HYPOSWISS
ADVISORS

Review & Outlook
April 2022

Review and Outlook

Hyposwiss Advisors SA

www.HyposwissAdvisors.ch

Q1 2022 Review

Ukraine war dominating the news, but not impressing the markets

The focus of **global news** turned from Covid-19 to Eastern Europe with the rather surprising but still anticipated war between Russia and Ukraine that began on February 24, when Vladimir Putin issued an order for Russian forces to 'liberate' Ukraine by a 'peacekeeping operation'.

World **equity markets** had already dropped before the conflict in expectation of the event and declined for a few trading days in response to the battle news. They however recovered soon, following the famous word of Baron Nathan de Rothschild: *Buy when the cannons are firing and sell when the trumpets are blowing.* Eventually, most markets were trading higher at the end of Q1 than when the war-news reached the shocked markets.

MSCI World Index in Local Currency – 01.01.2020 – 31.03.2022
Source: FIS Market Map

On March 31, the war was already lasting over 5 weeks and after many volatile trading days, the quarterly result is that the **MSCI World** declined by merely -5.53%, recovering strongly from earlier lows. The deepest point was reached by US markets on February 24 (S&P 500), the initial date of the invasion, whereas European markets continued their decline until March 8 and by this time had fallen over 20% from their peak value (EURO STOXX50).

A look at regions shows quite some differences. **Europe's** 2021/2022 outperformance was stopped by the ongoing crisis (EURO STOXX50 –9.21% QTD). Particularly Germany's market suffered strongly, as many companies are in various ways involved with Russia. The UK market remained strong (+1.78% QTD), thanks to the high index-weighting of energy and commodity stocks.

Asia's underperformance of the last 2 years continued so far in 2022 (MSCI Asia ex Japan -6.56% QTD). The main reason is the inferior result of China (SSE Comp. -9.99% QTD), as other markets did well, Singapore being the best market (Strait Times SG +9.49% QTD).

Another observation is that regions with high exposure to energy and materials are performing better. The best example is Canada (TSE 300 Toronto +3.14% QTD), but also Latin America is doing well (BOVESPA +14.48% QTD). The relative outperformance of Latin America to world equities is breaking its long-term downtrend which started in 2007.

Otherwise in Q1 2022, **Gold** could profit from the war noise (+6.01% QTD), climbing easily above USD 1'900 and reaching USD 2'069 as a peak value on March 8, when Vladimir Putin announced that Russia would put his nuclear weapons on high alert.

Oil surged strongly (CRUDE OIL WTI +31.62% QTD), crossing the important USD 100 level and climbing above USD 130. The Ukraine crisis fueled supply fears and pushed oil to prices which not so long ago were unimaginable. The authorization of President Joe Biden to release the massive Strategic Petroleum Reserve (SPR) was one of the reasons the oil price surge stopped. The **USD** continued its 2022 uptrend, advancing towards the Euro +2.66% QTD.

Equity

Stock markets must prepare for a stormy period ahead

With all the war news dominating the field, bringing oil prices to jump to unforeseen levels, and interest rates rising as high and fast as unexpected, it seems astonishing that the **MSCI World** declined by only -5.53% QTD.

As always in times of crisis, the USA is performing slightly better than the world (S&P500 -4.95% QTD). Within **sectors,** technology stocks continued their downtrend (NASDAQ Comp. - 9.10% QTD), as stocks with high multiples (high P/E ratios) are more vulnerable to interest rates movements. Energy and commodity stocks, next to traditional value stocks (consumer staples, health care, utilities), had superior performances, partly also because of their high dividends, and we think this trend will continue. Bank stocks disappointed, inasmuch as they are expected to rise along the significant increase in bond yields.

