MARKETING DOCUMENT | MARCH 2024

UBP House View

UBP

Union Bancaire Privée

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Is it still wise to hold US technology stocks?

As earnings season comes to an end, US tech companies have demonstrated strong results, beating earnings expectations and propelling the Nasdaq Composite higher by 6.18% since the beginning of the year.

As valuations soar and the Nasdaq Composite hit an all-time record, investors may wonder if tech companies still represent worthwhile investments.

Given their anticipated 16% increase in earnings per share for 2024 (rising from 9% in 2023), the remarkable performance of the sector appears justified. Additionally, earnings per share are higher than those in other segments of the market. Coupled with a resilient US economic backdrop, these dynamics support our decision for a substantial allocation to US tech names, with a preference for cloud computing, software and AI-related stocks.

Meanwhile, in Asia, Japan, which has remained one of our strongest convictions since November, has now reached its highest level since 1989 after an unprecedentedly long recovery. We continue to hold a positive view on this market.

In emerging markets, we favour the Indian market over that of China, which is encountering uncertainties and economic headwinds. Furthermore, India is more likely to redistribute value to shareholders, making it a compelling alternative for investors seeking exposure to emerging market growth.

Last, we increased our position on gold, firmly believing in the strength of its fundamentals. The continued demand from central banks, coupled with geopolitical uncertainties, is expected to drive the value of the yellow metal upwards.

Key Takeaways

1 ECONOMIC EXPANSION

Global growth looks set to reach 3% in 2024, remaining resilient thanks, in part, to a stronger contribution from the US.

2 GOLD

We tactically increased our exposure to gold, believing in the strength of its fundamentals.

3 EQUITIES

US tech companies have demonstrated strong results, beating earnings expectations.

With a preference for cloud computing, software and AI-related names, they remain our strongest convictions, as do Japanese equities.

We have slightly increased our exposure to emerging markets through India, as the country offers the most attractive investment case in the long term.

The opinions expressed in this document are as at 5 March 2024 and are subject to change without notice.

Macroeconomic environment

The rise of India as Asia's new growth frontier has only just started

Global growth looks set to reach 3% in 2024; it remains resilient thanks, in part, to a stronger contribution from the United States. Although some moderation is expected in the coming quarters, US growth should continue to outperform other developed markets.

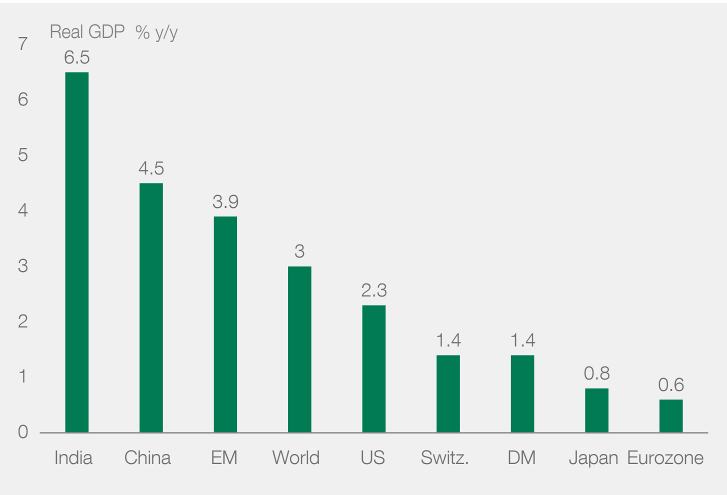
US inflation disappointed at the start of the year due to the resilience in services. However, disinflation should continue in the months ahead, albeit at a slower pace. Money market expectations for rate cuts have been readjusted and are now more in line with our scenario of an initial rate cut in June.

Among emerging markets, China benefited from a surge in demand during the Lunar New Year, but real estate remains a major constraint. Meanwhile, India is on a solid secular growth trajectory, benefiting from an industrial rebound and sustained domestic demand.

India emerges as Asia's new growth frontier

India's economy is expected to expand by 6.5% in 2024. Although that marks a modest change compared with 7.6% in 2023, the country should outpace other emerging markets in 2024.

