XO INVESTMENTS

MONTHLY COMMENT

March 2022

MARKET REVIEW

Hide these rates, lest I see them !

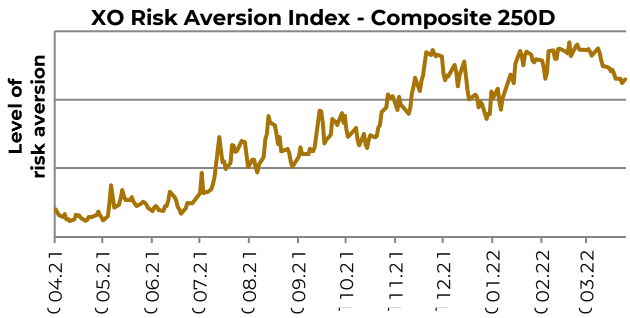
The war in Ukraine seems to mask one of the most important economic phenomena of the last 10 years: the massive rise in interest rates. In a deafening silence, Western interest rates are soaring. The Swiss and American 10-year rates have risen by 0.8% in 3 months. This major movement is impacting bonds, which are down 6% for the year. Real estate is down more than 4%. Even if rates remain low by historical standards, the movement is painful.

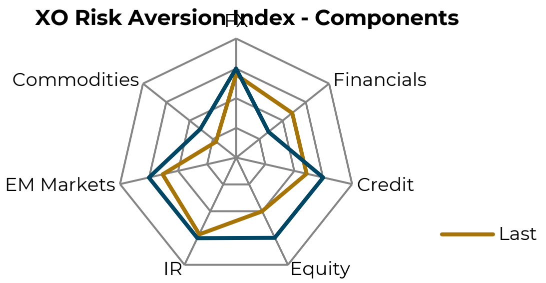
Traditionally, financial markets suffer when rates rise. This has not been the case in recent weeks. The progress of the negotiations between Russia and Ukraine is focusing the attention of the market participants and is allowing a recovery of the indices after two terrible months.

Oil is a volatile asset in March. It ended the month at around $100 a barrel, whereas it had touched $130 at the beginning of the period. Gold underwent a similar movement to end slightly positive.

The overall risk indicator remains high. Commodities and equities are seeing their risk reduced somewhat.

	Value	March	2022
Equity markets			
Switzerland (SMI)	12 162	1.46%	-5.55%
United States (S&P500)	4 530	3.58%	-4.95%
Europe (Euro Stoxx 50)	8 641	-0.46%	-8.95%
Japan (Nikkei)	27 821	4.88%	-3.37%
China (Shanghai SE)	3 252	-6.07%	-10.65%
Brasil (Bovespa)	119 999	6.06%	14.48%
Currencies			
USD/CHF	0.922	0.37%	1.02%
EUR/CHF	1.021	-0.74%	-1.58%
GBP/CHF	1.213	-1.41%	-1.74%
EUR/USD	1.108	-1.10%	-2.53%
Other asset classes			
Swiss Real Estate		-0.56%	-4.17%
Swiss Bonds		-2.73%	-6.06%
Foreign Bonds		-2.31%	-5.29%
Commodities		9.63%	33.13%
Oil	100.28	4.76%	33.33%
Gold	1 944.45	2.38%	6.30%
Rates / Indicators			Δ
10 years Swiss rate		0.60%	0.74%
10 years US rate		2.34%	0.83%
US Unemployment		3.80%	-0.10%
US GDP		5.50%	0.00%
US CPI		6.40%	0.90%





HOUSEHOLDS AND INFLATION

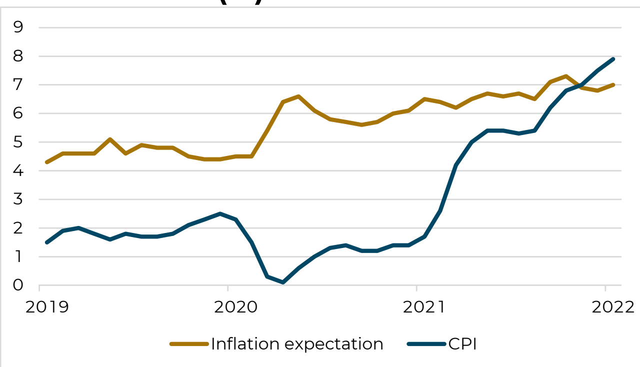
The return of inflation will have a marked impact on households that spend a large proportion of their income on food.

