MARKETING DOCUMENT | AUGUST 2024

UBP House View

UNION BANCAIRE PRIVÉE

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Asset Management

Risks mount on the horizon

Weak US labour data and the unwinding of Japanese yen carry trades triggered a market sell-off, resulting in the rise of volatility earlier this month. However, it might be too soon to buy the dip, as risks are mounting on the horizon. Following the equity rally in the first half of the year marked by unusually low volatility, we might encounter market instability that could persist until the US presidential election in November. In this context, we continue to hold equity carry strategies that should partially absorb any downside.

Amid the current increasing growth scare, we do not expect any recession this year that would likely lead to a prolonged market downturn. Instead, we anticipate US growth ranging from 1.5% to 2%, contingent on the outcome of the presidential election.

In Asia, due to near-term uncertainties, we tactically reduced our conviction rating on Japan from 4 to 3 out of 5 after an increase dating back to November 2023. Additionally, China's third plenum did not deliver concrete measures to invigorate the struggling economy, leading us to remain cautious on the country while continuing to favour India within emerging markets.

Looking ahead to the Jackson Hole symposium on the last weekend of August, the Federal Reserve is expected to provide further clarity about the timing and scope of its forthcoming rate-cutting cycle. However, challenges are looming due to the impending US election and mounting geopolitical risks, such as conflicts involving Israel and Iran, Russia and Ukraine, and potentially Taiwan, along with a weakening US dollar.

Key Takeaways

1 MACROECONOMY

Inflation is expected to decline to 2.5% by the end of the year, potentially prompting the Federal Reserve to cut interest rates.

2 EQUITIES

We maintain our rating of 3 out of 5 on equities and we continue to hold equity carry strategies.

3 FIXED INCOME

Our strategy continues to favour investment-grade bonds over government bonds, while maintaining a duration of approximately three years.

4 GOLD

Following the yellow metal's record high of USD 2,488 per ounce, we remain optimistic about its medium-term prospects.

The opinions expressed in this document are as at 09 August 2024 and are subject to change without notice.

Macroeconomic environment

SUSTAINED GLOBAL GROWTH, BUT VULNERABILITIES TO WATCH

Global growth is expected to remain robust at around 3.2%, but its pace is expected to change in the United States, while growth drivers in Europe and emerging markets remain fragile.

More moderate US growth in the second half of the year

US GROWTH CHANGES PACE

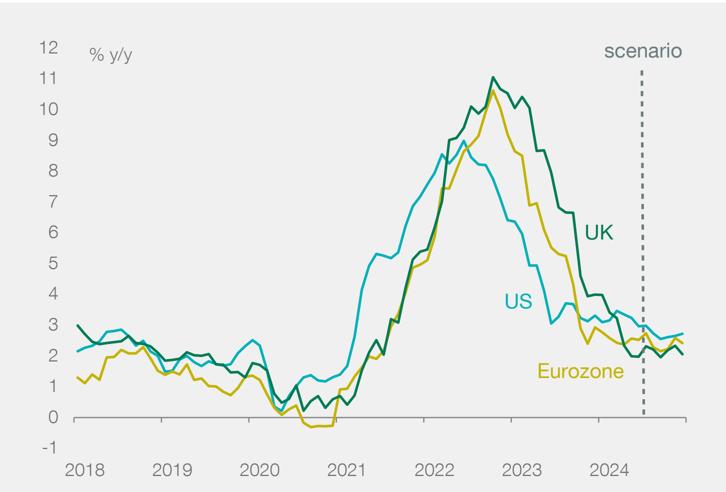
The United States experienced a marked slowdown at the end of the second quarter. Household and industrial confidence weakened, and activity was more volatile on both the supply and consumer sides, with a high turnover between sectors. In the second half of the year, growth should fall well below 2%, allowing the labour market to rebalance, with a likely rise in the unemployment rate, but also a slowdown in rental and service prices. Pending the new political situation following the presidential election, growth should settle at between 1.5% and 2% in the coming quarters.

CONTINENTAL EUROPE FACES UNCERTAINTIES

The recovery in the UK has continued post-election. The transition of power to a Labour government is going smoothly for the markets, thanks to the promise of a certain fiscal orthodoxy, and pending clarification of the chosen economic strategy.

