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12 November 2022

After a very weak September, markets rebounded in October and early November despite hawkish central banks. The ECB as well as the US Fed hiked rates by 75 basis points at the end of October and in early November respectively.

While inflation in the Eurozone reached an all-time high of 10.7%, US inflation continued to trend downwards, falling to 7.7% in October. Bond and equity markets sharply rallied after the release of the US inflation figure for October on 10 November, and the USD depreciated.

Meanwhile crypto markets have been shaken by the failure of FTX, the second-largest cryptocurrency exchange. It seems that various business models in crypto space are very vulnerable to say the least. Regulators have rushed to investigate the developments at FTX and Alameda, a related trading entity.

We consider the recent rally as a bear market rally and maintain our underweight equity position. We are, however, slightly overweight in defensive stocks, the dividend aristocrats.

Trauth

Thomas Trauth
CEO – IMT Asset Management AG

BEAR MARKET RALLY?

Financial markets

After a very weak September, equity markets rebounded strongly in October. The US S&P500 index increased by 8.0% and the MSCI Europe by 6.1%. The MSCI Emerging Markets index, however, fell by 3.2%. After the release of the US inflation figure, the S&P500 index jumped by 6.5% and the NASDAQ index even by 9.4% within two days

Bond yields edged clearly higher in October, as inflation remained high and central banks hawkish. European 10-year yields broke above 2% and US 10-year yields above 4%. While nominal 10-year yields rose in October, real 10-year yields fell on the back of rising inflation expectations. As risky assets rallied, credit spreads narrowed. High-yield spreads, for example, tightened by 87 basis points

The USD weakened in October. The USD DXY index fell by 0.5%. After the release of the US inflation number, the USD fell sharply, for example by 3% vis-à-vis the EUR within a couple of trading hours. The market was speculating that a softer inflation rate would encourage the US Fed to become more dovish.

The CHF weakened in October. However, after SNB President Thomas Jordan said on 11 November that monetary policy was not restrictive enough to tame inflation and that the SNB was ready to sell currency reserves, the CHF strengthened sharply.

The broad commodity index rose by 2% in October, mainly driven by rising prices for energy. The price of gold fell slightly. The global REITS index rose by 2.0% in line with stronger demand for risky assets.

Crypto markets

In October crypto assets recovered with Bitcoin up by 5.0% and Ethereum up by 17.5%. In November, however, FTX, the second-largest cryptocurrency exchange, based in the Bahamas, collapsed after massive withdrawals and widespread doubts about the solidity of the FTT coins, which fell by 80%. Consequently, FTX had to file for bankruptcy, and as a result the whole crypto market was shaken up with hefty losses across all crypto assets.

Macroeconomics

The manufacturing PMIs are on a clear downward trend and indicate that economies are likely to shrink sometime soon. A PMI level below 50 indicates that GDP is going to decline.

In the Eurozone inflation rose to an all-time high of 10.7% in October after 9.9%. The major driver for higher prices was energy costs, followed by food, alcohol and tobacco. Luckily, on the back of high European gas storage levels, gas prices declined recently.

European natural gas price, EUR/MWh

Meanwhile, US headline inflation slowed to 7.7% in October after 8.2%. This was clearly below consensus expectation. More importantly, core inflation fell to 6.3% from 6.6%.

US job growth was very robust in October. Non-farm payrolls rose by 261,000, clearly above expectations. At the same time the September figure was revised up to 315,000. The US Fed considers the US labor market to be overheated. Average hourly earnings rose by 4.7%, which indicates that wage pressure is likely to persist. However, wage growth has gradually been slowing since May.

The Republicans failed to win the US midterm elections with the landslide which some had expected. Many of the 300 candidates endorsed by former President Trump were not able to secure victories. This could indicate that Trump's star is fading. The final result of the midterms has not yet been determined. Chances are, however, that the Republicans will win the majority in one or both of the houses. In any case, in both parliaments the winning party will have only a narrow margin of control. History suggests that markets usually perform better in political stalemate situations.

In China the 20th National Party Congress does not bode well for a positive economic outlook. President Xi has consolidated his autocratic power. He seems to be committed to emphasizing national security and tighter regulation at the expense of the economy. There is no sign that Sino-US relations will relax any time soon.

Russian troops retreated from the region of Kherson and transferred men and equipment over the Dnipro river. This is another big win for the Ukrainian forces.

