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PostFinance

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Editorial

Will the tech rally ever end?

New technologies change our lives. They improve productivity, save resources and make many things more convenient. That means more revenue for the companies concerned. However, in a market economy higher revenue doesn't lead to continual earnings growth.

Philipp Merkt
Chief Investment Officer

Technological progress is what drives our economy forward. Innovation enables us to use fewer resources to meet existing requirements, or to resolve newly emerging challenges. If no progress had been made on improving processes and products, our standard of living would still be like it was back in the Stone Age.

"When investing in tech stocks, it's important to bear in mind that revenue and earnings growth aren't the same thing."

In a market economy, we create strong incentives for such progress. Advancements benefiting humanity deserve to be rewarded – but not forever. For example, we limit the protection of patents to a specific application, and generally also to a certain period of time. Afterwards, there's competition and initially high profit levels are eroded by rivals. This has resulted in market economies clearly outperforming other economic systems when it comes to generating wealth. Equally, no other economic system rivals ours in terms of social achievements, medical care, standard of living or promoting individual freedoms.

Why is that relevant to investors? Because tech stocks are increasingly at the heart of market developments and many investors get caught up in the euphoria and start dreaming of endless earnings growth and rising equity prices. New technologies really can produce a sharp rise in revenue and profit for certain highly innovative companies. A current example of that is the chip manufacturer Nvidia. The company launched on the stock exchange at the tail end of the dot.com bubble in 1999. One share was worth 4 US cents then. Its share price is now 135 US dollars.

Innovation in the chips manufactured and the general euphoric mood have driven revenue and profit up by a factor of more than 20 over the past ten years. However, the share price has risen by a factor of more than 300. In other words, the market expects the rapid increase in revenue and profit levels to continue at the same rate. While that may happen for an extended period, profit margins like today of 50 percent and over aren't conceivable long-term in our economic system.

Artificial intelligence clearly possesses huge potential: generative AI has changed a great deal in a short space of time and has entered everyday life through ChatGPT and other applications. There's a lot more to come, too, but markets tend towards hyperbole. Nobody knows how long things will last, but what we do know is that future developments at Nvidia won't be game-changing for the entire market. We've seen one new technology after the other since the Second World War. Contrary to the expectations of many people, a new technology has never yet significantly accelerated the rise in profit levels of the entire market. That's happened for certain companies and over a period of time, but not for the entire market, as earnings growth always returns to potential growth after the initial overperformance.

Things have to be that way too: what many observers forget is that products with high margins soon face competition or expensive products are replaced by cheaper ones. The providers of such innovations are often brought back down to earth after the initial euphoria.

Positioning

Healthy scepticism

There's still no clear, positive impetus from the economy. Meanwhile, very high expectations have already been factored into tech stocks. We remain cautious and favour value stocks, such as emerging market and defensive Swiss equities, over US and European shares.

The financial markets and especially the bond markets fluctuated between hope and fear last month in anticipation of the next steps for US monetary policy. Whereas last year market participants were anticipating a total of seven interest rate cuts by the end of 2024, these expectations have been increasingly lowered since the year began. That's why the Federal Reserve's decision on interest rates in June was eagerly anticipated. Information relevant to monetary policy caused volatility on the bond markets in the lead-up to the announcement. The recent fall in US inflation raised hopes that monetary policy could still be eased considerably this year. Neither the Federal Reserve's decision not to cut interest rates nor the rather cautious announcement that policy rates would not be lowered until the end of this year, if at all, changed the situation much.

High expectations placed on tech stocks

However, this had little impact on the US stock markets, which made gains despite the rollercoaster ride on the bond markets. Above all, tech stocks benefiting from artificial intelligence continued to rise. However, very high expectations have now been factored into the prices of these stocks. The past tells us that companies don't experience endless earnings growth. On the contrary, historical US data shows that new technologies have not changed the overall market's growth trajectory in the long term. High corporate earnings actually attract new rivals, bringing competition back into play and normalizing corporate profits and share prices.

