

Review & Outlook January 2024

Review and Outlook

- Q4-2024 Review
- Inflation and Central banks
- Asset returns
- Review and outlook
- Investment management

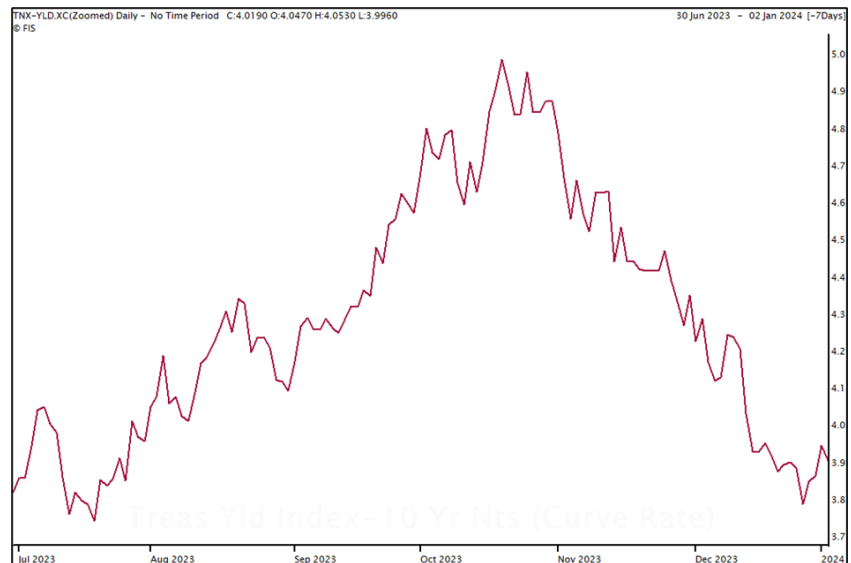
Mission Statement

Contact

Disclaimer

Q4-2023 Review

Bond markets reversed sharply during the final quarter of 2023. 10-year US yields declined from a high of 5.00% to end the year at 3.80%. Movements of a similar magnitude took place for bonds denominated in EUR, GBP, and CHF. These are unusually large moves, with some measures showing the largest monthly decline in yields for the past 30 years.



10-Year US Treasury Yield, from 30.06.2023 to 02.01.2024,
Source: MarketMap FIS

Inflation and Central banks

Of course, inflation statistics improved during the quarter. The improvement was geographically broad and is certainly reassuring. It could not however have been a surprise in terms of direction, only in terms of magnitude. More than the data itself, it was the Federal Reserve statement after its FOMC December 13 meeting, and the subsequent press conference by Chairman Powell, which impressed markets. We were particularly struck by the following components:

- The "summary of economic projections" indicated that the median participant expects three rate cuts in 2024.
- The stance taken by the board implies that the central bank no longer requires an economic slowdown to achieve its inflation objective.
- The Chairman explicitly recognized the need to start easing policy from prior to the attainment of the 2.00% inflation target.
- When given an opportunity, during the press conference, to protest the market easing of financial conditions (through lower bond yields), Chairman Powell declined to do so. This marks a stark departure from the stance adopted during the whole tightening process.

For all practical purposes, the Fed killed the concept of "higher for longer" on December 13. During 2022 and the first half of this year, the Fed was exclusively looking at realized inflation. From now on, it is adopting a balanced view towards its dual mandate and is focusing on the outlook for inflation, to avoid inflicting unnecessary pain on the economy, and therefore on labor markets.

The European Central Bank, which met two days later, did not (yet) adopt the same approach. President Lagarde flatly refused to entertain the

notion of rate reduction. The ECB also accelerated its own version of quantitative tightening to the second half of 2024. This did not stop EUR denominated bonds from rallying, with yields on 10-year bunds reaching sub 2.00% levels after having traded at 2.90% earlier during the quarter. In Switzerland, the Central Bank held its quarterly meeting on December 15 too. It acknowledged the disinflation trend by stating that, under unchanged rates, the forecast for inflation is within the price stability range. It also indicated that its CHF policy was no longer targeted at currency appreciation. CHF rates also declined meaningfully, from 1.75% to 0.90% for the 5-years SARON reference rate.



Asset returns

The large worldwide easing in bond yields is at the core of explaining asset market returns for Q4 2023, and therefore the annual gains achieved in many financial assets.

