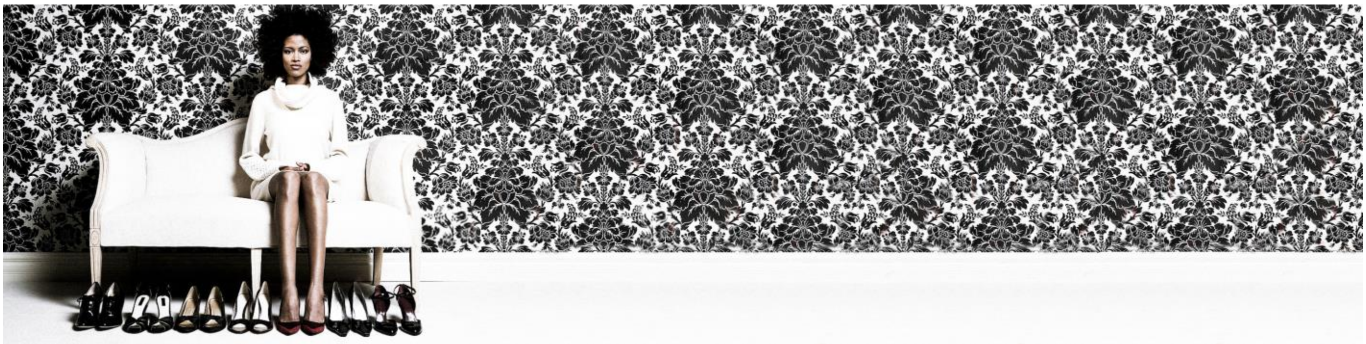
AquilaViewpoints

Market Outlook | 3rd Quarter 2022

sensusPLUS



Tactical Perspective: Macro ▼ Bonds ▼ Equities ▶ Other Asset Classes ▲

Executive Summary

- While the probability of a recession is increasing we don't think this will occur until at least next year.
- Growth momentum continues to weaken, but only slightly. There are no signs as yet of any weakening in the labor market.
- Inflation will remain well above central banks' target levels for longer, becoming a burden for companies.
- In the face of high inflation central banks are increasingly prioritizing their mandate of price stability and are raising key interest rates sharply.
- The ECB is working on a new package to support peripheral Eurozone countries.
- Interest rate hikes by the Fed and other central banks have made the bond markets nervous.
- However, the likely rise in interest rates has now, in our opinion, been sufficiently priced into yield curves.
- The mixture of high inflation, rising interest rates and a possible recession is a toxic environment for the stock markets.
- The USD is performing inconsistently but gold remains resilient.

Our macroeconomic assessment

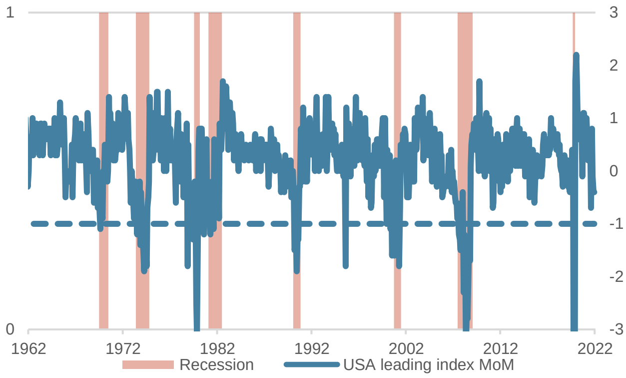
Business cycle

- We have adjusted our growth forecasts for 2022 slightly: World +3.2% (previously: +3.3%), US +2.6% (+2.7%), EU +2.5%, Japan +2.2%, China +4.2% (+4.4%), UK +2.8%, Switzerland +2.4%.
- According to a survey by Bloomberg, economists put the probability of a recession in the US within 12 months at 31.5%. The probability for the Eurozone is also around 30% with that for Switzerland slightly lower at 25%. Driving the slowdown are rising energy and food costs.
- The Purchasing Managers' indices for Japan continue to rise and are in the growth zone at over 50 points. In Europe and the US, they continue to slide back from historically high levels, but are still above the growth threshold of 50. In China, these activity indicators are rising significantly again as the severe covid-related restrictions are relaxed but they remain below 50. For China, a further rise back into the growth zone is to be expected.
- The momentum of the global economy continues to weaken slightly but remains in the growth zone.

Monetary policy

- The Fed raised its key interest rate by a full 75 basis points at the June Open Market Committee meeting. At the press conference following that meeting, Jerome Powell unequivocally placed the fight against unwelcome high inflation and regaining price stability at the forefront of monetary policy.

USA - index of leading indicators, % change month-on-month, since 1962



Source: Bloomberg Finance L.P.

- Given its concern for price stability, the SNB is emerging from the slipstream of the ECB with an interest rate increase of 50 basis points. The SNB's move is thus contrary to its previous communication to markets, namely that it would only follow the ECB in moving interest rates.
- At its regular monetary policy meeting in June, the ECB failed to announce measures to combat high (and now sharply rising) inflation in the Eurozone and in Germany. Increased interest rate premiums for Italy and Greece prevented the ECB from taking the necessary interest rate steps. Such "fragmentation" within the Eurozone is to be countered by measures, currently being worked on within the ECB, which should be authorized at the July policy meeting.

