IHAG PRIVATBANK

Monthly CIO Letter

21 August 2023

With oil prices having risen over the summer, inflation could once again become an issue. This issue aside, the wider labour market situation is another reason why central banks have no leeway to cut rates. The market remains overly optimistic; we are reaffirming our underweight stance in equities.

Christoph Boner
Chief Investment Officer

Highlights

- As expected, inflation has passed its peak. However, a further cooling of the overall economy will be required if price growth is to fall back to a sustainably reasonable level.
- Specifically, economic growth needs to remain below the level of potential growth. Achieving this without sending the economy into recession is very much a tightrope act.
- Expecting a soft landing after the economic slowdown looks too optimistic; cautious equity positioning is appropriate.

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
After a strong first half of 2023, the markets had lost some ground in the third quarter at the time of writing. With interest rates slightly higher it was not just bond markets that proved weak; equities too were generally on the back foot, even if declines have been modest with low fluctuation bandwidths.

The primary trigger of the development we have seen over the last few weeks may well have been the downgrading of the US's credit rating. But in truth the outlook for the further development of interest rates has darkened generally. Ever since the collapse of the first financial institutions in March 2023 due to higher interest rates, market participants have been expecting central banks to adopt a more moderate stance with respect to further rate hikes. Even if observers can rightly point to the softening of certain inflation targets as an argument for this stance, they are failing to mention – or perhaps simply overlooking – the fact that central banks cannot jeopardise their key asset, namely credibility. When in doubt, they will therefore choose a more restrictive monetary policy path as they continue to wage war against price inflation.

Most pertinently, with inflation still at an unacceptably high level, any enduring decline will require the economy to be slowed, which in turn means that economic growth must be kept below the level of potential growth at least. Only this way, through the creation of excess capacity, can inflation be sufficiently tamed.

Whatever level one selects as the ideal growth target for developed economies – a figure of slightly over 1% is often talked about for Europe, and around 2% for the US – it is nonetheless clear that central banks will have to negotiate an extremely narrow path, with a slide into the realm of contraction and recession being a very real possibility.

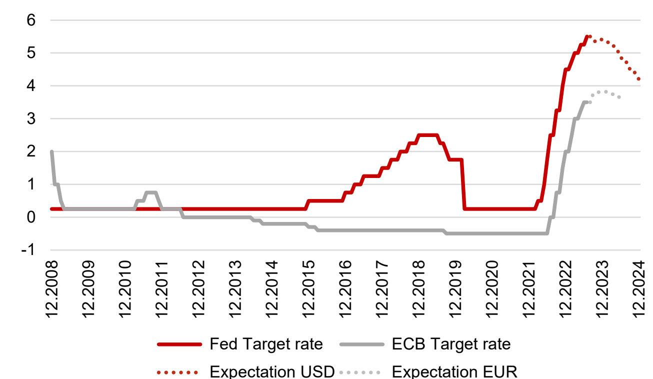
Against this backdrop, we are maintaining our slightly underweight equity allocation for the time being. The equity quota for a balanced risk profile therefore stands at 48%.

The weighting of fixed income securities remains unchanged. The bond allocation for the above-mentioned risk profile amounts to 40%, which includes an admixture 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.

With opportunity costs also rising further, we are continuing to hold gold and crypto investments for portfolio diversification purposes.

Bonds
Despite rather less optimistic interest rate expectations, rate cuts are still expected in both the US and in Europe as early as the first quarter of 2024. This expectation ignores the current labour market situation, however: Unemployment rates are stuck at historic lows and the number of vacant positions contrasts with too few (suitable) job applicants. Given this background, central banks cannot and will not embark on a rate-cutting path.

Market-implied development of key interest rates



Quite the opposite – both current inflation figures and the upcoming inflationary pressure from resurgent energy prices could prompt central banks to push through further rate hikes.

Even with higher yields at the long end, the shape of yield curves remains unattractive for investors thinking about extending the terms of the bonds in their portfolio. Similarly, credit spreads remain relatively narrow, which makes increasing the credit risk of portfolios unappealing.

Both the bond quota and the average duration therefore remain underweighted. By contrast, we are holding some emerging market bonds as these continue to offer an interesting yield premium. In addition, we remain positioned in such a way as to benefit from a normalisation of the yield curve.

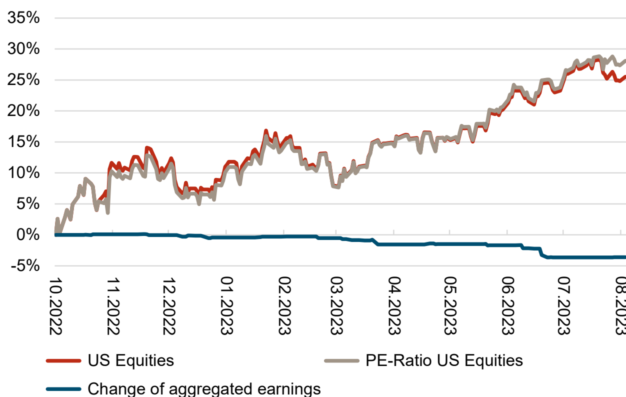
Equities
While the earnings season may have surprised on the positive side, it is clear that expectations had been downgraded in advance. As explained in our CIO Letter of July, there is virtually no earnings growth to be seen on a global basis; moreover, a simple analysis shows that earnings follow in the wake of leading indicators such as manufacturer sentiment, hence a further deterioration of the earnings outlook looks likely.

