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INVESTMENT OUTLOOK 12.2021

22 December 2021

The new Omicron variant of the SARS-CoV-2 virus was the dominant theme in recent weeks. The pathogen proved to be highly infectious, rapidly started to crowd out the Delta variant and led to an explosion of new cases. Uncertainty, especially at the beginning was high since we did not know enough about its characteristics. It now looks as if Omicron is at least partly vaccine-evasive but not necessarily more virulent than previous variants. In any case, new lockdown measures will slow down growth in the coming months. At the same time, several central banks have started to normalize monetary policy or to announce such measures.

Markets for risky assets sold off across the board. However, losses remained limited. In the second half of November, we decided to de-risk the portfolios by increasing the exposure to our volatility strategies, which have hedging characteristics. It proved to be just the day before equity markets sold-off.

Overall, we think that markets will bounce back, and that Omicron will not change the economic outlook fundamentally.

Trauth

Thomas Trauth
CEO – IMT Asset Management AG

OMICRON TAKES OVER

Financial markets

The emergence of the new Omicron variant unnerved investors in November. Equity markets sold-off. Developed markets lost 2.3% and emerging markets 4.1%. As during previous Covid-19 waves, technology stocks outperformed – the technology-heavy NASDAQ index was even slightly up – while financials and energy stocks underperformed.

The risk-off environment led to falling bond yields, despite more hawkish central banks. An exception was US 2-year yields, which rose by 7 basis points. US and German 10-year yields fell by 24 and 20 basis points, respectively. Despite a further uptick of headline inflation, break-even inflation rates fell somewhat. This indicates that the market expects that the inflation spike will be transitory. Credit spreads widened as investors avoided risky assets.

Growth concerns resulted in a sharp drop of energy prices. The price for Brent oil, for example, fell 16.5% in November. Precious metals did not serve as safe-haven assets. The price of Gold dropped 0.5%. As a result, the broad Bloomberg commodities index fell 7.3%. Global REITS weathered the storm and rose 0.3%. Listed private equity stocks held up well and fell 0.2% only.

The USD continued to rally in November, driven by a further widening of the US yield advantage. The USD index (DXY) gained 2.0% and appreciated 2.0% vis-à-vis the EUR. In contrast, the EUR weakened across the board. The EUR-CHF exchange rate, for example, fell by 1.6% to about 1.04, a level last seen in 2015.

Macroeconomics

Growth is slowing and inflation is rising. PMI’s are declining but remain at about 60, which means that growth continues to be very strong. High pent-up demand, extraordinary fiscal and monetary stimuli continue to drive growth, while the supply side struggles to satisfy demand. Pandemic-related supply side disruptions led to bottlenecks and skyrocketing prices for intermediate goods and services. US inflation reached 6.8%, a four-decade high.

US non-farm payrolls disappointed. The US economy added only 210,000 jobs in November, considerably less than consensus expectations.

Central banks

On 14-15 December the US Fed held its policy meeting and surprised markets with a more hawkish stance. The Fed announced a more rapid withdrawal from its bond-buying program than previously communicated. The Fed will cut purchases by USD 30 bn a month, starting in January. As a result, the Fed will stop the expansion of its balance sheet as early as March next year. Furthermore, Fed chairman Jerome Powell indicated that a first rate hike will follow relatively early thereafter. It is now expected that the Fed will hike three times in 2022. Interestingly, the market reaction was positive and equity markets rallied after the Fed meeting, as market participants appreciated that the Fed was taking credible measures to contain inflation.

On 16 December the ECB held its monthly policy meeting. Chairwoman Christine Lagarde said the ECB would scale back its crisis bond-buying. The EUR 1.85 tn PEPP (Pandemic Emergency Purchase Programme) will reduce purchases in 2022 and stop them in March. At the same time, and to cushion the tapering, it will increase its asset purchase program (APP) from EUR 20 bn per month to EUR 40 bn in the second quarter and EUR 30 bn in the fourth quarter. The APP will be back to EUR 20 bn after October. The ECB further said it would not hike rates in 2022. The ECB decision can be seen as a dovish tapering. As a result, the market reaction was muted. The EUR strengthened somewhat and European bonds sold-off.

Furthermore, the Bank of England and Norway's Norge Bank raised rates in December, the latter even for the second time this year. The Swiss SNB, however, kept rates unchanged at minus 0.75%. The SNB is concerned about the recent strengthening of the CHF, since it led to an unwarranted tightening of monetary conditions.

