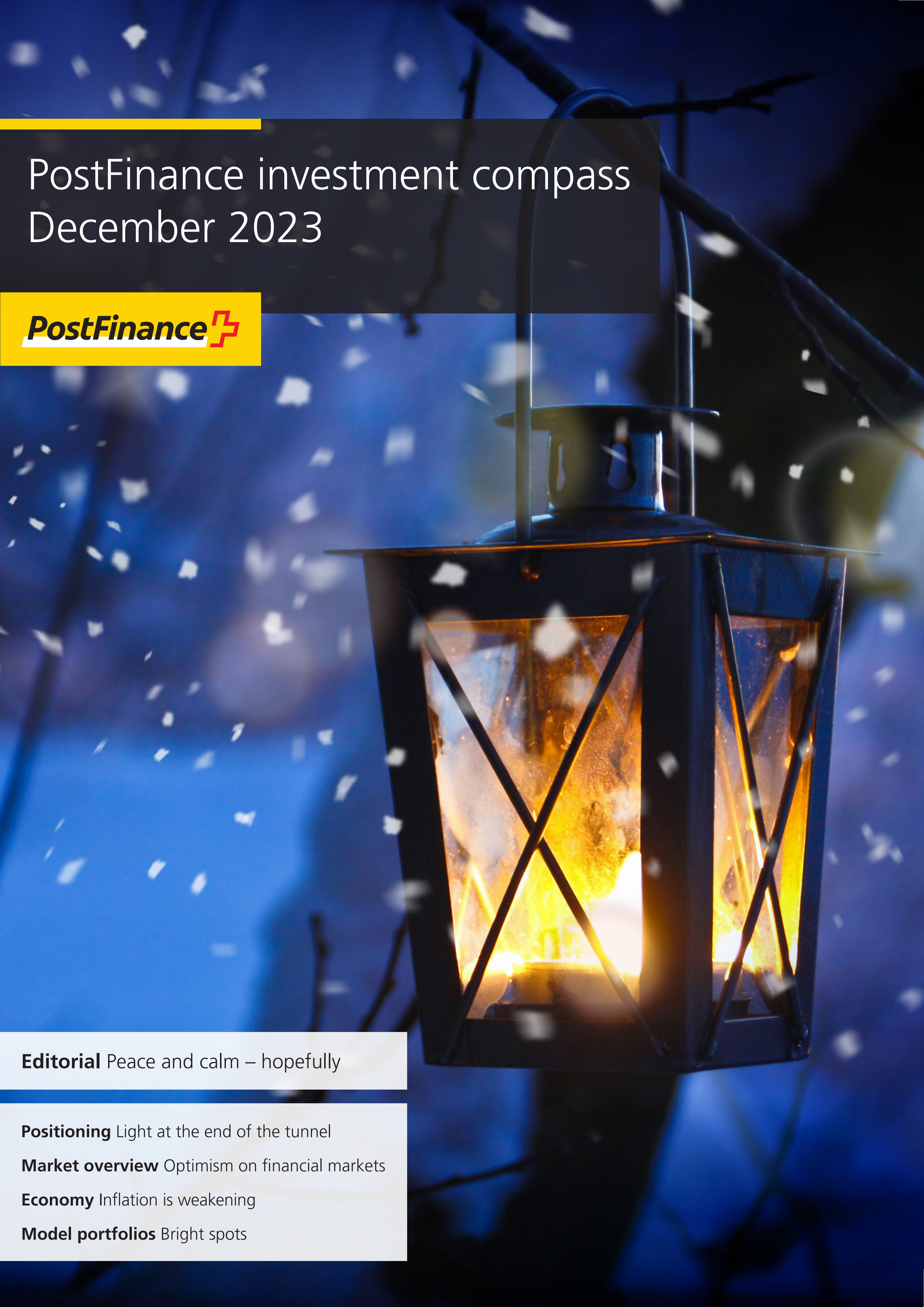
PostFinance investment compass December 2023

PostFinance



Editorial

Peace and calm – hopefully

After a volatile year, there has clearly been a dramatic slowdown in the real economy. Inflation has fallen sharply, alleviating people's gravest concerns and making a recovery seem conceivable again.

Philipp Merkt
Chief Investment Officer

What would we like to see happen as the year comes to an end? First of all, we'd like to see the year out calmly. 2023 was much too volatile for our liking with lots of bad news both economically and politically. The financial markets responded with huge fluctuations in interest rates and share prices. This created volatile conditions and means we're unable to say 2023 was a really good year for investment.

However, the worst fears people had a year ago have failed to materialize. Let's turn the clock back 12 months: European gas prices were four times higher than they are today. There were fears that gas supplies wouldn't be available every day in Europe, and in Switzerland too.

"We continue to adopt a cautious investment policy."

