ASSET ALLOCATION INSIGHTS

Monthly Update | Issue 92 02 May 2024

Key takeaways

- There has been a change of tone in the markets with equities pulling back in April and US 10-year yield moving up 45 basis points over the month, while gold and the dollar soared.
- The weight of evidence of our fundamental and market dynamics indicators leads us to remain neutral to positive on equities. While markets could stay choppy for a little while, we believe that the pullback could be contained, and that further equity market weakness is buyable.
- Going forward, we want to keep our allocation to Equities close to our strategic asset allocation (SAA) neutral weights. We upgraded our stance on European stocks (from neutral to positive) and downgraded our view on Japanese stocks from positive to neutral. We remain negative in fixed income and downgraded our view on Emerging markets bonds. We have also upgraded our stance on Commodities to positive from neutral. Last but not least, we reduced all currencies by one “notch” vs. USD: EUR, CHF, GBP & EM are reduced down to negative (from neutral) while JPY is down to neutral (from positive).

PRIVATE BANKING

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THE BIG PICTURE

After a 25% run higher in the S&P 500 over the past six months, the tone in the markets in recent weeks seems to have shifted with global equities moving broadly lower in April and US 10Y yields up roughly 45 bps since the start of the second quarter. Meanwhile, the dollar rallied for the fourth month in a row and gold hit a new all-time-high at $2,400.

What are the main drivers of this equity pullback? In our view, it can be explained by 3 factors.

First, the market has repriced Fed rate cuts and is now expecting just one rate cut in 2024, and it is adjusting to this new "higher for longer" interest-rate regime. The reasoning behind the repricing of the Fed rate cuts has been driven by recent U.S. inflation being more persistent than expected (Headline CPI has gone from 3.1% yoy to 3.5% in three months), strong economic growth and a resilient consumer (retail sales far exceeded expectations). However, we would highlight that nothing yet in recent inflation reports suggest that some of the recent disinflation trends have ended and that inflation has been reignited in a meaningful or sustained manner. In fact, the recent labor-market reports that show a gradual easing trend in wage gains also help support this point of view for the medium term.

Second, geopolitical tensions have been rising, particularly in the Middle East. A primary concern for investors may be the risk of the oil supply being severely disrupted in an economy like Iran. However, given available supply in both OPEC+ and in the U.S., this risk might be overestimated to some extent, as supply can be increased if needed, particularly during an election year in the U.S. Another driver of rising oil prices has been the fact the global economy seems to be stabilizing, which could also serve as a demand driver for global commodities broadly, i.e the “war” premium embedded in oil prices might be lower than many had feared.

Third, S&P 500 first-quarter earnings season is underway, and while companies are beating forecasts, the outlooks by some banks have been softer than expected and triggered some profit taking. However, strong earnings results and favourable guidance by some of the Mag 7 (Alphabet, Amazon, Microsoft) seem to be reigniting some positive momentum in the Tech sector and the markets more broadly.

So is the recent market’s momentum fatigue the start of a more severe correction? Will global equity markets soon resume their uptrend?

As explained in the next sections, the weight of the evidence built on our 5 pillars process points towards a neutral / positive stance towards equities. Positive nominal GDP growth prospects for the months ahead, with reduced downside risks, still warrant a positive assessment of the Macro cycle at that stage. The combination of positive real cash rates and QT, on the one hand, and easy broad financial conditions and expected rate cuts on the other hand, warrants to maintain a neutral assessment on liquidity conditions. Earnings growth is neutral with a positive momentum and earnings revision though much of these revisions are led by a small number of mega caps tech stocks. Equity valuations are not cheap – both on an absolute and relative basis. However, the S&P 500 ex-mag 7 P/E is in line with median historical P/Es while European stocks valuations are still attractive. Market Dynamics (trend, breadth) remain positive. Overall, the weight of the evidence points towards a neutral / positive stance towards equities.

As such, we are keeping our global equity allocation close to our Strategic Asset Allocation and refrain from 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-caps 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 upgrading Europe to positive (from neutral) and downgrading Japan to neutral (from positive). While China equities momentum is improving, we will refrain from adding to this region at this stage.

