Capicura Partners – Outlook 1st Quarter 2022

Inflation Yes, sharply higher interest rates No – correlation broken

- ***Nominal interest rates remain relatively low, real interest rates continue to be deeply negative***
- ***Geopolitical risks are rising, escalations cannot be excluded***
- ***Gold should (finally) benefit from increased inflation expectations***
- ***Digital assets deserve a place in a global portfolio despite high volatility***
- ***Maintain constructive asset allocation, equities remain asset class of choice***

During Q4 and especially in November, volatility returned to the financial markets. Even if the year is not completely boxed up yet, optimism is warranted that 2021 will be a good equity year.

«Strong rise in energy prices main driver of record high consumer prices»

Thanks to the global vaccination campaigns, countries started to reopen in 2021 and economic activity was kickstarted along with a strong recovery and normalisation in corporate earnings. We acknowledge that COVID-19 is still omnipresent, and it is not expected to disappear

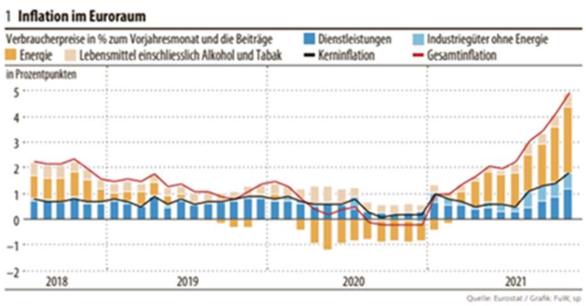

***Fig.1)** Eurozone Inflation, Source Finanz&Wirtschaft 11.12.21*

anytime soon, but we observe that the virus-related negative "shocks" or market reactions are becoming shorter and shorter and the setbacks smaller and smaller. Due to bottle necks and capacity constraints, the supply side was not able to keep up with the increased demand which has led to higher prices. The main driver for the record high inflation rate (USA with 6.8% highest level in 40 years) were clearly energy costs. In Europe, for example, higher energy prices account for more than half of the overall inflation number (see Fig. 1). We expect increased consumer prices to remain structurally and not just temporarily elevated, but to settle at a level that remains tolerable. After several deflationary years with central banks desperately trying to counteract price declines, the desired inflation is finally kicking in.

«A bit of inflation is preferred over deflation»

Now that prices are rising, people are concerned that inflation could get out of control. Investors remember the situation last seen in the 1970s (oil price and therefore inflation shock coupled with a weakening economy → stagflation). However, for inflation to get out of hand, another external shock would have to occur. Therefore, the current tense geopolitical situation should not be underestimated and should be closely monitored. A feared Russian attack on Ukraine could lead to just such an "external" event (oil and gas prices in particular would rise even further and jeopardize global economic growth). The threatened sanctions by the Biden administration seem to be rather "toothless" and the EU is also finding it difficult to formulate clear boundaries vis-à-vis Russia. Currently, no one seems to want to stand up to Russia. We do not completely rule out an escalation in the Russia/Ukraine conflict, but given the low probability it is not warranted to re-position the portfolio for such an event. Nevertheless, we must point out this looming geopolitical risk in addition to a potential China/Taiwan escalation, which could take the markets hostage. Moving back to inflation - we focus on the 5y5y forward inflation swaps which reflect the market's future inflation expectations (see Fig. 2). These "forwards" are one of the central banks' many indicators helping to define policy measures. We can see that the market expects 5-year USD inflation to be around 2.5% in 5 years, while in the

EUR area it is seen around 2%. That is close to the target rate set by the central banks which according to their definition, represents price stability (2% p.a.). We therefore expect price levels to remain elevated in the medium term on both sides of the Atlantic, but not to skyrocket. Subsequently, interest rates at the long end of the yield curve should only rise moderately.

Fig.2) *Data Bloomberg / Chart Capicura Partners*

«Forex volatility set to rise»

Regarding monetary policy, the market assumes that the US Federal Reserve will stop its bond purchases (QE) in March and raise interest rates 2-3 times until the end of the year. For the Eurozone and Switzerland, the picture looks different due to lower inflation figures - neither the ECB nor the SNB are expected to hike rates next year. This will result in a diverging picture for yield curves, flatter in the US, steeper in Europe. We expect this to lead to an increase in volatility on the foreign exchange markets, which have been exceptionally quiet during recent months. The USD should benefit from the rising interest rate differential and remain well supported.

«Strongly negative real interest rates still main drivers for asset prices»

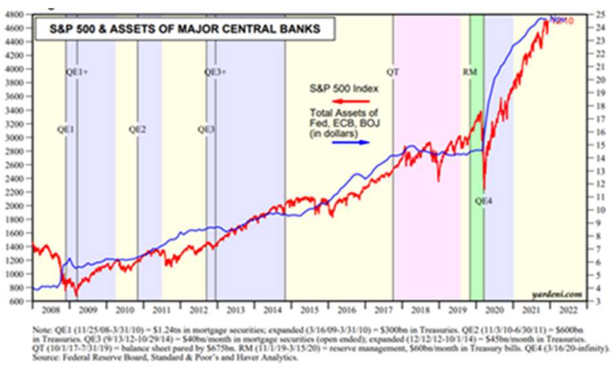

Fig. 3) *Source Yardeni Research*

We remain optimistic for real assets. In addition to low or even negative interest rates, inflated central bank balance sheets (see Fig. 3) and above-average liquidity, strongly negative real interest rates remain crucial, if not THE most significant driver for the future development of real assets.

«Continued focus on real assets"

Within a balanced portfolio, we start 2022 with an elevated equity allocation despite geopolitical risks. In addition to equities, we are also invested in real assets in the alternatives space via REITs (Real Estate Investment Trusts) and Gold (protection against inflation and geopolitical risks). In the future, we also want to consider digital assets. This still young sector has become too big to be ignored with a market capitalization of almost USD 2.1 trillion. Compared to the global equity market capitalization of an estimated USD 100 trillion, cryptocurrencies account for about 2%. More and more institutional money is seeking its way into "digital gold," a trend that is expected to continue in the new year.

Asset Allocation	
Cash	*10%*
Fixed Income	*20%*
Equities	*55%*
Alternative Investments (incl. REITs, Gold, Crypto Currencies)	*15%*

Fig. 4) *Suggested asset allocation for a Balanced Portfolio in Q1 2022*

We wish you and your families a relaxing holiday season and the very best for 2022.

Your Capicura Team