PostFinance investment compass June 2022

PostFinance

Editorial

Reversal in interest rates

The Swiss National Bank (SNB) has taken the first step towards reversing interest rates. While the economy remains intact, inflation and interest rates continue to rise, having an adverse impact on most asset classes. If there is a recession, equities – at the very least – will be hit. That's why we're retaining our cautious positioning.

Philipp Merkt
Chief Investment Officer

At its quarterly meeting in June, the SNB decided to raise money market interest rates by half a percentage point. As hinted in the last issue of the investment compass, this did not really come as a surprise: the rise in inflation rates was too steep and the response of capital market interest rates too great. The 0.75 percent hike announced in advance by the US Federal Reserve (Fed) paved the way for the scale of the SNB's interest rate rise, as the US central bank is now also taking tough measures to combat the inflation trends in its economy.

This means that the first step towards structurally higher interest rates and normalization after years of negative rates has been taken. Provided the economy does not slow down faster than expected, this won't be the last step the SNB takes, either. Higher interest rates aren't just a challenge for the financial markets – they also have a direct impact on our lives and the economy.

Owing to a change in the SNB's priorities, we may well see the value of the Swiss franc appreciate over the medium term. While monetary policy has been dominated by concerns that the Swiss franc has been too strong in recent years, our currency guardians will now focus more heavily on avoiding high inflation rates. Yes, a strong Swiss franc may even help to make imports relatively inexpensive and keep inflation low. Most export-oriented Swiss companies now seem prepared for a stronger Swiss franc.

The days of extremely cheap loans may well be over, too. That's becoming abundantly clear on the mortgage market. Whereas 10-year mortgages were still available at an interest rate of below 1 percent a year ago, they have now climbed to over 3 percent. This makes the long-term financing of purchasing a home more expensive. A SARON mortgage is an attractive alternative for anyone willing to assume the risk of variable interest. While the underlying SARON is also up by over 0.5 percent following the interest rate rise, it still remains in negative territory. It will take a whole series of interest rate hikes before a mortgage based on the SARON rate is more expensive than the current fixed-rate mortgage.

Finally, the SNB's recent interest rate decision suggests it will not stand by if inflation continues to rise. This means there is a real chance that inflation will not spiral out of control in Switzerland as it has in the USA or Europe, where the purchasing power of private households is currently falling sharply.

"Inflation undermines purchasing power, makes loans more expensive and damages the markets."

A look at sentiment shows just how seriously consumers are discomforted by inflation. Last month, the consumer confidence index in the USA plunged to the lowest level ever recorded – and the survey has been carried out for 70 years! Low consumer confidence in the USA is never good news – the US economy is too heavily dependent on consumption.

By contrast, the mood amongst companies remains very positive. Although the level of optimism has waned slightly over recent months, such positive sentiment indicators in business have in the past been followed by strong growth. The big question in economic monitoring is whether the significantly worse economic position among consumers will spread to business.

Rising interest rates and growing concerns over the global economy are having a major impact on the financial markets. In light of the greater risk of recession and high inflation, we're maintaining our cautious positioning and are now also underweighting US equities. We believe that it is still too early to bulk up the allocation of risk investments.

Positioning

Financial markets continue to falter

Persistent high inflation means that pressure on central banks to take action and upward pressure on interest rates remain high. Increased risks of recession are creating a challenging environment for higher-risk assets, such as equities. We're adopting an even more defensive position and under-weighting US equities.

The global trend of rising interest rates continued last month. This was mainly driven by continued high inflation in both the USA and Europe. The US Federal Reserve (Fed) responded by raising the key rates by 0.75 percentage points – the steepest hike since 1994. The European Central Bank (ECB) also announced an interest rate rise for July, as well as the end of some bond-buying programmes. Reining in inflation is now the priority for central banks. An economic slowdown is increasingly being anticipated. While the leading economic indicators still paint a bright picture, the tide is slowly starting to turn. Demand for goods has already fallen in the USA, and higher interest rates are causing a slowdown on the real estate market. Consumer confidence is particularly concerning, tumbling to an all-time low in the wake of high inflation. The likelihood of a recession has increased further – and not just in the USA. Upward pressure on interest rates looks set to persist worldwide for the time being, however, despite recession risks. This means that defensive positioning in the portfolio remains advisable.

