Investment letter

Monthly review of global financial markets

SWISS CAPITAL IB

January 2025

MACROECONOMICS

As expected, the Fed cut interest rates by 25 bps, bringing the Fed Funds rate to 4.25%-4.5%. With this move, the FOMC wraps up a 100-bps easing in 2024. **The main takeaway from this meeting was the upward revision in inflation forecasts for 2025.** Both Headline and Core PCE inflation are expected to run at 2.5% between Q4 2024 and Q4 2025, which is a substantial departure from the Fed's objective. The stubborn inflation scenario has become the FOMC's baseline, with the return to 2% postponed to 2027. **The dot plots point only at two rate reduction next year** (median: 3.9% in 2025 and 3.4% in 2026) against four still expected three months ago. Rate setters now see the terminal rate near 3%, marginally higher than 2.9% in September. **It is a sign that we are entering a new phase in the easing campaign: the bar for cutting is now higher**.

That said, the outlook on growth is better. The Fed expects GDP to grow by 2.5% in 2024 and 2.1% in 2025. Powell said that the economy has been "*remarkable*", especially in comparison with the rest of the world. Under such a scenario, the economy is bound for a "no landing". This was confirmed by **the upward revision of Q3 GDP from 2.8% to 3.1% annualized**. And PMIs also mirror a strong growth environment in Q4: the Composite hit 56.6 (vs 54.4 exp.) with Services running at 58.5 (vs 55.7 exp.) their highest since October 2021. Surveys reflect enthusiastic businesses, as the incoming Trump administration is widely expected to prove business friendly.

Accordingly, the labour market is in good shape with 227 000 jobs added in November and a 56 000 upward revision to September and October reports. But according to the Fed, the continuing normalization in job openings (7.74 million in Oct.) combined with solid productivity (+2.2% in Q3), implies that the labour market is no longer an inflationary threat.

A NEW PHASE IN THE FED'S EASING CAMPAIGN: THE BAR FOR CUTTING IS NOW HIGHER

The ECB also decided to cut its key interest rates by 25 bps, bringing the DFR from 3.25% to 3%. It was the ECB's fourth cut in this easing campaign, the third in a row. The ECB acknowledged that the disinflation process is well on track and that monetary policy keeps restrictive. Tellingly, there was **a sense of dovishness** in the removal of the ECB's sentence highlighting the necessity to bring inflation back to 2% timely ("*[The Monetary Policy Council] will keep policy rates sufficiently restrictive for as long as necessary to achieve this aim*"). It shows that **the confidence acquired in the disinflation process has reached a new threshold.** Accordingly, inflation forecasts have been revised down in comparison with September (2.1% in 2025 vs 2.2% exp.). As for growth, the ECB's projections are congruent with the message sent by poor recent PMIs. Even if the ECB highlighted that the dialling down of monetary policy restrictiveness should support consumption and investment over time, **growth projections have been revised down**: expectations are now for 0.7% in 2024 (vs 0.8% in September) and 1.1% in 2025 (vs 1.3%).

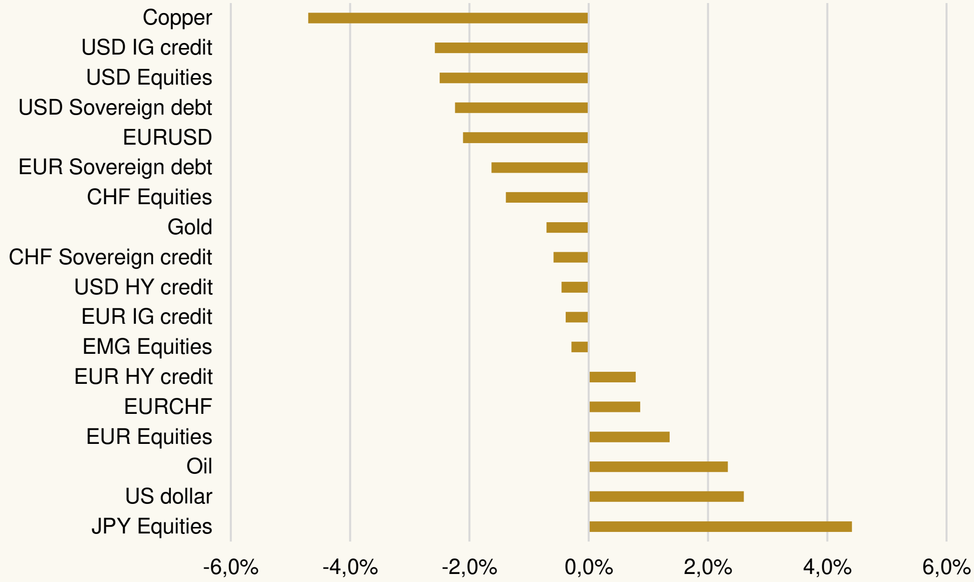
Going forward, the main question is the size and depth of the cuts needed to boost the European economy again. Lagarde hinted that the (nominal) neutral rate may be between 1.75%-2.5%, which seems pretty high, given the Euro area's structural challenges (ageing, low productivity…). This issue will be discussed more in the coming meetings. It is at least an indication that **the path to 2% (the next 100 bps cuts) is cleared and will be covered soon, in H1 2025**.

