MONTHLY COMMENT

September 2022

MARKETS REVIEW

Rising rates as a trigger for a storm

The rise in interest rates, which, after a pause in the summer, has resumed with renewed vigour, is hitting all financial assets like a storm. The energy crisis in Europe and the rumblings in Russia are not easing the situation.

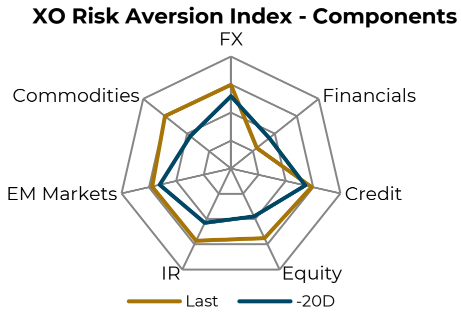
Equities are the first victims of this gust of wind with annual performances of around -20%. Despite its traditionally defensive nature, the Swiss index is affected to the same extent as the United States and Europe.

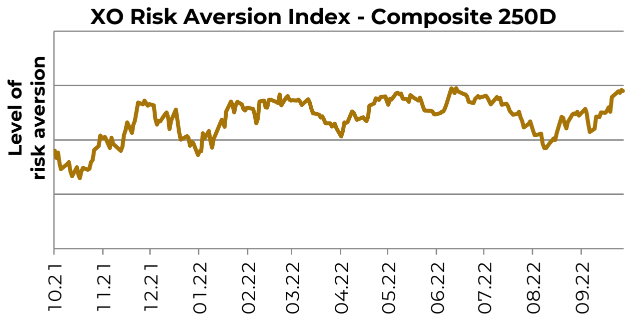
The tension on interest rates, with movements by the main central banks in September (+75 basis points in the USA and Switzerland), caused the bond and property indices to plunge. A rare phenomenon, performances are similar to those of equity indices.

In terms of currencies, the USD remains strong but the EUR and GBP are in free fall in a European market that is petrified by inflation. Inflation is no longer even reflected in rising commodity prices. Oil is falling massively, returning to the level of early autumn 2021 and showing almost no growth over the year. Gold is also down by 10%.

The risk indicator is up on all parameters except financials.

	Value	September	2022
Equity markets			
Switzerland (SMI)	10 268	-5.41%	-20.26%
United States (S&P500)	3 586	-9.34%	-24.77%
Europe (Euro Stoxx 50)	7 499	-5.57%	-20.99%
Japan (Nikkei)	25 937	-7.67%	-9.91%
China (Shanghai SE)	3 024	-5.55%	-16.91%
Brasil (Bovespa)	110 037	0.47%	4.97%
Currencies			
USD/CHF	0.987	1.21%	8.12%
EUR/CHF	0.967	-1.33%	-6.76%
GBP/CHF	1.102	-2.77%	-10.61%
EUR/USD	0.980	-2.50%	-13.79%
Other asset classes			
Swiss Real Estate		-4.38%	-16.76%
Swiss Bonds		-2.02%	-11.64%
Foreign Bonds		-3.49%	-13.60%
Commodities		-7.80%	21.80%
Oil	79.49	-11.23%	5.69%
Gold	1 660.61	-3.24%	-9.22%
Rates / Indicators			**Δ**
10 years Swiss rate		1.23%	1.37%
10 years US rate		3.83%	2.32%
US Unemployment		3.70%	-0.20%
US GDP		1.80%	-3.90%
US CPI		6.30%	0.80%





DIVERSIFICATION UNDER PRESSURE

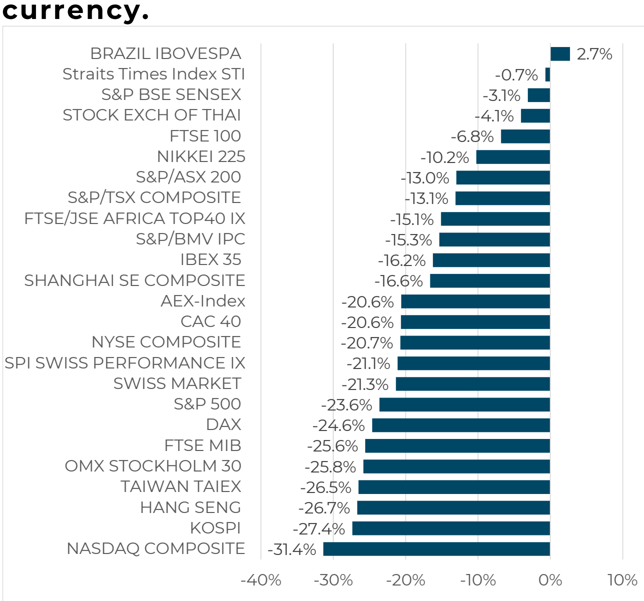
Inflation and rising interest rates lead to a temporary synchronization of all asset classes, thus undermining the principle of diversification.

