ASSET ALLOCATION INSIGHTS

Monthly Update | Issue 91

22 March 2024

When hawks fly like doves

Key takeaways

- The global growth cycle hit its lowest point in 2023 and is now picking up. Earnings estimates have been creeping higher. Although central banks are hesitant to lower interest rates at this moment, they are conveying more accommodative signals to the market, which maintains the prevailing "risk-on" sentiment.
- From a market perspective, the main equity indices continue to trend higher. Upside market participation is broadening while credit spreads remain tight. Cyclicals vs. defensives are exceeding expectations, the recent pick-up in commodities and outperformance of TIPS over US Treasuries are all pointing towards a “reflationary” message.
- Our well-diversified positioning since the start of the year has been playing out rather well with our two favourite equity markets (US and Japan) outperforming. Going forward, we want to keep our allocation to Equities close to our Strategic Asset Allocation (SAA) neutral weights.
- However, considering recent macro and market dynamic developments, we are cutting our fixed income allocation from neutral to negative by reducing our stance on government bonds and corporate investment grade. Proceeds are reinvested into cash.

Syz PRIVATE BANKING

Charles-Henry Monchau *Chief Investment Officer*
Luc Filip *Head of Discretionary Portfolio Management*
Adrien Pichoud *Chief Economist & Senior Portfolio Manager*
Gaël Fichan *Head Fixed Income & Senior Portfolio Manager*
Gaël Combes *Head of Equities*

THE BIG PICTURE

This time last year, California's Silicon Valley Bank collapsed and sparked a brief banking crisis in the US, roiling financial markets and ultimately claiming a few additional regional bank victims. Fast forward to March 2024: the St Louis Financial stress index is the lowest since the Fed began raising rates. Bank deposits have stabilised and risen since the 2023 banking panic, showing that confidence in the banking system is returning. What a difference one year makes. Indeed, while the number of Fed rate cut expectations has moved from 7 at the start of 2024 to 3 as of now, markets do not seem to care: the S&P 500 just crossed 5,200 for the first time ever, the Nikkei 225 index is trading above 40,000 for the first time in three decades, the Europe Stoxx 600 hit new all-time highs, gold is trading above $2,200 for the first time ever, oil prices are creeping higher, copper has suddenly broken out and US corporate bond spreads remain very tight. Last but not least, bitcoin has hit a new all-time high at $73,000 dollars.

Are we in the middle of a new mania? To be fair, there are indeed some reasons to be cheerful. First, the global economy is doing better than anticipated. A global manufacturing recovery seems to be unfolding. US consumer sentiment is holding up. China is finally considering deploying more fiscal stimulus. The hard landing scenario seems unlikely and the "no landing" probability is rising.

Better than expected economic numbers are propelling earnings estimates higher. Artificial Intelligence could trigger a productivity boom which should help keep corporate margins at a high level.

Market dynamics are also sending positive messages to investors: the upward trend remains robust, the participation to the upside is broadening, cyclicals are outperforming defensives, commodities are starting to pick up. Meanwhile, bond volatility is decreasing, and the dollar is stabilising.

Finally, investors seem to be cheering the fact that central banks will still cut rates DESPITE the resilience of economic growth and the stickiness of inflation. The "reflation" thesis was corroborated by the two most important central banks meetings that took place this week. First, Bank of Japan Governor Kazuo Ueda has decided to end the policy of negative rates. This move was widely anticipated, and the dovish tone around this decision pleased investors and didn't lead to the yen appreciation which was feared by markets. In the US, the Fed kept interest rates unchanged as expected. But there was a positive surprise for investors: as compared to their December forecasts, the Fed is expecting higher Real GDP growth (2.1% vs. 1.4%), lower Unemployment (4.0% vs. 4.1%) and higher Core PCE Inflation (2.6% vs. 2.4%), but it is still anticipating 3 rate CUTS this year. This sounds reflationary for markets: as in the case of Japan, the Fed hawks are flying like doves.

This positive mix of decent growth, stable inflation (albeit at a higher level than central bank's target), loosening financial conditions, upward trending markets with broader participation to the upside lead us to keep our global equity allocation unchanged (with the market effect, our tactical asset allocation to equities is now slightly higher than our strategic asset allocation).

So why not increase our equity allocation further?

Despite this rosy picture, we are also aware that many things could go wrong. The sectors of the economy which are the most affected by higher rates (e.g. US Commercial Real Estate, SMEs, etc.) continue to struggle. Sticky inflation in services and the rise of commodity prices could lead to higher headline inflation in the months to come – hence preventing rate cuts by central banks at a time when global debt keeps ballooning. A cracking of market heavyweights could lead global indices lower. Geopolitical conflict escalation in Ukraine or Middle East remains a risk. Investor sentiment appears complacent and elevated equity market multiples do not leave any room for disappointment.