The resultant surge in inflation seemed to be spiralling out of control. Consumer price inflation stood at over 9 percent in the eurozone and exceeded 10 percent in the UK. Inflation rates have now fallen again – and not just due to energy prices. The core rates, which are adjusted for energy and food prices, now also stand at a much lower level of 3 to 4 percent in the USA and Europe.

While the targets set by the central banks haven't been reached yet, progress has clearly been made. The money market interest rates raised by the central banks are now above inflation. That's a key requirement in achieving a return to normal economic conditions. Runaway inflation is no longer a concern.

It means the investment environment is much less fraught with risk than it was 12 months ago. Admittedly, bonds cannot yet be unconditionally classified as attractive investments. While interest rates on long-term bonds lie below money market interest rates, demand for these long-dated securities will be subdued. This situation, known as an inverted yield curve, has actually only occurred in phases immediately before a recession.

So while we remain cautious, we're bulking up our equity allocation for the first time in a long while. For this we're using the defensive Swiss market, despite its rather disappointing performance in 2023. The phase of poor price performance now appears to be behind us. Conversely, we recommend taking profits in emerging market bonds. The weaker US dollar over recent weeks has enabled emerging markets to cut interest rates more quickly than in the USA.

However, the overall position still favours a strong weighting in the Swiss money market. Compared with many higher-risk investments, the money market, with an interest yield of almost 1.75 percent, has become an attractive addition to a well-diversified portfolio again. However, in our view, it's still too early to re-enter high-risk asset classes more aggressively in light of the economic slowdown in Europe and the USA.

Positioning

Light at the end of the tunnel

The downward inflation trend is encouraging and means the situation is far brighter than in spring. It's reason enough to increase our risk appetite slightly, even though our overall approach remains cautious.

A mood of optimism has taken hold on the financial markets thanks to a clear downward inflation trend. In the USA, overall inflation stood at 7.1 percent at year-opening but had dropped to 3.1 percent by November. Inflation rates have also fallen sharply in the eurozone, plunging from 9.2 to 2.4 percent. This development has gone down well on the financial markets, which hope to see policy rate cuts soon. In the USA, most market participants now expect policy rates to be cut by over 100 basis points by the end of 2024. Hopes of less restrictive monetary policy have also led to a significant fall in long-term interest rates. In the USA, the yield to maturity on 10-year government bonds has fallen to below 4.2 percent, compared with 5 percent in October. Capital market interest rates have also declined significantly in Europe. The equity markets benefited from lower interest rates too, making gains of over 10 percent. That meant November was one of the best months for equities this year.

"In terms of inflation, the situation has improved considerably since the start of the year."

Better, but still not good

Does that mean inflation is no longer a concern? Not entirely. Core inflation – the main yardstick used by the central banks, which excludes volatile prices, such as energy and food – is falling at a much slower pace and is still well above the 2 percent target. It also appears likely the downward trend may gradually falter. Wage

Performance of asset classes

Asset class		**1M in CHF**	**YTD [1] in CHF**	**1M in LCY [2]**	**YTD [1] in LCY [2]**
Currencies	EUR	–2.3%	–4.8%	–2.3%	–4.8%
	USD	–2.7%	–5.4%	–2.7%	–5.4%
	JPY	–0.9%	–15.9%	–0.9%	–15.9%
Fixed Income	Switzerland	2.9%	7.1%	2.9%	7.1%
	World	1.1%	–3.0%	4.0%	2.5%
	Emerging markets	2.5%	1.7%	5.4%	7.4%
Equities	Switzerland	3.5%	4.7%	3.5%	4.7%
	World	1.8%	11.6%	4.7%	17.9%
	USA	1.8%	13.9%	4.6%	20.4%
	Eurozone	5.0%	11.8%	7.5%	17.5%
	United Kingdom	0.7%	2.6%	1.7%	4.5%
	Japan	0.2%	9.2%	1.2%	29.8%
	Emerging markets	–2.0%	–1.2%	0.8%	4.4%
Alternative Investments	Swiss real estate	5.2%	0.2%	5.2%	0.2%
	Gold	–0.7%	5.7%	2.1%	11.7%

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

Data as of 6.12.2023
Source: Web Financial Group, MSCI, SIX, Bloomberg Barclays, J.P.Morgan

growth rates remain strong and are now well above inflation. In the USA, median salaries are currently rising by 5.2 percent, while core inflation stands at 4.0 percent. Strong wage growth may boost private household consumption, creating more upward pressure on prices. This means expectations of a considerable easing in monetary policy seem premature in our view. Policy rates may remain high for some time yet, but the situation is far better than at year-opening. That's why we're increasing our risk appetite slightly and reducing our underweighted equity position by purchasing Swiss shares. However, we're maintaining our defensive positioning overall.

