M.M.WARBURG & CO
BANK

ECONOMIC SITUATION AND STRATEGY

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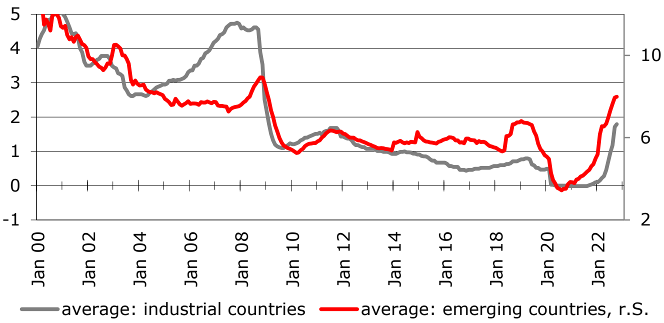
Stock markets: corporate earnings a rock?

For stock market players, the first nine months of 2022 were simply forgettable. High inflation rates and the resulting more restrictive monetary policy of the central banks, the energy crisis triggered by the Russian war of aggression against Ukraine and a global economic slowdown that is becoming increasingly apparent have had a severe impact on the stock markets. By the end of September, the DAX had lost almost 24 percent of its value, the MDAX was even down 36 percent. The situation is similar in the USA, where the S&P 500 also lost 24 percent and the Nasdaq technology index 32 percent.

September is traditionally the weakest stock market month of the year, while the period from October to December, with a few exceptions, has historically mostly shone. This year, too, the first trading days in October were positive and the stock markets were able to recover some of their recent losses. However, the environment remains challenging in the near term and it is still unclear whether the markets have already bottomed out. Monetary policy, in particular, continues to be a headwind as central banks, faced with record high inflation rates, have raised interest rates faster and more sharply than at any time in at least 40 years. And an end to the rate hike cycle is not yet in sight. In the past, sharply rising interest rates have often led to stress in the capital markets and to distortions in economic development. Examples are the financial and economic crisis of 2008 and 2009, which was triggered by rising US mortgage rates, or the Asian crisis of 1997/98, which was based on a strong appreciation of the US dollar; this was followed by the Russian default and the bankruptcy of the hedge fund Long Term Capital Management in 1998. The recent turmoil in the UK bond and currency markets may be the first warning signal that the global financial system may not be as resilient as hoped. Rising interest rates and the appreciation of the US dollar are a challenge to financial stability - as is often the case when interest rates have been low for a long time and investors' risk appetite has risen sharply.

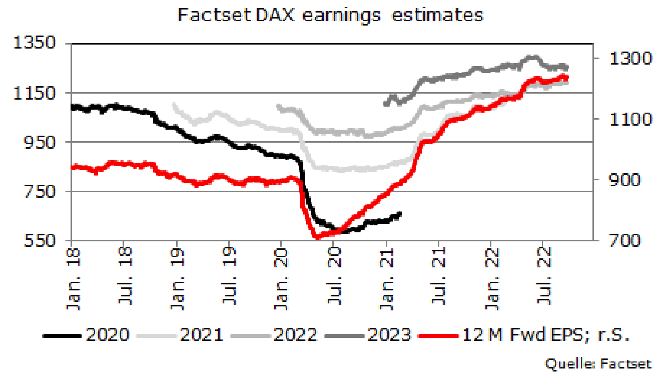
Key interest rates in industrial and emerging countries



