PostFinance investment compass October 2022

PostFinance

Editorial

There's always an element of risk

Swiss real estate funds offer attractive potential returns and justify the risk of investment.

Philipp Merkt
Chief Investment Officer

If this year has taught us anything, it's that there's no such thing as a risk-free investment. The best example of this is bonds, which are generally seen as "very secure investments", and helps explain why they're popular among investors looking to minimize risk. In 2022, this strategy hasn't paid off: if you'd invested 10,000 francs at the start of the year in a portfolio of secure Swiss government bonds with an average term, you would get much less than 9,000 francs back if you sold them today. That doesn't sound particularly secure.

"Swiss real estate funds provide opportunities."

Here's another example: if you'd put your savings into a savings account a year ago, you would still have the amount originally paid in, but the purchasing power of that money would have declined due to inflation. Investors in Switzerland have lost over 3 percent of their purchasing power, while their counterparts in Germany have lost almost 10 percent.

All investing entails risk. But if you don't invest, you'll definitely lose money due to inflation. It's therefore still essential to do so. But how?

We believe it's vital to invest in things that will create value for society over the long term. Investing in companies helps to create jobs, and enables products and services to be provided in a highly efficient and hopefully resource-friendly way. Investing in real estate helps create living space, commercial premises, hospitals and shopping malls. Meanwhile, investing in bonds allows companies and governments to fund urgently needed spending.

The more added value that is created, the greater the long-term yield on average. Since we don't usually know in advance exactly what will create which social benefits, we diversify our investments. In other words, we don't put all our eggs in one basket, which reduces the risk of losses.

Part of managing investment risks involves continual analysis to identify where there are currently opportunities to generate particularly high added value and to assess whether the financial markets are actually overlooking such opportunities. We think that such a situation exists right now. Swiss real estate funds have plunged by over 20 percent on average this year – but only due to lower premiums rather than falling real estate prices. Of course, rising interest rates could also result in lower valuations. However this is unlikely to materialize, given that demand for living space is currently at its highest for some time.

We expect immigration of around 60,000 people this year, and that around an additional 150,000 people are currently living in Switzerland due to the conflicts in Ukraine and Syria. At the same time, the construction of new housing has been declining for several years. In our view, it's worth assuming new, targeted risks in such situations – even if the general risks are still considered high.

Positioning

Have we hit rock bottom yet?

A sell-off is under way on the financial markets. This presents opportunities – but not in all areas yet. We advise investors to remain selective and make additional purchases in Swiss real estate funds.

The stock market has only been heading in one direction since the start of 2022 – and that's downwards. After 2018 and 2020, this is the third major downturn on the equity markets in just four years. That isn't just a remarkably high frequency, it's also extraordinary how quickly the stock markets bounced back in both 2018 and 2020.

"Stubbornly high inflation means central banks cannot yet afford to consider reducing interest rates."

Unlike those years, the current slump seems to fit the pattern of earlier market corrections. They taught us that lower prices alone are no guarantee of turning a quick profit. Ultimately, the economic environment has to be right. And the conditions for a sustainable stock market recovery aren't yet currently met in our view. There are two reasons for that.

The economy and monetary policy are weighing on the stock markets

First, the central banks won't cut their key rates for some time. Quite the opposite: the central banks in Europe and the US Federal Reserve look set to hike interest rates sharply again over the coming months. The prospect of interest rate cuts was one of the key conditions for a sustained stock market recovery in the past. Stubbornly high inflation in the industrial nations – with rates hitting their highest level in 40 years – means central banks can't yet contemplate reducing interest rates.

Secondly, high inflation and rising interest rates are weighing on the economy. Companies are still posting robust earnings, but the outlook is increasingly gloomy. Sentiment among consumers and producers is muted. They're becoming more restrained in terms of purchasing and orders, which will, in turn, increasingly impact on corporate revenues. If demand falls, it will also be more challenging for companies to pass on higher salary and energy costs to consumers. It means profit margins are coming under pressure, too.

