J. Safra Sarasin

Cross-Asset Weekly

09 August 2024

Forecast update: The calm after the storm

The financial market turbulences this week have highlighted that (1) macro risks are shifting from inflation to growth, (2) carry trades are vulnerable to sharp reversals in late cycle environments and (3) expectations regarding the additional earnings potential from artificial intelligence (AI) have their limits as well. Downside risks to economic growth have increased as the global manufacturing sector has slowed again. However, we note that spill-overs to the service sector are more moderate than in previous cycles. We are also convinced that markets have interpreted the latest US labour market report far too negatively. Consequently, we do not expect an immediate US recession or an emergency rate cut by the Fed before the September meeting. That said, we now forecast three Fed rate cuts by 25bp this year instead of just one. We maintain our expectations for three rate cuts by the ECB and the BoE, and one cut by the SNB in the second half of this year.

Consequently, we forecast bond yields to fall further over the next 6 to 12 months. We continue to favour intermediate maturities and have a neutral assessment on credit, both for Investment Grade and High Yield for now. In the FX space, we expect the yen to push higher, despite the sharp rally, as the yield gap to other currencies gets narrower. On the equity side, we retain our defensive stance. We note that companies provided a rather downbeat view on the US consumer in their Q2 reporting. We would thus reiterate our cautious stance, given the persistent uncertainty around the economic cycle as various indicators imply that the current slowdown has room to run.

This week's highlights

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Monthly macro and strategy forecast update

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The financial market turbulences of this week highlight that (1) macro risks are shifting from elevated inflation to lower growth, (2) carry trades are vulnerable to sharp reversals in late cycle environments and (3) expectations regarding the additional earnings potential from artificial intelligence (AI) have their limits as well. We acknowledge that the dynamic in the manufacturing sector has slowed globally such that risks to economic growth have increased. Yet, it is still too early to expect a recession in the US this year. We also forecast that the Fed will counter risks to growth with three rate cuts by 25 bp this year instead of one that we had expected so far. This is less than market expectations of more than 100bp, for which we would need clearer signals that the US economy is growing significantly below trend or falling into a recession. Economic data in the euro area have disappointed as well, supporting our expectations for three ECB rate cuts this year. Consequently, the risk is for bond yields to fall further over the next 6-12 months. We continue to favour intermediate maturities and have a neutral assessment on credit, both for Investment Grade and High Yield for now. Despite the sharp rally, we expect the yen to push higher as the yield gap to the rest of the G10 FX should get narrower. That said, we expect the US dollar to hold up relatively well, also in light of potential market uncertainty in the run-up to the US elections. On the equity side, we retain our defensive stance. We note that companies provided a rather downbeat view on the US consumer in their Q2 reporting. We reiterate our cautious stance, given the persistent uncertainty around the cycle as various indicators imply that the current slowdown has room to run.

Global macro

The unwind of yen carry trades and US recession fears

Financial markets received a wake-up call as markets corrected due to (i) concerns about an imminent US recession, (ii) the unwinding of yen carry trades and (iii) a more negative view about the earnings potential of US equities in a global slowdown. Geopolitical tensions in the Middle East contributed to the general risk-off sentiment. In the following, we will argue that there is an element of truth in all of these points, yet the market has been overly pessimistic. Hence, we consider the partial rebound in risk assets that followed as justified.

- It is true that macro data have disappointed over the previous weeks. This weakness, however, was mainly concentrated in the manufacturing sector as purchasing manager indices (PMI) in the US, China and Europe have shown. Spill-overs to other sectors are limited as the increase of the ISM index for the US services sector in particular showed. Markets also put too much weight on the weaker US labour market report last Friday. First, it might be biased due to adverse effects of hurricane Beryl. Second, there was an overly strong focus on the so-called «Sahm rule» that was triggered by the increase in the unemployment rate. The indicator signals that the US economy is in recession when the three-month average of the unemployment rate rises by at least 0.50 percentage points within a year. In our section on the US economy, we explain why we don't follow that rule mechanically.
- The US labour market report led some market participants to conclude that the Fed is far behind the curve and needed to lower policy rates quickly and significantly. Together with the BoJ's rate hike, this would imply a narrowing US interest rate advantage, making foreign-currency-funded carry trades less attractive. The unwinding of yen-funded carry trades triggered the initial sell-off. While we agree that US-

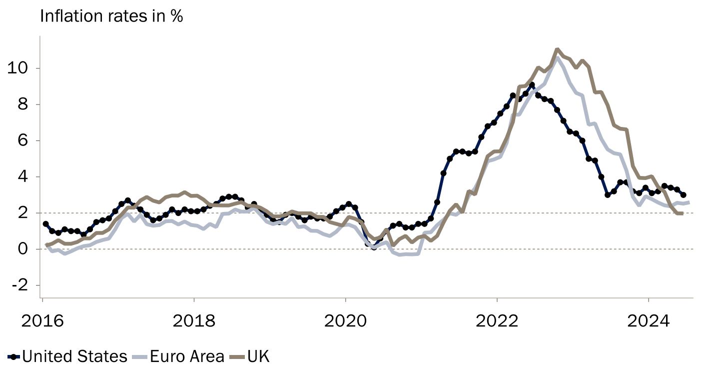
Japanese interest rate differentials should shrink further, leading to a stronger yen in the coming quarters, we do not believe that the Fed is behind the curve. Additionally, the BoJ's vice president indicated that further interest rate hikes would be unlikely this year as long as markets are unstable.

- Some market participants are moderating their expectations regarding the earnings potential of AI and some companies are reporting fading consumer demand in the US and China, yet the Q2 earnings season in the US was solid. In our equity strategy section, we will explain why we prefer more defensive sectors.

We now expect three rate cuts by the Fed this year

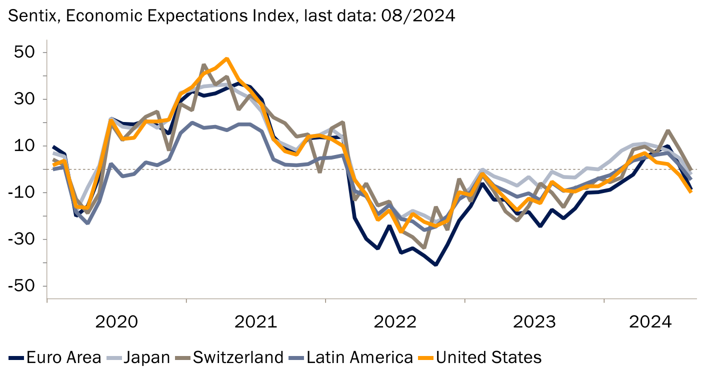
Overall, we believe that markets and central banks will focus less on the still elevated inflation rates and more on the labour market and deteriorating economic growth perspectives (Exhibits 1 and 2). In this environment, we expect three rate cuts by the Fed (previously one) and confirm our expectation for three more rate cuts by the ECB this year. Additionally, we have revised our forecasts for 2024 as follows: Euro area and Japan inflation both up to 2.5% from 2.4%, UK GDP up to 0.8% from 0.7% and GDP growth in China down to 4.8% from 5.1%. For 2025, we have lowered our inflation forecasts for the US to 2.6% from 2.7%, for Switzerland to 1.0% from 1.1% and increased it for Japan to 2.1% from 2.0%. We also increased our 2025 growth forecast for Japan from 1.2% to 1.3%. Please see our forecast overview table in Exhibit 34 on page 13.

