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# Investment Report

April 2022

Factum AG
Current positioning:

| Portfolio balanced | Neutral | Current | Change* |
|---|---|---|---|
| Liquidity | 3% | 6% | ↘ (-2%) |
| Bonds | 35% | 31% | ↗ (+2%) |
| Shares | 47% | 48% | → |
| Alternative investments | 15% | 15% | → |

**Changes since the last Investment Report (16 March 2022) & current assessment.*

**Strategy overview**

"The war in Ukraine, the fight against inflation as well as the Covid strategy in China are key uncertainty factors."

The Russian invasion of Ukraine had a seismic impact on international financial markets, although these subsequently bounced back – especially stockmarkets. At present, the situation is such that the war in Ukraine, the fight against inflation and the coronavirus strategy in China represent significant uncertainty factors. Purchasing managers' indices in the United States reflect the very healthy state of the economy there, while the situation in Europe is less positive, underscoring the divergence between the two economic blocs. The USA is geographically far removed from the war, and is largely self-sufficient in terms of energy supplies and food. In addition, Mexico acts as an outsourcing location for US industry, and is also not affected by the war in Ukraine. Moreover, the US economic upturn is being driven by consumption, while the war in Ukraine is weighing on European markets. The German ifo business climate index, for example, tumbled in March and expectations have become gloomier. Rising commodity prices and threats to Europe's energy supplies are adding to inflationary pressures and dampening growth prospects. On the interest rate side, yields on 10-year US Treasuries rose by over 50 basis points in March, reflecting robust economic data. In our view, however, a further increase in the coming months is doubtful. It ultimately depends on the development of inflation and associated expectations. Global stockmarkets have recovered significantly since the start of the war, with the World Equity Index, for example, trading around 8% higher after bottoming out in early March.

World Equity Index


Inflation figures, further stoked by the war in Ukraine, have led to a sharp rise in interest rates at the global level (for example in the USA: the yield to maturity on 10-year Treasuries rose from 1.51% at the end of 2021 to reach 2.58% on 07 April 22). Current events (undermining of purchasing power due to inflation, loss of fiscal support) mean that a weakening of the US economy in the second half of the year cannot be ruled out. This is likely to have an impact on current interest rate forecasts amongst investors. We are taking advantage of the more attractive interest rate levels to reduce our long-standing underweight in bonds, at the expense of the cash ratio. For all reference currencies, the adjustment is being made by means of a passive component in world bonds.

"We took advantage of the more attractive interest rate levels at the beginning of April to reduce the underweight in bonds at the expense of the cash ratio."

Following the initial "state of shock" at the start of the war, which was accompanied by increased volatility, the investment crisis as well as the start of talks to find a solution through diplomatic channels led to a strong rebound on stockmarkets. The US stockmarket in particular was able to recover a large proportion of its losses. In view of the rapid rebound as well as the persistent latent risks and imponderables, at the end of March we sold the part of the equity exposure that we purchased at the beginning of March. Most of the rebalancing was carried out through the world equities segment.

"Rebalancing the equity ratio – at the end of March we sold the part of the equity ratio we bought only at the beginning of March."

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In addition to rising interest rates brought about by the crisis, the emerging market bond investment segment was disproportionately impacted by the widening of risk premiums. Sanctions imposed on Russia led to a previously ubiquitous debtor first suffering a massive credit rating plunge (from BBB to CCC-) and later dropping out of the relevant bond indices. In addition, there was a massive sell-off of government bonds throughout the region, even in countries that were not directly affected (such as Serbia, Romania, Bulgaria, Macedonia, Armenia, etc.). The fund we deploy (Barings Emerging Markets Sovereign Debt Fund) was also affected by this market turmoil. Following discussions with the manager and an in-depth review of the positioning, we decided to increase the exposure back to the original ratio. The yield to maturity within the fund is currently in the region of 7%.

"Rebalancing bonds – increasing the exposure to the original ratio."

