MARKETING DOCUMENT | APRIL 2024

UBP House View

UBP

UNION BANCAIRE PRIVÉE

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Buying regional laggards

The Swiss National Bank's interest rate cut came as a surprise. Kicking off a new rate-cutting cycle, this first decrease in March by a quarter of a percentage point shows the way for other Western central banks. The global easing will lead to new investment opportunities in the broader market.

After a lacklustre performance in 2023, Swiss equities are now gaining attention, as evidenced by the SMI's 5.34% increase over the quarter. Given that about 80% of Swiss companies' revenues originate from outside Switzerland, their earnings are expected to rise naturally due to the depreciation of the Swiss franc and the stimulus resulting from lower rates. This context bolsters our confidence in the previously lagging market.

We also raised our conviction in the UK market, which has trailed behind in the aftermath of Brexit and during a surge of the cost of living. With inflation decelerating faster than expected, the Bank of England appears to have the greatest firepower to lower its interest rates and give a boost to its economy and domestic companies.

Lastly, we upgraded our outlook on the industrials sector as we believe equity performances will broaden. This sector shows potential for recovery, as visibility improves for cyclical end markets.

Key Takeaways

1 INFLATION

In the first half of the year, inflation is likely to remain above 3% in the United States, while in the euro area and the United Kingdom it could return more quickly to around 2.5%.

2 US ECONOMY

The strength of the US economy is challenging recent disinflationary trends and thus delaying expectations of rate cuts from the Federal Reserve.

3 EQUITIES

We are diversifying our exposure beyond the US by purchasing UK and Swiss mid-caps.

4 GOLD

We locked in recent gains on the yellow metal. Gold now trades well above levels indicated by historical correlations with US ten-year TIPS yields meaning that further outperformance from current levels is unlikely in the short term.

Macroeconomic environment

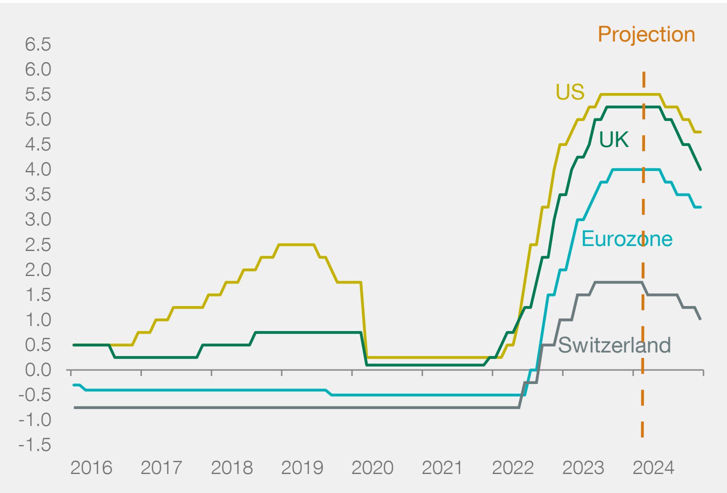
Switzerland: industry and exports to drive recovery

Global growth is expected to be around 3% in 2024. Although this will be a good performance, it masks significant differences between countries. US growth is expected to settle above 2%, with only a few developed countries growing by more than 1%. Chinese growth is expected to remain around 4.5%, but India and many Asian and Latin American countries will see stronger growth.

Disinflation will continue, but at a slow pace. Inflation has been resilient recently, driven by energy, food, and services prices. In developed countries, headline and core price indices should converge towards 2.5% by the end of the year. However, in the first half of the year, inflation is likely to remain above 3% in the United States, while in the euro area and the United Kingdom it could return more quickly to around 2.5%.

A new monetary regime is about to be put in place. Major central banks are ready to relax their policies once disinflation is confirmed. Following the Swiss National Bank's (SNB) action on interest rates, the Bank of England, the European Central Bank (ECB) and the Fed are expected to cut policy rates further over the next few quarters. Global easing is likely in the second half of the year, although the pace will vary from country to country.

MONETARY POLICY PROJECTION OF MAJOR KEY RATES



Sources: Bloomberg Finance L.P., central banks, UBP
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Switzerland: disinflation and lower interest rates to boost growth

The economy held up well in 2023, with strong domestic demand offsetting export difficulties. In 2024, consumers should continue to benefit from a still-buoyant labour market and strong disinflation. Switzerland is the first developed country to declare victory in the fight against inflation, with prices rising by 1.1% y/y in March despite increases in VAT and rents.

