

MARKET REVIEW

A blow to the markets

August started well, following on from July's progress. Unfortunately, the speech by Jerome Powell (FED chairman) at the end of the month left little hope for an immediate change in monetary policy. For Europe, fears of energy shortages are still weighing on the economic outlook and are causing electricity prices to soar.

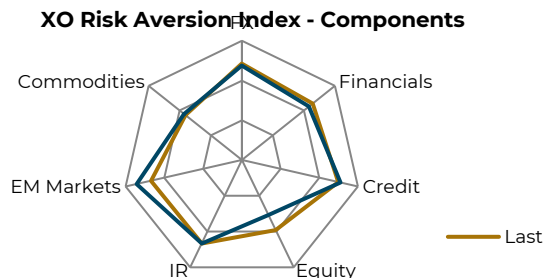
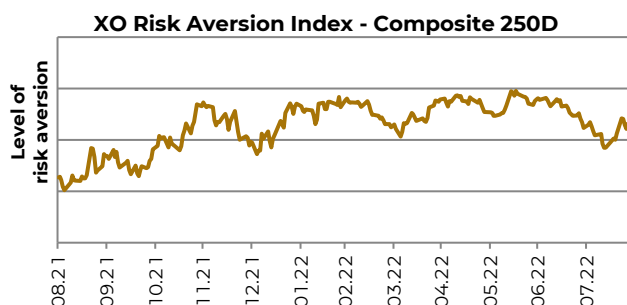
Equities are therefore back on the decline with European markets particularly impacted. Brazil is atypical in this complicated year.

Interest rates did the opposite, rising sharply in August and completely erasing July. Bonds are therefore heavily impacted and show annual performances of -10%. Swiss real estate follows the same pattern.

The EUR is under pressure, as are commodities, led by oil and gold.

The overall risk indicator is slightly up on all parameters.

	Value	August	2022
Equity markets			
Switzerland (SMI)	10 855	-2.61%	-15.69%
United States (S&P500)	3 955	-4.24%	-17.02%
Europe (Euro Stoxx 50)	7 940	-5.10%	-16.34%
Japan (Nikkei)	28 092	1.04%	-2.43%
China (Shanghai SE)	3 202	-1.57%	-12.02%
Brasil (Bovespa)	109 523	6.16%	4.48%
Currencies			
USD/CHF	0.975	2.39%	6.82%
EUR/CHF	0.983	0.98%	-5.25%
GBP/CHF	1.137	-1.96%	-7.91%
EUR/USD	1.005	-1.63%	-11.58%
Other asset classes			
Swiss Real Estate		-0.97%	-12.95%
Swiss Bonds		-2.84%	-9.82%
Foreign Bonds		-2.94%	-10.48%
Commodities		-2.68%	32.10%
Oil	89.55	-9.20%	19.07%
Gold	1 716.22	-2.82%	-6.18%
Rates / Indicators			Δ
10 years Swiss rate		0.84%	0.97%
10 years US rate		3.19%	1.68%
US Unemployment		3.50%	-0.40%
US GDP		1.70%	-3.80%
US CPI		5.90%	0.40%



THE ELECTRICITY FAIRY CASTS A BAD SPELL

The rise in oil prices is not an isolated phenomenon, as all energy sources, especially electricity, are exploding. This increase reflects Europe's dependence on Russian gas.

Price explosion

Over the past year and the end of Covid, oil prices have literally exploded. In April 2020, at the height of the crisis, oil was trading below \$20, before beginning an impressive rebound to \$75 at the end of 2021. The outbreak of the war in Ukraine and the various sanctions that were put in place only accelerated the phenomenon. Oil then exceeded \$120 in the spring.