On the rates side, Treasury supply continues to rise and coupled with sticky inflation, are pushing long-dated bond yields higher. We keep our negative view on the 10 years+ Government bonds. We are downgrading our view on Emerging Markets Debt to negative (from neutral). The downtrend in credit spreads has continued towards multi-year lows. We remain neutral credit with a preference for quality (investment grade). On an aggregate basis, our fixed income positioning is negative.

Within commodities, we are keeping 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. We are upgrading our view on Commodities to positive (from neutral).

In Forex, we believe that the dollar could continue to stay firm as monetary policy could remain restrictive for a longer period than in the rest of the world. We are reducing all currencies by one “notch” vs USD: EUR, CHF, GBP & EM are reduced down to negative (from neutral) while JPY is down to neutral (from positive).

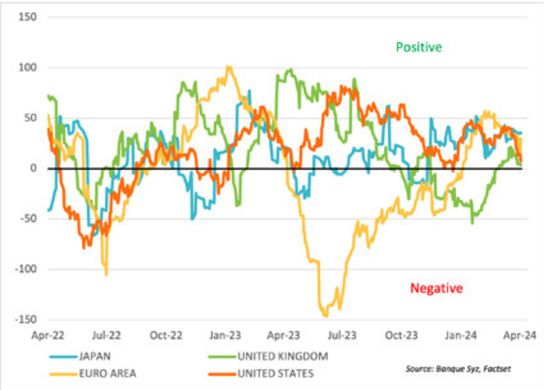
We continue to believe that our well-diversified portfolio positioning should help us navigate the current macroeconomic and market conditions.

A MACRO & MONETARY POLICY UPDATE

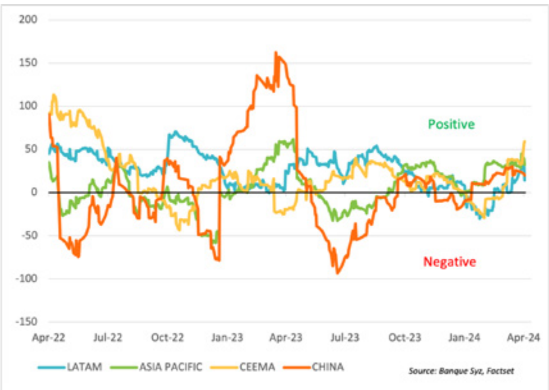
Global growth dynamic pickup is underway

Developed economies continue to exceed expectations, with positive economic surprises across all key economic areas.

Economic Surprise Indices
(Actual data release vs. consensus expectations)
Developed Economies

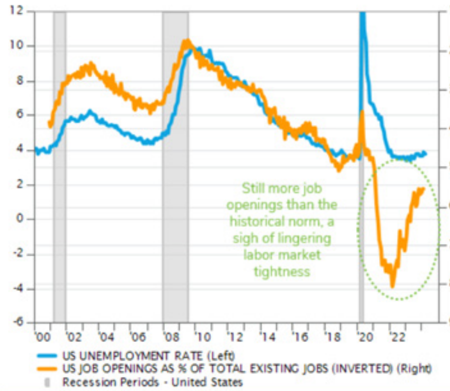


Economic Surprise Indices
(Actual data release vs. consensus expectations)
Emerging Economies

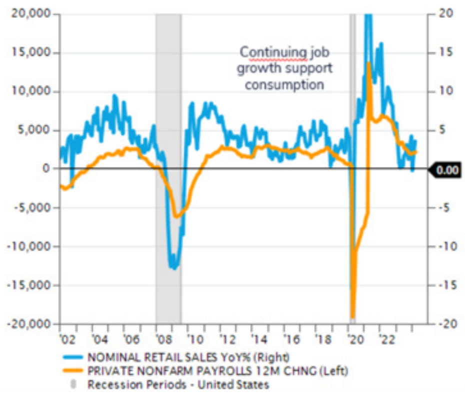


The US economy continues to grow firmly, slightly above trend, supported by a resilient labor market that fuels robust consumption growth.

