bordier | 1844

Investment Policy

Q2 2024 | March 2024

Editorial Staff | **Gianluca Tarolli, CFA** | Chief Economist and Strategist, co-CIO

Key points

Central banks in the starting blocks

Major central banks were late in getting to grips with inflation in 2021, forcing them to raise rates aggressively between spring 2022 and summer 2023. The inflation picture has since changed radically. The main challenge at the moment is to strike the right balance between easing too early (and risk rekindling inflation) and moving too late (and possibly triggering a recession).

In the US, the **Federal Reserve** appears in no hurry, as recently attested to by Chair Powell before the House Financial Services Committee. Growth is resilient and the unemployment rate (part of the Fed's two-pronged mandate) is extremely low. It can therefore take its time to ensure that the battle against inflation (the other part of the Fed's mandate) has effectively been won before taking action, conceivably this summer.

The **European Central Bank** has a single mandate: ensuring price stability. In the Eurozone, inflation is easing slightly more quickly compared with the US, and there has been the occasional upswing along the way – as in the US. But the trajectory is reassuring, with inflation due to revert to 2% at some point in 2025, based on latest projections from the ECB's economics unit. Even though sustaining business activity is not explicitly part of its mandate, the current lacklustre state of the Eurozone economy gives it reason not to delay action for too long.

The **Swiss National Bank** (SNB) probably finds itself in the most comfortable position. Inflation is even now back within the target range (between 0 and 2%), meaning that it can be the first central bank to cut its benchmark rate. It will also be able to manage CHF depreciation by reducing the size of its balance sheet. This represents a masterstroke by chairman Thomas Jordan, who will be leaving the SNB in September.

Only the **Bank of Japan** is swimming against the tide as it plans to shelve its negative rate policy. The yen stands to be the main beneficiary of this.

Scenario and conclusions

- Good news from broad **inflation** slowdown across the board
- **Central banks** readying their knives...
- **US** economy holding up well
- Economic stagnation in **Europe** and minor improvement in **Switzerland**
- **China** opting for targeted stimulus measures

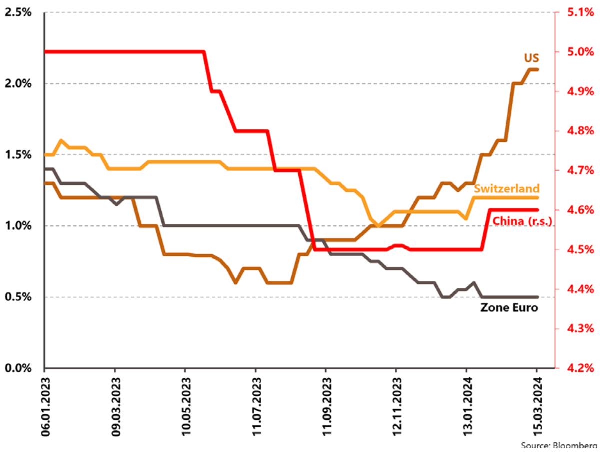
→ **Equities**: marginally underweight in US due to rich valuations
→ **Bonds**: overweight (IG corporate bonds)
→ **Currencies**: preference for CHF and USD
→ **Cash**: overweight

	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 deficit, EMU in a bind, modest recovery in China*

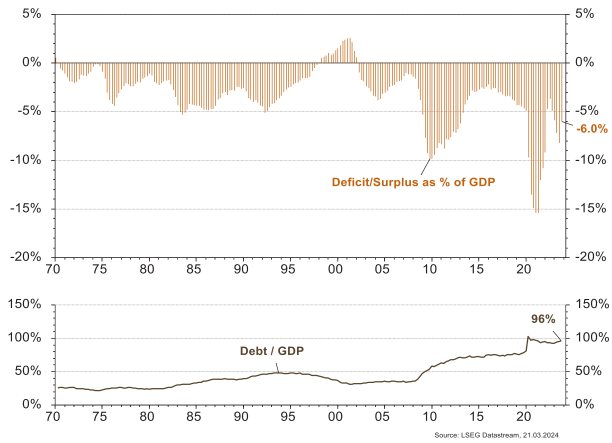
If we look at the world's major economies, the **US** is the only one that has been notching up its growth forecasts for this year. GDP is currently on course for 2% growth (**Chart 1**). In itself, this is nothing out of the ordinary. It is barely above the potential growth rate for the US.

