Monthly CIO Letter

30 October 2023

Geopolitical tensions are sending shockwaves through global financial markets. The fundamental situation has not changed, and a defensive positioning with broad diversification remains the order of the day. The equity market in particular continues to be overly optimistic in its expectations of economic development.

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Highlights

- Investors have become more cautious in the wake of recent events in the Middle East.
- The fundamental picture remains unchanged. In the still heated US economy, inflationary pressure and therefore upward pressure on interest rates remains high. Slowing economic momentum remains the Fed's priority.
- In Europe the slowdown is already evident, but there is still no leeway for monetary stimulus in the short term. The risk of a recession has increased sharply.

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	➡			●		

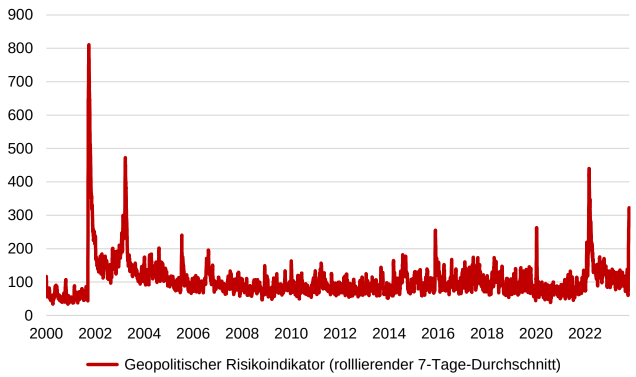
Change: compared to previous month, **Positioning**: -- strongly underweighted | - underweighted | = neutral | + overweighted | ++ strongly overweighted

Asset Allocation
Equity markets have lost ground in recent weeks, hit by economic uncertainties as well as the recent resurgence of conflict in the Middle East. The MSCI World posted a record high at the end of July – representing a gain of 20% since the start of the year – but most major equity markets are now around 10% down on the year.

Where economic developments are concerned, it has paradoxically been strong US economic data that has caused the most uncertainty recently. Unrelentingly robust consumer spending combined with a persistently tight labour market has fuelled fears of further rate hikes. Quite aside from the fact that this adjusted expectation inevitably translates directly into lower equity market prices, the unprecedented indebtedness of the global economy means that the risk of a hard landing grows with each rate hike.

Developments in the Middle East have also weighed on markets in recent weeks. Although this is a fairly insignificant factor from an economic perspective and parallels with the oil crisis of the 1970s look rather exaggerated, the resurgent conflict has put market prices under pressure due to the higher risk premium demanded by investors.

Risk indicator – newspaper articles about geopolitical tensions



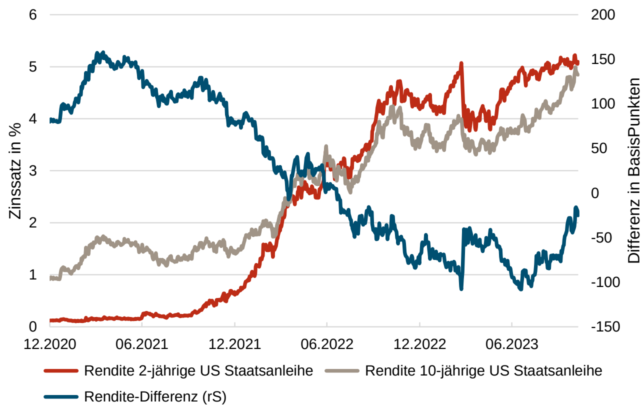
The clearly perceived shift away from a mono-polar world order and the unfolding of various global crises is also apparent in the sharp rise in the level of reporting on geopolitical tensions. As long as the above-mentioned conflict does not morph into a full-scale regional war – and the moderating voices of the various involved blocs currently give cause for optimism in this respect – the business cycle will remain the decisive factor for the direction of equity markets going forward. For now we are maintaining our slightly underweight equity allocation of 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. With the US yield curve having started to normalise in some respects, the corresponding positioning has also contributed to the further improvement in the investment result.

Gold and crypto investments continue to form part of the allocation, with their diversifying characteristics becoming very apparent over the last few weeks.

Bonds
Even though central banks – with the exception of the SNB – have not unveiled any surprises recently, interest rate volatility remains high. Yields on longer-dated bonds have scaled new peaks and the 10-year benchmark yield on US government bonds now stands at 5%, its highest level since July 2007. This compares with its low of 0.5% in August 2020. With government debt burdens remaining at record highs, this upward pressure on yields at the long end of the curve should persist.

Normalisation of US yield curve



The shift of the yield curve to a healthier shape is going hand-in-hand with an end – for now at least – to the rate-hiking cycle. Even if the recent strong economic data from the US has brought a further rate rise into the realm of the possible, what matters most for macroeconomic development is the market's expectations of monetary stimulus through cuts to key interest rates. Current expectations that the first rate cuts for the US will come as early as the second quarter of 2024 continue to look highly optimistic, even if it is reasonable to assume that the Fed will respond very quickly to any (excessive) economic slowdown with further rate cuts. After all, given the background of high levels of debt, the risks of a credit crisis are too great.

Meanwhile, a very different picture is emerging in Europe. While inflation continues to fall further here too and labour markets are in some cases just as tight as they are in the US, the difference is that economic growth is lacking in the Old World. Given this backdrop, the ECB can be expected to have reached the end of its rate-hiking cycle. And although the ECB is even more focused on its inflationary target than the Fed, it does not seem unreasonable to suggest that sufficiently great economic pressure could result in interest rates being cut sooner. As things stand, the economic picture in Europe looks too fragile and too heterogeneous. That said, any further rise in the oil price combined with a more severe winter could dash any hopes of more accommodating monetary policy. The risk of recession remains considerable here.

