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Investment Policy

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Key points

A turbulent US election campaign

Not so long ago, the outcome of the US presidential election seemed to be a foregone conclusion in favour of the Republicans. But that was before Joe Biden stepped down to make way for his Vice-President, Kamala Harris. Since then, the situation has been turned on its head. **Opinion polls** are promising a race that is too close to call.

Yet their platforms have very different focal points. The main thrust of the Republicans is **helping American companies**, namely by cutting the corporation tax rate from 21% to 15% and curtailing regulations across the board. For households, including the wealthiest, the main measure will be rolling over the tax cuts agreed during Trump's first term in office, which are due to expire at the end of 2025. The IRA (Inflation Reduction Act) is likely to be maintained by virtue of its effectiveness, but with some fine-tuning in favour of fossil fuels. Finally, the protectionist chapter, which consists of raising or introducing new customs duties on all imported goods – mainly, but not only, from China – and drastically limiting immigration, runs counter to the Democratic platform. It would also be more inflationary. On the tax front, the Harris camp wants to help **households** over businesses. Tax cuts would be rolled over but adapted to focus on families, leaving the highest-earning households out in the cold. Such largesse would be partly funded by an increase in the corporation tax rate to 28%. But despite the US heading for a **deficit** of 6.7% of GDP this year, neither side has its heart set on making savings.

Still, it will be the outcome of elections to **Congress** (both House and Senate) that will be decisive for either side to implement their respective manifestos. It is highly likely that Congress will be split, thereby diluting the most controversial parts of the candidates' plans. This could also mean gridlock, especially on the tax front.

The renewed political uncertainty is likely to keep financial markets relatively **volatile** between now and 5 November.

Scenario and conclusions

- **US elections** are driving mood of uncertainty
- **Inflation** remains on desired trajectory
- More central banks are jumping on **rate-cutting** bandwagon
- Signs of weakness emerge in US **employment**...
- ... while **Europe and China** fall short of expectations

→ **Equities**: slight underweight, limited regional bets
→ **Bonds**: overweight (IG corporate bonds)
→ **Currencies**: preference for CHF and USD
→ **Cash**: neutral

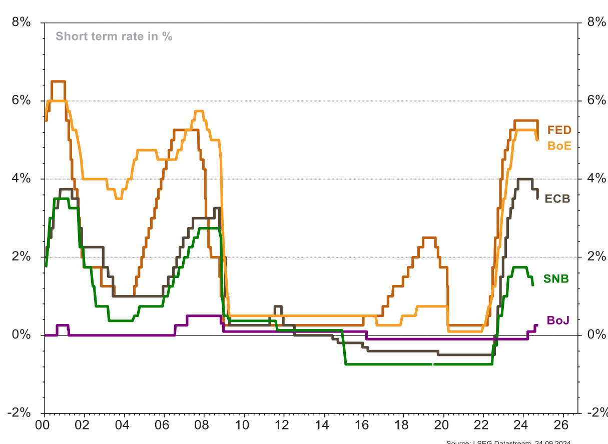
	UW (-)		N (=)		OW (+)
Asset allocation					
Equities		■			
Sovereign bonds			■		
Credit					■
Alternative investments			■		
Cash			■		
Equities					
US		■			
Europe			■		
Switzerland				■	
Japan				■	
Emerging markets			■		
Bonds					
Sovereign			■		
Corporate investment grade				■	
High-yield corporate	■				
Emerging market sovereign (USD)	■				
Emerging market sovereign (local)	■				

Economy: *slowing inflation justifies extensive monetary loosening*

The US economy is slowing down. And neither Europe nor China are picking up pace, despite the momentum witnessed in the first half of the year.

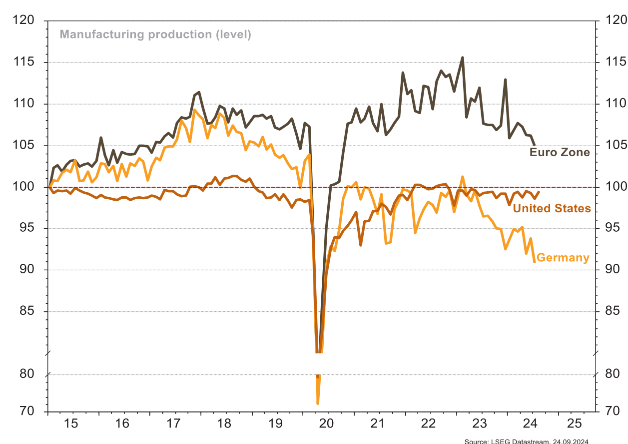
In the **US**, the prospect of an economic **soft landing** is still a debating point. This is because economic statistics in recent months have sent mixed signals. The slowdown in **inflation** is a major consideration in projecting the soft landing. If inflation were still high, it would be hard to imagine embarking on a cycle of monetary loosening aimed at galvanising private-sector lending (**Chart 1**).

