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SoundInsight N°3

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Lowest US unemployment rate since 1969 supports consumers

02

Retail sales spike

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Central bank pivot postponed for the time being

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We remain underweight equites as valuations become even more excessive

Back in the summer of 69

U.S. payrolls expose the central bank's dilemma: A strong labor market means strong consumers, which makes a monetary policy pivot unlikely.

Exciting news for the US labor market: last month saw the creation of a staggering 517,000 new jobs, surpassing economists' expectations by a large margin. Deviations from the consensus on such a scale were unheard of prior to the COVID pandemic. It is clear that the labor market is still struggling with the aftershocks of the lockdown, which makes forecasting a challenge.

Nevertheless, the creation of new jobs has led to a reduction of the US unemployment rate to just 3.4%, which is the lowest level since the summer of 1969. A strong labor market is also translating into a boost for US consumers. The University of Michigan Consumer Sentiment Index, a leading indicator, has risen to its highest level in a year and is on an upward trajectory since mid-2022. In absolute terms, however, it is still at a low level. Moreover, just like the PMI leading indicators, the negative trend seems to have been reversed for the time being. Retail sales in the US confirm the healthier consumer sentiment. They are rising three times as fast as in the last two economic cycles, reflecting higher prices and growing demand. Except for the pandemic, a 3% increase, as in January, was only achieved once in 2001. Thus, retail sales have increased nearly 31% since the end of 2020, reaching a new high just three months after hitting a low.

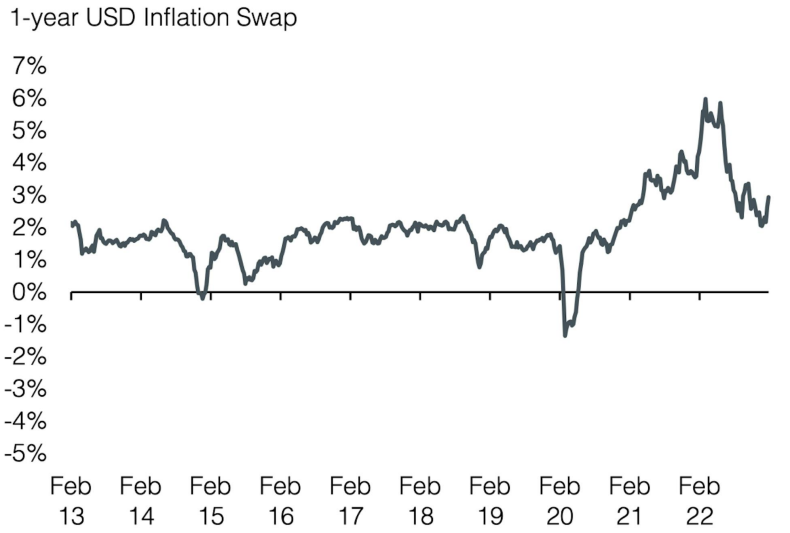
The current situation presents a challenge for central banks attempting to bring down inflation. Market participants who had anticipated interest rate cuts in the second half of the year may have been overly optimistic. As a result, the expected Fed's target rate at year-end has increased from 4.25% to over 5% since mid-January, suggesting a shift towards more restrictive monetary policy. In other words, the market is now giving a little more credence to the continuously restrictive monetary authorities.

Inflation remains a pressing concern, as the increase in producer prices in January surpassed economists' expectations. On top of that, December's figures have been revised upward. A decline in inflation in the near future appears unrealistic, and in conjunction with strong retail sales, the probability increases that central banks will keep key interest rates higher for longer than the market anticipates.

As a result, short-term interest rates have reached new highs in the current cycle. German government bonds maturing 12 months from today are yielding just under 3%, their highest level since 2008. The same tenor in the US is yielding just under 5%. The volatile market environment for bonds is likely to persist due to the

ongoing uncertainty about inflation. Considering rising interest rates and lower credit spreads, we maintain a neutral assessment of bonds. We favor high-quality borrowers, while avoiding high credit risks. Opportunities to increase the exposure to government bonds with longer maturities are likely to emerge in the coming weeks.

The predominantly positive start of stock markets since the beginning of the year is only partly justified in our view. Although equities have seen strong gains since early 2023, the monetary environment has deteriorated and tightened somewhat. On the company level, quarterly results for Q4 2022 indicate flattening momentum as the number of companies that exceeded analysts' expectations decreased and earnings growth declined. As a consequence of falling earnings expectations and rising share prices, the market is experiencing an increase in equity valuations. The unattractive equity risk premium also indicates that there is little fundamental justification for further upside potential. Therefore, we remain underweight equities. Furthermore, we have downgraded healthcare from overweight to neutral after a strong outperformance last year. On a regional level, we have reassessed Europe as neutral, mainly due to the valuation differential to the rest of the markets.



