FINAD
Financial Advisors | Since 1976

Market View
April 2024

Executive Summary

- The S&P 500 marked its largest first-quarter gain in five years. While momentum has recently slowed as equities react to rising Treasury yields, we anticipate a generally favorable market environment until mid-year.
- US Federal Reserve (Fed) Chair Jerome Powell has largely aimed to signal confidence in the resilient economy and the need for patience when it comes to reaching the Fed's inflation goal. Yet with market participants starting to acknowledge the risk of stickier inflation later this year, the Fed's ability to implement rate cuts proactively could be limited.
- Despite these risks, global macroeconomic improvements and hopes for a sustainable uptick in the productivity cycle have buoyed market sentiment and mitigated worries about a less dovish Fed.
- In Europe, the European Central Bank (ECB) is expected to follow the March surprise rate cuts by the Swiss National Bank (SNB), in June, given the softer inflation picture in Europe than in the US.
- The sustainability of the US fiscal path has come under growing scrutiny given the interest burden, double versus pre-pandemic levels. This puts pressure on the Fed to manage rising interest costs, despite potential inflation re-acceleration and resilient economic growth.
- The lack of confidence in global fiscal policies could be related to gold's record-breaking surge.

Wall Street rollercoaster: from risk sentiment to regulatory rumble

- Despite the massive six-month rally, a Citi analysis points to persistent demand for risk in equity flows.
- Likewise, a Bank of America (BofA) assessment reveals that overall positioning in the market remains within historical norms.
  - According to Savita Subramanian, BofA head of US equity and quantitative strategy, the March uptick in equity sentiment was well under euphoric levels.
  - BofA's Sell-Side Indicator – which tracks Wall Street sell-side strategists' average recommended allocation to equities in balanced funds – has risen to 55%, its highest level since May 2022. When at or below this level, the indicator has 94% of the time resulted in positive returns over the next 12 months. The current measure suggests potential gains of at least 13% over the coming year.
- Although the "Magnificent 7" stocks accounted for 60% of S&P 500 gains over the past year, regulatory scrutiny is a growing challenge for tech giants. US antitrust lawsuits have targeted Apple and Amazon, while the FTC is investigating AI deals involving Amazon, Google and Microsoft. In Europe, Apple is facing a USD 2 billion fine for breaching antitrust laws.

Market Development

World

- Our base case now leans towards a "no landing" scenario, which is bullish for risk assets as long as Fed policy does not shift back towards tightening. We perceive only a low risk of the Fed pivoting to tightening before the second half of the year as our working thesis is (and has been) that disinflation will continue – though bumpy – until mid-year. In the hopes of mid-cycle rate cuts, amid potential synchronized growth and an upswing in productivity, we still see a good backdrop for equities. Inflation data remain key to changing or reinforcing the bullish market tone.

- On a final note, we would like to acknowledge the passing of pioneering economist Daniel Kahneman in late March. His contributions to the field of behavioral economics were groundbreaking, and his renowned book Thinking, Fast and Slow will continue to offer profound insights for years to come.

Europe

- Euro-area inflation slowed more than expected in March, solidifying prospects for an ECB rate cut in June (2.4% YoY vs. the consensus-expected 2.5%, after 2.6% in February).

- Copernicus Wealth Management identified the factors driving a potential catch-up in European equity performance, despite remaining structural issues and geopolitical risks. We would agree that they include a pick-up in domestic growth, a fading destocking cycle, rising consumer real income, increased activity in China, the potential for more ECB rates cuts versus the Fed, and cheaper valuations in Europe.

Switzerland

- The Swiss franc has lagged behind its peers this year and could see more declines after the SNB, contrary to market consensus, cut interest rates last month while also scaling down intervention in currency markets. We highlighted this possibility in the March Market View.

The Fed continues taking a back seat to Yellen and fiscal policy

In the past year, the US has experienced what some have termed a fiscal melt-up". Under US Treasury Secretary Janet Yellen, the US Department of the Treasury has borrowed a staggering USD 3 trillion between Q1 2023 and Q2 2024, coming close to the record borrowing of USD 3.6 trillion during the Covid crisis.

With the federal debt increasing by approximately USD 1 trillion every 100 days (BofA), the trajectory of fiscal policy appears daunting. Expectations of further fiscal support this year seem reasonable given the upcoming US election in November.

The borrowing surge is gaining more attention as concerns mount over the sustainability of such fiscal measures.

- Bloomberg Economics ran one million forecast simulations on the US fiscal path, 88% of which classified the borrowing trend as unsustainable.
- Citadel CEO Ken Griffin also weighed in: In a recent letter to investors, he labeled the US government deficit of 6.4% of GDP in a non-recession environment as irresponsible and unsustainable.