This disinflation enabled the country's central bank to cut its key interest rates in March, to the surprise of the markets. The SNB expects inflation to remain between 1% and 1.5%, and will bring interest rates down to around 1% by the end of the year. The SNB also has less need for a strong franc to counter price rises in imported goods. The absence of support from the franc should boost exports, which have been penalised by a strong currency and high interest rates.

The recovery of the export sector and global industry will support growth, which is expected to be around 1.3% in 2024 and above 1.5% in 2025.

United Kingdom: on the road to stronger growth

UK: a faster and stronger growth rebound than in the eurozone

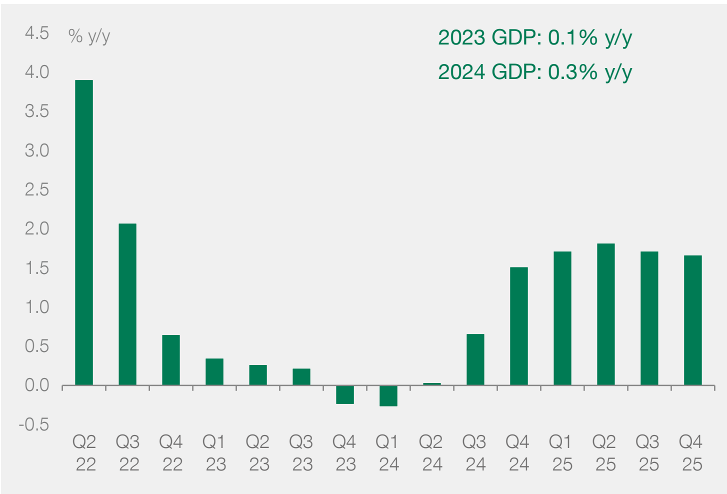
The UK economy entered a technical recession at the start of the year. High inflation and rapid rate hikes added to the constraints weighing on industry and services, leading to an overall contraction in activity.

The economy is expected to emerge from recession faster than continental Europe. Domestic demand should benefit from rapid disinflation: the return of inflation to around 2% in the second quarter will boost purchasing power, while labour data should remain positive.

The property sector is set to rebound thanks to sharp rate cuts. Indeed, the Bank of England could cut its key rates from 5.25% to 4% by the end of the year, a faster pace than other central banks. Last, the manufacturing sector should benefit from the global rebound in activity, which will enable a new investment cycle to get under way.

Since Brexit and the pandemic, the UK economy has underperformed other developed countries, but it has the capacity to bounce back. Growth could pick up in the second half of the year and be propelled towards 2% by 2025; if so, the UK would outperform the G7 and the eurozone.

UK GDP SCENARIO



Sources: ONS, UBP

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Strategy

Beginning in the summer, a potential "double-barrelled" easing would be supportive of equities and credit

WHAT HAPPENS WHEN THE FED CUTS RATES?

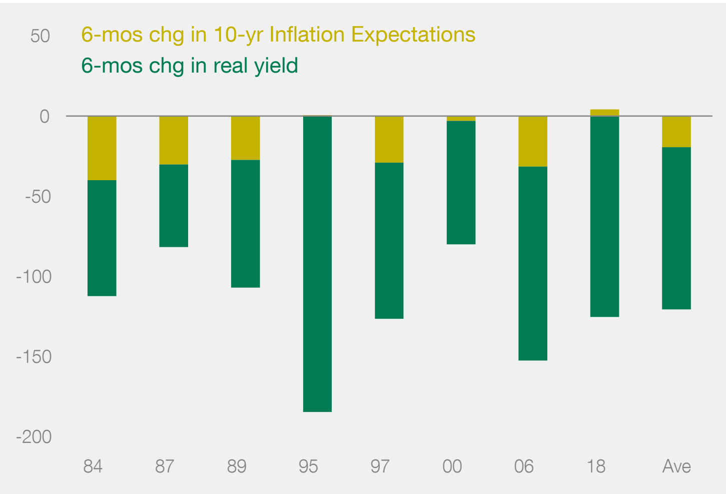
Since the early 1960s, 10-year Treasury yields have, on average, fallen by 90 bps in the months after the first Fed rate cut, which, this year, we expect over the summer.

