BELVOIR
CAPITAL AG

April 2024

Strategy Update

Foreword by Steffen Bauke, CEO

Dear investors,

In March, the markets continued to climb—and stock indices such as the Nasdaq 100, DAX, and the S&P 500 reached new highs. Given the geopolitical tensions and global crises, this may seem paradoxical at first. However, we experienced similar dynamics during the COVID-19 crisis: After the initial shock, the markets started to rise in April 2020, driven by the flood of money from central banks. Our perception often seems clouded by the constant negative headlines. Yet, a rational look at corporate figures shows that companies are achieving record profits and dividend payouts are reaching an all-time high this year. Moreover, inflation appears to be under control, and interest rates should gradually decrease. All these factors suggest that it is still advisable to stay invested.

Nonetheless, there are also reasons to expect a consolidation or a breather in the coming weeks and months. Since October 2023, the markets have risen rapidly without any correction. Some stocks, in which we and our clients have invested, have recorded significant price gains. These gains now need to be digested. Opportunities to invest in long-term sound investments will arise again. Over time, interest rates will normalize, allowing even risk-averse investors to achieve real returns in the bond market.

Zurich, April 9th 2024

Steffen Bauke

Strategy Update Q1 2024

Review - Nvidia's Growth Drives the Markets

The first quarter brought investors very pleasing results. Positive growth forecasts from companies and rather cautious tones from central banks contributed to the positive mood in the stock markets. Particularly outstanding were the impressive sales increases and record revenues of the chip manufacturer Nvidia, which strongly drove the markets. Stocks in the field of artificial intelligence (AI) were particularly in demand, and the associated price fantasies were already anticipated. AI will play an important role in all economic sectors in the future, further strengthening the robust earnings development of technology stocks.

The S&P 500 climbed to a new high with 5,254 points; and the Nasdaq 100 also surpassed its previous high from November 2021. The DAX made the leap over the 18,500 mark and achieved a plus of 10.4% in the first quarter. The Japanese Nikkei 225 achieved the largest gain of all indices with an increase of 20.6% and reached a new all-time high after 34 years—although calculated in Yen, which lost about 40% in value against the Euro and the US dollar in the same period. Also, this quarter, the Swiss SMI was among the laggards with only +5.3%, as especially the heavyweights Nestlé, Roche, and Novartis disappointed. The SMI is still 10.6% short of its high from December 2021.

The yields on 10-year bonds rose between 25 and 30 basis points (bps) in the first quarter, leading to slight losses in bond portfolios with longer maturities. The US dollar gained a good 2% against the Euro. The Swiss franc lost 7.2% against the US dollar and 4.9% against the Euro (see separate section).

Gold and Bitcoin also reached new record highs in the first quarter. However, the difference is significant: while gold in USD/oz increased by 8.1%, Bitcoin, often referred to as digital gold, rose by an impressive 68.6%.

