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PostFinance

Editorial

We must take note of China

Turbulence on the Chinese real estate market has triggered uncertainty on the financial markets. It is important that investors pay attention to this uncertainty but also take advantage of opportunities.

Daniel Mewes
Chief Investment Officer

The economic outlook remains bright despite the Delta variant, and central banks are scaling back their extraordinary support very cautiously: the short-term prospects for investors remain good. Only China is currently casting a shadow. The Chinese leadership under President Xi is attempting to restructure various parts of society and the economy through far-reaching interventions. One of these interventions affects the real estate market: years of announcements are now being followed up by measures to limit the huge overindebtedness of many real estate companies. This has left the major property developer Evergrande facing bankruptcy, which has caused short-term uncertainty on the global financial markets.

China's importance is growing – including in our portfolios

We will have to grow accustomed to the global financial markets focusing more heavily on developments in China. Thanks to higher trend growth than in western industrial countries, the Chinese economy is growing in importance each year. We may well need to pay attention to even minor events in China. When the Chinese economy weakens, it is a matter of concern for investors worldwide. With 1.3 billion increasingly wealthy consumers, China is currently a key player for many sectors and companies.

In the short term, there is nothing to worry about from our perspective. A financial crisis in China is unlikely, and the global economy is robust enough to avoid being knocked off course – even though the Chinese economy may prove vulnerable over the coming months. From a longer-term investment perspective, it is important not to fear any turbulence in China, but to instead take advantage of the wide-ranging opportunities. As part of our regular review of the strategic weighting of the individual asset classes, we have decided to increase our investments in emerging market equities in the portfolios entrusted to us. Chinese equities account for over a third of these emerging market equities.

Uncertainty is part of investment

However, recent developments in China also raise fundamental questions. China is clearly not a democracy. The Chinese authorities are supportive of market economy principles not due to their fundamental beliefs, but solely for pragmatic reasons. In other words, only for as long as these principles are useful. The Chinese leadership places great emphasis on growing national wealth over the long term. It has demonstrated great business acumen in recent decades.

However, the Chinese leadership is uncompromising when it comes to imposing its party policy. This may be beneficial from a market economy perspective: for example, if monopolies in the tech sector are broken up or measures are taken to tackle disparities on the real estate market. In both of these issues, China is showing what may well lie ahead for western industrial countries.

«With 1.3 billion increasingly wealthy consumers, China is currently a key player for many sectors and companies.»

But party policy doesn't just consist of market economy principles – in fact, quite the opposite. The fallout is far-reaching. We assume the Chinese leadership will be wise enough not to destroy the basis for a long-term growth path. But there is no guarantee of that, as all investments on the financial markets are subject to uncertainty. This is why portfolio diversification is so important. We have specifically increased the allocation of emerging market equities, and not just from China. There are other large, strong-growth economies too, such as India and Indonesia.

Positioning

Inflation increases the risk of interest-rate hikes

The thriving global economy is defying weakening Chinese performance. US inflation is unlikely to return to the Federal Reserve's target in the foreseeable future. We are maintaining our under-weighted position in global bonds.

The global economy remains dynamic thanks to strong figures from the USA and Europe. By contrast, the most recent economic figures from China are disappointing. The Chinese economy has been weakening for some time. The zero-COVID strategy – which is forcing the Chinese government to impose repeated local lock-downs – is proving problematic. Tighter regulatory measures introduced by the Chinese authorities on the real estate market are pouring more oil onto the fire. The real estate market has often driven Chinese growth in the past.

But the current state of the global economy should prove sufficiently robust to overcome weakness in China. There has been little impact on global trade so far. The reaction on the financial markets to the imminent bankruptcy of the real estate developer Evergrande did not last long. This is why we are maintaining our neutral equity market positioning.

Interest rates are rising in Europe

Attention is increasingly shifting back to interest rates. Long-term interest rates in Europe rose last month, mainly due to unexpected inflation developments. At 3 percent, inflation in the eurozone was surprisingly high in August, as was the UK rate, at 3.2 percent. Despite the recent rise, however, European interest rates are still well below the pre-coronavirus level. In contrast, interest rates have trended sideways in the USA of late. This means they are even further below the pre-coronavirus level. It is worth noting that the debate over central banks withdrawing from their bond-buying programmes has had little effect on interest rates – neither in Europe nor in the USA.

