BELVOIR
CAPITAL AG

October, 2023

Strategy Update

Foreword by Steffen Bauke, CEO

Dear investors,

Interest rates: "higher for longer" – markets are in a hangover phase

Anyone who thought that central banks would cut interest rates again as early as the end of 2023 or the beginning of 2024 has been proven wrong. Inflation figures are slowly improving in all industrialized countries but the economy remains especially robust in the US. The labor market there remains too strong, putting inflationary pressure on wages. For this reason, September saw the US Federal Reserve reviewing its stance and announced interest rate cuts as per end of 2024 at the earliest ("higher for longer"). Even if the rise in key interest rates has paused for the time being (US and SNB) or is likely to slowly peter out (ECB), the significant rise in US interest rates over the long term is increasingly causing headaches for investors. As a result, share prices have suffered, as higher discounting rates have now become a significant factor for company valuations. At the beginning of October, yields on 10-year US Treasuries were close to the 5% mark. Historically, this has often been considered a turning point in the market, since "safe money" or safe yield becomes a valid alternative to equities. After a summer lull on the stock markets, September once again proved that it is usually the year's worst stock market month. While sector rotations still dominated the market during the year, with only 7 companies from the S&P 500 driving the index, and 493 stocks more or less remaining in place, the stock markets lost value across the board during the summer months – particularly in September. In the last few weeks, in both the US and Europe, we saw corrections of 5-9% depending on the index.

However, we cannot let this unsettle us: during this period, selected stocks and sectors have become much more attractive again and offer opportunities for long-term investors. The important thing is to only stay invested in sectors and companies that have solid balance sheets with low debt levels. This is most important at a time of significantly higher interest rates, so inflation can be passed on via price increases. With interest rates close to – or, in the case of the US, above – the inflation rate, bonds should slowly find their way back into balanced strategies as an alternative to good equities.

