BELVOIR
CAPITAL AG

April 5, 2023

Introduction by Steffen Bauke, CEO

Dear investors,

What a volatile month it's been for stocks, bonds, currencies, and commodities. Above all, there has been a severe crisis of confidence in the overall stability of the financial system. Sparked by a bank run on Silicon Valley Bank, and its subsequent insolvency, followed by the state-backed rescue of Credit Suisse by UBS, memories of the 2008 financial crisis have come flooding back. As a result, gold has climbed to USD 2000 per troy ounce, now reaching a near all-time high. Government bonds have been bought heavily, first time since the start of the shift in interest rates. Also, quality stocks proved to be the winners. So, once again, it all comes down to making the right selection. Of course, we are monitoring this possible slowdown in economic growth and further rate hikes by the central banks with some concern. Despite this, the fact remains that many companies are doing very well and continue to generate high cash flows. In fact, dividend payments will reach a historic high in 2023. We nevertheless expect corrections once more in the following quarters, though these should be viewed more as opportunities to buy rather than to leave the market in fear. After all, the economy is in better shape than many realize, and China's reopening might positively surprise the world economy. Stock picking and intelligent industry weighting remain our daily challenge, especially since sector rotations have been more extreme in recent months than they have been for a long time. But we see also great opportunities in this environment.

Zurich, 5th April 2023

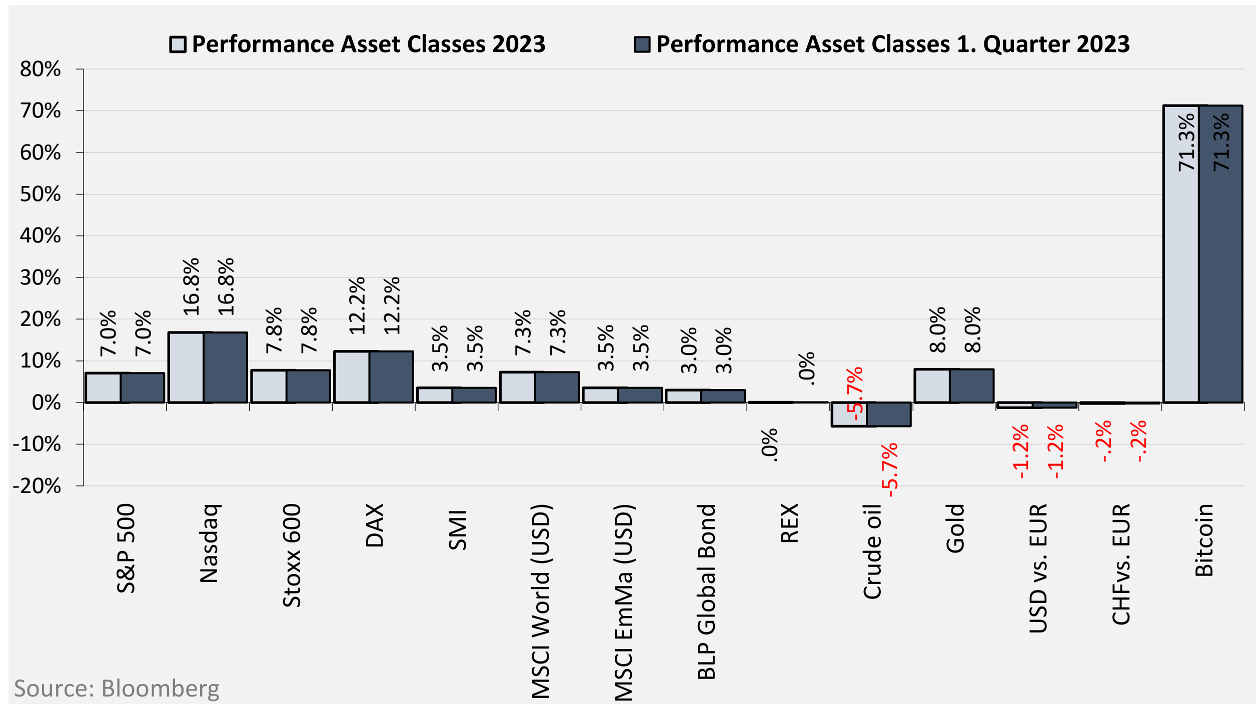
Strategy Update 1st Quarter 2023

5th April 2023

Review – “Sell the Winners, Buy the Losers”