Central banks

On 27 October the ECB raised rates by 75 basis points, which lifted the deposit rate to 1.5%. Since the ECB stated concerns about a looming recession and softened its outlook regarding further rate rises, markets rallied after the press conference.

On 2 November the US Fed hiked rates by 75 basis points for the fourth time in a row. The Fed Fund rates are now between 3.75% and 4.0%. Jay Powell said that rates may peak at a higher level than market participants expect. However, the next rate hike may be less aggressive. After the lower than expected inflation figure came out on 10 November, some Fed officials raised hopes for a slower pace of future rate rises.

At an event in Berne, SNB's president Thomas Jordan said that current policy is not sufficiently restrictive to create price stability in the medium term and that inflation is not adequately anchored. The SNB has hiked rates by 125 basis points in recent months and meets again on 15 December. After Jordan's speech, the Swiss franc appreciated strongly.

Covid-19

New Covid-19 cases in Europe peaked in mid-October and fell thereafter. While in previous years new Covid variants emerged in autumn, causing fresh waves of hospitalizations, it seems that this year the current Omicron variant, which is very contagious but less severe, remains uncontested. In China, however, the zero-Covid policy remains firmly in place. President Xi just recently reaffirmed his commitment to the policy at the Communist Party Congress. Nevertheless, markets speculated recently that China might move away from the zero-Covid approach.

Outlook

We think that the recent rebound of equity markets is a bear market rally. Markets have taken comfort from slowing US inflation and high levels of gas storage in Europe, which have led to much lower European gas prices. However, economic activity is slowing on the back of lost purchasing power, falling consumer and business sentiment, as well as heightened uncertainties. While the recession in the US might turn out to be mild, the European economy is entering a more severe downturn. Earnings have not fallen much so far but the earnings outlook is bleak. Furthermore, as mentioned above, the Chinese economy is very weak and has to deal with a real-estate bubble, while the Chinese government is focused on tighter regulation and its geopolitical ambitions.

As a result, we are maintaining our underweight equity positions, which we increased in recent months. We are underweight in the US, Europe, Asia ex Japan and emerging markets. We are overweight in the Dividend Aristocrats as a very defensive equity sector.

Furthermore, we are slightly underweight in commodities and REITS.

As a result, we hold a much larger cash position, which gives us dry powder for when we want to re-enter the market.

ECONOMICS

The manufacturing PMIs are on a clear downward trend and indicate that economies are likely to shrink sometime soon. A PMI level below 50 indicates that GDP is going to decline. While the Eurozone inflation is still rising, US headline inflation continues to fall. In October US headline inflation fell to 7.7% after 8.2%. US job growth was very robust in October. Non-farm payrolls rose by 261,000, clearly above expectations. Average hourly earnings rose by 4.7%, which means that wage pressure is likely to persist.

