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Review & Outlook
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Hyposwiss Advisors SA

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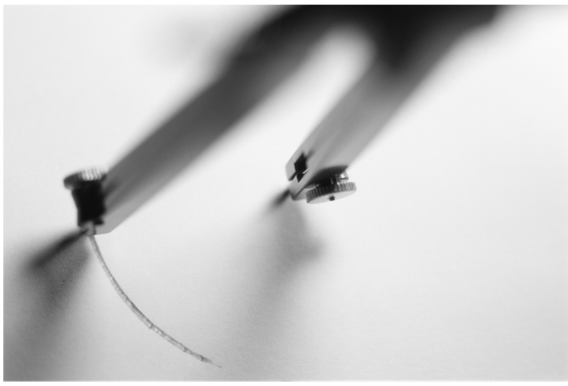
Q4 2022 Review

An impressive equity comeback – or a 'bear-market' rally?

2022 will go down in financial history as an **exceptional year** on many levels. Primarily, it has been one of the poorest years in history for bonds and a bad one for stocks too. For US Treasuries, the first few months were worse than anything witnessed since 1788, which highlights the historical dimension of the environment that investors had to deal with last year. In addition, 2022 marks a year in which almost **all assets** lost value in sync - not just bonds and equities - which by itself is a relatively rare occurrence.

The second peculiarity was the **state of the economies** during the same year. Global real growth at around 3% has fallen only slightly short of the average of the pre-pandemic years. Yet the global inflation rate has been overshooting at a staggering rate of 8%, which is higher than any number seen in the past decades. This combination of lackluster growth and record inflation suggests that 2022 has been a year of stagflation – a mix not seen since the 1970's.

MSCI World Index in Local Currency – 01.01.2021 – 31.12.2022
Source: FIS Market Map



There was a third peculiarity, which is the **monetary policy**, or rather the tightening of it. The growth / inflation mix has pushed central banks – first and foremost the US Federal Reserve (Fed) – to tighten its money supply at an unprecedented pace as another element of historic dimension. It started already early in the year when central banks were accused of and perceived as being "behind the curve" and then struggled to catch up. This created shocks not only for bonds but for the whole financial system and led to the asset price declines outlined above.

Finally, in Q4, global stocks were able to reduce their yearly losses by an impressive comeback rally of 9.81% QTD (**MSCI World**), whereby the main question was from the outset if this was a so called 'bear-market' rally or already the beginning of a new lasting uptrend, an open question as we enter 2023. Global markets did not manage to post a year-end rally though, as many investors had hoped for and finished with yet another negative month, thereby ending the year at -19.18% YTD.

Another interesting observation is that the whole 2022 stock market decline or crash happened in an **orderly fashion**, meaning there was not one single day with a heavy panic-driven sell-off which often marks the end of any crash. The final result is that the major averages closed 2022 with their worst annual losses since 2008, snapping a three-year win streak.

The **USD**'s rally continued in 2022, pushed initially by the war in the Ukraine and the following global risk aversion and flight to safety, later by the different rate hikes of the US Fed, and it rose to unexpected high levels, with the USD Index (DXY) reaching a 20-year high of 114.11 on September 27 last year.

Oil markets have sailed into calmer waters as of late, the price (Crude oil WTI) slightly negative in Q4 (-0.74% QTD), nonetheless finishing the year positively (+4.91% YTD). The ratcheting up of sanctions against Russia in December has not created so far, the turmoil feared by some participants and the supply situation has incrementally normalized as the markets anxiety slowly calms.

Gold was one of the few assets doing relatively well in 2022, and non-USD investors could even book some profits. It managed to post a Q4 gain of 9.55% QTD, to finish the year at USD 1'819 with a small loss of only -0.55% YTD. This recent strength continued in 2023, and the bullion was able to break technical resistance at USD 1'825, climbing to a six-month high and extending two straight monthly advances.

