

LMM COMPASS



Dear reader

After a period of very low interest rates, inflation is definitely back. The central banks have responded with interest rate hikes and the period of negative interest rates is over. The changed investment environment has led to significant price declines, both in bonds and equities. In our article, we look at some important points in connection with inflation – in the sense of an outline.



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THEMES



Market data
Markets and strategies



Specialist article
Some considerations on
inflation developments



MARKETS DATA

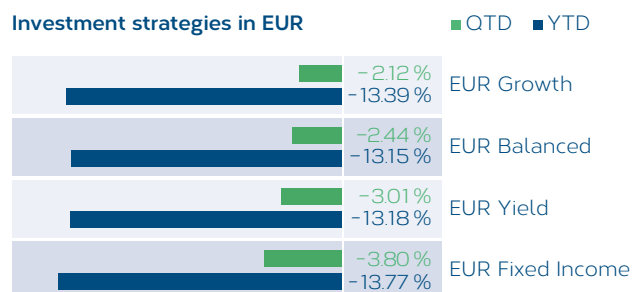
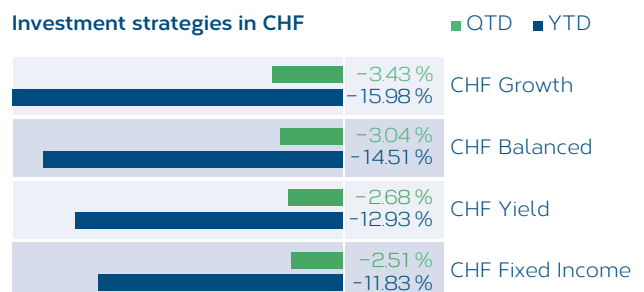
The current year is characterised by the fact that investors have to deal suddenly with a changed investment environment not seen for a very long time.

Inflation, originally described by central banks as temporary, has surprised with its dynamic. The central banks reacted with corresponding clarity, which drove up interest rates further and led to significant price declines on the bond and equity markets. Uncertainty among investors is high, and the reasons for this are manifold.

In the 3rd quarter, all investment strategies incurred even more losses. As already evident in the course of the year, the two main asset classes, bonds and equities, suffered further losses at the same time. In the current investment environment, the diversification effect often seen in the past during financial market turmoil did not play a role and bonds were unable to compensate for the equity losses. As a result, supposedly lower-risk investment strategies, which are generally characterised by a lower equity allocation and an overweight in bonds, also suffered significant price losses.

		Value	%QTD	%YTD	Currency
Currencies	EUR / CHF	0.96	-3.67	-6.95	
	EUR / USD	0.97	-6.30	-13.86	
	USD / CHF	0.98	+2.81	+8.02	
	USD / JPY	144.76	+6.54	+25.69	
Bonds	Switzerland		-1.61	-11.64	CHF
	Europe		-4.59	-16.16	EUR
	USA		-4.75	-14.61	USD
	EMMA (Hard Currency)		-4.75	-22.37	USD
	Inflation Linked		-9.96	-25.98	USD
	High Yield		-2.74	-19.15	USD
	World		-6.94	-19.89	USD
Equities	Switzerland		-4.94	-20.08	CHF
	Europe		-4.11	-17.38	EUR
	North America		-4.81	-25.08	USD
	Pacific		-8.09	-23.80	USD
	EMMA		-11.57	-27.16	USD
	World		-6.82	-25.63	USD
Alternatives	Real Estate		-11.39	-29.42	USD
	Commodities		-4.75	+12.42	USD
	Gold		-8.12	-9.22	USD
	Private Equity (listed)		-9.33	-39.31	USD
	Hedge Fonds		+0.51	-4.56	USD

Calculation LMM, reference date 01.01.-30.09.2022



Note: the figures are before costs

Calculation LMM: Period 01.01.-30.09.2022



SOME CONSIDERATIONS ON INFLATION DEVELOPMENTS

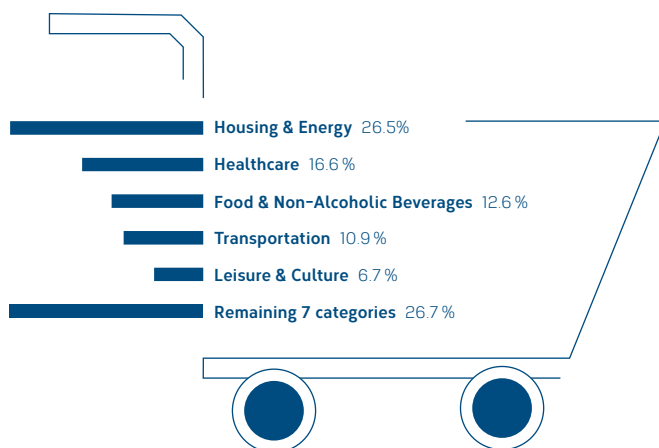
What happened?

