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SWITZERLAND TOP 50 INDEPENDENT ASSET MANAGERS 2021

Monthly Pulse – Thursday, 23rd December 2021

Economic Outlook

As a new wave of Covid-19 scares the markets yet again, inflation is worrying not only investors, but policy makers as well. The current environment is truly treacherous: central banks have to tread the fine line between tightening too fast, which amid the vulnerable economy might lead to a recession, and too slowly, which might let inflation get out of hand. Meanwhile, investors have to navigate the particularly tricky risk/return trade-off.

Tactical Asset Allocation

Liquidity	Neutral
Bonds	Underweight
Equities	Neutral
Alternative Investments	Neutral

Macroeconomics

In the last two months of 2021, US initial jobless claims returned to the pre-pandemic levels of around 200k per week. US unemployment rate in November was 4.2%, below the expected 4.5% and below the October reading of 4.6%, but still around 0.7 p.p. higher, than the pre-pandemic level. At the same time, labor participation still stood at 61.8%, around 1 p.p. below the pre-pandemic average. Moreover, November US non-farm payrolls turned out much below the expected 500k and stood at the level of 210k, meaning that much fewer people were employed in the US, than was expected by the analysts. All this shows that labor market in the US is recovering but has not yet regained its full strength. Inflation, however, is still elevated and the risk of it remaining high for longer is growing. The latest CPI figures showed, that in November consumer prices grew 6.8% year on year or 4.9% year on year if energy and food are excluded from the calculations. Central banks across the world are acknowledging this and adjusting their policies accordingly. So, after the December meeting, the Fed announced an increase in the speed of tapering: it will now decrease monthly asset purchases by $30 billion per month (instead of the previously announced $15 billion per month). Such a pace should bring the program to an end already by the second quarter of 2022, giving room for potential rate hikes. The majority of FOMC participants now expect three hikes throughout 2022, which signifies heightened concerns about inflation in the next couple of years. However, even though more hikes are now expected in the shorter term, the longer-run section of the dot plot is unchanged relative to the November picture. Thus, even though FOMC no longer calls inflation "transitory", it appears, that the long-run expectation is still mild.

Meanwhile, in the Eurozone area, seasonally adjusted unemployment rate in October was 7.3%, around the same level as in the end of 2019. The number of employed persons in the Eurozone area increased significantly in 3Q21 relative to the previous quarters and stood at over 160M, even slightly exceeding the pre-pandemic figures. Inflation in Europe is also elevated, although not as dramatically is in the US. November HCPI data indicated that prices in euro area grew 4.9% year on year or 2.6% if energy and food are excluded. The European Central Bank, while shifting its policy into the overall more hawkish direction, is still staying very careful and accommodative. After the December meeting, the ECB Governing Council announced, that the Pandemic Emergency Purchase Programme is to be discontinued at the end of March 2022, but a lot of room for flexibility was left in case the economy proves vulnerable. At the same time, the ECB plans to increase the pace of its asset purchase programme to €40 billion in 2Q22 and gradually decrease it to €20 billion per month from October 2022 onwards "for as long as necessary". Only after net purchases have been concluded, would the ECB raise the interest rates, but before that happens, the ECB wants to see their inflation projections stabilize over 2% on average over medium term. This implies that the central bank is still willing to tolerate periods of above-target price growth rates.

Fixed Income

It remains a challenging environment for Fixed Income Investors. Monetary policy normalization is set to proceed at a faster pace as inflation remains the hot topic. Supply chain problems, higher energy costs and strong consumer demand are the main driver. We already have seen that central banks are getting more hawkish as they don't want to lose their credibility. The last FOMC meeting showed that inflation has passed a level where it isn't considered to be transitory anymore. That means that the Fed is expected to start hiking rates already in March. This early move (Q1) would give them more room to manoeuvre. Especially when an above-trend growing economy can handle more tightening. Growth is likely to be frontloaded in1H22.

Currently, 10-year Treasury Yields are trading around 1.45%, which indicates that neither inflation nor an overheating economy seems to be a problem. On the contrary, it shows that investors don't believe in a prolonged tightening cycle.

