XO INVESTMENTS

MONTHLY COMMENT

July 2022

MARKET REVIEW

Inflation-recession pendulum

After a first half of the year totally influenced by inflation, the pendulum seems to be swinging back towards the fear of recession. At least that is what the central banks are saying and what the financial markets are interpreting. This is a relief for assets such as bonds and real estate, which benefit from an easing of interest rates. The monthly performance of these assets is approaching 3% but unfortunately remains largely negative for the year.

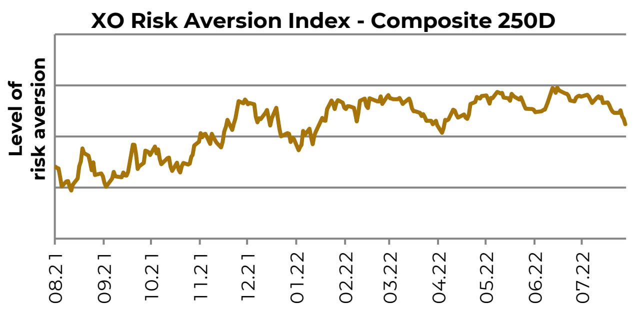
Equities rebounded in all markets, except China. The US is the best performer for the month. Major countries' equities are back to around -13% year to date.

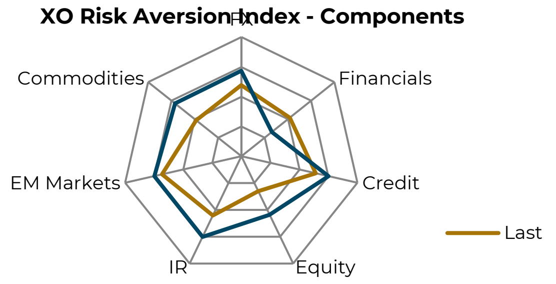
The only asset class under pressure in July was commodities, which were affected by fears of recession. Inflationary expectations are easing even though inflation figures are still breaking records in both the US and Europe.

Finally, currencies are depreciating against the CHF. The EUR is particularly affected as it ends July at 0.973 against the CHF, an all-time high.

The overall risk indicator is reduced on all parameters except for financials.

	Value	July	2022
Equity markets			
Switzerland (SMI)	11 146	3.77%	-13.43%
United States (S&P500)	4 130	9.11%	-13.34%
Europe (Euro Stoxx 50)	8 367	7.44%	-11.84%
Japan (Nikkei)	27 802	5.34%	-3.44%
China (Shanghai SE)	3 253	-4.28%	-10.62%
Brasil (Bovespa)	103 165	4.69%	-1.58%
Currencies			
USD/CHF	0.952	-0.14%	4.33%
EUR/CHF	0.973	-2.77%	-6.17%
GBP/CHF	1.159	-0.33%	-6.07%
EUR/USD	1.022	-2.51%	-10.11%
Other asset classes			
Swiss Real Estate		3.27%	-12.09%
Swiss Bonds		3.36%	-7.18%
Foreign Bonds		2.34%	-7.77%
Commodities		-0.04%	35.74%
Oil	98.62	-6.75%	31.13%
Gold	1 765.94	-2.43%	-3.46%
Rates / Indicators			**Δ**
10 years Swiss rate		0.44%	0.57%
10 years US rate		2.65%	1.14%
US Unemployment		3.60%	-0.30%
US GDP		1.60%	-3.90%
US CPI		5.90%	0.40%





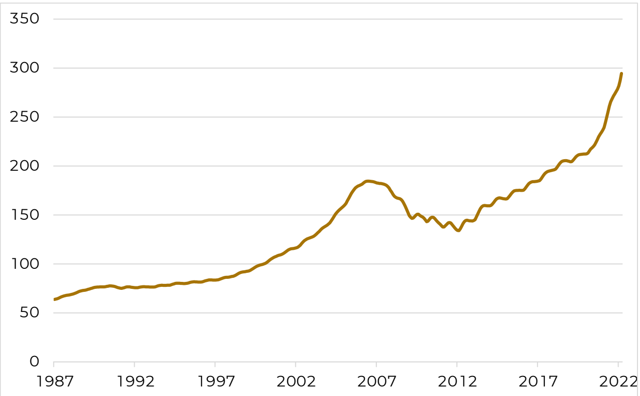
A CONSTRUCTIVE PROPERTY MARKET

After a period of low interest rates and a significant rise in prices, the property market is about to return to normal with a positive property premium again.