Against the backdrop of the above, we are starting the second quarter of 2022 with an overweight of the liquidity ratio. We will merely be making interim allocations to protect the capital base or to take advantage of investment opportunities that may arise. On account of the interest rate situation, we are underweighted in the bond field. To achieve acceptable returns, we are investing in a mix of government and corporate bonds and inter alia use funds with active duration management. We took advantage of the more attractive interest rate levels at the beginning of April to reduce the underweight in bonds at the expense of the cash ratio. We have neutrally weighted inflation-protected bonds and emerging market bonds. The equity ratio is marginally overweighted. In our view, maintaining a balance between "growth" and "value" stocks makes good sense. We have neutrally weighted alternative investments. For diversification reasons, we still consider the inclusion of hedge funds in the portfolio to be adequate. In addition, we have invested a portion in global real estate stocks with attractive returns under the heading of alternative investments. The gold position has proven to be a diversifier and remains a fixed portfolio component, not least against the background of the current geopolitical situation. A detailed breakdown of our current positioning is shown on page one.

"What is our positioning as we go into the second quarter of 2022?"

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## Politics

The human suffering caused by the war in Ukraine is painfully presented to us every day in the media. Geopolitically, Russia's invasion is leading to a realignment between East and West. Within this context, the major power China is likely to weigh its options with great care. One option might be for China to build on the friendship that existed with Russia before the war broke out. Alternatively, America and Europe could also encourage China to break with Russia. A third and realistic scenario is that China is driven primarily by self-interest. The current war poses uncontrollable risks for China, and for this reason Chinese support for Russia is likely to be constrained. In relative terms, the Russian market is small, and Chinese companies will not want to risk losing business with the West.

"Cold War 2.0 – relations between East and West are being shaken up by the war in Ukraine."

The way the war in Ukraine eventually plays out might show China how to win the contest for world domination with the USA, and in particular for supremacy in Asia. China will keep a close eye on how successful and hard-hitting the Western sanctions on Russia turn out to be. Unlike Russia, China has the economic power to assert itself and to flex its muscles. All these aspects will be taken into account in China's assessment some time in the future, when the question of Taiwan comes up. The island of Taiwan lies about 150 kilometres off China's coast and has 24 million inhabitants. Beijing insists that there is only one China and that Taiwan is a breakaway part of it. A possible military conflict over Taiwan would have much more dramatic consequences for the global economy than the current war in Ukraine.

"It will be fascinating to see how China behaves on the Taiwan issue in the medium term – Beijing sees Taiwan as a breakaway province."

China policy is set to remain a balancing act between conflicting interests for many years to come. Despite the realignment of regional blocs, however, it is important to remember that there are still key issues such as climate change that can only be solved collectively. In the case of Europe, it is worth asking how the Old World got itself so dependent on America for security and so dependent on Russia for energy over the past 70 years. The answer is undoubtedly that it was convenient and, of course, cheap. Inexpensive gas combined with streamlined military capabilities helped build prosperous economies with well-structured welfare states. The Russian invasion of Ukraine has been a painful reminder for Europe that it needs to start thinking in geopolitical terms. Tremendous energy dependence exists, and the military needs massive catch-up investment. Practically no NATO country in Europe would be able to conduct a war against Russia.

"How could Europe have become so dependent on the US for security and on Russia for energy?"

**Economy**

"Inflation hits new highs."

Inflationary pressures remain very high and are not limited to energy prices. For example, inflation in the Eurozone rose significantly again in March and currently stands at 7.5%. The core rate, which excludes energy and food prices, is significantly lower at 3%, but nevertheless well above the ECB's target of 2%. In the US, inflation figures for March will be published in mid-April. These are expected to show that inflation has soared well above the 8% mark. Moreover, the US core inflation rate of 6.4% is already very high. The US Federal Reserve has clearly stated that it intends to raise the base rate at each of the six remaining meetings this year, whereby rate steps of 50 basis points cannot be ruled out. At the press conference that followed the last meeting of the Federal Open Market Committee, Fed Chair Powell had also described the US labour market as being "unhealthily tight". Recent data has provided further evidence of this. For example, the number of job vacancies in February again exceeded 11 million, which shows that companies are still having great difficulty finding enough staff to fill their vacancies. This is also supported by signs that many Americans are continuing to quit their jobs in order to take up better-paid employment.

