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Market outlook from ONE Asset Management AG

ONE® Asset Management

01/ Equities p 3
02/ Bonds p 5
03/ Currencies p 6
04/ Commodities p 7
05/ Contact p 8

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ONE® Asset Management

01/ Equities

The international capital markets remain focused on central banks. As a result, inflation and labor market data, particularly from the US, continue to be in the spotlight. We are approaching the peak in the interest rate hike cycles, both in the USA and in Europe. At its last meeting, the US central bank Federal Reserve did not change key interest rates, but also left no doubt about its continued tough stance: A „hawkish pause.“ The European central bank ECB, on the other hand, raised its interest rate again, but accompanied the decision with dovish comments: A „dovish hike.“ How does this now shape market expectations? The bottom line is a „higher for longer“ interest rate forecast in each case. This has lifted interest rates again. In turn, this dealt the most important stock markets a severe blow. The major stock indices went on a downward slide that left some damage in its wake.

The markets technical picture has been hit particularly hard following the recent declines on the stock markets. Germany‘s leading index, the Dax, for example, slipped below its key support around 15,500 points. This marked a new low for half a year at the end of September. This is a classic sell signal, which opens up further downward space in the Dax towards 14,800 points.

Although the US stock markets also showed a weak September, the chart situation in the S&P 500 index appears somewhat less tense. Here, however, an imminent stabilization is also necessary in order not to sag downwards as well. Recently, the large US technology heavyweights, which had previously held the market up, have also been sold off. From this perspective, at least the start of the new quarter is likely to be difficult for the time being. However, stabilization will then be possible once the central banks‘ rhetoric calms down.

Investors cannot yet expect a tailwind from the economy, especially not from Germany. The economy in this country seems to be slipping more and more, as key data from recent months show. People are ranting about the „sick man of Europe,“ with an eye on the region‘s previous leader. German industrial production, for example, fell more sharply than expected in July. It showed a negative sign for the third time in a row. The export engine is also sputtering in the face of the faltering global economy. German exports fell by a further 0.9% in July compared with the previous month. At present, only the hope of an upturn in the global economy and lower inflation can act as a stimulus. This could boost consumption and thus overall demand - perhaps next year.

Recently, however, there have also been glimmers of hope. The ifo index fell only minimally in September, meaning that the German economy did not experience an aggravated crash. One conclusion is that Germany is stumbling, but worries about a sick man ultimately seem exaggerated. The view of the euro zone is not all black either. The PMIs for the manufacturing sector and also for the service sector have recently stabilized in Europe. However, the consequences of the interest rate hikes are likely to increasingly make themselves felt as an additional burdening factor in the coming months. In addition, the energy price problem will again come into sharper focus in the coming winter months .Not least the sharp rise in oil prices in recent weeks could fuel this issue. In the coming months, Europe and Germany will probably need to make a major effort and ultimately also improve their political assertiveness to get through this phase on a sound footing.

Wage increases and interest rates that are no longer rising could provide support. However, we think that the burden of the central banks‘ restrictive course is yet to come. For the time being, the situation remains bleak. The European economy is currently stagnating and Germany, the former growth engine, is tending to shrink. The manufacturing sector is being hit twice, by the restrictive monetary policy and a cyclical destocking. Added to this is the relatively greater dependence of Germany on China, whose push to re-open has so far been short-lived and disappointing, and not least the higher energy price level. In the longer term, Europe will also be structurally burdened by a disadvantageous demographic development and its debt.

Meanwhile, the geopolitical situation is relatively calm. The war in Ukraine is unfortunately continuing, but has recently been somewhat absent from the headlines. It seems that the global community is preparing for a protracted, drawn-out course of the fighting. Meanwhile, China is once again moving somewhat more into the political spotlight. This is not least due to clumsy and diplomatically very clumsy statements by German (foreign) policy. It does not seem very purposeful to call the Chinese head of state Xi a dictator, as Foreign Minister Baerbock did. That will certainly leave a bad taste. But China is currently weakening itself and is certainly not interested in starting a trade war with Europe. Ultimately the two parties, they are dependent on each other.

