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PostFinance

Editorial

Challenges for investors, not for business

Inflation rates are currently much lower in Switzerland than abroad. That's helping companies to cope with the rising value of the Swiss franc, but this appreciation is proving challenging for investors.

Daniel Mewes
Chief Investment Officer

The pace of economic developments has accelerated during the coronavirus crisis. The downturn happened at unprecedented speed, and the recovery was also extremely rapid – so fast that an overheated economy is now causing prices to soar worldwide.

But prices have risen much less sharply in Switzerland than abroad. This difference is also reflected in the Swiss franc exchange rate. We're all used to it: every currency falls in value against the Swiss franc over time. The US dollar once cost 4 francs, whereas today it's less than 1. The euro cost over 1.60 francs before the financial crisis, while today 1 euro is almost equivalent in value to 1 franc.

A strong franc is relative …

Switzerland's lower inflation rate lies behind these developments. Inflation rates are a clear indication of how much a currency is losing in terms of purchasing power. If the inflation rate in Switzerland stands at 1 percent, this means that 1 percent less can be bought with 1 Swiss franc than in the previous year. But if the purchasing power of other currencies falls more quickly than that of the Swiss franc, then their value declines against the franc. In other words: the "fair exchange rate" falls.

And that's exactly what's happened recently. The best approach is to look at the prices of goods leaving a factory – they're highly negotiable. In Germany, these prices have recently soared by 14 percent year-on-year, but in Switzerland, they have risen by just 5 percent. This is due to the fact that input prices in Germany – e. g. energy – have increased much more sharply. The strength of the Swiss franc – as we've seen recently – is relative. A company receives less for its products if it can no longer sell them at 1.15 francs, as was the case over two years ago, but instead only at 1.05 francs. But it also has much lower input costs than its competitors abroad, which means that it's not in a worse position overall.

…but presents challenges for Swiss investors

Swiss investors face a more challenging situation, however. Return earned abroad may look higher – but if that's only due to higher inflation rates in those countries, it's offset by currency losses. It's important for Swiss investors to measure return generated abroad in Swiss francs. That's also why the optimal domestic market allocation is much higher for Swiss investors than those abroad.

Due to the major differences in inflation at the moment, the probability of the Swiss franc continuing to appreciate is high – albeit at a steady rate, thanks to the Swiss National Bank's interventions. For this reason, focusing on other currencies does not seem tactically opportune at present.

«Inflation rates are a clear indication of how much a currency is losing in terms of purchasing power.»

Positioning

Financial markets resist inflationary pressure for the time being

For the time being, the financial markets remain unperturbed by growing inflationary pressure. But that can all change rapidly. We're maintaining a positioning that is geared towards rising interest rates and inflationary pressure.

Inflationary pressure continues unabated. In the USA, inflation recently hit 6.2 percent, something many people have only ever read about in history books. Inflation has also risen in Europe, although it still remains at a significantly lower level. There are fears that high inflation will not prove as temporary as the central banks would like. That's why we're maintaining a positioning that is geared towards inflationary pressure.

Equities hit new highs

The equity markets have largely been unperturbed by rising inflation thus far. They hit new record highs in many places in October. Thanks to high utilization of economic capacity, companies still have full order books. This was also demonstrated recently by outstanding quarterly figures. There has been little sign of inflationary pressure in company figures so far. Pressure on margins owing to higher input prices of raw materials or wages is having virtually no impact in this respect. Quite the opposite, in fact: companies can easily pass higher prices on to consumers without having to fear losses.

However, persisting inflationary pressure and ensuing higher interest rates suggest that there is still upturn potential in energy and financial sector securities that are performing robustly in this environment. With this in mind, we are maintaining our overweighted position in UK equities at the expense of European ones.

«The equity markets have largely been unperturbed by rising inflation thus far.»

