

Vontobel

# Investors' Outlook

A crude awakening

October 2023

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Bank Vontobel AG  
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### Editors

**Corinne Gretler,**  
Senior Investment Writer,  
Vontobel  
**Investment Content Team,**  
Vontobel

### Authors\*

**Marc Bindschädler,**  
Client Portfolio Manager for mtX,  
Conviction Equities Boutique,  
Vontobel

**Stefan Eppenberger,**  
Head Multi Asset Strategy,  
Vontobel

**Frank Häusler,**  
Chief Investment Strategist,  
Vontobel

**Michaela Huber,**  
Cross-Asset Strategist,  
Vontobel

**Christopher Koslowski,**  
Senior Fixed Income & FX Strategist,  
Vontobel

**Mario Montagnani,**  
Senior Investment Strategist,  
Vontobel

**Dan Scott,**  
Head of Vontobel Multi Asset,  
Vontobel

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# A crude awakening



—  
**Dan Scott**  
Head of Vontobel Multi Asset,  
Vontobel

Dear readers,

The month of September delivered a bolt from the blue to market dynamics.

In addition to investors' existing concerns about inflation, a recession, and central banks possibly making a mistake by hiking interest rates too high and for too long, the global economy and policymakers have been thrown an extra ball to juggle: surging oil prices.

Saudi Arabia and Russia wielded their power, extending curbs on oil production through December, a reflection of the ability of current and prospective BRICS economies to stand up and make themselves heard by controlling energy prices and reminding us just how thin the line is between commodities and politics.

While risk assets are still fairly well supported, oil's spike could turn into a cold shower for central bankers, who are starting to view inflation as sufficiently tamed to allow for breaks from the most aggressive interest-rate increases in four decades.

The biggest question revolves around what the impact will be, as the current picture is framed differently this time around. Will soaring energy prices kill the progress made on containing inflation and reignite a rise in consumer prices? Will it weigh on economic growth? And is stagflation, the word nobody wants to hear, back on the table as an increasing number of market observers have uttered it?

While we aren't (yet) too concerned about a significant price rise, the oil surge has already left its mark on the latest inflation data. But we believe central banks will look

past these temporary price increases—at least for now—as they mostly focus on core inflation, which has come down. The US Federal Reserve held rates at its September meeting, and while Chair Jerome Powell signaled that rate hikes are nearing an end, he also hinted at a higher-for-longer environment next year as a soft landing looks increasingly feasible.

We, however, continue to expect a recession as a Christmas present or a New Year's hangover, and the first cuts later in 2024. Fighting inflation has its price, and the economy is already showing signs of weakening. We also believe that investors' main focus will shift from inflation to growth and the coming recession, especially as the factors that have propped up the economy so far, such as pandemic savings, a surprisingly resilient labor market, and fiscal stimulus, slowly fade away.

In this Investors' Outlook, our colleagues in the Conviction Equities Boutique raise the question of whether it's time to separate China from a single emerging-market (EM) equities allocation to a stand-alone stance as they analyze the paradox of it being of being simultaneously dominant and underrepresented. You can also get a clearer picture on US fiscal spending and our decision to refrain from making any changes to our positioning for now.

Whether oil's run is short-lived or more persistent, we believe now is the time to keep a steady hand as jolts ripple through the system.

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## → Webcast

To view our webcast on recent market developments, click [here](#).

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## 4 Investment strategy



—  
**Frank Häusler**  
Chief Investment Strategist,  
Vontobel

# A September to remember?

**September kicked off with an unexpected surprise and set the tone for the month's market developments. The Organization of the Petroleum Exporting Countries (OPEC)'s announcement to voluntarily extend oil production cuts through year-end—longer than investors had expected—served as a reminder that the fight against inflation faces volatility and is not yet over.**

A look at US consumer prices shows they rose to 3.7 percent in August from 3.2 percent in July, and came in at 5.2 percent in the Eurozone, slightly less than initially estimated but still way above target. But monetary policy is still making its way through the economy.

This also means that stress is slowly but surely building, at least on the corporate side. As many as 69 US companies defaulted on their debt payments during the first eight months of 2023, reflecting a nearly threefold rise from the year-earlier period. August alone counted 16 defaults, the highest tally since 2009. More may be on the way.

Global economic growth remains weak overall and uneven across regions. While the US is still faring relatively well, others are struggling. The Chinese economy is facing various headwinds, ranging from subdued domestic demand to an ailing property sector. The Eurozone—notably its largest economy, Germany—is also mired in a downturn.

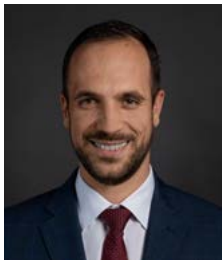
We continue to believe that a recession is on its way and that economists and markets are overly optimistic when it comes to future economic growth. This means that central bank policymakers should change course earlier than expected.

As we are comfortable with our current portfolio positioning, we see no reason for amendments at the moment. See the details of our asset allocation on page 5.

