

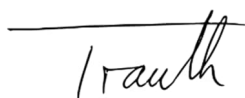
INVESTMENT OUTLOOK 01.2023

23 January 2023

Last year is likely to become a year for the history books. After 77 years, we had to face a major war in Europe, while at the same time, after 42 years, the inflation ghost came back. The latter led to aggressive monetary tightening. As a result, bond and equity markets sold off in tandem, both roughly by 20%. Such a phenomenon is rare, since bond and equity markets usually move in opposite directions. A traditional, so called 60-40 portfolio, consisting of 60% stocks and 40% bonds, had its worst year for a century and lost about 17%.

Since we reduced interest rate risks in recent years and included some strategies which are neither correlated with equity nor rates, we were able to clearly do better than a 60-40 portfolio.

In the first publication of the year issue we review our last year's predictions and discuss our outlook for 2023. We hope you enjoy our thoughts.

A handwritten signature in black ink, which appears to read "Trauth". The signature is written in a cursive, flowing style.

Thomas Trauth
CEO – IMT Asset Management AG

REVIEW OF LAST YEAR'S PREDICTIONS

What happened in 2022?

It looks as if 2022 will be a year for the history books. The war in Ukraine led to a global energy and food crisis. At the same time global economies were still adapting to the aftermath of the Covid crisis. The pandemic induced a massive demand shift from services to goods and, at the same time, disrupted global supply chains. After the easing of restrictions, demand for services suddenly rose sharply, while the supply side struggled to re-build capacity due to labor market shortages. On top of this, we had a phase of unprecedented simultaneous fiscal and monetary stimulus, as authorities were committed to protect consumers and corporations from economic hardship.

All this combined led to a sharp increase of prices in 2022. The last inflation shock dates back to 1980. Last year central banks realized that they had been behind the curve for too long and tightened monetary conditions very aggressively. The Fed raised rates by 4.5 percentage points and the ECB by 2.5 percentage points. In turn, bonds and equity markets sold off in tandem, leaving almost no place to hide for multi-asset class investors. The MSCI global equity index fell by 19.5%; the bond indices lost between 12% and 19%, depending on segment.
















The last time we had such a simultaneous sell-off was in 1969, also as a result of runaway inflation. The only other examples of similar situations came up in 1931, when Britain abandoned the gold standard, and in 1941, when the US entered World War II.

Only raw materials and in particular energy commodities put in a positive performance. The price of gold was very volatile but remained almost unchanged in year-on-year comparison. While the euro and especially the British pound depreciated, the US dollar, and the Swiss franc strengthened over the course of the year.

Last year's predictions

In the following, we review last year's predictions. For the details, we refer you to our Investment Outlook 01.2022.

Like most many others we were taken by surprise by the magnitude of the inflation shock and the decisive response of central banks. No wonder many of our financial market predictions turned out to be wrong. For a detailed overview, we refer to the table below.

Last year's prediction	Actual outcome	
1. Growth (real GDP)		
US: 5.0%	1.6%	
Eurozone: 4.5%	3.1%	
Japan: 3.0%	1.7%	
China: 5.5%	3.2%	
Note that GDP growth for 2022 is based on the latest estimates since official figures are not yet available.		
2. Inflation (end of period)		
US: 3.0%	6.5%	
Eurozone: 1.5%	9.2%	
Japan: 0.5%	4.0%	
China: 2.0%	1.8%	
3. Central Banks		
Fed with three rate hikes	+4.5%	
ECB unchanged	+2.5%	
Both reducing asset purchases	Correct	
4. Rates (10-year yields)		
US: 2.5-3.0%	3.8%	
US real: 0.0-0.5%	2.6%	
Eurozone: 0.0-0.5%	2.3%	
5. Credit		
High grade und high-yield spreads to widen.	High grade spreads widened by 43 basis points; high yield spreads by 230 basis points	