Equity

After its impressive Q4 run (7.35% QTD), the **S&P500** ended the year with a loss of -19.24% YTD and was thereby moving almost exactly in line with the MSCI World (-19.63% YTD). This figure however does not accurately provide the full picture of US markets, as the value-stock oriented **Dow Jones Index** was trading at a modest fall of -8.58% YTD only and therefore was yet again outperforming global markets as in all previous years, despite the strong USD.

The **equal weighted S&P500** lost only -12.4% YTD, which means that the drag on US equities was mainly related to the poor performance of some mega-cap growth stocks. All the long-term leading FAANG stocks suffered heavily, Amazon -49%, Alphabet -36%, Meta (formerly Facebook) -65%, Apple -25% and Netflix -50%. The market capitalization of Apple for example exceeded USD 3 trillion at one point and has shrunk to below USD 2 trillion within one year, despite record earnings / revenues of the iPhone producer.

The technology Index **NASDAQ Composite,** where FAANG stocks are heavy weighted, even tumbled -33.03% YTD, a remarkably high figure for an index of such a reputation and breath. It could be seen in the context of its previous multi-year long outperformance and the fact that it began the year on an all-time high. Most tech companies though were able to post solid earnings, but higher interest rates led and translated to a downgrading of their high P/E ratios.

Europe's better showing during the whole year of 2022 continued in Q4, as the EURO STOXX50 posted an astounding rally with a quarterly gain of 16.03% QTD, and it ended the year at only –10.43% YTD, thereby moving in similar fashion as the Dow Jones Index. If one includes the decline of the EUR/USD (-6.41% YTD), Europe is still lagging, but is notably 3% better than the S&P500. The **UK** surprisingly was the best performing market in Europe (FTSE 100 +1.74% YTD), even including the negative performance of the British Pound (GBP/EUR -5.13% YTD).

After lagging behind for the most part of 2022, **Asia** - led by Hong Kong - achieved an outperformance in Q4 (MSCI Asia ex Japan +11.73% QTD) and finished the year almost equivalent to world markets (-19.65% YTD).

Despite all the negative news regarding their Covid-19 policy, **China**'s markets were performing better than global markets (SHANGHAI Comp -15.13% YTD). A remarkable trend reversal occurred the last two months in Hong Kong, where the **Hang Seng Index** advanced by an astonishing +24.69% / +6.84% MTD, finishing at -15.08% YTD.

Client managed accounts:

We have reduced our **equity exposure** in our managed accounts in the last quarter back to 'neutral'. We keep this level for now, as we judge that in times of **high inflation**, stocks of quality companies proved to be a good investment, besides global inflation seems to have peaked. We measure a potential **recession** into our considerations. This requires a careful stock selection, whereby we prefer companies with high and sustainable cash-flows and of non-cyclical character.

We keep our slight overweight position in **China** as we judge that this market will show a solid comeback rally once the Covid-19 situation stabilizes. Regarding our other **Emerging Market** (EM) holdings, we watch them closely as a recession coupled with lower energy prices and with lower demand for industrial goods could hurt certain EM countries hard.

Fixed Income

Income: Positioning for rate cuts later in 2023

2022 was the **worst year** for bond investors in recent history, as a combination of nasty inflation surprises that forced central banks to tighten extraordinary fast and weak growth expectations - that drove credit spread wider - occurred at the same time. Yields across the board have been driven up at an unprecedented speed, albeit from a very low starting point. At the end of 2021, bond yields were in some currencies even in negative territory and in most countries at all-time lows and, similar and connected to the all-time highs of stock markets at the same time.

To put the losses of bond holders into real **numbers**, a few examples: US 10yr government bonds lost 15.7%, Investment Grade (IG) USD 10yr bonds lost 14.8% or French 10yr government bonds lost 15.0%.

After recovering initially in Q4, most government bonds markets showed heavy losses in late December again, in response to the hawkish messages from central banks, including the adaption of the yield curve control of the Bank of Japan (BoJ) on December 22. Within the **last two weeks of 2022**, the yield of the benchmark 10-yr government bonds increased 0.40% in Germany, 0.35% in the US and 0.34% in the UK, respectively. The yield of the 10-yr Japanese government bond tested the upper band of the BoJ's new range, rising from 0.25% to 0.43%.