A dynamic property market

The period of low interest rates has been beneficial for the entire real estate and construction sector. Over the last 35 years house prices in the US have increased fourfold. An impressive figure even if in comparison the price of shares has increased by 15 times and bonds by 6 times. Only the financial crisis of 2008, induced by the subprime crisis, put a stop to this upward momentum between 2007 and 2012, with a 20% drop. The massive fall in interest rates in 2020 and the injections of liquidity by central banks have further accelerated the phenomenon over the last two years.

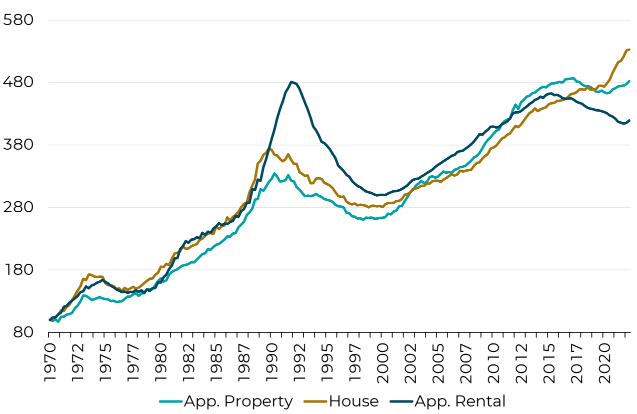
Case-Shiller US Home Price Index



Source : Bloomberg, XO Investments SA

This value increase occured in most countries. In Switzerland, over 50 years, villa prices have increased fivefold, despite a bubble 'pop' at the end of the 1980s.

Nominal supply price indices in Switzerland



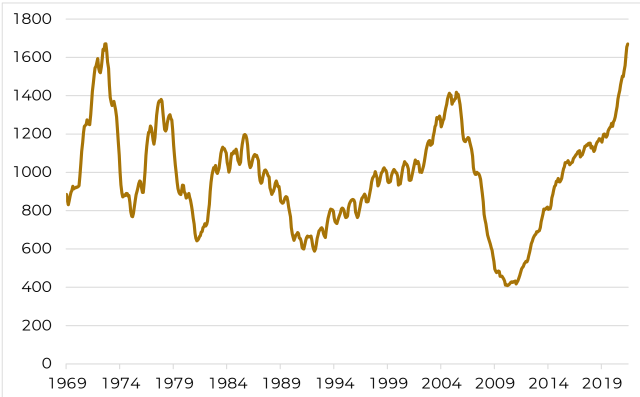
Source : Wüest Partner, XO Investments SA

The bursting of the 1980s excess entailed falls of between 20% and 40%!

Recently, rental apartments have shown less growth due to the increase in regulatory constraints and the increase in real estate taxation in some cantons. It is interesting to note that villas and condominiums have largely exceeded their 1988 bubble value, while rental apartments have still not recovered.

Momentum remains strong . In the US houses under construction are at a 50 year high with 1.7 million units being built. Switzerland is also continuing to build , however permit applications are slowing (-25% in 10 years).

Number of houses under construction in the USA (thousands)

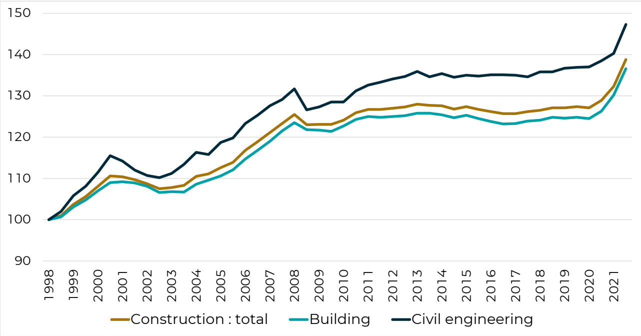


Source : Bloomberg, XO Investments SA

Underlying inflation

The inflation that is spreading to all commodities is obviously affecting real estate. While overall costs in Switzerland had remained stable for 10 years, the last two years have seen prices rise by almost 10%. This rise affects both the actual construction and civil engineering works. It is the latter that has increased the most in 20 years.

