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07.2022

6 July 2022

June was a particularly bad month for all major asset classes. Stocks, bonds, and commodities sold off in tandem. There is a lot to worry about: recession risk, accelerating inflation, hawkish central banks, food and energy shortages, and elevated geo-political tensions. The US Fed hiked rates by 75 basis points in June and announced that additional rate hikes will follow in the coming months. There are major concerns about gas supply for Europe, since Russian gas plays a vital role for many European countries. Gas prices has already risen 700% since the start of the year.

Interestingly, the Chinese equity market strongly bounced back in June, gaining 9.6%, after the Chinese authorities lifted very strict Covid lockdown measures.

We decided to remain cautious but not to sell risky assets into the current weakness. We think that markets have already discounted many of the above-mentioned risks. Of course, we are monitoring the situation very closely.

Trauth

Thomas Trauth
CEO – IMT Asset Management AG

RECESSION FEARS

Financial markets

In June equity markets indices dropped significantly. The US S&P500 fell by 8.4%, the MSCI Europe by 7.9%, the German DAX by 11.2%, and Emerging Markets by 11.2%. Recession fears and rising rates unsettled market participants. A notable exception was the Chinese CSI 300, which rose 9.6%, driven by relaxed Covid measures and the hope for stimulus measures by the Chinese leadership ahead of the party congress in autumn. The only equity sector which has performed strongly positively this year is the energy sector.

In June, yields were driven by hawkish central banks. 10-year government bond yields rose 17 basis points in the US and 21 basis points in Europe. Interestingly, inflation expectations, as measured by 10-year breakeven rates, fell by in Europe and the US by 24 and 31 basis points, respectively. As a result, real yields rose, which led to an underperformance of inflation-linked bonds. The risk-off environment drove credit spreads sharply higher. High-yield spreads, for example, reached 600 basis points.

After commodity prices rose steadily until May, we observed a market correction in June. Energy prices fell by 11%, prices for industrial metals by 16%, and prices for agriculture dropped 14.6%. It seems that recession fears, i.e., expectations for weaker demand outweigh concerns about supply side shortages. The price of gold continued to grind lower in June, declining by 1.6%. The global REITS index fell by 6.8%. The risk-off environment was particular bad for crypto assets. Bitcoin dropped 41% and Ethereum 48% in June.

The USD remained on the strong side as the US yield advantage remained supportive and even increased further. Also the CHF remained very strong. After the SNB surprised markets by a 50 basis points rate hike, the EUR-CHF exchange rate dropped below parity. Since the Bank of Japan remained dovish, the JPY continued to weaken. The USD-JPY exchange rate broke above 135.

Macroeconomics

All major manufacturing PMI indices declined in June, albeit remaining above 50. The US manufacturing ISM was at 53, after 56.1 and the European PMI at 52.1 after 54.6. In contrast, the Chinese manufacturing PMI strongly increased to 51.7 after 48.1.

At the same time, inflation continued to rise. US inflation reached 8.6% in May and European inflation 8.6 in June. US non-farm payrolls rose by 390,000 in May, above consensus expectations. The June report is due on 8 July and expectations are for about 310,000 additional jobs.

Ukraine

The Ukraine received delivery of heavy weapons from Germany and other Western countries. It seems that by and large the two opposing forces are currently in a deadlock with no sign that either of the two will be able to move the needle in their favor. In the meantime, Sweden and Finland are pursuing their applications for NATO membership, answered by harsh rhetoric from Russia.

Central banks

On June 15, the US Fed hiked rates by 75 basis points, the third rate hike this year and the largest hike since 1994. It is possible that the Fed will follow up with another 75 basis-point hike at its next policy meeting on July 26-27. The famous dot plot, the Fed board's rate expectations, point to further rate hikes, which would bring the policy rate up as high as 3.4% by the end of this year.

The ECB has not raised interest rates so far but indicated that it will hike rates by 25 basis points in its July 21 policy meeting. This may be followed by another possibly bigger hike in September. Some commentators are speculating that due to the latest increase of inflation to 8.6%, the ECB might already hike by 50 basis points in July. The ECB finds itself between a rock and a hard place, since it is equally concerned about a possible recession and another public debt crisis. The ECB already discontinued its net asset purchases under the PEPP (Pandemic Emergency Purchase Programme) at the end of March 2022.

