Reuss Private AG

Outlook 2024 – Update Q2

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The Big Picture I

Structural Environment

- High indebtedness + adverse demographic developments + low productivity growth = low global trend growth. Among other things, the high level of indebtedness leads to a more unequal distribution (Gini index). This is one of the reasons for shifts in political constellations (polarization).
- Re-nationalisation of economic and social policies. Stronger focus on distributional effects within countries.
- Supply shortages in labour markets are easing only gradually.
- A de-dollarisation and possible decoupling from the West of an enlarged BRICs group seems possible, but this would result in two newly competing currency systems.
- Geopolitical tensions – in particular the war in Ukraine as well as the conflict in the Near East – remain heightened.
- The polarisation between the "West" and the "Global South" can make it more difficult to finance Western debt in the long term – also due to the confiscation of state assets.

Economy

- Compared to the past decade, macro-economic volatility and nominal growth remain elevated for longer.
- Slow recovery during 2024. The recession probability in the USA is low.
- Inflation rates are falling significantly. However, service inflation is more persistent. Inflation in Europe and the US will not fall below 2% on a sustainable basis, but will remain high on average over the next few years.
- The US Fed and the ECB have ended their rate-hiking cycles. Interest rates will likely be cut from around the middle of the year onwards.
- In the longer term, (government-led) investment should increase and support growth.

The Big Picture II

Influencing factors

- Geopolitical risks (i.e. Ukraine, Israel, Iran, Taiwan and Turkey) have increased and will remain elevated for a prolonged period. This reinforces the deglobalization trend.
- Fiscal policy will remain expansionary, and no austerity policy is likely to be pursued. The fiscal tightening in Germany is an exception.
- Political risks, with the potential for long-term very adverse outcomes remain substantial, especially amid the ascent of EU/Euro critical parties in Europe and protectionist measures by the US government. Global risks, and thus the potential for markedly negative long-term scenarios, remain pronounced.
- An escalation of the global trade war – especially between the US and China – will have lasting consequences and will ultimately be a burden for global growth and financial markets.

Market environment

- The outlook for equities is volatile and accompanied by pronounced setbacks, but in the long term remains fundamentally positive. Monetary tightening has led to valuations that are attractive from a long-term perspective. Both increasing valuations and rising corporate profits can contribute to a positive performance.
- The trend towards sustainable investments and "green finance" will intensify across all asset classes in the coming years.
- Yields of “safe" bonds such as German Bunds and US Treasuries will trade sideways on a multi-year horizon.
- With prospects for rate cuts, spread products are attractive. Carry and roll-down remain important for fixed income investors.
- Longer term friendly environment for precious metals.

Positioning

Asset Class	What we like	What we underweight
Liquidity		
Bonds	▪ Short term to medium term investment grade assets (funds) ▪ Corporate bonds	
Equities	▪ Solid dividend stocks ▪ Sectors: Healthcare, Technology ▪ EM: India, Vietnam	
Alternative Investments	▪ Gold	
Currencies	▪ CHF ▪ JPY	▪ GBP

