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Investors' Outlook

At a crossroads

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For US, Canada and Latin American Clients

Vontobel Swiss Financial Advisers AG

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At a crossroads

—
Dr. Pascal Köppel
Chief Investment Officer,
Vontobel SFA

Dear readers,

Ex-president Donald Trump secured a second term of his US presidency in this month's US election. In the election the Republican party also secured a majority in the senate and most likely in the house as well. The implication of this is that there is a unified government which could make the implementation of new legislation easier.

As the new president will soon take over, the US economy remains in a reasonably strong position. Economic growth has slowed from levels well above trend in 2023 to those that are closer to trend. Meanwhile, the labor market has gradually cooled, contributing to a gradual slowdown in year-over-year employment growth, an unemployment rate approaching the natural rate and a deceleration in nominal wage growth. So far, the US economy has been on track to a soft landing.

Although the details on the exact policy measures will take a while to come through as a new government is formed, we can be sure of measures that can help US growth in the short run, with fiscal stimulus taking center stage. In that process, there is also the risk of inflation starting to flare up a bit again.

Amid declining inflation and signs of a weakening labor market, the US Federal Reserve (Fed) started to cut interest rates. However, a stronger-than-expected jobs report in September in combination with an expectation of stronger growth in 2025 has now sparked skepticism over whether the Fed will maintain its dovish stance (the hurricane and strike impacted October numbers are seemingly being treated as an outlier).

A key issue we are watching is the growing federal deficit, which will pose a challenge for the new president. The trajectory points toward higher federal debt which would be a potential risk to the US dollar and highlighting the need for diversified investment strategies.

Elsewhere in the world, we have seen some moderation in in high-frequency leading indicators. In Europe growth has picked up from the sluggish pace of 2023, although Germany remains a laggard. Other parts of the region, especially in the south, have been showing strong growth, with Spain achieving near 3 percent expansion in 2023, a trend expected to have continued in 2024 as well. The Chinese economy has been soft, but policymakers are working to stimulate growth through a broad set of policy measures. Nevertheless, we anticipate continued struggles in China where stronger (fiscal) measures are required to materially improve economic momentum. An expected increase of trade tariffs will be another challenge for especially the Chinese economy, as European companies have already relocated a significant part of their production to the US. We should probably be expecting Chinese policies to support growth in case US measures lead to a significant deterioration in Chinese growth.

In the markets, equities remain well supported, and corporate earnings are expected to remain solid. Valuation differences and market concentration in the US and the global MSCI index have increased. This emphasizes the need for an active approach to select the strongest companies globally at a fair price. We continue to favor investment grade bonds and gold, in addition to our constructive view on equities. Additionally, allocations to strong currencies, such as the Swiss franc, can provide protection to a broad range of potential surprises while still capturing equity gains.

At these crossroads, it is not just the direction we choose that matters but how we navigate each turn. We are ready to take the wheel for you.

—
Dr. Pascal Köppel
Chief Investment Officer,
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—
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Between the lines

Inflation continues to moderate, and most major central banks have embarked on a rate-cutting cycle, generally creating an attractive environment for investors.
The US economy has been on a soft-landing trajectory. With the Fed signaling it is focusing now more toward the labor market, having been satisfied with progress on inflation, the likelihood of a soft-landing has increased while the risk of a hard landing has reduced. However, the latest solid economic data combined with potentially more fiscal stimulus could also lead to a reacceleration of growth, as we also expect growth in other parts of the world to increase.

The implication of this for investors is the need to be prepared for different scenarios through greater diversification while also maintaining flexibility. In our asset allocation we have a preference for equities and within equities we prefer Switzerland and the US. In other asset classes we continue to prefer high quality investments, such as investment-grade bonds within fixed income and continue to be overweight in gold within commodities. More details can be found on page 5.

