

Review of Financial Markets Q1 2023

The financial markets got off to a surprisingly good start to the new year, with both equities and bonds posting gains. However, asset prices already reached their peak at the end of January. The recovery that began in October of the previous year was halted for the time being, with prices retreating in February. Inflationary trends and fears of recession dominated market behavior, while the war in Europe receded into the background.

Central banks remained committed to their restrictive course and continued to raise key interest rates. This policy had unexpected consequences for some U.S. regional banks, which were caught in a liquidity crisis fueled by mistrust. The crisis of confidence also affected CS, which was soon after forced by the government into an involuntary marriage with UBS. This tremor in the financial sector did not change the course of monetary policy in the US, the euro zone or Switzerland. The fight against stubbornly high inflation remains a priority, especially since the current economic data were not all that worrying.

However, economic signals remained somewhat contradictory. While the signals from the capital market, such as an inverse yield curve, point to a recession, survey results in the economy showed accelerating activity driven by the service sector. In addition, economic expectations were reinforced by China's abandonment of its zero-Covid policy.

The bond markets gained somewhat on the back of declining capital market interest rates, with indices rising between roughly 2% and 3%. Risk premiums remained little changed on average, except for debtors from the emerging markets segment.

The US dollar lost approximately 1% against the European currencies due to the change in interest rate expectations, but gained against the yen and AUD. The CHF/Euro exchange rate remained just below parity, resulting in a net weakening of the CHF by 0.6%.

The commodity index lost around 6%, with energy prices in particular pushing it down. The oil price fell by 7% (Brent) and the US gas price by 50%. The picture for industrial and precious metals was mixed. Copper and gold gained around 8%, while nickel and palladium lost 20% in value.

Equity markets continued their recovery from the autumn lows; the world index gained around 8%. Sector performance was partly a reversal of 2022, with technology, communications, and discretionary consumer stocks performing best.



In contrast, energy, the only positive sector last year, lost 3% in Q1. Health care and financial stocks were also slightly down. Not surprisingly, the Nasdaq Index was the main driver of the stock market recovery, followed by the Euro Stoxx. Small caps and emerging markets were less successful.

Waiting for the "Godot recession"?

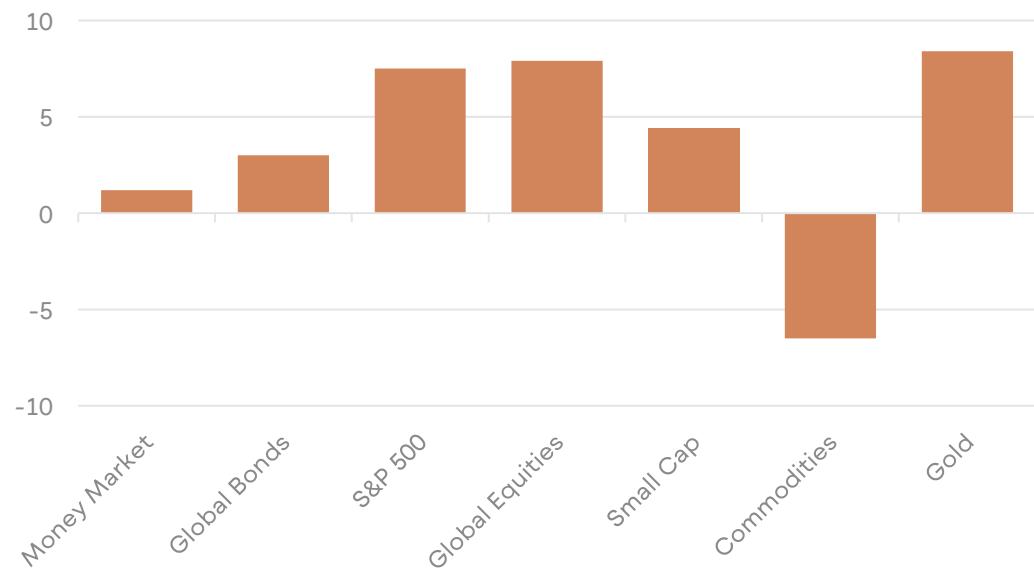
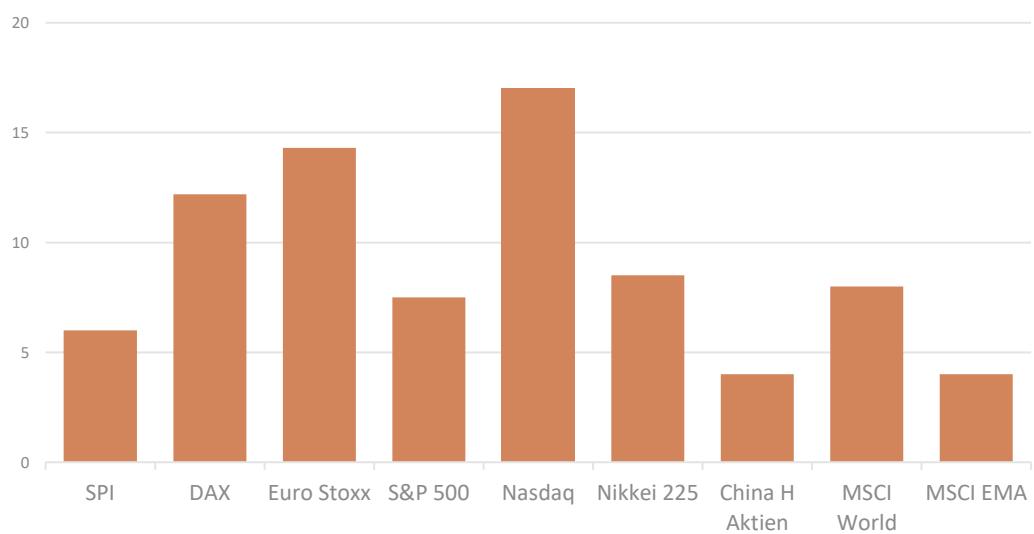
The higher key interest rates have tightened credit conditions and prompted banks to act more cautiously. Central banks have announced that further rate hikes may follow if deemed necessary to combat inflation. This tightening of the monetary policy will gradually rub off on the real economy and generate economic weakness. However, current economic indicators do not (yet) point in this direction. The monthly business survey data (Purchasing Managers Index) have been showing an upward trend since the beginning of the year, which suggests that the economy is growing at an attractive rate in the near future.

Thus, it remains open whether the recession that has been announced for months will occur in the foreseeable future. We believe that the difficulties in the banking system have exacerbated the danger of monetary "overkill" and that the central banks' interest rate cycles have (almost) reached their peak. Whether a turnaround in key interest rates in the U.S. will follow soon, as the fed funds market sees it, we would note with reservation. This will depend to a large extent on how quickly and strongly progress is made on the inflation front, while some economic losses are tolerated.

For the financial markets, the implications of the constellation outlined are not clear. The lower interest rates for government bonds as an expression of lower risk appetite and inflation expectations make the stock markets more interesting. This is especially true for those equities that have been excessively affected by sharply rising interest rates in the past. However, this correlation only works as long as earnings expectations are not too severely impaired by an economic slowdown.

In this current situation, we believe that a cautious approach to new investments in equities is still appropriate.



Chart 1: Gross return Q1 2023 in USD for different asset classes (in %)**Chart 2: Performance Q1 2023 in local currency for selected stock indices (in %)**

Wangs, 6. April 2023