2024 GDP GROWTH ESTIMATES: PRINCIPAL ECONOMIES



Source: UBP

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Activity was led by a recovery in domestic consumption, which accounts for nearly 70% of India's GDP, as well as double-digit manufacturing growth. India is benefitting from structural tailwinds that may enable the economy to shift towards higher potential growth of around 7.0% in the next decade.

Furthermore, India surpassed China to become the world's most populous country in 2023 with 1.4 billion people, but urbanisation rates remain surprisingly low.

The prospects of more people moving to cities will require enormous investment in infrastructure and housing. Moreover, this move would come in parallel with a rising trend in incomes and would support the burgeoning of the middle classes.

Structural reforms set to consolidate domestic demand

To capitalise on India's structural tailwinds, Prime Minister Narendra Modi launched an ambitious reform package in 2014 called "Modinomics". While a general election is expected to be held in this spring, it seems safe to assume that the reforms are most likely to continue.

The "Make in India" strategy is expected to attract global manufacturing operations

As productivity is low, the government plans to boost human resources through improved access to education. The country has also launched a digitalisation drive which aims to improve internet penetration rates. On the capital front, Modi's objective to become a "developed nation" by 2047 will require infrastructure growth of around 8.0% per annum.

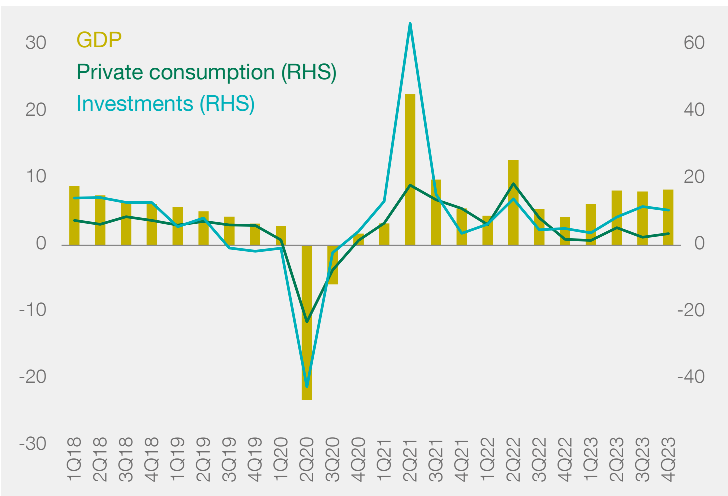
Under Modi's "Make in India" strategy, which targets capital expenditure growth in manufacturing of 12–14% per annum, multinational companies are also being offered attractive incentives to relocate their operations to India.

Policy settings to become more accommodative

Inflation declined to 5.1% y/y in January, in line with Reserve Bank of India's (RBI) 2–6% tolerance band. India will benefit from global disinflationary pressures, as it remains a large net energy importer and the government has taken measures to prevent food price overshoots. We expect that India will see its inflation differential with peers narrow, providing better visibility for investors. As a result, the RBI will remain "hands-off" throughout the first half of 2024 and it should cut key rates by 25–50 basis points in the second half of the year.

Lastly, global geopolitical shifts are expected to benefit India. In contrast to other Asian countries, India is not heavily exposed to slower demand from China. Moreover, its political system and incentives to attract foreign direct investment should help the country to capture a larger share of global value chains.

INDIA: GDP AND ITS MAIN COMPONENTS (Y/Y%)



Sources: CSO, Bloomberg Finance L.P., UBP

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Strategy

NEAR-TERM HEADWINDS, MEDIUM-TERM TAILWINDS

Since mid-2023, various tailwinds have been driving global equities higher. Yet, as February unfolded, some of these driving forces began to fade, temporarily, we expect, creating a more challenging landscape for investors as we move through spring.

To begin with, the re-rating of US equity valuations relative to bond yields on the back of positive real interest rates seems complete. This adjustment has contributed to almost 40% of the total returns since mid-2023.

