QUARTERLY REPORT:

ECONOMY AND MARKETS

Q2 2023 - BANCA DEL SEMPIONE

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SIMPLON BANK
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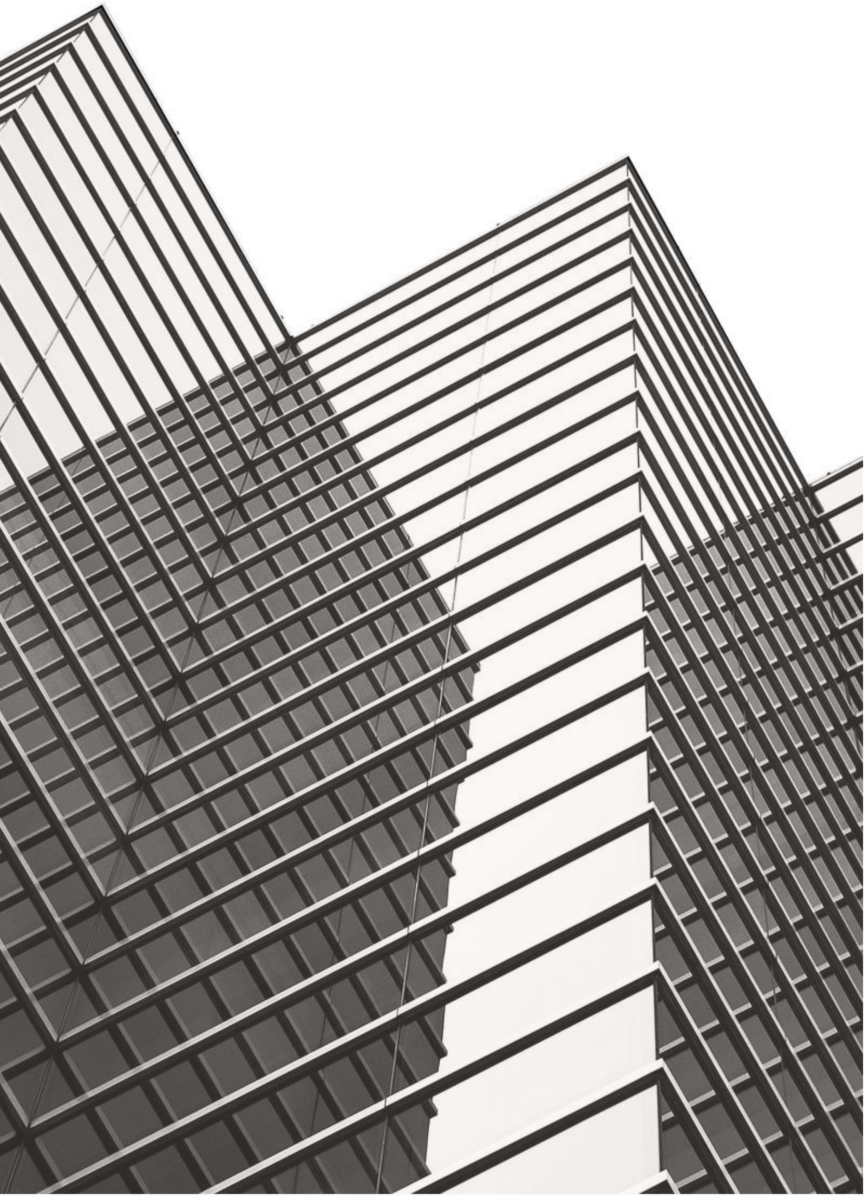

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MESSAGE – FINANCE AND MARKET DIVISION

The issue of inflation, with all the consequences this could have on financial markets, has remained the central point around which the main economic analyses are developed. A return to more moderate levels is evidenced by the data, which nevertheless show a less marked slowdown than most analysts' expectations in past months.

