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US Investors' Outlook

Continental breakfast

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Continental breakfast

—
Dr. Pascal Köppel
Chief Investment Officer,
Vontobel SFA

Dear readers,

Over the last month, European elections and primarily the French snap election have triggered significant investor and media interest. Through the lens of an investor, we think Paris (and Europe for that matter) is a good idea right now. Political developments have put pressure on asset prices within the Eurozone. We are tuning in to an overlooked section of the menu: the potential of European equities. The region's equities have been lagging behind their US counterparts, with the Stoxx Europe 600 Index struggling to keep pace. They also look relatively undervalued, presenting a good opportunity for investors, in our view and this is one of the reasons why the Investment Committee has confirmed the overweight in Eurozone equities.

Despite widespread focus on discontent and anger, particularly around issues like immigration and climate-change policies, as well as concerns over how the shift will affect policies on trade and regulation and market stability in the region, the center-right continues to dominate the European Parliament. This suggests that the balanced policy approaches are likely to maintain their influence, indicating that the situation in Europe is more stable than it might appear.

A power shift in the French Parliament could see increased public spending even amid the ongoing EU excess deficit procedure (EDP). However, foreign and defense policy chiefly fall under the presidential purview in the French political framework. Uncertainty surrounding the country's stance on Europe is likely to be contained until the next presidential election, which is slated for spring 2027.

Although surprising political developments can temporarily impact equity markets, history shows that these effects often don't tend to last. At the end of the day, it is important to look at the fundamentals: how does the overall environment impact on corporate earnings growth and are investors excessively pessimistic or optimistic? Of all the key regional equity indices, Europe is by far the most exposed to the global economy.

Across the pond, the US labor market seems to be showing more signs of cooling, losing some of its previous momentum. Job openings have declined and wage growth is moderating, suggesting that the post-pandemic hiring boom is tapering off. Against this backdrop, the US Federal Reserve (Fed) has signaled just one cut later this year.
In a global context, it appears that inflation is no longer posing that great a problem, as the world has seen price pressures easing to more manageable as this has been reflected in some central banks moving ahead with rate cuts. The Fed, however, is currently holding rate cuts in abeyance, awaiting more clarity on how best to balancing inflation control and economic growth in line with its dual mandate.

Similarly, this publication will be taking a hiatus for the summer. We will continue to monitor global market developments and return with a new spread of ideas for our September edition.

Savor the read and enjoy your holiday.

Dr. Pascal Köppel
Chief Investment Officer,
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Head Managed Solutions,
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Hustle and bustle

The month of June may not have brought a wealth of change to the macroeconomic menu, with economic data mainly confirming recent trends. However, many major central banks were anything but idle. They forged ahead with interest-rate cuts, while the Fed stuck to its cautious wait-and-see strategy. Investors were meanwhile served a dish of uncertainty, as European politics cast a shadow over equity and bond markets.

The European Central Bank (ECB) was among those to cut rates, a move that had been widely anticipated in the run-up to its June meeting. The Bank of Canada surprised markets by cutting its overnight rate ahead of the expected July cut and the Swiss National Bank (SNB) delivered its second cut while lowering its inflation forecasts.

The Fed seems to be in a bit of a dilemma and is sitting on the fence. It lowered expectations for rate cuts in 2024 from 0.75 percent to 0.25 percent—signaling just one cut. However, we believe a second cut is quite possible, as the US economy and its labor market in particular could gradually soften further. There are a number of labor market indicators that signal softening conditions. These include a gradual increase of initial and continuing jobless claims, a small rise in the unemployment rate and a decline in the hiring intention trend by small US business, according to the survey by the National Federation of Independent Business (NFIB).

In Europe, we see the recent political tremors and accompanying market jitters as a window of opportunity. The cyclical nature of European equities might just get a boost from the improving trend in the global manufacturing sector. We also anticipate a positive turn in European liquidity, as the ECB continues to ease monetary policy. Additionally, the region's earnings per share (EPS) dynamics look relatively solid, especially when stacked against other regions. Turn to page five for more details on our asset allocation.

