Financial Market Outlook

Basis for the management of BANTLEON AG's own investments and the »BANTLEON Funds«

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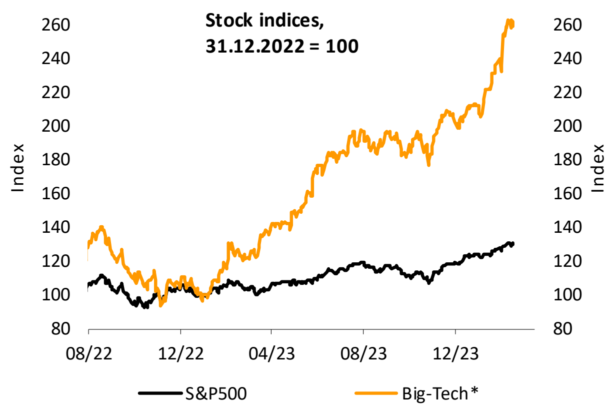
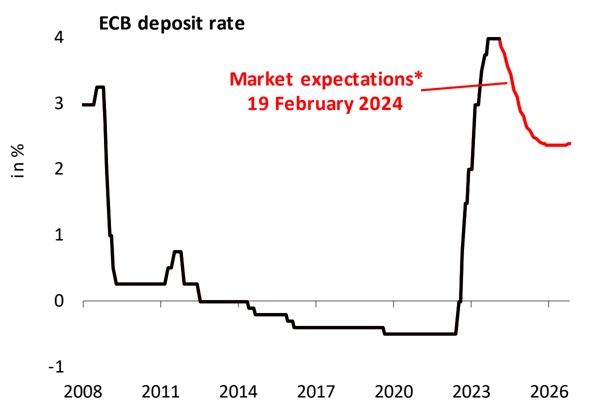
- US economy remains robust; slowdown likely in the 2nd half of the year
- Eurozone faces anaemic economic recovery
- Global disinflation should continue
- Central banks likely to cut key interest rates significantly
- Government bond yields have moderate downside potential
- Equity market rally should end in spring/summer
- Biggest risk: Inflation fears return
- In this case, bond markets will come under pressure

Figure 1: Higher and higher



Sources: Bloomberg, BANTLEON; * unweighted average of Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia

Figure 2: Waiting for the first interest rate cut



Sources: Bloomberg, BANTLEON

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US

The US economy has surprised positively for the most part in recent months; …

The US economy has surprised positively for the most part in recent months. For example, strong annualised GDP growth of 3.3% was once again reported for the final quarter of last year compared to the previous quarter. The expected slowdown following the sharp rise of 4.9% in the third quarter was therefore very moderate.

… among other things, the job market continues to run at high speeds ...

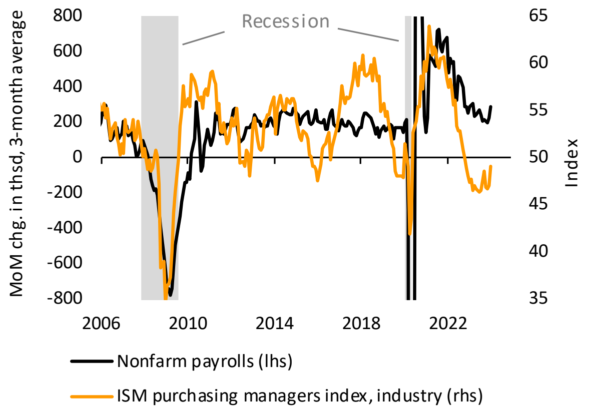
... and the corporate mood is brightening; …

There are also signs of a good start to 2024. In terms of private consumption, the 0.8% decline in retail sales in January (after +0.4% in December) points to a slowdown in growth – we expect consumption to increase by +1.5% in the first quarter (after +3.1% in Q4, both annualised compared to the previous quarter). Irrespective of this, a number of important economic indicators reflect a favourable environment. One of these is the significant increase in jobs of 353 thousand in January. Secondly, the dwindling pessimism in the previously sluggish industrial sector, which is reflected in the rise in the ISM purchasing managers index, is striking (see Figure 3).

… GDP growth in the current quarter is therefore again expected to be respectable, though weaker than in Q4/2023.

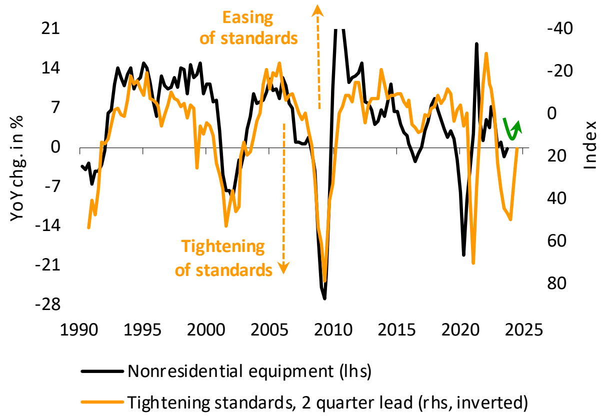
Against this backdrop, we expect another solid GDP increase of around 2.0% in the current quarter. In addition to a renewed boost from consumption, an increase in inventories should also have a supporting effect. According to the ISM survey, industrial companies see a noticeable need for their customers to catch up. The outlook for the second quarter has also brightened. Among other things, the banks' less restrictive lending standards point to a revival in investment (see Figure 4). The regional business climate surveys of the New York and Philadelphia Fed for January and February point in the same direction.

Figure 3: Positive economic signals at the start of the year



Sources: BLS, ISM, Bantleon

Figure 4: Investments support growth



Sources: BEA, Federal Reserve, Bantleon

Together with the bottoming of some of our leading indicators that are running far ahead, …

If we also take into account the fact that some of our leading indicators have bottomed out and are turning upwards again, a recession now seems increasingly unlikely. **We are therefore no longer assuming a hard landing in our base scenario.**

… in our view, this suggests that a recession is becoming increasingly unlikely.

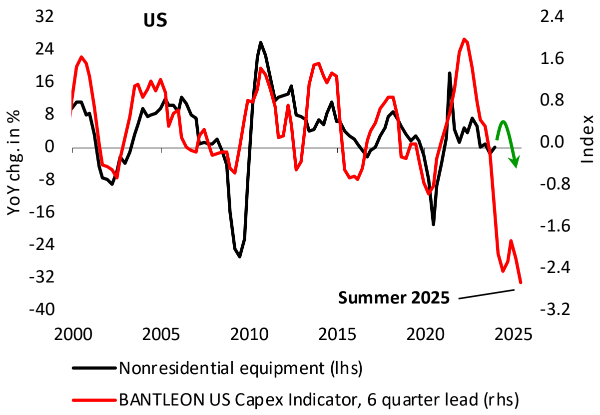
However, this adjustment does not mean that we are expecting an imminent and, above all, sustainable upturn. This is because the fundamental framework conditions have not changed: The economic tailwind is fading, which is reflected in the dwindling savings and liquidity surpluses, among other things. At the same time, there are many indications that the headwind from the massive tightening of monetary policy is increasing rather than

However, we do not expect an upswing; ...

... on the contrary, growth should slow over the course of the year; …

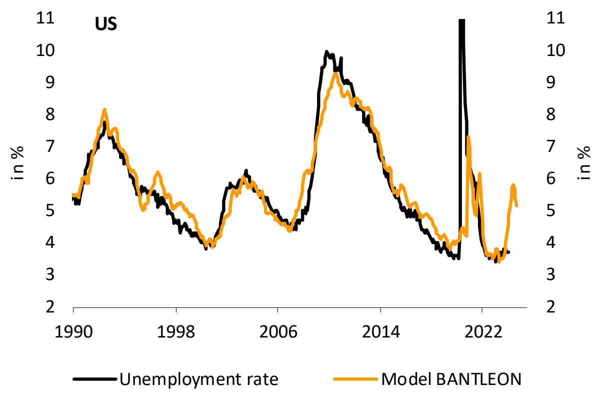
decreasing. At least that is the message from our leading monetary indicators, such as the US Capex Indicator (see Figure 5). The recent difficulties experienced by some banks as a result of the worsening commercial property situation point in the same direction. **Against this backdrop, economic growth is likely to weaken noticeably over the course of the year.** This would also leave its mark on the labour market and push the unemployment rate up to at least 4.2% by the end of the year (see Table 1).

