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UBP House View

Union Bancaire Privée

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Regional divergence on the horizon

Inflation and interest rates up: 2022 and 2023 will certainly leave their mark in the annals of economic history. However, as price increases abate and interest rates normalise, fundamentals are once again starting to recover, as confirmed by the rally in November and December 2023.

The theme for the coming months will therefore be one of asynchronous economic growth, with different regions showing significant divergences.

We are maintaining our conviction on the United States over Europe given the former's indexes' tech bias, whereas the latter is bogged down in economic and social issues. In Asia, we favour India's market dynamic over China's, which lacks visibility despite monetary stimulus packages and remains the greatest loser of the 2023 financial year.

At the same time, the US electoral calendar promises a positive year for the country's stock market, as the economy takes its place at the top of the agenda. Historically, US presidential elections have always led to an increase in volatility.

The return of market fundamentals will lead to positive performances across all asset classes. Against this backdrop, balanced portfolios remain attractive, leading to a window of opportunity for investments, as long as regions are carefully selected.

Key Takeaways

1 SOFT-LANDING SCENARIO

We expect moderate global growth of around 2.9% for 2024. Overall, our macroeconomic scenario remains constructive and selective.

2 2024: THE RESURGENCE OF THE BALANCED PORTFOLIO

A balanced mix of equities, fixed income and alternatives remains attractive in this normalised investment environment.

3 GOLD

Real interest rates are set to fall, reinforcing our view that bullion will gradually rise.

4 EQUITIES CONVICTIONS

In equities, we are sticking to our convictions on US Technology as well as in Japanese equities.

The opinions expressed in this document are as at 7 February 2024 and are subject to change without notice.

Macroeconomic environment

US growth will remain strong in 2024

Global growth is expected to be moderate at around 2.9% in 2024, despite persistent headwinds in Germany and China. Disinflation will continue in all countries, at different rates between total inflation and "core" indices, but the prospect of inflation returning to around 2.5% at the end of the year remains in developed countries.

Consequently, central banks confirmed at the start of the year that their key rates had reached their peaks and that the next step would be easing, which, according to our scenario, is expected at the end of the second quarter.

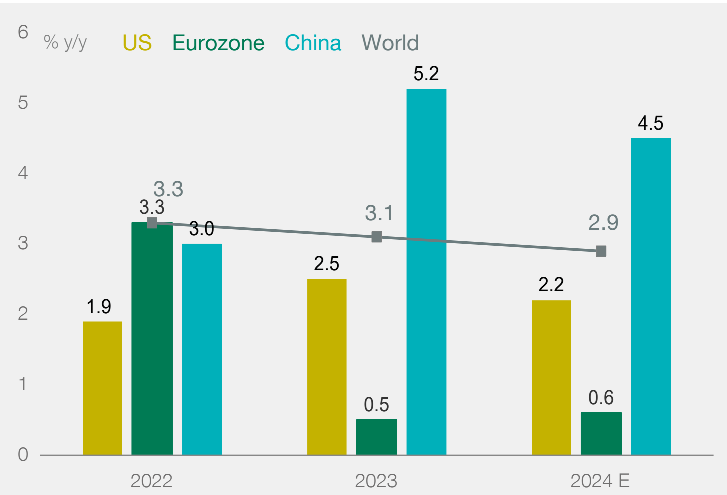
Growth in developed countries is expected to reach 1.3% in 2024 but with strong disparities. Germany is struggling to emerge from recession while Spain will lead the eurozone (1.5% expected against 0.6%) and Japan will progress by 0.8%. Once again, the United States is expected to post growth higher than that of other developed countries in 2024.

The return of US exceptionalism

The outlook for the US economy should remain strong: according to our analysis, growth should hit 2.2% in 2024 after 2.5% in 2023. This outperformance is the result of resilient domestic demand, made possible thanks to consumption, strong job creation and investment in new technologies and industrial relocations. In addition, the housing market has restarted thanks to the easing of long-term rates.

The good performance of the economy is not a coincidence of the cycle, but the result of fundamentals which anchor activity on a more sustained growth base than in Europe and Japan.

GLOBAL GROWTH: MAIN COUNTRIES



Sources: OECD, UBP

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Five factors fuelling American exceptionalism

Five factors distinguish the American economy from others by their strength and regularity: immigration and the workforce, spending on technology and innovation efforts, ample available private capital, and public support programmes for strategic sectors (e.g. technology, defence and medicine).