	UNDERWEIGHT		NEUTRAL	OVERWEIGHT		
	significantly	slightly		slightly	significantly	
<b>1</b> <b>Liquidity</b>			→			We retain our neutral cash positioning but are carefully monitoring the latest market consolidation and are ready to seize opportunities when they emerge.
<b>2</b> <b>Bonds</b>			→			We stay neutral on fixed income and maintain all sub-asset class views. The Treasury market selloff throughout August was partially influenced by a surge in bond issuance, but the main factor was the market adjusting its expectations regarding the trajectory of monetary policy. Over the course of one month, the yield on 10-year US Treasuries surged to the highest level since 2007. As we believe the Fed is close to concluding its most aggressive monetary policy tightening in 40 years, bond yields should eventually move lower. We stay overweight on government bonds, which should benefit when economic growth and interest rates come down. We keep a small overweight in EM bonds in hard currency amid attractive spreads and our anticipation of a weaker US dollar in 2024. We are neutral on investment-grade bonds and remain negative for the high-yield segment, which we think prices in a much too optimistic economic scenario.
<b>3</b> <b>Equities</b>			→			We reiterate our neutral stance on equities and stand by our views at regional level, not only because we expect a recession, but also because liquidity is being drained from the system by central banks. They are usually not supportive of equities, as well as unattractive equity risk premiums on fairly rich valuations. Analysts' expectations seem a bit too optimistic to us, especially for Eurozone equities, where we are double underweight. The Eurozone is more exposed to cyclical sectors than other developed stock markets and, as such, exposed to the risk of revisions. Still, there are also some tailwinds for stocks. Low and falling inflation across most developed countries and a likely dovish shift in central bank rhetoric argue against going underweight. But in the current environment, we prefer defensive, high-quality, structurally growing regions that display solid earnings predictability. We believe most of these qualities can be found in the US and Switzerland, for which we reiterate our overweight stance.
<b>4</b> <b>Gold</b>				→		We maintain our slight overweight on gold as we continue to expect a US recession toward year-end and a Fed rate cut in the first quarter of 2024. It should benefit from an eventual peak in the US dollar and declining real rates. Gold could also benefit if inflation flares up again and represents a good hedge in case geopolitical risks escalate.
<b>5</b> <b>Commodities</b>			→			Commodities managed to claw back some of their losses recently, almost exclusively driven by the energy complex (producer-orchestrated supply tightening, lack of swing producers, increasing inventory draws). OPEC's extended output cuts sparked supply fears and pushed oil prices above the 90-US dollar mark. While upside risks within the energy complex make for a compelling case to go overweight on commodities, our expectation of a looming US recession and lower bond yields argue against this cyclical asset class, as does the still very weak Chinese economy (China is an important commodity consumer). We stick to our neutral view on commodities.
<b>6</b> <b>Alternative strategies</b>			→			Our negative view on alternative funds and our neutral view on real estate remain unchanged, resulting in a neutral stance on alternative strategies.

# The US stimulus clock is ticking

Hardly a day has gone by in recent months without talk about a possible US recession. Some investors pointed to the sharply inverted yield curve, others to weakening leading indicators such as the purchasing managers' indices. Still others cited the New York Federal Reserve, whose models predict a 60 percent recession probability. However, the “most anticipated recession ever” has yet to materialize.



— **Stefan Eppenberger**  
Head Multi Asset Strategy,  
Vontobel



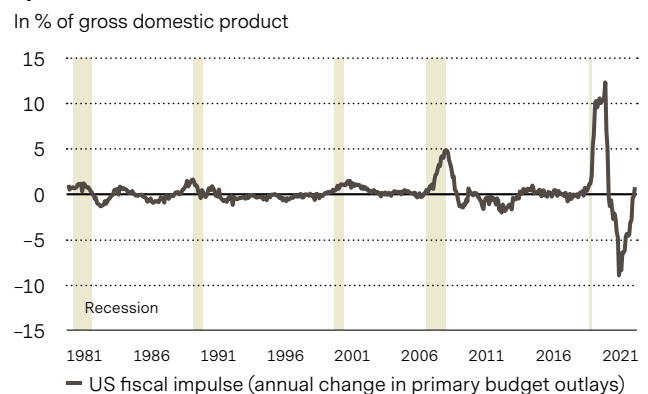
— **Michaela Huber**  
Cross-Asset Strategist,  
Vontobel

At first glance, one can quickly identify the reasons behind this delay. For one, the labor market is more robust than expected, with companies retaining existing employees or even adding to their workforce. Private consumption has also proven to be stronger than expected. But there is a third factor that has received little attention so far: support in the form of fiscal stimulus.

This fiscal stimulus is surprising; some might raise the question of whether it's time to tighten the belt after former President Donald Trump's tax cuts (in place since 2017) and the generous pandemic-related stimulus packages (in place since 2020). In view of the strong labor market, is stimulative fiscal policy necessary when the labor market is this resilient? Looking at government spending excluding interest payments, the fiscal impulse turned positive in the second quarter of 2023, resulting in a growth impulse (see chart 1).

There are several reasons for the growing US fiscal deficit. On the one hand, “Uncle Sam” has had to cope with considerable additional spending in recent months, in particular on education (one-time student loan forgiveness), health care (Medicare), national defense (Ukraine war), and social security. Government revenues are also no longer as abundant as they once were. While the

**Chart 1: The US fiscal impulse turned positive in Q2 2023**



Source: LSEG, Vontobel

US has enjoyed whopping capital gains (and the taxes levied on them), especially in recent years, tax revenues have reversed with the mixed 2022 financial market performance.

### Less help from Uncle Sam ahead

We're likely to see further fiscal stimulus in 2024 due to budget bills that have already been passed, such as the Creating Helpful Incentives to Produce Semiconductors and Science Act (CHIPS Act), which aims to boost investment in domestic semiconductor production capacity; the Infrastructure Investment and Jobs Act, which focuses on roads, bridges, and water infrastructure; or the Inflation Reduction Act, which promises investments in clean energy and research and development. The outcome of the US elections in November 2024 is unlikely to affect these spending bills.

