M.M. WARBURG & CO
BANK

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New DAX record: More illusion than reality?

So now it has happened after all: The German economy is in recession because, contrary to initial estimates, GDP fell by 0.3 percent in the first quarter compared with the previous quarter. Since there was also a minus of 0.5 percent in Q4 2022, the technical criterion for a recession is fulfilled. If we take a closer look at the expenditure side of value added, we quickly find the "scapegoat" for the surprisingly weak economic performance in the first three months of 2023: It is government consumer spending. At -4.9 percent, this was the sharpest quarter-on-quarter decline since German reunification. If we were to extrapolate this figure for the year as a whole, as is customary in the USA, we would see a slump of almost 20 percent! In view of the economic challenges facing Germany (energy turnaround, climate crisis, defense spending), one can only rub one's eyes in amazement and hope that the federal, state and local governments will once again spend a little more money in the coming quarters.

Agreement in US budget dispute only at the last second

Despite the fierce headwinds caused by weak economic data, a still far too high inflation rate and the more restrictive monetary policy of central banks, the DAX has gained almost 14 percent this year and even reached a new record of 16,332 points last week. Many investors are asking themselves how this could have happened in view of the current news situation and whether there is already another irrational exuberance on the stock market that must inevitably lead to a painful correction or a crash.

The icing on the cake of the current toxic cocktail of negative news is certainly the political tug-of-war over raising the debt ceiling in the US. Actually, this is a routine act that has already taken place about a hundred times. Finance Secretary Yellen has warned that "X-Day," when the U.S. Treasury runs out of money, could be reached on June 1. If the debt ceiling of $31.4 trillion to date is not raised or suspended by then, the government will no longer be able to make some of its payments. This could include, for example, interest payments or the repayment of maturing government bonds, which would be tantamount to a national bankruptcy. The effects on the economy and financial markets that could be associated with a default - even a short one - would probably be severe: The financial markets would be thrown into turmoil, and the economy could plunge into recession.

Estimated Economic Effects of Debt Ceiling Standoff: Q3 2023

Measure	Brinkmanship	Short Default	Protracted Default
Jobs, millions	-0.2	-0.5	-8.3
Real GDP, % annualized growth	-0.3	-0.6	-6.1
Unemployment, percentage points	0.1	0.3	5.0

Source: CEA analysis.

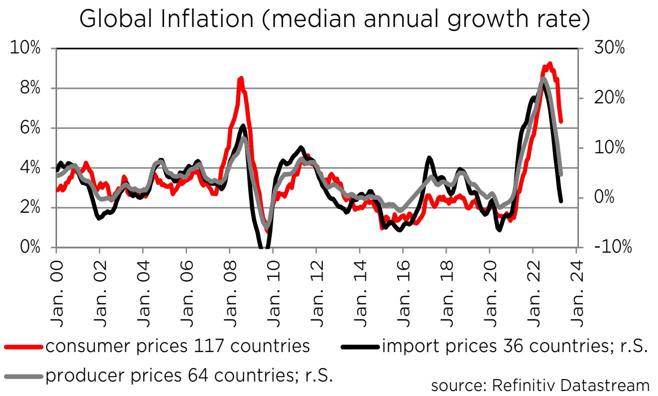
Table 1: Estimated Economic Effects of Debt Ceiling Standoff: Q3 2023

https://www.whitehouse.gov/cea/written-materials/2023/05/03/debt-ceiling-scenarios/

Because all parties are aware of these effects, the probability of a default is close to zero. Nevertheless, it looks as if an agreement will only be reached at the last second, so that the stock markets are likely to be under pressure for the time being. However, as has often been the case, this could be the wake-up call politicians need to reach a compromise. The experience of 2011 has shown investors that when driven to the brink (the "Brinkmanship" scenario in the table above), Washington eventually acts. Contrary to the fears that were harbored at the time, the economic impact of the debt dispute ultimately proved negligible. For this reason, the stock markets should rally again this time if a solution is found to the debt dispute.

Economy: Service providers up, industry down

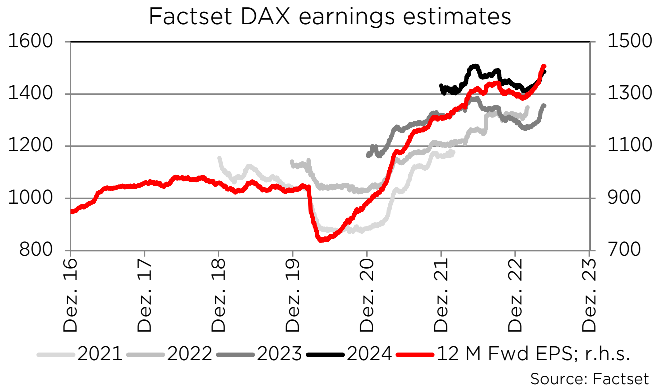
While the leading indicators from the manufacturing sector point to a recession not only in Germany but also in many other regions of the world, companies in the service sector are much more positive. This is good news for now, because services account for 80 to 90 percent of value added in most developed countries. In addition, labor markets are robust, supporting private consumption, and many companies still have above-average order backlogs. For this reason, we do not wish to join the chorus of recessionary sentiment, at least not at the present time.



