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Market outlook from ONE Asset Management AG

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Heiko Hudec

Heiko is the managing director of an asset management company. A graduate physicist, he headed the proprietary trading business of a prestigious securities trading company in Germany for many years. He developed very successful derivative financial market strategies in this capacity and is known as a professional and extremely experienced securities trading strategist.

01/ Equities

We expect the international stock markets to consolidate in the first quarter. After the strong upward sprint of equity since the beginning of November, fresh investment money could flow into the markets at the start of the year. That makes even new highs possible, but then a pause for breath seems more than appropriate. A setback could afterwards bring new investment opportunities.

The positive themes remain intact, particularly with regard to international central bank policy. There is a bullish mood on the stock markets in anticipation of the fact that the peak of the interest rate hike cycle in the USA has been reached and the Federal Reserve said it is ready to descend. In anticipation of interest rate cuts, equity buyers are already driving prices up sharply. Experts are still debating whether too much easing is already being anticipated or not. In our view, it is not important whether the first interest rate cut by the Federal Reserve in the USA comes one meeting earlier or later. Rather, „the trend is your friend“: the interest rate turnaround has begun.

For many investors, the „Goldilocks“ fantasy has once again moved to the forefront of their minds. The economy – starting from the USA as the leading market – is growing moderately. It is growing steadily, but not too strongly, so that inflation remains in check. In this environment, which is just right and not too extreme, equities are benefiting from solid corporate earnings growth.

Looking at the most important central banks, Christine Lagarde from the European Central Bank (ECB) has recently „outhawked“ her US colleagues. The Europeans were much more restrictive in their choice of words and are sticking to their „higher for longer“ course. Federal Reserve Chairman Jerome Powell, on the other hand, unequivocally heralded a turnaround in monetary policy. With a „dovish hold“ in December, the Fed signaled the end of the cycle of interest rate hikes. It also held out the prospect of interest rate cuts for the new year. The members of the Federal Open Market Committee (FOMC) now expect an average key interest rate of 4.6% by the end of 2024, down from their view of 5.1% in September. This could point to three interest rate cuts in the new year.

On the global financial markets, these signals fueled the recovery phase even more and in the end triggered a brilliant rally. Some European and US share indices jumped to new record highs, while others are within striking distance of their highs. In Asia, many stock markets are lagging behind. The China-related markets (Hong Kong) in particular are performing disappointingly.

The EuroStoxx50 index for the eurozone and the pan-European share barometer Stoxx Europe 50 are at a

high since 2001, while the German benchmark Dax even reached a record high of 17003 points in mid-December. Since the beginning of November, the leading index of Europe's biggest economy has recorded an impressive rise of almost 16% at its peak. From a technical perspective, the German blue chips have moved into uncharted territory where next resistance can only be derived.

However, the first resistance for the Dax is at the record high of 17,000 points. If this is overcome again, the German market will give a fresh buy signal from a technical perspective. After the exceptionally strong rise of the past two months, a pause for breath seems appropriate at the beginning of the year. The first correction target is the 16000-point mark, which could be tested again with a support zone of just under 15900 points. In the longer term, however, the DAX will remain on an upward trend and 20000 points could also be targeted.

From today's perspective, it seems questionable whether such a whopping 18% increase can be achieved in 2024 after such a strong year for equities. It is also worth taking a look at seasonal factors when projecting share prices on the stock exchanges. In the USA, as in some parts of Europe, an election year is on the horizon. The first half of the year is typically difficult on the markets in US election years. This fits in with our expectation of an imminent consolidation. In the second half of the year, shortly before the election, the stock markets then start to rise again seasonally. This could also be the case for the Dax. With a setback towards 16,000 points in the first quarter. At the beginning of the year, however, it could see another 17,000 points with a tailwind of fresh money.

As a performance index, the German blue-chip barometer can only be compared with the usual price indices to a limited extent. The reinvestment of dividends gives the Dax a natural upward slope. The Dax, adjusted as a price index, has so far remained a good 2% below its record of two years ago.

02/ Bonds

The spectre of inflation has vanished from the capital markets for the time being. Disinflation is the global trend, the extent of which can now be estimated.

In China, there are even concerns about deflation after the recovery from the long coronavirus pause continues to be too sluggish and disappointing. With a view to the most important central banks, this may lead to earlier and more aggressive interest rate cuts. In our view, however, the Fed will probably remain silent in the first quarter. The change in interest rate expectations in the US has been remarkably abrupt in recent weeks, triggered by tame price data in November. The Fed's last interest rate decision was interpreted as a „dovish hold“ and further fueled the imagination.