A summer rate-cutting cycle is a catalyst for the next leg for equities

Currently, US equities' earnings yields (the inverse of the price-earnings ratio) are trading in line with US 10-year yields. This alignment was prevalent prior to the quantitative easing cycle that spanned from 2008 to 2021 and the era of negative real interest rates. The valuation adjustment that started with the Federal Reserve's rate-hiking cycle in March 2022 should end the re-rating of US equities relative to US bond yields and leave investors focused on earnings recovery to drive the next leg of the market's ascent.

Furthermore, the liquidity boost that has driven US and global equities up from their October lows might see a drain of as much as USD 100 billion as we move into March 2024. This shift would represent the first temporary challenge for the markets since late summer 2023, when investors faced a 10% market correction within the broader context of a bull market. By June, however, investors should expect the liquidity tailwind to return as we move into the November 2024 US elections.

Moreover, while the industrial rebound we noted in October 2023 is materialising, the nearly 25% rally from the S&P 500's October lows surpasses any 6-month rally during a bottoming in the industrial cycle since 1971, with the exception of the rally following the 1982 US recession. This suggests that the initial surprise effect of the rebound is already reflected in equity market prices.

Encouragingly, the approaching close to a robust earnings season, alongside the unfolding of an expected industrial rebound, indicates that further earnings upgrades could be on the horizon later in 2024. The catalyst for these earnings upgrades, we expect, will be the start of the US rate-cutting cycle (which we expect to begin over the summer), underpinning a wider recovery in the economy and earnings in the second semester. Despite the near-term headwinds mentioned above, we are maintaining our strategic stance on US equities relative to global equities given the premium earnings growth offered relative to the rest of the world.

Asset allocation

1

Global equities outperformed all asset classes during the month with a 4.3% return (MSCI ACWI)

2

We increased our exposure to gold via a reduction in fixed income, which is facing headwinds due to slowing disinflation

3

Performance dispersion between EM countries remains significant and India probably offers the most attractive investment case over the long term

INCREASING GOLD EXPOSURE

The macroeconomic backdrop remained supportive in February, despite slowing disinflation trends in the US. The latter impeded the rally observed in bond markets since the end of October, with the asset class registering negative returns over the month (Barclays Global Aggregate Total Return -1.4%). Global equities outperformed all asset classes during the month with a 4.3% return (MSCI ACWI), with hedge funds also delivering positive returns (0.9%), while gold traded sideways. We carried out two main changes to our asset allocation (USD balanced) in February: increasing our exposure to gold and initiating a position in Indian equities.

We tactically and significantly increased exposure to gold ahead of the upcoming shift from central banks to start lowering interest rates and ending their quantitative tightening programmes (in place since April 2022). Our strong conviction on gold is now our largest tactical bet alongside technology and Japanese equities, which remain our largest strategic convictions. We funded the increase in exposure to gold via a reduction in fixed income, as the latter may continue to face headwinds in the short term owing to slowing disinflation trends. In the longer term, elevated interest rates still make fixed-income instruments an attractive asset class for portfolios.

