

# Our View in October

08. October 2024



# Announcement effect

**There is often little difference between relief and disappointment. This is what we are seeing in China right now. So you should not put all your portfolio eggs in one basket.**

China has announced plans to stimulate the economy and the property sector. For example, both interest rates on existing individual mortgages and the down payment ratio for the purchase of a second home will be reduced. As a result, the Chinese stock market went on a run. Emerging market equities in the broader sense also benefited. The MSCI Emerging Markets Index gained 12% between mid-September and early October. Chinese equities account for almost 30% of the index.

But fireworks need replenishment or they burn out. And that is what happened, at least in the short term, when the

Chinese government failed to provide details of additional measures. The result: Hong Kong's Hang Seng Index fell 9% in one day.

Financial markets thrive on hope. Or, to be more neutral, on expectations. When expectations are exceeded, prices rise. When hopes are dashed, things go the other way. As an investor, you are not immune to this. This makes it all the more important to compare your own expectations with those of others. Economic data can help. In China, the data continues to show an economy in trouble. So it was easy for the government's initial announcements to raise hopes. Now comes the hard part. Hopes have to be realised. With a diversified portfolio, this can be done with a healthy emotional distance.

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

# Our View on the Portfolio



- Falling inflation allows central banks to cut **interest rates**
- China's government announces measures to **stimulate the economy**
- **Short-duration US high yield** is a promising addition to portfolios



- US economy could still slip into **recession**
- Swiss government bonds have particularly **high interest rate risk** due to low yield to maturity
- Hurricane Milton could cause **significant damage**

- ● ● ● ● 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 Economy



- **Chinese government supports economy**, but success remains to be seen
- **Falling inflation** improves outlook for private consumption
- **Monetary policy** can support the economy by cutting interest rates



- Labour market **signals slowdown** in US economy
- **China's real estate crisis** far from over
- **Weakness** in Europe's largest economy

## Eurozone and China suffer

The eurozone economy is not getting back on its feet. The manufacturing sector in particular is suffering. What's more, the situation in industry seems to be getting worse. The newspapers are full of it: European carmakers are not doing well at the moment. The most prominent example is Volkswagen. Europe's biggest car manufacturer is threatening to close plants and lay off workers. The word "redundancies" is being used more and more often in the manufacturing industry. The eurozone is particularly suffering from China's weak economic performance. There has been no encouraging economic news from the Middle Kingdom. No wonder the central bank and government are now trying to counteract this with lower interest rates and higher government spending. It is questionable whether these measures will lead to a sustainable economic turnaround in China.

# Our View on Monetary Policy



- Inflation no longer the **main concern for central banks** in the short term
- Monetary policy can **support** the economy by cutting interest rates
- **ECB** has managed **market expectations well** so far



- **Market expectations** for Fed rate cuts are high, possibly too high
- **Drastic rate cuts** could look like panic
- **A new wave of inflation** cannot be ruled out

## Fed starts to cut rates - ECB follows suit in October

The Fed stepped into the breach with a 50bp rate cut. We had expected a smaller move of 25 basis points. On closer analysis, there has been little change in the US interest rate outlook. Although the Fed is likely to cut rates a little more than expected this year, the 100bp cut signalled in the Fed's projections for next year does not look like an aggressive cut. If the Fed sticks to its projections, the federal funds rate will still be above 3% at the end of 2025, a relatively high level. The ECB is likely to cut rates by another 25 basis points in October, given the sharp fall in inflation and the signs of an economic slowdown. This would be the third cut in the current cycle. European monetary authorities are also likely to cut by 25 basis points in December.