The economic situation in Germany remains fragile. After solid growth in the first quarter, indicators deteriorated at the end of the second quarter, except for confidence in the services sector. The recovery is therefore slow and,

INFLATION IN THE US, UK AND EUROZONE



Sources: ECB, BLS, ONS, UBP
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in some sectors, appears to be chaotic. Conversely, economic conditions are more favourable in Spain, where growth remains above 2%. Last, in France, the economy could be boosted by the Olympic Games, but the political landscape remains confused given the country's hung parliament.

Fed could begin its rate-cutting cycle in September

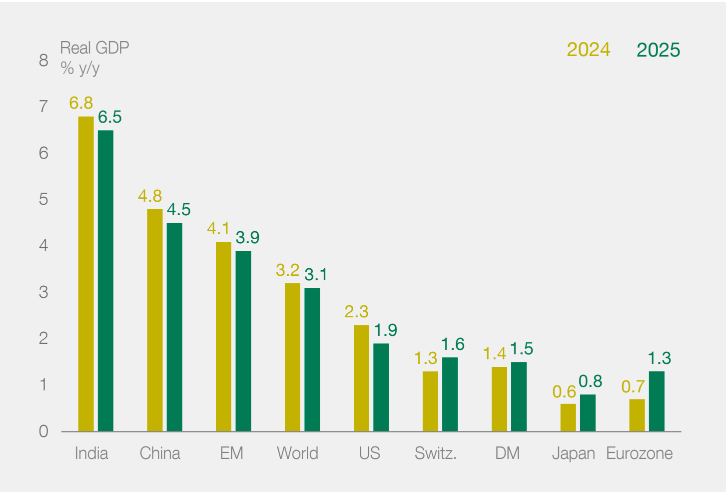
CHINA: AWAITING NEW INITIATIVES

Following a slowdown in activity in the second quarter (to 4.7% y/y), the third plenary meeting resumed discussions on growth trajectories to 2029, in particular the role of new technologies, the market, and consumption, but without deciding on any concrete measures. These are expected to drive growth in the coming months and help authorities achieve their 5% target. Meanwhile, India and other countries such as Taiwan and the Philippines are showing sustained activity and strong growth prospects through 2024.

INFLATION CONTINUES SLOW DECLINE

Global inflation is gradually declining. In developed countries, inflation should converge at 2.5% by the end of the year. Prices of manufactured goods are falling, but services are holding up well thanks to demand in the transport and tourism sectors. At the same time, wage growth remains more sustained in Europe than in the United States, and the labour market remains generally tight in the services sector.

2024-25 GDP GROWTH MAIN COUNTRIES AND REGIONS



Source: UBP
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THE FED COULD BEGIN ITS RATE-CUTTING CYCLE IN SEPTEMBER

European central banks are likely to continue to lower their key interest rates over the next few quarters. In the United States, rising unemployment and declining inflation should allow the Fed to cut rates as early as September, as Governor Powell has suggested. The Fed's strategy is more balanced, given the resilience of prices in the services sector and the marked slowdown in economic activity.

Strategy

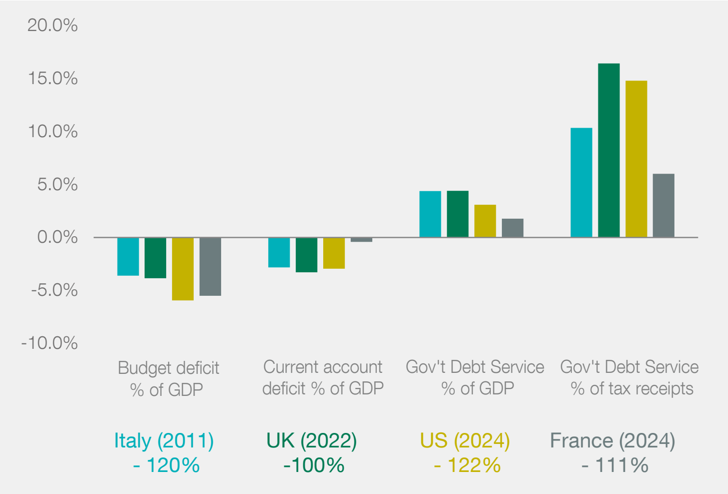
PIVOTING TO A RISK MANAGEMENT FOCUS

Since June, we have been counselling a two-pronged approach in the run-up to the election window. On the one hand, it consists of maintaining an equity exposure to capitalise on both an election-related tailwind and of a broadening of market performance beyond the technology leaders of the first half of the year; on the other, entering autumn, there should be a focus on risk management as debt sustainability concerns start to emerge.