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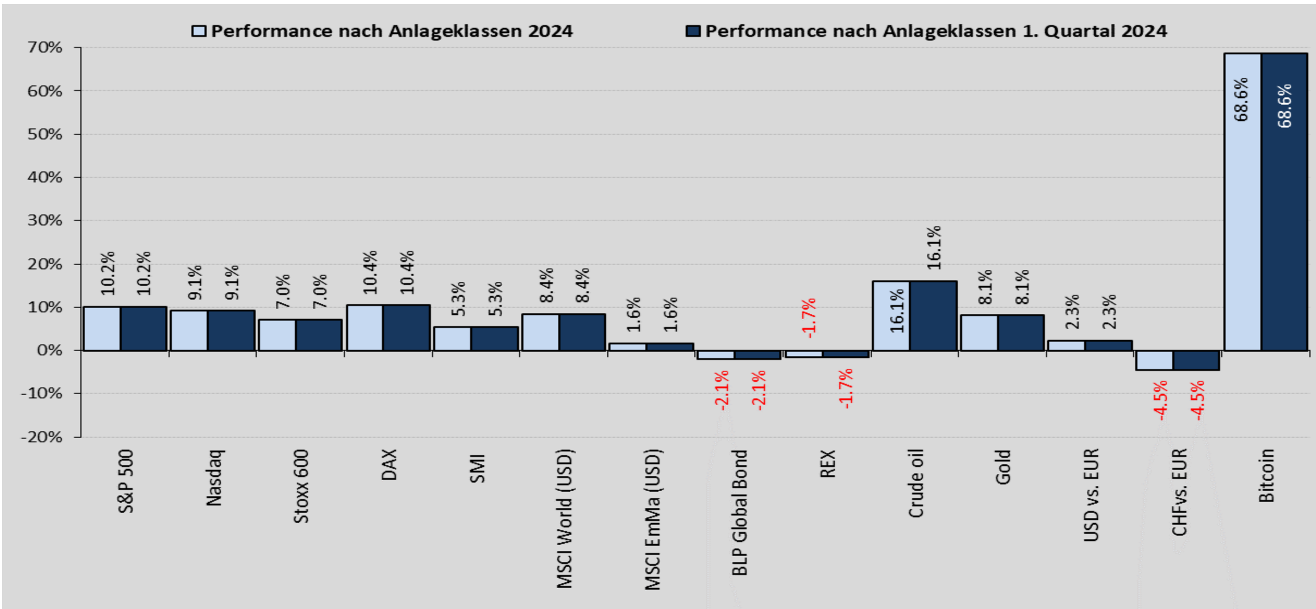
Performance of Selected Markets in Local Currency



Source: Bloomberg

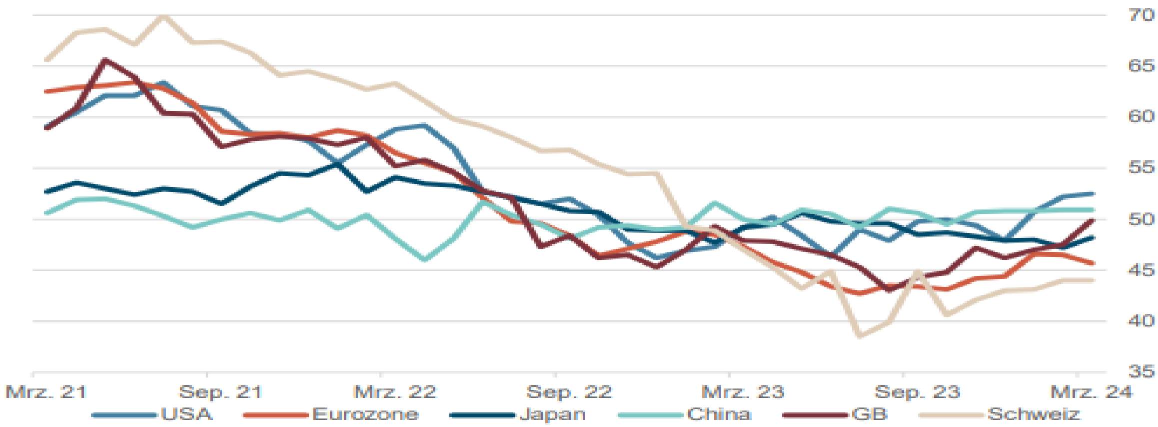
Economic Outlook - Recession Fears Dissipated

The US economy remains on track and is expected to grow by 2% this year. Europe, on the other hand, is slowly navigating through its economic trough and is likely to see modest growth of 0.3%. The US labor market continues to be robust, with 353,000 new jobs in January, 275,000 in February, and 303,000 in March. The unemployment rate stands at 3.9%. With 1.4 open positions per job seeker, there is full employment.

In Europe, the manufacturing sector is particularly lagging, while the services sector is showing improvements. Partially generous wage settlements are having a positive impact on consumer confidence and consumption but may keep inflation at a higher level than desired. Therefore, the expected interest rate cuts are being pushed further back in the calendar, and the number of cuts has also been significantly reduced.