# Our View on Government Bonds

● ○ ○ ○ ○  
strong underweight



- **Government bonds offer support** as risk appetite wanes in equity markets
- US dollar and euro interest rates **still have room to fall**, despite recent declines



- **Higher oil prices** threaten the achievement of central banks' inflation targets and, in isolation, argue for fewer interest rate cuts
- **Swiss Government bonds** have a particularly high interest rate risk due to its low yield to maturity

## Down

Government bonds staged an impressive rally until mid-September. Falling inflation rates were accompanied by interest rate cuts by the major central banks. At the same time, the global economic picture is showing cracks - an ideal environment for risk-free government bond prices to rise. The countermovement that has been underway for several weeks is hardly surprising. If too much is bought for too long, the market's elastic band will eventually be stretched and a countermovement will set in. This is the case now. The trigger for the fall in government bond prices and the associated rise in yields was the rise in oil prices associated with the escalation in the Middle East. Higher oil prices threaten central banks' inflation targets, but also pose an economic risk to the global economy - and it is the latter that argues against a significant rise in yields and that this is merely a technical market countermovement at the moment.

# Our View on Corporate Bonds



- Companies with lower credit quality **benefit most from falling key interest rates**
- Soft landing economic environment also **favours speculative bond segments**



- **Interest rate risks should be kept low** due to uncertainty about the future path of inflation

## After the rate cut is before the rate cut

Now it's happened, probably the most anticipated interest rate cut by the US Federal Reserve in history. Markets expect further cuts to around 3% by the end of 2025, which is good news for smaller companies with poor credit ratings. They tend to have more variable financing and will benefit faster and more from lower interest costs. The market expects a soft landing for the economy, which will also benefit lower-rated borrowers. However, this scenario also increases the risk of a second wave of inflation, which the market has not yet priced in. The lower-rated credits are also better positioned for this eventuality as they are less exposed to interest rate risk due to their short maturities. Investment grade and government bonds are likely to suffer in this scenario. Bonds with higher credit risk are therefore attractive in our view.

# Our View on Equities

● ● ● ○ ○  
neutral



- Fundamentally **intact market sentiment** for equities
- US Federal Reserve in **rate-cutting mode**
- **No US recession** in sight
- China surprises with **stimulus package**



- **Valuation** remains challenging
- **Escalating conflict** in the Middle East a negative factor
- **US presidential election** increasingly in investors' focus

## Surprises

There has been a lot going on in international stock markets in recent weeks. After a long period of hesitation, the Chinese government unveiled a series of measures to support the economy. Investors were electrified and helped the Chinese stock market to a significant rally. Earlier, investors had been eagerly awaiting the first interest rate cut by the US Federal Reserve, which opted for a hefty 50 basis points. However, the celebratory mood was only enough to push the leading US index, the S&P 500, to a new record high, while the technology-heavy Nasdaq failed to do the same. The economic situation in the eurozone remains much more uncertain than in the US. Nevertheless, European equity markets were able to benefit from the measures taken in the US and China. The escalating conflict in the Middle East is a source of uncertainty. Investors are also increasingly focusing on the US presidential election campaign.

# Our View on Equities Emerging Markets



- **Positive surprise** from Chinese leadership
- **Clear shift** in economic policy
- **Stock market** wakes from slumber



- It remains to be seen whether the plan will work
- **Structural problems** cannot be solved overnight

## China on the offensive

A real estate crisis has been weighing on economic performance in the People's Republic for some time. The crisis in this sector, which has long been an important driver of growth, is also contributing to weak consumption in China. This is because many people had invested their savings in property for a long time and feared a loss in value. Households have therefore been hoarding money for uncertain times rather than spending it. Under this pressure, the Chinese government has put together a comprehensive package of measures. It hopes to stimulate the economy and stabilise the ailing property market by lowering some key interest rates. To this end, private and public households will also be supported. It remains to be seen whether the plan will work, as China is struggling with structural problems that require comprehensive reforms and time. Investors were electrified and helped the Chinese stock market to a significant, short-term surge.