Taking profits

We're also taking profits from our position in US-dollar-denominated emerging market bonds. US dollar-denominated emerging market bonds not only offer relatively attractive yields to maturity, but this position also usually benefits from US dollar weakness. This has paid off since spring, so we're now closing our overweight position. Additionally, we see the Swiss money market as extremely attractive, given the persistent inverted yield curve. The Swiss money market is currently generating a return of almost 2 percent, while long-term government bonds, such as 10-year Swiss federal bonds, are now only yielding less than 0.7 percent. That's why we're maintaining our underweight in Swiss bonds and are continuing to invest our heavily overweighted liquidity position in Swiss money market funds.

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	1.0%	1.0%				■	
	Money market CHF	10.0%	10.0%					■
Fixed Income	**Total**	**33.0%**	**31.0%**		■			
	Switzerland	15.0%	15.0%		■			
	World[2]	10.0%	10.0%			■		
	Emerging markets[2]	8.0%	6.0%			■		
Equities	**Total**	**45.0%**	**47.0%**		■			
	Switzerland	23.0%	25.0%				■	
	USA	8.0%	8.0%		■			
	Eurozone	1.0%	1.0%	■				
	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

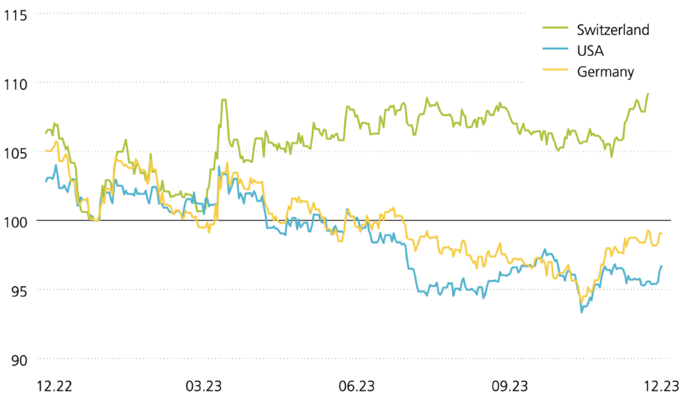
— Adjustment compared to last month

Market overview

Fixed income

The sharp fall in inflation in the USA and Europe came as a relief to market participants, even fuelling hopes that interest rates would soon be cut. This led to a significant fall in long-term capital market interest rates.

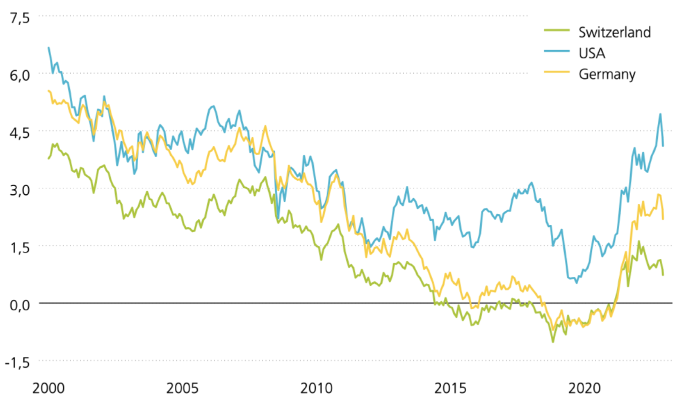
Indexed performance of government bonds in Swiss francs
100 = 01.01.2023



The trend that emerged last month towards falling interest rates at the long end of the curve continued until early December, triggering a sharp rise in government bond prices. Due to the strong franc, Swiss investors benefited only to a limited extent from this recent development. The decline in interest rates we observed is mainly due to falling inflation. Inflation rates have decreased surprisingly sharply this year. In the USA, the overall inflation rate dropped by 0.5 percent to 3.2 percent in November. In Europe, inflation fell by the same amount to 2.5 percent. The markets now appear to be expecting another cut in policy rates soon. In the USA, for example, the markets are trading on the assumption of policy rates being cut by over 1 percent by the end of 2024. As core inflation rates remain well above target, the current trading scenario on the financial markets is rather optimistic.

Source: SIX, Bloomberg Barclays

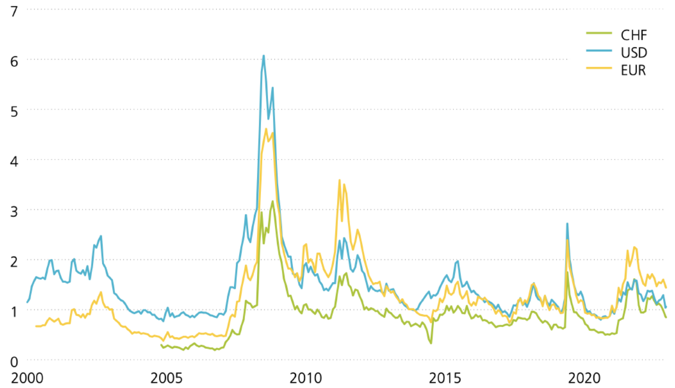
Trend in 10-year yields to maturity
In percent



With inflation rates falling again, yields to maturity on government bonds have also dropped. In the USA, the yield to maturity on 10-year government bonds now stands below 4.2 percent. In October, they peaked again at over 5 percent. Since year-opening, long-term capital market interest rates in the USA have only risen by 0.25 percent, despite policy rates increasing by 100 basis points over the same period. In Europe, long-term capital market interest rates have actually dropped over the course of the year, with the exception of the UK.