As such, we are keeping our global equity allocation close to our Strategic Asset Allocation and we won't be adding more exposure to equities at this stage. However, we believe that some sector and style rotation could continue to unfold. Indeed, the "reflation" thesis might trigger new leadership within equities. We are starting to see some large cap tech stocks stalling while sectors such as energy and materials have been outperforming the S&P 500 index recently. Within non-US markets, we are keeping our preference for Japan and staying neutral on Europe. Although momentum in China's equity markets is on the rise, we are currently choosing not to increase our investments in this region.

On the rates side, Treasury supply continues to rise and coupled with sticky inflation, is exerting upward pressures on long-dated bond yields. In this context, we are decreasing our allocation to Government bonds 1-10 years from positive to neutral and the 10 years+ Government bonds from neutral to negative. Proceeds are reinvested into cash which continues to offer positive real yields. The downtrend in credit spreads has continued towards multi-year lows. We remain neutral on credit with a preference for quality (investment grade). On an aggregate basis, our fixed income positioning has moved from neutral to negative.

Within commodities, we are maintaining our allocation to gold. The resilience of the yellow metal despite higher rates and ETF outflows is remarkable. Gold continues to offer a protection against geopolitical shocks and currency debasement. The recent technical breakout seems to indicate further upside ahead.

In Forex, we are keeping our neutral stance on the Euro, Swiss Franc and GBP against the dollar. Central banks on both sides of the Atlantic seem to be on a wait and see mode for the time being. We still believe that the change in monetary policy in Japan (raising rates at the time other central banks are contemplating a cut) could lead to some yen appreciation – hence our positive view on the yen versus dollar.

We continue to believe that our well-diversified portfolio positioning should help us navigate the current macroeconomic and market conditions.

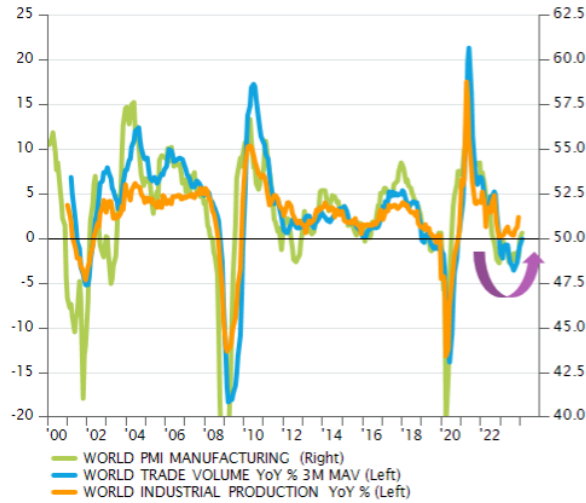
A MACRO & MONETARY POLICY UPDATE

Global growth dynamic pickup is underway

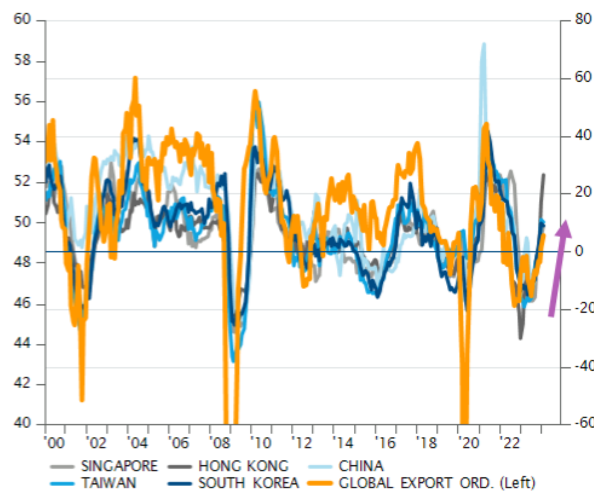
The global economic growth cycle reached its lowest point in 2023 and is now experiencing an upswing. Indicators of industrial activity and trade are showing signs of improvement, including exports from Asian economies.

