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ECONOMIC SITUATION AND STRATEGY

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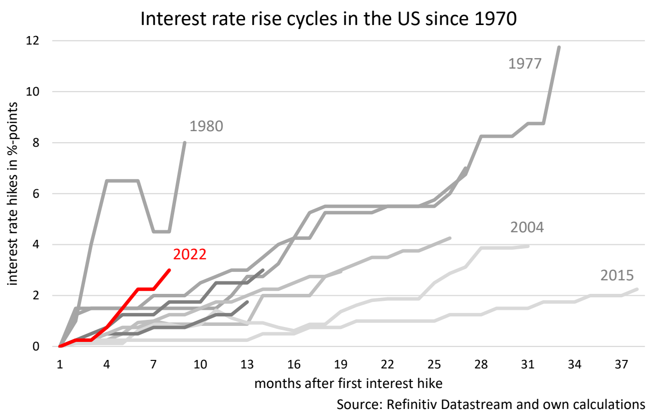
Has the stock market bottomed out?

Hardly any other question is currently being discussed more intensively on the markets. The rally in the S&P 500 in the second half of October and hopes of a looser monetary policy in the coming year led many investors to believe that the bottom had already been reached on the stock markets. Others may remember the bear market rally in July and August of this year, when the S&P 500 temporarily rose 13 percent before hitting new lows. Hopes that the Fed would initiate a turnaround in monetary policy in the coming year, thus easing the situation on the stock markets, were dashed by Fed Chairman Jerome Powell at the most recent FOMC meeting. He emphasized that the Fed might possibly reduce the extent of the next interest rate steps, but that the final interest rate level ("terminal rate") would be higher than previously expected by the market.

So is there still room for downside on the stock markets, or are we on the verge of a sustained price recovery after all? As far as we know, unfortunately no one has a crystal ball with which to look into the future. We do not possess such a crystal ball either, but from a fundamental point of view we do not yet see the bottom of the stock markets and therefore continue to advise caution. Two variables are decisive in this respect: On the one hand, the future course of monetary policy and, consequently, the development of interest rates will determine share prices. On the other hand, earnings expectations are important for the formation of share prices.

The fact that the U.S. Federal Reserve is committed to fighting inflation was made clear yesterday by the fourth consecutive increase in key interest rates by 75 basis points. This makes the current cycle of interest rate hikes one of the strongest and fastest in the Fed's history (see chart). However, with a duration of nine months since the first rate hike in March 2022, the current cycle is far below the historical average of 22 months.



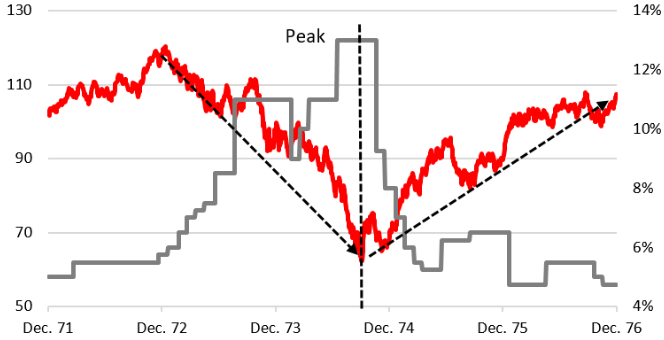
In addition to current monetary policy and the interest rate decisions at the upcoming FOMC meetings, the direction of monetary policy in the coming year is particularly relevant for sentiment on the stock markets. A look at the priced-in probabilities of further interest rate adjustments in the U.S. before yesterday's FOMC meeting showed that market participants were already expecting two interest rate cuts of 25 basis points each in September and November 2023. If such a turnaround in monetary policy were to materialize, this should provide a noticeable tailwind for share prices in isolation and suggest that the stock markets have (soon) bottomed out. However, hopes of interest rate cuts in the coming year are not new, although the expected date of the rate cut is being pushed back further. A few months ago, for example, market participants were already assuming a first rate cut in April 2023. After yesterday's FOMC meeting and Jerome Powell's hawkish comments, the expected interest rate cut date has shifted again: For the coming year, the market is currently only pricing in an interest rate cut in December.

What economic conditions have to be met for the Fed to lower interest rates, or what is the Fed's orientation for its monetary policy? At yesterday's meeting, Fed Chairman Jerome Powell once again emphasized that the Fed's actions are data-driven. In addition to price dynamics, the focus is on the U.S. labor market. However, no relief is expected from either side in the near future, so we are skeptical about the expectation of a quick monetary easing.

Price pressures remain high and a rapid return to the target inflation rate of two percent seems unlikely. Although the PCE inflation rate ("Personal Consumption Expenditures"), which is particularly relevant for the Fed, declined slightly to 6.2 percent in September from 6.8 percent in July, it remains well above the target level of two percent. If volatile energy and food prices are excluded and the core inflation rate is considered, it continues its upward trend after a brief breather and, with a rate of 5.1 percent, underscores that inflation is broad-based. Additional price pressure results from the sharp rise in wages and salaries. For example, the labor cost index rose 5.1 percent in the third quarter of 2022 compared with the previous year - the highest increase in more than 20 years. A similar conclusion is reached by the Atlanta Fed Wage Tracker, which measures the nominal wage development of American workers on the basis of population surveys. Based on monthly data, there has been a significant increase in wages since the middle of last year; most recently, the growth rate in September of 6.3 percent was well above the historical average of around 3.6 percent. This increases the risk of second-round effects and the pressure on the Fed not to lower interest rates too early.