Synchronised asset classes

The construction of a portfolio is based on a fundamental principle: diversification. Diversification between asset classes (shares, bonds, real estate) but also diversity within asset classes. Financial theory shows, for example, that for a portfolio of European equities, at least 20 securities should be held to limit the so-called "specific" risk. For this reason, portfolios are often made up of investment funds that provide access to various geographical regions, thus improving diversification.

Unfortunately, 2022 is putting the fundamental basis of portfolio construction methods to the test. Equity markets are falling uniformly. Only a few peripheral markets are more resilient, such as Brazil (which was negative in 2021), but from Europe to the US to Switzerland, markets have fallen sharply.

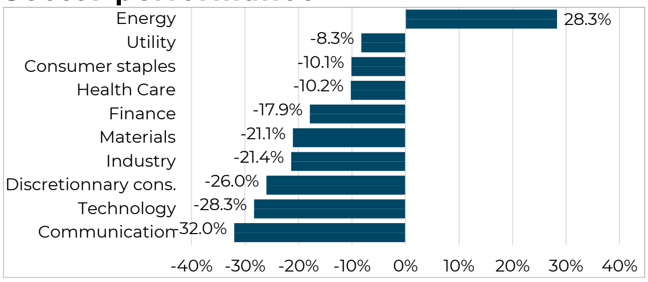
Equity market performance in local currency.



Source : Bloomberg, XO Investments SA

This decline is all the more significant in innovative sectors such as technology, represented by the Nasdaq index. In isolation, the energy sector is the exception in 2022.

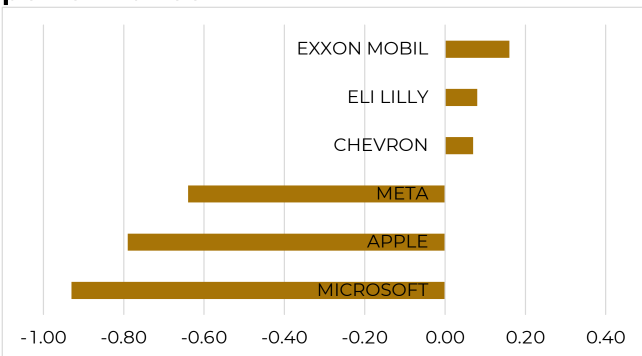
Sector performance



Source : Bloomberg, XO Investments SA

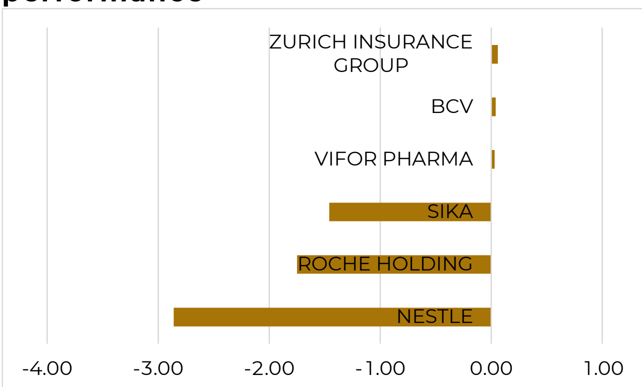
Taking a closer look at the core of the MSCI World Index, the most negative contributors are Microsoft and Meta. Microsoft alone contributes 0.93% negatively to the world index. Oil companies such as Exxon or Chevron are the only stocks that contribute to performance.

Main contributors (%) to MSCI World performance



Source : Bloomberg, XO Investments SA

Main contributors (%) to SPI performance

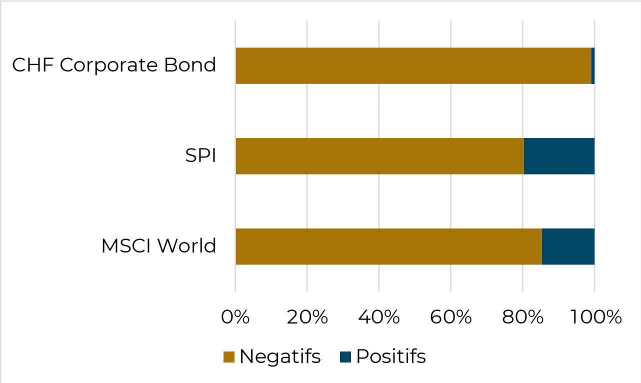


Source : Bloomberg, XO Investments SA

The observation is similar for Switzerland. Index heavyweights Nestlé and Roche are responsible for 2.86% and 1.75% of the performance contribution respectively, or 25% of the total index decline. These figures are colossal.

