TRAMONDO
INVESTMENT PARTNERS

MARKET COMPASS

A MONTHLY BRIEFING ON THE STATE OF THE FINANCIAL MARKETS AND OUR TACTICAL POSITIONING.

08/2023

TACTICAL POSITIONING

Cash	○	●	○	○	○
Fixed Income	○	○	○ →	●	○
Equity	○	○	●	○	○
Alt. Assets	○	○	○	●	○

We are happy to explain our detailed tactical positioning to you in a conversation. Please contact us.

SPOTTED

Credit demand in the Eurozone – According to the latest ECB data, demand for corporate loans in the Eurozone fell to a new all-time low in Q2 2023. The reasons for this are anchored both on the supply side – more restrictive lending standards of banks – and on the demand side – companies are reducing debt financing due to the high interest rate level as well as a slowdown in economic momentum.

SOON IN FOCUS

Jackson Hole meeting – The annual meeting of the world's most important central banks in idyllic Jackson Hole (Wyoming, USA) will take place this year from August 24 - 26. The meeting, which attracts a great deal of attention from the investment community, has already had a significant impact on the dynamics of the financial markets on several occasions in the past, most recently in the investment year 2022, when Fed Chairman Powell vehemently and unequivocally defended his cycle of interest rate hikes.

MARKET REVIEW

NO SUMMER FATIGUE ON EQUITY MARKETS

Solid earnings season supports equity market momentum – In the USA, around 60% of the companies have published their Q2 2023 figures as of the end of July. As an interim conclusion, it can be stated that "Corporate America" continues to perform robust, despite an advanced economic cycle. While S&P 500 earnings growth is clearly negative at -7.0%, around 80% of companies have exceeded (modest) analyst expectations, which is rather high in a historical context. In terms of earnings growth, cyclical companies in the US are currently performing particularly strong, as sectors such as Industrials, Consumer Staples and Financials continue to benefit from solid economic momentum. In Europe, companies also have made a decent start to the earnings season, although the cyclical sectors are finding it much more difficult to convince investors with their results – the deteriorating economic environment in the Eurozone is certainly not helping in this context. Given this starting position, it comes as no surprise that the US equity index S&P 500 (+3.1% in July) once again outperformed the other regional equity indices in the month under review - Europe's EuroStoxx 50 (+1.6%) and Switzerland's SMI (+0.3%) posted only modest gains despite robust quarterly corporate figures.

Possible end to interest rate hikes – The European Central Bank (ECB) and the Federal Reserve (Fed) each raised their reference interest rates by 25 basis points in the reporting month. After key interest rates in the Eurozone (reference rate at 4.25%, highest level since 2008) and the US (reference rate at 5.50%, highest level since 2001) have now reached levels that would have been unthinkable a few quarters ago, there are now increasing signs that the interest rate hike cycles in both regions are finally coming to an end. At their most recent meetings, both central banks chairs emphasized that future monetary policy decisions should be based even more on economic fundamentals, with labour market, inflation and economic growth figures naturally playing a key role in this context. This rhetoric provides monetary policy makers with the necessary flexibility to analyze the effects of the tightening campaign orchestrated over the past 18 months with the greatest possible objectivity. Based on the current fundamental situation, the probability is relatively high that the era of interest rate hikes is over for the time being, with the potential for surprises in the Eurozone probably being somewhat greater at present.

European industry under pressure – Eurozone In the European industrial sector, the latest leading indicators point to declining economic momentum. The Purchasing Managers' Index for the Eurozone industry fell to a level of 42.7 in July, well below the growth threshold of 50 points. The situation currently looks particularly bleak for Switzerland's most important trading partner: In Germany, the corresponding index fell to a level of just 38.8, a value that was only briefly undershot during the COVID-19 lockdown in 2020. Accordingly, it is not surprising that certain representatives from the industry (BASF, Lanxess, Lonza, Interroll) have issued a rather weak business outlook for the second half of 2023 in the course of the current earnings season.

DID YOU KNOW THAT..

..LONG-TERM BONDS OFFER ATTRACTIVE RETURNS AFTER THE END OF A MONETARY TIGHTENING CYCLE?