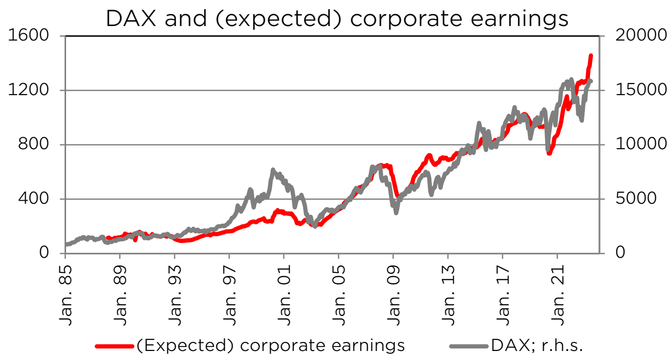
In addition, we have the impression that tactical asset allocation based on economic data has not achieved particularly good results in recent years anyway. Since 2000, we have been using so-called "business cycle models" that can control the equity allocation depending on various leading economic indicators. These models predicted both the major equity downturn from 2000 to 2003 and that of 2008 well. However, in recent years, the added value of this approach has been manageable. In our view, all economic factors were overshadowed by monetary policy. And it is precisely from this side that the stock market could receive support in the near future, as (global) price pressure has meanwhile eased considerably. In this respect, the phase of interest rate hikes should be coming to an end.

Corporate earnings and favorable valuations in Europe provide a tailwind

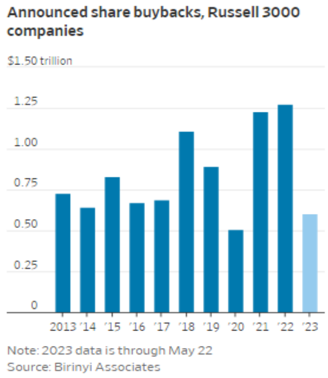
Despite the current widespread skepticism towards stocks, it should be noted that the reporting season for the first quarter resulted in a large number of positive earnings and sales surprises. Not only in the USA, but also in Europe, more companies than usual were able to exceed their expectations. The necessary adjustments to earnings estimates by company analysts have resulted in forward earnings, i.e. the corporate profits expected for the coming 12 months, for the DAX and the Euro Stoxx 50 rising to a record level. In this respect, the record stock prices are not a great surprise, as share prices are primarily based on corporate earnings.

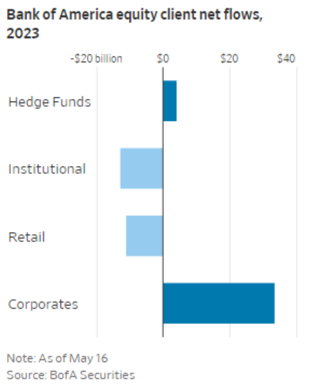


However, the question arises as to whether the underlying profit expectations could be too optimistic. After a five percent decline in profits for the DAX companies in 2023 compared to 2022 was expected at times, the forecasts for this year are now at the same level as in the previous year. For 2024, which is still a relatively long way off, analysts are, as usual, expecting a further increase in profits of around ten percent. Since corporate profits are a nominal figure, we consider the earnings forecasts for this year to be somewhat too cautious in view of an expected average inflation rate of five to six percent in 2023, while the expectations for 2024 are probably too optimistic. On the whole, however, the estimates for the next two years are understandable. This also means that the current price/earnings ratio for the DAX based on earnings forecasts of 11.5 is realistic and not based on artificially inflated earnings forecasts. Compared with the long-term average since 2003 of 12.6, the DAX is therefore still favorably valued despite its good run this year, so that a price increase to 17,000 points is possible by the end of the year, provided there is no more severe recession. The same applies to the Euro Stoxx with a current P/E ratio of 12.9 compared with the long-term average of 13.1 and to the Stoxx 50 with a P/E ratio of 13.9 compared with an average of 13.7.



Soure: Refinitiv Datastream, IBES





https://www.wsj.com/articles/share-buybacks-continue-at-torrid-pace-while-investors-sit-on-sidelines-4c1b4e59

U.S. stocks more expensive, but buyback programs keep prices rising

Although institutional and private investors in the USA have reduced their share exposure, the share buyback programs of the major companies have nevertheless ensured that share prices have continued to rise. According to the market research company Birinyi Associates, the companies included in the Russell 3000 have already announced plans to buy back shares worth more than 600 billion US dollars this year. This matches last year's record volume at this time. 2022 share repurchases totaling $1.27 trillion have been announced, of which $1.05 trillion worth of repurchases have been implemented.

Share buybacks lead to increased demand, which can drive up the share price. By canceling the repurchased shares, companies also reduce the number of shares in circulation, so that earnings per share increase. Otherwise, the comparatively high valuation of US stocks (S&P 500 P/E of 18.1 vs. 15.5 on average, Nasdaq 100 P/E of 25.4 vs. 19.9 on average) would be even more pronounced. Moreover, taxable investors do not incur additional taxes on share buybacks until they sell the shares and realize their capital gains, unlike dividend distributions, which are taxed as income.