Performance of asset classes

Asset class		1M in CHF	YTD [1] in CHF	1M in LCY [2]	YTD [1] in LCY [2]
Currencies	EUR	–1.0%	4.1%	–1.0%	4.1%
	USD	–1.3%	6.3%	–1.3%	6.3%
	JPY	–2.0%	–4.4%	–2.0%	–4.4%
Fixed Income	Switzerland	–0.2%	0.0%	–0.2%	0.0%
	World	–0.3%	3.7%	1.0%	–2.5%
	Emerging markets	–0.2%	8.9%	1.1%	2.4%
Equities	Switzerland	3.1%	10.9%	3.1%	10.9%
	World	1.6%	18.9%	3.0%	11.8%
	USA	2.3%	20.9%	3.7%	13.8%
	Eurozone	–1.4%	16.2%	–0.4%	11.7%
	United Kingdom	–1.6%	15.7%	–2.4%	8.3%
	Japan	–0.4%	13.5%	1.6%	18.8%
	Emerging markets	–1.3%	12.2%	0.0%	5.5%
Alternative Investments	Swiss real estate	–2.4%	1.4%	–2.4%	1.4%
	Gold	–3.3%	19.0%	–1.9%	11.9%

[1] Year-to-date: Since year start
[2] Local currency

Data as of 12.6.2024
Source: Allfunds Tech Solutions, MSCI, SIX, Bloomberg Barclays, J.P.Morgan

A further challenge for growth stocks, such as those in the tech sector, is that we see considerable upside potential in capital market interest rates. The current situation, where much higher interest can be earned on the money markets than on the capital market, isn't sustainable. Interest-sensitive growth stocks are usually hit hard by rising long-term interest rates. In this climate, we remain sceptical of the tech-heavy US stock market and favour value stocks.

"If a slowdown on the labour market actually materializes, this may put policy rate cuts within reach again."

A cautious approach is advised

European and Asian stock markets showed weakness compared to their US counterpart. Following political uncertainty in Europe in the wake of European parliamentary elections, equity markets in Europe have fallen sharply of late. Weaker economic numbers from Japan and China's still sluggish recovery meant Asian stock markets suffered losses, too. By contrast, the Swiss equity market was quite robust. After performing sluggishly earlier this year, it staged a recovery recently and its annual performance now stands at over 8 percent. The economic outlook for Europe nevertheless remains gloomy, while the US economy may also have peaked. That's why we're still favouring the defensive Swiss stock market and emerging market equities over European and US shares.

Positioning relative to long term strategy: Swiss focus

Asset class		**TAA[1] old**	**TAA[1] new**	**underweighted[3]**		**neutral[3]**	**overweighted[3]**	
				−−	−		+	++
Liquidity	**Total**	**7.0%**	**7.0%**					
	CHF	1.0%	1.0%					
	Money market CHF	6.0%	6.0%					
Fixed Income	**Total**	**31.0%**	**31.0%**					
	Switzerland	15.0%	15.0%					
	World[2]	10.0%	10.0%					
	Emerging markets[2]	6.0%	6.0%					
Equities	**Total**	**50.0%**	**50.0%**					
	Switzerland	25.0%	25.0%					
	USA	6.0%	6.0%					
	Eurozone	3.0%	3.0%					
	United Kingdom	2.0%	2.0%					
	Japan	2.0%	2.0%					
	Emerging markets	10.0%	10.0%					
	World Value	2.0%	2.0%					
Alternative Investments	**Total**	**12.0%**	**12.0%**					
	Swiss real estate	7.0%	7.0%					
	Gold[2]	5.0%	5.0%					

1 Tactical Asset Allocation: short to mid-term orientation
2 Currency hedge to CHF
3 Positioning relative to our long-term asset allocation

— Adjustment compared to last month

Market overview
Fixed income

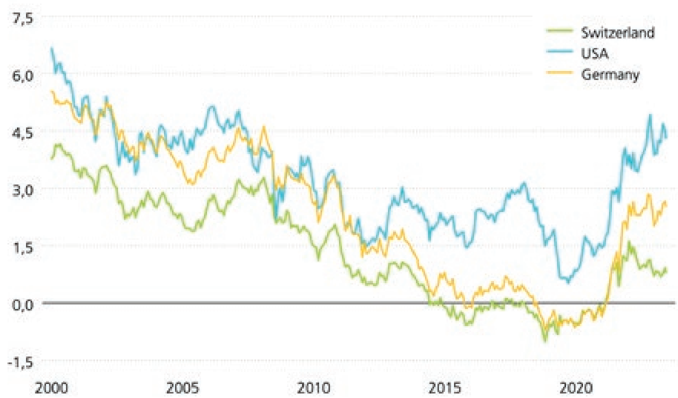
Uncertainty over US monetary policy led to volatility on the bond markets of industrialized nations.

