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PostFinance

Editorial

All-rounders (in good times)

Ever greater demands have been placed on central banks – which they have also met. There are increasing signs this task will become more challenging in future.

Daniel Mewes
Chief Investment Officer

High demands are being placed on central banks. They are expected to ensure price stability and support the economy during recessions. But central banks in industrial countries have gone above and beyond that remit recently. By keeping interest rates low, they ensured that neither states nor real estate owners were overwhelmed by their debt, provided the financial markets with prompt support when setbacks occurred and granted the banks so much liquidity that they were no longer at risk of bankruptcy. In Europe, the European Central Bank has saved the euro on top of its main tasks, while the Swiss National Bank has alleviated currency risks facing economic players with its currency policy.

Central banks have proven themselves to be real all-rounders. But they've been able to tackle other challenges because they haven't been overstretched by their main responsibility of ensuring price stability. Regardless of what the central banks did, inflation rates have remained low and stable.

Tackling inflation is making it more difficult for central banks to meet the other demands placed on them.

If prices rise more rapidly

They will face far greater challenges when inflation rates move out of their target bandwidths. Tackling inflation is making it more difficult for central banks to meet the other demands placed on them. Higher interest rates mean indebted states as well as financial and real estate markets are facing a strong headwind. It's why the current high level of inflation in many countries is a cause for concern, and the key question is whether or not these effects are temporary.

Making inflation forecasts for 2022 is now about as serious an art as predicting who will win the football World Cup in 2022. Just as Switzerland are highly unlikely to win the tournament, there are fewer and fewer indications that inflation rates will return to normal next year. We will at least get an indication of how central banks will act where they have to accept lower economic growth to tackle inflation.

Central banks face difficult decisions

All this means the central banks will face difficult decisions. They are currently still in support mode in the industrialized world. In the eurozone and the USA, the central banks are continuing to buy bonds on a huge scale. We expect these schemes to end soon – as already cautiously announced – but also that interest-rate decisions will become an increasingly important issue. While the Swiss National Bank is unlikely to be one of the frontrunners, it may also make adjustments in the wake of measures taken by other central banks. Tactically, we are continuing to align the portfolios entrusted to us towards a sustained period of high inflation. Besides adopting an underweighted position in global bonds, we are now focusing on equities, which perform better during phases of higher inflation.

Positioning

Financial markets gripped by inflation fears

Inflation pressure will not ease up any time soon. We are maintaining our underweighted position in global bonds and recommend buying UK equities at the expense of their European counterparts.

Historically, September has been a poor month for the equity markets. This also turned out to be the case last month. The financial markets showed signs of anxiety about a sustained period of inflation and the faltering Chinese economy. Fears over inflation are proving to be justified. Global trade has reached a record level, which is exacerbating the bottlenecks. On top of all this, energy prices are rising, the US labour market is stretched to capacity and living costs are spiralling upwards. There are many signs that inflationary pressure is not likely to ease up any time soon. The Chinese authorities' firm intention to put the brakes on the overheated real estate market is aggravating the situation. The fact the global economy remains robust is, however, reassuring. We think it's unlikely that Chinese economic concerns will spread to the global financial markets for the time being.

Inflation expectations are driving interest rates

Central banks are increasingly facing the prospect of having to focus on tackling inflation sooner than they anticipated. Yet, they continue to play a supportive role for the moment. The equity markets have responded to this mix of factors with ups and downs.

On most equity markets, September was the first negative month since the year began.

Performance of asset classes

Asset class		1M in CHF	YTD [1] in CHF	1M in LCY [2]	YTD [1] in LCY [2]
Currencies	EUR	–1.4%	–0.9%	–1.4%	–0.9%
	USD	0.3%	4.3%	0.3%	4.3%
	JPY	–3.2%	–5.2%	–3.2%	–5.2%
Equities	Switzerland	–1.8%	15.2%	–1.8%	15.2%
	World	–0.5%	21.2%	–0.9%	16.2%
	USA	0.3%	23.8%	0.0%	18.7%
	Eurozone	–2.6%	16.8%	–1.3%	17.9%
	United Kingdom	2.3%	20.9%	2.9%	15.8%
	Japan	–8.3%	6.3%	–5.3%	12.2%
	Emerging markets	–1.7%	4.2%	–2.1%	–0.1%
Fixed Income	Switzerland	–0.8%	–1.7%	–0.8%	–1.7%
	World	–1.6%	0.1%	–2.0%	–4.1%
	Emerging markets	–2.3%	2.3%	–2.6%	–2.0%
Alternative Investments	Swiss real estate	–1.6%	4.7%	–1.6%	4.7%
	Gold	0.7%	–0.6%	0.3%	–4.7%

