CHECK-UP

May 2024
Client information
Reichmuth & Co Private Bankers

Editorial

The headlines over the past few months have strengthened my wish for a positive narrative for the future. A vision in which the government is not held responsible for every single problem and required to provide a solution, but where its primary role is to create the conditions that will allow its citizens to flourish freely and with confidence.

The fertile conditions for this would be a business-friendly environment and a sound infrastructure. Whether my wish will come true remains to be seen. In any event, we will also support solutions in the future that are not reliant on the government.

These include integral asset management as well as independent pension plans. Our privately financed infrastructure investments make an active contribution to the transition to a more climate-neutral world.

Jürg Staub
General Partner

Forwards to the past

When the Neue Zürcher Zeitung newspaper mentions strategic infrastructure in Switzerland, a non-NATO country, as potential targets for Russian long-range missiles, as this would inflict maximum damage on the West without triggering the mutual assistance clause in the Treaty, when stocks in armament groups reach record highs, and when the price of gold rises by 20% in a short period of time, it forces us to ask unfamiliar questions. The world is returning to an era of geopolitical tension and blocs, with the USA and China as the main actors. What does this new geopolitical order, bolstered by protectionist trade policies and an increasingly digital decoupling, mean for investors?

Uninspiring US elections

This autumn, US voters will have to choose between two pretty uninspiring candidates and programmes; neither represents a departure. If the Democrats win, there is much to indicate things will remain "business as usual", i.e. an industrial policy with a heavily domestic slant, coupled with an increase in domestic production and incentives to promote renewable energies. At a global level as well, the status quo would remain unchanged, with a clear commitment to NATO and to sanctions against out-of-favour countries.

Donald Trump's Republicans, on the other hand, are putting their faith in trade tariffs and bilateral deals instead of sanctions and the international framework for global trade (WTO). For Trump, cheaper energy is also more important than renewable energy, which would be embraced by US oil companies in particular. Trump would also presumably not be willing to continue to foot the bill for the NATO defence shield provided by the USA. This would prove very expensive for Europe.

Europe in a quandary

US politics is already complicating the Atlantic trade. Under Trump, access to the US market would be even more challenging for European exporters. The European export surplus is a thorn in their side. With this in mind, the recently announced split of the Swiss-based Holcim cement group and the independent stock market listing of the US arm of the group seems to me to be a blueprint for the future. Holcim is seeking to benefit from attractive US framework conditions, with an incentive-driven industrial policy combined with cheap energy, without being hamstrung by the imminent trade restrictions and potential increases in import duties.

How China tackles its internal challenges

China is the diametric opposite of the Western world. It is currently struggling with the issue of its excessive, debt-financed real estate boom. But it expects to solve this with a combination of state aid and monetisation. This however places China in the trilemma of whether it wants to abandon its independent monetary policy, its capital controls or its fixed exchange rate. It will no longer be able to control all three. If China gives up its exchange rate, it should lead to the long-awaited rally on the Chinese stock market. Because risks in China are high owing to the revival of the Cold War, this time between the USA and China, only limited bets should be placed there.

What does this mean for our investment strategy?

In spite of a world that appears to be going backwards, investors must be forward-looking. Diversification remains the keyword, but it now requires an understanding of the geopolitical landscape. Investments in politically and economically stable regions and sectors are expected to return to the fore. Equities still appear more attractive to us than nominal values. For a long time, it was possible to devote attention to sectors regardless of where their production took place. In sectors heavily affected by the geopolitical situation – especially energy, telecommunications and technology – bloc affiliation must be carefully considered.

Focus on comparative strengths

Europe's strengths have traditionally lain in sectors like luxury goods, industry, motor vehicle manufacturing and renewable energies. These sectors contrast with the USA's leading role in information technology, biotechnology and entertainment. Differences such as these need to be taken into account in a diversified investment strategy. The size of the population in Asia also means it offers a dynamic economy and a wide range of markets. Asian firms are market leaders in electronics and semiconductors. A simplified model portfolio that takes account of bloc alignment could therefore look as follows: defensive shares worldwide from the food and healthcare industries, industrial stocks from Europe and Switzerland, combined with energy and technology stocks from the USA, shares in companies in the electronics and semiconductor industry from Asia and materials stocks from Australia.

