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Monthly CIO Letter

26 February 2024

A mixed bag of macro indicators along with higher-than-expected inflation figures are leading to an adjustment of interest rate expectations. The stronger focus on the issue of growth going forward reflects the need of the analyst community to find a plausible rationale for the current valuation levels. We remain underweight in equities and are taking a proportion of profits on the US currency.

Christoph Boner
Chief Investment Officer

Highlights

- After a subdued start to the year, global equity markets have trended upwards in recent weeks.
- The US economy, which continues to grow faster than its potential rate, has provided markets with a tailwind. Higher-than-expected inflation figures are fuelling doubts over optimistic interest rate expectations, however.
- With less dramatic cuts to interest rates now envisaged, investors are once again weighing up the current level of market valuations in the context of the likely magnitude of economic growth.

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	➡			●		
Themes	➡	●				
Alternative Assets						
Gold	➡			●		
Crypto Assets	➡				●	
Other	➡	●				
Currencies						
CHF	⬆			●		
EUR	➡				●	
USD	⬇				●	

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

Asset Allocation

After a subdued start to the year, global equity markets have taken a firm step forward since mid-January. Global equity markets are currently exhibiting a gain of more than 8% in CHF, which is above all attributable to the strong US stock market – again led by a select few technology heavyweights – and a strengthening of the greenback since the start of the year.

By contrast, the fixed income markets have reported slightly negative performance against a backdrop of higher capital market interest rates. The yield on 10-year Swiss government bonds has risen from 0.65% at the end of 2023 to a current level of 0.89%, while the yield on the US government equivalent has climbed from 3.88% to 4.32%.

While equity markets have been heavily shaped by a reporting season characterised by appealing figures and sufficiently optimistic outlooks, higher-than-expected rates of inflation have started to weigh on investor sentiment: In the event of rate cuts being of a lesser magnitude than those expected at the start of the year due to persistent inflationary pressure, current valuation levels will need sufficiently strong economic growth if they are to be maintained. The potential for disappointment has accordingly shifted, while as an additional factor the geopolitical risks continue to be largely disregarded.

Against a background of revised interest rate expectations, we are increasing the fixed-income allocation slightly in two different ways. On the one hand we are increasing the allocation to US government bonds by means of a structure that also allows us to profit from any further normalisation of the yield curve, while on the other we are increasing interest rate sensitivity in places via a slightly higher portfolio duration. Depending on the currency, this has ended up at around three years.

The bond allocation for a balanced mandate now stands at 38%. The high credit quality of the portfolio remains unchanged – we continue to view lower-quality bonds as unattractive given the background of rising refinancing requirements.

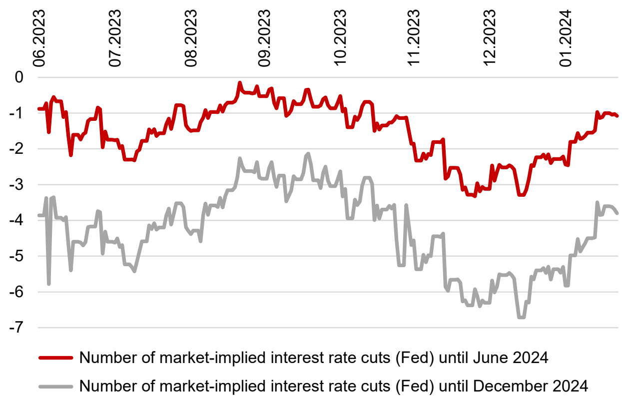
We are leaving the equity allocation for the above-mentioned risk profile at 42%, which is below the strategic allocation. Our underweight stance extends to various regions of the developed world, whereas emerging market equities are weighted neutrally given their attractive valuations.

Gold and crypto investments continue to form part of the allocation. Whereas gold possesses diversification and hedging characteristics, particularly in an environment of geopolitical upheaval, the further institutionalisation and impending halving of Bitcoin can be expected to provide further support to cryptocurrency prices over the coming months. Their positive contribution to the performance of the portfolio remains significant, while at the same time the degree of diversification – and therefore the risk mitigation effect – has strengthened for the overall allocation.

Bonds

After the market's previous expectation of three to four interest rate cuts in 2024 was confirmed by the shift in the Fed's communication in December 2023, the market then created another discrepancy with its updated expectations of six to seven rate cuts.

Market-implied interest rate expectations



With inflation figures having proved higher than expected in the meantime, this gap has begun to close in recent days. The market's current expectation is for a maximum of one rate cut by June, followed by between three and four further rate cuts by the end of the year.

This moderated expectation on the part of investors has put the bond market under slight pressure. With inflation remaining stubbornly above its target bandwidths in both the US and Europe, the scope for expansionary monetary policy remains restricted. Given this backdrop, an adjustment of interest rate expectations is only logical.

In terms of unexpected rate cuts, on the other hand, there is the possibility of central banks being influenced by exogenous shocks. These could prompt the guardians of monetary policy to initiate premature rate cuts in order to achieve a stabilising effect. All in all, this risk is by no means negligible over the next few months. In addition to the fact that geopolitical risks are being largely disregarded at the moment, the various impending elections around the world also harbour the potential for surprises.

