PERSONALIZED PORTFOLIO MANAGEMENT

Quarterly market review

JANUARY 2024

Editorial

2023—What an incredible year!

Once again, many will have been confused by these surprising markets. Last year's predictions by the Cassandras of a heavy recession and global stock markets at half mast, will have been dispelled. If the performance of emerging stock markets, led by China, proved modest (+7.04% for the MSCI Emerging Markets), in the United States, the S&P500 ended the year with a respectable +24.23%, while in Europe, the Eurostoxx 50 ended at +19.19%. As always, this performance did not happen in a straight line and operators experienced their share of cold sweats in 2023. Don't forget the downturn of March, with the banking crisis in the United States. Or the 3 months of sharp decline (in stocks and bonds), from the end of July to the end of October, against a backdrop of resilient core inflation, rather restrictive messages from central bankers and violent tension on long rates. And then this formidable and almost unexpected end-of-year rally from the beginning of November, with a nice easing of long-term yields and inflation which, at the dawn of this new year, has decreased significantly, both in Europe and in the USA. Thus, the American CPI (Consumer Price Index), which was still at 6.5% a year ago (after a peak at 9% in June 2022), is now stabilizing around 3.1%. Financial markets now expect the Fed and the ECB to start reducing interest rates in 2024, in a context where the outlook for overall economic growth for 2024 is expected to slow; a logical development after 11 consecutive interest rate hikes in the United States and 10 rate increases in Europe. The OECD, which released its latest forecast at the end of November, expects growth in the United States to slow to around 1.5% and growth to pick up slightly in the Euro Zone to around 0.9%.

If these forecasts prove correct, the first interest rate cuts in Europe and the United States should materialize in the coming months, probably at the start of the second quarter of 2024. It is this perspective which has, among other things, enabled the stock market rally of the last two months with European stock markets having recovered more than 12% since the end of October. Some economists, moving from one extreme to the other, are now forecasting a drop of 125 basis points in the United States and even 150 basis points for the Euro Zone in 2024. To us, this probably seems a little too optimistic given underlying inflation which is certainly falling, but which nevertheless remains relatively high in absolute terms (4% in the United States, 3.6% in the Euro Zone) and the propensity for labor costs to rise on both sides of the Atlantic. If the Fed lowers its rates by 75 basis points in 2024 (3 cuts of 0.25%), that will already be very good.

On the bond front, the easing of long-term rates was rapid and significant. In Europe, the 10-year yield on the German Bund rose from 3% at the start of October to 1.895% on December 27 before rising to 2.05% at the time of writing. Ditto for the yield on the 10-year US Treasury Bond, which rose from 5% in mid-October to 3.97% today. But despite these recent declines, bond yields remain at fairly attractive levels compared to what we have observed in recent years, during this long phase where central banks had pursued ultra-accommodative policies on both sides of the Atlantic. We remember that from May 2019 to January 2022, the yield on the 10-year German Bund even remained in negative territory, nonsense from the point of view of investors! Today, 4% yield on 10-year US government papers, while inflation is at 3.1, the economy is slowing and the Federal Reserve has not started its cycle of rate cuts; it's far from uninteresting. Not to mention the potentially protective aspect of such instruments if, unfortunately, the "soft landing" scenario, which remains the majority today, were to give way to a "hard landing" or, in other words, a heavy recession scenario. This is why, several weeks ago, we slightly extended the duration of our portfolios while strengthening the quality of our investments.

With these once again decent bond yields, diversified multi-asset portfolios have regained their attractiveness, especially as the decorrelation between stocks and bonds has been increasing again for some time. In other words, the benefits of diversification (the main one being the reduction of risk) by adding bonds to a mixed portfolio are increasingly felt.