Indexed performance of government bonds in local currency
100 = 01.01.2024

The rollercoaster ride on the bond markets continued last month. The main focus of attention was uncertainty over whether the US Federal Reserve would cut its policy rates. Monetary policy data from the USA, in turn, triggered sharp fluctuations on global bond markets. Concerns that the US economy would continue its strong performance, with inflation rates barely falling, were predominant until the end of May. However, the downward correction to US growth from 1.6 to 1.3 percent and the recent fall in US inflation reassured the markets recently. US government bonds gained overall during the month, whereas their European and Swiss counterparts fell slightly.

Source: SIX, Bloomberg Barclays

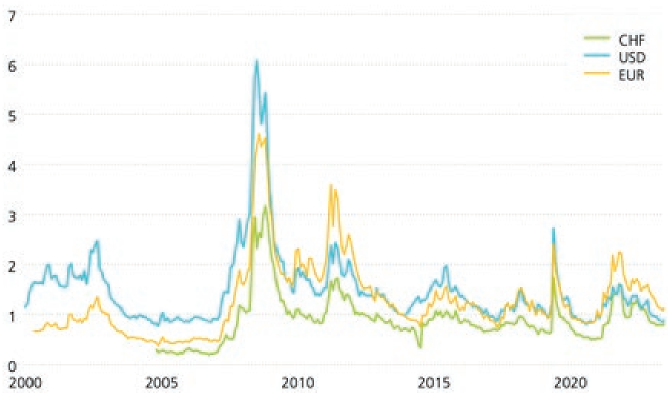
Trend in 10-year yields to maturity
In percent



Long term interest rates in the industrial nations experienced a volatile month. In the USA, positive economic data and a high number of newly created jobs in May initially put upward pressure on long-term interest rates. However, the downward correction to US growth and another fall in inflation led to a trend reversal. The US Federal Reserve's decision not to cut interest rates did little to change that either. As a whole, yields to maturity on 10-year government bonds in the USA declined slightly month-on-month standing at just over 4.3 percent, whereas they climbed marginally overall in the eurozone and Switzerland.

Source: SIX, Bloomberg Barclays

Credit spreads on corporate bonds
In percentage points



Credit spreads remain at a low level. By historical standards, risk premiums are now actually lower than after the global financial crisis. Measured in terms of credit spreads, it means the corporate bond market remains unconcerned about a recession. However, this situation could change quickly if interest rates in the USA remain high for an extended period and there is a significant economic slowdown.

Source: Bloomberg Barclays

Market overview

Equities

The recovery on the stock markets in early May faltered again over the course of last month. While the market proved relatively resilient to volatility on the interest rate markets, there was still no clear positive momentum.

Indexed stock market performance in Swiss francs

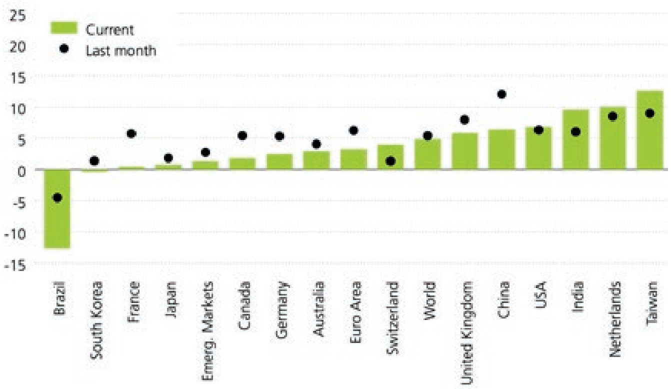
100 = 01.01.2024

The equity markets proved relatively resilient to interest rate volatility last month. The high number of newly created jobs in the USA in May and, in turn, fears of restrictive monetary policy being applied for a longer period weighed on the equity markets at the end of May, although they recovered strongly in June. This upturn nevertheless faltered overall. The Chinese equity market fared very poorly last month, which, in turn, weighed on the performance of emerging market equities. This is primarily due to tensions flaring up again in the trade dispute between China and the West. By launching an antidumping investigation on chemical imports, China sought retaliation for the sharp increases in customs duties introduced by the USA on Chinese products, such as electric cars.

