PostFinance investment compass December 2022

PostFinance

Editorial

A contemplative Christmas

We're in the depths of the dark winter months. The days are short and temperatures have fallen. This time of year provides an opportunity to reflect and take stock.

Philipp Merkt
Chief Investment Officer

When you think of 2022, the first thing that comes to mind is people without somewhere warm to stay this winter. The Russian invasion of Ukraine has caused huge suffering for many people. That applies directly to those in the war zone as well as the many refugees. But it also applies to everyone struggling to meet the cost of everyday living due to the increase in energy prices and general inflation.

"The markets still haven't found the right balance, but we hope to see this happen in the new year."

2022 wasn't an easy year, even for those whose survival wasn't directly under threat. Higher inflation has eroded our purchasing power and the value of our savings. Rapid and sharp interest rate rises have seen our assets fall in value and threaten to add to accommodation costs. It's hardly surprising that consumers all over the world are much more concerned this year. If we believe the various consumer confidence indicators in the industrial nations, people have never been as pessimistic about their economic futures as right now.

The mood is also gloomy in Switzerland. Even though we're faring much better than our European neighbours, Swiss consumer confidence has hit an all-time low. This is reflected in day-to-day spending. The calculation of our own PostFinance consumption indicator, for which we use anonymized payment transaction data from PostFinance customers, clearly shows that nominal household spending has been falling again since the summer. The high inflation we're seeing at the moment makes this development all the more alarming. It means the decline must be considerable when adjusted for inflation.

We think that's another reason to be cautious when investing. Our consumption indicator bears out the overall results from our analysis of the leading economic indicators. The signs point to a further slowdown in growth momentum, and probably even a recession in the first half of 2023.

On top of lower growth, there's persistently high inflation. Interest rates are still below (core) inflation in the key currencies. That's something the central banks cannot and should not ignore. They'll continue trying to halt the inflation trend with interest rate hikes. But rising interest rates and lower growth are toxic for the financial markets. That's why we advise continuing to adopt a cautious approach to financial market risks.

However, we are confident that we'll find a new balance between interest rates and inflation and, as a result, equilibrium on the financial markets next year. That may not happen immediately and could take a few months. We think it's highly unlikely that the new year will be as challenging as 2022.

Positioning

The markets are already celebrating Christmas

Will we see the January blues after Christmas gift-giving? The economic environment means cautious portfolio positioning, at least, is advised at the turn of the year.

The financial markets handed out their Christmas presents early this year. They've been making up ground strongly since the start of the fourth quarter. Global share prices recorded their best start to the final quarter for 20 years. Falling interest rates may once again have been the main driver of share prices. But in the case of Chinese equities, it was the Chinese government's decision to relax its zero-COVID-19 strategy that saw prices rise by almost 30 percent in November alone. And the rally wasn't just limited to the equity markets. Bonds also made strong gains in November thanks to falling capital market interest rates.

Lower corporate profits in future

It may be difficult for the financial markets to carry this strong momentum into the new year. They've already taken a breather – and rightly so, in our view. The investment environment is proving challenging at the end of the year, especially on the equity markets.

"Investors will have to say goodbye to record corporate margins and earnings over the next few quarters."

Performance of asset classes

Asset class		1M in CHF	YTD [1] in CHF	1M in LCY [2]	YTD [1] in LCY [2]
Currencies	EUR	–0.5%	–4.7%	–0.5%	–4.7%
	USD	–4.9%	2.6%	–4.9%	2.6%
	JPY	1.3%	–13.6%	1.3%	–13.6%
Fixed Income	Switzerland	2.4%	–8.7%	2.4%	–8.7%
	World	1.2%	–12.6%	6.5%	–14.9%
	Emerging markets	2.6%	–15.1%	7.9%	–17.2%
Equities	Switzerland	1.3%	–14.8%	1.3%	–14.8%
	World	–0.5%	–13.9%	4.7%	–16.1%
	USA	–1.5%	–15.1%	3.6%	–17.3%
	Eurozone	3.8%	–14.4%	4.3%	–10.1%
	United Kingdom	3.4%	–0.3%	2.6%	7.3%
	Japan	0.3%	–14.9%	–1.0%	–1.5%
	Emerging markets	2.6%	–17.1%	7.9%	–19.2%
Alternative Investments	Swiss real estate	–1.0%	–18.7%	–1.0%	–18.7%
	Gold	1.4%	1.7%	6.6%	–0.9%