Chart 1 | World: growth consensus for 2024



More surprising still is the resilience of economic activity in the face of the most aggressive monetary tightening in decades. We have already given several reasons for this, especially the household savings glut coming out of the pandemic and the incessantly wide corporate margins, helped by inflation. Another rarely discussed factor is the boost to growth from **public spending**. The government represented more than one-quarter of GDP growth in 2023. In Q4, this was still a massive 75 basis points relative to the solid 3.2% growth figure reported. But this policy is becoming unsustainable: the annual deficit is close to 6% of GDP, the public debt ratio is approaching 100% of GDP and, reflecting a rise in funding costs, the interest burden represents almost $1 trillion a year. The deficit is expected to remain high this year at over 5% of GDP, but its contribution to growth compared with last year will be lower (**Chart 2**). Furthermore, we believe that the **effects of monetary tightening** are not yet visible in their entirety and the threat of a business slowdown cannot be completely ruled out. We are keeping a close eye on the uptrend in credit card defaults and household interest payments, as well as monitoring the tangible signs of a weakening labour market, the reduction in hours worked per week and the lower number of temporary jobs. Similarly, purchasing manager confidence in the services industry, while still in expansion territory, has stopped improving. We will have to wait and see whether the Fed has achieved the first real soft landing for the economy after such an unprecedented round of monetary tightening.

Chart 2 | US: unsustainable deficits and debt



Eurozone growth was slightly in the red even back in Q3 (-0.25% q/q annualised) and was not much better in Q4 (-0.2% q/q annualised). Business activity has been stagnant for just over a year, and leading economic indicators do not point to any improvement in the coming months. While there may be reason to hope in the services sector, concerning which purchasing manager confidence reverted to expansion territory at 50.2 in February (after six months of contraction), the jury is still

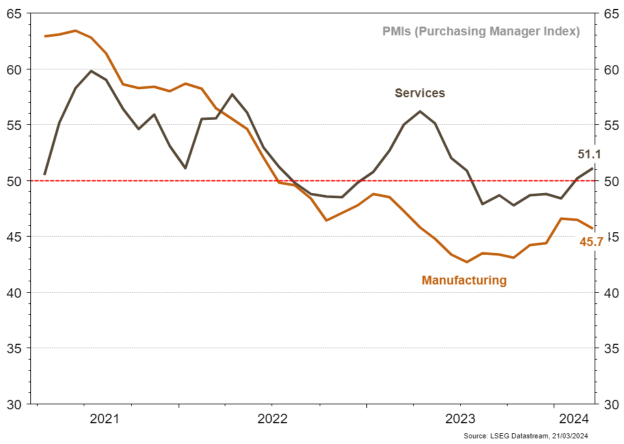
Financial markets

*) To 20.03.2024	Performance			Valuation			Earnings growth			
Equity markets	Price (local currency)	Quarter Q1*)	Since 31 Dec 2023	12-month P/EPS	Dividend yield	Price/ net assets	12-month EPS	2024 EPS	2025 EPS	2026 EPS
United States	4 979.52	9.39%	9.39%	21.09	1.7%	4.3	11%	10%	14%	12%
Europe	505.21	5.47%	5.47%	13.54	3.3%	2.0	6%	4%	10%	9%
Japan	2 750.97	16.00%	16.00%	14.68	2.0%	1.5	9%	15%	9%	9%
Switzerland	11 618.63	4.30%	4.30%	17.48	3.1%	3.7	11%	9%	14%	10%
United Kingdom	4 225.49	-0.15%	-0.15%	11.03	3.9%	1.7	3%	1%	8%	9%
Emerging Markets (USD)	1 032.12	0.82%	0.82%	12.16	3.0%	1.6	17%	18%	16%	11%
World (USD)	3 414.89	7.75%	7.75%	18.49	2.2%	3.1	9%	8%	12%	11%

Source: Datastream, IBES consensus

out on the manufacturing sector. The latest manufacturing PMI was only 46.5, below the 50 mark, where it has been since July 2022 (**Chart 3**), signalling a contraction in manufacturing activity. On the positive side, inventory rundowns seem to have almost run their course, meaning that production will need to resume to satisfy demand. More generally, Germany is the weakest link in terms of growth, which has been flat there for four years, while the Eurozone has grown by 3% over the same period. The manufacturing industry is not solely to blame. Consumer spending and services have also suffered more than elsewhere due to higher energy bills. Having said that, Germany's public debt ratio equivalent to 65% of GDP is almost where it was back in 2007 (before the financial crisis), making it the envy of most other developed countries. The government therefore has significant budgetary leeway to prevent the drama from turning into a crisis.

Chart 3 | Eurozone: improved services confidence readings



The deceleration in **inflation** is genuine good news for the Eurozone economy as a whole. Headline inflation slipped to 2.6% y/y in February (versus 10.6% y/y in October 2022), while core inflation (excluding food and energy prices) clocked in at 3.1% y/y (versus 5.7% at its March 2023 peak). Lower inflation is doubtless restoring households' purchasing power in the form of higher real wages, thereby permitting the ECB to ease monetary policy between now and the summer – which will galvanise the economic recovery.

