BELVALOR
Vermögensbetreuung

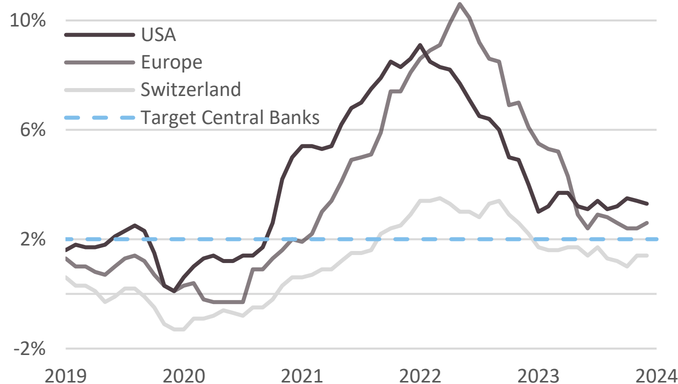
Financial Markets 2024: First Half-Year Conclusion

Resilient global economy

Robust consumer spending and a debt-focused fiscal policy are key factors in how the United States contributed to an impressive resilience of the global economy in the first half of 2024. Meanwhile, most economists foresee a "soft landing" — a controlled slowdown in growth and inflation rates without entering a recession — as the most likely scenario for the US economy. However, the restrictive interest rate environment is increasingly evident in economic data. Recently, momentum in the labor market has weakened, leading to expectations of further slowdowns in wage and consumption growth. Additionally, persistently high capital costs are negatively impacting investment activity. Overall, these factors suggest that growth potential in the US economy and elsewhere may be constrained for the remainder of the year.

The trend of declining inflation rates, particularly in the USA, decelerated, thereby largely undermining earlier expectations of imminent and substantial interest rate cuts by the US Federal Reserve.

Graph 1: Inflation in the USA, Europe and Switzerland*



*Source: Bloomberg, Belvalor; *Consumer Price Index (CPI); Europe: Eurozone*

In contrast, the Swiss National Bank (SNB) ranks at the forefront of interest rate cuts among the central banks of industrialized nations. Following an initial cut in March, the SNB reduced its key interest rate in June by another 0.25% to 1.25%. The decision to cut interest rates again is likely to have been driven primarily by comparatively low inflation and the renewed strengthening of the Swiss Franc in June. Following an initial reduction in the key interest rate in June, the European Central Bank is expected to cut interest rates further in the second half of the year.

Diverging equity markets

Against the backdrop of global developments, the performance of the equity market was surprisingly robust. Driven by some major (technology) heavyweights, numerous indices reached new highs. The Swiss equity market can also look back on an encouraging first half of 2024. Yet, in the US equity market and across parts of European markets, divergences have increased significantly, meaning that without the impetus of this year's equity market high-flyers, the development no longer looks quite so encouraging in many areas of the market. A development that is not only positive. Further, sustainable price appreciations would have to be supported by a larger number of stocks.

Conclusion and positioning

We continue to view global inflation dynamics as the key factor influencing further developments in financial markets. The persistence of inflation in some places is forcing central banks to exercise caution when cutting interest rates. Monetary policy remains correspondingly restrictive in those areas. Nonetheless, the fragile economic recovery in Europe has recently gained some momentum, which, however, is already partially reflected in stock prices, especially in cyclical sectors.

