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Hyposwiss Advisors SA

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Q4 2021 Review

Covid-19 did not prevent equities from reaching new all-time highs

Investors were shrugging off spiking Covid-19 cases globally and equity markets managed to register a year-end rally extending an already **strong Q4** run (MSCI World +8% QTD), again led by US markets (S&P500 +11%). Asian markets alone could not follow the trend (MSCI Asia ex-Japan -2%). As in previous quarters, the uptrend was supported by astonishingly strong US Q3 corporate results, topping initial consensus by 7% with 79% of companies delivering better earnings than predicted.

MSCI World Index in Local Currency – 01.01.2020 – 31.12.2021
Source: FIS Market Map

2021 will be remembered as the year when US markets posted **70 all-time highs,** ending with an overall gain of 29% (S&P500). This rally did not come without interruptions and you can easily say that markets were climbing against a wall of worries. These included the ongoing unpredictability of news related to the Covid-19 situation, which contrary to common prognosis at the start of the year did not disappear despite globally orchestrated vaccine campaigns. The interest rate situation was another concern, as USD long-term rates started to increase, the US 10-year Treasury climbing as high as 1.77% in Q1 of 2021.

A different discussion point is **inflation data**, coming in at higher numbers each month and it remains a yet disputed issue if this effect is only of a temporary nature or here to stay. Another headache was the increasingly high value of stocks. Despite increased earnings, most traditional **equity valuations** were reaching seemingly lofty levels. Last but not least, some single events lead to uneasiness, of which the liquidity problems of the Chinese real estate giant Evergrande was one example.

Otherwise in Q4, **gold** was able to cross the USD 1'800 level again but ended the year negatively (-5% in 2021). **Oil** traded sideways in Q4, but is still in a solid uptrend (2021 Crude oil Brent +53%), thereby pushing oil currencies and energy stocks up. Most but not all industrial metals had a strong performance 2021 (Aluminum +41%), as did many agricultural commodities (Wheat +23%).

The **USD** against most predictions had a solid 2021 uptrend, advancing to the Euro by +7%. Another strong mover was the **CHF**, which increased by +4% towards the Euro and many forex dealers forecast it will reach parity to the Euro in 2022, as the low inflation figures of Switzerland during the last few years will ultimately translate into currency appreciation.

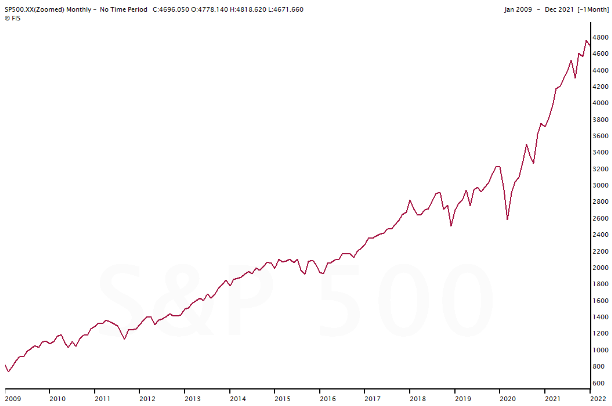
A look at the 31 most widely traded currencies in 2021 reveals that the **Israeli Shekel** was the best performing currency, climbing around 3% to the USD and almost 12% versus the Euro and thereby reaching a 25-year high. Reasons are a robust economy and along with it the outstanding performance of Israel's main **TA-125 Index** (+30% in 2021), as strong markets lead to a rising demand for the currency.

The increased value of the Shekel is a burden for its exporting industry (mainly high-tech products) and the tourism sector, and therefore the central bank, the **Bank of Israel**, not unlike the Swiss National Bank, is trying to take countermeasures by interventions in the currency market. Surprisingly, Israel's exports in 2021 hit a record high of USD 140bn, up 18% from last year, despite the fact that tourism is not yet at pre-pandemic levels.

Equity

Will the equity-rally continue amid rising interest rates?

The S&P500 finished last year with a gain of 29% on a total-return basis and investors are estimating the remaining power of the current secular bull market in US equities. The market was up every single year **since 2009**, except in 2018 (-6%).



