Zuger Kantonalbank

Portfolio

October 2021

Market overview and positioning

There is tension in the air: Evergrande, tapering, a debt ceiling, the Delta variant, and the outcome of the German election are all spicing up equity markets. These markets are still looking for a direction, with plenty of volatility. Nonetheless, the environment remains positive, and equities continue to be the top choice.

Turbulence recedes

In the short term, the general growth momentum has been slowed by the proliferation of the Delta variant, the waning impact of fiscal measures, and persistent disruptions to supply chains. At the same time, political uncertainties in the US and China have brought increased volatility to financial markets. We are currently expecting these headwinds to die down, and global growth to remain strong into the first half of 2022.

Post-pandemic inflation spike

The increase in global rates of inflation in recent months has been extraordinary. In our view, this reflects the huge imbalances between supply and demand as the economy picked up following the lifting of measures to combat coronavirus. These frictions can be expected to remain in place until the end of the year. In the medium term, we are not expecting inflation rates to remain at their current high levels, even if the monetary policy currently being pursued by central banks does pave the way for slightly higher inflation over the next two years.

Central bankers choose words carefully

The monetary policy of the world's key central banks has not changed a great deal in recent weeks. The meeting of leading central bankers in Jackson Hole a month ago produced no surprises. However, it is notable quite how carefully Christine Lagarde and Jerome Powell are choosing their words as they guide markets along the path to monetary normalization. The European Central Bank (ECB) will now be looking to slowly scale back its pandemic bailout programme.

"China is unsettling investors, the Fed is putting the brakes on, and a political shift to the left is apparent in Germany. The perfect autumn storm?"

Alex Müller, Chief Investment Officer

Tighter monetary policy

The US central bank (Fed) has now also joined the tapering debate. It is clearly satisfied with the progress made on the inflation front, even if the labour market recovery is less impressive than desired. The Fed has indicated that it expects to reduce its security purchase volumes from November 2021 onwards. The tapering process is due to be complete by mid-2022. Although the first rate hike could come in 2022, it is not a done deal. With this stance, the Fed met the expectations of financial markets. Like the ECB earlier, the guardians of US monetary policy managed to communicate monetary tightening without sending markets into a panic.

Wir begleiten Sie im Leben.

Market overview and positioning

Plenty of crunch moments ahead in US politics

Government indebtedness has once again become a topic of debate in the US. Indeed, Congress will have to act before October is out. Back in 2019, shortly before the suspension of the debt ceiling, US government debt had already reached 22 trillion (22,000 billion) US dollars. As a result of the unprecedented expenses caused by the coronavirus pandemic, that debt mountain has now grown to a mighty 28.5 trillion US dollars. It will be fascinating to see how Congress negotiates this perilous tightrope act: government debt, a pending infrastructure project, gulfs between the two political parties, and a possible government shutdown. Many scenarios are conceivable, but neither party wants to open itself up to the accusation of having unnecessarily prolonged the crisis. After all, mid-term elections loom next year.

China angers investors

Following the COVID crisis, China is now exuding self-confidence and flexing its muscles. Where Taiwan is concerned, this is taking both military and political form. In Afghanistan, Beijing has laid the foundations for greater regional influence. This is likely to further accentuate the strategic rivalry between China and the US, with repeated flare-ups likely in connection with certain themes. But quite aside from geopolitics, China has also been making headlines in the areas of economic and social policy. For example, Beijing has put the frighteners on the investor community by exercising direct pressure on particularly powerful technology companies.

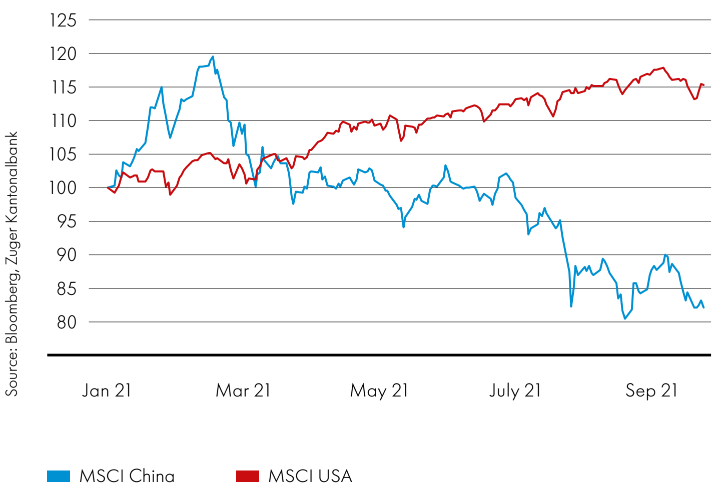
No profit through after-school tutoring

The Middle Kingdom is also taking unconventional regulatory steps to reduce social inequalities. The private education sector has been "reformed" without any prior warning being given – with immediate effect, it is now forbidden to make any profit from the offer of private tutoring services. This has ripped up the business models of various e-learning platforms in a single stroke. Nor is it just the equities of the affected companies that have reacted with dramatic losses: The entire Chinese stock market is suffering under regulatory pressure, and has lost significant ground against the US stock market since the start of the year (see graph). We remain cautious with respect to Chinese equities for the time being, even if valuations do look attractive.