	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. We remain overweight in investment grade (IG) credit. This supports our belief that current spreads offer a fair value risk-adjusted expected return, provided the global economy can avoid a severe downturn. We remain underweight in high-yield bonds. In our opinion, companies with weaker balance sheets and a greater dependence on external borrowing are more at risk, and their bond prices and spreads over higher quality bonds do not compensate for that risk. We should see lower 2-year and 10-year rates in the quarters ahead and therefore recommend extending duration in investment grade bonds.
3 Equities				→		We are keeping equities at a medium overweight. The macro environment has become more favorable overall for equities. We are seeing improved momentum in the global manufacturing sector, while the downside risks to the US economy continue to fall. Regionally, we prefer the euro area and Switzerland, while the UK remains an underweight in our tactical allocation.
4 Commodities / Gold			→			We maintain a positive view on gold. The yellow metal rallied strongly last year. Lower interest rates, higher geopolitical uncertainties and continued strategic buying of gold, especially by emerging market central banks, will be positive drivers of gold in 2024.

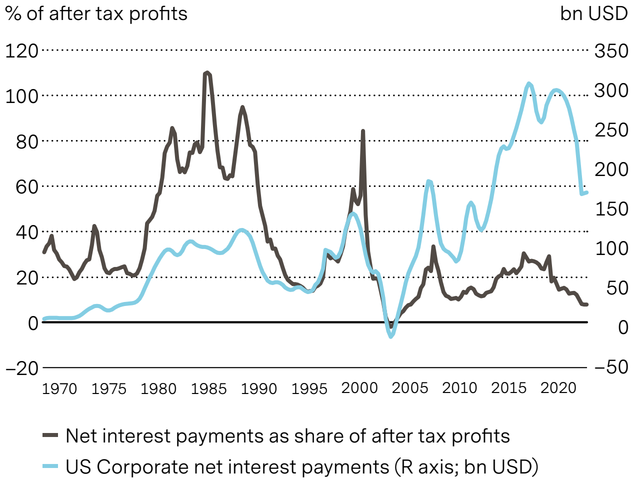
Changes month-on-month: same → higher ↗ lower ↘

Examining the financial buffet

The US economy is gradually slowing, but other regions are showing signs of improving economic conditions. US growth is still holding up and is expected to continue to perform reasonably well. This delays a first Fed rate cut while more central banks are joining the band of lowering interest rates.

—
Dr. Pieter Jansen
Chief Investment Strategist,
Vontobel SFA

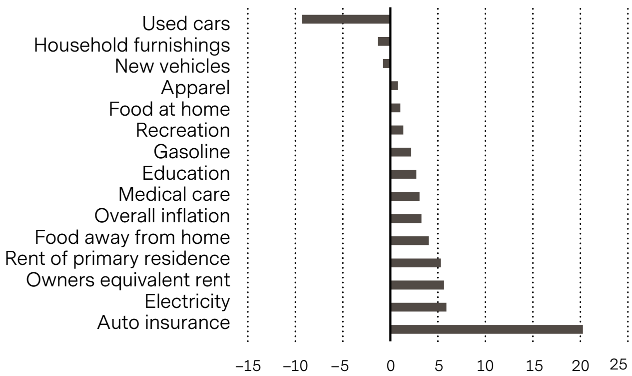
Chart 1: US corporate net interest payments



Source: Bloomberg, Vontobel SFA

Chart 2: Lagging inflation components like auto insurance surged

Selected US inflation components (year-on-year percentage change)



Note: Car insurance inflation is considered a lagging indicator of inflation because changes in car insurance premiums often reflect past data and events. Insurance companies use historical data on claims, accidents, repair costs, medical costs, and other factors to determine their rates. Therefore, when general inflation rises, it takes time for these increased costs to filter through into the data that insurers use to set their premiums. As a result, car insurance inflation tends to respond to changes in general inflation with a delay, making it a lagging indicator.

Source: LSEG, Vontobel; data as of May 2024.