	UNDERWEIGHT significantly	UNDERWEIGHT slightly	NEUTRAL	OVERWEIGHT slightly	OVERWEIGHT significantly	
1 Liquidity	→					We are keeping a significant underweight in cash, as we see scope for bonds and equities to outperform versus cash.
2 Bonds				→		The outlook for high-quality fixed income remains supportive, certainly after the recent increase of bond yields. We remain overweight in investment-grade (IG) credit. We continue to prefer high-quality (investment-grade) bonds and remain underweight in high-yield ones. In our opinion, companies with weaker balance sheets and a greater reliance on external borrowing are more vulnerable, and bond prices and spreads over higher-quality bonds do not sufficiently compensate for this risk.
3 Equities				→		We are maintaining a medium overweight position in equities. The fundamental outlook for equities remains constructive overall. Despite global manufacturing momentum showing signs of stalling, the key drivers for corporate earnings growth remain solid. Expected policy measures in 2025 by the new US government will support particularly US growth and will be positive for US equities. We have upgrade US equities to overweight and downgraded Europe to neutral. We continued to be overweight in Switzerland and underweight in the UK.
4 Commodities / Gold			→			We continue to hold a positive view on gold. The yellow metal rallied strongly last year and maintained this performance this year. Lower interest rates, heightened geopolitical uncertainties and ongoing strategic purchases of gold, especially by central banks in emerging market, remain positive drivers.

Changes month-on-month: same → higher ↗ lower ↘

Has the European economy turned the corner?

—
Dr. Pieter Jansen
Chief Investment Strategist,
Vontobel SFA

Euro area growth has gradually improved again

For five quarters, from the fourth quarter of 2022 until the end of 2023, euro area GDP growth stalled in real terms. There was one quarter of negative growth (–0.1 percent quarter on quarter), two quarters with flat growth and two quarters growth with +0.1 percent growth quarter on quarter. The euro area faced numerous challenges, including sharply rising energy prices in 2022 and the reliance of a number of countries on Russia for gas supplies. Additionally, in 2023 there was a global destocking in the manufacturing sector and disappointing growth in China, which had a particularly negative impact on Germany's economy.

Since the start of 2024, GDP growth has improved again, with a 0.3 percent quarter-on-quarter growth in the first quarter, followed by 0.2 percent and 0.4 percent in the second and the third quarters, respectively. This has brought GDP growth back to near-trend levels.

Euro area economic momentum

Even though the European PMI Manufacturing has made an impressive recovery from its 2023 low of 42.7 to 47.3 in the spring of this year, it has fallen back slightly since. Currently, the manufacturing PMI stands at 46.0, still indicating contraction in the manufacturing sector. Similar to other regions, confidence in the service sector has remained stronger and been above 50 points since February, indicating expansion. Considering broader global indicators and assuming no additional shocks, euro area PMI is expected to improve again over the coming quarters. Our broader global economic impulse indicator, which leads the euro area manufacturing PMI indicator by about three quarters, has continued its upward trend (see chart 1).

Euro area average inflation has slowed to 2 percent, down from its peak of 10.6 percent in 2022. Core inflation has slowed from 5.7 percent to 2.7 percent. This has given the European Central Bank (ECB) the confidence to implement three rate cuts so far. The market is still expecting one more rate cut before the end of the year. There is also positive news from the bank lending survey, which suggests the trend of tightening lending standards by banks has ended. The latest ECB survey indicates that (expected) demand for loans is beginning to recover. As a result, the Euro Area credit impulse is starting to improve, which should have a positive impact on euro area cyclical indicators.

With the US president-elect taking office in January, tension on trade policy is likely to increase. Higher import tariffs especially against China but also Europe will likely be another headwind for the German economy. However, many European companies have already relocated production facilities to or close to the US, which moderates the impact. That said, it will still be a headwind for particularly the German economy, also due to its exposure to China.