We are in the other camp. At current levels (UST 10yr @ 1.45%) we estimate the risk of rising 10yr-yields is higher than vice versa. Therefore, we remain cautious on duration and prefer to park the money at the short end. We need more evidence that inflation is only transitory, and the Fed is not behind the curve. Although it might be that the tightening process will be slower than in other cycles, it doesn't give us the confidence to already lock in long yields at current levels. It's too early but I would not exclude that we are going to reconsider this strategy later in 2H22.

Although 2-year rates will move up as well and therefore bond-prices are capped to the upside, we prefer to stay defensive by accepting a lower total return for our Fixed Income Instruments.

On the other hand, we still believe that the current state of the economy allows us to add some credit risk. Bonds from the energy, materials and financial (AT1's) sector still offer some elevated spread. Additionally, we remain positive for Hybrids from well-known Corporates. We feel comfortable to go down the credit curve or the capital structure, with picking up some names from the BB segment.

For USD Emerging Market bonds, we are a bit more cautious as a higher USD and higher US rates combined with a China slowdown might weight on the sentiment. Nevertheless, there will be some buying opportunities in high beta names later in the year.

China might provide some opportunities in 2022, as volatility from the property sector scared a lot of investors in 2021. There are signs that policy restrictions are easing, and fresh stimulus measures are arriving. But we think it's too early now to step into the HY property sector. But once it's time, we only would choose bigger developers which are related to the Government.

The IG part of the portfolio we see as a hedge and a potential source of funds in case of major correction in credit spreads.

Overall, the outlook for Fixed Income is rather dim this year, as higher rates, already tight credit spreads and ongoing risk-off waves coming from the Covid-19 front, will dampen investors' appetite. Although it might be more challenging, we believe that positive total returns are still possible to achieve. Short duration from well selected Corporates (BBB-BB area) would be our recipe.

Equities

After more than a decade, the financial community is used to reactive and influential Central Banks. Next year will not be an exception: while fiscal levers remain significant and tied to monetary policy, Central Banks will stay vigilant and keen to manage the growth/inflation twist that will be the dominant market narrative throughout 2022, in our opinion. This will most probably further increase the asynchrony of monetary policy worldwide and probably lead to increased volatility.

A surprising takeaway from the Fed's December meeting was its willingness to the off-ramp for hiking rates before fulfilling its employment mandate. The rate outlook makes most analysts cautious on equity, but history suggests very different paths for Fed hiking cycles that occur with high inflation/rapid tightening (-7.5% on the S&P 500 in the first 4 months after lift-off) or slow ones (+15% in the first 12m). Now the FOMC's updated projection shows the median dot moving higher to three hikes in both 2022 and 2023. The more hawkish stance was somewhat expected. But Powell seemed keener to get hiking started sooner rather than later and this is a worry. However, Omicron permitting, an easing of bottlenecks should lift growth in Q1, helping global stocks.

Equity Indicators

Valuation	Neutral
Momentum	Neutral
Seasonality	Positive
Macro-Economics	Positive

In terms of portfolio construction and generally speaking, 2022 will bring more challenges compared to 2021. Investors cannot expect 2021-level returns for equities, amid an environment of normalizing earnings growth and mounting pressure on margins. Toppish margins do not mean negative earnings growth or the end of a bull market, as top lines take the lead for driving EPS. Nevertheless, it implies a speed limit to expected returns as EPS growth should face from double digits to single digit in 2022. Then the direction of bond yields will become key. Rising bond yields provide some advantage to EMU. Japan should eventually benefit from a delayed recovery in H2 and a weaker JPY. Also be prepared to take a more positive stance on EM later on once the Chinese authorities accelerate accommodation. Moreover, the quality of growth will deteriorate (less growth, more inflation), even if growth remains above potential in 2022. This suggests considering Quality on top of core Value and Momentum. On themes, consider Value (banks), pricing power (luxury, semiconductors), rising commodities (energy), capex (capital goods) and Quality (pharma).