S&P500 Index – 01.01.2009 – 31.12.2021
Source: FIS Market Map

A recent study by *Ian Webster*, using U.S. Bureau of Labor Statistics' monthly CPI logs, shows that if you invested USD100 in the S&P500 at the beginning of 2009 (surely a low entry point after the 2007/2008 correction), you would have owned USD665 in 2021 (by August), assuming you reinvested all dividends, resulting in a return of **16.14% per year**, the inflation-adjusted yearly return would have been 14.05%.

With last year closing at an all-time high, and with an eye on the longevity of this market uptrend, the **future upside potential** is an obvious concern. Looking back, since 1871, yearly returns in excess of 20% (like 2021) were followed by an average gain of 9%. This is in contrast to the average yearly performance of any year preceding a negative yearly return, which is only 5%. These numbers show that a high trading market does not automatically mean that it will correct anytime soon.

The 2021-rally was not only led by the big-name technology stocks as in previous years, when FAANG stocks dominated the field (e.g. Amazon had a flat performance). It was generally more broad based and as a result, the **NASDAQ Composite** rose less (+22%) than the overall market. The underperformance of technology stocks started in November 2021, continued the first few trading days of 2022 and considering that higher interest rates are disadvantageous for growth stocks, might continue for a while.

European markets were following US markets, but their uptrend was less impressive (EURO STOXX 50 +21%). The UK market especially underperformed (FTSE100 +15%), as the country is still suffering from after-Brexit troubles (the UK formally left the EU on December 31, 2020). **Asian** markets never performed well and even finished the year in negative territory (MSCI Asia ex-Japan -4%). In the case of China, one reason was the legislative hurdles and restrictions the Chinese government imposed on some technology heavyweights, which are often trading as ADR's in New York or in Hong Kong (Hang Seng -15%).

Some 2021 **challenges** are expected to ease in 2022. One example being the supply chain de-bottlenecking and the inventory rebuild, as production ramps up following the adjustments to higher energy and raw material prices. Other 2021 issues remain in place, like the pandemic, the Ukraine conflict, Evergrande liquidity issues or oil supply disruptions among others. The pending **interest rate increases** in 2022 are another issue to be reckoned with. However, in the previous nine hiking cycles since 1970, equity investors have fared comparatively well, with US equities rising in seven of the nine cycles, albeit in some cases only modestly.

Client managed accounts:

We increased our **equity allocation** during 2021 in all categories to a level which is sustainable in our view and which is slightly more conservative than some of our peers. **Our US and European stocks** with their balanced mix of growth and value stock performed well and we estimate that in 2022 **value stocks** will outperform given the interest rate outlook. Our positions in **Asia** were underperforming in 2021 along with those markets. We decided to slightly reduce these holdings, but we like the superior long-term growth story of this region, which will ultimately prevail and translate into higher equity valuations.

Fixed Income

Interest rates are expected to climb in 2022

Global bond markets had recently some headwind as interest rates started to climb; a sign that markets are starting to price in a rate hike by the US Federal Reserve (FED) fairly soon. In addition, the fear of a more severe slowdown of the global economy is waning as many states report a very low usage of intensive care units, supporting the view that the omicron variant causes less severe symptoms than previous variants.

Furthermore, incoming economic numbers such as the global purchasing managers' index are consistent with above-trend growth and high price pressure. To make matters worse, there was lately a flood of new bond issues to digest as corporations and other issuers were eager to lock in the low rates. Last but not least, the FED has been well telegraphing a slowing of its bond buying program in 2022.

The resulting yield curve is staggered nicely upwards and therefore we presently face a **'*normal yield curve*'.** This current normal yield curve is an indication of no fear of potential economic troubles ahead, whereas **inverted yield curves** are considered as early indicators of pending economic recessions. **Economic cycles**, regardless of their length, have historically transitioned from growth to recession and back again. Since 1956 there exists a consistency of pattern that every recession has been preceded by an inverted yield curve as an essential part of such cycles.

For bond investors, FED rate-hiking cycles have proved to be a challenging matter, as in the previous **nine hiking cycles since 1970** (which typically lasted one to two years with an increase of 200bp-400bp), the 10-year yield rose eight times while the 2-year yield rose in all 9 cycles.