Exhibit 1: Declining inflation in the US, euro area and UK



Source: Macrobond, Bank J. Safra Sarasin, 08.08.2024

Exhibit 2: Sentix indices are back in negative territory



Source: Macrobond, Bank J. Safra Sarasin, 08.08.2024

US Macro

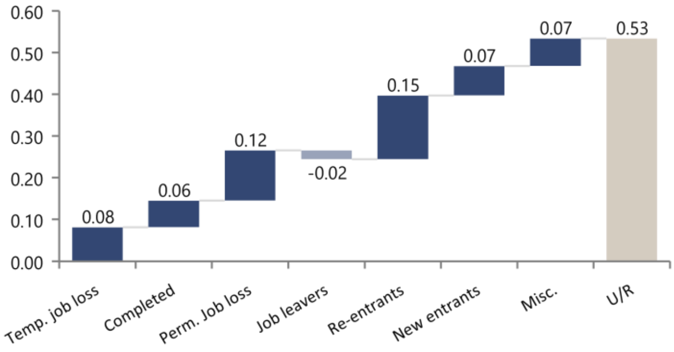
Investors are getting more concerned about the possibility of a US recession

Concerns about a US recession have resurfaced even before the latest ISM and labour market reports. Consumer confidence remained weak in July, with the gap between those saying jobs were plentiful and those saying jobs were hard to get falling to the lowest since March 2021. Earnings and industry reports, including the Fed's Beige Book, indicate that consumers are becoming price-sensitive again. Delinquency rates on credit cards have risen, and the bottom fifth of the income distribution now has 20% fewer liquid assets in real terms than before the pandemic. More broadly, the savings rate is very low at 3.4%, suggesting that consumers lack a buffer if the labour market deteriorates.

A large part of the rise in unemployment reflects stronger labour supply, unlike in previous times when it was primarily the result of permanent job losses

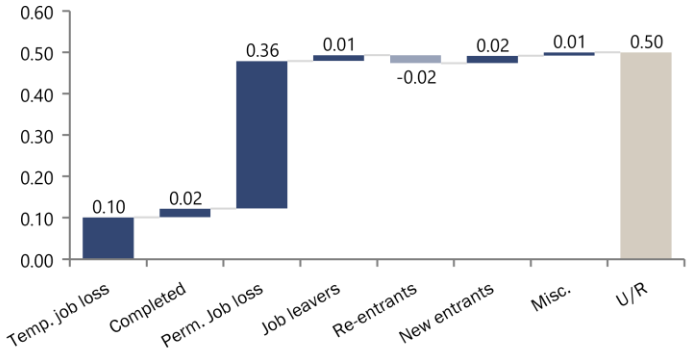
So, are we on the edge of a recession? We think not. As we have argued before, the unique characteristics of the current business cycle mean that many indicators that worked well in the past, such as the slope of the yield curve, might not be as accurate this time as they are based more on statistical regularities rather than economic rational. Moving back to the Sahm Rule, we can observe that the rise in the three-month average of the unemployment rate since it troughed in mid-2023 has a lot to do with people re-entering or joining the labour force. In contrast, in previous recessions, the 'rule' was triggered by job losses that then reduced personal income and spending by US households (Exhibits 3 and 4).

Exhibit 3: Labour supply has driven the unemployment rate higher since its trough in June 2023



Source: Macrobond, Bank J. Safra Sarasin, 08.08.2024

Exhibit 4: Between December 2000 and June 2001 the increase of the unemployment rate was driven by permanent job losses



Source: Macrobond, Bank J. Safra Sarasin, 08.08.2024

There are currently few signs pointing to widespread layoffs

History shows that recessions are associated with widespread layoffs. Currently, there are few signs of this happening. Actually, in June, the layoff rate has been at its lowest level in the 24-year history of the series. Initial claims surprised on the downside this week and confirm that hurricane Beryl has distorted the last labour market report. Cyclical indicators, such as truck sales, also point to low unemployment in the coming months. In short, the data indicate a cooling labour market, not a weak one.

But it's clear that labour demand is cooling

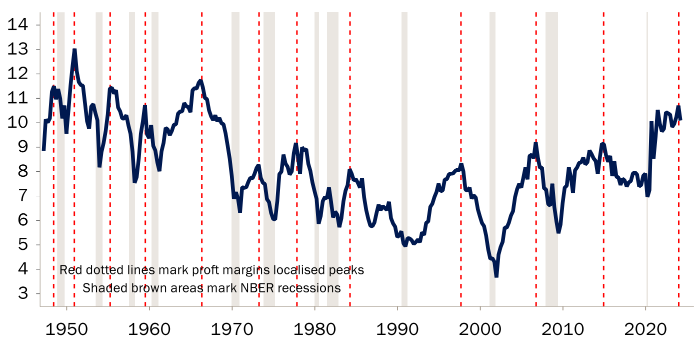
This does not mean that the rise in unemployment is insignificant. As labour supply has increased through stronger immigration flows and a higher participation rate among prime-age workers, cooling demand means that workers are taking longer to find jobs once they enter the labour force. The hiring rate has steadily declined since its peak at the end of 2021 and is now below its long-run average.

Elevated profit margins suggest that the unemployment rate is likely to remain low in 2H

Could large scale layoffs become inevitable if demand continues to moderate in the second half of the year? Again, we think this is unlikely in the short term. Companies do not tend to lay off workers when profit margins are elevated. Historical evidence shows that margins need to be significantly squeezed — by at least one to two percentage points — and for some time before companies reduce headcounts. Currently, margins for the non-financial sector remain close to their cyclical peak, suggesting strong final demand despite elevated labour costs (Exhibits 5 and 6). Even among small companies, the NFIB survey indicates that only 6% report poor sales as their most important problem; inflation and labour quality remain their main concerns.

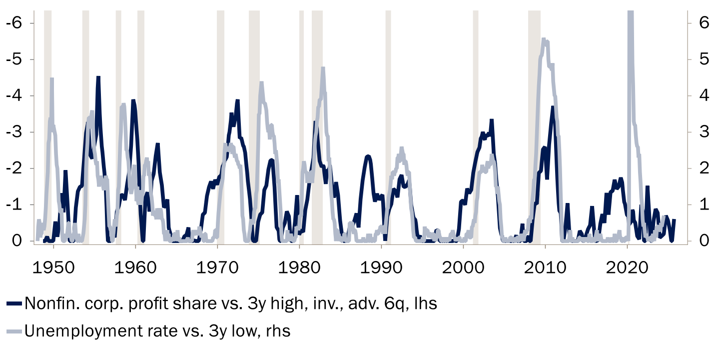
Exhibit 5: Profit margins remain close to their cyclical peak

Non-financial corporate profits as share of national income



Source: Macrobond, Bank J. Safra Sarasin, 05.08.2024

Exhibit 6: Corporates don't lay off workers when margins are high



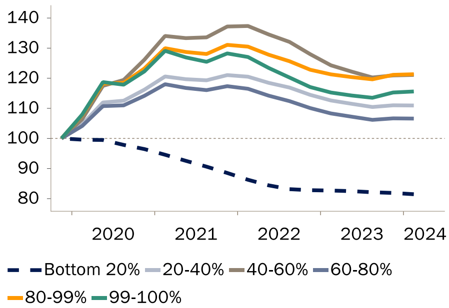
Source: Macrobond, Bank J. Safra Sarasin, 05.08.2024

Household balance sheets in aggregate are solid

Finally, households may have more of a buffer than sometimes reported. While the bottom 20% of the income distribution has been squeezed by high prices and interest rates, the rest of the population's financial situation appears robust, with real liquid financial assets up 10-20% compared to pre-pandemic levels. With equity and house prices rising significantly, aggregate net wealth has increased over the past year and is well above its pre-pandemic trend. And despite rising interest rates, household debt service ratios are near historical lows, reflecting fixed mortgage rates and relatively low indebtedness (Exhibits 7 to 9).

