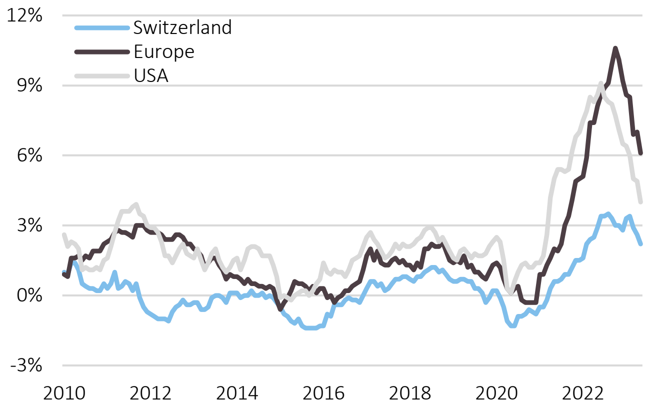
Inflation down, hopes up – Focus on quality and the CHF

Inflation has fallen, markets too optimistic?

The first half of the year saw solid returns of global equity markets – in contrast with the cautious forecasts that experts had been making at the start of the year. Until now, the economy has been proving to be more resilient than expected. The decline in inflation in many Western countries has been another key positive development over the year to date (see graph 1).

Graph 1: Inflation in Switzerland, Europe and the USA*



*Source: Bloomberg, Belvalor; * Consumer Price Index (CPI); Europe: Eurozone*

This has aroused the impression that central banks have inflation under control. Drawing hope from prospects of near-term interest rate cuts and looser monetary policy, sentiment in the most important equity markets, except China, has been slightly more optimistic. However, the hype surrounding artificial intelligence (AI) has injected new asymmetries into the market, which call for caution. Overall, it has paid off to hold onto investments in equities. Bonds have also – generally speaking – performed positively.

Cautious outlook

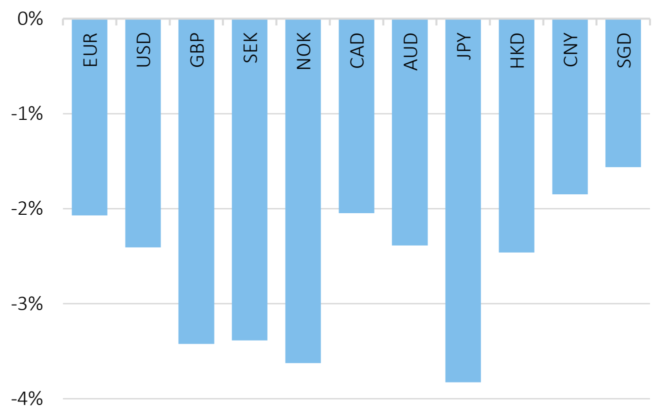
Economic prospects have recently become gloomier, with economic indicators pointing towards a slowdown in the second half of 2023 and at the start of 2024. Interest rates have started to bite (their effects were described in our previous quarterly report). Borrowing costs have risen – for investors, private individuals, companies and governments alike. Although inflation at first sight appears to have fallen, core inflation remains stubbornly high. This has been forcing central banks to rigorously pursue their battle against inflation by raising interest rates. The various interest rate hikes have slowed down the economy. In addition, there has still been little signs of momentum from regions such as Asia, which operate as engines of economic growth.

Companies have started to reduce inventories and put projects as well as investments on ice for economic and/or financial reasons. Depending upon the scale of the economic slowdown, previous assumptions could in some cases turn out to be too optimistic. We therefore take the view that there is some scope for downgrades of earnings estimates in equity markets.

Focus on quality, preference for CHF

Due to unresolved inflationary and interest rate risks, uncertainty on the economic growth front and existing geopolitical risks, we have become more cautious and are tactically not using up the full equity risk allocation. This enables us to invest in quality companies with good cash flows in case of market corrections. We are sticking to our long-term investment strategy focusing on real, inflation-proof assets, especially equities. Inflation remains an issue. Short-maturity corporate bonds are suitable as a complementary element within the portfolio, as well as being a liquidity substitute.

*Graph 2: Currency losses p.a. against CHF since 2000**



*Source: Bloomberg, Belvalor; * annual average (01/01/2000 – 28/06/2023)*

The above graph shows the annual outperformance of the Swiss franc compared to selected currencies. Due to the sustained high inflation rates throughout the world, we are not anticipating the difference to fall in future. This underscores our preference for holding a high proportion of Swiss francs in the portfolio.