Global growth is picking up

World manufacturing activity, trade, industrial production and GDP



East Asia Exports 3M MAV YoY% & Global New Export Orders



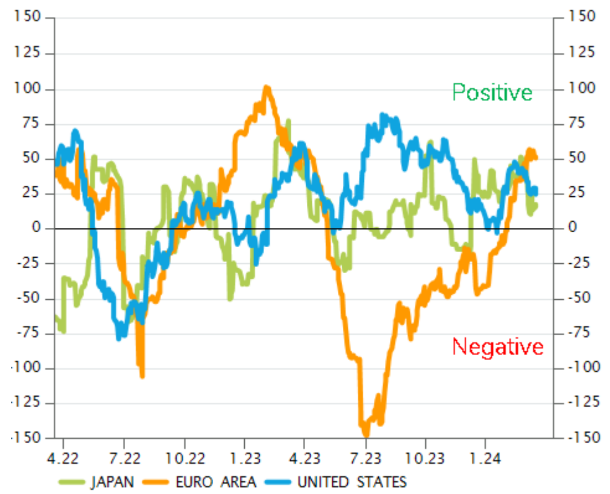
Developed economies are surpassing expectations, evidenced by ongoing positive economic developments in the US, alongside noticeable improvements in Europe and China. This presents a broadly synchronised trend of enhancement across the board, with Germany being the notable outlier among the major economies.

Positive surprises across all large economic areas

Economic Surprise Indices

(actual data release vs consensus expectations)

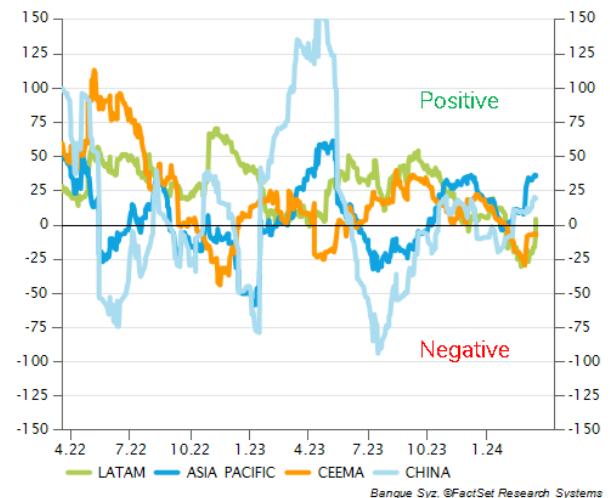
Developed Economies



Economic Surprise Indices

(actual data release vs consensus expectations)

Emerging Economies



The US economy continues to grow, slightly above trend, supported by robust real income and spending growth.

The Eurozone is slowly recovering from the Ukraine war shock, as consumption in services benefits from the ongoing disinflationary trend.

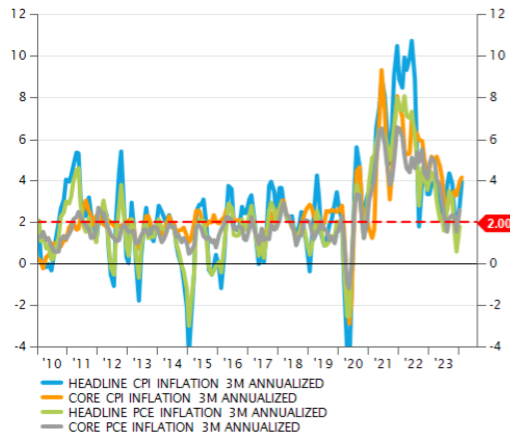
The Japan economy is growing slowly as domestic demand remains subdued, but business sentiment is strong.

The Chinese economy is stabilising at a growth rate around the 5% target, as a recovery in consumption and industrial activity balances continuing difficult conditions in the real estate market.

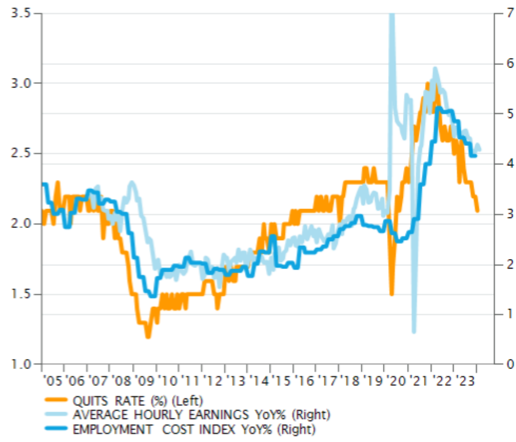
On the inflation front, upward pressures on wages are gradually abating and keep the disinflationary trend alive, but resilient demand sustains short-term inflation dynamics.