Germany votes for change

In Germany, the political course was set for the next few years at the weekend, with the parliamentary elections. After 16 years of Angela Merkel, the time was ripe for sweeping changes. The SPD emerged as the election winners, with the CDU/CSU left out in the cold. The composition of the coalition remains unclear, as does the identity of the future Chancellor. The reaction of the financial markets to the rise of the left remains to be seen – only in the medium term will it become clear how much this electoral result affects Germany's role in the EU, the green agenda, as well as other areas of redistribution and economic policy.

Comparative performance of Chinese and US equities



Investment Update

Listen to the podcast from 9 September 2021 and register for further market appraisals.

What does this mean for investors?

Equities remain top choice

We recommend that investors continue to overweight global equities from developed economies. High rates of inflation weigh primarily on money invested in bonds. Nominal yields are low to negative. We therefore continue to view government bonds – particularly European – as unattractive. By contrast, corporate bonds have repeatedly benefited from rising risk appetite in the markets since our last publication. On the other hand, they now look very expensive. High-yield and emerging market bonds still present opportunities: current yields are higher here, and the economic outlook is likely to keep credit spreads low.

Be selective with emerging markets

We remain circumspect for now with regard to the emerging markets, of which China is by far the largest. We have significantly reduced the weighting of emerging market equities since our last issue of "Portfolio". We have adopted a particularly cautious stance in China, where political risks are high. The events surrounding Evergrande have brought nervousness to the real estate market, and have cast a spotlight on some of the excesses of recent years. To argue that the debt problems of Evergrande pose a threat of international contagion would appear premature, however. We continue to hold the view that Beijing is likely to have the most interest in bringing the turbulence under control. Otherwise there would be a very real risk of undermining the trust of international investors.

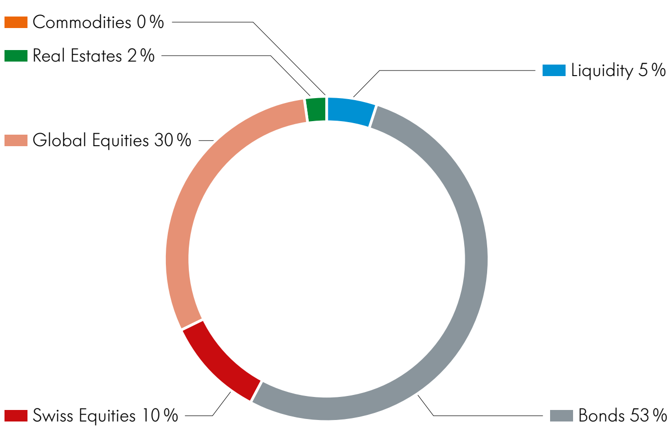
Active management worthwhile

The market dislocations in China show why an active investment approach should be favoured. If the uncertainty over further regulatory steps recedes following the Party Congress in March 2022, investors will be in a better position to look at the Chinese market more closely. We continue to recommend overweighting the equities of developed nations to counterbalance the reduction of emerging market equities. Here the environment remains attractive for this asset class. That said, the upcoming corporate earnings season will provide a test of its own. The investment community is facing the dilemma of working out which companies can pass on higher (commodity) prices, and which cannot.

Swiss real estate and gold

Gold has so far been unable to benefit from clearly negative real interest rates. Investors are obviously following the view expressed by central banks, namely that this is a temporary development. At the same time, investors have been showing a preference for riskier investments. Swiss real estate investments can look back on a successful year to date. While this asset class may now be very expensive, we continue to recommend maintaining a small real estate weighting in portfolios. Low interest rates continue to support valuations.

Strategic Allocation (Source Balanced Mandate)



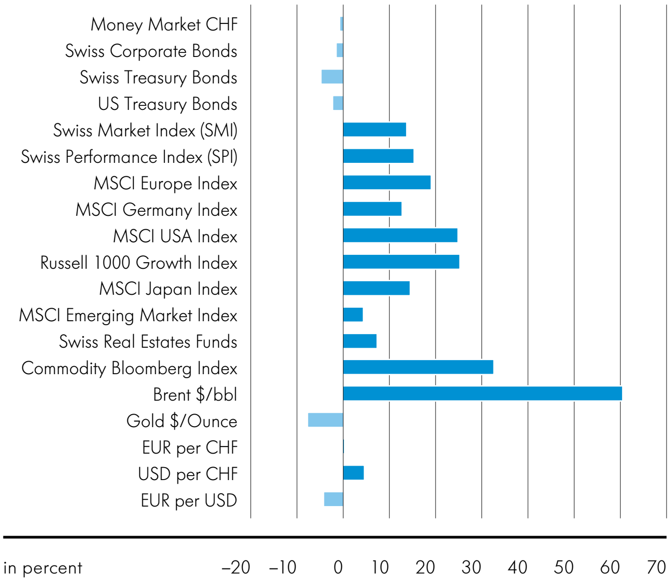
Tactical Allocation

	– –	–	=	+	+ +
Liquidity/Money Market				■	
Bonds	■				
Government Bonds		■			
Corporate Bonds		■			
High Yield Bonds & Emerging Markets				■	
Equities					■
Swiss Equities					■
Global Equities ex Switzerland				■	
Emerging Markets Equities		■			
Real Estates Switzerland			■		
Commodities				■	

