

Investment Report

January 2023

Factum AG

Current positioning:

Portfolio balanced	Neutral	Current	Change*
Liquidity	3%	6%	↘ (-2%)
Bonds	35%	33%	↗ (+2%)
Shares	47%	44%	→
Alternative investments	15%	17%	→

**Changes since the last Investment Report (7 December 2022) & current assessment.*

Strategy overview

The year 2022 was marked by the return of inflation, which was thought to be a thing of the past. Since the global financial crisis of 2008, the discussion at central banks and on the financial markets regarding the development of prices has been dominated by deflation risks. In contrast, a return of inflation was hardly a topic. The year 2022 can therefore be seen as a real turning point. Politics, the financial markets and the general public are becoming aware of inflation again, and the momentum is one that was hardly thought possible. The distortions on the financial markets show how unprepared the economic players were for this development. The central banks were also caught on the wrong foot by the enormous surge in inflation. The hypothesis at the beginning of last year that inflation would only be temporary turned out to be a gross misjudgement. Russia's war of aggression on Ukraine further aggravated the situation. Energy and food prices rose drastically once again. As a result, the central banks had to pull out all the stops and abruptly abandon the ultra-expansive monetary policy they had been pursuing for a long time.

“2022 - The return of inflation and a year for the history books.”

2022 was, without a doubt, a disappointing investment year in all respects. Even the principle of portfolio diversification did not work. In principle, portfolios with a higher proportion of bonds withstand turbulent market phases better. During the past year, however, equity and bond markets corrected themselves at the same time, which is a very rare occurrence from a historical point of view. Since 1926, this has only happened twice in the United States, namely in 1931 (the world economic crisis and global instability), 1969 (rising key interest rates and the Vietnam War) and now 2022 (energy crisis, inflation and the Ukraine war). Even gold ended the investment year 2022 in the negatives, but only marginally. The precious yellow metal took a dive as a result of the steep rise in interest rates in the USA, partly because it does not yield any current income, but then made up around 10%, i.e. practically the entire loss, from November onwards due to the flattening of the rise in interest rates. Unfortunately, from a geopolitical point of view we have to state that the world has become more uncertain and dangerous. In this context, the current war in Ukraine and the conflict between China and Taiwan need to be mentioned in particular. In retrospect, we have to note that the economy has weakened, inflation has remained high but is slowly easing from its peak (USA) and interest rates have risen steeply. All in all, 2022 will go down in the books as a disastrous one from an investment perspective.

“In the past year, stocks and bonds corrected simultaneously - this has only happened twice in the US since 1926, in 1931, 1969 and just now in 2022.”

Global Equity Index 2022



With 2023 in mind, we increased the global bond quota in all reference currencies in December last year: The sharp rise in global yields and signs of a weakening economy led us to further reduce our underweight in the bond asset class. Given the absolute level of yields, the decision was made in favour of global bonds, which offer the best opportunity for additional price

“Bond quota increase in December.”

gains, despite the costs of currency hedging in the event of declining interest rates. The balanced debtor structure as well as the good credit standing (high proportion of more cyclically resistant government bonds) also speak in favour of this segment. We have added to the existing Vanguard index fund. We are convinced that the current tactical asset allocation positions us well for the future. Once again, we would like to mention here how important it is to view the portfolio and its development over a period of several years. We should also emphasise the long-term importance of equity exposures, which provide the best returns over the long term, even in real terms, i.e. after deducting inflation.

We start the new investment year with an overweight of the liquidity ratio. We are only holding an interim allocation to protect the capital base or to take advantage of possible investment opportunities. As mentioned above, we further reduced our underweight in the bond asset class in November. To achieve an acceptable return, we invest in a mix of government and corporate bonds and also invest in funds with active duration management. Inflation protected bonds and bonds from emerging markets are neutrally weighted. The equity quota is currently underweighted, and this also in view of the darkening global economy and the strong price recovery that began in mid-October. For the stock selection, we still consider a balance between "growth" and "value" stocks to be sensible. Alternative investments are currently overweighted. For diversification reasons, we continue to regard hedge funds as a sensible addition to the portfolio. In addition, we have invested part of the alternative quota in global real estate stocks with attractive returns. The position in gold has proven itself as a diversifier and remains a fixed component in the portfolio, even against the background of sudden geopolitical escalations. The fading interest rate fantasy is likely to provide additional support for gold. Page one provides a detailed overview of our current positioning.

