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Vontobel

Investors' Outlook

Eyes on the end zone

March 2024

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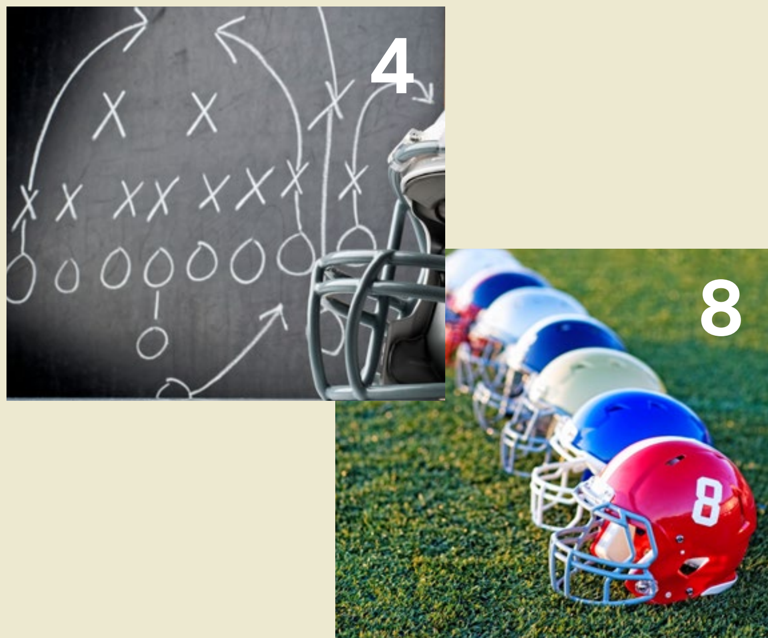

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Eyes on the end zone

—
Dan Scott
Head of Vontobel Multi Asset,
Vontobel

Dear readers,

US inflation kicked off the year stronger than anticipated, pouring cold water on investors' eager wait for the US Federal Reserve's (and other central banks') turn on interest rates. Fed Chair Jerome Powell previously made it clear that he's in no rush to slash rates just to fumble and risk inflation inching back up.

The market was probably overly optimistic in pricing in rate cuts as early as March, leading to the disappointment reflected in the recent market volatility. But inflation is still on a downward trend, and the world's biggest economy is—against all odds—far from being "benched". We continue to follow the economic data out of the US, especially as headline numbers veil the underlying signs of potential weakening, and think it's important to drown out the noise.

So, while one of the main topics for investors may now be the guessing game of when the first cuts—and how many—will occur, we believe the best course of action is to keep on moving the ball forward through the volatility that is poised to accompany the next few months by focusing on asset allocation and staying flexible. After all, the question is no longer if, but when rates come down; it's in the line of sight. Investors should resist being distracted by shorter-term volatility and focus on what their portfolios should look like, so they can be on the receiving end when conditions change.

In a scenario with relatively robust growth and moderating inflation, risk assets should be well-supported. At our last Investment Committee meeting, we decided to upgrade European equities as we believe that notoriously unloved Eurozone stocks may be poised for a recovery as the year progresses. That brings our overall position in equities to slightly overweight from neutral. In turn, we decided to reduce our exposure to commodities to underweight from neutral amid a mixed picture for global growth and our expectation for further moderating inflation.

We believe there is too much euphoria in bond markets and hardly any spreads for high-yield and investment-grade credit. We think it makes sense to stay defensive and see risk balanced in equities, which aren't overly expensive. The market could move higher, and there is more than USD 6 trillion of liquidity in money market funds.

In this Investors' Outlook, we take a closer look at whether China faces the same fate as Japan did in the 1990s, Vontobel's boutique heads' takes on quality investing, and our views on what the various rate cut expectations mean for currencies amid diverging economic signals.

The absence of a US recession doesn't necessarily mean that the Fed will refrain from cutting interest rates. Easing inflation may soon be enough reason to cut.

The journey may not be as swift as many investors had hoped, but we keep our eyes on the end zone.

→ Webcast
To view our webcast on recent market developments, click **here.**

—
Frank Häusler
Chief Investment Strategist,
Vontobel

Assessing on-field performance

February gave investors no shortage of surprising economic data to meticulously assess and anticipate central banks' moves.

The US economy and the Fed have been in the spotlight, with data repeatedly showcasing a resilient labor market and consumer. If you add the fact that the US manufacturing industry is on the verge of growing again and the services industry, which accounts for roughly two-thirds of the country's gross domestic product (GDP), is also gaining steam, it's no surprise there's growing optimism that a hard landing can be averted. We see the window for a recession closing if the job market and consumer spending don't weaken in the coming months. In any case, the Fed still plans to deliver 75 basis points of cuts this year, in line with their December 2023 projections.

Other economies are not faring as well. Japan, which has slipped to become the world's fourth-largest economy, and the UK have fallen into a recession. And while the Eurozone economy narrowly dodged one, the European Commission recently said it expects slower growth in 2024 than previously forecast and announced that the number of bankruptcy declarations had risen in the fourth quarter of 2023. Coupled with moderating inflation, the European Central Bank (ECB) is poised to cut rates in the coming months. The Swiss National Bank may beat its peers to the punch after inflation in Switzerland unexpectedly slowed in January, defying higher electricity prices and a value-added tax hike at the start of the year.

China's monetary policymakers seem reluctant to provide large-scale stimulus and are instead sprinkling little measures here and there to prop up the ailing economy. We don't expect any significant additional policy action anytime soon.

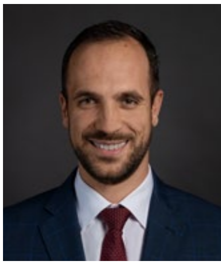
Turn to page 5 to see how these developments figure into our asset allocation.