Our investment policy conclusions

Bonds

- The interest rate increases of the Fed and other central banks have made the bond markets nervous, with price losses, especially in the European markets, becoming accentuated. That said, we believe that yield curves are now pricing in the likely scale of upcoming rate increases.
- Not only have benchmark yields risen, credit spreads on investment grade corporate bonds have also risen to around 90 basis points. In the past, an increase in spreads of over 100 basis points was often the trigger for a change of course in monetary policy in the direction of easing. Thus, in 2013 Ben Bernanke announced that a planned reduction in bond purchases would not be pursued. In 2015, Janet Yellen postponed a widely anticipated first rate hike and, in December 2018, turmoil in the US bond market forced Jerome Powell to reverse course.
- However, we assume that central banks will stick to their plans for monetary tightening this time, at least for the time being. Even so, we already see interesting opportunities here and there in the higher yield levels that are now available.

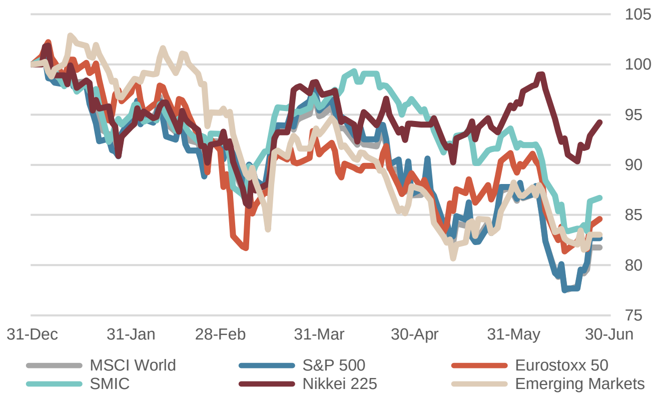
10 year government bond yields in %, last 5 years

Source: Bloomberg Finance L.P.

Equities

- The mixture of high inflation, rising interest rates and a possible recession represents a toxic cocktail for the stock markets. But we think that markets have broadly “priced in” the likely scale of upcoming interest rate hikes.
- Near-term, therefore, there is a good chance of a counter-reaction on the markets, as they are clearly oversold and sentiment is strongly negative. A significant support is coming from the companies themselves as they continue to buy in the context of their share buyback programs.
- But the Q2 reporting season, which starts in mid-July, will be challenging. Large-cap stocks probably have the best chance to surprise positively, as their size, operational advantages and balance sheet strength give them much more (pricing) power and their business models are intact. But the outlook for many smaller companies is weaker, as is being reflected in their stock prices.
- Given continued high volatility, we remain conservatively positioned and recommend a neutral to slightly underweight equity

Equity markets, performance year to date, indexed



Source: Bloomberg Finance L.P.

Forex

- With markets focusing on an increasing likelihood of a recession in the US given the Fed’s interest rate policy, the previous upward trend of the US dollar has run out of steam.
- The Fed's projected interest rate path (the "dot plots") is now seen by some economists as likely, if implemented, to induce a recession. Some think that this could prompt the Fed to change course even as early as this autumn (perhaps just before the November elections?).
- But the strength of the dollar is still very evident against the Japanese yen. The Bank of Japan's adherence to yield curve control (YCC) has led to a marked weakening of the yen. Quite a few analysts assume that a large part of current tensions within the financial system can be attributed to this.
- The Swiss franc has strengthened following the SNB’s recent bold interest rate decision and is likely to trade around parity with the EUR in the coming months.

EUR/USD, last 2 years

Source: Bloomberg Finance L.P.

Investment Strategy 3rd Quarter 2022

Meeting of the investment advisory commitee:
27.06.2022

	Asset class	Incomme	+/-	Balanced	+/-	Growth	+/-
Defensive	Liquidity	10%	0%	8%	0%	7%	0%
Defensive	Fixed income	50%	0%	30%	0%	15%	0%
Defensive	incl. Bond Funds						
Offensive	Stocks	25%	0%	50%	0%	65%	0%
Offensive	incl. Stock Funds and ETF						
Offensive	Others	15%	0%	12%	0%	13%	0%
Offensive	Real Estates, Commodities, Gold, Structured Products, Alternatives						
		100%		100%		100%	

Additional parameters

Reference currency CHF

Currency allocation

CHF	min.	50 %	
EUR	max.	20 %	
USD	max.	20 %	
GBP	max.	15 %	
Other	max.	20 %	max 10 % per currency

Variations +/- 5 % are possible for the various investment categories.

The current quarterly report has a new layout and is now called "Aquila Viewpoints". The format is the same, but the analyses are shorter, yet remain very informative. The last page shows the investment strategy for the following quarter as decided by the Investment Committee, a brief analysis of the development of the portfolios under management, and our assessments of the immediate future.
The past quarter was marked by the Ukraine war as well as by inflation, and the ensuing interest-rate hikes by the central banks. The stock markets started a downward spiral and, by the end of June, were only marginally above the level reached at the end of 2020. In addition, interest rates rose sharply. The portfolios we manage did not escape this negative trend and lost value accordingly. In comparison with the benchmarks we use, the performance of the individual asset classes was nevertheless satisfactory to good.
We expect the markets to remain uncertain throughout the further course of the year. The situation on the commodity markets remains tense and prices remain high. We deem the risk of a noticeable recession to be moderate. Economic growth will slow noticeably in the second half of the year and in 2023. Inflation will decrease only gradually. We expect the central banks to maintain their course and to further tighten monetary policy.
We remain focused on quality stocks. We pay particular attention to the business model, the consistency of management, the continuity of results, and the dividend policy.
These assessments have led the Investment Committee to keep the investment strategy unchanged.