With Germany still in recession in 2024, France heading for fiscal consolidation next year and risks of trade wars with the US, there are more and more reasons for the central bank not to lose time. However, as it is often the case with the ECB, the most likely outcome is a middle-edge: absent a huge surprise, **the ECB should remain gradual and proceed with back-to-back 25bps cuts**. Nothing else than its usual way to overcome the hawks-doves divide in the Governing Council.

In the UK, **the last meeting of the Monetary Policy Committee in 2024 saw the BoE hold rates constant at 4.75%.** The decision was no surprise, given the recent bounceback in inflation. But two elements hint at a dose of dovishness in the central bank's decision: the smaller-than-expected margin in favour of holding rates instead of cutting (6-3 vs 8-1 exp.) and the decision to attribute the latest increase in wages (+5.2% after +4.4%) to "volatility" in the data. **The MPC also conveyed that the economy is slowing, acknowledging that Q4 GDP growth will be flat.** It would come on the heels of an already zero growth in Q3 (GDP was downwardly revised from +0.1% q/q to 0% q/q). PMIs have nosedived in recent months: the Composite is just in expansion territory at 50.5, with Services at 51.4 and Manufacturing at 47.3. Going forward, the conjuncture increasingly sends signs of turning stagflationary.

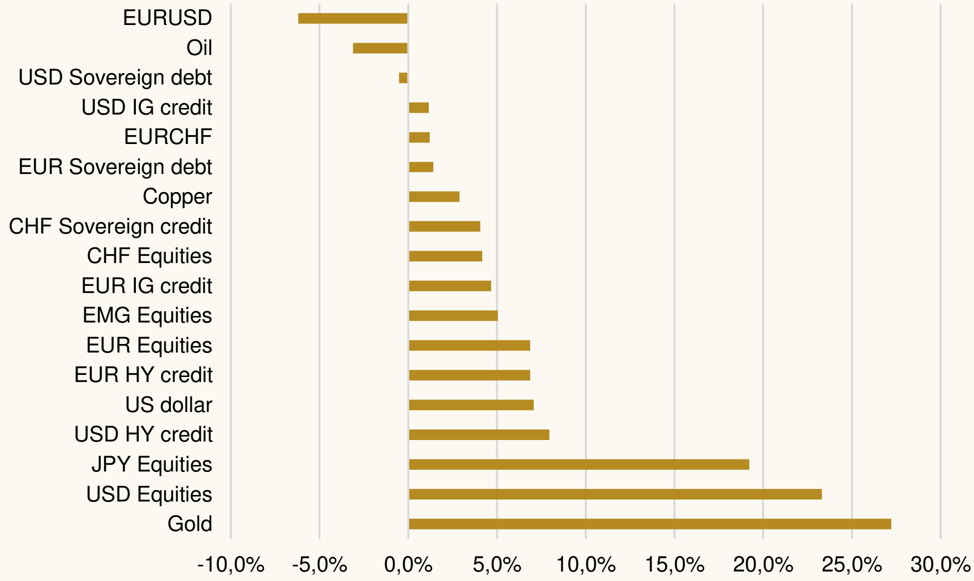
OVERVIEW

MAIN ASSET CLASSES
MONTHLY PERFORMANCE



Source: Bloomberg, 31/12/2024

MAIN ASSET CLASSES
PERFORMANCE YEAR-TO-DATE



Source: Bloomberg, 31/12/2024
Past performance is not indicative of future performance

MACROECONOMICS (CONTINUED)

The BoJ left its policy rates unchanged at 0.25%, explaining its decision in a speech that proved less hawkish than expected. 2024 will stay as a landmark for the BoJ, with the central bank hiking twice (20 bps in March and 15 bps in July) and, above all, putting an end to the NIRP era. But Kazuo Ueda hinted that the central bank needs "one more notch" of information to tighten policy further. It is seemingly **too soon to be certain that next spring's shunto negotiations will lead to substantial wage increases**. November inflation figures (Headline: +2.9%., Core: +2.7%) give credence to the hypothesis of a hike soon next year. PMIs picked up with Services rising to 51.4 and Manufacturing to 49.5.

