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INVESTMENT OUTLOOK 04.2024

13 October 2024

Declining inflation and cooling economies led central banks to start the easing cycle. The ECB cut rates twice, in June and September, with the US Fed following, likewise in September, with a strikingly significant cut of 0.5%-points. In addition, the Peoples Bank of China (PBoC) implemented a monetary stimulus package, including a small rate cut, lowering the reserve ratio and providing a capital pool to encourage equity purchases.

Equity and bond markets rallied on the back of monetary easing measures. Most notably, the Chinese CSI300 index jumped by more than 30% within a couple of days. While falling inflation, weaker economic data, and decisive rate cuts could paint a bleak picture, equity markets in particular clearly anticipate a soft landing. The recent robust US labor market data support this view.

Despite that and in view of remaining uncertainties, not least in relation to geopolitics, we remain cautious and are keeping our defensive stance, underweighting risk assets and overweighting cash and government bonds.

Thomas Trauth
CEO – IMT Asset Management AG

THE EASING CYCLE STARTED

Financial Markets

In Q3 equity markets continued to rally. A sharp short-term correction early August was reversed very quickly. However, in the aftermath we observed a significant sector rotation out of growth stocks into defensive sectors, which could indicate that market participants have become a bit more cautious. The tech-heavy NASDAQ index gained only 2.6% in Q3, outpaced by the Dividend Aristocrats, for example, which gained almost 14%. The Chinese stimulus package led to a remarkable rally in Chinese stocks, which jumped by more than 30% within a couple of days.

The start of the easing cycle had a major impact on the short end of the yield curve. 2-year rates fell by 1.1 and 0.7 percentage points in the US and Europe respectively. At the same time break-even inflation rates, a measure of inflation expectations, fell. After strong US labor market data were published in early October, short-term rates and inflation expectations edged higher. Credit spreads remained relatively tight, as investors continued to be risk-seeking.

The price of Gold rose another 13.2% in Q3. The price of brent oil fell by 16.9% in the same quarter but gained in recent weeks, when Iran became directly involved in the military conflict. However, oil trading below USD 80 is not impairing purchasing power nor is it inflationary. REITs rallied strongly in Q3, gaining more than 10%. REITs benefited from lower rates and the market's preference for defensive stocks. In Q3 the price for Bitcoin rose slightly, by 3%. During the same period Ethereum fell by 23.5%.

The USD weakened in Q3, driven by rate-cut expectations, which materialized in September. Towards the end of September, however, the USD recovered somewhat, probably driven by the tensions in the Middle-East. The JPY rallied strongly in Q3 driven by the narrowing yield differential. Starting at the end of September the JPY gave back some of its gains. The CHF continued to be on the strong side, as the Swiss economy remains vigorous and inflation under control.

Macroeconomics

Manufacturing purchasing managers' indices fell in recent months and are clearly below 50, indicating an economic slowdown.

The disinflationary trend continued, US inflation fell from 3.0% to 2.4% and EMU inflation from 2.5% to 1.8%. Although at the same time the US labor market lost some momentum, it still remained relatively robust. After non-farm payrolls had been weak for some months, the September reading surprised on the upside with 254,000 new jobs.

Central Banks

In view of the global drop in inflation and the economic slow-down, the important central banks decided to cut interest rates. In September the US Fed reduced its key rate by a surprisingly emphatic 0.5 percentage points.

In the same month the ECB cut its key rate by 0.25 percentage points, having carried out an initial rate reduction in June.

In addition, the Chinese government decided on monetary measures to stimulate the country's distinctly sluggish economic performance. The PBoC reduced the key interest rate slightly, lowered the banks' minimum reserve requirement and made a pool of capital of USD 114 billion available to encourage share purchases and share buybacks by companies.

Outlook

The economic indicators continue to give a mixed picture. Even though inflation and US labor market indicators give a predominantly favorable impression at present, we are maintaining our basic standpoint of caution. In the past, the share markets have often reacted very positively to initial interest rate cuts, only to be subjected to marked correction after a certain time lag and under the influence of an economic slow-down.

Moreover, in the weeks before a US election, market uncertainties and volatility tend to rise significantly. If the results of the upcoming election turn out to be very tight, as is expected, the outcome might be disputed, and there could conceivably also be outbreaks of violence.

In view of the macro-economic and geopolitical uncertainties, we are maintaining our defensive stance. We are underweight in shares, REITS, high-yield bonds and commodities, and we are overweight in nominal government bonds.

