Behind the curve

Our Opinion
May 2022

Dear Readers

The US Federal Reserve's preferred inflation measure (US Core Personal Consumption Expenditure Price Index) is currently at 5.18% per year. On page 3, in the article "Behind the curve" we show how the U.S. Federal Reserve (Fed) is trying to get to grips with soaring inflation.

Looking for advice and support on financial matters? Our investment advisors look forward to hearing from you and will be happy to talk to you personally.

We wish you a pleasant read.
Your Advisory Team

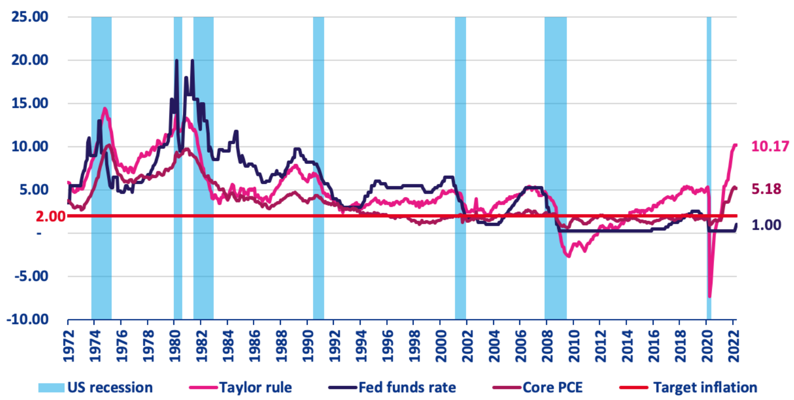
Neue Bank

Behind the curve

Economy

The US Federal Reserve's preferred inflation measure (US Core Personal Consumption Expenditure Price Index) is currently at 5.18% per year. The Fed has meanwhile started to raise key interest rates. Quite a few market observers believe this move comes far too late. Some are relying on the Taylor rule, named after a US economist who used a formula to calculate how high the ideal key rate should be to best achieve the Fed's statutory objectives (stable price level, high level of employment, and moderate long-term interest rates). Because there is currently an extreme divergence between the supposedly optimal interest rate and the effective interest rate (see chart below), experts are saying the Fed is "behind the curve" – i.e. lagging behind consumer prices, which have already risen, and all the more so given that the effect of rate hikes takes effect with a time lag. However, inflation is also due to exogenous shocks, which can be countered only to a limited extent by interest rate increases. For example, supply chain disruptions occurred in connection with lockdowns during the coronavirus crisis. The war in Ukraine has also increased energy and food prices.

The Fed is behind the curve

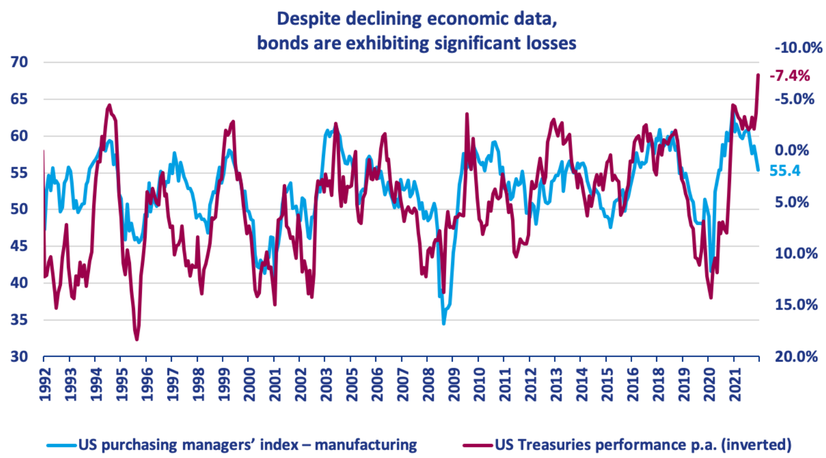


Source: Bloomberg, NEUE BANK AG

Over the next 12 months, market participants on average expect 8 more interest rate hikes and a key rate of about 2.75%. As the chart above shows, a recession has often followed a series of rate hikes (blue bars). In some cases, however, there was a soft landing. So far, our indicators show only a slowdown in growth. But the environment remains challenging. The Chinese government recently imposed a very strict coronavirus lockdown. Because the city has the port with the largest container throughput in the world, this does not indicate that shipments of goods will improve soon. An end to the war in Ukraine is also difficult to foresee.

