9 August 2024

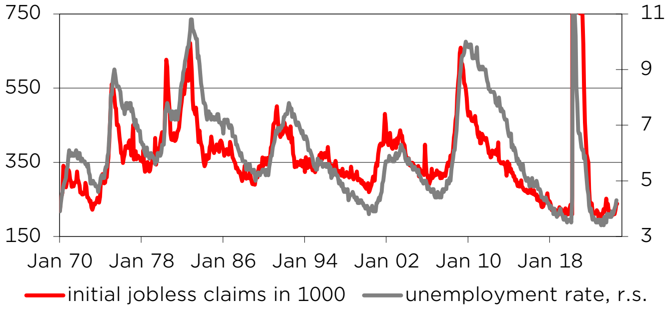
Stock market turbulence: don’t panic!

The sharp falls on the global stock markets attracted a great deal of attention on Monday. Not a single newspaper or news program failed to mention the turbulence on the capital markets. Headlines about a "crash" on the stock markets made the rounds. What had happened? In Japan, the Nikkei index plummeted by 12.4 percent, the biggest daily loss since October 20, 1987, the day after the infamous "Black Monday" on Wall Street. There were also massive losses on other Asian stock exchanges, with Taiwan and South Korea down eight and nine percent respectively. Europe and the USA came off more lightly with price losses of mostly two to three percent, although the falls on the two previous days were similarly high. What are the reasons for the price losses and what is the outlook for the future?

Is the USA facing a recession?

Last Friday's US labor market report was cited as the main reason for the price losses. At 114,000, the number of new jobs created was significantly lower than in previous months. At the same time, the unemployment rate rose to 4.3 percent. Although this is still a low figure, the rate has been rising continuously since spring 2023 (the low point at that time was 3.4 percent). The increase is particularly noteworthy because it triggers the so-called "Sahm rule", which is generally regarded as a good recession indicator (for details of this indicator, see our report from the previous week). However, in previous recessions, the unemployment rate was almost always higher than today and/or there were explicit job cuts. The inventor of this rule, US economist Claudia Sahm, also says that it is not a law of nature. It therefore remains to be seen whether the Sahm rule is actually an indicator of recession. As an economist and investor, you should never rely on just one indicator when it comes to forecasting a recession or developments on the capital markets. Even the inverted yield curve, which was considered an infallible recession indicator, did not work this time.

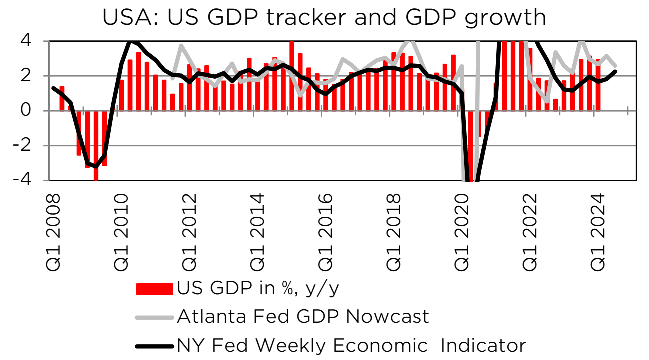
USA: Unemployment rate in % and initial claims for unemployment insurance



source: Refinitiv Datastream

Most of the economic data we are monitoring points to solid growth in the US. Indicators such as those from the New York Fed or the Atlanta Federal Reserve, which measure economic growth virtually in real time, point to economic growth of two to three percent in the third quarter. The data used by the National Bureau of Economic Research (NBER) to explain the "official" start of a recession is also currently unremarkable. Employment, industrial production, disposable income and corporate sales are all showing a positive rate of change compared to the previous year. For a recession to occur, however, at least three of these indicators would have to show a negative annual rate of change.

