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Stock markets convey an ambivalent picture amidst most recent correction

Will we still see a year-end rally?

After a disastrous year for equities as well as bonds in 2022, expectations were high that at least some of last year's losses could be recouped in the current year. Since mid-year, however, the markets have been stumbling. One of the main reasons is the surprisingly sharp rise in longer-term capital market interest rates. The roots and causes that are brought forward for this interest rate surge are manifold and, in our opinion, not all convincing or sustainable. We maintain our view that the rise in long-term interest rates is exaggerated and, moreover, that key central bank rates have peaked.

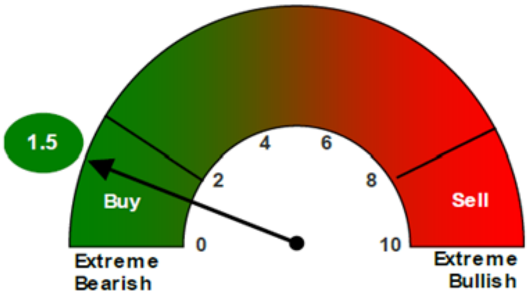
There are some striking discrepancies on the stock markets in terms of performance:
- Swiss stocks, small caps, Asian equities as well as the Dow Jones are all hovering around zero or negative performance year-to-date
- The S&P 500 gains just under 10%, the Nasdaq just over 20%
- Industry-wise, select IT stocks swing far out in front, while the majority of other sectors, for example the health care sector, show a negative performance on average

Differences in performance within an industry are not surprising, and depend on many factors such as cost control, price competitiveness, product innovation, government incentives, etc. Differences at the index level are also not surprising, as the composition can vary widely. The topic of artificial intelligence has further been dominating the stock markets this year and is thus somewhat distorting the information content of the headline performance numbers of stock markets. If the performance of the S&P 500 is calculated excluding the most important AI stocks, the result is a performance of -6%. The same calculation applied to the Nasdaq yields an almost identically negative result, which stands in stark contrast to the 21% of the overall index.

This correction shows that the stock markets are generally pricing in economic weakness, but not a recession. For Europe, this appears to be a plausible, and perhaps even somewhat optimistic, assumption. The industrial recession may have bottomed out, but weaknesses in the services sector could become more pronounced. For the USA, the economic assessment is more difficult. The economy is currently growing at a rate of almost 5%, well above average, and appears to be immune to the restrictive monetary policy. Strong fiscal stimulus and covid savings are counteracting the interest rate policy. The question remains open as to whether the USA will manage to achieve a soft landing or whether the long-predicted recession will occur, but with an unusual time lag as a result of the aforementioned factors.

At present, pessimism prevails on the stock markets, as indicated for example by the widely followed Bank of America indicator (chart at the bottom). Sentiment is also being depressed by geopolitical events and developments, which are fuelling uncertainty. The current focus is on fears that the conflict between Israel and Hamas could spread regionally and that the supply of oil and natural gas could be impaired.

For the last two months of the year, the U.S. stock market will largely be determined by quarterly earnings and, in particular, the companies' indications for the future outlook of their businesses and the wider economy. In general, and for all markets, interest rates will continue to have a significant impact and we tend to think rather a positive one. There remains a rest of economic uncertainty and a geopolitical premium that can change relatively quickly. Admittedly, many things are conceivable in this constellation. We tend to interpret the markets positively, although we would refrain from increasing equity positions. Indeed, the attractiveness of bonds cannot be overlooked and offers a valid alternative in the composition of overall assets.



Source: BofA Global Investment Strategy

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