Zuger Kantonalbank

Portfolio

February 2024

Market overview and positioning

Equities have enjoyed a fine start to the year. US economic data has strengthened confidence in a "soft landing", and inflation remains stable. In Switzerland, declining rates of inflation have even taken some of the heat out of the foreign exchange market. Are markets now in more tranquil waters, or is this just the calm before the storm?

Tough global growth environment

Global economic growth should be modest but constructive in 2024. The International Monetary Fund (IMF) is anticipating growth of 3.1%. The risks of previous years appear to have diminished. Market participants have now become used to higher interest rates and the various geopolitical flashpoints. A significant decline in inflationary prediction is also proving helpful. Although the conflict in the Middle East and US elections later this year could give rise to a new round of price pressure due to supply bottlenecks or fresh tariffs, we are expecting neither a pronounced recession nor a significant acceleration in growth in 2024.

"The new investment year has started well. The global decline in inflation is fizzling out. Switzerland can be expected to cut its key rates later this year."

Alex Müller, Chief Investment Officer

Robust US economy

The strong real growth data for the US economy point to a "soft landing" scenario (see graphic on following page). Support for the economy is coming from both the fiscal side (i.e. government expenditure) and consumer spending. At the end of last year, declines in capital market interest rates provided an additional boost to sentiment. Falling rates of inflation, a robust yet less tight labour market, and rising real incomes have also provided a tailwind. The US finds itself in an election year. Historically, election years have often coincided with a positive economic climate.

Will monetary policy expectations be fulfilled?

At its last meeting in mid-December 2023, the US central bank (Fed) left its key interest rate unchanged. The published observations of its members point to a declining interest rate environment in 2024. The Swiss National Bank (SNB) and the European Central Bank (ECB) likewise left their key rates unchanged. The extent to which the market's expectations of expansionary monetary policy prove correct will depend 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 actually cutting key interest rates.

No runaway inflation

The beneficial impact of monetary policy measures and commodity-price base effects helped bring about a sharp fall in inflation in 2023. In the last few months, fears that another uncontrollable wave of inflation is coming have evaporated.

Market overview and positioning

Timing of rate cuts uncertain

The road to the promised land of price stability is likely to be bumpy in 2024. Forecasts for the timing of the first rate cuts on the part of the ECB and Fed keep being recalibrated. We expect rate cuts to be on the agenda from mid-year onward – as long as the economy continues to develop robustly.

Europe's economy stabilises

For Europe, it is too soon to sound any definite "all-clear" on the business climate. The leading economic indicators for manufacturing currently point to a slowdown to levels below the growth threshold. The services sector is likewise not picking up and has confirmed the sluggish start to 2024. Monetary policy will have a significant impact on European economic development.

Switzerland confirms special status

In Switzerland, the inflation figures at the start of 2024 came as a positive surprise. Inflation amounted to just 1.4% in January, well within the SNB's target bandwidth. This also surprised the markets, which had expected a rate of 1.7%. The strong franc mitigated any inflation imported through higher commodity prices. Thus a rate cut in Switzerland is likely to come that much earlier than in Europe or the US.

Benign currency effects

Following the rapid and sharp appreciation of the Swiss franc over the last few weeks of 2023, the upward pressure has recently subsided somewhat. Supported by higher capital market interest rates in America, the US dollar has made a comeback. This should buoy the spirits of export-oriented Swiss companies. The euro too has gained a little ground. But on the other hand, the slight weakening of the franc is but a drop in the ocean for the export industry – what matters much more to this sector is the Eurozone's economic development. And it remains to be seen how long the current consolidation phase will last.

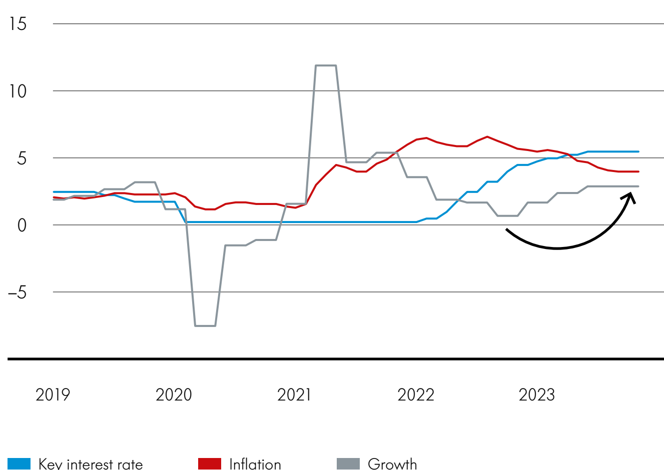
"US equities remain strong, but current yields on bonds are appealing. Don't forget government bonds."