"10-year interest rates rose by 0.7 percentage points in June alone."

Performance of asset classes

Asset class		1M in CHF	YTD [1] in CHF	1M in LCY [2]	YTD [1] in LCY [2]
Currencies	EUR	–2.5%	–1.7%	–2.5%	–1.7%
	USD	–3.6%	5.9%	–3.6%	5.9%
	JPY	–5.8%	–7.8%	–5.8%	–7.8%
Equities	Switzerland	–10.3%	–18.1%	–10.3%	–18.1%
	World	–10.7%	–17.7%	–7.4%	–22.3%
	USA	–11.8%	–19.4%	–8.5%	–23.8%
	Eurozone	–8.9%	–20.2%	–6.6%	–18.8%
	United Kingdom	–8.2%	–3.4%	–5.1%	–0.2%
	Japan	–5.8%	–13.3%	0.0%	–6.0%
	Emerging markets	–3.1%	–12.5%	0.5%	–17.3%
Fixed Income	Switzerland	–5.5%	–12.4%	–5.5%	–12.4%
	World	–6.3%	–9.5%	–2.9%	–14.5%
	Emerging markets	–6.8%	–15.3%	–3.4%	–20.0%
Alternative Investments	Swiss real estate	–10.9%	–19.0%	–10.9%	–19.0%
	Gold	–2.7%	7.1%	0.9%	1.1%

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

Data as of 16.06.2022
Source: Web Financial Group, MSCI, SIX, Bloomberg Barclays, J.P.Morgan

Swiss interest rates rise

Following in the footsteps of the Fed and the ECB, the Swiss National Bank (SNB) has also joined the fight against inflation. It has raised its policy rate by 0.5 percentage points to –0.25 percent, the first time in 15 years that it has taken such action. Through this clear reversal of policy, the SNB was also responding to higher inflation, which climbed to 2.9 percent in May. In anticipation of an interest rate rise, we decided to reduce the position of Swiss bonds in our portfolios last month. This decision proved justified. 10-year interest rates went up by 0.7 percentage points in June alone, causing the price of Swiss bonds to fall by around 5 percent. In light of the high inflation rates, we are maintaining an underweighted position in bonds in our portfolios.

Tough environment for equities

Last month's sharp interest rate hike resulted in losses for global bond markets – but also for equity markets and Swiss real estate funds, too. Down –5 percent, US equities fell slightly more sharply than their European counterparts. Only Chinese equities generated a positive return, despite the fact that the economic situation in China remains challenging. The recent relaxation of regulatory pressure on tech companies may have aided a recovery. The outlook for the equity markets remains bleak, however, especially in the USA and Europe. Both persistent upward pressure on interest rates and the greater risks of recession are creating a tough environment for equities. In response, we are now underweighting US equities as well as European equities.

Gold is a stabilizing factor, and Swiss real estate funds are fairly valued

Gold proved robust, despite rising interest rates and a strong US dollar, and continued to stabilize the portfolio. Gold also remains attractive from a diversification perspective, which can reap rewards in an environm ent that is still unsettled. That's why we're retaining our slightly increased gold allocation.

The steep rise in interest rates in Switzerland also resulted in a sustained correction for Swiss real estate funds. In our view, these assets are now valued fairly, which means that neutral positioning in their allocation is advisable.

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%**	**13.0%**					
	CHF	11.0%	13.0%					
Equities	**Total**	**48.0%**	**46.0%**					
	Switzerland	23.0%	23.0%					
	USA	10.0%	8.0%					
	Eurozone	3.0%	3.0%					
	United Kingdom	2.0%	2.0%					
	Japan	2.0%	2.0%					
	Emerging markets	8.0%	8.0%					
Fixed Income	**Total**	**27.0%**	**27.0%**					
	Switzerland	15.0%	15.0%					
	World[2]	6.0%	6.0%					
	Emerging markets[2]	6.0%	6.0%					
Alternative Investments	**Total**	**14.0%**	**14.0%**					
	Swiss real estate	7.0%	7.0%					
	Gold[2]	7.0%	7.0%					