Yellen's shift towards short-term borrowing, in particular through the issuance of Treasury bills (T-bills), could heighten these concerns. T-bills, now comprising over 85% of all US Treasury issuance, have reached a two-decade high, with a staggering USD 21 trillion in bills issued over the past 12 months. This surge in short-term borrowing – while stimulative for liquidity conditions in the short term – has led and will continue to lead to a rise in interest debt burden for the US, posing a challenge for monetary policy.

The Fed, in control of the short end of the curve, has kept rates higher for longer, contributing to the mounting interest obligation. Interest paid on US government debt has soared to USD 1.1 trillion over the last 12 months (double the annual pre-pandemic amount).

If the Fed maintains current interest rates, BofA expects that interest on the debt will reach USD 1.65 trillion in 12 months. But if Powell follows through with rate cuts, the interest burden would only increase to USD 1.2 trillion, representing a significant cashflow difference of USD 450 billion. The financial strain may indeed be a driving factor behind the Fed's decision-making this year, in the aim of alleviating pressure on the budget.

BofA also touches on the topic of regulation in the tech sector. The revenues generated by the Magnificent 7 stocks in the past year, USD 1.8 trillion in trailing 12-month net sales, present an enticing target for regulators and governments grappling with fiscal challenges. Regulatory pressures and increasing tax rates have historically signaled the end of exceptional sector growth. In our view, this issue needs to be closely watched.

- Over the past 12 months, the tech sector has been the least regulated, with an average tax rate of 15% for the Magnificent 7 compared with 21% for the rest of the S&P 500.
- While investors favor tech giants for their "moats" and other competitive (and monopolistic) advantages – which tend to protect margins, market share and pricing power – we question how much these attributes are at risk.

Positioning

Despite a strong rally as well as pockets of extreme risk-taking and overstretched sentiment, we believe the bull market that started in November 2023 is not in danger of ending any time soon.

We aim to manage risks prudently and see potential pullbacks of 5-10% (or sideways corrections) as buying opportunities, and we expect the current risk-on environment to last until mid-year. In addition, we anticipate a broadening of market leadership beyond large-cap US stocks.

- Evidence from BofA shows that in March, 60% of stocks outperformed the broader market index, a significant increase from 40% in February.
- Notably, oil & gas is now the S&P 500's second best-performing sector year-to-date, after semiconductors.

The US momentum factor has generated nearly double the risk-adjusted returns compared to the S&P 500 since late December 2023. While our investment approach has clearly benefited, the momentum factor may now in fact be over-extended.

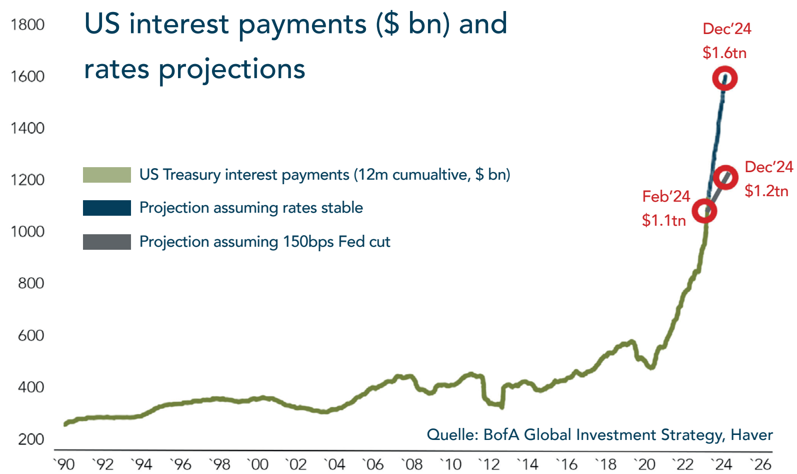
Despite initial consensus expectations for dollar weakness this year, the dollar has shown strength. A Bloomberg analysis, supported by BIS data, indicates that the dollar tends to strengthen by over 3% per quarter when the majority of central banks ease monetary policy simultaneously.

Gold, one of our core holdings, has surged above USD 2,300 an ounce, driven by expectations of Fed rate cuts and steady central bank demand, particularly from China. The metal's rise, despite elevated real US rates, suggests it may be detecting global fiscal vulnerabilities amid rising spending, soaring interest costs and geopolitical tensions.

In our view, a rising gold price could signal market concerns about a potential shift in US monetary policy over the medium to long term, ultimately towards yield curve control. The thinking goes that with the US Treasury seemingly unable to reduce spending, and Treasury bill issuance hitting unprecedented levels, there may come a point when the Fed feels obligated to step in and cap rates on government debt.

Will the Fed cut rates to relieve the US interest burden?