On the other hand, Germany‘s efforts to distance itself more strongly from China are depressing. So far, the advice of numerous top managers emphasizing China as an important market has not helped. This trend is also unlikely to be palatable to the Chinese leadership, which is classifying trade with the country as a risk. The recent announcement from Brussels that it is looking into Chinese subsidies for e-cars adds to this. But German industry has undeterredly invested heavily in China, despite the German government‘s „de-risking“ call. It is thus continuing to bet on the long-term market opportunities in China. Nevertheless, little relief can be expected from this side for the

01/ Equities

time being, because Germany's still most important trading partner is now noticeably lame itself.

China will also continue to play a central role for the global stock markets in the coming weeks. This is because the hoped-for positive boost from the return of the Chinese economy to the global market, after the long covid lockdown, has disappointed. The stock market players are wondering when and in what form will now come the usual stimulus injection from the Chinese government. If China manages to get back on track, world stock markets may get a boost. However, the impression seems to be gaining ground that the stimulus is no longer working. China has used these measures in the past and built up so much overcapacity in infrastructure and the real estate market. They would now have to rely more on private demand. But even that is difficult because of the very poor demographics. It could be that China will be out of action as an economic engine for longer.

Looking at the domestic reporting season, we are again generally pessimistic. The impetus from the economy and politics was too negative for German companies to shine with a particularly dynamic earnings performance. As in the third quarter, companies in the cyclically sensitive chemicals sector are likely to have a particularly hard time, but industrial groups will also have to stretch themselves.

By contrast, financial stocks are holding up relatively well and may even benefit from higher interest rates. In Germany, insurers have held up particularly well in recent months. Overall, especially in view of the current wobbly stock markets, careful stock selection remains crucial in order to be able to generate a sustainably good return in the relatively trendless market environment over the longer term. This requires full attention.

As a roadmap, we believe that the international stock markets should continue to have a difficult time until October. Until the interest rate situation has been digested and the difficult economic waters have been better incorporated into prices. Then the positive seasonality towards the end of the year could also come to the rescue of the stock markets. In addition, the central banks should increasingly reduce their restrictive course before the winter. Or an improved economic picture may favor an upward turn on the stock markets at the end of the year.

02/ Bonds

The Federal Reserve concluded its most recent FOMC meeting with a „hawkish hold.“ Their projection is for one more rate hike this year. The key message with regard to the interest rate is: „higher for longer“. Market hopes for rate cuts next year were once again dampened with the dot plot, the personal expectations of the FOMC members. As a result, the yield on US ten-year government bonds climbed above 4.65%, its highest level since 2007. However, thanks in part to the clearer view of the interest rate path, we think yields should settle down in the near term if the economy does not get too strong. We do think that interest rates could still rise somewhat at the long end in the coming weeks before the central banks‘ tough stance is digested at the approaching interest rate summit. The rhetoric of the central banks should then also soften somewhat.

Fed Minneapolis President Kashkari (2023 FOMC voting member) does currently see significant progress toward the 2% inflation target. However, he says it is unclear how much further long-term interest rates would have to rise and policy has to tighten to reach this target. Accordingly, he sees a 60% probability of a „soft landing“ scenario. In the opposite scenario, however, the central bank would have to raise interest rates significantly further, in his opinion, in order to finally get a grip on inflation. In principle, Kashkari is a proponent of a more moderate monetary policy, but less so in the current inflationary environment. There are hardly any avowed doves on the FOMC. Accordingly, the Fed‘s assessment of the situation remains tense, at least for the time being.

