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Market outlook from ONE Asset Management AG

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Asset
Management

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ONE® Asset Management

01/ Equities

The first quarter of the new year can easily be summarized as a record-breaking run on the world's most important stock markets. There are no signs of an end to the upward trend in the coming months either. The „Goldilocks" scenario is once again providing the capital markets with fertile breeding ground for gains across all asset classes. The weakness typical of election years in the USA was simply bypassed in the first few months.

The fear of recession that was still evident in the previous year turned into expectations of a „soft landing" scenario in the USA and then into a „no landing", meaning that the world's largest economy could get off to a flying start again. Not too hot and not too cold, but just the right temperature - that is the Goldilocks environment, just the way investors like it. It is characterized by stable, moderate growth, low inflation rates of around 2%, low interest rates, full employment and rising corporate profits. This best of all worlds is currently being priced in again on the markets. In the USA, the consumer is playing along cheerfully, supported by a strong labor market. Corporate profits should confirm the positive sentiment.

The US government continues to support the economy with high government spending. The subsequent, extremely high budget deficits are unusual for an economy that is performing so well. However, a departure from this policy is not to be expected, especially before the elections. This will therefore continue to fuel the economy.

At the moment, no investor wants to hear about the manifold risks to this ideal stock market world: „Party like it's 1999" is the motto. Nevertheless, we will list some of them. Risks include stubborn inflation, a further deterioration in the geopolitical situation - including the upcoming US election - and overly optimistic investor positioning. The sentiment of stock market participants is running upwards. From this perspective, a correction would be due. Even if market expectations remain positive, selective profit-taking and a rebalancing of our own positioning would therefore appear to make sense in our view.

The charts do not yet give cause for concern. Most share indices are jumping from one record high to the next. As a result, they continue to send positive signals in uncharted territory. For the Dax, for example, Fibonacci levels can be used to derive a price target of just under 18,650 points, which is now not too far away. It is quite possible that this level will be tested in April. April is traditionally a good month for the stock markets, before the stock markets tend to weaken in May in US election years.

The risk of a setback for the Dax is 17,000 points. The old record highs provide support below this level. In the long term, the share remains the most interesting form of investment for investors. In addition, capital has already flowed into Europe and, in particular, into the German stock market. This suggests that the DAX outperformed the US stock market last month.

Despite the breathtaking price gains in recent weeks and months, the stock market lights remain green for the US indices. The increasing market breadth of the rally is positive. Initially, the „Magnificent 7“ once again drove the rally, but now other outperformers are following suit. The returning Goldilocks scenario is attracting new buyers, particularly in cyclical stocks. Especially as the big seven stocks have now become the „Big 5“, given the disappointing performance of Apple and Tesla. Cyclicals are benefiting from the global rebound in the manufacturing sector, which is reflected in the expectations of the purchasing managers‘ indices. Overall, value stocks could climb more strongly in investors‘ favor again. Second and third-tier stocks could also traditionally catch up in the late phase of a bull market.

The „Gamestop“ mentality of 2021 has not yet returned to the US market either. This is underlined by the Schwab Trading Activity Index, which is driven in particular by the stock market transactions of small investors and is still far below the level of three years ago. Even if the stock market debutants such as the Trump Media SPAC launched by Donald Trump and the brilliant stock market debut of the Reddit share certainly suggest a short-term flare-up of this gold-rush mood. For the most part, however, share price developments are already proceeding along rational lines, so that a „pathological“ exaggeration is not to be seen. A healthy correction on the stock markets currently seems possible at any time, but in our view the start of a bear market is rather unlikely. Corrections offer buying opportunities.

Meanwhile, the Asian stock markets have been noticeably mixed. The disappointment over the very sluggish re-opening of the Chinese economy after the long Covid pause runs deep. The China-related markets in particular, such as Hong Kong‘s Hang Seng Index and of course the Chinese mainland stock exchanges, are lagging far behind the global markets. Repeated attempts to catch up have so far been unsustainable. However, a decisive recovery of the Shanghai Composite Index would be important to signal a real recovery in China.

In Tokyo, on the other hand, the stock market is performing like a free-for-all, buoyed in particular by the weak yen. This is making Japanese products ever cheaper for foreign buyers. The Nikkei index has actually managed to reach a record high. Since the beginning of the year, the leading index has shown the best price performance among the world‘s leading indices with an increase of more than 20%. A year ago, even great optimists would hardly have thought this renaissance of the Japanese stock market possible after the Japan bubble burst in the early 1990s. In the wake of the financial crisis, the index was down 82% from its high at the end of 1989 at the end of 2008. From the coronavirus low at the beginning of 2020, the Nikkei index still managed to gain a whopping 151%. The Nikkei thus only just lagged behind the Nasdaq100, which gained 173%. The Dax gained 123% in the same period.