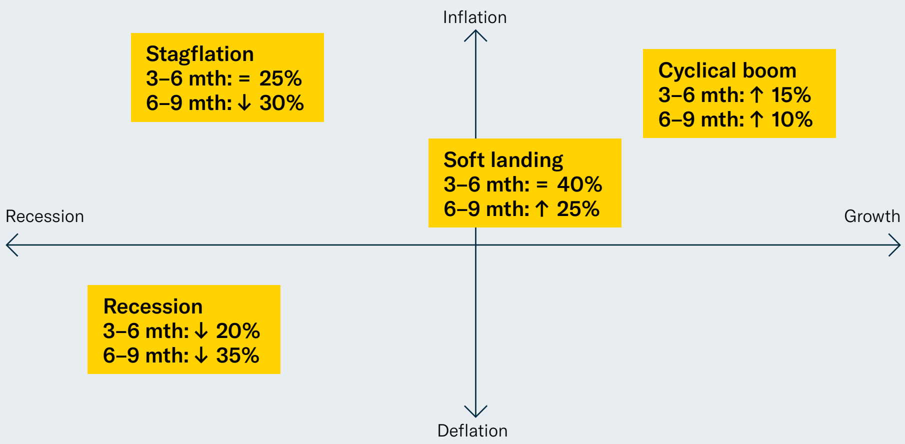
The situation with public debt

Financial markets are currently looking more robust than they were a year ago. Inflation has already peaked. Yields are also expected to fall at the short end. But longer-term yields are set to rise as a result of the ongoing very expansive fiscal policy with the taking on of new debt. Should public spending mushroom and new financial stability issues arise, these will be combated with the printing press. Who will be the first to take this measure – China, the USA, Europe or Switzerland? It is hard to say. What matters to us is whether it is the US Fed or the ECB. It will not be Switzerland – unless UBS gets into difficulties and has to be nationalised, which is extremely unlikely. From a CHF-perspective, it is therefore advisable to hold only real assets – i.e. shares with virtually no bonds – in countries with a high level of public debt. It is however also clear that the CHF cannot perform completely independently of the EUR and the USD – but gold can. Gold is a safe alternative in times of war and crisis. But like armaments, gold is not a productive investment and therefore does not increase the wealth of society. Nonetheless, the precious yellow metal is indestructible and so continues to have a place in our portfolio in spite of its most recent price rise.

Christof Reichmuth
General Partner

Scenarios and investment consequences

The risk of overheating is dampening hopes of a drop in interest rates



Current assessment

- Stock markets remain resilient with declining index concentration
- Increased probability of overheating of the US economy
- The risks of a recession are not off the table, but will not become acute until 2025

Scenarios – estimated probability of occurrence over time

↑↓= Changes since the previous publication

In light of the geopolitical uncertainties and creation of international blocs, as well as the ramifications of this on global energy supply and the shift in output markets, the major economic areas are proving extraordinarily resilient, and this is especially true for the US economy. Core Europe and China are confronted by a difficult environment, but the latest stabilisation in leading indicators provides hope for a recovery in the manufacturing sector.

Basic scenario: critical phase of a soft landing

Growth in China and Europe is stabilising at a low level; new growth impulses remain largely absent. The labour market in the USA is proving exceptionally strong and inflation rates are falling further, although they remain above the 2% target. In an environment with positive but low growth and diminishing interest rate pressure, quality stocks in trending areas are still sought-after, and the index concentration remains high. Stock markets continue to perform well, but divergence is high. Small & Mid caps are edging upwards thanks to a modest improvement in industrial production. Only under the surface are the initial indications of a softening in private consumption becoming visible.

