Vontobel

VSWA Flash

Current correction improves longer-term prospects for stocks

MARKET PERFORMANCES (as of June 17, 2022 – 14:55 CET)

	CURRENT	CHANGE 1 WEEK	CHANGE YTD		CURRENT	CHANGE 1 WEEK	CHANGE YTD
S&P 500 Index	3'666.77	-8.74%	-23.07%	Gold	1'851.34	-1.06%	1.25%
S&P/Toronto Stock	19'004.06	-6.27%	-10.45%	Silver	21.87	0.01%	-5.99%
EuroStoxx 50	3'467.45	-3.66%	-19.33%	Oil WTI	117.00	-3.04%	55.56%
SMI Index	10'502.45	-5.25%	-18.43%	EUR/USD	1.0498	-0.10%	-7.47%
DAX Index	13'175.57	-4.26%	-17.06%	EUR/CHF	1.0111	2.68%	2.60%
Nikkei Index	25'963.00	-6.69%	-9.82%	USD/CHF	0.9632	2.34%	5.53%
Emerging Market Index	59'763.83	-3.87%	-14.69%	USD/JPY	134.55	-0.14%	14.54%
Yield 10Y US Treasuries	3.203	0.0456	1.6921	CAD/USD	0.7688	1.73%	2.84%
Yield 10Y German Bund	1.646	0.1360	2.2211	USD/CNY	6.7034	0.07%	5.20%

[Source: Bloomberg]

U.S. consumer confidence falls to all-time low

The University of Michigan's June sentiment index fell from 58.4 to 50.2 in June, missing consensus expectations and representing the lowest reading on record. Consumers are increasingly concerned that high inflation and negative real wage growth will continue to erode their incomes. Rising by 8.6% in May from a year earlier, inflation reached a fresh 40-year high. Compared with a month earlier, consumer prices rose by 1%, which was significantly above estimates. Respondents to the Michigan survey expect inflation to rise by 5.4% over the next year and to advance by 3.3% over the next five to 10 years, up from 3% in May and the most since 2008. Inflation expectations rose despite the vast majority of participants expecting the Fed to continue hiking interest rates during next year. As inflation is exceeding wage growth, people are forced to dip into savings. Personal savings as a percentage of disposable income fell from around 15% at the end of 2020 to currently 4.4%, which represents the lowest level since 2008 and is well below its historic average. While consumer spending has remained robust so far, the broad deterioration in sentiment as well as the already low personal savings rate are concerning, as they may lead people to cut back on spending, adding further fuel to the current slowing in economic growth.

FED and SNB increased interest rates

The Fed continues its tightening path with an unusually large hike of 75bps in June, representing the largest rate hike since 1994 on overshooting inflation data. Market reaction wasn't too bad as the large move had in fact been priced earlier this week. The Fed has now hiked by 150bps since March. The new dots projection shows that rates will rise to 3.4% by the end of the year, which is 90bps above the Fed's estimate of the neutral Fed Funds rate and thus in restrictive territory. Based on our expectations, hikes will continue in the second half of this year with a 75bps hike in July, 50bps in September and smaller hikes at the last 2 meetings this year likely. Asked on how much economic pain is needed to bring down inflation, Powell admitted that achieving a soft landing may not be easy but that he currently sees no broader slowdown of activity. The Swiss National Bank joined the Fed in lifting its policy rate by 50bps to -0.25% in an unexpected move for the first time since 2007. They also said more tightening may be needed to stabilize inflation. The surprise decision came alongside a shift in inflation outlook, which the SNB now sees at 2.8% this year, 1.9% in 2023 and 1.6% in 2024.

Stock market valuation increasingly attractive

The drawdown in stock markets from December 2021 highs was exclusively driven by valuation multiple compression, as 12 months forward earnings estimates continued to move higher across markets. In case of the very well-known MSCI World Index, the Price-to-Earnings (P/E) ratio fell from 19.3 to 14.9 since the start of the year, which is now below the 10-year average P/E-ratio of 16 and the 20-year average of 15. This significant valuation multiple compression resulted from an index drawdown of roughly 18% and a rise in consensus index earnings of around 10%. Historically, there was quite a significant correlation between the P/E-ratio of a stock market and its subsequent return over 5 or 10 years. Lower P/E-ratios typically resulted in strong longer-term returns, while high P/E-ratios led to weak or even negative future returns. Based on this historical relationship the recent correction in risk assets is a healthy development because it increases the attractiveness and future return potential across major stock markets. In our view, stock markets have started to price in a recession, but they are far from having priced in a recession. Trough P/E-multiples of the MSCI World index during past recession periods ranged from 8 to 12, depending on the severity of the economic downturn. Key takeaway: the short-term trend in stocks is still very uncertain and risks remain high, but longer-term prospects considerably improved. We already reduced the equity overweight in our multi-asset-mandates during the second half of 2021 and are currently slightly underweight. We will use further market weakness to carefully increase positions in quality stocks we expect to outperform over the coming years.