Inflation is accelerating

Two years ago, the Covid crisis caused a massive decline in all financial assets. Commodities were no exception. The highlight of this phenomenon was the air transport shutdown, which caused oil to plunge into negative territory in April 2020. Two years later, it is clear that the huge injections of money from central banks, logistical difficulties and the economic recovery have changed monetary conditions.

Inflation is back in the world and is accelerating with the crisis in Ukraine. This war is allowing some US politicians, led by Nancy Pelosi, to try to blame the return of inflation exclusively on the Russian president. The Speaker of the US House of Representatives explains that inflation started with President Putin and that government spending is doing exactly the opposite... The abysmal deficit generated by the US government apparently has nothing to do with it...

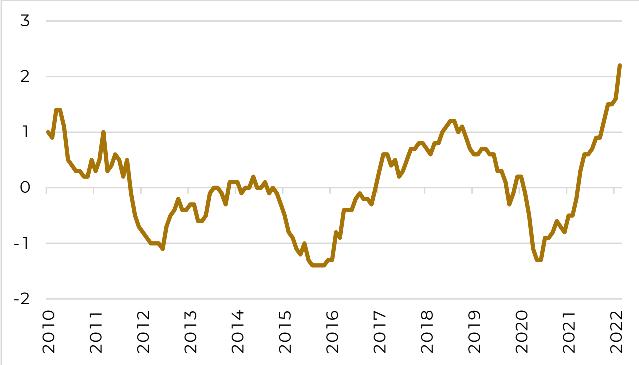
USA inflation (%)



Source : Bloomberg, XO Investments SA

With inflation now reaching 8% and exceeding expectations, an inflationary cycle seems to be taking hold. This is also the case in Switzerland, although the proportion is different. After a decade of 0% inflation, or even rather deflationary periods, Switzerland is back to inflation above 2%.

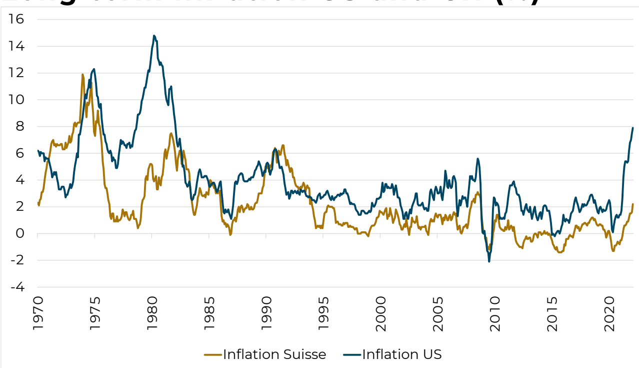
Inflation in Switzerland (%)



Source : Bloomberg, XO Investments SA

You have to go back to 2008 to get a figure of this level. For the US you have to go back 40 years, to a time in US economic history when interest rates were over 10%.

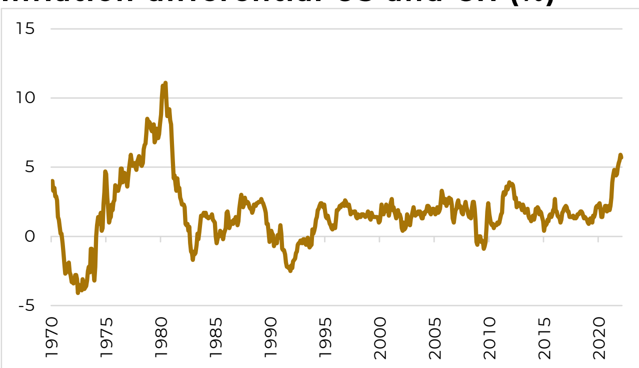
Long term inflation US and CH (%)



Source : Bloomberg, XO Investments SA

On average, over 50 years, the difference in the inflation rate between the US and Switzerland is 1.75%. This difference explains the appreciation of the CHF against the USD over the period by more than 2%.