02/ Bonds

Surprisingly, in March it was the Swiss National Bank (SNB) that initiated the cycle of interest rate cuts by the major central banks - with the exception of those in Asia. There have already been some countries in Europe that have cut rates, such as Poland, the Czech Republic and Hungary, but the SNB and the Swiss franc are the first with a globally important currency. The successful fight against inflation with the sustained restoration of price stability made the easing of monetary policy possible. The strong franc is likely to be a thorn in the side of the monetary authorities and they are helping the export-oriented Swiss industry from their comfortable position.

The Federal Reserve will remain an observer for the time being, with the key interest rate unchanged. Possible interest rate cuts are being pushed back further, but the Fed's forecasts continue to signal three interest rate cuts totaling 0.75% this year. This is despite the monetary authorities slightly raising their growth expectations for 2024 and now assuming a rate above trend growth for 2025-26. In contrast, they believe that the recent rise in inflation should prove to be a slip on the way back to inflation rates of around 2%.

Her boss Jerome Powell was generally relaxed. He fed the doves with his comments. The Fed is sticking to its path of interest rate cuts despite the good economy, but is waiting for inflation to move further towards 2%. Tailwinds are coming from the US labor market. It remains strong, but wage increases are quite low. The wage-price spiral is not being felt to the extent feared, so that the pressure on the inflation side appears to be easily calculable.

We are counting on at least one Fed rate cut in the second quarter. This is also because the closer the election gets, the more cautious the monetary authorities are likely to be. A rate cut is unlikely in the weeks leading up to November 5 due to the Fed's neutrality. However, there is a change in their forecast, the dot plots: there are now indications of one less interest rate cut for 2025. For this year, the first interest rate cut date in the US will be June. The Fed is thus supporting a „soft landing" in the US, which could ultimately turn into a „no landing". The neutral interest rate level should settle slightly higher than 2% in the long term.

All in all, we believe that the Fed will cut interest rates much less than expected. Government spending is likely to fuel the economy even after the election, while the job market and the economy continue to run smoothly. There is actually no reason to cut interest rates in the US. In view of the high expectations, this could prove to be a risk for equities in the longer term.

In Europe, the European Central Bank (ECB) is also keeping quiet. However, the first interest rate cut should also come in the second quarter, as the statements by ECB President Christine Lagarde already suggest for June. After stabilizing in March, the purchasing managers' indices also offer cause for optimism. Even if the largest European economies, Germany and France, are lagging behind, as is the manufacturing industry compared to the more dynamic service sector. In Europe, the expectations components of the purchasing managers' indices recovered last month for the sixth time in a row. Sentiment is now also improving in the core countries. The worst should therefore be over in the region's largest economies. At the same time, inflationary pressure is abating.

In Germany, the Ifo business climate index rose sharply in March to its highest level since June. This is a clear glimmer of hope for the largest economy in the eurozone and therefore for the entire region, even if a decline in gross domestic product is also possible in the first quarter. We are seeing a broad-based recovery across all sectors. There is even an abrupt rise in expectations in the manufacturing sector. The hospitality industry, which had to digest the loss of the VAT bonus, also saw an upward trend. Accordingly, our expectation is for slight growth in the second quarter. Although this is still on shaky ground, the hope of a tailwind from the ECB has an additional positive effect. This then moves back towards the Goldilocks scenario, as very fertile ground for the capital markets.

Meanwhile, the inflation rate continues to fall, in the USA and above all in the eurozone. The first inflation figures for March will be published at the beginning of April. After an annual rate of 2.6% in Europe, a slight decline is expected, but due to the relatively high base effect in March and April, we can already imagine a drop towards 2%, and the mark could then fall in April. From this perspective, there is certainly room for maneuver for the European monetary authorities.

The Bank of England is also entering the second quarter with an extended interest rate pause. As expected, the prime rate remained at 5.25% for the fifth time in a row. The disinflationary trend is also unbroken in the UK. Core inflation is nevertheless at an elevated level. Accordingly, the monetary authorities want to monitor the ongoing inflationary pressure and the robustness of the economy for the time being. As with the Fed and the ECB, the data situation will be decisive. However, the latest economic data signal a recovery in growth expectations. Overall, however, the Bank of England is also moving further in the direction of interest rate cuts. Two other members left the hawkish camp and voted neutral this time with a „hold".

The Bank of Japan also made a splash in the international central bank concert. The first key interest rate increase in 17 years makes eight years of negative key interest rates history. Direct control of capital market interest rates was also discontinued, as were ETF purchases. The still new central bank governor Kazuo Ueda has thus ushered in a new monetary policy era. In fact, however, many of the cornerstones of the expansionary policy no longer applied anyway. The recent high wage settlements are likely to have been the main reason for the interest rate hike. However, the Bank of Japan has announced that it will continue to pursue a loose monetary policy and will remain cautious.