However, the general expectation is that the Fed has almost completed its cycle of interest rate hikes. Accordingly, the markets are relieved that the burden on the economy is easing and are counting on new positive effects for growth, for example, from the first interest rate cuts in the coming year. The monetary watchdogs took the wind out of this somewhat at their last meeting, and Kashkari is continuing to do so. We think that government bonds, especially at the long end, still have room to move up in terms of interest rates. However, it may be possible to extend the duration in October to November if the situation eases as described.

Meanwhile, a renewed dispute over a „shutdown“ has been postponed in the USA and will probably go into round 2 in the new quarter. A budget freeze has been averted with a stopgap solution. Public facilities will remain open and government employees will not be sent on forced leave. However, the truce will only last until November 17. In the run-up, the issue will come up again. Goldman Sachs says this could cost 0.2% of annualized GDP per quarter each week.

In Europe, too, the yield on ten-year German government bonds climbed to its highest level since 2011. The ECB raised its key interest rate by another 25 basis points. In view of the economic risks in Europe, however, economists believe that this could be the last monetary policy tightening (for the time being). They viewed the move as a „dovish hike,“ an interest rate hike with a dovish outlook. Although the European monetary guardians want their course to continue to be seen as restrictive, the markets consider the further room for maneuver upward to be limited. Especially since the coming winter will also bring the energy price issue back into focus. This will not make it any easier for the ECB to pursue a sensitive course in the overall picture. We think that interest rates in Europe could remain stable for the time being.

In the meantime, economic data is becoming gloomier, especially in Germany. There, in particular, the economy appears to be in a downright slump. Most recently, leading economic institutes have warned that the recession in this country will be worse than previously thought, given inflation and the slowdown in industry. According to the IMF forecast, Germany will be the only leading economy to contract this year. For example, the all-important export performance remains severely battered, as described. In the sluggish global economy, Germany‘s industry-heavy exports are finding it particularly difficult. Against this background, even oil prices, which are tending to rise, are unlikely to lead to further interest rate hikes by the ECB. In any case, they should only have a limited impact on the inflation rate, which is likely to continue to decline.

Even the Bank of England, which is having an especially hard time in view of the particularly stubborn inflation, has recently only taken a small sip from the bottle. In June, for the first time in a long while, price increases had actually fallen back more sharply than expected, which gave the central bankers some breathing room. The BoE took its foot off the gas. It was a close decision; the surprisingly sharp drop in inflation was probably the decisive factor in keeping interest rates constant for the time being. However, the BoE did not rule out future increases.

However, more would have to come from the PBOC, China‘s central bank, in order to better stimulate the disappointing economic development. In this regard, a precise and powerful monetary policy course was announced, which should support the economic recovery. This is already improving with increasing momentum. However, insufficient domestic demand is causing problems. The central bank can provide some impetus with an expansion of the money supply, for which there is still room to the upside. However, the current Achilles‘ heel is the important real estate market, which is in a massive crisis of confidence. Construction and construction-related companies contribute up to 30% of GDP. The founder and chairman of China Evergrande, has apparently been placed under police surveillance. The highly indebted real estate group is lurching toward insolvency again.

03/ Currencies

Expectations regarding the interest rate policies of the major central banks will also remain a key determinant on the foreign exchange markets. However, expectations will not diverge massively from a „hawkish pause" by the Fed and a „dovish hike" in Europe, as shown. The interest rate summits are no longer far away on this and the other side of the Atlantic. Accordingly, events on the bond markets should tend to calm down somewhat in the long term and yields in Europe and the US should tend to converge somewhat further, if at all.

The strength of the dollar also reflects the significantly improved development of the real yield on U.S. securities compared with federal bonds. In the USA, therefore, capital is once again being paid for in real terms. If Europe can catch up with the U.S.A. on this measure through rising interest rates or faster falling inflation, then the U.S. dollar should possibly reduce some of its pronounced strength against the euro in recent weeks.

