Market Insights

Q2/2024

- The U.S. stock market had a strong start to 2024, with the S&P 500 experiencing its best beginning since 2019, rising by 10.2%. And this despite downward adjustments to Fed rate cut expectations, a surge in oil prices and a strong dollar. This bullish momentum, underscored by record lows in volatility, reflects a surge in investor optimism and positive earnings growth. Some of last year winners (AI, obesity drugs) continue to perform well but the market advance is broadening with reflationary sectors starting to outperform.

- 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.

- 2024 is a year of presidential election in the US. Joe Biden's administration has put in place a vast investment programme that should strengthen the United States' dominant industrial position, particularly vis-à-vis Europe. But at what cost? We compare the situation of US and Europe and the implications in terms of market preferences.

- We then have a look at Vietnam, a country which has been classified as one of the best positioned markets in Asia-Pacific for 2024 by the Asia House Annual Outlook. This article offers a comprehensive view of Vietnam's potential and obstacles on its path to economic prosperity.

- The last section focuses on the best performing asset class of 2023 and the first quarter of 2024: Bitcoin. How high can the price go? In this article, we attempt to answer this question using two very distinct valuation models.

PRIVATE BANKING

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The 1st quarter 2024 in 10 charts

Chart #1
US equities: best start of the year since 2019
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The U.S. stock market had a strong start to 2024, with the S&P 500 experiencing its best beginning since 2019, rising by 10.2%. This bullish momentum, underscored by record lows in volatility, reflects a surge in investor optimism. The tech and healthcare sectors continued to perform, while adjustments in Fed rate cut expectations and a strong dollar added to the market's complexity. Each quarter, the Syz investment team takes you through the last 3 months in 10 charts.

Charles-Henry Monchau
Chief Investment Officer

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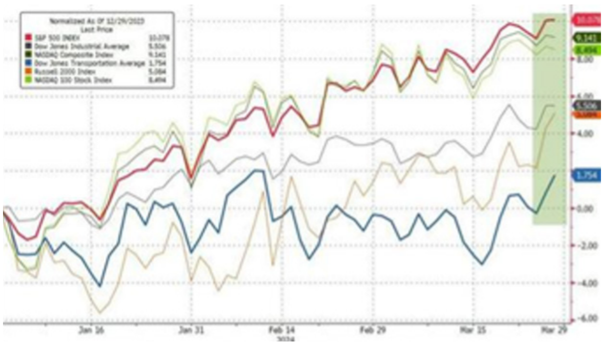
Junior Investment Analyst

Chart #1

US equities: best start of the year since 2019

The S&P500 has closed the first quarter off with a notable 10.2% gain. This represents the best start to a year for the index since 2019, outperforming the Nasdaq and other main US indices. Despite the S&P500's slight outperformance over the Nasdaq, both indices have been hitting new all-time highs, with the S&P500 breaking through 5,200 pts and the Nasdaq crossing above its previous 2021 high of 16,057 pts.

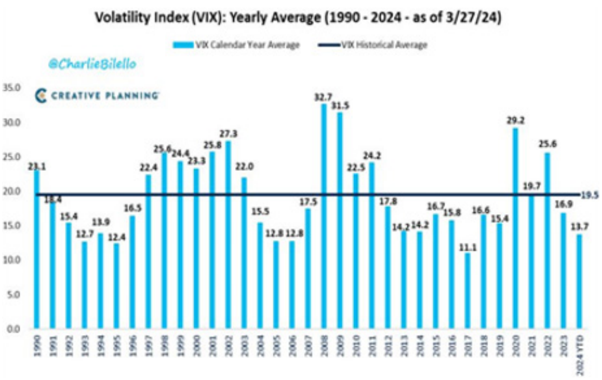


Source: Bloomberg

Chart #2

US volatility crashed, greed is back

The $VIX has averaged 13.7 thus far in 2024, a figure noticeably below its historical average of 19.5. These volatility levels are setting the scene for 2024 to have the lowest volatility since 2017. Greed on the other hand has been heating up, with the Fear & Greed index shifting between "Greed" and "Extreme Greed" during Q1. This sentiment is also expressed by the number of US households allocated into equities, which is now at record highs, above 48%.



Source: Charlie Bilello

Chart #3

US Equity: Winning & Losing Themes

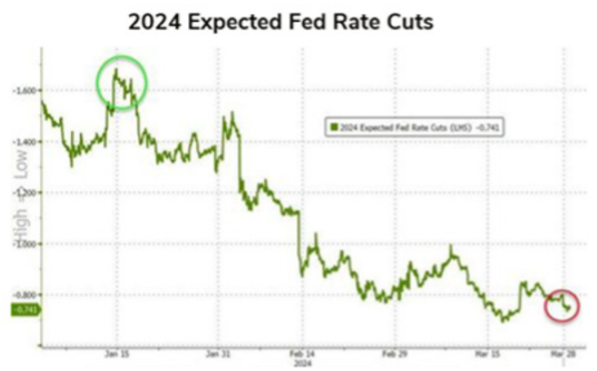
The first quarter of the year has seen themes from 2023 repeat themselves with the biggest winners among US equities being: Bitcoin-Sensitive, Artificial-Intelligence, Megacap Tech, and Obesity Drugs. Among the biggest losers have been: Liquid Regional Banks, Renewables, and China ADRs.

Source: Goldman Sachs

Chart #4

Smaller number of Fed rate cuts but FCI keeps loosening

Market expectations of Fed rate cuts have dramatically decreased during Q1. The strong "hard" data together with sticky inflation have driven 2024 rate cut expectations from almost 7 cuts, to now less than 3. However, the strength in equities and credit has overshadowed any rise in yields and pushed financial conditions to their lowest level since prior to the Fed's rate-hiking cycle. This decline is equivalent to about 100bps of rate cuts which gives the Fed breathing room to cut rates, but also creates uncertainty regarding if financial conditions are now becoming too easy to tame inflation.

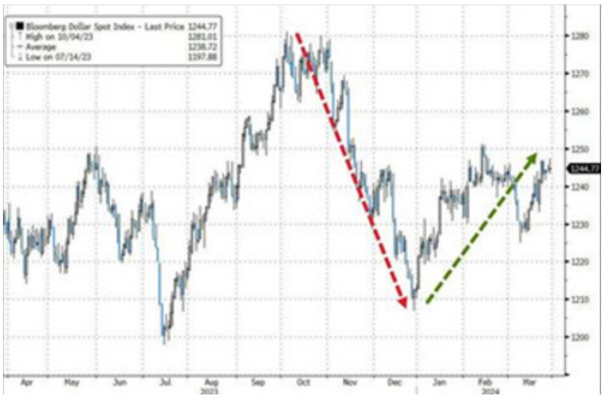


Source: Bloomberg

Chart #5

Dollar rallied in Q1

The dollar rallied in Q1, regaining around half of the ground lost during Q4. The USD was supported by yen weakness as the Japanese currency has plunged to its weakest since 1990. The scenario of higher interest rates for longer in the U.S. is also likely providing the dollar with a boost.



Source: Bloomberg

Chart #6

Oil outperformed the Nasdaq in Q1

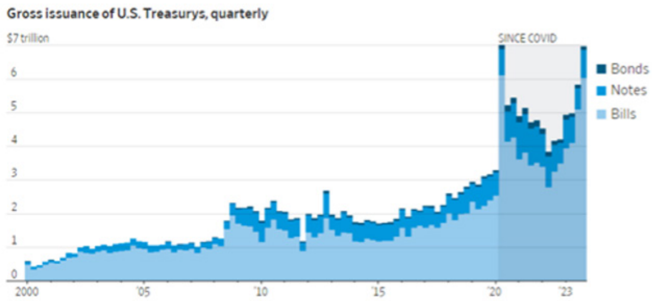
Oil prices are now up over 17% this year, with crude sitting well above $80/barrel again. The OPEC remains committed to production cuts and geopolitical tensions continue to threaten supply. Saudi Arabia leads the pack of production cuts, having recently extended its previously implemented cut of 1 million barrels per day, all through Q2 of 2024. Meanwhile, global demand forecasts are being raised and inflation appears to be rebounding. Even with non-OPEC production at record highs, oil prices continue to skyrocket.

Source: The Kobeissi Letter

Chart #7

US Government debt continues to skyrocket

Increasingly more key figures in finance are sounding the alarm on the snowballing US national debt, which now sits at around $34tn. BlackRock's CEO, Larry Fink, has been cautioning that there is no guarantee investors will continue to purchase U.S. Treasuries, and was quoted as saying: "The situation is more urgent than I can ever remember". The issuance of US Treasurys has been accelerating over recent years, sending the size of the U.S. government bond market to a record $27tn. This figure represents an approx. 70% increase from levels at the end of 2019, and is nearly 6x larger than prior to the 08-09 GFC. A key development in this story will take place with the US elections in November, as an expensive fiscal package, rolled out by the new administration, could lead to a fiscal crisis as early as 2025, according to Wharton's Professor Gomes.



Source: Securities Industry and Financial Markets Association

Chart #8

Fixed Income: US treasuries dumped. Spreads tightened

US treasuries have been dumped during Q1 as inflation numbers have been stronger than anticipated, and investors' expectations for FED rate cuts over 2024 have been decreasing. US High Yield Credit Spreads have moved down to 3.05%, representing their tightest level since January 2022. Similarly, US Investment Grade Credit Spreads have moved down to 0.91%, their tightest level since November 2021. Note that Fixed Income (based on the Global Aggregate index) is the worst performing asset class so far in 2024 (-2.1%).

