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No. 38 Autumn Mood

Zurich, 15th October 2024

We are rapidly approaching the end of the year. Invitations to outlooks for 2025 are fluttering in like leaves falling from the trees, and the shorter days are enticing us to cosy fondue evenings.

It feels as though the world is in chaos – yet it continues to move forward. The International Monetary Fund (IMF) has raised its forecast for global economic growth in 2024 to 3.2%. A global growth rate of over 3% is also expected for 2025. While this may not sound like much, in absolute terms it is impressive: with a global economic output of USD 105 trillion, 3% translates into an absolute increase of around USD 3 trillion! [1] This is more than four times Switzerland's economic output.

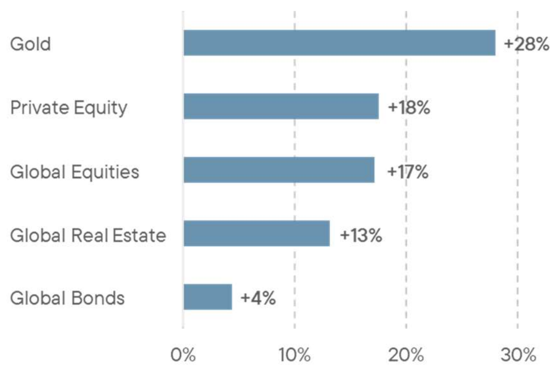
The positive momentum of the global economy is being disrupted by a range of events and actors. In Switzerland, questionable initiatives are constantly shaking an otherwise well-functioning system. The 13th AHV pension or the looming inheritance tax referendum are just two examples. Worse is the deliberate destruction of the industrial base by the "Ampel" coalition in Germany. The federal government has just significantly revised its economic forecast for 2024 downwards and now expects a decline in economic output of -0.2%.[2]. A "special" achievement in a growing world. Economic experts are also concerned about the level of US debt. The US pays USD 3 billion in interest on its astronomical debt per day, or USD 1.1 trillion per year. [3] And lastly, not much good is being heard from the Middle Kingdom. Despite all of China's success in recent decades, it is still ruled by a communist dictatorship. Those who believe that state actors will ultimately outperform a free market economy are mistaken.

China's model of flooding the world with products by relying on cheap labour and low quality and environmental standards is nearing its end.

Even though autumn may invite melancholy, looking back at the harvest reaped in 2024 is quite pleasing. The following chart shows the returns from the beginning of the year to the end of the third quarter in US dollars.

The 2024 Harvest

Global Market Returns 01.01.24-30.09.24 in USD



Source: Prio Partners, Bloomberg

The best performing asset class this year, with a +28% return, was gold. As a classic inflation hedge and a safeguard for worst-case scenarios, gold has gained relevance once again. Noteworthy is that central banks have been large-scale buyers of gold in 2024, purchasing 483 tonnes (or 23.6% of the annual production). [4] One has to wonder: why?

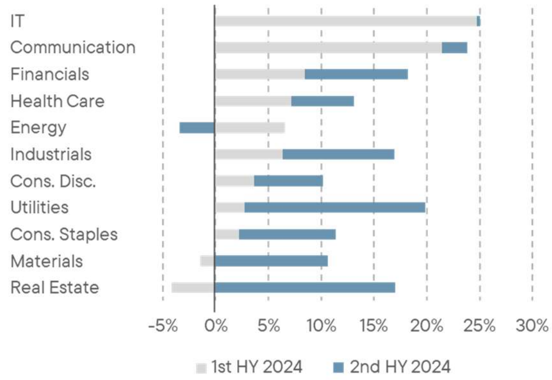
Global equity markets also performed well, with an average return of +17%. However, a closer look reveals an interesting picture: while markets were

[1] Worldbank GDP Dataseries 2023
[2] ifo Economic Forecast 2024
[3] treasury.gov
[4] World Gold Council, Semi-Annual Report 2024

largely driven by the technology sectors in the first half of the year, other sectors took the lead in the second half. Utilities, consumer staples, materials, and real estate sectors made dramatic gains, while financials, healthcare, and industrials also remained popular with investors. We hinted at this rotation in our last investment commentary "No. 37 – Balancing Act". Overall, there is a broad upward trend that could well continue until the end of the year.

Sector Return Distribution

MSCI World Sector Returns 1st & 2nd HY, in USD



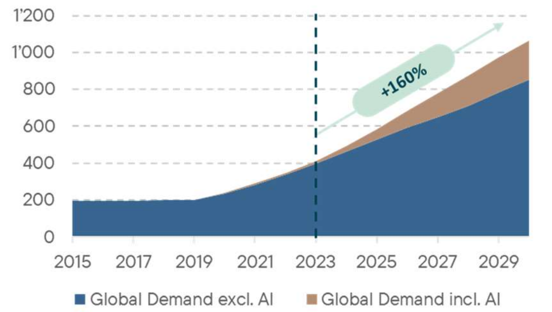
Source: Prio Partners, Bloomberg

One sector that has received little attention over the past twenty years has performed particularly well in the second half of the year: the utilities sector. So where does this fresh wind come from?

