Investment Report

October 2022

Factum AG
Current positioning:

Portfolio balanced	Neutral	Current	Change*
Liquidity	3%	5%	↘ (-2%)
Bonds	35%	31%	→
Shares	47%	47%	↗ (+2%)
Alternative investments	15%	17%	→

**Changes since the last Investment Report (6 September 2022) & current assessment.*

Strategy overview

The third quarter was also marked by persistently high inflation, the resolute intervention of central banks by means of interest rate hikes, the war in Ukraine and the zero Covid strategy in China. In addition, September confirmed the thesis that it was the weakest month on the stock market - the World Equity Index lost around 10% in value. The unexpected rise in the core inflation rate in the USA was the primary reason for a significant correction in the markets. Once again, by raising interest rates by 75 basis points, the Fed underscored the top priority it attaches to fighting inflation. A reversal by the Fed is not very realistic at this point in time. As a consequence, this led to a strong increase in yields on the bond markets and to lower valuation of equities. Furthermore, towards the end of September, the new government in the United Kingdom caused a great deal of uncertainty. In particular, the plan for significant debt-financed tax cuts sent the pound plummeting.

"The current investment environment is extremely challenging."

FACTUM

For the international stock markets, the question of whether the cyclical bear market will be replaced by a bear market with a corporate earnings recession is likely to be of utmost relevance in the coming months. Should inflation fall faster than expected in the coming months, there will be signs of optimism and vice versa. At present, the markets are oversold due to the recent falls in share prices. Equity allocations have declined and cash holdings have been increased. According to the "American Association of Individual Investors", the mood in the market is the worst it has been since the "Global Financial Crisis of 2009", which opens up opportunities for short-term oriented investors and it would not come as a surprise to see an upward correction in the short term. Long-term investors, on the other hand, should stick to their chosen strategy and give consideration to an occasional rebalancing. Once again, it is important to note that, as a rule, investments should be made in equities, as most of the market is in an upward trend. The challenge for us as asset managers is market timing, when to reduce or increase the risks again and consequently actively manage our bandwidths. At this point in time, we believe it makes sense to act defensively and to remain patient. On the positive side, the increased yield level now represents a valid investment alternative to equities. The TINA argument (there is no alternative to equities), which for some time had argued for above-average engagement in the equity markets, is no longer valid. TARA (there are reasonable alternatives to equities) is now on everyone's lips. Equities are no longer without alternatives; the higher bond yields now offer a suitable alternative, which speaks in favour of broadly diversified portfolios.

"It is important to keep in mind to be generally invested in equities - as the market is in an uptrend for the most part."

World Equity Index

Source: Bloomberg Finance L.P., Factum AG

After taking advantage of the summer recovery to reduce the equity ratio at the beginning of August, we decided to increase the equity ratio back to the original level (+2%) at the end of September. In our view, investor mood was extremely pessimistic and equities oversold, which meant that in the short term an upward revision would not come as a surprise. Currently, we have a neutral equity allocation vis-à-vis the strategy, with the effective weighting still slightly below this due to the significant market movement. Since the temporary interim high in mid-August, the global equity markets have corrected again by around 17%.

"At the end of September, we increased the equity quota for all mandates with an equity component."

At present, we have chosen to overweight the liquidity ratio in order to protect the capital base and to take advantage of any investment opportunities. We are currently underweighted in bonds. Although yields on first-class government bonds have risen sharply recently, they remain at a rather low level from a historical perspective. However, we can easily imagine reducing our underweight in the coming weeks or months or even increasing it to neutral once a "peak" in interest rates is discernible. The equity risk premium does not make equities look unattractive. For the most part, valuations in the markets we are observing are below the long-term average. From a technical perspective, a short-term upward countermovement is to be expected. Sentiment indicators show panic and are emitting buy signals. All in all, we consider a neutral equity ratio to be justifiable for the moment. At present, we have overweighted the alternative investment ratio. For diversification reasons, we continue to regard hedge funds as a sensible addition to the portfolio. If one considers the change in US real interest rates or the appreciation of the US currency in isolation as the most important price drivers, the slide in the price of gold this year appears moderate. Based on the factors we have observed and in a portfolio context in general, we still consider the gold position to be justified.

