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Investment Policy

Q1 2024 | December 2023

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Key points

Roll on 2024 !

US equities have outpaced expectations set at the beginning of the year, responding to a string of upgrades in economic growth figures. This has resulted in the broad market rising by nearly 20% year to date. The 'Fantastic 7' are even up 100%. Similarly, Eurozone equity indices have appreciated by over 10%. Switzerland, in contrast, has been disappointing, with the SMI gaining just 2-3%.

Short-term **interest rates**, which react directly to monetary policy, have kept pace with increases in benchmark rates. **Inflation** has been losing traction, signalling that the tightening cycle is now over. In contrast, 10-year sovereign yields have moved haphazardly, soaring to 5% in the US this summer before initiating a decline that looks set to continue. In the Eurozone, the peak (as measured by German Bunds) in the same period was 3%, but the yield is now even lower than at the start of the year. The highest yield on 10-year Swiss government bonds was 1.4% but the downtrend has gathered pace since 1 January to the point that this segment is no longer of interest to us.

The above movements broadly define the **starting point** for 2024. As central banks call time on financial repression, defensive assets (namely cash and long-term sovereign/corporate bonds) are offering **yields not seen** in 15 years in USD and, to a lesser extent, EUR. It's time to make the most of it. What's more, if growth clocks in below expectations, these assets will act as hedges and balance out the performance of multi-asset portfolios. Equities, particularly outside of US tech, are not overpriced and could be lifted by the improved economic outlook for the second half of the year.

As a result, 2024 offers a starting point that should deliver respectable performances for investors.

Scenario and conclusions

- Broad **inflation** slowdown across the board comes as good news
- **Monetary tightening** is over worldwide
- **US** economy has been resilient but is losing traction
- Economic stagnation in **Europe and Switzerland**
- **Chinese authorities** doing more to stimulate recovery

→ **Equities**: underweight in the US due to business risk and rich multiples

→ **Bonds**: overweight (IG corporate bonds)

→ **Currencies**: preference for CHF and EUR over USD and GBP

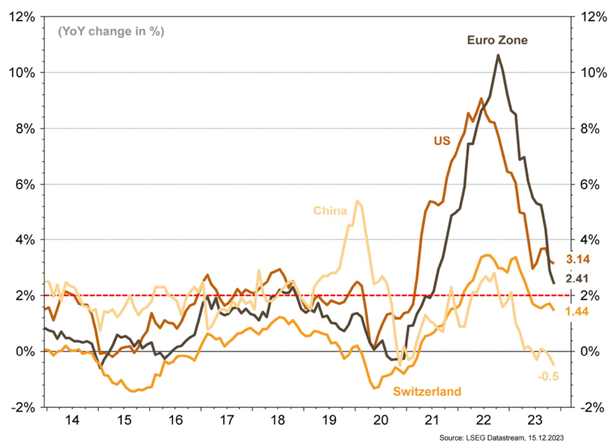
→ **Cash**: overweight

	UW (-)		N (=)		OW (+)
Asset allocation					
Equities		■			
Sovereign bonds		■			
Credit					■
Alternative investments		■			
Cash				■	
Equities					
US	■				
Europe				■	
Switzerland				■	
Japan			■		
Emerging markets			■		
Bonds					
Sovereign		■			
Corporate investment grade					■
High-yield corporate	■				
Emerging market sovereign (USD)	■				
Emerging market sovereign (local)	■				

Economy: *US resilient, stagnation in Europe and China recovering*

The prospect of a big hit from the **energy crisis** feared a year ago quickly faded. But the knock-on effects of **monetary tightening**, which has been severe from a historical perspective, are dividing opinion, particularly in the **US**. Many expect a soft landing for the economy, especially as inflation is slowing at a faster rate than expected (**Chart 1**). If inflation could indeed revert quickly to the 2% target, central banks would then be able to cut interest rates before the negative fallout from earlier tightening could impact economic activity and jobs. We cannot rule out such a scenario.

Chart 1 | World: inflation hitting the brakes



But bear in mind that this would be the Fed's first **success story** after a tightening cycle, so it would be quite a feat if it could pull it off. It is true that the US economy grew at an annualised rate of 5.2% quarter-on-quarter in Q3 and the economy seems to be weathering the shock much better than expected. The **services** sector in particular is still showing a respectable level of confidence, with the ISM services index edging up from 51.8 to 52.7 in November.

