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SWITZERLAND TOP50 INDEPENDENT ASSET MANAGERS 2022

Quarterly Pulse – Friday, 1st July 2022

Economic Outlook

With inflation beating the target levels, central banks continuing to tighten their policies, remaining supply-chain interruptions, and the geopolitical uncertainty, recession worries are coming to the forefront of investors' concerns. Markets have been extremely challenging this year: equity prices have suffered a hit from the worrying growth outlook, while bonds have failed to provide the safety net, being unattractive in the elevated-inflation environment. So what is next in store for investors?

Tactical Asset Allocation

Liquidity	Neutral
Rates	Neutral
Credit	Neutral
Equities	Overweight
Alternative Investments	Neutral

Macroeconomics

The May reading of the US year-on-year CPI growth was 8.6%, surprising investors to the upside and rising above the April reading of 8.3%. At the same time, in May, for the third month in a row, unemployment was 3.6%. This is just 0.1 p.p. above the February 2020 level. US labour force participation in May was at 62.3%, 1.1 p.p. below the pre-pandemic level. However, job openings in April, while lower than the all-time high in March 2022, were still more than 1.5 times the pre-pandemic figures. All this points to how tight the US labour market is, which increases the risk of an inflation spiral, as employers, struggling to hire workers, are forced to increase wages.

To counteract the rapidly rising prices, the US Fed raised the target federal funds rate by 75 b.p. (instead of the earlier expected 50 b.p.) at the June meeting, to bring it up to 1.50%-1.75%. Additionally, in May, the Fed has begun reducing their balance sheet by significantly limiting reinvestments of principal repayments in their portfolio. Fed Chairman Jerome Powell noted that aggregate demand is strong, while supply constraints drag on, contributing to price pressures. In multiple speeches, he emphasized the Fed's commitment to bringing inflation down to the 2% average.

The Fed's overseas counterpart, the ECB appears increasingly concerned about inflation too. The estimate of the June year-on-year EU CPI growth is expected to have increased to 8.5% from the already record-breaking May reading of 8.1%. Attempting to cool down prices, the ECB has concluded its net asset purchases in the end of June and is set on starting to raise policy rates at the July meeting - all in line with the earlier expectations. The ECB deposit facility rate is forecast to turn positive already in September, for the first time since 2012.

It is no wonder that in light of such a steadfast monetary policy response, the word "recession" is coming out to the foreground of investors' concerns. The June reading of the Conference Board Consumer Confidence index in the US fell for the second consecutive month and surprised to the downside: 98.7 instead of the expected 100.4. Moreover, the downward revision of the Q1 US real GDP growth (from -1.5% to -1.6%) has added fire to the recession fears. Jerome Powell claimed that a recession could be avoided, but he emphasized that it is "certainly a possibility" and made it clear that price stability currently takes priority over the labour market and growth.

The economic situation in Europe looks more fragile than in the US. While, in the EU, just as in the US, inflation is getting dangerously high and the labour markets are rather tight, the region has been hit much harder by the energy crisis because of its reliance on Russian oil and natural gas. Thus, overtightening might have greater ramifications in Europe. On a positive note, the EU might not need to tighten the policy rates as much as the US. According to the Bloomberg analysis, energy and food prices account for over three quarters of inflation in the EU - the ECB has no control over these prices, but they might start to stabilize on their own without further shocks. At the same time, services account for a much smaller share of inflation in the EU than in the US, where the services component of inflation is almost as large as the energy component and accounts for around one third of price growth rate. This reflects the extend of the labour market tightness in the US. Thus, unlike the ECB, the Fed is poised to raise rates to "restrictive" levels, to quote Powell. In other words, the policy rates are to be raised high enough to slow down the economic growth in the US, while in the EU they might not even need to get out of the accommodative territory.

Fixed Income

Fixed Income markets remain challenging with the Fed and other central banks forced to hike rates further and faster in order to tame inflation. The latest 75 bps hike was the biggest rate increase in 28 years, and more is yet to come.

Although the speed and scale of the tightening increased the risk of a hard landing or a recession, the Fed made it clear to

focus only on the inflation aspect of their mandate as the labour market is strong enough.

After unexpectedly accelerating to a fresh 40-year high in May, US CPI growth is seen slowing, with a Bloomberg survey of economists predicting 6.5% in Q4 and 3.5% by the middle of next year. So far they have been wrong. Therefore investors need to have evidence that inflation gets under control. Without that proof, rates markets will remain volatile and under pressure. For the moment, we can't see any light at the end of the tunnel. Although a lot is already priced in with the 2-10yr curve pretty flat, we think it is too early to step into the long end. This applies to all G7 nations as the fight against inflation is a global problem, except Japan.

