BRUELLAN PANORAMA
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QUARTERLY OUTLOOK / APRIL / MAY / JUNE 2024

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ECONOMIC OPTIMISM IS MAKING UP FOR LATER RATE CUTS

FLORIAN MARINI, CFA, CMT / CHIEF INVESTMENT OFFICE

An eminent risk at the onset of this year, besides geopolitical tensions, was the misalignment between market expectations for interest rate cuts – as regards both their magnitude and timing – and the more cautious stance communicated by central bankers. At that time, US futures markets were forecasting nearly seven cuts in 2024, for a cumulative reduction of 1.7%. This outlook has since undergone a significant adjustment, with expectations pared back to fewer than four cuts totalling 0.9%. Accordingly, the end-of-year projected US deposit rate has climbed from 3.7% to 4.5%. Eurozone expectations have followed a similar path, in terms of both the size and frequency of anticipated rate cuts.

Which raises the question of why such a recalibration of expectations did not jolt financial markets? The answer lies in the perception that rate cuts are being delayed not because of escalated inflationary forecasts, but because of improving economic conditions.

In our previous quarterly outlook, we highlighted the severe manufacturing downturn, particularly in Europe, suggesting that it was nearing its end and would pave the way for a new four-year economic cycle. There is increasing evidence to support the idea that an inflection point has indeed been reached. The Philadelphia Fed index, a leading economic indicator, was among the first to signal a shift towards expansion, closely followed by improvements in the ISM new orders and manufacturing indices. Although not fully in expansion territory, these indicators are showing a marked improvement.

At the global level, the services PMI has remained in expansion territory since early 2023, with the manufacturing sector joining this positive trend in February. A more detailed analysis reveals a doubling in the ratio of countries experiencing a manufacturing expansion, from 22% in the second and third quarters of 2023 to 50% today. The world's largest economy, the US, has even seen its 2024 GDP growth forecast improve from 0.6% to 2.1% over the last three quarters. While Eurozone growth expectations remain more modest, at 0.5% for 2024, we anticipate upward revisions, given the usual economic lags relative to the US.

