Investment letter

Monthly review of global financial markets

SWISS CAPITAL IB

February 2024

MACROECONOMICS

The year started with markets convinced that the Fed would start cutting its key interest rates as soon as March, giving a probability of 97.5% to such an outcome on January 1st. However, following solid macroeconomic data throughout the month and a less dovish Fed, markets were far less sure at the end of the month, with this probability down to 35% on January 31st.

It is true that the **December Services ISM** disappointed sharply, falling from 52.7 to 50.6, its weakest in 7 months, with a large decline in the employment component from 50.7 to 43.3, lowest since 2020. **Manufacturing** picked up to 47.4 but remains in contraction for the 14th month with soft demand.

However, the **job market** is still very tight, with persistently low initial jobless claims, a sustained pace of jobs' creation (353k in Jan.), a low unemployment rate (3.7%) and wage growth rising (4.5% y/y in Jan.)

The **December CPI** may also have created some uneasiness at the Fed, as the core fell just one tenth from 4.0% to 3.9% (3.8% exp), while the headline picked up more than expected, from 3.1% to 3.4%. That said, **core PCE**, the Fed's preferred inflation gauge, sent a softer message, with the core year-over-year measure falling to 2.9%, below 3% for the first time since March 2021.

> THE RISK SEEMS TO HAVE SHIFTED FROM RECESSION A YEAR AGO TO "TOO GOOD TO BE TRUE?" TODAY, AND THE JANUARY FOMC MEETING SHOWED A BIT MORE CAUTIOUSNESS REGARDING RATE CUTS.

In fact, for central bankers, data looked quite immaculate overall, with the economy approaching a Goldilocks' state of strong – but not overheated – growth and stable inflation, with the a**dvanced estimate for GDP in the 4th quarter** of last year and the **quarterly growth in core PCE** at 3.3% and 2% annualised respectively. Meanwhile, **preliminary Jan. PMIs** took the economy further away from recession, with manufacturing unexpectedly back in expansion (50.3), while services also surprised higher (52.9).

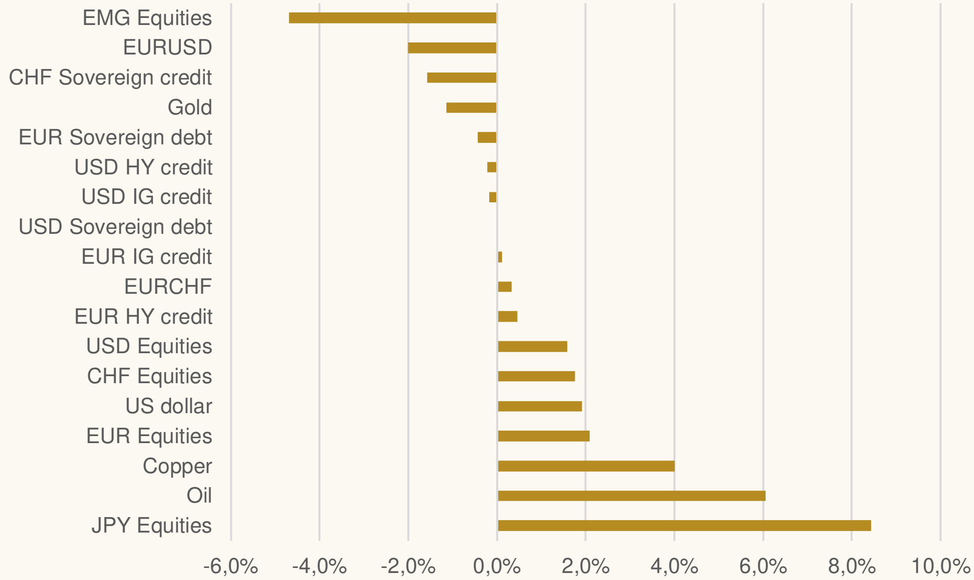
In all, the risk seems to have shifted from recession a year ago to "too good to be true?" today. Thus, **the FOMC meetin**g at the end of the month showed a bit more cautiousness than during its last meeting of 2023. Jerome Powell made explicit that a rate-cut in March was not their base case, as they are looking to gain more confidence that inflation is sustainably heading toward the 2% objective.

The picture is somewhat clearer in the **Eurozone**, where the ECB should probably cut rates sooner than the Fed if it wishes to prevent further protracted weakness.