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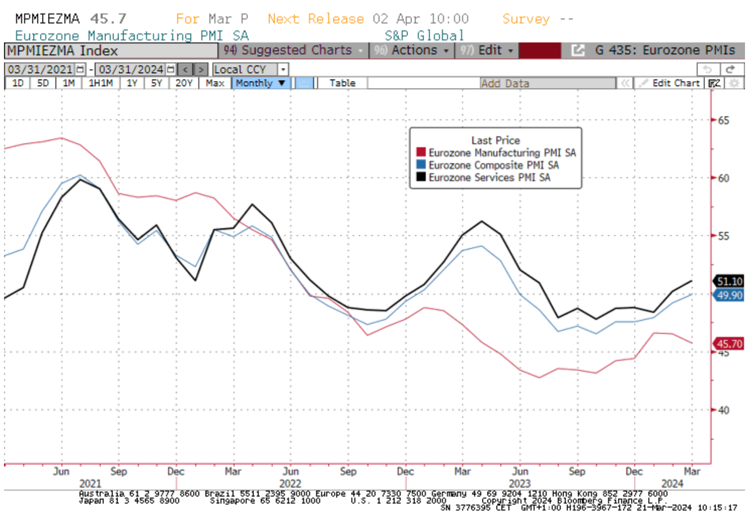
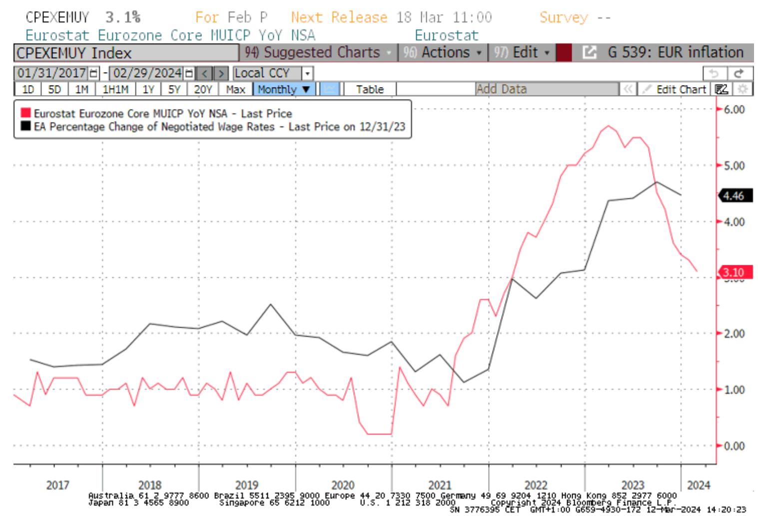
Eurozone I

PMIs



Wage growth & inflation

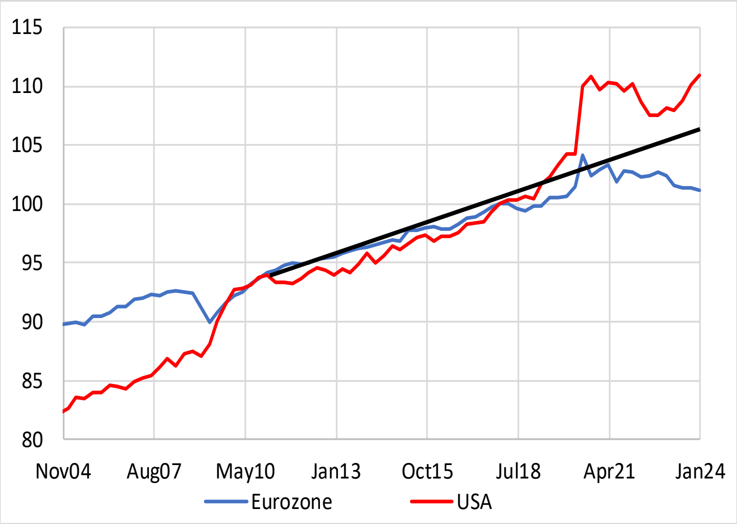


Source: Bloomberg

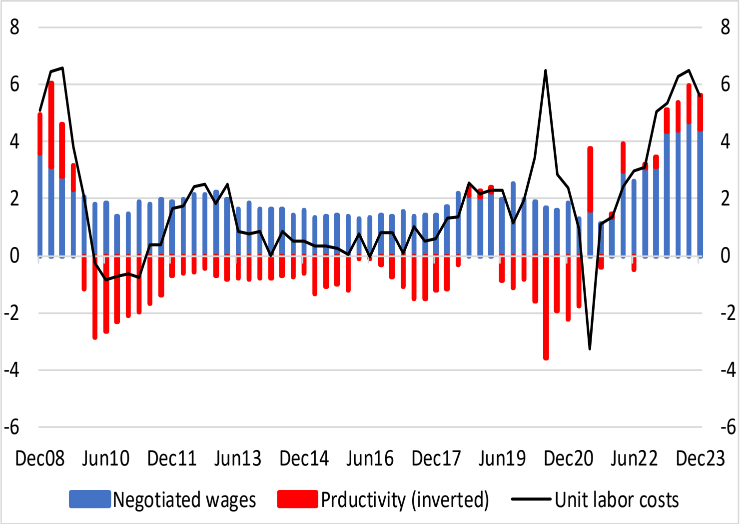
- It was cold and wet in north-western Europe between November and the end of January. As a result, the economic data both at the end of the last year and at the start of this year were too weak compared to the actual economic momentum. With the warmer weather since February, the economic data should signal a gradual improvement. In turn, the Purchasing Managers Index for the service sectors rose to over 50 in February for the first time since last summer, signaling increasing momentum.
- The industrial sector is showing signs of stabilization, albeit at low levels. The impact of the previously very high energy prices is easing noticeably. In addition, the global industrial cycle has improved.
- The purchasing power of consumers is increasing again due to high wage growth, in combination with the significant fall in inflation. As a result, growth momentum in the Eurozone may recover over the course of the year.

