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SoundInsight N°6

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Inflation expectations continue to drop

02
Supply chain issues seem re-solved

03
US-Consumption is expected to decline

04
Equities remain underweight

Lower Inflation, lower Profits & higher Equities

Global inflation continues to decline, raising hopes of an end to interest rate hikes. However, gains in the stock market are accompanied by declining corporate profits.

In April, both US consumer and producer prices rose less than expected by economists. Over the past 12 months, consumer prices in the US increased by 4.9%, while producer prices rose by 2.3%. The current wave of inflation is largely attributed to disruptions in global supply chains. Therefore, producer prices carry more significance when it comes to predicting the further development of inflation. Producer prices have been on a downward trajectory since March 2022, while consumer prices have been decreasing for the past 10 months, following producer prices with a delay of about 3 months. Given last month's data release, producer prices are now approaching the target range of 2% that the Federal Reserve wants to achieve with its goal-based approach.

In general, global supply chain disruption no longer seems to pose a significant problem. The New York Fed's Global Supply Chain Pressure Index has fallen to its lowest level since the financial crisis back in 2008. The number of published news headlines on the topic of "supply chains" has halved in the past 12 months. Freight rates for standard 40-foot-container boxes, where costs temporarily exceeded $10,000, have decreased by more than 80% and have reached long-term average levels in a sign of normalization.

Declining inflation also indicates an end to the restrictive monetary policy that has significantly shaped markets for slightly more than a year. The bond market has been signaling this for some time, as the Fed’s first interest rate cuts in more than 3 years are already priced into the market by the end of the year. Global stock markets benefit from the prospect of lower interest rates and reflect an almost perfect scenario: inflation is decreasing, interest rates will gradually decline until 2025, and corporate profits will continue to rise within the same period.

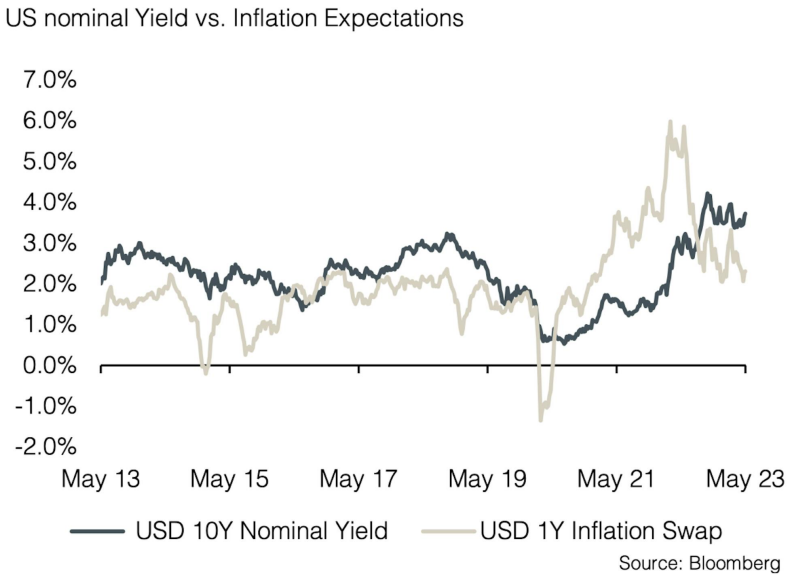
However, the current reporting season on corporate earnings justifies a somewhat cautious stance. Profits are declining in most sectors compared to the previous year, even though they have partially exceeded analysts' expectations that were cautiously optimistic.

In the coming months, profit margins could also deteriorate as they strongly correlate with declining inflation. The normalization of price levels is likely to shift investors' focus back to fundamental valuation factors.

However, these numbers are generally negatively impacted by a very sharp spike in interest rates, like the one that materialized over the last year. According to the latest Household Pulse Survey by the US Census Bureau, more Americans are facing difficulties in managing their expenses compared to immediately after the pandemic when millions of people lost their jobs. Approximately 38.5% of adult Americans are struggling to cover their household budgets. In the same period in 2021, this number was at 26.7%. One possible reason for this is the development of real wages, which have been declining for the past two years. Many households are accessing their credit card facilities to manage budget deficits, leading to increased debt among the lower-income segment, which is particularly affected by these circumstances. Considering the average credit card interest rates north of 20%, additional budget issues for consumers can be expected going forward. A research report provided by Bank of America shows that credit card transactions are already declining.