“With what positioning will we be starting the investment year 2023?”

Politics

Over the past year, we have been inundated with news, rumours and opinions that have caused some of us to worry about the state and future of the world. The war in Ukraine, the conflict between China and Taiwan, the supply chain issues, the steep rise in inflation, abrupt changes of government as in the UK, to mention but a few, have made the world more unpredictable. How should we view all this and are the good years over as the stock market performance in 2022 might suggest? As so often in challenging times, it is worth looking at things from a bit of a distance. Times have never been "normal" and there have always been political and economic developments that have caused colossal changes: The hyperinflation in Germany of the 1920s, the stock market crash of 1929, the Nazi takeover, the Second World War, the development and detonation of the atomic bomb, the Korean and Cuban crises, the Cold War and, for example, the 1973 oil embargo, to name just a few. All these events created major impacts that deeply affected people all over the world and left their mark on their assets.

The events mentioned above reveal the following: With the necessary distance, what at first glance appears to be an insoluble problem often becomes an opportunity that can be overcome. There is little point in complaining. It is important to keep assessing all possible influencing factors objectively and as impartially as possible. It is never a good idea to let emotions and headlines sway us from our tried and tested credos. The real art is to find the right mix between sticking to a chosen strategy and adapting to new circumstances. In the current situation, it is a matter of combining impartiality with experience and vigilance in order to draw the right conclusions. For us, this means that our service is based on clearly defined processes that we always critically scrutinise. We regularly review new approaches and product developments and integrate them into our investment repertoire as the situation demands. This view forward is one of the most important principles of our business activity: We are active and always have our clients' needs in mind.

“Have there ever been normal times?”

“We are active and always have our clients' needs in mind.”

Economy

In mid-December the Chinese government made a surprising U-turn in its zero-covid strategy. More quickly than most market participants had predicted, the Chinese government decided to turn away from the zero-covid strategy that it had been enforcing with all its might for almost three years. The largest wave of protests in decades rolled through several Chinese cities at the end of November. This discontent was directed against extensive curfews, forced quarantine, constant compulsory testing and control by the Corona app, but also against Xi Jinping and the Communist Party. It seems that the Chinese government found itself under pressure and had to act.

In December, China's exports shrank more drastically in annual comparison than at any time since the beginning of the Corona pandemic almost three years ago. In terms of the US dollar, the decline in exports increased from -8.9% in November to -9.9% last month. The decline is due to a weaker global demand for Chinese goods as well as some disruption in logistics networks and the supply of goods due to labour shortages (rapid increase in new infections). As growth outside China continues to slow, exports are likely to contract for a few more months.

In line with the deteriorating indicators (ISM Manufacturing and ISM Services) in the US, the sentiment of small businesses, which was recently published, has deteriorated further. The Small Business Optimism Index fell to its lowest level since July 2022, with most sub-components deteriorating. In particular, the economic prospects and profit expectations of the small businesses surveyed deteriorated significantly. High inflation remains the main concern, with labour shortages in second place.

The economic situation in Europe is developing better than was forecast. For example, the Sentix economic index, with its third increase, gives hope that the Eurozone will only go through a mild recession. The overall index improved from -21.0 to -17.5 points, its highest level since June 2022. High gas inventories, mild winter weather and, in particular, continued stable labour markets are boosting the economic outlook.

“The Chinese government is doing a U-turn on its zero-covid strategy.”

“China's foreign trade ends the year on a weak note.”

“Small businesses pessimistic as year ends in the US.”

“Sentiment brightening in the Eurozone.”

Citi Economic Surprise Index Eurozone 5 Years



All in all, the global economic outlook has deteriorated further. At the end of 2021, the International Monetary Fund (IMF) forecast a global economic growth of 4.9% for 2022. This has now been revised to 3.2%. Besides the energy crisis in Europe, and China's restrictive corona policy, the slower growth is mainly due to inflation-related losses in real income and higher interest rates. The global economic downturn has already led to a decline in the prices of industrial metals and energy. Recently, the price of gas in Europe has also declined. This is because the gas storage facilities are well filled and an acute energy crisis seems to have been averted. Leading indicators suggest that the global growth weakness will continue in the coming quarters.

