October 2024 | Issue no. 135

Investor Info
Investment Commentary

Briefing from the ARVEST Investment Committee

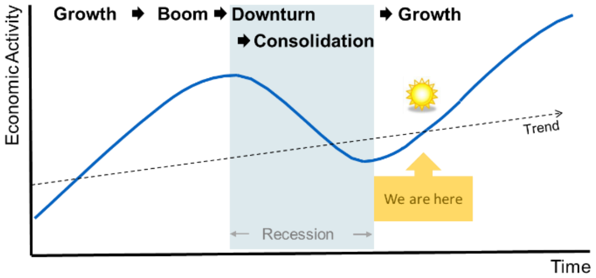
In the final weeks of September, the US Federal Reserve and the Chinese central bank initiated a turnaround in interest rates, after the European Central Bank and the Swiss National Bank had cut rates already in previous months. The Fed's cut came earlier and was also larger than expected at 0.5%, as we had predicted here in July. US markets are now pricing in further rate cuts to around 3.5% in the summer of next year. Is the global economy doing so badly that global rate cuts are necessary?

Global economic growth has indeed slowed in the third quarter, particularly in the three major economies of the US, Europe and China. But at the same time, inflationary pressures have eased. As a result, Western central banks now see their task of containing post-pandemic inflation as complete and are turning their attention to supporting economic growth by providing monetary stimulus.

These decisions by the US Federal Reserve have been largely confirmed and priced in by the markets. Over the past quarter, the focus of financial markets has also shifted from inflation to the economy and interest rates. Interest rates are being watched particularly closely as they are the key determinant of the cost of leveraged speculation in financial markets.

The three-day correction of almost 10% in global equity markets at the beginning of August was even a sign of recessionary fears. Rising unemployment figures in the US triggered the well-known Sahm recession model, which warned that the US economy would slip into recession in the near future. This in turn led to a rapid appreciation of the Japanese yen, which may seem surprising at first glance.

For many players, however, Japan was the cheapest place to borrow money to invest in global financial markets in recent years. If the forecast of a recession in the US were to materialise, this would mean a sharp fall in US interest rates and falling share prices. Within a very short time, some investors therefore sold their investments and bought back the Japanese yen in which they were leveraged. This led to an appreciation of the yen, particularly against the US dollar. In the weeks that followed, however, the scare was over almost as quickly and the 'soft landing' scenario for the US regained the upper hand. It became increasingly clear that the US unemployment rate was an important, but by itself insufficient indicator of a US recession.



Future Prospects

The ARVEST Investment Committee also adheres to the scenario of a soft landing in the US, according to which US growth should continue to weaken, but a recessionary spiral should be avoided. It will take time for the interest rate cuts to feed through to the real economy. At present, however, it looks as if the US interest rate turnaround has been implemented in time to prevent the economy from contracting. US growth figures for the last quarter are still expected to be clearly positive.

However, the effects are already being felt in the financial markets, where the future is traded today. From the point of view of a Swiss franc investor, the equity markets were able to maintain their high levels in the last quarter, but did not gain as much as in the first half of the year. At the same time, the market has broadened its base. It is no longer just the seven glorious US heavyweights that have gained - the companies that provide the technology and the models for artificial intelligence. Shares in companies involved in consulting and the actual development of AI projects have also risen. If these projects are successful, we expect that those using AI will ultimately be able to improve their margins and become more highly valued. However, many international companies are also benefiting from falling US interest rates, regardless of AI. In emerging markets in particular, demand is expected to rise. The extent to which a change in sentiment can have an impact on cheaply valued markets is illustrated by the fact that the Chinese central bank's credible announcement of an increase in liquidity alone triggered a 25% rise in Chinese equity markets over the past two weeks. This reaction may seem overdone, but true global diversification remains essential for us.

The main risk for equity markets as a whole is high valuation. External shocks could lead to significant price falls. What has been surprising in recent weeks is that increasing political uncertainty in the Middle East has had little impact on markets. We will continue to monitor geopolitical developments closely, particularly with regard to whether the US election result will remain controversial after the election. Overall, however, we remain positive on broadly diversified investments, as nothing stimulates financial market players more than falling interest rates and rising liquidity.

7 October 2024
On behalf of the Investment Committee
Stefan Kimmel
Chief Investment Officer ARVEST Funds AG