

Executive Summary

- › The current macro environment remains arguably the most dangerous for risk assets since the financial crisis and March 2020.
- › Most of the negative market impulses we observe today were established before the war in Ukraine – a possible ceasefire would therefore not automatically send an all-clear signal to the markets.
- › The Fed has chosen to fight inflation, above supporting growth and financial stability.
- › The negative supply shocks are short-term inflationary but medium-term disinflationary (demand destruction).
- › In this environment, consensus estimates for US growth remain too high in our view. We expect that the repricing of these growth expectations will mark the final and sustainable bottom of the current bear phase and will provide attractive entry points into risk assets.
- › Overall, we are likely to see higher two-way realized volatility in the coming months until key geopolitical risks have subsided, and markets have fully priced in the weaker growth outlook.

Nominal yields are rising sharply as the Fed chases inflation

- Federal Reserve officials are rattled by high trailing inflation, further war-induced negative supply shocks and rising criticism that they are behind the curve.
- In consequence, they have shifted toward an even more aggressive plan for rate hikes than they signaled just 2 weeks ago.
- China may have had its “whatever it takes moment” in March, but it now needs near-term, real stimulus follow-through. The risk here remains the geopolitical overhang (with ultimate tail risk of Sino-US escalation/disintegration).

Market Development

World

- At the time of writing, the Bloomberg Barclays Aggregate Bond Index had its worst start to a year (-6.8% YTD) in the 30 years of available data.
- 10-year US yields have risen nearly 100bps this year.

- The 2-10 US yield spread has already inverted briefly – if the inversion persists, it will signal a rising recession probability in the US.
- These developments have put a lot of stress on traditional 60/40 portfolios and risk-parity strategies.
- Interestingly, 10-year US real yields have remained more or less unchanged since the start of the war in Ukraine (this has supported risk assets), while nominal yields are 50bps higher.
- Meanwhile, equities have recovered ~50% of their peak-to-trough drawdown and have now reached a “normal” retracement level for a counter-trend rally.

Europe

- Eurozone March flash PMIs came out – the first set to be released since the war broke out.
- The Euro-Area PMI composite remains robust in expansionary territory at 54.5, compared to the Bloomberg consensus forecast of 53.8.
- The dependence on Russia and Ukraine for energy needs will remain a significant problem in the coming quarters.

Switzerland

- The franc has pulled back from its multi-year peak (EUR/CHF at parity) that it reached earlier in March.
- In its baseline scenario for 2022, the SNB now anticipates GDP growth of around 2.5%, down from the previous estimate of 3%.
- It also doubled its inflation forecast for this year to 2.1% from its previous level of 1%, which is still modest in comparison to other developed markets.

Equities will have to acknowledge the growth slowdown at some point

In some ways, 2022 is becoming a mirror image of 2020. While in 2020, the Federal Reserve stimulated pro-cyclically into a strong economic recovery, this year it is tightening pro-cyclically into an economic slowdown. Other contrasts are evident in the commodities market (e.g., 2020 Oil price negative vs 2022 blowout in Nickel).

Our base case is that financial conditions will tighten (a lot) further in Q2-Q3. The Fed is unlikely to receive any feedback from its (lagging) labor market or inflation statistics to re-think its tightening path any time soon – without financial markets revolting at some point.

- We now expect 50bp hikes in May and June as well as the start of Quantitative Tightening (QT) in May.
- The outlook for corporate earnings this year is dimming simultaneously. Global analyst earnings revisions have dipped into negative territory, which implies that an earnings recession later this year is a risk for markets.
- According to Bank of America, only 5 years in the last 60 saw earnings go down while rates and inflation were going up – and each of those 5 years printed negative S&P 500 returns.
- The bottom line is that the odds of the Fed achieving a “soft-landing” are low and the probability of a recession in the US is rising (in fact, bond markets are already pricing rate-cuts for 2024).

Notwithstanding this negative medium-term outlook for risk assets, we have seen a substantial counter-trend rally in the past 2 weeks, especially in equity markets.

- The rally was fueled by extremely bearish sentiment, oversold conditions, option-market dynamics (hedges rolling off) and quarter-end rebalancing.
- As is the case with these forceful “bear rallies”, many market participants that had strongly de-risked at the lows are now feeling pressured to chase the market higher.

Keep in mind that price-moves often change sentiment, and in today’s market everything is happening a lot quicker. The current implicit rationalization for chasing equities may be something like: *“We are in a stagflationary environment, so equities are better than negative real yielding assets, like bonds or cash”.*

However, we think that this mindset will be challenged when the growth slowdown accelerates. We expect this to occur in mid-to-late Q2. We may then see a confluence

of market negatives, such as back-to-back 50bp hikes, the start of QT, peak inflation, the first evidence of commodity-crisis induced demand destruction and weak corporate guidance (margin pressure).

Positioning

We are skeptical as to whether the current counter-trend rally will prove sustainable, since most medium-term negative market impulses remain firmly intact. Furthermore, we have not seen a real capitulation in stocks. Record equity allocations mean that long-only and retail investors are not positioned for recession fears.