ECONOMICS

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Fig. 1: PMIs

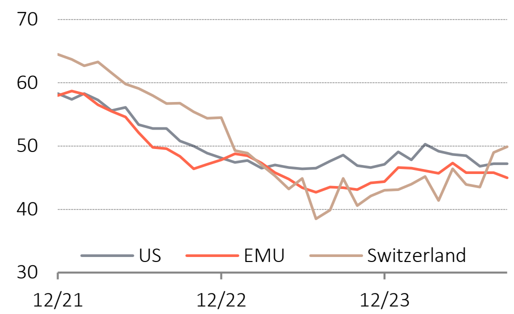


Fig. 2: PMIs

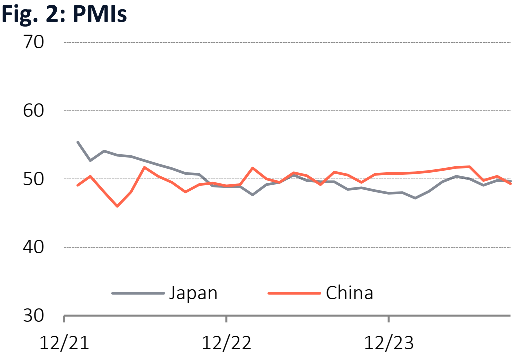


Fig 3: Consumer price inflation, in % YoY

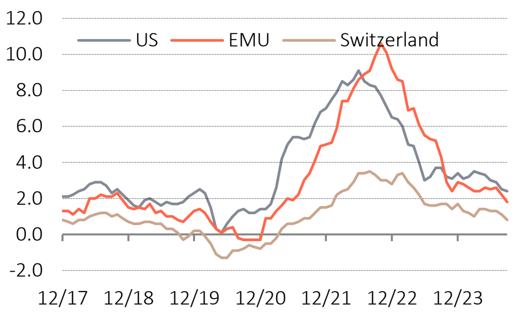


Fig. 4: Consumer price inflation, in % YoY

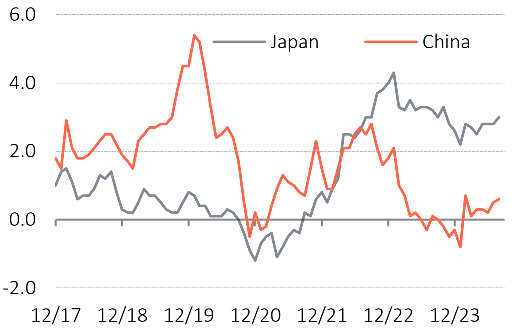


Fig 5: Unemployment rates, in %

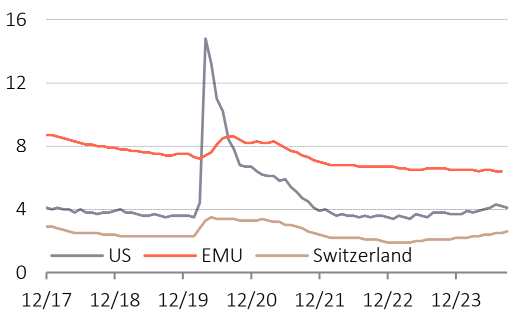
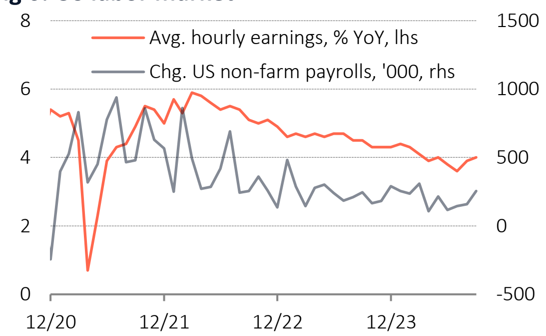


Fig 6: US labor market



FIXED INCOME

The start of the easing cycle had a big impact on the short end of the yield curve. 2-year rates fell by 1.1 and 0.7 percentage points in the US and Europe respectively. At the same time break-even inflation rates, a measure of inflation expectations, fell. After strong US labor market data were published in early October, short-term rates and inflation expectations edged higher. Credit spreads remained relatively tight, as investors continued to be risk-seeking.

