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DO WE EVEN NEED ANALYSTS?

MARKET INSIGHTS

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The course for US interest rates in 2023 seemed cast in stone. The Federal Reserve (Fed) would end its rate hike cycle later this year and at the long end, yields would rise neither substantially nor sustainably above the 2022 peaks. While the former came to pass as predicted, the latter was true only up to the summer. At the end of October, ten-year US government bonds yields rose above 5% for the first time since 2007. What caused the rise is not easy to see. Can artificial intelligence help here? Could it even make financial analysts dispensable? Let's ask ChatGPT: What were the decisive factors that led to the recent rise in interest rates?

By way of introduction, ChatGPT says: "To determine the decisive factors for the rise in interest rates [...] would require a detailed analysis of the current market situation [...]." This is exactly why I asked ChatGPT! Anyway, these were the five explanations ChatGPT produced – and what I think of them:

"Prospect of tighter monetary policy by the Fed": For a brief moment, another rate hike seemed possible, but that didn't last long. The argument is only valid to a limited extent, if at all.

"Rising inflation expectations": They have indeed risen somewhat, but do not justify the extent of the actual interest rate increase.

"Budget deficit/fiscal policy": ChatGPT has a point here. While the deficit/debt situation in the US is not new, the discussion about it has intensified again lately. The greater supply of US government bonds is pushing prices down and, in turn, the yields up.

"Rising commodity prices": The associated inflation concerns have favoured the rise in interest rates. However, core inflation, which is more relevant for central banks and excludes energy and food prices, is not directly affected by this and is therefore not a sustainable interest rate driver.

"International developments": A pretty vague argument. In relation to the current developments in the Middle East, this should rather have led to a flight into safe investments, such as US Treasuries. As was recently observed with gold. That is not an argument for rising interest rates.

The rise in interest rates resulted from a correlation of various factors. The insights gained from ChatGPT are modest and have not affected our initial market assessment in any way: The Fed's interest rate hike cycle is over, and we expect to see first interest rate cuts around the middle of next year. At the long end, interest rates are unlikely to rise above the current high levels, but rather ease somewhat in view of the weakening growth momentum and declining inflation.

In conclusion, ChatGPT says: "To obtain more accurate information on current market developments, it would be prudent to consult with [...] professional financial analysts." So the role of financial analysts does not seem to be quite redundant yet.

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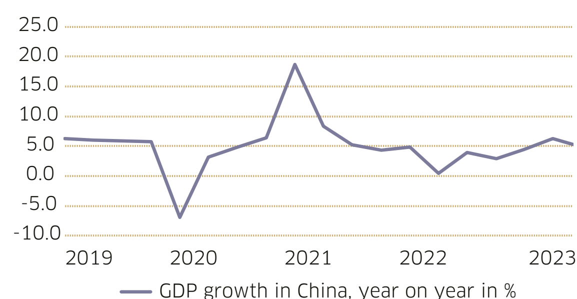
ECONOMY

To everyone's surprise, the US economy grew by a staggering 4.9% in the third quarter (annualised, quarter on quarter). The main drivers were private consumption, exports and government spending. Consumers continue to benefit from the robust labour market and savings accumulated during the pandemic. The Euro zone looks less good. Industry is in a sticky downturn, as manifested by the Purchasing Managers' Index level of only 43 points. Private consumption is also losing strength now that the pent-up demand for tourism has levelled off. China has likely passed the lowest point of the downturn. The economy grew by 4.9% in the third quarter compared to the prior-year period, which was stronger than expected. Private consumption and the industrial sector also performed better. The real estate sector, on the other hand, has not yet recovered.

Outlook: The US economy will not be able to maintain the current high momentum. We expect to see a soft landing. Recession remains a risk, but not the most likely scenario. The euro zone is facing a difficult winter. After that, there is a chance of a recovery in manufacturing and an improvement in private consumption provided that inflation continues to recede. China's economy should improve over the coming months, because of continued state stimulus programmes, currently with an increase in the budget deficit.

China: growth is stabilising



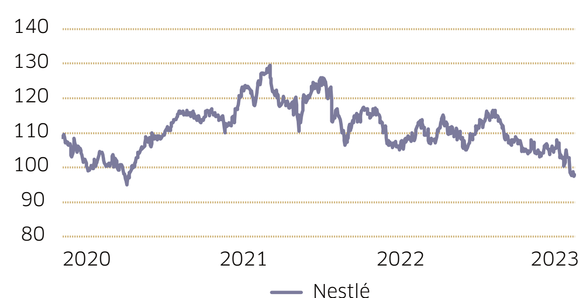
Source: Bloomberg, BAM

EQUITIES

International stock markets were predominantly losing ground in October. The S&P 500 corrected by around 3%, the Dax by almost 4% and the SPI lost more than 5%. There was a wide array of reasons for the poor performance, ranging from interest rate fears to poor corporate results to concerns about negative effects of the new fat reduction pills (GLP-1) produced by Novo Nordisk and Eli Lilly. One of the companies that suffered was Nestlé. The stock fell more than 15% since its high for the year in May. Investors fear that demand for food might decline. We believe these concerns are exaggerated and we see an opportunity to build an exposure in Nestlé. In addition, a valuation correction is taking place in highly priced stocks that failed to meet earnings expectations. Examples include Lonza or the entire luxury goods sector.

Stock markets are likely to remain on edge throughout the third-quarter reporting cycle. Until such time, we cannot rule out that indices will plunge deeper yet. After that, a recovery is likely as interest rates will have peaked out and seasonal effects may take hold. We continue to focus on high-quality stocks with solid balance sheets and low debt.

Nestlé under pressure



Source: Bloomberg, BAM

INTEREST RATES

The upward pressure on interest rates continued in October. Yields on ten-year US government bonds briefly exceeded even the 5% mark. A growing number market participants are finding this level attractive. Given the US economy has probably seen its strongest growth and inflation continues to decline, we tend to agree that interest rates have reached a peak.

After ten consecutive interest rate hikes, the European Central Bank (ECB) refrained from raising rates again at its October meeting. In her outlook, ECB President Lagarde emphasised the downside risks for the euro zone economy. We expect the ECB to leave key rates unchanged for a longer period. The same goes for the US. The Fed will not cut rates before it is sure that inflation has been defeated. The point is to minimise the risk of inflation flaring up again, as was the case in the 1970s, for instance. On the other hand, we see a good chance of the Fed soon ending its quantitative tightening, i.e. cutting down its government bond portfolio. The Fed began this process in April 2022 and has since sold bonds worth around USD 1 trillion.

Asset class	Appraisal	Commentary
Bonds		Central banks are through with interest rate hikes, but they will not cut key rates again hastily. The long end in the USA has become even more attractive with yields of 5%.
Government bonds		
Corporate bonds		
Equities		In October, equity markets suffered from higher interest rates and some poor corporate results. Nervousness is likely to persist throughout the reporting season. Afterwards, markets might well turn in the opposite direction.
Switzerland		
Euro zone		
United Kingdom		
US		
Emerging markets		
Real Estate		Real estate investments took a clear plunge in October. However, demand is still intact and valuations are favourable.
Switzerland		
Commodities		The outbreak of the Middle East conflict brought oil and gold back into focus. Fundamentally, however, the potential of both appears to be exhausted.
Oil		
Gold		

unattractive — attractive   Current asset class assessment

Imprint
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