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

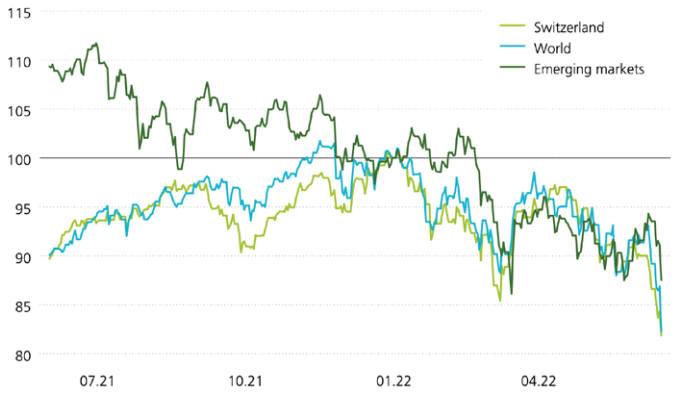
— Adjustment compared to last month

Market overview

Equities

The recovery on the equity markets at the end of May turned out to be very brief. Growing fears of recession and the hike in capital market interest rates saw prices plummet again recently.

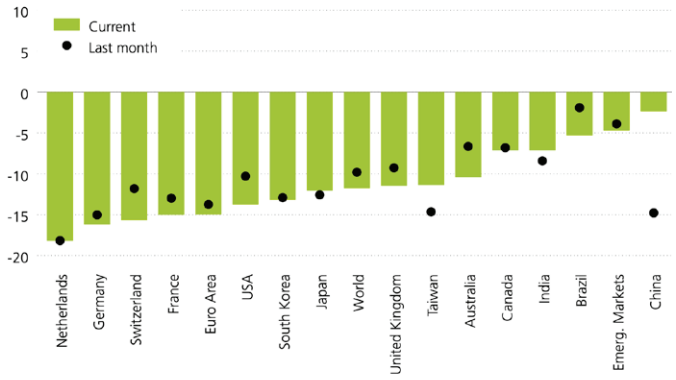
Indexed stock market performance in Swiss francs
100 = 01.01.2022



Stock markets have repeatedly attempted to mount a recovery rally over recent months – and did so again at the end of May. But after the inflation trend gained further upward momentum and the central banks stepped up their measures to combat inflation, there was another sharp downturn. There was also a significant rise in borrowing costs for companies on the capital markets. Measured in Swiss francs, the global equity markets lost almost 8 percent of their value last month alone. Prices have nosedived by over 17 percent in the year to date.

Source: SIX, MSCI

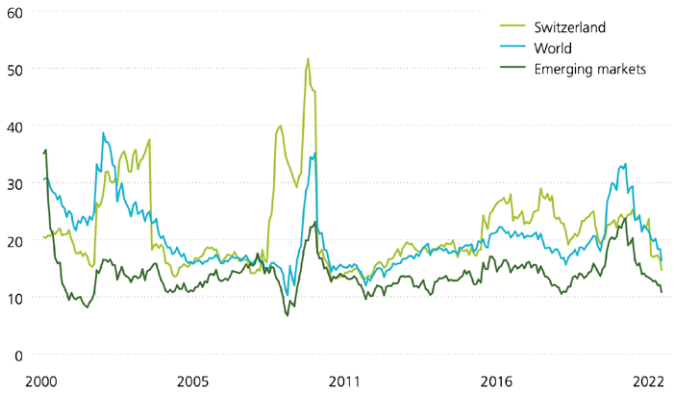
Momentum of individual markets
In percent



There is currently a strong downward trend on equity markets worldwide, but there are clear regional differences. The European countries and the USA have been especially hard hit. Both regions are currently contending with inflation challenges and geopolitical conflicts. The Asian stock markets were also in negative territory, but fared better than the global average. Only the Chinese equity market – despite continued negative momentum – achieved a significant improvement in trend compared with the prior month.

Source: MSCI

Price/earnings ratio
P/E ratio



The slump on the equity markets has seen the price/earnings ratio (P/E ratio) fall further since the start of the year. The average P/E ratio for companies currently stands at 15 worldwide, which means that the equity price is 15 times higher than earnings. This indicator briefly climbed to over 30.
The potential for companies to achieve higher earnings growth may also be exhausted for the time being. More and more companies are even revising their profit forecasts downwards for the current year. Growing restraint being shown by consumers is likely to be a key factor. The high inflation trend means consumers are losing purchasing power.

