

Our View in November

14. November 2023



The painkiller is (still) working

In times of need, it is less important why the pain subsides. The main thing is that it eases. The last few weeks have again shown how grateful financial markets are for painkillers. But the effect wears off over time.

It hurts when interest rates rise. It became really painful when the yield on 10year US government bonds climbed to 5 % in October. But then the Fed and the US Treasury reached into the medicine cabinet and took out the painkillers.

For its part, the US Federal Reserve did not touch key interest rates and sent the message that everything was under control. Of course, the Fed would not rule out further interest rate hikes, but as long as the economy cools down in an orderly fashion and inflation is not flaring up again, that was probably it for interest rate hikes in this cycle. At least that's what the markets read.

The Treasury on its part has announced which bonds it will issue in the first quarter to cover financing requirements. The fact that around 60% of the needs is being covered by short-dated bonds had a pain-relieving effect on markets. Normally this share is only 15 to 20%. Such a high proportion as now has only been recorded in times of crisis. The reason for the exception to the rule: there is too little demand for government bonds with longer maturities. The Treasury therefore did not want to risk yields rising further at the long end.

The markets have gratefully accepted this. And the painkiller is working in the short term. Only the causes of the pain have not been addressed. There is still a downturn looming. Therefore, we are maintaining our defensive portfolio allocation with an overweight in bonds and an underweight in equities.

Dr. Felix Brill, **Chief Investment Officer**

Our View on the Portfolio



- The major central banks have probably completed their **cycle of interest rate hikes**
- **Technical factors** could support equity markets until the end of the year
- Record levels of **insurance premiums** mean insurance-linked securities may potentially absorb higher losses



- Low **pain tolerance** of markets to higher bond yields
- Stronger **slowdown** in the US economy still likely
- Equity analysts with very optimistic **earnings expectations** for 2024

- ● ● ● ● strong overweight
- ● ● ○ ○ neutral
- ○ ○ ○ ○ strong underweight

(Base: Mandate CHF balanced)

Money Market



Bonds



- Government Bonds
- Corporate Bonds
- USD Bonds
- Emerging Market Bonds



Equities



- Equities Switzerland
- Equities Europe
- Equities USA
- Equities Japan
- Equities Emerging Markets
- Equities World and Themes



Alternative Investments



- Hedge Funds
- Insurance-linked Securities
- Convertible Bonds
- Gold



Our View on Monetary policy



- The **Fed** has reached the peak in the current interest rate cycle
- The **SNB** has probably reached its key interest rate high



- The **ECB** is in a dilemma due to a weak economy
- The **restrictive monetary policy** increases the potential for financial market stress

Rates more likely to go down

The inflation rate for the eurozone fell significantly in October, from 4.3% to 2.9%, which was more than expected. Energy prices climbed in the same month last year, resulting in a correspondingly larger base effect. Although food prices are still contributing significantly to inflation, this is less pronounced than a few months ago. Ultimately, price pressure is easing across the board. In the US, too, inflation is likely to slow further in the coming months. This is also true for the core inflation rate. In view of the drastic interest rate hikes and falling inflation rates, the central banks no longer need to take any further action. The interest rate high has probably been reached in this interest rate cycle. The next rate moves will be downwards, not upwards - but this is something for coming year.

Our View on the Economy



- Signs of a stabilisation at a low level have recently emerged in **manufacturing**
- The recession in the **US** is delayed



- The **eurozone** economy is struggling, and now the southern European countries are also coming under pressure
- The **global economic environment** remains difficult

Robust growth in the US

In the third quarter, the US economy outperformed many other economies. Gross domestic product (GDP) grew by 1.2% in the third quarter compared to the previous quarter. Consumers' wallets were still pretty loose recently. Private consumption was also fuelled by special effects. The hype surrounding the concert tours of singers Taylor Swift and Beyoncé as well as the two Hollywood blockbusters "Barbenheimer" (Barbie and Oppenheimer) have boosted the economy. It is unlikely that the strong growth will be repeated in the fourth quarter - things will cool down. The eurozone economy has already gone into reverse. The economy of the single currency area contracted by 0.1% in the third quarter. The decline in GDP is likely to be the prelude to a technical recession, as there is little hope of improvement in the fourth quarter.

Our View on Government Bonds



- An **economic slowdown** would cause government bond prices to rise
- We take the **record-high forward sales** of US government bonds as an indicator for falling yields



- Easing **recession risks** could cause yields at the long end of the yield curve to rise again
- **Falling credit ratings** may briefly come to the fore for investors

Yields: Only a brief stint above 5 %

Yield trends have played a prominent role in recent weeks. In the US, the much-noticed yield on 10-year government bonds moved shortly above 5%. As yields in this maturity range are also the benchmark for long-term loans, financing conditions have tightened. The US Federal Reserve also referred to this several times at the most recent FOMC meeting. After the rise, however, things went abruptly in the other direction. A weaker than expected labour market, weaker leading economic indicators and a cautious central bank contributed to this. The economic slowdown that we expect in the US, but also in the eurozone, should drive yields down significantly in both the short and long term.

