M.M. WARBURG & CO
BANK

Economic Situation and Strategy

12 April 2024

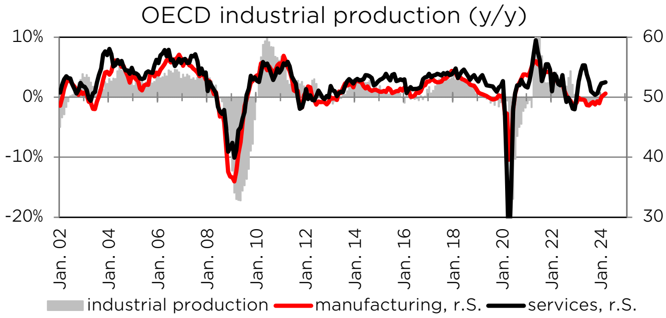
Stock price targets raised - despite fewer US interest rate cuts

The stock markets have started the new year with a lot of momentum, seamlessly continuing the surprisingly good performance of 2023. The MSCI World index, which comprises almost 1,500 shares from 23 industrialized countries, has so far recorded a price gain of just under seven percent. By contrast, shares from emerging markets, as measured by the MSCI Emerging Markets, are up just over three percent. The DAX has already exceeded our year-end forecast of 18,000 points, and the same applies to other indices such as the S&P 500 and the Euro Stoxx 50. This raises the question of what the future holds and how investors should position themselves. Take profits or let them run?

Prospects of falling interest rates worldwide and a "soft landing" in the USA boost

The positive stock market performance is due on the one hand to the expectation of falling key interest rates worldwide, and on the other hand to a robust US economy and the hope that economic growth in the European economies - especially in Germany - will accelerate over the course of the year. However, positive economic data is a double-edged sword for the stock markets: from a corporate earnings perspective, good economic data is always welcome, as it points to better sales and profit development and thus increases the stock market value of a company. However, only as long as stronger growth does not lead to significantly higher inflation. A little inflation is not a problem for the stock markets, as a certain amount of pricing power contributes to better margins and therefore higher profits. The problem arises when higher inflation calls the central banks into action because they have to raise interest rates or cannot lower them. This is because higher or rising interest rates mean that the discount factor for future profits increases, which reduces their current cash value and therefore also the value of the company. In addition, stocks become less attractive compared to bonds.

Global Purchasing Managers indices and OECD industrial production (y/y)

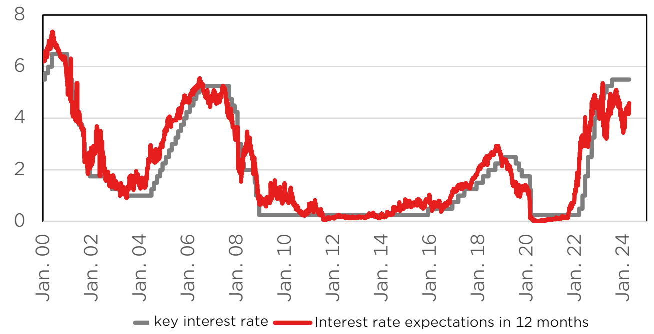


source: Refinitiv Datastream

It is precisely this balancing act between good economic data and less good inflation rates that can currently be observed in the USA. While inflation rates are weakening in most countries, this trend has recently stalled in the USA. Compared to the peak of nine percent in summer 2022, US inflation has weakened significantly in the meantime. Since fall 2023, however, the CPI inflation rate has fluctuated between 3.1 percent and most recently 3.5 percent, and the core inflation rate was also fairly stable at 3.8 percent in March - still quite far from the central bank's target of two percent. This is due to the recent rise in energy prices and the persistently high cost of housing and rents. In particular, hypothetical rents for property owners are still six percent above the previous year's level - and thus far above the values observed on the market. If, on the other hand, the price trend in the USA were measured in the same way as the basket of goods used in the Eurozone, the trend would look much more positive:

The full-year rate would then be 2.4 percent and the core inflation rate 1.9 percent. At the beginning of the year, market participants were still expecting up to seven interest rate cuts by the Federal Reserve, but now only two or three steps down are likely, starting in July or September. Whether the Fed will cut interest rates in the middle of the heated presidential election campaign is more than questionable. If the Fed does not cut rates in the summer months, it could even wait until November (US presidential election on November 5, FOMC meeting on November 7) or December to cut rates for political reasons. We do not share the fear that the US Federal Reserve will raise interest rates once again. This is because the real US key interest rate is already in a very restrictive range at around two percent. However, increasing doubts about a rate cut in the summer months and the associated prospect of higher interest rates could at least temporarily interrupt the stock market rally.

USA: key interest rate and interest rate expectations



Source: Refinitiv Datastream

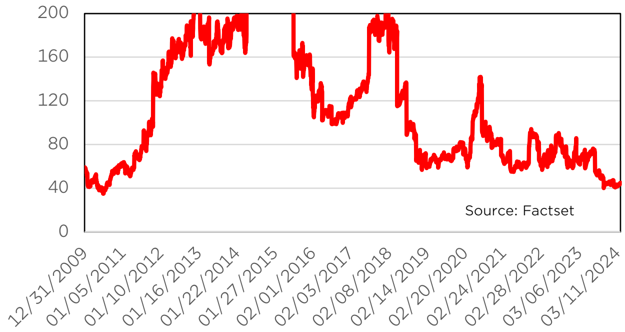
Reporting season could provide new impetus, focus on technology companies

Although we do not expect a trend reversal on the stock markets, a breather is more than overdue after the brilliant price performance of the past five months. In this respect, many investors are probably looking for arguments to take profits. But where to put the money? Even if the decline in inflation in the USA has been bumpy, the majority of international price statistics are pointing downwards. A first interest rate cut is on the cards for the Eurozone in June, which could be followed by two more this year. In Switzerland, the central bank has already decided to cut interest rates for the first time, and further steps downwards are likely due to the low inflation rate of just one percent. Some central banks in the emerging markets have also already adopted a more expansionary course (e.g. Brazil, Mexico, Chile, Peru, Poland, Hungary). Both international price trends and global central bank policy have shown a high degree of synchronization in the past; this is likely to remain the case.

Positive impetus for the stock markets could come from the start of the reporting season. In the US, corporate analysts normally revise their earnings forecasts downwards in the run-up to the publication of figures, so that the hurdle to be overcome is low. This time, however, expectations for Q1 earnings in the S&P 500 remained fairly stable. Although the forecasts for consumer-related sectors and industrial stocks were lowered, this was offset by more optimistic assessments for technology and energy companies.

The technology sector, which has led the stock market rally to date, will once again be the focus of interest. Due to the high weighting of these companies in the S&P 500, it has gained almost nine percent since the beginning of the year. Nevertheless, many are wondering whether this positive trend can continue in view of the high valuation. The S&P 500 has a price/earnings ratio of just under 21 based on the company's expected earnings in twelve months, while the Nasdaq 100 technology index is even more expensive with a price/earnings ratio of 27. In view of these lofty valuation levels, a failure to meet profit expectations is likely to lead to share price losses.