December headline CPI picked up from 2.4% to 2.9% y/y, but that was expected and driven by energy base effects as German and French subsidies ended. **Core inflation**, on the other hand, continued to fall, from 3.6% to 3.4% y/y, its lowest since Mar. 2022.

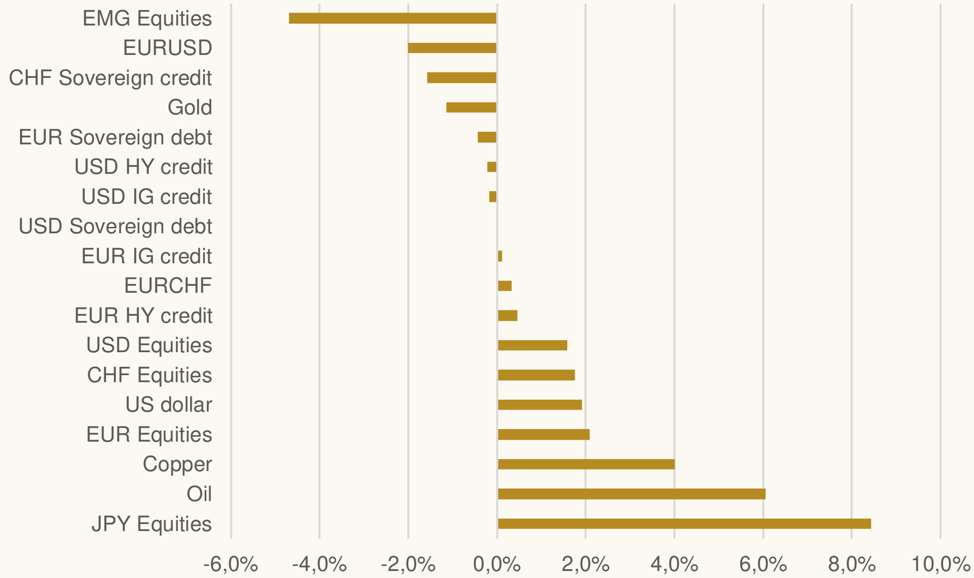
OVERVIEW

MAIN ASSET CLASSES
MONTHLY PERFORMANCE



Source: Bloomberg, 01/31/2024

MAIN ASSET CLASSES
PERFORMANCE YEAR-TO-DATE



Source: Bloomberg, 01/31/2024
Past performance is not indicative of future performance

MACROECONOMICS (CONTINUED)

Meanwhile, all **PMIs** were simultaneously in contraction in January for the 6th consecutive month and **1-year ahead median inflation expectations** fell to 3.2% in the November ECB consumer survey, from 4.0% in October, the lowest since Ukraine's invasion.

In this context, at the **first ECB post-meeting press conference of the year**, Christine Lagarde sounded less hawkish than during previous meetings, or than ECB members' comments before that meeting may have pointed to.

The policy statement dropped the reference to "elevated" price pressures. During the press conference, Christine Lagarde was balanced overall, but kept the door open for a cut in April, a dovish development for markets, which started to question this possibility when she pointed to the "summer" as a plausible timing in Davos.

She noted that the labour market is robust but with fewer advertised vacancies, inflation should ease further in 2024, and risks to growth are tilted to the downside.

While the consensus in the Council was that "it was premature to discuss rate cuts", they remain data-dependent, with Christine Lagarde highlighting the importance of updated projections available in March. Hence, no endorsement of an April rate cut, but no strong pushback either. Given the poor underlying growth dynamics in the Euro area, markets saw over 95% probability of a cut in April on January 31st, versus just 64% the day before the meeting.

EQUITY MARKETS

Equity markets had a good month in January, rising again (S&P 500 +1.6% in USD, Stoxx 600 Europe +2.8% in EUR over the month) after an excellent end to the year. This movement took the US S&P 500 and Nasdaq 100 indices to new all-time highs.

Enthusiasm for Artificial Intelligence has further strengthened, with spectacular gains for chip supplier NVidia (+24.2% over the month), semiconductor equipment maker ASML (+17.1%) and server manufacturer Super Micro Computer (+86.3%).

