Market review

In the second quarter, many market participants shifted their focus from inflation to economic growth. The appetite for risk increased after the US central bank, the Fed, and big bank JPMorgan prevented a larger meltdown in the financial system for now through targeted measures and after an agreement was reached in the dispute over the US debt ceiling.

Solid corporate quarterly reports could not, however, mask lacklustre economic data coming out of China and Europe. Given that changes in interest rates can take some time to affect the real economy, the Fed, which is further ahead in the cycle, deliberately refrained from raising rates in June so as not to depress the US economy even further.

Much to the delight of investors, the euphoria around artificial intelligence (AI) propelled mainly a handful of mega-cap US technology stocks to sensational price gains. US chip manufacturer NVIDIA posted stellar sales figures, causing analysts to almost double their earnings estimates for the year for the company. Setting the performance of these technology stocks aside, the US stock market as a whole has turned in a near flat performance since the beginning of the year. The question now is whether a bubble is forming around the expensive tech stocks or whether the gap between the leaders and the laggards will reduce.

Investor sentiment at the moment, as reflected in the latest sentiment barometers and low volatility indicators, can certainly be described as good. But for how long still?

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Market data
per 30.06.2023

Equity Markets		since 31.12.2022
SMI CHF	11'280.29	5.13 %
S&P 500 USD	4'450.38	15.91 %
EURO STOXX 50 EUR	4'399.09	15.96 %
FTSE 100 GBP	7'531.53	1.07 %
MSCI Emerging Markets USD	509.82	4.89 %
NIKKEI 225 JPY	33'189.04	27.19 %
MSCI All Country World Local	356.05	14.03 %

Bond Markets		since 31.12.2022
Eidgenossen (10y)	0.92 %	-65.9 Bps
US-Treasury (10y)	3.84 %	-3.8 Bps
Bund (10y)	2.39 %	-17.9 Bps
SBI AAA-BBB 3-5 TR	121.61	1.3 %

3 Month Key Rates		since 31.12.2022
CHF (SARON)	1.71 %	76.4 Bps
USD (SOFR)	5.06 %	76.0 Bps
EUR (ESTR)	3.40 %	151.0 Bps

Exchange Rates		since 31.12.2022
EUR/CHF	0.977	-1.27 %
USD/CHF	0.896	-3.13 %
EUR/USD	1.091	1.91 %

Alternative Investments		since 31.12.2022
Real Estate (UNGL)	2'021.66	-0.70 %
Gold (USD/Ounce)	1'919.35	5.23 %
US Crude Oil (USD/Barrel)	70.64	-11.99 %
Hedge Funds (HFRXGL)	1'374.55	0.49 %
Bitcoin (XBT)	30'390.91	83.75 %

Macroeconomic environment

Compared to the previous quarter, the global economy is proving surprisingly robust despite high inflation and restrictive monetary policy. Although estimates for economic growth in the USA, the eurozone and Switzerland for 2023 were revised upwards slightly at the beginning of the second quarter, the global economy started to lose momentum during the second half of the quarter.

In the USA, while demand for goods is continuing to weaken, a lot of money is still being spent on services, though the tendency is decreasing. After the eurozone effectively fell into a technical recession in the second quarter – driven by low consumer spending – leading indicators are now suggesting economic activity could slow in the coming months. Nor can Europe count on the hoped-for upswing in China materializing. The Chinese seem to be consuming less than expected since the lifting of the country's zero-COVID policy at the end of last year. And in May, Chinese exports tumbled. Youth unemployment in China is also continuing to rise. China's central bank, the PBC, reacted by lowering its short-term lending rate for the first time in ten months.

Inflation is fortunately continuing to fall in the USA, Europe and Switzerland. Core inflation though, which excludes energy and food prices, is turning out to be much stickier. The reason being that the economy has so far proved resilient and the labour market is still tight. This is leading to increased cost pressure, which, in turn, necessitates further rate hikes.