2015	2016	2017	2018	2019	2020	2021	2022	2023	Q1 '24
Euro Gov. 1.6%	US HY 17.5%	EM Debt 9.3%	Euro Gov. 1.0%	EM Debt 14.4%	Global IL 12.7%	US HY 5.3%	US HY -11.2%	US HY 13.5%	Euro HY 1.6%
EM Debt 1.2%	EM Debt 10.2%	Global IG 9.1%	US Treas. 0.9%	US HY 14.4%	Global IG 10.4%	Euro HY 3.4%	Euro HY -11.7%	Euro HY 11.9%	US HY 1.5%
US Treas. 0.8%	Euro HY 10.1%	Global IL 8.7%	US HY -2.3%	Global IG 11.5%	US Treas. 8.0%	Global IL 2.7%	US Treas. -12.5%	EM Debt 10.5%	EM Debt 1.4%
Euro HY 0.5%	Global IG 4.3%	US HY 7.5%	Global IG -3.6%	Euro HY 10.7%	US HY 6.1%	EM Debt -1.5%	EM Debt -16.5%	Global IG 9.6%	Euro Gov. -0.6%
Global IG -3.6%	Global IL 3.9%	Euro HY 6.1%	Euro HY -3.6%	Global IL 8.0%	EM Debt 5.9%	US Treas. -2.3%	Global IG -16.7%	Euro Gov. 7.1%	Global IG -0.8%
US HY -4.6%	Euro Gov. 3.2%	US Treas. 2.3%	Global IL -4.1%	US Treas. 6.9%	Euro Gov. 5.0%	Global IG -2.9%	Euro Gov. -18.5%	Global IL 5.8%	US Treas. -1.0%
Global IL -5.0%	US Treas. 1.0%	Euro Gov. 0.2%	EM Debt -4.6%	Euro Gov. 6.8%	Euro HY 2.7%	Euro Gov. -3.5%	Global IL -22.9%	US Treas. 4.1%	Global IL -1.8%

Source: JP Morgan

Chart #9

Gold Hit New All-Time High

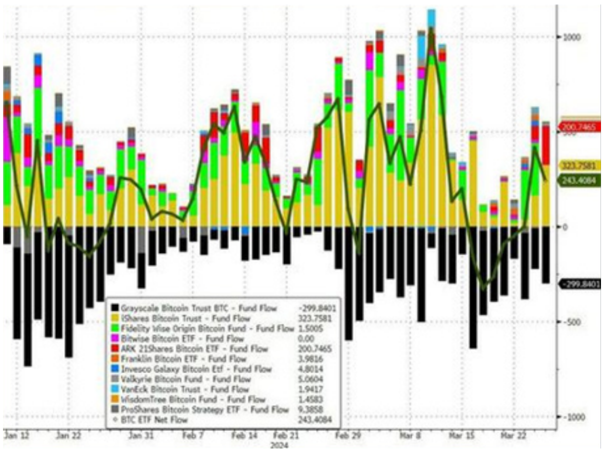
Gold has hit a new all-time high, reaching prices above $2,220/oz, even as funds continue to flow out of gold ETFs. As predictions of interest-rate cuts continue to moderate, gold ETFs recorded their 9th consecutive month of outflows in February. Central Banks around the world have continued their gold shopping spree, with China's PBOC leading the charge, adding over 12 tonnes to their reserves in February. Gold prices saw a remarkable rise of 9.1% during March 2024, marking its best monthly performance since July 2020. Additionally, gold has been outperforming the S&P500 since February.

Source: Bloomberg

Chart #10

Bitcoin breaks All-Time High and pushes past 70

Q1 was dominated by bitcoin headlines, especially since the launch of the Bitcoin Spot ETF in mid-January. The success of the spot ETF has been second to none, with the BlackRock BTC ETF being the fastest ever to reach $10bn AuM. The massive inflows into these ETFs, coupled with the media attention generated around Bitcoin, have sent its prices to new all-time highs against the USD, even breaking $73,000 in mid-March. Strong catalysts and growing institutional demand have led to wild speculation surrounding price targets for the remainder of the year; either way, Bitcoin will likely continue to make headlines in the months to come.



Source: Bloomberg

When hawks fly like doves

Key takeaways

- The global growth cycle hit its lowest point in 2023 and is now picking up. Earnings estimates have been creeping higher. Although central banks are hesitant to lower interest rates at this moment, they are conveying more accommodative signals to the market, which maintains the prevailing "risk-on" sentiment.
- From a market perspective, the main equity indices continue to trend higher. Upside market participation is broadening while credit spreads remain tight. Cyclicals vs. defensives are exceeding expectations, the recent pick-up in commodities and outperformance of TIPS over US Treasuries are all pointing towards a “reflationary” message.
- Our well-diversified positioning since the start of the year has been playing out rather well with our two favourite equity markets (US and Japan) outperforming. Going forward, we want to keep our allocation to Equities close to our Strategic Asset Allocation (SAA) neutral weights.
- However, considering recent macro and market dynamic developments, we are cutting our fixed income allocation from neutral to negative by reducing our stance on government bonds and corporate investment grade. Proceeds are reinvested into cash.

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THE BIG PICTURE

This time last year, California's Silicon Valley Bank collapsed and sparked a brief banking crisis in the US, roiling financial markets and ultimately claiming a few additional regional bank victims. Fast forward to March 2024: the St Louis Financial stress index is the lowest since the Fed began raising rates. Bank deposits have stabilised and risen since the 2023 banking panic, showing that confidence in the banking system is returning. What a difference one year makes. Indeed, while the number of Fed rate cut expectations has moved from 7 at the start of 2024 to 3 as of now, markets do not seem to care: the S&P 500 just crossed 5,200 for the first time ever, the Nikkei 225 index is trading above 40,000 for the first time in three decades, the Europe Stoxx 600 hit new all-time highs, gold is trading above $2,200 for the first time ever, oil prices are creeping higher, copper has suddenly broken out and US corporate bond spreads remain very tight. Last but not least, bitcoin has hit a new all-time high at $73,000 dollars.

Are we in the middle of a new mania? To be fair, there are indeed some reasons to be cheerful. First, the global economy is doing better than anticipated. A global manufacturing recovery seems to be unfolding. US consumer sentiment is holding up. China is finally considering deploying more fiscal stimulus. The hard landing scenario seems unlikely and the "no landing" probability is rising.

Better than expected economic numbers are propelling earnings estimates higher. Artificial Intelligence could trigger a productivity boom which should help keep corporate margins at a high level.

Market dynamics are also sending positive messages to investors: the upward trend remains robust, the participation to the upside is broadening, cyclicals are outperforming defensives, commodities are starting to pick up. Meanwhile, bond volatility is decreasing, and the dollar is stabilising.

Finally, investors seem to be cheering the fact that central banks will still cut rates DESPITE the resilience of economic growth and the stickiness of inflation. The "reflation" thesis was corroborated by the two most important central banks meetings that took place this week. First, Bank of Japan Governor Kazuo Ueda has decided to end the policy of negative rates. This move was widely anticipated, and the dovish tone around this decision pleased investors and didn't lead to the yen appreciation which was feared by markets. In the US, the Fed kept interest rates unchanged as expected. But there was a positive surprise for investors: as compared to their December forecasts, the Fed is expecting higher Real GDP growth (2.1% vs. 1.4%), lower Unemployment (4.0% vs. 4.1%) and higher Core PCE Inflation (2.6% vs. 2.4%), but it is still anticipating 3 rate CUTS this year. This sounds reflationary for markets: as in the case of Japan, the Fed hawks are flying like doves.

This positive mix of decent growth, stable inflation (albeit at a higher level than central bank's target), loosening financial conditions, upward trending markets with broader participation to the upside lead us to keep our global equity allocation unchanged (with the market effect, our tactical asset allocation to equities is now slightly higher than our strategic asset allocation).

So why not increase our equity allocation further?

Despite this rosy picture, we are also aware that many things could go wrong. The sectors of the economy which are the most affected by higher rates (e.g. US Commercial Real Estate, SMEs, etc.) continue to struggle. Sticky inflation in services and the rise of commodity prices could lead to higher headline inflation in the months to come – hence preventing rate cuts by central banks at a time when global debt keeps ballooning. A cracking of market heavyweights could lead global indices lower. Geopolitical conflict escalation in Ukraine or Middle East remains a risk. Investor sentiment appears complacent and elevated equity market multiples do not leave any room for disappointment.

As such, we are keeping our global equity allocation close to our Strategic Asset Allocation and we won't be adding more exposure to equities at this stage. However, we believe that some sector and style rotation could continue to unfold. Indeed, the "reflation" thesis might trigger new leadership within equities. We are starting to see some large cap tech stocks stalling while sectors such as energy and materials have been outperforming the S&P 500 index recently. Within non-US markets, we are keeping our preference for Japan and staying neutral on Europe. Although momentum in China's equity markets is on the rise, we are currently choosing not to increase our investments in this region.

On the rates side, Treasury supply continues to rise and coupled with sticky inflation, is exerting upward pressures on long-dated bond yields. In this context, we are decreasing our allocation to Government bonds 1-10 years from positive to neutral and the 10 years+ Government bonds from neutral to negative. Proceeds are reinvested into cash which continues to offer positive real yields. The downtrend in credit spreads has continued towards multi-year lows. We remain neutral on credit with a preference for quality (investment grade). On an aggregate basis, our fixed income positioning has moved from neutral to negative.

Within commodities, we are maintaining our allocation to gold. The resilience of the yellow metal despite higher rates and ETF outflows is remarkable. Gold continues to offer a protection against geopolitical shocks and currency debasement. The recent technical breakout seems to indicate further upside ahead.

In Forex, we are keeping our neutral stance on the Euro, Swiss Franc and GBP against the dollar. Central banks on both sides of the Atlantic seem to be on a wait and see mode for the time being. We still believe that the change in monetary policy in Japan (raising rates at the time other central banks are contemplating a cut) could lead to some yen appreciation – hence our positive view on the yen versus dollar.