Source: SIX, Bloomberg Barclays

Credit spreads on corporate bonds
In percentage points



Credit spreads on corporate bonds fell sharply again last month. As economic momentum is now slowing in the USA too, the corporate bond market continues to defy the gloomy economic outlook. Hopes of a more expansive interest rate policy, on which market trading is currently based, currently appear to be outweighing concerns over recession at the moment.

Source: Bloomberg Barclays

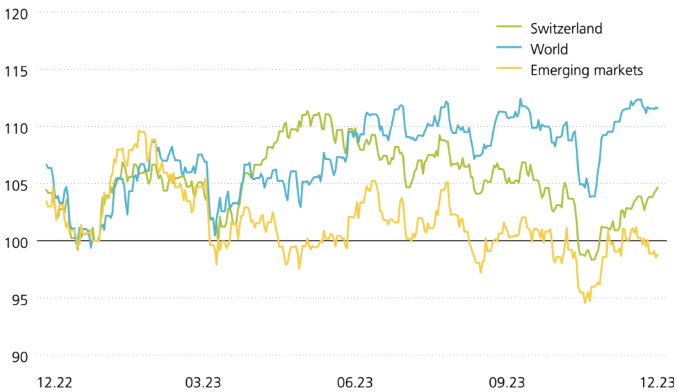
Market overview

Equities

Hopes of an imminent relaxation of monetary policy and lower interest rates are likely to have contributed to the stock market rally last month. In contrast, the economic slowdown that we have seen with falling inflation still remains relatively insignificant.

Indexed stock market performance in Swiss francs

100 = 01.01.2023

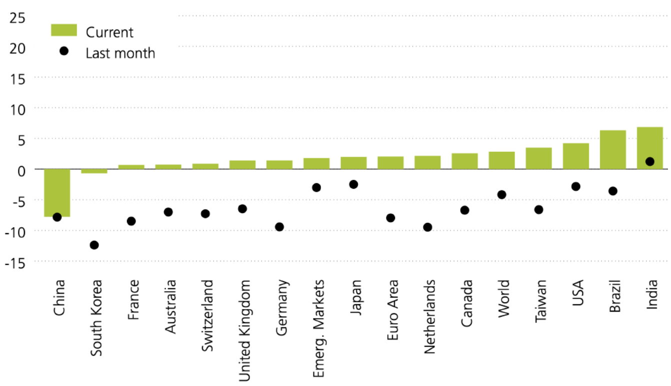


The equity markets made strong gains last month in the wake of lower capital market interest rates. In the USA, the leading index S&P 500 was just short of its high for the year of over 4,600. European equity markets also performed strongly. While the international equity markets fared well, their performance was relatively modest for Swiss investors, given the strong Swiss franc. The Chinese equity market's performance was also unimpressive. China was the only equity market to suffer losses, weighing on the performance of emerging market equities. The earnings outlook was dampened primarily by China's weak economic recovery – especially on the real estate market.

Source: SIX, MSCI

Momentum of individual markets

In percent

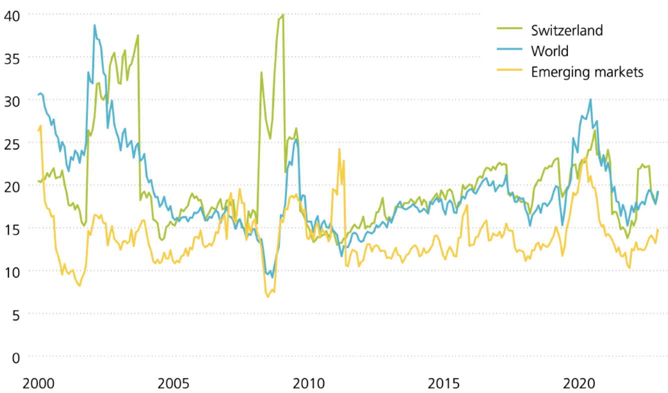


Momentum has been reversed thanks to recent positive performance on the equity markets. The only exception is the Chinese equity market, where momentum remains in negative territory. Since year-opening, China's is one of the few equity markets whose performance remains in the red. This also adversely impacted the momentum of emerging market equities. However, some individual emerging market equities are displaying strong momentum, such as India and Brazil.

Source: MSCI

Price/earnings ratio

P/E ratio



The price/earnings ratio of the equity markets improved significantly last month, principally due to the stock market rally in November. The lower expected earnings growth for the 4th quarter may also have contributed to the increase.

