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PostFinance

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Editorial

Economy goes into overtime

A good analogy can be drawn between the global economy and the Swiss national team at the Ice Hockey World Championships – as long as the players from the US NHL are performing well, not much can go wrong. That has actually been the case over recent years. China, the UK and Germany have slipped into recession, and the rest of Europe is faltering, but the USA has kept the global economy going.

Philipp Merkt
Chief Investment Officer

Simply keeping calm and carrying on may ward off a global recession. In the third year after the pandemic, we've gone into overtime in the current cycle, so to speak. In ice hockey parlance, this would be sudden death overtime. That means the next goal scored is decisive. The current economic situation is quite similar: another major country going into recession would tip the balance, creating a global recession.

"Sentiment in the USA is deteriorating, but there's no need to panic."

We haven't reached that point yet though. There have been signs for some time that the US economy may face the risk of a downturn in its national income. The latest news from the US generally made for difficult reading. First quarter growth halved and far fewer jobs were created on the labour market, while there was a rise in the number of people claiming unemployment benefits. To make matters worse, sentiment in industry and, more recently, among service providers has deteriorated. And consumer confidence also suffered a surprisingly sharp dip last month.

However, all of this actually helped ease concerns on the financial markets. The logic was that slower growth means less inflation, which, in turn, means lower interest rates. That's not wrong in principle. The big question is whether less growth will cause a recession, in turn leading to lower corporate earnings.

The economy is just like sport in this sense – it's never over until the final whistle. First quarter growth of 1.6 percent is actually roughly in line with potential growth – in other words, the level the US economy can achieve without producing higher inflation. A slower labour market also eases wage inflation, which remains high. While worsening sentiment is unpleasant, it doesn't yet have an impact on real revenue and profit figures or consumer spending behaviour.

Although we've been saying for some time that the possibility of a US recession is very real, it cannot be forecast with absolute certainty. Given the current climate, we remain cautious when it comes to assuming risks on the financial markets.

The stock markets once again made a very strong start to the new year, but we believe the volatile conditions since the end of March bear out our position. Valuations, especially on the US stock market, have hit record highs, which points to rather lower equity returns over the coming years.

And what about Switzerland? The Swiss stock market has received a major boost from the depreciation of the Swiss franc this year. The higher US dollar and euro rates have also increased our major companies' revenue and profit levels. Were it not for this development, the Swiss share index's performance would probably have been somewhat less encouraging.

We still face major risks, but, in our view, there's no reason to panic. Let's hope the US economy continues to perform as well as the NHL players in our national ice hockey team.

Positioning

Gloomy outlook

The economic outlook in the USA is increasingly deteriorating, which is likely to hit the financial markets, too. That's why we're maintaining our diversified positioning and favouring emerging market and defensive Swiss equities over their US and European counterparts.

Last month, the markets were concerned about continued high US inflation rates in addition to the Middle East conflict. Core inflation remained high at 3.8 percent in March, whereas the markets were hoping for a rate of 3.7 percent. The fact that the core rate has only dropped by 0.2 percent over the past six months is also worrying. This has made policy rate cuts a far more distant prospect, although the latest US labour market data eased the situation somewhat. Over 300,000 jobs were created in March, but that figure fell to 175,000 in April. Meanwhile, the unemployment rate climbed slightly from 3.8 percent to 3.9 percent. There has also been a sharp rise in unemployment benefit claimants recently.

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

Optimism on the financial markets

This development raised hopes on the financial markets that the robust US labour market to date may now start to slow down. That's because wage growth plays a key role in the inflation trend. If a slowdown on the labour market actually materializes, it may put policy rate cuts within reach again. This triggered an upturn on the equity markets as well as the bond markets.

Predominantly positive reporting from US companies to date has also contributed to the optimism on the stock markets. Over 80 percent of the companies on the S&P 500, the US leading index, have now published their quarterly results. So far, the US companies have reported earnings growth of 5.0 percent in the first quarter. If that figure is reached by the end of the reporting season, it would signify the highest earnings growth rate since the second quarter of 2022. Companies also posted considerably higher-than-expected profits.