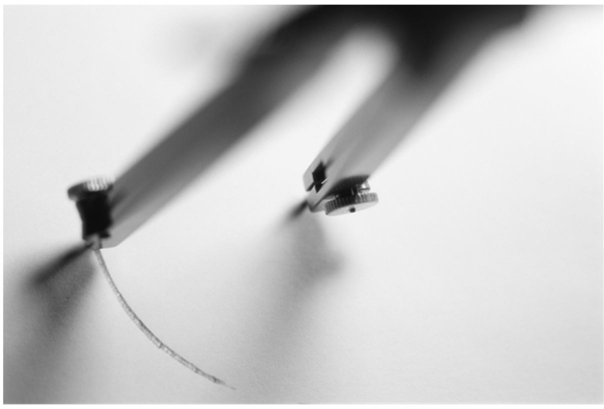
The **macroeconomic backdrop** continues to remain challenging for equites in the near-term. Central banks are withdrawing their policy support, which kept the markets rising for the last few years. This support is removed during the same time that economic growth is slowing down and the risk of moving into a stagflationary environment (economic downturn coupled with inflation) is increasing. Furthermore, the relentless rise in input prices will likely put pressure on corporate margins.

Looking forward, the fact that bond markets are suddenly confronted with an **inverse yield curve** is also potentially dangerous for stocks. Past yield inversions tell that it will be 15 months between the first signal (which has happened now) and a recession actually occurring. If true this time, one could argue that it would leave stock markets still some more quarters to advance while the recession is approaching, but it remains an uncomfortable situation for equities, as they typically trade on forward looking parameters.

The main concern of markets the last two years, the **COVID-19 situation**, seems to be under control (although not in China). That said, there is the potential danger that next winter a new and more dangerous variant could emerge and therefore this topic is at least a potentially negative factor.

Client managed accounts:

We had the last few months a conservative equity allocation and therefore felt comfortable with our situation. As described above, we currently think that markets are trading fairly high and maybe underestimating some of the risks which are existing on different levels. However, the technical uptrend of the multi-year equity bull market was not decisively broken and might last a few quarters longer. We are still reducing our **equity allocation** slightly by selling positions in Europe as we see reduced upside potential in this region.



Fixed Income

Interest rates possibly have reversed their 50-year decline

During March 2022, interest rates increased by truly historic dimensions, as for example the USD 5-year Treasury rate jumped by 92 basis points in a matter of weeks. The US Government and corporate bond index lost 6.4% in the first quarter of 2022, which is the **worst quarterly**

performance since 1980. It is worth taking note that this happened simultaneously with equities, meaning that bonds failed to offer any diversification benefit to portfolios.

The value of negative-yielding bonds in the global market has fallen by 80% the last three months and fixed income markets signal the **dawn of a new era**: The long-term downward trend of interest rates has likely been halted. Of course, there have been numerous false starts in rate reversal in the past few years, with the hope of higher rates repeatedly dashed by deflationary shocks.

The most widely watched rate, the **USD 10-year Treasury**, has fallen from almost 16% in 1980 to levels below 1% recently, a decline that lasted for 50 years! During the last few years, the regime of taxing bondholders via negative real yields has inflicted lots of pain for people saving money.

An additional discussion next to the rate increase per se occurred over the resulting **inversion of the yield curve**. During a few days, several pairs were inverted: the 5yr/10yr, the 20yr/30yr, the 7yr/10yr among others. It created a debate whether or not this meant a recession was upcoming and imminent. According to economic textbook theory, the time delay between a yield curve inversion and a recession is usually between 12–24 months, and the open question is if this will also be valid this time.

Although the current environment seems unique in recent economic history, the **statistical evidence** suggests this technical signal to be relevant and surprisingly accurate in predicting an economic downturn to be followed by a recession.

The publication of the last **FED minutes** (written record of the last FED meeting) reveals interesting details. Many participants indicated that, with inflation well above the Committee's target and the Federal Funds rate well below its long-run level as estimated by its members, they would have preferred the target rate to be raised by 50 basis points (bps) at the last meeting. It was only the war in Ukraine which led them to agree on 25bps. The next meeting will be May 3 and 4. The market is now betting on another 225bps of US interest rate hikes until the end of this year.

In the **Eurozone** area, there has been an acceptance within the ECB that the energy shock was unexpected and is lasting longer than forecasted. The Chief economist Lane remarked lately that the times of ultra-low inflation is unlikely to return after the pandemic and finally comes to a close.

The March ECB meeting highlighted the downside risk to growth, while having to meaningfully move the inflation projections higher. It was made clear that asset purchases must first stop before rate hikes can begin. Therefore, the announcement that the purchase program will now conclude sooner than expected was to prepare the markets for higher rates, which is a necessary step to counter rising inflation.