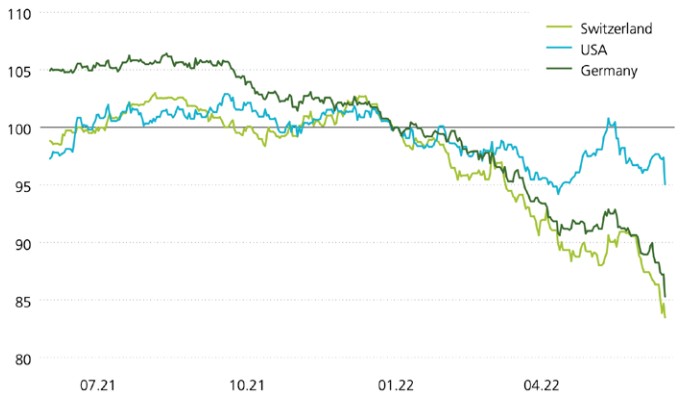
Source: SIX, MSCI

Market overview

Fixed income

The sharp rise in capital market interest rates gained further momentum last month, resulting in significant losses on bonds.

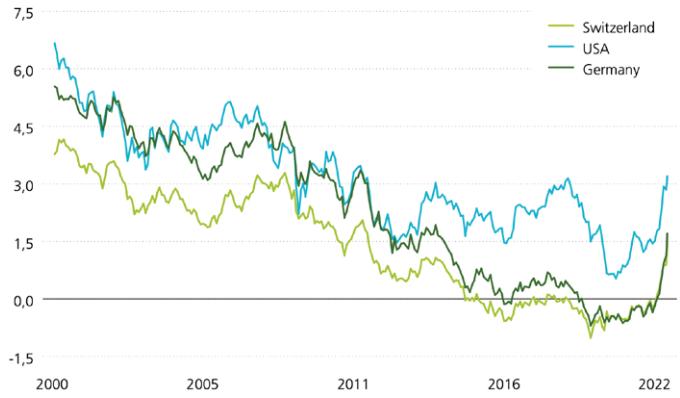
Indexed performance of government bonds in Swiss francs
100 = 01.01.2022



There was a slump on the bond markets last month. This was triggered by the even stronger than expected inflation trend in the USA and Europe and the decision by the major central banks to step up measures to rein in inflation. With the exception of the Bank of Japan, they have all now raised key rates. But this may be just the start of a much more restrictive monetary policy. As a result, secure government bonds suffered further losses last month. US government bonds are down by over 10 percent since year-opening, while the value of their Swiss and German counterparts has plunged by around 15 percent.

Source: SIX, Bloomberg Barclays

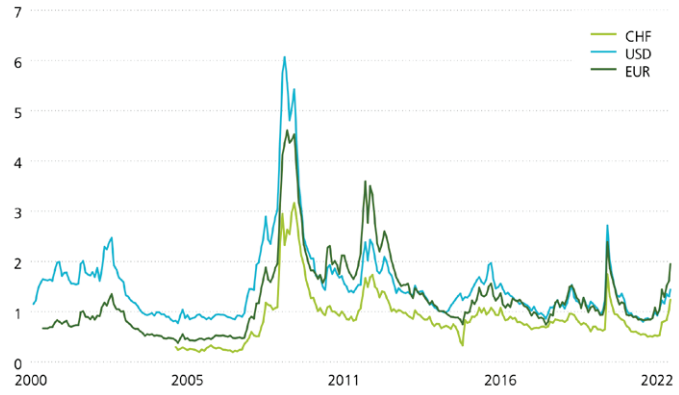
Trend in 10-year yields to maturity
In percent



Yields to maturity on 10-year US government bonds briefly hit their highest level since 2018 at just under 3.3 percent, more than doubling compared to the start of the year. Their Swiss and German counterparts now finally seem to have left negative territory behind. Yields to maturity of highly indebted peripheral European countries, including Greece and Italy, rose even more sharply. As a result, the ECB was forced to announce it would act to counter any significant widening of yields within the eurozone at any cost.