In this context, longer term government rates are not showing the volatility that can be observed on more short-term ones. This dynamic highlights investors' expectations for lower levels of inflation in the months ahead but also greater indecision about the attitude of central banks, which have reverted to more aggressive rhetoric. The consequence results in an inversion of the curves, whereby short rates are higher than long rates, an indicator always taken into high consideration by global investors to signal potential recessions.

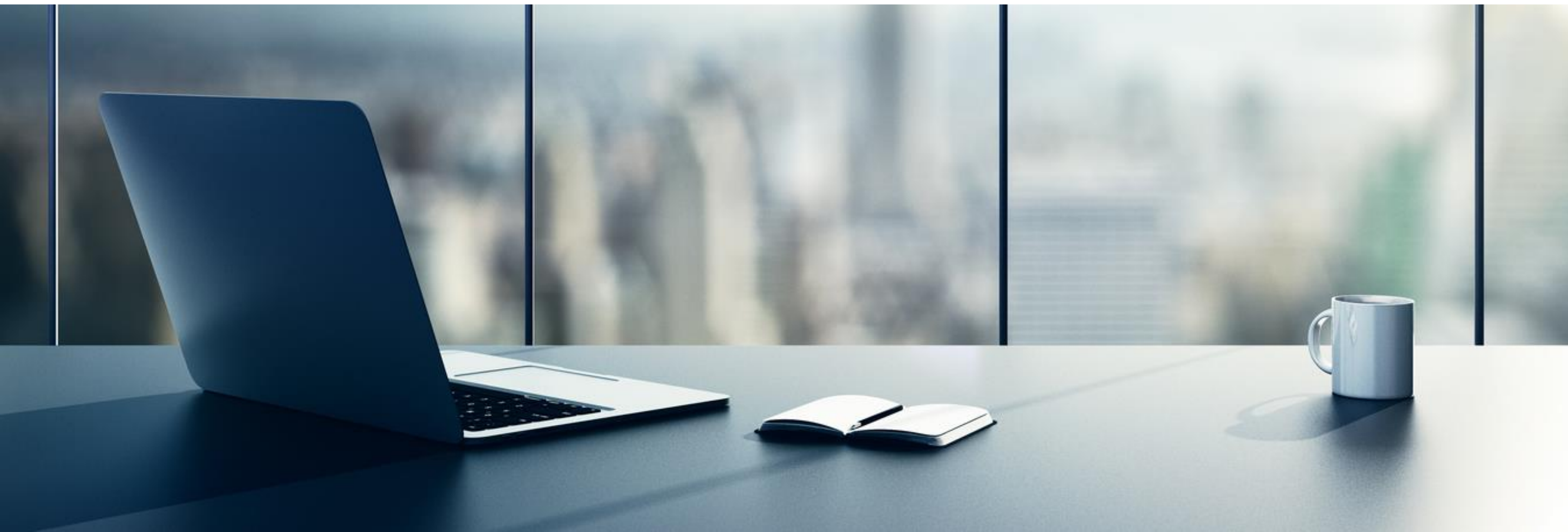
Stock indexes, in general, have shown a strong recovery from last year's losses, reaching in several cases the highs achieved before the sharp decline in 2022. Going into detail, however, the dispersion within the indices has been evident, where a few large stocks, driven mainly by prospects for improved earnings originated by the development of artificial intelligence, have secured most of the index returns.

Among geographic areas, a marked underperformance of emerging market indices is still observed. Overall, for many listed companies remains a discount compared to the highs of the end of 2021 that, however, the market cannot avoid applying, not only because of the differences of current monetary policies compared to the recent past, but also because of an objective difficulty of some sectors to recover convincingly from the stop imposed by the pandemic.

In our asset allocation we maintain a very constructive approach to the bond component, in the belief that current yield levels can be attractive and will pay off in the medium term, partly due to central banks nearing the end of their upward cycle. With regard to equity exposure, while maintaining our traditional approach, we prefer a selective attitude in the search for balance between long-term value and going along with market trends that sometimes push prices and valuations to high levels.