We believe that credit will be the key market to watch for the eventual pricing of below-trend growth in the US.

- If usual correlations hold, then a contracting credit cycle will lead long bond yields lower and not higher during H2-2022.
- History also suggests that when the yield curve first inverts, we can expect the following relative performance:

US > Rest of World equities; Growth > Value;
Large > Small; IG > HY

To us, risk management remains the highest priority in such an environment. Since October 2021, we have been gradually preparing our portfolios for a period of high volatility – by reducing credit and equity exposure while raising cash, gold and alternatives – and we remain defensively positioned. That said, upside risks for stocks may emerge in the event of better than expected earnings growth, fiscal handouts in the West or surprisingly large China stimulus.

Chart

Quality stocks with robust financial fundamentals are back in favor as the inversion of the Treasury yield curve fuels recession concerns. A Goldman Sachs index of strong balance sheet stocks has outperformed peers with weaker financials by nearly 5 percentage points since March 14.



Sources: Bloomberg, Barclays, Morgan Stanley, Kepler Cheuvreux, Nordea, Goldman Sachs, The Market Ear, Credit Suisse, Bernstein, MacroCompass, Financial Times, Finanz und Wirtschaft, Reuters, Data Trek, Citigroup, Bank of America

Disclaimer

The information contained in this document constitutes a marketing communication from FINAD (FINAD AG, Zurich; FINAD GmbH, Vienna or FINAD GmbH, Hamburg branch). This document is for general information purposes only and for the personal use of the recipient of this document (hereinafter referred to as "recipient"). It constitutes neither a binding offer nor an invitation by or on behalf of FINAD to purchase, subscribe, sell or return any investment or to invest in any particular trading strategy or to engage in any other transaction in any jurisdiction. It does not constitute a recommendation by FINAD in any legal, accounting or tax matters or a representation by FINAD as to the suitability or appropriateness of any particular investment strategy, transaction or investment for any individual recipient. A reference to past performance is not to be construed as an indication of future performance. The information and analyses contained in this publication have been compiled from sources believed to be reliable and credible. However, FINAD makes no warranty as to their reliability or completeness and disclaims any liability for losses arising from the use of this information. All opinions and views represent estimates that were valid at the time of going to press; they are subject to change at any time without notice or obligation to update. Before making any investment, transaction or other financial decision, recipients should determine the suitability of such investment, transaction or other business for their particular circumstances and independently (with their professional advisors, if necessary) assess the specific risks and the legal, regulatory, credit, tax and accounting consequences. It is the responsibility of the respective recipient to verify that he/she is entitled under the law applicable in his/her country of residence and/or nationality to request, receive and use this publication for personal use. FINAD declines all liability in this respect. Neither this document nor copies thereof may be sent to or taken into the United States or distributed in the United States or given to US persons.

This document may not be reproduced in whole or in part without the prior written consent of FINAD.

For Switzerland: FINAD AG, Talstrasse 58, 8001 Zurich, Switzerland is an independent public limited company specializing in financial services and asset management, incorporated under Swiss law with its registered office in Zurich and its domicile at Talstrasse 58. The provision of financial services by FINAD is subject to the "Swiss Code of Professional Conduct for the Practice of Independent Asset Management" of the Swiss Association of Asset Managers (SAAM), as amended from time to time, recognized by the Swiss Financial Market Supervisory Authority FINMA. FINAD is affiliated to the SAAM. The SAAM supervises and controls FINAD with regard to compliance with the aforementioned Swiss Code of Ethics and the money laundering regulations. Complaints about FINAD can be addressed to the SAAM (<http://www.vsv-asg.ch>).

For Austria: FINAD GmbH, Dorotheergasse 6-8/L021, 1010 Vienna, Austria is an investment firm pursuant to Section 3 of the Austrian Securities Supervision Act 2018 (WAG 2018) and as such is authorized to provide investment services in the areas of investment advice, portfolio management, and the acceptance and transmission of orders, in each case with respect to financial instruments. FINAD is not entitled to provide services that involve holding clients' money, securities or other instruments. FINAD is subject to the supervision of the Austrian Financial Market Authority (FMA), Otto-Wagner-Platz 5, 1090 Vienna (www.fma.gv.at). Complaints about FINAD can be addressed to the FMA.

For Germany: FINAD GmbH Deutschland, Schauenburgerstraße 61, 20095 Hamburg, Germany is the German branch of FINAD GmbH, Dorotheergasse 6-8/L/021, 1010 Vienna, Austria. FINAD is an independent financial services company specialized in investment consulting, investment brokerage and asset management (financial portfolio management). The provision of financial services by Finad is subject to the supervision of the Financial Market Authority (FMA), Otto-Wagner-Platz 5, 1090 Vienna, Austria (www.fma.gv.at) as well as the Federal Financial Supervisory Authority (BaFin), Graurheindorfer Straße 108, 53117 Bonn, Germany and Marie-Curie-Straße 24-28, 60439 Frankfurt am Main, Germany (www.bafin.de). Complaints about FINAD can be addressed to the FMA or BaFin.

© Copyright FINAD - all rights reserved.

FINAD

Financial Advisors | Since 1976