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RESEARCH

How good will the capital market year 2024 be?

Outlook for the rest of the year

Dr. Michael Heise on Global Economics

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The capital markets started 2024 with a high level of confidence. Although hopes of substantial interest rate cuts by central banks had to be dampened somewhat and capital market yields have risen since the start of the year, the stock markets have made strong gains. The continued strong upward trend for technology companies in the US shows that innovations in artificial intelligence play a very important role and have strengthened confidence in the earnings performance of technology companies.

Confidence in economic development

The stock markets' confidence is probably also based on positive expectations with regard to future macroeconomic development. Fears of an imminent recession have receded further into the background. There is great confidence that inflation rates will fall significantly in all major economic regions and that central banks will begin to ease their policies. This development seems to correspond to a scenario that seemed quite impossible a year ago: the scenario of flawless disinflation, or "Goldilocks scenario", in which inflation rates fall sharply even though the economy continues to grow and employment increases.

Risks in the "Goldilocks scenario"

However, this scenario ignores some risks too much. For example, the US economy, which was quite strong in 2023, is likely to tend to weaken in the current year, as the restrictive effect of monetary policy always comes with a time lag and will remain visible in the balance sheets of all sectors. The very strong stimulus from fiscal policy in 2023 is also unlikely to be maintained in view of the US government's enormous interest and debt burdens, regardless of who become president.

In Europe, the economy still has to overcome stagnation. Hopes are pinned on an increase in private consumption, although this is not yet apparent in the indicators. Even if a recession is avoided, which is likely, the financial burden of higher interest rates on private households and government debt and, above all, on the corporate sector should not be underestimated, as large volumes of bonds and loans are due to be refinanced in 2024. The rise in insolvency figures and loan defaults already observed last year is likely to continue.

Risks for development also include inflation proving to be more persistent and the central banks postponing interest rate cuts once again. There are also risks to profit development in the face of very weak growth. It is likely to become more difficult to pass on sharp increases in wage costs to prices. The European Central Bank, for example, expects that the strong increases in unit labor costs (6% in 2023) will also be cushioned by falling corporate profit margins and will not lead to rising inflation again.

In addition to the "endogenous" risks in macroeconomic development, there are geopolitical and electoral risks in 2024 that will continue to concern the financial markets. Although they can

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hardly be reliably priced into equity or bond valuations, they do exist. In any case, they reduce the confidence with which forecasts can be made for the rest of the year and increase uncertainty.

Not a bad year for equities, but volatility returns

So what could happen in 2024? After the highs of recent months, there will certainly be phases of consolidation on the stock markets with significant setbacks, which will then be followed by upward corrections by investors willing to enter the market. The 2023 stock market year was also characterized by a sharp slump in the months from July to October. Volatility can be expected again in 2024. The valuation level at the end of the year is unlikely to be any higher than it is currently.

Yield curve likely to steepen

The bond markets are likely to see price increases or yield declines for short maturities when the central banks in the USA and the eurozone start to cut interest rates in the second half of the year. I expect three small interest rate cuts. On the other hand, longer maturities are not expected to rise. The dominant factor here is not the influence of central banks, but the fact that a very high volume of new bond issues by companies and governments is expected in 2024. These issues will have to be placed on the market, as the central banks will no longer have demand for bonds. This may lead to rising yields. Ultimately, the interest rate structure is likely to normalize over the course of 2024 (yield curve steepening).

Conclusion

The capital market year 2024 will not be bad overall, but the brilliant performance of the first quarter on the equity markets will not be indicative. Volatility will return and risks will be more clearly recognizable. Developments on the bond market will also be characterized by nervousness, in a field of tension between interest rate cuts by central banks and the very high financing requirements of governments and companies. As an investor, it is probably a good idea to reduce equity market risk somewhat and prefer shorter maturities on the bond market.

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Rating system of the absolute valuation	
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