"The factors currently driving inflation are complex."

Inflation is unlikely to ease in the next quarter – assuming that geopolitical tensions persist and supply chains remain interrupted – even if commodity prices remain at today's levels or perhaps return to pre-war levels. The war in Ukraine is reinforcing already-existing de-globalisation trends as well as the problem of supply bottlenecks. In addition, the Chinese government's zero-Covid strategy is worsening the supply chain issue, and a move away from this strategy is not anticipated any time soon. Recent purchasing managers' survey results indicate that delivery times have continued to lengthen.

"The war in Ukraine is having an impact on European economic data."

Economic data coming out of Europe demonstrates that the war in Ukraine is having an impact on sentiment indicators. Economic confidence, for example, fell significantly in March to its lowest level in eleven months. Worsening sentiment is mainly attributable to the slide in consumer confidence. Uncertainty among consumers is currently very acute, which is why the momentum of private consumption is likely to weaken significantly. In the industrial sector and retail trade in particular, the outlook has clouded markedly, while the current situation has changed only marginally. Sentiment within the service sector, on the other hand, brightened somewhat due to the lifting of coronavirus restrictions.

In the United States, by contrast, consumers are holding up better. This is mainly due to the fact that employment growth remains strong, coupled with the relatively robust state of the economy. The outlook for households, on the other hand, has continued to deteriorate and was gloomier than at any time in the past eight years. This has also been brought about by record high inflationary expectations, which has undermined the financial outlook for households. Despite this, households have not reduced their consumption significantly of late. This is probably because they had been able to build up savings. Thanks to a strong January – consumer spending at the start of the year has again been revised sharply upwards – real consumer spending is also likely to have grown quite robustly in the first quarter, making a solid contribution to GDP growth.

"In contrast to Europe, the economic situation in the US is very different."

In China, the downside of the zero-Covid strategy is the significant deterioration in purchasing managers' indices. The severe measures being used to contain the spread of the virus caused the PMI Composite, which tracks the overall economy, to fall from 51.2 to 48.8 points, the first time it has been in the contraction zone since last August. While industry shrank only slightly, the service sector – which entails more face-to-face contacts – experienced a sharper decline.

"The impact of the zero-Covid strategy is a strain on the Chinese economy."

**Equity markets**

The war in Ukraine together with the imposition of more restrictive monetary policies have been the "game changers" in the current investment year. Russia's invasion of Ukraine is likely to have come as a surprise to most market watchers. Thereafter, trading was decidedly jittery. For example, European equities, see chart below, dropped by some 19 percent at their peak. At the same time, volatility spiked. In recent years, this has only been surpassed during the 2008 financial crisis and the 2020 pandemic. As so often in the past when military conflicts have broken out, there was a rapid rebound. The Swiss stockmarket, for example, which has a defensive profile, has gained around 10% since bottoming out at the beginning of March. The war and the monetary policies pursued by major central banks are likely to have a significant impact on the performance of stockmarkets over the coming months. It seems unlikely that military tensions will ease any time soon. Due to the strong recovery in March, we believe there is only limited potential for sustained higher equity prices.

"The war in Ukraine together with more restrictive monetary policies have been the game changers in the current year."