Fig. 1: Manufacturing PMIs

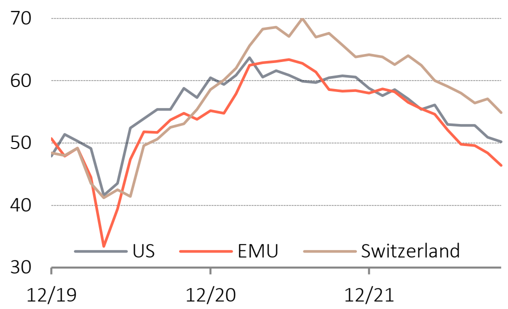


Fig. 2: Manufacturing PMIs

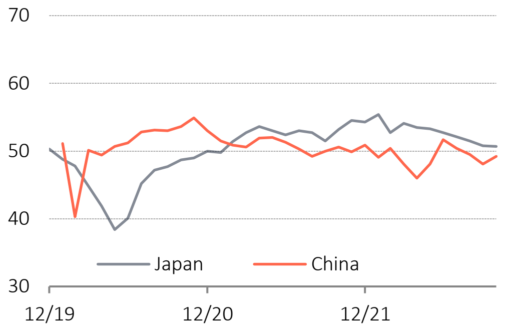


Fig 3: Consumer price inflation, in % YoY

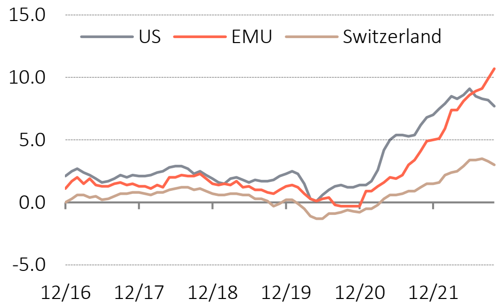


Fig. 4: Consumer price inflation, in % YoY

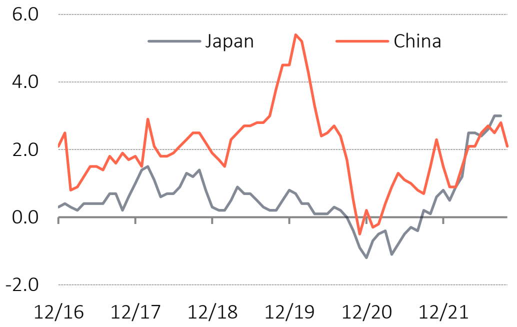


Fig 5: Unemployment rates, in %

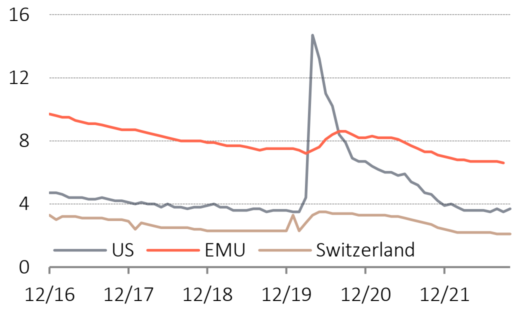
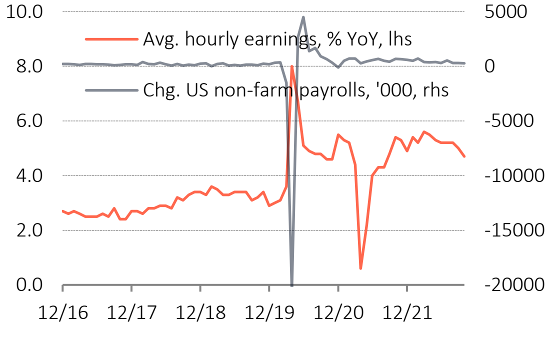


Fig 6: US labor market



FIXED INCOME

Bond yields edged clearly higher in October, as inflation remained high and central banks hawkish. European 10-year yields broke above 2% and US 10-year yields above 4%. While nominal 10-year yields rose in October, real 10-year yields fell on the back of rising inflation expectations. As risky assets rallied, credit spreads clearly fell. High-yield spreads, for example, tightened by 87 basis points.

Fig.7: 2Y government bond yields

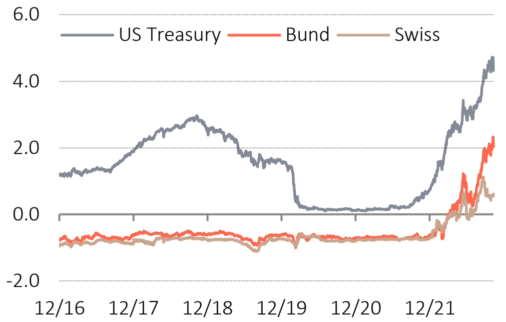


Fig. 8: 10Y government bond yields

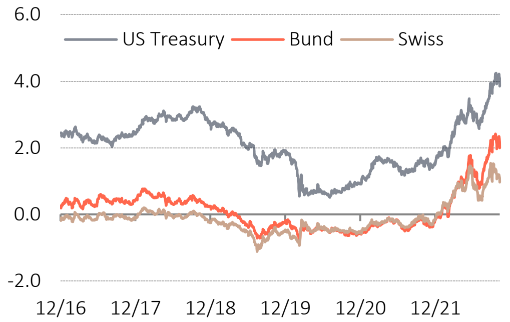


Fig 9: 10Y break-even inflation

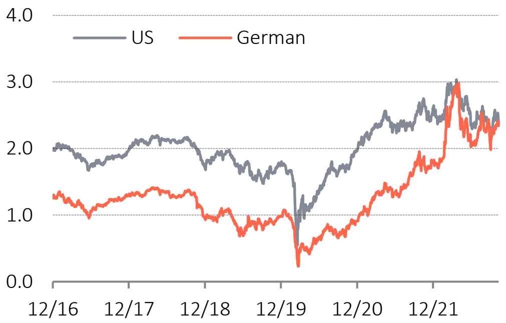


Fig. 10: Credit spreads, 5Y credit default swaps

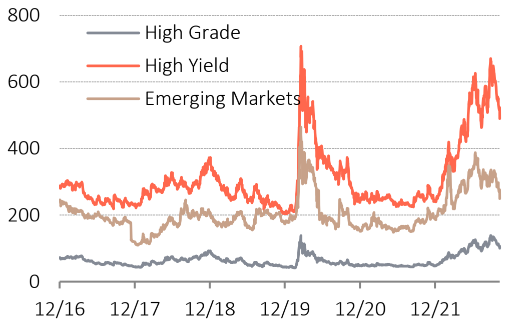


Fig 11: Money market spreads (O/N-2Y)