	UNDERWEIGHT		NEUTRAL	OVERWEIGHT		
	significantly	slightly		slightly	significantly	
1 Liquidity		→				For a nine- to 12-month investment horizon, we expect returns from asset classes to outpace those from cash, which remains underweight.
2 Bonds			→			We keep our neutral view on fixed income, with a defensive tilt at sub-asset class level and a preference for government and emerging-market bonds, in which we have an overweight stance. We consider emerging-market debt to be more attractive than the high-yield segment, where we remain underweight. We reiterate our neutral view on investment-grade credit amid the overall segment's very low spreads, downgrades, and rising defaults.
3 Equities				↗		We upgrade equities to slightly overweight from neutral while remaining selective and defensive in our regional positioning. Central banks seem to be done with rate hikes, and for a good reason: In the US, the unemployment rate held steady at 3.7 percent. Inflation continues to abate, as can be observed in February's US consumer durable goods prices, in deflationary territory for the first time since May 2019. This should pave the way for possible rate cuts as early as the second quarter. This scenario, featuring relatively robust growth along with moderating inflation, should continue to provide support for valuations of risk assets in the mid-term. Our upgrade in equities results from moving Eurozone stocks to underweight from double underweight. Despite the higher cyclical profile and the regional economy still struggling, we believe Eurozone stocks may be poised for a recovery as the year progresses. We continue to prefer quality, which we see best reflected in US and Swiss stocks, where we remain overweight. Despite the disappointing start to the year, a scenario of lower yields should play in favor of defensive Swiss equities. We stay neutral for Japanese and emerging-market stocks.
4 Gold				→		Stronger-than-expected US economic data and concerns that the disinflation progress may have stalled somewhat prompted Fed officials to adopt a more hawkish tone. This has challenged market expectations of an imminent rate cut and put pressure on gold. While the yellow metal still receives some support from the geopolitical side, further upside is limited in the absence of rate cuts. However, we reiterate our positive view on gold. We see lower US real yields and a weaker US dollar, which tend to be supportive for the precious metal. Gold also remains a good hedge against a recession.
5 Commodities		↘				Our equity trade is funded by reducing commodities to underweight from neutral. The global economic growth picture remains mixed at best, which prompts us to be more cautious on this very cyclical asset class. Our expectation of further moderating inflation argues against a neutral view on commodities. Upside risks include escalating geopolitical tensions and a stronger-than-expected acceleration of the Chinese economy, though that's not our base scenario. China is currently exporting deflation globally as its economy stumbles and excess capacity leads exporters to cut prices on products sold abroad.
6 Alternative strategies			→			We keep our neutral take on alternative funds and real estate. Within alternative funds, we like insurance-linked securities. They tend to have a low correlation with traditional financial markets as their performance is linked to specific insurance events, which can help reduce overall portfolio risk.

Changes month-on-month: same → higher ↗ lower ↘

Can China dodge a "Japanification" fumble?

Sony's Walkman as a coveted technology gadget. Nintendo's early gaming consoles that made children's hearts beat faster. Along with Toyota's and Honda's cars making their way onto the world's streets, these Japanese success stories were the embodiment of a phoenix rising from the ashes after the country's industry was almost completely destroyed during World War II. But the economic miracle didn't last, resulting in the "Lost Decade" and China subsequently taking its place as the world's second-largest economy. Comparing the Japan of yesteryear with today's China raises the question whether China could soon face a similar fate.



—
Stefan Eppenberger
Head Multi Asset Strategy,
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—
Michaela Huber
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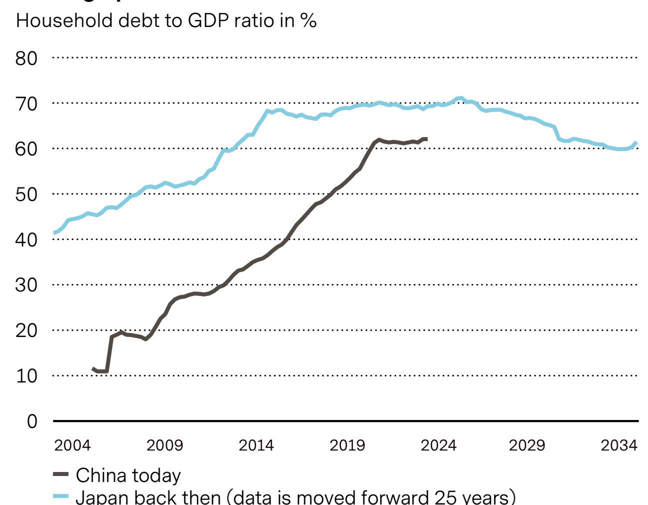
Japan experienced an economic boom after World War II up to the early 1990s. In 1988, Japan's theoretical land value exceeded all of that in the US (which is almost 25 times the size of Japan) by a factor of four to five, and real estate prices climbed to dizzying heights. A year later, eight of the world's 10 largest companies by market capitalization were domiciled in Japan, and the Nikkei 225 stock index soared from one high to the next.

Bank of Japan (BoJ) policymakers were concerned about the overheated economy, though mostly stayed on the sidelines, especially in the aftermath of the 1987 Black Monday shock. But one week after Yasushi Mieno took office as Governor of the BoJ at the end of 1989, he raised interest rates, saying the move would contribute to sustainable growth driven by domestic demand while simultaneously maintaining price stability. More hikes followed over months. Then, the Japanese asset bubble burst, triggering a balance sheet recession[1] and ushering in the "Lost Decade". The Nikkei 225 lost almost two-

Chart 1: Both countries grew with more and more leverage prior to their economic slowdown
Household debt to GDP ratio in %



Source: LSEG, Vontobel; data as of February 9, 2024.

[1] A balance sheet recession is a period characterized by deflation and weak growth and occurs when high levels of private sector debt lead to a slowdown or decline in economic growth amid a focus on repaying debt rather than investing or spending. According to economist Richard C. Koo, fiscal policy, not monetary policy (i.e., rate cuts), should be used to fight a balance sheet recession.

thirds of its value by 1992, while real estate prices plummeted around 70 percent by 2001.

