Reuss Private AG

Outlook 2023 – Update Q3

Reuss Private

The Big Picture I

Structural Environment

- High indebtedness + adverse demographic developments + low productivity growth = low global trend growth. Among other things, the high level of indebtedness leads to a more unequal distribution (Gini index). This is one of the reasons for shifts in political constellations (polarization).
- Re-nationalisation of economic and social policies. Stronger focus on distributional effects within countries.
- The pandemic has led to supply shortages while a strong fiscal as well as monetary policy accommodation has supported demand.
- Geopolitical tensions – especially the war in Ukraine and Russia's behavior – prolong this age of scarcities.
- A de-dollarisation and possible decoupling from the West of an enlarged BRICs group seems possible, but this would result in two newly competing currency systems.

Economy

- **Compared to the past decade**, macro-economic volatility and **nominal growth remain elevated** for longer.
- Currently, global growth is subdued. However, recession risks in Europe have diminished and growth momentum should recover over the course of the year. **Potential** slowdown in the US.
- In the US, and with some delay in Europe, inflation rates may fall significantly over the next few quarters. However, core inflation will fall much more slowly.
- Monetary policy is being tightened at an increasingly slower pace. **The U.S. Fed can end its rate hiking cycle with a last step in July** and will be able to cut rates from the beginning of 2024. The ECB will continue to raise policy rates through the summer.
- In the longer term, (government-led) investment should increase and support growth.

The Big Picture II

Influencing factors

- Geopolitical risks (i.e. Ukraine, Iran, Taiwan and Turkey) have increased and will remain elevated for a prolonged period. This reinforces the deglobalization trend.
- Fiscal policy will remain expansionary, and no austerity policy is likely to be pursued.
- Financial repression is likely to be severe for several years.
- Political risks with the potential for long-term very adverse outcomes remain substantial, especially amid the ascent of EU/Euro critical parties in Europe and protectionist measures by the US government. Global risks, and thus the potential for markedly negative long-term scenarios, remain pronounced.
- An escalation of the global trade war – especially between the US and China – will have lasting consequences and will ultimately be a burden for global growth and financial markets.

Market environment

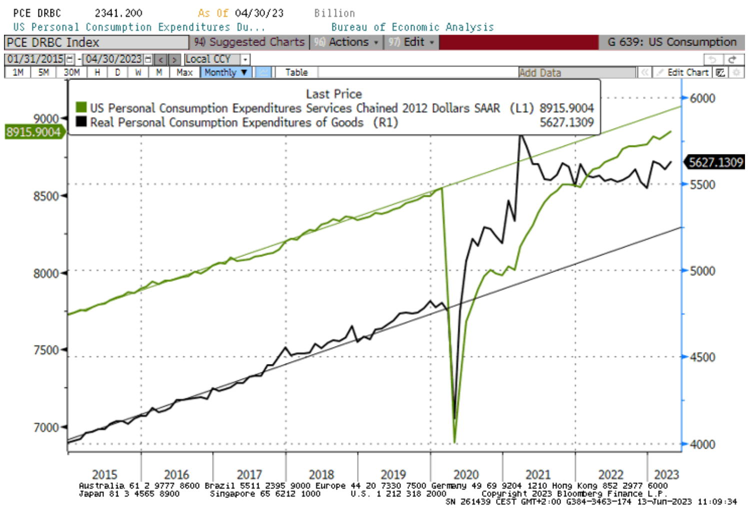
- The outlook for equities is volatile and accompanied by pronounced setbacks but remains fundamentally positive in the long term. Monetary tightening has led to valuations that are attractive from a long-term perspective.
- The trend towards sustainable investments and "green finance" will intensify across all asset classes in the coming years.
- Yields of “safe" bonds such as German Bunds and US Treasuries will increase moderately on a multi-year horizon.
- With a slowdown in the monetary tightening process, spread products are attractive. Carry and roll-down remain important for fixed income investors.
- Temporarily difficult environment for commodities, especially base metals. Longer term friendlier for precious metals.

