STRATEGY OUTLOOK

October 2022

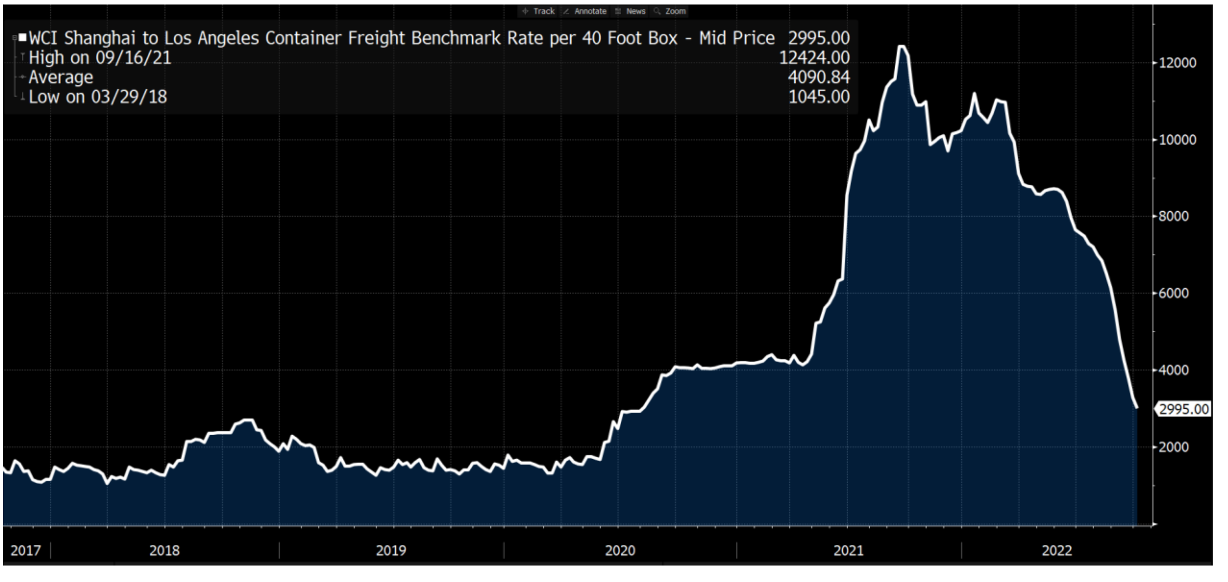
Key Takeaways –

- September was a brutal month for markets with a wide variety of drivers adding to the confusion and uncertainty of how much more rate tightening should we expect.
- Comparisons with the 2008/2009 housing crash and Lehman collapse are probably overdone. This time our concerns are on a traditional collapse in growth.

September was a brutal month for the majority of asset classes largely continuing the trend we have seen thus far this year. The full gambit of new possible issues hit a marketplace and investor base already dealing with a multitude of uncertainty across economics, society, politics, and geopolitics. The infamous quote from Lenin does a masterly job of encapsulating the current environment.

"There are decades where nothing happens; and there are weeks where decades happen"

In the interests of keeping this piece as succinct as possible yet trying to back up our quote please see a non-exhaustive list. The pound and euro hit 40 year lows; speculation about Credit Suisse and Deutsche Bank being the next Lehman hit markets- again; the Bank of England were forced to resume QE due to UK pension schemes having severe liquidity issues; the Nordstream pipeline was blown up (i.e. no more Russian gas for Germany) apparently by Russia (which makes no sense), Italy and Sweden both move right in elections; Hurricane season starts; the EU is talking about a 8th set of sanctions against Russia; OPEC threaten to cut oil production (to spite Biden) as Biden takes the strategic oil reserve to a 40yr low ahead of the Midterms; the fifth yearly congress of the Chinese Communist Party starts on 16 October; Iran sees mass protests; Japan intervenes in the currency markets to support the Yen, the first time in 24 years; the Queen passed away; India, the world's top exporter of rice, just slapped a 20% tax on exports; Russia introduces forced mobilization; Brazil, the second largest economy in the Americas goes to the polls and lastly quarter end hits. Christmas is now in sight and **how investors react to what has been, on the whole, a very poor year will be interesting.**