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

Data as of 14.10.2021
Source: Web Financial Group, MSCI, SIX, Bloomberg Barclays, J.P.Morgan

Bonds are not proving a good alternative to equities. Long-term interest rates climbed sharply last month, which resulted in bonds recording heavy losses for the first time since March. The main driver was inflation expectations, which now stand at an historic high. Despite recent rises, interest rates remain low. Inflationary pressure and greater calls on central banks to tackle inflation soon point to further upside potential for interest rates. This is why we are retaining our underweighted position in global bonds.

Inflation-resistant UK equity market

Not all equities have undergone the same degree of correction. Energy and financial stocks performed well. These two sectors prove to be better investments in times of higher inflation. This benefited the UK equity market in particular last month. It has a higher weighting towards energy and the financial sector in its composition. As we anticipate sustained inflationary pressure, we are adjusting our equity market positioning accordingly and increasing the weighting of these sectors by buying UK equities at the expense of their European counterparts.

Defensive currencies make gains

In a more volatile risk environment, safe-haven currencies – such as the Swiss franc and US dollar – rose, along with certain commodity currencies. The US dollar even briefly hit its highest level of the year. Conversely, the Japanese yen lost ground and was one of the weakest currencies. This confirmed our view that the Japanese yen no longer offers better protection against market turbulence than the Swiss franc. Gold did not prove a good hedge either. It has been trending sideways since June and has not risen due to rising inflation expectations either. We are therefore maintaining our neutral positioning.

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	5.0%	3.0%					
	United Kingdom	2.0%	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

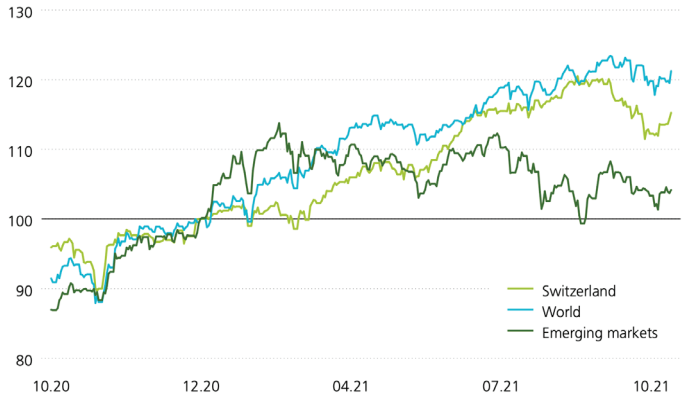
☐ Adjustment compared to last month

Market overview

Equities

The financial problems in the Chinese real estate sector and inflation concerns have triggered volatility on the equity markets. No new record highs have been achieved for over a month – for the first time this year.

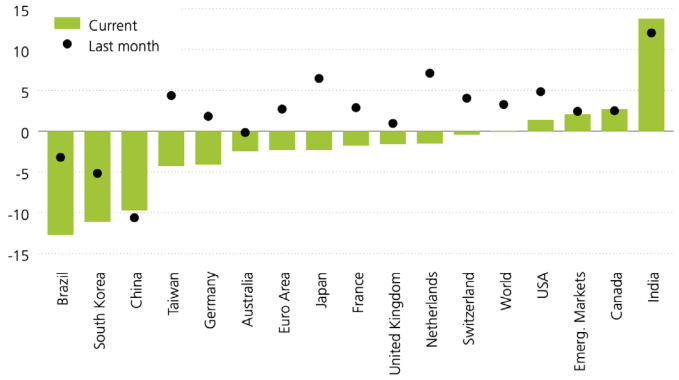
Indexed stock market performance in Swiss francs
100 = 01.01.2021



After a calm summer break on the global stock exchanges, the financial challenges facing the Chinese real estate company Evergrande have been causing anxiety since early September. As a result, the financial markets' attention has increasingly shifted to the fragile stability of the heavily debt-financed Chinese real estate sector. This briefly put a damper on the stock exchanges, but they recovered again quickly, particularly in the US. For the first time since year-opening, no new record highs were recorded on the stock markets last month.