The US economy has coped well with high interest rates, and a recession has not (yet) materialized. This resilience can be attributed to many companies and consumers securing favorable financing conditions, shielding them from the adverse effects of higher interest rates thus far. Net interest payments as share of after tax profits for corporates has hit a historically low level (see chart 1) while also in absolute terms the US dollar amount spend on interest has declined. This confirms the strength of US corporate balance sheets and also shows the absence of the need for significant cost reduction as a result of higher interest rates.

The absence of a recession in the US has also resulted in another outcome: Inflation has yet to subside. In May, US consumer price inflation stood at 3.3 percent, well above the Fed's 2 percent target. This persistent inflation is not only due to housing market shortages, which are driving up service inflation, but also unexpected factors such as significant increases in car insurance prices, soaring by a substantial 20.3 percent year-on-year in May (see chart 2).

As a result, the Fed has taken a notably relaxed stance on interest-rate cuts. During its June meeting, it released updated forecasts that initially appeared somewhat restrictive. On the one hand, the Fed raised its projections for core inflation (2024: from 2.6 percent to 2.8 percent, 2025: from 2.2 percent to 2.3 percent). On the other hand, it scaled back its expectations for interest-rate cuts in 2024, reducing the forecast from 0.75 percent to 0.25 percent, which corresponds to only one interest rate cut[1].

Disinflation trend should continue, slowly
Looking ahead to the second half of the year, we believe there's little reason to be overly concerned about US inflation. Firstly, real (inflation-adjusted) interest rates are restrictive, currently standing 7 percent higher than two years ago. Secondly, despite global tensions such as those in the Red Sea, global supply chains appear largely intact, as indicated by the New York Federal Reserve's Global Supply Chain Pressure Index. Thirdly, goods inflation has cooled, with some sectors like automotive even experiencing deflation due to high inventory levels. Fourthly, China, the world's second-largest economy, is exporting lower price pressures globally. Fifthly, US inflation expectations are also well anchored, which should help alleviate the Fed's inflation concerns somewhat.

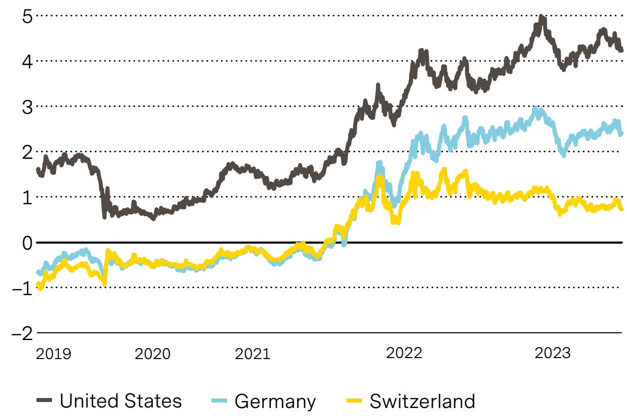
Regarding monetary policy, we caution against overinterpreting the updated Fed forecasts. Fed Chairman Jerome Powell has emphasized that the Fed's expected future interest rate path was "a very close call"[2]. He characterized the upward revisions in inflation forecasts as being on the conservative side. Other Fed officials share a similarly cautious but optimistic outlook. Governor Adriana Kugler said that the economy is "moving in the right direction" and if this continues, it will be time to start easing monetary policy "later in the year"[3].

The influence of monetary policy on bond yields
Monetary policy can influence bond yields directly (buying and selling of bonds) and indirectly. At the end of the day a 10-year Treasury yield is determined by the average expected short-term T bill over 10 years plus a premium for holding a 10-year bond. As we have seen over the past 13 years, we know this premium can be negative as well, as it depends on demand and supply balance for longer maturity treasury bonds. Via communicating short, medium, and long-term implied Fed rates, the Fed also impacts bond yields.