The year 2023 and especially the tremendous stock market rebound in November, which occurred after a drop of more than 10% over 3 months, has reinforced our convictions that short-term movements in stocks are very difficult to capture, and that it is very penalizing to be outside the market, even if the international context, which was, to say the least, anxiety-provoking this fall, encouraged reluctance. If we look at the evolution of the MSCI World over 20 years, from September 2003 to September 2023, the annualized performance comes out to +8.02% for an investor who remained invested over the entire period. But beware! The figure drops to +4.77% for the investor who missed the 10 best stock market

	Q4 2023	YTD 2023	Close 31/12/23
DOW JONES	12.48%	13.70%	34 065.02
S&P 500	11.24%	24.23%	4 311.12
FTSE 100	1.65%	3.78%	8 920.76
EUROST.50	8.31%	19.19%	4 521.65
CAC 40	5.72%	16.52%	7 534.18
FTSE MIB	7.47%	28.03%	30 351.62
MSCI EM	7.45%	7.04%	925.29
CRUDE OIL	-21.08%	-10.73%	71.65
GOLD	11.60%	13.10%	2 062.98
EUR/USD			1.1039
EUR/CHF			0.92887
EUR/GBP			0.86691
EURIBOR 1M			3.845%

sessions (out of a total of 4,800 sessions). At +2.71% for the investor who missed the 20 best days. And -0.23% for the investor absent from the 40 best sessions!

At the beginning of 2024, our convictions have not changed and we remain exposed to the equity markets for the moment. Perhaps slightly less than a week or two ago, the rally of the last two months having been conducive to some profit taking here and there. However, exposed all the same. Indeed, the risks and opportunities on the world stock markets are, from our point of view, currently well balanced.

Let's look at the supporting factors first. We can point out three main ones.

First of all, the end of the cycle of rate increases by central banks. If we analyze the last 35 stock market years, since 1989, it turns out that in 80% of cases, the stock markets experienced a positive development in the twelve months following the last rate increase by the American Federal Reserve. With an average performance of just over 15% for the S&P500 and just over 20% for the MSCI Emerging Markets. We will also address, among other things, in our Grand Angle on page 2 the issue of the Chinese stock market rebound which could finally materialize after three complicated years.

Another supporting factor in a likely context of falling short-term rates is earnings per share. Analysts currently estimate that EPS growth should accelerate in 2024 (+11.40% for the S&P500, +9.2% for the Stoxx600), which in theory is good for stock prices.

Thirdly, valuations. If the US market is today trading slightly higher than its historical average in terms of price/earnings ratio, the European Stoxx600 index is trading below (13.12 vs. 14.21

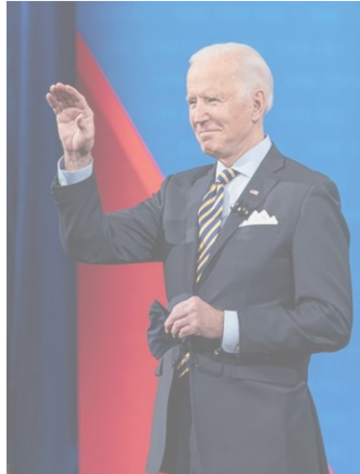
on average since 2006 with often peaks at 17 as in 2015, 2016 and 2017). And emerging markets are valued at their historical average. These figures also hide entire sections of the rating which are clearly undervalued. Let's not forget that during most of 2023, the performance of the stock markets was concentrated on a fairly limited number of stocks, especially technological ones, leaving aside many good companies which have not seen their stock price move upwards as they normally should have done. In a context of generalized economic slowdown in OECD countries, long-term rates should remain around current levels, or even fall a bit further. This is also mechanically beneficial for valuations.

Let's move on to the risk factors. What events could cause global stock markets to weaken in the coming months?

Everything we have written so far fits into a soft landing scenario for Western economies. But what would happen if the alternative scenario of stagflation materialized? Let's imagine for a moment that for one or another geopolitical reason, for example, inflation remains at current levels (i.e. above central bank targets), or even accelerates a little. This would lead central banks to keep short-term rates in restrictive territory for longer than expected, which would have the effect of slowing down the economy even more, at the risk of causing a recession. Not to mention the disappointment of operators who are currently counting on average 3 cuts of 25 basis points in the United States. This would create the conditions for a very negative environment for the equity markets, with pressure on profits and valuation multiples. Especially since the US market, as already seen earlier, is not particularly cheap.

Another potential factor of volatility is the American presidential elections on November 5, which will be held in a climate that is anything but calm. Donald Trump is currently the big favorite in the polls, but he is still plagued by legal disputes. The latest, the decision taken by the state of Maine excluding him from the ballots in the Republican primary. The billionaire was judged Thursday “unfit to serve as president” due to the January 2021 assault on the Capitol committed by his supporters. Trump immediately appealed the decision. But that says a lot about the mood of this pre-campaign. In the Republican camp, it is Nikky Haley, the former governor of South Carolina and United States ambassador to the United Nations, who seems to have the wind in her sails in the event that the former president is unable to run again.

