Vontobel

# US Investors' Outlook

## Staying ahead, reaching beyond

December 2023 / January 2024

Vontobel Swiss Financial Advisers AG

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# Staying ahead, reaching beyond

—
**Dr. Pascal Köppel**
Chief Investment Officer,
Vontobel SFA

Dear readers,

We are approaching the final stretch of the year and markets are in early Christmas rally mode, pricing in a pivot by the US Federal Reserve following two important data points: inflation remains on its downward trajectory after a brief spike, with all components heading in the right direction, and data shows that the US labor market is slowing. Here, (moderately) bad news is good news, because it means the economy is slowing down and, given its dual mandate of pursuing both price stability and maximum employment, the Fed is probably done with hiking.

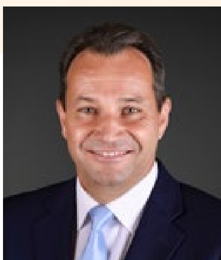
US inflation has slowed from 9.1 percent in June 2022 to 3.1 percent in November 2023. Euro area inflation has slowed from a peak of 10.6 percent in October 2022 to 2.4 percent this October and is therefore heading towards the target. While we understand the Fed's hawkish tone, we also recall that it was not concerned that inflation was below its target for a decade. We therefore believe it is not worried either if it is somewhat above 2 percent. The hawkish narrative needs to stay in place just to keep up appearances and hold financial conditions relatively tight.

In our view, economic growth in the US peaked in the third quarter. Factors supporting growth are fading, the most prominent ones being fiscal policy and the depletion of excess savings post Covid-19. In addition, the pain of higher interest rates will gradually affect consumers and businesses. Whether the slowdown will gain enough momentum to result in a recession remains unclear and largely depends on whether there will be adverse events in the financial and economic system. Our base case is unchanged in that we expect a US economic slowdown, which may or may not lead to a soft landing.

As was the case in January, financial markets in November once again demonstrated the risk of not being invested. Equity and bond markets had an incredibly strong month. Measured in US dollars, the MSCI World gained 9.3 percent and 1-year to 5-year broad US bonds gained 1.7 percent in November. The weaker US dollar helped the dollar return of international investments. The World Government Bond Index excluding US gained 3.9 percent in November, which was one of the best monthly performances in the last 20 years.

We believe it is not the right time to make significant changes to our portfolio. This means that we prefer to have well-diversified portfolios with a continued overweight in bonds and duration, and a tilt towards safety within the asset class allocation. We continue to favor an equity allocation at the long-term strategic weight. The bottom line is: stay invested, remain tactically overweight in duration and bonds, and apply safety and quality within assets.

This publication will return in early February. In the meantime, reflecting on the dynamics of the past year, we remain vigilant and proactive in navigating the ever-evolving economic landscape, and are ready and excited to embrace the opportunities the year ahead holds.



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# Market uncertainties remain into 2024

**Central banks spent November emphasizing the need to keep monetary policy restrictive for long enough. Macroeconomic data that showed signs of a weakening US labor and housing market, combined with evidence of slowing inflation, had investors questioning how long "long enough" will actually be. US economic growth will likely slow further, as higher financing costs start to bite consumers and businesses. Similarly, factors supporting growth, such as fiscal policy and excess savings, will start to fade away.**

In line with the beginning of 2023, we will enter 2024 clouded by uncertainty about economic growth. The year 2023 started with investors concerned about whether the US economy would enter a recession in the 12 months ahead. The scenario looks no different as we enter 2024. But are there differences? We have seen significant monetary tightening in 2023 and inflation has moderated substantially. Although inflation levels in the US and Europe did not return to the central banks targets, they came quite close by the end of the year.

2024 will likely bring a slowdown in US growth and scope for central banks to reduce rates. Macro and geopolitical uncertainties remain high. It remains to be seen whether US growth will slow enough to usher the largest economy into a recession. According to a Bloomberg survey, experts are now more uncertain about the probability of this occurring. At the start of 2023, 65 percent believed in a US recession within 12 months. This figure has now dropped to 50 percent.

