IHAG PRIVATBANK

Monthly CIO Letter

21 October 2022

With inflationary pressure proving more stubborn than originally thought, central banks are being forced to stick with their hawkish stance. As things stand, the market is continuing to ignore the medium-term likelihood of a recalibration of monetary policy. We are increasing the equity allocation.

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Chief Investment Officer

Highlights

– Inflation is proving more stubborn than originally thought, and central banks are thus being forced to maintain an uncompromisingly hawkish stance to combat further price increases.

– In the medium term, however, central banks will transition towards a more accommodating policy.

– This development is currently being completely ignored by market participants. Recessionary fears are prevailing.

– We believe the extreme negative sentiment is exaggerated. The equity weighting is being increased from neutral to 52%.

Asset Allocation

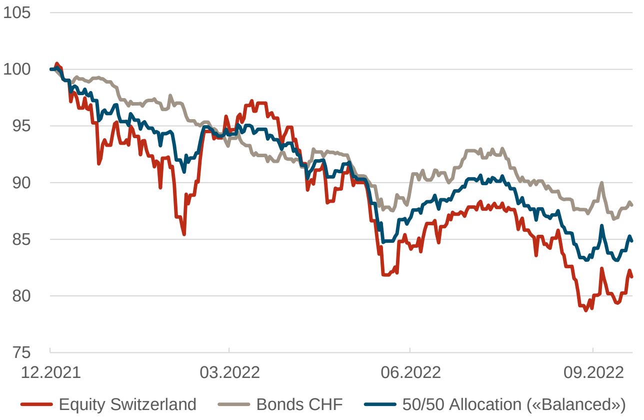
Asset Classes	Change	– –	–	=	+	+ +
Liquidity	⬇				●	
Bonds	➡	●				
Reference Currency	➡	●				
World	➡	●				
Emerging Markets	➡					●
Convertible Bonds	➡				●	
Equities	⬆				●	
Switzerland	⬆				●	
Europe	➡			●		
USA	⬆				●	
Pacific	➡			●		
Emerging Markets	➡	●				
Alternative Assets						
Gold	➡				●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

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

Asset Allocation

Coinciding precisely with the quarterly end, a number of equity and bond markets have closed at new annual lows. Persistently high rates of inflation, an unwavering hawkish stance on the part of central banks and the associated fears of recession are dominating – as well as investor sentiment. Even asset classes that supposedly offer diversification, such as precious metals and crypto investments, have been unable to escape this negative trend.

Market development 2022: Swiss equities and bonds



With inflation rates remaining stubbornly high in many regions, central banks are being forced to maintain their uncompromising monetary policy stance – both in their actions and in their communications – as they try and allay the market's fears that inflation could spiral even further. These fears are being fuelled further by the unrelenting strength of labour markets, the continued robustness of consumer spending, and even tax-cutting plans proposed by (clearly rather naïve) new governments who are not afraid of experimenting.

In keeping with the consistent stance taken by central banks, implied market expectations of further key interest rate steps have increased once again this month. For example, whereas in September the key interest rate in the US was expected to peak at 4.4% in March 2023, the equivalent expectation for April 2023 has now risen to 4.9%.

Even assuming that the central banks will overshoot their target in their battle against inflation – an assumption justified by historical precedent – the current peak figure of around 5% is so far above the level of the logical equilibrium point for interest rates that it constitutes an exaggerated market expectation, although even an exaggeration can still become more accentuated.

As already explained on various occasions in previous CIO Letters, central banks may have no alternative to a hawkish stance but the time will ultimately come – firstly in the form of verbal guidance and then as concrete action – when there will be a shift towards more accommodating monetary policy.

We consider current market expectations regarding the development of key interest rate developments to be exaggerated, and take the view that the market is overestimating the risk (or at least the depth) of any recession. As an additional factor, there continues to be a conflict between macroeconomic assessment and microeconomic reality.

As such, we are anticipating a counter-movement to set in over the next few weeks, and are increasing the equity weighting for a balanced allocation from neutral to 52%; we have a preference for the regions of Switzerland and USA.

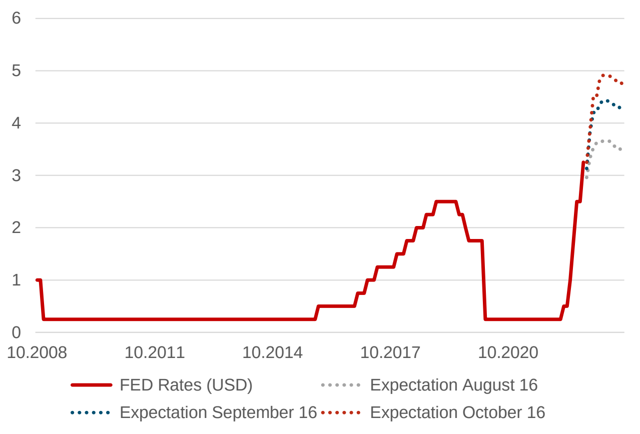
We are keeping the bond allocation towards the lower end of the possible bandwidth. A balanced strategy has a bond allocation of 35%, and we are also deliberately including hard currency bonds from emerging countries due to the higher yields they offer.

We believe the use of diversifying asset classes should also be an additional element in the asset allocation process, and are therefore holding gold in particular in the portfolios. We are also including an admixture of crypto investments.

Bonds

Central banks continue to be relentless in their efforts to tame inflation. The consistency of their stance is explained by the threat of second-round effects, which looms particularly large at the moment due to persistently strong consumer spending and a labour market that remains very robust. Against this background it is all the more essential that the inflationary expectations of market participants are kept under control.

