Monthly CIO Letter

21 April 2023

With the markets having revised their interest rate expectations after the turmoil in the global financial system, potential for a negative surprise has emerged. Combating inflation will remain the priority and further interest rate hikes could catch the market off guard. We are leaving our allocation unchanged for the time being.

Christoph Boner
Chief Investment Officer

Highlights

- In recent weeks, the markets have dramatically downgraded their expectations of further interest rate increases.
- Inflation appears to be on the retreat. But on closer look it is also proving quite stubborn. The central banks are hardly likely to abandon the path of restrictive monetary policy to the extent expected by the market.
- Although we do not believe that this discrepancy will weigh on markets immediately, the risk is nonetheless there. We are retaining our neutral stance in equities.

Asset Allocation

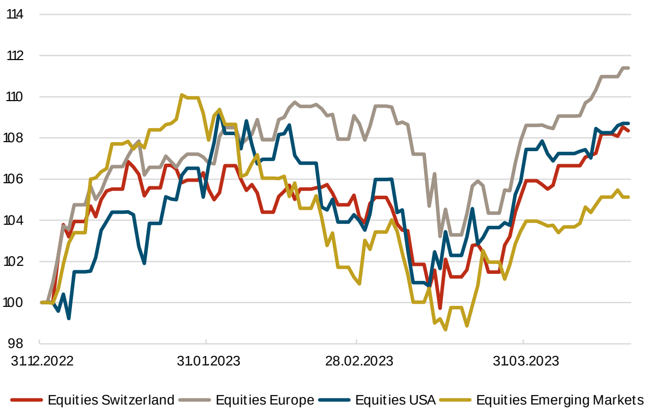
Asset Classes	Change	– –	–	=	+	+ +
Liquidity	➡				●	
Bonds	➡		●			
Reference Currency	➡	●				
World	➡	●				
Emerging Markets	➡					●
Convertible Bonds	➡				●	
Equities	➡			●		
Switzerland	➡			●		
Europe	➡			●		
US	➡			●		
Pacific	➡			●		
Emerging Markets	➡			●		
Alternative Assets						
Gold	➡				●	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

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

Asset Allocation

After various setbacks, equity markets have recovered powerfully in recent weeks. Indeed, many stock markets – particularly in Europe – have marked new peaks over the last few days. For the time being, the problems in the global financial system have receded into the background of investors' minds.

Equity markets in 2023



However, following the turmoil in the banking system, the revised expectations in respect of interest rate developments going forward have remained. Whereas up until now impending interest rate hikes have already been factored into prices, current stock market levels imply that further interest rate rises are improbable – whereas the actual level of inflation, which remains stubbornly high even though the rate is probably falling, makes this look rather doubtful. We see quite a discrepancy here, with the corresponding potential to surprise to the downside.

In our view, the battle against inflation is likely to remain the key priority for central banks. Firstly, a further cooling of the economy is required if inflation is to be brought under control in a lasting way; secondly, there are more suitable tools to provide any support required by tottering banking institutions. In any case, the negative economic implications do not lie in the risk of short-term implosions of financial companies; as explained in our blog, the reduced freedom of manoeuvre enjoyed by banks as a result of rapid interest rate rises has a much stronger impact on economic development.

That said, as the fundamental picture continues to look balanced and we are not expecting the risk alluded to above to materialise immediately, we are maintaining our neutral equity allocation of 50% for a balanced risk profile for the time being.

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 overall bond quota in the portfolio remains well above-average, while the duration is shorter than that of the market as a whole.

We believe the use of diversifying asset classes should be an additional element in the asset allocation process. With this in mind, we are continuing to hold crypto investments and gold in particular in the portfolios.

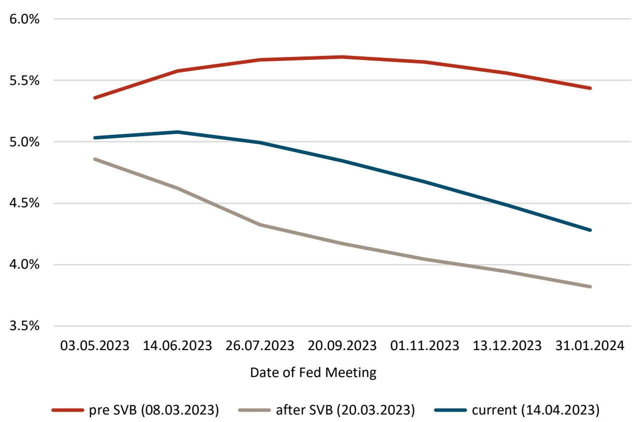
Bonds

Following the decline in interest rates and the widening of credit spreads in response to shock waves in the international banking system, a certain degree of calm has returned to the bond markets over the last few days. However, what has remained is a very different expectation of interest rate developments.

For example, as recently as the beginning of March the bond markets were expecting the Fed to continue to raise key interest rates in the US to well over 5.5%; rate cuts were not considered to be on the agenda. But following the collapse of Silicon Valley Bank (SVB) this expectation was radically revised: The interest rate peak was considered to have been reached, and the coming months were expected to bring gradual rate cuts.

The market now appears to have settled on middle ground, with a maximum of one further interest rate rise expected and the first rate cuts anticipated in the second half of the year. So whereas interest rate expectations in recent months always revolved around the likelihood of impending interest rate rises, current expectations are broadly for interest rates to remain as they are – implying an end to the rate hiking cycle.