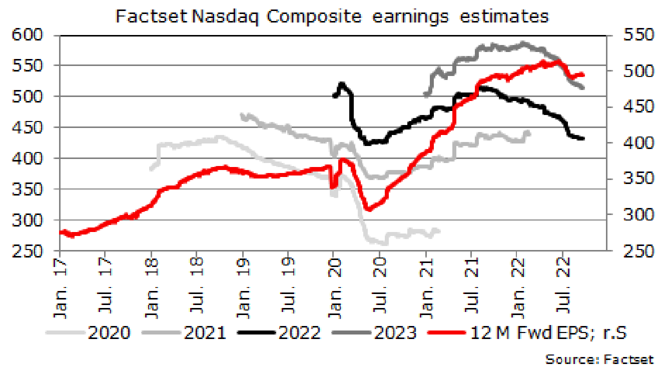
Source: Refinitiv Datastream

Although most global leading indicators have weakened in recent weeks and months, many companies seem to be coping well with the more negative conditions so far. At least this is what the earnings forecasts of the companies and the analysts accompanying them for this year and next year indicate. While most economists are forecasting a significant slowdown in growth or even a recession for many economies next year, company analysts are unwaveringly assuming that profits will continue to rise in most countries and sectors. Of course, it must be taken into account that economists are forecasting real growth rates, while analysts are expecting nominal profit increases, which may explain this discrepancy to some extent. However, most economists expect - in some cases significantly - falling inflation rates next year, so that the gap between real and nominal data should slowly close in the course of next year.

For DAX companies, profit growth of 7.3 percent is expected this year and another 5.4 percent next year (source: Factset). Despite the difficult economic environment, forecasts for 2022 earnings have been raised slightly since the beginning of July. The weakness of the euro and the expectation that companies also managed to pass on higher costs to prices in the third quarter are likely to have played a significant role in this. Although the earnings forecasts for 2023 have recently been reduced somewhat, they seem to us to be too optimistic in view of the economic risks, so we expect further downward adjustments. The reporting season for the past third quarter, which is about to start, should provide more clarity as to whether the positive outlook for the coming year can be maintained or not. Should this be the case, share prices could recover significantly in the near future, even a year-end rally is possible given the poor sentiment of most market participants. However, we would still advise caution at the moment.



We also consider the earnings forecasts for many US indices to be too optimistic, knowing that most US companies have been extremely profitable in recent years. This is the decisive reason why the US stock markets have clearly outperformed stock indices from other industrialised countries or from emerging markets. Even though a US recession is far from a foregone conclusion, we do not consider the expectations for corporate earnings to be realistic. Companies in the S&P 500 are expected to increase their profits by around eight percent both this year and next. The energy sector plays the leading role, with profits expected to rise by almost 150 percent this year before declining by 12 percent in 2023. However, if the profits of the energy companies were not taken into account, the S&P would achieve a profit growth of about four percent this year and nine percent in 2023. In other words: Despite a weakening economy and inflationary pressures that are very likely to ease, earnings growth is expected to be stronger next year. This is not plausible in our view.



Even more dramatic are the different earnings expectations for technology companies. After earnings growth of 16 percent this year and 17 percent next year was expected for companies in the Nasdaq Composite Index at the beginning of the year, the forecasts were adjusted to six percent (2022) and 19 percent (2023) by the beginning of July. In the meantime, the forecasts for this year have been revised downwards to -1.5 percent, while next year's growth is expected to remain unchanged at 19 percent. In our view, these assumptions could only materialise if the economy recovers quickly and strongly in the course of 2023 and companies manage to increase their profit margins at the same time. If this were to happen, it would be good from a profitability perspective on the one hand, but bad from an inflation perspective on the other. For then there would be no easing of price pressure next year, so that the central banks would be forced to raise interest rates quite a bit further. In this respect, the upcoming reporting season promises to be the most exciting in recent years.