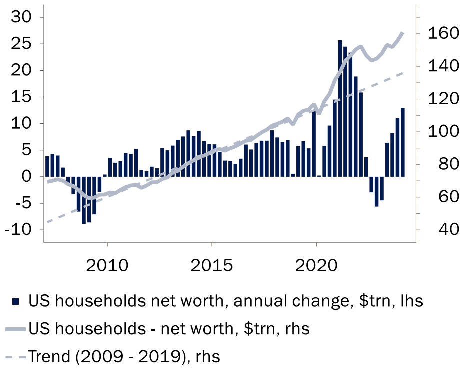
Exhibit 7: Most households still in the green

Liquid financial assets by income distribution, real USD (rebased 4Q19 = 100)



Source: Macrobond, Bank J. Safra Sarasin, 05.08.2024

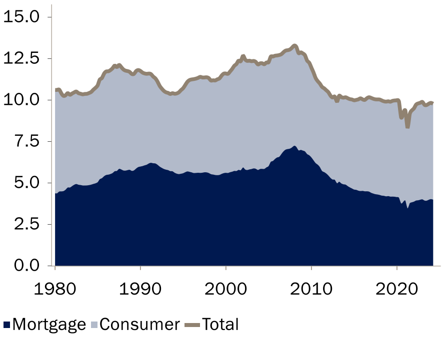
Exhibit 8: Net wealth has risen strongly



Source: Macrobond, Bank J. Safra Sarasin, 05.08.2024

Exhibit 9: Low debt service ratios

Debt service ratios, % disposable personal income

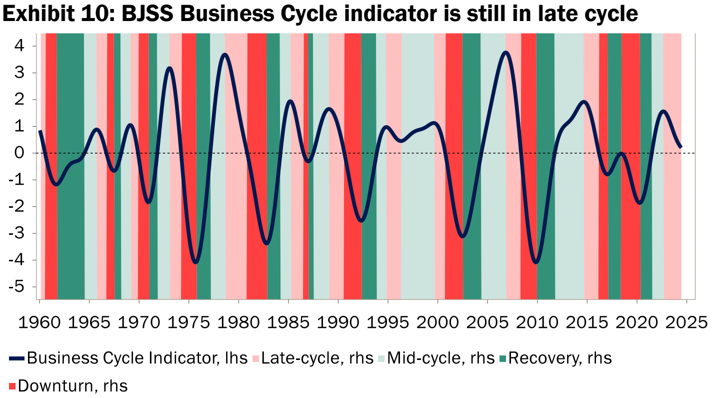


Source: Macrobond, Bank J. Safra Sarasin, 05.08.2024

Risks to the economy are skewed to the downside

In summary, the US economy is still on track for a soft landing. However, the risks of negative surprises have increased. Our Business Cycle Indicator suggests that the economy has moved deeper into its late cycle phase. So far, the desynchronised nature of this business cycle, with the different sub-cycles at different stages, has kept the overall expansion going, as was the case in the mid-90s (Exhibits 10 and 11). Still, we note that our six-month ahead recession probability model has risen as of late, reflecting a higher real fed funds rate and weaker building permits. Thus, the risks to our growth forecasts have increased. As a result, we added two further Fed rate cuts to our forecast for the second half of this year and now expect the Fed Funds rate at 4.75% towards the end of 2024 and at 3.75% towards the end of 2025, respectively.

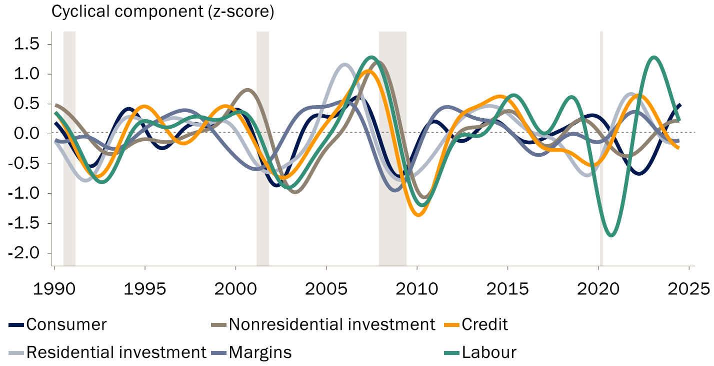
Exhibit 10: BJSS Business Cycle indicator is still in late cycle



Source: Macrobond, Bank J. Safra Sarasin, 31.07.2024

Exhibit 11: Out of sync cycles are keeping expansion going

Cyclical component (z-score)



Source: Macrobond, Bank J. Safra Sarasin, 31.07.2024

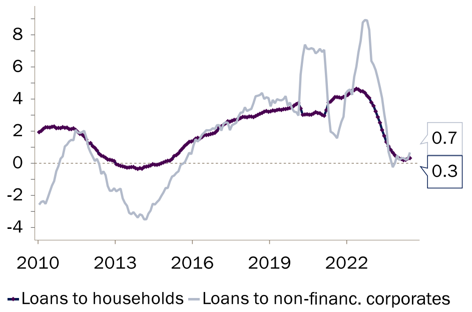
Euro area

Disappointing economic dynamics in the euro area

Euro area data have been mixed. Q2 GDP surprised positively with a growth rate of 0.3% qoq. Regional patterns remained familiar. Germany (-0.1%) and Austria (0.0%) disappointed, while Spain (0.8%) and Ireland (1.2%) were marching ahead. Inflation unexpectedly increased to 2.6% yoy in July from 2.5% in June. The increase was primarily driven by higher energy prices. Services inflation moderated slightly to 4.0%, but is still the biggest obstacle to faster and stronger policy rate cuts. We continue to consider ECB rates as far too high and expect three more rate cuts by 25bp this year. We do not believe that higher real wages alone can lead to a sustainable economic recovery as long as high real interest rates provide such a strong disincentive to investment spending. Unfortunately, latest indicators support our pessimism. Credit growth remains very low, PMIs have disappointed in July and even the unemployment rate has picked up slightly. Although consumer confidence continues to pick up, it remains below its long-term average, such that the increase of the savings rate to 15.3% in Q1 is no surprise. (Exhibits 12 to 14).

