

## The Fed's pivot is just around the corner

### Key takeaways

- We expect the Fed rate cut cycle to start soon and proceed gradually. Barring a financial crisis or a sharp and unexpected change in the path of inflation or unemployment, the upcoming rate-cutting cycle won't be dramatic; we expect the Fed to make incremental, 25 bps cuts to its policy rate. Moreover, the Fed is going to stay highly data dependent and will calibrate accordingly.
- Overall, this is a rather positive scenario for risk assets. Still, equity market valuations are becoming rich, especially in developed markets. Consequently, we keep our neutral stance on equities.
- We are upgrading all currencies (EUR, CHF, CHF, JPY, EM currencies) back to neutral vs. USD (from Negative). Technicals have turned against the US dollar and the Fed has sent a clear signal about coming rate cuts.

## THE BIG PICTURE

In our H2 market outlook (“Normalisation ahead”), we highlighted 5 key themes: 1) The normalisation of global economic growth; 2) Labour market normalisation; 3) Central banks kicking off easing cycle; 4) The normalisation of the equity market leadership and 5) A pick-up in volatility.

Throughout the summer, several of these stories have taken centre stage. We see tangible signs of a slowdown in the global economy, such as the positive momentum from the beginning of the year in Europe and China fading away, and the US economy gradually cooling down, although the risk of recession remains quite low. Still in the US, recent indicators show that the labour market is cooling off but remains supportive of robust consumption growth.

With regards to central banks, the expected global rate cut cycle has started in Europe and will soon begin in the US. Rarely in recent history has a central banker (bank?) been as clear as during the last Jackson Hole Symposium: The Fed’s pivot is coming, i.e. the Federal Reserve will start to adjust its monetary policy as soon as September FOMC meeting.

The summer was also characterised by 2 market developments. First, a brief come-back of volatility. As mentioned in our August Asset Allocation Insight, global equities endured a technical correction in early August led by the unwinding of the yen carry trade and growth fears. While the spectacular spike in the VIX index (S&P 500 implied volatility) was very brief, it was a harsh reminder that market positioning is quite extended and that a market accident can take place at any time. The other market development has been the early signs of a market style and sector rotation. Indeed, the 2023 and H1 2024 market darlings – the US mega-caps tech stocks – are struggling to regain their all-time highs. Meanwhile, the equal weighted S&P 500 hits all-time highs. The trend thus remains positive while the participation is broadening, which is a positive development.

So where do we go from here? As explained in a recent FOCUS note, it is possible to find the good, the bad, and the ugly sides in the current fundamental and technical backdrop.



### The Good

- › Macro: There is no hard landing in sight and the disinflation trend remains in place
- › Monetary policy & financial conditions (see below): Fed rate cuts are coming, and financial conditions (e.g. tight credit spreads) remain loose
- › Earnings: Q2 earnings season was strong and share buybacks are becoming a tailwind again
- › Technicals: the trend remains positive, market breadth is improving
- › Cross-assets: Bonds are fulfilling their role (as portfolio diversifiers), lots of cash on the sideline



### The Bad

- › Macro: Recession risk remains, and the risk of a hard landing is most likely underappreciated by markets
- › In the US, Q3 earnings forecasts are exhibiting negative revisions
- › Technicals: we note that leadership is shifting to defensive
- › Geopolitics: US election outcome remains very uncertain



### The Ugly

- › Geopolitics: The risk of a deterioration in the Middle Eastern situation and/or a worsening Russia-Ukraine conflict
- › Macro: The risk of a French fiscal crisis

## SPECIAL TOPIC

### Jackson Hole and US monetary policy

As usual, the central bankers’ symposium which took place at Jackson Hole (Wyoming) was eagerly awaited by market participants. Here’s a summary of the Fed’s Chairman Jay Powell:

1. “The time has come for Fed policy to adjust”
2. Fed “will do everything” to support a strong labour market
3. Fed does not welcome further weakening of the labour market
4. Confidence has grown that inflation is heading to 2%
5. Balance of risks to Fed mandates has changed
6. Inflation has declined significantly toward the goal

Therefore, it seems that the Fed’s pivot is just around the corner with the first rate cut to take place at next FOMC meeting.

While markets are now expecting 8 rate cuts over the next 12 months, we remain prudent with regards to how aggressively the Fed will loosen its monetary policy.