Positioning

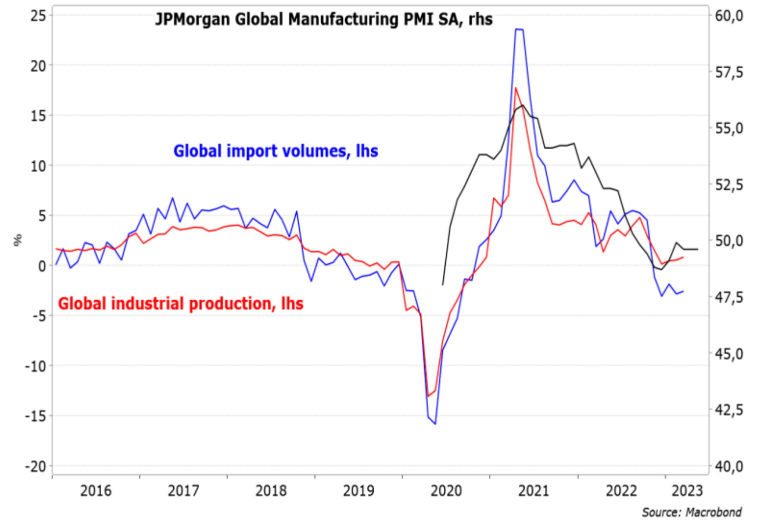
Asset Class	What we like	What we underweight
Liquidity		
Bonds	▪ Short term to medium term investment grade assets (funds) ▪ Corporate bonds	
Equities	▪ Solid dividend stocks ▪ Sectors: Healthcare, technology, cyclical consumer goods ▪ EM: China, Vietnam, India	
Alternative Investments	▪ Gold	
Currencies	▪ CHF ▪ JPY	▪ GBP

Global Economy I

US consumption (in bn USD)



Global imports & industrial production

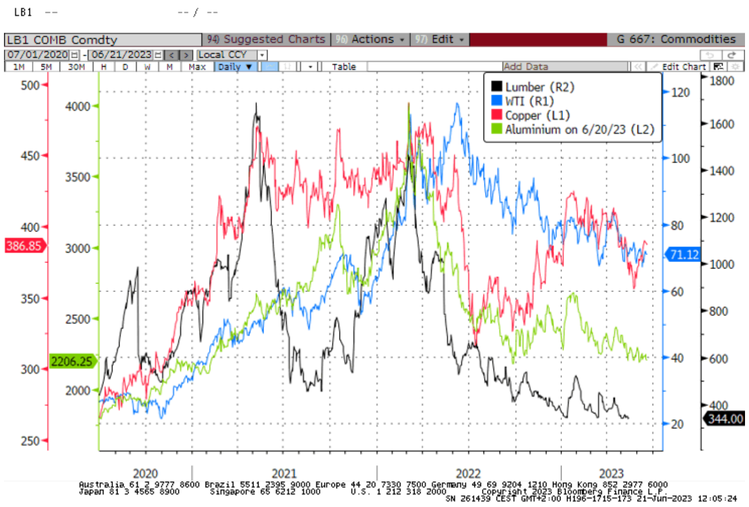


Source: Bloomberg, Macrobond

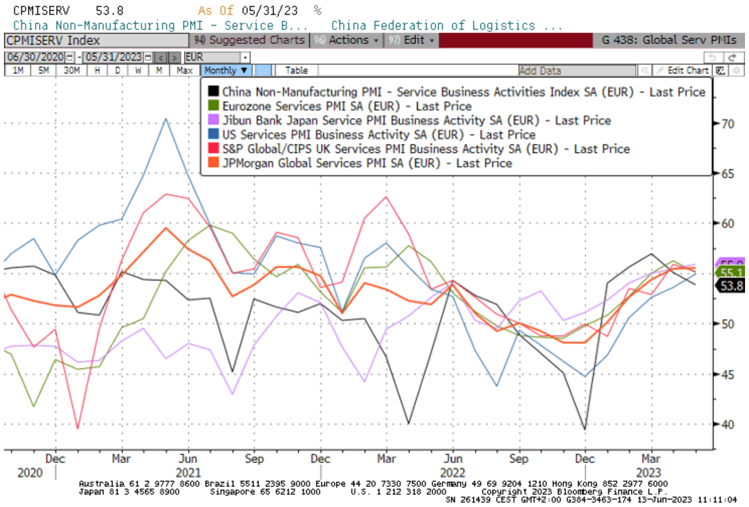
- During the pandemic, consumption shifted away from services towards goods. Both the demand for and the supply of services were severely constrained by the pandemic. Consumption of goods, on the other hand, was only affected at the beginning and was supported by strong fiscal easing during the pandemic. This, in turn, exacerbated goods shortages and hence goods inflation, and supported production. As vaccination and contagion of the population has progressed, consumption has begun to shift back to services. However, consumption of goods is still above and consumption of services below the pre-pandemic trend. This means that the normalisation process in consumption has probably not yet been completed.
- Global growth is currently subdued, with the industrial sectors and the real estate markets often being in a sector recession. Industrial production is being held back by lower demand for goods and (previously) high energy prices. Real estate markets have mostly weakened due to the significant rise in interest rates.

