# Perspectives
*Financial Markets*

*July 2024*

## Interest rates & bonds
Spread volatility is back

*Overview of bond yields and investment grade credit spreads*

| | 10-year government bond yield | | | Investment grade credit spread | | |
|---|---|---|---|---|---|---|
| | Current | June 2024* | Year-to-date* | Current | June 2024* | Year-to-date* |
| US | 4.3% | -17 bps | 45 bps | 94 bps | 9 bps | -5 bps |
| Eurozone | 2.5% | -21 bps | 43 bps | 120 bps | 12 bps | -18 bps |
| UK | 4.1% | -19 bps | 60 bps | 124 bps | 10 bps | -15 bps |
| CH | 0.6% | -29 bps | -9 bps | 83 bps | 6 bps | 1 bps |

10-year government bond yield eurozone = DE, bps = basis points.
* Change as at 26 June. Source: Bloomberg

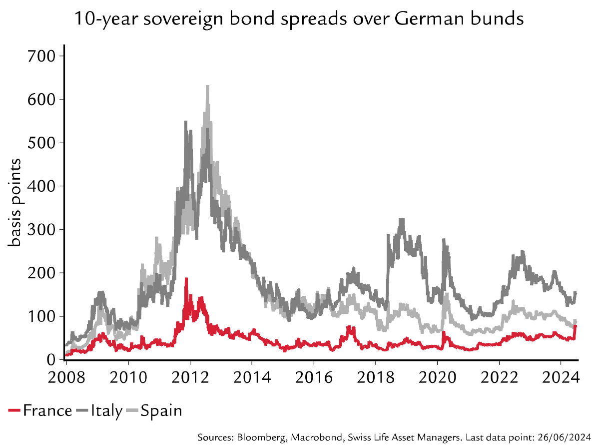
*USA*
- US macroeconomic data have disappointed recently, but the economy is still comparatively healthy.
- Given signs of a weakening growth momentum, the likelihood for policy rate cuts in 2024 has increased. We expect two rate cuts by the Fed this year.

*Eurozone*
- Eurozone economic momentum seems to have bottomed out, and consensus GDP growth estimates for 2024 have been revised upwards since May.
- As expected, the ECB cut its policy rate in June but remained vague regarding further easing and revised its inflation forecasts for 2024 and 2025 upwards. We expect two more rate cuts this year.

*UK*
- Compared to May estimates, the consensus forecast for UK GDP growth for 2024 increased, driven by some positive economic data surprises.
- Despite a recovering economy and a still-high services inflation rate, we expect the Bank of England to cut its policy rate twice by December 2024.

*Switzerland*
- May core inflation was below expectations, and the CHF appreciation is adding to disinflationary trends.
- Against market expectations, the SNB delivered a 25 -basis point policy rate cut on 20 June as it revised its inflation forecasts down. We expect no further rate cut in 2024.

*Spread volatility has returned to the markets*




As a result of the European election and the following unexpected announcement of snap elections in France, French sovereign bond spreads have widened noticeably to the highest level since March 2013. Market repricing accounts for the elevated political risk as both a left- or right-wing victory in France's snap elections (to be held on 30 June and 7 July) would make fiscal consolidation even more unlikely and potentially complicate decision-making at French and EU level. There are three positive factors for credit investors. First, absolute yield levels in investment-grade (IG) and high-yield (HY) credit are trading above their 10-year average. Second, near-term recession probabilities in the EU and the US remain low. Third, further rate cuts by the Fed and the ECB in 2024 are expected. On the negative side, demand for credit is high and credit spreads are trading below their 10-year average, particularly in the US. European credit spreads vs. US are trading wider, given a higher exposure to geopolitical and elevated political risks. We are keeping our neutral stance on IG credit (in both USD and EUR) and HY USD credit but opting for a wider spread view for HY EUR credit. Over three months, we expect lower government bond yields in Europe and the US and a sideways move in Switzerland. The elevated US rates volatility, however, highlights risks around inflation and Fed policy rate cuts.

