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Investment Policy Q2/2023

English version

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WHEN UNCERTAINTY RULES

Investment Policy

In light of the many factors of uncertainty that the scenario presents, even investment policy requires not only caution, but a defensive approach that allows one to take advantage of opportunities while limiting risks as much as possible. Globalization "rethought" with the creation of blocs on a geopolitical and ideological basis, sanctions and countermeasures more and more frequent, raw materials used in the form of strategic pressure, "green" transition programms to be financed and realizied among many difficulties, central banks torn between combating inflation and the danger of a recession, the increasingly decisive role of China and still threatening geopolitical conditions.

After a disastrous 2022 for the bond market, which was also negative for equities and saw commodities as the only winners, the investment portfolio can now look to a more traditional composition in terms of diversification among different asset classes. Fixed income provides attractive returns, although the equity component cannot be neglected for its medium-long term contributions. Liquidity, in the form of monetary instruments, also finds a return, while, if anything, doubts remain on the side of currency diversification, in light of a possible weakening of the U.S. dollar.

Outlook

The market is discounting a retreat in inflation and the approaching end for the central banks' restrictive maneuvers, with a "pause" by the U.S. Federal Reserve (FED) before major cuts, while the European Central Bank (ECB) and the SNB are expected to increase rates further, due to their lag in their monetary policy cycle compared to the counterpart across the Atlantic. Determining the occurrence of these expectations will be the upcoming data (GDP, labor market, insolvencies), private and public debt trends, the latter whose ceiling in Washington is struggling to be agreed upon, and the situation of the U.S. banking sector, subject to increasing turbulence.

Macro

Growth, according to the forecasts of various institutions, starting with the International Monetary Fund, appears destined for a global slowdown, with outcomes that may range from a mild contraction to a full-blown recession during 2024, up to a condition of stagflation should inflation remain at high levels and force Western central banks to revise their targets (in any case, not very credible as they are set at 2%), and even to prepare new forms of support (QE), however particularly challenging given the high rate scenario.

China's post-Covid recovery is confirmed, albeit at lower than historical levels but, in this case, Beijing's forecast may be deliberately cautious in order to positively surprise markets at the 2023/2024 turnaround.

Europe has shown good resilience to headwinds in recent months, but institutional tensions remain, exacerbated by the Russian-Ukrainian crisis that appears far from a solution.

Fixed Income

It has been mentioned how the ECB appears intent on still maintaining its restrictive strategy, mediating the pressures of the northern European "hawks" with those of the southern partners, ready to possibly intervene with new support instruments, also because the level of rates makes it costly for issuers to service their debt.

In the U.S. already for many months the yield curve appears with an inverted shape, already discounting future cuts by the FED ("seen" at a maximum of 5.25%) but also anticipating a possible recession, considering also a still problematic inflation, since the "core" is still at too high levels.

In the euro area, spreads remain high in the banking sector following the US crisis, and yields on the 2-3 years appear attractive.

In high-yield segments, caution is neeed because default rates might pick-up due to rate dynamics.

The Swiss National Bank (SNB), despite low inflation due to the strength of the franc, may maintain a restrictive strategy) so the purchase of long bonds seems at the moment to be still premature.

Equity Markets

For European stock markets, which are cheaper than those in the U.S. (average PE of 12 versus Wall Street's 18), the relatively positive trend continues, thanks to falling energy prices and the reopening of China. The luxury goods sector, which led the French CAC40 to new all-time highs, and the retail sector stood out. Less well for the automotive sector, which fell victim to uncertainties surrounding the Brussels road map for green transion and imbalances in the raw materials needed for that process.

In the U.S., the spotlight shifts to corporate earnings seen on average down 10%; while still perceived with a positive underlying tone, some volatility can be expected.

In Zurich, in light of the many uncertainties, the dominant sector is defensive (and dividend-paying) stocks, for example in food and pharma, while interest in industrials is back after the correction.

The Japanese market has been neglected for some time, with the Bank of Japan being among the few to maintain a clearly expansionary strategy, and now the Nikkei, which has just returned above the 30,000 mark, is once again being watched with interest as part of global diversification.

Asia offers no particular cues at the moment, pending a clearer picture. Looking ahead, however, it is worth considering further elements of diversification, even beyond China, for example in

India and Indonesia, or toward those markets that are considered “frontier” but are now becoming key players in the search for new geopolitical balances thanks to the fact that they are rich in raw materials.

Alternative Investments

For hedge funds, the most attractive strategies, even for defensive purposes, are Arbitrage and Long/Short strategies with low net exposure, although some volatility should be considered.
Oil has weakened from last months highs but remains at high levels due to the additional, and unexpected, cut by OPEC Plus to support the price. Over the coming months, some supply deficit may become evident, caused in part by the slump in investments that the sector has suffered, for basically ideological reasons.
Several factors have contributed to gold’s renewed rally: geopolitical and economic-financial risks, heavy buying by many central banks, crises that have occurred in the banking sector, and the expectation that rates will stabilize and fall, resulting in a further weakening of the U.S. dollar.

Currencies

Forecasts of decorrelated monetary policy by the ECB and FED weaken the U.S. dollar as global transactions made in different currencies increased and the dollar share declines in the reserves of various central banks. For the Swiss franc, solid fundamentals and the SNB’s new policy less inclined to counter its appreciation in order not to import inflation, keeps interest all the more so given the prevailing turmoil. There is little interest in the Japanese yen with its very low yields, while for those seeking long-term returns are still interesting the Norwegian krone and the Australian dollar.

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