

## HALF-YEARLY REPORT 2023

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- A flying start to the year on the global stock markets
- Regional banking crisis in the US brings the rally to a swift close
- More restrictive lending conditions and fears of a recession weigh down small and mid caps
- Euphoria surrounding artificial intelligence
- Xantos share class A achieves a return of +6.5% (CHF) and +10.1% (USD), respectively in the first half of the year, driven by the information technology sector
- Portfolio: greater focus on information technology and healthcare, cyclical components reduced
- Sentiment remains subdued – economy weighed down by higher interest rates – stock picking becomes more important
- Global small and mid caps attractively valued

### Performance of Xantos A in CHF and USD



Past performance is not indicative of future results.

### A flying start to the year on the global stock markets

Contrary to many predictions, the year got off to a very promising start, with the stock markets enjoying a heartening rally in January. Last year's losers became this year's winners, none more so than the tech giants and stocks in the consumer cyclical sector. Xantos was no exception, posting a brilliant return of almost 9% in January.

Inflation had been falling for several months. Yet, in the same stroke, concerns about the economy were growing. All major economies were exhibiting declining levels of consumption and a lull in the construction sector. China seemed to have overcome its wave of coronavirus and the markets were hopeful that the Chinese economy would normalise. Supply chain problems finally looked like they would be a thing of the past and the tourism sector was looking forward to a global renaissance following its downturn during the COVID-19 pandemic. The normalisation of the economic chain looked like it might have a deflationary effect and the markets were already celebrating China's comeback.



### Stubborn inflation and rising interest rates cast a shadow over markets in February

Hopes that inflation would fall quickly, which buoyed the stock markets in January, were dashed in February. The data from the first two months of the year showed that reducing inflation was tougher than hoped. At the same time, the economy was stagnating. This did not pass the markets by unnoticed and led to setbacks. Xantos managed to escape the pressure on sales and posted gains in February. The positive difference in returns was generated by companies in possession of a technological innovation, optimised products, local dominance or other dominating factors. Fortnox, QT Group, Alphatec, Surgical Science and Nordnet seem to have been less affected by the stagnant economy.

Some companies showed signs of weakening pricing power. The price increases implemented across the board started to affect sales volumes. Fixed costs rose and reduced households' disposable income. Credit card debt in the US increased dramatically over the last year. Increases in both debt and the interest burden put pressure on the budgets of lower earners in particular. The stock markets seemed to have priced in two to three more small interest rate increases in the US in February.

### US regional banking crisis

The rising interest rates claimed their first victims. The collapse of Silicon Valley Bank in California in early March triggered the worst banking crisis since the financial crisis of 2008, brought on by the sharp increase in base rates implemented by the Federal Reserve to combat inflation. Many investors lost faith and withdrew their money from various US regional banks. Other US regional banks collapsed like dominoes in the following weeks, including Signature Bank and First Republic Bank, which was acquired by JP Morgan Chase. Various other banks faltered, including Credit Suisse, which was acquired by UBS in a deal brokered by the Swiss government. The turbulence among the banks led to a downturn in the stock market of between 7% and 10%. Following a variety of government interventions, the markets calmed down in the second half of the month and the stocks regained some of their value.

### More restrictive lending conditions and fears of a recession weigh down small and mid caps

As a result of the banking crisis, lending conditions became more restrictive. At the same time, money supply (M1) fell while interest rates continued to rise. This tightening would go on to make its mark on the real economy and lead to cyclical weakness. Sentiment grew more cautious, with the latest data showing that consumers were becoming more reticent. A weakening of economic growth or even a recession seemed to be brewing. However, a recession was yet to become apparent in the data record or early indicators. Full employment in the western industrialised countries was still holding up. The ongoing restrictive monetary policy and the resulting depressed economic sentiment took their greatest toll on smaller and mid-sized companies. Small and mid-sized companies suffered disproportionately under the restrictive monetary policy, as they are more heavily indebted on average than large cap companies and therefore feel the effects of higher interest rates and the tightening of credit more acutely. The situation was particularly difficult for companies with negative cash flow which depend on capital markets for their financing.