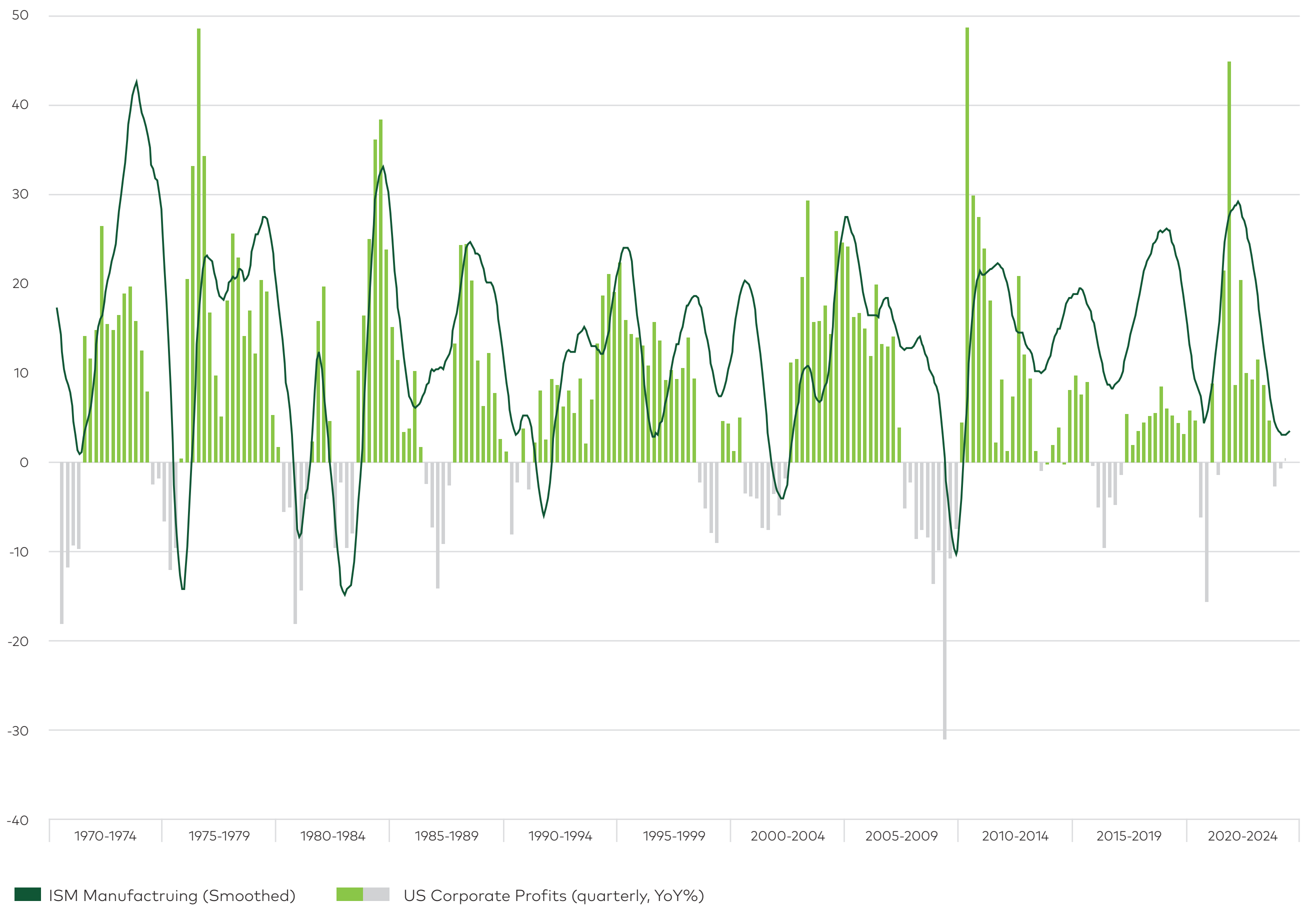
In China, the measured response to the real estate crisis and policymaker efforts to rejuvenate the economy, avoiding large-scale stimulus to prevent further currency depreciation, are beginning to bring about signs of stabilisation. This is illustrated by the recent transition to positive export growth from South Korea and Taiwan to China, following 18 months of contraction. We adopt a cautiously optimistic stance on the region's prospects. The forthcoming Politburo meeting in April should prove a pivotal occasion for China, as it will define significant policy strategies for the nation's future.

On the inflation front, pressures at the commodity, producer and consumer levels have receded notably over the past 20 months. The more stubborn component of consumer inflation, particularly services inflation which includes costs such as shelter and wage growth, is also demonstrating signs of a slowdown, although the situation in Europe is less pronounced when it comes to wages. Cutting inflation back from 9% to nearly 3% in the US (and from 10.6% to 2.8% in the Eurozone) was the more straightforward phase. Completing the "last mile" of inflation targets will likely prove more challenging, in a context of rising economic growth expectations and greater frictions within global supply chains.

Recognising this, central banks are opting to delay interest rate cuts and to moderate the scale of such adjustments. Their cautious approach, motivated by stronger economic growth, is much better than facing the dual challenges of recession and persistent inflationary pressures. Investors have already adjusted to this perspective, with market expectations now closely aligned to central bank rhetoric. The global forward price-to-earnings (P/E) ratio of 18.5x would tend to suggest that equity markets are somewhat overvalued. That said, the anticipation of stronger economic growth does mean potential improvement in earnings growth over the upcoming quarters, supporting equity markets. Historically, the beginning of an economic cycle has seen strong EPS growth (chart).

On a regional perspective, the US market is trading at an elevated P/E of 21x, contrasting with Europe's more attractive 14x. However, this US overvaluation is largely attributable to a few mega-cap stocks, known as the "Magnificent Seven". An equal-weighted analysis of the S&P 500 reveals a more reasonable P/E of 17x. In other terms, the valuation of the broader US market is not as stretched as the skewed perspective caused by mega-cap dominance would suggest. We thus maintain a neutral regional allocation.

