2pm PERSONALIZED PORTFOLIO MANAGEMENT

Quarterly marketreview

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Editorial

2024 is a year that is off to a flying start!

10.16% increase for the S&P500 in the United States, 12.43% increase for the Eurostoxx50...The stock markets got off to a more than good start to the year, practically without any corrective downward wave. This is all the more remarkable since the last quarter of 2023 was very good, also with double-digit increases for the S&P500 (+11.24% over Q4 2023). Faced with such a surge, we obviously wondered if this increase was supported by good fundamentals or if it was a bubble. It is clear that this stock market euphoria did not happen in a vacuum. In the United States, more than 2/3 of companies published results above expectations for the fourth quarter of 2023. And above all, economic growth proved resilient, with falling inflation and a recovery in the manufacturing sector and corporate profits which are holding steady, or even increasing sharply like the “mega” caps linked to artificial intelligence. Investors who feared a recession in 2023, unable to stay out of the market forever, had to jump on the bandwagon and this positive dynamic helped propel the S&P 500 to new records.

However, if we take a closer look at this American economy, we notice a few pitfalls. There are indeed signs that low-income households are under pressure. As a result, delinquency rates on credit cards and auto loans have become higher than levels seen before the pandemic. At the corporate level, unpaid debts in the commercial real estate sector continue to increase and the situation of regional banks is hardly thriving. Fortunately, businesses and households have built solid protections against the monetary tightening of the American Federal Reserve after the Covid pandemic, by accumulating significant liquidity reserves and by freezing interest rates at very low levels on 30-year mortgages and long-term corporate bonds. However, these defenses are weakening today and make finely calibrated Fed action crucial, so that inflation manages to settle around 2% and the unemployment rate remains at low levels. The task will not be easy for Jerome Powell: delaying rate cuts and easing too slowly can create a risk of recession, while easing too quickly could trigger a rebound in inflation. We will need to monitor this closely in the coming months. For the moment, operators are anticipating a first rate cut from July. This clearly supports the equity markets. But be careful if the Fed's caution with regard to sticky inflation (i.e. inflation that would have difficulty falling towards its target rate of 2%) should further delay rate reductions. This would increase the likelihood that the soft landing currently assessed by markets will turn into a mild recession.

Most other developed economies have also demonstrated economic resilience, notably Europe and Japan. The Euro Zone was helped by gas prices returning to levels below those seen before Russia's invasion of Ukraine, a recovery in global manufacturing activity and a resumption of bank loan growth. And a European Central Bank, which in its speech suggests that rate cuts could probably begin in June in response to the downward trend in core inflation. Japan also surprised positively, both in terms of economic activity and corporate profit growth and on the financial markets with the Nikkei index up 20.03% in the first quarter. Two points to watch for in this country: has the improvement in governance now completely integrated into prices?

Jerome H. Powell, governor of the Federal Reserve Board

And what about the yen? After three years of sharp decline, against the USD and against the EUR, the yen has currently returned to its low points of 1998, around 151 yen per dollar. This is favorable for Japanese exporters but considerably increases the cost of energy imports. Will the Bank of Japan be tempted to intervene? Should we expect further rate hikes?

As for China, the news has been a little more mixed in recent months. The problems of the real estate market in particular are far from being resolved. So far, stimulus measures have been piecemeal, but Beijing's 5% GDP growth target for 2024 suggests more significant measures in the coming months. For the moment, operators are continuing to wait-and-see, both on China and on emerging stock markets in general. The Hang Seng Index is down -2.97% over the quarter while the MSCI Emerging Markets is up only a modest 1.63%.

	Q1 2024	YTD 2024	Close 29/03/24
DOW JONES	5.62%	5.62%	39,807.37
S&P 500	10.16%	10.16%	5,254.35
FTSE 100	2.84%	2.84%	7,952.62
EUROST.50	12.43%	12.43%	5,083.42
CAC 40	8.78%	8.78%	8,205.81
FTSE MIB	14.49%	14.49%	34,759.69
MSCI EM	1.63%	1.63%	1,043.20
CRUDE OIL	16.08%	16.08%	83.17
GOLD	8.09%	8.09%	2,229.87
EUR/USD			1.0790
EUR/CHF			0.9730
EUR/GBP			0.8548
EURIBOR 1M			3.855%