The Bank of England (BoE) raised interest rates by 25 basis points in June. This has been the fifth rate hike in back-to-back meetings, starting in December 2021, pushing the benchmark rate up to 1.25%. The inflation outlook in the UK is clearly worse than in the rest of Europe. The BoE expects inflation to reach 11% by the end of this year.

The Swiss National Bank (SNB) raised its benchmark rate by 50 basis points in a surprise move on June 16. This was the first rate hike since 2007. The SNB, removed references to a "highly valued" Swiss Franc, which implies that the SNB is likely to allow the Swiss Franc to strengthen. After the announcement the Swiss Franc appreciated and the EUR-CHF exchange rate fell clearly below parity. The SNB said that it was not so much concerned about the inflation outlook and that the economic outlook for Switzerland remained positive as the adverse impact from the Ukraine war has been relatively mild for the Swiss economy.

Covid-19

After some relief and falling numbers of new Covid cases, hospital admissions started to surge again, driven by the BA.5 subvariant of Omicron. This variant seems to be an efficient evader of Covid immunity, irrespective of whether immunity was acquired by vaccination or by earlier infections with other Covid variants. So far, most countries have not introduced new Covid restrictions, especially since the new Omicron variants seem to be less harmful.

The situation in China, however, is very different, as the Chinese leadership follows a strict Zero-Covid policy. Although China lifted its strict lockdown rules at the beginning of June, it ordered mass testings and local lockdown measures in the Shenzhen and Shanghai area later in June.

Outlook

The outlook is clouded by recession risks, stubbornly high inflation, hawkish central banks, and huge geopolitical tensions. So far, we have decided to remain more or less neutral with regard to our strategic asset allocation.

As a reminder, we made a couple of changes to our strategic asset allocation in the last two years, which prepared our portfolios well for the current environment. We reduced interest rate risks significantly, for example, by reducing our exposure to nominal governments bonds. For our balanced portfolios we even reduced the allocation to nominal government bonds to zero. Furthermore, we built an allocation to high quality stocks, i.e., dividend aristocrats, which proved to be very resilient this year.

In addition, we introduced a combination of trend following and volatility strategies. Both strategies have the potential to perform strongly, even if bonds and stocks fall. The trend following strategy performed very well this year, gaining 38% as of June 30. However, our volatility strategies were faced with a difficult environment. Despite falling stock markets, option prices did not rise much. As a result, some of our volatility products suffered from significant losses.

We continue to monitor the global developments very closely and remain on the cautious side. We did not sell risky assets into the current weakness since we believe that markets have already discounted many of the above-mentioned risks. Recently we reduced our exposure to the European equity market, which is especially exposed to the risk of gas supply disruptions and recession risks. At the same time, we increased our investment in the dividend aristocrats, which clearly outperformed in recent months. As a result, our portfolios became more defensive.

ECONOMICS

All major manufacturing PMI indices declined in June, albeit remaining above 50. The US manufacturing ISM was at 53, after 56.1 and the European PMI at 52.1 after 54.6. In contrast, the Chinese manufacturing PMI strongly increased to 51.7 after 48.1. At the same time, inflation continued to rise. US inflation reached 8.6% in May and European inflation 8.6 in June. US non-farm payrolls rose by 390,000 in May, above consensus expectations. The June report is due on 8 July and expectations are for about 310,000 additional jobs.

