

» *Fisch View*

*September's topic:
„Long-term interest rates continue to rise“*



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Long-term interest rates continue to rise

- Interest rates on long-term government bonds continue to rise globally. The reasons are persistent inflationary pressure, rising inflation expectations and increasing government debt.
- The equity and high-yield credit markets are largely ignoring this rise in interest rates.
- For this reason, and owing to possible negative surprises, we remain cautiously positioned in terms of risk exposure and are running a neutral to slightly shorter duration.

Overall economic situation

While until recently a recession in the US was a consensus expectation, there has been a clear shift in opinion. "Soft landing" or even "no landing" are now the main scenarios. However, the eurozone, China and the UK, among others, have been struggling for some time. But supporting factors are also running out in the US so far. The prevailing extremely positive consensus for the US could therefore once again prove to be wrong.

Recent developments: Global economy facing headwinds

- The US economy remains robust for the time being. A latest estimate (GDPNow) even signals a significant pick-up in growth in the current quarter. The reasons for this development are once again rising real incomes (interest income, strong wage growth), massively higher government spending (5% of GDP) and high surplus savings thanks to pandemic aid programmes.
- However, the impact of these supporting factors is now rapidly diminishing. In particular, the high surplus savings of private households will soon be used up. In addition, banks are tightening lending conditions, while the central bank's monetary policy remains restrictive and real interest rates are rising. Inflation-linked bonds (TIPS) are trading at a 16-year high.
- Another critical factor for global economic development is the slowdown in China. The problems in the real estate market continue to worsen and are greater than previously assumed. In addition, youth unemployment rose to over 20%, and no further data will be published from now on. This censorship is worrying and underlines the seriousness of the situation.
- But Europe and the UK are also struggling. Swiss exports, for example, plummeted in July.

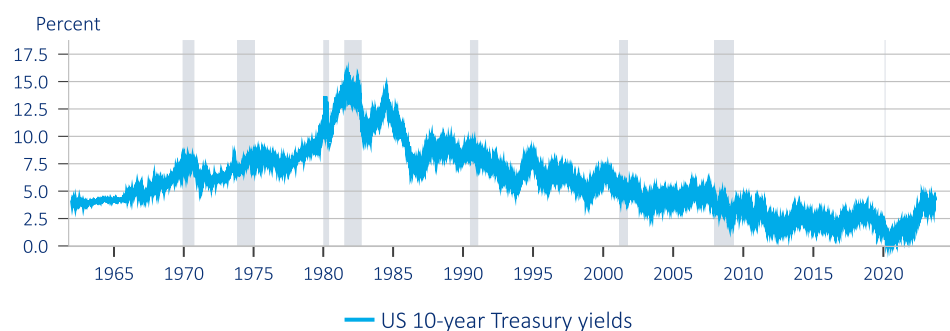
➡ **On the radar:** A wage-price spiral looms in the US (page 6)

Overview & outlook: Dangerous optimism

» The US regional bank crisis continues to smoulder.

- The purchasing managers' indices for the service sector (Service PMI) fell to well below 50 in the euro area in August and are thus at contraction level. The manufacturing PMI has been at recession level for some time. This clearly exacerbates the downward economic pressure in the eurozone. Since China is also suffering from problems, there is a risk of global contagion, especially for the US. Here, the services PMI also weakened in August.
- The US regional bank crisis, which was superficially contained in March with a lot of emergency liquidity, continues to smoulder. The outflow of customer funds continues unabated. The profitability, liquidity and lending capacity of many institutions are rapidly declining. The losses on large government bond positions on the balance sheets of regional banks are far from written off. Overall, the system continues to be highly dependent on assistance from the government and central bank (Federal Home Loan Banks). This development thus contributes to an additional economic slowdown in the US, but also globally.
- Nevertheless, monetary policy remains restrictive, as the inflation trend for the coming months shows a slight rebound due to the disappearance of base effects. The high borrowing by the US government (but also European countries) and sales of US government bonds by China and Japan to support the increasingly weak yuan and yen are draining additional liquidity from the financial system. Moreover, this is pushing up long-term government bond yields.
- All in all, this results in a dangerous combination for global financial markets of recessionary risks combined with restrictive monetary policy, falling money supply, rising long-term interest rates and declining credit. However, the equity and credit markets continue to price in exactly the opposite of this development.

Chart: Upward pressure on long-term government bond yields in the US



Source: U.S. Department of Treasury, Macrobond, Fisch Asset Management
 Note: The shaded areas reflect periods of recession in the US

Positioning: Remain cautious on equities and high yield

» We favour emerging market high yield on a relative basis versus developed markets.