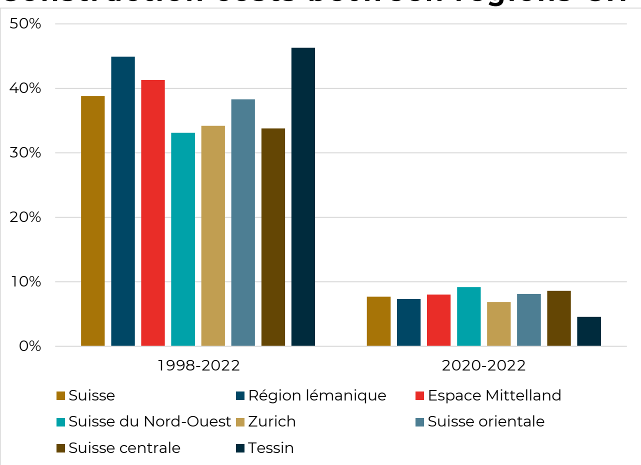
Construction costs



Source : Bloomberg, XO Investments SA

Nevertheless, construction costs do not evolve uniformly over a territory. In Switzerland over the period 1998-2022, costs rose more in Ticino and the Lake Geneva region. This mirrors the increase in property prices. Over the last two years, it is North-Western and Central Switzerland that are most affected by cost increases, while Ticino is the least affected region.

Construction costs between regions CH



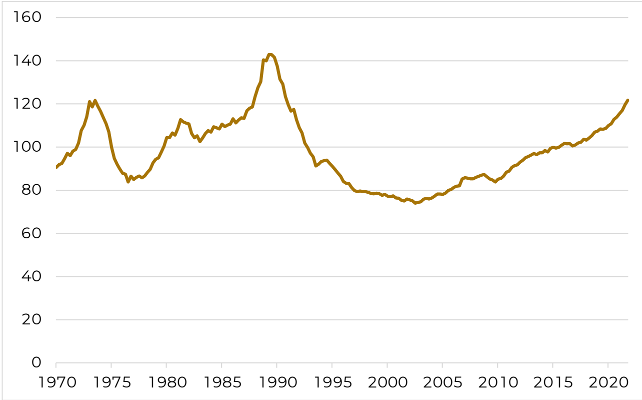
Source : Bloomberg, XO Investments SA

Buying is becoming more expensive than renting

Rising construction costs, rising house prices and rising mortgage rates are having an impact on the attractiveness of buying as opposed to renting.

The ratio of property prices versus rentals in Switzerland has risen significantly over the past 10 years. Nevertheless, this figure is still lower than the bubble period of the early 1990s. In 2022 the 1973 level with be reached.

Price/rental ratio in Switzerland

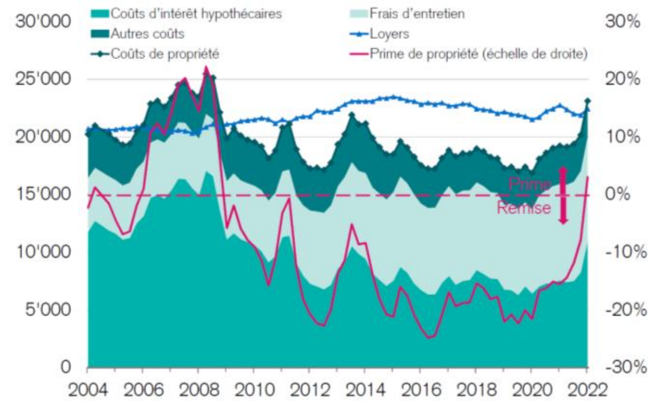


Source : Bloomberg, XO Investments SA

Credit Suisse, in one of its recent studies(below) made the comparison between buying and renting, taking into account all cost factors for housing. For the first time in 13 years, buying is becoming more expensive than renting. The property premium becomes positive again, by approximately 3%, at the beginning of 2022.

This increase in the property premium is the result of rising mortgage rates. Mortgage interest rates remain the decisive factor in the cost of ownership.

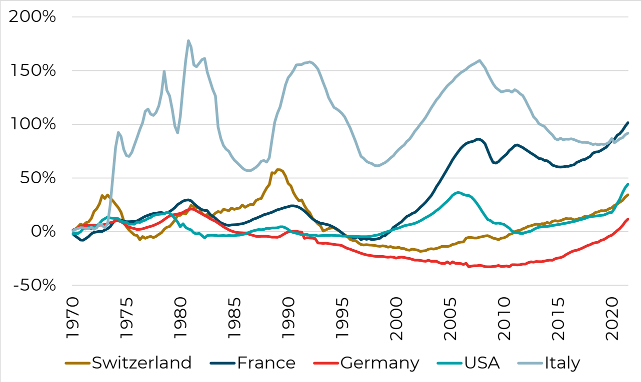
Comparison of purchase and rental in Switzerland



Source : Crédit Suisse, BNS

The ratio between house prices and rentals behaves very differently from country to country. Germany has not seen this statistic increase over the last 50 years. Despite a drop at the beginning of the millennium, the ratio has remained stable over the period. Italy, however, has seen this ratio change significantly from one period to the next, depending on the interest rates. In France, property prices have doubled in relation to rentals in 20 years. It is becoming increasingly expensive in France to move from renting to owning. This summarises the difficulty of young French households to find a property in their budget, explains the migration from the city centres to the countryside and validates the legislative change of President Macron by orienting the taxation not on wealth but on real estate wealth to rebalance things.

