

» *Fisch View*

*March's topic:
„Deceptive indicators“*



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Distorted economic indicators in the US

- Various historically reliable economic indicators have been giving false recession signals for the US for some time now.
- These distortions can be explained by a number of extraordinary factors that are influencing current economic developments. These include extremely high public spending by the US government, liquidity generation in the banking system and high consumer spending due to excess savings.
- In deference to this ambiguous situation, we are positioning ourselves in a neutral range in terms of risk and duration.

Overall economic situation

The US economy is weakening again compared to its peak in the third quarter of last year, but remains well above the long-term trend. Although various positive one-off factors evident previously are easing, they continue to distort the growth trend upwards. Conversely, in Europe, the economy has remained close to recessionary levels for four quarters now, which is consistent with the relevant weak leading indicators. A similar trend can also be observed in China, with a corresponding global dampening effect. However, significant monetary easing is likely to provide somewhat more positive impetus in the foreseeable future.

Recent developments: Liquidity supply is still good

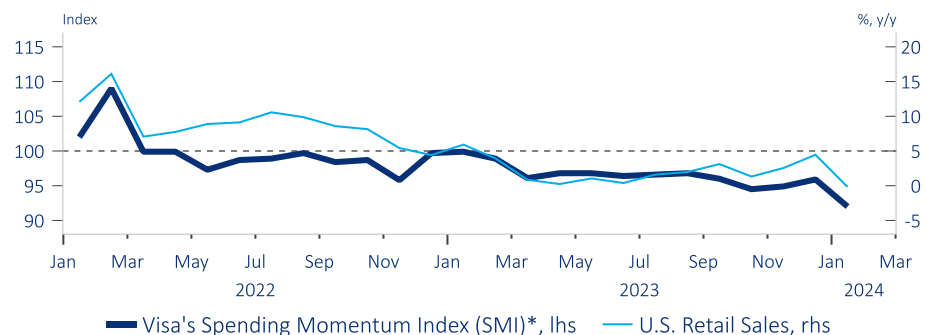
- The excess reserves held by the US banking system at the Fed (known as the "Overnight Reverse Repo Facility") were reduced by a further USD 100 billion in February and by USD 350 billion since the beginning of the year. This money flowed into the US financial system and indirectly also into global markets. For the time being, this is still providing positive impetus for the economy and, in particular, for equity and bond markets.
- However, inflation figures rose again globally due to the expansive monetary environment and persistent inflation in services, causing disappointment among investors. Although the anticipated date of the first interest rate cut has now been pushed back, markets continue to expect falling inflation rates and lower interest rates. However, apart from the former US Treasury Secretary, Larry Summers, nobody dares to mention the possibility of a further interest rate hike.

Overview & outlook: Liquidity remains high for the time being

» Markets are already pricing in a first rate cut in June.

- Some of the liquidity generated by the Fed and the US government during the Covid-19 pandemic is still circulating in the financial system and supporting private consumption in the form of excess savings, and thus the economy. This liquidity compensates for the central bank's restrictive monetary policy and creates a “Goldilocks environment” with robust consumption and rising wages. In addition, persistently high government spending leads to additional growth stimuli that are not actually necessary at present.
- This means that historically reliable leading economic indicators (Conference Board Leading Economic Index (LEI), OECD Composite Leading Index) are currently sending distorted recession signals for the US. These indicators largely reflect the manufacturing sector rather than private consumption or the service sector, which are currently providing economic stimulus.
- Due to this very positive economic development, which is distorted by extraordinary factors, there is a general lack of concern, and economic warning signals are being ignored. Moreover, solid corporate profits are still expected. Nevertheless, markets are already pricing in a first interest rate cut. Although this has been pushed back to June since the beginning of the year, 65% of analysts in the US also expect lower rates at the long end.
- However, this means that disappointments are increasingly likely in the form of rising interest rates and falling equity markets. This is particularly the case due to a very possible combination of higher inflation rates and a simultaneous decline in economic momentum. The latter would be due to the weakening special factors mentioned above. In any case, retail sales and credit card spending increasingly point to a weakening of the previously very robust consumer and services sector.
- In the medium term, inflation is likely to fall further after the temporary rise mentioned above, which would actually allow interest rates to be cut. However, this will probably be too late to prevent a significant economic slowdown or even a recession by then.

Chart: Consumer spending dynamics are weakening in the US



* When the SMI falls below 100, spending momentum is weakening and fewer consumers are spending more, relative to the previous year (et vice versa).

