

Volatility and rotation ahead



Key takeaways

- After a strong first half of the year for equity markets, we believe that there are 5 key themes to watch in the coming months: 1) Normalisation of global economic growth; 2) Labour market normalisation; 3) Central banks kicking off their easing cycle; 4) The normalisation of the equity market leadership and; 5) A pick-up in volatility.
- On a more tactical basis, our view on risk assets remains constructive but there are indeed a few indicators which lead us to become slightly more prudent as we head into Summer. As such, we have been rebalancing our clients' portfolios to reflect our neutral view on equities. We recently decreased our slight tactical overweight on equities back to neutral. We remain underweight fixed income and overweight alternatives and Gold. We also decided to downgrade our view on the JPY from NEUTRAL to negative vs USD and all major currencies. We remain positive dollar against EUR, GBP and CHF.

THE BIG PICTURE

Risk assets have been performing well so far this year. Equities are recording double digit gains and have been outperforming bonds and cash. Indeed, global economic growth has been more resilient than expected. And strong earnings momentum is offsetting the fact that the Fed remains reluctant to cut rates at this stage.

As we move into the last 5 months of the year, our key theme is normalisation. Indeed, we believe that global economic growth, the job market, central bank policy, and market leadership should all normalise. We also believe that volatility could come back with a vengeance in the coming months.

In our view, there are 5 key trends to watch for the coming months.

Trend #1

Normalisation of global economic growth

Despite the Fed's aggressive tightening campaign, the US economy has been more resilient than expected. However, growing evidence suggests that high borrowing costs are slowly filtering through the economy, which is finally cooling down toward a more sustainable and balanced pace of expansion.

In Europe and in China, 2023 was a negative year in terms of growth. Since the beginning of 2024, both economies have been recovering, achieving growth rates consistent with their long-term potential. For them, normalisation in 2024 means the dissipation of the troubles experienced in 2023.

In Japan, nominal GDP is growing for the first time since the 1990's and interest rates are on the rise. In the Emerging world, countries such as India, Mexico or Vietnam are benefiting from the US-China economic war and the nearshoring / friend shoring trend.

In summary, while some fast-growing economies are expected to decelerate in 2024, others will recover from weaker conditions, contributing to a global normalisation of economic growth.

Trend #2

Labour market normalisation

Labour shortages in many sectors have been a remarkable feature of the past three years. Demographic dynamics and surging demand for service sector jobs have driven unemployment rates to record lows in the US and in Europe. This situation has led to an acceleration in wage growth that has fuelled domestic consumption, but also raised inflationary pressures. Recent indicators have pointed to an easing in tensions on the labour market. Job opening and turnover indicators are falling back from peak levels.

Underlying dynamics within the labour market have also shifted toward more temporary jobs at the expense of full-time contracts. This normalisation of labour markets will lead to a healthier situation where high employment continues to support consumer spending, but where upward pressures on wages gradually abate.

Trend #3

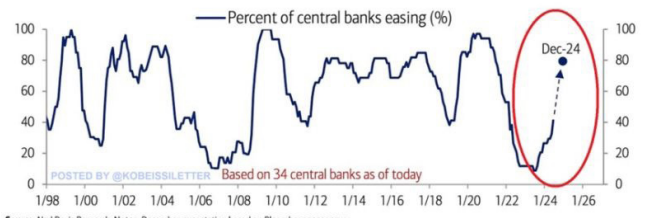
Central banks kick off their easing cycle

Central banks around the world have had to hike interest rates aggressively in 2022 and 2023, in response to the inflation revival. As economic growth, labour market conditions, and inflation normalise, the necessity for restrictive monetary policies diminishes.

Put simply, current interest rates are too high given the environment of moderate inflation and growth. Consequently, central banks are anticipated to reduce interest rates in the future. This trend has already begun, with the Swiss National Bank leading the way in March, followed recently by the Bank of Canada and the European Central Bank.

As growth and inflation normalise on a global scale, the Fed and other central banks will join this trend and gradually adjust their key rates lower too. Barring an unexpected economic downturn, the speed and magnitude of this rate cut cycle will likely be gradual and less pronounced than in the past 25 years.

Exhibit 13: 80% of global central banks are expected to be in easing mode by the end of 2024 vs only 10% in July 2023
Percent of central banks in easing mode

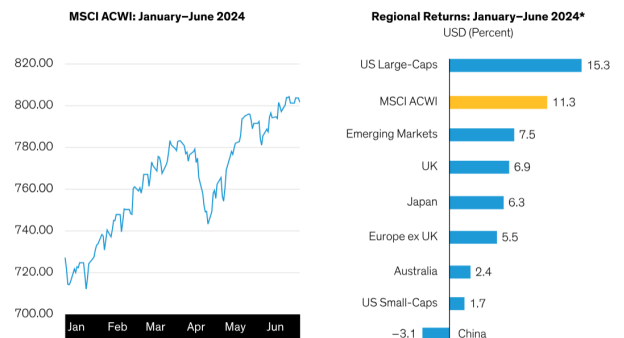


Trend #4

The normalisation of the equity market leadership

Nvidia, the artificial intelligence industry leader, was the star of the first half of the year as it briefly joined the \$3 trillion dollar club in terms of market capitalisation. As of now, just three stocks - Microsoft, Apple and NVIDIA - now account for 20% of the index, and their outsized gains have helped the S&P 500 to enjoy double-digit returns since the start of the year.

