Review & outlook

June 2024

Review of 2024

Positive start to the year

2024 got off to a good start for equity investors. US economic data raised hopes of a soft landing, while inflation remained stable. In Switzerland, declining rates of inflation removed some of the heat from the foreign exchange market at an early stage. Economic data from the US remained predominantly positive, while in Europe the process of normalisation continued at a low level. We positioned ourselves for a constructive growth environment with falling rates of inflation, and increased equity exposure accordingly in the first of the year.

Tough global growth environment

The global economy has grown at a modest rate in 2024 to date. The International Monetary Fund (IMF) is expecting the global economy to maintain a consistent growth rate of 3.2% in 2024 and 2025, which is broadly in line with growth in 2023. Even back then, the IMF was expecting sluggish development: Its forecast is below the historical average of 3.8% recorded over the period 2000–2019. We are therefore expecting neither a severe recession nor impressive growth in 2024.

"The first half of 2024 delivered solid returns for equity investors in particular. For bond investments, rising interest rates were a mixed blessing. US technology stocks continued to dominate global equity markets."

Alex Müller, Chief Investment Officer

US economic momentum slows

In the US, the key growth indicators weakened somewhat at the end of the first quarter. This pointed to the US economy enjoying less momentum as it moved into the second quarter. The weakening of the services sector and a decline in manufacturing provided grounds for concern. However, the real growth data continued to point to a "soft landing" scenario. Both government spending and consumer expenditure played a supportive role. The overall environment therefore remained largely constructive.

Inflation delivers negative short-term surprise – no trend reversal

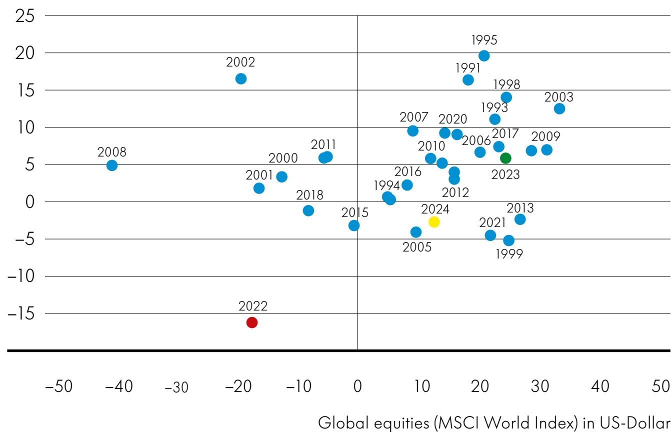
The financial markets were only occasionally unsettled in the first half of the year. The dynamism of inflation accelerated briefly. Faced with both higher oil prices and rising interest rates, this inevitably prompted a bout of equity market weakness. In our view, the latest data exaggerated the true inflation trend, primarily due to effects in the area of rental price development. We therefore adhered to our existing positioning.

Volatile interest rate expectations

Given the volatility of inflationary developments, the eyes of the investor community remained firmly focused on central banks, particularly the US Fed. Its members anticipated rates being cut in three steps in 2024. The capital market dynamically adjusted its expectations to inflationary developments. Lower inflation figures and weakening economic indicators confirmed our assumption that US interest rates had peaked and were no longer rising. Meanwhile, inflationary momentum in the Eurozone pointed to the European Central Bank (ECB) cutting interest rates even before the Fed. But it was actually the Swiss National Bank (SNB) that was first to act.

Performance equities vs. bonds (in percent)

Global bonds in US-Dollar



Source: Zuger Kantonalbank, MSCI

SNB the "first mover"

In Switzerland, inflation data surprised on the positive side right at the start of 2024. The inflation rate amounted to 1.3% in January, within the SNB's target bandwidth. This pleased the markets, which had expected a rate of 1.7%. The strong franc had the effect of mitigating inflation imported through higher commodity prices. This allowed the SNB to reduce its key interest rate by 0.25 percentage points to 1.5% in March. In June it acted again, cutting the key rate by a further 25 basis points to the current level of 1.25%. These steps were justified by substantially lower inflation forecasts for both 2024 and 2025. According to the SNB, Swiss inflation should work out around 1.3% for 2024 before declining to 1.1% for 2025.

As the SNB has now already acted twice, it is likely that the guardians of Swiss monetary policy will adopt a wait-and-see stance going forward, as long as Switzerland avoids falling into a severe recession.