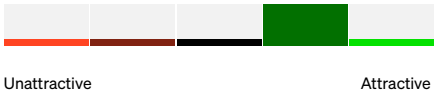
Currently, there is little evidence that the stock market is reflecting these negative economic developments. Therefore, it is worthwhile to take a closer look at valuations. The equity risk premium remains at an unattractively low level and has not improved materially over the last weeks. Rising stock prices are accompanied by declining profits, further inflating market valuation. Especially US heavyweights like Apple, Amazon, Google, Microsoft, NVIDIA, etc., have propelled the US market to rise by over 10% since the beginning of the year. Excluding these stocks from the overall calculation, the gain drops to 1.7%. Globally, slightly more than half of the stock market contribution year-to-date comes from just seven US companies, whose valuation now appears expensive in absolute and relative terms.

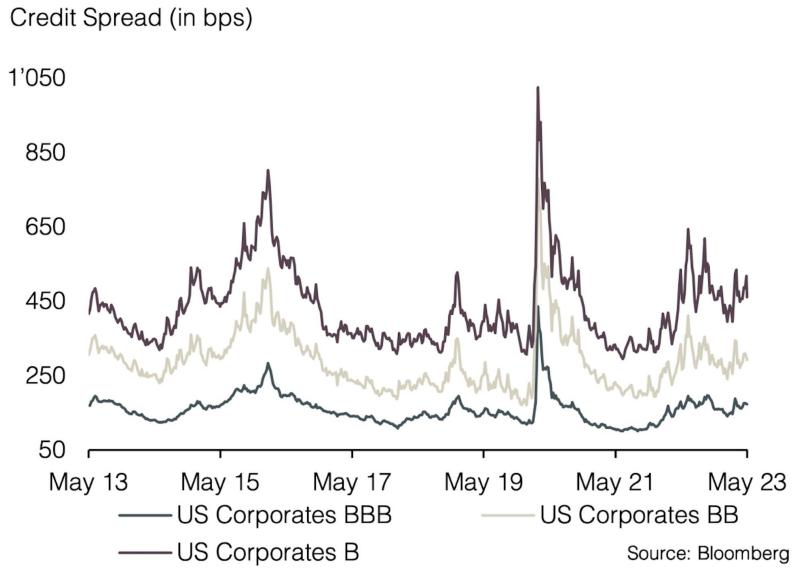
Hence, we continue to maintain a defensive position with an underweight in equities. We welcome the drop in equity volatility, which makes it cheaper to buy protection and hedge parts of an equity allocation through options. Higher credit spreads for bonds reinforce our view that quality should be the ultimate focus for fixed-income investments.



Yields

Investors seem to believe that inflation is under control. In the US, an inflation rate of 2.3% is expected over the next 12 months, while in Europe, 2.8% is priced in. Due to declining inflation expectations, interest rates, especially in Europe, have slightly decreased. Real interest rates have remained almost unchanged. The interest rate level remains attractive.

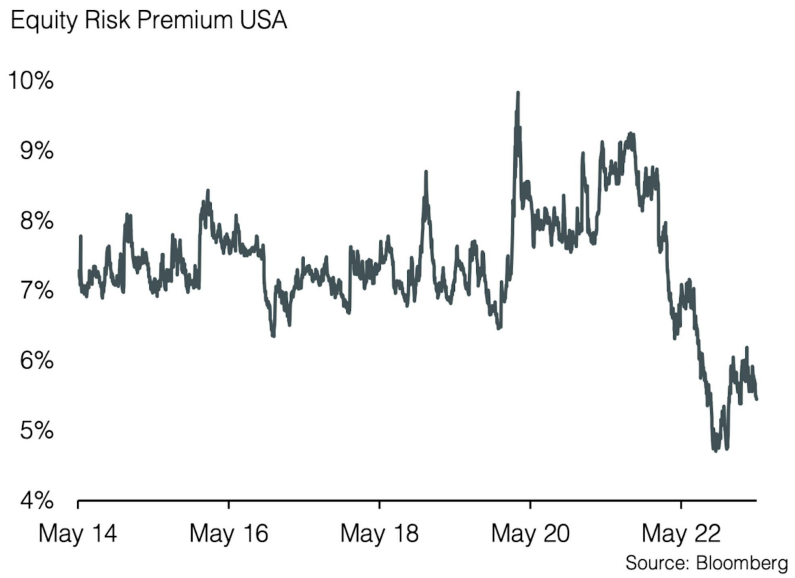




Spreads

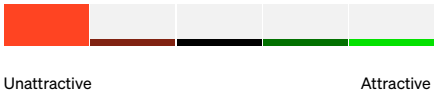
Last month, it was plain to see how credit spreads increased based on quality. The higher the risk, the bigger the spread widening. Although the assessment is currently at a neutral level, a further increase in credit spreads would result in a positive evaluation and an overweight for fixed income investments.





