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PostFinance

Editorial A step in the right direction

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In January, the mood amongst industrial companies worldwide was more optimistic for the first time in a long while, increasing the chances that the recession in Germany and Europe's economic weakness won't continue for too much longer. While we remain cautious in this climate, we're responding to the improved situation by reducing our underweight position in European equities.

Philipp Merkt
Chief Investment Officer

Today – with some distance – we can look back slightly incredulously at 2020 and 2021, the years dominated by the pandemic: all of a sudden, our everyday lives were turned upside down. The impact of that dramatic period is still being felt – not least economically. Inflation rates in most countries still lie well above central bank targets, even though they're far lower than at their peak. Industry also faces a challenging situation worldwide.

"The European economy appears to have bottomed out."

This trend emerged during the pandemic when there was a huge spike in demand for goods. The restrictions imposed on movement and consumption as well as generous state support measures in many countries were major contributory factors. At its peak, demand for goods in the USA was around 10 percent above the expected level.

In this context, we indicated back in 2022 that the sharp rise in demand for goods could trigger a wave of inflation and that the subsequent slump in demand could lead to a recession. The risk appeared particularly high in the European economy, which is largely powered by Germany – the world's second biggest exporter of goods. In response to higher risk, we significantly reduced our European equity allocation twice over the course of 2022.

Now, almost two years on, we've seen an enormous rise in the level of prices. The European economy has stopped growing and Germany has actually entered recession. China, the world's biggest goods exporter, is also facing difficulties. So it's hardly surprising that industrial companies in many countries have been extremely pessimistic, at least until recently.

Sentiment among industrial companies improved considerably in January for the first time in years on a transregional basis. While companies remain cautious, the mood both in Europe and other industrial nations, too, is much more upbeat. Global demand for goods and the goods price trend have also stabilized recently. This has reduced the risk of another significant deterioration or a sustained slump in the European economy.

In combination with the sharp drop in inflation in the autumn, Europe's economic prospects have improved. We've responded to this positive development by reducing our underweight position in European equities. This decision also takes into account that upturns on the financial markets often begin before phases of economic weakness come to an end, but after the worst point is over. At the same time, we're aware the economic climate remains challenging and are maintaining slightly defensive positioning overall.

Positioning

Emerging hope

Sentiment in industry is more upbeat, giving rise to hopes in Europe that the worst of the economic downturn is over. We're reducing our underweight position in European equities, but remain defensively positioned overall.

Economic data from the USA indicates the economy remains robust. The US economy grew recently by 3.3 percent, which is still above trend. Consumer confidence and sentiment in the industrial and services sectors have also improved of late. This means there's currently no sign of a looming recession. The situation in Europe is rather different.

The slowdown in the region is more advanced, and is already being felt in Germany, the eurozone's biggest economy. Sentiment in the economy also remains low by historical standards. However, the mood in industry has improved considerably of late. This is the first sign that the worst of the recession may be over. With the downturn seemingly having bottomed out, Europe, in particular, appears to have taken a step towards recovery. In response, we're reducing our heavily underweighted position in European equities. We are maintaining a slight underweight, though, as we want to see clearer evidence that this bottoming-out process will last.

"With the downturn seemingly having bottomed out, Europe, in particular, appears to have taken a step towards recovery."

Monetary easing has become a more distant prospect

The situation is somewhat better, then, but still slightly unsettling overall. Inflation rates remain above target. Core inflation stands at 3.9 percent in the USA, and at 3.3 percent in Europe. The 2 percent target is still a good way off. Progress on reining inflation in has faltered recently. Rising wage inflation is a cause for concern in both the USA and Europe. Sharp cuts to policy rates imminently appear difficult to achieve in this climate, as we pointed out last month. Instead the pressure on long-term interest rates is being maintained.