The Purchasing Managers' Indexes (PMIs) published in March do not yet indicate an improvement in Europe. The PMI for Europe has worsened from 46.5 to 46.1, placing it in the deep red zone (values above 50 indicate an improvement in the economic environment). Germany is the laggard in Europe with a PMI of 41.9. The PMIs of the two largest economic blocs, the USA and China, have improved to over 50, with 50.3 and 50.8 respectively, indicating an increasingly better economic environment.

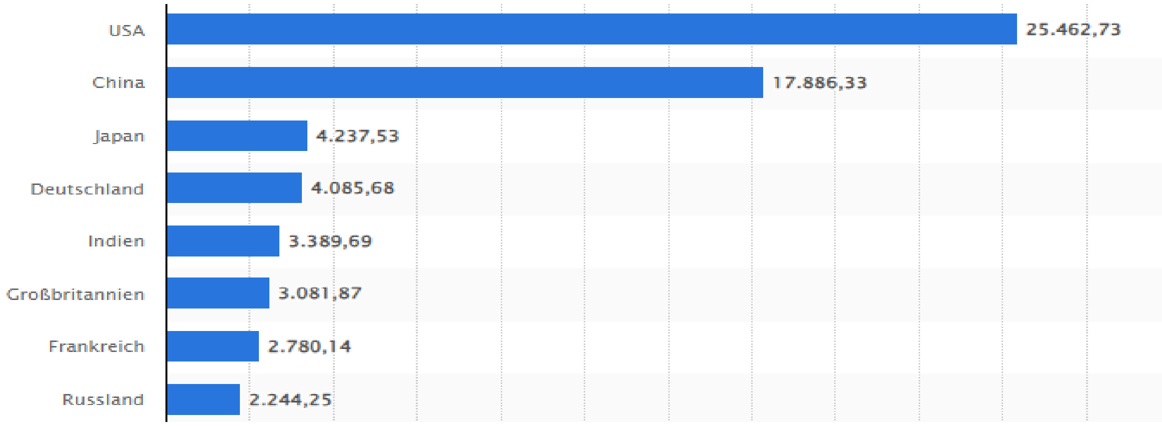
Purchasing Managers' Indices Manufacturing Industry



Source: Bloomberg, Aquila AG

As the following graph shows, the USA, China, Japan, and the EU are the main drivers of the global economy. If one of these "cylinders" fails, the "engine" stutters worldwide. In 2022, the USA contributed more than a quarter to the global GDP. China follows with 18.5%. The share of Asia in the global GDP has risen from 25.1% in 1992 to 35.7% in 2022, while the share of Europe decreased from 35.3% to 21.4%. The GDP of Switzerland, with 790 billion US dollars, accounts for only 0.78% of the global GDP.

GDP of the 8 Largest Countries in 2022 in USD Billion



Source: Statistica

Inflation Decrease - Final Mile Bumpy

Inflation has only marginally decreased over the past three months, with slight increases observed in some instances. In the United States, inflation surged to 3.4% in December, surpassing economists' expectations. It moderated to 3.1% in January, only to edge up to 3.2% in February. The PCE core index (Personal Consumption Expenditure, excluding food and energy costs), closely monitored by the Federal Reserve, stood at 2.8% in February, down from 2.9% in January.

In Europe, inflation experienced a year-end uptick before retreating to 2.8% in January and further to 2.6% in February. However, core inflation remained notably above the 2% target, registering at 3.1%. European Central Bank (ECB) officials have revised their 2024 inflation forecast to 2.3%, with expectations for inflation to realign with the long-term target of 2% by 2025. The German Federal Statistical Office reported a March inflation rate of 2.2%, marking the lowest level since April 2021. In Switzerland, inflation dipped more significantly than anticipated, reaching 1% in March.