Equity Risk Premium

Although there have been major shifts in the bond market, the equity risk premium remains at an unattractive level. In particular, the lower growth prospects are reflected in dividend-based models and continue to be the reason stocks appear unappealing.



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Leading Indicators

Manufacturing PMI

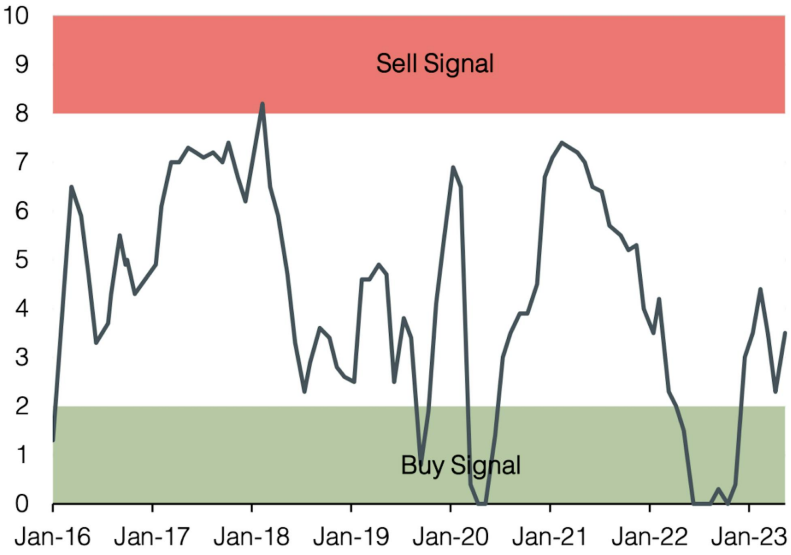
	Aug 21	Sep 21	Oct 21	Nov 21	Dec 21	Jan 22	Feb 22	Mar 22	Apr 22	May 22	Jun 22	Jul 22	Aug 22	Sep 22	Oct 22	Nov 22	Dec 22	Jan 23	Feb 23	Mar 23	Apr 23
Global	54.1	54.1	54.2	54.2	54.3	53.2	53.7	53.0	52.3	52.3	52.2	51.1	50.3	49.8	49.4	48.8	48.7	49.1	49.9	49.6	49.6
USA S&P Global	61.1	60.7	58.4	58.3	57.7	55.5	57.3	58.8	59.2	57.0	52.7	52.2	51.5	52.0	50.4	47.7	46.2	46.9	47.3	49.2	50.2
USA ISM	59.6	60.7	60.4	60.8	58.6	57.6	58.4	57.0	55.9	56.1	53.1	52.7	52.9	51.0	50.0	49.0	48.4	47.4	47.7	46.3	47.1
Europe	61.4	58.6	58.3	58.4	58.0	58.7	58.2	56.5	55.5	54.6	52.1	49.8	49.6	48.4	46.4	47.1	47.8	48.8	48.5	47.3	45.8
Germany	62.6	58.4	57.8	57.4	57.4	59.8	58.4	56.9	54.6	54.8	52.0	49.3	49.1	47.8	45.1	46.2	47.1	47.3	46.3	44.7	44.5
United Kingdom	60.3	57.1	57.8	58.1	57.9	57.3	58.0	55.2	55.8	54.6	52.8	52.1	47.3	48.4	46.2	46.5	45.3	47.0	49.3	47.9	47.8
France	57.5	55.0	53.6	55.9	55.6	55.5	57.2	54.7	55.7	54.6	51.4	49.5	50.6	47.7	47.2	48.3	49.2	50.5	47.4	47.3	45.6
Italy	60.9	59.7	61.1	62.8	62.0	58.3	58.3	55.8	54.5	51.9	50.9	48.5	48.0	48.3	46.5	48.4	48.5	50.4	52.0	51.1	46.8
Spain	59.5	58.1	57.4	57.1	56.2	56.2	56.9	54.2	53.3	53.8	52.6	48.7	49.9	49.0	44.7	45.7	46.4	48.4	50.7	51.3	49.0
Sweden	60.6	64.7	64.3	63.1	61.3	61.9	57.8	56.8	54.3	54.5	53.1	52.2	49.7	49.0	46.7	46.0	45.9	46.9	47.2	45.5	45.5
Switzerland	67.3	67.4	66.3	64.1	64.5	63.7	62.7	63.3	61.6	59.8	59.1	58.0	56.7	56.8	55.4	54.4	54.5	49.3	48.9	47.0	45.3
China Local	50.1	49.6	49.2	50.1	50.3	50.1	50.2	49.5	47.4	49.6	50.2	49.0	49.4	50.1	49.2	48.0	47.0	50.1	52.6	51.9	49.2
China Caixin	49.2	50.0	50.6	49.9	50.9	49.1	50.4	48.1	46.0	48.1	51.7	50.4	49.5	48.1	49.2	49.4	49.0	49.2	51.6	50.0	49.5
Japan	52.7	51.5	53.2	54.5	54.3	55.4	52.7	54.1	53.5	53.3	52.7	52.1	51.5	50.8	50.7	49.0	48.9	48.9	47.7	49.2	49.5

