Zuger Kantonalbank

Portfolio

September 2024

Market overview and positioning

The leading economic indicators painted a chiaroscuro picture in August. The US central bank (Fed) remained unmoved and stuck to its restrictive monetary policy. This combination triggered quite a rollercoaster ride for stock markets. Our basis scenario is still unchanged: we remain overweight in equities.

Stock market rollercoaster in August

Just a fortnight ago, equity markets were extremely nervous. At times, US stock market volatility hit levels not seen since the Covid pandemic (see graph). However, the VIX index, which acts as a "fear indicator" by measuring the volatility of markets, declined again rapidly. In a month-on-month comparison, equity market traffic lights are once again set to green.

Yen slump gives investors the jitters

As initially expected by the market, there was no cut in US interest rates in July. But soon after, the leading indicators for the manufacturing sector and the US labour market report ("non-farm payrolls") pointed to an economic slowdown. The increase in key interest rates in Japan further exacerbated the situation and attracted extremely hawkish comments, which led to a depreciation of the yen. Investors duly liquidated significant positions in the Japanese currency. Prior to this they had been borrowing yen for many years, investing the money globally in bonds or equities. This unwinding of positions significantly increased the downward pressure on stock markets.

Policy error to trigger recession?

Weak labour market data just two days after the Fed's meeting gave rise to fears that the US central bank would act too late – just as it had done when inflation spiked.

"The electoral battle in the US will keep markets on edge. Investors continue to focus on expected rate cuts by the Fed."

Alex Müller, Chief Investment Officer

The consequence of this would be a "hard landing" of the economy, in other words a recession in the United States. However, we still do not expect this scenario to materialise. In the middle of the market's jittery phase, positive data on business activities in the US services sector had a calming effect.

Positive effects for securities

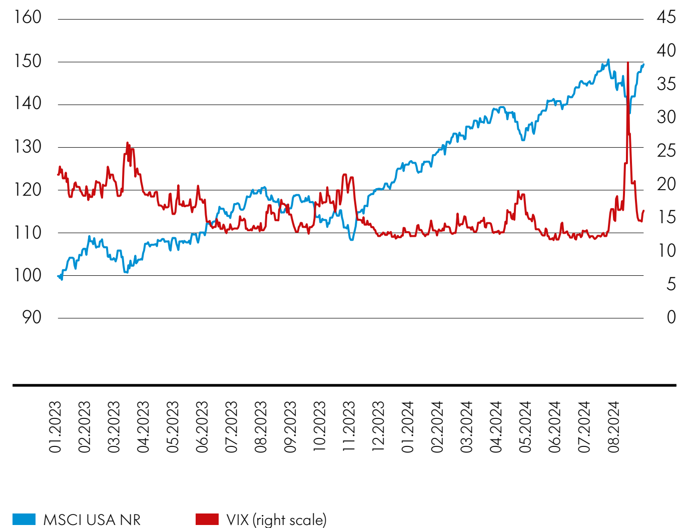
The global economy is likely to grow in the second half of 2024 too. This assumption lies at the heart of our forecasts. We continue to anticipate a gradual slowdown in US economic growth. Together with declining rates of inflation, this is having two positive effects: firstly, the financial markets are now expecting an environment with moderate growth and low rates of inflation. Secondly, capital market interest rates should remain stable or decline slowly, which means bond investments retain their appeal.

Market overview and positioning

Summer meeting in Jackson Hole

At the traditional late summer meeting of central bank representatives in Jackson Hole, Fed Chairman Jerome Powell sketched out the likely pathway of monetary policy over the coming months. His speech contained clear indications that key interest rates in the US would finally be cut in September for the first time in around four and a half years. He revealed that the Fed's focus was likely to lie more on the labour market than on inflation for now – as the US central bank has a dual mandate to deliver not just stable rates of inflation but also full employment. Following the recent rapid rise in the unemployment rate, the latest data points more to an improvement in the situation. Meanwhile, the impending elections are unlikely to prompt the Fed to ac t rashly. Bearing this in mind, we think investors have priced in rapid interest rate cuts to an exaggerated degree.

Development of US equity market and volatility



Source: Zuger Kantonalbank, Bloomberg L.P./DL, MSCI Inc.

New constellation for the US presidential election

Over the last few months, turbulence has also been triggered by a variety of global political events. Be it the assassination attempt on Donald Trump, creeping escalation in the Middle East, or Joe Biden's decision to step down: major breaking headlines never seem to be that far away. The new situation in the US presidential election has so far left financial markets cold. It remains to be seen whether Kamala Harris can continue to ride a wave of success. So far, she has disclosed little about her probable agenda. On 10 September, former President Trump and his new rival will face off in a live TV debate. This exchange of blows will almost certainly have repercussions.

