

*August's topic:
„The return of volatility“*





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The return of volatility

- Economic and political turbulence is dominating markets: The latest news from the US labour market and the US election campaign have led to a steeper yield curve and a sell-off in stock markets.
- The US labour market and inflation are at a turning point. The further course of events will determine whether the economy stabilises or cools down further.
- Our sell signals have been triggered and we have lowered our risk exposure to neutral. We also expect the US yield curve to steepen further in the coming months.

Overall economic situation

The US economy has cooled compared to the previous year and is at a turning point: a further weakening of the US labour market could destabilise the consumer-led economy. Recession fears are once again widespread and investors now expect the Fed to cut interest rates four to five times (25 basis points each) from September until the end of the year. No positive impetus is currently expected from Europe and China.

Recent developments: Mixed signals

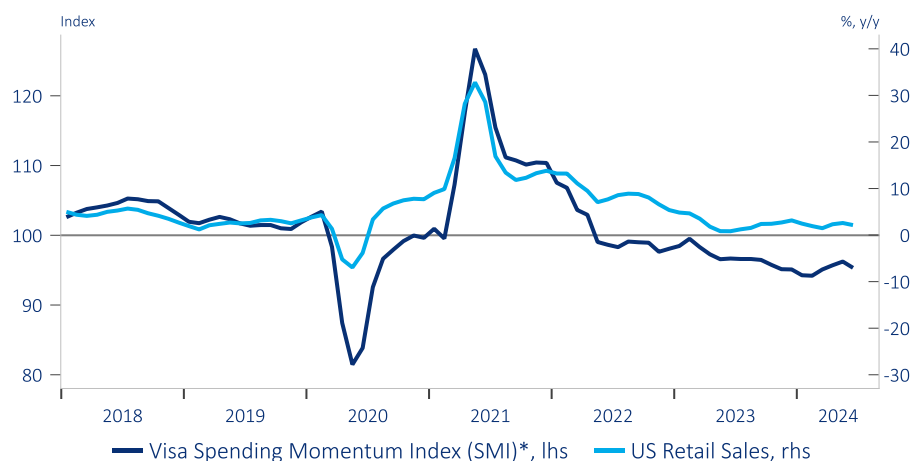
- The latest labour market report in the US caused shockwaves: the unemployment rate rose to 4.3% and triggered the Sahm rule (more on this on the next page). US inflation, on the other hand, was a positive surprise. In particular, the important rental price inflation has returned to pre-pandemic levels and is expected to remain there. This triggered a rotation from mega-cap companies into more defensive sectors, which was exacerbated by some disappointing quarterly figures from the "Magnificent Seven".
- The European purchasing managers' indices have repeatedly disappointed and indicate that the economic recovery that had started at the beginning of the year is already slowing down again. The improvement in real incomes has not yet been reflected in higher consumer spending and a dynamic economic upturn will be difficult to achieve without further monetary easing.
- The Chinese economy continues to face considerable challenges. The latest economic data shows a slowdown in growth, persistent deflation and a decline in retail sales. This is also reflected in the weakening copper price. In order to achieve the 5% growth target for 2024, measures are needed to revitalise domestic consumption.

Overview & outlook: Market volatility is increasing

- The disappointing July labour market report in the US was one too many: the repeated rise in unemployment led to a broad sell-off in global stock markets and a bond market rally, which has been exacerbated by the unwinding of yen-financed carry trades. In addition, the much-cited Sahm rule, a recession indicator, was triggered. The higher unemployment rate can be attributed to both an increased labour supply (e.g. as a result of immigration) and a weaker demand for labour. However, the number of vacancies and newly created jobs continues to fall steadily and it is therefore likely that the unemployment rate will continue to rise in the coming months.
- The US election campaign is also keeping the markets on their toes. Even before President Biden's resignation as presidential candidate on 21 July and the appointment of Kamala Harris, Donald Trump's chances of winning were steadily increasing, resulting in a steeper yield curve. This is based on the consensus view that a Trump presidency will push up interest rates. However, opposing forces are at work in the medium term: higher import tariffs act like a tax on US companies and households, leading to falling real incomes and lower trend growth, and thus having a dampening effect on interest rates. Tax cuts, on the other hand, would further increase the already very high budget deficit with the risk that investors would act as "vigilantes" and demand higher interest rates as a sign of their concern about further deficits.
- The further course of the US economy will also play a decisive role in the outcome of the US elections. The cumulative price increases of the last few years have led to poor consumer sentiment. Retailers such as Walmart and Target are reporting that consumers are becoming more selective in their purchases and are responding with price cuts. This confirms that households are increasingly having to cut back on their spending due to depleted savings. The slowdown in consumer spending is being exacerbated by the weaker labour market. We therefore expect a further economic slowdown and a steeper US yield curve in the coming months.

» US consumers are becoming more selective, retailers are lowering prices.

Chart: Visa transaction data confirm slowing consumer momentum



* SMI values below 100 indicate decreasing consumer spending (and vice versa).

Sources: Visa, USCB, Fisch Asset Management

Positioning: Defensive approach pays off

» Owing to the triggered sell signals, we remain positioned neutral to slightly defensive.