However, this is not enough for us to ignore the risks that are still hanging over economic activity. Simply look at the average growth rate in the quarters preceding the onset of recession, which has historically been 3% (counting 12 such episodes). And while the American **consumer** is still fighting fit, cracks are appearing, as evidenced by a rising default rate for consumer credit. The **labour market** will be decisive in this conundrum. So far, jobs are not in free fall, although signs of weakness are appearing insofar as temporary job creation, which acts as a bellwether for the market as a whole, is declining (**Chart 2**). After a lacklustre employment report in October which recorded only 150,000 job additions, November brought some respite as it saw 199,000 new jobs.

The **real estate** sector is still feeling the pressure. Developers (NAHB) are feeling down and turnover is slow. Home prices as a whole may still be rising moderately (+4% y/y), but the prices of new houses are more than 17% lower on a 12-month basis. The **manufacturing** segment is also contracting, as evidenced by industrial production edging down 0.7% year-on-year, while leading manufacturing indicators in November, at 46.7 (ISM) and 49.4 (PMI), do not herald an upturn. Other indicators, most notably exports from 'cyclical' countries such as Taiwan, South Korea and Chile, or indicators pointing to receding inventories, are sending out a more upbeat message. While we do not anticipate a sharp acceleration in manufacturing output, we believe that the low point has been reached, which is good news in itself.

The **Eurozone** has been stagnating since the start of the year. GDP contracted slightly in Q3 (-0.1% q/q and barely +0.1% y/y). Industrial output was down by 6.5% year-on-year in September, while the upturn in the manufacturing PMI since July (from 42.7 to 44.2 in November) is still too small to represent a pick-up in business trends. Moreover, contrary to events across the Atlantic, services are also suffering. Confidence among purchasing

Financial markets

*) To 14.12.2023	Performance			Valuation			Earnings growth			
Equity markets	Price (local currency)	Quarter Q4*)	Since 31 Dec 2022	12-month P/EPS	Dividend yield	Price/ net assets	12-month EPS	2023 EPS	2024 EPS	2025 EPS
United States	4 505.53	10.30%	23.80%	19.10	2.0%	4.4	12%	2%	11%	13%
Europe	476.57	5.85%	12.20%	12.35	3.3%	1.9	6%	-1%	6%	9%
Japan	2 321.35	-0.09%	23.00%	13.48	2.3%	1.4	9%	14%	7%	9%
Switzerland	11 209.95	2.20%	4.50%	16.00	3.3%	3.6	9%	2%	9%	13%
United Kingdom	4 176.90	1.20%	2.50%	10.42	3.9%	1.7	5%	-12%	5%	7%
Emerging Markets (USD)	992.51	4.17%	3.78%	11.34	3.2%	1.6	18%	-4%	18%	15%
World (USD)	3 128.89	9.66%	20.20%	16.74	2.4%	3.1	9%	1%	9%	11%

Source: Datastream, IBES consensus

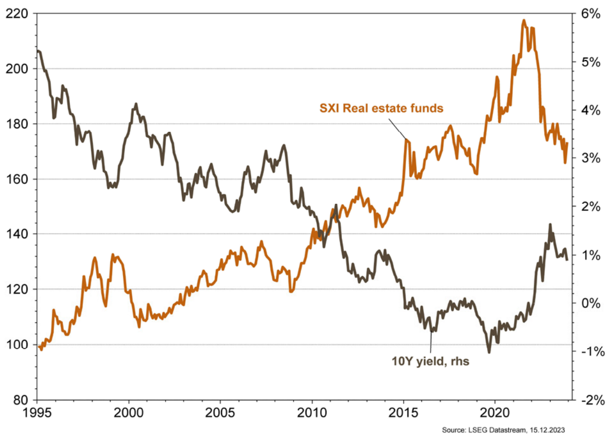
managers (48.7 in November) is still in contraction territory (<50). If no agreement can be reached on new budgetary rules, the former Maastricht criteria governing public debt and deficits will be reactivated in 2024. Let's hope that the inflation slowdown will enable the ECB to start easing monetary policy as soon as possible to offset the fiscal tightening that lies ahead.

Chart 2 | US: ominous drop in temporary jobs

The **property industry crisis** is far from over in **China**. Governing authorities are continuing to take action to prevent the slump from turning into a social and political crisis. Unusually, the budget deficit was increased during the year (from 3% to 3.8% of GDP) to cope with the fallout, but this may not be enough to achieve the 5% GDP growth target set for 2024. Yet governing authorities are perfectly aware of the danger and the need to restore **confidence**. We can expect more firepower from them if this proves necessary. The absence of inflation (-0.5% y/y in November) gives the central bank the opportunity, in addition to the fiscal stimulus mentioned above, to ease monetary policy as a means of galvanising the recovery.