Client managed accounts:

We have lowered our exposure to Fixed Income already this year and sold some long-dated bonds and/or bond ETF's. 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. 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, and we also like Floating Rate Bonds (FRN) and Treasury Inflation-Protected Securities (TIPS).

Currencies

The USD to remain strong, the Yuan is ready for long-term gains

The **USD** as a structural safe-haven currency profited from the sharp increase in geopolitical tensions. The uptrend is further supported by the FED's frontloaded policy normalization, which will prolong and even increase the positive interest rate spread towards the Euro and the Yen. Some downsides remain the FED's tolerant approach towards inflation, which could hurt the USD's purchasing power and the still elevated negative current-account and trade balances. A return of risk appetite once the Ukraine-war is over could promote investments outside the USA again.

The **Euro** is suffering from currency fundamentals like relative price dynamics and term-of-trade developments, as energy and other raw material prices soared in the last quarter. The European Central Bank (ECB) did signal an increasing willingness to normalize its monetary policy as the inflation overshoot grows bigger. Compared to the US FED however, this move comes at a much later date, which is not supportive for the Euro just now.

The **CHF** did appreciate in the wake of the soaring risk aversion relating to the war in Ukraine. The comparatively small debt level of Switzerland and its low inflation data compared to most countries could further strengthen the currency, a parity to the Euro seems likely.

The **GBP** was trading along the Euro this year. The Bank of England (BoE) is more advanced in rate normalization than many peers. As the UK's inflation hit record highs, the BoE will follow with more tightening, however Brexit-related labour supply issues might challenge its growth. The GBP seems undervalued and promises some further upside potential.

The **CAD** profited from higher oil prices and rising interest rate differentials. A hawkish Bank of Canada (BoC) initiated a rate normalization in early March, against higher commodity prices and amid geopolitical uncertainties. The attractive (under-)valuation of the Loonie indicates some more room to the upside.

The **Chinese Yuan CHN** is supported by China 's large trade balance even in times of heightened geopolitical risks. In the short-term, the economic challenges due to Covid-19 outbreaks in some major cities and the ongoing property downturn have led to money outflows.

Going forward, a further opening of domestic financial markets could attract more capital inflows. In the long-term, the Chinese currency could become a valid substitute for the USD in the Emerging Market world, as certain countries dislike the sanctions imposed by the US government and the potential inability to use their USD-reserves in times of crisis.

Economics

Do high oil prices and supply bottlenecks slow the after-pandemic growth?

The war in the Ukraine and the economic sanctions against Russia are weighing on the global economic outlook. Economic headwinds come mainly from aggravated supply bottlenecks and **higher commodity prices**, which might cause a stagflationary environment over the next quarters.

The **US labour market** appears to be very strong, with the unemployment rate approaching the record lows seen before the pandemic. Even though the 431'000 new jobs reported by the payroll survey for March disappointed expectations, upward revisions of the figures for the previous months and the alternative household survey that reported 736'000 new jobs portrayed a strong job market. The slow expansion of the work force is the major reason for the tight market and is driving **US wages** higher. From a labour market perspective, the US economy is overheating. The low unemployment rate and the solid job creation give the **US Federal Reserve (FED)** additional arguments to hike rates by 50 bps at its next meeting in May and yet another 50bps in June.

The **US housing market** is also beginning to show signs of strain, as mortgage rates have risen the most in 40 years. The average rate for a 30-year fixed mortgage rose from 2.65% in January 2021 to now 4.67%, as the latest weekly survey of Freddie Mac is showing. This has led demand for houses to weaken slightly, but it is still exceeding supply, and the USA is experiencing a severe housing shortage.

In **China**, the economy faces the most severe Covid-19 outbreak since spring 2020. Shanghai, which is China's largest city in terms of population and economic output, extended its two-phase city-wide lockdown, which was imposed end of March, as cases continue to rise. Economic indicators show that economic activity contracted less modestly than in 2020, however the lockdowns are still costly and the growth outlook for 2022 has been revised down from 4.9% to 4.7%. Maybe it is worth remembering that the Chinese authorities had set the bar at 5.5% earlier in the year.

The **Eurozone** economy will be strongly hit due to its geographical proximity to the war in Ukraine and its heavy dependence on energy imports from Russia. The European Central Bank (ECB) will probably in a first phase stop its asset purchases, before turning to rate hikes in Q3 2022, which is lagging the USD for months.

