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Investment letter – 4th Quarter 2023

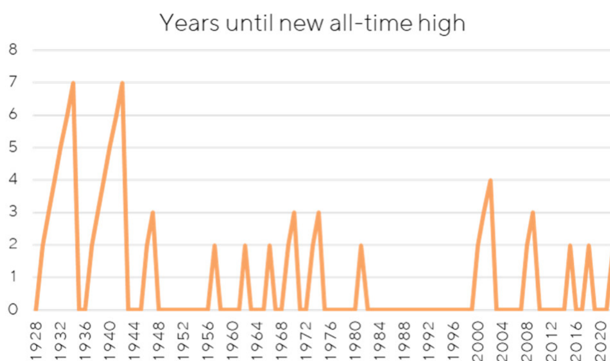
The long-term strategy in mind

Even though the end of the year is arbitrary, it is a good opportunity to reflect on the past and learn for the future. In the past year, we were once again able to see how much the consensus can lead us astray on complex issues. The majority of market participants and economists predicted a negative economic development for 2023. Even our assessment, in hindsight, was not positive enough to do justice to the strong market development. A variety of challenges shaped the economic landscape. The extraordinarily high inflation forced central banks to raise interest rates sharply and pursue a restrictive monetary policy. After a long period of low interest rates, companies, consumers and states were suddenly confronted with rising interest rates and their diverse effects.

Meanwhile, the global supply chain bottlenecks have largely normalized. This has mitigated a major driver of inflationary pressure and allowed central banks to pause interest rate hikes in the second half of the year and adopt a wait-and-see stance. Therefore, an important factor of uncertainty has stabilized, which benefits the valuation of the financial markets. The risk premium of equities over fixed-income government bonds, a measure to judge the attractiveness of equities vs bonds, has therefore remained at a low level despite all the uncertainties. The strong stock market increases reflect, on the one hand, the declining long-term interest rates and the anticipated interest rate cuts by central banks for 2024. On the other hand, corporate earnings for the overall market have continued to grow and have already reached new highs, unlike the stock market. These two factors have made valuations both absolutely and relatively more attractive and have accordingly made the surprisingly positive performance possible. Most companies were able to pass on price increases to their customers and increase sales despite a weakening economy and partly declining sales volumes. A less impressive picture emerges when purchasing power is considered, but nominal growth feels better than nominal stagnation nonetheless.

As active investors, our goal is to invest in the world's best companies, which not only preserve purchasing power, but also generate a long-term excess return compared to the market. We take into account the comprehensive earning power, which includes earnings growth, dividends, share buybacks and debt. Based on these factors, we regularly scrutinize all listed companies that are eligible for investment. We

are always fascinated by how successful many companies generate added value for both customers and owners through innovation and efficiency. When we underpin these fundamental impressions with historical data, we do find it difficult not to look positively into the future. A statistic that supports this feeling is the number of years it takes on average for a portfolio to reach new highs. The graph below shows that balanced mandates reach a new valuation high every three years on average. Especially after strong corrections, it is worthwhile to keep this in mind.



A lower equity exposure further shortens this duration, but at the expense of long-term returns. A variety of dangers, whether inflation, geopolitical events or fundamental economic changes, are not unusual in the historical context and are represented in this data set. For evolutionary reasons, we tend to overestimate dangers, because this was essential for survival. However, equally natural is the desire of all market participants to maneuver the current environment as best as possible. Accordingly, the best companies emerge stronger from difficult phases.

What can we expect for 2024? The current economic indicators continue to paint a bleak picture and the long awaited recession remains possible. With certainty we know, that 2024 will be a record year for politics. In more than 50 countries, a new government will be elected. Election years not only provide ample controversial topics for discussion but are also, at least in the short term, a positive driver for the economy. Several studies indicate that governments tend to increase spending in election years. As a result, government debt is expected to increase due to higher expenditures, possibly accompanied by measures from central banks. These measures, including interest rate cuts, may contribute to an expansion of the central banks' balance sheets. As always, there are therefore sufficient reasons to justify both a positive and negative assessment. The decisive factor is how the actual development differs from the expectations embedded in the market prices. In this regard, we observe that market participants while less pessimistic compared to a year ago, show no signs of widespread euphoria. This is also reflected in the valuation differences of the various equity sectors. Specifically, the valuation in the technology sector already factors in substantial anticipated growth rates, whereas significant portions of the markets anticipate declining profits instead. This provides us with the chance to benefit from relative valuation differences and make corresponding adjustments in the portfolio. In view of the dynamic market conditions, we remain committed to our strategy of generating long-term value for our investors through careful analysis and selective investments.

Zurich, end of December 2023