Investment letter

Monthly review of global financial markets

January 2024

SWISS CAPITAL IB

MACROECONOMICS

With all eyes on the Fed, December's FOMC meeting proved far more exciting than the expected decision to hold rates unchanged at 5.25%-5.5% pointed to. The Fed and J. Powell were **unequivocally dovish**, both quantitatively and qualitatively. **The dots were revised materially lower**, with the end of the hiking cycle confirmed and the median dot showing 3 cuts, for a total of 75bps, in 2024. Meanwhile, Powell said that **the timing of rate cuts had been discussed** during the meeting – a notable evolution – and, even more importantly, underlined that **they were aware of the risk to start cutting rates too late**. As a result, markets now expect a 1st cut in March, and almost 150bps of total cuts next year. If realized, that might help to avoid (delay?) the "usual" end-of-cycle recession next year, but risks of persistent core inflation in an uncomfortable area (2.5%-3%) would increase.

This meeting came on the heels of an uneventful CPI report, largely in line with expectations, with core CPI stable at 4% y/y and headline at 3.1% y/y in Nov. The Nov. PPI report, on the other hand, surprised on the downside, with, notably, the core PPI (ex-Food & Energy) down to 2% y/y in Nov. **Most other data pointed to a still solid economic momentum**. Retail sales beat expectations in Nov. The Nov. ISM services index surpassed forecasts, rebounding to a healthy 52.7, a testament to the continued resilience of the consumer so far. Meanwhile, Q3 Nonfarm productivity growth was revised higher to a strong 5.2%. It is too early to know if this is the beginning of a new trend, or catch-up from previous weak readings, but this is helping the non-inflationary growth scenario.

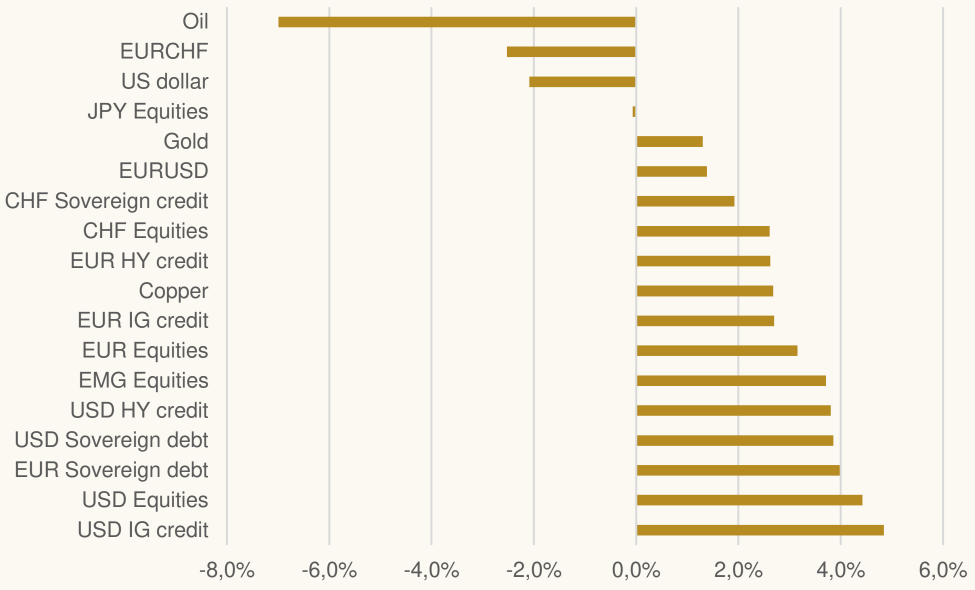
> WHILE WE THINK THAT DATA WILL WORSEN MORE SHARPLY AT SOME POINT IN 2024, WARRANTING RATE CUTS BY THE FED, WE SUSPECT THEY MAY COME CLOSER TO MID-YEAR, WHEN CORE INFLATION WILL BE NEARER TARGET AND JOB DATA MATERIALLY LOOSER, THAN LATE Q1/EARLY Q2.