China as the "Japan 2.0"?
There are similarities worth considering, such as the high level of debt. In the 1990s, Japanese household debt amounted to almost 70 percent of GDP. China's debt has swelled to 62 percent in the third quarter of 2023 (the latest available data) from around 11 percent in the early 2000s (see chart 1).

The state of China's real estate market evokes memories of what transpired in Japan. Property developers' heavily leveraged business model has come under pressure after years of soaring Chinese house prices, and a Hong Kong court in January ordered the liquidation of troubled real estate developer Evergrande. A further escalation of the crisis could have a drastic impact, as the real estate market accounts for almost 30 percent of China's GDP.

China's GDP growth is expected to slow to 4.6 percent this year and to 3.5 percent in 2028, from around 5 percent in 2023, according to the International Monetary Fund. This is also reflected in lower price pressure, with signs mounting that China faces even more deflation. Lower prices may be positive at first glance, but harbor the risk that consumers postpone purchases in anticipation of even lower prices and thus of a deflationary spiral, as has been seen in Japan for decades.

Both countries are grappling with unfavorable demographic trends, such as a shrinking working population. Japan's fertility rate (number of births per woman) peaked in 1967 at 2.2 and has fallen continuously since then, dropping to 1.5 in the early 1990s and remaining at 1.3 since 2020. China's latest available fertility rate (2021) is even lower, at 1.2.

Deteriorating US-Chinese relations over the last few years (trade war, "near-shoring" or "friend-shoring", etc.) is also reminiscent of Japan, which faced increasing US criticism for unfair trading practices[2].

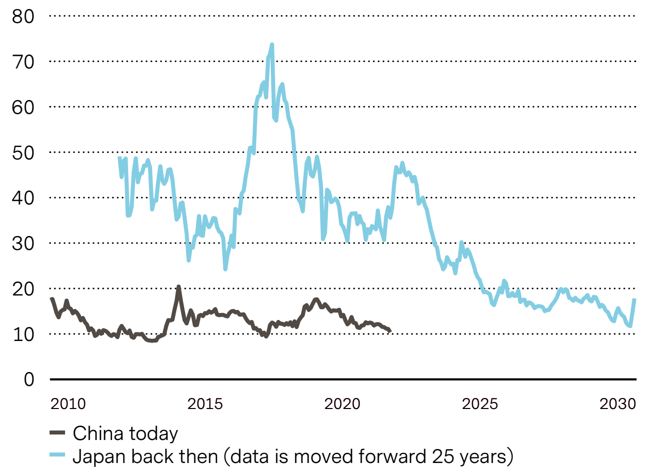
What speaks against a Japanification of China?
For one, the Chinese economy appears to be struggling primarily with a hot real estate market, but not with a hot stock market. The Nikkei 225 was trading at 70× price to earnings (P/E) at the height of the Japanese bubble, while the Shanghai Composite is currently trading at around 12× (see chart 2).

The Japanese yen appreciated 20 percent in just a few months after the 1985 Plaza Accord[3]. That's not the case for the Chinese yuan, which, unlike the free-floating yen, is pegged.

Despite its growing influence in the world, China is still an emerging market. Developments like years of increasing urbanization speak against a Japanification of China as it's often associated with higher economic growth. And finally, Chinese decision-makers do have one advantage: they can draw lessons from Japan's economic history.

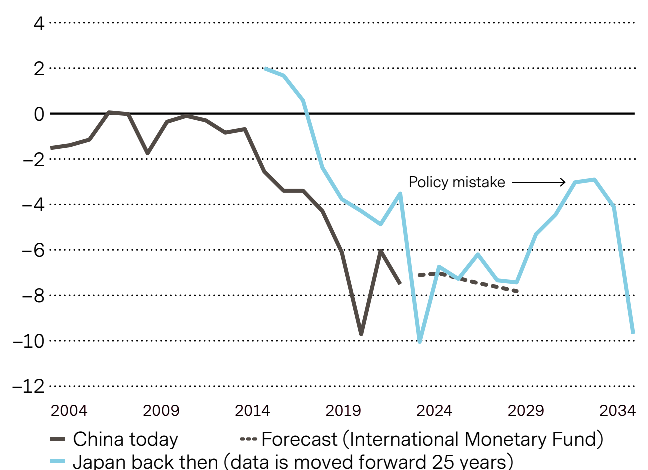
Food for thought
While we count several parallels between China today and Japan in the 1980s and 1990s, it's not a one-to-one comparison. Should China face the same situation as Japan, it would reverberate throughout the global economy, given China's much higher contribution to the world's GDP and its importance for commodity markets. China will probably have to bolster the economy with a supportive fiscal policy rather than via monetary policy (see chart 3).

Chart 2: No Chinese stock market bubble
Equity valuation: 12-months forward price-to-earnings ratio



Source: LSEG, Vontobel; data as of February 9, 2024.

Chart 3: Can China avoid a structurally high fiscal deficit to counter a balance sheet recession?
Fiscal deficits in % of GDP



Source: LSEG, Vontobel; data as of February 9, 2024.

[2] Source: Article by Bruegel think tank, "Will China's trade war with the US end like that of Japan in the 1980s?", published May 13, 2019.
[3] An agreement between France, West Germany, Japan, the US, and the UK to weaken the overvalued US dollar.

A question of perception: how quality investing evolves over time

—
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Andrea Gentilini
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In the 1980s, most equity managers were defined as either growth or value; quality was merely a niche. Today however, quality is a distinct and popular approach for a compelling reason: it has worked. Over time, the definition of quality has broadened and become subject to a variety of interpretations, with sometimes significant divergence in the performance of quality strategies depending on market conditions. Four Vontobel investment experts explore the nuances of quality, and what investors can expect from a quality approach in 2024.

