HOUSE VIEWS

January 2024

2024: back to normal?

An unusual cycle ends with a strong market rally. 2023 ended on a sharp rally by nearly all asset classes which made good much of the decline seen in 2022. Underpinning these gains are hopes for big central bank rate cuts in 2024. Evidently, investors believe the worst period of inflation is now behind us and price pressures and monetary policy are moving back toward some kind of “normal”. At the same time, economies continue to show proof of resilience, most obviously in buoyant job markets while resorbing the excess savings – one of the key characteristics of this unusual cycle. We agree with investors that the end of this unusual cycle is near. Inflation is retreating and central bank rates are approaching their pivot points. Nonetheless, we remain cautious about how quickly we will get back to normal. Progress could be quite gradual. What is more, we may be dealing with a new normal for some time to come. The structural factors of recent years – e.g., deglobalisation and a path to net zero - remain in play and will continue to affect growth and inflation going forward.

We remain Overweight bond markets and US equities. We retain a highly diverse global positioning, which has allowed us to catch the rally in equities while retaining protection against any correction. We maintain our preference for the US equity market, which should continue to benefit from a resilient economy. In contrast, we are Underweight Emerging Markets as investors are showing a lasting reluctance to return to the Chinese equity market. Meanwhile, we remain Overweight bond markets, particularly Investment Grade corporate bonds. The looming pivot by central banks makes corporate debt especially attractive, notably as a means to lock in today's yields. Moreover, defaults by highly-rated companies remain rare with most still sitting on solid balance sheets.

Unless specified, all figures and statistics in this report are from Bloomberg and Macrobond on 12/01/24, publication completion date.

OUR STRONGEST CONVICTIONS

Economic soft landing

Recent data has continued to point to resilience in the US economy, in line with our scenario of a soft landing. In Europe, growth is likely to remain sluggish. A recession in either the US or Europe does not seem the most likely scenario. The delayed impact of monetary policy and the resorption of excess savings should be offset by a boost to household purchasing power from the fall in inflation.

Central banks: moderate rate cuts expected

Inflation reached levels close to 3% year-over-year in the United States and the euro area at the end of 2023, compared with peaks of at least 9%. Against this backdrop, central banks are likely to begin a cycle of rate cuts this year. They could, however, remain cautious and cut rates only gradually given persistent tensions in the labour market, which may only allow a slow return to the 2% inflation target.

Playing the diversification card

In 2023, the majority of asset classes experienced both high volatility and positive performances. Consequently, broad diversification was beneficial. Given the pivot of central banks, the economic slowdown and geopolitical risks, we have decided to maintain a global diversified position.

Preference for US equity markets

Equity markets should benefit in 2024 from the same tailwinds as in late 2023: the prospect of lower key interest rates and inflation, against a backdrop of resilience in the global economy and corporate earnings. These favourable factors should persist into 2024. We remain overweight US equities: despite a gentle slowdown ahead, the US economy is likely to remain stronger than its peers, supporting US corporate earnings. We are also maintaining our underweight on Emerging Markets mainly due to the continuing difficulties of the Chinese economy.

A favourable environment for corporate bonds

In 2024, the policies of the main central banks will come to a head against a backdrop of falling inflation: given the persistently high level of interest rates, bond markets remain attractive, especially highly rated corporate bonds. We are maintaining our overexposure to the latter, which not only offer an attractive carry but should also benefit from solid corporate balance sheets.

Remaining neutral on the dollar

Changes in monetary policy have been the main driver of currency movements in 2023 and we anticipate this will be the case in 2024 too. We expect the Fed, ECB and BoE to cut rates in near-synchrony. Therefore, we are maintaining our neutral stance on these currencies.

Gold underweight maintained

Despite a strong end to the year for gold - partly due to the fall in the dollar and interest rates - we are maintaining our underweight position in the metal, which appears less attractive in the context of high interest rates.

OUR ASSET ALLOCATION

The table below presents the latest conclusions of our Global Investment Committee (GIC).