Amazon: price/earnings ratio

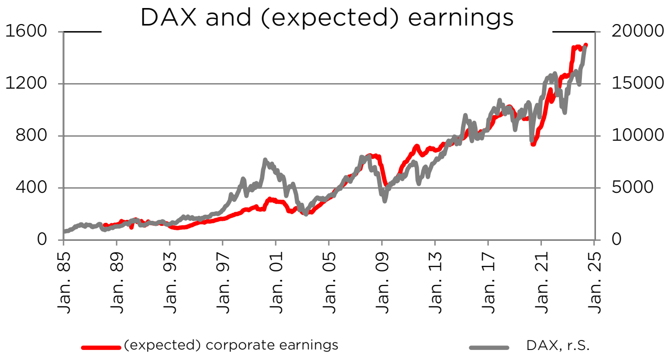


The good news, however, is that the first figures we have from the reporting season are promising. Of the 25 companies that have already published their Q1 figures, 80 percent were able to exceed their profit expectations. Among companies from the technology sector, the proportion of positive surprises was even higher than 80 percent. Reports from Apple, Alphabet, Amazon, Meta, Microsoft and Nvidia in particular are likely to be scrutinized again. Thanks to their outstanding business models and the ability to sell products and services without high fixed costs and at low variable costs, these companies have developed into real profit machines in recent years. As a result, the current P/E valuation is more favorable than in previous years despite the very good share price performance - with the exception of Microsoft. Amazon, for example, is valued more favorably today with a P/E ratio of 45 than at the end of 2022 (P/E ratio of 60) or at the peak of the sell-off in late summer 2022 (P/E ratio of 73). Thanks to strong cash flows, which amounted to around USD 100 billion at Apple, Microsoft, Alphabet and Amazon in the last 12 months, there is plenty of money available for takeovers, dividends or share buy-back programs. For this reason, we assume that the share prices of technology companies will continue to rise.

Positive earnings performance leads to higher share price targets

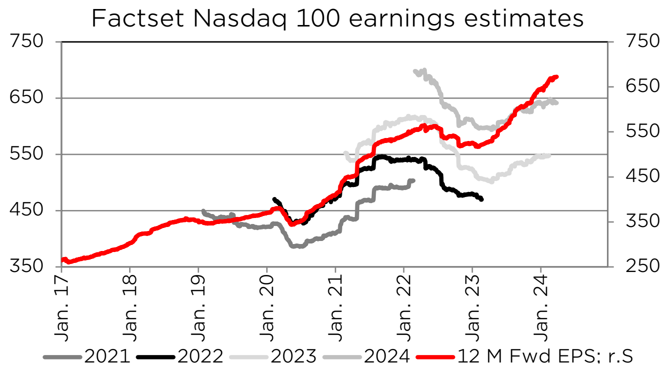
Despite the price gains already achieved on the stock markets, our outlook for the rest of the year remains positive, even if the negative factors are not diminishing. Crises and negative headlines have become loyal companions. However, investors should not let this unsettle them. Nor is the absolute level of an index or stock price a sufficient reason to buy or sell. If, as we expect, the global economy grows more strongly again over the course of the year and at the same time inflation rates continue to fall and key interest rates are lowered, the fundamental conditions for the equity markets will improve.

Some of these positive developments are certainly reflected in the current share prices. However, the moderate earnings expectations for the DAX and the Euro Stoxx 50 and the still low valuations in contrast to the USA point to further price rises in the coming months. We are therefore raising our year-end targets for the DAX from 18,000 to 19,500 points and for the Euro Stoxx 50 from 4,800 to 5,300 points. Record corporate profits are the reason why the stock markets are also reaching new highs.



Source: Refinitiv Datastream, IBES

We are raising our year-end target for the S&P 500 from 5,000 to 5,500 points. Although valuations are already relatively high, we still see scope for upside, particularly in technology stocks. However, our target increase only reflects the improved earnings expectations and is not based on the assumption of an even higher valuation multiple. Our message to investors is therefore clear: stay invested or, if you are not yet invested, use price setbacks to build up positions.