«However, there are many indications that inflation may remain high for a longer period.»

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%	1.0%	1.6%	1.0%
	USD	1.7%	4.8%	1.7%	4.8%
	JPY	1.2%	–1.3%	1.2%	–1.3%
Equities	Switzerland	–2.0%	16.9%	–2.0%	16.9%
	World	2.0%	23.2%	0.3%	17.5%
	USA	1.8%	25.3%	0.1%	19.5%
	Eurozone	0.5%	20.0%	–1.1%	18.8%
	United Kingdom	–0.2%	18.9%	–1.5%	12.4%
	Japan	9.9%	15.4%	8.6%	17.0%
	Emerging markets	2.3%	5.3%	0.6%	0.5%
Fixed Income	Switzerland	–1.2%	–1.2%	–1.2%	–1.2%
	World	1.2%	2.1%	–0.5%	–2.5%
	Emerging markets	2.9%	5.4%	1.1%	0.6%
Alternative Investments	Swiss real estate	–1.8%	6.2%	–1.8%	6.2%
	Gold	–0.5%	–3.0%	–2.1%	–7.4%

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

Data as of 16.09.2021
Source: Web Financial Group, MSCI, SIX, Bloomberg Barclays, J.P.Morgan

Inflation risks are growing

Attention remains focused on US inflation. With rates currently standing at over 5 percent, the Federal Reserve's 2 percent target is unlikely to be hit in the foreseeable future. Central banks are attempting to argue that the high inflation figures are temporary. In fact, factors such as energy prices in the New Year are highly likely to have an adverse effect on inflation. However, the utilization of production capacity in the USA is exceeding the pre-crisis level again, which means that the economy could be at risk of overheating. The USA may also see another sharp rise in living costs, which is a major driver of inflation. This high rate of inflation may also be reflected in interest rates at some point. In light of this, we are maintaining our underweighted position in global bonds

Fair valuation of Swiss franc

High inflation rates in the eurozone have not only impacted on interest rates, but have also further reduced the overvaluation of the Swiss franc based on purchasing power parity. The Swiss franc is therefore no longer overvalued against the major currencies. This may restrict the extent of SNB interventions and increasingly expose the Swiss franc to market forces again. As a result, the Japanese yen is no longer a better insurance policy against market turbulence than the Swiss franc. For this reason, we are reducing our overweighted position in Japanese yen.

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	10.0%	11.0%					
	JPY	1.0%	0.0%					
Equities	**Total**	**50.0%**	**50.0%**					
	Switzerland	23.0%	23.0%					
	USA	10.0%	10.0%					
	Eurozone	5.0%	5.0%					
	United Kingdom	2.0%	2.0%					
	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%					

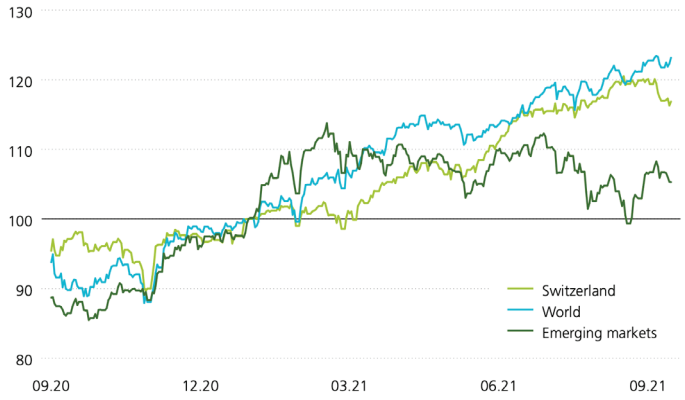
[1] Tactical Asset Allocation: short to mid-term orientation
[2] Currency hedge to CHF
[3] Positioning relative to our long-term asset allocation

☐ Adjustment compared to last month

Market overview
Equities

The upward trend of recent weeks on the global stock markets has been interrupted and they have undergone a slight correction. Japanese equities emerged as the big winners.