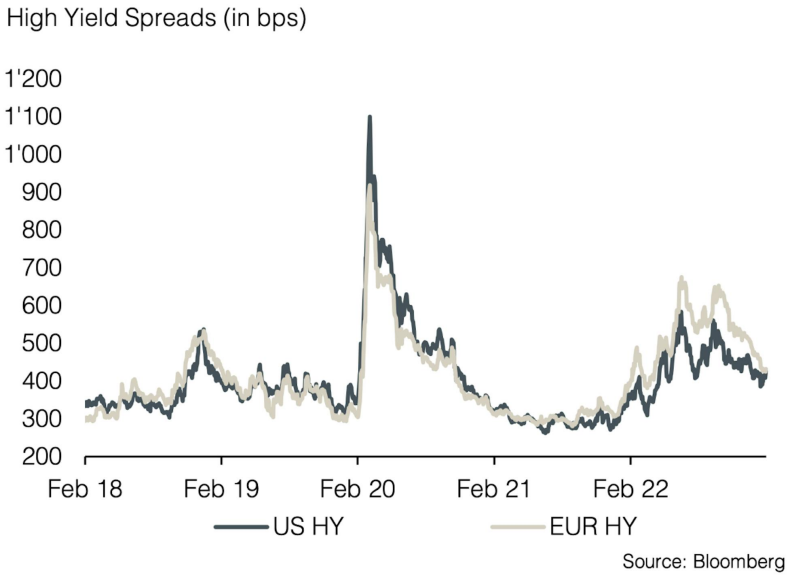
Source: Bloomberg

Yields

In the past month, there was a brief expectation for a reversal in long-term US interest rates, but strong labor market data and retail sales have confirmed that inflation expectations were too optimistic. The expected US inflation rate over the next 12 months was estimated to be 2% only one month ago, but recent events have pushed inflation expectations to just under 3%. Thus, interest rates increased across all maturities. Despite an improved inflation outlook compared to the US, Europe still lags in terms of monetary tightening. We think that a further increase in the yield of high-quality government bond rates presents an opportunity to extend maturities.



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Source: Bloomberg

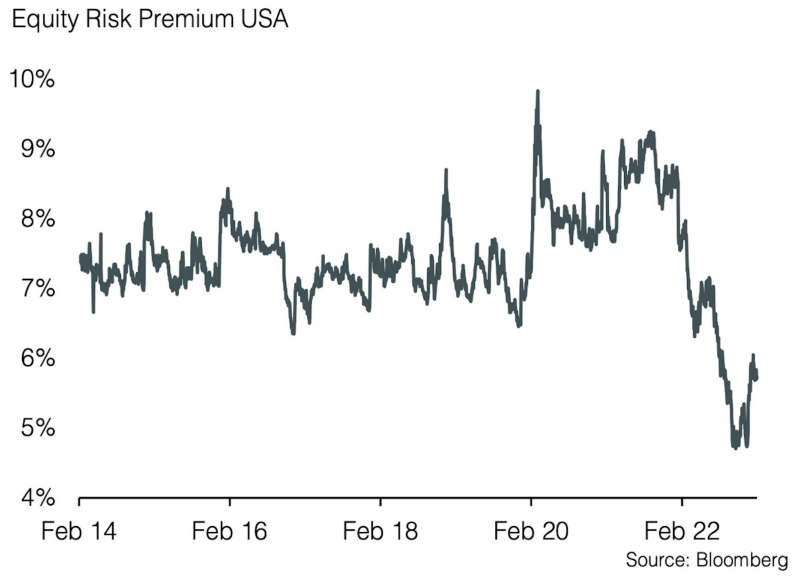
Spreads

The probability of a U.S. recession over the next 12 months has remained at 65% in recent weeks. Despite the elevated risk of an economic downturn, credit spreads have fallen to an unattractive level in February. This could be due to strong inflows into the bond market and a generally greater appetite for risk among investors. However, optimism among high yield bonds may be misplaced, as the market is now expecting higher interest rates for a longer period. Overall, we believe that investors are currently a bit too optimistic with regards to credit risk.



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Equity Risk Premium

The combination of rising real interest rates, rising share prices, and declining earnings expectations has caused risk premiums to fall again. This only reinforces our belief that the current valuation of the stock market is rather unattractive, and that the current rally in the equity market is not supported by fundamentals.