Inflation differential US and CH (%)



Source : Bloomberg, XO Investments SA

Inflation differential and CHF

Variable	Average 1970-2022
Inflation differential US-CH	-1.75%
USD/CHF	-2.32%

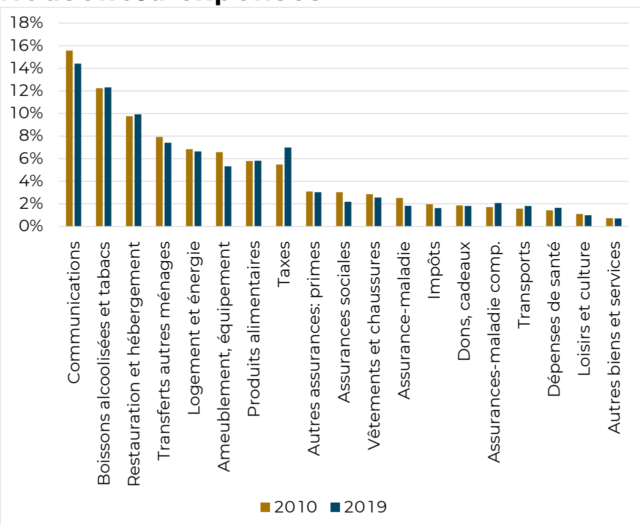
Source : Bloomberg, XO Investments SA

However, the differential is now much larger and well over 5%. This suggests that either inflation in Switzerland will increase, inflation in the US will decrease, or the CHF will appreciate against the USD in the coming months.

Expenses that change

Households will have to adapt to this new inflationary environment. The consumer price index is an instrument to check the impact of inflation on households. Each country defines a standard basket and measures its evolution over time.

Household expenses



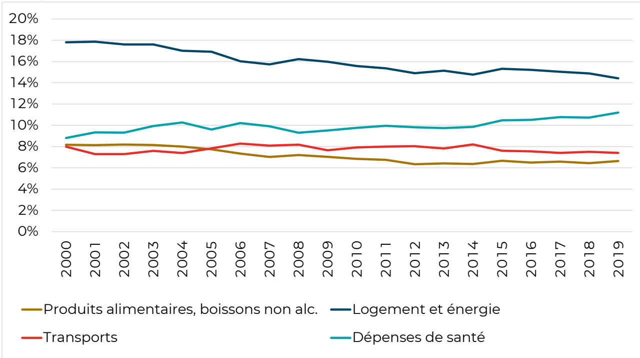
Source : OFS, XO Investments SA

In Switzerland the main categories of expenditure are housing, taxes (even if in the imagination of foreigners this category does not exist in Switzerland), social insurance, health, and transport. Housing includes energy expenditure, which will increase significantly in the coming months.

Energy is central since it has implications in all categories: in transport and housing obviously but also in food (energy is needed to heat seedlings, gas for fertilisers or to dry products,...) or household equipment. The energy increase alone can lead to inflation in all other categories.

It is interesting to measure the evolution of expenditure items over time. In Switzerland, the housing/energy category has largely decreased in 20 years. On the other hand, health expenditure has increased steadily.

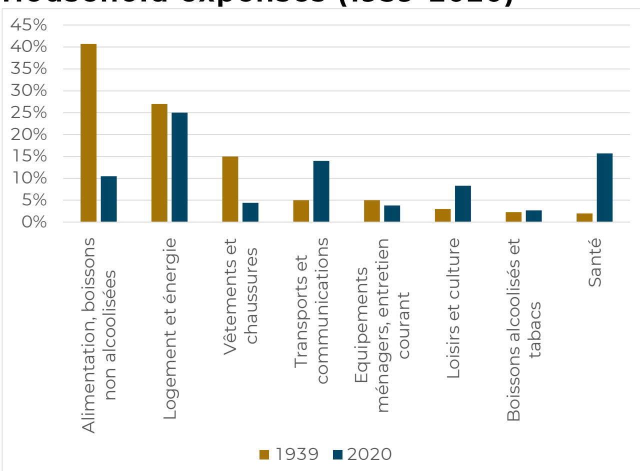
Evolution of the main household expenditure items in Switzerland



Source : OFS, XO Investments SA

The FSO and Bilan magazine recently published a very long-term analysis comparing household expenditure between 1939 and 2020. It allows us to understand the changes in consumption patterns. In 1939, Swiss households spent 40% of their income on food, i.e. four times more than today. Clothing and shoes accounted for 15%. Housing and energy have decreased but to a lesser extent than the first two items mentioned. Health, leisure, transport and telecommunications have increased significantly.