Summary house views

			UW	Slight UW	N	Slight OW	OW	Variation since previous GIC
EQUITY		GLOBAL EQUITY			■			=
EQUITY		United States				■		=
EQUITY		Euro area			■			=
EQUITY		United Kingdom			■			=
EQUITY		Japan			■			=
EQUITY		Emerging		■				=
FIXED INCOME	SOVEREIGN	GLOBAL RATES				■		=
FIXED INCOME	SOVEREIGN	U.S. Treasuries			■			=
FIXED INCOME	SOVEREIGN	Bunds			■			=
FIXED INCOME	SOVEREIGN	Gilts			■			=
FIXED INCOME	SOVEREIGN	EM Govies ($)		■				=
FIXED INCOME	CORPORATE	U.S. IG				■		=
FIXED INCOME	CORPORATE	U.S HY		■				=
FIXED INCOME	CORPORATE	EMU IG				■		=
FIXED INCOME	CORPORATE	EMU HY		■				=
FIXED INCOME	CORPORATE	U.K. IG				■		=
FOREX		EURUSD			■			=
FOREX		USDJPY			■			=
FOREX		GBPUSD			■			=
FOREX		EURCHF		■				=
ALT.		Commodities			■			=
ALT.		Gold		■				=
ALT.		Hedge funds		■				=

Previous GIC : 22 November 2023

ECONOMIC OUTLOOK

Central banks to pivot on rates

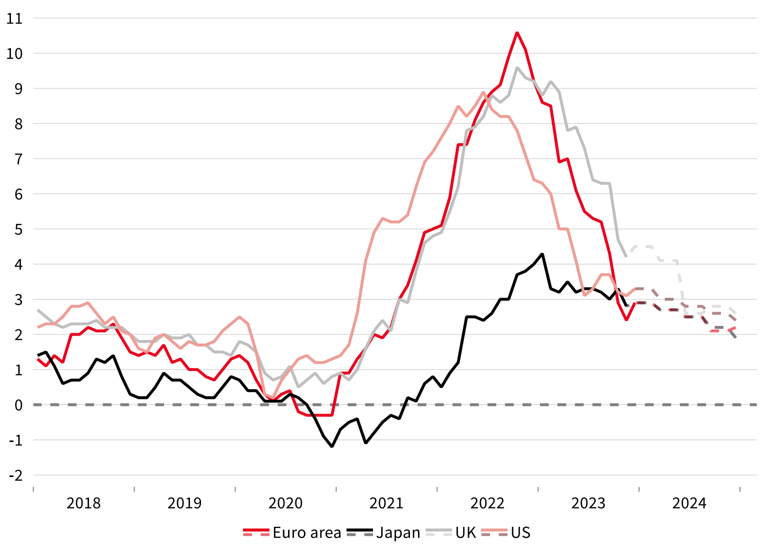
Highlights of our 2024 scenario: soft landing for the economy, inflation continues its gradual fall, central banks pivot and governments normalise fiscal policy at different paces.

Soft landing in the economy. We expect a gradual slowdown in developed economies. The run-down of excess savings and the impact of past monetary tightening will likely depress economic prospects. On the other hand, still healthy labour markets and declining inflation should help bolster household purchasing power and avoid any drastic slowdown. The US economy should continue to grow faster than Europe's, thanks in part to a more accommodative fiscal policy in a highly contested election year. Meanwhile in China, the economy will likely continue to be hampered by its troubled real estate market.

Inflation continues to fall, but some effects linger on. Inflation is falling in both the United States and Europe, to 3.4% year-over-year in the US, 2.9% in the euro area in December and 3.9% in the UK in November (compared to peaks of 9.1%, 10.6% and 11.1% a bit more than a year ago). Driving this is the fade-out of short-term inflationary factors due to Covid and of the surge in commodity prices. However, it is likely to be several months yet before the main central banks see underlying inflation return to its 2% target. Labour markets remain strong in both the United States and Europe and this should sustain some inflationary pressure via wages. In Europe, this effect will be exacerbated by weak productivity gains. Moreover, new structural inflationary factors are now coming through, including a softer pace of globalisation (pushing up import prices) and policies to combat global warming (pushing up energy prices).

