J. Safra Sarasin

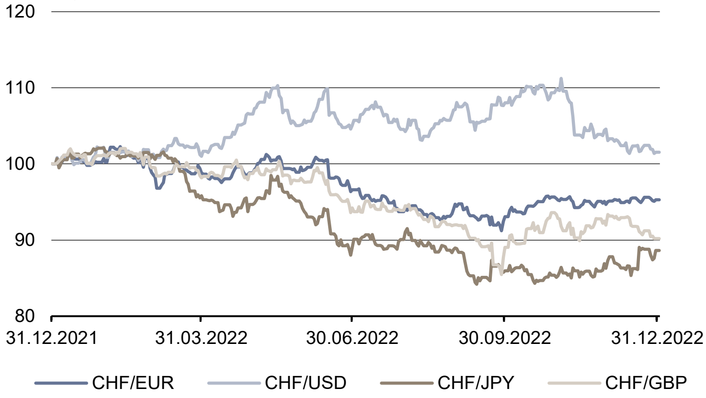
Half-yearly market report

31.12.2022

New year, new beginning?
The year 2022 marked the end of an "annus horribilis" for investors. But the strong revaluations in equity and bond markets should also open up opportunities in 2023.

The year 2022 was one of the worst in decades for multi-asset portfolios. There is therefore justified hope that 2023 will be significantly better. This is particularly true for the high-quality bond segment, which now offers significantly higher yields and is attractively valued again for the first time in quite awhile. For equities, we are still cautious at the beginning of the year, as the impending recession is likely to put pressure on corporate earnings. A positive surprise this year could come from China, which should finally emerge from the clutches of the pandemic. Against this backdrop, emerging market assets have significant catch-up potential in 2023.

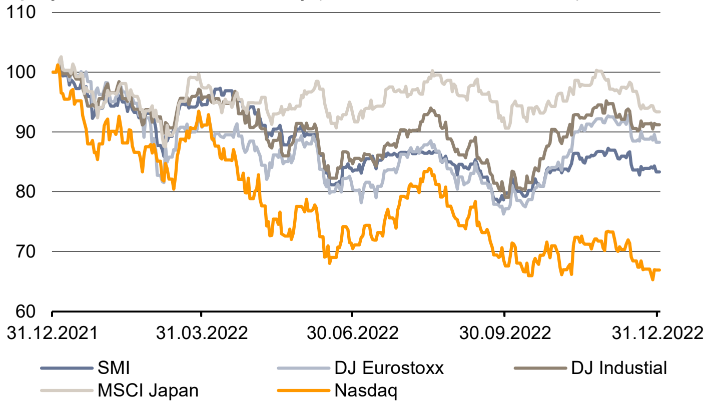
Exchange rates versus CHF (indexed since 31.12.2021)



Macro-outlook: The recession year 2023
Many years feel historic. The year 2022 actually was. Investors experienced the highest inflation and the fastest and strongest rate hiking cycle in 40 years. For the first time in more than 100 years, both equities and long-term bonds fell more than 20% during the year. You had to look very hard to find an asset class that ended the year on a positive note. This was driven by an unusual combination of very expensive valuations at the beginning of the year, high inflation and aggressive monetary tightening by global central banks. In this environment interest rates rose to their highest levels since the global financial crisis within just ten months – a development that normally takes place over a period of several years. The adverse effects on the overall macroeconomic picture are accordingly strong: the housing market is suffering, industrial production and new orders are continuing to decline, sentiment remains depressed, and purchasing managers' indices are still below the contraction threshold. Economic activity in Europe has also slowed down, but has been better than expected due to the extremely mild winter so far and a surprisingly strong service sector.

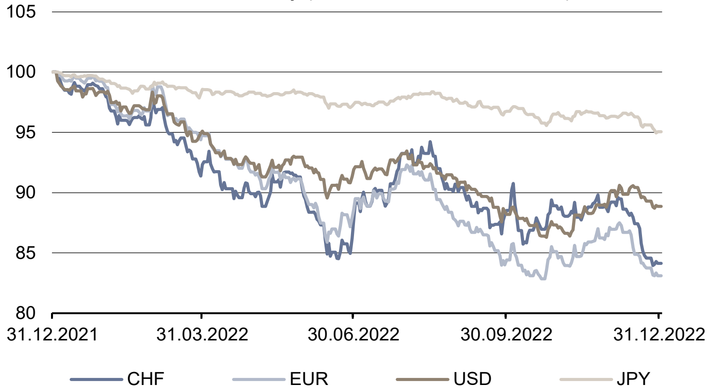
Looking ahead, we are faced with global central banks which, in the face of all these developments, continue to tighten monetary policy to combat persistently high inflation rates. Thus for they remain undeterred by an imminent recession in Europe and the USA, which we expect to happen this year and undeterred by a complex mix of geopolitical risks in Europe and Asia, which will continue to accompany us in the months ahead. In this mixed environment, central banks will have to prove their credibility. Although we expect headline inflation to decline further in the coming months, thus taking some pressure off central banks, it will still be with us for quite some time. One development that could change the overall global picture for the better is China's surprisingly rapid departure from its zero COVID policy. While the extremely high COVID case numbers make the short-term outlook highly uncertain, Beijing's stimulus measures and rising consumption should lead to a strengthening of not only regional but also global economic growth over the course of the year.