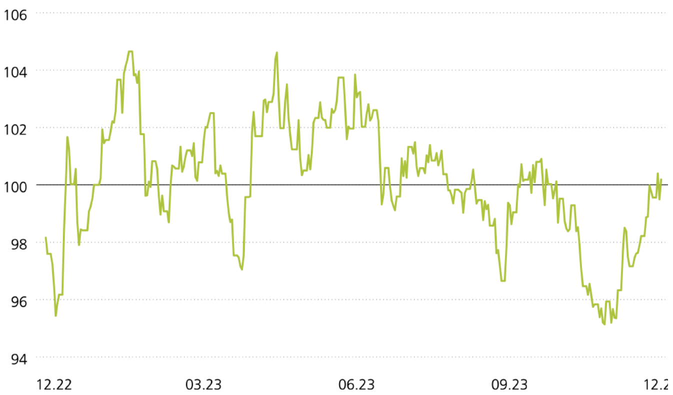
Source: SIX, MSCI

Market overview

Swiss real estate investments

Swiss real estate funds recovered in November, recouping the substantial losses from the previous month. However, there's a risk that this is just a brief interlude.

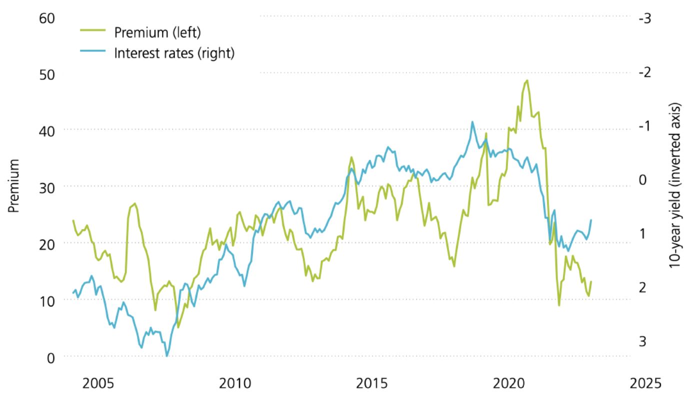
Indexed performance of Swiss real estate funds
100 = 01.01.2023



Exchange-listed Swiss real estate funds began to recover after a challenging October, making strong gains again. The current valuation is similar to that at year-opening. Falling long-term capital market interest rates, in particular, provided momentum last month. Yields to maturity on 10-year Swiss government bonds fell from around 1.0 percent to 0.7 percent. The current interest-rate level on the Swiss capital market nevertheless seems remarkably low. The economic outlook has shown little improvement, remaining very gloomy. That means the potential for Swiss real estate fund valuations to fall remains high.

Source: SIX

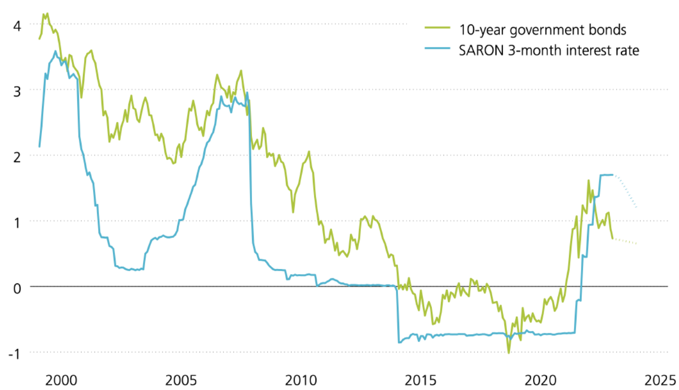
Premium on Swiss real estate funds and 10-year yields to maturity
In percent



A premium is usually paid when investing in real estate funds. This is the difference between the issue price of a fund unit and its net asset value (NAV). As the NAV is only determined at regular – usually annual intervals – the premium has also gone up due to the recent increase in valuation. By historical standards, the premium nevertheless remains low. However, the NAV may be corrected downwards during the next revision due to the higher level of interest on many properties, which would see premiums rise sharply.

Source: SIX

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



SARON, the Swiss reference interest rate, has been well above yields to maturity on 10-year government bonds since the spring of this year. That means long-term interest rates are currently well below short-term ones. That's unusual as investors normally want to be compensated for a longer period of commitment. This special situation is known as an inversion of the yield curve. It's mainly due to most market participants expecting the Swiss National Bank (SNB) to cut its policy rate again over the coming months. However, the SNB hasn't tired of pointing out that it intends to maintain the current interest-rate level for a longer period.

Source: SIX

Market overview

Currencies

The US dollar weakened significantly last month, depreciating on a broad front. In particular, this benefited the Swiss franc and Scandinavian kronas.

After making strong gains from July to September and remaining at that level until mid-November, the US dollar underwent the correction expected last month. The US currency suffered losses on a broad front, depreciating significantly against most currencies. This correction was expected as currencies with high inflation tend to depreciate and the dollar's valuation was high considering the US price level.
In contrast, the Swiss franc performed robustly last month. The Swiss currency, which is on an upward long-term trend due to much lower inflation by international standards, rose sharply in value. Against the euro, the Swiss franc is not far away from its all-time high of mid-October.
The Scandinavian kronas also made gains. The Norwegian krone and Swedish krona, in particular, made gains last month, reducing their significant undervaluation slightly.