BofA projects that if the current debt trend remains unchanged over the next 12 months, with the US refinancing rate at around 4.4%, annual interest costs would rise from USD 1.1 to 1.65 trillion. Conversely, if the Fed were to implement a cut of 150 basis points in the next 12 months, the average refinancing rate would drop to approximately 3.2%, keeping interest payments within a range of USD 1.2-1.3 trillion over the next two years.



Sources: Bloomberg, Morgan Stanley, Bank of America, Goldman Sachs, The Macro Compass, The Market Ear, Steno Research, 42Macro, JPM, Hightower Naples, ZKB, Strategas, RBC Capital, FT, HCP, Yardeni Research, Copernicus Wealth Management

Disclaimer

The information contained in this document constitutes a marketing communication from FINAD (FINAD AG, Zurich; FINAD GmbH, Vienna or FINAD GmbH, Hamburg branch). This marketing communication has not been prepared in accordance with legislation promoting the independence of investment research and is not subject to any prohibition on trading following the dissemination of investment research. This document is for general information purposes only and for the personal use of the recipient of this document (hereafter referred to as "recipient"). It does not constitute a binding offer or invitation by or on behalf of FINAD to purchase, subscribe, sell or return any investment or to invest in any particular trading strategy or to engage in any other transaction in any jurisdiction. It does not constitute a recommendation by FINAD in legal, accounting or tax matters or a representation by FINAD as to the suitability or appropriateness of any particular investment strategy, transaction or investment for any individual recipient. A reference to past performance should not be construed as an indication of the future. The information and analyses contained in this publication have been compiled from sources believed to be reliable and credible. However, FINAD makes no warranty as to their reliability or completeness and disclaims any liability for losses arising from the use of this information. All opinions and views represent estimations that were valid at the time of going to press; we reserve the right to make changes at any time without obligation to update or communicate them. Before making any investment, transaction or other financial decision, recipients should clarify the suitability of such investment, transaction or other business for their particular circumstances and independently (with their professional advisors if necessary) consider the specific risks and the legal, regulatory, credit, tax and accounting consequences. It is the responsibility of the respective recipient to verify that he/she is entitled under the law applicable in his/her country of residence and/or nationality to request, receive and use this publication for personal purposes. FINAD declines any liability in this respect. An investment in the funds and other financial instruments mentioned in this document should only be made after careful reading and examination of the latest sales prospectus, the fund regulations and the legal information contained therein and after prior consultation with your client advisor and - if necessary - your own legal and/or tax advisor. It is the responsibility of the respective recipient to check whether he is entitled to request and receive the relevant fund documents under the law applicable in his country of residence and/or nationality. Neither this document nor copies thereof may be sent to or taken into the United States or distributed in the United States or handed over to US persons.

This document may not be reproduced in part or in full without the prior written consent of FINAD.

For Switzerland: FINAD AG, Talstrasse 58, 8001 Zurich, Switzerland is a public limited company specialized in financial services and asset management, established under Swiss law. FINAD is authorised as asset manager by the Swiss Financial Market Supervisory Authority (FINMA) and supervised by the Supervisory Organization (SO) AOOS. FINAD is also associated with OFS Ombud Finance Switzerland (http://www.ombudfinance.ch). Complaints about FINAD can be addressed to SO AOOS or OFS.

For Austria: FINAD GmbH, Dorotheergasse 6-8/L021, 1010 Vienna, Austria is an investment firm according to Section 3 of the Austrian Securities Supervision Act 2018 (WAG 2018) and as such is entitled to provide investment services of investment advice, portfolio management as well as the acceptance and transmission of orders, in each case with regard to financial instruments. FINAD is not authorized to provide services that involve holding clients' money, securities or other instruments. FINAD is subject to the supervision of the Financial Market Authority (FMA), Otto-Wagner-Platz 5, 1090 Vienna (www.fma.gv.at). Complaints about FINAD may be submitted to the FMA.

For Germany: FINAD GmbH Deutschland, Schauenburgerstraße 61, 20095 Hamburg, Germany is the German branch of FINAD GmbH, Dorotheergasse 6-8/L/021, AT-1010 Vienna, Austria. FINAD is an independent securities services company specialized in investment advice, investment brokerage and asset management (financial portfolio management). The provision of securities services by FINAD is subject to the supervision of the Financial Market Authority (FMA), Otto-Wagner-Platz 5, 1090 Vienna, Austria (www.fma.gv.at) as well as the Federal Financial Supervisory Authority (BaFin), Graurheindorfer Straße 108, 53117 Bonn, Germany and Marie-Curie-Straße 24-28, 60439 Frankfurt am Main, Germany (www.bafin.de). Complaints about FINAD can be addressed to the FMA or BaFin.

FINAD is not authorized to practice law, provide tax advice or auditing services.