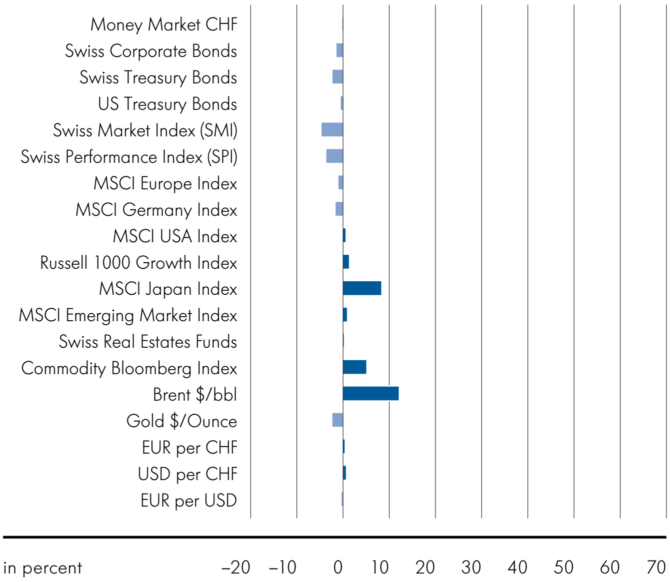
Source: Zuger Kantonalbank

Market data (exchanges & markets)

Return Asset Class (in CHF) since year start (as of 24.09.2021)



Return Asset Class (in CHF) since year start (as of 24.09.2021 rolling)



Source: Bloomberg, Zuger Kantonalbank

Swiss Equities SMI (since year start till 24.09.2021)

Partners Group 56.6% / CHF 1594.5	**ABB** 34.5% / CHF 32.33	**Sika** 34.3% / CHF 321.9	**Alcon** 33.2% / CHF 78.26	**Geberit** 32.8% / CHF 722.8
Lonza 31.3% / CHF 742.6	**Richemont** 28.1% / CHF 100.45	**UBS** 20.8% / CHF 14.72	**Swiss Life** 19.7% / CHF 471.4	**Givaudan** 19.3% / CHF 4372
Swisscom 16.7% / CHF 532.8	**Roche** 13.4% / CHF 340.4	**Nestle** 11.6% / CHF 113.44	**SGS** 10.5% / CHF 2866	**Zurich** 8.5% / CHF 385.1
Logitech 7.7% / CHF 91.64	**Swiss Re** 3.1% / CHF 80.3	**Lafarge Holcim** –3% / CHF 45.51	**Novartis** –4.5% / CHF 76.96	**Credit Suisse** –18.5% / CHF 9.19

Leading Indicators of industrial production
Values > 50 indicate expansion, Values < 50 indicate contraction

	Aug 2020	Sep 2020	Oct 2020	Nov 2020	Dec 2020	Jan 2021	Feb 2021	Mar 2021	April 2021	May 2021	June 2021	July 2021	Aug 2021
Global	51.8	52.4	53.1	53.8	53.8	53.6	54	55	55.8	56	55.5	55.4	54.1
Switzerland	51	52.8	52.9	54.5	57.3	59.4	61.3	66.3	69.5	69.9	66.7	71.1	67.7
Eurozone	51.7	53.7	54.8	53.8	55.2	54.8	57.9	62.5	62.9	63.1	63.4	62.8	61.4
Germany	52.2	56.4	58.2	57.8	58.3	57.1	60.7	66.6	66.2	64.4	65.1	65.9	62.6
Great Britain	55.2	54.1	53.7	55.6	57.5	54.1	55.1	58.9	60.9	65.6	63.9	60.4	60.3
USA	55.6	55.7	58.8	57.7	60.5	58.7	60.8	64.7	60.7	61.2	60.6	59.5	59.9
Japan	47.2	47.7	48.7	49	50	49.8	51.4	52.7	53.6	53	52.4	53	52.7
Emerging Markets	52.5	52.8	53.4	53.9	52.8	52.1	51.6	51.3	52.2	52	51.2	50.6	49.6
China	53.1	53	53.6	54.9	53	51.5	50.9	50.6	51.9	52	51.3	50.3	49.2
Brasil	64.7	64.9	66.7	64	61.5	56.5	58.4	52.8	52.3	53.7	56.4	56.7	53.6

Source: Bloomberg, Zuger Kantonalbank

Do you have any questions or thoughts regarding the current portfolio?

Simply contact us by e-mail (alex.mueller@zugerkb.ch) or call us at +41 (0)41 709 11 11.