Market Outlook

NORMALISATION AHEAD

H2 2024

Syz PRIVATE BANKING

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INTRO

Normalisation ahead

Welcome to our CIO mid-year outlook!

Risk assets are off to a strong start of the year. Equities, commodities and cryptos are recording double digit gains and have been outperforming bonds and cash.

Indeed, global economic growth has been more resilient than expected. And strong earnings momentum is offsetting the fact that the Fed remains reluctant to cut rates at this stage.

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

Trend #1

Normalisation of global economic growth

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

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

In Japan, nominal GDP is growing for the first time since the 1990's and interest rates are on the rise.

In the Emerging world, countries such as India, Mexico or Vietnam are benefiting from the US-China economic war and the nearshoring / friend shoring theme.

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

Trend #2

Labour market normalisation

Labour shortages in many sectors have been a remarkable feature of the past three years. Demographic dynamics and surging demand for service sector jobs have driven unemployment rates to record lows in the US and in Europe.

This situation has led to an acceleration in wage growth that has fuelled domestic consumption, but also raised inflationary pressures.

Recent indicators have pointed to an easing in tensions on the labour market. Job opening and indicators of turnover are falling back from peak levels. Underlying dynamics within the labour market have also shifted toward more temporary jobs at the expense of full-time contracts.

This normalisation of labour markets will lead to a healthier situation where high employment continues to support consumer spending, but where upward pressures on wages gradually abate.

Trend #3

Central banks kick off easing cycle

Central banks around the world have had to hike interest rates aggressively in 2022 and 2023, in response to the inflation revival.

As economic growth, labour market conditions, and inflation normalise, the necessity for restrictive monetary policies diminishes. Put simply, current interest rates are too high given the environment of moderate inflation and growth. Consequently, central banks are anticipated to reduce interest rates in the future.

This trend has already started, with the Swiss National Bank being a precursor in March, followed recently by the Bank of Canada and the European Central Bank. As growth and inflation normalise on a global scale, the Fed and other central banks will join this trend and gradually adjust their key rates lower too.

Barring an unexpected economic downturn, the speed and magnitude of this rate cut cycle will likely be gradual and less pronounced than in the past 25 years.

Trend #4

The normalisation of the equity market leadership

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

However, unlike last year's very narrow gains, more sectors, asset classes and regions are participating in the upside. This is a positive sign for the strength and length of the bull market.

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

Trend #5

We also expect a normalisation of volatility

Market volatility has remained subdued so far in 2024. But the outlook for the remainder of the year is less certain. For instance, elections tend to be associated with a perceived risk of greater public sector instability.

As such, we aim to remain nimble, implement portfolio protections and use volatility at our own advantage to build positions at more attractive prices.

Trading insights

The US equities market has experienced a significant shift with the return of retail investors and notable changes in trading patterns. Last May, off-exchange trading volumes reached an all-time high, with 51.60% of all US equities traded occurring off-exchange as of 4:30 PM. This surpasses the previous peak of approximately 50% in January 2021. Data dating back to 2008 underscores the growing influence of retail investors in shaping market dynamics.

A particularly striking trend is the surge in zero-day options trading. Currently, 50% of S&P 500 options traded daily expire in 6.5 hours or less, setting a new record. This indicates a marked shift towards short-term trading strategies among investors, with each trading day evolving into its own unique ecosystem. Investors are now more responsive than ever to immediate market movements and news, reflecting a broader trend of increased market fluidity.

As we approach the summer, there is considerable speculation about whether retail investors will once again favour tech stocks, reminiscent of previous summer rallies. Historically, tech stocks have benefited from seasonal popularity, driven by a combination of positive earnings reports, new product launches, and overall market optimism. Should this trend continue, we can expect increased volatility and trading volumes within the tech sector, presenting both opportunities and challenges for traders.

Adding to the complexity of the market, the upcoming US election looms large. Elections typically bring a degree of uncertainty, which tends to amplify market volatility. Investors will be keenly watching for potential policy changes and their implications across various sectors. From the perspective of a trading desk, it is crucial to prepare for heightened volatility and rapid shifts in market sentiment as election day approaches.

Should there be no clear Presidential winner, markets are likely to experience significant volatility due to increased uncertainty. Investors typically become more risk averse. Prolonged uncertainty, especially if results are contested, can exacerbate market instability, and affect global markets.

Transitioning to international markets

Turning our attention to Europe, the need for a consolidated tape, an electronic system that collects and reports real-time data of stocks that are traded on an exchange, has become increasingly urgent. The current fragmented reporting system, where certain types of liquidity such as principal versus principal trading in Bank SIs and buyside internalisation are not fully captured, creates a misleading perception of low liquidity. This issue is exacerbated by declining on-exchange volumes. Regulators have assured the industry that a consolidated tape is on the way, initially for bonds and subsequently for equities. The benefits are substantial: a consolidated tape would offer a clearer and more accurate picture of market liquidity, thereby enhancing market efficiency and transparency, facilitating better decision-making, and fostering a more competitive market environment.

In parallel with these regulatory changes, bilateral trading is becoming more prevalent in Europe as the buyside shows increasing comfort in direct interactions with market makers. This trend coincides with a growing interest in alternatives to traditional, heavily bilateral traded markets, such as European listed ETFs on exchanges. There is speculation that equity markets might shift towards a model similar to that of FX markets, where bilateral trading predominates, and costs are reduced. However, this model presents challenges. Actionable Indications of Interest (IOIs) are gaining popularity in equity trading but come with the caveat that market makers can refuse trades, resulting in fill rates that, while ideally high, have been declining in FX markets due to market makers aiming for an 'acceptable' fill rate. Additionally, there are concerns regarding the reporting of bilateral liquidity if market makers do not operate a venue or systematic internaliser (SI), potentially leading to gaps in market transparency.

Emerging Markets and Digital Assets

Shifting focus to the EMEA region, emerging markets have experienced a remarkable surge in turnover since 2019, increasing by 99%, in stark contrast to the flat turnover in developed markets on-exchange. Countries like Turkey and Saudi Arabia have been at the forefront of this growth, fuelled by the rise in retail trading, a spate of initial public offerings (IPOs), and advancements in low-latency trading. Saudi Arabia, with its ambitious goal to rank among the top 5 markets by capitalisation (currently 9th), highlights the dynamic and rapidly evolving nature of these markets. This growth trajectory reflects the increasing importance and influence of emerging markets in the global financial landscape, presenting new opportunities and challenges for investors and market participants alike.

On the digital front, the outlook for crypto adoption in the latter half of the year remains positive. Recent 13F filings have disclosed significant bitcoin holdings among professional investors, underscoring a growing institutional interest in cryptocurrencies. As of the latest filings, 937 professional investors collectively hold $11 billion in U.S. Spot Bitcoin ETFs, representing 18.7% of the ETFs' assets under management. This level of investment marks a stark contrast to the early adoption of Gold ETFs, highlighting a more rapid and widespread acceptance of bitcoin.

H2 2024 OUTLOOK

The expected and unexpected surprises of H1 2024

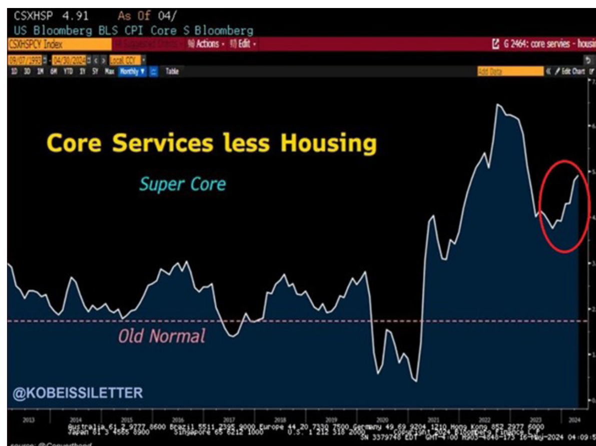
At the end of 2023, we tried our hand of Byron Wien's favourite exercise: trying to identify the top 10 events and surprises that could impact financial markets and global economy in the New Year. As we are getting closer to mid-year, we are seizing the opportunity to perform a sort of health check on the Top 10 surprises 2024. Which of these surprises actually occurred? And what are the events which took place in the first half of the year and that no one was expecting?

Let's start with the 2024 surprises that happened (or at least partially):

Surprise #6

What if inflation were to rise again in 2024?

While the disinflation trend remains in most G7 countries, inflation has been surprisingly resilient in the US, especially on the services side of the economy. For instance, the Supercore CPI (Core inflation less housing) has been up 3 months in a row (before finally pausing in May). The next phase of lowering inflation will be more challenging than the initial decline from the 2022 peak, but it will need support from reduced consumer demand, which we anticipate will happen moving forward.