PIETRO SCIBONA

DEPUTY GENERAL MANAGER
HEAD OF FINANCE AND MARKETS



MACROECONOMIC OVERVIEW

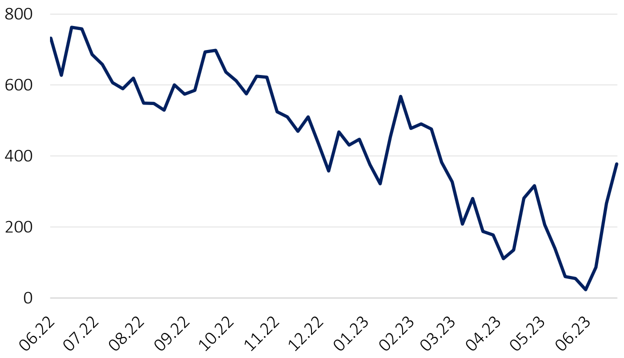
Global economic scenario

The second quarter of 2023 witnessed a relative easing of the concerns that arose in March due to the liquidity crisis in the financial system. **First Republic Bank** was the latest bank to face a bank run in the first half of the year, resulting in its acquisition by **JPMorgan**. Fortunately, the rest of the global banking system managed to handle the impact of interest rates and capital outflows with the help of significant liquidity injections from central banks.

During this quarter, negotiations surrounding the "***Debt ceiling***" garnered significant media attention. These discussions within the US Congress proved to be complex, and an agreement to suspend the ceiling was reached just few days before the US Treasury's liquidity would have been exhausted, potentially leading to a state default.

Liquid assets held in U.S. Treasury

USD bn; 06.22 – 06.23



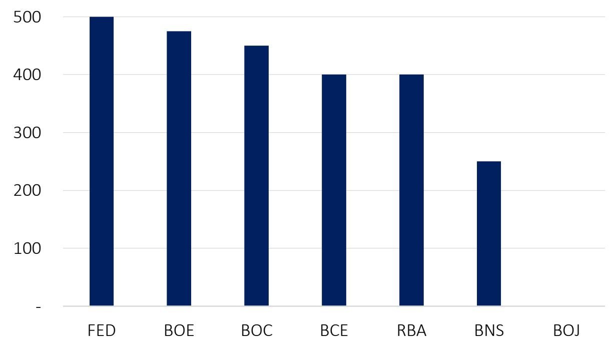
Source: Bloomberg

The global macroeconomic environment remains challenging to decipher. On one hand, there are initial signs of an economic slowdown, as evidenced by two consecutive quarters of decreasing European GDP, marking the onset of a "**technical recession**." Additionally, macroeconomic indicators forecast a declining global economy in the second half of 2023. On the other hand, consumer demand for goods and services continues to be supported by a robust labour market, leading to wage renegotiations. Consequently, inflation has begun to gradually decline, mainly due to energy and food prices normalizing, although prices for services and rents continue to experience significant growth, keeping inflation levels relatively high.

Throughout the quarter, central banks took further steps towards finalizing their monetary policies. The US **Federal Reserve**, after implementing a 25 basis point hike in May, chose to maintain its interest rate unchanged in June for the first time in over a year. However, they indicated that a path towards rate cuts would still be distant. Conversely, the **European Central Bank** opted to increase its benchmark rates by 0.5% points during recent interventions, intending to continue with additional interest rate hikes while adopting a more data-driven approach based on macroeconomic indicators.

Rate increased by central banks since January 2022

Basis points; 01.22 - 06.23



Source: Bloomberg

It's worth noting that some central banks, such as the **Bank of England** and **Norges Bank**, reintroduced 50 basis point hikes in the last meeting of the quarter. In contrast, the **Bank of Japan** remains on a counter-trend being the only central bank persisting with an expansionary monetary policy despite recent leadership changes.

China's post-lockdown economic recovery has been less vigorous than anticipated, with investment, consumption, and production still falling short of analysts' expectations. Weakness in the real estate sector continues to exert pressure on the economy, prompting the government and central bank to implement multiple stimuli throughout the quarter in an effort to mitigate the impact on the Chinese population.