Typically, high quality bonds (say AA and better) have positive correlations as they are substitutes. Different monetary policy directions can influence domestic bond yields up to a certain extend. The positive correlation is basically visible on a daily basis. Significant swings in bond yields, such as pricing out of Fed cuts or pricing in, tends to be followed by other markets as well (chart 3). That said, Switzerland was much less affected by higher inflation in comparison with other regions, such as the US and the Euro area. The SNB was also able to reduce interest rates earlier for that reason, and in June the SNB cut rates for the second time. Despite positive daily correlation, the 10 year Swiss government bond yield decoupled from the German 10 year yield in mid-2022.

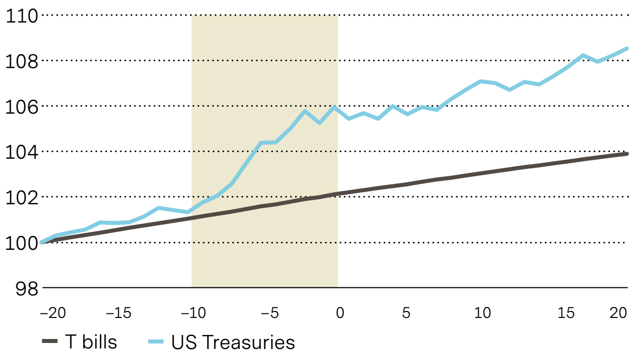
In general, the bond market is forward looking. It anticipates monetary policy action. In case investors wait until the first rate cut is actually delivered by the Fed they may miss a large part of the positive longer duration performance; an example is Switzerland over the past years. Government bond and corporate bond yields already peaked at the beginning of 2023 in Switzerland. In the US, the peak was reached in October. History, based on the past six Fed rate cutting cycles, has also shown that US treasury bonds tends to outperform cash significantly, measured from 20 weeks before until 20 weeks after the first rate cut (chart 4). A large part of that performance is realized during the 10 weeks before the first Fed rate cut. Since it can be difficult to forecast exactly when the first rate cut takes place, it seems advisable not to wait too long to switch from shorter to longer duration. Current US government and high-quality corporate bonds still offer an attractive entry level.

Chart 3: 10 year government bond yields
In %



Source: Bloomberg, Vontobel SFA

Chart 4: Total return of T-bills and 10 year US Treasuries from 20 weeks before first Fed rate cut*
Indexed total return in US dollar



* Measured over past 6 Fed rate cutting cycles

Source: Bloomberg, Vontobel SFA

[1] The US Federal Reserve, published June 12, 2024. www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20240612.pdf
[2] Source: Reuters article, published June 13, 2024. www.reuters.com/markets/rates-bonds/fed-expected-hold-rates-steady-project-fewer-cuts-2024-2024-06-12/#:~:text=Powell%20himself%20said%20the%20decision,additional%20anticipated%20cut%20onto%202025.
[3] Source: Bloomberg article, published June 18, 2024. www.bloomberg.com/news/articles/2024-06-18/fed-s-kugler-says-rate-cut-likely-appropriate-later-this-year

Evolving monetary policy expectations as 2024 unfolds

—
Philipp Wartmann
Senior Investment Adviser,
Vontobel SFA

At the start of 2024, market expectations leaned heavily towards significant monetary policy easing and numerous rate cuts. The assumption was that inflation would swiftly return to target, paving the way for the Fed to reduce interest rates. However, inflation has proven more stubborn than anticipated, leading to a rapid erosion of those expectations. The Fed confirmed as much in its June meeting with the release of the dot plot.

The most notable change is the adjustment from a median forecast of three rate cuts this year to just one. Looking further ahead, projections now point to an annual easing of 100 basis points in both 2025 and 2026, up from the previous 75 basis points, while maintaining a final target of 3.125 percent for 2026. Traders are now pricing in only one or possibly two rate cuts this year.

The Fed believes monetary policy is currently restrictive, especially when compared to their assessment of the neutral interest rate, which they consider to be significantly lower. It seems likely that the Fed will start to ease monetary policy carefully before year end.

Just three years ago, investors considering buying Treasuries had very little yield cushion[5]. By mid-2021, a rise of just under 20 basis points in the 10-year yield would have caused losses on a total-return basis. Today, potential buyers of the 10-year note enjoy nearly 60 basis points of protection at current yields. The 10-Year Treasury yield would have to exceed 4.8 percent for a negative total return over one year (see chart 1).

