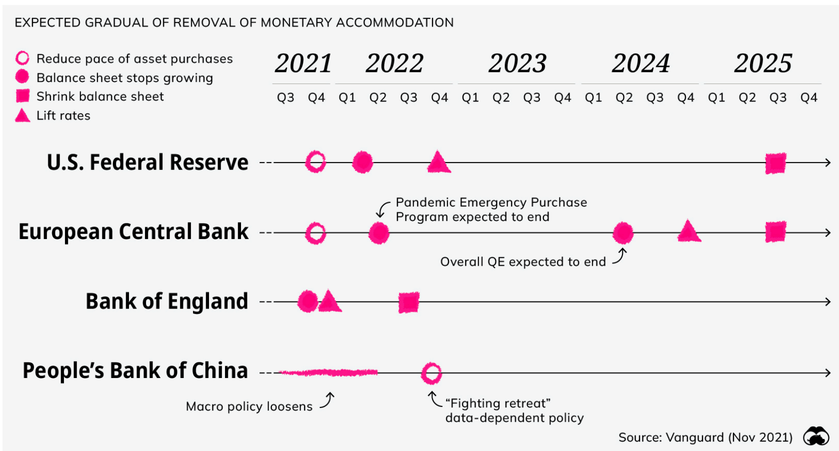
REYL
INTESA SANPAOLO

MARKET INSIGHT

JANUARY 2022

CHRISTIAN BAUER
MANAGING DIRECTOR
HEAD OF ZURICH BRANCH

"Rising inflation and tapering lead to a potential turning point"



HOW ACTIVE INVESTORS SHOULD PROFIT IN 2022

Flexibility is the order of the day. The once popular "buy and hold" investment strategy may no longer be relevant, and investors need to adapt more quickly. Rising inflation, high equity valuations and increasing volatility will provide opportunities for dynamic investment managers in 2022.

Conditions for active investment management are favourable this year, with rising inflation, which is expected to remain high, even if the current supply bottlenecks see further easing. Rising inflation tends to reduce the diversification benefits of a portfolio. Add to this the fact that the year began with very high equity valuations worldwide: Apple, for example, reached a record stock market value of 3000 billion US dollars for the first time in January 2022. In comparison, this is four times more than the value of the Swiss gross domestic product (GDP). For the world's top 100 companies by stock market value, the unweighted mean and valuation average for 2022 is a price-to-earnings (P/E) ratio of 31.5, well above the long-term average of 18 times earnings.

VOLATILITY CREATES OPPORTUNITIES

Of course, having conviction is important, and selecting stocks according to the high conviction strategy does have its uses. High conviction is a focused management style with a clear investment philosophy expressed through more concentrated portfolios for longer holding periods. But conviction is often elusive, and it is therefore equally important to be able to reposition oneself. With the current environment, now is not necessarily the time to be a passive investor. Active investing has become even more attractive, considering that volatility generally offers greater opportunities.

During periods of economic recovery and loose monetary policy investing passively from an asset allocation and equity perspective is a good strategy, and investors could benefit from the rising markets of the last decade with asset classes such as equities and real estate trending steadily upwards. When there were bouts of volatility, central banks usually came to the rescue - and investors were able to buy in when prices fell. However, those who continue to invest passively could end up missing their targets. Over the next five years, market returns are likely to be much lower than before. What if interest rates rise rather than fall? What happens if we have a more volatile environment in the future because central banks can no longer be as accommodative due to higher inflation? Rising inflation and the steady reduction in stimulus (tapering) lead a potential turning point. The old patterns have changed. If bonds and equities become positively correlated, bonds will no longer provide the same level of defensive characteristics as in the past.

GET ACTIVE

It has become difficult to find high yields in the capital market, and the outlook is sobering: all major asset classes from equities to bonds to real assets are likely to yield lower returns than in the past 30 years. Equity returns over the next few years are likely to be driven primarily by growth in corporate earnings and dividends, rather than technical factors. In such an environment, an active approach to asset allocation becomes increasingly important. It requires both clear convictions and a willingness to reconsider one's thinking as market dynamics evolve.

We continue to favour funds that are uncorrelated with traditional asset classes. Furthermore, in the context of increased volatility, uncertain markets and increased inherent risks, the sub-strategies we favour have at least one of the following characteristics: diversification, trading approach, focus on liquidity, relative value style, search for idiosyncratic opportunities, dispersion and convexity. Many of these alternatives have historically shown low correlation to equity price movements and should therefore dampen volatility.

REYL
INTESA SANPAOLO