Last year's prediction	Actual outcome	
6. Equities		
Low positive returns	S&P 500 fell 19.4%, MSCI Europe dropped 11.9%	☹️
with the US outperforming Europe	Europe outperformed the US	☹️
and cyclicals (industrials and US financials) to outperform	US financials and industrials outperformed the broad index	✓
7. Equities, emerging markets		
Low positive returns.	The MSCI Emerging Markets index lost 4.6% and the Chinese CSI 300 5.2%	☹️
8. Commodities		
Industrial metals up	Industrial metals fell slightly, by 2.4%	☹️
Oil up	Oil prices rose by 10.5%	✓
Gold down	Gold fell marginally by 0.3%	(✓)
9. Alternatives		
REITS have upside	The global REITS index fell by 22.4%	☹️
10. Currencies		
EUR-USD between 1.12-1.18	Year end at 1.07	☹️
EUR-CHF between 1.04-1.08	Year end at 0.99	☹️

OUTLOOK 2023 – TEN PREDICTIONS

1. Growth

Global economic development is slowing down. It is quite possible that the USA will slide into a, probably mild, recession, and it is highly probable that a rather deeper recession lies ahead for Europe.

The outlook for China is clouded since the government has moved away from a strict zero Covid policy and is allowing the virus to spread. While a number of issues will continue to weigh on the Chinese economy, including ever more aggressive US trade policies, slowing global demand, and a weak housing sector, the re-opening will help to revive the Chinese economy, especially in the second half of 2023.

In 2023 we expect US real GDP growth of 1.0% (down from 1.60% in 2022), Euro area growth of 0.5% (down from 3.1%), Japanese growth of 1.6% (down from 1.7%) and Chinese growth of 4.4% (up from 3.2%).

2. Inflation

At present inflation is falling again. We assume that this trend is set to continue over the next several months. In our opinion, however, it will take longer for inflation to come back down to the central banks' target level of 2% or less.

At the end of 2023 we think US inflation is likely to be at 2.3%, EMU inflation at 4.5%, Japanese inflation at 1.2%, and Chinese inflation at 1.8%.

3. Central Banks

The market currently expects the US Fed to raise interest rates to 5% by May and then to lower the rates in the second half of the year. We regard this scenario as very improbable, because inflation is going to persist significantly above 2% for much longer than is generally anticipated. So our view is that market expectations are very likely to be disappointed. We rather think that the Fed will continue to raise rates to 5% and keep rates high for a longer period.

The ECB will also hike rates to a terminal rate of probably 3.25%.

Accelerating Chinese growth will most likely boost demand for commodities. This is a clear risk to the inflationary outlook and could create additional challenges for central banks to tame inflation.

4. Rates

We are not convinced that bond yields are likely to fall from current levels. First, the hiking cycle is not over and we think it is likely that the US rate hike expectations have to be repriced. Second, we expect inflation to be sticky, which could lead to a rise in market-implied inflation expectations. We expect US 10-year yields to be between 4.5-5.0% at the end of 2023 and European yields between 2.75-3.25%.

5. Credits

As we move towards a recession and we expect to enter a risk-off environment in the coming months, we think that credit spreads are likely to widen first. At the same time, if the mild US recession scenario plays out, we think that especially high-yield spreads look attractive. For the whole year we expect credit to be flat or somewhat positive, unless the economy falls into a more severe recession.

6. Equities, developed markets

We expect equity markets to correct in the first half of this year and think that thereafter, once the rate hike cycle has peaked and earnings expectations have come into line with the recessionary environment, markets could perform positively in the second half of the year. Overall US and European equity markets may end the year flat.

7. Equities, emerging markets

An overall weaker USD and the China reopening may provide the basis for positive equity market returns for Asia and emerging markets.

8. Commodities

Oil prices are likely to stay at current levels or higher, as supply will be kept tight, which is likely to overcompensate for lower demand as the world economy slows. Industrial metals will stay weak initially but will be boosted after the Chinese economy gains momentum in the second half of 2023.

Gold prices recovered recently and are surprisingly high given that real interest rates have risen considerably in recent months. We regard gold as rather overvalued. However, geopolitical risks may have supported gold prices. While there might be some

further upside for gold in the coming months, we expect gold prices to end the year lower than in January.