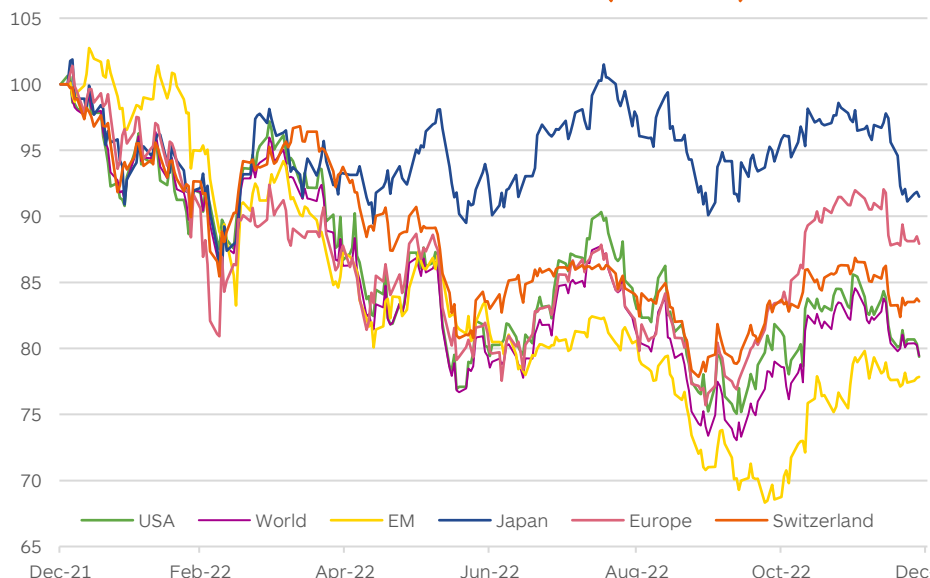
“Global economy is facing a downturn.”

Equity markets

The World Equity Index lost about 18% of its value last year, bottoming out at about -26% in mid-October. In recent months, the stock markets have rallied significantly and are anticipating an environment with significantly lower inflation and solid economic and earnings growth. The question now is, how realistic is this scenario? Should inflation in America and the Eurozone fall to the central bank's target of 2%, this would probably only be accompanied by a significant economic downturn, if not a recession. Corporate profits would then collapse, which would hardly leave the stock markets unaffected.

“How sustainable is the equity recovery that began in October?”

Global stock markets 2022 (indexed)



Source: Bloomberg Finance L.P., Factum AG

We are rather cautious about the short-term prospects on the equity markets. As long as we do not have more visibility, we consider it sensible to keep the equity quota slightly underweighted. In the past, a recessionary economic development has always led to a significant decline in corporate profits. On the other hand, the majority of analysts continue to expect growth in earnings this year, albeit modest. We view better growth prospects to be imperative for a sustainable recovery on the stock markets.

“As long as we do not have more visibility, we consider it sensible to keep the equity quota slightly underweighted.”

However, at this point we would like to mention how important it is to be permanently invested in the stock market. After all, the historical equity returns of around 8% per year also includes bear markets, i.e. difficult market phases such as the Great Depression of the 1930s or the financial crisis of 2008.

“Never take your eye off the long-term plan.”

Bond markets

In mid-December, not only the Fed but also the ECB, the BoE and the SNB raised their key interest rates by 50 basis points and made it unmistakably clear that these were not the last rate hikes. In particular, the ECB and the Fed have signalled that they consider further rate hikes necessary. The ECB, for example, believes that interest rates still need to rise significantly and to do so at a steady pace in order to reach a sufficiently restrictive level to ensure a timely return of inflation to the 2% medium-term target. Christine Lagarde, the ECB chief, said the ECB would raise its key interest rates by 50 basis points at the next meeting and possibly the one after that, and that market participants had not yet priced in enough rate moves. This would bring the key interest rate to 3.50% instead of the previously forecast of 3%.

“December 2022: Key interest rate hikes across the board.”

In view of the extremely high inflation, such a move seems appropriate. However, it bears the risk that a possible recession will be deeper and last longer.