Key interest rates: development and expectations



Over the last few weeks, the most recent interest rate steps and the associated statements of various central banks have led to repeated increases in expectations of key interest rate movements. For example, the Federal Funds Rate in the US is now expected to rise to more than 4.9% by April 2023.

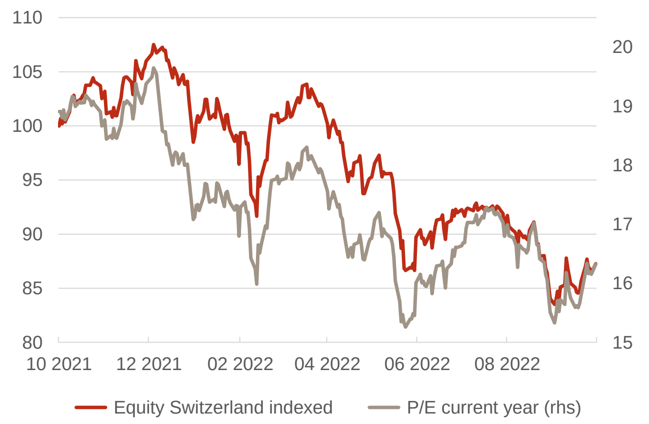
Scary numbers like this are fuelling fears of recession, hence the wide-scale losses recorded over the last few weeks. Even if central banks are likely to overshoot their targets once again, we believe that current expectations of key interest rate developments are at the very upper end of the possible bandwidth, and therefore expect less extreme pessimism over the coming weeks. This is also reflected in credit spreads, which in many cases are likely to have widened without this indicating any potential credit problems of the kind that can be expected in a severe recession. The current shape of the yield curve – which is characterised by less pronounced rises at the long end – is also not pointing to a severe recession at the moment.

We are leaving the bond weighting unchanged for now, as we see greater recovery potential on the equity side. For fixed-income assets, we continue to advocate an admixture of hard currency bonds from the emerging markets.

Equities
The renewed fears of a recession have been reflected in further price falls, and these have primarily resulted in compressed price/earnings ratios. But there is evidence of a continuing and oft-cited discrepancy between the assessments of strategically-oriented investors on one hand and those of corporate data-oriented analysts on the other: Based on data released by companies and guidance provided by managements, analysts are expecting any recessionary tendencies in the overall economy to have a significantly milder negative impact.

The attractive level of current valuations, combined with a further increase in risk aversion and an oversold market situation, has prompted us to increase the equity weighting. A counter-movement can be expected to set in over the coming weeks. Here we are concentrating on the more conservative Swiss equity market and the US equity market. By contrast, emerging market equities remain underweighted, above all due to the ongoing pressure exerted by a strong greenback.

Parallel development of Swiss equities and P/E contraction



Due to the ongoing and fundamental uncertainty over macroeconomic development going forward, volatility will remain high. The frequently cited risk scenarios will remain with us.

Alternative Assets
Alternative investments serve to provide additional diversification in a portfolio context and thereby help to improve the risk/return ratio. Due to risk considerations we are continuing to hold investments in gold. We are likewise invested 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 US key interest rates, we still expect USD to strengthen slightly and are therefore refraining from hedging this currency. Where EUR is concerned, we do not consider hedging at current levels to be opportune, as there is unrelenting pressure for further ECB rate hikes.

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Appendix

Economy and Markets

GDP (E: Consensus)

	2021	2022E
USA	5.9%	1.7%
EU	5.9%	3.3%
Switzerland	4.3%	2.2%

Inflation (E: Consensus)

	2021	2022E
USA	4.7%	8.0%
EU	2.6%	8.2%
Switzerland	0.6%	3.0%

Central Bank Rates

	19.10.2022	Outlook
USA	3.3%	4.50%
EU	0.8%	2.50%
Switzerland	0.0%	1.75%

Capital Market Rates (10 Years)

	19.10.2022	Outlook
USA	4.1%	4.00% - 4.50%
Germany	2.4%	2.20% - 2.60%
Switzerland	1.3%	1.20% - 1.60%

Foreign Exchanges

	19.10.2022	Outlook
EUR/CHF	0.982	0.95 - 0.99
USD/CHF	1.004	0.98 - 1.02
EUR/USD	0.977	0.96 - 1.00

Raw Materials and Alternatives

	19.10.2022	Outlook
Gold (USD/Ounce)	1629.4	1625 - 1725
Oil (USD/Brent)	92.4	88 - 105
Bitcoin USD	19’196	18'000-22'000

Equity Markets

	P/E ø 5J.	P/E 2023	Div. Yield	Outlook
Welt	18.2x	13.9x	2.3%	slightly up
USA	19.8x	15.3x	1.8%	slightly up
Europa	15.9x	10.7x	3.6%	sideways
Switzerland	18.7x	14.9x	3.1%	slightly up
Emerging Markets	13.4x	10.3x	3.5%	sideways

Markets in Local Currencies

Equity Markets

	QTD	YTD
World	2.6%	-23.2%
USA	3.1%	-21.5%
Europe	2.6%	-15.9%
Switzerland	1.7%	-18.6%
Emerging Markets	-1.1%	-27.8%

Government Bond Yield (10 Years)

	19.10.2022	31.12.2021
USA	4.13%	1.51%
Germany	2.38%	-0.18%
Switzerland	1.31%	-0.14%

Raw Materials and Alternatives

	QTD	YTD
Gold (USD/Ounce)	-1.9%	-10.9%
Oil (USD/Brent)	8.5%	106.8%
Bitcoin USD	-1.2%	-58.6%

Foreign Exchanges

	QTD	YTD
EUR/CHF	1.5%	-5.4%
USD/CHF	1.7%	10.0%
EUR/USD	-0.3%	-14.0%

Data as of 19 October 2022, QTD: Performance since Beginning of Quarter, YTD: Performance since Beginning of Year