Xantos had already sold off the majority of its loss-making companies last year to focus on companies with solid balance sheets. Nonetheless, Xantos did not come away unscathed from the pressure that shares in small and mid-sized companies were under in April and had to post a negative return. In addition to the weakness of the US dollar, the



economically sensitive semiconductor companies exerted particular downward pressure on return performance. The overall very weak demand in conjunction with the sustained destocking effects, which had already been observed among clients in the first quarter, persisted into the second quarter.

#### Euphoria surrounding artificial intelligence

The stock market adage “Sell in May and go away” proved correct as the majority of markets showed a downward trend in May. In addition to weaker economic figures, above all in the manufacturing industry in the US, Europe and China in particular, concerns about the debt ceiling in the US also depressed the sentiment. A handful of tech stocks managed to buck the general trend, buoyed by hype surrounding artificial intelligence. In May, Xantos achieved positive returns, which can largely be attributed to our position in the technology sector (semiconductors, software). The AI euphoria was most welcome.

#### US averts insolvency

The debt woes in the US were once again resolved after both chambers – the Senate and the House of Representatives – approved draft legislation that prevented the United States from becoming insolvent. Now that this risk factor has been removed and fears of inflation have subsided to some extent, attention is increasingly shifting to the general economic situation and the extent to which the economy will be calmed by the restrictive monetary policy. Growth is weakening, particularly in Europe. Germany is already in a “technical” recession. We are probably already in a global industrial recession and industry prices are falling. However, the services and tourism sectors are still expanding significantly. Inflationary pressure is still present in these sectors.

## Portfolio

#### Performance drivers

All sectors apart from finance and energy made positive contributions to returns in the first half of 2023. The largest contribution to returns by a significant margin came from the information technology sector at around 84%. Last year, this sector was particularly hard hit by a contraction in valuation due to rate hikes. This year, buoyed by the euphoria surrounding artificial intelligence, semiconductor companies, including BE Semiconductor Industries, Lattice Semiconductor and Kalray Sadir, have performed particularly well. But also a variety of software companies, including SPS Commerce, QT Group and Fortnox, achieved above average returns in the first half of the year. In the consumer cyclical sector, the portfolio benefited in particular from the two US residential construction companies PulteGroup and Meritage Homes. The limited supply of existing housing stock spurred interest in new builds and both shares climbed to new all-time highs in the first half of the year as a result. The recreational vehicle manufacturer Thor Industries seems to have been priced in somewhat pessimistically, as this share also made an above average contribution to returns in the first half of 2023. In the industrial sector, the defence companies Rheinmetall and SAAB AB, which are continuing to profit from the war in Ukraine, stood out once again. But VAT as a supplier to the semiconductor industry also performed very well, although the company has just announced short-time work. In this regard, the market already seems to be on the road to recovery. In the



healthcare sector, the medical technology company Alphatec contributed the most to return performance in the first half of the year.

#### Portfolio structure and adjustments

At the beginning of 2023, approximately 30% of Xantos' investments were in the information technology sector, 15% in industrial stocks and 13% in the healthcare sector. This makes the fund significantly more diverse than during the pandemic, when the information technology and healthcare sectors made up almost 70% of the portfolio.

At the beginning of the year, we mostly made new and additional investments in the information technology sector (Universal Display, MKS Instruments, Temenos, Coherent, Lumentum) and the consumer cyclical sector (Vipshop, Zalando, PulteGroup, Meritage Homes). Occasionally in April, but in particular in May and June, we expanded our investments in the healthcare sector (Demant, Quanterix, Exact Science, Veracyte, Surgical Science, AddLife, NeoGenomics). Conversely, we sold stocks in the industrial sector (Bossard, Bertrandt, Aumann), financial sector (Lakeland Financial, First BanCorp.) and energy sector (Patterson-UTI Energy, Uranium Energy Corporation), including some reductions in alternative energy (Sunpower, SolarEdge). We also made some reductions in the consumer staples sector, by selling Lamb Weston on the one hand and, on the other hand, by taking the jump in share value of salmon farms in conjunction with the lower-than-expected tax burden as an opportunity to reduce our positions.