MACROECONOMIC OVERVIEW

Focus: geopolitical context and Switzerland

Geopolitical context

Relations between **China** and the **United States** have eased once again, as evidenced by the resumption of contacts between the two economic powers. A significant meeting took place in June between U.S. Secretary of State Antony Blinken and Chinese Foreign Minister Wang Yi. Both sides described the dialogue as calm and constructive, culminating in the promise of a potential meeting between President **Biden** and President **Xi Jinping** in the coming months.

On the other hand, the **United States** continues its mission to build alliances to counterbalance China's growing influence. The quarter witnessed a strengthening of economic ties between the U.S. and India, facilitated by both the government and leading technology companies such as **Apple**, **Alphabet**, and **Amazon**. Furthermore, at the G7 summit held in **Niigata**, Japan, diplomats from **Washington**, **Tokyo**, and **Seoul** agreed to establish a new information system in the semiconductor field, aiming to mitigate the risk of a potential invasion of Taiwan.

The **Russian-Ukrainian** conflict remains at a standstill. The advancement of **Putin's** army appears to have reached its limits, but the counteroffensive by **Kiev's** troops has yet to yield significant results. President **Zelenskiy** has engaged in dialogues with leaders of nations that initially chose not to condemn the Russian invasion, including **India, China, and Brazil**, in an effort to weaken the **Kremlin's** alliance ties. On the Russian front, an insurgency attempt led by the **Wagner** mercenary group was swiftly foiled shortly after its arrival in Moscow, following **Putin's** accusations of treason directed at **Prigozhin**, the leader of the military group.

On the domestic political front, several European nations witnessed a series of electoral outcomes in the last quarter. In **Greece**, the center-right party's resounding victory favored the reappointment of Prime Minister **Mitsotakis**, while **Turkey** re-elected **Erdogan** with diminished support. Notably, former President **Trump** has been indicted on seven counts, including the seizure of classified documents and obstruction of justice, making his ongoing trial a historically significant event if he is eventually convicted..

Switzerland

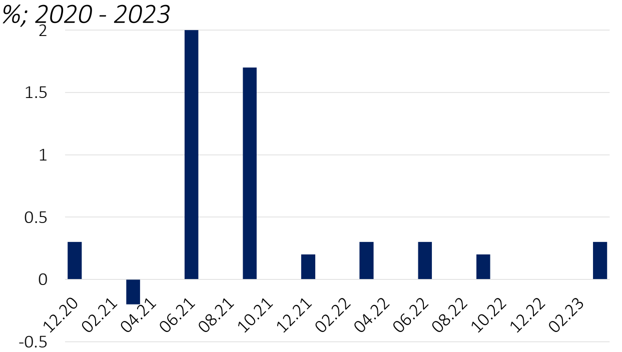
The second quarter brought positive macroeconomic news. The **GDP** for the first three months of the year returned to a mild growth trajectory, rising by 0.3% compared to year-end values. This growth was supported by a general recovery in consumption, investment, and net exports. **Unemployment** levels are now approaching the lowest recorded levels in over 20 years, standing at 1.9%, despite the high participation rate of the Swiss workforce, which has reached 85% in the 15-64 age group. Additionally, the rate of price increases reached the desired target set by the Swiss National Bank (**SNB**), with the latest inflation figure for June reaching 1.8% year-on-year.

In response to these developments, the **Swiss National Bank (SNB)** raised its interest rate by an additional 25 basis points, bringing the general deposit rate to 1.75%. President **Thomas Jordan** stated that further measures to restrict monetary policy and contain potential inflationary pressures are not being ruled out. Furthermore, the **SNB** continued to support the Swiss franc by reducing its foreign exchange reserves.

The acquisition debacle involving **Credit Suisse** and the **UBS** Group concluded during the quarter, resulting in the removal of **CS**'s stock from the Swiss Stock Exchange and the **Swiss Market Index (SMI)**. Among the top 20 listed companies in Switzerland, the shipping and aviation giant **Kuehne & Nagel** now occupies a prominent position.

