# VIG HOUSE VIEW

VIG ASSET MANAGEMENT HUNGARY

What happened in the last month?

What can we expect in the coming period?

- Investment Clock
- Tactical asset allocation
- Focus funds
- ESG theme of the month

SEPTEMBER 2024

# WHAT HAPPENED **IN THE LAST MONTH?**

## IN FOCUS: GETTING ALL DEFENSIVE, ARE WE?

### The world

Rarely has there been such a need for prudence in investment as there is right now. Everywhere we look, ominous clouds are appearing. The world's strongest economy, for example, continues to slow, with factories in the US cutting output further in August. The **Institute for Supply Management's** monthly survey of manufacturing purchasing managers showed that only 47.2% reported an expansion during the month (anything below 50% indicates an overall sectoral contraction). Demand remains weak, which is making a central bank rate cut, aimed at trying to stimulate the economy through cheaper credit, appear increasingly likely. Europe is not doing that well either: Germany, for example, the Old Continent's leading economy, is forecast to shrink by 0.1% in 2024 according to the autumn forecast of the authoritative Kiel Institute for the World Economy. Back in Spring, 0.2% growth was being forecast.

### Hungary

Hungary has not escaped the spillover effects of the deteriorating international situation – and the domestic situation is being compounded by a number of specific local problems. The Hungarian economy has still not moved on from its pre-crisis levels, with GDP contracting by 0.2 percent in the second quarter of this year, despite more optimistic expectations. The poor export and income outlook has put a big brake on industry, with investment falling and household consumption also declining.

US Manufacturing Purchasing Managers' Index


*Source: Trading Economics*

# WHAT HAPPENED **IN THE LAST MONTH?**

## EQUITY MARKET NEWS

With economic indicators deteriorating, the downside risks are now greater than the potential upside. As a result, the outlook for global developed equity markets is weaker overall than in previous months. And this despite the fact that the world's major stock markets are breaking all-time records. Indeed, at a time when leading economies are drifting further and further into recession according to new statistical evidence, and stock markets are pricing in a 100% probability of a "soft landing", investors' optimism seems excessive. Volatility is increasing, we're not in the most equity-friendly season of the year (stock market crashes tend to occur in September and October), and the upcoming US presidential elections are only adding to the uncertainty.

There are still some good opportunities to be had in the stock market, though in our opinion it's no longer country-based strategies that are likely to work best, but sector-based ones. As we predicted in July, sector rotation has begun: while technology stocks were the to performers until recently, the traditional sectors now look poised to close the gap (requiring more of an emphasis on active portfolio management). Financial stocks, healthcare companies, consumer staples and utilities are likely to outperform the market going forward. The upcoming interest rate cuts will also give a boost to economies, and this should ultimately translate into higher corporate earnings. However, with stock prices so high already, it could be argued that this has already been priced in and so any positive earnings surprises, which have been a key driver of investor optimism in recent years, are likely to be few and far between.

# WHAT HAPPENED **IN THE LAST MONTH?**

## BOND MARKET NEWS

With inflation falling, the need to fight price rises is increasingly being replaced by a focus on the need to stimulate growth in central banks' communications. And the best tool for this is a central interest rate cut: In the US, the policy rate could fall by 25-50 basis points as early as September and by 50-100 basis points by the end of the year. And investors expect the current base rate to fall to 3% by the end of 2025. But if fears of a recession continue to grow, the Fed, in its role as central bank, could go even further. As the interest rate cuts ripple through the economy, not only could new loans (retail or corporate) become cheaper, but bonds issued earlier with higher yields could also appreciate. Therefore, safe bonds from developed economies in similar situations could prove a wise choice for investors.

The bond market may also be boosted by a wave of selling in the overvalued equity markets (and the money thus freed up would be better invested in bonds, with the rising demand likely leading to a further increase in bond prices). There are also some promising potential investments in emerging markets: in some Latin American countries, the local currency has depreciated for various specific reasons – and this means now may be a good time to buy local high-yielding securities.

## ALTERNATIVE INVESTMENTS NEWS

The looming threat of recession is not having a good impact on commodities. Investors have also become more downbeat: the global commodity price index has fallen below the 200-day moving average – which, according to a stock market rule of thumb, signals the reinforcement of a downward trend.
Because of the economic slowdown, demand is falling: we don't need so much oil or copper. A huge consumer of both is China, but that country is yet to recover from a housing crisis that has plagued it for years now.