9. Alternatives

REITS are faced with a difficult market outlook. Rising interest rates provide a headwind, and a slowing economy could impair tenants' ability to pay rent. However, REITS currently trade at a large discount to private real estate. Most REITS have fixed mortgage rates long-term during the period of ultra-low rates. Furthermore, the REITS universe has become very diverse and does not only consist of more exposed residential and commercial real estate. An increasing share of the REITS market manages storage facilities, data centers, and infrastructure and is, therefore, less exposed to the rates cycle. We expect REITS to perform in line with developed markets.

10. Currencies

The USD has been very strong in recent years and has become overvalued. Since Q4 2022 the USD has corrected significantly. We think that if we enter a risk-off environment, the USD has potential to regain some temporary strength. However, longer term we expect the USD to weaken. At the end of 2023 we expect EUR-USD to be around 1.10.

Review of our strategic asset allocation

We have reviewed our strategy, as we do every year. Considering the fundamentally new interest rate situation, we have decided to increase the proportion of government bonds in the portfolios. Returns on European and US bonds went up by about 2 percentage points in 2022. We think that government bonds have therefore regained the stabilizing effect and hedging impact they have on portfolios. We have in turn reduced active absolute return strategies.

ECONOMICS

Growth slowed significantly in 2022 but labor markets have not been affected negatively. In fact, the US continued to create new jobs at a healthy pace and most Western economies enjoy full employment. As

a result, wage pressure is not yet declining. Inflation started to soften in the second half of 2022. For example, European gas prices recently fell below pre-war levels.

