GAM Investments Rahul Mathur Highlights Strategies to Isolate Alpha in these Uncertain Times

Rahul Mathur, Investment Manager at GAM Investments delivered a thought-provoking presentation at the Hubbis Thailand Wealth Management Forum, explaining how private clients can think about finding alpha in today's environment. He highlighted how central banks are facing up to the dilemma of preserving financial stability and at the same time taming inflation. He asked if regarding European fixed income, the ECB had done enough. He said in the Emerging markets policymakers appear to be ahead of the curve and pointed to selected economies where the GAM Global Rates team thinks the opportunity continues to be very attractive. And he discussed currency trends, asking if FX markets are driven by rates or growth differentials, and whether investors should see currencies as a separate asset class.

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Rahul opened his talk by talking about the US economy, explaining that, in his view, the economy is still performing well and certainly not in recessionary territory. Between employment, retail sales and production data, the data that emerged in April suggests that the US economy is doing just fine, he said.

"But when we turn to cross-country comparisons, a very interesting story emerges," he reported. "There is notable weakness across almost all economies, with developed economies significantly weaker than emerging economies. The US is heading the manufacturing PMI data and stands out especially versus the contraction in Europe in recent months."

He noted that while manufacturing can provide a lopsided view of economies, particularly in the US in dollar terms, where services are about two times as large as goods, services spending in the US keeps rising quite rapidly. "In short," he reported, "there are no signs of a recession in services, and this we think has a very important implication for the outlook for inflation."

Rahul reported that after a whirlwind of tightening, headline inflation has fallen by about 3.5% in the past year or so. But he said the data shows that the labour market is very tight, and two key areas that still exhibit inflationary dynamics are owners' rents and the cost of labour, which has been rising sharply this year. Add that to other data and he said that in his view inflation is actually still suffering upside pressure.

He explained that looking across at Europe, around two-thirds of the inflationary pressures in the US have been driven by labour costs and services in particular. This contrasts very sharply with the experience of Europe, where around two-thirds of the inflationary impulses come from commodities, and specifically, energy prices, adding that with falling gas and other prices in recent months of 2023, the inflationary pressures in Europe are dropping back.

In short, he said the real picture is inflationary pressure in the US, and reducing inflationary pressures in the Eurozone. "This should be a warning bell in the US," he stated, "and we think this is an important time for the Federal Reserve to get inflation under control, because the longer it takes for inflation to come down, the more likely that inflation expectations can become unanchored, and that is the situation the Federal Reserve will be keen to avoid."

He noted that policy tightening that has been undertaken by the Fed is starting to have an impact in parts of the US economy and most obviously, in terms of the tightening in lending standards to small businesses. He said on the other hand that the ECB Bank Lending Survey data for Q1 of 2023 exhibits a sharp contraction in both lending standards and credit demand.

Delving much more deeply into the US credit environment and overall stability of the banking sector, Rahul concluded that the regional and other bank problems had highlighted some strains in the banking sector that they had weathered thus far. But he also noted that Treasury Secretary Yellen had suggested to big bank CEOs that more mergers may be needed.

He said: "Perhaps this is a sign that actually there are more weak banks out there that may not be able to survive on their own against the backdrop of rapid monetary tightening. In the 1980s, there were around 14,000 regional banks in the US, and that number has shrunk to around 4000, so consolidation appears to be a natural evolution in the US midrange banking sector."

He also noted that the market continues to price rate cuts of about 45bps for the US versus rate hikes of around 50bps for the Euro area for the second half of this year.

"We think that this presents a very attractive opportunity to be positioned long Euro area fixed income versus the US," he concluded. "This sort of cross-country

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He drew the talk towards a close by remarking that in sharp contrast to the denial and delay approach of several Western central banks, one central bank that really stands out for having been proactive is the Central Bank of Brazil.

He said the bank had taken policy rates to 13.75%, with real rates around 9.5% and this policy tightening is having a material impact on bringing down inflation and slowing activity, especially in the manufacturing sector. This means Brazil is well placed to lower rates starting in Q3 this year. "On this basis, we have a high conviction view on Brazilian fixed income," he told guests.

In currencies, he said the Global Rates team increasingly finds that the relative real interest rates or interest rates adjusted for inflation are once again exerting their influence on currency pairs. "Accordingly, we are closely monitoring this indicator, as we look for opportunities," he added.

He closed his talk by concluding that given many of the conditions and assumptions he had described, in his view a liquid, diversified investment approach that focuses on minimising the correlation to traditional asset classes is the "most thoughtful way to proceed".