BELVÉDÈRE
Asset Management

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BETTER THAN EXPECTED, WORSE THAN FEARED

MARKET INSIGHTS

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The bare figures actually speak for themselves: it was a good first quarter – better than anyone could have expected. Despite all the risks, there is no sign of the feared recession. The winter was too mild, while the labour market was too strong and so was consequently the consumption. The year also started well for investors. Practically all asset classes were up, and some significantly so. American and German government bonds rose by 3% and 2.5%, respectively, Swiss government bonds even by more than 4%. Things looked even brighter on the equity side. From Switzerland (SPI +5.9%) to the euro zone (Euro Stoxx +12.0%) and from the US (S&P500 +7.5%) to Japan (Topix +7.1%) and Asia (MSCI Asia ex Japan +4.3%), all key markets made gains.

A certain recovery was to be expected after the dismal investment year 2022, but the actual extent was quite astonishing. The equity rally and the decline in long-term interest rates in January were largely shaped by the expectation that central banks – above all the US Fed – would end their cycle of interest rate hikes earlier and possibly even cut key interest rates again in the course of the year. The moment it became evident that these hopes were a mere pipe dream, the market momentum vanished into thin air. A turbulent March ensued. It began with the troubles at the not so widely known American Silicon Valley Bank (SVB) and ended with the forced takeover of Credit Suisse (CS) by UBS. Both, SVB and CS were in worse shape than feared, which ultimately led to their demise (see Equities section). Without the intervention of central banks and other authorities, the whole affair might have escalated into a full-scale banking crisis. The CS story may yet entail some political and legal repercussions. For all markets are concerned, though, the matter is probably done and dusted. While the US banking sector has regained some poise lately, the risks have not been anything but eliminated. Nevertheless, the end of the quarter demonstrated once again how quick investors can be to forget. The financial sector turmoil has rekindled expectations that the Fed might start cutting interest rates again as early as July. This interest rate fantasy in turn boosted equity markets and made for a conciliatory close of the quarter.

So, what's up next? Despite the overall positive market performance in the first quarter, there is no widespread euphoria. In fact, the mood seems depressed. Absent any further "accidents" of the SVB or CS sort, we shall stick to our prior assessment: growth will continue to slow down, but without the risk of a recession – anyway, not this year. Inflation is (slowly) subsiding. Central banks will raise key interest rates one last time by summer, but in contrast to current market expectations there will be no interest rate cuts. This means that there are no triggers for any big leaps on the stock markets. Despite all the recent weeks' turmoil, the scenario we outlined for the economy and markets at the beginning of the year still holds water, albeit, risks have increased.

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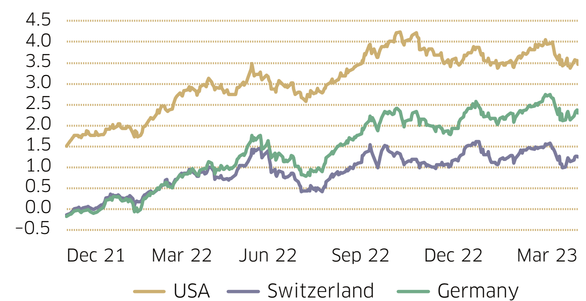
INTEREST RATES

The US Federal Reserve (Fed) raised interest rates twice by 25 basis points in the last three months. This was in response to the core inflation, which was still too high in February at 5.5%. The European Central Bank also raised interest rates twice, but by 50 basis points each time. In Switzerland, inflation was higher than expected at 3.4% in February. Since inflation is not expected to ease any time soon here either, the Swiss National Bank raised its interest rates by another 50 basis points.

The monetary tightening has also led to a significant rise in interest rates at the long end, which only came to a halt as the banking crisis erupted in early March. For instance, ten-year US government bond yields narrowed from over 4% to 3.4% within a short space of time and expectations for the US key interest rates were suddenly reversed. While just a month ago markets were still expecting up to three more interest rate hikes in 2023, they now anticipate a maximum of one more rate hike in May followed by at least two cuts before the year is over. The Fed has now the enormously difficult task of continuing to fight inflation, but without putting banks under even more pressure at the same time. For, the banks would need to raise interest rates on savings deposits to prevent further outflows into higher-yielding money market investments. All in all, we stand by our assessment that the cycle of interest rate hikes is drawing to close, but that hopes for any cuts in the near future will be disappointed. At the long end, interest rates are likely to recover a bit after the substantial decline.

