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Monthly CIO Letter

25 March 2024

Despite the latest inflationary data once again disappointing slightly and interest rate expectations being adjusted to some extent, the financial markets remain in a buoyant mood. While it is possible for this constellation to persist, the carefree stance of the investor community right now is at odds with the prevailing general situation. We remain underweighted in equities and are taking some profits on crypto investments.

Christoph Boner
Chief Investment Officer

Highlights

- Inflation data for February disappointed once again, with the figures released being slightly higher than expected. This has quashed some of the optimism over imminent rate cuts.
- This does not appear to have ruffled equity markets. Revised growth expectations are propping up prices, even though valuations are now starting to look on the expensive side.
- As things stand, ongoing geopolitical risks are being largely disregarded.

Asset Allocation

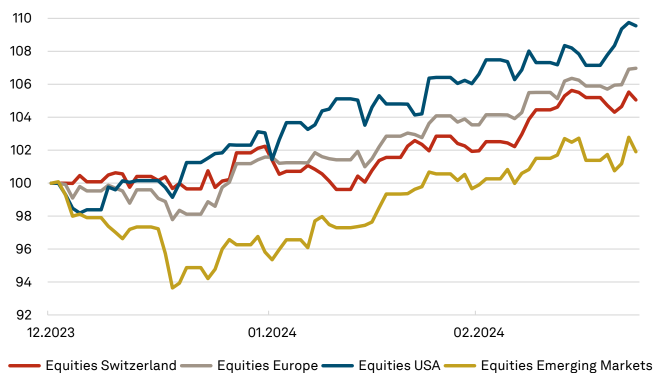
Asset Classes	Change	– –	–	=	+	+ +
Liquidity	➡					●
Bonds	➡		●			
Reference Currency	➡		●			
World / Themes	➡		●			
Emerging Markets	➡			●		
Convertible Bonds	➡				●	
High-yield Bonds	➡	●				
Equities	➡		●			
Switzerland	➡				●	
Europe	➡				●	
US	➡		●			
Pacific	➡			●		
Emerging Markets	➡			●		
Themes	➡	●				
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

Global equity markets continued their upward trend in March, with some stock markets even surging to new highs. However, despite a positive performance of just over 5% in the year to date (as per mid-March), the Swiss equity market has fallen behind to some extent. Emerging market equities have underperformed even more sharply due to the situation in China.

Equity markets in 2024



The positive development over the last few months has been fuelled first and foremost by the persistent robustness of many parts of the economy, hopes of impending rate cuts, and expectations of stronger economic growth in the form of productivity gains – not least due to the latest developments in the sphere of artificial intelligence.

Indeed, the potential growth rate of the US economy has actually been revised upwards in the last couple of months, and now stands at an estimated 2.5% to 3.0%, well above the Fed's own estimate of 1.8%. This is attributable to both labour market growth and productivity increases being higher than previously expected. If this reassessment of growth potential were to prove correct, this would remove some of the pressure from the Fed to slow the economy further via the path of higher interest rates in order to tame persistently excessive inflation. That said, with the US economy growing already close to this revised growth rate, there is also little scope for interest rate cuts, and the market's heady optimism in this respect has indeed started to recede in response to the latest data on the development of inflation.

With the recent adjustment to interest rate expectations, bond markets have exhibited slightly negative performance due to the interest component, although in some cases this has been more than compensated for by the further narrowing of credit spreads. For certain credit segments these are now tighter than has been the case for many years, which means that investors are increasingly disregarding the credit risk these investments pose.

We are leaving the bond allocation for a balanced risk profile at 38%. The high credit quality of the portfolio remains unchanged – we do not consider lower-quality bonds to be particularly attractive given the above-mentioned tightness of credit spreads.

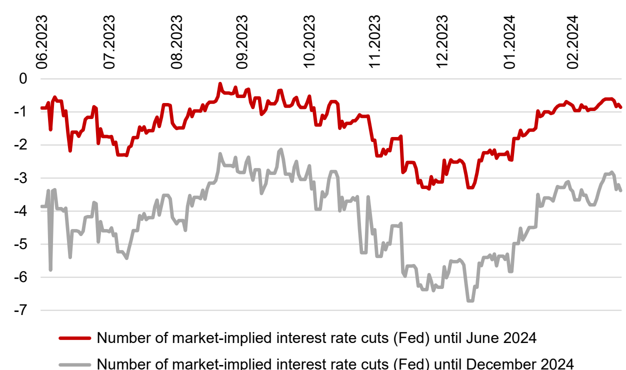
We are leaving the equity allocation for the balanced risk profile at 42%, which is below the strategic allocation. Our underweight stance extends to various regions of the developed world, whereas emerging market equities are weighted neutrally given the attractive valuation of this market segment. Following recent developments, we are leaving our relative overweight stance in Chinese equities unchanged.

Two components of the portfolio, gold and crypto, have recorded new all-time price highs in recent days. We are leaving our gold quota (which comprises 3% of the portfolio) unchanged as a diversifying element. By contrast, we are taking some profits on the portfolio's crypto investments by reducing our exposure to 1%.