Source: SIX, MSCI

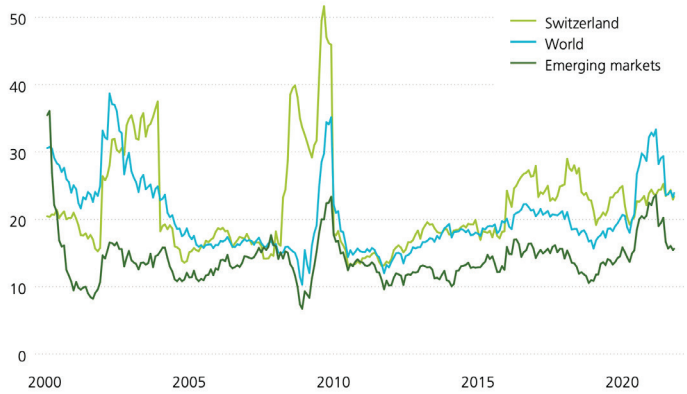
Momentum of individual markets
In percent



Turbulence on the financial markets in September has tipped the momentum of almost all stock exchanges into negative territory. This does not come as a surprise after the impressive recovery rally over recent months. The Brazilian equity market in particular has struggled recently. Headwind has been created by high local inflation rates, which have now reached double digits, causing the Brazilian central bank to raise interest rates for the fifth time this year. A positive exception is India's equity market, which is currently breaking records, spurred on by a privatization initiative launched by the Indian government focusing on the petroleum, aviation, rail and shipping sectors.

Source: MSCI

Price/earnings ratio
P/E ratio



Last month's turbulence impacted on equity prices. At country level, prices overwhelmingly suffered losses month-on-month. This is also reflected by the valuation measured by price/earnings (P/E) ratio, which fell slightly again last month, despite strong profit levels. With a P/E ratio of 23, Swiss equities are valued slightly lower than the global average.

Source: SIX, MSCI

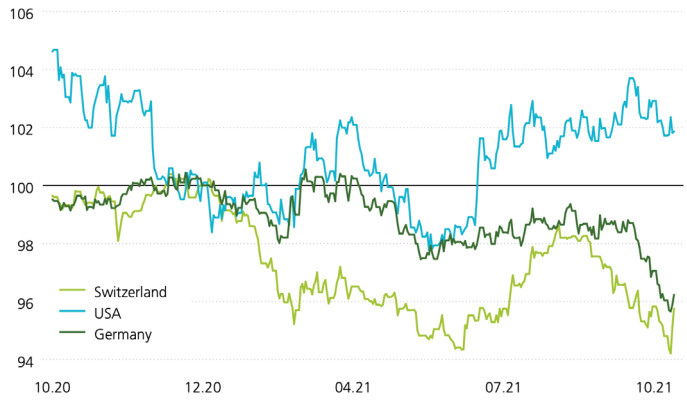
Market overview

Fixed income

Interest rates surged worldwide last month, reaching the level seen in spring in many places. The main factors behind this widespread rise in interest rates are higher inflation expectations and the solid economic outlook.

