



# Market Commentary

## 3rd Quarter 2023

### Interest Rates at Multi-Year High

#### Market and Economic Developments

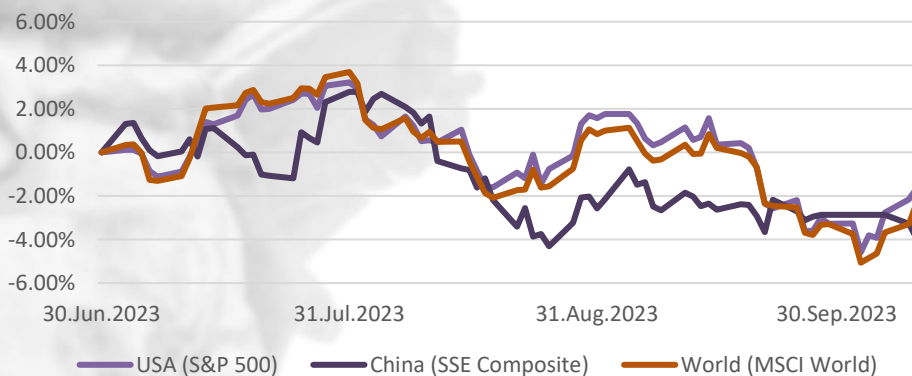
At the quarter's onset, stocks were robust until a significant correction in August. This was primarily due to concerns about the manufacturing sector and, in some instances, escalating inflation figures that triggered a securities sell-off. Additionally, China's economy, particularly the real estate sector, showed signs of further deterioration. This was highlighted by the crisis surrounding the Country Garden real estate group, which sought a moratorium from its lenders in August. Consequently, Chinese indices fell in line with the economic outlook (Fig.1).

In August, Fitch downgraded the U.S. credit rating to AA+, citing an unbalanced government budget. Despite a preliminary agreement on the budget dispute, market volatility persisted. The removal of the Speaker of the House of Representatives particularly caused stock market volatility to spike. The U.S. Congress now faces the challenging task of reaching a bipartisan compromise swiftly to avoid a shutdown.

As winter approaches, energy issues regained prominence. However, the rising oil price also reflects Saudi Arabia's reduced production volume, which is expected to continue until year-end. The renewed conflict involving Israel also pushed up oil prices due to fears of escalating hostilities.

In Switzerland, UBS's semi-annual report was a focal point of the third quarter. Credit Suisse's business showed signs of stabilization in the second quarter. Additionally, an ambitious timeline for a merger set to be finalized in 2024 was unveiled.

Figure 1: Equity Indices



Source: Refinitiv, Datastream as of 10.10.2023



#### Key Takeaways

- There were slight stock price gains at the beginning of the quarter and losses towards the end.
- Political power plays complicated the resolution of the budget dispute in the U.S. towards the end of September.
- Interest rates reached a multi-year high while inflation declined towards the end of the quarter.
- Gold saw a slight increase at the start of the quarter before losing significant value. However, it rebounded in the early days of October due to the conflict in Israel.
- Crude oil increased in value throughout the quarter due to heightened demand in the summer and a supply shortage.

## Monetary Policy

The battle against inflation remains unresolved, as echoed by central banks globally. In Q3, they once again hiked interest rates, with the U.S. Federal Reserve pausing towards the end. Unexpectedly, the Swiss National Bank (SNB) also opted to maintain current interest rates, while the European Central Bank (ECB) continued with rate hikes.

Central banks are particularly focused on core inflation, which excludes energy and food prices. Although it is declining, it is only slowly approaching the target range. In the U.S., inflation has also increased in August but remains low. The inflation surge is primarily attributed to higher oil prices due to seasonal summer travel demand. Coupled with Saudi Arabia's voluntary production cut and Russia's partial loss as a supplier, oil prices soared. Consumers immediately felt the impact of rising energy prices at gas stations. Housing-related costs such as rent were another major driver of inflation. Certain base effects, which had previously caused inflation rates to fall, disappeared after a year, providing another technical reason for the increase.

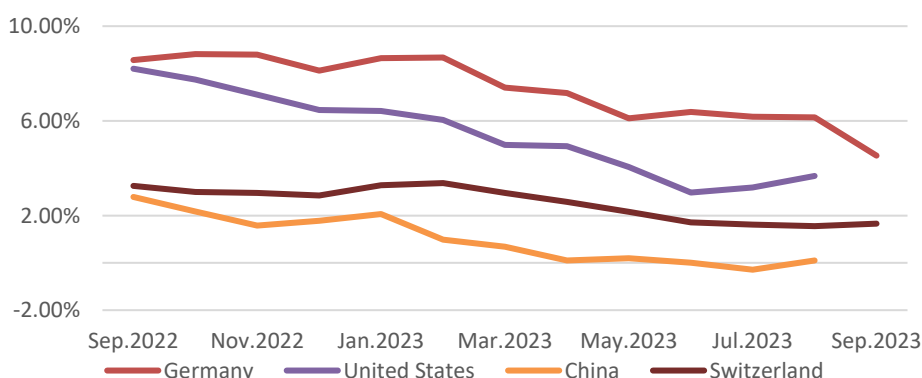
In Switzerland, Q3 inflation was already within the target range of up to two percent. However, the SNB warns of challenges that could reignite inflation in the country. These include second-round effects such as wage increases or higher prices for energy supplies and healthcare.

