Market Insights

Q4 2023

- While equity and bond market volatility could persist in the short-run, we expect more positive market conditions towards the end of the year. Indeed, with the US & global economy cooling down in the months to come, central banks are expected to pause their monetary policy tightening. This would be a positive for equity and bond markets over time.
- In the first part of this publication, we review the top 10 stories from the past quarter. We then share the investment conclusions of our latest tactical asset allocation committee.
- Next, we take a step back and look at how the economic and financial world has evolved over the 15 years that followed the Lehman Brothers crisis. We then have a look at two fascinating themes: the huge potential of Electric Vehicles wireless charging and investing in AI beyond Nvidia.
- The last section focuses on our home country and how Switzerland Fiscal responsibility and reasonable indebtedness can be seen as a model for the rest of the world.

Syz PRIVATE BANKING

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Market review in 10 charts

Q3 2023 in the rear view

After a strong first half of the year, the mood has shifted during the Summer as markets are adjusting to the reality of “persisting inflation & sticky rates”, a narrative which is adding pressure on equities and valuations. What has also changed in recent weeks has been some sense that the bill for the US fiscal profligacy is coming due, pushing long-dated bond yields to record highs.

Here are 10 stories to remember from an eventful Q3 2023.

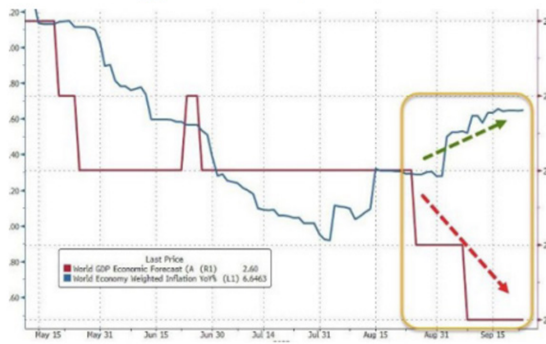
Charles-Henry Monchau
Chief Investment Officer

Chart #1

The come-back of stagflation fears

This chart alone explains why market sentiment has deteriorated throughout the 4th quarter: global economic growth forecasts are down, while inflation forecasts are up. After the very clear deflationary trend seen in the 1st half of the year, the specter of stagflation is once again looming, weighing on investor morale.

Global GDP growth forecasts (red line) vs. weighted 12-month rolling global inflation (blue line)



Source: Bloomberg, www.zerohedge.com

Chart #2

US debt and debt servicing costs are sky rocketing

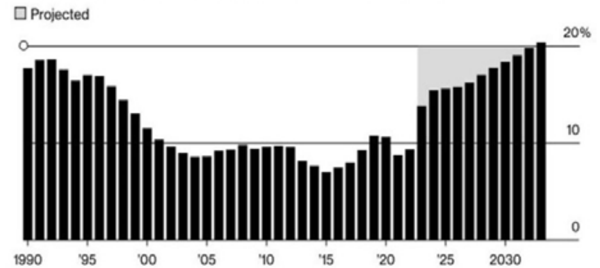
Fears of another US Federal government shutdown also weighed on market sentiment towards the end of the quarter. After repeated attempts to pass legislation averting a government shutdown, Rep House Speaker Kevin McCarthy changed the plan during the last weekend of the quarter, reversing his previous opposition to a bipartisan package and putting forward a last-minute, six-week continuation of current spending levels. The House passed the measure with a vote of 335-91, including 200 Democrats carrying the vote. The same day, the legislation went to the Senate which passed the measure and President Joe Biden signed the spending bill into law, preventing a government shutdown. Rep House Speaker Kevin McCarthy was ousted from the House a few days after.

This resolution implies that for the next 45 days or so, the US government will NOT be shut down. However, this stopgap bill is only a temporary solution. Decision makers are just “kicking the can down the road another time”. Indeed, the House and Senate are both struggling to approve yearlong spending bills, and the gulf between the two parties remains vast. And there is no long-term plan.

For nearly 20 years, it was effectively free for the US to issue debt as debt service costs were ~1.5%. Now, debt service costs have doubled to 3% and will rise toward 5% as rates skyrocket.

To put this in perspective, 5% on $33 trillion is ~$1.7 trillion per year on interest expense. As deficit spending rises, so are rates, as the US issues trillions in bonds to cover the deficit. It's a never-ending cycle of borrowing to spend which is driving rates higher and leading to interest expense being 20% of US revenue.

Net Interest on Debt as Share of Federal Revenue



Source: Congressional Budget Office | Bloomberg

Chart #3

Disinflation trend continues

Headline inflation peaked in the second half of 2022 across large developed economies and has been slowing down since then as Good prices’ inflation (coming from supply chains’ tensions) and energy prices trended lower. The impact of those two drivers will gradually wane off from 12-month rolling inflation rates going forward. “Core” inflation has followed with a lag but has only slightly slowed down in the US and Europe for now, as Service prices’ inflation remained fuelled by firm consumer demand (especially in the US) and rising wages and labor costs. “Core” inflation is still clearly above central banks’ targets.

Leading indicators and gauges of consumer and business inflation expectations have been trending lower recently on both sides of the Atlantic.

Key Gauge of Underlying Inflation Slows
Excluding food and energy, Fed's preferred price index rose by least since 2020

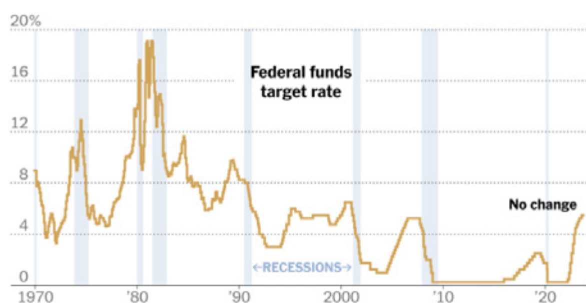
Source: Bureau of Economic Analysis | Bloomberg

Chart #4

The Fed decides to take a pause in the rate hike cycle but leaves the door open to further monetary tightening

As expected, the US Federal Reserve decided to leave interest rates unchanged in September, keeping the benchmark rate within the target range of 5.25% to 5.5%. 12 Fed members are forecasting a further rate hike at upcoming meetings, while 7 members are no longer forecasting one. The dot plot of rate projections shows that US monetary policymakers are still expecting another rate hike this year. Also, the rate projections for 2024 and 2025 have all risen by half a percentage point, indicating that the Fed expects rates to remain higher for longer. The Fed is forecasting inflation of 2.6% in 2024. The median projection for economic growth in 2023 is raised from 1% in June to 2.1%; officials significantly cut unemployment forecasts and now expect the unemployment rate to peak at 4.1%, rather than 4.5%. It should be noted that the Fed acknowledges that job creation has "slowed» but affirms that it "remains strong".

The market has de facto revised the path of interest rates upwards: the Fed's futures contracts no longer point to rate cuts before September 2024. To put things in perspective, three months ago, the futures contracts were forecasting 4 rate cuts in 2023. Today, the market expects interest rates to pause for at least a year.



Source: The New York Times

Chart #5

The SNB puts an end to the monetary tightening cycle

The SNB left its key rate unchanged at 1.75%, thwarting market expectations of a further 25 basis point rise. Underlying this decision are the slowdown in inflation, the extent of the monetary policy tightening already implemented (short-term Swiss franc rates were still negative a year ago) and the growing risks surrounding the global outlook.

Indeed, with inflation in line with the SNB's target (1.6%, within the 0%-2% range), economic activity slowing (0% GDP growth in the second quarter of 2023) and the Swiss franc remaining firm, the case for further tightening had become much less convincing in recent weeks. Unlike the ECB, which was forced to raise rates the previous week because inflation was still well above its target, the SNB had very good reasons to pause and adopt a cautious stance.

However, the SNB is not ruling out further hikes in the future, if necessary. It is also interesting to compare the SNB's decision and body language with those of the Fed and the ECB.

Indeed, Mrs. Lagarde and Mr. Powell left an impression of great confusion. On the one hand, they were obliged to acknowledge that the battle against inflation was not yet won. On the other, they shared their fears about the impact of higher rates on the economic cycle. In the case of the SNB, things are much clearer. Inflation is already within the SNB's target range. Activity is slowing down. These two factors allow the SNB to come up with a clear and unambiguous decision: the end of rate hikes for this cycle. And if economic activity were to accelerate or slow too much, the SNB has several options available.

SNB's surprise move to pause rate hikes

The Swiss National Bank has entered "wait and see mode" after a surprise decision to hold its policy interest rate unchanged at 1.75% as inflation dipped, but still left the door open for more tightening.

Note: CPI figure is for August 2023.
Source: LSEG Datastream | Reuters, Sept. 21, 2023 | By Pasit Kongkunakornkul

Source: Bloomberg

Chart #6

Oil supply deficit set to worsen in Q4

This chart from Bloomberg shows the huge supply deficit that oil markets will face over the next quarter. OPEC is forecasting a supply deficit of more than 3 million barrels a day. If OPEC is right, the result will be the biggest reduction in stocks since 2007. Voluntary production cuts by OPEC members are removing an additional 1.3 million barrels from the oil supply every day. This shortfall is taking place against a backdrop of rising oil prices and at a time when US reserves are at their lowest.

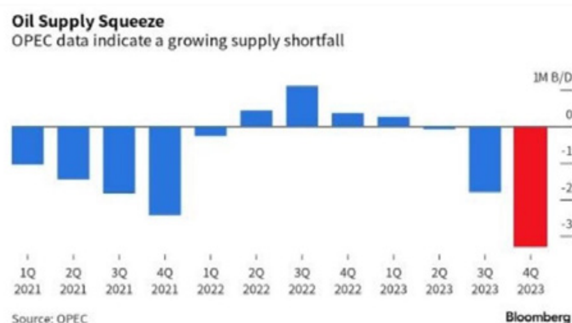


Chart #7

A change in cross-assets leadership

After a strong first half of the year for stocks, a change in leadership took place during the third quarter. Commodity (+4.7%) was the best performing asset class during the quarter but remains nevertheless in the red on a year-to-date basis (-3.4%). Oil recorded a strong performance in the 3rd quarter (+32.6% for US WTI crude oil benchmark) on the back of supply/demand imbalance prospects (see chart #6).

Developed market equities fell by -3.4% over the quarter, taking year-to-date returns down to a still strong 11.6%. Value stocks (-1.7%) were more resilient than growth stocks (-4.9%). However, growth continues to lead year to date with an 18% outperformance. MSCI Emerging Markets (-2.8%) fared slightly better than developed markets equities. From a country perspective, Japan Topix (+2.5%) was the best performer in Q3 and continues to lead on a year-to-date basis (+25.7%). The S&P 500 was down -3.3% over the quarter but is still up +13.1% year-to-date (as of the end of September). MSCI Europe ex-UK was the worst quarterly performer (-3.4%) but remains up 10% year-to-date.

A sell-off in global bond markets was partly to blame for the pressure on risk assets, with the global aggregate bond benchmark falling by -3.6% in the third quarter. The US Treasury market was a notable laggard, while in credit, the lower interest rate sensitivity of high yield bond benchmarks helped both the US and European high yield bond markets to eke out positive returns, returning 0.5% and 1.5% respectively. On a year-to-date basis, the global aggregate bond index is down -2.2%.