Exhibit 12: Low credit growth

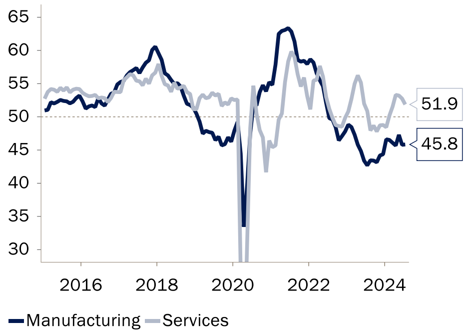
Euro area, Loans Adjusted for Sales & Securitisation in % yoy, latest data: 06/2024



Source: Macrobond, Bank J. Safra Sarasin, 08.08.2024

Exhibit 13: Falling PMIs

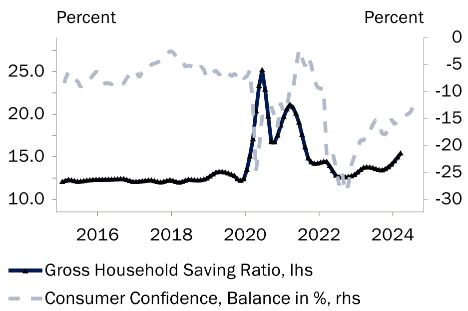
PMI, output (Index >50 = expansion), last data: 07/2024



Source: Macrobond, Bank J. Safra Sarasin, 08.08.2024

Exhibit 14: Increasing savings rate

Household saving ratio in %, latest Eurostat data: 03/2024



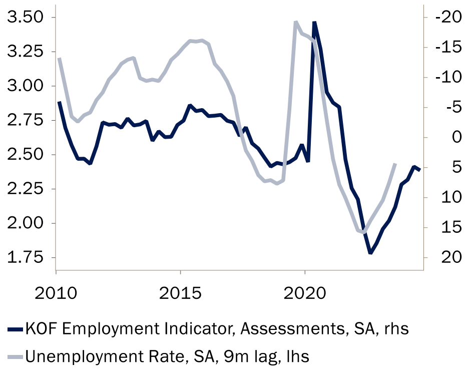
Source: Macrobond, Bank J. Safra Sarasin, 08.08.2024

Switzerland

The economy grows below potential

Switzerland's macro dynamics are somewhat better than in the euro area, mainly because inflation has been under control for a while, which enabled the Swiss National Bank (SNB) to cut policy rates almost back to neutral again. That said, the Swiss manufacturing sector is suffering from a lack of demand from its trading partners and a slight overvaluation of the Swiss franc. Unemployment has been rising and should increase further as the economy is growing below potential (Exhibit 15). Economic demand has replaced scarcity of labour as the main reason that is restricting additional output.

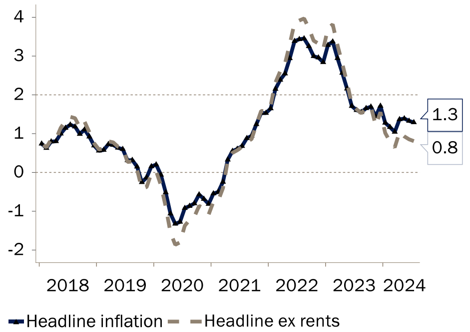
Exhibit 15: Unemployment and KOF



Source: Macrobond, Bank J. Safra Sarasin, 08.08.2024

Exhibit 16: Inflation ex rent matters most

Swiss Inflation, CPI in % yoy, latest data: 07/2024



Source: Macrobond, Bank J. Safra Sarasin, 08.08.2024

Exhibit 17: Nominal wage growth

Federal Statistical Office, Estimate of Nominal Wages, in % yoy, latest data: 2024 Q1

Source: Macrobond, Bank J. Safra Sarasin, 08.08.2024

The headline inflation rate at 1.3% yoy should not be misinterpreted as a signal that inflation risks are towards the upper end of the SNB inflation target range of 0% to 2%. Risks are skewed to the downside. CPI ex rent – currently the best measure of underlying inflation – fell to 0.8% yoy in June (Exhibit 16). Nominal wage growth amounted to only 0.6% yoy in Q1 and is hardly a source of inflation in the coming quarters (Exhibit 17). The strong Swiss franc will lower import prices further. As a result, we stick to our previous forecast that the SNB will cut its policy rate to 1% in September and to 0.5% by the same time next year. As a consequence, monetary policy would be broadly neutral by fall and become expansionary by next spring. We have lowered our inflation forecasts slightly to 1.0% for 2025 on reports that electricity prices are likely to fall by around 8% next January. We also see the risks to our policy rate forecast on the downside. Given that we expect the ECB and the Fed to cut by 150bp and 175bp respectively, Swiss interest rate differentials versus the euro and the dollar would narrow meaningfully, which could put upward pressure on the Swiss franc.

Fixed income

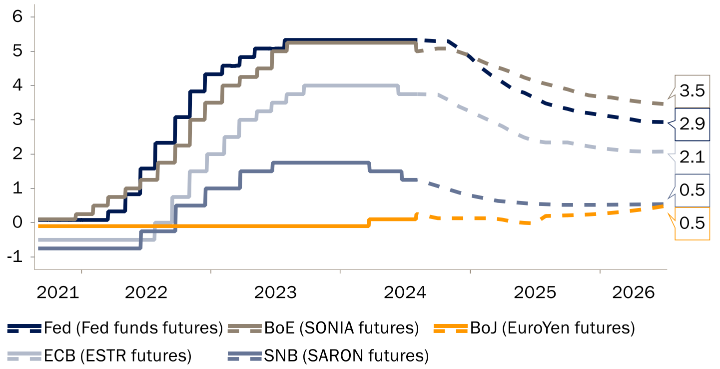
The past week's bout of volatility is characteristic for late-cycle behaviour in financial markets

The past week's bout of volatility in financial asset markets is characteristic for late (interest rate) cycle behaviour in financial markets. When interest rates are held in restrictive territory for a prolonged period of time, the risk for negative economic surprises increases and stretched valuations for financial assets tend to get challenged. This time, it was the unwind of the yen carry trade that led to selling pressure in risky assets and a flight to safety. The weak readings on the ISM manufacturing index and the soft employment report from the establishment survey raised fears of a US recession and accelerated the sell-off.

Markets have shifted from the "high-for-longer" narrative to pricing multiple fast cuts as downside risks to growth have increased

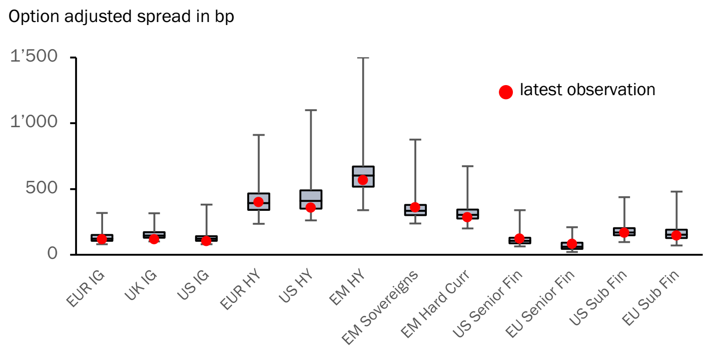
The market narrative has shifted once again from "high-for-longer" to multiple and fast rate cuts, particularly in the US. Forward markets imply 110bp worth of Fed cuts until the end of 2024 and a cumulative 220bp of cuts until the end of 2025 (Exhibit 18). But also, implied policy rate trajectories in Europe have moved lower over the past few weeks, as economic data has come in softer than expected. We acknowledge that downside risks to growth have increased as the global manufacturing sector is weakening again. However, the spill-over to the service sector seems more moderate than in previous cycles. Consequently, a US recession in particular is not our base.