Investment grade credit remains attractive from a fundamental perspective.
We have seen a lot of supply coming to the bond market this year with decent levels of new issuance. This supply has been absorbed well by the market, which confirms our positive view on fixed income valuations. These appear relatively attractive, especially for investors with a medium to longer-term horizon. Looking at the current all-in yields and comparing these over the past 10 years, most segments of the bond market currently score well, despite rather tight credit spreads historically.

With regard to investment grade, the non-fin US IG credit market (ICE BofA 3-5 Year US Corporate Index Effective Yield) is trading at a yield of 5.3 percent (see chart 2). This compares with 4.9 percent at the start of the year. It then reached a high in tandem with US Treasury yields in April (approx. 5.5 percent). Investment grade credit remains attractive from a fundamental perspective, given the solid economy and robust balance sheets. Although we believe that spreads can remain tight for an extended period of time, the risk reward is better in high quality investment grade bonds (minimum A rating) from a relative value perspective.

[5] Yield cushion refers to the buffer or margin that an investor has before rising interest rates begin to cause the total return of a bond investment to become negative.

Chart 1: 10-year yield cushion over a one-year horizon

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

Chart 2: ICE BofA 3-5 Y US Non-Financial Corp Index yield (to worst)

Source: Bloomberg, Vontobel SFA

Spinning two plates

—
Markus Bruhin
Head Managed Solutions,
Vontobel SFA

US equities reached a new milestone in June, with the S&P 500 Index hitting its 31st all-time high so far this year, again driven predominantly by technology stocks. In contrast, Eurozone indices, which had kept pace with tech-heavy US market through the end of May, were hit by a perfect storm at the beginning of June. Could this turbulence present buying opportunities? We believe it does.

The US market is going from strength to strength this year. Historically, election years are associated with positive market performance and 2024 has marked the best start to any election year on record. Nvidia alone has contributed more than 40 percent to the year-to-date performance of the index, with the US technology sector overall accounting for more than 50 percent. In June, Nvidia also became the 12th company since 1926 to hold the largest index weighting in the S&P 500 Index, surpassing USD 3 trillion in market capitalization for the first time, dethroning briefly both Microsoft and Apple (see chart 1). The S&P 500 Index edged out a total return of slightly above 15 percent for the first half of 2024, whereas the same index with all constituents equally weighted only returned slightly above 4 percent.

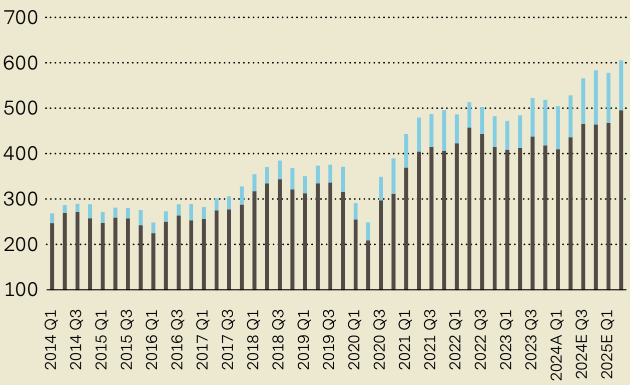
The concentration of market gains among a handful of US equities, six of which have recently reached all-time highs, has understandably heightened investor anxiety. However, these equities have demonstrated exceptional earnings per share (EPS) growth, averaging nearly 40 percent over the past year. This has contributed significantly to the S&P 500 Index's overall gain this year. Moreover, these companies have continued with their aggressive share repurchasing programs, now accounting for 25 percent of nearly USD 240 billion repurchased for the entire S&P 500 Index in the first quarter of 2024, the largest quarterly amount on record.

Looking at Eurozone equities, several issues are at play here. These range from the outcome of the French election, which indicates a strengthening of emerging right-wing sentiment reminiscent of the euro crisis of 2012, to the imposition of tariffs on Chinese electric vehicles prompting fears of retaliatory measures. This led to market jitters which led to sizeable capital outflows from the region. We view this situation as an opportunity for several reasons.

