BRUELLAN PANORAMA
Q1/2024

QUARTERLY OUTLOOK / JANUARY / FEBRUARY / MARCH 2024

2024: BETWEEN GEOPOLITICAL CHALLENGES AND INVESTMENT OPPORTUNITIES

SWITZERLAND
HAPPILY DISAPPOINTED

EUROPE
DON'T PLAY THE SCORE AHEAD OF THE CONDUCTOR

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Bruellan

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2024: BETWEEN GEOPOLITICAL CHALLENGES AND INVESTMENT OPPORTUNITIES

FLORIAN MARINI, CFA, CMT / CHIEF INVESTMENT OFFICE

The past few years have been marked by significant instability and uncertainty, a trend that is set to continue in 2024. Russia, which is planning to increase its military budget by 70%, appears to be gearing up for a prolonged conflict in Ukraine. This escalation, amid signs of fragmentation of Western support, is concerning. In the Middle East, although robust US military presence has so far prevented a broadening of the war between Israel and the Hamas, long-term stability remains precarious. The US, up until recently focused on countering China's economic and military ascent, now finds itself stretched thin, active on multiple fronts. And the potential election of Donald Trump as President could further intensify these complex geopolitical dynamics.

But while this instability might be becoming the "new normal", it has not and it will not substantially alter our macroeconomic outlook, except to suggest a likelihood of increased government spending and sustained higher long-term inflation.

For 2023, our guiding principle was the expectation of a significant decline in inflationary pressures, which we believed would bolster equity markets. As we move into the first half of 2024, our stance regarding inflation has not changed. The majority of the inflationary impacts that stemmed from the COVID-19 shutdowns, particularly disruptions in global supply chains, have largely normalised. Additionally, inflation linked to commodities is currently receding. And even in the most persistent areas of inflation – that is, services inflation with a focus on housing costs and wage growth – leading indicators are now signalling a potential easing in 2024.

The COVID-19 disruption triggered a partial desynchronisation of the manufacturing and services growth cycles. The manufacturing sector began to decelerate in the second quarter of 2021, then plunging into severe recession by the third quarter of 2022, a trend that has since persisted (especially in Europe). This manufacturing downturn was, however, partially mitigated by the resilience of the services sector.

As we look ahead to the first half of 2024, our projections are more optimistic. While we expect a relatively muted performance in services, the manufacturing sector is poised in our view for a significant rebound. This forecast is grounded in historical trends, which suggest that purchasing managers often exhibit excessive pessimism at cyclical turning points. Currently, their level of pessimism parallels that observed during all recessions since the 1980s, with the notable exceptions of the Great Financial Crisis and the COVID-19 pandemic.

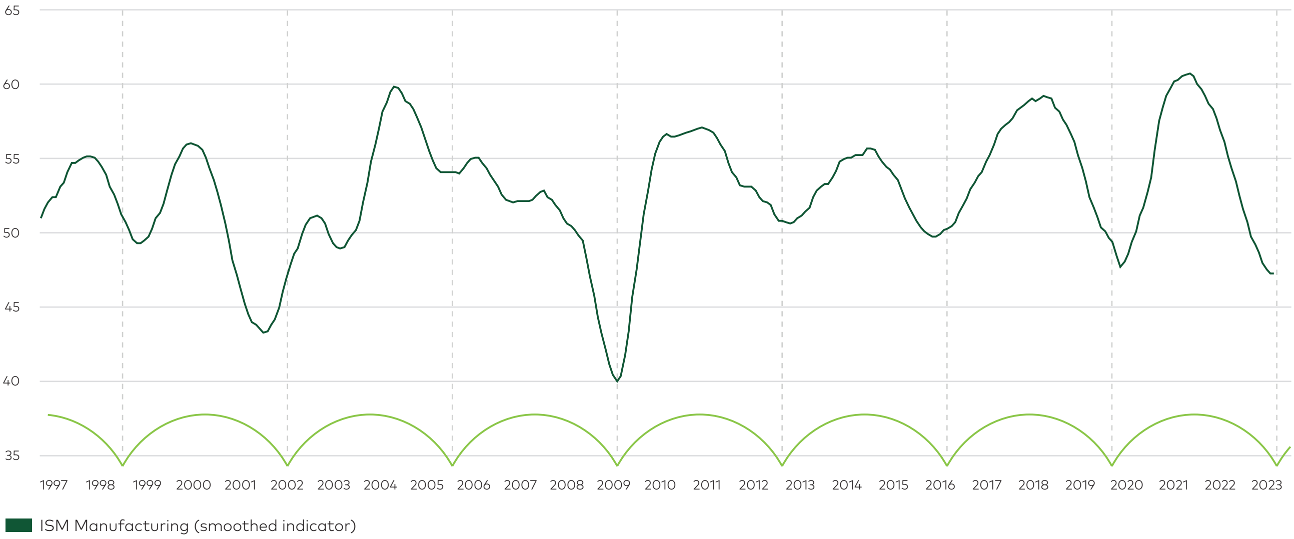
Additionally, economic patterns tend to be cyclical, particularly in the manufacturing sector. Typically, a full cycle spans approximately 11 quarters. On this basis, we are anticipating the onset of a new cycle towards the end of 2023, leading to a potential resurgence in manufacturing as 2024 progresses.

In China, the post-pandemic economic rebound has proved more subdued than generally expected, with significant stimulus measures still on hold despite consumer and producer disinflation. Authorities are balancing these factors against the need to counter currency depreciation. A critical indicator of the country's economic trajectory is the trend in exports from Taiwan and South Korea to China. After languishing in negative territory for a year and a half, they have recently started to exhibit positive growth, hinting at a resurgence of economic activity in China. With GDP growth currently projected at ca. 4.5%, this recent development suggests a cautiously optimistic outlook for the Chinese economy.

As the major central banks continue to navigate the path towards disinflation, their strategy appears to be leaning towards a shorter duration of "high interest rates for longer", with rate cuts to be initiated sometime in the second or third quarter of 2024. Investors are currently pricing in the first European Central Bank (ECB) rate cut in April, to be followed by the Federal Reserve (Fed) in May. Such a pivot in monetary policy is likely to be received positively by financial markets.

From a valuation perspective, equities might not appear particularly attractive. The forward P/E ratio of the MSCI World index stands at 17x, above its long-term average of 15x. That said, lower interest rate expectations enhance the attractiveness of equities by increasing the present value of future earnings. Moreover, as discussed above, we anticipate a medium-term rebound in manufacturing

ISM manufacturing (smoothed indicator) vs. economic cycle
An early 2024 recovery is likely.



activity which, historically, has been significantly correlated with earnings growth. We thus foresee earnings potentially growing in the high single digits. And even assuming stable earnings growth as a base case, the projected drop in interest rates should act as a catalyst for higher equity prices.

In conclusion, contrary to the widespread expectation of an early 2024 recession, we foresee a recovery in the manufacturing sector, particularly in Europe. This rebound will likely bolster the overall economy, offsetting potential weaknesses in the services sector. We expect inflation to continue to recede over the next months, supporting more accommodative central bank policies. This backdrop, combining modest earnings per share (EPS) growth and lower interest rates, should prove supportive for equity markets during the first half of 2024.

On a longer horizon, we will continue to watch out for a potential second wave of inflation, a repercussion of the global supply shock experienced in 2020.