Indeed, with election-related tailwinds having produced the strongest election year performance since WWII and the start of a rotation away from technology leadership, investors should focus on the risk management component as summer moves into autumn.

In particular, disappointment in China's policy response to growing deflationary pressures means our tactical trade against a structural Chinese equity bear market backdrop did not meet our expectations. Instead, our long-cycle focus on the persistence of Indian equities' earnings power should be the focus for global and emerging market investors.

DEBT SUSTAINABILITY CONCERNS SET TO RISE IN THE UK, FRANCE AND THE US LOOKING INTO 2025



Sources: US Treasury, Eurostat, Bank of England, Bloomberg Financial L.P. and UBP
Figures in the legend represent national debt/GDP levels in the year indicated.
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Similarly, the ongoing reform- and restructuring-driven earnings growth continues to provide a foundation for sustained Japanese corporate earnings growth. However, in light of the recent soft US economic data and the dramatic strengthening of the Japanese yen, new investors can likely tactically seek better entry points once Japanese earnings expectations adjust to the new backdrop.

New autumn budgets in the UK and France warrant a growing focus on risk management

As we enter autumn, investors will also be faced with budgets from new governments in the UK and France, as well as greater clarity on the US election outcome. Given debt burdens in the US, the UK, and France, 2022-style UK risks may loom on the horizon for sovereign bond investors.

As a result, credit and income-focused strategies in fixed income are favoured, avoiding meaningful interest rate risks that we expect lie ahead. Moreover, gold has once again established itself as an anchor for investors' long-term wealth preservation. Looking ahead, the yellow metal will benefit from growing debt sustainability concerns, as well as from the prospect of the next chapter in the US-China "strategic competition" that may come in 2025.

In essence, we expect that this two-pronged approach going into year-end should help investors as the global economy and markets face greater two-way risks than those seen at any time over the past 18 months.

Asset allocation

1

The equity market decline was due to technical reasons and deteriorating investor sentiment rather than corporate stress

2

Movements in high-yield and investment grade spreads remain far from panic levels

3

We have downgraded the conviction rating on Japan from 4 to 3 due to near-term uncertainties

REDUCING EQUITY EXPOSURE SLIGHTLY

In July, the developments in the race for the White House and the start of the global earnings season contributed to a pick-up in equity market volatility and heavy sector rotation. In this context, global equities registered a gain of +1.6%, but the Nasdaq significantly underperformed (-1.6%) on the back of profit-taking and an overall earnings season in line with expectations, namely in the technology sector (-2.1%). In the meantime, gold and fixed income outperformed (+3.1% and +1.5%, respectively), while hedge funds offered steady returns with a +0.4% contribution.

The start of August has been marked by the re-emergence of US recession fears and the Japanese yen strength following a rate hike by the Bank of Japan. This contributed to a sudden sell-off in global equities (-6.4% over 1–5 August), and, more notably, Japanese equities, with the MSCI Japan plummeting by -20.6% and the Magnificent 7 dropping by -9.0%.The latter two suffered mainly from the unwinding of a popular and highly leveraged carry trade since the beginning of the year, i.e. borrowing in Japanese yen to finance the purchase of Japanese equities or the Magnificent 7.

While fear gripped equity markets, movements in high-yield and investment grade spreads remained far from panic levels, as they are currently trading near their 10-year averages, leading us to believe the majority of the equity market decline was due to technical reasons and deteriorating investor sentiment rather than corporate stress.

With Japanese equities rebounding in the days that followed the initial sell-off (+12.2% over 6–7 August), we took the opportunity to reduce our exposure to the region and downgrade our conviction level from 4/5 to 3/5 due to near-term uncertainties, such as the continued unwinding of carry trade and potential yen strength. Despite several headwinds still on the horizon for the second half of the year, we maintain our rating of 3/5 on equities, and we continue to hold equity carry strategies which should partially absorb the downside participation in the current equity market turbulence.

Within fixed income, we advise against chasing the recent downward move in yields, which has seen US 10-year yields moving from 4.7% in May to below 4% currently, but rather to favour shorter-dated maturities while remaining vigilant for opportunities to further increase high-yield exposure. We remain confident with our current positioning, which has remained unchanged from June; this consists of short-duration assets with high carry strategies in high yield, AT1s and emerging debt.