We started 2023 with a cash ratio of 17%, but reduced this to 11% in January. In the following months leading up to April, we gradually increased the cash ratio to 17% again. As of late June, the cash ratio is around 13%.

Geographically speaking, 39% of Xantos' investments are in the US and 43% in Europe.

#### Xantos sector and country breakdown at the end of June 2023

##### Sectors in %



■ Information Technology	36.2%
■ Health Care	17.7%
■ Industrials	12.8%
■ Consumer Discretionary	7.3%
■ Financials	5.8%
■ Materials	3.6%
■ Cash	12.9%

##### Countries in %



■ USA	38.9%
■ Germany	8.7%
■ Sweden	8.6%
■ Switzerland	4.0%
■ Norway	3.4%
■ Other Countries	23.7%
■ Cash	12.9%



## Outlook

### Sentiment remains subdued in the short term

Sentiment in the capital markets remains subdued. A series of factors is continuing to affect the mood and stifle share prices.

Inflation is stubborn in many countries and is abating too slowly for many investors' and central bankers' liking.

China's economy only made a brief resurgence after the coronavirus restrictions were lifted before growing sluggish this year. The crisis in the Chinese real estate sector is ongoing, youth unemployment is at a record high and the government is intervening ever more frequently right up to the corporate level.

Geopolitical tensions have been mounting for several months. Under President Trump, there was "merely" a trade war between China and the US. Now, however, the western block and China seem to be growing ever more estranged and the rhetoric and measures are becoming ever more heated. The war in Ukraine, the Taiwan question and the global arms race are only the military face of the widening rift between the political blocks.

### Economy weighed down by higher interest rates

Rhetoric surrounding inflation is still dominating the markets and much of the media. However, additional rate hikes entail an increased risk of yet more financial turbulence and corrections in the real estate markets. They would also significantly increase the likelihood of a recession. Additional interest rate increases might inflict enormous damage on the global economy.

Inflation will continue to ease. The amount of damage additional rate hikes would inflict is growing. A recession of any kind would put central banks under immense pressure to belatedly lower interest rates again.

### Will inflation be followed by deflation?

Inflation is stubborn and the world will have to adjust to higher interest rates for a long time to come. This seems to be the prevailing view among many figures within central banks, including Powell, and the majority of analysts and market commentators. The sharp increase in interest rates has, however, already triggered an industry recession. The services sector is also already showing its first signs of weakness. With few exceptions, companies no longer have any pricing power. In actual fact, only state-regulated service providers and oligopolies have been able to increase their prices without negative effects on volumes. Consumers are losing purchasing power.

A recession seems inevitable. Money supply has fallen sharply across all major currencies. Once the inflation hysteria has subsided, the world might have to confront the spectre of deflation sooner than thought. If this happens, central banks will feel forced to begin printing money again.

### Artificial intelligence remains a dominating topic

One exception has been the topic of artificial intelligence, which is playing an ever-larger role in many sectors and is surely one of the next megatrends. However, hype about artificial intelligence is currently being drummed up by both the media and companies. Not all companies will be able to keep the promises they are making. In this case, the enormous price gains might soon turn out to be a bubble. Some of the valuations already seem to be based on a future that is a long way off.



