Reuss Private AG

Outlook 2023 – Update Q4

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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, in combination with a strong fiscal easing, had led to supply shortages that are only easing gradually - especially in the labour markets.
- 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. **Slow recovery with a view to 2024. The probability of a recession in the USA is rather low.**
- 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, and will remain elevated over the next few years.
- **The US Fed and the ECB have most likely ended the cycle of rate hikes. No rate cuts expected for a prolonged period of time, especially in the case of the ECB.**
- 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. The fiscal tightening in Germany is an exception.
- 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 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, energy ▪ EM: Vietnam, India	
Alternative Investments	▪ Gold	
Currencies	▪ CHF ▪ JPY	▪ GBP

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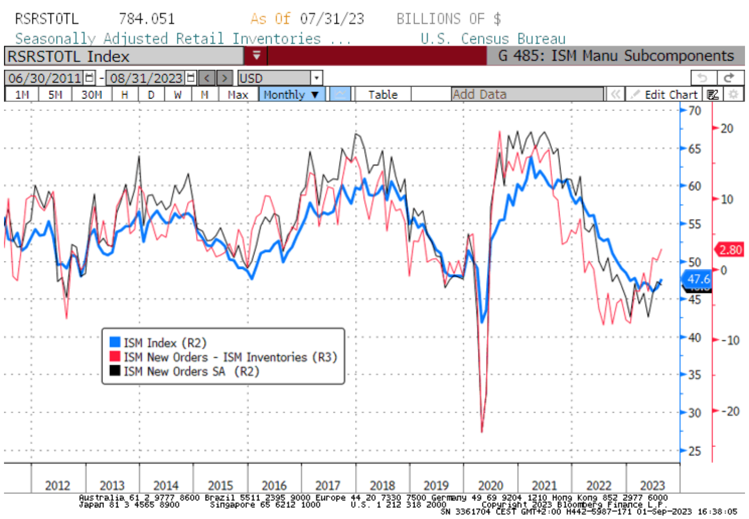
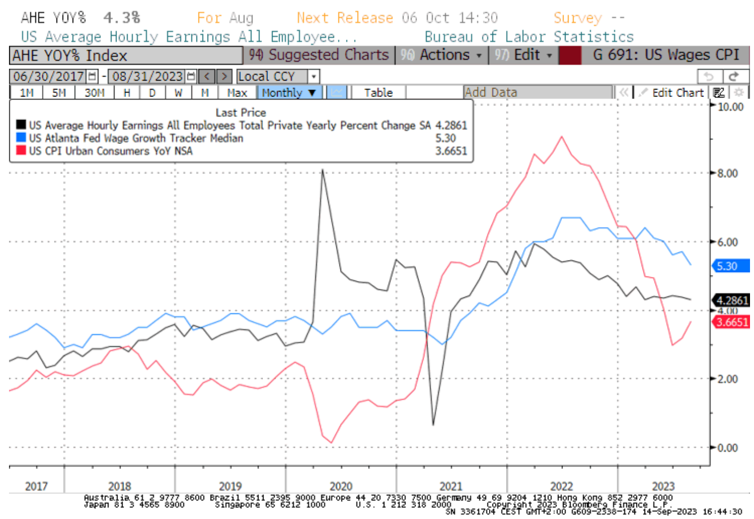
USA – Economy

ISM (purchasing mananger index, new orders & inventory)



Wage growth & inflation (yoy in %)

