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Review of Financial Markets Q3 2024

The US Federal Reserve lowered its key interest rate by 0.5% in September, (finally) joining the global cycle of interest rate cuts. In the third quarter, the European Central Bank, the Swiss National Bank and the Bank of England also reduced their key rates by 0.25% each. Japanese monetary policy moved in the opposite direction with a 0.1% rise in interest rates.
The US economy was surprisingly strong, but developments on the labor market pointed to less favorable trends. By lowering interest rates, the Fed has shifted the objective of monetary policy from fighting inflation to stabilizing the economy. The European Central Bank is more hesitant, although inflation is lower than in the USA and growth momentum, particularly in Germany, appears frozen. Switzerland has been able to afford greater interest rate easing as inflation has been brought under control earlier.
After a long period of hesitation, Chinese leadership has decided to counter the deflationary economic trends with various monetary and fiscal policy measures. The main aim is to stimulate consumer spending and improve the willingness to borrow and invest.
Monetary and fiscal measures have had a positive impact on financial markets. The impact on Chinese equities was most noticeable, because it was the most surprising. The increase of almost 30% was also the result of direct measures to support share purchases. Except for Japan, all equity markets rose. Falling interest rates helped the emerging markets and small caps to achieve a respectable performance. The bond markets were also able to benefit from the easing of monetary policy. Yields on 10-year government bonds fell, by a noticeable 0.6% in the USA, which led to a 4% increase in the value of a global bond portfolio in the last quarter.
Precious metals remained in favor with investors, whereby gold was primarily a matter of central banks converting their currency reserves. Base metals also reacted positively in the hope that China's economy would pick up because of the various measures announced by the government. Energy prices, on the other hand, fell significantly in the last quarter due to a presumed oversupply.

On the foreign exchange market, the opposing interest rate trend resulted in an 11% rise in the yen against the USD. This brought an end to the popular trade of borrowing money in yen and parking it in higher-yielding currencies. In trade-weighted terms, the US currency lost around 5%, slightly more against the Swiss franc at 6%. The latter appreciated by 2% against the euro, although the exchange rate has remained virtually unchanged since the beginning of the year, even though interest rates in the eurozone have fallen less sharply.
The US election campaign saw a surprising turnaround with the resignation of Biden. Harris made an astonishingly strong start to the newly launched battle for

the presidency. In terms of economic policy, the two candidates differ significantly. However, as Congress is likely to be a major hurdle in implementing any substantial policies, any 'worries' in financial markets were hardly noticeable.

Development trend

The reaction of markets to the 'paradigm shift' in US monetary policy was positive. This leads to the conclusion that the majority of market participants continue to believe in a soft landing. However, a number of relevant leading economic indicators are flashing yellow and are signaling a sharp slowdown. The stock market will therefore be caught between falling interest rates on the positive side and falling earnings expectations on the negative side.

In Europe, a renewed tendency towards recession is recognizable in the manufacturing sector, and it is unclear whether the service sector will remain strong enough to prevent an overall economic contraction. In any case, there is sufficient reason for the ECB to cut key interest rates significantly. The dilemma for financial markets remains the same as in the USA.

If the Chinese government's measures prove to be effective, domestic equities and those from neighboring countries are likely to be favored. The comparatively favorable valuation, both historically and by global standards, should help.

The interest rate cuts initiated by most central banks should favor the bond markets, and even more so should economic disappointments occur. Weighing up return and risk, bonds therefore remain an important investment component, although securities with very long maturities are not particularly attractive. In addition, great attention must be paid to credit quality, as risk premiums are very low by historical standards and could react violently to an economic slump.

The bull market in gold and silver is likely to continue as (real) interest rates fall. It can also be assumed that demand from central banks in Asian countries will continue. Precious metals will also be boosted by geopolitical instability.

The oil price is likely to remain under pressure and thus favor the development of inflation. A presumed expansion of supply by Saudi Arabia and the return of Libyan oil to the market will increase supply, while demand is more likely to fall than rise for economic reasons.

The current escalation of the war between Israel and Iran and its allies harbors great uncertainty regarding the consequences for regional political stability and the economic impact on the global economy. The elections in the USA will be decided in November and could shake financial markets depending on the outcome.

To summarize, nothing can be derived from these prospects other than to pursue a cautious investment policy for the time being.

Wangs, October 2024

Chart 1: Performance Q3 2024 in USD for different asset classes (in %)

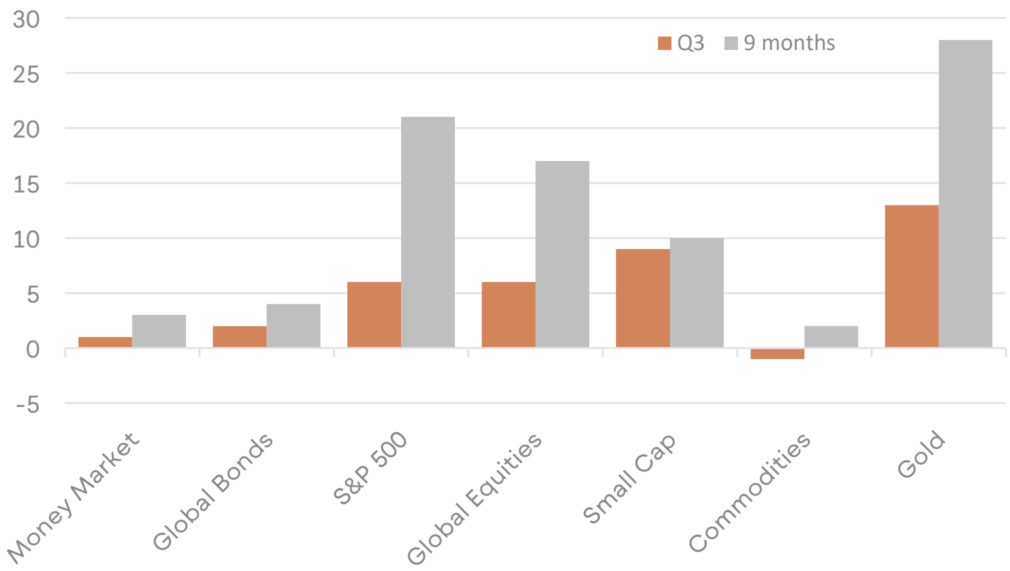

Chart 2: Performance Q3 2024 in local currency for selected stock indices (in %)