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Posted 5/28/2024 by Christian Luchsinger

SoundInsight N°17

01	02	03	04
The ECB is scheduled to cut interest rates next month	Economic data in April supports lower interest rates	Stocks and commodities touched alltime highs	Unchanged weighting in bonds and equities

Bad news is good news

Last month offered a glimmer of hope for those anticipating lower interest rates. For the first time this year, a variety of economic indicators fell short of expectations. However, a clear trend remains elusive.

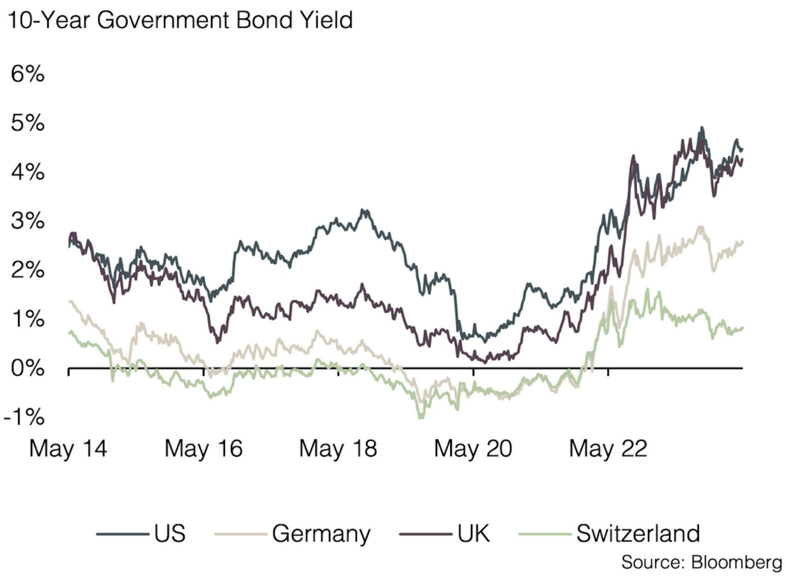
April was marked by surprising economic developments in the US. Inflation rose by 0.3% compared to the previous month, falling short of economists' expectations. It was the first time this year that inflation data printed lower than projected, which can certainly be seen as a positive sign. However, it is still unclear whether economic growth will stabilize sustainably around current levels and if inflationary pressure will trend lower.

Another significant economic indicator, the number of new jobs created, showed its lowest reading since October 2023. This could indicate that the closely watched US labor market is losing momentum. Additionally, retail sales fell short of expectations. Given an almost too hot US economy, this is good news for all major asset classes.

In the current market environment, negative economic surprises paradoxically led to a positive reaction in financial markets. Investors around the globe interpreted the weaker economic data as a sign that central banks, particularly the Federal Reserve, might cut interest rates multiple times this year. The economic trajectory has been continuously fluctuating between positive and negative developments regarding inflation for some time now. While data in the fourth quarter of 2023 fostered expectations for up to six rate cuts for 2024, data of recent months cast doubt on whether US interest rates would be cut at all this year. Now, for the first time this year, April seems to bring a bit of optimism for rate cuts again. Nevertheless, a clear trend with regards to the further path of inflation has yet to emerge. Fixed income benefited from the lowered interest rate expectations and gained globally. Investors responded positively to the possibility of stable or even declining rates. Stock markets were also supported by lower interest rates, reaching new record highs in various regions. The reaction to the latest set of data highlights how strongly markets are currently betting on lower rates and how sensitive they are to economic indicators.