Eurozone II

Labour productivity per hour worked (Q4 2017 = 100)



Wage growth, productivity & unit labor costs

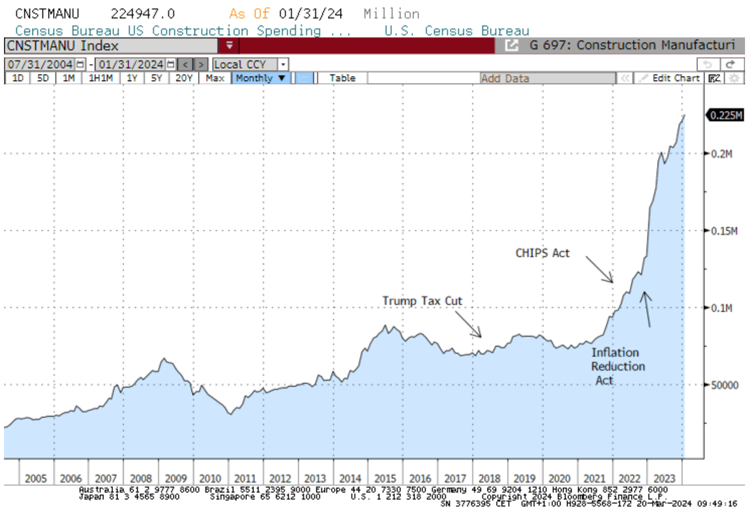


Source: Eurostat, Bloomberg

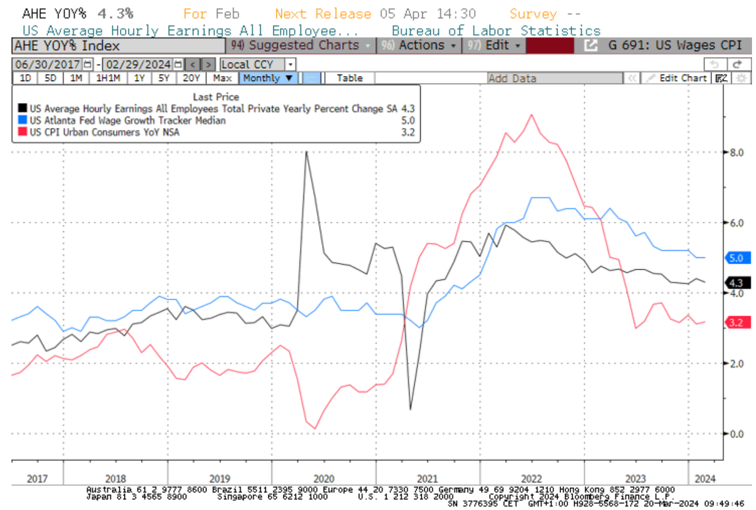
- However, growth will remain subdued. Productivity in the Eurozone is developing very poorly. Labour productivity increased steadily until around 2018, but since then, it has stagnated and has even fallen slightly in recent quarters. In addition to a high level of regulation, the significantly more difficult export environment in recent years is likely to have played a role. This has had a particularly negative impact on sectors with above-average productivity. Sectors with below-average productivity continue to show job growth. High levels of sick leave also had a negative impact on productivity. However, higher productivity is needed to increase prosperity in the long term.
- Amid the tight labour markets, combined with the loss of purchasing power, employees are exerting increasing pressure to achieve higher wage agreements. However, higher wages without higher productivity led to significantly higher unit labour costs. The danger is particularly pronounced in the services sectors that companies will pass on these higher costs through higher prices. Due to the low level of productivity gains, inflation risks are therefore higher in the longer term, despite only modest economic dynamics.