The surge of **government bond yields** shows that central bankers across the globe managed to overwhelm already hawkish market expectations in their communication. Now that this dust settles, investors can focus on economic realities again, which are the rolling recessions among Western economies and the lower level of energy prices which will slow headline inflation. The end of supply-chain disruptions and the saturation of pent-up demand for services are other key factors which will slow inflation in 2023. USD Investors will thus increasingly look beyond the next one or two rate hikes and start positioning for rate cuts which could already happen in the second half of 2023.

In contrast to the Fed, the **European Central Bank** (ECB) has not yet raised rates to a level that is restrictive in its own view. Accordingly, the case for potential rate cuts in the eurozone is less pronounced. On top of this, the price finding process after such a long time of central bank distortion has not been completed yet.

Client managed accounts:

We reduced our **exposure** to Fixed Income (FI) in the **first half** of this year in our managed accounts and shortened our duration as we sold some long-dated bonds and/or bond ETF's. Besides we reduced our holdings in the High-Yield (HY) and Emerging Market (EM) universe.

At the end of both **Q3 and Q4**, we increased our bond-allocation again by 1.5% to 4%, depending on the risk category of each client. We used the lower bond prices to buy lower Investment Grade (IG) bonds with a duration of 2-5 years. With these moves, we have reduced our HY and EM exposure, determining the potentially looming recession as a potential default risk for such holdings. We did not yet increase our bond holdings in CHF accounts as these yields are still below our expectations.

Even after these purchases, we have an **underweight** in this asset class. We currently see no immediate need for further increases as short-term instruments offer a high return and as one expects two more rate hikes in the first half of 2023 in the USA and therefore, short-term yields will climb even higher. This scenario is also true for other currencies, as particularly the ECB is bound to rise rates this year.

Currencies

The USD might have reached a long-term high in 2022

The **USD** was certainly the King in 2022, and the USD Index rose 8.74% YTD, gaining against almost every currency globally other than the Brazilian Real and the Mexican Peso. However, since September, the greenback is on the retreat. This trend was spurred by the November US consumer price index (CPI) readings, which showed a peak of inflation and caused markets to reconsider their expectations for the Fed's policy-rat trajectory, after arguably pricing in too many rate hikes.

The revived risk appetite is one reason that the USD might have reached a **peak in 2022**. Another more important reason is that the Fed seems closer to ending its monetary tightening compared to other central banks, thus ending a period of dominance of USD interest-rate advantages.

The ECB, in contrast to the USA Fed, increased its hawkishness at its December policy meeting and will likely continue hiking in early 2023, thereby reducing the interest-rate disadvantage of the **Euro** versus the USD as the year proceeds. Furthermore, softening energy prices in Europe are reducing price divergences to energy-producing economies like the US. The reduced risk appetite and flight to safety which were drivers for the USD in 2020 are disappearing currently which will benefit the Euro in 2023.

The **CHF** had a strong showing in 2022 by crossing the 1:1 parity level to the Euro, as the Swiss National Bank (SNB) decided to end a seven-year phase of a negative interest-rate policy. This unexpected move is allowing the SNB to shrink its inflated balanced sheet and at the same time is helping to fight inflation, which is low compared to most European countries (November 2022 at 2.80%).

In **Canada**, a hawkish Bank of Canada (BoC) has continued its policy normalization with the US Fed with another rate hike of 4.25% in December and may deliver a higher terminal rate than many of its peers. A strengthening of risk appetite and rising rates may enable the risk-sensitive loonie to recover from undervalued levels against the USD. Higher oil prices have boosted the trade balance into positive territory in 2022, however going forward a moderation of oil prices will erase this tailwind.

In the **UK**, the new Sunak government's budget restored trust in its fiscal policy, but at the cost of austerity. The Bank of England (BoE) hiked by 50bps to 3.5% in December, by that being ahead of the eurozone. The GBP is undervalued but forceful macro headwinds due to a recession and high inflation, less policy tightening, and structural long-term headwinds likely prevent a further appreciation. The hike of corporate tax in April 2023 has been confirmed, which will lift the overall tax burden as a percentage of GDP to the highest level since the 1950s.