Covid-19

The emergence of the Omicron variant led to a sharp rise in new cases globally. Data from South Africa show that Omicron replaced Delta as the dominant variant in a matter of two weeks. We still do not know for sure whether Omicron will be vaccine-evasive (seems very possible) and more deadly (initial evidence suggests it won't). In any case, many countries have re-introduced lockdown measures and travel restrictions, which will slow down growth in the coming quarters. Pharma companies are working on amended vaccines, which should be available within 100 days.

Outlook

The new Omicron variant has showed us first that the virus is mutating rapidly, second that new variants can spread very quickly globally, and third that immunization of the population is still not high enough. Furthermore, politicians are clearly struggling to implement clear and cohesive plans to contain new waves of infections.

Nevertheless, there are also some positive elements. As time goes on the immunization of the population will increase, as the number of recovered and vaccinated people steadily rises. Further research will help the pharma industry to adapt their vaccines to new variants faster and to develop better medication to treat infected patients.

Overall, we expect that we will be able to cope well with the new Omicron wave. Even if Omicron proves to have more lasting effects on the economy, we would expect that additional fiscal and monetary support measures will be taken. This would protect risky assets to the downside.

Our overall outlook for 2022 remains constructive, although equity market returns will most likely stay single-digit and volatility will continue elevated as uncertainties remain and the economic cycle matures. Inflation is likely to fall next year as labor market and supply chain disruptions ease. Interest rates will rise as central banks cautiously move towards normalizing monetary policy.

What are the risks to our rather positive outlook? Inflation could remain sticky, warranting more aggressive monetary tightening. A new, more aggressive Covid variant could emerge, which would warrant more severe lockdown measures and thus cause a recession.

We also observe some geopolitical developments with concern. The Kremlin has moved large numbers of troops toward the border with Ukraine, which increases the likelihood of an invasion. In the meantime, Western politicians have been very outspoken about potential sanctions against Russia and even military aid for Ukraine. An outbreak of war between Russia and Ukraine would disrupt energy supply in Europe and drive energy prices higher.

ECONOMICS

Growth is slowing and inflation is rising. PMI's are declining but remain at about 60, which means that growth continues to be very strong. High pent-up demand and extraordinary fiscal and monetary stimuli continue to drive growth, while the supply side struggles to satisfy demand. Pandemic-related supply side disruptions have led to bottlenecks and skyrocketing prices for intermediate goods and services. US inflation reached 6.8%, a four-decade high. US non-farm payrolls disappointed. The US economy added only 210,000 jobs in November.

