December 2023

Market overview and positioning

Investors have enjoyed pleasing returns over the last two months. Hopes of a soft landing for the economy, rapidly falling rates of inflation, and normalising capital market interest rates have provided a boost to almost all asset classes. The monetary policy stance of central banks confirmed this trend last week.

Monetary policy dominates

Tighter monetary policy provided the key backdrop for financial markets in the 2023 investment year. The major central banks were confronted by the challenge of taming inflation on the one hand without impairing economic growth excessively on the other. No less than eleven interest rate rises on the part of the US central bank (Fed) from the spring of 2022 onwards, together with multiple rate hikes by the European Central Bank (ECB) too, sent out clear signals.

Inflation curbed

It was not long before inflation, which had been one of the major headaches of 2022, was showing a clear downward trend in the US, Europe and Switzerland. While this underscored the effectiveness of the monetary policy measures taken, it was also the result of an improvement in the functioning of global supply chains and base effects in connection with commodity prices. The result of all this was greater confidence in the economy. Fears of an uncontrolled inflationary spiral dissipated. In the US, this development was accompanied by very robust labour markets (see graph).

Switzerland gets a grip on inflation

Switzerland proved particularly successful in getting inflation under control. At the start of the year, the Swiss National Bank (SNB) was confronted with an inflation rate above its target figure of 2%. It responded with a total of five interest rate hikes in order to restore price stability. By November 2023 inflation had come down to 1.4%, well within the SNB's target bandwidth. This is a noteworthy success, and one that sets Switzerland apart from other developed economies. In particular, the strong Swiss franc has proved particularly helpful in alleviating imported inflation via the channel of higher commodity prices.

"Central banks are signalling a loosening of monetary policy and declining rates of inflation: Both bonds and equities have once again been in top form as the year draws to a close."

Alex Müller, Chief Investment Officer

Global rate-hiking cycle over

At its final meeting of 2023 in mid-December, the Fed left key US interest rates unchanged. In their published commentary, the Fed's key decision-makers indicated the likelihood of lower interest rates in 2024. The SNB likewise left key interest rates unchanged, significantly reducing its inflation forecasts for both the current and subsequent years. The guardians of Swiss monetary policy believe that price stability will be re-established in 2024. The ECB likewise left key interest rates unchanged.

Equities and bonds gain ground

These parameters have buoyed equity and bond markets in recent weeks. Thanks to lower capital market interest rates, both government and corporate bonds recorded strong price gains. Equities also benefited from lower interest rates despite the subdued economic outlook. These lower rates should mean an improvement in financing terms. Furthermore, the strong results published by companies in recent quarters provide investors with the assurance that the economy is performing robustly.

Soft landing the base scenario

Global economic growth is expected to be positive, albeit modest, in 2024. We are expecting neither a pronounced recession nor another significant acceleration in growth. Fiscal support will wane in Europe but remain supportive in the US. Whether or not the strong real growth figures recorded by the US economy in recent quarters can be maintained in 2024 is open to doubt. Moreover, the extent to which the market's expectations of monetary policy will prove correct ultimately depends on the further development of price momentum: other than in Switzerland, inflation rates remain outside of their target bandwidths, hence central banks will be watching out for possible second-round effects in particular before they actually take the step of cutting key interest rates. Above all in Europe, monetary policy will play a key role in the development of the economy. The ECB is currently faced with both high inflation and a weak economy – a potentially insurmountable problem. In the US we are entering an election year. Historically, election years have often coincided with a positive economic climate.

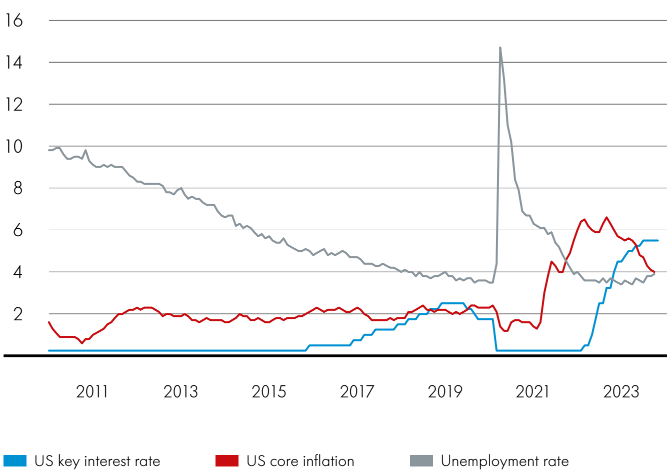
Consumer spending as prop

The economy continues to gain support from strong balance sheets in the corporate sector. Savings rates remain high in Europe, while US households still have hefty cash holdings. The strong labour market is shoring up consumer confidence. The wage increases of the last two years will provide a strong basis for spending for the time being. That said, consumers can be expected to become more circumspect. Rising credit costs, more rigorous lending guidelines and higher energy prices are eroding their financial flexibility.