It should also be noted that continued potential pressure from the labour market has a much more direct impact

on the services sector, which has yet to show signs of weakening – wage costs as a proportion of overall company expenditure are much higher in this sector at an average of 75%. The slowdown evident in the manufacturing industry will also spread to the services sector in due course.

When looking at valuations, the divergence between price development and key corporate figures is clearly apparent. In short, equity price development over the last few months has primarily been driven by an expansion of valuations, whereas the underlying figures for profits and margins have changed only slightly.

Price and earnings development of US equities



Following our profit-taking in June, we are leaving the equity allocation unchanged, i.e. slightly underweight.

Alternative Assets

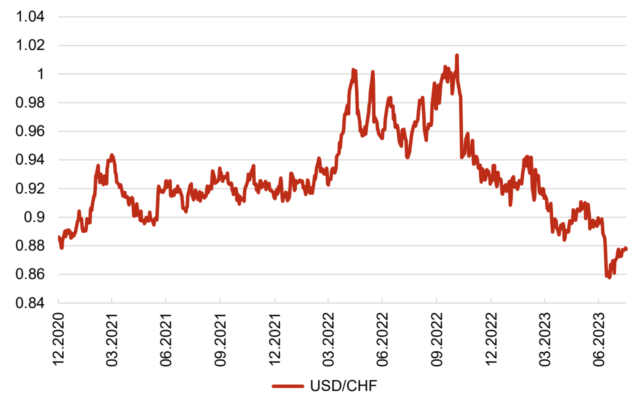
Alternative assets such as gold and crypto investments bring diversification to the portfolio.

We are maintaining our gold exposure despite this being more costly in an environment of high interest rates, as this key precious metal is both a stabilising and a diversifying element in the event of a crisis.

Currencies

Following a prolonged period of weakness, USD has found its feet again in recent weeks, in keeping with the market's rather less optimistic interest rate expectations.

USD to CHF



We are leaving our foreign currency proportions in USD and EUR unchanged for the time being, deliberately diversifying the former currency risk with the above-mentioned position in gold.

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Appendix

Economy and Markets

GDP (E: Consensus)

	2022	2023E
USA	2.1%	1.6%
EU	3.5%	0.7%
Switzerland	2.1%	0.8%

Inflation (E: Consensus)

	2022	2023E
USA	8.0%	4.1%
EU	8.4%	5.5%
Switzerland	2.9%	2.3%

Central Bank Rates (higher)

	15.08.2023	Consensus
USA FED	5.5%	5.50%
EUR ECB	3.8%	4.00%
CHF SNB	1.8%	

Government Bonds (10 Years)

	15.08.2023	Outlook
USA	4.21%	3.85% – 4.30%
Germany	2.67%	2.5% – 2.75%
Switzerland	1.07%	1.00% – 1.20%

Foreign Exchanges

	15.08.2023	Outlook
EUR/CHF	0.958	0.93 – 0.98
USD/CHF	0.879	0.86 – 0.92
EUR/USD	1.091	1.08 – 1.12

Raw Materials and Alternatives

	15.08.2023	Outlook
Gold (USD/Ounce)	1'902	1'850 – 1'950
Oil (USD/Brent)	84.9	78 – 88
Bitcoin USD	29'172	28'000 – 32'000

Equity Markets

	P/E ø 5J.	P/E 2024	Div. Yield	Outlook
World	18.8x	16.5x	2.1%	sideways
USA	20.4x	18.3x	1.6%	slightly down
Europe	15.9x	12.0x	3.5%	sideways
Switzerland	19.7x	17.1x	3.0%	sideways
Emerging Markets	13.6x	11.3x	3.0%	sideways

Markets in Local Currencies

Equity Markets

	QTD	YTD
World	-0.4%	14.9%
USA	-0.1%	16.8%
Europe	-1.1%	10.3%
Switzerland	-2.5%	5.5%
Emerging Markets	-0.2%	4.9%

Government Bond Yield (10 Year)

	15.08.2023	30.12.2022
USA	4.21%	3.87%
Germany	2.67%	-0.18%
Switzerland	1.07%	1.62%

Raw Materials and Alternatives

	QTD	YTD
Gold (USD/Ounce)	-0.9%	4.3%
Oil (USD/Brent)	12.8%	-3.2%
Bitcoin USD	-4.0%	76.0%

Foreign Exchanges

	QTD	YTD
EUR/CHF	-1.9%	-3.2%
USD/CHF	-1.9%	-5.0%
EUR/USD	0.0%	1.9%

Data as of 15 August 2023, QTD: Performance since Beginning of Quarter, YTD: Performance since Beginning of Year