Unfortunately, credit markets don't look better. Recession fears are taking over, with investors adjusting their allocations to the cycle. New issue activity in the HY bond market is down 73% year over year and HY mutual funds and ETF's are facing sustained outflows every month as part of a broader rotation away from riskier assets.

Default rates are expected to rise due to higher input costs and higher interest expense, although this will take some time. Index spreads tend to anticipate broader default cycles by 8-10 month, a dynamic that would make for increased defaults beginning in 4Q and accelerating in 2023, according to Bloomberg.

All this uncertainty in rates and credit has resulted in the largest draw down in US bond market history. For the moment, we can't find any catalyst to change this situation, except a lower inflation.

Although we think that a lot is already priced in at current levels, we would be careful to add risk. For new investments we feel more comfortable to extend duration a bit, but would not go longer than 5-6 years in good quality names. It's too early to call it a bottom.

For non-investment grade credits we choose even shorter maturities with a pull-to-par feature. HY bond spreads of 560 bps are now in line with the long-term non-recessionary average but are expected to widen further in a recession (970 bp average in a recession).

Overall, the outlook remains dim, with inflation being the key for rates and recession-probability for credit. A reactivated New Issue business and Fund inflows will be good indicators that the current trend is changing.

Equities

The sharp YTD sell-off in stocks has been led by declining valuations rather than a shift in earnings expectations. Multiples on developed market stocks have slipped from close to 20x in 12-month forward earnings at the start of the year, to around 15x at the end of May. Over the same period, earnings growth expectations for this year have actually been upgraded, from 7% to more than 10%, despite the deterioration in the economic outlook. But we understand that there is a risk that earnings growth disappointment could drive equities another leg lower.

However, history shows that temporary disconnects between economic growth and earnings growth are not uncommon. Earnings growth continued to accelerate as the economy slowed in the recoveries that that followed both the Dotcom bust and the GFC, although this trend only persisted for a matter of months.

Some signs indicate that earnings expectations may be approaching a peak (see Figure 1). Earnings revisions ratios tend to give a good steer on the direction of earning ahead. These ratios have been declining lately, implying a larger number of downgrades than upgrades. The rotation away from pandemic trend was clear in Q1 earnings, with several of the Covid-19-Winners now reporting weakening demand as consumers shift back toward their old ways.

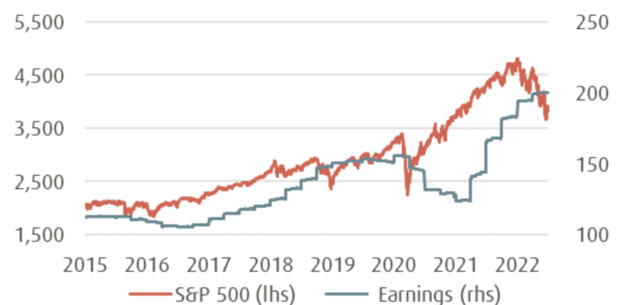

Figure 1: Earnings Expectations May Be Approaching a Peak. Source: Clarus Capital, Bloomberg

In the end, while earnings expectations always take some time to reflect the evolution of the economy, the lag is, perhaps, more understandable this year given the unique circumstances of this recovery. We may see some downgrades ahead, but market moves are already consistent with a modest slowdown in profits. Looking at our base scenario, we think that corporate earnings across DM should keep growing this year, albeit by less than current expectations. Additionally, macro momentum in the U.S. should help risk appetite to return which suggests an upside potential in the near term. Hence, we continue to have an overweight stance in the equities but are on alert for the forthcoming CPI data and FOMC meeting.

Equity Indicators

Valuation	Attractive
Momentum	Neutral
Seasonality	Negative
Macro-Economics	Neutral

Within the current environment, we seek companies with resilient business models, present-day cash flows and growing dividends. These companies can be found across the market. Yet there are some sectors that are more vulnerable in this changing economic environment, and others where we see a greater prospect of earnings strength. And finally, speaking of country exposure, we prefer U.S. over Europe despite the higher valuation, as the growth engine appears solid.

Alternative Investments

Commodities suffered in the second quarter from the lower economic growth. Energy still profited from the ongoing Ukraine/Russia conflict, whereas metals, especially industrial metals, corrected significantly due to the lockdowns in China. Tin has been the worst performer, plummeting 39%, while aluminum is down by around a third and copper has fallen by about a fifth. In the third quarter, demand for industrial metals might reverse as most of the inventories are at historic lows especially for cooper and nickel.

Gold headed for a third straight monthly decline as investors weighed rising interest rates against recession fears. Currently, it seems that the forces driving gold up, such as geopolitical turmoil and Russian gold import ban, are battling with the negative ones, such as higher real yields, and the price development continues to be stable.