Firstly, political developments reflected in equity markets have historically been short-lived. Secondly, we expect a positive liquidity impulse for the region, as the ECB continues to ease monetary policy (see chart 2). This should play in favor of Eurozone equities that are traditionally exposed to cyclical sectors. Thirdly, Eurozone equities are displaying solid EPS dynamics compared to other regions, coupled with attractive valuations.

Chart 1: Flying high

S&P 500 Index's quarterly net profit (in USD billion)

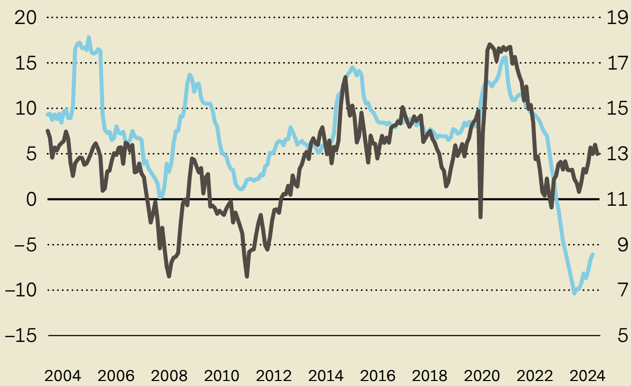


— S&P 500 Index Net profit ex-Top 5 (in USD billion)
— S&P 500 Index Top 5 Net profit (in USD billion)

Source: Bloomberg, Vontobel; data as of June 21, 2024.

Chart 2: Liquidity impulse should improve and support valuation multiples in Eurozone

In % P / E ratio



— MSCI Eurozone 12-month forward P / E ratio (right-hand side)
— Eurozone one-month money supply (year-on-year change in %, left-hand side)

Source: LSEG, Vontobel; data as of June 21, 2024.

Gold—awaiting the "King Dollar's" abdication

—
Christoph Windlin
Deputy Head
Investment Management,
Vontobel SFA

Gold remains one of the best-performing asset classes in 2024. After briefly hitting an all-time high of 2,412 US dollars per ounce in mid-April and approaching that level again in mid-May, prices have taken a breather. Several factors contributed to this pause.

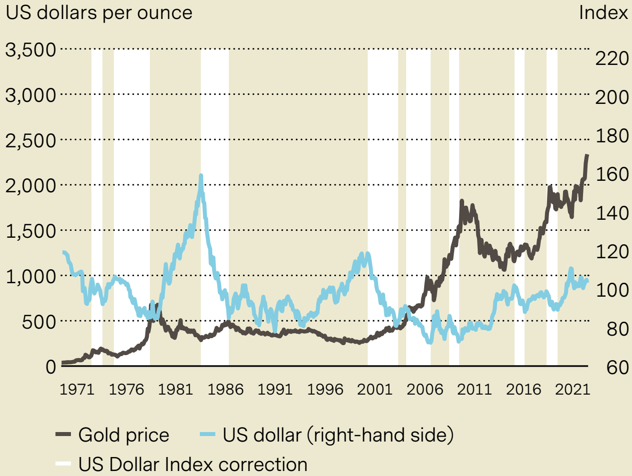
Positive economic news often negatively impacts gold. The combination of resilient economic growth in the US, persistent inflation and increasingly hawkish rhetoric from the Fed led some investors to anticipate later-than-expected interest-rate cuts. As a non-yielding asset, gold does not generate dividends or coupons like equities or bonds, making it less attractive when interest rate cuts are delayed.

Why a small gold overweight may still be a good idea
Gold's future performance hinges on several factors, including the Fed's inflation-fighting credentials, future Fed policy and everything that comes with it (e.g., a weaker US dollar), future central bank demand and "safe haven" considerations, among other things. As for the Fed, hopes for US interest rate cuts are alive and kicking—markets still expect one to two cuts by the end of 2024. This should eventually lead to a peak in the US dollar. Historically, such a peak has been positive for gold (see chart 1).

