ARVEST

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Investor Info
Investment Commentary

Briefing from the ARVEST Investment Committee

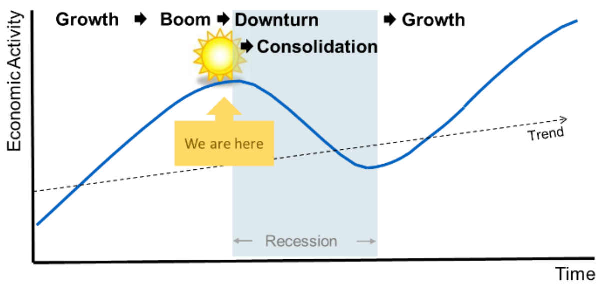
Unfortunately, the ARVEST Investment Committee does not see any trend reversal in the developments of the financial markets and the global economy compared to the previous quarter. Growth in the global economy has weakened further, while labor markets have remained stable to date. Many of the indicators we track allow no other conclusion than that the USA and the European countries will enter a recession within the next six months. Only then will unemployment also rise significantly. The Chinese economy is also likely to remain too weak to prevent a global economic contraction due to the ongoing problems on the property market, even if the restrictive zero-Covid policy were to be eased there. With this assessment, we are more pessimistic than most. In particular, investment bank analysts expect corporate profits to continue to grow, which is incompatible with a recession.

In our view, financial markets began to price in recession risks more sharply in September. As a result, by the end of September, global equity markets had lost about 20% in Swiss franc terms since the beginning of the year. However, since lower economic growth usually also leads to less inflationary pressure, bad economic news over the past few months has also repeatedly led to positive price reactions on the stock markets. After all, falling inflation would allow central banks to stop hiking interest rates earlier or even cut them again. These price rallies made perfect sense in so far as rising inflation and interest rate expectations were also decisive factors in the previous losses. Such different interpretations are currently causing stock prices to fluctuate wildly on a daily basis. In our view, this volatility is downright characteristic of a late boom phase before a recession.

The behavior of other asset classes was in line with this as well. Cyclically sensitive commodities likewise corrected in the last quarter. Globally, bonds have fallen by around 20% in local currencies since the beginning of the year due to higher interest rate expectations. The same held true for global real estate funds (-23% in CHF). Since all asset classes lost equally, diversification between equities and bonds, as is the basis of regulatory investment profiles, was unfortunately unable to protect against steep losses this year. This was possible only with different strategies, which used liquidity in strong currencies such as the US dollar and the Swiss franc or applied hedges.

Future Prospects

Both the behavior of investors in the financial markets and our assessment of the economy reinforce our belief that the entry into a recession and the associated capitulation in the financial markets are yet to happen. The ARVEST Investment Committee defines a recession according to the NBER[1] as a significant decline in economic activity extending across the entire economy and lasting longer than a few months. We include the labor market in particular in this definition of the entire economy. A technical recession, meaning a decline in GDP for at least two quarters, is just a helpful rule of thumb for us. For instance, thanks to the booming labor market, the US was not in recession in the first half of 2022 despite two consecutive negative quarters.



A capitulation on the stock markets is usually characterized by a sharp decline in stock prices (crash). This usually happens when there is a shock event and investors give up hope that this economic weakness can be overcome by the tried and tested means that brought us the last upswing. In this respect, recessions are also major crises of confidence. They are thus more than a number or a formula. Only the capitulation provokes a change in thinking and behavior. But it also enables something new to be created.

Forecasting a recession is difficult, but not impossible. Indeed, exaggerations in the business cycle can be observed, measured and compared with previous business cycles. On the other hand, we can only speculate about the exact timing and extend of the capitulation, as well as about the duration of the subsequent consolidation phase. Nonetheless, we are already concerned with the question of how the industrialized countries might emerge from the looming recession. The decisive factor will be whether inflationary pressure can be sustainably contained by a recession, or whether inflation will immediately flare up if central banks cut interest rates again. We will be monitoring this closely.

We have already reduced the equity allocation in the portfolios during the year and do not need to reduce it much more. Particularly if inflation remains stubbornly high for longer than the financial markets are currently pricing in, quality stocks with safe and sustainable dividends and global diversification of investments will remain crucial. However, we believe it is still too early to reinvest in the stock market.

10 October 2022
On behalf of the Investment Committee
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[1] https://www.nber.org/research/business-cycle-dating