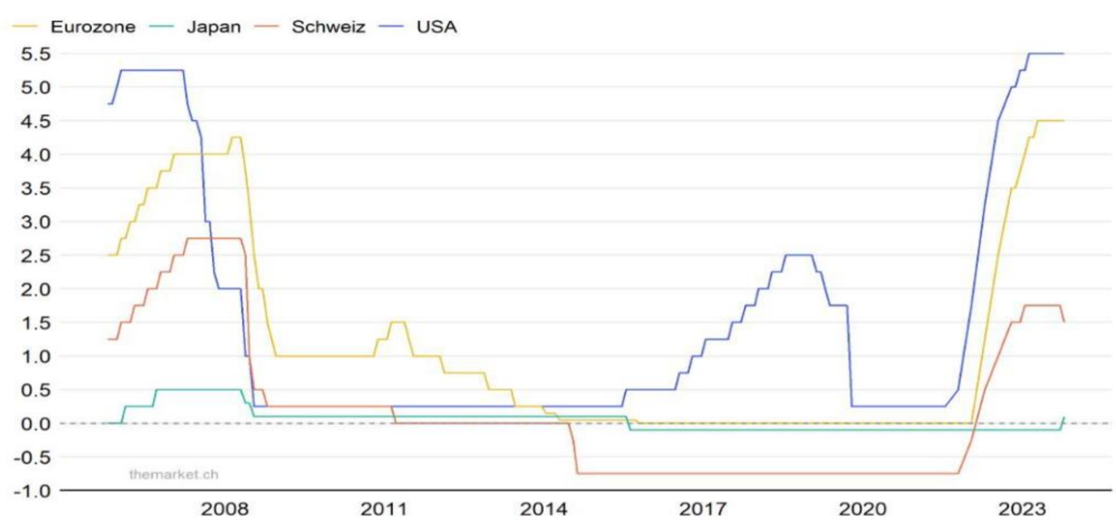
Central Banks - Swiss SNB Initiates Rate Cut Sequence

After the US Federal Reserve (Fed) hinted at rate cuts for the first quarter of 2024 in December, strong economic growth and a robust labor market now suggest that the first rate cut will occur no earlier than June. Currently, the futures markets anticipate a maximum of three 25 basis point (bps) rate cuts from the Fed. On March 20th, the Fed kept the federal funds rate unchanged for the fifth consecutive time, maintaining it within the range of 5.25% to 5.5%. The latest US inflation data indicated a more sluggish easing than hoped for at the end of last year.

The European Central Bank (ECB) kept its key interest rate at the current level for the third time in a row on March 8th. The Eurozone's monetary authorities prefer to wait until at least June 6th for crucial wage development data in the Euro area. Given the current rhetoric from both the Fed and ECB, there's a certain risk that key interest rates will be cut later and by a lesser extent than anticipated at the end of last year. Central banks want to be convinced that inflation is moving towards their target of 2%.

Surprisingly, the Swiss National Bank (SNB) decided on March 21st to cut its key interest rate to 1.5%. On March 19th, Japan ended its eight-year zero interest rate policy with a minimal increase in the key rate from 0.0% to 0.1%.

