Cham, July 6th 2023

Outlook into the 2nd Semester of 2023

The stock market year 2024 is already on the horizon

Looking ahead to the stock market in 2024, our portfolios stabilised in Q2 despite high sentiment and price fluctuations, thanks to the clear long-term MPM strategy. The focus on future-oriented business areas raises questions about slightly overweighted portfolio positions. Factors such as interest rate policy, inflation, and economic growth remain important considerations. The market efficiently dealt with defining events like the Crédit Suisse collapse and the war in Ukraine. However, investors find it challenging to maintain a clear overview due to daily statements from central bank members using confusing forecasts as a deliberate tool.

The political theatre surrounding the US debt ceiling on its current 78th round has become routine, with the media sensationalising the events. The happy ending always looks the same. Not surprisingly, this time the media made a doomsday event out of it, a prelude to the presidential elections in 2024, so to speak. Experienced observers are aware that negotiations continue fiercely until the final hour and even beyond, presenting a welcome opportunity for equity traders and portfolio managers to generate crazy transaction fees. However, the ultimate agreement raises the important question: who will bear the responsibility of financing the additional $1.4 trillion in the budget? The market may experience a temporary liquidity loss. However, one thing is clear: it will not involve a withdrawal of liquidity from the stock exchanges.

So, who will buy the new 1.4 trillion Treasuries by the end of 2024? The national debt of the USA has been an ongoing issue for over 100 years. The rating agencies have already threatened to withdraw the AAA rating and thus also triggered the discussion about the sense of ratings of government paper.

Furthermore, our viewpoint regarding government obligations in Europe is clear. Can a rational investor genuinely believe that the EU, or more specifically, the ECB, would abandon a country in the eurozone? In any case, a help program would assist a financially struggling nation in recovering. The example of Greece speaks for itself, as bond investors reaped substantial profits. Government bonds within the eurozone will undeniably be honoured, regardless of credit ratings. Sovereign ratings within the same currency zone result in costlier conditions for struggling members and divert much-needed capital in the wrong direction. For those uninterested in interest-bearing securities, focusing on high-quality, high-dividend stocks can be a viable alternative. The net yield from such stocks often surpasses that of bonds.

Returning to the USA, where the national debt in relation to the gross national product stands at 122%. In comparison, Germany boasts a solid 66% ratio, while Switzerland sets the standard with a mere 28%. This largely explains the stability of the Swiss Franc.

However, when considering the overall situation, Europe is not in a more stable position compared to the USA. Greece, currently burdened with a debt of 178%, is projected to improve to a still high 135% of GDP within three years, joined by Italy (145%), France (111%), Spain (112%), Portugal (116%), and the UK (101%).

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The "R-word" still scares short-term investors. The Central Bank of Switzerland have not confirmed any recessions worthy of the name since 2000, and the USA has only experienced three such instances since 1950. Nevertheless, the population should be reminded of the possibility of a recession to encourage discipline. While recessions plague many countries worldwide, our geographic investment universe remains unaffected.

German officials recently reported an unnoticed 0.3% recession during the first few months of this year. One of the causes was consumer uncertainty resulting from political discussions surrounding the unpopular Ministry of Economic Affairs and Energy.

Backlog demand and a strong increase in orders in the economy will not confirm this short phase of weakness. Nevertheless, the economy is hampered by the politically caused planning uncertainty.

In contrast, the US economy is running at full steam, despite contradictory and often negative warnings. Job creation has exceeded forecasts twofold; inflation has fallen to 4%, and new mortgage applications (up 7.5%) indicate healthy growth for the infrastructure and construction sectors. The Federal Reserve deserves credit for its effective management of inflation through rapid interest rate hikes without causing a recession.

In Europe, inflation remains too high but is showing noticeable signs of decline. In Switzerland the inflation rate oscillates around 2.2%, and in China it is even around nil.

Japan also has no problem with its relatively low inflation. On the other hand, the Japanese Yen is weakening significantly, which means that exposure to the Japanese stock exchange only can be recommended combined with a currency hedge.

The State Street Confidence Global Index, an important early indicator of stock market sentiment, demonstrated a positive rebound and reached a pleasing level of 90 points by the end of May 2023. This improvement is notable considering the index started the year at a weaker level of 76 points indicating lingering scepticism among investors. A look-back analysis reveals the challenges of 2022, as the index plummeted from 114 in October 2021 to a seriously undervalued 76 points by the end of 2022. Although June numbers are not known yet, we can anticipate a further positive increase paving the path for rising share prices the second half of 2023.

The strong performance in the first half of this year can be attributed to several factors. Firstly, there were price recoveries from undervalued assets, which contributed to the overall positive performance. Additionally, the end of the bear market caught many short sellers by surprise, leading them to cover their positions through costly panic buying.