On the labour market front, the picture continues to be one of tightness. JOLTs data admittedly sent a loosening signal, with 8.7mn job openings, the lowest since March 2021, but **initial jobless claims continued to hover at low levels and the Nov. labour market report proved stronger than expected with 199k jobs created, unemployment falling back to 3.7%**, and wage growth flat at 4%, too rapid for 2% inflation. While we think that data will worsen more sharply at some point in 2024, warranting rate cuts, we suspect they may come closer to mid-year, when core inflation will be nearer target and job data materially looser, than late Q1/early Q2, as markets currently expect.

The **ECB meeting** proved far less dovish than its transatlantic peer's, with C. Lagarde showing much less enthusiasm towards rate cuts. She acknowledged downside risks to growth but continued to send mixed messages on inflation. While all measures of underlying inflation declined and monetary policy transmission is forceful, the ECB notes that there are still price pressures in strong wage growth and falling productivity, leading her to keep a "data-dependent" approach. C**. Lagarde declared: "We did not discuss rate cuts at all", "no discussion, no debate on this issue."** Markets, however, still see almost 60% chance of a cut in March, **with a cut in April fully priced.**

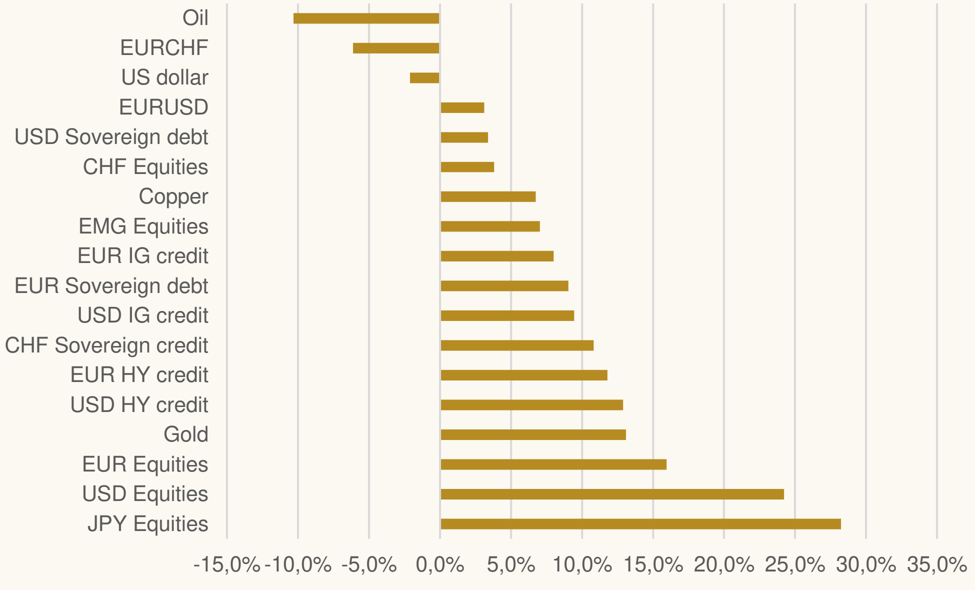
OVERVIEW

MAIN ASSET CLASSES
MONTHLY PERFORMANCE



Source: Bloomberg, 12/31/2023

MAIN ASSET CLASSES
PERFORMANCE YEAR-TO-DATE



Source: Bloomberg, 12/31/2023
Past performance is not indicative of future performance

MACROECONOMICS (CONTINUED)

These projections seem justified in our view. Indeed, the sharp fall in Eurozone Nov. inflation from 2.9% to 2.4% for the headline and 4.2% to 3.6% for the core, demonstrates that monetary policy is being channeled to the economy, as the contracting money supply has been signaling for months. Moreover, with **Q3 GDP growth confirmed in contraction at -0.1%,** and Dec. PMIs all contracting for the 5th straight month, data in the Eurozone points to **a form of stabilisation at low level**, with hopes that the situation could improve later in 2024 if the ECB's reaction function proves dovish enough. The Sentix Economic index increased by 1.8 pt to -16.8 in Dec., its highest since May, but still in negative territory. Meanwhile, retail sales volumes grew in Oct. for the first time in 3 months, albeit below expectations, by 0.1% m/m, with the annual decline moderating from -2.9% y/y to -1.2% y/y, indicating that disinflation is starting to partially relieve the consumer. A hawkish reaction function on the other hand, with belated rate cuts, could precipitate a deeper recession.

