ASSET ALLOCATION INSIGHTS

Monthly Update | Issue 93 31 May 2024

Can the equity bull market continue?

Key takeaways

- We believe global economic growth could soften but will likely remain positive while the disinflation trend should stay in place. This, coupled with monetary and fiscal policy support ahead of the US elections, is creating an attractive backdrop for equity markets in the months ahead.

- Within our opportunistic asset-allocation guidance, we recommend clients to go underweight Fixed Income and overweight US and European stocks while staying underweight Emerging markets stocks. Commodities and Gold are still useful portfolio diversifiers. We are staying long dollars.

- There is one change within our preference grid this month: we increase Government bonds 1-10 years from NEUTRAL to POSITIVE.

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*

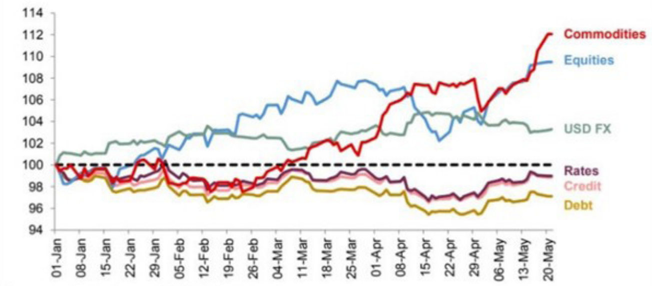
THE BIG PICTURE

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.

CHART OF THE WEEK: COMMODITIES OUTPERFORMING SO FAR IN 2024

MAJOR CROSS-ASSET PERFORMANCE (REBASED 1 JANUARY 2024 = 100)



Source: Bloomberg, MUFG Research

As we move into the second half of 2024, the one billion dollars question for investors is whether the equity bull markets will continue.

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 cap 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 stock valuations are still attractive. Market Dynamics (trend, breadth) remain positive. Overall, the weight of the evidence points towards a neutral / positive stance towards equities.

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 also keep our negative view on Emerging Markets Debt. 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 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 also kept our positive view on Commodities.

In Forex, we believe that the dollar could continue to stay firm as monetary policy could stay restrictive for a longer period than in the rest of the world. We keep our negative on USD: EUR, CHF, GBP & EM vs. USD. We also keep our neutral view on JPY.

Overall, we keep our preference for equities over fixed income and continue to consider commodities and gold as diversifiers. As we move into the second half of the year, we believe that 3 conditions are needed for the equity bull market to continue:

1) The disinflation trend should stay in place to prevent bond yields from crossing some key thresholds;
2) Corporate profit growth in the double-digits range for the rest of the year
3) The AI effect starting to expand into multiple sectors of the market over time.

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

Macro-cycle: POSITIVE (unchanged)

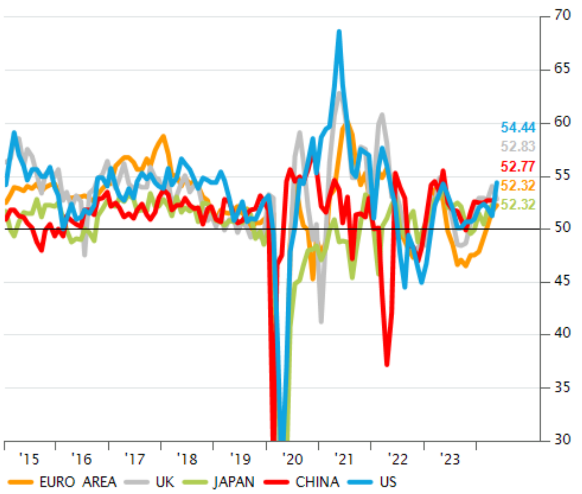
Liquidity: NEUTRAL (unchanged)

The global economy remains in solid expansion over the spring, as the favourable trends at play since the end of 2023 continue to blossom. In the United States, activity in the service sector is still the main driver of GDP growth, with high employment, elevated wage growth and unabated support of fiscal policy being powerful supports to consumption spendings. As household consumption weights close to 70% of the US GDP (consumption of services alone being almost 50%), the ongoing positive dynamic in this key component keeping US GDP growth above its trend rate. In the meantime, Europe continues to recover after the soft patch of 2023 and still exhibits a clear growth momentum. Here too, the service sector is also the main driver of the expansion, even in Germany where the slowdown had been most pronounced last year. A favourable economic dynamic is also visible in Asia, where Japan benefits from rising global demand for its manufactured goods at a time when households face a long-forgotten phenomenon for them, rising prices. In China, the real estate market remains a drag on consumption that the government is trying to fix without reigniting an investment bubble. But industrial activity is recovering and supports a pace of expansion in line with the target set by the authorities.

