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An extraordinary half year

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It's not just people who can't rest easy – directly connected to the pandemic, the war in Ukraine and a "rude awakening" in terms of inflation are causing unrest. The stock markets are looking back on a half-year full of tensions. This is clearly shown in the following chart:

Income shares and bonds, 1977-2022

Source: Bloomberg; as of June 30, 2022; annual returns through 2021; equities: MSCI ACWI TR USD (prior to 1998: MSCI World TR USD); bonds: Bloomberg Global Aggregate TR USD (before 1991: Bloomberg US Aggregate TR USD).
Note: Past performance is not a sufficient indicator of the future performance of the fund.

2022 stands out visibly from the cloud of dots from almost 50 years ago. Since 1997, there have been only seven years in which the development of global bonds was negative. 2022 is one of them. In addition, the extent of the simultaneous negative development of stocks and bonds is unprecedented in this period.

Historical parallel

The sell-off of all asset classes – equities, bonds, inflation-linked bonds, industrial metals and crypto investments (only [alternative investments](#) were able to decouple) especially since the beginning of April – shows parallels to the situation in 1981 and 1982: A U.S. Federal Reserve with very limited room for maneuver (1981: Paul Volker as president, 2022: Jay Powell), i. e. i.e., room to maneuver that is no longer available in the event of extraordinary inflation; and a geopolitical conflict with direct consequences on the energy markets for oil and natural gas (1981: Iran-Iraq war, 2022: Russia-Ukraine war). Especially in Europe, the impact of energy prices on inflation and disposable household incomes is dramatic. Memories of oil shortages and austerity measures in the past come to mind.

If we now follow the template from 1981/82 and apply it to 2022/23, it is arguable that stock prices could already be higher again in 12 months, and bond prices could be on the verge of bottoming out or have already done so.

Share prices and corporate profits

Historically, stock prices are related to corporate earnings. Occasionally, prices or earnings run ahead. In the medium term, however, there is a coincidence. The following chart shows prices in the largest global stock market, the U.S., as well as its corporate earnings and expectations for 2023:

Share prices and corporate earnings (USA)

Source: Bloomberg; as of June 30, 2022; S&P 500 TR Index; "Estimated Earnings Per Share" since 2012 and for 2023
Note: Past performance is not a sufficient indicator of the future performance of the fund.

This shows that corporate earnings in the USA (light blue line) are seen as stable due to the robust economy, also with regard to their forecast for 2023. So why have share prices fallen since the beginning of the year? One component is valuations, which in turn are factored in, such as the so-called price/earnings ratio. Their development is due to the general risk appetite, which is currently in the pessimistic range. The other component is a potential recession (definition: the economy stops growing for two or more quarters and shrinks), which could result from the central bank hitting the economic brakes hard by raising interest rates in the coming months. An impact from a recession on corporate profits is not yet apparent. Whether it will actually happen, and to what extent, is something we monitor closely in our investment decisions.

At the same time, we believe it is important to take a global and differentiated approach when investing in equities, as we have always done in our balanced funds. If the European region is characterized by further uncertainty, as is unfortunately conceivable in the event of a worsening of the energy situation in the coming winter, the U.S. and possibly other regions offer a fallback option. We would not invest more heavily in Europe again until the situation has calmed down.

Asset diversification

In uncertain times, the spread of assets (diversification) is key to being able to ride out a difficult phase on the stock market. Especially when it has been as historically pronounced as it was in the 1st half of 2022. What does that mean in concrete terms? The key is to make the asset class selection for the portfolio as diversified as possible.

Conclusion

The 1st half of 2022 put investors' patience to the test. The reason was pronounced price declines in equities and bonds at the same time. For the second half of the year, the key to taking advantage of more positive developments is to have a portfolio that is as broadly diversified as possible.

For a glossary of technical terms, please visit this link: [Fund Glossary](#) / [Erste Asset Management](#)

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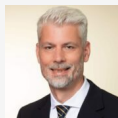
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