Switzerland: quarterly growth of Gross Domestic Product

%; 2020 - 2023



Source: Bloomberg

FINANCIAL OVERVIEW

Equity market

Indices	Price	Quarterly Performance	YTD Performance
MSCI World	2,791.4	7.2%	7.2%
SMI	11,106.2	3.5%	3.5%
STOXX Europe 50	4,315.0	13.7%	13.7%
FTSE MIB	27,113.9	14.4%	14.4%
DAX	15,628.8	12.2%	12.2%
S&P 500	4,315.0	7.0%	7.0%
NASDAQ 100	13,181.3	20.5%	20.5%
Nikkei 225	28,041.5	7.5%	7.5%
Hang Seng	20,400.1	3.1%	3.1%

Source: Bloomberg

Following the events in March that raised concerns for the U.S. banking sector and beyond, the second quarter experienced positive performance in equity indices. The injection of liquidity by the **FED** into the financial system to assist regional banks in managing capital withdrawals helped normalize the situation, allowing the market to maintain its positive trend that began earlier in the year.

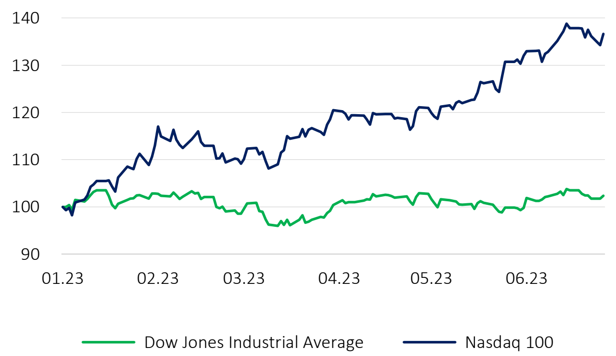
The **macroeconomic context** also contributed to supporting stock index prices, with inflation data showing a decline (albeit at a slower pace than anticipated at the beginning of the year). *Leading indicators*, although slowing, remained in expansion territory. Notably, a contrasting trend emerged between manufacturing data, which entered contraction territory, and services data, which continued to drive economic activity. Corporate results in the early part of the quarter surprised on the upside, with improved outlooks for the rest of the year. The resilience of corporate earnings and the stability of corporate margins at high levels led many analysts to raise their estimates.

Going into greater detail on **geographic performance**, after a relatively stable month of April, a clear American outperformance was observed relative to Europe. The reasons for this relative performance are, once again, to be attributed to differences in sector composition among the indices. Taking a closer look at **geographical performance**, after a relatively stable April, the American market outperformed Europe significantly. This relative performance can be attributed to differences in sector composition among the indices.

The **S&P 500** index benefited from the strength of **major tech companies**, led by **Nvidia**, which capitalized on the renewed interest in artificial intelligence sparked by the success of **ChatGPT**, the fastest app in history to reach one million users. It is evident that, in this quarter, the performance of major U.S. indices (**S&P 500** and **Nasdaq**) was primarily driven by a handful of stocks, accounting for most of the year's gains. This disparity is evident in the performance gap between the **Dow Jones** and the **Nasdaq 100**, with the industrial index (DOW) recording a modest 3.80% increase, while the technology index (NASDAQ) surged by 38.75% since the beginning of the year.

<u>Dow Jones Industrial Avg and Nasdaq100 Indices Performance</u>

100; 01.23 – 06.23



Source: Bloomberg

In contrast, performance in the **European markets** was relatively uneventful, with indexes remaining almost flat. Sectors that initially drove early-year gains, such as luxury goods, experienced some profit-taking due to slightly slowing data and the Chinese economic restart falling below expectations. However, more cyclical sectors, including financials and automotive, saw a recovery after post-bankruptcy write-downs.

Emerging markets continued to lag behind, as **China's** long-awaited economic recovery did not materialize despite reopening and exiting zero Covid policies. To address the situation, **Xi Jinping's** government introduced a series of economic stimuli at the end of the quarter.