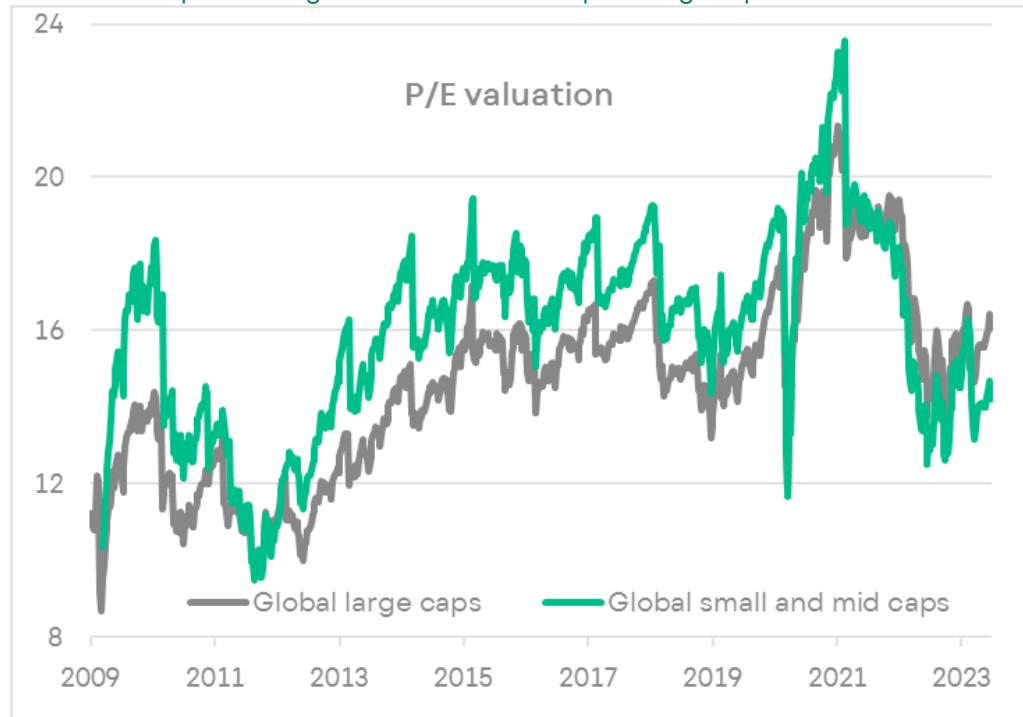
### Stock picking becomes more important

Higher interest rates and lower growth potential as a result of an ageing labour force, declining investments and falling productivity are also lowering the expected yield of stocks. For this reason, stock picking with a focus on niches with above average growth drivers is becoming all the more important. We remain cautious about the consumer sector. Medical technology has undergone a large decline in value and there is a backlog of demand in the wake of the pandemic. In an environment of weak growth, it becomes more important to increase productivity. Technology, be it software or semiconductors, could play a key role in this regard. As we enter the second half of the year, it seems like the semiconductor industry has risen from its slump. Consolidation within industries may increase, which would work in favour of profitable small and mid-sized companies.

### Global small and mid caps attractively valued

Global small and mid caps are attractively valued both from a historical standpoint and in relation to large caps. Global small and mid caps are currently trading at a discount of 11% compared to large caps, whereas over the last 15 years they have traded at a premium of almost 10% on average. Small and mid-sized companies may be more heavily affected by a weakening economy than large companies. However, this does open up investment opportunities as the potential for a recovery is greater.

Valuation comparison of global small and mid caps vs large caps



### Interest rates and technology

Share prices seem to be on an upward trend once again, but the months ahead may still be bumpy. Interest rates remain a dominating factor for stock market performance. We are operating on the assumption that central banks will pursue more moderate interest rate policies. Inflation needs to be reined in, but at the same time, the ailing economy needs room to breathe. The end of rate hikes may ultimately shift the focus back to profit dynamics. New technologies/innovations remain a key driver of the stock markets. New technologies have the potential to create new markets. However, it is often existing companies that implement these new technologies. The deployment of artificial intelligence, automation and digitalisation is continuing to advance.

The short-term focus continues to be on growth niches. We are convinced that strong companies that increase their productivity, develop new products and explore new markets, can grow even in a rocky economy. The active selection of strong companies is therefore becoming all the more important.