Interest rate increases ended in March (10-year government bond yields, in %)

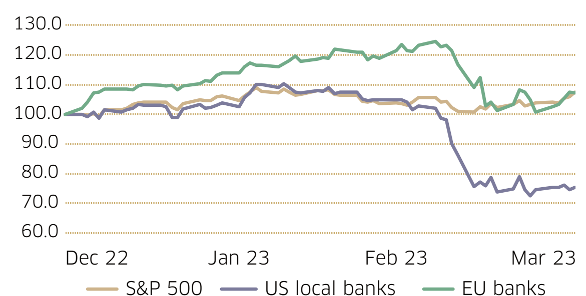


Source: Bloomberg, BAM

EQUITIES

Equity markets got off to a flying start in the new year and January lived up to its reputation as a good month for markets. However, the momentum soon waned, partly because hopes of a rapid fall in inflation and subsequent cuts in key interest rates in the USA evaporated. The mood turned fully negative as of 10 March, after regulators had to close down the Silicon Valley Bank (SVB), which specialises in venture capital. What had happened? During the pandemic, SVB was inundated with new client money inflow, which the bank invested in presumably safe long-term US government bonds. However, with the rise in interest rates last year, their value collapsed, so that in the end the SVB was no longer able to meet the suddenly surging demand for client payouts. The crisis spread and clients started withdrawing their deposits from other regional banks. Before too long, European banks were also drawn into the undertow of the crisis, first and foremost Credit Suisse, the weakest link in the chain. The outflow of money there accelerated to such an extent that the regulator, fearing a second financial crisis, ordered a forced takeover by UBS. Despite the turbulence in March – which eased somewhat towards the end of the month – most stock markets ended the quarter above board, notably the Euro Stoxx with +12.0%. The Swiss SPI rose by 5.9%, the American S&P 500 by 7.5%. Our outlook for equities remains cautious and we expect the sideways trend to continue.

Local banks in the US under pressure (indexed, 31.12.2022 = 100)



Source: Bloomberg, BAM

ECONOMY

The economic slowdown or even recession many market observers saw coming in the US and the euro zone has so far not materialised. Nor has the much feared energy crisis, which is why the euro zone has held up better than expected. This was due to a mild winter, liquid gas supply from the US and some austerity measures. In the US, particularly private consumption evolved better than expected, because the labour market remained robust and there were still some savings left over from the pandemic. Growth was also bolstered up by investments and exports. Only housing development has been receding due to the sharp rise in interest rates.

Having disappointed last year, the Chinese economy made a turnaround in the last three months, as the corona restrictions were lifted. The purchasing managers' indices for manufacturing as well as services demonstrated a recovery and are above the growth threshold of 50 points. The hard-hit real estate market is seeing buyers return and has probably put the worst behind it. So, where do things go from here? While we feel confident for the euro zone and China, the economic risks in the US have evidently increased due to the banking crisis. The danger of a recession setting in by the end of this year or into 2024 has increased.

Asset class	Appraisal	Commentary
Bonds Government bonds Corporate bonds		Although the cycle of interest rate hikes is drawing to a close, hopes for cuts in the near future could be disappointed. A slight increase at the long end is possible due to the substantial decline in interest rates.
Equities Switzerland Euro zone United Kingdom US Emerging markets		Negative factors such as falling profit expectations, still relatively high valuations and newly unresolved banking issues keep us cautious about equities.
Real Estate Switzerland		Real estate investments are a key portfolio diversifier in the current environment. Valuations remain within a reasonable range.
Commodities Oil Gold		Gold is unlikely to benefit sustainably from the banking crisis. Oil is priced low and ready for a turnaround, as Russia cuts supply and China's economy gains momentum.

unattractive — attractive ■ Current asset class assessment

Imprint
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