In Switzerland, the SNB delivered a surprisingly deep cut. It lowered its policy rate by 50 bps, bringing it from 1% to 0.5%. With inflation lodged near the bottom of the SNB's 0-2% inflation range target, the SNB decided to go big. **Inflation was just 0.7% in November** and the risk is clearly downward in the near term, as electricity prices will drop by 10% in January. These slowing-prices outlook is mirrored in the SNB's updated forecast, with **an obvious decline from 0.6% to 0.3% in the 2025 inflation outlook**. Low rates are expected to put a floor under economic activity (GDP: +1-1.5% in 2025) and should cap the rise in unemployment (2.6% in Nov.). Going forward, negative rate policies are an increasingly likely option for the SNB.

In China, **the December CEWC** (Central Economic Work Conference) **will be added to the growing list of disappointments for investors**. It could have been an opportunity for authorities to deliver a highly expected fiscal stimulus, which they did not. Instead, the PBoC updated its doctrine for the first time since 2011, **shifting from a "prudent" to a "moderately loose" stance**. But this is hardly enough: Caixin Manufacturing and Services PMIs (both 51.5) are just marginally higher than before the government's September announces. Retail Sales are subdued (+0.2% m/m) and the economy is still on the edge of deflation (CPI: +0.2% y/y, -0.6% m/m). **Tellingy, the 10-year yield dropped below 2% and the 1-year south of 1%.**

EQUITY MARKETS

THE TURBULENT CONTEXT DID NOT STOP THE AMERICAN TECH GIANTS FROM STANDING OUT

Major event of the final stretch of the year, the December FOMC significantly cooled equity markets (S&P 500: -2.5%, NASDAQ 100: +0.4%). **The Fed's less confident tone about disinflationary forces** and the prospect of rates decreasing by only 50 basis points (compared to the 100 hoped for in September) brought back volatility, marking the second-highest VIX peak in 2024, reaching 27. The subsequent correction was sharp (the worst FOMC day for the S&P 500 since 2001) but short-lived. However, it's important to note that all indicators remain green for U.S. economic activity. GDP growth for Q3 was revised from +2.8% to +3.1% quarter-over-quarter on an annualized basis. The Fed forecasts +2.1% growth from the end of 2024 to the end of 2025, and PMIs continue to exceed expectations (Composite 56.6 vs. 54.4 expected). The market's reaction to the Fed's announcements might give us a preview of the coming months, when new political uncertainties (such as the return of Donald Trump) will add to existing economic and technological questions.

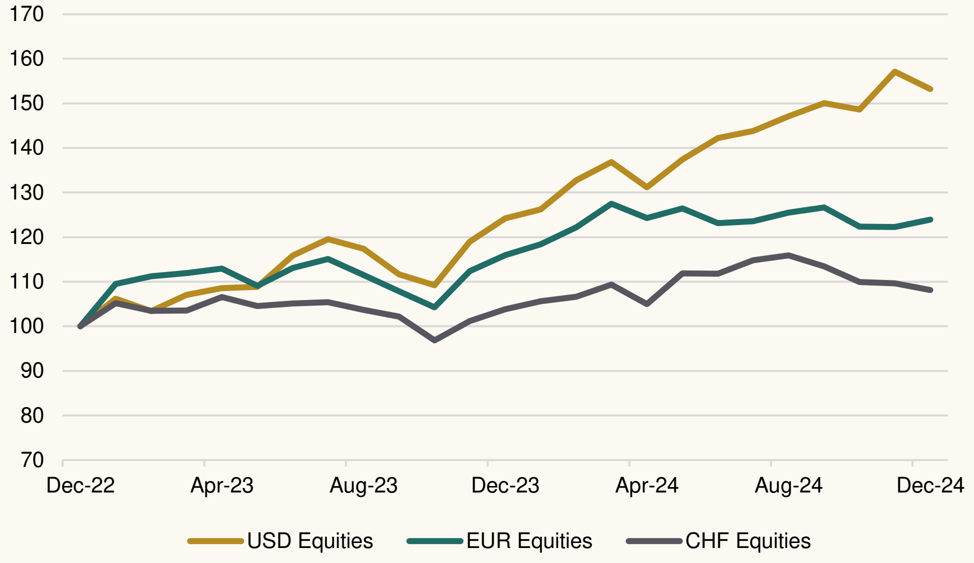
This turbulent context hasn't stopped **the American tech giants from standing out.** Have they become safe havens? In any case, the **BAATMMAN group (with the addition of Broadcom – up +43.0% in December – to the league of tech giants worth over $1 trillion)** benefited from excellent news on the AI development front: new chips for data centers, autonomous driving, advancements in quantum computing… Thus, December's S&P 500 sector performance perfectly reflects the past year. Leading the pack were Communication Services (+3.5%), which include Meta and Alphabet, followed by Consumer Discretionary (+2.3%), which includes Tesla and Amazon, and Technology (+1.1%). All other sectors ended December in the red. Many sectors displayed performances opposite to the prior month (Industrials: -8.1% after +7.3%, Energy: -9.3% after +6.3%, Financials: -5.6% after +10.2%, Consumer Staples: -5.2% after +4.5%). Thus, while U.S. indices can still be considered expensive, **the post-presidential-election rally has been completely wiped out outside of tech.**