The People's Bank of China (PBOC) is likely to have

02/ Bonds

further room for reserve rate easing after the somewhat surprising RRR rate cut in January. The medium-term MLF rate could also be lowered to combat deflation, which could also restore confidence in the markets. The optimistic central bank statements regarding positive signals from the still tense real estate market should also restore confidence. A positive indication was also provided by industrial profits, for example, which rose by 10.2% year-on-year between the beginning of the year and February. The industrial sector may have bottomed out in China.

03/ Currencies

The inflation rate in Europe should move faster towards the 2% mark - and below - than in the USA. At first glance, this results in greater pressure on the ECB to cut interest rates, which could lead to a widening of the interest rate differential. Accordingly, the euro could tend to weaken further at the start of the quarter. However, the approaching election in the US will then increase the pressure on the Fed to act before the window slowly closes in the run-up to the referendum. This is because the Fed does not want to be accused of acting to the advantage of the incumbent shortly before the election date. This could offset the interest rate argument.

However, the US dollar is currently bursting with strength. Even the dovish press conference by Fed Chairman Jerome Powell could not change this. The strong US economy is attracting capital flows into the dollar zone. There are currently many indications that the international central banks will lower key interest rates almost in lockstep. Accordingly, there is currently hardly anything to be said against a strong US dollar. The pressure on the Fed to cut interest rates appears to be limited by the continuing robust data from the labor market and the economy. It is possible that the interest rate level in the US will remain higher in the longer term than the majority of economists currently think, and perhaps there will be no interest rate cut. This continues to speak in favor of the dollar.

Meanwhile, the pound remains in a sideways phase, which somehow also reflects the signals from the central bank and from the data side: Not fish, not fowl. However, the British currency also made strong gains in November and seems to be still digesting this. The Bank of England did not give the pound any new impetus, even if the vote was somewhat more dovish than many had expected. There are new forecasts at the BoE‘s next meeting that could breathe more life back into the pound. If inflation continues to surprise to the downside, a rate cut could also come in the UK. Depending on the data - also in the UK.

The yen is in focus with the Bank of Japan. Despite the interest rate hike, the Japanese currency remains weak against the US dollar. The monetary authorities also sold their mini-rate hike as dovishly as possible and a brilliant rate hike cycle is certainly not to be expected. As a result, the yen bulls have thrown in the towel, with hardly any interest rates likely to be paid in Japan in the foreseeable future. The yen quickly entered „intervention territory“. There were emergency meetings between the monetary authorities and politicians. However, the yen is unlikely to turn around.

However, intervention will be difficult. The Ministry of Finance, together with the Bank of Japan, would have to credibly convince currency traders of the yen‘s intrinsic value, most likely with signals of a tighter interest rate policy. Without the market‘s conviction that the yen was actually trading too weakly, dollar sales will almost certainly come to nothing.

The PBOC in China also has its hands full protecting the yuan from excessive weakness. Fundamental uncertainty remains high in view of the persistently faltering economy, not least because the measures taken by the central government are much more cautious than the markets are used to. Accordingly, the yuan is likely to remain under pressure for the time being.

04/ Commodities

Everyone is talking about gold again - the yellow metal recently reached a historic high above $2200. Technology plays an important role here, as the precious metal attracted new buying interest with the new high. There have been no classic drivers such as its status as a safe haven recently. However, the prospect of interest rate cuts is also likely to have had a very positive effect. After all, falling interest rates make gold appear more attractive as a store of value investment compared to other alternatives such as bonds. The recent trend towards a weaker US dollar also helps somewhat. As gold purchases are usually settled in US dollars, this makes gold cheaper for many market participants.

These classic support factors for gold appear to be intact for the time being. Interest rate cuts, not only in the US in a positive, non-recessionary economic environment, should continue to serve as an accelerator for gold prices. In addition, rapidly rising global debt is a supporting argument. The record hunt should continue in the new quarter. Overall falling real interest rates could also boost demand for ETF funds again.

Even if the demand for gold is not very cyclical, the scenario of interest rate cuts and a simultaneous recovery of the global economy offers a favorable environment for commodities in general. Accordingly, oil prices may also remain on the upswing in the new quarter.

Oil prices also performed well in the first quarter of this year, driven primarily by an upturn on the demand side. Both US WTI and Brent oil have seen double-digit percentage increases since the beginning of the year. Further momentum is now coming from the start of the „driving season“, when spring trips are taken. After the winter, people are getting back into their cars or planes more often. More important and decisive, however, will be the „return“ of China with its great thirst for oil. There are positive signals here, which also continues to speak in favor of oil. Recently, the massive destruction of oil infrastructure in Russia has also supported oil prices.

The ongoing production restrictions imposed by OPEC+ are also having a positive effect. No changes to the supply policy of the producing countries appear to be on the cards in the coming meetings. The war in Ukraine and the Middle East is also providing support. The stock markets are also sending out positive expectations for the oil price trend: The sector index of US oil service providers has performed well and has technically broken out. The upward trend channel for oil itself also remains intact. The revival in demand with supply remaining under control suggests that prices will continue to rise. In the new quarter, both types are likely to climb above $85 per barrel towards $90.

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