Indexed performance of government bonds in Swiss francs

100 = 01.01.2021

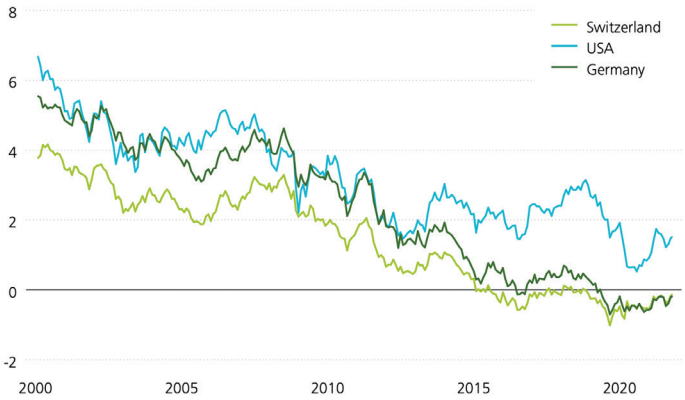


The recovery of the global economy is continuing in the third quarter – even though persistent, global bottlenecks in industrial production and on the labour market are having an impact. In combination with the sharp rise in energy prices, many market participants have concluded that inflation will not be as temporary as previously assumed. There is less demand for bonds in an inflation environment – which also proved the case last month: the value of Swiss government bonds is currently 5 percent below the year-opening level, while their German counterparts are down 4 percent. Despite the recent setbacks, 10-year US bonds measured in Swiss francs have just remained in positive territory thanks to the strong US dollar.

Source: SIX, Bloomberg Barclays

Trend in 10-year yields to maturity

In percent

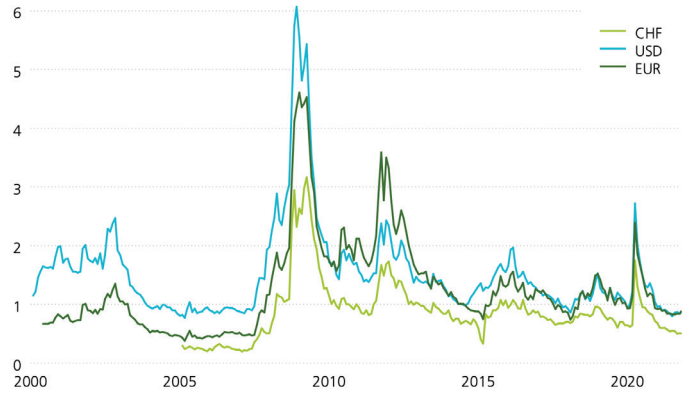


The trend in European interest rates in August is now apparent at a broad level: yields to maturity rose worldwide last month. The rise in interest rates on 10-year US bonds stands at over 0.3 percentage points. They currently stand at over 1.5 percent and are approaching spring's level again (1.7 percent). Yields to maturity on Swiss and German bonds are currently nearing the zero mark again. Expectations of a much more restrictive monetary policy from the major central banks due to persistent high inflation is a factor in the rise in interest rates.

Source: SIX, Bloomberg Barclays

Credit spreads on corporate bonds

In percentage points



The growing turbulence on the financial markets led to negative returns on bonds of all categories in September. Corporate and high-yield bonds also recorded losses. Higher-risk corporate bonds in particular have recently seen a rise in risk premiums compared to more secure government bonds. This indicates that investors are again differentiating more based on risk.

Source: Bloomberg Barclays

Market overview

Swiss real estate investments

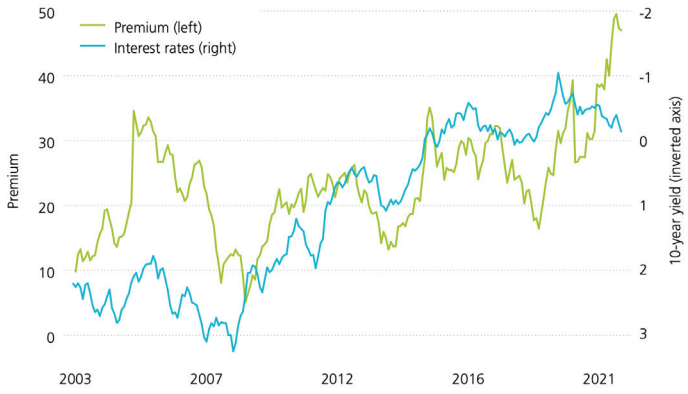
There have been minor corrections to Swiss real estate funds since the end of summer. Given the low interest rates, valuations are still very high.