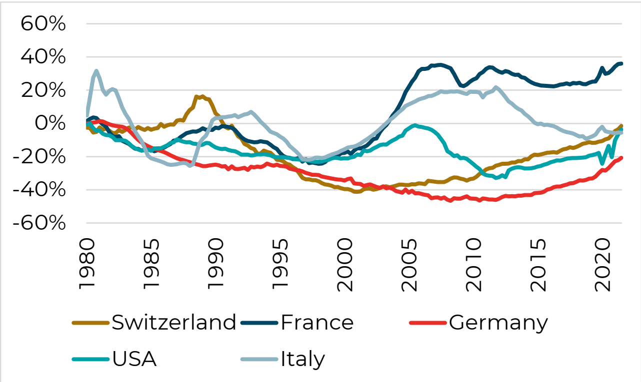
Comparison of price/rental ratio



Source : Bloomberg, XO Investments SA

The same conclusions can be drawn from the study of the ratio between property prices and income. Property is now much more difficult to afford in France in relation to median income.

Comparison of price/income ratio

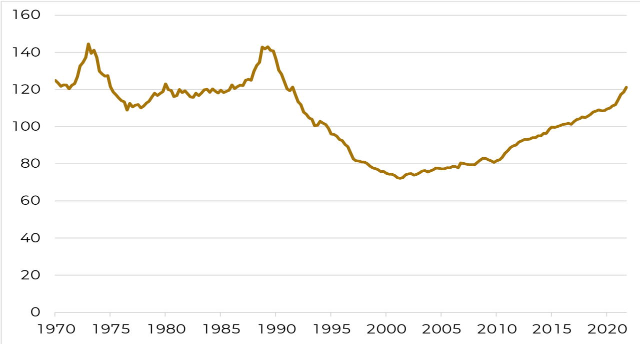


Source : Bloomberg, XO Investments SA

Focusing on Switzerland, and contrary to popular belief, the price/income ratio is not excessive in historical comparison. We are back to the levels of the 1970s and 1980s. Only in the period from 1990 to 2000 has the ratio fallen massively.

Switzerland stands out, however, as the proportion of homeowners is much lower than the OECD average, while the debt levels of homeowner households are much higher.

Price / income ratio in Switzerland



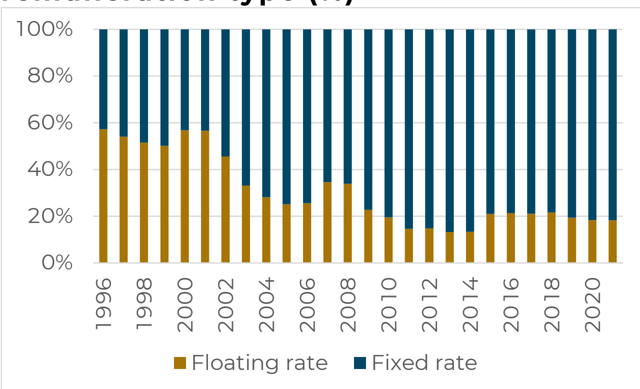
Source : Bloomberg, XO Investments SA

Swiss market prepared for higher rates

The rise in interest rates marks a change for the real estate sector as after a period where becoming a homeowner was cheaper than staying a tenant, we are now back to a situation of a property premium. The period of negative interest rates being abnormal, the property market can also be considered as returning to normal.

Although property prices have risen sharply, the ratios between property prices and rental prices or prices in relation to income remain correct. Only in some countries are the levels too high and subject to correction.

Mortgages in Switzerland by remuneration type (%)



Source : Crédit Suisse, BNS

Despite its high level of private debt, Switzerland seems to be prepared to absorb a rise in interest rates. Nearly 80% of mortgage debt is at a fixed rate. The rise in rates will therefore not have an immediate impact on households, which will have time to adapt to the new market conditions.

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