Euro area is more than Germany and France

Analysts and investors often focus on Germany and, to a lesser degree, France when assessing the economic performance of the euro area. This is understandable, as these two countries account for nearly 50 percent of the region's economic output. However, there are the other 18 countries that make up the other 50 percent of the region's GDP. Based on the Bloomberg consensus for expected growth in 2024, Germany ranks among the four slowest-growing countries (see table 1). Seven countries are projected to grow by at least 2 percent this year, with Spain being one of the top performers. The Spanish economy is expected to expand by 2.8 percent this year following 2.7 percent growth in 2023. Spanish growth is driven by various different factors, including immigration, tourism and a surge in foreign direct investments.[1] Other southern European countries, such as Portugal and Greece, have also been performing well. All three countries are starting to benefit from economic reforms implemented during the European sovereign debt crisis over 10 years ago.

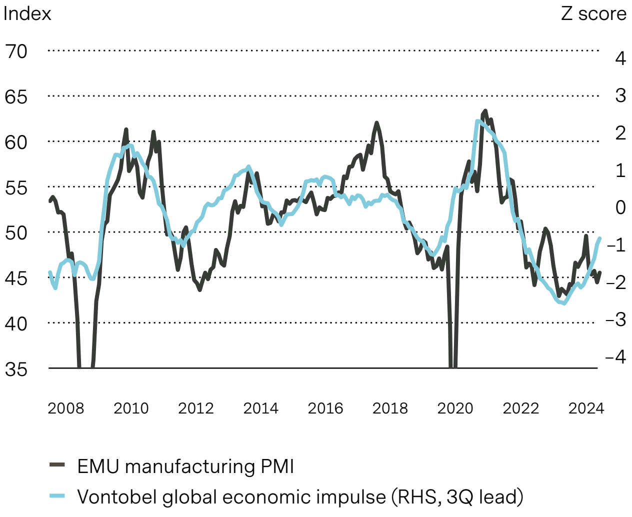
The euro area is an integrated economic region, unified by shared monetary institutions, economic partnerships and a common currency. However, differences between countries still lead to varying levels of economic performance. Although Germany remains reliant on Chinese demand in the short-run, other areas in the European economy continue to offer growth opportunities. In September a study led by Mario Draghi confirmed the need for reform to improve European business competitiveness.[2]

Table 1: Bloomberg consensus GDP growth forecasts for 2024

	GROWTH 2024	WEIGHT EURO AREA
Croatia	3.5	0.5
Cyprus	3.2	0.2
Spain	2.8	10.2
US	***2.6***	
Greece	2.3	1.5
Lithuania	2.3	0.5
Slovak Republic	2.3	0.9
Slovenia	2.0	0.4
Portugal	1.7	1.8
Luxembourg	1.2	0.6
Belgium	1.1	4.1
France	1.1	19.5
Italy	0.8	14.5
Latvia	0.8	0.3
Euro Area	***0.7***	
Netherlands	0.6	7.2
Ireland	0.2	3.5
Austria	0.0	3.3
Germany	***0.0***	***28.7***
Finland	−0.4	1.9
Estonia	−0.6	0.3
Malta	n.a.	0.1

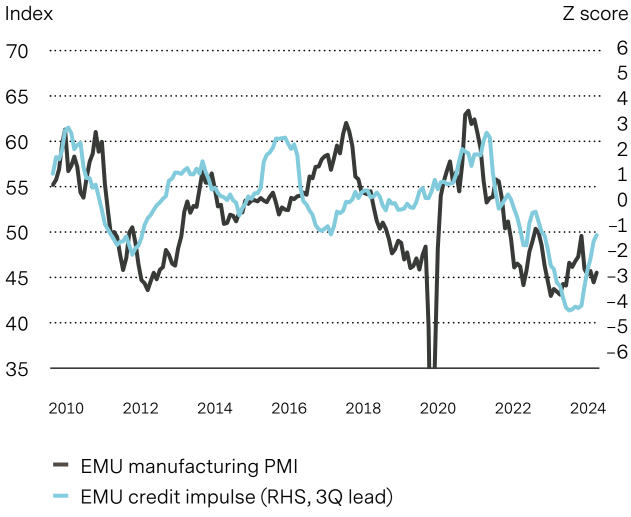
Source: Bloomberg, Vontobel SFA

Chart 1: Europea manufacturing PMI will likely pick up



Source: LSEG, Vontobel

Chart 2: Credit impulse turning more positive



Source: LSEG, Vontobel

[1] Financial Times Europe edition, October 30, 2024
[2] commission.europa.eu/topics/strengthening-european-competitiveness/eu-competitiveness-looking-ahead_en#paragraph_47059

