BELVÉDÈRE
Asset Management

July 2023

HALF-TERM

MARKET INSIGHTS

HALF-TERM

It's the 2023 market half-term – time to take stock. Results are positive almost without fail. Following a substantial setback in the wake of the US banking sector turmoil in March, equity markets resumed the year's initial upward trend in the second quarter. The leader among major markets is Japan, with a gain of more than 22% (in yen) in the first six months. The USA (S&P 500 +16.9%) and the euro zone (EuroStoxx +15.6%) also made significant gains. The Swiss market (SPI +8.2%) lagged somewhat behind, as its composition meant that it benefited less from the cyclical recovery at the beginning of the year and from the subsequent technology boom. One notable exception to the positive overall picture was the Chinese stock market. Having risen significantly from the end of 2022 up to February (Hang Seng Index +50%, Shanghai Shenzhen Index +40%) due to the reopening of the economy, it has been evidently struggling and losing ground continuously ever since. After a highly promising start into the year, it soon became apparent that growth is neither a given nor quite limitless in China.

The surprising thing about equity markets this year to date is not that they have recovered, albeit the sheer extent was quite unexpected. What is surprising is that – apart from the brief dip during the aforementioned banking crisis – markets have proven extraordinarily robust. Most remarkably, monetary easing in the US – which was still reckoned with in April and presumed one of the pillars of the stock market boom – has been completely priced out without leaving the slightest dent on equity markets. Even the debt ceiling debate in the US – generally a reliable driver of volatility – failed to unsettle the markets. This positive trend is also reflected in fixed-income markets. Central banks continued their interest rate hikes. Long-term interest rates, notably in Switzerland, have fallen on balance (falling interest rates = rising bond prices) despite – or perhaps precisely because of – this, as it could indicate that fixed-income markets are expecting a further slowdown in growth. Or indeed a recession?

Which brings us to the outlook for the second half of the year. What can be expected from financial markets by the end of the year? As mentioned here a month ago, opportunities and risks balance each other out. No change there. A recession has not yet materialised, but it is still one of the risks for markets. Probably not for 2023, but perhaps going into the next year. Interest rates should not pose any headwinds for equity markets. The key interest rate cycle is about to peak out and we do not expect a marked increase at the long end either. At the same time, there is a lack of driving forces for equities. High valuations, especially in the USA, speak against a further rise. Therefore, the most likely scenario for the time being seems to be a consolidation at current levels. From September onwards, the mist might clear around the question where the journey is heading. The focus will be on inflation, the central banks' response, corporate results and the previously raised topic of a recession. Then it will become plain which will prevail – the opportunities or the risks.

Th. Heller

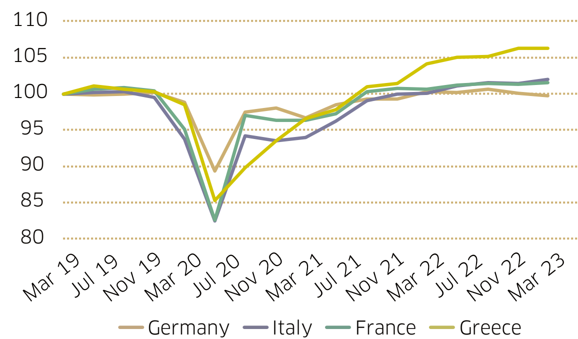
Thomas Heller
CIO, Belvédère Asset Management

ECONOMY

Relative to expectations, the US economy was the best performer in the second quarter. To everyone's surprise, the regional banks crisis left hardly any negative marks on the economy as a whole. Supported by private consumption and robust investments, the economy remained on the growth path of 2%. The euro zone slipped just into a technical recession, i.e. the economy contracted by 0.1% in both the final quarter of 2022 and the first quarter of 2023. This was mostly owed to Germany. Countries such as Italy, France or Greece, on the other hand, performed better and their economies did not shrink (see chart). China certainly disappointed the most. After a successful start into the year thanks to the reopening of the economy, the momentum wore off considerably in the second quarter. Industry and exports were weaker, and consumer sentiment withered. It would seem that the issues emanating from the real estate sector are having longer-lasting effects.

