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Compass

2nd Quarter 2024

US presidential elections

Focus on US government debt

Gold as an investment -
A comprehensive analysis

Your wealth, our responsibility.

Gold shines amid rising US government debt

Financial markets are looking forward to 5th November this year, when the 60th US presidential election will take place. Joe Biden and Donald Trump have impressed in the primaries, and the election is shaping up to be a neck-and-neck race. The balance of power in the US Congress is also extremely close. Both parties are defending a razor-thin majority of 51% in each chamber. What policies can be expected under a Democratic or Republican government? A look at the past few years shows that neither party has been able to prevent the US national debt from rising. For years, Congress has debated raising the so-called debt ceiling. This is one of the reasons why US public finances should be monitored closely. However, there is no convincing long-term solution to the US debt crisis in sight. In such rough waters, investors are increasingly looking for safe havens to protect their assets. In times of inflation, increased volatility and geopolitical risks, gold has historically been able to shine. Since the launch of several bitcoin ETFs earlier this year, the blockchain-based cryptoasset has received a lot of media attention. In this context, bitcoin is often compared to gold but can bitcoin deliver on its promise as "digital gold"?

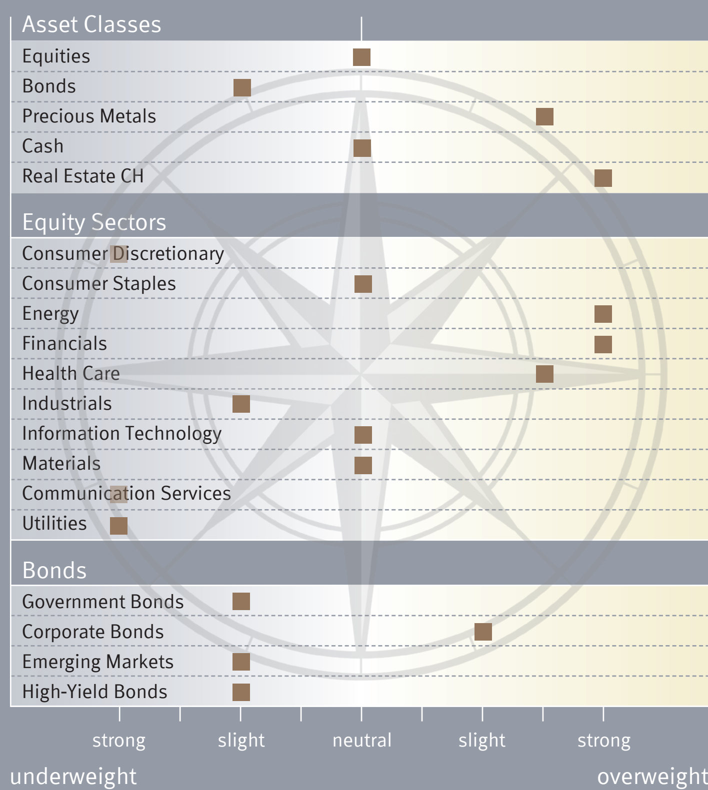
Fed decisions and AI euphoria drive the stock markets

The US Federal Reserve's decision to leave interest rates unchanged, together with positive labor market data and continued euphoria in the field of artificial intelligence, drove global equity markets in the first quarter of this year. In order to benefit from this positive trend, we increased our equity allocation from a slight underweight to neutral. At the same time, bond markets declined as expectations of fast interest rate cuts faded.

The rally in equity markets led to overvaluation in some segments. In such an environment, selective investment becomes increasingly important. We have significantly increased the weighting of the energy sector on the back of attractive valuations, while reducing the weighting of the more expensive healthcare sector due to declining momentum.

By increasing the equity allocation, we have reduced the bond allocation. It is still advisable to assess the credit quality of issuers carefully and to hold only bonds issued by first-class borrowers. Given the macroeconomic environment characterised by geopolitical tensions, we remain heavily overweight in the defensive asset gold. We also maintain our overweight in Swiss real estate.