Fig.7: 2Y government bond yields

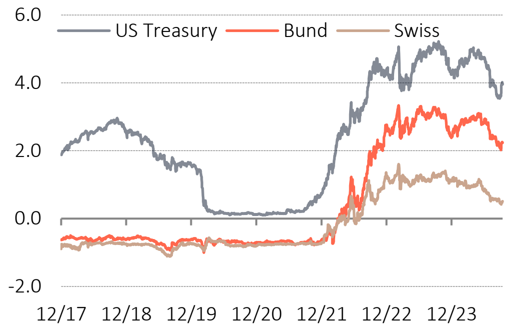


Fig. 8: 10Y government bond yields

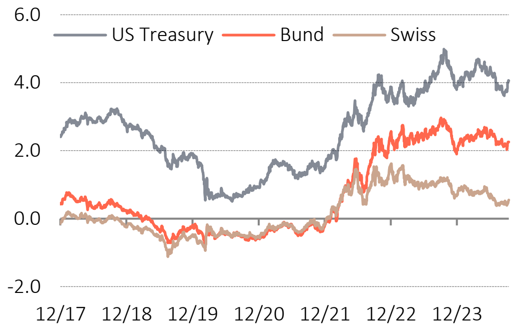


Fig 9: 10Y break-even inflation

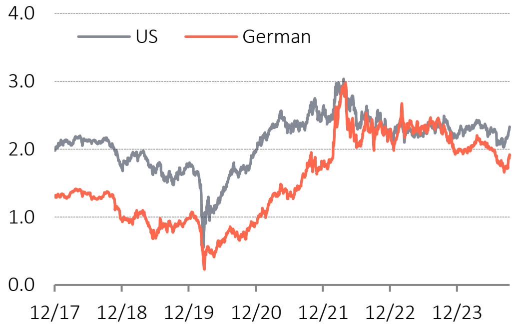


Fig. 10: Credit spreads, 5Y credit default swaps

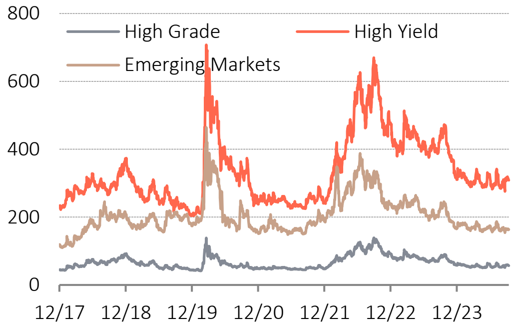


Fig 11: Money market spreads (3M-2Y)

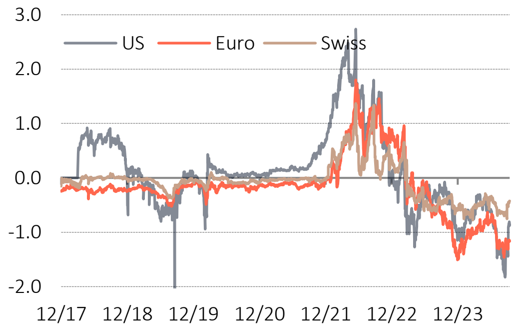
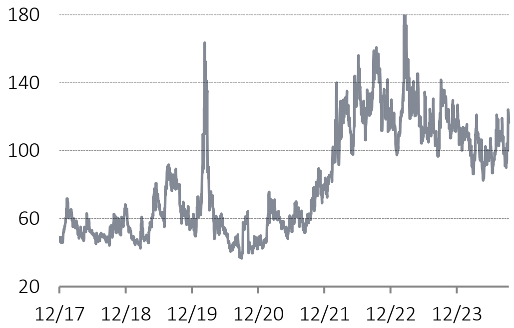


Fig 12: Merrill Lynch volatility index (MOVE)



EQUITIES

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Fig. 13: MSCI equity indices – major regions