Inflation: unexpected rebound doesn't challenge the downward trend yet

US Headline & "core" CPI and PCE inflation 3-month annualized rate



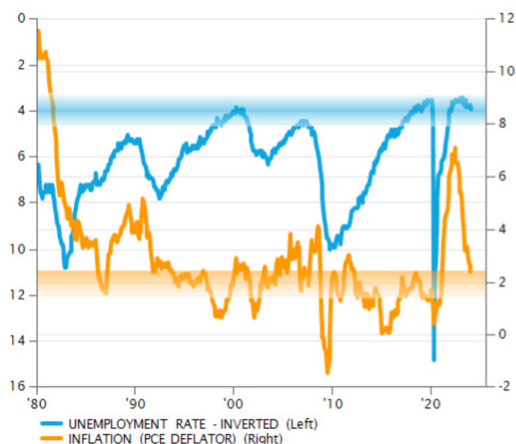
US gauges of wage growth dynamics and Quits Rate (measure of labor market tightness)

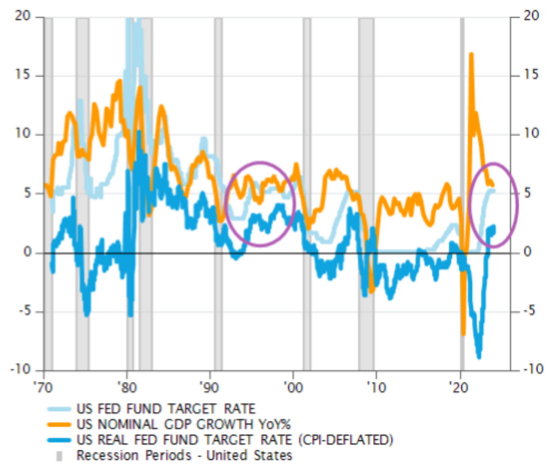


Rate cut expectations are revised downward

The Fed is close to its "comfort" zone and appears on track to achieve a "1995-style" soft-landing. Indeed, the two objectives of the Fed (maximum employment and stable prices) are (almost) perfectly reached. The Fed can relax and afford to "wait-and-see" before eventually recalibrating. The current environment is one of solid nominal GDP growth, positive real short-term rates and Fed Funds around 5%, that looks very similar to what we went through in the second half of the 90s.

Back to the 1990s? The US economy is on track for a soft-landing

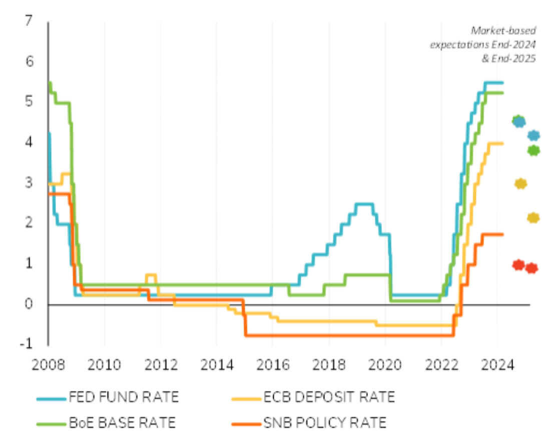




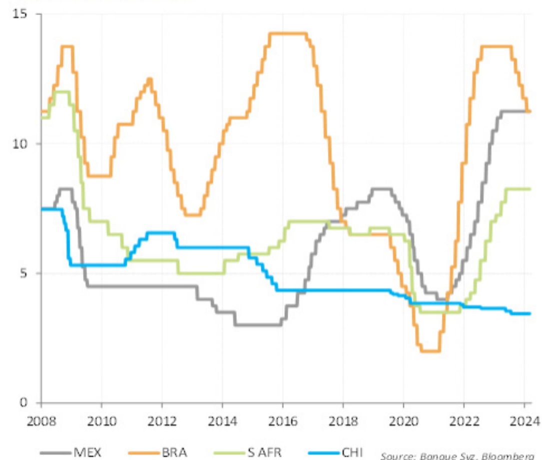
Rate cut expectations for the Fed and the ECB are revised lower and being pushed toward the second half of the year. The global rate cut cycle is about to start, most likely in June. This cycle may have more legs in some areas than in others.

Central banks: rate cuts ahead, but at different times and paces

DM central bank key rates



EM central bank key rates



Source: Banque Syz, Bloomberg

Alternative measures to central banks' balance sheet show a more positive liquidity environment.

Our scenario: US resilience and improving global momentum reinforce the likelihood of a "soft landing" in 2024.

THE WEIGHT OF THE EVIDENCE

Our asset allocation preferences are based on 5 indicators including 4 macro & fundamental indicators (leading) and 1 market dynamics (coincident). The weight of the evidence suggests a neutral allocation to equities. Below we review the positive and negative factors for each of them.

