IHAG PRIVATBANK

Monthly CIO Letter

25 September 2023

While further interest rate rises may be off the table for now, the market remains overly optimistic over the development of the economy going forward. Given expiring base effects and ongoing restrictions on the supply side, there is no leeway for interest rate cuts. The equity allocation remains underweight.

Christoph Boner
Chief Investment Officer

Highlights

- Given further rises in oil prices and the expiry of inflation-suppressing base effects, inflation is still above the desired level of 2%.
- Without a sufficient recovery on the supply side, only lower growth will be able to force the rate of inflation back into its target range while demand remains strong.
- An additional economic slowdown – even potentially heading into the territory of a "hard landing" – is on the cards.

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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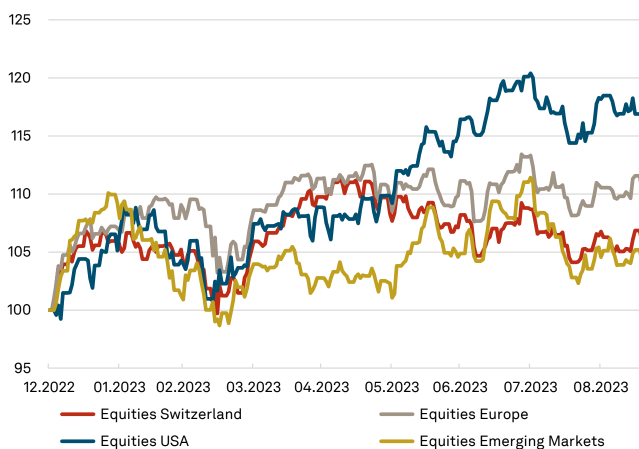
Asset Allocation

For several weeks now, the equity markets have failed to establish any decisive pattern. For example, the global equity market MSCI World reached an (interim) annual high at the end of July, having risen just under 20% (in USD) since the start of the year. Since then, however, it has been characterised by a certain lack of direction, which reflects the market's uncertainty over economic developments going forward.

Equity market development 2023



On the one hand, inflation has clearly receded from its peaks of previous months, and it seems reasonable to expect central banks to adopt a less aggressive stance. On the other, it should be borne in mind that while interest rates have been raised at an unprecedented pace, the desired braking effect on the overall economy is likely to unfold only gradually. Quite aside from the causal link between interest rate rises and economic slowdown not being altogether clear-cut, even more important in the current context of a rapid rate-hiking phase is the time lag factor. Empirical evidence tells us that the desired effects take between 12 and 18 months to feed through, whereas the last interest rate increases (so far) for Europe and the US have only just been initiated.

More crucial right now is the market's current expectation of interest rate developments going forward. As things stand, the first interest rate cuts are expected in the first quarter of 2024. Even though the strength of consumer spending is likely to have provisionally peaked against a backdrop of high indebtedness and low savings rates, ongoing restrictions on the supply side and a persistently tight labour market will not allow any rate cuts for the foreseeable future. The current upward pressure on price development due to rising energy prices and the onset of the colder time of year in the northern hemisphere are further obstacles to more expansionary monetary policy.

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

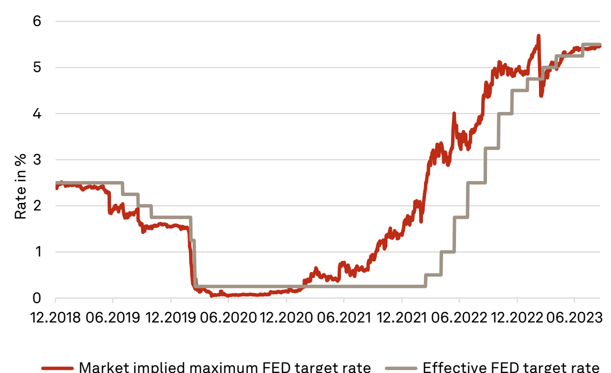
Despite opportunity costs also rising further, we are continuing to hold gold and crypto investments for portfolio diversification purposes.

Bonds

Minds were made up even prior to the most recent central bank meetings: The US Fed will be introducing a pause, at least for the time being, while the ECB must continue to tighten the interest rate screws given the continuing inflation momentum, and the SNB will follow suit, as a depreciating Swiss franc could jeopardise the containment of inflation achieved so far.

As things stand, the market-implied interest rate highs for the US reveal that the end of the rate-hiking cycle is likely to have been reached for the time being. However, the market's expectation of rate cuts coming as soon as the first quarter of 2024 harbours plenty of potential for a negative surprise. Quite aside from the waning of the base effects that have been relieving the upward pressure on inflation, unwanted second-round effects via labour markets could also start to materialise – with both Hollywood and Detroit being perfect show cases for such a development. Further inflationary pressure is stemming from the oil price, which has been gradually rising for many weeks, and the onset of colder weather in the northern hemisphere.

