Market Commentary
4th Quarter 2022

Challenging investment year ended

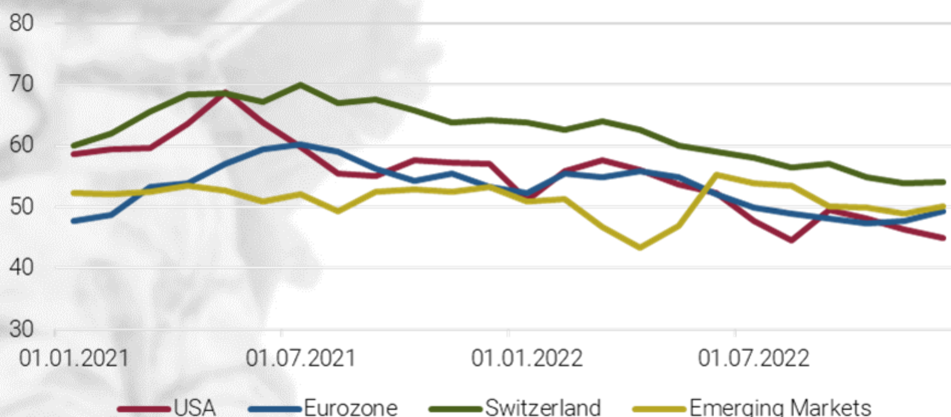
Business Activity and Global Economy

The past year 2022 was a challenging one which brought headwinds for the economy on several fronts. The Russian attack on Ukraine led to a massive price spike on international commodity markets, resulting in higher input prices for companies and causing a major problem for the manufacturing sector particularly in Europe. The higher prices for energy and other raw materials were passed on to end consumers wherever possible, who thus suffered the effects of higher prices not only for their personal energy consumption, but also for many other day-to-day consumer goods. This had a negative impact on consumer sentiment and thus further slowed demand after the "Covid reopening effect" had also slowly vanished. In addition, the more restrictive monetary and fiscal policy put a brake on the individual economic subjects, who were no longer supplied with equally cheap money as in previous years.

After more than two years of the pandemic, the corona virus continued to affect us last year. Although most Western countries have largely lifted the measures and restrictions, the world's second-largest economy, China, stuck to its "zero-covid policy" for a surprisingly long time. In addition to the resulting uncertainties and delays in supply chains, consumption in China also fell short of expectations. Despite the many challenges of the past year, it has been estimated that the developed economies are likely to post economic growth of between 1.5 and 2.5 percent year-on-year. While these growth figures look promising at first glance, they are significantly lower than in the previous year.

We continue to expect a challenging environment in 2023. Although visibility has improved again in recent weeks, many risk factors such as energy supply, restrictive monetary policy, high inflation, etc. remain in place also this year. In our base scenario, we currently assume a mild/technical recession.

Figure 1: Purchasing Managers Indices (Composite)



Source: Refinitiv, Datastream

Key Takeaways

- The economic environment is likely to remain challenging this year.
- In our base scenario, we expect a moderate weakening of the economy.
- The biggest risk factors for the economy are monetary policy and inflation, as well as energy supply.
- We expect that central banks will primarily implement the interest rate steps that have been priced in so far.

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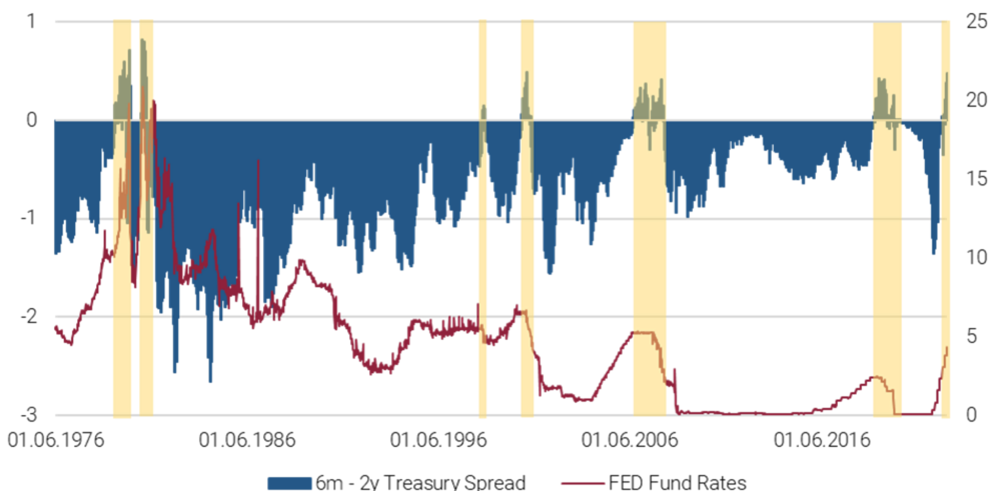
Monetary Policy

