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Market outlook from ONE Asset Management AG

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ONE® Asset Management

01/ Equities

Investors can look forward to an exciting second quarter. In March, the global financial system suddenly began to falter. Fears of a repeat of the 2008 banking crisis are rife. But so far, the stock markets have coped well. Is this „the shortest financial crisis ever“?

However, the crisis foothills, together with existing concerns about inflation and central bank policy, as well as the war in Europe, will continue to keep us investors on tenterhooks. However, there are also positive aspects and issues that have kept the world stock markets in balance so far.

To be sure, nervousness will remain high. Caution is advisable, especially since good news is no longer consistently received positively on the stock markets. They often lead to interest rate fears and are sold off, as further increases in yields are seen as a threat to the markets. Investors‘ perceptions are not clear-cut. We must factor this into our investment decisions.

So far, no lasting damage has been done to the stock markets by the turbulences in the banking sector, even though prices often fluctuate extremely. This illustrates a continuing internal strength of the markets. In the first quarter, equities performed extremely well. Most indices posted double digit percentage gains. In the process, the overall market – as predicted in December – was driven considerably by the fantasy generated by the reopening of China. After a long covid shutdown in the big country, the Europe-wide sector overview of the Stoxx600 index shows the consumer as well as travel and leisure sectors at the top, together with shares of the big technology firms.

On the other hand, there are strong fears of an intensified credit crunch. Some sectors are suffering particularly from deteriorating financing conditions. Real estate stocks slid. They often had to cancel their dividends and were sold off steadily from mid-January. Commodity stocks also underperformed the overall market. The extent to which this will be put into perspective in the event of an easing of the situation in view of the turbulent financial markets in the new quarter remains to be seen.

There is an increased awareness of burdensome market issues. However, good opportunities also arise and we intend to continue to exploit them. The stock market is currently continuing to climb a wall of fears. The Dax defended its strong support zone around 15,000 points in the banking crisis setback. From a technical perspective, this is now compounded by a typical positive seasonality for stocks. In US pre-election years, shares tend to regularly rise from April onwards. This can be explained by lavish election promises. For the Dax there is definitely a chance of a new record high.

A calming on the interest rate side could also turn out to be a positive trigger. Overall, we remain cautiously optimistic for equities. Caution is a basic prerequisite here, because the current situation in particular underscores the fact investors are never immune to disruptive fires in the markets.

The financial crisis flared up completely unexpectedly. SVB was the first major domino to fall in the US. The house bank of many Silicon Valley startups went bust virtually overnight. Beginning outflows due to the liquidity needs of customers and the rapid central bank-induced interest rate increases led to the first realized losses in their bloated own portfolio of long-dated government bonds. A resulting necessary capital increase could not be realized in time. As a result, SVB‘s well-connected major clients withdrew their deposits at record speed. This was followed by outflows from other clients as well, which then became so large that the devastating bank run finally occurred.

This ad event was followed by the collapse of the major Swiss bank Credit Suisse. It also had to be rescued in dire straits and forcibly married to the countries industry leader UBS. This now creates a new risk with a banking giant whose dimensions would probably be difficult to control in a crisis situation. However, this potential problem is barely visible in the background and does not play a role yet. After an initial shock, the financial markets showed relief and put the banking crisis to bed for the time being. On balance, investors reacted with little emotion and very little fear.

However, the issue is not yet over for us. It is quite possible that no more dominoes will fall as the trouble spots have been quickly cared for. Also, the financial sector turbulences this time were not triggered by asset faults like the Lehman crisis, but resulted from the credit crunch. This is qualitatively somewhat different. Ultimately, the steep increase in interest rates had an effect. This brought new problems with duration management as a pitfall for many banks.

Even if a systematic crisis as in 2008 probably does not materialize. The turbulences have still severe consequence, in our view. They act as a brake on the economy. Lending will become even more restrictive meaning slower growth. On the other hand, this will dampen price pressures, which in turn should help the central banks work. The effects of such a drastic event are correspondingly complex. Overall, the current situation is quite confusing and requires increased attention.

Central banks were also caught off guard by the turmoil. They now need to rethink their restrictive monetary policy. Their historically rapid interest rate hikes after years of cheap money are hurting. The Federal Reserve had already reduced its rate to 25 basis points in February. But Fed chief Powell

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rowed back because of the high inflation. He brought again 0.5% steps into the discussion. These failed to materialize because of the banking crisis. The Fed stoically invoked the stability of the financial system and showed determination to smooth the waters. But the Fed is still following its mandate to maintain monetary stability. Meanwhile, the still very robust labor market is pushing its other task of promoting maximum employment into the background, so that fighting inflation is currently the top priority for the monetary watchdog out of its dual mandate.