Alex Müller, Chief Investment Officer

Geopolitical situation to remain tense in 2024

The various geopolitical flashpoints around the world remain a focus. 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.

Development of Fed Funds Rate, inflation and growth (USA)



Source: Zuger Kantonalbank, Bloomberg LP/DL

US elections: doubts over key contestants

The impending elections in the US will recalibrate the geopolitical priorities of this superpower. Until then, the financial markets are bound to be giving Washington nervous glances even more frequently. Doubts have been raised as to whether the current US President is capable of serving again. Meanwhile, likely opponent Donald Trump faces the question of whether he will be permitted to serve again. But however the US elections turn out, geopolitical realities will be recalibrated in 2024. Indeed, the shockwaves of Trump's possible re-election can already be felt in Europe.

Middle East conflict not spreading

So far, the war in the Middle East has not had the feared negative repercussions. True, disruption to the Red Sea shipping route has led to higher short-term freight costs. But in the absence of any supply-side bottlenecks appearing and with demand for goods having slowed generally, fears of a renewed inflationary spike have also receded. The indirect effects of potential escalation – above all in the form of higher commodity prices – remain under scrutiny.

What does this mean for investors?

US remains attractive

The US equity market can be expected to remain popular with investors, even if it doesn't look cheap. Earnings expectations are ambitious in the technology sector in particular, and the market is watching the development of these companies like a hawk. Tech companies will have to impress analysts with their sales and earnings figures over the next few quarters too. In our view, however, the boom induced by artificial intelligence justifies the valuation premium for now. For this reason, we expanded our position in US equities at the start of the year.

Exploit positive momentum

Given expectations of a soft landing for the US economy, both equities and high-yield bonds have appeal. The latter allow investors to benefit from both high current yields and stable credit spreads. In the event of an unexpected weakening of the US economy, falling interest rates should cushion some of the loss arising from any widening of spreads. Overall, we recommend a positioning close to the strategic allocation, with a low cash quota.

Bonds are back

We have taken some profits in the area of international government bonds, specifically US Treasuries. These fixed-income investments benefited from falls in inflation rates and the anticipated economic slowdown at the end of 2023. Their appeal has now diminished somewhat. However, we do like the diversification aspect of government bonds. In addition to their ongoing income streams, they offer protection in turbulent times.

Keep the faith with domestic market

Switzerland's leading economic indicators have stabilised at a low level. Corporate earnings expectations are developing stably, and in some cases rising. The valuation of the Swiss equity market is another positive point. Portfolios should include structurally strong sectors, defensive plays and above all quality stocks that can maintain stable margins even in difficult times. In the event of global economic momentum slowing once again contrary to our expectations, the Swiss stock market is likely to prove one of the more robust building blocks in the portfolio.

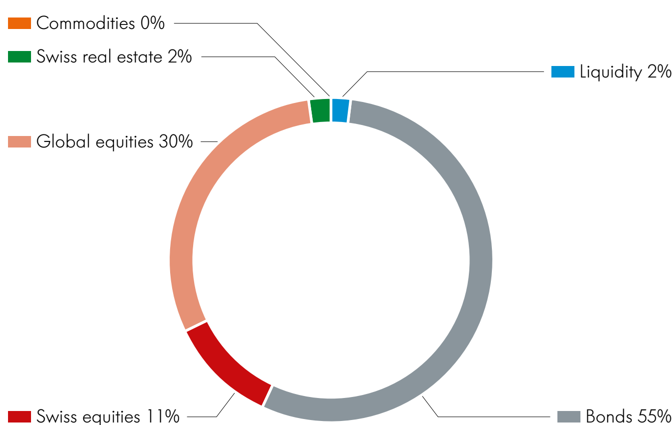
European equities look cheap

As the year gets under way, we continue to recommend a slight underweighting of European equities. The economic headwinds confronting the EU have strengthened further. That said, we do see opportunities in this market. Many stocks remain cheaply valued, and should therefore gain in appeal over the course of the year.