Global Economy II

Commodity prices



Services PMIs



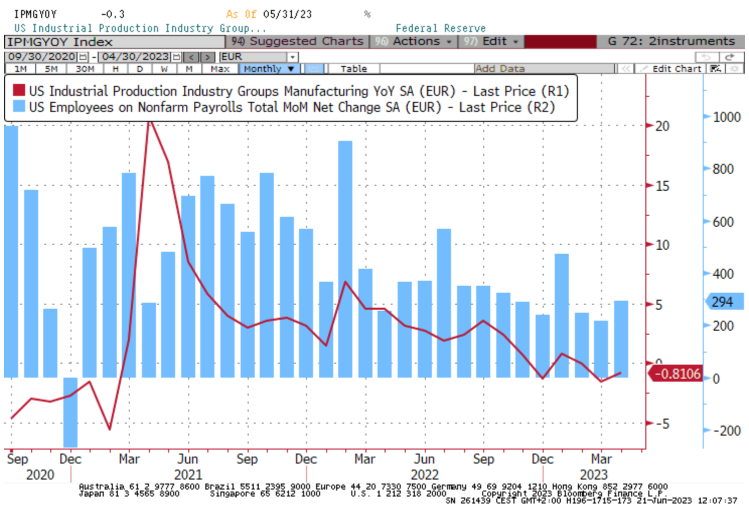
Source: Bloomberg

- Both the construction activity and the industrial production are raw material intensive. With declining construction activity and weak momentum in industrial production, demand for commodities is therefore currently mostly subdued. As a result, shortages of important raw materials have eased, leading to sideways to lower commodity prices.
- While the industrial sectors are weak globally, the situation in the service sectors is much better. They are supported by the end of the pandemic and the resulting increase in supply and demand. In contrast to industrial production, services are not raw material intensive but labor intensive. As a result, employment has mostly increased in recent quarters despite the difficult situation in the industrial and real estate markets. These favorable labor market dynamics in turn support wage growth and, in combination with falling inflation rates, household incomes.