Fig. 1: PMIs

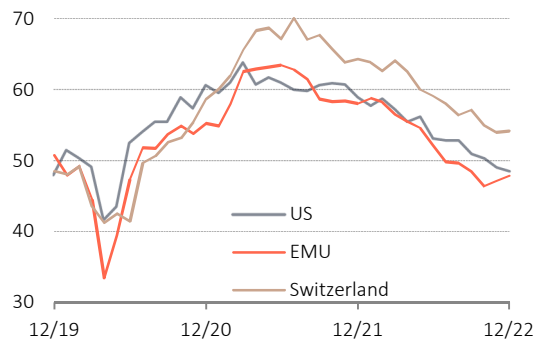


Fig. 2: PMIs

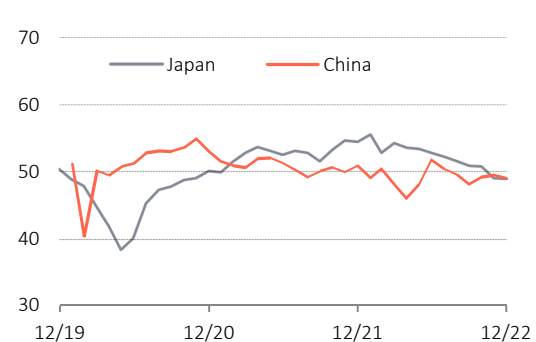


Fig 3: Consumer price inflation, in % YoY

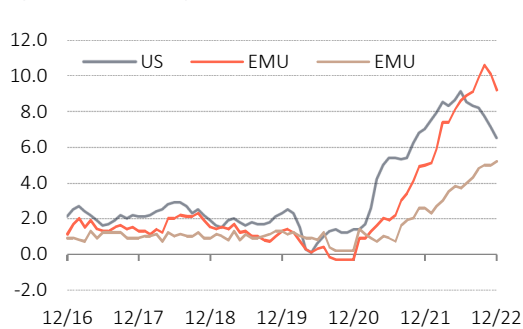


Fig. 4: Consumer price inflation, in % YoY

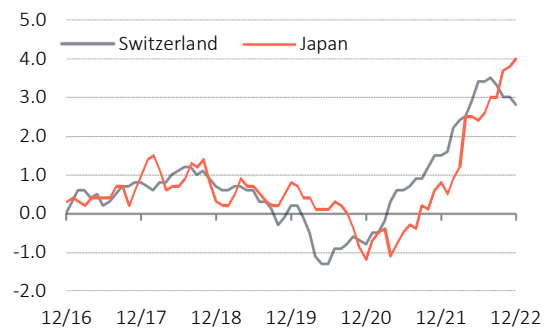


Fig 5: Unemployment rates, in %

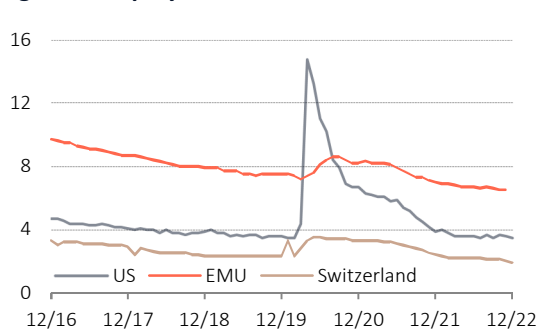


Fig 6: US labor market



FIXED INCOME

Bond markets fell victim to the surge of inflation and aggressive rate hikes by central banks. This led to a historic sell-off and losses across most bond segments. Despite rising inflation, implied inflation expectations, i.e., the break-even inflation rates, fell

during 2022, reflecting the market's assumption that inflation will be temporary. The risk-off environment resulted in significant credit spread widening.

Fig.7: 2Y government bond yields

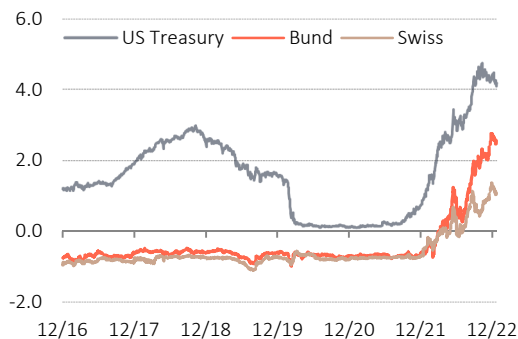


Fig. 8: 10Y government bond yields

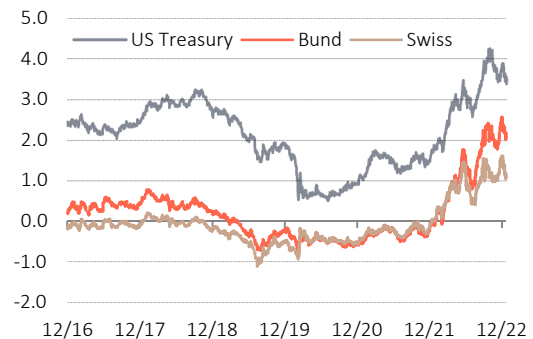


Fig 9: 10Y break-even inflation

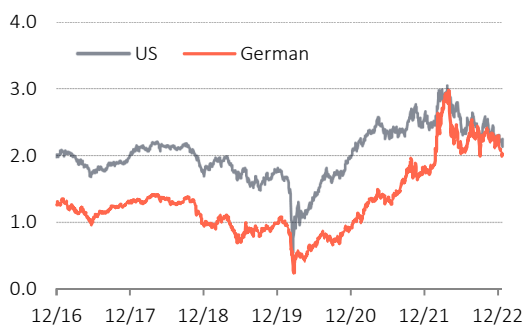


Fig. 10: Credit spreads, 5Y credit default swaps

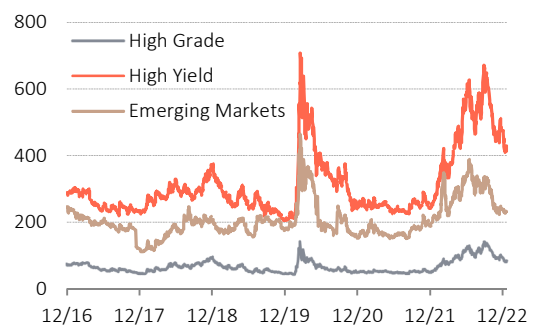


Fig 11: Money market spreads (3M-2Y)