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, August 2024

STRATEGIC		TACTICAL
□ □ ■ □ □	**Equities**	□ □ ■ □ □
	United States	□ □ □ ■ □
	Europe	□ □ ■ □ □
	Switzerland	□ □ □ ■ □
	United Kingdom	□ □ □ ■ □
	Japan	□ □ ■ ● □
	India	□ □ ■ □ □
	China	□ ■ □ □ □
	Emerging ex China	□ ■ □ □ □
	Equities - Sector	
	Technology	□ □ □ ■ □
	Telecom	□ ■ □ □ □
	Media	□ □ □ ■ □
	Utilities	□ □ ● ■ □
	Financials	□ □ ■ □ □
	Industrials	□ □ ■ □ □
	Consumer Discretionary	□ ■ □ □ □
	Real estate	□ □ ■ □ □
	Healthcare	□ □ ● ■ □
	Materials	□ □ ■ □ □
	Energy	□ □ ■ □ □
	Consumer staples	□ □ ■ □ □

Directional views

LOW CONVICTION | BASE LINE ALLOCATION | HIGH CONVICTION

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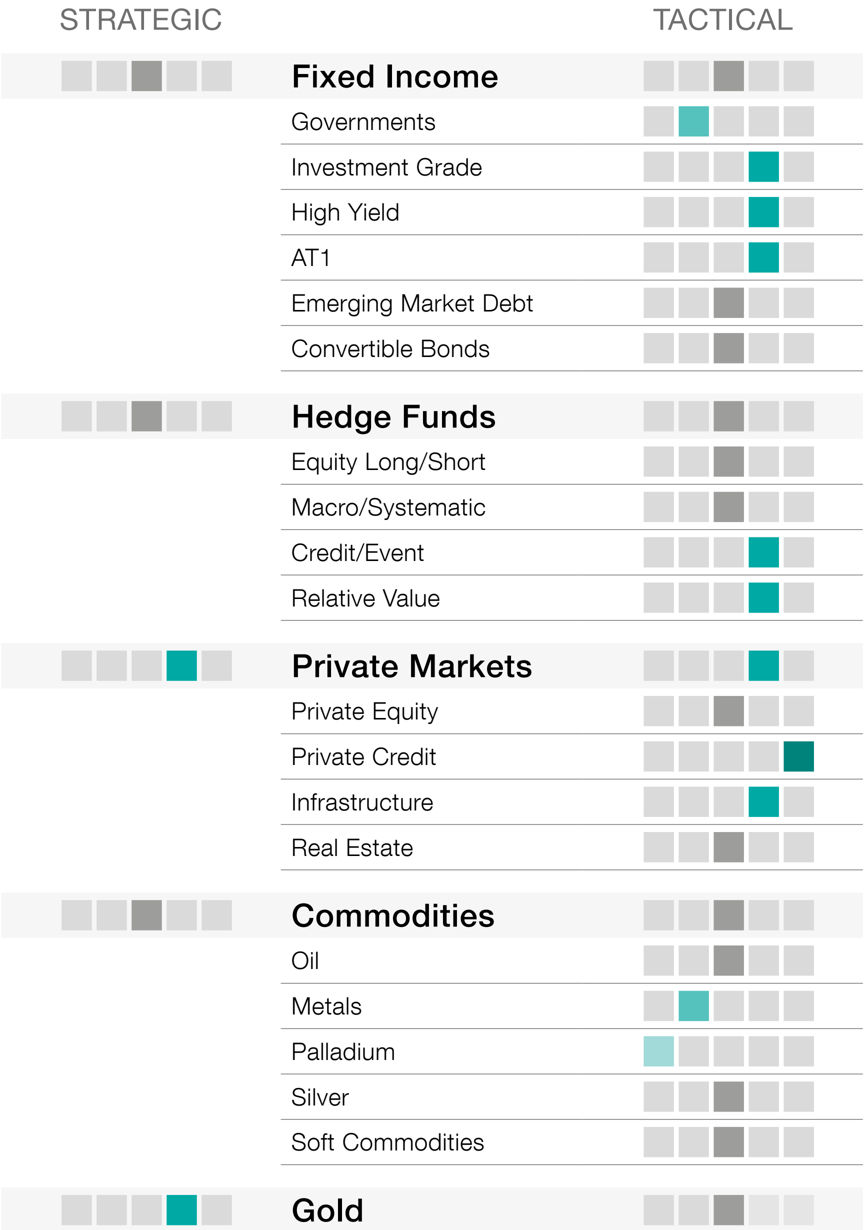