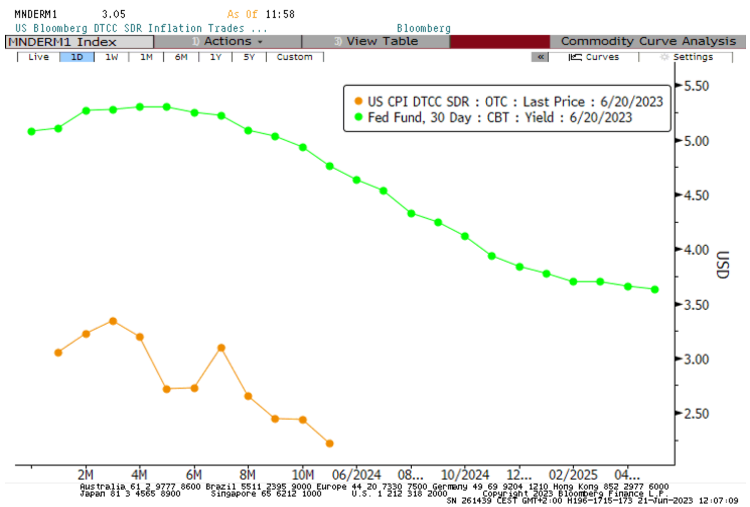
Reuss Private

USA

Industrial production & employment change



Inflation expectations & Fed Funds forwards

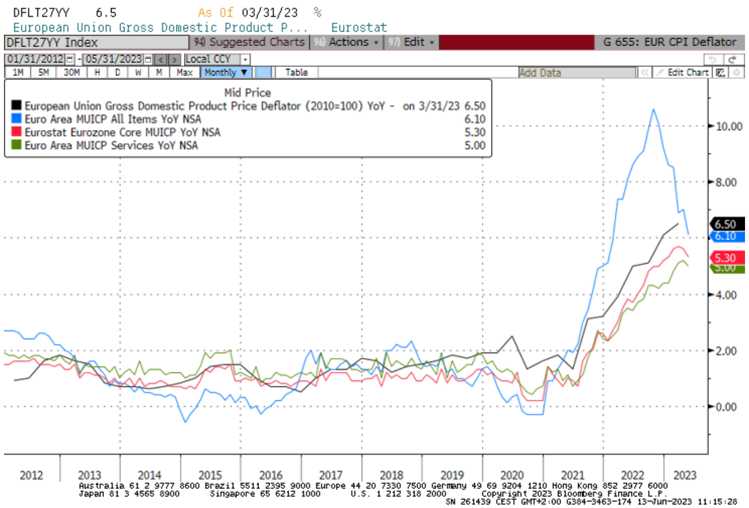


Source: Bloomberg

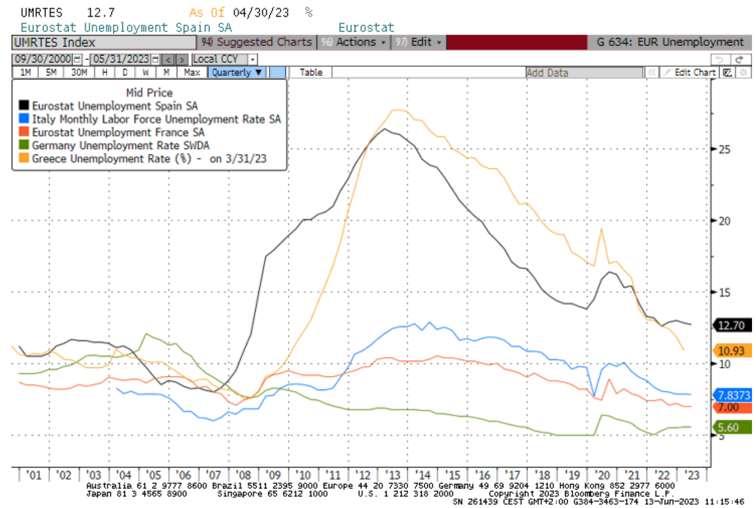
- In the USA, industrial production contracted due to subdued demand for goods and the strong US dollar. The housing market has weakened due to the sharp rise in mortgage rates and more restrictive lending standards. At the same time, labor market dynamics remain friendly due to sustained demand in the service sectors. Combined with easing inflation, this is strengthening purchasing power. As a result, the US economy is weakening, but only relatively slowly. Although a recession cannot be ruled out, it is only a risk scenario.
- Inflation is currently easing significantly due to the sharp drop in commodity prices and substantial base effects. Because monetary policy is already restrictive and growth is slowly weakening, the Fed does not need to raise interest rates any further. However, due to the high labor market dynamics, the FOMC still keeps the option for one more rate increase. With lower inflation and a subdued growth environment, the Fed should then be able to lower interest rates slightly from the beginning of 2024.