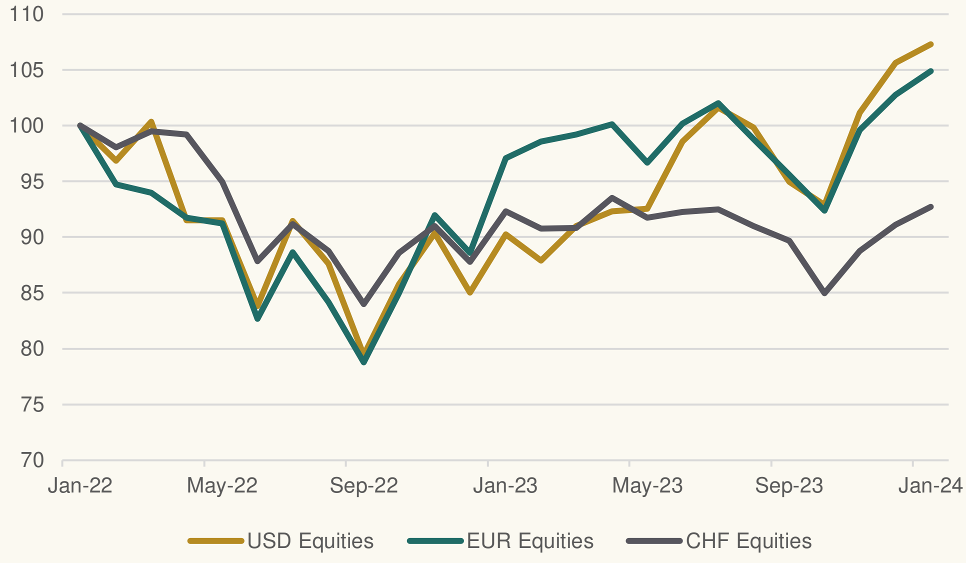
ENTHUSIASM FOR ARTIFICIAL INTELLIGENCE HAS FURTHER STRENGTHENED, WITH SPECTACULAR GAINS FOR STOCKS WITH AN EXPOSURE TO THIS THEME.

One factor tarnished this favorable momentum: **the timetable for the US Federal Reserve's pivot**, which was widely expected in March at the start of the month, was called into question in an increasingly tangible way as the month progressed, with economic indicators showing the strength of the US economy, **until at the very end of the month Jerome Powell deemed a first rate cut in March "unlikely"**, leading to a fall in the equity markets and thus reducing the monthly performance of the major indices.

In terms of sectors, **the tech was the biggest gainer** (S&P Communications +4.8%, Stoxx 600 Tech +7.5%), while the materials (S&P 500 Materials -3.9%, Stoxx 600 Basic Resources -4.8%) and automotive (S&P 500 Auto -20.8%, Stoxx 600 Auto -0.7%) sectors fell back, the latter weighed down by the collapse of Tesla (-24.6% in January).