Client managed accounts:

Considering the situation of Fixed Income markets, we retain an underweight for bonds in USD based accounts and an even higher underweight in our CHF/EUR based accounts. We did lower our allocation three times last year and depending on the situation might reduce it even further. However, despite low returns, we keep a certain portion of Fixed Income mainly for **capital preservation**, as we hold primarily bonds with a duration below 5 years. To generate some additional income, we invest into higher yielding instruments within the **High Yield (HY)** space, which we carefully monitor or cover through active managers with a proven track record.

Currencies

The USD to remain strong for now, the Yuan is ready for further gains

The **USD** had against most expectations a strong 2021, outperforming all major currencies other than the Chinese yuan. The underlying reasons continue, therefore this uptrend could persist well into 2022. The shift towards a tighter monetary policy of the FED together with interest rate hikes are somewhat known facts, but in our view markets did not completely price in the resulting additional rate advantage. Another supporting factor for the USD is price development. The rather closed US economy seems to cope better with rising producer prices than the more globally export-oriented Eurozone.

The **Euro** lost 7% against the USD in 2021 largely due to constraints by the dovish policy of the European Central Bank (ECB). The Euro is now trading well below its fair value but will continue to do so until the ECB is initiating an interest rate normalization. Going forward, the recovery from the pandemic will progress, with risk aversion strengthening again and investors seeking exposure outside the USD. In addition, the long-term outlook for the Euro remains constructive as Europe's **purchasing power** remains strong and the main European countries offer a solid **balance of payments** situation, contrary to the USA.

The **CHF** has been trending stronger recently (EUR/CHF 1.03) and is close to levels which were used by the Swiss National Bank (SNB) to intervene in the markets. Looking at the SNB's sight deposits, it has not reacted so far. This 'laissez-faire' stance of the SNB might have different reasons, one being that the CHF only increased towards the Euro but not against the USD. Another factor is that the stronger CHF dampens inflationary pressures, which can be seen in the November consumer-price inflation figure, which was only 1.5% in Switzerland, compared to 4.9% in the Eurozone and 6.8% in the USA.

The **Chinese Yuan CHN** demonstrated remarkable stability in 2021. It was unimpressed on issues like the Chinese growth slowdown in wake of deleveraging efforts (in particular real estate debt woes like Evergrande) or the unpredictable regulatory crackdowns, which mainly resulted in negative reactions in the stock market. It is also noteworthy that the multi-year long correlation of the CHN to the USD seems to be broken in recent months.

Going forward the Yuan enjoys **three major supporting factors.** First, despite the approaching monetary policy tightening in the US, the yield advantage remains sizeable. Secondly, the Yuan enjoys heavy investment inflows, despite the regulatory uncertainties and thirdly, the positive trade balance has reached a new record surplus thanks to strong export demand in the recovery.

Economics

Outlook of the economy still depending on the progression of the pandemic

A year ago, there was hope we would have declared victory in the war against Covid-19. That has not yet occurred for **three main factors**: The first was the emergence of the **Delta variant** in the middle of the year with its higher transmission and illness rate compared to the original Alpha virus.

Secondly, there is the **vaccine hesitancy** coupled with the slow approval process for vaccinating children in most countries, which added together left 25%-35% of the population of advanced economies unprotected against the virus. The third factor is somehow linked to the emergence of the **Omicron variant** and is basically the fact that poorer parts of the world have not been able to make enough progress in vaccinating their population. Without making any judgement on the governments of richer economies to prioritize their own citizens, these decisions have left some countries as a de-facto breeding ground for new variants, as the Omicron out of Africa has shown.

Ironically however, if the currently dominating view that Omicron produces less severe diseases than the Delta virus proves valid, the perspective of a reduced burden on the health care system might become a game changer.

Dr. Anthony Fauci, President Joe Biden's top medical adviser and by many considered to be 'Americas Doctor', said on December 29 on CNBC that it will likely be only a couple of weeks, maybe already at the end of January, that the Omicron wave will peak, but indicating that the diversity of vaccination versus not vaccination is making predictions tough to make. He further said that it is technically possible that Omicron could hasten the end of the pandemic, if it proves true that the variant, with its high degree of transmissibility, replaces other strains of the virus that cause more severe infections. Of course he added that there's no guarantee that this would mean the end of the pandemic.