Traditional Investments

Currencies

Foreign exchange markets are volatile as a result of economic factors and the differential pace of monetary policy tightening. With the interest rate tightening cycle coming to an end soon, the US dollar is generally expected to weaken over the longer term. Hedging US dollar risk remains expensive for Swiss franc investors though due to large interest rate differentials (about 3.5% p.a.).

Bonds

As long as inflation is well above target, central banks will continue to raise interest rates. Yields on 10-year government bonds in the developed markets rose slightly during the quarter, while the yield on 10-year Swiss Eidgenossen fell to below 1%. Yield curves remain sharply inverted, signalling a possible recession.

Credit spreads on corporate bonds narrowed further towards the end of the quarter. Given the possibility of an economic downturn and the rising interest rate costs for companies, we consider it prudent to focus on bonds from companies with good credit ratings.

A turnaround in interest rates in Western countries with high inflation – starting with the USA – is not expected before the spring of 2024. Europe and even Switzerland are still far from such scenarios. While key interest rates continue to be raised and real yields are still negative, we prefer bonds with a short duration and remain underweight in this asset class.

Equities

Global equity markets carried over the positive momentum from the first quarter into the second quarter and closed 6.6% higher. Initially in April the markets were somewhat cautious in the wake of the banking crisis in the USA; but good quarterly corporate results lifted investors' optimism. The US market – and technology stocks in particular – moved higher (NASDAQ 100: +15.4%) as expectations of a recession in the USA receded and amid the general hype about artificial intelligence (AI). Returns on European and Swiss equities were comparatively lower in the first quarter at +3.7% and +3.0% respectively.

Investors had an increased appetite for equities, especially growth stocks, during the quarter. Broadly speaking, we are now in an environment where riskier assets are being sought. In the short term, however, there may well be some profit-taking during the summer weeks should global concerns about growth or inflation becoming pressing. Global equity valuations are trading only slightly above their 10-year average and have upside potential. We are sticking to our baseline scenario of maintaining a neutral equity allocation in the mandates.

Alternative Investments

Commodities: The gold price lost some ground once concerns about the US banking crisis eased and the US debt ceiling dispute was resolved. We are of the view that gold has now reached a level where it should not be very vulnerable to major setbacks, as the US rate tightening cycle seems to have come to an end and in the past this has had a positive impact on the gold price.

Hedge Funds: Hedge funds made overall a marginal contribution to the positive performance in the second quarter. Trend-following hedge funds (so-called CTAs) recovered some of this year's losses on the back of strong trends with low volatility, especially in equities and commodities. We see low diversification and return potential in an overall portfolio context.

Real Estate: Real estate fund valuations are much more attractive again in terms of premiums. Given the development of interest rates, however, uncertainties remain.

Alternative Debt Securities: Higher base rates lead to increased expected returns on microfinance investments, albeit with a lag. Low correlation to traditional asset classes also enhances the diversification effect in a portfolio context, while the impact strategy allows additional returns.

Other Alternative Investments: More well-known cryptocurrencies such as Bitcoin and Ether have performed strongly since January (>+60.7% in USD), while US lawsuits against Binance and Coinbase, which are among the largest cryptocurrency exchanges, have caused turbulence of late in the cryptocurrency scene. Cryptocurrencies received a boost when BlackRock, the world's largest asset manager, recently announced it was seeking to launch a Bitcoin ETF. Bitcoin remains a strategic portfolio building block.

Private Markets

Private Equity: Market trends have started to normalize after a difficult year in 2022, but there is still a dearth of exits in the private market universe. Exits via an IPO are being looked at again. An example here is the German heating and water billing specialist Techem GmbH, where a sale or IPO is being considered.

Private Debt: Rising base rates will have a positive yield effect on private debt investments over the coming months. Default and recovery rates will, however, have a significant impact on performance.

We see broadly diversified private market investments as long-term strategic portfolio building blocks.

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