Performance of asset classes

Asset class		1M in CHF	YTD [1] in CHF	1M in LCY [2]	YTD [1] in LCY [2]
Currencies	EUR	–1.6%	–2.5%	–1.6%	–2.5%
	USD	–0.7%	4.0%	–0.7%	4.0%
	JPY	–1.4%	–5.8%	–1.4%	–5.8%
Equities	Switzerland	5.8%	20.2%	5.8%	20.2%
	World	4.9%	25.6%	5.7%	20.7%
	USA	5.9%	29.1%	6.6%	24.1%
	Eurozone	4.6%	20.2%	6.3%	23.2%
	United Kingdom	1.1%	21.2%	3.6%	19.0%
	Japan	0.0%	7.5%	1.5%	14.1%
	Emerging markets	0.6%	5.1%	1.3%	1.1%
Fixed Income	Switzerland	0.5%	–1.9%	0.5%	–1.9%
	World	–0.4%	–0.5%	0.3%	–4.3%
	Emerging markets	0.6%	2.8%	1.4%	–1.1%
Alternative Investments	Swiss real estate	–2.3%	4.9%	–2.3%	4.9%
	Gold	4.9%	2.4%	5.7%	–1.6%

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

Data as of 11.11.2021
Source: Web Financial Group, MSCI, SIX, Bloomberg Barclays, J.P.Morgan

Slightly more unease on bond market

The bond market proved volatile last month. Long-term interest rates reached post-coronavirus highs in the industrialized countries in mid-October, but then fell back again. It's interesting to note that the interest rate level remained almost unchanged month-on-month, but the composition changed. This resulted in stronger demand for inflation-protected bonds than nominal government ones. Interest rates adjusted for inflation fell, while inflation expectations rose.

This meant that concerns over inflation impacted on the bond market to some extent. Overall, however, interest rates remain at a remarkably low level in light of high inflation rates in the USA and Europe. But there are still strong signs that inflationary pressure will continue to mount, forcing central banks to act at an earlier stage. This indicates a risk of rising interest rates. In light of this, we are maintaining our underweighted position in global bonds.

Defensive currencies and gold strong

There was also slightly more anxiety on the currency market. Last month, there was strong demand for defensive currencies, such as the Swiss franc and US dollar. Gold also found favour with investors once again, for the first time since spring. If the financial markets increasingly gear themselves towards persisting high inflation, further upturn potential for gold cannot be ruled out. For this reason, we are maintaining our neutral positioning for the time being.

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%					
Equities	**Total**	**50.0%**	**50.0%**					
	Switzerland	23.0%	23.0%					
	USA	10.0%	10.0%					
	Eurozone	3.0%	3.0%					
	United Kingdom	4.0%	4.0%					
	Japan	2.0%	2.0%					
	Emerging markets	8.0%	8.0%					
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%					
Alternative Investments	**Total**	**10.0%**	**10.0%**					
	Swiss real estate	5.0%	5.0%					
	Gold[2]	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

Market overview

Equities

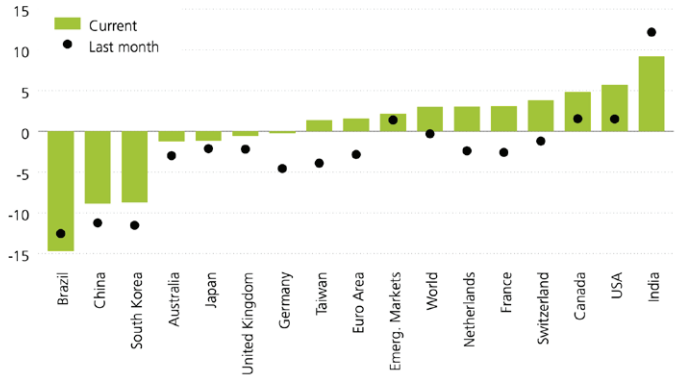
After a brief lull in September, the equity markets – driven by strong quarterly financial statements – began to climb again, reaching new record highs.

Indexed stock market performance in Swiss francs
100 = 01.01.2021

In September, the global equity markets failed to hit new record highs for the first time since the start of the coronavirus recovery rally. But this lull was only brief. Prices began climbing again in October, exceeding their previous record highs. They rose by over 5 percent last month. This means that global equities are up by around 26 percent since the start of the year. Emerging market equities performed comparatively weakly.