- In equities markets, the MSCI World Index ended the year with a gain of 23.80%. The US index (S&P 500) gained 26.30%. Emerging market equities are showing a respectable return of 9.80% for the year but are still lagging developed markets.
- On a sectoral basis, Information Technology (+56.40%), communication services (+54.30%) and consumer discretionary (+41.00%) are leading for the year by a wide margin. Among underperformers, Health care is up only 0.30% and energy is down - 4.80%.
- Returns from sovereign/high grade bonds have caught up with money market returns after a stellar quarter. The US aggregate index is returning 5.50% for the year.
- High yield credit achieved a stellar performance (13.40%) as this asset class benefitted from the strong economy and has seen any impact from rising defaults.
- On the currencies side, the USD logically declined during the quarter, penalized by the perspective of Fed easing in 2024. It is ending the year down a couple of percentage points on a trade weighted basis, which masks large regional differences and doesn't account for carry.

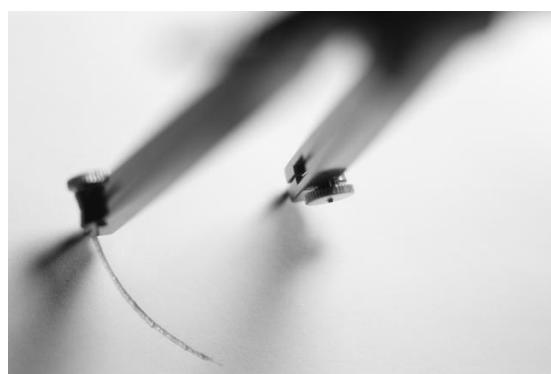


MSCI World Index, for year 2023,
Source: MarketMap FIS

Review and outlook

As 2023 draws to a close, we can make the following observations.

- Most forecasters were confounded by the resilience of economic activity to the extensive cumulative monetary tightening of the past two years.
- The trajectory of inflation in 2024 did not follow historical precedents. A large increase in costs did not lead to a wage costs spiral, and inflation started to decline from its peak without a recession or meaningful slowdown. This is no doubt due to the unusual nature of inflation in this cycle, which can be summarized as supply driven inflation (in the sense that post Covid restricted supply in goods and labor were the root of this inflation process).
- The adjustment of the real economy to outside shocks has been nothing short of impressive. Labor markets have rebalanced (witness the normalization of job openings in the US back to pre-Covid levels), supply chains have been quickly and efficiently realigned for many goods. The oil market absorbed the shock of the middle east crisis and a series of supply restrictions from OPEC+ with a decline of USD 10 in the price per barrel. We now know that OPEC supply has been efficiently replaced by US shale output (without an increase in rig counts, but through productivity improvements).



To sketch an investment outlook for 2024 we are required to answer the following questions:

- Are the effects of the large monetary policy tightening campaign exhausted or will they still hit the economy in the future?
- Is corporate profitability on a solid upwards trajectory for many companies or only for a select few mega cap equities?
- What type of interest rate regime can we expect once inflation has normalized?
- Is China un-investable, or should investors pay attention to the low valuation levels?

We sketch out below our tentative answers:

- The question of monetary policy is open to debate. Many observers point to the fact that, in the US, a very loose fiscal policy (the US budget deficit is estimated at 7.50% of GDP for 2023) counteracted the effects of monetary tightening. Another line of argument used is to point out that a vast majority of mortgages are fixed rate, and the reset of rates is only affecting new buyers. Other economists' models indicate that the peak effect of tightening is behind us, and that if a recession hasn't occurred yet it is not more likely than in an average year to develop now. We can observe that the staff at the Federal Reserve is on this camp, and we will therefore take this scenario as our base case.
- The stellar performance (in term of profits and margins) of a handful of mega cap tech companies in the US has distracted attention from the overall profitability of the US corporate sector. Based on our assessment, the profits have likely bottomed in Q3 2023 and are now on a modest but solid rising trend.
- The interest rate regime after the normalization of inflation is subject to many uncertainties. There has been some talk about the expected difficulties of the "last mile" normalization (i.e., from 3.00% to 2.00%). Recent data on inflation however

shows that such concerns are unwarranted. Discussions on the neutral rates for short rates are typically very academic and unhelpful. For the purpose of our asset allocation, we will adopt the long term forecast of the FOMC and consider that US short rates of around 3.00-3.50% should represent the norm in the post Covid world (i.e. the level at which the economy is neither stimulated nor restrained).

- China is suffering from well documented macroeconomic ailments and from serious governance issues. These weaknesses are reflected in very cheap valuations for Chinese equities. China is also a leader in some global categories, such as electric vehicles. Finally, we could be seeing the beginning of a stabilization in the China/US relationship. For us, this means that while being absent from Chinese markets, we should be ready for sharp occasional rallies. We also are mindful of the need to replace Chinese exposure in portfolios and favor an allocation to "Emerging Markets ex China" instruments. This will give portfolios an exposure to the global growth in EM (e.g. India, Korea, Brazil) without undue risk.



