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Quarterly Pulse – July 2nd 2024

Economic Outlook

The first half of 2024 presented investors with a mixed outlook across global economies and markets. In the U.S., the economic situation appeared almost unrealistically positive, prompting caution among investors as the anticipated scenario of sustained low interest rates materialized.

The decline in inflation in the U.S. and the Eurozone is allowing central banks to adopt a less restrictive monetary policy moving forward. A soft-landing scenario is becoming more likely, positively impacting stocks and bonds.

Tactical Asset Allocation

Liquidity	Neutral
Rates	Overweight
Credit	Neutral
Equities	Overweight
Alternative Investments	Neutral

Macroeconomics

Negative inflation surprises have decreased in recent weeks. U.S. financial markets are pricing in a soft economic landing after a stronger-than-expected inflation decline in May, with stocks resuming their upward trend in June. The prospect of U.S. rate cuts has lowered bond yields and increased prices. This contrasts with April, when financial markets were dampened by three consecutive negative inflation surprises causing stock declines and bond price drops.

In the Eurozone, economic outlooks are improving, dispelling fears of a deep recession. Recent preliminary purchasing manager indices suggest stabilization, despite the composite index falling slightly above the critical 50-point mark. While manufacturing is declining more than previously assessed, the service sector is expected to continue expanding, albeit at a slower rate. The European Central Bank (ECB) began rate cuts in early June, with more expected, reducing economic headwinds in the coming months. 25 basis point cuts in September 2024 and March 2025 are anticipated. The core inflation trend in the Eurozone has recently decreased, with core inflation expected to fall significantly below the 2% target in the second half of 2024, and overall inflation to drop below 2% for the first time in July. The ECB's gradual approach to rate cuts is supported by its restraint.

The Swiss National Bank (SNB) lowered its policy rate from 1.50% to 1.25% and reduced its inflation forecast until 2025, despite a slight inflation increase since March. This opens the door for another rate cut at the next meeting in September 2024. Alongside the rate cut, the SNB expressed its readiness to remain active in currency markets, interpreting its mention of currency interventions as a willingness to weaken the franc in response to recent appreciation due to increasing political uncertainty in the Eurozone. This explicit readiness to respond to franc strength is another reason to expect a further rate cut at the next meeting.

US Election Input:

On November 5, U.S. voters will decide the outcome of the first presidential rematch since 1956, between Democratic President Joe Biden and Republican President Donald Trump. Current polls show Trump with a slight lead, but many voters remain undecided. The ability of either candidate to implement a robust legislative agenda in 2025 will depend on the congressional races' outcomes.

The upcoming U.S. presidential election is expected to increase market volatility, evidenced by a notable "kink" in the VIX futures curve around November, indicating higher equity volatility expectations on election day.

Probabilities assigned to different outcomes are as follows:

- 45% for a "red sweep" (Trump victory with Republican control of both the Senate and House)
- 40% for a Biden victory with a divided Congress (Republican-controlled Senate, Democratic-controlled House)
- 10% for a "blue sweep" (Biden victory with Democratic control of both the Senate and House)
- 5% for a Trump victory with a divided Congress

The key takeaway is that the election outcome remains highly uncertain. Investors are advised to avoid making investment decisions based solely on political predictions. Instead, they should recognize the potential market and policy impacts of the election and manage risks to their wealth accordingly.

Summary:

The economic slowdown and lower inflation expected in the second half of 2024 are likely to lead to more interest rate cuts by major central banks, prompting markets to anticipate lower future rates. Investors are advised to move excess cash into quality fixed-income assets and consider selling into U.S. dollar strength while seeking opportunities in artificial intelligence, infrastructure rebuilding, and commodities.

Equity market volatility is expected to rise as the U.S. presidential election approaches in November. Risk management strategies should be considered, especially in sectors like U.S. consumer discretionary and renewables, which may be impacted by a potential Trump victory and Republican control of Congress. Financials could see more upside in this scenario. Hedging election-sensitive stocks and geopolitical risks with gold is our preferred method.

The second half of 2024 is crucial for central banks, the U.S. electorate, and investors, with key decisions needed to navigate AI developments, interest rate changes, and the U.S. election landscape successfully.

Fixed Income

Looking back at the first six months of 2024, we recognize that the situation has a similar pattern to last year. Growth continued to prove more resilient than expected, and inflation only came in below expectations in May.

Although the FED's battle against inflation has made significant progress with a current CPI at 3.3%, it is still above the FED's goal of 2%. This calls into question whether the central bank will cut rates this year or not.