Source: SIX, MSCI

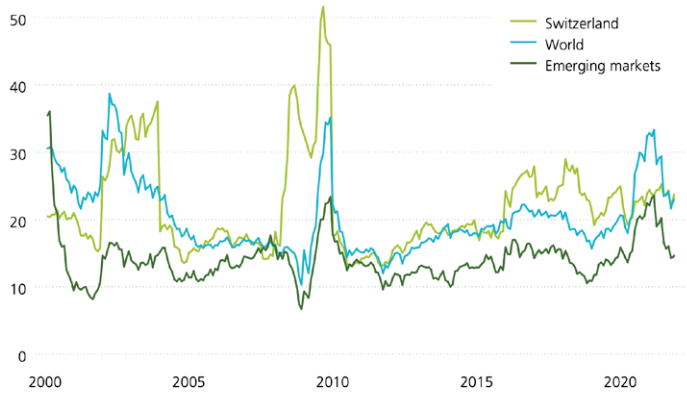
Momentum of individual markets
In percent



After broad-based declining momentum in the prior month, this picture has now reversed – driven by strong quarterly financial statements. All equity markets gained momentum again last month, with the exception of India and Brazil. The USA led the way, followed by Canada and the Netherlands. The European and Swiss equity markets also returned to positive territory. The Asian countries, meanwhile, fared less well. Led by a weakening China, South Korea and Taiwan also recorded negative momentum once again.

Source: MSCI

Price/earnings ratio
P/E ratio



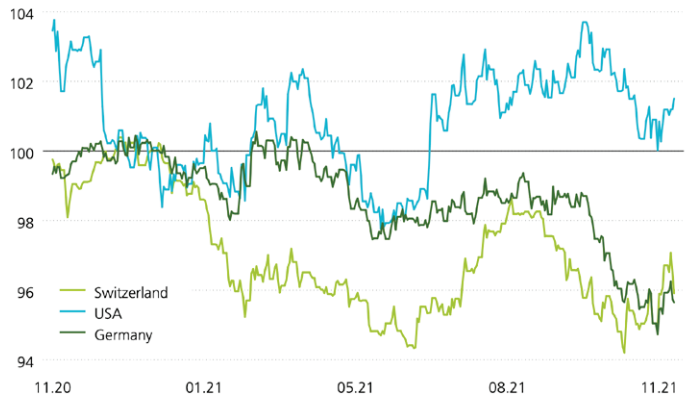
After last month's rise in equity prices, equity market valuations, measured by price/earnings (P/E) ratio, also increased significantly. The valuation of Swiss equities is now in line with the international average, while that of emerging market equities is considerably lower, with a P/E ratio of 15. Third-quarter financial statements again showed outstanding profits, particularly in the USA and Europe.

Source: SIX, MSCI

Market overview
Fixed income

Rising energy prices have triggered a spike in inflation rates worldwide over the summer months. As a result, there was also strong demand for inflation-protected securities on the bond markets.

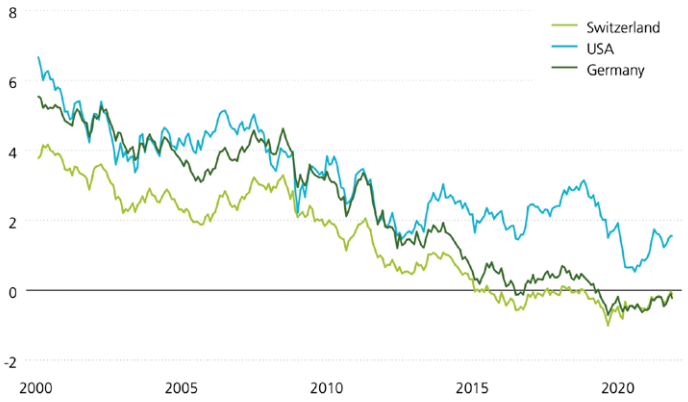
Indexed performance of government bonds in Swiss francs
100 = 01.01.2021



The trend towards higher inflation is increasingly being reflected on the bond markets – and justifiably so. In October, inflation rose to 6.2 percent in the USA and hit 4.1 percent in the eurozone, its highest level since July 2008. This resulted in particularly strong demand for inflation-protected bonds. These are preferable to nominal government bonds when inflation is high, as the payments made to investors are adjusted for inflation.