We note that correlation between bonds and stocks spiked in the 3rd quarter, echoing the market dynamics of 2022.

2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	YTD	Q3 '23
Global REITS 23.0%	Small cap 32.9%	Global REITS 22.9%	Growth 3.5%	Small cap 13.3%	MSCI EM 37.8%	Global Agg -1.2%	Growth 34.1%	Growth 34.2%	Global REITs 32.6%	Cmdty 16.1%	Growth 21.1%	Cmdty 4.7%
MSCI EM 18.6%	Value 27.5%	Growth 6.5%	Global REITS 0.6%	Value 13.2%	Growth 28.5%	Global REITS -4.9%	DM Equities 28.4%	MSCI EM 18.7%	Cmdty 27.1%	Value -5.8%	DM Equities 11.6%	Value -1.7%
Small cap 18.1%	DM Equities 27.4%	DM Equities 5.5%	Small cap 0.1%	Cmdty 11.8%	Small cap 23.2%	Growth -6.4%	Small cap 26.8%	DM Equities 16.5%	Value 22.8%	Global Agg -16.2%	Small cap 3.3%	MSCI EM -2.8%
Growth 16.6%	Growth 27.2%	Value 4.4%	DM Equities -0.3%	MSCI EM 11.6%	DM Equities 23.1%	DM Equities -8.2%	Global REITs 24.4%	Small cap 16.5%	DM Equities 22.3%	DM Equities -17.7%	Value 2.7%	DM Equities -3.4%
DM Equities 16.5%	Global REITS 2.3%	Small cap 2.3%	Global Agg -3.2%	DM Equities 8.2%	Value 18.0%	Value -10.1%	Value 22.7%	Global Agg 9.2%	Growth 21.4%	Small cap -18.4%	MSCI EM 2.2%	Global Agg -3.6%
Value 16.4%	MSCI EM -2.3%	Global Agg 0.6%	Value -4.1%	Global REITS 6.5%	Global REITS 8.0%	Cmdty -11.2%	MSCI EM 18.9%	Value -0.4%	Small cap 16.2%	MSCI EM -19.7%	Global Agg -2.2%	Small cap -4.3%
Global Agg 4.3%	Global Agg -2.6%	MSCI EM -1.8%	MSCI EM -14.6%	Growth 3.2%	Global Agg 7.4%	Small cap -13.5%	Cmdty 7.7%	Cmdty -3.1%	MSCI EM -2.2%	Global REITs -23.7%	Cmdty -3.4%	Growth -4.9%
Cmdty -1.1%	Cmdty -9.5%	Cmdty -17.0%	Cmdty -24.7%	Global Agg 2.1%	Cmdty 1.7%	MSCI EM -14.2%	Global Agg 6.8%	Global REITs -10.4%	Global Agg -4.7%	Growth -29.1%	Global REITs -4.1%	Global REITs -6.5%

Source: The New York Times

Chart #8

The surge in long-dated bond yields

The yield on 10-year US Treasury bonds continues to rise, reaching a high of 4.63% at the end of the quarter, its highes level since June 2007 (at the time of our writing, the 10-year trades at 4.77%). Between the Fed's last meeting and the end of the quarter, the yield on 10-year bonds has risen by 35 basis points. Since the Fed's last rate hike in July, the yield has risen by 60 basis points. In the meantime, the Fed's rate hike forecasts have not changed. In fact, the current yield curve has revised downwards the probability of another rate hike this year. How can we explain the upward acceleration in 10-year yields?

Firstly, the market seems to have accepted that the Federal Reserve will take a long pause. Previously, investors were expecting a large number of rate cuts as early as 2024. The current curve now anticipates just two rate cuts next year. In addition, strong bond issuance by the US Treasury at a time when the Federal Reserve is accelerating the reduction in the size of its balance sheet through Quantitative Tightening (QT) is creating unfavourable supply/demand conditions for longdated bonds.

This upward movement in bond yields is contributing to the rise in the dollar and weighing on equity valuations, particularly those of so-called growth stocks (e.g. Technology) – see next chart.

Source: Bloomberg

Chart #9

Short duration stocks outperform long duration stocks

A regime change has been in place over the second half of the quarter. Despite the rise in 30-year real yields, short duration stocks (i.e value and the likes) were underperforming long duration ones (i.e IT/growth stocks). Things are now normalizing as short duration stocks are progressively catching up in terms of relative performance. The growth/IT basket probably needs 30-year real yield to reverse trend in order to outperform again.

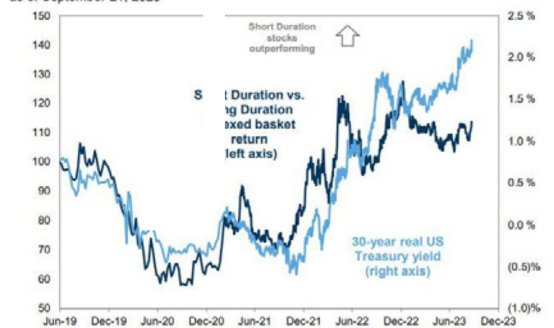


Chart #10

The king dollar

The U.S. Dollar Index ($DXY) recently experienced its 10th successive week of gains, marking its longest period of increase in 9 years. The flight to safety, the yield differential between US and the rest of the world and the macroeconomic weakness observed in Europe and Asia have been pushing the greenback upward.

Source: FT

Cash & bond yields are significant competition for stocks

Key takeaways:

- After a strong first half of the year, the mood has shifted during the Summer as markets are adjusting to the reality of "persisting inflation & sticky rates", a narrative which is adding pressure on equities and valuations.
- While equity and bond market volatility could persist in the short-run, particularly through a historically choppy September/October, we expect more positive market conditions towards the end of the year. Indeed, with the US & global economy cooling down in the months to come, central banks are expected to pause their monetary policy tightening. This would be a positive for equity and bond markets over time.
- We remain neutral on equities, rates and credit. Cash and bond yields are a clear competition to equities and our multi-assets portfolios reflect this reality. We are negative on the EUR and CHF against dollar. We upgraded Swiss equities to positive. We are keeping Gold as a diversifier.
- We continue to favour 3 main investment themes: 1) Diversify into the lagging segments of the equity market that carry lower valuations; 2) Use volatility at our own advantage by buying on pullbacks; and 3) Use the bear steepening of the curve to extend duration within fixed-income portfolios.

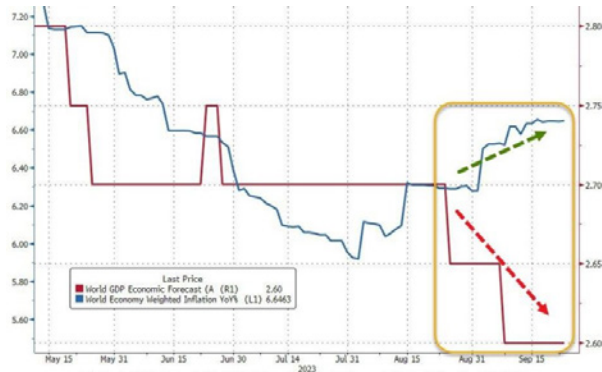
Charles-Henry Monchau *Chief Investment Officer*
Adrien Pichoud *Chief Economist & Senior Portfolio Manager*
Luc Filip *Head of Discretionary Portfolio Management*
Fabrice Gorin *Deputy Head of Portfolio Management*
Gaël Fichan *Head Fixed Income & Senior Portfolio Manager*

The big picture

The bull market which took place between October of last year and the month of July was driven by two strong trends: 1) Disinflation and; 2) The Artificial intelligence “mania”. Markets were embracing the prospects of a new “goldilocks” scenario with a cooler economy but neither too cold nor too hot, leading central banks to pivot their monetary policy towards a gradually less restrictive stance.

However, the uncomfortable combination of rallying oil and US long end breaking up is disrupting this equilibrium and triggering concerns of another episode of “stagflation” fears.

This chart explains by itself why the market mood has been deteriorating over the last few weeks: growth forecasts moving down / world inflation going up



Source: Bloomberg, www.zerohedge.com

Indeed, projections by OPEC of a supply/demand imbalance close to 3 million barrels a day in the fourth quarter of the year has triggered a rally in oil prices. Meanwhile, the resilience of the economy and signs that inflation is stickier than expected have been pushing long-term bond yields to new highs. Indeed, the yield of the Bloomberg Global Aggregate Total return index is at its highest since the months that preceded the Great Financial Crisis.

Equity markets are now getting uncomfortable with those rate levels. We also note that the last leg up in yields has been accompanied by an outperformance of defensives over cyclicals. Key indices (S&P 500, Dow, Nasdaq) trade below their 50 day and 100 days moving averages. For the 1st time since March, the S&P 500 is down more than 5% from its high. Volatility is making a come-back with the VIX trading above 17. Global equities ex-US are faring even worse.

Interestingly, the pause by the Fed at the September FOMC meeting didn’t provide the boost some were expecting. As anticipated, the Fed held rates steady at 5.25% - 5.5% at this meeting, but kept the option of an additional rate hike on the table, maintaining its outlook for a peak Fed Funds rate of 5.6%.

The message from Jerome Powell was clear: The Fed will continue to keep rates elevated until inflation moves more convincingly toward 2.0%. The Fed's new set of projections also reduced the number of potential rate cuts in 2024, from 1.0% to 0.5% of cuts next year – implying that the elevated interest-rate environment may last longer than expected. Meanwhile, the Fed continues to reduce the size of its balance sheet through quantitative tightening.

Another concern for investors is the lag effects of the rise of interest rates on the real economy. Renewed weakness by US banks stocks seems to indicate that the most aggressive rate hike cycle in recent history will not leave the economy and financial system unscathed. This might explain the surprising statement by Fed Chair Powell, who said he would not call soft landing a baseline expectation, hence sharing his fears that keeping real rates elevated for a long period of time is creating some downside risks for the economy and the markets.

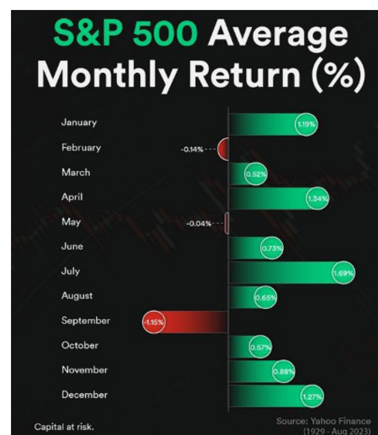
US 10y real yields (10y nominal yields - 10y inflation expectations) jumped to 2.11%, the highest since 2009

On a more optimistic note, US earnings revision trend remains positive. If consensus estimates prove true, the second quarter will mark the end of the earnings downturn. S&P 500 earnings are expected to turn positive in the third quarter and rebound further in 2024. The combination of positive earnings growth simultaneously with the Fed finally pausing could very well help equity markets to resume their uptrend.

