THE BUSINESS TIMES PUBLISHED ON : 27 APRIL 2024

Equities still best for riding the tech wave

But bonds offer a very adequate return, along with some alternative investments

By : Bjorn Jesch

AFTER the fastest interest rate hike cycle in decades, inflation is coming down without economic growth coming to a complete halt. Apart from some US regional banks, collateral damage from the interest rate hikes has so far been limited.

Restrictive monetary policy has largely done what it aimed to do: reduce inflation. But the future interest rate path is not yet fully determined – because the prospects for growth and inflation remain uncertain. Among other risks, America's highly expansive fiscal policy might lead to a second wave of inflation.

Productivity growth offers a potential source of optimism. Artificial intelligence (AI) could help ensure higher margins and lower inflationary pressure. But it seems premature to imagine that AI will have this impact on the whole economy.

The stock market, however, loves to dream. At present, the so-called Magnificent Seven – technology-heavy US stock market heavyweights such as Apple, Microsoft and Nvidia – are indeed the stuff of dreams.

Stock market ebullience is doing its bit to prop up the economy. But for the market as a whole, we see rather meagre earnings growth this year and only a slight acceleration next.

At asset management company DWS, we are nevertheless raising our share price targets by roughly 10 per cent. This is because the risk premium for equities, especially in the US, has fallen for three reasons.

First, there is a sharply reduced probability of recession, in our view. Second, the index seems set to become less prone to cyclical swings as the proportion of tech-related companies – with increasing recurring revenue streams – is growing further. The third is the implicit option on AI potential.

In these circumstances, we favour the telecommunications services and consumer discretionary sectors.

Regionally, we see catch-up potential in Europe, particularly in banks. Although we are positive on Japan and India, there is still a big drag on the entire Asian region from China, where declining economic growth is encountering a difficult capital market environment.

Bonds and alternatives

Bonds are generally considered less volatile than equities, but they too have seen a lot of volatility recently. Within less than six months, the market has swung from predicting one, to three, then back to one Fed Funds interest rate cut by June 2024.

Our view, given that the core inflation rate is only slowly falling below 4 per cent, is that there will be just three interest rate cuts in the US by March 2025, and we forecast four interest rate cuts by that time in the eurozone.

In the alternatives sector, we remain positive on gold, which is benefiting from a stabilising interest rate environment and continued high central bank and Asian retail purchases.

In summary, we would emphasise that the reduction in inflation desired by the central banks is beginning to happen. But stock markets' current euphoria contrasts with meagre economic growth prospects in the next two years, and companies' profit margins are already very high, giving little scope for them to rise.

However, as the past six months alone have shown, equities remain the best vehicle for participating in a technological wave, in our view.

At the same time, bonds offer a very adequate return these days, along with some alternative investments – so investors have a good range of options to choose from at present.

The writer is global chief investment officer at DWS