However, due to the weakening of the labor market, which the US Federal Reserve has deliberately (and successfully!) brought about with its restrictive monetary policy in order to curb inflationary pressure from the wage side, consumption is likely to lose momentum in the coming months. There is always a risk that monetary tightening will overshoot the mark and lead to a recession. This cannot be ruled out this time either, but in our opinion the current data situation does not allow for such a scenario. Should the economic data weaken significantly, the US Federal Reserve has plenty of ammunition to take countermeasures with a key interest rate of almost 5.5 percent. We therefore believe that fears of recession are exaggerated.



source: Refinitiv Datastream

Disappointing company results?

The lack of convincing company reports in the current reporting season combined with high stock valuations were another reason for the sharp fall in share prices. Whether one is disappointed by the figures or not naturally always depends on the individual observer and the individual company. However, if we take a sober look at the Q2 earnings figures published so far, we can draw a positive conclusion: Of the 440 companies in the S&P 500, 80 percent have exceeded their earnings expectations. The proportion of positive surprises is therefore roughly as high as in previous quarters. In qualitative terms, however, this earnings beat is better, as unlike usual in the run-up to the reporting season, there were no or only minor downward revisions to expectations; this applies in particular to the technology sector. The hurdle to be overcome was therefore higher this time. Nevertheless, profit growth in the second quarter was better than expected: instead of the nine percent expected before the start of the reporting season on June 30, the increase compared to the same quarter of the previous year is now 12.4 percent. The Communication Services (+27 percent), mainly thanks to Meta (+73 percent), Netflix (+48 percent) and Alphabet (+31 percent), Information Technology (+19 percent), Financials (+18 percent), Health Care (+15 percent), Utilities (+15 percent) and Consumer Discretionaries (+13 percent) sectors, including Amazon (+94 percent), recorded double-digit percentage profit growth. The Materials (-9 percent) and Industrials (-2 percent) sectors recorded lower gains than in the previous year. The positive development is also underlined by the fact that, according to database provider Factset, companies' profit margins rose to 12.1 percent in the second quarter (after 11.8 percent in the previous quarter).

Interestingly, the quantitative analysis of reported corporate profits shows that the proportion of positive profit surprises is also above average in Europe. This fact has been completely overlooked in the media coverage. In the Dax, almost 70 percent of 26 companies have so far performed better than expected, while the historical average is around 60 percent. The Euro Stoxx 50 and the Stoxx 50 fare even better in this respect: both indices have positive surprise ratios of around 80 percent, while the historical average is just under 60 percent. In the case of the Stoxx 600, on the other hand, the proportion of positive reporting companies among all companies corresponds roughly to the historical average of 60 percent. This indicates that large companies are performing better in the current environment than small and medium-sized companies. In Germany, for example, this can be seen from the fact that the majority of companies in the MDAX and SDAX have failed to meet expectations.

Evaluation of the reporting season Q2 2024 (source: Factset)

08.08.2024		reporting company	thereof: positive	thereof: negative	positive Surprise-Ratio	average pos. S-R
S&P 500	earnings	440	350	90	80%	73%
	revenue		259	180	59%	62%
	price reaction		239	192	55%	51%
Dow Jones	earnings	26	20	6	77%	80%
	revenue		14	12	54%	63%
	price reaction		10	16	38%	50%
Nasdaq 100	earnings	78	61	17	78%	76%
	revenue		52	26	67%	69%
	price reaction		38	38	50%	54%
DAX	earnings	26	18	8	69%	58%
	revenue		16	13	55%	54%
	price reaction		13	15	46%	49%
MDAX	earnings	26	10	16	38%	55%
	revenue		15	12	56%	50%
	price reaction		17	10	63%	41%
SDAX	earnings	11	4	7	36%	
	revenue		13	5	72%	
	price reaction		9	17	35%	
Euro Stoxx 50	earnings	32	26	6	81%	59%
	revenue		23	18	56%	59%
	price reaction		23	19	55%	51%
Stoxx 50	earnings	27	21	6	78%	56%
	revenue		21	17	55%	60%
	price reaction		23	19	55%	51%
Stoxx 600	earnings	249	148	93	61%	55%
	revenue		179	143	56%	56%
	price reaction		219	218	50%	51%

It could now be argued that Q2 earnings are a look in the rearview mirror and that stock prices have come under pressure because the companies' outlook for the next quarter points to a significant deterioration in the environment. Indeed, corporate analysts have recently revised their earnings estimates for the companies in the S&P

500 downwards by around two percent for the third quarter. However, according to Factset, these revisions are in line with what has usually been observed at this point in the past for the following quarter. At sector level, the strongest downward revisions were in the energy sector, followed by industrials and materials. In contrast, the forecasts for the Technology sector remain stable.