# Our View on Insurance-linked Securities



neutral



- Shortly before the end of the hurricane season, there are still **no losses for CAT bonds**
- High losses for primary insurers force them to outsource risks to the CAT bond markets, which leads to **rising premiums**



- Collateral income also declines as **key interest rates** fall
- As we went to press, Hurricane Milton was **threatening Florida's urban centres**. Such setbacks are typically **buying opportunities**

## Hurricane season draws to a close

To be clear, the dystopian predictions for the current hurricane season have not materialised. The season began with the earliest category one hurricane on record. At an estimated USD 2 billion, the losses were below the relevant threshold for cat bonds. In the case of the current Hurricane Helene, wind damage was limited as it hit the least populated area of Florida. Flood damage was the bigger issue. However, these are expected to be fully covered by the National Flood Insurance Programme (NFIP). However, most of the 15-26 billion in losses were uninsured. The insured losses are expected to be fully borne by primary insurers. This is fuelling demand for insurance and cat bonds for the coming season. Premiums, and hence investor returns, are therefore likely to remain high.

# Our View on Currencies



- The **Swiss franc** remains a safe haven
- The **euro** has held up well against the US dollar and sterling during the market turmoil



- In the past, large movements on the currency markets were often a **warning signal for greater adversity**
- The Japanese **yen** is still significantly undervalued despite the recent appreciation

## Euro under the spell of weak economic data

The euro has recently weakened again against the dollar. The weak economic outlook for the single currency area and the significant fall in the inflation rate below the ECB's target of 2% make an interest rate cut in October very likely. The fall in inflation is mainly due to base effects in energy prices. However, we assume that the still relatively high inflation in the services sector will gradually weaken in view of the sluggish economic development. This will push the currently still relatively high core inflation rate of 2.7% towards the 2% mark in the medium term and thus open up further scope for interest rate cuts. For this very reason, the euro is likely to depreciate further against the US dollar. At the same time, there are still no signs of any significant weakness in the US economy. The dollar should therefore remain well supported.

## Authors

Dr. Felix Brill, Dr. Thomas Gitzel, Manfred Hofer, Bernhard Allgäuer, Jérôme Mäser

## Responsible for this content

VP Bank AG

CIO Office

Aeulestrasse 6, 9490 Vaduz, Liechtenstein

T +423 235 63 99; [cio-office@vpbank.com](mailto:cio-office@vpbank.com)

## VP Bank Sustainability Score (VPSS)

Our overall score expresses a comprehensive assessment of a company's sustainability. It is composed of the ESG rating, ESG momentum, business practices, business activities as well as the SDG and Impact score. The scale ranges from "insufficient" to "below average", "average", "good", "very good" to "excellent". Read more here: <https://www.vpbank.com/vp-bank-sustainability-score>

## Important legal information

This document was produced by VP Bank AG (hereinafter: the Bank) and distributed by the companies of VP Bank Group. This documentation is for information purposes only and does not constitute an offer or an invitation to buy or sell financial instruments. The recommendations, assessments and statements it contains represent the personal opinions of the VP Bank AG analyst concerned as at the publication date stated in the document and may be changed at any time without advance notice. This document is based on information derived from sources that are believed to be reliable. Although the utmost care has been taken in producing this document and the assessments it contains, no warranty or guarantee can be given that its contents are entirely accurate and complete. In particular, the information in this document may not include all relevant information regarding the financial instruments referred to herein or their issuers. Past performance is not indicative of future results.

Additional important information on the risks associated with the financial instruments described in this document, on the characteristics of VP Bank Group, on the treatment of conflicts of interest in connection with these financial instruments and on the distribution of this document by the companies of the VP Bank Group can be found at [https://www.vpbank.com/en/legal\\_notice](https://www.vpbank.com/en/legal_notice)

Liechtenstein: VP Bank AG, 9490 Vaduz · [info@vpbank.com](mailto:info@vpbank.com)

Schweiz: VP Bank (Schweiz) AG, 8001 Zurich · [info.ch@vpbank.com](mailto:info.ch@vpbank.com)

Luxembourg: VP Bank (Luxembourg) SA, 2540 Luxembourg · [info.lu@vpbank.com](mailto:info.lu@vpbank.com)

Singapore: VP Bank Ltd Singapore Branch, 018960 Singapore · [info.sg@vpbank.com](mailto:info.sg@vpbank.com)

British Virgin Islands: VP Bank (BVI) Ltd, Tortola VG1110 · [info.bvi@vpbank.com](mailto:info.bvi@vpbank.com)