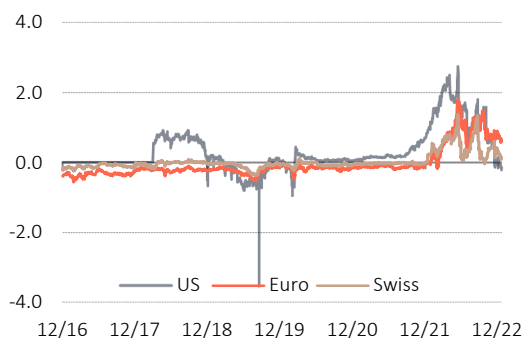
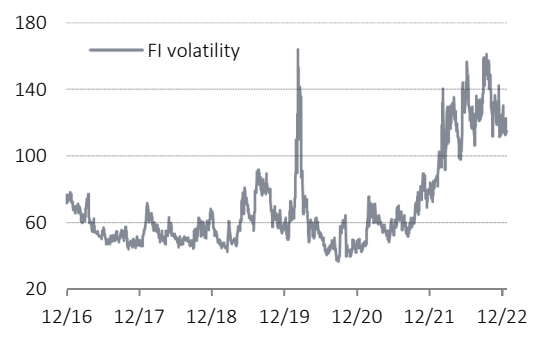


Fig 12: Merrill Lynch volatility index (MOVE)



EQUITIES

Equity markets sold off in 2022. Losses amounted roughly to 20%. While valuations have fallen, it remains questionable whether an expected decline of earnings in a recession is already fully anticipated by the markets. Energy was the clear outperformer in

2022 as oil and gas prices surged. Surprisingly, implied volatility remains very low and even fell during the year, as hedging demand did not pick up.

Fig. 13: MSCI equity indices – major regions

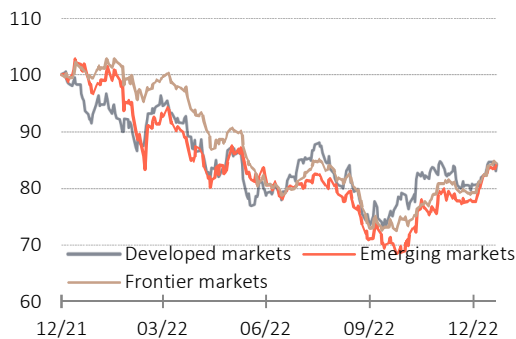


Fig.14: Equity indices – major developed markets

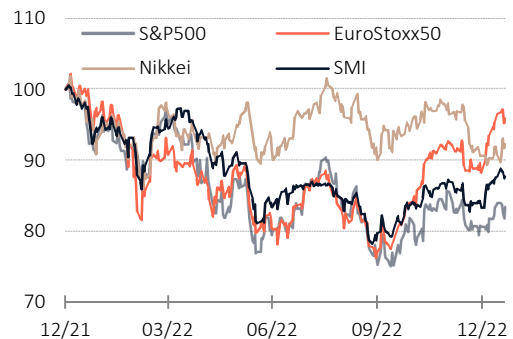


Fig 15: Equity indices – major emerging markets

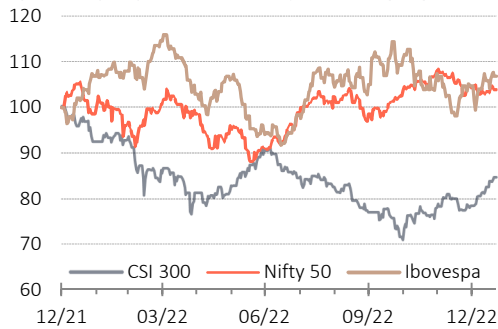


Fig. 16: Sector performance, MSCI Indices, 2022

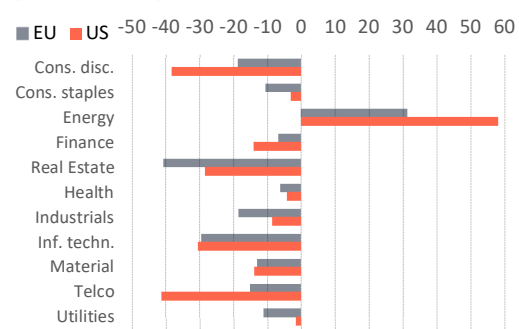
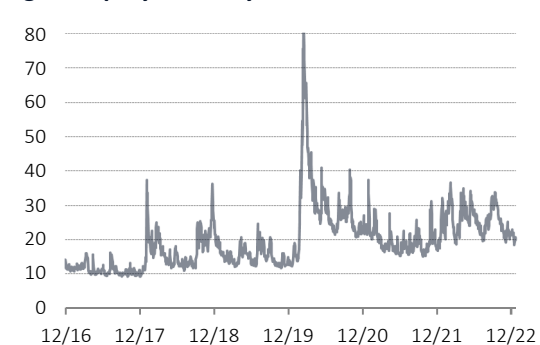


