

Sound Invest

July 2024

Inflation data for June prints below expectations

The labor market appears to be back in balance

First USD rate cuts are expected in Q3

Continued neutral allocation to equities

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Monetary Policy as a Balancing Act

The Federal Reserve faces the challenging task of bringing inflation back to its target level of 2% while simultaneously stabilizing economic growth. Recent macroeconomic data suggest that a change in interest rate policy is imminent.

In the aftermath of the pandemic, the Federal Reserve faced the highest inflation since the early 80s. In response, interest rates were rapidly raised from 0% to 5.5%. The unprecedented tightening of monetary policy slowed the strong economic growth that was triggered by government stimulus and pandemic-related catch-up effects, bringing inflation under control. In the past, an economic "soft landing", where the central bank tightens monetary policy without triggering a recession, was successfully achieved only once in the 90s. Thus, market participants are trying to assess whether a "soft landing" can be accomplished in the current market environment.

Examining the data from the past few months reveals that, after minimal progress at the beginning of the year, inflation has now steadily declined over the last three months. US consumer prices for June once again printed below economists' expectations. The significant drop in shelter costs, which had previously proven to be very persistent and a strong driver of core inflation, was particularly well received.

Examining the U.S. labor market, recently released data shows a slowdown in job creation. Furthermore, wage growth seems to be moderating. The unemployment rate rose to 4.1%, the highest level in more than two and a half years, already reaching the Fed's forecast for the end of 2024.

Overall, economic momentum is slightly weakening. The leading US purchasing managers' indices printed weaker than expected, with both the manufacturing and services sectors falling below the neutral value of 50. Additionally, there has been an increase in delinquencies on credit card debt, and the savings of US households, apart from the very wealthy ones, are largely depleted.

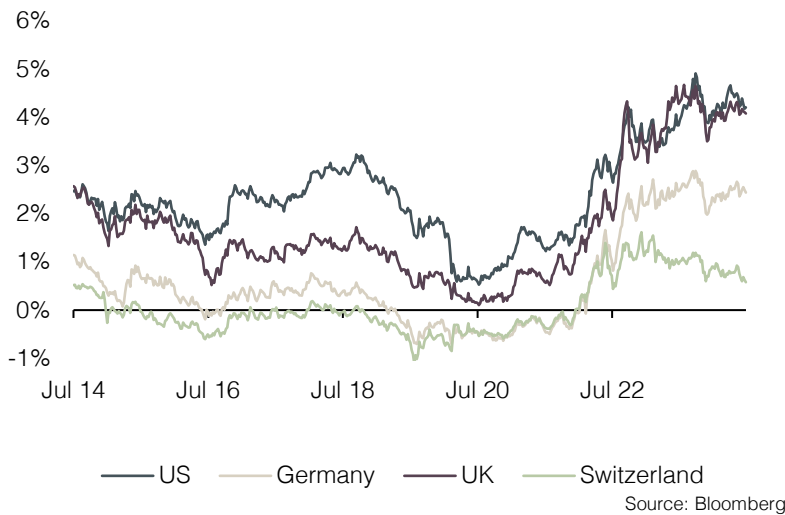
In summary, current economic data suggest that the Fed is likely to soon increase its focus on its second mandate — promoting maximum employment — alongside its dual mandate of price stability. Interest rate forwards also reflect these expectations and now anticipate that the Fed will cut interest rates by 0.25% in September, followed by at least one more cut in November or December. Overall, confidence in a soft landing of the economy is growing in the stock market. More cyclical and interest rate-sensitive equity sectors have significantly outperformed since the release of the latest inflation data while previously dominant technology stocks have underperformed. Small caps, which have been totally out of favor by investors, jumped by more than 10% in only 5 days, with banks and real estate companies also gaining.

Equity prices already reflect significant investor optimism, resulting in elevated valuations and high expectations for future earnings growth. Therefore, we maintain our neutral stance towards equities and focus on high-quality companies with solid balance sheets that can perform well even during periods of slowing economic growth. Achieving a soft landing seems within reach, but history also shows that the likelihood of external shocks increases the longer rates stay high.

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Bonds	<input type="radio"/> <input type="radio"/> <input checked="" type="radio"/> <input type="radio"/> <input type="radio"/>	Equities	<input type="radio"/> <input type="radio"/> <input checked="" type="radio"/> <input type="radio"/> <input type="radio"/>
Yields	<input type="radio"/> <input type="radio"/> <input type="radio"/> <input checked="" type="radio"/> <input type="radio"/>	Risk Premium	<input checked="" type="radio"/> <input type="radio"/> <input type="radio"/> <input type="radio"/> <input type="radio"/>
Spreads	<input type="radio"/> <input checked="" type="radio"/> <input type="radio"/> <input type="radio"/> <input type="radio"/>	Leading Indicators	<input type="radio"/> <input type="radio"/> <input checked="" type="radio"/> <input type="radio"/> <input type="radio"/>
		Risk Index	<input type="radio"/> <input type="radio"/> <input checked="" type="radio"/> <input type="radio"/> <input type="radio"/>