Source: SIX, MSCI

Momentum of individual markets

In percent

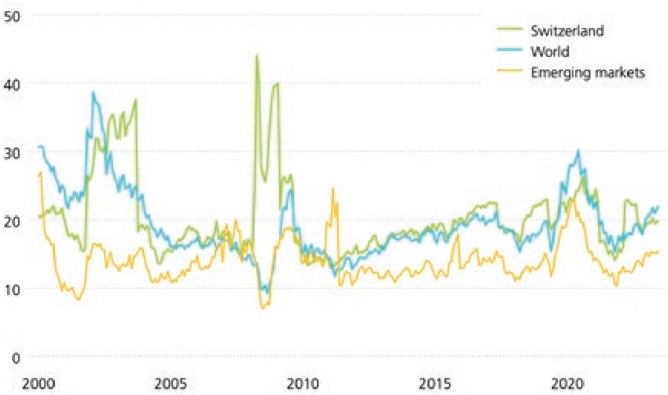


Momentum on most equity markets weakened again last month, but, despite few exceptions, remains in positive territory. The Chinese equity market in particular faltered sharply. In contrast, the Swiss equity market performed well, gaining significant momentum. The Swiss equity market has been on the road to recovery since April, due to the strong performance of index heavyweights from the pharma and food industries.

Source: MSCI

Price/earnings ratio

P/E ratio



The price/earnings ratio on the stock markets improved slightly month on month, primarily due to the positive performance of equity markets last month as the contribution from corporate reporting has now eased off. While the chip manufacturer Nvidia wowed investors again with impressive results at the end of May, this had little effect on the overall market.

Source: SIX, MSCI

Swiss real estate investments

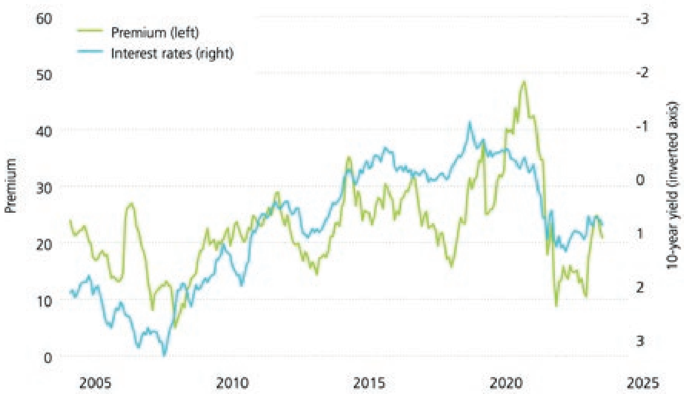
Exchange-listed Swiss real estate funds came under pressure from the rise in long-term interest rates, and have fallen in value over recent weeks.

Indexed performance of Swiss real estate funds
100 = 01.01.2024

The value of Swiss real estate funds traded on the stock exchange declined sharply last month, mainly due to the increase in Swiss capital market interest rates. Yields to maturity on 10-year Swiss government bonds have climbed by around 15 basis points to just over 0.7 percent in recent weeks. Interest rates rising usually means a decline in the valuation of long-term investments as it causes a fall in the present value of future returns. The recent decrease brings year-to-date performance close to zero again. Real estate funds made further strong gains in the first few months of 2024, thanks mainly to higher rental income and, in turn, a rise in expected returns.