Bonds

This has been an extremely bad year for bonds. Following the low of about 0.5% in 2020 as a consequence of the coronavirus crisis, yields on 10-year US government bonds have risen to over 3% in the meantime. The low interest payments could only marginally dampen the price losses. This resulted in an index performance of worse than -7% over the past 12 months. Corporate bonds have also performed poorly. The yield premiums on this asset class have risen, which has had an additional negative impact on price performance.



Source: Bloomberg, Neue Bank AG

As a rule, bonds are well suited for diversifying equity risks. As the chart above shows, their price development correlates inversely with the economy (as represented by the US purchasing managers' index). Most recently, however, the PMI has been indicating a slowdown in growth, while the prices of US Treasuries have continued to fall (in the chart, their performance is displayed inverted). This also has to do with the significant rise in inflation. For 30 years, inflation hovered around 2% before jumping to currently more than 5% (see first chart). The inflation-linked bonds included in the active portfolio management mandates have helped to dampen the losses somewhat, along with our underweight in bonds.

Equities

The strong rise in interest rates has also made equity investors nervous. This has led to significant corrections on the equity markets.

“Sentiment indicators continue to be low, which has generally supported prices in the past.”

In March, the Neue Bank traffic light switched back to light green (from neutral to slightly bullish), following a period of extremely negative sentiment on the equity market. An initial countermovement was short-lived, however, before new lows were reached in the reporting month. Sentiment indicators continue to be low, which has generally supported prices in the past. This is why our traffic light remains unchanged.

Currencies

The USD has gained significantly in recent months. Measured by the USD index (which looks at the exchange rates to the world’s major currencies), the increase since the beginning of 2021 has been more than 15%. This certainly helps fight inflation. For the USD/CHF currency pair, the valuation of the greenback – measured in terms of relative purchasing power parity – is now close to record levels. No trend reversal can be seen so far, which is why we continue to refrain from hedging in our mandates

Neue Bank traffic light

- strongly bearish
- bearish
- neutral
- slightly bullish
- bullish
- strongly bullish

Alternative investments

When bond investments fail to have a negative correlation with equities – as has been the case this year – it would of course be advantageous if at least alternative investments were to exhibit such a diversification characteristic. For many years, hedge funds have been advocated for this purpose. But measured by the global hedge fund index (HFRX), the overwhelming majority of these funds in fact correlate with equity investments.

"We have not been investing in hedge funds for a long time."

Although the setback of this investment category has been "only" a bit more than 3.75% this year, the entire return of the previous year has been lost. In general, the prices of the hedge fund index moved practically parallel to the global share index (MSCI World), simply with smaller fluctuations – sort of like shares with a low beta. We have not been investing in hedge funds for a long time, given that they do not fulfil their originally intended purpose and are often also expensive. In alternative investments, we have instead benefited from our satellite position in commodities in particular, where we remain invested for now.

PRIMUS–ACTIVE

With the PRIMUS-ACTIVE mandate, we offer you the opportunity to invest your assets according to traditional insights of well-known portfolio theories. We place particular emphasis on broad diversification, both in the strategic definition of asset classes and in the selection of securities. We also take into account that the financial markets are subject to long-term cycles and trends, and we strive to use these fluctuations to your advantage. The client advisors of Neue Bank AG look forward to showing you the special features of this asset management solution in a personal consultation.

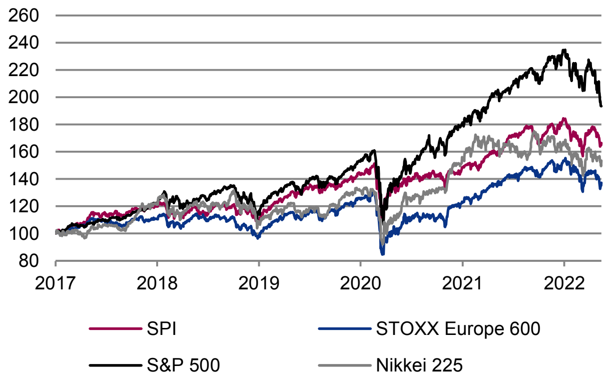
Key performance indicators for PRIMUS–ACTIVE Balanced in CHF[1]

	30.04.2022	2021	2020	2019	2018	2017
PRIMUS-ACTIVE Balanced	-5.96%	8.39%	3.05%	11.13%	-2.51%	3.82%
Peergroup	-7.60%	4.51%	3.21%	8.81%	-5.67%	3.44%