USA

Construction spending by corporates



Wage growth & inflation (yoy in %)

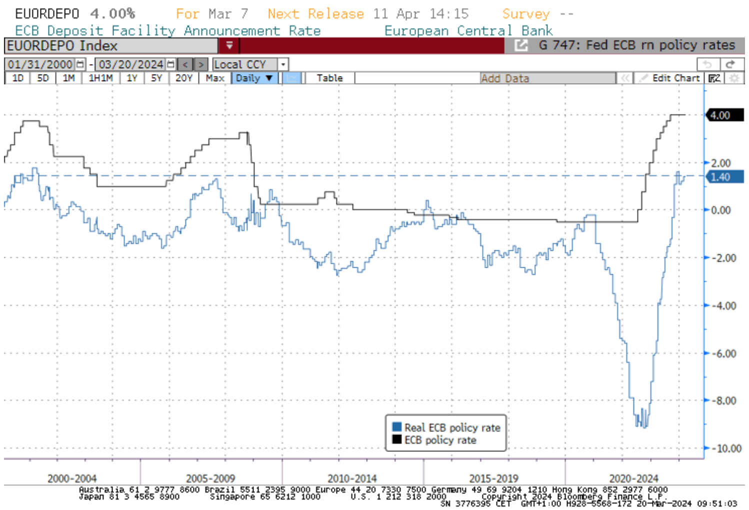


Source: Bloomberg

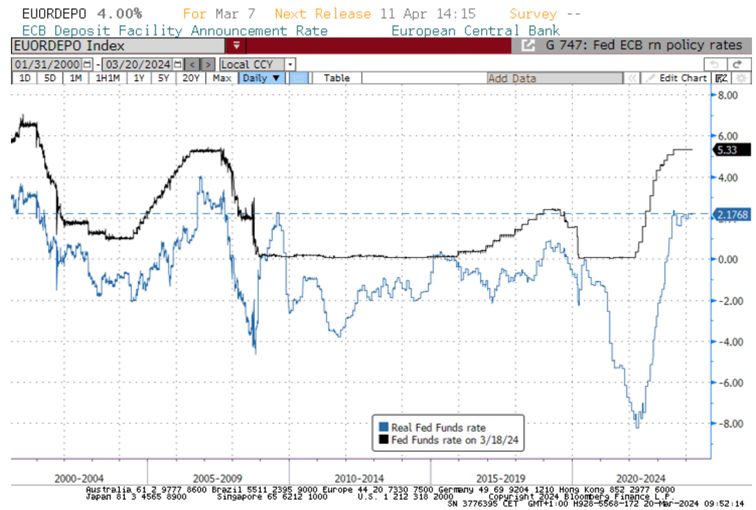
- Productivity in the US has improved considerably since the trade conflicts sparked by Trump in 2018 and against the backdrop of the pandemic and a more activist fiscal policy. The topic of “Artificial Intelligence" may also have played a role in this, as the US is dominant among AI companies.
- US economic policy has become more business-friendly in recent years. This supports companies' (construction) investment activity.
- Real wages have risen again for several months. This is supporting consumption.
- The outlook for the US economy is rather favorable. Although growth is likely to weaken somewhat in the first half of the year before recovering again, a recession remains only a risk scenario.

ECB & US Fed

Nominal and inflation adjusted ECB policy rate



Nominal and inflation adjusted Fed Funds rate



Source: Bloomberg

- The ECB is moving towards lowering interest rates. However, it still needs further data (particularly on wage trends) to confirm that the inflation target is within reach. June remains the most likely date for the first rate cut. As productivity in the Eurozone is stagnating, there is an increased risk that inflation will settle above the ECB's target in the long term despite the subdued growth environment. Policy rates will therefore only be lowered hesitantly, and the extent of the reduction will hardly exceed 100 basis points.
- Due to the high real policy rates, the US Federal Reserve may also begin to lower the Fed Funds rate in June to counteract a further rise in real interest rates. As growth momentum is likely to remain favorable and inflation is unlikely to fall below 2% in the long term, interest rate cuts will also be moderate.