Our View on Corporate Bonds



neutral



- **Government bond** yields may already have peaked
- **Yield level** above the current inflation rate again



- **Credit spreads** compensate insufficiently for the impending economic slowdown
- In a **recession**, credit spreads rise more sharply than risk-free yields fall
- **Highest risk** with a combination of long duration, low credit rating and high leverage

Rate hikes are having an effect

At its last meeting, the Federal Open Market Committee (FOMC) pointed to deteriorating financial conditions for households and companies, which are weighing on growth, the labour market and inflation. In other words, the interest rate hikes are taking effect. According to the investment bank Morgan Stanley, capital markets (especially mortgage rates which have climbed) are acting like an additional 80 basis points rate hike. This is good news for government bonds, as the peak in yields could be behind us. However, corporate bonds could be negatively impacted by this development, which could even lead to a recession. Profit margins are already falling and weaker cash flows as well as rising financing costs are weighing on credit ratings. As credit spreads do not adequately compensate for this risk, we recommend focussing on top qualities or keeping the duration short for lower qualities (see [this investment idea](#)).

Our View on Equities

● ● ○ ○ ○
underweight



- **Profit growth** in the USA in the third quarter
- **End of interest rate hikes** reached
- **Low positioning** could have a supportive effect if there were a Santa rally



- The stock market is dependent on **interest rate trends** and is vulnerable
- Leading indicators continue to point to a **recession**, which is not reflected in share prices
- **China's** economic weakness is impacting European stocks

Under the spell of bond yields

Despite the impetus provided by the quarterly results, the global equity markets continued to be driven primarily by bond yields in the US. Equities were on a continued downward path since mid-October until the yield on 10-year US government bonds heralded a turnaround at just over 5%. Investors are now focussing on a possible Santa rally. If this were to happen, it would be more for technical reasons, as the outlook for the fourth quarter and for 2024 is moderate at best, particularly in Europe. Technical indicators and the reduced equity allocation of many investors would speak in favour of a rally towards year end. If interest rates in the US really have peaked, this would also be a plus. In the past, this has often led to a positive price trend. In the end, a possible rally will also depend on the central banks.

Our View on Equities Europe

● ● ○ ○ ○
underweight



- **Weaker euro** should help companies
- **Low investor positioning** and technical indicators favour a recovery



- **Weak leading indicators** point to continued weak economic development
- **Negative order trend** for companies and weak outlook for the coming quarters
- Important **markets such as China** are suffering from low demand

The market is not budging

Despite a short-term recovery due to falling US government bond yields, the European market has been on a downward trend since July following a long sideways movement this year. Contrary to the statements of the International Monetary Fund (IMF), the signs for Europe continue to point to recession, which is underpinned by leading indicators. Companies are receiving fewer orders. The weakness of the Chinese economy is also acting as a brake. Companies have also become less positive about their business in North America. Cyclical sectors and smaller companies in particular are witnessing this. Only technical factors could help the market to rally towards the end of the year, as little news is expected from companies until 2024. In addition, investors' equity allocations are at a low level and some shares are trading at lower levels than a year ago.

Our View on Insurance-linked Securities



neutral



- **Record values** for insurance premiums
- Even **higher losses** can be absorbed with these premiums
- **El Niño** phenomenon often lasts up to three years and favours the asset class



- Natural disasters **cannot be predicted**
- A once-in-a-100-years event is possible at any time which may lead to **considerable losses**

Will the record year be extended?

The losses due to bonds on the books of insurance companies and major loss events in recent years have caused the supply of insurance capital to shrink. The insurance premiums paid on the market have therefore risen to record levels. In the years 2014 to 2021, two to three times the expected losses were paid; today the factor is 6.9. In addition to the record premiums, the actual losses incurred are decisive for investors. 2023 was an unusually intense hurricane season due to increased water temperatures in the Atlantic. Nevertheless, cat bonds remained loss-free until recently. The devastating hurricane Otis, which hit Acapulco (Mexico) hard, is likely to be the first loss of the current season. With total returns of plus 15 %, the funds are achieving records this season. Subject to future losses, the outlook for the coming year is also bright.

Our View on Currencies



- The Swiss **franc** remains well supported, also thanks to the SNB's currency interventions
- The British **pound** has benefited from higher rates and the narrowing interest rate differential to the Fed



- The **euro** no longer has support from monetary policy
- **Geopolitical risks** are capping emerging market currencies

No significant dollar weakness expected

The dollar has recently shown slight signs of weakness. The markets have come to realise that the Fed has reached the end of its interest rate hike cycle and that the next rate move will be downwards. So far, a further rate hike at the FOMC meeting in December had not been off the table. This has noticeably reduced the influence of monetary policy on the movements of the dollar, resulting in losses. However, we do not expect the dollar to continue to depreciate significantly in the coming months. International conflicts, economic uncertainty and the still large interest rate difference to most currency areas should support the greenback. The Swiss franc should also remain well supported in the current environment.

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