Rapidly rising interest rates make current floating-rate debt and new debt more expensive. This prompts questions about the sustainability of the substantial government debt that has been accrued over years in a low-interest environment. In 2023, one third of the fixed-interest U.S. debt traded on the market (notes, bills and bonds) is expected to mature and needs renewal.

The housing market situation is also tense. We already discussed the UK housing market situation last quarter. However, this phenomenon, with regional specifics, is global. Canada is another example: Specifically, high residential property prices were financed by debt. Since Canadian mortgages often have short durations or variable interest rates, debtors are particularly affected. Hence, negative amortization is no longer an exception in this market. On a positive note, loans in Canada are granted more conservatively than in the neighboring U.S., resulting only in isolated defaults so far. Many borrowers who took on debt in recent years' low-interest environment are currently suffering from higher interest rates and paying the bills using savings accumulated over recent years.

However, towards the end of Q3, positive economic signals could also be observed. For instance, purchasing manager surveys (PMI) in the manufacturing sector showed slight improvements, especially with still full order books. Likewise, inflation in the euro zone has decreased compared to the previous month, with Germany showing a particularly significant decline.

Figure 2: Inflation Development in Selected Countries



Source: Refinitiv, Datastream as of 10.10.2023



## Market Data

Equity Markets Perf.	2023
SPI	4.59%
DAX	10.77%
Euro Stoxx 50	14.27%
S&P 500	14.97%
Nasdaq Composite	30.43%

Yield to Maturity of Government Bonds	in %
10Y Swiss Federal Bond	1.12%
10Y German Federal Bond	2.78%
10Y US Treasury	4.65%

Gold (oz.) Perf.	2023
in CHF	0.19%
in EUR	3.07%
in USD	2.35%

Commodities Perf.	2023
Oil Brent	10.13%

Year-to-Date (YTD) performance in local currency, as of 10.10.2023

Source: Refinitiv, Datastream

## Financial and Capital Markets

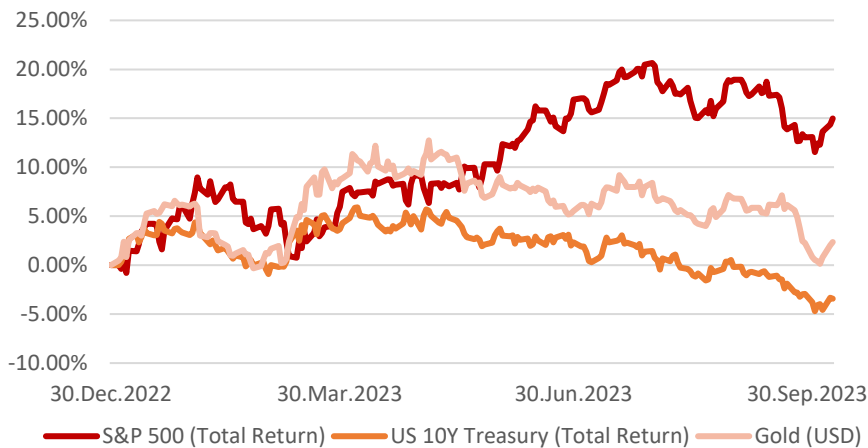
The equity markets experienced a tumultuous quarter. Initially, the stock rally continued as it had in the first half of the year. Stocks from the tourism sector, including Airbnb and Royal Caribbean Cruises, saw gains over the summer and into the first month of Q3. The Japanese stock market also continued its positive performance from the previous six months. However, global economic sentiment was dampened in August due to China's slow recovery from pandemic-induced turbulence. Investor concerns included high unemployment rates among young, educated university graduates, elevated public debt at the local level, and new laws restricting private and foreign companies. These factors, coupled with skepticism abroad, subdued domestic demand, and high Western interest rates, placed significant pressure on globally indebted real estate firms. This culminated in Country Garden missing coupon payments on some dollar bonds. Despite an interim settlement and subsequent share price increases, the group remains heavily indebted.

The crisis in China, domestic political tensions in the U.S., and a high-interest-rate environment led to a correction in equity markets. Concurrently, yields on U.S. bonds reached a multi-year high, with 10-year U.S. government bonds offering a yield-to-maturity of 4.8 percent at one point. This led to discounts on already issued bonds, reflected in their price performance (before interest payments). However, a drop in interest rates at the start of October resulted in significant performance gains for long-duration bonds.