Eurozone

GDP deflator & inflation



Unemployment rates

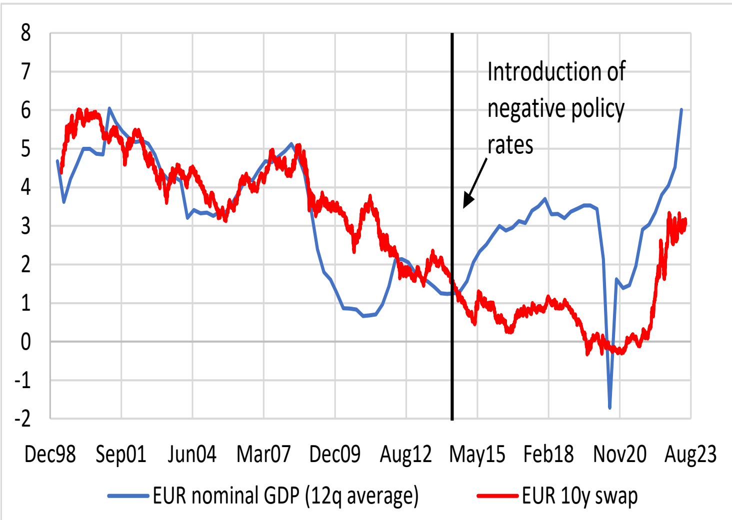


Source: Bloomberg

- Due to lower energy prices, headline inflation is falling on an absolute basis as well as vs. core inflation, which is more persistent than expected so far. While last year, the rise in headline inflation relative to core inflation reflected a negative terms-of-trade shock which was accompanied by substantial welfare losses, this dynamic has reversed since late fall. The prices of important energy imports are falling, and this is accompanied by compensation for the previous losses in prosperity. At the same time, labor market dynamics in the Eurozone remain friendly so that a larger part of the incurred losses in purchasing power is being offset by higher wages. Thus, and in contrast to 2022, a falling inflation rate, combined with rising employment and higher wage growth, is now supporting purchasing power.
- The GDP deflator, which is crucial for nominal growth, is driven more by core inflation than by the headline rate. Because core inflation is falling only slowly, nominal growth also remains elevated for longer. This supports the more indebted peripheral countries on the one hand and corporate profit growth on the other.

Fixed Income

Nominal GDP growth & 10y EUR swap rate



EUR credit spreads & implied swaption volatility

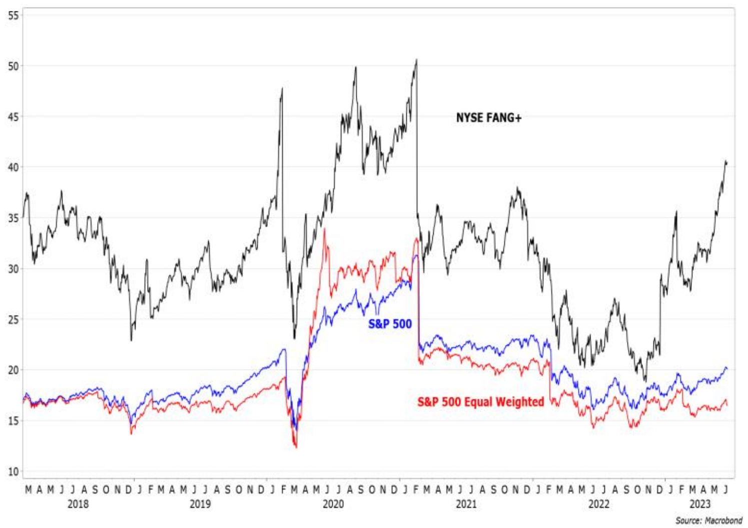
Source: Bloomberg

- Yields are likely to rise further from a long-term perspective. The global growth outlook, as well as that for the Eurozone, is improving somewhat, and nominal growth will remain high in the longer term. Over a long period, nominal growth and bond yields moved in tandem. The last few years have been an exception, and nominal growth has been well above bond yields due to a very loose monetary policy (negative interest rates and bond purchases).
- For spread products, the outlook remains favorable, and they can continue to be overweighted. On one hand, high nominal growth should be supportive as it makes it easier to service existing debt. On the other hand, interest rate volatilities are likely to decline during the remainder of this year. As a result, risk-adjusted spreads will increase. This increases the attractiveness of carry products. At the same time, the price risk (lower duration and higher current interest rates) has decreased due to the rise in interest rates over the past year and a half. This means that spread risks should still be preferred over duration risks.