US unemployment rate and selected gauge of labor market tightness



Nonfarm payrolls and retail sales (annual change)

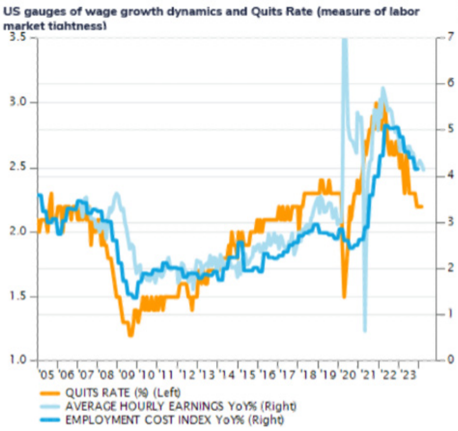


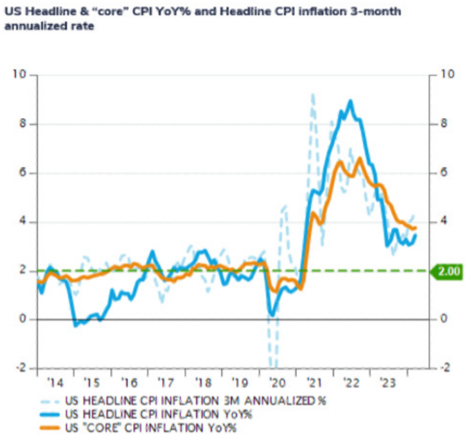
The Eurozone continues to recover (with Germany lagging behind), as consumption in services benefits from the ongoing disinflationary trend.

The Japanese economy also exhibits positive momentum, and the end of deflation might be in sight.

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

Short-term inflation dynamics remain stronger than expected, especially in the US, fuelled by resilient final demand and upward pressures on energy and commodity prices. However, upward pressures on wages are gradually abating and still suggest that underlying inflationary pressures will ease in the medium term.



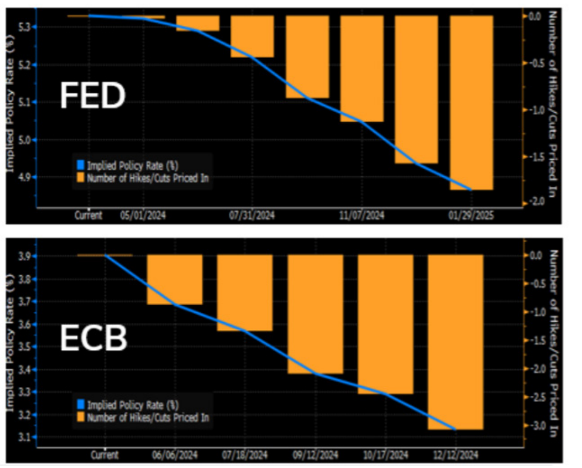


On the political front, fiscal intervention is no longer a tailwind for growth in 2024, but not a headwind either. Many important elections in 2024 (US first and foremost) could impact medium-term economic and geopolitical prospects. Geopolitical risks remain elevated.

Rate cut expectations are revised downward

Rate cut expectations are being revised lower in this context of positive growth momentum and sticky inflationary pressures. The expected global rate cut cycle might rather be a "fine tuning" exercise of policy recalibration rather than the typical rate cut cycle of the past two decades.

Current projection of Fed & ECB rate cuts:
less than two 25bp cuts for the Fed, three 25 bp rate cuts for the ECB (starting in June)



Alternative measures of liquidity show a slightly less favorable environment entering Q2.