Against most expectations of many market participants, the stock market had a great start in January. This rebound was buoyed by hopes that inflation would fall significantly throughout 2023, allowing central banks to soon end their tightening policies and interest rate hikes. However, a strong sector rotation occurred where value stocks – which remained relatively stable in 2022 – lost significant value in the beginning of the year, while growth and cyclical stocks – especially the large US Tech Giants – were in favor again. Things changed once more in early February, when the US reported strong employment data and higher inflation figures than forecasted. This killed market hopes for an early end to interest rate hikes. As a result, both the bond and stock markets – above all, the Nasdaq – lost most of their January gains. In March, the consequences of higher interest rates led to insolvency for Silicon Valley Bank and Signature Bank, the first in the US. In turn, this led to a loss of confidence in the financial system bringing Credit Suisse to its knees as the next victim. In mid-March, stress in the banking system has caused a sharp sell-off in financial stocks. Within the bond markets, subordinated bonds of financial institutions came under considerable pressure, while government bonds rallied, with yields on 2-year US Treasury bonds falling by up to 30% (from 5.1% to 3.6% p.a.). The market only calmed down after March 20th, due to the emergency rescue of Credit Suisse by the SNB and UBS and the massive injections of liquidity and guarantees from the central banks. On balance, the quarter ended on a positive note. Despite the stress in March, the markets in Europe performed comparatively better throughout the 1st quarter than stock exchanges in Asia and the US (except for the Nasdaq). Europe’s strong performance can be ascribed to lower valuations, surprisingly robust economic data and a different, more defensive composition of indices. In a time of increased uncertainty in the financial system, the proven winners were gold, solid stocks, government bonds and Bitcoin. Movements in the currency pairs EUR/USD, USD/CHF and EUR/CHF were moderate, showing fluctuations of up to 5%, only, despite the stress in the markets. Cryptocurrencies had the best performance in the first quarter. Bitcoin gained 72.4%, while Ethereum gained 52.4%. Only very few market participants expected this at the beginning of the year, whilst some large players in the crypto market also had to file for bankruptcy.

Development of selected markets in local currency



Economy – Remarkably Robust to Date

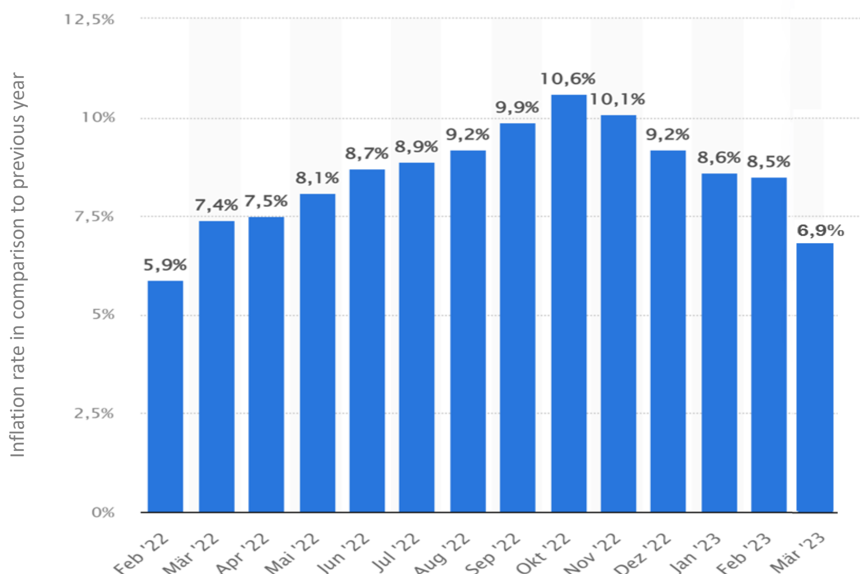
The economy – particularly in Europe – is looking much better than expectations forecast six months ago. A mild winter and the development of other energy sources have helped greatly. At the start of the year, the IFO business climate indicator rose for the fourth time in a row, while the European purchasing managers' index (composite services and industry) signaled economic growth at 54.1. The US economy is also proving robust, reflected in a dried-up labor market and a low unemployment rate; in fact, this is near its lowest point at 3.6%. China's economy is also experiencing significant recovery due to a U-turn in its COVID-19 policy. The IMF predicts a global growth of 2.9% for 2023. However, in the coming months, stronger monetary policy headwinds, higher interest rates and deglobalization are likely to weigh on the economies. Higher interest rates have also started to negatively impact the real estate market. Here lurks a great danger: the real estate market uses a lot of borrowed capital, and prices are declining significantly. REITs (listed real estate companies) have already lost 70-80% of their market capitalization from their highs. If debt refinancing becomes more difficult or even impossible due to changed interest rates and falling real values, this could trigger a domino effect. Private homeowners are also under

