Monthly CIO Letter

18 December 2023

Optimism persists over the prospect of an impending easing of monetary policy. Quite how this is supposed to tally with a forecast of a “soft landing” is anyone’s guess. Empirical evidence points to the contrary: not only has such an outcome hardly ever come about, the more hopes have been pinned on it in the past, the less likely it is to have actually transpired.

Christoph Boner
Chief Investment Officer

Highlights

- Unlike the weather, the capital markets have been showing investors their sunnier side in November.
- Waning inflationary pressure is fuelling hopes of imminent rate cuts, which has prompted both equities and bonds to record their second-strongest monthly performance of 2023.
- The negative effects of the rapid interest rate rises of recent months and record-high debt levels are unlikely to simply disappear.

Asset Allocation

Asset Classes	Change	– –	–	=	+	+ +
Liquidity	⬆					●
Bonds	➡		●			
Reference Currency	➡		●			
World / Themes	➡		●			
Emerging Markets	➡			●		
Convertible Bonds	➡				●	
High Yield 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

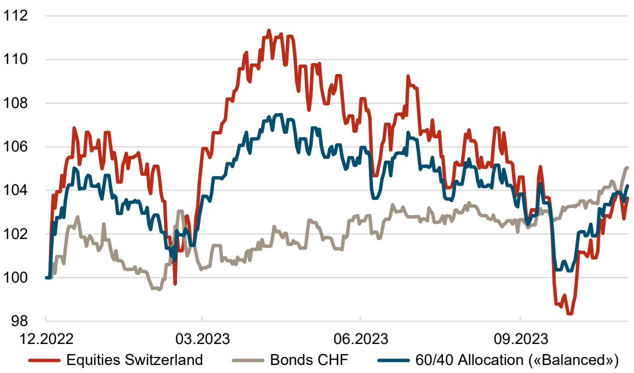
Asset allocation

Following a solid November for investors, the first half of December has also largely delivered positive price movements in the markets, which should ensure that 2023 turns out to be a gratifying investment year.

While equities – as measured by the global equity indices (in USD) – are up some 20% since the start of the year, the various global bond segments have also posted significant positive performance, with value gains ranging from 2% for investment-grade bonds to more than 10% in some cases for the securities of issuers with lower credit ratings.

A simple portfolio consisting of 60% Swiss equities and 40% CHF bonds of good quality has also enjoyed positive performance of more than 4% over the year to date.

60/40 allocation equities and bonds: 2023 performance



The less pronounced positive performance of the Swiss allocation illustrated here is attributable to the persistently lower CHF interest rate environment, but also to the Swiss equity market underperforming in an international comparison. A broader investment universe once again helped to improve the investment result in 2023.

With the investment strategy 2024, asset class coverage will be further expanded and diversified, including consistent currency management to optimise the strategy along with flexibility in the tactical allocation.

Against this backdrop, the equity quota for the "Balanced" profile is being reduced to 45%, bringing it into line with the new strategic equity quota. The reduction is being implemented for the most part by reducing exposure to Switzerland, which will have a lower strategic weighting going forward due to the broader diversification.

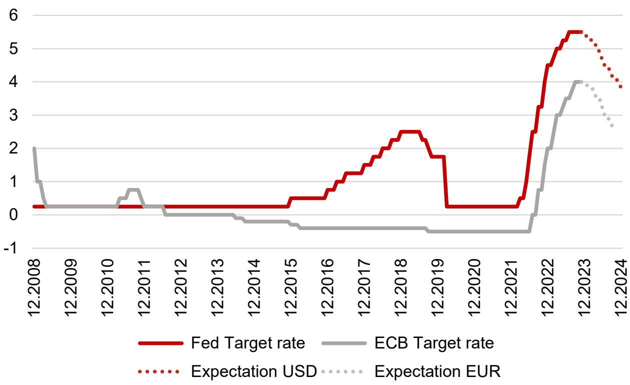
The allocation to interest-bearing securities will remain unchanged for the time being. With a short duration and high credit quality, the portfolio remains both robustly and defensively positioned. The fixed-income quota for the above-mentioned risk profile therefore now amounts to 36%, with exposure to emerging market bonds remaining unchanged. We are likewise positioned in anticipation of a further normalisation of the USD yield curve. Even if the high-yield segment will form part of the strategic allocation going forward, we continue to hold no securities in this riskier bond segment – the credit spreads for bonds of low quality are far too meagre, particularly since they have recently become narrower.

Gold and crypto investments continue to form part of the allocation, with the former to be held as a strategic component from 2024 onwards. Crypto investments remain a tactical addition.

Bonds

The strong performance of bond markets in recent weeks was driven by two factors: On the one hand, expectations of imminent rate cuts resulted in falls in longer-dated yields, some of them considerable. On the other, hopes of a so-called "soft landing" have led to a broad-based decline in credit risk premiums.

