SoundCapital™

Posted 10/23/2024 by Christian Luchsinger

SoundInsight N°22

01
Lower rates drive expectations for higher profit margins

02
Equities touch new all-time highs

03
Emerging Market Equities upgraded to neutral

04
European Equities downgraded to underweight

From Headwind to Tailwind

Global stock markets reached new highs in October, while the default probabilities for U.S. corporate bonds hit record lows. This positive momentum is being driven by expectations of lower interest rates and rising corporate profits.

Investors have plenty to celebrate this year. In the aftermath of the pandemic, inflation acted as a significant headwind for stocks and bonds. However, as inflation has been trending down recently and the central banks started to ease monetary policy, it is now turning into a crucial tailwind. Although the Consumer Price Index (CPI) for September came in slightly above expectations at 2.4%, it remains below the levels typically seen during previous interest rate-cutting cycles. Furthermore, when looking at the past 25 years, inflation has now returned below the average for that period.

This cooling of consumer prices creates room for a more accommodative monetary policy, while also fostering improved corporate fundamentals. Particularly within the S&P 500, net margins have been recovering since their low point at the end of 2022, with many analysts forecasting positive margin growth through 2025.

The bond markets are also sending positive signals. Declining interest rates are providing smaller companies with greater opportunities to strengthen their balance sheets. As a result, credit spreads for high-quality U.S. corporate bonds have fallen to their lowest levels since 2005.

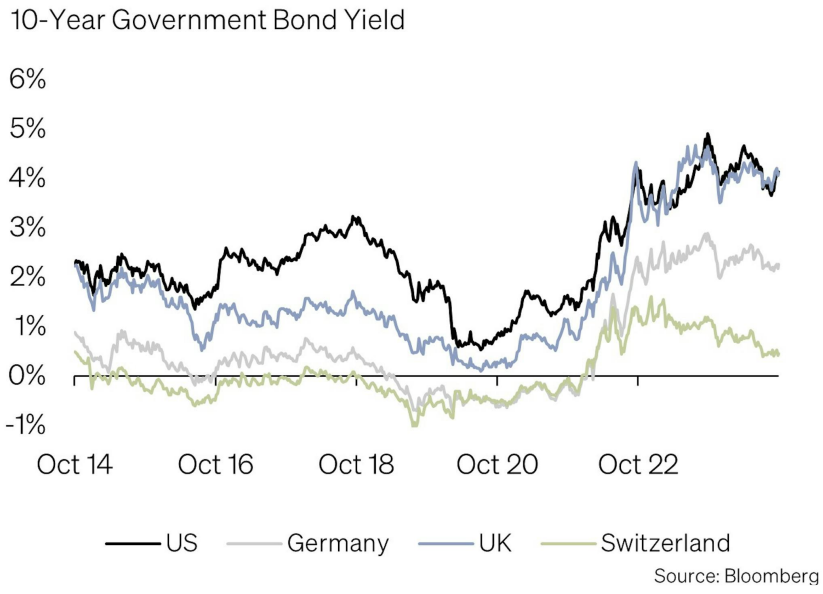
The current record highs in the stock market and record lows in credit spreads reflect that many positive developments, especially due to falling interest rates, have already been priced in. This is also evident in analysts' expectations for the coming quarters. While the current earnings reports still show a transitional phase in terms of growth, double-digit earnings growth is anticipated from the fourth quarter of 2024 through 2025.

However, in our view, an important point is often overlooked: the risk of resurgent inflation has not been fully eliminated. Factors such as economic stimulus packages (e.g., in China), geopolitical tensions (Middle East), and the upcoming U.S. elections could reignite inflation. A good indicator of this is the price of gold, which has risen by more than 30% in USD this year, outperforming stock markets. We continue to believe that gold remains a crucial component of any portfolio in this market environment.

In Europe, the Purchasing Managers' Indexes (PMIs) are not aligned with market performance, especially in the industrial sector, where a downward trend is evident. As a result, we have implemented a regional

underweighting for Europe. In contrast, we have raised our outlook for emerging markets to neutral. This decision is supported by attractive valuations, the U.S. interest rate cycle, and stimulus measures in China. Overall, we remain neutral on equities, even though recent market enthusiasm has pushed the risk index to its highest level in three years.