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	0.80	0.70 – 0.90	USD neutral
GBP/CHF	1.10	1.21	1.05 – 1.38	Pound neutral
JPY/CHF	0.59	0.93	0.77 – 1.09	Yen undervalued
SEK/CHF	8.34	9.87	8.86 – 10.89	Krona undervalued
NOK/CHF	8.01	10.68	9.49 – 11.86	Krona undervalued
EUR/USD	1.08	1.12	0.97 – 1.26	Euro neutral
USD/JPY	147.16	85.72	67.35 – 104.09	Yen undervalued
USD/CNY	7.14	5.98	5.57 – 6.39	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 gold price increased substantially last month, and temporarily reached a new all-time high. The asset class, seen as a safe haven in turbulent times, is currently extremely popular.

Indexed performance of gold in Swiss francs
100 = 01.01.2023

The precious metal's value rose significantly last month, and now lies above the mark of 2,000 US dollars per troy ounce once again. It temporarily climbed to 2,135 dollars, hitting a new all-time high. Various factors have contributed to its considerable increase in value. There is strong demand for secure asset classes due both to geopolitical uncertainty and inflation rates, which remain particularly high. The US dollar's weakness has made gold even more attractive, as purchasing the precious metal – carried out in dollars worldwide – has become less expensive for international investors.

Source: Web Financial Group

Economy

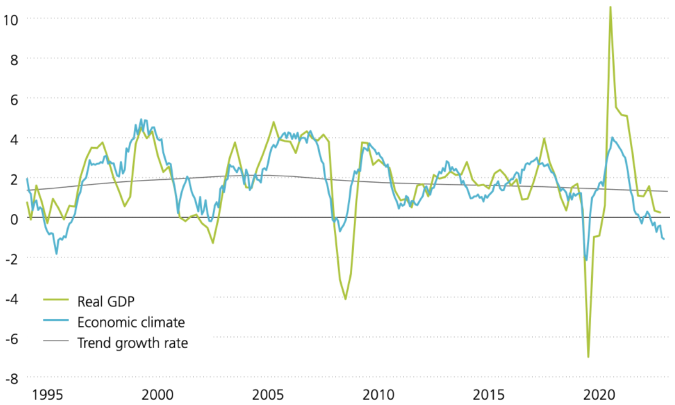
Inflation is weakening

Inflation rates worldwide have dropped sharply of late, giving a boost to equity and capital markets. The strong decline, which surprised many market participants, is likely to be due to the global slump in demand for goods, Europe's weak economy and the low prices of Chinese goods that many companies use as preliminary products for their own production. However, the current euphoria seems premature. Inflation in many countries remains well above central bank targets, people's inflation expectations have risen significantly in many places and strong wage growth will keep the pressure on rising prices.

Switzerland

Growth, sentiment and trend

In percent



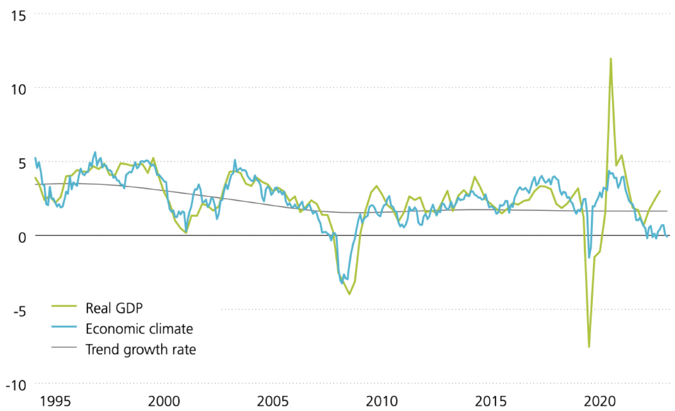
Source: Bloomberg

The Swiss economy is still making little headway. The State Secretariat for Economic Affairs' (SECO) latest estimates indicate growth of just 0.3 percent over the last four quarters. The industrial sector, which is being hit by weak international demand, remains under particular pressure. Recession in China and Germany – Switzerland's two main trading partners – is having a major impact. The construction industry and financial sector are also suffering and are facing significantly declining value added. Leading indicators suggest the Swiss economy will remain weak over the coming months. Sentiment amongst companies in the key industrial sector is still downbeat due to low order volumes. By contrast, the inflation trend is a positive development. Inflation has continuously fallen recently and now stands at 1.4 percent. The fall in inflation has been aided by the appreciation of the Swiss franc, making it less expensive to import foreign goods.

