Monthly CIO Letter

22 April 2024

Exaggerated hopes of multiple interest rate cuts have finally returned to more normal levels in the face of persistently stubborn inflation figures. The reaction of equity markets has been modest so far. Given inflated valuations and the ongoing geopolitical risks, a cautious positioning remains the order of the day. Equities remain underweighted; crypto investments and gold are helping to stabilise returns.

Christoph Boner
Chief Investment Officer

Highlights

– Whereas at the start of year the market was still expecting the Fed to make six interest rate cuts, that expectation has now been reined in to less than two.

– As a result of this shift in interest rate expectations – essentially an acceptance of "higher for longer" – all asset prices are coming under pressure. Equity markets have so far only partially priced this in.

– The geopolitical risks remain acute and are another argument for a more cautious positioning.

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

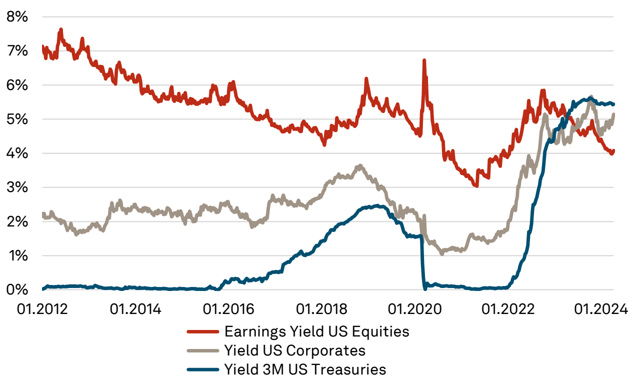
Asset Allocation

Following an extremely positive first quarter for investors, equity markets have now completed a (temporary) change of direction to mark the start of Q2. Whereas the positive market development in the first quarter was driven mainly by investors' rose-tinted expectations of interest rate cuts, which were viewed as the catalyst of a growth recovery, remarkably stubborn inflation figures for the US have now started to erode the scope for rate cuts in the near future.

A further decline in base effects and a general rise in commodity prices are maintaining the upward pressure on inflation, while in the labour market there are only sporadic signs of any cooling; the risk of second-round effects has not gone away. As explained in our last CIO Letter, the narrative of higher potential growth thanks to (expected) productivity advances and a (demonstrably) growing labour market – which should in turn entail a structural decline in inflationary pressure – is ultimately no more than that: a structural shift that will not exert its influence immediately.

With interest rate expectations now significantly reined in, bond markets too have performed negatively in recent weeks. Only CHF-denominated bonds have recorded slight gains, this being attributable to an interest rate cut on the part of the SNB. Credit spreads continue to be tight, providing insufficient compensation for the default risks that are apparent in some places.

Yield comparison: equities and bonds



We are leaving the bond allocation for a balanced risk profile at 38%. The high credit quality of the portfolio remains unchanged, as we do not consider lower-quality bonds to be particularly attractive. With an appropriate investment vehicle we have profited from the ongoing normalisation of the US yield curve in recent months – the yields on longer-dated instruments have risen, whereas the short end of the curve has hardly shifted.

We are leaving the equity quota for the balanced risk profile at 42%, which is below the strategic allocation. On a regional basis we are scaling back the Swiss equity quota in favour of greater exposure to the US. This reflects the strategic adjustments made at the start of the year, which were in anticipation of a rise in the (currency-hedged) US equity market. Emerging market equities are neutrally weighted due to their attractive valuations. We are maintaining our relative overweight stance in Chinese equities.

The diversifying positions in gold and cryptocurrencies have been left unchanged. We explained the reasons for the (at first glance surprising) surge in the price of gold and the argument for including these alternative investments in a portfolio in our last two blogs.

Bonds

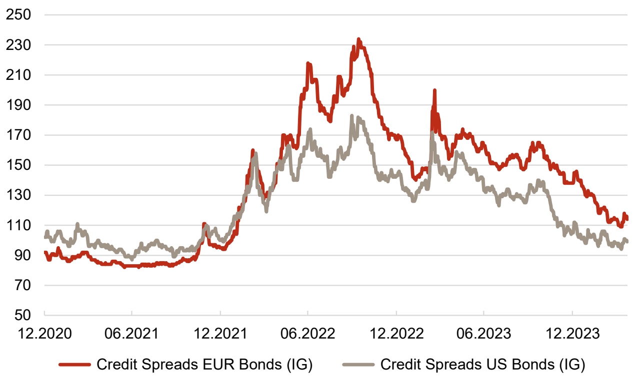
For all that it is primarily deficit-driven, the persistently strong growth of the US economy is maintaining the upward pressure on inflation – the economy is therefore stuck in a "non-landing" scenario. The risk of inflation remaining too high is in turn restricting the scope for manoeuvre of the US central bank (Fed) – a point conceded by Fed Chair Jerome Powell in recent statements. As things stand, the market is expecting less than two interest rate cuts of 25 basis points before the end of the year. This change in expectations has also resulted in an increase of the 10-year US Treasury yield to more than 4.6%.

Given Europe's significantly inferior economic development, the European Central Bank (ECB) is likely to be the more expansionary player in 2024. Thanks to a structurally strong currency and hence lower levels of inflation, the Swiss National Bank (SNB) has been able to lower its key interest rate for the first time.