This is definitely not your grandfather’s rate-cutting cycle:

A different entry point: Traditionally, the Fed starts cutting rates in response to an economic downturn, a financial shock/crisis, or both. The upcoming rate-cutting cycle is more about letting off the brake, which the Fed has had its foot firmly pressed for the last two years.

Inflation is coming down, but it is not yet back to the Fed’s long-term target or sustainable (tolerable) levels. Unemployment has ticked up but there is no need of immediate life support. The Fed is likely to gradually reduce rates to get monetary policy closer to a more neutral setting.

Bottom-line: We expect this rate-cutting cycle to start, and gradually proceed.. Barring a financial crisis or an unexpected change in the path of inflation or unemployment, the upcoming rate-cutting cycle won’t be dramatic. We expect the Fed to make incremental, 25 bps cuts to its policy rate. Moreover, the Fed is going to stay highly data dependent and will calibrate accordingly. Overall, this is a rather positive scenario for risk assets.

**The unwinding of the yen carry trade:** The sharply hawkish tone adopted by Bank of Japan governor Kazuo Ueda after last Wednesday’s meeting and market expectations for US Federal Reserve rate cuts have led to a spectacular appreciation of the Yen. As a result, investors are forced to unwind yen-funded carry trades (see next FAQ). This unwinding has compounded the upward move in the yen, leading to more unwinding, and so on.

## A MACRO & MONETARY POLICY UPDATE

### GLOBAL GROWTH

Global economic growth remains positive but at a moderate level (close to 3%). While positive, it is now at risk of slowing down due to high interest rates and geopolitical uncertainties.

The positive momentum of the beginning of the year in Europe and China is dwindling, and the US economy is gradually cooling down. Global manufacturing activity is still under pressure while services hold well across most regions. The risk of recession is low and all key economic areas are in moderate expansion in 2024, including Europe and China.

In the United States, the labour market is cooling off but remains supportive of robust consumption growth. The US labour market has been normalising and can no longer be described as tight, easing pressures on wages. However, it is still supportive for domestic consumption and keeps the US economy growing.

In the Eurozone, economic growth has settled into a soft but positive rate as service sector activity is supported by domestic demand. Manufacturing sector activity remains under strong pressure from weak external demand and high interest rates. Germany is particularly impacted by the weakness in manufacturing activity, while service-oriented economies fare better.

Switzerland's economic activity continues to gradually recover but remains soft.

In Japan, the flap of a butterfly wing in Tokyo can cause a storm on global financial markets. The Bank of Japan has finally started the normalisation of its monetary policy with a rate hike from 0.10% to 0.25%. More rate hikes could come in the months ahead, as the BoJ is far behind the curve and economic activity has recovered from the 2023 soft patch.

China is muddling through moderate growth without significant monetary or fiscal policy support. Weak growth (around 5%), as depicted by the latest data is the price to pay for getting rid of past excesses. The real estate market's slump continues, and the authorities have no interest in engineering a short-term economic recovery. China has its eyes on the long term and prepares for the future challenges, such as Western tariffs and a stronger domestic demand.

In other developing markets, India continues to run hot, and Brazil's prospects are improving.

### GLOBAL INFLATION

Inflation is slowing down across the board and now tends to surprise to the downside in Developed and Emerging economies. The disinflationary trend remains in place as excess demand and labour market imbalances normalise (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.

### MONETARY POLICY

The expected global rate cut cycle has started in Europe and will start in the US, with room to cut if inflation actually normalises. Central banks will cut rates in developed and emerging economies and will likely proceed gradually as long as economic growth remains positive, but they could cut significantly in 2025 if inflationary pressures truly dissipate. The potential for rate cuts might be even larger in some EM economies once the Fed starts cutting rates.

For the US Federal Reserve, the time has come for policy to adjust. The direction of travel is clear, and the timing and pace of rate cuts will depend on incoming data. Inflation is slowing and close to target and the labour market has normalised. The Fed will start cutting rate in September and will continue, possibly at each meeting, into 2025.

For the ECB, as wage growth slows, the path for more rate cuts is cleared. Upward wage pressures were the lingering source of concerns for some ECB officials, and the latest data proved to be quite reassuring on that front. Inflation is close to target and wage pressures are easing in the Eurozone, clearing the way for ECB rate cuts. Soft economic growth and waning upward pressures on wages and prices no longer warrant the current level of restrictiveness of the ECB policy. The ECB will cut rate gradually (25bp in September, 25bp or 50bp in Q4 & possibly 100bp in 2025).