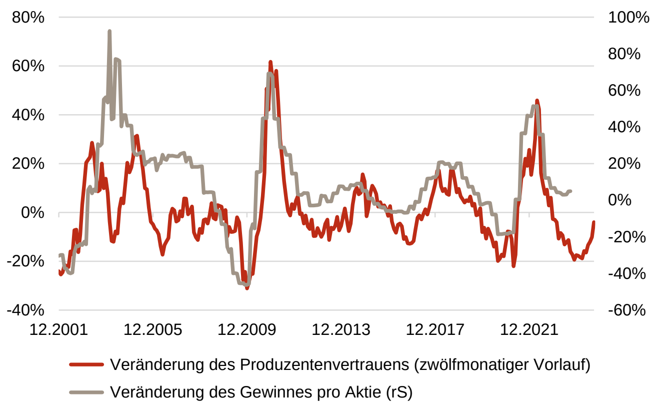
Bearing all this in mind, the premiums payable on higher-risk bonds currently seem too low. The additional yield that these instruments offer does not compensate investors for the generally elevated risk of default. What's more, there is no scope in monetary terms – and little fiscal scope either – for bailing out individual borrowers, let alone the market as a whole. A cautious credit positioning remains the order of the day. Moreover, we are keeping duration decidedly short as the yield curve starts to normalise.

Equities

Given that the fundamental picture as we head into the reporting season has barely changed, the latest equity market setbacks can be ascribed mainly to heightened risk awareness on the part of investors. The crucial factor for equity prices going forward will be the development of the economy and to what extent the currently anticipated "soft landing" will materialise. For the US, the risk of a hard landing has increased, while in Europe – which already finds itself in a zero-growth environment – the key question is how rapidly the ECB might switch to a more supportive monetary policy under certain circumstances.

The fact of the matter is that current earnings growth is insufficient to give equity markets an enduring boost. At 4.9%, the current level of global earnings growth is admittedly rather higher than it was last quarter, but with interest rates now also being much higher, earnings growth needs to pick up considerably to negate this problem. Such a development does not look likely in view of the ongoing decline in manufacturer sentiment.

Manufacturer sentiment and earnings development



On the positive side, certain market segments once again have more attractive valuations, while calendar effects could give a further boost to equity markets as we approach the year-end. However, these factors will obviously not have a lasting impact. We are leaving the equity allocation at underweight, with a continued preference for market segments with lower betas when selecting investments.

Alternative Assets

Alternative assets such as gold and crypto investments bring diversification to a portfolio. Moreover, it is now clear that the diversification effect of cryptocurrencies in particular is greater than might have been suspected last year. Given the prevailing global tensions, gold can be expected to contribute further to the stabilisation of the portfolio, despite higher real interest rates.

Currencies

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

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Appendix

Economic and market development

Wirtschafts- und Marktentwicklung

BIP-Entwicklung (E: Konsens)

	2022	2023E
USA	1.9%	2.2%
EU	3.5%	0.6%
Schweiz	2.7%	0.8%

Inflation (E: Konsens)

	2022	2023E
USA	8.0%	4.2%
EU	8.4%	5.6%
Schweiz	2.9%	2.2%

Zentralbanken Leitzinsen

	24.10.2023	Markterwartung
USD FED	5.50%	5.50%
EUR EZB	4.00%	4.00%
CHF SNB	1.75%	

Staatsanleihen (10 Jahre)

	24.10.2023	Prognose
USA	4.82%	4.50% – 5.00%
Deutschland	2.83%	2.60% – 3.00%
Schweiz	1.11%	1.00% – 1.20%

Währungen

	24.10.2023	Prognose
EUR/CHF	0.946	0.93 – 0.97
USD/CHF	0.893	0.87 – 0.92
EUR/USD	1.059	1.04 – 1.08

Rohstoffe und Alternative

	24.10.2023	Prognose
Gold (USD/Unze)	1'971	1'900 – 2'000
Ölpreis (USD/Brent)	88.1	82 – 96
Bitcoin USD	33'651	30'000 – 35'000

Aktienmärkte

	P/E ø 5J.	P/E 2024E	Div. Rendite	Prognose
Welt	18.8x	15.6x	2.1%	seitwärts
USA	20.5x	17.4x	1.6%	leicht sinkend
Europa	15.8x	10.6x	3.6%	seitwärts
Schweiz	19.7x	16.0x	3.2%	seitwärts
Schwellenländer	13.7x	10.8x	3.0%	seitwärts

Marktentwicklung in Lokalwährung

Aktienmärkte

	QTD	YTD
Welt	-1.7%	9.6%
USA	-0.9%	12.1%
Europa	-3.3%	5.6%
Schweiz	-5.3%	-1.0%
Schwellenländer	-3.3%	-1.3%

Staatsanleihen Rendite (10 Jahre)

	24.10.2023	30.12.2022
USA	4.82%	3.87%
EU	2.83%	2.57%
Schweiz	1.11%	1.62%

Rohstoffe und Alternative

	QTD	YTD
Gold (USD/Unze)	6.6%	8.1%
Ölpreis (USD/Brent)	-4.5%	4.2%
Bitcoin USD	24.3%	103.0%

Währungen

	QTD	YTD
EUR/CHF	-2.2%	-4.4%
USD/CHF	-2.4%	-3.4%
EUR/USD	0.2%	-1.1%

Daten per 24. Oktober 2023, QTD: Performance seit Quartalsbeginn, YTD: Performance seit Jahresbeginn