INVESTMENT COMMENT Sep. 2023

- **When will the rate hiking cycle be over?**

We expect U.S. rates peak after another 50 basis points hike, despite a 0.6% CPI increase in September. The Fed does not want to be accused of influencing the U.S. presidential election and is likely, therefore, to refrain from changing rates going into the election year. Europe remains behind the U.S. and will likely be forced to raise rates further.

At the beginning of the year we called for an end of the FAANG rally. However, aided by three worries as well as irrational expectation about the potential of profitability improvements thanks to artificial intelligence the “Magnificent Seven” (Facebook, Amazon, Apple, Nvidia, Google, Microsoft and Tesla) staged a breath-taking rally this year. The three worries included a) an inverted yield curve which would lead to a recession; b) the Silicon Valley Bank collapse which prompted the Fed to reopen the liquidity flood gates; and c) the unexpected China weakness after early hopes for a speedy recovery when the leadership stopped all Covid-19 measures in October of last year. As the “Magnificent Seven” are priced to perfection, even the smallest disappointment could lead to a correction. Taking some chips off the table may be prudent.

- **Are we entering a commodity super cycle?**

Given that we are entering a multipolar world, political blocks will have to invest huge amounts of capital to “friend-shore” production away from political foes. Supply chains need to be re-engineered and billions of dollars need to be invested into decarbonization. This will be very supportive for materials and hence selective emerging markets. The reason for why the commodity sector has not done well yet is that investors traditionally linked price expectations to China’s demand. We do not think that this argument still applies. Nevertheless, while the new super cycle will be about the transition into renewable energy and a redesign of supply chains, China cannot fall apart. If it does, all bets are off.

- **China – on hold for now**

The negative news out of China is not ending. First, Chinese middle class feels poorer after having invested too much into the deflating real estate bubble. This leads to a disillusioned middle class and to significant political risk for the government. Second, youth unemployment broke 21% prompting the government to stop publishing the number going forward. This leads to a disenchanted youth, which could add to social unrest. Third, Chinese consumer sentiment remains firmly below 50% which indicates a negative outlook on the future. The Chinese communist party needs to deliver progress and prosperity to fulfil its end of the social contract it has with its people. We are witnessing a balance sheet recession, whereby an overleveraged private sector (individual and corporate) is trying to regain financial flexibility by curbing spending and paying off debt. If not addressed, China could turn into a deflationary tail spin.

China needs decisive fiscal stimuli from the government and reassuring statements from the leadership that entrepreneurship will be supported not stifled The measures announced so far were all but visionary.

- **Asset Allocation**

We remain with a neutral position in equities and continue to hold predominantly short duration fixed income. Within equities we like U.S., certain emerging market and Swiss equities due to defensive nature and a structurally strong Swiss franc. Since there is also no change to our rate expectation (*higher rates for longer),* gold remains stuck in its sideways channel until real rates start to decelerate.

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