ARVEST

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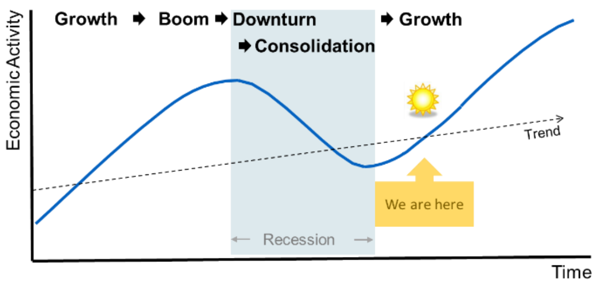
Investor Info

Investment Commentary

Briefing from the ARVEST Investment Committee

The global economic picture is somewhat mixed: While the US is experiencing a slowdown in its previously strong economic growth, Europe and many other countries are recovering from a low base.



The US economy is showing signs of a "soft landing", a phase in which economic growth slows without leading to a recession. Unlike other central banks, the Federal Reserve (Fed) has not yet cut interest rates. The financial markets expect a first rate cut of 0.25% in November or December, as labour market data remains stable and inflation (excluding second-round effects) is slowly declining. The ARVEST Investment Committee believes that the rate cut could be larger or earlier due to the burden of high interest rates on mortgage borrowers, provided that the Fed's independence is maintained in the US election campaign.

Outside the US, several economic regions, notably Europe, performed better than expected. The Chinese economy grew by just under 5%, roughly in line with its five-year average and stronger than in most other countries, despite a further slowdown in the property sector. The measures announced by the Chinese central government in May to reduce the stock of unfinished properties have yet to have an impact. Competition in the industrial sector is fierce and there is spare capacity, which is increasingly being used for exports to emerging and developing markets. Chinese companies are steadily increasing their investment in production facilities in Southeast Asia and, where possible, directly in the West to avoid the threat of sanctions.

The strong performance of the US equity market in the first half of the year was largely driven by a small number of large-cap stocks with high price momentum. This was fuelled by high expectations for artificial intelligence (AI). This decline in market breadth, i.e. the concentration of investors in fewer and fewer stocks, is also reflected in global equity indices. Historically, this has often been a harbinger of stock market highs.

Future Prospects

Technical factors and investor hopes are therefore currently dominating stock market performance. The current economic situation seems to have little impact. The Investment Committee discussed the thesis that the importance of economic cycles for financial markets may generally diminish over the medium term. This is because in an environment of national industrial policy, labour markets and the earnings situation of leading companies are more dependent on politics.

The strategies of the US, Europe, Japan and China to stabilise the economy through higher government debt and targeted industrial policy are similar to historical approaches that were pursued in different countries at different times. To avoid structural inflation in the long run, it will be crucial to raise labour productivity on a sustained basis. China has shown that this is possible, even if high debt levels are now also restricting fiscal space. Moreover, AI has the potential to be a major driver of productivity and profit margins for many companies.

Against the backdrop of rising levels of debt, financial repression is also to be expected. The state can lower its financing costs in order to create policy space, e.g. by setting interest rates below the market level or by prescribing certain investments such as government bonds, but also by outright bans on gold or foreign equities.

The increasing influence of politics on financial markets is also reflected in the amount of time the Investment Committee devotes to this topic at its meetings. Given the aggressive election campaigns in the US, France and other democracies, there is a risk that the election results will not be accepted by the losers. If court rulings on these issues are dismissed as corrupt and ultimately ignored, the loss of the rule of law is likely to undermine investor confidence more than a less market-friendly election outcome.

This, of course, would be very negative for investors. Financial markets are currently pricing in very little of this political risk in democratic countries. Despite all the negative news, the Investment Committee also sees this as a medium-term rather than a short-term risk. However, we will continue to monitor the situation closely.

5 July 2024
On behalf of the Investment Committee
Stefan Kimmel
Chief Investment Officer ARVEST Funds AG