Best investment ideas:
- Strengthening the defensive sectors like Healthcare and Consumer Staples
- Swiss industrial stocks
- Gold as a hedge around geopolitical risks

Alternative scenario: cyclical boom/overheating

Pandemic-related supply chain problems are now a thing of the past. Low inventory levels are leading to a new order cycle. Global economic growth, which had been driven primarily by the service sector for the past two years, has returned to being fuelled more by the manufacturing sector and is increasingly broad based. Lagging, cyclical stock market segments have catch-up potential. Energy prices are rising, and there is a risk of overheating in what is already a tight labour market. The US Federal Reserve will have to pump the brakes once again in order to prevent a second wave of inflation. Short-term corrections are liable to occur in highly valued market segments.

Best investment ideas:
- Materials stocks on the back of increasing demand; especially of industrial metals
- Value stocks such as banking and energy stocks
- Avoid bonds

Cajetan Bilgischer und Silvan Betschart

Fire and ice

Focus on a robust portfolio structure

Fears of a recession and the risk of overheating are evenly matched. Investors are betting on a soft landing, a stock-friendly scenario, and are concentrating on a very low number of stocks whose growth drivers are independent of the market environment. This has led to an extreme concentration in indices on a limited number of technology shares. Anyone who thinks in absolute terms and is seeking to preserve real value should not concentrate their investments on just a few technology stocks.

Given the fragile economic and geopolitical environment, we are opting for breadth in our portfolio and are diversifying into the best alternative investments outside of the momentum bubble. Even though the upwards trend in leading technology stocks remains intact, we are expecting a dip in the high market concentration over the medium term.

What are the arguments against a soft landing?
In the short term, there are few. However, many contributing factors are in motion, did heavily over- or undershoot during the pandemic, and are currently experiencing a normalisation phase. This is especially true of unemployment and inflation. History has shown that unemployment is not very stable over the longer term and always diverges sharply from the average. The reverse is true for inflation. Inflation was stable for an extended period, but it dramatically overshot as a result of the pandemic and is slowly returning to normal in many areas, also thanks to base effects. The current favourable situation, with low unemployment and declining inflation, will not endure over time, thanks to the forces of normalisation. We are therefore focusing less on the matter of timing and more on estimating what the consequences of a shift towards a recession or overheating would mean for asset allocation.

Overheated US economy – upturn in Europe?
In spite of the considerable rise in interest rates over the past two years, the dampening effect on the economy has been minor. Major fiscal programmes are still running in most Western markets and supporting the economy. In the USA in particular, much has been invested in developing new capacities, and AI has the potential to boost productivity in the workplace. The wealth effect produced by rising stock markets, positive interest on savings and a slight recovery in the real estate sector is shoring up consumption. Even though confidence surveys are indicating the manufacturing sector is only just recovering from its nadir, we consider a further stabilisation more likely than a sharp upturn. In core Europe, and in Germany in particular, the mood could hardly be any worse, and industrial stocks appear particularly promising in this scenario (see our article on page 6). But smaller capitalised companies should also benefit from a slight improvement in sentiment, whether in the information technology sector, biotech or even cyclical small-caps.

What if the risks of a recession increase?
Rising commodity prices and slightly increasing long-term yields are indications of an upswing, reducing the likelihood of rapid interest rate cuts. The refinancing situation for many companies will thus remain strained for the next 12–18 months. Despite continuing low unemployment, the labour market is gaining pace. The number of job vacancies is decreasing and individual firms are already downsizing. Banks are still hesitant when it comes to granting loans. If unemployment figures begin to rise, this will hamper consumption and significantly cool the economy. Earnings estimates for many companies are not based on the assumption of an economic downturn. Defensive sectors like healthcare and basic consumer goods should be better able to weather such a recession environment. Thanks to their stable cash flows, many of these companies are paying out attractive dividends. Some of these securities have not performed quite as well as the market over the past few months, relatively speaking. If fears of a recession continue to rise, these sectors should be in demand.