Last rate hike	Change in 2-year yields	Change in 10-year yields	6-month return of short-term bonds	6-month return of long-term bonds
21.08.1984	-2.2%	-1.0%	11.0%	19.3%
04.09.1987	-1.0%	-1.0%	6.1%	11.6%
24.02.1989	-1.3%	-1.2%	7.0%	12.0%
01.02.1995	-1.4%	-1.2%	5.6%	12.8%
16.05.2000	-1.0%	-0.8%	5.5%	9.3%
29.06.2006	-0.4%	-0.5%	3.7%	8.9%
19.12.2018	-0.9%	-0.7%	3.8%	11.4%
Average	**-1.2%**	**-0.9%**	**6.1%**	**12.2%**

US GOVERNMENT BOND YIELDS AFTER INTEREST RATE HIKES;
SOURCE: BLOOMBERG, TRAMONDO

HISTORY HAS TAUGHT US THAT THESE ISSUERS HAVE BEEN ABLE TO GENERATE SIGNIFICANT EXCESS RETURNS AFTER THE LAST INTEREST RATE HIKE BY CENTRAL BANKS.

In view of the advanced stage of the monetary and economic cycle, we currently consider high-quality government and corporate bonds with longer maturities to be an attractive investment opportunity. History has taught us that these issuers have been able to generate significant excess returns after the last interest rate hike by central banks. For example, over the last seven Federal Reserve rate hike cycles, long-term US Treasury bonds have returned an average of 12.2% in each of the six months following the last rate hike. At a closer look, this fact should not come as much of a surprise: At the end of a monetary tightening cycle, bonds offer high coupons as well as the potential for price gains if late-cycle growth concerns in financial markets cause bond yields to fall.

As discussed at the beginning of this paper, we believe that the rate hike cycle in the US is likely to be over. Only an overly strong comeback of inflation might prompt the Federal Reserve to raise interest rates again – but overall, we consider the chances of such a scenario to be rather low.

At Tramondo, we evaluate the monetary policy cycle very closely in order to draw conclusions about the performance of different market segments. In this context, it is amazing how historical patterns, some of which played out on the financial markets several decades ago, can also be found in current data. Accordingly, in the context of tactical asset allocation, we always try to incorporate empirical data analyses into our decision-making process. There is no doubt that historical correlations cannot always be applied to a given financial market constellation, but empirical patterns help us to better quantify the probability of success of our investment decisions. Or as the American writer Mark Twain once aptly put it: «History does not repeat, but it often rhymes».

LOOKING AHEAD TO THE NEXT FEW MONTHS, WE RECOMMEND A QUALITY-ORIENTED SELECTION APPROACH WITHIN EUROPEAN EQUITY MARKETS.

MARKET OUTLOOK

On the back of a solid earnings season, global equity markets once again posted robust gains in the month under review. Our proprietary market indicators currently point to a balanced risk/reward setup in equity markets, which is why we are maintaining our neutral equity allocation in August. On a relative level, US equity markets are currently in the favourite position, as fundamental as well as technical factors favour a constructive stance. Looking ahead to the next few months, we recommend a quality-oriented selection approach within European equity markets, as the noticeably weakening economic cycle holds out the prospect of a more challenging second half of the year. Accordingly, we prefer cyclically resilient business models for this region, predominantly in the healthcare and consumer goods sectors, selectively also in industrials.

On a global level, we reaffirm our balanced sector strategy, which favours cyclical (industrial), defensive (healthcare) and growth-oriented sectors (information technology). This approach provides us with the necessary flexibility and agility in an investment environment that is likely to become increasingly heterogeneous and challenging in the coming months.

Thanks to strong US economic data, interest rates on fixed income markets rose again somewhat in July. In this context, we took the opportunity to increase the allocation to bonds (to overweight) in the month under review and accordingly started to substitute excess liquidity with high-quality corporate bonds. In the current environment, these bonds offer an interesting combination of current cash income as well as attractive price potential. Given the advanced credit cycle, we remain cautiously positioned in issuers with higher credit risk ("high yield").

We remain constructively positioned towards alternative investments. Within the asset class, we continue to focus on industrial metals, which should benefit from a robust macro environment. China offers an interesting optionality in this context, as stimulus packages - which have again been discussed somewhat more prominently in the recent past - would additionally stimulate the demand side. We continue to hold an allocation towards market-neutral investment strategies, which can offer a valuable contribution to stabilizing a balanced investment portfolio – possibly already in the second half of the year.

WHO WE ARE

Tramondo Investment Partners AG is a bank-independent Swiss asset manager based in Zug and licensed by the Swiss Financial Market Supervisory Authority (FINMA) to act as an asset manager of collective investment schemes. Tramondo is the investment arm of a multi-family office group that has been in existence for over 45 years.

For the third time, the company was named one of the 50 most influential independent asset managers in Switzerland and Liechtenstein by the renowned media company Citywire.

Tramondo is a member of the Alliance of Swiss Wealth Managers (ASV/ASWM), founded in 2016. The members of the Alliance currently represent more than 100 billion Swiss francs in client assets.

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