Regarding future central bank demand, we think the longer-term structural story remains intact. The Global Public Investor 2024 survey[6] by the Official Monetary and Financial Institutions Forum's (OMFIF) suggests that diversification and geopolitical considerations are top of mind for many policymakers (see chart 2). Additionally, central bank holdings in emerging markets are still lower than in developed markets, indicating potential for increased overall central bank demand. On the geopolitical front, we believe a small overweight in gold could be beneficial, should unexpected risk events materialize (e.g., Russia-Ukraine, the Middle East, US elections).

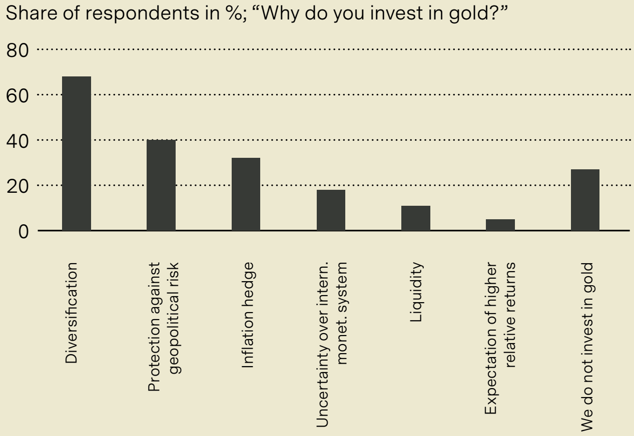
[6] Source: OMFIF Global Public Investors survey for 2024. www.omfif.org/gpi2024/

Chart 1: Dollar peak historically positive for gold



Source: LSEG, Vontobel; data as of June 16, 2024.

Chart 2: Diversification and geopolitics as key drivers



Source: Official Monetary and Financial Institutions Forum's Global Public Investor 2024, Vontobel.

SNB strikes again

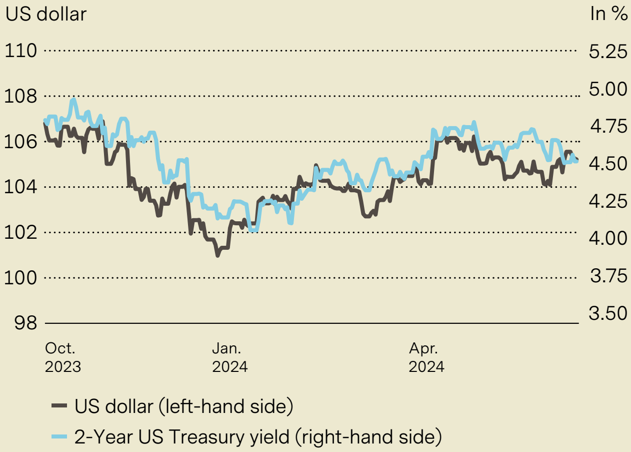
—
Dr. Pieter Jansen
Chief Investment Strategist,
Vontobel SFA

Currency markets are still largely driven by central bank actions and expectations.

In the short term, the dollar remains supported by the Fed not being able to reduce interest rates yet. We expect the current phase of dollar support to ease when we see a shift in economic data out of the US and the Fed starts cutting interest rates. However, this may only happen towards the end of the year. We believe there is considerable potential for US short-term yields to decline, which would negatively impact the dollar (see chart 1). The primary risk to our negative US dollar outlook is if the Fed maintains its current interest rates throughout 2024. That said, from a medium term perspective, the US dollar is overvalued versus a broad basket of currencies.

SNB rate cuts curtail the Swiss franc
The SNB reduced interest rates for the second time this year. In its commentary, the SNB noted that inflation expectations have moved lower but it was also concerned about the recent appreciation of the Swiss franc (see chart 2). The SNB seeks to keep the real effective exchange rate of the Swiss franc stable. The intended weakening of the franc was therefore aimed at realigning the currency after the appreciation of last year. Keeping the real effective exchange rate more or less stable would still allow for a continued appreciation of the Swiss franc in nominal terms. After all, inflation is structurally lower and Swiss inflation is much more benign than in other regions, certainly in the current environment. The recent appreciation of the Swiss franc also reconfirms the safe haven status of the franc: the Swiss franc benefited as soon as worries about the euro increased. This safe haven status will most likely also apply to other kinds of global geopolitical and other market shocks.

