Portfolio manager comments
September 2022

Market review

The indices of the Swiss occupational pension system fell significantly again in the third quarter, making the first nine months of 2022 among the worst in the last 20 years. Central bankers reaffirmed their commitment to fighting inflation, with key rate hikes totalling 1.5% for the Fed, 1.25% for the ECB and 0.75% for the SNB. As in the previous period, the simultaneous decline in virtually all asset classes made it particularly difficult to manage a balanced portfolio (bonds did not offer the protection that investors usually expect). In local currency terms, the MSCI World Index and SPI lost 4.4% and 4.8% respectively. In fixed income, bond yields continued to rise, especially at the short end of the curve. The yield on two-year US Treasuries is now above 4.2%, its highest level since October 2007. Ten-year maturities briefly reached 4.0% in September, their highest level since November 2008. In local currency terms, sovereign paper (FTSE WGBI LC) was down 4.2%. Swiss bonds fared better, shedding 1.6%. The credit and emerging debt bond segments were also laggards. On the currency side, the dollar and the Swiss franc acted as safe-haven currencies (USD/CHF: +3.5%; EUR/CHF: -3.2%; JPY/CHF: -3.0%; GBP/CHF: -5.1%). All alternative investment segments posted negative performances (S&P GSCI: -10.3%; HFRX Global CHF hedged: -0.2%; SXI Real Estate: -2.2%; S&P GSCI Gold: -7.9%).

Portfolio Activity – LPP/BVG-Short-Mid Term Bonds

We started the quarter with a short duration positioning on the Swiss curve which we decreased in July. We remained short on the 1-3y part of the curve and long on the 3-5y part of the Swiss curve. On the credit side, we were active on the primary market and participated in the new issues from Aéroport de Genève, Axpo, BFCM, Bawag, Commerzbank, Cornèr Banca, Crédit Agricole, Dormakaba, Groupe E, Nationwide Building and SGS. To finance those new deals, we sold bonds that trade at unattractive levels in our view like Banco de Chile, Bell Food Group, Cbq Finance, Cembra Money Bank, Coop Gruppe, Emirates NBD, FCA Capital, Ferring, Firmenich, Heathrow, Lonza and Nestle. We are cautious on selected names which might be at risk of downgrades and have therefore reduced single names such as RCI Banque and Heathrow to underweight. We reduced our UK exposure, and we implemented a small CDS index hedge. In terms of sector allocation our main overweights are in financials, regional banks and utilities on domestic names. Finally rating wise we are long BBB names against a short in AA and AAA issuers.

Portfolio Activity – LPP/BVG-10 ESG

We started the quarter with a significant underweight in equities, favouring cash, international government bonds and foreign real estate. Regarding the bonds, we kept the preference for government bonds to the detriment of developed credit (both investment grade and high yield). In July, we increased the portfolio duration by buying some Swiss and long duration bonds (Germany, UK and USA) until the second half of August. Then, on the back of higher European inflation expectations which postponed the probability of a peak in rates, we decided to reallocate the German Bunds and UK Gilts to their inflation-linked peers. However, the UK government announcement to launch a new budget plan without clear financing created turmoil in the bond market and incited us to sell the UK inflation linkers at the end of September. Within the equities, we continued to favour the Swiss market while in the real estate space, we neutralised our Swiss exposure and kept the overweight in foreign markets. Equities ended the quarter at 6.7% and bonds at 65.9% while cash at 9.9%.

Our exposure to the funds equivalent to article 8 and 9 of the SFDR classification stood at 83.7% at the end of the period.

Portfolio Activity – LPP/BVG-25 ESG

We started the quarter with a significant underweight in equities, favouring cash, international government bonds and foreign real estate. Within bonds, we kept the preference for government bonds to the detriment of developed credit (both investment grade and high yield). In July, we increased the portfolio duration by buying some Swiss and long duration bonds (Germany, UK and USA) until the second half of August. Then, on the back of higher European inflation expectations which postponed the probability of a peak in rates, we decided to reallocate the German Bunds and UK Gilts to their inflation-linked peers. However, the UK government announcement to launch a new budget plan without clear financing created turmoil in the bond market and incited us to sell the UK inflation linkers at the end of September. Within equities, we neutralised the small caps, continued to favour the Swiss market and reinforced the defensive stance by selling the agribusiness, metals and value ESG certificates to the benefit of US infrastructure ESG stocks. In the alternatives space, we neutralised our Swiss real-estate exposure, kept am overweight in foreign real-estate, and an underweight in hedge funds. Equities ended the quarter at 20.7%, bonds at 47.3% and cash at 15.2%. Our exposure to the funds equivalent to article 8 and 9 of the SFDR classification stood at 74.8% at the end of the period.