Figure 5: However, headwinds from higher interest rates should increase ...



Sources: BEA, BANTLEON

Figure 6: ... which is also likely to leave its mark on the labour market



Sources: BLS, BANTLEON

… the risks associated with this outlook are on both sides.

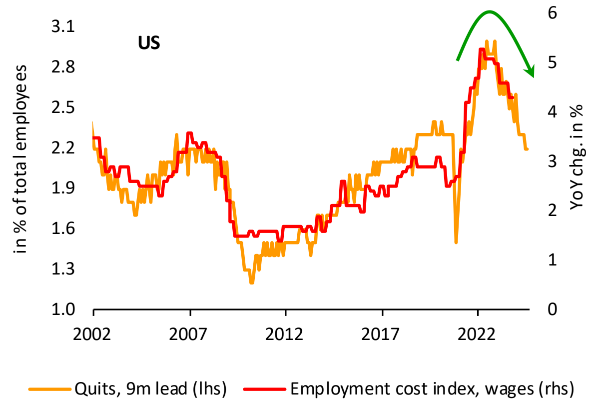
Overall, the US economy should lose momentum in 2024, but still grow slightly. The risks to this outlook are two-sided. It cannot be ruled out that the US economy will prove resilient throughout the year and continue to grow by at least 2%. However, there is also a risk that the sharpest interest rate hikes in four decades could cause greater economic damage than is currently foreseeable (see Figures 5 and 6).

As a result of the slowdown in growth, the labour market should also lose momentum ...

... and wage growth should slow further; …

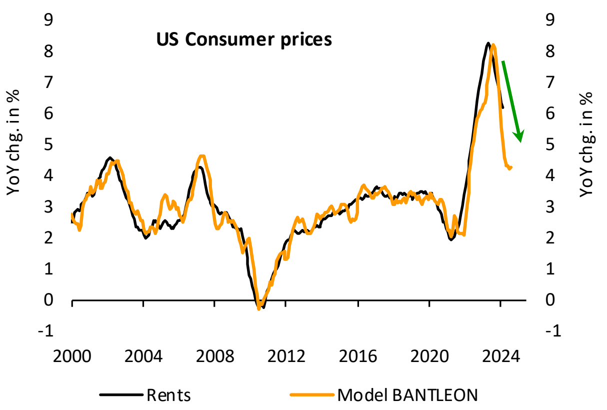
If overall economic demand weakens as outlined in our baseline scenario, wage and inflationary pressure should also continue to ease. With regard to wage growth, an easing is therefore on the cards. A number of leading indicators - such as the declining number of quits - are already showing that the labour market is cooling and that wage increases should decline as a result in the coming quarters (see Figure 7).

Figure 7: Further easing of wage pressure ahead ...



Sources: BEA, BLS, BANTLEON

Figure 8: ... the disinflation trend should continue



Sources: BLS, BANTLEON

… the downward trend in inflation rates is likely to continue accordingly …

This is one reason why the surprisingly strong rise in core inflation of 0.4% in January compared to the previous month should not be seen as the start of a sustained flattening of the disinflation trend. In addition, the unexpected surge in inflation at the beginning of the year was driven by a number of temporary special factors that are likely to lose momentum again in the coming months (see our ad hoc statement from 13 February). **With regard to the core PCE deflator, the Fed's favoured inflation measure, there is therefore a good chance that it will almost reach the central bank's 2% target by the end of the year, starting from its current level of 2.9%** (see Table 1).

... and should put the Fed's 2% target for the end of the year within reach.

The Fed can lower key interest rates in this environment; …

What does this economic and inflation scenario mean for monetary policy? The Fed is currently focussing on inflation. The closer inflation approaches the 2% target, the less necessary and justified it is to leave the key interest rate at the current clearly restrictive level of 5.38% (mean value of the key interest rate range of 5.25% to 5.50%). At the same time, the easing inflationary pressure means that the real key interest rate would continue to rise, making monetary policy even more restrictive. For these reasons, the Fed has held out the prospect of easing monetary policy slightly. The median forecast of the FOMC members in December was for three 25 bp steps. In view of our expectation that the disinflation trend will soon resume, we believe an initial rate cut in May is likely. However, if inflation data remain high for the time being, the June meeting would also be a conceivable starting point.

Table 1: Macro Forecasts 2024/2025 for the US

	Annualised Quarterly Growth in %								Annual Growth in %			
	Q1/23	**Q2/23**	**Q3/23**	**Q4/23**	**Q1/24**	**Q2/24**	**Q3/24**	**Q4/24**	**2022**	**2023**	**2024**	**2025**
GDP	2.2	2.1	4.9	3.3	2.0	1.7	1.0	1.0	5.8	1.9	2.5	2.4
GDP (YoY chg.)	1.7	2.4	2.9	3.1	3.0	2.9	2.0	1.5	-	-	-	-
Private consumption	3.8	0.8	3.1	2.8	1.5	2.0	2.0	1.5	8.4	2.5	2.2	2.3
Corporate investm.	4.9	7.0	1.1	1.9	1.0	0.4	-1.6	-1.6	6.0	5.4	4.0	1.2
Residential investm.	-5.3	-2.2	6.7	1.1	5.0	5.0	5.0	10.0	-9.0	-10.7	4.3	12.8
Inventories [1]	27.2	14.9	77.8	82.7	60.0	40.0	10.0	0.0	-	-	-	-
Exports	6.8	-9.3	5.4	6.3	3.0	2.0	3.0	3.0	7.0	2.7	2.9	2.9
Imports	1.3	-7.6	4.2	1.9	1.0	2.0	2.0	3.0	8.6	-1.7	1.4	3.4
Government	4.8	3.3	5.8	3.3	3.0	3.0	2.0	2.0	-0.9	4.0	3.2	1.4
Inflation rate, CPI [2]	5.8	4.0	3.6	3.2	3.1	3.0	2.6	2.4	8.0	4.1	2.7	2.4
Core rate, CPI [2]	5.6	5.2	4.4	4.0	3.7	3.2	3.0	2.6	6.1	4.8	3.1	2.5
Core PCE deflator [2]	4.9	4.6	3.9	3.2	2.6	2.2	2.1	2.1	5.0	4.2	2.3	2.2
Unemployment rate [3]	3.5	3.6	3.7	3.7	3.7	3.8	4.0	4.2	3.7	3.6	3.9	4.4
Fed funds rate [4]	5.00	5.25	5.50	5.50	5.50	5.00	4.50	4.25	4.50	5.50	4.25	4.25

Sources: Bloomberg, BANTLEON; [1] Changes in bn USD; [2] Annual and quarterly averages, year-on-year change in %; [3] Annual and quarterly averages in %; [4] Upper bound of target range, year-end and quarter-end levels in %

… we anticipate more extensive easing than the monetary authorities have so far promised.

However, the three 25 bp rate cuts outlined by the Fed in December would push the key interest rate down to just 4.63%, which would still be well above the neutral key interest rate, which the Fed estimates at 2.50%. In our view, it is therefore more plausible to assume interest rate cuts totalling at least 125 bp (to 4.13%) if our forecast of a weakening economy and further falling inflation rates is fulfilled. The expectations of around 90 bp priced into the money futures markets also seem too cautious to us.