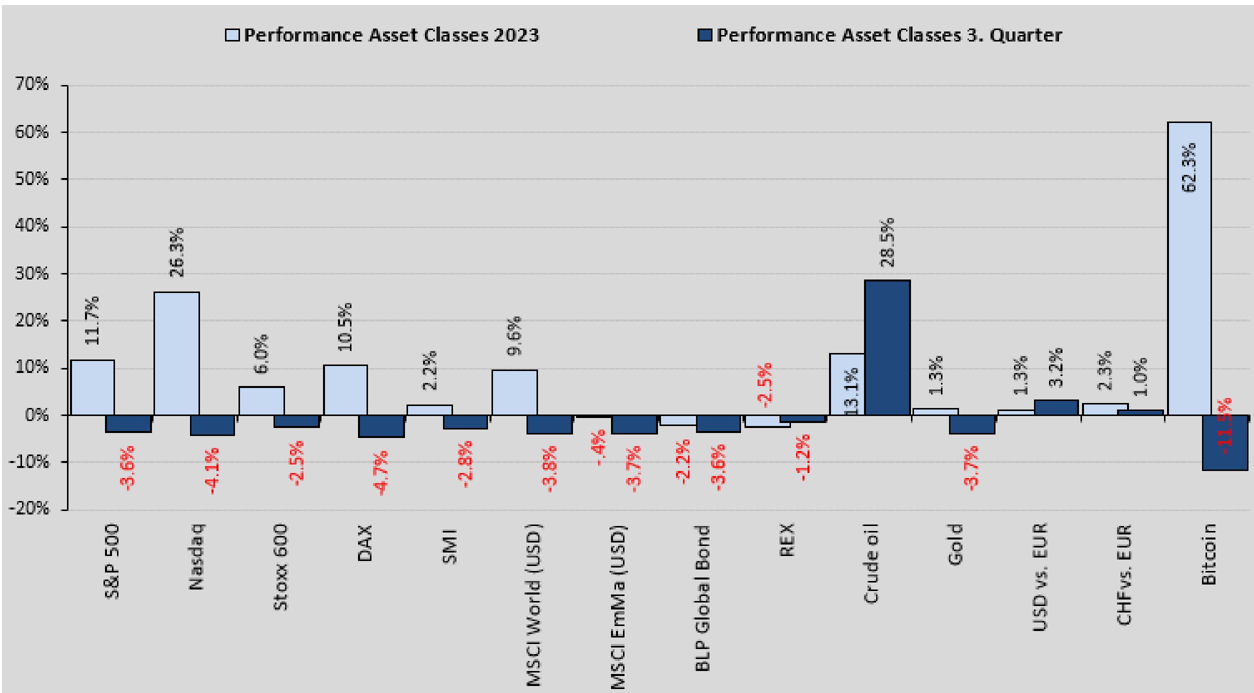
Zurich, 6th October 2023

Strategy Update 3rd Quarter 2023

6th October 2023

Review – A quarter in correction mode

In Q3, or rather since the end of July, financial markets have been in correction mode. Stock markets have been weighed down by poor economic data (especially in Europe), rising yields and wage costs (particularly in the US), as well as higher oil prices and lowered growth rates for the global economy for the coming year. Generally, August and September tend to be seasonally poor stock market months. In Q3, the S&P 500 lost 3.65%, the DAX 4.71%, and the SMI 2.81%. The "Magnificent 7" US tech stocks, which were largely responsible for higher indices in the first half of the year, lost an average of 7% (Apple 11.7%, Microsoft 7.3%). Regarding specific sectors, energy and utilities gained slightly, while IT and raw materials lost the most. Higher yields on the bond markets were particularly noticeable in Q3. The yield on 10-year US Treasuries rose from 3.85% to 4.66% from June 30 to September 30, while the yield on 10-year German Bunds rose from 2.39% to 2.93%. Investors in 10-year US Treasuries had to accept price losses of 6.5% within 3 months due to the increase in yields. On the other hand, major currency pairs such as EUR/USD and EUR/CHF barely changed from their June 30 value. However, due to partly unexpected central bank decisions and new interest rate expectations, September saw certain adjustments, such as a stronger USD. The EUR/USD traded weakest at 1.124 on July 18, but rose to 1.0590 by the end of the quarter. Gold in USD/oz lost 3.68% in Q3. For EUR or CHF terms, gold remained virtually unchanged due to the stronger USD.



Development of Selected Markets in Local Currency

Economy – Losing momentum

The US economy has shown great resilience, with a decreasing likelihood of a recession. The press is now speaking more of a “soft landing” than a “recession”. In contrast, the Eurozone economy is looking increasingly fragile and is expected to contract slightly as early as Q3. The ECB has downgraded its growth forecasts: for 2023 to 0.8% (previously 0.9%) and for 2024 to 1.0% (previously 1.5%). European Purchasing Managers' Indices stabilized in September, but at a worryingly low level. For the Eurozone industry, the value fell to 43.4. The Ifo Institute reported a drop in the Business Climate Index to 85.0 points (from 85.7) on September 25, adding to recession concerns. Germany is likely to be one of the few countries with a shrinking economy this year. The OECD's forecasts for global economic growth in 2023 have been revised downward from just over 3% to 2.7%. This underscores the weak momentum outside the US and China. However, despite the decline, China will contribute almost half of global growth in 2023. For 2024, the global economy is forecast to grow by 2.9%, which is below the long-term growth trend.

Inflation – Surprising progress in Europe

In the US, consumer prices rose by 3.7% in August, following 3.2% in July. Partly responsible were higher energy prices. Core inflation fell from 4.7% to 4.3%. For Europe, the statistics office Eurostat published surprisingly significantly lower inflation figures on September 29. The inflation rate, which was still at 10.6% in October 2022, fell to 4.3% in September 2023 (previous month: 5.2%). In Germany, too, inflation fell to a surprising 4.3% (previous month: 6.45%). Although the 2% target is still some way off, the latest data indicate that interest rate hikes are having an effect, and that the country is on the right track. Annual inflation in Switzerland was 1.6% in August. However, this is unlikely to remain the case: Rents will rise again in November due to a higher reference interest rate, electricity will become 28% more expensive in 2024, the SBB will increase tariffs and, finally, VAT will be raised to 8.1% next January. All this is likely to push inflation above the target range of 0 to 2% once again.