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

Data as of 8.12.2022
Source: Web Financial Group, MSCI, SIX, Bloomberg Barclays, J.P.Morgan

Over the next few quarters, investors will have to say goodbye to the record margins and earnings that companies worldwide have been posting for the last two years. Consumers are gradually yielding. The decline in consumption, as shown by the PostFinance consumption indicator for Switzerland, has also occurred in Europe and the USA. Less purchasing power due to inflation has made consumers more cautious. Companies may find it more difficult to pass on higher salary, energy and raw material costs to consumers in the short term. They're increasingly having to absorb higher costs by reducing their margins and, in turn, their profits.

We don't think this trend is sufficiently reflected on the equity markets at the moment, given the expectations of companies and equity market analysts. This means we're adopting cautious positioning in the portfolios entrusted to us as we head into the new year. With a sizeable cash quota, we've got enough liquidity available to purchase more shares selectively in the event of dips.

Asian equity markets have an advantage

We're particularly sceptical about equity markets in the industrial nations. We remain fully invested in Asia and the emerging markets. Very low valuations in some cases, coupled with a far less daunting inflation trend, are advantages for these regions in our view.

Robust rental income as a defensive hedge

On the other hand, we don't expect to see much margin pressure on listed Swiss real estate investments. While recession and the resulting decline in consumer spending are likely to lead to a fall in corporate earnings, rental income will barely be affected in the short term. We see listed real estate funds, which primarily invest in residential property, as a defensive investment in the current environment. After the sharp fall in prices this year, valuations are now attractive, relative to the interest rate environment.

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%**	**11.0%**					
	CHF	11.0%	11.0%					
Fixed Income	**Total**	**29.0%**	**29.0%**					
	Switzerland	17.0%	17.0%					
	World[2]	6.0%	6.0%					
	Emerging markets[2]	6.0%	6.0%					
Equities	**Total**	**44.0%**	**44.0%**					
	Switzerland	23.0%	23.0%					
	USA	8.0%	8.0%					
	Eurozone	1.0%	1.0%					
	United Kingdom	2.0%	2.0%					
	Japan	2.0%	2.0%					
	Emerging markets	8.0%	8.0%					
Alternative Investments	**Total**	**16.0%**	**16.0%**					
	Swiss real estate	11.0%	11.0%					
	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

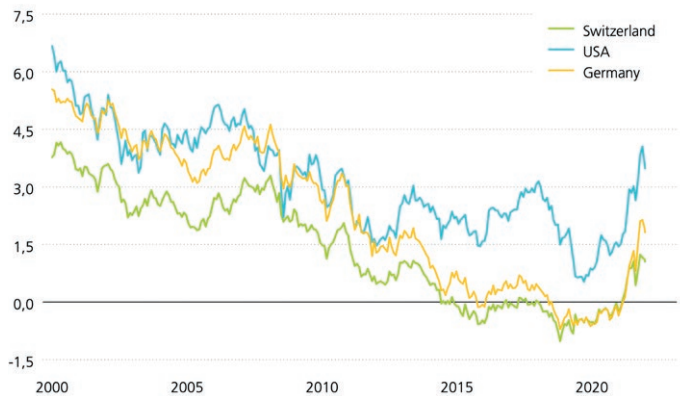
The bond markets once again touched their lows for the year in October. They recovered in November after the inflation trend gradually eased.

Indexed performance of government bonds in Swiss francs
100 = 01.01.2022

Last year was not a good one for the bond markets, which suffered record-high losses. The value of Swiss government bonds briefly fell by around 15 percent, and their German counterparts by over 20 percent. The was due to concerns over runaway inflation, which hit record highs in many places. However, there's been a turnaround in momentum recently. US inflation has been falling since June, and the price trend also declined in the eurozone for the first time in November. This saw a mood of greater optimism return to the bond markets. 10-year Swiss bonds rose by 2 percent last month.