Indexed performance of Swiss real estate funds
100 = 01.01.2021

The minor corrections to Swiss real estate funds at the end of summer lasted for only a brief period. Prices are rapidly climbing back to August's level. Despite this sidewards movement over the course of the month, the prices of indexed real estate investments are up by 5 percent since the start of the year. This means that Swiss real estate investments are the exception by international comparison. Losses of 5 percent or more were recorded in the UK, Japan and the eurozone last month due to greater turbulence on the financial markets.

Source: SIX

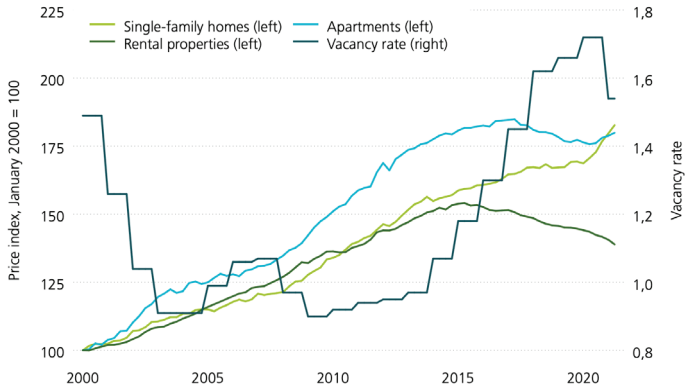
Premium on Swiss real estate funds and 10-year yields to maturity
In percent



The sharp rise in yields to maturity on 10-year Swiss government bonds – from –0.42 percent in August to just under zero recently – is also having an impact on premiums. With an average premium on the value of the properties contained in the funds of 47 percent, they are now slightly below their record high of 50 percent in August.

Source: SIX

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



A country's population development is a key component of the real estate market. There has been strong growth in Switzerland over recent decades. At the end of the second quarter, Switzerland's population stood at 8.7 million, which is around 1.6 million more than in 2000. The higher demand for real estate is also explained by the growing need for space. The Swiss population comprises 3.9 million households, of which over a third consist of only one person. A further third are two-person households. Less than a fifth of Swiss households today have four or more members.

Source: SNB, BfS

Market overview

Currencies

The commodity currencies are benefiting from a huge hike in energy prices. There is also strong demand for the Swiss franc and US dollar. By contrast, emerging market currencies are falling in value.

Commodity currencies made strong gains after the rally on the commodity markets. The Canadian dollar, the Norwegian krone and the Russian rouble rose by almost 3 percent. The Swiss franc and US dollar also benefited from the mood of uncertainty on the financial markets. The Japanese yen, a popular defensive currency, did not follow suit, falling in value. Emerging market currencies also suffered losses, particularly the Brazilian real. Rising inflation rates are creating a bleak outlook in Brazil.

Currency pair	Price	PPP [1]	Neutral area [2]	Valuation
EUR/CHF	1.07	1.09	1.01–1.17	Euro neutral
USD/CHF	0.92	0.84	0.74–0.94	USD neutral
GBP/CHF	1.26	1.39	1.20–1.58	Pound neutral
JPY/CHF [3]	0.81	1.02	0.86–1.18	Yen undervalued
SEK/CHF [3]	10.69	11.39	10.29–12.50	Krona neutral
NOK/CHF [3]	10.92	12.14	10.84–13.45	Krona neutral
EUR/USD	1.16	1.30	1.13–1.47	Euro neutral
USD/JPY	113.70	82.44	67.49–97.40	Yen undervalued
USD/CNY	6.44	6.25	6.01–6.50	Renminbi neutral

[1] Purchasing power parity. This metric calculates an exchange rate using relative inflation rates.
[2] Range of historically normal fluctuations.
[3] Francs per 100 Yen or Krona.

Source: Web Financial Group

Gold

The gold price is proving resilient, remaining in the range of 1,750 to 1,800 US dollars. Even rising inflation worldwide could not change this trend.

Indexed performance of gold in Swiss francs
100 = 01.01.2021

Prices are coming under pressure globally. Inflation in the eurozone hit the 3-percent mark in September for the first time since the 2008/2009 financial crisis, while it stands at over 5 percent for the fourth month in a row in the USA. This trend is even more evident in the emerging markets – inflation rates in Brazil, for example, have reached double digits. But gold has emerged completely unscathed thus far. Despite its reputation as a popular way of hedging against inflation, the price per troy ounce remains stubbornly in the range of 1,750 to 1,800 US dollars.