We also note that the amount of shorting in US equities by hedge funds since mid-August is the largest in six months and ranks in the 98th percentile vs. the past decade (source: Goldman Sachs). Meanwhile, the level of short gamma is the highest in a long time. We need to keep in mind that these kind of moves work both ways, so a possible bounce from here would force hedge funds and dealers to buy back the stocks they sold recently.

Last but not least, seasonality will soon turn positive There are only 100 days left in 2023 and we are getting closer to the most favourable period of the year for stocks. Almost 80% of the time, the S&P 500 records gains during the last 100 calendar days of the year.

Based on history, the S&P 500 will soon enter the most favourable months of the year



Source: Yahoo Finance

In the next section, we respond to the frequently asked questions from clients. We present our latest asset allocation decisions based on the 5 pillars of our asset allocation process. To conclude, we suggest three investment themes for the months to come.

Frequently asked questions (FAQs)

FAQ #1

Where do we stand in our global growth scenario?

Recent months have delivered some surprises and some long-awaited confirmations on the global economic front.

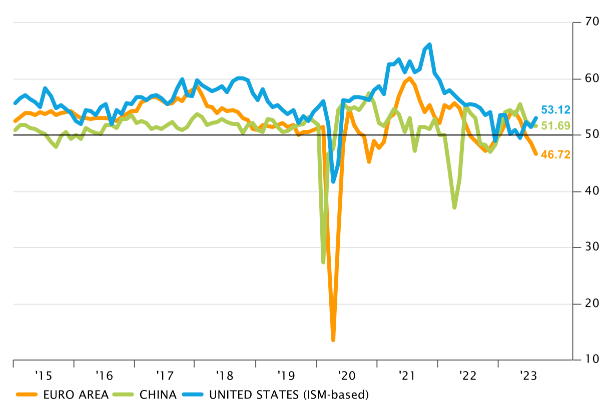
The US economy has continued to surprise to the upside, extending its streak of positive economic data surprises at play since the beginning of the year, thanks to unabated domestic demand for services.

The European economy has continued to surprise to the downside, with an unexpected sharp deterioration in economic indicators over the summer, as the impact of more restrictive financing conditions began to filter through economic data and added to existing headwinds already in place since 2022.

The Chinese economy has finally shown signs of stabilization, after a long period of slowdown and disappointing data over the Spring, when the post-reopening recovery failed to match expectations. The long-awaited stabilization in China's economic growth now appears to take shape.

Our take: The global economy is exhibiting unusual desynchronization at the moment, with very different growth dynamics between the main drivers of global growth. Such desynchronization cannot last for very long. While China can remain in a cycle of its own, the US will likely lose momentum at some point and narrow the existing gap with Europe.

Unusual desynchronization



FAQ #2

US economy: a "soft landing" after all? or a delayed recession?

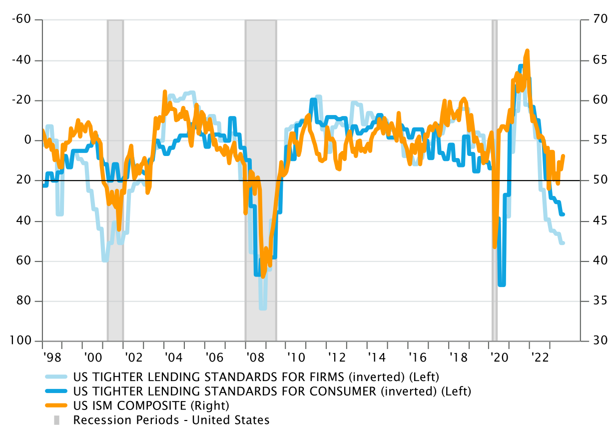
The US economy has proved to be surprisingly resilient throughout the summer, as the strength of consumer spending, supported by a still tight labor market, has defied expectations of a slowdown.

The scenario of a "soft landing" in growth, in which the US economy would gently slow down under the impact of higher rates, but without stalling or falling into recession, has therefore gained some credibility (being even adopted as their central economic scenario by a few large US banks).

The early "real-time" estimate of Q3 GDP growth currently pointing to 4.9% annualized GDP growth for Q3 only reinforce the sentiment that a US recession might be avoided after all, and that growth will gently converge toward its long-term potential of 2%.

Our take: The longer US consumers are able to extend their spending spree, the more likely a "soft landing" scenario becomes plausible as it allows for the ongoing correction in cyclical sectors (industry, real estate) to be absorbed without broader damages to the economy. However, several leading indicators continue to point to downside risks ahead and a recession in 2024 (not necessarily a very deep one) still appears as the most likely scenario.

US growth is more fragile than most think



FAQ #3

Europe: already in recession, but how bad will it be?

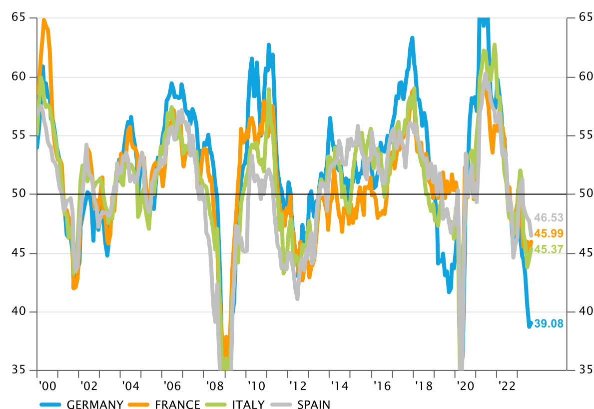
Economic indicators have been deteriorating sharply in the Eurozone over the summer, to the point where the question no longer appears to be "recession or no recession?" but rather "how bad is/will be the recession?"

Industrial and manufacturing activity was already under pressure since 2022 but the dynamic has deteriorated in the recent months, especially in the "powerhouse of Europe", Germany, where industrial activity is sharply contracting.

Service sector activity, that had continued to expand so far as low unemployment supported consumer spending, has recently turned negative as well and likely drove the Eurozone into recession in the course of the Q3. The tentative recovery in consumer sentiment from the "peak energy concerns" of late 2022 is now reversing down.

Our take: the Eurozone had been fragilized by the ripple effects of the war in Ukraine (energy prices, inflation in food prices, sanctions on Russia weighing on exports). The impact of rising rates appears to have "broken the camel's back" as activity in the service sector has turned south in the summer. With the ECB forced to maintain a restrictive monetary policy as it faces an uncomfortable combination of slowing growth and too high inflation, the growth outlook for the Eurozone appears bleak. Especially as rising energy prices are currently inflicting an additional blow to consumers already in a difficult situation.

Europe is facing serious headwinds



FAQ #4

Is China finally stabilizing?

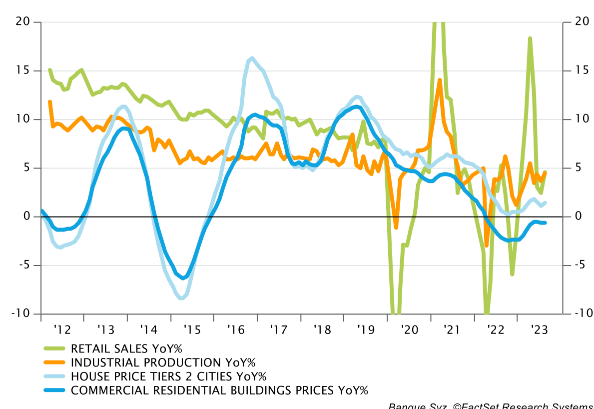
The Chinese economy had been on a slowdown trend for the past three years, under the successive and combined pressures of Covid-related restrictions, regulatory crackdowns on several sectors and a real-estate market correction.

For the past year, Chinese authorities have taken numerous gradual steps to stem this slowdown and prevent an economic crisis. But they have refrained from delivering large-scale stimuli as they wanted to avoid fuelling another credit-led bubble like in previous crises.

This approach eventually appears to bear fruits, as latest data on consumption, industrial activity and real estate prices point to a stabilization at levels that might be consistent with the government's goal of sustainable and balanced economic growth of 5%.

Our take: the combination of successive small rate cuts, selected easing in credit conditions and selective targeted government support appears to eventually succeed in engineering a stabilization in China's growth dynamic. An extension in recent trends would allow China's GDP to reach the government's 5% target for this year. Such stabilization in China's growth would remove a significant headwind having weighed on global growth in the past three years.

Signs of stabilization in China



Banque Syz, ©FactSet Research Systems

FAQ #5

Where do we stand in our expected «disinflation scenario»?

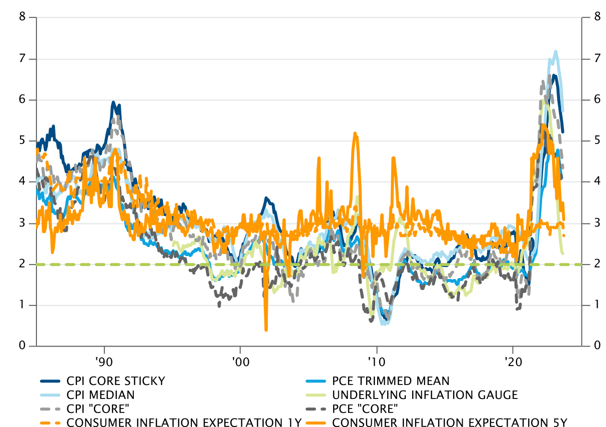
Headline inflation peaked in the second half of 2022 across large developed economies and has been slowing down since then as Good prices' inflation (coming from supply chains' tensions) and energy prices trended lower. The impact of those two drivers will gradually wane off from 12-month rolling inflation rates going forward.

"Core" inflation has followed with a lag but has only slightly slowed down in the US and Europe for now, as Service prices' inflation remained fuelled by firm consumer demand (especially in the US) and rising wages and labor costs. "Core" inflation is still clearly above central banks' targets.

Leading indicators and gauges of consumer and business inflation expectations have been trending lower recently on both sides of the Atlantic.

Our take: the scenario of a gradual slowdown in underlying inflation dynamics remains in place. The combination of labor market normalization, of higher rates and of slowing economic growth (especially in Europe) will gradually cool down upward pressures on prices. In this context, the recent rise in energy prices is more likely to be an additional headwind for growth than to trigger another round of underlying inflationary pressures.

A gradual slowdown in underlying inflation dynamics remains in place



FAQ #6

Is there a risk of stagflation?

The burst in inflation post-Covid was initially triggered by supply factors (scarcity of goods, commodity prices) that have mostly normalized. It then morphed into demand-driven inflation, led by strong consumption and tight labor markets, that a slowdown in final demand has recently started to dampen, as reflected by moderating "core" inflation indices.