The **Chinese Yuan CHN** has experienced unusual volatility in 2022. Economic growth was held back by lasting strict Covid-19 restrictions, while authorities enforced deleveraging of the property sector, both worsening investor sentiment. With the recent **U-turn** in its Covid-19 policies towards a more relaxed western-like approach, sentiment has improved again. On the other hand, the resulting surge in cases is bound to keep economic activity weakened. Furthermore, reopening effects will hardly benefit the currency, as increased domestic demand will rather boost imports, while exports are set to remain fragile given the slow-down of global demand, dragging the balance of payments deeper into the negative.

Economics

Markets expect a mild recession in 2023

The **US labor market** ended last year with solid 223'000 job gains, slightly more than expected, but there are signs of a less tight market. Job growth slowed compared to November and weekly hours worked and overtime declined in December, signaling that the US labor market is cooling markedly. More important, average hourly earnings growth slowed as well in December and has been revised lower for November. Less aggressive wage growth dampens the fear that a price-wage spiral is in the making and reduces the risk that **inflation** should surprise to the upside in the coming months.

Final readings of the **purchasing manager's indices** (PMI) of December suggest that the broad-based slowdown of manufacturing activity in major developed markets is here to stay for the next few months. Within the services sector, the reported economic activity is generally stronger than in manufacturing, and the figure for the USA (44.7) is suggesting that high inflation and soaring interest rates are taking their toll on demand for services.

In the **Eurozone,** driven by record high inflation, energy supply bottlenecks and a significant increase in interest rates, the economy will fall into a recession already in Q1 of 2023. However, due to extensive fiscal stimulus measures and persistently high backlog of orders, the recession is expected to be relatively mild. As a result, unemployment should only increase modestly.

After reaching an all-time high of 10.6% in October, **headline inflation** fell more sharply than expected in November to 10.1% and core inflation to 5.0%. The ECB raised its key interest rate by 50bps to 2.50% in December and hinted at further significant rate hikes in the coming months. Quantitative tightening will start in March 2023, with the stock of bonds falling by EUR15bn per month through reduced investments.

Commodities

Oil prices suffered lately due to challenging fundamentals

Oil prices dropped heavily at the beginning of 2023 and fell below the **much-watched USD 80** per barrel level (Crude Oil WTI). China's pandemic and reopening challenges weigh on the market mood and put the bull thesis of a demand rebound under scrutiny.

The **big picture** looks challenging for oil markets. Oil production is growing and increasing supply, political constraints are disappearing, and demand is stagnant at best as recession fears haunt the market. **China's** oil demand catch-up should not be overestimated because recent setbacks were limited, the property market faces structural headwinds and road fuel demand is exposed to a rapid electrification shift.

More generally, the oil market is victim of some overarching economic themes. **First**, the post-pandemic inventory cycle's **restocking phase** seems over, muting demand temporarily. That said, the lack of adequate storage data in China and generally in Emerging Markets (EM) adds a degree of uncertainty.

Second, the easing of energy prices more broadly significantly cools inflation at least in this part of the broader consumption basket. Dropping energy prices might lead to a phase of deflation rather than inflation which might be an economic surprise.

Thirdly, the geopolitical noise seems elevated, as Russian oil still finds its way to buyers and the production drop is absorbed by a domestic demand slump. Other issues are that the USA oil production is on track for a new record high in 2023 and finally, future oil demand will suffer as the shift to electric mobility erodes fuel use.

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Gold: Central banks of EM-countries enter the field

The sharp increase of gold prices the last two months of 2022 and at the beginning of 2023 can be attributed to the changing tone in **US monetary policy**, which resulted in a weaker USD and lower bond yields.

As of late, a new element enters the field. As **central bank** gold buying typically happens behind the scenes, it hardly hits the headlines, but the news of record-high gold buying during the last quarter has become a new focus aera for the gold market and created a stir in the market. Most purchases could not be allocated to a specific country, but China 30 tons (30t), Turkey (31t), Uzbekistan (26t) and India (17t) were identified. Russia should be on the list as well, but it has stopped reporting reserves since the start of the war with the Ukraine.