Notwithstanding the uncertainty regarding the pandemic, the market is expecting the current **economic cycle** to continue at a moderate pace of 4% in 2022 after 5.6% in 2021 (World GDP numbers). Consumption is set to lead the growth trend. Healthy labor markets and a decline in savings should balance the erosion of the purchasing power.

Commodities

Supply chain stress was the key word in 2021

Supply chain stress has been caused by spikes in **commodity prices** and 2021 became a year of hiccups, as the rapid economic recovery and manufacturing-driven rebound unleashed wild market dynamics. Some industrial metals climbed to record highs. The energy crunch fueled **shortage fears** as different supply chains reached their capacity limits and oil prices exceeded USD 80 (Crude oil Brent) in October for a few weeks.

The spike in the **oil price** was maybe the biggest surprise on the commodity side in 2021, as the focus was initially more on natural gas and coal. It caused extraordinary turmoil and nourished the ongoing debate on the energy transition, leading to power shortages in China and shaking up the utility business, specifically harshly in the United Kingdom, where certain people no longer could afford to heat their homes.

Oil prices surpassed the much-watched USD 80 level again at the beginning of 2022. Support came from the petro-nations announcement to maintain their path of easing supply restrictions, which can be interpreted as a view of tightening the market.

However the **long-term picture** looks different. In 2022 and the following years, a surplus might be building as supply growth will exceed demand growth. In the developed markets, oil demand has already reached high levels, whereas supply continues to grow incrementally given the healthy levels of shale drilling activity and ongoing easing of the petro-nations output restrictions. The oil market is in a transition phase where storage shifts from tightening towards easing. Sources of uncertainty include the pandemic, ongoing supply chain interruptions and to a large extent oil politics given the underlying shift of fundamentals. Finally, the oil price surge was adding much fuel to the ongoing **inflation debate**, along with other rising commodity prices soaring.

Gold: The gold market believes the inflation to be temporary

Contrary to the overall **commodity market**, both gold and silver did not move much in 2021. Prices remained range-bound for most of the year as neither the temporary weakness of the USD nor record-low USD real-bond yields provided sustainable support to any of the attempted rebounds.

Not even the increasing inflation issue was able to lastingly lift prices, despite inflation rates rising to their highest levels in decades in the US and Europe. The underlying open question is if we currently experience a *good inflation* or a *bad inflation*. The **good inflation** would mean that it only reflects the ongoing economic recovery without any wage-price spiral which would necessitate consumer price increases, and as a result make the current inflationary episode to be transitory.

Gold prices (XAU ounces) in USD – 01.01.2020 – 31.12.2021
Source: FIS Market Map

The **bad inflation** would be very bullish for gold as it expresses a lack of trust in central banks and could materialize into a period of stagflation, i.e. rapidly rising prices which no longer reflect an economic recovery. Either way, the gold market for now has decided that the current inflation is of temporary nature.

Entering 2022, the biggest downside risk for gold is a faster than expected scaling back of stimulus measures and rapid interest rates increases by the FED, as already observed during previous tightening cycles. Demand which is originated only by safe-haven seekers will not lift gold prices enough as long as global economic growth remains robust.

Client managed accounts:

We hold our long-term strategic position of 5% gold as an insurance against all possible **geopolitical negative events** including the Russia-Ukraine and the China-Taiwan conflicts and the usual Middle-East tensions, a systematic financial crisis or an unexpected acceleration of inflation.

Outlook

Equities are supposed to outperform (unattractive) bonds

The global outlook for economies is depending considerably on the **progression of the pandemic**. Our base scenario is that the pandemic will meaningfully recede in importance this year, which would lay the groundwork for a more normal labor market, prices and the supply of both goods and services. Economic growth in advanced economies should be above-trend for the year as a whole. Any economic activity disrupted by Omicron in the first half of 2022 will likely shift into the second half of the year.