Fed Chairman Jerome Powell has already clearly signaled that he will consider a reduction before the official inflation target of 2% is reached. We are assuming 2.5% for the core rate as a benchmark. This could already be reached in February with the PCE deflator used by the Fed. The current reading was 2.6%. Accordingly, some market participants are speculating on a US interest rate cut in March. For us, the „higher for longer“ announcement still sounds too good to be true at such an early stage. Our interest rate cut expectations have so far tended towards the later first half of the year or the second half. If the trend towards interest rate cuts starts earlier, we will have to scrutinize whether this does not conceal a substantial weakness in the economy. The Fed has held out the prospect of three interest rate cuts for 2024 and clearly announced the end of the rate hike cycle.

However, Raphael Bostic from the Fed, who will be a voting member from 2024 onwards, recently emphasized that he currently sees no urgency for an interest rate cut. The Atlanta Fed chief expects two interest rate cuts in the new year, probably from the third quarter onwards. Looking at the labor market, this rather cautious assessment makes sense. Employment grew solidly in November – somewhat distorted by strikes. The unemployment rate fell slightly and wages rose in line with forecasts. Overall, the jobs report was surprisingly positive, but also did not indicate overheating. The situation is likely to deteriorate in the coming months. However, as US companies are still looking for workers, we expect a „soft landing“, as in the economy as a whole, which may be a little bumpier at times. Given that the labor market is expected to remain stable, we do not want to overdo it with our expectations of interest rate cuts.

In Europe, investors will have to hold back a little longer. In December, the European monetary authorities were not yet tempted out of their reserves with regard to a rapid change in monetary policy. The ECB wants to maintain the current key interest rate level for a longer period of time. This is despite the fact that the central bank's economists have significantly reduced their inflation projections for the coming year to just 2.7% in the core rate.

Inflation could rise again temporarily. In Germany, for example, VAT in restaurants will be increased at

the beginning of 2024 and the CO2 tax will be raised, which could probably drive-up inflation again. Other measures in the „emergency budget“ could also make the cost of living more expensive again. According to leading economists, however, the core rate could fall to around 3% and thus come noticeably closer to the ECB target. At the same time, the ECB economists were somewhat more pessimistic with their growth forecast of just 0.8% in the eurozone in 2024.

At European level, there have recently been glimmers of hope for the economy. Although consumer confidence in the eurozone remains in negative territory, it has resumed its recovery trend and exceeded economists' forecasts in December. In the coming months, this trend should continue thanks to wage increases coupled with easing inflationary pressure and improved household finances. However, retail sales in the eurozone have stagnated so far and have yet to show signs of recovery. Sentiment on the corporate side has been stable recently and could also turn upwards. However, the purchasing managers' indices have not yet signaled a Europe-wide return to growth. They were weak again in December. There are still no signs of a trend reversal. In addition, the interest rate hikes to date have only had a partial impact on the economy. The full impact is only likely to be felt in the coming year.

Ultimately, however, this apparent reluctance to signal a turnaround in interest rates in Europe is likely to be transitory: Economic development is just too weak. In view of declining inflation, the European monetary authorities are unlikely to withhold their support for the economy through a more expansionary monetary policy in the long term. However, it could take more time than in the USA before the first interest rate move downwards. On the other hand, it could possibly be larger.