"With what positioning do we start the fourth quarter of 2022?"

Politics

Almost three months after Prime Minister Boris Johnson announced his resignation, in early September the British Tories revealed the result of the protracted process to find his successor as party leader. As expected, Liz Truss, the former Foreign Minister, emerged as the winner. She was able to get around 57 per cent of the votes of the approximately 140,000 Tory members. Her rival, former Finance Minister Rishi Sunak, received 43 per cent, which was better than predicted.

"Liz Truss is the new Prime Minister."

FACTUM

On 16 October, the 20th Party Congress of the Communist Party (CP) starts in Beijing. During the congress, which only takes place every five years, all the bodies of the party are newly appointed. What is presented to the outside world as a democratic process is in fact largely based on non-transparent procedures and agreements. In the end, Xi Jinping, who ignores the principle of collective leadership, will be confirmed as General Secretary for the third time. It remains unclear whether Xi Jinping had to make concessions to the reform-oriented wing or whether only closely trusted persons will be awarded the most important top posts. The decision on who will succeed Premier Li Keqiang and the vice-governor in charge of economic affairs is also eagerly awaited.

"The 20th Congress of the Communist Party (CP) starts on 16 October."

Meanwhile, an increasingly icy wind is blowing in Xi Jinping's face and he has to steer China through choppy waters. The zero Covid strategy, which always goes hand in hand with drastic lockdowns, is massively damaging the economy and is creating a lack of understanding among the population. In terms of foreign policy, he has made himself vulnerable as a result of his close friendship with Vladimir Putin. Another negative aspect of China is its demographic development. The Chinese working age population is falling drastically. Between 2020 and 2035, the number of residents of working age will shrink by 70 million. The number of retirees will increase by 130 million in the same period. This development puts enormous pressure on the social system. The ageing of society is primarily due to mismanagement on the part of the government. In the 1950s and 1960s, Beijing encouraged people to have as many children as possible. In 1979, the government put on the brakes and introduced the one-child policy, which has led to the current misery.

"China will need to address a number of issues."

In addition, the economy is in a crisis and grew by only 0.40% between April and June 2022 compared to the same period in the previous year. The real estate crisis and the zero Covid strategy with constant lockdowns have been the main contributing factors. Even after the pandemic is finally over, China will have to get used to weaker growth rates. Growth rates of 8 percent of GDP seem too ambitious; China will probably have to be content over a longer period with growth rates of two to three percent. What makes life even more difficult for the Chinese economy is its high dependence on the real estate market. Together with downstream industries such as cement or steel, the sector accounts for almost 30 percent of the Chinese economy.

"The economy is undoubtedly in crisis."

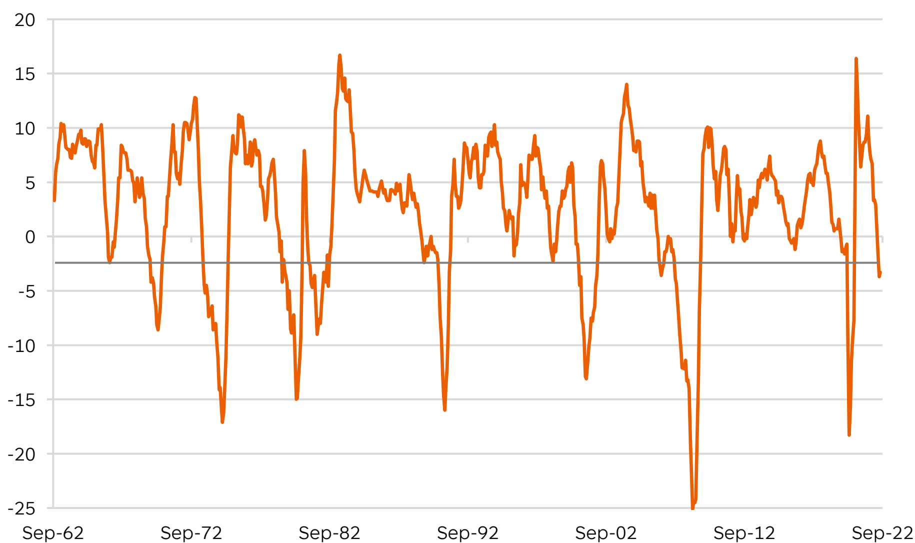
Parliamentary elections were held in Italy at the end of September. As predicted, Giorgia Meloni, leader of the Fratelli d'Italia, which emerged from the post-fascist movement, has won a clear majority in both chambers in these early parliamentary elections, together with the parties of Matteo Salvini (Lega) and Silvio Berlusconi (Forza Italia). That parliament meets for the first time on 13 October in this new constellation.

