

# » *Fisch View*

*May's topic:  
„Plenty of residual energy in the system“*



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## Plenty of residual energy in the system

- Consumption in the US remains robust due to various monetary and fundamental factors and this is overshadowing persistent signs of weakness in the manufacturing industry and among SMEs for the time being.
- However, the continuing supportive factors are also leading to higher inflationary pressure and rising interest rates.
- Economic imbalances are building up. Our indicators are not yet providing any sell signals, which is why we continue to position ourselves neutrally in terms of risk exposure, but cautiously in terms of duration.

## Overall economic situation

The US economy is cooling, but remains solid. Consumers are keeping the economy going, but several indicators are pointing to declining consumer momentum and the manufacturing sector remains weak. This means that the US economy is not on a sustainable and self-supporting footing and there is the potential for an economic imbalance in the medium term. Moreover, no supportive influences are to be expected from the EU and China in the short term, as the economy is already only performing very moderately there.

## Recent developments: US retail sector very strong

- After a strong start to the year, April was a difficult month for financial markets. Global equity markets came under pressure, while long-term interest rates rose. This was partly due to stubborn US inflation, and doubts arose as to whether the Fed would be able to cut interest rates at all this year. Accordingly, the Fed gave no indication of an imminent change in its interest rate policy at the beginning of May.
- Mirroring the stubborn inflation, US retail sales rose significantly again in March as a sign of a robust economy. The reasons for this are a strong labour market, rising wages, high interest rates on savings and rising stock markets with correspondingly positive wealth effects.
- However, all of these positive factors are ultimately based on unsustainably high government spending and residual liquidity in the banking system from the pandemic period. This in turn leads to upward pressure on long-term interest rates, on inflation and inflation expectations.

## Overview & outlook: Difficult timing

» Opposing forces are influencing long-term US interest rates.

- The US national debt is currently rising at an enormous rate of 7.5% p.a. (in relation to gross national product). The debt-to-GDP ratio is approaching 130% (in contrast to the eurozone with a much more moderate 89%). This is significantly increasing the supply of US government bonds. In addition, there is a refinancing requirement of around USD 9500 billion over the next 12 months. At the same time, various foreign central banks are increasingly dropping out as buyers as they seek to reduce their dependence on US dollar investments, while the Fed is continuing to sell its US Treasury holdings. The Bank of Japan is also tightening its monetary policy, thus attracting more capital from the US to Japan. These are all factors that are putting upward pressure on long-term US Treasury yields.
- In addition, there is stubborn inflation and an important demographic factor in the medium term: the baby boomer generation is increasingly retiring and has to liquidate its savings invested in US government bonds. We are also seeing similar developments in Europe, albeit to a lesser extent.
- However, this upward pressure on interest rates is also being counteracted by strong opposing forces. For example, the previously important source of liquidity in the US banking system ("Overnight Reverse Repo Facility"), which has driven inflation and markets, will soon dry up. In recent months, this facility has seen more than USD 2,000 billion flow into markets and there is now only around USD 440 billion left. This will lead to a decline in money supply growth in the foreseeable future and thus have a dampening effect on inflation and interest rates. In addition, various sectors and segments (manufacturing and the US SME sector) have been showing signs of weakness for some time now. In the coming months, this could spread to consumption, which has been robust to date, and lead to a decline in economic momentum this year. This would also have a temporary dampening effect on interest rates. In this case, the Fed would also likely intervene with rate cuts and possibly even buy government bonds again.
- However, such support measures by the Fed (and possibly also other central banks) could have the exact opposite effect if implemented too early and lead to higher inflation and therefore also higher long-term interest rates. This means that the current situation remains highly susceptible to disruption and difficult to time.

**Chart: Long-term interest rates continue to climb**



Sources: Macrobond, U.S. Treasury, Fisch Asset Management

## Positioning: No sell signals yet - but vigilance is key

- Overall, this unsustainable starting position could quickly lead to an economic slowdown in the US, while inflation and long-term interest rates remain under upward pressure.
- At the moment, however, the equity and credit markets appear to be ignoring the dangers in this regard. Market sentiment is currently positive and risk premiums are trending downwards. In addition, the persistently robust US economy, due not least to the hype surrounding artificial intelligence (AI), is boosting sentiment and the "Magnificent Seven" in particular have benefited from this trend thus far. In future, however, investors will increasingly focus on the resulting profits and, due to the high valuations, disillusionment and corrections may occur at any time.
- Together with the macroeconomic imbalances described above, this is likely to lead to increasing volatility and technical corrections on the equity and credit markets. A sector rotation from growth sectors to value and commodities is also possible. In contrast to the strength of the US dollar, the current rise in the gold price seems well supported to us.
- Our short-term indicators for the equity and credit markets only provide warning signals, but not yet clear sell signals. We therefore remain neutral in terms of risk exposure, but cautiously positioned in terms of duration. Some sluggish auctions of US Treasuries in recent weeks also point to continued selling pressure on US government bonds.
- We currently see active management as central, which should replace buy-and-hold strategies.

» Our short-term indicators are not yet providing any sell signals.