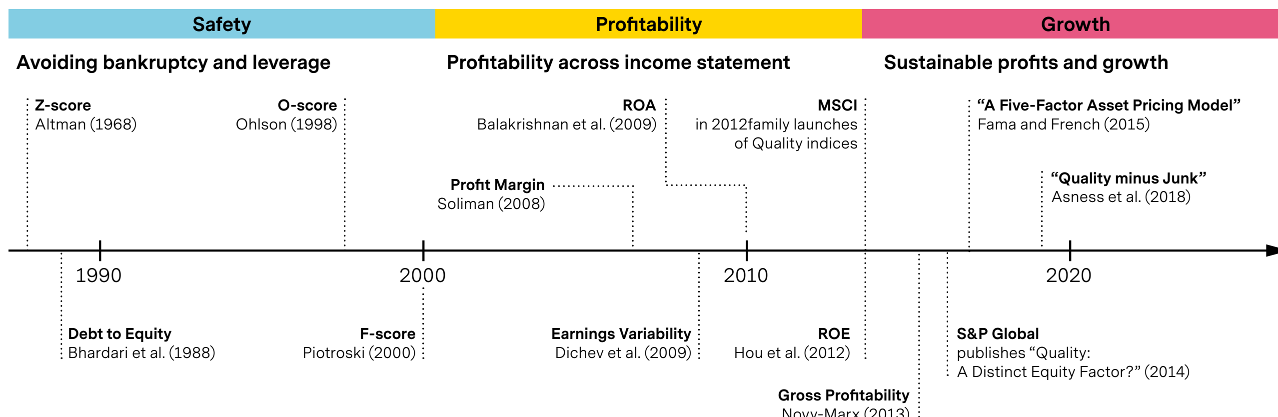
— Is there an academic definition of quality and how has it evolved?
Andrea Gentilini, Head of Quantitative Investments: Yes, and the definition has evolved because specific aspects of quality became more relevant for investors over different time periods. In the early days, investors focused on measures such as the debt-to-equity ratio to gauge a company's leverage. The quality lens then evolved to profitability across the income statement and most recently it morphed into growth and elements of stability, with much of today's academic literature focused on persistence (see chart 1: "Quality minus Junk"). Going forward, we expect quality measures to shift toward impact on the planet and society, with some recent research on the correlation between quality and ESG factors illuminating this trend.

— How do you find quality companies across industries and geographies?
Matthew Benkendorf, CIO Vontobel Quality Growth Boutique: As an active manager, we implement quality by consistently looking for business models with elements of safety, profitability, and growth throughout the cycle. Looking back to the internet bubble, some argued that 'eyeballs' (website visits) should replace earnings as a profitability yardstick. Today, some argue that investing outside a strategy's stated objective, i.e., style drift, is a viable strategy. We disagree and stick to our distinct quality discipline over time.

In seeking quality, we require a minimum track record of profitable growth before investing. In our view, a transformational company will continue to show earnings and growth potential after 5 years. If you invested in Amazon in 2010, thirteen years after its IPO and with a 5-year track record of profitable growth, your original investment would have multiplied by 17 times today. Active managers can add value by identifying companies with not only historical track records of competitive advantages, but those that can also be sustained into the future.

Jean-Louis Nakamura, Head of Vontobel Conviction Equities Boutique: Quality companies tend to have strong industry positions and the ability to invest in future growth. However, we do look at different quantitative metrics when assessing quality between industries, not only at the company level, but in the context of the industry itself. For instance, in heavy asset industries such as energy and mining, we look more closely at a company's ability to consistently deliver profits, whereas in the biotechnology segment of the health care industry, we look more closely at a company's ability to reinvest in R&D, as well as its innovation process. By geography, we may use similar factors when evaluating quality in our Swiss universe compared to emerging markets, but our qualitative analysis, which includes meetings with management, will certainly be different.

Chart 1: The definition of quality has evolved, adapting to the market sentiment of the time



Source: Vontobel, for illustration purposes only. From 1968–2024.

Matt: Quality companies can prove more enduring in developed markets and, given a greater understanding of quality approaches, they are more likely to be broadly used there. The picture is a little different in emerging markets—as a style, quality is not as well established there and it's evolving more rapidly. Quality is cheaper in EM because of the inherent risks and it also requires more patience, while valuation is becoming a more important element in developed markets.

Jean-Louis: We constantly refine how we assess industry positioning, which can be challenging in today's regulatory environment and competitive playing field. It's a delicate balance to be forward-looking while not deviating too much from our definition of quality, which is why a solid academic framework is important.

— Will quality stand the test of time?

Andrea: Style factors—quality, momentum, value, volatility, and size—help explain performance amid increasingly complex global markets. Understanding how each of these drives returns and risk in a portfolio can help investors choose an optimal mix of strategies. Factor investing ranks companies along a metric (aka the factor), and then observes whether the highest-ranked companies outperform the bottom-ranked. Since 2001, the quality factor has outperformed 83 percent of the time (see chart 2).

— Is quality more tactical or strategic?

Dan Scott, Head of Vontobel Multi Asset: Most of our multi-asset returns come from strategic asset allocation (SAA), with only a small amount from tactical asset allocation (TAA). So for us, investing in quality is not a question of timing, rather it's a strategic decision. This is because losing less in down markets can be the key to successfully compounding wealth over time. The low volatility associated with quality investing also removes the behavioral bias, and investors are less likely to act irrationally, e.g., sell low and buy high.

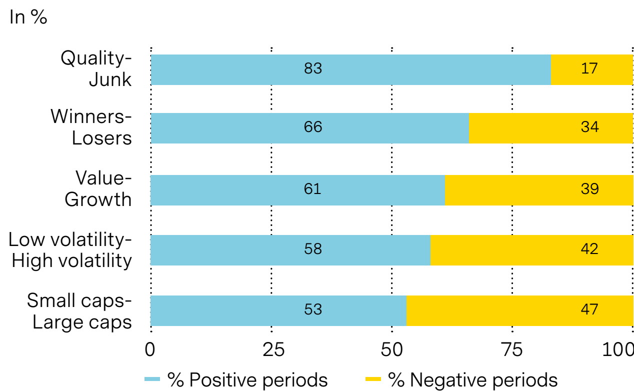
Quality can be expensive, but over the long-term investors can be well compensated for paying what seems like a high price. Take Nestlé, for example. A Swiss company perceived as 'boring,' yet since 1996 its total return exceeded 12 percent annually, handily beating the MSCI World Index, which returned 6.9 percent. Even when dividends are removed, a large portion of Nestlé's returns, it still outperforms.