Geopolitical risks
Political stock markets have short legs, according to common stock market wisdom. But in light of smouldering conflicts around the world, the risks are substantial both for the economy and financial markets. 2024 is an election year, not only in the USA, and the outcomes could accelerate this momentum. If countries on important trade routes or major raw materials producers become embroiled in armed conflicts, there will be an increased danger of a supply shock. This can lead to significant price distortions, as well as triggering a flight to safe havens.

Therefore, we believe that precious metals and energy shares of large multinationals belong in a well diversified portfolio. Even cryptocurrencies could be in demand in such situations, although their extreme volatility makes them suitable only for speculative investors.

Alternatives for portfolio diversification

A 10-year Swiss government bond currently yields around 0.7%. This is even lower than normalised expectations for inflation and no longer offers significant price and diversification potential if interest rates fall. Interest rates are admittedly higher for foreign government bonds, but in a crisis situation the Swiss franc tends to strengthen, risking currency losses. Better diversification comes in the form of certain active alternative strategies, which can generate positive returns even during negative market trends or strong commodity price trends. A mix of cash and alternative investments, depending on tolerance for fluctuations, offers the best alternative to interest-sensitive investments like bonds and real estate.

To sum up, we are keeping a high weighting in equities but, unlike the indices, have a higher weighting of defensive sectors and are investing opportunistically in segments with the potential for recovery, like small-caps and industrial stocks. We are taking account of the geopolitical risks using precious metals and energy stocks, and prefer cash and alternative investments to traditional bonds.

Patrick Erne
Head of Research

"Sell in May and go away?"

Three options for a more robust portfolio structure

1. Asset allocation – don't put all your eggs in one basket.

- Gold is particularly in demand during geopolitical crises and supply is limited
- Commodities (e.g. oil) should behave differently to the market in a supply shock
- Alternative strategies with low correlation to the overall market (i.e. active managers, ILS)
- Avoid nominal investments with high interest rate risks

2. Tactical equity allocation management

- Keep a certain amount of cash in reserve for new opportunities when risk premiums are low
- Temporary hedges, e.g. put options or futures if sentiment becomes euphoric
- Set stop-loss limits for speculative securities and adjust them accordingly
- Define a buy level at which liquidity is being deployed in the event of falling prices

3. Active sector and stock selection

- Avoid cluster risks and bubbles, whether in individual stocks, sectors or factors
- Look out for small-caps with barely any representation in the indices
- Higher weighting for defensive sectors with a focus on dividend stocks that are less interest-sensitive
- Pay attention to formation of geopolitical blocs and the respective focus on comperative strengths

Summary: In the current environment, we are opting for a broad diversification in terms of both asset allocation (#1) and our choice of securities (#3) to take account of the geopolitical situation. We are currently keeping our equity allocation high, as improved sentiment in industry is emerging and real assets are preferred over bonds.

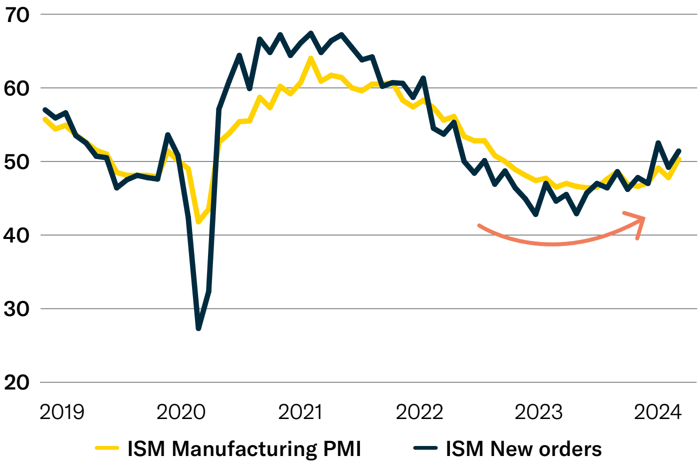
Industrial stocks with a tailwind

More than just a short-term upswing

The global industrial sector witnessed a veritable boom in orders following the outbreak of the Covid pandemic, stocks were built up on a massive scale for fear of supply bottlenecks. A long period of destocking then began in 2022. Over the past few weeks, there have been increasing signs that the industrial sector has bottomed out.