Exhibit 18: Markets still price a relatively shallow rate cut trajectory



Source: Bloomberg, Bank J. Safra Sarasin, 08.08.2024

Exhibit 19: IG credit spreads tight, HY spreads have has widened a bit



Source: ICE, Bank J. Safra Sarasin, 08.08.2024, daily data since 2012

The risk/return trade-off for owning duration is attractive

While we do not see convincing signals for a recession in the US, we see clearer signs of moderating growth and only a slow economic recovery in the euro area and the UK. Monetary policy is still restrictive across developed markets. We now forecast three rate cuts by the Fed in 2024, less than the market is currently priced for, and we also expect three cuts by the ECB and the Bank of England. We are at a stage of the cycle at which the probability for negative economic surprises increases and the risk of significant losses even on longer duration fixed income instruments is greatly diminished. We see risks for even lower yields over the next 6 to 12 months and steeper yield curves. We therefore conclude that the risk/return trade-off for owning duration has improved further. Intermediate maturities (5 to 10 years) are preferred as (i) they benefit from steeper yield curves; (ii) they have sufficient duration to profit from lower yields, and (iii) current intermediate yields provide significant downside protection in an adverse yield scenario.

Neutral on credit for now, neutral on IG vs HY

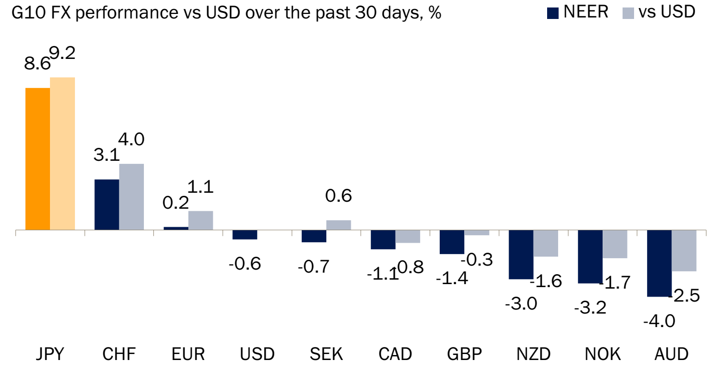
Credit spreads continue to be tight even after the recent widening (Exhibit 19). While they can grind a bit tighter in the short term when central banks cut rates, they will likely widen more over the next 6 to 12 months. In the absence of meaningful economic weakness, the magnitude of the expected widening should be contained. We therefore retain our neutral assessment on credit for now, both for Investment Grade (IG) and High Yield (HY). That said, this position needs to be evaluated on an ongoing basis.

FX

A weaker-than-expected US labour market and soft manufacturing data pushed the dollar down, while the yen posted large gains

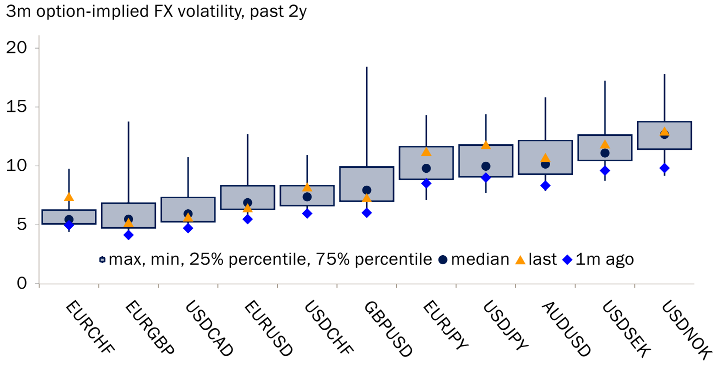
Last week's market correction also left its mark on the currency space. While FX rates remained fairly steady following the Fed's rate decision on July 31, they were quick to react after the release of a weaker-than-expected ISM manufacturing index on August 1, where the employment component in particular surprised to the downside. What's more, last week's uptick in the US unemployment rate pushed the real-time «Sahm rule» indicator into recession territory. As a result, the DXY dollar index suffered. The Japanese yen was the big winner in the G10 FX space, gaining around 10% both against the dollar and in trade-weighted terms over the past 30 days (Exhibit 20). The euro was able to post some gains, given that the US cycle appeared to slow at a relatively faster pace compared to the euro area. Also, FX option-implied volatilities rose markedly and are trading around their two-year median levels (Exhibit 21).

Exhibit 20: The yen was the big winner over the past 30 days



Source: Macrobond, Bank J. Safra Sarasin, 08.08.2024

Exhibit 21: FX-option implied volatilities closer to their 2y averages

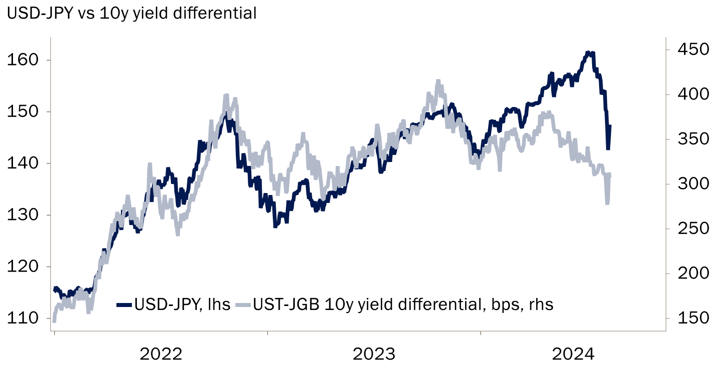


Source: Bloomberg, Bank J. Safra Sarasin, 08.08.2024

The yen should appreciate further against the dollar while euro and sterling will likely be range-bound in the months ahead; FX volatilities should rise as we approach the US election date

While we expect US data to continue to soften going forward, we are less inclined to think that this will push the dollar meaningfully lower from here. In our view, the drop in longer-term US Treasury yields relative to other G10 rates has gone quite far. Also, the dollar's uncertainty premium is unlikely to fade ahead of the US elections, which should keep asset price volatility elevated and support the dollar. Given the yen's recent rally, USD-JPY is now more in sync with its yield differential (Exhibit 22). Another wave of the yen-funded carry trade unwind will likely push the yen still somewhat higher towards year-end. Yet we do not expect USD-JPY to fall meaningfully below 140, which in our view would require the US to fall into recession. Our view on the euro and the pound are unchanged. Over the coming months, we expect both currencies to be range-bound versus the dollar, but note that FX volatility is likely to increase as we are moving closer to the US election date.

Exhibit 22: USD-JPY now more in sync with its yield differential

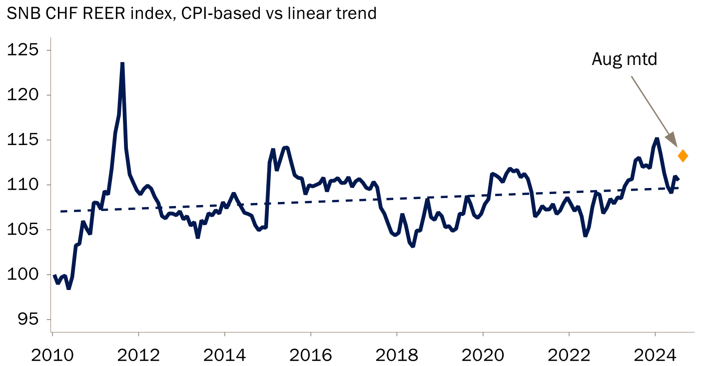


Source: Macrobond, Bank J. Safra Sarasin, 08.08.2024

Exhibit 23: USD-CHF has fallen in excess of what yields suggest

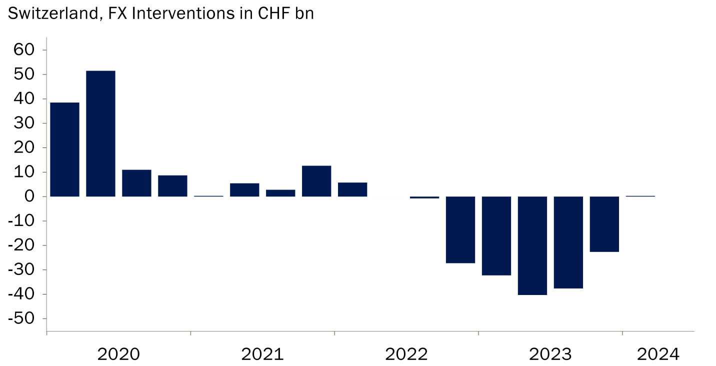
Source: Macrobond, Bank J. Safra Sarasin, 08.08.2024

Exhibit 24: Swiss franc back at the SNB's FX intervention levels?