Global Equity Markets Advanced in First Half, Led by US Large-Cap Stocks



Past performance and current analysis do not guarantee future results.
*US large-caps represented by S&P 500, emerging markets by MSCI Emerging Markets, UK by MSCI UK, Japan by MSCI Japan, Europe ex UK by MSCI Europe ex UK, Australia by MSCI Australia, US small-caps by Russell 2000 and China by MSCI China.
As of June 30, 2024.
Source: FactSet, FRED, Bloomberg, MSCI, S&P and AllianzBloomberg (AB)

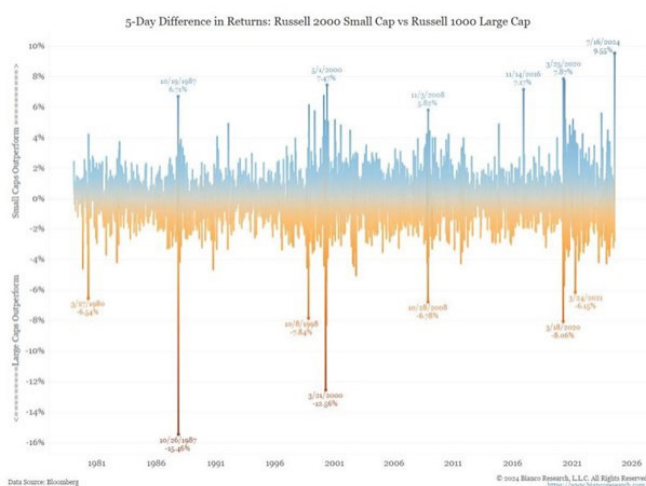
However, unlike last year's very narrow gains, more sectors, asset classes and regions are participating in the upside.

We also note that the NYSE A-D Line keeps reaching new highs (see chart below – source: J-C Parets). The US equity bull market is not just 7 stocks. It's not just Tech either. And it's definitely not just large caps. Yes, some correction and rotation can take place from time to time. But it remains a bull market until proven otherwise. It's just a bull market... And it has been for over 2 years now.



This is a positive sign for the strength and length of the bull market. We continue to see value in diversification. So far, the benefits of AI have gone to companies developing it and providing its hardware and infrastructure. The next phase could benefit companies applying AI for productivity gains. We recommend balancing equity portfolios between growth stocks and cyclical and value-style investments.

The “equity rotation” has been accelerating recently with the come-back of the equity markets “laggards” (small-caps, value style) at the expense of Tech / growth sectors. As shown on the chart below (source: Bianco research), we just witnessed the biggest outperformance of small-cap stocks over large-cap stocks, over a 5-day period, in history (data starts in 1978).

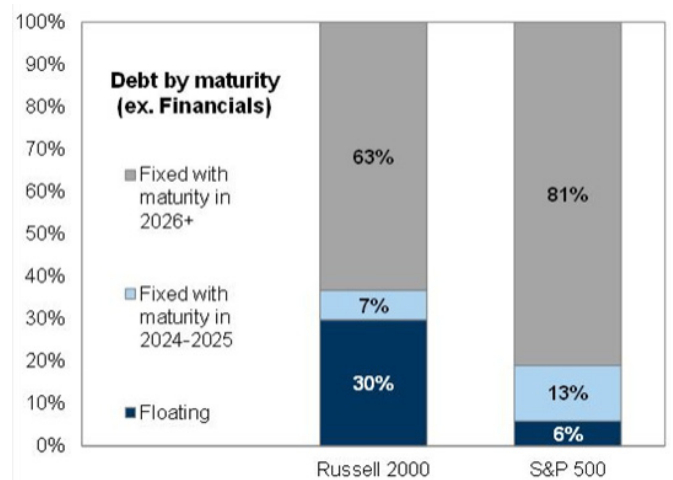


What are the triggers for the current “size / style rotation”?