Performance of asset classes

Asset class		1M in CHF	YTD [1] in CHF	1M in LCY [2]	YTD [1] in LCY [2]
Currencies	EUR	1.3%	1.4%	1.3%	1.4%
	USD	2.9%	3.9%	2.9%	3.9%
	JPY	0.4%	–1.1%	0.4%	–1.1%
Fixed Income	Switzerland	0.0%	–0.9%	0.0%	–0.9%
	World	1.8%	1.4%	–1.1%	–2.4%
	Emerging markets	3.7%	2.6%	0.9%	–1.2%
Equities	Switzerland	0.5%	0.6%	0.5%	0.6%
	World	7.7%	7.1%	4.7%	3.1%
	USA	9.5%	8.8%	6.4%	4.7%
	Eurozone	4.5%	3.6%	3.2%	2.2%
	United Kingdom	1.4%	1.9%	–0.7%	–1.1%
	Japan	7.5%	7.1%	7.1%	8.3%
	Emerging markets	2.9%	1.8%	0.1%	–2.0%
Alternative Investments	Swiss real estate	2.6%	3.0%	2.6%	3.0%
	Gold	2.1%	2.1%	–0.7%	–1.8%

1 Year-to-date: Since year start
2 Local currency

Data as of 7.2.2024
Source: Web Financial Group, MSCI, SIX, Bloomberg Barclays, J.P.Morgan

Swiss capital market interest rates have upside potential

We see further upside potential here, particularly in Switzerland. Not only are long-term interest rates at a much lower level than in other countries, they've also risen less sharply in the last two years due to more restrictive monetary policy. It means capital market interest rates in the USA and Europe have gone up five times more sharply than in Switzerland.

What's more, investors on the bond market are still in the unusual situation of being less well remunerated for longer terms than shorter ones. In Switzerland, investors can earn almost 2 percent on the money market, whereas 10-year Swiss bonds are yielding just under 1 percent. However, a normalization of the yield curve through reductions in interest rates alone seems unlikely in our view. It's more likely that capital market interest rates will also increase. This is the reason we still see both Swiss fixed income and Swiss real estate as relatively unattractive and remain under-weighted in these asset classes.

Positioning relative to long term strategy: Swiss focus

Asset class		**TAA[1] old**	**TAA[1] new**	**underweighted[3]** −−	−	**neutral[3]**	**overweighted[3]** +	++
Liquidity	**Total**	**11.0%**	**9.0%**					■
	CHF	1.0%	1.0%				■	
	Money market CHF	10.0%	8.0%					■
Fixed Income	**Total**	**31.0%**	**31.0%**		■			
	Switzerland	15.0%	15.0%		■			
	World[2]	10.0%	10.0%			■		
	Emerging markets[2]	6.0%	6.0%			■		
Equities	**Total**	**47.0%**	**49.0%**		■			
	Switzerland	25.0%	25.0%				■	
	USA	8.0%	8.0%		■			
	Eurozone	1.0%	3.0%		■			
	United Kingdom	2.0%	2.0%			■		
	Japan	2.0%	2.0%			■		
	Emerging markets	9.0%	9.0%				■	
Alternative Investments	**Total**	**11.0%**	**11.0%**			■		
	Swiss real estate	6.0%	6.0%		■			
	Gold	5.0%	5.0%			■		

1 Tactical Asset Allocation: short to mid-term orientation
2 Currency hedge to CHF
3 Positioning relative to our long-term asset allocation

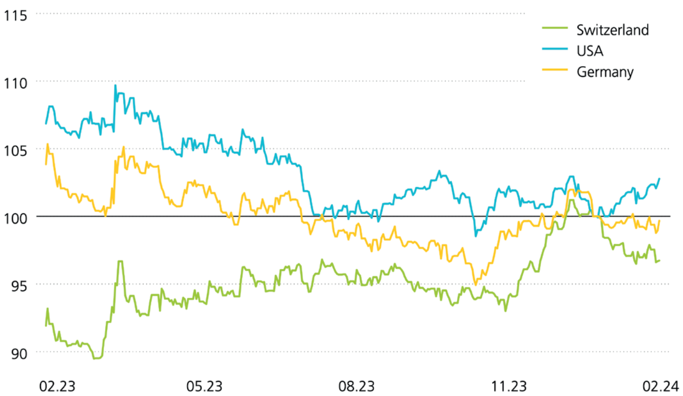
— Adjustment compared to last month

Market overview

Fixed income

An easing of monetary policy soon seems increasingly unlikely due to persistent inflationary pressure, which has caused capital market interest rates to rise sharply again.