Central Banks –

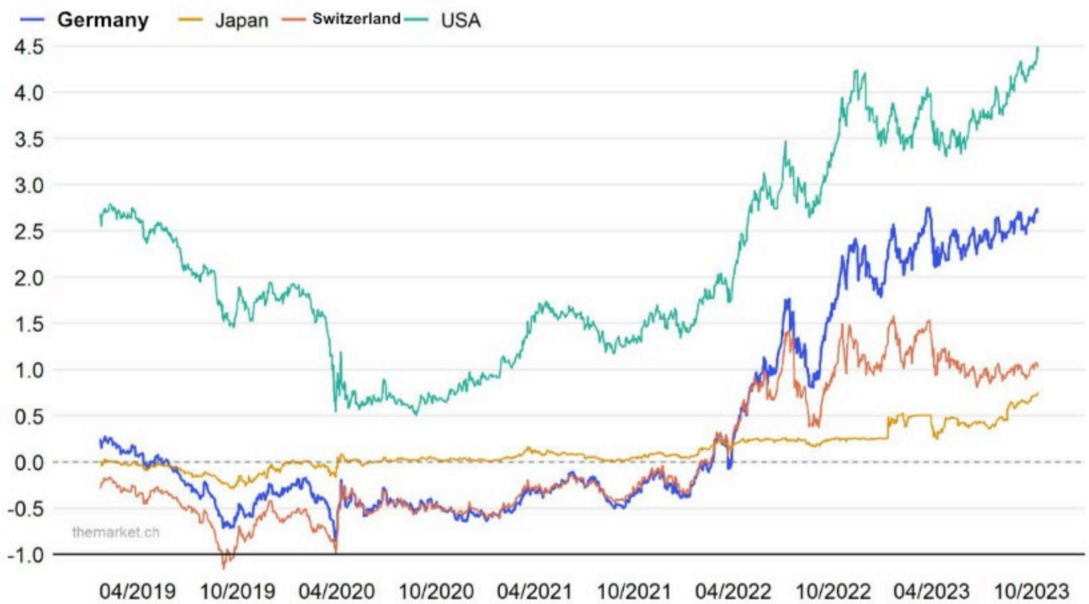
We're "in the home stretch" but at a "higher level for longer"

Western central banks have ended or are about to end their tightening of monetary policies. As financial markets have expected, the Fed left the key interest rate in the range of 5.25 – 5.5% on September 20. In September, the Fed's key message was that rates will not necessarily rise much higher. Instead, they will remain at this level for an extended period. However, the Fed is keeping the door open for further monetary tightening in Q4. Whereas financial markets recently assumed that the first interest rate cuts would occur in the US at the beginning of 2024, this expectation has been postponed to the second half of 2024. On September 14, the ECB raised its key interest rate for the tenth time in a row to 4.5%. According to Christine Lagarde, inflation is most likely declining, but it is expected to remain high for some time. Interest rates are now at a level that counteracts inflation. Most market participants believe that we will remain at this level for longer without further increases. Quite surprisingly, the Swiss National Bank paused on September 21 after five key rate hikes and left the key rate at 1.75%.

Bond Markets – More interesting due to higher yields

As already noted in this review, Q3 saw a significant rise in yields – particularly those in USD. As of September 29, the yield on 10-year US Treasuries stood at 4.66%, its highest level in 17 years. Thus, real interest rates in the US have also risen significantly. In general, we predict yields in most markets to correct lower over the coming quarters. This makes it very unlikely that bonds will generate negative returns over the next 12 months, unlike in 2022. Bonds – especially in USD – are a real alternative to equities. For our clients, we remain invested in diversified bond funds that include corporate bonds and subordinated bonds, among others.