Opportunities in fixed income

—
Philipp Wartmann
Senior Investment Adviser,
Vontobel SFA

In recent weeks, the fixed income market has experienced rising yields driven by various news events. Just over a month ago, the Fed implemented a 50-basis point reduction in interest rates, typically viewed as favorable for bonds. Right after the election they cut rates again.

Initially, markets expected further easing, forecasting a total of 100 basis points in additional cuts after the initial 50 bps. However, following strong employment data in September, this expectation has shifted to a projected 50 basis points over the next three meetings, with the possibility of rates being held steady at least once. This change aligns with recent Fed communications signaling a move away from aggressive rate cuts.

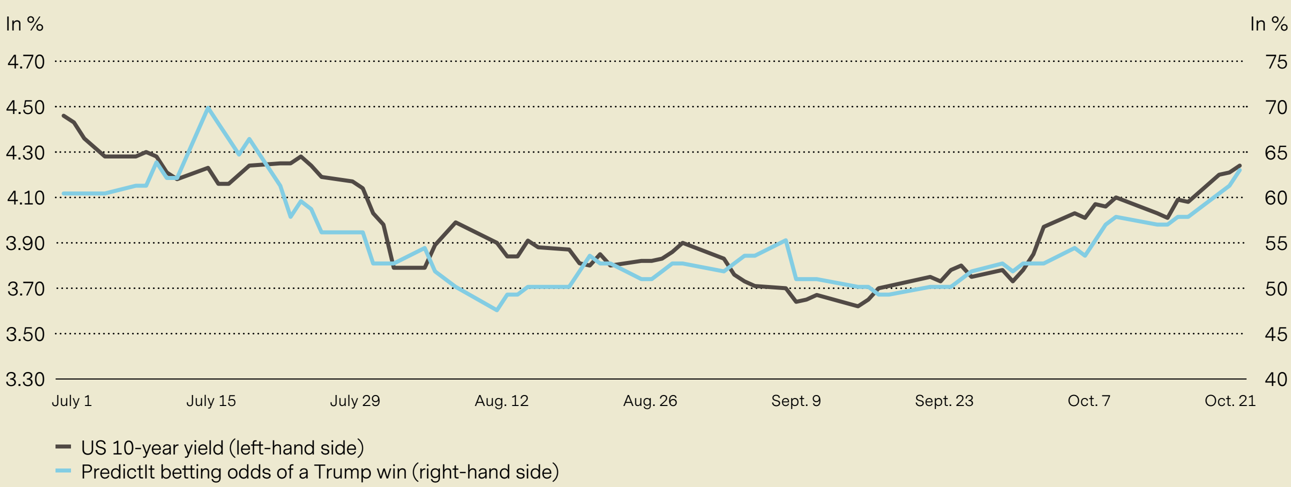
The expectation of more growth stimulus measures by the US president-elect will probably also lead to fewer interest rate cuts in 2025 as well. It is even possible the Fed goes on hold or, in case inflation starts to drift higher again, the Fed may even look to tighten policy. Chart 1 shows that bond yields rose in line with the increasing probability of a Trump victory already before the election.

There is still some upward drift in bond yields, but uncertainty surrounding bond yields remains high. For 2025 bond yields may be more range bound, depending on cyclical developments and inflation behavior.

Investment-grade bonds remain attractive
We continue to favor credit markets and believe that investment-grade (IG) bonds are the optimal choice in an environment of slow growth and softer inflation. The credit fundamentals of most investment-grade companies—including default rates, rating trends, interest coverage and leverage—are relatively solid. While we acknowledge that IG market spreads are at their tightest levels in many years, the attractive rates in the treasury market make this bond segment appealing due to its all-in yields. This should continue to attract inflows into this asset class, in particular as money market rates continue to fall.