Weaker franc helps investors

After the SNB's first rate cut, the upward pressure on the Swiss currency declined significantly. Supported by higher capital market interest rates in America, the US dollar exhibited strength. The euro too gained some ground. This should buoy the spirits of export-oriented Swiss companies. However, the slight weakening of the franc was just a drop in the ocean for the export industry: the economic development of the Eurozone was a more important factor. With elections in Europe, a rate cut from the ECB and political uncertainties, the Swiss franc strengthened again slightly towards the end of the period under review, with the SNB's second interest rate cut doing little to slow the countermovement.

Glimmers of hope for Europe's economy

The economic picture brightened in Europe. Following a gloomy period in which growth stagnated for five successive quarters, signs of a recovery became more apparent. The leading economic indicators exceeded the growth threshold for the first time since October 2023. Thanks to declining rates of inflation, the ECB was able to cut interest rates in June.

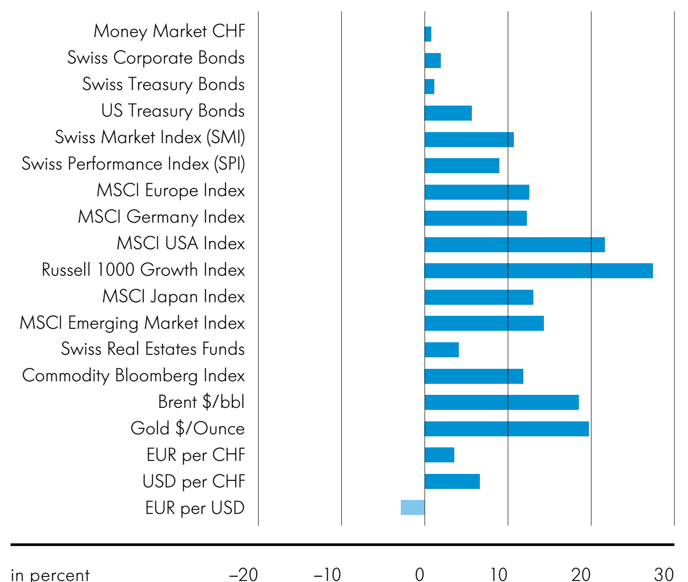
Germany shows signs of life

Whereas many European countries experienced a stabilisation of their economies in the first half of the year, Germany continued to struggle to start with. However, signs of hope emerged in the second quarter: The ifo Business Climate Index improved for the third month running in April, with companies becoming more satisfied with business development and their expectations brightening. This pointed to a slight uptick in overall growth, supported by consumer spending.

No further escalation in the Middle East

It seemed as if the world's major conflicts would have barely any impact on financial markets. With the US having approved a package of armaments for Ukraine with a value of some USD 61 billion, investors pushed the risk of an even stronger Russian advance to the backs of their minds. In the Middle East, Iran's retaliatory attack on Israel proved

Return Asset Class (in CHF) year to date (as of 28.06.2024)



Source: Zuger Kantonalbank, Bloomberg LP, MSCI, Six Index, Frank Russell Company

ineffective against efficient defences. The situation remained critical, but without escalating at any point. Towards the end of the period under review, hopes for a temporary ceasefire in Gaza alternated with fears of an escalation in Lebanon. Against this backdrop, the development of crude oil prices was marked by volatility. The threat of a wider regional conflagration nevertheless appears to have receded for now.

Constructive environment for equities

Global economic growth can be expected to be muted in the second half of the year too, but should remain positive. This is our basic assumption, which is supported by analysis of the leading indicators. As expected, the US economy is cooling slowly. The economic indicators in June provide support for this view too. We are expecting this to continue to support the prices of riskier investments such as equities. Together with declining ates of inflation, this has a two-fold positive effect: Firstly, it is fuelling financial expectations of a "Goldilocks" scenario – i.e. an environment in which the growth of the global economy is neither too high nor too low and inflation rates remain modest. Secondly, capital market interest rates are also likely to remain stable – or even come down – in such an environment, which is positive for fixed income investments.