To be fair, some signs have appeared recently that raise the risk of a deterioration in this positive economic environment for the second part of the year.

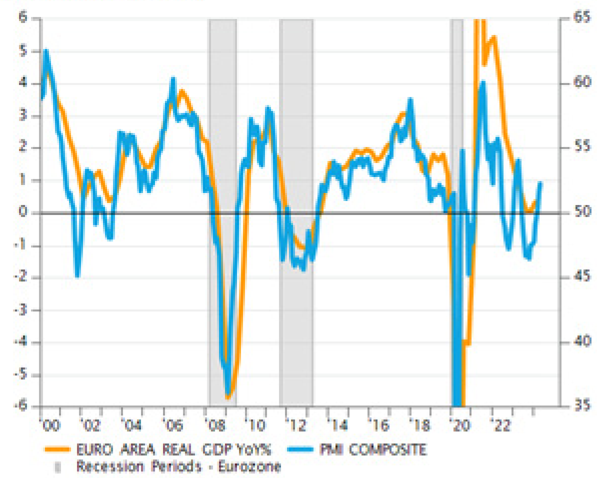
↓ *Global growth is settling on a soft-but-positive rate after two years of slowdown*

PMI Composite by country



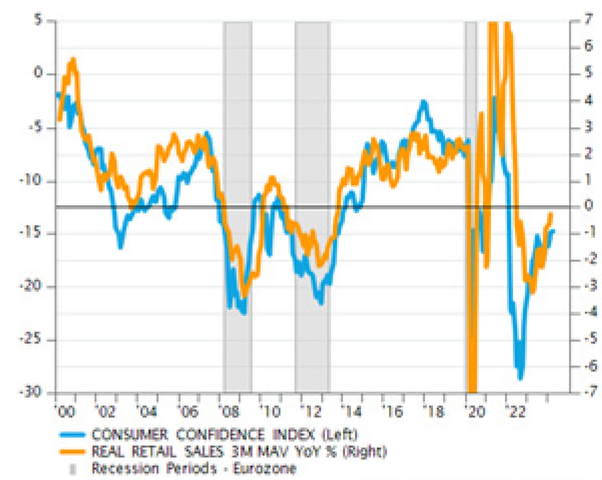
↓ *Eurozone – Economic activity continues to recover and is gradually converging toward 1% after the 2023 recession*

