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Monthly CIO Letter

26 August 2024

Significant turmoil in the financial markets at the start of the month has given way to a rapid recovery. The latter is being driven primarily by hopes of imminent interest rate cuts. While the fundamental picture remains intact for the time being, growth expectations continue to look ambitious. We are leaving the equity quota at underweight, and are maintaining our broad diversification with a view to keeping the portfolios resilient in the face of the prevailing risks.

Christoph Boner
Chief Investment Officer

Highlights

– Various economic indicators and a few company results unleashed turmoil in the markets at the start of the month. But actually the fundamental picture has not changed to any material extent.

– In addition to persistently high growth expectations, it has been above all hopes of interest rates falling soon that have brought calm to markets and led to price recoveries in recent days.

– We are implementing a slight regional shift and remain broadly diversified overall with a cautious asset 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	➡			●		
World / Themes	➡	●				
Alternative Assets						
Gold	➡			●		
Crypto Assets	➡				●	
Other	➡	●				
Currencies						
CHF	➡		●			
EUR	➡				●	
USD	➡				●	

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

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Asset Allocation

Barely had the weather barometer switched to a sunnier outlook in Western Europe than the financial markets revealed their own significant capacity to change direction: In less than three weeks, the global equity market lost more than 8% of its value from the peak recorded in mid-July – when converted into Swiss francs, a strong currency effect increased this loss to more than 12%.

This reversal was triggered by a cluster of economic data that appeared to point to a slowdown of the US economy in particular. At the same time, a few key companies disappointed the market with their latest figures, which then sparked off growth fears. The downward pressure on equity markets was exacerbated by the (in some cases forced) unwinding of various positions in interest rate differential strategies.

In anticipation of this (necessary) economic cooling – how else are persistently elevated inflation rates to be tamed while the supply side is suffering from bottlenecks? – and against a backdrop of data showing that inflation is at least not rising once again, hopes of rapidly falling interest rates soon materialised.

In keeping with this change in interest rate expectations, bond markets recorded strong gains. For once the low correlation of bond and equity markets proved effective, helping to stabilise the performance of mixed portfolios.

The recent turbulence notwithstanding, we are leaving the equity quota slightly underweight at 42% for a "Balanced" profile for the time being. While the fundamental picture remains intact, current valuation levels imply quite lofty growth expectations – which does not sit well with persistent inflation. At the same time, growth fears have once again started to fuel rate-cutting fantasies in recent days. To this extent, the risks have once again shifted somewhat, namely away from growth expectations and in the direction of exaggerated rate-cutting hopes. The fact remains, however, that with valuations at their current levels there is an unhealthy amount of downside potential despite supportive fundamentals, and given this constellation we are currently refraining from any increase in the equity quota.

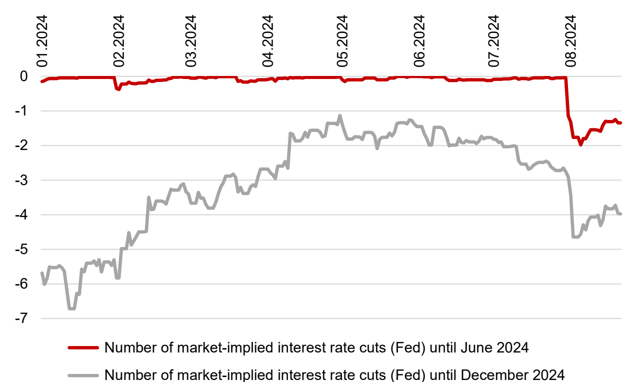
Having increased the bond quota a month ago, we are now leaving it at 40% for a balanced profile. We are continuing to ensure higher credit quality than the market and remain positioned for a normalisation of the US yield curve. The duration likewise remains short given a virtually non-existent time premium and prevailing interest rate expectations.

Our diversifying investments in gold and cryptocurrencies likewise remain in place. As an additional form of diversification, particularly in view of the ongoing geopolitical risks, we also remain invested in oil of the Brent variant through an appropriate structure.

Bonds

Whereas in July the market's expectations for interest rate cuts for 2024 – two for the US, 1.5 for Europe, and one for Switzerland – were aligned with the macroeconomic environment, the picture changed dramatically in the first few days of August. Weaker-than-expected indicators in respect of the outlook in the manufacturing sector followed by data revealing a slightly less tight labour market fuelled interest rate fantasies: The former could make more rapid rate cuts necessary to combat a growth slowdown, while the latter would actually allow for such a step to be taken thanks to waning inflationary pressure from the labour market.

2024 interest rate cuts: change in expectations



The market is now expecting 1.5 interest rate steps for the US by September – and even a double cut of 50 basis points is not ruled out. For Europe too, rate-cutting expectations have increased to more than 2.5 by the end of the year, even if the latest data on inflation has already started to rein in these expectations.

With the fundamental economic picture remaining essentially unchanged, it seems reasonable to assume that the rate-cutting steps expected by the market are once again slightly exaggerated. Closer analysis of the specific composition of inflation – with services sector prices as a strong driver – shows the persistence of inflation has explicable causes, quite

aside from the fact that base effects following energy price spikes have long since faded away.

