

The economic situation weighs on the market

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That equity prices are close to their all-time high does not change that. Every cycle of Fed rate hikes ends in a recession or financial crisis.



Last month, a major global banking crisis developed and is expected to have a negative impact on the economy. Since mid-March, the price of oil has risen almost 20%, mainly due to a supply shock that has pushed inflation up. Currently, the ISM data looks weak.

HIGHEST OF ALL TIME

The Fed has hinted that it won't cut interest rates again this year, yet risk assets are rebounding like never before. European equities are trading near all-time highs. US stocks erased their recent losses.

Central banks raised interest rates as much as possible and maintained their forecasts. However, they remain cautious in their forecasts. Recession forecasts have been revised down slightly and expectations for monetary policy easing have been brought forward.

CORE INFLATION IS MOVING AWAY FROM TARGET

At the same time, markets were expecting consumer price inflation to head back into central banks' comfort zone at the start of the year. The good news is that the headline inflation rate has now been falling for eight consecutive months. The bad news is that core inflation, at 5.5%, is still far from the target value.

The pressures exerted by the tightening of monetary policy on credit are increasing.

Inflation in the United States remains a serious problem and is not coming down as quickly as expected. Every cycle of Fed interest rate hikes has ended in a recession or financial crisis: given recent events, it's hard to believe it will be any different this time around.

CHINA AND THE UNITED STATES GIVE IMPETUS

Despite the aforementioned concerns in the banking sector, the Chinese and US economies have shown strength and resilience, leading to a sharp upward revision to the forecast for global GDP in the first quarter of 2023.

Recent developments have led to an upward revision of the GDP forecast for the first quarter of 2023 in the United States to 2.5%, with consumer spending growing at a rate above 4%.

INFLATION, INTEREST RATES AND THE ECONOMY ARE CAUSE FOR CONCERN

High inflation, rising interest rates and slowing economic growth remain our main concerns. Pressures from tighter monetary policy on credit are mounting, while waning supply shocks are gaining momentum.

In addition, the tendency of central banks to pursue high monetary policies over the long term is challenged by the persistence of inflation and growing concerns about financial instability. Taken together, these developments currently limit the potential for a soft landing and reduce the likelihood of a substantial hike in policy rates.

The contrast between the volatility of equities and that of fixed income securities is difficult to explain. One could argue that the authorities' commitment to stabilizing the economy and maintaining the outlook for the real economy is helping equities, or that the real economy is now less sensitive to interest rates than before.

HIGH VOLATILITY AND OVERLY HIGH EARNINGS ESTIMATES

However, it is more likely that asset price volatility will be higher: the likelihood that the Fed will make a policy mistake in the future is very high. Surprisingly, bonds are now counting on a 100 basis point rate cut from June, although Powell has explicitly said the Fed is unlikely to cut rates this year.

The AI "revolution" could open new opportunities for growth.

Earnings estimates for the full year still look too optimistic. But we also think the current earnings quarter could prove more resilient and better than the market is currently expecting. As such, we continue to recommend a neutral equity allocation, albeit with a bias towards defensive and value-oriented stocks. We follow market developments and are ready to react immediately if things unexpectedly develop differently.

CONSUMPTION, HEALTH, IT

Looking at individual sectors, we currently recommend an overweight in consumer, healthcare and IT.

The consumer sector offers low but steady revenue growth and generally does well during economic downturns. It is a defensive sector with moderate valuation and high pricing power.

Historically, the healthcare sector has been negatively correlated with rising bond yields. However, it is resisting weak growth and has good visibility in terms of revenue and cash flow.

The IT sector is still in a secular bull market and offers growth prospects. Earnings growth and balance sheets are strong and valuations have improved significantly. Within the IT sector, we prefer software to hardware and semiconductor companies. The AI "revolution" could open new opportunities for growth.

COMMODITY OPPORTUNITIES

We also recommend overweighting commodities: gold rebounded on the weakening interest rate outlook and financial instability. Overall, China's reopening and economic improvements provide a continued opportunity for commodities. The start of the US Federal Reserve's interest rate cut cycle later this year and several unresolved supply-side issues should keep market balance sheets stretched.



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George Alevrofas has been dedicated for more than 20 years to the follow-up of private and institutional clients. First with one of the largest Swiss pension funds and a subsidiary of the Credit Suisse Group, he has worked since 2017 for VT Wealth Management. The symbiosis between traditional, modern and digital management, proximity to the client, investment quality and risk diversification are for him central elements of successful asset management.



WEALTH MANAGEMENT AG

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