Europe continued to struggle (Stoxx 600 Europe: -1.1%) despite a dovish tone from the ECB, which opened the door to multiple rate cuts next year. The blame lies with growth that remains stagnant—far from recovering. **The PMIs (Composite: 49.5 vs. 48.2 expected)** leave little doubt about the recession looming in Q4 2024. And the outlook for 2025 is not much brighter. Worse, the European market was weighed down by **Novo Nordisk's collapse (-21.0%) following disappointing results for its new anti-obesity drug, CagriSema.** At the other end of the spectrum, the Auto sector began to rebound after two disastrous quarters (SXAP: +4.1%). Renault (+15.1%) benefited from discussions between Honda and Nissan (in which it holds a 36% stake), and Volkswagen's (+10.1%) deep restructuring plan boosted its stock. But there is still a long road ahead.

In China, **markets struggled to find direction (CSI 300: -0.4%)**, offering a snapshot of Chinese stock behavior since September. First, there was another monetary announcement: this time, a doctrinal shift by the PBoC, moving from a "prudent" stance to a "moderately accommodative" one. This rekindled hopes for fiscal stimulus… but ultimately failed to materialize, despite all eyes turned to Beijing for a major CCP meeting (the Central Economic Work Conference).

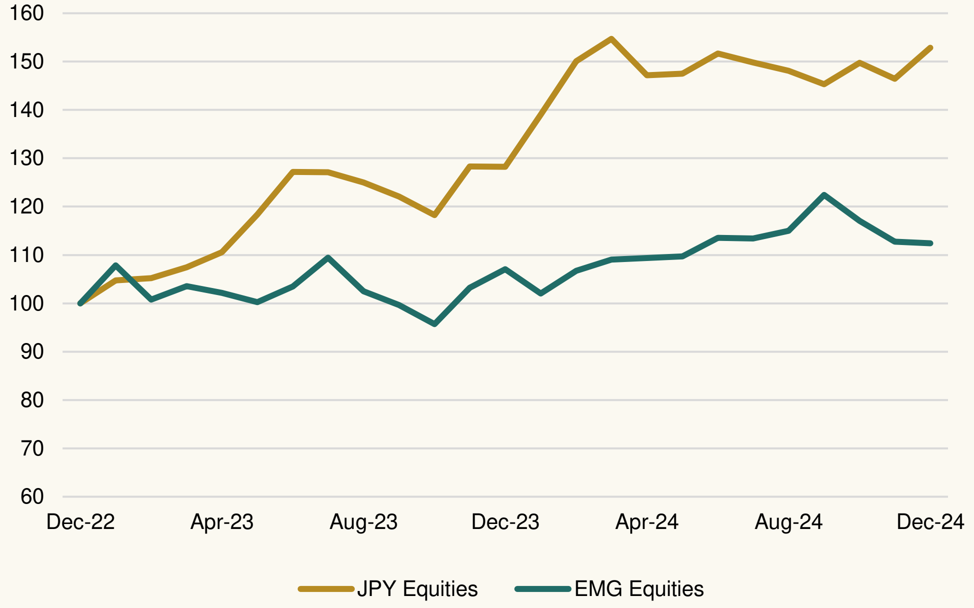
EQUITY MARKETS

EQUITY MARKETS EUR USD CHF
PERFORMANCE OVER 2 YEARS



Source: Bloomberg, 31/12/2024

EQUITY MARKETS JAPAN – EMERGING MARKETS
PERFORMANCE OVER 2 YEARS



Source: Bloomberg, 31/12/2024
Past performance is not indicative of future performance

