Monthly CIO Letter

15 July 2024

Equity markets have reached new peaks, but market breadth has narrowed further. Current valuation levels require growth. Combined with low implied volatility, this is not the moment to change the orientation of the portfolios – not least given the prevailing geopolitical risks. Risk diversification remains strong, the equity quota remains underweight, and the proportion of Bitcoin is being slightly increased.

Christoph Boner
Chief Investment Officer

Highlights

- A significant proportion of the rise in the prices of equities over the last few weeks is attributable to an expansion of valuation.
- This valuation surge increases the risk of a growth deficit.
- We are remaining cautious where the equity quota is concerned and are heading into high summer with a well-balanced allocation.

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	↑				●	

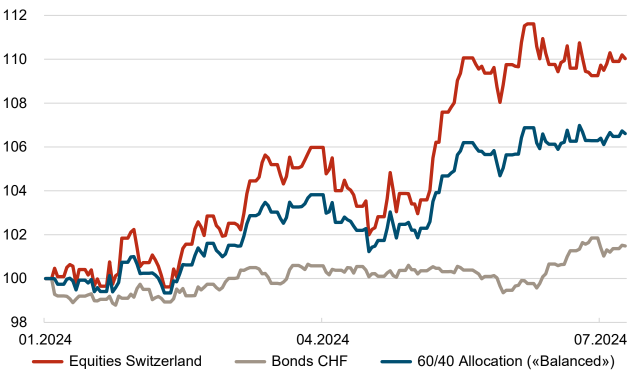
Change: compared to previous month, **Positioning**: -- strongly underweighted | - underweighted | = neutral | + overweighted | ++ strongly overweighted

Asset Allocation

The first half of 2024 is already in the rear-view mirror. Whereas the weather in our latitudes is proving reluctant to get in the summer mood, the equity market picture is altogether sunnier. A number of markets have recorded new highs, with the global equity market up just under 12% (in USD) for the first six months of the year. Bond markets too have performed positively for the most part, although here the greatest rewards came to those who took greater credit risks.

For a standard allocation of a CHF investor with a 60/40 portfolio, pre-cost performance works out at around 6% for the first half of 2024. Thanks to a broadly diversified strategy and an active allocation across the various markets, the post-cost performance of the corresponding mandates exceeded 7%.

First half of 2024: market development



The dominant theme during the first half the year was the development of interest rates – or to be more precise, interest rate expectations. Even though expectations of imminent cuts to key interest rates had to be significantly scaled back in the face of persistently stubborn inflation, neither equity nor bond markets came under pressure as a result. Even though interest rates coming down less sharply and quickly than expected should in theory result in declines in the prices of capital assets, expectations of higher growth can – likewise in theory – compensate for the dashing of rate-cutting fantasies. This narrative has taken hold, if nothing else at least to justify the way markets have developed in recent months.

The fact of the matter is that the great majority of the rise in global equity markets over the first half of 2024 – more than 70% indeed – is attributable to an expansion of valuation. And even though valuations could rise even further, higher valuation require higher growth, which by extension means the risk of growth falling short of expectations has increased. It is important not to lose sight of the fact that persistently elevated inflation figures and a tight labour market, particularly in the US, are essentially forcing central banks to constrain economic development in the interests of containing inflation.

Accordingly, we are leaving the equity quota slightly underweight at the level of 42% for a "Balanced" profile for the time being.

The bond quota for a balanced risk profile is being increased slightly to 40% through the purchase of short-dated high-yield instruments. The high credit quality of the portfolios is being maintained, and we are also remaining positioned for a normalisation of the US yield curve, as even if this normalisation is not expected to occur imminently, the waiting period is sweetened for us with a handsome current yield of around 5% p.a.

We are also maintaining our diversifying positions in gold and cryptocurrencies; where the latter is concerned, we have used the recent setbacks to the price of Bitcoin to (slightly) increase our exposure in the crypto area. As a further form of diversification, particularly in view of the ongoing geopolitical risks, we remain invested in oil of the Brent variant through an appropriate structure.

Bonds

The interest rate steps currently expected by the market by the end of 2024 – two cuts for the US, 1.5 for Europe, and just the one for Switzerland – look to be consistent with macroeconomic environment. The US economy continues to grow above potential and inflationary pressures remain. However, the labour market is showing the first signs of easing, consumption, measured by credit card defaults, also seems to have passed its peak, all of which will facilitate the first rate-cutting steps. Europe likewise has leeway for (further) rate cuts as the ongoing economic pain of various countries means that inflationary pressure is significantly less acute here. That said, both central banks – the Fed and the ECB – are likely to refrain from cutting rates in the absence of any clarity, as they will be mindful of expiring base effects and the ongoing risk of second-round effects.

