IHAG PRIVATBANK

Monthly CIO Letter

20 January 2023

Markets have broadly got off to a stunning start into 2023. Macroeconomic data has fuelled hopes among investors of a less hawkish stance by central banks. But is a soft landing possible? We have taken profits on our equity quota, which we raised to overweight in October.

Christoph Boner
Chief Investment Officer

Highlights

– Macroeconomic data and labour market developments in particular have fuelled hopes among market participants that far-reaching second-round effects can be avoided.

– With inflation figures now falling, it is now assumed that central banks will adopt a less aggressive stance, which is in turn raising hopes of a soft landing.

– After the strong recent market gains, we are taking profits on our overweight equity quota.

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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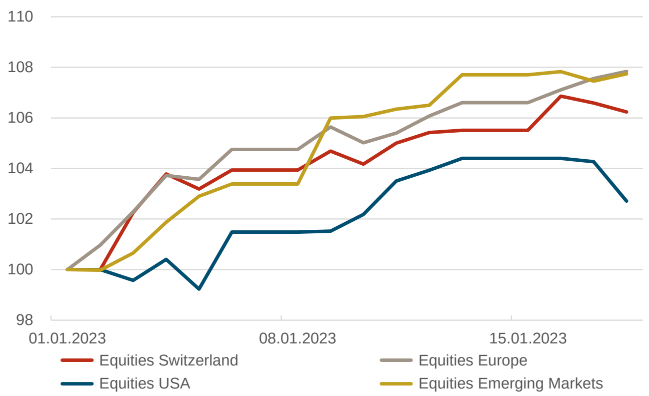
Asset Allocation

The investment markets have got off to a stunning start to the year. Equity markets are up generally, in some cases by double-digit percentage rates. In particular, equities from Europe and the emerging markets have recorded strong price gains in recent weeks. In the wake of slightly declining interest rates and narrowing credit spreads, the bond markets have also made a positive start to the year. While gold has also shown some strength, we are now even seeing rises in the prices of crypto investments, which took a real battering in 2022.

The background to the improvement in market developments since October is rising optimism that central banks will tone down their hawkish monetary policy stance going forward. This hope is being fed not just by more moderate inflation figures, but also by the easing of tensions in the labour and commodity markets, to the point where the absence of at least wide-scale second-round effects is a feasible scenario.

Equities: Strong start into 2023



Following our increase in the equity allocation in October – based on our view that the investment community was overly negative in its expectations of further inflation development, above all due to the almost obsessive belief that central banks would continue to pursue a restrictive path – we are now taking profits on these positions. But just as fears of continued hawkishness in the sphere of monetary policy were exaggerated, so too is the market's current faith in the possibility of a soft landing rather extreme. Even if central banks – as observed on various occasions – are likely to tolerate slightly higher inflation rates in the medium term in the interests of maintaining sufficient economic growth, this scenario appears overly optimistic.

The equity allocation for a balanced mandate is now 50%; while we do not currently have a strong regional preference, we are continuing to overweight our quota of Chinese equities at the expense of other emerging markets.

By contrast, we are increasing the fixed income allocation, even though we remain underweight in this area. Specifically, we are increasing the proportion of high-quality bonds with a short to medium duration. Higher interest rates have given this segment a superior risk-adjusted return to money market investments, and portfolio diversification has been increased by the high credit quality. The bond allocation for a balanced mandate now amounts to 38%, in which we are deliberately retaining emerging market bonds denominated in hard currency (USD).

We believe the use of diversifying asset classes should also be an additional element in the asset allocation process, and are therefore continuing to hold gold in particular in the portfolios. Crypto investments are also included in the portfolios.

Bonds

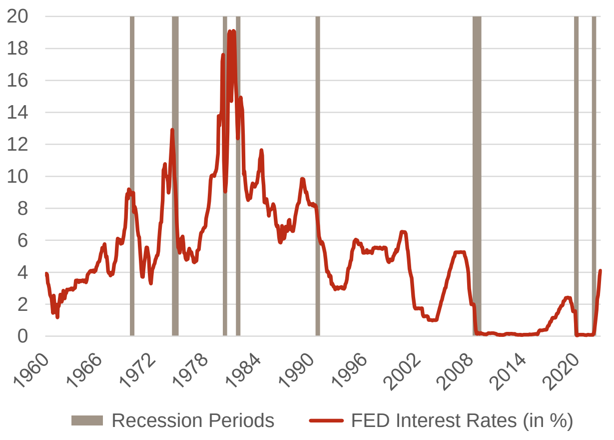
2022 will go down in history as an *annus horribilis* for bond investors. Sharp surges in inflation – due to the expansion of money supply over a period of many years, demand overhangs following the pandemic-related restrictions, the emergence of bottlenecks on the supply side, and last but not least higher energy and food prices against a backdrop of escalations of geopolitical conflicts – presented central banks with quite a cocktail. They are now trying to put the inflation genie back in its bottle with strong, repeated interest rate increases, while at the same time seeking to contain the inflationary expectations of market participants. The latter is particularly crucial if negative second-round effects are to be avoided.