US corporate profits (quarterly YoY) vs. economic cycle (smoothed ISM Manufacturing)



In conclusion, while central bank decisions to delay rate cuts are typically viewed negatively by markets, particularly when driven by uncontrollable inflation, the current context is different and much more constructive. Central banks are adopting a cautious stance because of stronger-than-anticipated economic performance, coupled with the recognition that the final phase of the battle against inflation is always the most challenging.

Although equity markets are not cheap, the prospect of improving earnings growth will likely bolster them. As such, it will be crucial to consider any correction (the probability of which is increasing given the substantial rally since the October 2023 lows) as a normal aspect of a healthy bull market, rather than the precursor to a bear market. Thus also as an opportunity to make strategic investments.

MARKETS PERFORMANCE

YTD AS OF 29.03.2024

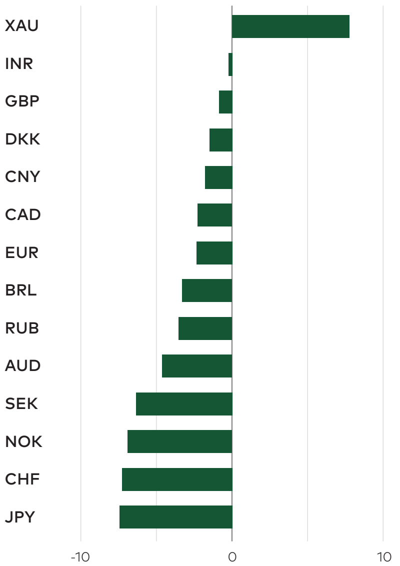
Economic Indicators

	Real GDP %		Inflation %		PMI	Debt % GDP	Current Account % GDP	Budget % GDP	Unemploy-ment %	Interest rates	
	2023	2024	2023	2024	Current	Current	Current	Current	Current	3 months	10 years
USA	2,5	2,2	4,1	2,9	52,2	97,3	-2,9	-5,9	3,8	5,4%	4,6%
Euro Area	0,4	0,5	5,4	2,4	46,5	91,0	1,9	-3,5	6,5	3,7%	2,5%
Switzerland	0,7	1,2	2,1	1,5	44,0	20,9	7,6	1,4	2,2	1,4%	0,8%
UK	4,5	0,3	7,3	2,5	47,5	101,0	-3,3	-5,0	3,9	5,2%	4,2%
Asia ex Japan	5,1	4,8	1,8	2,3	-	4,1	1,3	-5,8	3,7	4,5%	3,5%
Japan	1,9	0,7	3,3	2,3	47,2	216,3	3,6	-5,3	2,5	-	0,9%
Brazil	2,9	1,7	4,6	3,9	54,1	60,9	-1,3	-9,2	7,7	-	11,4%
Russia	3,6	2,0	6,0	6,7	54,7	23,1	2,7	-3,1	2,9	15,0%	12,7%
India	7,0	7,5	6,6	5,4	56,9	46,5	-0,9	-6,0	8,5	7,5%	7,1%
China	5,2	4,6	0,2	0,8	50,9	354,6	1,5	-4,6	4,0	3,6%	2,3%
World	3,2	2,8	6,0	4,0	-	-	0,6	-	7,1	-	-

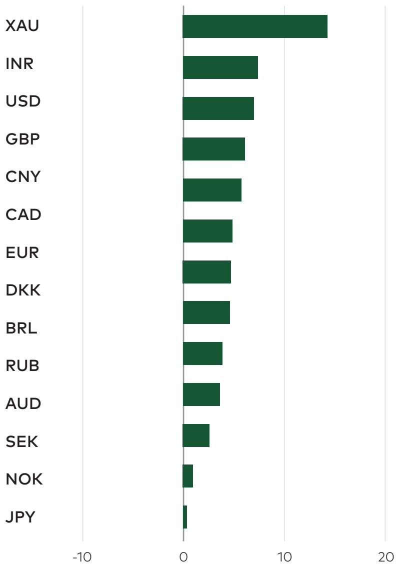
Market Performance

Exchange-Rates

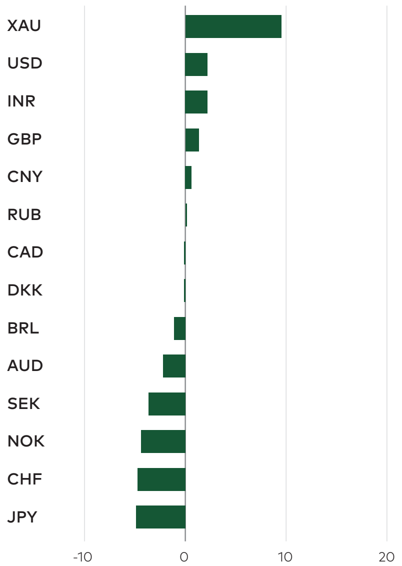
AGAINST USD (%)