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

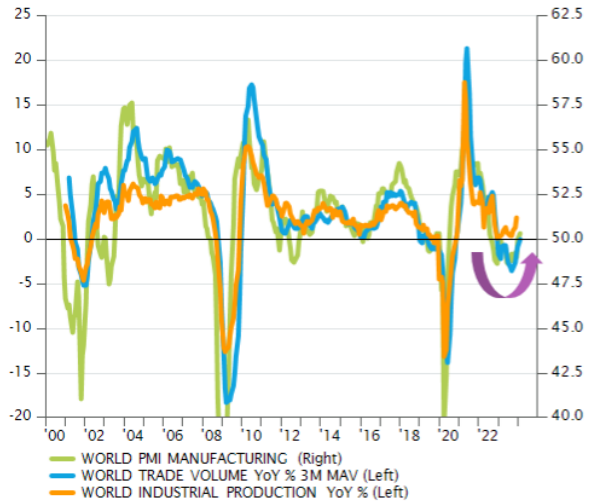
A MACRO & MONETARY POLICY UPDATE

Global growth dynamic pickup is underway

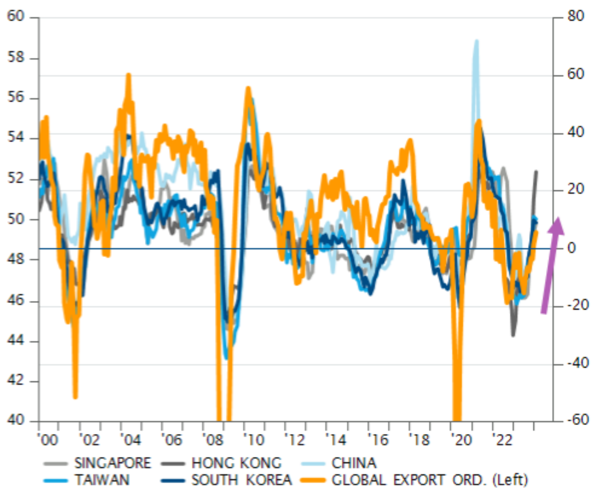
The global economic growth cycle reached its lowest point in 2023 and is now experiencing an upswing. Indicators of industrial activity and trade are showing signs of improvement, including exports from Asian economies.

Global growth is picking up

World manufacturing activity, trade, industrial production and GDP



East Asia Exports 3M MAV YoY% & Global New Export Orders



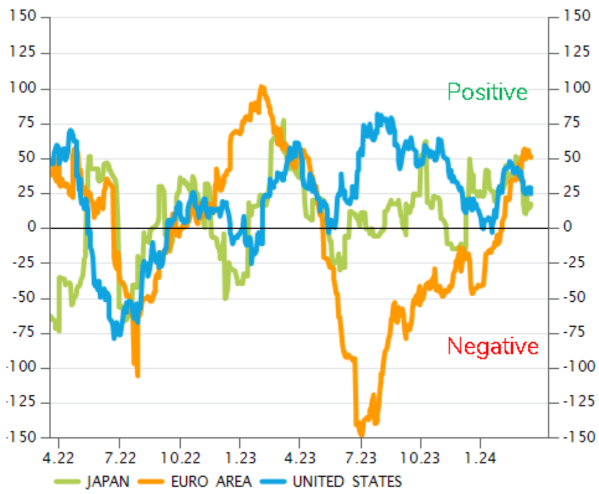
Developed economies are surpassing expectations, evidenced by ongoing positive economic developments in the US, alongside noticeable improvements in Europe and China. This presents a broadly synchronised trend of enhancement across the board, with Germany being the notable outlier among the major economies.

Positive surprises across all large economic areas

Economic Surprise Indices

(actual data release vs consensus expectations)

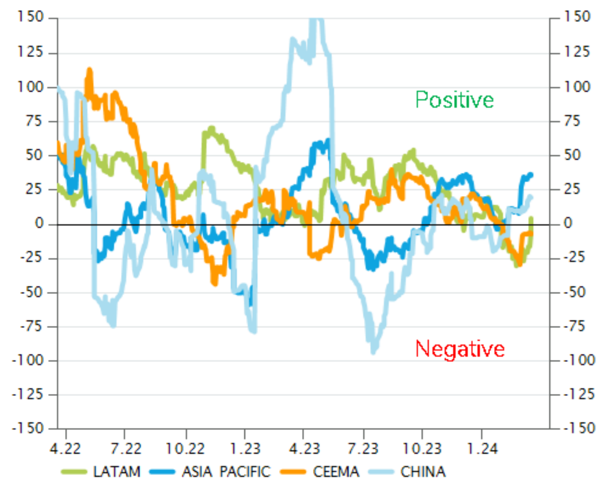
Developed Economies



Economic Surprise Indices

(actual data release vs consensus expectations)

Emerging Economies



Banque Syz, ©FactSet Research Systems

The US economy continues to grow, slightly above trend, supported by robust real income and spending growth.

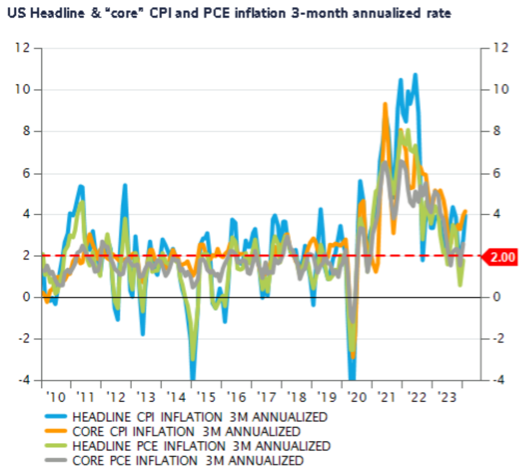
The Eurozone is slowly recovering from the Ukraine war shock, as consumption in services benefits from the ongoing disinflationary trend.

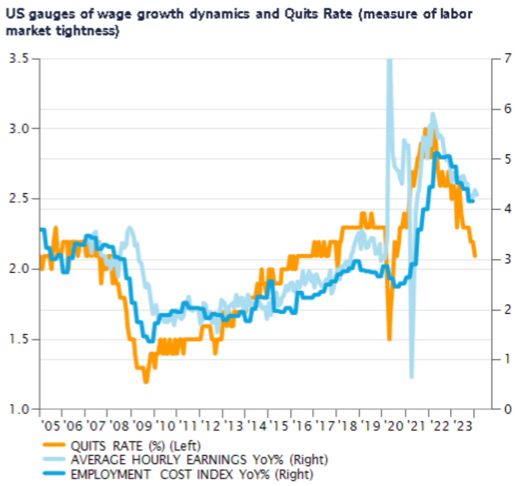
The Japan economy is growing slowly as domestic demand remains subdued, but business sentiment is strong.

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

On the inflation front, upward pressures on wages are gradually abating and keep the disinflationary trend alive, but resilient demand sustains short-term inflation dynamics.

Inflation: unexpected rebound doesn't challenge the downward trend yet

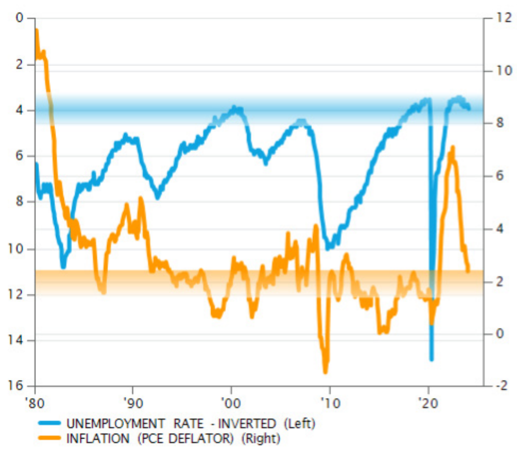


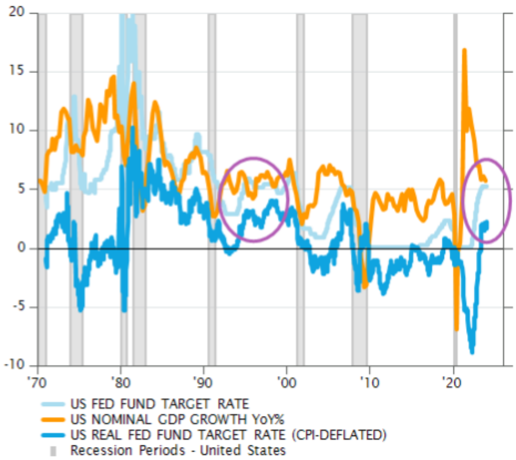


Rate cut expectations are revised downward

The Fed is close to its "comfort" zone and appears on track to achieve a "1995-style" soft-landing. Indeed, the two objectives of the Fed (maximum employment and stable prices) are (almost) perfectly reached. The Fed can relax and afford to "wait-and-see" before eventually recalibrating. The current environment is one of solid nominal GDP growth, positive real short-term rates and Fed Funds around 5%, that looks very similar to what we went through in the second half of the 90s.

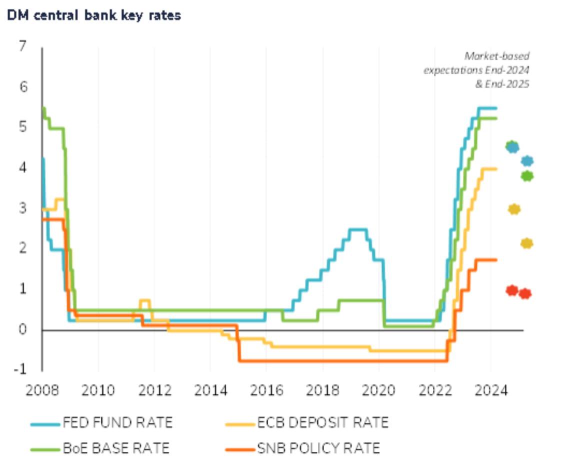
Back to the 1990s? The US economy is on track for a soft-landing

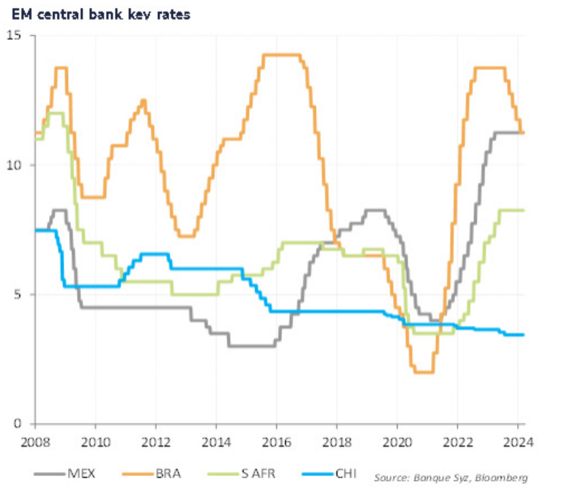




Rate cut expectations for the Fed and the ECB are revised lower and being pushed toward the second half of the year. The global rate cut cycle is about to start, most likely in June. This cycle may have more legs in some areas than in others.

Central banks: rate cuts ahead, but at different times and paces





Alternative measures to central banks' balance sheet show a more positive liquidity environment.