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

	(+)	(-)	WEIGHT OF THE EVIDENCE
MACRO CYCLE	Global economic surprises have been improving. The US economy remains supported by domestic consumption. China growth seems to be stabilizing. There are short-term upside risks on inflation but medium-term prospects still point to disinflation.	Tighter financing conditions could ultimately impact growth.	**POSITIVE**
LIQUIDITY	Financial conditions are on the "easy side", despite the recent pullback caused by equity and credit markets' pullback. Central banks are still expected to cut rate in the second half of the year to avoid maintaining unnecessarily restrictive financing conditions as inflation gradually slows down.	Central banks might continue to keep Quantitative Tightening and interest rates at elevated levels for few more months.	**NEUTRAL**
EARNINGS GROWTH	Q1 earning season is off to a decent start. A resilient US economy should support forward earnings growth. Earnings momentum has turned positive.	Because valuations have risen over the past five months, the bar of expectations is high, and companies must deliver the earnings and outlook to support these valuations.	**NEUTRAL**
VALUATIONS	Ex Mag-7, valuations in the US and abroad are not expensive.	S&P 500 12-months forward P/E is back to 20x. Equity risk premium remains elevated as bond yields have been on the rise There is competition from cash and bonds.	**NEUTRAL**
MARKET FACTORS	Technical indicators have reached an "oversold" territory. With the model's contrarian approach this means a "buy" signal. Market breadth has remained high and has oscillated around key levels with a last reading above it.	The recent market correction has led to a neutral stance on trend indicators (one remains positive the other turns negative).	**POSITIVE**

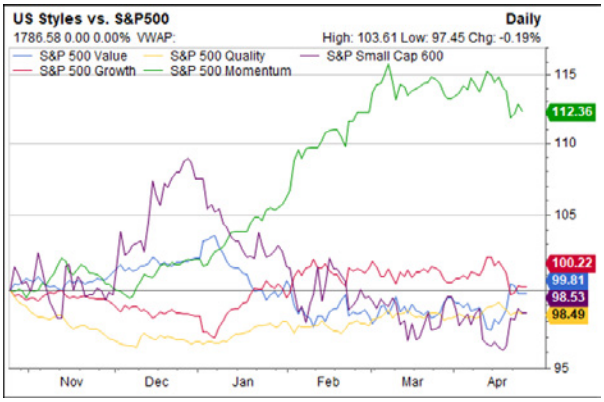
ASSET ALLOCATION VIEWS

EQUITIES

We continue to be constructive on equities as an asset class. The macro regime remains supportive as global leading indicators continue to show signs of a global pick-up in economic activity including signs of stabilization in China. The earnings season is on and, on aggregate, earnings and guidance in the US are on pace for a 10% yoy growth in 2024.

Regions	Last	EPS CY0	EPS CY+1	YoY %	EPS CY+2	YoY %	PE CY+1	PE CY+2
S&P 500	5 071.6	218.1	241.7	10.8	275.8	14.1	21.0	18.4
STOXX Europe 600	505.6	34.2	35.8	4.8	39.6	10.5	14.2	12.8
FTSE 100	8 040.4	671.7	685.6	2.1	745.7	8.8	11.7	10.8
Switzerland SPI	712.0	35.8	39.8	11.1	45.4	14.0	18.0	15.8
Hang Seng Index	17 201.3	1 805.1	1 954.3	8.3	2 121.0	8.5	8.6	7.9
Japan Nikkei 225	38 460.1	1 589.3	1 855.5	16.8	2 100.8	13.2	n/a	17.9

The better health of the US economy makes inflation stickier there, and investors have re-assessed the timing for interest rate cuts by the FED and the 'higher for longer' scenario while geopolitical tensions in the Middle East have exacerbated this repricing process. This is causing some style rotation away from momentum and growth.