FINANCIAL OVERVIEW

Bond market

Government yields (in % p.a.)	2 years	5 years	10 years
Switzerland	1.20	0.97	0.92
Italy	3.88	3.74	4.07
Germany	3.19	2.55	2.39
United States	4.90	4.16	3.84

Source: Bloomberg

After experiencing a disappointing 2022 with unprecedented repricing in the bond segment, the current year was anticipated by many to mark the beginning of a renewed interest in fixed income investing. However, as we reach the halfway point of the year, there is understandable disappointment among investors who have not witnessed the desired performance in their bond portfolios.

During the second quarter, gradually increasing **interest rates** failed to provide the stability that investors were hoping for. Uncertainty continues to prevail regarding the prospects of **inflation** returning to more manageable levels and the stance of central banks in halting the process of raising official rates.

Toward the end of the quarter, statements from the **ECB** and the **FED** led to markets pricing in additional unexpected rate hikes, causing **government bond** yield curves to shift upward with a more pronounced flattening or inversion movement.
To summarize with some figures, since the beginning of the year, markets have remained within relatively wide yield ranges. Volatility has been influenced by inflation data, which has varied between more or less positive, and the tone of central bank statements, which have ranged from more or less hawkish. For instance, the **U.S. 10-year** yield has fluctuated between 3.25% and 4%, currently standing at around 3.85%. Meanwhile, the **German 10-year** yield has ranged from 2% to 2.70%, presently at approximately 2.45%. Surprising investors and central bankers alike, economies have displayed unexpected resilience with ongoing growth, potentially providing central banks with more leeway to adopt a more aggressive stance on rates to tackle inflation more effectively.

It is worth noting that, despite the less favourable market conditions, the **spread** between European periphery countries, particularly Italy, and core countries has narrowed.

This narrowing suggests a growing conviction in the inevitability of the European integration process and the resulting convergence of yields.

In the **credit segment**, the quarter exhibited a fluctuating but generally positive *trend*, with a noticeable reduction in spreads, albeit at a slow pace. The **Credit Suisse** incident at the end of March surprised the markets, both in terms of its swiftness and the consequences it had on certain subordinated products (AT1 bonds), which were fully written off, involving bondholders in the rescue of the Swiss bank. Although the widening spreads in the subordinated banking segment were initially observed, they have subsequently normalized. This rebound is primarily attributed to the robust and well-capitalized European financial sector, making it a relatively safe haven for bond investments.

Credit spread index on financial subordinates Europe
Basis points; 01.23 - 06.23

Source: Bloomberg

In **emerging markets**, underperformance persists, aligning with trends seen in equity markets, and failing to attract significant new inflows. Despite the overall attractiveness of this asset class, investors appear to be awaiting the conclusion of the hawkish rate cycle in developed countries, which has been postponed for the time being, before resuming investment with more conviction. Historically, this asset class have benefited from expansionary monetary cycles, particularly led by the **FED**.

FINANCIAL OVERVIEW

Currencies	Price	Quarterly Performance	Yearly Performance
EUR/CHF	0.9770	-1.53%	-1.27%
USD/CHF	0.8956	-2.15%	-3.13%
EUR/USD	1.0909	0.65%	1.91%
GBP/USD	1.2703	2.97%	5.13%
USD/JPY	144.31	8.62%	10.06%

Source: Bloomberg

<u>Currencies</u>

The currency market remains heavily influenced by central bank policies and their efforts to combat inflation, which has yet to reach desired targets.

This combination of market risk sentiment and interest rate differentials has kept the **EUR/USD** exchange rate within a range of 1.065 to 1.1050.