This topic also encompasses the undervaluation of numerous companies. In addition to providing price opportunities for investors, these undervalued companies face an increasing risk of hostile takeovers. What was once considered a common occurrence in the USA is now becoming a growing threat in Europe as well. Solid German companies, often undervalued in the stock market and with founding families holding a significant stake, are particularly vulnerable. Activist hedge funds, with even a small percentage of shares, can aggressively pursue positions on the supervisory board and subsequently dismantle the company. Only a fair share price can effectively counteract this.

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In the panic phase around Silicon Valley Bank, the big banks in the USA took over hundreds of regional banks in the crisis of confidence. The most reputable bank balance sheet is no longer of any help when customers storm the counters in panic after rumours.

In the days of an unexpectedly threatening domino effect, the big names of the financial sector hijacked hundreds of the small competitors under cover of 'bailout' with around 540 billion USD, i.e. more than the bailout sum during the Lehman collapse in 2009. The danger that this game will take hold in Europe cannot be neglected.

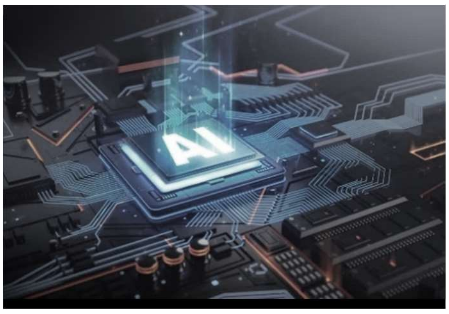

image source: Fraunhofer IPMS

The major focus in the upcoming months revolves around artificial intelligence (AI). MPM has long held beneficiaries of this megatrend in its customer portfolios. A heated debate has emerged regarding the pros and cons of this technology, but its progress cannot be halted. AI holds enormous economic potential, with investments predicted to multiply by a factor of 20 by 2028. Skilful stock picking is necessary to distinguish winners from losers.

Whether overweighting attractive positions in a diversified portfolio is justifiable depends on the investor's risk profile and temperament. Industry-wise, one can align the focus on growth or a specific economic sector, in our opinion IT and the luxury sector are the best ‘money machines’ at the moment. In fact, the majority of the economy has a significant IT component. In the case of individual titles, diversification discipline is the order of the day, despite brilliant company prospects.

The statements from central banks will play a significant role in shaping the weeks ahead. As the first half of the year has come to an end, the US Federal Reserve has stabilized interest rates without further increases, at least for the time being. The economy remains robust, with inflation still unacceptably high but showing a rapid decline. We believe that the peak of the interest rate landscape has been reached in the USD. However, discussions revolve around when interest rates will begin to decrease again. We would be surprised to see the first rate cut this year and anticipate the initial interest rate cuts to occur during the course of 2024. Nevertheless, the possibility of an extended period of interest rates at the current level cannot be disregarded. The central bank committees are not showing their cards.

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The situation is different in Europe, where the economic cycle lags several months behind that of the USA and the combination of inflation and economic momentum is forcing the ECB to square the circle. Necessary small rate hikes could further slowdown the economy. In the days leading up to the end of the quarter, the financial markets had to cope with another global wave of rate hikes.

The FED Chairman, Powell, communicated the future interest rate policy in a sibylline manner. Uncertainty is a tool. The fact is that a recession is becoming increasingly unlikely in the US and the fight against inflation is prioritised. In any case, Switzerland is no longer under pressure to raise interest rates on this issue.

In mid-July of this year, attention will turn to reported results, and we anticipate a dividend boom that will likely result in the crossing of index barriers on the stock markets. The S&P 500 index, currently trading around 4400 points, is aiming for 4600. The German Dax is at an all-time high.

The negative scenarios for the second half of 2023 are expected to be manageable, and historically, election years in the USA, such as 2024, have typically been positive for the stock markets. However, when looking back at election years back to the 1960s, it is worth noting that they experienced negative outcomes in the election years of 2000 and 2008. It is important to remember that in the stock markets, no rules are set in stone.

A well-managed portfolio should be prudently adjusted to the myriad of risks using reliable market information. The emergence of news, occasionally woke, movements should not disrupt a solid long-term strategy. In recent times, greenwashing has become prevalent among many companies. The recent IT trade fair in Las Vegas, known as a hub for greenwashing, was the final straw that led regulators to intervene. The claimed eco-standard is being scrutinised to protect gullible investors from misleading claims. Here, too, the regulator replaces the self-responsibility of investors. Here is an example in Germany:

Did you know that around 40% of construction costs are caused by state levies and regulations? It's a case of the state standing in the way of its own progress, as the process could be much more cost-effective. With this poisonous comment of the month, we wish the investment community a pleasant summer.

Your MPM Swiss AG

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