USA

Growth, sentiment and trend

In percent

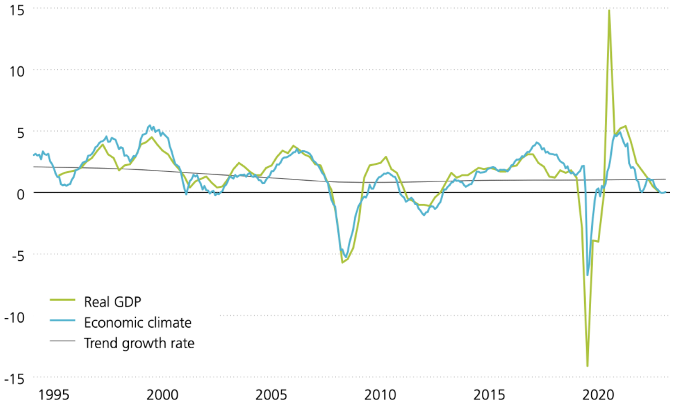


Source: Bloomberg

The US economy achieved strong growth up to the third quarter of 2023 and represented a major exception amongst the industrial nations. However, since the start of the fourth quarter, it now also seems to be falling into line with the global economic trend and is gradually weakening. Industrial production is now declining and capacity utilization is falling. Additionally, private household consumption is now only growing slowly and at a much reduced pace than over the year so far. The labour market is showing the first signs of weakening too. The number of newly created jobs is falling slightly, while the unemployment rate is up a little. By contrast, economic performance continues to be supported by the still thriving services sector. Another positive note is the progress made on reining in inflation. The core rate of inflation has now fallen to 4.0 percent. Another significant reduction may be difficult to achieve at the moment as the economic data is still too good, the difference between current economic output and its long-term potential too great and wage growth too high.

Eurozone

Growth, sentiment and trend
In percent

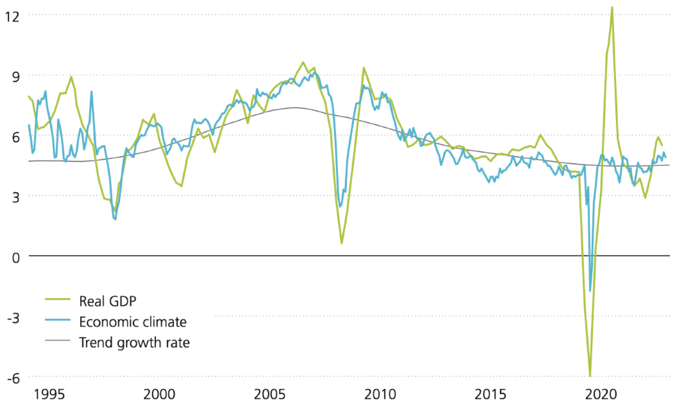


Source: Bloomberg

For once, sentiment indicators in the eurozone didn't paint a completely negative picture. While the mood amongst industrial companies, service providers and consumers remains pessimistic, it didn't deteriorate further last month. We will see whether this represents a bottoming-out over the coming months. A look at foreign trade figures suggests that it may not. Both imports and exports are still falling sharply. Import figures are down 20 percent year-on-year. This decline is only partly due to lower energy prices. Low imports primarily seem to indicate weak domestic demand. A positive side-effect of the economic downturn is a significant slowdown in inflation. The core rate fell from 5.5 percent in July to 3.6 percent in November.

Emerging markets

Growth, sentiment and trend
In percent



Source: Bloomberg

The economic recovery in China, the largest emerging market economy, remains sluggish. Production and profits in industry are decreasing, while the population's consumption figures have improved slightly, primarily supporting the services sector. There's no sign of the situation on the real estate market easing and the bankruptcy rate has hit a new high. Sentiment figures from companies have barely shifted and remain low. The weak economy is also reflected in extremely low inflation rates. The core rate has fallen again and now stands at 0.6 percent. Together with the sharp depreciation of the Chinese renminbi, this has led to much lower prices for Chinese goods on the global market than in previous years. As many international companies rely on Chinese preliminary products for their production, this may have a significant effect on curbing global inflation.

Global economic data

Indicator	Switzerland	USA	Eurozone	UK	Japan	India	Brazil	China
GDP Y/Y [1] 2023Q2	0.3%	2.4%	0.6%	0.6%	1.7%	7.8%	3.4%	6.3%
GDP Y/Y [1] 2023Q3	0.3%	3.0%	0.0%	0.6%	1.2%	7.6%	2.0%	4.9%
Economic climate [2]	↘	↘	→	↘	↗	→	↘	↗
Trend growth [3]	1.3%	1.6%	0.8%	1.7%	1.1%	5.2%	1.5%	3.9%
Inflation	1.4%	3.1%	2.4%	4.6%	3.3%	4.9%	4.8%	–0.5%
Key rates	1.75%	5.50%	4.5% [4]	5.25%	–0.1%	6.5%	12.25%	4.35%