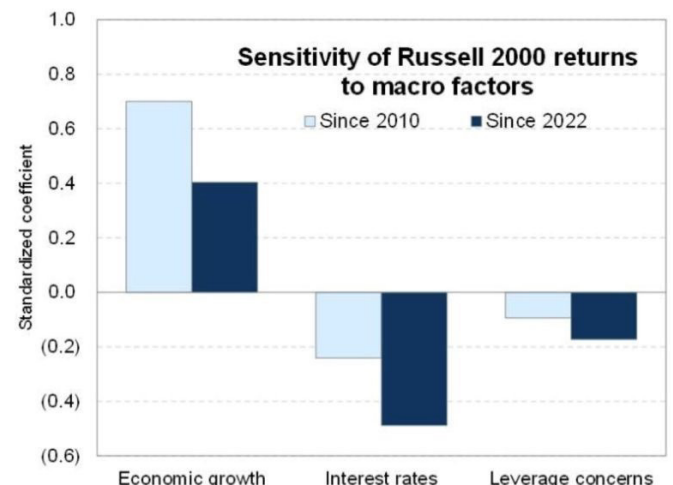
While many analysts do see it as a “Trump trade”, we tend to disagree. Since the weaker US CPI print, the market has been pricing in a dovish “Powell trade”: the dollar has been weakening and US long term bond yields are going down. The style/size rotation which has been taking place is a reflection of this.

If the market was putting on a “Trump trade”, we think the exact opposite should be happening: the dollar should be strengthening and US yields should be rising (more on this in the appendix at the end of this note).

Small-caps have been the main casualties of the monetary policy tightening (as shown on the chart below – source: Goldman), a large portion of Russell 2000 debt load is floating. It thus makes a lot of sense that small caps were the most hit by monetary policy tightening / higher interest rates. Now the Street is anticipating rate cuts, small-caps underperformance might be coming to an end...



For US small caps, rates are just as important as growth since 2022. And as we know, March of 2022 was when the hiking cycle began...

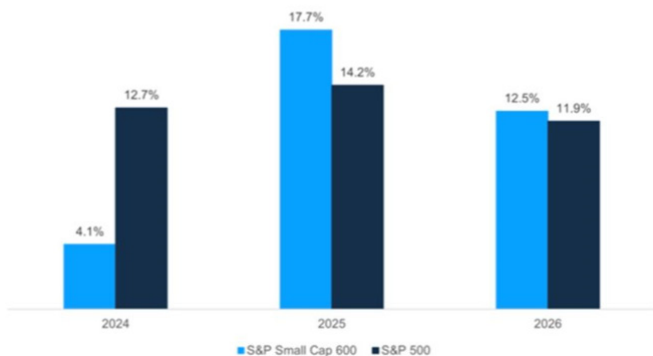


Earnings dynamics are also playing a role in this size rotation (see below chart from JPM). Indeed, 2025 and 2026 look much better for US small caps earnings, relative to large caps.

On our side, we don't necessarily play the rotation through small caps only. Indeed, we believe the change of leadership will also benefit the "Magnificent others". These are firms that have sound balance sheets, consistent earning streams, and significant growth potential, but have not yet been rewarded by investors.

Companies like these can be found across sectors and industries, including value segments and non-US markets.

Forward Expected Earnings Growth
S&P Large and Small Cap Indices

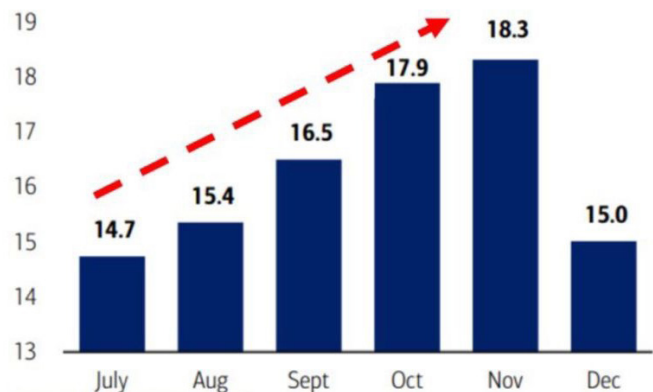


Trend #5

We also expect a normalisation of volatility.

Market volatility has remained subdued so far in 2024. But the outlook for the remainder of the year is less certain. For instance, elections tend to be associated with a perceived risk of greater public sector instability and often trigger a pick-up in volatility (see chart below – source: BofA).

Exhibit 3: 25% increase in volatility from July-Nov of election years
Average monthly volatility (VIX 1990-present, monthly average of daily S&P 500 return volatility 1928-1989) for US election years since 1928



POSTED BY @KOBESSILETTER

Source: Bloomberg, FactSet, BofA US Equity & Quantitative Strategy

BofA GLOBAL RESEARCH

CONCLUSION

As such, we aim to remain nimble, implement portfolio protections and use volatility at our own advantage.

In the next section, we dive into the 5 pillars of our investment process. Overall, our view on risk assets remains constructive but there are indeed a few indicators which lead us to become slightly more prudent this Summer. As such, we have been rebalancing our clients' portfolios to reflect our neutral view on equities. We recently decreased our slight tactical overweight on equities back to neutral. We remain underweight fixed income and overweight alternatives and Gold. We also decided to downgrade our view on the JPY from NEUTRAL to negative vs USD and all major currencies. We remain positive dollar against EUR, GBP and CHF.

A MACRO & MONETARY POLICY UPDATE

Summary of our macroeconomic views and scenario

Global economic growth is positive and is settling around a soft-but-positive rate after two years of slowdown. All key economic areas are in expansion in 2024, including Europe and China. Global growth, while positive, is not accelerating, due to high interest rates and geopolitical uncertainties.