Equities I

Expected P/E-ratios & Fed Funds rate (inverted)

Forward P/E-ratios



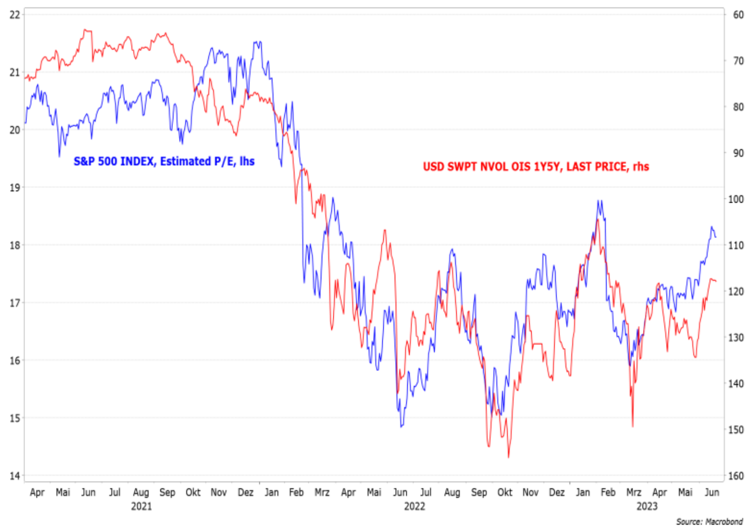
Source: Macrobond

- Central bank monetary tightening and higher bond yields have weighed on equity market valuations during the past year, and these have fallen significantly. Except for the USA, they are at historically moderate levels. In the US, valuations are skewed by the highly capitalized FANG+ stocks. The valuation of the equally-weighted S&P500 has fallen relative to the market-capitalized S&P500 index and is now at a historically modestly favorable level. The highly capitalized FANG+ stocks, unlike many smaller companies, are not burdened by higher interest rates. For example, they often have larger financial assets on the asset side than debt on the liability side and therefore benefit from rising interest rates. Investors are also increasingly focusing on the topic of "artificial intelligence" and are generating inflows into corresponding technology stocks.
- With an end to the US rate hiking cycle, valuations may trend higher as the year progresses.