The bulk of these declines can be attributed to falling inflation-adjusted yields. However, inflation-adjusted 10-year Treasury yields have only been lower than current levels during the Fed's post-2008 quantitative easing era. This suggests the sustained declines in yields like those seen in previous Fed easing cycles are unlikely as the Fed cuts rates in 2024.

In contrast, credit spreads have historically only widened modestly in Fed rate-cutting cycles, despite the 21st century's default cycles. For bond investors, this means a focus on income (i.e. carry) from credit should offer more attractive return profiles than interest-rate-focused strategies seeking falling yields ahead.

For equity investors, sharp equity market sell-offs amidst systemic stress triggered the Fed's easing cycles in 2001, 2008, and 2020. The Fed appears to be seeking to pre-empt similar risks in 2024.

BOND YIELDS HISTORICAL FALL IN EASING CYCLES DRIVEN BY FALLING REAL YIELDS. BUT, REAL YIELDS HAVE ONLY BEEN LOWER DURING QUANTITATIVE EASING, LIMITING THEIR ABILITY TO DECLINE MEANINGFULLY



Sources: Federal Reserve Bank of Cleveland, Federal Reserve Bank of St. Louis, Bloomberg Financial L.P. and UBP
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US Fed Chair Powell's recent press conference highlights a proactive policy stance designed to ease in the months ahead should the job market weaken, risking an industrial recession.

However, the surprise from the March meeting was the Fed's plans to slow its quantitative tightening programme "soon" to pre-empt the money market stress and financial system instability as in other 21st-century cutting cycles, offering a potential "double-barrelled" policy easing beginning in the summer.

With anticipated Fed policy pivots underpinning the soft-landing narrative, equity investors can instead focus on the US soft landings of 1984 and 1994, both of which saw Fed easing cycles kick off sustained, earnings-driven bull markets as the Fed cut rates.

Thus, the next stage of the current bull market should be supported by an accelerating, Fed-driven liquidity backdrop beginning in the summer. This should broaden earnings momentum beyond the tech-led sectors that characterised the first quarter to include more cyclical sectors in the US and cyclical economies and sectors in Europe, Japan and emerging markets.

DOUBLE-BARRELLED POLICY PIVOTS BY THE FED SOLIDIFY THE SOFT-LANDING SCENARIO AND A CONTINUED TAILWIND FOR EQUITIES

Sources: Standard & Poor's, Bloomberg Financial L.P. and UBP
*1974, 1981–82, 1987, 2001, 2008–09, 2020
**Left-hand scale trimmed, Deep Recession / Systemic Shock max drawdown = -51.6%
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Asset allocation

1

Gold overshot our target of USD 2,300 per ounce

2

Leadership shifted from the usual technology names towards more cyclical sectors

3

We decreased our conviction level on fixed income from 4 to 3

PROFIT-TAKING IN GOLD AND DIVERSIFYING TOWARDS REGIONAL LAGGARDS

The outperformance of global equities (+2.88% for the MSCI World) against fixed income (-0.02% for the Bloomberg Global Aggregate USD) persisted in March on higher US inflation expectations.

The strength of the US economy is challenging recent disinflationary trends and thus delaying expectations of rate cuts by the Federal Reserve. At asset-allocation level, we decreased our conviction level on the fixed-income asset class from 4 to 3.

In line with our March tactical overweight, gold emerged as the top performer of the month, surging by 9.87% and reaching our target of USD 2,300 per ounce. Nevertheless, we reduced our tactical conviction level from 5 to 3 as any upside now looks more limited.

For the fifth consecutive month, equities delivered positive returns, but sector leadership shifted for the first time from the usual mega/large-cap technology names towards more cyclical sectors such as energy, financials, and materials. We expect this broadening to continue in the near term as investors may look to hedge the risk of rate cuts by the Federal Reserve being pushed out by turning to regions such as Switzerland, the UK and Europe, where rate cuts are expected to occur sooner.