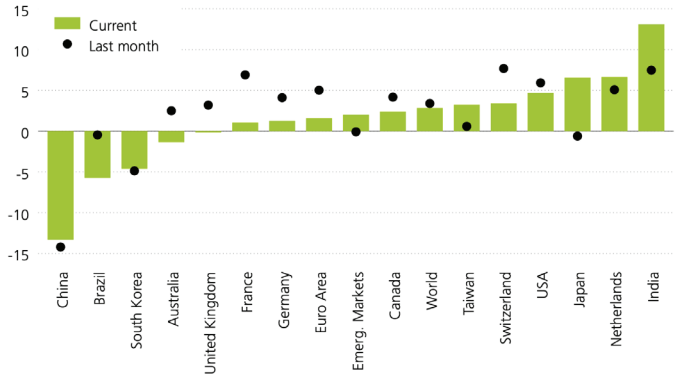
Indexed stock market performance in Swiss francs
100 = 01.01.2021



The virtually unchecked upward trend we had seen on the global equity markets slowed down at the end of summer. There have also been minor corrections over the past month. These included Brazilian equities, which fell by 8 percent, and South Korean equities, down by 5 percent. The outlier on the upside was the Japanese equity market, climbing by almost 8 percent since Prime Minister Suga announced his resignation. Investors are anticipating that his successor will pursue a more expansive economic policy.

Source: SIX, MSCI

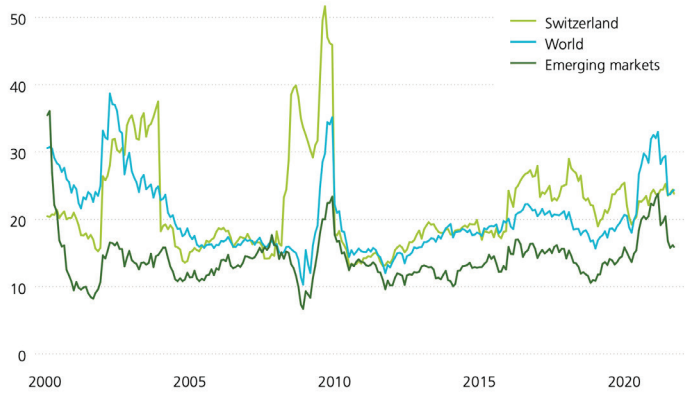
Momentum of individual markets
In percent



After the phenomenal recovery rally during the first half-year, there is now a slowdown in recovery growth worldwide. Momentum on the equity markets has weakened accordingly, but predominantly remains in positive territory. Indian equities displayed the greatest momentum last month. India had been hit by a second, severe wave of coronavirus recently. But the worst now seems to be over, boosting equity prices. Chinese equities have struggled recently. Yet, momentum now appears to have shifted after the publication of the 5-year plan on the "rule of law" despite moderate economic news.

Source: MSCI

Price/earnings ratio
P/E ratio



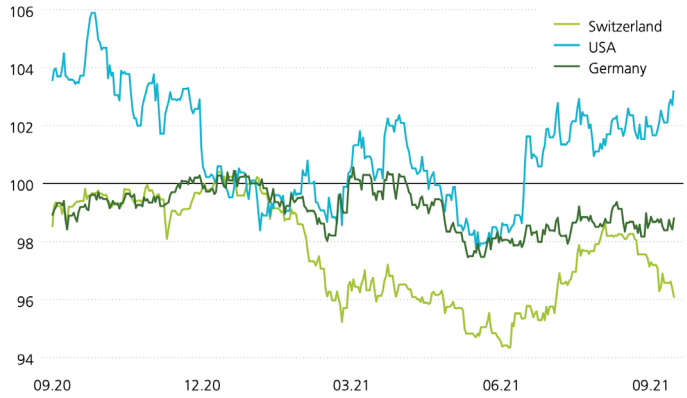
In the wake of the post-coronavirus recovery, companies worldwide posted higher profits again. Brazil achieved the highest earnings growth recently, up by over 30 percent quarter-on-quarter. But earnings were once again positive on the Swiss market, too. This also impacted on equity valuations measured by their price/earnings ratio (P/E ratio). The P/E ratio for the Swiss equity market currently stands at 23, which is in line with the global average. The valuations of emerging market equities are now even more attractive with a P/E ratio of 16.