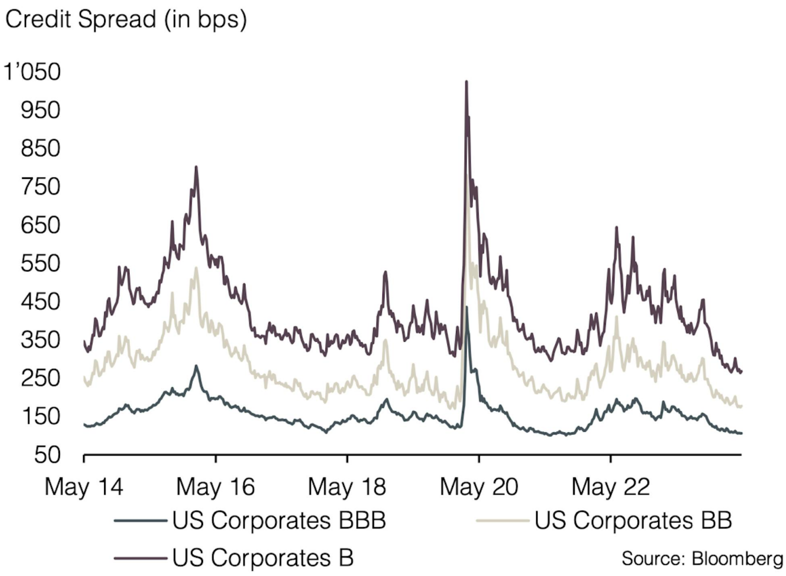
A crucial factor in the coming weeks will be the central bank meetings of the European Central Bank (ECB) and the Federal Reserve (FED) in early June. The ECB is expected to announce its first rate cut since 2016, which would be a significant step in European monetary policy. A rate cut could stimulate economic activity in the Eurozone and weaken the euro, supporting the export industry. On the other hand, the FED is likely to focus on clear communication regarding the further path of monetary policy. Although a rate cut is only expected at the end of the year, the FED's statements will be carefully analyzed for how the policymakers assess the current situation. In the alternative investment space, the development of commodity prices does not indicate lower inflation from our perspective. In particular, base metals are reaching record levels, increasing production costs in many industries and potentially worsening inflationary trends in the long term. Since commodity cycles run over longer periods, this topic will continue to be discussed in depth in our investment committee.

Over the last month, we made no changes to our asset allocation. Currently, macroeconomic data leaves much room for interpretation. Therefore, we are focusing on our systematic process and prefer longer duration and high quality in bonds. In the equity space, we remain neutrally weighted but note an increasing risk appetite as markets become more expensive.



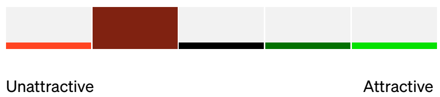
Yields

Long-term interest rates have dropped significantly since their yearly highs in April, particularly in the US. However, since the beginning of the year, rates are still considerably higher and remain attractive for longer maturities, especially in USD and GBP.



Spreads

Writing about the subject seems somewhat repetitive, but credit spreads have decreased even further. In some segments, levels are being reached that were last seen before the 2008 financial crisis. Hence, credit spreads remain unattractive.



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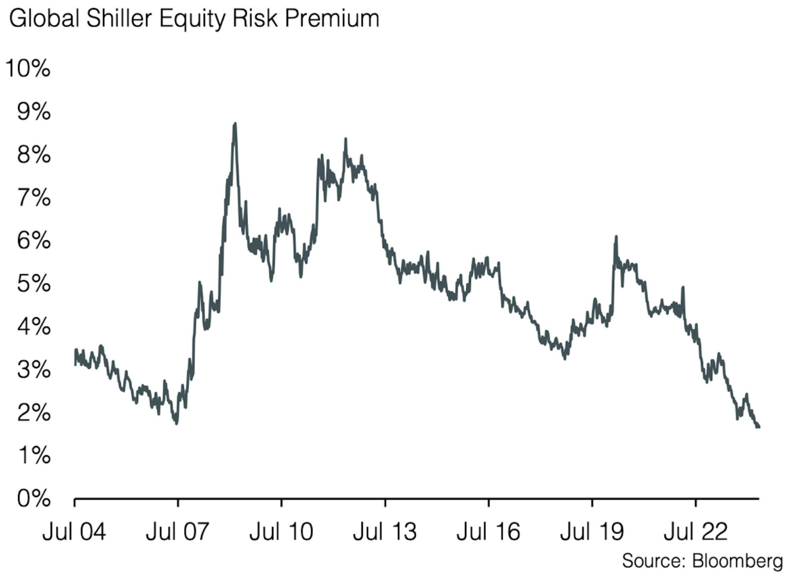

Equity Risk Premium

Even though corporate earnings in the current reporting season were a positive surprise, stock

prices have appreciated disproportionately. As a result, the market has become even more expensive and remains unattractive in terms of the equity risk premium.

