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FORUM FINANCE

1994

MONTHLY NEWSLETTER

March 2023

KEY ECONOMIC DATA PUBLISHED IN FEBRUARY

- China's Caixin PMI Manufacturing rose to 51.6 in February, above market expectations of 50.7.
- China's Caixin PMI Services rose to 55 in February, above market expectations of 54.3.
- Economic sentiment in the Eurozone rose in February (ZEW survey at + 29.7 vs. + 16.7 in January). The PMI Composite number rose from 50.3 to 52.3 (forecast of 50.7).
- In Germany, economic sentiment (ZEW survey) jumped in February (+ 28.1 vs. + 16.9 in January). The IFO Business Climate Index rose to 91.1, in line with forecasts.
- US consumer confidence dropped to 102.9 in February, below forecasts.
- The Markit US Manufacturing PMI Index rose to 47.8 in February vs. 47.2 expected. The Services PMI was also higher than expected, at 50.5.
- US payrolls in the private sector rose by 443K in January compared to forecasts of + 190K, with December numbers being revised higher from + 220K to + 269K.

Source: Bloomberg

MARKETS WERE IMPACTED BY A REPRICING OF POLICY RATES IN FEBRUARY

4%

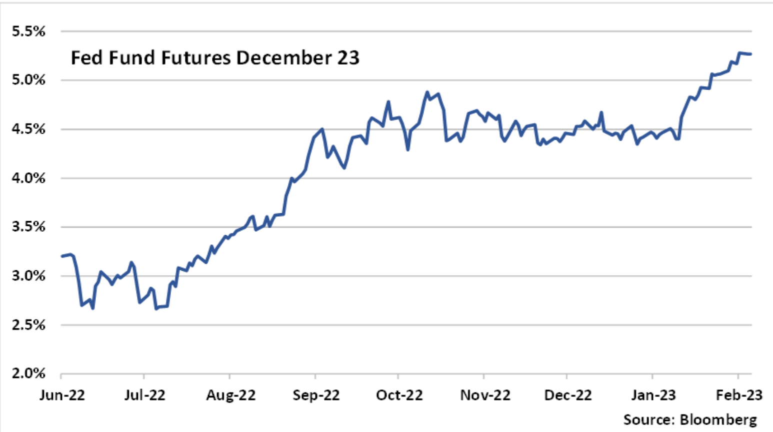
THE EXPECTED PEAK LEVEL OF THE ECB'S KEY RATE

INVESTMENT PERSPECTIVE

The early-year optimism in financial markets gave way to renewed concerns over inflation and even tighter monetary policies, triggering a significant drop of bond markets. As often observed in 2022, the volatility in bond markets rose noticeably and impacted the momentum of other asset classes. The yields of 10-year Treasuries ended the month 41bps higher at 3.92% with those of Bunds with a similar maturity climbing by 37bps to 2.65%. While European equity markets proved to be resilient, as the Euro Stoxx 50 Index edged 1.8% higher, emerging market and US ones gave back a large portion of their January gains; the MSCI EM Index fell by 6.5% and the S&P 500 Index lost 2.6%. In this context, the US dollar benefited from the widening of the interest rate differential between Treasuries and Bunds, and from its safe haven status, to record a solid performance against other major currencies. A strong dollar and higher real interest rates meant that gold saw its early-year gains being erased, while other commodity prices also dropped.

Early-year market confidence over the decline of inflation appears to have been replaced by concerns that it will be more sticky and remain higher for longer than previously anticipated. This change of outlook was triggered by the publication of inflation data which was above forecasts, on both sides of the Atlantic, and was reflected by the steep rise of inflation expectations. The correction of bond markets in February means that they are more closely aligned now with the outlooks of the Federal Reserve and the ECB, with an implicit admission that policy rates will end up at much higher peak levels than previously expected. Markets are now pricing in peak policy rates of 5.5% in the US and 4% in the Eurozone, compared to January 2023 lows for peak rates of 4.7% and 3.05% respectively.