EQUITY MARKETS

THE FRENZY TURNED A NARRATIVE SHIFT TOWARDS THE SOFT-LANDING SCENARIO INTO A VIBRANT RALLY

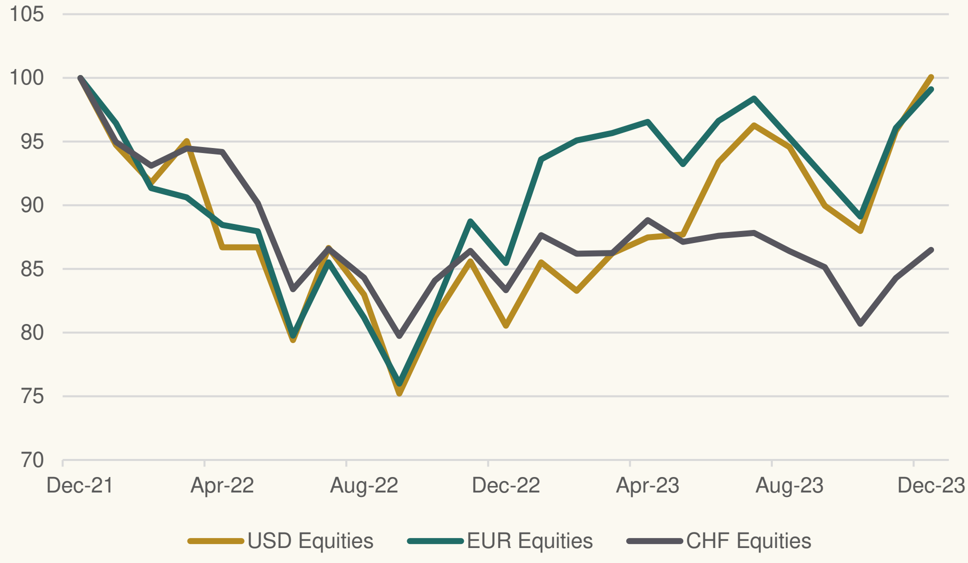
In December, FOMO pervaded equity markets amid hopes that the Fed and the ECB will cut 150 bps through 2024. T**he frenzy turned a narrative shift towards the soft-landing scenario into a vibrant rally** with US (NASDAQ +5.52%, DJIA +4.84%, SPX +4.42%) overperforming Europe (SX5E +3.18%, SXXP +3.77%). **Hence a bullish capitulation we see resisting until January**.

The extraordinary November-December we witnessed were spurred by four essential factors: Goldilocks economic prints, a decline in yields, sliding oil prices and the deployment of cash parked on the sidelines. All that produced a triumphing sense of euphoria among investors. **Europe saw the VSTOXX drop to a post-Covid low while the SX5E hit an RSI above 80 for the first time in 23 years**. EU Cyclicals vs Defensives have lost the track of both bond yields and PMIs. **In the US, the average stock has hit its highest overbought level since the 90s**. Such an alignment has pushed the SXXP towards its late-2021 highs and the SX5E has even topped its 2007 pre-GFC peak. Meanwhile, the SPX hit an all-time high.

Though, past records were reached in low interest rate eras, which is not the case at the moment and won't be either at the end of 2024. We are convinced that the European economy is on the brink of a recession whose premises were reflected in a dull Q3 earnings season. December Composite PMI at 47 (48 expected) hints at a difficult recovery too. In the US, the resilience of the economy through 2023 amid slowing inflation conveys the message that the relationship between the labour market and prices is not linear, suggesting that a break at a certain point cannot be ruled out. Hence our bearish forecasts for next year. Moreover, **EPS expectations above 10% for 2024 are also inconsistent with a subdued economy. Let's remind that a recession typically dents EPS by -5 to -15%!**