Credit spreads in the fixed income market remain very narrow – too narrow in our view given the current risk constellation.

Equities

In the light of recent adjustments to interest rate expectations, the question of the magnitude of economic growth going forward has become more pressing in the context of equity market valuations. With rate cuts expected to be less dramatic, a continuation of current valuation levels can only be justified by higher growth – otherwise valuations lose their anchor.

When looking at current valuation levels in a historical context, the Swiss equity market looks fairly valued, the European market looks for the most part cheap, while the US market appears slightly overvalued. This situation is aligned with prevailing growth expectations. The US is a very good example of how a further rise would have to be driven by an expansion of valuations, since – as already explained – the successful and enduring taming of inflation makes it paramount that economic growth falls back to below its potential growth line. However, this in turn would be incompatible with current valuation levels.

With this in mind, we are keeping our equity allocation below the strategic target weighting for the time being. Betting on an expansion of valuations would mean taking on additional risk, which looks particularly unappealing given the backdrop of the above-mentioned geopolitical risks.

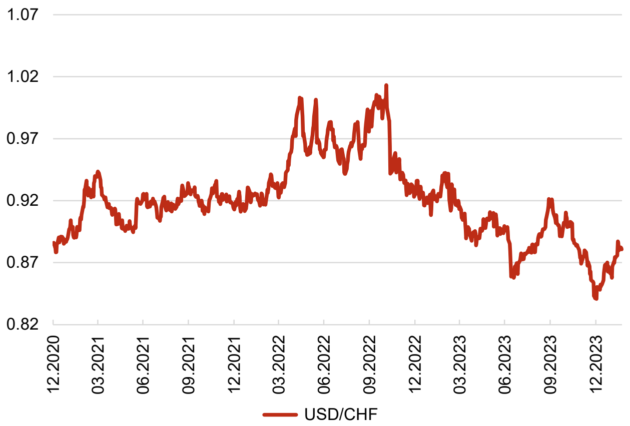
Alternative Assets

The alternative assets of gold and crypto have also appreciated in value 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.

Currencies

In view of the changed inflation situation – inflation has fallen back into a reasonable bandwidth in Switzerland, whereas both the US and Europe are still experiencing excessive rises in prices – the scope for heady expectations of potential cuts to interest rates has been squeezed. The fact that the SNB has the potential to cut rates from now onwards whereas both the Fed and the ECB look to be more constrained in this regard has seen both USD and EUR appreciate against CHF over the last few weeks.

Currency development: CHF to USD



Not least due to current interest rate differences – i.e. a relatively "expensive" hedge at around 4% annually – we are scaling down the share of USD in the portfolio via a currency hedge, thereby realising a proportion of the recent gains in this currency.

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Appendix

Economy and Markets

GDP (E: Consensus)

	2023	2024E
USA	2.5%	1.6%
EU	0.5%	0.9%
Switzerland	1.2%	0.8%

Inflation (E: Consensus)

	2023	2024E
USA	4.1%	2.7%
EU	5.4%	2.3%
Switzerland	2.1%	1.5%

Central Bank Rates (higher)

	21.02.2024	Consensus
USA FED	5.5%	5.50%
EUR ECB	4.0%	4.00%
CHF SNB	1.8%	

Government Bonds (10 Year)

	21.02.2024	Outlook
USA	4.32%	4.15% – 4.45%
Germany	2.45%	2.25% – 2.55%
Switzerland	0.89%	0.80 – 1.00%

Foreign Exchanges

	21.02.2024	Outlook
EUR/CHF	0.952	0.93 – 0.97
USD/CHF	0.880	0.85 – 0.89
EUR/USD	1.082	1.06 – 1.10

Raw Materials and Alternatives

	21.02.2024	Outlook
Gold (USD/Ounce)	2'026	1'975 – 2'050
Oil (USD/Brent)	83.0	75 – 85
Bitcoin USD	51'389	45'000 – 55'000

Equity Markets

	P/E ø 5J.	P/E 2024	Div. Yield	Outlook
World	19.1x	18.4x	1.9%	slightly down
USA	20.9x	18.4x	1.4%	slightly down
Europe	15.8x	12.6x	3.2%	slightly down
Switzerland	19.8x	18.9x	3.0%	slightly down
Emerging Markets	13.8x	12.1x	2.6%	slightly down

Markets in Local Currencies

Equity Markets

	QTD	YTD
World	3.4%	3.4%
USA	4.7%	4.7%
Europe	2.7%	2.7%
Switzerland	2.4%	2.4%
Emerging Markets	-0.2%	-0.2%

Government Bond Yield (10 Year)

	21.02.2024	29.12.2023
USA	4.32%	3.88%
Germany	2.45%	-0.18%
Switzerland	0.89%	0.70%

Raw Materials and Alternatives

	QTD	YTD
Gold (USD/Ounce)	-1.8%	-1.8%
Oil (USD/Brent)	9.4%	9.4%
Bitcoin USD	22.5%	22.5%

Foreign Exchanges

	QTD	YTD
EUR/CHF	2.5%	2.5%
USD/CHF	4.5%	4.5%
EUR/USD	-2.0%	-2.0%

Data as of 21 February 2024, QTD: Performance since Beginning of Quarter, YTD: Performance since Beginning of Year