Source: SNB, Macrobond, Bank J. Safra Sarasin, 08.08.2024

Exhibit 25: SNB's focus should be back on purchasing foreign currency



Source: Macrobond, Bank J. Safra Sarasin, 08.08.2024

Expect the Swiss franc to dip around the SNB's next rate cut, but there is upside into the coming year

Likewise, the Swiss franc has risen markedly as a reaction to a lower Swiss yield disadvantage. While the USD-CHF has eased somewhat, it remains a bit stretched as the pair has undershot the level that shorter-term yields would indicate (Exhibit 23). Therefore, the Swiss franc's near-term upside looks limited and we explicitly note the possibility of a dip once the SNB delivers its next rate cut in September – as we expect. Given its strength, the SNB will focus on limiting the Swiss franc's upside rather than managing downside risk (Exhibits 24 and 25). In inflation-adjusted terms, the Swiss franc again trades significantly above its long-term trend, which suggests that we have moved a bit closer to the SNB's intervention threshold. We are more constructive on the Swiss franc into the coming year as the currency should benefit from a further retracement in global rates. Most central banks are set to deliver more rate cuts than the SNB, which should also affect the longer end of the rate curve and reduce the Swiss yield disadvantage. The Swiss currency also holds up well in an environment of weakening global activity.

Gold should remain well-supported as ETF buying is picking up

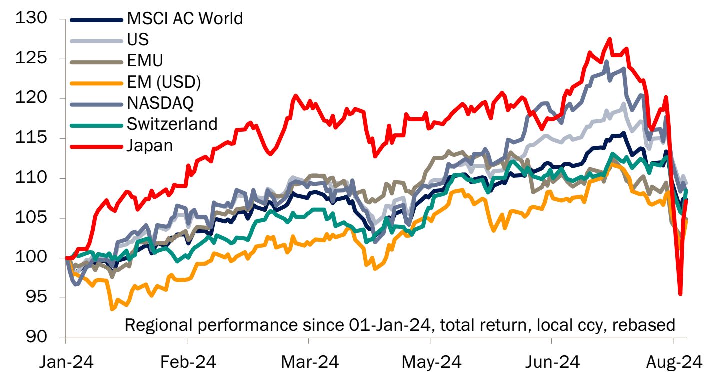
While initially benefitting from lower real yields, gold has retraced to its July average at around $2'400 per troy ounce. We believe the price drop is a result of recent profit-taking amid rising liquidity needs following the slump in risk assets. Yet ETF buying is picking up as of late, which should act as a tailwind. We do not expect an accelerated rally for the precious metal, but the environment should remain generally supportive, given softening macro momentum and nearing US elections.

Equities

The recent rotation in equity markets has levelled year-to-date performances among major regional indices

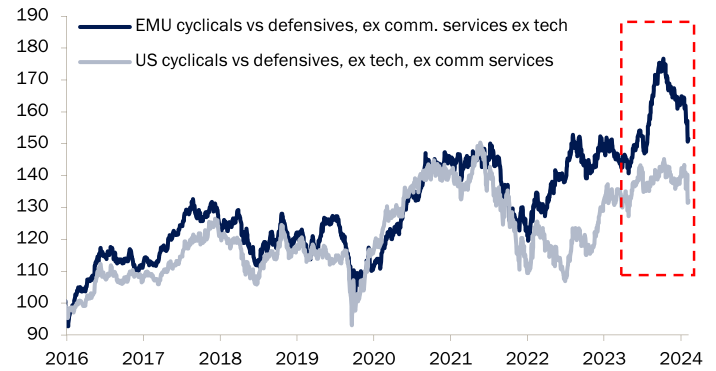
Equity markets have seen a volatile few days. Triggered by a combination of moderating inflation, disappointing US manufacturing data and indications that the US labour market may be slowing, US yields plunged and equity markets rotated sharply out of segments which had suffered the most from rising rates before. Most notably, the Japanese equity market experienced a watershed moment, briefly erasing all of its year-to-date (ytd) gains, which had peaked at 27% in July, before settling at a ytd gain of 7% on 7 August 2024 (Exhibit 26). Taking a bit of a broader view, it is interesting to see that the moves over the past few weeks have all but levelled regional differences in performance this year. While Japanese equities and US tech had clearly led global equities until mid-July, the recent unwind has narrowed the performance of all major regional indices to 4% to 7% year-to-date. Among equity sectors, a similar shake-out has happened. European and US cyclicals, which had outperformed strongly over recent months, fully erased their ytd leadership in a matter of weeks, while defensive sectors regained previous losses (Exhibit 27).

Exhibit 26: The recent rotation has levelled year-to-date gains



Source: Refinitiv, Bank J. Safra Sarasin, 08.08.2024

Exhibit 27: Cyclicals have given up their year-to-date outperformance



Source: Refinitiv, Bank J. Safra Sarasin, 08.08.2024

The recent episode is likely more of a trend reversal than a one-off

The most pressing question obviously is whether the recent moves have been a one off or if they mark a reversal in recent market trends. We tend to argue for the latter and would thus stick to our more defensive allocation, which tends to work in an environment of slowing growth, moderating inflation and falling yields.

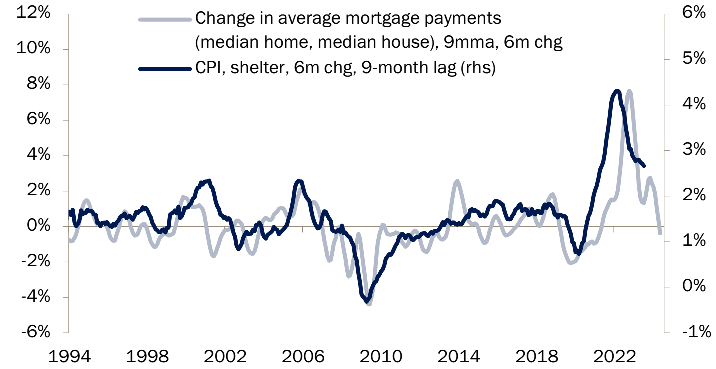
Inflationary pressures continue to ease and should do so going forward

As we had argued before, inflation is unlikely to re-accelerate materially in the near-term, for two reasons; (i) super-core services (ex-rent) inflation tends to follow the non-manufacturing ISM with a 12-month lag (Exhibit 28). Given the moderation in the non-manufacturing ISM over the past year, super-core services inflation should accordingly be at around current levels or slightly lower in the months ahead; (ii) the rent component should not be much of an inflation driver either. It tends to follow housing affordability measures, which are a function of mortgage rates. As mortgage rates have declined in line with treasury yields, the upside pressure on rents and shelter inflation has faded (Exhibit 29).