The demand for gold, however, remains strong. The global price of the precious metal, traditionally a safe haven in uncertain times, recently reached a new high of $2,500 an ounce, mainly due to large-volume purchases by central banks in the less developed countries. The largest purchases have been by the national banks of Poland, India, Turkey, Uzbekistan and the Czech Republic, with total central bank gold purchases now exceeding 1,000 tonnes a year – a trend that is probably driven at least in part by rising geopolitical tensions and fears of sanctions.

# WHAT CAN WE EXPECT **IN THE COMING PERIOD?**

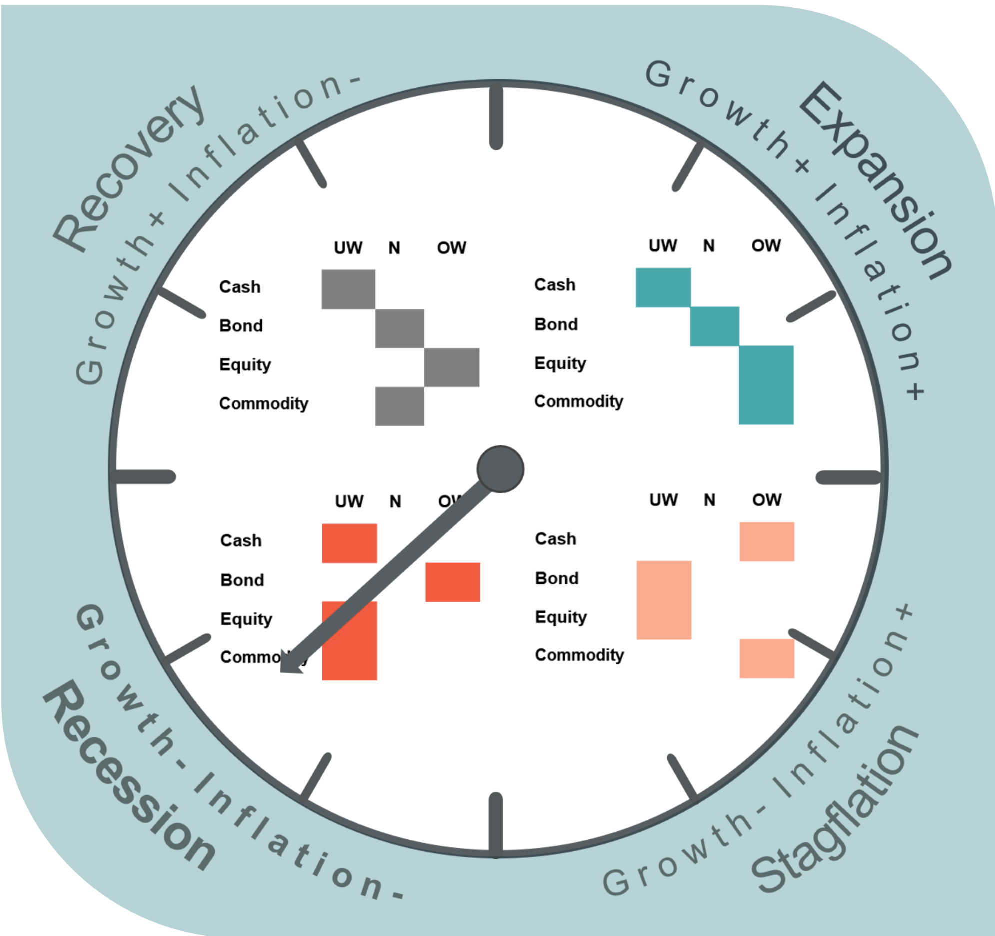
## INVESTMENT CLOCK: RECESSION

The Clock is showing the current economic environment as being in the “Recession” phase, characterised by low economic growth and falling inflation. During this period, investors tend to be more cautious, and the weight of safer assets such as bonds and cash increases in portfolios. The low-interest rate environment and uncertain economic outlook make equities and commodities less attractive, as their performance is likely to be weaker in the wake of a slowdown in economic activity.