MARKETS PERFORMANCE

YTD AS OF 30.09.2023

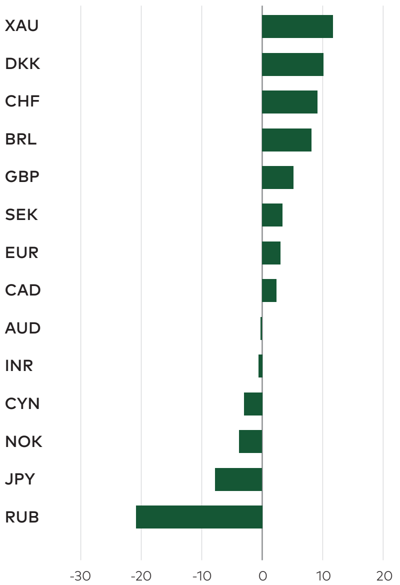
Economic Indicators

	Real GDP %		Inflation %		PMI	Debt % GDP	Current Account % GDP	Budget % GDP	Unemploy-ment %	Interest rates	
	2022	2023	2022	2023	Current	Current	Current	Current	Current	3 mois	10 ans
USA	2,1	2,4	8,0	4,1	49,4	79,2	-3,1	-6,3	3,7	5,3%	4.1%
Euro Area	3,5	0,5	8,4	5,5	44,2	91,0	1,3	-3,8	6,5	3,5%	2.2%
Switzerland	2,0	0,8	2,9	2,2	42,1	20,9	8,3	1,4	2,1	1,7%	0.9%
UK	4,0	0,5	9,1	7,4	47,2	101,0	-2,0	-5,6	4,0	5,2%	3.8%
Asia ex Japan	3,2	4,6	2,9	2,2	-	4,1	1,7	-6,9	3,7	4,5%	3.5%
Japan	1,1	2,0	2,5	3,2	48,3	216,3	2,9	-6,8	2,7	-	0.6%
Brazil	3,0	3,0	9,3	4,6	49,4	60,0	-1,9	-7,8	7,6	-	10.6%
Russia	-3,0	3,0	13,8	6,0	53,8	23,1	4,7	-3,1	3,0	11,7%	11.1%
India	8,7	7,0	5,4	6,6	56,0	46,5	-1,0	-6,4	8,5	7,3%	7.2%
China	3,0	5,2	2,0	0,4	50,7	360,3	1,8	-4,7	4,0	2,8%	2.5%
World	3,1	2,9	7,6	6,0	-	-	0,6	-	7,1	-	-

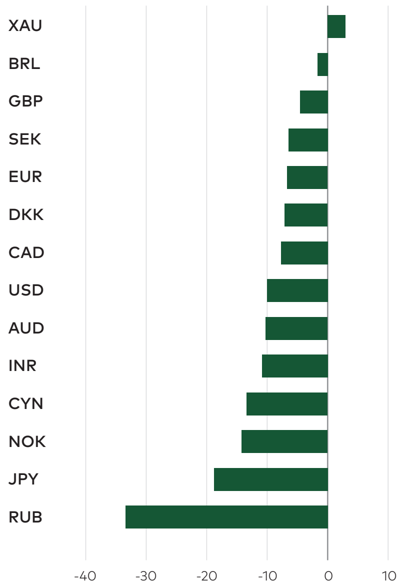
Market Performance

Exchange-Rates

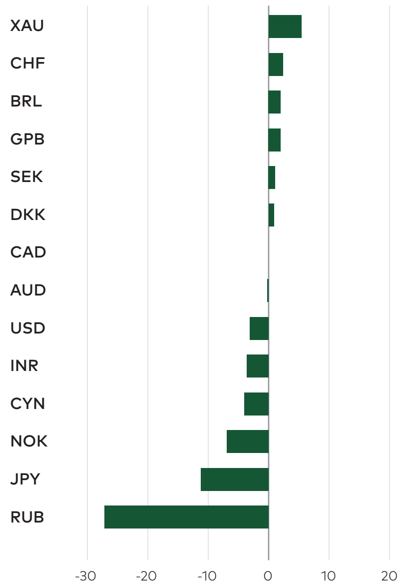
AGAINST USD (%)



AGAINST CHF (%)



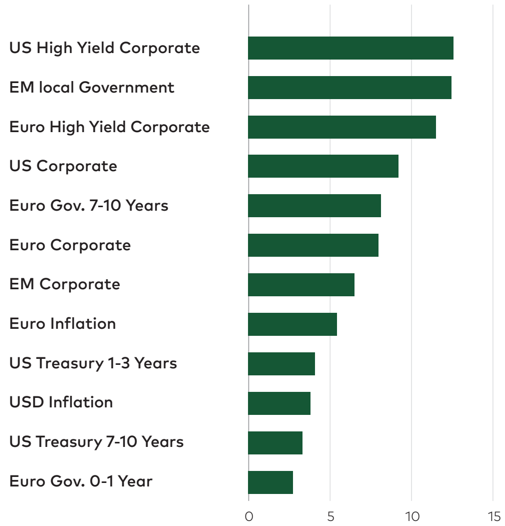
AGAINST EUR (%)



Stock Markets / Total Return & Valuation

	USD	EUR	CHF	GPB	Leading PE	
					Médiane LT	Current
S&P 500	26,3%	22,3%	15,0%	19,7%	17,9	21.8
Eurostoxx	26,3%	22,2%	14,9%	19,7%	14,4	12.6
Swiss Perf. Index	16,5%	12,8%	6,1%	10,5%	19,1	19.4
FTSE 100	13,9%	10,2%	3,7%	7,9%	15,2	11.3
MSCI Asia Ex-Jpn	7,4%	3,9%	-2,3%	1,8%	14,6	14.6
Nikkei 225	21,8%	17,9%	10,9%	15,5%	20,6	24.3
Brazil Bovespa	33,1%	28,4%	21,3%	26,1%	14,4	9.4
MSCI Russia	-	-	-	-	6,0	-
India SENSEX	20,8%	17,0%	10,0%	14,5%	20,4	24.1
China CSI 300	-11,9%	-14,8%	-19,8%	-16,5%	15,7	11.7
MSCI World	23,8%	19,8%	12,7%	17,3%	17,5	18.9

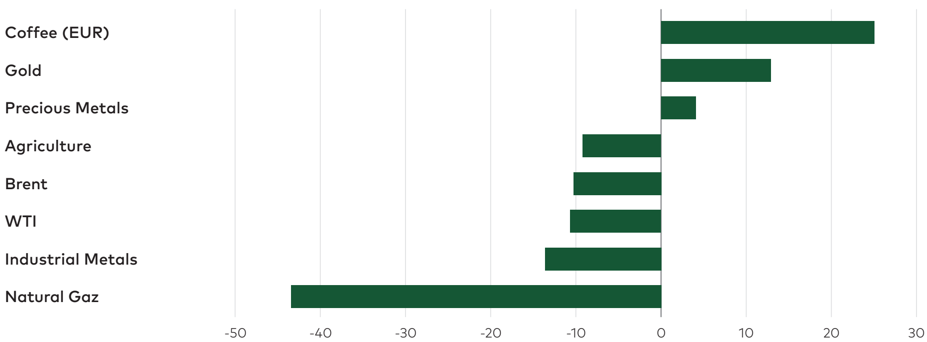
Bond Market



Sectors / Returns & Valuation (Leading PE)

	USA	Europe	World	USA		Europe		World	
				LT Median	Current	LT Median	Current	LT Median	Current
Cons discr.	41,0%	13,4%	33,6%	21,6	27.1	15.0	12.4	18.8	20.3
Cons. Staples	-1,6%	-1,0%	0,1%	19,4	20.2	18.7	17.4	19.2	19.1
Financials	12,2%	16,5%	13,1%	14,2	15.4	12.1	9.0	13.7	12.7
Energy	-4,8%	4,5%	-0,7%	14,6	9.8	11.2	7.8	13.8	9.6
Industrials	18,9%	24,7%	21,2%	18,4	22.4	18.9	19.7	18.4	20.2
Technology	54,1%	33,1%	52,3%	22,4	32.7	25.7	25.1	23.1	31.9
Materials	10,4%	8,3%	11,7%	17,4	19.6	14.7	16.2	16.1	16.7
Utilities	-9,9%	9,5%	-2,5%	16,7	17.2	14.1	13.5	16.5	15.0
Health Care	0,6%	6,4%	2,4%	19,4	21.9	20.3	18.7	20.2	21.3
Telecom	53,4%	10,9%	44,0%	17,5	20.2	16.0	15.5	18.3	20.4
Real Estate	7.3%	6.8%	17.7%	44.3	37.2	30.8	13.9	28.3	26.9