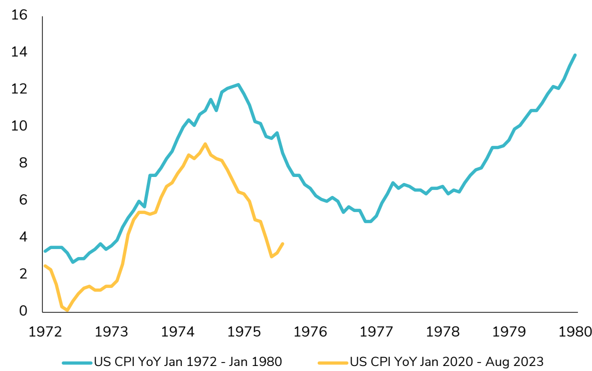
With economic growth already slowing down sharply in Europe, and expected to cool down in the US, this "disinflationary" trend should extend further and gradually bring back inflation rates toward central banks' targets of 2%.

Still, there is a potential alternative scenario: what if the successive shocks mentioned above, combined with new structural trends such as reshoring, unfavorable demographic dynamics (baby boomers' retirement, tighter control of immigration), result in persisting inflationary pressures, regardless of a slowdown in economic growth?

The economist's take: our central scenario (i.e. with the highest probability) remains one where economic growth slowdown will dampen inflationary pressures by easing labor market tensions and lowering demand for goods and services. However, the risk of a Stagflation scenario, where inflationary pressures would persist for structural reasons despite an economic growth slowdown, cannot be ruled out

at this stage. We have integrated this as a "tail risk" in our scenario and asset allocation.

The risk of stagflation is real but is note our core scenario



FAQ #7

Have we seen the end of the central banks' rate hike cycle?

The past two years have seen the most violent and coordinated global rate hike cycle in recent history, across all developed and most emerging economies (China being the noticeable exception).

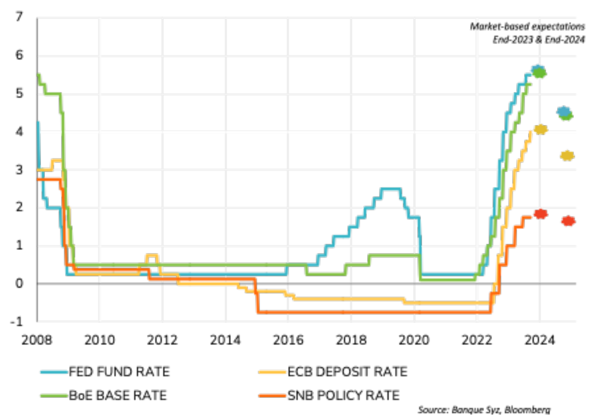
As inflation dynamics appear to be peaking globally, while economic growth is losing momentum or even deteriorating in some regions, it appears increasingly likely that the global cycle of central banks' rate hikes has or is about to end.

The ECB, constrained by its single inflation mandate, has been forced to raise its key rate by 25bp in September despite a sharply worsening growth outlook, but is unlikely to continue on this path. The Fed, the BoE, the SNB all face situations where they either could pause already or deliver one last hike before pausing. Large EM central banks had been ahead of their DM counterparts and some of them (notably Brazil) are already reversing course.

Future markets are also pricing such "peak rate" scenario and assign a limited probability of one last hike before year-end for large DM central banks, before some rate cuts in 2024.

The economist's take: The global rate hike cycle has reached its end in September. The ongoing growth slowdown across DM economies, and its impact on underlying inflationary dynamics, will not warrant additional monetary policy tightening going forward. Whether rate cuts will be implemented in 2024, and how many, will depend on growth and inflation developments.

The global rate hike cycle might have reached its end in September



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 (+)	WEIGHT OF THE EVIDENCE (-)	
MACRO CYCLE	The US economy remains supported by domestic consumption. Fiscal intervention continues to be a support to economic growth on both sides of the Atlantic.	Economic growth is slowing down globally. Europe is losing steam while China's weakness is a concern. Tighter financing conditions will ultimately impact growth.	NEUTRAL
LIQUIDITY	We are getting closer to the end of rate hike cycle.	Central banks might continue to keep QT and interest rates at elevated levels even during a recession.	NEGATIVE
EARNINGS GROWTH	Top-line growth and margins have been resilient in H1. Earnings revisions are positive and earnings momentum is expected to improve going forward.	AI-driven margins improvement are most likely overpriced. Positive earnings revisions are decoupling from PMI surveys.	NEUTRAL
VALUATIONS	Absolute valuations have improved recently. Excluding, P/Es are at or below historical average.	Equity risk premia are at or close to record lows. There is competition from cash and bonds	NEUTRAL
MARKET FACTORS	The trend remains a positive (but S&P 500 is now below 50 day moving average). High-Low is back to positive.	Breadth has been disappointing. Markets are not oversold yet	POSITIVE

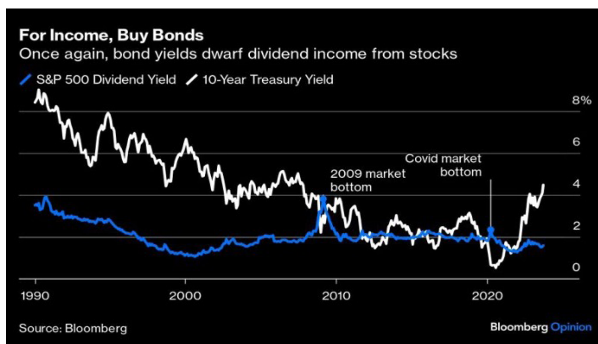
Asset Allocation

EQUITIES

We have a NEUTRAL stance on equities with a slightly positive view on the US, Japan and Switzerland (upgraded from neutral), a neutral view on the UK, EM Latam and China/EM Asia and a slightly negative view on Eurozone and other EMs.

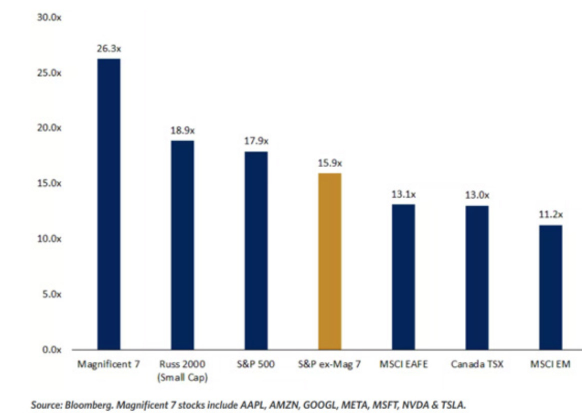
As mentioned earlier, earnings revision has been a tailwind for equities during the first 9 months of the year and if consensus is right, earnings momentum will turn positive in 3Q and 4Q this year. From a valuation perspective, US equities large caps remain expensive both on an absolute and relative basis. Importantly, cash and bond yields create significant competition for stocks. Treasury yields now surpass stock dividend yields by the widest margin since the Global Financial Crisis.

For income, buy bonds



But this relative expensiveness is mainly explained by the high valuation multiples of the "Magnificent 7". Valuations outside of this specific segment of the market appear less stretched (see chart below).

Valuations are more reasonable outside Technology (forward P/E ratio)



We are upgrading Swiss equities from neutral to positive due to their defensive characteristics and the fact the Swiss National Bank is probably at the end of its monetary policy tightening cycle.

FIXED INCOME

Within Fixed Income, we are maintaining a neutral stance on both Rates and Credit, with a slightly positive outlook on Investment Grade and a slightly negative view on High Yield.

While last year's rise in interest rates was primarily due to concerns about inflation, this year, higher yields appear to be driven by the market's improved perception of economic growth potential, resulting in real interest rate levels not witnessed in decades. Conversely, we recognize the potential for lower rates due to a global growth slowdown. In this rate environment, we recommend gradually extending duration, as there is an attractive asymmetry in long-term rates, supported by expected moderation in growth and inflation. The resurgence of oil prices could temporarily weigh on short-term rates but increases the case for a long-term growth slowdown.

Considering our concerns about the Eurozone's growth outlook and the potential conclusion of the ECB rate hike cycle, we are adopting a neutral stance on EUR rates. Within the credit space, our neutral stance emphasizes high-quality corporate bonds. We are avoiding the pursuit of higher yields in the High Yield sector due to overpricing relative to risk. In Emerging Market debt, we maintain a vigilant stance due to valuation and potential risk considerations. Higher oil prices and a strong US dollar pose challenges for oil-importing EM nations, especially Asian countries, while some Latin American countries may benefit.

The Bloomberg dollar index (DXY)

Source: TME, Refinitiv

FOREX & ALTERNATIVES

On the forex side, we remain negative on EUR and CHF (versus USD) and neutral on JPY, GBP and EM currencies (versus USD). The dollar index ($DXY) golden cross is now in place.

US 2- and 10-year Treasury yields moved to new cycle highs following the Fed meeting

Within commodities, we remain positive on gold, which continues to exhibit low volatility with other asset classes and should be a beneficiary of any tail risk event. We note that a significant gap has opened up between gold

and real yields. Why? 1) With debt sustainability having become an ever-increasing issue, the market anticipates that real interest rates cannot stay at this level for too long; 2) Investors buy gold as an insurance against adverse circumstances (inflation, recession, etc.). But for gold to appreciate in dollar, a drop in real yields is probably required. In the meantime, gold remains a true diversification asset.

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

Gold shrugs off yields

Source: Bloomberg

Tactical positioning: our asset allocation matrix

	--	-	NEUTRAL	+	++
Portfolio risk			Equities Credit Spreads Rates		
Equities		Euro zone Other EM	United Kingdom China & EM Asia EM Latam	United States Japan → Switzerland	
Fixed Income		HY Credit	Government Bonds Subordinated debt EM Hard EM Local	IG Credit	
Yield curves			USD EUR “peripheral” CHF GBP	EUR “core”	
Forex (vs USD)		EUR CHF	EM currencies GBP JPY		
Commodities		Commodities		Gold	
Alternative Investments				Hedge Funds	

Change from last month → More attractive ← Less attractive

Source: Investment strategy group - 22 September 2023

Investment conclusions

A “goldilocks” scenario, with a cooler economy but neither too cold nor too hot, would be a welcome outcome for the Fed - and the markets.

However, the uncomfortable combination of rallying oil and US long end breaking up is disrupting this equilibrium and triggering a rotation into the “persisting inflation & sticky rates” narrative, adding pressure on equities and valuations.

Our core scenario remains unchanged. While market volatility could persist in the short-run, particularly through a historically choppy September/October, we expect the US & global economy to cool down in the months to come, leading to a Fed pause. This would be a positive for equity and bond markets over time. We thus keep a NEUTRAL stance on equities and believe that a market correction could provide opportunities to increase equity exposure. We are also keeping a NEUTRAL stance on credit and bonds.

A balanced allocation to the three main asset classes is justified by the fact that bonds currently offer attractive real yields while equity market remains our favourite asset class for the long run.

We continue to favour 3 main investment themes:

1) Diversify into the lagging segments of the equity market that carry lower valuations;

2) Use volatility at our own advantage by buying on pullbacks; and

3) Use the bear steepening of the curve to extend duration within fixed-income portfolios

15 years after Lehman

The world, and the markets, have done better than survive one of the most resounding bank failures in history.
But at what price?

Fifteen years ago, a monument to global finance collapsed, leaving behind a gap of more than $600 billion. On the night of 14 September 2008, Washington decided to let go of the Lehman Brothers investment bank. And what Wall Street feared the most became reality: a major bank went bankrupt, plunging the financial markets and the global economy into an immense unknown.