Some fast-growing economies are slowing down in 2024, while some economies are recovering from weaker situations. This means economic growth normalization at the global level for H2 2024.

The US economy is on track for a smooth, soft landing in H2 2024, as domestic consumption finally slows down. The labor market is gradually cooling down and is now close to being back to balance, a welcome development for easing wages and inflationary pressures. Business activity indicators have recently improved, while households consumption is losing steam. We should brace for rising macro volatility in 2025 under the new Administration.

In the Eurozone, economic growth is still weak but continues to slowly recover toward its potential rate. In Switzerland, economic activity continues to gradually recover but remains soft.

In China, domestic consumption still suffers from the slump in real estate and weak credit growth, while industrial activity benefits from positive the global growth momentum

When it comes to global inflation, it is resuming a slowing trend after an unexpected pickup. The rate of price increase is slowing down as post-Covid excess demand fades away and labor market conditions normalize (especially in the US). With more confirmation of inflationary pressure easing, central banks will be able to adjust interest rates lower as their monetary policy is currently on the restrictive side.

Gradual disinflation remains our "core" scenario, with different paces of normalization among economies.

Monetary policy & liquidity perspectives

Monetary policy is clearly restrictive in the US and in Europe. Central banks have to cut short-term interest rates after having successfully dampened inflationary pressures.

In the US, inflation is slowing but remains too high, the labor market normalizes but remains strong. The Fed will start cutting rates once it is confident that inflationary pressures are normalized or if signs of a pronounced slowdown in growth and employment appear. While possible in September, the most likely scenario is for one 25bp cut in November, and another one in December.

In the Eurozone, despite inflation being close to target, the ECB remains concerned by strong wage growth and moves cautiously after its first cut. The ECB is expected to cut rates gradually (25bp in Q3, 25bp in Q4, more in 2025).

In Switzerland, the CHF cash rate is now close to neutral. The SNB is ahead of the pack and has already done most of the adjustment.

The expected global rate cut cycle has started in Europe and will soon start in the US. It will rather be a “fine tuning” exercise of policy recalibration, dictated by specific domestic conditions.

Central banks will cut rates in developed and emerging economies, but they will proceed carefully, waiting for evidence that inflationary pressures are really abating. The ECB has started in June and the Fed will follow by the end of the year. The trend will likely extend into 2025.

SPECIAL FOCUS: An update on the latest economic and monetary policy developments in Japan

BoJ rate hikes may come later and slower than expected at our previous House View committee. Indeed, Recent economic developments in Japan have pointed to a stabilization in growth and inflation dynamics, rather than an improvement that may have pushed the BoJ to accelerate monetary policy tightening.

Growth and inflation have indeed stabilized at a positive but moderate pace (PMI Composite hovering around 50, Tankan survey reflecting positive business confidence but not much momentum, underlying inflation trend not accelerating further...). As such, the Japanese economy is currently growing around its potential, without creating undue inflationary pressures or signs of overheating.

In this context, the Bank of Japan has no reason to rush into tightening its monetary policy. Now that it has escaped the “negative interest rate policy” trap, the BoJ is likely to be cautious in raising rates further. Economic conditions may warrant some increases in short-term rates but the BoJ will likely be rather late than early in the process, in order to ensure that Japan is truly and definitely out of the 30-year long period of deflation. Future markets currently price a 50% chance of a 10bp rate hike at the July 31st meeting (vs 100% probability at the end of May), and a cumulative 20bp rate hike by the end of the year (vs 30bp at the end of May).

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

The main change from last month is the downgrade of Market Dynamics from Positive to Neutral. The overall stance remains NEUTRAL for risk asset.

	(+)	(-)	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 growth 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 downside 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 Tightening is still ongoing 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 turned negative at some point as new highs in the market were made with lower participation. It has however improved recently.	Technical indicators are back in the “overbought” territory which means a “reduce” signal from our contrarian models. Market sentiment is now neutral (from complacent).	NEUTRAL (↓)