Commodities



ALLOCATION GRIDS

Global Asset Classes

	Overweight	Marketweight	Underweight	Main Drivers	Risks
Stocks	●			We expect inflation and interest rates to continue to recede over the next months, supporting equity markets.	A second wave of inflation or central bank missteps.
Bonds	●			Yields on global bonds are looking attractive, as inflation drifts lower. This asset class should regain its diversification virtues, were the economic slowdown to prove harsher than anticipated.	Stickier-than-normal inflation and very expansive fiscal policies.
Gold		●		Receding real rates support gold prices.	Rising real interest rates.
Cash			●		

Equities

	Overweight	Marketweight	Underweight	Main Drivers	Risks
US		●		Private income and demand continue to be strong, amid waning inflation and easier monetary conditions.	Over-optimistic expectations with regards to a soft landing.
Europe		●		Core inflation should continue to back down, and manufacturing activity is bottoming thanks to depleted inventories and cyclicality.	Market complacency leading the ECB to strengthen its tone and keep rates high for too long. Resurgence of (recently overlooked) geopolitical risks, particularly given the 2024 electoral agenda.
Switzerland		●		Against a backdrop of slowing inflation, lower rates should enable small- and mid-caps to stage a rebound. If the low point of the manufacturing recession has been reached, this will provide further support.	A stronger-than-expected pick-up in inflation in early 2024, because of one-off factors (VAT, rents and electricity), that could prompt a market correction.
Asia Pacific ex-Japan		●		Deflationary pressures persist, but disposable income and consumption have picked up somewhat.	Debt issues and weakening external demand.
Japan		●		The still accommodative monetary policy and weak yen are supporting exports.	Continued decline in real disposable income and weakness in personal consumption.

Bonds

	Overweight	Marketweight	Underweight	Main Drivers	Risks
Developed Sovereigns	●			Sovereigns provide investors with stable, visible and liquid cashflows, as well as renewed safe haven characteristics and positive net-of-inflation yields. Inflation-indexed bonds can make for an attractive diversification.	Sticky inflation, aggressive central banks or fiscally undisciplined governments could drive yields higher.
Corporates (IG)	●			High quality corporates offer a good mix of yield and spreads, with a very low risk of default; favour medium-term maturities.	Recession-related pressure on credit fundamentals and financial stress would cause a widening of credit spreads.
High-Yield			●	Caution is warranted, given the likely increase in defaults and unappealing spreads. Prefer short-dated high-yielding bonds.	High-yield bonds could suffer more should the financial turmoil worsen.
Emerging		●		Relative valuations are attractive, alongside resilient economic and credit fundamentals.	Emerging countries could come under pressure in the event of a global recession, rising USD or significant drop in commodity markets.

Currencies

	Overweight	Marketweight	Underweight	
EUR vs USD	●			In a "risk on" environment, an undervalued EUR should continue to appreciate.
EUR vs CHF			●	The CHF can be expected to appreciate against the EUR, although the potential is limited by the likely slowdown in the pace of SNB balance sheet reduction.
USD vs CHF			●	The CHF will likely continue to appreciate against the USD, as the interest rate differential becomes less of an advantage for the USD.
EUR vs GBP	●			The current account deficit and a central bank that has fallen behind the curve argue for further GBP depreciation. We would turn neutral if the EURGBP pair breaks 0.85.
EUR vs JPY		●		The EUR's third quarter correction has increased its attractiveness against the JPY, in an environment of still EUR-favourable interest rate differential.
USD vs GBP	●			The current account deficit and a central bank that has fallen behind the curve argue for further GBP depreciation.

SWITERLAND
HAPPILY DISAPPOINTED

ANICK BAUD / SENIOR FUND MANAGER

Three months ago, while indeed expecting that Switzerland would escape recession, we did not bank on growth holding up so well, given the weakness in manufacturing. And although recognising that the slowing of inflation was well underway, we were expecting a slight uptick at the end of the year – which did not come about. Absent a severe recession in Germany, we believe that the Swiss outlook is not looking that bad moving into 2024.

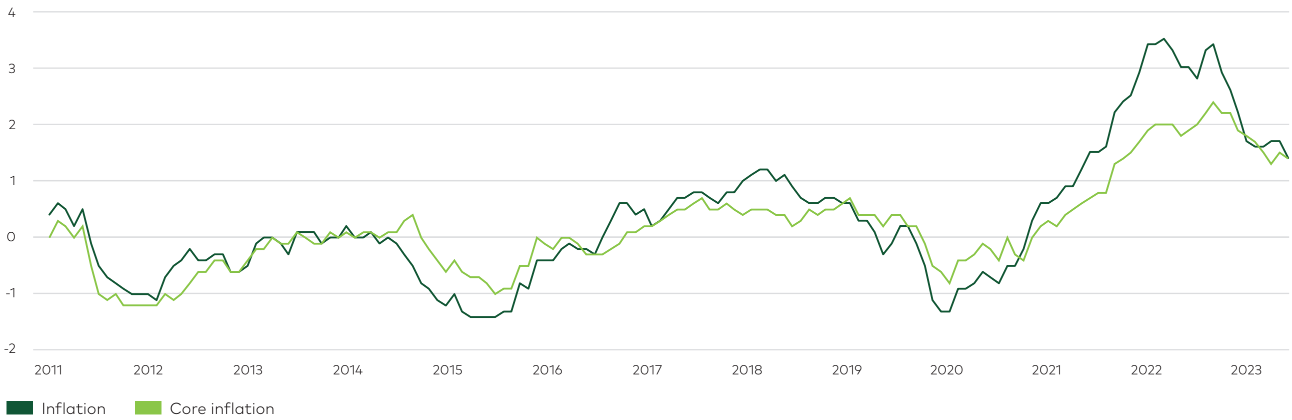
Some light at the end of the tunnel:
Switzerland has been in what is termed a manufacturing recession for almost a year now. For 11 consecutive months, the purchasing managers' indicator (PMI) has been below the growth threshold of 50, and last summer it even came close to levels not experienced since the 2008 financial crisis. The latest data cannot yet be considered a true reversal of trend, but there are nonetheless some tiny reasons for rejoicing. For instance, the "order books" and "production" components have improved slightly, which gives us hope that, for industrial companies, the worst is now behind. The "clean-up" of excessively high inventories has proved a much lengthier process than expected, but it does now seem that, outside of a few very specific activities, the situation has finally returned to normal and demand, albeit timid, is making a comeback. Also, contrary to what some feared during the summer, the services PMI continues to hold up well. Above 50 for a fourth consecutive month, it testifies to the resilience of the domestic economy and the strength of the consumer, which is both pleasing and surprising in this gloomy context.

All eyes are on Germany:
For months now, when discussing the global (and more particularly European) economy, the recession word has hung like a sword of Damocles over our heads. To date, this threat has not yet materialised, and is in fact regularly postponed. The Swiss economy remains resilient, despite its very open nature and the weakness of manufacturing output. Third quarter GDP growth proved a pleasant surprise, up 0.9% after adjusting for the positive effects of the 2022 sporting events. Once again, and this will come as no surprise, private consumption acted as a buffer and more than offset the weakness in investment and production. For 2024, we continue to believe that Switzerland will stay clear of recession, but its economic strength will depend largely on the health of its main trading partners, particularly Germany. The largest European Union (EU) member is going through an unprecedented crisis, with repercussions for Swiss companies, particularly those in industry and construction, that could ultimately weigh on the country's growth and reverse the onset of a trend reversal. To say that Germany's fate will determine that of Switzerland next year would be an exaggeration, as the country can rely on other supports such as a still solid US economy and domestic consumption that is holding up. Still, we must admit that a lack of impetus from the other side of the Rhine could well tarnish the Swiss outlook.

