IHAG PRIVATBANK

Monthly CIO Letter

18 November 2022

An easing of inflationary pressure in some respects is currently bringing calm to the financial markets. This development, coupled with higher base interest rates, a lower level of valuations and ongoing uncertainty on the part of investors, prompts us to stick with the equity overweight stance initiated in October.

Christoph Boner
Chief Investment Officer

Highlights

– Estimating precisely where interest rates will peak remains a game of trial and error.

– Given the exceptionally consistent stance adopted by central banks in their determination to keep inflation under control, implied interest rate peaks have soared far beyond sustainable levels.

– The correction of this expectation has buoyed the markets in recent weeks. We remain overweight in equity.

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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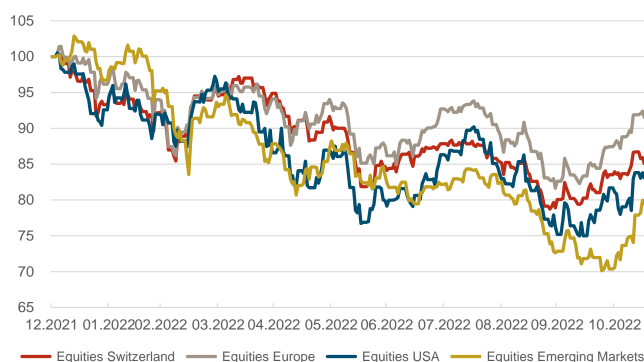
Asset Allocation

The publication of consumer price developments in the US on 10 November lit a touch-paper under equity prices. US equities rocketed by more than 5% that day, and European and Asian stock markets likewise posted strong gains. Interest rates fell across the board and USD depreciated dramatically.

Even though the published inflation figure of 7.7% remains far above the Fed’s target bandwidth – namely 2 percent in the longer run – the relief it brought to investors was considerable. This figure had moved in the right direction for the fourth month in a row. In addition, it was also below the level expected by the market consensus.

Market development 2022: global equity markets (indexed)



As explained in the CIO letter of October 2022 when the equity weighting was increased, central banks have been and remain forced to adopt an uncompromising stance in the fight against price increases in order to anchor inflationary expectations. “Uncompromising” in this context means that economic development – and in particular the risk of a recession – is a minor or even irrelevant factor for the time being. This uncompromised stance has caused market participants to form exaggerated expectations of interest rate developments, namely a Federal Funds rate in excess of 5%.

The latest development of the rate of inflation has calmed the situation for now, and could give central banks some leeway in the medium term to factor economic development into their decision-making. At the same time, it is only reasonable to assume that slightly higher inflation rates (relative to the target range) may be tolerated in the future.

The implied market expectation has now fallen back below the 5% mark since the announcement of the latest inflation figures, which once again puts it – as explained in October – closer to the medium-term equilibrium level.

However, a side-effect of this moderating interest rate expectation was that the US dollar came under selling pressure, depreciating by more than 6% in a week.

With the exaggerated interest rate expectations of investors now having been reined in, we see scope for a further recovery of markets. Not only do investors enjoy a more attractive base rate , while further rate hikes seem already be priced in; the contraction of valuations and unrelentingly pessimistic sentiment among market participants also offer further price potential.

Accordingly, we are leaving the equity weighting unchanged and take some profits following the strong market counter-movement. The equity weighting for a balanced allocation amounts to 52%, with a regional preference for Switzerland and the US.

We are keeping the bond allocation at 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 their yield pick up. Thanks to their specific duration profile and the tightening of credit spreads, the latter have a much more attractive risk/return profile than reference currency bonds.

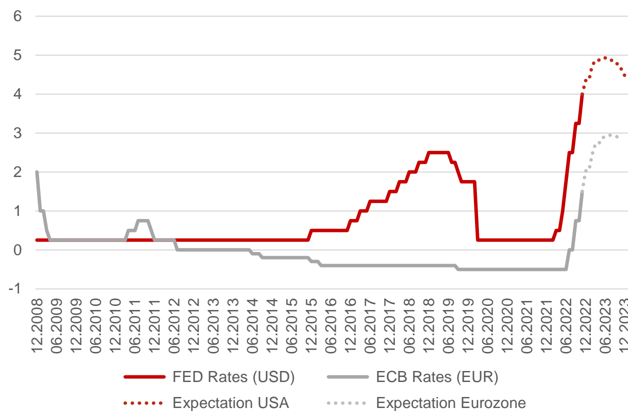
We consider the use of diversifying asset classes to be an additional element in the asset allocation, and are therefore keep gold in the portfolios. We are also holding some crypto investments.