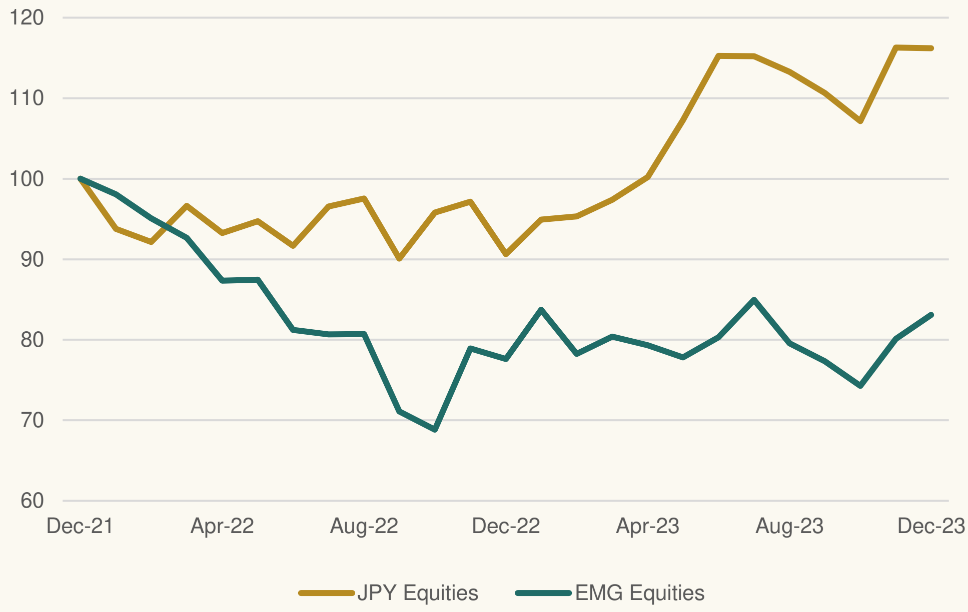
EQUITY MARKETS

EQUITY MARKETS EUR USD CHF
PERFORMANCE OVER 2 YEARS



Source: Bloomberg, 12/31/2023

EQUITY MARKETS JAPAN – EMERGING MARKETS
PERFORMANCE OVER 2 YEARS



Source: Bloomberg, 12/31/2023
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BOND MARKETS

After a record month in November, **risky assets continued to rise in December, still fueled by expectations of central banks pivot and lower long-term interest rates in the US and Europe.** The US 10-year fell by 50bp in December, compared with around 40bp for the 2-year.

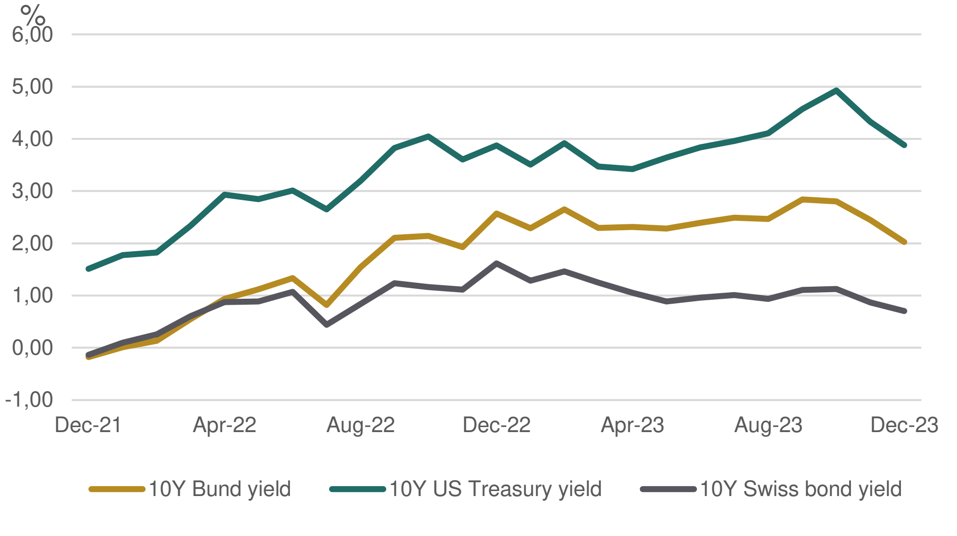
European yields moved in tandem with US yields, with the southern European countries outperforming given their positive ratings trends. T**his acceleration in the fall in rates leaves little room for maneuver for 2024**, unless the economies contract sharply, which is not the central scenario today.