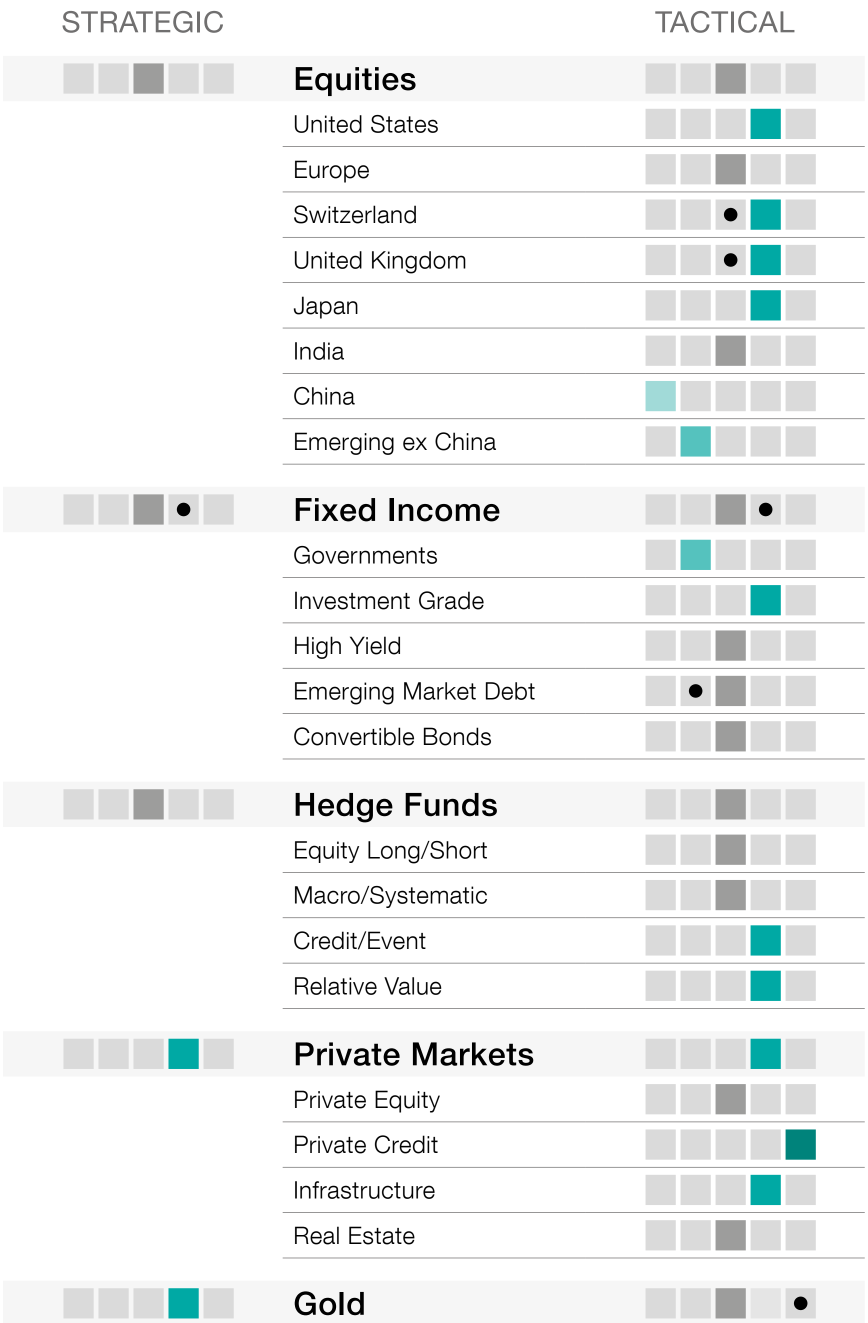
We carried out three main changes to our asset allocation concerning USD-balanced profiles in March: locking in recent gains in gold, reducing exposure to fixed income, and increasing our exposure to regional equity laggards, such as UK and Swiss mid-caps.

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, April 2024



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Asset classes

EQUITIES

BUYING UK AND SWISS MID-CAP EQUITIES

UK equities with elevated domestic sales exposure offer an attractive risk/reward profile given macroeconomic expectations that are set to improve with the worst of the impact from the post-Covid rate-hiking cycle behind us. The rapid decline in headline inflation should lead the Bank of England to lower interest rates. This is likely to trigger a domestic economic recovery, which is not priced in to many sectors such as UK real estate or consumer discretionary.