But despite these differing developments, an essentially cautious positioning remains appropriate where the duration is concerned, as yield curves remain flat to inverted. The average duration in the portfolios currently stands at just over three years.

Exogenous shocks – taking the form of negative geopolitical events, for example – could yet turn out to be the joker in this interest rate game. Such developments could prompt central banks to initiate premature rate cuts in order to achieve a stabilising effect.

Credit spreads on corporate bonds (IG)



The risk premiums on fixed income securities have declined further. Despite an ailing economy and correspondingly high default risks, European bonds of investment-grade (IG) quality currently exhibit a risk premium of just 115 basis points – i.e. less than 1.2%. Meanwhile, their US counterparts are yielding just 99 bps (i.e. less than 1%) more than the risk-free rate achievable on US government bonds. Given the backdrop of significantly high indebtedness in many areas, the belated acceptance of interest rates remaining higher for longer, and bankruptcy figures having risen for the seventh quarter in succession, the level of compensation being offered to investors for the default risks they are taking on is simply too low. Our cautious credit positioning therefore remains unchanged.

Equities

Persistently strong growth figures essentially provide a positive backdrop for equities. Furthermore, the International Monetary Fund (IMF) has recently upgraded its 2024 growth forecast for the global economy by 0.1 percentage points to 3.2%. With inflationary pressure now expected to last for several months longer as a result, the last few weeks have seen the market downgrade its interest rate expectations as described above.

If interest rates do not come down to the expected extent, all asset prices will be directly and negatively affected. Given this backdrop, the equity market reverses of recent days look to be understandable in their magnitude but at the same time insufficient – either equity markets were too cheaply valued at the start of the year, and/or they are overvalued now. Indeed, some of the positive performance of equity markets in the first quarter of 2024 is attributable to an expansion of valuations – which is also a reflection of declining risk aversion on the part of the investment community.

As this alignment of risks points to a valuation correction, our equity allocation remains below the strategic target weighting for the time being. Within the equity quota we are switching a proportion of our Swiss equity exposure to US equities – in line with the strategic adjustments implemented at the start of the year.

Alternative Assets

Despite the persistently elevated level of interest rates, both gold and selected crypto investments continue to perform strongly and have temporarily recorded new highs. Both positions remain unchanged in the portfolio and can be expected to have a stabilising effect in the event of market turmoil.

Currencies

As a result of the increase in US equity exposure at the expense of Swiss equities, the USD proportion in the mixed risk profiles has risen by just under two percentage points. This proportion now stands at 9%, whereas the EUR proportion is unchanged at 5%. One of the consequences of the SNB embarking on a pathway of declining interest rates prior to other central banks is that currency hedging becomes more expensive – and acts as an obstacle to a lasting appreciation of CHF.

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Appendix

Economic and market development

GDP (E: Consensus)

	2023	2024E
USA	2.5%	2.4%
EU	0.5%	0.9%
Switzerland	0.7%	1.2%

Inflation (E: Consensus)

	2023	2024E
USA	4.1%	3.0%
EU	5.4%	2.3%
Switzerland	2.1%	1.3%

Central Bank Rates (higher)

	17.04.2024	Consensus
USA FED	5.5%	5.50%
EUR ECB	4.0%	3.75%
CHF SNB	1.5%	

Government Bonds (10 Year)

	17.04.2024	Outlook
USA	4.59%	4.15% – 4.40%
Germany	2.47%	2.25% – 2.55%
Switzerland	0.78%	0.60 – 0.85%

Foreign Exchanges

	17.04.2024	Outlook
EUR/CHF	0.972	0.95 – 0.99
USD/CHF	0.911	0.89 – 0.93
EUR/USD	1.067	1.05 – 1.09

Raw Materials and Alternatives

	17.04.2024	Outlook
Gold (USD/Ounce)	2'361	2'180 – 2'450
Oil (USD/Brent)	87.3	80 – 90
Bitcoin USD	60'855	55'000 – 75'000

Equity Markets

	P/E ø 5J.	P/E 2024	Div. Yield	Outlook
World	19.2x	16.5x	1.9%	slightly down
USA	21.0x	18.1x	1.4%	slightly down
Europe	15.8x	12.8x	3.2%	slightly down
Switzerland	19.9x	16.4x	3.0%	slightly down
Emerging Markets	13.8x	10.6x	2.8%	slightly down

Markets in Local Currencies

Equity Markets

	QTD	YTD
World	-4.5%	4.1%
USA	-4.4%	5.7%
Europe	-2.5%	5.1%
Switzerland	-3.5%	2.2%
Emerging Markets	-2.9%	-0.5%

Government Bond Yield (10 Year)

	17.04.2024	29.12.2023
USA	4.59%	3.88%
Germany	2.47%	-0.18%
Switzerland	0.78%	0.70%

Raw Materials and Alternatives

	QTD	YTD
Gold (USD/Ounce)	5.9%	14.4%
Oil (USD/Brent)	0.3%	18.5%
Bitcoin USD	-14.1%	45.1%

Foreign Exchanges

	QTD	YTD
EUR/CHF	-0.1%	4.6%
USD/CHF	1.0%	8.2%
EUR/USD	-1.1%	-3.3%

Data as of 17 April 2024, QTD: Performance since Beginning of Quarter, YTD: Performance since Beginning of Year