Monthly CIO Letter

23 September 2022

The lack of a consensus about the macroeconomic outlook has left the markets rudderless. Having taken profits in August, we are leaving the portfolio allocation unchanged.

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Highlights

- Inflation is proving more stubborn than was generally feared.
- The onus is therefore on central banks to keep inflation expectations in check by taking resolute action to combat it.
- This has revived fears of a recession, which are acting as a drag on the markets.
- Some valuation levels are attractive – but while TINA has left the party, FOMO has yet to show up.

Asset allocation

Asset classes	Change	– –	–	=	+	+ +
Liquidity	➡				●	
Bonds	➡	●				
Reference currency	➡	●				
World	➡	●				
Emerging markets	➡					●
Convertible bonds	➡				●	
Equities	➡			●		
Switzerland	➡				●	
Europe	➡			●		
USA	➡				●	
Pacific	➡			●		
Emerging markets	➡	●				
Alternative investments						
Gold	➡				●	
Cryptos	➡				●	
Currencies						
CHF	➡			●		
EUR	➡			●		
USD	➡			●		

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

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Asset allocation

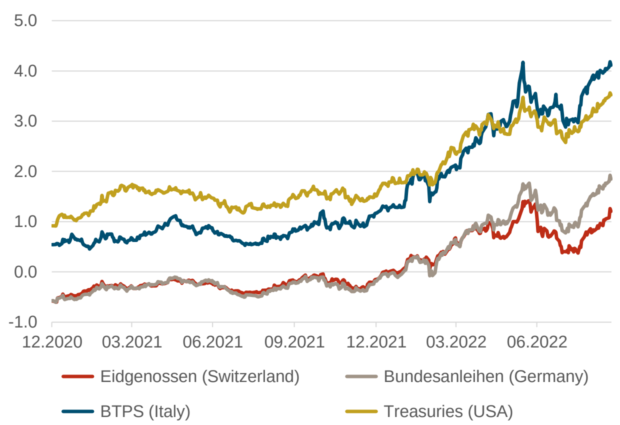
The last five weeks have seen a sobering picture emerge in the markets after their rises between the end of June and mid-August.

Stock markets are down across the board, and bond markets are also posting losses due to further interest rate rises. Even investments that are supposed to be safe or at least diversifying, such as gold, commodities and cryptos, have been heading south.

While equity markets are (still) trading above their lows for the year, some bond yields have reached new year-to-date highs. This is because inflation has been more stubborn than expected, leading the markets to expect key interest rates to rise even higher to combat it.

As the situation is still contradictory in some areas, we are remaining neutral for the moment with an equity quota of 50% (profile: balanced). This is after we realised the gains from market rises in August.

Government bonds: development of 10-year interest rates



We are maintaining the bond quota at the lower end of its possible range. A balanced strategy has a bond quota of 35%, though higher interest rates have led us to add selected hard-currency bonds from emerging markets.

We regard diversifying asset classes as additional components in portfolio allocations. For that reason, we hold gold in particular. We have also added investments in cryptos.

Bonds

The global economy continues to exhibit a serious imbalance between supply (where disrupted value chains and deglobalisation tendencies are key factors) and demand. The latter has been shaped by years of very loose monetary policy, but also continues to reflect the backlogs that built up following covid-related slumps and the related postponement of consumption.

In an environment like this, inflation is a natural consequence. The only way to combat inflation directly is to curb demand, as the supply side can only be influenced indirectly and with a longer time lag.

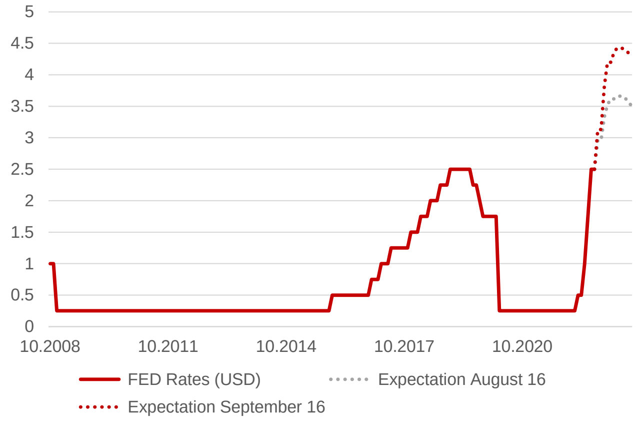
The present imbalance can be corrected, and inflation combated, by deliberately allowing inflation to exceed wage growth – thus achieving a de facto reduction in real purchasing power – or by allowing demand to be curbed by recession. As labour markets remain strong, the option of higher inflation – even taking account of the performance mandates of a number of central banks – is not feasible, because the resulting wage/price spirals would entail the risk of hyperinflationary tendencies and thus cause further problems, especially with regard to allocation mechanisms.

Current central bank policy, with its almost blinkered focus on price development, should be seen against this risk backdrop. If it triggers a recession, this should be seen as a lesser evil that must be accepted for the moment.

