IHAG PRIVATBANK

Monthly CIO Letter

22 July 2022

Investors are being buffeted by concerns around inflation, political turmoil, growth and the prospect of a recession. Sentiment is at a historic low in places. We are seeing exaggerated market reactions accompanied by signs that the situation is easing, and are retaining our equity overweight.

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Chief Investment Officer

Highlights

- Persistently high inflation figures are continuing to induce central banks to hike interest rates – in some cases aggressively.
- A growth slowdown is therefore on the cards and the general mood on the markets is currently low by historical standards.
- Various indicators are pointing to exaggeration on the markets, although a number of risk scenarios are still in evidence and the fundamental picture remains on the gloomy side.
- We are maintaining our equity overweight in the expectation of a further countermovement.

Asset Allocation

Asset Classes	Change	– –	–	=	+	+ +
Liquidity	➡				●	
Bonds	➡	●				
Reference Currency	➡	●				
World	➡	●				
Emerging Markets	➡					●
Convertible Bonds	➡				●	
Equities	➡				●	
Switzerland	➡				●	
Europe	➡				●	
US	➡				●	
Pacific	➡			●		
Emerging Markets	➡		●			
Alternative Assets						
Gold	➡				●	
Crypto Assets	➡				●	
Currencies						
CHF	➡			●		
EUR	➡			●		
USD	➡			●		

Change: compared to previous month, **Positioning**: -- strongly underweighted | - underweighted | = neutral | + overweighted | ++ strongly overweighted

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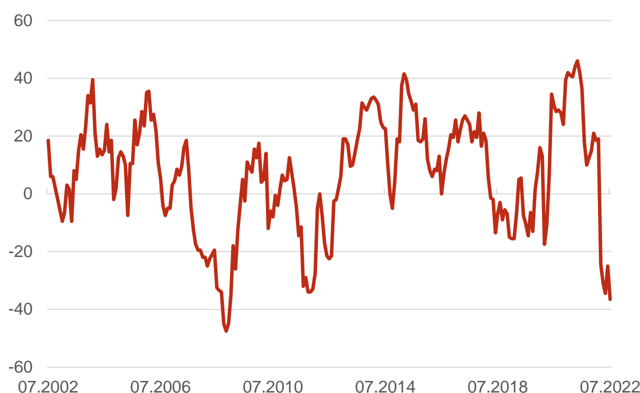
Asset Allocation

The second half of June and the first two weeks of July presented a somewhat unusual picture: bonds – with the exception of riskier high yield bonds and emerging market papers – are showing gains. At the same time, equities are recovering from their (interim) lows for the year. This is the case even though both bonds and the equity markets have almost without exception posted losses in the past six months.

Against a backdrop of increasing indications of an (at least temporary) easing, accompanied by unusually low sentiment on the part of market participants (see graph below), we are retaining our equity overweight. Even though the risk scenarios are still in evidence and the fundamental picture remains rather gloomy, we are expecting to see a further countermovement develop. The equity allocation for a balanced investor profile is 52%.

Sentix index of institutional investors' expectations



We are keeping the bond allocation towards the lower end of the possible range. A balanced strategy has a bond allocation of 30%, and we are also deliberately including hard currency bonds from emerging countries, due to higher yields. We are likewise keeping the duration below the market's average interest rate sensitivity.

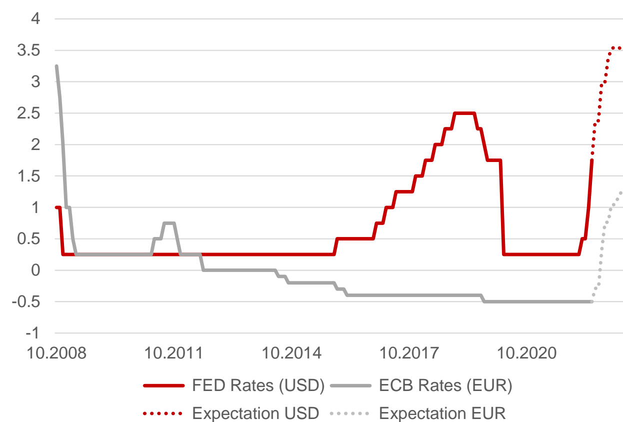
Given the generally higher level of market volatility, we regard diversified asset classes as key elements in the portfolio allocation. Having taken some profits on gold in March, we are continuing to hold a smaller position owing to risk considerations. We are also holding some crypto investments, in which we expect to see a further recovery following the dramatic swings of recent months.

Bonds

After seven months of losses, the global bond markets are for the first time showing signs of stabilising – at least in the investment grade segment. Interest rates at the longer end of the relevant curves have passed their current highs and are falling back in some cases. Only credit spreads are still widening in places, which is why high yield bonds and emerging market debt are notching up further losses.

Two circumstances account for this development: firstly, inflation figures can be expected to peak in the near future, and secondly, this is prompting the market to start pricing in an end to the current interest rate cycle. The prices of money market instruments are thus indicating an end to USD interest rate rises in February 2023. An about-turn for the EUR and CHF may also be expected in the first half of next year.

Key interest rates: Development and market-implied expectations



This is good news: an expected easing of the current inflationary pressure will directly reduce the occurrence of (much riskier) second-round effects. The central banks' efforts to anchor inflation expectations may be regarded as successful for the time being. It also means that the central banks' current one-sided focus on inflation will probably give way to a broader consideration of the overall economic situation, with the result that – while taking somewhat higher inflation rates into account in future – they are likely to pay more attention to the economy as a whole when deciding how to act.