Even though it is certainly not a given that we will see a recession, we are confident about a US growth slowdown and plenty of volatility. In our view, a well-diversified portfolio can best withstand these challenges in 2024. Even after the about 80 bp drop in 10-year US bond yields, fixed income remains attractive and can provide favorable returns and portfolio protection, should we experience a period of macroeconomic turbulence in which growth, inflation and central bank rates decline. At the same time, we want to remain invested in equities at the strategic weight as we enter 2024 and prefer a tilt to quality within equities via an overweight in Switzerland. The preference for quality and safety is also evident in other asset classes in our allocation. Within bonds we prefer investment grade over high yield, while within commodities we favor gold over other, more cyclical asset classes.

| | UNDERWEIGHT | | NEUTRAL | OVERWEIGHT | | |
|---|---|---|---|---|---|---|
| | significantly | slightly | | slightly | significantly | |
| **1 Liquidity** | | → | | | | We continue to hold an underweight in cash, as the expected returns on bonds are attractive. |
| **2 Bonds** | | | → | | | We are sticking to our slightly positive view on fixed income and reconfirm all sub-asset class views. We remain overweight in investment grade (IG) credit, supporting our belief that current spreads offer a fair value risk-adjusted expected return, provided the global economy can avoid a severe downturn. We also remain underweight in high-yield bonds. In our opinion, companies with weaker balance sheets and a higher dependence on external borrowing are more at risk, and their bond prices do not compensate for that risk. Lastly, we also remain positive on emerging market debt, supported by an expected softening US dollar, because of a less hawkish US central bank rhetoric and the Fed's pause. 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 remain neutral on equities and our defensive positioning is unchanged on a regional level. We see the asset class as being stuck between a rock and a hard place. A slowdown in growth that avoids a recession, combined with rate cuts, may not require significant earnings adjustments. A recession poses a risk. However, it could be further delayed and the risk of being underinvested in equities for a longer period can lead to underperformance. We prefer high-quality, defensive regions such as Switzerland, which also display high earnings predictability. This is financed via an underweight in the UK, where there is significant exposure to cyclical commodities. |
| **4 Commodities / Gold** | | | → | | | We maintain a slightly positive view on gold. The yellow metal rallied strongly after the conflict in the Middle East sparked a flight to safety among investors. However, its appeal diminished as the weeks progressed. The recent batch of softer-than-expected US economic data and easing inflation have increased the likelihood of rate cuts by the Fed, providing a supportive backdrop for gold, as lower interest rates reduce the opportunity cost of holding the non-yielding asset. In light of the ongoing macroeconomic and geopolitical risks, gold is attractive relative to other more cyclical commodities such as energy and base metals. |

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

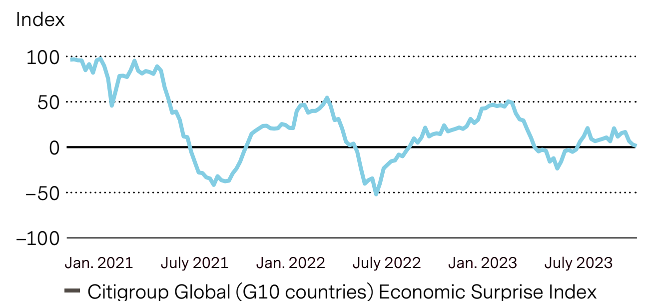
# Outlook for the economic landscape in 2024

**As 2023 draws to a close, investors will likely look back at a relatively decent year on the equity markets, especially following a dreadful 2022. This is partly due to economic developments, with growth surprising on the upside and inflation on the downside. Will the story be the same next year?**

—
**Dr. Pieter Jansen**
Chief Investment Strategist,
Vontobel SFA

Global economic growth exceeded expectations in 2023 (see chart 1), despite the below-average global growth rate. The majority of economists expected a US recession. However, that did not materialize this year in the end, as high levels of inflation and the steep cycle of interest-rate hikes did not impact businesses and consumers as much as had been feared. Companies deferred taking out new loans at high interest rates. They also reduced vacancies, instead of resorting to laying off employees. Consumers were able to tap into the significant savings they accumulated during the pandemic and benefit from a stable labor market. In addition, fiscal policy was surprisingly expansionary, especially in the US, where government support remained generous.