Europe – some good, some bad

Meanwhile, the traffic lights for Europe's economy are changing colour with rather greater frequency. The picture currently looks mixed. Economic momentum had slowed by the end of the second quarter. Where the manufacturing sector is concerned, the leading indicators in July pointed to persistent weakness. The leading indicators also deteriorated in Germany. On the other hand, households in the Eurozone are in good shape. They have not gone through all the savings accumulated during the pandemic, and the savings rate remains high at more than 15%. By contrast, the savings rate in the US is below pre-pandemic levels. We are expecting consumer spending in the Eurozone to pick up against a backdrop of rising real incomes and a weakening of the propensity to save.

China still not firing

Over in China, a strong first quarter (GDP growth in excess of 6% in a quarter-on-quarter comparison) was followed by a sharp slowdown in the second quarter (GDP growth of 3%). The leading indicators published in July still do not point to any recovery. The growth target set by the political leadership in Beijing is therefore in jeopardy. Structural excess capacity and an economic programme with a pronounced supply-side focus are exerting persistent deflationary pressure. Export prices are falling, and service sector inflation is only just in positive territory. This weakness is rippling out as far as Europe.

Swiss fixed-income investments offer barely any return

Ever since the start of the year, investors in Swiss bonds have benefited from a combination of significantly lower inflation rates and inflation forecasts, lower key interest rates, and a flight to Swiss interest-bearing securities. This trend has become further accentuated in recent weeks. The Swiss franc has strengthened in step with the rise in general uncertainty. As a result, the likelihood of the Swiss National Bank (SNB) pushing through a further rate cut in September has also risen.

What does this mean for investors?

Mixed portfolios offer protection

The events of the last few weeks have once again brought it home to investors that a broadly diversified portfolio offers decent protection at times of market turbulence. Attractive current yields on bonds have cushioned some of the losses suffered during the equity market sell-off. The government bonds of developed economies, as well as bonds denominated in Swiss francs, have been highly sought after recently. This has resulted in their prices rising and their yields falling (the two always having an inverse relationship).

Taking profits on bonds

Capital market interest rates declined worldwide due to growth fears. The yield on 10-year US government bonds fell back to 3.8%. Whereas Fed members are now expecting just one rate cut in 2024, the financial markets are anticipating four. Against this backdrop, we believe that the decline in interest rates has been excessive and that the market has priced in too much. We are taking profits on these positions and scaling back our exposure to US government bonds.

Scenario intact for US equities

In the US, growth stocks have experienced heavy corrections as a result of the sell-off. In addition to the factors cited above, a seasonal weak phase has intensified this consolidation process. However, the results unveiled by major cloud providers such as Microsoft, Alphabet, Amazon, and Meta support our assumption that the "Artificial Intelligence (AI)" investment theme will remain prominent. The latest quarterly figures released by the tech giants point to persistent investment in infrastructure and data centres, with the sums being channelled into this area set to rise further in 2025. This is the key growth driver for the sector as a whole.

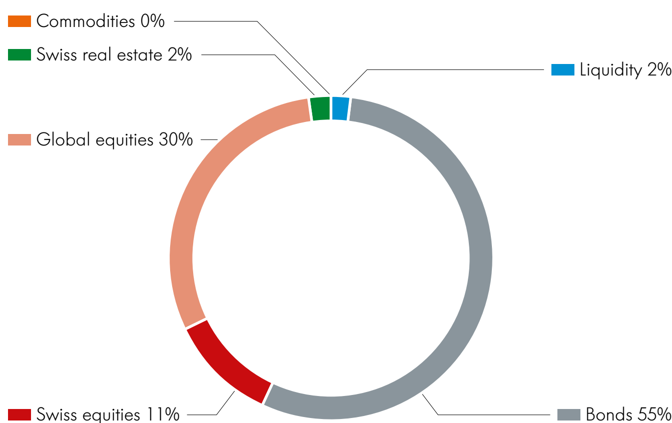
Europe – waiting for improvement

The economic environment in Europe remains contradictory. However, many factors suggest a slow recovery is likely. We are therefore maintaining our overweighting of European equities. Consumer confidence continues to improve. In-depth analysis of European equities provides grounds for optimism. For example, valuations are at attractive levels when compared with the US. What's more, corporate earnings momentum has improved further, which is likewise exerting a positive effect.

Switzerland in a good place

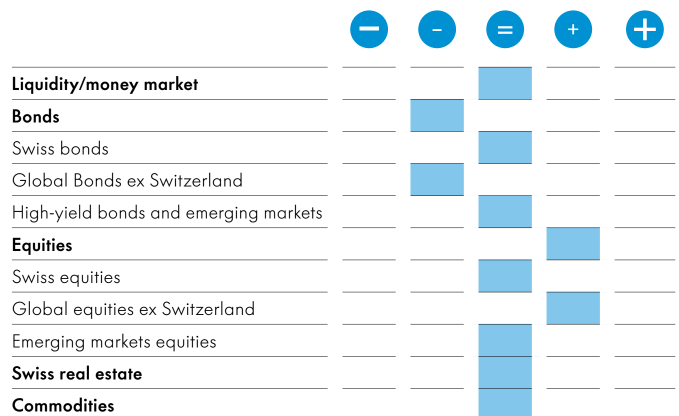
The Swiss corporate reporting season has delivered better figures than investors had been anticipating. Business outlooks for the second half of the year look positive. Many companies are expecting the economic situation to improve, which would lead to higher sales and earnings. The expected sales development of companies (excluding banks and insurers) for the next 12 months is now positive for the first time in six quarters. This is a factor that should support equity prices.