Commodities

Brent Crude prices surged above USD 130

The war in the Ukraine dominates energy markets and oil prices are one of the related fear barometers. The partial losses of Russian and Caspian exports are supply shocks which came on top of an already cyclically tight market. In real numbers, the two add up to roughly **5% of world supplies.**

While meaningful **direct sanctions** are largely absent until now, the 'self-sanctioning' by the corporate world turns Russian oil toxic, cripples its exports and puts it on discount. Nevertheless, reputation is only a soft factor and could lose its effect over time.

The **USA** does the heavy lifting of plugging the new supply gap. While substantial releases from the Strategic Petroleum Reserve compensate for the shortfall in the near term, the acceleration of drilling activity boosts shale oil production in the medium term. US production is set to surpass the previous record highs in 2023, which suggests that structural constraints are overstated.

Petro-nations stick to their slow path of easing production restrictions, undermining their credibility as oil market guardians. Middle Eastern output-increases only partially fill the supply gap. The West might allow Iran back to the market under a revised nuclear deal, which on the other hand would deepen the rifts with and within the Middle East further.

In the **long-term**, the shift towards electric mobility likely brings a peak in oil demand before 2025. The current shock wave is a price crisis rather than a supply crisis. Furthermore, Venezuela and Iran will eventually return to the market which could even result in a period of surplus supplies.

Gold did rise but still disappointed gold enthusiasts

During the past few weeks, gold prices remained rangebound around USD 1'930. As the war in Ukraine is still raging and no solution in sight, this may seem surprising. As always in times of war, gold is supported by safe-haven demand, which can be seen in the fact that demand for **physically backed gold** products has surged, with inflows of more than 185 tons since the war broke out. The demand for **gold coins** is also strong, as for example the sales of the US American Eagle has been trending at the upper end of its five-year range. Interestingly, gold demand from speculative and short-term traders has not picked up, as evidenced by their positioning in the futures market.

The reasons for the **meager performance** of gold are coming from two sides. First from the USD itself, which is a safe-haven in his own right and has reached the highest level in around two years. The other headwind are USD real bond yields. The increase in nominal yields has outpaced inflation expectations and hence, after the sharp sell-off, the bond market is another shelter for safety seekers. The outstanding value of negatively yielding bonds worldwide has dropped from almost USD 18 billion at the beginning of the year to less than 3 billion as of today.

Gold prices (XAU ounces) in USD – 01.01.2020 – 31.03.202
Source: FIS Market Map

Client managed accounts:

We hold our long-term strategic position of 5% gold as an insurance against all possible **geopolitical negative events** as we have just seen in the Ukraine, potential conflicts like a China-Taiwan confrontation, a systematic financial crisis or a further acceleration of inflation.

Outlook

Despite uncertainties, equites are still more attractive than bonds

Investors face significant geopolitical and economic uncertainty. In the near-term the outcome for markets will focus primarily on the question of when we will reach – or if we have already reached – **peak sanctions** and oil prices.

We think that **sanctions** are likely to remain in place regardless of whether or not a cease-fire is agreed in the coming weeks or months. This means that **higher energy costs** are here to stay which are likely to lift inflation and contribute to higher rates. The FED has already signaled a willingness for further rate hikes and the ECB has indicated at least to stop its asset purchases.

Such higher rates and rising inflation figures do not necessarily call for a global recession. The FED continues to argue that it can raise rates and still manage to achieve a **soft landing**, similar to previous rate-hike periods in the past (1984/1994). The risk of a recession is greater in Europe given its reliance on Russian oil and gas. China must combat its Covid-19 situation, its tech regulation issue and its bad USA relations.

Equity markets face many uncertainties and must withstand upcoming higher interest rates. On the other hand, **global equities** trade at 18-times forward earnings. Relative to real bond yields, stocks continue to lock reasonably cheap. Even in the USA, where valuations are more stretched, the earnings yield on stocks exceeds the real bond yield by 570bps. At the peak of the market prior to the crash in 2000, the gap between earnings yields and real bond yields was close to zero. The result is that stocks are still more attractive than bonds if measured by valuation only.