Yields on ten-year government bonds

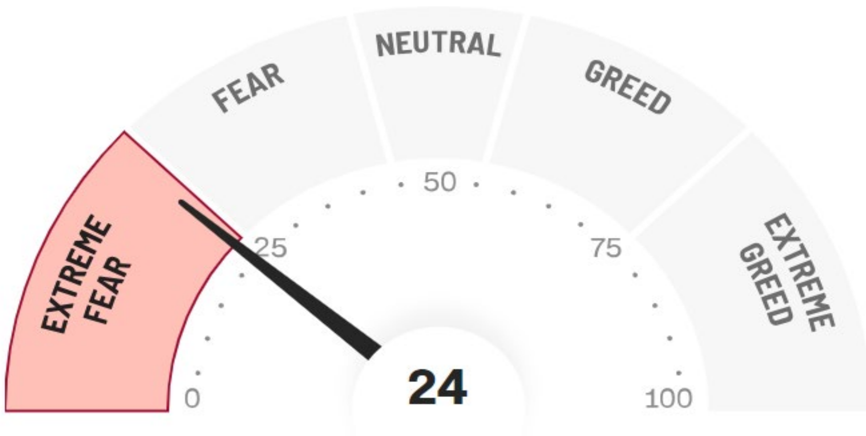


Source: themarket.ch; Bloomberg

Stock markets – Patience will pay off

Positive returns on the stock markets are almost exclusively attributable to the first half of the year, in which a few US tech stocks boosted US markets. Investors' appetite for risk decreased in Q3. The Fear & Greed Index swung from "extreme greed" in June to "extreme fear" in September.

Fear & Greed Index

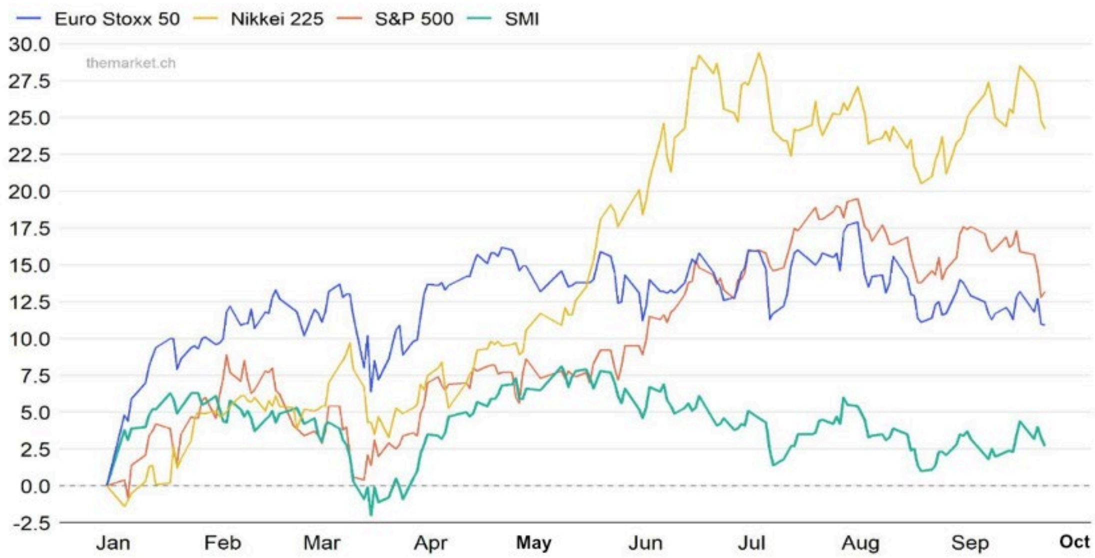


Source: CNN Business

After a positive first half of 2023, there was a setback in August. Economic anxiety, especially in Europe, and fears that interest rates could remain elevated for much longer caught up with stock markets. For Q3, all known indices are in the red. In addition to US tech stocks, this year's winners include Japan, Italy, and Spain, with the latter making gains in the first half of the year. The DAX and Euro Stoxx are in the upper mid-range for the full year 2023, at 10.5% and 10.0%, respectively. The Swiss SMI lagged sharply behind, only 2.2% higher in 2023. Our last Quarterly Review assumed "value over growth", but this has not proven itself yet. We still consider Swiss equities to be a safe haven; though they are not cheap, they have good dividend yields. Moreover, the dividend yields of app. 3% are better than bond yields.

Seasonally, August and September are rarely good stock market months. We believe that there has been much negativity anticipation, and that the equity asset class has now overcome the worst. In the coming quarters, we expect falling yields, a weaker USD, somewhat lower oil prices, and better corporate results once more, especially in the US. All these factors should give this asset class a boost.