The commodities market also saw substantial fluctuations. Crude oil emerged as a winner; despite starting the quarter in negative year-to-date territory (in CHF), increased summer travel demand and an artificial supply shortage drove prices up sharply. EUR and CHF investors also benefited from USD appreciation on their crude oil positions.

Gold had a mixed quarter. Initial slight price gains in July were partially offset by USD depreciation for EUR and CHF investors. Subsequent gold price corrections over the next two months, driven by higher bond interest rates, neutralized annual gains since March. Even USD appreciation towards quarter-end failed to offset this decline for EUR and CHF investors. However, gold benefited from geopolitical uncertainties at the start of October and falling interest rates.

Figure 3: YTD-Performance of the S&P 500, 10Y Treasury and Gold



Source: Refinitiv, Datastream as of 10.10.2023



## Asset Allocation

Asset Class	Positioning
Cash	Overweight
Fixed Income	Underweight
Equities	Small Underweight
Gold	Strong Overweight

- Liquidity is being consistently reduced and invested in the market.
- We continue to selectively purchase bonds, but maintain an underweight position, preferring to invest in the money market.
- The equity selection remains constant. Our existing stocks have significantly contributed to the performance.
- The overweight position in gold will be maintained in the upcoming quarter

## Current Asset Allocation

The bank maintains a defensive stance, particularly with regard to substantial debt in the high-interest-rate environment as a potential hazard. Consequently, the bank selectively invests in both equities and bonds, favoring issuers with conservative financing.

Throughout Q3, we gradually increased the bond allocation across various mandate currencies to capitalize on the high-interest-rate environment. Both government and corporate bonds were targeted in our investment approach. Our investment strategy follows a core-satellite approach, investing in broadly diversified indices and setting selective focuses based on the bank's view. The increase in the bond allocation was offset by a slight reduction in liquidity holdings. Despite the increase, there remains a bond underweight, which is particularly noticeable in CHF, partly due to the lower interest rates in Switzerland.

We also managed to diversify our equity investments regionally in Q3 without increasing the equity quota. However, we remain slightly underweight in equities, which proved advantageous in Q3.

The gold allocation remained unchanged throughout the quarter. Consequently, price declines significantly impacted portfolio performance. However, currency fluctuations slightly mitigated the losses, similar to equities.

Overall, we managed to keep up with our competitors and even gain some ground. This was primarily due to their more aggressive positioning and correspondingly higher equity exposure. Given the increased geopolitical uncertainty and significant price fluctuations, we approach the last quarter of 2023 cautiously and feel well-positioned with our current investment strategy.



Contact

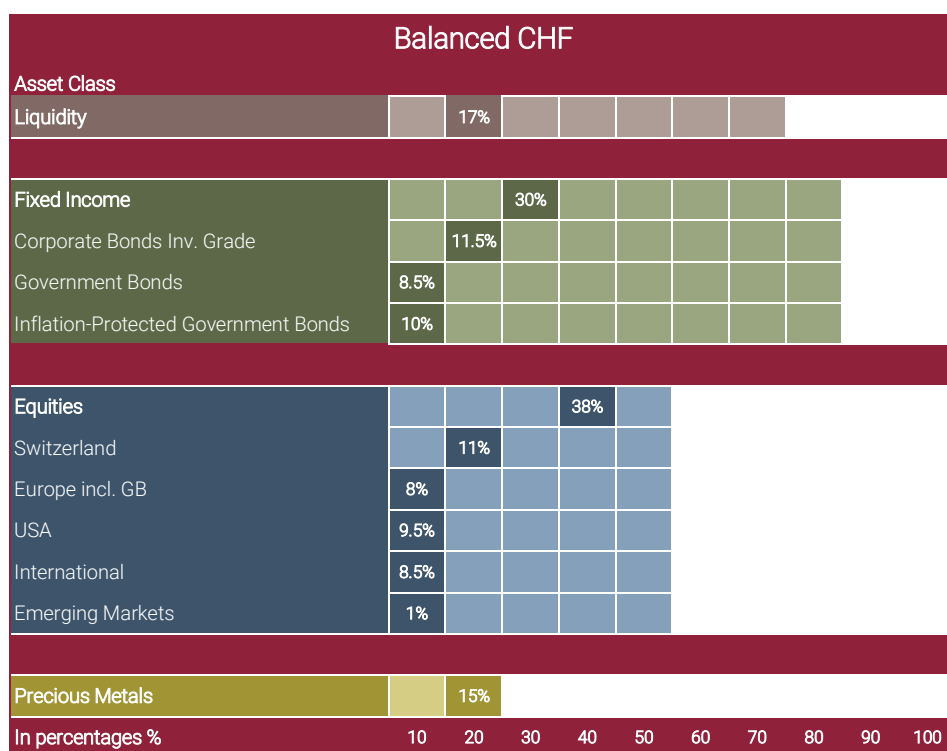
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Figure 4: Current Asset Allocation



This report was published on the 10<sup>th</sup> of October 2023.