Source: SIX, MSCI

Market overview
Fixed income

The announcement by central banks of plans to scale back bond-buying schemes has had little impact on the bond markets so far. However, higher-than-expected inflation in the euro zone has seen interest rates rise moderately in Europe.

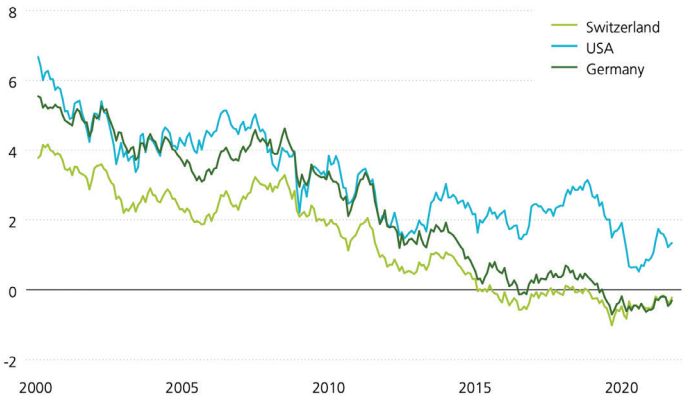
Indexed performance of government bonds in Swiss francs
100 = 01.01.2021



The Delta variant's impact on the global economy has been limited and the economic outlook remains bright. However, demand for secure government bonds is still strong. US securities remained at the prior month's level and barely reacted to the debate about scaling down the US Federal Reserve's bond-buying programme. European securities saw moderate losses. Swiss government bonds have been in negative territory by just under 4 percent since the start of the year as have their German counterparts by just over 1.5 percent.

Source: SIX, Bloomberg Barclays

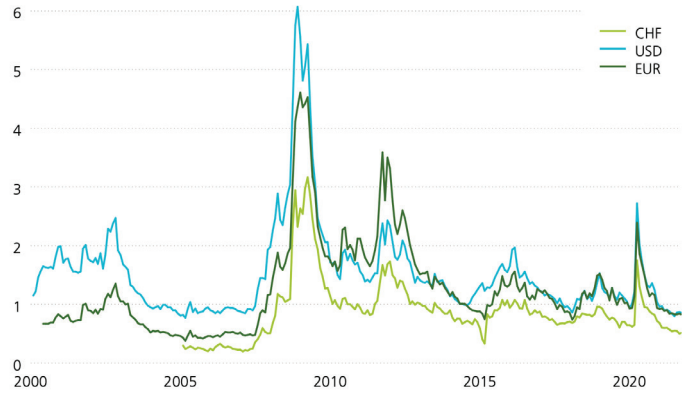
Trend in 10-year yields to maturity
In percent



Yields to maturity on government bonds have been falling again worldwide since the spring after almost reaching a record-high at the start of the year. European interest rates in particular climbed again slightly last month. This is likely to be due to much higher-than-expected eurozone inflation of 3 percent in August. The yield to maturity on 10-year German securities now stands at just under –0.3 percent again, while that on their Swiss counterparts is slightly higher. Yields to maturity on 10-year US bonds have trended sideways, at around 1.3 percent.

Source: SIX, Bloomberg Barclays

Credit spreads on corporate bonds
In percentage points



The buoyant mood on the financial markets saw further demand for higher-risk investments last month. This means investors are differentiating less between higher-risk corporate bonds and secure government bonds, which is illustrated by the spread being demanded on the market. The spread on US corporate bonds fell further, reaching 0.9 percent at the end of August. This brings US credit spreads into line with their European counterparts. This spread is much lower for Swiss corporate bonds, at 0.5 percent.

