PostFinance investment compass August 2024

PostFinance

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The air is getting thinner

The recent turmoil on the stock exchanges highlight that the risks on the financial markets have increased. That's why we're maintaining our cautious approach towards equities. However, growing concerns over recession mean that a higher allocation of international bonds is advisable.

Philipp Merkt
Chief Investment Officer

What a start to August! First, lovely Swiss National Day celebrations with family and friends, and then the stock markets plummeted – just as quickly as the remnants of burnt-out fireworks fell to the ground. The Japanese stock market saw the greatest volatility, hitting the yen and tech stocks. Around 20 percent was wiped off the value of the Nikkei, traditionally Japan's main stock market index, in just a week. At the same time, the yen appreciated by around 9 percent and the share price of the US chip manufacturer NVIDIA also tumbled by over 20 percent.

"With carry trades faltering, the stock markets now lack the oxygen required to soar to great heights."

Closer analysis reveals that the volatility of the yen and tech stocks actually began on 10 July. The significance of these developments and the fact that they happened at the same time led many observers to suspect that these factors may be related. A carry trade is the term used by stock market traders when someone takes out a loan in a low-interest currency, such as the yen, and then exchanges the currency for an investment in another currency. However, the yen carry trade against tech stocks would appear to be over for the time being.

The weak economic data from the USA also contributed to the disaster in early August. Worsening sentiment in industry and a slowdown on the labour market meant market participants were not hoping for lower inflation and a more rapid fall in interest rates for once. Instead, the economic risks became more prevalent. As a result, the downturn on the stock market in early August wasn't limited to tech stocks. On top of this, some tech giants published disappointing quarterly figures, prompting further concerns over the outlook for the tech sector, which is so important to the US economy.

The extent of the turmoil and the significant correction in such a short space of time indicate there's little room for further strong price gains. The market had largely overlooked the economic risks up to that point. Tech stocks seemed to move in only one direction: upwards. But that's now over for the time being. Somewhat more realistic risk analysis is now clearly starting to be applied. While that's positive, it also raises concerns.

Unfortunately, the global economic outlook hasn't improved over recent weeks. The Chinese economy is still floundering. Europe is failing to gain much momentum, and more bad than good news has been coming out of the USA lately. The latter development won't come as a surprise to our customers, however. We've been warning for some time that a significant slowdown in US economic performance was the most likely scenario. That's also been reflected in our tactical asset allocation for some time – we've favoured value stocks and the defensively positioned Swiss equity market, while taking up an underweighted position in US equities.

However, as concerns over the economy grow, long-term bonds, especially in the USA, are becoming more attractive. This means now is the right time to bulk up our long underweighted allocation of international interest-bearing securities: this will provide the portfolio with greater balance and protection against any economic downturn.

Positioning

Change in outlook

While the financial markets have settled down again somewhat after the turmoil, the outlook has changed. We see US government bonds and the Japanese yen as good investment opportunities.

The financial markets held their breath over significant price volatility last month. The value of higher-risk investments fell at the end of July, while secure asset classes made gains. Although financial market conditions have now settled down again somewhat, the outlook has changed.

Carry trades in big trouble

Beleaguered carry trades in Japanese yen were at the center of last month's turbulent events. These inexpensive loans in yen to purchase other investments come under pressure if the Japanese currency appreciates strongly or the value of the investments made, such as tech stock like NVIDIA, falls sharply. In such situations, the loans taken out in yen often have to be repaid by quickly offloading the investments purchased. This unwinding of the carry trades is caused by appreciation of the Japanese currency and losses on the investments made. This pattern of events has been very evident over recent weeks.

Tech stocks under pressure

In addition to the unwinding of the carry trades, disappointing quarterly reports by major tech companies benefiting from the AI boom, such as Microsoft, also contributed to the market turmoil. Until early July, it seemed as though the profit expectations of these companies would continue rising endlessly. However, the latest reports put a dampener on these expectations. It's becoming increasingly clear that investment in artificial intelligence still has to pay off. We expressed scepticism over the high expectations in May and adjusted our positioning in the tech-heavy US equity market in favour of value stocks. In addition to significant price corrections

"There are growing concerns over a slowdown in the US economy."