# Equities

Another good month

*Overview of equity market performance*

| | June 2024* | Year-to-date* |
|---|---|---|
| USA | 3.8% | 14.9% |
| Eurozone | -1.9% | 9.0% |
| UK | -0.3% | 8.6% |
| Switzerland | -0.1% | 8.9% |
| Emerging Markets | 3.8% | 7.4% |

MSCI net total return indices in local currency.
* Performance as at 26 June. Source: Bloomberg

*US*

- The US market continued its uptrend in June. The year-to-date performance of almost 15% is clearly above our upper estimate of around 7% for 2024.
- The positive market development was driven mainly by the favourable earnings season and upward revisions of earning expectations after the releases.
- As in the previous year, the year-to-date performance differences between styles and sectors are significant. Value stocks have increased by 7.3% and growth stocks by 22.2%. Momentum has been the best-performing style so far this year with an increase of 24.9%. The rally is still confined to mega large caps while small caps have gained only 0.9% so far in 2024.
- The US market is expensive, and its valuation remains much higher compared to all other markets.

*Eurozone*

- The announcement of snap parliamentary elections in France after the right-wing victory at the European election weighed on European stocks in June.
- The European market is now valued around neutral.

*UK*

- Ahead of the general election on 4 July, the UK market ended the month slightly down.
- The UK market still benefits from a low valuation.

*Switzerland*

- Swiss equities outperformed their European peers as the SNB surprised markets with a second rate cut.
- The Swiss equity market is the second-most expensive market after the US.

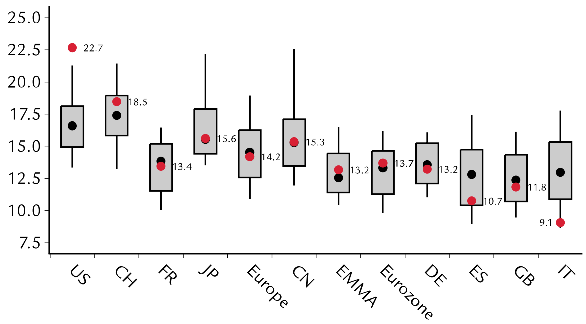
*Emerging markets*

- Emerging markets continue to show a heterogeneous picture with the Chinese market catching up to a year-to-date performance of 6.9% this year while the Brazilian market is down 18% since January.

*Taking stock of the current market environment*

As we reach the mid-year point it is time to evaluate the market potential for the second half. Global equities have surged by 14% so far this year, surpassing our estimated return range of 4–7%. Looking ahead, we see both positive and negative aspects. On the negative side, valuation indicators, especially in the US market, are elevated, and the relative attractiveness compared to bonds is low. The current (forward) price-earnings ratio in the US scores among the top 5% of its values over the last 20 years (see chart). Additionally, the monetary environment remains restrictive, and we expect that the elevated interest rates will at some point have a more pronounced effect on prices and valuations. Furthermore, geopolitical risks remain elevated, and the upcoming US election may introduce higher volatility. Finally, the equity market is still only driven by very few US tech stocks and has so far seen no meaningful drawdown this year.

Equity valuations (forward price-earnings ratio)




● Current value ● Median (period from Jan. 2004 to May 2023)
Normal range (25th–75th Quantile), broad range (10th–90th Percentile)

Sources: Bloomberg, Macrobond, Swiss Life Asset Managers. Last data point: 26/06/2024

The three positive aspects are: earnings dynamics, lower central bank policy rates coupled with a low global recession probability, and strong momentum. Q1 earnings exceeded expectations, prompting upward revisions of analysts' forecasts. Earnings growth expectations of around 10% over the next 12 months seem very optimistic, given a slowing US economy. The SNB and the ECB have started to cut rates amid sluggish economic growth and declining inflation, and the Fed is expected to follow suit this year. Historically, the market reaction to declining rates in a non-recessionary environment has been very positive. The current momentum is very strong, and the AI and mega-cap rally may continue or even broaden to value and small cap stocks. Overall, we are maintaining a neutral view on equities for the next three months.