Large US technology stocks in particular are responsible for the lion's share of buybacks. Apple, Alphabet, Meta Platforms and Microsoft were the biggest buyers of their own shares in the first quarter, according to S&P Dow Jones. Apple led the way with $19.1 billion in issuance during the period. As many of these companies still have high cash holdings, the good performance of the Nasdaq 100 index should continue thanks to share buybacks - despite the relatively high valuation.

Market data

Stock marktes	As of 26.05.2023 12:10	Change versus 18.05.2023 -1 week	24.04.2023 -1 month	24.02.2023 -3 months	23.05.2022 -1 year	30.12.2022 YTD
Dow Jones	32765	-2,0%	-3,1%	-1,2%	2,8%	-1,2%
S&P 500	4153	-0,1%	0,5%	3,5%	4,5%	8,2%
Nasdaq	12698	1,6%	5,2%	9,6%	10,1%	21,3%
DAX	15734	-1,4%	-0,9%	1,7%	11,0%	13,0%
MDAX	26711	-2,5%	-3,7%	-7,0%	-9,3%	6,3%
TecDAX	3185	-0,9%	-2,7%	-2,1%	3,0%	9,0%
EuroStoxx 50	4263	-1,4%	-3,3%	0,1%	14,9%	12,4%
Stoxx 50	3977	-1,4%	-2,5%	1,2%	10,1%	8,9%
SMI (Swiss Market Index)	11319	-1,0%	-1,2%	0,6%	-1,3%	5,5%
Nikkei 225	30916	2,7%	8,2%	14,1%	14,5%	18,5%
Brasilien BOVESPA	110054	0,5%	5,4%	2,3%	-0,3%	0,3%
Russland RTS	1048	0,8%	2,8%	12,7%	-16,4%	7,9%
Indien BSE 30	62488	1,5%	4,7%	4,8%	15,1%	2,7%
China CSI 300	3851	-2,8%	-4,5%	-6,2%	-5,0%	-0,5%
MSCI Welt	2797	-0,9%	-0,9%	2,2%	3,5%	7,5%
MSCI Emerging Markets	964	-1,2%	-1,7%	-2,4%	-6,8%	0,8%
Bond markets						
Bund-Future	133,62	-185	3	-104	-1949	69
Bobl-Future	116,88	-106	11	80	-1018	113
Schatz-Future	105,34	-31	5	0	-490	-8
3 Monats Euribor	3,46	31	56	106	382	157
3M Euribor Future, Dec 2023	3,83	14	5	14	227	22
3 Monats $ Libor	5,37	1	12	42	385	61
Fed Funds Future, Dec 2023	4,97	34	30	-25	205	33
10 year US Treasuries	3,79	20	21	-11	92	-5
10 year Bunds	2,51	17	2	8	149	-5
10 year JGB	0,42	6	0	-8	19	1
10 year Swiss Government	1,10	9	-6	-30	38	-51
US Treas 10Y Performance	595,41	-1,2%	-1,0%	2,1%	-3,2%	2,7%
Bund 10Y Performance	536,64	-1,1%	0,4%	0,6%	-9,7%	2,1%
REX Performance Index	434,64	-0,9%	0,1%	1,0%	-6,1%	0,5%
IBOXX AA, €	3,69	10	5	10	170	10
IBOXX BBB, €	4,65	7	10	21	172	-4
ML US High Yield	8,74	2	23	8	98	-23
Convertible Bonds, Exane 25	6620	0,0%	0,0%	0,0%	-2,7%	0,0%
Commodities						
MG Base Metal Index	375,48	-2,3%	-9,3%	-11,9%	-20,6%	-10,2%
Crude oil Brent	76,67	-0,4%	-6,2%	-6,8%	-32,5%	-9,7%
Gold	1952,89	-1,4%	-1,3%	7,3%	5,3%	7,6%
Silver	23,43	-1,2%	-6,2%	9,8%	7,6%	-1,3%
Aluminium	2202,60	-4,6%	-7,7%	-6,4%	-24,9%	-6,3%
Copper	8035,74	-2,7%	-8,5%	-9,6%	-16,2%	-3,9%
Iron ore	105,60	-1,7%	-9,9%	-16,1%	-21,2%	-5,1%
Freight rates Baltic Dry Index	1215	-14,7%	-19,2%	48,9%	-63,9%	-19,8%
Currencies						
EUR/ USD	1,0729	-0,9%	-2,3%	1,1%	0,7%	0,6%
EUR/ GBP	0,8681	0,0%	-1,9%	-1,5%	2,3%	-2,2%
EUR/ JPY	149,87	1,1%	2,0%	4,6%	10,2%	6,5%
EUR/ CHF	0,9694	-0,5%	-1,0%	-2,0%	-6,0%	-1,6%
USD/ CNY	7,0582	0,8%	2,4%	2,3%	6,1%	2,3%
USD/ JPY	138,60	0,7%	3,3%	2,9%	8,4%	5,7%
USD/ GBP	0,81	0,9%	0,4%	-2,7%	1,8%	-2,6%

Source: Refinitiv Datastream

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