Geopolitical uncertainties and the unwinding of carry trades

In addition to fears of a possible US recession and the frequently observed negative comments on company results, two other factors are likely to be responsible for the price turbulence on the stock markets: The geopolitical uncertainties arising from a possible imminent attack by Iran on Israel and the impact of the Bank of Japan's interest rate hike.

A potential conflagration in the Middle East could have a negative impact on the global economy, particularly through higher oil prices. However, despite the tense political situation in the region, the price of oil has fallen over the past five weeks; the price of a barrel of Brent crude has weakened from just over USD 80 at the beginning of July to USD 70 at the start of this week. There are currently no signs of an economic slowdown or a new oil price crisis.

The possible unwinding of so-called "carry trades" may also have been behind the temporary sell-off on the stock market, particularly in Japan. In a carry trade, investors take out a loan in a low-yielding currency ¬ in this case the Japanese yen ¬ and invest this money in a higher-yielding asset class, either in the same or a different currency. After the Japanese central bank raised interest rates last week and announced a further tightening of monetary policy, this trading strategy has become less attractive. As plausible as this argument sounds, it is difficult to verify (for us) as there is simply no publicly available data to confirm or refute this thesis.

Long-term investment strategy is crucial

What does all this mean for investors? In our view, none of the much-discussed reasons for the stock price slide are really convincing, even if the arguments may sound plausible in themselves and as a whole. However, the US economy is not in recession and corporate profits are developing well. We can only speculate about the influence of the interest rate hike in Japan. Within a few days, however, the interpretation of the factors influencing stock market developments has changed completely. Weak economic data is no longer interpreted positively (desired by the central bank and necessary for interest rate cuts), but negatively (harbinger of a recession). Nevertheless, panic is never a good guide when making investment decisions. Investors should always have a long-term perspective when investing in stocks. Price losses, even if they are painful, are part and parcel of investing in stocks. The end of the world has often been predicted. The fact is that stock prices have recovered from every slump so far. It only makes sense to sell now if you have the confidence in your timing to get back in at a lower level. However, this usually has more to do with luck than clever analysis. For all those who are not yet invested, on the other hand, the setback is an opportunity to enter the stock market more cheaply than in recent weeks. However, you also have to be able to withstand the volatility of the stock market.

It can be assumed that the stock markets will remain unsettled for the time being, as the current price movements have unsettled many market participants. In addition, liquidity on the markets decreases in the summer months, meaning that even small orders can trigger major price movements. Historically, August and September are the two weakest months on the stock markets anyway, so some will use this time to take profits. However, our analysis also shows that the current "soft landing" narrative does not have to be written off just yet. Moderate economic growth with easing inflationary pressure and a more expansive monetary policy is an optimal scenario for the capital markets. And as stocks with very stable fundamentals in particular were punished during last week's price slumps, prices should gradually be able to recover.