In the bond space, we continue to advocate for a cautious approach to credit risks, as we believe that the compensation for taking on additional risks is currently not sufficiently high.

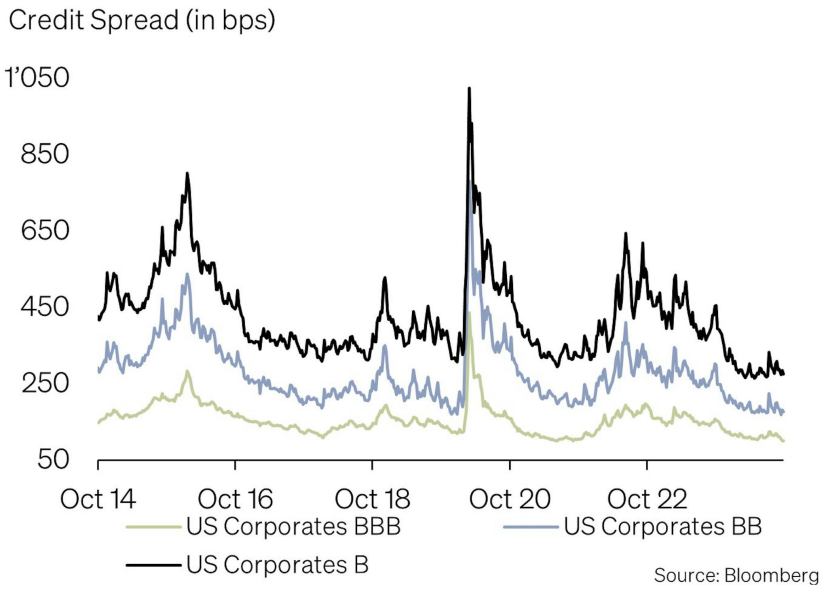


Source: Bloomberg

Yields

In the past month, macroeconomic data has shifted slightly toward positive surprises. While the previous three months were largely marked by disappointing labor market data, last month revealed early signs that the U.S. economy may not be cooling as quickly as previously expected. As a result, the market has adjusted its expectations and no longer anticipates double interest rate cuts by the Federal Reserve this year, leading to a modest increase in interest rate levels. Consequently, we continue to find interest rates, particularly in the USD segment, appealing.





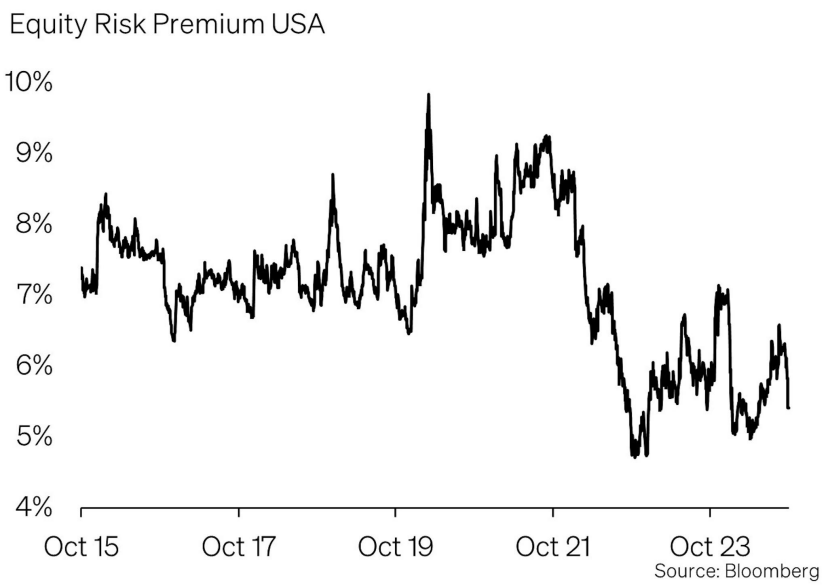
Source: Bloomberg

Spreads

Credit spreads for U.S. companies have fallen to their lowest levels since 2005. These premiums reflect an economically optimal scenario and present companies with a welcome opportunity to secure financing under the most favorable conditions seen in years. In this environment, we prefer bonds with high credit quality and avoid riskier bonds.



