quantumrock

December 2022

Market Commentary

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The year 2022 was a year of economic and interest rate turnaround and ends with the prospects of a recession in most industrialized countries. Inflation remains the dominant issue. On the one hand, inflationary pressure seems to be easing slightly. On the other hand, inflation is unlikely to normalize during the winter, especially in Europe.

Looking at the global economy, economic development in most industrialized countries remains fragile, with ongoing geopolitical unrest supporting recession concerns. Above all, Europe faces the major challenge of striving for a more sustainable and independent energy supply.

Continuing Fed and ECB rate hikes through early 2023 are likely to keep Treasury and Bund market yields at elevated levels early next year. In addition, the Fed's continued quantitative tightening and the ECB's entry into balance sheet reduction will continue to tighten liquidity policy.

While 2022 will go down in ECB history as the year of the big interest rate turnaround, 2023 is likely to be no less challenging for central bankers. The main focus will be finding the right balance between a forced fight against inflation and the looming recession. Although European inflation data for November came as a surprise, showing a significant year-on-year decline in the inflation rate from 10.6% to 10.0%. While this sign may partially appease ECB hawks, it is unlikely to lead to a change in direction due to the unchanged high core inflation of 5%.

Earlier this month, the Federal Reserve approved a half-point interest rate hike, a smaller increase than in recent months and acknowledgement that inflation may finally ease. The positively surprising U.S. labor market report suggests that this year's interest rate hikes have yet to effect fully and that inflation could be more stubborn than currently suspected.

Economic slowdowns, aggressive monetary tightening, and geopolitical and energy challenges will temporarily impact financial and emerging markets. As a result, continued high volatility in equity and fixed income markets appear realistic.

In addition to alpha-generating strategies, such as *quantumrock Equity Alpha*, *quantumrock Fixed Income Alpha* and *quantumrock Absolute Return*, investors may want to consider investing in natural resources to diversify their portfolios. Goldman Sachs expects the S&P GSCI Total Return Index - a leading measure of commodity price performance - to rise 43% in 2023. This would add to gains of 24% so far this year.

In Focus: Risks and Diversification Opportunities

- Interest rate steps by the Fed and the ECB could slow down.
- Still no clear end to interest rate hikes in sight.
- Hard assets, such as gold, copper, oil and precious stones, as a safe haven and diversification opportunity.
- Inflation remains one of the key issues in the markets.

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