In the Democratic camp, on the other hand, vagueness predominates. Joe Biden, himself potentially vulnerable with his son's federal indictment for tax fraud, said he would run again if Trump ran. On the other hand, given his age and apparent fatigue, it is likely that he will throw in the towel if another Republican emerges in the opposing camp. Problem: there aren't many people who clearly stand out in the Democratic camp, not really a natural candidate at the moment. Very open elections therefore, with important consequences in terms of foreign policy, in particular if Donald Trump were elected, and this in an increasingly uncertain world, marked by the strong return of empires (the Russian Empire, Persian Empire, Ottoman Empire, Middle Kingdom…).



This geopolitical dimension is probably the thorniest problem, both for the global economy and for the financial markets in 2024. The shock wave of the bloody attack by Hamas in Israel on October 7 with its intense reprisals for three months in the Gaza Strip have not yet affected the markets, the operators having rightly but not without cynicism considered that as long as the conflict remained “local”, the stock markets had no reason to be impacted. The situation is perhaps changing these days with the targeted elimination of Saleh al-Arouri, number 2 of Hamas, by an Israeli drone strike in the southern suburbs of Beirut, Tuesday January 2nd, an elimination which sparks a strong concern. All eyes are now on Hezbollah, which until then had kept quiet (the presence of the two aircraft carriers in the Mediterranean certainly had something to do with it), but which has promised reprisals following this blow in the heart of its territory, the first attack of its kind since 2006. Could Israel, which has not completed its hunt for Hamas in the Gaza Strip, face a second front in the north of its territory? Not to mention the West Bank in the East... Further south, it was the attacks of the Houthi rebels against commercial ships which worried the operators. Rightly so. Using missiles, drones, assaults at sea and hostage-taking, the latter are increasing operations in the Red Sea against cargo ships, container ships and oil tankers, ensuring they target ships heading towards the Hebrew nation or being linked, in one way or another, to Israel. Several shipping and oil companies have already suspended maritime traffic in the Red Sea due to these Houthi attacks supported by Iran. This fuels concerns about possible disruptions to supply chains. Reason being, the diversion of boats via the Cape of Good Hope extends transport times by 10 to 15 days on average. And therefore the delivery costs. A little further to the North-East, the United States is carefully examining the Strait of Hormuz, very close to Iran, through which a third of the crude transiting by sea in the world circulates. And 12% of world trade.

On the Ukrainian front, Russian bombings have increased in intensity on Kyiv in recent days, to both create a climate of terror and destabilize the power in place. The Poles, for their part, are strengthening their military presence at the border and are ready to intervene with their planes if necessary. A question remains at this stage. Does Vladimir Putin only want Donbass, Crimea, free access to the Black Sea? Or does he want to overthrow the current government to establish a “friendly” pro-Russian government? Are the Poles and Moldovans right to worry?

Finally let’s close with the elections on January 13 in Taiwan. These elections will be particularly scrutinized by China and the United States because of their importance for the future relations between the autonomous island and Beijing. The Middle Kingdom, which considers it an integral part of its territory, has vowed to one day bring it back into its fold, using force if necessary. Another potential conflict zone, in a part of the world where, again, a large part of world trade passes.

In conclusion, multi-asset portfolios could once again perform well in 2024, with stocks still potentially quite volatile but which could benefit from falling rates and bonds, especially the most qualitative segment, which should continue their movement appreciation began several months ago. But the world has never been so uncertain as we have just mentioned, with many centers of instability in several parts of the globe. All of this encourages us to remain humble in the face of risks and to prepare for all scenarios. Once again, quality and diversification will be the key words of our approach.

Christophe Carrafang

Macro-economy

Inflation: Disinflation sets in

- Euro Zone : Inflation fell further to +2.4% in November, with the “core” index also falling to +3.6%.
- In the USA the price index is +3.1%. The “core” index continues to decline at +4%.
- In the United Kingdom, the price index accelerates its decline to +3.9%, compared to +6.7% just a quarter ago.

Job market: Still stable

- Despite very weak growth in 2023, the unemployment rate in the Euro Zone remains very stable at 6.5%, at historically low levels.
- In the United States, the unemployment rate increased slightly from 3.4% to 3.7%. Job creation, even if lower than in 2022, remains at an average of 200 000 jobs created monthly.