- We feel that our cautious positioning in risky assets has been justified. Nervousness in equity markets has increased significantly due to weak US economic data and underwhelming quarterly results from some tech heavyweights. On top of this, seasonality is poor in August and September and geopolitical risks in the Middle East are rising again. Our sell signals were triggered and we reduced our risk exposure in good time. We remain neutrally to slightly defensively positioned in equities and credit exposure (investment grade, high yield and emerging markets).
- At its July meeting, the Fed hinted at a first interest rate cut in September and we expect the yield curve to steepen again, despite the recent bond rally. We have increased the duration due to the rising economic risks and our model signals.
- In view of the environment described above, we would switch from equities to convertible bonds now due to the favourable asymmetrical risk/reward profile. We are additionally focussing on corporate bonds with solid credit ratings (including in the high-yield segment).

	US	Europe	Japan	Asia ex-Japan	LatAm	CEEMEA	Key:
<i>Return drivers</i>							
Equities	o	o	o	o	o	o	++ Strong positive market
Gov. Bonds	o	+	-				+ Positive market
Credit IG (Spreads)	o	o		-	o	o	o Neutral
Credit HY (Spreads)	o	o		o	o	o	- Negative market
<i>Total return</i>							-- Strong negative market
Convertibles	o	o	o	o			
Credit IG	o	+		o	o	o	
Credit HY	+	+		+	+	+	
	PrecMet	InduMet	Energy				
Commodities	o	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
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 – Balanced deep investment grade Chinese tech with high convexity 	<ul style="list-style-type: none"> – Utilities, REITS – Unprofitable, early stage, expensively valued IT and biotech – 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"> – Capitals goods, technology – Maturities >10 years
Global Corporates	<ul style="list-style-type: none"> – Energy, healthcare, financials – Investment grade – Developed markets 	<ul style="list-style-type: none"> – Capitals goods, technology – High yield – Emerging markets
Global High Yield	<ul style="list-style-type: none"> – Capital goods, energy – Basic industry – Telecommunications 	<ul style="list-style-type: none"> – Transportation – Financial services – Technology & electronics
Emerging Markets - Defensive	<ul style="list-style-type: none"> – LatAm, parts of Asia – Brazil, Korea, Indonesia – Maturities <7 years 	<ul style="list-style-type: none"> – Asia, Middle East – Israel, Qatar, Saudi Arabia, China & Taiwan – Maturities >7 years
Emerging Markets - Dynamic / Opportunistic	<ul style="list-style-type: none"> – LatAm (esp. Brazil) – High yield energy – Short-dated high-yield 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: Is the US labour market at a turning point?

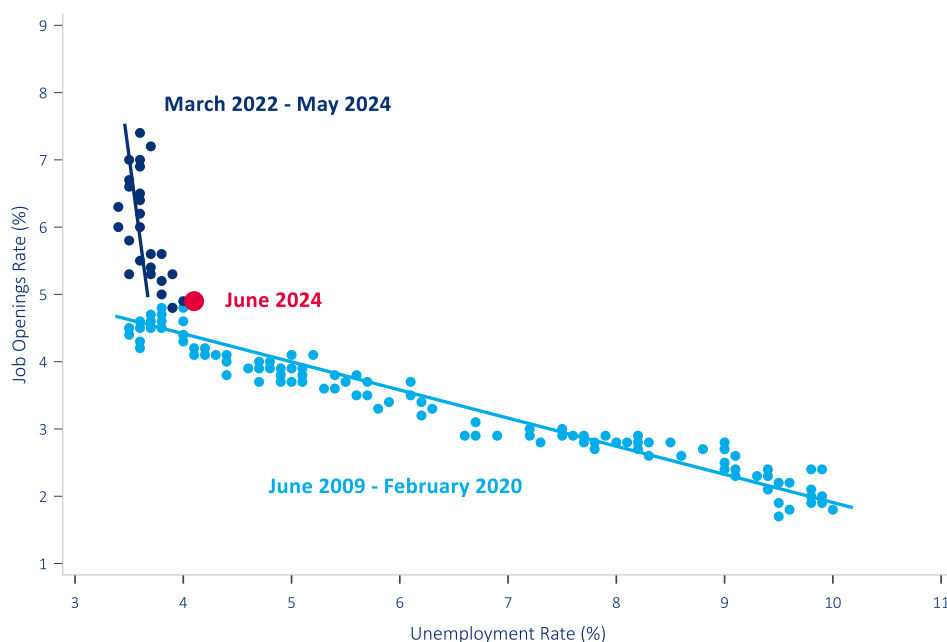
An important concept from labour market theory is the Beveridge curve, which shows the relationship between the unemployment rate and the vacancy rate (number of vacancies in relation to the working population) in an economy. It typically shows an inverse relationship: when unemployment is low, there are more vacancies and vice versa.

» The cooling of the US labour market has significantly reduced the vacancy rate.

After the economic standstill in the US due to the pandemic, there was a boom phase, which led to a nationwide labour shortage and caused the vacancy rate to rise sharply. The Beveridge curve now clearly shows how the cooling of the labour market to date has greatly reduced the vacancy rate, while the unemployment rate has risen only slightly. At the start of 2022, there were two vacancies per unemployed person, the highest figure since measurements began. Now it is 1.2, which corresponds to the pre-pandemic level. This is interesting in that renowned economists warned after the pandemic that the unemployment rate would have to rise significantly for inflation to fall. This has not been the case so far – workers have re-entered the labour market, while companies have reduced their job advertisements.

However, the US labour market is now back on the flatter section of the Beveridge curve before the pandemic and thus at a turning point. A further weakening of labour demand and thus a decline in the vacancy rate could lead to a further rise in the unemployment rate. This is a likely scenario due to the slowdown in consumer spending in the US. Such an environment favours bonds over equities.

Chart: Beveridge curve signals possible rise in unemployment



Sources: BLS, Fisch Asset Management

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