

February 2024

Interest rates & bonds

The same solution to different problems

USA

- The US 10-year government bond yield rose by 15 basis points (bps) in January, while corporate credit spreads continued to tighten, decreasing by 4 bps. These spread levels are unprecedented since the Federal Reserve began its rate-hiking cycle.
- Market participants currently expect the first policy rate cut by May, with a 50% chance of an adjustment already in March (all data on this page as at 30 January).

Eurozone

- Eurozone credit spreads, though still higher than their US counterparts, are progressively narrowing the gap. They tightened by 9 bps in January, while 10-year German Bund yields increased by 18 bps.
- The European Central Bank (ECB) maintained steady policy rates in January but signalled the possibility of cuts starting in the summer. The market, however, anticipates a potential cut as soon as April.

UK

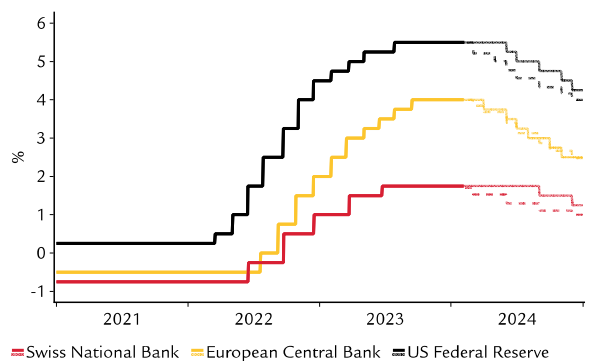
- In the UK, 10-year Gilt yields climbed by 34 bps in January, and credit spreads tightened by 7 bps, reaching a two-year low.
- The UK's composite Purchasing Managers' index (PMI) has returned to expansionary territory since November and inflation has unexpectedly reaccelerated to 4%. Therefore, pressure on the Bank of England to postpone its cutting cycle is increasing. This development places the expected first cut in June at risk.

Switzerland

- The Swiss markets continue to operate distinctively, with 10-year bond yields lingering at a low 0.8% and corporate credit spreads standing at just 83 bps.
- Switzerland's inflation rate has remained within the SNB's target range of 0-2% since June 2023. Coupled with low PMIs and a strong CHF, these factors could lead the Swiss National Bank to consider an earlier rate cut than our expectation of a first rate cut in September.

Expectations for various central bank rate paths

Central bank policy rates, incl. Swiss Life Asset Managers forecasts (thin lines) and market expectations (dotted lines)



Sources: Bloomberg, Macrobond, Swiss Life Asset Managers. Last data point: January 2024

As inflation continues its downward trend in developed markets, central banks are poised to reduce interest rates, even though inflation is not yet below the 2% target in many economies. Intriguingly, markets expect a rather synchronised move, anticipating rate cuts of about 100 basis points (bps) in 2024 in the US, the eurozone and the UK. A notable outlier is the Swiss National Bank, where markets expect 50 bps of cuts in 2024, albeit from a relatively low rate. This expectation of a synchronised move appears somewhat inconsistent given the varied economic dynamics across regions. The eurozone, UK, and Switzerland are witnessing very weak GDP growth, while inflation rates have declined markedly in recent months. Swiss inflation, in particular, has already been in the target range since June 2023. Contrastingly, the US economy has maintained robust growth in the second half of 2023 and persistent inflation above 3% year-on-year for the past seven months. Factors like rising transportation costs and oil prices, exacerbated by Middle Eastern geopolitical tensions, along with recent financial easing, could potentially rekindle inflation, casting doubt on the anticipated rate cuts. Given this landscape, we adopt a neutral duration stance but show a preference for European rates over their US counterparts. Moreover, European credit risk appears more attractive at present, with spreads still relatively wide compared to the US.

Equities

Surprisingly good start to the new year

US

- The US market gained 1.5% in January. The “Magnificent 7” stocks (+1.8%) were again a key driver of the positive performance. Due to an appreciation of the USD, the performance in CHF was much higher (+4.0%).
- The earnings season has just started. The percentage of S&P 500 companies reporting positive earnings surprises is below-average. The aggregated earnings reported by the companies are below expectations.
- The US valuation is still far above historical averages and also much higher than for the other markets (see also the chart).

Eurozone

- The market gained 2.2% in January 2024.
- The earnings season has just begun. SAP, the biggest technology company in Europe, reported satisfactory results and announced a reorganisation.
- The European market is still very attractively valued from a longer-term perspective. Depending on the metric, the valuation relative to the US market is at an all-time low.

UK

- Apart from Emerging Markets, the UK is the only market that has had a negative performance so far this year (-1.2%).
- The UK market still benefits from the lowest valuation and the highest dividend yield of all major developed markets (4.1%). However, we think that the UK is currently a “value trap”.

Switzerland

- The Swiss market also started the year positively with a performance of 1.6%.
- The index heavyweights except for Roche started the year on a positive note, and Lonza gained more than 20%.
- The Swiss equity market is the second-most expensive market after the US market (see chart).

Emerging Markets

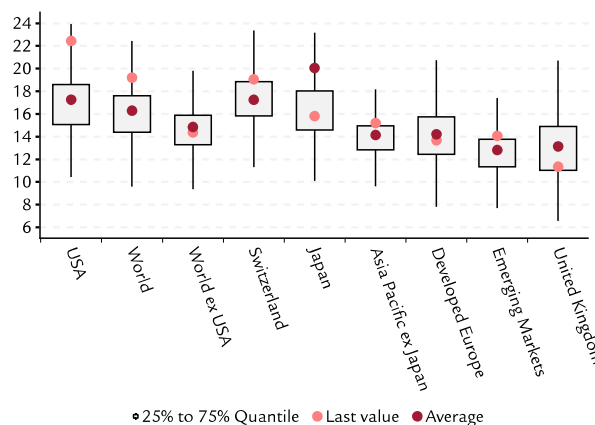
- Emerging Markets continued to underperform in January with a performance of -4.6%.
- As last year, the key driver is the Chinese stock market. In USD terms, the market is down 10.6%. The market still does not seem to believe in the efforts by the central government to prop up the economy.