Key interest rates and market-implied expectations



Both expectations are an expression of the prevailing optimistic view that taming inflation by shrinking the money supply will not lead to a recession. But actually there is almost no empirical justification for this view. In the past, central banks have repeatedly shown how prone they are to overshooting their targets. As an additional complicating factor, the economy has exhibited considerable resilience to contractionary monetary policy in recent months thanks to various special effects – such as fiscal support measures, extraordinarily low unemployment rates, and consumers continuing to work through their savings following the pandemic-related restrictions.

With leaner (government) budgets, far-reaching normalisation of the supply side and a savings rate currently at a record low, aggregate demand can be expected to decline quickly at the first signs of weakness. Add to all this the negative effect of current rises in real interest rates, and we are left with quite a toxic mix, which experience shows can easily lead to a recession of medium severity involving an economic contraction in the range of 1% to 3%. In the event of such a development, interest rate cuts would obviously be on the cards to cushion the downturn – but the problem is that in such a scenario the downturn would precede the rate cuts. Inflation rates remain too high and the risk of second-round effects is too pronounced for a reverse sequence of events to unfold that would bring about a "soft landing".

The premiums payable on riskier bonds should consequently be viewed as too low. The additional compensation does not make up for an elevated and widespread risk of default as a result of an economic slowdown. A cautious credit positioning remains the order of the day, and the duration is being kept at its much shorter current level.

Equities

In keeping with expectations of easing monetary policy pressure and narrowing credit spreads, equities have started to gain ground. Even though this development is hardly justified by the fundamentals, it could well persist over the coming weeks.

However, the reasons for this are of a purely technical nature. For example, (supposed) calendar effects could be posited – in addition to the likely event of another positive end to the financial market year, the fact that elections are looming in the US in 2024 could provide equities with further support. On the corporate front, a noticeable rise in the number of share buyback programmes is also apparent, and while this may not be a positive sign from a medium-term standpoint it will help equity markets in the short term due to earnings densification. Last but not least, investor excitement and growth expectations due to technological progress – think artificial intelligence – could provide further stimulus for markets. In the event of these flights of fancy proving to be more than just that, some current equity valuations really could be viewed as sustainable, as explained in our last CIO letter.

Against this backdrop of an expected slowdown, diversification remains the order of the day. As mentioned earlier, the equity quota in the individual profiles will be aligned with the new strategic quotas, which will involve taking profits in the Swiss equity market in particular.

Alternative assets

The alternative assets of gold and crypto have also enjoyed significant value gains in recent weeks, but without losing their diversification potential. Given current global tensions, gold can be expected to contribute further to the stabilisation of the portfolio despite higher real interest rates. Should interest rates start falling, both investments can be expected to appreciate further.

Gold price and Bitcoin 2023 (indexed)

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

GDP (E: Consensus)

	2022	2023E
USA	1.9%	2.4%
EU	3.5%	0.5%
Switzerland	2.7%	0.8%

Inflation (E: Consensus)

	2022	2023E
USA	8.0%	4.1%
EU	8.4%	5.5%
Switzerland	2.9%	2.2%

Central Bank Rates (higher)

	14.12.2023	Consensus
USA FED	5.5%	5.50%
EUR ECB	4.0%	4.00%
CHF SNB	1.8%	

Government Bonds (10 Years)

	14.12.2023	Outlook
USA	3.92%	3.80% – 4.20%
Germany	2.12%	2.00% – 2.30%
Switzerland	0.66%	0.55% – 0.80%

Foreign Exchanges

	14.12.2023	Outlook
EUR/CHF	0.954	0.93 – 0.97
USD/CHF	0.868	0.87 – 0.91
EUR/USD	1.099	1.06 – 1.10

Raw Materials and Alternatives

	14.12.2023	Outlook
Gold (USD/Ounce)	2'036	1'950 – 2'050
Oil (USD/Brent)	76.6	70 – 80
Bitcoin USD	42'995	38'000 – 45'000

Equity Markets

	P/E ø 5J.	P/E 2024	Div. Yield	Outlook
World	18.9x	17.2x	2.0%	sideways
USA	20.6x	19.4x	1.5%	sideways
Europe	15.8x	12.7x	3.3%	sideways
Switzerland	19.7x	17.8x	3.0%	sideways
Emerging Markets	13.7x	11.3x	2.8%	sideways

Markets in Local Currencies

Equity Markets

	QTD	YTD
World	10.0%	22.8%
USA	10.5%	24.9%
Europe	6.2%	16.0%
Switzerland	2.1%	6.8%
Emerging Markets	2.7%	4.9%

Government Bond Yield (10 Year)

	14.12.2023	30.12.2022
USA	3.92%	3.87%
Germany	2.12%	-0.18%
Switzerland	0.66%	1.62%

Raw Materials and Alternatives

	QTD	YTD
Gold (USD/Ounce)	10.2%	11.6%
Oil (USD/Brent)	-12.8%	-4.4%
Bitcoin USD	58.8%	159.3%

Foreign Exchanges

	QTD	YTD
EUR/CHF	-1.4%	-3.6%
USD/CHF	-5.2%	-6.2%
EUR/USD	4.0%	2.7%

Data as of 14 December 2023, QTD: Performance since Beginning of Quarter, YTD: Performance since Beginning of Year