Sources: Visa, U.S. Census Bureau, Macrobond, Fisch Asset Management

Positioning: Neutral risk exposure

- Due to the still positive but weakening factors, such as high liquidity and a solid economy in the US, as well as a stabilisation of developments in China (and to some extent in the manufacturing sector in Europe), we are keeping the risk exposure in our strategies in a neutral range for the time being.
- We are also maintaining duration in the neutral range, as positive and negative factors for interest rate trends are currently balancing each other out here too.
- However, the current equilibrium is very fragile and the positive factors are largely priced into the markets. Even minor disruptions can lead to negative surprises and therefore high volatility. In particular, negative feedback loops may arise if the previously positive market factors begin to weaken simultaneously and these trends were to reinforce each other.
- Nevertheless, corporate bond markets still offer interesting opportunities, particularly in the emerging markets and in the BB/BBB crossover market segment. Diversification continues to have an effect here, which at least partially offsets the negative impact of rising credit spreads through falling interest rates in the case of a recession. However, we are focussing our analyses on potential downside risks.
- Equity exposure can be taken via convertible bonds. Convertible bonds offer an asymmetrical risk/reward ratio and are therefore well suited in times of great uncertainty or unstable market equilibrium. In addition, the universe of convertible bond issuers is relatively cheap in relation to the global equity universe.

» The effect of higher spreads is partly compensated by falling rates.

	US	Europe	Japan	Asia ex-Japan	LatAm	CEEMEA	Key:
Equities	+ ↑	o	+	o	o	o	++ Strong positive market
Gov. Bonds	o	o ↓	-				+ Positive market
Credit IG	o	o		o	o	o	o Neutral
Credit HY	o ↑	o ↑		o	o	o	- Negative market
Convertibles	+ ↑	o	+	o			-- Strong negative market
	Edelmet	InduMet	Energie				
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 – Bond-like CBs with quality credits and attractive yields 	<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, healthcare, financials – 5-10 year maturities 	<ul style="list-style-type: none"> – Rail – Maturities >10 years
Global Corporates	<ul style="list-style-type: none"> – Energy, healthcare, 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"> – Retail – Technology
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

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: Deceptive leading indicators

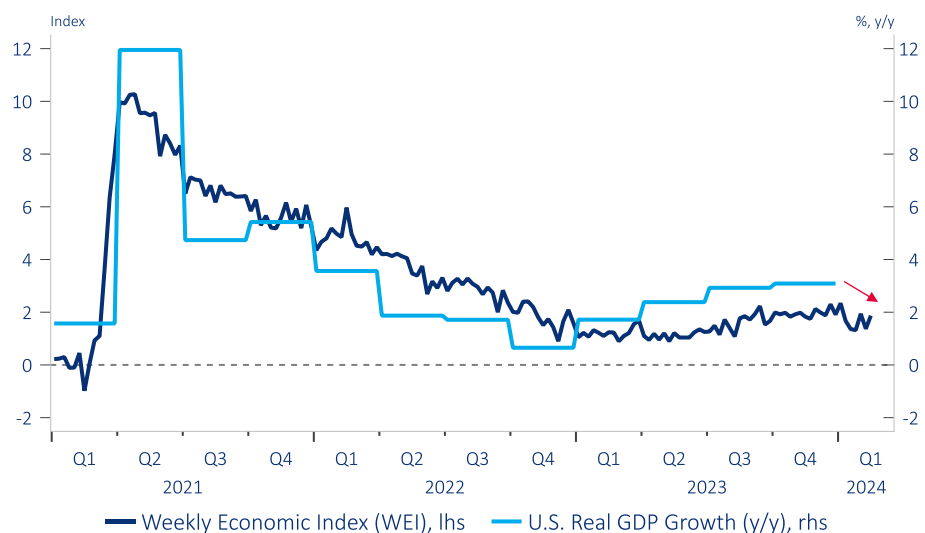
The chart shows the Weekly Economic Index (WEI), which has been calculated for the US economy since the outbreak of the Covid-19 pandemic (based on a model developed by economists Lewis, Mertens and Stock in 2020). It incorporates daily or weekly data (including electricity and petrol consumption, rail traffic and consumer behaviour), which provides a very up-to-date picture of economic development (much more up-to-date than the Atlanta Fed's GDPNow).

» The Weekly Economic Index accurately reflects the state of the US economy.

In addition, the WEI – compared to leading indicators such as the Conference Board Leading Economic Index and/or the OECD Composite Leading Index – has a lower proportion of components from the manufacturing sector and gives greater weight to data from the service sector. This is a more accurate reflection of the economic situation in the US, which is currently still characterised by special factors. It is therefore not surprising that the WEI has better reflected the solid course of the US economy and the strong stock markets recently and has not signalled a recession.

Currently, however, the WEI has weakened from 2.34% to 1.87% in the last six weeks. This is moderate, but nevertheless noteworthy. As we also expect an accelerating decline in consumer spending, which is driven by excess savings, in the coming months, this latest reversal in the WEI could signal a further slowdown in economic momentum in the US.

Chart: The Weekly Economic Index does not signal a recession yet



Sources: Dallas Fed, BEA, Macrobond, Fisch Asset Management

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