The difficulty with 2022 is that nearly 80% of stocks are in negative territory. In this context, it is difficult to find a way out, especially as these stocks are concentrated in a sector that is unloved by so-called "ESG" investors, i.e. those who favour the environment.

Share of negative securities



Source : Bloomberg, XO Investments SA

The figures are even more impressive for bonds. For the CHF corporate bond index, more than 99% of the securities are down for the year! And the results are the same for government bonds or more global indices, or even Swiss real estate

Performance Bloomberg US Aggregate Bond TR in USD.

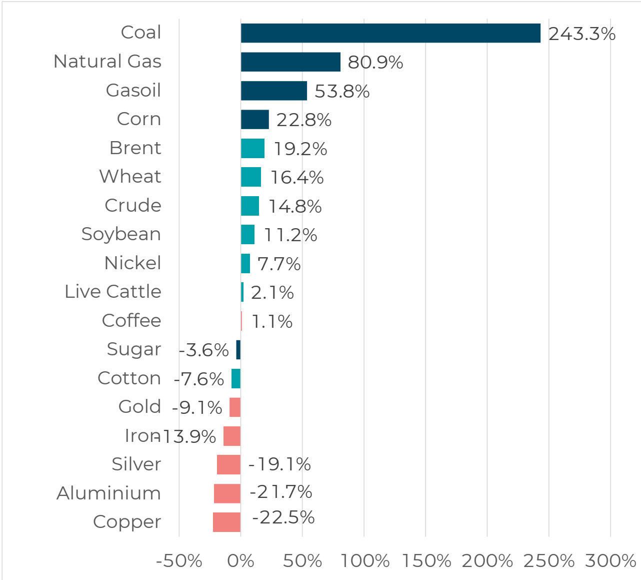
Year	Perf.	Year	Perf.	Year	Perf.
1977	9.63%	1993	11.26%	2009	6.50%
1978	2.79%	1994	0.36%	2010	8.13%
1979	3.55%	1995	9.50%	2011	5.37%
1980	-1.29%	1996	7.62%	2012	6.59%
1981	3.13%	1997	7.63%	2013	0.47%
1982	20.98%	1998	10.25%	2014	2.69%
1983	21.60%	1999	3.35%	2015	3.23%
1984	8.00%	2000	4.31%	2016	3.42%
1985	21.46%	2001	12.35%	2017	1.11%
1986	21.33%	2002	7.81%	2018	-0.32%
1987	5.52%	2003	7.89%	2019	7.10%
1988	7.92%	2004	3.80%	2020	8.65%
1989	10.10%	2005	3.68%	2021	0.45%
1990	9.01%	2006	2.27%	2022	-14.23%
1991	13.18%	2007	5.81%		
1992	12.39%	2008	5.85%		

Source : Bloomberg, XO Investments SA

This year is also the worst since the construction of the global bond indices. Not since 1977, when it was launched, has the Bloomberg Global Bond Index had such a poor performance. Only 3 years are negative and 2022 is far beyond the worst historical performance.

Diversification between asset classes is not working this year either if one invests in commodities outside energy. Precious metals, some industrial metals or agricultural products have lost much of the good performance of the first quarter of 2022 despite still high inflation figures.

Main commodity prices in usd



Source : Bloomberg, XO Investments SA

Asset correlation figures confirm the convergence of asset classes in 2022. While the correlation coefficient between the Swiss Equity Index (SPI) and the Swiss Bond Index (SBI) was only 11% since 2016, it rises to 23% in 2022. The correlation with listed real estate (SWIIT) is also increasing.

Correlations in Switzerland since 2016

	Equities	Bonds	Real Estate
Equities	1	11%	42%
Bonds		1	38%
Real Estate			1

Source : Bloomberg, XO Investments SA

Correlations in Switzerland in 2022

	Equities	Bonds	Real Estate
Equities	1	23%	49%
Bonds		1	54%
Real Estate			1

Source : Bloomberg, XO Investments SA

Markets returning to normal

The difficulties of the year are largely due to the significant rise in interest rates as a result of inflation. However, this rise in interest rates is not only negative.

Indeed, in August 2019, a period of extremely low rates, the main CHF bond funds were offering largely negative yields to maturity and contained up to 95% of negative yield positions.