In addition to price developments, the state of the U.S. labor market plays a decisive role in the direction of monetary policy. Here, too, the data so far do not point to a trend reversal. With a historically extremely low unemployment rate of 3.5 percent, the labor market remains in an extremely robust condition. There continues to be a mismatch between unemployed and vacant positions, which strengthens the bargaining power of the workforce and thus maintains wage pressure. On average, 100 job vacancies are matched by only 54 people registered as unemployed - the historical average since 2001 is around 223 unemployed. As long as the number of employees remains stable and wages continue to grow strongly, private consumption will support the US economy, so no softer stance on the part of the Fed is to be expected.

Federal Funds Target Rate and S&P 500



Source: Refinitiv Datastream and own calculations

Federal Funds Target Rate and S&P 500

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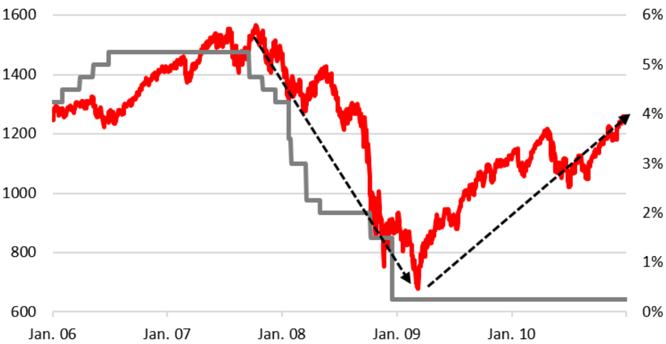
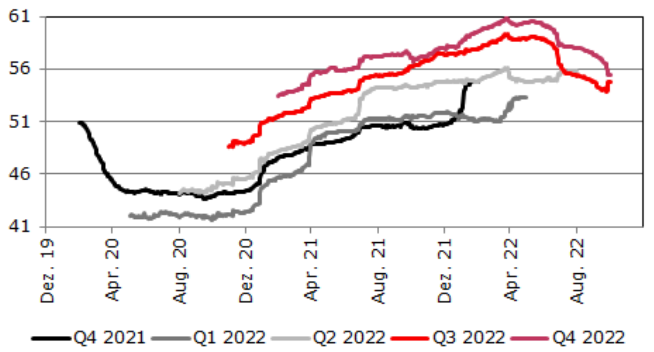


Source: Refinitiv Datastream and own calculations

Even if history does not repeat itself and the past cannot be transferred one-to-one to the present, it often provides valuable insights. Therefore, we have taken a closer look at three bear markets of the S&P 500 and the corresponding interest rate cycle as examples. In all three examples, it is noticeable that the bear market only ended after the last interest rate step. The top chart shows the price trend of the S&P 500 and the key interest rates during the first oil crisis at the beginning of the 1970s. At that time, the U.S. economy was struggling with inflation rates similar to today's, facing price increases of over twelve percent at the peak. It was only after the last interest rate hike on July 16, 1974 that the S&P 500 recovered sustainably.

The two lower charts capture the bursting of the dotcom bubble in the early 2000s and the global financial crisis in 2008 and, unlike the first example, reflect a deflationary environment in each case. But here, too, the bear market ends only after the end of the interest rate cycle. Looking at the current cycle of rising interest rates, there would therefore still be room for the S&P 500 to fall.

S&P 500: Quaterly earnings estimates



Source: Factset

In addition to future interest rate dynamics, earnings expectations play a key role for the stock markets. The current reporting season for the third quarter has so far gotten off to a mixed start and, at first glance, points to a (still) robust earnings trend. Although around 70 percent of the companies in the S&P 500 exceeded earnings expectations, which is roughly in line with the historical average, these have been successively revised downwards in recent months. Furthermore, a loss that is lower than analysts' expectations is also considered a positive "beat" - this may be technically correct, but it obscures the absolute profit trend. But it is not only the view in the rear-view mirror that is mixed, but also future profits. The increasing pessimism is reflected in the statements of company representatives and in the lowered earnings expectations of analysts for the fourth quarter. Although much is certainly priced in, we expect further downward revisions. Why? Profits are nominal measures that get a boost in an inflationary environment and rising selling prices. As the volume component of profits still remained stable at many companies, profits could also develop positively. However, due to the cooling economy and restrictive interest rates, sales volumes are likely to decline, thus depressing profits. If, in addition, the inflation rate falls in the coming quarters, the pressure on profits will increase.