Performance of asset classes

Asset class		1M in CHF	YTD[1] in CHF	1M in LCY[2]	YTD[1] in LCY[2]
Currencies	EUR	–0.6%	5.2%	–0.6%	5.2%
	USD	0.1%	7.7%	0.1%	7.7%
	JPY	–2.3%	–2.4%	–2.3%	–2.4%
Fixed Income	Switzerland	0.2%	0.4%	0.2%	0.4%
	World	–0.4%	4.2%	–0.5%	–3.2%
	Emerging markets	0.1%	9.1%	0.0%	1.3%
Equities	Switzerland	1.7%	6.2%	1.7%	6.2%
	World	0.3%	16.6%	0.3%	8.3%
	USA	0.3%	17.9%	0.2%	9.5%
	Eurozone	1.0%	17.2%	1.7%	11.5%
	United Kingdom	4.9%	16.6%	5.9%	10.1%
	Japan	–3.2%	13.5%	–1.0%	16.2%
	Emerging markets	1.7%	12.7%	1.6%	4.6%
Alternative Investments	Swiss real estate	–2.5%	4.1%	–2.5%	4.1%
	Gold	0.3%	20.5%	0.2%	11.9%

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

Data as of 9.5.2024
Source: Allfunds Tech Solutions, MSCI, SIX, Bloomberg Barclays, J.P.Morgan

Leading economic indicators point to a gloomy outlook

Although this is clearly positive news, investors need to keep a close eye on recent developments in the world's largest economy's leading economic indicators. Recent sentiment has become much gloomier among both US industrial and service sector companies, while consumer confidence has also fallen. This suggests the US economy may have peaked. At PostFinance, we've been closely monitoring this development for some time and have diversified our portfolio accordingly. We're still favouring emerging market equities and the defensive Swiss stock market over US and European shares.

Swiss money market remains more attractive

We're also maintaining a slightly underweighted bond position. The long-term interest rate level in Switzerland is still too low in our view. 10-year Swiss government bonds are currently yielding less than 0.7 percent, whereas twice as much can be earned on the money market, even after the Swiss National Bank's (SNB) policy rate cut. This is why we're favouring short-term investments on the money market over longer-term Swiss government bonds. With regard to global bonds, we have reduced inflation-linked bonds in favour of non-inflation-linked bonds due to what we consider to be a lower risk of inflation surprises.

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	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

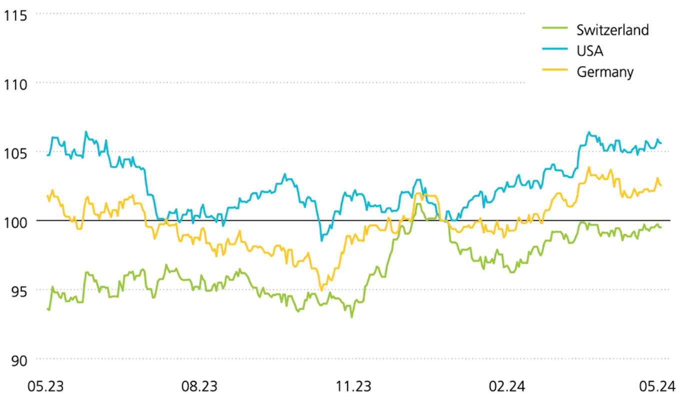
— Adjustment compared to last month

Market overview

Fixed income

Concerns over high US inflation rates and the Middle East conflict put bond markets under pressure. The recent weaker US labour market report eased the situation to some extent. However, it is doubtful this development will last, given the continued strength of the US economy.

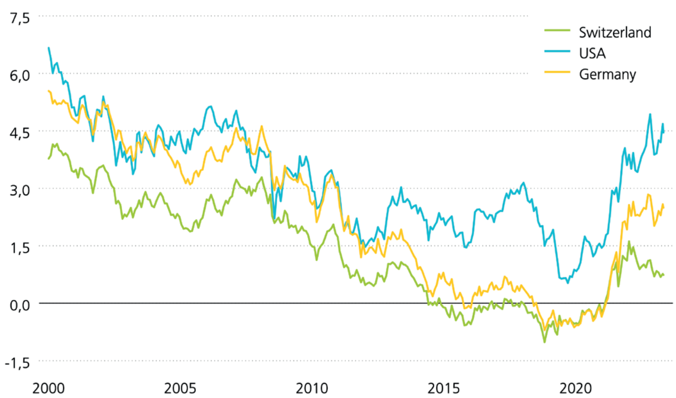
Indexed performance of government bonds in Swiss francs
100 = 01.01.2024