The race for dominance in the field of artificial intelligence is driving the rapid expansion of data centres. The energy consumption involved is immense. A single Chat GPT request consumes about ten times more energy than a Google search query. According to a study by Goldman Sachs, the energy consumption of data centres will increase by +160% by 2030.[5]

Global Energy Demand of Data Centres

Incl. and excl. Artificial Intelligence, in TWh



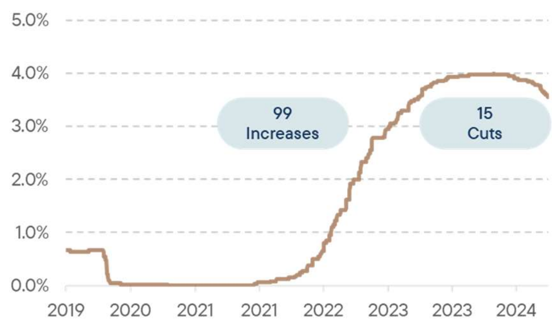
Source: Prio Partners, Goldman Sachs Research

At the same time, large technology companies are signing direct contracts with energy suppliers to secure their enormous energy needs. Microsoft is investing USD 10 billion in renewable energy to supply its data centres directly with energy. Alphabet and Amazon have concluded similar agreements. Companies such as Vistra Corp. or Constellation Energy Corp. are benefiting from this.

This positive development is further fuelled by central bank activities. After sharp interest rate hikes in recent years, the central bank rate pendulum is swinging back. The ten largest central banks in the world have already cut interest rates 15 times this year.[6] We expect further steps by the end of the year.

The Easing of Central Banks Returns

Ø Key Interest Rate, Top 10 Central Banks, %



Source: Prio Partners, Bloomberg

In the communication of central banks, falling inflation rates are cited as the main argument for interest rate cuts. A precautionary change in interest rates amid a healthy economy is also part

[5] Masanet et al. (2020), Cisco, IEA, Goldman Sachs Research

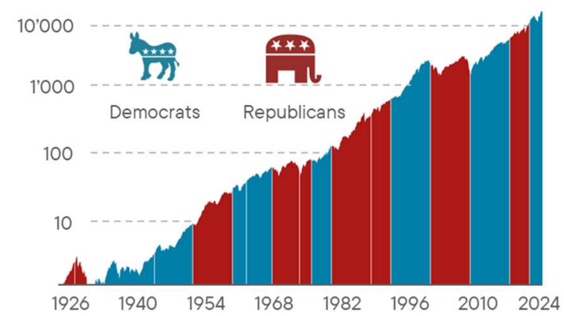
[6] Key Interest Rate Publications of Global Central Banks

of their strategic considerations. An extreme example can be seen in the actions of the Chinese central bank: on the 24th of September, the Chinese central government announced a comprehensive stimulus package to boost economic growth and, in particular, the real estate market. A total of USD 200 billion in liquidity is being injected into the financial system. [7] As a result, the Chinese stock index CSI 300 rose by around +30% within two weeks. Whether this monetary policy easing will have a lasting effect remains to be seen.

Looking Ahead

The next major event on the horizon is the US presidential election on the 5th of November 2024, and the associated question of whether the outcome will have a significant impact on our investment policy. There is much to suggest that a Trump administration would pursue a more business-friendly policy, which could at least temporarily boost the stock markets. However, in the long run, the development of the stock markets is less dependent on the governing party than one may think.

US-Presidents and the Stock Market
Performance S&P 500, 1926 – 2024, in USD



Source: Prio Partners, Dimensional Research

Over the last 100 years, stock market performance has been positive in 62% of months under Democratic presidents and in 63% of months under Republican presidents.

We are also considering extreme events, the likelihood of which is difficult to estimate. The number of airspace violations by the Chinese air force over Taiwan has been rising alarmingly for years. Those familiar with Chinese culture know that President Xi's public commitment to reunification with Taiwan carries great significance. Even though such a war would seem utterly insane, we know from Russia's invasion of Ukraine that this would not deter autocratic regimes from taking such a step.

60% of the world's semiconductor revenue comes from Taiwan[8]

According to studies, the costs of such a conflict could amount to as much as 10% of global economic growth. By comparison, the COVID pandemic caused a loss of 5% of global economic growth. It is abundantly clear that such an escalation would cause enormous disruption to capital markets. In our view, gold provides a means of partial protection. Additionally, we recommend reducing direct exposure to the region.

Conclusion

It feels like the world is in chaos, yet it continues to move forward. It is clear that the market is becoming more broadly supported at the sector level, making balanced sector allocation a sensible strategy. Additionally, falling interest rates are currently supporting all asset classes. Regarding the US elections, we see a potential Trump administration having a short-term positive impact on stock markets. In our strategic asset allocation, we continue to prefer equities but position ourselves more defensively in terms of sector mix. We are selectively buying high-quality corporate bonds. We continue to hold gold as a last resort, not least to provide some protection against extreme events.

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[7] Reuters «China launches stimulus push to meet 2024 growth target»

[8] Bloomberg Economics, «Xi, Biden and the $10 Trillion Cost of War Over Taiwan»