The US Federal Reserve has also emphasised that it is planning further interest rate hikes. The Fed's rate forecast signals another 75 basis points of rate hikes next year, or a rate peak of 5.25%. Should the pace of hikes be reduced to 25 basis points at the next meeting, as indicated, this would correspond to three more rate hikes until early May. The Fed would then pause to observe the impact of past rate hikes on the economy. In contrast, market expectations for the key rate peak remain just below 5%. However, how long key rates will have to remain at the peak in order to sufficiently contain inflationary pressures is likely to be much more important than this figure. The monetary authorities do not expect key rates to be lowered until 2024, while market expectations see key rates falling back below the current level as early as the end of 2023. We believe that the Fed will raise rates one last time in February, probably by 25 basis points, and then pause for a longer period. The wide dispersion of rate forecasts over the next few years, however, clearly illustrates that monetary policymakers do not have a clear idea of how the US economy will react to the sharp rate hikes and so they will act depending on incoming economic data.

"Fed - what next?"

Ten-year US Treasury yield in % - 2022



2022 was very challenging not only for shares, but also for bonds. Securities are considered to be safe investments, but those who had them in their portfolios last year suffered significant losses. A glance at indices such as the

"Bob – Bring on bonds."

iBoxx Euro Sovereign Index, which tracks government bonds of the Euro-zone, illustrates this. This index lost around 18.5% in value. However, there is also a positive side to these losses. After all, bond yields rise when prices fall. Conversely, this means that bonds are once again offering significantly more attractive yields than in previous years. This led us to further reduce our underweight in the bond asset class last November. The main reason for the higher yields is the significant interest rate increases by the central banks last year in response to the persistent high inflation.

Commodities

Even gold ended the investment year 2022 in the negative, but only marginally. The precious yellow metal took a dive as a result of the steep rise in interest rates in the USA, partly because it does not yield any current income, but then made up around 10% from November onwards due to the flattening of the rise in interest rates, in other words, practically the entire loss. This means that gold clearly held up better than equities or bonds in 2022. The development of the US currency and the interest rate situation in the USA are likely to be of central importance for gold. We are maintaining our neutral ratio in the gold quota - which corresponds to 3% in a mixed portfolio - and still consider the position to be justified in the portfolio context.

“Gold only with marginal loss in the past investment year.”

Gold price 2022



The balance between supply and demand will be of utmost relevance for commodities in general in the coming months. On the one hand, if the economic slowdown is stronger than expected, declining demand would weigh on commodity prices. On the other, global supply of most commodities re-

“We are sticking to our industrial metals position.”

mains below average by historical standards. We are sticking to our industrial metals position in homeopathic doses - energy transition, decarbonisation, scarcity, underinvestment, etc. In the wake of the "risk-on" sentiment in the last quarter of 2022, our position in commodities - an exchange-traded index product on the Wisdom Tree Energy Transition Metals Index - gained around 20% in value.

Currencies

The dominance of the US dollar is likely to have passed its peak with the transition from the third to the fourth quarter of 2022. In the last three months of last year, almost all currencies of the G10 countries, with the exception of the Canadian dollar, gained more than 5% vis-à-vis the greenback. Such significant movements are often followed by periods of consolidation and counter-trends. Probably, the weightiest factor behind the weakening of the US currency is the markets' confidence that inflation in the US has peaked and that the Fed will not raise the key interest rate above 5% in this cycle.

"Tectonic shifts also in the foreign exchange markets."

U.S. Dollar Index over a 5 year period



Market overview 31 December 2022

Stock indices (in local currency)	Current	1 Mt (%)	YtD (%)
SMI	10,729.40	-3.58	-14.29
SPI	13,734.86	-3.27	-16.48
Euro Stoxx 50	3,793.62	-4.04	-8.55
Dow Jones	33,147.25	-4.09	-6.86
S&P 500	3,839.50	-5.77	-18.13
Nasdaq	10,466.48	-8.66	-32.51
Nikkei 225	26,094.50	-6.57	-7.38
MSCI Emerging Countries	956.38	-1.51	-19.94

Commodities

Gold (USD/fine ounce)	1,824.02	3.14	-0.28
WTI oil (USD/barrel)	80.26	-0.36	6.71

Bond markets

US Treasury Bonds 10Y (USD)	3.87	0.27	2.36
Swiss Eidgenossen 10Y (CHF)	1.62	0.50	1.75
German Bundesanleihen 10Y (EUR)	2.57	0.64	2.75

Currencies

EUR/CHF	0.99	0.56	-4.62
USD/CHF	0.92	-2.24	1.27
EUR/USD	1.07	2.87	-5.85
GBP/CHF	1.12	-1.88	-9.28
JPY/CHF	0.71	2.99	-10.97
JPY/USD	0.01	5.30	-12.20

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