Fig. 1: PMIs

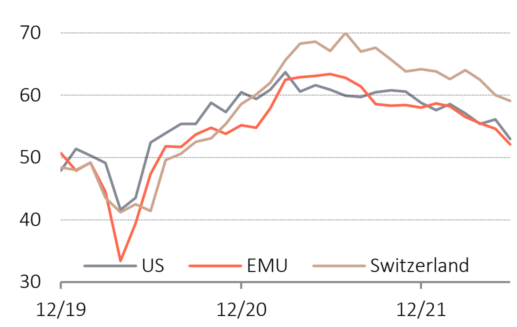


Fig. 2: PMIs

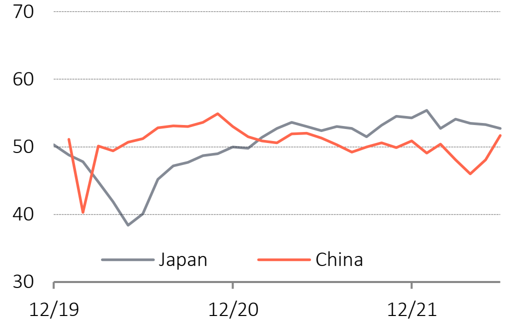


Fig 3: Consumer price inflation, in % YoY

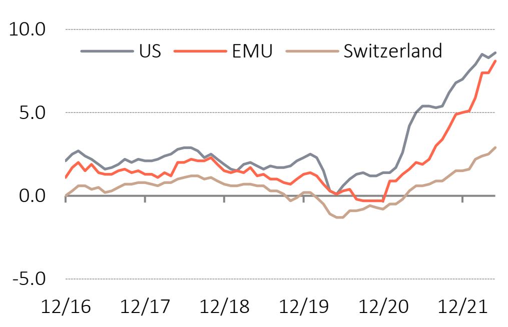


Fig. 4: Consumer price inflation, in % YoY

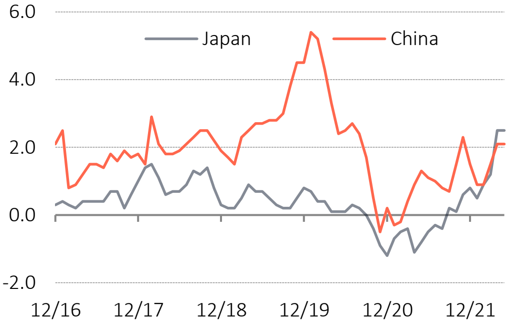


Fig 5: Unemployment rates, in %

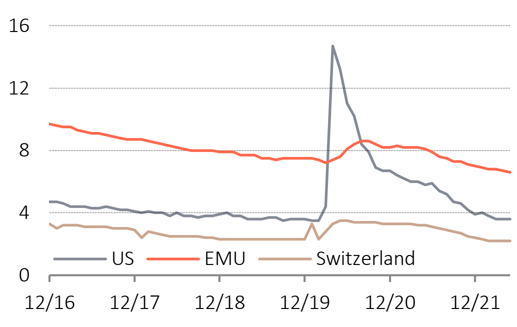
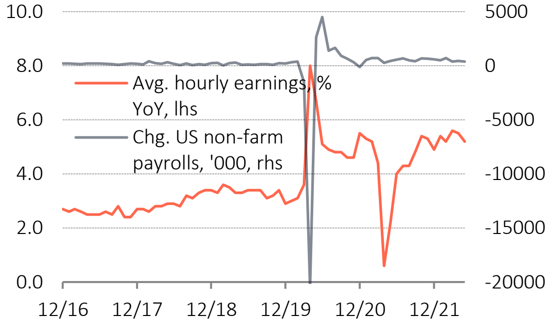


Fig 6: US labor market



FIXED INCOME

In June yields were driven by hawkish central banks. 10-year government bond yields rose 17 basis points in the US and 21 basis points in Europe. Interestingly, inflation expectations, as measured by 10-year break-even rates, fell by in Europe and the US by 24 and 31 basis points, respectively. As a result, real yields rose, which led to an underperformance of inflation-linked bonds. The risk-off environment drove credit spreads sharply higher. High-yield spreads, for example, reached 600 basis points.