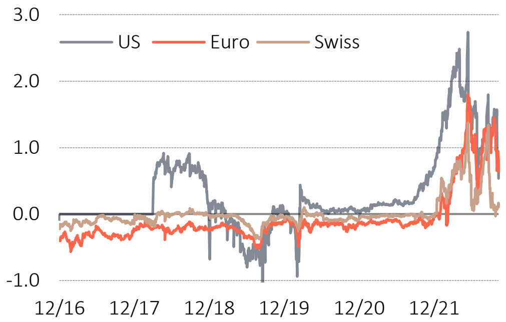
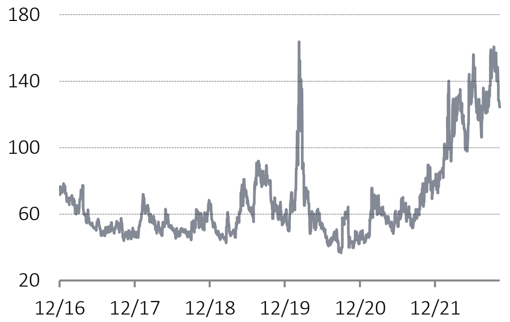


Fig 12: Merrill Lynch volatility index (MOVE)



EQUITIES

After a very weak September, equity markets re-bounded strongly in October. The US S&P500 index increased by 8.0% and the MSCI Europe by 6.1%. The MSCI Emerging Markets index, however, fell by 3.2%.

After the release of the US inflation number, the S&P500 index jumped by 6.5% and the NASDAQ index even by 9.4% within two days.