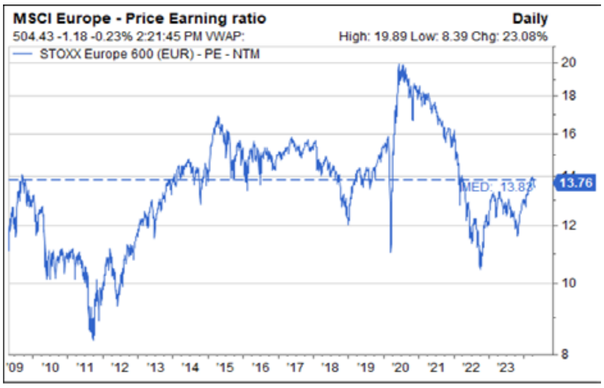


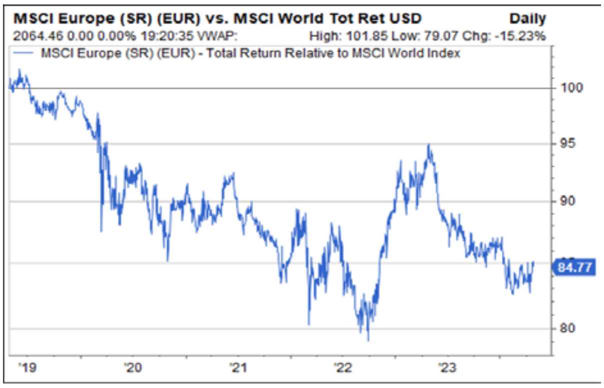
In terms of regions, our preferences are for the US and Europe. In the US, the strong economy remains a support for equities even if rate cuts are delayed. The resilient economy will allow for a broader earning growth next year.

Sectors US	Last	EPS CY0	EPS CY+1	yoy	EPS CY+2	yoy	PE CY+1	PE CY+2
S&P 500 / Consumer Discretionary -SEC	1 414.7	48.7	54.6	12.1%	63.3	16.0%	25.8	22.2
S&P 500 / Consumer Staples -SEC	810.4	37.3	39.2	4.8%	42.3	7.9%	20.5	19.0
S&P 500 / Energy -SEC	735.2	57.5	56.4	-1.9%	60.7	7.5%	13.0	12.1
S&P 500 / Financials -SEC	683.7	38.8	43.7	12.9%	48.7	11.3%	15.6	14.1
S&P 500 / Health Care -SEC	1 641.2	74.7	81.0	8.6%	96.8	19.5%	20.3	17.0
S&P 500 / Industrials -SEC	1 033.3	43.9	47.5	8.1%	54.5	14.8%	21.9	19.1
S&P 500 / Materials -SEC	556.3	27.0	26.5	-1.8%	30.6	15.3%	21.0	18.2
S&P 500 / Information Technology -SEC	3 606.9	110.9	130.5	17.7%	153.7	17.7%	27.6	23.5
S&P 500 / Telecommunications Services -IG	122.1	11.5	11.6	0.5%	12.6	8.6%	10.5	9.7
S&P 500 / Utilities -SEC	339.0	18.6	20.3	8.8%	22.0	8.4%	16.6	15.3
S&P 500 / Real Estate - SEC	229.6	13.7	13.9	1.2%	14.8	6.7%	16.5	15.5

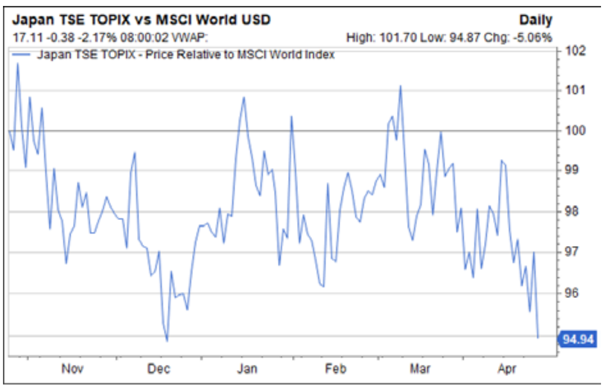
Source: Factset

In Europe, while the economy is less buoyant, inflationary pressures are receding, which is a short-term support for corporate margin, and the ECB is likely to cut interest rates sometime this year. In addition, valuation is less stretched (left chart) and Europe, which is a bit more cyclical and value in style than US equities, is stabilizing in terms of relative performance (right chart). Finally, for once, the banking sector is not a weak link for the region.





On the other hand, we are now less enthusiastic about Japanese equities after the strong performance in local currency as the continuous weakness on the yen is making the mission of the BoJ more complicated while inflationary pressures are mounting.



FIXED INCOME

We are keeping our negative stance on Fixed Income, primarily driven by our bearish view on the long end of the yield curve and a cautious approach towards the credit markets. Specifically, we maintain a neutral outlook on Investment Grade (IG) bonds, while harboring a slightly negative view on High Yield (HY) bonds. We have downgraded Emerging Market (EM) debt denominated in USD from neutral to negative, as valuations have become expensive, and the protracted normalization of Federal Reserve monetary policy is likely to hinder EM debt performance.