Market-implied interest rate highs for the US



Against such a backdrop, central banks will not have any leeway to push through interest rate cuts. As we explained in the August edition of our CIO Letter, the credibility of central banks – their most valuable asset – depends on them delivering an economic slowdown. Growth must be brought down to below the level of potential growth through further restrictions on the supply side – a tricky tightrope act, as the grim spectre of recession lurks on the other side of this narrow pathway.

The pressure of higher interest rates will therefore remain in place for the time being, even if the more attractive current yields on offer do provide some compensation for the prevailing risks. By contrast, relatively narrow credit spreads are a strong disincentive to increase the level of credit risk.

Both the bond quota and the average duration remain underweighted in the portfolios. 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.

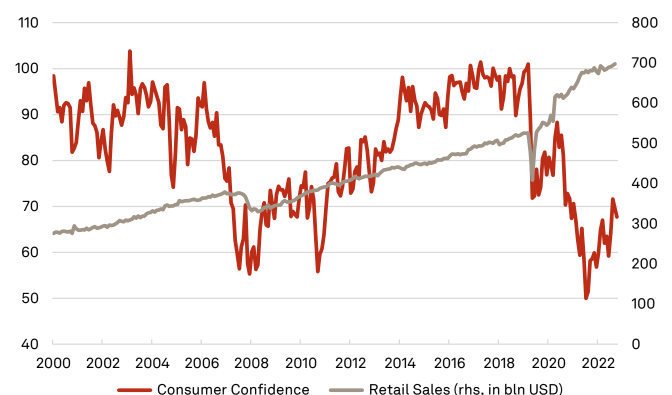
Equities

Whereas equity markets have moved sideways in recent weeks when viewed overall, price/earnings ratios have in some cases risen further – and as earnings have not recorded any growth on aggregate, equity market price rises must have been driven by an expansion of valuations.

Other supportive factors include very bullish investor sentiment over the potential of AI – which if correct, could help mitigate the aforementioned supply problem via a rise in productivity – along with the persistent strength of consumer demand. The latter aspect may look surprising given the background of high indebtedness and elevated interest rates. But consumers remain upbeat as the strong labour market is feeding their sense of security, hence the savings rate – currently languishing at a nadir – is being further eroded. As such, the demand situation looks to be on a weak footing and will become all the more critical as the weeks tick by. Even if it is attributable to the supply side to a significant extent, the inflation problem will primarily be resolved by the demand side.

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

Consumer confidence and consumption in the US



Alternative Assets

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

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.

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.

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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Appendix

Economy and Markets

GDP (E: Consensus)

	2022	2023E
USA	2.1%	2.0%
EU	3.5%	0.7%
Switzerland	2.7%	0.8%

Inflation (E: Consensus)

	2022	2023E
USA	8.0%	4.1%
EU	8.4%	5.6%
Switzerland	2.9%	2.3%

Central Bank Rates (higher)

	19.09.2023	Consensus
USA FED	5.5%	5.50%
EUR ECB	4.0%	4.00%
CHF SNB	1.8%	

Government Bonds (10 Years)

	19.09.2023	Outlook
USA	4.36%	4.00% – 4.50%
Germany	2.74%	2.5% – 2.85%
Switzerland	1.11%	1.00% – 1.20%

Foreign Exchanges

	19.09.2023	Outlook
EUR/CHF	0.959	0.94 – 0.98
USD/CHF	0.898	0.87 – 0.92
EUR/USD	1.068	1.05 – 1.10

Raw Materials and Alternatives

	19.09.2023	Outlook
Gold (USD/Ounce)	1'931	1'875 – 1'975
Oil (USD/Brent)	94.3	82 – 96
Bitcoin USD	27'192	25'000 – 30'000

Equity Markets

	P/E ø 5J.	P/E 2024	Div. Yield	Outlook
World	18.8x	16.4x	2.0%	sideways
USA	20.5x	18.1x	1.6%	slightly down
Europe	15.9x	12.0x	3.4%	sideways
Switzerland	19.7x	17.0x	3.0%	sideways
Emerging Markets	13.6x	11.3x	2.9%	sideways

Markets in Local Currencies

Equity Markets

	QTD	YTD
World	-0.1%	15.3%
USA	0.2%	17.1%
Europe	-0.7%	10.7%
Switzerland	-2.3%	5.7%
Emerging Markets	-0.7%	4.3%

Government Bond Yield (10 Year)

	19.09.2023	30.12.2022
USA	4.36%	3.87%
Germany	2.74%	-0.18%
Switzerland	1.11%	1.62%

Raw Materials and Alternatives

	QTD	YTD
Gold (USD/Ounce)	0.6%	5.9%
Oil (USD/Brent)	25.4%	7.6%
Bitcoin USD	-10.5%	64.0%

Foreign Exchanges

	QTD	YTD
EUR/CHF	-1.9%	-3.1%
USD/CHF	0.2%	-2.9%
EUR/USD	-2.1%	-0.2%

Data as of 19 September 2023, QTD: Performance since Beginning of Quarter, YTD: Performance since Beginning of Year