We expect the US economy to continue to perform well. However, the risks will grow towards the end of the year as the savings accumulated during the pandemic dry up. For the euro zone, we expect a slight growth driven by services.

GDP performance comparison (indexed)

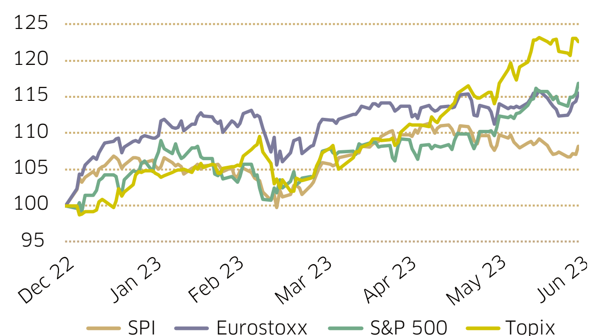


Source: Bloomberg, BAM

EQUITIES

Equity market sentiment remained bright in the last quarter, despite discussions about the US debt ceiling, priced-out interest rate cuts and fairly high equity valuations. On a regional level, the US (S&P 500 +8.7% in the second quarter) made up for its shortfall from the first quarter and outperformed euro zone equities (+3.2%). US markets were under the spell of the AI fantasy heralded by chip designer Nvidia on 24th May. Yet, the Japanese market was the performance champion, driven by low interest rates, improved corporate results and the inflow of money from foreign investors. On the flipside, the yen lost about 10% against the Swiss franc in the second quarter, wiping out much of the market performance for foreign investors. Swiss equities were in low demand amid markets driven by tech fantasy (SPI +2.2%), while small-cap stocks remained virtually stagnant (+0.10%). After the surprisingly favourable first half-term, the question is can this positive trend last. Supporting arguments include the generally intact macro, rising earnings expectations and the fact that many investors' equities exposure is still quite cautious. Relatively high valuations and sticky inflation, notably in the US, speak against it, though, as they could prolong the cycle of interest rate hikes. We see opportunities and risks roughly balancing each other out at the moment.

Equity markets year to date (indexed, in local currency)



Source: Bloomberg, BAM

INTEREST RATES

In the past quarter, the European Central Bank raised its key interest rates twice, the US Federal Reserve and the Swiss National Bank took one more step each. Neither of the three central banks would rule out further rate hikes. The reason being that the core rate of inflation is declining less quickly than expected. We expect central banks to raise interest rates one more time, but then take a break to see the effects of the higher interest rates on the economy, which generally occurs at a lag.

At the long end, interest rates rose slightly in the second quarter in the USA and the euro zone, but without exceeding the respective historic peaks. We expect no change there. In Switzerland, on the other hand, interest rates fell by 25 basis points to less than 1%. The high demand for Swiss government bonds was mostly due to the more favourable inflation trend in Switzerland compared to other countries, and the fact that the debt ceiling was reached in the USA.

Asset class	Appraisal	Commentary
Bonds Government bonds Corporate bonds		The peak in key interest rates is imminent, but cuts before the end of the year are unrealistic. Long-term interest rates are likely to continue to move sideways under spells of volatility.
Equities Switzerland Euro zone United Kingdom US Emerging markets		Following the strong rally in the first half of the year, the risk/reward ratio of equities is balanced. Prices might continue to rise, but the risk of a major setback is increasing alongside.
Real Estate Switzerland		Further interest rate hikes are holding back price increases. However, valuations are still comparatively interesting by historical standards.
Commodities Oil Gold		China's weakening economy is weighing on the oil price. The gold price still lacks drivers.

unattractive — attractive ■ Current asset class assessment

Imprint
© BAM 2023. All rights reserved | Publisher: Belvédère Asset Management AG | Authors: Thomas Heller, Matthias Wullschleger | Stop press: 30.6.2023

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Belvédère Asset Management AG | Part of Fundamenta Group
info@belvedere-am.com | www.belvedere-am.com