



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. Budelmann is member of the bank's executive board and heads the investment committee.

OUTLOOK 2023: END OF THE BEAR MARKET IN BONDS

From a macroeconomic perspective, 2023 will be a rather difficult year. "In the capital markets, however, this dull outlook is probably already priced-in for the most part", said Till Christian Budelmann, Chief Investment Officer of the Swiss private bank Bergos. After the sharp rise in interest rates, bonds are again attractive as a portfolio investment. Like equities, they should deliver gains by the end of 2023, albeit with great volatility. Therefore, active asset management will be a major success factor in 2023.

After the annus horribilis of 2022, markets should be somewhat more friendly to investors in 2023. In every year since the 1960s in which equities closed the year in negative territory, the major bond market benchmarks were always up or at least flat. However, this portfolio balancing effect failed to materialize in 2022. Whereas both equities and bonds have been clearly negative in the calendar year to date, Till Budelmann now sees good chances that both asset classes will deliver a positive performance by the end of the coming year.

In terms of the economy, however, things will go downhill at first. Under the strain of the energy crisis, the Eurozone is heading into a recession already in the fourth quarter of 2022. On an annualized basis, Bergos expects that gross domestic product will contract by almost 3 percent, compared to the fourth quarter of 2021, and then by slightly more than 2.5 percent in the first quarter of 2023. After that, the situation should improve, with economic output potentially rising again in the autumn of next year. The economic downturn will come somewhat later and will be generally milder in the United States. Bergos sees the deepest decline of around 1.5 percent occurring there in the second and third quarters of 2023. The GDP forecast for the full year 2023 is around -0.2 percent for the United States and around -0.8 percent for the Eurozone.

Geopolitical tensions, inflation and central bank policy: Volatility is assured

"The economic downturn is expected and has already been priced-in by capital markets, in our opinion", Budelmann said. Nonetheless, investors must be prepared for volatility. There will be no shortage of risks. Geopolitical issues like the war in Ukraine and the rivalries between the United States and China will continue to fuel volatility.

Markets will also be decisively affected by inflation and the related development of interest rates in 2023. "In the United States, we expect the inflation rate to fall by half from around 8 percent in 2022 to a range of 4 to 4.5 percent in 2023. In the Eurozone, inflation will be more persistent due to the continuing energy crisis", Budelmann said. Bergos predicts that it will be around 6 to 7 percent in 2023, after 8.5 percent in 2022.

As usual, the United States is somewhat ahead of the Eurozone in the rate hike cycle. Future contracts currently reflect an expectation that the US benchmark rate will peak at around 5 percent in the middle of March 2023. As for the ECB's benchmark rate, the market is currently anticipating a peak of 3 percent in June 2023. "There is still a risk that inflation will remain stuck at a high level, urging central banks to act more forcefully and for a longer period of time than is currently priced-in", Budelmann said.

Bonds: Upgraded from underweight to neutral

The interest rate hikes have an important effect for investors by making bonds more attractive. Investors are therefore adding bonds to their portfolios again. "We had long considered equities to be more attractive than bonds and therefore gave them a relatively stronger weighting. That has changed now. After consistently underweighting bonds in 2020 und 2021, we have now upgraded this asset class to neutral", Budelmann said. This change was driven by one development in particular: The yield gap, meaning the difference between the earnings yield of equities and the yield of 10-year bonds, has narrowed further. In the United States, the yield gap is only 1.9 percentage points now, corresponding to the historical average since the 1970s. "Thus, equities are no longer more attractive fundamentally than bonds", Budelmann explained.

Or in other words, TINA ("There is no alternative") has been replaced by TARA ("There are reasonable alternatives"). And this reasonable alternative to equities are bonds, which again deserve a stronger place in a multi-asset portfolio. In this context, Budelmann is not so much thinking about government bonds as high-quality corporate bonds, which now offer respectable yields again. However, Bergos is still sticking with rather short durations, although this positioning is now somewhat less pronounced than before. In terms of regions, Bergos sees better opportunities in the United States than in Europe given that interest rates are higher there and the expected trend is more favourable. Certain emerging-market bonds can serve as a useful portfolio addition.

Equities: Beaten-down high-quality growth stocks represent good buying opportunities

Also with respect to equities, Budelmann continues to prefer the United States over Europe: “The macroeconomic data are better in the United States and the US market is also much more growth-heavy.” High-quality growth stocks are among his favourites. Growth stocks performed historically poorly compared to value stocks in 2022. “We think the market overreacted in this regard. From this level, we see more potential for growth stocks than for value stocks”, said the Bergos CIO. In Europe, he prefers companies that generate a large part of their revenues outside of Europe.

He is also sticking with an overweight in Japanese equities, accompanied by currency hedging. This country offers the advantage of relatively low inflation and comparatively expansive central bank policy. By contrast, caution is still advised with respect to equities in China and emerging markets.

An argument in favour of equities at the present time is the extremely pessimistic investor sentiment, as reflected by many indicators. For example, the VIX index, which shows expected volatility in the S&P 500 and is also known as the “fear index”, was higher on average in 2022 than ever with the exception of only a few years. In most cases, a “year of fear” is followed by a good year for stock markets. Known examples from the recent past include 2003, 2009/2010 and 2021.

Alternative investments: Gold as a key element, convertible bonds offer potential

Whereas equities and bonds are now neutrally weighted in the Bergos portfolios, alternative investments remain overweighted. “We consider gold to be a key element of a multi-asset portfolio as a crisis hedge”, Budelmann said. He also sees potential for convertible bonds again in 2023, after that asset class having been beaten down severely in 2022 due to the poor performance of both equities and bonds. With regard to currencies, in addition to hedging the Japanese yen, a partial US dollar hedge is also an option for Euro investors with strong exposure to US Dollar investments.

Budelmann's conclusion: “2023 will be a stock-picking year without a truly clear trend. Markets will still be very volatile in the coming months and investors will therefore need to react tactically at times. If the market tanks in the meantime, investors should seize opportunities, not only by picking stocks and bonds, but also by fine-tuning the equity allocation as a whole. Active asset management will be crucial for investment success.”



B E R G O S

P R I V A T E B A N K

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