Government bonds fell considerably in value until the end of April, with little progress being made on tackling US inflation and a sharp escalation of geopolitical tensions in the Middle East. However, the weaker US labour market report published in early May eased the situation again. The financial markets hope the slowdown in the previously very strong US labour market may lead inflation rates to fall to the US Federal Reserve's targets soon. Government bonds of western industrial nations have made strong gains again since early May. After these fluctuations, monthly performance remained virtually unchanged overall.

Source: SIX, Bloomberg Barclays

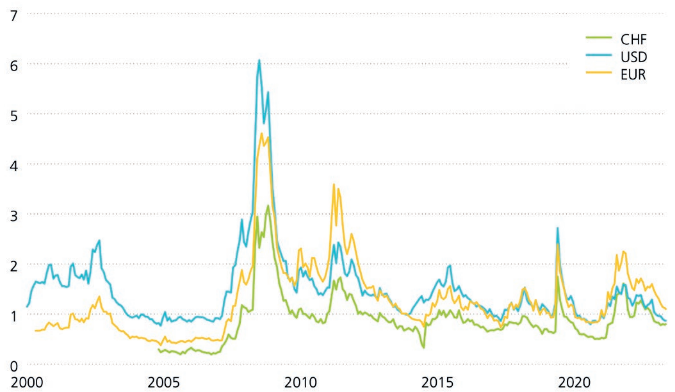
Trend in 10-year yields to maturity
In percent



Long-term interest rates in industrial nations rose sharply again in April due to stubbornly high US inflation rates and Iran's attack on Israel. In the USA, yields to maturity on 10-year bonds briefly climbed to almost 4.7 percent. They then dropped to below 4.5 percent on rising hopes of a US labour market slowdown. European government bonds followed a similar pattern.

Source: SIX, Bloomberg Barclays

Credit spreads on corporate bonds
In percentage points



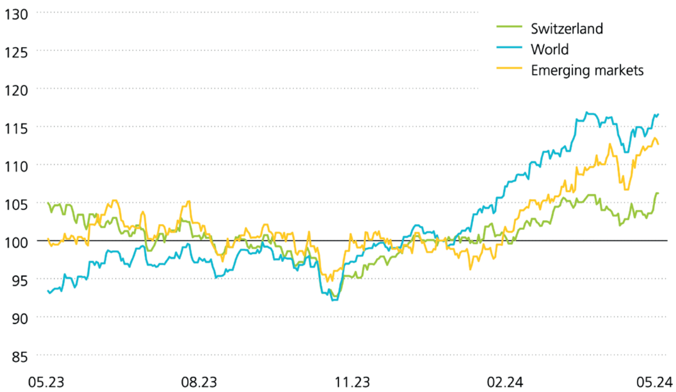
After the turnaround in interest rate policy in spring 2022, credit spreads on corporate bonds initially widened considerably. However, they have displayed a clear narrowing trend since autumn 2022. This trend continued last month. Credit spreads are now low by historical standards, and well below levels typically observed during periods of economic slowdown. The corporate bond market is hardly concerned about the prospect of recession despite economic weakness in Europe and China and the fact that the US economy has peaked.

Source: Bloomberg Barclays

Market overview
Equities

Momentum on the equity markets faltered last month due to the stagnating decline in inflation and Middle East conflict. However, there was a recovery in early May.