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.

Equities

Even after the setbacks at the start of the month – and the ensuing counter-movements – equity markets remain slightly in overvalued territory when viewed in overall terms. Such a premium could easily be justified given sufficient growth or imminent cuts to interest rates.

And indeed, the fundamental picture remains extremely solid in the corporate sector too, with growth fears only being voiced in certain areas. For example, in the recent reporting season that is just drawing to a close, 73% of US companies in the wider S&P 500 Index have met or even exceeded expectations.

Despite this persistently promising fundamental backdrop, we are leaving the equity quota slightly underweight for the time being. There is still plenty of downside potential given the above-mentioned growth and interest rate expectations – and for good measure, the market is largely disregarding the geopolitical risks.

It should also be pointed out that the newly formed interest rate expectations have created something of a lose-lose situation for central banks – if their expectations are not met, the markets will be irritated. If expectations are met, this is likely to be interpreted by market participants as a clear sign of an alarmingly sharp slowdown in which case their reaction would more likely be more severe.

We have responded to the sharp corrections to the Japanese equity market by increasing our exposure to this market. At the same time, we have slightly reduced the Swiss equity quote.

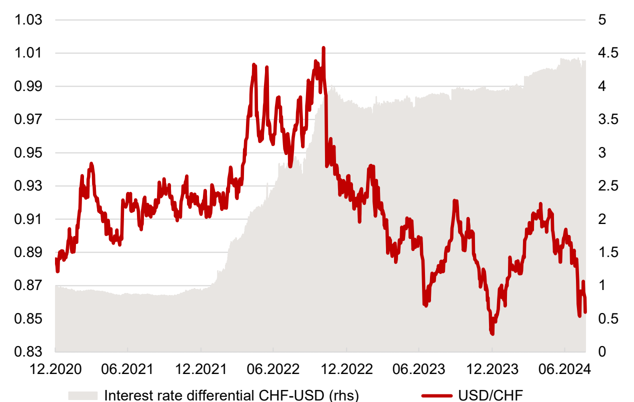
Alternative Assets

The diversification of the portfolios remains assured through the inclusion of gold, crypto investments and oil. The efficiency of gold and oil as diversifying instruments has a strong track record. Where crypto investments are concerned, we envisage a structural demand overhang thanks to increasing institutionalisation, which should act as an upward driver of prices in the future too.

Currencies

The recent capital market turmoil obviously did not pass the currency markets by. The Swiss franc once again lived up to its reputation as a place of refuge in a storm, appreciating against all other key currencies.

USD/CHF: Interest rate differential and price development



Despite the persistence of significant interest rate differences, we are maintaining our broad-based hedging of USD. 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%	1.1%
Switzerland	0.8%	1.3%

Inflation (E: Consensus)

	2023	2024E
USA	4.1%	3.0%
EU	5.4%	2.4%
Switzerland	2.1%	1.3%

Central Bank Rates (higher)

	20.08.2024	Consensus
USA FED	5.5%	5.25%
EUR ECB	3.8%	3.75%
CHF SNB	1.3%	

Government Bonds (10 Year)

	20.08.2024	Outlook
USA	3.81%	3.60% – 4.00%
Germany	2.22%	2.05% – 2.35%
Switzerland	0.39%	0.30 – 0.50%

Foreign Exchanges

	20.08.2024	Outlook
EUR/CHF	0.951	0.93 – 0.96
USD/CHF	0.854	0.84 – 0.87
EUR/USD	1.113	1.09 – 1.12

Raw Materials and Alternatives

	20.08.2024	Outlook
Gold (USD/Ounce)	2'514	2'350 – 2'600
Oil (USD/Brent)	77.2	75 – 85
Bitcoin USD	59'311	53'000 – 70'000

Equity Markets

	P/E ø 5J.	P/E 2024	Div. Yield	Outlook
World	19.4x	17.8x	1.8%	slightly down
USA	21.3x	20.2x	1.3%	slightly down
Europe	15.8x	11.8x	3.3%	slightly down
Switzerland	19.9x	17.8x	2.9%	slightly down
Emerging Markets	13.8x	11.3x	2.7%	slightly down

Markets in Local Currencies

Equity Markets

	QTD	YTD
World	6.0%	15.6%
USA	7.1%	18.4%
Europe	2.0%	10.0%
Switzerland	5.5%	11.8%
Emerging Markets	7.6%	10.2%

Government Bond Yield (10 Year)

	20.08.2024	29.12.2023
USA	3.81%	3.88%
Germany	2.22%	-0.18%
Switzerland	0.39%	0.70%

Raw Materials and Alternatives

	QTD	YTD
Gold (USD/Ounce)	12.7%	21.9%
Oil (USD/Brent)	-7.7%	9.7%
Bitcoin USD	-16.3%	41.4%

Foreign Exchanges

	QTD	YTD
EUR/CHF	-2.3%	2.3%
USD/CHF	-5.3%	1.5%
EUR/USD	3.2%	0.8%

Data as of 20 August 2024, QTD: Performance since Beginning of Quarter, YTD: Performance since Beginning of Year