Source: Bloomberg Barclays

Market overview

Swiss real estate investments

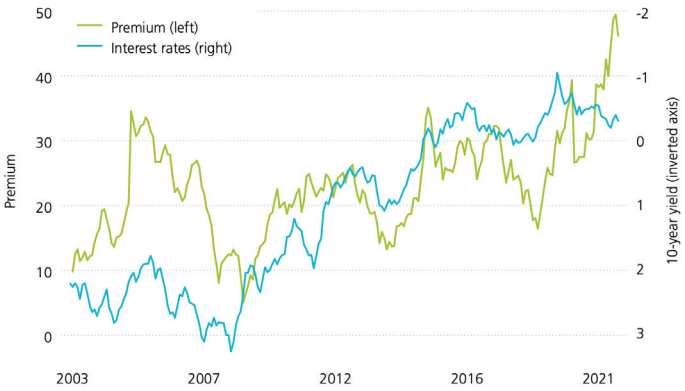
Swiss real estate funds experienced a slight correction at the end of summer. Given the low interest rates, valuations are still very high.

Indexed performance of Swiss real estate funds
100 = 01.01.2021

Demand for Swiss real estate funds remained high over the summer, with prices trending sideways at a record-high level. Momentum slowed in early September and prices fell by almost 2 percent. This was overdue given the record-high valuations. The increase for the year to date is still 6 percent.

Source: SIX

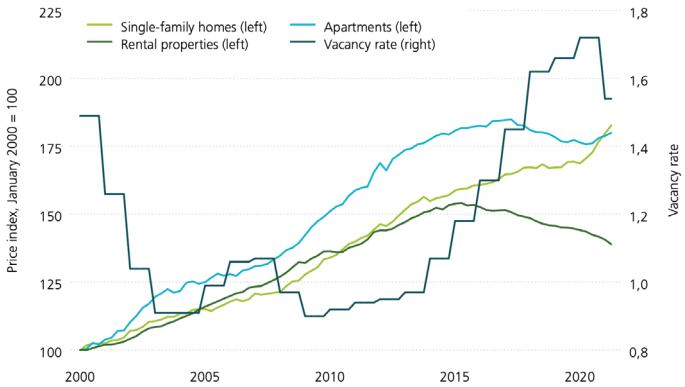
Premium on Swiss real estate funds and 10-year yields to maturity
In percent



In the wake of the price correction on indexed Swiss real estate investments, premiums also fell slightly again last month. They had reached the 50 mark for the first time in August. Never before had investors been willing to pay such a high premium on the value of the properties contained in the funds. At the same time, the yield to maturity on 10-year Swiss government bonds rose to just under –0.2 percent. However, the overvaluation measured by interest rates was still down slightly, overall, from its recent record-highs.

Source: SIX

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



It isn't just the prices of Swiss real estate that have constantly risen over the past 20 years. The number of vacant properties has also increased every year since 2009. The share of vacant properties on the Swiss real estate market climbed from 0.9 percent to over 1.7 percent during this period. On 1 June 2021, data from the Swiss Federal Statistical Office indicated a fall in the vacancy rate for the first time since, dropping to 1.5 percent. Besides the high demand for living space, the decline in construction work also helps explain this development.

Source: SNB, BfS

Market overview

Currencies

There was less movement on the currency markets last month. Some commodity currencies strengthened again. Due to the increased inflation difference, the value of the Swiss franc fell sharply, measured by purchasing power parity.

There was little movement on the international currency markets last month. After falling further last month, commodity currencies strengthened again recently – at least in some cases. The Norwegian krone achieved the strongest gains, rising 3 percent against the Swiss franc, followed by the Swedish krone, which was up 1 percent. The Canadian and Australian dollars both recorded slight losses again. With the uptick in inflation in the euro zone, the Swiss franc is now valued fairly against the euro once more, based on purchasing power parity.

Currency pair	Price	PPP [1]	Neutral area [2]	Valuation
EUR/CHF	1.09	1.10	1.02–1.17	Euro neutral
USD/CHF	0.93	0.84	0.74–0.94	USD neutral
GBP/CHF	1.28	1.39	1.20–1.58	Pound neutral
JPY/CHF [3]	0.84	1.02	0.86–1.18	Yen undervalued
SEK/CHF [3]	10.76	11.40	10.29–12.50	Krona neutral
NOK/CHF [3]	10.73	12.15	10.85–13.46	Krona undervalued
EUR/USD	1.18	1.31	1.14–1.48	Euro neutral
USD/JPY	109.72	82.14	67.28–96.99	Yen undervalued
USD/CNY	6.46	6.24	5.99–6.48	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

After recovering from its flash crash in early August, the gold price per troy ounce again slipped well below the USD 1,800-mark recently.