Performance of asset classes

Asset class		1M in CHF	YTD[1] in CHF	1M in LCY[2]	YTD[1] in LCY[2]
Currencies	EUR	–2.3%	2.6%	–2.3%	2.6%
	USD	–3.3%	2.8%	–3.3%	2.8%
	JPY	3.7%	–1.6%	3.7%	–1.6%
Fixed Income	Switzerland	1.8%	3.5%	1.8%	3.5%
	World	–0.3%	4.5%	3.1%	1.6%
	Emerging markets	–1.7%	8.5%	1.6%	5.5%
Equities	Switzerland	–2.2%	10.2%	–2.2%	10.2%
	World	–6.0%	15.4%	–2.8%	12.2%
	USA	–6.0%	17.9%	–2.8%	14.6%
	Eurozone	–7.8%	8.2%	–5.6%	5.5%
	United Kingdom	–3.6%	13.9%	0.9%	10.0%
	Japan	–8.1%	9.3%	–11.3%	11.0%
	Emerging markets	–7.1%	10.2%	–4.0%	7.1%
Alternative Investments	Swiss real estate	–0.2%	6.1%	–0.2%	6.1%
	Gold	–1.3%	21.5%	2.1%	18.2%

1 Year-to-date: Since year start
2 Local currency

Data as of 14.8.2024
Source: Allfunds Tech Solutions, MSCI, SIX, Bloomberg Barclays, J.P.Morgan

to tech stocks after the quarterly reports, the latest development in the competition law investigations, with the judgement on the Google case in the USA, also confirmed our positioning. This development may strengthen the competition, making it harder to generate high profit levels favoured by monopoly positions. Even after the recent recovery on the financial markets, returning to the previous trend may prove difficult in view of these prospects. That's why we continue to favour value stocks.

Growing fears of recession in the USA

Growing concerns over a slowdown in the US economy proved challenging for the financial markets last month. This realization also appears to be gradually setting in on the financial markets. Equity prices fell again worldwide after the publication of weaker US labour market data at the end of July. In contrast to the rest of the current year so far, bad economic news was also deemed a negative development for the financial markets in July. This situation did not come as a surprise to us. We've been warning of the risk of an economic slowdown in the USA for some time and have adopted appropriate defensive positioning. With the heightened risk of recession in the USA, lower capital market interest rates are now much more likely, prompting us to neutralize our bond allocation by purchasing US government bonds.

Japanese yen has potential to appreciate

During the recent turmoil related to the unwinding of carry trades, the Japanese yen made strong gains. However, unlike other asset classes, it has failed to recover since the turmoil. In our view, the Japanese currency is unlikely to return to its previous level of weakness. Instead, the yen looks set to make further gains, as it is still significantly undervalued and has shown recent upward momentum. For this reason, we recommend purchasing Japanese yen.

Positioning relative to long term strategy: Swiss focus

Asset class		TAA[1] old	TAA[1] new	underweighted[3] −−	−	neutral[3]	overweighted[3] +	++
Liquidity	**Total**	**7.0%**	**5.0%**			■		
	CHF	1.0%	1.0%				■	
	Money market CHF	6.0%	2.0%	■				
	Money market JPY	0.0%	2.0%				■	
Fixed Income	**Total**	**31.0%**	**33.0%**			■		
	Switzerland	15.0%	15.0%		■			
	World[2]	10.0%	10.0%			■		
	Emerging markets[2]	6.0%	6.0%			■		
	US government bonds[2]	0.0%	2.0%				■	
Equities	**Total**	**50.0%**	**50.0%**			■		
	Switzerland	25.0%	25.0%				■	
	USA	6.0%	6.0%	■				
	Eurozone	3.0%	3.0%		■			
	United Kingdom	2.0%	2.0%			■		
	Japan	2.0%	2.0%			■		
	Emerging markets	10.0%	10.0%				■	
	World Value	2.0%	2.0%				■	
Alternative Investments	**Total**	**12.0%**	**12.0%**			■		
	Swiss real estate	7.0%	7.0%			■		
	Gold[2]	5.0%	5.0%			■		

1 Tactical Asset Allocation: short to mid-term orientation
2 Currency hedge to CHF
3 Positioning relative to our long-term asset allocation