Indicators review summary - our five pillars

There are two changes versus last month:

- → The “macro cycle” pillar has moved from NEUTRAL to POSITIVE. The nominal global GDP growth momentum is improving with reduced downside risks. It warrants a POSITIVE assessment of the macro cycle at this stage. There are short-term upside risks on inflation, but medium-term prospects still point to disinflation.
- → The “market dynamics” pillar has moved from NEUTRAL to POSITIVE. Trend indicators remain positive and strong. In addition, the recent relative pause in the equity upward trend was welcomed, as the market is not overbought anymore. Finally, market breadth has improved, supporting the robustness of the current market rally.

	(+)	(-)	WEIGHT OF THE EVIDENCE
MACRO CYCLE	The global cyclical momentum is improving. The positive nominal GDP growth prospects for the months ahead, with reduced downside risks, warrant a POSITIVE assessment of the macro cycle at this stage.	There are short-term upside risks on inflation (but medium-term prospects still point to disinflation).	POSITIVE (↑)
LIQUIDITY	Underlying measures show an environment of relatively stable liquidity. Financial conditions are on the “easy side” and have continued to ease since the beginning of the year. Central banks are expected to cut rates in the second half of the year to avoid maintaining unneces-sarily restrictive financing conditions as inflation gradually slows down	Central banks maintain a restrictive monetary policy stance, a combination of positive real short-term rates and of Quantitative Tightening (gradual reduction of their balance sheet size)	NEUTRAL
EARNINGS GROWTH	Top-line growth and margins remain resilient. Earnings revisions are positive and earnings mo-mentum is expected to improve going forward	AI-driven margins improvement are most likely overpriced.	NEUTRAL
VALUATIONS	Absolute valuations have improved recently. Ex-technology, P/Es are at or below historical average	Equity risk premia are at, or close to, record lows. There is competition from cash and bonds	NEUTRAL
MARKET FACTORS	Trend indicators remain positive and strong. Market is not overbought anymore. Market breadth has improved.	Sentiment looks over-optimistic (for example: put-call ratio). MACD and mean-reversion are flashing red.	POSITIVE (↑)

ASSET ALLOCATION VIEWS

EQUITIES

We remain NEUTRAL on equities as we think the strong performance of the past few months already reflects most of the improving macroeconomic outlook. The earnings momentum remains favourable. However, market sentiment and valuations seem a bit overstretched.

The macro regime remains supportive for equities as an asset class as global leading indicators are showing signs of a rebound and China is stabilising. Valuation is high in US large caps but remains more reasonable elsewhere while earnings are supportive.

1. The macro regime remains favourable for equities

The global cyclical momentum is improving as shown by global leading indicators and this reduces the likelihood of downside risk in the near-term.

There is still near-term inflationary pressure, but medium-term prospects still point to disinflation, which is a support for equities and any interest cut by the Fed to reflect lower inflation will be a positive.

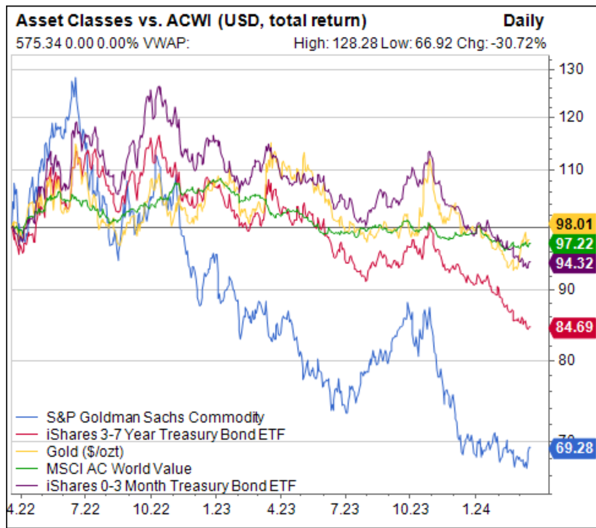
2. Positive earnings outlook

Earnings momentum remains strong with 11% and 17% yoy growth respectively for US and Japanese equities this year. For 2025, earnings growth is expected to accelerate in the US (+13% yoy), Europe (+10%) and Switzerland (+13%) while China is expected to remain steady (+9%).