Source: Factset

Carsten Klude

Market data

Stock marktes	As of 12.04.2024 09:43	Change versus 05.04.2024 -1 week	11.03.2024 -1 month	11.01.2024 -3 months	11.04.2023 -1 year	29.12.2023 YTD
Dow Jones	38459	-1,1%	-0,8%	2,0%	14,2%	2,0%
S&P 500	5244	0,8%	2,5%	9,7%	27,6%	9,9%
Nasdaq	16442	1,2%	2,6%	9,8%	36,7%	9,5%
DAX	18127	-0,3%	2,1%	9,5%	15,8%	8,2%
MDAX	27000	0,3%	3,7%	3,6%	-1,6%	-0,5%
TecDAX	3386	0,4%	-1,3%	4,7%	2,4%	1,5%
EuroStoxx 50	5013	0,0%	1,7%	12,8%	15,7%	10,9%
Stoxx 50	4407	0,8%	1,4%	8,5%	10,2%	7,7%
SMI (Swiss Market Index)	11491	0,0%	-1,7%	3,0%	2,0%	3,2%
Nikkei 225	39524	1,4%	1,8%	12,8%	41,5%	18,1%
Brasilien BOVESPA	127396	0,5%	1,0%	-2,5%	19,9%	-5,1%
Russland RTS	1163	0,6%	0,8%	2,8%	19,5%	7,4%
Indien BSE 30	74427	0,2%	1,3%	3,8%	23,7%	3,0%
China CSI 300	3476	-2,6%	-3,2%	5,5%	-15,2%	1,3%
MSCI Welt	3391	-0,3%	0,7%	7,4%	21,2%	7,0%
MSCI Emerging Markets	1055	0,9%	1,5%	6,1%	5,9%	3,1%
Bond markets						
Bund-Future	131,34	-88	-205	-380	-453	-588
Bobl-Future	117,60	-18	-76	-46	-37	-168
Schatz-Future	105,52	-10	-34	-51	-17	-103
3 Monats Euribor	3,91	0	1	1	80	3
3M Euribor Future, Dec 2024	3,21	14	27	67	34	91
3 Monats $ Libor	5,56	1	-2	-2	32	-3
Fed Funds Future, Dec 2024	4,95	19	42	106	175	112
10 year US Treasuries	4,54	15	44	56	111	68
10 year Bunds	2,40	3	13	20	10	40
10 year JGB	0,85	11	9	27	45	23
10 year Swiss Government	0,73	-1	-1	-15	-49	3
US Treas 10Y Performance	574,38	-1,3%	-3,4%	-3,7%	-5,5%	-4,4%
Bund 10Y Performance	549,21	-0,6%	-1,2%	-1,5%	1,2%	-2,9%
REX Performance Index	440,40	-0,5%	-0,8%	-0,7%	0,9%	-1,7%
IBOXX AA, €	3,38	9	9	7	-13	31
IBOXX BBB, €	3,94	9	5	-4	-53	18
ML US High Yield	8,20	17	33	24	-34	41
Commodities						
MG Base Metal Index	419,71	1,5%	7,8%	10,3%	3,2%	7,4%
Crude oil Brent	90,40	-1,3%	9,4%	14,4%	5,5%	16,4%
Gold	2394,84	3,1%	9,6%	18,2%	19,5%	15,9%
Silver	27,99	2,2%	14,2%	23,9%	11,6%	15,4%
Aluminium	2405,10	-0,3%	8,6%	9,9%	6,5%	2,5%
Copper	9209,90	0,0%	7,6%	11,5%	4,0%	8,8%
Iron ore	104,71	4,7%	-7,3%	-24,6%	-13,5%	-23,2%
Freight rates Baltic Dry Index	1690	3,8%	-28,9%	8,8%	12,1%	-19,3%
Currencies						
EUR/ USD	1,0676	-1,5%	-2,3%	-2,8%	-2,1%	-3,4%
EUR/ GBP	0,8535	-0,5%	0,0%	-0,9%	-2,8%	-1,5%
EUR/ JPY	163,66	-0,3%	2,0%	2,5%	12,7%	4,7%
EUR/ CHF	0,9739	-0,6%	1,5%	4,3%	-1,3%	5,2%
USD/ CNY	7,2372	0,0%	0,7%	0,9%	5,0%	1,9%
USD/ JPY	153,28	1,1%	4,3%	5,5%	14,7%	8,7%
USD/ GBP	0,80	0,9%	2,4%	1,7%	-0,6%	1,9%

Source: Refinitiv Datastream

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