China

The bankruptcy of Evergrande once again brought the problems of the Chinese real estate sector to the spotlight; …

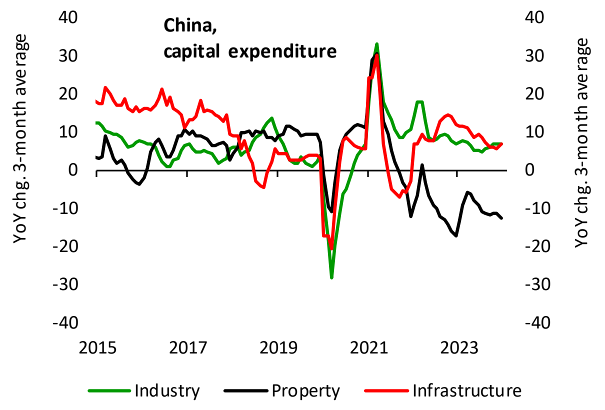
… however, this event is unlikely to trigger a wildfire; …

At the end of January, Hong Kong's Supreme Court ordered the liquidation of property developer Evergrande, which once again highlighted the many problems facing the Chinese construction sector. Concerns have been expressed on various occasions that the bankruptcy could spread into a conflagration and thus have a negative impact on the global economy. We consider this risk to be low. One of the reasons for this is the very limited ability of the insolvency administrator in Hong Kong to access the company's assets in China. Accordingly, the announced insolvency is likely to be just another step in the recovery of the Chinese property sector. In our view, this process has a good chance of proceeding in an orderly manner, as the government has many options to intervene in a supportive manner due to the great influence of state-owned banks and property companies.

… nevertheless, it reminds us once again how big the problems are in this area.

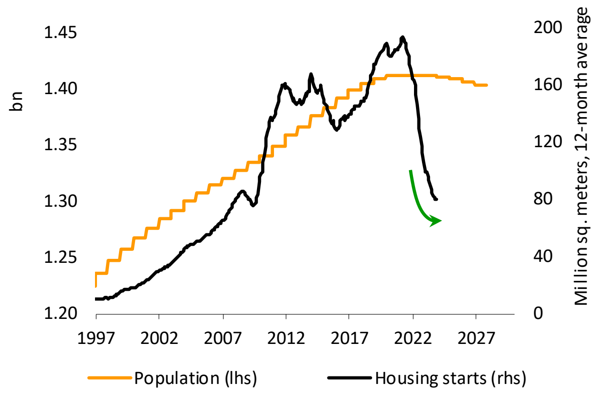
Nevertheless, China faces major challenges in overcoming the problems in the property sector. These include the need to reduce massive overcapacity, which is reflected in vacancy rates of around 20% in some cities, and above all the over-indebtedness of many property developers. This misery is reflected not least in the fact that investment in the construction sector has been falling almost uninterruptedly for two and a half years (see Figure 9).

Figure 9: Construction industry as a brake on growth



Sources: NBS, BANTLEON

Figure 10: Bottom could be reached soon



Sources: NBS, IMF, BANTLEON

To overcome the challenge, the government has incepted extensive projects to support the construction industry; …

… although the scope of these projects does not match the massive stimulus programmes of 2008/2009, …

To tackle the problems, the government launched »three major projects« last autumn to support the construction industry: (1) expansion of social housing, (2) upgrading of dilapidated traditional neighbourhoods (so-called urban villages) and (3) new infrastructure investments to ward off natural disasters. Beijing is directly providing around 2 trillion yuan for these projects. yuan (≈ EUR 250 billion, 1.6% of GDP) for these projects. The central bank's reduction of the minimum reserve ratio by 0.5% to 10.0% at the beginning of February will also provide the banking sector with 1 trillion yuan in additional liquidity to finance its defence projects. Yuan in additional liquidity for the banking sector to expand lending.

… nevertheless, they should contribute to stabilising the economy; …

In terms of scope, the stimulus programmes launched still do not come close to the measures launched in the wake of the 2008/2009 financial crisis, which amounted to more than 10% of GDP at the time. **However, the latest actions should at least help to stabilise the situation.** As a result, the downward trend in construction starts could slowly come to an end (see Figure 10).

… however, economic growth is likely to slow slightly in the current year compared to 2023 due to the fading coronavirus pent-up demand.

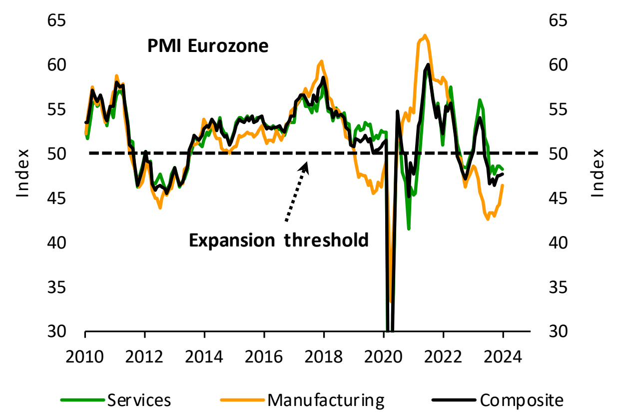
In this case, the dampening effect of the construction industry on GDP growth should gradually diminish. At the same time, however, the growth-stimulating catch-up effects that boosted the economy in 2023 after all coronavirus restrictions were lifted should fade. In our view, the latter effect will outweigh the stabilisation of the property market, which will most likely be slow to materialise. **Overall, economic growth is likely to fall behind the pace of +5.2% seen in 2023. We expect growth of just under 5.0% in 2024.**

Eurozone

The first leading indicators suggest an end to the economic downturn in the monetary union; …

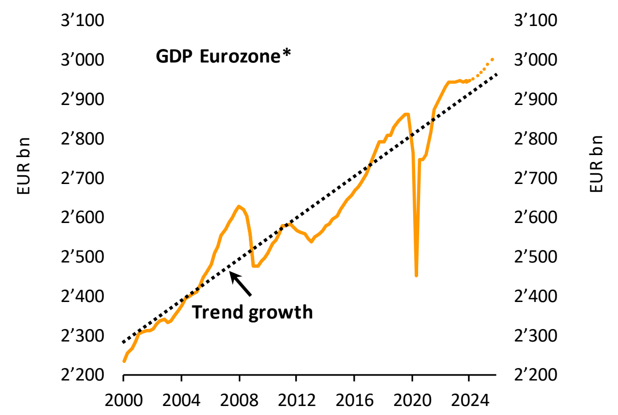
In the Eurozone, there are increasing signs that the economy is bottoming out. Initial sentiment indicators such as the ZEW index have turned upwards and point to an upturn over the course of the year. The most important leading indicator, the composite purchasing managers index (EMI), also appears to have reversed the trend and suggests that the situation will at least not deteriorate any further (see Figure 11). If the upward trend consolidates in the coming months and the index climbs above the 50-point mark, this would be a strong signal for a return to positive GDP growth rates after economic output in the Eurozone has been treading water for over a year (see Figure 12).

Figure 11: Trend reversal in leading indicators



Sources: S&P Global, BANTLEON

Figure 12: After more than a year of stagnation, the economy should pick up from the middle of the year



Sources: Eurostat, BANTLEON; * from Q1 2024 forecast BANTLEON

… the Eurozone would thus have survived the strongest energy price shock in combination with the sharpest monetary tightening in over 40 years without a recession; …

This would also put an end to the wait for Godot or the recession that never came. Should this scenario actually materialise, it would be absolutely remarkable. The most severe energy price shock since the second oil price crisis at the end of the 1970s, combined with the sharpest monetary policy tightening in the monetary union for over 40 years, would only have brought individual sectors such as German industry to their knees, but not the entire Eurozone economy. In fact, there are indications that the same could happen.

… the bright spot is private consumption,…

Private consumer spending – which came under considerable pressure in the wake of the inflationary surge in 2022 and 2023 – is at the centre of this cautiously optimistic assessment. Back then a crash was probably only averted thanks to the extremely robust labour market and the massive government support measures. **We expect to see a noticeable revival in private consumption in the coming quarters.**

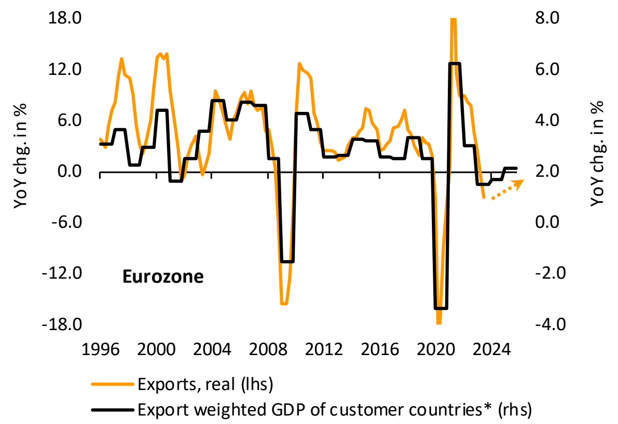
… which is likely to be driven by rising real wages and a robust labour market.