Geopolitical uncertainty and ongoing inflation surprises have supported both demand and the price of gold in the first months of this year. According to World Gold Council figures, gold demand in Q1 2022 increased by around one-third year-on-year. While physical demand from the jewelry industry was restrained in view of higher prices, investment demand increased significantly. Gold ETF holdings at the beginning of June are around 7% higher than at the start of the year, although investor interest has declined somewhat since the end of April.

Overall, however, the fundamental drivers have not developed in favor of gold since the beginning of the year. Due to the strong monetary policy reversal by the U.S. FED, the opportunity cost of gold, as measured by yields on inflation-protected U.S. government bonds, has risen by more than one percentage point. In a historical context, this would have been accompanied by a double-digit percentage correction in the price of gold. In addition, the USD has appreciated since the beginning of the year, which is also a burden. Finally, at least in the realized figures for overall inflation, the peak has probably been reached eventually. Up to now, gold was able to largely escape the emerging headwind. All in all, however, there is downside potential from a fundamental perspective, should the Ukraine war move even further into the background on the financial markets and the fundamental data return to the focus of investors.

Investors are broadly bullish on the yellow metal, forecasting it to finish the year at USD 1’866, a slight increase from current prices. On a technical basis, gold also looks poised to break higher as its commodity peers revert toward their historic mean, according to Bloomberg Intelligence.

However, we think that recession fears or a confirmation of a recession may lead to a reversal of the FED tightening cycle at some point and lower real rates. Hence, we think that we soon may see have a bottom around the USD 1780-1800 per oz.

In the long term, tight supply remains the most important driver of the gold price. As in the past, the precious metal is likely to compensate for accumulated inflation in the future. Assuming that the financial markets are right and the current US inflation expectations of 2.5% to 3% annually over the next ten years prove to be correct, this implies an increase potential of around 30%.

Commodities in general continue to be attractive, when taking into consideration that most of the commodity curves are in backwardation and therefore yielding significantly positive.

Hedge Funds lost 3.5% within the quarter. Systematic strategies, commodity, CTA and macro strategies returned positively, whereas the convergent strategies performed negatively with Relative Value Arbitrage and Convertible Arbitrage at the bottom with more than 5 to 8% losses. Taken into account the still high management fee, low liquidity and low transparency, we focus on implementing hedge fund strategies either directly or not to enter them. The only strategies where investors have a clear view are CTA strategies. However, we think it is not the time to invest into CTA strategies. Volatility saw another spike within the last three months. The spot VIX index jumped by 50% to 28, the investable strategies such as the mid-term only increased by 14%. The short-term investable ETN even performed negatively by 7% indicating how difficult it is to take advantage from the negative correlation between equities and volatility. The main reason behind this price development is the steep VIX future curve currently loosing between 3 to

10% per month. Volatility investments should only be considered when actively traded but never as buy and hold.

Private Markets might not be able to mitigate the risk off environment we are in. Especially the IT sector has seen a hit and also significantly less investments into Venture Capital due to the IT stock market meltdown. Also for Private debt it seems that the private offering is now more attractive than the banks' conditions. Key questions here are: do we end up in a recession and when is the IPO window open again? Most private debt funds are concentrating on SME companies and a recession could hurt their non-performing-loan rate. The losses of our diversified private markets instruments add up to 1% for the first five months of this year. We expect them to lag the public markets and therefore might see more corrections. However, we consider the private markets the most interesting sub asset class in the Alternative Investment space.

In the currency space, the USD and US yields both lost ground. The drop in the greenback and US yields occurred despite a hawkish tone from FED's Powell at his testimony to the US Senate, where he reiterated a tightening bias aimed at taming inflation but conceded that achieving a soft landing looks very challenging. This price action suggests that the USD may struggle to derive support solely from hawkish FED rhetoric, with market focus having shifted to a deterioration in US growth dynamics and the associated risk of a US recession.

After a strong start to the week, risk sentiment in EURUSD turned gloomy in what could be confirmation of a bear market rally. The single currency is struggling accordingly, and momentum has turned 180 degrees from earlier in the week, when EURUSD failed again to break above 1.06. However, the 1.0350 looks like a solid bottom and we suggest to buy the dip below 1.04 for a bounce.

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Market Overview as of Friday, 1 July 2022, 2:26 PM