Portfolio activity – LPP/BVG-Multi Asset Flexible

In September, we significantly added to cash (17.2%, +7.0%) and, to a lesser extent, to uncorrelated assets (20.3%, +1.6%), at the expense of growth (32.4%, -1.8%) and protection assets (30.1%, -6.8%). In delta-adjusted terms, growth assets also decreased (33.1%, -1.1%). Growth assets were composed of 29.3% equities, 1.1% commodities, and 2.0% credit. In equities, we reduced secular growth (Security, IT), and fine-tuned cyclicals (out of FTSE 100 into DAX, out of Nikkei 225 into Topix banks) and defensives (out of utilities into consumer staples and health care). Protection assets comprised 28.5% core bonds, 2.6% precious metals, and -1.0% equity hedges. We exited UK I/L gilts and EUR bonds, as tighter monetary and looser fiscal policy is another headwind for bonds. Equity hedges (-1.0%) consisted of an S&P 500 out-of-the money put option and a short position on global equities via MSCI World futures. In total, equity hedges amounted to an economic exposure of -8.3%, down from -7.7%. Uncorrelated assets included 11.1% hedge funds and 9.2% real estate. In hedge funds, we added to Winton Trend, an effective diversifier when assets are correlated with one another. Regarding currencies, we added to our US dollar exposure (82.3%, +1.3%).

Portfolio Activity – LPP/BVG-40 ESG

We started the quarter with a significant underweight in equities, favouring cash, foreign bonds and real estate. Within bonds, we kept the preference for government bonds to the detriment of developed credit (both investment grade and high yield). In July, we increased the portfolio duration by buying some Swiss and long duration bonds (Germany, UK and USA) until the second half of August. Then, on the back of higher European inflation expectations which postponed the probability of a peak in October, we decided to reallocate the German Bunds and UK Gilts to their inflation-linked peers. However, the UK government announcement to launch a new budget plan without clear financing created turmoil in the bond market and incited us to sell the UK inflation linkers at the end of September. Within equities, we neutralised the small caps, continued to favour the Swiss market and reinforced the defensive stance

by selling the agribusiness, metals and value ESG certificates to the benefit of US infrastructure ESG stocks. In the alternatives space, we neutralised our Swiss exposure and kept the overweight in foreign markets as well as the slight underweight in hedge funds. Equities ended the quarter at 36.2%, bonds at 35.5% while cash at 11.6%. Our exposure to the funds' equivalent to article 8 and 9 of the SFDR classification stood at 71.1% at the end of September.

Portfolio Activity – LPP/BVG-60 ESG

We started the quarter with a significant underweight in equities, favouring cash, foreign bonds and real estate. Within bonds, we kept the preference for government bonds to the detriment of developed credit (both investment grade and high yield). In July, we increased the portfolio duration by buying some Swiss and long duration bonds (Germany, UK and USA) until the second half of August. Then, on the back of higher European inflation expectations which postponed the probability of a peak in rates, we decided to reallocate the German Bunds and UK Gilts to their inflation-linked peers. However, the UK government announcement to launch a new budget plan without clear financing created turmoil in the bond market and incited us to sell the UK inflation linkers at the end of September. Within equities, we neutralised the small caps, continued to favour the Swiss market and reinforced the defensive stance by selling the agribusiness, metals and value ESG certificates to the benefit of US infrastructure ESG stocks. In the alternatives space, we neutralised our Swiss real-estate exposure and kept the overweight in foreign real-estate, as well as our slight underweight in hedge funds. Equities ended the quarter at 53.7%, bonds at 14.9% while cash at 13.2%. Our exposure to the funds' equivalent to article 8 and 9 of the SFDR classification stood at 66.8% at the end of the period.

Market outlook

Our economic cycle indicators suggest that the risk of recession is growing as central banks put pressure on monetary conditions in much of the world to control inflation. The outlook has deteriorated in particular in the euro area, where consumer confidence has plunged to a record low and energy rationing poses an additional risk to industrial sectors. Growth prospects are also weak in the US, although there are some positive signs of resilience in the world's largest economy. The ISM manufacturing surveys show that businesses are reluctant to increase spending while the housing market is facing a collapse in construction activity, pointing to a decline in house prices in the coming months. According to our liquidity metrics, central banks have never withdrawn stimulus as fast as they are currently doing, indicating a determination on their part to act aggressively and tame inflation – which is at its highest level in over 40 years. The Fed has made it clear that it is prepared to tolerate a recession as a necessary compromise to regain control of inflation. The continued tightening of financial conditions increases the likelihood of an economic recession in the coming quarters. An exception is China, where the PBC is reducing financing costs and offering targeted easing measures to boost credit demand.

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