**So why is the indicator currently where it is?**
The position of the indicator is a response to declining inflationary pressures and lower economic growth. Central bank policies, such as interest rate cuts, can no longer provide a significant stimulus to growth, further fuelling fears of a recession.

**What can be expected in such an environment?**
In this economic phase, low-risk assets such as bonds and cash may provide stable returns. Growth in the price of equities and commodities is expected to be more subdued, and so investors should hold relatively less of these asset classes. In a recessionary environment, maintaining liquidity and focusing on safety are usually the key to effective portfolio management.

**Recommended strategy**
Keep in mind the importance of diversification, and focus on safe assets, as these often perform better in an uncertain environment such as this.




**OW:** Assets expected to perform well in the given period.

**N:** Assets expected to perfom less well in the given period.

**UW:** Assets expected to perform poorly in the given period.

*Source: VIG Asset Management*

# WHAT CAN WE EXPECT **IN THE COMING PERIOD?**

## TACTICAL ASSET ALLOCATION

Next month, we have revised down our outlook for commodities and equities in light of the expected deteriorating risk environment. In contrast, we believe that cash and money market instruments, as well as primary market bonds, may now offer a more favourable risk-return profile.

## MONTHLY ASSET ALLOCATION (SEPTEMBER 2024)

| Asset class | H UW | UW | S UW | N | S OW | OW | H OW | Change |
|---|---|---|---|---|---|---|---|---|
| **Cash (Money market)** | | | | | ■ | | | ↑ |
| **Fixed income** | | | | | ■ | | | ↑ |
| Core market fixed income | | | | | ■ | | | ↑ |
| EM local currency bonds | | | | ■ | | | | |
| EM hard currency bonds | | | | ■ | | | | ↓ |
| CEE government bonds | | | | ■ | | | | ↓ |
| **Commodities** | | | ■ | | | | | ↓ |
| Gold | | | | | ■ | | | |
| **Equities** | | | ■ | | | | | ↓ |
| DM Equities | | | ■ | | | | | ↓ |
| US Equities | | | ■ | | | | | ↓ |
| EU Equities | | | | ■ | | | | ↓ |
| EM ex China Equities | | | | ■ | | | | ↓ |
| CEE Equities | | | | ■ | | | | ↓ |

Changes – change compare to the the previous month

The table was prepared based on our investment clock and quadrant model.

### Weights:

The weights indicate the evaluation of the respective country, region, and asset class, providing a basis for portfolio managers in structuring portfolios and establishing positions, thus helping to capitalize on market opportunities.

- Strongly underweight
- Underweight
- Slightly underweight
- Neutral
- Slightly overweight
- Overweight
- Strongly overweight

# WHAT CAN WE EXPECT **IN THE COMING PERIOD?**

## FOCUS FUNDS

### VIG SOCIALTREND ESG EQUITY INVESTMENT FUND

The **VIG SocialTrend ESG Equity Investment Fund** focuses on long-term social and technological trends such as digitalisation, healthcare, education and sustainability. These megatrends are growing global sectors with high long-term growth potential, especially in green energy, electric vehicles, innovative technologies and online services. The Fund should directly benefit from this growing demand, as it invests in companies that meet strict ESG criteria and can position itself favourably among sustainability-focused investors. Companies that operate according to ESG criteria are often better prepared for market challenges and crises, as they can ensure more stable operations in the long term. These companies may be more resilient to regulatory, environmental or social changes, offering investors lower risk and more stable returns over the longer term. European and global governments are placing increasing emphasis on sustainability initiatives, green investments and the development of renewable energies. The related grants and regulations should benefit companies in the Fund, especially those that are leaders in sustainable energy or environmental innovation.

# **ESG THEME** OF THE MONTH

## WHO KILLED THE ESG PARTY?

The "ESG hype" that began around 2020 reached a peak in Europe in 2021, but after that, it quickly died down. The interesting question here is what caused this sudden change, and whether interest in ESG will ever return to its previous levels:

Without going into too much detail, the following factors can be cited as explanations for the decline that started in early 2022, which is also very evident in the graph:

Firstly, there have been global events that have created uncertainty, and these events have made sustainability appear less important or less attractive as a factor in comparison. In February 2022 the Russian-Ukrainian war broke out, and a perfectly normal human reaction to this was to start worrying less about what would happen to our environment in 20-30 years' time and more about our immediate futures, which suddenly seemed more uncertain than ever. The war brought with it an energy crisis, and the question was no longer whether we'd be using sustainable energy, but whether we'd have enough energy of any kind for the next winter. This has been coupled with a rising yield environment, where longer-term projects, including sustainability projects, have become less appealing due to the increased cost of capital.