pressure here. Thus, in the coming weeks and months, we will be paying close attention to developments in the real estate industry.

Inflation – More Persistent than Expected; a 2% Target seems Out of Reach

The surprisingly strong economy means that inflation will remain at a significantly higher level, even if the base effect from lower energy prices causes inflation to weaken between March and April. Although inflation already peaked in October 2022, it is falling more slowly than hoped. Deglobalization, decarbonization, protectionism and demographics are driving long-term inflation. However, thanks to developments in AI, ChatGPT and blockchain technology, this effect should be offset to an extent by a boost in productivity. Central banks are anxious about second-round effects – especially higher wages – which could fuel inflation once more. In the US, inflation figures on March 14th came back as expected to 6.0%, down from 6.4%. However, core inflation fell only slightly to 5.5%. In the Eurozone, inflation fell to 8.5% in February, and further to 6.9% in March. The ECB still expects inflation to average 5.3% this year. Many companies are using inflation to raise their prices well above this number, which is driving inflation further. Given the current wage negotiations, particularly in Germany, an inflation target of 2% is without a doubt totally unrealistic until at least the end of 2025.

Eurozone Inflation Rates from February 2022 to March 2023

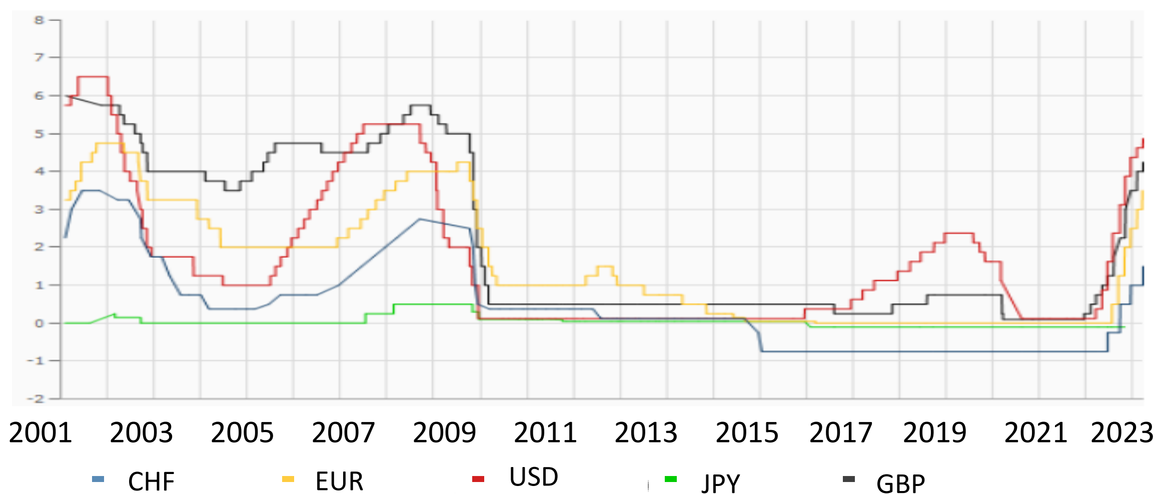


Source: Statista.com

Central Banks – an Extended Rate Hike Cycle, but with a Cap

Despite stability risks within the financial and banking system, the US Federal Reserve increased key interest rates in the US on March 22nd by 0.25%, moving from 4.75% to 5.0%. Fighting inflation is (still) a clear priority. Judging by today, a further step of 25 basis points by the May meeting is a realistic expectation, even though peak inflation and interest rates seem to have been reached. Even if Fed Chair Jerome Powell has not yet raised any hopes for a rate cut this year, the market is already pricing them in. Most market participants expect a high of 5.25-5.5%. On March 23rd, the Swiss National Bank raised the key interest rate by 0.5% to 1.5%, despite the banking crisis in the US and problems with Credit Suisse. Given this fourth rate hike in a row, the SNB is again counteracting the greater inflationary pressure. It is likely that there will be another 25 bps hike on June 20th. In mid-March, the ECB already raised the key interest rate by 0.5% to 3.5%, making this the sixth increase since July 2022. This signals that it considers the banking sector stable and that the fight against inflation will continue. Measured in terms of inflation, the ECB is lagging behind the US in its interest rate policy. We don't anticipate that the