Source: Bloomberg, The Kobeissi Letter

Surprise #8

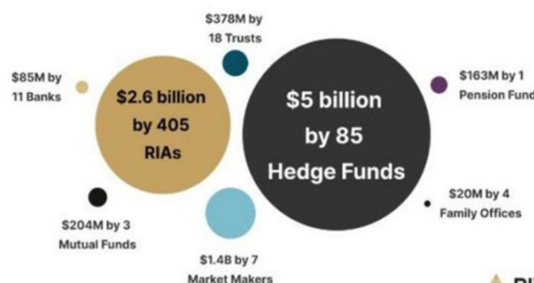
A third candidate enters the US election race

Early April, the independent presidential candidate Robert F. Kennedy Jr. emerged as the wild card of the 2024 election, attracting a motley mix of ideologically diverse supporters, raising piles of cash and drawing legal attacks from Democrats and verbal barrages from Donald Trump. Democrats have been haunted by third-party candidates since 2000, when Ralph Nader, running with the Green Party, was partly blamed for costing Al Gore the election. Fears among Democrats are particularly acute this year, with polls suggesting that Mr. Trump's base of enthusiastic support is stickier than Mr. Biden's.

Surprise #9

Bitcoin soars above $100,000 and enters the wallets of most private banks

This did not happen as bitcoin hit $73,000 in March and has been pulling back since. Nevertheless, this year has so far been 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 and many currencies. 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.



And then there were the REAL surprises, the ones no one saw coming:

- **The Fed held rates steady:** At the start of the year, the consensus amongst economists between 6 and 7 expected Fed rate cuts to take place in 2024, with the first cut happening in March. However, the resilience of the US economy and stubbornly high inflation forced the Fed to postpone the easing of monetary policy. As of now, the market is expecting less than 2 rate cuts to take place in 2024. Despite the hawkish Fed, the S&P 500 – and many markets around the world – are trading at new all-time highs.

- **A very quiet market:** While many analysts were expecting a shaky first half of the year, markets have been surprisingly quiet. It has now been almost 340 days since the S&P 500 recorded a decline of 2% or more--the longest stretch since February 2018. Meanwhile, the VIX (the "fear" index) is hovering near record low levels.

- **The US equity market remains very "narrow":** The AI euphoria continues to provide a continuing tailwind to tech-related stocks and growth shares, which continue to outpace the rest of the market. The Magnificent 7 stocks have officially exceeded $15 trillion in combined market cap for the 1st time ever. The rest of the market has been lagging as the S&P 500 is up nearly 15% while the S&P equal-weight advance is a meagre 5%.

- **Utilities become an AI play:** While utilities is a capital-intensive sector and thus sensitive to high interest rates, it has been the best performing sector so far in 2024. The reason? AI and data centres are driving up electricity usage in the US after a decade of flat demand. As a result, the utilities sector is performing strongly, especially independent power producers.

- **The rebound of Chinese stocks:** Most asset allocators entered the year with a very bearish view and a low – if any – exposure to Chinese stocks. Despite continuing real estate market woes, better than expected macroeconomic numbers have triggered a strong rebound of China stocks at least in the first quarter and has caught the shorts by surprise.

- **The collapse of the yen:** The Japanese yen reached a significant low in H1, weakening to 160 against the US dollar for the first time since 1990. The BoJ faces a complex economic dilemma: managing excessive debt and inflationary pressures with accommodative monetary policies.

- **Commodities are coming back with a vengeance:** The risk of escalation in the Middle East has led to a surge in commodity prices. The Bloomberg Commodities index recorded a sharp rebound during the first 4 months of the year, before slightly pulling back in May/June. . US oil futures surpassed $85 a barrel after tensions in the Middle East escalated, demand forecasts were revised upwards, and risks of supply disruption increased. Copper climbed around 14% to a two-year high of $10,000 per tonne. Against a backdrop of geopolitical uncertainty, gold played its role as a safe haven and inflation hedge. It reached record levels, topping $2,400 an ounce. In addition, China's central bank has been actively accumulating gold, with the aim of diversifying its reserves away from the US dollar.

- **Macron called for a French lower house snap election:** The latest European elections have delivered one main message: voters are increasingly attracted by anti-establishment, populist, far-right parties, that will now hold around 25% of the seats in the European Parliament. In France, this upsurge has even triggered snap national elections. If the *Rassemblement National* performs similarly in the upcoming legislative elections, the risk to France's bonds could intensify, driven by potential shifts in fiscal policy and sustained political uncertainty.

As we enter the second half of the year, let's see if some of the 10 surprises 2024 will still happen. We also expect some unknowns to unfold in the final months of 2024...

US ECONOMY

On track for a smooth soft landing

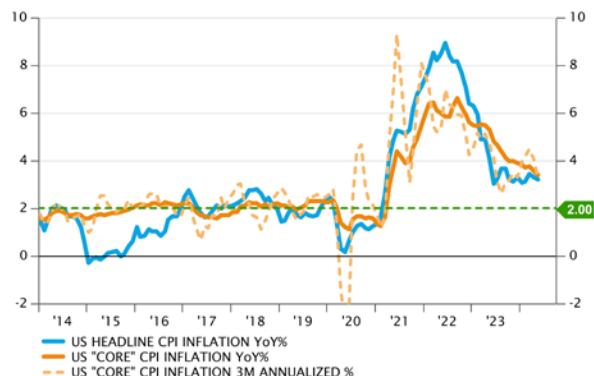
The past couple of weeks have brought useful insights about the US economy. And although pockets of weakness, risks and uncertainties remain, while the Presidential election looms, the general situation today appears to be quite good for the world's largest economy. Business activity remains clearly positive, inflation has resumed a slowing trend after a short-lived unexpected pickup, and the Fed has clear room for easing its monetary policy if needed but has no need to rush neither. The scenario of a smooth, soft landing, where inflation would gently converge toward the Fed target, growth would gently converge toward its long-term potential, and the Fed would eventually gently loosen its monetary policy toward a neutral stance, no longer appears to be a pipe dream.

Inflation has resumed a slowing trend

Inflation had been unexpectedly reaccelerating in the first months of 2024, running at a 4.5% annualized rate during the first quarter. This had stoked concerns that inflationary pressures were stickier than expected, as a still tight labour market, resilient demand for services and sector-specific price dynamics (shelter, motor vehicle insurances) were preventing upward pressures on inflation rates to abate. Even inflation expectations had started to pick up again, highlighting the risk of households starting to anticipate a state of sustainably higher inflation.

Fortunately, those fears have been alleviated by data released over the past month. Yesterday's CPI report pointed to a clear moderation of the inflation dynamic that makes the Q1 reacceleration likely to be a "bump" on the disinflationary road rather than a truly worrying development. While prices of shelter (housing rents) show no sign of slowing down yet, prices of other services have not increased last month, for the first time in more than two years. In the meantime, prices of durable goods continue to decline as they have for more than a year.

Chart 1: Inflation resumes a downward trend after the Q1 rebound

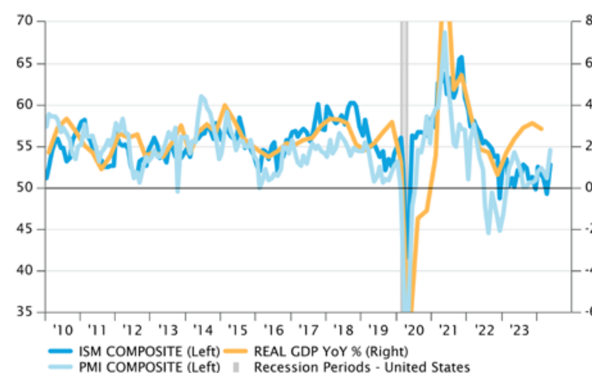


Consequently, the CPI inflation rate fell to 3.3% in May. More importantly, the "core" inflation rate, a better gauge of underlying price dynamics, slowed to its lowest level in three years, at 3.4%. The trend toward lower inflation and softer price pressures therefore remains in place, even if it proves to be a gradual process and even if some sectors still experience persistent price increases. Reassuringly, this appears to be felt by consumers as well, as inflation expectations have recently receded after a Q1 rebound.

Economic growth remains firm, and the labour market normalises

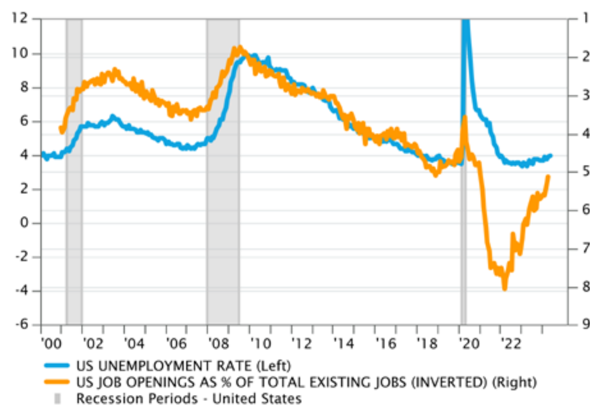
Growth remains firm in the US and recent data have shown no sign of slowdown. The soft GDP growth experienced in Q1 (+1.3%) was mostly due to inventory adjustments and external trade, while domestic demand grew at a healthy +2.5%. And real-time estimates of GDP growth for the second quarter currently point to a solid +3.1% expansion rate. Growth continues to be led by the service sector, as reflected by the strong rebound in the ISM Services in May. A gauge of small business activity (NFIB index) that had drifted to a 10-year low in March has been rebounding over the past two months. PMI indices for the manufacturing and service sectors have improved in May and the PMI Composite is up to its highest level in two years. Quoting the Fed, "economic activity continues to expand at a solid pace".