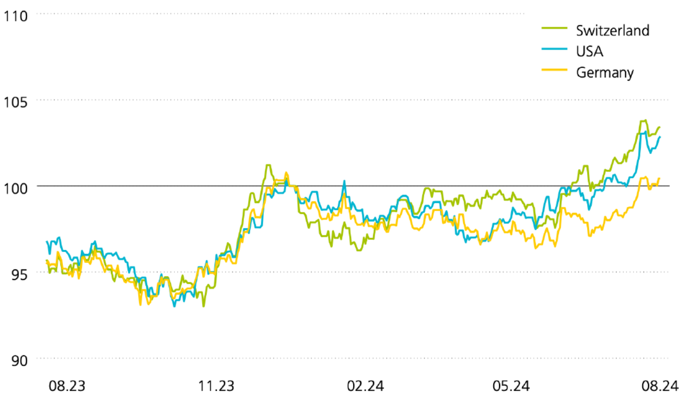
— Adjustment compared to last month

Market overview

Fixed income

Both the prospect of US monetary policy being eased imminently and a shift to safe-haven investments during the recent market turmoil resulted in price gains on the bond markets.

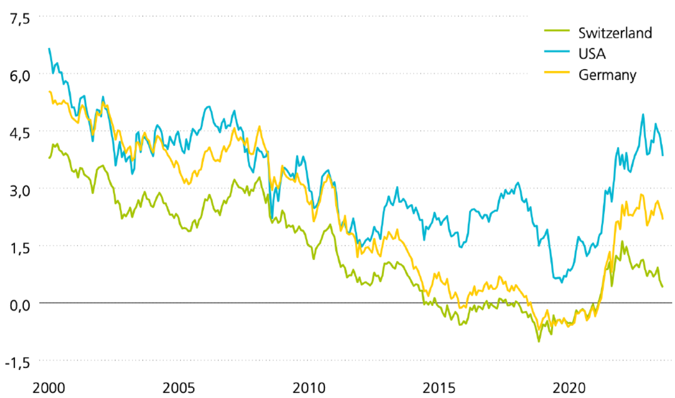
Indexed performance of government bonds in local currency
100 = 01.01.2024



While the US Federal Reserve hasn't yet eased its monetary policy, the clear change in the tone of communication has significantly improved the chance of a policy rate cut in September. Market participants are now actually expecting an interest rate cut of over 25 basis points. Both the growing signs of a slowdown in the US economy and the recent turmoil on the bond markets have led to substantial price gains.

Source: SIX, Bloomberg Barclays

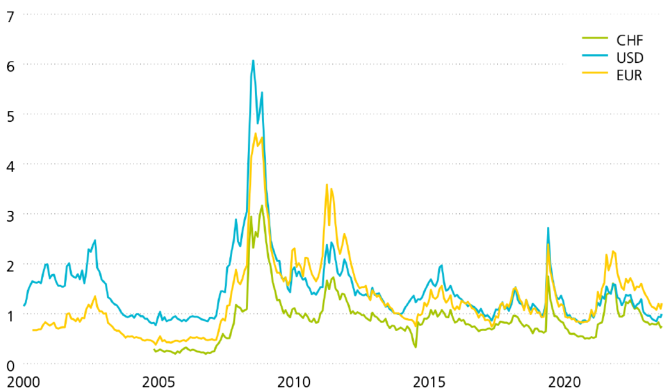
Trend in 10-year yields to maturity
In percent



The downward trend in long-term interest rates gained momentum last month. US capital market interest rates fell very sharply. Yield to maturity on 10-year government bonds currently stands at below 3.9 percent – its lowest level since the end of last year. Capital market interest rates are at a low level in Switzerland too. The yield on 10-year Swiss federal bonds is at its lowest for two years. Japanese capital market interest rates actually fell – despite the policy rate being raised at the end of July. 10-year government bonds were still yielding over 1 percent in mid-July.

Source: SIX, Bloomberg Barclays

Credit spreads on corporate bonds
In percentage points



The credit spreads of corporate bonds haven't reflected any fears of recession so far. Instead, spreads have remained at a remarkably low level, particularly in the USA. That all changed last month. With growing signs of a US economic slowdown, credit spreads widened considerably, especially in the USA. Spreads on US corporate bonds have now returned to their level of year-end 2023.