— Is there a correlation between quality and growth?

Jean-Louis: Quality and growth are undoubtedly two distinct factors and should be viewed as such. Many of the metrics that are used to characterize quality are related to fundamentals, such as margins, sales, and revenues. The last decade of accommodative monetary policy was supportive of sales growth and margin expansion, which has

Chart 2: The quality factor – top-rated companies outperform the bottom most often

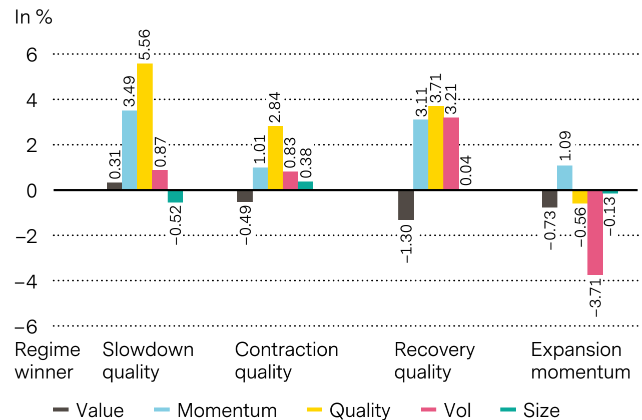
In %



Source: FactSet, Bloomberg, and Vontobel; for the period from January 2001 to November 2023.

Chart 3: Relative outperformance of the MSCI factor indices vs. MSCI World since January 1990

In %



Source: LSEG, Vontobel. As of November 2023.

led to a success story for many growth companies, some of which are now deemed 'the magnificent 7'. But that has not been the case for all companies, which is why we believe a clear distinction between quality and growth is important.

Matt: While growth is often interpreted as synonymous with quality, solely focusing on growth to the exclusion of all else can be detrimental. If investors don't get quality right, they miss downside capture and are subject to greater risk because they also lose valuation discipline, which will become more relevant as we journey through 2024.

— How do you reconcile a short-term mismatch between a quality company and its long-term returns?

Matt: It requires patience, which is a difficult but crucial element of investing. Consider health care businesses, particularly MedTech—they have the potential to grow predictably for years to come, yet in 2023 the market ebbed and flowed around them, focusing on euphoria in the tech space. This year they may be affected by the election cycle or rhetoric around regulation. Health care is a prime example where patience is required for long-term returns, despite short-term mismatches.

— How does quality perform in different macro regimes?

Andrea: Among the five factors, it is true that momentum performs well in all regimes, but in those where quality performs well, it does markedly better (see chart 3). How we view the future regime is important—most investors don't expect the rampant, liquidity-fueled bull market of the past decade to continue into the next one. With an expansion regime unlikely, quality is a good path.

— Is now the time for quality?

Dan: We expect true quality companies are well poised to deliver returns going forward where the cost of capital will be higher and GDP growth will likely be lower than what we've become accustomed to in the zero-interest rate environment of the past. Avoiding losses over time is part of a sound investment process, and as the landscape becomes more volatile investors' focus will shift to a company's quality of earnings, its ability to generate return on invested capital, and the efficiency with which it manages its capital. That said, in our view, investing in quality is not really an issue of timing since the bedrock elements of quality should remain a constant in any balanced portfolio.

The Fed's dilemma

—
Christopher Koslowski
Senior Fixed Income & FX Strategist, Vontobel

As the year unfolds, Fed officials face a situation that would typically be welcome: Inflation has decreased more rapidly than anticipated. However, this situation also presents a conundrum.

The issue is that with inflation consistently approaching the Fed's 2 percent goal, real rates—those adjusted for inflation—have increased, potentially over-tightening the grip on economic activity (see chart 1). Given the Fed's best estimate of a "neutral" nominal policy rate that neither stimulates nor slows growth, or inflation at 2.5 percent (0.5 percent in real terms), anything above that is essentially still weighing on the economy. This suggests the Fed could comfortably cut rates without changing its "higher for longer" mantra. Monetary policy would remain restrictive. The challenge lies in determining the timing and magnitude of rate cuts that are likely to begin in the second quarter. According to the Fed's latest summary of economic projections, the central bank intends to reduce its policy rate this year by at least 75 basis points.

Tight lending standards

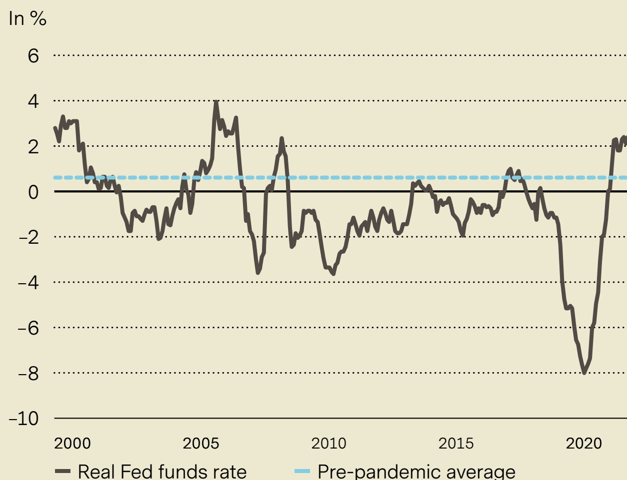
The Fed's Senior Loan Officer Opinion Survey shows that while banks tightened their lending standards through the fourth quarter of 2023, the proportion has decreased from previous quarters.