Source: SIX, Bloomberg Barclays

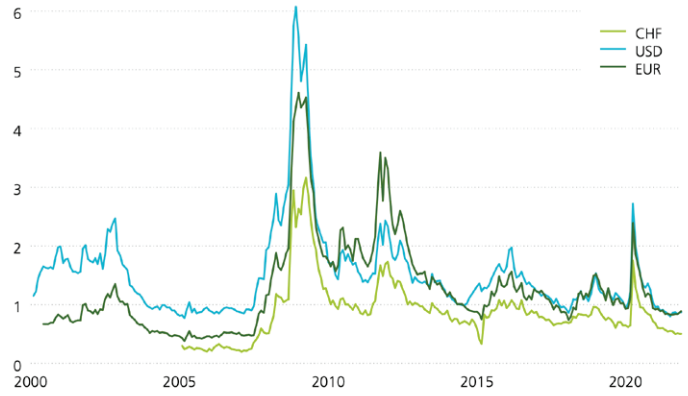
Trend in 10-year yields to maturity
In percent



The yields to maturity of government bonds were on a downward trend last month and were unaffected by growing concerns over inflation, despite the fact that inflation expectations on the market reached record highs recently. The publication of US consumer price inflation for October – which was unexpectedly high, at 6.2 percent – triggered a reversal in trend. At 1.5 percent, interest rates on 10-year US government bonds are remarkably low in light of the inflation risks. Interest rates on 10-year Swiss government bonds briefly exceeded the zero mark in early November but have since fallen again slightly and have now returned to negative territory.

Source: SIX, Bloomberg Barclays

Credit spreads on corporate bonds
In percentage points



Greater concern over inflation has also had little impact on the corporate bond market so far. After the high profits posted for the third quarter, companies appear to be in a secure position. This means that the risk premiums on corporate bonds remain very low compared to secure government bonds. The difference between the risk premium being demanded on Swiss corporate bonds and that on their counterparts denominated in euros or US dollars widened again recently.

Source: Bloomberg Barclays

Market overview

Swiss real estate investments

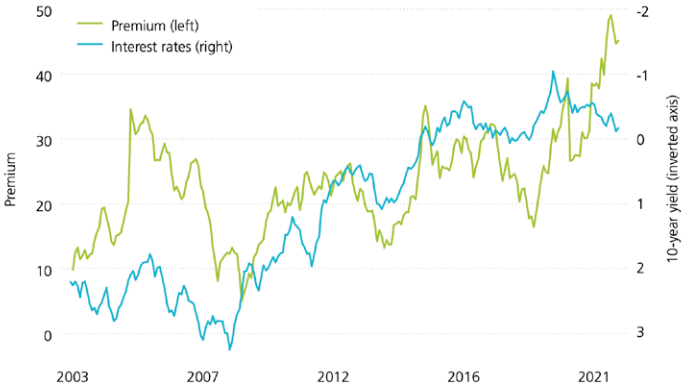
Swiss real estate fund prices have been fluctuating in recent weeks. After the recent surge in inflation expectations, however, demand for real estate also rose.

Indexed performance of Swiss real estate funds
100 = 01.01.2021

The price trend for indexed Swiss real estate investment has been very uncertain over recent weeks and months. The significant downturn in October meant that this was the worst month since the start of the year. Prices soared again in November, achieving a sharp rise within a short space of time.

