



Dr. Carlos Mejia

Chief Investment Officer

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CIO Lens

Finding clarity in an uncertain economic landscape

In a rapidly evolving geopolitical landscape, financial markets are feeling the weight of numerous global challenges. In our interview with Wealth Management Switzerland's CIO, Dr. Carlos Mejia, we explore the shared concerns voiced by clients across Europe, from the impacts of the upcoming U.S. presidential election to the economic uncertainties in China and Europe.

Your role gives you a unique chance to meet clients across Europe and hear their views and concerns. Are there particular concerns that are similar across different locations?

Yes, I have the privilege to talk to our clients and prospects in various cities, each with different backgrounds, levels of experience, and financial needs. Despite these differences, there are some recurrent topics in our conversations. These include concerns over the very tense geopolitical environment across the world, the upcoming U.S. presidential elections, and the disappointing performance of China's economy, along with questions about emerging alternatives. Additionally, clients frequently mention weak economic activity in Europe, particularly in Germany, high levels of debt in many countries and uncertainty over falling interest rates will be enough to avoid a recession.

The current geopolitical environment is understandably causing significant concern. How serious are these concerns, and what potential impact could this have on financial markets?

This year will be remembered not only for the instability in the Middle East but also for the fact that over two billion people across approximately 75 countries will have voted for new governments. Many of the people I've spoken with share concerns that these events could have a profound impact on financial markets.



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The important thing to understand is that geopolitics affects individuals differently than financial markets as a whole. Financial markets can be very impersonal, and there is not straightforward link between geopolitical events and market movements. Instead, factors like the health of the global economy, employment, inflation, consumer behaviour, interest rates, corporate profitability, valuations, and regulatory changes are the main drivers of how financial markets evolve.

Historically, geopolitical shocks have had a negative impact on financial markets, but these effects have usually been short lived, creating opportunities for seasoned investors.

The only times when the impact has been profound and long-lasting are when such shocks filter into the global economy and cause sustained imbalances, ultimately leading to recessions like during the Great Depression in the U.S. or the 2008 Global Financial Crisis.

Of course, the situation can change rapidly, and part of our role is to monitor these developments closely. However, at this point, none of the current events appear likely to trigger a severe recession.

While some events may have a short-lived impact on the markets, presidential elections—especially on the scale we are witnessing—can have a more lasting effect, can't they?

Our analysis shows that elections do not have the impact people often expect. The uncertainty they create can make some people nervous. However, incumbents tend to do whatever they can to ensure that the economy is in good shape during election years, to maximise their chances of staying in power. Equity markets "know" this and, on average, tend to perform positively in anticipation of economic and fiscal stimulus.

This is understandable, even if it may seem counterintuitive at first. However, different political agendas are likely to have varying impacts on the economy and markets. For instance, how does equity performance differ under Democratic versus Republican administrations?

The difference is negligible. We have analysed data going back to 1900, adjusting for inflation to make it comparable. Despite having different policies and having gone through some very turbulent periods under both parties, the annualised performance of the equity market has been broadly the same, at around 7.5%.

Of course, there can be some difference in sector performance depending on which candidate wins but remember that they will still need approval by the Congress, and that process is far from straightforward for either party.

Despite the political uncertainty, the real economy continues to grow at a decent pace. Recently, the U.S. economy has been growing slightly ahead of long-term trends, which is encouraging. Employment levels are high, and central banks are providing some stimulus, which should continue to support the real economy. Ultimately, this is what matters most for financial markets.

Let us move across the Pacific and talk about China. The economy and real estate market have been disappointing for many years, and relations with the United States are strained. Recently, the government announced measures to stimulate the real estate market and provide support to the poorest parts of the population. Is this the beginning of a Chinese revival?

Yes, there has been a lot of excitement recently. First of all, the government's intervention in different sectors of the economy had a much more negative impact than anticipated. Financial markets have suffered, with Chinese equity markets underperforming global markets by about 50% in recent years. This has made the valuations of some companies attractive. Naturally, the question arises: is now a good time to invest?

The recent stimulus measures from the Chinese government and the Central Bank have brought some hope, and they have sent a message that they want to stimulate not only

the economy but financial markets. Initially, this news was well-received, with the market reacting positively. Unfortunately, they failed to make more concrete plans for how the stimulus will be sustained over time. Additionally, they have not addressed some critical challenges, such as the excess supply in the housing market and the high levels of consumer debt. However, they failed to provide detailed plans for how the stimulus will be sustained over time.