Chart 1: Anticipating a drop in short-term yields



Source: Bloomberg, Vontobel; data as of May 24, 2024.

Chart 2: Swiss franc per US dollar

Source: Bloomberg, Vontobel SFA

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	2.5	2.7	2.6
Eurozone	3.4	0.4	0.4	0.7	1.4
USA	1.9	2.5	2.9	2.4	1.8
Japan	1.0	1.9	–0.1	0.3	1.1
UK	4.5	0.3	0.2	0.7	1.2
Switzerland	2.7	0.7	0.8	1.2	1.5
Australia	3.8	1.9	2.1	1.3	2.2
China	3.0	5.2	5.3	4.9	4.5

INFLATION	2022	2023	CURRENT[2]	2024 CONSENSUS	2025 CONSENSUS
Global (G20)	7.5	4.4	5.7	5.1	3.1
Eurozone	8.4	5.5	2.6	2.4	2.1
USA	8.0	4.1	3.3	3.2	2.4
Japan	2.5	3.3	2.8	2.4	1.9
UK	9.1	7.3	2.0	2.6	2.2
Switzerland	2.8	2.2	1.4	1.4	1.1
Australia	6.6	5.7	3.6	3.4	2.8
China	2.0	0.2	0.3	0.7	1.5

KEY INTEREST RATES (IN %)	2022	2023	CURRENT	CONSENSUS IN 3 MONTHS	CONSENSUS IN 12 MONTHS
EUR	2.50	4.50	4.25	3.35	2.65
USD	4.50	5.50	5.50	5.30	4.40
JPY	–0.10	–0.10	0.08	0.06	0.28
GBP	3.50	5.25	5.25	4.95	3.95
CHF	1.00	1.75	1.25	1.14	0.97
AUD	3.10	4.35	4.35	4.20	3.60
CNY	3.65	3.45	4.35	4.25	n.a.

GOVERNMENT BOND YIELDS, 10 YEARS (IN %)	2022	2023	CURRENT	CONSENSUS IN 3 MONTHS	CONSENSUS IN 12 MONTHS
EUR (Germany)	2.6	2.0	2.40	2.31	2.24
USD	3.9	3.9	4.25	4.33	4.02
JPY	0.4	0.6	1.00	1.07	1.23
GBP	3.7	3.5	4.06	3.92	3.62
CHF	1.6	0.7	0.65	0.77	0.79
AUD	4.1	4.0	4.22	4.19	3.92

FOREIGN EXCHANGE RATES	2022	2023	CURRENT	CONSENSUS IN 3 MONTHS	CONSENSUS IN 12 MONTHS
CHF per EUR	0.99	0.93	0.96	1.00	1.00
CHF per USD	0.94	0.84	0.89	0.92	0.90
CHF per 100 JPY	0.72	0.60	0.56	0.61	0.62
CHF per GBP	1.12	1.07	1.13	1.18	1.16
USD per EUR	1.06	1.10	1.07	1.09	1.11
JPY per USD	130.00	141.00	160.00	150.00	145.00
USD per AUD	0.67	0.68	0.67	0.68	0.69
GBP per EUR	0.88	0.87	0.85	0.86	0.85
CNY per USD	6.91	7.10	7.26	7.20	7.18

COMMODITIES	2022	2023	CURRENT	CONSENSUS IN 3 MONTHS	CONSENSUS IN 12 MONTHS
Brent crude oil, USD per barrel	86	77	85	85	79
Gold, USD per troy ounce	1,824	2,063	2,330	2,330	2,200
Copper, USD per metric ton	8,372	8,559	9,683	9,500	9,985

[1] Latest available quarter
[2] Latest available month, G20 data only quarterly
Source: Vontobel, respective statistical offices and central banks; as of June 24, 2024

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