As explained in our last CIO Letter of December, which took the Fed as its example, the US central bank increased interest rates last year at a tempo not seen for a good half century. The aim of these aggressive rate hikes is to slow the economy by putting a brake on demand, which in turn can be expected to rein in upward price development. Thanks to this mechanism, inflation should be brought back down to a healthy level.

But experience shows that central banks have a tendency to react too late due to the imponderables surrounding this mechanism – its effect is not that clear and does not manifest itself immediately in any case – and hence the pudding tends to be "overegged". Indeed, analysis of past cycles reveals that interest rate rises are often followed by a recession.

At the same time, it is clear that central banks have to adopt an uncompromising stance in the process of combating inflation: Only by doing so can they ensure that inflationary expectations are kept sufficiently low. If these inflationary expectations were to become extreme, the resulting second-round effects could potentially trigger an inflationary spiral that would be difficult to control.

Economy: interest rate cycles and subsequent recessions (US)



In view of this unrelenting stance of central banks, markets began to anticipate a sharp slowdown in the economy in the second half of 2022, which in turn led to a widespread belief that a "hard landing" would be unavoidable. Here the investment community lost sight of the necessity of consistency in the central bank action and tone. Implied interest rate expectations of well above 5% for the US made this abundantly clear.

But with inflation rates having now eased and an easing of tensions becoming apparent in both the labour and the commodity markets, fears of a hard landing have in many quarters been flipped around into hopes of a soft landing. Both interest rates and credit spreads have stabilised. We are taking this opportunity to take advantage of higher yields on investment-grade bonds. Here we are deliberately keeping the duration at the shorter end, as in our view the yield curve is currently not compensating investors sufficiently for the higher risk of longer maturities. The deliberate focus on strong credit quality helps to make the allocation more stable through a further improvement in diversification.

Equities

As a result of the improvement in market sentiment in recent weeks, stock markets have risen, in some cases impressively so. Hopes of a soft landing have prompted investors to increase equity exposure. The positive mood has also gained support from recent releases of corporate data, which continue to suggest that the economy overall is not slowing dramatically. The discrepancy between the macroeconomic view of market strategists and the microeconomic picture painted by analysts, which we have flagged up on a number of occasions, has accordingly narrowed in recent weeks.

We are taking advantage of the recent market counter-movement, in which some stocks have recorded very strong rises, to take profits on our equity overweighting. We are now adopting a neutral stance in our equity allocation, whereby within the emerging markets segment we have a preference for Chinese equities due to their lower valuations and increasing evidence of further normalisation of the Chinese economy.

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 both gold and cryptocurrencies. Both these investments have made positive performance contributions in recent weeks.

Currencies

Due to the change in appraisal of the policy stance likely to be taken by various central banks, USD can be expected to weaken further against both CHF and EUR. The EUR/CHF exchange rate is likely to remain in a very narrow bandwidth.

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Appendix

Economy and Markets

GDP (E: Consensus)

	2021	2022E
USA	5.9%	1.9%
EU	5.4%	3.4%
Switzerland	4.3%	2.0%

Inflation (E: Consensus)

	2021	2022E
USA	4.7%	8.0%
EU	2.6%	8.4%
Switzerland	0.6%	2.9%

Central Bank Rates (higher)

	17.01.2023	Consensus
USA FED	4.5%	5.00%
EUR ECB	2.0%	3.50%
CHF SNB	1.0%	

Government Bonds (10 Years)

	17.01.2023	Outlook
USA	3.5%	3.40% – 3.70%
Germany	2.1%	1.85% – 2.25%
Switzerland	1.1%	0.85% – 1.35%

Foreign Exchanges

	17.01.2023	Outlook
EUR/CHF	0.995	0.95 – 1.00
USD/CHF	0.922	0.90 – 0.94
EUR/USD	1.079	1.07 – 1.10

Raw Materials and Alternatives

	17.01.2023	Outlook
Gold (USD/Ounce)	1908.7	1830 – 1950
Oil (USD/Brent)	85.9	78 – 92
Bitcoin USD	21,316	18'000 – 22'000

Equity Markets

	P/E ø 5J.	P/E 2024	Div. Yield	Outlook
World	18.1x	14.7x	2.2%	sideways
USA	19.7x	16.2x	1.7%	sideways
Europe	15.7x	12.1x	3.2%	sideways
Switzerland	18.6x	15.5x	2.8%	sideways
Emerging Markets	13.3x	10.9x	3.0%	sideways

Markets in Local Currencies

Equity Markets

	QTD	YTD
World	5.2%	5.2%
USA	4.0%	4.0%
Europe	7.5%	7.5%
Switzerland	6.6%	6.6%
Emerging Markets	7.5%	7.5%

Government Bond Yield (10 Years)

	17.01.2023	30.12.2022
USA	3.55%	3.87%
Germany	2.09%	-0.18%
Switzerland	1.08%	1.62%

Raw Materials and Alternatives

	QTD	YTD
Gold (USD/Ounce)	4.6%	4.6%
Oil (USD/Brent)	0.0%	0.0%
Bitcoin USD	28.6%	28.6%

Foreign Exchanges

	QTD	YTD
EUR/CHF	0.5%	0.5%
USD/CHF	-0.3%	-0.3%
EUR/USD	0.8%	0.8%

Data as of 17 January 2023, QTD: Performance since Beginning of Quarter, YTD: Performance since Beginning of Year