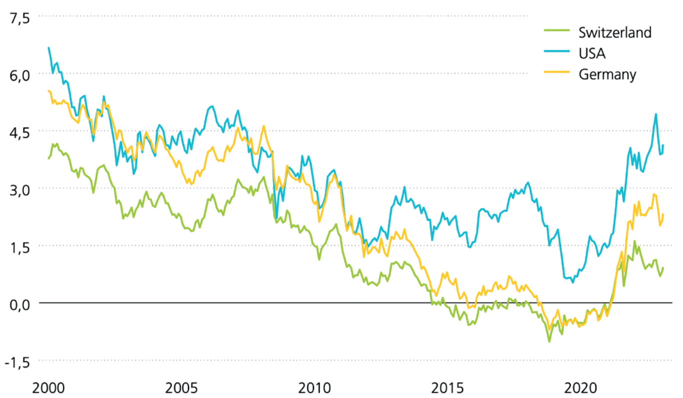
Indexed performance of government bonds in Swiss francs
100 = 01.01.2024



Last month, it became more apparent that imminent policy rate cuts aren't the most likely scenario. The still robust US economy and strong wage growth in many economic areas are keeping the pressure on monetary policy. The US Federal Reserve, European Central Bank and Bank of England also left their policy rates unchanged. The announcements made by the heads of these central banks indicate policy rate cuts aren't expected before the summer months. The bond markets slumped on this news. However, Swiss investors barely felt this downturn owing to the weaker Swiss franc.

Source: SIX, Bloomberg Barclays

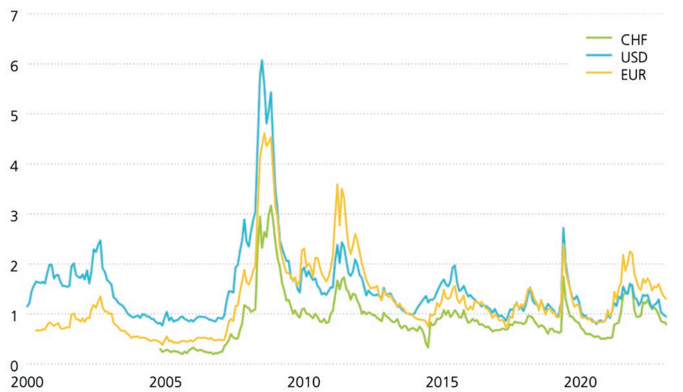
Trend in 10-year yields to maturity
In percent



Monetary easing has become a more distant prospect. This caused yields to maturity on 10-year government bonds to rise sharply again after a brief dip in early February. In the USA, yields to maturity now stand at 4.2 percent again – up by around 30 basis points on year-opening. The UK recorded the strongest upturn, with a rise of almost 40 basis points. The yields to maturity on Swiss federal bonds also followed this trend of rising interest rates and have now climbed to over 0.8 percent again.

Source: SIX, Bloomberg Barclays

Credit spreads on corporate bonds
In percentage points



Risk premiums on corporate bonds fell again last month, despite the long-term interest level trending upwards. This can be explained by the positive mood on the financial markets, especially the equity markets. The level remains remarkably low by historical standards, barely reflecting concerns about a recession.

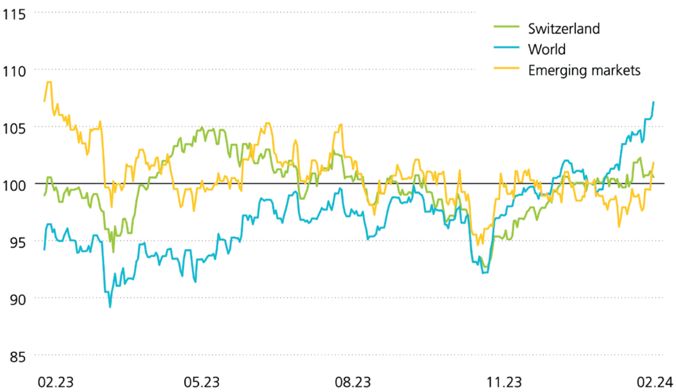
Source: Bloomberg Barclays

Market overview

Equities

The equity market resisted rising interest rates last month, making strong gains. Once again, tech stocks were the main driver, on the publication of strong annual results by the large technology companies in the USA.

