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BONHÔTE

Inflation seems to have peaked

Overview

Highlights this week include the ECB's probable rate lift-off on 21 July and initial jobless claims out of the US. Inflation rates are peaking in all corners of the globe, having risen on the back of cheap money during the recent pandemic and surging energy prices. Central banks are fighting this wave of price gains by drastically tightening monetary policy. The market now expects short-term rates to be 3.5% in the US and 1.7% in Europe. But policy rate hikes may turn out to be more moderate than currently expected. The European Commission believes that inflation has probably peaked and as a result expects a rate of 7.6% in 2022, falling to 4% in 2023.

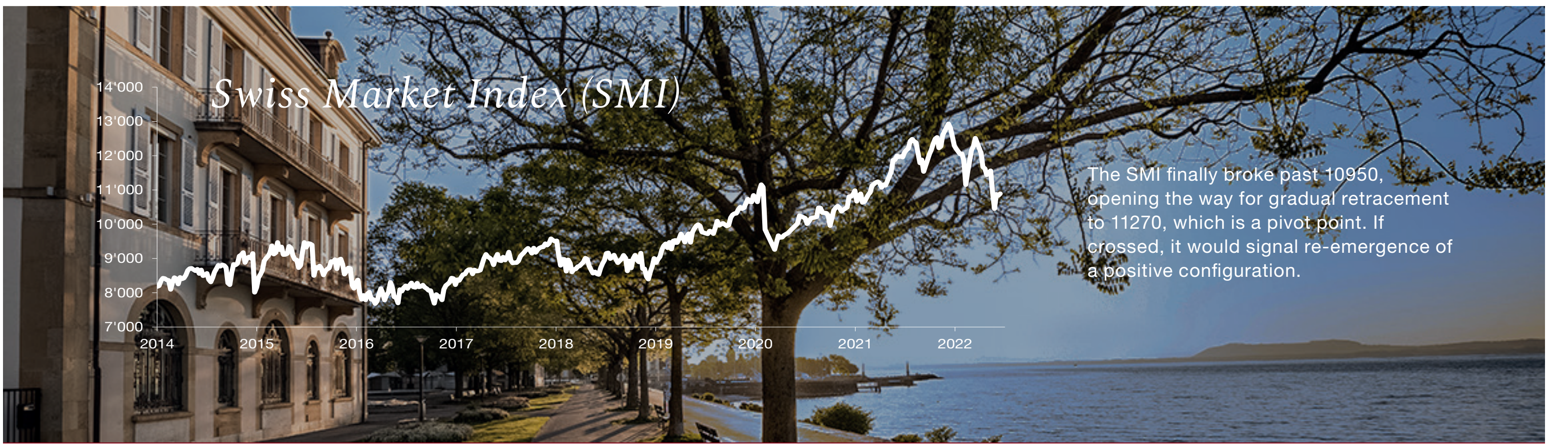
ECB set to kick off rate-hike cycle on Thursday

The first effects of restrictive monetary policies are being felt. Experts are revising down their growth forecasts. The IMF puts US growth at 2.3% this year. The equivalent figure for Europe, issued by the European Commission, is 2.4%. We think these forecasts are slightly too upbeat, especially for Europe. On our estimates, growth will be positive but closer to the zero mark. This is because the labour market in Europe is much less flexible than in the US and does not have scope for wage adjustments based on current inflation. Making matters worse, Europe has scant production assets for fossil fuels and is therefore dependent on the prices set by global markets. Demand is beginning to wane in tandem with higher petrol-pump prices. Note that oil prices – though still lofty and subject to fluctuations – have reverted to below their June peak.

The macroeconomic slowdown has well and truly begun. The probability of a recessionary interlude has increased to 50% in the US and is even higher in Europe. But strange times also bring opportunities. History has shown that periods of economic downturn have been followed by periods of high returns for those investors who have taken advantage of adverse conditions. Financial markets and the real economy tend to evolve out of step with each other. The former acts as a leading indicator of the latter, so during difficult times the market falls back early on but also bounces back before the economic upturn is replicated in the statistics.

Macroeconomic slowdown has well and truly begun

Markets halted their losses in June. Long-term bonds gained 6%, Swiss real estate clawed back 7% and equity indices recovered across the board. The low market liquidity typical of the summer period could give rise to volatility and opportunities that we have every intention of harnessing. Revisions to our investment strategy are in the pipeline.



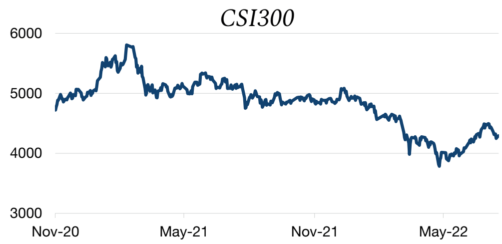
The SMI finally broke past 10950, opening the way for gradual retracement to 11270, which is a pivot point. If crossed, it would signal re-emergence of a positive configuration.

Key data

	USD/CHF	EUR/CHF	SMI	EURO STOXX 50	DAX 30	CAC 40	FTSE 100	S&P 500	NASDAQ	NIKKEI	MSCI Emerging Markets
Latest	0.98	0.98	10'982.09	3'477.20	12'864.72	6'036.00	7'159.01	3'863.16	11'452.42	26'788.47	961.85
Trend	→	↓	↑	→	→	↑	→	↑	↑	↑	↓
YTD	7.01%	-5.06%	-14.71%	-19.10%	-19.01%	-15.62%	-3.05%	-18.95%	-26.80%	-6.96%	-21.93%

(values from the Friday preceding publication)

Better prospects from China



Despite China's lacklustre second-quarter growth of 0.4% year-on-year, the outlook for the year as a whole is still well above Western countries. According to Beijing, China's GDP is set to expand by 5.0-5.5% in 2022. We think 4% is more likely.

Even so, such growth is undeniably an advantage in a global comparison, and the Chinese equity market now seems to be taking this on board. China's market index, the CSI300, has started to recover, rising by 14% from late-April lows. Increased confidence can be explained by several factors:

» The gradual reopening of the country's major cities is a cornerstone of the new relaxed policy, after the government's zero-covid policy and resulting lockdowns took a heavy toll on the country's economy by crippling logistics and supply chains.

» The Chinese government has introduced more than 33 specific measures to support the economy.

» China's low inflation (approx. 2.5%) gives the central bank plenty of leeway for rate cuts if necessary. Given the red-hot inflation in the West, neither the Fed nor the ECB has such an advantage.

We also note sharp increases in foreign investment during June (+17%) and a less severe default rate in the real estate sector than expected. Beijing seems to have succeeded in preventing this sector from imploding through supportive measures.

Although covid is still the main unknown, the Chinese market may be the unexpected winner for investors in the second half of this year.

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