Given the above scenario, we **enter Q2 2022** with the assumption that global equity markets will remain fragile and trade with high volatility. A careful stock selection with a bias towards value stocks is warranted. We keep some shorter dated bonds for capital preservation and like Floating Rate Bonds (FRN) and Treasury

Inflation-Protected Securities (TIPS). We continue to hold gold for unforeseen events and use 'Alternative Investments' including 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

Automation and Robotics

The Covid-19 pandemic has major consequences on our economies, our lives and our mental health. The level of stress and the sensation of feeling burned out have increased exponentially and have pushed people to reconsider their lives and priorities. In the USA, millions of workers (47 million in 2021) have decided to voluntarily resign, a phenomenon referred to as the **'Great Resignation'**. A similar trend is visible in many other countries. In China it has taken the name of 'lie flat' and aims at rebelling against harsh market conditions as employees need to work long hours. In Japan the younger generation is refusing to go along Japan's office culture of 15 hours a day in favor of more occasional jobs.

Such **demographic trends** are drivers to support further adoption of automation and robotics. The desire to produce more while reducing both the time needed to do so and physical constraints have always existed and more so today as we are at the inception of a **new industrial revolution**, the fourth in our history, which will be powered by connectivity and the emergence of new technologies like Artificial Intelligence (AI), Big Data, Internet of Things, 5G and the digitalization of our production, meaning a further trend towards industrial automation.

The use of **industrial robots** around the world is accelerating at high speed, as robot density has reached 126 robots per 10'000 employees, thereby doubling the level that we saw in 2015, but with huge differences among countries. South Korea, Singapore and Japan are the countries with the highest robot density (at 932, 605 and 390 units / 10'000 workers, respectively). South Korea has 7.4x more robots than the global average, which means that countries like the USA or Europe must catch up if they want to improve their competitiveness. China is only 9th in terms of robots installed but is quickly making huge progress and already is the largest robot market in terms of absolute numbers, with an annual installation of 168'000 units in 2020.

According to the International Federation of Robotics (IFR), **global robot instalments** are expected to grow at 13% in 2022. Going forward the market is evolving from static robots with limited movements to flexible and smarter machines that can interact with humans. The trend for a higher penetration into certain technologies like sensors, vision products, lasers, 3D printing and other manufacturing tools will guarantee the further growth of automation.

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.

Contact

Hyposwiss Advisors SA

www.HyposwissAdvisors.ch
info@advisors.hyposwiss.ch

Head Office
Rue de Hesse 7
1204 Geneva - Switzerland
Mr. Elio Barzilay

Tel.: +41 22 310 76 40
Fax: +41 22 310 76 39

Branch
Nüschelerstrasse 31
8001 Zürich - Switzerland
Mr. Michael Bösch

Tel.: +41 22 310 76 35
Fax: +41 22 310 76 39

Disclaimer

All the contents of publications of Hyposwiss Advisors SA or its affiliates are for information purpose only. Information contained herein does not constitute a solicitation or offer or recommendation to buy or sell any investment instruments, to effect transactions or to conclude any legal transaction of any kind whatsoever.

The information contained and the opinions expressed herein by Hyposwiss Advisors SA are subject to change without notice. No guarantee or undertaking is offered regarding completeness, reliability or accuracy of the information given. Financial instruments and securities or any other investments mentioned in this document may involve significant risks including the possible loss of principal. No assurance is given that the investment objective of any product will be achieved. Past performance should not be taken as an indicator or guarantee of future performance. Hyposwiss Advisors SA or any of its affiliates may or may not at any time hold a position in or with respect to the investments which could be mentioned herein.

This document may not be reproduced, distributed or published without the prior written consent from Hyposwiss Advisors SA.

Access to the information may be restricted by laws or regulations to which the individual user is subject. As a consequence, this document is not directed at, or intended for distribution to or access by any person or entity who is a citizen or a resident of any jurisdiction where the information in question would be prohibited by law or regulations.

Hyposwiss Advisors SA does not render tax, legal or accounting advice. Clients are encouraged to seek their own competent independent professional legal, tax and accounting advice.

Registrations with the US Securities and Exchange Commission and the Canadian Securities Administrators do not imply a certain level of competence, education, skill or training. The protections of the US and Canadian rules and regulations are only available to residents of the respective country, province or territory.

■ ■ ■ ■ ■