For monetary policy, 2022 was a year of transition. Due to excessive inflation, central banks were forced to return from a previously ultra-expansive to a restrictive monetary policy. In addition to a sharp increase in key interest rates, other monetary policy instruments such as bond purchasing programs were also applied more restrictively or, in some cases, suspended entirely. The goal is to withdraw enough liquidity from the markets to bring inflation rates back within the central banks' target range and thus to fulfill the mandate of price stability. The challenge, however, is to raise interest rates only as much as necessary without causing a recession and threatening market stability. Current monetary policy therefore remains a balancing act between fighting inflation and achieving economic growth.

In December, both the European Central Bank and the Fed in the USA as well as the Swiss National Bank raised their interest rates by another 50 basis points each. This leaves the key interest rates in the Eurozone at 2.5%, in the US at 4.5% and in Switzerland at 1.0%. The monetary guardians are still relatively cautious about a possible end to the interest rate hike cycle. Although inflation has peaked in most currency regions, it is still too early to declare an all-clear. Compared with the previous year, inflation rates are still well above the central banks' target. In addition, there is still a threat of so-called second-round effects due to the pressure for inflation compensation in wages. If this were to set in motion a wage-price spiral, as we know it from the theory of economics, inflationary momentum could pick up again despite the recent slowdown.

The yield curves in the major currency areas currently indicate a decreasing momentum in interest rate hikes. In the US, where the yield curve is still strongly inverted, two to three more interest rate hikes are currently priced in. In the Eurozone and Switzerland, the yield curve has now also inverted, indicating an end to interest rate hikes in the near future as well. We also expect that the central banks will only execute the interest rate steps that are currently priced in. In our view, the economic environment is too fragile for further major rate hikes to be implemented. A good indicator for an upcoming end of the rate hike cycle was a positive interest rate spread between the 6-month and 2-year U.S. Treasury (Figure 2). Therefore, the current spread implies that we are in the final phase of interest rate hikes.

Figure 2: US Treasury Spread and Fed Fund Rates



Source: Refinitiv, Datastream

Market Data

Equity Market Perf.	2022
SPI	-16.48%
DAX	-12.35%
Euro Stoxx 50	-8.83%
S&P 500	-18.11%
Nasdaq 100	-32.38%

Yield to Maturity Government Bonds	in %
10Y Swiss Federal Bond	1.61%
10Y German Federal Bond	2.56%
10Y US Treasury	3.83%

Gold oz. Perf.	2022
in CHF	1.16%
in EUR	6.16%
in USD	-0.37%

Commodities Perf.	2022
Crude Oil (Brent)	7.22%

In local currency, as of 31.12.2022
Source: Refinitiv, Datastream

Financial and Capital Markets

The past year was a year of turbulence for the financial and capital markets, and in many regards an exceptional one. Virtually all asset classes, with the exception of precious metals and some other commodities, posted a negative performance. Even bonds, which usually correlate negatively to equities in times of market turmoil, have lost double-digit percentages in value. As a result, traditional strategies (such as 60% equites /40% bonds) have had one of their worst years due to the lack of diversification provided by bonds. To make matters worse, commodities and precious metals were underrepresented in the portfolio allocation of most asset managers.

Due to very high inflation, central banks had to raise interest rates more than expected last year, which not only caused short-term interest rates to rise, but also increased the current yield of longer-dated bonds. These rate hikes not only triggered a rough correction in the bond markets, but also caused the stock markets to plummet. Due to higher interest rates, a company's future cash flows are valued lower, which is also reflected in a lower company valuation and thus a lower share price.