Thus, the visibility for the central banks‘ direction is low. With the inflation issue smoldering, monetary guardians are wary of dovish tones. In Europe, the ECB raised interest rates again by 50 basis points. At the same time, lending is already tightening substantially. So, Europe remains on an upward trajectory. However, the central bankers are extremely data-dependent and rather cautious with their forecasts. In contrast to the last meeting, the ECB has not firmly announced any new hikes.

Other problems were initially pushed into the background by the banking crisis, especially as the inflation issue seemed to calm down somewhat. At present, however, it is also difficult to form a clear expectation with regard to inflation. If investors continue to look at double-digit price increases in England in March, the markets can hardly be hopeful. As in the US, the problem is the very tight labor market. The wage-price spiral is turning upward in the UK. However, if the situation eases in view of the numerous job cuts announced, the inflation issue will lose some of its steam here as well. On the other hand, Spain, for example, already gave cause for optimism with an annual inflation rate of just 3.1%, down from 6.0% in the previous month. Declining energy prices helped here.

Central banks obviously have to come up for their past monetary policy, that remained expansionary for too long, as they originally underestimated inflation risks as temporary. Now their rate hiking path appears correspondingly very aggressive. At the same time, the record-high inversion of the yield curve in the US highlights a recession risk, that continues to be perceived by investors.

In view of this complicated situation, we believe it is questionable whether interest rate CUTS baked in already for this year, will actually be implemented. A wait-and-see approach by the Fed and other Central Banks seems more conceivable to us. They could take a break for the time being after one more triple step this summer. This is also because interest rate measures take effect with a time lag

02/ Bonds

The bond markets have also been unusually turbulent. Like equities, bond prices also fluctuated in some cases to an extreme degree. Yields went on a roller coaster ride. As a representative example, the yield on ten-year German government bonds plummeted from 2.7% to 1.9% in the wake of the SVB default, before the extreme interest rate movement was put back into perspective to the current level of 2.3%. Overall, bonds are once again an investment alternative at this level.

Meanwhile, the banking crisis shifted the focus to corporate bonds, or rather the spreads traded. Insurance premiums, especially for securities issued by financial institutions, were closely monitored. These credit default swaps (CDS) rose rapidly at many major European banks, including Deutsche Bank. They show the cost to investors of insuring against credit default. Apparently, fears were regularly circulating that another major domino could fall in Europe after Credit Suisse. In view of the extremely tense situation on the real estate market, this cannot be ruled out either.

The international central banks are thus operating in a highly sensitive environment. But how should we react to the stress in the banking system? After all, the aggressive interest rate policy of the Central Banks also plays a significant role as a possible trigger for the problems. After all, higher interest rates are generally seen as positive for banks. But the resulting credit crunch, with growing concerns about more non-performing loans, are a sword of Damocles hanging over the market.

Fed & Co. will have to escape this predicament. Investors are unswervingly speculating on interest rate cuts in the USA at the end of this year with bets up to 200 basis points. The Fed is reacting alienated to this. It is emphasizing its restrictive course, which is likely to continue until the inflation problem is under control. However, whether the monetary guardians will stick to their interest rate hike path, unaffected by the current turmoil in the financial system, remains at least questionable.

The aforementioned fear of a credit crunch remains. ECB chief Lagarde is also very concerned about this. Even more restrictive lending could then put additional pressure on the economy. This currently suggests that the global central banks will slowly take their foot off the gas.

The stress in the financial sector has not yet been clearly reflected in the economic indicators. In Germany, for example, ZEW economic expectations in March suffered significantly from the abrupt uncertainty on the financial markets. However, the Ifo-index painted a very different picture: companies defied the market turbulence. Both the current situation – the component climbed to its highest level since August – and the future outlook are assessed as significantly better than recently. Business expectations reached their highest level since the beginning of the war. This lack of clarity in the data, including other indicators, makes the work of the central banks more difficult.