Indexed performance of gold in Swiss francs
100 = 01.01.2021

The flash crash in early August saw the gold price per troy ounce drop by USD 100 to just under USD 1,730. This lost ground was recouped over the following weeks, but gold has yet to exceed the USD 1,800 mark on a sustained basis. Prices fell well below this level again recently. Persistently high consumer price inflation in the USA – which stood at 5.3 percent in August – has not yet resulted in increased demand for gold.

Source: Web Financial Group

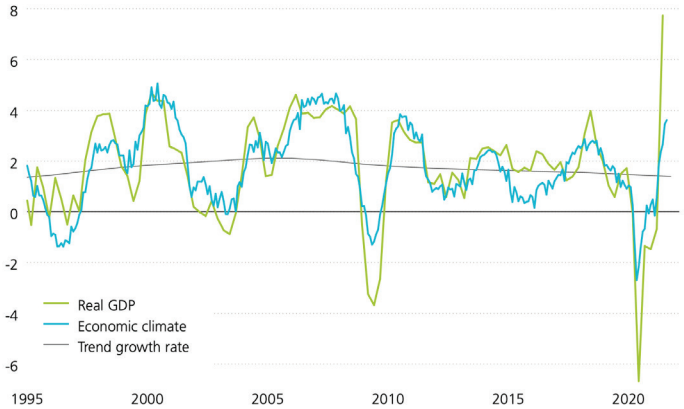
Economy

Global trade resilient despite China's weakness

The Chinese economy is being held back by the Delta variant and regulatory measures. The economies of the western industrial nations look strong enough to make up for China's weakness.

Switzerland

Growth, sentiment and trend
In percent

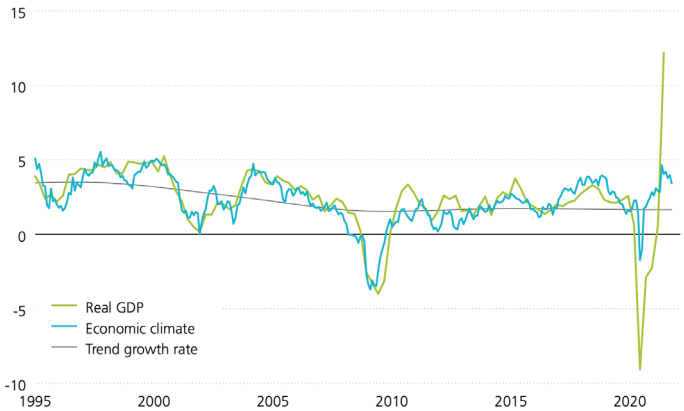


Source: Bloomberg

The Swiss economy has come through the coronavirus crisis relatively unscathed. Not only has the Swiss Federal Statistical Office retroactively revised economic growth upwards for the year 2020 to just –2.4 percent, but the gap to the pre-crisis level was almost closed during the second quarter, with GDP growth of 1.8 percent. The outlook for the Swiss economy remains good. In August, the PMI, the leading indicator for industry, stood at 67.7 points. The pharmaceutical industry performed strongly with record-high exports, but the manufacturing sector also has healthy order books. Growth in consumption slowed slightly after retail sales soared to 8 percent above the pre-crisis level in the second quarter.

USA

Growth, sentiment and trend
In percemt



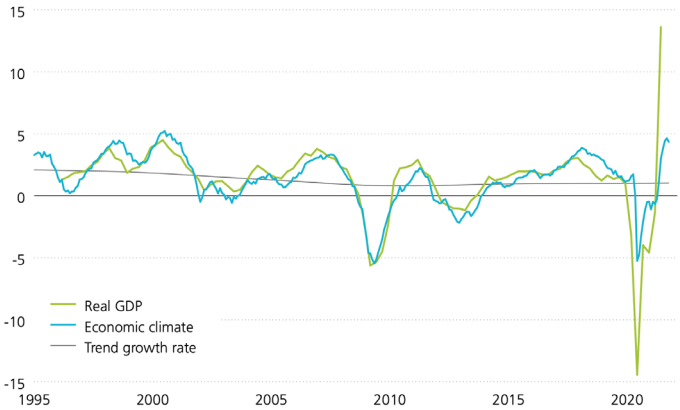
Source: Bloomberg

The US economy closed the gap to the pre-crisis level during the first six months of the year, and also performed well in the second quarter with sustained strong economic momentum. At this very high level, a slowdown in growth is now looming. But sentiment in US industry remains very good and the order books are full. Global supply chain issues are the main limiting factor for production. The best example is the ongoing semiconductor bottlenecks, which have caused automotive production to be scaled back in some places. Despite higher inflation of 5.3 percent in August, consumption was surprising, with growth of 0.7 percent month-on-month.