PMI Composite by country



Banque Syz, ©FactSet Research Systems

Consumer confidence and Real retail sales YoY%

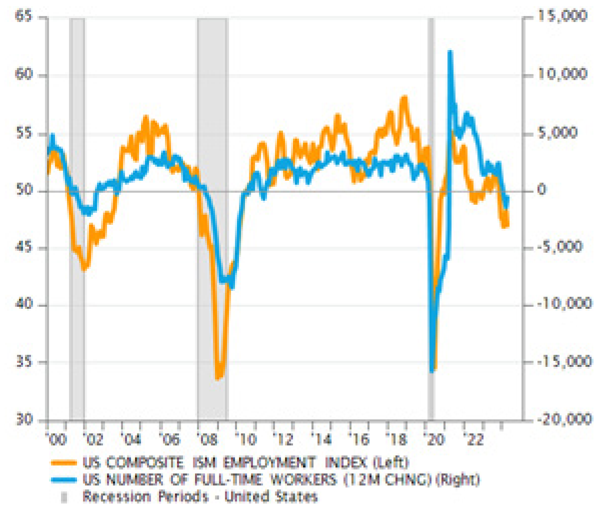


Banque Syz, ©FactSet Research Systems

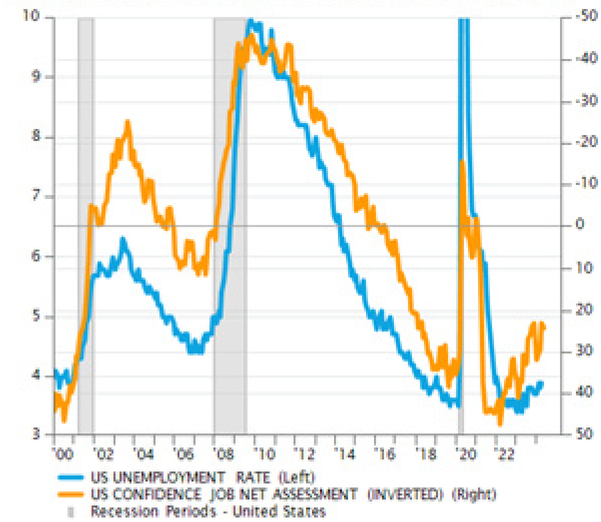
The deterioration in US consumer sentiment is one of them, as rising prices in several goods and services, from gasoline to housing, affect the purchasing power of a growing part of the population. In a context of high interest rates that make the use of credit cards and other forms of credit very expensive, persistent inflationary pressures are eroding households' purchasing power and confidence despite the positive dynamic of the broader economy. Five months ahead of the Presidential election, this situation is clearly unwelcome for Joe Biden, who is likely to pull every lever he can in the near future to enhance the economic sentiment of US voters. An economic growth slowdown just ahead of the election would indeed hamper the chances of re-election for the incumbent President.

↓ *US economy – The labour market is slowing down at last, a welcome development for easing inflationary pressures. But also a downside risk for growth*

Full-time payrolls (12m change) and ISM Employment "Composite" index



Unemployment rate and Consumer sentiment on the job market (inverted)

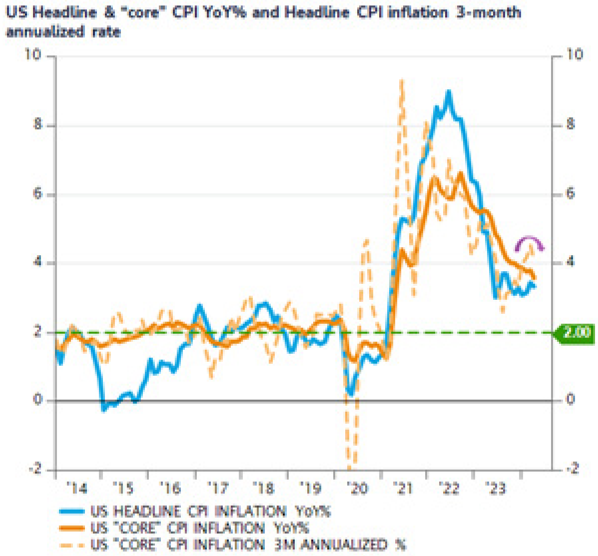


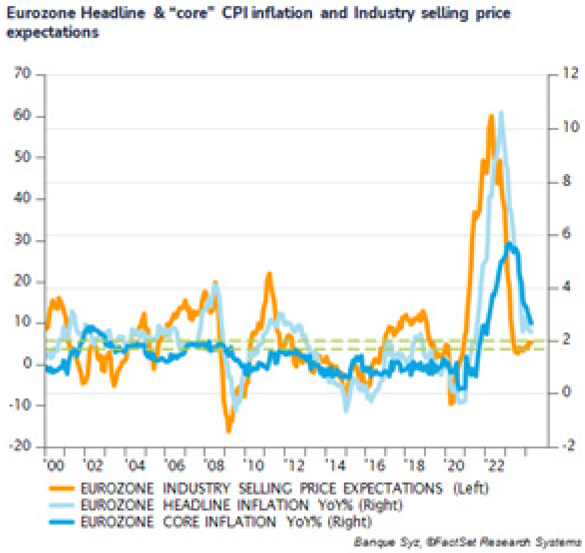
Lingering weakness in China's domestic consumption is also a potential risk for the second half of the year. The world's second largest economy can no longer rely exclusively on external demand for its growth, especially in a context of rising protectionist pressures in its two key export markets (US and Europe). Selective measures to stabilize the real estate market and prospects of rising government support via public debt issuance should help support a recovery in consumption spending, but the domestic momentum is still subdued in China for the time being.