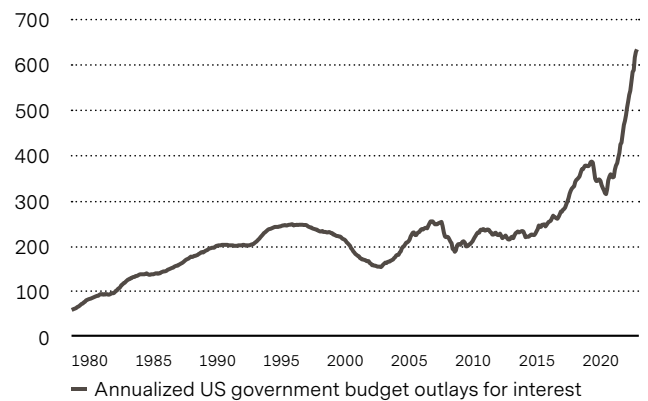
However, we expect fiscal stimulus to peak soon. US voters are increasingly critical of deficit spending. A Pew Research Center poll showed that 57 percent of those surveyed think reducing the budget deficit should be a top priority, up from 45 percent in 2022. Republicans found deficit reduction significantly more important (71 percent) than Democrats (44 percent). There will also likely be minor savings associated with the debt ceiling after US Congress suspended it in June 2023. The Supreme Court's June decision to rule the planned partial forgiveness of student loans—one of President Joe Biden's key campaign promises—unconstitutional means borrowers have to resume repayments in October. The measure would have cost some 400 billion US dollars, according to the budget office.

In addition, the US faces higher debt and increased costs to service that debt. According to the US Treasury, annualized interest outlays have swelled to 628 billion US dollars in July 2023 from 313 billion US dollars in April 2021. This leaves less room for other spending (see chart 2).

As we expect fiscal stimulus to weaken in the coming months, providing less of a tailwind for the US economy, the weakening fiscal impetus comes up against an already very restrictive monetary policy. If history is any guide, this is not an ideal environment for risk assets. The S&P 500 Index usually trends sideways in the 12 months before US elections, due in no small part to the pre-election fiscal stalemate (see chart 3).

### Chart 2: Interest costs are surging amid higher rates and high debt

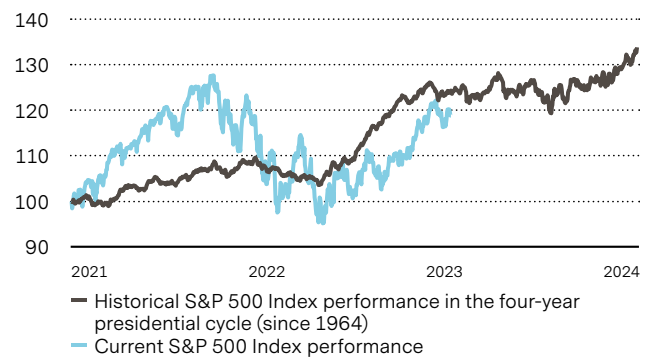
In billion US dollars



Source: LSEG, Vontobel

### Chart 3: Stocks trend sideways before US elections

Index



Source: LSEG, Vontobel. Past performance is no reliable indicator for future performance.



# The China paradox

Since China began opening and reforming its economy in 1978, its growth in gross domestic product (GDP) has averaged over nine percent per year and more than 800 million people have lifted themselves out of poverty<sup>1</sup>. In 2022, China accounted for just over 18.6 percent of the world economy, making it the second largest by nominal GDP after the US<sup>2</sup>. This year, the International Monetary Fund expects just over one-third of global economic growth to come from China.



—  
**Marc Bindschädler**

Client Portfolio Manager for mtX,  
Conviction Equities Boutique,  
Vontobel

While the past decade played out the “Chinese paradox” of its stock market (which saw a +4.3 percent annualized return for the period 31.12.2011 – 31.12.2022<sup>3</sup>) not keeping pace with GDP growth (+6.6 percent annualized over the same period<sup>3</sup>), the Shanghai and Shenzhen stock exchanges have grown strongly in terms of capitalization and importance. With a combined market capitalization of 11.6 trillion US dollars, the Shanghai and Shenzhen stock exchanges are now the second largest in the world, behind the US stock exchanges of NYSE and NASDAQ and their combined market capitalization of 44.4 trillion US dollars<sup>4</sup>.

The weight of Chinese equities in the MSCI Emerging Market Index has more than doubled since 2011, increasing from 15.3 percent to 30.8 percent<sup>5</sup>. However, as China’s capital markets are still not fully accessible to international investors, the market capitalization of shares listed in Shanghai and Shenzhen is only weighted by an allocation factor of 20 percent. If this factor were increased to 100 percent, China’s weight in the MSCI EM Index would rise to 44 percent, meaning it would account for almost half of the index. This highlights a second paradox of the Chinese stock market: it is dominant but also underrepresented at the same time.

In the past three years, however, Chinese politics and the economy have changed. President Xi Jinping’s current focus appears to be setting a sustainable basis for the continued expansion of China’s global influence and overcoming the “middle-income trap” via an economy that generates greater added value and provides a better standard of living for its people (common prosperity). Recent years have seen crackdowns on major technology companies, such as Alibaba, indicating that wealth inequality and dominant market positions of private companies are frowned upon. At the same time, interest in a planned socialist economy appears to be growing. This is playing out in a restructuring of GDP away from infrastructure and real estate investments toward selected strategic industrial sectors and the increasing consumption of the domestic middle class. Likely to result in a lower future growth rate, this res—

tructuring understandably triggers uncertainty and insecurity among many western investors.