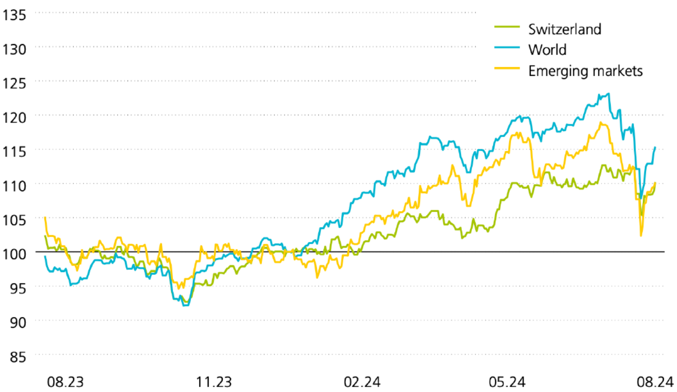
Source: Bloomberg Barclays

Market overview

Equities

The sudden unloading of equities, triggered by beleaguered carry trades, growing concerns over the economy and disappointing results in the reporting season saw equity markets suffer substantial losses last month.

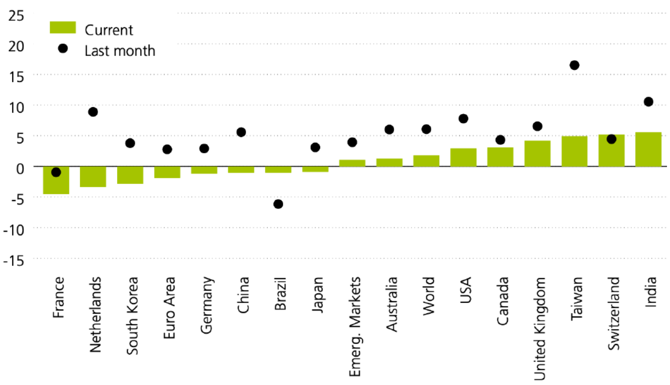
Indexed stock market performance in Swiss francs
100 = 01.01.2024



The equity markets were hit by turmoil last month. Heightened concerns over the US economy, disappointing quarterly reporting from major tech companies and beleaguered carry trades in Japanese yen all played a key part in this development. The biggest loser was the Japanese equity market. Well over 10 percent has been wiped off its value over the past four weeks. Conversely, defensively positioned equity markets, such as those in Switzerland and the UK, performed more robustly. Last month's losses were even more painful for Swiss investors due to the strong franc.

Source: SIX, MSCI

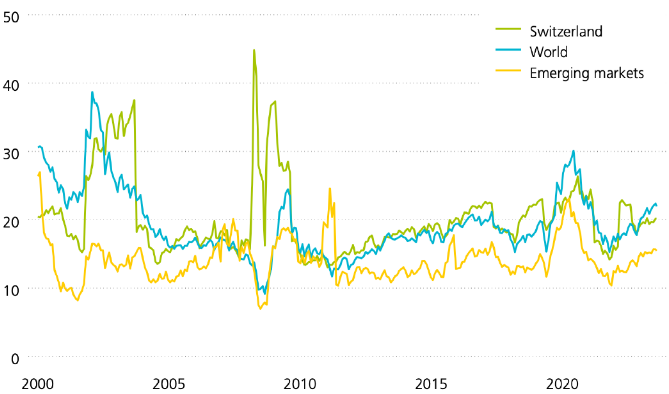
Momentum of individual markets
In percent



Falling prices saw the equity markets lose more momentum. The stock markets in Taiwan and the Netherlands suffered the heaviest losses. These markets had benefited greatly from the boom in artificial intelligence, which meant they were hit hard by the recent downturn in view of the sizeable losses suffered by tech stocks. Momentum has now slipped into negative territory in over half of the equity markets monitored.

Source: MSCI

Price/earnings ratio
P/E ratio



The downturn on the global equity markets put downward pressure on the price/earnings (P/E) ratio month-on-month, especially that of global and emerging market equities. Some disappointing quarterly results, especially from major tech companies, contributed to the decline in the P/E ratio. However, the Swiss stock market's P/E ratio only underwent slight correction as prices fell less sharply here.

Source: SIX, MSCI

Swiss real estate investments

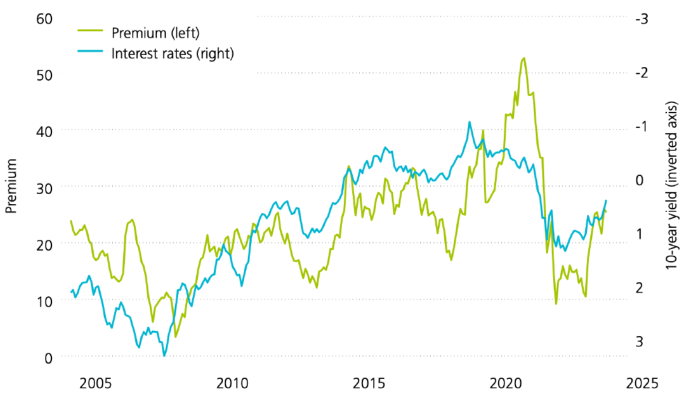
The value of Swiss real estate funds fell again recently – despite lower capital market interest rates – but are still well into positive territory since year-opening.