In Switzerland, the CHF cash rate is now close to neutral, and the SNB has already done most of the job. One or two rate cuts might be warranted, in 2024 (or 2025).

When it comes to global liquidity, conditions are rather neutral, and broad Financial Conditions remain quite accommodative. Quantitative Tightening is still ongoing in the US and Europe, but "cleaner" measures of liquidity have broadly stabilised. Broad Financial Conditions remain accommodative as market credit spreads are tight and equity markets close to ATH.

## THE WEIGHT OF THE EVIDENCE

Our asset allocation preferences are based on 5 indicators including 4 macro and 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.

	(+)	(-)	WEIGHT OF THE EVIDENCE
<b>MACRO CYCLE</b>	The Macro cycle remains positive for equity markets, with recession risk being low, inflation coming down. In the United States, the labor market is cooling off but remains supportive of robust consumption growth. 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.	<b>POSITIVE</b>
<b>LIQUIDITY</b>	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 US 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.	<b>NEUTRAL</b>
<b>EARNINGS GROWTH</b>	The second quarter earnings season is now behind and was rather reassuring with AI/technology and the high-end consumer in the US remaining resilient. In aggregate, guidance provided by corporates have confirmed the outlook for 2024 earnings with negative revisions for cyclicals and smaller caps offset by positive revisions for the mega caps.	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.	<b>NEUTRAL</b>
<b>VALUATIONS</b>	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.	We are turning more cautious on valuation for equities as a) the earnings slowdown in mega caps is pressuring multiples, b) the economic activity continues to normalize (slow), c) earnings growth expectations in areas of the market such as mid/small caps are high and should warrant lower valuation multiple in our view and d) the equity risk premium remains unattractive.	<b>NEGATIVE (downgrade)</b>
<b>MARKET FACTORS</b>	The recent market rebound has re-confirmed the positive stance of trend indicators (both remain positive). In parallel, technical indicators are positive as markets have not reached yet the "overbought" territory. Market breadth and volume are back to positive as the recent days of the rebound have been made with a higher participation.	Market sentiment remains neutral as volatility is going down (and the put call ratio is not too complacent yet).	<b>POSITIVE (upgrade)</b>

## ASSET ALLOCATION VIEWS

### EQUITIES

#### Regions, sectors, and styles

We remain neutral on equities on the backdrop of a resilient albeit still slowing growth environment and elevated valuation. From a regional perspective, we continue to favour US and European equities, as China continues to battle a weak internal demand and Japan economic momentum remains soft. From a sector/style perspective, we lean toward large/quality capitalisation, with a reasonable valuation as some rotation is going on with investors expecting the easing cycle to start soon by the Fed. On the other hand, we don't see yet conditions to increase exposure to smaller capitalisations and cyclicals, which would be early signs of a reacceleration of economic growth.

#### Earnings

The second-quarter earnings season is now behind us and was rather reassuring, with AI/technology and the high-end consumer in the US remaining resilient. Overall, guidance provided by corporations has confirmed the outlook for 2024 earnings, with negative revisions for cyclicals and smaller caps offset by positive revisions for mega caps.

Looking ahead, we speculate that the debate will centre around: a) the pace of the earnings growth slowdown for large-cap tech, b) the sustainability of AI investment, and c) the realism of the sharp earnings acceleration.

Regarding the deceleration of earnings growth for large cap tech, it is coming from a high base (+37% YoY in 2024) to still an attractive growth of >20% for 2025 that is above the market average.

Mag 7	Last	EPS CY0	EPS CY+1	Gr yoy	1m Chg %	EPS CY+2	Gr yoy	1m Chg %
Apple Inc.	226.8	6.1	6.7	9.4%	1.3	7.4	11.1%	2.1
NVIDIA Corporation	129.4	1.3	2.7	110.1%	0.6	3.8	39.8%	2.7
Microsoft Corporation	416.8	9.8	13.2	34.7%	11.7	15.4	16.5%	15.2
Amazon.com, Inc.	177.0	2.9	4.7	63.0%	3.3	5.9	23.9%	0.2
Tesla, Inc.	220.3	3.1	2.2	-28.2%	-8.0	3.2	41.6%	-5.3
Alphabet Inc. Class A	165.6	5.8	7.6	31.7%	0.5	8.7	13.6%	0.7
Meta Platforms Inc Class A	528.0	14.9	21.3	43.0%	5.0	24.1	13.5%	4.1
<b>Average</b>				<b>37.7%</b>	<b>2.1</b>		<b>22.9%</b>	<b>2.8</b>

Source: Factset

On AI, more and more investors are questioning the future return on investment from the massive investments done by large technology companies. While the concern is valid, companies like Alphabet and Meta are already benefiting from AI-driven optimisations, and most recognise the need to keep investing to avoid falling behind competitors. Nvidia's second-quarter results makes us believe the investment cycle will likely continue into 2025. The next important milestone will be the capital expenditure (capex) guidance that large-cap tech companies, expected at the beginning of next year.