BOND MARKETS

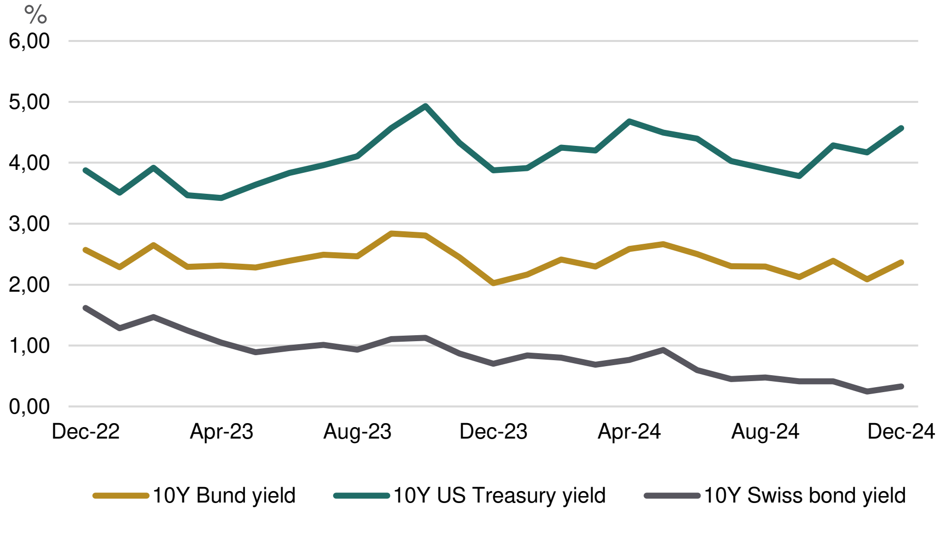
2024 was not the year of the bond rally that many strategists were predicting at the beginning of January. Even though the central banks made considerable progress with their monetary easing (100bp of cuts for the FED and the ECB), volatility remained high throughout the year on the long and intermediate parts of the curve, due to still strong growth in the US, very slowly falling inflation and still high deficits. December was a good example of these difficulties, with US and European 10-year yields up by 40bp and 28bp respectively.

In contrast, the credit market experienced little volatility in 2024, and even no major upheavals over 12 months, thanks to very healthy balance sheets in the private sector and well-oriented equity markets apart from the episode in August (unwinding of carry trade positions). The HY and subordinated segments largely outperformed investment grade debt, with the search for yield the main motivation for 2024.

On interest rates, we expect less amplitude in movements in 2025 in view of a Fed that has well limited expectations (maximum 50bp cut). In credit, we expect the market to be less linear (spreads are already very tight) and the premium on cyclical names to return.

> DECEMBER IS A GOOD EXAMPLE OF THE CHALLENGES FACED BY BOND MARKETS IN 2024, WITH 10-YEAR US AND EUROPEAN YIELDS RISING.

10Y SOVEREIGN BOND YIELDS
EVOLUTION OVER 2 YEARS



Source: Bloomberg, 31/12/2024
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CURRENCIES

After the boost provided by Trump's victory in the US presidential election, **the dollar found another tailwind in the Fed's hawkish December speech (DXY: +1.9%)**. The central bank's inflation forecasts have been revised up for next year and **rates will thus keep higher for longer**. In parallel, growth is expected to run above 2% next year and Q3 GDP growth was updated to +3.1% q/q annualized (from +2.8% in early estimates). Thus, forces have aligned to support the greenback. The DXY ventured to a new 2-year high at 108.5.

The EUR lost ground in December (EURUSD: -1.4%), as the ECB opened the door to fresh cuts in early 2025 while growth remained subdued. With political crises in Germany and France, little could prevent EURUSD to fall from 1.035 to parity and drop to 2022 lows.

The CHF took a battering after the SNB opted for a jumbo 50-bp rate cut (CHFUSD: -2.3%). Also, Martin Schlegel made clear that negative rates are in the SNB's toolbox and cannot be ruled out. All this helped to weaken the CHF which turns out to be too strong for the economy.