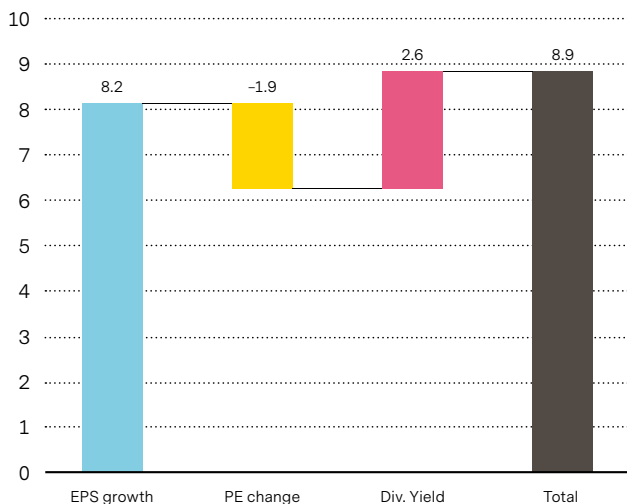
#### **Five patterns of investor response**

Based on these contrasting developments and their interpretation, investors are increasingly looking at different ways to incorporate China into their portfolio. The plain-vanilla approach of adopting a global EM equity framework in which China sits is starting to be challenged. Based on conversations with investors around the globe, we see five broad approaches emerging:

- 1. Taking full control:** Many investors want complete control of their exposure to Chinese equities and therefore set a target within their overall strategic asset allocation. This allows the level of exposure to be changed in line with comfort levels, as they either rise or fall. It requires separating China out of the overall global EM portfolio, akin to having a separate US equity allocation sitting alongside a Global ex-US equity portfolio. Although it makes intuitive sense, implementing such an approach in an active portfolio has not been straightforward during the past few years as product availability has been limited.
- 2. Limit exposure:** A more cautious interpretation or a lower risk appetite may lead investors to limit the weighting to current levels. Similar to the first option, this approach allows the investor to take control by effectively setting a ceiling for the Chinese equity exposure within their overall portfolio. Controlling the level of Chinese equity exposure can best be achieved by separating China from global EM equity.
- 3. Reduce exposure:** Some investors with a very long-term orientation have said they expect lower levels of Chinese economic growth, driven by deteriorating demographics and comparatively better structural growth opportunities in other emerging countries, such as India and Indonesia. They are therefore making a conscious decision to reduce their exposure to China. Once again, separating China from global EM equities makes this option more operationally feasible.
- 4. Maintain the status quo:** In this scenario, the investor has examined the issues and decides to continue

**Chart 1: Return decomposition MSCI EM ex-China Index**

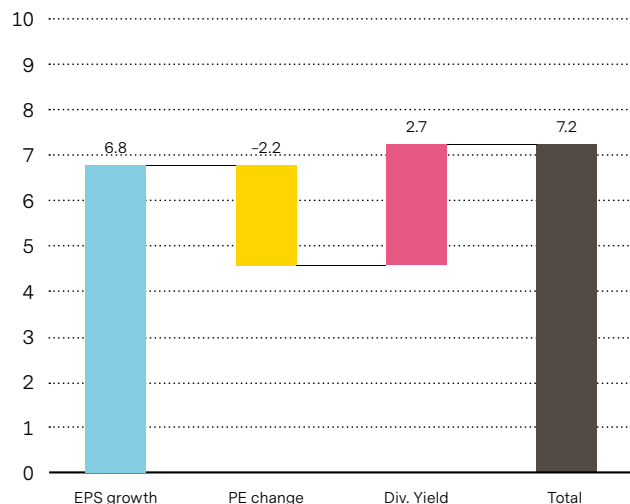
Return p. a. in USD (2002 – 2022), in %



Source: Vontobel Asset Management data, as of May 31, 2023

**Chart 2: Return decomposition MSCI EM Index**

Return p. a. in USD (2002 – 2022), in %



Source: Vontobel Asset Management data, as of May 31, 2023

investing in a global EM portfolio that includes China. This implies comfort with the following scenarios: an inclusion factor for Chinese equities nearing 100 percent and a Chinese equity market that's even more dominant in both the benchmark and the investor's own portfolio.

- 5. Zero exposure:** The fifth and most extreme option is the total removal of Chinese stocks from a client's portfolio. In our experience, this type of approach is rare and, if enacted, tends to be driven by ethical opinions on topics such as autocracy, human rights violations, freedom of expression, and the social surveillance of citizens. In this approach, return considerations are firmly in the background of the investor's mind—that is, the possible loss of return is consciously accepted.

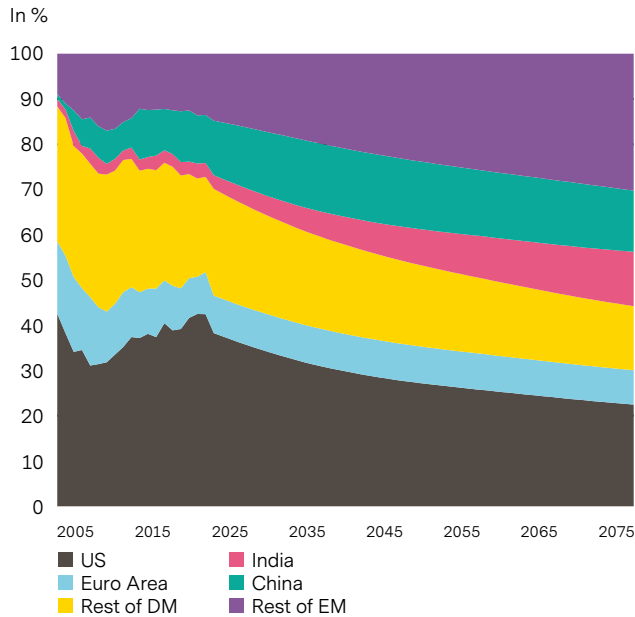
### A look at the past performance of EM ex-China

It can be helpful to consider how the EM ex-China approach has fared in the past. Let's start by looking at the annualized return for the period 2002–2022 (in US dollars): the MSCI EM Index returned 8.9 percent compared to 7.2 percent for the MSCI EM ex-China Index<sup>6</sup>, which makes sense given the Chinese economy's strong growth in both absolute and relative terms during this period. Breaking down the return—into the components

of earnings per share, earnings growth, valuation (P/E) change, and dividend yield—shows that valuations declined by a good 2 percent annually, both with and without China (see charts 1 and 2). Given that lower growth justifies a lower valuation, this can be explained by the declining (or even negative) growth premium of all EM, compared to the developed world, during this period. In addition, the past five years saw the MSCI EM ex-China index display slightly higher volatility.

