BELVÉDÈRE
Asset Management

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INTEREST RATES – QUO VADIS?

MARKET INSIGHTS

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Having eased significantly towards the end of 2023, long-term interest rate trend in the US took an abrupt change in course this year, bringing the peaks of 5% back within reach.

What happened? On the one hand, the US economy is once again performing better than expected – the recession anticipated by many market participants has receded further into the distance. On the other hand, inflation is more persistent, specifically with the March inflation report showing little sign of progress (see page 4). These factors have led markets to expect only one interest rate cut by the end of the year – significantly less than the five that were forecast at the beginning of the year. And there is another unpleasant factor – the rising national debt in the US. The budget deficit is expected to rise to 5.6% of gross domestic product (GDP) in 2024 and is not deemed likely to change in the future according to forecasts by the Congressional Budget Office (CBO). This is partly due to rising interest costs. This year, the national debt is approaching the 100% mark; before the covid crisis, it was below 80% of GDP. The crux of the matter lies in financing. The Treasury has to refinance one-third of all outstanding bonds, or USD 8,900 billion, this year. Unlike in 2023, the aim is now to issue increasingly longer-term bonds. The next auctions are scheduled for the second week of May. In view of rising government debt and the persistent inflation rate of currently 3.5%, such securities may very well not sell like hot cakes any more. In other words, investors might increasingly demand a term premium – i.e. a risk premium for longer maturities.

On the positive side, the US Federal Reserve is likely to slow down the speed of its balance sheet reduction, which has been cut by around 18% over the past two years. This would mean a lower volume of government bonds for investors to absorb. However, such a step could only provide relief in the short term. A sustainable solution, which would need to include curbing spending growth, is not in sight. Should Donald Trump be elected president again, this would further aggravate the issue, as he is not known to be an austerity champion. Consequently, we see a far from negligible risk of turbulence on the US bond market over the course of this year.

What are the implications for Swiss government bonds? The situation in Switzerland is quite different. Firstly, inflation is under better control and is already very low again at 1.0% (as per April). Secondly, Swiss government debt is among the lowest in the world at around 18% of GDP. Even though interest rates often move in parallel and yields in Switzerland are low, the risk of a significant rise in interest rates in Switzerland seems quite low.

Giorgio Saraco
CEO, Belvédère Asset Management

ECONOMY

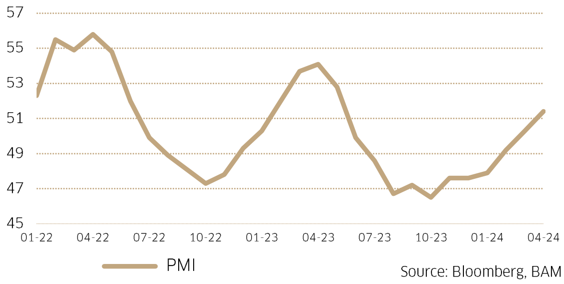
Although GDP growth in the US slowed significantly in the first quarter from 3.4% to 1.6% (annualised, compared to the previous quarter), it is still perfectly robust. The slowdown was due to lower government spending and higher imports. On the bright side, private consumption was rock-solid. However, upward pressure on prices remained high, setting off fears of stagflation.

After a prolonged lean period, the picture in the eurozone appears to be brightening up gradually. Driven by improved prospects in the services sector, the Composite PMI, which tracks the economy as a whole, reached an eleven-month high. At country level, the outlook for Germany is also more positive. According to the ifo economic index, corporate confidence has never been higher since April 2023. At the same time, the GfK-established consumer confidence level is also improving.

In our view, there is a good chance that the German economy, along with the rest of Europe, will pick up pace over the year.

This should also benefit the Swiss economy, where notably exporting industries have been suffering from slow demand. Meanwhile, the weakening of the Swiss franc might bring about some long-awaited relief.

Eurozone: Purchasing Manager's Index



Source: Bloomberg, BAM

EQUITIES

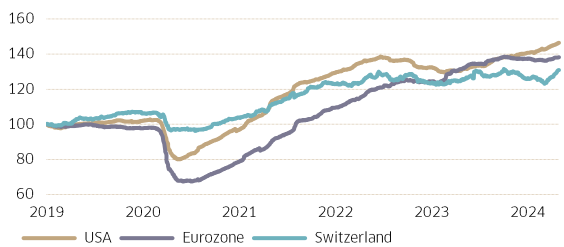
Equity markets were struggling to carry their momentum from the first quarter into April, and went into a consolidation instead. This was primarily due to the persistent inflation in the US, which led to a rise in interest rates at the long end. Consequently, the markets' fantasies of interest rate cuts vanished into thin air. This led to the following equity market performance rates for April: SPI -2.0%, Euro Stoxx -0.8% and S&P 500 -2.6%. For the S&P 500, technology stocks, which had previously performed well, now proved to be a drag. Among the individual Swiss stocks, Roche disappointed once again, while Novartis exceeded expectations. Lift manufacturer Schindler was also doing well. The company is currently benefiting from upgrades to existing systems and from its maintenance business.

What's next for equity markets? Economic growth is certainly one positive element. It should remain good in the US and we expect an improvement in the eurozone.

Companies are also well positioned and keep increasing their profits. This is also the case in the US: in the current reporting season for the first quarter, companies have so far exceeded expectations by a high 8.4% and profit growth compared to the previous year is around 8%. The weaker franc is also a positive driver for the Swiss market.

In our view, the imminent risks are the seasonality coming to an end, the already relatively high valuations and the geopolitical tensions, which could have a negative impact on the markets through a higher oil price.

Earnings estimates continue to rise
(indexed, in local currencies)



Source: Bloomberg, BAM

INTEREST RATES

The US inflation report for March dominated interest rate markets in April. At 0.4%, month-on-month inflation rose more strongly than expected and the core rate remained at a comparatively high 3.8% compared to the previous year. Falling goods prices are a positive factor. On the other hand, disinflation in housing has come to a standstill. Housing is 5.7% more expensive than in the previous year and is a significant driver of inflation due to its high weighting of 36% in the basket of goods and services. Due to falling asking rents, we assume that the increase in housing costs is easing over the year.

However, there is a risk that inflation might not return to the 2% that the US Federal Reserve demands, but will stabilise instead at a higher level of 2.5% to 3%.

Asset class	Assessment	Comment
Bonds		The market is now pricing in only about one interest rate cut in the US. At the long end, US interest rates are decoupling from those in the eurozone and Switzerland. Yield premiums on corporate bonds are not very attractive.
Government bonds		
Corporate bonds		
Equities		Equity markets have entered a consolidation phase. There has been a sector rotation away from technology and toward cyclicals, which is likely to continue. We remain constructive for the market as a whole and expect prices to go up slightly.
Switzerland		
Eurozone		
Great Britain		
US		
Emerging markets		
Real Estate		Swiss residential property is now fairly valued, while commercial property still has catch-up potential.
Switzerland		
Commodities		Oil is fundamentally fairly valued, but could rise further due to geopolitical risks. Gold is likely to take a breather after the strong gains.
Oil		
Gold		

unattractive attractive current assessment

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Imprint

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