Market data

Stock marktes	As of 07.10.2022 09:51	Change versus 29.09.2022 -1 week	05.09.2022 -1 month	05.07.2022 -3 months	05.10.2021 -1 year	31.12.2021 YTD
Dow Jones	29927	2,4%	-4,4%	-3,4%	-12,8%	-17,6%
S&P 500	3745	2,9%	-4,6%	-2,3%	-13,8%	-21,4%
Nasdaq	11073	3,1%	-4,8%	-2,2%	-23,3%	-29,2%
DAX	12436	3,8%	-2,5%	0,3%	-18,2%	-21,7%
MDAX	22948	5,3%	-7,0%	-6,8%	-32,6%	-34,7%
TecDAX	2780	6,6%	-4,3%	-2,4%	-24,5%	-29,1%
EuroStoxx 50	3423	4,4%	-1,9%	1,9%	-15,8%	-20,4%
Stoxx 50	3401	2,8%	-2,8%	0,3%	-3,2%	-10,9%
SMI (Swiss Market Index)	10377	2,5%	-4,1%	-3,0%	-10,4%	-19,4%
Nikkei 225	27116	2,6%	-1,8%	2,6%	-2,5%	-5,8%
Brasilien BOVESPA	117561	9,2%	4,8%	19,6%	6,4%	12,2%
Russland RTS	1022	-4,7%	-20,6%	-10,9%	-44,5%	-36,0%
Indien BSE 30	58048	2,9%	-2,0%	9,2%	-2,8%	-0,4%
China CSI 300	3805	-0,6%	-5,2%	-15,2%	-21,8%	-23,0%
MSCI Welt	2478	3,2%	-4,6%	-3,0%	-17,8%	-23,3%
MSCI Emerging Markets	911	4,3%	-5,9%	-8,2%	-26,4%	-26,1%
Bond markets						
Bund-Future	138,96	146	-877	-1228	-3070	-3241
Bobl-Future	119,57	41	-371	-604	-1536	-1367
Schatz-Future	107,05	6	-185	-264	-518	-499
3 Monats Euribor	1,20	54	129	178	175	179
3M Euribor Future, Dec 2017	2,19	-9	31	0	274	3
3 Monats $ Libor	3,78	4	64	144	366	357
Fed Funds Future, Dec 2017	4,08	8	51	0	400	3
10 year US Treasuries	3,85	10	65	104	232	235
10 year Bunds	2,13	-7	56	94	231	231
10 year JGB	0,25	0	2	3	20	18
10 year Swiss Government	1,29	-1	37	45	143	143
US Treas 10Y Performance	580,53	0,0%	-4,1%	-6,8%	-16,2%	-16,9%
Bund 10Y Performance	547,90	1,6%	-3,9%	-6,5%	-17,4%	-17,3%
REX Performance Index	440,11	0,9%	-2,4%	-4,1%	-10,6%	-10,3%
US mortgage rate	0,00	0	0	0	0	0
IBOXX AA, €	3,33	-20	57	91	300	285
IBOXX BBB, €	4,61	-23	66	94	391	374
ML US High Yield	9,21	-38	69	30	452	431
Convertible Bonds, Exane 25	6264	0,0%	-4,6%	1,8%	-23,6%	-23,5%
Commodities						
MG Base Metal Index	376,35	0,7%	-0,2%	-2,6%	-13,6%	-18,4%
Crude oil Brent	94,72	6,8%	-0,7%	-8,0%	14,6%	20,8%
Gold	1711,39	3,3%	0,0%	-3,2%	-2,5%	-6,1%
Silver	20,41	8,7%	12,0%	6,2%	-9,7%	-12,3%
Aluminium	2345,25	7,3%	2,4%	-1,2%	-19,3%	-16,4%
Copper	7725,25	1,0%	-0,1%	0,9%	-15,8%	-20,7%
Iron ore	95,46	-3,0%	-0,1%	-16,0%	-19,0%	-15,1%
Freight rates Baltic Dry Index	1992	13,4%	75,8%	-5,1%	-63,2%	-10,1%
Currencies						
EUR/ USD	0,9800	1,0%	-1,2%	-4,8%	-15,5%	-13,5%
EUR/ GBP	0,8769	-0,9%	1,7%	2,0%	3,0%	4,4%
EUR/ JPY	142,01	1,1%	1,8%	1,6%	10,1%	8,9%
EUR/ CHF	0,9695	1,6%	-0,5%	-2,4%	-9,8%	-6,2%
USD/ CNY	7,1135	-0,2%	2,6%	5,8%	10,3%	11,9%
USD/ JPY	144,66	0,1%	2,9%	6,5%	29,8%	25,7%
USD/ GBP	0,89	-1,3%	3,0%	6,6%	21,9%	21,2%

Source: Refinitiv Datastream

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