Future markets price in a 70% chance for a cut in September and a full cut in November.

All remains data dependent very much. We expect Treasury yields to remain rangebound through the summer as the FED is in no rush to ease. Current levels in 10-year yields (4.45%) are fairly priced in our opinion.

To break the 4% level, the market needs further evidence that the economy is calming down and that the inflation is moving towards its 2% target. The FED needs to see "a few more months of inflation data that looks like it's coming down".

Overall, in terms of strategy, we believe that the macro backdrop continues to validate our medium-term bullish duration outlook, but as always, timing is key. Higher for longer is not off the table yet, but we have a high conviction that the next move by the FED is a cut.

In the meantime, just enjoy coupon clipping.

Elsewhere in the world, growth expectations are weaker and central banks are expected to cut more rapidly, especially in Europe. But the interest rate level in Europe cannot decouple itself from the American level. In addition, the political uncertainty in France complicates the situation even further.

In credit, we stick to Investment Grade bonds as current spread levels in High Yield and Emerging Markets are tight. Sure, risk-on sentiment is still dominating and helping spreads to perform, but once the party comes to an end, these will be the first sectors to underperform.

Nevertheless, we don't think that this moment has arrived yet, therefore we continue to hold this sector as an addition to a relatively conservative fixed income portfolio.

On the curve, we prefer the 5-7year sector, as the profit potential of the 10 years only comes into play in case of a sharp economic downturn.

All in all, current levels of around 4.5 - 5% for solid corporates are attractive. Demand for the asset class is extremely robust as high absolute yields offer a good cushion to absorb wrong timing on interest rate cuts.

Solid economic growth, coupled with taming inflation are a good mixture for credit markets to perform.

Equities

Equity markets have rallied impressively in the first half of 2024, with the S&P 500 gaining 15% year-to-date, buoyed by an artificial intelligence-driven boost to corporate profit expectations. These gains have occurred despite persistent U.S. inflation, delays to interest rate cuts, and rising 10-year U.S. Treasury yields. While the geopolitical landscape remains uncertain, volatility across asset classes has stayed relatively low.

Equity Indicators

Valuation	Neutral
Momentum	Positive
Seasonality	Positive
Macro-Economics	Neutral

Looking ahead to the second half of the year, several key events will shape the market. The U.S. will decide its next president, artificial intelligence will continue its rapid advancement, and U.S. interest rates are likely to be cut. We believe the backdrop remains supportive for equity markets, driven by solid economic and earnings growth, particularly in the technology sector. Although uncertainty surrounds the timing of rate cuts from central banks worldwide, we anticipate a downward trajectory for rates, which should also support the stock market.

In our view, despite current valuations, there is still substantial upside potential in AI-linked semiconductors and tech mega-caps. We have been overweight in the U.S. for some time and will maintain this position. Additionally, while U.S. small- and mid-cap stocks have lagged, we believe their time to shine is approaching.

Broadly speaking, the Momentum factor continues to drive equity gains. The long leg of Momentum is up another 12% year-to-date and 21% cumulatively since early 2022, while the short leg has underperformed significantly at -0.2% and +2.6% over the same period. This makes Momentum the best-performing factor since 2022, followed by Quality (+19%) and Low Volatility (+14%). Momentum remains concentrated in Mega Caps and High-Quality stocks. While Quality has outperformed Value since 2022, there has been a noticeable rotation into Value year-to-date in the U.S. and more so abroad where the AI theme is less dominant.

Since Nvidia's earnings surprise in May 2023, six S&P 500 large language model (LLM) stocks have driven 65% of the index gains over this period and 75% year-to-date. To put these gains in perspective, these LLM stocks are worth $15 trillion, equivalent to the combined market caps of Japan, Germany, India, and Brazil.

Our outlook remains positive for equities, and we continue to overweight stocks. Our analysis indicates few clouds on the horizon for the next month or two. However, as we approach the U.S. election, we expect volatility to increase and the economy to show some sluggishness, necessitating a more detailed assessment of our equity exposure.

Alternative Investments

Under current conditions, active management appears opportune to us, given the anticipated market dislocations stemming from global developments in interest rates, artificial intelligence (AI), and elections. As stocks and bonds may move in tandem amid rate and inflation fluctuations, we view hedge funds as effective portfolio diversifiers.

In the present environment, we are looking at the following strategies that can complement our portfolios:

We believe low net equity long/short (L/S) strategies can capitalize on market dispersion, mitigate directional risks, and cushion against sudden market downturns, complementing traditional equity holdings.