Incoming orders in industry are slowly rising again. In addition to this cyclical recovery, the sector also still has a structural tailwind: the energy transition, the shift in the supply chains and years of under-investment in strategic resources are heralding a new cycle of capital investment.

SENTIMENT INDICATORS ARE RECOVERING



Source: Macrobond, Bloomberg

A surge of subsidies in the West

Over the coming years, public industrial policy will play a key role in consolidating and transforming the industrials sector. The drivers for this are not merely the energy transition and the infrastructure's need for renovation. Increasingly, arguments regarding national security and supply security also play a role. New subsidy programmes are being announced on virtually a daily basis; in the West alone, these have totalled almost USD 2 trillion since the beginning of last year.

Fourth industrial revolution

Automation and the use of artificial intelligence (AI) are fundamentally changing the industrials sector. After the revolutionary developments of water power in the 18th century, mass production in the 19th century and information technology in the 20th century, digitisation is now paving the way for the fourth industrial revolution. Artificial intelligence, big data and robotics hold the promise of significant increases in productivity, reduced costs and improvements in quality.

Where do the opportunities lie?

When selecting stocks, we focused on those that stand to benefit directly from these trends. The substantial support programmes from the Biden administration (Infrastructure Investment and Jobs Act, Inflation Reduction Act, CHIPS Act and Science Act) will predominantly benefit companies based in the US. Alongside the construction industry, suppliers and equipment manufacturers for the semiconductor industry as well as for renewable energies and electric mobility are also feeling the tailwind.

Opportunities in Europe and Switzerland

On the topic of the energy transition and automation, there are some interesting companies to be found in Europe. One example is Schneider Electric, which specialises not only in energy management for buildings but also energy systems for data centres. In addition to large-cap industrial firms, we still see opportunities in small-caps in Switzerland. The surprising interest rate cut by the SNB and the ailing CHF have also calmed headwinds here.

How are investors behaving?

Over the past 18 months, investors have been focusing on the direct beneficiaries from AI, whose impressive performance has led to some high valuations. We are now seeing a shift in interest: the focus is moving to companies that use automation and AI and are benefiting from the new focus of subsidy policies, away from short-term support for individual households towards an industrial policy geared to the long term. In this regard, the industry sector is in the spotlight as the main beneficiary of this development.

Matthias Ramser
Chief Investment Officer

Burning issues

Five questions our clients are frequently asking at the moment

1) How do you evaluate the upheaval in the big bank landscape of Switzerland?
The new UBS is a colossus in relation to Switzerland's economy, and calls for strict regulations are loud, but they could never offer absolute security. First of all, this forced takeover confirms that size also has its downsides, and secondly, it showed once again that every investor must independently and responsibly chose their banking partner with care. I also hope that the strengths of our financial industry will depend less on one single, massive banking group, and more on a multitude of rock-solid small and medium-sized banks.

2) Where are the tax advantages that I should look for?
Clients are always surprised at how substantial the tax advantages offered by personal financial planning can be. We recommend clients aged 50 and over have their personal situation reviewed by one of our pension experts. This will allow them to plan for the remaining years of their working life and tell them how they can bolster their own pension, or even reduce their income tax through voluntary buy-ins. Pension fund assets can also be withdrawn in stages to smooth out progressive taxation. Some other important questions are: How are my loved ones protected? How and when can I pass on my assets tax-efficiently to the next generation? I can highly recommend a non-binding chat with our pension experts and estate planners.

3) Should I be locking-in my mortgage now?
Generally speaking, the majority of people have fared better with short-term variable mortgage financing, so I would normally prefer this path. However, the yield curve is highly atypical. Long-term mortgages are cheaper than short-term ones, and also offer an attractive rate of around 2%. If I were to take out a mortgage today, I would lock in a portion of it for longer and keep the remainder variable. Ideally, you should ensure you have enough flexibility to repay it at least in part, in the event that interest rates at the short end rise further (contrary to expectations). Anyway, I would recommend not utilising borrowing capacity in the challenging valuation market for private real estate.

