Letter from the President and the Fund Managers
January 2023

2022 IN BRIEF

2022 is a year that merits a place in the economic history textbooks, just like 1979.

First of all, it was the year in which high, unexpected and persistent inflation came back with a vengeance. In the United States, inflation rose to 9.1% in June (annual rate), while inflation in Europe topped 10.6% in October. An increase not seen for 40 years. And, more importantly, in early 2022 this inflation was still regarded as being the result of post-Covid bottlenecks and hence as a temporary phenomenon. Inaction on the part of the central banks thus appeared to be the most prudent approach, since they were reluctant to exert any influence on the economic cycle. Once they realised that the inflation was actually a reflection of excess demand, the central bankers suddenly changed tack.

And this marked the second event – the speed and extent of the change of course by the US Federal Reserve in the first instance, followed by the Bank of England and then, more recently, by the European Central Bank. All our central bankers have adopted a series of rapid and surprisingly broad measures in a bid to stem the rising inflation. Their rate increases, dubbed “jumbo” hikes, have reached 75 basis points at times. And the decisions have not taken long to make themselves felt – the entire term structure of interest rates has risen, driven by the increase in real rates.

From an investment point of view, the real rates have certainly played a key role, as has, more importantly, the speed at which they have gone up. Real ten-year rates have risen from negative levels in the United States (-1.08%) and the euro zone (-1.98%) to reach positive levels in both regions again, at +1.57% and +0.29% respectively. The consequences for the markets have been particularly clear to see. All the assets that had benefited from negative real rates for such a prolonged period of time recorded a negative performance in 2022. Bonds suffered to an extent not seen since 1979, with the major global indices going down by as much as -15% at times. Bonds were not, however, the only assets that had previously benefited from the decline in real rates – the stock market, and especially the market for “growth” stocks, also revealed its clear dependence on these low rates. As interest rates rose, the stock markets fell, albeit to differing extents for “value” stocks (-6%) and “growth” stocks (-29%). One figure is all that is needed to sum up the true extent of this correction. At the end of 2022, “growth” stocks had wiped out their entire outperformance of “value” stocks over the period 2020-2022. And just to remind you – this outperformance had been approximately +40% at the end of 2021.

A three-year parenthesis has thus come to an end – the parenthesis of the 2020 stimulus policy aimed at curbing the impact of containment measures. A huge fiscal package was put in place (equivalent to almost 30% of GDP in some countries), financed by an ultra-accommodative monetary policy. This fiscal package has finally given rise to abnormal inflation, which is now being combatted by these same central banks. The snake is biting its own tail! The question now is what impact the side effects of this new treatment will have.

2023: OUTLOOK

The next chapter of the story concerns the side effects of this treatment that the central bankers are applying in their endeavours to eliminate inflation. The mechanics of the approach adopted are disconcertingly simple. By raising interest rates, the bankers are putting the brakes on credit and hence on economic activity to the point where this is affecting employment and triggering a rise in unemployment. The resulting drop in demand then puts an end to the price increases being demanded by companies. The central bankers are thus setting out to create unemployment in order to destroy inflation – a certain degree of unemployment but not too much. And this is where the risk for 2023 lies. Is it not conceivable that the real rates returning to normal so rapidly could trigger a more damaging period of recession? If this were to be the case, the stock market and credit valuations could still be a long way off their lowest point and further declines could be seen in 2023.

This is not the predominant scenario for the moment. As the year gets going, the market is anticipating more of a situation where declining inflation is coupled with a limited rise in unemployment – the famous soft landing… In a setting like this, a slight overexposure to stocks and credit would still seem to make sense. Let’s remain cautious – we’re a long way off the highly robust conditions of 2017, for example.

To sum up, the central scenario is still one of a moderate but necessary recession, and the chief risk associated with this is a more pronounced recession – 2023 does not look set to be a particularly bullish year.

DEVELOPMENT IN THE VALUE OF CPIC SHARES

Under these difficult financial and macroeconomic conditions, the portfolios registered a negative performance, albeit to a contained extent, in the course of 2022.

Segment A (in EUR):

Management of segment A is conducted in a diversified manner with active management on the one hand (aimed ultimately at outperforming the benchmark for the mandate, while controlling the risk), and management based on a risk budget, on the other hand (aimed at controlling risks while still ensuring a return). The portfolio is exposed to short-term fluctuations on the financial markets, going both up and down, but in a controlled fashion on account of the active management and strong diversification.

This portfolio experienced the sharp decline in the markets and, at the end of December 2022, its value had fallen from EUR 287.63 to EUR 253.79, representing a performance in EUR of -11.8%.

Segment B (in EUR):

Management of segment B is focused on the preservation of capital, combining money-market investments and a conservative, diversified risk-based management. It fulfilled its role of preserving capital in 2022 by comparison to traditional conservative portfolios.

The value of the segment B share has fallen from EUR 159.53 to EUR 155.34, representing a performance in EUR of -2.6% at the end of December 2022.

Segment C (in CHF):

The management of segment C is comparable to that of segment A, with similar risks, but in Swiss francs. The robust appreciation of the Swiss franc has led to additional losses.

The value of the segment C share has fallen from CHF 133.66 to CHF 113.41, equivalent to a performance in CHF of -15.2% at the end of December 2022.

Jacques-André Schneider
President of the Foundation Board