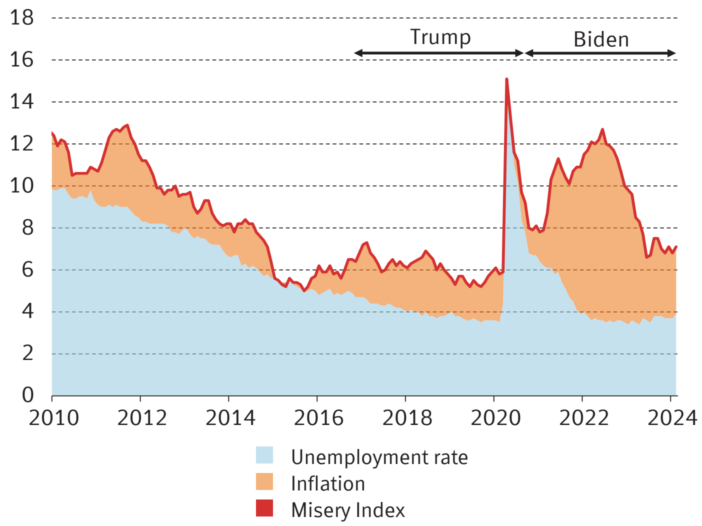
Asset allocation recommendation as of April 1st, 2024 for investors with CHF as their reference currency.



Current Topic:
US presidential elections

Current Topic 1:

Percent

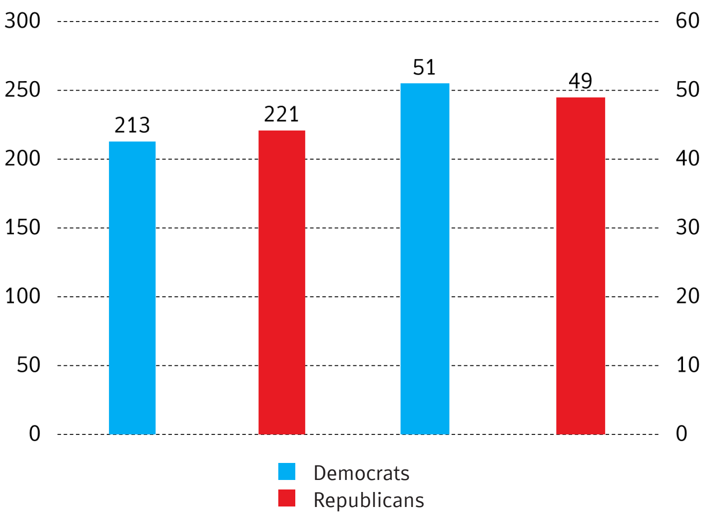


Trump ahead of Biden?

The 60th US presidential election is scheduled for November 5th, with incumbent Democrat President Biden and former Republican President Trump expected to be the nominated candidates. While a Trump presidency was considered unlikely until recently, the candidates are now tied with the bookmakers. Besides health concerns, the case against Biden is that despite full employment during his presidency, the economic well-being of voters has deteriorated due to rampant inflation. This is clearly shown by the "Misery Index," which represents the sum of the unemployment rate and the inflation rate. A cooling of the labor market as a result of the restrictive monetary policy should further improve Trump's chances.

Current Topic 2:

US House of Representatives — US Senate

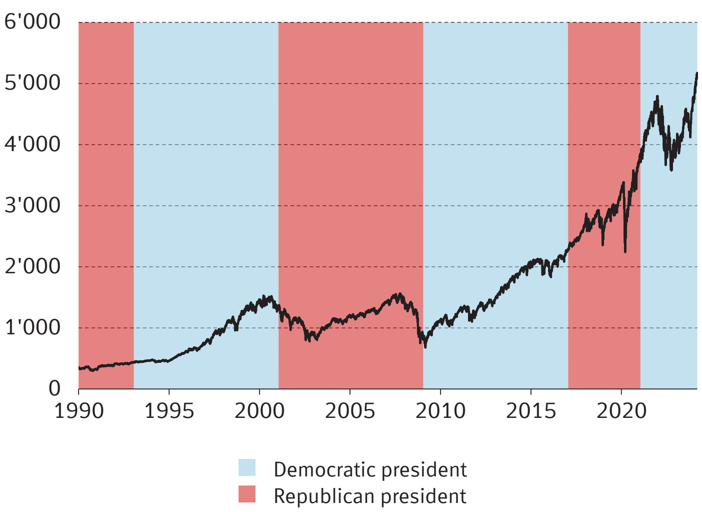


Narrow majorities in Congress

The Congress is the legislative body of the USA and consists of two chambers: the Senate and the House of Representatives. At the beginning of the Trump administration in 2017, the Republicans had the majority in both chambers of Congress. This is known as a "united government". It can push through projects such as the comprehensive tax cuts more easily. However, midterm elections often lead to a change of power in Congress in favor of the opposing party. This kind of "divided government" is often characterised by tough negotiations. Since the 2022 midterms, the majorities in Congress have been extremely close. Both parties have a majority of 51% in each chamber: the Democrats in the Senate and the Republicans in the House of Representatives.

Current Topic 3:

Price performance of the S&P 500 Index in USD



What politics can we expect?

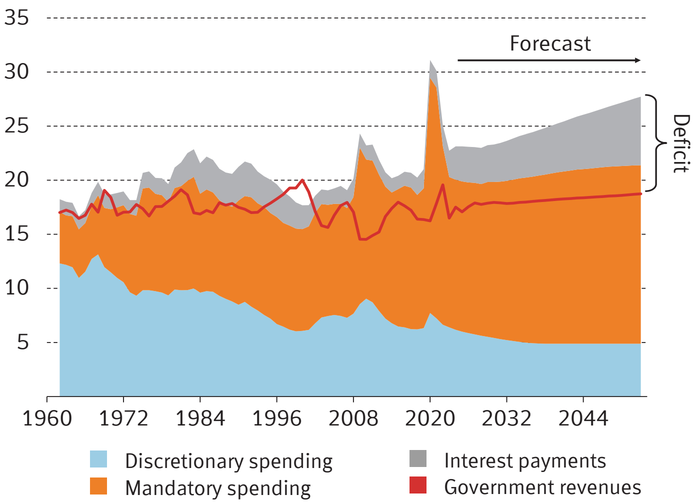
Under Biden, two important federal laws were passed that are intended to generate higher tax revenue in the long term but massively increase government spending in the short term. For example, they promote lower drug prices and renewable energy (Inflation Reduction Act) or the US semiconductor industry (CHIPS and Science Act). Biden plans to stabilise the budget primarily through tax increases. Trump, on the other hand, is calling for tax cuts, also because parts of his income tax laws expire after 2025. Lower corporate taxes will probably have a positive impact on profit margins, but barely any effect on real growth. "America First" particularly envisages a rigorous immigration policy and a protectionist trade policy. Although stock cycles and trade relations can be influenced by tariffs, the impact of election results on the stock markets is often overestimated.

Basic Trend:
Focus on US government debt

Basic Trend 1:

Source: Congressional Budget Office

Percent of US GDP



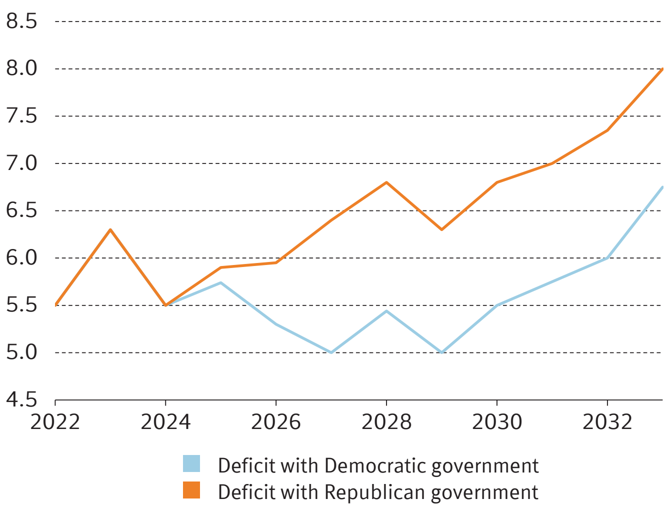
Composition of US government spending

US government spending consists of three components. Discretionary spending includes programs for which the Congress must approve funds every year. This includes areas such as defense, education and environmental protection. Mandatory spending is set by law and is not subject to the annual budget process, but is fixed over several years. This includes social security benefits such as Medicare and other compulsory expenditures. Discretionary and mandatory spending together account for 92% of total spending. Interest payments on government debt make up the remaining 8%. Although the two major American parties have differing fiscal policy priorities, government debt has risen steadily under both administrations.