ECB will raise interest rates much more, due to deficits in Eurozone countries increasingly affected by war, the refugee crisis, climate policy and sharply increased arms expenditure. In addition, the rising interest rate spread for government bonds is a risk that has still not been acknowledged, yet we know the consequences all too well from history (10-year government bonds: Germany 2.3%; Italy: 4.1%). All these factors put a certain cap on interest rates, which we expect to be at a maximum of 4%.

Development of Key Interest Rates in Switzerland, Europe, USA, Japan, UK



Source: finanzen.ch

Bond markets – Still a Long Way from Positive Real Yields

Only recently, there was much talk of short-term negative interest rates. Those times now seem far in the past when considering all what has happened in the last 18 months. While the interest rate on 10-year US Treasuries was still at 1.7% at the beginning of 2022 and Swiss federal bonds with a term of up to 30 years were no longer showing positive returns, the situation is now very different. By the end of 2022, 10-year US Treasuries achieved yields of over 4.2% and also briefly moved above 4% at the beginning of March. Since the bank closures and subsequent rescue operations, US interest rates have again fallen to 3.55%. This development has been accelerated by searches for secure returns, as well as the expectation of a US recession expected by the end of 2023 into the beginning of 2024. Overall, the interest structure curve has become significantly inverted.

Development of 10-year Government Bonds, Key Markets 5 Years, in %

Source: Bloomberg Finance L.P.

German 10-year bonds have had a similar yield development. Starting from a negative yield of -0.2% at the beginning of 2022, these have risen to 2.7%, only to now fall back to 2.3%. Measured against the current inflation figure, the real interest rate for 10-year federal bonds is still around minus 5%. This development is the same in Switzerland, even if the Swiss federal bonds have barely reached the 1% mark. The risk of bond setbacks seems limited, as the market has already

priced in higher interest rate expectations. Declining inflation rates and weak growth (possibly a recession) are reflected in lower yields at the longer end (from a 5-year term).

After a long period of caution in bonds investments, which spared us losses in 2022, we have begun weighting bonds higher again in this quarter, partly via diversified funds and partly via direct exposure. Above a certain amount, excess liquidity have been placed on overnight deposit, currently yielding over 4% in USD, over 2% in EUR, and at least slightly over 0% in CHF. Depending on the reference currency, our return expectations for active funds range between 4 and 7%. When selecting fund managers, we rely on active management and a solid track record.

