INVESTMENT MANAGEMENT & SERVICES | PETER NÜNLIST

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Investment commentary as of 30. September 2022

Dear Sir or Madam

At the beginning of the 3rd quarter, investor sentiment brightened as the economy showed smaller bouts of weakness than had been expected. The view spread that inflation could also be kept under control. This triggered a price rally - known as a typical summer rally - by the end of August. However, this optimism was overshadowed by another unexpectedly sharp rise in inflation. The U.S. Federal Reserve then announced that it would raise interest rates until inflation started to fall again. In doing so, the Fed is accepting that the economy will be deliberately maneuvered into a recession. This spooked investors, triggering a sell-off. Stock market levels ended the 3rd quarter below their mid-year lows!

These volatile market movements are extremely challenging. Although we took various measures, we were unfortunately unable to prevent the high negative returns which you will find in the separately sent portfolio statement or in your online banking mailbox. Every asset class has lost value this year - even cash holdings, when inflation is taken into account. The last time we saw such setbacks in the equity markets was during the financial crisis in 2008. Bonds even experienced the sharpest downfall since the 1970s.

In this difficult situation, it takes a lot of patience and discipline to stay true to your strategy and investment horizon. We tried to minimize losses and positioned ourselves to enter investments at lower price levels in case of a recovery. In the end, however, we had no choice but to continue to increase our cash positions as the outlook became more grim. Nevertheless, the current crisis reminds us of 2009, when stock markets suddenly started to rise in the midst of the ongoing recession. Sometimes all it takes is a small ray of hope, which we cannot yet imagine today.

The SMI, which is considered a defensive index, lost around -21%. The small- and mid-cap index SMIM, which is more sensitive to economic cycles, dipped -33% this year. The DAX and the EuroStoxx50, representing the EU area, fell by -24%. In the U.S., the Dow Jones lost -21%, the S&P500 -25% and the Nasdaq -33%. In the latter, many technology companies continue to show high valuations. China is struggling with its zero-covid policy, which led to various large-area lockdowns, and added -23% to this global bear market. Only Japan managed to stand out with -12%.

In the wake of rising interest rates, gold lost its appeal and depreciated by -8% in Q3. On the other hand, the USD rose by +7% against the CHF. The EURO exchange rate, on the other hand, suffered a currency loss of -6%. Bonds and real estate lost about the same amount this year, namely -17% on average! In the commodities sector, the focus was on oil and natural gas. The former still has an annual plus of +20% and the gas price doubled first in September, before remaining at +80%. Emerging recession concerns triggered these price corrections here as well.

Market review

As early as the beginning of the second half of the year, our information systems indicated that many stocks were trading below their intrinsic value. In other words, investors' emotions were overriding the fundamentals. We therefore considered buying again and were soon confirmed in our intention when the markets rose in the summer. To us, however, this soon appeared to be a temporary rally, which is why we wanted to maintain our underweight in equities and therefore triggered sales. After all, in a bear market the rule of thumb is no longer "buy the dip" but "sell the rally". Among other things, we sold positions such as the *2XIdeas Global Mid-Cap fund* and the *Asia 50 index fund*. In doing so, we were unable to avoid realizing book losses in some cases. We also did this with individual equity positions where we expected tougher business conditions and lower profit margins, e.g. *Partners Group*, *Stadler Rail*, *Vetropack*, *DSM* or *EMS Chemie*.

Here, it is more important to pay attention to expectations than to historical prices. When dark clouds appeared on the investment horizon again in September, investors again pressed the sell button. In particular, sustainable and growth stocks in the technology, biomedical and industrial sectors were sacrificed by investors. This showed us that in times of distress, the market subordinates growth stocks that invest in future trends to current trends such as war material manufacturers, oil and gas, nuclear power and banks. Indeed, these were the only sectors with positive returns this year. However, we were not, or hardly, invested in these for ethical reasons. In the long term, however, we believe that the trend towards progress and sustainability will continue. We were able to escape the downward spiral somewhat with the hedging investments *Carmignac Long/Short Europe* and *Man AHL Diversified* as well as *Robeco Global Premium*.

Market outlook

In recent months, economic forecasts have been successively revised downward. China, for example, still shows a growth rate of 3.5%, which looks like a lukewarm breeze compared to earlier times. The strict covid strategy as well as the real estate crisis are weighing on the country, which also has a negative impact on the supply chains of Western companies. Globally, rising interest rates, a declining economy, and a difficult geopolitical environment are limiting the potential returns for investors.