Bonds

The macroeconomic damage caused by (uncontrolled) inflation should be viewed as far more detrimental than the economic fallout of a recession. On back of this thesis and in order to preserve their credibility, central banks are following an extremely consistent line in their battle against inflation. However, this task – a challenging one in any scenario – is currently being complicated by the fact that inflationary developments are being driven to a large extent by the supply side, while the economy itself (when judged on the basis of either the labour market or consumer spending) is still chugging along nicely.

The most recent US inflation data shows that the Fed is following the right path. Even if pessimists continue to point out that the central bank response has been too late and too pronounced – an opinion clearly borne out by analysis of historical precedent – the latest figures do show a partial correction to the market’s exaggerated expectations. Implied interest rate expectations have been reined in noticeably. Even if the expected peak of US interest rates is now clearly lower (namely 4.9% in June 2023), predicting that peak is essentially a game of trial and error.

Key interest rates: development and expectations



What ultimately matters, however, is that inflation starts to come down to the extent that the expected interest rate peak can be identified in the first half of 2023. With further rate hikes still priced in and the existing base rate of interest at its current level, a significantly more attractive return profile is likely over the next few months, even if interest rate volatility is set to remain higher than normal. We are leaving the bond exposure unchanged for now, as we discern greater recovery potential on the equity side.

Equities

The anticipated economic slowdown is becoming increasingly apparent in company figures. Although the expectations of analysts will be largely met this quarter, this is partly due to the fact that they have underestimated profit inflation. Put simply, rising prices lead directly to higher profits. But more important are company expectations – and there is clear evidence of cooling demand in some sectors and therefore a deterioration in the outlook.

That said, much of this development has also been anticipated through contraction of valuations. Specifically, valuations have largely declined in parallel to equity prices.

Even in the event of later batches of data disappointing, the potential for a reversal is much more limited than it has been in recent months. Conversely, an improving of sentiment could lead directly to rising prices through an expansion of valuations – and without the need for any improvement in corporate earnings.

Combined with the continued predominantly negative sentiment of many market observers and persistently high risk aversion (and thus inflated risk premiums), we are sticking to our overweight stance on the equity side.

Parallel development of Swiss equities and P/E contraction

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 continue to hold investments in both gold and cryptocurrencies.

Currencies

As a consequence of the changing expectations on key interest rates in the US, the USD has lost ground significantly. We anticipate a sideways movement at current levels.

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Appendix

Economy and Markets

GDP (E: Consensus)

	2021	2022E
USA	5.9%	1.8%
EU	5.4%	3.2%
Switzerland	4.3%	2.2%

Inflation (E: Consensus)

	2021	2022E
USA	4.7%	8.1%
EU	2.6%	8.5%
Switzerland	0.6%	2.9%

Central Bank Rates

	16.11.2022	Outlook
USA	4.0%	4.50%
EU	1.5%	2.50%
Switzerland	0.0%	1.75%

Capital Market Rates (10 Years)

	16.11.2022	Outlook
USA	3.7%	3.50% – 4.00%
Germany	2.0%	1.85% – 2.35%
Switzerland	1.0%	0.85% – 1.35%

Foreign Exchanges

	16.11.2022	Outlook
EUR/CHF	0.982	0.95 – 1.00
USD/CHF	0.945	0.94 – 0.99
EUR/USD	1.040	0.99 – 1.05

Raw Materials and Alternatives

	16.11.2022	Outlook
Gold (USD/Ounce)	1773.9	1725 – 1825
Oil (USD/Brent)	92.9	88 – 105
Bitcoin USD	16'531	16'000 – 20'000

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	12.0%	-16.2%
USA	10.7%	-15.8%
Europe	11.1%	-9.0%
Switzerland	6.2%	-14.9%
Emerging Markets	9.1%	-20.3%

Government Bond Yield (10 Years)

	16.11.2022	31.12.2021
USA	3.69%	1.51%
Germany	2.00%	-0.18%
Switzerland	1.03%	-0.14%

Raw Materials and Alternatives

	QTD	YTD
Gold (USD/Ounce)	6.8%	-3.0%
Oil (USD/Brent)	11.7%	117.7%
Bitcoin USD	-14.9%	-64.3%

Foreign Exchanges

	QTD	YTD
EUR/CHF	1.5%	-5.4%
USD/CHF	-4.3%	3.5%
EUR/USD	6.0%	-8.6%

Data as of 16 November 2022, QTD: Performance since Beginning of Quarter, YTD: Performance since Beginning of Year