Exhibit 28: Super-core services inflation is set to trend lower

Source: Refinitiv, Bank J. Safra Sarasin, 08.08.2024

Exhibit 29: Upside pressure on shelter CPI is fading

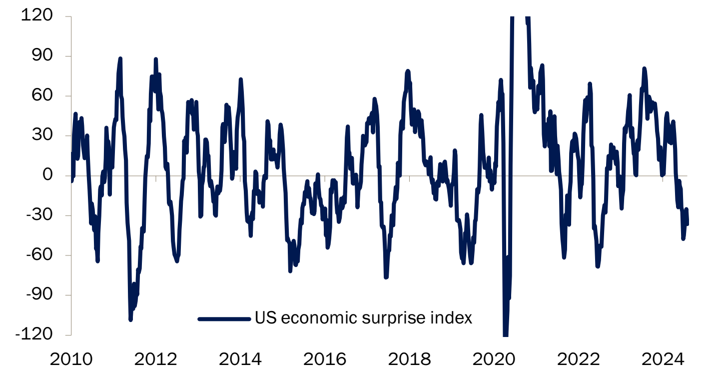


Source: Refinitiv, Bank J. Safra Sarasin, 08.08.2024

The cycle has been softening

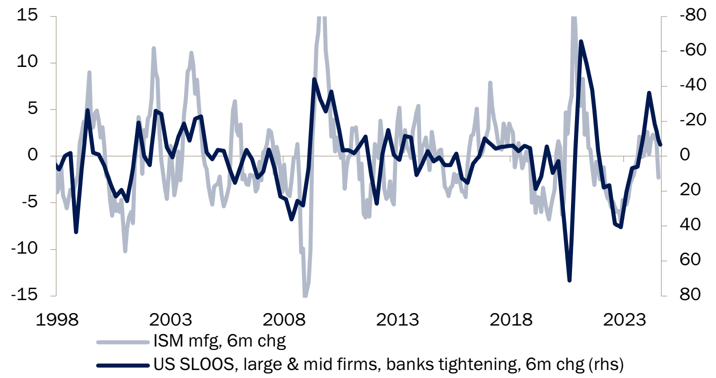
With inflation being less of an issue, the market has recently been much more focussed on the macro cycle. Here, the data has generally been on the softer side, most notably the manufacturing ISM and July labour market data. But other data have been weaker as well, reflected by the fact that macro surprises have recently dropped to the lowest level since mid-2022 (Exhibit 30). Looking ahead, while surprises may improve, we believe the low point has yet not been reached for many indicators.

Exhibit 30: Macro surprises at the lowest since mid-2022



Source: Refinitiv, Bank J. Safra Sarasin, 08.08.2024

Exhibit 31: Financing conditions are not easing as quickly anymore



Source: Refinitiv, Bank J. Safra Sarasin, 08.08.2024

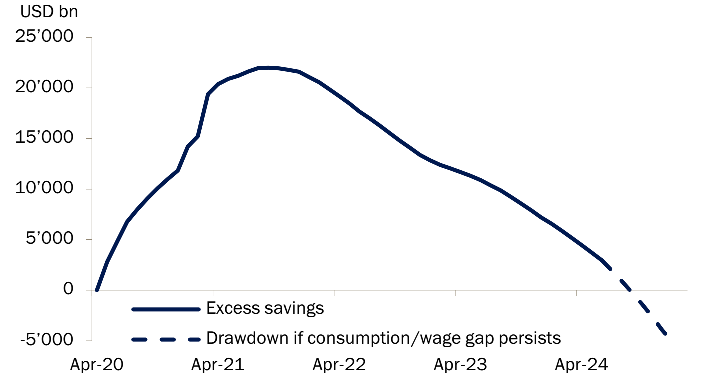
Indicators related to manufacturing have dropped while the pressure on consumers is rising

With regard to manufacturing, the credit cycle has peaked in Q1 2024, when the pace of easing of lending conditions was the strongest (Exhibit 31). As regards the non-manufacturing sector, several factors that have supported the US consumer are fading as well. Excess savings, are close to being fully depleted, which will likely result in US households raising their propensity to save at the cost of consumption going forward (Exhibit 32). An easier labour market may further weigh on household's willingness to spend and fiscal policy now is also a headwind to growth.

Companies provided a rather downbeat view on the US consumer in their Q2 reporting

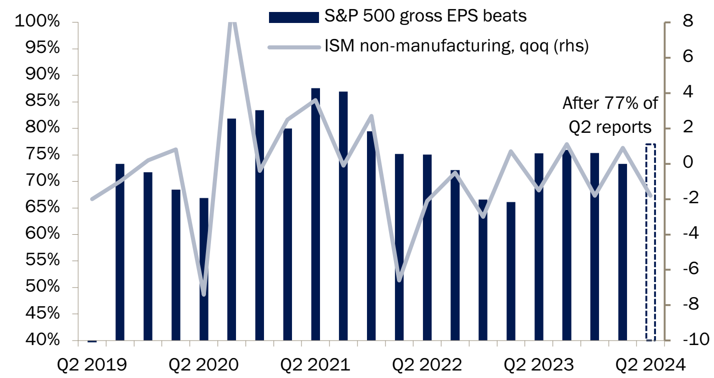
Q2 reporting also provided interesting insights into the health of the consumer. Even though headline earnings data had been quite strong for Q2, with 77% of US companies beating expectations, the take from companies on demand growth was substantially more cautious (Exhibit 33). Travel-related businesses reported a tapering of the post-pandemic travel boom, some auto manufacturers disappointed as customers pushed back car purchases. But also, fast food chains, consumer durables, household & personal goods as well as food & beverage companies reported softening demand.

Exhibit 32: US household excess savings close to depleted



Source: Refinitiv, Bank J. Safra Sarasin, 08.08.2024

Exhibit 33: Q2 reporting has been solid at the surface



Source: Refinitiv, Bank J. Safra Sarasin, 08.08.2024

We stick to our defensive preferences

We would thus reiterate our cautious stance, given the persistent uncertainty around the cycle and the fact that various indicators imply that the current slowdown has room to run.

J. Safra Sarasin

Cross-Asset Weekly

09 August 2024

Exhibit 34: JSS Forecast overview

Breakdown per Asset Class

Equities Countries / Regions	
USA	→
Eurozone	→
Switzerland	↑
United Kingdom	→
Japan	↓
Emerging Markets	→
China	→

Equity Sectors	
Energy	→
Materials	→
Industrials	↓
Consumer Discretionary	↓
Consumer Staples	↑
Health Care	↑
Banks	↓
Insurance	→
Information Technology	→
Communication Services	→
Real Estate	→
Utilities	↑

Fixed Income Performance	
US Treasuries	→
German Bunds	→
UK Gilts	→
Swiss Eidgenossen	→
IG Credit	→
HY Credit	→
EM USD Government Bonds	→

↑ **Overweight** → **Neutral** ↓ **Underweight**

Asset class views (overweight, neutral, underweight) express a tactical recommendation with a 3-month horizon. Tactical views might diverge from year-end stock index targets, which are based on our long-term economic and interest rate forecasts.