A significant net share of banks reported fewer inquiries from potential borrowers regarding the availability and terms of new credit lines or increases in existing lines (see chart 2). This suggests US businesses remain very cautious and reluctant to put money to work right now. There appears to be "decreased customer investment in plant or equipment and decreased financing needs for inventories, accounts receivable, and mergers or acquisitions," according to the report. Less borrowing often reflects declining investments by businesses and a drop in hiring activity, which in turn weighs on economic growth. In the past, tighter lending standards have led to a widening spread between yields for riskier corporate bonds and government bonds.

Current tight spreads don't compensate for the expected hit to corporate balance sheets from higher funding costs, in our view. We reaffirm our positive outlook for high-quality bonds and maintain a defensive stance on overall credit allocation, with a neutral and underweight position on investment-grade bonds and high-yield, respectively.

Chart 1: The invisible hand – unveiling the real Fed funds rate

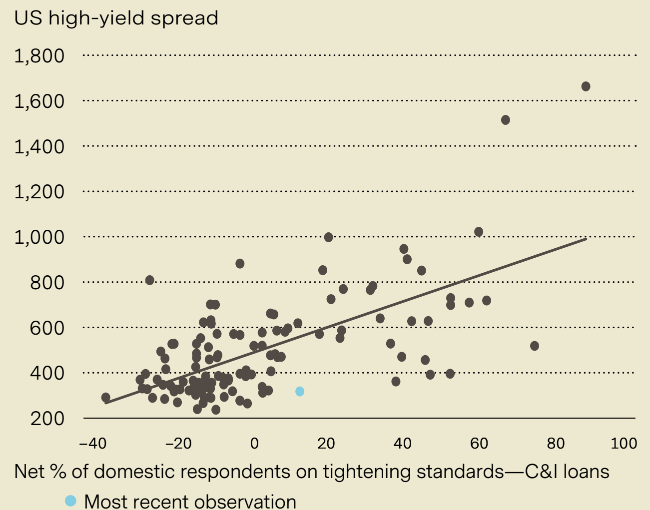
In %



Source: Bloomberg, Vontobel; data as of February 14, 2024

Chart 2: The tight grip of lending standards and the rise in borrowing costs

US high-yield spread



Source: Bloomberg, Vontobel; data as of February 14, 2024

A tactical move

—
Mario Montagnani
Senior Investment Strategist,
Vontobel

After the "almost everything rally" that characterized November and December, equity investors have become more selective since the beginning of January. On the one hand, the combination of solid data on economic growth and strong employment figures further fueled hopes of a soft landing. On the other hand, mixed inflation data for December and January, along with a strong economy, led central banks to push back on impending rate cuts.

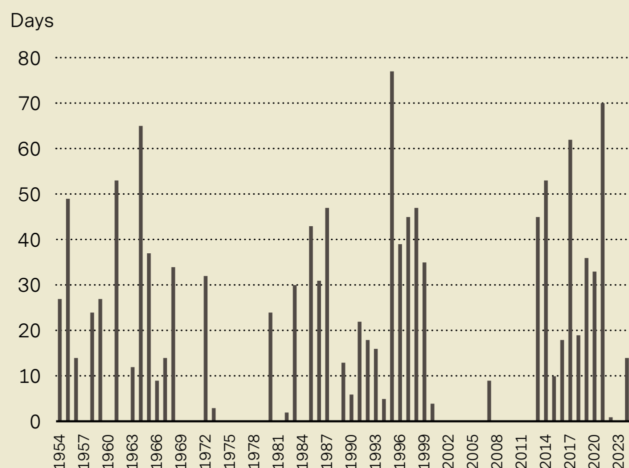
This was particularly the case for the Fed, which clearly adopted a less dovish tone at its meeting in late January. Still, at the time of writing, markets are powering ahead, with the MSCI ACWI Net Total Return Index up more than 3 percent year-to-date, reaching a record high and topping the December 2021 peak. Too much, too soon? We do not think so and tactically upgrade equities to overweight.

The US market remains a substantial driver behind global indexes, which reminds us of what transpired in 2023, when US technology-linked mega-caps led the way. In the US, encouraging earnings, particularly in the large-cap technology segment, and supportive macroeconomic data pushed the S&P 500 Index above the 5,000 mark for the first time and to its 14th all-time high since the beginning of 2024 (see chart 1).

February saw the biggest single-day market cap addition in history, with Meta topping the leaderboard after posting fourth-quarter earnings and an almost USD 200 billion jump in market cap (see chart 2). A glance at Europe shows a similar picture, with the Stoxx Europe 600 Index in positive territory as well, driven by technology, communication services, consumer discretionary (particularly luxury goods), and financials. At the tail end, we have emerging markets, still in consolidation. Chinese stocks reflect a struggling economy, as evidenced by disappointing retail sales and a further deterioration in real estate activity.

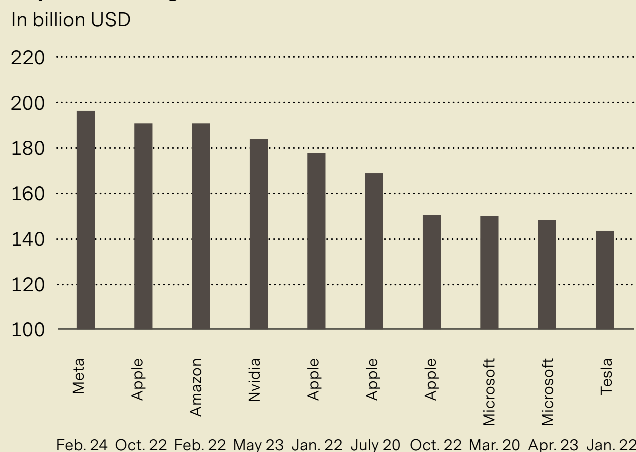
Looking ahead
Growth estimates for 2024 and 2025 do not seem too ambitious. A likely dovish shift in central banks' language should be supportive for valuation multiples, not to mention a major swing factor for assets currently invested in money-market funds. In that spirit, by taking a nine- to 12-month horizon, the Vontobel Investment Committee tactically lifts equities to overweight while remaining regionally diversified and favoring earnings predictability, which we believe can be found in Swiss and US equities. Find more details on page 5.

