

» *Fisch View*

*February's topic:
„Opposing forces“*



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Opposing forces are at work in the markets

- Economic developments and financial markets are currently being dominated by a variety of mutually offsetting forces.
- Previously supportive factors, such as the high fiscal stimulus, strong labour markets and liquidity generation in the banking system, are weakening. But there is still a lot of “residual energy” in the economy in the form of solid consumer spending and stubbornly high money supply.
- In terms of risk exposure, we take a neutral position in our strategies and favour corporate bonds due to their attractive risk/reward ratio.

Overall economic situation

The economy, interest rates, inflation and financial markets are currently being influenced by a number of positive and negative forces, which largely cancel each other out. This means that the general environment is in an unstable equilibrium that can be disrupted by even small shifts in forces. In particular, the influence of previously supportive factors is diminishing, which increases the risk of an economic slowdown. At the same time, continuing high levels of government debt, particularly in the US, are potentially pushing up interest rates at the long end of the yield curve.

Recent developments: “Residual energy” in the system is declining

- Various factors that have so far provided strong support for the economy and for financial markets will weaken significantly in the foreseeable future. In particular, the Overnight Reverse Repo Facility, a powerful source of liquidity for stock markets since April last year, will soon dry up completely (see also “On the radar” on page 6). Although this is a US-based source of liquidity, it has an indirect impact on the global money supply. In addition, the enormous surplus savings of private households in the US will be exhausted in the foreseeable future.
- Overall, this means that an important monetary and economic support factor will disappear at the same time. As a result, the central banks' continued restrictive monetary policy and the weakening labour markets will once again gain greater influence. However, there is currently still enough “residual energy” in the system to delay or dampen any major turbulence.

➡ **On the radar:** Liquidity generation remains high for now (page 6)

Overview & outlook: Risks and opportunities in balance

» A normalisation of the high growth in the US is desirable.

- Growth in the US slowed to 3.2% in the fourth quarter from 5.1% in the previous quarter. Meanwhile, the eurozone is already close to a recession. The leading indicator from the Conference Board is also signalling a further slowdown for the US.
- However, a normalisation of the high growth in the US, which is driven by exceptional factors, and an easing of conditions in labour markets are generally desirable, and will have a dampening effect on interest rates and inflation in the medium term (also globally). This will allow the economy, inflation and interest rates to stabilise at a healthy long-term equilibrium.
- On the way to this equilibrium, however, there may be temporary disruptions and increased market volatility due to the diminishing positive factors mentioned above (overnight reverse repo liquidity, excess savings and strong labour markets).
- In addition, the monetary policy of both the Fed and the ECB appears to be a little too restrictive. The focus is still on fighting inflation (despite significantly falling rates) and not on potential liquidity crises. And the Bank of Japan is also likely to switch to a more restrictive course soon. Overall, this increases the short-term risks for stock markets. However, in the event of turbulence, there is plenty of room for manoeuvre for monetary easing and emergency liquidity.

Chart: Hiring on the US labour market is steadily declining



Sources: BLS, Macrobond, Fisch Asset Management

Positioning: Positive factors predominate for corporate bonds

» Convertible bonds currently offer a highly asymmetrical risk/reward ratio.

- We currently see a favourable environment for corporate bonds. On the one hand, companies are still benefiting from the aforementioned residual economic energy. At the same time, cooling economic and inflationary momentum should lead to lower interest rates.
- Furthermore, in the event of a more pronounced economic slowdown, the negative effect of rising credit spreads would be offset by rapidly falling interest rates, particularly for borrowers with better credit ratings. In addition, central banks would loosen their monetary policy very quickly, and even increase the money supply and balance sheets again if necessary. And the attractive current yields offer an additional risk buffer.
- Many positive expectations are currently priced into equity markets. Due to the still positive but weakening factors, disappointments can therefore occur at any time. We would therefore only take equity exposure via convertible bonds. There is currently an interesting and highly asymmetrical risk/reward ratio here. Our convertible bond strategies are neutrally positioned at present, but with a focus on credit risks.
- Overall, we would still hold residual cash back for investments in order to enter at lower levels in the event of a market correction.