	US	Europe	Japan	Asia ex-Japan	LatAm	CEEMEA	Key:
<b>Return drivers</b>							++ Strongly positive
<b>Equities</b>	o	o	+	o	o	o	+ Positive
<b>Gov. Bonds</b>	o	o	o				o Neutral
<b>Credit IG (Spreads)</b>	o	o		-	o	o	- Negative
<b>Credit HY (Spreads)</b>	o	o		o	+	o	-- Strongly negative
<b>Total return</b>							
<b>Convertibles</b>	o	o	+	o			
<b>Credit IG</b>	o	o		o	o	o	
<b>Credit HY</b>	+	+		+	+	+	
	<b>PrecMet</b>	<b>InduMet</b>	<b>Energy</b>				
<b>Commodities</b>	+	o	o				

**Notes regarding the table:** The table summarises the model results for the total return of convertible bonds and credit investment grade and high yield, which are a function of the listed return drivers. 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 take German Bunds into account for Europe.

## Cross asset class preferences

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

	Most preferred	Least preferred
<b>Convertible Bonds</b>	<ul style="list-style-type: none"> <li>– Software (Cybersecurity)</li> <li>– Semiconductor (AI-related)</li> <li>– CBs with high convexity</li> <li>– Bond-like CBs with quality credits and attractive yields</li> </ul>	<ul style="list-style-type: none"> <li>– Utilities, REITS</li> <li>– Unprofitable, early stage, expensively valued IT and biotech</li> <li>– Weak credit quality and/or liquidity</li> </ul>
<b>Global IG Corporates</b>	<ul style="list-style-type: none"> <li>– Energy, healthcare, consumer goods</li> <li>– 5-10 year maturities</li> </ul>	<ul style="list-style-type: none"> <li>– Technology &amp; base metal</li> <li>– Maturities &gt;10 years</li> </ul>
<b>Global Corporates</b>	<ul style="list-style-type: none"> <li>– Energy, healthcare, automotive</li> <li>– Investment grade</li> <li>– Developed markets</li> </ul>	<ul style="list-style-type: none"> <li>– Technology &amp; base metals</li> <li>– High yield</li> <li>– Emerging markets</li> </ul>
<b>Global High Yield</b>	<ul style="list-style-type: none"> <li>– Capital goods, energy</li> <li>– Basic industry</li> <li>– Leisure</li> </ul>	<ul style="list-style-type: none"> <li>– Transportation</li> <li>– Financial Services</li> <li>– Technology &amp; electronics</li> </ul>
<b>Emerging Markets - Defensive</b>	<ul style="list-style-type: none"> <li>– South Korea, Africa</li> <li>– A-rated bonds</li> <li>– Maturities &lt; 5 years</li> </ul>	<ul style="list-style-type: none"> <li>– Hong Kong, Middle East</li> <li>– BBB-rated bonds</li> <li>– Maturities &gt;7 years</li> </ul>
<b>Emerging Markets - Dynamic / Opportunistic</b>	<ul style="list-style-type: none"> <li>– LatAm (esp. Brazil and Mexico)</li> <li>– High yield energy</li> <li>– Short-dated high-yield bonds</li> </ul>	<ul style="list-style-type: none"> <li>– Maturities &gt;10 years</li> <li>– A-rated bonds</li> </ul>

**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: Greenspan's Fed model

The famous Fed model, which compares the interest rate level with the earning power of S&P 500 companies, and was developed by the legendary Fed Chairman Alan Greenspan, is providing a warning signal for the stock market for the first time in 22 years.

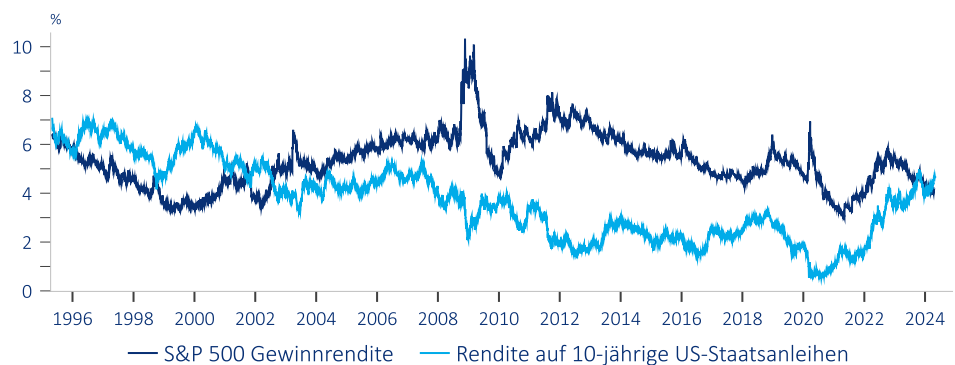
» US government bond yields are above the earnings yields of the equity market.

Due to the recent rise in interest rates on 10-year US government bonds and the simultaneous appreciation of the US equity market in the form of higher price/earnings ratios, the government bond yield has recently exceeded the earnings yield (earnings yield =  $1/P/E$  ratio) of US equities (see chart). According to the Fed model, it is therefore currently more profitable to invest in government bonds (without any credit risk) than in equities.

This signal indicates a paradigm shift from a deflationary to an inflationary environment with a tendency towards higher long-term interest rates. Overall, the equity and interest rate markets are currently seeking a new equilibrium. As there is also a huge increase in US government debt, the pressure on interest rates is intensifying.

We do not yet see any immediate sign of major dangers for the equity and interest rate markets. In an emergency, a further rise in interest rates could be curbed by renewed government bond purchases (QE) by the Fed. In many cases, however, such measures are a way of combating symptoms and not a solution to the problem.

**Chart: Fed model provides a warning signal for equities for the first time in 22 years**



Quellen: Bloomberg, Fisch Asset Management

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