INVESTMENTS

MONTHLY COMMENT

May 2022

MARKET REVIEW

The USD as a symbol of market hysteria

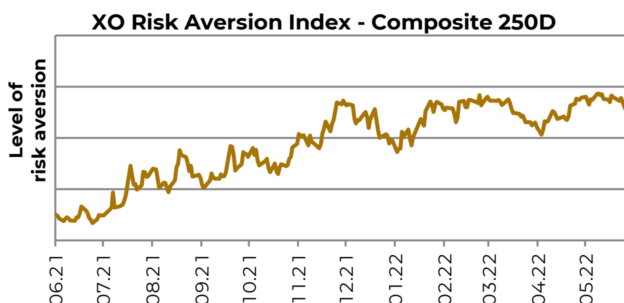
If one month of 2022 were to sum up the year, it would undoubtedly be May. The movements were enormous in this traditionally volatile month. All assets started off with a violent decline before an apparent calm returned and allowed for less red-hot performances. The markets were obviously shaken by the war in Ukraine, but above all by concerns about inflation on all products.

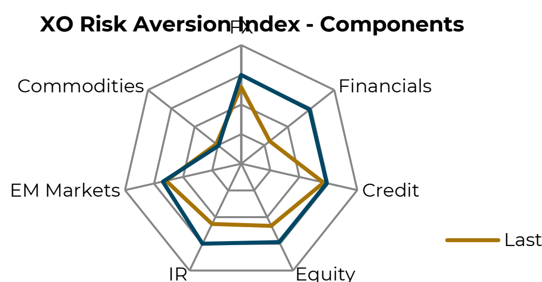
In this context, equities ended slightly positive on almost all markets. The only exceptions to this rule are Switzerland, which is led down by major stocks such as Roche and Nestlé, and the Nasdaq.

Interest rates have paused in their rise, allowing bond indices to stop bleeding. Swiss real estate, on the other hand, continues to decline, falling 6% since the beginning of the year. The most glaring symbol of this ambient nervousness is the fact that the USD rose at the beginning of the month against the CHF, temporarily exceeding parity. The rest of the month was less vivid, as it ended negative, just above 0.95. Finally, commodities resumed their rise, with the exception of gold.

The overall risk indicator remains high but is gradually being reduced.

	Value	May	2022
Equity markets			
Switzerland (SMI)	11 611	-4.27%	-9.82%
United States (S&P500)	4 132	0.01%	-13.30%
Europe (Euro Stoxx 50)	8 535	0.87%	-10.07%
Japan (Nikkei)	27 280	1.61%	-5.25%
China (Shanghai SE)	3 186	4.57%	-12.46%
Brasil (Bovespa)	111 351	3.22%	6.23%
Currencies			
USD/CHF	0.958	-1.38%	4.98%
EUR/CHF	1.030	0.35%	-0.71%
GBP/CHF	1.209	-1.20%	-2.00%
EUR/USD	1.073	1.76%	-5.62%
Other asset classes			
Swiss Real Estate		-4.42%	-9.44%
Swiss Bonds		-0.59%	-8.48%
Foreign Bonds		-0.28%	-8.33%
Commodities		5.07%	47.04%
Oil	114.67	9.53%	52.47%
Gold	1 845.97	-2.69%	0.92%
Rates / Indicators			Δ
10 years Swiss rate		0.89%	1.02%
10 years US rate		2.84%	1.33%
US Unemployment		3.60%	-0.30%
US GDP		3.50%	-2.00%
US CPI		6.20%	0.70%





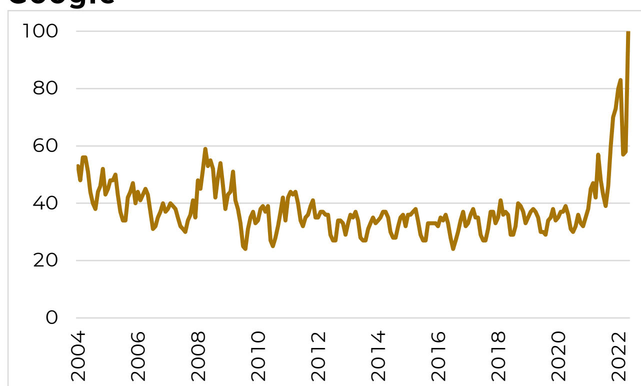
BONDS BEYOND LIMITS

Terrible start to the year for bonds with extreme performances, beyond all historical statistics

Inflation disrupts rates

The term inflation has been on everyone's lips since the beginning of the year. With shortages of products such as oil and flour, steep rises in others and longer delivery times, investors are gradually becoming aware that a new world is taking hold. The proof is in the pudding, as the word "inflation" is the number one search term on Google in May 2022. Household purchasing power is becoming the main focus.