AGAINST CHF (%)



AGAINST EUR (%)



Stock Markets / Total Return & Valuation

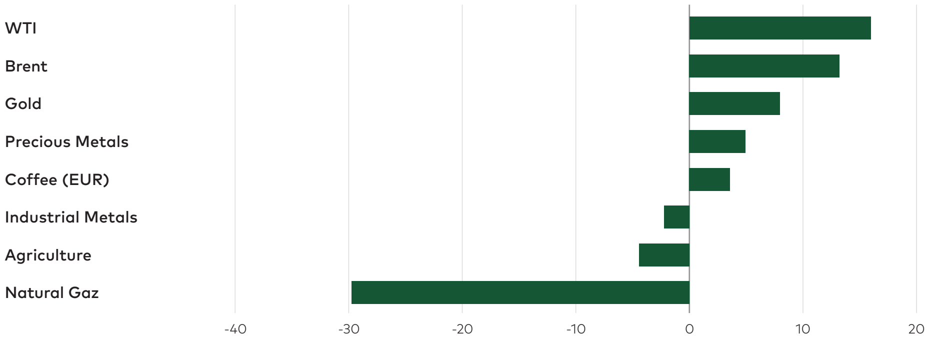
	USD	EUR	CHF	GPB	Leading PE	
					LT Median	Current
S&P 500	10,6%	13,3%	18,7%	11,8%	17,9	21,3
Eurostoxx	10,1%	12,8%	18,2%	11,3%	14,2	14,1
Swiss Perf. Index	-1,3%	1,1%	6,0%	-0,2%	19,1	18,9
FTSE 100	2,9%	5,4%	10,5%	4,0%	14,9	11,7
MSCI Asia Ex-Jpn	1,8%	4,3%	9,4%	2,9%	14,7	13,4
Nikkei 225	12,5%	15,3%	20,8%	13,7%	20,4	23,0
Brazil Bovespa	-7,4%	-5,0%	-0,8%	-6,6%	14,3	8,3
MSCI Russia	-	-	-	-	6,2	-
India SENSEX	6,1%	8,7%	13,9%	7,2%	20,4	21,4
China CSI 300	0,8%	3,3%	8,3%	1,9%	15,6	13,6
MSCI World	8,8%	11,6%	16,9%	10,0%	17,4	19,3

Bond Market

Sectors / Returns & Valuation (Leading PE)

	USA	Europe	World	USA		Europe		World	
				LT Median	Current	LT Median	Current	LT Median	Current
Cons discr.	4,9%	12,0%	6,5%	21,6	25,9	14,9	13,7	18,8	20,9
Cons. Staples	6,8%	-1,5%	2,9%	19,4	19,6	18,7	15,8	19,3	18,4
Financials	12,3%	10,1%	9,9%	14,2	16,0	12,0	9,6	13,6	13,3
Energy	12,2%	2,5%	8,8%	14,6	12,5	11,0	9,7	13,6	11,9
Industrials	10,7%	9,2%	9,2%	18,4	22,8	18,9	20,2	18,3	21,1
Technology	12,1%	17,6%	12,1%	22,5	39,2	25,8	30,9	23,2	38,8
Materials	8,4%	3,2%	2,6%	17,5	21,8	14,7	16,9	16,1	18,2
Utilities	4,6%	-5,4%	0,6%	16,7	16,5	13,9	12,2	16,4	14,7
Health Care	8,2%	7,0%	7,0%	19,4	19,3	20,4	18,2	20,2	19,2
Telecom	14,6%	4,3%	12,7%	17,7	20,4	16,2	14,5	18,2	19,9
Real Estate	-1,8%	-1,3%	-1,4%	44,0	36,2	24,4	14,1	28,2	26,3