Manufacturing activity : Stabilization of the activity sector

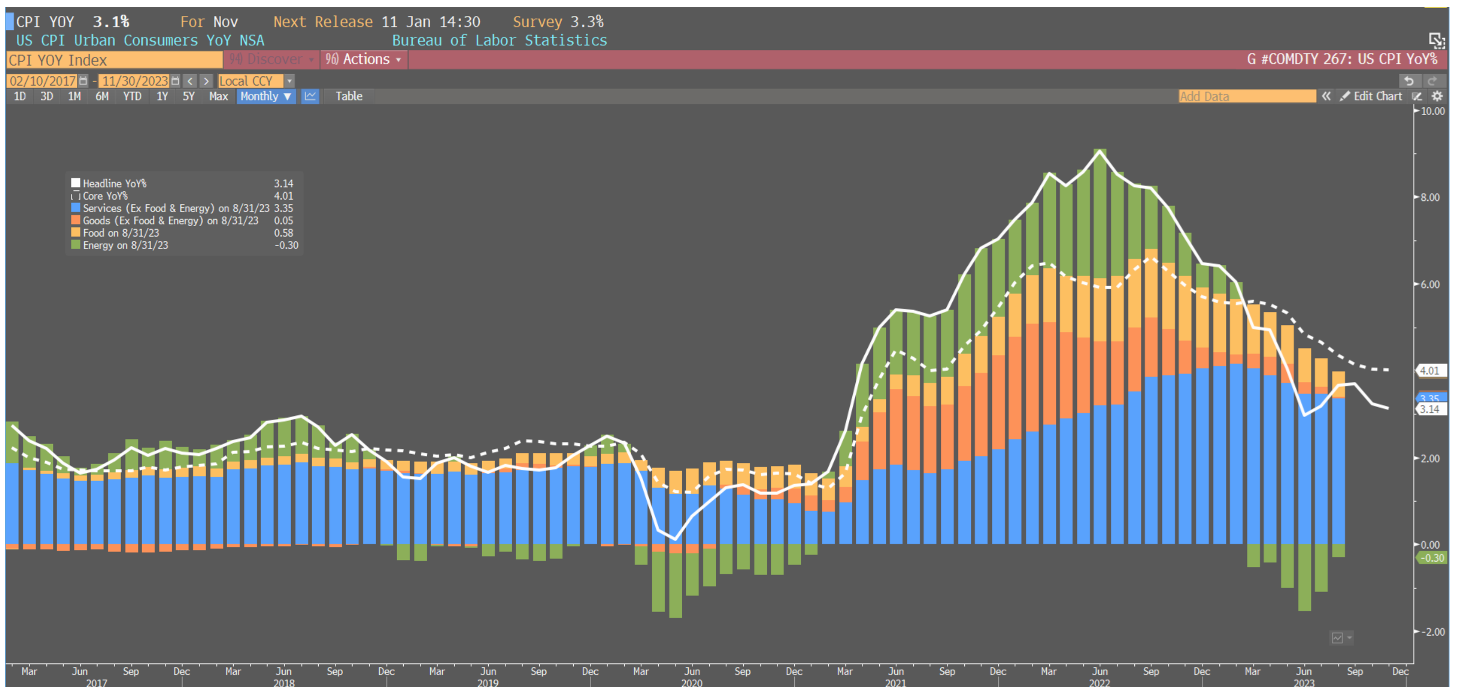
- The overall indicator of around 49 for more than a year, hovers in the recession zone.
- In the USA nothing new, the manufacturing ISM remained between 47.4 and 46.7 throughout the year.
- European indicators have remained depressed between 42 and 44 for several months.
- In China, activity is stable around 50 with the real estate sector still down.
- The end of stock clearances did not promote activity, but stabilized it.

Services activity : A moderate slowdown

- The predominant indicator has been relatively stable since August, slightly above the contraction zone.
- In the United States, the ISM for services is expected at 52.5 in December compared to 52.7 for November.
- In the Euro Zone, the indicator is stabilizing in a contraction zone after dropping in the summer to 48.1.
- Growth in services in China remains sluggish, but is expected to increase slightly for December between 50.5 and 51.6.

Damien Liegeois

US CPI YoY (*) since 2017



(*) This index represents changes in the prices of all goods and services purchased by American urban households.