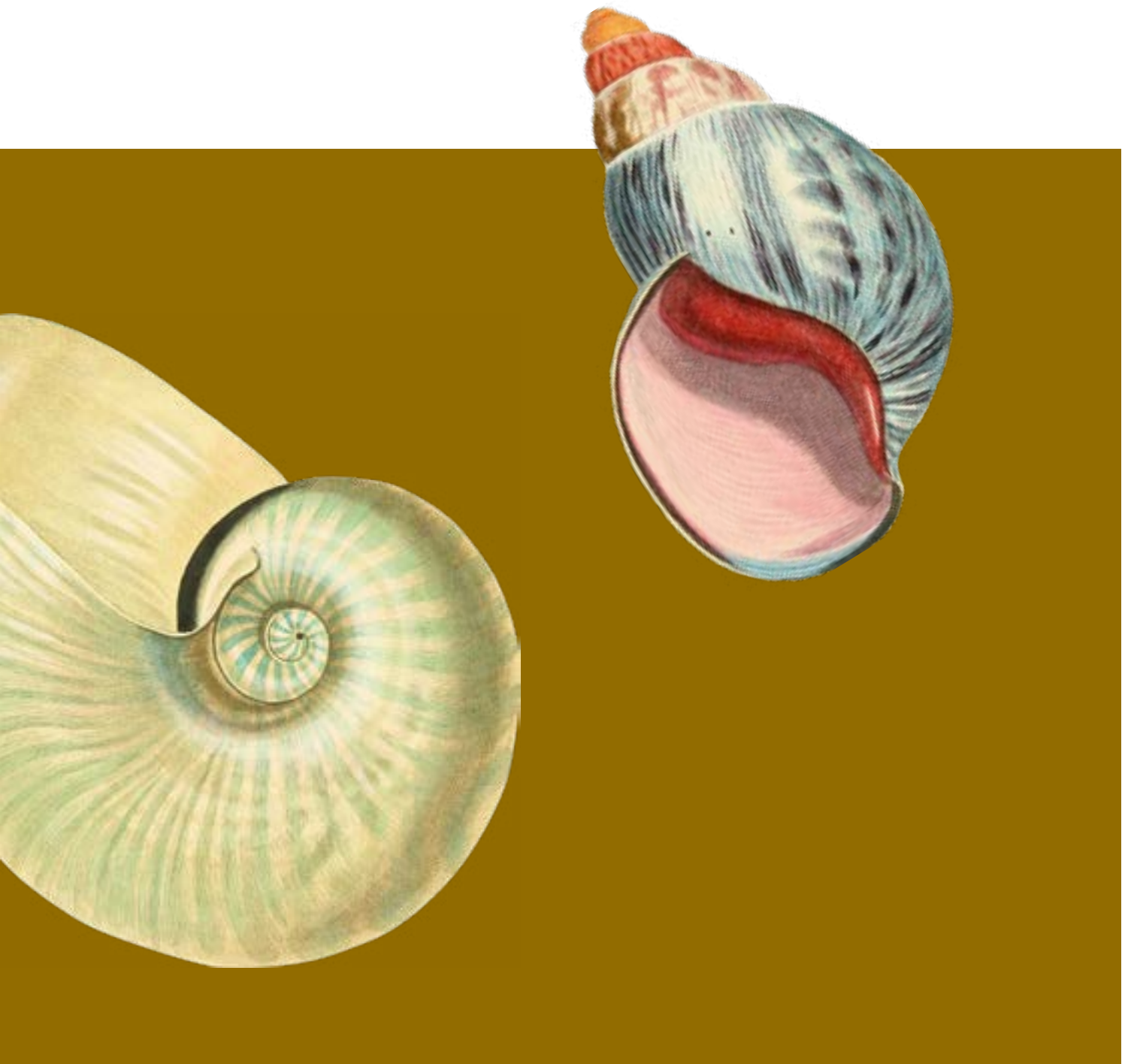
The economy is sluggish and Germany's growth engine in particular appears to be stuttering. The wobbles of the coalition government with its sometimes-difficult predictability and insufficient decision-making power are not helping at all. In December, the important ifo business climate index disappointed with the first decline in four months. The previous rise could prove to be a flash in the pan and the index could pay tribute to the difficult situation. However, falling inflation together with some generous wage increases could also bring new hope if private consumption picks up and drives the industry forward. Additional help could come from the ECB. At the beginning of the year, however, the outlook appears rather pessimistic, as the ifo index shows.

The Bank of Japan is maintaining its marginally negative key interest rate and is leaving the target yield for ten-year Japanese government bonds unchanged. The new head of the central bank, Kazuo Ueda, is not budging either. However, the markets are speculating that the monetary authorities will soon abandon the negative key interest rate – probably in the first quarter. From the central bankers' point of view, the economy appears to be recovering at a

02/ Bonds

moderate pace. Corporate profits are also developing positively. In this environment, we believe that the BoJ's continued negative interest rate policy is no longer necessary. This underpins the assumption of an imminent gradual tightening. Looking at interest rates, ten-year government bonds could rise again towards a yield of 1%.

Expectations have also changed in the UK. Inflationary pressure is falling rapidly. After inflation data had repeatedly been well above economists' forecasts until the summer and the Bank of England was repeatedly forced to raise interest rates, price data has regularly been better than expected in recent months. The significant fall in inflation has also given the monetary authorities new leeway. As a result, bets on an interest rate cut are already increasing. Presumably, the British monetary authorities are still deeply shocked by the renewed jump in inflation in the first half of the year. Current inflation also remains well above the BoE's target. Even though the British had played a pioneering role in the rate hike cycle, we now expect them to be more hesitant in reversing their interest rate policy. The BoE is likely to lag behind with interest rate cuts.



03/ Currencies

The euro has recently benefited from the renewed divergence in interest rate expectations between the US and Europe. The abrupt end to the cycle of interest rate hikes in the US and the almost aggressive shift towards a clearly dovish tone has caused interest rate expectations in the US to fall significantly. Interest rates have also fallen significantly in Europe. The strength of the euro, or rather the weakness of the US dollar, clearly reflects expectations regarding central bank policy, especially that of the Fed: Currency traders are taking a more dovish view of the monetary policy outlook in the US - i.e. more expansionary - than in other countries and are shifting capital from the US to other currency areas accordingly. The dollar index, which tracks the value of the US currency against a basket of other leading currencies, fell continuously in the fourth quarter.