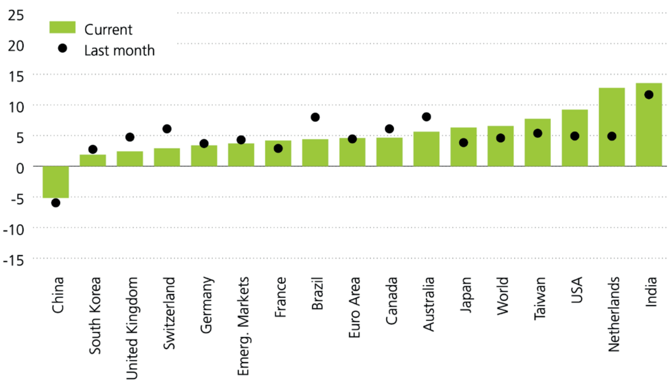
Indexed stock market performance in Swiss francs
100 = 01.01.2024



The stock market was unperturbed by dwindling hopes of an imminent easing of monetary policy. Instead, share prices rose considerably last month, with tech firms, in particular, making a huge contribution. These companies recently published impressive annual results in the USA, pushing equity prices up significantly. By contrast, the performance of the market as a whole was relatively modest. The Swiss equity market was particularly weak. Roche, the index heavyweight, was a major factor behind the subdued performance, with its share price falling more than 9 percent last month.

Source: SIX, MSCI

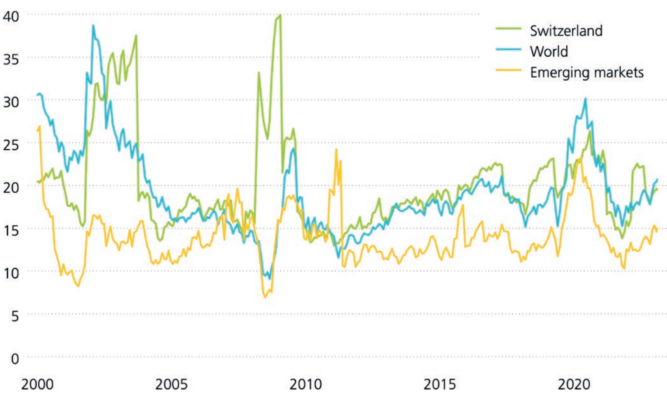
Momentum of individual markets
In percent



Optimism on the equity markets meant most of them experienced positive momentum. There was further upward impetus on the tech-heavy stock markets, such as the USA, Taiwan and the Netherlands. In contrast, the negative momentum intensified on the Chinese equity market, mainly due to the still-troubled real estate sector and challenging economic outlook.

Source: MSCI

Price/earnings ratio
P/E ratio



The price/earnings ratio of the equity markets improved significantly in many places again last month due to continued equity price rises. In contrast, the P/E ratio fell slightly in Switzerland. The recently published fall in profit and revenue at the pharmaceutical company Roche is likely to have been a major factor.

Source: SIX, MSCI

Market overview

Swiss real estate investments

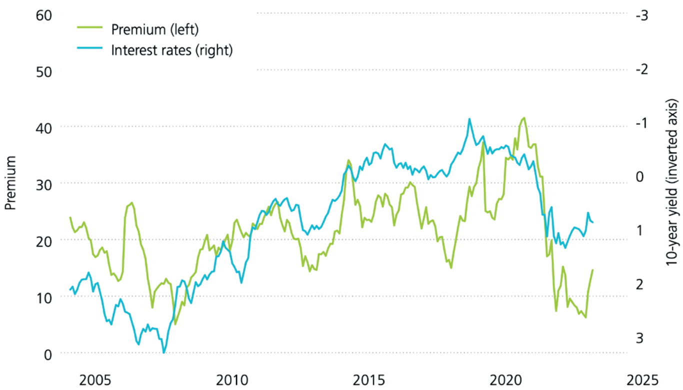
There has been another upturn in Swiss real estate investments. Although long-term interest rates have gone up since the start of the year, Swiss real estate funds have made substantial gains again.

Indexed performance of Swiss real estate funds
100 = 01.01.2024

Exchange-listed Swiss real estate funds have continued their sustained upward trend since November 2023, and their value increased significantly at the start of the year. They climbed by 3 percent in the first few weeks of 2024. The positive development was achieved despite the significant rise in long-term capital market interest rates. Yields to maturity on 10-year Swiss government bonds have increased since early January from below 0.7 percent to almost 0.9 percent. Higher rental incomes achieved due to the rise in the reference interest rate are likely to be a major reason for the increase in value.