The risk of weak or weaker domestic demand in the US and China, half the world's GDP between them, has to be closely watched in the months ahead even if, for the time being, ongoing dynamics and the likely support of government policies still point to a continuation of the positive growth trend over the summer.

Much of the economic developments will also depend on the evolution of inflationary pressures in the coming months. The inflation picture is quite contrasted across the main economic areas and might dictate divergent monetary policy responses by the end of the year. In China, weak domestic demand keeps inflation at a depressed level (+0.3% in April) that provides room for monetary and fiscal policy support. In Europe, inflation appears to be on a clear slowing trend (+2.4% in April) and is getting close to the ECB's 2% target. This will allow the central bank to start relaxing its monetary policy stance with a first rate cut in June, likely to be followed by more easing by the end of the year. The situation is less clearcut in the United States, where inflation is still significantly above the Fed's 2% target (+3.4% in April) and has proved to be stickier than expected since the beginning of the year. The latest data were encouraging in showing some softening of upward price pressures, but inflation remains a key issue for US households and for the Fed. The ongoing easing in US labour market tensions should gradually alleviate those inflationary pressures, but the risk of inflation persisting for some time in the US cannot be ruled out. It could disrupt the positive scenario expected for the second half of 2024, by dampening consumer sentiment and spendings, and preventing the Fed from relaxing its monetary policy stance.

Inflation is still too high for central banks (especially the Fed), but gradual disinflation remains the most likely scenario





The broad economic picture therefore remains quite positive for the time being and is most likely to remain supportive as we head toward the summer. A combination of positive economic growth, supportive fiscal policy, abating inflationary pressures and monetary policy easing (including a stabilization in liquidity conditions) would indeed be a favourable environment for the remaining of 2024. However, lingering inflationary pressures in the US, and question marks around domestic consumption in the US and China are potential downside risks that will have to be watched closely in the coming weeks.

Our scenario: A favourable economic environment heading toward the summer, but watch for inflation in the US and domestic demand in China.

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 growth remains in solid expansion. The US economy is still supported by domestic consumption, helped by fiscal policy. Europe & China gowth have recovered from 2023 lows. There are short-term upside risks on inflation but medium-term prospects still point to disinflation.	Some signs of weaker sentiment across US households point to potential doswide risks. Domestic demand remains subdued in China and prevents a stronger recovery. Tighter financing conditions could ultimately impact growth.	**POSITIVE**
LIQUIDITY	Financial conditions remain on the "easy side". 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. The pace of US Quantitative Tightening is slowing down, easing pressures on USD liquidity.	Central banks, especially the Fed in a context of lingering inflationary pressures, might continue to keep interest rates at elevated levels for few more months. Quantitative Tighening continues in the US and Europe.	**NEUTRAL**
EARNINGS GROWTH	Q1 earning season has been slightly ahead of expectations and led to upward revisions in the US and Europe. In the US, a broadening of earnings growth is expected in 2025. A resilient global economy should support forward earnings growth.	The bar of expectations is high, and companies must deliver the earnings and outlook to support these valuations. Downside risks around US consumption warrant to be monitored.	**NEUTRAL**
VALUATIONS	Ex Mag-7, valuations in the US and abroad are not expensive. Valuation is contrasted across regions, with China standing out with below historical median valuations.	S&P 500 12-months forward P/E is back above 20x. Expectations are relatively high in both earnings and valuation. Equity risk premium remains elevated as bond yields have been on the rise There is competition from cash and bonds.	**NEUTRAL**
MARKET FACTORS	The recent market rebound has re-confirmed the positive stance of trend indicators. Market breadth has remained high and has oscillated around key levels.	Technical indicators have quickly moved close to an "overbought" territory which means a "reduce" signal from our contrarian models.	**POSITIVE**

ASSET ALLOCATION VIEWS

EQUITIES

Earnings NEUTRAL (unchanged)

The first quarter earnings season is almost completed and has been slightly ahead of expectation even, in aggregate, revenues have seen little revision. As a result, earnings estimates have been mostly revised upward for the US and Switzerland that is seeing a boost from the weaker Swiss franc following the move by the SNB. Elsewhere, revisions are more muted notably in Japan due to a slowdown in economic activity.