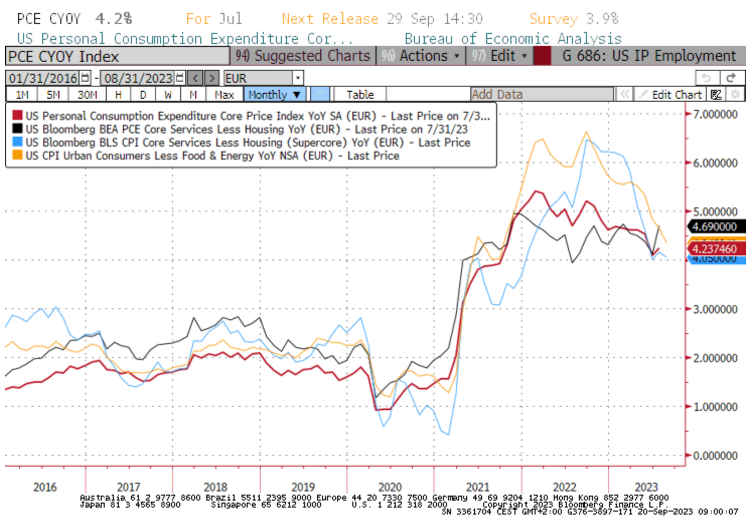


Source: Bloomberg

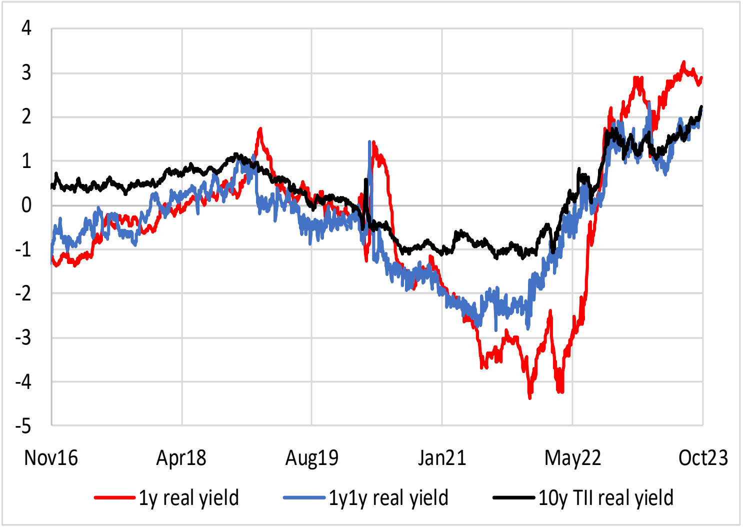
- The momentum of the US economy is weakening, but the slowdown is only gradual. The main argument for lower growth remains the significant monetary tightening by the Federal Reserve. Monetary tightening has not yet fully fed through to the real economy due to the time lag. At the sectoral level, the economic weakness has so far been particularly evident in the housing market and industry.
- However, there are increasing signals that the weakness in industry may soon come to an end. For example, against the background of the “CHIPS Act” and the “Inflation Reduction Act”, corporate construction investments have increased considerably since last year. In addition, with the new orders sub-indicator, the sub-component of the Industrial Purchasing Managers' Index (ISM), which is usually leading the ISM, is now also showing signs of improvement. Consumption should also provide support in the medium term. Because labour-intensive services are in greater demand in the post-pandemic cycle, the labour market weakens only slowly. Inflation has also fallen significantly, and real wages are thus rising again.

USA – Inflation & Monetary Policy

Private consumption & inflation indices (yoy in %)