Fig.7: 2Y government bond yields

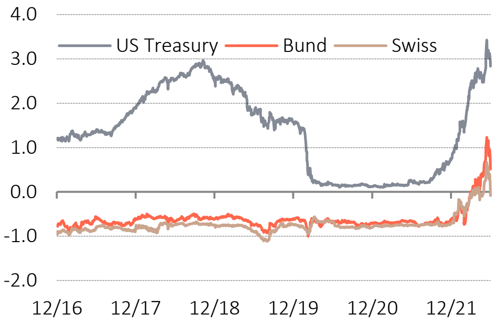


Fig. 8: 10Y government bond yields

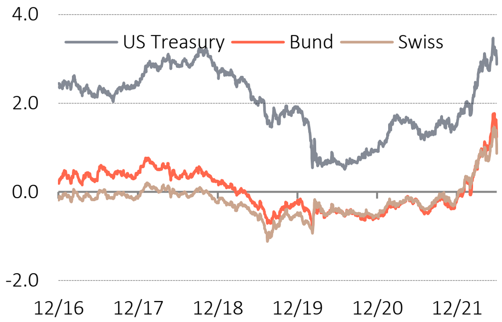


Fig 9: 10Y break-even inflation

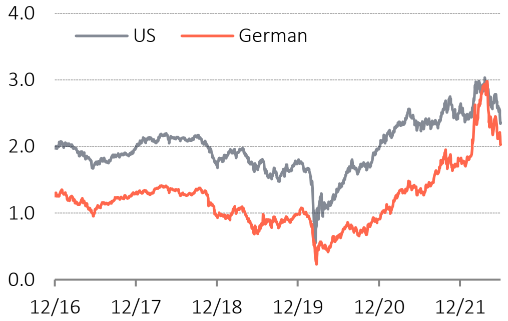


Fig. 10: Credit spreads, 5Y credit default swaps

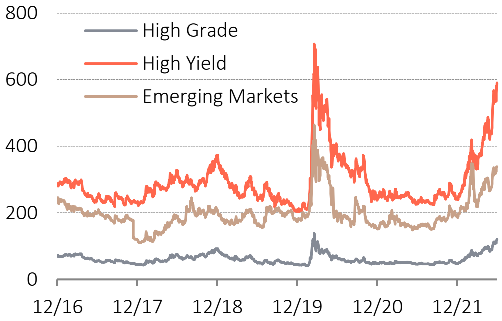


Fig 11: Money market spreads (O/N-2Y)

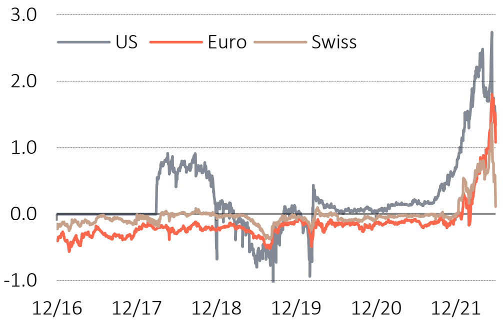
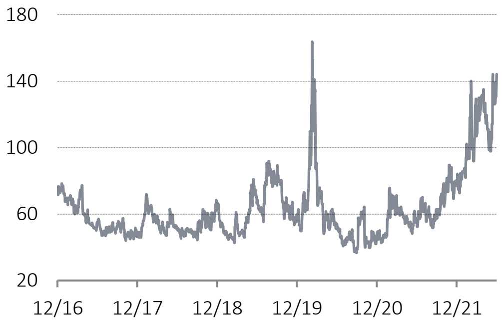


Fig 12: Merrill Lynch volatility index (MOVE)



EQUITIES

In June equity markets indices dropped significantly. The US S&P500 fell by 8.4%, the MSCI Europe by 7.9%, the German DAX by 11.2%, and Emerging Markets by 11.2%. Recession fears and rising rates unsettled market participants. A notable exception was the Chinese CSI 300, which rose 9.6%, driven by relaxed Covid measures and the hope for stimulus measures by the Chinese leadership ahead of the party congress in autumn. The only equity sector which has performed strongly positively this year is the energy sector.