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Equity Risk Premium

With rising interest rates and markets climbing last month, equity risk premiums have correspondingly declined and remain unattractive. In general, stock markets face the pressure to meet high expectations for earnings in order to justify current valuations.



Services PMI

	Jan 23	Feb 23	Mar 23	Apr 23	May 23	Jun 23	Jul 23	Aug 23	Sep 23	Oct 23	Nov 23	Dec 23	Jan 24	Feb 24	Mar 24	Apr 24	May 24	Jun 24	Jul 24	Aug 24	Sep 24
Global	50.0	52.5	54.3	55.2	55.3	53.8	52.6	51.0	50.7	50.4	50.7	51.6	52.3	52.4	52.4	52.7	54.0	53.1	53.3	53.8	52.9
United States	46.8	50.6	52.6	53.6	54.9	54.4	52.3	50.5	50.1	50.6	50.8	51.4	52.5	52.3	51.7	51.3	54.8	55.3	55.0	55.7	55.2
USA ISM	54.7	55.0	51.2	52.3	51.0	53.6	52.8	54.1	53.4	51.9	52.5	50.5	53.4	52.6	51.4	49.4	53.8	48.8	51.4	51.5	54.9
Eurozone	50.8	52.7	55.0	56.2	55.1	52.0	50.9	47.9	48.7	47.8	48.7	48.8	48.4	50.2	51.5	53.3	53.2	52.8	51.9	52.9	51.4
United Kingdom	48.7	53.5	52.9	55.9	55.2	53.7	51.5	49.5	49.3	49.5	50.9	53.4	54.3	53.8	53.1	55.0	52.9	52.1	52.5	53.7	52.4
Switzerland	56.7	55.3	54.2	52.2	52.6	49.6	42.7	50.3	52.8	52.2	53.6	56.9	54.6	53.0	47.6	55.6	48.8	52.0	44.7	52.9	49.8
China	54.0	55.6	56.9	55.1	53.8	52.8	51.5	50.5	50.9	50.1	49.3	49.3	50.1	51.0	52.4	50.3	50.5	50.2	50.0	50.2	49.9
Japan	52.3	54.0	55.0	55.4	55.9	54.0	53.8	54.3	53.8	51.6	50.8	51.5	53.1	52.9	54.1	54.3	53.8	49.4	53.7	53.7	53.1