Commodities



8 ALLOCATION GRIDS

Global Asset Classes

	Overweight	Marketweight	Underweight	Main Drivers	Risks
Stocks	●			Although equity markets are not cheap, the prospect of improving earnings growth is likely to support them.	An excessive economic recovery that might trigger inflation or, conversely, an excessive slowdown that could lead to recession.
Bonds	●			Global bonds offer attractive yields, as inflation drifts lower. Bonds should retrieve their diversification virtues if economic growth drops more than anticipated.	Stickier-than-usual 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		●		Household purchasing power remains strong, on the back of high employment and productivity gains.	Weakening labour market towards the summer.
Europe		●		Core inflation should continue to back down, and manufacturing activity is bottoming thanks to depleted inventories and cyclicality.	Any weakness in world GDP, due to higher for longer than expected»» interest rates. Resurgence of (recently overlooked) geopolitical risks, particularly given the 2024 electoral agenda.
Switzerland		●		The recent drop in the value of the Swiss franc should enable a rebound in corporate earnings, particularly those of small- and mid-caps, during the second half of the year, which could be a real driver of performance.	Excessive labour market weakness, in the context of a slowdown and a return to normality after three years of worker shortages, which could affect consumer sentiment and undermine growth.
Asia Pacific ex-Japan		●		Disposable income and consumption demand are showing encouraging signs of reacceleration.	Debt and real estate issues, as well as weakening external demand.
Japan		●		Recession has been averted, and a modest recovery continues amid normalising monetary policy.	Inflation that continues to outpace wage gains, hampering purchasing power.

Bonds

	Overweight	Marketweight	Underweight	Main Drivers	Risks
Developed Sovereigns	●			Sovereigns provide investors with stable, visible and liquid cashflows, alongside renewed safe haven characteristics and positive inflation-adjusted 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 yields and spreads, with a very low risk of defaults; favour medium maturities.	Sticky inflation, aggressive central banks or fiscally undisciplined governments could drive yields higher.
High-Yield			●	Caution is warranted, given the likely rise in defaults and unappealing spread levels. Prefer short-dated high yielding bonds.	High-yield bonds could suffer further if financial turmoil worsens.
Emerging		●		Relative valuations are attractive, with also resilient economic and credit fundamentals.	Emerging countries could be hurt in the case of a global recession, rising USD or significant drop in commodity prices.

Currencies

	Overweight	Marketweight	Underweight	
EUR vs USD	●			In this risk-on environment, EUR upside is limited by potential ECB rate cuts ahead of the Fed. Consider going long on EUR/USD above 1.115 and short below 1.069.
EUR vs CHF			●	The SNB's rate cut reduces the appeal of the CHF vs. EUR, but it might be too early to anticipate a shift in trend, especially as the ECB appears poised to adopt a similar approach.
USD vs CHF			●	The SNB's rate cut reduces the appeal of the CHF vs. USD, but it might be too early to anticipate a shift in trend, especially as the Fed appears poised to adopt a similar approach.
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
THE SNB PAVES THE WAY

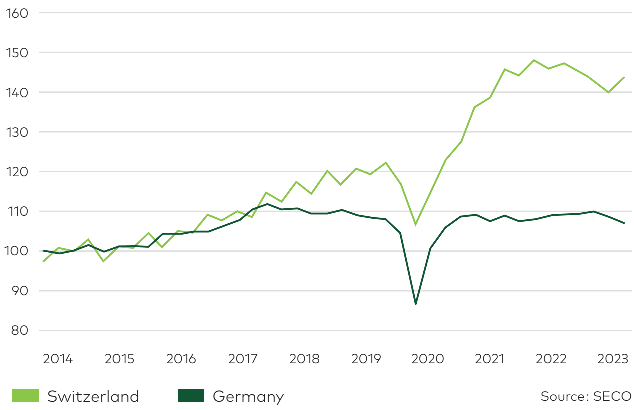
ANICK BAUD / SENIOR FUND MANAGER

Inflation has been under control for many months, growth is below potential, industrial activity seems to have bottomed out, and the labour market is showing first signs of weakness. Add to this a currency which, following its peak in 2023, has eased somewhat, giving exporters some breathing space. This is the subdued context within which the SNB decided, against all expectations and ahead of all the major central banks, to begin cutting rates, paving the way for a less restrictive monetary policy.