On the one hand, real wages will increase noticeably this year and next: an expected decline in the inflation rate towards 2.0% is likely to be met by nominal wage growth of around 4.0% in each case. On the other hand, the labour market is proving surprisingly resilient. Despite the quasi-stagnation in growth, employment increased by 1.4% in 2023. In addition, the savings rate of private households is still significantly higher than in the years before the pandemic: in the third quarter of 2023, it was 14.0%, compared to an average of 12.5% in the years 2010 to 2019. This should therefore tend to provide tailwinds rather than headwinds for private consumption.

Nevertheless, we expect the economic recovery to be sluggish; …

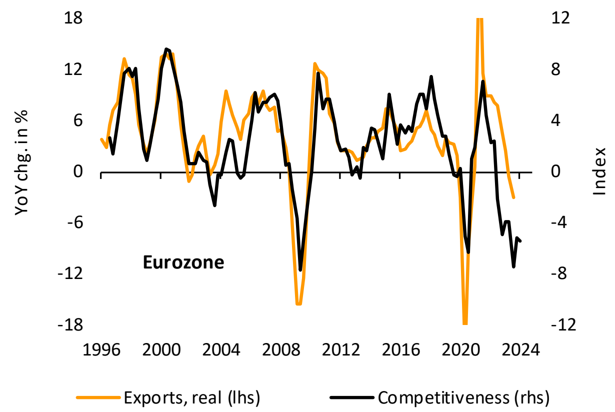
The fact that the expected boost in private consumption is not an initial spark for the economy, but rather a sluggish recovery, is primarily due to two factors: on the one hand, the less than favourable export prospects and, on the other, the unfavourable environment for investments.

Figure 13: The export outlook remains dampened in view of the sluggish global economy ...



Sources: Eurostat, BANTLEON; * 2024 and 2025 forecast BANTLEON

Figure 14: … and the still extremely unfavourable competitive position



Sources: Eurostat, EU-Commission, BANTLEON

... besides the dampened export prospects ...

Although the outlook for foreign trade has brightened slightly recently – contrary to previous assumptions, the US is likely to avoid a recession – things are still not going well in China in particular. We have therefore only slightly raised our forecast for export growth this year. However, the annual average is still likely to be slightly negative (see Figure 13). In addition to the expected rather meagre global economic expansion, this is also due to the fact that European companies still consider their international competitiveness to be miserable (see Figure 14).

… the unfavourable investment environment also argues against a dynamic upswing; ...

Weak export demand is also a burden on corporate investment. Investment in equipment in particular is traditionally heavily dependent on the development of goods exports. Apart from this, the noticeably tighter financing conditions are also acting as a brake. **This applies in particular to construction investment, which is likely to fall even more sharply in the coming quarters than between the 1st quarter of 2022 and the 3rd quarter of 2023 (-1.8%).** The weakness in construction should be particularly pronounced in Germany. For example, incoming orders in residential construction in Germany have slumped by almost 42% since the end of 2020 (see Figure 15). The outlook for the construction industry is also bleak in Italy. The expiry of the Superbonus – a tax incentive for the energy-efficient refurbishment of residential properties – is likely to result in a decline in construction activity this year and next.

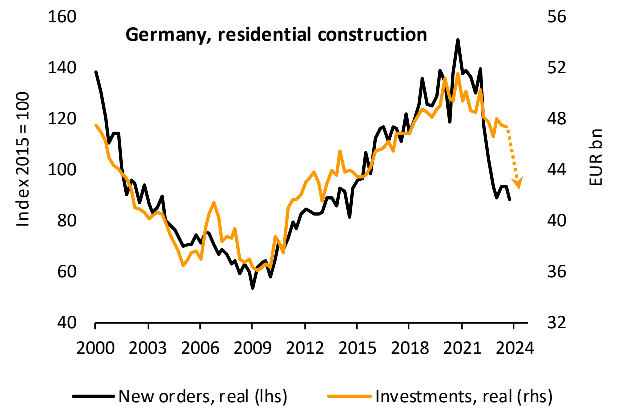
… especially as fiscal policy should also provide only a modest tailwind; …

… this applies first and foremost to Germany …

… and further worsens the already precarious economic situation here; …

A slight upturn in government investment activity is likely to dampen the weakness in the private sector, but not compensate for it. Government consumption, on the other hand, will in all likelihood grow somewhat more strongly again after increasing by an estimated meagre 0.3% in 2023. However, we believe that the government stimulus will be very unevenly distributed: While we anticipate recognisable growth for most eurozone countries, the increase in Germany is likely to be rather small as a result of its self-imposed austerity policy. Germany is therefore repeating the same mistake that was made in numerous peripheral countries during the austerity policy in the wake of the euro debt crisis between 2010 and 2013: **The state saves into a recession, in which Germany finds itself in contrast to the rest of the Eurozone, and thus drives the economic downward spiral even further.**

Figure 15: The German construction industry is facing the edge …



Sources: Destatis, BANTLEON

Figure 16: … the manufacturing industry is already one step ahead

Sources: Destatis, BANTLEON

… the German economy is therefore unlikely to emerge from the recession before the middle of the year at the earliest.

If the extremely tense situation in the German manufacturing sector is also taken into account – ignoring the Covid shock incoming orders plummeted to their lowest level since July 2010 in December excluding volatile bulk orders – it is becoming apparent **that Germany will be left behind in economic terms for some time to come** (see Figure 16). Economic output in the current quarter is likely to shrink at a similar rate to the end of 2023 (-0.3% compared to the previous quarter) and the second quarter could also see another decline. The recovery we expect in the second half of the year should be anaemic.

Against this background, we expect the Eurozone economy to gradually pick up over the course of the year after a weak start; …

Against this backdrop, we expect a weak start to the year in the Eurozone – even another small decline in GDP in the first quarter is within the realms of possibility. **The economy should then gradually gain momentum from the spring onwards in view of the favourable outlook for private consumption.** Initially to a lacklsutre extent, as the after-effects of the marked tightening of monetary policy over the past two years are still having a dampening effect, but then more noticeably towards the end of the year (see Table 2).

… for 2024 we expect GDP growth of 0.4%; …

For the annual average, we forecast economic output to grow by 0.4% (consensus: 0.5%). This corresponds to an upward revision of our previous forecast by 0.2%-points. We are thus taking into account the global environment, which we consider to be less unfavourable. In addition to rising real wages, the ECB's interest rate cuts expected for the current year should

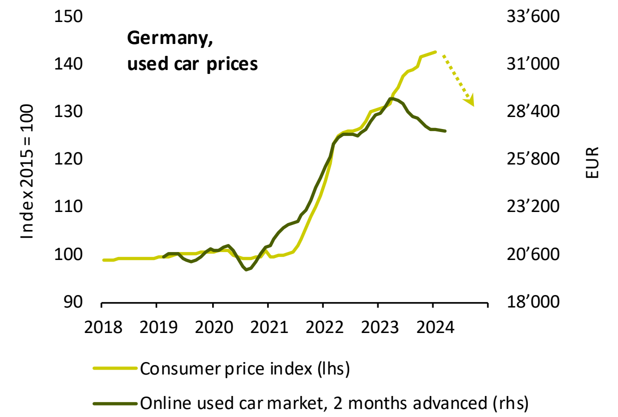
... German economic output, on the other hand, is likely to shrink by 0.3%.

have a positive impact in 2025. **We therefore expect GDP growth of 1.3% (consensus: 1.4%). The outlook for Germany is much less favourable.** We estimate that GDP will shrink by 0.3% in the current year (consensus: +0.2%).