Fig. 13: MSCI equity indices – major regions

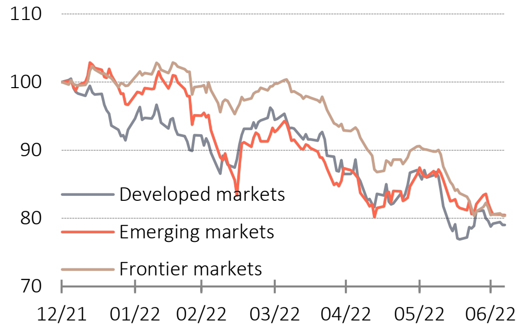


Fig.14: Equity indices – major developed markets

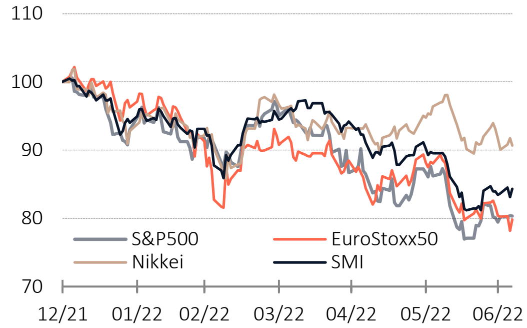


Fig 15: Equity indices – major emerging markets

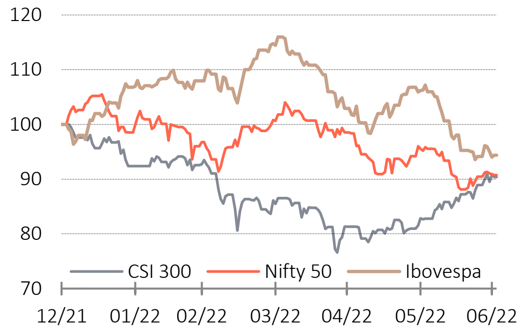


Fig. 16: Sector performance, MSCI Europe, YTD

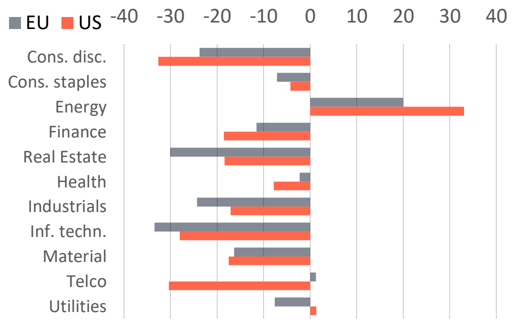


Fig 17: Price-earnings ratios

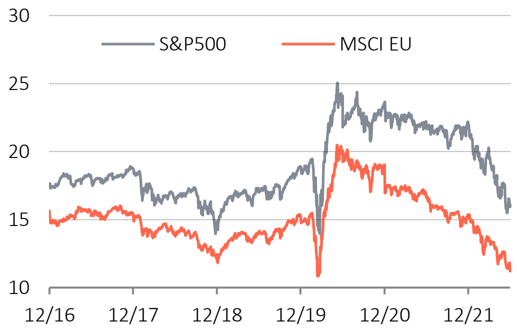
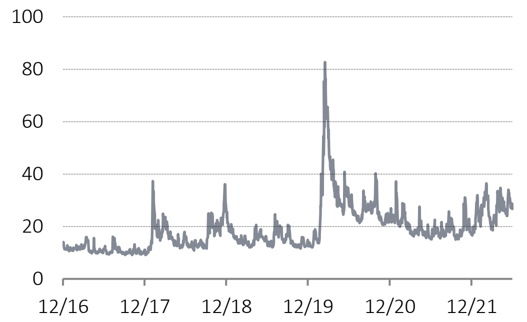


Fig 18: Equity volatility – S&P500 VIX index



ALTERNATIVE INVESTMENTS

After commodity prices rose steadily until May, we observed a market correction in June. Energy prices fell by 11%, prices for industrial metals by 16%, and prices for agriculture dropped 14.6%. It seems that recession fears, i.e., expectations for weaker demand outweigh concerns about supply side shortages. The price of gold continued to grind lower in June, declining by 1.6%. The global REITS index fell by 6.8%. The risk-off environment was particular bad for crypto assets. Bitcoin dropped 41% and Ethereum 48% in June.

Fig. 19: Gold price, USD/oz

Fig.20: Brent oil price, USD/bl

Fig 21: Bloomberg commodity indices

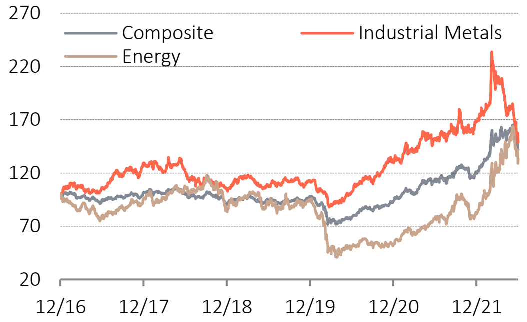


Fig. 22: HFRU hedge fund indices

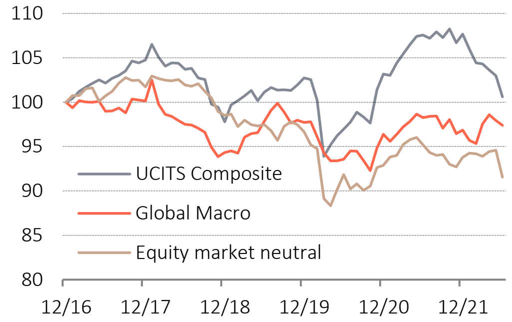
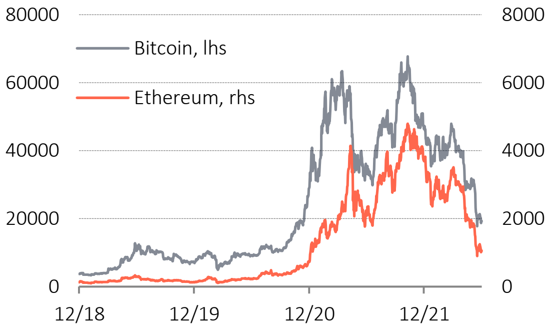


Fig 23: FTSE EPRA/NAREIT global REITS index

Fig 24: Crypto Assets



CURRENCIES

The USD remained on the strong side as the US yield advantage remained supportive and even increased further. Also the CHF remained very strong. After the SNB surprised markets with a 50 basis points rate hike, the EUR-CHF exchange rate dropped below parity. Since the Bank of Japan remained dovish, the JPY continued to weaken. The USD-JPY exchange rate broke above 135.