Our scenario: US resilience and improving global momentum reinforce the likelihood of a "soft landing" in 2024.

THE WEIGHT OF THE EVIDENCE

Our asset allocation preferences are based on 5 indicators including 4 macro & fundamental indicators (leading) and 1 market dynamics (coincident). The weight of the evidence suggests a neutral allocation to equities. Below we review the positive and negative factors for each of them.

Indicators review summary - our five pillars

There are two changes versus last month:

- → The "macro cycle" pillar has moved from NEUTRAL to POSITIVE. The nominal global GDP growth momentum is improving with reduced downside risks. It warrants a POSITIVE assessment of the macro cycle at this stage. There are short-term upside risks on inflation, but medium-term prospects still point to disinflation.
- → The "market dynamics" pillar has moved from NEUTRAL to POSITIVE. Trend indicators remain positive and strong. In addition, the recent relative pause in the equity upward trend was welcomed, as the market is not overbought anymore. Finally, market breadth has improved, supporting the robustness of the current market rally.

	(+)	(-)	WEIGHT OF THE EVIDENCE
MACRO CYCLE	The global cyclical momentum is improving. The positive nominal GDP growth prospects for the months ahead, with reduced downside risks, warrant a POSITIVE assessment of the macro cycle at this stage.	There are short-term upside risks on inflation (but medium-term prospects still point to disinflation).	POSITIVE (↑)
LIQUIDITY	Underlying measures show an environment of relatively stable liquidity. Financial conditions are on the "easy side" and have continued to ease since the beginning of the year. Central banks are expected to cut rates in the second half of the year to avoid maintaining unnecessarily restrictive financing conditions as inflation gradually slows down	Central banks maintain a restrictive monetary policy stance, a combination of positive real short-term rates and of Quantitative Tightening (gradual reduction of their balance sheet size)	NEUTRAL
EARNINGS GROWTH	Top-line growth and margins remain resilient. Earnings revisions are positive and earnings momentum is expected to improve going forward	AI-driven margins improvement are most likely overpriced.	NEUTRAL
VALUATIONS	Absolute valuations have improved recently. Ex-technology, 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	Trend indicators remain positive and strong. Market is not overbought anymore. Market breadth has improved.	Sentiment looks over-optimistic (for example: put-call ratio). MACD and mean-reversion are flashing red.	POSITIVE (↑)

ASSET ALLOCATION VIEWS

EQUITIES

We remain NEUTRAL on equities as we think the strong performance of the past few months already reflects most of the improving macroeconomic outlook. The earnings momentum remains favourable. However, market sentiment and valuations seem a bit overstretched.

The macro regime remains supportive for equities as an asset class as global leading indicators are showing signs of a rebound and China is stabilising. Valuation is high in US large caps but remains more reasonable elsewhere while earnings are supportive.

1. The macro regime remains favourable for equities

The global cyclical momentum is improving as shown by global leading indicators and this reduces the likelihood of downside risk in the near-term.

There is still near-term inflationary pressure, but medium-term prospects still point to disinflation, which is a support for equities and any interest cut by the Fed to reflect lower inflation will be a positive.

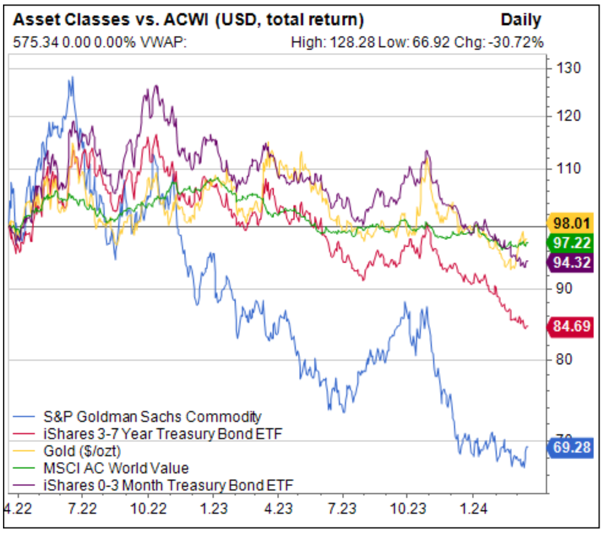
2. Positive earnings outlook

Earnings momentum remains strong with 11% and 17% yoy growth respectively for US and Japanese equities this year. For 2025, earnings growth is expected to accelerate in the US (+13% yoy), Europe (+10%) and Switzerland (+13%) while China is expected to remain steady (+9%).

Regions	Last	EPS CYO	EPS CY+1	YoY %	EPS CY+2	YoY %	PE CY+1	PE CY+2
S&P 500	5 178.5	218.2	242.4	11.1	275.2	13.5	21.2	18.7
STOXX Europe 600	505.2	34.1	35.8	4.8	39.4	10.2	14.1	12.8
Switzerland SPI	724.2	35.8	29.5	10.4	44.9	13.6	18.4	16.2
Hang Seng Index	16 529.5	1 804.7	1 966.5	9.0	2 142.1	8.9	8.5	7.8
Japan Nikkei 225	40 003.6	1 589.3	1 870.8	17.7	2 112.6	12.9	21.2	18.8

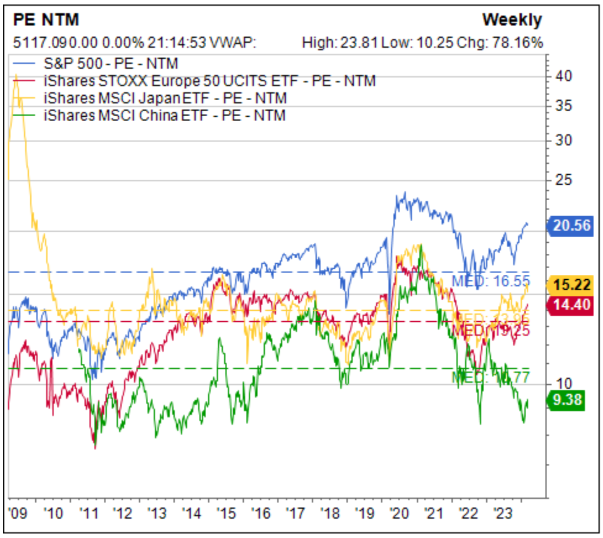
3. Good momentum vs. other asset classes

Equities continue to benefit from a favourable macro regime and are seen as an "edge" against inflationary pressure and money debasement. Most large companies have been able to pass through inflation pressure via price increases during the last couple years.



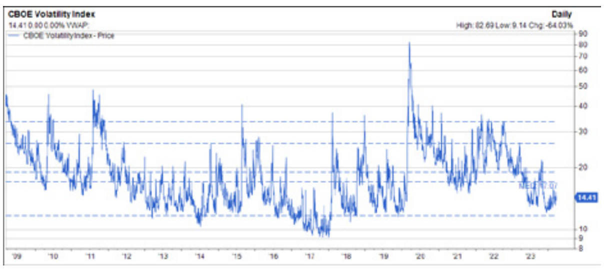
4. Valuation varies greatly within equity markets.

Valuation is stretched amongst US large cap names, but appears more reasonable when looking at Europe or Japan.



5. Risk environment and seasonality remains supportive.

The risk environment can quickly change, but the current low volatile environment combined with still a positive seasonality, remains in favour of the equity asset class.



From a regional/country standpoint, we maintain our slight preference for the US and Japan as earning growth is expected to continue this year and next.

We are neutral on Swiss equities. We also keep our neutral stance on the Eurozone/UK as earning momentum remains muted.

We are under exposed Emerging and Chinese equities as the dollar remains strong and, in the case of China, the lack of consumer and corporate confidence keeps us at bay for the time being. We note however that the market momentum has improved recently.

In the US, market concentration remains high, but we have seen some improvement in market breadth recently. The S&P 500 index remains expensive with an aggregate at PE at 20x. However, adjusted for the concentration, the S&P500 equal weight PE stands at 16x which is more in-line with historical averages.

FIXED INCOME

Our preference has moved from neutral to negative on Fixed Income. This is primarily influenced by our bearish perspective on the long end of the yield curve, coupled with a cautious approach towards Credit markets. Specifically, we have adjusted our rating on Investment Grade (IG) bonds from positive to neutral, while maintaining a slightly negative view on High Yield (HY) bonds.

Our evaluation of government bonds is nuanced, taking into account the maturity of the securities. For bonds with maturities of less than 10 years, we hold a neutral stance. This position is supported by the presence of high real yields, an anticipated peak in central bank's tightening, a shift towards disinflation, their relative value when compared to equities, and an improvement in correlations.

On the other hand, we exercise caution towards bonds with maturities exceeding 10 years. The presence of an inverted yield curve and negative term premiums diminishes their appeal, especially amidst ongoing interest rate volatility. Although initial apprehensions regarding the supply of long-term bonds in early 2024 were notable, recent successful auctions — including the record-setting 10-year US Treasury issuance — and reassurances from Treasury Secretary Yellen regarding supply stability have introduced a degree of optimism. The market is adjusting to the realities of quantitative tightening, albeit a moderation in its pace is anticipated. Market expectations are now aligned with the Federal Reserve regarding the anticipated number of rate cuts in 2024.

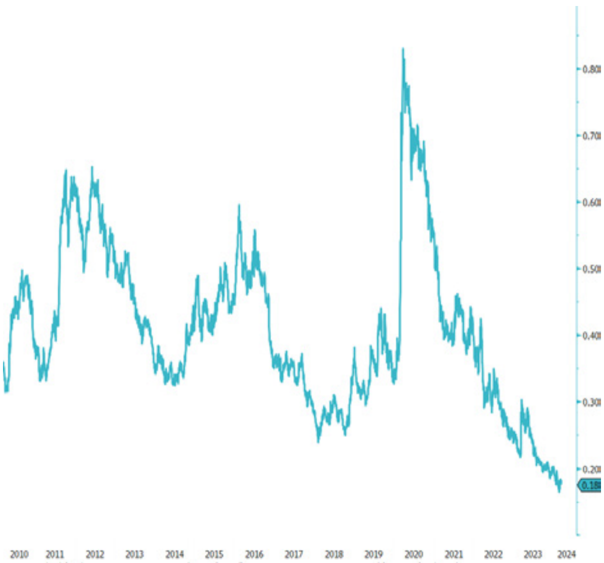
Balancing the Scales: Positive vs. Negative Factors in Bond Investments

Source: Syz CIO office

In Europe, our concern for the Eurozone's growth prospects and the potential slowdown in the ECB's rate cycle prompts a neutral view on EUR rates. The tightening of spreads in Euro Peripherals, especially between Italian and German 10-year yields, calls for caution. Nonetheless, the UK bond market stands out as an attractive opportunity, thanks to expected CPI decreases signalling inflationary relief and supporting the potential for Bank of England rate cuts by mid-2024. This backdrop, combined with appealing yields following recent market pullbacks, underscores the UK bond market as an attractive investment avenue. Additionally, the market does not anticipate a rate cut until the first half of 2024.