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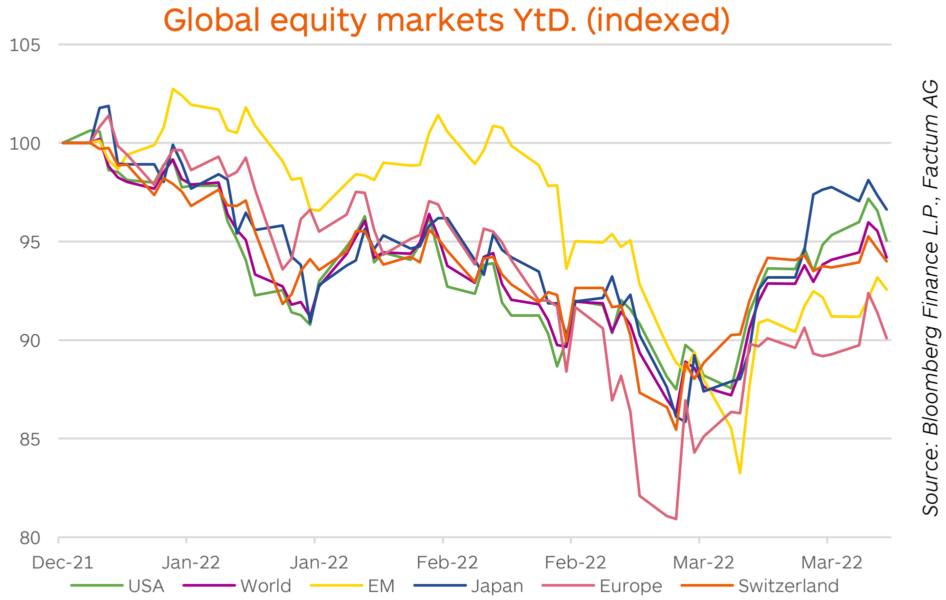


Stiff economic sanctions against Russia and rising energy prices are putting financial stocks and cyclical consumer shares under huge pressure. In recent years, Ukraine has become a supplier for the automotive industry in Europe, producing cable assemblies. According to estimates, the current squeeze on supplies is leading to a production shortfall amounting to three percent, with European manufacturers being hit hardest.

"Financials and consumer cyclicals under pressure."

**Bond markets**

There was news from the US Federal Reserve in mid-March. For the first time since 2018, it raised its base rate by 25 basis points. All members of the Federal Open Market Committee voted in favour of the rate hike, with the exception of James Bullard, who called for a 50 basis point increase. The Federal Reserve also left no doubt that, despite current geopolitical events, the fight against inflation is a top priority and stated that further interest rate hikes were both appropriate and set to follow. The dot plot depicting the monetary watchdog's rate hikes unequivocally underscores this goal. Indeed, projections suggest that there will be eight rate hikes in the current year with a May rate move that is likely to amount to 50 basis points.

"Fed is planning a rate hike at each meeting this year."

It is paradoxical: While equities have recovered significantly since the beginning of March – the SMI in Switzerland gained around 10% over this period – bond prices remain under pressure. The reason for this remarkable development, of course, is rising interest rates: The prospect of a series of rate hikes has pushed the yield on 10-year US Treasury bonds from around 1.50% at the end of 2021 to 2.34% at the end of March 2022.

"Unlike equities, bond price slides have not recovered."

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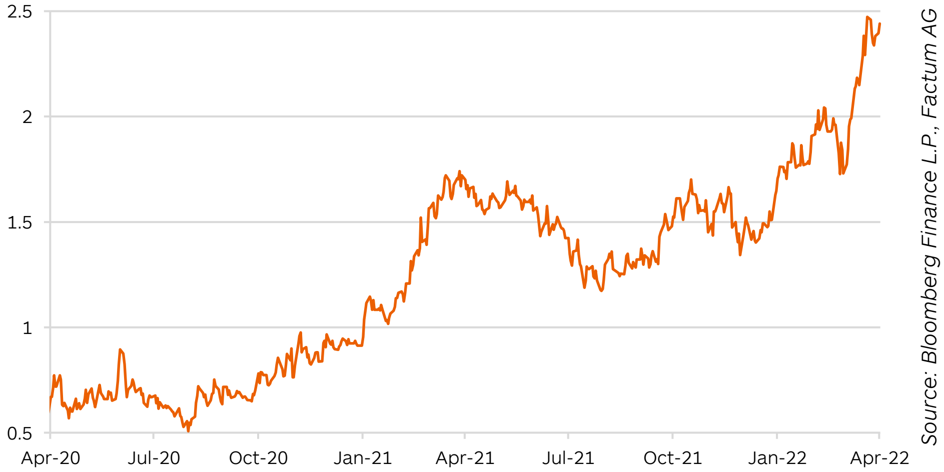
## Yield on ten-year US treasuries in %