The "order book" component of the PMI has improved since the low point of summer 2023

Inflation largely under control:
The excellent news as of the end of 2023 is the low level of inflation. Since February, price indices have dropped steadily and, during the summer, even fell below the 2% mark (1.4% in November). The Swiss National Bank (SNB) has thus won its battle against inflation and can claim to be, as of today, the only major central bank to have fulfilled its contract. A few minor setbacks, such as increases in electricity prices, VAT, transport and rents, could still fuel inflation at the onset of 2024, but these effects will be temporary and small-scale. While we feared up until recently that the increase in the benchmark mortgage rate applicable to lease contracts would have a major impact on rents, which account for almost 20% of the inflation computation, this has not proved the case. In fact, the first hike implemented

The SNB has won its battle against rising prices



in June had very little impact on rents, less than 2%, and even though a second increase just took place in December, it should have only a very temporary and modest impact on price indices. We thus believe that the SNB is well and truly done with its monetary tightening, as evidenced by its December meeting, and the first rate cuts, against a backdrop of weak growth, are even expected in 2024.

A weakened but not defeated consumer:
For more than two years, domestic consumption has been the engine of Swiss growth, its strength offsetting other weaknesses. Such robust consumer health is the result of a particularly vibrant labour market and the surplus savings accumulated during the pandemic. But can the economy still count on this support, considering that, as per the latest surveys, companies stand ready to cut their workforce during coming months, and purchasing power is eroding? What we can say is that the SNB's restrictive policy has had fewer negative effects than expected, and that the tightening phase now seems to be well and truly over. In addition, thanks to the pullback in inflation, a very slight increase in real wages can be expected in 2024 (+2.1% in nominal terms according to the KOF, i.e. exceeding estimated inflation). While a larger number of companies are now planning to cut jobs, the scale of such downsizing should be curbed by hiring difficulties, admittedly less severe than a few months ago but still present. This situation might even be exacerbated by large waves of retirements. To this list of factors supporting consumption, we should also add the above-average demographic growth in Switzerland thanks to immigration. The picture is not entirely rosy, however, and the very substantial increase in health insurance premiums in 2024 (+9% vs. a 20-year average of +3%) will likely weigh on domestic demand. According to UBS estimates, household disposable income could suffer a 0.5% hit. Even weakened, the consumer should nonetheless continue to contribute positively to overall economic growth.

The strength of the Swiss franc and corporate margins:
The Swiss currency has tended to be strong against those of its major trading partners throughout economic history. That said, the speed with which the Swiss franc has acted as a safe haven over the past two years has been a real headache for Swiss exporters. While it must be acknowledged that such appreciation helped contain the rise in imported prices and that the value of the franc measured in purchasing power parity terms is lesser than in nominal terms, given the low relative level of inflation, the impact on profit margins is not insignificant. Especially when it comes to small and medium-sized businesses, less likely to have natural «hedges» and whose costs in Swiss francs are disproportionately higher than their income. Ultimately, if the strength of Swiss companies lies in their ability to overcome this issue through productivity gains and constant innovation, a means to justify higher prices, it no doubt proved a drag on Swiss equity returns in 2023. And even though the Swiss franc will likely remain structurally strong, we can imagine that, in a context of controlled inflation where the SNB no longer needs to make massive buybacks in order to support the currency, 2024 should bring some relief to Swiss companies' earnings, which is bound to have a positive impact on their share prices.

EUROPE
DON'T PLAY THE SCORE AHEAD OF THE CONDUCTOR

MALEK DAHMANI / FUND MANAGER

The November and December equity rally has saved the full-year performance, with 2023 having started, and ended, on a very strong note but lost considerable ground in between. While the optimism that is currently driving financial markets may well carry over into 2024, we feel that its beat is a little too rapid.

For those who like puzzles, here is a little riddle: as 2023 ended in an – apparently – similar manner to 2022, will the onset of 2024 be similar to that of 2023, bearing in mind that a rich political agenda await us across the globe, notably with elections in the US and Taiwan, that the geopolitical situation remains volatile and that we will be entering the year of the Dragon in the Chinese calendar, a sign of success? Unsolvable? Let us take a closer look.

The current enthusiasm, boosted by Jerome Powell's clear change of rhetoric mid-December, would seem to point to a very good start of 2024. The current rally is enabling 2023 to close on much better equity returns, particularly European, than were expected by most investors 12 months ago. The main reasons lie in a successful balancing act: avoidance of the long-awaited recession despite interest rates that continued to rise until September, coupled with decelerating inflation on both sides of the Atlantic, which opens the door to cuts in those same rates. Add to this recipe a pinch of artificial intelligence to revive the technology sector, and you get a very solid performance, more than double the current risk premium in this market. Ultimately, the losers were the defensive names, notably healthcare and consumer staples, abandoned by investors as the scenario unfolded. Barbell strategies combining growth and value stocks, on the other hand, benefited from the good performance of both these market segments, each having enjoyed a period of positive momentum during the year.

Against this backdrop, and as the new year begins, we believe it is important to stay measured, and not to play the score ahead of the conductor, namely central banks. In particular, we see a number of reasons to adopt a cautious short-term approach, while keeping a constructive exposure to European equities over the long run. The key will be to take advantage of investment opportunities as soon as the market enthusiasm cools down.

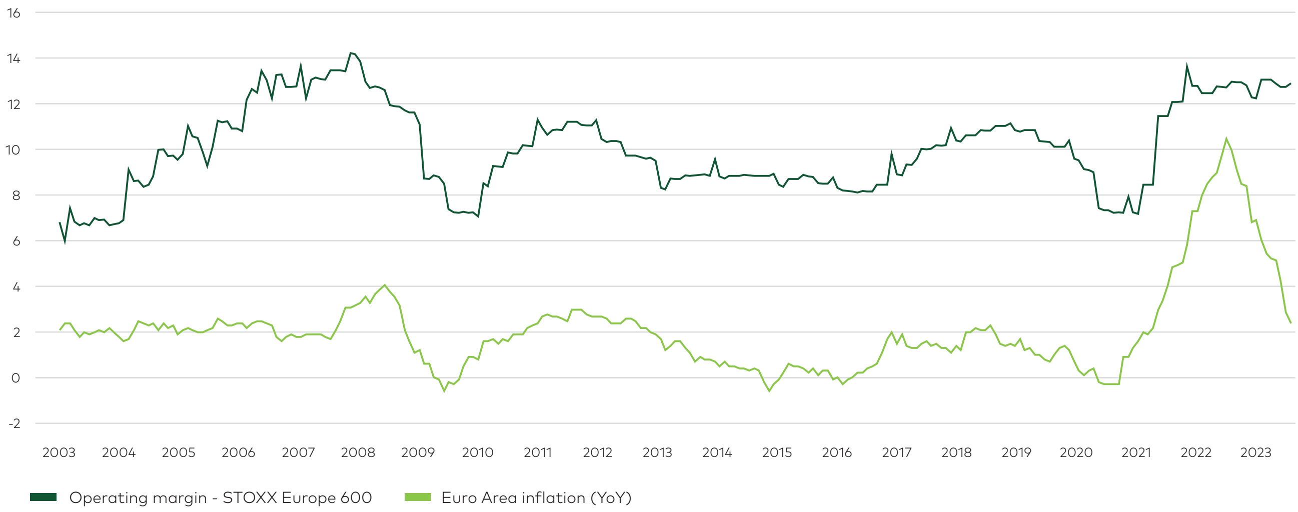
A certain amount of good news is unlikely to occur again in 2024. The pace of inflation deceleration is set to slow, with the spectre of a resurgence making frequent appearances. Households and businesses will meanwhile likely increasingly feel the bite of high interest rates. Moreover, before considering any rate cuts, the ECB is determined to slow down two indicators directly linked to households and businesses: wage inflation and profit margins.