Comparing the S&P500 and the S&P500 Equal Weight, we see that mega caps (Mag7) are expected to contribute meaningfully to earnings growth this year while investors expect a broadening of earnings growth in 2025 as market cap and equal weight are showing close growth rate.

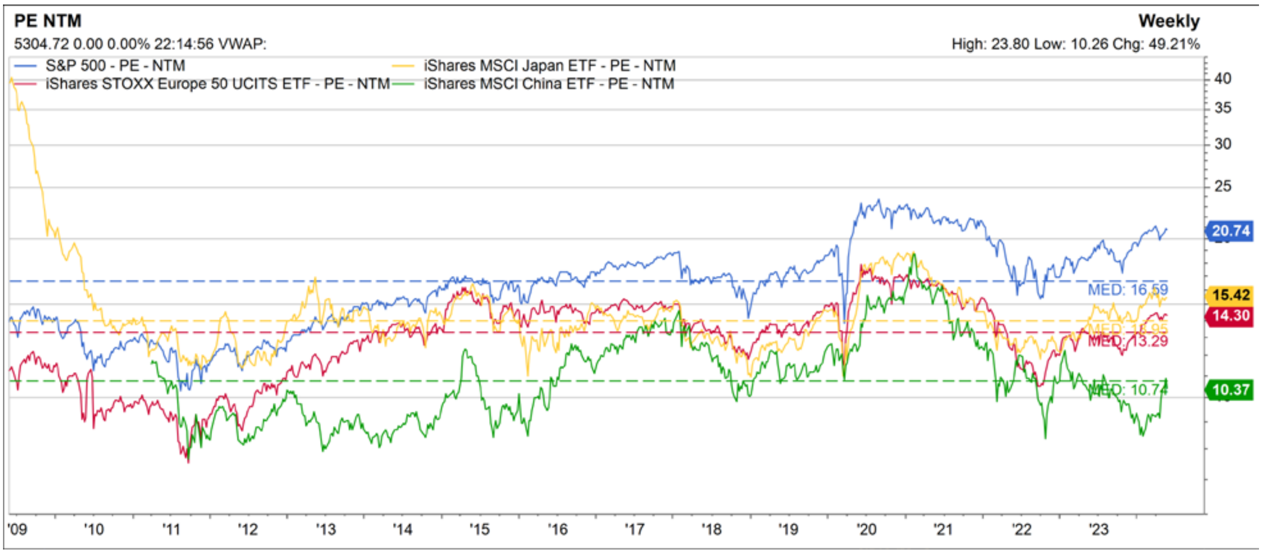
This scenario coupled with an earning growth acceleration next year in the US and Europe is positive for equity markets but, as stated in our macro view, would be challenged should consumption get weaker in the US.

Regions	Last	EPS CY0	EPS CY+1	yoy	1m Chg %	EPS CY+2	yoy	1m Chg %
S&P 500	5 304.7	217.9	243.3	11.6%	1.04	277.6	14.1%	1.01
S&P 500 Equal Weighted	6 720.5	368.3	390.9	6.1%	0.21	444.1	13.6%	-0.09
STOXX Europe 600	522.2	34.2	36.2	5.8%	0.29	39.9	10.2%	0.03
FTSE 100	8 317.6	671.6	684.7	1.9%	-0.54	747.9	9.2%	-1.23
Switzerland SPI	744.5	35.8	40.4	13.0%	0.57	45.5	12.7%	0.58
Hang Seng Index	18 827.4	1 805.2	1 980.9	9.7%	0.13	2 135.0	7.8%	-0.55
Japan Nikkei 225	38 900.0	1 586.3	1 826.1	15.1%	-1.42	2 074.5	13.6%	-0.49

Valuation NEUTRAL (unchanged)

Valuation is contrasted across regions with higher than historical multiples in the US and Europe reflecting the acceleration in earnings growth in 2025. This is also the reason of our neutral stance as expectations are relatively high in both earnings and valuation but the earning momentum (i.e., revision) remains positive.