Source: SIX, Bloomberg Barclays

Credit spreads on corporate bonds
In percentage points



The risks of recession have increased significantly since year-opening. Less surprising is greater risk aversion among investors. This is clearly evident on the corporate bond markets where prices include a risk premium due to the greater risk of default compared with state-issued bonds. These risk premiums on corporate bonds – also called spreads – have risen sharply again since the start of the year, but are still below the level of two years ago at the start of the coronavirus crisis. The average credit spread on European corporate bonds now stands at 2 percent and has now reached 1.3 percent on Swiss corporate bonds.

Source: Bloomberg Barclays

Market overview

Swiss real estate investments

Real estate investments suffered significant losses again last month. The value of Swiss real estate investments fell by around 6 percent.

Indexed performance of Swiss real estate funds
100 = 01.01.2022

Listed Swiss real estate funds also endured painful losses last month. Prices plunged deeper into the red, falling almost 6 percent month-on-month. The main reason for this sharp downturn is the huge hike in interest rates. Year-to-date losses now stand at around 17 percent.

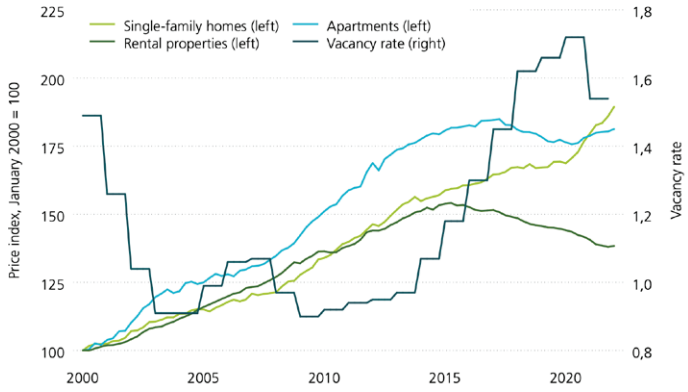
Source: SIX

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

The premiums on Swiss real estate funds have tumbled sharply over recent months. While premiums of 50 percent on average were being demanded on the value of the properties contained in the funds last summer, they have now slipped to 24 percent. This means premiums have now almost reached a fair value again, given current interest rates.

Source: SIX

Vacancy rate and real estate prices
100 = January 2000 (left) and in percent (right)



There is a growing gap between property owners and tenants on the Swiss housing market. The ratio of house to rental prices in Switzerland is currently over 35 percent higher than the long-term average. Real household income is also being adversely impacted by the high inflation trend. This means the risk of a bubble on the Swiss residential property market has increased again this year according to UBS's Real Estate Bubble Index.

Source: SNB, SFSO

Market overview

Currencies

The US dollar is extending its leading position. The Swiss franc overcame its period of weakness, while the Japanese yen disappointed again.

The US dollar performed well again last month. Against a basket of currencies known as the dollar index, the global reserve currency reached its highest level in two decades. Measured by purchasing power parity, it had not been as overvalued for four decades. After a phase of weakness, the Swiss franc recouped some ground. It is trading at 0.96 against the US dollar. The Swiss National Bank's decision to raise the key rate may have helped to strengthen the national currency. The Japanese yen disappointed again, remaining the most undervalued G10 currency.

Currency pair	Price	PPP [1]	Neutral area [2]	Valuation
EUR/CHF	1.02	0.87	0.80–0.93	Euro overvalued
USD/CHF	0.97	0.77	0.67–0.86	USD overvalued
GBP/CHF	1.19	1.29	1.12–1.47	Pound neutral
JPY/CHF	0.73	0.98	0.83–1.14	Yen undervalued
SEK/CHF	9.53	10.16	9.19–11.14	Krona neutral
NOK/CHF	9.72	10.86	9.70–12.02	Krona neutral
EUR/USD	1.06	1.13	0.98–1.27	Euro neutral
USD/JPY	132.27	78.16	63.33–93.00	Yen undervalued
USD/CNY	6.70	5.68	5.43–5.93	Renminbi 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 defended the 1,850-US-dollar mark, successfully resisting the strong downward trend on the financial markets last month.