Fig. 13: MSCI equity indices – major regions

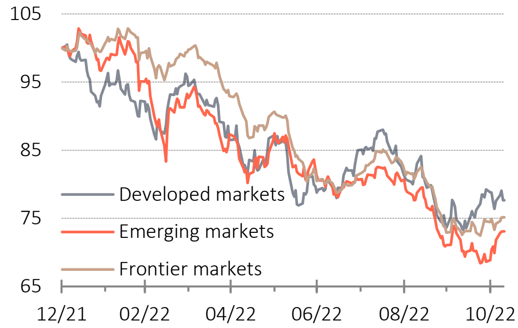


Fig.14: Equity indices – major developed markets

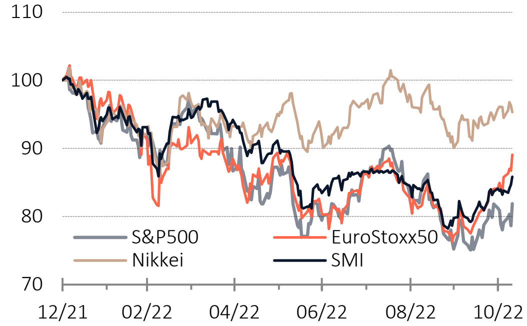


Fig 15: Equity indices – major emerging markets

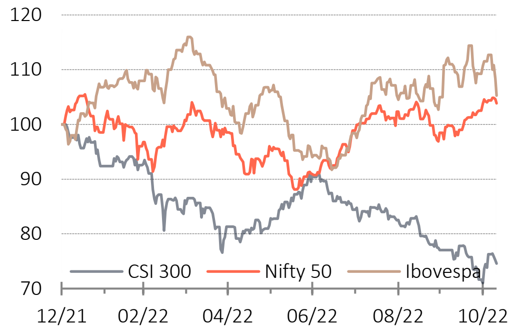


Fig. 16: Sector performance, MSCI Europe, YTD

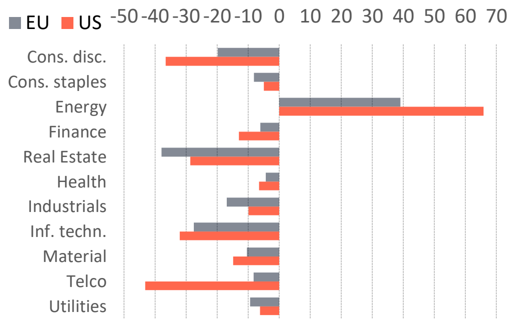


Fig 17: Price-earnings ratios

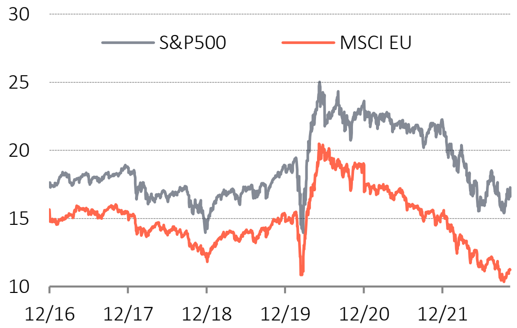
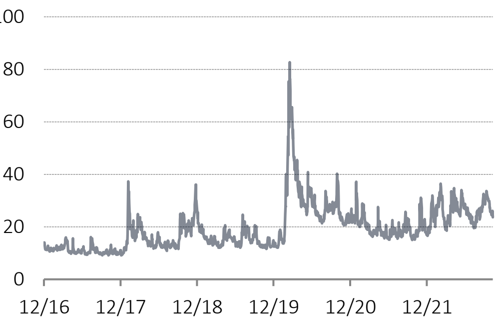


Fig 18: Equity volatility – S&P500 VIX index



ALTERNATIVE INVESTMENTS

The broad commodity index rose by 2% in October, mainly driven by rising prices for energyThe global REITS index rose by 2.0% in line with stronger demand for risky assets. Crypto assets recovered with Bitcoin up by 5.0% and Ethereum up by 17.5%. In November, however, Bahamas-based FTX, the second largest cryptocurrency exchange, collapsed after massive withdrawals and widespread doubts about the solidity of the FTT coins. Consequently, FTX had to file for bankruptcy, and as a result the whole crypto market was shaken up.

Fig. 19: Gold price, USD/oz

Fig.20: Brent oil price, USD/bl

Fig 21: Bloomberg commodity indices

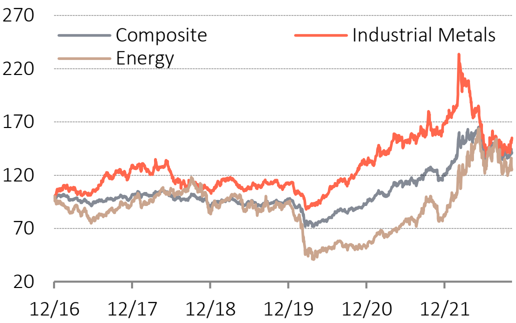


Fig. 22: HFRU hedge fund indices

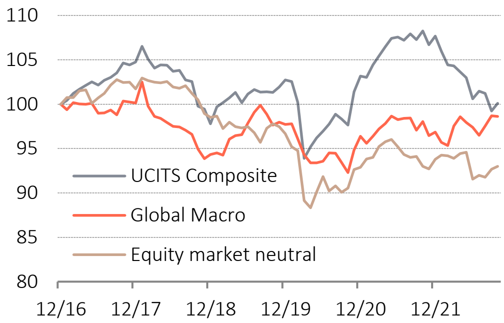
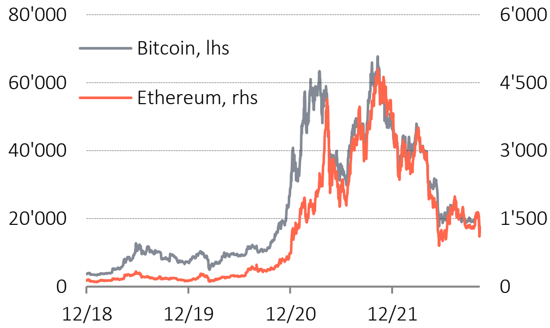


Fig 23: FTSE EPRA/NAREIT global REITS index

Fig 24: Crypto Assets



CURRENCIES

The USD weakened in October. The USD DXY index fell by 0.5%. After the release of the US inflation figure, the USD fell sharply, for example by 3% vis-à-vis the EUR within a couple of trading hours. The market was speculating that a softer inflation number would encourage the US Fed to become more dovish. The CHF weakened in October. However, after SNB President Thomas Jordan said on 11 November, that monetary policy was not restrictive enough to tame inflation and that the SNB was ready to sell currency reserves, the CHF strengthened sharply.