# Currencies

"King dollar" reigns on

*Overview of major currencies*

| | June 2024* | Year-to-date* | 1-month view |
|---|---|---|---|
| EUR/USD | -1.5% | -3.2% | ↘ |
| EUR/CHF | -2.1% | 3.2% | → |
| GBP/USD | -0.9% | -0.9% | ↘ |
| USD/JPY | 2.2% | 14.0% | ↗ |

* Performance as at 26 June. Source: Bloomberg

*USA*

- In June, the USD appreciated 1% on a trade-weighted basis. Among major currencies, only the CHF, SEK, AUD and the South African rand (ZAR) outperformed the greenback.
- We expect continued USD strength in Q3/2024 on the back of its carry advantage and looming (geo-)political risks (see main text).

*Eurozone*

- The EUR lost 1% on a trade-weighted basis in June on the back of a higher political risk premium after the populist sweep in the European election and notably the surprising announcement of snap elections in France.
- We expect EUR to remain under pressure against USD but have a neutral view against GBP and CHF.

*UK*

- The GBP remains relatively unfazed by the approaching UK general election and was stable on a trade-weighted basis in June.
- Consistent with our view of general USD strength, our three-month view on GBP/USD is negative.

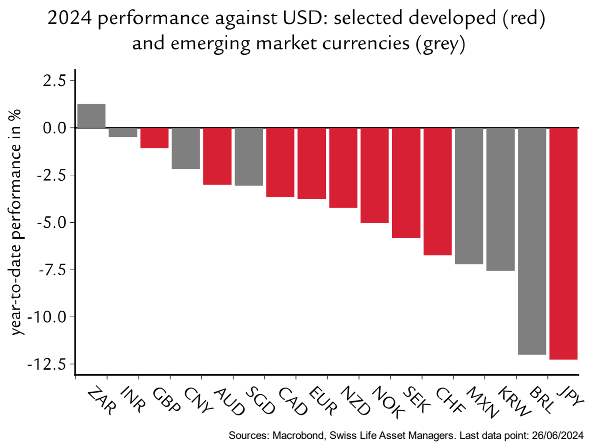
*Switzerland*

- Due to increasing political risks in Europe, the CHF appreciated strongly against the EUR in June. However, the rate cut by the SNB on 20 June, which was not fully priced in by markets, reversed the trend in the last days of the month.
- At the current level, we have a neutral view on EUR/CHF for the next three months.

*Japan*

- The JPY remains the weakest major currency year-to-date, with USD/JPY even surpassing the 160 mark at the end of June, a level last seen in 1986.
- We expect further yen weakness from here as the Bank of Japan has not embarked on a credible interest rate hiking path so far.

*H1/2024: USD outperforms almost all currencies*




The first half of 2024 is over, and this is a good moment to take stock of currency developments in the past six months. A glimpse at the year-to-date performance (chart above) shows that all major currencies except the South African rand (ZAR) depreciated against the USD. The ZAR benefited from a general "risk-on" mood in financial markets, higher commodity prices as well as a reduction in the country's risk premium as the ruling party ANC lost its absolute majority in the 2024 general elections, forming a coalition with the market-friendly main opposition party DA and three other smaller parties. Overall, we have a clear picture of "King Dollar" regaining power in 2024 after a weak 2023, as we correctly titled in the annual outlook published back in January.

Our view of structural USD strength remains unchanged, at least for the next three months. Even though the US economy will likely weaken somewhat further in H2/2024, thereby paving the way for a first rate cut by the US Federal Reserve, the disinflationary progress seems more advanced in most other developed and emerging markets, militating for an unchanged or even widening interest rate differential. This carry advantage will likely continue to support the USD, alongside elevated (geo-)political uncertainty and the risk of an intensifying trade war irrespective of who is the next US President (higher US tariffs on imports are generally USD-supportive). We also expect the USD to appreciate against the CHF, as the interest rate differential has widened after the two policy rate cuts by the SNB in the first half of this year.