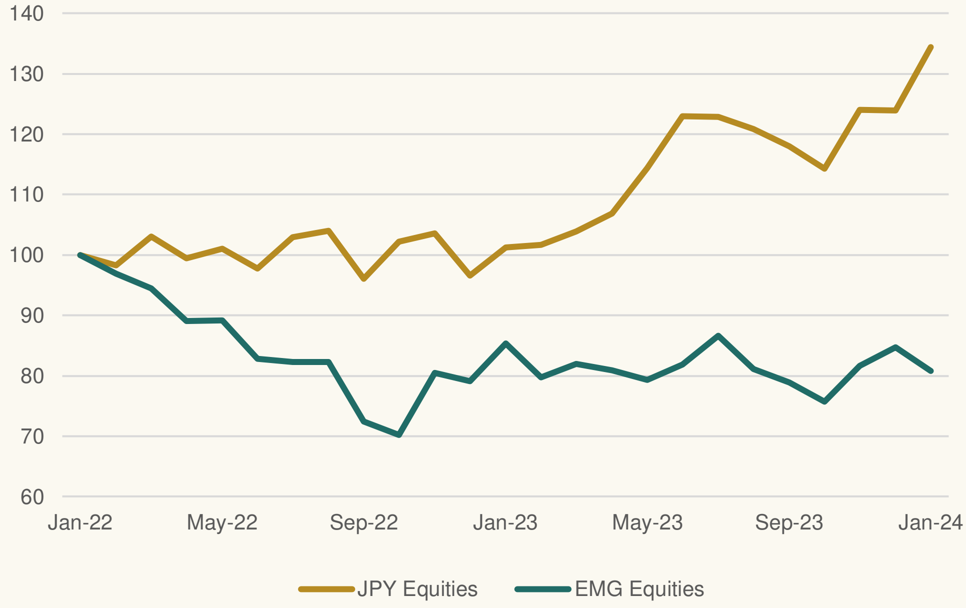
EQUITY MARKETS

EQUITY MARKETS EUR USD CHF
PERFORMANCE OVER 2 YEARS



Source: Bloomberg, 01/31/2024

EQUITY MARKETS JAPAN – EMERGING MARKETS
PERFORMANCE OVER 2 YEARS



Source: Bloomberg, 01/31/2024
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BOND MARKETS

2024 is off to a good start for the bond markets. Economies are slowing without entering recession, inflation is falling month by month on both sides of the Atlantic, corporate earnings remain at very decent levels in the more traditional sectors (ex-tech) and refinancing levels are beginning to ease in the face of investor appetite.

This favourable environment led to a very buoyant January on the primary market, across the board, with valuations generally trending upwards. Net inflows into bond funds were substantial in January, particularly on the IG side, reflecting a rebalancing of money market funds towards longer maturities. The expectation of a central bank pivot logically leads investors to favour the long-end of the curve if they think that the short-end will soon be much less attractive.

Spreads, which were already tight at the end of 2023, have helped to keep valuations in check. We are seeing almost 18bps of tightening on EUR HY, -7bp on EUR IG and a few basis points on the US IG curve. Unsurprisingly, US HY has diverged by +20bp since the start of the year, given very tight valuations for this part of the credit market.

In line with our expectations, **the bonds with the largest carry at the start of the year outperformed in January**: AT1 financial bonds were up +1.3% in January, compared with +1.0% for the corporate subordinated portion (corporate hybrids). Lastly, the steepening move of the curves continued, with the 30y-2y spread now hovering around zero in the USA and for the Bund (+15bp ytd).

2024 IS OFF TO A GOOD START FOR THE BOND MARKETS.

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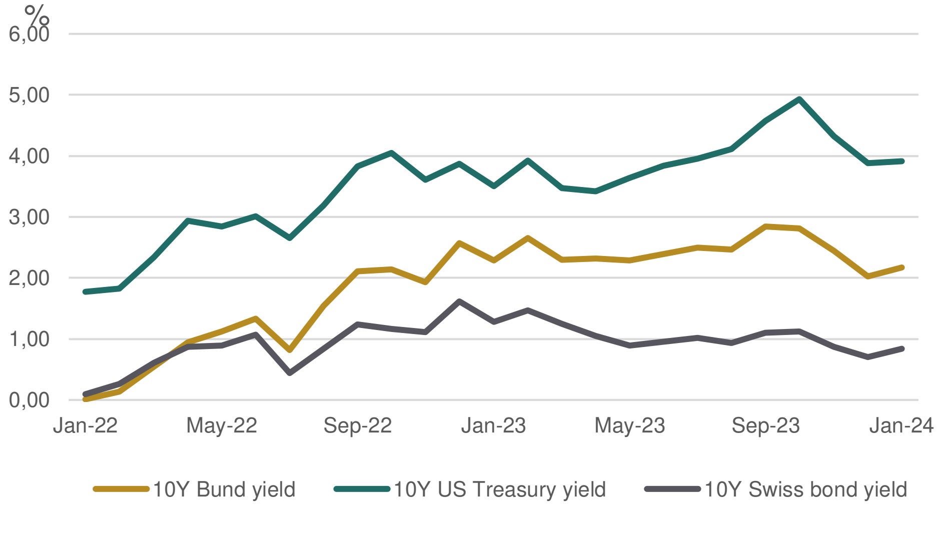
10Y SOVEREIGN BOND YIELDS
EVOLUTION OVER 2 YEARS