Source: Web Financial Group

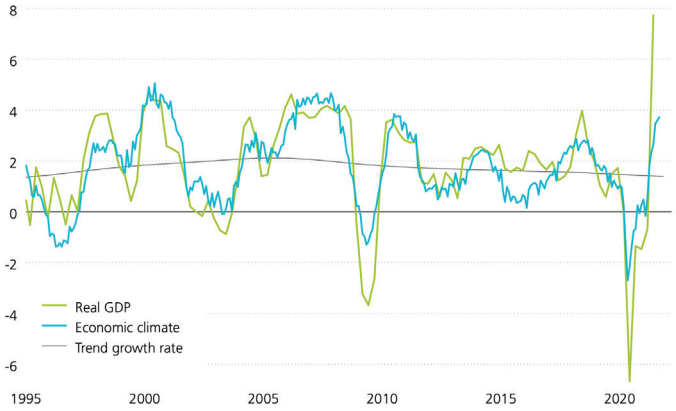
Economy

Chinese economy faces strong headwind

China's economic problems are persisting. But the outlook for the USA and Europe remains positive.

Switzerland

Growth, sentiment and trend
In percent

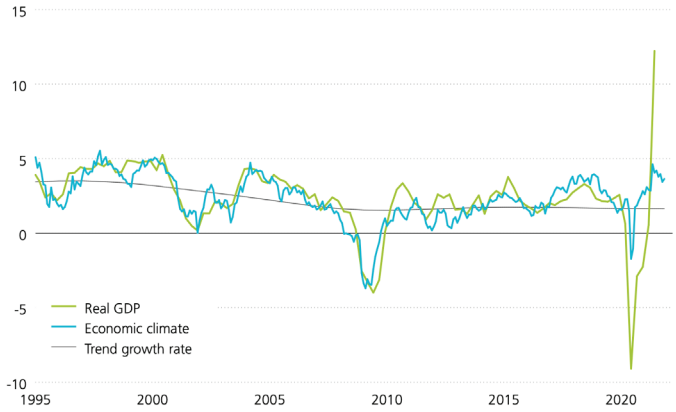


Source: Bloomberg

The economic situation in Switzerland remains strong in the third quarter. The impact of the coronavirus pandemic is now evident only in tourism, where the number of international guests remains below the pre-crisis level. Labour market figures are also encouraging. In August and September, the unemployment rate continued the fall it has been experiencing since the start of the year, standing at just 2.6 percent in recent times. Likewise, consumer sentiment was strong, and retail sales in August were up by 1.1 percent on July's figure. This means that sales remain 4 percent above the pre-crisis level. While most other countries are currently contending with soaring inflation, the Swiss rate remained unchanged in September, at 0.9 percent.

USA

Growth, sentiment and trend
In percemt



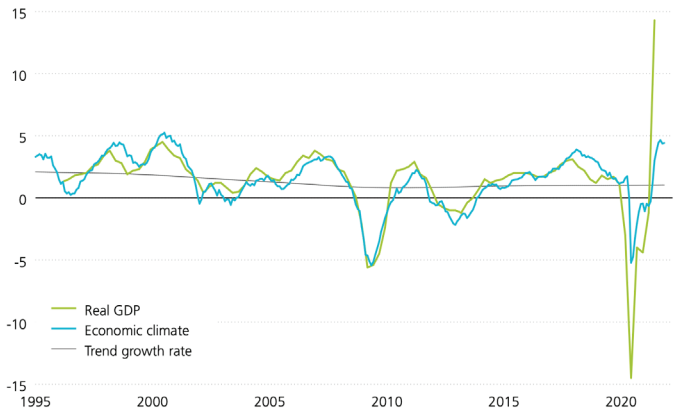
Source: Bloomberg

The signs for the economy remain good in the USA. Consumption in particular has been supporting growth recently. Retail sales rose by 0.8 percent in September, after a very positive August, which saw a +2 percent increase. This means that growth compared to the previous year's level stands at around 14 percent. By contrast, continuing bottlenecks are still holding back production in industry. The automotive sector in particular is being hit hard by the shortage of semi-conductors. Market participants are increasingly focusing on inflation. After hitting 5.3 percent in August, inflation again stood at 5.4 percent in September. There are growing signs that this higher price trend will continue for an extended period. The US Federal Reserve has indicated that the scaling-back of the bond-buying programme, which currently stands at 120 billion US dollars a month, should begin in November or December.