Our assessment of government bonds is differentiated by maturity. For bonds with maturities under 10 years, we remain neutral, buoyed by high real yields and the likelihood that central bank tightening has peaked. However, we are cautious towards longer-maturity bonds due to an inverted yield curve and negative term premiums, which lessen their attractiveness amid ongoing rate volatility. Concerns about the timing of the Federal Reserve's first rate cut and the trajectory of policy normalization also weigh on valuations. Additionally, projections of a growing US fiscal deficit and increased Treasury issuances—expected to double in 2024 compared to 2023—in a period where central bank demand is diminishing (quantitative tightening) complicate the outlook. Nevertheless, market expectations are now more closely aligned with the Federal Reserve's anticipated rate cuts in 2024, indicating a much longer path to policy normalization than previously expected by the market.

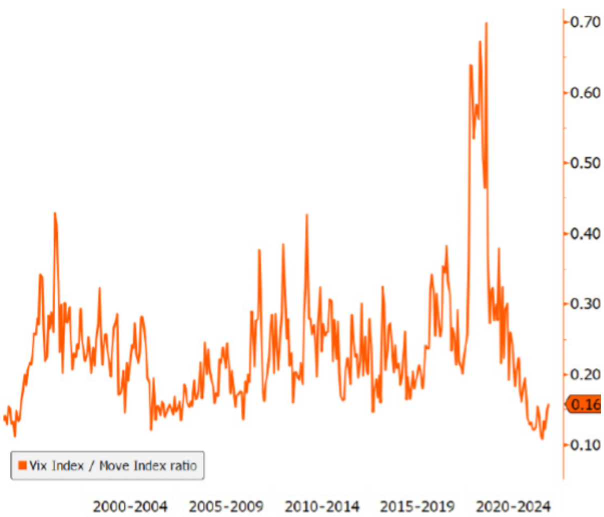
In Europe, we maintain a neutral stance despite a recent uptick in Eurozone economic activity. Our baseline scenario still anticipates the first ECB rate cut in June, yet the pace of normalization remains uncertain, heavily dependent on economic data. With wages remaining high, particularly in the services sector, and European inflation being sensitive to commodity prices, caution is advised. The tightening of spreads, especially between Italian and German 10-year yields, further necessitates a cautious approach. While we previously held a positive outlook on UK government bonds, the strong economic ties to the US and recent upward revisions in Gilt supply by the Debt Management Office have prompted us to adjust our stance to neutral, recognizing the Bank of England's difficult position as the job market deteriorates.

Within the corporate bond segment, we continue to adopt a neutral stance on investment-grade corporate bonds. A significant tightening in credit spreads, now at their lowest levels since 2021, has substantially reduced the margin of safety, with spreads now accounting for only 15% of the total yield on investment-grade bonds. This "priced to perfection" scenario calls for heightened vigilance. However, given that the macroeconomic outlook remains positive—supported by strong US corporate fundamentals and growing concerns about the sustainability of US Treasury debt—a premature reduction in credit exposure might be overly cautious. In the High Yield sector, we favor subordinated debts due to their favorable risk/reward profile. We also see value in short-term maturity corporate high yield bonds.

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

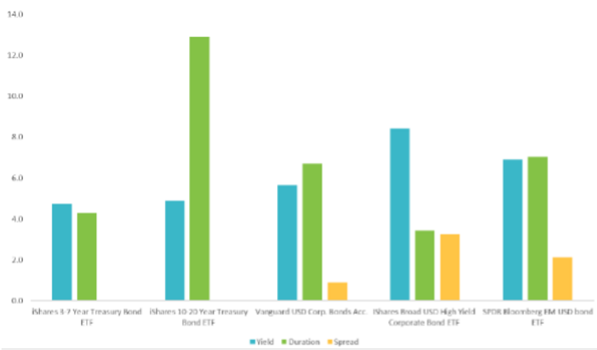
Source: Syz CIO office

Volatility Comparison Between Bond and Equity Markets



Source: Syz CIO office

Breakdown of Yield in Different Fixed Income Segments



Source: Bloomberg, Syz CIO Office

We have shifted from a neutral to a negative outlook on hard-currency Emerging Market (EM) debt. While we find specific opportunities in EM bonds with maturities up to 4 years and yields above 6.5% appealing, concerns about a strengthening US dollar and rising US real interest rates are significant. The comparative outperformance of this segment in recent months, relative to other bond markets, has led us to take profits. Additionally, the sentiment is deteriorating towards this fixed income category, as evidenced by persistent negative capital flows since the start of the year and an increase in short interest in USD-denominated EM debt, indicating growing market pessimism.