Despite high valuations, IG spreads are likely to stay tight unless there is a major shift in the economic outlook, such as fears of a recession instead of a soft landing. Currently, we do not see any triggers for spreads to widen significantly. Given the current macroeconomic environment and what we believe to be the late stage of the credit cycle, we prefer non-cyclical sectors, such as healthcare, and those that benefit from lower interest rates, including estate and capital goods companies.

Chart 1: As odds of a second Trump term rose, bond yields rose also



Source: Bloomberg, Vontobel; as of October 23, 2024.

October performance pause

—
Markus Bruhin
Head Managed Solutions,
Vontobel SFA

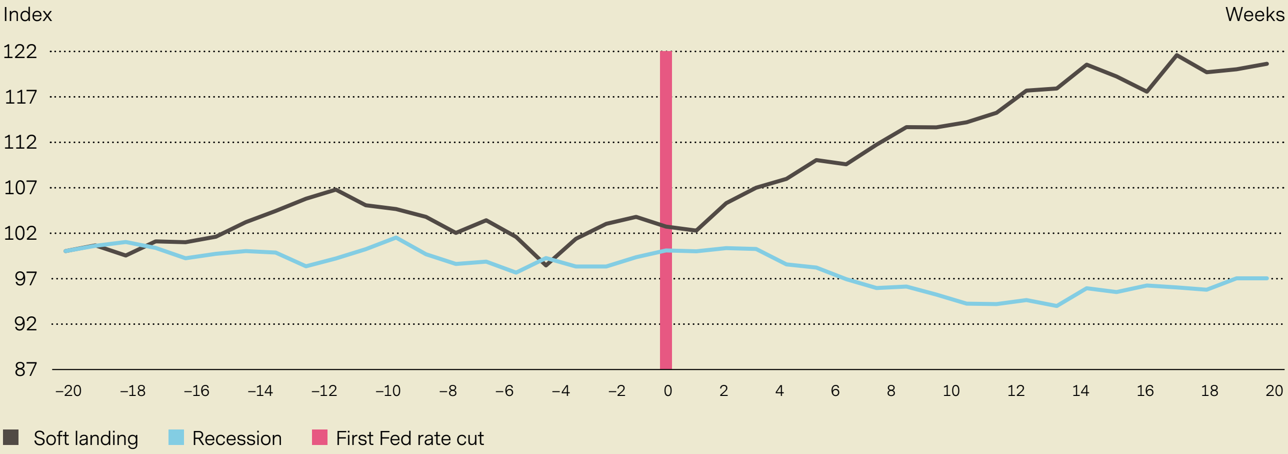
Global stock markets recorded their first negative monthly performance in October after a winning streak since May 2024. Ongoing geopolitical tensions, especially in the Middle East, subdued investor sentiment about China's economic growth and lowered expectations for the ongoing Q3 earnings season prompted investors to take profits.

The first rate cut by the Fed in September, typically viewed as a positive indicator for equity markets in a soft-landing scenario (see chart), was followed by softening investor sentiment in October due to escalating tensions in the Middle East. Additionally, analysts have reduced their earnings growth expectations for the Q3 earnings season, limiting short-term share price upside potential. Moreover, major technology companies reported earnings that fell short of market expectations, further dampening overall investor sentiment. The dominance of US technology companies in US equity market indices generated a lot of newsprint throughout the year, and their influence on overall index trends and investor sentiment, was once again evident in the current earnings season.

Given the rally in global stock markets in 2024, there is increasing investor concern about the sustainability of the uptrend, with many pointing to the number of new all-time highs as an indication of an overextended market, although this is a normal occurrence during a positive market trend. However, the US president-elect will likely provide stimulus that boosts the outlook for near term US economic growth supports earnings growth expectation, especially in the US. In other regions the impact is more mixed, given the potential for trade tariff increases.