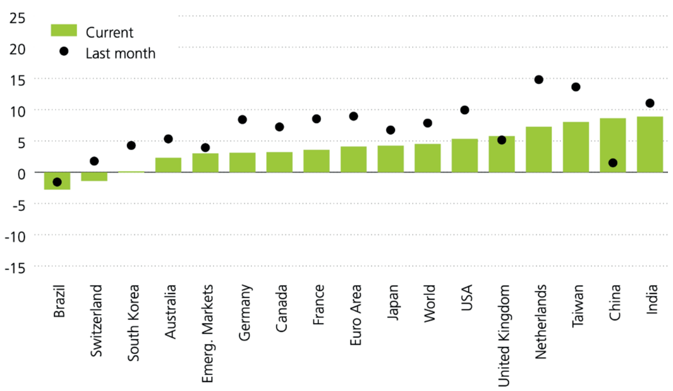
Indexed stock market performance in Swiss francs
100 = 01.01.2024



Like the bond market, equity markets also came under pressure in April. Both upward pressure from interest rates and the escalating Middle East conflict weighed on share prices. However, there were signs of recovery in May. They emerged on hopes that weaker US labour market figures in April will now enable progress to be made on cutting US inflation. As a result, most equity markets edged back into positive territory month-on-month. By contrast, the Chinese equity market performed very strongly. It staged a recovery last month, rising almost 10 percent.

Source: SIX, MSCI

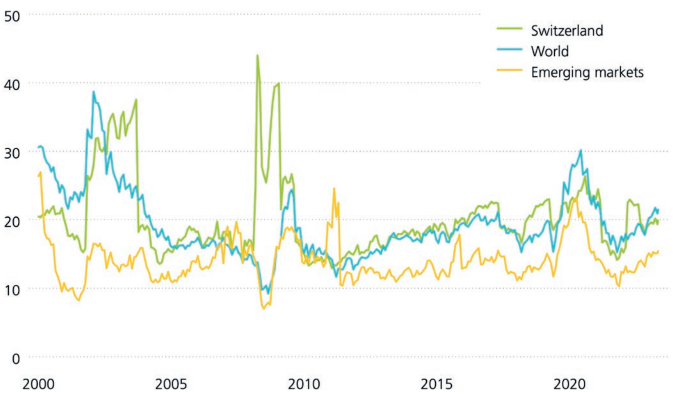
Momentum of individual markets
In percent



Momentum on the equity markets is waning considerably worldwide. The only exception is the Chinese equity market, where momentum has risen substantially. and is now well into positive territory again. By contrast, Brazil's equity market is performing extremely weakly once more and has displayed negative momentum since April. Measured in US dollars, it has fallen by almost 10 percent in value since year-opening.

Source: MSCI

Price/earnings ratio
P/E ratio



The price/earnings (P/E) ratio of the equity markets remained at a similar level month-on-month. This is mainly due to the volatility of stock market prices last month. However, measured in terms of P/E ratios, equity markets have become much more expensive since the end of 2022. The P/E ratio of global equity markets is now particularly high.

Source: SIX, MSCI

Market overview

Swiss real estate investments

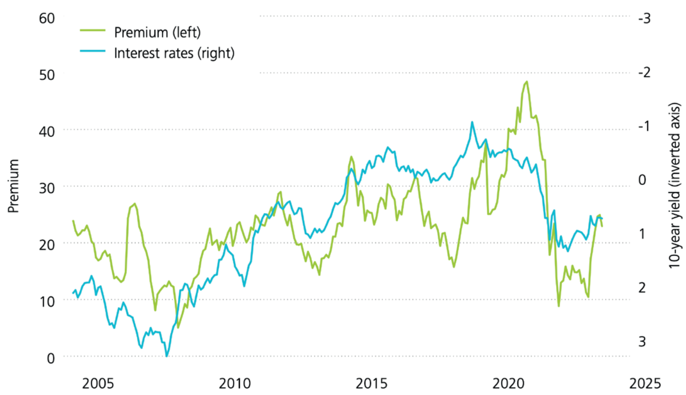
The value of Swiss real estate funds fell slightly last month. However, performance has remained well into positive territory since year-opening.

Indexed performance of Swiss real estate funds
100 = 01.01.2024

Exchange-listed Swiss real estate funds were exposed to higher fluctuations last month and fell slightly in value. However, their year-to-date performance remains well into positive territory. This is mainly due to the increase in rental income, which is having a positive impact on yield expectations for real estate investments, and the decline in long-term capital market interest rates towards the end of 2023. The Swiss National Bank's (SNB) rather surprising decision to cut its policy rate in March may also have made real estate investments more attractive.