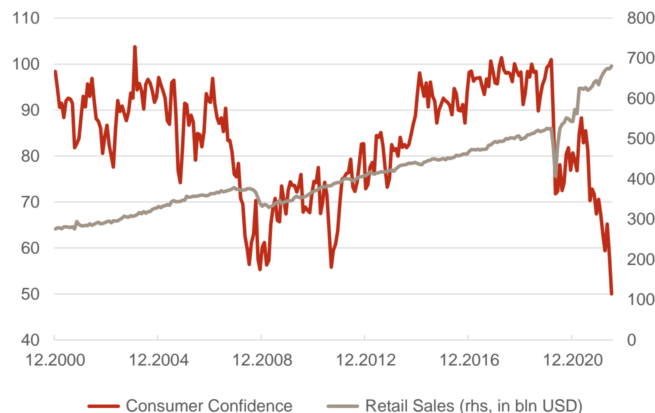
We are leaving the bond allocation at the lower end of the bandwidths. Credit spreads, in particular, are still not always adequately reflecting the higher default rate that can be expected in the wake of recessionary trends. Given the significant decrease in credit quality on the market as a whole during the low interest phase, caution is called for when interpreting the significance of current credit spreads on an aggregate basis. Due to the expansive monetary policy of recent years, credit spreads in the market have been much too low in places.

Equities

The global equity markets have fallen to new lows for the year over recent weeks. Not only are investors continuing to be more cautious, partly because of the prevailing risk scenarios (key words: war and gas), but the narrative of a looming global recession has now become the consensus view. This growth slowdown, or even contraction, is being preempted by falling prices on the equity markets – some of them hefty.

One major reason for this is the current lack of consumer confidence, which has fallen to a new low in the US, for example. This is a key factor, given the importance of consumption as the biggest element in demand, and bearing in mind the historical pattern, which has always seen a recession follow whenever this indicator hits a new low.

Consumer confidence and retail sales in the US



However, it is also important to note that consumption figures are currently hitting new highs. Actual consumer sales show no sign of decreasing, which indicates corresponding support for the market.
This continuing strong demand is also reflected in the fact that companies are revising their expectations – downwards – only marginally.

If we take another look at the current low (by historical standards) that investor sentiment has reached, share price levels are indicating potential for recovery. This countermovement should not be seen as fundamental, but as a reflection of the currently exaggerated market reaction produced by the widespread negative view of economic growth in the coming months. We are therefore maintaining the equity overweight we instituted at the end of June.

The risk scenario of a further escalation in the Russia-Ukraine conflict along with the negative impacts of higher energy prices, or even energy shortages, is still in place. There is therefore little likelihood of a sustained decline in volatility over the next few weeks.

Alternative Assets
Alternative assets serve to further diversify the portfolio. Having taken profits on gold, we are continuing to hold a reduced position in the precious metal owing to risk considerations. We are at the same time maintaining our positions in cryptocurrencies, where we are expecting a market recovery – as general confidence returns – following the upheavals seen in recent weeks.

Currencies
In view of the more rapid rise in USD key interest rates, we still expect the USD to strengthen slightly and are therefore refraining from hedging the dollar. The CHF immediately appreciated against the EUR following the SNB's interest rate decision. We are refraining from hedging the EUR, given that the ECB has come under significantly more pressure to raise interest rates in recent weeks.

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Appendix

Economy and Markets

GDP (E: Consensus)

	2021	2022E
USA	5.7%	2.6%
EU	5.4%	3.0%
Switzerland	3.8%	2.5%

Inflation (E: Consensus)

	2021	2022E
USA	4.7%	7.5%
EU	2.6%	7.1%
Switzerland	0.6%	2.3%

Central Bank Rates

	21.06.2022	Outlook
USA	1.75%	2.50%
EU	-0.50%	0.00%
Switzerland	-0.25%	-0.25%

Capital Market Rates (10 Years)

	21.06.2022	Outlook
USA	3.27%	3.25% - 3.5%
Germany	1.77%	1.6% - 1.9%
Switzerland	1.45%	1.3% - 1.6%

Foreign Exchanges

	21.06.2022	Outlook
EUR/CHF	1.018	1.01 - 1.03
USD/CHF	0.966	0.95 - 0.98
EUR/USD	1.053	1.03 - 1.07

Raw Materials and Alternatives

	21.06.2022	Outlook
Gold (USD/Ounce)	1833.0	1800 - 1900
Oil (USD/Brent)	114.7	100 - 125
Bitcoin USD	20’838	20'000-30'000

Equity Markets

	P/E ø 5J.	P/E 2023	Div. Yield	Outlook
Welt	18.3x	13.9x	2.2%	sligthly upwarrds
USA	19.9x	15.1x	1.7%	sligthly upwarrds
Europa	16.2x	11.2x	3.6%	sligthly upwarrds
Switzerland	18.8x	14.4x	3.0%	sligthly upwarrds
Emerging Markets	13.6x	10.4x	2.9%	sideways

Markets in Local Currencies

Equity Markets

	QTD	YTD
World	-16.2%	-20.4%
USA	-16.6%	-20.4%
Europe	-8.8%	-14.2%
Switzerland	-13.1%	-17.8%
Emerging Markets	-10.3%	-16.5%

Capital Market Rates (10 Years)

	21.06.2022	31.12.2021
USA	3.27%	1.51%
Germany	1.77%	-0.18%
Switzerland	1.45%	-0.14%

Raw Materials and Alternatives

	QTD	YTD
Gold (USD/Ounce)	-5.4%	0.2%
Oil (USD/Brent)	20.3%	90.5%
Bitcoin USD	-54.5%	-55.0%

Foreign Exchanges

	QTD	YTD
EUR/CHF	-0.4%	-1.9%
USD/CHF	4.7%	5.8%
EUR/USD	-4.8%	-7.4%

Data as of 21 June 2022, QTD: Performance since Beginning of Quarter, YTD: Performance since Beginning of Year