Eurozone

Growth, sentiment and trend

In percemt



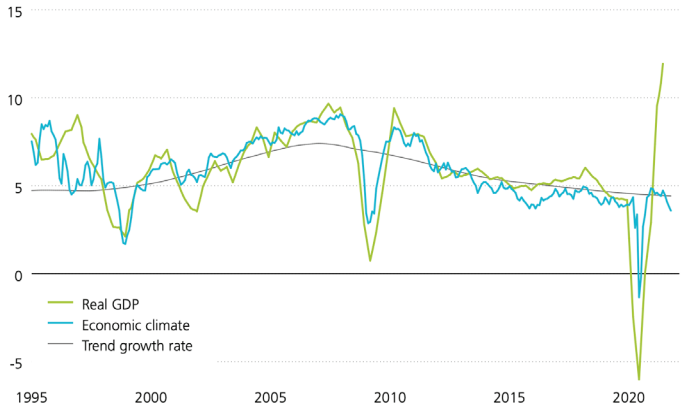
Source: Bloomberg

Unlike the USA, the eurozone has not yet reached its pre-crisis level. Only the Scandinavian member states have recouped the lost ground, while the gap still stands at 4 percent in Germany, France and Italy. 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. Meanwhile, prices climbed to 3 percent in August.

Emerging markets

Growth, sentiment and trend

In percemt



Source: Bloomberg

The Chinese economy is losing further momentum in the third quarter. On the one hand, this is due to the rapid spread of the Delta variant, which the Chinese government is again trying to control through lockdowns. This is putting additional pressure on Chinese consumption, already lagging during the recovery phase. At the same time, the government, led by President Xi, is pushing through a series of new regulations that will affect various sectors including the real estate market. The Chinese authorities are clearly prepared to accept more significant signs of economic slowdown to implement their objectives. None of this has impacted on Chinese foreign trade up to now. Both imports and exports hit a new all-time high in August.

Inflation is very high in Brazil and Russia, at 9.7 and 6.7 percent respectively. Both the Russian and Brazilian central banks are responding with further interest rate measures.

Global economic data

Indicator	Switzerland	USA	Eurozone	UK	Japan	India	Brazil	China
GDP Y/Y [1] 2021Q1	–0.7%	0.5%	–1.2%	–6.1%	–1.3%	1.6%	1.0%	18.3%
GDP Y/Y [1] 2021Q2	7.7%	12.2%	14.3%	22.2%	7.6%	20.1%	12.4%	7.9%
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%	5.3%	3.0%	3.2%	–0.3%	5.3%	9.7%	0.8%
Key rates	–0.75%	0.25%	0.00%	0.10%	–0.10%	4.00%	5.25%	4.35%