4) How should I behave with my liquidity if virtually no interest is paid on savings?
We have compiled an attractive list of money market investments for this purpose. This ranges from a) fixed deposits at our bank via b) well-diversified money market funds to c) fiduciary investments at third-party banks abroad. Even low-risk covered bonds (Pfandbriefe) with a remaining term of under one year pay 1.3% and can be used to park liquidity.

I also hope that the strengths of our financial industry will depend less on one single, massive banking group, and more on a multitude of rock-solid small and medium-sized banks.

5) What is your position on gold and cryptocurrencies?
Gold and Bitcoin have both gained significantly in value over the past few months. These two investments do not generate cash flow, but are still in demand owing to limited supply and their function as an 'alternative' to central bank money. Gold has a diversifying role to play in every mandate and offers a certain level of protection against geopolitical or monetary policy derailments. Bitcoin is more speculative, but supply is limited and demand is increasing once again, partly thanks to the recently launched ETFs and to institutional investors. This furthermore makes it a speculative opportunity for risk-tolerant investors. In our own company strategy, gold has a weighting of around 5%. For about a year now, we have been offering interested parties direct access to and secure storage of Bitcoin and Ethereum.

Remy Reichmuth
General Partner

Value compass

Interview with Sandro Kutschera, Partner

You joined Reichmuth & Co at the beginning of 2024. How did you get started?
I did not take the decision of changing employers after 20 years lightly. The crucial factors in my decision were values like proximity to clients, security, identification with the owners and the entrepreneurial aspect. I could no longer influence these issues at my previous place of work, so it became clear to me that I had to take action myself. My value compass led me very quickly to Reichmuth & Co and I am delighted to be able to say after only four months that it is a perfect fit!

What struck you as particularly positive?
I've known the banking sector for 30 years and knew roughly what to expect in terms of content. Being from Lucerne, at any rate, because Reichmuth & Co bank was always a very innovative and agile competitor for me. But that is a result of the culture. I would never have guessed that they were so heavily focused on client needs. People here attach incredible importance to client individuality, understanding client investments properly and developing sustainable, viable concepts. The work often spans different disciplines, which I really enjoy. Even the most critical points are immediately addressed. The aim is always to move forward together without any envy, politics or fighting for resources.

You mentioned identifying with the owners. How much do you feel that in your daily work?
Enormously. The fact that Reichmuth & Co is managed by partners with unlimited liability is unexpectedly highly topical. That should interest me both as an employee and as a client. For me, it's a question of someone's attitude when taking risks, i.e. running a firm, in the knowledge that they could not only make money but also lose everything they have. I don't have to explain this twice to entrepreneurs. The owner structure, composed of the Reichmuth family, employees and founding shareholders, is compelling and allows the bank to think long-term. There are no weekly sales promotions with us.

But if you can no longer fall back on the range of services of a large bank, how do you manage?
In my view, clients appreciate a transparent and successful business model. There are unfortunately enough examples out there of people spreading themselves too thin and not succeeding. This brings us back to the topic of security and peace of mind. But comprehensive advice goes further than expected. Alongside asset management, provisioning is a very important pillar of the bank's business, as is investing in infrastructure, to name but two examples. However, client requirements change so the bank's services change with them. Reichmuth & Co is therefore always reviewing the services it offers. As someone coming from the outside, I can help make the bank even more attractive for our clients. We have short decision paths and plenty of our back office work is done in-house – virtually right next to us. This means that no one can hide behind processes. That makes us agile and quick, a factor not to be underestimated.

What are your plans for the next few years?
My decision was also about committing to something for the long term and returning to working in much greater proximity with clients. I enjoy my work and, depending on what happens to the Swiss statutory retirement age, have another 15–20 years in front of me. I am convinced that clients benefit when advisers are not preoccupied with themselves and can devote their time and energy to their clients. That is what made my change possible. On this basis, I can bring as much of my network and experience as possible to the table.