On the credit side, investor appetite remained solid in December, with spreads ending the year at their lowest level for 2023. **At these levels, we see little potential for further tightening over 2024, particularly in the USA where spreads are already well below their 10-year average**. Performance in 2024 will therefore come mainly from carry, which is currently more advantageous on the subordinated part of issuers (corporate hybrids and financial subordinates).

> RISKY ASSETS CONTINUED TO RISE IN DECEMBER, STILL FUELED BY EXPECTATIONS OF CENTRAL BANKS PIVOT AND LOWER LONG-TERM INTEREST RATES IN THE US AND EUROPE.

10Y SOVEREIGN BOND YIELDS

EVOLUTION OVER 2 YEARS



Source: Bloomberg, 12/31/2023
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CURRENCIES

High expectations around approaching Fed rate cuts drove the **DXY** down to 101, its lowest since last July. The trend was compounded by slightly weaker expectations for the US economy, slowing down from a stellar Q3.

Conversely, the **EUR** benefited from a hawkish ECB to climb past **1.10 USD**. In particular, the **EUR** experienced a first leap in the wake of J. Powell's speech, before jumping again the subsequent day when C. Lagarde turned out tougher than expected. A sign that, as the peak yield narrative resonates with investors, interest rates differences will be the key to currencies moves again.

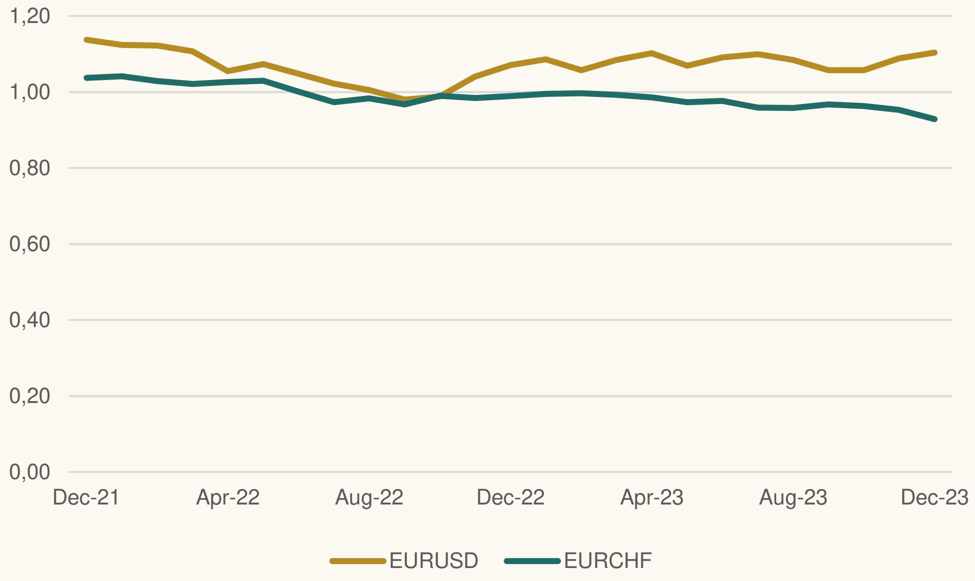
An adamant BoE helped the **GBP** extend gains against the USD, towering over **1.27 USD** after the MPC meeting. However, inflation surprised heavily on the downside (3.9% vs 4.4% expected) stoking bets that the central bank will cut quickly next year and bringing the GBP near 1.26.

The **CHF** hit its highest against the USD since 2011, above **1.18 USD** after testing 1.20. The SNB kept its rates unchanged at 1.75% but underscored uncertainty with regards to price stability. Moreover, the central bank continued its effort to maintain a floor under the CHF by drawing into foreign exchange reserves.