The People's Bank of **China** now holds 2000t of gold, which puts it already into seventh place among its peers. That said, China's gold accounts for around 3% of its total currency reserves, which is less than the world average of around 13%. The political component has increasingly become important, as the world has started to become more multipolar. This growing multipolarity supports these EM-countries buying the precious metal, as buying gold means buying the anti-dollar, which at the same time is also sending **political statements** to Washington, Berlin and Brussels, as these countries want to be less dependent on the dollar-dominated financial system. The freezing of Russian central bank assets in reaction to the war in the Ukraine looks like a very important trigger in that regard.

Yet these central bank purchases (9% of overall gold demand) alone will not lift gold prices into a longer-lasting rally as investment demand (47%) next to jewelry-orders (37%) are more important for the movement of the gold-price. Technically, gold was able to cross back above its 40-week Moving Average Line (MAV) at the beginning of 2023, leaving room for further upticks.

In regard to **industrial metals,** 2022 will also be a year to remember, as prices went on a rollercoaster ride. They were spiking sharply initially on fears that the war in the Ukraine and the related sanctions against Russia would lead to severe shortages. In Q1, aluminum, copper, iron ore were up between 10% to 50%. Metal traders shifted into panic mode only to realize later that Russian metal was still flowing, not only eastwards, but even westwards. Aluminum exports as one example to the USA and Europe were up 7% and 16% respectively during the first eight months of the year. The price increases later provided an incentive for producers to ramp up output, which led to a normalization of the situation.

Gold prices (XAU ounces) in USD – 01.01.2021 – 31.12.2022
Source: FIS Market Map

Client managed accounts:

We hold our long-term strategic position of 5% gold as an insurance against possible **negative geopolitical events** as we are witnessing with Ukraine, potential conflicts like a China-Taiwan confrontation, not to mention a nuclear escalation from Russia. Furthermore, gold has held up relatively well during the 2022 equity market downturn, particularly for non-USD investors.

Outlook

Inflation risks are fading, but recession risks are growing

The counter for financial markets is set back to zero at the beginning of 2023 – same procedure as every year. The contours of the investment landscape of 2022 - inflation and recessions fears – have evolved as we enter 2023. One primary obstacle, the stubbornly elevated **inflation**, looks less imposing with each set of data coming in. In the US, there is high evidence that inflation peaked in October 2022, with both headline and core CPI readings showing significant year-over-year declines. Decreasing oil and commodity prices are one reason, and real estate and labor markets which are showing signs of returning to balance are other factors which are reducing upward pressure on rent and wages.

Meanwhile, the second main obstacle, a **recession**, looms as large as ever. The shift from inflation risk to recession risk reflects the impact of aggressive tightening by the world's central banks, which have fixated on inflation-fighting at the expense of economic growth, or as the Fed Chair Powell conveyed back in November by saying that rates are likely to remain 'higher for longer'. The **inverted curve** of bonds yields is also giving a usually valid signal for an upcoming recession.

Looking into 2023, there may be brighter days ahead for **equity markets** all the same. History has shown that US markets tend to rebound after 'down' years. In fact, the S&P500 has, on average, rebounded by 15% in the next year following a year where it lost more than 1%. On the other hand, **many analysts** are still reluctant to fully price-in a recession into corporate earnings estimates and many stocks might on a case-by-case basis suffer from these too optimistic figures.

When reading through the 2023-outlook papers of different providers, the consensus is that a difficult and volatile year is lying ahead and hardly anybody expects high returns in any asset class, meaning **pessimism** is high among bankers and investors alike. It is therefore tempting to become a contrarian and move against the crowd. We have decided not to follow such a path in the current environment, with the magnitude and length of a recession unknown and the fight against inflation not yet won.

We enter 2023 with a watchful approach and think it is still too early to put new money into equities despite their low levels. We accommodate a neutral weighting in equites as we judge that global equity markets need time for their bottoming process. We increasingly keep short-dated bonds for capital preservation plus to generate interest-income and continue to hold Alternative Investments for diversification and gold for unforeseen events.