Indexed performance of gold in Swiss francs
100 = 01.01.2022

While most asset classes made further year-to-date losses last month, gold successfully held its price of 1,850 US dollars per troy ounce, fluctuating very little. In doing so, the precious metal underlined its reputation as a safe haven investment. Gold has actually gained by around 7 percent since year-opening.

Source: Web Financial Group

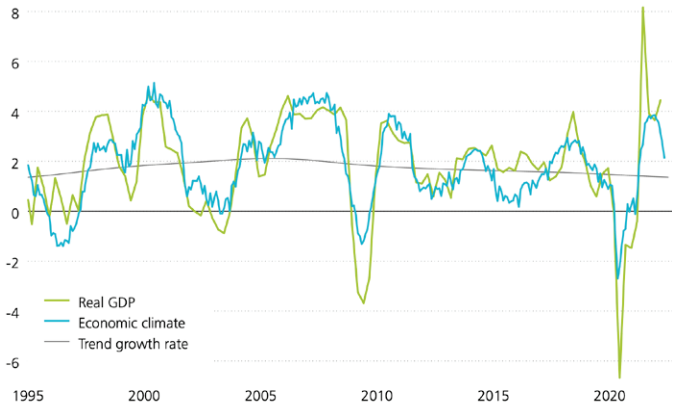
Economy

Switzerland: First interest rate rise for 15 years

High inflation rates are forcing more and more central banks to take drastic action. The Swiss and US central banks have responded by raising interest rates sharply.

Switzerland

Growth, sentiment and trend
In percent

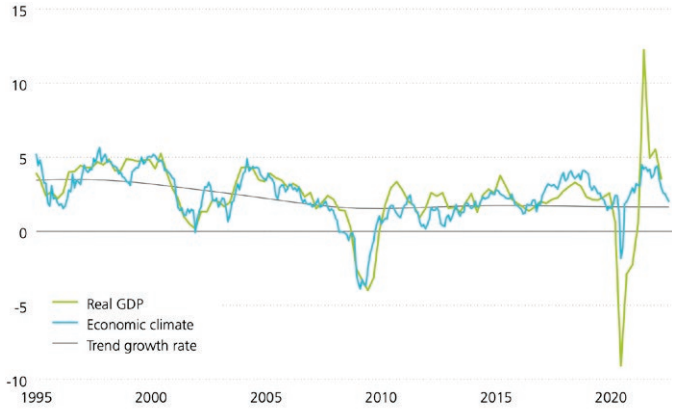


Source: Bloomberg

The Swiss economy achieved further impressive growth of +0.5 percent at the start of the year. Unlike in 2021, the pharmaceutical industry was not the main driver of growth, but other sectors of industry made up ground instead. While there are growing fears of recession globally, which would inevitably hit Switzerland, Swiss companies remain optimistic about the future so far. Sentiment surveys indicated that optimism in the services sector even rose in May.
Switzerland has been unable to avoid the global inflation trend. At 2.9 percent, inflation recently climbed to its highest level since 2008. The Swiss National Bank (SNB) has reacted to high inflation by raising interest rates for the first time in 15 years and has said that it is not ruling out further hikes.

USA

Growth, sentiment and trend
In percent

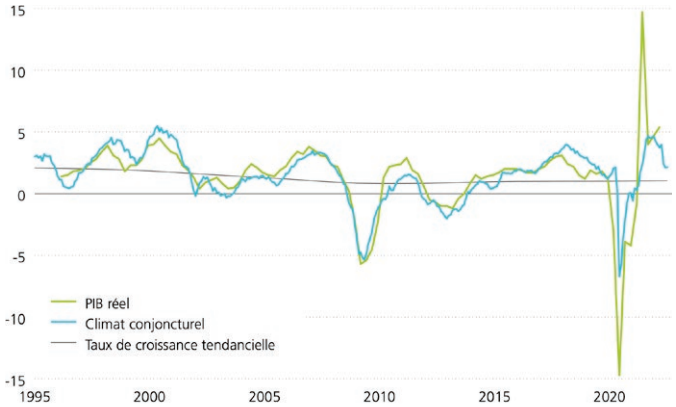


Source: Bloomberg

Despite a record number of vacancies and unemployment falling to its lowest ever level in the USA, US households are more pessimistic about the future than ever before, according to a survey by the University of Michigan. High inflation is causing great concern. Despite generally being expected to fall, inflation rose again to 8.6 percent in May, underlining that it is set to remain with us for some time. The US Federal Reserve is attempting to rein inflation in and recently raised the key rate sharply by 0.75 percentage points. In its outlook for the current year, the Federal Reserve only anticipates growth of 1.7 percent as opposed to 2.8 percent previously.