Also, we should not forget that ESG concerns are largely a European phenomenon, and that it is here that regulation related to ESG is the strictest. And as if that wasn't enough, that regulation is constantly changing, making things very difficult to predict. Sudden changes in regulation have resulted in major downgrades in the past, resulting in sudden sell-offs. And due to the lack of predictability, it has proved very hard for trust to be regained.

When comparing ESG in Europe with the US, it is important to note that the oil sector is an important part of the US economy, and is currently not especially compatible with the principles of sustainability. This is coupled with a critical and sceptical attitude on the part of the American public, fuelled by political rhetoric.

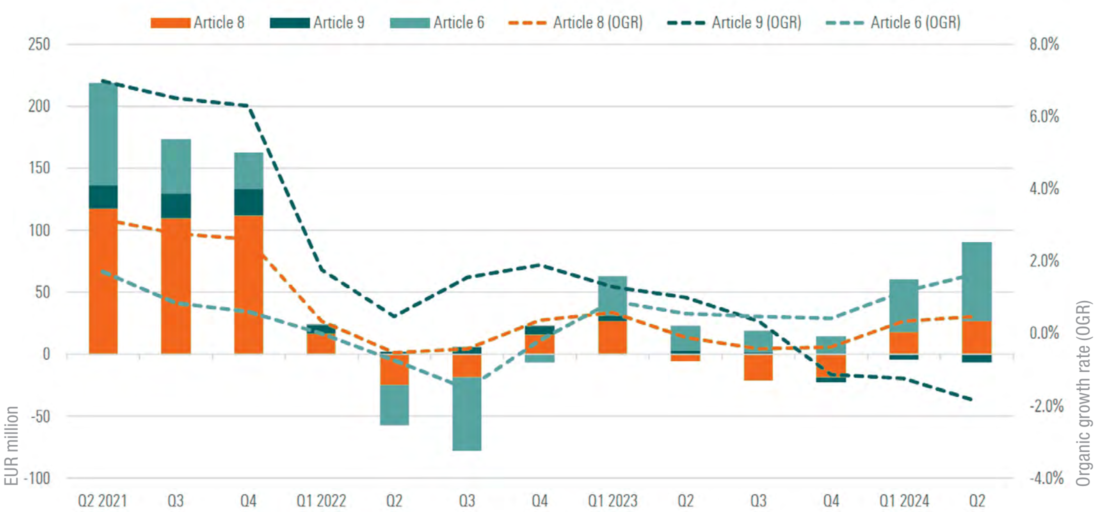
Finally, we may well ask whether time horizons related to investment funds are compatible with ESG-related time horizons. The time horizons associated with investment funds are generally shorter (1-3 years) than the time horizons associated with sustainability objectives, which tend to be more like 40-50 years. That sort of time is more in line with the investment horizons of pension funds, though that is certainly not to say that ESG is irrelevant when it comes to short-term investment. It is just as true of short-term investment as it is of longer-term investment that if risks are not properly managed, returns will suffer. And climate change is one risk that is recognised by the market, and therefore any investment funds that ignore that risk do so at their peril.

At VIG Asset Management, we see this risk is already recognised by the insurance industry, and we believe this concern will soon ripple out to other sectors. In addition, a generation will soon grow up that will no longer question whether climate change is a real problem, because they will have grown up experiencing it, and so for them it will be a phenomenon as obvious as gravity.

So in 10 to 20 years' time, it will no longer be a question of whether we are dealing with ESG per se, as it will be fully integrated into our investment decisions and therefore into our lives too.

(The above ideas are drawn in part from the views expressed in **Financial Times** video **Who killed the ESG Party?**

Quarterly flows into Articles 6, 8 and 9 funds (EUR billion) and organic growth rates (%) in Europe*




*Source:*
*Morningstar Sustainalytics*

PDF

*Open-ended and exchange-traded funds, excluding money market funds and funds of funds

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