Global Investment Strategy

Fourth Quarter 2023

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Overview

World economy

- Momentum: Acceleration in the US in the third quarter. Europe subdued. China soft but supported by stimulus measures.
- Higher-than-normal savings from pandemic lockdowns and a high share of fixed mortgages: Delayed impact of increased interest rates on household budgets.
- Sharp rise in oil prices: Slowing the decline in inflation and weighing on the economy.

Capital markets

- Central bank interest rates: Near the peak, though lasting phase of high rates, with the Fed raising its interest rate forecast in defiance of rate cut expectations next year.
- Bonds: Flattening yield curve. Real yields attractive.
- Equities: News flow from the US supportive. Positive seasonal effects in the final quarter of the year.

Chapter 1: Performance review

In the wake of economic data that continued to be fairly positive, at least in the US, bond yields rose in the third quarter and the prices of government bonds fell. Corporate bonds, especially the high-yield segment, clearly outperformed.

Despite seasonally negative factors, equity markets held up quite well in the third quarter.

As expected, oil prices finally reacted positively to the OPEC+ production cuts enacted in the spring.

Global financial markets

	EUR-Performance			CHF-Performance			USD-Performance		
	Sep-23*	3Q23*	2023*	Sep-23*	3Q23*	2023*	Sep-23*	3Q23*	2023*
Equity markets									
MSCI World	**-1.7%**	**-0.5%**	**11.3%**	**-0.7%**	**-1.4%**	**8.9%**	**-3.6%**	**-2.9%**	**10.6%**
MSCI Value	0.2%	1.4%	2.0%	1.2%	0.4%	-0.3%	-1.7%	-1.1%	1.3%
MSCI Growth	-3.4%	-2.2%	21.4%	-2.5%	-3.1%	18.7%	-5.3%	-4.6%	20.7%
MSCI Quality Growth	-2.9%	-0.4%	17.6%	-1.9%	-1.3%	15.0%	-4.7%	-2.9%	16.9%
Stoxx Europe 600	-1.6%	-2.4%	6.1%	-0.7%	-3.4%	3.7%	-3.5%	-4.9%	5.4%
DAX (price return)	-3.1%	-4.4%	7.4%	-2.1%	-5.3%	5.0%	-5.0%	-6.7%	6.7%
Swiss Market Index	-2.1%	-1.5%	4.9%	-1.1%	-2.5%	2.5%	-4.0%	-4.0%	4.2%
USA (S&P 500)	-2.3%	-0.5%	13.2%	-1.3%	-1.4%	10.7%	-4.2%	-2.9%	12.5%
Nasdaq	-4.0%	-1.7%	27.0%	-3.1%	-2.7%	24.2%	-5.9%	-4.2%	26.2%
Japan (Topix)	2.1%	3.8%	12.0%	3.1%	2.8%	9.4%	0.2%	1.2%	11.3%
MSCI Emerging Markets	**0.3%**	**-0.1%**	**1.5%**	**1.3%**	**-1.0%**	**-0.8%**	**-1.6%**	**-2.6%**	**0.8%**
Emerging Asia	0.4%	0.1%	1.1%	1.4%	-0.9%	-1.2%	-1.5%	-2.4%	0.4%
Bond markets									
Germany (5-7 y.)	-1.4%	-0.7%	0.6%	-0.4%	-1.7%	-1.6%	-3.3%	-3.2%	0.0%
Switzerland (5-7 y.)	-1.6%	0.8%	5.5%	-0.6%	-0.2%	3.1%	-3.5%	-1.7%	4.8%
Europe, investment grade	-0.6%	0.6%	2.8%	0.4%	-0.4%	0.5%	-2.5%	-1.9%	2.2%
Europe, high yield	0.6%	2.1%	6.6%	1.6%	1.1%	4.2%	-1.3%	-0.5%	5.9%
USA (5-7 y.)	0.4%	0.7%	0.1%	1.4%	-0.3%	-2.1%	-1.5%	-1.8%	-0.5%
USA, high yield	1.2%	3.5%	7.0%	2.2%	2.5%	4.6%	-0.8%	0.9%	6.3%
Emerg. mark. (hard curr.)	0.0%	0.8%	2.8%	1.0%	-0.1%	0.5%	-1.9%	-1.7%	2.2%
Commodities									
Crude oil (Brent)	10.0%	29.1%	16.7%	11.1%	27.8%	14.1%	7.9%	25.9%	16.0%
Industrial metals	1.6%	4.7%	-5.6%	2.6%	3.7%	-7.7%	-0.3%	2.1%	-6.2%
Gold ($/ounce)	1.1%	2.8%	6.2%	2.1%	1.8%	3.8%	-0.8%	0.3%	5.5%
Agric. commodities	1.0%	0.5%	-4.8%	2.0%	-0.5%	-6.9%	-0.9%	-2.0%	-5.4%
Hedge Funds									
Hedge fund of funds	-	4.1%	4.0%	-	3.0%	1.7%	-	1.5%	3.4%