**Chart 1: Global growth surprised to the upside most of the year**




Source: LSEG, Vontobel; data as of November 23, 2023

**Can the US consumer continue to pull the cart?**
Higher interest rates come at a cost and are already exposing the first cracks in the economy. We only have to remember the banking crisis last spring. The longer interest rates remain high, the greater the impact—something to bear in mind when considering that we are dealing with the most significant surge in real interest rates since the early 1980s (see chart 2). Inflation-adjusted rates have reached a 15-year peak.

Shoppers have been quite happy to splurge, boosting the economy long after the pandemic lockdowns were lifted. But what if consumers aren't ready to tighten their purse strings just yet? Excess savings accumulated during the pandemic are gradually drying up and US credit card debt recently reached an all-time high of more than USD 1 trillion. This will contribute to an easing. As the labor market slows, consumers run out of excessive savings and the cost of financing consumer debt rises, it will become much more difficult to maintain the current high level of consumer growth.

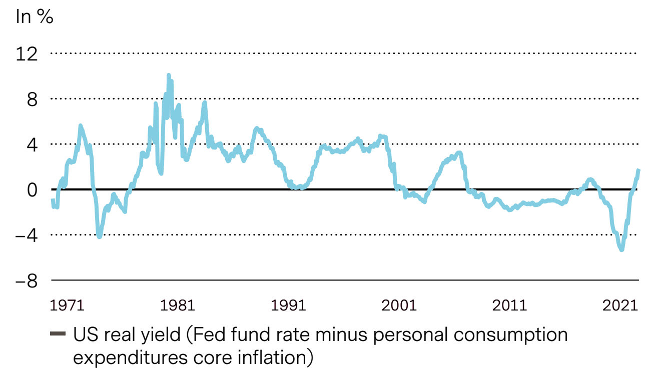
**Can Europe and / or China surprise on the upside in 2024?**
Of the key economic regions, China has been loosening monetary policy this year. Troubled by an ongoing real estate crisis and inflation of just below zero, the PBoC reduced interest rates and lowered the reserve requirement ratio for banks, while the central government announced a sizeable fiscal stimulus program of CNY 1 trillion (0.8 percent GDP). If the manufacturing sector is stabilized and US consumption avoids a hard landing, China could contribute positively to global growth momentum in 2024. This could have a positive effect on another troubled economy: Germany. The German economy has shrunk by 0.1 percent over the past four quarters.

When investors focus on the USD 14 trillion euro area economy, they tend to focus on the heavyweights of Germany and France. This is understandable, as together they represent 49 percent of the region's GDP. But what is happening in the other half? Although several countries are dealing with sluggish growth, 8 out of the 20 member states have still managed to grow by at least 2 percent over the past four quarters. The largest economy of these is Spain, the region's fourth largest economy (+2.2 percent growth). Greece has grown by 2.7 percent over the past four quarters.

The euro area is a large diverse economic region. Even though the divergence in economic growth between the euro area member states has narrowed significantly since the introduction of the euro, it has been increasing again since the pandemic. The standard deviation of the Economic Sentiment Indicator (ESI) between each euro area member state has risen again recently (Chart 3) and was historically high in 2023. The predominant focus on growth weakness in Germany does not justice to other countries in the region that have managed to grow significantly, despite challenges to growth in the core economies.

