



MARKET COMMENTARY

BERGOS
PRIVATE BANK



TILL C. BUDELMANN

As Bergos' Chief Investment Officer, Till Christian Budelmann regularly comments on events on the international capital markets and examines them in the context of economic and political trends. Since 2004, Budelmann has been responsible for various investment strategies and sits on the bank's Investment Committee. He has been Managing Director since 2013.

INVESTORS WILL NEED STRONG NERVES THIS YEAR

Many investors were unsettled by the development of markets in January. And they should brace themselves for repeated phases of turbulence in the rest of the year as well. On balance, however, Till Budelmann, Chief Investment Officer of the Swiss private bank Bergos, is rather optimistic, believing that equity prices will close the year at a higher level than today. This expectation is based on the following considerations: The global economy is growing at least at the trend rate, corporate earnings growth is positive, investor sentiment as a contrarian indicator is rather pessimistic, and there is still no alternative to equities as a source of return. He still prefers the US equity market despite its recent relative weakness. Extremely short durations in US bonds can protect against the steep losses that could result from a further rise in yields.

January was indeed nerve-wracking for investors. Volatility soared and equity markets suffered heavy losses in some cases. "However, it pays to look beneath the surface because the equity market as a whole was not sold. There were, in fact, winners", said Till Budelmann. Higher-valued stocks, as measured by the price earnings ratio for example, fell harder on average. High-valuation growth stocks such as tech stocks were sold the most. A renewed rotation into value stocks was clearly evident. Winners included the energy sector, which gained on the month. In terms of regions, US equities underperformed equity markets in the rest of the world for the first time in a long time.

"The US Federal Reserve was the main cause of the market turbulence. It had clearly signalled that it will actively counter the high rate of inflation and more quickly change course in the direction of a more restrictive monetary policy", Budelmann said. He expects the first interest rate hike in March, followed in all likelihood by several small steps in the remainder of the year.

Investors seeking return will still be reliant on equities

With that in mind, it could be a turbulent year for investors. "Advisors should make sure their clients truly have the stomach for stock-heavy portfolios. In this regard, January was a good test", Budelmann said. This is not to say, however, that he advises against equities. On the contrary: "If you want return, you will still be reliant on equities. We have entered a new bull market after the crash triggered by the coronavirus in the spring of 2020. The latest correction is the result of a valuation adjustment due to the fact that many stocks had simply risen too far", Budelmann said, explaining: "Future corporate earnings must now be discounted at higher interest rates. That is why growth stocks in particular underwent a valuation adjustment."

The Bergos CIO sees good reasons to think that the worst may already be behind us. For example, the sentiment of individual investors is more pessimistic than at any time since 2013, according to the AAll Sentiment Survey. "We consider that as a good sign. History shows that the more pessimistic the sentiment, the better the performance in the subsequent weeks and months", Budelmann said. The average positioning in systematic strategies, which is currently strikingly defensive, points in the same direction.

Equities are still relatively attractive despite higher bond yields

Another argument in favour of equities is the yield gap, which refers to the gap between the earnings yields of equities and the yields of 10-year government bonds. Rising corporate earnings and falling share prices have pushed up earnings yields so significantly that the yield gap has actually widened, despite the recent noticeable rise in bond yields, so that the relative attractiveness of equities over bonds is still well above the long-term average.

Among the risks that could threaten the positive performance of equities, Budelmann cites a possible war in Ukraine and inflation rates, which have exceeded the already high expectations of market participants. Bergos expects up to 5 percent inflation in the United States, for example, in 2022.

Positioning: United States, consumer cyclicals again, short durations still preferred

In terms of regions, Budelmann still sees the greatest upside potential in the United States, despite the relative weakness recently. He also favours Japan. As in the US, particularly high earnings growth is expected here. Bergos continues to overweight both these markets. After downgrading consumer cyclicals at the end of last year, Bergos used the sharp declines in January as an occasion to build up positions in this sector again. "Given the overbought technical picture and a good start to the reporting season, we see potential for earnings revisions and a valuation expansion in the sector," Budelmann said.

High inflation rates and the expectation of a more restrictive Fed policy have also created turmoil in the bond markets. All things considered, Bergos thinks it is advisable to underweight this asset class. The yields of bonds have recently moved much higher. "Our extremely short duration in the United States has paid off and we are sticking with this strategy because we expect bond yields to rise further", Budelmann said. However, he does not expect them to rise all too far; but, the yields of 10-year US Treasuries, which have risen from 1.1 to 1.9 percent over the last 12 months, are likely to exceed the 2 percent mark.

Gold is still important in the multi-asset context, despite a lack of catalysts

Despite the high level of uncertainty in the markets, gold cannot be expected to rally in the near term. "The price of gold is still caught between rising nominal yields and rising inflation rates. So from a fundamental perspective, there are no clear drivers. Also in terms of chart-technical analysis, gold is stuck within its trading range of USD 1,700 to USD 1,900 per ounce", Budelmann explained. Nevertheless, he still considers gold to be a good natural hedge in the portfolio context.

The market behaviour in January already suggests that 2022 will not be an easy year. Investors will need strong nerves, but the global equity markets will probably end the year at a higher level than today. Budelmann: "Active portfolio management is especially important in the current environment. By that, I don't mean hectic buying and selling, but rather the courage of conviction to seize regional and sectoral opportunities as they arise."



B E R G O S

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