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Asset classes

EQUITIES

MARKET VOLATILITY RETURNS

July saw significant performance dispersion between regions and sectors. Global equities registered gains (+1.6%) while the Nasdaq faced selling pressure (-1.6%) as technology companies (-2.1%) confronted growing doubts about the monetisation of artificial intelligence. This shift, along with geopolitical events, supported a rotation from the US technology sector to value (S&P 500 Value +4.8%) and US small- & mid-caps, with the Russell 2000 (+10.1%) outperforming the S&P 500 by its widest margin ever.

However, this outperformance was short-lived: over 1–5 August, the Russell 2000 dropped -9.5% over the first three sessions, as global equities generally overall came under pressure, with a decline of -6.4% over the same period.

This decline followed a series of macro and micro events that created a risk-off mood in the markets: mixed results from mega-cap technology companies which had stretched valuations, along with disappointing US macro data (such as manufacturing and employment figures) that renewed recession fears. Additionally, there was an unwinding of a popular, highly leveraged carry trade that involved borrowing in Japanese yen to finance purchases of Japanese equities and the Magnificent 7.

Japanese equities and the Magnificent 7 also bore the brunt of the early-August equity market decline (-20.6% and -9.0%, respectively, over 1–5 August), followed by the Nasdaq 100 (-7.6%). While Japanese equities rebounded in the days immediately following the sell-off (+12.2% from 6–7 August), market appetite has been more muted elsewhere.

Although the recent sell-off has adjusted equity market valuations (namely for mega-cap technology companies), headwinds remain on the horizon for the asset class. These include US election noise, geopolitical tensions involving Israel and Iran, Russia and Ukraine, slowing US economic growth and elevated earnings growth expectations.

Even if earnings growth over the first half of the year has beaten expectations (S&P 500 EPS Q1 +6% vs. +3% expected and Q2 +11.5% vs. +9%), it comes against an easy comparison base on a year ago and a strong economic backdrop. The former becomes more difficult for Q3 and Q4 (where EPS growth of +6% and +16%, respectively, are expected), and the latter is set to slow. Furthermore, an acceleration in earnings growth is also expected in 2025 (+15% vs. +11% for 2024) which seems too optimistic at this stage.

As such, we are not buyers of the current equity market dip and would use any technical rebound to reposition portfolios to more defensive areas of the market consisting of companies with elevated revenue and earnings visibility, as well as structural growth beneficiaries. In this context, we upgraded our sector ratings on utilities and healthcare (both to 4/5 vs. 3/5 prior) whose earnings growth are relatively immune to economic slowdowns and are thus better protected from the risk of downwards earnings revisions. Furthermore, these two sectors are perceived as bond proxies and should benefit from improving market sentiment amid a rate-cut narrative. These upgrades join our continued conviction on technology (4/5) which continues to be a sector supported by structural growth.

Regionally, we downgraded our conviction level on Japanese equities from 4/5 to 3/5 due to near-term uncertainty (the continued unwinding of carry trade) and potential yen strength. With the Bank of Japan opening the door to interest rate hikes, it remains to be seen whether this is a positive or negative for the Japanese economy even if higher interest rates are simply the result of economic normalisation after an extended period of loose monetary policy. In the context of slowing global economic growth led by the US, Japan's cyclically-oriented equity market is also at risk, justifying our more cautious stance.

FIXED INCOME

FAVOURING SHORT-DATED MATURITIES

In July, we made no changes to our fixed income asset allocation, following the adjustments made in June aimed at enhancing portfolio carry. These changes included increasing exposure to high-yield bonds, additional tier 1 (AT1) bonds of major European banks, and emerging market debt. Our strategy continues to prioritise investment-grade bonds over government bonds, while maintaining a relatively short duration of around three years. We advise against chasing the recent downward move in yields, favouring shorter-dated maturities, while remaining vigilant for opportunities to further increase our high-yield exposure.