Though the BoJ sticked with its previous decisions in December (overnight interest rates stable at -0.1% and YCC allowing 10-year government bonds to rise above 1%), hopes that Kazuo Ueda will announce a normalization of the Japanese monetary policy in the coming months helped the **JPY** rise back from a 30-year low. Back in November, the **USD/JPY** had towered over 150, before a forceful comeback of the yen, strengthening its way to 141.

USD & CHF

EVOLUTION OVER 2 YEARS AGAINST THE EUR



Source: Bloomberg, 12/31/2023
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COMMODITIES

OIL

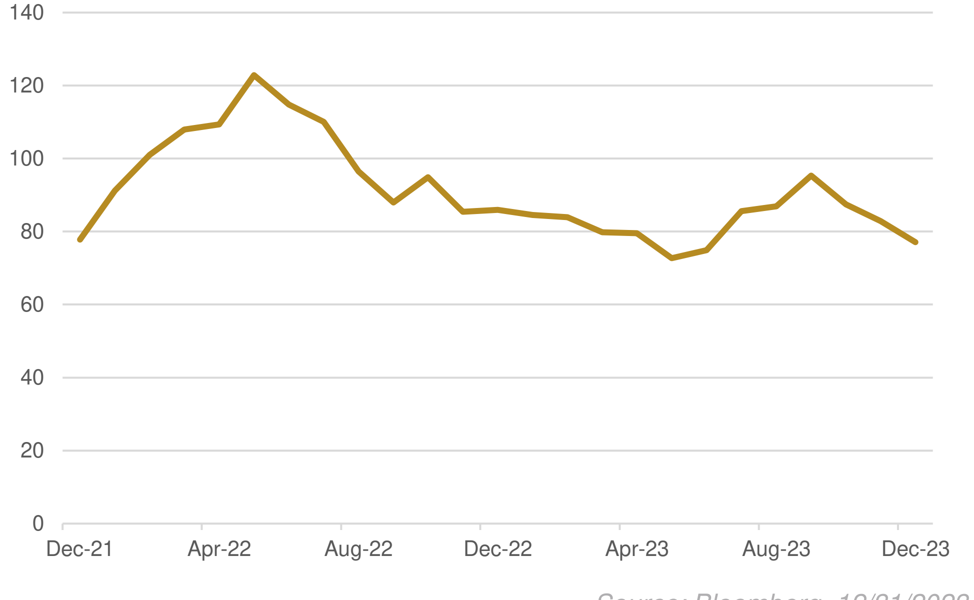
After plunging near YTD lows ($73), the Brent rebounded forcefully towards $80, on the back of trade disruptions sparked by attacks off the Yemeni coast. As a consequence, the Brent's prompt spread shortly swung from contango to backwardation, a rather bullish move. **However, the last hours of the month saw uncertainty around the macroeconomic background put a lid on prices.**

Uncertainty around the macroeconomic background put a lid on prices.

Furthermore, the supply's resilience should continue into 2024: US shale industry proved robust through 2023 while sanctions on Iran and Russia did not hinder production. OPEC's unity – and ability to enforce production cuts - was even questioned when Angola turned its back on the cartel after a row over quotas allocation.

OIL

EVOLUTION OF BRENT PRICES OVER 2 YEARS



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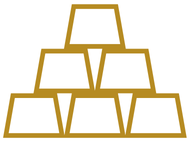
COMMODITIES

