The risks should not be underestimated

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| George Alevrofas, VT Wealth Management, Zurich

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After the March banking turmoil, markets recovered quickly. But geopolitical and other risks should not be underestimated. Caution remains in order.

Thanks to very solid and good quality corporate results, the equity market continues to perform well. Even a further jolt in US mid-sized banks, which culminated in the takeover of First Republic Bank, failed to halt the upward trend.

The VIX Volatility Index, commonly referred to as "Wall Street's anxiety meter", recently fell to 17 for the first time since 2021, which is exceptionally low given the rise in interest rates, tighter financial conditions, increased macroeconomic risks and geopolitical tensions.

Market participants seem to be focused on the positive news: the global economy recorded solid growth in the first quarter of 2023 and the momentum continued at the end of the quarter.

We should, however, expect a slowdown in growth in regional survey data or Asian export indicators. Given the ongoing tensions in inventories and the tech sector, it will be some time before a broad-based rally takes hold. In addition, the Fed and the ECB raised their interest rates by another 25 basis points, to 5.25% and 3.25% respectively. The Fed's rate hike cycle may be coming to an end, but uncertainty remains.

In this context, stocks continue to move within a certain range, which is currently at the high end of the range. Core inflation remains tenacious, as expected, and we are still close to full employment, but the markets offer the best of all worlds. Equity valuations are high and equity volatility is too low. The earnings season has so far surprised positively, but caution is warranted on growth.

The U.S. job market continues to boom and average hourly wages were the highest since March 2022, making it even more difficult for the Fed.

CLOSE-UP ON BIG TECH

The recent rally is heavily focused on “big tech” in the US and consumer and growth stocks in Europe. The Fed's evocation of economic and financial developments appears to be a clear allusion to the ongoing turmoil in the US regional banking sector, which means, at least for now, that further rate hikes may be ruled out.

However, the U.S. job market continues to boom and average hourly wages were the highest since March 2022, making it even more difficult for the Fed.

BETWEEN HOPES AND FEARS

Equities are in a late cycle, torn between hopes of an end to the rate hike cycle and fears of a recession. The path of least resistance could lead to higher stock markets if central banks manage to maintain the current fragile balance.

But more and more cracks are appearing, with a more stressed banking sector and lower commodity prices, meaning the outlook for growth continues to deteriorate. This lack of visibility calls for a very defensive portfolio allocation. If financial conditions continue to tighten and equity markets take profits, the dollar's depreciation could come to a temporary halt.

After the March banking turmoil, markets rallied quickly, but we believe the likelihood of tighter credit conditions and lower growth is not properly factored into current market pricing. of shares.

LESS BAD DOES NOT MEAN GOOD, FAR FROM IT

The corporate earnings season seems to have been better than expected, but “less bad” doesn't mean good, far from it. The earnings recession appears to have been pushed back, but the risk of a relapse later in the year remains.

We favor more defensive equity sectors such as consumer staples and healthcare: communication services fundamentals have become less negative due to stabilizing economic data. First quarter earnings and outlook may continue to give us a boost.

Consumer staples offer low but stable revenue growth and generally perform well during economic downturns. It is a sustainably defensive sector with moderate valuation and high pricing power.

The healthcare sector has been negatively correlated to rising bond yields in the past, but is resilient to weak growth and has good revenue and cash flow visibility.

George Alevrofas
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George Alevrofas has been dedicated for more than 20 years to the follow-up of private and institutional clients. First with one of the largest Swiss pension funds and a subsidiary of Credit Suisse Group, he has worked since 2017 for VT Wealth Management. The symbiosis between traditional, modern and digital management, proximity to the client, investment quality and risk diversification are for him central elements of successful wealth management.

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