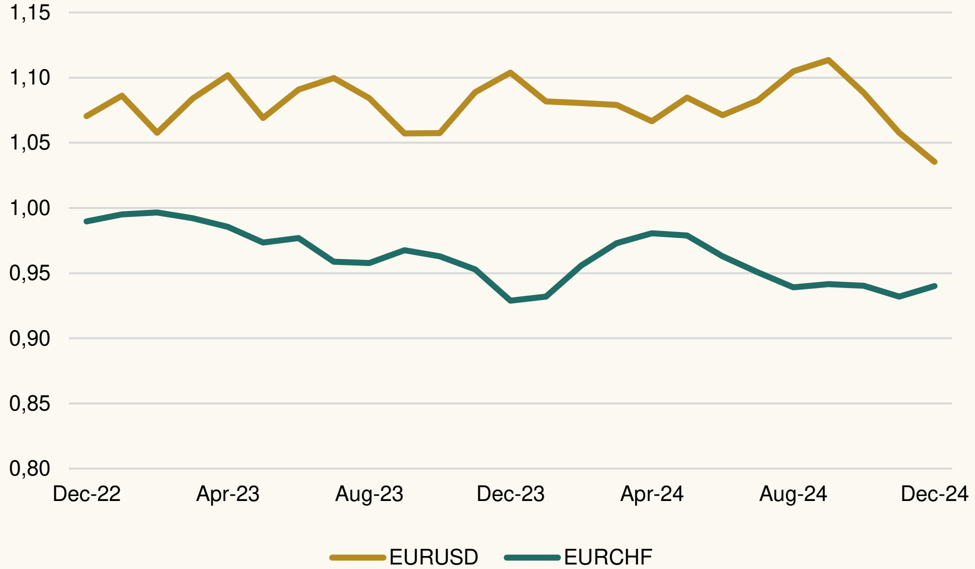
The GBP weathered the dollar's strength remarkably due to a new batch of high inflation figures, fueling bets of higher-for-longer BoE rates. Even if it is becoming clear that the UK and the US will be the two major economies keeping a higher-for-longer stance in 2025, **the BoE's dovishness at its December's meeting finally weighed on the pound (GBPUSD: -1.1%).**

The JPY was severely punished after the BoJ's choice not to hike, holding its policy rate at 0.25% **(USDJPY: +5.1%)**. In the aftermath of the decision, the USDJPY peaked above 157, a 5-month high (after 162 in July). But a stronger-than-expected Japanese inflation report revived hopes that a rate hike could materialize soon in 2025.

> **THE DOLLAR FOUND ANOTHER TAILWIND IN THE FED'S HAWKISH DECEMBER SPEECH**

USD & CHF

EVOLUTION OVER 2 YEARS AGAINST THE EUR



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COMMODITIES

OIL

Oil prices lacked direction for most of December, before rising in the last days of the month. **Brent seesawed in a $71-74 range, ending with a decent +3.9%.**

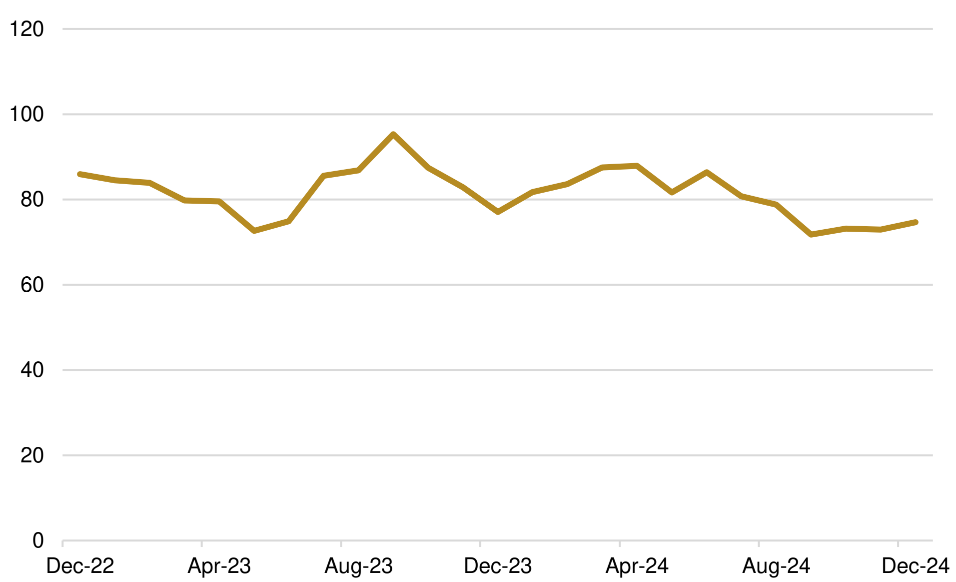
The recent OPEC+'s decision to postpone the easing of its voluntary production cuts by three months and to extend the gradual increase period by nine months, now running through September 2026, has significantly mitigated the risk of a potential supply surplus in the near term.

However, ongoing overproduction by certain OPEC+ members, strong output growth from non-OPEC+ nations, and moderate global oil demand growth suggest the market will remain well-supplied in 2025. Moreover, a strong US dollar put a lid on oil prices. We keep our bearish stance on crude oil, on a tactical investment horizon.

Strong output growth from non-OPEC+ nations, and moderate global oil demand growth suggest the market will remain well-supplied in 2025.

