BELVÉDÈRE
Asset Management

August 2024

ROTATION

MARKET INSIGHTS

ROTATION

This year's trends have seemed quite obvious so far: driven by the fantasy of artificial intelligence (AI), technology stocks have been rushing from peak to peak and analysts have been outbidding one other with ever higher price targets for the leaders in this segment. At market level, the Nasdaq and the S&P 500 in particular benefited from this development, while the Swiss market or small-cap stocks in general remained rather demure on the fringes globally. This market movement has led to extreme valuation discrepancies, i.e. large technology stocks became very expensive, while prices in neglected segments crumbled.

In such scenarios, it can take just a minor event to set off a trend reversal. In this case, the release of the lower-than-expected inflation figure for the US on 11th July was the straw that broke the camel's back. This figure spurred on the fantasy of interest rate cuts, from which smaller companies would benefit the most as they are more prone to be in debt. Hence, the Russell 2000 rose by almost 10% until the end of the month, while the Nasdaq corrected by 8%.

The rotation described above not only took place at index level, but could also be observed in individual stocks. Specifically, in the pharmaceutical sector for fat reduction pills, where the two companies Novo Nordisk and Eli Lilly have dominated until now. As a result, investors paid price/earnings ratios of 38x and even 60x, respectively, for these equities. Roche shares, meanwhile, were a slow seller. In July, the company presented surprisingly positive research data on an oral fat-reducing agent, triggering a rotation out of the former winners into Roche. The shares rose by 14.4% in July, while Novo Nordisk and Eli Lilly corrected by more than 10%.

However, not even close to all former losers were able to benefit from the rotation. Prominent among them were packaged foods suppliers, including the Swiss representative Nestlé. The sector has raised its prices sharply in recent years due to higher costs for commodities and wages. Customers initially played along, but have recently either been buying less or turning to cheaper products. Consequently, brand product suppliers have seen their sales volumes decline. Although Nestlé was able to break the trend in the second quarter by hiking up promotions, the stock came under pressure and is still trading at its lowest level since February 2019, around one-third below its peak at the beginning of 2022. Nestlé is now valued at a 10-year low. It is therefore quite probable that the largest food company, with its global presence and excellent long-term track record, will soon regain the investors' favour.

Giorgio Saraco
Partner

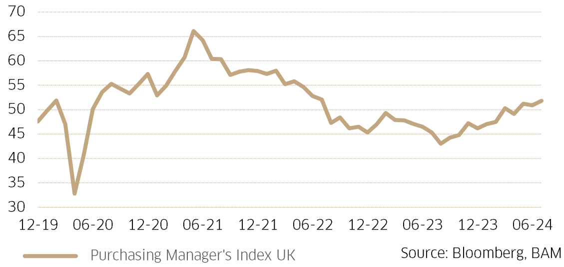
ECONOMY

The US economy grew by a relatively strong 2.8% in the second quarter compared to the prior period. However, there are increasing signs that the economy might soon cool off. For instance, the number of private loan defaults is on the rise and retailers are reporting that customers are increasingly opting for cheaper products. In the corporate sector, investments in new factories and infrastructure are growing at a slowing pace. It remains to be seen how severe the downturn will be. It depends not least on whether the Federal Reserve will adequately cut interest rates.

In the eurozone, the cyclical upturn appears to be losing momentum again. A clear sign for this emanates from July Purchasing Managers' Indices, which fell in both for manufacturing and services. Germany is giving rise to concern, as it keeps struggling with structural issues. Outside the eurozone, the UK stands out with good figures. Inflation is falling, real incomes are rising and the Purchasing Managers' Index in manufacturing has been on the road to recovery for a year.

Growth in China weakened significantly in the second quarter. One of the main reasons for this is private consumption. With the ongoing real estate crisis, private consumers are holding back on major spending. On top of interest rate cuts, the government thus responded by launching an additional stimulus program for private consumption (trade-in). Whether this will be enough is anything but certain. Overall, the outlook for the Chinese economy is not too bright. There is also the risk of the US presidential race. If re-elected, Donald Trump has already announced tariffs of 60% on imports from China, which could reduce China's growth by up to 2.5 percentage points during 2025, according to UBS estimates.

UK: Purchasing Manager's Index is recovering



Source: Bloomberg, BAM

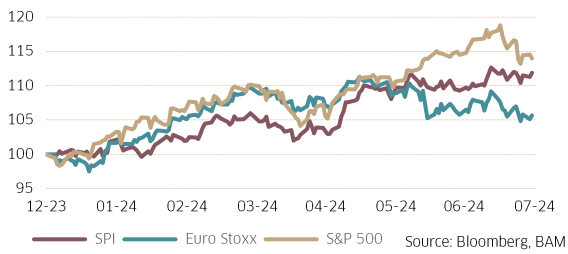
EQUITIES

The aforementioned weakness of the Chinese economy is taking an increasing toll on European equities. The once booming luxury goods sector has been hit particularly hard. The sector depends heavily on Chinese consumers and is currently feeling the effects of the gloom. Louis Vuitton (-8.6% in July) and Swatch (-1.6%), for example, reported weaker results.

Equity markets generally evolved in diverging directions in July and volatility increased. Thanks to good interim reports from companies such as Lonza (+18.0%), Belimo (+17.5%) and Sandoz (+14.5%), the SPI performed well and gained 2.4% in July. By contrast, the Euro Stoxx and the S&P 500 moved sideways and the Nasdaq corrected by 3.3%.

We are likely to keep seeing some high volatility over the coming months, not least because the US election campaign is picking up momentum. We continue to anticipate a difficult environment for large tech stocks for the coming months. By contrast, we believe the defensive Swiss market should benefit.

SPI is catching up (Performance in local currency, indexed)



Source: Bloomberg, BAM

INTEREST RATES

The US Central Bank seems to be getting into gear for the first interest rate cut in September. Measured by the private consumer expenditure index, inflation fell to 2.5% in June and is therefore sufficiently close to the Fed's target. The European Central Bank left its interest rates unchanged at its last meeting, but is also likely to make a move in September. The Swiss National Bank might also follow with a third and most probably last cut.

In Switzerland, interest rates for 10-year government bonds continued to decline at a fast pace. Demand is very high, which pushed interest rates down to below 0.5%. In the rest of Europe, bond markets calmed down again after the French elections and interest rates declined here too. In the US, interest rates fell by 24 basis points to 4.15%. Given the high budget deficit of over 6% of GDP, this figure is astonishingly low.

Asset class	Assessment	Comment
Bonds		Government bonds are becoming less attractive as yields continue to decline. Spreads on corporate bonds remain low.
Government bonds		
Corporate bonds		
Equities		Volatility in the stock markets is likely to remain elevated. The correction in large technology stocks is not over yet. Defensive Swiss stocks are the preferred choice in the current environment.
Switzerland		
Eurozone		
Great Britain		
US		
Emerging markets		
Real Estate		The significant fall in interest rates on Swiss government bonds has made real estate investments look even more attractive.
Switzerland		
Commodities		Oil is trading at the lower end of its range, making it more interesting. Gold is lingering in a consolidation phase.
Oil		
Gold		

unattractive — attractive — current assessment

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Imprint

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