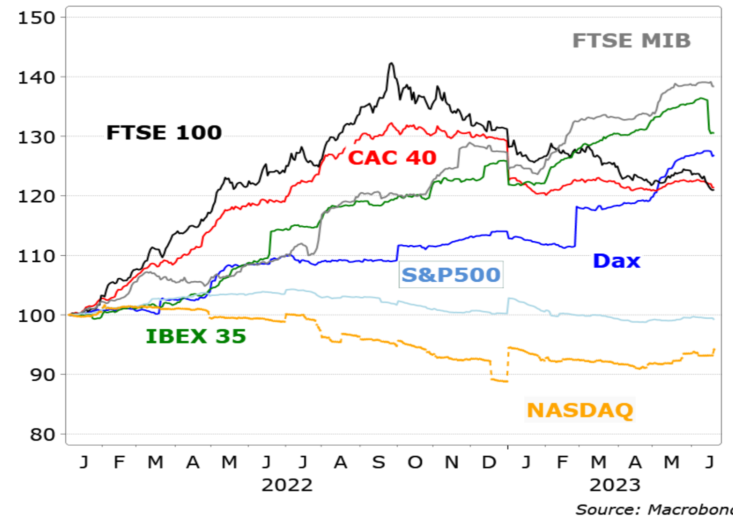
Reuss Private

Equities II

S&P 500 P/E-ratios & 1y5y USD swaption volatility



Earnings expectations

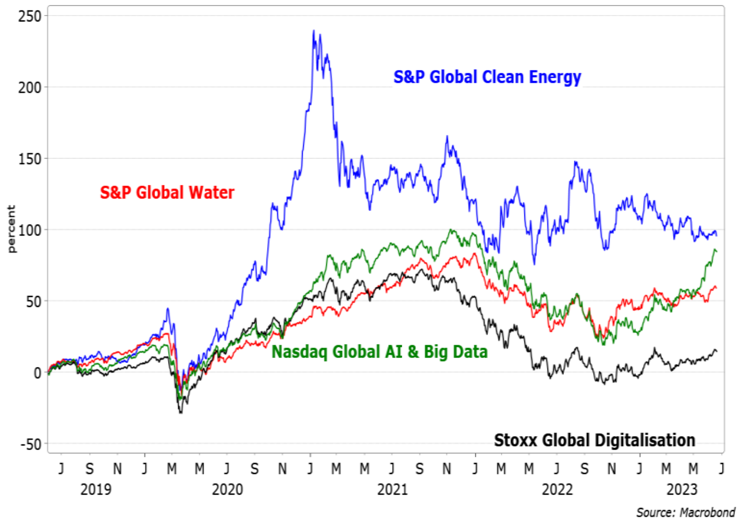


Source: Macrobond

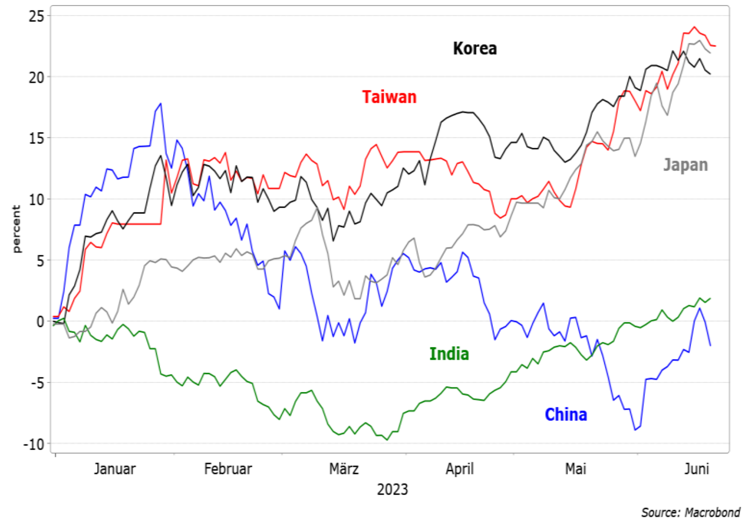
- Last year, interest rate volatilities rose very sharply due to the energy price crisis and the increasingly rapid pace of monetary tightening. Now, by contrast, the energy crisis has eased massively and as a result, the downside economic risks have also diminished significantly. In addition, central banks have significantly slowed the pace of interest rate hikes or have already ended their hiking cycle altogether. As a result, volatilities have started to fall and may trend even lower as the year progresses. However, lower volatility is a positive factor that is generally associated with lower risk premia and therefore also supports the valuation of risk assets. Over the last two years, the USD swaption volatility and the price/earnings ratio based on expected earnings of the S&P500 index show a similar development.
- At the same time, nominal growth remains high and supports earnings growth. This should also be accompanied by higher stock prices. From a strategic perspective, a moderate equity market overweight continues to be appropriate. Major setbacks remain buying opportunities.

Equities III

Performance thematic indices



Asian MSCI country indices (Jan 2023 = 100)



Source: Macrobond

- Investors are increasingly focusing on the topic of "artificial intelligence". In recent weeks, there has been a clear outperformance of corresponding equities compared to other investment themes.
- In Japan, both the TOPIX and the Nikkei have reached new highs since the early 1990s. In addition to domestic factors – the Japanese stock market is attractively valued, and the BoJ has so far maintained its very loose monetary policy – geopolitical factors may also be partly responsible for this. In Asia, there is an increasing discrepancy between the Chinese stock market on the one hand and those in Japan, South Korea and Taiwan on the other. Chinese companies are suffering from increasing state influence and the danger of a technological decoupling of China and the "West". South Korea, Taiwan and Japan are part of the geopolitical "West" but can still benefit from a recovery of the Chinese economy due to their export-oriented economies.

Disclaimer

Felix B. Ronner
Senior Partner and CIO Reuss Private Group AG

Reuss Private AG
Wiesenstrasse 8
CH-8008 Zürich

Phone: +41 44 512 45 10
Email: felix.ronner@reussprivate.com
Web: www.reussprivate.com

Reuss Private