Source: SIX

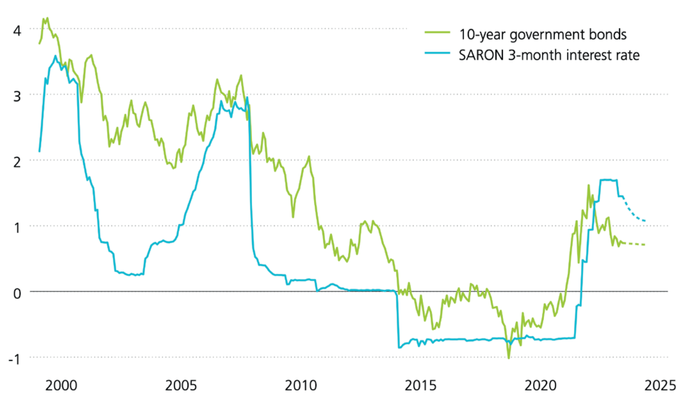
Premium on Swiss real estate funds and 10-year yields to maturity
In percent



The premium paid by investors on exchange-listed real estate funds compared with the properties' net asset value has risen considerably since year-opening due to the increase in value of real estate funds and now stands at well over the 20 percent mark. Despite the positive overall performance of Swiss real estate over recent months, the premium is at a far lower level than the record highs of 2022.

Source: SIX

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



As part of its quarterly assessment, the Swiss National Bank (SNB) decided to cut its policy rate from 1.75 to 1.5 percent at the end of March, leading to a fall in the short-term SARON interest rate. Despite this decrease, the short-term interest rate level remains well above the long-term one. Yields to maturity on 10-year Swiss government bonds now stand at around 0.6 percent. This unusual situation is known as an inversion of the yield curve. This generally occurs when market participants expect a recession and anticipate a sharp fall in the short-term interest rate level.

Find out more in our interest rate forecast for mortgages

Source: SIX

Currencies and cryptocurrencies

The value of the Swiss franc and Japanese yen fell again in April. The Japanese authorities actually intervened on the foreign exchange market to prevent an even greater depreciation of the yen.

In April, the Swiss franc continued its downward trend observed since year-opening. It lost around 2 percent against the still extremely strong US dollar, which gained by almost 4 percent in April on a trade-weighted basis. However, the Swiss franc fell less sharply in value overall than in the previous months. It dropped by around 1 percent against the euro in April, after depreciating by 2 percent on average from January to March. The Japanese yen has fallen sharply in value, hitting a low of around 159 yen to the US dollar at the end of April. The subsequent strong gains made in early May are likely to be a result of intervention on the foreign exchange market by the Japanese authorities to support the currency.

Currency pair	Price	PPP [1]	Neutral area [2]	Valuation
EUR/CHF	0.97	0.92	0.85 – 0.99	Euro neutral
USD/CHF	0.91	0.79	0.69 – 0.90	USD overvalued
GBP/CHF	1.14	1.20	1.04 – 1.36	Pound neutral
JPY/CHF	0.59	0.91	0.75 – 1.07	Yen undervalued
SEK/CHF	8.37	9.79	8.78 – 10.79	Krona undervalued
NOK/CHF	8.32	10.60	9.41 – 11.79	Krona undervalued
EUR/USD	1.08	1.16	1.01 – 1.31	Euro neutral
USD/JPY	153.00	87.18	67.93 – 106.44	Yen undervalued
USD/CNY	7.24	6.07	5.63 – 6.50	Renmimbi undervalued

Cryptocurrency	USD rate	YTD [3]	Annual high	Annual low
Bitcoin	63’821	51.65%	73’121	39’528
Ethereum	3063.72	33.41%	4072.8	2207.26

[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 gold price hit a new record high of almost 2,395 US dollars per troy ounce by mid-April. After fears of further escalation in the Middle East eased slightly, the price of the precious metal fell back again.

Indexed performance of gold in Swiss francs
100 = 01.01.2024

The gold price continued to climb until mid-April due to instability in the Middle East and the related investor uncertainty. Israel’s retaliation against Iran was quite restrained, easing fears of much greater escalation, which led the gold price to fall. Another reason for the decline in the precious metal’s value is the strong US dollar as gold is traded in this currency. The opportunity cost of investing in gold remains high as policy rate cuts in the USA seem a more distant prospect owing to stubborn inflation.