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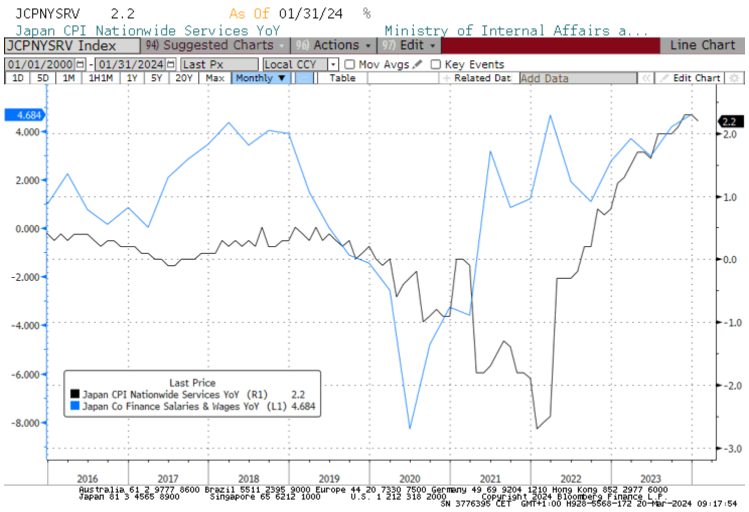
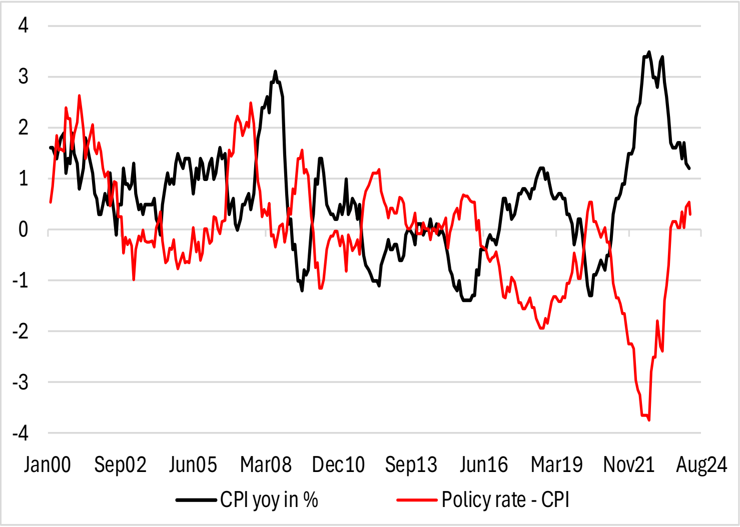
BoJ & SNB

Japan: Services inflation & wage development



Switzerland: Inflation & real policy rate

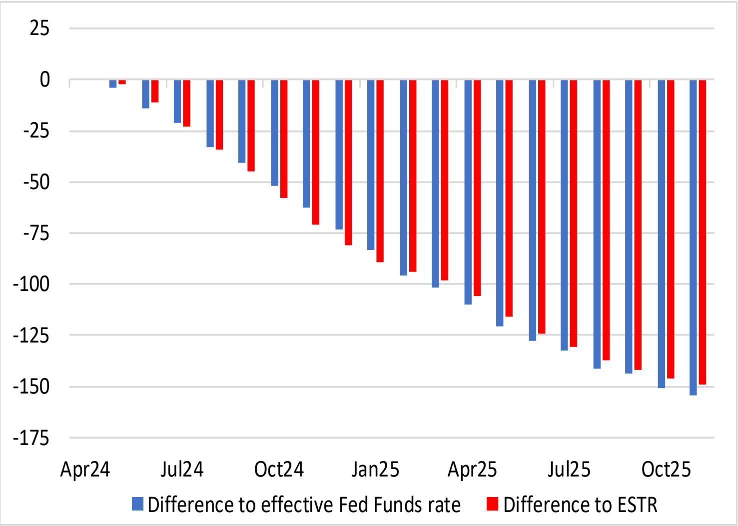


Source: Bloomberg

- Wage pressure in Japan is increasing and is accompanied by higher medium-term price risks. Services inflation has risen to more than 2%, the highest level in this millennium. The Bank of Japan (BoJ) has therefore raised its policy rate for the first time in 17 years and ended the phase of negative interest rates. Quantitative easing through the purchase of government bonds is being maintained, at least for the time being. Monetary policy can be tightened further in the coming quarters, albeit only cautiously.
- Inflation has fallen back into the target range of the Swiss National Bank (SNB). The central bank assumes that this will remain the case for the foreseeable future, and it therefore cut its policy rate at its most recent meeting. However, the SNB had previously only raised rates moderately in an international comparison and the real rate – i.e. the policy rate adjusted for inflation – is not historically high. As a result, the SNB may lower rates further over the course of the year, but only to a moderate extent. Two further rate cuts down to around 1% are probable.