GOLD

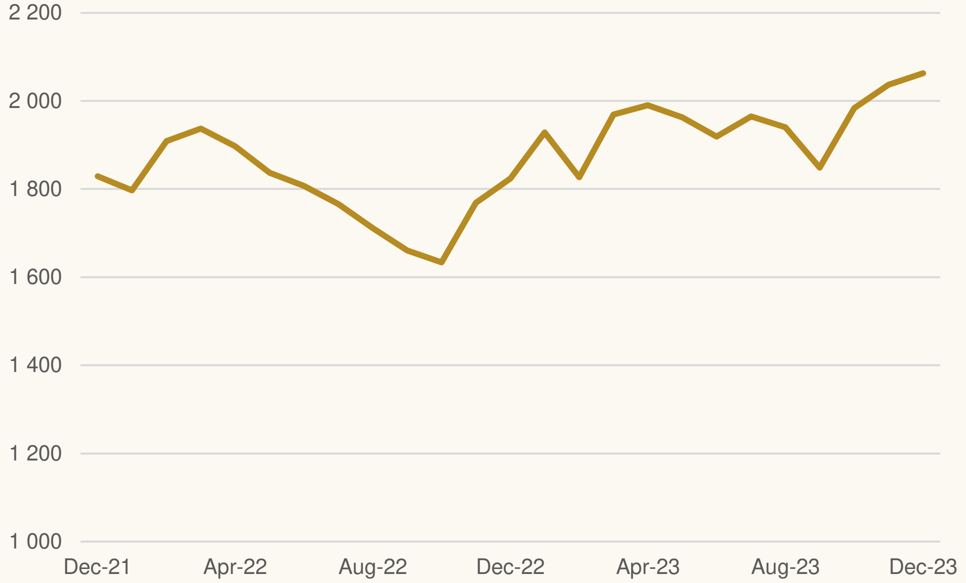


The fall in rates helped Gold climbing above historical highs, with a new record established in early December at $2072/oz, surpassed at the end in the month at $2077. With rates set to decline in the coming months as the economy recedes and the $2060 resistance now in the rearview, **tailwinds are multiplying for the yellow metal.**

The fall in rates helped Gold climbing above historic highs.

GOLD

EVOLUTION OVER 2 YEARS



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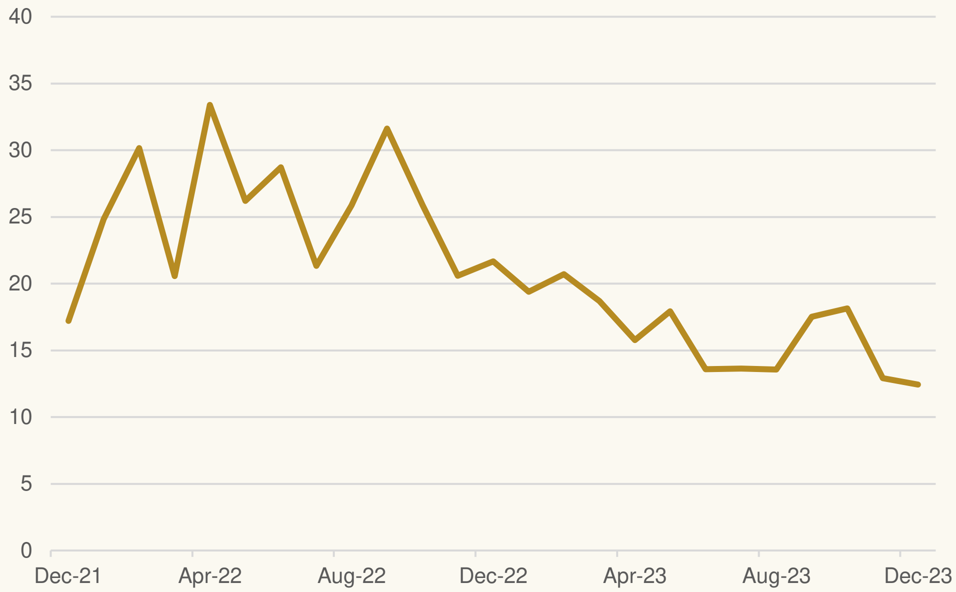
VOLATILITY