Given the meagre global economic outlook and the weakness of the Chinese economy in particular, there are signs of a further decline in consumer price inflation for goods; ...

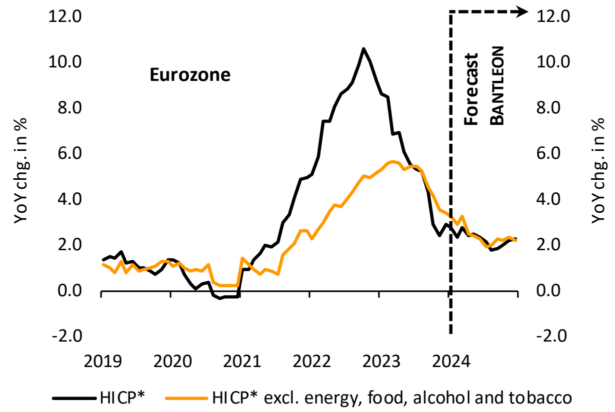
The rather weak global economic situation is likely to favour the decline in underlying inflation in the Eurozone. **We still see downward potential for goods price inflation in particular.** The downward pressure on prices emanating from China should not be underestimated. Producer prices there are falling again significantly following the temporary spike in 2021 and 2022 caused by the pandemic. This affects almost all non-energy industrial goods such as clothing, household appliances, consumer electronics, toys and sporting goods. New and used car buyers can look forward to noticeable price reductions. The discount battle for electric cars is having an impact on new car prices, while various indicators suggest that price pressure on used car prices is easing (see Figure 17).

Figure 17: Used car prices are showing signs of easing



Sources: Destatis, AutoScout24, BANTLEON

Figure 18: The disinflationary trend will continue in 2024



Sources: Eurostat, BANTLEON; * Harmonised consumer price index

... the downward potential for service prices is not quite as strong, ...

However, the outlook for service prices is not quite as favourable. The strong wage growth that is becoming apparent in the coming quarters, combined with the forecast revival in private consumption, argues against a similarly sharp fall as in goods prices. Nevertheless, we believe that there will be some easing. Prices in the leisure, tourism and catering sectors in particular were raised exceptionally sharply last spring. This year, price increases are expected to be significantly less pronounced, meaning that inflation should fall compared to the previous year. This is already evident in room prices for hotels and in the catering sector. Service price inflation is therefore also likely to move from 4.0% in January towards 3.0%. **Overall, the core inflation rate – excluding energy, food, alcohol and tobacco – is expected to fall from 3.3% at the beginning of the year to just over 2.0% in the second half of the year** (see Figure 18)**. We expect an annual average of 2.4%** (consensus: 2.5%)**.**

... overall, however, the core inflation rate should move towards 2.0% by the middle of the year; ...

The overall inflation rate is likely to fall temporarily below 2.0% in the summer and then stabilise at around 2.0% (see Figure 18)**.** This is based on our forecast of falling energy prices and a significant decline in food price inflation. **On an annual average, we forecast an overall inflation rate of 2.2%** (consensus: 2.3%)**.**

... the overall inflation rate is likely to fall below 2.0% for a short time.

In view of falling inflation rates and only a hesitant economic recovery, the ECB is likely to start lowering its key interest rates from spring.

In our opinion, the continued decline in inflation combined with the weak economic environment will prompt the ECB to ease its monetary policy from April. **We expect four consecutive key interest rate cuts of 25 bp each. The deposit rate would therefore be 3.00% from September, bringing it closer to the neutral level.** If the economic recovery we expect fails to materialise in the autumn because consumers, contrary to expectations, continue to increase their savings rate or because the global economy develops less favourably than currently assumed, further interest rate cuts would be likely.

Table 2: Macro Forecasts 2024/2025 for the Eurozone

	Quarterly Growth in %								Annual Growth in %			
	Q1/23	Q2/23	Q3/23	Q4/23	Q1/24	Q2/24	Q3/24	Q4/24	2022	2023	2024	2025
GDP	0.1	0.1	-0.1	0.0	0.0	0.1	0.2	0.3	3.4	0.5	0.4	1.3
GDP (YoY chg.)	1.3	0.6	0.1	0.1	0.1	0.2	0.4	0.7	-	-	-	-
Private consumption	0.1	0.0	0.3	0.3	0.4	0.5	0.5	0.4	4.2	0.5	1.5	1.9
Gross fixed investm.	0.4	-0.1	0.0	-1.0	-1.0	-0.4	0.1	0.6	2.8	0.5	-1.9	2.9
Exports	-0.4	-1.1	-1.2	0.3	-0.2	0.0	0.6	1.1	7.4	-0.9	-0.3	3.7
Imports	-1.7	-0.9	-1.2	0.0	0.0	0.2	0.9	1.4	8.0	-1.5	0.3	5.3
Government	-0.5	0.2	0.4	0.4	0.3	0.3	0.3	0.3	1.6	0.3	1.3	1.2
Inflation rate, [1]	8.0	6.2	5.0	2.8	2.6	2.4	1.9	2.1	8.4	5.4	2.2	2.1
Core rate [1]	5.5	5.5	5.1	3.8	3.1	2.4	2.1	2.3	3.9	5.0	2.4	2.2
Unemployment rate [2]	6.6	6.5	6.5	6.7	6.5	6.7	6.9	6.9	6.7	6.6	6.8	6.4
ECB main refin. rate [3]	3.50	4.00	4.50	4.50	4.50	4.00	3.50	3.50	2.50	4.50	3.50	3.50
ECB deposit rate [3]	3.00	3.50	4.00	4.00	4.00	3.50	3.00	3.00	2.00	4.00	3.00	3.00

Sources: Bloomberg, BANTLEON; [1] Annual and quarterly averages, year-on-year change in %; [2] Annual and quarterly averages in %; [3] Year-end and quarter-end levels in %

Financial Markets

Risk assets are currently benefiting from the favourable economic data ...

2024 has so far been very positive for risk assets in many respects. The majority of economic data has surprised on the upside in recent months. Above all, the US economy has started the year with momentum. The most impressive signal was the strong growth in employment in January (+353 thousand new jobs). In the Eurozone, there are also increasing signs of a tentative recovery in the hard-hit industrial sector (see *Eurozone*).

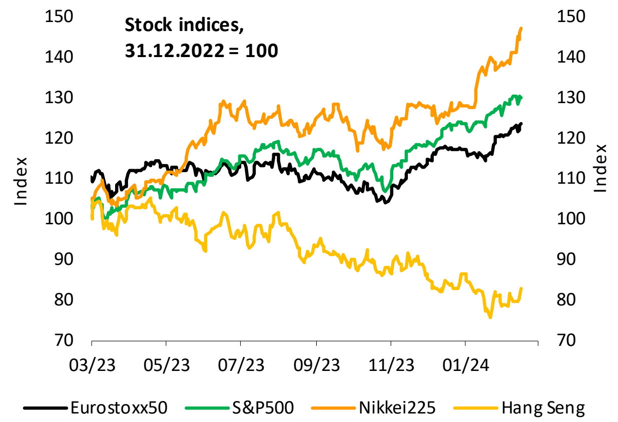
… and the continuing disinflation trend; ...

At the same time, the global disinflation trend remains intact, even though the January inflation data in the US and the Eurozone was slightly higher than expected. Notwithstanding this, inflation rates in the US and the Eurozone were only around 3.0% at the beginning of the year – down from 9.1% and 10.7% respectively at the end of 2022.

… it is the almost perfect Goldilocks environment; ...