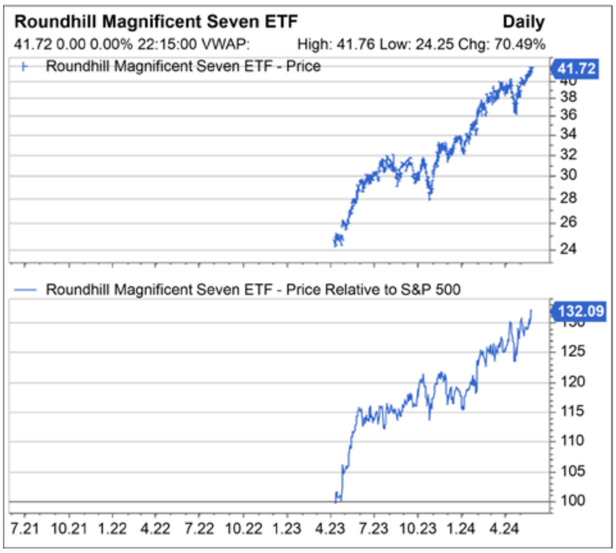
China remains the stand-out with below historical median valuation levels, but the economic outlook remains challenged and earnings are expected to decelerate next year.

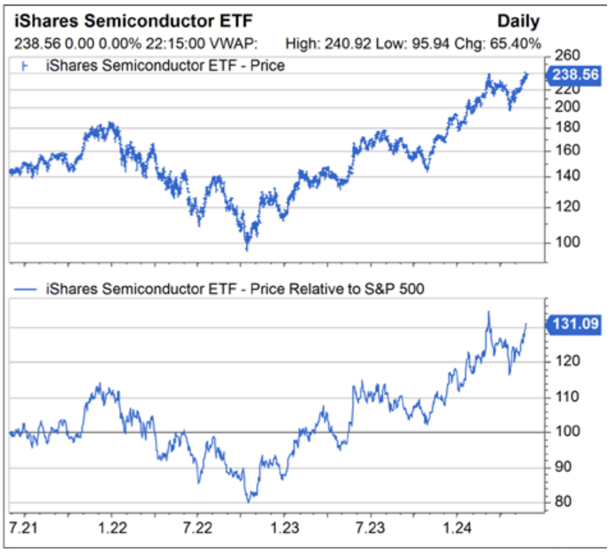


Market trends

The market concentration effect continues in the US with the Mag7 representing the bulk of earnings growth and the performance of the index, and we are not yet seeing a reversal of this trend.

Another strong trend is the "AI trade" notably visible in the semiconductor space as Nvidia and the SOXX index are performing strongly.





Regions and Sectors

Valuation is contrasted across regions with higher than historical multiples in the US and Europe reflecting the acceleration in earnings growth in 2025. This is also the reason of our neutral stance as expectations are relatively high in both earnings and valuation but the earning momentum (i.e., revision) remains positive.

China remains the stand-out with below historical median valuation levels, but the economic outlook remains challenged and earnings are expected to decelerate next year.

FIXED INCOME

We maintain a prudent approach in our fixed income strategy, influenced by a bearish perspective on long-duration bonds and a judicious stance on credit sectors. Despite our general caution, we have upgraded our view on short and intermediate government bonds from neutral to positive, while continuing to express concern for bonds maturing beyond 10 years. Our position on Investment Grade (IG) credit remains neutral, while we adopt a negative stance on High Yield (HY) and USD-denominated Emerging Market (EM) debt.