Within the corporate bond segment, we turn more cautious on IG corporate bonds. The sharp tightening in credit spreads, reaching lowest level since 2021, has considerably reduced the margin for safety in credit. Spreads now represent less than 20% in the total yield of an investment grade bond. This "price to perfection" encourages us to be more vigilant in this segment. In HY, we prefer subordinated debts over corporate bonds, recognising their favourable risk/reward profile within the fixed income landscape.

How much spreads represent of the total yield of Investment Grade corporate bonds?



Source: Bloomberg

Our stance remains neutral towards Emerging Market (EM) debt, specifically targeting bonds with maturities of up to 4 years and yields exceeding 6.5%. This cautious optimism is moderated by the recognition that spreads in EM corporate bonds are at their narrowest since 2018, necessitating vigilant valuation and risk assessments.

FOREX

Given recent macro developments in the US, the timing and extent of Fed's rate cuts in 2024 is more uncertain and might be later than expected, and less than expected.

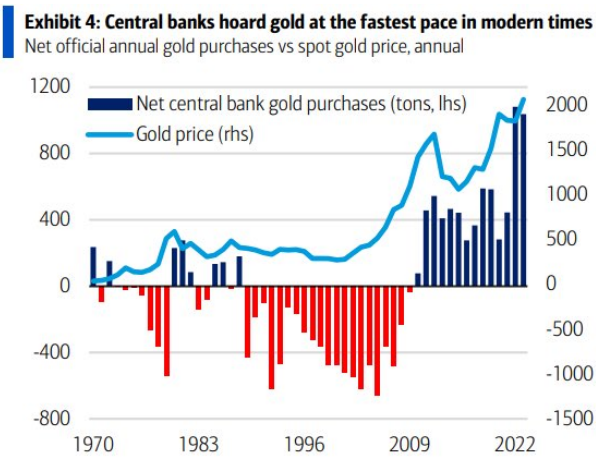
As a result, there is no more reason at this stage to hold a positive view on the EUR and CHF, as the scenario of a stronger-than-previously-expected USD has gained probability.

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

CHF/USD: Fundamentals no longer warrant additional CHF appreciation, and the real rate differential pleads for a firmer USD vs Swiss franc at least in the short run, especially after the surprise decision by the SNB to cut rate already in March. In the short-term, the USD might benefit from the real interest rate differential (nominal rate - inflation rate) that has recently become more supportive for the greenback: inflation in the US is slowing while short-term nominal rates remain high, which leads to rising real USD rates. A higher real rate differential supports USD. However, when the Fed starts cutting its key rate, this real rate differential between USD & CHF should reverse lower and weigh on the USD vs CHF in the later part of 2024 → our rating is NEUTRAL.

ALTERNATIVES

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 remains between gold and real yields. Why? 1) With debt sustainability becoming an ever-increasing issue, the market anticipates that real interest rates cannot stay at this level for too long; 2) Investors buy gold as an insurance against adverse circumstances (inflation, recession, etc.); 3) There is heavy demand stemming from central banks, especially in emerging markets.



Source: BofA

But for gold to appreciate in dollar terms, a drop in real yields is probably required. In the meantime, gold remains a true diversification asset.

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

INVESTMENT CONCLUSIONS

TACTICAL ASSET ALLOCATION (TAA) DECISIONS– 18.3.2024

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

We downgraded Fixed Income from NEUTRAL to NEGATIVE and increase our Cash exposure.

Global equities (NEUTRAL)

- → US and Japan remain our favourite markets (POSITIVE)
- → We remain NEUTRAL on Switzerland
- → We KEEP OUR NEGATIVE stance on Emerging Markets

Fixed Income (from NEUTRAL to NEGATIVE)

- → We downgraded Government bonds 1-10 year from POSITIVE to NEUTRAL and downgraded Government Bonds 10+ from NEUTRAL to NEGATIVE
- → We downgraded Corporate Investment Grade Bonds from POSITIVE to NEUTRAL

FOREX

- → We remain NEUTRAL EUR and CHF (vs. dollar)
- → We remain POSITIVE JPY vs. dollar

Commodities and Alternatives

- → We remain POSITIVE Gold and NEUTRAL on Hedge Funds and Commodities

ASSET ALLOCATION GRID

TACTICAL POSITIONING: OUR ASSET ALLOCATION MATRIX

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

Change from last month: More attractive → Less attractive ←

Source: Investment strategy group - 18 March 2024

US vs. Europe: Mind the gap

Introduction

Joe Biden's administration has put in place a vast investment programme that should strengthen the United States' dominant industrial position, particularly vis-à-vis Europe. But at what cost?

Charles-Henry Monchau *Chief Investment Officer*

Oliver Ramos *Junior Investment Analyst*

Quick rundown

At a time of environmental concerns and geopolitical upheaval, the importance of economic planning and the development of new industrial strategies has never been greater. Under the Biden administration, the United States has implemented a gigantic investment programme aimed at strengthening its position as the world's leading power. On the old continent, the EU and the UK seem to be moving in the opposite direction, grappling with challenges such as de-industrialisation and energy dependency.

On the face of it, the strategic turn taken by the United States should give it a major competitive advantage over Europe. Their energy independence and local production of semi-conductors give them a definite advantage in a world prey to "slow-balisation" and geopolitical risks. But the price of Bidenomics is high. In particular, budget deficits will widen, and indebtedness will accelerate (see below for the CBO's projections for the coming years). Such a headlong rush will have consequences for future taxes and/or inflation ("the hidden tax"). As President Ford once said, "A government that is big enough to give you everything is a government that will also be there to take everything from you..."

Another price to pay for 'Bidenomics' is what is known as 'crowding out', an economic phenomenon characterised by a fall in investment and private consumption as a result of increased public spending. In simple terms, Uncle Sam's massive public spending is absorbing not only available capital but also labour (with effects on wages and hence inflation). The very large Treasury bond issues needed to finance Bidenomics are pushing up bond yields, with effects on the cost of capital for companies. As mentioned by Gavekal Group, Biden's interventionism should lead to a more stable US economy, but with negative effects on labour productivity growth and, by extension, on US structural growth.

For Europeans, there is an urgent need to modernise their industrial base and secure access to energy. This means putting in place a new foreign affairs policy common to the whole Union. It also means resorting to major investment plans similar to the Bidenomics. But the room for manoeuvre is limited. Firstly, because the level of debt is already very high. But also, because Germany's debt brake rules prevent the pursuit of such policies. Last week, the German Council of Wise Men came out in favour of reforming these rules. Europe urgently needs to take action.

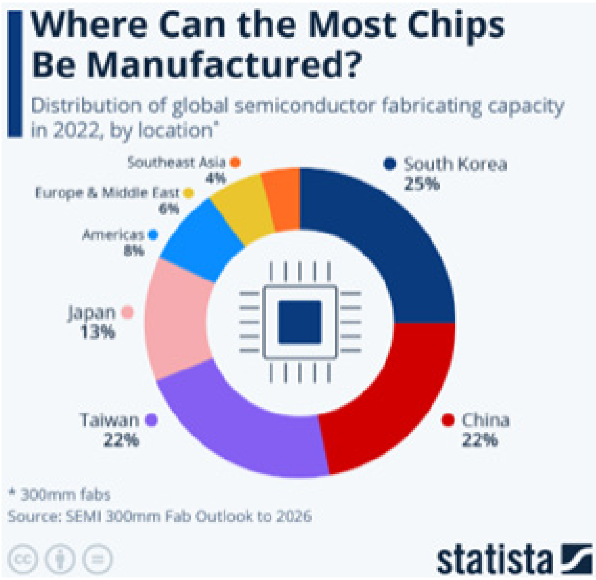
Bidenomics and their implications

Bidenomics, the term used to describe President Joe Biden's fiscal stimulus policy, is characterised by major public investment in US infrastructure, technology, and labour policy.

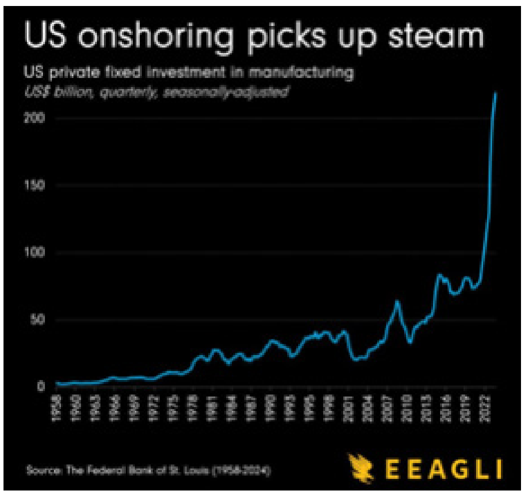
These investment programmes include those related to inflation reduction (the IRA), local semiconductor production (the CHIPS Act), infrastructure and employment.

The IRA, signed into law in August 2022, covers major investments in the fight against climate change, healthcare, and the revitalisation of the US manufacturing industry. The legislation represents a deliberate move towards a more sustainable and resilient economy, with a focus on renewable energy and reducing the carbon footprint. The legislation is part of Mr Biden's ambitious goals of reducing emissions by 50% by 2035 (compared to 2005 levels) and achieving a net zero carbon footprint by 2050. This text has already produced promising results: the IRA has already created more than 170,000 jobs in the clean energy sector and companies have announced investments of $110 billion in clean energy production in 2022 alone.