We expect the U.S tapering to proceed normally. But investors should bear in mind of any downside risks coming along such as:

- Several risks precipitate an economic downturn, whose depth depends on the nature and intensity of the shock.
- Upward price pressures fade, as global demand falls, and labor markets deteriorate.
- Renewed monetary and fiscal accommodation, possibly a further step in financial repression.
- Inflation to resurface later, forcing Central Banks to deviate from their guidance and lose credibility.
- Possible triggers include China's hard landing, Covid-19 resurgence, financial shocks, de-anchoring inflation expectations, climate-change-related natural disasters, and policy mistakes.

This renewed slump towards a stagflation is not our base scenario, but it is something to have on the radar. Concluding, we keep our neutral stance and are cautiously optimistic about the equity markets in Q1 2022 which should be supported by the forthcoming Q4 earnings season.

Alternative Investments

As in the equity world, commodities will also see volatile times, capping the risk/reward ratio. Oil is torn between demand shocks caused by Corona and further lock-down measures, but supply is still limited and should support prices. Brent started the year at $50 and is now close to $72 peaking at $85 in October. Crude oil movements were likewise also impressive. If you then look at total return indices, which take into account the forward curve, you could have added throughout the year an additional 10%. Absolute highflyer in the energy sector was Natural Gas with a spot price increase of 680 percent. Gold was range-bound this year starting close to USD 1'900 with a flash crash below USD 1'700 just to recover due to inflation fears back to USD 1'800. Implied Volatility in Gold therefore, decreased significantly from 20 percent to only 14 percent. Gold is driven by higher rates expectation in the US but should work as a hedge for inflation.

In hedge funds markets, low beta strategies are favoured. The most returning hedge fund strategies were found in long/short, sector-oriented such as Energy whereas Macro and CTA funds were in a negative territory. There has not yet been need for a hedge for equity markets.

For Private Market investment, it has been another good year with returns equalling public equity markets. Due to its illiquidity premium, private markets merit a strategic allocation in a portfolio. More can be read in our special topic about "Private Markets".

Looking at the FX space, the rising interest rate differential will also be reflected and offers support for the North American currencies and the GBP. In addition to the steep path of interest rate hikes, the CAD is supported by continued strong economic growth and the higher crude oil price level despite the recent setback. The solid development of the US economy and expectations of earlier interest rate hikes will also continue to support the USD. However, the upside potential of the USD is limited due to its already high valuation. The GBP, on the other hand, is relatively cheaply valued, which offers opportunities for next year.

The environment for the EUR has also deteriorated. However, the economy should continue to recover, and lower inflation rates in the euro zone will lead to higher real yields again. Against this backdrop, the EUR will be able to gain ground overall.

The CHF has recently continued to benefit from stagflation concerns. However, the ongoing global economic recovery and higher real yields will put the CHF under selling pressure in 2022.

The playbook for the greenback should be clear: if anything, the FED has become much more data sensitive, and so early next year as Omicron fades, QE comes to an end and lift-off is initiated, US rates and hence the USD will see a clearer path higher. And this usually does not bode well for EM currencies.

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Market Overview as of Thursday, 23 December 2021, 11:30 AM

Fixed Income

	Rate	Δ 1m	Δ 3m	Δ ytd
USD Overnight	0.07	0.00	0.01	0.00
USD 1y Swap	0.53	0.13	0.35	0.34
USD 3y Swap	1.16	0.01	0.50	0.92
USD 5y Swap	1.35	-0.09	0.30	0.92
USD 10y Swap	1.55	-0.17	0.09	0.63
EUR Overnight	-0.49	0.00	0.00	0.01
EUR 1y Swap	-0.49	0.00	0.01	0.04
EUR 3y Swap	-0.19	0.02	0.17	0.31
EUR 5y Swap	-0.05	0.02	0.16	0.41
EUR 10y Swap	0.22	-0.01	0.11	0.48
CDX Xover 5y	2.97%	-0.09%	0.23%	0.04%
iTraxx Xover 5y	2.47%	-0.14%	0.08%	0.04%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
USD Deposit 1m	0.2%	0.5%	0.9%	0.9%
USD Aggregate 1-3y	0.0%	-0.6%	-0.4%	-0.5%
USD Aggregate 3-5y	0.3%	-0.9%	-0.7%	-1.5%
USD Aggregate 5-7y	0.6%	-0.7%	-0.3%	-2.3%
USD Aggregate 7-10y	1.2%	-0.5%	0.2%	-2.6%
EUR Overnight	0.0%	-0.1%	-0.2%	-0.5%
EUR Aggregate 1-3y	-0.1%	-0.2%	-0.2%	-0.4%
EUR Aggregate 3-5y	-0.1%	-0.4%	-0.2%	-0.6%
EUR Aggregate 5-7y	0.1%	-0.5%	-0.1%	-1.1%
EUR Aggregate 7-10y	0.3%	-0.6%	0.2%	-2.0%
US Corp. HY	1.0%	-0.1%	1.7%	4.9%
EUR HY	0.0%	-0.5%	0.4%	3.1%