Towards the end of the month, weak macroeconomic data (particularly in manufacturing, jobs, and unemployment) rekindled fears of a recession. This, coupled with a slowdown in inflation, heightened expectations for additional rate cuts this year. The situation intensified in early August as the rapid unwinding of the Japanese yen carry trade led to significant volatility in equity markets, amplifying the downward movement in rates that had already been observed in July.

Currently, derivatives markets are pricing in four rate cuts, up from two at the end of June; this seems excessive to us as we do not expect a recession in the US. The yield curve underwent a bull steepening, with short-term rates declining more sharply than their long-term counterparts. As a result, the spread between yields on 2-year and 10-year Treasuries narrowed from -50 basis points in June to just -5 basis points in early August.

CONVERTIBLES

BROADENING THEMATICS

July has clearly been marked by a violent rotation reversing some of the moves observed in recent quarters. The trigger was the release of US CPI data on 11 July that came in below expectations. The market reacted by pricing a first rate cut by the Fed at almost 100% at the September meeting. The consequence for equity markets was an intense rotation out of the largest capitalisations (the Magnificent 7) and into smaller-capitalisation companies. This benefited the convertible bond market that delivered an average performance of +1.3%, which was a favourable outcome compared with the main equity indices (MSCI World +1.7%, S&P 500 +1.2%, and the Nasdaq in negative territory). The extent of the relative outperformance was nonetheless held back by the value bias of the small/mid-cap rerating, while the convertible bond market has a bias towards growth companies. Telecoms and financials were the best-performing sectors in small- & mid-caps, as these two sectors have little representation. Semiconductors and technologies lagged behind and are well represented within issuers. We nonetheless see the broadening thematic as an ongoing potential performance catalyst for this part of the market in the coming months.

HEDGE FUNDS

RETURN OF VOLATILITY TOWARDS THE END OF THE MONTH

Equity long/short continued its strong year in July with most of the gains made in the first part of the month. Towards the end of the month, some of the strong year-to-date trends, such as Artificial Intelligence, began to come under pressure. For global macro/trend-following funds, the spread of returns between managers widened according to their level of portfolio exposure to commodities, which is generally weaker, and government bonds, which started to rally on the back of weaker economic and inflation numbers. Credit managers continued to post steady positive returns as several catalysts led to sharp price gains within the high-yield market.

The overall positioning has been towards the lower end of most managers' exposure range based on seasonally low levels of liquidity in markets and that political uncertainty has increased across Europe and the US. Exposure for discretionary and quantitative global macro managers has remained within rates and equities, as the volatility of May and June in commodities led to many reducing exposure.

We continue to favour managers with low net exposures and balanced portfolios who are well placed to benefit from dispersion and idiosyncratic opportunities in a wide range of markets.

PRIVATE MARKETS

OPPORTUNITIES IN REAL ESTATE

Market participants continue to turn their attention to real estate and the long-lasting effects of rate increases. Buying opportunities will emerge or are currently emerging for opportunistic, cash-rich investors.

Additionally, some sub-segments, such as hospitality, logistics and retail stores, continue to present appealing niche investment opportunities. Increasing global trade activity, combined with the need to accommodate specific demand, supports logistics. Southern European hospitality continues to be in high demand while retail can present opportunities to acquire stabilised assets with long-term, high triple net leases.

CURRENCIES

HIGH BETA UNDERPERFORMANCE

In July, high-beta G10 currencies generally underperformed, reflecting the deterioration in external growth profiles, particularly in the eurozone and China. This affected the likes of the AUD, CAD, SEK and NOK, and to a lesser extent the GBP.

Coming into August, we think that both the CHF and JPY can benefit from position squaring as investors reduce exposure to carry trade strategies, which will benefit funding currencies.

Key event risks lie with the Jackson Hole symposium towards the end of the month, where the Fed will likely give clear signals about the timing and scope of its forthcoming rate-cutting cycle. This will weigh on the USD over the coming months, as markets price in a lower rate profile for the greenback.