Fixed Income I

Priced policy rate changes for the ECB & Fed in bps



10y sovereign bond yields

Source: Bloomberg

- While the Fed and the ECB will start cutting interest rates around the middle of the year, both are likely to lower their policy rates more slowly and to a lesser extent than anticipated. The US economy is dynamic compared to expectations. Although growth in the Eurozone is low, inflation risks are higher in the medium term due to low productivity gains.
- Nominal growth will remain higher in the coming years compared to the last decade. Bond supply is also substantial, particularly in the USA, due to the Fed's quantitative tightening and the high budget deficit. Despite the probable interest rate cuts, the downside potential for yields on "safe" bonds is therefore limited. On the contrary, longer bonds remain vulnerable to setbacks.

Fixed Income II

Yield spreads of 10y peripheral sovereigns vs. Bunds

Eurozone inflation swaps

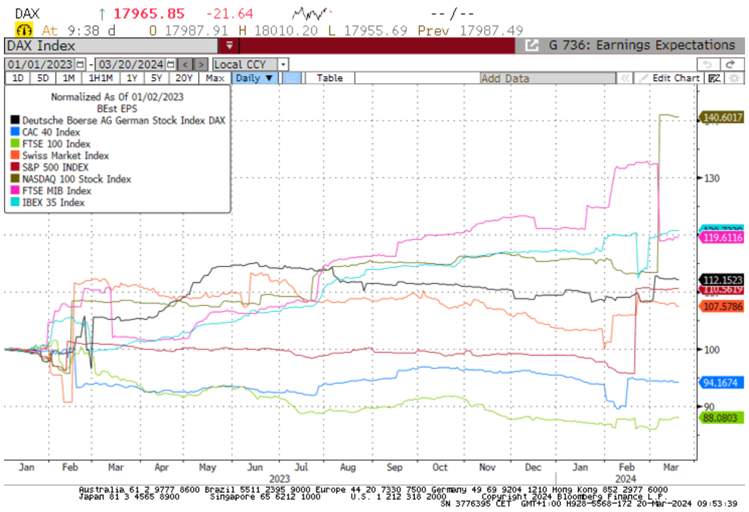
Source: Bloomberg

- The outlook for carry products is relatively favorable. High nominal growth should have a supportive effect, as this will make it easier to service existing debt. In addition, the weak development of the German economy compared to the periphery is accompanied by an outperformance of peripheral government bonds compared to German Bunds. An overweighting of bonds with a yield pick-up is therefore still advisable.
- The environment for inflation-linked bonds is favorable. Low productivity growth in the Eurozone is a supportive factor. It goes hand in hand with low trend growth, and this limits the upside potential for real yields. On the other hand, inflation risks remain pronounced in the longer term despite the current disinflation. Inflation-linked bonds benefit from both factors, i.e. from both limited upside potential for real yields and potentially higher inflation rates. Inflation swaps as an indicator of inflation expectations have fallen significantly since last September and currently offer little scope for further declines. As the year progresses, higher inflation expectations and thus an outperformance of inflation-linked bonds compared to conventional bonds are probable.