Fig 17: Price-earnings ratios



Fig 18: Equity volatility – S&P500 VIX index



ALTERNATIVE INVESTMENTS

Prices for industrial metals were flat in 2022. Prices for energy and food rose by 36% and 15.5% respectively. Monetary tightening, the risk-off environment

and fraud cases brought many crypto assets into free fall. Bitcoin lost 65% in 2022. Global REITS fell by 22.5%.

Fig. 19: Gold price, USD/oz



Fig.20: Brent oil price, USD/bl



Fig 21: Bloomberg commodity indices

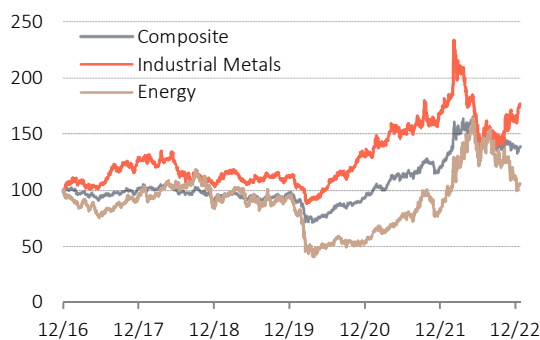


Fig. 22: HFRU hedge fund indices

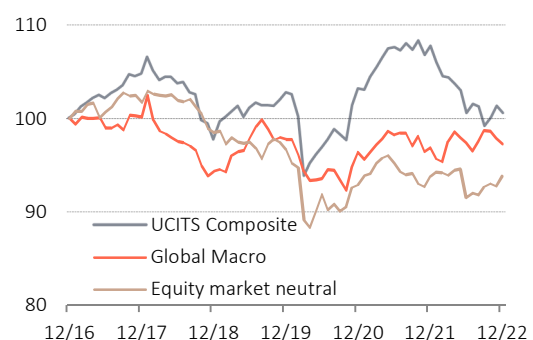
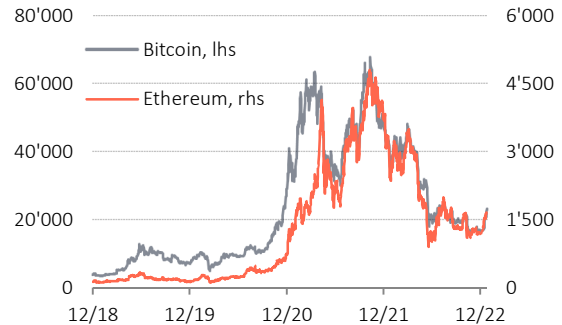


Fig 23: FTSE EPRA/NAREIT global REITS index



Fig 24: Crypto Assets



CURRENCIES

It was another strong-USD year. On average the USD strengthened by 8.2%, and by 6% vis-à-vis the EUR. The CHF also rose vis-à-vis the EUR, which fell clearly below parity. The Brazilian Real even appreciated

against the USD, driven by strong demand for Brazilian natural resources. The JPY was clearly weaker as the BoJ remained dovish when most other central banks tightened monetary policies.