Eurozone

Growth, sentiment and trend

In percemt



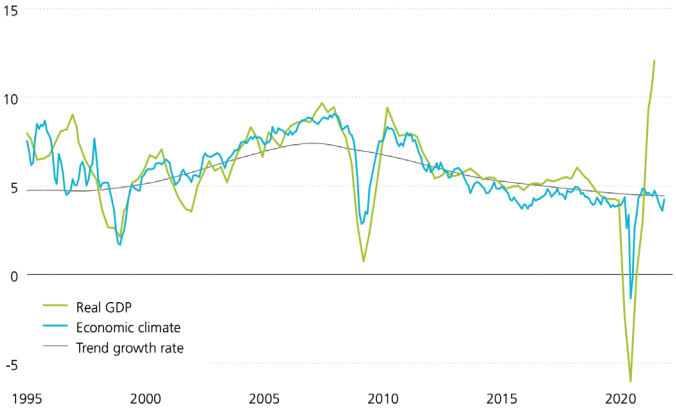
Source: Bloomberg

Unlike the USA, the eurozone has not yet reached its pre-crisis level. Only the Scandinavian and Baltic Member States have already recouped the lost ground. In Germany, France and Italy, the gap still stood at 4 percent in the second quarter. European industry also faces global supply shortages, which are hampering efforts to work through the full order books. But these full order books mean the sentiment barometer published by the European Commission remains high, so production looks to be secure for a few more months. European consumers say that they are currently slightly more cautious. In July, retail sales fell moderately in the eurozone, both month-on-month and year-on-year. Germany recorded the biggest decline, with sales in July coming in at –5.1 percent below the prior month's level. At the same time, inflation rose to 3.4 percent in September.

Emerging markets

Growth, sentiment and trend

In percemt



Source: Bloomberg

The Chinese economy is continuing to lose momentum and is now on the verge of recession. Economic output grew by only 0.2 percent in the third quarter. The low growth is partly due to the impact of a coronavirus outbreak in the Fujian province, which has once again been tackled with extensive measures. A major electricity shortage, which brought production to a standstill at many companies in September, is another contributing factor. New regulations have also caused a slowdown in the significant construction sector. Foreign demand for Chinese products remains very robust, however. Both Chinese imports and exports reached new all-time highs in August. Conversely, beneficiaries are emerging from the Chinese and global energy shortage: countries such as Russia and Saudi Arabia are currently reaping rewards from the sharp rise in energy prices.

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%
Economic climate [2]	↘	↘	↘	↘	↘	↘	↘	↘
Trend growth [3]	1.4%	1.6%	0.8%	1.6%	1.0%	5.0%	1.1%	4.2%
Inflation	0.9%	5.4%	3.4%	3.2%	–0.4%	4.4%	10.2%	0.7%
Key rates	–0.75%	0.25%	0.00%	0.10%	–0.10%	4.00%	6.25%	4.35%

