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Prices, taxes, crises: a summer on the defensive

Strategies after the ECB decision and Draghi's resignation Diversify as much as possible, prioritise the US and China, greater focus on bonds than shares. Hoping that the high cost of living will ease by September...

by **Gabriele Petrucciani**

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There should be no earthquakes on the financial markets. Not in Europe, where the ECB surprised everyone by raising interest rates by 0.50% rather than the expected 0.25%, nor in Italy, mired in political crisis after the resignation of Mario Draghi. Portfolio balances are remaining stable and those operating across a medium-long time horizon must simply hold tight and wait for the storm to pass - or rather for inflation to reach its peak, and withstand the inevitable ups and downs of the markets. This is the prevailing opinion among managers and analysts. "The only way to bring down supply-generated inflation is to act on demand, slowing it down," explains Marco Mossetti, strategist at Credit Suisse Am. And it's already working. This is giving rise to the hope that the winds may finally changing, likely as early as September, as confirmed by the leading inflation indicators which point to possible improvements. So on the markets, it's time to grit your teeth. The market correction we have seen so far has been extensive, almost reaching the levels of previous corrections, particularly in the US, where rate normalisation is way ahead. My suggestion would be to have a well diversified portfolio, leaning towards the US - which as a net exporter of energy is therefore less vulnerable to shocks than Europe - and China, where the monetary policy cycle is desynchronised compared to developed countries."

What's happening in Frankfurt

There was no other option. The ECB had to act and send an important signal. "It was crucial to curb inflation expectations and that is why the 0.50 percent increase didn't catch us by surprise. We were expecting it," notes Luca Riboldi, Head of Investments at Banor Sim, "and it's likely that we will see another squeeze of 0.50 percent as early as September. People are demanding pay rises across Europe, justified by inflation that is running above 8%. But a price-salary spiral would be very dangerous and must be avoided. This is why the central banks are trying to bring real rates back into positive figures. The US has already succeeded on its 10-year rates and now it's Europe's turn. Besides, we couldn't stay too far away from the United States. We had to narrow the gap on rates, avoiding too fast a devaluation of the euro against the dollar and an increase in imported inflation."

Of course, in a context of decelerating economic growth, a monetary tightening can create a poisonous cocktail for the markets. However, not all bad things come to pass, observes Riboldi: "the US 10-year bond, for example, has settled at a cap of 3% percent, against an expected 10-year inflation of 2.35 percent. The Fed has succeeded in lowering cost-of-living expectations, which is precisely why, in our opinion, it will not go ahead with all of the hikes it has announced. It is very likely that the central banks will take us to the brink of recession and then take their foot off the gas."

And from that moment on, new scenarios will open up for the markets. In a nutshell, Riboldi isn't anticipating any great shocks. The markets will adapt and be very selective.

Which stocks are likely to suffer the most? "Those that aren't able to pass on the increase in energy prices and labour costs," responds Riboldi.

Choosing a position

Slightly increasing the bond component at the expense of equities could be a good defensive tactic at this time that doesn't disrupt the portfolio. This is also wise because "with a suitably long horizon, markets are beginning to enter relatively interesting areas," argues Mossetti. We are not too far off a return to positive values. On the other hand, those with a low appetite for risk operating in a short-term scenario should be more defensive, leaning towards government bonds as rate hikes take effect, and then taking on more risk in the latter part of the year".

And there must also be room in the portfolio for quality corporate bonds, which begin to offer a little more protection, "selecting issues according to rating and looking at leading companies with good management and competitive positioning", adds Riboldi.

What's happening in Rome

Draghi's resignation heralded the start of a period of uncertainty in Italy. Spread tensions cannot be ruled out, but the anti-fragmentation tool announced by the ECB will serve to dampen the shock, not least because it could be linked to the