**Chart 2: We see the fastest and biggest rise in real yields since the early 1980s**

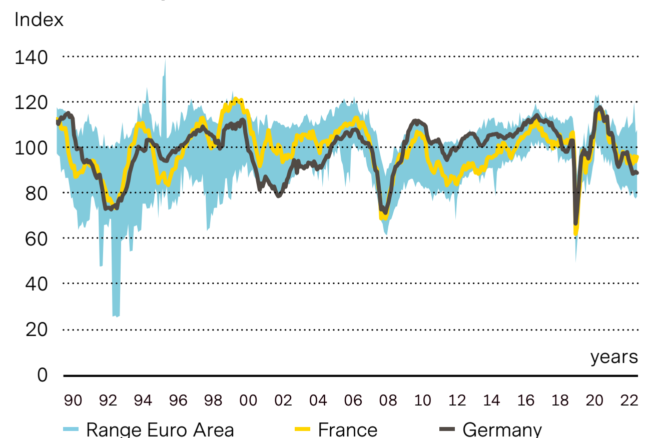
In %




Source: LSEG, Vontobel; data as of November 23, 2023

**Chart 3: European Economic Sentiment**

Index




Source: Bloomberg, European Commission, Vontobel SFA

# Market twist: further Fed rate-hike expectations take a dive

—
**Matthias Ribback**
Portfolio Manager,
Vontobel SFA

**Cooling inflation and signs of slower growth in the US revived a bid for duration. Yields on 10-year Treasuries dropped by about 70 basis points in a span of one month. While Fed Funds futures in September implied a 60 percent chance of another hike, they have now fully priced out increases and anticipate a rate cut by spring of next year (see chart 1).**

The US economy has shown impressive resilience amid the most significant monetary tightening in more than four decades, as reflected by the pace and scale of the interest-rate increases. While the expected pattern of tightened monetary policy, leading to reduced private sector credit growth, did materialize, the economy continues to exhibit unusually robust growth.

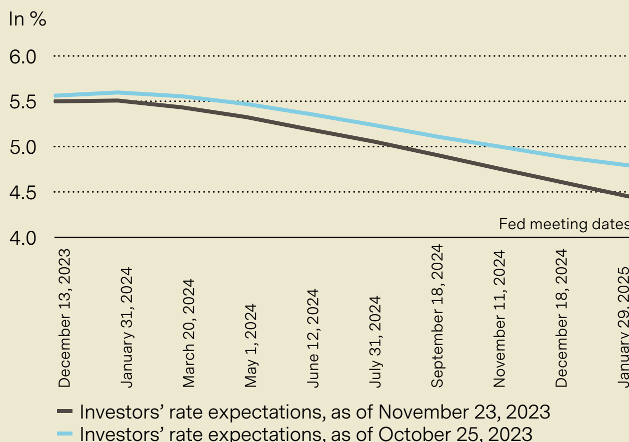
With the expected slowdown in economic growth and ongoing normalization of inflation, rate cuts in 2024 are becoming more likely, even though central bankers do not want to discuss them at this point. It is even quite possible that the ECB will be the first to cut rates ahead of the Fed. Although the President of the ECB, Christine Lagarde, has commented that rate cuts are unlikely in the first two quarters of 2024, we could see a first one in the first half of the year. Growth in Europe is weak and inflation has meanwhile slowed to below 3 percent.

**Be aware of worsening credit fundamentals**

Bond investors should be aware of worsening credit fundamentals. Chart 2 illustrates the percentage of US high-yield corporate bond yields that are attributable to credit spreads. The current level of 43 percent is the lowest since 2007. The absolute spread level in a historical context suggests that high-yield bonds have a very limited cushion in case of significant economic headwinds.

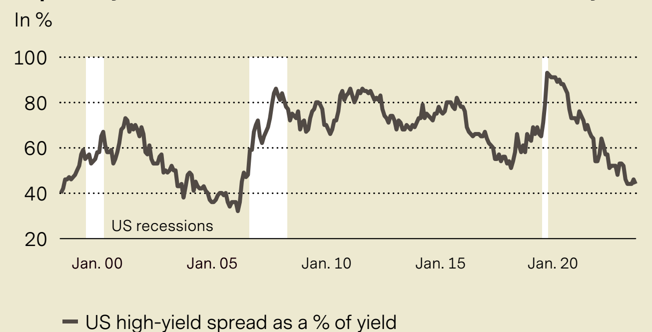
According to Moody's, the high-yield default rate in the US is running above 5 percent. This is the highest since the first half of 2021, when credit markets were recovering from a wave of defaults caused by the pandemic. Rising defaults suggest that high borrowing costs have started to hit credit markets more significantly and that the economy is softening. We favor a tilt towards quality within our fixed income allocation.