OIL

EVOLUTION OF BRENT PRICES OVER 2 YEARS



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COMMODITIES

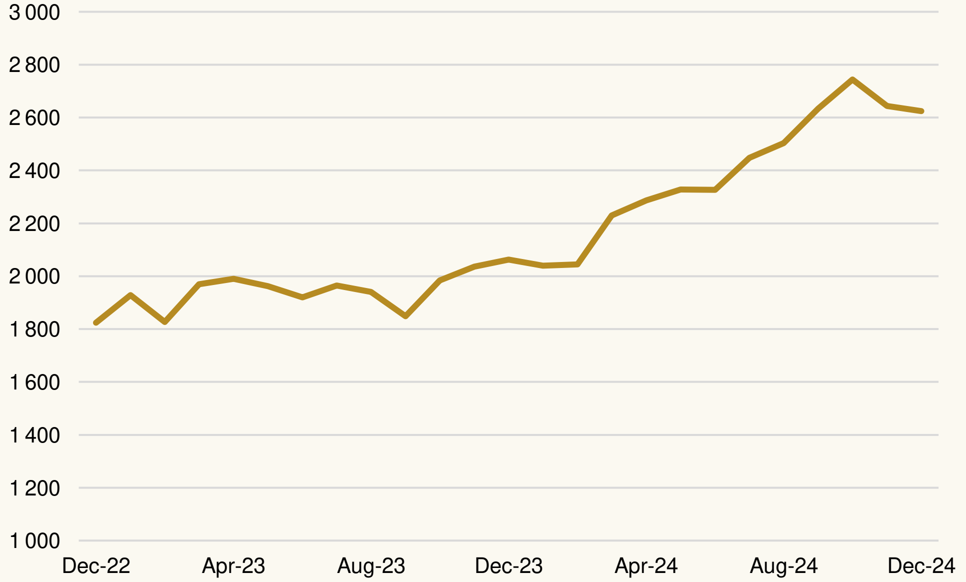
GOLD

Gold (-0.6%) and Silver (-5.3%) failed to maintain their momentum. They even tumbled on the heels of the Fed's hawkish speech. **After defying economic laws through the year, they found back their inverse correlation with yields and the dollar.** Silver underperformed Gold obviously in the sell-off. Gold retested a $2600 support three times, but it bounced back each time. However, both metals showcase stellar returns over the year (Gold: +27.5%, Silver: +22.1%).

Both Gold and Silver showcase stellar returns over the year.

GOLD

EVOLUTION OVER 2 YEARS



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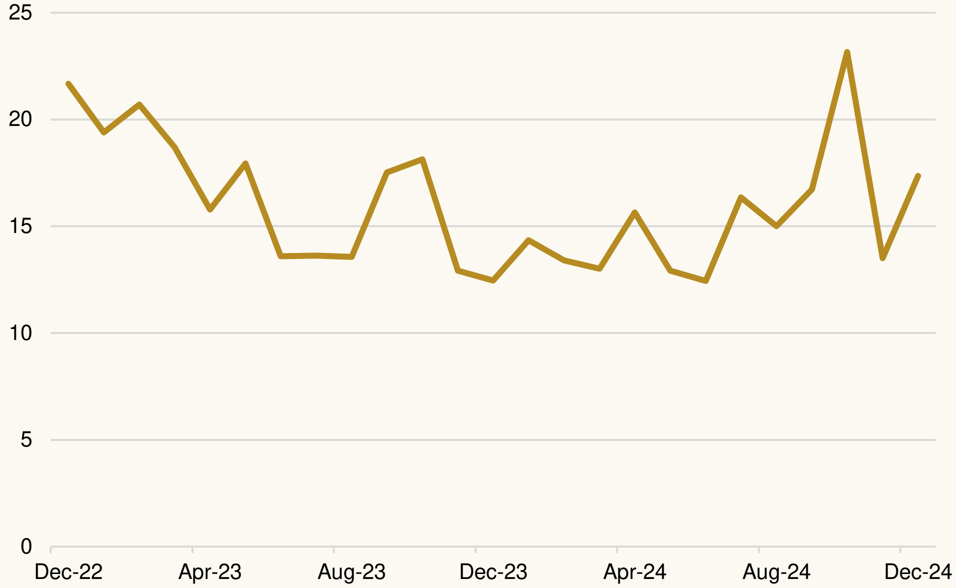
VOLATILITY

