Crafter's Strategy Letter

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Central banks recalibrate, stock markets celebrate

The U.S. Federal Reserve (FED) is now on board with lower interest rates. For the first time in years, it has cut its key interest rate by 0.5% and plans to gradually reduce it to neutral. The FED does not foresee a recession any time soon. At the end of September, the Chinese central bank, PBOC, has finally acted too, though for entirely different reasons. Consequently, stock markets are celebrating cheaper finance.

Source: Dan God, Unsplash

In Q3, markets experienced brief but intense weakness. In early August, the market caught the jitters and become extremely volatile within a few days. The release of a weak US labour market report created significant uncertainty. Simultaneously, Japan's central bank caused widespread panic by implementing an unexpected rate hike. As a result, the Nikkei 225 index fell by -13% in one day, accompanied by the fastest spike in volatility ever recorded. Since then, panic has subsided, countless speculative carry trades in US dollars – Yen have unravelled, and global stock markets have nearly regained their all-time highs. This occurrence strongly reminds us of the French saying “Reculer pour mieux sauter” (step back to leap forward).

In Beijing, the leadership finally reacted to the ongoing deflationary pressure and real estate crisis which has mired its economy in misery. They announced the largest stimulus package since the end of COVID. By cutting interest rates, decreasing banks’ liquidity requirements and injecting around USD 110 billion into the stock market, China hopes to steer its economy back to growth.
During Q3, stock prices have surged, fuelled by loosened monetary policies: The S&P500 (+5.5%), Europe (Eurostoxx 50 +2.2%) and the Swiss market (SMI +1.5%). Gold continued its rally, breaking the USD 2,500 per ounce mark and reaching once more a new all-time high of USD 2,672/oz. Falling yields for both short and long durations allowed bonds to rally as well (+7.0% Bloomberg Global Aggregate).
Meanwhile, the shifts in interest rate dynamics triggered movement in currencies. The US dollar weakened significantly (USD Index -4.8% in Q3).

The Swiss franc appreciated strongly against the US dollar, euro, and pound in Q3, breaking from its trend from the beginning of the year (Q3: USD lost -5.9%, GBP -0.5% and EUR

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-2.2% against CHF).

The Swiss National Bank was quick to reduce rates, temporarily making the franc less attractive. However, geopolitical risks and further escalation in the Middle East likely contributed to the franc's strength, as it has always been seen as a safe haven.

Equities	YTD 2024	Q3 2024
MSCI World AC (USD)	18.7%	6.6%
S&P 500 (USD)	20.8%	5.5%
Eurostoxx 50 (EUR)	10.6%	2.2%
SMI (CHF)	9.3%	1.5%
FTSE 100 (GBP)	6.5%	0.9%
Nikkei (JPY)	13.3%	-4.2%
MSCI Emerging(USD)	14.4%	7.8%
Bonds	**YTD 2024**	**Q3 2024**
Bloomberg Global Aggregate	3.6%	7.0%
US Treasury 10y	1.2%	3.9%
US Corporate	5.3%	5.8%
Bund 10y	-1.7%	2.5%
EU Corporate	3.8%	3.3%
Currencies	**YTD 2024**	**Q3 2024**
USD Index	-0.5%	-4.8%
EUR/USD	0.9%	3.9%
GBP/USD	5.1%	5.8%
USD/CHF	0.5%	-5.9%
EUR/CHF	1.4%	-2.2%
GBP/CHF	5.5%	-0.5%
Other	**YTD 2024**	**Q3 2024**
Brent oil	-6.8%	-16.9%
WTI Crude	-4.9%	-16.4%
GOLD SPOT $/OZ	27.7%	13.2%
Silver Spot $/Oz	30.9%	6.9%
Iron Ore	-24.1%	-4.3%
BBG Commodities Index	1.7%	-0.6%
US REIT	15.7%	16.1%

The “sick” man in Berlin

According to the “dot plot” in the latest FED report, members of the US central bank expect further rate cuts of around 1.5% by the end of 2025. Historically, the start of a rate-cutting cycle during non-recessionary periods has proven beneficial for stock markets. Ultimately, the FED’s efforts should lead to lower mortgage and credit rates, leading to a further boost of the already robust US consumer spending, which is the key driver of economic growth in the US.

In such a scenario, it would make sense for market breadth, particularly outside the technology sector, to increase.

In Europe, the economic outlook is more challenging, partly due to its considerable interconnectedness with the weakened Chinese economy. Europe is proving to be significantly less economically resilient than the US- just have a look at the German automobile industry. Germany, the continent’s driving force, is not only struggling to find its footing economically but also with its domestic politics.

All in all, the recent announcement of economic measures in China complements our macroeconomic outlook for a soft landing of the US economy. Europe may get a short-term boost from this, but its structural challenges remain, and fundamental reforms are urgently needed. With lower interest rates and a weaker euro, the ECB can provide economic stimulus, but its monetary actions are delayed. The ongoing political discord between Paris and Berlin being most likely one of the main reasons. We expect Europe to continue its sluggish recovery.

Direct equity investment as a core competence & the pinnacle of portfolio management

Our clients know them well: Our favourite stocks, which we fondly call ‘Crafters’, are companies we have analysed in-depth, and they form the core of the portfolios that we manage. We, as well as our clients, want to know exactly in what we are investing in. We also consider each client’s individual risk profile, domicile, and personal preferences or aversions.
As active portfolio managers and stock-pickers, we currently see opportunities for additional purchases in our preferred sectors: We currently

favour healthcare, European energy stocks, luxury goods, and industrials. Despite the market's strong performance, including new record highs in some cases, we still identify several companies that have unjustifiably lagged.

Our working method and expertise require a great deal of craft and experience. We are confident that this approach adds value for our clients. In our CIO Office, we collect ideas and after thorough analysis based on reports, studies and third-party opinions we determine our 'Crafters' selection.
As recently reported in the financial press, many banks are abandoning their own equity research, leading to a concentration of this service in fewer players. The reason: Margins are too thin. Thus, more and more analysts are being laid off. Some speak of a structural crisis in research, others even describe it as an obsolescent model on its way out. Since 2018, thanks to MiFID II, research costs are no longer allowed to be charged as a part of trading commission. Analyst reports are therefore no longer distributed for free, and many clients are unwilling to pay for them.

We are critical of composing portfolios solely through funds or other trendy financial products. Not only do ambiguous product costs negatively impact returns, but these products can also introduce unwanted risks into portfolios. Examples of the latter could be an exposure to Russian debt, junk bonds, illiquid stocks, or the use of securities lending.
Furthermore, it is far more challenging and time-consuming to monitor the risks in such a portfolio in comparison to simply analysing the top 10 names in a factsheet.

Finally, liquidity risk is a significant consideration, as it can render investors powerless during turbulent market phases.

We continue to see a positive trend for stock markets, especially since the US consumer appears to be in good shape. The long-anticipated market breadth should provide the necessary momentum. Thus, small and mid-sized companies (SMEs) that are profitable, well-financed, and possess pricing power are particularly interesting. We continue to be overweight in Swiss francs and gold to use as hedges against exogenous shocks and the geopolitically motivated realignment of major economies such as the US, Russia, India, and China.

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