Fig. 25: EUR-USD exchange rate

Fig. 26: GBP-USD exchange rate

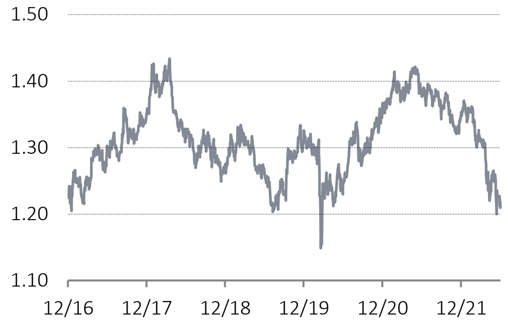


Fig 27: USD-JPY exchange rate

Fig. 28: USD-CNY exchange rate

Fig 29: EUR-CHF exchange rate

Fig 30: USD-CHF exchange rate

COVID-19

After some relief and falling numbers of new Covid cases, hospital admissions started to surge again, driven by the BA.5 subvariant of Omicron. This variant seems to be an efficient evader of Covid immunity acquired by vaccines or earlier infections with other variants. So far, most countries have not reacted with new Covid measures, especially since the new Omicron variants, still seem to be less harmful. The situation in China is very different. Although China lifted its strict lockdown rules at the beginning of June, it re-introduced local mass testing and lockdown measures in the Shenzhen and Shanghai area.

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

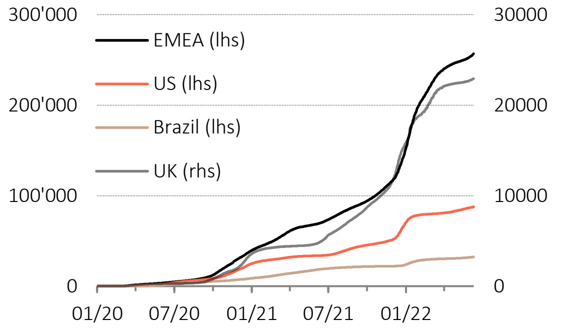


Fig. 32: New cases per day (7-day average)

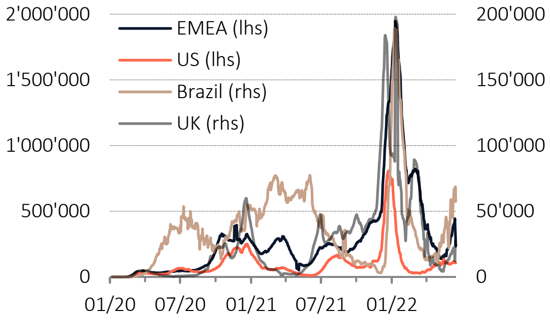


Fig 33: Vaccination rate
(% of the population fully vaccinated)

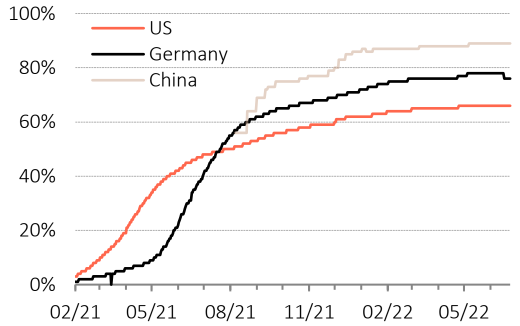


Fig.34: Central bank total assets (indexed)

