How far can optimism drive equity markets?

From rotation to correction? Quite possibly!

The MSCI World Equity Index has risen substantially since the end of October last year. This masks the fact that the performance of individual shares varies enormously. In the last few days, a movement has now set in that could reverse some of this inequality; star performers from the tech sector are under pressure and neglected stocks are catching up. How long this rotation will last is unclear and the more fundamental question is whether the momentum on equity markets will continue or whether the rotation will lead to a more pronounced correction.

The Biden administration's intention to introduce stricter controls in the semiconductor sector in order to keep the Chinese in check is one of the triggers for the latest development, but also shows the fundamental vulnerability to politics of this market segment. Even under a possible President Trump, this political influence is unlikely to change.

The market is fundamentally driven by profit and interest rate expectations, or rather by changes in these expectations. Based on an optimistic economic picture, earnings expectations are calling for double-digit growth. Furthermore, the latest inflation figures have re-ignited hopes of two to three interest rate cuts in the USA. This constellation boosts investor confidence and thus the willingness to take risks. Conversely, however, this also means that developments that fall short of consensus expectations are likely to have an above-average impact.

As previously stated, we do not fully share the market's optimism. In particular, we are not entirely convinced of a soft-landing or no-landing scenario for the US economy. We therefore decided some time ago to adopt a more defensive investment policy. The focus was on profit-taking in the technology sector, to which we previously assigned considerable weight. Exposures to longer-term themes such as renewable energies and e-mobility were reduced as well, having been pushed aside from a stock market perspective. With a Trump 2.0 scenario, a revival of these themes on the stock markets will be a distant prospect. We furthermore reduced exposure to consumption-driven stocks, as weaker consumer growth is expected in the USA and consumer restraint continues in China.

For the time being, we will stick to this more defensive investment policy and closely monitor economic, interest rate and geopolitical developments.

Wangs, 18.7.2024