Chart 1 | Central banks: monetary easing becoming the trend



Inflation is deemed under control once it nears the 2% target set by central bankers. In the US, inflation is still humming along at 2.6% y/y but at an annualised rate of only 1.1% over the past three months. This shows that price growth is following the intended path. The resilience of the **services sector** also bolsters the assumption of a soft landing. Purchasing manager confidence in August, whether measured by the PMI (55.2) or the ISM (51.5), points to continued growth in business activity, following on from GDP growth of 3% in Q2 (annualised q/q). By contrast, the **manufacturing** sector is stagnant at best, with output in July 2024 lower than in March 2022 (**Chart 2**), and the outlook is not improving. The ISM leading indicator of manufacturing confidence has been hovering in contraction territory (<50) since October 2022, stuck around 47.2. Worse still, this weak state of affairs is echoed in the loss of 33,000 manufacturing jobs since the start of the year.

Chart 2 | Global: manufacturing output stagnating or declining in places



Employment is indeed the most thorny issue in the current soft landing debate. The annual revision of job creation over the last 12 months (to March 2024) shows 830,000 fewer jobs than initially reported, and the last two months have been disappointing, with only 89,000 and 142,000 jobs added in July and August, respectively. Even so, the US economy is still hiring, and this acts as a boost on consumer spending. However, while redundancies are still limited, signs of weakness are becoming increasingly apparent. The number of job vacancies is falling, as is the number of temporary positions (**Chart 3**). Similarly, aside from the health and education sectors, the number is clearly declining. Historically, these are warning signs of a broader deterioration in the labour market, pointing to a recession.

Financial markets

***) To 20.09.2024**	Performance			Valuation			Earnings growth			
Equity markets	Price (local currency)	Quarter Q3*)	Since 31 Dec 2023	12-month P/EPS	Dividend yield	Price/ net assets	12-month EPS	2024 EPS	2025 EPS	2026 EPS
United States	5 427.20	4.51%	19.20%	21.04	1.6%	4.9	14%	10%	16%	13%
Europe	514.26	0.56%	7.35%	13.07	3.3%	2.0	9%	4%	10%	10%
Japan	2 642.35	-6.00%	12.00%	13.22	2.2%	1.3	9%	9%	10%	9%
Switzerland	11 934.07	-0.50%	7.10%	16.74	3.1%	3.9	11%	14%	10%	10%
United Kingdom	4 501.08	1.10%	6.40%	11.37	3.7%	1.8	6%	0%	8%	8%
Emerging Markets (USD)	1 106.44	1.86%	8.08%	11.47	2.9%	1.6	17%	24%	16%	11%
World (USD)	3 676.84	4.70%	16.00%	18.29	2.1%	3.3	12%	8%	13%	12%

Source: Datastream, IBES consensus

While growth in the first half of the year in the **Eurozone** (excluding Germany) was better than expected, the regional economy is running out of steam. Even in Q2, the composition of GDP growth (+0.2% q/q; +0.6% y/y) was disappointing. Unsustainable government expenditure (+0.6% q/q) offset the contraction in consumer spending (-0.1% q/q) and business investment (-2.2% q/q). As with the US, manufacturing is suffering, but to an even greater degree. The sector is clearly in **recession**. Manufacturing output contracted by 4.9% y/y in June in the Eurozone as a whole, with Germany down by almost 6% y/y in July (**Chart 2**). The HCOB Eurozone Manufacturing PMI was 45.8 in August, which was better than the July 2023 nadir of 42.7 but remains in contraction territory. The manufacturing business recovery will have to wait. The dichotomy in relation to services is the same as in the US. The level of confidence is higher, rising to 52.9 in August. But this figure was artificially inflated by all the froth surrounding the Paris Olympics, which optimistically drove the outlook on French services from 50.1 in July to 55 in August. The good news lies with inflation, which clocked in most recently at 2.2% y/y, allowing the **ECB** to continue the rate cuts which it began in June (**Chart 1**). This trend has been accompanied by an easing in lending conditions by commercial banks, which should help improve the outlook.