Real yields

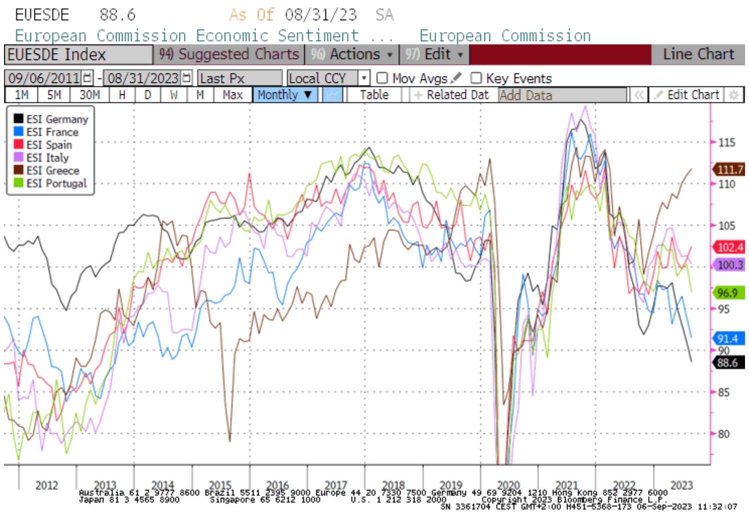


Source: Bloomberg

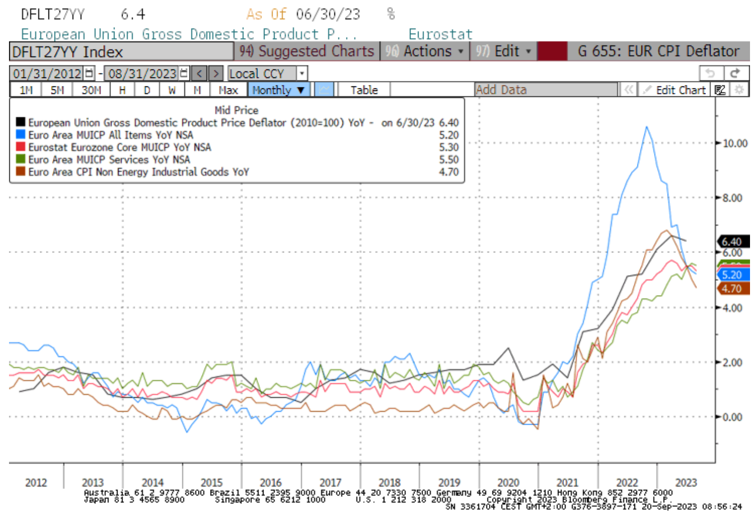
- Inflationary pressures are broadly declining for energy and food as well as for goods and services, with the exception of housing costs. Housing costs follow house prices with a lag of around 15 months and new rents with a lag of just under one year. The underlying price pressure in housing costs is no longer increasing, is even declining. Due to the way housing costs are measured, this will only show up in inflation rates with a significant time lag. The inflation rate may fall close to 2% by mid-year 2024.
- Monetary policy is already restrictive. Because growth is slowing and inflation is falling, the Fed no longer needs to raise rates and the rate hike cycle has probably already ended. The tightening bias will be maintained for longer. Because inflation is falling, real rates are rising. With a gradual slowdown of economic growth, the Fed may start to cut rates moderately in the course of 2024. At the same time, however, the estimate for the long-term neutral Fed funds rate is likely to be raised.

Eurozone

Business cycle indicator



Inflation rates



Source: Bloomberg

- The energy crisis has led to pronounced losses of real purchasing power and to production shutdowns in industry. Higher interest rates are weighing on the real estate market. As a result, current economic momentum is subdued.
- Labour market dynamics remain positive. In addition, there are increased state-directed investment activities for the energy transformation of the national economies, the securing of supply chains for important goods and a partial military build-up. Falling inflation rates combined with rising employment and higher wage growth may support purchasing power and contribute to a gradual economic recovery during the course of 2024. However, the economy remains vulnerable to renewed increases in energy prices.
- The outperformance of the peripheral countries compared to the core of the Eurozone, especially Germany, is expected to continue.
- Even though the ECB has most likely ended its rate-hiking process, interest rate cuts are not foreseeable for a longer period.