*Data as per 25-Sep-23. Hedge Funds as per latest available month-end. Source: Index provider

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Chapter 2: World economy – US comparatively solid

Although fears of recession arose already a year ago, the economies of the western industrialised countries are in surprisingly good shape despite sharply increased central bank interest rates. Growth estimates for the US economy have risen from around 0.5% at the beginning of the year to now around 2.0%. The better-than-expected economy is still likely e due to special factors related to the pandemic. Many private households still have higher-than-normal savings from the time of the lockdowns. In the low-interest-rate environment at the time, many US homeowners were also able to refinance their mortgages at record low rates. In Europe, too, the high proportion of fixed-rate mortgages is likely to have reduced the immediate impact of rising interest rates on consumption. In contrast, the investment activity of companies is more greatly influenced by the profit trends, which are still quite good, than by interest rates.

Some signs of economic weakness, however, are discernible in Europe. For the US, our baseline scenario remains that an economic slowdown will occur in the first half of 2024 as a result of the sharp rise in central bank interest rates (which are now, at over 1%, at their highest level in over 15 years in real terms, i.e. net of inflation). China is in a transition phase towards structurally lower growth, which will not be driven primarily by the real estate sector as in the past, but by consumption and innovative industries. In China's largely state-run economy, disorderly trends are not to be expected.

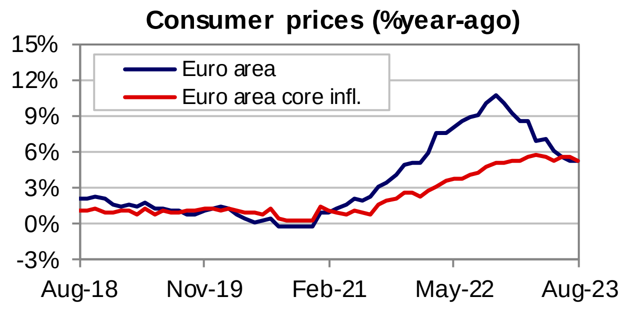
In terms of inflation, many of the factors exerting strong upward pressure last year have eased. These include supply chains, transport costs and, in Europe, natural gas and electricity prices. It is evident from timely data from the US that the number of job openings, which rose enormously at the end of the pandemic last year, have been falling. Wage pressures have also been easing somewhat, especially for new hires. With regard to core inflation (which does not include energy and food), which is the focus of central banks, the latest data in Europe does not look as favourable as hoped, while in the USA progress in reducing core inflation is noticeable. A novel near-term negative factor for both economic activity and inflation is the marked rise in oil prices in recent months.