Source: SIX, Bloomberg Barclays

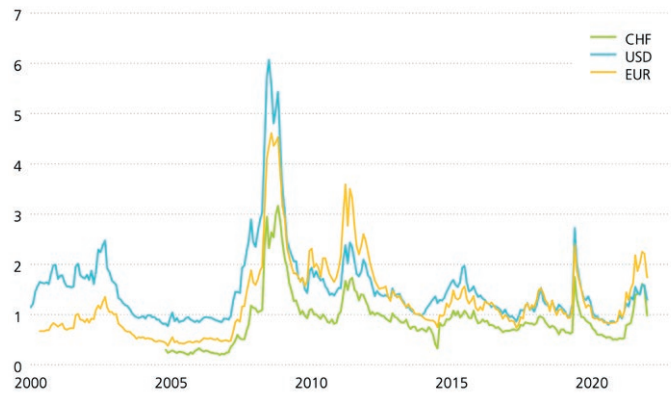
Trend in 10-year yields to maturity
In percent



Yields to maturity on government bonds fell sharply last month. Given lower inflation figures in many places, market participants viewed the situation as less risky and demanded slightly lower interest rates as a result. This trend was particularly evident in the USA. While yields to maturity on 10-year US government bonds stood at around 4.5 percent in early November, they are now at 3.5 percent.

Source: SIX, Bloomberg Barclays

Credit spreads on corporate bonds
In percentage points



The ongoing decline in credit spreads on corporate bonds was also striking last month. This means investors now view the market environment much more positively than during the summer months. The credit spreads on corporate bonds issued in euros are now below the 2 percent mark again on average, while their counterparts in Swiss francs now stand at 1 percent again.

Source: Bloomberg Barclays

Market overview
Equities

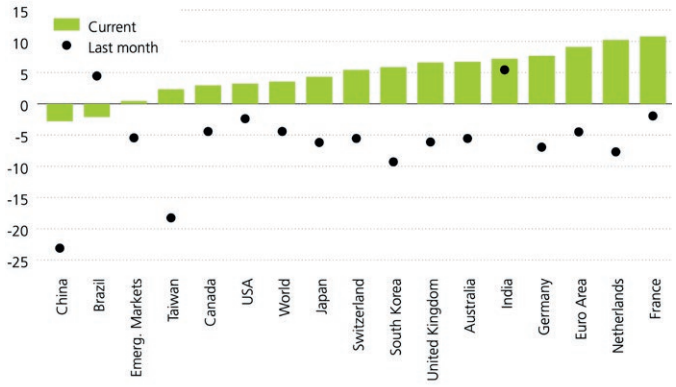
The equity markets suffered heavy losses this year. However, momentum turned at the start of the final quarter as the equity markets began their recovery rally.

Indexed stock market performance in Swiss francs
100 = 01.01.2022

The equity markets recorded huge losses this year, moving from one low to another, and across almost all sectors. But momentum turned abruptly at the start of the fourth quarter. The previous month's losses had already been recouped in October. A continuation of the rally in November meant that losses have actually halved in the year to date.

Source: SIX, MSCI

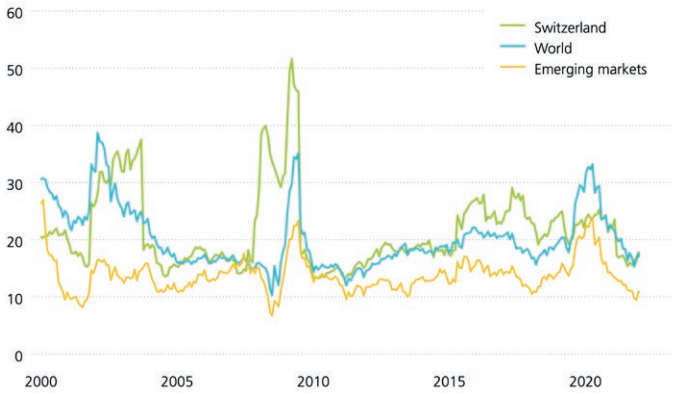
Momentum of individual markets
In percent



The trend reversal on the global equity markets is clearly being felt. Momentum improved across all regions last month, and is now back in positive territory – except for China and Brazil. China, in particular, faces huge challenges at the moment: the economy hasn't found its way out of trouble yet, and the government only recently relented after nationwide protests and started to relax its zero-COVID-19 policy. Equity prices fell sharply in this challenging environment, although there has been a reversal in momentum over recent weeks.