Source: SIX

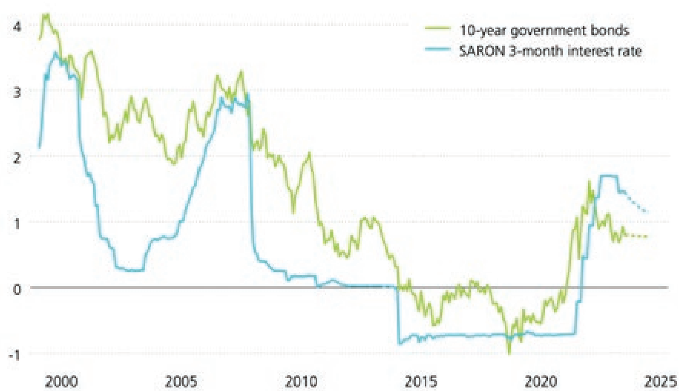
Premium on Swiss real estate funds and 10-year yields to maturity
In percent



The premium paid by investors on exchange-listed real estate funds compared with the properties' net asset value (NAV) has fallen again recently. As the NAV of many properties has barely changed of late, the decline is mainly due to the fall in the value of real estate funds mentioned earlier. The premium now stands at just over the 20 percent mark, which is in line with the average for the last 20 years. The premium is typically lower during phases of high interest rates, and usually slightly higher in phases of low rates.

Source: SIX

3-month SARON and 10-year yields to maturity
In percent



The yields to maturity on 10-year Swiss government bonds climbed slightly in May, but, at around 0.7 percent, are still well below the SARON interest rate. This situation where short term interest rates lie above long term rates is referred to as an inverted yield curve. It generally indicates that market participants expect a recession and, accordingly, a fall in short term interest rates. This is reflected in the market's current short-term expectations, with further interest rate cuts anticipated.

Find out more in our interest rate forecast for mortgages

Source: SIX

Market overview

Currencies and cryptocurrencies

The Swiss franc reversed its downward trend since year-opening in May, and gained in value. The Scandinavian kronas also performed very strongly. In contrast, the US dollar fell in value.

After suffering a sharp fall in value from January to April, the Swiss franc staged a recovery last month, gaining by around 1.5 percent against the US dollar. The US dollar also weakened against other major currencies, after appreciating significantly in spring. The Swiss franc was up slightly against the euro for the entire month after making strong gains at the end of May.

The Scandinavian kronas appreciated significantly last month. The Norwegian krone recorded the strongest performance, gaining around 2.2 percent against the Swiss franc. Despite this rise, both the Norwegian krone and Swedish krona remain undervalued.

Currency pair	Price	PPP [1]	Neutral area [2]	Valuation
EUR/CHF	0.98	0.92	0.85 – 0.99	Euro neutral
USD/CHF	0.92	0.79	0.69 – 0.90	USD overvalued
GBP/CHF	1.15	1.20	1.04 – 1.36	Pound neutral
JPY/CHF	0.58	0.91	0.75 – 1.07	Yen undervalued
SEK/CHF	8.35	9.86	8.84 – 10.88	Krona undervalued
NOK/CHF	8.28	10.60	9.40 – 11.79	Krona undervalued
EUR/USD	1.07	1.16	1.01 – 1.31	Euro neutral
USD/JPY	157.54	87.33	67.92 – 106.75	Yen undervalued
USD/CNY	7.24	6.09	5.65 – 6.53	Renmimbi undervalued

Cryptocurrency	USD rate	YTD [3]	Annual high	Annual low
Bitcoin	68’243	62.16%	73’121	39’528
Ethereum	3’559	54.99%	4’073	2’207

1 Purchasing power parity. This metric calculates an exchange rate using relative inflation rates.
2 Range of historically normal fluctuations.
3 Year-to-date: Since year start

Source: Allfunds Tech Solutions, Coin Metrics Inc.

Gold

The price of gold was volatile last month. Despite falling slightly, the precious metal’s price remains at a high level of just over 2,300 US dollar per troy ounce.

Indexed performance of gold in Swiss francs
100 = 01.01.2024

Despite falling slightly in mid-May and early-June, the gold price remains high. The precious metal’s price had risen sharply over recent months owing to the Middle East conflict. In times of uncertainty, gold doesn’t just offer protection against inflation, but is also a very secure investment generally. The slight decrease in its price in May was mainly due to the Chinese central bank not buying additional gold reserves for the time being. It had previously built up its gold reserves over several months, which supported the gold price.