Indexed performance of Swiss real estate funds
100 = 01.01.2024

The exchange-listed Swiss real estate funds also struggled last month. This occurred despite Swiss capital market interest rates, and, in turn, opportunity costs for long-term investment, falling significantly over the same period. Yield to maturity on 10-year Swiss government bonds declined from around 0.5 percent in mid-July to 0.35 percent in mid-August. The slight correction on the Swiss real estate market may indicate that any scope for further significant gains – like those seen over recent months due to higher rents and consequent improvement in expected returns – has gradually been exhausted. The performance of Swiss real estate funds is nevertheless still well up on year-opening.

Source: SIX

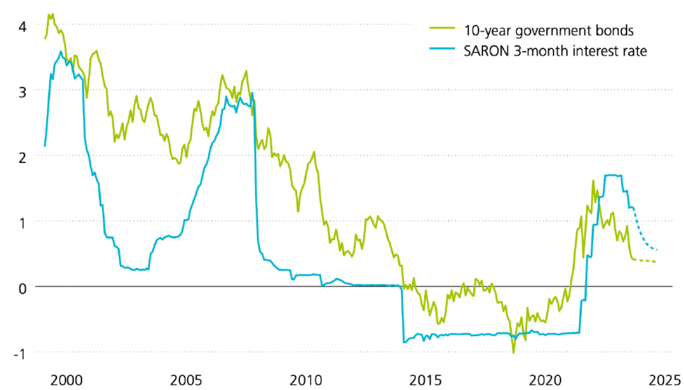
Premium on Swiss real estate funds and 10-year yields to maturity
In percent



Investors in exchange-listed real estate usually have to pay a premium on the net asset value (NAV) of properties. This premium has dropped slightly due to the recent decline in the value of exchange-listed funds. The current level is nevertheless still at the upper end of the range. Significantly higher premiums have only been observed in the past during periods of negative interest on 10-year government bonds.

Source: SIX

3-month SARON and 10-year yields to maturity
In percent



The interest-rate situation has changed dramatically in Switzerland over recent months. On one hand, short-term interest rates, such as the three-month SARON, have fallen significantly after the Swiss National Bank (SNB) cut its policy rate twice, easing money market conditions. On the other, long-term interest rates, which are set on the capital market, have dropped again in recent weeks. The yield on 10-year Swiss government bonds now stands at just 0.35 percent. As both short-term and long-term interest rates have fallen at the same time, the interest curve remains inverted. This means the unusual situation, where short-term money market investments are yielding a higher return than long-term capital market investments, continues for the time being.

Source: SIX

Market overview

Currencies and cryptocurrencies

The Japanese yen has appreciated significantly over recent weeks, while the Swiss franc has also made strong gains. Currencies losing ground by contrast include the US dollar.

The Japanese yen's strong appreciation has had a major impact on momentum on the financial markets over recent weeks. The Japanese currency was up by almost 10 percent against the US dollar from mid-July to early August. Despite a slight reversal over recent days, it has still appreciated significantly. The yen soared after the Japanese central bank's change in monetary policy. The unwinding of beleaguered carry trades and repurchases in connection with this are likely to have supported the currency.
Last month's winners also included the Swiss franc – considered a secure investment – which benefited from general uncertainties in the financial system. In contrast, the US dollar depreciated.

Currency pair	Price	PPP [1]	Neutral area [2]	Valuation
EUR/CHF	0.95	0.93	0.86 – 1.00	Euro neutral
USD/CHF	0.87	0.79	0.69 – 0.90	USD neutral
GBP/CHF	1.11	1.20	1.04 – 1.36	Pound neutral
JPY/CHF	0.59	0.89	0.73 – 1.05	Yen undervalued
SEK/CHF	8.26	9.77	8.75 – 10.79	Krona undervalued
NOK/CHF	8.07	10.58	9.37 – 11.78	Krona undervalued
EUR/USD	1.10	1.17	1.02 – 1.33	Euro neutral
USD/JPY	147.33	89.05	69.05 – 109.05	Yen undervalued
USD/CNY	7.15	6.15	5.70 – 6.60	Renmimbi undervalued

Cryptocurrency	USD rate	YTD [3]	Annual high	Annual low
Bitcoin	58'697	0.39	73'121	39'528
Ethereum	2'666	0.16	4'073	2'207

[1] Purchasing power parity. This metric calculates an exchange rate using relative inflation rates.
[2] Range of historically normal fluctuations.
[3] Year-to-date: Since year start

Source: Allfunds Tech Solutions, Coin Metrics Inc.

