IHAG PRIVATBANK

Monthly CIO Letter

24 March 2023

Banks have dominated market events in recent days. With the manifestation of the first negative repercussions of aggressive interest rate rises, the market has significantly revised its expectations of future interest developments. Combating inflation will continue to be the priority, however. We are sticking to our neutral positioning in equities.

Christoph Boner
Chief Investment Officer

Highlights

- As individual banks have wobbled or even collapsed, the market has significantly downgraded its expectations of future interest rate rises by central banks.
- Even if (as expected) inflationary developments have recently provided a reason for investors to hope that central banks will be less hawkish going forward, combating inflation – which is still too high – will remain the priority.
- While the microeconomic picture in particular continues to look promising and valuations are fair, the downgrading of interest rate expectations has actually given rise to a new risk of its own.

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

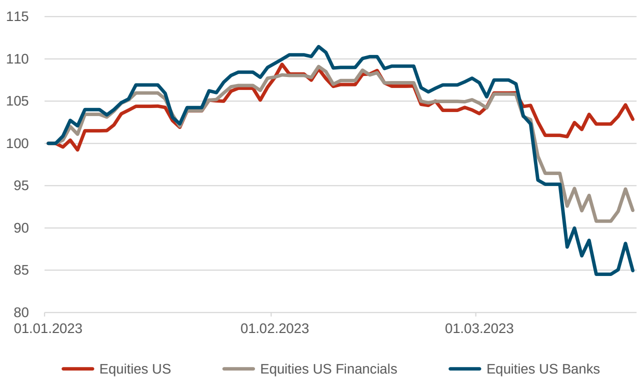
Asset Allocation

Banks and the financial system have been very much the focus of markets in recent days. The aggressive interest rate rises pushed through over the last months have taken an initial toll – even if in these cases individual failures and other problems should really be viewed as the primary cause.

The reaction of the markets was severe. Equities relinquished the gains of the first two months of the year, in some cases entirely, while certain specific segments and particularly banking stocks plunged deep into negative territory. On the other hand, bonds of higher quality appreciated considerably, whereas the credit spreads of bonds of poorer quality widened. Gold likewise gained in value, as did other assets perceived as safe havens.

However, the most dramatic market reaction of all was that in respect of the expected course of the interest rate trajectory. Whereas US key interest rates were expected to peak at 5.8% as recently as the first week of March, this figure plummeted to below 5% in the blink of an eye. The tensions that have appeared suddenly in the financial system due to the rapid rises in interest rates by central banks could prompt the guardians of monetary policy to abandon the path of rate rises or at least proceed more slowly. Should they combat inflation or save the banks? A new dichotomy has appeared.

Banking sector: investors take a big hit



We are expecting the battle against inflation to remain the clear priority. Any support required by the banking system can be provided in other ways. As explained in our blog, the key themes here are confidence and liquidity – with the level of interest rates and the rapidity of rate rises very much a secondary factor.

A neutral positioning in equities looks appropriate given the very different factors influencing the market – on the one hand a valuation picture that is fundamentally still healthy at company level and in some cases even more attractive after the setbacks of recent weeks, and on the other much more modest interest rate expectations, which could easily be disappointed as a result of a negative surprise. The asymmetrical risk picture highlighted in our last CIO Letter remains in place for the time being. The equity allocation for a balanced investor profile therefore remains 50%.

We are also sticking to our underweight stance in the area of fixed income securities. The bond allocation for a balanced mandate stands at 38%, whereby we are deliberately continuing to include emerging market bonds denominated in hard currency (USD). The credit quality of the portfolio bond quota as a whole remains clearly above-average.

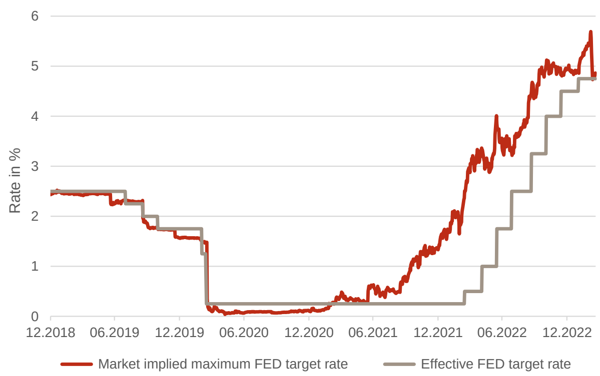
We believe the use of diversifying asset classes should also be an additional element in the asset allocation process, and are therefore continuing to hold gold in particular in the portfolios. Following the hefty price rises of crypto investments, we are scaling back this portfolio element.

Bonds

The turmoil in the global financial system has well and truly shaken interest rate markets. With the rise in uncertainty and a flight to safe havens, the yields on government bonds have fallen sharply. For example, the yield on 10-year Confederation bonds, which amounted to 1.57% in the first few days of March, has slumped below 1%. The yield on the equivalent US paper has similarly dipped below the 3.50% mark.

Due to burgeoning fears over the financial system following the collapse of various banks, the market has likewise significantly downgraded its expectations of further interest rate rises. The currently expected peak of 4.9% for the FED Fund rate in May 2023 is now at the current level of US key interest rates.

US key interest rates: development of expected peaks



While figures for inflation now appear to be on the expected downward trajectory, they nonetheless remain well above acceptable levels. We take the view that central banks will continue to focus on taming inflation as their key priority, and that the market's current stance overestimates the degree to which the monetary policy will be influenced by possible problems in the banking sector. As the current situation in connection with First Republic Bank shows, individual institutions may well end up in dire trouble in the future too – but lower interest rates are not needed to save them.