Additionally, we explore strategies that can leverage current macroeconomic shifts and imbalances. Historically, macro funds have adeptly navigated opportunities arising from monetary policy discrepancies, heightened volatility across yield curve and rates trading, inflation-related trades, and commodities trading.

In commodities, we see opportunities across a broad range. Brent crude oil prices are forecasted to reach around USD 87/bbl by the end of the year, up from USD 85/bbl currently, due to solid demand and OPEC+ efforts to balance the market. Risk-tolerant investors might consider hedging against Brent's downside price risks. Copper prices are forecasted to reach USD 11,500/mt by year-end, up from USD 9,786/mt. We also see potential for gold and silver prices to rise. Gold prices are forecasted to increase to USD 2,600/oz by year-end and USD 2,700/oz by mid-2025 from USD 2,330/oz currently. Central banks have been increasing their gold purchases to diversify their reserves. Ahead of the U.S. election, gold could serve as an effective hedge against geopolitical polarization, the U.S. deficit, and inflation. Silver prices are projected to rise to USD 38/oz by mid-2025, with industrial demand benefiting from greater use in renewables and electronics. Investors can also gain indirect exposure to these copper and gold opportunities through mining stocks.

Bitcoin (BTC) fell off a cliff and printed lows of 60.5k after Mt. Gox Trustee announced it will start distribution by early July. Despite repeatedly extending its deadline over multiple years, the Exchange Trustee transferred over 140,000 BTC (valued at 9bn) earlier this year in preparation for repayment. Miners have been under tremendous pressure to sell given higher breakeven prices post-halving. Miner BTC holdings have dropped to the lowest level we've seen in the past 14 years, with total reserves lower by 50,000 from the start of the year. BTC Price is likely to be capped in the near-term but explosively bullish into year-end.

Foreign Exchange

The dollar index has risen nearly 4% year-to-date, bolstered by robust U.S. economic data and interest rate cuts in other major economies. The U.S. dollar is currently expensive, similar to levels seen in the mid-1980s and early 2000s in real trade-weighted terms. Depreciation pressures may increase if markets start expecting a more aggressive Fed rate-cutting cycle. Concerns about the U.S. fiscal deficit may also lead to a weaker dollar in the long run.

A Republican sweep of the White House and Congress could boost expectations of a stronger dollar. However, with limited fiscal headroom and the U.S. dollar already 17–18% stronger than when President Trump first took office, this effect might be less pronounced than during Trump's first term.

The Swiss franc has depreciated by 5% year-to-date against the U.S. dollar, with the SNB being the first major central bank to cut rates. However, the Swiss franc might appreciate from here. We anticipate the SNB will further lower its policy rate to 1.00% from 1.25% following June's rate cut. The franc's safe-haven qualities provide stability amid political uncertainty in Europe, the U.S., and elsewhere. The EUR/USD exchange rate is expected to remain rangebound due to the convergence of easing monetary policies.

The anticipated shift to labor in the upcoming British elections is unlikely to significantly impact the GBP.

The stability of the CHF against the EUR is supported by a diminishing interest rate differential. China's fragile economic outlook and a negative yield differential continue to exert pressure on the CNH.

Investors seeking carry trades should focus on Latin America, particularly with the BRL and MXN benefiting from their central banks' hawkish stances, although political uncertainties under Mexico's new government could affect the MXN negatively.

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Market Overview as of Friday, 29 June 2024, COB

Fixed Income

	Rate	Δ 1m	Δ 3m	Δ ytd
USD Overnight	5.06	0.00	0.25	0.74
USD 1y Swap	5.03	-0.18	0.01	0.25
USD 3y Swap	4.30	-0.25	0.07	0.53
USD 5y Swap	4.05	-0.23	0.08	0.52
USD 10y Swap	3.92	-0.20	0.09	0.46
EUR Overnight	3.71	-0.22	-0.22	-0.28
EUR 1y Swap	3.55	-0.10	-0.07	0.09
EUR 3y Swap	3.05	-0.09	0.15	0.50
EUR 5y Swap	2.89	-0.04	0.22	0.46
EUR 10y Swap	2.83	0.02	0.25	0.34
CDX Xover 5y	3.44%	0.00	0.10%	-0.12%
iTraxx Xover 5y	3.09%	0.00	0.12%	-0.01%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
USD Deposit 1m	0.0%	-0.3%	0.6%	0.6%
USD Aggregate 1-3y	0.6%	1.1%	1.4%	1.4%
USD Aggregate 3-5y	0.8%	1.1%	0.5%	0.5%
USD Aggregate 5-7y	1.0%	0.9%	-0.3%	-0.3%
USD Aggregate 7-10y	1.2%	0.8%	-1.5%	-1.5%
EUR Overnight	0.3%	1.0%	2.0%	2.0%
EUR Aggregate 1-3y	0.5%	0.6%	0.7%	0.7%
EUR Aggregate 3-5y	0.6%	0.0%	-0.3%	-0.3%
EUR Aggregate 5-7y	0.5%	-0.6%	-1.0%	-1.0%
EUR Aggregate 7-10y	0.3%	-1.3%	-1.6%	-1.6%
US Corp. HY	0.9%	1.3%	2.6%	2.6%
EUR HY	0.3%	1.2%	2.0%	2.0%