We mentioned it in our last Quarterly Newsletter, this end of 2023, this fantastic rebound in the stock markets which materialized over the last two months of the year, confirmed to us the validity of not being in outside the market. Short-term movements remain very difficult to predict. And getting out of stocks remains a perilous exercise, forcing you when you are wrong to chase the market and buy back at a higher price what you sold before. But overall, we remain attentive and vigilant. Today, at the start of April, we are 10 to 12% higher compared to our last publication and it is obvious to say that the market, especially American perhaps, will be at these levels more sensitive to bad news or unpleasant surprises, both economic and geopolitical. The S&P500 index is now trading around 21.5x 2024 earnings, well above the average of the last ten years. Note, however, that the tremendous increase over the last four months has not been uniform, far from it. The Russell 2000 index, representative of American small and mid-caps, only rose 4.81% YTD (vs +10.16% for the S&P500). Same last year: +15.09% for the Russell 2000, + 24.23% for the S&P500, + 53.81% for the Nasdaq 100! The American stock market is therefore full of quantities of cheap stocks, ignored for the moment by investors, obsessed with the magnificent 7 (Apple, Amazon, Alphabet, Meta, Microsoft, Nvidia, Tesla). But be careful, these seven values, since the beginning of the year, have progressed in a slightly more dispersed order. Thus, Tesla is down -29.25% while Nvidia is up +82.46%, driven by the global craze around Artificial Intelligence, a revolution comparable for some analysts to that of the steam locomotive or of the advent of the

Internet at the end of the 90s. Still in the United States, it should also be noted that the market is currently anticipating an increase of approximately 10% in earnings per share this year. And sentiment indicators are very positive, with operators collectively rather optimistic, anticipating a soft landing with falling inflation and not a recession or stagflation. A lot of good news is likely baked into current prices. So be wary of disappointments.

In comparison, Europe, lacking the stocks linked to Artificial Intelligence which boosted the Nasdaq last year, appears cheaper, with a price/earnings ratio of 14.29x for the Eurostoxx50. Ditto for the MSCI Emerging Markets which is currently paying 12.59x profits. They could benefit in relative terms in the coming months if profits manage to exceed the relatively timid market consensus, which forecasts growth of only 2.8% in earnings per share for 2024. Another potential supporting factor, the European Central Bank which could prove to be a little more accommodating than the Fed this year. Or in any case, perhaps earlier in its rate cut cycle. Stay tuned…

Regarding the bond sector, we remain very constructive on this asset class for the rest of the year, especially after the upward retracement observed on long rates since the start of the year. The yields on the 10-year US government bond had in fact fallen sharply since mid-October, going from 5.00% to 3.88% at the end of the year. This movement was probably a little exaggerated, anticipating a reduction in its key rates by the Fed that was probably too large and too rapid. On the other hand, we ended the quarter at 4.20% for the US 10-year bond. And 2.30% on the 10-year Bund vs. 2.02 at the end of December. And these levels seem to us to constitute a good entry point for the bond funds of our selection. As mentioned in our Special Topic, we continue to favor mature funds, which guarantee very good diversification. As credit spreads are now very tight between High Yield issuers and government bonds, we have recently increased the portion allocated to the Investment grade segment, which is more qualitative and protective in the event of an unfavorable economic scenario.

We obviously continue to closely monitor the geopolitical situation and firstly a possible more direct involvement of Iran in the conflict between Israel and Hamas. The recent rise in the price of a barrel is undoubtedly partly linked to the uncertainties surrounding the zone. The increasingly anti-Western rhetoric of President Putin, who sees the hand of the West everywhere, including behind the terrible attack in Moscow, has so far had little influence on the financial markets. With one notable exception: values in the defense sector, which have risen sharply for three months. The Russian leader will in any case have won one thing: he will have brought NATO out of its hibernation and caused a stir among European leaders on the need to increase their military spending. This means profitable gain for our European flagships such as Dassault Aviation and Thales.

Christophe Carrafang

The Big Picture

China: the big loser in the American elections?

At the start of 2024, among the major geopolitical risks retained by investors, the Cold War between the United States and China was at the bottom of the ranking. Indeed, both parties have good reasons to maintain the calm in their relations this year. US President Joe Biden does not need an additional foreign policy crisis in an election year, already busy with Ukraine and the Middle East. As for the Chinese leader, Xi Jinping, he has enough internal problems to manage with a persistent economic malaise.

We have even found a semblance of improvement in US/China relations in recent months: with a first official meeting between the two heads of state, last November, to try to ease tensions over Taiwan; and a recent telephone interview where Artificial Intelligence, TikTok, Russia and Fentanyl were discussed.

But this relative calm could have an expiration date: November 5, polling day in the US elections. Especially, since the confirmation that Donald Trump will be the candidate of the Republican Party. Despite his setbacks with the law, he should be able to run.

Trump's ambitions for a second term could once again impact ties between the United States and China. Indeed, let's not forget the trade confrontation initiated by Donald Trump in 2018: economic relations had been largely weakened. Today, this does not seem to have changed: Trump wants to impose enormous tariffs likely to considerably minimize trade with China, to the point of reducing it to zero according to Bloomberg Economics. Trump's strategy could force Joe Biden to adopt tougher stances towards China to strengthen his electorate.

Under the Biden administration, although the tone has changed slightly, the fundamental strategy towards China remains firm. Biden is aware that he must take an unyielding position. While his proposals are not as extreme as the tariffs Trump is considering, and his administration has expressed opposition to full decoupling, he has an unprecedented array of restrictions to impose, from data management to the electric vehicle industry.