Chart 3 | US: dichotomy between fundamentals and equity markets

The **Swiss economy** is holding up better in comparison, after forecast-beating GDP growth of +0.7% q/q in the second quarter. Its growth breakdown is healthier than the Eurozone's, with consumer spending up 0.3% q/q. Nevertheless, investment in capital goods disappointed, contracting by 0.8% q/q. As elsewhere, the manufacturing sector is suffering. The outlook is not encouraging, despite a small rebound in the purchasing managers' index to 49 in August – the highest reading in 18 months. Confidence in the services sector has improved to 52.9, consistent with its respectable growth performance. Inflation continued to decelerate, slowing to 1.1% y/y in August – representing a sharper fall than the SNB had been expecting back in June. This encouraging trend gives room to the SNB to cut interest rates further before the end of the year (**Chart 1**).

The pick-up in **Chinese** economic activity is taking time to materialise. The property crisis has been eroding consumer confidence, prompting the population to save rather than spend. Additionally, authorities are focusing efforts on supply-side stimulus. The risk is that overcapacity will increase and keep price growth too low, sustaining the spectre of deflation. Based on latest figures, consumer price inflation is only 0.6% y/y while producer price inflation is negative at -1.8% y/y. The PBoC may therefore be challenged to lean in more heavily as it waits for decisions geared more towards the demand side.

10-year sovereign bonds	Level at 20.09.2024	Change Q3*) (bps)	Change since 31 Dec 2023 (bps)
USD yields – United States	3.73%	-65	-14
EUR yields – Germany	2.15%	-30	15
JPY yields – Japan	0.87%	-16	25
CHF yields – Switzerland	0.51%	-5	-19
GBP yields – United Kingdom	3.90%	-26	30
Emerging markets (USD)	6.54%	-99	-78
Emerging markets (local currency)	3.64%	-29	-44
Commodities	**Price**	**Quarter Q3*)**	**Since 31 Dec 2023**
Gold (USD/oz)	2 614.05	12.0%	27.0%
Brent (USD/bl)	75.58	-14.0%	-2.9%

FX	Level at 20.09.2024	Change Q3*)	Change since 31 Dec 2023
EUR vs. CHF	0.9476	-1.60%	1.93%
EUR vs. USD	1.1130	3.84%	0.75%
EUR vs. JPY	160.9440	-6.65%	3.35%
EUR vs. NOK	11.7320	2.81%	4.58%
GBP vs. EUR	1.1905	0.92%	3.17%
GBP vs. USD	1.3281	5.06%	4.18%
USD vs. CHF	0.8504	-5.36%	1.04%
USD vs. CAD	1.3576	-0.79%	2.95%
AUD vs. USD	0.6794	1.72%	-0.44%

Source: Datastream

Monetary preferences

Rank 1	Rank 2	Rank 3
Appreciation expected	Stabilisation	Depreciation expected
CHF | USD	GOLD | EUR | JPY | NOK	GBP

Rank 1 – CHF | USD

- **CHF**: haven and hedging currency, which compensates for lower yield; no longer overvalued
- **USD**: rich valuation, but benefits from higher interest rates and haven status

Rank 2 – GOLD | EUR | JPY | NOK

- **GOLD**: rate cuts will provide support. Hedge against geopolitical risk, US deficits and a depreciating dollar
- **EUR**: attractively valued but political uncertainties are a drag
- **JPY**: very attractively valued; scrapping of zero-interest-rate policy provides support
- **NOK:** diversification play, correlated with the price of oil

Rank 3 – GBP

- **GBP**: valuation is no longer a reason for buying, and growth potential is weaker; new-found political stability provides support.

Investment conclusions

The high valuation of **equities** becomes increasingly untenable in the face of economic conditions that have proven less favourable than initially anticipated, coupled with mounting uncertainty surrounding the outcome of the US election. More generally, the hopes and dreams pinned on AI seem to have become excessive, leaving the tech sector (which represents over 30% of the US market capitalisation) vulnerable to even the slightest upset. In light of the above, a more cautious stance on this asset class is warranted.

In contrast, further signs that inflation is slowing in the US, the Eurozone and Switzerland mean that central banks can continue their cycle of lowering benchmark policy rates. This is also helping longer-dated yields, which are decreasing as a result. We have therefore added to positions in **sovereign bonds** (except in CHF) and rotated out of cash, returns on which are falling. In Switzerland, **listed residential real estate**, decorrelated structured products and selected hedge fund strategies represent viable alternatives to bonds, whose yields are already too low, particularly on the longest-dated maturities.

The onset of monetary loosening by the Fed could trigger a downtrend on **USD**. Even so, greenback-denominated returns remain high, so any reduction in our exposure will be staggered.
A rebalancing towards **gold**, which already features prominently in our allocations, represents not only a dollar hedge but also shields against the risk of a ballooning budget deficit. In addition, lower real rates are having a positive effect on its price.

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