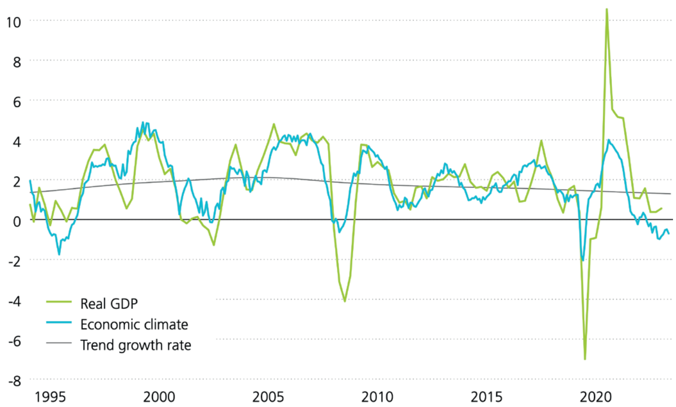
Source: Allfunds Tech Solutions

Mixed economic signals

Economic data has not indicated any clear direction in the past few months: the US economy appears to be achieving strong growth, but we are seeing a significant deterioration in business sentiment and consumer confidence. While the economy continues to stabilize in Europe and China, the potential recovery is very sluggish and keeps suffering setbacks. And, after temporarily bottoming out, Switzerland is on a gradual downward trend again. The global economy remains stuck in a rut for the time being. However, this is not unusual when there are wide regional variations in economic cycles.

Switzerland

Growth, sentiment and trend
In percent

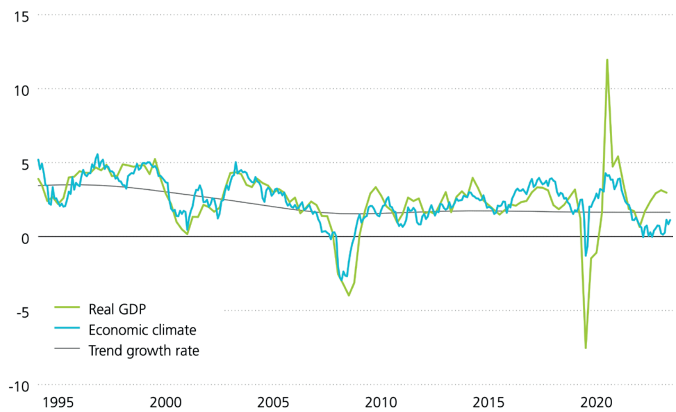


Source: Bloomberg

After stabilizing to some extent towards the end of 2023, the Swiss economy is facing more signs of weakness in the new year. Industrial companies in particular are still being hit hard by the continued recession in the manufacturing sector. This is illustrated by the recent significant deterioration in sentiment in the industrial sector and a sharp decline in goods exports during the first quarter of 2024. In this context, there are even fears that Swiss economic growth may now have entered negative territory, at least based on the most recent short-term indicator from the State Secretariat for Economic Affairs' (SECO). Yet, how weak the Swiss economy actually is also depends heavily on the performance of the services sector. The sector's performance is currently difficult to estimate as the sentiment values of services companies have fluctuated unusually sharply over recent months.

USA

Growth, sentiment and trend
In percent

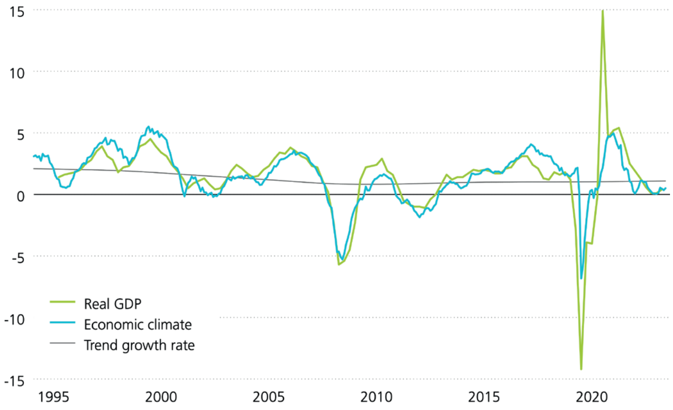


Source: Bloomberg

The latest economic data from the USA disappointed market expectations. The US economy grew by 0.4 percent in the first quarter, which is much less than anticipated. However, annualized growth of 1.6 percent is still roughly in line with the long-term trend. The US economy continues to have a high level of capacity utilization, but there is a considerable deterioration in business sentiment at the moment. The business outlook is much gloomier in both the industrial and services sectors. The recent labour market figures are also much lower than in previous months. The inflation trend shows little sign of weakening again. Barely any progress has been made on tackling it in recent months. There is, in turn, a risk of inflation becoming entrenched at just below 4 percent, which is twice the US Federal Reserve's target.