Stocks are expected to outperform bonds significantly, but equity returns might be only in single-digit territory. These **low equity returns** are a net result of robust revenue growth (which is positive per se), but some compression of the currently high profit margins and the already elevated earnings multiples will limit the upside potential. In the already announced lead-up to the US monetary policy tightening in 2022, market volatility would rise.

Within regions, the **Eurozone** might outperform the USA for a change, as Euro-area earnings have more post-pandemic catchup potential than US stocks and Europe's indices contain more value and cyclical stocks, which enjoy a revival in times of higher interest rates. The outlook for **Asia** remains open, until clearer signs of a Chinese policy easing emerge. The higher growth rates for Asian economies however will ultimately translate into higher stock prices.

We **enter 2022** with the assumption that global stock markets will continue their uptrend at modest levels and amid high volatility. We keep some shorter dated bonds for capital preservation, HY/EM bonds to generate income, gold for unforeseen events and regard 'Alternative Investments' including real estate and commodities as important tools to diversify portfolios.

Walter Küng
Senior Portfolio Manager

Remark:

"Client managed accounts" refers to a generic description of general investments for managed accounts under discretionary mandates. Each account and portfolio could be materially different from this description and could invest or not in substantially different securities or products, based on individual risks and objectives. The descriptions above are not meant to reflect exact holdings by all accounts. Non-discretionary mandates could also be managed in a manner materially different than the description above.

For any question or doubt, please contact your Relationship Manager that will review your account and provide personalized comments and information.

Asset Allocation

USD Reference – Balanced

Thematic investment idea

Investing in a future megatrend

Fintech

Financial technology (Fintech) refers to the integration of technology by financial companies to automate the delivery of financial services and includes any company which uses new technology to disrupt the financial industry. Fintech only emerged in the 21st Century, and its **fields** are still increasing, and include: Peer to Peer lending / Blockchain-powered Solutions / Digital banking / Billing / Payment Software / Money Transfers / Crowd Sourcing / Insur-tech / Robo-Advising / Budgeting / and more.

Investments include generally **3 types** of companies: 1) Fintech startup companies, the most famous example being **Paypal,** founded in 1998 among others by Elon Musk and Peter Thiel and worth around USD 225bn 2) Big tech companies who want to disintermediate the financial industry 3) Old financial services companies who look to remediate their traditional services.

Investors are piling in billions of dollars into this fast growing industry, hoping to find the next Paypal. Already in 2015, JP Morgan's CEO Jamie Dimon warned that traditional banks are 'grossly inefficient and have ineffective processes' and that new Fintech companies might put the old banks out of business. Since then virtually all large banks have declared themselves to be technology companies, but at the same time are watching helplessly how Fintech startup companies are running hot and are creating new business models.

The situation for Fintech looks even more promising in **Emerging Markets.** In a recent survey in Latin America, 90% of the banks acknowledged that they lack suitable products for small and medium sized companies. In many regions, there are more people connected to the internet than to bank accounts, a situation which empowers the way for e-commerce. Fintechs offer an easy solution through on-line factoring along with collection of payments that provide more efficient ways of keeping cash flows than those offered by traditional banks.

Fintech companies are also on the front position in the transformation towards a wallet-less or cash free economy. They have delivered technologies that have made payments more comfortable and offer enhanced experience, which is what innovation is created or designed to execute.

The **outlook** for Fintech is promising and means a rapidly evolving industry over the next decades. Smaller disruptors will continue to shake up the industry, IPO's and M&A activity will likely continue at elevated levels, and existing Fintechs will race to grow their market share and capitalize on untapped opportunities.

We believe there is a **long-term opportunity** for investors to participate in this fast growing global thematic. Should you want to know more about this trend and how to invest, please feel free to contact your relationship manager.

Mission Statement

- Hyposwiss Advisors' mission is to offer **personalized asset management services and financial advice** to high net worth individuals and families based in the **USA** and **Canada** with the overriding objective of **capital preservation** and **asset growth** performance oriented.

- Investments in compliant global assets are used to construct a **diversified balanced portfolio** tailored to the investor's requirements and deposited with **international banks** acting as qualified custodians.

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