COMMODITIES

SHORT-TERM WEAKNESS

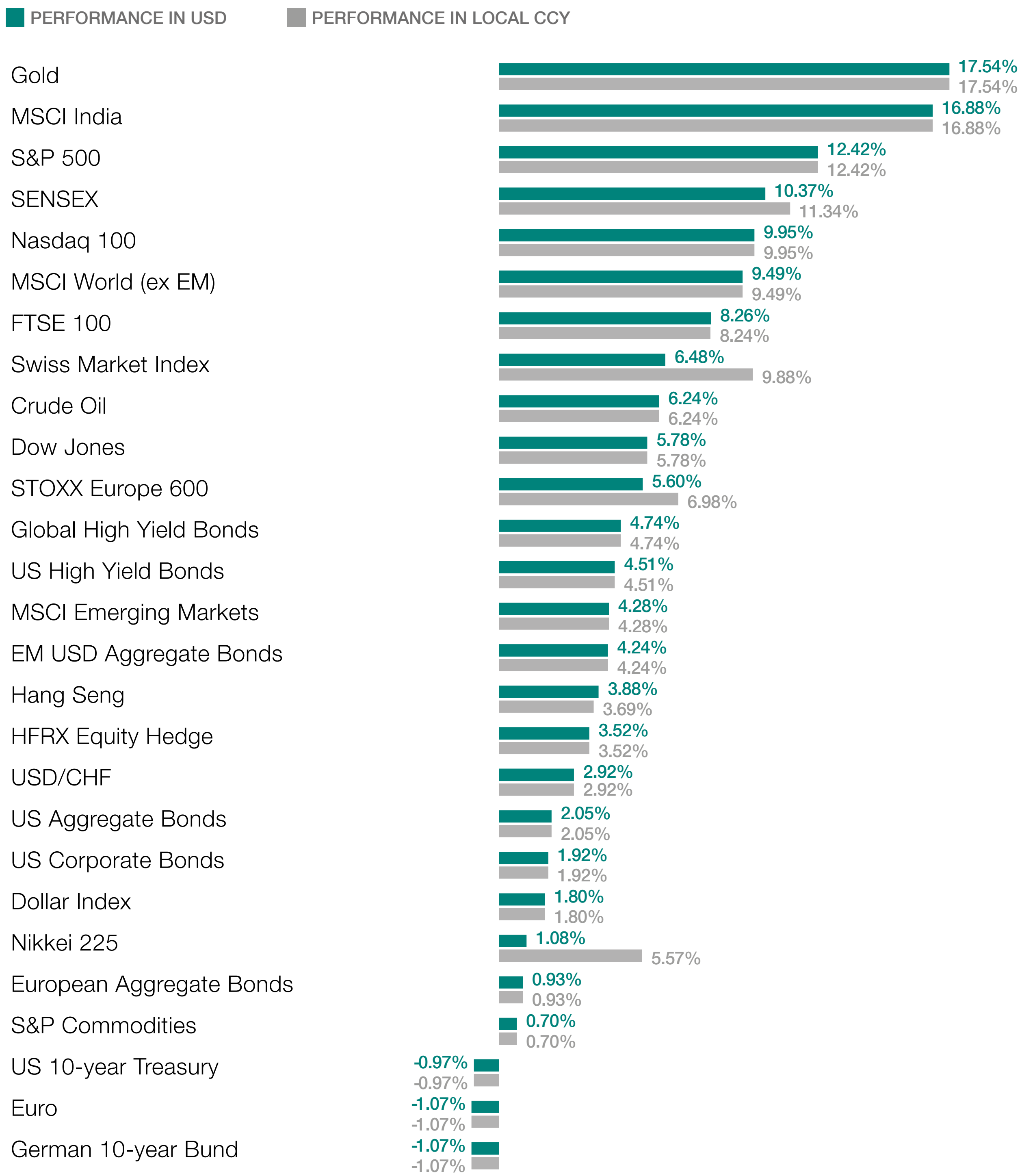
Brent crude traded lower to levels below USD 80/bbl in July. This decline reflected bearish sentiment regarding Chinese demand along with increasing concerns regarding future aviation demand in Europe. US inventories experienced large drawdowns, pointing towards a still-tight physical market.

Worries regarding wobbling Chinese demand also weighed on both iron ore and copper, which fell over the month. Still-elevated futures positioning will act against any copper rally in the short term.

However, gold traded at new all-time highs of USD 2,488 per oz, as markets digested lower-than-expected US CPI data and the prospect of imminent Fed rate cuts. The outlook remains constructive over the medium term.

Market performances

2024 YEAR-TO-DATE RETURNS (%), DATA AS AT 08 AUGUST 2024



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