Equity markets in local currency (indexed since 31.12.2021)



Equities: Where are the earnings expectations going?
In a recessionary environment, companies are likely to lower their earnings forecasts further. In our view, global equity prices do not yet adequately reflect the impending recession and the associated potential for disappointment in corporate earnings. This will particularly weigh on markets such as the US equities market, which remains relatively highly valued despite the losses in 2022. We are keeping a close eye on developments in China. In particular, consumer and travel activity around the "Chinese New Year" at the end of January should be revealing in this regard and also be supportive of the European markets, which are economically exposed to China.

Bond markets in local currency (indexed since 31.12.2021)



Bonds: Here to stay
Global central banks are likely to continue raising their policy rates for the time being due to high inflation rates and against the back-drop of a still solid labor market, and thus rates should remain at high levels in 2023. Contrary to market expectations, we do not expect the US Federal Reserve to lower policy rates as early as this year. Interest rates are therefore unlikely to fall too sharply despite an increasingly likely recession - especially at the short end of the yield curve, which primarily reflects the prevailing monetary policy. The current level of interest rates is therefore likely to remain with us for a while. The era of negative-yielding debt officially came to an end at the beginning of the year. TINA ("There is no alternative"), the abbreviation for the longstanding relentless hunt for yield in the negative or low interest rate environment, has now been

replaced by BOB ("Bring on bonds"). In our view, investors do not have to venture too far into the lower end of the risk spectrum for fixed-income assets to capture the now increasingly attractive yields. The yields on short-dated corporate bonds with high credit ratings adequately compensate for recession risks.

Asset Allocation: A cautious start to the new year

In an environment of still alarmingly high inflation and further imminent rate hikes, the market must prepare for continued difficult times and increased volatility. The short-term macroeconomic path – and thus also the development in financial markets – is now more broadly spread due to greater regional differences. On the one hand, US recession risks have increased. On the other hand, there is hope for an acceleration of growth in China. We therefore start the new investment year as we ended the previous one: with an underweight in equities, a neutral positioning in bonds and an overweight in alternative investments (incl. gold), as well as high liquidity in the portfolios.

However, not everything should be viewed too negatively with regard to 2023. In the past, equities began to stabilize as soon as inflation eased and central banks stopped raising rates. As soon as it is clear that the economy is in recession and the outlook brightens, this more optimistic scenario will also be reflected in rising stock prices. Until that happens, we continue to favor defensive sectors and companies with strong pricing power within our equity allocation, which can defend their margins even in an environment of high inflation rates. We also like dividend stocks that generate stable and consistent earnings growth. Due to the developments in China, we have increased our positioning in emerging markets equities to neutral. The outlook for the region has changed for the better due to China's departure from its zero-COVID policy, justifying a neutral positioning.

Given the massive revaluation in the bond space over the past quarters, high-quality bonds with short maturities offer an attractive risk-return profile. Therefore, we have gradually increased our bond allocation to a neutral level. Heading into a global recession, it seems premature to increase our allocation in high yield or emerging market bonds, despite a fairly high risk premium. We remain underweight. These asset classes should deliver positive returns in 2023, but could come under temporary pressure due to recession risks. To take advantage of such opportunities during the year, we maintain our overweight in liquid and safe money market assets.

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Contact

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Overview of the investment groups

Traditional LPP life cycle	Equities bandwith	Strategic equities quota	Investment horizon
LPP Yield	0–20%	15%	min. 1 year
LPP Income	10–30%	25%	min. 5 years
LPP Growth	20–40%	35%	min. 10 years
LPP Future	30–50%	45%	min. 10 years
LPP Equities 80 – non-BVV2-compliant	50–95%	80%	min. 15 years
Sustainability LPP life cycle			
LPP Sustainability Income	10–35%	25%	min. 5 years
LPP Sustainability	20–50%	38%	min. 10 years