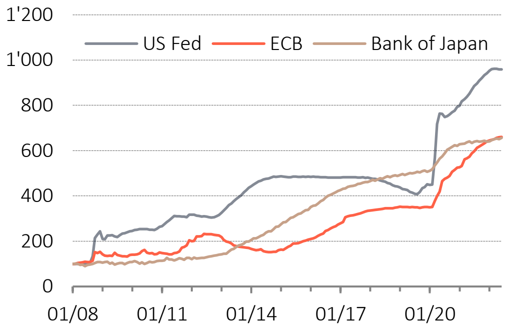


Fig 35: US bankruptcy index

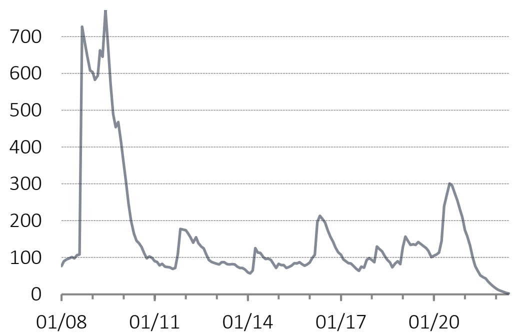
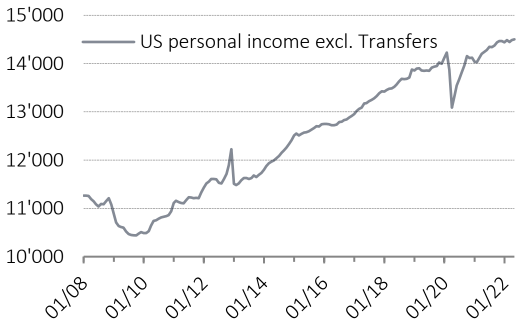


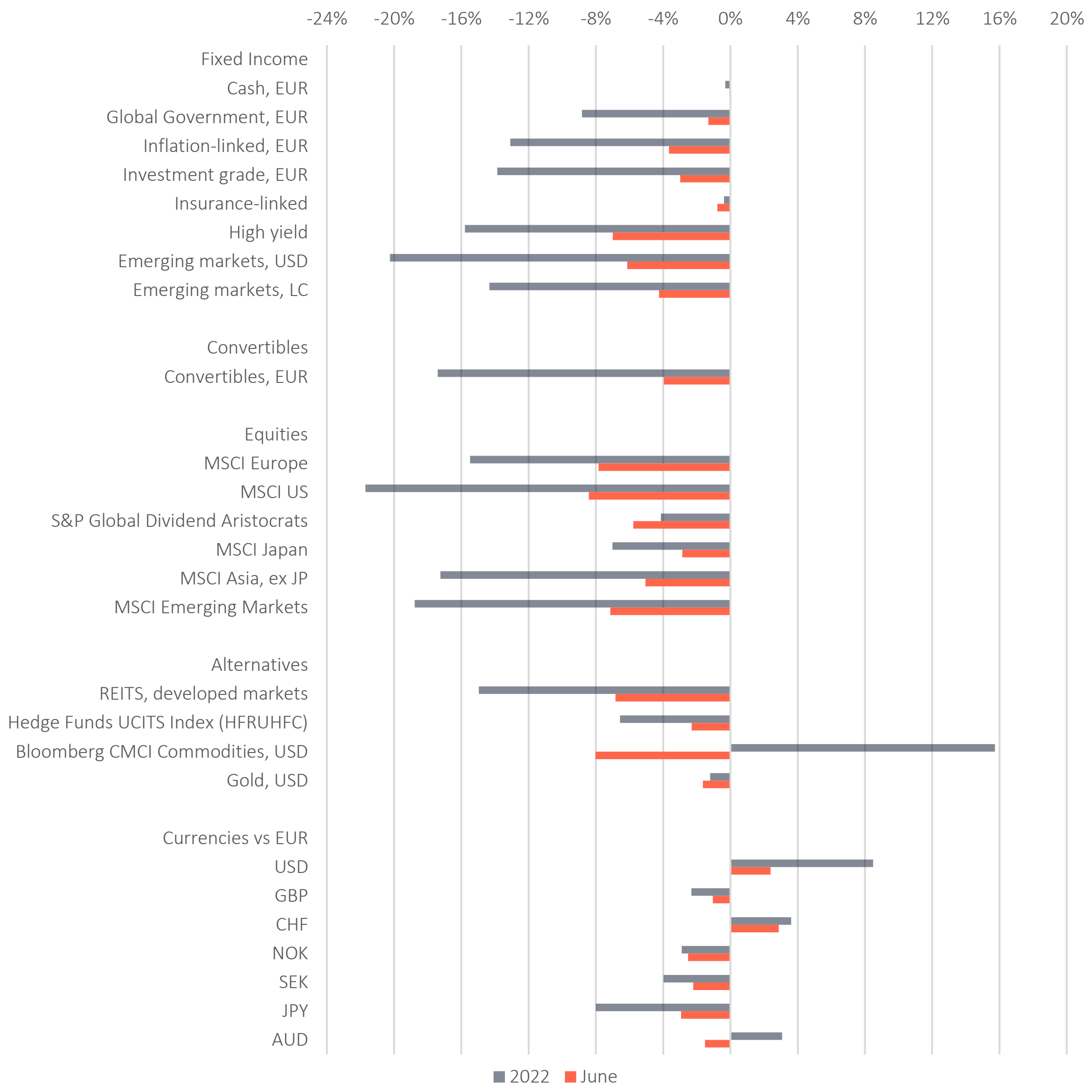
Fig 36: US personal income, excl. transfers
(USD bn, 2012 prices)