Charles-Henry Monchau *Chief Investment Officer*

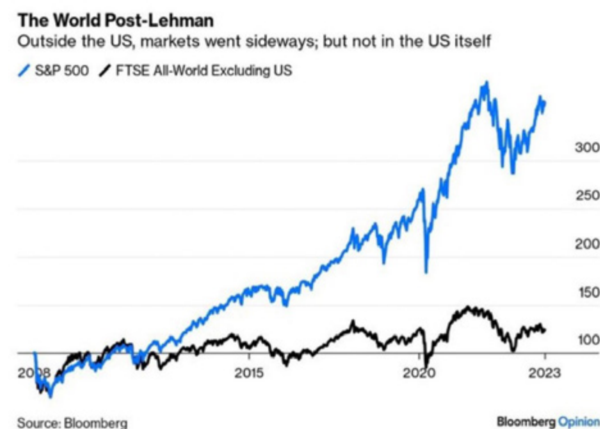
The resilience of the global economy and financial markets

While the world feared it was heading for an economic and financial crisis similar to that of 1929, nothing of the sort has happened. Despite Lehman and the many shocks that have occurred over the last 15 years (European debt crisis, US debt ceiling, pandemic, etc.), global nominal GDP has grown by 57% over the period, from $64 trillion to over $100 trillion. In most developed countries, unemployment is close to historic lows.

With the return of confidence and the credit boom, the world has experienced one of the strongest waves of innovation ever seen: blockchain, artificial intelligence, robotics, the human genome, foodtech, electric cars, the energy transition, etc. are fueling growth and are sources of productivity gains and progress.

As for real estate and personal property assets, they have undergone one of the most euphoric phases in their history. Since the day Lehman went bankrupt, the S&P 500 has risen by more than 400% (total return dividends reinvested). Ironically, between 2008 and today, US equities have outperformed the rest of the world by a phenomenal margin, even though it was the United States that caused the great financial crisis in the first place.

S&P 500 index vs. the rest of the world since the Lehman crisis



The bond market, government bonds and credit, experienced one of the biggest bubbles in its history.

The property market experienced an unprecedented boom in most developed countries. Venture capital and private debt markets have also grown strongly. The last 15 years have also seen a proliferation of digital assets. Bitcoin, born out of the ashes of the great financial crisis, is now making its mark on the financial markets.

The development of intuitive trading applications and easy access to financial information via social networks have contributed to the enthusiasm of 'small' investors for the markets.

Addiction to money printing and debt

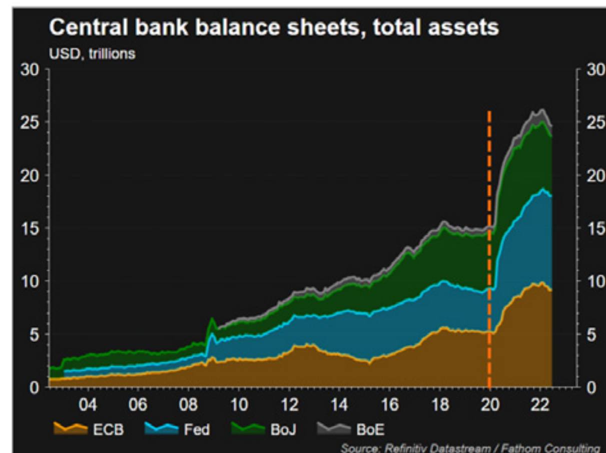
However, the almost idyllic picture described above conceals a rather worrying reality: the price that had to be paid to save the global economy and the financial markets.

While the collapse of Lehman Brothers was primarily due to poor risk management, the final blow to the now-defunct investment bank came from the collapse of the sub-prime mortgage market, itself triggered by excessive leverage on the part of individuals and banks. Years of fiscal indiscipline and an overly accommodating monetary policy were the main causes of this over-indebtedness.

Unfortunately, governments and central banks decided to solve a debt crisis by issuing more debt and printing even more money.

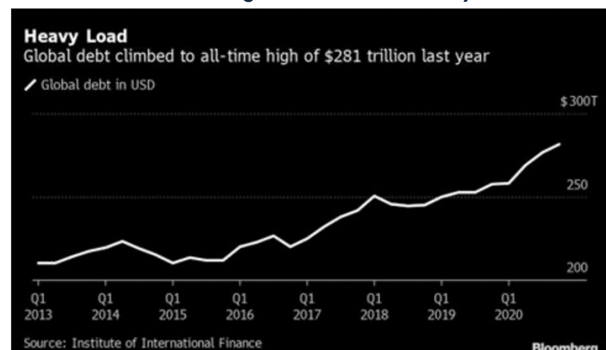
Following the great financial crisis of 2008, most of the G10 countries implemented an expansionary monetary policy, including the famous quantitative easing (QE). In the space of 15 years, the balance sheets of the G4 central banks have grown almost fivefold.

Aggregate size of balance sheets of 4 central banks (ECB, Fed, Bank of Japan and Bank of England) in trillions of dollars



As mentioned above, the policies put in place have certainly enabled us to get out of deflation and prevent the global economy from collapsing. But QE also has many drawbacks and risks: the markets' addiction to liquidity inflows, the proliferation of numerous bubbles (growth stocks, cryptos, bonds, property markets), the widening of inequalities (leading to social crises, referendums such as Brexit, populists coming to power as in Italy, etc.) but also, and above all, the explosion of debt, since it has cost virtually nothing for years.

Global debt hit a new high of $281 trillion last year



The 2008 debt crisis, which mainly affected households and banks, has given way to another type of debt overhang, that of nations.

For years, this over-indebtedness did not lead to an increase in the cost of debt. During the crisis, the vast majority of governments were able to resort to massive fiscal support while benefiting from a fall in bond yields, "miracle" achieved thanks to the phenomenal expansion of central bank balance sheets described above.

But since 2021, the headwinds increased: strong monetary growth against a backdrop of limited supply of goods and services has generated record inflation, driving up interest rates and bringing the QE experiment to an end. Russia's invasion of Ukraine and the sanctions that followed are now forcing many countries to call on fiscal support to help businesses and households cope with the energy crisis.

Japan, which was the first to use QE and has the highest debt/GDP ratio in the G10 (250%), has for several quarters been using the "Yield Curve Control" mechanism, i.e., buying a large proportion of long bonds, despite the rise in inflation and the sharp fall in the yen. Due to its huge debt burden, Japan wants to avoid a rise in bond yields, thus demonstrating the limits (and dangers) of excessive QE.

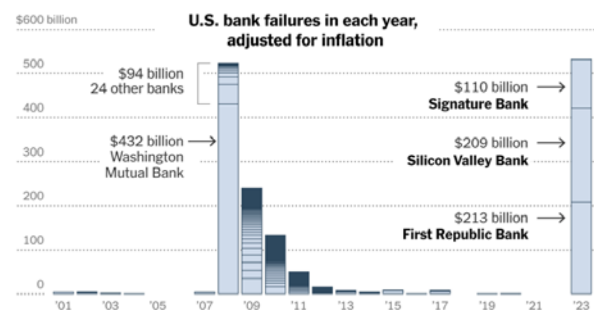
Last summer, the United Kingdom was faced with the beginnings of a sovereign crisis that also threatened its pension fund system. Through a monetary injection and a process similar to Yield Curve Control, the Bank of England managed to save face. But for how long?

Other G10 countries could soon face the test of the markets. Like Japan, Italy, France and even the United States could one day be forced to resort to Yield Curve Control.

A slow-motion bank run

15 years after Lehman, the United States is undergoing another banking crisis. Adjusted for inflation, the three banks failed in 2023 (SVB, Signature and First Republic Bank) are larger in size than the 25 that collapsed in 2008.

Aggregate size of balance sheets of 4 central banks (ECB, Fed, Bank of Japan and Bank of England) in trillions of dollars



Source: The New York Times

How can such bankruptcies be explained when the US economy seems to be in relatively good health?

1. THE COLLATERAL DAMAGE OF RISING INTEREST RATES

In recent years, as the financial world was awash with liquidity, deposits at banks have risen sharply. After the global financial crisis (2008), commercial banks were required to maintain a liquidity coverage ratio of over 100%. This means that they must always have enough "high quality liquid assets" to cover deposit outflows in a crisis scenario.

Banks have invested a large proportion of their liquid assets in bonds. With the Fed raising interest rates and QT (quantitative tightening), the market value of bonds held by banks has fallen sharply, resulting in large (unrealized) losses for the banks.

2. THE FLIGHT OF DEPOSITS

As reserves, the value of bonds held on the balance sheet, shrink, banks face another problem: funding (i.e., available deposits) is drying up. American households can obtain a risk-free interest rate of over 5% by buying Treasury bonds rather than depositing money in banks. For example, SVB deposits yield only 2.3%, whereas 6-month US Treasury bills currently yield 5.3%.

This sets off a vicious circle: the more funding dries up, the more the banks have to pay down their debts, resulting in losses that force them to raise capital. The resulting fall in their share prices can trigger a "bank run" that further jeopardises funding. And so on. This is exactly what happened at SVB...

When SVB collapsed in March, the Fed was quick to put in place mechanisms to contain the crisis. However, total deposits continue to flee US banks. Since the start of the rate hike cycle, US banks have recorded almost $900 billion in capital outflows, by far the largest on record. In fact, this is the first bank run of the digital age...

Bank runs used to be slow. The digital era sped them up

Source: Apollo

Deposits have been transferred mainly to money market funds, a sign that some savers are losing confidence in banks. This loss of confidence is not confined to the United States (e.g., Crédit Suisse).

The flight of deposits is creating funding problems, while banks continue to face very large unrealized losses on their bond portfolios. Use of the Fed's emergency bank financing facility continues to rise and has just reached a new record of $108 billion. The banks that almost collapsed a few months ago are now borrowing record levels of debt from the Fed at very high rates (around 5.5%).

15 years after Lehman, could another US banking crisis take place?

The failure of the SVB in March should be seen as an extreme and hopefully isolated event. Indeed, while all banks were affected by the rise in interest rates and the withdrawal of some deposits, the SVB was affected more than the others because of its heavy reliance on deposits (89% of liabilities) and its exposure to the technology sector.

However, the double shock of bond losses on balance sheets and the flight of customer deposits creates a risk for many US banks.

From a macroeconomic point of view, the difficulties in the US financial system could lead to even tighter credit conditions, which would be negative for economic growth.

Cycles of interest rate rises have often led to financial and/or macroeconomic accidents. While many fundamentals remain supportive for financial markets (earnings revisions, consumer resilience, etc.), we are currently at a stage in the economic cycle that requires a degree of vigilance. As Mark Twain said, "History doesn't repeat itself, but it does rhyme"...

Electric vehicles: the huge potential of wireless charging

The Electric Vehicle (EV) segment is growing rapidly, but faces a number of challenges, not least of which are charging solutions. Wireless EV charging is a revolutionary technology that promises to redefine the way vehicles are powered.