Unattractive Attractive

Leading Indicators

Manufacturing PMI

	Aug 22	Sep 22	Oct 22	Nov 22	Dec 22	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
Global	50.3	49.8	49.4	48.8	48.7	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	
USA ISM	52.8	50.8	50.0	48.9	48.1	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	
Europe	49.6	48.4	46.4	47.1	47.8	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	47.4
United Kingdom	47.3	48.4	46.2	46.5	45.3	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	51.3
Switzerland	56.7	56.8	55.4	54.4	54.5	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	
China Local	49.4	50.1	49.2	48.0	47.0	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	
Japan	51.5	50.8	50.7	49.0	48.9	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	50.5

Services PMI

	Aug 22	Sep 22	Oct 22	Nov 22	Dec 22	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
Global	49.2	49.9	49.1	48.1	48.0	50.0	52.6	54.3	55.3	55.3	53.8	52.6	51.0	50.7	50.4	50.6	51.6	52.3	52.4	52.4	52.7	
USA ISM	55.9	55.7	54.7	55.2	49.0	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	
Eurozone	49.8	48.8	48.6	48.5	49.8	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	53.3
United Kingdom	50.9	50.0	48.8	48.8	49.9	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
Switzerland	56.6	52.8	53.8	53.4	49.5	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	
China Local	51.9	48.9	47.0	45.1	39.4	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	
Japan	49.5	52.2	53.2	50.3	51.1	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	53.6

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 Purchasing Managers' Indices (PMIs) in April were among the negatively surprising economic data. For the first time this year, the steady upward trend seemed somewhat broken. However, initial data for May, which is being released at the time of writing this report, already show an improving trend again. The overall assessment remains neutral.

Unattractive Attractive

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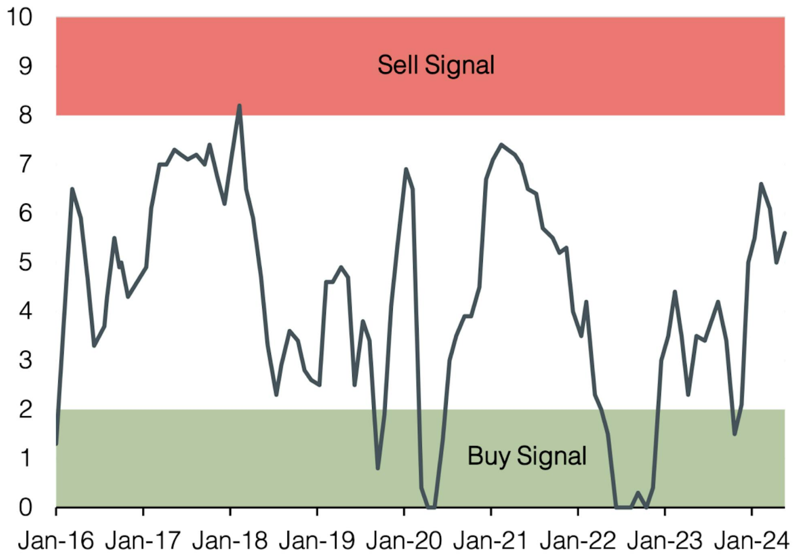

Risk-Index

Investor risk appetite increased last month. Some areas of the stock market, particularly the so-called "meme stocks", are a clear signal that some parts of the market show irrational behavior. However, additional triggers are needed for a sell signal and the corresponding market euphoria. Thus, the overall indicator remains neutral.

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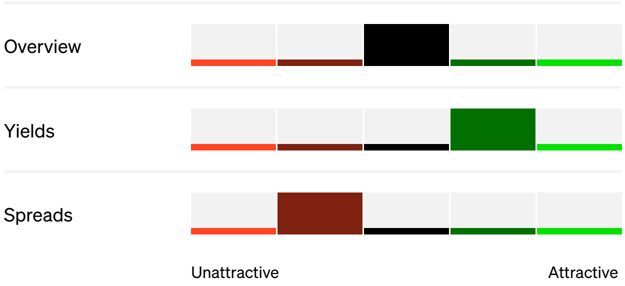
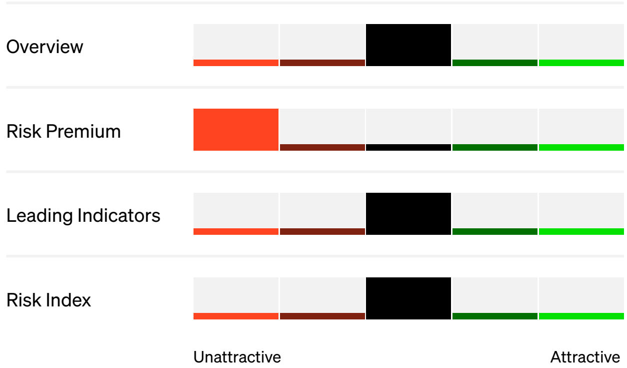
Bonds



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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