Oil price per barrel (\$)



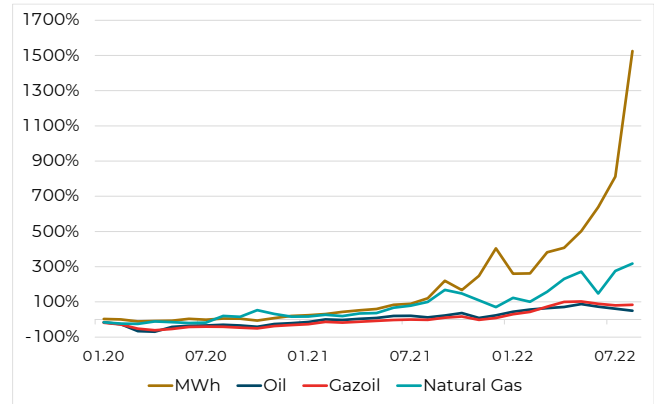
Source : Bloomberg, XO Investments SA

Unfortunately, this phenomenon is not isolated to oil. However, incredibly, oil is the least affected, in relation to other energy sources !

While diesel behaves relatively similarly to oil, natural gas and critically electricity have experienced soaring prices. Natural gas is three times more expensive than a year ago, while electricity is eight times more expensive!

This movement is largely due to the end of Russian exports of natural gas, which is not only used directly by industry but also in gas-fired power stations to produce electricity. Even if the phenomenon was largely accelerated by the war, the increase started long before. It is the result of an increase in gas consumption for electricity generation in Germany following the shutdown of nuclear power. And as 50% of French nuclear power plants are shut down due to corrosion problems, no one is able to provide compensatory energy.

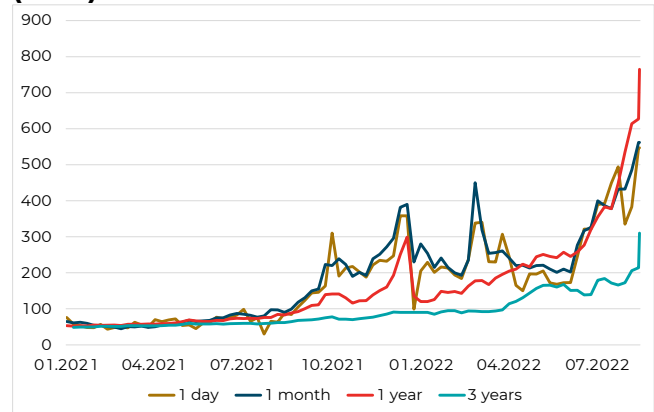
Evolution of the cost of energy sources



Source : Bloomberg, XO Investments SA

This devastating rise in electricity prices has occurred, regardless of time frames, whether purchasing, immediately (either spot or 1 day), 30 days or annually. Only long-term purchases (3 years and beyond) remained below this level, increasing only by a factor of 5 and not by 20...

Comparison of MWh cost by maturity (EUR)

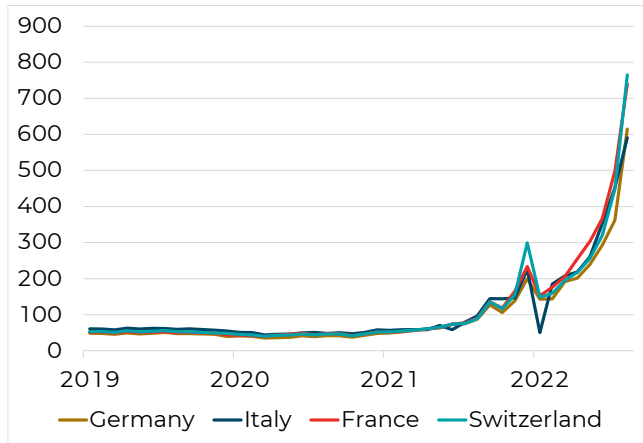


Source : Bloomberg, BNS

Swiss energy dependency

Each country has slightly different prices depending on its power generation capacity and the period. Unfortunately, they all suffer equally.