Meanwhile, the labor markets remain buoyant. In the USA, new jobs continue to be created strongly. The figures, which are always very robust, seem to be completely unaffected by the sharp rise in interest costs. The service sector in particular is still booming, which is clearly boosting the consumer. This, in turn, is further fueling the risk of inflation in many countries. From this perspective, an easing of monetary policy remains rather unlikely. In summary, yields should settle at current levels for the time being until there is more clarity about the monetary policy strategy of the Fed & Co. Technically speaking, ten-year Bunds will give a breakout signal to the upside above 2.8%. If, on the other hand, the key support level of 1.9% is broken, this suggests that yields will have room ease further.

03/ Currencies

Quietness has returned to the foreign exchange market recently. The major currency pairs are hardly moving actually for the last months. The euro tended to benefit from the melting interest rate differential between the U.S. and Europe. The Fed had taken some momentum out of its interest rate hike policy, while the ECB continued on its path for the time being with a 50-basis-point hike. Accordingly, the single currency held up well despite renewed uncertainty in the markets.

The US dollar meandered sideways at lower level despite its traditional safe haven status. Interest rate expectations receded ultimately steering against this. The Fed, too, fears a further tightening of credit due to the stress in the banking system. This reduces concerns about the aggressiveness of monetary policies and even leads to the speculations on interest rate cuts this year. Accordingly, the yield levels of the countries are converging and the euro is gaining in value. Especially as the key interest rate in the USA is higher than in the euro zone giving the Fed more leeway.

If financial market stress continues to ease, concerns about a higher rate peak in the US and a longer restrictive monetary policy will increase. This would then argue for a renaissance of the US dollar. However, if the banking crisis flares up again, this could even help the euro. For the currency pair, the course of the financial crisis will thus be decisive in the second quarter. In fact, with their rates hikes central banks have already created a risk buffer for themselves. They have been able to react more flexibly to a changed situation from the now significantly higher key interest rate level.

However, if a further Fed rate hike in May materializes, the market would have to scale back its current overly optimistic expectations. We remain skeptical about possible interest rate cuts this year. If this scenario is to be priced out on the currency market, the US dollar should benefit from this. Overall, the downside of the euro could rather be tested for the time being.

Meanwhile, the Bank of England has also only raised its rates by 25 basis points at a reduced pace. But it has left no doubt to its determination to fight inflation hard. The British are clearly sticking to their hawkish policy, so the pound is little changed with no change in expectations. This should stay.

The yen also remains at the level of the beginning of the year. Nevertheless, the Japanese currency did have an eventful quarter. Some weakness was quickly offset, but seems to come back now. After the surprising turnaround from the strict curve control rate policy in December, calm had returned in the wake of the change at the top of the Bank of Japan. The new head of the central bank, Ueda, will now roll out his monetary policy. This is likely to be rather restrictive, after Kuroda had already turned the tide. Thus, the yen should continue to tend towards strength in the medium term.

The fiercely rising Bitcoin also made headlines – not only about the numerous offenses of individual market operators. The cryptocurrency was strongly driven by the turmoil in the global banking system in March. This effect seems to have been worked off for the time being, though. Until the fog lifts and new clear impulses come back to the market, bitcoin should see a volatile sideways phase.

04/ Commodities

There's life in the old dog yet! Gold has recently regained its strength. Here, too, the banking crisis has had an impact. It caused investors' need for security to rise. This time, the directly affected U.S. dollar could not offer a safe haven. The trend toward a lighter U.S. currency also supported the gold price. The latter adjusted upward to the lower dollar and the increased credit risks.

Technically speaking gold is also looking constructive at the moment. The old record high at $2075 is coming into focus. However, the air should then become thin, as long as the Fed – for example, with interest rate cuts in the recession scenario – does not send clear signals as a new trigger for gold.

Oil prices have disappointed. It suffered from unclear economic prospects and a sufficiently good supply. The technology looks correspondingly bad. Oil also came under pressure because of the banking stress with new economic worries, as well as low investor interest. Inventories swelled, and demand lagged. In addition, countries outside OPEC are flooding the market with oil. This is pushing the supply/demand ratio and thus the price down. A positive impulse could come from China if consumption picks up significantly as the economy picks up again. So far, however, the engine has stuttered somewhat after the prolonged Corona break. This may improve in the new quarter.

Current figures from China already read more positively so bringing back some fantasy to sensitive oil prices. The purchasing managers' indices moved clearly into expansionary territory, not only for the service sector but also for industry. Accordingly, optimism may grow again, with positive implications for the economy. This may not only lead to improved prospects for oil in the coming months.

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