Key Interest Rates USA, Eurozone, Switzerland and Japan



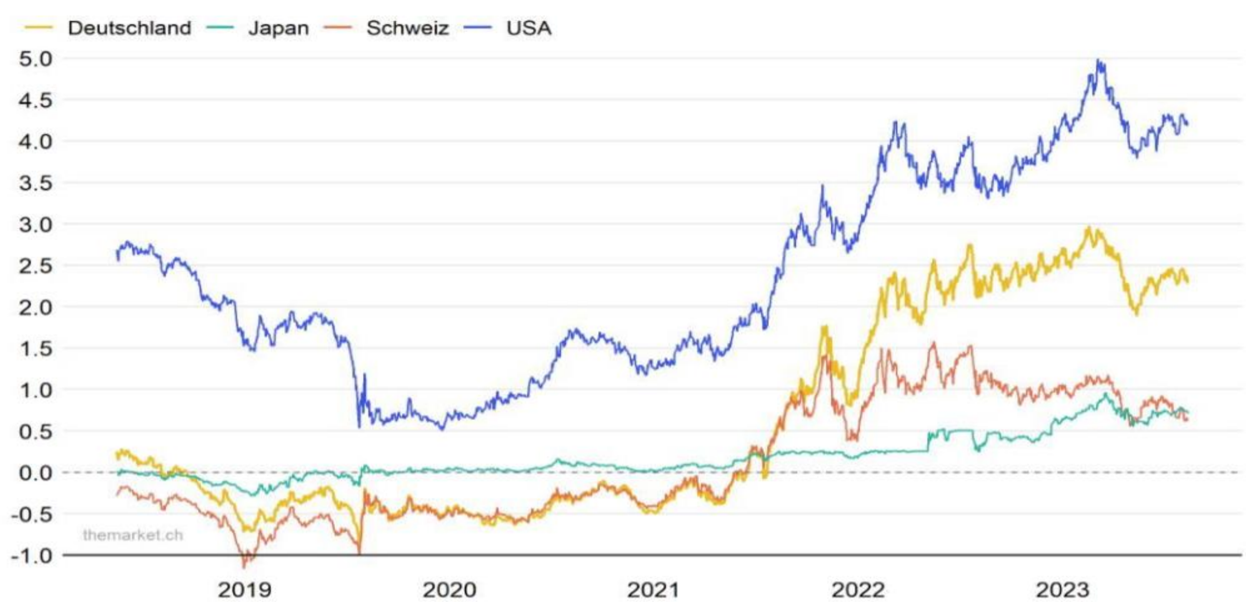
Source: themarket.ch/Bloomberg

Bond Markets - Rate Cut Expectations Were Exaggerated

Currently, the USD and EUR exhibit inverted yield curves, where three-month government securities yield higher returns than ten-year ones. However, history shows that such inverted yield structures are temporary phenomena. Therefore, we expect short-term interest rates to rebound more strongly than long-term rates. Even with lower inflation rates and central bank rate cuts anticipated, we see the decline in interest rates for longer-term bonds as limited. The yields for 10-year Treasuries, German Bunds, and Swiss Confederates are currently at 4.4%, 2.3%, and 0.7%, respectively. For ten-year USD Treasuries, we expect a maximum yield decrease of 40-50 basis points within the next twelve months, and 25-30 basis points for Bunds.

The risk premiums for lower-rated government and corporate bonds are currently very low. The yields are not in a reasonable proportion to the risk when considering inflation, taxes, and fees. Should Trump be elected in November, we foresee negative impacts on the already strained budget deficits and national debt, which argues against significantly lower yields.

Yield on 10-year Government Bonds



Source: themarket.ch/Bloomberg

Stock Markets - AI and Central Banks in Focus?

The enthusiasm for artificial intelligence (AI) continued into the first quarter. Momentum strategies were particularly successful, with only a few sectors and stocks leading the rally and driving indices higher. Nvidia surged by 82.46% in the first quarter, accounting for about a third of the S&P 500's performance. Despite the outstanding development in chip values, the market broadened in March, with over 80% of US stocks trading above their 200-day line. In Europe, it was 70%.