Equity

	Price	P/E	D. Yield	FCF yield
MSCI World	9,608	20.0	1.8%	4.9%
S&P 500	4,697	22.5	1.3%	3.4%
NASDAQ	16,180	30.0	0.6%	2.8%
Euro Stoxx 50	4,238	16.3	2.8%	13.8%
SMI	12,740	19.6	2.6%	5.9%
FTSE 100	7,361	12.5	4.0%	10.3%
DAX	15,659	14.5	2.7%	8.6%
MSCI Asia Pacific	191	15.0	2.5%	5.8%
FTSE China A50	15,917	14.5	2.3%	11.9%
MSCI Emerging Market	1,210	12.9	2.9%	7.3%
PH Semiconductor	3,892	21.4	1.1%	3.4%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
MSCI World	-0.3%	2.8%	6.8%	20.0%
S&P 500	0.1%	5.6%	10.7%	25.0%
NASDAQ	-0.8%	5.6%	13.4%	25.5%
Euro Stoxx 50	-1.1%	1.0%	4.0%	19.3%
SMI	3.0%	6.7%	7.1%	19.0%
FTSE 100	1.3%	4.0%	4.1%	13.9%
DAX	-1.7%	0.1%	1.3%	14.1%
MSCI Asia Pacific	-3.6%	-5.0%	-7.9%	-4.7%
FTSE China A50	1.7%	6.3%	-7.8%	-10.1%
MSCI Emerging Market	-3.6%	-4.9%	-11.1%	-6.3%
PH Semiconductor	1.5%	12.6%	21.7%	39.2%

Commodity

	Price	FCST 21	FCST 22	Δ Future
Gold	1,806	1792.4	1720	-0.1%
Silver	22.88	25.16	23.84	1.0%
Platinum	967	1091	1088.75	1.0%
Palladium	1,885	2410	2156.25	2.7%
Crude Oil	72.62	68.12	70	1.0%
Brent Oil	75.16	70.95	72.3	-0.6%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
Gold	1.2%	3.3%	1.3%	-4.7%
Silver	-2.6%	0.7%	-12.9%	-14.5%
Platinum	0.1%	-3.0%	-11.8%	-11.7%
Palladium	1.8%	-4.6%	-28.5%	-22.4%
Crude Oil	-6.8%	1.1%	6.0%	53.5%
Brent Oil	-7.6%	0.5%	5.5%	48.9%

Foreign Exchange

	Price	FCST 21	FCST 22	Δ Spot
EUR/USD	1.1321	1.14	1.16	2.4%
GBP/USD	1.3402	1.35	1.37	2.2%
USD/CHF	0.9205	0.93	0.94	2.1%
USD/JPY	114.31	114	115	0.6%
EUR/CHF	1.0421	1.06	1.09	4.5%
USD/RUB	73.32	71.19	71.65	-2.3%
EUR/RUB	83.00	80.7	81.63	-1.7%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
EUR/USD	0.6%	-3.6%	-5.1%	-7.3%
GBP/USD	0.2%	-2.3%	-4.0%	-2.0%
USD/CHF	1.3%	0.4%	-0.2%	-3.8%
USD/JPY	0.7%	-3.5%	-2.9%	-9.7%
EUR/CHF	0.7%	4.2%	5.1%	3.8%
USD/RUB	1.3%	-0.7%	-1.0%	1.5%
EUR/RUB	0.8%	2.8%	4.4%	9.2%

Source: Clarus Capital Group, Bloomberg

Special Topics

Inflation

Elevated inflation is currently an omnipresent phenomenon. Although most CPI components showed growth above the target levels, by far the greatest contributor to heightened inflation in 2021 was energy, as oil and gas inventory shortages fuelled price growth rate.