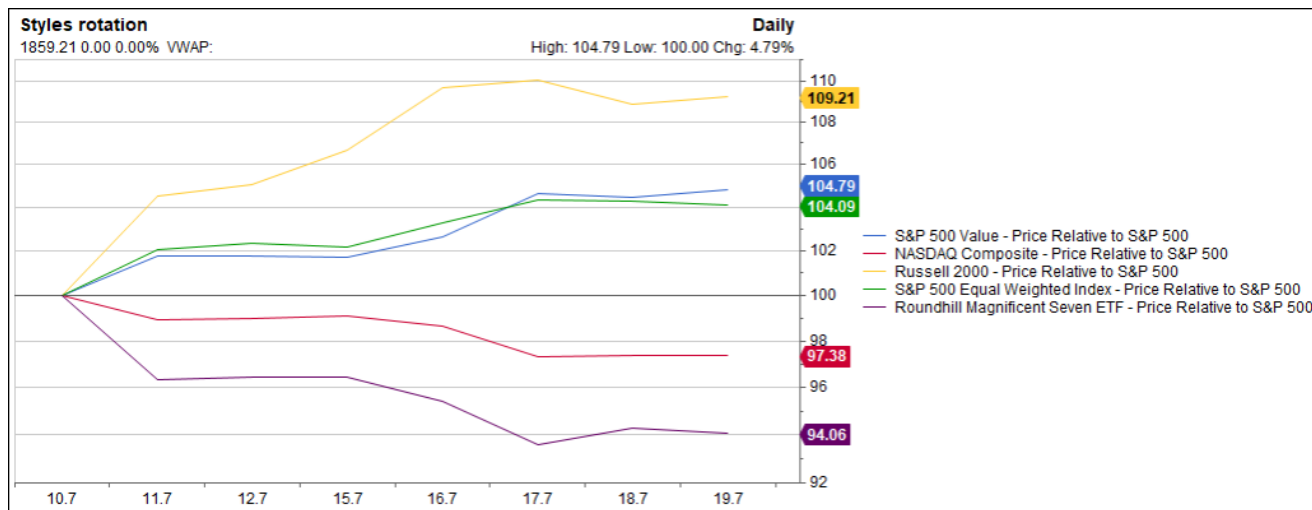
ASSET ALLOCATION VIEWS

EQUITIES

We remain overall neutral on equities on the backdrop of a muted macro environment, relatively elevated valuation, low volatility, and high concentration as, since the beginning of the year, the US market has been boosted by the mega capitalization stocks.

Lately, however, volatility is returning with significant rotation amongst sectors and styles triggered by the looming interest rate cut by the Fed, as well as the higher odds of a Trump election in November. The outlook of lower interest rates is causing some rotation into more value and smaller size companies as they are the most sensitive to interest expenses and economic activity. In addition, the rhetoric from the Trump camp is echoing in favor of more domestic oriented businesses vs the technology/semiconductor sector as he believes the production should come back to the US.

As shown below, small caps (Russell 2000) sharply outperformed the Mag 7 over the past couple of weeks.



In that context, we remain neutral equities with a tilt towards the US for its economic resilience and Europe for its slow but continuing recovery. On the other hand, we remain underexposed China as the housing market continues to pressure consumption and Japan as the external demand doesn't offset a weak domestic consumption.

Earnings

Q2 earnings season is on and has started on a good footing with the banks and TSMC that reassured investors on the strength of the semiconductor cycle. However, these good results in the semiconductor space were offset by the negative news flow out of the US stating that more export restriction should be applied for China.

US equities are expected to continue to grow earnings at the fastest pace and with an acceleration from 11.3% to >14% EPS growth in 2025. The Mag 7 are still large contributors as the consensus expects this group to grow EPS by more than 20% in 2025, but the main acceleration is expected from the rest of the market with the S&P 500 Equal Weight to more than double the pace of EPS growth next year despite recent negative revisions.

This phenomenon is not visible in Europe, where EPS growth is quite similar across the size spectrum, but the earnings acceleration is also visible from a mid-single digit EPS growth this year to more than 10% next year.

Switzerland and Japan estimate revisions benefitted from a weaker currency.

Regions	Last	EPS CY0	EPS CY+1	yoy	1m Chg %	EPS CY+2	yoy	1m Chg %
S&P 500	5 505.0	217.7	242.3	11.3%	-0.30	277.6	14.5%	-0.11
S&P 500 Equal Weighted	6 824.6	368.3	391.6	6.3%	-0.43	446.1	13.9%	-0.57
S&P Mid Cap 400	3 015.3	178.7	178.2	-0.3%	-0.43	208.4	17.0%	0.16
STOXX Europe 600	510.0	34.2	36.1	5.6%	-1.33	39.9	10.4%	-0.83
Euro STOXX Mid	501.4	40.6	43.0	5.8%	-0.89	47.6	10.6%	-0.78
FTSE 100	8 155.7	680.8	683.5	0.4%	-1.59	745.7	9.1%	-0.94
Switzerland SPI	754.3	35.8	39.9	11.4%	0.46	45.2	13.2%	0.33
Hang Seng Index	17 417.7	1 803.3	1 970.3	9.3%	0.04	2 113.4	7.3%	-0.15
Japan Nikkei 225	40 063.8	1 586.3	1 826.5	15.1%	0.54	2 088.7	14.4%	0.58