Description: The Purchasing Managers' Index (PMI) is a forward-looking economic indicator based on company surveys. A value above 50 indicates an improving economic environment, whereas a value below 50 indicates a worsening environment.

The divergence between the purchasing managers' indices in the manufacturing sector and the service sector has further intensified. The service sector globally improved last month and continues to indicate a positive trend. However, there is still an ongoing contraction in the manufacturing sector, especially in Europe, where it seems to be worsening. We maintain a neutral outlook.



Unattractive Attractive



Risk-Index

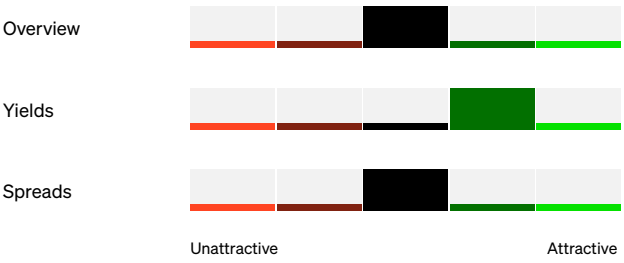
Despite high inflows into government bonds and cash holdings, investor sentiment remains neutral. Inflows in the equity market have slowed down in recent weeks, but this does not result in significant changes in sentiment. We maintain our neutral outlook.



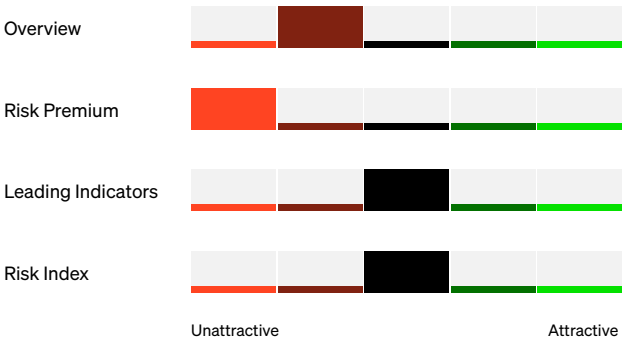
Unattractive Attractive

SoundCapital™

Bonds



Equities



Appendix

Sound Invest is the central tool for our investment allocation. We use it to systematically and consistently assess the aspects that are relevant to the development of the financial markets. As a result, our clients can rely on a rational and anti-cyclical implementation of our investment decisions.

- **Focusing on the essentials** Interest rate level, risk premium, valuation, economic development, investor sentiment and positioning. These are the decisive factors for success on the financial markets, especially in turbulent times when the temptation to react irrationally to the headlines is particularly strong.
- **Comparability over time and place**
  The factors mentioned above are equally relevant for all markets and at all times. This is the result of a strict «backtesting» process that continues into the future.
- **Cumulating our investment experience**
  Our strength lies in the many years of experience of our partners and principals. It is precisely this experience that we summarize and make it applicable with Sound Invest.
- **Transparency**
  Thanks to our monthly publication, our clients always know where we stand in the investment cycle and how we expect the financial markets to develop.

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