> "2024 continues to present opportunities for mixed investment portfolios: Government bonds offer protection against the economic downturn, while equities are benefiting from a persistently robust economy and rising corporate earnings. After the first televised presidential debate between Joe Biden and Donald Trump, attention has already shifted to the US elections."
>
> Alex Müller, Chief Investment Officer

Consumer spending as prop

Various factors point to the unlikelihood of a severe downturn. The economy continues to gain support from strong balance sheets in the private sector. Savings rates remain high in Europe, while US households still have hefty cash holdings. The strong labour market is underpinning consumer confidence. The wage increases seen over the last two years provide a strong base – real wages are rising due to falling rates of inflation. That said, consumers can be expected to become more circumspect. Rising credit costs, more rigorous lending guidelines, and higher energy prices are eroding their financial flexibility.

Artificial intelligence as booster

Even in the first half of 2024, the possibilities of artificial intelligence (AI) were providing an unexpectedly strong boost to equity markets. Chip manufacturer Nvidia unveiled stunning results in 2023, and has since been a driving force for global indices as well as the US stock market. Other companies from the semiconductor sector as well as cloud service providers should likewise benefit from the enormous potential of AI in the future. US technology stocks were the key driver of equity market performance in 2023.

Geopolitical situation remains tense

"Political markets are short-lived" is old stock market adage. In other words, markets typically recover quickly after dislocations caused by political events. But the current geopolitical conflicts look to be more complex than their predecessors, and are having a deeper impact. Domestic politics will also be a focus of financial markets in 2024. In the Eurozone, the elections to the European Parliament showed the direction the political wind is blowing. A striking feature here was the slump in support among the electoral base for incumbent governments in Germany and France. At the same time, the major source of stimulus for global export activity – China – continues to falter. In Europe, the tremors triggered by the European Parliament elections will continue to preoccupy us in the second half of the year.

Will the US elections prove a turning point?

The impending elections in the US could recalibrate the geopolitical priorities of this superpower given the major conflicts in the Middle East and Ukraine, in which the US is also military involved, albeit indirectly. The markets are still viewing the upcoming election as a straight fight between Donald Trump and Joe Biden for the time being, but after the first televised debate between the two, a shift in this scenario appears feasible. This could trigger significant unrest in the markets.

A look at Switzerland

Switzerland has not been immune to international developments. Here too, the leading economic indicators are pointing to a persistent weak phase. This, coupled with the low level of inflation, formed the foundation for the SNB's two interest rate cuts. The fear that higher rents and an increase in administered prices such as VAT could

prompt another slight rise in the rate of inflation appears to have receded into the background.

Mixed portfolios have potential

Equity investors were clearly compensated for the risk they took on in 2023, albeit with a fair amount of accompanying volatility. By contrast, the environment remained challenging for bonds in the first half of 2024 too. In almost no segment of the fixed-income market could positive returns be achieved if exchange-rate fluctuations were being hedged. We remain convinced that the environment of declining rates of inflation and subdued growth will support mixed portfolios.

US equities expensive but still supported

We are recommending an overweighting of US equities once again as the second half of the year gets underway: The US stock market can be expected to remain popular with investors, even if it doesn't look cheap. Earnings expectations are ambitious in the technology sector in particular; the upcoming reporting season should once again be the litmus test.

Exploit positive momentum

We have continued to reduce our exposure in the area of international government bonds, specifically US bonds. These fixed-income investments benefited from falls in inflation rates and the anticipated economic slowdown at the end of 2023. Their appeal has now diminished somewhat. However, we remain convinced of the value of government bonds as a diversifying portfolio element.

Swiss franc a positive

The Swiss stock market has risen over the year to date, but without yet coming close to the kind of performance levels delivered by its European and American counterparts. The main culprits for this underperformance are the defensive heavyweights of the Swiss market, which remain out of favour with investors. Nevertheless, the prospects look bright for Swiss equities in the second half of 2024. Sales and earnings expectations for Swiss corporate have risen, and positive economic momentum is building. This tallies with the positive outlooks of many companies. What's more, the Swiss equity market is modestly valued, which is a good starting point.

European equities

European equities too should be overweighted in portfolios. The economic headwinds in the EU have weakened further after five disappointing quarters, and the manufacturing sector is showing tentative signs of life even in Germany. Consumer confidence is on the rise, and real wages are rising against a backdrop of declining rates of inflation. Saving rates can be expected to decline.

So our advice for the second half of the year is as follows: Remain invested! A robust and broadly diversified investment strategy is the best recipe for success.

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