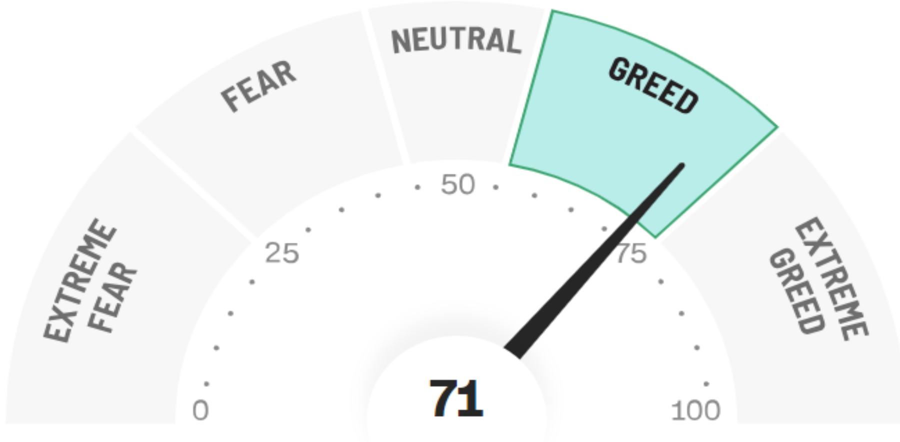
The share of the 10 largest stocks in the S&P 500 gives us pause for thought: this amounts to around 31% of capitalization. For the 10 largest stocks in Europe, this figure is 20%. A decline in these mega stocks could pull the stock market indices down significantly. However, from a fundamental perspective, these shares are not trading significantly above their historical comparisons. As long as profits continue to flow, there is little danger of a crash.

In market segments that have not benefited from the AI hype, there is greater upside potential. This favors the equally weighted S&P 500 at the index level, which we implemented in most discretionary mandates. The forward price-earnings ratio (P/E) of the DAX is currently at 11, which is favorable both historically and in an international comparison. In contrast, the P/E of the S&P 500 is at 20.

Recent years have shown that the P/E ratio does not always have to be a reliable indicator of stock market performance—innovation, profit growth, momentum, and future prospects were the important drivers. Nevertheless, we believe that the valuation gap should narrow somewhat in favor of Europe over the next few quarters. This assessment was already confirmed in March. Therefore, good stock picking remains a crucial factor for performance.

The stock markets have risen sharply in the last two quarters. Therefore, it is not surprising that the "Fear & Greed Index" indicates some overvaluation. A temporary consolidation due to possible profit-taking or a breather seems possible. However, we do not expect a strong correction. Bull markets end in euphoria; we have not reached this level yet. Whether a few months earlier or later, inflation and interest rates will return. In this environment, the rally in the stock markets can continue despite a more cautious outlook for the coming quarter.

Fear & Greed Index March 31st 2024

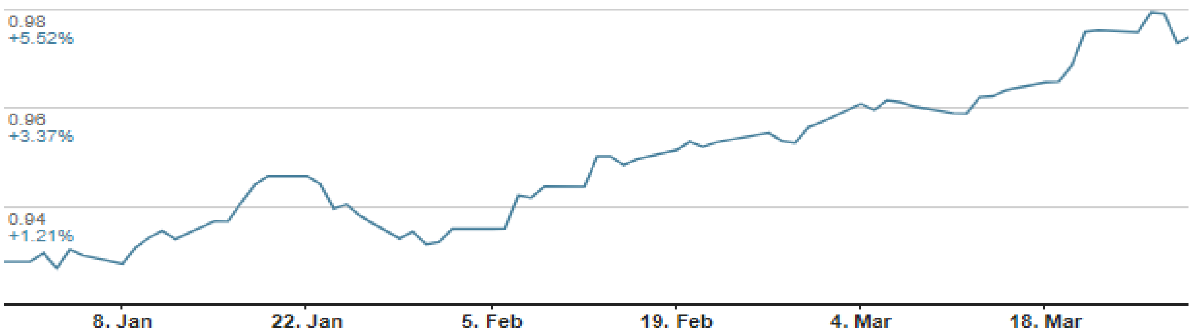


Source: CNN/business

Currencies - Weaker CHF in the 1st Quarter

In the first quarter, the Swiss Franc lost 4.9% of its value against the Euro and 7.2% against the US Dollar. On March 26th, the Euro rose to 0.98 EUR/CHF, the highest level since June 2023. The Swiss National Bank's (SNB) surprising interest rate cut further weakened the CHF. However, it is unlikely that the current weakness of the Franc marks the beginning of a trend reversal. In a longer-term context, inflation development must be considered, which was lower in Switzerland than in the Eurozone. We expect the Franc to continue appreciating against the Euro over time due to its structural advantages. Any kind of political or financial crisis in the EU is likely to put pressure on the Euro.