Fig. 25: EUR-USD exchange rate

Fig. 26: GBP-USD exchange rate

Fig 27: USD-JPY exchange rate

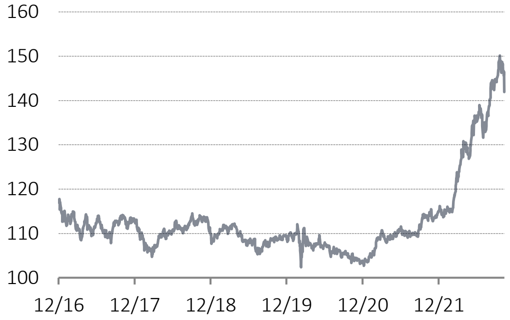
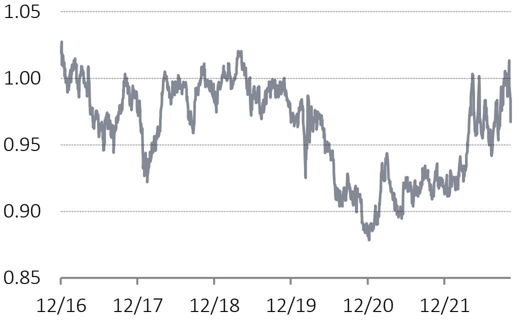


Fig. 28: USD-CNY exchange rate

Fig 29: EUR-CHF exchange rate

Fig 30: USD-CHF exchange rate



COVID-19

New Covid-19 cases in Europe peaked in mid-October and fell thereafter. While in previous years new Covid variants emerged in autumn, causing new waves of hospitalizations, it seems that this year the current Omicron variant, which is very contagious but less severe, remains uncontested. In China, however, the zero-Covid policy remains firmly in place. President Xi just recently reaffirmed his commitment to the policy at the Communist Party Congress. Nevertheless, markets speculated recently that China might move away from the zero-Covid approach.

Fig. 31: Total Covid-19 cases (m)

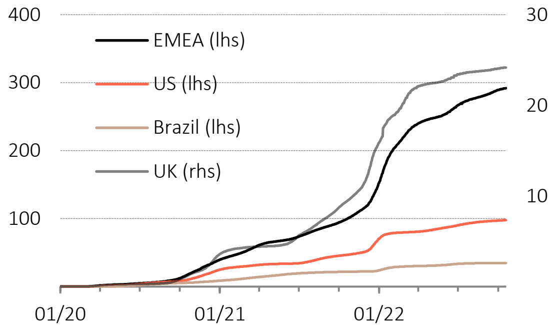


Fig. 32: New cases per day (7-day average x 1'000)

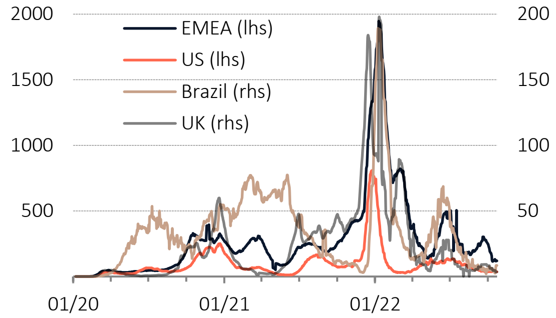


Fig 33: Vaccination rate
(% of the population fully vaccinated)

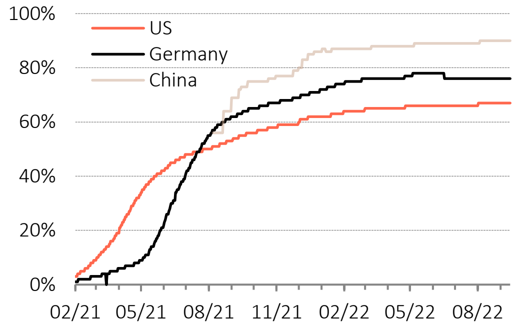


Fig.34: Central bank total assets (indexed)