Source: SIX

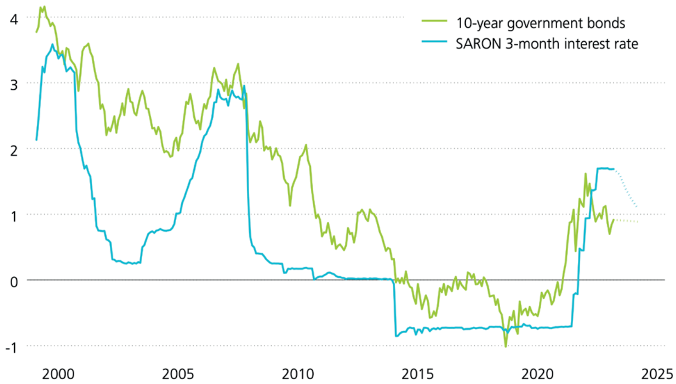
Premium on Swiss real estate funds and 10-year yields to maturity
In percent



The premium paid on exchange-listed real estate funds compared with the properties' net asset value has risen considerably over recent months. This is mainly due to the increase in the value of the real estate funds. In contrast, the NAV of many properties changed only slightly, which will come as a relief for many real estate investors. Due to the much higher interest level compared with the past 10 years, there were fears that the NAV of many properties would suffer a downward correction.

Source: SIX

3-month SARON and 10-year yields to maturity
In percent



Despite the recent rise, yields to maturity on 10-year Swiss government bonds remain well below the Swiss reference interest rate SARON. This means Swiss investors are still facing the exceptional situation of short-term interest rates being higher than long-term rates. The reverse is usually true and longer-term financing solutions are better remunerated than short-term ones due to the higher risks and greater opportunity costs involved. This means that when deciding on a mortgage term, expectations of potential interest rate cuts by the Swiss National Bank (SNB) are a key factor. Market participants currently anticipate that policy rates will be cut to around 1 percent by the end of the year.

Source: SIX

Market overview

Currencies

In the first few weeks of the new year, the US dollar appreciated considerably, interrupting its downward trend over the previous months. Exceptionally, the Swiss franc was one of the weaker currencies.

The start of the new year marked a trend reversal for many currencies. For example, the US dollar was the best-performing G10 currency in January, after depreciating significantly at the end of 2023. By early February, the US currency had gained by almost 3 percent on a trade-weighted basis. The strong performance was mainly due to the US economy's robust economic growth.

The Swiss franc also underwent a trend reversal. After a very strong year-end, the franc suffered an exceptional substantial fall in value in January. The Swiss National Bank's (SNB) announcement that it would intervene on the foreign exchange market again, if necessary, may have been a factor in the currency's depreciation. However, the Swiss franc is likely to appreciate again over the long term given comparatively low inflation.

Currency pair	Price	PPP [1]	Neutral area [2]	Valuation
EUR/CHF	0.94	0.89	0.82 – 0.96	Euro neutral
USD/CHF	0.87	0.79	0.69 – 0.89	USD neutral
GBP/CHF	1.10	1.20	1.04 – 1.37	Pound neutral
JPY/CHF	0.59	0.92	0.76 – 1.08	Yen undervalued
SEK/CHF	8.35	9.78	8.78 – 10.79	Krona undervalued
NOK/CHF	8.26	10.61	9.42 – 11.79	Krona undervalued
EUR/USD	1.08	1.13	0.98 – 1.27	Euro neutral
USD/JPY	148.19	86.32	67.62 – 105.01	Yen undervalued
USD/CNY	7.19	6.02	5.60 – 6.44	Renmimbi undervalued

[1] Purchasing power parity. This metric calculates an exchange rate using relative inflation rates.
[2] Range of historically normal fluctuations.

Source: Web Financial Group

Gold

The precious metal is still extremely popular at the start of the new year and remains stable above the mark of 2,000 US dollars per troy ounce.

Indexed performance of gold in Swiss francs
100 = 01.01.2024

The gold price changed only marginally in January and early February, maintaining its high level. Robust demand for the precious metal can be explained by various factors, including a number of geopolitical conflicts, little progress of late on combating inflation and greater uncertainty over investment in the Chinese market. Demand appears so strong that it has completely offset the appreciation effect of the US dollar. Appreciation of the US dollar, as we saw at the start of the year, usually causes the precious metal, which is traded in dollars, to fall in value.

