IHAG PRIVATBANK

Monthly CIO Letter

26 May 2023

The market is currently showing off its more benign side – thanks to widespread hopes of interest rate cuts. Even if these expectations are unlikely to be met, the fundamental picture nonetheless remains robust for now. We are leaving our equity allocation unchanged.

Christoph Boner
Chief Investment Officer

Highlights

- The market's revised interest rate expectations are exhibiting a certain persistence – the belief is that interest rates will peak soon and that the Fed will at least start to cut rates before year end.
- As explained last month, this optimism has given rise to negative surprise potential. That said, the fundamental picture still looks robust. As things stand, there is not (yet) any reason to reduce the level of risk.
- The US yield curve remains heavily inverted. In expectation of a normalisation, we are selectively increasing the US government bond 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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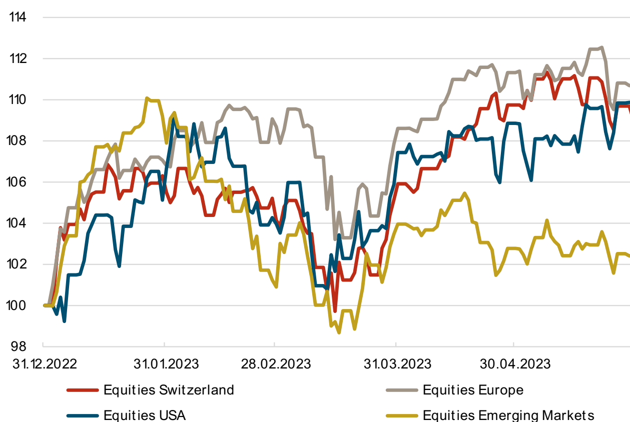
Asset Allocation

Global equity markets have remained benign in recent weeks. Various stock markets have surged to new highs, and as of mid-May the MSCI World Index was up more than 10% (in USD) since the start of the year. Only emerging market equities have lagged behind in their development, but even they have recorded positive performance this year.

Let's be clear, however: It's not as if the risks have evaporated. The optimism as regards interest rate developments going forward (with the first rate cuts expected as early as September 2023), a considerable disregard for geopolitical risks, and now the intensifying debate over the US debt ceiling all harbour risks for global capital markets.

Equity market performance – 2023 to date



A risk asymmetry is easy to discern: on the one hand we have the above-mentioned risk factors, while on the other it is not easy to see where the potential triggers for further sustainable price rises might come from. The fundamental picture – specifically the development of corporate earnings and the labour market situation – continues to look sufficiently robust. Markets therefore look fairly valued at the moment. We are adhering to a neutral equity quota of 50% for a balanced risk profile for the time being.

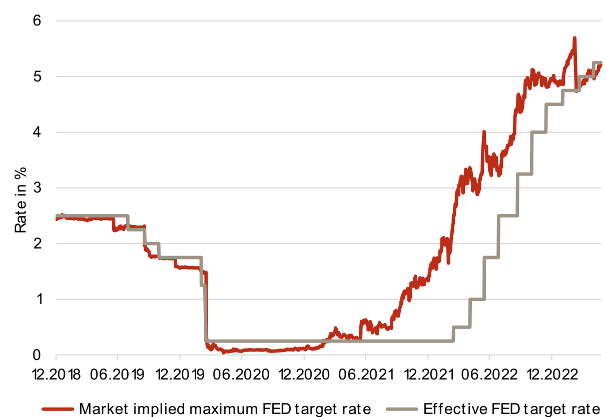
By contrast, we are increasing the weighting of fixed income securities, specifically by buying US government bonds. We are designing our investment structure in such a way that will additionally allow us to profit from the normalisation of the USD yield curve – i.e. a return to a normal, rising curve. The bond allocation for a balanced mandate now amounts to 40%. We are also continuing to hold USD-denominated emerging market bonds. The credit quality of the overall bond quota in the portfolio remains above average, while the duration is shorter than that of the market as a whole.

For diversification purposes we are continuing to hold crypto investments and gold in the portfolios.

Bonds

With the demise of certain US regional banks, the market's expectation in respect of the peak level of US key interest rates has plummeted from almost 6% at times to around 5% – or close to current levels – just like that. The market is assuming that interest rates in the US have peaked and expects the Fed to cut rates from as early as September.

Interest rate expectations and US key rates



We view this expectation as optimistic. Inflation is probably on the retreat, but a combination of persistently strong consumer spending combined with only a very sluggish cooling of the labour market will keep the pressure on central banks high. Where Europe is concerned, the market is currently still expecting between one and two further rate-hiking steps, but here too the first interest rate cuts are already implied for the first quarter of 2024.

By contrast, it should be noted that the historic intensity of interest rate rises suggests it would be expedient for central banks to pause for a while; after all, history shows that the consequences of higher interest rates only become apparent with the passage of several months, and the current rate-hiking cycle for the US is 14 months' old, and the cycle for Europe just 10 months'.

Cautious positioning in the interest rate market remains the order of the day as far as we are concerned. The portfolio focuses on high credit quality. We are steering clear of the high-yield segment entirely, and the portfolio duration remains below that of the market.

Nonetheless, we are selectively increasing our exposure to US government bonds. The aim here is to achieve a structure that will benefit from a normalisation of the yield curve – i.e. a decline of short-term interest rates and/or a rise in long-term rates.