Source: SIX

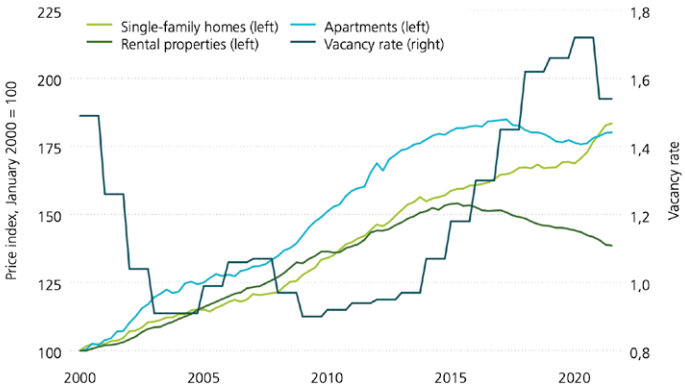
Premium on Swiss real estate funds and 10-year yields to maturity
In percent



After the strong price performance of indexed Swiss real estate funds last month – a weak October followed by a strong recovery – these valuations, which are derived from long-term interest rates, remain at a high level. The average premium on Swiss real estate investments currently stands at 45 percent.

Source: SIX

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



In the wake of the coronavirus pandemic, "living" has acquired a new status. The strong demand for more living space – combined with the low level of planning permission – is continuing to drive up prices on the Swiss real estate market. Year-on-year, the prices of single-family homes and condominiums rose by more than 6 percent. However, compared to the situation worldwide, inflation is still contained. The value of US real estate, for example, has risen by over 20 percent since year-opening.

Source: SNB, BfS

Market overview

Currencies

The Swiss franc remains strong, offsetting higher inflation rates abroad. But the yen and pound sterling performed weakly again.

The strong demand for commodity currencies in the previous month has waned in recent weeks. One exception was the Australian dollar, which gained in particular against the US dollar. The Swiss franc performed strongest last month, living up to its reputation as a "safe haven" in light of growing concerns over inflation. Despite its appreciation, its valuation remains fair, which is due to considerably higher inflation rates abroad. Demand for the Japanese yen and pound sterling was weak, and both currencies recorded losses.

Currency pair	Price	PPP [1]	Neutral area [2]	Valuation
EUR/CHF	1.06	1.06	0.99–1.13	Euro neutral
USD/CHF	0.92	0.83	0.73–0.94	USD neutral
GBP/CHF	1.23	1.38	1.19–1.57	Pound neutral
JPY/CHF	0.81	1.01	0.85–1.17	Yen undervalued
SEK/CHF	10.56	10.67	9.64–11.70	Krona neutral
NOK/CHF	10.64	11.99	10.70–13.28	Krona undervalued
EUR/USD	1.15	1.27	1.11– .44	Euro neutral
USD/JPY	114.06	82.54	67.52–97.56	Yen undervalued
USD/CNY	6.39	6.27	6.02–6.52	Renminbi neutral

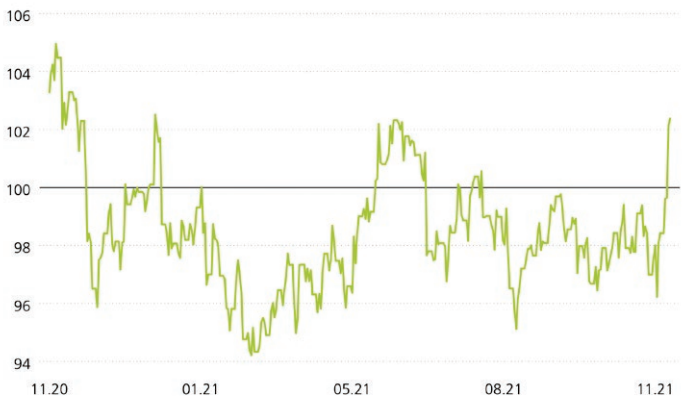
[1] Purchasing power parity. This metric calculates an exchange rate using relative inflation rates.
[2] Range of historically normal fluctuations.

Source: Web Financial Group

Gold

The price for a troy ounce of gold broke through the mark of 1,850 US dollars for the first time since June, responding to the trend towards higher inflation, which had previously been overlooked.

Indexed performance of gold in Swiss francs
100 = 01.01.2021



The price per troy ounce had remained below the mark of 1,800 US dollars for a long period, not even reacting to the trend towards higher inflation worldwide. This changed in early November, when the price per troy ounce climbed to over 1,850 US dollars for the first time in five months. Measured in Swiss francs, this means that the price of gold has returned to its year-opening level.