"The right-wing alliance around Giorgia Meloni wins a clear majority."

Economy

Although we continue to assess the economic situation in the USA as more robust than in Europe, there are increasing signs of an impending recession in America as well. At the end of September, the leading indicators deteriorated for the sixth time in a row. The index of leading indicators fell by 0.3% in August compared to the previous month. As a result, the annualised six-month change fell below the threshold that has quite reliably indicated the onset of a recession over the past 60 years. This, combined with a continued tightening of financial conditions due to aggressive monetary stringency, suggests that a recession will be difficult to avoid. Current economic conditions are not consistent with contraction, mainly because of the still robust labour market.

"USA: The economic situation continues to deteriorate."



FACTUM

The more restrictive financing conditions on the real estate market are becoming clearly noticeable. The sentiment among residential builders in the USA has deteriorated in September for the ninth month in a row. For an increasing number of consumers, higher mortgage rates and house prices are making the purchase of a new home unaffordable. The housing downturn is expected to continue unabated, putting downward pressure on house prices.

"The real estate market in the US is experiencing a downturn."

Currently, the economic data from Europe know only one direction and are pointing steeply downwards. In September, consumer confidence in the eurozone and the United Kingdom deteriorated again significantly and more strongly than feared. In the monetary union, the monthly sentiment barometer of the EU Commission fell from -25 to -28.8 points and once again fell below the previous historic low of July. In the UK, too, consumers were more pessimistic than ever before in September, despite the British government passing a huge fiscal package to cushion rising gas and electricity prices.

"European economic data point steeply downwards."

The latest results of the survey of purchasing managers also do not give rise to any hope for the economy in Europe. Just the opposite: In September, the composite PMI is below the critical 50-point mark for the third time in a row and, at 48.2 after 48.9 points in August, it is signalling the sharpest decline in growth since January 2021. With the exception of the pandemic months, this is the lowest value since May 2013. The main factor behind the decline in economic strength was industry, which saw its fourth consecutive fall in output, the sharpest since May 2020. In the services sector, the second successive fall in business was the sharpest since February 2021. Apart from the months of lockdown during the pandemic, their severity was even greater

"A recession in the eurozone is practically inevitable."

than at any time in the last ten years. Travel, tourism, leisure activities, real estate and insurance declined at an accelerated pace. As a result, a recession in the eurozone is practically inevitable.

"China with a continued slowdown in growth."