Manufacturing PMI

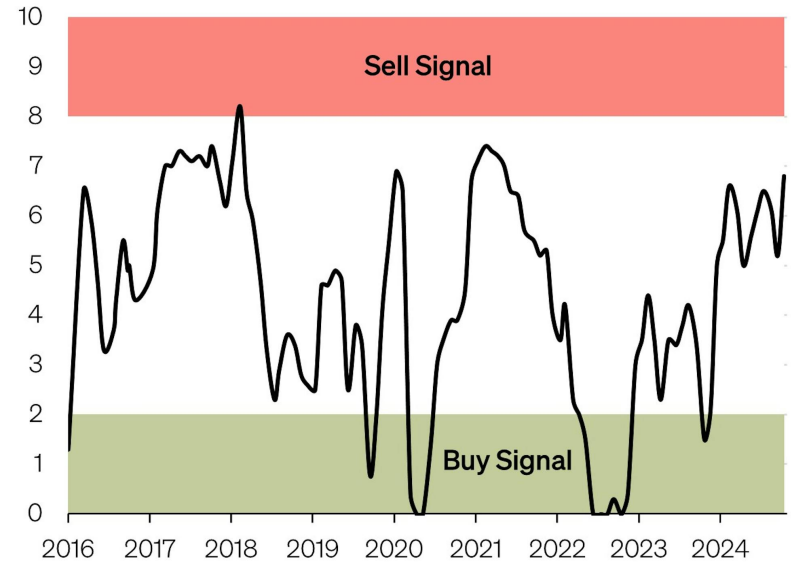
	Jan 23	Feb 23	Mar 23	Apr 23	May 23	Jun 23	Jul 23	Aug 23	Sep 23	Oct 23	Nov 23	Dec 23	Jan 24	Feb 24	Mar 24	Apr 24	May 24	Jun 24	Jul 24	Aug 24	Sep 24
Global	49.1	49.9	49.6	49.6	49.5	48.7	48.6	49.0	49.2	48.8	49.3	49.0	50.0	50.3	50.6	50.3	51.0	50.8	49.7	49.6	48.8
USA S&P Global	46.9	47.3	49.2	50.2	48.4	46.3	49.0	47.9	49.8	50.0	49.4	47.9	50.7	52.2	51.9	50.0	51.3	51.6	49.6	47.9	47.3
USA ISM	47.4	47.7	46.5	47.0	46.6	46.4	46.5	47.6	48.6	46.9	46.6	47.1	49.1	47.8	50.3	49.2	48.7	48.5	46.8	47.2	47.2
Europe	48.8	48.5	47.3	45.8	44.8	43.4	42.7	43.5	43.4	43.1	44.2	44.4	46.6	46.5	46.1	45.7	47.3	45.8	45.8	45.8	45.0
United Kingdom	47.0	49.3	47.9	47.8	47.1	46.5	45.3	43.0	44.3	44.8	47.2	46.2	47.0	47.5	50.3	49.1	51.2	50.9	52.1	52.5	51.5
Switzerland	49.3	48.9	47.0	45.3	43.2	44.9	38.5	39.9	44.9	40.6	42.1	43.0	43.1	44.0	45.2	41.4	46.4	43.9	43.5	49.0	49.9
China Local	50.1	52.6	51.9	49.2	48.8	49.0	49.3	49.7	50.2	49.5	49.4	49.0	49.2	49.1	50.8	50.4	49.5	49.5	49.4	49.1	49.8
Japan	48.9	47.7	49.2	49.5	50.6	49.8	49.6	49.6	48.5	48.7	48.3	47.9	48.0	47.2	48.2	49.6	50.4	50.0	49.1	49.8	49.7

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.

Leading Indicators

Leading indicators, especially in Europe's industrial sector, point to weak performance. The recent short-term recovery seems to have ended, and the trend has turned more negative. However, with the service sector still reporting relatively strong numbers, the overall indicator remains neutral.





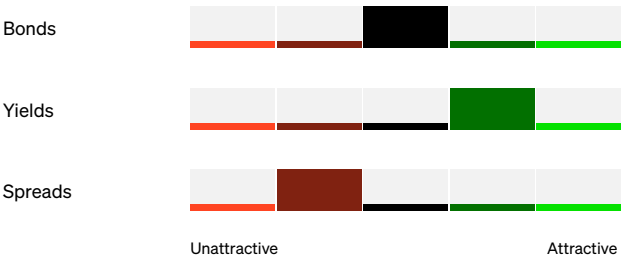
Risk-Index

Investors haven't been this close to euphoria in more than three years. A continued upward trend could push the risk index into a sell signal zone – although it has not reached that point yet.

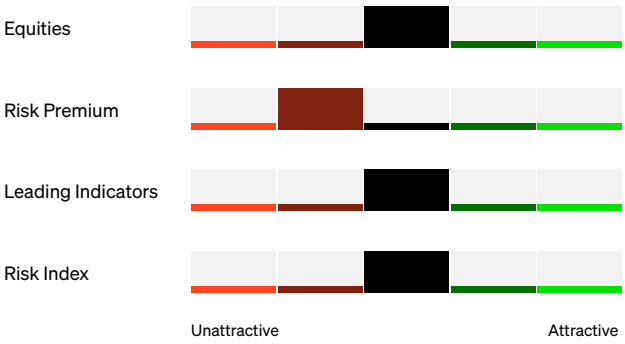


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Bonds



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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