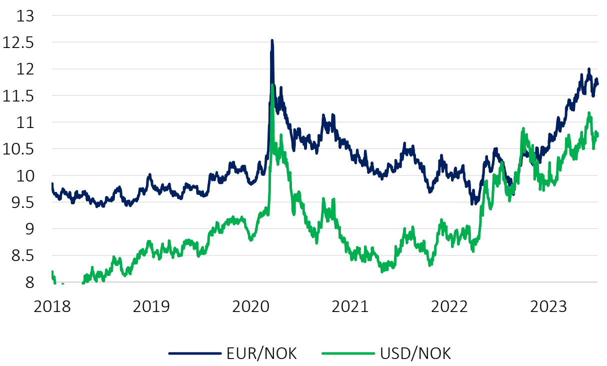
The monetary policy of **SNB** continues to rely on rising rates and maintaining the strength of the Swiss franc through the release of reserves, which has led to the **CHF**'s appreciation during the quarter.

In **Japan**, despite relatively high inflation compared to recent years, the **BOJ** continues to pursue an accommodative policy, resulting in a weakened Japanese yen (**JPY**).

An interesting movement occurred with the Norwegian Krone (**NOK**), which experienced a sharp depreciation due to weaker oil prices and delayed rate adjustments, followed by a rapid recovery.

<u>Norwegian Kroner (NOK) evolution against EUR and USD</u>

%; 01.20 - 06.23



Source: Bloomberg

Commodities	Price	Quarterly Performance	Yearly Performance
Petrolio WTI	70.64	-6.65%	-11.99%
Petrolio Brent	74.90	-6.11%	-6.11%
Gas Nat. TTF	36.70	-21.91%	-21.91%
Oro	1'919.35	-2.54%	-2.54%

Source: Bloomberg

<u>Commodities</u>

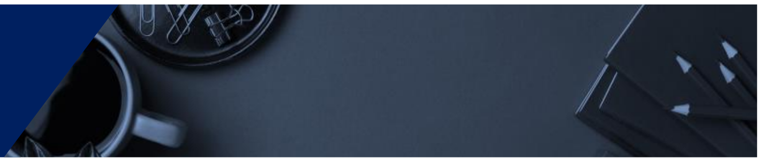
Commodities, in general, experienced price declines and reduced demand in the second half of the year. This was influenced by a challenging macroeconomic environment in manufacturing and a slower-than-expected post-lockdown recovery in Chinese production. The aggregate commodity **index** fell by 3.4% over the observed period.

In the energy sector, **natural gas** prices continued to normalize, approaching pre-2021/22 gas shortage rates, supported by milder weather conditions and restored supply flows. **Oil** prices, after initial declines due to reduced demand and delayed replenishment of strategic oil reserves in the United States, stabilized between USD $72 and USD $77 per barrel (**Brent** futures). This stability was driven by significant output cuts implemented by the **OPEC+** cartel, particularly led by **Saudi Arabia.**

With easing tensions related to geopolitical conflicts and the financial sector, along with rising real yields and a stronger dollar, **gold** experienced a gradual decline in price, settling around USD $1,920 per ounce. This decline also affected **silver** and other precious metals.

Industrial metals witnessed a similar scenario, with an average decline of 11%, primarily driven by **steel** and **copper** prices. Food prices experienced a smaller decline of 3%, with a mixed environment within the sector. These developments have alleviated some of the upward pressure on inflation from production and consumption.

Did you know that...



...with public debt at around 120% of GDP, the current level of interest costs will force a parsimonious weighting of government spending...

On June 1st, 2023, the U.S. Congress approved the suspension of the ''*Debt Ceiling*,'' which will expire on January 1st, 2025. was

How did the debt ceiling matter unfold?

The U.S. Congress initially established a debt ceiling for the Treasury Department in 1917 to facilitate the issuance of new government bonds. The initial debt ceiling was set at USD 65 billion and has been revised numerous times over the subsequent decades. As of the end of March 2023, the public debt had reached USD 31'458 billion, necessitating the gradual suspension of financing activities from the market due to the proximity of the legal threshold.