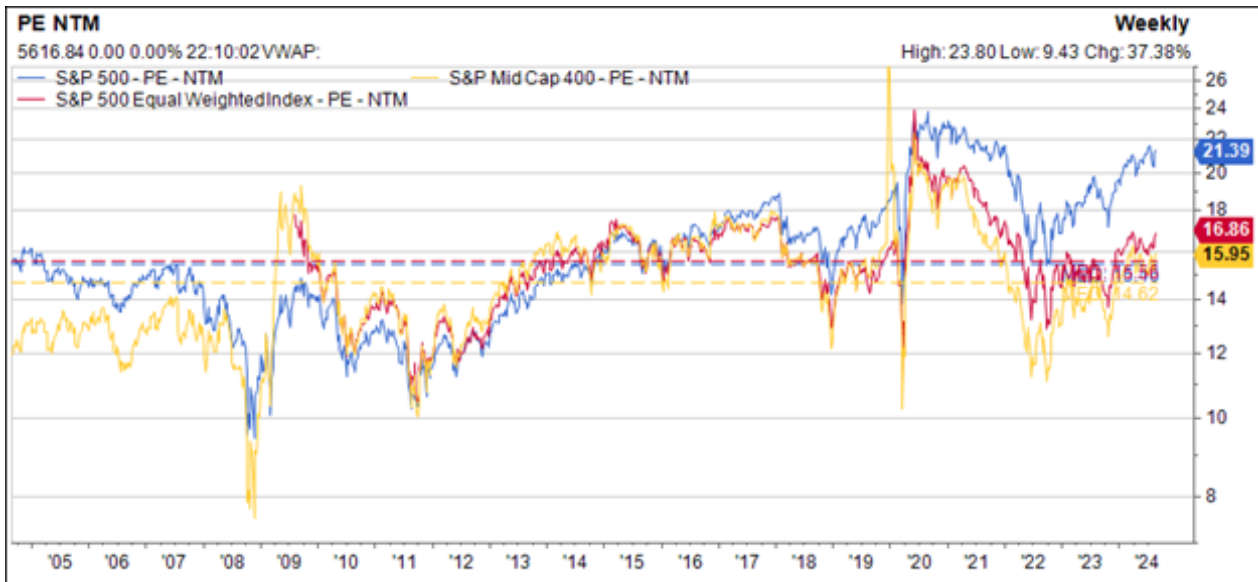
Regarding the third point, the sharp earning acceleration for the rest of the market is debatable to us. While there are some tailwinds such as lower inflationary pressure, a favourable base effect, and the prospect of lower interest rates, economic activity is not expected to accelerate meaningfully from here. Additionally, consensus earnings tend to be revised lower until the mid-year, so we should expect this negative revision process to unfold over the coming quarters for calendar 2025.

Regions	Last	EPS CY0	EPS CY+1	Gr yoy	1m Chg %	EPS CY+2	Gr yoy	1m Chg %	20y avg yearly EPS Gr
S&P 500	5 592.2	217.7	241.0	10.7%	-0.2	277.7	15.2%	0.0	8.6%
S&P 500 Equal Weighted	7 036.2	368.3	381.7	3.7%	-2.4	442.2	15.8%	-0.4	
S&P Mid Cap 400	3 059.6	178.1	176.5	-0.9%	-1.5	205.5	16.4%	-1.2	
STOXX Europe 600	520.6	34.2	35.9	5.0%	-0.8	39.6	10.2%	-0.4	7.6%
Euro STOXX Mid	504.7	40.6	41.9	3.1%	-0.6	46.6	11.2%	-0.4	
FTSE 100	8 343.9	680.8	672.7	-1.2%	-3.2	739.0	9.9%	-1.0	8.0%
Switzerland SPI	764.8	35.8	39.5	10.4%	-2.5	44.2	11.7%	-2.2	
Hang Seng Index	17 692.5	1 803.3	1 973.6	9.4%	0.8	2 106.7	6.7%	1.3	4.7%
Japan Nikkei 225	38 371.8	1 586.3	#N/A	#N/A	#N/A	2 123.2	#N/A	1.6	17.1%