MWh cost

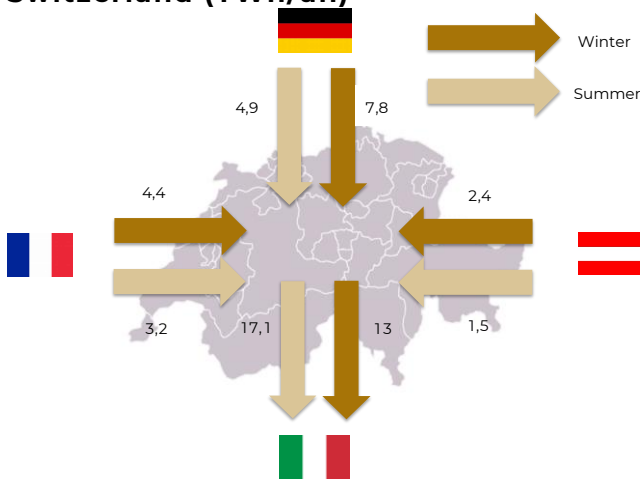


Source : Bloomberg, BNS

France is seeing its price rise the most. Indeed, the decrease in nuclear production forces France to use other, more expensive energies. Traditionally, when prices rise in winter and Switzerland is an importer, Swiss prices adjust to match the most expensive country, namely Italy. When Switzerland becomes an exporter, in summer, prices stick to the cheapest country, i.e. German prices. This trend is somewhat modified this year, but Switzerland closely follows the highest price.

Switzerland is at the center of Europe, especially in energy matters. Switzerland imports from France, Germany and Austria but exports to Italy. Every year, 10% of the total amount of electricity exchanged between the 34 European countries passes through Switzerland.

Import/export balance of electricity in Switzerland (TWh/an)



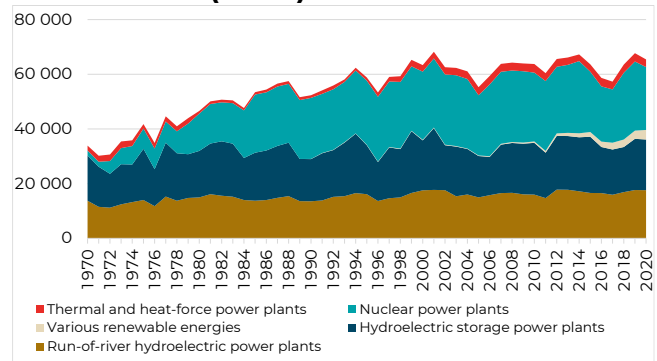
Source : Bloomberg, XO Investments SA

Switzerland produces 65,000 GWh per year. 35% of this production comes from nuclear power. This is the source that has made the most progress in 40 years. 55% of Swiss electricity is produced by hydroelectric power stations,

making Switzerland a leading country in green energy. This source of energy has the great advantage of being precise and flexible, allowing production imbalances to be overcome. Only 4% comes from thermal power plants that emit CO₂.

The European mix is on average less virtuous than what Switzerland offers. France stands out for having a production essentially based on nuclear power.

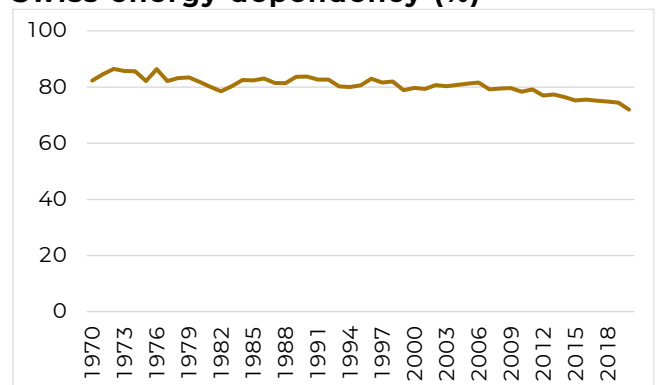
Domestic electricity production in Switzerland (GWh)



Source : OFEN, OFS, XO Investments SA

Unfortunately, the increase in production capacity in Switzerland over the last 50 years has not been sufficient to supply the Swiss market, which is becoming increasingly dependent on imports. Whereas in 1970 Switzerland had to import just under 20% of its energy, it is now 30% that has to be purchased to meet demand. Switzerland, like Europe, is becoming more dependent on external providers for its energy with the closure of a nuclear power plant (Mühleberg) and the constant increase in consumption.