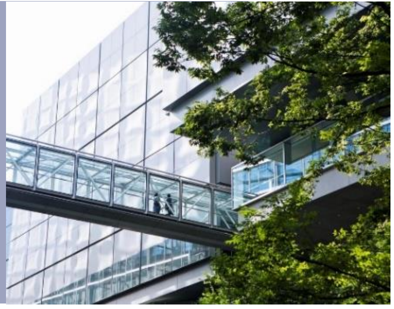
Central banks faced with asymmetric inflationary risks may opt for prudence. Central banks were tightening policy hard until the summer of 2023. The Federal Reserve (Fed) made its likely last hike in late July, the Bank of England in early August and the European Central Bank (ECB) in September. Markets are now pricing in a sharp and speedy reversal of policy with hefty rate cuts starting in March. However, with inflationary risks still tilted toward the upside, monetary authorities may opt to tread a more cautious line. We expect the main central banks to pivot in sync as from Q2 with rates then coming down at a gradual pace.

Headline inflation (year-over-year)
Bloomberg consensus forecasts



Sources: SGPB, Macrobond, Eurostat, NBS, ONS, BLS, SBJ 12/2024

EQUITIES



Preference for US equity markets maintained

Stock markets in 2024 should continue to ride the bull factors of 2023: falling interest rates and inflation, a resilient global economy and sustained corporate earnings. We remain overweight on US and underweight on EM.

Style preferences

	Growth	Value
United States	Blended	
Euro area	Blended	
United Kingdom		

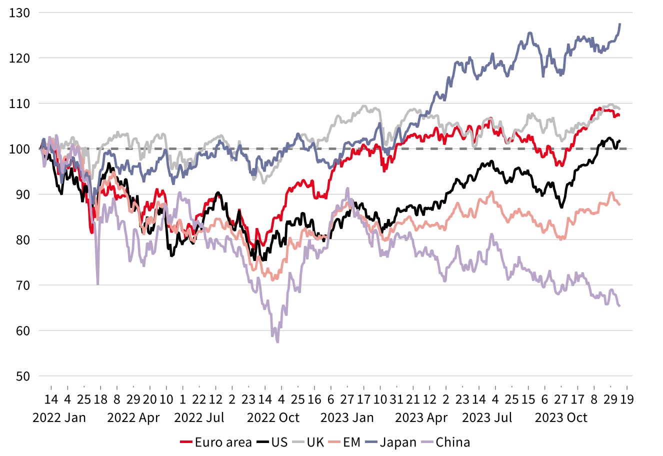
United States. 2023 got off to a flying start with stock markets putting on 15% in January alone. Later, they fell back as a banking turmoil erupted in March and 10-year yields and oil prices shot up between June and October. However, as inflation retreated and the rate outlook improved, US markets mounted a 25% rally in the final few months of the year, with AI-exposed stocks leading the charge. This has left stocks trading on apparently high valuations both in absolute terms and compared to bond yields. Nonetheless, corporate profits should remain strong as the economy completes its soft landing. Finally, momentum and sentiment indicators are in positive territory, suggesting the strong performance should continue. We therefore retain our preference for United States equity markets.

Euro area. European markets had a remarkable performance in 2023, up more than 20% despite meagre domestic demand across the zone. As in the United States, falling 10-year yields meant 2023 finished on a positive note. Euro area markets continue to trade on attractive multiples – price/earnings ratios and spreads to bond yields are both close to their long-term average. Nonetheless, corporate profit margins are likely to remain modest amid weak growth and a persistently strong labour market. We therefore remain Neutral on European equities.

United Kingdom. The UK market lagged its peers in 2023, gaining just 8%, partly due to heavy exposure to energy stocks. However, valuations remain near their long-term average and upcoming bank rate cuts should provide some support. We therefore remain Neutral on the UK market.