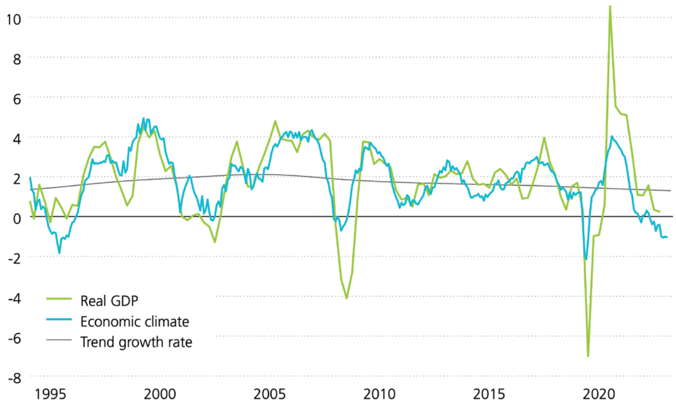
Source: Web Financial Group

Ray of hope in industry

Manufacturing is under huge pressure in many countries. The world's biggest exporters of goods, China and Germany, are actually in recession. That's partly due to the aftermath of the COVID-19 pandemic. During this period, many people cut their consumption of services both voluntarily and due to government restrictions, and substituted it for the consumption of goods. The resulting saturation has unsurprisingly led to a sharp decline in global demand for goods over recent months. However, sentiment indicators in industry improved on a broad basis for the first time in January. Goods prices also seem to be gradually stabilizing. While that's good news for the global economy, it may make it harder to bring down inflation further.

Switzerland

Growth, sentiment and trend
In percent

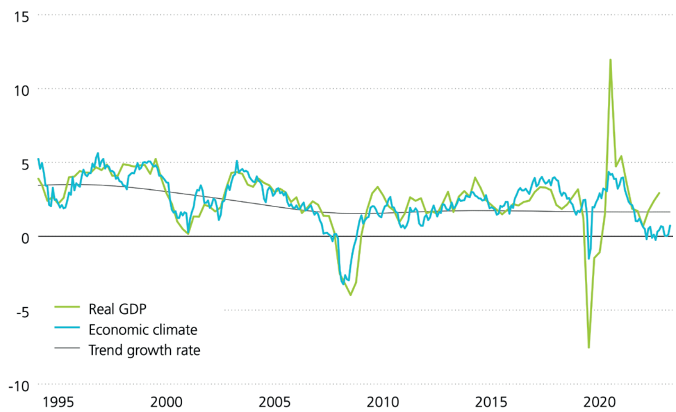


Source: Bloomberg

Swiss economic performance remains sluggish. Unlike many European countries and the USA, sentiment in industry hasn't improved recently. Order volumes and capacity utilization remain very low, reflecting the sustained downturn in manufacturing. The sector's performance would be even weaker without the chemicals and pharmaceutical sector, which is less sensitive to economic conditions. On a positive note from this perspective, the Swiss franc didn't appreciate further in the first few weeks of the new year. The services sector, which is more heavily focused on domestic consumption, is currently steady. This is despite the fact that Swiss consumer confidence remains low and inflation is likely to rise slightly again at the start of the year due to the adjustment to many administered prices – such as electricity prices, VAT and public transport fares.

USA

Growth, sentiment and trend
In percent

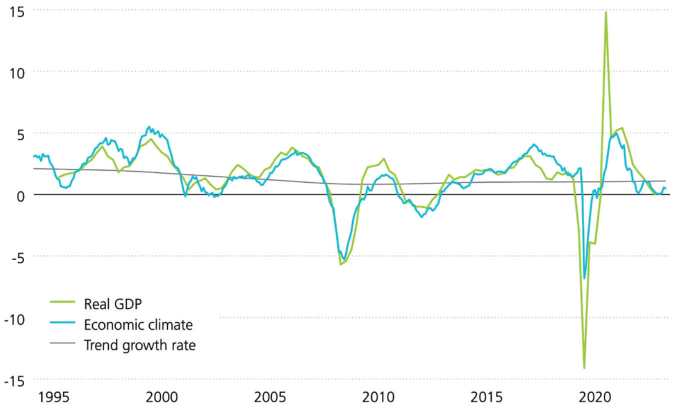


Source: Bloomberg

The US economy performed strongly again, growing by 0.8 percent in the fourth quarter of last year. The gains made by the world's biggest economy over the second six months of 2023 would normally take an entire year based on the long-term average. Growth was supported by all demand components, with private consumption, in particular, rising sharply again. Strong wage growth, which is currently outstripping inflation, may also support demand over the coming months. Besides positive numbers from the real economy, the mood in industry, among service providers and consumers also improved. However, this strong overall picture may keep price pressure high, presenting a growing challenge for the US Federal Reserve (Fed). Efforts to tackle inflation have been much less successful in recent months. Core inflation fell from 4.1 to just 3.9 percent from September to December 2023.