VOLATILITY – VIX INDEX
EVOLUTION OVER 2 YEARS



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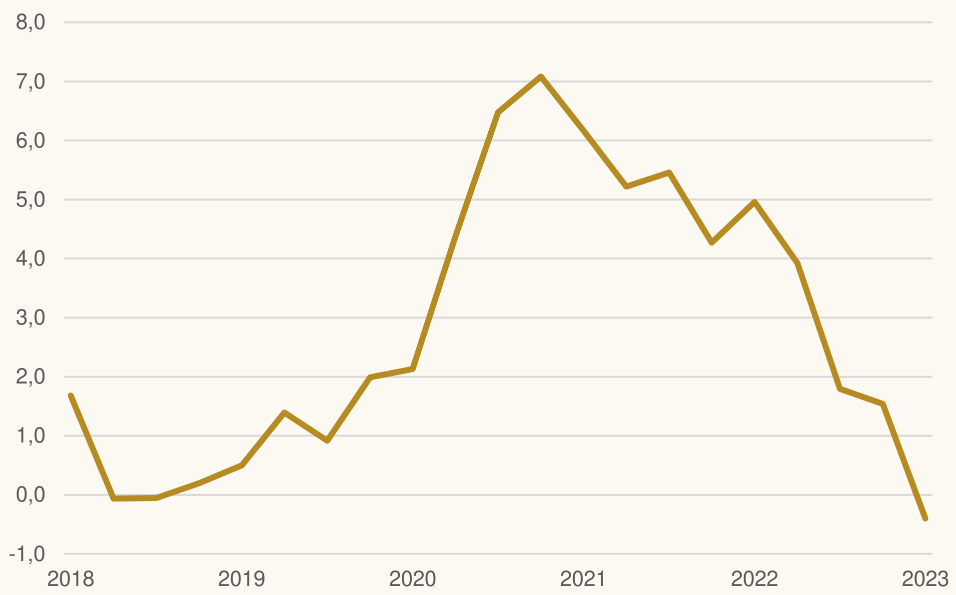
REAL ESTATE

SWISS RESIDENTIAL REAL ESTATE
ANNUAL PRICE CHANGE



Source: Bloomberg, 12/31/2023
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CALENDAR

Date	Country	Economic Data	Period	Previous
04 January	Eurozone	Markit Services PMI	Jan-24	48,1
	UK	Markit Services PMI	Jan-24	52,7
	Japan	Nikkei Manufacturing PMI	Jan-24	47,9
05 January	US	Employment (000s)	Dec-23	199,0
	US	Unemployment Rate (%)	Dec-23	3,7
	US	ISM Non-Manufacturing Index	Dec-23	52,7
	Eurozone	Inflation (YoY)	Dec-23	2,4
08 January	Switzerland	Inflation (YoY)	Dec-23	1,4
09 January	Eurozone	Unemployment Rate (%)	Nov-23	6,5
	Germany	Industrial Production (MoM)	Nov-23	-0,4
	Switzerland	Unemployment Rate (%)	Dec-23	2,1
11 January	US	Inflation (YoY)	Dec-23	3,1
12 January	China	Exports (YoY)	Dec-23	0,5
	China	Inflation (YoY)	Dec-23	-0,5
15 January	Eurozone	Industrial Production (MoM)	Nov-23	-0,7
16 January	UK	Unemployment Rate (%)	Aug-23	4,3
17 January	US	Industrial Production (MoM)	Dec-23	0,2
	China	Retail Sales (YoY)	Dec-23	10,1
	China	Real GDP (YoY)	Dec-23	4,9
	China	Industrial production (YoY)	Dec-23	4,3
	UK	Inflation (YoY)	Dec-23	3,9
18 January	US	Philadelphia Fed Business Survey	Jan-24	-10,5
	Japan	Industrial Production (MoM)	Dec-23	-0,9
	US	Consumer Confidence	Jan-24	69,7
23 January	Japan	Bank of Japan Interest Rate (%)	Jan-24	-0,1
24 January	Eurozone	Markit Manufacturing PMI	Jan-24	44,4
	UK	Markit Manufacturing PMI	Jan-24	46,2
25 January	US	Real GDP (QoQ)	Dec-23	4,9
	Eurozone	ECB Interest Rate (%)	Jan-24	4,0
	Germany	Ifo Business Climate	Jan-24	86,4
29 January	Germany	Real GDP (QoQ)	Dec-23	-0,1
30 January	Eurozone	Real GDP (QoQ)	Dec-23	-0,1
	France	Real GDP (QoQ)	Dec-23	-0,1
	Italy	Real GDP (QoQ)	Dec-23	0,1
	Switzerland	KOF Leading Indicator	Jan-24	97,8
31 January	US	Federal Reserve Interest Rate (%)	Jan-24	5,5

LET’S TALK ABOUT IT.

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