Overall, possible explanations to what is happening include:

- Energy prices (production is not yet back to pre-pandemic levels; oil and gas inventory shortages; natural events contributing to relatively low stockpile, which, in turn, lifted energy prices)
- Base effect (2021's price growth is amplified by the deflationary environment in 2020, caused by the worldwide large-scale lockdowns and decreased spending)
- Pent up demand (after reduced spending throughout the course of the pandemic, people have more money than normal to spend on goods and services even at higher prices)
- Supply-chain bottlenecks (production and shipping suffered due to pandemic-related quarantines and closures, which created shortages and contributed to rising prices)
- Unprecedentedly large monetary and fiscal stimulus added liquidity into the system

The US Fed and the ECB, according to their forecasts, expect heightened inflation levels to pass within the next couple of years, be it due to the natural economic developments or their own actions. In particular, energy prices are expected to stabilize in 2022 (however, an unusually cold winter in the Northern Hemisphere would pose a risk of lifting energy prices yet further), base effects are naturally going to fade away, as well as the excess savings and monetary and fiscal stimulus. Supply chain bottlenecks are also expected to be resolved once the virus is truly under control and potential lockdowns and quarantines are no longer an issue. A more dangerous potential contributor to rising prices is wage growth. If labour shortage it continues, employers will be forced to increase wages to attract workers. Then there might be a potential for a self-reinforcing inflation spiral, where rising wages fuel rising prices as companies attempt to compensate for the more expensive production, which leads to workers demanding pay rise to compensate for higher prices, and so on. However, as pandemic subsides, more people should be willing to come back to work, which should eliminate this factor.

While major central banks are careful in their actions, trying not to harm the recovery, it looks like they are quite cautious about the rising prices, and are now shifting their policy towards a more hawkish direction. Of course, sounding too pessimistic about inflation getting out of hand would pose the risk of creating a self-fulfilling prophecy (inflation expectations force firms and markets to prepare for higher prices, which ends up lifting prices). Nonetheless, major banks and analysts expect, that inflation will peak in the first half of 2022 and subside from then on.

Despite that, market participants seek to protect their investments in this environment. There are several ways to do that. First, assets with positive real returns, such as inflation-linked bonds and senior loans with floating rates, are natural protectors against inflation. Second, commodities or stocks of commodity-producers are another way to protect your portfolio against inflation, since not only are they correlated with inflation, but their prices actually affect it. Third, investing in companies with stronger pricing power should be a good choice, since their margins are less likely to suffer as costs increase.

Is crypto legitimate in the portfolio context?

The key question here is how cryptocurrencies may fit into a multi-asset portfolio. In recent years, balanced portfolios have become imbalanced as low bond yields have provided less of a buffer against equity drawdowns and as the risk of rising inflation has grown. This has kicked off an intense search for alternative diversifiers that can help portfolios buffer growth or rate shocks. But to add value from a portfolio perspective, an asset should offer an attractive risk/reward or low correlations with other asset classes, and preferably both. Over the last 35 years, bonds served this role as they delivered attractive risk-adjusted returns while being negatively correlated with equities.

