IHAG PRIVATBANK

Monthly CIO Letter

17 July 2023

Although various leading indicators are increasingly pointing to a slowdown in economic activity, the financial markets do not seem to be that concerned. The upcoming corporate reporting season is eagerly awaited; we are leaving the equity quota unchanged, i.e. slightly underweighted.

Christoph Boner
Chief Investment Officer

Highlights

- Central banks are doing their best to pour cold water on the market's optimism over the development of interest rates going forward.
- There is still no reason to expect a switch to more accommodating monetary policy, given the backdrop of tight labour markets and persistently elevated inflation rates.
- The unfolding reporting season will provide further clarity regarding the extent of the desired and necessary slowdown of the overall economy.

Asset Allocation

Asset Classes	Change	- -	–	=	+	+ +
Liquidity	➡				●	
Bonds	➡		●			
Reference Currency	➡	●				
World	➡		●			
Emerging Markets	➡					●
Convertible Bonds	➡				●	
Equities			●			
Switzerland	➡			●		
Europe	➡			●		
USA	➡		●			
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

Following a promising to good first half of 2023 for investors, the second half of the year has kicked off with a slight reversal. This was attributable to higher interest rates, after a number of central banks attempted to derail the market's expectation of rate cuts in the near future – the message essentially boiling down to "higher for longer". Among other things, this saw the yield on ten-year US government bonds briefly rise above the 4% mark for the first time since the collapse of Silicon Valley Bank. The emerging tensions in the financial system that became apparent in March prompted markets to downgrade their interest rate expectations.

This optimism has been quashed by various central banks over the last few weeks. For example, while the Fed has not pushed through any more rate hikes, it has made it abundantly clear that there is currently no scope for rate cuts. Both the ECB and the SNB raised interest rates again, with the former making it explicitly clear that further increases for the Eurozone would follow.

With this correction to the expectations, the financial markets suffered generally. Equity markets recorded falls of around 5% in the first few days of July, and even bond markets were down across the board.

However, analysis of the various risk indicators makes it clear that this correction was almost entirely attributable to changes in interest rate expectations – there was no widening of credit spreads or any rise in the costs of option premiums as a price for hedging.

Given the ongoing uncertainty of the repercussions of the rapid interest rate rises of recent months, such a development hardly comes as a surprise – after all, an economic slowdown is actually desirable in view of persistently elevated rates of inflation and unrelentingly tight labour markets. Such a slowdown should be expected in the face of much higher interest rates and the anticipated negative asset effects.

Against this backdrop, we are leaving our equity allocation unchanged for the time being, i.e. slightly underweight, whereby this stance now also applies to the US technology sector following our decision to take profits on the corresponding investments in June. The equity allocation for a balanced risk profile therefore stands at 48%.

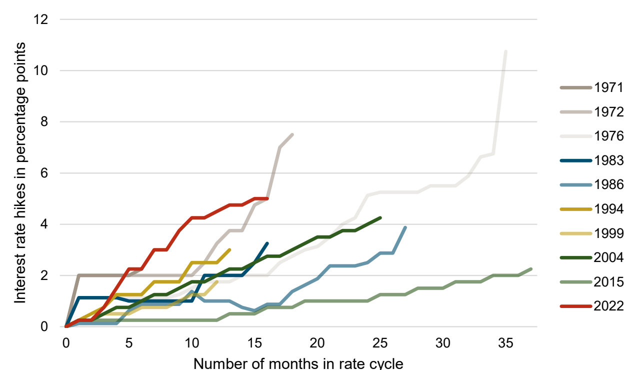
The weighting of fixed income securities is unchanged. The bond allocation for the above-mentioned risk profile amounts to 40%, which includes a sprinkling of emerging market bonds. The credit quality of the overall bond quota remains above average, while the duration is shorter than that of the market as a whole.

Despite higher opportunity costs, we are continuing to hold gold and crypto investments for portfolio diversification purposes.

Bonds

Our warnings of excessively optimistic interest rate expectations in the June CIO Letter have been borne out by events. Following the recent comments of central banks and despite a further decline in inflation, markets have now adjusted to the likelihood of even higher rates in some cases. Above all, however, expectations of a more accommodating monetary policy stance by central banks have been firmly reined in. For example, the market now anticipates between one and two further rises in the US Federal Funds Rate, and expectations of a decline in this key interest rate before the end of the third quarter have evaporated.