FOREX

Given recent macro developments in the US, the timing and extent of the Fed's rate cuts in 2024 is more uncertain and might be respectively later, 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 probability of a stronger USD has grown.

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

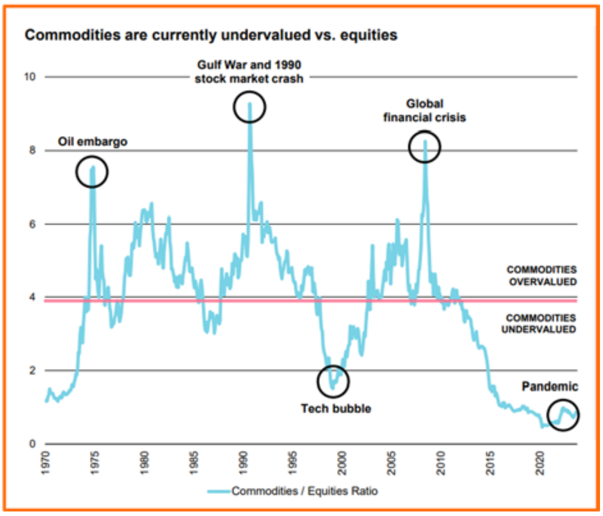
CHF/USD: Fundamentals no longer warrant additional CHF appreciation, and the real rate differential pleads for a firmer USD vs Swiss franc at least in the short run. In the short-term, the USD might benefit from the real interest rate differential (nominal rate - inflation rate) that has recently become 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. As real CHF rates remain broadly stable, a higher real rate differential supports the US dollar -→ our rating is NEGATIVE.

JPY/USD: It is highly likely that Japanese authorities will intervene as the JPY has been testing the 160 level against dollar. Nevertheless, there is no guarantee that intervention will prove effective. The BoJ is "trapped": Japan is experiencing increasing inflation expectations alongside a continuous devaluation of the yen, exhibiting an almost perfectly negative correlation. This reflects the dilemma of an economy burdened by excessive debt, necessitating continuous accommodative monetary policies in the face of structural inflationary pressures. If Japan wants to slow its FX devaluation, they could raise rates. However, that would greatly increase their deficit, which the BOJ would have to monetize, and thus accelerate money supply growth.

ALTERNATIVES

Within commodities, we remain positive on gold, which continues to exhibit low volatility compared to 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 having become 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 emerging markets.

We are tactically adding to commodities as a portfolio diversifier and protection against inflation upside. Commodity prices are moving higher driven by strong US growth, geopolitical uncertainty, segmentation of global trade and AI demand for energy. We also note that Commodities relative to equities currently stand at a near record low.



Source: Vontobel

We maintain a neutral view on Hedge Funds. We like well-established Global Macro funds that have a multi-portfolio managers 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– 24.4.2024

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

Global equities (NEUTRAL)

→ We increase Eurozone to Positive (single "+")

→ We decrease Japan to Neutral

Fixed Income (NEGATIVE)

→ We reduce EM Debt to Negative (single "-")

FOREX

→ Reduction of all currencies by one "notch" vs USD

→ EUR, CHF, GBP & EM down to Negative (single "-")

→ JPY down to Neutral

Commodities and Alternatives

→ Addition of Global Commodities as a Positive (single "+")

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) EM Debt ←	Govies 1 - 10 (local) Corporate IG (local)		
Equities		Emerging Markets	United Kingdom Switzerland Japan ←	United States → Euro Zone	
Alternative Investments			Hedge Funds		
Commodities				Gold → Commodities	
Forex (vs USD)		EUR ← CHF ← GBP ← EM currencies ←	JPY ←		

Change from last month: More attractive → Less attractive ←

Source: Investment strategy group - 24 April 2024

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