So far, there are no signs that this clear trend will reverse in the foreseeable future. We expect the dollar to continue to weaken, which makes the eurozone look attractive. Due to declining inflation, both central banks have room to cut interest rates, but the ECB will take more time and is likely to cut less sharply in 2024 and 2025. Overall, the ECB's policy is positive for the euro. However, new episodes of inflation could entail risk premiums on the currency market and cap the euro's potential.

On the other hand, the US dollar should tend to remain weak if the Fed sticks to its monetary policy reversal as expected. However, if the „soft landing“ is successful, the US economy should remain relatively robust compared to the other leading industrialized nations. This would then increasingly speak in favor of the US dollar in the longer term.

The development in Japan with the BoJ's stoic calm is particularly exciting. Monetary policymakers are clearly playing for time with their continued cautious stance. Accordingly, the yen is coming under a certain amount of pressure on the currency market. However, this is no longer sustained. Until the beginning of November, the Japanese currency had been under significant pressure throughout the year. The trend even broke above 150 yen per dollar.

At that time, there was repeated speculation of interventions in favor of the yen and finally the trend reversed. At currently 142 yen, the cushion has become quite comfortable over the past two months. Speculation that the BoJ will soon abandon its negative interest rate policy is helping the yen. If this is still a long time coming, the yen may come under pressure from time to time. However, the central bank is then likely to move and strengthen the yen further.

With an eye on China, many market participants are still waiting for monetary and fiscal policy stimuli, which have so far been used as a boost during periods of relative weakness. On the foreign exchange market, the offshore yuan has been able to recover hand in hand with the yen, with the weakness of the dollar playing into the Chinese currency's hands. A sustained upturn for the Chinese economy, which could also take pressure off the currency in the long term, has yet to materialize.

Some political support is coming, which should favor a moderate cyclical recovery of the Chinese economy in the first quarter. However, this currently remains on shaky ground, as structural weaknesses continue to weigh heavily on the economy. The government has a difficult task ahead of it to clean up its act and put the country back on a sound footing.

04/ Commodities

The attacks by the Yemeni Houthi on transport ships in the Red Sea recently gave oil prices a major push. After the very weak development in the fourth quarter, prices stabilized and turned upwards. Large shipping companies are avoiding the sea route to the Suez Canal and are now bypassing Africa, which can lead to delays in supply chains and shortages. The USA is currently trying to mobilize a multilateral intervention force.

However, the question of the extent to which the OPEC plus countries manage to maintain their (production) discipline remains crucial for crude oil. If prices continue to rise, this will be easier for the members of the oil cartel. Joint cuts may even become possible. This would provide further support for the market. If prices weaken, however, discipline could fail due to the resistance of many countries and cause another setback.

Angola is now leaving Opec+. This is unlikely to have much impact on supply in the short term, as the Africans are already producing at the limits of their capacity. However, the long-established cartel is showing cracks. In the long term, other countries could leave, as they apparently feel under pressure from the two large Opec+ states, i.e. Russia and Saudi Arabia. The plans of the Arab Emirates in particular are being criticized. The market power of Opec+ could decline, with negative implications for oil prices. Added to this is the USA, which is constantly expanding its production. It is therefore difficult to reduce the abundant supply on the oil markets.

The demand side was burdened by gloomy economic expectations. China's disappointing opening has so far failed to provide the hoped-for boost to consumption. However, global economic expectations have recently improved again, not least due to the dovish monetary policy signals from the US. This could provide fundamental support for oil prices. Especially if China can manage to break free from the current upward trend. This positive trend should continue for the time being and could underpin the current upward trend in black gold for the coming weeks.

The gold price benefited from the broad-based weakness of the dollar in the past quarter: The yellow metal reached a record high of USD 2135 at the beginning of December. Gold was not quite able to maintain the level from the abrupt price jump, but the precious metal is holding up well above the psychologically important USD 2000 mark.

As mentioned in our previous report, gold can also benefit from market technicals in addition to the weak US currency, which makes the price appear more favorable to foreign buyers. Seasonality in particular is on the side of the yellow metal. There is support from this side until the end of February. Typically, over the course of the past thirty years, gold continues to rise in price in the first two months of the year before prices take a breather until mid-September.

Support from the interest rate side should not disappear either. The surprisingly abrupt turnaround in monetary policy in the USA - at least the interest rate peak has been reached - has caused interest rates to fall again. Falling (real) interest rates are good for precious metals. With their value-preserving function, this form of investment competes with bonds, among other things, which become more attractive with higher interest rates and thus attract capital into bonds.

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contact

Austrasse 14
9495 Triesen
Liechtenstein
+423 237 79 99
team@oneam.com
www.oneam.com