Source: Web Financial Group

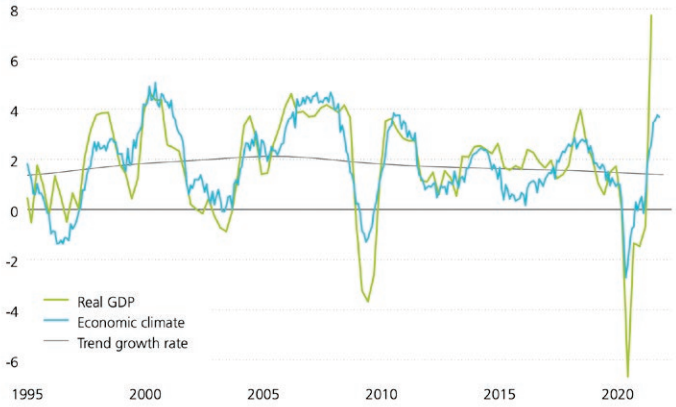
Economy

US inflation continues to rise

Die Konjunkturaussichten halten sich gut. Die Inflationszahlen steigen derweil weltweit weiter an. Während Zentralbanken in Schwellenländern mit Zinserhöhungen darauf reagieren, sind die Zentralbanken der grossen Währungsräume noch zurückhaltend.

Switzerland

Growth, sentiment and trend
In percent

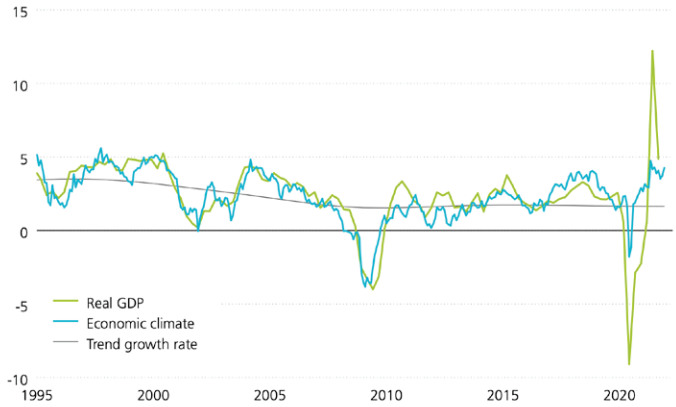


Source: Bloomberg

The Swiss economy looks in good shape again this autumn. Strong global demand for goods is also benefiting Swiss industry. The bottlenecks are reflected in the leading indicators, which remain at a very high level. Swiss consumers are also still willing to spend. Retail sales climbed again slightly in September, up 2.5 percent year-on-year.
Inflation also rose in Switzerland. Standing at 1.2 percent in October, however, it remains at a low level. This is partly due to energy prices in Switzerland being of less significance to consumer prices. Switzerland's starting point is also much lower than in other countries – in spring 2020, Swiss inflation was –1.5 percent.

USA

Growth, sentiment and trend
In percemt



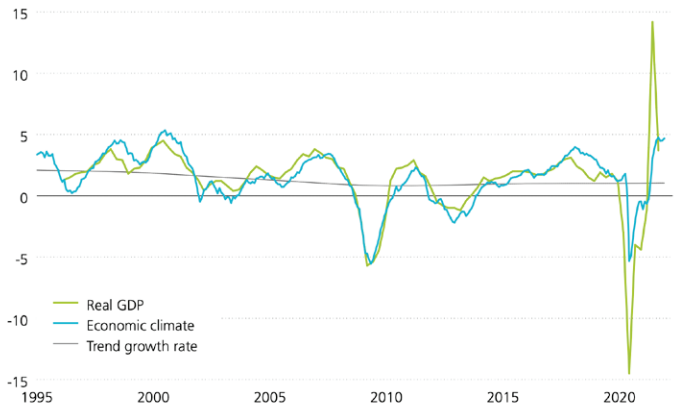
Source: Bloomberg

The US economy is still running at peak levels. The services sector, which for some time failed to hold pace with the strong recovery in demand for goods, also caught up recently. Demand for goods now stands at over 20 percent above the pre-crisis level. As a result, US imports hit a new historic high in September, with a goods value of 288.5 billion US dollars. But the strong recovery also led to bottlenecks and triggered price rises. Inflation had already been above the 5-percent mark since May, before climbing to 6.2 percent in October. The US Federal Reserve has not yet seen any need for prompt interest rate hikes, but is starting to scale back its bond-buying programme this month.