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CURRENCIES

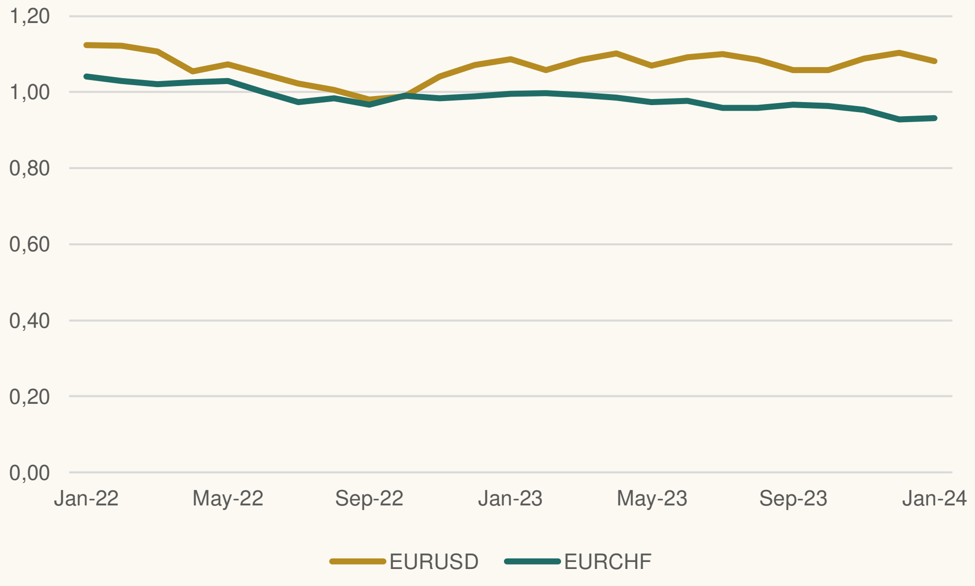
After losing ground in November and December, the **Dollar Index** was a strong performer in January, up by +1.9%, and strengthening against every G10 currency. This was led by a continued robust sequence of economic data, which meant that the growth differential remains in favour of the US versus the rest of the world.

Going forward, whilst the US economy will likely soften in 2024 and the Fed prepares to cut rates at some point this year, other major blocs, such as the Eurozone, will do the same. Indeed, Christine Lagarde kept the door open for a first rate-cut as soon as April in the Eurozone, a scenario that markets now almost fully price. The **EUR-USD** is down from over 1.10 on January 1st to 1.08 at the end of the month. The pair may struggle for direction in the near term as markets continue to assess when and by how much central banks will cut rates this year. Ultimately, we would not be surprised to see the pair weaken toward 1.05 as further near-term resiliency in the US economy could lead the Fed to delay the first rate-cut to June rather than May (as markets currently expect), while we agree with markets' pricing for April in the Eurozone.

With Swiss inflation at 1.7% and 1.5% y/y at the headline and core levels respectively in December, the SNB has no reason to maintain a hawkish tilt, especially since its main worry was to import inflation from the rest of the world, where it is materially declining as well. As such, the **CHF-USD** cross was down from 1.19 to 1.16 over the course of January. Meanwhile, the **CHF-EUR** pair was slightly down in January from 1.08 to 1.07. While the CHF may remain under a bit of downward pressure versus the USD, it could remain strong against the EUR. The SNB has hiked rates much less than its ECB counterpart and has less room to lower them as a result, thus the rate-differential should remain in favour of the CHF. However, with current levels close to all-time highs, the upside seems very limited from here.

USD & CHF

EVOLUTION OVER 2 YEARS AGAINST THE EUR



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COMMODITIES

OIL

Brent is back above the USD80 mark at the end of January as strikes from the Houthi rebels on commercial shipping in the Red Sea led to significant supply-chain disruption.

As a result, oil prices rose again in January after three months of declines, with Brent up +6.1% to 81.7USD/bbl. Freight costs soared, with Drewry's World Container Index up to USD3,964 per 40ft container as of 25 January. That's almost triple its levels from late-October when costs were at a post-pandemic low.

Going forward, oil prices should remain in a tug-of-war between softer global demand as economic momentum softens, and fears of supply disruptions leading to episodic price spikes.

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OIL

EVOLUTION OF BRENT PRICES OVER 2 YEARS

Source: Bloomberg, 01/31/2024
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COMMODITIES

GOLD

The **yellow metal** was slightly down (~1%) from USD2’063 to USD2’040 in January but remains well anchored above the symbolic USD2’000 mark since mid-December 2023.

Rising geopolitical tensions along with lower rates contribute to maintain a floor under Gold. Going forward, central banks’ cuts may maintain prices elevated, but we would caution that those cuts are likely in the price already, while a somewhat stronger dollar could also weigh on prices.

