HYPOSWISS ADVISORS

# Review & Outlook
# April 2024

Review and Outlook

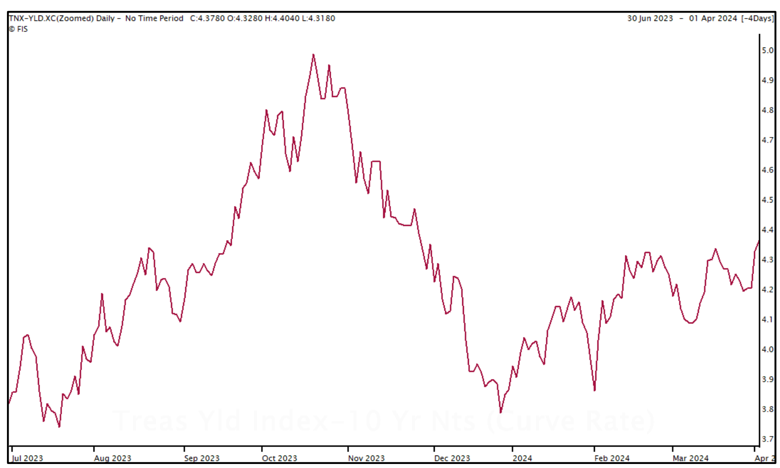


## Lessons Learned:

As the first quarter draws to a close, we propose to summarize below some of the lessons of this period.

***First lesson***: inflation no longer (really) matters for risky assets.

After the spectacular fall in inflation indices in the second half of 2023, the indicators evolved unfavorably in 2024, on both sides of the Atlantic. This led financial markets to revise their rate-cutting expectations and put upward pressure on long yields, both real and nominal. Credit spreads and equity markets, on the other hand, remained unaffected by this development, continuing the positive trend that began in October 2023.




*10-Year US Treasury Yield, from 30.06.2023 to 01.04.2024,*
*Source: MarketMap FIS*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***Second lesson***: the major central banks have resolutely adopted a more balanced attitude to the risk of inflation.

We are no longer in 2022-2023, a period during which no risk could be taken by monetary authorities in the face of rising prices. Communication from the major central banks, led by the Federal Reserve, has become much more balanced. The US central bank is now concerned with the "employment" part of its mandate, and explicitly states that the objective of returning inflation to 2% is a longer-term one. The European Central Bank, meanwhile, is doing nothing to discourage expectations of a May/June rate cut. It also seems that the rate cut initiated by the Swiss National Bank is not insignificant. Although justified by better inflation fundamentals than elsewhere, it would probably not have taken place if the Swiss monetary authorities were not convinced that a global easing cycle would soon be underway. Finally, Japan's central bank is going against the tide by abandoning its policy of negative interest rates but is taking care in its communication to make it clear that this is not the start of a tightening process, but rather a limited adjustment.

***Lesson three***: global economic activity remains resilient despite accumulated monetary tightening.

Activity levels diverge widely by sector and geography, with several sectors showing weakness. Even so, in global terms, there is no doubt that the slowdown many expected in response to restrictive monetary policies has not taken place. Plausible explanations include generally accommodating fiscal policies and the resumption of investment by a private sector whose confidence levels are rising again.

***Lesson four***: corporate margins are not normalizing downwards but are continuing to expand overall.

Overall margins have (for a long time) been strongly driven upwards by the technology sector, which for the past 12 months has also benefited from favorable (and probably sustainable) tailwinds from investment in artificial intelligence. Recently, the maintenance of high margins is a more general phenomenon, forcing investors to revise upwards the earnings prospects of listed companies.

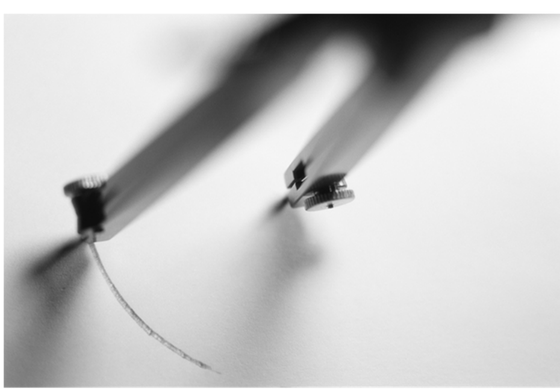
***Lesson five***: gold is proving less sensitive to interest rates than expected.