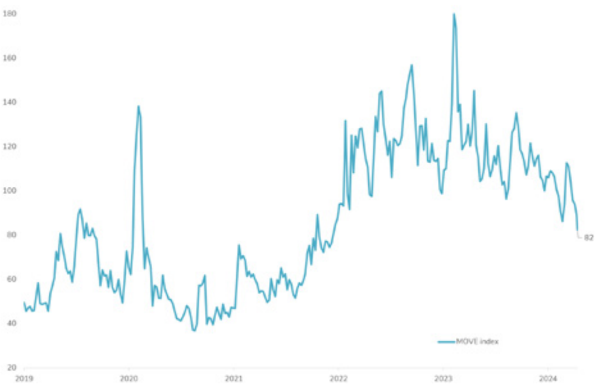
Government Bonds:

For bonds with maturities under 10 years, we now hold a positive outlook, anticipating favorable conditions for yield improvements by year-end over potential declines. This change is driven by several factors:

- Economic Stability: A normalization in the US economy paired with a gradual decline in inflation rates, despite occasional volatility.
- Monetary and Fiscal Policies: Efforts by the Federal Reserve and US Treasury to stimulate demand, including easing quantitative tightening and enhancing liquidity in the Treasury bond market through a buyback program.
- Valuation and Market Dynamics: Real rates remain above 2%, offering attractive value relative to equities, and the market anticipates a prolonged monetary policy normalization process, expecting over two years until reaching the terminal rate.
- Historical Trends: Bonds have traditionally shown strong performance ahead of the first rate cut, especially 2 to 4 months prior. With the first rate cut projected for Q3/Q4 2024, we are approaching a favorable period.

However, our cautious perspective persists for longer maturity bonds, influenced by an inverted yield curve, negative term premiums, and ongoing rate volatility. Additional concerns include uncertainty over the Federal Reserve's timing for the first rate cut, policy normalization trajectories, and the implications of a growing US fiscal deficit and increased Treasury issuances.

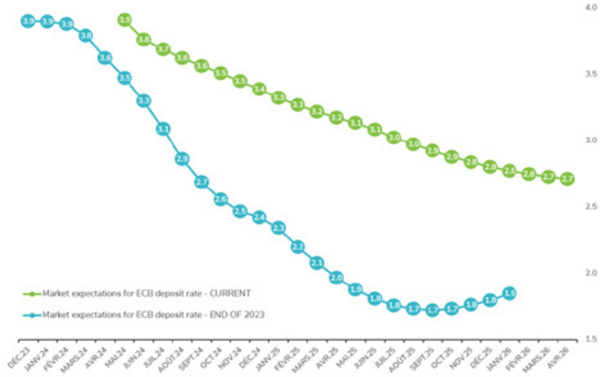
↓ *US Bond Volatility Trends - Lowest Since 2022*



Source: Syz CIO Office, Bloomberg

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, though the pace of normalization remains uncertain and highly dependent on economic data. With wages remaining high, particularly in the services sector, and European inflation sensitive to commodity prices, caution is advised. The tightening of spreads, especially between Italian and German 10-year yields, further necessitates a cautious approach. We remain neutral on UK government bonds, as the latest inflation figures (a smaller drop than expected) and the decision to hold a snap election on July 4th give the Bank of England all the economic justification it needs to possibly delay its monetary policy adjustment until August.

↓ *ECB Monetary Policy Outlook - Market Perception Shifts*

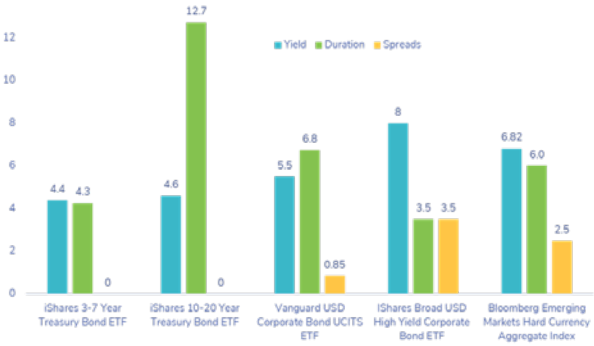


Source: Syz CIO Office, Bloomberg

Corporate Bonds

Our neutral stance continues in the investment-grade segment, where credit spreads have tightened significantly to their lowest since 2021, reducing the safety margin (now only 15% of total yield). The current market conditions are "priced to perfection," necessitating vigilance. Additionally, for the first time since 2022, there are more BBB-rated bonds with a negative outlook than those with a positive outlook. Despite these factors, the solid macroeconomic backdrop and concerns over US Treasury sustainability suggest that reducing credit exposure prematurely might be inadvisable. In the high-yield domain, we prefer subordinated debts and recognize opportunities in short-term maturity corporate high-yield bonds, given their favorable risk/reward profile.