The Swiss Equity Market: review and outlook

The large-cap Swiss equity market gained only 3.8% in 2023, while global equities gained around 13% in CHF terms. Swiss small caps performed in line with large caps while global small caps delivered a total return of 5%. The significant underperformance of the Swiss (large cap) market in 2023 was due to company specific factors and the unique sector allocation. On a company level, the two index heavyweights (30% of the index) Roche and Nestlé delivered a performance of -13% and -6%, respectively. To keep up with global equities, the other 70% of the index would have needed a performance of 23% which is a big number if we consider that the market has very little exposure to the best-performing sectors IT and Communication Services. These two sectors, which globally returned 40-45% in CHF last year, have a weight of around 2% in the SPI. Weak-performing sectors such as Health Care and Consumer Staples (combined index weight of around 50% in Switzerland) lost around 5% last year globally.

We have a positive outlook for the Swiss market (large and small caps) for 2024. As we expect total returns for global developed equities to be around 5% this year and a rather weak first semester, defensive equities with decent dividend yields could stage a comeback. In addition, the valuation premium of the Swiss market relative to other markets is reasonable and compared to its own history, the Swiss market valuation is at the upper end of the neutral range. We recommend investing in the SPI as well as the SPI Extra Index in order to benefit from the full potential of the Swiss market and to achieve an improved sector diversification.

Global equity valuation (Forward P/E ratio), 2004-2024



Source: Swiss Life Asset Managers, Macrobond, Bloomberg. Last data point: 29.12.2023

Currencies

Fed patience and positive data surprises support USD

USA

- The USD had a good start to 2024, appreciating against almost all developed and emerging market currencies.
- We reiterate our positive view on the USD (see main text on the right). The January meeting by the Federal Reserve, where Chair Powell pushed back against expectations of a first rate cut in March, reinforced our view that a first rate cut in summer is the more likely scenario. This message removed, in our opinion, some downside risks to the USD in the near term.

Eurozone

- The EUR lost 2% against the USD in January, but appreciated marginally against CHF and more strongly against NOK and SEK.
- We expect the EUR to remain weak in 2024 amid weak growth, falling inflation pressure and the resulting need to ease monetary policy.

UK

- Better-than-expected economic data and a surprising rebound in inflation led to a 1.7% appreciation of GBP against EUR, while sterling remained roughly almost stable against the USD.
- Nevertheless, we expect GBP/USD to weaken somewhat in February, in line with our view of a generally strong USD.

Switzerland

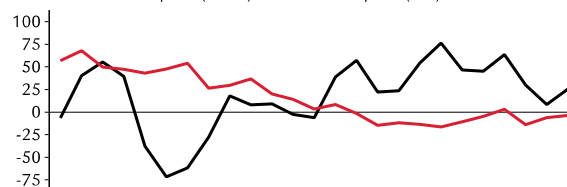
- The CHF appreciation trend was halted in January, with the trade-weighted CHF losing 0.7% over the month. In an interview, SNB President Thomas Jordan mentioned that the strong CHF is a concern to the SNB, a statement that might have added to the CHF depreciation.
- For the month of February, we have a neutral view on EUR/CHF and a positive view on USD/CHF.

Japan

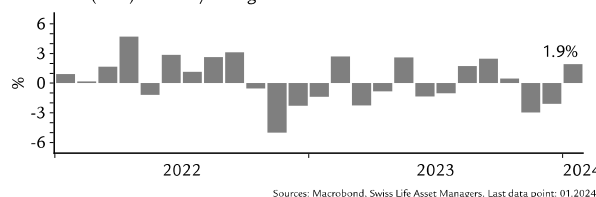
- In January, the JPY lost 4% against the USD as the Bank of Japan remained in a “wait-and-see mode” and as inflation data for the Tokyo area surprised significantly to the downside.
- We do not expect monetary policy to be normalised enough in 2024 to make the JPY an attractive proposition due its significant carry disadvantage.

Strong US data and a strong USD in January 2024

Citi US economic surprise (black) & inflation surprise (red) index



USD Index (DXY): monthly change in %



Sources: Macrobond, Swiss Life Asset Managers. Last data point: 01.02.2024

The USD ended 2023 on a weak note. A significant decline in US government bond yields and the dovish turnaround in the US Federal Reserve's rhetoric in December weighed on the greenback. US economic data releases still surprised positively, but less so than in the third quarter (see chart). However, in line with our expectations, the USD staged a comeback in January, with the USD Index (USD vs. a basket of six developed market currencies) gaining 1.9% over the month. For once, monetary policy expectations were not the major driver. To be sure, the over-optimistic market expectations of significant Fed policy rate cuts were scaled back somewhat, but this was also the case regarding the rate cut expectations for other central banks, which were a bit too excessive at the beginning of the year. Three factors likely played into the greenback's hand in January: The first factor is a technical one: speculative positioning was very much short USD and long EUR at the end of 2023. As some of these positions were reduced in January, this contributed to the USD recovery after two weak months. Second, US economic data, notably the first estimate of Q4/2023 GDP growth, again surprised positively, adding to a rebound of the Citi Economic Surprise Index and cementing the idea that the US economy was in better shape at the start of 2024 than the rest of the developed world. Third, and very importantly, the interest rate differential (“carry advantage”) was in favour of a strong USD. The latter two drivers will likely persist in the short term, leading us to reiterate our positive view on the USD.

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