With 20 percent global debt offering negative yields, the hurdle rate for other assets to compete with bonds for the role of diversifier has declined. As a result, the lack of cashflow or yield from cryptocurrencies has become less of a concern, especially as the same is true for gold and most

developed market fiat currencies. And bitcoin, which was the first cryptocurrency and has the largest market cap today, has posted strong risk-adjusted returns mostly "uncorrelated" with traditional assets. But the history of bitcoin has been short and volatile, with a large proportion of that volatility idiosyncratic – making it difficult to assess how much of a beneficial role it could play in portfolios. Additionally, bitcoin's proclaimed advantage of seemingly uncorrelated returns to traditional asset classes also appears to be crumbling. Since 2014, bitcoin has actually often declined during equity drawdowns like in 2015, 2018 and Q1 2020. These large drawdowns, combined with bitcoin's high volatility, have eventually outweighed the benefits of having it in a portfolio at higher allocations.

Studies have shown that even with just a 5% allocation in a 60/40 portfolio, bitcoin drove roughly 20% of the portfolio's volatility, while US 10Y bonds contributed only 2%. That is likely too much concentrated risk exposure for an institutional portfolio. Such a high volatility also limits the potential allocations from investors employing risk parity strategies or targeting a specific level of risk in the portfolio.

Other points, that speak against crypto in the portfolio context:

- Low and unstable correlations since 2012
- No positive expected return that is both predictable and attractive on a risk-adjusted basis
- Its true value is questionable
- Regulatory and tax concerns have driven sharp pullbacks
- High volatility requires more frequent and unfavorable rebalancing; meaning investors need to buy into a drawdown and sell during a rally
- Overall crypto market is small and rather illiquid compared to the bond and equity markets
- Custody and counterparty risks can be difficult and costly to manage

All these factors mentioned above may slow broad adoption from institutional investors. But since new inventions take time to be adopted, chances are at some point in the future cryptocurrencies will be more widely accepted. This would lead to a maturing market and subsequently declining volatility and returns, as it happened to gold, when private investors were allowed to get exposure in 1970s.

Private markets: still a premium?

Public market developments are spilling over into private markets. The pandemic has accelerated structural trends and sustainability is another trend driving investments. The issue with Private investments is that they are typically hand-picked and require active management, offering potential long-term value and diversification.

Blackrock sees opportunities for private markets financing technologies for energy resilience, power innovation, electric vehicles, among others. The evolution of climate technologies in private markets is likely to remain a dominant theme due to a further implementation of ESG. Sectoral positioning, granularity and relative value opportunities will be key. In real estate, the wide divergence between favoured sectors (logistics) and unfavoured sectors (offices) is likely to continue. Mergers and restructurings are expected to stay busy as companies adapt to megatrends at play.

More broadly, we see private markets as a core strategic holding for their diversification characteristics and potential returns. However, investors should bear in mind that two key drivers are essential:

- The attractiveness of small- and mid-sized deals
- Democratization of private assets (liquidity options, access options)

In private markets, one factor that is often overlooked and that investors can turn to their advantage is that the vast majority of transactions are small and mid-sized deals following Schroders. They represent 95% of all transactions and 50% of the total transaction volume - the long tail of private assets.

"Given its high number of transactions, the long tail of private assets provides investors with a wider array of opportunities to capture what we call the "complexity premium" – unique skill sets applied to complex investment opportunities" (Schroders).

Examining the private equity landscape of the past 18 months, Schroders conclude that the impacts of the Covid-19 pandemic were short-lived, and that the environment ahead is smooth sailing. Deal activity and exits are at all-time highs. Returns rebounded strongly since the nadir of the pandemic, and in 2020 the asset class posted its highest return in 14 years. However, this smooth surface hides significant turbulence beneath. The dispersion between individual funds' performance has widened compared to the experience of the past decade, reflecting broader differences in trajectories of companies, sectors, and segments of the economy.

Following Schroders this dispersion may be a harbinger of a turbulent era ahead. Some challenges, like digitization and automation, are accelerations of pre-pandemic trends. Others, like inflation volatility, may be remerging after a quarter-century—but a vastly changed economy and market structure compared to prior periods of volatile inflation mean that history may offer limited guidance. Still others, such as a political and social environment in which private equity may find itself in a spotlight after years of operating in opacity, are new. All these changes are taking place in the context of record-high valuations in private markets, with attendant implications for the way managers must select and manage their investments.

At Clarus Capital we offer you tailor-made solutions to Private Markets. Please ask your Relationship Manager for any specific ideas.

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