Differences in valuations between regions remain. The current valuation of the US and the global stock markets is already quite a bit above their historical median (MSCI World: 19.2 × earnings vs. 16.4 × median; MSCI USA: 22.0 × vs. 17.9 × median), international markets are trading around or below their median (MSCI Europe at 13.8 × vs. 14.1 × median; MSCI Switzerland 17.5 × vs. 17.6 × median). Even though the valuation in US equities seems stretched, we expect earnings growth to be supported and we have increased US equities to an overweight. At the same time, we have reduced Europe to neutral. There are valid reasons for the lower valuation of European markets (i.e. dependency on China, trends in the automotive sector), the outlook for Swiss equities—coupled with an attractive currency—remains compelling given their favorable valuation. Earnings for European companies will likely not be impacted significantly by new US tariffs, either because they already have sizeable production facilities in the US (manufacturing sector) or have significant pricing power (luxury sector), currently market sentiment is working against a European overweight. For now, we find a neutral allocation to European equities appropriate.

Chart 1: MSCI USA performance in weeks around first Fed rate hike



Source: Bloomberg, Vontobel SFA

Good, better, precious metals

—
Christoph Windlin
Deputy Head
Investment Management,
Vontobel SFA

Gold's impressive run has surpassed even the most bullish forecasts this year, climbing above USD 2,700 per ounce in October, with a year-to-date gain of over 30 percent. Its surge has been outdone only by silver, which has jumped by more than 40 percent.

Factors driving gold's rally include uncertainty surrounding the US elections, ongoing tensions in the Middle East, and investors' expectations for further US interest-rate cuts, which make non-yielding assets like gold more appealing. Demand has also been picking up slowly but surely for the exchange-traded funds (ETFs), supported by the Fed's long-awaited policy pivot.

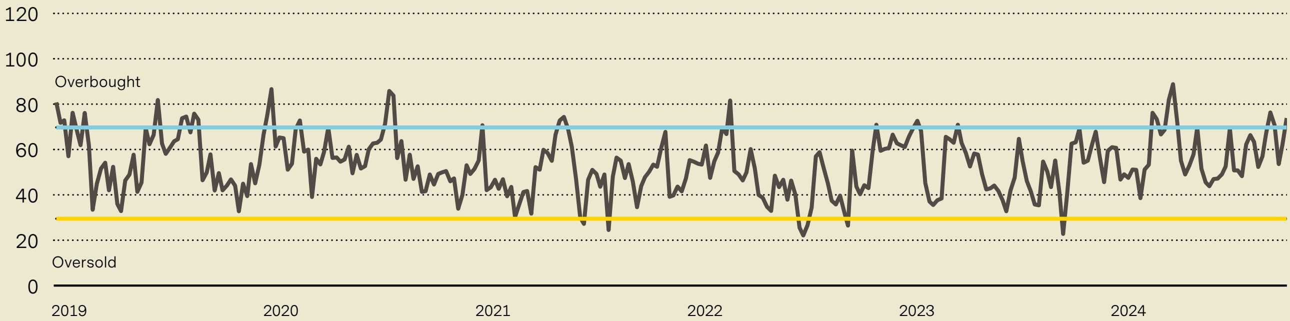
But do the aforementioned factors fully explain gold's relentless march higher, especially with technical indicators suggesting it is in overbought territory (see chart 1)? Probably not. Other forces are likely at play that have helped to compensate for rising US real yields and the three-month high of the US dollar, which typically makes gold more expensive for holders of other currencies. Once again, the answer likely lies in physical demand. Some central banks have continued to buy despite high prices, coupled with strong consumer demand in India, where gold is a traditional gift during the festive season.

Another (more speculative) explanation is that BRICS nations[2] may be planning a currency alternative to the US dollar, partially backed by gold.[3] This theory gained traction following the BRICS summit in Kazan, Russia, in late October and comments by ECB President Lagarde, who cited gold as a reason not to take currencies for granted.