Fig. 1: PMIs

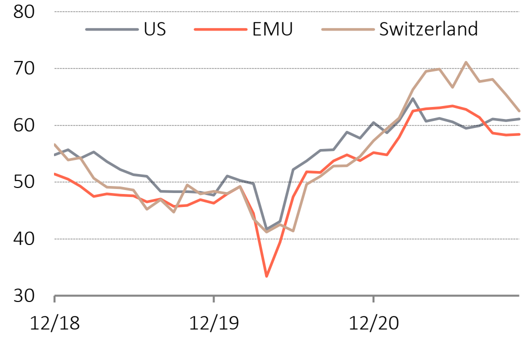


Fig. 2: PMIs

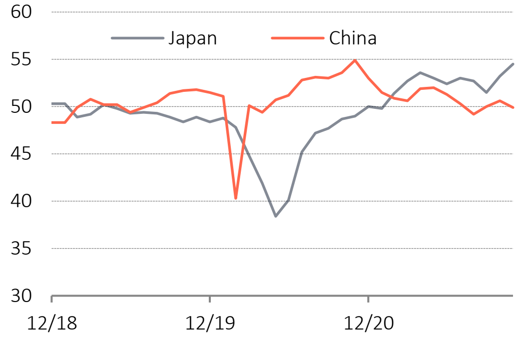


Fig 3: Consumer price inflation, in % YoY

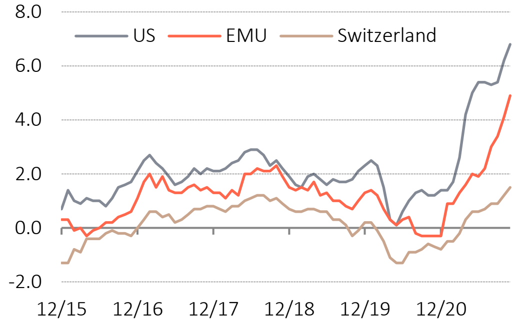


Fig. 4: Consumer price inflation, in % YoY

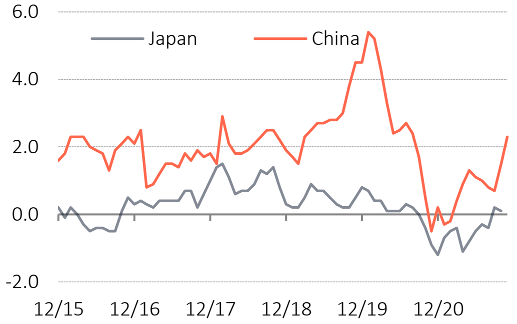


Fig 5: Unemployment rates, in %

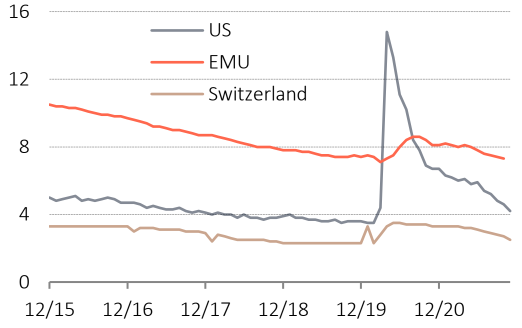
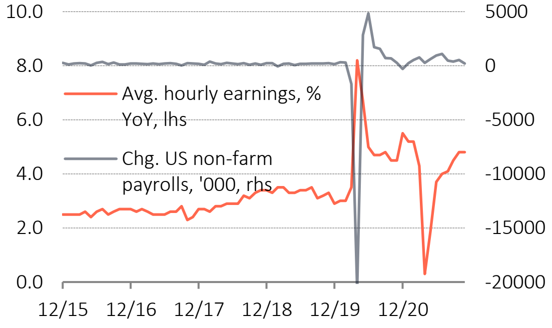


Fig 6: US labor market



FIXED INCOME

The risk-off environment led to falling bond yields, despite more hawkish central banks. An exception was US 2-year yields, which rose by 7 basis points. US and German 10-year yields fell by 24 and 20 basis points, respectively. Despite a further uptick of headline inflation, break-even inflation rates fell somewhat. This indicates that the market expects that the inflation spike will be transitory. Credit spreads widened as investors avoided risky assets.

