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Smooth sailing for an economic recovery? Not quite: The challenges persist

The soft landing of the US economy is foreseeable, as is the end of the interest rate hike cycle for most central banks. However, the battle against inflation is not yet won and we consider the high expectations of near interest rate cuts as premature. Nevertheless, it seems that the low point of the economic downturn is in close reach and we continue to prioritise an increased equity positioning in portfolios.

Source: Canva

AI and the decline in inflation as drivers of the stock markets in 2023

2023 ended positively for financial markets, though mainly driven in the United States by a handful of technology stocks. From a geopolitical perspective, the global situation looks inevitably bleaker. With its theatres of war, the new multipolar world not only has caused concern due to the significant human suffering and the loss of democratic understanding but also its influence on the economy. The combination of stuttering economic activity, banking crises, declining but stubborn inflation, higher interest rates leading to stagnation, problems in investment activity, as well as the lacking visibility for companies, notably left its marks on 2023. On the bright side, the still robust job market, the resilience of the US economy, the high degree of innovation, productivity advancements due to artificial intelligence, and the normalisation and optimisation of supply chains had a positive influence. The significantly lower inflation rates gave the financial markets hope for an end to interest rate hikes.

The probability of a soft landing of the US economy further increased in the last few months. Financial markets began to rule out further central bank interest rate hikes and speculate about when first interest rate cuts would occur. Long-term interest rates in the USA reached their peak in mid-October at 5% (10-year US Treasury bonds); however, they rapidly fell again to 3.9% by the end of the year.

Over the last quarter, both stock and bond markets remained volatile. Investors were torn between fear of interest rate hikes and hope for interest rate cuts. The stock markets (MSCI World in USD) accelerated further: 11% from the end of September to the end of December. The technology-driven US stock markets were able to maintain their leading position throughout the year: The S&P 500 ended with a gain of 24.2% (in USD for 2023). The defensive Swiss stock market SMI was unable to match this

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performance and ended the year with 3.8% (in CHF for 2023). The Chinese stock market was the big disappointment at – 11.2% (MSCI China in USD for 2023). The expected reopening effect after the lifting of strict Covid restrictions has not occurred yet.

The price of gold, driven in part by the easing of interest rate pressure and demand from non-western central banks, temporarily surpassed its previous all-time high of USD 2050 by reaching USD 2135 and closed at USD 2063. The addition of gold to portfolios proved its worth in 2023.

Equities	YTD 2023	Q4 2023
MSCI World AC (USD)	22.2%	11.0%
S&P 500 (USD)	24.2%	11.2%
Eurostoxx 50 (EUR)	19.2%	8.3%
SMI (CHF)	3.8%	1.6%
FTSE 100 (GBP)	3.8%	1.6%
Nikkei (JPY)	28.2%	5.0%
MSCI Emerging(USD)	7.0%	7.4%
Bonds	**YTD 2023**	**Q4 2023**
Bloomberg Global Aggregate	5.7%	8.1%
US Treasury 10y	0.5%	4.5%
US Corporate	8.5%	8.5%
Bund 10y	3.2%	6.7%
EU Corporate	8.2%	5.5%
Currencies	**YTD 2023**	**Q4 2023**
USD Index	-2.1%	-4.6%
EUR/USD	3.1%	4.4%
GBP/USD	5.4%	4.4%
USD/CHF	-9.0%	-8.1%
EUR/CHF	-6.1%	-4.0%
GBP/CHF	-4.2%	-4.0%
Other	**YTD 2023**	**Q4 2023**
Brent oil	-10.3%	-19.2%
WTI Crude	-10.7%	-21.1%
GOLD SPOT $/OZ	13.1%	11.6%
Silver Spot $/Oz	-0.7%	7.3%
BBG Commodities Index	21.7%	12.1%
Iron Ore	-12.6%	-5.9%
US REIT	13.8%	16.0%

Inflation and interest rates should continue to decline: Is everything in the clear?

On December 13, 2023, FED Chairman Jerome Powell communicated that the interest rate hike cycle was completed and up to three interest rate cuts can be expected in 2024. Thus, nothing is standing in the way of a soft landing of the economy. Where are the stumbling blocks? In general, much of the decline in inflation has occurred due to energy and goods components (excluding food). However, the core rate (including prices for services) remains at a persistent, elevated level in most countries. Therefore, the all-clear signal cannot yet be given, especially since inflation-driving components that have been neglected in the last two years could increasingly make a comeback: Decarbonisation as a key towards a carbon-neutral society and further deglobalization. Furthermore, the post-Covid reduction of inventory is coming to an end, which should normalise the prices of certain goods upwards. Thus, we expect inflation rates not to return to pre-pandemic levels and that economies will have to adapt to higher baseline inflation. However, this should be well digested in the financial markets if the economic situation improves.

To summarise, we expect only a handful of isolated interest rate cuts and an alignment of the interest rate at an elevated level in 2024.

We identified two scenarios with higher probability: 1) Achieving a successful soft landing (with the potential help of small interest rate cuts) or 2) the economy slips into a recession. The first scenario (soft landing) we award a heightened probability of 50%. In comparison, we allot the second scenario (recession) an also high probability of 40%. The remaining 10% represent the scenario of a reaccelerating economy. Leading indicators still suggest a weakening of the economy; however, they stabilised on the lower levels.

Election year, geopolitics, and economic implications

In 2024, we will see the highest number of presidential elections worldwide. 50% of the

world's population will be called to the polls. Some of the elections will not cause any major surprises. Yet the US is a different story: The outcome of the election could have far-reaching implications for an increase or decrease in protectionist measures and for or against further aid to Ukraine. Although the FED claims to be independent, a politically motivated interest rate cut to prevent an economic downturn is not unthinkable this year: A recession in an election year would be fatal, as it could help Trump win in November.

It is likely that geopolitical tensions are not only going to continue to be part of everyday life, but further escalation is also a possibility. A trigger for volatility in financial markets, so to speak.

China could continue to move opportunistically on the geopolitical stage. So far, Xi Jinping has refused to support the economy with stimuli, even though it is in deflation mode and consumption is not really picking up. Real estate prices have been falling for over two years; thus, the weak spending is no surprise, as Chinese households hold around 60% of their savings in real estate. What's next? Equity valuations are at an all-time low, pessimism is very high and the population holds a lot of money in accounts; a few rays of hope could be enough for a strong countermotion in the stock markets. All in all, a sustainable economic recovery in China would also have a direct positive impact on the economies of its surrounding and the Western countries.

Several challenges seem to await us this year. The 'Magnificent 7' firms from the technology sector that outperformed the US stock market are likely to 'calm down' this year. We focus on lagging companies in the sectors healthcare, consumer and industrials. The healthcare sector is attractively valued and accounts now for 10% of the global GDP. Challenges are increasing and with them the need for medications, as the world's population is getting older.

We start the year with an overweight in stocks, remain well-diversified and prefer the higher investment-grade segment in bonds.

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