Stubbornly high inflation figures over the last few weeks have once again thrown this mechanism into the limelight. The expectation that the central banks will have to intervene even more forcefully has raised interest rates across the board, while equities have continued to lose value in expectation of a further slowdown in growth – or even a recession. The expected peak in US federal fund rates, for example, has shifted from 3.6% in February 2023 (which made more economic sense, as we said in the last CIO Letter) to 4.4% in April 2023. Also, the growth outlook has at the same time been revised downwards again. On an annualised view, though, it is still too early to speak of a recession.

As we said in the July CIO letter, the central banks will (have to) accept slightly higher inflation in the medium term in order to avoid an excessive braking effect on the overall economy. This applies all the more to the European region, which is much closer to recessionary tendencies – on top of the structural challenges presented by higher energy prices.

Key US interest rates: changed implicit market expectations



For the moment, even though interest rates are currently expected to approach equilibrium, we are leaving the bond quota at the lower end of the bandwidths – but we are considering a selective increase via high-quality issues. We still see the addition of hard-currency bonds from emerging markets as attractive.

Equities

Renewed fears of recession are currently weighing on the stock markets. While a slowdown is to be expected (and also welcomed), the crucial question is its extent. Tighter central bank activity in recent weeks has made it significantly less likely that the economy will achieve a soft landing.

Given companies' current outlook, the equity markets are probably fairly valued in a historical context – but the quality of the outlook has deteriorated: valuations have already contracted, and the slowdown in growth has made this process more likely to intensify.

Rising interest rates are also a contributory factor at present: the TINA principle (There Is No Alternative) has been a popular buzzword in recent months, but they have made it less valid. While we are on the subject of modestly original acronyms, it must be said that FOMO (the Fear Of Missing Out) is currently not even on the horizon.

Volatility will probably remain high in the coming months, reflecting a lack of direction – as well as the challenging task of assessing the market situation and forecasting future economic development. We are keeping the equity quota at a neutral level for the time being.

Alternative investments

Alternative investments further diversify portfolio risk, helping to improve the risk-return ratio. With risk in mind, we retain our investments in gold – and we also hold cryptocurrencies, as we expect the market to recover after the distortions of the last few weeks as general confidence returns.

Currencies

We are not hedging the USD, as we continue to expect it to strengthen slightly as interest rates outpace those of other currencies. Nor does it seem opportune to hedge the EUR at its current level, because the ECB remains under pressure to raise interest rates further.

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Appendix

Economy and Markets

GDP (E: Consensus)

	2021	2022E
USA	5.7%	1.6%
EU	5.8%	3.1%
Switzerland	4.3%	2.4%

Inflation (E: Consensus)

	2021	2022E
USA	4.7%	8.0%
EU	2.6%	8.2%
Switzerland	0.6%	2.9%

Central Bank Rates

	20.09.2022	Outlook
USA	2.5%	4.25%
EU	0.8%	2.00%
Switzerland	-0.3%	1.25%

Capital Market Rates (10 Years)

	20.09.2022	Outlook
USA	3.6%	3.30% - 3.70%
Germany	1.9%	1.70% - 2.20%
Switzerland	1.3%	1.20% - 1.60%

Foreign Exchanges

	20.09.2022	Outlook
EUR/CHF	0.961	0.95 - 0.99
USD/CHF	0.964	0.94 - 0.98
EUR/USD	0.997	1.00 - 1.04

Raw Materials and Alternatives

	20.09.2022	Outlook
Gold (USD/Ounce)	1664.9	1625 - 1725
Oil (USD/Brent)	90.6	88 - 105
Bitcoin USD	18’974	18'000-25'000

Equity Markets

	P/E ø 5J.	P/E 2023	Div. Yield	Outlook
Welt	18.2x	14.3x	2.2%	sideways
USA	19.9x	15.8x	1.7%	sideways
Europa	16.0x	10.9x	3.5%	sideways
Switzerland	18.7x	14.9x	3.0%	sideways
Emerging Markets	13.5x	10.7x	3.4%	sideways

Markets in Local Currencies

Equity Markets

	QTD	YTD
World	0.7%	-19.7%
USA	2.2%	-18.2%
Europe	-0.5%	-14.8%
Switzerland	-3.1%	-18.4%
Emerging Markets	-4.4%	-21.2%

Capital Market Rates (10 Years)

	20.09.2022	31.12.2021
USA	3.56%	1.51%
Germany	1.93%	-0.18%
Switzerland	1.29%	-0.14%

Raw Materials and Alternatives

	QTD	YTD
Gold (USD/Ounce)	-7.9%	-9.0%
Oil (USD/Brent)	-11.3%	90.8%
Bitcoin USD	1.3%	-59.0%

Foreign Exchanges

	QTD	YTD
EUR/CHF	-4.0%	-7.3%
USD/CHF	0.9%	5.6%
EUR/USD	-4.9%	-12.3%

Data as of 20 September 2022, QTD: Performance since Beginning of Quarter, YTD: Performance since Beginning of Year