Inflation Europe

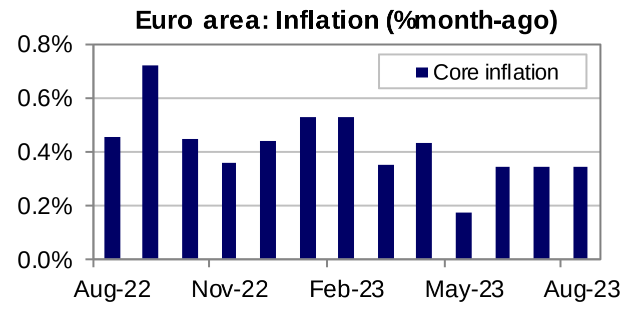
Inflation in the euro area (consumer prices year-on-year) has fallen due to lower energy and transport costs, although the decline has not continued in recent months (see the 3-month change in the chart).

Producer prices have been declining, in line with global trends, as a result of lower transportation costs and normalising supply chains.

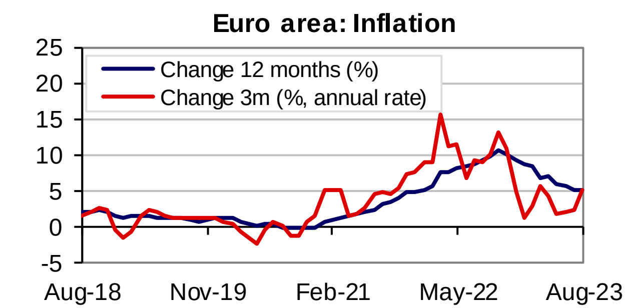
Core inflation (i.e. inflation excluding energy and food), however, has not yet fallen as hoped on a monthly basis, although there was a significant year-on-year decline in September, given the very high monthly value in the same month last year.



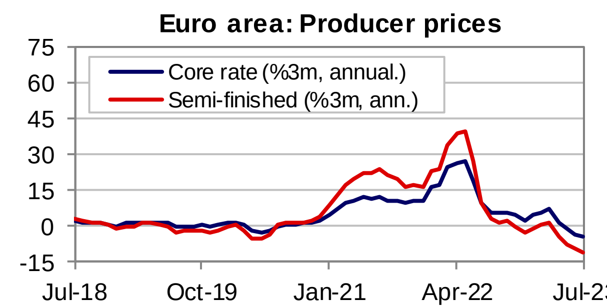
Source: Eurostat



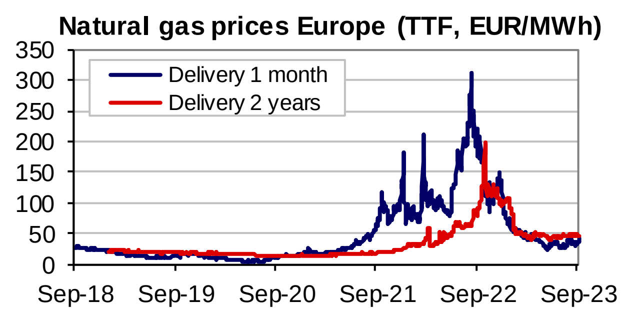
Source: ECB



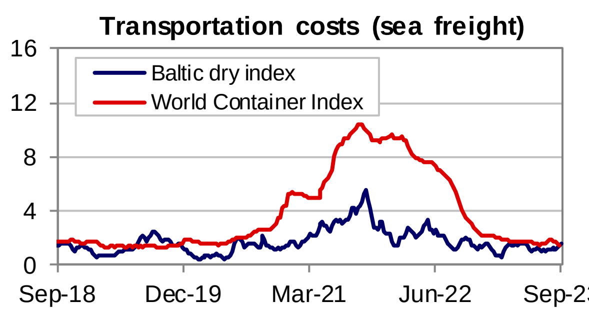
Source: European Central Bank



Source: Eurostat



Source: Bloomberg



Source: Baltic Dry Exchange, Drewry

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Chapter 3: Central bank policy – Fed raises forecast again

Despite easing inflation, the resilience of the economies of Europe and the US is a challenge for the central banks, especially since an economic slowdown, which is also clearly visible in the labour market, is considered to be a prerequisite for inflation to sustainably return to the central banks' target ranges.