In addition, political uncertainties will be factored into considerations: Populist programmes inevitably entail a significant increase in government expenditure and therefore aggregate demand. In the absence of any deadweight or substitution effects, this will have an inflation-stoking effect. It is worth noting that the absence of rate cuts provides central banks with the leeway to deploy supportive monetary policy measures, which is not insignificant in view of the ongoing geopolitical risks.

The bond allocation remains cautious. We are leaving the duration of the EUR bond market at 4.4 years and that of the CHF and USD markets at around three years. Credit risks likewise remain underweighted, although we are trimming our underweight position in high-yield bonds. Here we rely on global exposure with a duration close to zero and above-average credit quality. Even if the credit spreads in this area remain relatively narrow, unlike the market for bonds of higher quality (i.e. “investment grade”), the market for high-yield paper has undergone a structural improvement in quality in recent years, which makes a lower credit premium only logical.

Equities

Looking at global equity markets through a historical lens, it may be said that current valuations are slightly on the high side. For example, the broad US equity market is currently trading at a price-earnings ratio of just under 22; the average for the last five years stands at 19.5. Indeed, improvements in earnings over the last few months account for only a small proportion of equity price rises.

Global equity markets: earnings development and prices

This expansion of valuations, together with a decline in market breadth and evidence of strong risk appetite on the part of investors at the moment, has prompted us to keep our equity positioning slightly underweight. The allocation remains broadly diversified, and our decision to increase the Japan and emerging market quotas a month ago has paid off.

Within the equity quota, we are making a slight shift away from European equities to a a general global focus on automation. While AI-related enthusiasm is boosting selected technology stocks in particular, efforts on the part of Western economies to reduce dependency on China through industrial reshoring will provide a lasting tailwind for the theme of automation.

Alternative Assets

The diversification of the portfolios remains assured through the inclusion of gold, crypto investments and oil. We have taken advantage of recent setbacks to the price of Bitcoin to (slightly) increase the portfolio weighting of this leading cryptocurrency. This decision was not taken on valuation grounds alone – the ongoing institutionalisation of this market will result in a structural demand overhang that should prove beneficial to the price development of established crypto currencies. The diversification contribution made by gold and oil has been demonstrated many times in the past; we are consciously accepting the corresponding opportunity costs as a hedging premium.

Currencies

The recent tweaking of allocations has entailed only minor changes in the currency allocation. The reference currency proportion for a balanced profile remains at around 75%, with the USD proportion amounting to some 6% and the EUR proportion coming in at below 4%.

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Appendix

Economic and market development

GDP (E: Consensus)

	2023	2024E
USA	2.5%	2.3%
EU	0.5%	1.0%
Switzerland	0.8%	1.3%

Inflation (E: Consensus)

	2023	2024E
USA	4.1%	3.1%
EU	5.4%	2.4%
Switzerland	2.1%	1.3%

Central Bank Rates (higher)

	09.07.2024	Consensus
USA FED	5.5%	5.50%
EUR ECB	3.8%	3.75%
CHF SNB	1.3%	

Government Bonds (10 Year)

	09.07.2024	Outlook
USA	4.30%	4.20% – 4.40%
Germany	2.58%	2.40% – 2.65%
Switzerland	0.67%	0.60 – 0.80%

Foreign Exchanges

	09.07.2024	Outlook
EUR/CHF	0.971	0.95 – 0.99
USD/CHF	0.898	0.88 – 0.91
EUR/USD	1.081	1.06 – 1.09

Raw Materials and Alternatives

	09.07.2024	Outlook
Gold (USD/Ounce)	2'364	2'275 – 2'450
Oil (USD/Brent)	84.7	80 – 90
Bitcoin USD	57'928	55'000 – 75'000

Equity Markets

	P/E ø 5J.	P/E 2024	Div. Yield	Outlook
World	19.3x	17.9x	1.8%	slightly down
USA	21.2x	20.1x	1.3%	slightly down
Europe	15.8x	13.1x	3.3%	slightly down
Switzerland	19.9x	17.2x	3.0%	slightly down
Emerging Markets	13.8x	11.6x	2.5%	slightly down

Markets in Local Currencies

Equity Markets

	QTD	YTD
World	4.8%	14.2%
USA	6.5%	17.8%
Europe	1.7%	9.7%
Switzerland	3.8%	10.0%
Emerging Markets	7.8%	10.5%

Government Bond Yield (10 Year)

	09.07.2024	29.12.2023
USA	4.30%	3.88%
Germany	2.58%	-0.18%
Switzerland	0.67%	0.70%

Raw Materials and Alternatives

	QTD	YTD
Gold (USD/Ounce)	6.0%	14.6%
Oil (USD/Brent)	1.3%	20.5%
Bitcoin USD	-18.2%	38.1%

Foreign Exchanges

	QTD	YTD
EUR/CHF	-0.2%	4.5%
USD/CHF	-0.4%	6.7%
EUR/USD	0.2%	-2.0%

Data as of 9 July 2024, QTD: Performance since Beginning of Quarter, YTD: Performance since Beginning of Year