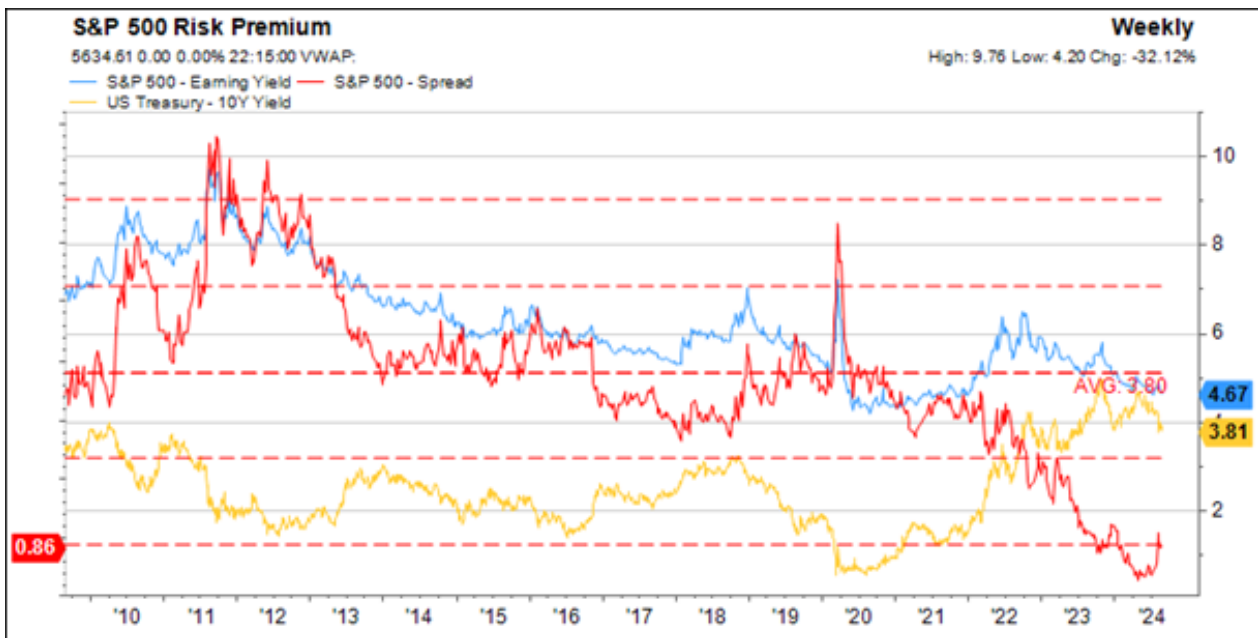
#### Valuations

We are turning more cautious on valuation for equities as: a) the earnings slowdown in mega-caps is pressuring multiples, b) the economic activity continues to normalise (slow), c) earnings growth expectations in areas of the market such as mid/small-caps are high and should warrant lower valuation multiple in our view and d) the equity risk premium remains unattractive.

Overall, the US market remains expensive while the smaller spectrum of this market relies on optimistic earnings growth. This indicates investors should be more sensitive to valuation, and we have seen this occur over the recent weeks with richly valued stocks performing underperforming.



Additionally, looking cross assets, the equity risk premium looks unattractive by historical standard.



## FIXED INCOME

### Overview

As we navigate through August, we maintain a neutral position in fixed income within our portfolios, guided by a mix of reassuring inflation data, a cooling job market, and the anticipation of upcoming Federal Reserve rate cuts. While these positive signals provide some optimism, several factors warrant caution. Ongoing supply pressures to finance the high fiscal deficit, the persistently inverted yield curve, and continued interest rate volatility suggest it's too early to adopt more bullish stance. Additionally, with a soft landing still as our base case scenario, the potential for significant long-term interest rate declines remains limited. In this context, we continue to favour the short and intermediate portions of the yield curve over long-duration bonds. We remain cautious on high yield, holding a neutral position on Investment Grade credit, while expressing more reservation toward high yield given stretched valuations—especially compared to Investment Grade credit—at this stage of the cycle. Moreover, with potential volatility on the horizon in H2 2024, we are also cautious with regards to USD-denominated Emerging Market debt, although EM local debt could present opportunities if the US dollar continues to weaken.