The Big Picture

A highly anticipated return from investors on Chinese assets

The last three years have been difficult for investors in Chinese stocks. The gap is absolute, but above all relative performance has widened sharply: since the start of 2021, the MSCI China index has underperformed the MSCI World index by almost 70%.

Many factors, which we have already discussed in our last publications, are at the origin of this poor result.

• A lack of confidence on the part of investors in the government following strict policies linked to Covid-19.

• Difficulties in the over-indebted real estate sector, which are still ongoing, and which may last.

• Government interventionism that is both unpredictable and sometimes hostile to the largest Chinese companies.

• Moreover, it is quite a busy election year, particularly in the United States and the United Kingdom. Will China be used as a punching bag by politicians, as we have experienced in the past?

There are nevertheless reasons to believe that Chinese stocks will rebound in the coming months:

• The valuations of Chinese equity markets are very low: they have fallen by 57% compared to their highest level in 2021. The valuation gap between Chinese equity markets and most other major global markets is close to its historic highs. Unless the Chinese economy really collapses, stock markets appear to offer a lot of value.

• There is a consensus among forecasters for this year 2024 that we should see a rebound in Chinese indexes: they are betting on a government stimulus and a catch-up in consumption. The government appears to have started to stimulate in earnest: the expansion of the People's Bank of China's balance sheet has just reached unseen levels in more than a decade.

• China's resilience can be explained by a significant development: over the last 5 years, the mix of Chinese exports has moved up the value chain to include products with high added value (trains, panels solar, automobiles). This helped support wage growth among industrial workers, which maintained consumption. A rebound in growth would alleviate some concerns and could once again attract international investors.

If China takes longer to recover, other emerging countries will take over. In recent months, we have seen a shift in supply chains from China to other emerging players. This should lead to a virtuous circle of increased investment and job growth, particularly in India, Mexico and Vietnam. But China is also well placed, with a large number of companies present, to participate in the strong growth of the Eurasian continent in the years to come.

Damien Beasse

Special Topic

ECB : Disturbed by an economic slowdown without unemployment?

In mid-September, the European Central Bank surprised the markets with the 10th rate increase since July 2022. In just over a year, the key rate went from zero, where it had been since 2016, to 4.5%; an increase of unprecedented speed.

If the previous increases were all more or less expected, the last one surprised in more ways than one.

Since our commentary a quarter ago, the situation in terms of inflation has continued to evolve contrary to the forecasts of the European Central Bank. Over the period, inflation was more than halved, from +5.2% to +2.4%! "Core" inflation increased from +5.3% to +3.6%.

Inflationary pressure is falling sharply due to the decline in energy prices, Chinese deflation and the economic slowdown which is starting to have effects on the price of services.

Why is the Central Bank struggling to change its position on the subject?

One of the reasons may be due to the famous adage of "not counting your chickens before…", especially after having been a little late when it came to initiating these rate increases.

Another reason is undoubtedly linked to the job market, the elasticity of rate increases has changed over this cycle. Indeed, after such increases in such a short time, a sharp increase in unemployment would have seemed obvious. However, the structural shortage of labor, linked to fundamental demographic issues, is disrupting macroeconomic models despite a slowdown in activity, and raising fears of new pressure on wages.

The fact that unemployment in the Euro Zone, after a year where rates rose from 0% to +4.5%, is reaching record lows is astonishing. Of course it will probably increase in 2024 but it is not expected to reach the peaks of previous cycles. If there is no unemployment, households keeping their jobs continue to pay their consumer and real estate loans (the latter taken out mostly at low fixed rates). Thus, the real estate sector is suffering from a lack of new transactions but not from a collapse caused by payment defaults. Logically, simple rate cuts should allow it to start again.

The financial markets, over the last two months, have clearly chosen to be satisfied with this disinflation, coupled with a measured economic slowdown. The rate cuts, partially envisaged by some a few months ago for the end of 2024 (-50bp), are now expected from the first quarter of 2024 with a drop of more than 100bp by July.

At the end of summer 2023, the watchword of bond strategists, influenced by the speeches of central bankers, was: "high rates for a long time"; they did not see the rate cuts of the last two months coming. Many made a mistake and did not benefit enough of this bond investment window. The question now is will they have another one in 2024, or if their next slogan will be more linked to deflation...?

Damien Liegeois

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