Source: MSCI

Price/earnings ratio
P/E ratio



The price/earnings ratio (P/E ratio) – a popular valuation standard for equities – has fallen sharply worldwide since summer 2020 due to rising corporate earnings and falling equity prices over the first three quarters of this year. The recovery rally during the fourth quarter and generally flat corporate earnings means the downward trend has not intensified, but instead we are seeing moderate upward momentum. The P/E ratios for Swiss equities are in line with the global average, with shares trading at around 18 times earnings.

Source: SIX, MSCI

Market overview

Swiss real estate investments

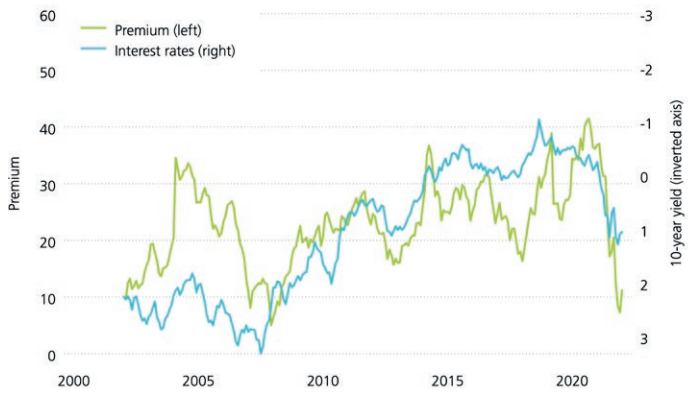
The cautious optimism on the global real estate markets has stabilized the prices of listed real estate investments.

Indexed performance of Swiss real estate funds
100 = 01.01.2022

Real estate investments were not spared the impact of higher capital market interest rates this year, and also suffered losses. The return of cautious optimism during the fourth quarter brought the negative momentum of real estate investments to an end. Swiss listed real estate funds actually gained by just under 1 percent last month.

Source: SIX

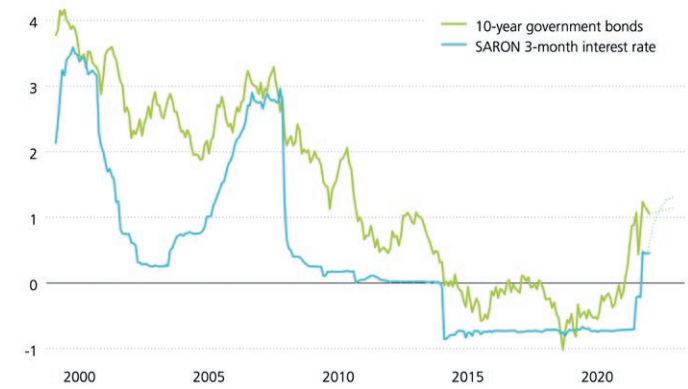
Premium on Swiss real estate funds and 10-year yields to maturity
In percent



The premiums on the Swiss real estate market remain very low. While real estate prices rose slightly worldwide last month, the upward trend was minimal in Switzerland. The premiums – the supplement paid on the inventory values of the properties – remain at a very low level compared with the long-term average.

Source: SIX

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



Interest rates on long-term mortgages in Switzerland fell slightly again recently. This is because yields to maturity on bonds have decreased slightly. Mortgage rates are based on bond yields. Variable Saron mortgages may become more expensive if the Swiss National Bank raises its key rate again as market participants expect.

Source: SIX

Market overview

Currencies

The strengthening of the US dollar dominated the currency markets this year.
Only recently has the US currency looked unable to further strengthen its dominant position.
By contrast, the Japanese yen gained in value.

The US dollar has only headed in one direction this year, and that's upward. In such difficult circumstances, the other currencies have struggled to hold their ground. In October, it seemed as though a trend reversal had begun: since the start of the fourth quarter, the dollar has fallen by over 7 percent on a trade-weighted basis. By contrast, the Japanese yen has shaken off its lethargy, and gained by over 2 percent last month. The pound sterling, Swedish krona and Norwegian krone also strengthened recently.