Complementing the IRA is the CHIPS Act, a strategic initiative aimed at regaining and securing the United States' position in the global semiconductor industry. Figures from the semiconductor lobbying organisation SEMI show that around 70% of total manufacturing capacity is in South Korea, Taiwan and China, with North America in fifth place at 8% of global capacity. Guaranteeing the independence of this sector is particularly important at a time when technology underpins every facet of the economy and national security. The law aims to strengthen the domestic supply chain, encourage research and development, and ultimately reduce dependence on foreign semiconductor production. By investing in this critical sector, the United States is protecting its economic interests and guarding against geopolitical risks (e.g., China's possible invasion of Taiwan).

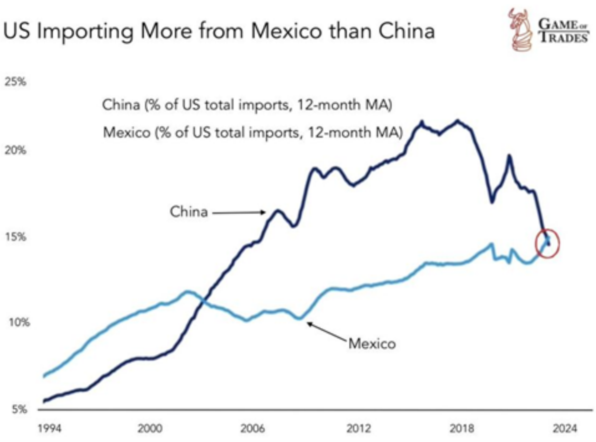


Signed into law by President Biden in November 2021, the Infrastructure Investment and Jobs Act (IIJA) will provide more than $1 trillion in federal spending to address infrastructure needs, including repairing and building roads and bridges, expanding high-speed internet access, and upgrading electricity and water systems. Now approaching its third year, this investment programme has launched more than 40,000 projects in all 50 states, stimulating economic growth and improving the quality of life for all Americans.



In addition to substantial investment in its own infrastructure, the United States has changed its business dynamics through "Friendshoring". Also known as "nearshoring", this trend appears to be a strategic manoeuvre aimed at reshaping supply chain dynamics and commercial relationships. The aim is to strengthen and diversify supply chains by relocating or establishing manufacturing and service facilities closer to home, often in allied nations or neighbouring countries. The principle is to respond to vulnerabilities exposed by global shocks such as the COVID-19 pandemic and recent conflicts (Russia-Ukraine, Middle East, etc.). In this way, the US is seeking to mitigate the risks associated with long-distance supply chains, including transport delays, increased costs, and political instability.

The “friendshoring” policy offers economic benefits such as job creation, encouraging technological collaboration and promoting environmental sustainability by reducing transport emissions. For the countries involved in relocation efforts, this represents opportunities for economic growth, investment, and access to the US market. Mexico is one of the countries seizing these opportunities, having eclipsed China as the United States' largest trading partner in 2023.



Source: Game of Trades

The implications of Bidenomics are also proactive, long-term measures that should enable the US economy to benefit from growth that is both sustainable and better able to protect itself from external shocks.

US energy independence

Energy security has become synonymous with national security, and the United States is gearing its strategy towards energy independence, a goal that promises greater economic stability and strengthens its geopolitical position.

Diversification of the energy portfolio is at the heart of this strategy. The US is not only increasing its production of oil (now the world's leading producer - see graph below) and natural gas, which guarantees a steady domestic supply, but is also investing aggressively in renewable energies such as wind, solar and bioenergy. Thanks to the IRA, wind power generation is set to triple by 2030 and solar power generation is set to increase sevenfold. This balanced approach to energy independence mitigates the risks of over-reliance on any single energy source and paves the way for a smooth transition to cleaner, more sustainable energy.

Source: Bloomberg

The effects of energy independence extend far beyond national borders, influencing global energy markets and geopolitical dynamics. These changes in the global supply and demand equation, could stabilise or even lower world energy prices.

Europe's de-industrialisation and energy dependence

While the United States is moving towards energy independence and revitalising its industrial base, the picture on the other side of the Atlantic is very different. Continental Europe and the UK are facing de-industrialisation and heavy energy dependency. The implications for their economic and geopolitical future should not be underestimated.

De-industrialisation in the EU and the UK is characterised by a steady decline in manufacturing and heavy industry, due in part to globalisation, automation, and stricter environmental regulations than in the rest of the world. This loss of competitiveness has economic consequences, such as the loss of traditional industrial jobs and the erosion of the national manufacturing base (see the case of Germany below). It also has repercussions for trade balances, technological sovereignty, and the overall resilience of their economies.

Energy dependency on the EU and the UK only exacerbates this loss of industrial competitiveness. Heavily dependent on imports to meet their energy needs, these regions are sensitive to the vagaries of international energy markets. The dangers of this overdependence became real when the war in Ukraine broke out and countries like Germany, which received more than 50% of its natural gas imports from Russia, saw this supply threatened.

By 2023, the EU will still be 60% dependent on imports to cover its energy needs. This exposes it to volatile prices, supply disruptions and geopolitical manoeuvring. The situation is further complicated by ambitious environmental targets and a difficult transition to renewable energies, which, while laudable, require substantial investment and structural change. In addition, countries such as Germany have closed all their nuclear power stations, exacerbating their dependence on imports of non-renewable energy.

The combination of de-industrialisation and energy dependency poses significant challenges to the long-term economic competitiveness of the EU and the UK. The erosion of manufacturing capacity can limit their participation in global value chains and the benefits that accrue from this, particularly in high value-added sectors such as technology and advanced manufacturing. These factors have profound implications for policy autonomy. Energy dependence can translate into geopolitical leverage for supplier countries, which can influence diplomatic positions and political decisions. The energy transition involves a balance between environmental objectives and economic and industrial priorities.

On the face of it, the strategic turn taken by the United States should give it a major competitive advantage over Europe. Their energy independence and local production of semi-conductors give them a definite advantage in a world prey to "slowbalisation" and geopolitical risks. But the price of Bidenomics is high. In particular, budget deficits will widen, and indebtedness will accelerate (see below for the CBO's projections for the coming years). Such a headlong rush will have consequences for future taxes and/or inflation ("the hidden tax"). As President Ford once said, "A government that is big enough to give you everything is a government that will also be there to take everything from you..."

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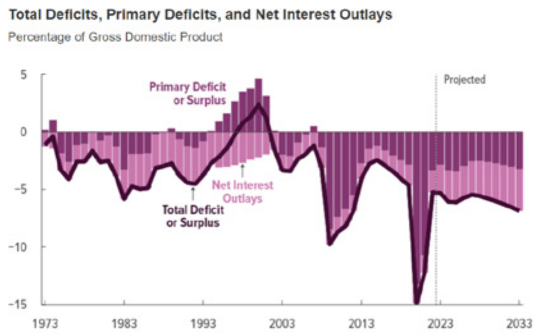
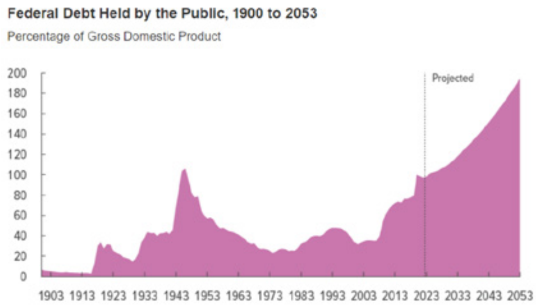




Vietnam: The Rising Dragon

Image source: iStock

Introduction

The Asia House Annual Outlook 2024 classifies it as one of the best positioned markets in Asia-Pacific for 2024. Nestled beside the giant China, Vietnam aspires to become a high-income country by 2045, relying on a growing economy, strong manufacturing activity and rising middle class.

This article offers a comprehensive view of Vietnam's potential and obstacles on its path to economic prosperity.

Charles-Henry Monchau *Chief Investment Officer*

Assia Driss *Junior Investment Analyst*

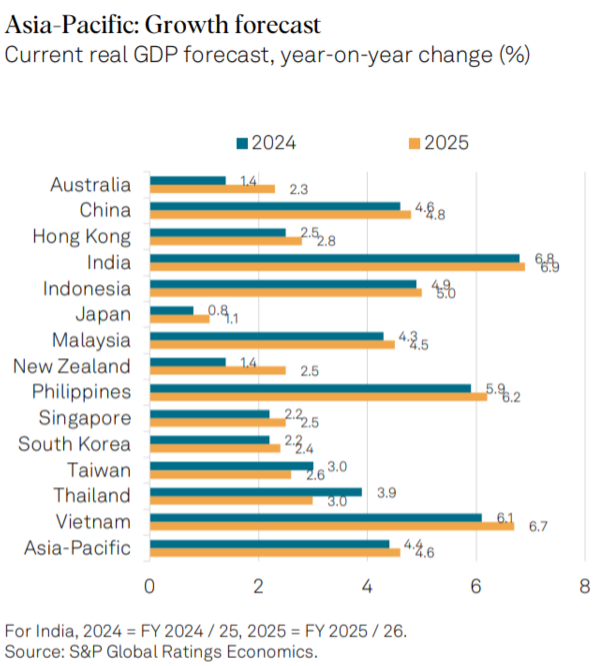
Nevine Pollini *Senior Investment Analyst*

Vietnam's economic development

Vietnam's journey from a centrally controlled economy to one of the most dynamic emerging countries in the East Asia region is an economic success story. Since the launch of Đổi Mới (renovation) in 1986, a series of economic reforms, coupled with beneficial global trends, propelled Vietnam from one of the world's poorest nations to a lower middle-income country within a generation. This transformation has seen Vietnam's GDP per capita increase 3.6 times between 2002 and 2022, reaching nearly $4,200. Poverty rates have seen a significant decline, from 14% in 2010 to 5.7% in 2023.

After lifting health restrictions, the economy rebounded strongly with an 8% growth rate in 2022. However, by 2023, growth had slowed to 3.1%. This deceleration was due to a combination of external shocks, such as declining global demand and US monetary tightening, and internal factors, including a property sector crisis and a confidence shock in the financial sector. These issues highlighted Vietnam's macro-financial vulnerabilities, notably its low foreign exchange reserves, and banking system weaknesses.

Despite these challenges, Vietnam's economic outlook remains strong, supported by the burgeoning export manufacturing sector and substantial foreign direct investment (FDI) inflows. Vietnam is anticipated to experience the highest growth in Southeast Asia, with projections of 6-6.5% in 2024, driven by exports, services (including tourism), robust imports, and stronger manufacturing activity. The economy's growth momentum is expected to maintain an annual rate comfortably above 6% in the subsequent quarters.