### Government Bonds

Our outlook for government bonds with maturities under 10 years remains optimistic, as we anticipate favourable conditions for yield improvements by year-end. This perspective is supported by several key factors:

- Reassuring Inflation Data and Economic Stability: The US economy is showing signs of normalisation, with the job market cooling and inflation rates gradually declining, albeit with occasional volatility.

- **Monetary Policies:** Federal Reserve Chair Powell’s recent statement—“the time has come”—has paved the way for a possible rate cut at the upcoming FOMC meeting in September. Additionally, easing quantitative tightening and enhancing liquidity in the Treasury bond market (buyback program), are expected to further stimulate demand.
- **Bonds as a Diversifier:** Bonds are once again proving their worth as effective diversifiers in balanced portfolios, with their correlation to equities turning negative.
- **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 likely in September, we are in a favourable 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.

↓ **Bond-Equity Correlation Turns Negative in August for the First Time in a Year!**



Source: Syz CIO office, Bloomberg

In Europe, we maintain a neutral stance as the European Central Bank (ECB) initiates monetary policy normalisation, beginning with its first rate cut in June. We anticipate additional 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, idiosyncratic risk. Indeed, we haven’t seen any contagion to other European issuers; for instance, the yield spread between 10-year Italian and German bonds returning to pre-election levels of 130bps. However, the bond market still perceives some risk, as the 10-year French real yield is near its highest level this cycle. While European wages remain a concern, the latest wage report shows promising progress, and ECB members are confident of further normalisation soon. Our outlook on UK government bonds is also neutral but close to turning positive. The political shift following Labour’s victory has not significantly impacted the gilt market, with memories of the 2022 crisis under Liz Truss fostering caution towards expansive fiscal policies. The 10-year UK Gilt yield has returned to 4%, an attractive level considering the market currently prices in only four rate cuts within the next year, half that of the US. Additionally, there is growing anticipation of an earlier start to monetary policy normalisation (rate cut) by the Bank of England, possibly as soon as September.

↓ **Market Perception of French Election Risks**

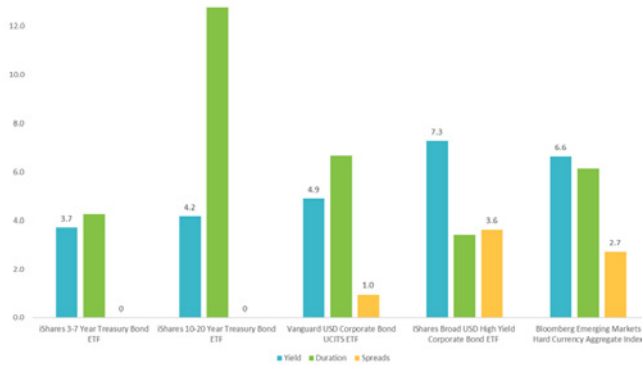


Source: Syz CIO office, Bloomberg

## 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,” needing 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 favourable risk/reward profile, though we acknowledge that overall valuations in high yield are stretched, especially if volatility increases in the second half of 2024.

### Yield Composition Across Fixed Income Segments



Source: Syz CIO Office, Bloomberg.

## Emerging Markets

Our stance on hard-currency EM debt remains cautiously negative, although we identify some attractive opportunities in bonds with up to 4-year maturities and yields above 6.0%. Market sentiment toward EM debt remains subdued, as evidenced by ongoing negative capital flows and rising short interest in USD-denominated EM debt. Valuations are notably stretched, with EM corporate spreads at their narrowest since 2007. However, the recent weakening of the US dollar and declining US real interest rates have provided some relief to EM local debt, making it an attractive investment consideration.

### Evolution of Emerging Market Local Currency bonds: +6% since the start of Q3 2024



Source: Syz CIO Office, Bloomberg.