The dollar index in general has had an impressive rally that we did not expect to see in this form. With the Fed hawkish and interest rates elevated, and in search of a safe haven also in view of the otherwise higher economic uncertainty, capital apparently flocked to the country, and the dollar was in strong demand. The extent can be seen even more clearly against the Asian currencies. Following the failure of monetary policy to turn around in Japan, the yen has lost massive ground, and the Chinese PBOC is also struggling with yuan weakness.

As already mentioned, the hoped-for dynamic recovery of the Chinese economy after the long Covid lockdown has failed to materialize. Meanwhile, fears of deflation are more likely to prevail in China. Most recently, consumer prices rose again slightly year-on-year by 0.1%, with lower deflation in the prices of food and other goods contributing to the increase.

Overall, the weak price development reflects hesitant demand, which raises expectations of a policy response. Meanwhile, the PBOC, China's central bank, has already fired a first interventionist warning shot. The monetary guardians made it clear that the financial supervisory authority was in a position to keep the yuan exchange rate stable and to take decisive action against one-sided and procyclical bets on the market. Speculators are now likely to act more cautiously in the range of 7.30-7.35 yuan per U.S. dollar in the future, as at this level the patience of the currency guardians seems overstretched. We expect a sideways movement here.

The Western industrialized nations do not have this problem. Fierce and constant inflationary pressure, which was not thought possible for too long, continues to cause problems for the central banks. Accordingly, this remains the key issue on the currency markets. In the US, the next inflation print will come on October 12. A further slight weakening of inflation is expected to 3.6% annually after 3.7% and 4.1% in the core rate excluding food and energy after 4.3%.

The resilient labor market in the USA remains robust, but is showing initial signs of deterioration. Although the unemployment rate is still expected to fall slightly to 3.7% at the beginning of October, the number of new non-farm jobs created should be lower than in the previous month and point to an overall slowdown on the US labor market. However, wage developments will be watched with a wary eye. The data will interact to shape expectations for Fed policy. If the inflation rate and the labor market calm down, the Fed could take its foot off the gas further.

In Europe, inflation rates in some core countries are even further away from the ECB's inflation target. For September, Germany reported preliminary annual inflation of 4.5%, lower than economists had expected. This is the lowest level since the outbreak of the war in Ukraine and a whopping minus. In the previous month, it had been 6.1%. In France, the level is likely to remain higher in September. Accordingly, the inflation problem is far from over for the ECB, probably into the coming year 2024. Inflation is high and the economy is weak, worryingly „stagflation" comes to mind as a buzzword. But it is on the retreat. One would not want to be in the shoes of the European monetary guardians, whose primary task is to maintain monetary stability. Europe is still some way from achieving this. Not to mention that rising oil prices are a new inflation and growth risk.

04/ Commodities

Oil prices soared in the past quarter and became the number one topic on the capital markets. The extended production cuts by Saudi Arabia and Russia kicked off the rally. In addition, there was the export ban on gasoline and diesel from Russia, with which the government wants to ensure the supply of its own market. Currently, Moscow has also reiterated that there is no need to increase oil exports. The Kremlin stands by the current agreements with OPEC+. At the same time, demand has picked up, especially to meet China's crude oil needs. At the same time, low inventories have recently been reported in the United States. The resulting shortage is driving the price of Brent towards $100. So far, there is no reason to doubt the upward trend caused by this. As long as there are no fundamental changes, which are currently not foreseeable, crude oil will remain in demand.

The gold price is having a hard time. Rising real interest rates in the US make the precious metal, which in itself does not yield any dividend like return, relatively less attractive compared to government bonds, for example. At the same time, the US dollar has benefited from this, as described above, which puts additional pressure on gold sentiment. A strong US dollar makes the yellow metal more expensive for foreign buyers and additionally discourages them from making a commitment. However, if this situation calms down, then demand for precious metals should also increase again. From a technical point of view, the seasonality in the last quarter also tends to have a positive effect on the price of gold. Accordingly, the gold price should tend to recover somewhat from its current level in the coming months.

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