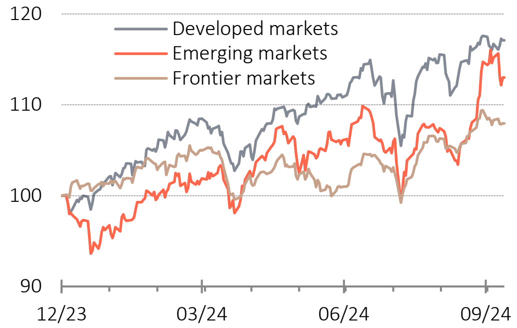


Fig.14: Equity indices – major developed markets

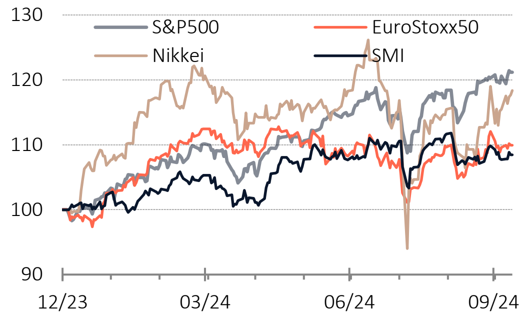


Fig 15: Equity indices – major emerging markets

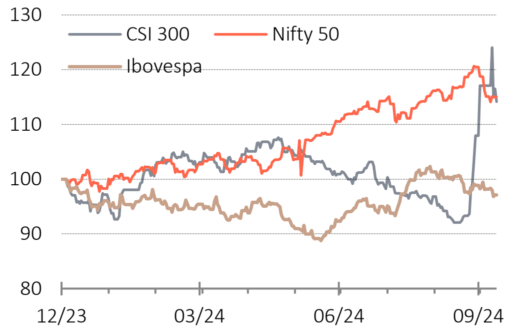


Fig. 16: Sector performance, MSCI Indices, 2022

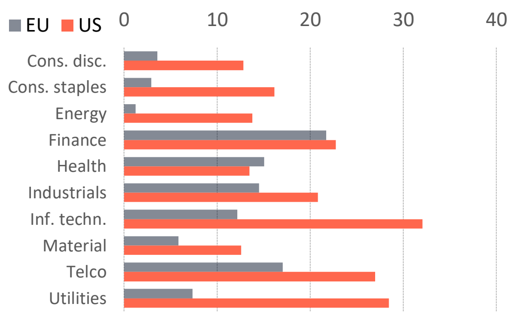


Fig 17: Price-earnings ratios

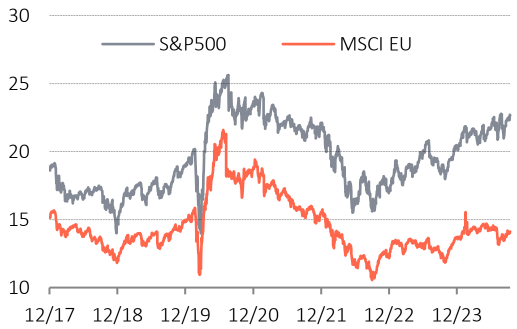
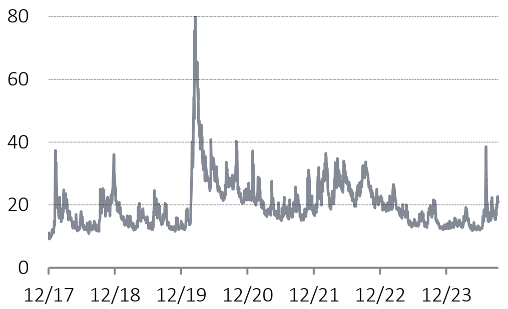


Fig 18: Equity volatility – S&P500 VIX index



ALTERNATIVE INVESTMENTS

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Fig. 19: Gold price, USD/oz

Fig.20: Brent oil price, USD/bl

Fig 21: Bloomberg commodity indices

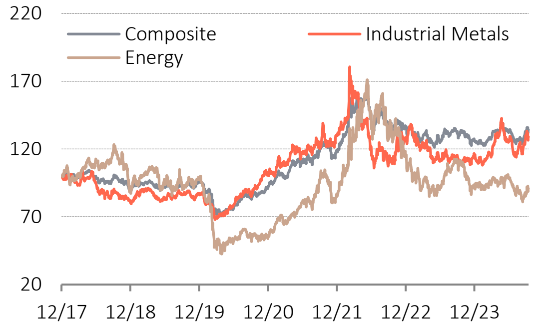
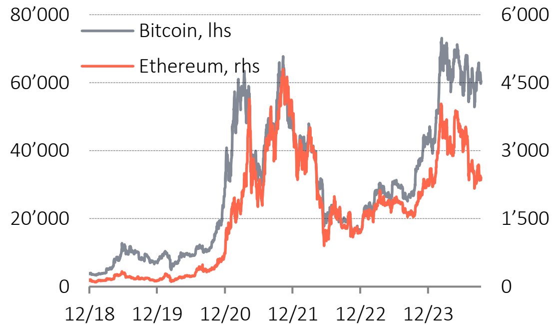


Fig. 22: Global Listed Private Equity

Fig 23: FTSE EPRA/NAREIT global REITS index

Fig 24: Crypto Assets



CURRENCIES

The USD weakened in Q3, driven by rate-cut expectations, which materialized in September. Towards the end of September, however, the USD recovered somewhat, probably driven by the tensions in the Middle-East. The JPY rallied strongly in Q3 driven by the narrowing of the yield gap. Starting at the end of September the JPY gave back some of its gains. The CHF continued to be on the strong side, as the economy remains vigorous and inflation under control.