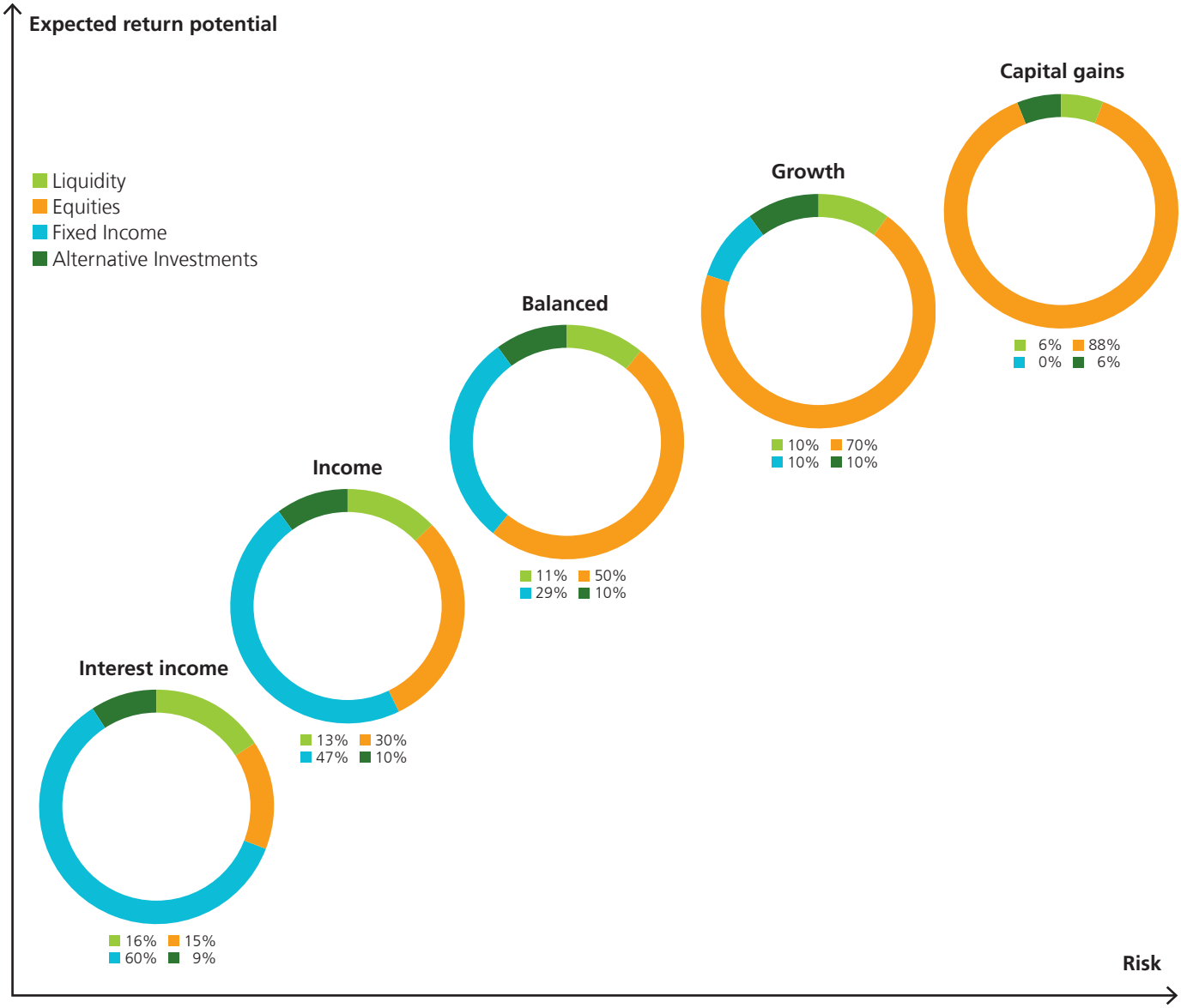
[1] Growth compared to year-ago quarter.
[2] Indicator, measuring the overall sentiment and typically leading 1 to 2 quarters in advance of GDP. A green arrow indicates accelerating economic growth, a red arrow indicates a slowing down.
[3] Potential growth. Long-term change in Gross domestic product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

Source: Bloomberg

Model portfolios Swiss focus

Lower exposure to the yen

The global economy continues to be robust thanks to strong figures from the US and Europe - robust enough to cushion the weakness in the Chinese economy. We maintain our neutral equity market positioning. Attention continues to be focused on US inflation. Starting from the current rates of over 5 per cent, this is unlikely to return quickly to the central bank's target of 2 per cent. Eventually, this will also be reflected in interest rates. We are therefore maintaining our underweight in global bonds. Thanks to high inflation rates in the USA and the Eurozone, the Swiss franc is no longer overvalued against the most important currencies in terms of purchasing power parity. This should limit the extent of SNB intervention and leave the Swiss franc more in the hands of market forces. As a result, the Japanese yen no longer proves to be a better insurance against market turbulence than the Swiss franc. We are therefore reducing our overweight in the Japanese yen.



Source: PostFinance Ltd

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