Fig.7: 2Y government bond yields

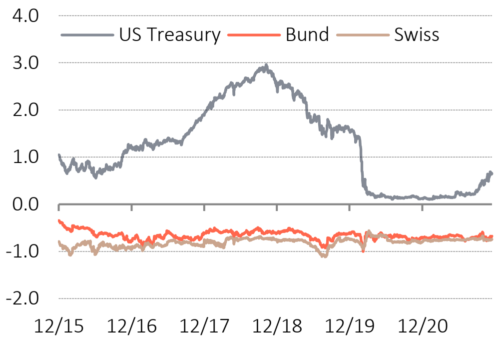


Fig. 8: 10Y government bond yields

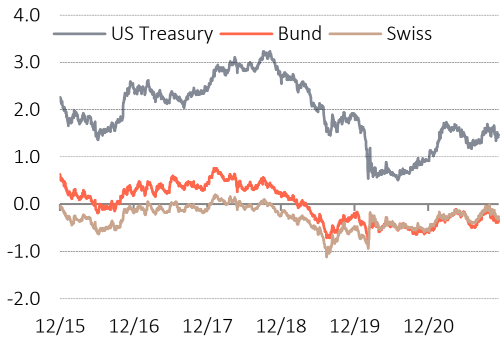


Fig 9: 10Y break-even inflation

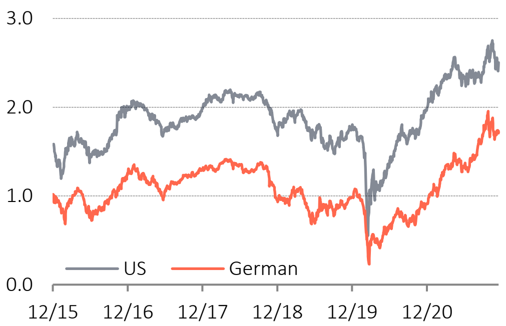


Fig. 10: Credit spreads, 5Y credit default swaps

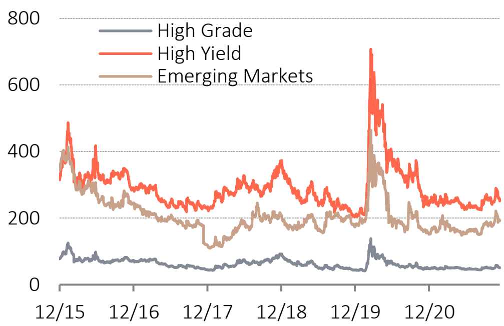


Fig 11: Money market spreads (3M-2Y)

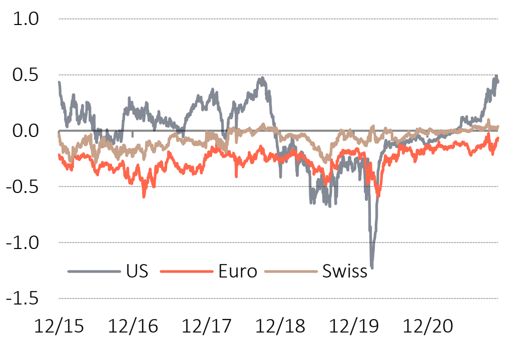
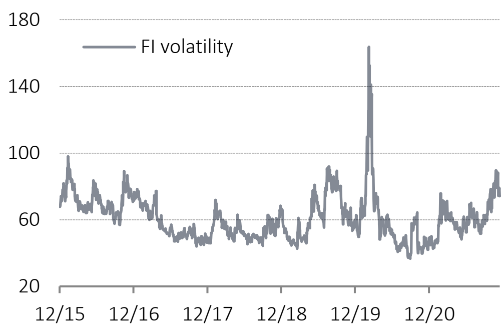


Fig 12: Merrill Lynch volatility index (MOVE)



EQUITIES

The emergence of the new Omicron variant unnerved investors in November. Equity markets sold-off. Developed markets lost 2.3% and emerging markets 4.1%. As during previous Covid-19 waves, technology stocks outperformed – the technology-heavy NASDAQ index was even slightly up – while financials and energy stocks underperformed.