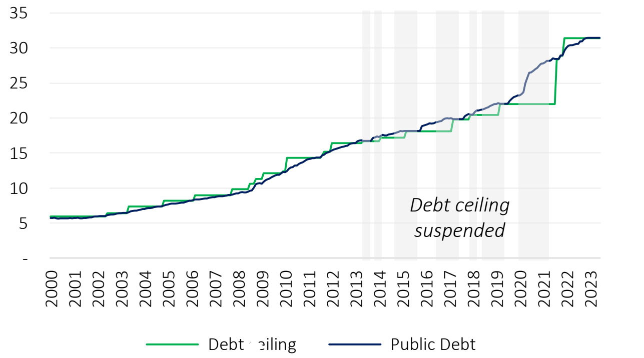
Janet Yellen, the U.S. Treasury Secretary, indicated that cash reserves would be depleted by the first weeks of June, beyond which the world's largest issuer would no longer be able to service its debt. The complex negotiations in May between the Democrats, led by Speaker Joe Biden, and the Republicans, led by House Speaker Kevin McCarthy, resulted in a tentative understanding to suspend the limits, thereby averting a default.

What are the consequences of a suspension of the debt ceiling?

Over the past decade, the debt ceiling has been suspended seven times through bipartisan agreements. During periods of suspension, government spending tends to increase more vigorously. The absence of a concrete limit allows the incumbent government to fund significant stimulus plans and government investments, aiming to gain greater electoral support. However, despite President Biden's plans to invest nearly USD 400 billion through the Inflation Reduction Act, considering the public debt level of around 120% of GDP, the current interest costs will necessitate cautious management of public spending to avoid jeopardizing the country's AAA credit rating. On the other hand, the suspension of the debt ceiling eases President Joe Biden's pressures related to the deficit as he approaches the fall 2024 elections.

Evolution of the US public debt ceiling

Trillions of USD; 2000 - 2023



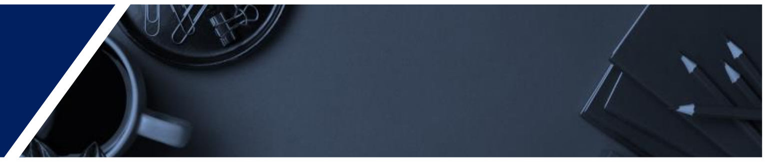
KEY TAKEAWAYS

1 – TOTAL US GOVERNMENT DEBT EQUIVALENT:	2 – LEVEL OF DEBT TO GDP IN THE 1 QUARTER 2023 (FRED[1]):	3 – NUMBER OF PUBLIC DEBT SUSPENSIONS SINCE 2012:
USD 31'500 Bln	**118.57%**	**7**

1. Data published by the St. Louis FED (FRED)

Source: Treasury Department

Expert Talk
Benedetto Mancini



What are the uses of derivatives in investment strategies?

Interview with ***Benedetto Mancini:*** *Asset Manager and Investment Advisor*

When it comes to derivatives, their use, and their significance in the overall market value, which strategies benefit the most from utilizing derivatives?

In my opinion, bond strategies, in general, derive the most benefits from utilizing derivatives. These instruments are particularly valuable in situations of market stress when liquidity is constrained. They enable managers to swiftly adjust exposures at a fraction of the cost compared to buying and selling physical bonds.

Furthermore, for funds employing macro and absolute return strategies, derivatives offer great flexibility in taking specific positions, such as on yield curves. These positions can be challenging to implement individually in portfolios but offer significant diversification potential from a risk-return perspective.

Given the flexibility of derivatives and their associated risks, what is the best utilization of derivatives that you have witnessed by fund managers?

Like with any tool, the flexibility of derivatives is accompanied by risks, which, if not properly managed, can result in excessive leverage or concentration. In my view, the best use of derivative instruments is in position management.

Even highly skilled managers can find themselves slightly ahead or behind the market, leading to positions initially not going in the desired direction.

In such cases, when used appropriately, derivatives allow the manager to optimize performance if the market does not move as anticipated. Once the market starts moving in the desired direction, derivatives enable full participation in the upside.

> *“... if employed properly, derivatives empower managers to optimize performance when the market doesn’t align with expectations…”*

BENEDETTO MANCINI

Asset Manager and Investment Advisor

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