Share price development since January 2023

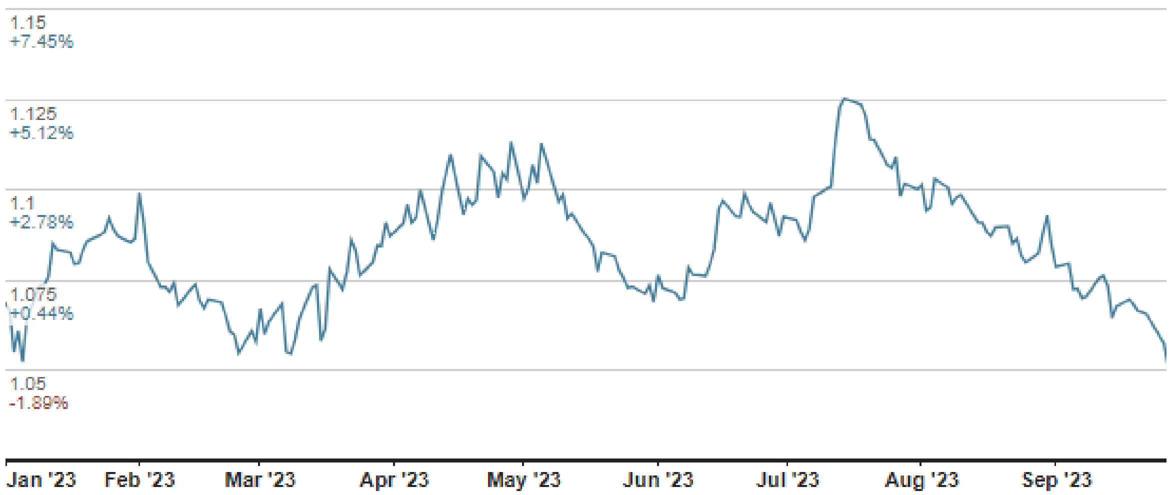


Source: themarket.ch; Bloomberg

Currencies – USD to become weaker again soon?

Briefly, in recent months, there has been an improved outlook for the USD. The US economy is proving to be more robust than expected, and high interest rates have made investments in USD more attractive. In addition, market participants assume that USD interest rates will also remain at a higher – and thus more attractive – level for longer. The USD has gained 7% from its low on July 14, at EUR/USD 1.1250. Even though interest rate cuts in the US will come later than recently anticipated, the US is ahead of Europe in terms of timing. We expect the USD to weaken again with the first interest rate cuts. Since mid-July, the USD has also gained a good 7% against the CHF. The unexpected interest rate pause by the SNB has put pressure on the CHF.

EUR/USD



Source: Quotes, UBS

Gold – only falling real yields can make it more attractive

Gold in USD/oz lost 3.68% in Q3. Mainly two factors ensured that gold did not trade higher: On the one hand, it was the higher dollar, on the other hand continually rising yields on long-term US bonds. If yields remain at current levels, gold is unlikely to benefit. Today, the question is how long interest rates will stay at high levels, and not how high they will rise. This environment has led investors to reduce gold holdings via Futures and ETFs. On the other hand, central banks have been active with record buying, maintaining the 2022 trend. Over the past 12 months, central bank demand has more than doubled to 1,136 tonnes, the highest level in 55 years. Falling inflation rates should have a positive impact on gold. We are maintaining our weighting in gold in anticipation of a weaker US economy, continued geopolitical tensions, and a first Fed rate cut in the second half of 2024.

Gold USD/oz, 50- and 200-day line (red)

Source: statistica.ch

Conclusion – Outlook

We’ll take the liberty of quoting the first lines of our Q2 report once more: "As an investor, it’s important to be patient during challenging economic phases, and not to give too much weight to short-term negative headlines and disappointments. It’s almost impossible to time stock markets correctly." The whirl of stock market and economic news will improve again. As long as we have diversified investments in quality stocks, we can remain calm. At today’s yield levels, bonds are an interesting alternative to equities. We remain invested in gold based on the above reasonings.

We thank you for placing your trust in us and are always available for further information and questions.

Your Belvoir-Team

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