We have mentioned wage inflation on several occasions in our recent publications. We argued that it plays a key part in ensuring that core inflation is anchored at the 2% level that our economic system hopes for. Acknowledging the words of Christine Lagarde, the process is clearly taking longer than we would have expected: «When we look at the (wage) data that we have now, it is not declining» (Christine Lagarde, 14 December 2023).

> *"Inflation could also turn out higher than anticipated (…) if wages or profit margins increased by more than expected"*
> *(Christine Lagarde, BCE, 14 December 2023).*

European company operating margins have meanwhile reached highs not seen since 2008. It has now been established that part of this improvement is due to inflation, with companies having captured a significant share of price increases in their earnings. This phenomenon is corroborated both by macroeconomic studies and by our discussions with company managements. Such a dynamic can become vicious if it sets about a spiral in wages and, ultimately, prices. The ECB thus clearly wants to see this data degrading, at least slightly, before truly starting to cut rates. Falling corporate profit margins, leading to restructuring measures and impact on employment, are the most effective way of stabilising wage growth. The way ECB members have taken turns to insist that there is no certainty regarding rate cuts during the first part of 2024 seems confirming this scenario of «higher until we see wages and profits margin pointing south».

Stoxx 600 operating margin and core inflation



Such ECB intent, with a tone that is currently firmer than the Fed's, does not seem credible for now. It is indeed hardly reflected in 2024 market expectations, nor in investors' rather euphoric mood heading into year-end festivities. Against this backdrop, it is worth adjusting portfolio exposure to some defensive sectors. They could benefit from their characteristics to make a positive contribution to performance, assuming the scenario suggested above unfolds.

Maintaining exposure to growth segments as well as small- and mid-caps is also still a good idea in our opinion. The ECB, like its US peer, will have to react swiftly at the first tangible signs of wage deceleration and falling profits margins. Central bankers will need to switch from being orchestra conductors to tightrope walkers. The goal being to loosen monetary conditions and avoid too deep a recession, bearing in mind that some countries, not least Germany, are already in a very difficult situation. Portfolios will then have to be well exposed to the above-mentioned segments. As the months of October 2022 and November 2023 clearly demonstrated, when the music starts up again, it waits for no one!

If the score is played correctly, the rest of the concert should be harmonious. The long-term growth outlook remains robust, thanks to the secular trends of energy transition and sustainability, in which European companies are at the forefront, and digitalisation, that underpins long run productivity.

UNITED STATES
SOFT LANDING OR RECESSION, THAT IS THE QUESTION

PETTERI PIHLAJA / CONSEILLER // **ANTTI TILKANEN** / CONSEILLER

The labour market continues to soften, albeit very gradually. High interest rates are starting to bite, but household disposable income and spending will remain firm for some time. Much hinges on the savings rate, namely whether or not it moves back up as disposable income catches up with higher prices.

2023 proved a year of continuously rising economic estimates, a dynamic that started amid bleak expectations a year ago but is unlikely to persist throughout 2024. The overall US economy has remained very resilient, thanks to healthy – all-important – household demand, largely unhindered by the higher level of interest rates. Other parts of the economy, notably industrial production and housing have meanwhile been sluggish, the impact of interest rates being more immediate.

Looking to 2024, inflation that will continue to recede, alongside significant lags and uncertainties in terms of monetary policy impact, means that central banks could adjust their stance somewhat too late (as is often the case). Whether a soft landing or a recession scenario will emerge as the base case thus remains the most interesting question.

A definite answer to this question has been pushed out farther into the future. While the trajectory of inflation has matched expectations, consumption demand has surprised to the upside. Despite some early signs of easing, no rapid rollover is occurring – for the time being at least.

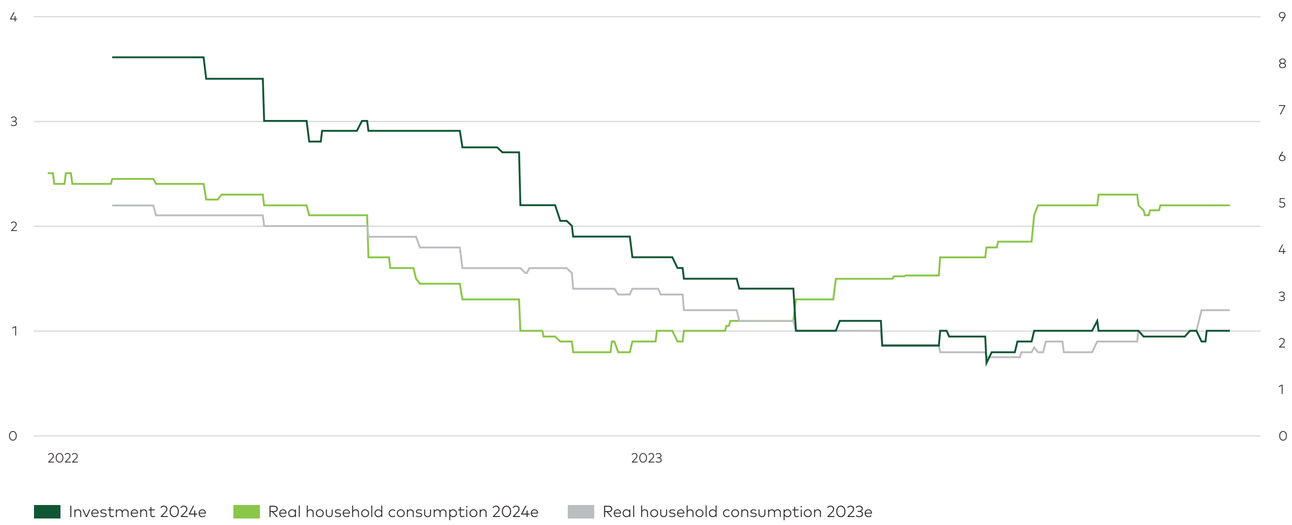
The most important indicators to monitor in this respect are those related to the labour market, to wages and to household finances.

The labour market remains tight. Unemployment is trending up very slightly, but currently still stands at 3.7% which essentially means full employment. Payroll growth is very low outside of the healthcare and education sectors, which are less sensitive to the business cycle.

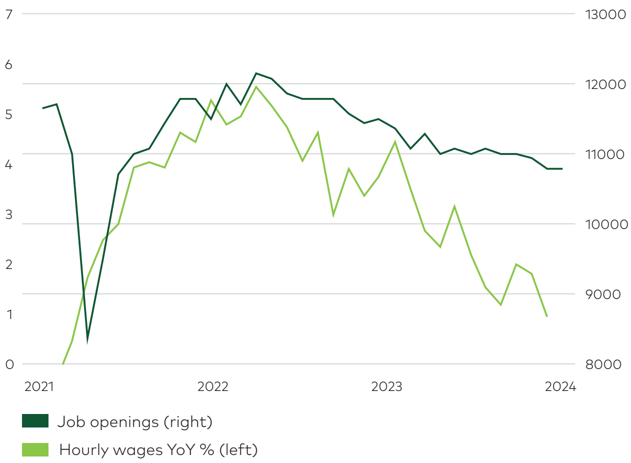
Jobless claims, quit rates and job openings are showing some initial signs of weakening. The effects of higher rates are starting to be visible, but the process will take more time. Even in the industrial sector, the situation is rather stable. Output is stagnating and PMIs are hovering below 50, but job openings have stabilised or even started to improve slightly.