In recent years, gold had shown an inverse relationship with interest rates, often acting like a bond asset. This relationship was broken during the quarter, as the metal reached all-time highs while rates were rising. We see two possible explanations for this: purchases by less price-sensitive central banks as part of their reserve diversification, and the mistrust of some investors in the face of continuing growth in global public debt.

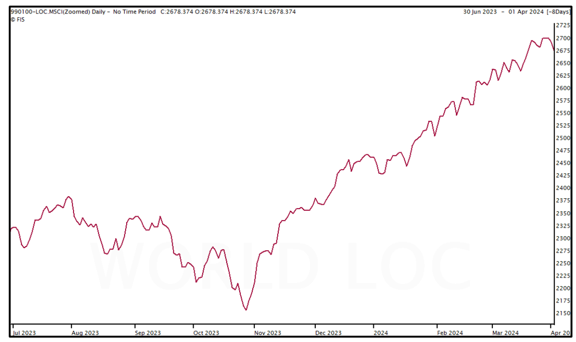
## Investment Outlook

The combination of higher bond yields and surprisingly resilient corporate margins / earnings is at the core of explaining asset market returns for Q1 2024.

- In equities markets, the US index (S&P 500) gained 10.6%. MSCI Europe gained 7.6% and emerging market equities are showing a return of only 2.4%. Encouragingly, the Q1 equity rally was not led only by a small number of mega caps lech. We are witnessing a broadening of the participation in the rally, which we see as condition for its sustainability.
- Returns from sovereign/high grade bonds have suffered from the uptrend in yield and are negative. High yield credit achieved a steady performance (1,6%) as this asset class benefitted from the strong position of the corporate sector and has not yet seen any impact from rising defaults.
- On the currencies side, the two notable moves were the decline in the CHF and in the JPY. For the Swiss currency, the move came as a reaction to favorable inflation data (+1% year on year) and a rate cut and is desired by the authorities. For the Japanese currency, it came despite the first-rate hike in 17 years and is running contrary to the direction desired by the authorities.



Gold rallied to all-time highs, reaching USD 2350 per ounce in early April. This move is notable because it occurred in the absence of the usual drivers (the USD is not weak, real rates are high and rising).



*MSCI World Index, from 30.06.2023 to 01.04.2024,*
*Source: MarketMap FIS*

In order to design an investment outlook for the remainder of 2024 we are required to answer the following questions:

- Will inflation moderate in line with central banks forecast, allowing for a rate cut cycle to begin around June?
- Are corporate margins likely to remain stable?
- Can risk assets continue to absorb higher yields and higher commodities prices?

We sketch out below our tentative answers:

- The Federal Reserve is explicitly acknowledging it may cut rates even if the labor market shows strength. It is also stressing that the 2% inflation objective should be achieved "over time". Consequently, the bar is intentionally low and rate cuts are unlikely to be derailed by inflation data between now and the summer.
- Our expectation, in line with the consensus, is for US margins to through in Q1 and then rebound later this year.

- Higher yields and higher commodities prices that are driven by a better cyclical behavior of the world economy should not prove, at this stage, a lasting threat to the valuations of equities.

From an investment management standpoint:

- The portfolios under our supervision have absorbed the increase in yields and have benefitted from the equity rally of Q1. They are ending the quarter with appreciable gains.
- Bonds remain a core part of allocation for yield and risk diversification purposes. We have however refrained from adding to this asset class in Q1 (despite rising yields) because of the impact of inverted yield curves.
- In term of geographical allocation, our portfolios remain overweight in developed markets and are sharply underweight in China related assets. In terms of sectors, we maintain a well-diversified approach recognizing the significant valuation dispersion among financial assets. We are encouraged by the broadening of performance beyond the mega cap tech companies and are positioned for this trend to continue into 2024. We also have reorganized equity holdings to achieve direct exposure to the beneficiaries of the artificial intelligence investment boom.

**Daniel Jakobovits**
**Head of Investments**

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