Gold

The precious metal remains very popular with central banks and investors and has made further gains over recent weeks.

Indexed performance of gold in Swiss francs
100 = 01.01.2024

Demand for gold remains strong. The precious metal traded in US dollars gained ground last month and stabilized at a new level of over 2,400 US dollars per troy ounce. Momentum seems less strong if performance is measured in Swiss francs, which is mainly due to the appreciation of the Swiss currency. There are a number of reasons why the price of gold is soaring at the moment – in addition to geopolitical uncertainty, the weak US dollar and lower capital market interest rates are also creating favourable conditions for the precious metal.

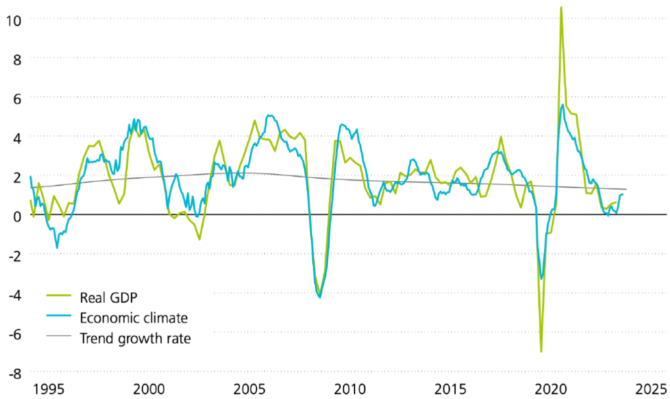
Source: Allfunds Tech Solutions

Generally disappointing economic data

The economic data has generally been disappointing over recent weeks. The economic recovery hoped for failed to materialize in both China and the eurozone, while the key leading indicators weakened again in the USA. There has been positive impetus recently in the UK and – thanks to strong export growth in the chemical and pharmaceutical sector – also in the Swiss economy. This points to a continued slowdown in the global economy.

Switzerland

Growth, sentiment and trend
In percent

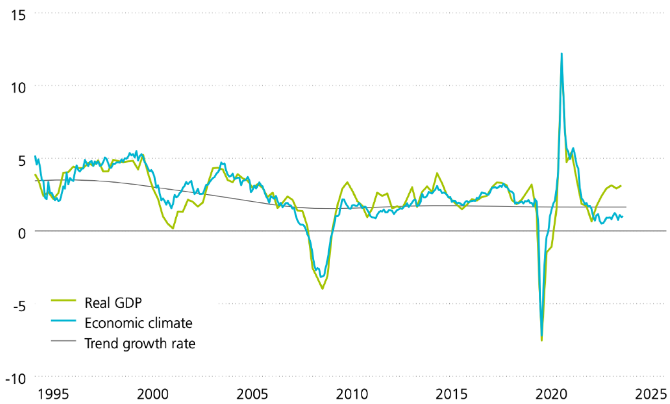


Source: Bloomberg

The Swiss economy has been boosted by strong export growth in the pharmaceutical and chemical sector over recent months. In the second quarter, the real (price-adjusted) export volume climbed by 3.5 percent, lending considerable impetus to overall Swiss economic growth. However, if we look at the sectors primarily geared to domestic demand and exclude the positive effects of foreign trade, then momentum remains low. The significant slowdown in consumption recently and deteriorating sentiment in the services sector are particularly striking. This means the economic recovery is on shaky foundations, particularly in view of the Swiss franc, which has appreciated strongly of late and could hold back a further upturn in the export sector.