Chart 1: S&P 500 Index – Flying high



Source: LSEG, Vontobel; data as of February 16, 2024

Chart 2: Top 10 biggest single-day market capitalization gains in history



Source: Bloomberg, Vontobel; data as of February 16, 2024.

Oil's economic drill

—
Michaela Huber
Cross-Asset Strategist,
Vontobel

There has been plenty of geopolitical support for oil recently—attacks on Russian oil infrastructure, failed efforts to achieve a ceasefire in Gaza, or uncertainties in the Red Sea. Despite the tense situation, oil prices have been trading between USD 75 and USD 85 for months.

There are mixed signals from the demand side. The International Energy Agency reduced its forecast for global oil demand, now expected to only grow by 1.2 million barrels per day (mbpd) in 2024 due to the weakening Chinese economy. This is less than a previous forecast for 1.24 mbpd. The Organization of the Petroleum Exporting Countries (OPEC) is much more optimistic with its call for 2.25 mbpd. Meanwhile, travel-hungry consumers support jet fuel demand, while solid US economic data buoys hopes for a soft landing (see chart 1).

On the supply side, US oil production, which reached a record high of over 13.3 mbpd at the end of 2023, according to the Energy Information Administration, which was lower than expected in January (12.6 mbpd). Extreme weather caused wells and pipelines to freeze. Along with a series of planned shutdowns, this led to a slump in refinery production to its lowest level since the end of 2022. At almost the same time, the Energy Information Administration said US oil inventories rose by 12 million barrels in the first week of February, significantly more than the expected 2.6 million barrels. While the increase was probably partly due to lower refinery activity, some interpreted it as a sign of weakening demand.

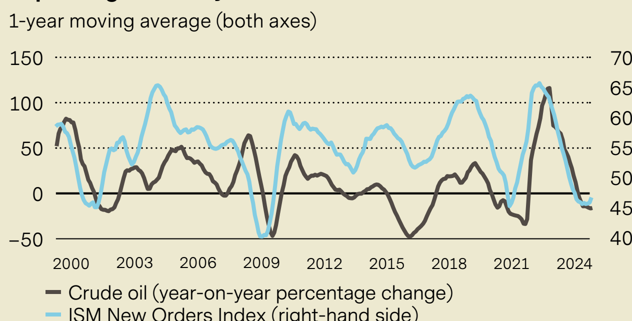
OPEC cuts

OPEC and its allies will continue with their announced production cuts until the end of the first quarter. Saudi Arabia indicated the curbs may continue beyond that. However, in view of the accumulated excess capacity and the fact that Saudi Arabia will have to shoulder most of the cuts alone, market participants appear to have doubts as to whether words will really be followed by deeds (see chart 2). The U-turn on Saudi Aramco's planned capacity expansion was also seen as bearish by some. The Kingdom instructed the state-owned energy company to aim for a maximum capacity of 12 mbpd by 2027, one million less than previously announced.

While geopolitical escalation or a significant reacceleration of the Chinese economy is not our base case, it remains a tail risk that could push prices significantly higher. In the absence of unexpected shocks, oil should continue to trade in a range of USD 75 to USD 85.

Chart 1: Leading indicators suggest an improving economy

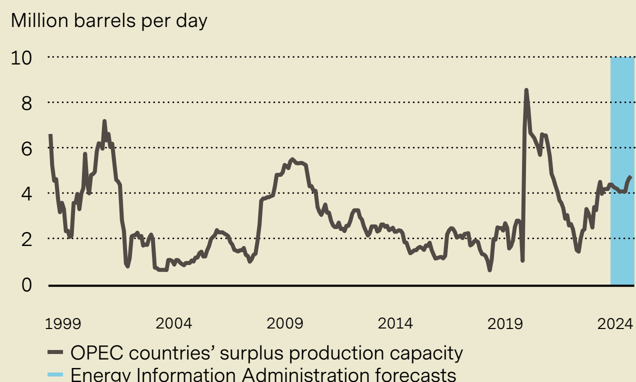
1-year moving average (both axes)



Source: LSEG, Vontobel; data as of February 16, 2024

Chart 2: Surplus capacity will become a topic in 2024

Million barrels per day



Source: LSEG, Vontobel; data as of February 16, 2024

A Swiss surprise

—
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The Swiss franc depreciated slightly against the euro and weakened more significantly against the US dollar in January, which is when SNB President Thomas Jordan said the central bank is increasingly worried about the franc's strength and its negative impact on Swiss businesses. This acknowledgement may be seen as a first step towards actively managing the franc lower.

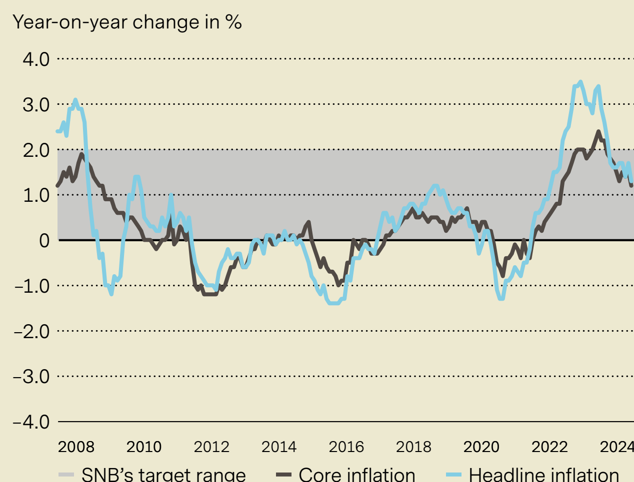
A strong currency is no help amid worries about an economic downturn and deflationary conditions. While it's unlikely that the SNB will start selling Swiss francs outright, merely halting purchases amid lower yields in Switzerland could contribute to a weakening of the franc over the course of this year.