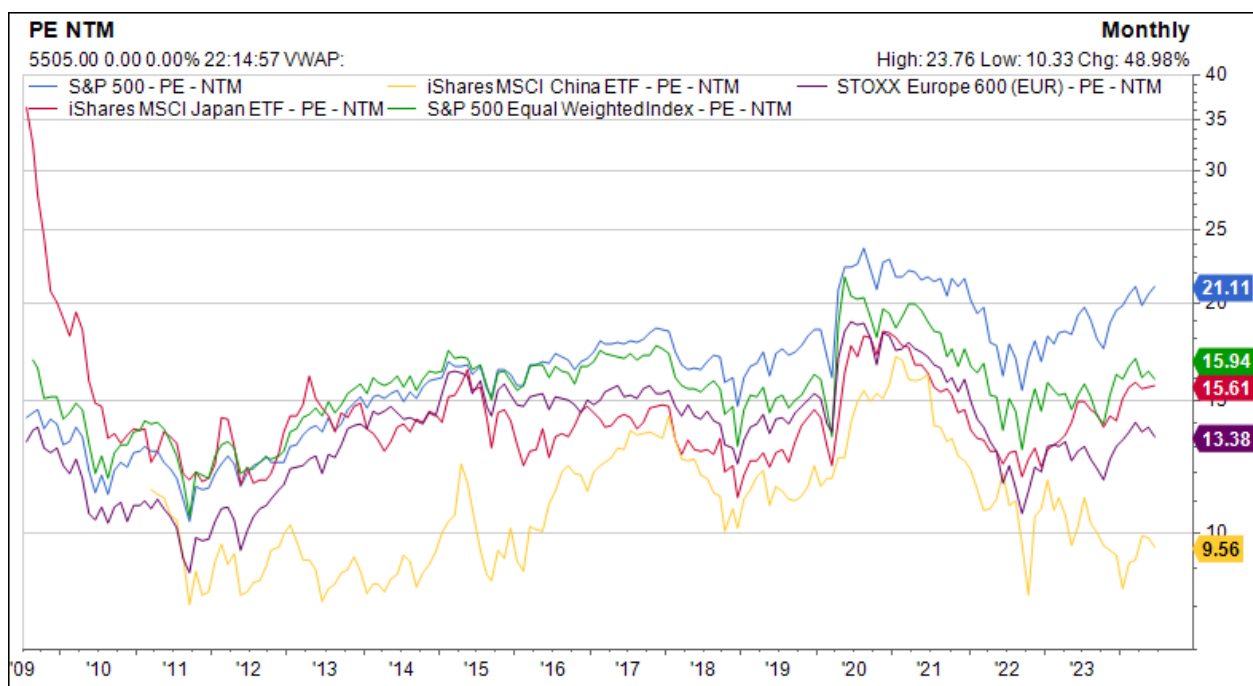
Source: Factset

The Mag 7 stocks remain large EPS growth contributors albeit the expected EPS growth rate is slowing from 34% this year to 21% next year. Tesla is the only exception due to a sharp EPS contraction in 2024 that is expected to normalize in 2025.

Mag 7	Last	EPS CY0	EPS CY+1	yoy	1m Chg %	EPS CY+2	yoy	1m Chg %
Apple Inc.	224.3	6.1	6.6	7.9%	-0.25	7.3	10.1%	-0.54
NVIDIA Corporation	117.9	1.3	2.7	108.7%	-0.22	3.7	35.6%	-1.98
Microsoft Corporation	437.1	9.8	11.8	20.5%	-0.12	13.4	13.0%	0.05
Amazon.com, Inc.	183.1	2.9	4.6	57.7%	-0.02	5.8	27.7%	0.07
Tesla, Inc.	239.2	3.1	2.4	-22.2%	-0.81	3.4	37.9%	-1.75
Alphabet Inc. Class A	177.7	5.8	7.6	30.9%	-0.58	8.6	13.3%	-0.50
Meta Platforms Inc Class A	476.8	14.9	20.2	36.1%	-0.15	23.2	14.5%	0.08
Average				34.2%			21.7%	

Valuation

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.



However, valuation is cheaper as we go down the size spectrum, both in the US and Europe.

Regions	PE CY+1	PE CY+2
S&P 500	22.7	19.8
S&P 500 Equal Weighted	17.4	15.3
S&P Mid Cap 400	16.9	14.5
STOXX Europe 600	14.1	12.8
Euro STOXX Mid	11.7	10.5
FTSE 100	11.9	10.9
Switzerland SPI	18.9	16.7
Hang Seng Index	8.8	8.2
Japan Nikkei 225	21.9	19.2

Source: Factset

FIXED INCOME

Our fixed income strategy remains close to neutral but with a slightly negative tilt overall. We hold a cautious stance, influenced by mixed market signals. While we are wary of long-duration bonds and certain credit sectors, we see potential opportunities in short and intermediate government bonds. Our position on Investment Grade (IG) credit is neutral, while we are more reserved about High Yield (HY) and USD-denominated Emerging Market (EM) debt.