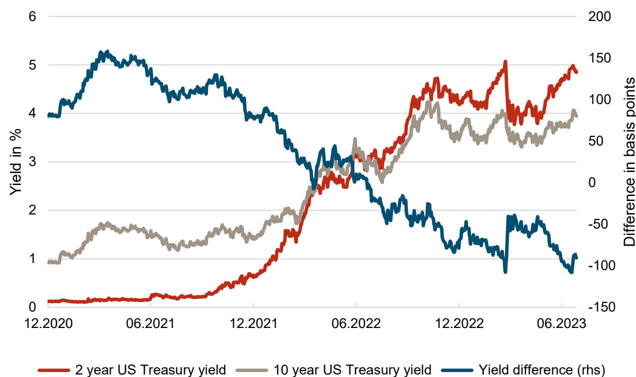
Development of Fed fund rate across various cycles



This recalibration of interest rate expectations has further increased uncertainty over the development of the economy going forward. When viewed in a historical context, the current interest rate cycle – which has seen the Fed raise rates ten consecutive times in just 15 months, and in some cases by 50 or 75 basis points rather than the usual 25 – is already the most aggressive tightening of monetary policy ever witnessed. However, the repercussions of this will only become apparent after a time lag of several months, and uncertainty over the extent of the current economic slowdown has increased further.

This development is starkly reflected in the further inversion of the US yield curve. Ten-year government bonds currently have a yield-to-maturity of just 4%, more than 90 basis points below the corresponding yield on two-year bonds. The persistence of this paradoxical situation in the interest rate market is attributable to the general uncertainty over future growth.

Inversion of the US yield curve



We are deliberately avoiding any increase in the bond allocation and average duration in this environment. By contrast, we do not believe the situation of an inverted yield curve is sustainable, and have positioned ourselves accordingly in anticipation of the curve normalising.

Equities

The current slowdown in economic activity, which higher interest rates were intended to bring about, will feed through into earnings development and companies' expectations in this respect.

While the latest figures unveiled by companies do not point to either a significant slowdown in demand or any pressure on margins as a result of inflationary developments and higher financing costs, the imminent reporting season will be closely scrutinised by market observers.

A look at the leading indicators – such as the producer confidence survey, which expresses the extent to which these companies are expecting sales growth or contraction on the basis of their order situation – shows that the change in this yardstick feeds through into a change in profitability with a certain time lag.

US producer confidence and earnings development

Whereas the confidence of manufacturers in the US has gradually waned in recent months (red line in graph), the subsequent weakening of earnings development is unlikely to have fully fed through yet (grey line).

Following our profit-taking in June, we are therefore leaving the equity allocation unchanged, i.e. we have a slight underweight positioning.

Alternative Assets

Alternative assets such as gold and crypto investments bring an additional level of diversification to a portfolio.

Currencies

For the time being, we are leaving our currency holdings proportions in USD – reduced following the sale of certain US stocks in June – and EUR unchanged for the time being.

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%	1.3%
EU	3.5%	0.7%
Switzerland	2.1%	0.8%

Inflation (E: Consensus)

	2022	2023E
USA	8.0%	4.1%
EU	8.4%	5.4%
Switzerland	2.9%	2.4%

Central Bank Rates (higher)

	11.07.2023	Consensus
USA FED	5.3%	5.50%
EUR ECB	3.5%	4.00%
CHF SNB	1.8%	

Government Bonds (10 Years)

	11.07.2023	Outlook
USA	3.97%	3.75% – 4.10%
Germany	2.65%	2.5% – 2.75%
Switzerland	1.11%	1.00% – 1.20%

Foreign Exchanges

	11.07.2023	Outlook
EUR/CHF	0.968	0.95 – 1.00
USD/CHF	0.880	0.87 – 0.93
EUR/USD	1.101	1.08 – 1.12

Raw Materials and Alternatives

	11.07.2023	Outlook
Gold (USD/Ounce)	1'932	1'900 – 2'000
Oil (USD/Brent)	79.4	75 – 85
Bitcoin USD	30'579	28'000 – 32'000

Equity Markets

	P/E ø 5J.	P/E 2024	Div. Yield	Outlook
World	18.7x	16.4x	2.1%	sideways
USA	20.4x	18.4x	1.5%	sideways
Europe	15.9x	12.0x	3.5%	sideways
Switzerland	19.6x	16.7x	3.0%	sideways
Emerging Markets	13.6x	11.3x	2.9%	sideways

Markets in Local Currencies

Equity Markets

	QTD	YTD
World	6.6%	15.0%
USA	8.5%	16.6%
Europe	0.5%	9.1%
Switzerland	-0.4%	5.5%
Emerging Markets	1.9%	5.9%

Government Bond Yield (10 Year)

	11.07.2023	30.12.2022
USA	3.97%	3.87%
Germany	2.65%	-0.18%
Switzerland	1.11%	1.62%

Raw Materials and Alternatives

	QTD	YTD
Gold (USD/Ounce)	-1.9%	5.9%
Oil (USD/Brent)	-2.1%	-9.6%
Bitcoin USD	7.7%	84.4%

Foreign Exchanges

	QTD	YTD
EUR/CHF	-2.4%	-2.2%
USD/CHF	-3.9%	-4.9%
EUR/USD	1.6%	2.8%

Data as of 11 July 2023, QTD: Performance since Beginning of Quarter, YTD: Performance since Beginning of Year