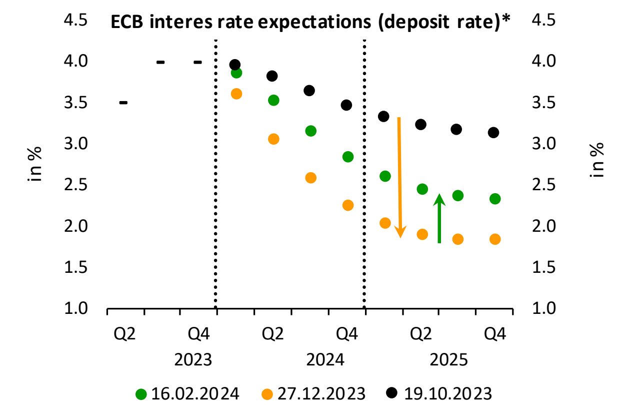
All in all, the current environment is already close to what is commonly referred to as Goldilocks. Such a framework, characterised by moderate growth and inflation, makes companies' coffers ring on the one hand and gives central banks the leeway to lower key interest rates on the other – both of which play into the hands of equities. The fact that many companies currently have no reason to complain was also demonstrated by the reporting season for the fourth quarter. According to Bloomberg, almost 80% of US companies exceeded analysts' earnings estimates.

Figure 19: Equities on the rise – with a few exceptions



Sources: Bloomberg, BANTLEON

Figure 20: Interest rate cut expectations are scaled back



Sources: Bloomberg, BANTLEON; * derived from EURIBOR Futures

… as a result, the prominent stock market indices are rushing from record to record.

In view of this, it is not surprising that numerous stock market indices have climbed to new records or at least cyclical highs in recent days (see Figure 19). This applies first and foremost to the Nikkei225, which is already up 15% this year and is thus sniffing at its all-time high from 1989 after 35 years. The NASDAQ 100 (5%), the S&P500 (5%), the Eurostoxx50 (5%), the CAC 40 (3%), the DAX (2%) and the SMI (2%) follow at some distance behind. There are a few downside outliers – such as the British FTSE 100 (-0.1%) and the Hang Seng (-5%) – but even there a bottoming out is in progress.

Government bonds, on the other hand, are suffering ...

Unlike equities, government bonds have suffered from the favourable economic data. The aggressive bets on falling key interest rates, which had taken on a life of their own at the end of 2023, have been dampened as a result (see Figure 20). It is now clear that the central banks are in no hurry to start

... that the aggressive interest rate cut expectations are being scaled back.

easing monetary policy. As a result, yields on 10-year German government bonds have rebounded from 1.90% to 2.40%, which means that almost half of the decline in yields between the beginning of October (3.03%) and the end of December 2023 (1.89%) has been made up for (see Figure 21).

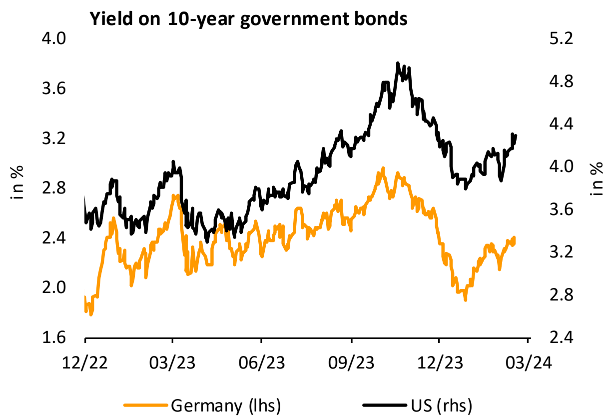
In the short term, the current trends are likely to continue, ...

... accordingly the global equity markets should continue to boom; ...

... a volatile sideways movement can be expected for government bonds.

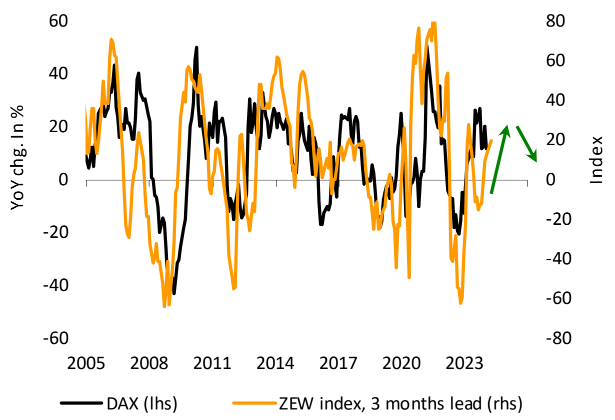
We expect the current constructive framework for equities to continue for a few more weeks (see Figure 22)**.** In addition to the fundamentals, this is also supported by the favourable technical environment (see *Technical Analysis*). **In view of this, the global equity markets should set their sights on new records, i.e. the DAX should head for 17,500 points and the S&P500 for 5,150 points.** Another upward twitch in government bond yields, which could push 10-year Bund yields to or even above 2.50%, cannot be ruled out either. However, we assume that the February inflation data will be more favourable again and thus support the bond markets from this side. **In view of this, a volatile sideways movement in government bonds is the most likely scenario in the short term.**

Figure 21: Counter-movement or new trend?



Sources: Bloomberg, BANTLEON

Figure 22: Boost for equities for the time being



Sources: ZEW, Bloomberg, BANTLEON

However, there should be a regime change by the middle of the year at the latest; ...

... although a hard landing in the US has now become unlikely, ...

... nevertheless, a slowdown in growth remains our base scenario; ...

In our view, however, the almost ideal environment for risk assets will not last the whole year. There is likely to be a regime change by the summer at the latest – but in which direction? There is no doubt that the US economy has coped better than expected with the severe monetary policy restrictions of the past two years. From today's perspective, a recession seems to have been averted. **Nevertheless, in our view it remains likely that the US economy will cool down over the course of the year** (see *US*)**.** On the one hand, monetary policy is still having a dampening effect, while on the other hand, the fiscal stimulus from 2020/2021 is increasingly losing steam. **Our base scenario is therefore that US growth rates will fall below the potential rate in the second half of the year.** An even sharper slump is conceivable, but would probably require an additional trigger (e.g. an exogenous shock) that cannot be predicted in advance.

… the latter would also further fuel the disinflation trend; ...

If there is an economic slowdown in the US, the Eurozone will also suffer. The economic recovery is likely to be even more anaemic than expected. At the same time, the sluggish global economy will make it difficult for companies to push through higher prices. The disinflation trend will receive a further boost from this side. **Inflation rates in the US and the Eurozone are therefore likely to approach the 2% mark by large steps.**

... taken together, this gives the central banks room for manoeuvre for significant interest rate cuts; ...

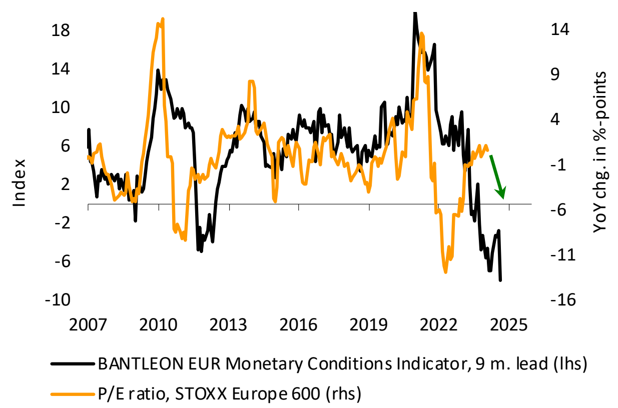
In such an environment, which is characterised by a weak economy and falling inflation rates, the central banks can reduce key interest rates to a neutral level – but probably not much lower. **In this case, the potential for key interest rate cuts is 200 bp in the US and 150 bp in the Eurozone. This is more than is currently priced in on the money futures markets** (around 90 to 100 bp in both the US and the Eurozone). **Accordingly, government bond yields still have room to fall.** However, the extent of this is limited if there is no sharp downturn in the global economy. **We therefore expect yields on 10-year German government bonds to be around 40 to 50 bp lower at the end of the year than at present and thus slightly below the 2.00% mark** (see Table 3). Yields on 10-year US Treasuries are likely to be around 80 bp lower, which corresponds to a yield level of around 3.50%.

... government bond yields therefore still have downside potential – but not too much.

The yield curve should steepen, but money market interest rates will remain above capital market yields.