Government Bonds

We have a cautiously optimistic outlook on government bonds with maturities under 10 years, expecting favorable conditions for yield improvements by the end of the year. This view is supported by several key factors:

- **Economic Stability:** The US economy is showing signs of normalization, with inflation rates gradually declining despite occasional volatility.
- **Monetary and Fiscal Policies:** Efforts by the Federal Reserve and US Treasury, such as easing quantitative tightening and enhancing liquidity in the Treasury bond market through a buyback program, are expected to stimulate demand.
- **Valuation and Market Dynamics:** Real rates above 2% make bonds attractive compared to equities. The market anticipates a gradual normalization process for monetary policy, with more than two years expected to reach the terminal rate.
- **Historical Trends:** Historically, bonds have performed well ahead of the first rate cut, typically 2 to 4 months in advance. With the first rate cut projected for Q3/Q4 2024, we may be approaching such a favorable period.

However, we remain cautious about longer-term bonds due to the inverted yield curve, negative term premiums, and ongoing rate volatility. Additional concerns include the growing US fiscal deficit and increased Treasury issuances.

↓ **Is a Fed Rate Cut on the Horizon Before the Elections?**

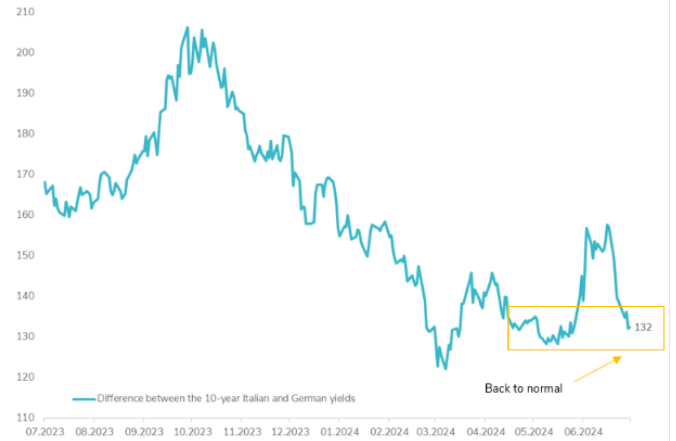


Source: Syz CIO office, Bloomberg

In Europe, our stance is neutral as the European Central Bank (ECB) begins monetary policy normalization, starting with the first rate cut in June. We expect further rate cuts in September and December, which could support a bull steepening of European rates. The market has largely priced in the French election outcomes as a contained risk, with the yield spread between 10-year Italian and German bonds returning to pre-election levels of 130bps. While European wages are a concern, ECB members are confident they will normalize soon. Our outlook on UK government bonds is

also neutral. The political shift following Labour's victory has not significantly impacted the gilt market, with memories of the 2022 crisis under Liz Truss prompting caution towards expansive fiscal policies. The 10-year UK Gilt yield has fallen by 7bps to 4.12%, reflecting increased investor confidence in the new government's fiscal prudence. Additionally, there is growing anticipation for an earlier start to monetary policy normalization by the Bank of England, possibly by August or September.

↓ **Market Perception of French Election Risks**

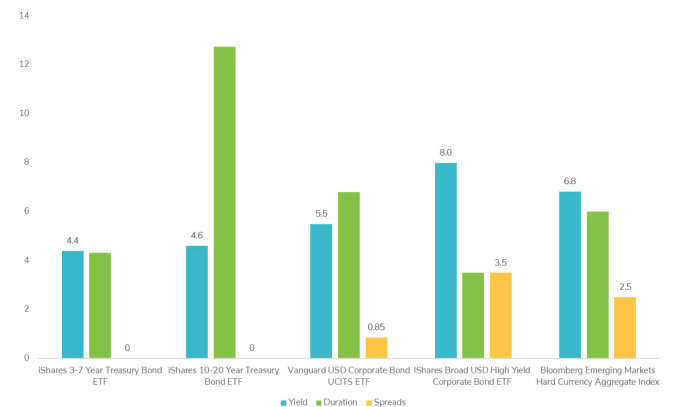


Source: Syz CIO office, Bloomberg

Corporate Bonds

Our stance on investment-grade bonds remains neutral. Credit spreads have tightened significantly to their lowest levels since 2021, reducing the safety margin to just 15% of the total yield. Current market conditions are "priced to perfection," necessitating close monitoring. 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 it might be premature to reduce credit exposure. In the high-yield sector, we see selective opportunities in short-term corporate high-yield bonds due to their favorable risk/reward profile, though we acknowledge that overall valuations in high yield are stretched, especially if volatility increases in the second half of 2024.

↓ **Breakdown of Yield in Different Fixed Income Segments**

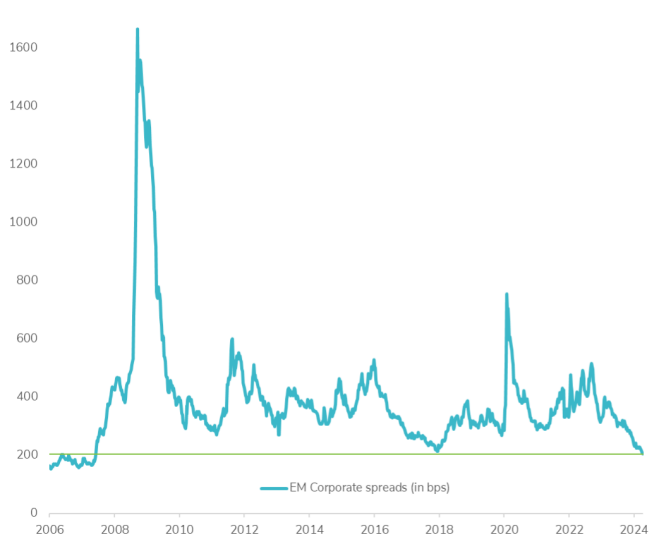


Source: Syz CIO Office, Bloomberg.