Regions	Last	EPS CYO	EPS CY+1	YoY %	EPS CY+2	YoY %	PE CY+1	PE CY+2
S&P 500	5 178.5	218.2	242.4	11.1	275.2	13.5	21.2	18.7
STOXX Europe 600	505.2	34.1	35.8	4.8	39.4	10.2	14.1	12.8
Swit-zerland SPI	724.2	35.8	29.5	10.4	44.9	13.6	18.4	16.2
Hang Seng Index	16 529.5	1 804.7	1 966.5	9.0	2 142.1	8.9	8.5	7.8
Japan Nikkei 225	40 003.6	1 589.3	1 870.8	17.7	2 112.6	12.9	21.2	18.8

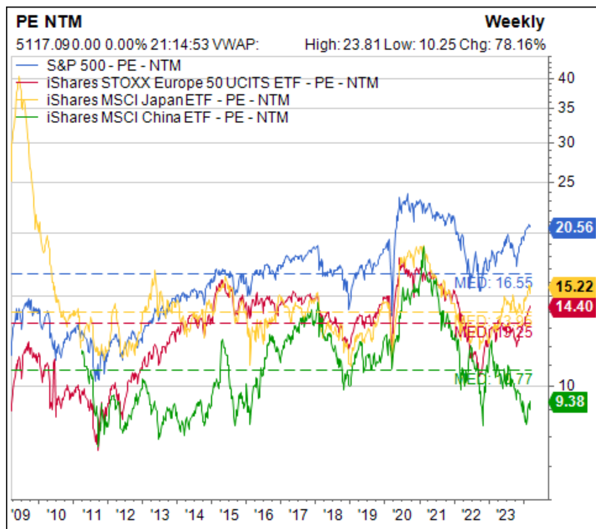
3. Good momentum vs. other asset classes

Equities continue to benefit from a favourable macro regime and are seen as an "edge" against inflationary pressure and money debasement. Most large companies have been able to pass through inflation pressure via price increases during the last couple years.



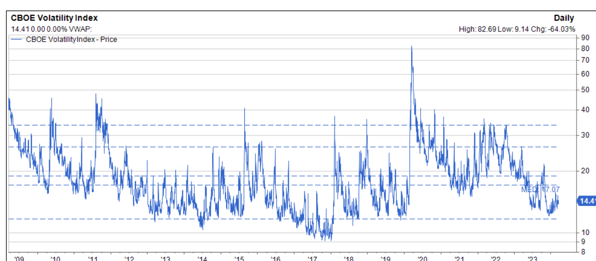
4. Valuation varies greatly within equity markets.

Valuation is stretched amongst US large cap names, but appears more reasonable when looking at Europe or Japan.



5. Risk environment and seasonality remains supportive.

The risk environment can quickly change, but the current low volatile environment combined with still a positive seasonality, remains in favour of the equity asset class.



From a regional/country standpoint, we maintain our slight preference for the US and Japan as earning growth is expected to continue this year and next.

We are neutral on Swiss equities. We also keep our neutral stance on the Eurozone/UK as earning momentum remains muted.

We are under exposed Emerging and Chinese equities as the dollar remains strong and, in the case of China, the lack of consumer and corporate confidence keeps us at bay for the time being. We note however that the market momentum has improved recently.

In the US, market concentration remains high, but we have seen some improvement in market breadth recently. The S&P 500 index remains expensive with an aggregate at PE at 20x. However, adjusted for the concentration, the S&P500 equal weight PE stands at 16x which is more in-line with historical averages.

FIXED INCOME

Our preference has moved from neutral to negative on Fixed Income. This is primarily influenced by our bearish perspective on the long end of the yield curve, coupled with a cautious approach towards Credit markets. Specifically, we have adjusted our rating on Investment Grade (IG) bonds from positive to neutral, while maintaining a slightly negative view on High Yield (HY) bonds.

Our evaluation of government bonds is nuanced, taking into account the maturity of the securities. For bonds with maturities of less than 10 years, we hold a neutral stance. This position is supported by the presence of high real yields, an anticipated peak in central bank's tightening, a shift towards disinflation, their relative value when compared to equities, and an improvement in correlations.

On the other hand, we exercise caution towards bonds with maturities exceeding 10 years. The presence of an inverted yield curve and negative term premiums diminishes their appeal, especially amidst ongoing interest rate volatility. Although initial apprehensions regarding the supply of long-term bonds in early 2024 were notable, recent successful auctions — including the record-setting 10-year US Treasury issuance — and reassurances from Treasury Secretary Yellen regarding supply stability have introduced a degree of optimism. The market is adjusting to the realities of quantitative tightening, albeit a moderation in its pace is anticipated. Market expectations are now aligned with the Federal Reserve regarding the anticipated number of rate cuts in 2024.

