INVESTMENT COMMENT November 2023

- **Navigating through a challenging world**

As the situation in the Middle East deteriorates, investors are faced with an additional challenge besides the war in Ukraine, higher energy prices, high interest rates, rising yields in medium to long-term debt, a strong US dollar and more lower-than-expected earnings reports. Regarding fossil fuels, we do not think that crude oil and natural gas production will meaningfully be impacted just yet. This could change if other regional powers get pulled into the fighting.

- **Fixed income has become relatively more attractive**

In September of 1981, the 10-year US treasury yield peaked at 15.8%. Since then it has traded down to as low as 0.5% in July 2020, which marked the peak of a 40-year bond rally. Meanwhile, companies benefitted from ever cheaper credit and equities from higher valuations. Since then, the tables have turned. The 10-year UST yield touched 5% in October – a level not seen since 2007 – and 30-year mortgage rates are close to 8% weighing on stocks and fueling fears the resilient U.S. economy could fall into recession after all.

Coupled with higher inflation, the U.S. budget deficit almost doubled last year. It comes as no surprise that rating agency Fitch downgraded the long-term rating of U.S. debt to AA+ down from AAA. Fitch expects the general government deficit to rise to 6.3% of GDP in 2023, up from 3.7% in 2022 on the back of new spending initiatives, a higher interest rate burden and significantly lower federal revenues (mostly due to lower tax income). They also cited a steady erosion of governance (political standoffs on the election of a speaker for the House and on the debt ceiling which was only resolved the last-minute).

Inflation is not under control. We continue to expect short-term rates to remain higher for longer, since wage pressure in the U.S. continues to stay high (e.g. large compensation package increases for U.S. autoworkers) and energy prices have risen sharply with the increased tensions in the Middle East.

- **Asset Allocation**

If history is any guide, geopolitical crises usually cause emotional shocks more than disruptive long-term downturns like financial crises do. The best hedge against this type of risk is diversification across asset classes and taking advantage of market overreactions.

We remain neutral weighted in equities, albeit with a negative bias. Despite a significant pullback in equity prices, we do not think it is time to buy the dips yet. We would remain slightly over-weight in Swiss equities for their defensive nature and the strength of the Swiss Franc.

In addition to expecting short rates to remain higher for longer, we also expect yields on the long end to remain at least at current levels. Higher rates is making bond investing more attractive again if held until maturity. We are buying investment grade bonds of companies with strong balance sheets that do not need to refinance in the near term, while at the same time extending the maturity from the very short end to the medium term.

The current crisis in the Middle East has pushed gold above the USD 2,000 mark. We expect it to remain trading around these levels until the dust settles in the Middle East.