As a consequence, bonds have suffered price losses this year. Corporate bonds, where investors are compensated not only for the interest rate risk but also for a credit risk, show even bigger price losses. With a globally diversified ETF in high-quality corporate bonds, investors are now some 7% in negative territory since the beginning of the year. In the case of emerging market bonds, investors actually lost over 8% in Swiss franc terms. Will this price slide continue and are bonds attractive at the current level? Well, this is not a simple question, but is strongly related to what assumption one makes about the inflationary outlook. What seems increasingly clear is that traditional portfolios with 60% equities and 40% bonds will have a tough time. This mix has proven successful for decades, not least in view of interest rates, which have declined over the last 40 years. For this reason we favour a broad mix of liquidity, bonds, equities and alternative investments.

"With a globally diversified ETF in high-quality corporate bonds, investors are now some 7% in negative territory since the beginning of the year."

### Commodities

There has recently been a welcome easing of pressures on the oil market. The US announcement that it would be releasing strategic oil reserves on an unprecedented scale resulted in a significant drop in prices. The US government is looking to make an average of one million barrels of crude oil available each day throughout the next six months, that is to say a total of 180 million barrels. This would eliminate any oil market supply bottlenecks in the second quarter, and would even mean a supply surplus in the third quarter – based on the IEA's current supply and demand forecasts. At the same time, the US government announced new measures to boost domestic oil production. The release of strategic reserves is intended to bridge any supply shortfalls until the end of the year, by when domestic production is expected to

"Release of substantial volumes from US strategic oil reserves trims oil prices."

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have been ramped up. The release of oil reserves has been coordinated with international partners. As a consequence, the oil price (WTI) fell below the USD 100 mark for the first time since mid-March. There is therefore another USD 10 to go before oil prices have returned to the levels they had before the onset of the conflict. The release of emergency reserves should help at least to partially offset the loss of Russian oil supplies brought about by the war in Ukraine and should stop oil prices spiking. Russia is the world's third largest oil producer, with an output of around 5 million barrels of crude oil and around 2.85 million barrels of petroleum products per day.

Oil price (WTI)


Source: Bloomberg Finance L.P., Factum AG

In the interim, following the first 25 basis point rate hike in March and sustained elevated commodity prices, expectations for further rate hikes have risen significantly. For 2022, the market is expecting eight interest rate steps, taking this to 2.50%. In combination with longer-term inflationary expectations, which are markedly below the levels currently being recorded, real interest rates have probably bottomed out in the present cycle. Geopolitical hotspots remain and can be expected to make gold additionally attractive if the various situations deteriorate. In our view, the pros and cons balance each other out, which is why we have given gold a neutral weighting, i.e. 3% in a portfolio with a balanced profile. Within the portfolio context, gold, which is trading around 6% higher this year as at the end of March, has helped us cushion losses on the bond and equity sides.

"Our current gold allocation accounts for three percent of a managed portfolio with the balanced strategy."

After an extended "dry spell", our exposure to gold mines, which we sold at the end of February after it had outperformed world equities by around 20% in 2022, has paid off.

"Divestment of our gold mining exposure at the end of February."