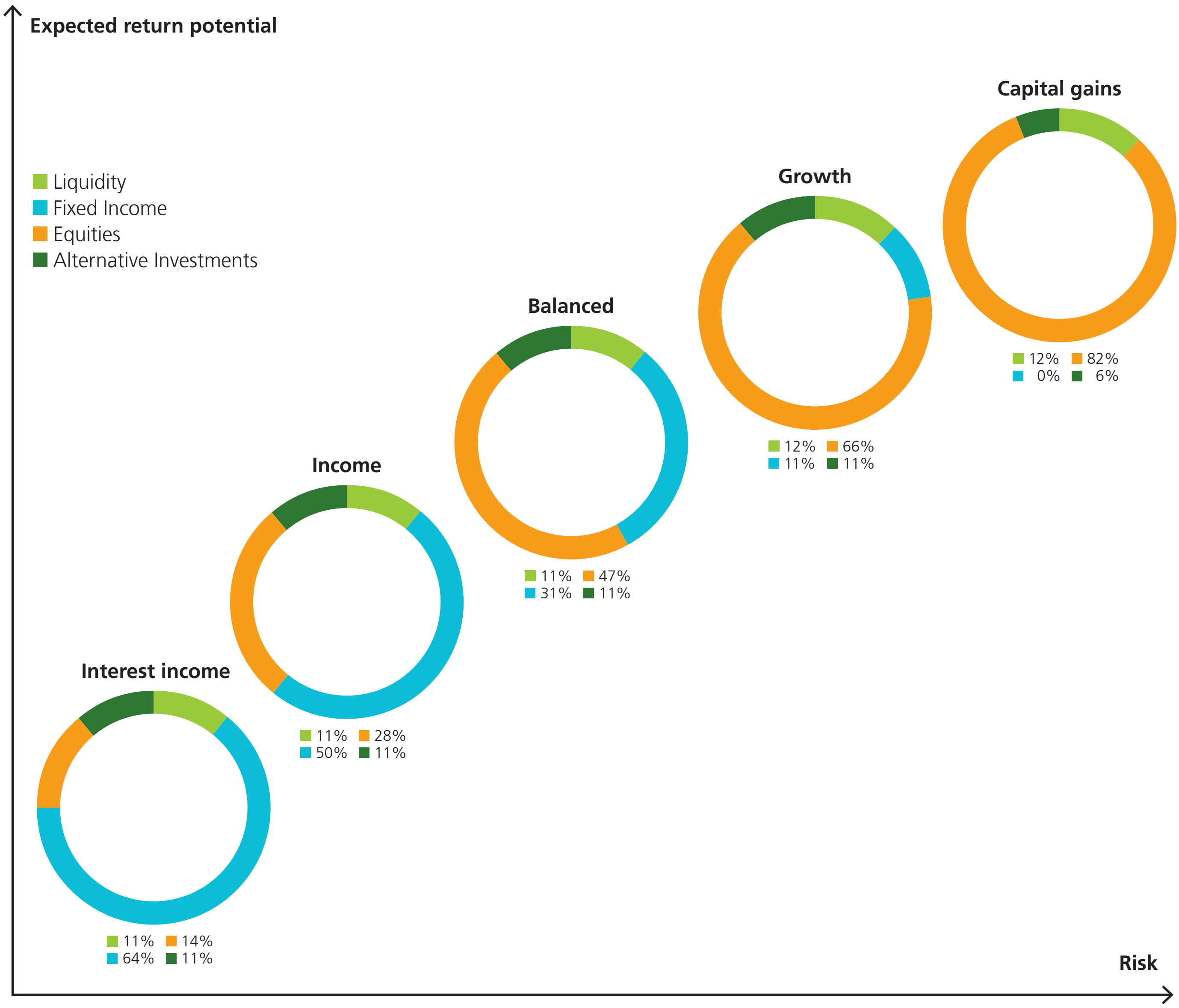
[1] Growth compared to year-ago quarter
[2] Indicator, measuring the overall sentiment and typically leading 1 to 2 quarters in advance of GDP. Green arrow indicates an increasing economic growth, red arrow a slowing.
[3] Potential growth. Long-term change in gross domestic product with sustainable capacity utilization.
[4] This is the ECB's main refinancing rate, the deposit rate is 0.5 percentage points lower.

Source: Bloomberg

Model portfolios Swiss focus

Bright spots

The financial markets are optimistic. Last month's fall in inflation rates has fuelled hopes that monetary policy will be eased in the near future. As a result, both the bond and equity markets have risen. In fact, the dynamics of inflation rates are encouraging. It is doubtful whether monetary policy will actually be eased as quickly as the markets would like. However, the starting position has improved noticeably compared to the spring. We are increasing our risk appetite slightly by reducing our underweight in the equity market by buying Swiss equities. At the same time, we are taking profits from emerging market bonds.



Source: PostFinance Ltd

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Data as of 7 December 2023
Editorial deadline: 11 December 2023

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