In **China**, the government is well aware of the economic slump – not only the crisis in the property sector but also the low consumer confidence. In response, the National People's Congress has announced a series of measures to stimulate economic activity. However, **shock therapy** is not planned at this stage. Measures are still being targeted at the supply side (automation, digitalisation and energy transition projects), including the annual issuance of special treasury bonds for RMB 1trn (~USD 140bn) to finance specific policies and projects. At the same time, the PBoC is quickening the pace of monetary easing. It has cut the banks' reserve requirement by 0.5% and the 5-year borrowing rate – the rate most commonly used for mortgages – from 4.2% to 3.95%. Finally, a growth target of 5%, though seen as ambitious by the authorities themselves, has been established.

The **Swiss economy** is suffering from the bad form of trading partner Germany, which accounts for 13.5% of its total exports and which is the main recipient of its exports to the Eurozone (roughly 40%). Added to that, manufacturing output shrank by 1.6% in 2023, and the manufacturing PMI confidence bellwether is in contraction territory. In Q4 2023, the strength of domestic consumption (+1.3% y/y in Q4) offset weak business investment (-4.3% y/y in Q4) to deliver a better-than-expected overall GDP figure (+0.3% q/q; +0.6% y/y). Nonetheless, the SNB's move to ease monetary conditions, made possible by inflation slowing to 1.2% y/y in February, is likely to encourage a modest recovery in troubled sectors and stimulate consumer spending.

10-year sovereign bonds	Level at 20.03.2024	Change Q1*) (bps)	Change since 31 Dec 2023 (bps)
USD yields – United States	4.28%	41	41
EUR yields – Germany	2.42%	42	42
JPY yields – Japan	0.73%	11	11
CHF yields – Switzerland	0.71%	1	1
GBP yields – United Kingdom	4.02%	42	42
Emerging markets (USD)	7.48%	16	16
Emerging markets (local currency)	4.01%	-7	-7
Commodities	Price	Quarter Q1*)	Since 31 Dec 2023
Gold (USD/oz)	2 157.20	4.4%	4.4%
Brent (USD/bl)	86.7	11.0%	11.0%

FX	Level at 20.03.2024	Change Q1*)	Change since 31 Dec 2023
EUR vs. CHF	0.9674	4.05%	4.05%
EUR vs. USD	1.0859	-1.71%	-1.71%
EUR vs. JPY	164.6172	5.70%	5.70%
EUR vs. NOK	11.5730	3.16%	3.16%
GBP vs. EUR	1.1706	1.45%	1.45%
GBP vs. USD	1.2711	-0.29%	-0.29%
USD vs. CHF	0.8913	5.89%	5.89%
USD vs. CAD	1.3565	2.87%	2.87%
AUD vs. USD	0.6529	-4.32%	-4.32%

Source: Datastream

Monetary preferences

Rank 1	Rank 2	Rank 3
Appreciation expected	Stabilisation	Depreciation expected
CHF | USD	EUR | JPY | NOK	GBP | GOLD
▪ **CHF**: a haven and hedging currency; no longer overvalued ▪ ↑ **USD**: rich valuation, but should benefit from higher interest rates for longer thanks to strong growth momentum	▪ ↓ **EUR**: attractively valued, but faster ECB rate cuts and anaemic business trends skew to the downside ▪ **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	▪ **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

The upward realignment on **major yield curves** has caused bond allocations to suffer slightly year to date. However, the level attained is now much more compatible with the prospect of a soft landing for the economy. These yields have consequently restored the value of high-grade medium- and long-term corporate bonds (5-7 years), in which we remain overweight in EUR and USD.

In CHF, interest rates on these maturities have been too low to justify the same allocation. In this currency, non-government bonds with maturities of just 1-3 years offer higher yields and lower risk. The **residential property** asset class represents, in our view, a solid alternative to longer-dated maturities. The dividends paid out are very competitive relative to coupons and, most importantly, there is greater potential for capital appreciation. We increased our exposure to this asset class at the start of the year after initiating the position last December.

We have also increased our exposure to **US equities** and likewise to the **US dollar** during the quarter. Some of the hopes pinned on the prospective productivity gains from AI are legitimate. Valuations are increasingly lofty and multiples have expanded despite the higher interest rates. Even so, they are not yet excessive. Our underweight in equities is now only marginal, reflecting a small degree of caution following the sharp rise in equity indices since October 2023.

Finally, our reallocation more towards the US dollar reflects the fact that the Fed is likely to cut rates later than elsewhere.

Publication date | 11 March 2024

Bordier & Cie SCmA | Banquiers Privés depuis 1844
Rue Rath 16 | case postale | CH-1211 Genève 3 | t +41 58 258 00 00 | f +41 58 258 00 40 | bordier.com