The Swiss Franc is poised to strengthen in the latter half of 2024

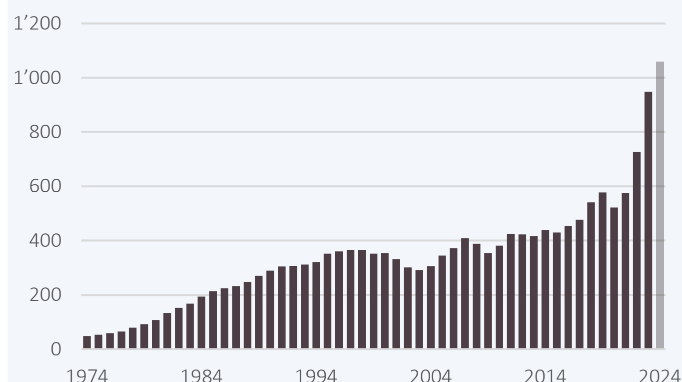
The prevailing concerns regarding inflation and interest rate trends persist, while geopolitical risks show no signs of abating. The recent election outcomes in Europe add to existing complexities. Additionally, the upcoming US presidential elections later this year introduce further intricacies, amplifying the challenges in the geopolitical landscape. These risks and uncertainties generally favor a strong Swiss Franc and underscore the importance of a long-term, diversified investment strategy, which aligns with our approach: Focus on real assets with inflation protection characteristics, especially equities. Not fully deploying our equity allocation allows us to invest additional capital during corrections in high-quality companies that generate strong returns on invested capital.

Record-high debt and higher interest rates: Our thoughts on the US budget deficit and concerns about a potential new debt crisis in Europe.

The world is drowning in debt. According to statistics from the Institute of International Finance (IIF), global debt has recently soared to a record high of USD 315 trillion (in numbers: 315,000,000,000,000). While debt levels, particularly in developing countries, have surged since the COVID-19 pandemic, financial market participants are primarily focusing on the United States due to its high refinancing needs and record deficits. Despite strong recent economic growth, the US budget deficit is expected to reach 5.6% this year and 6.1% next year. The current government debt level of approximately USD 34.7 trillion as of early 2024 represents slightly more than 121% of the nation's annual gross domestic product (GDP). The Congressional Budget Office (CBO), a non-partisan research institution, forecasts this ratio to exceed 180% by 2050.

The increase in interest rates over the past two years has led to the United States' interest expense exceeding USD 1'000 billion for the first time this year. This corresponds to a doubling within the last four years and means that the US currently spends more money per year on interest payments alone than on its defense budget – or more than Switzerland's annual GDP.

Graph 2: Annual interest payments of the USA (in bn $)



Source: St. Louis Fed, Belvalor

Government finances and the mounting debt burden barely feature in the political discourse in the USA. Neither Joe Biden nor Donald Trump prioritize a prudent fiscal policy in their agendas. Therefore, the projections provided by the CBO seem credible, if not optimistic.

In Europe, while the uncertainty has not yet reached the levels seen at the beginning of the "Euro crisis" in 2011, approximately half of the Eurozone countries consistently violate their self-imposed debt rules, which include a maximum government debt limit of 60% of GDP. Currently, France's government debt stands at 111% of GDP and the country has not achieved a budget surplus in over 50 years. Consequently, alongside the USA and Japan, France is now the world's third-largest sovereign debtor. Numerous other countries in the Eurozone exhibit similar debt levels relative to GDP. In Switzerland, government debt currently stands at just under 40% of GDP, attributable in no small part to Article 126 of the Swiss Federal Constitution, known as the debt brake.

Conclusion and positioning

It is improbable that the debt levels in the economies mentioned will precipitate an immediate crisis, given the remaining flexibility in fiscal policies and central banks' capacity for maneuver. Moreover, the alleviation provided by the expectedly declining interest rates may temporarily reduce the fiscal burden by lowering debt costs. Nevertheless, looking forward, a shift in course is inevitable, as these elevated government debt levels are unsustainable and could potentially be exacerbated by populist actions from governments.

A look at Japan, which has debt exceeding 250% of its GDP, the highest in the world, illustrates a possible path forward for other indebted economies: Central banks are increasingly purchasing newly issued government bonds to artificially stimulate demand and keep interest rates low despite deteriorating credit ratings. As the money supply is increased, this expansionary monetary policy inevitably leads to an economy's currency depreciation.

Highly indebted countries will likely see their currencies devalue further

To mitigate these risks, our current investment strategy is increasingly centered on tangible assets, particularly equities. We steer clear of committing to long-term government bonds and allocate a substantial portion of our managed assets to Swiss Francs, renowned as a safe haven that has demonstrated long-term value retention. We maintain a cautious approach toward currencies of highly indebted countries.