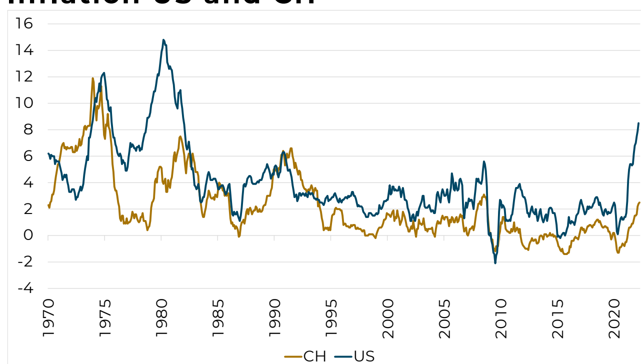
Search for the word « Inflation » on Google



Source : Google Trends, XO Investments SA

The consumer price index reflects this. The US is over 8%, and the figure is similar for Europe. In Switzerland, the rate is 2.4%, the highest level in 15 years. This change in trend takes us back to the 1970s, a period of high inflation. And this has consequences for the development of interest rates.

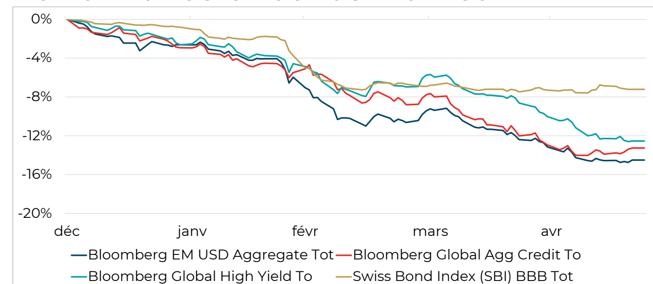
Inflation US and CH



Source : Bloomberg, XO Investments SA

All global bond markets are under pressure from central bank announcements and inflation figures from different countries each month. Whatever the market, performances are largely negative in a strong downward movement. Bond indices lost between -8% for Switzerland and -14% for the global credit and emerging markets.

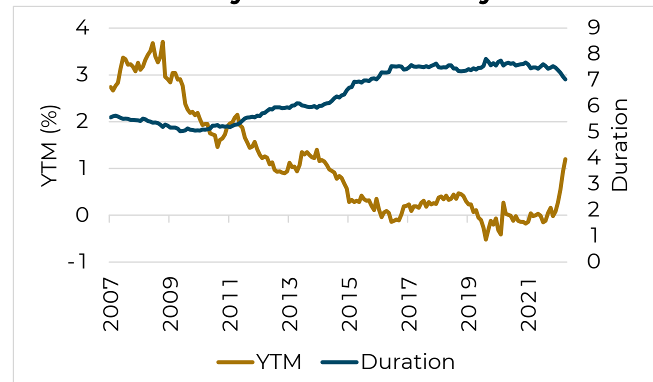
Performance of bonds market



Source : Bloomberg, XO Investments SA

The SBI index, which for a long time had a negative yield to maturity, is back above 1% with a spectacular boost. The average duration is falling slightly to below 7 years. The market is therefore being totally disrupted by these new economic configurations.

Duration and yield to maturity SBI

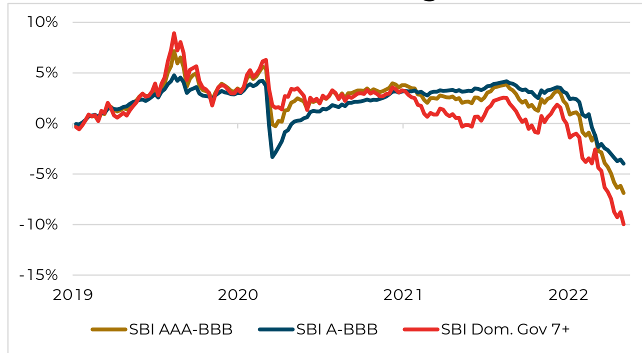


Source : Bloomberg, XO Investments SA

Credit less affected than long maturities

All segments of the SBI are largely negative. Even though credit is suffering from an anticipated slowdown, it is the long investment grade bonds that are most affected by the tightening of rates. The Swiss domestic government segment with maturities of more than 7 years is down by more than 10% over the year.