Wage growth continues to trend downwards, now at 4% year-on-year. This is indicative of a lesser demand for labour, which is an obvious prerequisite for medium-term inflationary pressures to be kept in check. All signals point

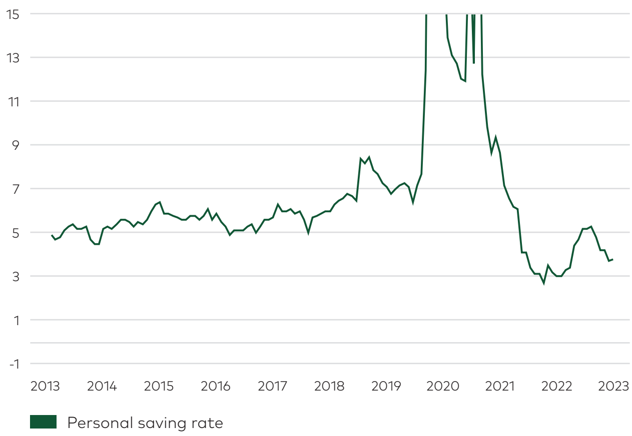
Consumption and investment estimates



Hourly wages and job openings



Savings rate



to this trend continuing far into 2024, as the mismatch between labour supply and demand has diminished. That said, a significant drop is not to be expected, with the participation rate having climbed back close to the pre-pandemic levels, meaning that there is no longer an ample supply of workers that could re-enter the labour force.

Backed by the solid employment situation, as well as healthy balance sheets, households continue to spend – keeping the "higher for longer" narrative alive for now. It should, however, be added that consumption is not completely backed by disposable income growth, making the situation somewhat precarious. Consumers have drawn upon "excess" savings accumulated during the pandemic, which boosted consumption demand by about USD 2 trillion over the past two years and are now largely depleted. In other words, the savings rate has been somewhat lower than its usual levels of the past 10 or 20 years, with incomes slow to catch up on inflation.

While the current ca. 4% savings rate is not unsustainable from a fundamental perspective, households might start to prefer to save more as the outlook becomes more uncertain and savings more lucrative. This, in turn, could lead to a slight slowdown in consumer demand. But, with rising incomes to maintain consumption growth in positive territory, some ebbing would not alarming per se, as long as no cracks appear in the labour market. In any event, developments on this front will warrant close monitoring. After all, US household consumption is the number one driver of demand in the US economy, as well as globally.

Corporate profitability remains strong. The small earnings recession of the past nine months passed with little damage and forward earnings estimates are now approaching their prior peak. The slow revenue growth of 2023 is expected to improve somewhat going into 2024, to around 5%. In short, fundamentals are not the issue currently. Rather, it is the valuation levels that look demanding. A forward earnings yield of 4.5% may not be exceptional by recent history, but relative to a 4.2% 10-year Treasury yield it is somewhat stretched. A reacceleration that significantly pushes the earnings outlook upwards relative to interest rates seems unlikely. In a soft-landing scenario of continued growth and easing monetary policy, current valuation levels make sense, but the risk premium is certainly thin.

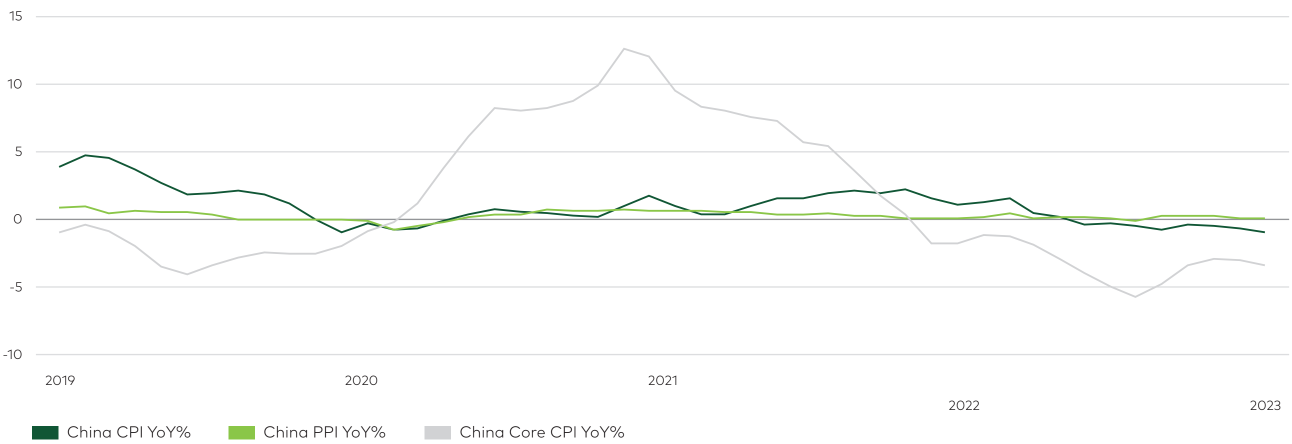
ASIA

WILL AN INVESTMENT SHIFT TOWARDS MANUFACTURING HELP REBALANCE THE CHINESE ECONOMY?

PETTERI PIHLAJA / CONSEILLER // **ANTTI TILKANEN** / CONSEILLER

The Chinese economy continues to face deflationary pressures, with weak end demand and a faltering property sector. Authorities have recently been shifting investments towards the high tech manufacturing sector, but this might actually create more problems than it solves.

Chinese CPI, core CPI and PPI YoY



The past year turned out pretty much as expected in terms of economic outcome, although the trajectory was rather more subdued than anticipated. At the onset of 2023, we thought that the lifting of Covid lockdowns would bring about an aggressive rebound in consumer spending, followed by a slowdown in the latter half of the year. The weakness of the actual rebound proved quite a surprise. Which has only served to further strengthen our view that the Chinese economy has a serious structural problem, owing to the lack of private consumption.

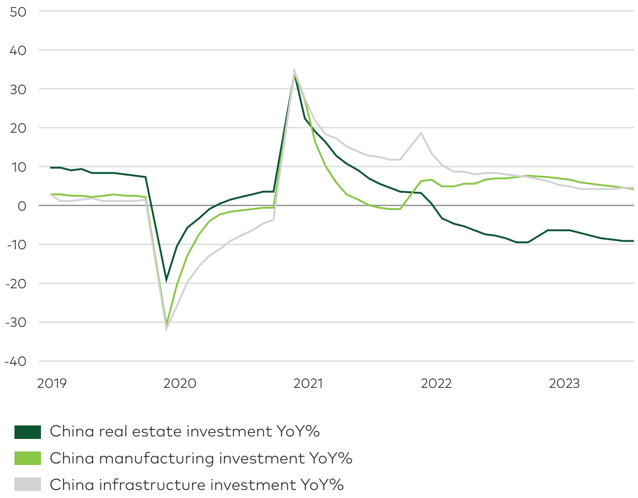
This weakness in consumption is highlighted by the recent deflationary pressures faced by the Chinese economy. Unlike the rest of the world, China did not have to fight rapidly rising inflationary expectations. These of course, find their roots in the massive Covid era stimulus (fiscal and monetary policy support) across the Western world. China, on the other hand, did not rely on direct transfers to private sector. As a matter of fact, the country's authorities have done surprisingly little to help struggling private enterprises.

The official consumer price index (CPI) remains in negative territory, while the core CPI (excluding food and energy) is barely positive. Food prices are down 4% year-on-year, and presently the main deflationary factor. Producer prices have been declining for over a year already, which is no surprise given the weak end demand for manufactured goods.

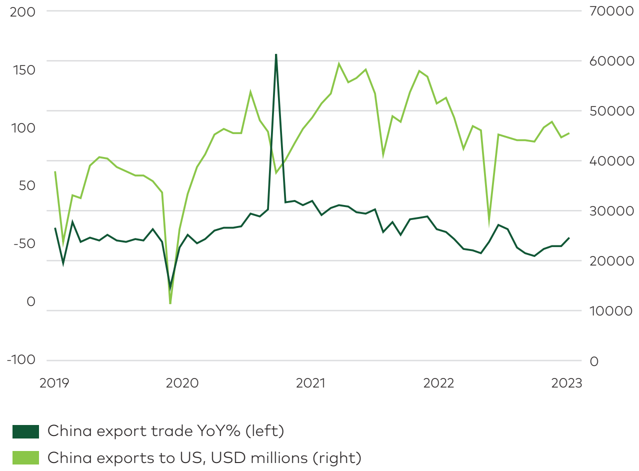
The property sector, with its massive debt load, continues to weigh on Chinese growth. The government is currently shifting lending from overextended developers to the manufacturing sector. In doing so, it aims to support new technologies, claimed to also boost employment and consumption over the long run. This is true in some sectors such as semiconductors, where US sanctions have slashed access to state-of-the-art manufacturing equipment. To cover its domestic chip requirements, China needs to reinvent almost the entire supply chain for semiconductor manufacturing equipment. The country has made steady progress on this front, and we would argue that these government-controlled investments will be useful and profitable ones.