With its interest rate decision on 22 March the Fed made this quite clear, as did the ECB only the week before, even though both central banks very deliberately adopted a more moderate tone in their forward guidance.

Equities

While equity markets took a beating in the wake of recent problems in the banking system, they recovered just as quickly over the days that followed. Expectations of less hawkish key interest rate policy fed through into rapid stock market rises.

Looking at the valuations of individual markets, these can now be assessed as fair to attractive. Even if recent interest rate rises are starting to leave their initial mark on income statements, the outlook at corporate level remains positive – and negative surprises constitute the exception rather than the rule.

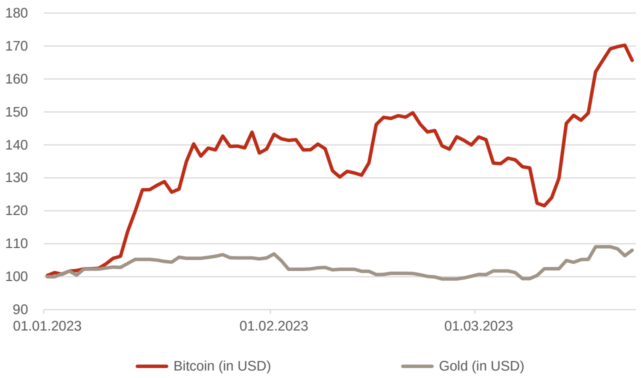
Looking at the market through an anti-cyclical lens, a number of indicators – such as the ratio of bulls to bears and levels of market-implied volatilities – can be put forward as additional buying arguments. On the other hand, given our earlier observation that the market's changed expectation regarding interest rates introduces a new risk element, we are leaving the equity allocation at its current neutral level.

Alternative Assets

Alternative investments serve to provide additional diversification in a portfolio context and in doing so help improve the risk/return ratio.
Gold has appreciated significantly in recent days against a backdrop of rising uncertainty and more modest expectations over future interest rate policy. We are retaining our overweight positioning here.

The first cryptocurrency protocols introduced in 2008 in the wake of the financial crisis have given much greater credence to the idea of an alternative monetary system. Following a rise in value of some 70% in our cryptocurrency position since the start of the year we are reducing our quota here, albeit maintaining some residual exposure. Potential dislocations in the financial system, further progress in institutionalisation, and the impending halving of the mining value in the first half of 2024 are likely to support this category.

Alternative: development of Bitcoin and gold since start of 2023



Currencies

The USD should continue to trend towards relative weakness as it is at a more advanced stage in the interest rate cycle. We expect the EUR/CHF exchange rate to move sideways.

Editorial Investment Center
Christoph Boner, CIO (BOC), +41 44 205 12 16, bonerchristoph@pbihag.ch
Patrick Frei, CFA (FRP), +41 44 205 13 32, freipatrick@pbihag.ch

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Annex

Economy and Markets

GDP (E: Consensus)

	2022	2023E
USA	2.1%	0.9%
EU	3.6%	0.5%
Switzerland	2.2%	0.6%

Inflation (E: Consensus)

	2022	2023E
USA	8.0%	4.1%
EU	8.4%	8.4%
Switzerland	2.9%	2.4%

Central Bank Rates (higher)

	22.03.2023	Consensus
USA FED	5.0%	5.25%
EUR ECB	3.0%	3.50%
CHF SNB	1.0%	

Government Bonds (10 Years)

	22.03.2023	Outlook
USA	3.4%	3.40% – 3.75%
Germany	2.3%	2.30% – 2.50%
Switzerland	1.2%	1.20% – 1.50%

Foreign Exchanges

	22.03.2023	Outlook
EUR/CHF	0.996	0.95 – 1.00
USD/CHF	0.917	0.90 – 0.94
EUR/USD	1.086	1.06 – 1.09

Raw Materials and Alternatives

	22.03.2023	Outlook
Gold (USD/Ounce)	1'970	1900 – 2000
Oil (USD/Brent)	76.7	72 –80
Bitcoin USD	27'392	25'000 – 30'000

Equity Markets

	P/E ø 5J.	P/E 2024	Div. Yield	Outlook
World	18.7x	14.9x	2.3%	sideways
USA	20.2x	16.2x	1.7%	sideways
Europe	15.9x	12.0x	3.4%	sideways
Switzerland	19.5x	16.1x	3.0%	sideways
Emerging Markets	13.5x	10.2x	3.2%	sideways

Markets in Local Currencies

Equity Markets

	QTD	YTD
World	3.7%	3.7%
USA	2.9%	2.9%
Europe	5.8%	5.8%
Switzerland	2.8%	2.8%
Emerging Markets	0.9%	0.9%

Government Bond Yield (10 Years)

	22.03.2023	30.12.2022
USA	3.43%	3.87%
Germany	2.33%	-0.18%
Switzerland	1.24%	1.62%

Raw Materials and Alternatives

	QTD	YTD
Gold (USD/Ounce)	8.0%	8.0%
Oil (USD/Brent)	-11.3%	-11.3%
Bitcoin USD	65.2%	65.2%

Foreign Exchanges

	QTD	YTD
EUR/CHF	0.6%	0.6%
USD/CHF	-0.8%	-0.8%
EUR/USD	1.4%	1.4%

Data as of 22 March 2023, QTD: Performance since Beginning of Quarter, YTD: Performance since Beginning of Year