## FOREX (view against USD)

We decided to adjust our view on the USD to Neutral (from Positive)

- › Following the recent US economic data on inflation and employment, and the speech of Jerome Powell at Jackson Hole, we now expect the US dollar to remain broadly stable against other major currencies in the coming months. We no longer expect a stronger US dollar.
- › The clear easing in inflationary pressures in the US, along with the normalisation of the labour market, now give sufficient confidence to the Fed for starting to lower its key rate. This will start in September and will likely be followed by more rate cuts in the following meetings of 2024 (November 7<sup>th</sup> and December 18<sup>th</sup>) and into 2025. Depending on labour market and inflation data, the Fed could even implement 50bp rate cuts to bring the real cash rate rapidly closer to a neutral stance.
- › Up until now, the dynamism of the US economy compared to other large economic areas suggested that USD rates could have remained higher than other G7 currency rates for longer, with the rate differential possibly even widening as the ECB, the BoE or the SNB were already cutting their rates. This would have supported the US dollar.
- › With the Fed now able and willing to significantly relax its monetary policy stance, interest rate differentials will no longer be as much of a support for the Greenback, and the upside potential for the USD appears limited. This is why we no longer maintain a positive view on the US dollar.
- › In our current economic scenario, the US economy will continue to grow faster than other developed economies, and the Fed will implement a gradual easing of its monetary policy, instead of an aggressive easing that would be warranted if the economy slips into recession. In our scenario, the US dollar isn't expected to weaken significantly, as the global central bank rate cut cycle will be quite synchronised. This is why we don't move to a negative view on the US dollar and rather opt for a neutral stance.

## 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? Because: 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, such as 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

- As highlighted in our August 2024 Asset Allocation Insight, our view was that the early August market correction was driven by technical factors rather than macro and fundamentals. The unwinding of the yen carry trade was an accident waiting to happen (see our June 2022 FOCUS note "Has Japan's central bank created a monster?"). The heavy net long positioning by CTAs, the traditional low liquidity of August and the high valuation ratios of some crowded trades (e.g. Mag 7) created the perfect "summer cocktail" for pullbacks of major global equity indices and a spectacular spike of the VIX.
- As explained in the August 2024 Asset Allocation Insight FAQ, there was no reason to panic as macro and fundamental conditions remain favourable to equity markets. Still, history shows that stock markets remain bumpy in the 4 to 6 weeks which follow a spike in the VIX.
- We expect the Fed rate cut cycle to start soon and proceed gradually. Barring a financial crisis or unexpected change in the path of inflation or unemployment, the upcoming rate-cutting cycle won't be dramatic; we expect the Fed to make incremental, 25 bps cuts to its policy rate. Moreover, the Fed is going to stay highly data dependent and will calibrate accordingly.
- Overall, this is a rather positive scenario for risk assets. Still, equity market valuations are becoming rich especially in developed markets. Consequently, we keep our neutral stance on equities.
- We are upgrading all currencies (EUR, CHF, CHF, JPY, EM currencies) back to neutral vs USD (from Negative). Technicals have turned against the US dollar and the Fed has sent a clear signal about coming rate cuts.

## TACTICAL ASSET ALLOCATION (TAA) DECISIONS– 27.08.2024

### TAA Balanced moves

We started the year with an allocation to equities which was close to our Strategic Asset Allocation (SAA). Due to market effects, the allocation has been rising progressively to OVERWEIGHT throughout the first half of the year and we didn't sell into strength.

However, during our July Tactical Asset Allocation Committee, we decided to rebalance portfolios towards a neutral allocation to equities, which means that we effectively reduced our exposure to equities in 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). Regarding Fixed Income, we also made some minor 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 changes mentioned above resulted in a cash increase, typically by around +1% in balanced accounts.

As mentioned earlier, our stance on equities remains neutral but we expect market volatility to stay elevated for a while. We also note that the correlation between equities and bonds is turning negative, which improves the diversification characteristics of government bonds.

As such, the committee agreed to continue the move further toward neutral on the fixed income side, by moving the long end government bonds back to neutral while holding our equity allocation at neutral.

### Matrix of preference moves (see below)

#### Cash to underweight (from neutral)

→ The strong rebound of the main stock markets since the 5<sup>th</sup> of August has pushed the equity allocation to slightly overweight and lowered the cash allocation. As we are not rebalancing portfolios, we are downgrading the preference to cash from neutral to negative to represent the portfolio reality in our grids.

#### All currencies are back to neutral vs. USD (from Negative)

→ Technical indicators have turned against the US dollar, and the Fed has sent a clear signal about coming rate cuts. As a result, the Asset Allocation Committee agreed to remove the underweight position in all currencies against the US dollar.

## ASSET ALLOCATION GRID

### TACTICAL POSITIONING: OUR ASSET ALLOCATION MATRIX

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

Change from last month: More attractive ↵ Less attractive ↵

Source: Investment strategy group - 27 August 2024

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