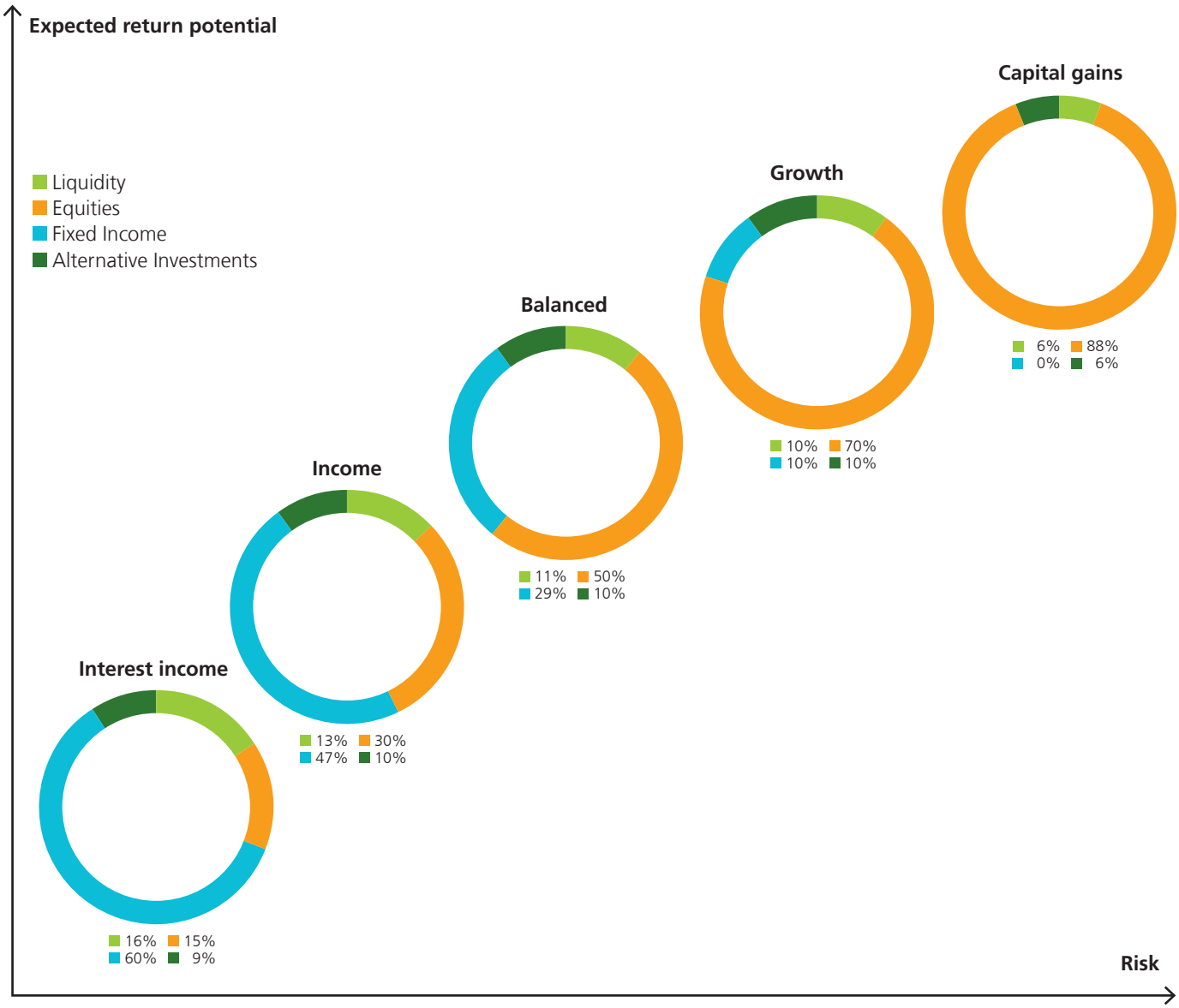
[1] Growth compared to year-ago quarter.
[2] Indicator, measuring the overall sentiment and typically leading 1 to 2 quarters in advance of GDP. A green arrow indicates accelerating economic growth, a red arrow indicates a slowing down.
[3] Potential growth. Long-term change in Gross domestic product with sustainable capacity utilization.

Source: Bloomberg

Model portfolios Swiss focus

Energy and financial stocks hold their own in inflationary environment

The financial markets have had a turbulent start to the autumn. China's economy is suffering from the cooling of the property market and bottlenecks are causing sand in global supply chains. It is becoming increasingly obvious that inflationary pressures will not abate quickly. The major central banks are also increasingly realising this. The rising inflation expectations of market participants are causing interest rates to rise. In this environment, we are maintaining our underweight in global bonds. On the other hand, stocks from the energy and financial sectors are proving to be resistant to inflation. In the past, these sectors have already performed well in an inflationary environment. For this reason, we recommend buying the British equity market with its strong weighting in these two sectors at the expense of European equities.



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