Currency pair	Price	PPP [1]	Neutral area [2]	Valuation
EUR/CHF	0.99	0.79	0.73–0.85	Euro overvalued
USD/CHF	0.94	0.76	0.67–0.86	USD overvalued
GBP/CHF	1.15	1.20	1.04–1.36	Pound neutral
JPY/CHF	0.69	0.95	0.79–1.10	Yen undervalued
SEK/CHF	9.07	9.83	8.84–10.82	Krona neutral
NOK/CHF	9.40	10.67	9.53–11.80	Krona neutral
EUR/USD	1.06	1.04	0.90–1.17	Euro neutral
USD/JPY	136.65	80.48	64.36–96.60	Yen undervalued
USD/CNY	6.97	5.59	5.27 – 5.91	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

November was a good month for gold. The price per troy ounce rose by almost 150 US dollars.

Indexed performance of gold in Swiss francs
100 = 01.01.2022

The gold price has undergone major fluctuations in recent weeks, particularly from the perspective of investors in US dollars. However, there was significant upward momentum last month: the gold price per troy ounce gained by almost 150 US dollars, and briefly even exceeded the 1,800-US-dollar mark. From the perspective of Swiss investors, the precious metal proved a significant stabilizer in the portfolio this year.

Source: Web Financial Group

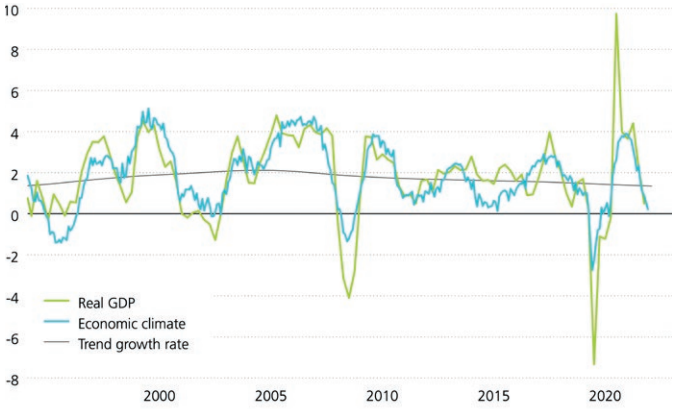
Economy

Uncertainty at the turn of the year

Consumer confidence remains extremely low worldwide. Business optimism is gradually dwindling. With inflation still excessively high, there are growing fears of recession.

Switzerland

Growth, sentiment and trend
In percent

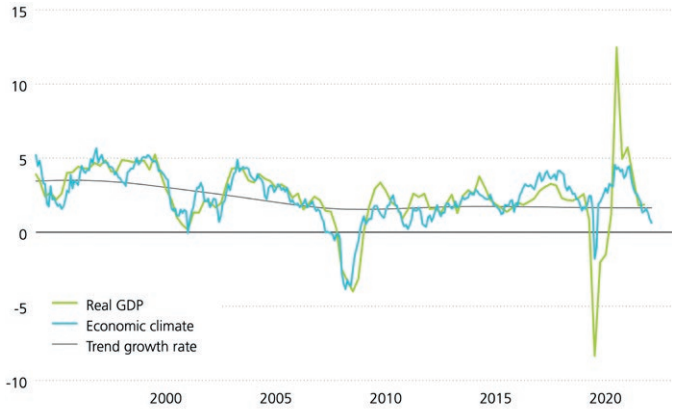


Source: Bloomberg

The Swiss economy grew by just 0.2 percent in the third quarter, which means the global slowdown in growth has now reached Switzerland, too. Whereas private consumption rose strongly again despite record-low consumer confidence about the future, value creation in the construction industry fell for the fourth consecutive quarter. Financial service providers also experienced their second negative quarter. Meanwhile, leading economic indicators deteriorated again last month. The good news was inflation not rising again for the time being. With a stable labour market and inflation currently moderate, there's a good chance the economic downturn will be milder in Switzerland than in the rest of Europe.