Eurozone

Growth, sentiment and trend
In percent

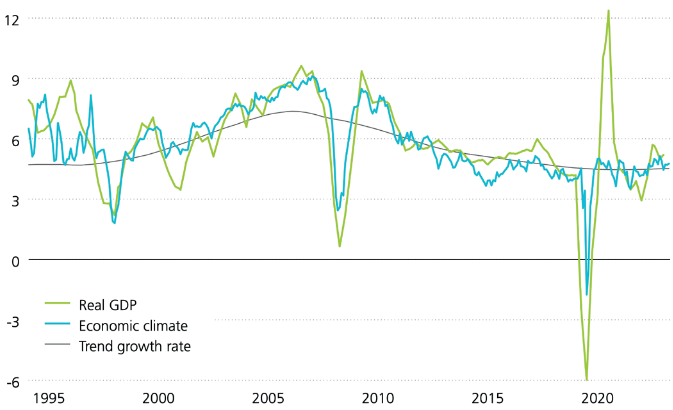


Source: Bloomberg

The recently published growth figures for the fourth quarter of 2023 show the huge impact of weak global demand for goods on the European economy. This resulted in zero growth for the eurozone as a whole, while Germany, the area's biggest economy, actually contracted by 0.3 percent. However, the latest economic figures weren't all bad news for once, as sentiment numbers and the business climate in industry were much more positive in January. This is the first clear improvement in sentiment in over a year. It's supported by hopes that the persistent recession in manufacturing will not worsen over the coming months. We're also seeing another positive sign in goods prices, whose downward trend came to a halt recently, and have now stabilized. Whether this represents a sustained trend reversal in the European economy remains to be seen over the coming months.

Emerging markets

Growth, sentiment and trend
In percent



Source: Bloomberg

Many emerging markets continue to significantly outperform industrial nations in terms of economic performance. The Indian economy, which posted impressive growth of 7.3 percent last year, is a major growth driver. China, the world's second biggest economy, is still facing major challenges though. On one hand, the situation in the crisis-hit real estate sector looks unlikely to improve soon. On the other, the economy remains weak, which is clearly reflected in the price trend. In January, Chinese inflation fell to –0.8 percent, remaining in deflationary territory. And there is no sign of any significant economic support measures from fiscal or monetary policy. The Chinese government appears to have resigned itself to the downturn to avoid further investment and prevent the real estate market from overheating even more.

Global economic data

Indicator	Switzerland	USA	Eurozone	UK	Japan	India	Brazil	China
GDP Y/Y [1] 2023Q3	0.3%	2.9%	0.0%	0.3%	1.2%	7.6%	2.0%	4.9%
GDP Y/Y [1] 2023Q4	n.a. [4]	3.1%	0.1%	n.a. [4]	n.a. [4]	n.a. [4]	n.a. [4]	5.2%
Economic climate [2]	↘	↘	↗	→	↗	↘	↘	↗
Trend growth [3]	1.3%	1.6%	0.8%	1.7%	1.1%	5.2%	1.5%	3.8%
Inflation	1.3%	3.1%	2.8%	4.0%	2.6%	5.7%	4.5%	–0.8%
Key rates	1.75%	5.5%	4.5% [5]	5.25%	–0.1%	6.5%	11.25%	4.35%