Carsten Klude

Market data

Stock marktes	As of 09.08.2024 07:46	Change versus 02.08.2024 -1 week	08.07.2024 -1 month	08.05.2024 -3 months	08.08.2023 -1 year	29.12.2023 YTD
Dow Jones	39446	-0,7%	0,3%	1,0%	11,7%	4,7%
S&P 500	5346	0,0%	-4,1%	3,0%	18,8%	12,1%
Nasdaq	16660	-0,7%	-9,5%	2,2%	20,1%	11,0%
DAX	17680	0,1%	-4,3%	-4,4%	12,1%	5,5%
MDAX	24107	-1,5%	-5,6%	-9,7%	-13,6%	-11,2%
TecDAX	3241	-0,3%	-4,1%	-3,3%	3,8%	-2,9%
EuroStoxx 50	4669	0,6%	-6,1%	-7,3%	8,9%	3,3%
Stoxx 50	4324	0,1%	-4,4%	-3,5%	9,1%	5,6%
SMI (Swiss Market Index)	11827	-0,4%	-1,9%	1,9%	7,0%	6,2%
Nikkei 225	34831	-3,0%	-14,6%	-8,8%	7,6%	4,1%
Brasilien BOVESPA	128661	2,2%	1,7%	-0,6%	8,0%	-4,1%
Indien BSE 30	79680	-1,6%	-0,4%	8,5%	21,0%	10,3%
China CSI 300	3344	-1,2%	-1,7%	-7,9%	-16,0%	-2,5%
MSCI Welt	3428	-0,6%	-4,3%	0,9%	14,7%	8,2%
MSCI Emerging Markets	1046	-1,4%	-5,5%	-1,9%	4,2%	2,2%
Bond markets						
Bund-Future	134,12	-110	284	276	92	-310
Bobl-Future	117,99	-36	186	93	180	-129
Schatz-Future	106,34	-8	80	105	110	-21
3 Monats Euribor	3,57	-10	-9	-34	-20	-31
3M Euribor Future, Dec 2024	2,99	3	-33	-26	-17	69
3 Monats $ Libor	5,37	-12	-20	-22	-26	-23
Fed Funds Future, Dec 2024	4,45	14	-48	-52	38	62
10 year US Treasuries	3,97	18	-30	-53	-5	10
10 year Bunds	2,27	16	-23	-18	-18	27
10 year JGB	0,87	-10	-19	-1	26	24
10 year Swiss Government	0,44	4	-21	-30	-52	-26
US Treas 10Y Performance	609,53	-1,5%	2,6%	5,1%	4,1%	1,4%
Bund 10Y Performance	564,50	-0,7%	2,5%	2,5%	4,4%	-0,2%
REX Performance Index	451,01	0,1%	2,2%	2,1%	3,7%	0,7%
IBOXX AA, €	3,21	10	-21	-18	-40	14
IBOXX BBB, €	3,73	10	-21	-23	-69	-2
ML US High Yield	7,85	-4	-17	-23	-69	6
Commodities						
MG Base Metal Index	390,54	-2,6%	-11,4%	-10,9%	1,8%	-0,1%
Crude oil Brent	79,18	2,9%	-8,2%	-5,2%	-8,2%	1,9%
Gold	2418,13	0,2%	1,9%	4,5%	25,5%	17,1%
Silver	27,42	-3,3%	-10,6%	-0,2%	20,7%	13,1%
Aluminium	2221,04	0,8%	-10,2%	-11,2%	3,4%	-5,3%
Copper	8670,92	-2,9%	-11,2%	-11,2%	4,4%	2,4%
Iron ore	100,75	-3,1%	-8,4%	-13,6%	-3,5%	-26,1%
Freight rates Baltic Dry Index	1683	0,5%	-13,2%	-23,6%	47,4%	-19,6%
Currencies						
EUR/ USD	1,0919	0,8%	0,8%	1,6%	-0,2%	-1,2%
EUR/ GBP	0,8559	0,4%	1,4%	-0,5%	-0,5%	-1,2%
EUR/ JPY	160,45	-0,6%	-8,0%	-4,0%	2,5%	2,6%
EUR/ CHF	0,9457	0,3%	-2,6%	-3,2%	-1,5%	2,1%
USD/ CNY	7,1650	0,1%	-1,5%	-0,9%	-0,8%	0,9%
USD/ JPY	147,29	0,5%	-8,4%	-5,3%	2,7%	4,4%
USD/ GBP	0,78	0,4%	0,6%	-2,0%	-0,2%	0,0%

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