In **Switzerland**, like elsewhere, the latest inflation figures were reassuring. Prices were up 1.4% year-on-year in November, suggesting that inflation is under control. The **SNB** can therefore call time on monetary tightening, although rises in VAT, electricity prices, health insurance premiums and rents (for those indexed to the reference rate) will drive inflation higher. But this will be transitory and does not represent the onset of an inflationary spiral. Still, the price hikes in early 2024 could have a negative impact on household purchasing power and therefore hurt business activity. Talking of business activity, this proved more robust than expected in Q3, with GDP up by a stronger-than-expected 0.3% quarter-on-quarter. The manufacturing sector is suffering (November's manufacturing PMI clocked in at 42.1), but the upturn in purchasing manager confidence in the services sector (PMI = 53.6) bodes well for the future. As the SNB regains some leeway in its monetary policy, we feel confident that Switzerland can navigate the current soft patch without jobs taking too much of a hit.

Chart 3 | Switzerland: falling interest rates boost property market potential



10-year sovereign bonds	Level at 14.12.2023	Change Q4*) (bps)	Change since 31 Dec 2022 (bps)
USD yields – United States	3.91%	-66	8
EUR yields – Germany	2.10%	-71	-46
JPY yields – Japan	0.68%	-8	26
CHF yields – Switzerland	0.65%	-44	-97
GBP yields – United Kingdom	3.87%	-57	20
Emerging markets (USD)	7.39%	-94	-33
Emerging markets (local currency)	4.19%	-25	-23
Commodities	**Price**	**Quarter Q4*)**	**Since 31 Dec 2022**
Gold (USD/oz)	2 040.25	9.9%	12.0%
Brent (USD/bl)	76.71	-17.0%	-11.0%

FX	Level at 14.12.2023	Change Q4*)	Change since 31 Dec 2022
EUR vs. CHF	0.9522	-1.69%	-3.57%
EUR vs. USD	1.0794	1.94%	1.11%
EUR vs. JPY	155.7811	-1.40%	10.63%
EUR vs. NOK	11.5015	2.09%	9.40%
GBP vs. EUR	1.1603	0.65%	2.89%
GBP vs. USD	1.2761	4.55%	6.08%
USD vs. CHF	0.8661	-5.33%	-6.39%
USD vs. CAD	1.3422	-0.73%	-0.94%
AUD vs. USD	0.6700	3.81%	-1.20%

Source: Datastream

Monetary preferences

Rank 1	Rank 2	Rank 3
Appreciation expected	Stabilisation	Depreciation expected
CHF | EUR	**JPY | NOK | USD**	**GBP | GOLD**
▪ **CHF**: a haven and hedging currency; no longer overvalued ▪ **EUR**: attractively valued, but faster ECB rate cuts are a risk	▪ **JPY**: attractively valued after sharp depreciation; ditching the current loose monetary policy would be a catalyst ▪ **NOK**: diversification play, correlated with the price of oil. ▪ **USD**: richly valued; still a reliable hedge against a global slowdown in economic activity	▪ **GBP**: attractively valued but structural effects of Brexit are hurting growth potential ▪ **GOLD**: ripe for a re-rating; rate cuts and a depreciating dollar would provide support; role in hedging geopolitical risk proven

Investment conclusions

Movements in asset prices can be explained by the faster-than-expected deceleration in **inflation** in the US, the Eurozone and Switzerland.

We share the opinion that the battle against inflation by central banks has largely been won and policy rates have peaked. We therefore **reinforced** our exposure to high-grade **corporate bonds** in USD and EUR (5-7 year maturities) during the quarter. This asset class is now overweight in our allocations. For CHF portfolios, we consider that yields are too low (0.7% at 10 years) and prefer to initiate a position in **domestic residential property** (through investment funds), whose valuation and upside is more attractive (yield, renewed premiums and tax considerations for some) (**Chart 3**).

These long positions are being financed using cash in our portfolios, on which the current generous returns are set to recede next year, and by reducing our allocation to hedge funds.

The negative effects of rate rises to date on growth are not yet all visible, which is why we are maintaining a moderate underweight in **equities**, mainly in the US. We believe that US stocks are overvalued for this stage of the economic cycle. In the rest of the world, equities are not as expensive, offering better upside.

In terms of **currencies**, while we favour keeping a significant amount of exposure in the base currency, we reiterate our preference for CHF and EUR over the US dollar.

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