Over the last 20 years, the financial markets have been characterised by steadily falling interest rates. The actions and programs of central banks and governments have supported the investment markets in the sense of the often cited “Fed put”.

The significant decline in interest rates was accompanied by an increase in valuations and prices of most asset classes, which resulted in above-average positive investment results in recent years. Although there were some references to possible side effects, very few expected the environment to change as early as this year.

How is inflation measured?

In order to measure price developments, a so-called “basket of goods” is defined. The composition of the basket of goods is based on the real expenditure of an average household. In Switzerland, the basket of goods is called the national consumer price index (CPI). Around 100,000 prices are surveyed every month to measure price trends.



LCI shopping cart and weights 2022 Source: bfg.admin.ch

Are there differences in inflation measurement from a global perspective?

The calculation methods and coverage of the national consumer price indices can differ significantly from country to country. An international comparison of inflation based on the national indices is therefore very difficult. For this reason, the member states of the European Union (EU) have introduced an indicator – the harmonized index of consumer prices (HICP). When making comparisons using the HICP, however, it is important to note that the value per good and service varies from country to country.

What is core inflation?

When measuring price developments, certain goods have a greater influence. Therefore, so-called core inflation is additionally calculated, which excludes certain goods of the basket of goods (in the case of Switzerland, it is around 15%, mainly food and energy). The calculation of core inflation is intended to show the long-term price trend, irrespective of short-term effects.

What prescriptions are used to fight inflation?

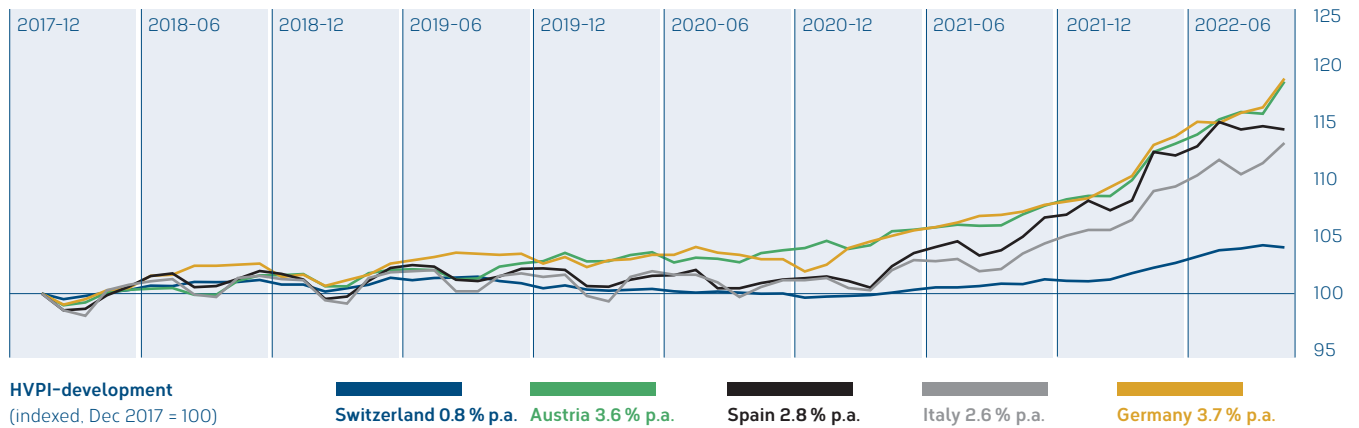
For central banks, it is important that inflation does not overshoot and that they counter it with the instruments at their disposal. In practice, interest rate hikes are the rule. The big challenge here is to find the right “dose” at the right time. This is because interest rate hikes have a dampening effect on economic growth, consumption falls and investments become more expensive.

What side effects may occur?

The current situation on the financial markets provides an example of the impact of rising interest rates in the wake of rising inflation figures. Central bank policy influences interest rates on the capital markets and investors adjust their expectations. Among other things, this leads to revaluations of stocks and bonds, i.e. price declines. Fighting inflation is like a balancing act.



How has inflation developed over the medium term?



The goal of reducing inflation is offset by weaker economic growth and higher interest costs for debtors.

What principles should be followed in an inflationary environment?

The past has shown that there is no patent remedy for investors. The timing of a pickup in inflation is almost impossible to predict.

Inflation does not affect all asset classes equally. Studies show that so-called real assets (commodities, precious metals) can offer some protection. Liquidity

and bonds are more affected, as inflation eats away the returns. In the case of equities, the great general uncertainty surrounding economic developments, falling margins and rising interest costs often have a negative impact.

Taking into account that inflation is difficult or impossible to forecast, a broadly diversified investment portfolio is recommended. A certain amount of liquidity ensures the ability to act and real assets can offer a certain protection against inflation in the long term.



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