Since monetary policy is currently somewhere between slightly expansionary (slightly negative real interest rates in the euro area, comparable to the years before the pandemic) and restrictive (over 1% real central bank interest rate in the US), the peak levels of key interest rates are within reach. At the same time, it is foreseeable that central bank interest rates will remain high for longer than expected earlier in the year, a view that has been confirmed in the Federal Reserve's forecast presented in September.

Fed forecast: Federal funds rate

Forecast as of:	Dec-22	Mar-23	Jun-23	Sep-23
Median forecast				
Dec-24	4.13	4.25	4.63	5.13
Dec-25	3.13	3.13	3.37	3.88
Dec-26	-	-	-	2.88
Average forecast				
Dec-24	4.30	4.40	4.75	5.05
Dec-25	3.32	3.33	3.58	3.97
Dec-26	-	-	-	3.22
Long term	2.50	2.50	2.50	2.50

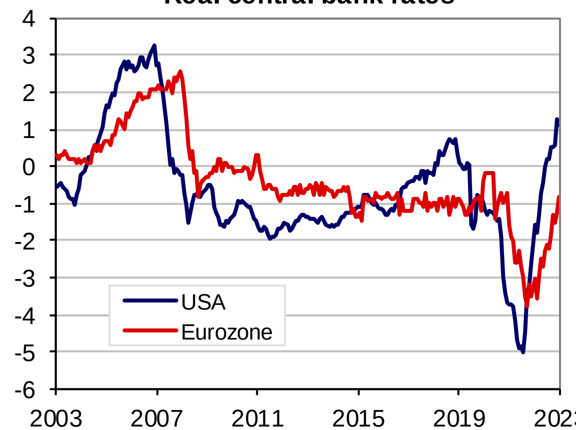
Source: Federal Reserve

Central bank policy rates

	Central bank rate			Rate in 6 months		Market price
	Current	Last change		Rate	Direction	Sep. 2024
Eurozone	4.00	14.09.2023	0.25	4.00	Stable	3.63
UK	5.25	03.08.2023	0.25	5.50	Hike	5.04
Switzerland	1.75	22.06.2023	0.25	2.00	Hike	1.81
USA	5.38	26.07.2023	0.25	5.63	Hike	4.97
Canada	5.00	13.07.2023	0.25	5.25	Hike	5.47
Australia	4.10	06.06.2023	0.25	4.25	Hike	4.43
Brazil	12.75	20.09.2023	-0.50	12.00	Easing	-
Japan	-0.10	19.12.2008	-0.20	-0.10	Stable	0.00
China	2.50	15.08.2023	-0.15	2.40	Easing	-
India	6.50	08.02.2023	0.25	6.50	Stable	-

*Data as per 22-Sep-23. Last column: Forward rate. Source: Central banks, exchanges, own forecast

Real central bank rates



Source: Fed, ECB

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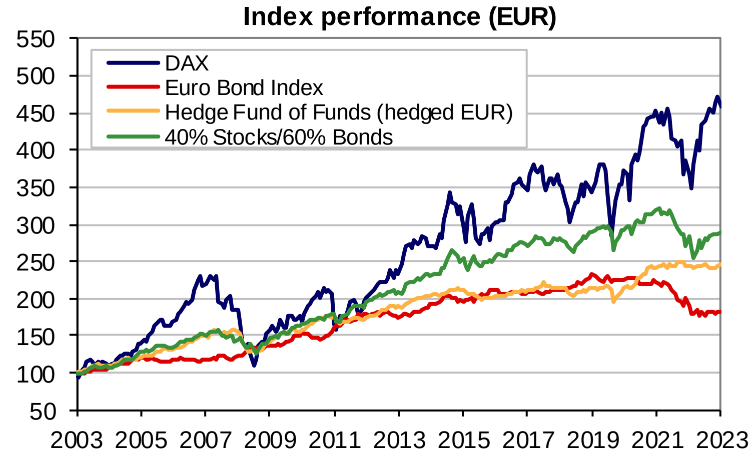
Hedge funds have delivered fairly weak returns in recent years, most often shy of a classic balanced portfolio (50% stocks/50% bonds), which we consider to be a natural benchmark.