USA

Growth, sentiment and trend
In percent

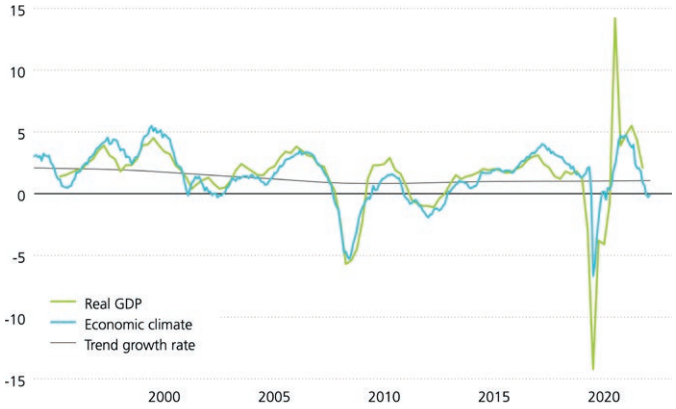


Source: Bloomberg

US inflation seems to have peaked. Consumer price inflation has fallen back below 8 percent for the first time since February. Sentiment amongst private households improved slightly. But it remains at levels last seen during the depths of the financial crisis or in the second oil crisis during the 1970s. There's also growing pessimism in industry. Order volumes have been rising at a slower pace than production for some time. Only service providers have reported an improved situation. That's against a backdrop of a labour market still showing employment growth. But this seems increasingly under threat from the very weak performance of the US real estate market.

Eurozone

Growth, sentiment and trend
In percent

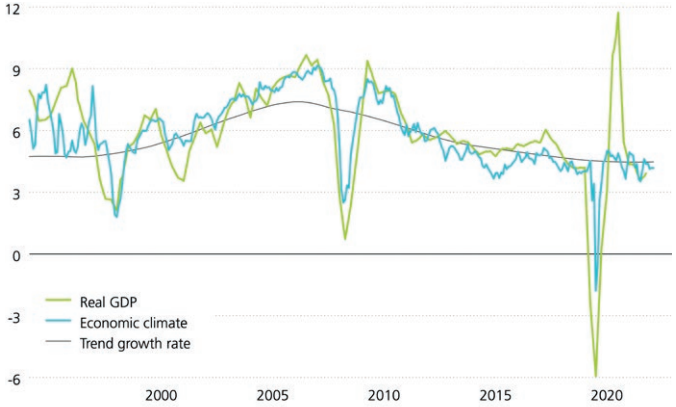


Source: Bloomberg

Sentiment among economic participants in Europe is also depressingly poor. On top of the gloomy global economic outlook and very high inflation, there's immediate concern over temporary outages of electricity and gas. In the Eastern European countries at least, concerns over a direct threat from Russia are probably also contributing to people's pessimistic outlook. The economic figures deteriorated again recently across the board. Only gas prices have eased from their excessive levels during the period of hectic filling-up of German gas storage facilities. However, economic growth is expected to suffer a further decrease in momentum.

Emerging markets

Growth, sentiment and trend
In percent



Source: Bloomberg

China remains the problem child for economic development in the emerging markets. As one of the world's two biggest economies, China is also holding back the global economy. Business sentiment worsened significantly last month owing to the government's zero-COVID-19 policy. Industrial production is barely growing, while the economy's import and export levels have declined by over 10 percent compared with the previous year. However, the recent relaxation of measures to combat the pandemic provide hope that the economy has bottomed out. By contrast, the Indian economy remains on its growth path, at least giving the South-East Asia region positive momentum.

Global economic data

Indicator	Switzerland	USA	Eurozone	UK	Japan	India	Brazil	China
GDP Y/Y [1] 2022Q2	2.2%	1.8%	4.3%	4.4%	1.6%	13.5%	3.7%	0.4%
GDP Y/Y [1] 2022Q3	0.5%	1.9%	2.3%	2.4%	1.5%	6.3%	3.6%	3.9%
Economic climate [2]	↘	↘	↘	↘	↘	↘	↘	↘
Trend growth [3]	1.3%	1.6%	0.8%	1.7%	1.1%	5.1%	1.3%	4.0%
Inflation	3.0%	7.7%	10.0%	11.1%	3.7%	5.9%	5.9%	1.6%
Key rates	1.0%	4.25%	2.5%	3.5%	–0.1%	6.3%	13.75%	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.