[2] Acronym for Brazil, Russia, India, China, and South Africa. It is an intergovernmental organization that also includes Iran, Egypt, Ethiopia, and the United Arab Emirates.
[3] Source: The Economist article, published October 20, 2024. www.economist.com/international/2024/10/20/putins-plan-to-dethrone-the-dollar

Chart 1: Technical indicators: Is the air getting thinner?

Gold: Relative Strength Index



The Relative Strength Index (RSI) is a momentum indicator that measures the speed and magnitude of recent price changes. Traditionally, an RSI reading of 70 or above indicates an overbought condition. A reading of 30 or less indicates an oversold condition.

Source: LSEG, Vontobel; as of October 24, 2024.

Dollar at a fork in the road

—
Dr. Pieter Jansen
Chief Investment Strategist,
Vontobel SFA

Over the past months, the US dollar has regained ground against a broad set of currencies. The main driver has been stronger economic data, which has reduced expectations for Fed rate cuts. In the short-term, the greenback's movements remain driven by Fed monetary policy adjustments relative to current market pricing.

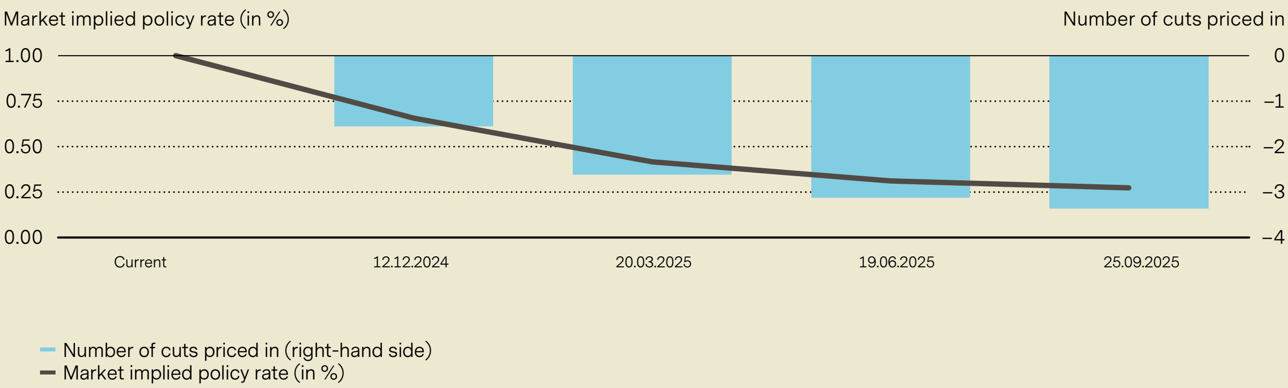
The impact of a second Trump term on the dollar is positive in the short-run but the medium-term outlook remains negative. Growth stimulative policies which could lead to inflation trending a bit higher as well, will make it more difficult for the Fed to return interest rates to neutral soon. This is supportive for the US dollar. However, from a medium- to longer-term perspective the valuation of the US dollar is already stretched and the rising government debt trend is also a negative factor for the dollar. In addition to that, president-elect Trump may not be seeking a stronger dollar. It would (partially) undo the effects of higher tariffs and make it more difficult to restore the trade imbalance.

SNB's rate-cut dilemma

Swiss inflation has fallen to its lowest level in more than three years, raising the odds of further monetary easing by the Swiss National Bank (SNB). Like the Eurozone, Switzerland is caught in a cycle of rate cuts and disinflation. The sharp drop in September's inflation figures has intensified speculation ahead of the SNB's December meeting: will the central bank opt for a 25 or 50 basis-point rate cut?

With inflation slowing more rapidly than expected and the Swiss franc maintaining its strength, the SNB's options may be limited. Unless there is an unexpected reversal in the franc's appreciation—currently an unlikely scenario—the SNB could feel compelled to act more aggressively. A 50-basis point cut be on the cards if inflation continues to weaken to avoid the economy falling into (sustained) deflation.

Chart 1: What's next for the SNB?