Eurozone

Growth, sentiment and trend
In percent

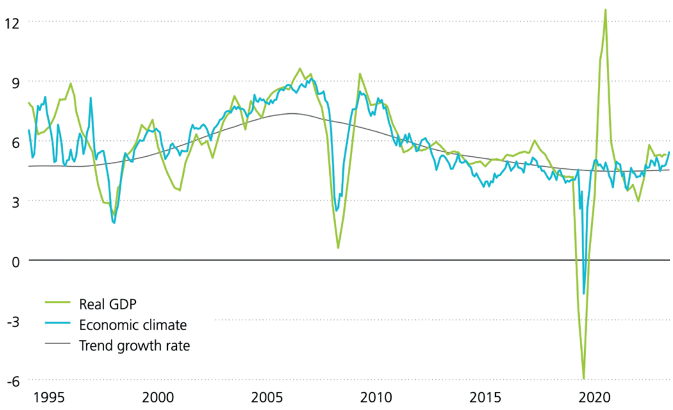


Source: Bloomberg

The eurozone's economy appears to be gradually stabilizing. The overall economy grew by 0.3 percent in the first quarter of 2024, which is the first significant improvement in economic performance for almost two years. Sentiment among companies is also gradually improving. Services companies in particular were much more optimistic in April. The first signs of bottoming out in Germany, Europe's biggest economy, is a further positive development. By contrast, the industrial sector throughout the entire eurozone continues to face challenges in recovering from the global downturn in the goods cycle. This means the economic recovery remains on shaky foundations. The inflation trend remains encouraging. The core inflation rate fell again in April and now stands at 2.7 percent.

Emerging markets

Growth, sentiment and trend
In percent



Source: Bloomberg

China's economy – by far the biggest amongst the emerging economies – is struggling to gain any real momentum. While the officially published first quarter growth rates of 1.6 percent appear impressive, a closer analysis of the Chinese economy reveals a somewhat gloomier picture. Investment and consumer activity remain weak and goods exports are well below the previous year's level. At an annual growth rate of 0.1 percent, inflation also remains uncomfortably low. Only sentiment data points to the likelihood of improved economic performance.

Global economic data

Indicator	Switzerland	USA	Eurozone	UK	Japan	India	Brazil	China
GDP Y/Y [1] 2023Q4	0.6%	3.1%	0.1%	–0.2%	1.0%	8.4%	2.1%	5.2%
GDP Y/Y [1] 2024Q1	n.a. [4]	3.0%	0.4%	n.a. [4]	n.a. [4]	n.a. [4]	n.a. [4]	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%	3.4%	2.4%	3.2%	2.7%	4.9%	3.9%	0.1%
Key rates	1.50%	5.5%	4.5% [5]	5.25%	–0.1%	6.5%	10.75%	3.45%