Source: S&P Global Ratings Economics

The economic expansion has also benefited from a favourable interest rate environment, with the State Bank of Vietnam cutting interest rates by 150 basis points to 4.5% in 2023. This adjustment encouraged companies to borrow at around 4-5% (7-8% at the beginning of 2023) for working capital and capital expenditure, further supporting economic growth. Inflation is forecasted to be at 3.5% in 2024, enabling the Vietnamese government to continue its accommodative monetary and fiscal policies.

Why Invest in Vietnam?

Strategic location, young demographics, and favourable business environment

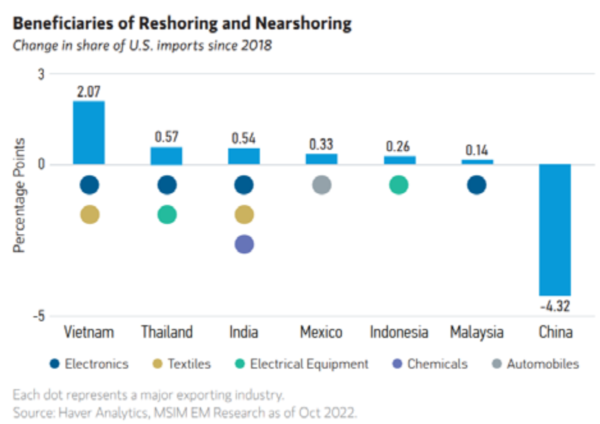
Vietnam's appeal to investors is clear: a prime location in Southeast Asia, a youthful and educated population, and a business-friendly environment. Situated at the centre of ASEAN, it offers direct access to nearby countries such as China, Thailand, and Malaysia, making it a key hub for regional operations. Vietnam boasts a young (median age 33 years) and educated (literacy rate of 97%) nation of 100 million people.

Actively engaging in significant trade deals, Vietnam is part of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the EU-Vietnam Free Trade Agreement (EVFTA), and the ASEAN Free Trade Area (AFTA), which collectively grant Vietnamese exports preferential access to a market of over 500 million people. Moreover, Vietnam is undertaking substantial efforts to enhance its business environment, streamline bureaucratic processes, and attract foreign investment, all of which have contributed to the expansion of its industrial sector in recent years.

ChinaPlusOne Strategy

Against the backdrop of ongoing trade tensions between the US and China, exacerbated by rising labour costs and geopolitical challenges, companies are actively seeking alternative manufacturing destinations. In this context, Vietnam emerged as increasingly appealing destination for foreign investment and a viable alternative to China as a manufacturing hub.

Vietnam's strategic location, abundant natural resources, and a burgeoning skilled workforce make it an attractive prospect for companies looking to move away from China. Tech giants including Apple, Dell, Google, Microsoft, and Intel, all diversified their supply chains through investments in Vietnamese facilities in recent years, as part of a "ChinaPlusOne" strategy. Vietnam's manufacturing sector remains highly attractive to both international and domestic investors, particularly in the smartphone supply chain and consumer electronics., This was evidenced by Apple's supplier Luxshare Precision Industry, $504 million investment in a Vietnamese facility. Its rival, Samsung Electronics, produces half of its smartphones in Vietnam and has invested a total of $22.4 bn in the country. Dutch chipmakers are also joining the trend, with BE Semiconductor Industries planning a $5 million investment in factory space. Looking ahead, Vietnam aims to expand its semiconductor manufacturing capabilities, with plans to train 50,000 engineers by 2030, indicating its commitment to become a key player in the global semiconductor industry.



Source: Morgan Stanley March 2023

FDI to transform the economy

Since joining the World Trade Organisation in 2007, Vietnam has seen a remarkable influx of foreign direct investment (FDI), which has been pivotal in transforming its economy into a significant manufacturing and export hub.

This period marked a notable shift towards an export-driven model, with goods exports leaping from 57% of GDP in 2011 to an impressive 91% in 2022. During this time, Vietnam's share in global exports tripled from 0.5% to 1.5%, with the share of sales of telephones, computers, and other electronic goods accounting for 32% of total exports.

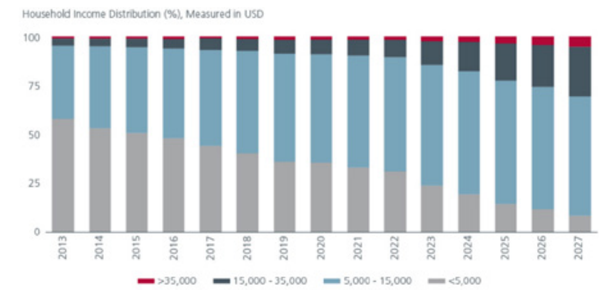
Despite a temporary setback during the COVID-19 pandemic, where net FDI inflows averaged $15.3 billion annually, down slightly from the pre-pandemic average of 4.7% of GDP, Vietnam's FDI inflows have shown resilience and growth. In 2023, inbound FDI inflows rebounded significantly to $36.6 billion, up 32% year-on-year, with half originating from Greater China

This wave of FDI is not just numbers on a balance sheet, it is manifesting in substantial projects, particularly in the manufacturing sector ($62bn invested in over 4600 projects) and in major infrastructure investments like the construction of Long Thanh International Airport.

Source: Le Toan

Rising middle class in Vietnam driving new trends of consumption

The Vietnamese economic growth is accompanied by a steady expansion of the middle class (daily expense higher than $12 as defined by World Data Lab), a demographic segment with major impact on the consumer market. Based on this definition, the middle class in Vietnam is estimated to comprise around 13 million people, representing about 13% of the total population and is expected to double (30%) by 2026. This demographic shift signifies not just an upturn in disposable income but also a heightened demand for diverse goods and services, offering investors and businesses a lucrative opportunity to penetrate the Vietnamese market.



Source: EIU Forecast; OOSGA Analytics. April 2023.

Source: Eastspring investments

The rapid expansion of Vietnam's youthful middle class is significantly enhancing its appeal to international brands. Coupled with an increase in the average income, this demographic evolution aligns with a rise in smartphone usage and internet access, thus fuelling a surge in e-commerce. With the country's online market value expected to hit $39 billion by 2025, Vietnam is positioned to become Southeast Asia's second-largest e-commerce market after Indonesia.

Upgrade into MSCI Emerging markets index to be expected

Vietnam remains excluded from the MSCI Emerging Markets Index, despite demonstrating qualities commonly associated with emerging market economies. This absence can be attributed to its historical conflicts, including colonial rule and communist governance, which hindered its ability to embrace foreign investment and establish robust corporate governance systems.

After losing over 30% in 2022, the Vietnam Ho Chi Minh Stock Index (VN-Index) recovered by around 12% in 2023. Average daily trading volume also increased, from $500 million in 2022 to $1 billion a day in 2023, according to Andy Ho, chief investment officer of VinaCapital, one of the country's largest investment management companies. " Now is the right time for investors to enter Vietnam stocks" he suggested on CNBC, pointing to inexpensive valuations (11 to 12 times earnings for 2023, a 20% discount to the regional average). The Vietnamese stock market is also becoming more diversified, with the top five stocks accounting for 23% of the VN-Index, compared with 53% ten years ago.

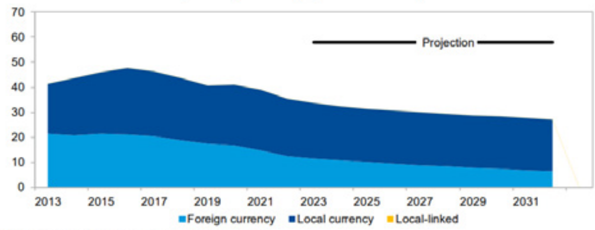
Source: MacroMicro

Nevertheless, Vietnam's rapid industrialisation and urbanisation, as well as its market capitalisation's growth, have made it a serious candidate for emerging market status. Analysts anticipate an upward reclassification to emerging market status within the next 1-2 years, potentially ushering in a new era of heightened investor interest and capital inflows into the country.

Vietnam's trade surpluses strengthen its external solvency

With imports of goods experiencing a sharper decline compared to exports in 2023, coupled with improvements in the balances of services and income, Vietnam witnessed a substantial current account surplus exceeding $22 billion, equivalent to over 5% of GDP. This surplus, a record level for Vietnam, indicates a strengthening of its external solvency and liquidity position. Thanks to these surpluses, the external debt is moderate, estimated at 36% of GDP and 44% of goods export receipts in 2023.

Figure 3. Vietnam: Public Debt Structure Indicators
(Debt by currency (percent of GDP))



Note: The perimeter shown is general government.

Source: IMF

However, Vietnam's foreign exchange reserves remain a point of concern. Although they slightly recovered in 2023, following a decline in previous years, they still cover just over three months of imports of goods and services, raising the need for sustained efforts to stabilise and enhance reserves in the face of significant capital outflows observed in recent years.

Bumps in the road...

Investing in Vietnam can be gratifying, but it also carries its share of challenges.

Firstly, Vietnam's real estate sector, once buoyed by rapid growth, now exacerbates the nation's debt burden through escalated bond issuances from US$12 billion in 2020 to US$26 billion by the end of 2021. This surge in financing was a reaction to liquidity crises faced by overleveraged firms during the COVID-19 pandemic downturn, leading to a massive jump in bond issuances connected to real estate. The sector's struggles were further highlighted by regulatory scrutiny following global market tremors caused by the Evergrande default and exacerbated by geopolitical tensions and inflationary pressures, which led to regulatory reforms and increased interest rates, tightening liquidity further.

Additionally, multinationals dominate the export sector, accounting for 75% of foreign sales. The domestic stock market is therefore overly exposed to banks and real estate developers (50% of equity market), who in turn are exposed to currency risks. It is worth mentioning that the Vietnamese Dong is not a freely convertible currency and may not always be taken out of Vietnam.

Moreover, Vietnam is the third-most exposed country to flooding in the world. Urban centres like Ho Chi Minh City and Hanoi confront persistent flooding, magnified by climate change and infrastructural deficits. This poses significant risks for investments and requires risk mitigation strategies. More than 4,000 flood-proof houses have been built since 2018 by the joint efforts of United Nations Development Programme and the national government.