Performance of the SBI segments



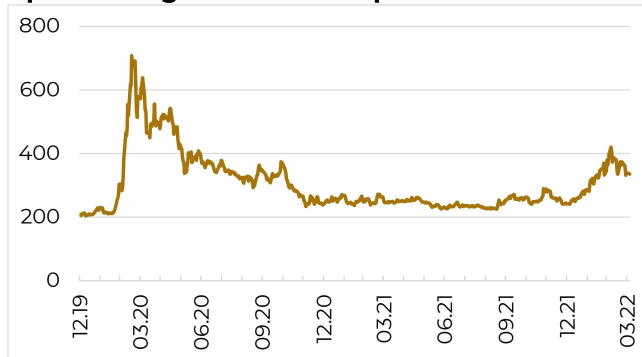
Source : Bloomberg, XO Investments SA

Credit spreads, i.e. the difference in yield between a credit bond and a government bond, are rising. But this stress is much less than during the Covid lockdown. Both investment grade and high yield bonds in Europe are seeing their spreads widen to 80 and 400 basis points respectively.

Spread Investment Grade Europe

Source : Bloomberg, XO Investments SA

Spread High Yield Europe



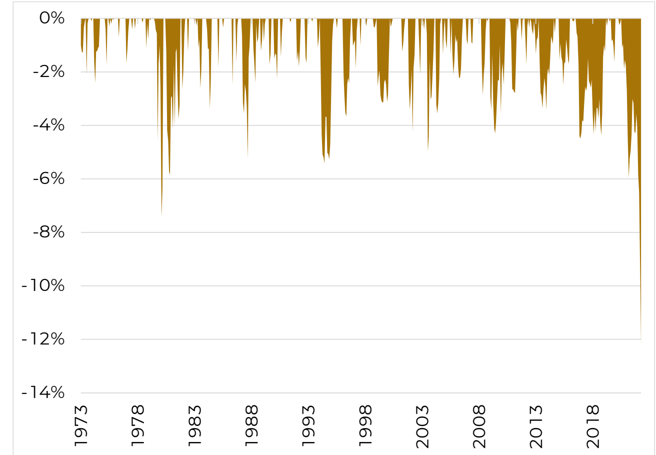
Source : Bloomberg, XO Investments SA

Losses beyond statistics

The losses since the beginning of the year represent statistical records. If we look at the maximum drawdowns of all the major bond indices, i.e. the extreme losses between the high and low points of the crisis, we exceed all historical figures.

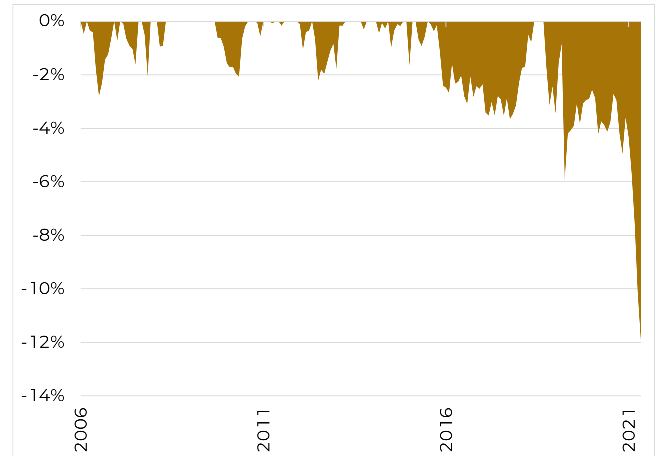
The performance of US Treasuries has exceeded a 10% loss, which is well above what was recorded in the stagflationary years of the 1970s. Never before has the SBI (Swiss Bond Index) posted a loss of more than 10%.

