GENERAL INVESTMENT CLIMATE

The Economy

Roaring twenties? While the initial post-Covid boom was very explosive and filled with optimism, the present shows us a completely different world. Only roaring now is headline inflation pushing another 12-month high. Energy prices are sky high and the business outlook seems to stumble with relatively weak ISM and PMI prints, especially in Europe. Many investors fear stagflation (high inflation combined with slow economic growth). But how did we get here?

Early 2020, a worldwide pandemic forced the world almost to a standstill. A virus-induced lockdown forced many business operations to slow down or stop altogether. Due to a very aggressive expansionary monetary policy from central bankers worldwide, a devastating multi-year recession was avoided. The extreme drop in 2020 was followed by an even more extreme upswing the year after. And now, in 2022, the world is feeling the repercussions of the global lockdown more than ever. Disruptions in supply chains, combined with multi-decade high freight rates, port congestion, and shortages in semiconductors and commodities have put a lot of pressure on business operations. Many companies have tried to refill inventories and compete for the same goods and services. This ‘bullwhip effect’ combined with aggressive monetary policy, the Russia v Ukraine war, and wage growth (discussed in our previous letters) led to inflation. That is the inflation part of the stagflation equation. But what about the slowdown in economic growth?

Households have been severely impacted by rising inflation pushing consumer sentiment to historic lows. Energy and transport costs have put a dent in the purchasing power of the consumer. According to some people, this in theory, would lead (ultimately) to a slowdown in economic growth, therefore pushing the stagflation narrative. So what is next?

Central bankers have shifted from the ‘inflation is transitory’ narrative, towards a hands-on approach and started to hike rates. The ECB will have its first hike of 25 bps in July and will stop buying Northern-European bonds. They will continue to buy Southern European bonds to avoid too much stress on these economies. The FED has hiked more aggressively and is looking to hike another 75 bps in July to a total rate of 2.25%. The FED also officially started quantitative tightening in June. The Bank of England implemented its fifth straight rate hike of 25 bps in June and is at 1.25%. This to cool demand, have inflation come down and restore supply chains, whilst trying to avoid a recession. A serious task on hand.

So with the economic framework laid out, is there any reason to be cautiously optimistic? In our view, yes! Unemployment is very low in the western world with a very hot labor market. People keep spending but have shifted their flows. We saw the same during corona when people continued to shop online and refurbished their homes. In high contrast with the consumer sentiment and recessionary environment, retail travel is almost back at pre-covid levels!. Savings increased during corona through government measures, lowering credit risk. In contrast with the stagflation environment in the 80s, companies have not stopped innovating. Under the impulse of large-scale government projects, they even accelerated their investments to switch to new energies. While oil & gas prices might remain stressed, other commodities are already cooling off rapidly after spikes earlier this year, e.g. lumber (40% down from high, copper (25%), and cotton (more than 40% from previous high). We see a positive outlook for the rice harvest which could be a great substitute for elevated grain prices around the globe.

Currency and Money Markets

The second quarter of 2022 was all about the dollar. The aggressive contractionary policy of the FED has caused the dollar to roar against other currencies. As of our previous letter, the EUR/USD has fallen 5.27%. Supported by the massive buying of dollars to compete for oil (due to the petrodollar standard) and its reserve currency status. Meanwhile, the JPY can't seem to catch a break, sliding another 10% against the dollar and 3% against the EUR since the previous quarter.

In the money markets, the US10Y yield closed the quarter at 2.825% declining from its peak of 3.475% on the fourteenth of June. The NL govt noted at 1.589%.

Stock Markets

Table 1.1 - General

	30-Jun-22	31-Mar-22 - 3 mnth	31-Dec-21 - 6 mnth	30-Sep-21 - 9 mnth	30-Jun-21 - 12 mnth
AEX	659,23	-8,97%	-17,38%	-14,60%	-9,64%
BEL20	3682,07	-11,46%	-14,57%	-11,47%	-10,76%
DAX	12783,77	-11,31%	-19,52%	-16,23%	-17,69%
EU50	3454,86	-11,47%	-19,62%	-14,65%	-14,99%
DJ	30775,43	-11,25%	-15,31%	-9,07%	-10,80%
SP500	3785,38	-16,45%	-20,58%	-12,12%	-11,92%
Nasdaq	11028,74	-22,44%	-29,51%	-23,67%	-23,96%
EUR/USD	1,05	-5,27%	-7,22%	-9,46%	-11,59%
Euribor 3 months	-0,20	0,26	0,38	0,35	0,36
NL govt 10 year	1,71	0,91	1,74	1,78	1,81