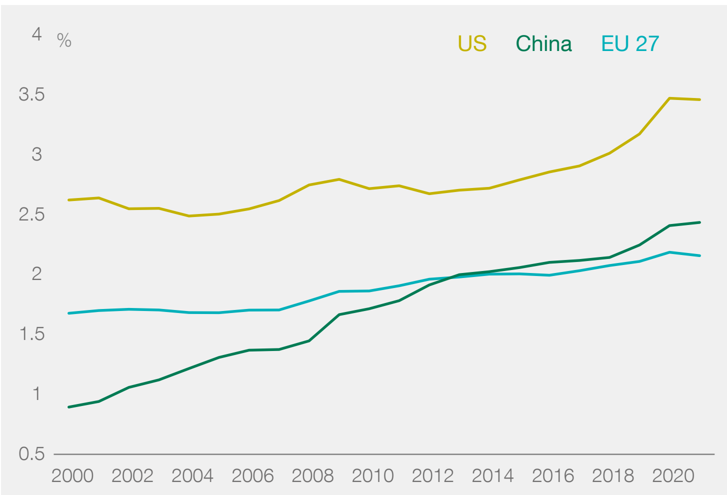
Historically, these factors remain more dynamic than in Europe and investment ratios in the US in terms of percentage of GDP are between 1.5 and 2 times higher than those in Europe, particularly as regards investment in new technologies and research & development.

These factors are substantial competitive advantages for America compared with other developed countries and make it possible for the country to face an economic battle with China, which has positioned itself in strategic technology sectors. The American economy has a high growth base, is displaying strong productivity and is capable of rebounding more quickly than Europe, which is fully reflected in the outlook for 2024.

Future key rate cuts will reinforce the soft-landing scenario

US inflation should return to around 2.3% at the end of the year. Core prices and total inflation should converge towards 2.5% at the end of the first half of the year, thus validating the expectation of an easing of the Fed's key rates. However, these results will be gradual and total inflation will move to just below 3% between February and next May, which explains the wait-and-see attitude advocated by the Fed at its January meeting. The easing of rates will be aligned with the scenario of declining inflation, but a reduction of around 100 basis points from the Fed remains relevant in 2024. This change in monetary strategy will reinforce the soft-landing and normalisation scenarios in the United States, while this will take longer to achieve in other developed countries.

RESEARCH & DEVELOPMENT AS % OF GDP



Sources: OECD, UBP
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Strategy

The unfolding US soft landing suggests investors can look forward to an earnings re-acceleration as the next catalyst

POSITIONING AS THE SOFT LANDING TAKES SHAPE

With the US macro backdrop playing out as expected – falling inflation paired with still-firm growth –, American equities have rallied while bonds have marked time, as expected, at the start of 2024.

Historically high US equity valuations and 10-year US Treasury yields below the 4.5% target outlined in our 2024 Investment Outlook are understandably leaving investors cautious about chasing the rally from the October 2023.

However, strong data from the ISM and on the US job market in January have added to evidence that the industrial slowdown in the US economy may have in fact troughed and begun to rebound as the new year begins.

This suggests that the earnings recession of 2023 may also be at an end. Investors can therefore look forward to an earnings re-acceleration in the coming quarters. This should help to drive an earnings-driven leg as stock markets price in a broader earnings trough beyond the technology sector moving into mid-year.

As this transition in equity market drivers unfolds, volatility will undoubtedly pick up. However, medium-term investors can use any such volatility to reposition portfolios for the earnings growth phase ahead.

Outside the US, investors can look to the reform- and restructuring-driven earnings growth in Japan and earnings growth driven by the repositioning of global manufacturing in China to India and Mexico as non-cyclical earnings drivers looking ahead, much as was seen when US manufacturing capacity was shifted to China in the 1990s and 2000s.

In fixed income, a still-inverted US yield curve poses a risk to full-duration exposure. As the soft landing materialises, longer-dated yields may fall more modestly than moderate and short-duration yields to finally normalise the yield curve after nearly two years of inversion.

However, fixed-income exposures can still serve as a cushion for balanced portfolios. Moderate-duration credit should remain well bid, as a recovering US economy should keep (admittedly cyclically) tight spreads contained. Moreover, deployment of cash into moderate-duration credit can help lock in yields as central banks begin rate-cutting cycles moving through mid-year.

Asset allocation

1

We are sticking to our convictions on US Technology and Software sub-sectors

2

Carry remains attractive enough to absorb a stabilisation in rates

3

Any signal indicating a slowdown in inflation would serve as a trigger for gold

Despite the recent significant rallies in both equities and fixed income, we are maintaining our exposure to risk assets given the robust US macroeconomic data published in January. From concerns about a hard landing twelve months ago to a consensus view of a soft landing, risks are appearing that the US economy may be running too hot. This could slow the recent decline in interest rates which could in turn lead to a pause in the bond rally in the near term. The market environment still remains supportive of equities, as corporates should benefit from a healthier-than-expected economic backdrop.