Performance of asset classes

Asset class		1M in CHF	YTD [1] in CHF	1M in LCY [2]	YTD [1] in LCY [2]
Currencies	EUR	2.1%	–5.7%	2.1%	–5.7%
	USD	4.0%	9.5%	4.0%	9.5%
	JPY	2.2%	–14.2%	2.2%	–14.2%
Fixed Income	Switzerland	–1.4%	–12.5%	–1.4%	–12.5%
	World	–1.3%	–13.6%	–5.1%	–21.2%
	Emerging markets	–4.2%	–18.8%	–7.9%	–25.9%
Equities	Switzerland	–6.4%	–20.5%	–6.4%	–20.5%
	World	–4.1%	–17.2%	–7.8%	–24.4%
	USA	–3.1%	–16.1%	–6.8%	–23.4%
	Eurozone	–5.5%	–26.2%	–7.4%	–21.8%
	United Kingdom	–4.5%	–9.7%	–6.9%	–1.8%
	Japan	–4.2%	–19.6%	–6.3%	–6.3%
	Emerging markets	–9.2%	–22.1%	–12.7%	–28.9%
Alternative Investments	Swiss real estate	–8.7%	–22.7%	–8.7%	–22.7%
	Gold	0.5%	0.0%	–3.3%	–8.7%

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

Data as of 13.10.2022
Source: Web Financial Group, MSCI, SIX, Bloomberg Barclays, J.P.Morgan

Corporate earnings over the coming months are, in turn, likely to be much lower than in recent years. The profit forecasts of companies and market analysts still appear overly optimistic in our view. Disappointments are almost inevitable and are likely to interrupt short-term market rallies.

Inflation remains a risk for bonds

This has led us to adopt a cautious approach towards purchasing equities in the portfolios entrusted to us. We're still holding back on bonds, although prices have now reached attractive levels. We remain patient, given the fact that core inflation, which excludes energy and fresh food prices, continues to rise in the industrial nations. At the moment, there's still a risk of long-term interest rates rising again and bond prices falling accordingly.

Swiss real estate funds – a preferred asset class

Two months ago, we increased the positions in Swiss real estate funds. After a brief recovery, prices dropped again, which means the investment has not yet paid off. But we're retaining these investments out of conviction, and are taking advantage of falling prices to make further purchases. Firstly, we believe there's strong demand due to the shortage of residential property on the market. At the same time, the valuations of exchange-listed real estate funds are low enough to provide a comfortable safety buffer for any further interest rate hikes. It makes these investments more attractive than bonds. Also more attractive in relative terms is the average profit distribution of these funds, which currently stands at 3 percent a year.

Positioning relative to long term strategy: Swiss focus

Asset class		TAA[1] old	TAA[1] new	underweighted[3] ––	–	neutral[3]	+	overweighted[3] ++
Liquidity	**Total**	**11.0%**	**9.0%**					
	CHF	11.0%	9.0%					
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	6.0%	6.0%					
	Eurozone	3.0%	3.0%					
	United Kingdom	2.0%	2.0%					
	Japan	2.0%	2.0%					
	Emerging markets	8.0%	8.0%					
Alternative Investments	**Total**	**16.0%**	**18.0%**					
	Swiss real estate	9.0%	11.0%					
	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
Fixed income

The bond markets suffered significant losses last month, continuing the previous month's negative trend. Prices have fallen to multi-year lows in many regions.

Indexed performance of government bonds in Swiss francs
100 = 01.01.2022

Bond markets have struggled since the start of the year. However, historically high losses were posted again last month. Over 5 percent was wiped off the value of global bond markets within a month, while losses for the year to date now stand at more than 21 percent. This recent sell-off was triggered by heightened fears over the impact of the major central banks' measures to combat inflation.