Source: Allfunds Tech Solutions

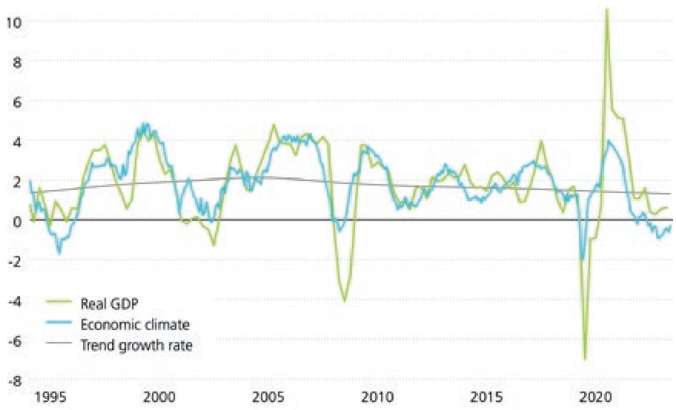
Economy

Growth on hold

There's still no sign of any clear direction in the global economy. While the most recent US economic data was generally weaker, the outlook for the European economy has improved slightly. The gradual recovery in momentum of global trade in goods is striking, though, and most economies recorded a sharp upturn in foreign trade in May. This underlines our view that the global goods cycle has bottomed out.

Switzerland

Growth, sentiment and trend
In percent

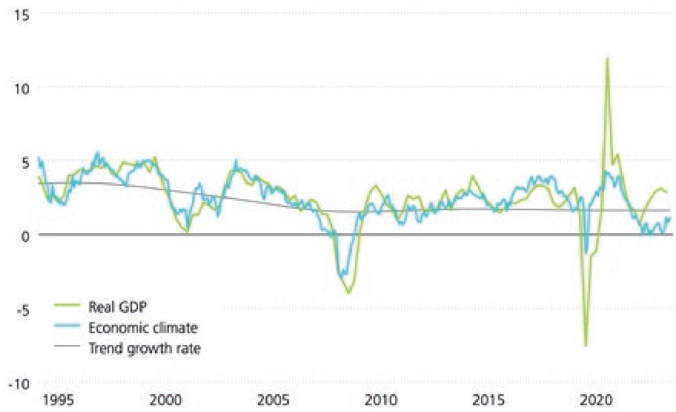


Source: Bloomberg

Swiss economic data has fluctuated significantly over recent months. That applies to sentiment values for the service and industrial sectors as well as figures on real economic activity. In May, there was a significant uptick in the business activity of the export-oriented industrial sector, after dropping to a remarkably low level in April. The overall picture for the Swiss economy remains weak, though, and there's no rapid recovery in sight. This means economic output per capita – which hasn't risen for two years – looks set to continue stagnating. One positive side-effect of the economic weakness is that core inflation has now stabilized at between 1 and 1.5 percent, moving to within the Swiss National Bank's (SNB) target range.

USA

Growth, sentiment and trend
In percent

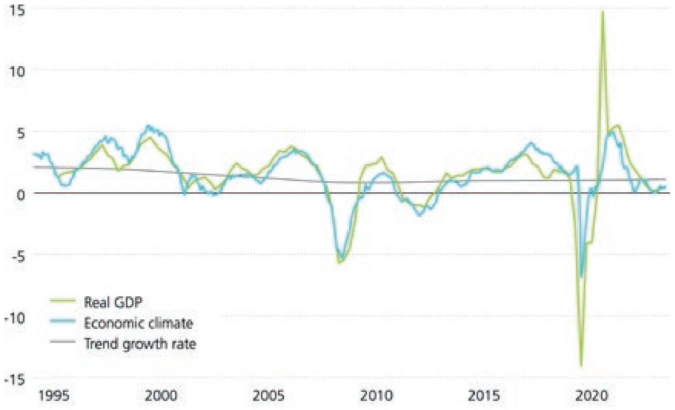


Source: Bloomberg

Economic news from the USA was generally weaker again in May. Growth estimates for the first quarter of 2024 were corrected downwards, and sentiment among both industrial companies and consumers deteriorated markedly. Economic development nevertheless remains stable overall. In particular, this is reflected on the labour market: almost 300,000 new jobs were created in May, which significantly exceeded market expectations, while strong wage growth continued, too. In this climate, concerns about inflation persist for the time being. This means the US Federal Reserve is unlikely to make an initial cut in interest rates yet.