US key interest rates: change in market expectations



By contrast, while inflation probably is on a downward trajectory as per expectations, it is also displaying a certain persistence – particularly core inflation, which is still a long way off the generally desired ballpark figure of 2%. It is therefore only logical to assume that central banks will prioritise price stability and turn the monetary screws further, contrary to current market expectations. In other words, a negative surprise for the markets could be on the cards.

Equities

The prospect of an imminent curtailment of the cycle of aggressive interest rate rises has given equity markets a lift in recent weeks, despite increasing signs of an economic slowdown. Nor is it just the leading indicators that point to a cooling – an economic slowdown is also apparent in recent figures released by a number of companies.

Following the recovery trend of recent weeks, the majority of equity markets now look fairly valued from a technical and historical perspective. However, not least given the latent potential for a negative surprise as described above, we do not currently see a strong argument for a more aggressive positioning. Given the finely balanced picture, we are sticking to our neutral equity allocation of 50% for the time being. The portfolio beta remains slightly higher than 1 due to our continued focus on growth-oriented stocks.

Alternative Assets

Alternative investments serve to provide additional diversification in a portfolio context and thereby help improve the risk/return ratio.

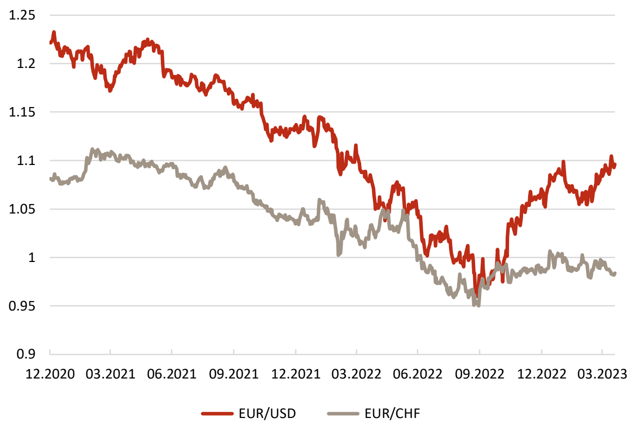
Gold has appreciated further recently, but we are sticking to our overweight stance due to risk considerations – even if further rate hikes would probably put downward pressure on the price of this precious metal.

Although we scaled back our positions in crypto investments last month following a period of strong price development, we are keeping some exposure to the five main crypto currencies. Even though the intrinsic value of these investments cannot be ascertained, the conceptual background of this asset class – as an alternative to the traditional monetary system – gives it huge price potential against a backdrop of a financial system under strain, quite aside from the potential diversification effect. The impending "halving" of the block reward for Bitcoin miners in the first half of 2024 can be expected to provide further stimulus.

Currencies

Whereas the EUR/CHF currency pair has trended sideways in recent weeks, USD has weakened as expected. This development has been compounded by the (downward) recalibration of USD interest rate expectations.

Currencies: change in value of EUR against USD and CHF



In the event of the Fed surprising markets with further rate hikes as alluded to above, the downward trajectory is likely to be halted for the time being. We are maintaining our USD exposure for now.

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Annex

Economy and Markets

GDP (E: Consensus)

	2022	2023E
USA	2.1%	1.1%
EU	3.6%	0.6%
Switzerland	2.2%	0.6%

Inflation (E: Consensus)

	2022	2023E
USA	8.0%	4.2%
EU	8.4%	8.4%
Switzerland	2.9%	2.5%

Central Bank Rates (higher)

	18.04.2023	Consensus
USA FED	5.0%	5.25%
EUR ECB	3.0%	3.50%
CHF SNB	1.5%	

Government Bonds (10 Years)

	18.04.2023	Outlook
USA	3.6%	3.40% – 3.75%
Germany	2.5%	2.35% – 2.60%
Switzerland	1.2%	1.10% – 1.30%

Foreign Exchanges

	18.04.2023	Outlook
EUR/CHF	0.983	0.95 – 1.00
USD/CHF	0.896	0.88 – 0.93
EUR/USD	1.097	1.00 – 1.05

Raw Materials and Alternatives

	18.04.2023	Outlook
Gold (USD/Ounce)	2'005	1950 – 2050
Oil (USD/Brent)	84.8	80 –88
Bitcoin USD	30'422	28'000 – 33'000

Equity Markets

	P/E ø 5J.	P/E 2024	Div. Yield	Outlook
World	18.7x	15.6x	2.2%	sideways
USA	20.3x	17.2x	1.7%	sideways
Europe	15.9x	12.6x	3.3%	sideways
Switzerland	19.6x	17.2x	2.8%	sideways
Emerging Markets	13.5x	10.8x	3.2%	sideways

Markets in Local Currencies

Equity Markets

	QTD	YTD
World	1.7%	9.7%
USA	1.2%	8.7%
Europe	2.6%	11.4%
Switzerland	2.5%	8.5%
Emerging Markets	1.1%	5.2%

Government Bond Yield (10 Years)

	18.04.2023	30.12.2022
USA	3.58%	3.87%
Germany	2.48%	-0.18%
Switzerland	1.15%	1.62%

Raw Materials and Alternatives

	QTD	YTD
Gold (USD/Ounce)	1.8%	9.9%
Oil (USD/Brent)	6.1%	-2.1%
Bitcoin USD	7.1%	83.5%

Foreign Exchanges

	QTD	YTD
EUR/CHF	-0.9%	-0.6%
USD/CHF	-2.1%	-3.1%
EUR/USD	1.2%	2.5%

Data as of 18 April 2023, QTD: Performance since Beginning of Quarter, YTD: Performance since Beginning of Year