USA

Growth, sentiment and trend
In percent

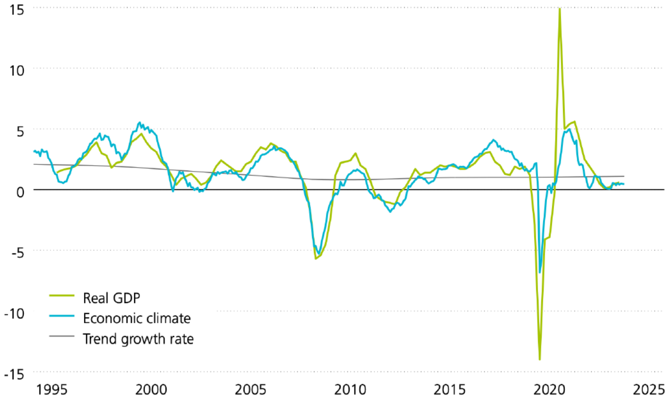


Source: Bloomberg

The economic data coming out of the USA has been mixed recently. The figures for the second quarter were surprisingly positive. This meant economic growth stood at 0.7 percent quarter-on-quarter and at 3.1 percent year-on-year – with both figures exceeding the long-term trend. Growth was also supported by all demand components. By contrast, the figures on the current state of the economy were disappointing. The unemployment rate rose again in July and now stands at 4.3 percent compared with 3.6 percent at the start of the year. Sentiment in industry has also deteriorated lately, pointing to a substantial slowdown in business activity over the coming months.

Eurozone

Growth, sentiment and trend
In percent

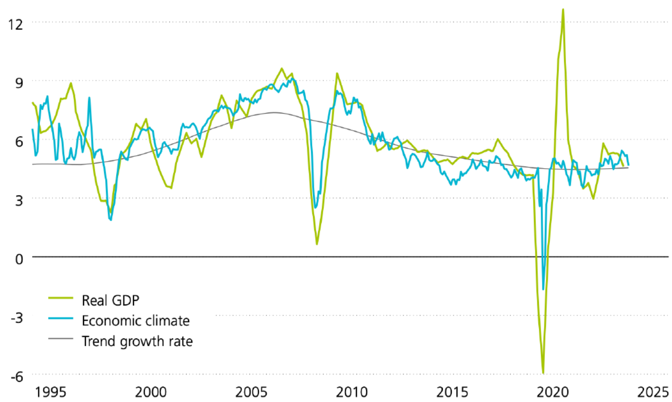


Source: Bloomberg

The European economy continues to stagnate. The business outlook of industrial companies remains at a very low level in view of a fall in order intake and declining capacity utilization. The outlook of services companies also worsened in July, presumably due to weakening consumption of late. No progress has been made on tackling inflation over recent months either. The inflation rate remains above the European Central Bank's (ECB) target range. On a positive note, consumer confidence has improved recently and real wages are growing strongly. Both factors may support consumption over the coming months.

Emerging markets

Growth, sentiment and trend
In percent



Source: Bloomberg

In China, the biggest economy amongst the emerging markets, there is still no sign of recovery from persisting economic weakness. In July, both consumption and investment figures remained at a low level, while core inflation dropped to a remarkably low 0.4 percent, heightening the risk of a sustained deflationary phase. The real estate crisis is continuing, reflected by an accelerated slump in property prices. While the Chinese central government has tried to counteract this development by easing monetary policy conditions, the slight cuts made to interest rates will not be enough to kick-start growth and inflation again.

Global economic data

Indicator	Switzerland	USA	Eurozone	UK	Japan	India	Brazil	China
GDP Y/Y [1] 2024Q1	0.6%	2.9%	0.5%	0.3%	–0.9%	7.8%	2.5%	5.3%
GDP Y/Y [1] 2024Q2	n.a. [4]	3.1%	0.6%	0.9%	–0.8%	n.a. [4]	n.a. [4]	4.7%
Economic climate [2]	↗	↘	→	↗	↗	↗	↘	↗
Trend growth [3]	1.3%	1.6%	0.8%	1.8%	1.1%	5.2%	1.6%	3.8%
Inflation	1.3%	2.9%	2.6%	2.2%	2.8%	3.5%	4.5%	0.5%
Key rates	1.25%	5.5%	4.25% [5]	5.00%	0.3%	6.5%	10.50%	3.35%