EUR/CHF – 1st Quarter Performance



Source: UBS Quotes

Cryptocurrencies - Bitcoin Reaches New Record High

In the first quarter, Bitcoin surged an impressive 68.6%. On March 13th, Bitcoin reached $73,104 and marking a new all-time high. Investors attribute the rise to factors including the approval of exchange-traded funds (ETFs) based on Bitcoin spot prices by the US Securities and Exchange Commission (SEC)—and the anticipation of the so-called Halving event, which halves the reward for Bitcoin mining.

The total market value of all cryptocurrencies currently stands at around $2,210 trillion, with Bitcoin accounting for more than half of this (approximately $1,160 trillion). For comparison, the value of all Microsoft shares is about $3,077 trillion. Thus, the cryptocurrency market is not an excessively large market with risks to the financial system, especially since banks hold few assets in cryptocurrencies.

Bitcoin is often described as digital gold. However, its fluctuations are enormous compared to gold. In the past, prices were strongly positively correlated with the NASDAQ technology exchange. Forecasting the future price development of Bitcoin remains challenging, but a new high of $150,000 in the next 12 to 18 months is certainly within reach. Bitcoin remains largely a speculative asset, but one thing is certain: Blockchain technology, like AI, will gradually establish itself and become a part of our everyday lives.

Bitcoin Price in USD (Logarithmic)

Source: BiTBO

Gold - New High, Central Banks, and Demand from India and China Compensate for Lower Investor Demand

The gold price has quietly risen to a record high while investments in gold ETFs have continued to decline. The rise in the gold price is surprising, as central banks have shown no signs of imminent interest rate cuts. The market is increasingly driven by individual central banks that want to reduce their dependence on the dollar and mitigate sanction risks, thus offsetting the declining demand from investors. According to forecasts by the World Gold Council, central banks, especially those in China and Poland, increased their gold reserves by 1,000 tons in 2023, nearing the record mark of 1,100 tons in 2022.

Global ETF gold holdings have reduced from a peak of 3,400 tons in autumn 2020 to approximately 2,700 tons currently, losing their significance as a determining factor. Today, two-thirds of the demand comes from China and India, contradicting the theory that gold is primarily dependent on the USD and interest rates. An economic boom in India supports demand, and Chinese investors disappointed by stocks and real estate are likely to turn more to gold again. Geopolitical risks are also expected to increase, and US budget deficits and debt are likely to continue rising. Both factors should support the gold price and attract financial investors back.

Gold prices USD/oz

Sources: UBS Quotes

Conclusion - Outlook

In the past six months, easing inflationary pressures, anticipated central bank rate cuts, and declining bond yields have propelled stock markets. However, this supportive momentum may wane. The impressive stock returns seen in recent quarters may have peaked for the moment, but a broad-based stock market could sustain them in the future—provided corporate profits remain robust. We have strategically reduced our exposure to technology stocks and market leaders, shifting our focus towards more defensive sectors. Additionally, we have increased our cash allocations, which are yielding attractive interest rates in both EUR and USD.

Our outlook on the stock markets remains fundamentally positive, though we are poised to capitalize on any market pullbacks to adjust our allocations. The relatively robust profit growth is expected to continue and support stocks. The interest rate turn in the USA and Europe is coming – albeit less strongly and later than assumed a year ago. Corporate profits in Europe are slowly improving, but we remain predominantly invested in the USA. In Asia, we focus on Vietnam and India, the main drivers of regional growth. Here, after intensive due diligence, we have selected two very good, active fund managers. In bonds, we also consider actively managed funds and strategies with added value, including subordinated bonds. Gold remains an important component of our portfolios.

Your Belvoir Team

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