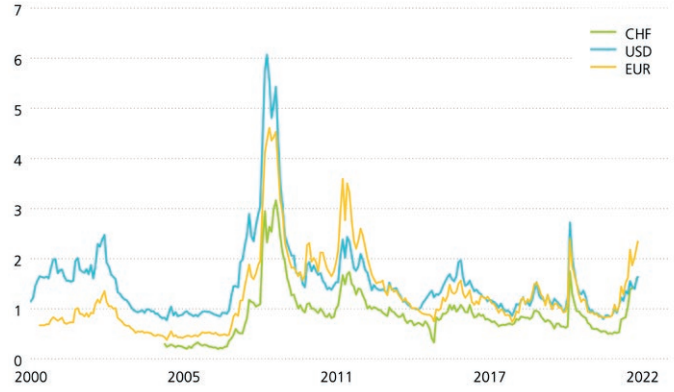
Source: SIX, Bloomberg Barclays

Trend in 10-year yields to maturity
In percent

Capital market interest rates skyrocketed last month, causing a price slump. Particularly in the UK, soaring interest rates forced the Bank of England to launch an emergency bond-buying programme to prevent market failure. 10-year yields to maturity on US government bonds also surged. While they stood at 3.2 percent in early September, they've now reached the 4 percent mark.

Source: SIX, Bloomberg Barclays

Credit spreads on corporate bonds
In percentage points



The gloomier outlook for future economic performance was also reflected in the credit spreads being demanded on corporate bonds. It's very clear that investors now see European corporate bonds as much higher risk than their US counterparts. It means the spreads here are also higher. The opposite applied in the past. But this reflects investors' concerns over the continued impact of the Ukraine conflict – especially in terms of securing Europe's energy supply.

Source: Bloomberg Barclays

Market overview
Equities

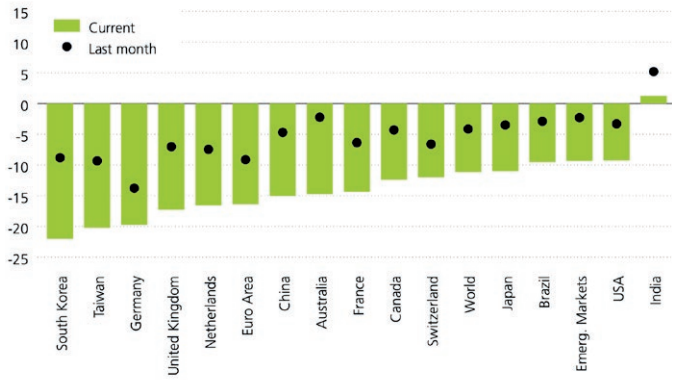
The global equity markets suffered a severe setback in September, posting double-digit losses.

Indexed stock market performance in Swiss francs
100 = 01.01.2022

After the summer high on the equity markets, the first autumn storms had already arrived by September. Equities in developed markets, measured by the MSCI World Index, fell by 8.5 percent, Swiss equities by 6 percent and emerging market equities by 11 percent, measured in Swiss francs. The outlook for the stock markets remains challenging as there are no signs as yet of the economic environment improving – quite the opposite, in fact.

Source: SIX, MSCI

Momentum of individual markets
In percent



Last month's major downturn has tipped momentum on the stock markets back into negative territory. As well as the European markets, the east Asian countries, including South Korea and Taiwan, were also badly hit. While Europe is anxious about the energy shortage this winter, the east Asian countries are now feeling the impact of the recession in China.

Source: MSCI

Price/earnings ratio
P/E ratio

The ratio between corporate earnings and share prices – generally known as the price/earnings (P/E) ratio and a well recognized benchmark – has fallen significantly this year. It's actually halved in terms of the global average. Equity prices have nosedived this year, but corporate earnings have been robust. However the latter trend is increasingly likely to change. Particularly in Europe, a growing number of exchanged-listed companies are now posting lower earnings growth.

Source: SIX, MSCI

Market overview

Swiss real estate investments

The challenging market environment is also having an impact on Swiss real estate funds, which plunged to a new low for the year recently.

Indexed performance of Swiss real estate funds
100 = 01.01.2022

Exchange-listed real estate investments were also severely hit by the recent turmoil on the interest rate markets. In terms of the global average, real estate equity prices tumbled by around 13 percent last month. The prices of listed Swiss real estate funds themselves fell by around 8 percent. On a positive note, the average distribution yield of the real estate funds has risen slightly this year to 3 percent.