In equities, we are sticking to our convictions on the US Technology and Software sub-sectors, as well as our positions in Japanese equities. We are maintaining our baseline allocation in Europe and emerging markets due to limited visibility on the earnings landscape. This view has so far been confirmed by the ongoing global Q4 earnings season that began in mid-January. US corporates have delivered higher-than-estimated earnings growth of +7.8% y/y, while European companies are reporting negative growth of -8.5% over the same period. Our exposure to stocks is unchanged and we remain patient as regards any increase in the event of an equity correction.

Our fixed-income allocation is also unchanged with a high conviction on investment grade (medium maturities) and high yield (short-term maturities). We are maintaining our positions as carry remains attractive enough to absorb a stabilisation in rates should US economic resilience continue.

Gold exhibited a sideways trading pattern in 2023 despite increasing geopolitical risks (purchases by central banks in emerging markets; US elections) and larger fiscal deficits in developed economies. This can primarily be attributed to the strength of the US economy, which could sway the Federal Reserve to postpone its first rate cut in 2024, as well as to taper its balance sheet. Nevertheless, any signal indicating a slowdown in inflation and the Federal Reserve halting its quantitative tightening would serve as a trigger for gold to appreciate.

We are maintaining a constructive exposure to hedge funds which continue to be a valuable source of diversification within portfolios should bonds and equities experience simultaneous declines.

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, February 2024

STRATEGIC		TACTICAL
□□■□□	**Equities**	□□■□□
	United States	□□□■□
	Europe	□□■□□
	Switzerland	□□■□□
	United Kingdom	□□■□□
	Japan	□□□■□
	China	■□□□□
	Emerging ex China	□■□□□
□□□■□	**Fixed Income**	□□□■□
	Governments	□■●□□
	Investment Grade	□□□■□
	High Yield	□□■□□
	Emerging Market Debt	□■□□□
□□■□□	**Hedge Funds**	□□□■□
	Equity Long/Short	□□■□□
	Macro/Systematic	□□□■□
	Credit/Event	□□□■□
	Relative Value	□□□■□
□□□■□	**Private Markets**	□□□■□
	Private Equity	□□■□□
	Private Credit	□□□□■
	Infrastructure	□□□■□
	Real Estate	□□■□□

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Asset classes

EQUITIES

FOCUS ON EARNINGS

The equity market rally initiated at the end of October 2023 moderated in January, with global equities (MSCI ACWI) delivering +0.53% over the month. With the supportive macroeconomic backdrop and the soft-landing narrative now being the consensus opinion, investors' attention has shifted to the health of corporate earnings for Q4 2023 and their initial outlooks for 2024.

As at the end of January, earnings in the US were stronger than expected, increasing by 7.8% y/y (with 50% of companies having reported thus far) and large-cap technology companies also generally having delivered solid figures on high expectations. As a consequence, the "Magnificent 7" companies continue to drive most of the returns, year-to-date (+7.95% as of 2 February), significantly outperforming global equities (MSCI World +1.85% as of 2 February). This is encouraging for the 2024 forecast of 10 – 12% earnings growth, as US economic strength continues to surprise on the upside.

We are sticking to our baseline allocation to global equities (50% in a balanced portfolio) and our structural convictions on the US Technology & Software sub-sector along with our exposure in Japan. Tactically, we see limited opportunities at the moment, but remain vigilant to add exposure should a pullback occur due to any unexpected external shocks.

BONDS

BEWARE OF REINVESTMENT RISK; LAST CHANCE TO LOCK IN YIELDS

Bond yields climbed slightly higher in January offering the last opportunity to add bonds to portfolios. 3–5-year investment-grade corporate bonds still represent the sweet spot to achieve the highest expected returns to volatility.

Even though credit valuations are looking stretched since the strong rally started at the end of October, investors should continue to focus on optimising the carry in their portfolios by selectively holding emerging market and short-term high-yield bonds in line with our no-recession scenario and constructive outlook.

CURRENCIES

CENTRAL BANK PUSHBACK

In late January and early February, the major central banks pushed back against the narrative of early interest rate cuts, resulting in a modest firming in USD exchange rates, with the EUR/USD falling to 1.08.

In February, we think that we will see a pause in directional moves given the absence of central bank policy movements. This means that investors should expect the EUR/USD to trade at around 1.08 with downside risks. The USD/JPY will trade in a tight range of 146–148.

ALTERNATIVE INVESTMENTS

BENEFIT FROM UNCORRELATED STRATEGIES

After strong convictions on Global Macro managers, the outlook is more balanced going into 2024. Fixed-Income Arbitrage should continue to benefit from higher rate volatility. For Relative Value, the convertible arbitrage strategy could post attractive returns due to high issuance. Strategies investing in asset-backed securities could benefit, as delinquency rates are rising. Within Equity Long/Short, low-net-exposure managers are still favoured, but we are positive on specialists in sectors that have been out of favour for the past two to three years. For diversifying strategies, Global Macro with an emerging market focus could outperform.