US Treasury bills drawdown



Source : Bloomberg, XO Investments SA

Drawdown SBI

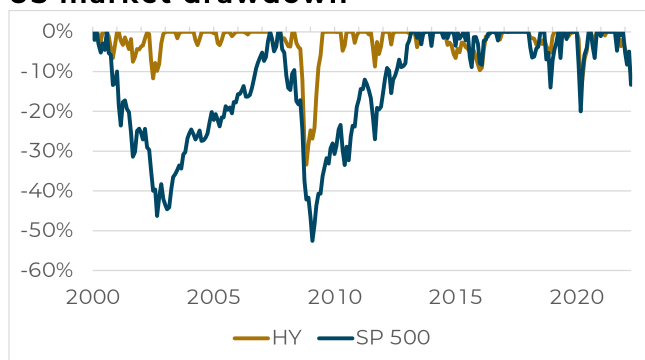


Source : Bloomberg, XO Investments SA

For global investment grade indices or European treasury bills, the conclusions are identical. All markets are experiencing extreme downturns in a very short period of time.

The current situation is even more extreme when you consider that both bonds and equities are in a period of massive drawdown. Rarely have both asset classes performed so negatively at the same time.

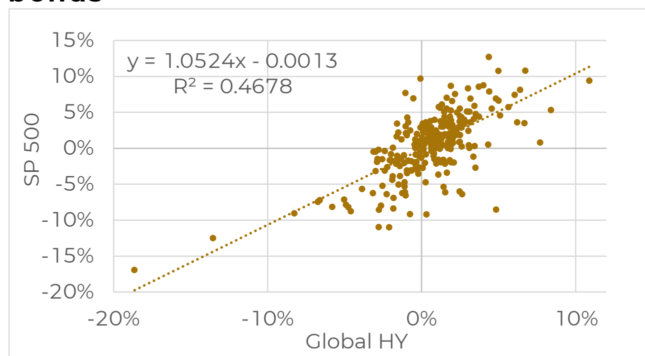
US market drawdown



Source : Bloomberg, XO Investments SA

We can go further in this reflection by comparing the performance of US equities and the high yield bond index. A non-statistically significant link seems to be established between these two variables.

Link between equities and high yield bonds



Source : Bloomberg, XO Investments SA

In fact, the correlation is becoming more and more important. The correlation since 2000 is 68%. When using data since 2013, it rises to 74%. Finally, when we look at the performance of high yield stocks and bonds since 2019, we see a correlation of 81%. So, the principle of diversification diminishes over time.

This phenomenon is identical if we compare equities to a global bond index with a correlation that goes from 39% between 2000 and 2022 to 67% since 2019.

This finding is probably linked to the massive injections of liquidity by central banks.

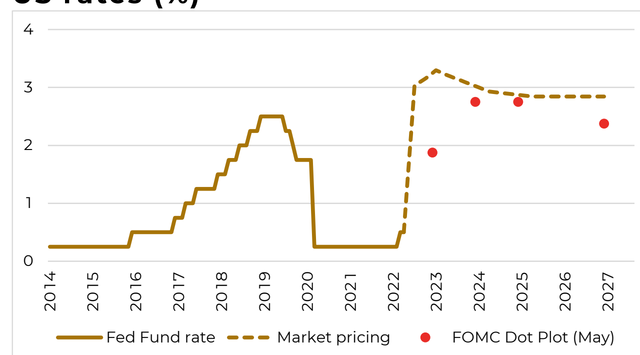
The anticipated upward cycle

Financial markets always anticipate, so it is no different in the current crisis. The FED's

speeches are scrutinised by all players who adapt their interest rate expectations to the FED's stated desire to raise rates quickly.

However, the market now seems to be anticipating more interest rate hikes than the members of the US Federal Reserve want to achieve. This is what the chart below seems to show us with market rates above the stated averages of the FED members.

US rates (%)



Source : Bloomberg, XO Investments SA

The market thus appears to be relatively extreme in its forecasts. The negativism displayed by all markets, especially the bond markets, is at an all-time high.

We therefore feel it is prudent not to expect more extremes in the future. As interest rates have risen, the spread between equity and bond yields is normalizing. Bonds are gradually becoming more attractive again, with bond yields approaching equity dividends and reaching absolute levels that are starting to become attractive for an investor willing to take little risk while generating a decent return. Finally, if inflation were to stabilise, interest rates would undoubtedly take a break, allowing a recovery of some of the losses of 2022.