Chart 2: Activity indicators have picked up in May and GDP growth remains firm



Some recent indicators have pointed to an easing in tensions on the labour market. They suggest that the imbalance between demand and supply for workers that had characterized the US economy since 2021 is now close to being bridged. The perception of households on the job market has also become gradually less upbeat, even if it remains clearly positive. Underlying dynamics within the labour market have also shifted toward more temporary jobs at the expense of full-time contracts.

Chart 3: The post-Covid imbalance of the labour market is close to being solved

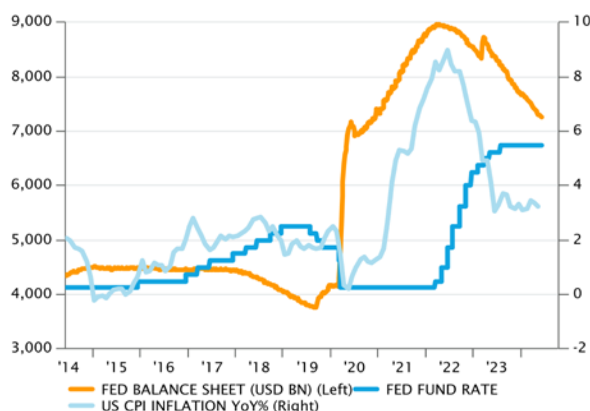


However, those developments shouldn't be seen as worrying for the economic outlook, as they are merely an adjustment from a situation of unprecedented tightness of the job market. Labour shortages in many sectors have been a remarkable feature of the past three years, caused by a combination of lower immigration, demographic dynamics, a change in the relationship with work caused by lockdowns and Work-from-home, and surging demand for service sector jobs. This situation has led to an acceleration in wage growth that has fueled domestic consumption, but also raised inflationary pressures, becoming the key source of concern for the Fed. The current easing of the US labour market is therefore a welcome development as it will contribute to normalize underlying inflationary dynamics. As it stands, it doesn't threaten the growth outlook as employment remains high: job creations continue to be positive and the unemployment rate, at 4%, is still close to its historical lows.

The Fed will cut rates, but it is in no rush

Those developments on inflation and economic activity are probably as close to the perfect set up for the Fed as they could ever be. After having been caught by surprise by the surge in inflation in 2021/22, the Fed has reacted forcefully with an aggressive monetary policy tightening. Short-term rates have been raised from 0.25% to 5.5% in 18 months, the most aggressive rate hike cycle since the 1970's. Some $1.7tn liquidity has been removed in two years via Quantitative Tightening (close to 20% of the Fed's balance sheet at its peak). And unlike in any other monetary policy tightening cycle, it hasn't triggered a recession!

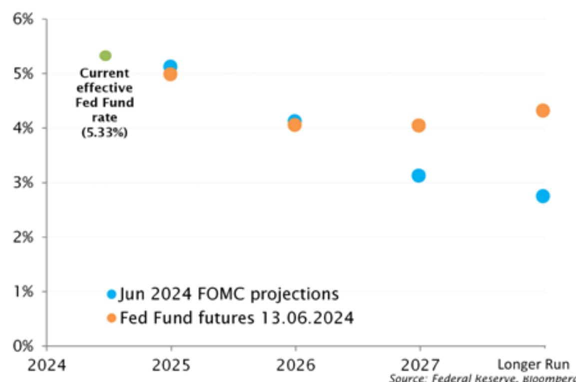
Chart 4: The monetary policy tightening in 2022/23 was a historic one



Last Wednesday, Fed members updated their economic and rate forecasts. And what they expect can be deemed as a "perfect" soft landing, in which economic growth and the unemployment rate will stabilize close to their long-term trend while inflation, that is still above the 2% target, will gradually slow down toward the desired level. The Fed indeed confirmed its forecast of a 2.1% GDP growth in the US this year, followed by 2% growth in 2025 and 2026. It maintained its forecast of an unemployment rate at 4.0% this year and marginally revised up its projection for the following years, at 4.2% and 4.1%. In parallel, inflation forecasts were slightly revised up and point to a more gradual easing in upward price pressures before reaching the 2% target in 2026.

The implications of this economic outlook are clear: no need to rush! While the current monetary policy stance likely is too restrictive if growth and inflation behave as expected in the coming months, there is no evidence yet that it is already spelling troubles for the US economy as a whole (even if some sectors such as real estate are obviously already feeling the pinch of higher rate levels). The Fed can therefore afford to wait for "gaining greater confidence that inflation is moving sustainably toward 2 percent" before reducing its interest rate. This has led almost all FOMC members to reduce the number of rate cuts they expect to implement by the end of the year. While, in March, the majority expected three 25bp cuts in 2024, the median projection is now for only one 25bp cut this year. One of the two "missing" cuts has been postponed to 2025, when median projections are now for four 25bp cuts. And the other one has simply "disappeared", likely a consequence of the resilient growth and slower disinflationary trend mentioned above.

Chart 5: Fed's median rate projections and Future markets' rate pricing

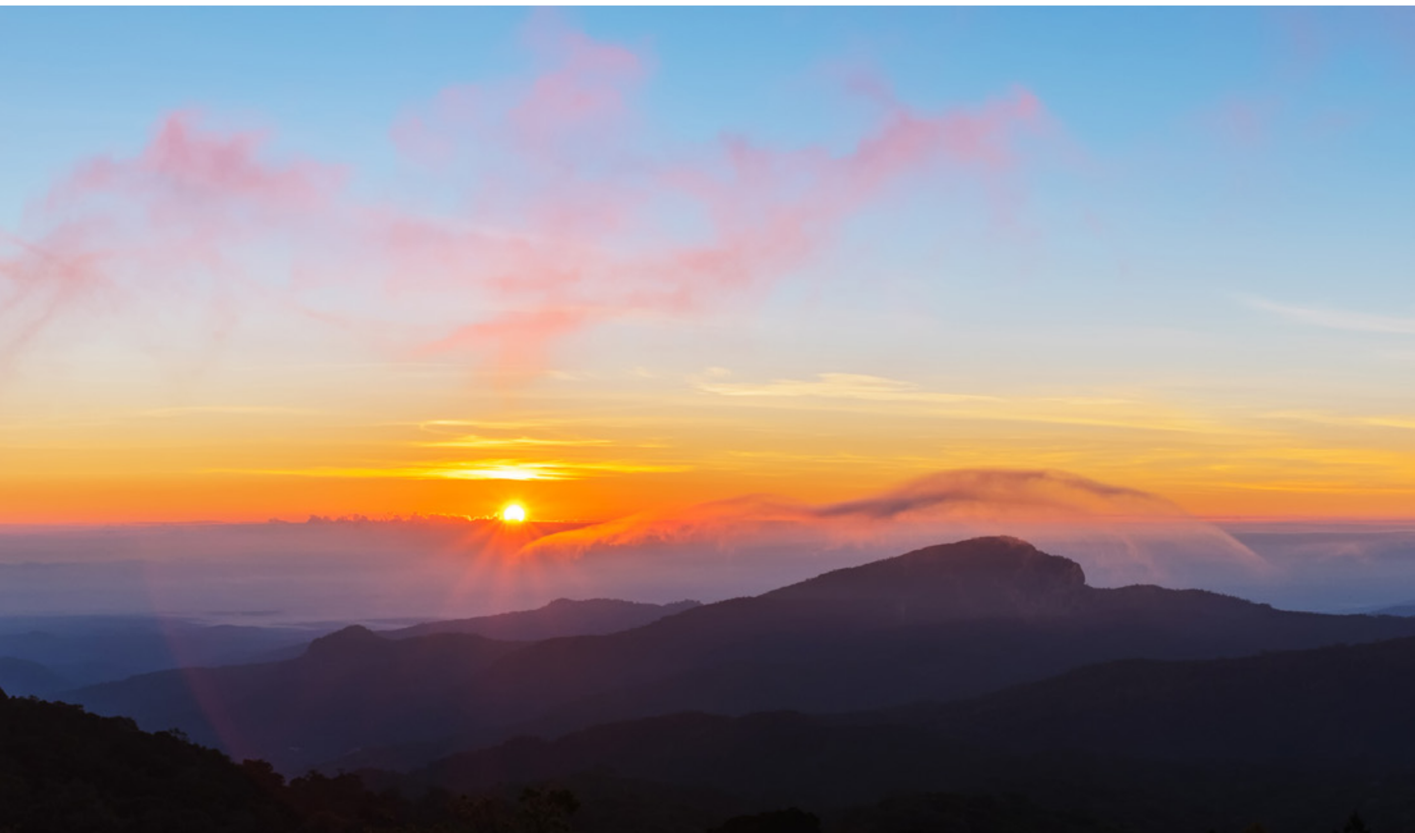


However, the trend remains clearly toward a recalibration of the level of interest rates in the years ahead under the current economic scenario. While revised up yesterday to 2.75% (from 2.5%), the neutral Fed Fund rate is still estimated to be much lower than current rate levels, highlighting the fact that current monetary policy is restrictive for the long run in the US. Financial markets currently hold a different view and do not expect short term rates to decline below 4% in the years ahead. This would imply that the neutral policy rate might have been raised a lot by the various shocks experienced by the US economy in the past four years. It may also reflect an additional premium for the uncertainties around economic policies after the US Presidential election, especially on the fiscal side.