Imagine a world where your electric vehicle recharges itself, without any bulky cables or domestic installations, simply by parking in a designated space. Or, even more futuristically, roads would be able to recharge your vehicle as you drive along...

This is not fiction, but a project that companies like Tesla are working hard on. With the recent acquisition of wireless charging specialist Wiferion, Tesla has signalled its desire to be a pioneer in this field. But what is wireless charging for electric vehicles? How does it work, and why is there so much interest in it?

Charles-Henry Monchau *Chief Investment Officer*
Oliver Ramos *Research Analyst*

History of wireless charging for electric vehicles

Statistical Overview

The concept of the electric vehicle dates back to the early 19th century, when inventors around the world experimented with battery-powered cars and trams. However, it wasn't until the late 20th and early 21st centuries that EVs emerged, thanks to advances in battery technology and environmental concerns. Naturally, with the growing adoption of EVs came the need for efficient and convenient charging solutions. Since then, traditional charging methods involving physical connectors and cables have become the norm. These methods are effective, but they come with their own set of difficulties, such as worn connectors, the need for manual plugging and potential risks in adverse weather conditions, to name but a few.

The search for a more seamless and user-friendly charging experience has led innovators to explore the possibilities offered by wireless charging. Inspired by the principles of electromagnetic induction, which is very similar to the way wireless phone chargers work, researchers began to develop systems for transferring energy without any physical connection. The first prototypes of wireless chargers for electric vehicles were introduced in the late 1990s and early 2000s, marking the start of a new era in electric vehicle infrastructure. Companies and research institutes began to recognise the potential of this technology. Pilot projects were launched in several cities to test the feasibility and effectiveness of wireless charging for public transport vehicles such as buses and trams.

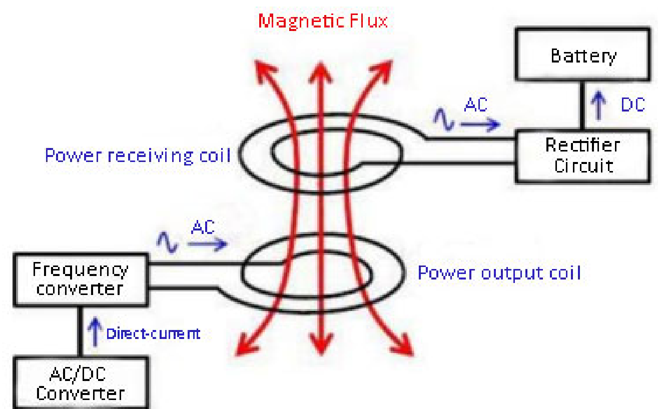
The idea of wireless charging is not limited to fixed charging points. The concept also incorporates the idea of dynamic wireless charging, i.e., roads equipped with charging coils that can power vehicles in motion. Although still in its infancy, this idea promises to transform our motorways into perpetual sources of energy. With giants like Tesla jumping into the fray, wireless charging of electric vehicles has gone from being an experimental project to a possible commercial reality. The acquisition of companies specialising in wireless charging, combined with increased investment in R&D, is evidence of a strong desire across the industry to make wireless charging a new standard.

Technical aspects

The role of unions

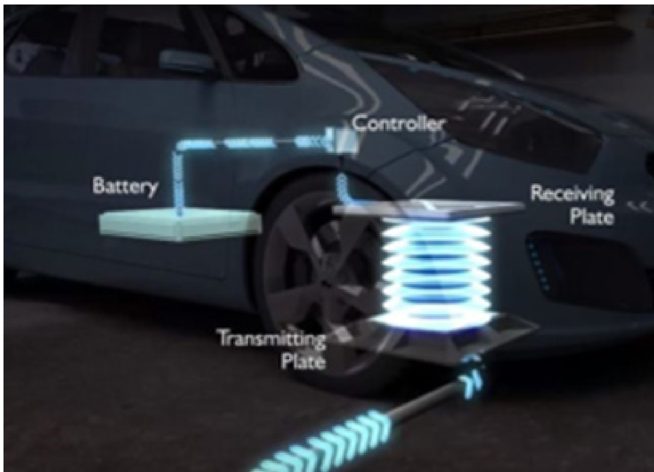
Electromagnetic induction was first discovered by Michael Faraday in the early 19th century. This innovative technology is based on the simple but profound concept that a changing magnetic field in one coil induces an electric current in a neighbouring coil. In wireless recharging of electric vehicles, the first coil, often called the transmitter, is usually buried in the ground or in a recharging base. The second coil, called the receiver, is located at the bottom of the vehicle. When electricity flows through the transmitter coil, it generates a magnetic field. This field in turn induces a voltage in the receiver coil, enabling the vehicle's battery to be charged. The ground element, or transmitter plate, is what you generally find in car parks or specialist garages.

This plate is directly connected to the electrical network and houses the transmitter's critical coil. On the other side, the receiving plate, fixed under the vehicle, is connected to the car's battery. The efficiency of this energy transfer is ensured by resonators. These components are essential to ensure that the transmitter and receiver 'resonate' at the same frequency, optimising energy transfer and minimising potential losses. In addition, an electronic control unit manages the flow of energy, ensuring that the charging process is both safe and efficient. This unit also communicates with the vehicle and adjusts the charge rate according to the battery's current needs.



Source: Murata

As well as the undeniable convenience that these charging methods can offer, wireless charging has a number of additional advantages over traditional methods. Firstly, the absence of physical connectors means that the system is less susceptible to wear and tear. In addition, environmental factors such as rain, snow or dirt can sometimes compromise plug-in chargers, whereas they pose little or no threat to wireless systems. As for the future, there is a palpable enthusiasm and curiosity around the concept of dynamic wireless charging. This vision is more ambitious and involves integrating transmitter coils directly into the road surface. As vehicles travel along these roads, the coils are activated sequentially, providing a continuous charge. Such an innovation has the potential to revolutionise long-distance EV travel and give it the edge over combustion engines.



Key market players in the EV wireless charging industry

Several companies are at the forefront of this revolution, each offering unique solutions and perspectives. Among the major players shaping this sector, one of the most important is Tesla. Its efforts in the field of wireless charging have been marked by strategic moves, the most notable being the acquisition of Wiferion, a German company specialising in wireless charging solutions. This acquisition not only reinforces Tesla's already outstanding technical prowess, but also demonstrates its commitment to making wireless charging a mainstream option for its vast user base. By leveraging Wiferion's expertise, Tesla is poised to integrate efficient and fast wireless charging capabilities into its vehicles, further strengthening its position as the industry leader.

But Tesla is not the only player in this field. EVgo, one of the largest public EV charging networks in the US, is exploring wireless charging solutions to improve user convenience. The focus on fast charging infrastructure combined with wireless technology could redefine public charging experiences. Other players such as HEVO (Hybrid & Electric Vehicle Optimization) are proposing an interesting approach. Their wireless charging solutions are designed not only for cars, but also for a whole range of vehicles, including delivery trucks and drones. Volta Charging offers another interesting approach to this innovation. As well as offering free charging to EV users, their stations also serve as advertising platforms.

Overall, these companies are not content to develop technologies in isolation. Whether it's more efficient charging pads or dynamic on-the-go charging solutions, these innovations are the result of collective efforts. As these companies continue to push the boundaries, the primary beneficiaries are consumers who can enjoy a seamless, efficient, and futuristic charging experience.

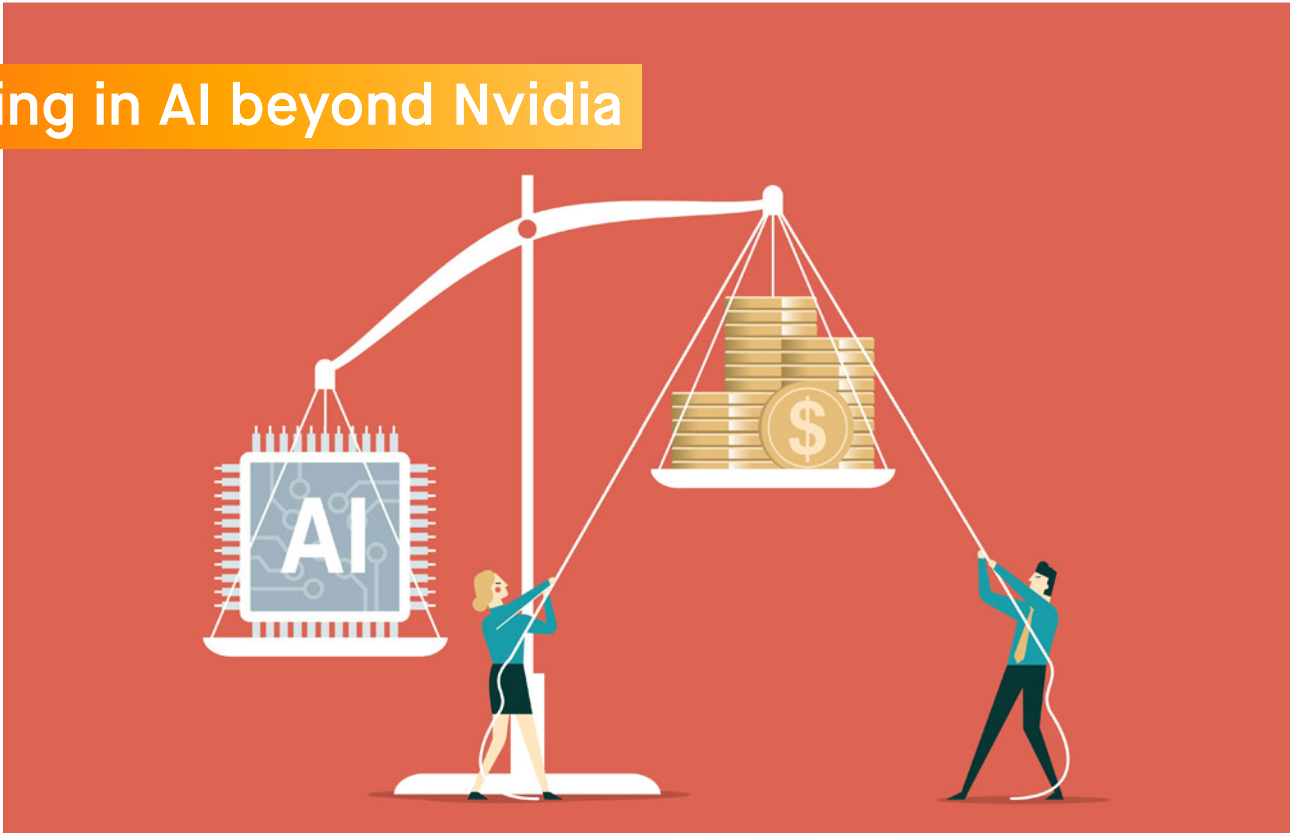
Advantages and disadvantages of wireless charging for electric vehicles

Wireless charging however presents a number of challenges. The first of these, and probably the biggest, is infrastructure development. Moving to wireless charging on a large scale requires major infrastructure changes. The installation of charging points in public car parks, the upgrading of existing charging stations and the possible installation of charging coils on roads all require considerable investment and logistical planning, which is likely to be met with resistance from local communities. Then there are the efficiency issues mentioned above. Although advances in wireless charging have made it increasingly efficient, there are still concerns when compared with traditional charging methods. It is essential, for both economic and environmental reasons, to ensure minimal energy loss during the transfer process. Finally, as you can probably imagine, the initial installation costs of wireless charging systems can be higher than those of traditional charging solutions. Although prices are expected to fall as the technology matures and adoption rates increase, the initial investment can be a significant deterrent for some consumers and businesses.