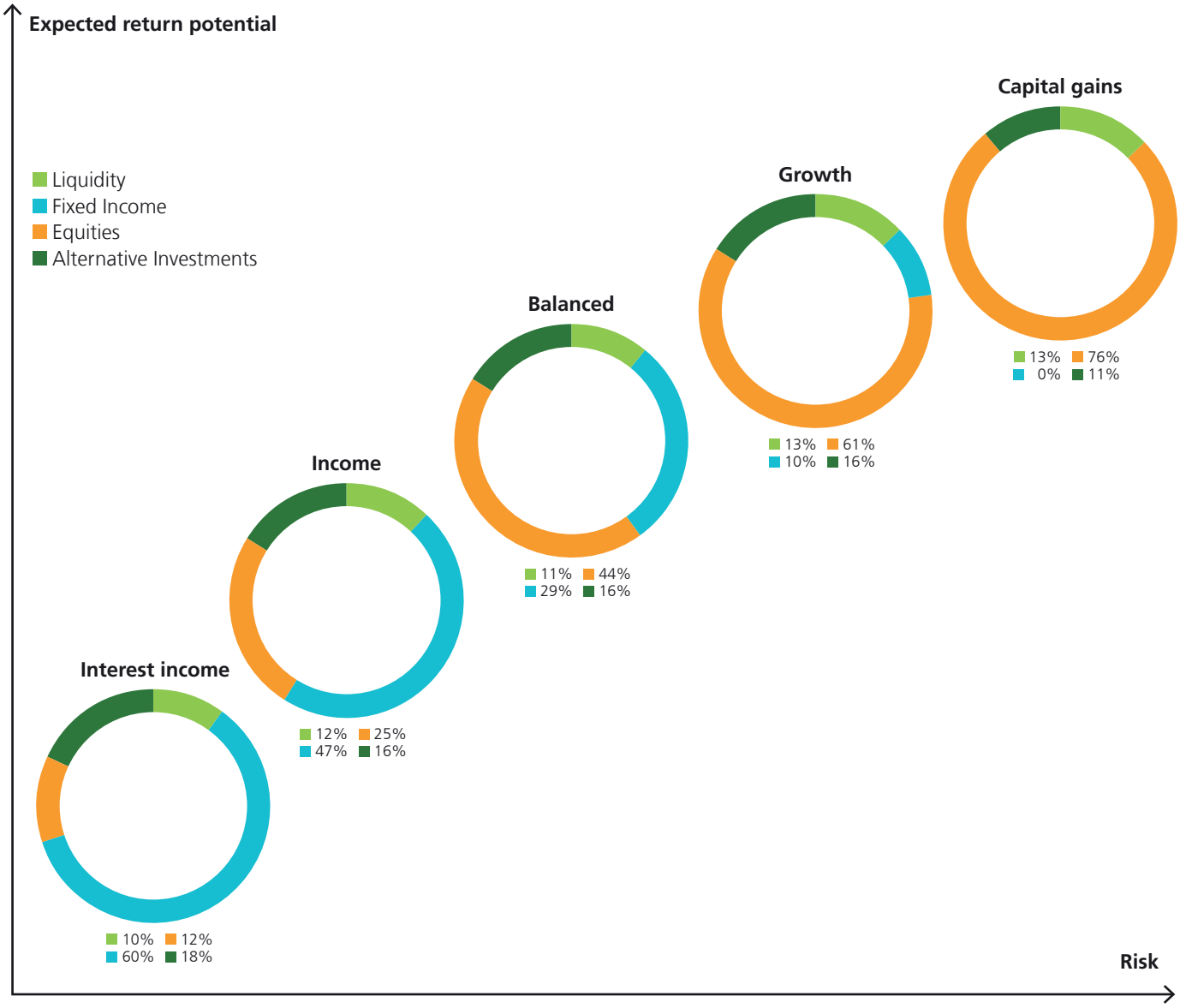
Source: Bloomberg

Model portfolios Swiss focus

Restraint in equity market positioning

At the turn of the year, we are cautiously adjusting the portfolios entrusted to us. We remain defensively positioned, especially with regard to equity investments in the markets of the industrialised nations. On the other hand, we are more positive about equities from emerging markets and Asia. These should benefit more than average from the weakening US dollar. The lower inflation rates compared to the industrialised nations ensure that these equities are also less exposed to rising interest rates.

We also consider listed Swiss real estate funds to be robust. In contrast to equities, the majority of funds invested in residential real estate should provide stable income even in economically difficult times.



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