Equities

P/E ratio based on expected earnings & US financial conditions

Earnings expectations (Jan23 = 100)

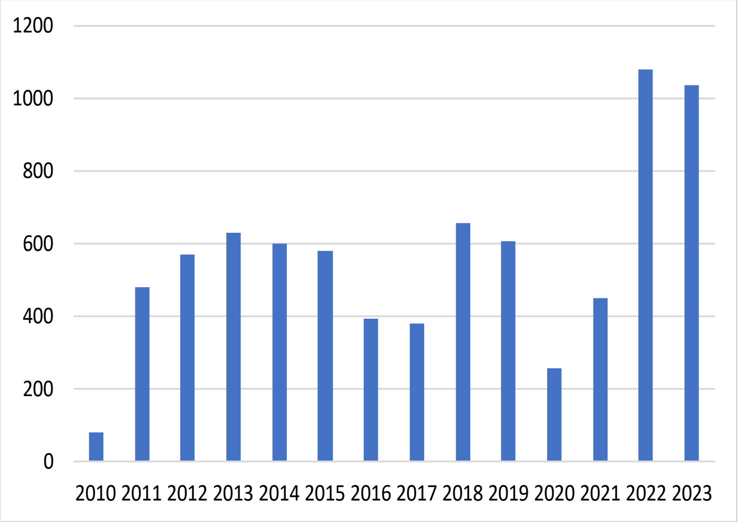


Source: Bloomberg

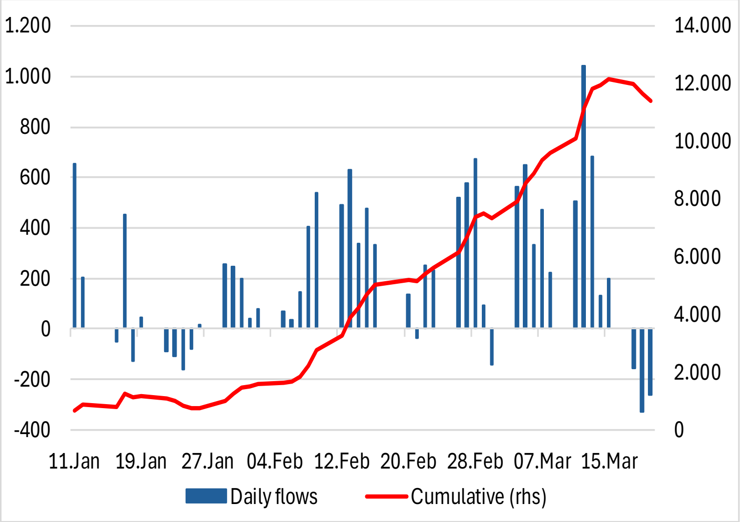
- The longer-term outlook for equity markets remains favourable. The probable interest rate cuts by major central banks should support market valuations (price/earnings ratios). In the past, there has been a fairly good correlation between financing conditions and market valuations, with more favourable financing conditions generally going hand in hand with higher valuations. In addition, high nominal growth compared to the decade leading up to the pandemic is supporting earnings trends.
- While the upward trend in US equities was previously only driven by a very small number of stocks, market breadth has recently increased noticeably. This is seen as a bullish technical signal.
- As a result, equity market exposure can continue to be overweighted. Geographically, the USA, the periphery of the Eurozone and west-oriented Asian countries can continue to be preferred.
- Major setbacks continue to offer themselves as buying opportunities.

Gold & Bitcoin

Central banks' gold purchases (in tonnes)



In-/Outflows(*) US Bitcoin ETFs (in USD mln)



Source: World Gold Council, Bloomberg

- Both gold and Bitcoin have reached new highs. Geopolitical developments are providing support for gold in particular. Following Russia's invasion of Ukraine, western countries have confiscated significant parts of Russia's currency reserves – particularly bonds. This potentially reduces the value of investments in securities from countries that resort to confiscation. Gold thus offers itself as an alternative investment. Net purchases by central banks have risen significantly since the outbreak of the war. China has also steadily increased its gold holdings during the last quarters. In combination with probable interest rate cuts by the Fed, the outlook for gold remains favourable in the longer term.
- Due to the approval of Bitcoin ETFs in the US in January 2024 and the prospect of further approvals of ETFs for other cryptos such as Ethereum, investment capital is increasingly flowing into cryptocurrencies. Added to this is the upcoming Bitcoin "halving", which will lead to a smaller increase in supply and is likely to take place in April. However, cryptos remain very volatile and accompanied by major setbacks. Still, in order to establish themselves as an asset class, further regulation is necessary.

*adjusted for outflows from the Grayscale Bitcoin Trust launched in 2013

Disclaimer

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