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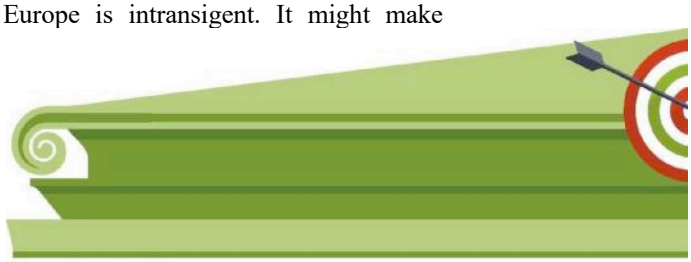
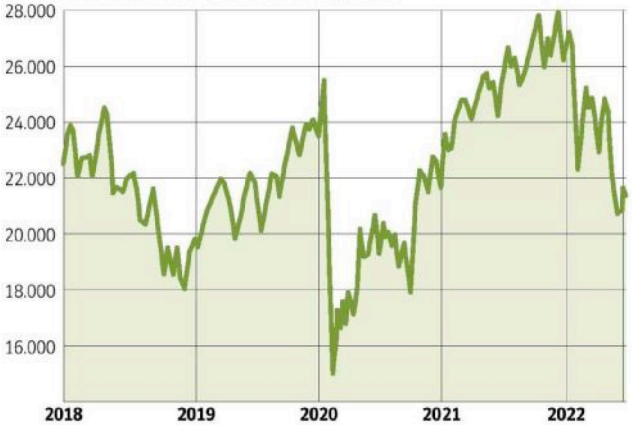
NRRP, "making our economic policy more disciplined", Mossetti points out. Elsewhere, the reform agenda must move forward, echoes Elisabetta Villa, investment specialist at Etica Sgr: "the conditions for accessing the other tranches of the funds are fairly clear and Europe is intransigent. It might make some allowances because of the election, but the results must be brought home," no ifs, no buts.

The ECB and the Fed are moving decisively: if they succeed in curbing the price hikes, this will be the turning point the markets are waiting for



The fluctuations

The performance of the Ftse Mib over the legislative period



Fixed vs variable

A selection of Italian and foreign government bonds to protect against inflation

Isin	Issuer	Gross coupon	Maturity	Rating	Price	Gross return	Notes
US912828W713	T-Bond	2.125%	31/03/24	AA+	98.11	3.31%	a
IT0005174898	Btp Italia[1]	0.40%	11/04/24	BBB	102.61	-1.12%	
IT0005004426	Btp €i[2]	2.35%	15/09/24	BBB	107.78	-1.27%	
IT0005252520	Cct	0.392%	15/10/24	BBB	100.91	1.27%	b
IT0005359846	Cct	0.662%	15/01/25	BBB	102.58	1.37%	c
FR0012558310	OAT[1]	0.10%	01/03/25	AA-	104.98	-1.76%	
IT0005410912	Btp Italia[1]	1.40%	26/05/25	BBB	103.16	0.28%	
DE0001030567	Bind €i[2]	0.10%	15/04/26	AAA	106.36	1.54%	
US912828R366	T-Bond	1.625%	15/05/26	AA+	94.20	3.26%	a
IT0005332835	Btp Italia[1]	0.55%	21/05/26	BBB	100.20	0.47%	
US912828S505	T-Bond i[4]	0.125	15/07/26	AA+	98.72	0.47%	
IT0005388175	Btp Italia[1]	0.65%	20/10/27	BBB	98.42	0.95%	
US9128286B18	T-Bond	2.63%	15/02/29	AA+	96.63	3.20%	a
IT0005415291	Btp Futura	1.15%	14/07/30	BBB	86.21	3.32%	
IT0005494239	Btp	2.50%	01/12/32	BBB	90.04	3.66%	

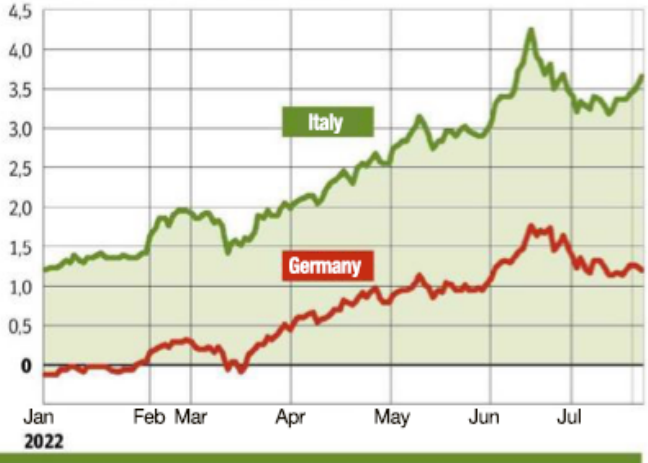
1) Indexed to Italian inflation.
2) Indexed to Eurozone inflation;
3) Indexed to French inflation; **4)** Indexed to US monetary inflation; US dollar
Notes:
a) US dollar; **b)** coupons: 6 months Euribor rate + 1.10; **c)** coupons: 6 months Euribor rate + 1.85

Italy and Germany

The Btp-Bund spread since the start of 2022 based on the duration of the securities

Growing

The ten-year Italy/Germany rate since the start of the year



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