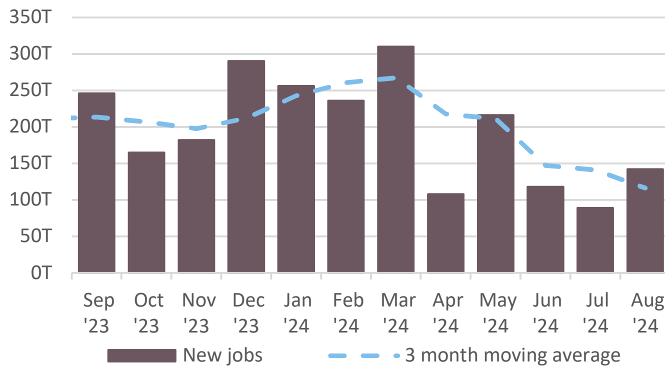
BELVALOR
Vermögensbetreuung

Markets in Autumn 2024: Economic Recovery Driven by Rate Cuts?

Focus on the US labor market

The economic environment has deteriorated recently, particularly in the Eurozone and China. However, financial markets continue to focus on the USA, the world's largest economy. Rising interest rates are putting pressure on the US economy, and early signs of weakness are becoming apparent. Leading indicators, particularly in industry, have deteriorated and defaults on credit cards and car loans are on the rise. Although the US labor market remains historically robust, there are increasing signs of a slowdown. This development could impact consumer behavior and economic momentum in the medium term, posing potential risks for global markets.

Graph 1: Monthly job creation in the USA*



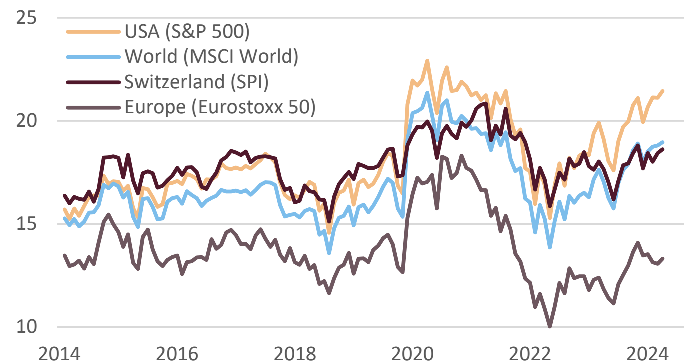
*Source: Bloomberg, Belvalor; *Nonfarm payrolls*

The US Federal Reserve responded in September, deciding to cut interest rates for the first time since March 2020. With inflation having recently cooled to an annual rate of 2.5%, this action makes sense from today's perspective, although the size of the 0.5% cut is unusually large. The European Central Bank and the Swiss National Bank continued their already initiated turnaround on interest rates, each cutting their key rates again in September. In Switzerland, rates are now at 1% and are likely to fall further, not least because of the continuing upward pressure on the Swiss franc and inflation well below 2%.

Robust equity markets defy risks

In the third quarter, equity markets largely consolidated the gains made in the first half of the year, although volatility increased. Market expectations of interest rate cuts - some of which have materialised - and solid half-year results of many companies supported the performance of the main equity indices. However, recent gains have been driven not only by improved fundamentals but also by increased risk appetite as reflected in higher valuations.

Graph 2: Price-earnings ratio of equity indices*



*Source: Bloomberg, Belvalor; *Basis: monthly; earnings: consensus estimates for the next 12 months (01.01.2014 – 31.08.2024)*

Outside the United States, economic growth remains weak, and sentiment is subdued. Consumer demand continues to be at low levels, and inventory replenishment is not occurring at the anticipated pace. In certain sectors, such as automotive and luxury goods, there are even signs of falling demand. This impression was shared by many of the CEOs of domestic companies we have met at conferences and meetings in recent weeks. However, there is cautious optimism that the recovery is delayed (expected from 2025) rather than canceled altogether. The recent interest rate cuts by most major central banks are expected to provide support in this regard.