Equity

	Price	P/E	D. Yield	FCF yield
MSCI World	11'047	19.83	1.9%	3.6%
S&P 500	5'460	22.61	1.4%	3.1%
NASDAQ	19'683	29.28	0.8%	2.7%
Euro Stoxx 50	4'894	13.64	3.4%	5.9%
SMI	11'994	18.42	3.1%	5.6%
FTSE 100	8'164	11.75	3.9%	5.9%
DAX	18'235	13.28	3.2%	6.4%
Japan	2'824	15.58	2.3%	4.4%
MSCI Asia Pacific	181	15.09	2.6%	4.1%
FTSE China A50	12'110	10.58	3.6%	6.0%
MSCI Emerging Market	1'086	13.16	2.8%	4.3%
PH Semiconductor	5'472	35.38	0.9%	1.4%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
MSCI World	2.0%	3.0%	11.7%	11.7%
S&P 500	3.5%	4.1%	14.5%	14.5%
NASDAQ	6.2%	7.6%	17.0%	17.0%
Euro Stoxx 50	-1.8%	-3.7%	8.2%	8.2%
SMI	-0.1%	2.2%	7.7%	7.7%
FTSE 100	-1.3%	2.7%	5.6%	5.6%
DAX	-1.4%	-1.4%	8.9%	8.9%
Japan	1.9%	3.8%	19.3%	19.3%
MSCI Asia Pacific	2.1%	2.8%	6.6%	6.6%
FTSE China A50	-2.7%	-1.5%	5.3%	5.3%
MSCI Emerging Market	3.6%	4.2%	6.0%	6.1%
PH Semiconductor	6.8%	10.3%	31.1%	31.1%

Alternatives

	Price	FCST 24	FCST 25	Δ Future
Gold	2'337	2219	2200	0.2%
Bitcoin	63'298	n/a	n/a	n/a
Silver	29.43	25.75	27.70	0.7%
Platinum	1'008	984.58	1150.00	1.0%
Palladium	981	1059.00	1070.00	2.3%
Crude Oil	82.09	80.00	77	0.8%
Brent Oil	85.57	84.00	80	-1.1%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
Gold	0.6%	4.5%	12.8%	12.8%
Bitcoin	-6.0%	-9.4%	50.4%	50.4%
Silver	-4.4%	15.1%	18.9%	18.9%
Platinum	-2.3%	10.0%	0.4%	0.4%
Palladium	7.4%	-3.2%	-12.8%	-12.8%
Crude Oil	7.0%	1.2%	14.5%	14.5%
Brent Oil	5.8%	0.9%	12.8%	12.8%

Foreign Exchange

	Price	FCST 24	FCST 25	Δ Spot
EUR/USD	1.0767	1.09	1.12	3.9%
GBP/USD	1.2682	1.27	1.30	2.5%
USD/CHF	0.8987	0.91	0.90	0.1%
USD/JPY	160.97	150.00	140	-14.0%
EUR/CHF	0.9676	0.99	1.02	5.3%
GBP/EUR	0.85	0.86	0.86	1.3%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
EUR/USD	-1.3%	0.2%	-2.5%	-2.5%
GBP/USD	-1.0%	1.0%	-0.4%	-0.4%
USD/CHF	-0.3%	0.6%	-6.5%	-6.4%
USD/JPY	-3.0%	-5.8%	-12.5%	-12.4%
EUR/CHF	0.9%	0.4%	-4.0%	-4.0%
GBP/EUR	0.3%	0.8%	2.1%	2.1%

Source: Clarus Capital Group, Bloomberg

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research@claruscapital.ch, www.claruscapital.ch