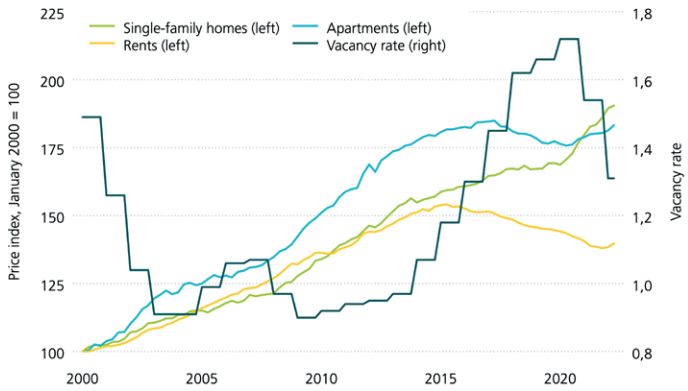
Source: SIX

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

The premiums on Swiss real estate funds have rarely been as low as of late. With the average premiums being demanded on properties' net asset value in the single-digit range, the valuations are currently very low. This is due not just to the recent price slump, but also to the fact that the impact of higher capital market interest rates is now being felt.

Source: SIX

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



The number of vacant apartments in Switzerland fell again last year. As at 1 June, there were around 61,000 vacant apartments throughout Switzerland, which is 17,000 less than in 2020, the year of COVID-19. This does not come as a surprise as leaving an apartment unused is increasingly costly in the current environment.

Source: SIX

Market overview

Currencies

The US dollar and Swiss franc remain strong. However, Asian countries are going through a phase of weakness, while the commodity currencies have also performed disappointingly recently.

The currency landscape changed dramatically over the past year, becoming much more one-sided. The US dollar and Swiss franc reaffirmed their strong position again last month, clearly benefiting from their reputation as crisis-proof currencies. In contrast, the pound sterling and the Swedish krona suffered considerable losses. The performance of the commodity currencies was also generally disappointing. Only the Japanese yen bucked the trend, and did not suffer any further price losses last month. For the first time in 20 years, the Japanese central bank was forced to intervene in the currency markets to protect the value of the yen from slipping further.

Currency pair	Price	PPP [1]	Neutral area [2]	Valuation
EUR/CHF	0.98	0.79	0.74–0.85	Euro overvalued
USD/CHF	1.00	0.76	0.67–0.86	USD overvalued
GBP/CHF	1.13	1.23	1.07–1.40	Pound neutral
JPY/CHF	0.68	0.96	0.81–1.11	Yen undervalued
SEK/CHF	8.90	9.27	8.38–10.15	Krona neutral
NOK/CHF	9.46	10.61	9.48–11.75	Krona undervalued
EUR/USD	0.98	1.04	0.91–1.18	Euro neutral
USD/JPY	147.20	79.42	63.74–95.09	Yen undervalued
USD/CNY	7.17	5.60	5.31–5.89	Renmimbi undervalued

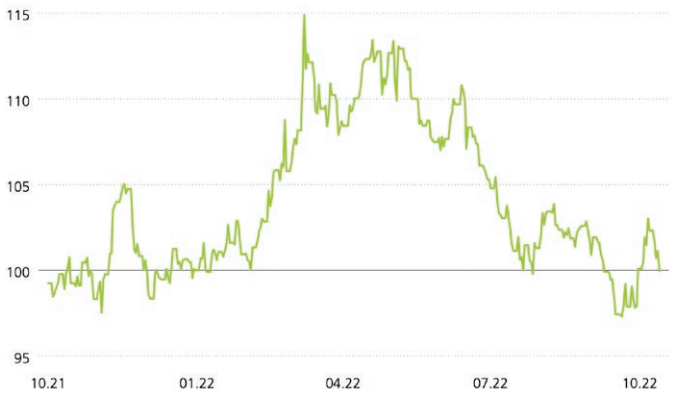
[1] Purchasing power parity. This metric calculates an exchange rate using relative inflation rates.
[2] Range of historically normal fluctuations.

Source: Web Financial Group

Gold

Despite all the financial market turmoil, gold – usually seen as a crisis-proof investment – also declined in value.