Investment management

From an investment management standpoint:

- The portfolios under our supervision have benefitted from the coordinated bonds/equities rally of Q4 and are ending the year with appreciable gains. We have added to the bond exposure at attractive yields levels and intend to hold this allocation well into 2024.
- In term of geographical allocation, our portfolios remain overweight in developed markets and are sharply underweight in China related assets. In terms of sectors, we maintain a well-diversified approach recognizing the significant valuation dispersion among financial assets. We are encouraged by the broadening of performance in Q4 beyond the mega cap tech companies and are positioned for this trend to continue into 2024.

Looking forward, in adopting a 6/18-months investment horizon, we can make the following statements:

- The large decline in bond yields that occurred during the quarter is a significant easing of financial conditions. It will therefore, if maintained, contribute to promote economic activity over the coming quarters.
- The disinflationary process under way has been explicitly acknowledged by the Federal Reserve. It will allow the US central Bank to progressively reduce rates from current restrictive levels. Risks on inflation are evenly balanced, and investors should consider the possibility of inflation undershooting central bank targets at some point in the future.
- Corporate profits in the US have bottomed in Q3 2023 and can grow at a 5.00–7.00% annual rate from here.

The above environment leads us to follow the following guidelines in investment policy:

- The fixed income portion should be maintained. It is geared towards achieving a positive carry over time versus cash yield levels with a reasonable risk. Although bonds have rallied substantially, we can see value in intermediate bonds and in inflation linked securities (at a real yield of 1.80% for 10-year Treasuries). We also are at the stage of the cycle where bonds offer very useful diversification benefits for portfolio construction. We currently concentrate holdings in the investment grade and BB segments of the market.
- For equities, the environment of disinflation and steadily growing profits will be broadly supportive. Over time it will allow for a broadening of equity performance beyond mega cap tech companies.
- We will continue to be attentive to the geopolitical environment and its influence on energy prices, shipping costs etc. but do not believe it is appropriate to let these considerations drive long term asset allocation decisions.

Daniel Jakobovits
Head of Investments

“Luck shouldn’t
be part of your
portfolio.”

HYPOSWISS
A D V I S O R S

Expect the expected

Mission Statement

- Hyposwiss Advisors' mission is to offer personalized asset management services and financial advice to high-net-worth individuals and families based in the USA and Canada with the overriding objective of capital preservation and asset growth performance oriented.
- Investments in compliant global assets are used to construct a diversified balanced portfolio tailored to the investor's requirements and deposited with international banks acting as qualified custodians.

Contact

Hyposwiss Advisors SA

www.HyposwissAdvisors.ch
info@advisors.hyposwiss.ch

Head Office

Office address: Rue Bovy-Lysberg 10
Mailing address: Bd du Théâtre 10
1204 Geneva – Switzerland

Tel.: +41 22 310 76 40



Disclaimer

All the contents of publications of Hyposwiss Advisors SA or its affiliates are for information purpose only. Information contained herein does not constitute a solicitation or offer or recommendation to buy or sell any investment instruments, to effect transactions or to conclude any legal transaction of any kind whatsoever.

The information contained and the opinions expressed herein by Hyposwiss Advisors SA are subject to change without notice. No guarantee or undertaking is offered regarding completeness, reliability or accuracy of the information given. Financial instruments and securities or any other investments mentioned in this document may involve significant risks including the possible loss of principal. No assurance is given that the investment objective of any product will be achieved. Past performance should not be taken as an indicator or guarantee of future performance. Hyposwiss Advisors SA or any of its affiliates may or may not at any time hold a position in or with respect to the investments which could be mentioned herein.



This document may not be reproduced, distributed or published without the prior written consent from Hyposwiss Advisors SA.

Access to the information may be restricted by laws or regulations to which the individual user is subject. As a consequence, this document is not directed at, or intended for distribution to or access by any person or entity who is a citizen or a resident of any jurisdiction where the information in question would be prohibited by law or regulations.

Hyposwiss Advisors SA does not render tax, legal or accounting advice. Clients are encouraged to seek their own competent independent professional legal, tax and accounting advice.

Registrations with the US Securities and Exchange Commission and exemption status in Canada do not imply a certain level of competence, education, skill or training. The protections of the US and Canadian rules and regulations are only available to residents of the respective country, province or territory.

■ ■ ■ ■ ■

© 18 January 2024 – All rights reserved.