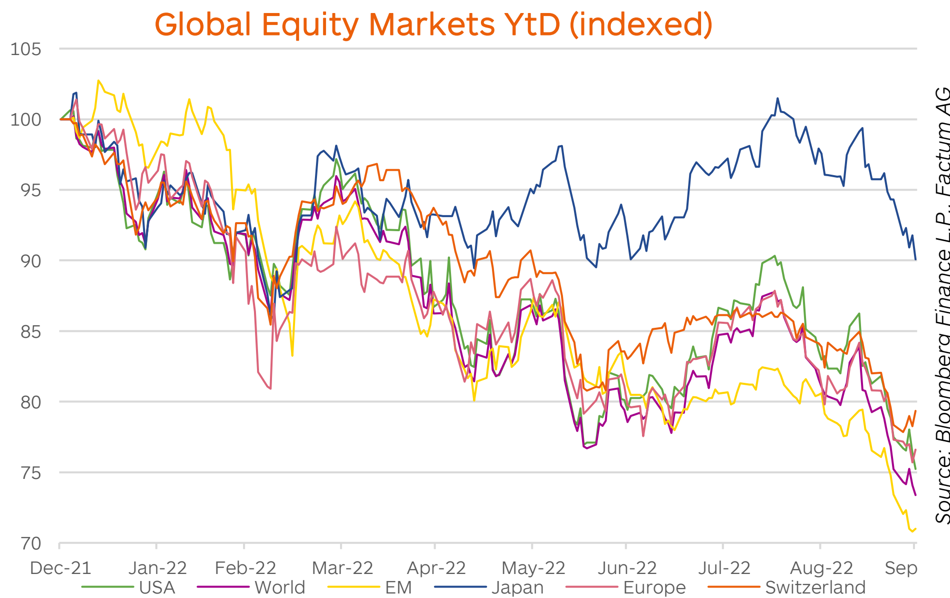
The purchasing managers index in China indicates that the overall economy is still growing, but the momentum is slowing down significantly. Foreign trade, on the other hand, was extremely weak in August. Data released in September showed that export and import growth slowed much faster than expected and the trade surplus narrowed by more than 20%. Reports of renewed and widespread virus-related restrictions, for example in Shenzhen, a metropolis known as a tech hub, also weigh heavily on the future prospects of the Chinese economy. At least, China does not have an inflation problem. Both consumer and producer prices rose much more slowly than expected in August. The inflation rate fell from 2.7% to 2.5% and producer prices declined from 4.2% to only 2.3% compared to the previous year. This is the lowest rate of increase in 18 months. We expect inflation to remain below the 3% ceiling set by the Chinese central bank (PBoC). The PBoC may therefore ease monetary policy further to support the economy. We doubt, however, that this will give the economy an additional big boost. This would require a change of strategy in the zero Covid policy, which is still not in sight at the moment.

Equity markets

"We currently consider a neutral weighting of the equity quota to be adequate."

The weak performance of the equity markets this year has been largely caused by rising interest rates and the consequent decline in the price-earnings ratio. However, corporate earnings have performed surprisingly well in the first quarters of this year, despite the slowdown in growth and geopolitical problems. Recently, the interim recovery in the summer months was replaced by another phase of weakness, which was mainly triggered by the announcement by central banks of further interest rate hikes. In addition, the geopolitical risks have increased again in recent weeks with the partial mobilisation in Russia and Putin's threat to use nuclear weapons. In the coming months, the earnings situation is likely to become more difficult for many companies. Rising costs for wages, energy and financing may be the reason for this. For this reason, it can be assumed that the consensus of analysts will have to revise earnings estimates for the next few months downwards. In the event of a decline in demand, which should not come as a surprise in the coming months, some companies may again increase their inventories, which could lead to price reductions and put additional pressure on profit margins. The risk-off phase is likely to last in the coming weeks and months, which would tend to argue against equities. In the short term, however, an upward correction is likely, as sentiment among equity investors is extremely

negative and equities are clearly oversold. In the past, this initial situation often formed the background for prices rising in the short term, which is why we consider a neutral weighting of the equity quota to be adequate, at least for the moment.



Bond markets

The Fed has once again made it very clear that it attaches absolute priority to fighting inflation. Price stability is the foundation of the economy and the other goal of the central bank, full employment, cannot be achieved without price stability. In other words: As long as inflation is clearly too high, there is no conflict of objectives between price stability and full employment in the eyes of the Fed. According to the interest rate projections of the individual monetary watchdogs, a 75-basis point increase in the key interest rate can also be expected at the next meeting on 2 November. The orgy of key rate hikes is thus likely to continue, and if you browse through the books of economic history, you will realise that the USA's monetary policy conditions have not been tightened so quickly for around 40 years. A further interest rate hike of 50 basis points is planned for December. This will bring the target range for Fed funds rates to between 4.25% and 4.50% by the end of the year. In addition, the projection of the Fed members foresees a further, final interest rate hike of 25 basis points next year. Moreover, the Fed expects to keep the key interest rate in the restrictive range for a longer period of time. The decision mirrors the speech at Jackson Hole, when Powell stressed that history teaches that the fight against inflation must be waged without compromise until the job is done. This implies a willingness to keep key interest rates in the restrictive range and to keep them there for longer. One third of

“The Fed attaches the highest priority to fighting inflation.”

the monetary watchdogs forecast a key interest rate of 4.375% at the end of 2023, one third of 4.625% and one third of 4.875%.