Eurozone

Growth, sentiment and trend

In percemt



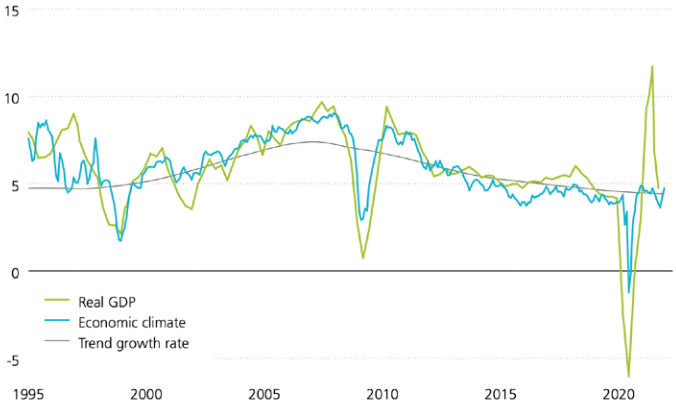
Source: Bloomberg

In retrospect, the economic situation in the eurozone was much better in the summer than initially expected. During the third quarter, the economy grew by 2.2 percent compared with the previous quarter. France posted the strongest GDP growth, almost reaching the pre-crisis level. It was followed in second and third place by Italy (2.6 percent) and Spain (2 percent). This means that the production gap is increasingly closing, while high capacity utilization has already been reached in France and Italy. German industrial production, which focuses heavily on the automotive sector, recorded another slight decline in September, however. Overall, the economic outlook remains very bright, even though the recovery is causing shortages of materials and delivery delays in Europe. Inflation in the eurozone rose to 4.1 percent in October, but the ECB is not planning to scale back its expansive monetary policy until the spring.

Emerging markets

Growth, sentiment and trend

In percemt



Source: Bloomberg

The environment for emerging markets remains challenging, particularly in Brazil, where inflation reached the double-digit range in October. The central bank responded promptly with a rate hike of 1.5 percentage points – the sixth this year.

Global economic data

Indicator	Switzerland	USA	Eurozone	UK	Japan	India	Brazil	China
GDP Y/Y [1] 2021Q2	7.7%	12.2%	14.3%	23.6%	7.6%	20.1%	12.4%	7.9%
GDP Y/Y [1] 2021Q3	–	4.9%	3.7%	6.6%	1.4%	–	–	4.9%
Economic climate [2]	↘	↘	↘	↘	↘	↘	↘	↘
Trend growth [3]	1.4%	1.6%	0.8%	1.6%	1.0%	5.0%	1.1%	4.2%
Inflation	1.2%	6.2%	4.1%	3.1%	0.2%	4.5%	10.7%	1.5%
Key rates	–0.75%	0.25%	0.00%	0.10%	–0.10%	4.00%	7.75%	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. Plus indicates an increasing economic growth, minus a slowing.
[3] Potential growth. Long-term change in gross domestic product with sustainable capacity utilization.