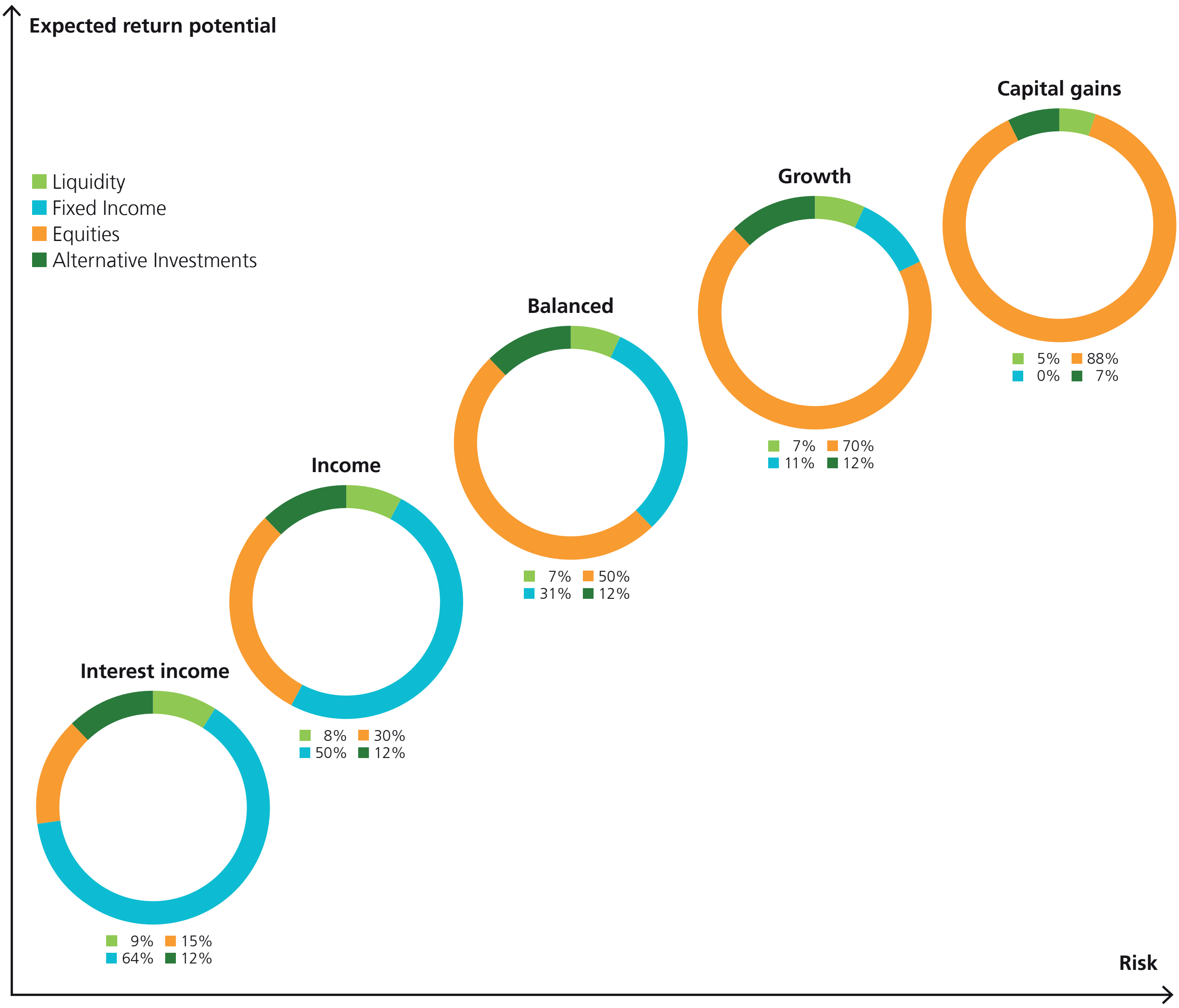
1 Growth compared to year-ago quarter
2 Indicator, measuring the overall sentiment and typically leading 1 to 2 quarters in advance of GDP.
Green arrow indicates an increasing economic growth, red arrow a slowing.
3 Potential growth. Long-term change in gross domestic product with sustainable capacity utilization.
4 No data available
5 This is the ECB's main refinancing rate, the deposit rate is 0.5 percentage points lower.

Source: Bloomberg

Model portfolios Swiss focus

Gathering clouds

The past month was economically weak. In the USA, weaker data on the labor market and poorer sentiment among service providers and consumers were particularly surprising. However, this gave rise to hopes that the economy could cool down, allowing inflation to make progress again. With the prospect of further interest rate cuts, the stock markets recovered noticeably from the previously weak April. In addition, good corporate reporting in the USA gave the stock markets an optimistic boost. Nevertheless, the leading economic indicators paint a gloomy picture for the US economy. We are therefore sticking to our diversified equity positioning and prefer emerging market equities and the defensive Swiss equity market to US and European equities. On the Swiss bond market, we continue to regard the money market as more attractive than long-term Swiss bonds.



Source: PostFinance Ltd

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