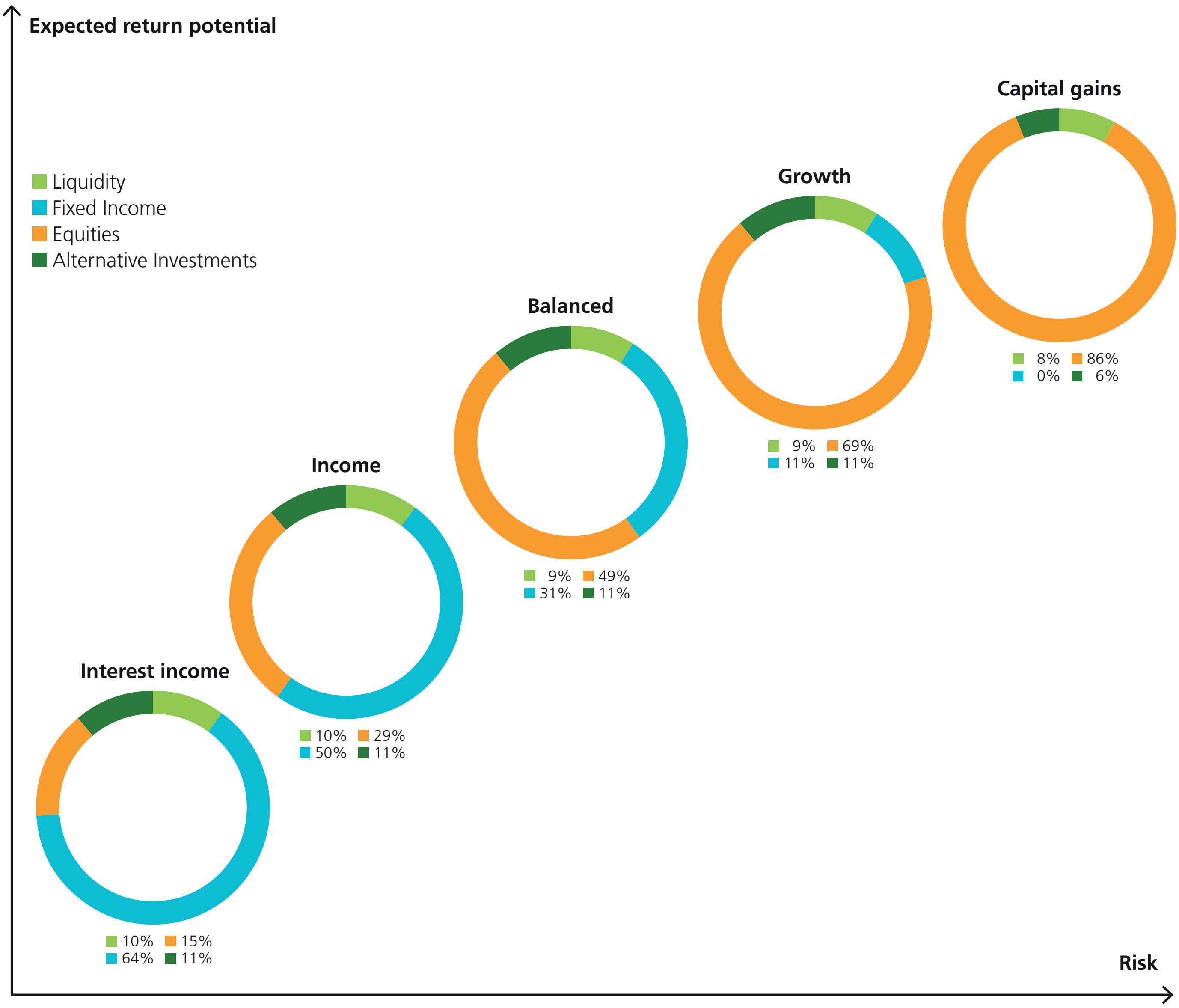
[1] Growth compared to year-ago quarter
[2] Indicator, measuring the overall sentiment and typically leading 1 to 2 quarters in advance of GDP. Green arrow indicates an increasing economic growth, red arrow a slowing.
[3] Potential growth. Long-term change in gross domestic product with sustainable capacity utilization.
[4] No data available
[5] This is the ECB's main refinancing rate, the deposit rate is 0.5 percentage points lower.

Source: Bloomberg

Model portfolios Swiss focus

Bottom formation

The economic environment remains difficult. The recession in the goods sector is weighing on the economies of Europe and China in particular. In addition, the leading economic indicators remain at a low level. However, the worst of the recession in the goods sector may be behind us. Sentiment in industry has improved for the first time in a long time and goods prices have also stopped falling recently and have even risen slightly. This seems to indicate that the economy is bottoming out. The European economy in particular could benefit from this. We are therefore slightly reducing our underweight in European equities. Overall, however, we remain defensively positioned.



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