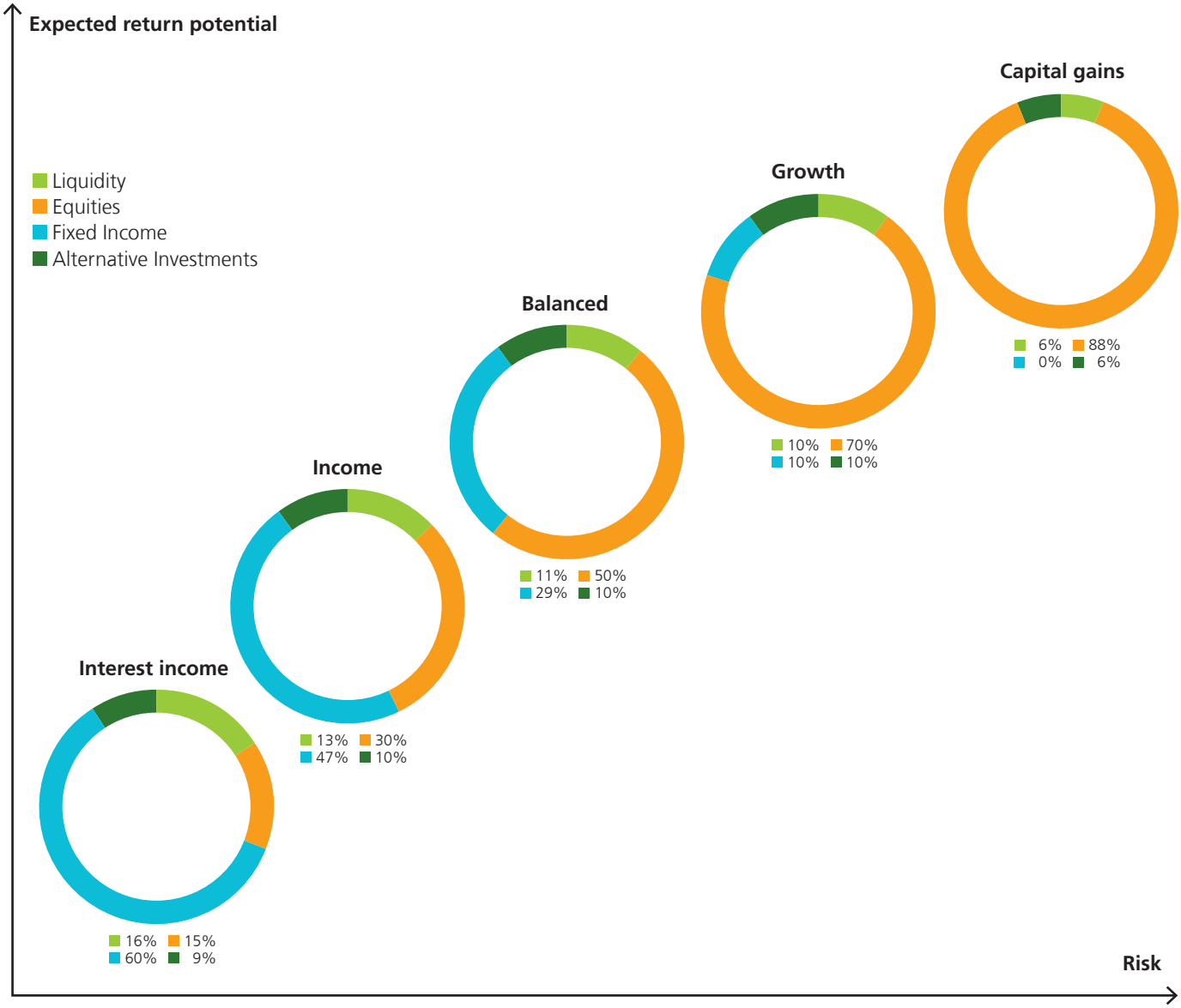
Source: Bloomberg

Model portfolios Swiss focus

Geared to inflationary pressures

Inflationary pressure continues. In the USA, inflation recently reached 6.2 percent, a level that many only know from history books. It is to be feared that the high inflation will not prove to be as temporary as the central banks would like. The persistent inflationary pressure speaks for the risk of rising interest rates. We are therefore maintaining our underweight in global bonds.

The equity markets have not yet been particularly impressed by high inflation – and rightly so, as a look at their high margins shows. With its large share of energy and financial stocks, the British equity market continues to show particular upside potential in an inflationary environment, in our view.



Source: PostFinance Ltd

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PostFinance Ltd
Mingerstrasse 20
3030 Berne

Phone +41 848 888 900

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