Eurozone

Growth, sentiment and trend
In percent

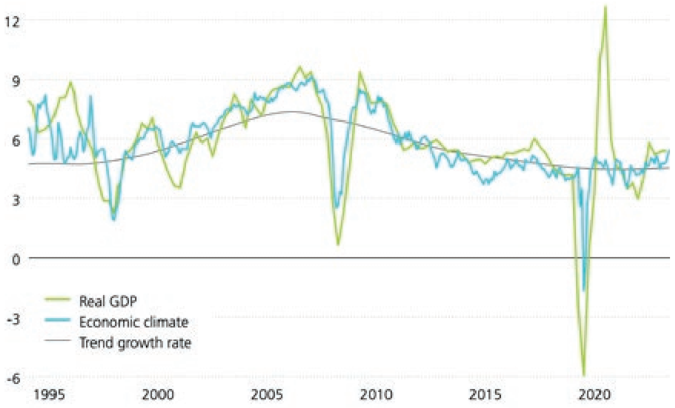


Source: Bloomberg

Tentative signs of economic recovery in the eurozone were confirmed last month. Sentiment among companies continues to improve, while industrial production and goods exports appear to be gradually stabilizing. However, many economic activity indicators remain below the previous month's level, highlighting just how weak economic development has been of late. More attention is now being focused on inflation again. The core rate climbed from 2.7 to 2.9 percent in May, interrupting its downward trend. Unchecked price rises in the services sector are a growing cause for concern. The European Central Bank (ECB) nevertheless decided to relax its monetary policy in June again for the first time in this cycle. It cut its policy rate by 25 basis points to 4.25 percent (= main refinancing rate).

Emerging markets

Growth, sentiment and trend
In percent



Source: Bloomberg

There has been positive news recently from many major emerging markets. India, Brazil and Indonesia achieved stronger growth in the first quarter than market participants had expected. By contrast, China – the biggest emerging market economy by some distance – continued to perform far more sluggishly. Sentiment figures among Chinese companies and consumers have still not recovered, while prices continued to plunge on the real estate market. Inflation also remained exceptionally low. With no prospect of any major fiscal or monetary policy support measures from the government, growth momentum in the Chinese economy appears limited to the export sector at the moment. Goods exports, at least, rose sharply in May.

Global economic data

Indicator	Switzerland	USA	Eurozone	UK	Japan	India	Brazil	China
GDP Y/Y [1] 2023Q4	0.5%	3.1%	0.2%	–0.2%	1.0%	8.6%	2.1%	5.2%
GDP Y/Y [1] 2024Q1	0.6%	2.9%	0.4%	0.2%	–0.2%	7.8%	2.5%	5.3%
Economic climate [2]	↘	↘	→	↗	↗	→	→	↗
Trend growth [3]	1.3%	1.6%	0.8%	1.8%	1.1%	5.2%	1.6%	3.8%
Inflation	1.4%	3.3%	2.6%	2.3%	2.5%	4.8%	3.9%	0.3%
Key rates	1.25%	5.5%	4.25% [4]	5.25%	–0.1%	6.5%	10.50%	3.45%