Yields

10-Year Government Bond Yield



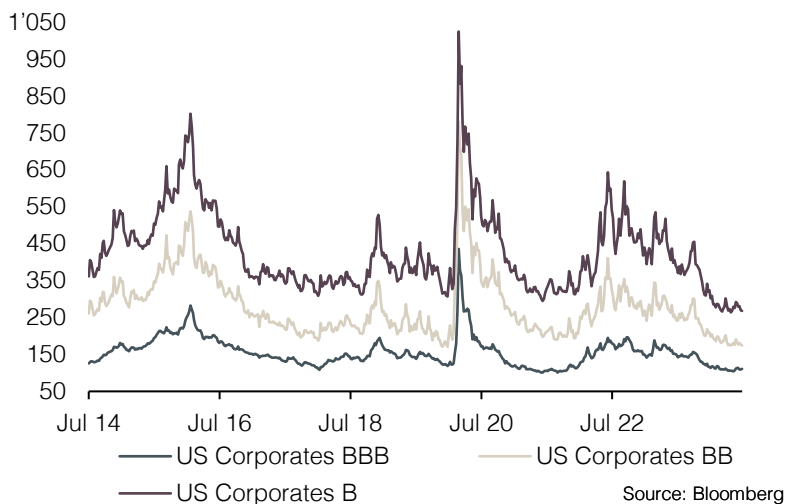
View:



Weaker economic data and lower-than-expected inflation has led to a decline in interest rates. Interest rates in USD and GBP remain attractive, which is why we still favor longer duration in these currencies. In CHF, where interest rates were already low and have declined further, we advise against taking on increased duration risk.

Spreads

Credit Spread (in bps)



View:

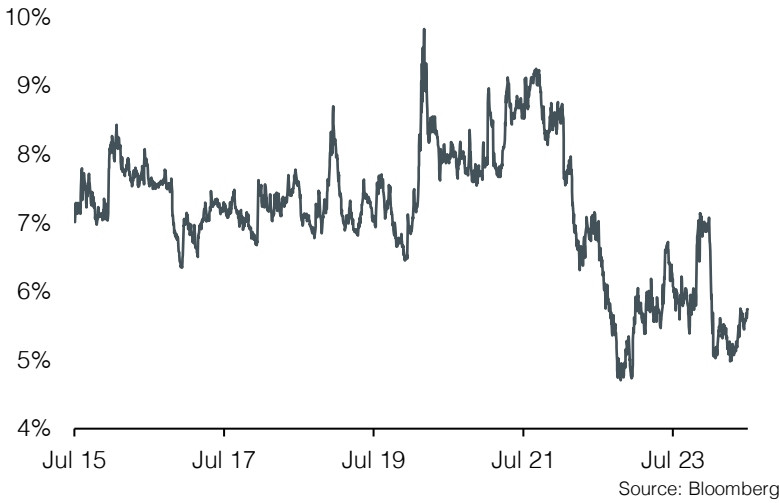


Credit spreads have slightly decreased over the past month. However, the situation is more nuanced for high-yield bonds: Credit spreads for issuers with very low credit ratings (CCC) are rising, whereas credit spreads for higher-rated companies (BB) are falling.

Equity Risk Premium

Equity Risk Premium USA

View:



Globally, the equity risk premium remains at an unattractive level. High earnings growth expectations are already largely reflected in stock prices, with the US stock market showing elevated valuations. The upcoming second-quarter reporting season is likely to serve as a reality check for many companies.

Leading Indicators

The positive trend in global Purchasing Managers' Indices (PMI) has moderated over the last month. Notably, the US ISM Services PMI has fallen significantly below the 50 mark. However, given the trend of the last months, our indicator continues to reflect a neutral assessment.

View:



Manufacturing PMI

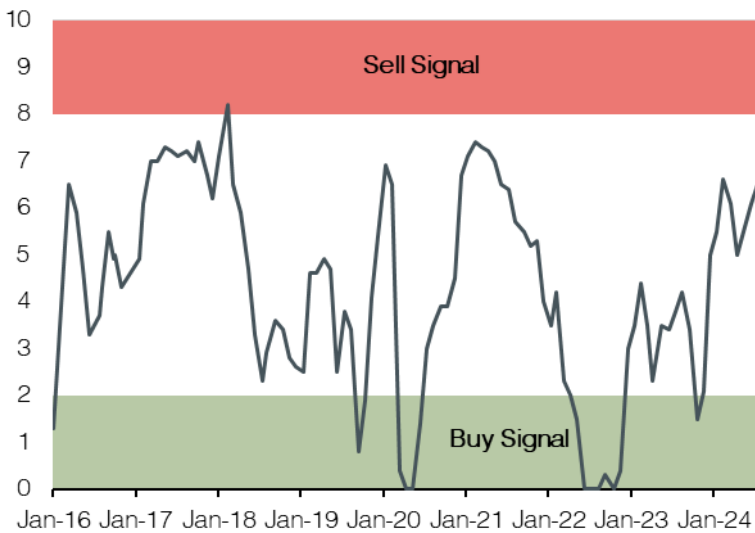
	Oct 22	Nov 22	Dec 22	Jan 23	Feb 23	Mar 23	Apr 23	May 23	Jun 23	Jul 23	Aug 23	Sep 23	Oct 23	Nov 23	Dec 23	Jan 24	Feb 24	Mar 24	Apr 24	May 24	Jun 24
Global	49.4	48.8	48.7	49.1	49.9	49.6	49.6	49.5	48.7	48.6	49.0	49.2	48.8	49.3	49.0	50.0	50.3	50.6	50.3	51.0	50.9
USA ISM	50.0	48.9	48.1	47.4	47.7	46.5	47.0	46.6	46.4	46.5	47.6	48.6	46.9	46.6	47.1	49.1	47.8	50.3	49.2	48.7	48.5
Europe	46.4	47.1	47.8	48.8	48.5	47.3	45.8	44.8	43.4	42.7	43.5	43.4	43.1	44.2	44.4	46.6	46.5	46.1	45.7	47.3	45.8
United Kingdom	46.2	46.5	45.3	47.0	49.3	47.9	47.8	47.1	46.5	45.3	43.0	44.3	44.8	47.2	46.2	47.0	47.5	50.3	49.1	51.2	50.9
Switzerland	55.4	54.4	54.5	49.3	48.9	47.0	45.3	43.2	44.9	38.5	39.9	44.9	40.6	42.1	43.0	43.1	44.0	45.2	41.4	46.4	43.9
China Local	49.2	48.0	47.0	50.1	52.6	51.9	49.2	48.8	49.0	49.3	49.7	50.2	49.5	49.4	49.0	49.2	49.1	50.8	50.4	49.5	49.5
Japan	50.7	49.0	48.9	48.9	47.7	49.2	49.5	50.6	49.8	49.6	49.6	48.5	48.7	48.3	47.9	48.0	47.2	48.2	49.6	50.4	50.0

Services PMI

	Oct 22	Nov 22	Dec 22	Jan 23	Feb 23	Mar 23	Apr 23	May 23	Jun 23	Jul 23	Aug 23	Sep 23	Oct 23	Nov 23	Dec 23	Jan 24	Feb 24	Mar 24	Apr 24	May 24	Jun 24
Global	49.1	48.1	48.1	50.0	52.5	54.3	55.2	55.3	53.8	52.6	51.0	50.7	50.4	50.7	51.6	52.3	52.4	52.4	52.7	54.0	53.1
USA ISM	54.7	55.2	49.0	54.7	55.0	51.2	52.3	51.0	53.6	52.8	54.1	53.4	51.9	52.5	50.5	53.4	52.6	51.4	49.4	53.8	48.8
Eurozone	48.6	48.5	49.8	50.8	52.7	55.0	56.2	55.1	52.0	50.9	47.9	48.7	47.8	48.7	48.8	48.4	50.2	51.5	53.3	53.2	52.8
United Kingdom	48.8	48.8	49.9	48.7	53.5	52.9	55.9	55.2	53.7	51.5	49.5	49.3	49.5	50.9	53.4	54.3	53.8	53.1	55.0	52.9	52.1
Switzerland	53.8	53.4	49.5	56.7	55.3	54.2	52.2	52.6	49.6	42.7	50.3	52.8	52.2	53.6	56.9	54.6	53.0	47.6	55.6	48.8	52.0
China Local	47.0	45.1	39.4	54.0	55.6	56.9	55.1	53.8	52.8	51.5	50.5	50.9	50.1	49.3	49.3	50.1	51.0	52.4	50.3	50.5	50.2
Japan	53.2	50.3	51.1	52.3	54.0	55.0	55.4	55.9	54.0	53.8	54.3	53.8	51.6	50.8	51.5	53.1	52.9	54.1	54.3	53.8	49.4

Description: The Purchasing Managers' Index (PMI) is a forward-looking economic indicator based on company surveys. A value above 50 indicates an improving economic environment, whereas a value below 50 indicates a worsening environment.

Risk-Index



View:



In general, the market reflects a growing risk appetite. Consequently, the risk index continues to rise toward a sell signal but still provides a neutral signal for the time being.

Sign up here:



Appendix:

Sound Invest is the central tool for our investment allocation. We use it to systematically and consistently assess the aspects that are relevant to the development of the financial markets. As a result, our clients can rely on a rational and anti-cyclical implementation of our investment decisions.

- **Focusing on the essentials:** Interest rate level, risk premium, valuation, economic development, investor sentiment and positioning. These are the decisive factors for success on the financial markets, especially in turbulent times when the temptation to react irrationally to the headlines is particularly strong.
- **Comparability over time and place:** The factors mentioned above are equally relevant for all markets and at all times. This is the result of a strict «backtesting» process that continues into the future.
- **Cumulating our investment experience:** Our strength lies in the many years of experience of our partners and principals. It is precisely this experience that we summarize and make it applicable with Sound Invest.
- **Transparency:** Thanks to our monthly publication, our clients always know where we stand in the investment cycle and how we expect the financial markets to develop.

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Datasource: Bloomberg, BofA ML Research