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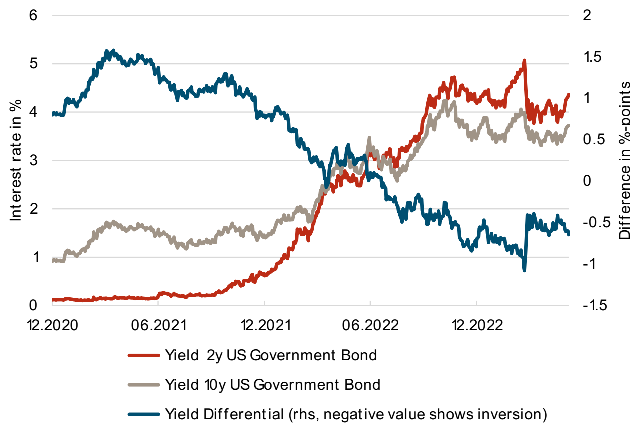
US interest rates – inverted yield curve



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 the increasing realisation that a recessionary phase is ultimately necessary. Inflation figures remain too high and the causes of inflation are too supply-side-driven for central banks to get inflation under control through interest rate rises alone – these are only enough to dislodge inflation from its peak and bring it down to the realm of 4-5%. In combination with a persistently heated labour market, only a recessionary phase can put sufficient pressure on the rate of inflation to bring it back down to the typical target level of 2%.

By contrast, the fundamental data continue to point to a healthy picture for the corporate sector, and there are few signs of an impending recession on the horizon. In the current reporting season, three out of four companies have achieved or surpassed their targets, and both the growth targets set and corporate expectations are very much in positive territory. Against this backdrop, equity markets remain fairly valued.

The ongoing discussion over the debt ceiling in the US can be expected to trigger increased volatility. The likely outcome is a last-minute compromise; short-term payment problems with the corresponding financial market dislocations cannot be ruled out. We are leaving the equity quota for a balanced profile unchanged at 50%.

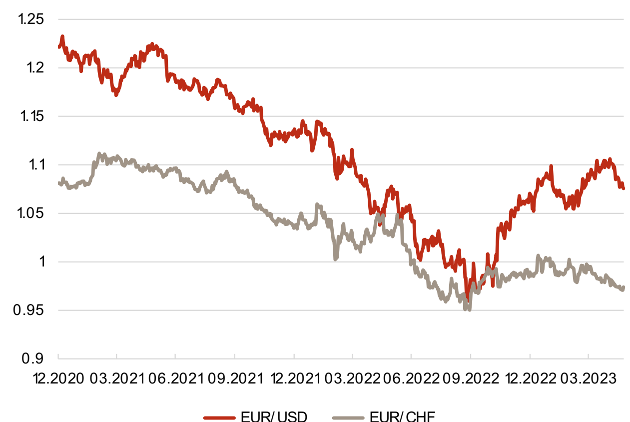
Alternative Assets

Alternative assets serve to achieve further diversification in a portfolio context. For this reason, we continue to hold gold as well as a position in cryptocurrencies.

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. 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.

Currencies: change in value of EUR against USD and CHF



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Annex

Economy and Markets

GDP (E: Consensus)

	2022	2023E
USA	2.1%	1.1%
EU	3.6%	0.7%
Switzerland	2.2%	0.6%

Inflation (E: Consensus)

	2022	2023E
USA	8.0%	4.2%
EU	8.4%	5.6%
Switzerland	2.9%	2.5%

Central Bank Rates (higher)

	23.05.2023	Consensus
USA FED	5.3%	5.25%
EUR ECB	3.3%	3.75%
CHF SNB	1.5%	

Government Bonds (10 Years)

	23.05.2023	Outlook
USA	3.7%	3.40% – 3.80%
Germany	2.5%	2.35% – 2.60%
Switzerland	1.0%	1.00% – 1.25%

Foreign Exchanges

	23.05.2023	Outlook
EUR/CHF	0.971	0.95 – 1.00
USD/CHF	0.901	0.88 – 0.93
EUR/USD	1.077	1.03 – 1.08

Raw Materials and Alternatives

	23.05.2023	Outlook
Gold (USD/Ounce)	1'975	1'950 – 2'050
Oil (USD/Brent)	76.8	70 – 80
Bitcoin USD	27'223	25'000 – 30'000

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	16.0x	12.2x	3.4%	sideways
Switzerland	19.6x	17.3x	2.9%	sideways
Emerging Markets	13.5x	10.7x	3.2%	sideways

Markets in Local Currencies

Equity Markets

	QTD	YTD
World	1.4%	9.4%
USA	1.1%	8.7%
Europe	3.3%	12.2%
Switzerland	3.9%	10.1%
Emerging Markets	-0.8%	3.2%

Government Bond Yield (10 Years)

	23.05.2023	30.12.2022
USA	3.69%	3.87%
Germany	2.47%	-0.18%
Switzerland	1.05%	1.62%

Raw Materials and Alternatives

	QTD	YTD
Gold (USD/Ounce)	0.3%	8.3%
Oil (USD/Brent)	-4.8%	-12.0%
Bitcoin USD	-4.1%	64.2%

Foreign Exchanges

	QTD	YTD
EUR/CHF	-2.1%	-1.9%
USD/CHF	-1.5%	-2.5%
EUR/USD	-0.6%	0.6%

Data as of 23 May 2023, QTD: Performance since Beginning of Quarter, YTD: Performance since Beginning of Year