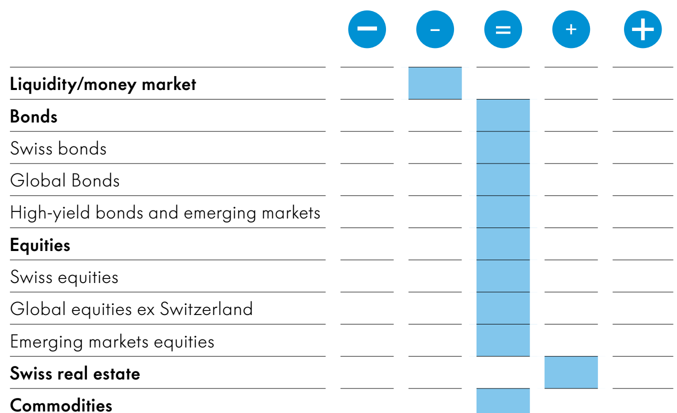
Profits taken on real estate

Swiss real estate funds have appreciated in value against a backdrop of declining capital market interest rates. Their valuations are now almost fair given the current interest rate environment. We have therefore reduced our allocation slightly, but are still overweight here due to the structural strength of this market segment.

Strategic positioning (based on balanced mandate)

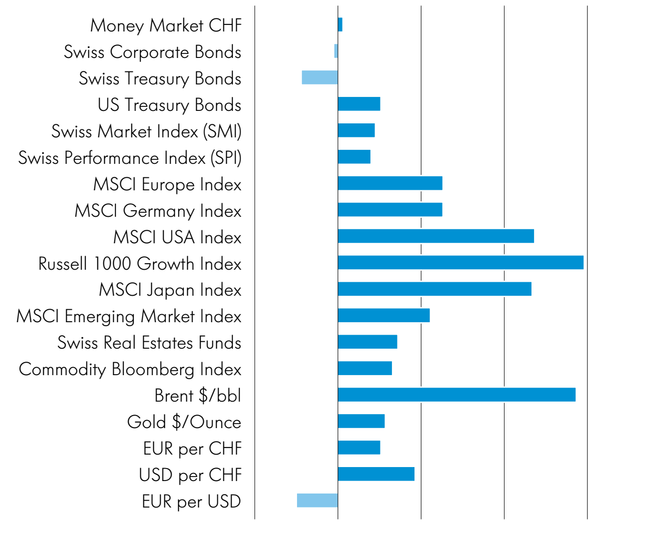


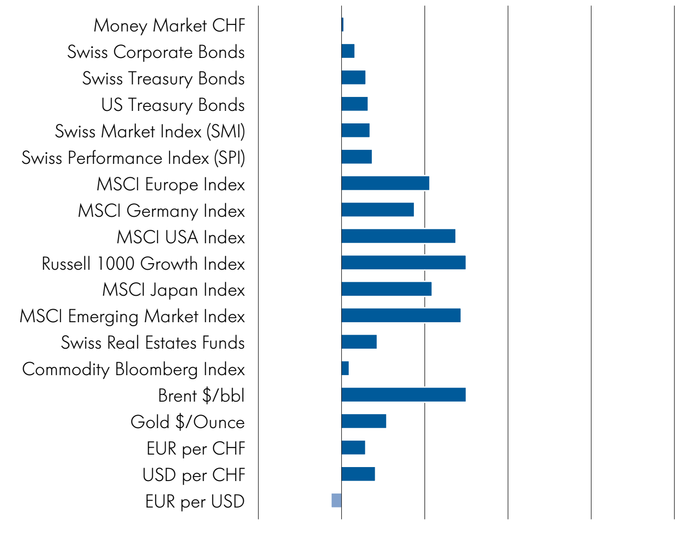
Tactical positioning



Source: Zuger Kantonalbank

Market data (exchanges & markets)





Source: Zuger Kantonalbank, Bloomberg L.P., MSCI, Six Index, Frank Russell Company

Equities Switzerland SMI (from start of the year to 23.02.2024)

Lonza 31.1% / CHF 463.6	**Richemont** 18.9% / CHF 137.6	**Swiss Re** 12.6% / CHF 106.5	**Swiss Life** 11.1% / CHF 648.8	**Givaudan** 8.8% / CHF 3791
ABB 8.2% / CHF 40.37	**Novartis** 8% / CHF 91.63	**Alcon** 7.4% / CHF 70.5	**Sonova** 6% / CHF 290.9	**Zurich** 5.3% / CHF 463
Holcim 5% / CHF 69.32	**Partners Group** 3.3% / CHF 1252.5	**Swisscom** 2% / CHF 516.2	**Kühne&Nagel** –0.7% / CHF 287.9	**Logitech** –1.2% / CHF 78.8
Nestle –2.2% / CHF 95.35	**Geberit** –2.8% / CHF 523.8	**Roche** –4.9% / CHF 232.4	**UBS** –5.3% / CHF 24.72	**Sika** –5.4% / CHF 258.8

Source: SIX Index, Zuger Kantonalbank

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.

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