Fig. 13: MSCI equity indices – major regions

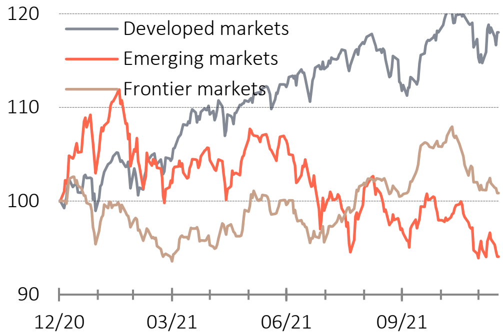


Fig.14: Equity indices – major developed markets

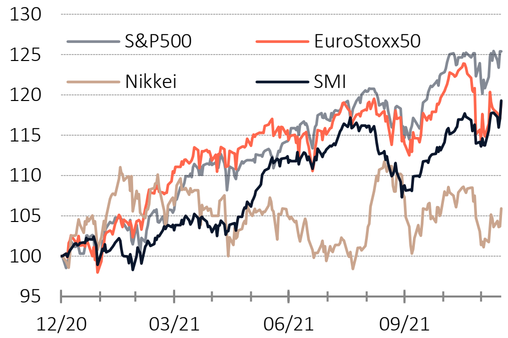


Fig 15: Equity indices – major emerging markets

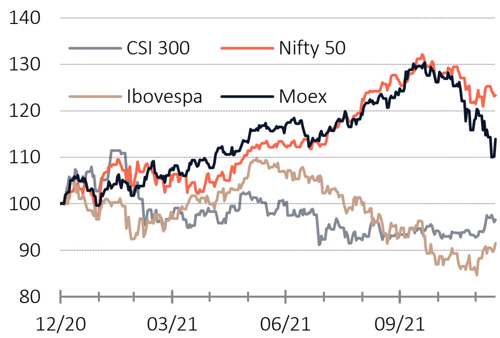


Fig. 16: Sector performance, MSCI Europe, YTD

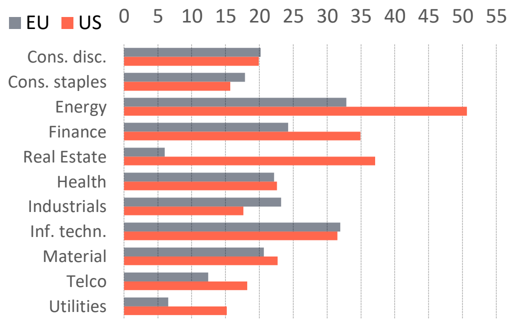


Fig 17: Price-earnings ratios

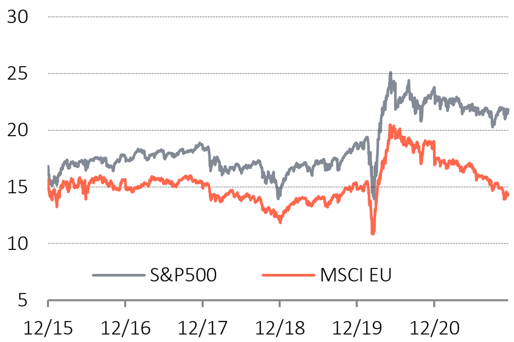
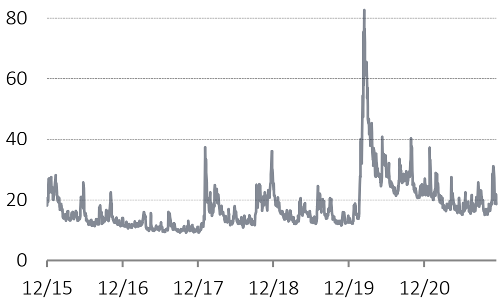


Fig 18: Equity volatility – S&P500 VIX index



ALTERNATIVE INVESTMENTS

Growth concerns resulted in a sharp drop of energy prices. The price for Brent oil, for example, fell 16.5% in November. Precious metals did not serve as safe-haven assets. The price of Gold dropped 0.5%. As a result, the broad Bloomberg commodities index fell 7.3%. Global REITS weathered the storm and rose 0.3%. Listed private equity stocks held up well and fell 0.2% only.

Fig. 19: Gold price, USD/oz

Fig.20: Brent oil price, USD/bl

Fig 21: Bloomberg commodity indices

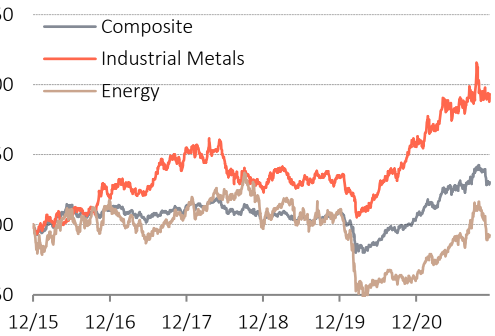


Fig. 22: HFRU hedge fund indices

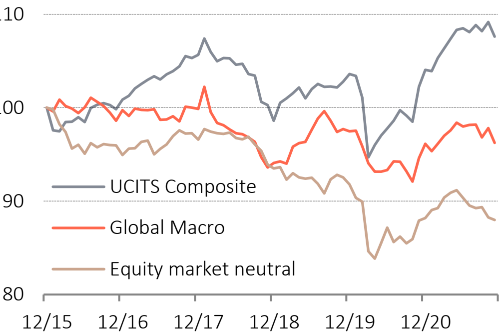
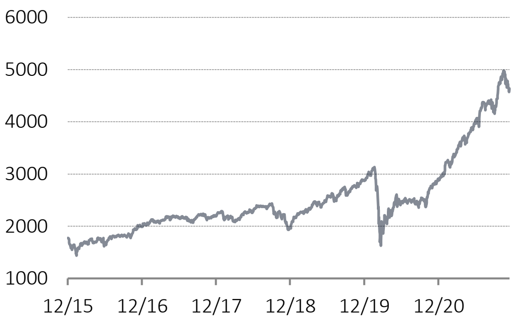


Fig 23: FTSE EPRA/NAREIT global REITS index

Fig 24: LPX global listed private equity



CURRENCIES

The USD continued to rally in November, driven by a further widening of the US yield advantage. The USD index (DXY) gained 2.0% and appreciated 2.0% vis-à-vis the EUR. In contrast, the EUR weakened across the board. The EUR-CHF exchange rate, for example, fell by 1.6% to about 1.04, a level last seen in 2015.