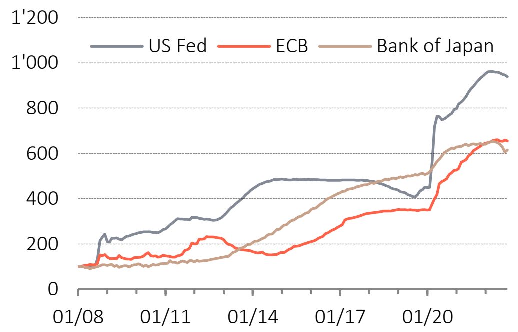
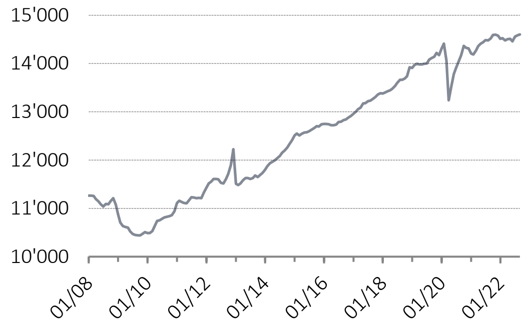


Fig 35: US bankruptcy index

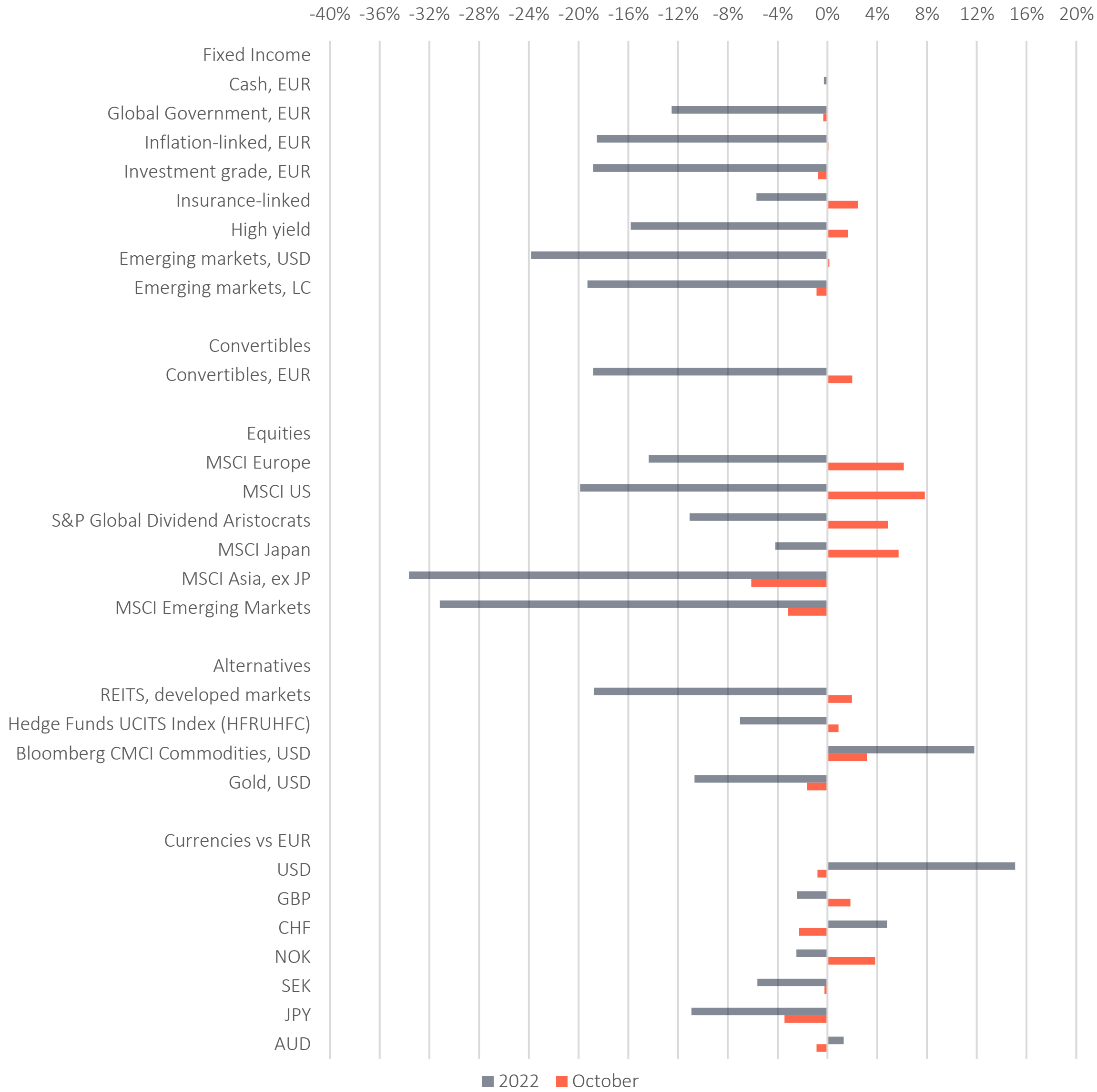
Fig 36: US personal income, excl. transfers
(USD bn, 2012 prices)