**Chart 1: Market no longer sees further Fed rate hike**




Source: Bloomberg, Vontobel; data as of November 24, 2023

**Chart 2: Credit spreads appear notably narrow—especially in terms of their contribution to the overall yield**




Source: Bloomberg, Vontobel; data as of November 24, 2023

# A no-exception November

—
**Markus Bruhin**
Head Managed Solutions,
Vontobel SFA

**November is typically the best month for stocks and it didn't fail to deliver again this year. This time round, the market not only reversed October's negative performance but also posted the best monthly returns since the Covid-19 vaccine breakthroughs in late 2020 (see chart 1). November's index development once again shows that not being invested causes opportunity losses, and we ask ourselves: was the strong performance too good to be true? We don't think so.**

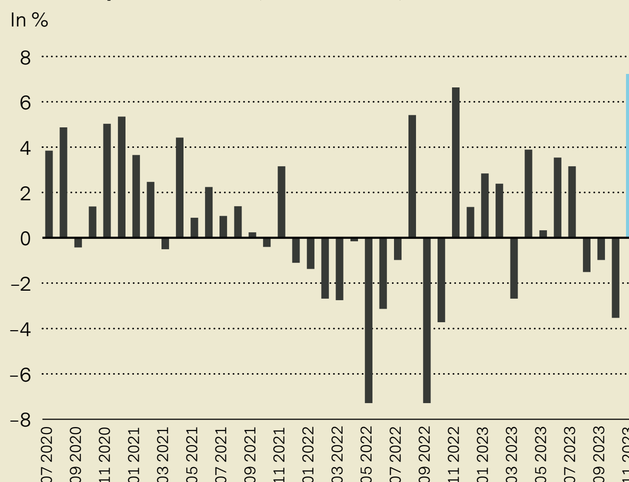
We seem to have already overcome two out of three key macroeconomic factors dominating the scene. First, US inflation peaked more than 12 months ago, which has also been the case in other developed markets since then. Second, central banks appear to have reached the finish line in their rate-hiking campaigns. Historically, both events have set off positive market reactions over the subsequent year (see chart 2). The third and final missing piece would be a pronounced slowdown in economic activity in the US. The data released during November confirmed that the US has started to descend towards a soft landing.

Scratching the surface of the MSCI ACWI Total Return Index's absolute year-to-date, mid to low double-digit gains, investors should consider that few sectors (technology, communication services, consumer discretionary) have boosted their performance with common features such as quality, excess liquidity and low leverage and large market capitalization. Excluding these sectors, performance beneath the surface has been more or less flat.

**So, what to expect for 2024?**
The good news is that the growth forecasts for earnings-per-share (EPS) have moderated recently. Valuation multiples remain below the peak levels reached in 2021, possibly because a slowing macroeconomic outlook is already priced in. EPS growth for 2024 – 2025 might come across as ambitious. However, it is not overly surprising, considering the relevance, contribution and visibility of large dominant sectors. In this environment, we will stay invested according to our long term strategic weight and remain regionally diversified in our tactical allocation. We continue to favor quality, high profitability and earnings predictability. At the same time, we remain alert to any possible change in monetary policy that could trigger moves to different investment styles and sectors.