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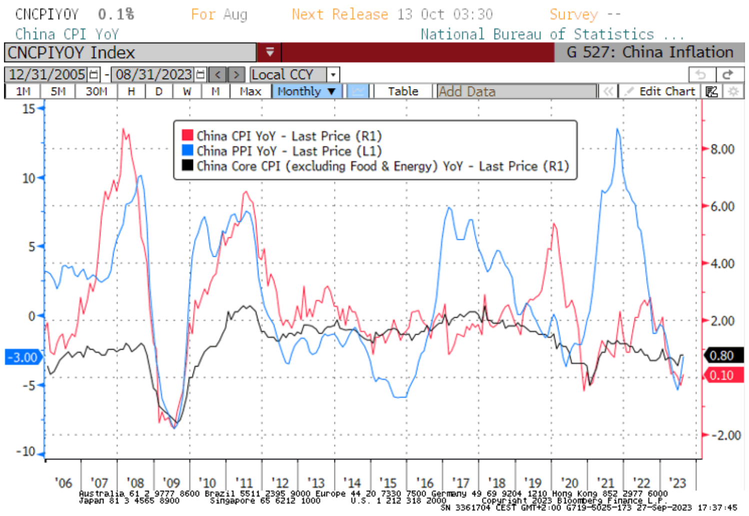
China

Retail sales & imports (yoy in %)

Inflation rates

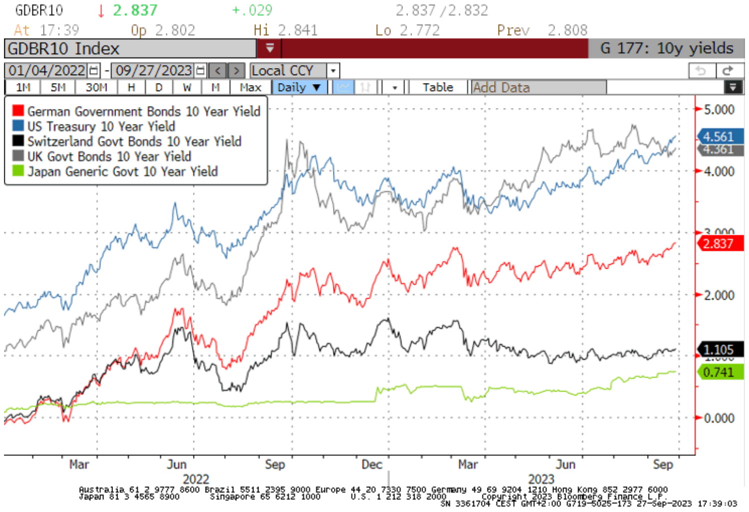


Source: Bloomberg

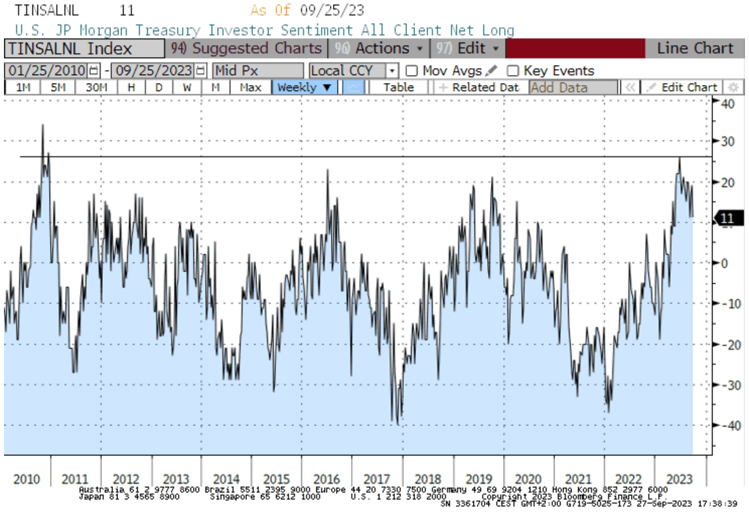
- Due to macro policies during the pandemic that supported supply but not demand, the weakening of the real estate market, and the general imbalances in the Chinese economy (high debt, low consumption share) and demographics, aggregate demand is weak. Thus, Chinese growth has been disappointing, imports from the rest of the world are subdued and inflation is low.
- This low inflation allows for the implementation of additional macroeconomic support measures. However, they will be modest due to already high debt levels. Growth will recover but only moderately.
- In combination with a partial technological decoupling between the US and China as well as geopolitical developments, foreign direct investment has declined, as has portfolio investment. As a result, capital is flowing out of China to a significant extent, and despite the high trade surplus, the Yuan is wekening.