In any case, the latest rate projection adjustments made by the Feddo not alter the big picture: as the US economy continues to grow firmly and inflation gradually slows down, short-term interest rates will have to be lowered. The timing and the magnitude of the rate adjustment will be dictated by the evolution of the economy, as always.

ASSET ALLOCATION

Can the equity bull market continue?



Key takeaways

- We believe global economic growth could soften but will likely remain positive while the disinflation trend should stay in place. This, coupled with monetary and fiscal policy support ahead of the US elections, is creating an attractive backdrop for equity markets in the months ahead.
- Within our opportunistic asset-allocation guidance, we recommend clients to go underweight Fixed Income and overweight US and European stocks while staying underweight Emerging markets stocks. Commodities and Gold are still useful portfolio diversifiers. We are staying long dollars.
- There is one change within our preference grid this month: we increase Government bonds 1-10 years from NEUTRAL to POSITIVE.

THE BIG PICTURE

After a 25% run higher in the S&P 500 over the past six months, the tone in the markets in recent weeks seems to have shifted with global equities moving broadly lower in April and US 10Y yields up roughly 45 bps since the start of the second quarter. Meanwhile, the dollar rallied for the fourth month in a row and gold hit a new all-time-high at $2,400.

What are the main drivers of this equity pullback? In our view, it can be explained by 3 factors.

Source: Bloomberg, MUFG Research

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

As explained in the next sections, the weight of the evidence built on our 5 pillars process points towards a neutral / positive stance towards equities. Positive nominal GDP growth prospects for the months ahead, with reduced downside risks, still warrant a positive assessment of the Macro cycle at that stage. The combination of positive real cash rates and QT, on the one hand, and easy broad financial conditions and expected rate cuts on the other hand, warrants to maintain a neutral assessment on liquidity conditions. Earnings growth is neutral with a positive momentum and earnings revision though much of these revisions are led by a small number of mega cap tech stocks. Equity valuations are not cheap – both on an absolute and relative basis. However, the S&P 500 ex-mag 7 P/E is in line with median historical P/Es, while European stock valuations are still attractive. Market Dynamics (trend, breadth) remain positive. Overall, the weight of the evidence points towards a neutral / positive stance towards equities.

On the rates side, Treasury supply continues to rise and coupled with sticky inflation, are pushing long-dated bond yields higher. We keep our negative view on the 10 years+ Government bonds. We also keep our negative view on Emerging Markets Debt. The downtrend in credit spreads has continued towards multi-year lows. We remain neutral on credit with a preference for quality (investment grade). On an aggregate basis, our fixed income positioning is negative.

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

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

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

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

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

A MACRO & MONETARY POLICY UPDATE

Macro-cycle: POSITIVE (unchanged)

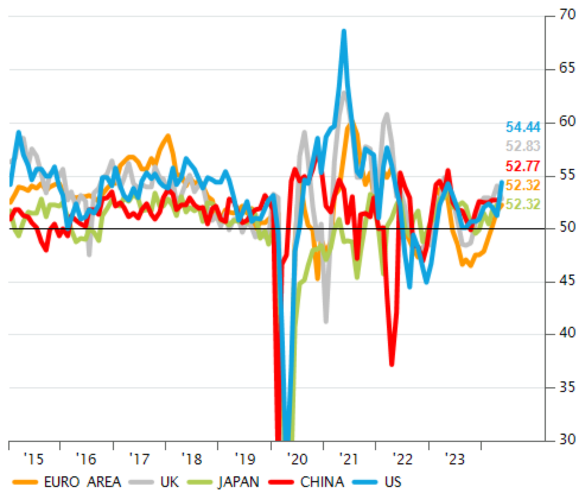
Liquidity: NEUTRAL (unchanged)

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

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

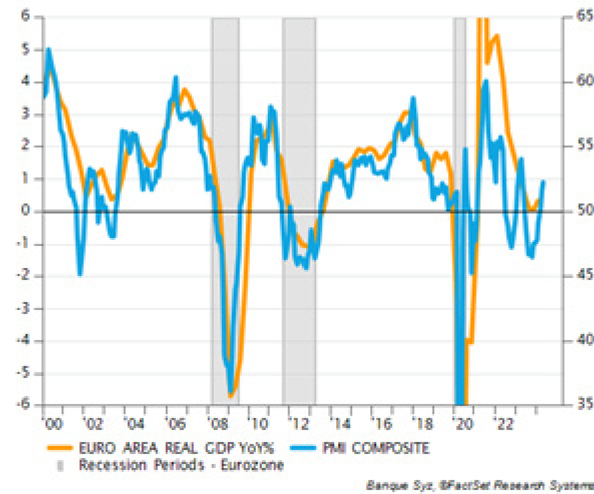
↓ *Global growth is settling on a soft-but-positive rate after two years of slowdown*

PMI Composite by country



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

PMI Composite by country



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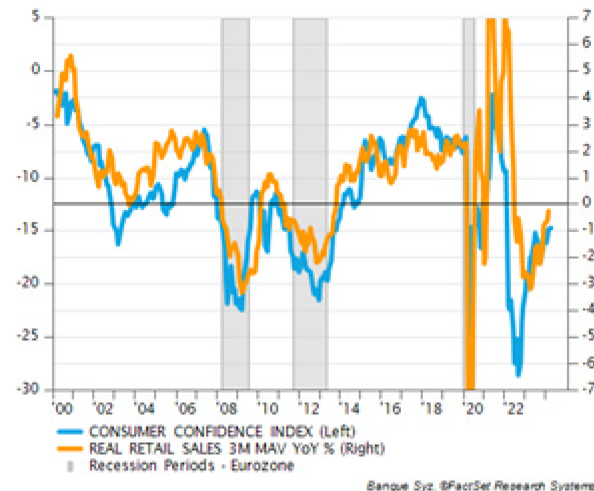
Consumer confidence and Real retail sales YoY%



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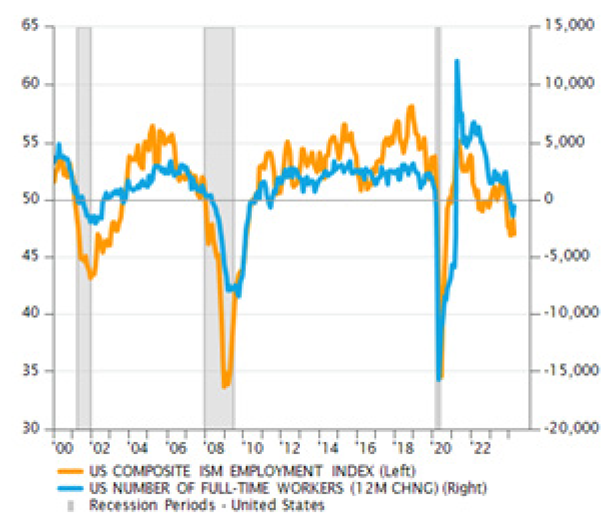
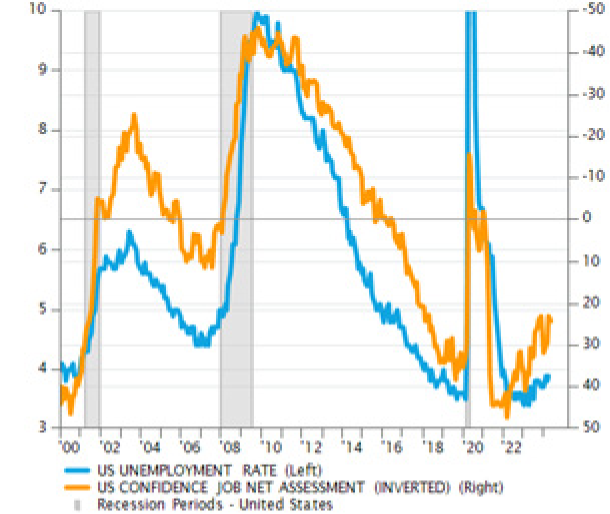
The deterioration in US consumer sentiment is one of them, as rising prices in several goods and services, from gasoline to housing, affect the purchasing power of a growing part of the population. In a context of high interest rates that make the use of credit cards and other forms of credit very expensive,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