### Excluding China doesn't necessarily eliminate its influence

An indication of the long-term development of an EM ex-China approach could come from looking at the link between expected population growth, economic growth, and stock market capitalization. While China's population is shrinking, decades of strong population growth remain forecast for nations such as India, Pakistan, Nigeria, and Indonesia. Economies with growing populations are expected to display stronger economic growth and—as GDP per capita means an increase in income and wealth, which in turn will be invested in stocks via pension assets—the market capitalization of stock exchanges could even increase disproportionately to population growth. This scenario would see India overtake China in terms of capitalization from around 2050 and the above-

**Chart 3: Share of global market cap by region / country**

Source: Goldman Sachs Investment Research, "The Path to 2075"

mentioned countries would be weighted more heavily in the MSCI EM index<sup>7</sup> (see chart 3). However, it is worth bearing in mind that emerging countries such as Nigeria and Pakistan are either not accessible to many professional investors or don't yet have a stock market compliant with institutional standards.

Imports and exports to and from the West are, in aggregate, even more important for most emerging economies than those to and from China. Moreover, since the Covid-pandemic, China's economic cycle has decoupled from that of other countries, which in turn has reduced the sensitivity of corporate profits to changes in profits and economic activity in China. However, if investors decide to forgo China in their EM approach—either in whole or in part—they should not forget just how

intertwined its economy is with the global one and those of other EM. Consider that China is now the largest single trading partner for almost all countries in Asia, South America and Africa.

There is no right or wrong answer to which approach is the most suitable. When considering how to include China in an EM portfolio, as with any investment decision, it must make sense for the investor and correspond to individual circumstances and beliefs. While the last few years have been difficult for the Chinese stock market, completely removing exposure from the second-largest market in the world might be an extreme move. Providing ex-China solutions allows investors to take control and make allocation decisions suited to their individual circumstances. Read the full article [here](#).

<sup>1</sup> As measured by the CSI 300 Index. Source: [The World Bank](#), April 20, 2023

<sup>2</sup> Source: [IME](#), May 1, 2023

<sup>3</sup> Source: Vontobel Asset Management, Bloomberg, data as of July 31, 2023

<sup>4</sup> Source: [Statista](#), data as of April 30, 2023

<sup>5</sup> Source: MSCI, Bloomberg; data as of July 31, 2023

<sup>6</sup> Source: Vontobel Asset Management, Factset; data as of May 31, 2023

<sup>7</sup> Source: Goldman Sachs Investment Research, The Path to 2075—Capital Market Size and Opportunity, June 8, 2023

<sup>8</sup> Source: [S&P Global Ratings](#)

# Adjusting expectations



—  
**Christopher Koslowski**  
 Senior Fixed Income & FX Strategist,  
 Vontobel

**We reiterate our constructive view on high-grade fixed income and maintain a defensive stance toward overall credit allocation, with a neutral position in investment-grade bonds and an underweight recommendation in high-yield.**

The Treasury market selloff throughout August was partially influenced by a surge in bond issuance. However, the predominant factor was the market adjusting its expectations regarding the trajectory of monetary policy. Over the course of one month, the 10-Year US Treasury yield surged over 30 basis points, climbing from 4 percent to its current rate of 4.36 percent—a peak not witnessed since 2007. It has since risen even further. This increase is largely attributed to a rise in real yields (see chart 1).

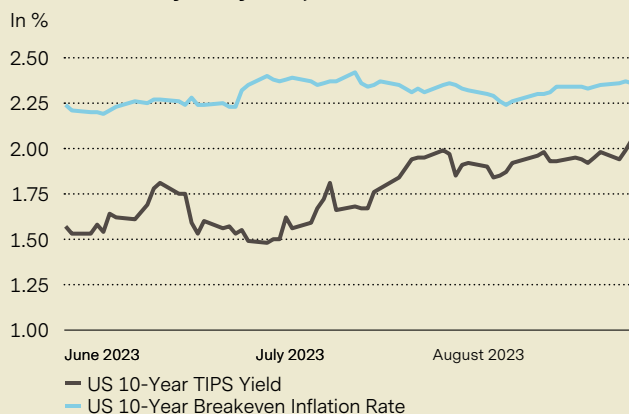
The outlook for economic growth has remained robust, and yields have reacted to positive surprises in growth while overlooking negative surprises in inflation. The Fed is likely close to concluding its most aggressive monetary policy tightening effort in 40 years. We believe that interest rates in the US are now sufficiently restrictive to bring inflation back down to the central bank's 2 percent target. Our constructive view on fixed income centers around

an expected less hawkish stance from the Fed, which we believe will result in a bullish steepening of the yield curve.

## Credit fundamentals continue to weaken

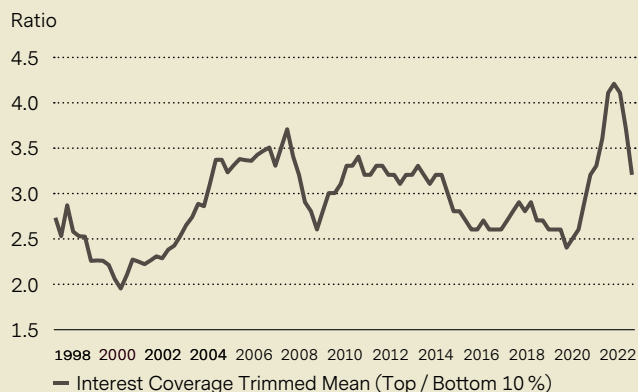
In spite of weakening credit fundamentals and growing default rates, corporate bonds have done well in recent months. At present valuations, though, corporate bonds are not very attractive. Considering the tightness in spreads, investors aren't adequately compensated for all the things that can go wrong in the next nine to 12 months. The excess return outlook is therefore poor, given the weakening credit quality. Weaker credit profiles have room to run, with gross margin and interest-cost pressures still accruing and the maturity calendar moving into view. Interest coverage ratios have fallen from high levels (see chart 2), reflecting a significant increase in interest expense, which is now growing at rates not seen for over two decades. The interest coverage ratio is a financial metric that helps determine how easily a company can pay its interest expenses on outstanding debt. A high interest coverage ratio indicates that the company can easily meet its interest obligations because it has a large amount of earnings before interest and taxes relative to its interest expense. A low ratio suggests the opposite, indicating potential financial distress if earnings decline.