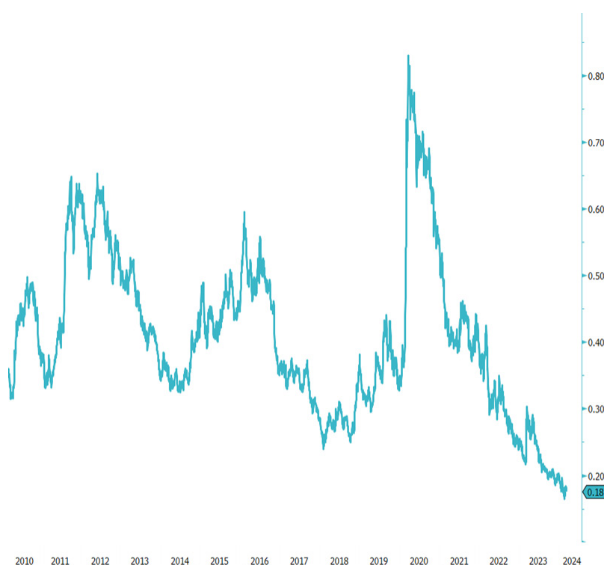
Balancing the Scales: Positive vs. Negative Factors in Bond Investments

Source: Syz CIO office

In Europe, our concern for the Eurozone's growth prospects and the potential slowdown in the ECB's rate cycle prompts a neutral view on EUR rates. The tightening of spreads in Euro Peripherals, especially between Italian and German 10-year yields, calls for caution. Nonetheless, the UK bond market stands out as an attractive opportunity, thanks to expected CPI decreases signalling inflationary relief and supporting the potential for Bank of England rate cuts by mid-2024. This backdrop, combined with appealing yields following recent market pullbacks, underscores the UK bond market as an attractive investment avenue. Additionally, the market does not anticipate a rate cut until the first half of 2024.

Within the corporate bond segment, we turn more cautious on IG corporate bonds. The sharp tightening in credit spreads, reaching lowest level since 2021, has considerably reduced the margin for safety in credit. Spreads now represent less than 20% in the total yield of an investment grade bond. This "price to perfection" encourages us to be more vigilant in this segment. In HY, we prefer subordinated debts over corporate bonds, recognising their favourable risk/reward profile within the fixed income landscape.

How much spreads represent of the total yield of Investment Grade corporate bonds?



Source: Bloomberg

Our stance remains neutral towards Emerging Market (EM) debt, specifically targeting bonds with maturities of up to 4 years and yields exceeding 6.5%. This cautious optimism is moderated by the recognition that spreads in EM corporate bonds are at their narrowest since 2018, necessitating vigilant valuation and risk assessments.

FOREX

Given recent macro developments in the US, the timing and extent of Fed's rate cuts in 2024 is more uncertain and might be later than expected, and less than expected.

As a result, there is no more reason at this stage to hold a positive view on the EUR and CHF, as the scenario of a stronger-than-previously-expected USD has gained probability.

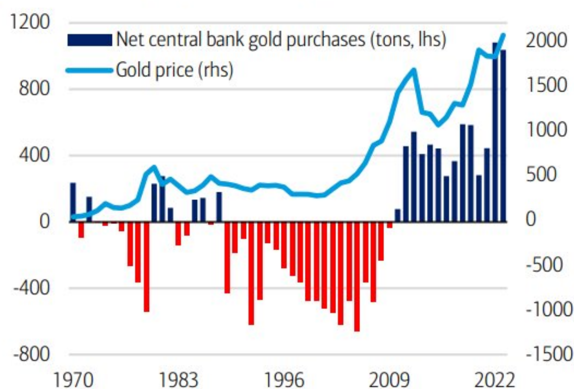
EUR/USD: Rates and macro dynamics are less negative for the EUR, but macro developments importantly also support the USD → our rating is NEUTRAL.

CHF/USD: Fundamentals no longer warrant additional CHF appreciation, and the real rate differential pleads for a firmer USD vs Swiss franc at least in the short run, especially after the surprise decision by the SNB to cut rate already in March. In the short-term, the USD might benefit from the real interest rate differential (nominal rate - inflation rate) that has recently become more supportive for the greenback: inflation in the US is slowing while short-term nominal rates remain high, which leads to rising real USD rates. A higher real rate differential supports USD. However, when the Fed starts cutting its key rate, this real rate differential between USD & CHF should reverse lower and weigh on the USD vs CHF in the later part of 2024 → our rating is NEUTRAL.

ALTERNATIVES

Within commodities, we remain positive on gold, which continues to exhibit low volatility with other asset classes and should be a beneficiary of any tail risk event. We note that a significant gap remains between gold and real yields. Why? 1) With debt sustainability becoming an ever-increasing issue, the market anticipates that real interest rates cannot stay at this level for too long; 2) Investors buy gold as an insurance against adverse circumstances (inflation, recession, etc.); 3) There is heavy demand stemming from central banks, especially in emerging markets.