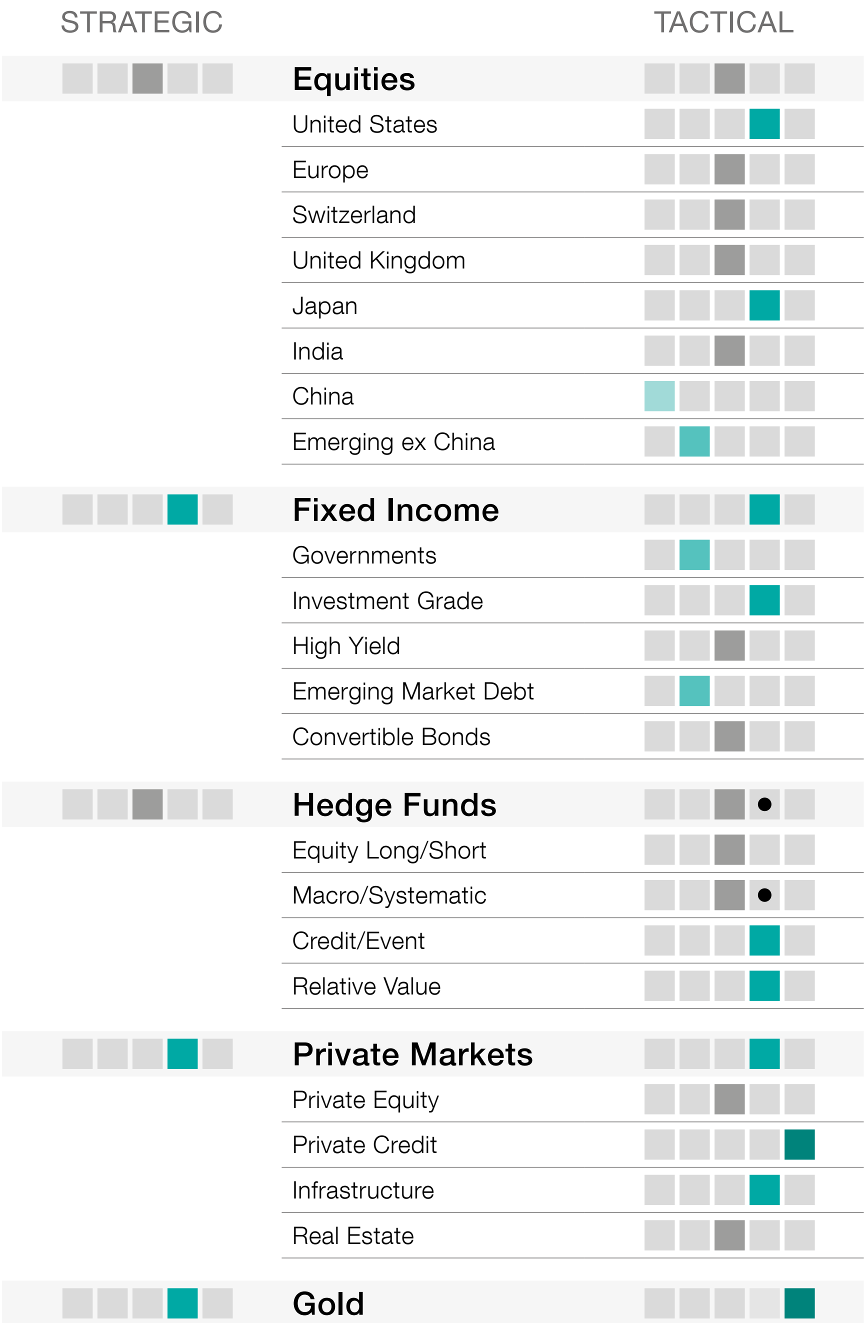
Within equities, we maintain our strategic and long-term allocations to US technology & software, and Japanese equities. Nevertheless, we recognise that a short-term pause in the current equity market rally is needed. Within emerging markets, we initiated a 1% position in Indian equities which have demonstrated a 20-year track record of delivering 10–12% annual returns (in USD). This increases our exposure to emerging markets from 2% to 3%, but we maintain a relatively low allocation and conviction level to the sub-asset class. Performance dispersion between EM countries remains significant and India probably offers the most attractive investment case over the long term, despite elevated valuations. Economic growth in India is set to remain strong under the expected re-election of Prime Minister Modi who will continue to carry out market-friendly economic reforms, allowing the transmission of economic growth into earnings growth to continue.

Directional views

LOW CONVICTION | BASE LINE ALLOCATION | HIGH CONVICTION

PREVIOUS VIEW ● (no dot means no change)

Strategic (long-term view) and tactical (1–6 month) on broad asset classes, March 2024



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Asset classes

EQUITIES

ADJUSTING OUR EMERGING MARKET EXPOSURE

Equities remained positively oriented in February, with the US and Japan outperforming (5.3% and 5.5%, respectively), while Europe lagged behind (1.9%). Emerging markets also jumped sharply (4.8%), boosted by a technical rebound in China. Surprisingly, global equities have continued to rally despite a trend reversal in 10-year Treasuries during the month. This is due to a solid Q4 earnings season in the US which delivered 9.8% earnings-per-share growth – twice as much as previously expected.