Swiss inflation data took an unexpected turn in January, possibly paving the way for the SNB to consider rate reductions sooner than anticipated. Headline consumer prices increased 1.3 percent from a year earlier, significantly below the 1.7 percent economists had forecast. The core inflation rate, which excludes the impact of volatile items such as energy and food, decelerated to 1.2 percent from 1.5 percent (see chart 1). This decline came as a particular surprise, as some prices within the Swiss economy are controlled. Moreover, electricity costs and the value-added tax increased at the start of the year. Economists were initially eyeing September for the SNB to commence rate cuts, but the lower-than-expected inflation has prompted some to bring that timeline forward. The market-implied probability for a 25-basis point cut in March has doubled to more than 60 percent from around 30 percent. The SNB, unique among its global counterparts, convenes quarterly, making its schedule less flexible.

US dollar's return to strength
The euro's decline partially reflects a correction from the overly rapid sell-off of the US dollar in November and December, with January witnessing a retracement of some of those movements (see chart 2). It's challenging to be optimistic about the euro-dollar exchange rate, given the stark contrast between strong US economic indicators and lackluster news from the Eurozone. The question remains whether the favorable economic narrative in the US will persist, which would influence yields and the outlook for the dollar in 2024.

Investors are laser-focused on when rate cuts will begin. The ECB said there was "broad consensus" that it was premature to discuss policy rate cuts at the January meeting, but there is no doubt it's moving towards them. ECB President Christine Lagarde pushed back against market expectations, emphasizing the importance of more data and being further along in the disinflation process.

Chart 1: Swiss inflation shows surprise slowdown



Source: Bloomberg, Vontobel; data as of February 14, 2024

Chart 2: Dollar bulls back in charge

Source: Bloomberg, Vontobel; data as of February 14, 2024

Economy and financial markets 2022 – 2025

The following list shows the actual values, exchange rates and prices from 2022 to 2023 and consensus forecasts for 2024 and 2025 for gross domestic product (GDP), inflation / inflationary expectations, key central bank interest rates, ten-year government bonds, exchange rates, and commodities.

GDP (IN %)	2022	2023	CURRENT[1]	2024 CONSENSUS	2025 CONSENSUS
Global (G20)	2.9	2.7	2.9	2.3	2.6
Eurozone	3.4	0.5	0.1	0.5	1.4
USA	1.9	2.5	3.1	1.6	1.7
Japan	1.0	2.0	1.0	0.8	1.0
UK	4.5	0.3	–0.2	0.4	1.2
Switzerland	2.7	0.8	0.4	1.2	1.5
Australia	3.8	1.9	2.1	1.4	2.2
China	3.0	5.2	5.2	4.6	4.4

INFLATION	2022	2023	CURRENT[1]	2024 CONSENSUS	2025 CONSENSUS
Global (G20)	7.5	4.4	3.6	5.3	3.3
Eurozone	8.4	5.5	2.8	2.3	2.1
USA	8.0	4.1	3.1	2.7	2.3
Japan	2.5	3.2	2.6	2.2	1.7
UK	9.1	7.3	4.0	2.6	2.1
Switzerland	2.8	2.2	1.3	1.5	1.4
Australia	6.6	5.7	4.1	3.4	2.8
China	2.0	0.2	–0.8	1.0	1.7

KEY INTEREST RATES (IN %)	2022	2023	CURRENT	CONSENSUS IN 3 MONTHS	CONSENSUS IN 12 MONTHS
EUR	2.50	4.50	4.50	4.25	3.25
USD	4.50	5.50	5.50	5.15	3.90
JPY	–0.10	–0.10	–0.10	–0.02	0.05
GBP	3.50	5.25	5.25	5.05	3.85
CHF	1.00	1.75	1.75	1.60	1.16
AUD	3.10	4.35	4.35	4.35	3.70
CNY	3.65	3.45	4.35	4.25	–

GOVERNMENT BOND YIELDS, 10 YEARS (IN %)	2022	2023	CURRENT	CONSENSUS IN 3 MONTHS	CONSENSUS IN 12 MONTHS
EUR (Germany)	2.6	2.0	2.38	2.19	2.15
USD	3.9	3.9	4.27	3.87	3.69
JPY	0.4	0.6	0.74	0.85	0.95
GBP	3.7	3.5	4.09	3.79	3.55
CHF	1.6	0.7	0.91	0.85	0.96
AUD	4.1	4.0	4.19	4.27	3.87

FOREIGN EXCHANGE RATES	2022	2023	CURRENT	CONSENSUS IN 3 MONTHS	CONSENSUS IN 12 MONTHS
CHF per EUR	0.99	0.93	0.95	0.96	–
CHF per USD	0.94	0.84	0.88	0.87	–
CHF per 100 JPY	0.72	0.60	0.59	0.61	–
CHF per GBP	1.12	1.07	1.11	1.10	–
USD per EUR	1.06	1.10	1.08	1.10	–
JPY per USD	130.00	141.00	150.00	142.00	–
USD per AUD	0.67	0.68	0.65	0.68	–
GBP per EUR	0.88	0.87	0.85	0.86	–
CNY per USD	6.91	7.10	7.19	7.13	–

COMMODITIES	2022	2023	CURRENT	CONSENSUS IN 3 MONTHS	CONSENSUS IN 12 MONTHS
Brent crude oil, USD per barrel	86	77	83	83	83
Gold, USD per troy ounce	1,824	2,063	2,005	2,050	2,115
Copper, USD per metric ton	8,372	8,559	8,314	8,500	9,091

[1] Latest available quarter
[2] Latest available month, G20 data only quarterly
Source: Vontobel, respective statistical offices and central banks; as of February 16, 2024

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