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

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



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



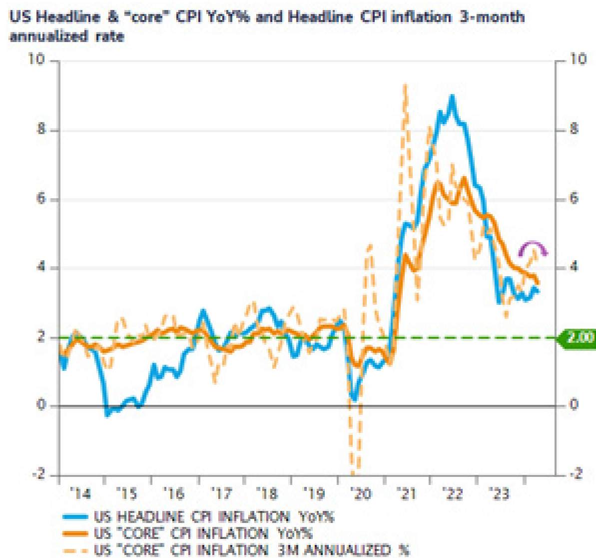
Lingering weakness in China's domestic consumption is also a potential risk for the second half of the year. The world's second largest economy can no longer rely exclusively on external demand for its growth, especially in a context of rising protectionist pressures in its two key export markets (US and Europe). Selective measures to stabilize the real

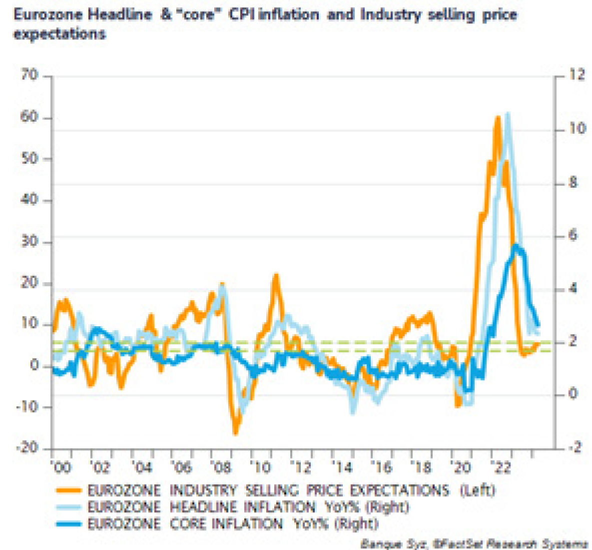
estate market and prospects of rising government support via public debt issuance should help support a recovery in consumption spending, but the domestic momentum is still subdued in China for the time being.

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

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

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





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

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

THE WEIGHT OF THE EVIDENCE

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

Indicators review summary - our five pillars

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

ASSET ALLOCATION VIEWS

EQUITIES

Earnings NEUTRAL (unchanged)

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

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

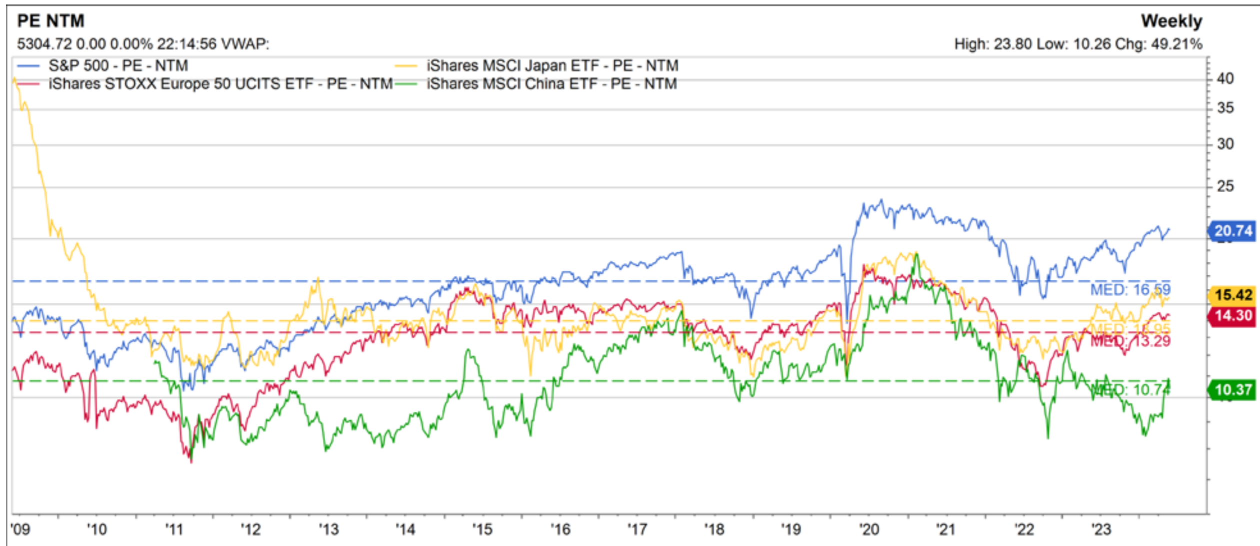
This scenario coupled with an earning growth acceleration next year in the US and Europe is positive for equity markets but, as stated in our macro view, would be challenged should consumption get weaker in the US.

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

Valuation NEUTRAL (unchanged)

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

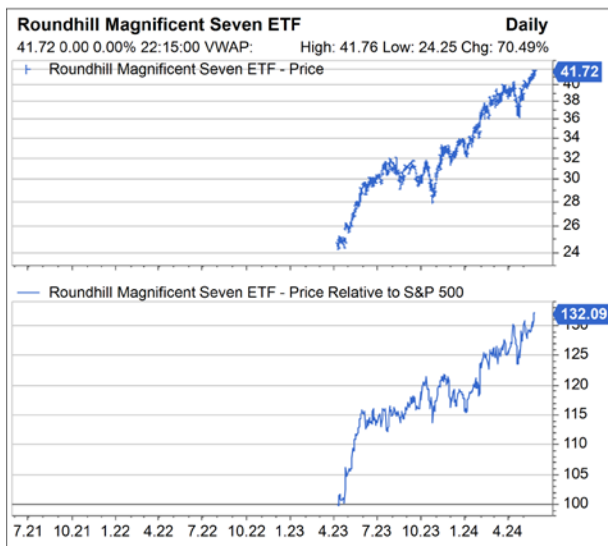
China remains the stand-out with below historical median valuation levels, but the economic outlook remains challenged and earnings are expected to decelerate next year.

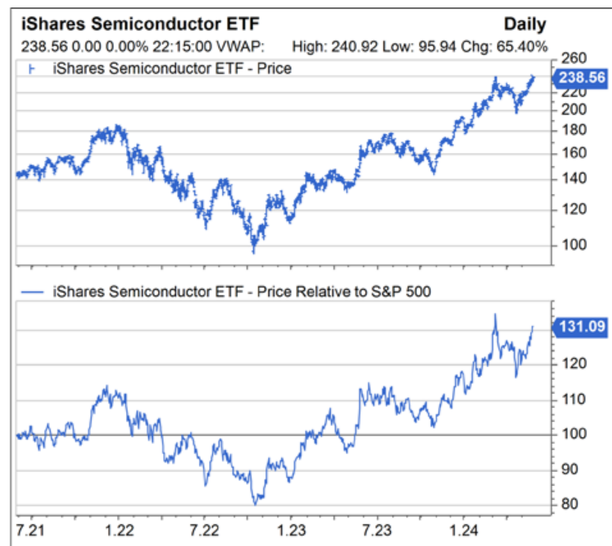


Market trends

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

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





Regions and Sectors

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

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

FIXED INCOME

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

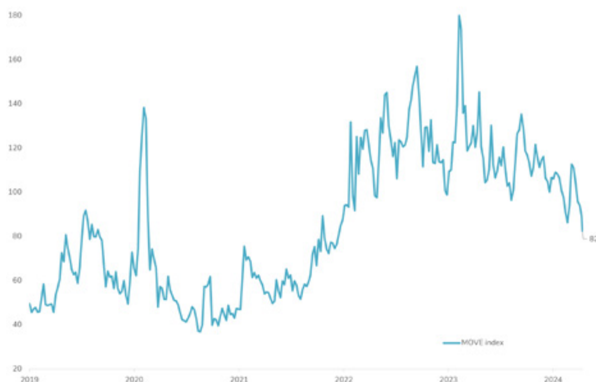
Government Bonds:

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

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

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

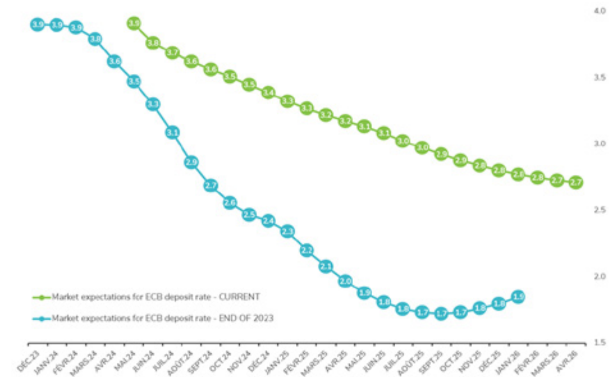
↓ *US Bond Volatility Trends - Lowest Since 2022*



Source: Syz CIO Office, Bloomberg

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

↓ *ECB Monetary Policy Outlook - Market Perception Shifts*

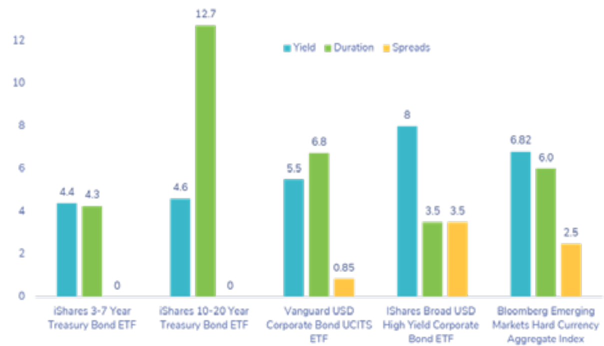


Source: Syz CIO Office, Bloomberg

Corporate Bonds

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

↓ *Breakdown of Yield in Different Fixed Income Segments*



Source: Syz CIO Office, Bloomberg

Emerging Markets

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

Emerging Market Corporate Spread Evolution (in bps)

Source: Syz CIO Office, Bloomberg

FOREX

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

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

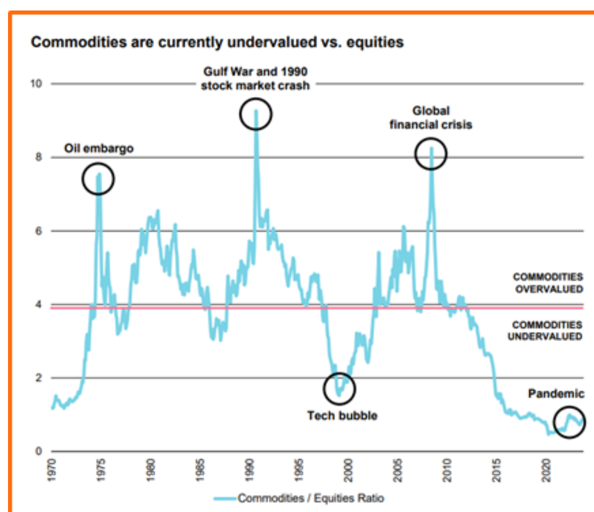
EUR/USD: Rates and macro dynamics are less negative for the EUR, but macro developments importantly also support the USD => our rating is NEGATIVE.

CHF/USD: Fundamentals no longer warrant additional CHF appreciation, and the real rate differential pleads for a firmer USD vs Swiss franc at least in the short run. In the short-term, the USD might benefit from the real interest rate differential (nominal rate - inflation rate) that has recently become more supportive for the greenback: inflation in the US is slowing while short-term nominal rates remain high, which leads to rising real USD rates. As real CHF rates remain broadly stable, a higher real rate differential supports the US dollar => our rating is NEGATIVE.

JPY/USD: It is highly likely that Japanese authorities will intervene as the JPY has been testing the 160 level against the dollar. Nevertheless, there is no guarantee that this intervention will prove effective. The BoJ is "trapped": Japan is experiencing increasing inflation expectations alongside a continuous devaluation of the yen, exhibiting an almost perfectly negative correlation. This reflects the dilemma of an economy burdened by excessive debt, necessitating continuous accommodative monetary policies in the face of structural inflationary pressures. If Japan wants to slow its FX devaluation, they could raise rates. However, that would greatly increase their deficit, which the BOJ would have to monetize, and thus accelerate money supply growth => our rating is NEUTRAL.

ALTERNATIVES

We remain positive on gold, which continues to exhibit low volatility with other asset classes and should be a beneficiary of any tail risk event. We note that a significant gap remains between gold and real yields. Why? 1) With debt sustainability having become an ever-increasing issue, the market anticipates that real interest rates cannot stay at this level for too long; 2) Investors buy gold asinsurance against adverse circumstances (inflation, recession, etc.) 3) There is heavy demand stemming from central banks, especially in emerging markets.



Source: Vontobel

We are keeping a positive stance on commodities as a portfolio diversifier and protection against inflation upside. Commodity prices are moving higher, driven by strong US growth, geopolitical uncertainty, segmentation of global trade and AI demand for energy. We also note that Commodities relative to equities currently stand at a near record low.

INVESTMENT CONCLUSIONS

TACTICAL ASSET ALLOCATION (TAA) DECISIONS– 27.05.2024

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

There is one change within our preference grid this month:

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

ASSET ALLOCATION GRID

TACTICAL POSITIONING: OUR ASSET ALLOCATION MATRIX

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

Change from last month: More attractive Less attractive *Source: Investment strategy group - 27 May 2024*

EUROPE

EU parliamentary elections: what you need to know

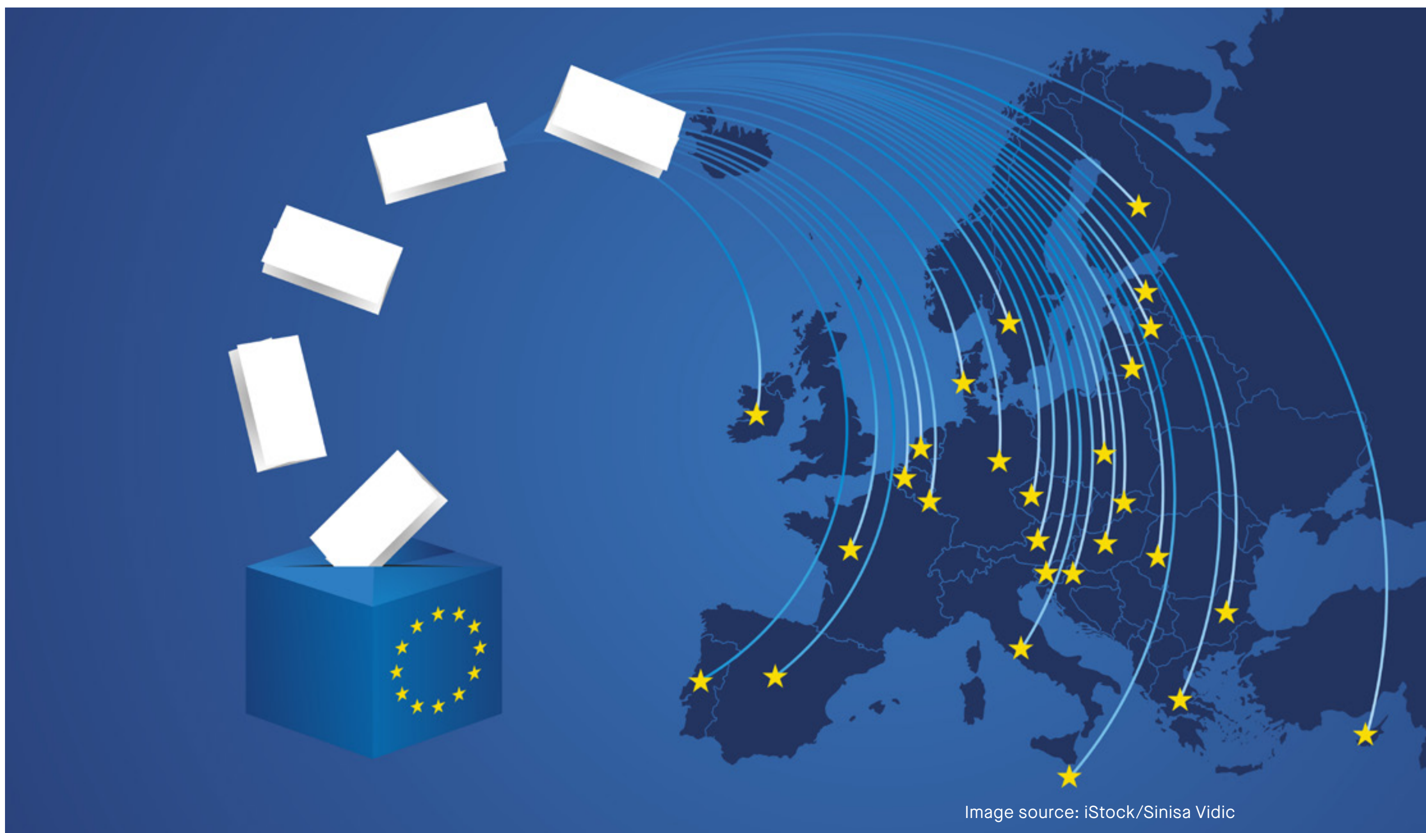


Image source: iStock/Sinisa Vidic

The long view

The latest European elections have delivered one main message: voters are increasingly attracted by anti-establishment, populist, far-right parties, that will now hold around 25% of the seats in the European Parliament. In France, this upsurge has even triggered snap national elections.