Conclusion

Vietnam's strategic location, skilled workforce, rising middle class, balanced foreign policies, robust FDI climate, and status as a manufacturing hub justify its investment appeal. The land of the rising dragon must harness its strategic advantages to achieve its ambitious 2045 vision.

What is bitcoin's target price?


Image source: iStock

Introduction

The price of bitcoin has surged sharply since the beginning of the year, having increased almost fivefold from its 2022 lows. How high can the price go? In this article, we attempt to answer this question using two very distinct valuation models.

Charles-Henry Monchau *Chief Investment Officer*

Assia Driss *Junior Investment Analyst*

Almost one hundred years ago, Henry Ford, the man behind the Ford Motor Company, imagined an "energy currency", suggesting that instead of gold, nations could base their currencies on energy resources. While this idea never materialised - probably due to its potential to undermine government control over wealth- Ford's concept is partly reflected in bitcoin. This cryptocurrency, often referred to as digital gold, operates on a decentralised network and is created via a "mining" process that requires a significant amount of energy. Indeed, some argue that the value of bitcoin is intrinsically linked to the energy expended in its creation.

Capriole Investments developed the "Energy Value Equivalence" model, which calculates the value of bitcoin based on its energy consumption. According to this model, bitcoin's intrinsic value is higher than its current price.

Another valuation model for bitcoin is the "stock-to-flow" ratio, which assesses its scarcity by comparing existing supply with annual production. This model has attracted considerable interest for its ability to accurately predict bitcoin's price movements.

The two above models offer distinct but complementary perspectives, highlighting the dynamics driving bitcoin's appreciation. Overview below.

Bitcoin 101

As a reminder, bitcoin is not controlled by a central authority such as a bank or government. Instead, a global network of computers, known as miners, verify and record every bitcoin transaction on a decentralised network powered by the blockchain. These miners compete to solve complex mathematical puzzles to confirm and add transactions to the blockchain. Miners invest in high-performance computing devices and consume large amounts of electricity to solve these puzzles and earn rewards in the form of bitcoins. This process is known as "Proof-of-Work" (PoW) and is the reason why bitcoin is so secure and immutable.

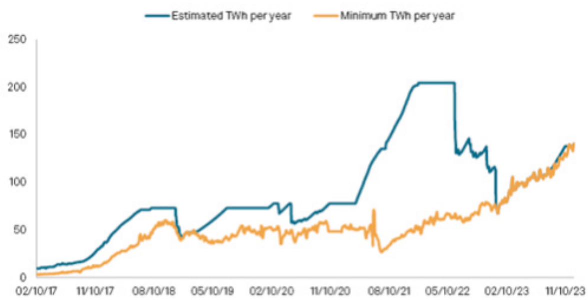
When it was launched in 2009, the bitcoin protocol included a set of predefined rules, one of which stipulates that a new block containing a set of transactions must be verified and recorded on the blockchain every 10 minutes or so. It also sets a limited supply, capped at 21 million bitcoins by the year 2140. Currently, around 19.6 million bitcoins are in circulation, with the production of new bitcoins halving every four years, a phenomenon known as halving.

Unlike traditional assets such as stocks or bonds, bitcoin lacks tangible metrics like earnings, dividends, or net assets that investors typically rely on to gauge value. Consequently, determining a fair value for bitcoin remains elusive, as conventional valuation methods are not directly applicable. The price of one bitcoin will thus tend to align with factors such as supply and demand dynamics, geopolitical events, investor sentiment and its production cost through the mining process.

“The price of any commodity tends to gravitate toward the production cost. If the price is below cost, then production slows down. If the price is above cost, profit can be made by generating and selling more. At the same time, the increased production would increase the difficulty, pushing the cost of generating towards the price. In later years, when new coin generation is a small percentage of the existing supply, market price will dictate the cost of production more than the other way around.” - Satoshi Nakamoto, pseudonymous developer of bitcoin, 2010

The bitcoin Energy Consumption Index tracks real-time energy usage in the bitcoin network, with electricity as the primary expense in mining. As of March 2024, bitcoin's annualised energy consumption is 151.28 TWh, equivalent to Malaysia's annual power consumption. And energy consumption for bitcoin mining is set to rise even further. Bloomberg reports that miners are rapidly increasing their energy consumption due to factors such as the soaring price of bitcoin, the launch of exchange-traded funds (ETFs) for bitcoin cash and "halving", the halving the marginal supply of bitcoin scheduled for April.

Global energy consumption from bitcoin mining doubled in 2023 (TWh/year)



Data accessed Dec. 19, 2023.
Index built on assumption that miner incomes and energy consumption are related.
Source: Digiconomist.
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The energy value model explained

In 2019, Capriole Investments developed an interesting model known as the Energy Value Equivalence, focusing on the energy expended in bitcoin's production. At its core, this model seeks to assess the intrinsic value of bitcoin by quantifying the energy expended in its production and compare it to the energy required to produce other assets or commodities.

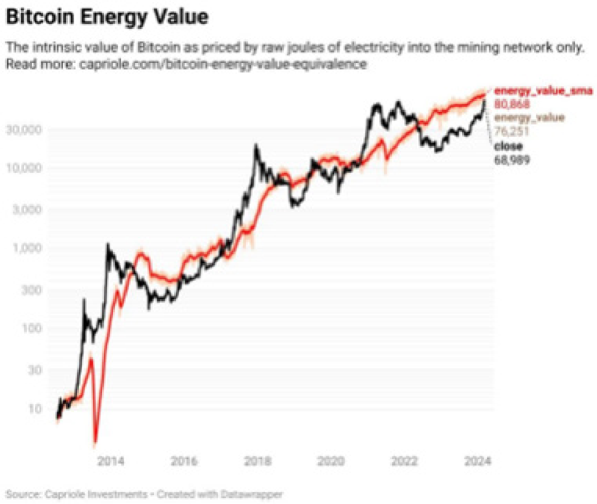
The model highlights several key insights: firstly, that energy, measured in raw Joules, is a fundamental determinant of bitcoin's fair value. Secondly, increased energy input corresponds to a higher fair value for bitcoin. Moreover, the Energy Value model suggests that bitcoin's price tends to revert to its mean Energy Value over time.

The assumption underlining the model suggests that bitcoin’s intrinsic value is a function of the amount of energy expended in its production, the rate at which its supply grows, and a conversion factor to fiat currency for energy expenditure.

All units cancelling out, the equation suggests that the fair value of bitcoin (V) is a function of the Joules of energy spent to produce it.

On this basis, Capriole Investments built a statistical model on daily data from January 2010 to 2019. The resulting R-squared of the model in relation to the actual bitcoin price of 80%, the higher the R-squared, the more reliable the model. As shown in the graph below, bitcoin's price and its energy value tend to converge, despite occasional deviations, driven by the invisible hand of the market. According to the Energy Value model, bitcoin's intrinsic value currently stands close to $81,000.

This piece of information was not overlooked by Bill Ackman, CEO of Pershing Square Capital Management. In a post on X, Ackman outlined, "Bitcoin price rise leads to increased mining and greater energy use, driving up the cost of energy, causing inflation to rise and the dollar to decline, driving demand for Bitcoin and increased mining, driving demand for energy and the cycle continues." He added humorously, "Bitcoin goes to infinity, energy prices skyrocket, and the economy collapses."



Source: Capriole Investments

Stock-to-flow model explained

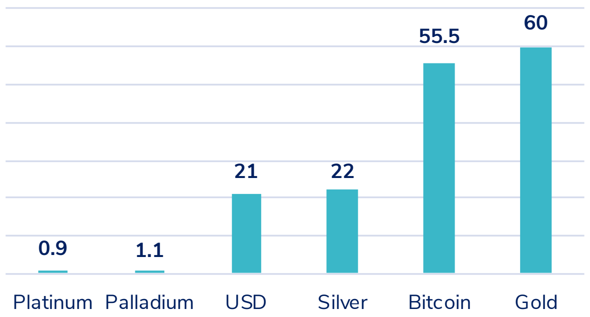
Also in 2019, Plan B, a mysterious Dutch institutional investor, presented the Stock-to-Flow (S2F) model assessing the value of bitcoin with surprising accuracy. This quantitative model attempts to predict the theoretical value of bitcoin over time based on asset scarcity. Initially greeted with scepticism, in 1999 the model predicted a rapid rise in bitcoin to $55,000 after the May 2020 "halving". A prediction that proved accurate, as bitcoin reached this level in 2021, reinforcing its credibility through its ability to predict prices.

In simple terms, the "Stock-to-Flow" model is an indicator of the scarcity (or abundance) of a commodity. It is the total amount of a resource's reserves (the "stock") divided by its annual production (the "flow"). The Stock/Flow ratio therefore measures the annual marginal supply, or additional supply, in relation to existing reserves. The higher this ratio, the less supply is renewed, and therefore the more the asset in question can be considered "scarce".

This model is generally applied to precious metals, such as gold. Current gold reserves (the "Stock") are estimated at around 192,000 tonnes. The "Flow" corresponds to the quantity of gold extracted each year, i.e., 3,200 tonnes. Dividing the total supply by the "Flow" gives a ratio of ~60. This means that, at current production rates, it would take around 60 years to extract 192,000 tonnes of gold.

Given bitcoin's unique properties (e.g., time-limited supply), the stock-flow model seems to apply to bitcoin in the same way as it does to precious metals. Bitcoin currently has a "stock" of around 19.6 million and a "flow" of 0.353 million per year, giving a SF of 55.5. Before the May 2020 "halving", the SF was 25 (the SF was even lower a few years earlier). In the future, bitcoin's SF should continue to rise, influenced by its limited supply and the halvings every 4 years. The SF is predicted to be 110 after the April 2024 halving.

Comparing Stock-to-Flow Ratios of Various Assets



Source : Athena Alpha

The statistical model built on gold, silver and bitcoin revealed a strong correlation between SF and asset value, with a 95% coefficient of determination. This suggests that as scarcity increases, so does asset value.

To estimate the price of Bitcoin, the model suggests using the 365-day average of the SF ratio. The stock-to-flow model has an R-squared of 88% on the same data used in the energy value model. The current model price currently stands close to $100,000...

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