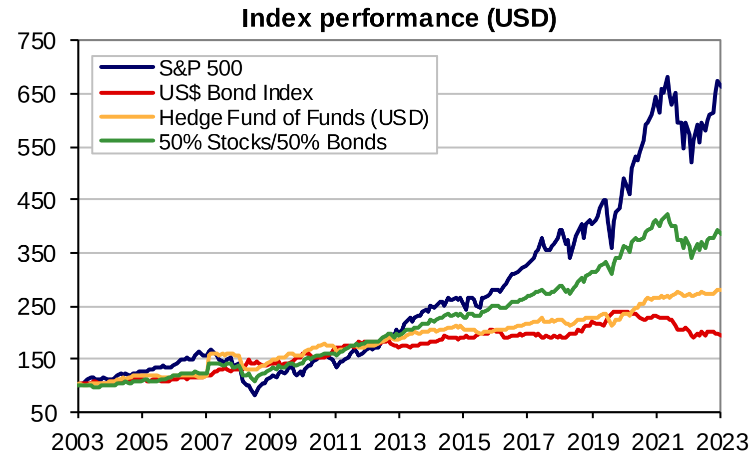
Hedge Funds

	CCY		Year*	2022
Hedge fund index	**USD**	**Hedge Fund of Funds**	**3.4%**	**1.1%**
Currency hedged	EUR	Hedge Fund of Funds	-0.1%	-1.3%
	CHF	Hedge Fund of Funds	-0.7%	-2.2%
Classic portfolio	**USD**	**50% US-Stocks/50% US Bonds**	**8.8%**	**-17.2%**
Equity type	USD	Equity Market Neutral	2.9%	1.7%
	USD	Long-Short Equity	7.4%	-5.8%
	USD	Emerging Markets	1.2%	-6.0%
	USD	Convertible Arbitrage	2.4%	-3.3%
Event/fixed income	USD	Distressed	4.2%	-4.5%
	USD	Event Driven	5.6%	-6.8%
	USD	Event Driven-Multi Strategy	6.2%	-8.0%
	USD	Fixed Income Arbitrage	4.8%	-1.0%
Macro/CTA, other	USD	Global Macro	-7.4%	15.9%
	USD	Managed Futures	-3.0%	19.1%
	USD	Multi-Strategy	8.0%	1.3%
	USD	Risk Arbitrage	4.2%	-2.2%

*Note: Data available as per 31-Aug-23. Source: Bloomberg



Source: German Stock Exchange, Bloomberg Indic., HFR, ICE, own calculations



Source: S&P, Bloomberg Indices, HFR, own calculations

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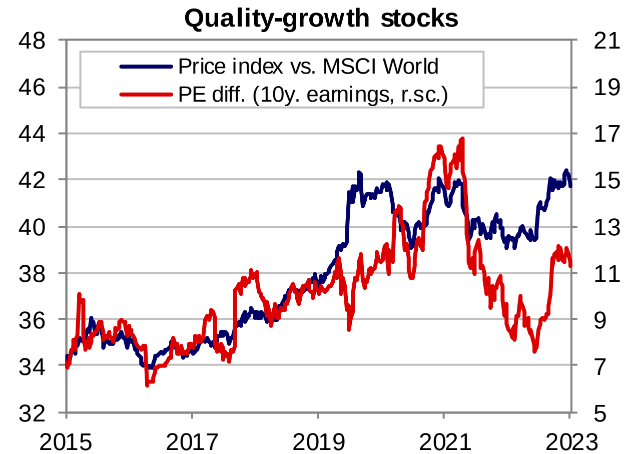
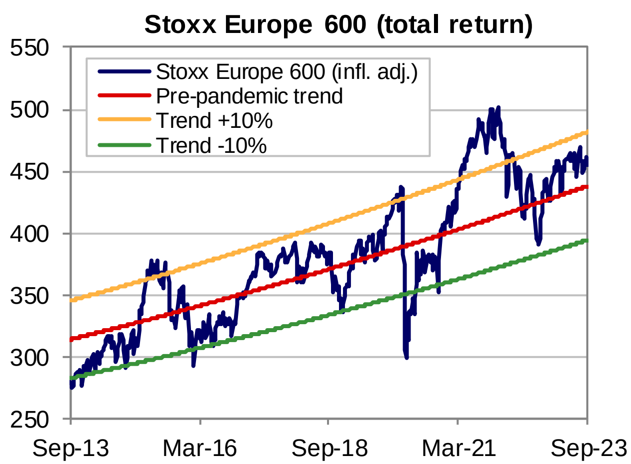
Chapter 7: Equity markets – News flow about neutral