Indexed performance of gold in Swiss francs
100 = 01.01.2022



Investors still generally see gold as a means of protecting against crises and inflation. The precious metal is only performing this role to some extent this year – at least from the perspective of US and Swiss investors. The gold price plummeted by 100 US dollars to 1,620 US dollars within a few days in September, hitting a new low for the year. Despite a phase of recovery, the precious metal is still hovering around the 1,650 dollar mark. The recent strength of the US dollar has also had a major impact on price performance. Over the first three quarters, gold is up by 5.3 percent measured in euros, by 10 percent in pound sterling and by over 14 percent in yen.

Source: Web Financial Group

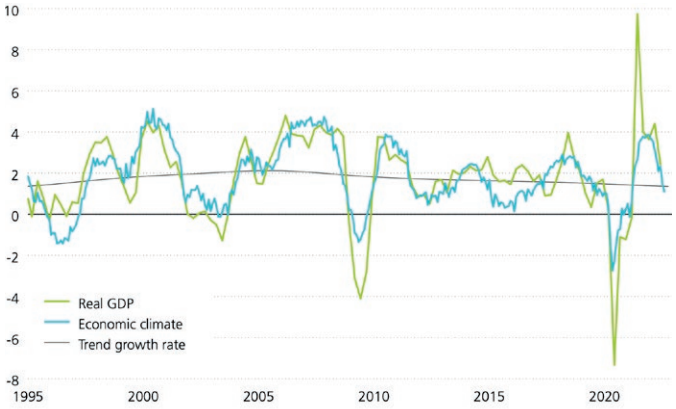
Economy

The economy continues to falter

China is in recession, Europe is on the verge, while the USA is set to enter one in winter.

Switzerland

Growth, sentiment and trend
In percent

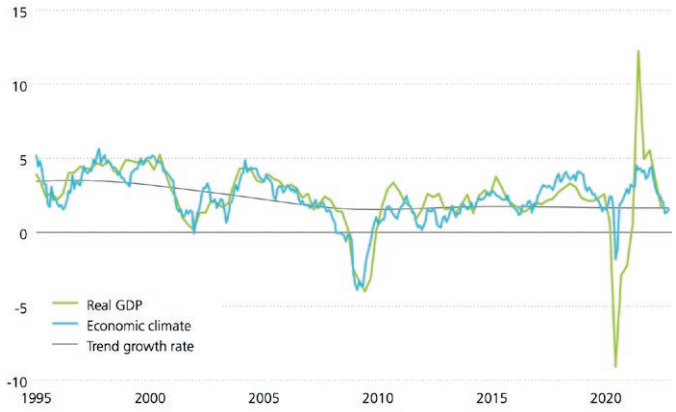


Source: Bloomberg

Compared with general performance in Europe, Swiss economic indicators are remarkably robust. While consumer confidence has also plummeted to an historic low in Switzerland, companies are still reporting strong sentiment ratings. Although the Purchasing Managers' Index fell slightly again, the indexes for order volumes and production point to sustained growth – even if production is increasingly for stock purposes. The inflation-adjusted weak Swiss franc is proving just as beneficial as relatively low inflation. With an overall rate of just 3.3 percent and a core rate of 1.9 percent at consumer level, Switzerland looks to be an island of relative price stability.

USA

Growth, sentiment and trend
In percent

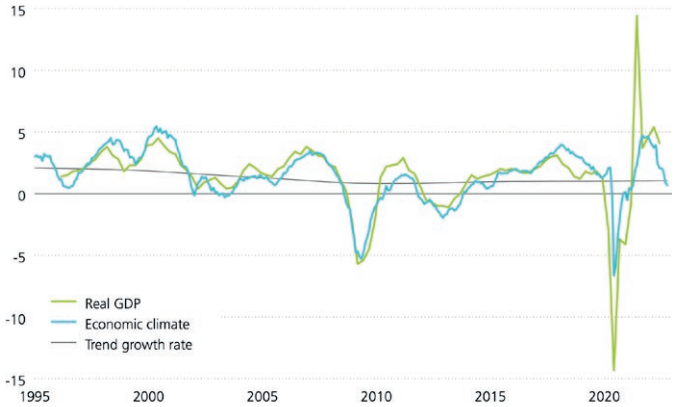


Source: Bloomberg

Sentiment among US companies deteriorated further last month. Stubbornly high inflation was a contributory factor. While the overall rate of inflation fell from 9.1 to 8.2 percent over a four-month period, the core rate rose and now stands at 6.6 percent. This eased the price situation slightly, despite inflation being felt on an increasingly broad basis. Economic growth in the USA was negative in the first six months, and declined by 1.6 percent in the first quarter and 0.6 percent in the second quarter. The recently observed fall in inflation means improved economic performance is anticipated in the third quarter despite inflation remaining high. But a winter recession is still the most likely scenario in view of poorer sentiment ratings and rising interest rates. It also means the US Federal Reserve will probably make further significant interest rate hikes.