Stock Index Price Targets

	07.08.	4Q24	2Q25	4Q25
S&P 500	5’200	5’500	5’700	5’900
MSCI UK	2’336	2’500	2’500	2’500
DJ Euro Stoxx 50	4’668	5’000	5’150	5’300
DAX	17’615	19’300	19’900	20’500
SMI	11’843	12’800	12’950	13’100
MSCI Japan	1’532	1’650	1’700	1’750
MSCI EM	1’050	1’100	1’125	1’150
MSCI China	56	61	62	63

Key Policy Rates in %

	07.08.	4Q24	2Q25	4Q25
US Fed Funds	5.50	4.75	4.25	3.75
EUR Depo Rate	3.75	3.00	2.50	2.25
SNB Target Rate	1.25	1.00	0.75	0.50
BoE Base Rate	5.00	4.50	4.00	3.50
BOJ Policy Balance Rate	0.00	0.25	0.50	0.50

Bond Yields (10yr Benchmark)

	07.08.	4Q24	2Q25	4Q25
USA	3.95	4.10	4.05	3.95
Germany	2.21	2.10	2.25	2.40
Switzerland	0.44	0.70	0.90	1.05
United Kingdom	3.98	3.85	3.65	3.50
Japan	0.89	0.95	1.05	1.10

FX-Forecasts

	07.08.	4Q24	2Q25	4Q25
EUR-CHF	0.94	0.94	0.93	0.92
EUR-USD	1.09	1.08	1.10	1.12
EUR-GBP	0.86	0.85	0.86	0.87
GBP-USD	1.27	1.27	1.28	1.29
USD-JPY	147	140	136	132
USD-CHF	0.86	0.87	0.85	0.82
USD-CNY	7.18	7.40	7.35	7.30
Gold, USD per ounce	2’400	2’500	2’550	2’600

Macro Forecasts

		2023	2024	2025
US	GDP	2.5	2.5	1.5
	CPI	4.1	3.0	2.6
Euroland	GDP	0.4	0.7	1.0
	CPI	5.4	2.5	2.3
Switzerland	GDP	0.7	1.3	1.0
	CPI	2.1	1.3	1.0
UK	GDP	0.1	0.8	1.0
	CPI	7.3	2.6	2.3
Japan	GDP	1.8	-0.1	1.3
	CPI	3.3	2.5	2.1
China	GDP	5.2	4.8	4.5
	CPI	0.3	0.4	1.1

Economic Calendar

Week of 12/08 – 16/08/2024

Country	Time	Item	Date	Unit	Consensus Forecast	Prev.
Monday, 12.08.2024						
US	17:00	NY Fed 1-Yr Inflation Expectations	Jul	%	--	3.02%
Tuesday, 13.08.2024						
UK	08:00	Average Weekly Earnings 3M/YoY	Jun	yoy	--	5.70%
	08:00	Employment Change 3M/3M	Jun	3M/3M	--	19k
GE	11:00	ZEW Survey Expectations	Aug	Index	--	43.70
US	13:00	NFIB Small Business Optimism	Jul	Index	91.50	91.50
	14:30	PPI Ex Food and Energy MoM	Jul	mom	0.20%	0.20%
	14:30	PPI Ex Food, Energy, Trade YoY	Jul	yoy	--	3.00%
Wednesday, 14.08.2024						
UK	08:00	CPI MoM	Jul	mom	--	0.20%
	08:00	CPI YoY	Aug	yoy	--	2.00%
	08:00	CPI Core YoY	Sep	yoy	--	3.50%
EU	11:00	GDP SA QoQ	2Q	qoq	--	0.30%
	11:00	GDP SA YoY	2Q	yoy	--	0.60%
US	14:30	CPI Ex Food and Energy MoM	Jul	mom	0.20%	0.10%
	14:30	CPI Ex Food and Energy YoY	Jul	yoy	3.20%	3.30%
Thursday, 15.08.2024						
UK	08:00	GDP QoQ	2Q	qoq	--	0.70%
	08:00	GDP YoY	2Q	yoy	--	0.30%
	08:00	Industrial Production MoM	Jun	mom	--	0.20%
	08:00	Industrial Production YoY	Jul	yoy	--	0.40%
US	14:30	Philadelphia Fed Business Outl.	Aug	Index	7.00	13.90
	14:30	Empire Manufacturing	Aug	Index	-6.00	-6.60
	14:30	Retail Sales Control Group	Jul	mom	0.10%	0.90%
	14:30	Initial Jobless Claims	Aug10	1'000	--	--
	16:00	NAHB Housing Market Index	Aug	Index	--	42.00
Friday, 16.08.2024						
UK	08:00	Retail Sales Ex Auto Fuel MoM	Jul	mom	--	-1.50%
	08:00	Retail Sales Ex Auto Fuel YoY	Jul	yoy	--	-0.80%
US	14:30	Building Permits MoM	Jul	1'000	1435k	1446k
	16:00	U. of Mich. Expectations	Aug	Index	--	68.80
	16:00	U. of Mich. 5-10 Yr Inflation	Aug	%	--	3.00%

Source: Bloomberg, J. Safra Sarasin as of 07.08.2024

J. Safra Sarasin

Cross-Asset Weekly

09 August 2024

Market Performance

Global Markets in Local Currencies

Government Bonds	Current value	Δ 1W (bp)	Δ YTD (bp)	TR YTD in %
Swiss Eidgenosse 10 year (%)	0.45	5	-25	2.5
German Bund 10 year (%)	2.27	9	24	-0.2
UK Gilt 10 year (%)	3.98	1	44	-0.5
US Treasury 10 year (%)	3.97	18	9	2.0
French OAT - Bund, spread (bp)	75	-5	21	
Italian BTP - Bund, spread (bp)	143	-3	-25	

Stock Markets	Level	P/E ratio	1W TR in %	TR YTD in %
SMI - Switzerland	11,827	18.3	-4.0	9.5
DAX - Germany	17,680	13.0	-2.2	5.5
MSCI Italy	1,022	8.7	-3.1	6.6
IBEX - Spain	10,558	10.2	-2.7	7.9
DJ Euro Stoxx 50 - Eurozone	4,669	13.1	-2.0	6.2
MSCI UK	2,330	11.9	-1.4	8.0
S&P 500 - USA	5,319	22.2	-2.3	12.4
Nasdaq 100 - USA	18,414	28.0	-2.5	9.9
MSCI Emerging Markets	1,046	12.6	-3.7	4.3

Forex - Crossrates	Level	3M implied volatility	1W in %	YTD in %
USD-CHF	0.87	8.4	0.8	3.0
EUR-CHF	0.95	7.4	1.1	1.8
GBP-CHF	1.10	8.7	0.6	3.1
EUR-USD	1.09	6.3	0.1	-1.1
GBP-USD	1.28	7.5	-0.4	0.2
USD-JPY	147.0	12.0	0.3	4.2
EUR-GBP	0.86	5.1	0.5	-1.2
EUR-SEK	11.47	7.8	-0.6	3.0
EUR-NOK	11.84	9.3	-0.9	5.5

Commodities	Level	3M realised volatility	1W in %	YTD in %
Bloomberg Commodity Index	96	10.7	-0.9	-3.1
Brent crude oil - USD / barrel	80	28.3	-1.6	3.7
Gold bullion - USD / Troy ounce	2,419	16.5	-1.1	17.2

Source: J. Safra Sarasin, Bloomberg as of 07.08.2024

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