For Xi Jinping, the likely intensification of the economic conflict with the United States comes at a critical moment. Beijing already has to manage the collapse of the real estate sector, which has seriously affected its growth engine, as well as the fall in stock markets. China's proximity to Russia before and during the invasion of Ukraine reinforced the American narrative. European allies, who previously viewed China more as a market than a geopolitical threat, began to pay attention to American warnings, particularly regarding the risk of invasion of Taiwan. The overall impact is clearly negative, weighing on Chinese growth and increasing pressure on its economy ahead of the US elections.

We remain attentive to possible developments in the trade conflict between the United States and China. We have not increased our exposure to the area, but we are maintaining the positions. The attractive valuations and the economic support provided by the government could set a floor on Chinese equity indexes.

Damien Beasse

Macro-economy

Inflation: A more contained decline.

- Euro Zone: Inflation stabilizes around +2.4% in March, with the core index continuing its decline to +2.9%, compared to +3.4% in December.
- In the USA we observe the same phenomenon; the price index is at +3.2% and the core index continues to decline at +3.8%.
- China is (temporarily?) emerging from deflation with an indicator of +0.7% at the start of the year.

Job market: Still remarkably stable.

- Structural demographic factors are still at work and allow for great stability in the unemployment rate in the Euro Zone at 6.5%, at historically low levels.
- In the United States, the unemployment rate rose slightly from 3.7% to 3.9% over the quarter. Job creation remains at an average of 200,000 new jobs per month.

Manufacturing activity: Improvement except for heavy trucking vehicles in the Euro Zone.

- The overall indicator, around 49 for a year, returned to positive over the quarter (50.6 in March).
- In the USA the indicator is finally in the green at 50.3; the manufacturing ISM had remained between 47.4 and 46.7 for over a year.
- France and Germany remain subject to manufacturing difficulties, while for once, the south of the Euro Zone is doing better.
- Chinese activity recovered in March, but it is too early to draw conclusions.

Services activity: A contrasting situation.

- The overall indicator has been fairly stable for several months.
- In the United States, the ISM for services disappoints (51.4), but the price index is reassuring!
- In the Euro Zone the indicator is picking up, driven by Southern Europe and Germany. France lags behind.
- Growth in services in China has been rebounding for several months thanks to healthy household consumption, although activity in the real estate sector is still sluggish.

Damien Liegeois

US Jobs Opening

This index represents the total number of unfilled job openings in the United States per month, thus providing an indicator of labor demand in the economy.

Special Topic

Why has High Yield outperformed since 2022?

The year 2022 was a year of strong correction in all segments of the bond market except that of variable rates. High Yield bonds were swept away by the decline but in relative terms they held up better: falling by -14% while at the same time an index of better quality bonds fell by - 15% and that of government bonds by -19 %.

Subsequently, and more surprisingly, this outperformance has continued until today with more than +20% performance at its lowest, notably through active managers, who have the capacity for selection and who can avoid companies that are in too much debt and over-represented in benchmark indices.

Usually the rate increases that we have experienced are quickly accompanied by a deterioration in the activity and financial statements of these so-called "more fragile" companies. What follows are rising default estimates and a widening of credit spreads (difference with risk-free rates), causing a general fall in the price of the lowest-rated corporate bonds.

It is clear that the cycle we are experiencing is different, and it calls into question the forecast models of strategists who only bought high yield once the decline in rates had started.

Why is this cycle so different?

A particularity of this cycle is that it comes barely two years after the Covid shock. CFOs have been scarred, and have learned to be extremely careful. The period of low rates was used to rebuild reserves at very advantageous rates; companies are generally well supplied with cash and refinancing deadlines are well spread over time.

In the Corporate High Yield world, balance sheets have been cleaned up and the level of debt is relatively low. This observation is the same in developed countries as well as throughout the emerging world. Moreover, the ratings are clearly improving: on the eve of the 2008 crisis, in the high yield universe, there were 39% of BBs, there are currently 57%; B ratings fell from 46% to 34%. Thus, default rates remain low and contained to companies that were already fragile before the rate increases.

Another particularity of this cycle is that, despite a manufacturing recession and a struggling real estate sector, the economies, for the moment, have not fallen into recession or only very partially. Several elements explain this new phenomenon: shorter economic cycles without inventory, a structural shortage of labor which keeps the unemployment rate low, supporting consumption and the services sector.

The sector's good performance is also due to the fact that, for investors, even if the yield spread is relatively tight, the absolute rate of return is very attractive and at levels which protect both possible new rate increases and a widening of spreads in the event of economic deterioration.

For our exposure through this asset class, we have mainly chosen the approach of "dated funds" with very diversified staggered maturities, which give us peace of mind with regard to what most worries investors in this universe: default payments.

Damien Liegeois

Spread HY vs Govies 10Y

This graph represents the yield spread between high yield bonds and 10-year government bonds.

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