Household expenses (1939-2020)



Source : OFS, Bilan, XO Investments SA

In addition to the price development that influences the consumer price index statistics, every 5 years the Federal Statistical Office (FSO) readjusts the composition of the standard basket. This allows the calculation to be adapted to consumption patterns. To give just a few examples:

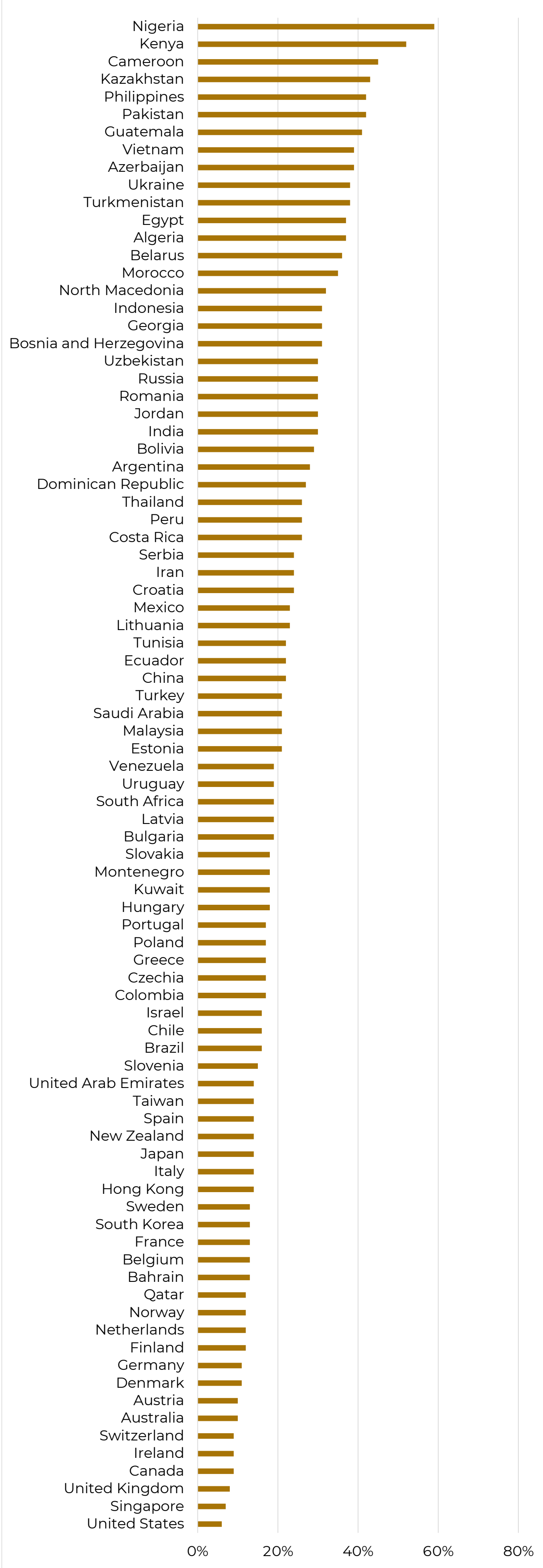
- 1977: inclusion of fresh and frozen fish but deletion of oatmeal;
- 1993: addition of hearing aids, micro-computers;
- 2001: take-away food and sewage taxes are introduced;
- 2011: fixed line and internet packages introduced and analogue cameras removed;
- 2016: sewing machines replaced by household robots;
- 2021: fabric for clothing is phased out, while disposable hygiene masks and hand sanitisers appear;

The typical basket thus reflects changing lifestyles. In terms of food, part of this change is product substitution. Brussels sprouts were eliminated in 2006, while coffee capsules were introduced. Rising food prices, particularly for wheat, will lead to further changes in our diet and the typical basket. If wheat continues to rise, meat prices will rise. Protein consumption will either decrease in a more vegan mode or by substituting meat with other animal protein sources such as insects (grasshoppers, locusts) which are already appearing in the shops.

The weight of food as a symptom of inequality

The weight of food in household consumption gives an idea of the impact that rising food prices can have in different countries. This weight represents a form of inequality due to inflation. François Mitterrand said: "Inflation, a tax for the poor, a bonus for the rich, is the oxygen of the system...". It is therefore quite logical to find a classification where households in Western countries spend only a small portion of their income on food. In contrast, households in poor countries spend the majority of their income on food. 60% for Nigerians, for example.