Equity Markets – Interest Rate and Inflation Concerns Remain Key Factors

Our primary concerns are these two questions: 1. Does the more robust US economy mean that the Fed must keep interest rates higher for longer than the market is currently discounting, enabling it to significantly bring down inflation? 2. Does the relatively strong economy indicate that we may avoid a recession or is it a hard landing for the time being, with a more severe downturn to come? Looking back, it's certain that a central bank has never sufficiently dampened inflation without leading the economy into a recession. However, at present, we're not expecting a severe recession, since the signals from the economy are too robust. On the other hand, interest rates will remain high for a longer period; the zero-interest rate policy, implemented during the COVID-19 pandemic, is definitely over. Consequently, it's crucial to bet on winners in the equity sector. These sectors and companies are not involved in price wars and have technological and market leadership in their segment. In particular, it is the more highly valued companies with low margins, high levels of debt and little pricing power that will remain vulnerable. If short-term US Treasury bonds still manage a return of over 5%, and the US S&P displays a profit yield of 7%, this clearly indicates that the US markets are overvalued. Declining profits and still restrictive central banks could lead to a valuation correction; this is likely to be mildest where valuations are comparatively cheap. In fact, this is still the case in Europe. We are still underweighting equities and, as has been the case for a long time, we rely on companies that are excellent in their respective segments. In times of rising interest rates, our focus lies more on defensive sectors and, in particular, on well-capitalized companies. The coming quarters will also bring a lot of movement. It's important to keep calm and remain invested in quality, or to increase exposure rather than reduce in the event of setbacks. In strong phases, it is advisable to take profits. When selecting stocks, we rely on expert management, a transparent strategy, pricing power for products and services and – of course – good profits and positive cash flows. It's vital to us that the range of products

and services will continue to impress for years to come. Many of the companies we invest in are a part of our everyday life, directly or indirectly: either as a supplier of products, software or a producer of everyday goods. Without giving any kind of recommendations, we want to highlight Microsoft, Apple and Nestlé: all three firms are market leaders in their fields and continually manage to reinvent themselves. After the first excellent quarter for the two US giants, we expect the price development to pause for a breath in Q2. However, this should fundamentally offer new entry opportunities.

Currency – Overvalued USD, CHF with Potential

In May, when the peak in interest rates will become apparent, the USD will lose an important reason for its strength, and calls for the first-rate cuts will become louder. In terms of purchasing power parity, it is also heavily overvalued. When it comes to interest rate peaks, Europe is not as far along as the US. Interest rates are even likely to rise a little more in Europe and will only fall later on. This will inject more funds into the Eurozone. The shift in the EUR/USD exchange rate from 0.96 to 1.09 over the last 8 months is already pointing the way. The CHF should remain strong due to the quite restrictive monetary policy of the Swiss central bank, as its interest rates are relatively higher while inflation is well below that of the Eurozone.

Gold – Protection Against Crises and Inflation

In the first quarter, gold confirmed its stalwart position as a hedge against turmoil in the capital market and was amongst the winners so far in 2023. A spike in March was caused by turbulence in the banking sector. Since we are not expecting a financial crisis on the scale of 2008, gold should no longer be boosted by this. With higher interest rates, opportunity costs have risen, but the increased inflation will remain a buying criterion for gold. After all, the average production costs per ounce of gold are now over USD 1,800. In the short term, discussions on the US debt ceiling should weigh on the markets and support gold this summer. Exorbitant debts in the Eurozone and the US are seen in the context of discussion and planning of a new currency for Asian and Middle East nations. This harbors the danger that the USD may be replaced as the world's leading currency in the next 10-20 years. Another argument in favor of gold is that many central banks want to increase their reserves in gold once more to make themselves less dependent on the USD. Central bank net purchases were at a record level in 2022, at around 1,150 tons. We remain invested in gold as a crisis hedge and protection against inflation.

Conclusion – Forecast

Our decisions aren't any different from those of 3 months ago, even if the indices are currently at higher levels. Equities remain the best long-term asset class as a hedge against inflation. Yet, this depends heavily on the selection. Of course, we're concerned about the possible slowdown in economic growth and further rate hikes by the central banks, but the fact remains that many companies are doing very well and continue to generate high cash flows, with dividends on the rise. Why don't you observe the companies that crop up in your everyday life through their products and services – starting from your cup of coffee from well-known suppliers, to products for private and business communication, to personal care and health, and any recent purchases? These companies will continue to be a part of your everyday life and will earn money in the future. There will also be troughs in the coming quarters, and this is a good thing; we want to benefit from these to get started. Stock picking and intelligent industry weighting remains our motto and forms our daily work and challenge. We are supplementing our investment strategies with more bonds and more gold. However, in order to achieve capital preservation, investors have to take a certain or even higher risk with good stocks.

Thank you for placing your trust in us, and we are always available for further information and to answer any questions.

Your Belvoir Team

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