Eurozone

Growth, sentiment and trend
In percent

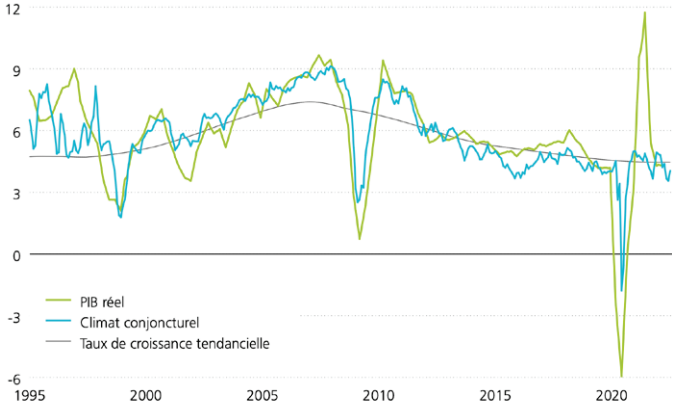


Source: Bloomberg

The eurozone made a strong start to the New Year, posting growth of +0.6 percent in the first quarter. But inflation, which recently hit 8.1percent, is increasingly approaching US levels. The European Central Bank (ECB) has so far been much more hesitant in tackling inflation than its US counterpart – in the knowledge that southern European countries, particularly Italy and Greece, could soon face a financing crisis if interest rates are raised too sharply. At a recent crisis meeting, it was forced to announce that funds freed up from its bond-buying programme could be used to purchase government bonds to prevent the gulf in interest rates between northern and southern member states from widening too much.

Emerging markets

Growth, sentiment and trend
In percent



Source: Bloomberg

Unlike in western industrial nations, rising inflation rates have been a major issue for some time in certain emerging markets. This helps explain why various central banks are introducing rigorous measures to combat inflation. Brazil is taking major steps to tackle inflation, which has now entered double-digit territory once again – in early June, the Brazilian central bank hiked interest rates for the 11th consecutive time, raising its key rate by 50 basis points to 13.25 percent. The central bank in neighbouring Chile was also forced to raise its key rate to 9 percent after facing inflation of 11.5 percent in May – the highest level in almost 30 years. A similar picture has emerged in Asia. India, South Korea and Hong Kong have all increased their key rates again over recent weeks.

Global economic data

Indicator	Switzerland	USA	Eurozone	UK	Japan	India	Brazil	China
GDP Y/Y [1] 2021Q4	3.6%	5.5%	4.7%	6.6%	0.4%	5.4%	1.6%	4.0%
GDP Y/Y [1] 2022Q1	4.4%	3.5%	5.4%	8.7%	0.4%	4.1%	1.7%	4.8%
Economic climate [2]	↘	↘	↘	↘	↗	→	↘	↘
Trend growth [3]	1.4%	1.6%	0.8%	1.7%	1.1%	5.1%	1.2%	4.1%
Inflation	2.9%	8.6%	8.1%	9.0%	2.5%	7.0%	11.7%	2.1%
Key rates	–0.25%	1.63%	0.00%	1.25%	–0.10%	4.90%	13.25%	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.