Future prospects and conclusion

Forecasts point to strong growth in wireless charging infrastructure, driven by both technological advances and growing consumer demand. As cities become increasingly intelligent and connected, wireless charging stations can be expected to become as ubiquitous as traditional petrol stations once were. One of the most eagerly awaited innovations in this area is dynamic charging on motorways. Imagine motorways dotted with recharging coils, powering vehicles as they go. Such a system could virtually eliminate range anxiety and make EVs the preferred choice for all kinds of journeys. Another exciting prospect is the integration of wireless charging with renewable energy sources, which conjures up almost utopian images of energy use. As the world faces the challenges of climate change, the synergy between clean energy and electric vehicles is becoming increasingly crucial. Wireless recharging stations powered by solar energy or recharging centres powered by wind energy could make the process of recharging electric vehicles even more sustainable. Ultimately, the role of wireless charging goes beyond mere convenience. It is a key piece in the jigsaw of a sustainable transport future. As fossil fuel reserves dwindle and environmental concerns intensify, wireless EV charging represents a bastion for a cleaner, greener future for all.

Investing in AI beyond Nvidia



Nvidia has become the must-have name when it comes to investing into the artificial intelligence theme. But there are other options to consider. Including vigilance...

Charles-Henry Monchau *Chief Investment Officer*

2023, the year of AI

Since the announcement of ChatGPT 3.5 in November 2022, the financial markets and much of the public have been captivated by the seemingly limitless possibilities of AI. How can we explain such enthusiasm?

Firstly, the free availability of ChatGPT has enabled everyone to realize the tremendous potential of generative AI. Unlike traditional AI models, which operate within predefined parameters, generative AI uses algorithms (such as ChatGPT) to create new content, including audio files, coding, images, text, simulations, and videos.

Another factor explaining the buzz around AI: wage pressure in an inflationary context unseen since the 1980s and geopolitical upheavals forcing companies to relocate their formerly foreign-based entities ("reshoring" or "nearshoring"). Both contribute to creating a sense of urgency to improve productivity in order to preserve margins. In this context, the explosion in the number of AI tools comes at just the right time for many companies, who are setting up task forces or specialized entities before reinventing their business models.

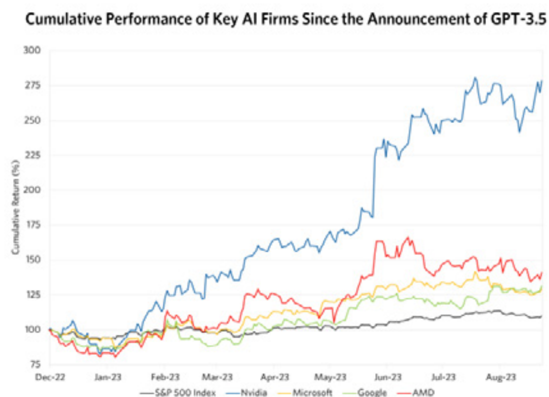
What about investment opportunities?

The AI bubble

Bank of America doesn't hesitate to speak of the birth of a new investment bubble on par with the Internet bubble, the Biotech bubble, Ark Invest stocks, bitcoin or GAFAs.

While some AI-related stocks have the potential to deliver a growth rate in line with current market expectations, history tells us that most of them will not. As explained in a recent article by Research Associates, picking future AI winners is the equivalent to investing in Amazon, Apple and ADP in early 2000. These three stocks are the only ones among the 40 biggest names in the technology sector at the turn of the century to have recorded double-digit performances in the 23 years since.

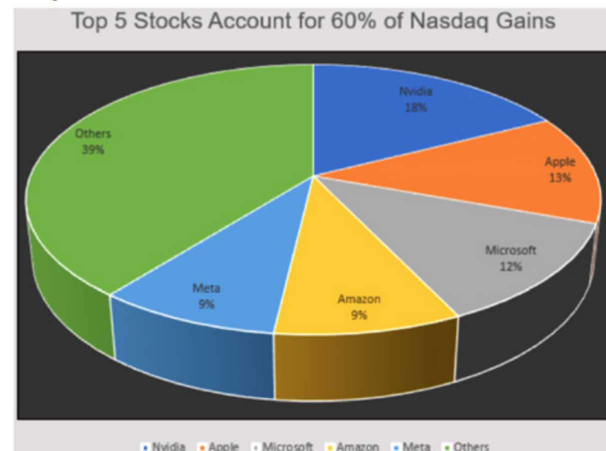
Since ChatGPT 3.5 was released by Open AI in November 2022, companies deemed likely to be AI leaders in the coming years have seen their share prices significantly outperform the rest of the market.



In fact, a new term has emerged on Wall Street - "The Magnificent Seven", or the seven large-cap tech companies considered to be the likely AI winners. At the time of writing, these seven stocks account for almost 28% of the S&P 500's market capitalization.

Indeed, since the start of the year, the performance of the major US stock market indices has been heavily concentrated on a small number of stocks. As the chart below shows, 5 stocks are responsible for over 60% of the Nasdaq 100's gains in 2023. AI is a common denominator for these American market behemoths.

The big five



Source: Bloomberg

Many investors tend to see these stocks as the sole beneficiaries of the AI revolution, not only because of their ability to attract talent, but also because of their financial strength, which enables them to make huge R&D investments in their AI branches. This is an important difference from the dot-com bubble of the 2000s, when not only large-cap companies were riding the ".com" wave; indeed, numerous IPOs of Internet stocks had broadened the spectrum of available investment opportunities.

Should we deduce from the above that the best way to invest in AI is to be positioned in a very limited number of stocks? Are there other stocks and sectors that stand to benefit from this technological transformation?

The potential winners of the AI revolution

We believe there are two types of beneficiaries:

1. The Innovators

First and foremost, these are the companies that stand to benefit from the immense investment capital expenditure associated with AI. A vast ecosystem of industries and sectors is poised to benefit directly from the rise of AI, each playing a unique role in technological transformation.

We can identify 3 distinct sub-categories:

i. **The model builders or the so-called "platform" companies:** these include Microsoft, Alphabet, Baidu, MetaPlatform, Amazon, Tencent, Alibaba and others.

The software industry is undergoing a metamorphosis driven by the demands of generative AI. The total market for generative AI software is estimated at $150 billion,

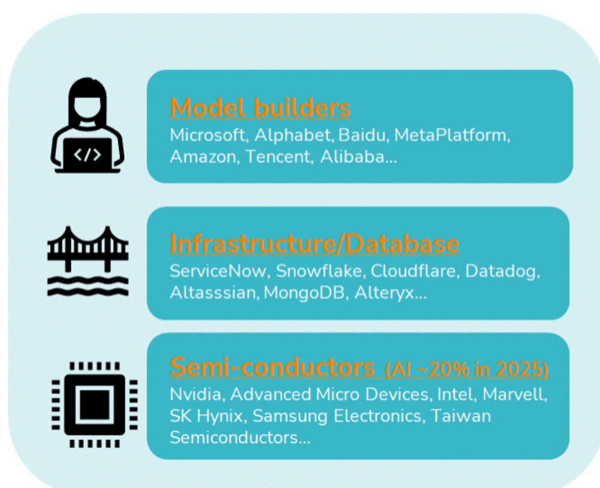
opening up a veritable boulevard for software developers and companies specializing in AI-based applications. The tools and platforms these companies develop will certainly prove essential for harnessing the power of AI in a variety of sectors.

ii. **Infrastructure and database companies:** ServiceNow, Snowflake, Cloudflare, Datadog, Altassian, MongoDB, Altervx, etc.

The recent craze for AI has highlighted its insatiable thirst for data. Storing, managing and accessing this data requires a solid infrastructure. This is where data centers and cloud service providers come into play. These entities ensure that AI algorithms have uninterrupted access to the vast data sets they need, making them indispensable cogs in the AI machinery.

iii. **Semiconductor companies:** Nvidia, AMD, Intel, Marvell, SK Hynix, Samsung Electronics, Taiwan Semiconductors, etc.

At the heart of AI's computing prowess are, of course, semiconductor companies. They provide the essential hardware that powers AI's complex algorithms. With the growing demand for AI algorithms, the need for computing power is increasing massively. Semiconductor companies, beyond Nvidia, are well placed to reap major benefits. Their role in making generative AI work, places them at the forefront of AI's direct winners.



Beyond the established players, a new generation of startups and innovators are making their way into the AI landscape. These smaller entities are pushing the boundaries of what's possible with AI. Their innovations, whether niche AI applications or revolutionary algorithms, position them as future nuggets. As investors look to diversify their portfolios, identifying these direct beneficiaries offers a roadmap for navigating the AI investment landscape.

Whichever path the investor decides to take, he must do so by implementing a diversified approach and adopting all necessary measures to avoid idiosyncratic risk. One way of doing this is to include ETFs in the portfolio. ETFs with exposure to the AI theme include BOTZ, the Global X Robotics & Artificial Intelligence ETF, and ROBO, the ROBO Global Robotics and Automation Index ETF.

2. The beneficiaries of innovation

The AI technology revolution also affects the businesses that adopt and implement this technology. From retail giants leveraging AI to create personalized shopping experiences to healthcare facilities harnessing AI for diagnostics, the spectrum of end-user companies likely to benefit is vast. Investments by these companies in AI-based software and infrastructure services will not only improve operational efficiency, but also redefine customer and workforce engagement paradigms.

AI beyond the United States

The USA has long been at the forefront of AI innovation, thanks to its tech giants and pioneering research institutions. It is precisely these tech giants, such as Nvidia, Microsoft and Alphabet, that are not only shaping the discourse on AI, but also setting benchmarks in the research and application of these technologies.

But the USA does not have a monopoly on innovation. China is rapidly establishing itself as a formidable player in the AI field. The country has drawn up ambitious plans to become the world's leading center of AI innovation by 2030. Its own tech giants, such as Baidu, Alibaba and Tencent, are by no means mere regional players, but rather global competitors pushing the boundaries of AI research and use. The country has made AI a strategic priority, recognizing its potential in sectors ranging from healthcare to national security.

Although Europe has recently lagged behind the USA and China in terms of innovation, it has a rich history of research and scientific discovery and is making its mark in the AI world. It may not have comparable technological behemoths , but Europe's strength lies in its regulatory foresight and its focus on AI ethics. In many ways, the EU is regarded as the global standard for regulatory guidelines, and this is no exception in the field of AI, as it strives to ensure accountability and fairness while emphasizing transparency.