Japan. The Japanese stock market advanced 28% in 2023 making it one of the year's top performers. Most of the gains happened between March and September as markets priced in reflation and a likely end to the Bank of Japan's yield curve control policy. With the economic story unchanged going into 2024, we remain Neutral on the Japanese equities market.

Equity markets: 2023 gains (partly) offset 2022 losses.



Sources: SGPB, Macrobond, MSCI 10/01/2024

Emerging Markets. We remain Underweight emerging markets largely due to our scepticism about the economic outlook in China. Chinese equities posted one of the weakest performances of any market in 2023, losing 12% of their value as the expected post-Covid rebound disappointed and the property market struggled. Real estate is likely to remain weak in 2024, hence our Underweight.

FIXED INCOME

Bonds, particularly corporate bonds, remain attractive.

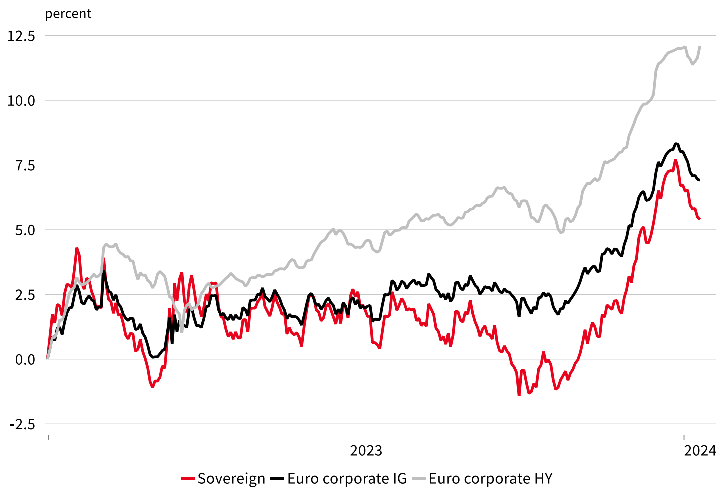
2024 will bring the pivot in main central bank rates as inflation retreats. This means that, despite a price surge in late-2023, bond markets remain attractive, particularly IG corporate credits.

Rates

United States. 2023 was a year of volatility for sovereign debt. Following the spring banking turmoil, US 10-year yields took a rising path from May, attaining a 10-year high of 5% by October on fears of sticky inflation, only to drop back thereafter to 3.8% in late December. They then recovered somewhat, again topping 4%. Markets expect the US Federal Reserve (Fed) to pivot soon – discounting a 60% probability of a rate cut by March – and to cut rates sharply by 150 bps by year-end. Falling inflation plus some signs the labour market may be slowing should be enough to justify an easing of monetary conditions. The Fed may however opt for prudence and ease policy gradually as inflation edges down. In either case, the prospect of a Fed pivot boosts the appeal of bond markets, based both on current attractive yields and expectations of a further boost to valuations. We remain Neutral on US bonds with a duration Overweight.

Euro area. Yields in Europe experienced similar volatility to the US in 2023. Having risen more slowly than US yields, most yields across Europe peaked in October with the French OAT at 3.5% and the German bund at 2.9%. Peripheral debt tracked a similar path. The Italy-Germany spread was a striking 150-200 bps in 2023. Yields subsequently fell back after November inflation figures showed a surprisingly sharp drop, allowing European bond markets to outperform their US equivalents. Since new year, yields have edged upward but markets still expect the ECB to ease policy soon – 80% probability of first cut by April – and sharply – by 150 bps by year-end. Like the Fed, the ECB may prove more cautious than markets expect as inflation is still showing signs of stickiness. Whatever the timing, the upcoming ECB pivot adds to the appeal of European bond markets. We remain Neutral on zone bonds with a duration Overweight.