Fig. 25: EUR-USD exchange rate

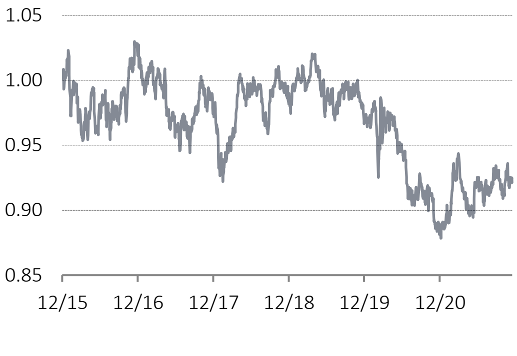
Fig. 26: GBP-USD exchange rate

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

The emergence of the Omicron variant led to a sharp rise in new cases globally. Data from South Africa show that Omicron replaced the Delta variant as the dominant strain in a matter of two weeks. We still do not know for sure whether Omicron will be vaccine-evasive (seems very possible) and more deadly (first evidence suggests it won't). In any case, many countries re-introduced lockdown measures and travel restrictions, which will slow down growth in the coming quarters. Pharma companies are working on amended vaccines, which should be available within 100 days.

Fig. 31: Total Covid-19 cases (x 1000)

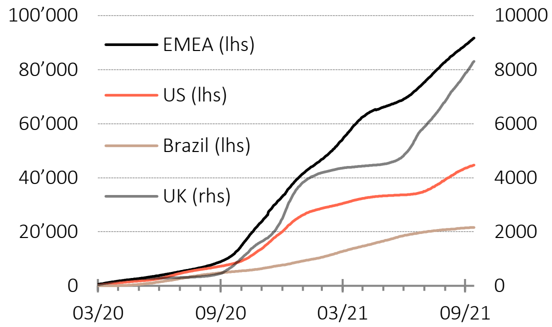


Fig. 32: New cases per day (7-day average)

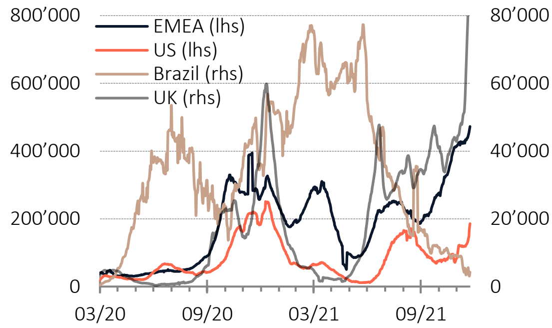


Fig 33: Global vaccination campaign
(doses per 100 people)

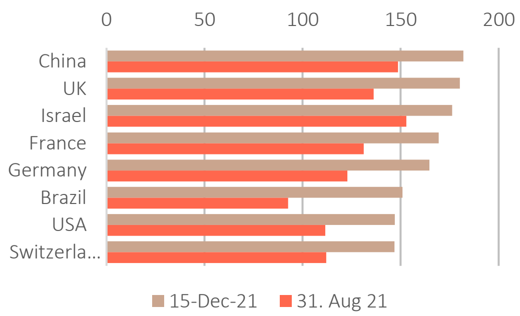


Fig.34: Central bank total assets (indexed)