Source: Bloomberg

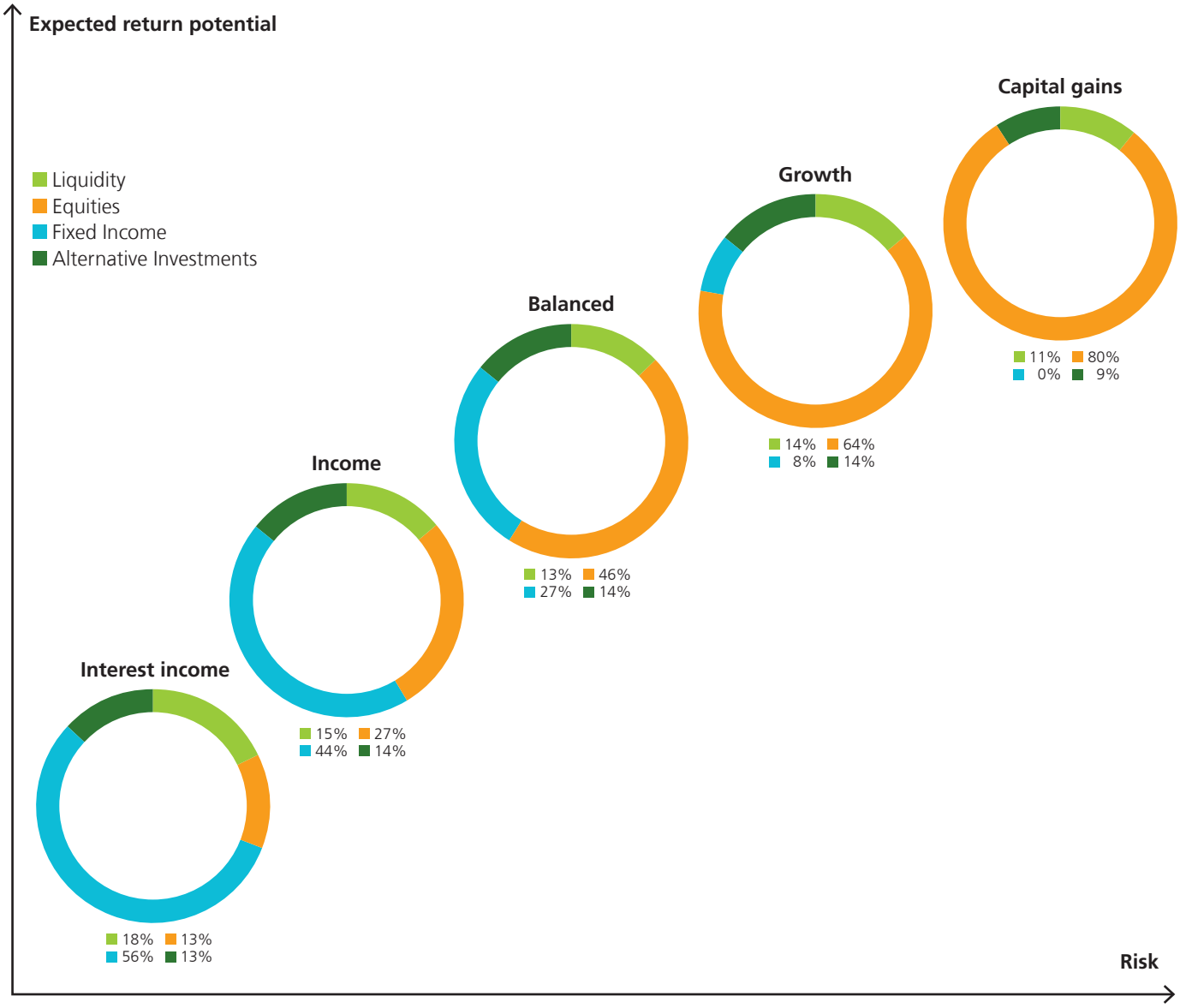
Model portfolios Swiss focus

More defensive in the face of increased recession risks

The major central banks have now set course to fight inflation and have begun to raise key interest rates. A cooling of the economy, possibly even a recession, is being consciously accepted. Therefore, the global upward pressure on interest rates is likely to continue for the time being despite the risks of recession. Defensive positioning in the portfolio remains appropriate.

As a consequence, we confirm our underweighting of bonds in our portfolio, especially in view of the continuing high inflation dynamics. Last month, we underweighted Swiss bonds as we expected the Swiss National Bank to raise interest rates. This decision has now paid off positively.

Despite the recent price declines, the turbulent times on the equity markets could continue, as both the upward pressure on interest rates and the increased risks of recession represent a difficult environment. We are therefore now underweighting US equities - in addition to European equities. Gold proved to be robust despite rising interest rates and a strong US dollar and thus continues to stabilise the portfolio. We are therefore maintaining our slightly increased gold quota.



Source: PostFinance Ltd

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