Even though we do not have a crystal ball, we maintain that we do not believe that the bottom has been reached in the price trend of the S&P 500 - as a proxy for the equity markets. First, we believe that the Fed's expected rate cut in the course of next year is premature, and we see little scope for monetary easing against the backdrop of broad-based inflation, the risk of second-round effects, and a robust labor market. Only when the Fed changes its rhetoric with regard to future interest rate developments, the end of the rate hike cycle is in sight. Second, the three case studies show that bear markets in the S&P 500 have historically only come to an end after the last interest rate adjustment. And third, we expect further (unpriced) downward earnings revisions due to the cooling economy and tougher financial conditions for companies.

Market data

Stock marktes	As of 04.11.2022 08:21	Change versus 28.10.2022 -1 week	03.10.2022 -1 month	03.08.2022 -3 months	03.11.2021 -1 year	31.12.2021 YTD
Dow Jones	32001	-2,6%	8,5%	-2,5%	-11,5%	-11,9%
S&P 500	3720	-4,6%	1,1%	-10,5%	-20,2%	-22,0%
Nasdaq	10343	-6,8%	-4,4%	-18,4%	-34,6%	-33,9%
DAX	13130	-0,9%	7,5%	-3,4%	-17,7%	-17,3%
MDAX	23248	-1,7%	2,5%	-16,4%	-34,6%	-33,8%
TecDAX	2799	-1,8%	3,1%	-11,4%	-28,6%	-28,6%
EuroStoxx 50	3593	-0,5%	7,5%	-3,7%	-16,6%	-16,4%
Stoxx 50	3539	0,4%	5,7%	-3,3%	-5,3%	-7,3%
SMI (Swiss Market Index)	10711	-0,6%	4,1%	-4,2%	-13,5%	-16,8%
Nikkei 225	27200	0,3%	3,8%	-2,0%	-7,9%	-5,5%
Brasilien BOVESPA	116896	2,1%	0,7%	12,6%	10,7%	11,5%
Russland RTS	1094	-1,7%	0,2%	-1,1%	-40,1%	-31,4%
Indien BSE 30	60794	1,4%	7,1%	4,2%	1,7%	4,4%
China CSI 300	3767	6,4%	-1,0%	-7,4%	-21,9%	-23,7%
MSCI Welt	2468	-3,6%	1,6%	-10,4%	-23,2%	-23,6%
MSCI Emerging Markets	861	1,8%	-1,7%	-12,7%	-31,8%	-30,1%
Bond markets						
Bund-Future	137,21	-212	-397	-1975	-3213	-3416
Bobl-Future	119,06	-84	-191	-835	-1539	-1418
Schatz-Future	106,71	-33	-78	-323	-543	-533
3 Monats Euribor	1,73	107	107	181	230	232
3M Euribor Future, Dec 2017	2,29	5	15	0	285	3
3 Monats $ Libor	4,51	7	76	168	437	430
Fed Funds Future, Dec 2017	4,18	2	16	0	410	3
10 year US Treasuries	4,16	15	51	141	258	266
10 year Bunds	2,26	17	36	144	242	244
10 year JGB	0,25	1	1	6	17	18
10 year Swiss Government	1,23	11	19	74	133	136
US Treas 10Y Performance	564,77	-0,9%	-3,6%	-10,0%	-18,2%	-19,2%
Bund 10Y Performance	537,83	-1,4%	-2,9%	-11,5%	-18,7%	-18,8%
REX Performance Index	435,85	0,0%	-0,5%	-6,7%	-11,3%	-11,2%
US mortgage rate	0,00	0	0	0	0	0
IBOXX AA, €	3,53	11	24	167	316	305
IBOXX BBB, €	4,91	10	31	190	412	404
ML US High Yield	9,36	45	-12	167	453	446
Convertible Bonds, Exane 25	6450	0,0%	4,3%	-4,4%	-21,4%	-21,2%
Commodities						
MG Base Metal Index	367,69	-1,0%	1,1%	-5,8%	-18,5%	-20,3%
Crude oil Brent	96,71	0,9%	8,8%	0,0%	18,6%	23,4%
Gold	1647,26	0,4%	-2,6%	-6,3%	-6,6%	-9,6%
Silver	19,34	1,2%	-5,6%	-3,1%	-16,9%	-16,9%
Aluminium	2251,00	2,3%	1,8%	-5,4%	-14,7%	-19,8%
Copper	7596,00	-0,3%	-0,1%	-1,0%	-21,3%	-22,0%
Iron ore	83,37	-10,4%	-11,5%	-24,3%	-16,1%	-25,9%
Freight rates Baltic Dry Index	1290	-15,9%	-27,9%	-25,5%	-55,4%	-41,8%
Currencies						
EUR/ USD	0,9775	-1,8%	0,1%	-4,1%	-15,6%	-13,7%
EUR/ GBP	0,8716	1,5%	0,1%	4,2%	2,8%	3,8%
EUR/ JPY	144,60	-1,5%	2,2%	6,2%	9,6%	10,9%
EUR/ CHF	0,9868	-0,5%	2,2%	1,0%	-6,6%	-4,5%
USD/ CNY	7,2510	-0,1%	1,7%	7,3%	13,2%	14,1%
USD/ JPY	148,28	0,5%	2,6%	10,8%	30,1%	28,8%
USD/ GBP	0,89	3,4%	0,6%	8,0%	21,8%	20,8%

Source: Refinitiv Datastream

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