VSWA Flash

Monetary policy combined with slower economic growth

MARKET PERFORMANCES (as of September 30, 2022 – 14:57 CET)

	CURRENT	CHANGE 1 WEEK	CHANGE YTD		CURRENT	CHANGE 1 WEEK	CHANGE YTD
S&P 500 Index	**3'640.47**	**-3.13%**	**-23.62%**	**Gold**	**1'664.87**	**1.27%**	**-8.98%**
S&P/Toronto Stock	**18'441.84**	**-0.21%**	**-13.10%**	**Silver**	**18.94**	**0.38%**	**-18.73%**
EuroStoxx 50	**3'299.11**	**-1.48%**	**-23.25%**	**Oil WTI**	**80.76**	**2.57%**	**7.38%**
SMI Index	**10'194.69**	**0.56%**	**-20.82%**	**EUR/USD**	**0.9760**	**0.75%**	**-14.16%**
DAX Index	**12'070.73**	**-1.74%**	**-24.01%**	**EUR/CHF**	**0.9555**	**-0.33%**	**8.58%**
Nikkei Index	**25'937.21**	**-4.48%**	**-9.91%**	**USD/CHF**	**0.9790**	**0.29%**	**6.75%**
Emerging Market Index	**54'161.21**	**-2.87%**	**-22.69%**	**USD/JPY**	**144.53**	**-0.84%**	**20.38%**
Yield 10Y US Treasuries	**3.710**	**0.0235**	**2.2003**	**CAD/USD**	**0.7285**	**0.99%**	**8.61%**
Yield 10Y German Bund	**2.085**	**0.0684**	**2.6600**	**USD/CNY**	**7.1143**	**0.20%**	**10.66%**

[Source: Bloomberg]

Tighter monetary policy globally meets…
You have heard it before, but we are getting a bit tired of talking about inflation and monetary policy week after week. But most recent data releases suggest there is no respite in inflation concerns as we approach the last quarter of 2022. However, this theme continues to largely influence asset prices day after day, not only in fixed income and currencies but also within equity markets.
Despite signals that global economic growth is slowing, central banks are staying the course in substantially tightening monetary policy. Last week, several developed market central banks strengthened their hawkish stance including the Fed. Their communications indicated a persistent willingness to further large increases in interest rates can be expected because of the level and persistence of inflation.
Fed Chair Powell suggested a high bar for slowing the pace of hikes amid sustained inflationary pressures, resilient growth, and a still-robust labor market. The dot-plots show a terminal rate of 4.625% in January suggesting additional interest rate hikes of 75bps in November, 50bps in December and 25bps in January. However, a faster deterioration in the labor market could lead the Fed to shift down the pace of tightening or to reach terminal rate level earlier than expected. The ECB communication was also hawkish, with ECB President Lagarde and other members of the Council reiterating their view for further hikes to curb inflation, despite slowing demand. The central banks of small open European economies have tightened policy sizably too. In Sweden, the Riksbank hiked the policy rate by 100bps to 1.75% against market expectations of a 75bps increase. In Norway, Norges Bank increased the deposit rate by 50bps to 2.25%. In Switzerland, the SNB ended the era of negative rates and moved its policy rate from -0.25% to 0.5%.

… lower growth
We believe that the pace of monetary tightening is slowing economic activity globally. Euro area flash PMIs in September declined further below 50 (prints below this level mean contraction in activity) both in the manufacturing and services sectors. They signal a pace of slowdown comparable to the beginning of the 2011 recession. However, the employment index remains high, albeit continuing to decline in the manufacturing sector.
In the US, PMIs rebounded strongly especially in the services sector, providing a signal now more in line with the ISM data. High frequency indicators for all sectors are holding up better than in other major economies. We believe that tighter policy slows the economy further below its potential, pushing the unemployment rate higher and lowers consumption more meaningfully in 2023. In addition, higher rates most directly affect new investment decisions, this is true in residential construction and in business spending. The data flow of recent months already points to declines in response to higher growth rates, and a higher peak rate will worsen the declines. Tighter monetary policy and lower growth expectations resulted in another week of negative performance across assets with bonds and equities selling off together.

Rising real yields continue to be a major headwind for valuations across assets. Current levels of equity valuations may not fully reflect related risks and we assume that we do not have reached a market trough yet. Since the "Grand Financial Crisis", TINA (there is no alternative) has been a key support for equities. Real yields declined strongly, stocks were more attractive versus fixed income, with relatively high equity risk premia. Investors are now facing TARA (there are reasonable alternatives) with bonds appearing more attractive. In our multi asset currency mandates we remain our equity weighting and stay slightly underweighted. Recently, we deployed some cash and reinvested the proceeds in medium-term bonds for CHF and EUR mandates. Finally, attractive yields can be achieved.