Euro area: strong bond market performance



Sources: SGPB, Macrobond, 10/01/2024

United Kingdom. UK inflation may have surprised on the downside recently, but it remains well above European and US rates. Markets expect the Bank of England to pivot later (not before summer) and ease less sharply than other central banks. We remain Neutral on Gilts and Overweight duration.

Credit

Developed Markets. We remain Overweight investment grade corporate debt which offers better carry, despite a recent fall in yields, with limited risks under our soft-landing scenario.

Past performance does not prejudge future performance. Investments may be subject to market fluctuations, and the price and value of investments and the resulting revenues may fluctuate downward and upward. Your capital is not protected, and original investments may not be recovered.

CURRENCIES

Dollar Neutral in the short term

Currency market developments should continue to mirror monetary policy in 2024. We expect the Fed, the ECB and Bank of England to cut rates broadly in tandem. Consequently, we remain Neutral on these currencies. We also remain Neutral on the USD/JPY and Underweight the EUR/CHF.

Dollar index. The dollar fell only marginally against other major currencies during 2023, with the DXY index losing 1% year-on-year. However, this is slightly deceptive. Drilling down, the dollar lost up to nearly 4% over the summer before rebounding to a peak of 3% up year-to-date in October. This roller-coaster ride primarily reflected changing expectations of Fed monetary policy. Moreover, the stable DXY performance conceals some large geographical divergences: sharp rises against the JPY and CNY (+10% and +4%) but sharp falls against, notably, the MXN (-13%), BRL and CHF (both -8%) and to a lesser extent the GBP and EUR (-5% and -4%, respectively).

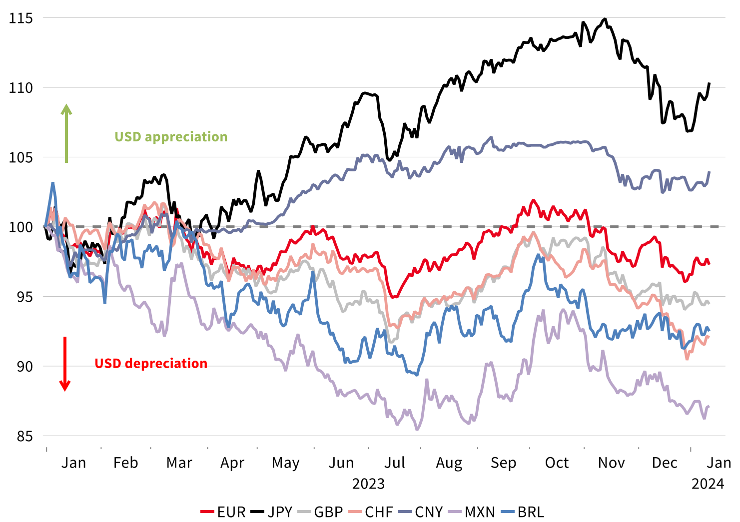
EUR/USD. Having fallen to USD 1.04 over the summer, the euro rallied strongly from October – topping USD 1.10 in late December as market sentiment about the monetary cycle improved. We remain Neutral on the EUR/USD. In the short term, we anticipate movements in the cross will continue to be largely driven by monetary policy and we expect the Fed and ECB to start cutting rates at roughly the same time. Longer term, balance of payments issues should come to the fore and with the euro area in surplus and the United States in deficit, this will play in favour of the euro.

GBP/USD. The British pound has essentially shadowed the euro's performance against the dollar since July – falling sharply from July to October and then rallying strongly until December. However, the story was very different in the first half of the year, when sterling made much stronger gains, partly reflecting the resilience of the UK economy. We remain Neutral on the GBP/USD as we expect both countries to move monetary policies in sync and both run trade deficits.

USD/JPY. The yen also gained ground against the dollar after October but had fallen sharply earlier in the year, by 15% at its lowest point. We remain Neutral on the USD/JPY. The yen should be strengthened by the divergence of US and Japanese monetary policy – Japan is looking to exit deflation and abandon its yield curve control policy while the Fed is expected to cut rates. However, we still predict policy tightening in Japan will be a gradual process given the country's weak economic activity.