Exhibit 4: Central banks hoard gold at the fastest pace in modern times
Net official annual gold purchases vs spot gold price, annual



Source: BofA

But for gold to appreciate in dollar terms, a drop in real yields is probably required. In the meantime, gold remains a true diversification asset.

We also maintain a neutral view on Hedge Funds. We like well-established Global Macro funds that have a multi-portfolio manager approach. We cautiously like Relative Value funds but are wary of liquidity conditions. We like having a core position in a diversified systematic strategy with a long-term commitment. We prefer staying away from Equity long/short and directional funds as their beta is too high. We do not like Event Driven funds as we believe the merger & arbitrage landscape will be very challenging in 2023.

INVESTMENT CONCLUSIONS

TACTICAL ASSET ALLOCATION (TAA) DECISIONS– 18.3.2024

Our allocation to equities remain close to our Strategic Asset Allocation (SAA). Due to market effects, the allocation is sligthly above the NEUTRAL weight.

We downgraded Fixed Income from NEUTRAL to NEGATIVE and increase our Cash exposure.

Global equities (NEUTRAL)

- US and Japan remain our favourite markets (POSITIVE)
- We remain NEUTRAL on Switzerland
- We KEEP OUR NEGATIVE stance on Emerging Markets

Fixed Income (from NEUTRAL to NEGATIVE)

- We downgraded Government bonds 1-10 year from POSITIVE to NEUTRAL and downgraded Government Bonds 10+ from NEUTRAL to NEGATIVE
- We downgraded Corporate Investment Grade Bonds from POSITIVE to NEUTRAL

FOREX

- We remain NEUTRAL EUR and CHF (vs. dollar)
- We remain POSITIVE JPY vs. dollar

Commodities and Alternatives

- We remain POSITIVE Gold and NEUTRAL on Hedge Funds and Commodities

ASSET ALLOCATION GRID

TACTICAL POSITIONING: OUR ASSET ALLOCATION MATRIX

	--	-	NEUTRAL	+	++
Portfolio Risk		Fixed Income ←	Cash Equity Alternatives		
Fixed Income		Govies 10+ (local) ← HY (local or global hdg)	Govies 1 - 10 (local) ← Corporate IG (local) ← EM Debt		
Equities		Emerging Markets	Euro Zone United Kingdom Switzerland	United States Japan	
Alternative Investments			Hedge Funds		
Commodities				Gold	
Forex (vs USD)			EUR CHF GBP EM currencies	JPY	

Change from last month: More attractive → Less attractive ←

Source: Investment strategy group - 18 March 2024

For further information

Banque Syz SA
Quai des Bergues 1
CH-1201 Geneva
Tel +41 58 799 10 00
Fax +41 58 799 20 00
syzgroup.com

Charles-Henry Monchau, Chief Investment Officer
charles-henry.monchau@syzgroup.com

Luc Filip, Head of Discretionary Portfolio Management
luc.filip@syzgroup.com

Adrien Pichoud, Chief Economist & Senior Portfolio Manager
adrien.pichoud@syzgroup.com

Gaël Fichan, Head Fixed Income & Senior Portfolio Manager
gael.fichan@syzgroup.com

Gaël Combes, Head of Equities
gael.combes@syzgroup.com

This marketing document has been issued by Bank Syz Ltd. It is not intended for distribution to, publication, provision or use by individuals or legal entities that are citizens of or reside in a state, country or jurisdiction in which applicable laws and regulations prohibit its distribution, publication, provision or use. It is not directed to any person or entity to whom it would be illegal to send such marketing material.
This document is intended for informational purposes only and should not be construed as an offer, solicitation or recommendation for the subscription, purchase, sale or safekeeping of any security or financial instrument or for the engagement in any other transaction, as the provision of any investment advice or service, or as a contractual document. Nothing in this document constitutes an investment, legal, tax or accounting advice or a representation that any investment or strategy is suitable or appropriate for an investor's particular and individual circumstances, nor does it constitute a personalized investment advice for any investor.
This document reflects the information, opinions and comments of Bank Syz Ltd. as of the date of its publication, which are subject to change without notice. The opinions and comments of the authors in this document reflect their current views and may not coincide with those of other
Syz Group entities or third parties, which may have reached different conclusions. The market valuations, terms and calculations contained herein are estimates only. The information provided comes from sources deemed reliable, but Bank Syz Ltd. does not guarantee its completeness, accuracy, reliability and actuality. Past performance gives no indication of nor guarantees current or future results. Bank Syz Ltd. accepts no liability for any loss arising from the use of this document.