# Asset allocation

Fair weather with chances of thunderstorms

*Review*

- June had plenty of surprises in store, meteorologically, politically and financially.
- While interest rates have experienced a slight decrease, their volatility persists. Concurrently, spreads have seen a modest widening. CHF bonds did well, supported by the unexpected policy rate cut by the SNB. The higher spreads could potentially be attributed to a Japanese bank's forced liquidation of its foreign currency credit bond portfolio, a consequence of substantial losses that weakened their capital base. This incident, however, was isolated and did not spill over to the national or global banking systems.
- Equity markets displayed considerable diversity, with the US and emerging Asia at the forefront, propelled by the surge in AI. In contrast, the eurozone and the UK grappled with a challenging political environment. Switzerland found a middle ground, bolstered by the unexpected rate cut by the SNB. The substantial price correction of NVIDIA in the latter half of the month was a brief surprise, but the sector promptly rebounded.

*Current asset allocation views*

| Asset class | Active weight |
|---|---|
| Global Government Bonds | overweight |
| Global Investment Grade Credit | underweight |
| Emerging Market Bonds | underweight |
| Global Equities | neutral |

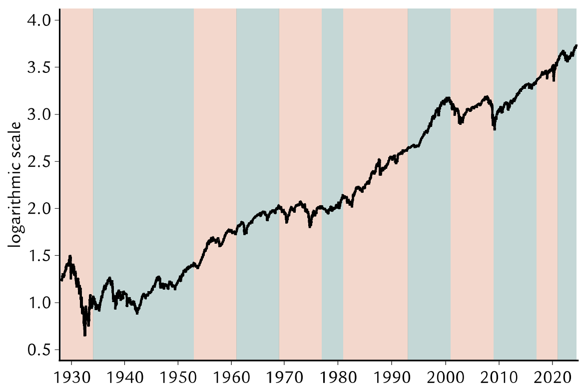
Source: Swiss Life Asset Managers

- Despite the surprising resilience of the US economy, the fundamental landscape has largely remained unchanged. We are closely monitoring the political shifts in Europe that could potentially trigger volatility. However, at this juncture, we see no compelling reason to alter our asset allocation.
- Despite the weakening fundamentals and market momentum, we are maintaining a neutral stance on equities as the market does not appear poised for a repricing. Consistent with our previous position, we continue to underweight corporate and other higher-risk bonds.
- Given the recent only modest decline in rates we are still overweighting government bonds. Real rates remain elevated, and central banks remain data-driven as their readiness to lower interest rates is contingent on the macroeconomic development.

*The US presidential election and the stock market*

As financial markets favour stability and a business-friendly political environment they are essentially 'apolitical'. However, government agendas with potential negative implications for future earnings can adversely affect markets. 2024 is politically charged with several significant elections worldwide, including the US presidential election. This raises the question: should investors adjust their portfolios in anticipation of such events? Below, we charted the S&P 500's development since 1928, covering several Republican and Democrat political regimes. The index data is presented on a logarithmic scale to facilitate detection of trend changes.

S&P 500, republican (red) and democratic (blue) US presidents




Sources: Bloomberg, Macrobond, Swiss Life Asset Managers. Last data point: 26/06/2024

The chart implies that, at least in the US, elections do not systematically influence market developments. Instead, markets (and the economy) can significantly impact the elections. You may have heard the phrase "It's the economy, stupid!" to explain why a certain president was elected. The S&P 500 has moved in both directions under both Democrat and Republican administrations. The same is true considering only periods during which a president's party also held the majority in the US Congress. Even when the initial market reaction to an election is negative, this is usually only short-lived. Therefore, it seems to make little sense to bet on election outcomes, at least in developed countries. Only with a very strong conviction of a significantly and permanently different economic policy under a new president might a bet be warranted. Considering the upcoming elections, while a potential second Trump term could result in some short-term volatility and a stronger dollar, we would otherwise not expect a fundamentally different market environment compared to the one under a Biden administration.

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