**Chart 1: MSCI ACWI Net Total Return Index's monthly performance (in US dollars)**

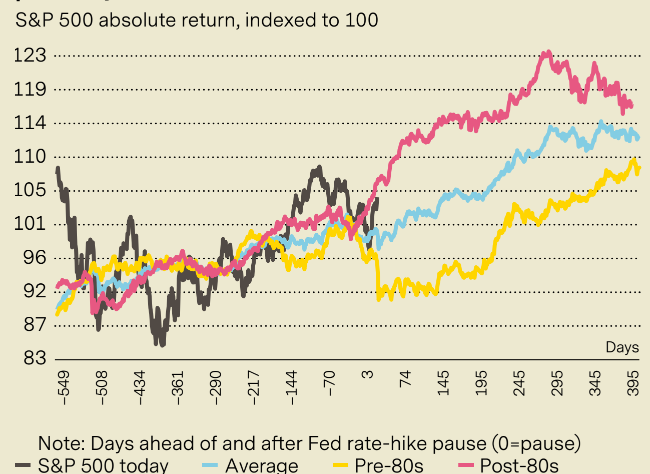
In %




Source: LSEG, Vontobel; data as of November 24, 2023

**Chart 2: Stock markets around a Fed pause in the past 60 years**

S&P 500 absolute return, indexed to 100




Source: LSEG, Vontobel; data as of November 24, 2023

# Gold breaks records but cyclical commodities face headwinds

—
**Christoph Windlin**
Deputy Head
Investment Management,
Vontobel SFA

**Oil markets witnessed a sharp sell-off in November. Contrary to "black gold," "real" gold proved more resilient.**

Oil prices fell to a four-month low towards mid-November. The fact that the conflict between Israel and Hamas has so far not expanded further into the region seems to have pushed concerns about a possible oil shock into the background for many investors. Instead, the focus has shifted to US oil production, which recently reached an all-time high of 13.2 million barrels per day. Rising US oil inventories, mixed US economic data and a slowdown in Chinese refinery activity also weighed on sentiment, while OPEC struggled to stabilize the price.

Not only the energy complex but industrial metals too are struggling. Of the different sectors in the BB commodity index, energy and industrial metals are the most cyclically sensitive. With rising global economic risks and weakness in the manufacturing sector, in particular, these two sectors have been the weakest throughout most of the year (see chart 1).

The other extreme is gold. Gold was unperturbed by the declining war risk premium: it was able to hold on to its October gains and even crossed the psychologically important USD 2,000 per ounce threshold in late November. That is due to a string of weaker-than-expected economic data and easing inflation levels in the world's largest economy, which prompted investors to price in a first Fed interest-rate cut in the first half of 2024. The end of the Fed's tightening cycle and everything that it entails, such as falling real yields and a weaker US dollar, has often been a positive catalyst for gold in the past.

High cyclical risks and falling interest rates are supportive factors for 2024 as well. Central bank buying provides a longer-term tailwind. While central banks were net sellers in the three decades following the collapse of the Bretton Woods system, they started to build up their reserves again after the global financial crisis. This trend has intensified in recent years, particularly after the Western world froze Russia's central bank reserves. According to the World Gold Council, about a quarter of the world's central banks also expect to increase their gold reserves in the coming year (see chart 2).

Going into 2024, we continue to favor gold while remaining underweight the broader commodity universe, which has a higher cyclical sensitivity.

**Commodity sector performance**
Index

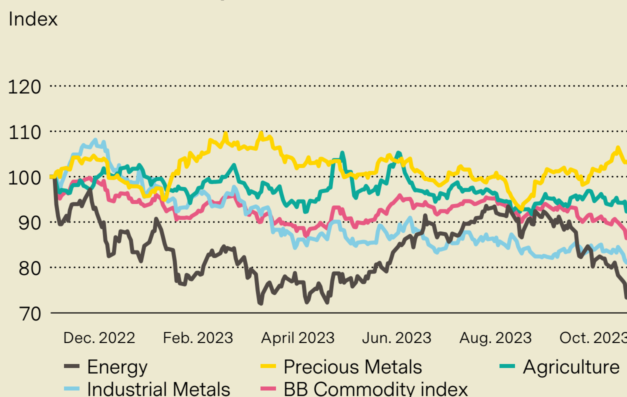
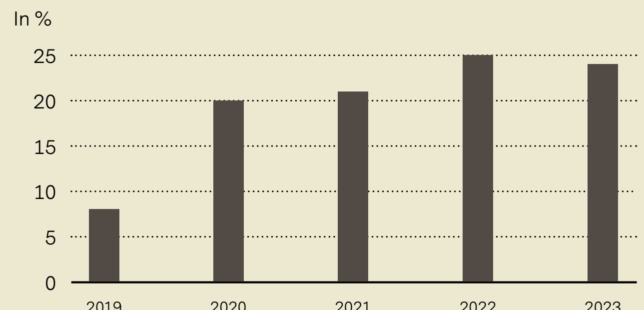



**Chart 2: Nearly a quarter of central banks expect their gold reserves to rise over the next year**
In %




Source: World Gold Council's annual "2023 Central Bank Gold Reserves Survey", Vontobel