**Chart 1: US real yields near 15-year high, with bond selloff driven by real yields, not inflation fears**



Source: Bloomberg, Vontobel

**Chart 2: Interest coverage declining sharply**



Source: Bloomberg, Vontobel

# A focus on quality and defensiveness to soften the blow



—  
**Mario Montagnani**  
 Senior Investment Strategist,  
 Vontobel

**The September effect, which has historically brought weak stock market returns with it, lived up to its reputation. Equity markets, which mostly closed in negative territory, saw high volatility in terms of performance. Higher energy prices further complicated the picture, spurring speculation about a possible second wave of inflation and the prospect of higher interest rates for an extended period of time, as was suggested by the Fed on the sidelines of its last meeting.**

These factors further weighed on stock markets. In the absence of catalysts, investors' eyes are now on the upcoming earnings season kicking off in October, which may already show signs of weakening momentum. If proven true, this would shake earnings growth prospects for 2024, estimated on average at over 10 percent for most markets and considered by many as too ambitious.

## A neutral stance

We continue to feel comfortable with our August decision to reduce our long-standing equities overweight to neutral. In our view, macroeconomic dynamics and the resulting central bank decisions will again be the main drivers

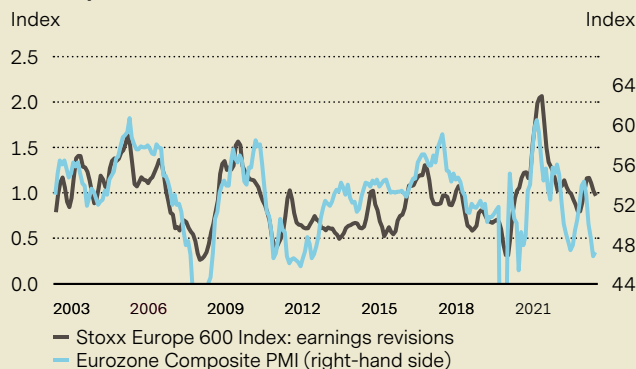
for equity markets from here on out. On this front, we believe that tightening cycles are in their final stages. As such, we believe that with a nine-month investment horizon, a constructive view on stocks makes sense. Regionally, we remain focused on quality, defensiveness, and strong earnings predictability, which we find in the US and Switzerland. In the US, the disinflation trend is proceeding rather smoothly despite the modest reversal seen in August and employment data show the labor market's normalization is at an advanced stage. In Europe, weakness in the manufacturing and services sectors confirm the deterioration of the macroeconomic environment. Leading indicators for the manufacturing sector have dropped below the 50-point threshold, the watershed between growth and contraction. In addition, there is still a substantial gap to earnings revisions, which are likely to be lagging behind the most (see chart 1).

## Favoring Swiss stocks

Recession risks have thus risen in Europe, with Germany, the region's largest economy, already finding itself in a technical recession.

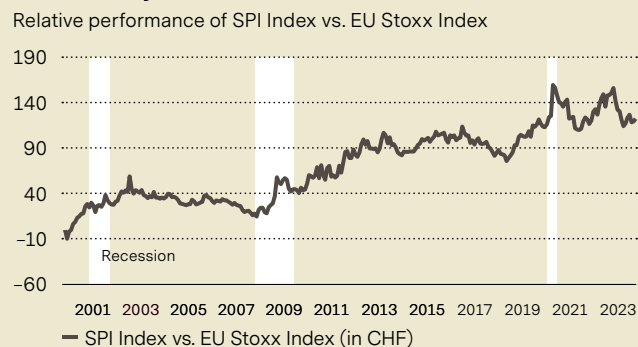
Swiss equities represent an effective hedge in periods of economic stress or, even worse, recessions. This, in combination with stable dividends and buybacks yielding a total of more than 5 percent annually, makes Swiss stocks an indisputable asset at this time (see chart 2). China, without decisive action by the central government to resolve the crisis in the country's real estate sector, lacks catalysts at the moment. More details on page 5.

**Chart 1: European stocks—sharp deterioration in the macro picture**



Source: IBES, LSEG, Vontobel

**Chart 2: Swiss equities—an excellent hedge in recessionary times**



Source: Bloomberg, Vontobel

# Adding fuel to the fire



—  
**Michaela Huber**  
Cross-Asset Strategist,  
Vontobel

**September was only a few days old when OPEC decided to extend its oil output cuts until the end of 2023. This was much longer than the expected one-month extension and made investors sit up and take notice.**