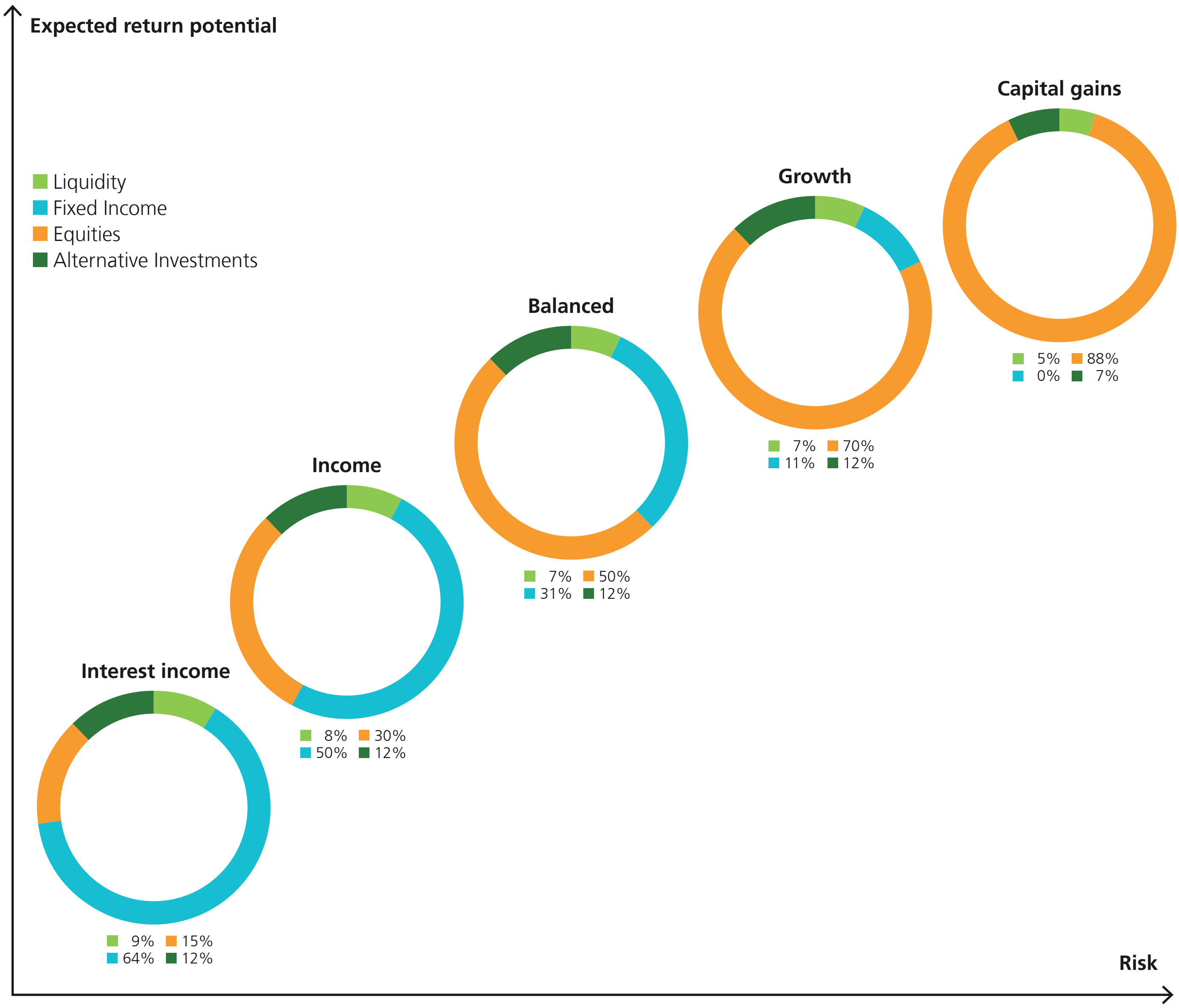
1 Growth compared to year-ago quarter
2 Indicator, measuring the overall sentiment and typically leading 1 to 2 quarters in advance of GDP. Green arrow indicates an increasing economic growth, red arrow a slowing.
3 Potential growth. Long-term change in gross domestic product with sustainable capacity utilization.
4 This is the ECB's main refinancing rate, the deposit rate is 0.5 percentage points lower.

Source: Bloomberg

Model portfolios Swiss focus

High expectations

Despite the already muted prospects of numerous interest rate cuts by the US Federal Reserve (Fed) this year, there was a great deal of tension in the run-up to the interest rate decision in June. Accordingly, information relevant to monetary policy caused ups and downs on the bond markets. However, the US equity markets, particularly technology stocks, were unimpressed by this and continued to rise. Very high expectations for these stocks are now likely to be priced in. In addition, the US economy is likely to have passed its peak, while the European economy continues to lack any positive impetus. We therefore continue to favour the defensive Swiss equity market and emerging market equities over US and European equities. We are also sceptical about the technology-heavy US equity market and continue to overweight value stocks.



Source: PostFinance Ltd

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