Unfortunately, massive top-down investment programs almost always lead into inefficiencies, as evidenced by the electric vehicle market. Production of electric vehicles has increased rapidly in China over the past few years, and the market is now facing declining profitability. This is a usual

Chinese real estate, infrastructure and manufacturing investments



Chinese export trade and exports to the US YoY



outcome for many product segments into which China entered via massive investment incentives: a higher global market share, coupled with oversupply and lower profitability.

There is also a question regarding the absorption of new capacity. Manufacturers in the private sector have been reluctant to invest, amid very weak domestic demand. It is estimated that the Chinese manufacturing base currently exceeds 30% of global capacity, while consumption accounts for merely 15%. This highlights the core problem with using greater lending (or direct subsidies) to the manufacturing sector as a tool to drive GDP growth: the Chinese consumer base will not be able to absorb the additional output.

Manufacturers in the private sector have been reluctant to invest, amid very weak domestic demand.

The excess may of course be absorbed by export markets, but to an extent that is questionable given the slowdown currently underway in many regions. Eurozone, for instance, is barely growing, while inflation expectations are fast receding. It is not exaggerated to expect Europe to start experiencing deflationary pressures sometime in 2024. The US consumer has held up very well during the inflationary phase, thanks to household balance sheets in a much better condition than during the 2008 crisis. Even though a soft landing represents the base assumption for now, any pickup in unemployment would drastically change this outlook for the worse. Overall Chinese exports have been quite weak for some time already, while those to the US have fallen back after a clear short-term spike caused by stimulus packages. As such, the question really is whether the US will be able to absorb all the excess Chinese manufacturing, given that not all investments are likely to go into underutilised product segments.

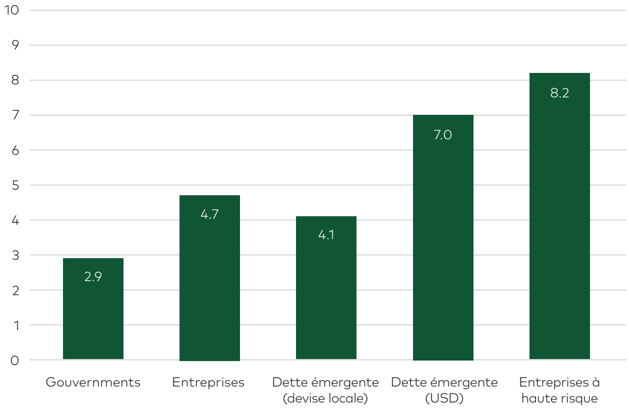
Overall, China's approach to restructuring its economy seems passive at best. Even Chinese mainland economists all agree as to where the problems lie – and have been suggesting real solutions. But the government continues to micro-manage the economy via investments. Given this backdrop, the Chinese economy has actually done well, with a recent pickup in consumption and disposable income growth. In March, we will get further information as to official GDP growth rate targets. By then, hopefully, the government will also have agreed on measures that more directly support the households' share of the income pie.

FIXED INCOME

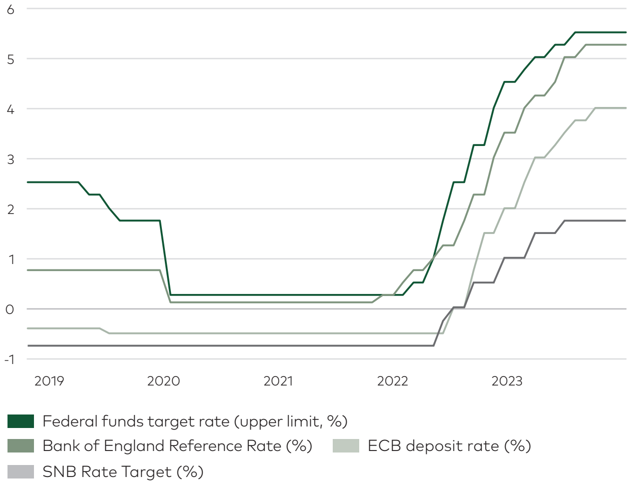
MANUEL STREIFF / CONSEILLER

The pivot in central bank tone during the final months of 2023 was notable. Policymakers moved away from tightening monetary conditions to slow demand and inflation, and begun to signal that interest rates would be eased during 2024. Following a strong third quarter, economic growth moderated towards the end of the year. In the US, the Fed communicated its optimism that inflation had been largely vanquished without a recession. In Europe, price indices dropped precipitously, allowing the ECB to end its rate hiking cycle.

Yield to maturity per fixed income segments: Sovereigns, Corporates, Emerging debt in local currencies, Emerging debt in USD and High Yield



Key central banks target rates

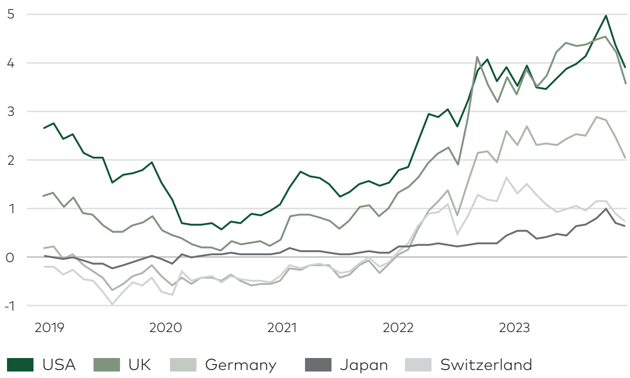


DEVELOPED MARKET SOVEREIGNS

Late October, bond markets began one of their sharpest rallies since the onset of the Covid pandemic in early 2020. US and European sovereign yields have moved down by more than 1%, with investors anticipating a faster pace of rate cuts over the next few years. By the end of December, investors had priced in more than 1.5% of rate cuts in 2024, almost twice what the Fed signalled in its summary of economic projections (dot plot).

In the US, the Treasury added to the Fed's dovish pivot by moderating its signalling of new bond issuance. European bonds meanwhile benefited from lower energy prices, reversing part of the energy shock that followed the Russian invasion of Ukraine and subsequent sanctions. Italian and other European government bonds outperformed their German peers.

Sovereign yield to maturity (10Y benchmarks)



The performance of Japanese bonds proved weaker, as the Bank of Japan gradually prepared the market for an exit from its ultra-accommodative monetary policy.

Within a well-balanced bond portfolio, inflation-linked bonds remain attractive. The high real yield and relatively low discount in spread terms to nominal bonds provide investors with a reasonably cheap protection against an eventual inflation shock.

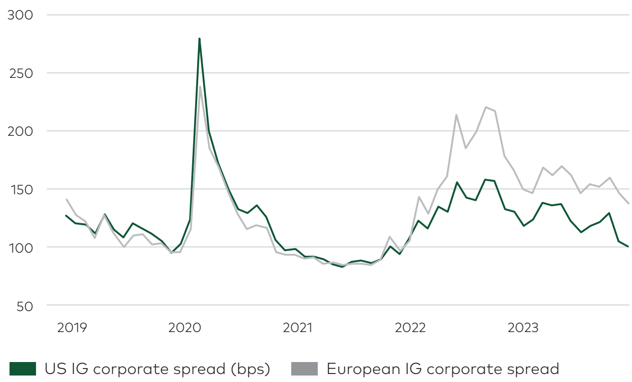
DEVELOPED MARKET CORPORATES

Corporate bonds in developed markets are very sensitive to government bond yields and, as such, benefited strongly from the rally in government bonds. Credit spreads also tightened as investors reduced their recession expectations.