To diversify our regional exposure outside the US, we are increasing our exposure to domestically oriented UK equities, funded by some profit-taking from our tactical position in gold as well as reducing exposure to derivative strategies.

Following years of underperformance, the Swiss Performance Index also started to outperform in March on the back of Swiss franc weaknesses; this was the result of a surprise rate cut by the Swiss National Bank. We tactically increased exposure to Swiss mid-caps, funded via a reduction in fixed income, as the latter may continue to face headwinds related to slowing disinflation trends.

FIXED INCOME

MUTED CAPITAL GAINS EXPECTED AS THE FED FACES NO URGENCY TO CUT RATES

Fixed-income assets have benefitted from high carry as well as capital gains since last October when interest rates peaked globally. We are now adjusting our stance to a “baseline allocation” on the fixed-income asset class to reflect expected returns aligned with current yields levels. Our preference still lies within the 3–5-year range for investment-grade bonds and shorter-dated maturities in the high-yield sector given the historically elevated carry rates but still tight credit spreads. We are upgrading our tactical outlook on emerging markets, propelled by an optimistic macroeconomic scenario.

CONVERTIBLE

CONVERTIBLE BONDS SET TO BENEFIT FROM CENTRAL BANKS’ PIVOT

The convertible bond market had gone through a period of significant headwinds until the main market rates peaked in October 2023. Historically, persistent high-yield environments proved to be positive for the asset class, both in terms of absolute performance and asymmetry benefits. On top of that, in the event of a Goldilocks-type market such as the one during October and November 2023, the asset class would benefit from all its drivers at the same time. Rates and spreads are pushing the bond part higher, whereas underlying equities are outperforming.

The asset class is therefore well suited for investors looking for an exposure to the central banks’ pivot theme. With its bias towards mid-cap companies, especially in the US tech/software sub-segment, the asset class can also be used to diversify away from the mega-cap overrepresentation in the main equity indices while keeping an exposure to secular growth drivers.

CURRENCIES

US DOLLAR REMAINS IN POLE POSITION

Coming into April, the US dollar remains in pole position. Strong US labour market data means that front-end US yields have firmed, resulting in a meaningful rate spread move in favour of the greenback.

The upshot from this is that the USD/CHF will continue to trade at levels above 0.90, and the EUR/USD will struggle to rise above levels of 1.0950. The USD/JPY is trading above 150, however, we anticipate elevated intervention risks from the Japanese Ministry of Finance when this rises above 152.

HEDGE FUNDS

MIXED PICTURE FOR MACRO MANAGERS

Year-to-date, nearly all funds are in positive territory, helped by rising equity markets and tightening credit spreads. Non-directional strategies have benefitted from increased dispersion in both equities and credit as markets reacted strongly to earnings announcements. Interestingly, several managers generated strong alpha (and in several cases, positive contributions) from their short books.

For macro managers, the picture has been mixed, as stronger-than-expected inflation numbers triggered a repricing on rates. Several discretionary managers suffered from this while most of the quantitative strategies managed to navigate this period and made gains. We continue to prefer running portfolios that stand to benefit from dispersion rather than from directional moves. The systematic strategies in particular have recently increased both risk and directionality. Consequently, in a quick market reversal, the portfolio protection feature of these strategies could temporarily be challenged.