From an economic standpoint, the short-term impact of this elections might be limited at the European level. However, this dynamic further undermines one guiding principle upon which European economic policies have been built: fiscal orthodoxy.

The recent years have altered the people's perception toward public finances. It had long been generally accepted (even if never very popular) that sound public finances was necessary. But the public spending bonanza of the Covid years, the war in Ukraine and the ensuing inflationary wave have shifted the focus away from public finance sustainability.

In this context, the new EU Parliament, and more importantly most European governments, appear unlikely to implement significant public spending cuts and higher taxes, that may yet be necessary to drive back government deficits toward sustainable levels.

One can therefore expect public debt to continue surging in euro terms in the coming years. It will also likely increase as a percentage of GDP, driven by rising interest payments on public debt due to higher interest rates. A rating agency downgrade looms, as recently experienced by France.

Paradoxically, inflation both drives and results from fiscal overspending. Accommodative fiscal policies are likely to sustain inflationary pressures by keeping final demand firm and preventing downward adjustments in prices after the surge of 2021/22. This may lead to persisting inflationary pressures that will further reinforce the appeal of populist policies and may force the European Central Bank (ECB) to maintain rates at a “high” level.

In this sense, last Sunday’s results may signal a continuing long-term trend of escalating public deficits and debt, rising inflation, and increasing interest rates. It’s not entirely surprising that a growing portion of the population is supporting these economic policies. Inflation can be a powerful and tempting way to reallocate wealth, away from creditors and capital owners, and toward debtors and workers provided wages rise in parallel of prices. Unfortunately, history has shown that the long-term economic consequences of such dynamic are always dire.

European equities: reasons to be fearful, reasons to be cheerful

The European election results show that the world is becoming more fragmented after decades of globalization. To counteract the negative impact on growth, we resort to increased government spending. This leads to higher inflation and more regulation.

While this backdrop is less favourable for asset prices, equities remain attractive in this low growth and inflationary environment. Effectively, as long as we avoid outright deflation, corporate profits are geared to nominal growth and therefore provide a hedge against inflation. In addition, contrary to debt that we have plenty and we keep issuing, high quality equities are getting scarcer as the concentration of profit is increasing and the corporate share buy-backs are reducing the supply.

As the world is getting more fragmented, it is important to look at businesses that can adapt to this new environment. This means businesses that are more local or regional and/or with very strong competitive advantages. On the other hand, investors should be cautious investing in heavily regulated industries as visibility may decrease.

Fixed income: OAT spreads on the rise while credit spreads remain well behaved

One of the main lessons from the recent European elections is that higher interest rates are here to stay for the foreseeable future. The initial market reaction was an increase in interest rates across European countries, with 10-year EUR government yields rising by an average of 10 basis points (bps). France, in particular, saw a significant impact after the announcement of snap elections, with its 10-year OAT yield increasing by nearly 20 bps to reach a yearly high.

While government bonds were notably affected, the credit market remained relatively stable. The iTraxx Europe Main index, which tracks investment-grade European credit, only rose by 2 bps. The iTraxx XOVER index, which tracks high-yield European companies, increased by 5 bps, remaining well-contained. The only sector that saw a notable decline was AT1 bonds, the most subordinated part of a bank’s capital structure after equity, which dropped by 0.6% over two trading sessions.

This situation calls for caution. Potential rating downgrades for France could put more pressure on government bonds, especially as major investors, like those in Japan, find more attractive opportunities in their domestic markets. We have been underweight on fixed income for some time now, especially on long-term government bonds, due to the inverted yield curve, negative term premium, high interest rate volatility, and large supply. We continue to hold this position.

Additionally, political risk is a major concern in 2024, with many elections happening around the world. Given the current political uncertainty, recent credit rating downgrades, and the possibility of more downgrades, along with fiscal policies under a new government, we prefer to avoid OATs for now. The increased risk and volatility in France’s fixed income market make OATs less attractive.

Forex: Euro is (again) under pressure

As the consequences of the rise in anti-establishment parties will only be felt over the medium-to-long run in the economy, the initial reaction to the European elections was rather muted on Forex markets. The modest decline in the EUR/USD and EUR/CHF exchange rate (-0.6% in the following two days) may rather be linked to the uncertainty created by France’s snap elections than by the EU level election results.

Over the medium term, an environment of higher inflation and rising public debt is certainly negative for any currency and the euro will be no exception. However, as inflation and public debt dynamics are not specific to Europe, but rather a global trend among most developed economies, other currencies will also face similar headwinds in the future. In the US, fiscal policy is likely to remain expansive regardless of who wins the next Presidential election, which could weaken the US dollar’s fundamentals under the next Administration.

As such, exchange rates between currencies may not be the best barometer of the impact of those long-term economic trends, except for the rare economies that don’t give in to the siren calls of rising public debt and inflation (Switzerland being the best example). Gold is likely to be a better gauge of the erosion in currencies’ value caused by this trend. The yellow metal was up +1.6% versus the euro in the two days following the European elections.

For the time being, we continue to hold a negative view on the EUR vs USD. Political uncertainty in Europe adds to the existing dynamic of rate differentials between the ECB and the Fed, as the ECB has started to cut rates ahead of its US counterpart.

We also continue to hold a positive view on Gold, for the diversification that it brings in portfolios and for the hedge it can offer, precisely when inflation and public deficits become more structural.

DIGITAL ASSETS

Lugano, Europe's crypto hub?

Introduction

Thanks to numerous strategic partnerships and visionary local players, Ticino's largest city is establishing itself as a European cryptocurrency and blockchain capital.

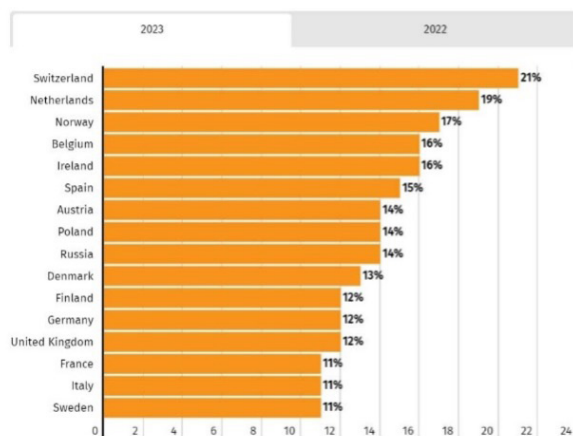
It is one of the sunniest places in Switzerland. Located between the metropolitan areas of Milan and Zurich, Lugano is the ideal place to work and live. Beyond its stunning natural landscapes and strategic importance, the economic capital of Italian-speaking Switzerland is making a name for itself in the world of cryptocurrency. Under the leadership of Mayor Michele Foletti, Deputy chief financial officer, Paolo Bortolin and with key insights from Paolo Ardoino, Chief Executive Officer of Tether, the City of Lugano offers a unique cryptocurrency experience.

« Plan B » - B like Bitcoin

In Switzerland, the City of Zug is known as the “Crypto Valley”, being home to about half of Switzerland’s crypto start-ups. The city of Lugano is not just trying to outshine Zug, it is setting its sights higher, aiming to become the European capital of cryptocurrencies. Lugano's bold ambition is supported by a key partnership with Tether, the company behind the world’s biggest stablecoin, Tether, who is leading the charge in shaping the city's technological future through a project known as "Plan B."

European countries with the highest share of respondents who either owned or used cryptocurrencies in 2022 and 2023

Source: Statista Consumer Insights



Source: Financial Mirror, Statista

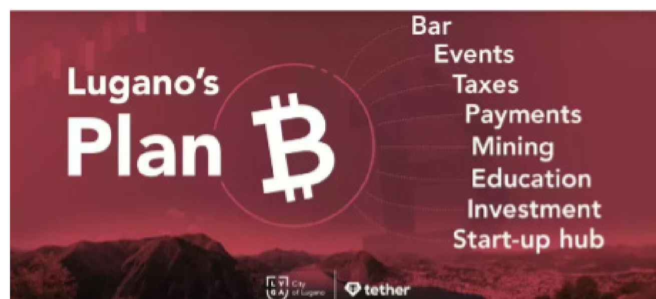
"Plan B" ("B" written like the Bitcoin logo) is a strategic initiative between Lugano and Tether. The goal: to use Bitcoin technology to completely reshape the city's financial system. The initiative aims to deeply integrate blockchain into the daily lives of the people of Ticino. The plan includes purchases in local shops, museum entrance tickets, but also tax payments, naturalisation fees and even funeral expenses. To facilitate this, the citizens of Ticino and Tether have introduced two major financings: a CHF 100 million investment aimed at attracting blockchain startups to the city, and a CHF 3 million fund designed to help local businesses adapt to a cryptocurrency-powered economy. The collaboration led to the development of 3Achain, an institutional blockchain platform that supports financial transactions.