Walter Küng
Senior Portfolio Manager

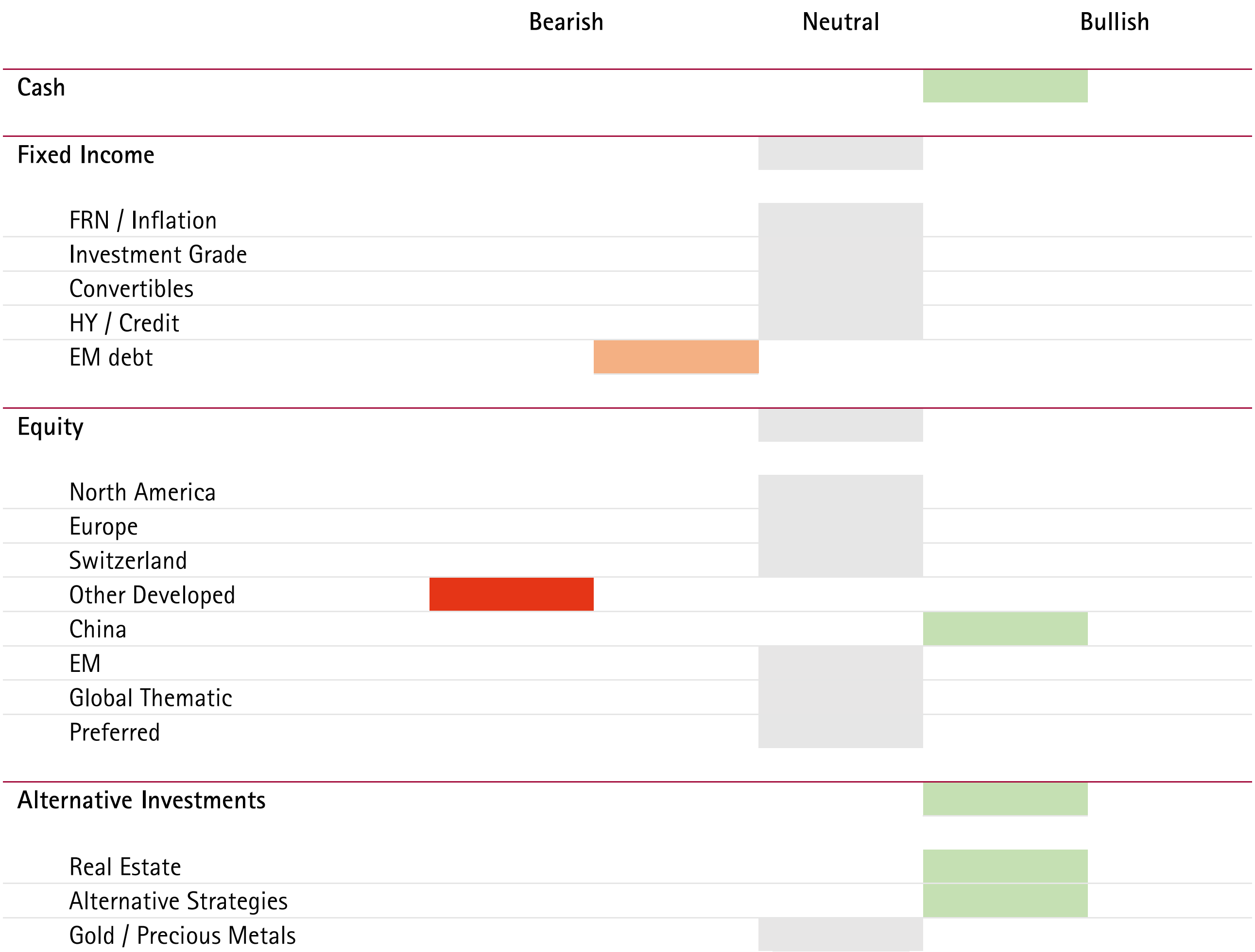
Remark:

"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



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- 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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