### Falling inventories and lack of swing producers fuel the bullish narrative

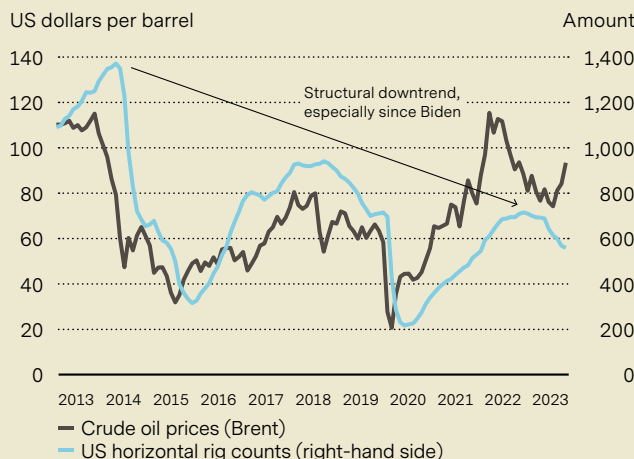
Concerns about supply shortages—the US Energy Information Administration already held out the prospect of falling inventories in mid-September—drove oil prices well above the 90 US dollar per barrel mark at the end of the month. Apart from regular inventories, the Strategic Petroleum Reserve (the emergency stockpile of oil maintained by the US Department of Energy) is also flashing warning signs. After the US government repeatedly tapped the reserve, stocks currently stand at just 351 million barrels. The last time inventories were similarly low was in the early 1980s. It is unlikely that US shale oil producers will be able to rush to the rescue. Horizontal rig counts, considered a leading indicator of future production, have been on a structural downward trend for years (see chart 1). At the same time, the US has already ramped up its oil

production. If the Department of Energy is to be believed, not much more oil is to be expected in 2024. After many speculators have burned their fingers in recent months, positioning is not yet overly bullish.

### The big “buts”: Recession, China, politics

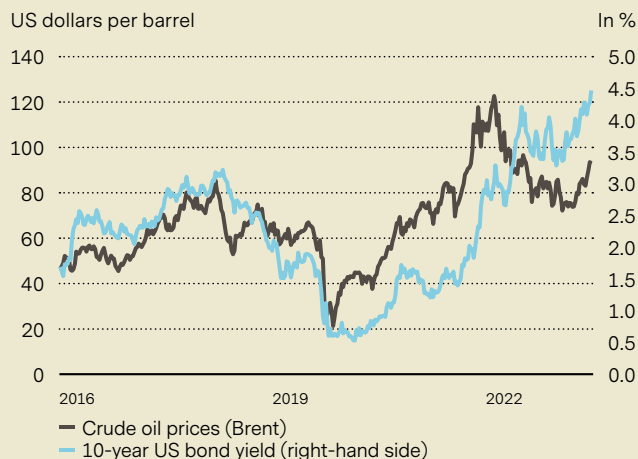
Despite the upside risks in the energy complex, we have decided to maintain our neutral view on commodities for several reasons. First, we continue to expect a US recession and lower bond yields. This is typically not a beneficial environment for commodities (see chart 2). Second, the Chinese economy remains weak (China is an important commodity consumer). Third, OECD oil inventories remain above the long-term average. It is also questionable whether Democrats will tolerate high oil prices before the elections, providing a strong incentive to tap the strategic reserve again. At the same time, Iranian oil production is rising after months of quiet diplomacy. Sanctions relief is also currently being discussed for Venezuela. Finally, the OPEC cartel is also walking a fine line, as the best cure against high prices is high prices. Demand destruction is not in the cartel’s interest.

**Chart 1: Swing producers are likely not coming to the rescue**



Source: LSEG, Vontobel

**Chart 2: Our key macro convictions argue against commodities**



Source: LSEG, Vontobel

# Against all odds



—  
**Christopher Koslowski**  
Senior Fixed Income & FX Strategist,  
Vontobel

**Contrary to our expectations of a tougher environment for the US dollar in the second half of the year, the greenback has continued to show widespread strength.**

The US Dollar Spot Index has experienced a notable recovery, climbing close to 6 percent since hitting a low just shy of 100 in July. Despite this resurgence, the index continues to trade within its annual range of 99 to 106 and is trading above the 50- as well as the 200-day moving average (see chart 1). The 50-day moving average indicates short-to-medium-term trends, while the 200-day moving average reflects long-term trends.

## Economic contrasts

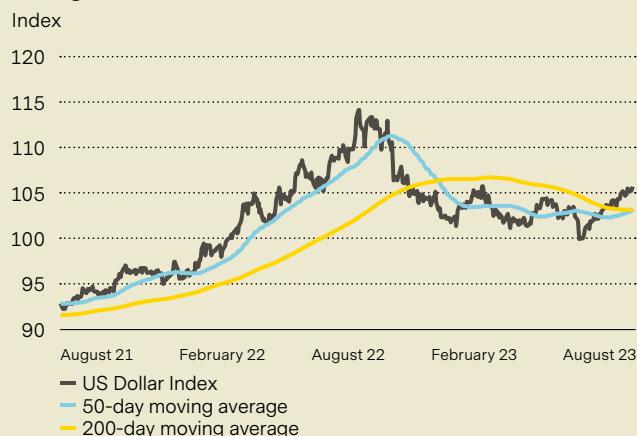
The US economy has shown remarkable strength recently. This robust performance is in sharp contrast to the underwhelming economic data from the Eurozone and widespread worries about the state of China's economy. While US short-term interest rates may have peaked or are close to peaking, the dollar's nature as a counter-cyclical currency means that subdued global growth could continue to support the dollar's strength in the immediate future. Further out, though, the dollar is expected to decline. It is still overvalued compared to its purchasing

power parity exchange rate, which has traditionally been a dependable indicator of the currency's future trajectory.