Figure 3: Performance of S&P 500 and 10-Year US Government Bonds

Source: Refinitiv, Datastream

For 2023, we anticipate a generally friendlier environment on the financial markets than last year, but do not rule out negative surprises. Interest rates have recovered to a level where selective bond purchases may be made. Should a recession materialize, bonds will again provide a better diversification contribution at current yields. Despite the valuation contraction triggered by the interest rate shift, equities are still relatively expensively priced. The interest rate hikes have probably been priced in by now and are no longer putting any significant pressure on valuations. Nevertheless, the earnings expectations for 2023 that have been priced in are relatively ambitious. If, contrary to expectations, a profit recession should emerge, further correction potential for equities is likely to exist.

Asset Allocation

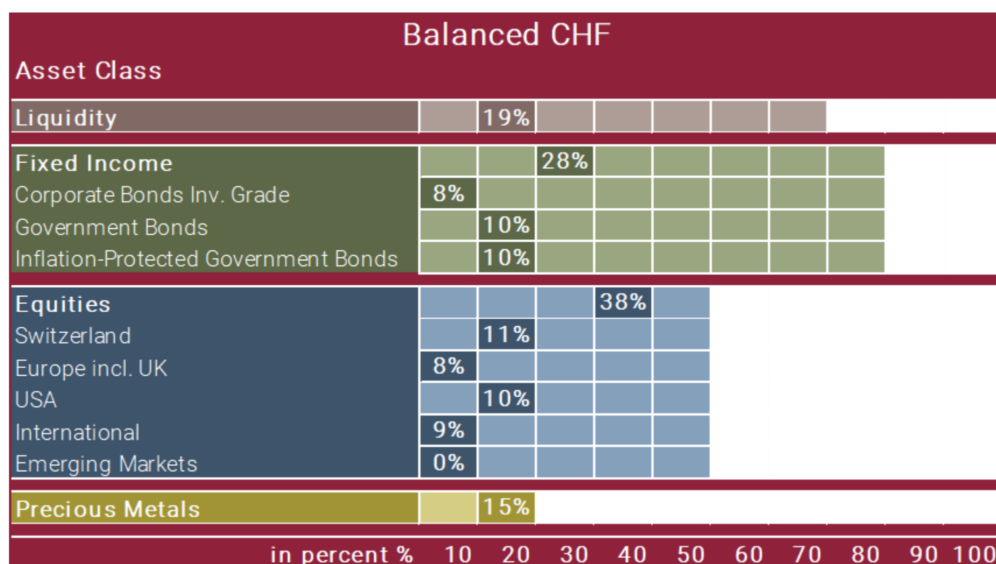
Asset Class	Positioning
Cash	Strong Overweight
Fixed Income	Underweight
Equities	Small Underweight
Gold	Strong Overweight

- For bonds, we continue to focus on high credit quality, but have reduced our strong underweight.
- For equities, we have again made tactical purchases and are currently only slightly underweighted.
- Physical gold remains an important diversification element in the portfolio.

Current Asset Allocation

We are still rather defensively positioned in our asset management strategies. After holding a strong underweight in equities for a long time in 2022, we made selective purchases in the last quarter of the year. Currently, we therefore only hold a slight underweight in equities and will make further purchases depending on the market situation. Due to the sharp rise in interest rates, we have also become buyers again in bonds and have also slightly reduced our very strong underweight. Purchases were mainly limited to government bonds with high credit quality. We still consider the time to be too early to take major credit risks again. Therefore, credit quality remains one of our most important selection criteria for fixed-income investments. Physical gold continues to be an important element in our portfolios. The portfolio contribution was positive last year for our Swiss Franc and Euro strategies. In U.S. Dollars, gold was virtually unchanged at year-end compared to the previous year.

Last year, our strategies in CHF, EUR as well as USD were able to achieve a high relative outperformance compared to the market. Our conservative asset allocation therefore paid off last year. With the current allocation of the portfolios, we feel well positioned for the new year. In addition, the overweight in physical gold continues to be a good hedge against unexpected events.



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