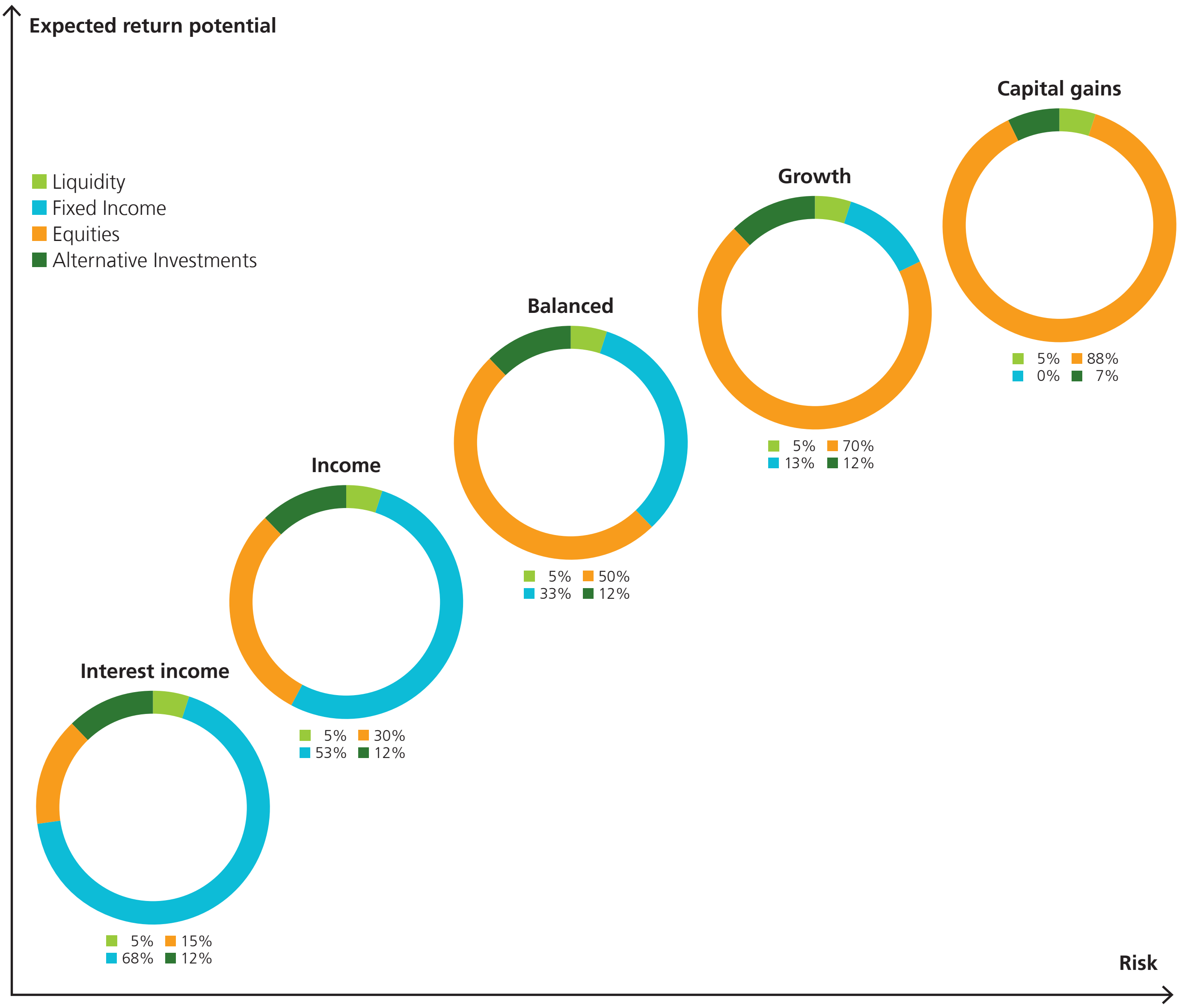
1 Growth compared to year-ago quarter
2 Indicator, measuring the overall sentiment and typically leading 1 to 2 quarters in advance of GDP. Green arrow indicates an increasing economic growth, red arrow a slowing.
3 Potential growth. Long-term change in gross domestic product with sustainable capacity utilization.
4 No data available
5 This is the ECB's main refinancing rate, the deposit rate is 0.5 percentage points lower.

Source: Bloomberg

Model portfolios Swiss focus

Turning point

The financial markets came under pressure last month. Bad economic news has once again become bad news for the financial markets. In particular, the increased risk of recession in the USA significantly increases the probability of lower capital market interest rates. We are therefore closing our underweight in bonds by buying US government bonds. In addition, the continued massive undervaluation of the Japanese yen and the momentum favour buying the Japanese currency.



Source: PostFinance Ltd

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Editorial deadline: 19 August 2024

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