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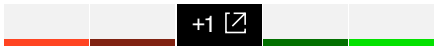
Manufacturing PMI

	May 21	Jun 21	Jul 21	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
Global	56.0	55.5	55.4	54.1	54.1	54.2	54.2	54.3	53.2	53.7	52.9	52.3	52.3	52.2	51.1	50.3	49.8	49.4	48.8	48.7	49.1
USA S&P Global	62.1	62.1	63.4	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
USA ISM	61.9	61.1	60.0	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
Europe	63.1	63.4	62.8	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
Germany	64.4	65.1	65.9	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
United Kingdom	65.6	63.9	60.4	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
France	59.4	59.0	58.0	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
Italy	62.3	62.2	60.3	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
Spain	59.4	60.4	59.0	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
Sweden	65.8	65.7	65.0	60.6	64.7	64.3	63.1	61.2	61.9	57.8	56.8	54.6	54.5	53.0	52.2	49.7	49.0	46.8	46.0	45.9	46.8
Switzerland	68.6	67.1	70.0	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
China Local	51.0	50.9	50.4	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
China Caixin	52.0	51.3	50.3	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
Japan	53.0	52.4	53.0	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

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.

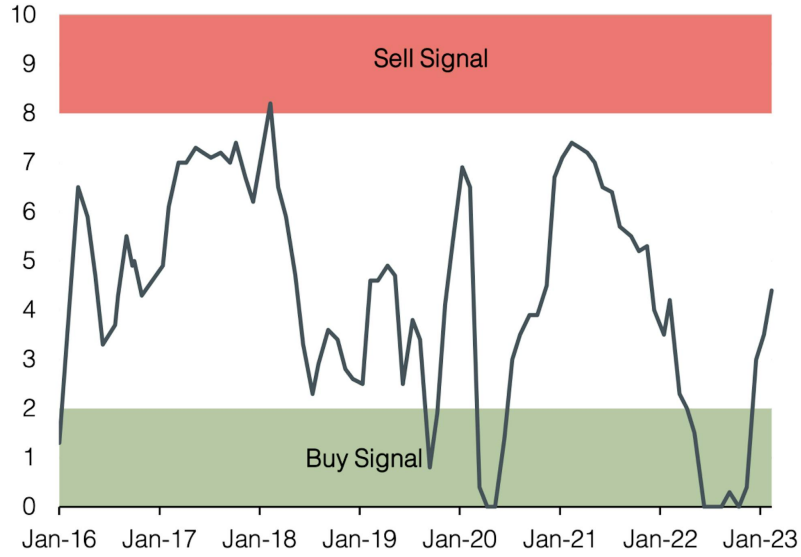
Leading Indicators

The latest economic data shows a clear improvement in the leading indicators, especially in Europe, following China's reopening. Purchasing managers' indices in France, Italy, and Spain have improved, indicating a potential end to economic contraction. Although the absolute figures are still below 50, the upward trend is encouraging. As a result, we have increased our assessment to a neutral level.



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Risk-Index

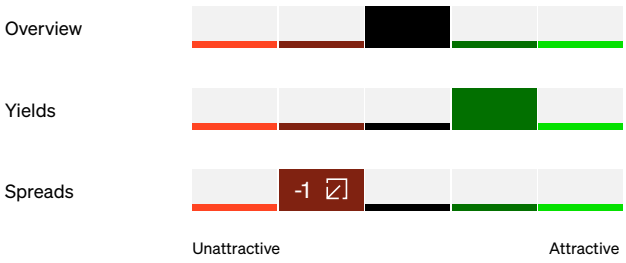
The risk index remained unchanged at a neutral level last month. However, the upside momentum in the direction of euphoric investor sentiment has somewhat stalled.



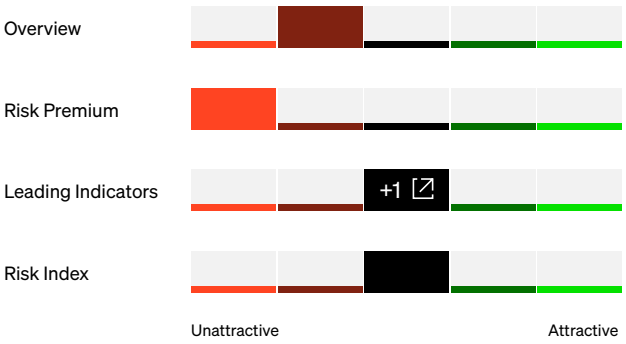
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Bonds



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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