Fig. 25: EUR-USD exchange rate



Fig. 26: GBP-USD exchange rate



Fig. 27: USD-JPY exchange rate

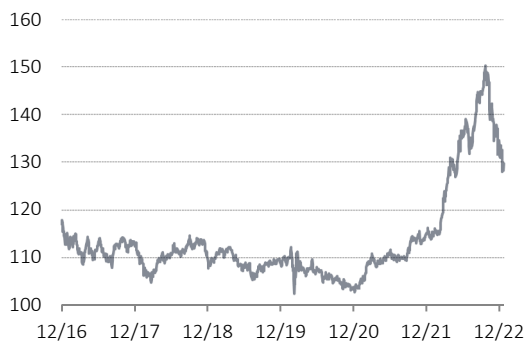


Fig. 28: USD-CNY exchange rate



Fig. 29: EUR-CHF exchange rate



Fig. 30: USD-CHF exchange rate

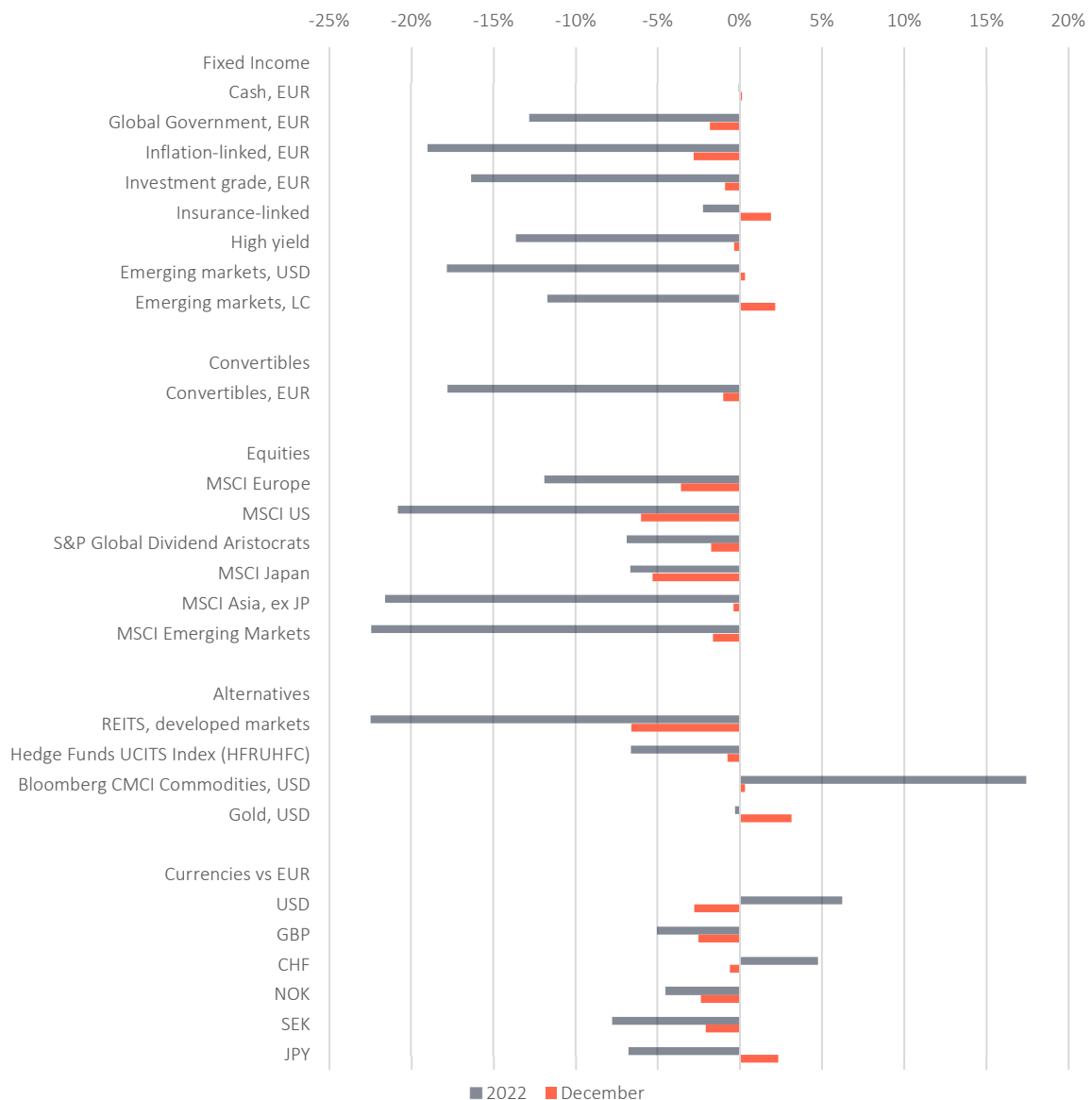


ASSET ALLOCATION

The graph below illustrates that most asset classes clearly performed negatively. There was almost no place to hide. EUR investors enjoyed some cur-

rency gain, especially as the USD appreciated. Commodities also gained in 2022 and provided some hedge against geopolitical and inflation risks.