Fig. 25: EUR-USD exchange rate

Fig. 26: GBP-USD exchange rate

Fig 27: USD-JPY exchange rate

Fig. 28: USD-CNY exchange rate

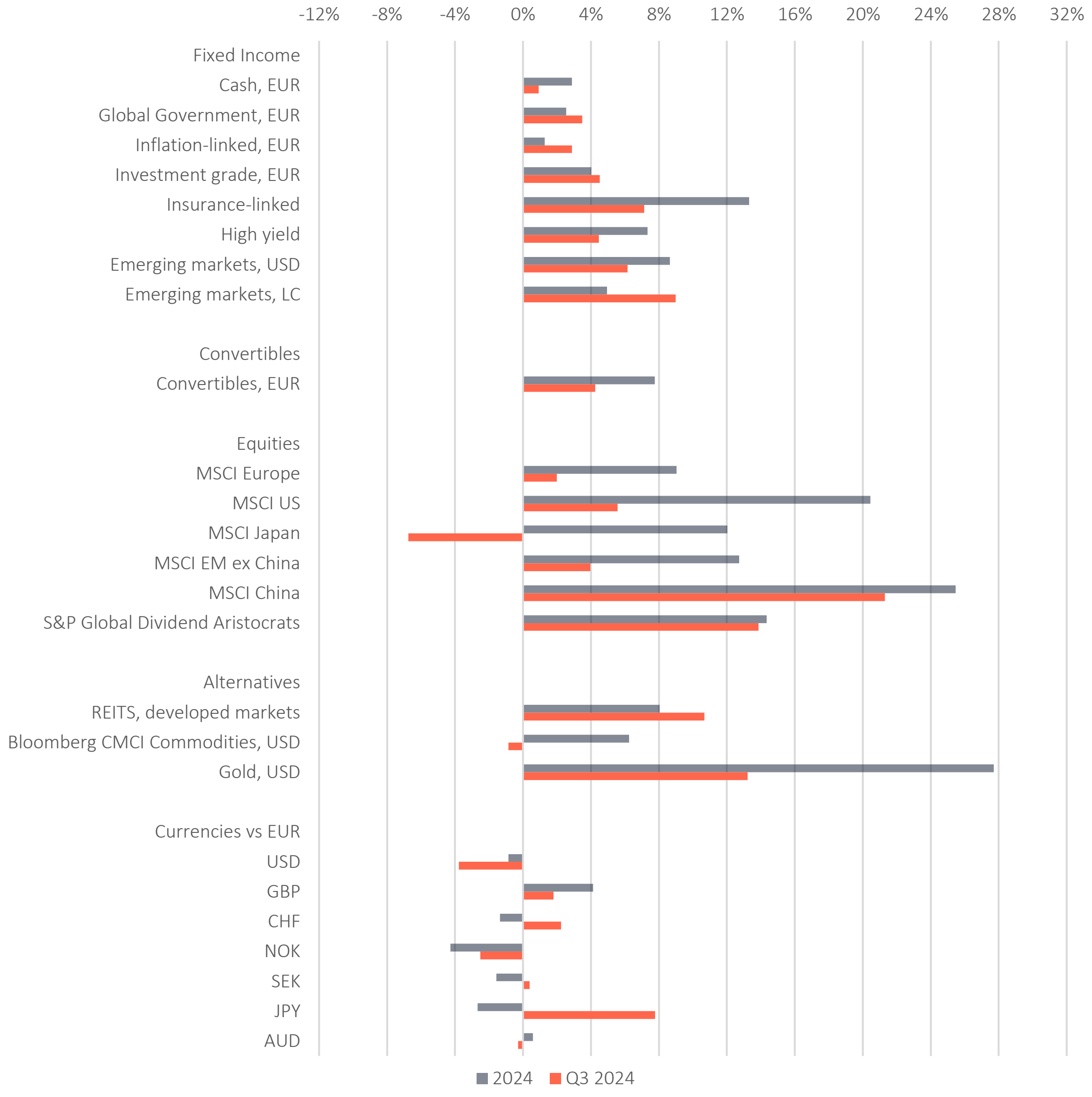
Fig 29: EUR-CHF exchange rate

Fig 30: USD-CHF exchange rate

ASSET ALLOCATION

Driven by monetary easing, most asset classes performed well in Q3. The exception was Japanese stocks, which, after a strong rally and the recent appreciation of the JPY, fell by 6.7%. Chinese stocks jumped after the PBoC's stimulus package and outperformed in Q3. The Dividend Aristocrats, which underperformed earlier this year when big tech caught all the attention, rose by 13.9%. All fixed income asset classes were positive. The USD weakened, while other safe-haven currencies, most notably the CHF and the JPY strengthened.