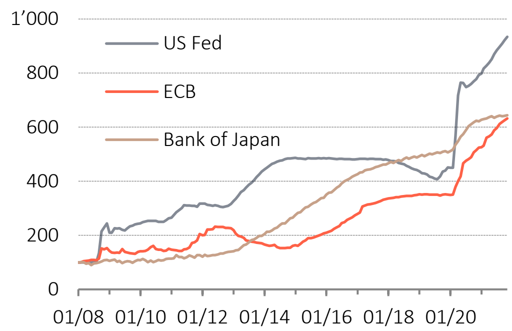


Fig 35: US bankruptcy index

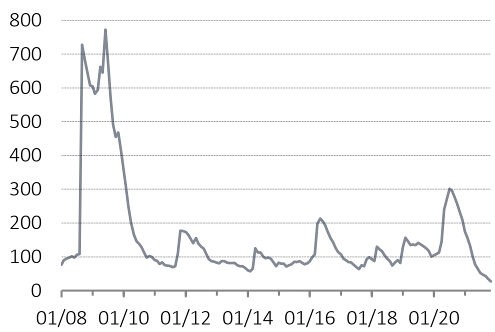
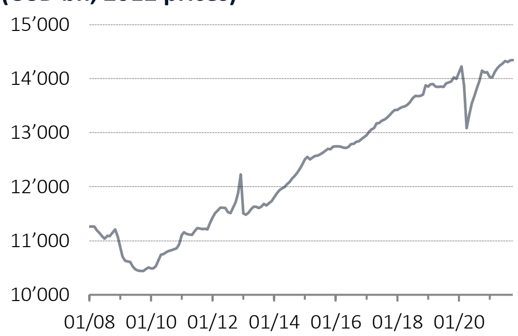


Fig 36: US personal income, excl. transfers (USD bn, 2012 prices)



ASSET ALLOCATION

November was a difficult month for multi-asset class portfolios. Almost all asset classes exhibited losses. Exceptions were government bonds, especially inflation-linkers. Insurance-linked bonds and REITS performed slightly positively. The USD and the CHF contributed positively to the overall performance.

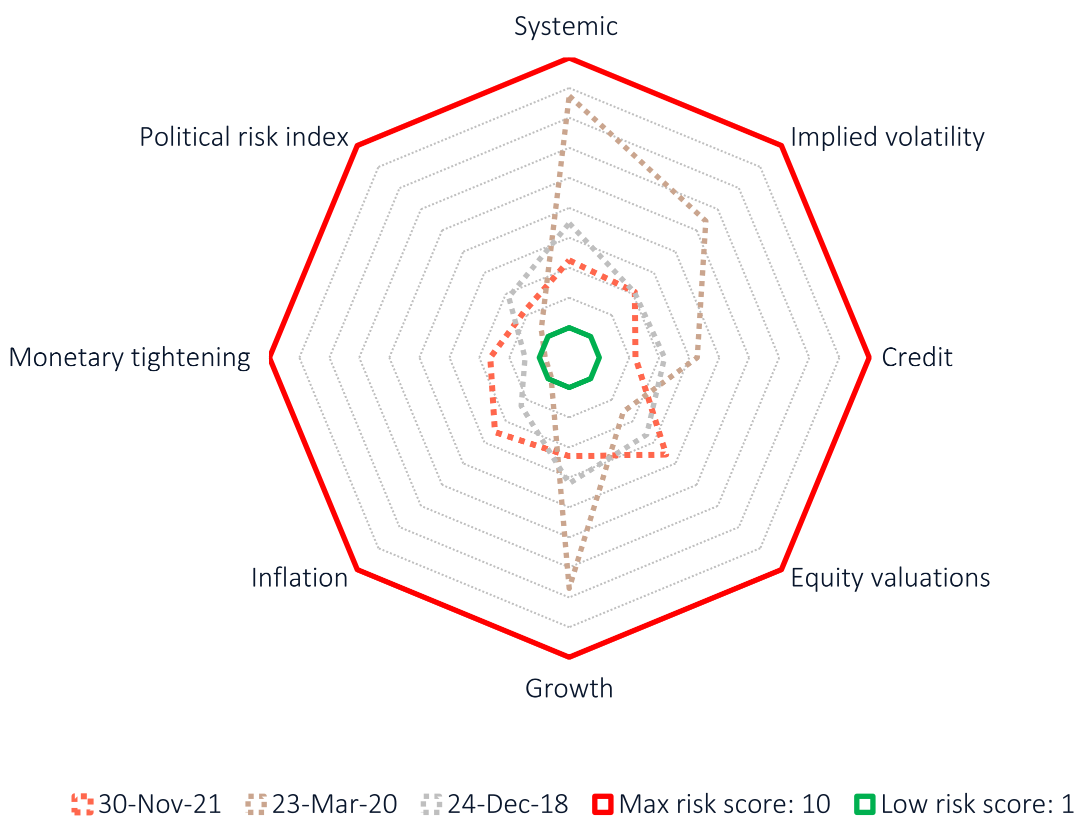
Fig. 37: Performance of major asset classes, based on our EUR portfolio strategy

RISK MONITOR

Monetary tightening and inflation risks have risen lately. Also implied volatility (option prices) increased in November, though was relatively mild compared to previous phases of market stress. Equity valuations fell slightly.

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.