Furthermore, we have been exploring an exposure to the metals & mining sector in recent weeks. The arguments for an exposure are multi-faceted: geopolitical tensions, supply bottlenecks, rising inflation, the shift away from fossil fuels (decarbonisation and electrification, which requires huge amounts of copper, aluminium, nickel etc.). However, for reasons of timing – passive ETFs have gained around 30% in this sector this year – we are inclined not to invest at present and are waiting for a more attractive entry opportunity. This might occur if there is an easing of military tensions in Ukraine.

"Exploring an investment in the metals & mining sector."

**Currencies**

Russia's brutal intervention in Ukraine and its consequences have once again turned the US dollar and the Swiss franc into safe-haven currencies. Both have gained significantly against the euro, against the currencies of Eastern European states and especially against the rouble in recent weeks. At one point, the rouble lost fifty percent of its value due to the massive sanctions imposed by the West, while the currencies of Hungary and Poland each lost around ten percent and the euro around four percent. The Swiss franc actually reached parity with the euro in the first week of March. Given the ongoing geopolitical uncertainties, the extremely loose monetary policy in Europe (despite the high rate of inflation), Switzerland's enormous credibility, as well as the country's low public debt and chronic current account surplus, the strength of the Swiss franc is probably justified.

"The US dollar and the Swiss franc are seen as safe havens."

The US dollar is currently benefiting from several factors. On the one hand, there are the current uncertainties on international financial markets brought about by the war in Ukraine. This is prompting an increasing number of investors to position themselves more defensively. In the case of major American institutional investors, this means tactically taking leave of foreign investments and parking the money in the domestic market instead. The other important aspect is that, despite all the geopolitical turmoil, the US Federal Reserve is set to take its foot off the monetary policy accelerator in the near future. With inflation pushing towards 8%, it will be raising its key interest rate in a number of steps. Despite the fact that the US dollar has lost almost 80% of its value against the franc over the past 50 years, nine-tenths of all global foreign exchange transactions are still conducted via the dollar and two-thirds of all currency reserves are denominated in dollars. Furthermore, more than 50 percent of all international loans, debt securities and commercial transactions are settled using the "greenback", along with about 40 percent of international payments.

"The US dollar is presently benefiting from several factors."

U.S. Dollar Index

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## Market overview 31 March 2022

| Stock indices (in local currency) | Current | Current month (%) | YtD (%) |
|---|---|---|---|
| SMI | 12,161.53 | 2.82 | -4.27 |
| SPI | 15,538.57 | 2.42 | -5.51 |
| Euro Stoxx 50 | 3,902.52 | -0.42 | -8.86 |
| Dow Jones | 34,678.35 | 2.49 | -4.10 |
| S&P 500 | 4,530.41 | 3.71 | -4.60 |
| Nasdaq | 14,220.52 | 3.48 | -8.94 |
| Nikkei 225 | 27,821.43 | 5.68 | -2.58 |
| MSCI Emerging Countries | 1,141.79 | -2.25 | -6.99 |
| **Commodities** | | | |
| Gold (USD/fine ounce) | 1,937.44 | 1.49 | 5.92 |
| WTI oil (USD/barrel) | 100.28 | 4.76 | 33.33 |
| **Bond markets** | | | |
| US Treasury Bonds 10Y (USD) | 2.34 | 0.51 | 0.83 |
| Swiss Eidgenossen 10Y (CHF) | 0.60 | 0.35 | 0.74 |
| German Bundesanleihen 10Y (EUR) | 0.55 | 0.41 | 0.73 |
| **Currencies** | | | |
| EUR/CHF | 1.02 | -0.72 | -1.57 |
| USD/CHF | 0.92 | 0.62 | 1.05 |
| EUR/USD | 1.11 | -1.35 | -2.66 |
| GBP/CHF | 1.21 | -1.45 | -1.69 |
| JPY/CHF | 0.76 | -4.91 | -4.33 |
| JPY/USD | 0.01 | -5.52 | -5.41 |

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