EUR/CHF. The Swiss franc rose sharply against the euro in 2023, gaining 6% despite Switzerland's much lower inflation: 1.7% in December compared to 2.9% in the euro area. The franc was boosted by the Swiss National Bank (SNB) running down its foreign exchange reserves, the franc's safe-haven status and Switzerland's massive balance of payments surplus. These support factors should persist into 2024. We therefore remain Underweight the EUR/CHF.

USD vs. main currencies (100=01/01/2023)



Sources: SGPB, Macrobond, Macrobond 10/01/2024

EM currencies. The big movements in emerging market currencies versus the dollar were a sharp fall by the CNY/USD, reflecting the ongoing troubles of the Chinese property sector, and gains by Latin American currencies (MXN, BRL), helped by friend-shoring and prudent economic policies.

ALTERNATIVES

A limited appeal in a context of high rates

Current high interest rates are making diversification into alternative investments less attractive. We remain Neutral on commodities but have reduced our gold position to underweight. While Hedge Funds are a reasonable option for diversification, they remain less attractive compared to fixed income products.

Commodities and Gold

Commodities. Brent crude prices were highly volatile throughout 2023, reflecting the ups and downs of supply and demand and geopolitical tensions. Having traded between USD 80 and USD 85/bbl until March, oil prices then slumped to USD 70, their lowest since late-2021. Prices remained weak through most of the spring before rocketing over the summer to near USD 95 in September and then falling back to USD 75 in December. Crude prices could remain fairly stable at around USD 80/bbl for the next few weeks and months. There is excess supply from the US while OPEC+ countries are struggling to agree further cuts to production.

Gold. Gold prices rose sharply in 2023, from $1,825 an ounce to $2,060. It reached its all-time high at the beginning of December, benefiting in particular from the weakness of the dollar. Despite the sharp rise over the year, gold prices have been swinging significantly on the back of geopolitical tensions, inflationary risks and movements in the dollar.

Hedge Funds

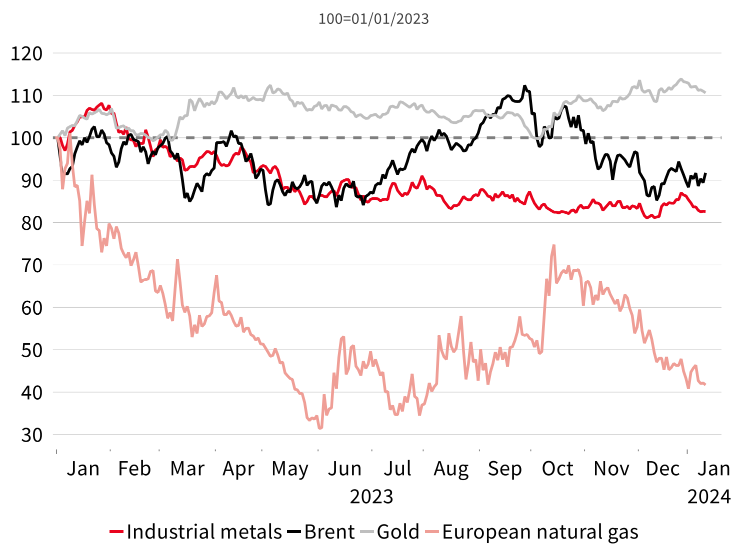
Long/Short Equity. Higher volatility and dispersions, coupled with the cycle nearing its end, should offer rich pickings for Long/Short Equity plays, at least those that follow non-directional strategies.

Event Driven. High interest rates are bad for M&A and make this fund category less appealing.

Fixed Income Arbitrage. With rates high, there are opportunities for funds playing sovereign debt. We retain our relative interest in funds positioned in the credits segment.

Global Macro / CTA. Commodity Trading Advisers (CTAs) are still doing well out of their traditional protection against market volatility, but the current period does not seem to offer the best entry point.

Main Commodity Prices



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