Monetary policy knows only one direction at the moment and the hope of rapid interest rate cuts cherished by the financial markets only a short time ago has receded into the distance, at least for the moment. With the exception of Japan, all other important central banks in the industrialised countries will follow the Fed's example. By the end of September alone, the Bank of England, the Swedish, Norwegian and Swiss National Banks had raised their key interest rates by 50 to 100 basis points. On the interest rate markets, the reassessment of monetary policy has led to a clear upward shift in the entire yield curve. As a result, returns at the long end of the yield curve have also risen significantly once again.

"With the exception of Japan, all other important central banks in the industrialised countries follow the Fed's example."

Yield to maturity - 10-year US government bond

Source: Bloomberg Finance L.P., Factum AG

However, the rise in yields at the far end of the yield curve should now be coming to an end. The monetary policy of the central banks, which has become more restrictive once again, will keep inflation expectations in check and cause inflation to fall next year. Recently, the risks of recession have intensified, which should also put pressure on the far end of the yield curve. Although yields could rise again in the short term, we expect lower yields over the next six to twelve months. Investors are likely to prefer better credit quality over a weaker credit rating when the risk of a slowdown in the economy and corporate earnings increases, as default risks tend to increase in a weaker economy. We are currently underweight in bonds. Although yields on first-class government bonds have risen sharply recently, they remain at a rather low level from a historical perspective. However, we can easily imagine

"In our view, there will be interesting entry opportunities in the bond sector in the coming weeks and months."

reducing our underweight in the coming weeks or months or even increasing it to neutral once a "peak" in interest rates is discernible.

Commodities

Commodity prices are likely to struggle in the months ahead to recover significantly, especially against the backdrop of growing recession fears, higher real interest rates and the strong US dollar. Higher interest rates will pose particular challenges to interest rate-sensitive sectors such as the real estate market and the automobile industry. The appetite for commodities is particularly pronounced in these sectors. The crisis in the Chinese housing market in particular is dampening demand for commodities. In the medium term, we see upside potential for commodities as soon as speculation on further interest rate hikes diminishes and, as a consequence, the US dollar depreciates. Inventories are relatively low for some metals, and rising growth and higher investment in sustainable energy sources should lead to deficits and rising metal prices. We continue to maintain our exposure to industrial metals in homeopathic doses.

"In the medium term, we see upside potential for commodities as soon as speculation on further interest rate hikes diminishes and, as a consequence, the US dollar depreciates."

In the short term, the oil price is likely to struggle to move significantly higher for more or less the same reasons as commodity prices in general, due to growing fears of recession and the resulting decline in demand for oil, the strength of the USD and higher real interest rates. However, there are also positive aspects in the medium term that could see the oil price heading north. At the end of this year, no more Russian oil can be exported to Europe and the supply of Russian oil on the world market will tend to decrease. In addition, the USA could start replenishing its strategic oil reserves again. Moreover, OPEC+ announced at the beginning of September that it would cut production by 100,000 barrels at the beginning of October. This is not significantly less, but it shows that it does not want to see the oil price much lower and is prepared to cut oil production further if necessary, should the oil price continue to fall, which means that a bottoming out of the oil price is likely. In the medium term, therefore, the oil price should trend higher due to a renewed increase in demand for this black gold and the fact that supply will remain tight.

"In the medium term, we see the oil price going higher."

Gold has developed disappointingly in the course of the year so far and was not able to live up to its status as a shield against inflation and geopolitical uncertainty. In addition, from the chart perspective, the important support level at around USD 1,680 was breached. The main reasons for this are the rise in real interest rates and the very strong US dollar, which is considered a safe haven. However, many negative scenarios are currently factored into the gold price and sentiment is very negative. Based on the factors we have observed and in a portfolio context in general, we still consider the gold position to be justified.