PRIVATE MARKETS

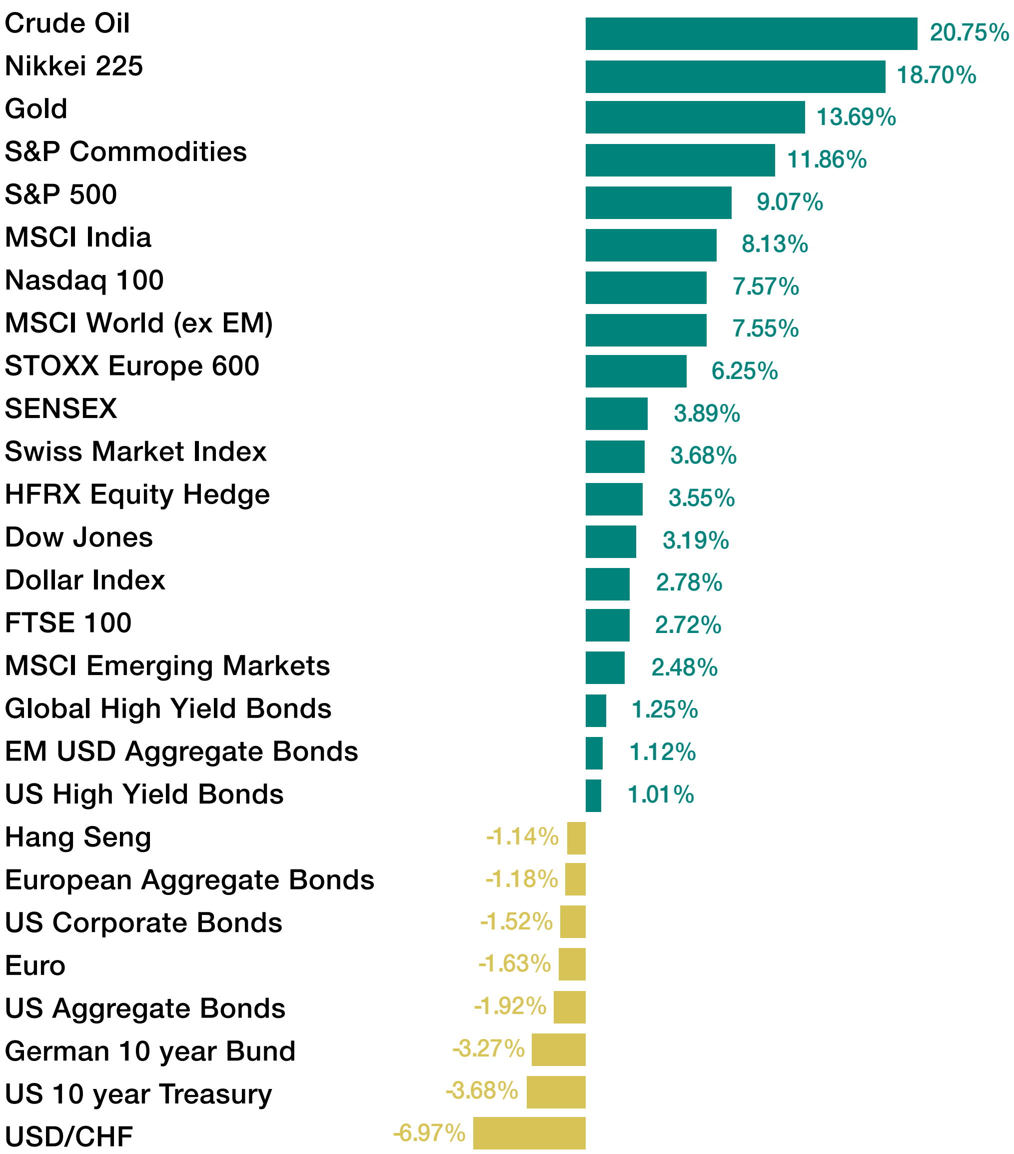
THE TONE HAS STARTED TO SHIFT FOR PRIVATE EQUITY EXITS

2023 was a complicated year for capital markets and deal activity, as sellers and buyers had a hard time agreeing on valuations and investors were still adjusting to higher rates. In the early innings of the second quarter of 2024, it seems that the mood is gradually improving, in a continuation of the progress seen in the first quarter, while optimism is starting to return as fears of recession are receding.

According to a recent report from Ernst & Young (EY), global IPO volumes were down 7% during the first quarter, but proceeds were up 7% year-on-year. Additionally, EY notes that PE-backed IPOs are also improving, with the deal size during the first quarter up 26% on 2023. In terms of valuations, it should be remembered that the biggest factor that brought IPOs to a halt were valuation expectations mismatches between sellers and buyers. An interesting metric to observe is the outperformance of newly listed companies versus their offer price, and, so far, a vast majority of IPOs are currently outperforming the offer price. Current capital market activity is a good omen for private equity managers, indicating that the tone has changed and that market participants are adapting to the new reality of non-zero interest rates. The flipside could be that, as 2024 is an election year in the US, some companies might decide to postpone a public exit in anticipation of a blurred political landscape.

Market performances

2024 YEAR-TO-DATE RETURNS (%), DATA AS OF 08 APRIL



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