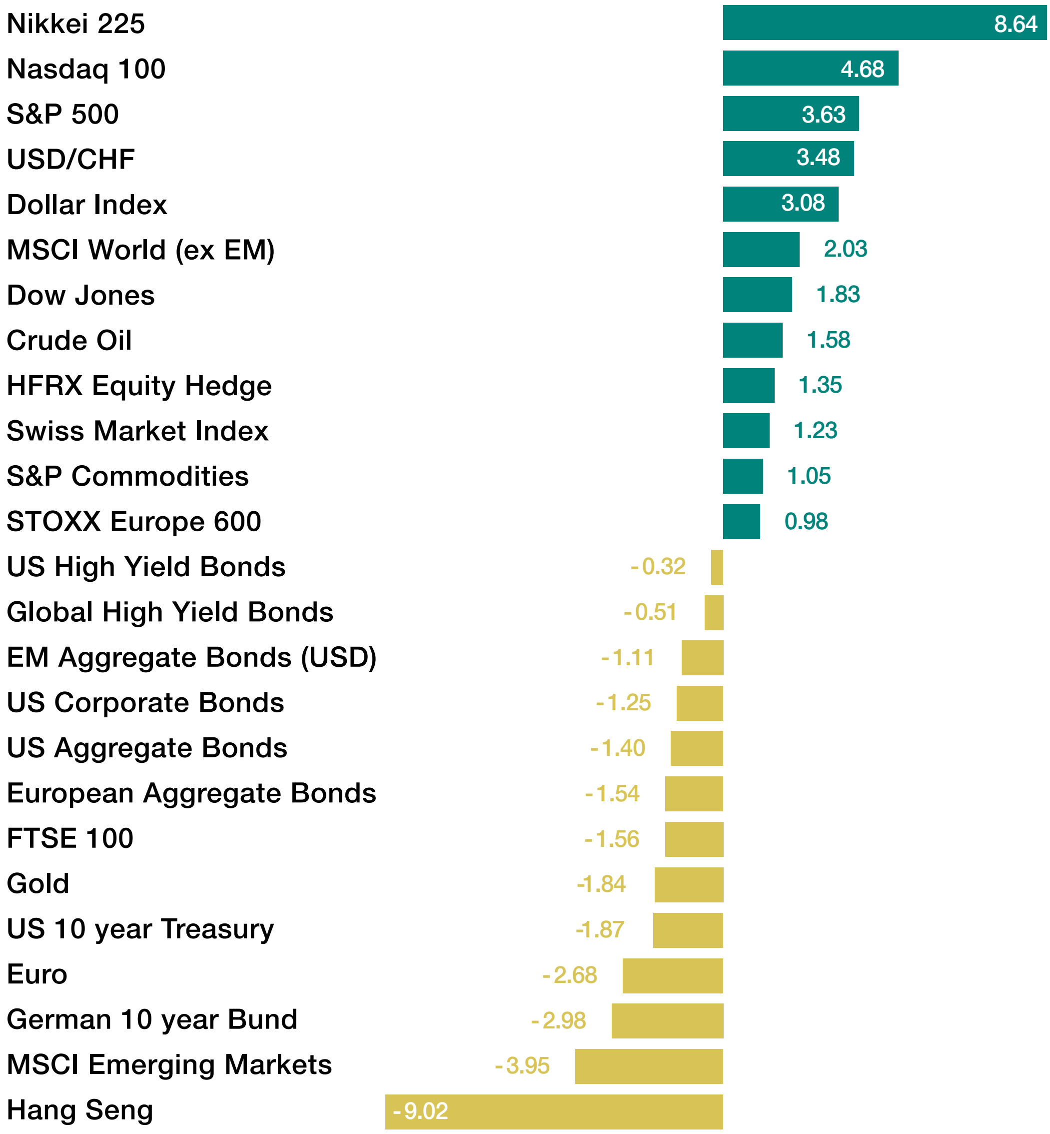
PRIVATE MARKETS

STRUCTURAL OPPORTUNITIES MATTER MORE THAN BETA

As investors are looking to add private market exposure to their portfolios for the sought-after diversification benefits, the focus should continue to be on finding structural opportunities. Infrastructure, supported by robust tailwinds and the various megatrends developing in digitalisation, decarbonation and global needs for electrification, requires an immense amount of capital; the private financing of infrastructure is now playing a crucial role in the development of key infrastructure for modern economies. On the credit side, the Bank's disintermediation trade continued unabated and private debt remains one of the most active corners of private markets. From direct lending to more complex opportunities, investors have plenty of options for building exposure to uncorrelated return streams.

Market performances

2024 YEAR-TO-DATE RETURNS (%)



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