VOLATILITY – VIX INDEX
EVOLUTION OVER 2 YEARS



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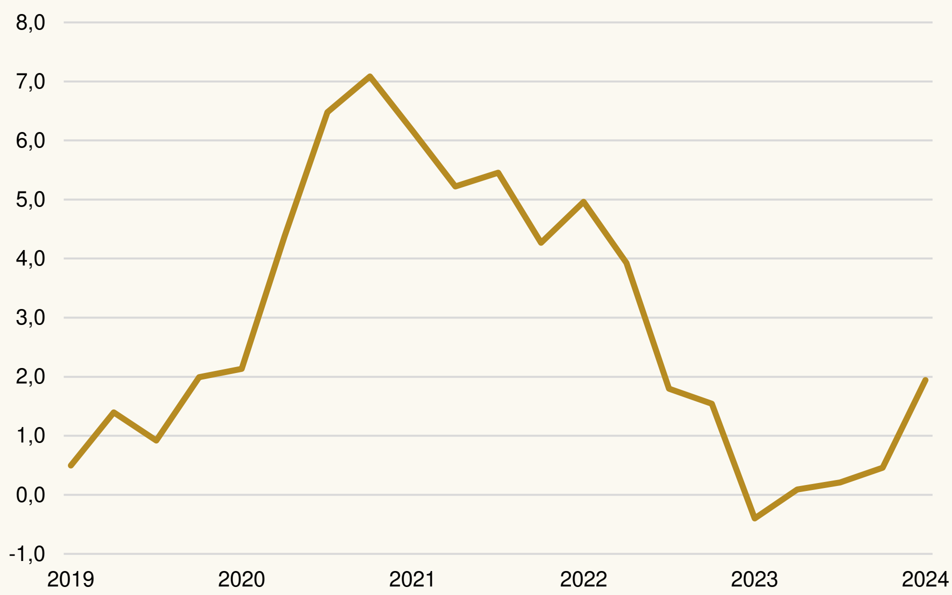
REAL ESTATE

SWISS RESIDENTIAL REAL ESTATE
ANNUAL PRICE CHANGE



Source: Bloomberg, 31/12/2024
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CALENDAR

Date	Country	Economic Data	Period	Previous
07 January	US	ISM Non-Manufacturing Index	Dec-24	52,1
	Eurozone	Inflation (YoY)	Dec-24	2,3
	Eurozone	Unemployment Rate (%)	Nov-24	6,3
	Switzerland	Inflation (YoY)	Jan-25	0,6
08 January	US	Fed minutes	Apr-26	
09 January	China	Inflation (YoY)	Dec-24	0,2
	Germany	Industrial Production (MoM)	Nov-24	-1,0
10 January	US	Consumer Confidence	Jan-25	74,0
	US	Employment (000s)	Dec-24	227,0
	US	Unemployment Rate (%)	Dec-24	4,2
	Switzerland	Unemployment Rate (%)	Dec-24	2,6
13 January	China	Exports (YoY)	Dec-24	6,7
15 January	US	Inflation (YoY)	Dec-24	2,7
	Eurozone	Industrial Production (MoM)	Nov-24	0,0
	UK	Inflation (YoY)	Dec-24	2,6
16 January	US	Philadelphia Fed Business Survey	Jan-25	-16,4
17 January	US	Industrial Production (MoM)	Dec-24	-0,2
	China	Retail Sales (YoY)	Dec-24	3,0
	China	Real GDP (YoY)	Dec-24	4,6
	China	Industrial production (YoY)	Dec-24	5,8
20 January	Japan	Industrial Production (MoM)	Dec-24	-2,3
21 January	UK	Unemployment Rate (%)	Nov-24	4,3
24 January	Eurozone	Markit Manufacturing PMI	Jan-25	45,1
	Eurozone	Markit Services PMI	Jan-25	51,6
	UK	Markit Manufacturing PMI	Jan-25	47,0
	UK	Markit Services PMI	Jan-25	51,1
	Japan	Nikkei Manufacturing PMI	Jan-25	49,6
27 January	Germany	Ifo Business Climate	Jan-25	84,7
29 January	US	Federal Reserve Interest Rate (%)	Jan-25	4,5
30 January	US	Real GDP (QoQ)	Dec-24	3,1
	Eurozone	ECB Interest Rate (%)	Jan-25	3,0
	Eurozone	Real GDP (QoQ)	Dec-24	0,4
	France	Real GDP (QoQ)	Dec-24	0,4
	Germany	Real GDP (QoQ)	Dec-24	0,1
	Italy	Real GDP (QoQ)	Dec-24	0,0
	Switzerland	KOF Leading Indicator	Jan-25	99,5
31 January	China	Caixin Manufacturing PMI	Jan-25	50,5

LET'S TALK ABOUT IT.

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DISCLAIMER