Basic Trend 2:

Sources: Congressional Budget Office, BCA

US federal budget deficit as a percentage of GDP



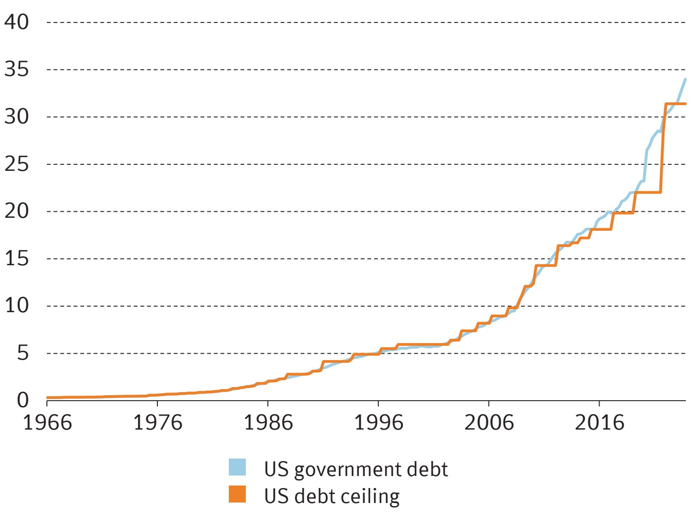
Further deficit growth expected

In 2023, the US budget deficit amounted to 6.3% of GDP. The deficit is likely to increase further in the future as the ageing population causes higher social spending and the interest burden continues to rise. To date, neither the Republicans nor the Democrats have taken any serious measures to reduce government spending. Another aspect that could fuel deficit growth is tax policy. The likelihood of an increase in corporate taxes is extremely low. Should the Republicans gain control of the Congress, Trump's "Tax Cuts and Jobs Act" from 2017 is likely to be continued and possibly extended. Even if the Democrats were to hold the Senate, it is unlikely that the corporate tax rate of 21% would be increased.

Basic Trend 3:

Sources: US Treasury, FRED

USD trillions



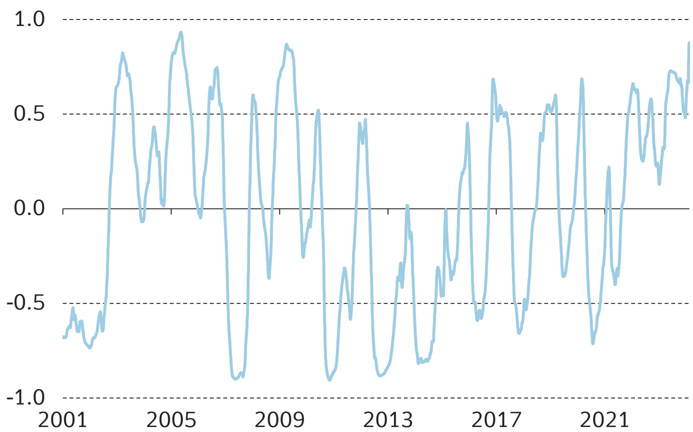
The US debt ceiling

To limit American government spending and control government debt, a debt ceiling was introduced in 1917. However, this is often seen as a purely symbolic constraint, as it has already been raised more than 100 times to meet current financial needs. Not raising the debt ceiling could lead to spending cuts and would affect the creditworthiness of the US, with severe consequences for the global economy. The latest extraordinary measures were taken in January 2023, when the current debt ceiling of USD 31.4 trillion was reached. A few days before the projected "X-date" - the day on which the government would become insolvent — the White House and the Congress agreed on the Fiscal Responsibility Act of 2023. The debt ceiling is thus suspended until January 1st, 2025.