Hybrid bonds still look attractive. Given already tight credit spreads, longer-maturity corporate bonds are less interesting than government bonds should recession risks pick up.

That said, short-term high-yielding debt issued by companies with manageable financing profiles remains attractive. While spreads have narrowed, the very front part of the US yield curve continues to offer high yields.

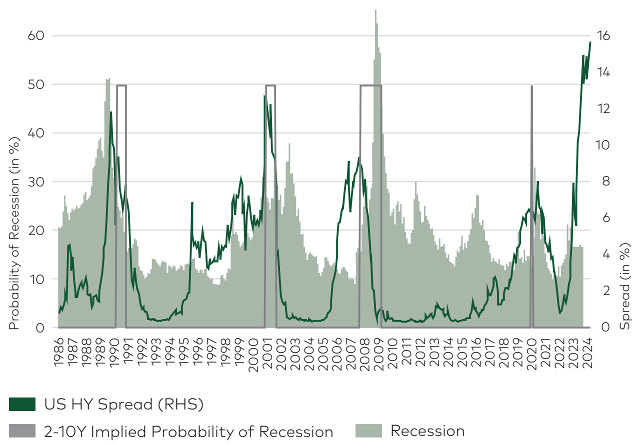
US and European Corporate Spreads (Investment Grade)



HARD CURRENCY EMERGING MARKET DEBT

Emerging market debt has benefited from the more constructive investor attitude towards risk. The weaker US dollar reduces the credit risk of such bonds, as it implies a lower servicing cost measured in the issuers' local currency.

US High Yield spreads and probability of recession, as derived from the yield curve

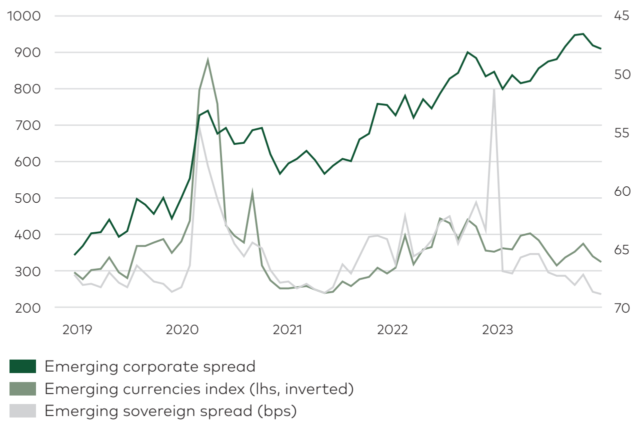


LOCAL CURRENCY EMERGING MARKET DEBT

The more dovish Fed benefits local currency denominated bonds through two channels. US dollar depreciation strengthens currencies and reduces imported inflation, allowing emerging market central banks to cut interest rates. And lower yields in the US and other developed economies encourage outbound portfolio flows, in search of higher yields.

Within the segment, bonds of countries with high real (inflation-adjusted) yields are particularly attractive. Brazilian local debt for instance offers high yields in both absolute terms and relative to US yields. A stable to appreciating currency further enhances the capital gain potential of such investments. Chinese bonds are less attractive, as their absolute yields are very low and the recently announced substantial increase in government issuance will exert downward pressure on prices.

Emerging Spreads (corporate and sovereign) and emerging currencies index (vs. USD, inverted)



BRUELLAN FIXED INCOME PROJECTION

Segments	Yeld (%)			Return View (12m horizon)
	USD	EUR	CHF	
Cash	5,37	3,43	1,51	↘
Short-Term High-Yielding	6,14	4,55	2,04	↗
10y Government Bonds	3,93	2,07	0,70	↗
10y Government Inflation-Linkers	1,72	0,08	n.a.	↗

Segments	Spread over Sovereigns (bps)	Return View (12m horizon)
Developed Corporates	116	↗
Corporate Hybrids	225	↗
Developed High Yield	428	→
Emerging Sovereigns	365	↗
Emerging Corporates	277	↗
Emerging Local-Currency Debt	n.s.	↗

Source: indices Bloomberg avec risque de devise couvert

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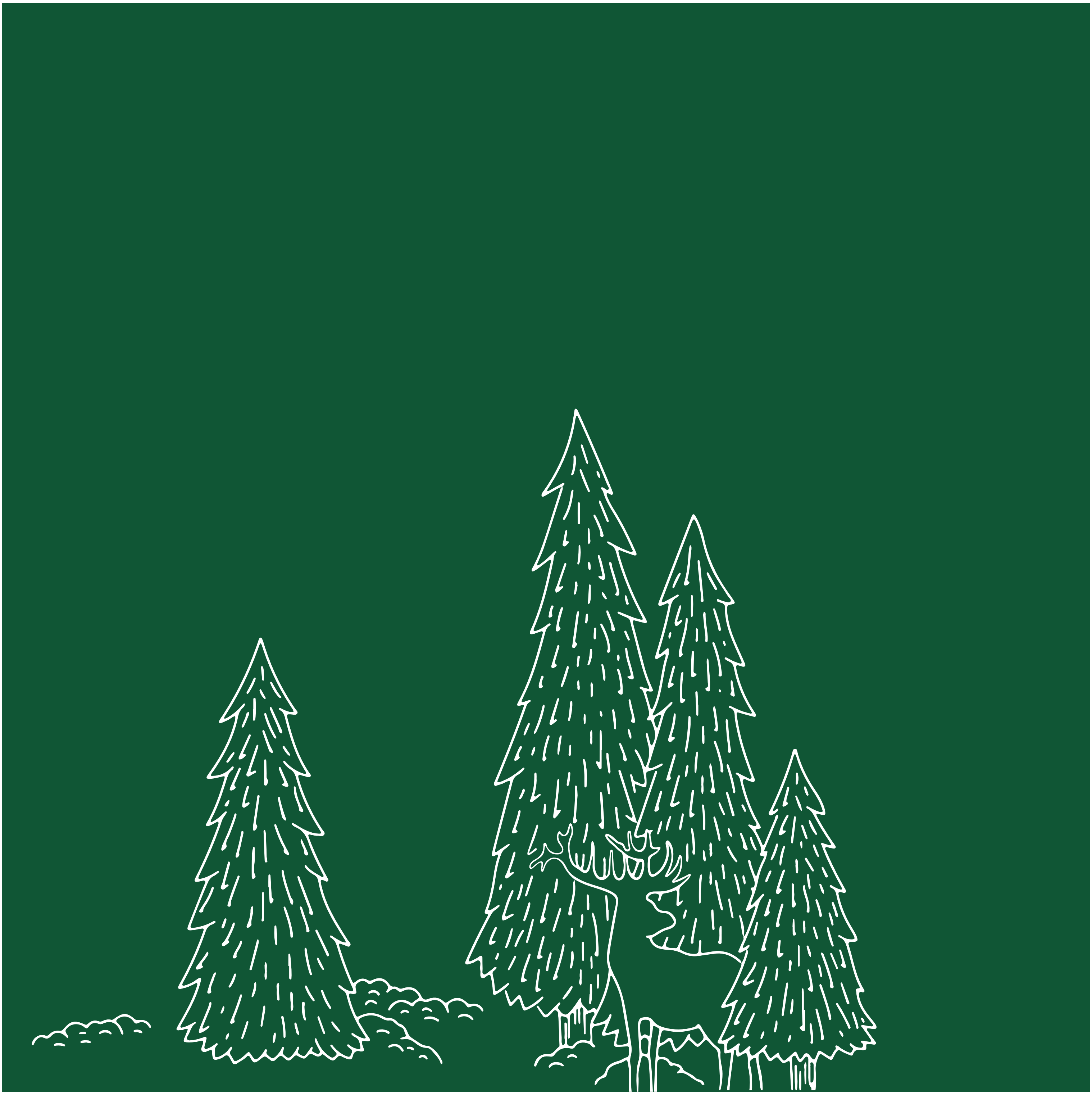

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