- The dangers of a very restrictive monetary policy combined with a cooling economy and lower corporate profits are not priced into developed market equities and high-yield bonds. We therefore remain defensively positioned in our convertible bond and high-yield strategies. Negative surprises are possible at any time. However, the high-yield credit market currently offers an attractive current yield (thanks to the high interest rate level) and still moderate default rates. Our underweight in risk exposure is therefore moderate.
- In the emerging markets, we consider the high-yield credit markets to be somewhat more attractive than in the developed countries due to higher credit spreads and continued stable economic development in many countries (with the exception of China), and we are therefore neutrally positioned there. In contrast, we remain cautious on emerging market bonds in the investment grade segment. Despite high interest rates, credit spreads currently do not fully compensate for possible macroeconomic risks.
- We see only limited upside potential for long-term government bond yields and lower rates again in the medium term. Therefore, we keep the duration in our multi-asset strategies slightly above neutral. The risk exposure (equities and high yield), on the other hand, is slightly below target.

	US	Europe	Japan	Asia ex-Japan	LatAm	CEEMEA	Key:
Equities	-	-	+	o	o	o	++ Strong positive
Government Bonds	o	o	- ↓				+ Positive
Credit IG	o	o		- ↓	- ↓	- ↓	o Neutral
Credit HY	-	-		o	o	o	- Negative
Convertibles	- ↓	-	+ ↑				-- Strong negative
	PrecMet	InduMet	Energy				
Commodities	o	-	o				

Notes regarding the table: Changes from prior month are indicated with ↓ or ↑. i.e. "O ↓" means that the output has weakened from a prior value of + or ++. The methodology for calculating model outputs, and how the various pieces fit together to form the big picture, is explained [here](#). Within government bonds, we consider the most important bonds for each region, e.g. German Bunds in Europe, and a representative group of countries for Latin America, Asia ex-Japan and CEEMEA (Central and Eastern Europe, Middle East and Africa).

Cross asset class preferences

This table combines top-down views with bottom-up analysis at the portfolio level.

	Most preferred	Least preferred
Convertible Bonds	<ul style="list-style-type: none"> – CBs with positive yield – Stocks with strong secular trends (renewables, healthcare) – CBs with high convexity 	<ul style="list-style-type: none"> – Weak credit quality and/or liquidity – REITS
Global IG Corporates	<ul style="list-style-type: none"> – Energy, healthcare – 5-10 year maturities 	<ul style="list-style-type: none"> – Real estate – Maturities >10 years
Global Corporates	<ul style="list-style-type: none"> – Energy, healthcare – Investment grade – Developed markets 	<ul style="list-style-type: none"> – Real estate, transport – High yield – Emerging markets
Global High Yield	<ul style="list-style-type: none"> – Capital goods, energy – Basic industry 	<ul style="list-style-type: none"> – Retail – Technology – 'CCC' rating segment
Emerging Markets - Defensive	<ul style="list-style-type: none"> – Middle East – Indonesia, South Korea – Maturities <10 years 	<ul style="list-style-type: none"> – LatAm – China, Hong Kong – Maturities >10 years
Emerging Markets - Dynamic / Opportunistic	<ul style="list-style-type: none"> – High yield energy, gold miners – LatAm (esp. Mexico and Colombia), Indonesia 	<ul style="list-style-type: none"> – Deeper credit B/CCC segment

Note: Preferred sectors/regions may differ between asset classes owing to respective performance drivers. In particular, equity exposure is the key performance driver for convertible bonds and is not relevant for corporate bonds.

On the radar: A wage-price spiral looms in the US

The US may be facing a serious wage-price spiral. The chart below shows a substantial increase in the expected wages of job seekers. According to the Fed's quarterly Survey of Consumer Expectations, expectations for annual wages have risen by an average of 11.8% since the last survey. And due to the still extremely dried-up labour market, we assume that these high wage expectations will actually be met.

» The sharp increase in wage expectations came as a surprise.

Since companies can at least partially pass on these wage increases via higher product prices due to the continuation of solid consumer demand, this creates dangerous inflationary pressures. The chart shows that the increase came as a surprise. Previously, wage expectations had been consolidating since the end of 2020. Fed Chairman Jerome Powell always emphasised that wage pressures had even been declining in recent months and is unlikely to be pleased about the current development.

Accordingly, monetary policy cannot be eased for the time being, although there are increasing signs of a cooling US economy and the surplus savings (from the pandemic aid programmes) of private households have now been almost completely used up. All in all, this is a troublesome situation that can lead to a rapid change in consumer and financial market sentiment at any time.

Chart: "Fed Survey of Consumer Expectations" – rising wage expectations



Source: Federal Reserve Bank of New York, Macrobond, Fisch Asset Management

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