Fixed Income I

10y sovereign bond yields



Net US-Treasury long positions (JPM survey)



Source: Bloomberg

- Although the interest rate cuts priced into the market appear premature and thus the longer money market rates still offer moderate upside potential, the risk-reward potential in the shorter bond segment is favourable. Interest rates have risen significantly and thus offer a buffer against negative developments.
- On the other hand, the risk in longer bonds remains substantial and yields may continue to rise. Inflation will remain elevated in the longer term compared to the last decade and central banks will take their time with any interest rate cuts.
- In addition, an imbalance between the supply of duration and its demand has been emerging, especially in the US. Supply has increased against the backdrop of quantitative tightening by central banks combined with increased deficits. Demand from major investor groups, on the other hand, is subdued. For example, the PM Treasury Survey, which measures institutional investors' positioning in the US Treasury market, reached a twelve-year high at the end of June, indicating that these investors already have a significant "long" positioning. The potential for further purchases is likely to be limited.

Fixed Income II

Yuan & 10y US-Treasury yield

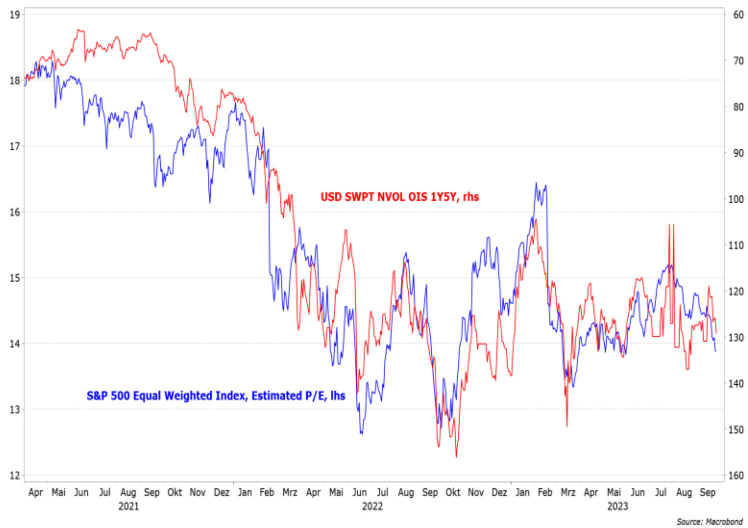
10y UST nominal & real yield, 2-10y yield spread (inverted)

Source: Bloomberg

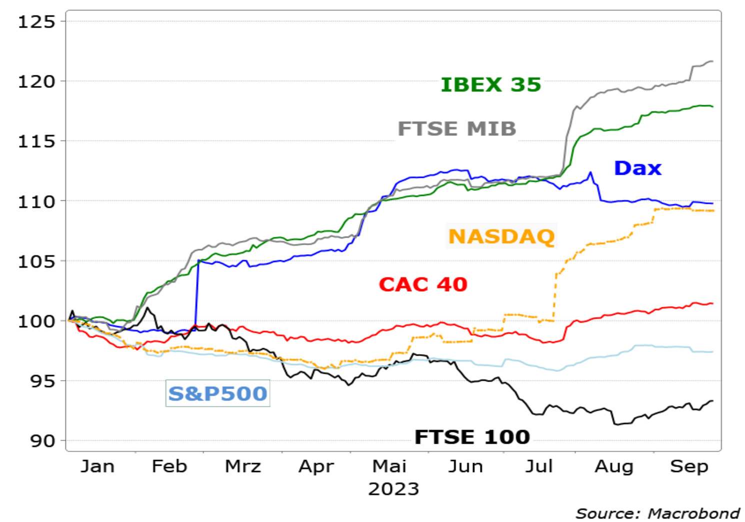
- In recent years, China bought US bonds on a large scale. This was due to China continuously weakening the Yuan to support the export-driven growth model while building up foreign currency reserves, primarily in US dollars. As a result, China became the second largest foreign holder of US Treasuries. However, because growth is now subdued and capital inflows have declined, the Yuan tends to weaken. Accordingly, foreign currency holdings will not continue to build up. This also weighs on the demand for US treasuries bonds.
- In addition, there is a change in the behavior of US banks. In recent years, banks have been big buyers of duration. The holdings of treasuries and agencies increased massively between the beginning of 2019 and the end of 2021. Since 2022, however, holdings have been declining. The main reason is likely that client deposits are falling, making less cash available for treasuries and agencies.
- This duration imbalance leads to a steepening of the yield curve and is accompanied by higher real interest rates at the long end.