The economic trough seems behind, but employment is faltering:
The Swiss Purchasing Managers' Index (PMI) has spent the past 14 months in contraction territory. While the most recent figure clearly remains below the 50 threshold, there are nonetheless some signs of improvement, with 4 consecutive monthly increases, suggesting that the economic trough may well be behind for the manufacturing sector. New orders appear to be trending upwards, and the production component is also clearly on the rise. The improvement in the inventory situation is indeed confirmed by the companies we have met, who expect inventories to be fully resorbed by the end of the first half of 2024. Among the smallest companies, the picture is even slightly more optimistic, since the orders component has already moved above the growth threshold. What is new, however, is the recent weakness of the employment component. While it had remained at a high level for the past two years, amid worker shortages, a slow normalisation can now be observed owing to the drop in demand, and companies are more cautious regarding the labour market. The fact that 17% of industrial companies have resorted to short time working fits in with this trend. Rising unemployment could well dampen consumer sentiment and weigh on consumption, the main economic pillar to date. For the time being, the services PMI remains in expansionary territory, but this is obviously something to keep under close watch.

When Germany sneezes, Switzerland no longer catches a cold:
The fates of Switzerland and Germany have long been closely entwined, with the Swiss economy following and suffering the ups and downs of its Rhineland neighbour and long-standing trading partner. Since the pandemic, however, their paths seem to have diverged slightly, and not only because the US have become the leading importer of Swiss goods and services. Since 2020, Switzerland's GDP has held up much better than Germany's, thanks in part to the strength of pharmaceutical exports, and also to the tremendous support provided by private consumption. German consumers, strangled by an inflation rate triple that

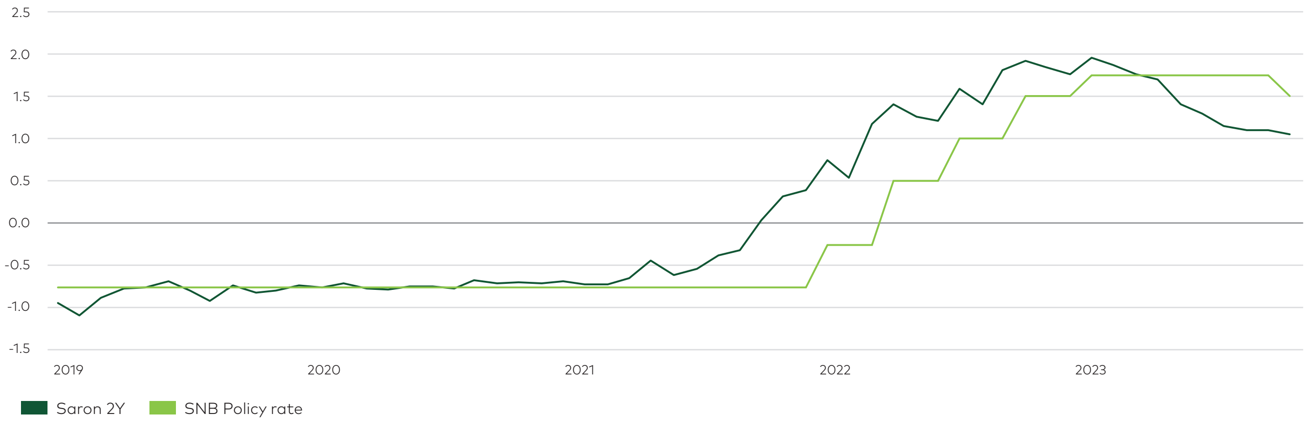
The gap between the Swiss and German industrial value added* has widened notably



*industrial value added, real, seasonally adjusted.