Strategic positioning (based on balanced mandate)



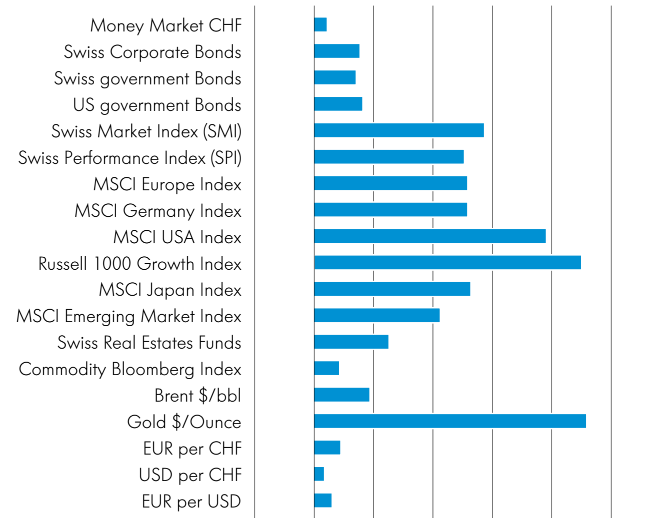
Source: Zuger Kantonalbank

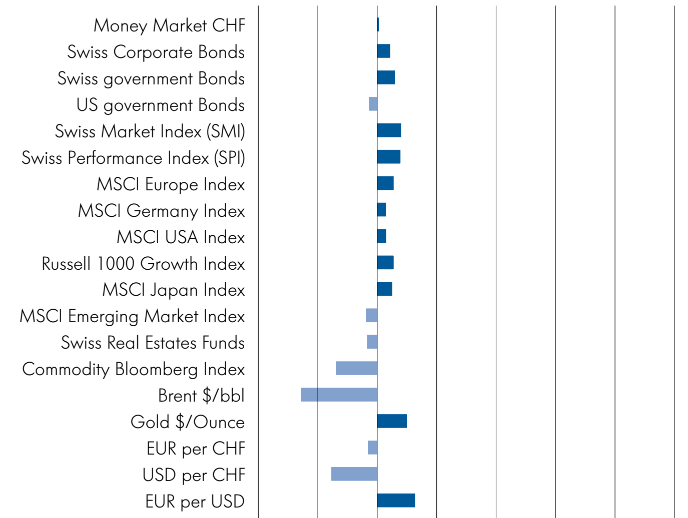
Tactical positioning



	−−	−	=	+	++
Liquidity/money market			■		
Bonds		■			
Swiss bonds			■		
Global Bonds ex Switzerland		■			
High-yield bonds and emerging markets			■		
Equities				■	
Swiss equities			■		
Global equities ex Switzerland				■	
Emerging markets equities			■		
Swiss real estate			■		
Commodities			■		

Market data (exchanges & markets)





Source: Zuger Kantonalbank, Bloomberg L.P., MSCI Inc., SIX Index AG, Frank Russell Company

Swiss equities SMI (from start of the year to 23.08.2024)

Lonza 59,4% / CHF 559.4	**Swiss Re** 32,3% / CHF 117.85	**ABB** 31,6% / CHF 48.08	**Holcim** 27,7% / CHF 81.42	**Alcon** 24,8% / CHF 81.66
Givaudan 22,8% / CHF 4207	**Novartis** 22,7% / CHF 100.4	**Swiss Life** 22,1% / CHF 677.4	**Roche** 20,6% / CHF 283.2	**Richemont** 19% / CHF 137.7
Zurich 17,7% / CHF 488.8	**Sonova** 10,3% / CHF 298.2	**Swisscom** 9,9% / CHF 534	**Partners Group** 4,6% / CHF 1229	**UBS** 3,9% / CHF 26.43
Geberit 1,6% / CHF 533.6	**Sika** –1,3% / CHF 266.9	**Logitech** –2,3% / CHF 77.94	**Nestle** –5,2% / CHF 89.54	**Kühne&Nagel** –5,8% / CHF 262.1

Source: SIX Index AG, Zuger Kantonalbank

Do you have any questions or thoughts on the current portfolio?

Contact us by email (alex.mueller@zugerkb.ch) or call us on 041 709 11 11.

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