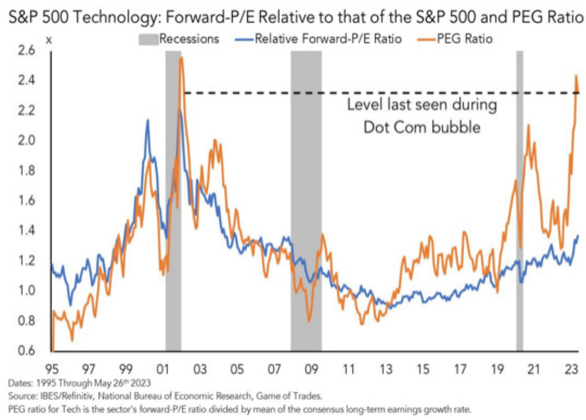
Countries such as Singapore, South Korea and India are also emerging as important players in the AI world, thanks in part to government support, a talent pool and strategic collaborations.

Conclusion and Forewarn

From our point of view, the potential of AI is enormous, and we have probably entered a new era. Like the Internet, AI will revolutionize the business world and our daily lives.

The history of financial bubbles tends to repeat itself. As was the case during the Internet boom, financial markets tend to pay very high valuation multiples for companies that seem best positioned to benefit from the new technological revolution.

Never before has a mega-cap traded on the basis of Nvidia's current multiple (nearly 45 times sales and over 100 times earnings). Looking at relative valuation ratios, like in the example below, with relative PEG - i.e. P/E compared with expected earnings growth rate, the S&P 500 technology index is trading at a valuation premium similar to that of the dot.com bubble. The potential for correction is therefore significant.



Source: Game of Trades

Another characteristic of financial bubbles is that investors too often tend to overlook the fact that the main beneficiaries of technological innovation are the customers of that innovation, and not necessarily the innovators themselves.

Finally, the companies that initially appear to be the leaders of a technological revolution are not necessarily those of tomorrow. In a recent article, Research Associates highlighted the example of the Smartphone. In 2000, Palm's market capitalization was briefly worth more than that of General Motors. But in 2003, Palm Pilot was supplanted by the Blackberry, which in turn was replaced by the iPhone in 2008. Often, it's the disruptors who pay the highest price for disruption.

Today, Nvidia is the most emblematic stock of the AI bubble. But it is also perhaps the one most likely to disappoint investors' very high expectations. As mentioned above, investors can consider other stocks and instruments to invest in AI innovators and should consider the impact of AI on companies as a whole. This means identifying companies capable of using AI to generate the greatest productivity gains and/or transform their business model. Investing in AI is likely to be more of a marathon than a sprint.

NB: These are not investment recommendations.

Fiscal responsibility & national debt: the Swiss model

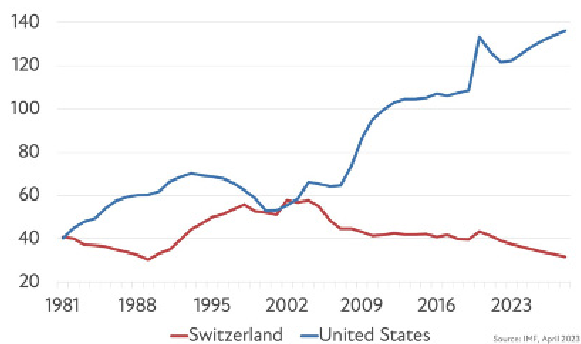
The two "sister republics" (the United States and Switzerland) have in turn drawn inspiration from each other's constitutions. A mimicry that has no place when it comes to fiscal responsibility and indebtedness.

Charles-Henry Monchau *Chief Investment Officer*

You may not know it, but Switzerland and the United States have often been referred to as "sister republics". Indeed, after the United States declared its independence in 1776, the founding fathers chose to base the American Constitution on the Swiss model of a confederation of sovereign states. Less than a century later, Switzerland in turn drew inspiration from the American Constitution when, in 1848, it adopted the Constitution that founded modern Switzerland, i.e. that of a federal state rather than a confederation of states.

But when it comes to public debt, the comparison stops there: over the last twenty years, the two sister republics have taken diametrically opposed paths, as the graph below shows.

Public debt of Switzerland (red line) and the United States (blue line) as a percentage of GDP



Source: IMF, Costa Vayenas

The Swiss positive austerity

In 2001, Article 126 of the Swiss Constitution codified a structural balanced budget rule for the federal government, known as the 'debt brake'. This was designed to prevent structural deficits leading to an increase in debt, as happened in Switzerland in the 1990s.

The provision was approved by popular vote (referendum) with an approval rate of 85% at the end of 2001. The new constitutional provision was applied for the first time to the 2003 federal budget.

The Swiss rule is relatively simple. The bulk of the federal budget must be planned to break even each year, after adjustment for economic conditions. In other words, "structural" borrowing is prohibited. Instead, the Swiss are content to cap federal spending each year at the level of structural tax revenues, i.e., adjusted for cyclical variations. As a result, public spending remains broadly stable around the trend in public revenues, rather than undergoing cycles of austerity and largesse.

When economic growth is below trend, budget deficits can occur. However, over the whole economic cycle, every Swiss franc of expenditure covered is paid for: surpluses must be generated in periods of expansion to compensate for borrowing when the economy is slowing down. In other words, it is a counter-cyclical fiscal policy.

Among the key principles of the budget rules:

1. The spending cap is linked to revenue estimates derived from past trends and short-term forecasts, not on long-term forecasts which are by their nature highly uncertain. This forces policymakers to raise taxes before permanently increasing spending. They cannot make allowances based on future 'room for manoeuvre' founded on over-optimistic projections.

2. Certain budgetary constraints can be relaxed during periods of recession and emergency. For example, spending that is useful during a downturn (e.g., unemployment insurance) is excluded from the spending ceiling. A six-year horizon has been granted to cover the accompanying measures linked to the Covid 19 pandemic. If borrowing has been higher than expected, the budget will be adjusted gradually. It is this flexibility that allows these budgetary rules to be compared to positive austerity.

3. Additional flexibility was built into the debt brake: it applies only to the federal budget. The cantons are able to establish their own rules to guarantee their financial health, and they do so responsibly.

The results are there for all to see. Since the introduction of this new constitutional provision, Swiss public debt as a percentage of GDP has fallen almost uninterruptedly. Despite the financial and the Covid-19 crises, the rule has stabilised gross public debt at around 40% of GDP. This ratio should even fall in the coming years.

Uncle Sam and the debt ceiling

Unlike Switzerland, the United States has never introduced a constitutional amendment aimed at establishing a balanced budget and curbing indebtedness. To make the federal government more fiscally responsible, it created the debt ceiling. Set by Congress, this ceiling is the maximum amount that the federal government can borrow to finance the obligations that elected officials and presidents have already approved.

The ceiling, which currently stands at $31.4 trillion, was created over a century ago. Since 1960, Congress has raised or extended the debt ceiling 78 times, including 29 times under Democratic presidents and 49 times under Republican presidents.

At the beginning of August, the rating agency Fitch downgraded the US Treasury's debt rating from AAA to AA+, corroborating what all the major federal budget and monetary agencies have been saying for years: the country is on an imprudent and unsustainable fiscal path, and nothing has been done to remedy it. The figures speak for themselves: since fiscal year 2000, the debt subject to the ceiling has risen from around $5.7 trillion to around $32.5 trillion today. Total federal liabilities and unfunded social insurance obligations have risen from around $20 trillion in fiscal year 2000 to around $125 trillion today. Over the same period, the ratio of total public debt to GDP has risen from around 55% to around 120%. The Congressional Budget Office (CBO) predicts that it will reach about 181%

of GDP by 2053 and that it will continue to rise under current legislation. What's more, the fastest-growing federal expense is interest on the debt: interest charges have risen by around 50% over the past year, to almost $1,000 billion on an annual basis.

While the United States has never had trouble finding investors to finance this gigantic debt, the situation is now becoming more complicated. The amounts of US treasury bonds held by the Chinese and Saudis are falling steadily. This is a paradigm shift, and the geopolitical situation has a lot to do with it. On the other hand, Japanese investors (who are the main holders of US debt) could also start to shun US debt at a time when yields on Japanese bonds are rising following the Bank of Japan's change of monetary policy.

The Japanese experience

Despite the aforementioned risks, it seems impossible to envisage the United States defaulting on its debt at all. There is a simple reason for this: a government can never default on its local currency debt if its central bank is prepared to buy the bonds. This is the case not only for Uncle Sam but also for Japan.

The Japanese case is also instructive, particularly in terms of the hidden risks incurred by investors in government bonds. Indeed, one consequence of a central bank buying unlimited quantities of domestic sovereign bonds is that, at some point, the private sector no longer wants this paper. For example, the Bank of Japan now owns more than half of the Japanese government bond market, which has the effect of making this market relatively illiquid.

Another consequence of a central bank buying generous amounts of government paper is that these purchases are generally made by printing more fiat money. The result is either inflation or currency depreciation, or both.

The chart below shows that the Japanese yen has lost more than half its value against the Swiss franc since the turn of the century. This depreciation makes investing in Japanese bonds totally inadvisable for an investor whose reference currency is the Swiss franc. Indeed, even if Japanese government bonds have never run the risk of default, their illiquidity and the chronic depreciation of the yen against the Swiss franc make Japanese bonds an unadvisable investment vehicle.

Source: IMF, Costa Vayenas

The same reasoning applies to the US bond market. Despite the generous yield differential between Treasury bonds and Swiss government bonds, Swiss investors must take into account the risks of inflation and currency depreciation incurred by the United States.

A Swiss model for the world?

As Daniel Müller-Jentsch of Avenir Suisse put it: "Switzerland has drawn up the blueprint for what I am sure will be the standard tax model of the future".

Although the debt brake is already part of the policies of many governments in the form of fiscal rules using predefined ratios (e.g., the EU's stability pact), these mechanisms have not always been respected due to occasional economic threats, resulting in a sharp rise in public debt in many developed economies. Rapidly ageing populations and rising social protection costs linked to unemployment and health insurance threaten to add a further debt burden in most of these countries. For many states, the temptation is great to turn to the central bank and commercial banks for help in financing their growing debt. As we saw above with the Japanese case, these lax policies are not sustainable in the long term and will one day force these countries to return to budgetary discipline.

In this context, Switzerland's positive austerity could well serve as a model. It teaches us that two measures are essential to restore the health and viability of a nation's public finances.

First, the introduction of a constitutional amendment on fiscal responsibility. The debt ceiling and other approaches designed to limit federal spending and prevent an increase in the debt burden have failed to achieve their objectives. The only way to bind both current and future legislative powers is through a constitutional amendment. This is what was put in place in Switzerland.

Secondly, the setting up of a non-partisan Commission whose mission would be to formulate a set of budgetary, expenditure and revenue recommendations aimed at reducing public debt/GDP to a given level by a given year. To be effective, this Commission must be made up of competent, credible and non-conflicting individuals from different political affiliations. The Commission will also have to educate and involve the people. And this is perhaps where the greatest difficulty lies. Direct democracy is part of Switzerland's success story of positive austerity. Remember: it was approved by 85% in a referendum. Will the same be true for other nations?

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