ASSET ALLOCATION

In October risky assets rebounded. Especially developed equity markets performed strongly, while Asia and emerging markets suffered from losses. In addition, high-yield bonds, commodities and REITS performed well. Insurance linkers recovered somewhat from the strong sell-off in September, when hurricane Ian caused estimated insurance losses of USD 45-65 bn. The EUR strengthened vis-à-vis the USD and the CHF.

Fig. 37: Performance of major asset classes, based on our EUR portfolio strategy

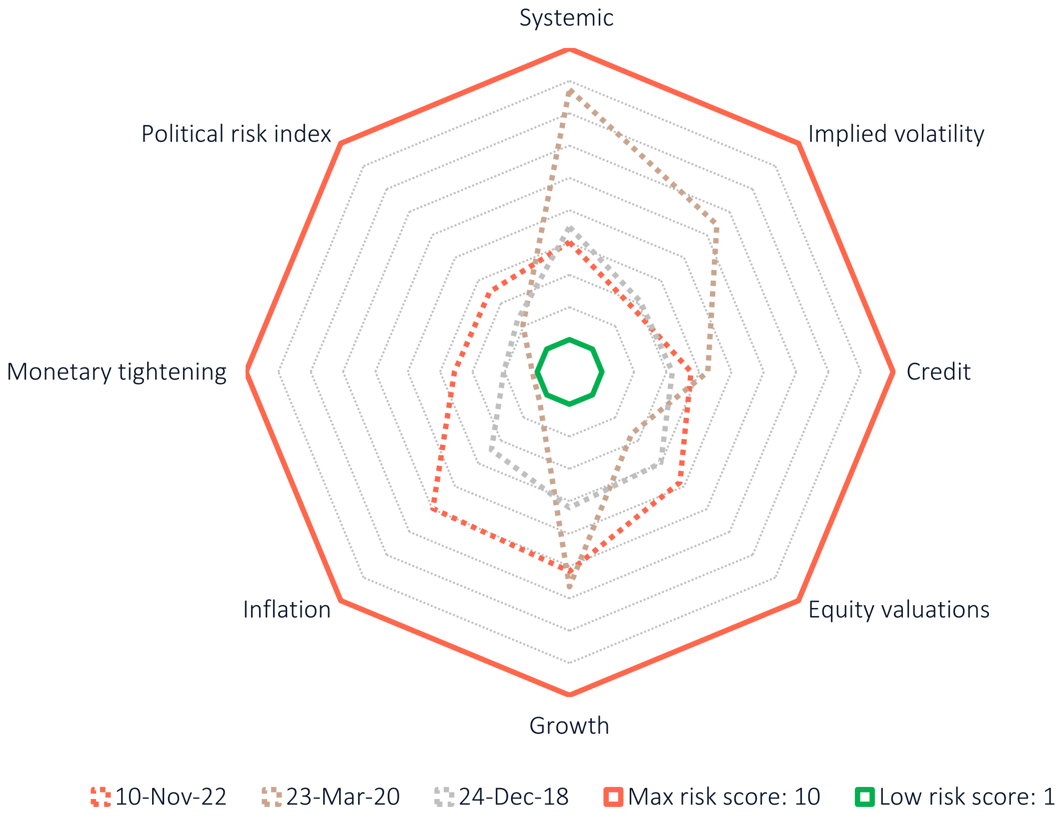


RISK MONITOR

Inflation and growth risks dominate the risk landscape. Other risk factors have receded lately. Especially systemic risks declined noticeably in recent weeks. Monetary tightening risks also declined, since after the recent rate hikes, markets expect that we are moving closer to the peak of the interest-rate cycle.

Fig. 38: IMT Risk Monitor

23-Mar-2020: Global pandemic
24-Dec-2018: Growth and monetary tightening fears



DISCLAIMER

Source for all graphs: IMT Asset Management AG, Bloomberg, Real Clear Politics, for Fig 36 Statista (de.statista.com), for Fig. 38, the political risk index: "Measuring Geopolitical Risk" by Dario Caldara and Matteo Iacoviello at https://matteoiacoviello.com/gpr.htm.