Eurozone

Growth, sentiment and trend
In percent

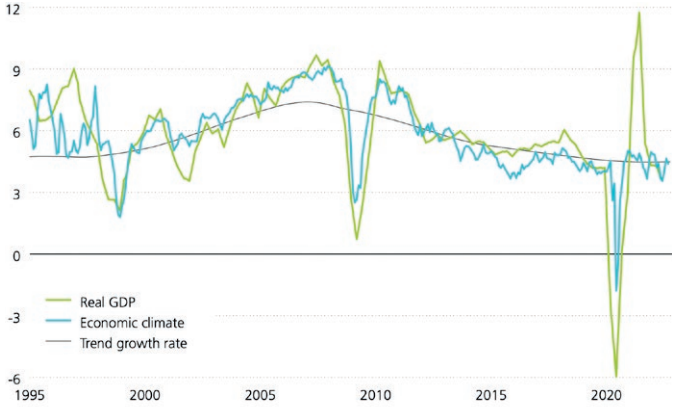


Source: Bloomberg

Amongst the industrial nations, the signs of recession are currently clearest in Europe. For the first time since COVID-19, the UK has experienced a three-month period of falling GDP. In the eurozone, the Purchasing Managers' Index for industrial and services companies has also dipped below the figure required for growth for the first time. The inflation trend has accelerated again, with the overall rate of inflation standing at 10 percent and the core rate of inflation rising sharply to 4.8 percent. At producer price level, the inflation rate stands at a colossal 20 percent. The ECB is expected to make further significant interest rate hikes.

Emerging markets

Growth, sentiment and trend
In percent



Source: Bloomberg

So far the Chinese government has failed to put the economy back on track. Neither significant depreciation of the currency nor a fall in interest rates have brightened the outlook for consumers – let alone increased spending. The economic data published during the National Congress cannot hide the facts either. The situation on the real estate market remains precarious, with prices tumbling further. This is particularly evident when looking at declining imports in real terms, which points to a weak domestic economy. Companies in all sectors are less optimistic, which appears to be related to the government's COVID-19 policy that is still holding back growth in the short term.

Global economic data

Indicator	Switzerland	USA	Eurozone	UK	Japan	India	Brazil	China
GDP Y/Y [1] 2022Q2	2.4%	1.8%	4.1%	4.4%	1.6%	13.5%	3.2%	0.4%
GDP Y/Y [1] 2022Q3	–	–	–	–	–	–	–	–
Economic climate [2]	↘	↘	↘	↘	↘	↘	↘	↘
Trend growth [3]	1.4%	1.6%	0.8%	1.7%	1.1%	5.1%	1.3%	4.0%
Inflation	3.3%	8.2%	10.0%	9.9%	3.0%	7.4%	7.2%	2.8%
Key rates	0.50%	3.25%	1.25%	2.25%	–0.10%	5.90%	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.