"The gold price fell in 2022 despite crises."

Currencies

The strong interest rate hike on the part of the ECB must also be seen against the background of several months of euro weakness, because the weak euro and the strong US dollar have made rising commodity prices an even bigger inflation problem for the eurozone this year. Meanwhile, overall inflation in the eurozone is even higher than in America. Only time will tell whether the 75-basis point interest rate hike will be enough to strengthen the euro. But given the weakening eurozone economy, one can remain sceptical. This also applies to the euro vis-à-vis the Swiss franc, because inflation is lower in Switzerland than in the eurozone, which puts additional pressure on the euro. The last few months have shown us that the fluctuations of the currency markets - to a similar extent as the bond markets - have almost matched the fluctuations of the equity markets in the current year.

"Major shifts in the currency markets in the current year."

There are currently some plus points in favour of the US dollar, but these are likely to be factored into the dollar exchange rate and the US currency is highly overvalued. However, it may well rise even further due to the safe-haven idea or as a result of a risk-off phase. The greenback is likely to put pressure on the profits of US companies though. This will also inevitably lead to lower US economic growth and tighter monetary conditions, which will tend to reduce the need for massive interest rate hikes by the Fed. In the medium term, these factors should lead to a weaker US currency. But this will require a certain trigger, which cannot be identified at the moment, and until then the US dollar is likely to continue its rise.

"The US currency is clearly overvalued - but if the risk-off phase continues, it may well rise further."

FACTUM

Market overview 30 September 2022

Stock indices (in local currency)	Current	1 Mt (%)	YtD (%)
SMI	10,267.55	-5.29	-17.98
SPI	13,166.38	-5.98	-19.93
Euro Stoxx 50	3,318.20	-5.54	-20.40
Dow Jones	28,725.51	-8.76	-19.72
S&P 500	3,585.62	-9.22	-23.88
Nasdaq	10,575.62	-10.44	-31.99
Nikkei 225	25,937.21	-6.99	-8.19
MSCI Emerging Countries	875.79	-11.70	-26.98
Commodities			
Gold (USD/fine ounce)	1,660.61	-2.95	-9.22
WTI oil (USD/barrel)	79.49	-11.23	5.69
Bond markets (change in basis points)			
US Treasury Bonds 10Y (USD)	3.83	0.64	2.32
Swiss Eidgenossen 10Y (CHF)	1.23	0.40	1.37
German Bundesanleihen 10Y (EUR)	2.11	0.57	2.29
Currencies			
EUR/CHF	0.97	-1.58	-6.76
USD/CHF	0.99	0.97	8.12
EUR/USD	0.98	-2.51	-13.79
GBP/CHF	1.10	-3.00	-10.61
JPY/CHF	0.68	-3.02	-13.95
JPY/USD	0.01	-3.99	-20.47

Author: Christof Wille, Dipl. Private Banking Expert NDS
Editorial deadline: 14 October 2022

Please do not hesitate to contact us if you have any questions. Factum AG Vermögensverwaltung is a licensed, independent asset management company that is subject to the Liechtenstein Financial Market Authority. It is the exclusive purpose of this publication to inform; it is neither a request nor an offer nor a recommendation to purchase or sell financial instruments or to take any other decisions on investments. It is therefore not a financial analysis in terms of the Marktmissbrauchsgesetz (Act on Market Misuse), either. The information and opinions contained in this publication originate from reliable sources and have been prepared with the utmost diligence. Nevertheless, we exclude any liability for accuracy, completeness and topicality. All information contained and all prices stated in this publication may change at any time without notice. The value of financial instruments may rise or fall. Future performance cannot be deduced from the past development of prices. Under particular market-related or title-specific circumstances, financial instruments can be sold only with delay and the risks that it is subject to. We would like to point out that Factum AG Vermögensverwaltung and its employees are allowed in principle to hold, purchase, or sell the financial instruments mentioned in this document, without however putting clients at any disadvantage whatsoever. This publication and the information contained in it are subject to Liechtenstein law. In the event of any disputes, jurisdiction rests exclusively with the Liechtenstein courts at the legal venue of Vaduz.