J. Safra Sarasin

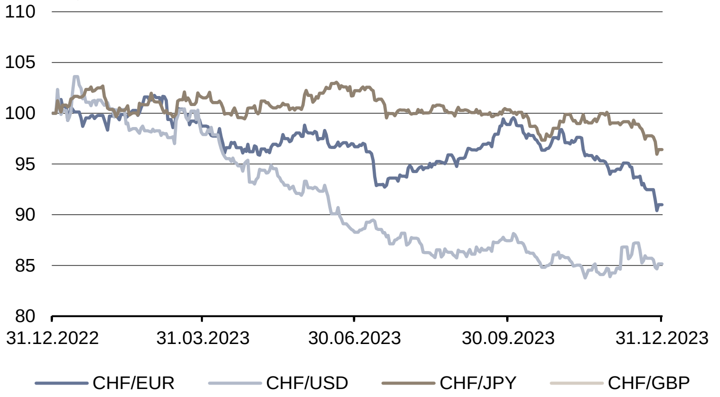
Half-yearly market report

As good as it gets

Short-term consolidation, but medium-term good return perspective for mixed portfolios.

After a spectacular year-end rally, the new year is off to a more leisurely start. The financial markets have anticipated a lot of positive news, so a consolidation phase is imminent. Things are unlikely to get any better in the short term. In the medium term, however, we see scope for further gains in the equity markets thanks to the expected interest rate cuts. We therefore think that 2024 will be a good investment year overall.

Exchange rates versus CHF (indexed since 31.12.2022)



Macro-outlook: Mild recession, and then?

Market participants' interest rate expectations changed significantly in the fourth quarter. Market expectations for the number of interest rate cuts in 2024 doubled, rising from three at the end of September to six at year-end (see chart). The representatives of the US Federal Reserve did not communicate any strong resistance to the falling interest rate expectations at their December meeting or in the weeks that followed. It can therefore be assumed that the rate hike cycle is over and that the first rate cuts will soon follow. This is mainly due to inflation, which is on a downward trend and is likely to continue to fall in the coming months thanks to low energy prices.

Economic growth in the US remained robust in the fourth quarter. Although there were some weaknesses at the end of the year, for example in the service sector, there is no sign of a recession. The labour market in particular remains strong and rising real incomes should continue to bolster consumer confidence at the beginning of this year. Although it is possible that the economy will fall into a mild recession this year, the expected interest rate cuts should ensure a soft landing. The financial markets are therefore already focusing on the time beyond and are expecting a renewed upturn and rising corporate profits in the second half of the year.

In Europe, the economy was significantly weaker than in the US last year and is in a stagnation phase at the start of this year. Europe has suffered in recent quarters, not least due to weak demand from China. From this level the downside risk for economic growth in 2024 now appears limited. Indeed, thanks to rising real wages, consumption could even surprise on the upside in 2024.

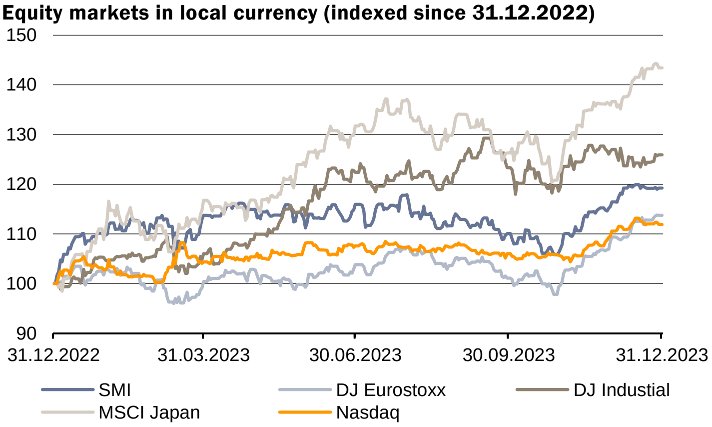
In China, the property market remains the cause for concern. However, the government's gradual stimulation of the economy should have a positive impact on demand in 2024. We do not expect a strong recovery in 2024, but at least growth of 4 to 5%.

Equities: Very optimistic sentiment in the short term

The stock market has benefited the most from the expected turnaround in interest rates and many equity indices have staged a significant year-end rally. Investor sentiment turned around in the fourth quarter and is now very optimistic. It is therefore hardly surprising that profit-taking is now taking place at the start of the year. Historically, positive investor sentiment is not a problem for the equity markets. In the past, there have been many phases in which sentiment remained at a high level for several quarters while the equity markets performed very positively. As the positioning of many investors in equities is not particularly high, but rather neutral, as several recent surveys show, sustained positive momentum could lead to further inflows into the equity markets.