Swiss bond yields August 2019

Fund	Weight of bonds with negative YTM	Weight of bonds with positive YTM	Average YTM
CSIF Switz. Bond Index AAA-BBB	95.9%	4.1%	-0.59%
UBS Bonds CHF Inland Pas	95.3%	4.7%	-0.54%
Pictet -CHF Bonds	92.6%	7.4%	-0.63%
iShares Core CHF Corp Bond	86.4%	13.6%	-0.32%

Source : Bloomberg, XO Investments SA

This period seems to be over for good, as 100% of the positions held by the main investment funds in this asset class now offer positive returns.

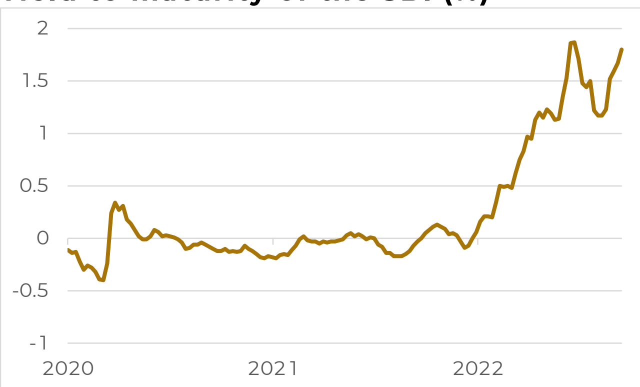
Swiss bond yields September 2022

Fund	Weight of bonds with negative YTM	Weight of bonds with positive YTM	Average YTM
CSIF Switz. Bond Index AAA-BBB	0.2%	99.8%	1.89%
UBS Bonds CHF Inland Pas	1.6%	98.4%	1.84%
Pictet -CHF Bonds	0.7%	99.3%	2.00%
iShares Core CHF Corp Bond	-0.1%	100.1%	2.41%

Source : Bloomberg, XO Investments SA

The yield to maturity of the Swiss Bond Index (SBI), like all global indices, has risen massively. This yield to maturity is approaching 2%, which means that investors will once again be able to invest in a low-risk asset class with the prospect of a return.

Yield to maturity of the SBI (%)

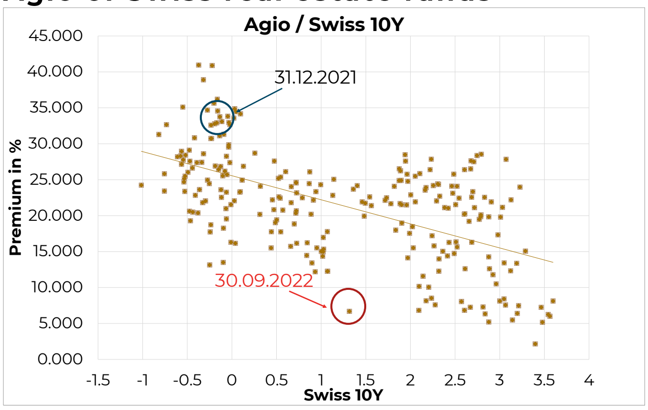


Source : Bloomberg, XO Investments SA

Real estate is in a similar situation with a collapsing premium. The premium between the value of the funds and the value of the real estate has melted away over the past 9 months. Whereas it was over 30% at the end of 2021, it is now around 10%, even though interest rates have not risen at a rate that could justify such a movement. There is even a certain imbalance in the following graph, which represents the historical relationship between 10-year rates in Switzerland and the average agio. Each point represents the average of all Swiss funds over one month for the last 20 years.

The line below represents the equilibrium relationship between the two parameters: rates and fees. The value on 30 September is at the very bottom of the line. This means that we have moved away from the equilibrium. Two paths are possible: increase in rates (shift to the right) or increase in the premium (shift upwards).

Agio of Swiss real estate funds



Source : Bloomberg, XO Investments SA

Opportunities to take advantage of

Many opportunities are emerging in a market shaken by inflation and energy fears. Bonds or some listed real estate positions are starting to offer returns more in line with the risk of these asset classes. Even if it is difficult to establish a precise time path, the end of the negative interest rate period in the main currency areas will allow us to return to the cornerstone of portfolio construction: diversification.

XO INVESTMENTS SA
info@xoinvestments.ch
www.xoinvestments.ch

HEAD OFFICE
Fbg de l'Hôpital 10 – CH-2001 Neuchâtel
+41 32 722 60 10

CONTACT ADRESS
Rue du Mont-Blanc 7 – CH-1211 Genève
+41 22 910 20 30