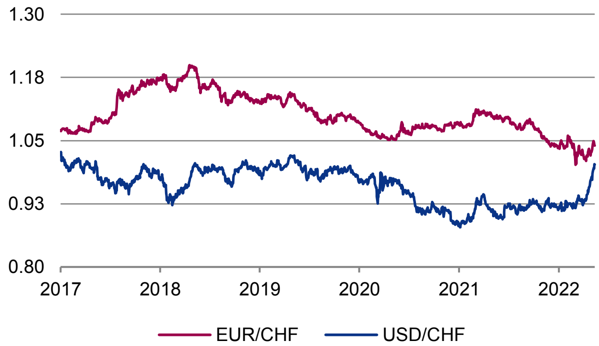
[1] Past performance is not an indicator of future performance and offers no guarantee of success in the future. The presentation of performance is gross without taking into account your individual tax liability. The net performance is lower due to fees. You can also find Our Opinion on our website: www.neuebankag.li S.E.& O.

Market data

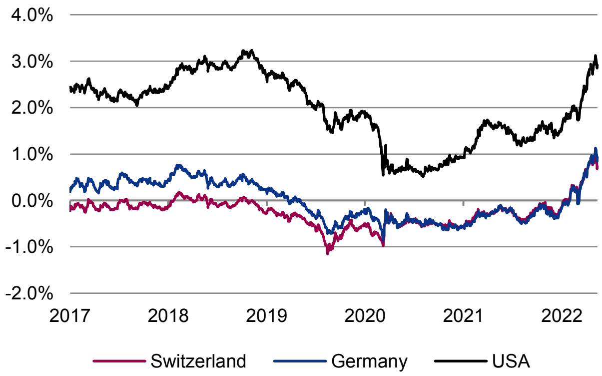
Stock market (indexed)



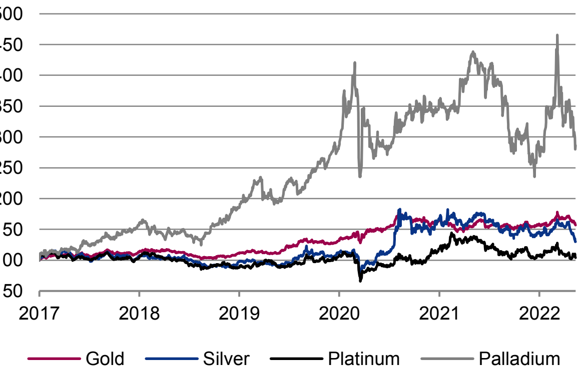
EUR/CHF and USD/CHF



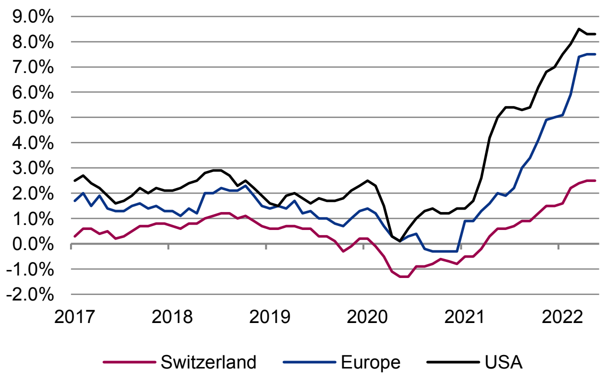
10-year government bond yield



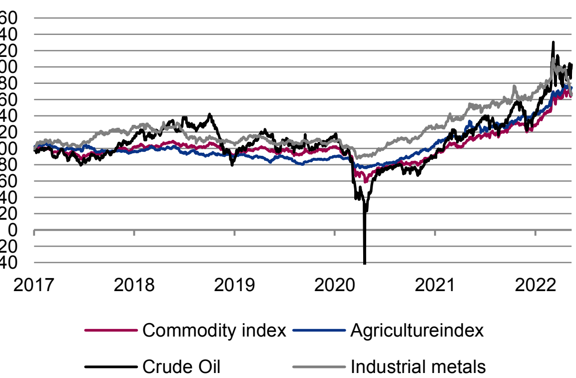
Precious metals (indexed)



Inflation rate



Raw materials (indexed)



The price developments are shown over 5 years.

You can reach us at

Neue Bank AG
T +423 236 08 08
F +423 236 07 35
info@neuebankag.li