Lugano's first venture into the cryptocurrency world began in 2020, during the Covid-19 pandemic, when it introduced the LVGA stablecoin, a loyalty points system designed to stimulate local economic activity. These points are collected in a blockchain-based digital wallet within the "MyLugano" app, can be spent on a wide range of goods and services throughout the city and provides a 10% cashback on each transaction. The LVGA token is linked to the Swiss franc, is regulated by FINMA, but can only be spent in Lugano's local businesses and leisure spaces and cannot be bought or traded on cryptocurrency exchange platforms.

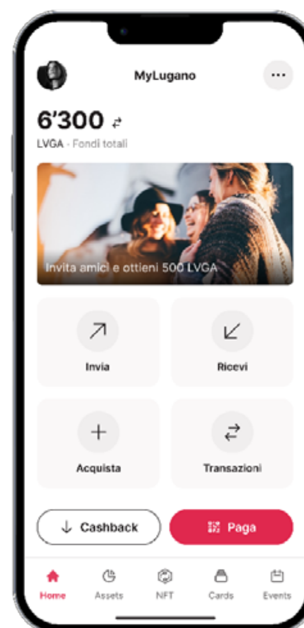
Lugano and Tether have partnered with GoCrypto to implement the payment system in the city. This system supports transactions in Bitcoin Lightning, USDT and LVGA. They have introduced a point-of-sale (POS) system that merchants can use for in-store and mobile app transactions. The "onboarding" process is simplified, and transactions are completed very fast (in just 4 to 6 seconds) thanks to the use of the Bitcoin Lightning network (a second-layer protocol built on Bitcoin's primary blockchain). This enables nearly instantaneous secure transactions at no cost.

In addition, the city is committed to fostering educational opportunities through the "Plan B Summer School", a collaboration with local universities and research institutes.

There is also the "Plan B Forum", an annual conference that brings together leading cryptocurrency experts every October.



Source: Plan B



Source: MyLugano

In Lugano, you can pay your taxes in cryptocurrencies

Following successful cryptocurrency municipality payment integrations in Zug and Zermatt, the City of Lugano broadened its payment options by allowing businesses and citizens to pay all types of municipal charges, including taxes, fines, and naturalisation fees with cryptocurrencies. Invoices can be settled in bitcoin (BTC) and tether (USDT), with no upper limit on the amount.

Bitcoin Suisse, a Zug-based company recognised for its expertise in processing cryptocurrency payments, handles the technical aspects of the transactions. This partnership ensures a seamless and automated payment process. The procedure is simple: taxpayers scan the Swiss QR-bill on their invoices or access the official Lugano payment page, select the type of cryptocurrency (BTC or USDT) and pay.

Payments are processed the following day (T+1). However, should there be a need to refund an invoice paid in cryptocurrency, the refund will be issued solely in Swiss Francs. Any exchange fees, losses, or payment charges incurred during the transaction will not be reimbursed.

As stated by the FAQs section on www.lugano.ch/crypto, the City of Lugano “does not manage cryptocurrency treasury” and that “any amount paid in cryptocurrency will be immediately converted into Swiss francs.” Lugano’s deputy chief financial officer, Paolo Bortolin describes Lugano as “pioneers” at a municipality level. He told Global Government Fintech: “Our internal accounting services will not even notice somebody paid in crypto. It is a full adoption [of crypto payments] with full automation of all processes.”

A blockchain bond

In 2023, Lugano issued its first native digital bond, a 6-year senior unsecured bond for a notional amount of CHF100 million and with maturity in 2029. In 2024, Lugano launched its second blockchain bond, also for CHF100 million, this time as part of the Swiss National Bank's "Project Helvetia". The project explores the use of a central bank digital currency (CBDC) to settle transactions on the SIX Digital Exchange (SDX).

The latest blockchain bond issuance, “part of the city’s usual capital-raising on the financial markets”, was carried out in collaboration with Zürcher Kantonalbank (ZKB), Basler Kantonalbank, and J Safra Sarasin serving as joint lead managers. The instrument has a 10-year maturity and a coupon rate of 1.415%. ZKB reported that the order book closed in just 17 minutes, with the largest single allocation, being CHF 8 million. Nearly half was attributed to asset managers, then banks, insurers, and pension funds.

Similar to Lugano’s first digital bond, the bond is dual-listed, available both on SDX's blockchain platform and the traditional SIX Swiss Exchange. This allows investors to engage without needing blockchain access directly.

Moody’s has rated the bond 'Aa3', equivalent to Lugano's traditional bonds. In his announcement, Mayor Michele Foletti emphasised the significance of this step for the public sector and encouraged other public entities to adopt this innovative method of issuance.

“One thing that is certain is that we will continue to issue digital bonds.” – Paolo Bortolin

Lugano ties its crypto city dream to Tether

Tether is partnering with the city of Lugano to demonstrate the real-world use of blockchain technologies by applying them concretely to the region's local communities under Plan B. Despite Tether not receiving direct financial compensation from the city, the partnership is seen by Paolo Ardoino, Tether's CEO (pictured below), as a form of “philanthropy”, benefiting both Tether and the global crypto ecosystem in the long run. Fostering broader crypto acceptance globally through initiatives like Plan B will end up in Tether and its parent company, the cryptocurrency exchange Bitfinex, having more business. It is a “win-win” situation for Tether and the industry at large. Tether is not headquartered in Switzerland but has relocated part of its operations to Lugano and is actively recruiting staff dedicated to this partnership.

Source: laRegione

"If you build it, they will come"

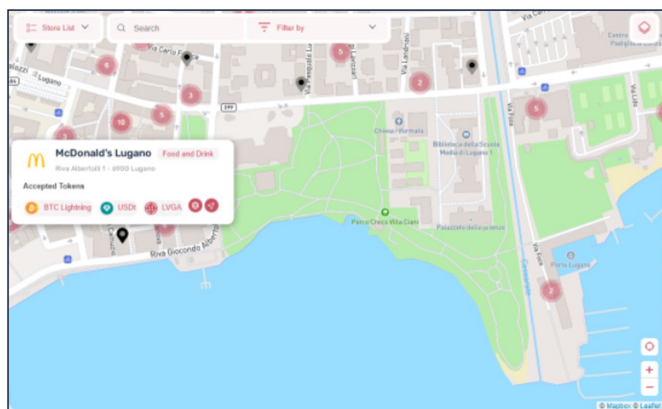
In 2021, El Salvador made history by becoming the first country to recognise bitcoin as an official currency. This forced local merchants to accept bitcoin as a means of payment. Unlike El Salvador's directive approach, Lugano is taking a more voluntary path to encourage the adoption of

bitcoin and other cryptocurrencies among local merchants. Plan B offers merchants three options: continue as usual with no changes, accept a free crypto-enabled POS terminal from the local government, or wait for their existing POS systems to be upgraded to support cryptocurrency transactions. Merchants can configure these terminals to automatically convert crypto transactions into Swiss-francs or keep a portion in cryptocurrencies.

Plan B counts nearly 400 merchants in Lugano that accept bitcoin, tether, or LVGA. This includes prominent businesses like McDonald's. Already, more than a third of the population uses the MyLugano wallet, with 8,000 monthly transactions processed on the 3Achain. Ardoino hopes that by the end of 2025, when Lugano's four-year contract with Tether is due for renewal, all the city's merchants will be "bitcoiners."

The city's strategy is drawing international attention too. Within a month of unveiling Plan B, numerous companies began relocating to Lugano, bringing with them substantial assets from diverse regions like Zug, Dubai, and Italy. Polygon, the entity behind the MATIC cryptocurrency, has even moved several subsidiaries to Lugano, becoming a key infrastructure partner in Plan B.

Beyond boosting business, Lugano is also investing in its people. The city plans to offer 500 scholarships at its universities, covering a range of programmes from computer science to financial risk management, all designed to prepare students for careers in the field of blockchain technology. This educational push ensures that Lugano is not just a place where technology is used, but also a place where future leaders in blockchain are educated, fostering a community that's as informed as it is innovative.



Source: Map of merchants accepting cryptocurrencies in Lugano, PlanB.lugano

Conclusion

Lugano is quickly heading towards its dream of becoming the European capital of cryptocurrencies. These innovative initiatives by a Swiss city give credibility to the cryptocurrency world and are likely to inspire other cities to explore similar pathways to integrate digital finance into their economies.

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