	US	Europe	Japan	Asia ex-Japan	LatAm	CEEMEA	Key:
Equities	o	o	+ ↑	o	o	o	++ Strong positive market
Gov. Bonds	o ↑	+ ↑	-				+ Positive market
Credit IG	o	o		o	o	o	o Neutral
Credit HY	- ↓	- ↓		o	o	o	- Negative market
Convertibles	o ↑	o	+ ↑	o			-- Strong negative market
	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"> – Software (Cybersecurity) – Semiconductor (AI-related) – CBs with high convexity – Short-dated solid CBs with YTM 2% above Swap rate 	<ul style="list-style-type: none"> – Utilities, REITS – Consumer discretionary – Unprofitable or expensive technology – Weak credit quality and/or liquidity
Global IG Corporates	<ul style="list-style-type: none"> – Energy, financials – 5-10 year maturities 	<ul style="list-style-type: none"> – Rail – Maturities >10 years
Global Corporates	<ul style="list-style-type: none"> – Energy, financials – Investment grade – Developed markets 	<ul style="list-style-type: none"> – Rail – High yield – Emerging markets
Global High Yield	<ul style="list-style-type: none"> – Capital goods – Energy – Basic industry 	<ul style="list-style-type: none"> – Technology – Financial services – 'CCC' rating segment
Emerging Markets - Defensive	<ul style="list-style-type: none"> – South Korea, Mexico – A-rated bonds – Maturities <5 years 	<ul style="list-style-type: none"> – China, Hong Kong, Israel – BBB-rated bonds – Maturities >7 years
Emerging Markets - Dynamic / Opportunistic	<ul style="list-style-type: none"> – LatAm (esp. Brazil and Mexico) – High yield energy – BB-rated bonds 	<ul style="list-style-type: none"> – Maturities >10 years – A-rated bonds, CCC-rated bonds

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: Liquidity generation remains high for now

Over the course of the past year, the US financial system saw a remarkable and historically unprecedented generation of liquidity by commercial banks and the US government, which fully compensated for the Fed's restrictive monetary policy.

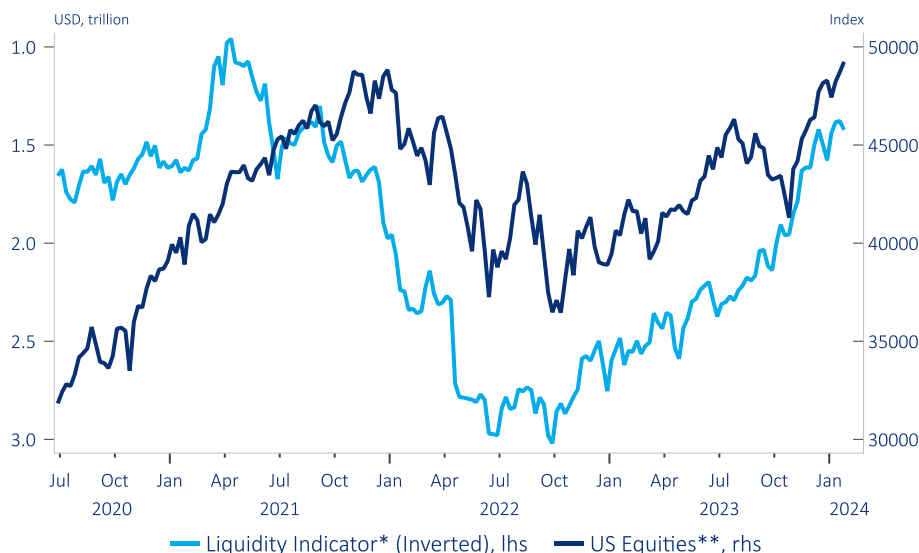
In the following chart, the light blue line shows this increase in liquidity since the beginning of 2023 in the order of around USD 1,500 billion. The high correlation with equity markets is also striking, particularly in the case of a previous decline in this indicator.

» US monetary policy is currently not in a tightening cycle.

The main driver of this development was the aforementioned overnight reverse repo money (see page 2), which private banks withdrew from the Fed and shifted into US Treasury Bills. This reallocation led to an increase in the money supply and therefore also in the liquidity in the system. And the sharp hike in US government spending had the additional effect of boosting liquidity. The President of the New York Fed, John Williams, recently even stated that US monetary policy is therefore not currently in a tightening cycle.

However, this source of liquidity is now weakening and is likely to dry up at the end of the first quarter. Until then, a supportive effect can therefore still be expected, particularly on equity markets. After that, however, there could be increased liquidity stress, at least temporarily, if the Fed does not ease in a timely manner.

Chart: Liquidity in the financial system is increasing despite restrictive monetary policy



* Sum of Fed reverse repo facility & U.S. Treasury General Account

** US equities proxied by the Wilshire 5000 Total Market Index.

Sources: New York Fed, Fed, Wilshire Associates Incorporated, Macrobond, Fisch Asset Management

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