Emerging Markets

Our outlook on hard-currency EM debt is slightly negative, although we identify some attractive 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.

↓ Evolution of Emerging Market Corporate Spreads (bps)



Source: Syz CIO Office, Bloomberg.

FOREX (view against USD)

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

CHF/USD (negative): 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, leading 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 (from neutral to negative): 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.

We have decided to downgrade the view on the JPY from NEUTRAL to negative vs USD and all major currencies. While we are aware that the JPY has already lost significant ground vs most currencies, we take note of some recent economic developments that have lowered the chances of a BoJ catchup in rate hikes and of a resulting rebound in the currency.

ALTERNATIVES

We remain positive on gold, which continues to exhibit lower volatility than 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 insurance against adverse circumstances (inflation, recession, etc.);
- 3) There is heavy demand stemming from central banks, especially in emerging markets.

We are keeping a positive stance on commodities as a portfolio diversifier and protection against inflation upside (which is not our core scenario). Commodity prices are moving higher, driven by resilient US growth, geopolitical uncertainty, segmentation of global trade and AI demand for energy.

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 2024.

INVESTMENT CONCLUSIONS

TACTICAL ASSET ALLOCATION (TAA) DECISIONS– 03.07.2024

TAA Balanced moves

We started the year with an allocation to equities which were close to our SAA (Strategic Asset Allocation). Due to market effects, the allocation has been rising above the NEUTRAL weight. In light of the aforementioned market views, we decided to rebalance portfolios towards a NEUTRAL allocation to equities, which means that we are effectively slightly reducing our exposure to equities within our clients' portfolios. We did so by rebalancing our US Equity exposure towards SAA neutral point (e.g this implied a 2% reduction in balanced accounts).

Within Fixed Income, we also performed some slight rebalancing moves within portfolios. For instance, in a balanced account we reduced the underweight of High Yield bonds while staying slightly underweight vs our SAA across all 4 currencies (+1%).

The two above changes resulted in an increase in cash (typically +1% in balanced accounts).

Matrix of preference moves (see below)

During our last House View investment committee (3rd July), we have decided to downgrade our view on the JPY from NEUTRAL to negative vs USD and all major currencies.

While we are aware that the JPY has already lost significant ground vs most currencies, we take note of some recent economic developments that have lowered the chances of a BoJ catchup in rate hikes and of a resulting rebound in the currency.

This warrants an adjustment of our view, as there is still some potential for further depreciation, especially in a context where the US economy holds firm and the Fed doesn't engage into an aggressive rate cut cycle (soft landing scenario).

Hedging the JPY brings a positive yield in all currencies. Now that the potential positive triggers for the JPY have not materialized, it is attractive to hedge the JPY exposure, not only for risk management but from a performance contribution point of view

Yield received when hedging the JPY on a 12m horizon per currency are the following: 4.99% in USD, 3.22% in EUR, 4.78% in GBP and 0.87% in CHF.

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 JPY ↵ EM currencies			
Change from last month:	More attractive ↶	Less attractive ↷			

Source: Investment strategy group - 3 July 2024

APPENDIX: WHY IS THE “TRUMP TRADE” STILL NOT PRICED IN?

As mentioned above, if the market was putting on a “Trump trade”, the dollar should be strengthening and US yields should be rising. This is due to the following reasons:

1) A Republican sweeping victory decreases the risk of a recession (this leads to a more hawkish fed, higher bond yields and a stronger dollar)

By securing unified government, fiscal flexibility goes up, raising the ability to respond to negative growth shocks. This is negative rates and bullish dollar.

2) Trade policy risk increases

A unified government would provide legislative authority to a Trump administration to not only increase tariffs but also to permanently change trade policy. There is a high probability of Tariff-financed corporate tax cuts to take place. This would lead to higher inflation and higher domestic growth which is bearish rates and bullish dollar.

3) The dollar would likely remain the safe-haven currency.

While Donald Trump has always been very vocal about the dollar being over-valued, a more uncertain world should inevitably push global investors to look after safe-haven currencies; the dollar is one of the very few remaining.

From a thematic point of view, here are the potential winners:

- › Financials that could benefit from any potential de-regulation of the industry or from a rebound in capital markets activity.
- › Onshore producers and enablers of the onshoring trend
- › Construction involved in the infrastructure of the country's border.
- › Energy, Coal, and Steel production in the US.
- › Law enforcement and domestic security
- › US companies that have close to 100% of sales from small businesses.

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

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