Overall, we consider the news flow – key for the stock markets is the economy and inflation – in the US to be modestly supportive and in Europe to be neutral to slightly negative. With regard to corporate earnings for the third quarter, we see hardly any surprises on average, as the economy has held up quite well overall, and a number of companies have already lowered their expectations somewhat with the publication of their second quarter results.

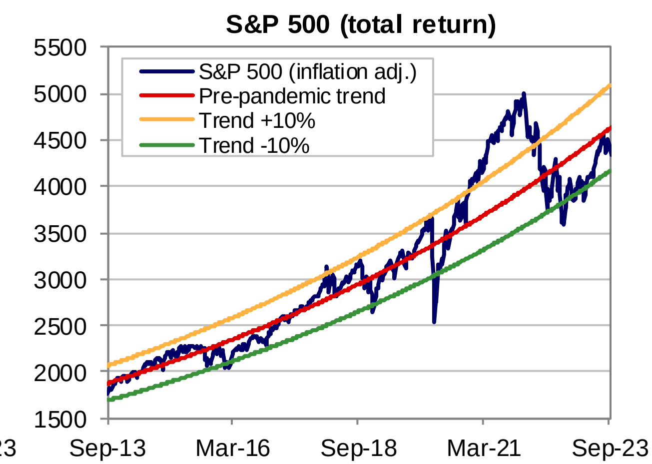
The stock markets are roughly in the middle of the trend channel (US) or in the upper half (Europe), though not at extremes outside the channel. Seasonal factors are positive in the final quarter. Quality growth stocks should continue to perform comparatively well, despite near-term headwinds from rising bond yields.



Source: MSCI



Source: Stoxx, Eurostat, own calc.



Source: S&P, BEA, own calc.

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Chapter 9: Investment strategy – Stay invested

For the capital markets, the economy is ultimately the most important factor. Our baseline scenario is unchanged and does not foresee a slide into recession in the near term. The US economic data are better than expected, while Europe is undoubtedly weaker. We now see the risk of a significantly weaker economy primarily in the first half of 2024.

Inflation, especially core inflation, which is the focus of central banks, is more likely to fall in the US (lower rent inflation) than in the euro area, where it has remained surprisingly high in recent months. Monetary policy, in contrast, no longer takes centre stage as interest rate peaks are within reach.

All in all, the news flow, which is currently better in the US than in Europe, argues for at least supported stock markets. Oil prices bear watching, with the recent rise an incremental negative for inflation and the economy. Recent upwards pressure on bond yields is not expected to have a lasting impact on the broader stock market, as long as economic data do weaken.

The recommended asset allocation, therefore, remains unchanged, with a neutral weighting in equities. A focus on quality growth stocks offers some protection in a weaker economic environment. After the strong rally in technology-related sectors in the first half of the year, driven by enormously high expectations regarding the future use of language models, we continue to expect a fairly balanced sector performance, similar to the third quarter. Profit-taking in the technology sector likely will continue (also in semiconductor stocks), in part driven by upward pressure on interest rates.

In the medium term, we see an attractive environment for government bonds. Corporate bonds with good credit ratings also remain interesting. We would choose longer maturities for government bonds than for corporate bonds (neutral duration on average). We would also consider inflation-protected bonds as part of the fixed-income allocation. The weighting of the US dollar remains neutral for the time being.

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