Swiss energy dependency (%)

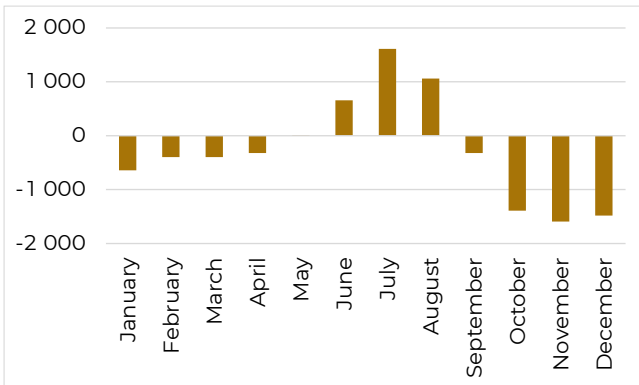


Source : OFEN, OFS, XO Investments SA

This dependence is not uniform. While Switzerland exports electricity in the summer months, it becomes an importer from

September until spring. In winter, about 20% of consumption is covered by imports.

Difference between production and consumption of electrical energy in Switzerland (GWh, 2021)



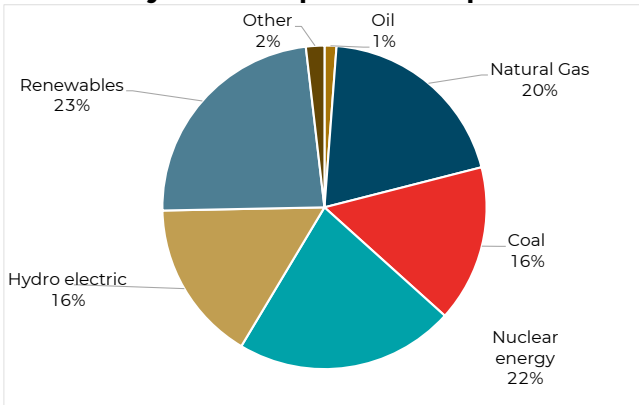
Source : Swissgrid, XO Investments SA

A European problem

This occurrence of winter dependence is identical to Europe.

In Europe, 35% of the electricity consumed comes from fossil sources: oil, gas or coal. Hydroelectricity and renewable energy sources account for almost 40%, which is well ahead of the other continents. In winter, the production of electricity from gas is unfortunately not 20% but 30%, which makes Europe a continent very dependent on this raw material which it does not produce.

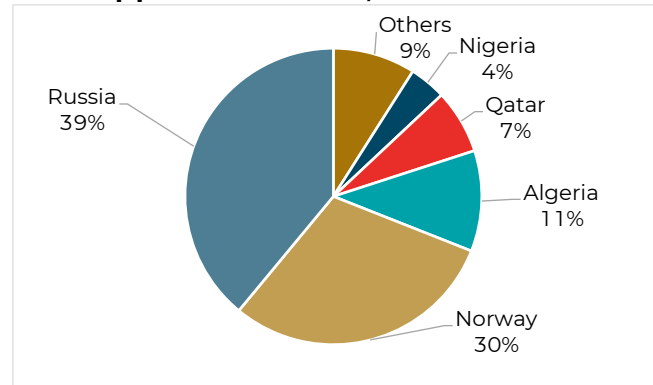
Electricity consumption Europe



Source : BP Stat Review, XO Investments SA

Europe's problem is that gas becomes a crucial source in winter for electricity generation, and its main gas supplier is none other than Russia.

Gas supplier to the UE, 2019



Source : BP Stat Review, XO Investments SA

Seeking to limit the impact of the sanctions on gas, Europeans began to seek to stockpile and the panic in the markets resulted in a sharp rise in the price.

No oil ... ideas ?

After more than a decade marked by the desire to phase out nuclear power and little investment in alternative infrastructure, Europe is facing its fate. Demands to reduce consumption are increasing and fears of shortages are growing. Europe has no oil or gas, so it is time to get some ideas or risk a cold shower, literally and figuratively...

The people of Europe could pay the price for the lax energy policies of the past decades and the geopolitical failures that have led to a major conflict on European soil. Europeans will have to define a coherent energy policy and avoid the glaring discrepancies between completely opposite strategies: electrification of the entire car fleet but use of coal-fired power stations, reduction of CO2 emissions but suppression of nuclear power, installation of windmills but deforestation. The electricity fairy is casting a very bad spell on us. Let's hope that this is not the spark that ignites the powder keg and leads us to even more serious conflicts.