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

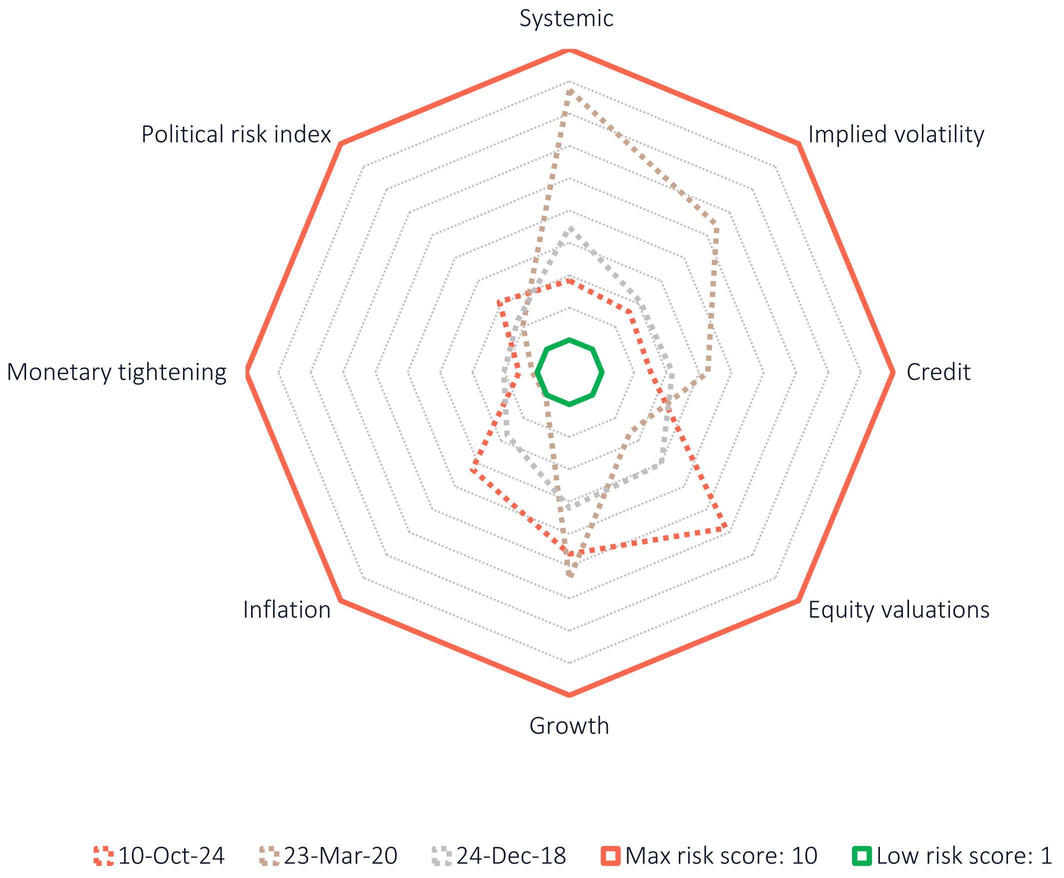


RISK MONITOR

Market risks are skewed towards equity valuations, and economic growth. While geopolitical risks are, in our view, clearly elevated, our political risk index has not captured that. Implied volatility spiked in the first week of August, but fell back relatively quickly afterwards. In the weeks before US elections volatility usually tends to go up. We expect this to happen this year, especially as the odds for a tight result are high, which could lead to a fiercely contested outcome.

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.