So, we do think that it is a good business opportunity, but one that is likely to remain volatile. The Chinese government is expected to continue intervening - not only in the financial markets, but also in the real estate market - and this level of control is something international investors tend to dislike.

In our opinion, China will continue to play a very significant role in the global economy. Its trade partners are expanding, not just in Asia, but increasingly with Africa and Latin America. This trend is unlikely to change anytime soon, but investors will need to be strategic when holding Chinese assets. In our main portfolios, we have exposure to Chinese assets, but we prefer to do so through capital-protected products rather than direct investments.

And what is the current state of Europe's economic health?

The European economy has been disappointing, which hasn't come as a surprise to many. Recently, Mario Draghi, the former president of the European Central Bank (ECB), presented a 400-page report on the future of European competitiveness. This report outlined the main issues in Europe and potential solutions. You don't need to read the entire report to understand that the primary challenge is Europe's lower productivity compared to the U.S., which is central of the report, along with U.S. strategies to boost productivity across the continent.

The report argues, and I agree, that a significant part of the productivity gap stems from a lack of innovation and technological investment. Addressing these issues could help close this gap. Another major challenge for Europe has been its heavy reliance on cheap oil and gas from Russia. Reducing this dependency and transitioning towards more sustainable, potentially domestic, energy sources could help strengthen Europe's economic position.

Historically, the saying goes: "When Germany sneezes, Europe catches a cold," highlighting Europe's dependence on Germany's economic health. Interestingly, despite Germany's stagnation in recent years, other parts of Europe have shown growth. Countries like France, despite political turmoil, have demonstrated economic improvement, while Spain has been recovering steadily with declining unemployment rates. Italy, too, has been making economic progress.

In the short term, we hope to see Germany becoming more productive and a revival in industrial demand. Two key factors could drive this: first, central banks lowering interest rates to stimulate domestic demand, which could particularly benefit Germany's middle class, which relies on cheap credit. Second, as Europe is predominantly an exporting economy, the relatively strong performance of the U.S. and China's efforts to stimulate its own domestic economy could provide additional support.

Given that the U.S. and China are Europe's two largest trading partners, external factors could play a crucial role aiding Europe's economic recovery.

Should we expect central banks to continue supporting economies by lowering interest rates in the near future?

Yes, the main issue has been inflation, which has remained high for many years. Central banks have stepped back from active market support to control inflation. Now that inflation is approaching the target range of 2% to 2.5%, they have more leeway to stimulate the economy. In the case of the U.S., the recent 50-basis-point rate hike seemed, in our opinion, unnecessary, as inflation was already declining, and



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employment was relatively healthy. However, the Federal Reserve wanted to reaffirm its commitment to supporting economic growth.

There is an expectation of a 100-basis-point reduction in interest rates by the end of the year. Whether or not we see this reduction, we believe the market may be overestimating the need for aggressive cuts from the Fed. Initially, we saw a recovery in the services sector, and now the industrial sector is also showing signs of improvement. This trend is expected to continue, and central banks will likely keep supporting economic growth. Across the U.S., China, and Europe, we anticipate interest rates will gradually decrease from their current levels.

Rothschild & Co is a long-term investor with an investment philosophy centred on quality. What's the value of choosing this approach, especially in the current market environment?

The companies we invest in are quite unique. We focus on businesses with a strong competitive edge, high visibility of cash flows, and a very strong pricing power—companies whose services are not easily substituted. These qualities make them well-positioned for success over the medium term, especially in uncertain markets, where investors seek stability and quality.

That said, it's not uncommon for the market to lose sight of these long-term strengths, leading to sell-offs even in fundamentally solid companies. When this happens, we see it as an opportunity rather than a cause for concern. As you say, we invest for the long-term and we think like business owners. Hence, short-term setbacks in these high-quality companies often provide attractive opportunities to increase our exposure.

While periods of market weakness can last a month, two, or longer, we view these moments as chance to enhance our returns. We are confident that, over time, companies with strong competitive edges, predictable cash flows, and a very strong pricing power will regain their value. Being patient during these dips can ultimately lead to better outcomes for our investment strategy. It's all about keeping our focus on the long-term picture, even when the market momentarily loses sight of it.



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