July 2022 | Issue no. 126

Briefing from the ARVEST Investment Committee

Heavy losses in the most important asset classes marked the first half of the year. The world equity index lost almost 18% in Swiss francs, the SMI fell by over 16%. Neither Swiss franc bonds (around -10%) nor domestic real estate funds (-15%) were able to cushion these losses to any significant degree. The price corrections were even more pronounced for the speculative high flyers of last year, such as cryptocurrencies or SPACs. Have attractive investment opportunities already returned to the financial markets as a result?

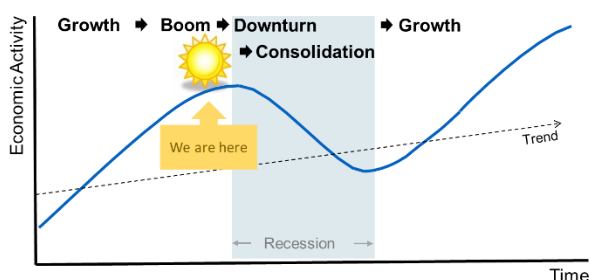
The broad price declines on the financial markets in the first half of the year were primarily caused by the central banks' reversal of interest rates. After inflation proved to be more persistent and higher than initially expected, one central bank after the other announced the prospect of raising key interest rates. Thus, the financial markets started to price in further interest rate hikes. This led to an orderly valuation correction for long-term investments. Although the war in Ukraine increased the uncertainty and thus intensified the price corrections, there was neither a liquidity shortage nor a panic in the market. While the destruction of value in recent months has been painful, the partial normalisation of policy rates has brought us closer to a sustainable financial environment. By contrast, financial markets were truly unsustainable in the years before and during the pandemic, which were characterised by extremely expansive monetary and fiscal policies. We attribute the main cause of inflation to this policy. The war has only added fuel to the fire.

Since the beginning of June, when the US Federal Reserve and the Swiss National Bank raised interest rates sharply, investments such as commodities or energy and bank stocks, which had previously benefited from rising inflation, have also corrected. Financial market participants are increasingly concerned about whether the aggressive interest rate hikes will not only fight inflation but also plunge the global economy into a recession. A recession would in turn temporarily dampen demand and thus inflation. This could allow central banks to raise interest rates to a lesser extent in the future or even to lower them again. In recent days, the financial markets have actually started to price in the first rate cuts in 2023. However, a recession in the US, which would be of crucial importance for the financial markets, is by no

means priced intothe stock markets. Analysts' expectations for corporate earnings and sales growth in 2023 are still at record levels, which is incompatible with a recession. Nor is a recession being forecast by any institute. Is a recession imminent or not?

Future Prospects

According to the ARVEST Investment Committee, economic activity in the US (and Switzerland) has slowed. However, both countries remain in a late-cycle economic boom phase with full employment. This situation is accompanied by a growth collapse in China (after the party-state-imposed Covid house arrest), strong signs of a slowdown in Europe, and very mixed economic trajectories in other countries.



For us, it is increasingly likely that the US economy could slide into recession as from the first half of 2023. The indicators we use are distorted by the effects of the pandemic and thus less reliable than previously. Without the support of positive external events, such as a falling oil price (thanks to a rising global supply or an end to the war in Ukraine) or a significant improvement in domestic consumption in China (thanks to an adjustment of the Covid policy following the preparation of the resolutions of the 20th Party Congress in November), we do not expect a turnaround towards stronger growth. We therefore expect the financial markets to continue to be driven by considerable uncertainty. Markets are likely to swing between fear and greed, as is typical in boom phases.

In view of the economic growth risks, we have again reduced the equity quota in favour of liquidity and short-term bonds with maturities of up to five years. In equities, we prefer quality stocks that are better able to withstand unwelcome surprises. The US dollar is likely to remain in demand as a safe haven for the time being as it is the reference currency for most investors.

Unfortunately, in addition to the economic growth risks, we also see the consensus of a prolongation of the forty-year growth regime with low interest rates and contained inflation in the global reserve currency, the US dollar, in jeopardy. Asian companies and institutions are increasingly trying to do business in other currencies, i.e. their own. If international investors are not compensated by attractive interest rates for the inflation risks they take in the US dollar in the coming years, this process could accelerate and the trade-weighted US dollar could fall back from its current highs.

We therefore remain cautious for the time being.

7 July 2022
On behalf of the Investment Committee
Stefan Kimmel
Chief Investment Officer ARVEST Funds AG

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