As can be seen in the table above, many equity indices have traded significantly lower this year. Investors seem to have many different views on where the market goes forward. They can only agree on one thing: increased volatility. The US had the worst first half of the year since 1970 (which would later rebound strongly). In Europe, most equity indices were falling less. Especially the non-profitable and richly valued companies have taken a hit. The Shanghai Composite Index rallied in the 2nd half of the quarter, now only being down 6% YTD, similar to the FTSE.

Other markets

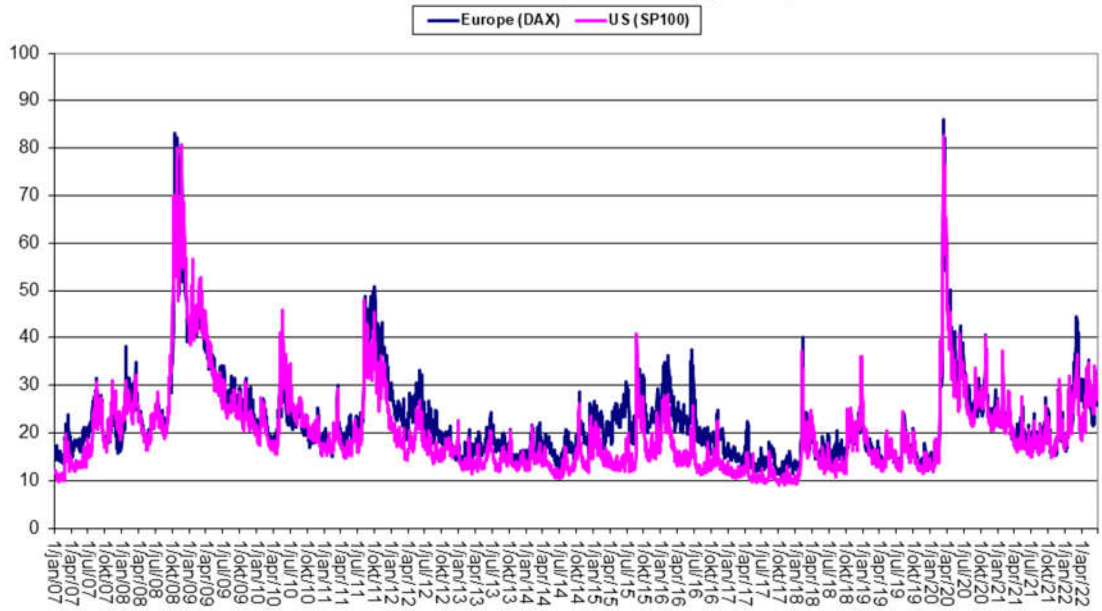
European capital market interest rates increased by 1.5% to 2.0% caused by an acceleration of the downward trend of the bond market and causing the highest losses for many years. In the US the bond market had its roughest start in history.

The biggest loser of the first half of the year was most definitely the highly speculative Crypto and NFT market with some so-called 'stable coins' losing all of their value almost overnight (Luna and Terra), Crypto banks blowing up (Celsius) and 'Crypto hedgefund' 3AC getting liquidated. Showing weakness in this speculative part of the market. In the 2nd quarter of 2022, the IPO market dried up, with global IPOs almost halving year-over-year with 'only' $ 40.6 bln in total deal value being done. The market for SPACs has crashed as eToro recently cancelled the merger with its sponsor.

Implied Volatility

Investors could only agree on one thing and that was increased volatility. The European stock market volatility index VDAX has not dropped below 20% during the entire quarter and seems to remain structurally elevated.

Table 1.2 Development of the implied volatility jan 07 - jun 22



The Long Term

The tech-heavy AEX has dipped below the 200-day moving average as it did at the start of corona, showcasing weakness. We might reach some technical support levels soon. Most of the companies of the index have mean-reverted which might prove for some interesting buying opportunities.

Table 1.3 Long-term development AEX jan 03 - jun 22