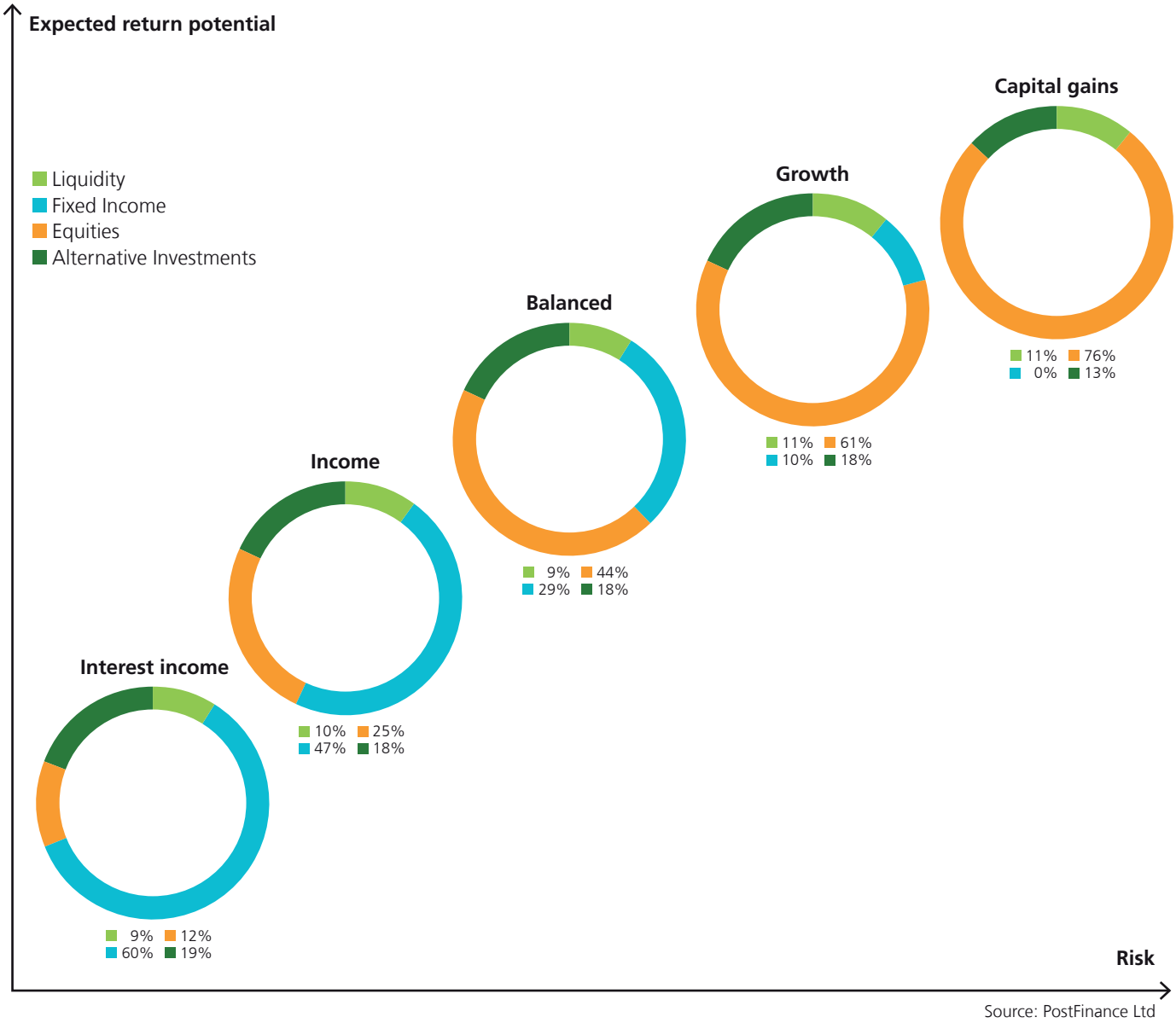
Source: Bloomberg

Model portfolios Swiss focus

Tactical opportunity in the real estate market

The financial markets got off to a stormy start in the autumn and suffered major losses across all asset classes. Despite significantly lower prices in the meantime, an end to the sell-off is not yet guaranteed, especially since the economy, inflation and monetary policy are likely to continue to make for a difficult investment environment. Defensive positioning in portfolios is therefore still advisable.

However, we see a tactical buying opportunity in listed Swiss real estate funds. We already increased our position in this asset class two months ago. In view of the low valuations and the continuing demand for residential real estate, we see a tactical opportunity for further purchases.



Source: PostFinance Ltd

Legal information

This document and the information and statements it contains are for information purposes only and do not constitute either an invitation to tender, a solicitation, an offer or a recommendation to purchase a service, buy or sell any securities or other financial instruments or to perform other transactions or to conclude any kind of legal transaction.

This document and the information it contains is intended solely for persons domiciled in Switzerland.