FED FUND RATE EXPECTATIONS JUMPED IN FEBRUARY



Source: Bloomberg

The chart above shows that investors repriced their expectations for the Fed Fund December rate by close to 0.9% in February, up to 5.3% for the end of 2023. The probability for rate cuts in the second half of this year was also cut drastically; compared to expectations in January for two rate cuts of 0.25%, markets are now pricing in a 33% likelihood for one rate cut only. This anticipation of higher for longer policy rates also triggered a significant upwards shift of yield curves.

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INVESTMENT STRATEGY

We maintained our defensive asset allocation in February. Thanks to an underweight allocation towards equities and a low duration of the fixed income exposure, the drawdown of portfolios was not too deep. In last month’s newsletter, we had reiterated our scepticism about the markets’ optimistic outlook over a pivot by the Fed in the second half of 2023 and were therefore not surprised by the retreat of equity markets in view of rising bond yields. We believe that equity risk premiums are not attractive at this stage, leading us to remain cautious, especially in view of concerns over profit margins and the path of earnings.

We are closely observing the level of European bond yields as we are approaching a point where we would likely increase the duration of the portfolios. The latest developments in bond markets also mean that the recent appreciation of the US dollar has stalled. As we did not reach our first target on the EUR/USD parity, we have not yet reduced our dollar exposure for non-USD denominated portfolios.

INVESTORS HAVE BACKTRACKED FROM THEIR OPTIMISTIC STANCE OVER TERMINAL RATES

PORTFOLIO ACTIVITY/NEWS

February was a negative month for the portfolios as both the equity and fixed income asset classes were detractors, while hedge funds produced only a marginal positive contribution. For non-USD denominated portfolios, the appreciation of the dollar provided a welcome positive contribution. Some of January’s best performing funds fared the worst during the month under review; the metal mining fund and Chinese equities were the largest equity detractors, whereas emerging market corporate bonds and the long duration investment-grade fund were the biggest fixed income ones. European Value and cyclical equities provided the best contributions within the equity asset class and the short duration European high yield fund generated the only positive fixed income contribution.

In February two new funds were approved by our investment committee. The first one runs a systematic Global Macro strategy based on fundamental and price-based indicators. The fund combines carry, fundamental, trend-following and value/reversion strategies, and displays a remarkable track-record over an extended number of years. The second fund is a concentrated US Value fund, which seeks to invest into great businesses trading at a “bargain”. Since its inception in 2008, the strategy has outperformed both its Value bench-mark and the broader S&P 500 Index.

	End 2022	January 2023	February 2023	MTD	2023
Equities					
S&P 500	3’839.5	4’076.6	3’970.2	- 2.6%	+ 3.4%
Euro Stoxx 50	3'793.6	4'163.5	4'238.4	+ 1.8%	+ 11.7%
MSCI EM	956.4	1’031.5	964.0	- 6.5%	+ 0.8%
Yields					
UST 10-year	3.87%	3.51%	3.92%	+ 41bps	+ 5bps
Bund 10-year	2.57%	2.29%	2.65%	+ 36bps	+ 8bps
BBB EU	4.42%	3.94%	4.30%	+ 36bps	- 12bps
Currencies					
EUR/USD	1.071	1.086	1.058	- 2.6%	- 1.2%
USD/CHF	0.925	0.916	0.942	+ 2.8%	+ 1.8%
EUR/CHF	0.990	0.995	0.997	+ 0.2%	+ 0.7%
GBP/USD	1.208	1.232	1.202	- 2.4%	- 0.5%
Commodities					
CRB Index	277.7	278.1	269.8	- 3.0%	- 2.8%
Oil (WTI)	USD 80.3	USD 78.9	USD 77.1	- 2.3%	- 4.0%
Gold	USD 1’824	USD 1’928	USD 1’827	- 5.2%	+ 0.2%

Source: Bloomberg