Fixed Income

	Rate	Δ 1m	Δ 3m	Δ ytd
USD Overnight	1.57	0.74	1.24	1.51
USD 1y Swap	3.23	0.54	1.20	2.70
USD 3y Swap	3.03	-0.02	0.21	1.86
USD 5y Swap	2.96	-0.03	0.31	1.59
USD 10y Swap	3.02	0.01	0.54	1.44
EUR Overnight	-0.51	-0.02	-0.01	-0.01
EUR 1y Swap	0.80	0.27	0.86	1.28
EUR 3y Swap	1.48	0.09	0.65	1.63
EUR 5y Swap	1.73	0.12	0.70	1.72
EUR 10y Swap	2.15	0.23	0.93	1.85
CDX Xover 5y	5.78%	1.12%	2.04%	2.85%
iTraxx Xover 5y	5.77%	1.33%	2.40%	3.35%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
USD Deposit 1m	0.2%	0.5%	0.9%	0.9%
USD Aggregate 1-3y	-0.5%	-0.4%	-3.1%	-3.1%
USD Aggregate 3-5y	-0.6%	-1.5%	-6.3%	-6.3%
USD Aggregate 5-7y	-0.9%	-2.8%	-8.3%	-8.3%
USD Aggregate 7-10y	-1.4%	-5.0%	-11.7%	-11.7%
EUR Overnight	0.0%	-0.1%	-0.3%	-0.3%
EUR Aggregate 1-3y	-0.6%	-1.6%	-2.9%	-2.9%
EUR Aggregate 3-5y	-1.3%	-3.4%	-7.0%	-7.0%
EUR Aggregate 5-7y	-1.9%	-5.3%	-10.4%	-10.4%
EUR Aggregate 7-10y	-2.5%	-7.8%	-14.1%	-14.1%
US Corp. HY	-6.7%	-9.7%	-14.2%	-14.2%
EUR HY	-6.1%	-9.7%	-13.4%	-13.4%

Equity

	Price	P/E	D. Yield	FCF yield
MSCI World	7'755	14.9	2.3%	6.6%
S&P 500	3'785	16.6	1.7%	4.8%
NASDAQ	11'504	20.7	1.0%	4.0%
Euro Stoxx 50	3'438	10.9	3.8%	14.7%
SMI	10'679	15.9	3.2%	13.5%
FTSE 100	7'147	9.9	4.4%	14.2%
DAX	12'752	10.4	3.8%	10.3%
MSCI Asia Pacific	158	12.5	3.0%	7.3%
FTSE China A50	14'894	13.3	2.5%	6.7%
MSCI Emerging Market	1'001	11.4	3.3%	8.0%
PH Semiconductor	2'556	13.9	1.6%	4.8%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
MSCI World	-8.0%	-16.3%	-20.5%	-20.5%
S&P 500	-7.7%	-16.7%	-20.6%	-20.6%
NASDAQ	-8.3%	-22.6%	-29.5%	-29.5%
Euro Stoxx 50	-8.5%	-12.2%	-20.0%	-20.0%
SMI	-7.1%	-12.3%	-17.0%	-17.1%
FTSE 100	-5.1%	-5.1%	-3.2%	-3.2%
DAX	-11.0%	-11.7%	-19.7%	-19.7%
MSCI Asia Pacific	-6.6%	-12.1%	-18.2%	-18.2%
FTSE China A50	10.2%	6.3%	-4.9%	-5.1%
MSCI Emerging Market	-6.3%	-12.7%	-18.8%	-18.8%
PH Semiconductor	-16.2%	-24.1%	-35.2%	-35.2%

Commodity

	Price	FCST 21	FCST 22	Δ Future
Gold	1'789	1798	1892.5	0.2%
Silver	19.54	25.1	23.72	0.8%
Platinum	862	1091	1051	1.0%
Palladium	1'875	2410	2326	2.3%
Crude Oil	108.64	68.12	97.5	0.8%
Brent Oil	112.10	70.95	99.75	-1.1%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
Gold	-3.0%	-6.8%	-2.2%	-2.2%
Silver	-11.1%	-21.1%	-16.6%	-16.7%
Platinum	-14.0%	-13.2%	-11.4%	-11.0%
Palladium	-6.0%	-17.0%	-2.0%	-2.4%
Crude Oil	-3.5%	13.9%	50.7%	50.5%
Brent Oil	-1.2%	11.9%	50.0%	49.9%

Foreign Exchange

	Price	FCST 21	FCST 22	Δ Spot
EUR/USD	1.0437	1.14	1.08	3.4%
GBP/USD	1.2043	1.35	1.24	2.9%
USD/CHF	0.9609	0.93	0.97	0.9%
USD/JPY	135.24	114	130	-4.0%
EUR/CHF	1.0029	1.06	1.03	2.7%
USD/RUB	118.69	71.19	69.44	-53.6%
EUR/RUB	57.45	80.7	77	29.3%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
EUR/USD	-2.1%	-5.6%	-7.7%	-8.2%
GBP/USD	-3.7%	-8.3%	-10.8%	-11.0%
USD/CHF	0.2%	-3.7%	-4.4%	-5.0%
USD/JPY	-3.7%	-9.3%	-14.6%	-14.9%
EUR/CHF	2.4%	2.1%	3.6%	3.4%
USD/RUB	-36.8%	-38.2%	-38.3%	-37.1%
EUR/RUB	17.7%	66.1%	46.7%	48.8%

Source: Clarus Capital Group, Bloomberg

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