The decisive factor for the performance of the equity markets will be how the economy develops in the coming months. There is a risk of a mild US recession in which corporate profits could come under pressure. However, the expected early interest rate cuts limit the economic downside risk. In the event of a significant downturn or increased financial market volatility, the Fed is likely to cut interest rates more than expected. As inflation appears to be under control, at least in the short term, the Fed's leeway has widened again. The Fed's hedging of the capital markets, the so-called "Fed put" is back, which is having a very positive effect on the prices of risk assets. Not least because of the presidential elections in November, the Fed is likely to do everything it can to avoid a hard landing.

Equity markets in local currency (indexed since 31.12.2022)

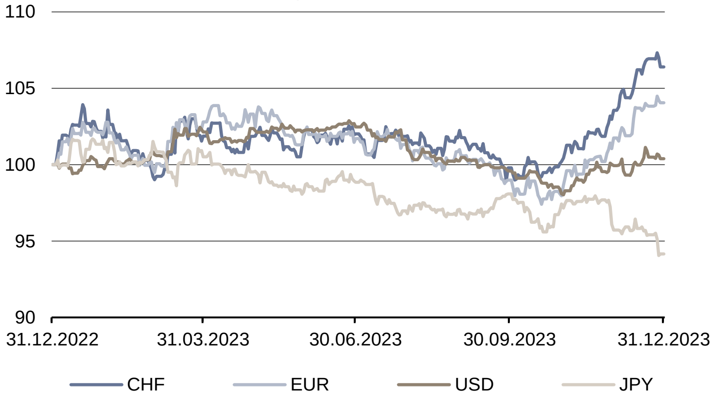


Bonds: Much of the potential has been exhausted

The bond markets caused a lot of volatility in the fourth quarter of 2023. While 10-year US interest rates were still at 5% in October, they were below 4% at the end of the year. The massive turnaround was due to falling inflation and interest rate expectations. Now that six interest rate cuts by the US Federal Reserve have already been priced in, the question arises as to whether long-term interest rates can fall even further. Of course, an undershooting is always possible, but at current yields of around 4%, the potential for lower yields seems limited. This also applies to Europe and Switzerland, where government bonds have undergone a very similar movement in recent months.

The credit markets also enjoyed a very positive performance in November and December, with credit risk premiums in the high-yield segment falling to their lowest level since May 2022. They are now well below the historical average and therefore offer little buffer against a possible recession. We therefore remain slightly underweight in high-yield bonds and are focusing on good quality in the investment grade segment.

Bond markets in local currency (indexed since 31.12.2022)



Asset Allocation: good diversification

After the major rally in the financial markets in the fourth quarter, a breather is welcome at the start of the year. How long this consolidation phase will last depends on various factors. On the one hand, the upcoming inflation data should confirm its downward trend. On the other hand, corporate earnings, which will soon be reported for the fourth quarter and the full year 2023, should at least not come as a negative surprise. If these two factors turn out to be positive, the equity markets should continue to benefit from the tailwind of the expected interest rate cuts.

We currently remain neutrally weighted in our portfolio allocation, but would buy equities in the event of significant setbacks. Within equities, we have no major convictions in terms of regions or sectors. We are positive on bonds in the medium term, but expect interest rates to rise in a countermovement in the short term. We have therefore slightly reduced our allocation to bonds. We are maintaining our focus on high quality, as risk premiums have fallen sharply overall. This also applies to subordinated bank bonds. Nevertheless, these still appear attractively valued compared to other bonds of similar quality.

In the area of alternative investments, we continue to focus on good diversification in our mixed portfolios. We prefer catastrophe bonds and commodities, both of which have a low correlation to equities. Commodities are also particularly suitable as protection against inflation, should it unexpectedly become a problem again.

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Overview of the investment groups

Traditional LPP life cycle	Equities bandwith	Strategic equities quota	Risk profile	Investment horizon
LPP Yield	10–20%	15%	1	min. 2 years
LPP Income	20–30%	25%	2	min. 5 years
LPP Growth	30–40%	35%	3	min. 7 years
LPP Future	40–50%	45%	4	min. 10 years
LPP Equities 80	50–95%	80%	5	min. 15 years
Sustainability LPP life cycle				
LPP Sustainability Income	10–35%	25%	2	min. 5 years
LPP Sustainability	25–50%	38%	3	min. 7 years