Knowledge & Experience: Gold as an investment - A comprehensive analysis

Knowledge & Experience 1:

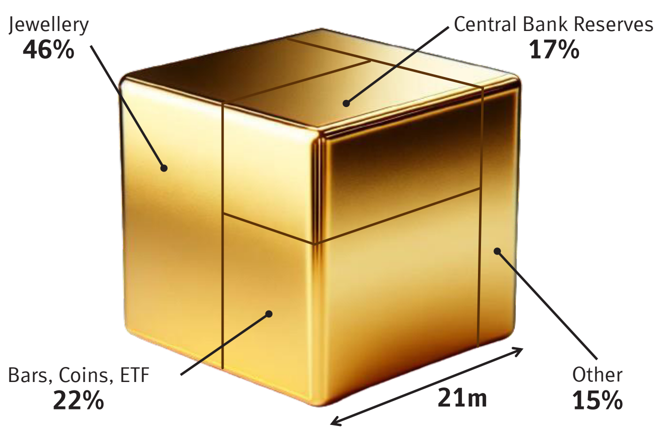
Rolling 1-year correlation between gold and equities



A safe haven in stormy times

Although a default by the US is virtually ruled out, the long-term sustainability of the high debt levels is increasingly being questioned. Against the backdrop of growing uncertainties, gold is gaining more attention from investors, as it is seen as a safe haven in times of heightened volatility and impending instability of the financial system. This is due to its limited availability, low correlation with traditional asset classes, and the intrinsic value of gold. It is the physical properties and associated industrial applications that give the precious metal its intrinsic value. In addition to diversification benefits, gold is also used as a hedge against inflation and to mitigate geopolitical risks.

Knowledge & Experience 2:

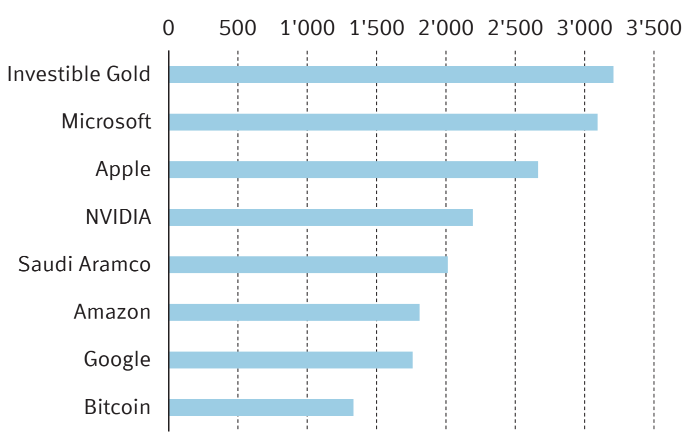


Distribution of global gold holdings

For thousands of years, gold has played a central role as a store of value. To date, over 200'000 tonnes of the precious metal have been mined, with approximately two-thirds of that extracted after 1950. Currently, the annual gold production corresponds to about 2% of the current gold stock. Nearly half of the world's gold has been processed into jewellery. Central banks hold about one-sixth of the total gold stock and less than a third is held in investment forms such as bars, coins, or gold ETFs. The gold stock available for investment purposes thus amounts to approximately 45'000 tonnes, equivalent to a value of about USD 3 trillion. This represents only a small portion of the total gold stock of approximately USD 14 trillion.

Knowledge & Experience 3:

Market capitalisation in USD billions as of March 2024



Is Bitcoin the New Gold?

Since the launch of several Bitcoin ETFs earlier this year, the blockchain-based crypto asset has received a lot of attention. In this context, Bitcoin is often compared to gold. The comparison is primarily based on their limited availability, their function as a hedge against financial system instabilities, and their protection against inflation. Additionally, both assets do not generate income for investors. Despite some similarities, the two assets differ fundamentally. Gold, with its long history, is considered a defensive tangible asset. Bitcoin, on the other hand, is a new and digital asset with unproven intrinsic value and high volatility. Unlike gold, Bitcoin has not yet experienced a deep recession and therefore needs to prove its function as a hedge in turbulent times.

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