Fig. 31: Performance of major asset classes, based on our EUR portfolio strategy



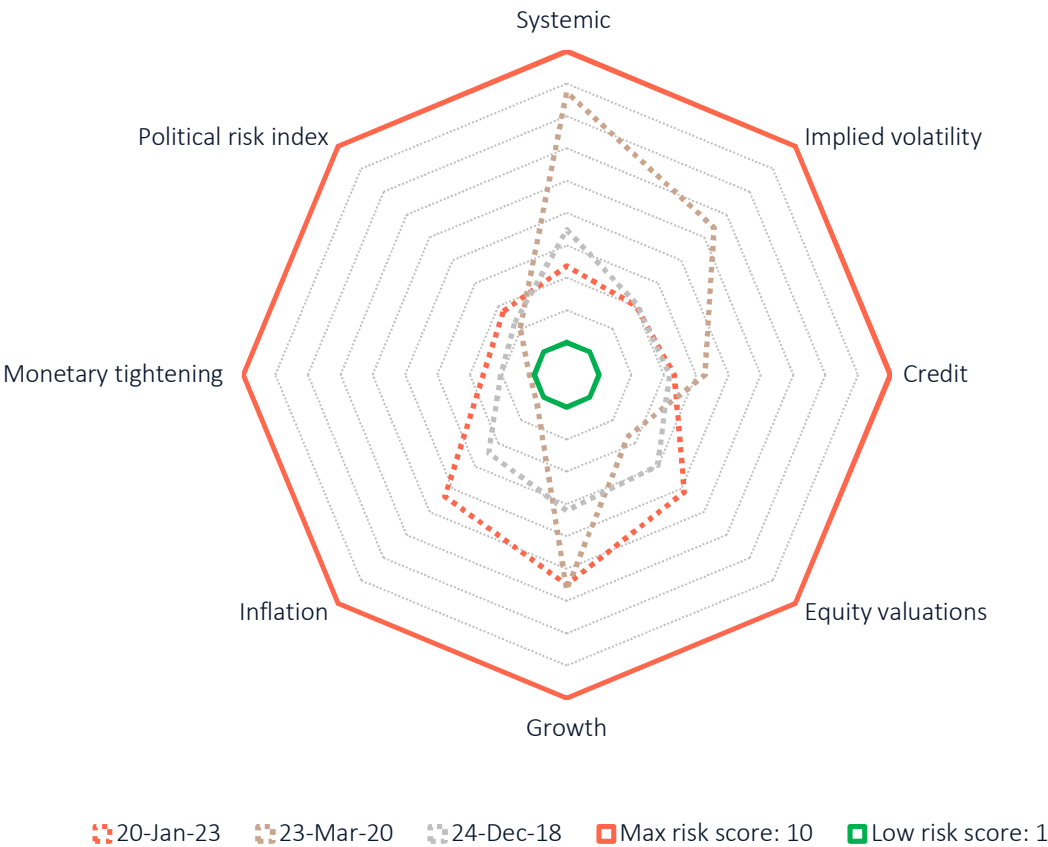
RISK MONITOR

Inflation and growth risks dominate the risk landscape, while equity valuation risks have declined. Since we are approaching the later phase of the tightening cycle, monetary tightening risks have started to decline. Implied volatility remains at very

low levels, as the investors show little interest in hedging.

Fig. 32: IMT Risk Monitor

24-Dec-2018: Growth and monetary tightening fears
23-Mar-2020: Global pandemic



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Source for all graphs: Bloomberg, IMT Asset Management AG.