Geopolitical situation to remain tense in 2024

Conventional wisdom dictates that (geo)politically-driven market movements are short-lived. Markets typically recover after dislocations caused by political events. But the current geopolitical conflicts look to be more complex than their predecessors, and are having a deeper impact. Domestic politics will also be a focus in 2024. In the Eurozone, Germany in particular is inward-looking right now. The current government lacks not just support for its agenda, but also the money to implement it. At the same time, the major source of stimulus for global export activity – China – is faltering.

USA: Interest rate, inflation and labour market environment



Source: Bloomberg L.P., Zuger Kantonalbank

US elections as turning point?

The impending elections in the US could recalibrate the geopolitical priorities of this superpower. The backdrop of all this is major conflict in both the Middle East and the Ukraine, with the US also involved militarily in both theatres, albeit indirectly. 2024 could therefore turn out to be a watershed year for Ukraine. China currently appears to be preoccupied by internal challenges, but competition with the US is likely to create plenty of friction next year too.

A look at Switzerland

Switzerland has not been immune to international developments. Here too, the leading economic indicators are currently pointing to a weak phase. This confirms that the interest rate plateau has been reached. However, higher rents and an increase in administered prices such as VAT could bring about another slight rise in the rate of inflation.

What does this mean for investors?

Positioning for 2024

The leading economic indicators for the US were rather mixed in the fourth quarter, if anything on the negative side. In Europe, the economic environment is suffering from economic weakness in China, political squabbles in Germany and high energy costs. In Switzerland, it was above all manufacturers that felt the downswing in Europe. How should investors now position themselves?

International bonds are back

Our focus on US and European government bonds has paid off. These fixed-income investments have benefited from falls in inflation rates and an anticipated economic slowdown. We are convinced that their diversification properties will once again prove valuable in 2024, with investors in government bonds likely to enjoy higher current yields.

Remain true to existing approach and domestic market

Equities remain an important portfolio element. Portfolios should include structurally strong sectors, defensive plays and above all quality stocks that can maintain stable margins even in difficult times. Stock selection should be based on whether companies can confirm their earnings expectations or whether a downgrade is on the cards. Swiss stocks remain heavily weighted, accounting for a quarter of the entire equity quota. Thanks to their convincing business models, these companies have considerable price-setting power. They generate attractive cash flows and deliver high returns on capital. As a result, Swiss companies should be well up to mastering the challenges of the global economic environment.

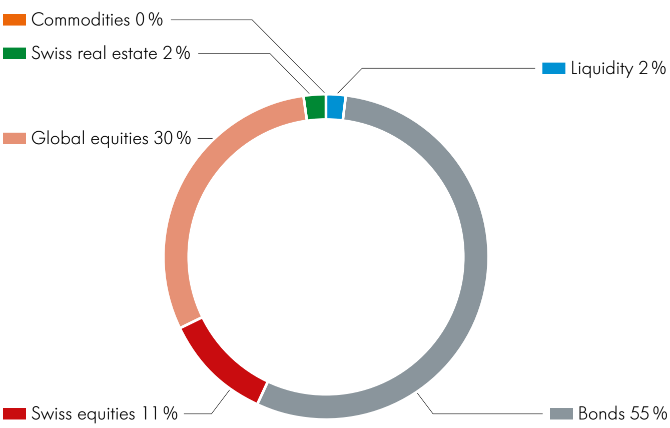
European equities look cheap

As the year gets under way, we continue to recommend a slight underweighting of European equities. The economic headwinds confronting the EU have strengthened. Nonetheless, we believe European equities have genuine potential. Given the current uncertainties, they are now very attractively valued. Accordingly, this region will become increasingly appealing as the year progresses.

Keep faith with strategy over the longer term

From the investor's perspective, it is crucial to be – and remain – well diversified over an investment cycle, in keeping with the individual's risk tolerance and risk capacity. The year just ended in particular has once again confirmed that wide-scale switching in a portfolio rarely pays off. So we therefore emphasise the following once again: Remain true to your selected investment strategy in order to achieve success in investment matters over the medium term.

Strategic positioning (based on balanced mandate)



Source: Zuger Kantonalbank

Tactical positioning

	−	-	=	+	+
Liquidity/money market			■		
Bonds		■			
Swiss bonds			■		
Global Bonds			■		
High-yield bonds and emerging markets	■				
Equities		■			
Swiss equities			■		
Global equities ex Switzerland		■			
Emerging markets equities			■		
Swiss real estate				■	
Commodities			■		

Do you have any questions or thoughts on the current portfolio?

Contact us by email (alex.mueller@zugerkb.ch) or call us on 041 709 11 11.