ASSET ALLOCATION

In June all asset classes, shown below, sold-off, partly even significantly. Equity and commodity markets lost the most. Year-to-date only commodities performed positively. The USD and CHF continued to appreciate. Among the alternatives, trend-following strategies performed strongly, as commodities, fixed income, currencies and equity markets show clear trends.

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

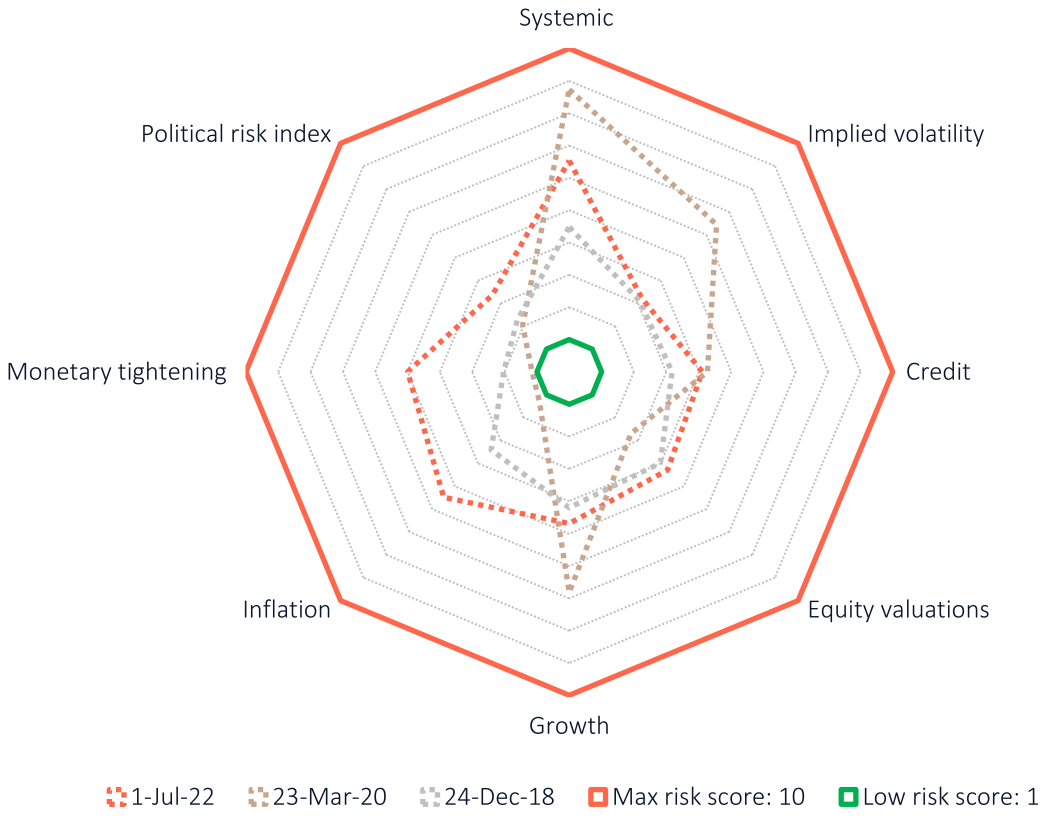


RISK MONITOR

Monetary-tightening, inflation, and systemic risks are elevated. In recent months, systemic risks (related to the stability of the financial sector) rose, especially due to the widening of financial credit spreads. Implied volatility (option prices) are not rising as much compared to past bear markets. Equity valuations are declining.

Fig. 38: IMT Risk Monitor

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



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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.