Source: Bloomberg, Vontobel; data as of September 19, 2024.

Economy and financial markets 2022 – 2025

The following list shows the actual values, exchange rates and prices from 2022 to 2023 and consensus forecasts for 2024 and 2025 for gross domestic product (GDP), inflation / inflationary expectations, key central bank interest rates, ten-year government bonds, exchange rates, and commodities.

GDP (IN %)	2022	2023	CURRENT[1]	2024 CONSENSUS	2025 CONSENSUS
Global (G20)	2.9	3.0	3.0	2.5	2.6
Eurozone	3.4	0.4	0.6	0.7	1.2
USA	1.9	2.5	3.0	2.6	1.8
Japan	1.0	1.9	–1.0	0.0	1.2
UK	4.5	0.3	0.7	1.0	1.3
Switzerland	2.7	0.7	1.7	1.4	1.4
Australia	3.8	1.9	2.1	1.2	2.1
China	3.0	5.2	4.6	4.8	4.5

INFLATION	2022	2023	CURRENT[2]	2024 CONSENSUS	2025 CONSENSUS
Global (G20)	7.5	4.4	4.8	5.0	3.0
Eurozone	8.4	5.5	1.7	2.4	2.0
USA	8.0	4.1	2.4	2.9	2.2
Japan	2.5	3.3	2.5	2.5	2.0
UK	9.1	7.3	1.7	2.6	2.3
Switzerland	2.8	2.2	0.8	1.2	1.0
Australia	6.6	5.7	3.8	3.4	2.8
China	2.0	0.2	0.4	0.5	1.3

KEY INTEREST RATES (IN %)	2022	2023	CURRENT	CONSENSUS IN 3 MONTHS	CONSENSUS IN 12 MONTHS
EUR	2.50	4.50	3.40	2.80	2.30
USD	4.50	5.50	5.00	4.05	3.30
JPY	–0.10	–0.10	0.23	0.51	0.68
GBP	3.50	5.25	5.00	4.40	3.55
CHF	1.00	1.75	1.00	0.60	0.60
AUD	3.10	4.35	4.35	4.15	3.50

GOVERNMENT BOND YIELDS, 10 YEARS (IN %)	2022	2023	CURRENT	CONSENSUS IN 3 MONTHS	CONSENSUS IN 12 MONTHS
EUR (Germany)	2.6	2.0	2.28	2.14	2.16
USD	3.9	3.9	4.20	3.69	3.67
JPY	0.4	0.6	0.96	1.13	1.32
GBP	3.7	3.5	4.23	3.81	3.69
CHF	1.6	0.7	0.47	0.53	0.70
AUD	4.1	4.0	4.41	3.91	3.93

FOREIGN EXCHANGE RATES	2022	2023	CURRENT	CONSENSUS IN 3 MONTHS	CONSENSUS IN 12 MONTHS
CHF per EUR	0.99	0.93	0.94	0.96	0.99
CHF per USD	0.94	0.84	0.87	0.87	0.88
CHF per 100 JPY	0.72	0.60	0.57	0.62	0.65
CHF per GBP	1.12	1.07	1.13	1.15	1.19
USD per EUR	1.06	1.10	1.08	1.11	1.13
JPY per USD	130	141	152	140	135
USD per AUD	0.67	0.68	0.66	0.70	0.72
GBP per EUR	0.88	0.87	0.83	0.84	0.85
CNY per USD	6.91	7.10	7.12	7.04	6.93

COMMODITIES	2022	2023	CURRENT	CONSENSUS IN 3 MONTHS	CONSENSUS IN 12 MONTHS
Brent crude oil, USD per barrel	86	77	74	78	75
Gold, USD per troy ounce	1,824	2,063	2,719	2,595	2,500
Copper, USD per metric ton	8,372	8,559	9,507	9,800	10,125

[1] Latest available quarter
[2] Latest available month, G20 data only quarterly
Source: Vontobel, respective statistical offices and central banks; as of October 25, 2024

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