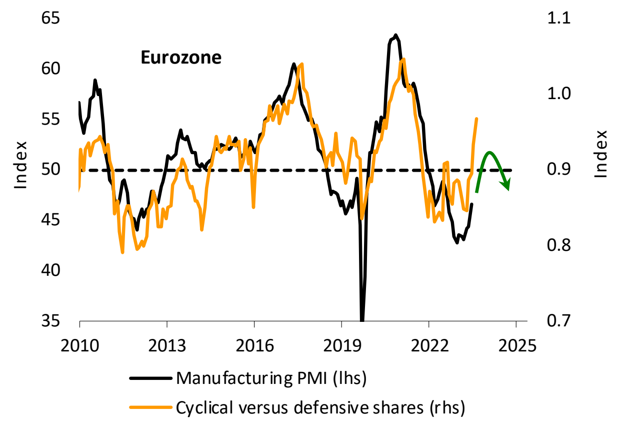
At the short end of the curve, the decline in yields should be even greater, so that the 10-year versus 2-year spread is slightly positive again (in the US and the Eurozone). **However, money market interest rates will continue to be significantly higher than capital market yields.** The 3-month EURIBOR is therefore likely to fall towards 2.30% to 2.40% at most.

Figure 23: Profit expectations under pressure in the medium term



Sources: Bloomberg, BANTLEON

Figure 24: Cyclical equities at temporary high



Sources: S&P Global, Bloomberg, BANTLEON

Sentiment on the equity markets is likely to deteriorate over the course of the year due to the economic slowdown and share prices are likely to be moderately dampened.

In terms of the equity markets, our base scenario – a weakening of the global economy but no recession – is certainly not a nightmare scenario. Nevertheless, analysts will have no choice but to revise their in some cases ambitious earnings estimates (S&P500: around 10% for 2024 and 2025, DAX: 5% to 10%) downwards (see Figure 23). Added to this are the ambitious valuation levels in the technology equities sector (P/E ratio > 30), the euphoric or carefree sentiment and the now one-sided positioning, which is reflected in a strong overweight in equities. **In view of this, a moderate setback on the global equity markets over the course of the second half of the year seems plausible.** As a result, the outperformance of cyclical equities observed at present is likely to prove to be only a short-term interlude (see Figure 24). **Defensive stocks will soon return to focus.**

Corporate bonds (investment grade) should continue to perform well.

Alongside equities, other risk assets have also recently started to rise. For example, the risk premiums of high-yields over government bonds in the US and the Eurozone have fallen below 400 bp for the first time since the beginning of 2022. This trend may continue for a few more weeks in line with the bull market in equities. As the year progresses, however, global economic uncertainty should trigger a countermovement. B**ut here too, if the US**

recession does not materialise, the setbacks will be limited, especially in the conservative bond segments. Investment-grade corporate bonds, for example, should be able to cushion moderate widening of spreads via coupons without any problems.

In our risk scenario, we assume that the US economy will barely lose momentum ...

... and that the disinflation trend will start to stall.

In our view, the base scenario is highly plausible. **Nevertheless, it is offset by a significant risk scenario.** The US economy has so far proved to be more resilient than expected. **It can therefore not be ruled out that the restrictive monetary stimuli will ultimately fizzle out without effect and that the US economy will expand by 2% to 3% throughout the year. In line with this, the labour market is likely to remain tight and wage pressure high.** There is therefore a risk that US inflation rates will turn upwards again before they have even reached the 2% mark.

There is then hardly any reason for the Fed (and the ECB) to lower key interest rates; ...

... in this case, yields will take another leap upwards, ...

There would then be hardly any reason for the Fed to loosen monetary policy. Key interest rates are therefore likely to be lowered in a homeopathic dose at best (25 to 75 bp). As a result, further key interest rate cuts would be priced in on the money futures markets, which would be associated with rising government bond yields. **In our risk scenario, we therefore assume that the yield highs from 2023 – 3.03% for 10-year German government bonds and 5.02% for US Treasuries – will be tested again.**

Table 3: Financial Market Forecasts 2024/2025

	»BANTLEON Prognosen«	Mar 23	Jun 23	Sep 23	Dec 23	Mar 24	Jun 24	Sep 24	Dec 24	Mar 25
Yield (%)	Fed-Funds Rate (upper limit)	5.00	5.25	5.50	5.50	5.50	5.00	4.50	4.25	4.25
	10Y Treasuries	3.47	3.84	4.57	3.88	4.10	3.90	3.70	3.50	3.70
	ECB Deposit rate	3.00	3.50	4.00	4.00	4.00	3.50	3.00	3.00	3.00
	10Y Bunds	2.29	2.39	2.84	2.02	2.30	2.10	2.00	1.90	2.10
	2Y Bunds	2.68	3.20	3.20	2.45	2.60	2.20	2.00	1.80	2.00
Spreads (Bp)	Bund/Pfandbriefe (10Y)	84	82	72	75	75	80	85	90	85
	Bund/Corporates	170	164	154	139	130	150	170	180	170
	Bund/High-Yields	489	464	453	406	370	450	520	580	520
Equities	DAX	15’628	16’147	15’386	16’751	17’500	16’800	16’300	15’800	16’300
	Eurostoxx50	4’315	4’399	4’174	4’521	4’850	4’650	4’500	4’400	4’550
	SMI	11'106	11’280	10’963	11’137	11’600	11’100	10’800	10’500	10’900
	S&P500	4'109	4’450	4’288	4’769	5’150	4’950	4’750	4’600	4’800

Sources: Bloomberg, BANTLEON

... which is also a negative factor for the equity markets.

The consequences of our risk scenario for equities would be ambivalent. Although the continuing robust economy would have a supportive effect, rising yields would be a negative factor. **In view of the fragility described above (high valuations, exhausted sentiment, one-sided positioning), a moderate setback on the global equity markets is therefore also very likely in this scenario.**

Investment-grade corporate bonds, on the other hand, are likely to perform well in this environment. Although they would also suffer from rising yields, they are better protected than government bonds due to their higher coupons.

The winners in such a scenario would be commodities and linkers.

However, the real winners in the risk scenario would be commodities and linkers, which would benefit from the continuing buoyant global economy and the associated inflation risks. **This would also be a constructive environment for numerous emerging markets.**

Conclusion: After a brilliant start, the bull market in equities should falter over the course of the year; ...

... we remain fundamentally constructive on government bonds, but the risk of a setback is high.

Conclusion: After a brilliant start to the year, equities should come under pressure over the course of the year, as suggested by both our base case and our risk scenario. Headwinds could therefore come from a slowdown in growth or renewed fears of inflation. The outlook for government bonds is more complex. If the global economy weakens, yields are also expected to fall thanks to a further decline in inflation rates. In the risk scenario of an inflationary boom, however, the exact opposite is likely to occur. All in all, there is a high risk of being caught on the wrong foot this year. Particularly in the case of government bonds, close monitoring of economic trends and maximum flexibility in positioning are therefore required.

Table 4: Current Asset Allocation Recommendation*

	Underweight ←				→ Overweight
	--	-	o	+	++
Equities					
Total exposure		🟢	🟡		
North America		🟢	🟡		
Europe		🟢	🟡		
Asia developed			🟢🟡		
Emerging markets			🟢🟡		
Value/Growth			🟢🟡		
Small/Large Caps		🟢	🟡		
Bonds					
Duration Bunds			🟡	🟢	
Duration Treasuries			🟡	🟢	
Governm. Bonds Peripheral Countries		🟢	🟡		
Gov.-related bonds/Covered bonds			🟢🟡		
Linker		🟢🟡			
Corporate bonds IG			🟢🟡		
Corporate bonds HY		🟢	🟡		
Commodities					
Gold				🟢🟡	
Industrial metals		🟢🟡			

As of 20 February 2024; * 🟢 strategical (3 to 6 months) 🟡 tactical (1 to 3 months)

Technical Analysis

Equity Markets

The significant improvement in risk sentiment led to an impressive rally in equities, meaning that the positive seasonal pattern has once again prevailed.

Almost all sentiment indicators are now generating a positive signal, which leaves little room for a further improvement in risk sentiment; ...

... but there are no signs of a deterioration yet.