Bonds

Whereas at the start of the year as many as six interest rate cuts were anticipated for 2024, this expectation has now been scaled back to fewer than three rate cuts, with expectations for the first half of the year now not even being equivalent to a single cut.

Market-implied interest rate expectations



Despite the potential growth rate for the US economy exceeding the Fed's expectation, the scope for interest rate cuts remains limited due to a further tightening of the labour market and the further potential for inflationary pressure that this implies. Equally, it does not appear that far-fetched to take the view that central banks will want to err on the safe side before initiating the first rate cuts – i.e. they are more likely to favour a course of action that is "too late" rather than "too early".

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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.

Meanwhile, the risk premiums on fixed-income investments have declined further, which means that investors are ignoring the risk of higher interest rates persisting for a longer period of time. The logic of a cautious positioning is therefore not just restricted to the portfolio's duration.

Equities

Any persistence of solid economic growth will continue to exert a positive influence on corporate earnings development. At the same time, however, the pressure from the labour market will also persist, and if this cannot be offset through sufficient productivity growth, the corresponding pressure on inflation – and by extension on longer-term interest rates – can be expected to weigh on equity valuations. Rising interest rates have historically led to a greater compression of key valuation metrics (such as price-earnings ratios, for example) than the change in earnings would achieve on its own.

With the further expansion of valuations over the last few weeks, this risk has risen further. Indeed, both the US and the Swiss equity market are currently sitting at valuation levels above their historic averages. Of course, it is quite possible for valuations to rise even further from their current levels – but as explained in our last CIO Letter, this is not something we would care to bet on.

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 all the more inappropriate given the backdrop of the above-mentioned geopolitical risks.

Alternative investments

The alternative admixtures to the portfolio – gold and Bitcoin – have touched new all-time highs in recent days despite the fact that the revision of interest-rate expectations has hardly provided a tailwind.

Performance of gold and Bitcoin

While Bitcoin has enjoyed strong demand from various investors thanks to the newly-launched ETFs, gold has also remained sought after by central banks in particular as they seek to diversify their USD investments.

We are leaving our gold exposure in the portfolio unchanged, but are taking some profits on the crypto side by liquidating half of our position.

Currencies

Following the currency gains in the first few weeks of the year and the partial hedging of these in February, we are leaving the currency allocation unchanged for the time being. With an EUR quota of 5% and a USD quota of 7% the currency risk remains manageable, without driving up the costs of hedging to an excessive level.

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Appendix

Economic and market development

GDP (E: Consensus)

	2023	2024E
USA	2.5%	2.1%
EU	0.5%	0.9%
Switzerland	0.7%	1.2%

Inflation (E: Consensus)

	2023	2024E
USA	4.1%	2.8%
EU	5.4%	2.4%
Switzerland	2.1%	1.5%

Central Bank Rates (higher)

	21.03.2024	Consensus
USA FED	5.5%	5.50%
EUR ECB	4.0%	4.00%
CHF SNB	1.8%	

Government Bonds (10 Year)

	21.03.2024	Outlook
USA	4.27%	4.15% – 4.40%
Germany	2.41%	2.25% – 2.55%
Switzerland	0.70%	0.60 – 0.85%

Foreign Exchanges

	21.03.2024	Outlook
EUR/CHF	0.975	0.95 – 0.99
USD/CHF	0.898	0.87 – 0.92
EUR/USD	1.086	1.07 – 1.10

Raw Materials and Alternatives

	21.03.2024	Outlook
Gold (USD/Ounce)	2'181	2'125 – 2'250
Oil (USD/Brent)	85.8	80 – 90
Bitcoin USD	65'467	55'000 – 75'000

Equity Markets

	P/E ø 5J.	P/E 2024	Div. Yield	Outlook
World	19.1x	17.3x	1.8%	slightly down
USA	20.9x	19.2x	1.4%	slightly down
Europe	15.8x	12.0x	3.1%	slightly down
Switzerland	19.8x	17.1x	2.9%	slightly down
Emerging Markets	13.8x	10.7x	2.7%	slightly down

Markets in Local Currencies

Equity Markets

	QTD	YTD
World	8.8%	8.8%
USA	10.3%	10.3%
Europe	7.1%	7.1%
Switzerland	5.5%	5.5%
Emerging Markets	2.8%	2.8%

Government Bond Yield (10 Year)

	21.03.2024	29.12.2023
USA	4.27%	3.88%
Germany	2.41%	-0.18%
Switzerland	0.70%	0.70%

Raw Materials and Alternatives

	QTD	YTD
Gold (USD/Ounce)	5.7%	5.7%
Oil (USD/Brent)	15.7%	15.7%
Bitcoin USD	56.1%	56.1%

Foreign Exchanges

	QTD	YTD
EUR/CHF	4.9%	4.9%
USD/CHF	6.7%	6.7%
EUR/USD	-1.6%	-1.6%

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