## Too early to discard our positive outlook for the euro

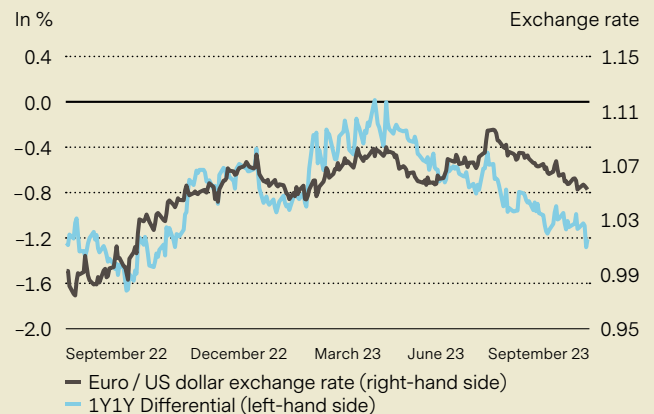
It has been a tough couple of months for the euro, falling more than 5 percent from its peak in July and down 2 percent since the start of September, alongside a pull-back in euro-dollar rate differentials (see chart 2). This shift was in part triggered by the Eurozone's economic data falling short of expectations. Moreover, China's challenges pose a greater concern for the Eurozone compared to the US. The euro's resilience might temporarily face more headwinds if the stream of news continues to be negative. Based on our current analysis and understanding, we anticipate that the US economy may experience a more pronounced slowdown toward the end of the year. Such a development would rejuvenate our optimistic outlook on the euro-dollar exchange rate, suggesting a potential strengthening of the euro relative to the dollar.

**Chart 1: The US dollar continues to show widespread strength**



Source: Bloomberg, Vontobel

**Chart 2: Pullback in euro-dollar rate differentials**



Source: Bloomberg, Vontobel

# Economy and financial markets 2021 – 2024

The following list shows the actual values, exchange rates and prices from 2021 to 2022 and consensus forecasts for 2023 and 2024 for gross domestic product (GDP), inflation/inflationary expectations, key central bank interest rates, ten-year government bonds, exchange rates, and commodities.

<b>GDP (IN %)</b>	<b>2021</b>	<b>2022</b>	<b>CURRENT<sup>1</sup></b>	<b>2023 CONSENSUS</b>	<b>2024 CONSENSUS</b>
Global (G20)	5.6	2.6	3.3	2.5	2.2
Eurozone	5.3	3.5	0.5	0.5	0.8
USA	5.9	2.1	2.5	2.0	0.9
Japan	2.3	1.1	1.6	1.8	1.0
UK	8.5	4.0	0.4	0.4	0.5
Switzerland	4.3	2.0	0.6	0.8	1.3
Australia	5.3	3.6	2.1	1.6	1.4
China	8.4	3.0	6.3	5.1	4.5

<b>INFLATION</b>	<b>2021</b>	<b>2022</b>	<b>CURRENT<sup>2</sup></b>	<b>2023 CONSENSUS</b>	<b>2024 CONSENSUS</b>
Global (G20)	3.5	7.3	3.7	5.2	4.2
Eurozone	2.6	8.4	5.2	5.6	2.7
USA	4.7	8.0	3.7	4.1	2.6
Japan	-0.3	2.5	3.2	3.1	1.9
UK	2.6	9.1	6.7	7.5	3.1
Switzerland	0.6	2.9	1.6	2.3	1.5
Australia	2.9	6.6	6.0	5.6	3.3
China	0.9	2.0	0.1	0.6	1.9

<b>KEY INTEREST RATES (IN %)</b>	<b>2021</b>	<b>2022</b>	<b>CURRENT</b>	<b>CONSENSUS IN 3 MONTHS</b>	<b>CONSENSUS IN 12 MONTHS</b>
EUR	-0.50	2.00	4.00	3.89	3.47
USD	0.25	4.50	5.50	5.55	4.65
JPY	-0.10	-0.10	-0.10	-0.10	-0.07
GBP	0.25	3.50	5.25	5.55	5.05
CHF	-0.75	1.00	1.75	1.94	1.71
AUD	0.10	3.10	4.10	4.20	3.65
CNY	3.80	3.65	4.35	4.30	4.25

<b>GOVERNMENT BOND YIELDS, 10 YEARS (IN %)</b>	<b>2021</b>	<b>2022</b>	<b>CURRENT</b>	<b>CONSENSUS IN 3 MONTHS</b>	<b>CONSENSUS IN 12 MONTHS</b>
EUR (Germany)	-0.2	2.6	2.73	2.43	2.30
USD	1.5	3.9	4.47	3.87	3.60
JPY	0.1	0.4	0.75	0.71	0.75
GBP	1.0	3.7	4.26	4.23	3.75
CHF	-0.1	1.6	1.08	1.13	1.04
AUD	1.7	4.1	4.34	3.96	3.49

<b>FOREIGN EXCHANGE RATES</b>	<b>2021</b>	<b>2022</b>	<b>CURRENT</b>	<b>CONSENSUS IN 3 MONTHS</b>	<b>CONSENSUS IN 12 MONTHS</b>
CHF per EUR	1.04	0.99	0.96	0.97	0.99
CHF per USD	0.91	0.94	0.91	0.89	0.89
CHF per 100 JPY	0.79	0.72	0.61	0.64	0.67
CHF per GBP	1.23	1.12	1.11	1.12	1.15
USD per EUR	1.14	1.06	1.06	1.09	1.13
JPY per USD	115.00	130.00	148.00	140.00	132.00
USD per AUD	0.73	0.67	0.64	0.66	0.70
GBP per EUR	0.84	0.88	0.87	0.87	0.87
CNY per USD	6.37	6.91	7.30	7.20	7.00

<b>COMMODITIES</b>	<b>2021</b>	<b>2022</b>	<b>CURRENT</b>	<b>CONSENSUS IN 3 MONTHS</b>	<b>CONSENSUS IN 12 MONTHS</b>
Brent crude oil, USD per barrel	79	86	94	85	87
Gold, USD per troy ounce	1,829	1,824	1,927	1,966	2,015
Copper, USD per metric ton	9,720	8,372	8,194	8,400	8,800

<sup>1</sup> Latest available quarter

<sup>2</sup> Latest available month, G20 data only quarterly

Source: Vontobel, respective statistical offices and central banks; as of September 22, 2023

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Bank Vontobel AG  
Gotthardstrasse 43  
8022 Zurich  
Switzerland  
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