# Opportunities for the laggards

—
**Dr. Pieter Jansen**
Chief Investment Strategist,
Vontobel SFA

**The US dollar weakened significantly during November. Some factors that played a role here were indications of the economic slowdown, the sharp drop in US bond yields and improved risk sentiment. There is still some short- and medium-term downside risk for the greenback.**

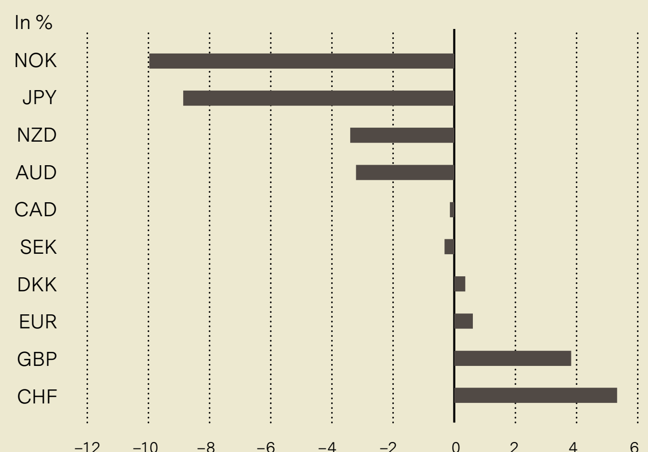
The euro has strengthened against most G10 currencies, with the notable exception of the Swiss franc. Interestingly, the rise of the euro comes despite a lack of particularly favorable news. This resilience may be attributed to a combination of negative economic developments already factored into its price and growing speculation that a downturn in the US economy is coming. These factors have collectively bolstered the euro-dollar currency pair and the euro more broadly. The Fed's medium-term monetary policy trajectory and the market's perception of this trajectory continue to be key drivers for the euro. We expect this influence to persist into next year.

**Troubled Japanese yen**
The Swiss franc stands out as the strongest performer among the G10 currencies this year, maintaining an approximate 5 percent to 6 percent gain against the US dollar in terms of spot return (see chart 2). The Japanese yen has lost nearly 9 percent this year. The weakness of the yen this year is understandable. Of the G10 central banks, the Bank of Japan is the only one not to have increased interest rates this year. This has opened a significant interest rate differential this year that has contributed to the unattractiveness of the yen. However, it may be making a comeback. The Bank of Japan is still contemplating whether to increase rates. This may get harder as other central banks move in the opposite direction. Changing central bank momentum in 2024 and the fact that investors are significantly underweight in the yen offers potential for the currency to recover some of its 2023 losses in the year ahead. In fact, at the start of December the yen could already cover some lost ground.

**Chart 1: US dollar at a crossroads: Turning point ahead?**

Source: Bloomberg, Vontobel; data as of November 24, 2023

**Chart 2: Year-to-date spot returns of G-10 currencies vs US dollar**




Source: Bloomberg, Vontobel SFA

# Economy and financial markets 2021 – 2024

The following list shows the actual values, exchange rates and prices from 2021 to 2022 and consensus forecasts for gross domestic product (GDP), inflation / inflationary expectations, key central bank interest rates, ten-year government bonds, exchange rates, and commodities.

| GDP (IN %) | 2021 | 2022 | CURRENT[1] | 2023 CONSENSUS | 2024 CONSENSUS |
|---|---|---|---|---|---|
| Global (G20) | 5.6 | 2.6 | 3.5 | 2.6 | 2.1 |
| Eurozone | 5.3 | 3.5 | 0.1 | 0.5 | 0.7 |
| USA | 5.9 | 2.1 | 2.9 | 2.3 | 1.0 |
| Japan | 2.3 | 1.1 | 1.2 | 1.7 | 1.0 |
| UK | 8.5 | 4.0 | 0.6 | 0.5 | 0.4 |
| Switzerland | 4.3 | 2.0 | 0.6 | 0.8 | 1.1 |
| Australia | 5.3 | 3.6 | 2.1 | 1.8 | 1.5 |
| China | 8.4 | 3.0 | 4.9 | 5.2 | 4.5 |