We modified our exposure to emerging markets, adding positions in India, which stands out as a long-term value compounder. Although Indian equities appear expensive on both absolute and relative bases (forward PE 22.5x, 30% premium vs. global equities, respectively), in our view the expected earnings growth trajectory justifies the premium valuation. With a 16% return on equity (higher than Europe at 14%) and a 20%+ earnings-per-share growth environment, India should continue to deliver on its 20-year track record of 10–12% total annual returns for investors. We are maintaining a small exposure to China but have protected downside risks via a structured product solution.

BONDS

COMPELLING YIELDS IN INVESTMENT-GRADE BONDS: STILL THE PLACE TO BE

The timing of the first Fed rate cut was pushed out last month, but growth has proved to be resilient, leading us to continue to favour credit over government bonds.

Strategically, we like holding a high exposure to the belly of the investment grade curve (3–5 years) with still-attractive yields to be locked in and the highest expected return/volatility. Investment-grade credit spreads are expected to trade rangebound and heavy issuance to be met with strong demand.

Lower-than-anticipated default risks and rates that are expected to trend down have been supportive of high-yield bonds. Due to tight valuations, we remain selective and favour 1–3 year exposures to high yield.

CURRENCIES

USD FIRM IN THE SHORT TERM; CHF TO STABILISE

We anticipate that the USD will remain firm over the coming weeks, as the greenback benefits from still-robust US macro data and high front-end yields. The EUR/USD has modest downside risks, but, overall, we expect the recent range-trading environment to persist.

The USD/CHF has risen to around 0.88, and there is a chance of further modest upside in the short term. The Swiss National Bank (SNB) will likely lower its inflation forecast at its March meeting, and markets will move to price in SNB rate cuts. As the CHF already weakened significantly in February, we think that the change in market pricing will serve to stabilise CHF exchange rates, albeit at slightly weaker levels than before.

HEDGE FUNDS

TAKE ADVANTAGE OF DISPERSION

So far this year, most funds are in positive territory on the back of rising equity markets and tightening credit spreads. Interestingly, managers benefited from increased dispersion in both credit and equity as markets reacted strongly to earnings announcements. For global macro managers, the picture has been mixed, as stronger-than-expected inflation numbers triggered a repricing on rates. Discretionary managers suffered while most of the quantitative ones finished in positive territory. We continue to favour well balanced portfolios able to benefit from dispersion rather than directional ones. Nevertheless, we have lowered our tactical score on global macro managers, as the systematic ones have increased both risk and directionality. Thus, in a quick market turnaround, the portfolio protection feature could be temporarily challenged.