↓ *Breakdown of Yield in Different Fixed Income Segments*

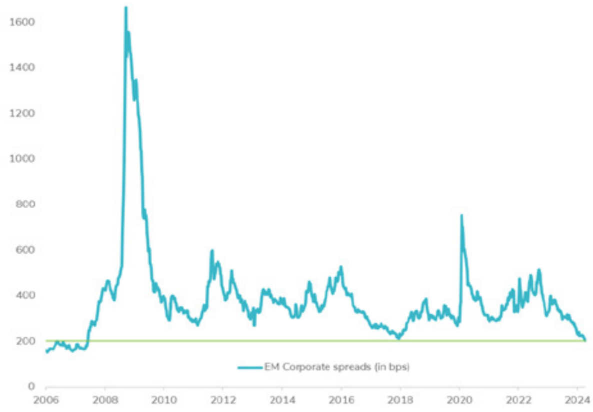


Source: Syz CIO Office, Bloomberg

Emerging Markets

Our stance on hard-currency EM debt remains negative, although we identify attractive investment opportunities in bonds with up to 4-year maturities and yields above 6.5%. The strengthening US dollar and rising US real interest rates pose significant challenges, overshadowing the recent relative outperformance of this segment. Market sentiment towards EM debt has worsened, reflected by persistent negative capital flows, and increased short interest in USD-denominated EM debt. Valuations are notably stretched, with EM corporate spreads at their narrowest since 2007.

Emerging Market Corporate Spread Evolution (in bps)



Source: Syz CIO Office, Bloomberg

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 scenario of a stronger USD has an increased probability.

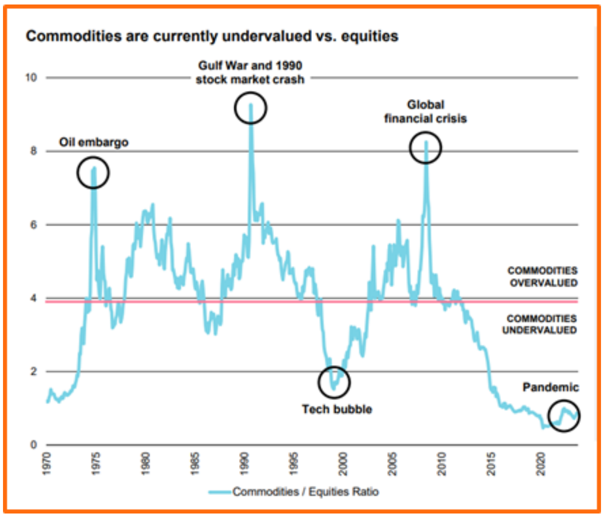
EUR/USD: Rates and macro dynamics are less negative for the EUR, but macro developments importantly also support the USD => our rating is NEGATIVE.

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 the dollar. Nevertheless, there is no guarantee that this 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 => our rating is NEUTRAL.

ALTERNATIVES

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 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 asinsurance against adverse circumstances (inflation, recession, etc.) 3) There is heavy demand stemming from central banks, especially in emerging markets.



Source: Vontobel

We are keeping a positive stance on 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.

INVESTMENT CONCLUSIONS

TACTICAL ASSET ALLOCATION (TAA) DECISIONS– 27.05.2024

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

There is one change within our preference grid this month:

→ We are upgrading **Government bonds 1-10 years** from NEUTRAL to POSITIVE

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	Corporate IG (local)	Govies 1 - 10 (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 - 27 May 2024*

For further information

Banque Syz SA - Quai des Bergues 1 - CH-1201 Geneva - Tel +41 58 799 10 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