| INFLATION | 2021 | 2022 | CURRENT[2] | 2023 CONSENSUS | 2024 CONSENSUS |
|---|---|---|---|---|---|
| Global (G20) | 3.5 | 7.3 | 4.1 | 5.5 | 4.7 |
| Eurozone | 2.6 | 8.4 | 2.9 | 5.6 | 2.7 |
| USA | 4.7 | 8.0 | 3.2 | 4.2 | 2.7 |
| Japan | –0.3 | 2.5 | 3.0 | 3.2 | 2.2 |
| UK | 2.6 | 9.1 | 4.6 | 7.4 | 3.1 |
| Switzerland | 0.6 | 2.9 | 1.7 | 2.2 | 1.6 |
| Australia | 2.9 | 6.6 | 5.4 | 5.6 | 3.4 |
| China | 0.9 | 2.0 | –0.2 | 0.4 | 1.7 |

| KEY INTEREST RATES (IN %) | 2021 | 2022 | CURRENT | CONSENSUS IN 3 MONTHS | CONSENSUS IN 12 MONTHS |
|---|---|---|---|---|---|
| EUR | –0.50 | 2.00 | 4.00 | 3.96 | 3.20 |
| USD | 0.25 | 4.50 | 5.50 | 5.50 | 4.45 |
| JPY | –0.10 | –0.10 | –0.10 | –0.10 | 0.03 |
| GBP | 0.25 | 3.50 | 5.25 | 5.25 | 4.50 |
| CHF | –0.75 | 1.00 | 1.75 | 1.75 | 1.54 |
| AUD | 0.10 | 3.10 | 4.35 | 4.35 | 3.80 |
| CNY | 3.80 | 3.65 | 4.35 | 4.25 | 4.25 |

| GOVERNMENT BOND YIELDS, 10 YEARS (IN %) | 2021 | 2022 | CURRENT | CONSENSUS IN 3 MONTHS | CONSENSUS IN 12 MONTHS |
|---|---|---|---|---|---|
| EUR (Germany) | –0.2 | 2.6 | 2.62 | 2.56 | 2.39 |
| USD | 1.5 | 3.9 | 4.40 | 4.31 | 3.74 |
| JPY | 0.1 | 0.4 | 0.73 | 0.95 | 1.03 |
| GBP | 1.0 | 3.7 | 4.25 | 4.28 | 3.86 |
| CHF | –0.1 | 1.6 | 1.02 | 1.25 | 1.28 |
| AUD | 1.7 | 4.1 | 4.48 | 4.25 | 3.85 |

| FOREIGN EXCHANGE RATES | 2021 | 2022 | CURRENT | CONSENSUS IN 3 MONTHS | CONSENSUS IN 12 MONTHS |
|---|---|---|---|---|---|
| CHF per EUR | 1.04 | 0.99 | 0.96 | 0.97 | 1.00 |
| CHF per USD | 0.91 | 0.94 | 0.88 | 0.90 | 0.90 |
| CHF per 100 JPY | 0.79 | 0.72 | 0.59 | 0.62 | 0.66 |
| CHF per GBP | 1.23 | 1.12 | 1.11 | 1.11 | 1.13 |
| USD per EUR | 1.14 | 1.06 | 1.09 | 1.07 | 1.11 |
| JPY per USD | 115.00 | 130.00 | 150.00 | 145.00 | 136.00 |
| USD per AUD | 0.73 | 0.67 | 0.66 | 0.66 | 0.70 |
| GBP per EUR | 0.84 | 0.88 | 0.87 | 0.88 | 0.88 |
| CNY per USD | 6.37 | 6.91 | 7.15 | 7.23 | 7.00 |

| COMMODITIES | 2021 | 2022 | CURRENT | CONSENSUS IN 3 MONTHS | CONSENSUS IN 12 MONTHS |
|---|---|---|---|---|---|
| Brent crude oil, USD per barrel | 79 | 86 | 81 | 88.75 | 89 |
| Gold, USD per troy ounce | 1,829 | 1,824 | 1,991 | 1,950 | 1,970 |
| Copper, USD per metric ton | 9,720 | 8,372 | 8,354 | 8,500 | 9,000 |

[1] Latest available quarter
[2] Latest available month, G20 data only quarterly
Source: Vontobel, respective statistical offices and central banks; as of October 27, 2023

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