The strengthening USD due to the increase in U.S. interest rates is becoming another problem for many countries. In Europe, the import of raw materials is becoming more expensive as they are paid for in USD. This is additionally fueling inflation. Until now, higher energy and transportation costs could be fully passed on to consumers under the guise of inflation, pandemic, supply shortages and the energy crisis. In the meantime, inflation has struck our daily lives, and it is a matter of time before consumers start to cut costs. Although this development would help to get inflation under control, we see a strong likelihood of a prolonged weakening of the economy as soon as the state starts paying out subsidies and a wage-price spiral gets underway.

Recession expectations are now as high as they were back in March 2009 or April 2020, and the financial markets are hoping for a change of course of the Fed’s monetary policy as soon as unemployment rises significantly - but at the moment there is still full employment everywhere! For this reason, it is not yet advisable to make additional purchases, even though some stock valuations are below historical averages. In addition, some EU countries are again in a fragile state similarly to that of 10 years ago. The ZEW index, which measures the business climate in Germany, has now fallen to -60 points. The lowest values in this survey, -95 points, were reached in the crisis years 2002, 2008 and 2020, which shows that the current crisis has probably not yet reached its low point. This is also supported by expected profit warnings from companies, which the stock markets have not yet fully taken into account. Patience, however, can also pay off in times of bumpy stock markets. After all, solid investments react sensitively to bright spots. Often, it is precisely in such moments that a good entry point presents itself. That is why timing will be crucial to investment success in the coming months.

Investment strategy

With the latest interest rate hikes by the SNB and ECB, the era of negative interest rates is coming to an end after 8 years. Since mid-September, our models have been indicating that the potential on the bond side will become increasingly attractive in the future. For example, U.S. government bonds are now yielding over 4% again!

Due to the volatile environment, it is important to be able to cover short-term liquidity needs without having to sell at the all-time low. For this reason, we are currently holding an increased cash ratio.

In anticipation of a recession taking hold in many countries, we currently prefer our home market Switzerland, as it has a defensive composition. Moreover, the economic situation in Switzerland outweighs the pessimistic sentiment at the moment. We are invested in dividend stocks that have strong pricing power, high free cash flow and a reasonable debt level. We primarily favor companies from the more defensive sectors such as pharmaceuticals, food and telecom. We therefore use correction phases to increase our positions in *ABB*, *Nestlé*, *Novartis*, *Galenica*, *Emmi*, *Barry Callebaut* and *Swisscom*. We also like *Zurich Insurance*, *Procter & Gamble*, *Galenica*, *Novo Nordisk*, *Air Liquide*, *Alphabet*, *RWE*, *Generall Mills* and *Coca Cola*. Looking at dividend yields, we maintain our positions in the *iShares Global Dividend* and *UBS Global High Dividend funds*.

The UK equity market also contains many value stocks with an attractive dividend yield and a low valuation due to the Brexit correction - which has now also dragged on for 6 years. However, as these are global companies that primarily generate their revenues abroad, we see the local turmoil with the new government as a potential entry point. For this reason, we are considering an investment in the *Vanguard FTSE 100 ETF* or the *iShares MSCI United Kingdom ETF*.

Given the risk-off reaction, investments in the sustainability space have been discarded and are now more attractively valued. However, climate change and the change in European energy architecture away from Russia means higher subsidies and growth in this area. Thus, we are considering an increase/rebalancing in the *Vontobel Clean Technology fund* as well as a new investment in the *Vontobel Energy Revolution fund* or the *Enetia Energy Infrastructure fund*.

In the past, turbulent times have always offered opportunities to enter the market. Given the very pessimistic mood at the moment, a short-term recovery based on the U.S. congress elections in November and a December rally, for example, cannot be ruled out. **Due to the uncertainties, it makes sense to build up / rebalance positions in a staggered manner over the next 6 months and reinvest some of the liquidity to be ready for a possible post-crisis recovery**. In these times, it is crucial to stay true to your long-term investment strategy. In addition, diversification across different sectors and asset classes is the best way to smooth out the sharp market fluctuations.

It is a special time that we are all experiencing, and it challenges us in a number of ways. It takes a lot of patience and confidence in the future. We thank you for trusting in our investment activities and are always available to answer any questions you may have.

We wish you and your loved ones a colorful autumn season.

Yours faithfully

Peter Nünlist | René Flory