Equities

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



Earnings expectations (Jan23 = 100)

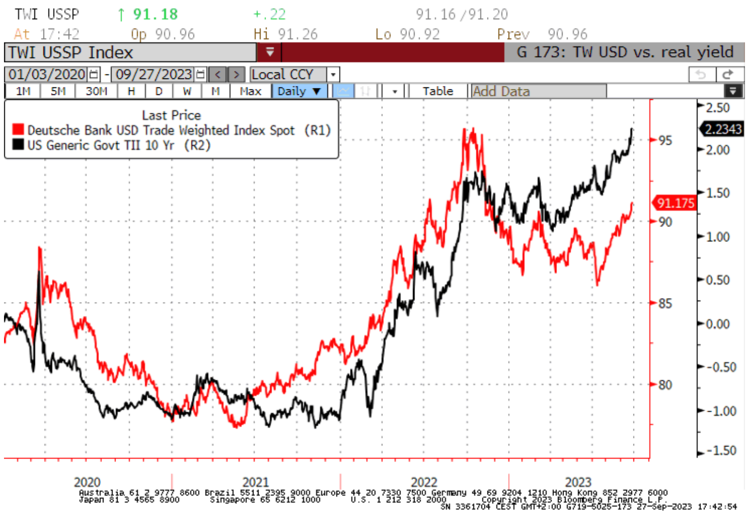


- The strategic outlook for risk assets remains generally favorable. The end of monetary tightening should provide moderate support for valuations. Due to the likely end of policy rate hikes and the entry into a longer period of unchanged policy rates, interest rate volatilities may fall starting from the short end. Lower interest rate volatilities are usually accompanied by falling risk premia and therefore tend to result in higher valuations for risk assets.
- In addition, high nominal growth compared to the last decade supports corporate earnings developments.
- At the same time, however, the attractiveness of bonds has increased due to the sharp rise in interest rates. As a result, a moderate overweighting of the equity market exposure is advisable, and additional purchases can be made in the event of major setbacks. Equities with low P/E-ratios remain attractive. Geographically, preferences may lean towards the USA, peripheral Eurozone, and Western Asian countries.

US-Dollar

USD, budget- & current account deficit (in % of GDP)

Trade weighted USD & 10y US real yield



Source: Bloomberg

- The US dollar has appreciated since the beginning of 2021 due to the significant tightening of financing conditions and the global growth slowdown. The US dollar appears overvalued. In addition, from a longer-term perspective, the high budget and current account deficits may become increasingly burdensome.
- At present, however, the US dollar is supported by a better-than-expected economic environment in the USA, and at the same time a weaker-than-expected environment in China and Europe. Rising real interest rates are also leading to capital inflows into the US dollar.
- In the short term, the US dollar may trend stronger. Only with a progressing economic slowdown in the USA and moderate interest rate cuts in 2024, the currency will sustainably depreciate.

Disclaimer

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