop in equity volatility given the various sources of uncertainty outlined above, we decided to adjust our investment policy.

We therefore reduced our equity exposure in two phases, given that the markets seemed to be rising too fast and because the upside potential we expected by year end appeared to have been achieved toward the end of the recent rally.

Hence, having held our equity positions during the difficult period between April and June, and maintained a neutral weighting, we adopted a more cautious stance in August.

We are now underweight on international equities. Moreover, we have strengthened our US exposure at the expense of Europe and emerging markets.

The reduction in our stock market positions in recent weeks swelled the cash component, which is overweighted in our investment policies.

We also strengthened our bond positions in light of renewed pressure on interest rates in August. We therefore reinforced the existing bias towards the front end of the yield curve; similarly, with a view to rigorous management of bond portfolio risk, our recent purchases favoured government bonds and higher-quality corporate bonds.

To conclude, we spent several months arguing that it was too late to divest from risky assets in light of the panic that seemed to have taken hold of investors, especially in June, taking stock market prices to levels we viewed as incorrect.

The sharp equity rally that began in July gave us an opportunity to scale down to levels more in line with our assessment of the fundamentals.

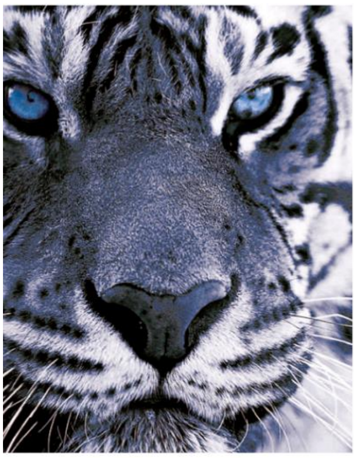
We still believe that it is extremely difficult to gain a clear picture of the outlook for the economic cycle, owing to the many sources of uncertainty (political, economic or geostrategic) we face and which make the current period so unusual.

We will continue to keep a close watch over developments every day and will not hesitate to take action where necessary.

In this regard, several key events are already in the calendar for September (US employment statistics, consumer price indices in developed countries, and decisions by the ECB and the Fed).

All of this comes as market operators return to the office, after a summer break that did everyone a world of good, ready to confront the market twists and turns that have already proven so plentiful in 2022.

Geneva, 31 August 2022



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