The year-end rally that began at the start of November 2023 continued unabated in the new year. In addition to further declines in inflation data – particularly in the US – positive economic and labour market data were the driving factors. As a result, the S&P500 reached a new all-time high of 5,048 points. Meanwhile, the Eurostoxx was only a blink of an eye below its all-time high of 489 points. The seasonal patterns of »year-end rally« and »January effect« have thus once again proven true. In the FMM of 20 November 2023, we highlighted the potential for a further brightening of the risk sentiment, which was still neutral at the time. In contrast to then, the majority of sentiment indicators currently paint an extremely positive picture that offers little room for further improvement. The CNN Fear and Greed indicator, for example, stands at 78 points and is therefore at the level of »extreme greed«. According to the AAII US Investor Sentiment Readings survey, the ratio of equity bulls to equity bears stands at a factor of 2.2 compared to 0.5 at the beginning of November - the equity optimists are therefore clearly in the majority. At the same time, the ratio of put to call options on the CBOE is at a very low level of 0.54, which also speaks in favour of a high degree of carelessness among market participants. This is confirmed by the premia for credit default swaps (measured by the Markit iTraxx Europe Crossover Index), which have levelled off at a low level and show no signs of a trend reversal.

At the same time, market participants appear to be aware of the smouldering risks and are using the accumulated profits to build up risk hedges.

Nevertheless, market participants appear to be well aware of the current economic and geopolitical risks. The TDEX index – a measure of the demand for out-of-the-money put S&P options – has been rising gradually since January. As a result, some of the accumulated equity gains are being reinvested in the form of risk hedging. Overall, however, sentiment on the markets is extremely favourable. Without further positive macro impulses, it will therefore be difficult to maintain the positive sentiment.

The dominance of (tech) megacaps is continuing in the current year.

This indicates a weak market range, as the equity rally is only being driven by a few stocks and sectors.

The market breadth only appears solid at first glance. For example, 73% of equities in the S&P500 and 64% in the Eurostoxx are trading above their 200-day line, which suggests that the rally is being driven by a broad mass of equities. In addition, 91% of regional equity indices show a positive monthly performance, reflecting a global equity rally. Only China, Thailand and Russia are lagging behind. At second glance, however, the good impression crumbles. The outperformance of the market-weighted S&P500 (+5.6%) compared to the equally weighted index (+1.9%) continues. The tech heavyweights thus continue to dominate the performance trend, which is why active stock selection remains highly relevant. There are also significant sectoral differences. While basic materials (-9.9%), real estate (-8.1%) and utilities (-10.3%) have noticeably lost market capitalisation in the Eurostoxx since the beginning of the year, technology (+15.8%) and media (+10.1%) have made significant gains. Accordingly, the current rally is being driven by a few stocks and sectors and not by the broad equity market. We therefore assess market broadness as rather weak.

In chart terms, the picture is positive and suggests that the rally will continue.

The technical chart picture is consistently positive. Both the S&P500 and the Eurostoxx are moving in intact upward trends. Both indices are trading above the 20-, 50-, 100- and 200-day lines as well as the exponential moving

For the Eurostoxx, this means a price potential of 6.5% in the event of a continuation of the trend, compared with 3.6% for the S&P500.

average. The MACD also generated buy signals for both indices. The barometers are also trading close to the upper Bollinger band. An (at least temporary) top formation could be assumed if the middle Bollinger band were to be undercut, which would require a correction of at least one per cent in both indices. In the Eurostoxx, this would pave the way for a correction from the current 488 to 472 (-2.0%) and then to 463 (4.0%, = historical interim high). In the S&P500, the first support level is at 4,818 points (-2.7%), followed by the 4,600-point mark (-7.2%, = cyclical high). The relative strength index is still just below the critical 70 mark in both indices. In the positive scenario of a continuation of the upward trend, the Eurostoxx must first sustainably exceed the resistance line of the all-time high at 489 points. If this succeeds, there would be a price potential of 6.5% up to the 123.6% Fibonacci retracement at 520 points. In the S&P500, the 123.6% Fibonacci retracement lies at 5,130 points, which corresponds to a price potential of 3.6%.

Conclusion: The technical market picture is positive on balance, which is why tactically we expect the rally to continue. However, caution is advised in view of the extremely positive risk sentiment. A deterioration in sentiment could quickly lead to a trend reversal and result in lower index levels.

Figure 25: Eurostoxx Index

Sources: Bloomberg, BANTLEON

Figure 26: S&P500 Index

Sources: Bloomberg, BANTLEON

Bond Market

The outlook on the bond market looks less rosy in the short term in view of the continued increased volatility and positioning of market participants.

The higher-than-expected US inflation figures in January recently put a strong damper on expectations of key interest rate cuts. The US market now expects a total of four cuts of 25 bp each by February 2025, compared to five cuts before the CPI publication. At the same time, volatility remains at an elevated level. The MOVE index – a volatility indicator for US Treasuries – once again failed to break below the 100 mark. Investors are therefore continuing to price in an increased volatility risk premium for bonds, which is likely due to uncertainty regarding the timing of the first interest rate cut. As soon as there is more clarity about the monetary policy course, volatility on the bond market should also decrease noticeably.

The CFTC data, an indicator for the positioning of market participants, also provides little tailwind. The proportion of short positions in US Treasuries with ten-year maturities relative to total outstanding futures contracts remains high at over 70%. As there is no sign of a trend reversal so far, there is a lack of momentum that would be necessary for market participants to reposition. In combination with the very positive risk sentiment highlighted above, the conditions for dynamically falling yield levels are not in place in the short term. An exogenous shock or a concretisation of the monetary policy course is required to break out of the volatile sideways trend.

Only the relative attractiveness compared to equities raises hopes of an imminent recovery in bond prices.

However, the relative attractiveness of bonds compared to equities continues. The dividend yield in the Eurostoxx Index is currently 3.55%, which is just 0.2%-points above the yield on 1-year German government bonds. At 4.90%, the yield on 1-year US Treasuries is even 0.45%-points higher than the dividend yield on the Dow Jones Select Dividend Index. The equity risk premium has therefore fallen significantly, making bonds more attractive in relative terms, especially in the short term.

Figure 27: Euro-Bund-Future

Sources: Bloomberg, BANTLEON

Figure 28: US-Treasury-Future

Sources: Bloomberg, BANTLEON

From a chart perspective, there is much to suggest that the volatile sideways movement that has been ongoing since the beginning of last year will continue.

In the base scenario, the Bund future is expected to move between 132.76 and 135.75 in the coming weeks; ...

... the trading range for US Treasury futures is likely to be between 109.67 and 112.65.

Once again, the charts paint a less positive picture. Both the Bund future and the T-note future have been trading in an intact downward trend since the beginning of the year. In addition, the MACD and the Bollinger Bands are signalling a continued downward trend. The RSI is in neutral territory for both contracts. The Bund future should find support at the level of the 200-day line at 132.65 (-0.9%). Below that, a move to 130.00 (-2.8%, = cyclical interim low) and then to 127.40 (-4.8%, = cyclical low) would be possible. However, the most likely scenario is a move within the Bollinger bands and thus between 132.76 and 135.75, whereby a breach of the middle band at 134.25 points (+0.3%) would be seen as a positive signal. The situation is very similar for the T-Note future. The contract should find support at the level of the 100-day line at 109.67, where the contract is currently trading. If it falls below this level, the downward trend is likely to continue to 107.00 (-2.5%, = cyclical interim low) and then to 105.70 (-3.7%, = low for 2023). However, a development within the Bollinger Bands between 109.67 and 112.65 is more likely. If the contract manages to exceed the middle band at 111.16, which also corresponds to the level of the 200-day line, this would be a positive sign. Until then, however, the technical picture is negative.

Conclusion: Overall, the technical picture for the Bund and T-Note futures is negative. In addition to the technical charts, there is a lack of positive signals from the positioning of market participants. In addition, there is no increased demand for safe-haven assets in view of the very positive risk sentiment. Only the relative attractiveness raises hopes of an imminent recovery in bond prices. The most likely scenario from a market perspective is therefore a continuation of the very volatile sideways trend.

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