The investment analyses from Investment Research are produced and published by PostFinance. PostFinance selects the information and opinions published in this document carefully and includes sources deemed reliable and credible. However, PostFinance cannot guarantee that this information is accurate, reliable, current or complete and, to the extent permitted by law, does not assume any liability for it. In particular, PostFinance rejects any liability for losses resulting from investment performance based on information contained in this document. The content of this document is based on various assumptions. Differing assumptions can result in significantly different outcomes. The opinions expressed in this document may differ from or contradict the views of other PostFinance business units, as they are based on the use of different assumptions and/or criteria. The content of this document is specific to a particular date. This means that it is only current at the time of creation and may change at any time. Past performance is not a reliable indicator of future results. The performance shown does not take account of any commissions and costs charged when purchasing units or of the service fee. The price, value and return of investments may fluctuate. Investment in financial instruments is subject to certain risks and does not guarantee the retention of the capital invested or an increase in value. The analyst or group of analysts who produced this report may interact with employees from marketing and sales or other groups for the purposes of collecting, compiling and interpreting market information. PostFinance has no obligation to update information or opinions, to specify that information is no longer up to date, or to remove such information.

No advice (investment, legal or tax advice, etc.) is provided through this document. This information does not take into consideration the specific or future investment objectives, financial or tax situation or particular needs of any specific recipient. This means the information and opinions are not a suitable basis for investment decisions. We recommend that you consult your financial or tax advisor before every investment. Downloading, copying or printing this information is permitted for private use only, provided that the copyright notice or other legally protected names or symbols are not removed. Complete or partial reproduction, communication (electronic or otherwise), modification, linking or use of the newsletter for public or commercial purposes and non-commercial distribution to third parties is prohibited without prior written consent from PostFinance. PostFinance accepts no liability for claims or legal action by third parties based on the use of this information. Further information is available on request.

Important information on sustainable investment strategies
PostFinance may include sustainable investments when selecting instruments for the model portfolio. This means that environmental, social and governance (ESG) criteria are taken into account in investment decisions. If ESG criteria are implemented, certain investment opportunities may not be pursued which would otherwise be compatible with the investment goal and other general investment strategies. Taking account of sustainability criteria can result in the exclusion of certain investments. As a result, investors may not pursue the same opportunities or market trends as investors who do not apply such criteria.

Source: MSCI. Neither MSCI nor any other party involved in or related to compiling, computing or creating the MSCI data makes any express or implied warranties or representations wieht respect to such data (or the results to be obtained by the use thereof), and all such parties hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability or fitness for a particular purpose with respect to any of such data. Without limiting any of the foregoing, in no event shall MSCI, any of its affiliates or any third party involved in or related to compiling, computing or creating the data have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of the possibility of such damages. No further distribution or dissemination of the MSCI data is permitted without MSCI's express written consent.

Source: J.P.Morgan. Information has been obtained from sources believed to be reliable but J.P. Morgan does not warrant its completeness or accuracy. The Index is used with permission. The Index may not be copied, used, or distributed without J.P. Morgan's prior written approval. Copyright 202[0], JPMorgan Chase & Co. All rights reserved.

Source: Bloomberg Index Services Limited. BLOOMBERG® is a trademark and service mark of Bloomberg Finance L.P. and its affiliates (collectively "Bloomberg"). BARCLAYS® is a trademark and service mark of Barclays Bank Plc (collectively with its affiliates, "Barclays"), used under license. Bloomberg or Bloomberg's licensors, including Barclays, own all proprietary rights in the Bloomberg Barclays Indices. Neither Bloomberg nor Barclays approves or endorses this material, or guarantees the accuracy or completeness of any information herein, or makes any warranty, express of implied, as to the results to be obtained therefrom and, to the maximum extent allowed by law, neither shall have any liability or responsibility for injury or damages arising in connection therewith.

Data as of 14 October 2022
Editorial deadline: 18 October 2022

PostFinance Ltd
Mingerstrasse 20
3030 Berne

Phone +41 848 888 900

www.postfinance.ch

461.40 en (pf.ch/dok.pf) 10.2022 | Advertising from PostFinance Ltd