BELVÉDÈRE
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OUTLOOK 2024: «CONSTRUCTIVE»

MARKET INSIGHTS

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"The impossible seems possible" and "The annus horribilis will not be followed by an annus mirabilis" were two of our key assumptions for 2023. How did they fare? A review and an outlook.

The US Federal Reserve has hardly ever managed to tighten the reins without setting off a subsequent recession. The inverted yield curve since 2022 underpinned this fear. Only once since the 1960s has an inverted yield curve not been followed by a recession. "The impossible seems possible" aimed to suggest that this time it could be different. In fact, the US economy proved to be extremely robust in 2023. And what about 2024? The US yield curve is still inverted, and growth momentum is slowing. However, we still do not expect a recession. The sharp downturn that was feared in Europe has not materialised. However, stagnation has been lingering for a year now. This lull will continue for a while before a cyclical upturn sets in. China remains an element of uncertainty as the property crisis is still a concern. If the economy does not pick up soon, it will be interesting to see whether the Chinese government is going to step up its hitherto restrained support. From a global perspective, the dip in growth is likely to be overcome in the first half of the year, followed by a tentative recovery in the second half.

2022 was one of the worst investment years ever. A recovery was to be expected. However, the outlook did not seem so rosy. Bond markets had initially been lifted by some exaggerated fantasies of interest rate cuts but came under significant pressure when these were priced out again. Signals from central banks that there might be some actual interest rate cuts in 2024 have boosted the bond markets again since November. What's next? The central banks' cycle of interest rate hikes has long since ended and markets even expect significant interest rate cuts in 2024. We also expect lower key interest rates, but less than has been priced in. After the recent fall in interest rates at the long end, some of the steam should be off.

Interrupted only by the US banking crisis in March, equity markets were rising well into the summer of 2023. Excessive expectations regarding monetary policy subsequently led to a noticeable correction. Similar to bond markets, this was followed by a year-end rally that lifted the S&P 500 and the Euro Stoxx to +26.3% and +19.5%, respectively, over the year. The Swiss market lagged this trend due to the sector composition (little technology), the strong franc (+10% against the US dollar, +6% against the euro) and company-specific factors (heavyweights Nestlé and Roche in the red). The turbulences in the banking sector, combined with the collapse of Credit Suisse and its takeover by UBS, also caused share prices to correct sharply in spring. As a result, the SPI gained only 6.1% for the entire year.

What will 2024 bring for the equity markets? No boom, but no recession either. Some easing of monetary policy. The mood is good, but not euphoric. Such an environment could be described as "constructive", which at least suggests a positive year for markets.

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ECONOMY

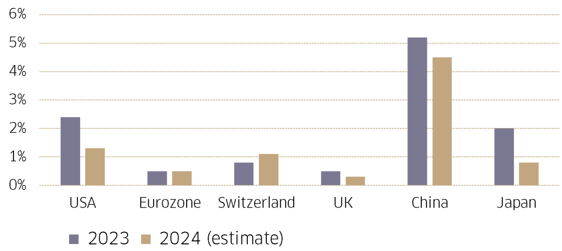
A year ago, the consensus forecasts were unequivocal: recession in the US and a strong upturn in China following the covid pandemic. Yet, things turned out differently. The Chinese economy never really got off the ground, while momentum in the US actually increased over the course of the year.

The consensus for 2024 is a soft landing in the US. But there is little faith in seeing economies grow in China or the eurozone. A slight acceleration is expected for the Swiss economy, although the strong currency remains a challenge.

We are cautiously optimistic about the prospects for 2024. One important reason for this is the declining inflation in many parts of the world, caused among other things by more favourable energy prices. As a result, real incomes are rising, which is supporting private consumption.

In manufacturing, the persistent destocking is likely to come to an end and help the sector to grow over the course of the year. The major beneficiaries: the eurozone and Swiss exporting companies. We would not entirely write off the Chinese economy. The problems in the property market are being addressed and the country remains an indispensable production hub despite everything and is way ahead of the West – for instance, in manufacturing leading-edge electric vehicles.

GDP growth (versus previous year)



Source: Bloomberg

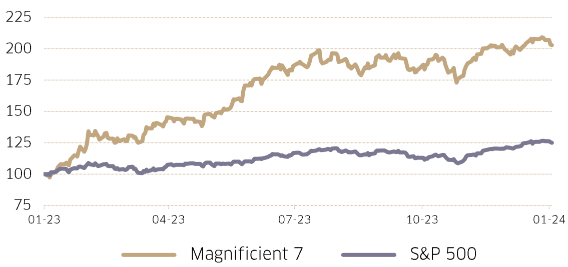
EQUITIES

Against the backdrop of global crises and some weak economies, equity markets performed surprisingly well last year. The main drivers were falling interest rates towards the end of the year, price increases by companies and new trending topics – notably, artificial intelligence (AI) – which incited investors' imagination. The picture was somewhat distorted, though, by the phenomenal performance of the so-called Magnificent 7 (Apple, Microsoft, Amazon, Nvidia, Alphabet, Tesla, Meta), which now make up around 17% of the MSCI World.

We expect a positive market environment for equities in 2024 but anticipate a change in favourites. The performance of the aforementioned Magnificent 7 is unlikely to be repeated. They could be replaced by defensive sectors, such as pharmaceuticals, food or utilities, which should also benefit from the now low interest rates.

From a regional perspective, Switzerland might become more attractive. The risk premium of the SPI has improved and the dividend yield of around 3% is attractive compared to the sharply fallen interest rates for 10-year government bonds of 0.7%. Small and medium-sized companies from Switzerland and the euro zone could also benefit if the anticipated inventory build-up materialises.

Magnificent 7 vs. S&P 500 (total return)



Source: Bloomberg, BAM

INTEREST RATES

Long-term interest rates rose sharply last year, reaching for instance 5% in the US – a level not seen since the financial crisis. The situation eased significantly only towards the end of the year. However, things are unlikely to continue at this pace, as the high volume of new issues due to the tight US budget is quite likely to weigh on the market again. Meanwhile, Swiss government bonds led a life of their own last year because the franc was in demand and inflation remained low by international standards.

The central banks' cycle of interest rate hikes has clearly come to an end. It is less clear, though, when and by how much interest rates will be cut this year. Particularly the US Federal Reserve is likely to be wary of cutting interest rates too hastily, as it will not want to run the risk of letting inflation flare up again like in the 1970s. In this vein, the three interest rate cuts currently priced in by the market by the middle of the year appear highly optimistic. By refraining from further currency sales, the Swiss National Bank has paved the way for an interest rate cut this year.

Asset class	Assessment	Comment
Bonds		The Fed is about to cut interest rates, but the current high expectations are likely to be disappointed. Even lower rates at the long end look less straightforward.
Government bonds		
Corporate bonds		
Equities		The stock market landscape should remain fundamentally favourable. After the exorbitant performance of technology stocks, there could be a change in favourites. Beneficiaries: the Swiss market and defensive sectors.
Switzerland		
Eurozone		
Great Britain		
US		
Emerging markets		
Real Estate		Residential properties are benefiting from rising rents. Commercial real estate is favourably valued by historical standards.
Switzerland		
Commodities		The US is compensating for lower OPEC production. Current price levels seem attractive again. Gold benefited already considerably from lower interest rates.
Oil		
Gold		

unattractive — attractive — Current assessment

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