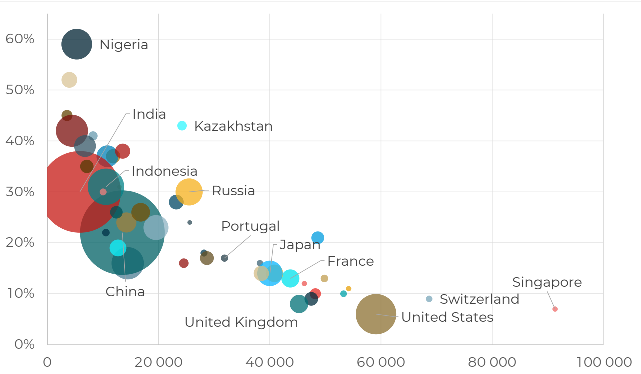
Share of food expenditure in the world



Source : USDA 2017, XO Investments SA

A relationship therefore exists between the proportion of food expenditure of an average household in a country and the GDP per capita, the average wealth of the country. The richer the country, the less money its inhabitants will spend on food as a proportion of their income.

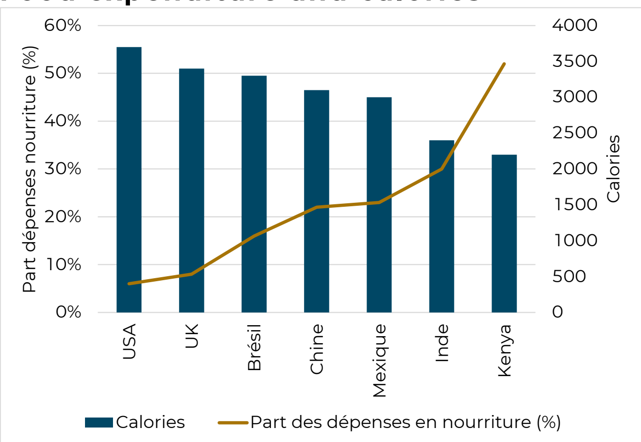
Food expenditure and GDP per capita



Source : USDA 2017, World Bank, XO Investments SA

There is, however, a difference. Spending a lot on food does not necessarily mean eating large meals. In calorific terms, even if Americans spend proportionally less on food, the calorific intake is not comparable to that of Kenyans who spend 50% of their budget on food.

Food expenditure and calories



Source : USDA, FAOSTAT, XO Investments SA

The central problem with a return of food price inflation in fragile countries is the risk of humanitarian crises, or even social crises leading to revolutions. The Arab Spring of 10 years ago came at a time when wheat prices were high. This crucial period must therefore be approached with caution.

Underestimated inflation

Inflation therefore seems to be back. The CPI, the consumer price index, is the barometer for judging this return.

Unfortunately, this measurement tool is not perfect. It does not measure the expenditure that individuals make in order to live but calculates the evolution of a basket of goods and services consumed. The FSO estimates that 40% of expenditure in Switzerland is excluded from this calculation. However, it is often forced expenditure such as health insurance that has risen sharply. Real inflation is very likely to be higher than that mentioned in the statistical publications. The consumer but also the investor should therefore be prepared as best as possible to face this new environment and adopt their behaviour or their investments accordingly.

HIRING AT XO INVESTMENTS

Thierry Kohler will join XO Investments as an asset manager from 1 April 2022.

XO Investments is pleased to announce the appointment of Thierry Kohler as Asset Manager.

With more than 20 years of experience in the industry, **Thierry Kohler** will join XO Investments as of April 1, 2022 and will assume the role of Asset Manager and Head of Mortgage Advisory.

Thierry Kohler worked in an international banking institution at the beginning of his career before joining two national banks in the canton of Neuchâtel and finally taking on the role of manager of the Migros Bank for the Neuchâtel and La Chaux-de-Fonds branches.

The partners and employees of XO Investments are delighted to have hired someone who shares the same values as XO Investments, namely independence, proximity and availability. In his new role, Thierry will be able to offer his clients his extensive expertise in both asset management and mortgages.

XO Investments is therefore continuing its development in a context of concentration of financial institutions and regulatory densification. The XO Investments team is delighted to have a new member of staff who attaches great importance to the quality of service offered to clients.