On the other hand, geopolitical risks may lead to episodes of Gold’s spikes, justifying some measured exposure to the metal.

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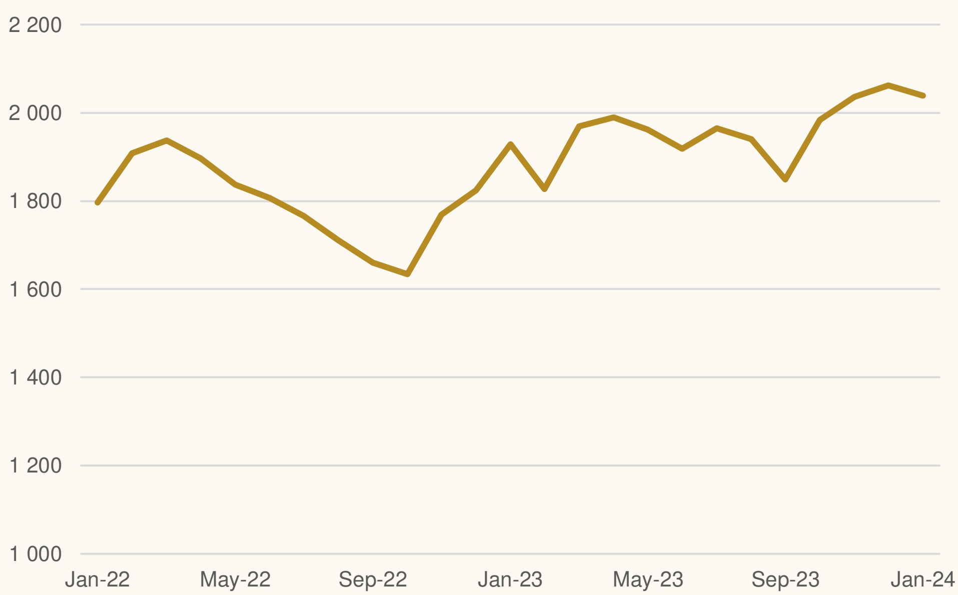
GOLD

EVOLUTION OVER 2 YEARS



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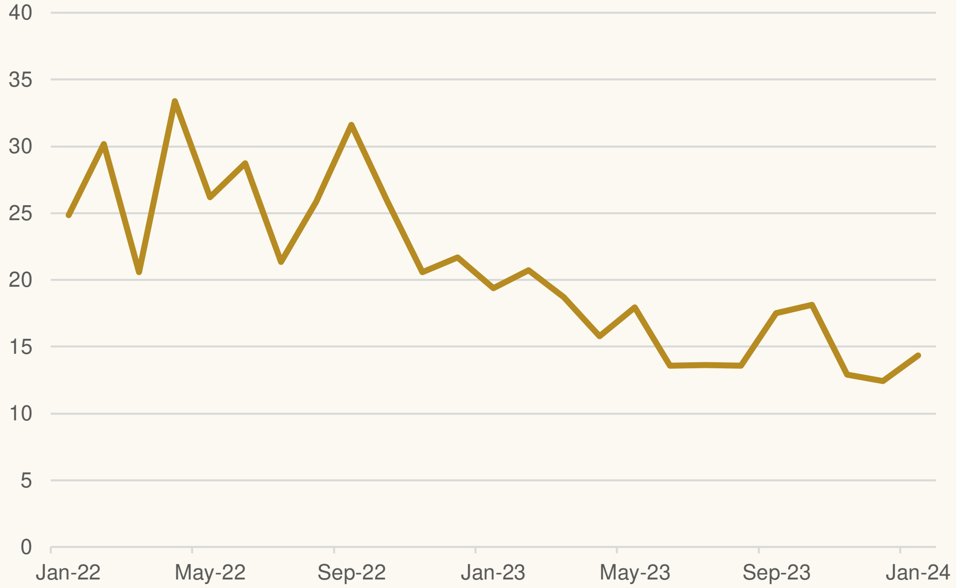
VOLATILITY