Things began to break in September as the impact of hikes in interest rates hit home. It's likely that we have already experienced peak hawkishness, indeed this week we have already seen the Royal Bank of Australia hike rates 25bps versus expectations of 50bps. Further evidence is clear from weakening (albeit slow) economic data. The above chart shows the cost of sending a container from

Shanghai to Los Angeles which this year is down 70%. That's not inflationary nor a sign of strong demand. Market darlings like Tesla and Nike have both been out warning about economic conditions. The CEO of FedEx on their earnings call stated he believes we are in a worldwide recession; the US consumer is "definitely spending less" and **"We are reducing our capex quite significantly this year".**

We continue to believe that growth and issues in markets will force the hand of central banks to pause and await the impact of their tightening which has seen the fastest hiking in over 40 years. The uncertainty of how high rates will go and when they will stop has been a constant headwind to markets.

A quick word on Credit Suisse. This driver is not new, indeed the performance of European banks on a standalone and relative to US banks basis is clear and reasonably well understood. To our mind these are **"known unknowns"** and having lived happily in Switzerland for several years the Swiss do planning and contingencies better than anyone, there will be a plan, if required.

There are positives. Corporates are on the whole flush with cash with relatively low inventories and stable leverage. Consumers have healthy cash balances, have been resilient and unless we see mass layoffs have regular income. Household balance sheets are a lot stronger than in 2008 and so, of course, housing can go down but ultimately, it's not anywhere near the last housing bubble. Average US 30yr mortgage hitting 6.9%, last seen in 2000 is a significant headwind for new buyers but the demographics in the US are strong and arguably this type of asset class needs to be viewed on a 10-year view rather than a monthly view.

Consumers should benefit from commodity price falls, median rent falls, reduced pricing power, services & manufacturing PMI prices falling, trucking and shipping rates falling, used car prices falling, consumer inflation expectations falling. Inflation looks to have peaked fuelled by weakening growth and less pent-up demand. Oil however can be the troublemaker.

"Why all the fuss over a simple pipeline?"

As Europe awaits the onslaught of winter and what that means for energy prices and availability the ineptitude of national and regional energy strategy continues to come to the fore. Fifteen years ago, Europe produced more natural gas than Russia exported. By 2020 Russia exported nearly 3x more natural gas than Europe produced. The UK stores enough gas to meet the demand for only 4-5 winter days or just 1% of Europe's total available storage. Germany, by comparison, has 16x the storage. The decision to shut down and not invest in gas storage by the then, Tory government has again shown a startling lack of planning. **As the cartoon from 1982 shows the reliance on a single source was all too clear for some.**

The energy markets are going to be in disarray for years. No investment has taken place due to the constant threats of excess profits on taxes, carbon taxes, expropriation, and price caps. Energy is everything, even maybe the new gold or Bitcoin. Indeed, Exxon has now overtaken, a former market darling, - Meta's market value for the first time in 5 years.

Swedish, Norwegian, and Israeli central banks have launched a project with the Bank of International Settlements to test digital currency payments using central bank digital currencies. These are coming across the board and should be a concern to the individual. Without proper regulation the invasion into one's life, as is being witnessed, in China could be distinctly dystopian.

The outlook continues to point towards holding a defensive stance in markets. However, we do seem to be getting to extreme levels of bearish sentiment and short covering rallies are likely. The Fed and other **central banks must be concerned that they are driving blind,** they really have no idea what the impact of their tightening has and is doing. However, for the time being portfolios remain underweight stocks, long cash with a small overweight in the long end of the Government bond curve. Positioning to alternatives and gold remain unchanged.

ROVS Zurich portfolio team.

CONTACTS

SWITZERLAND

REYL Overseas Ltd
Talstrasse 65
8001 Zurich
T +41 58 717 94 00
F +41 58 717 93 01
contact@reyl-ovs.com
www.reyl-ovs.com

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