Conclusion and positioning

The second quarter earnings reporting season has confirmed that corporate sales and profits continue to grow, suggesting that companies are able to cope with the slowdown in economic momentum. Geopolitical risks - including the upcoming US presidential election - remain a source of disruption that could lead to increased volatility in the short term. This is one of the reasons why we reiterate our preference for the Swiss franc. Despite higher valuations, equities remain our first choice. They should benefit from falling interest rates.

US Presidential Elections 2024: Our thoughts on the election spectacle in America and its implications for the financial markets

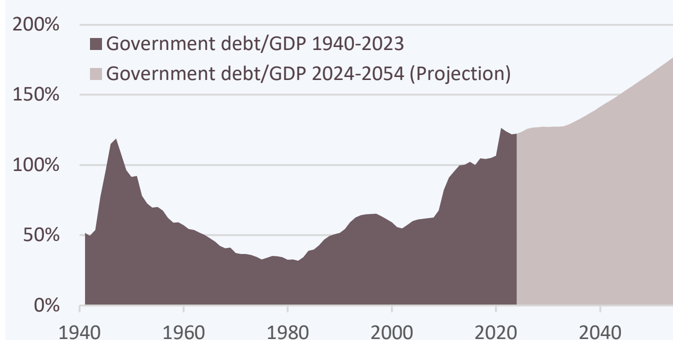
From a Swiss perspective, the US presidential election often appears to be an overblown spectacle, as in Switzerland, substantive issues are decided through referendums. In contrast, the polarizing battle between political factions is central to US elections, which is also reflected in the economic programs of the two candidates.

Trump vs. Harris: Program priorities

Donald Trump wants to cut personal and corporate taxes, tighten immigration laws and raise tariffs. This could strengthen the domestic market in the short term, but also lead to lower tax revenues and higher inflation. Kamala Harris, on the other hand, plans to raise taxes on the rich and large corporations, while providing some relief to smaller businesses. Her program also focuses on strengthening the middle class and affordable housing, which would lead to higher government spending but could reduce social inequalities.

What both programs have in common is that balancing the national budget is not a priority. In this regard, the Congressional Budget Office (CBO) has reaffirmed its forecast regardless of the outcome of the election and continues to expect a significant increase in debt as a percentage of gross domestic product (GDP). Trump's tax plans could even add another 1 to 1.5% of GDP to the annual deficit.

Graph 3: US government debt relative to GDP



Source: US Congressional Budget Office (CBO), Belvalor

The role of Congress

Since the implementation of programs largely depends on the composition of the new Congress, focusing solely on the presidential election would be too narrow. All 435 seats in the House of Representatives and 34 of the 100 seats in the Senate are up for election. Currently, the Republicans control the House, while the Democrats hold the Senate. If Congress remains divided, it could act as a check on extreme political initiatives. Otherwise, there is a risk that a unified Congress will implement the White House's plans without much resistance, which could lead to far-reaching economic changes.

Consequences for trade relations

The US is Switzerland's second most important trading partner after Germany. In 2023, Switzerland exported goods worth approximately 56 billion Swiss francs to the US, accounting for 15% of its total exports. The pharmaceutical industry, in particular, is heavily reliant on the American market. Should US policy after the elections be shaped by economically liberal forces, open markets and free trade could benefit not only Swiss companies but global trade in general. However, a protectionist approach - similar to Donald Trump's "*America First*" policy during his first term from 2017 to 2021 - could result in trade barriers and tariffs, complicating global trade and exerting renewed upward pressure on inflation. For this reason, a balanced distribution of power in Congress would be desirable to prevent extreme economic policies.

Conclusion and positioning

In the short term, the US presidential election on 5 November 2024 will keep financial markets on edge and potentially create volatility. In the medium to long term, however, economic growth, corporate earnings and monetary policy will remain the key factors driving global financial markets. Given the current economic slowdown, earnings expectations for 2025 seem ambitious. Analysts are forecasting 15% earnings growth for the 500 largest US companies, but these high expectations carry the potential for disappointment.

In the long run, the US should continue to benefit from its attractiveness, driven by high productivity growth - especially compared to Europe - and a business-friendly environment, which will ultimately benefit the global economy. We remain cautious on the US dollar and long-term US government bonds due to the rising US national debt. Irrespective of the election outcome, we prefer to invest in stable real assets such as equities, especially in Swiss francs.