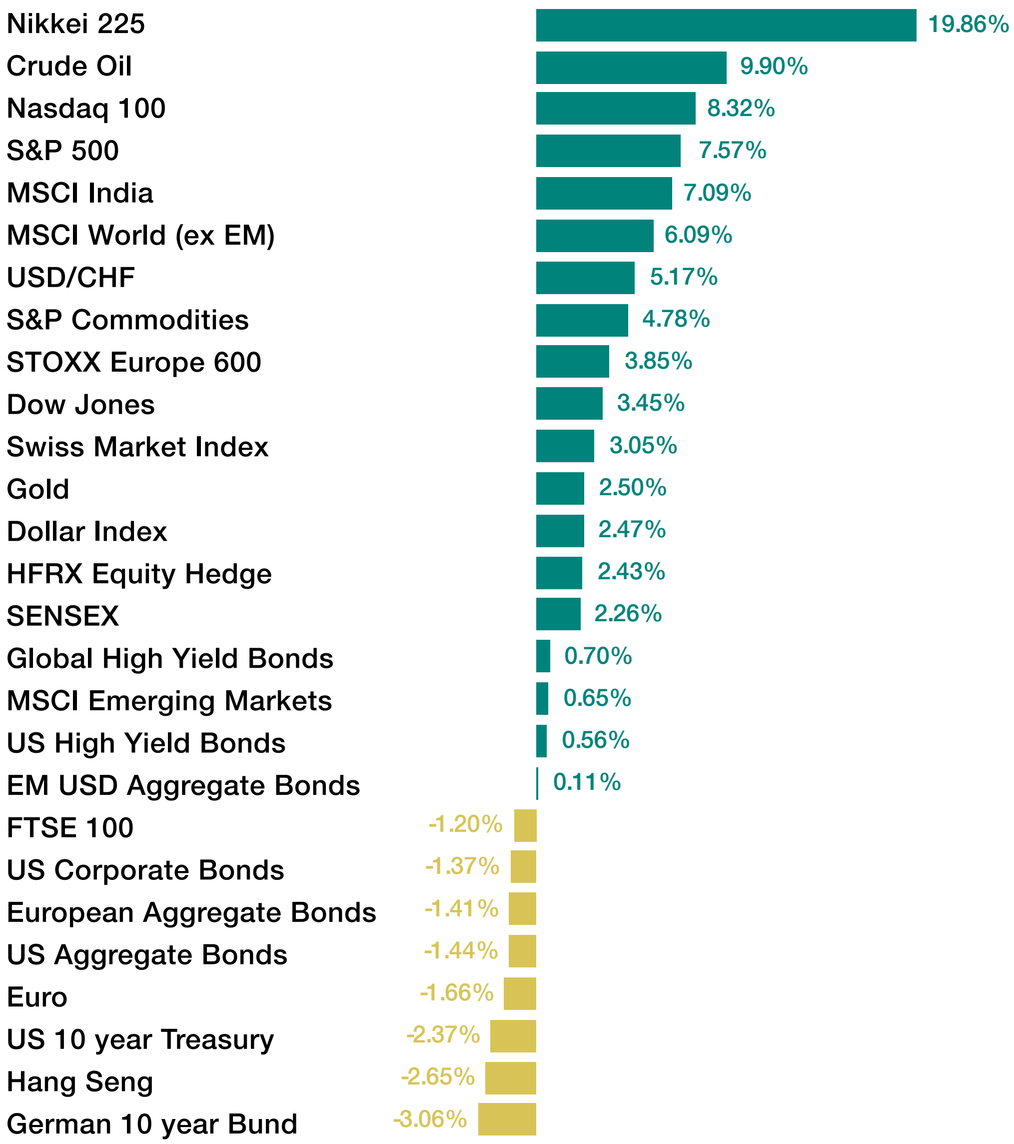
PRIVATE MARKETS

THINK DOWNSIDE PROTECTION AND DEFENSIVE ASSETS WITH ASSET-BASED LENDING

“Lock in higher yields while you can”. This is what fixed-income investors have been hearing over the last three months; they have been urged to take advantage of higher yields while they were available. Inflation expectations have been adjusted since then and both rates and credit have been repriced, as illustrated by the iTraxx Xover, which has lately been trading at around 300, i.e. below its long-term average. The “lock in higher yields” argument has therefore sailed away. Thankfully, other segments allow investors to benefit from higher yields; one of them is asset-based lending, another is real estate-backed lending to defensive markets such as the European residential segment. Not only is the underlying collateral supported by macro tailwinds, such as a structural scarcity and strong demand, but lenders are also able to alternate between fixed and floating rates depending on their views. Lenders will underwrite more fixed-rate loans in an environment in which rates are expected to fall. Structural features, such as first lien loans and reasonable loan-to-value, are creating solid downside protection and, combined with the defensive features of residential real estate lending, ultimately create a defensive strategy. Cautious investors should consider this specific strategy typology to generate stable yields with significant embedded downside protection thanks to the specific dynamics of its underlying market.

Market performances

2024 YEAR-TO-DATE RETURNS (%), AS OF 4 MARCH 2024



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