VOLATILITY – VIX INDEX
EVOLUTION OVER 2 YEARS



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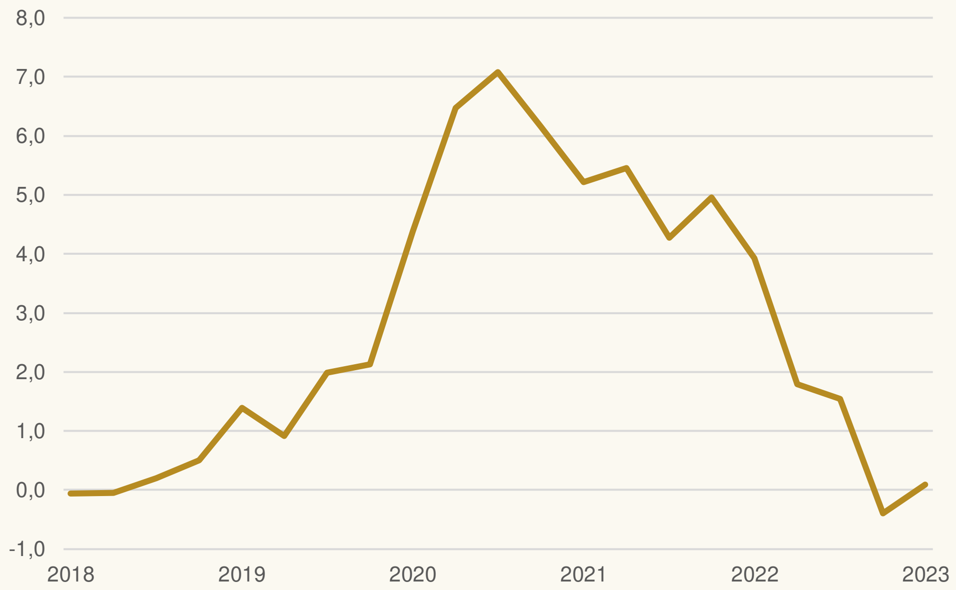
REAL ESTATE

SWISS RESIDENTIAL REAL ESTATE
ANNUAL PRICE CHANGE



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CALENDAR

Date	Country	Economic Data	Period	Previous
01 February	US	Manufacturing PMI	Jan-24	46,7
	China	Caixin Manufacturing PMI	Jan-24	50,7
	Eurozone	Inflation (YoY)	Jan-24	2,4
	Eurozone	Markit Manufacturing PMI	Feb-24	44,4
	Eurozone	Unemployment Rate (%)	Dec-23	6,5
	UK	Markit Manufacturing PMI	Feb-24	46,2
	UK	Bank of England Interest Rate (%)	Feb-24	5,3
	Japan	Nikkei Manufacturing PMI	Feb-24	47,9
	Switzerland	Manufacturing PMI	Jan-24	42,1
02 February	US	Consumer Confidence	Feb-24	78,8
	US	Employment (000s)	Jan-24	216,0
	US	Unemployment Rate (%)	Jan-24	3,7
05 February	US	ISM Non-Manufacturing Index	Jan-24	50,6
	Eurozone	Markit Services PMI	Feb-24	48,4
	UK	Markit Services PMI	Feb-24	53,8
07 February	Germany	Industrial Production (MoM)	Dec-23	-0,7
	Switzerland	Unemployment Rate (%)	Jan-24	2,2
08 February	China	Inflation (YoY)	Jan-24	-0,3
13 February	US	Inflation (YoY)	Jan-24	3,4
	France	Unemployment Rate (%)	Dec-23	7,4
	UK	Unemployment Rate (%)	Aug-23	4,3
	Switzerland	Inflation (YoY)	Jan-24	1,7
14 February	Eurozone	Industrial Production (MoM)	Dec-23	-0,3
	Eurozone	Employment (QoQ)	Dec-23	0,2
14 February	UK	Inflation (YoY)	Jan-24	4,0
15 February	US	Industrial Production (MoM)	Jan-24	0,1
	US	Philadelphia Fed Business Survey	Feb-24	-10,6
	UK	Real GDP (QoQ)	Dec-23	-0,1
	Japan	Real GDP (QoQ)	Dec-23	-2,9
21 February	US	Fed minutes	Mar-25	
23 February	Germany	Ifo Business Climate	Feb-24	85,2
28 February	US	Real GDP (QoQ)	Mar-24	3,3
29 February	Switzerland	Real GDP (QoQ)	Dec-23	0,3

LET'S TALK ABOUT IT.

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