of Switzerland, were unable to cushion the impact of sluggish industrial activity. The State Secretariat for Economic Affairs (SECO) has rightly highlighted the differential in industrial value added between the two countries since 2014 (graph 1). While the data moved in tandem through 2018, a dramatic gap then opened up. Switzerland has seen its value added almost double in the space of 10 years whereas, for Germany, the improvement stands at only 10% over the same period. The two countries have pursued extremely different industrial policies over the past decade. While Germany was enjoying a weak currency and very low energy costs, which did not encourage the necessary restructuring measures, the Swiss franc gained 25% against the euro, forcing Swiss companies to invest massively in innovation and to keep restructuring in order to remain agile and flexible. Still, although the dichotomy is real, it should not be over-interpreted, and a healthier Germany would be good news, not just for Switzerland but also for the European Union as a whole. Even though the German PMI remains very depressed, albeit rising slightly, the first positive signs seem to be coming from the ZEW index, which tracks investor sentiment regarding the country's economic outlook. It shows not only that economic

The market expects two more SNB rate cuts



expectations have undergone an eighth consecutive month of improvement, but that Germany may also have passed the trough, which bodes well for the Swiss economy.

The SNB takes the first step:
If there was one belief shared by all economists ahead of the Swiss National Bank (SNB) meeting in March, it was that rates would not be cut before June. To everyone's surprise, the SNB decided otherwise, thus acting as a pioneer relative to the other major central banks, which continue to fear inflation spikes. The SNB had also expected second-round effects early this year, which might have put a temporary brake on the price deceleration that began a year ago, but these turned out to be more modest than feared. At most, there was a very slight uptick in rents due to the two 2023 increases in the mortgage reference rate for lease contracts, but this effect was more than offset by other factors. Also prompting the SNB to act rapidly was the Swiss franc's appreciation in real terms at the end of last year, which exerted unbearable pressure on exporters. However much the latter are used to a strengthening currency, the speed of the appreciation and the narrowing of the inflation differential vs. Switzerland's main trading partners warranted a swift change in SNB monetary policy. Finally, faced with a still below-potential GDP growth rate and a job market that is beginning to show signs of weakening, the monetary institution wanted to provide a clear sign of support for economic activity. If market expectations are anything to go by, the SNB could cut rates twice more between now and the end of the year (graph 2) and seems to view 1% as the neutral level. Moreover, the SNB has not given up on the franc as a monetary policy instrument, as some had envisaged. It says that it is ready to be active on the foreign exchange market if the backdrop so requires, thus retaining maximum flexibility in an environment that still contains far too many uncertainties.

Some breathing space for exporters and small- and mid-cap companies:
In 2023, the strength of the Swiss franc had a major impact on corporate earnings, with some profits swallowed up by costs in francs that far exceed local revenues. Currency weakness year-to-date has brought some relief to exporting industries, and particularly to smaller companies that cannot always compensate by relocating production. This welcome boost is unlikely to be visible in the first half of the year, since both the dollar and euro levels vs. franc were higher through July 2023 than they are today. But should the trend persist, the impact on corporate profits could be significant in the second half. The Swiss currency having been no stranger to the lacklustre Swiss equity market performance last year, this breath of fresh air could well act as a catalyst, especially in the small- and mid-cap arena. All the more so given that, outside of 2021, small- and mid-caps have lagged the SMI significantly since 2018. Indeed, since June 2018, the (negative) performance differential between the SPI Extra and the SMI exceeds 40%, an almost unprecedented situation that buttresses our preference for this asset class.

EUROPE

WHEN NEWS CAN BE BOTH GOOD AND BAD

MALEK DAHMANI / FUND MANAGER

What did we learn during the past three months? Well, the caution that we emphasised in our last publication proved warranted only for the first two weeks of the quarter. Subsequently, momentum took hold and propelled the equity market upwards. The current environment is one of a slowdown in business activity coupled with receding inflation, pointing towards potential rate cuts by June. At the same time, company management feedback suggests a moderation of activity rather than a freefall. It seems, however, that this scenario is largely priced into the market, leaving little room for surprises in the short term. As such, we suggest continuing to wait for better entry points. On a longer term horizon, we still see attractive returns for European companies, notably those that are comforting their leadership positions across the world – and especially in the US.

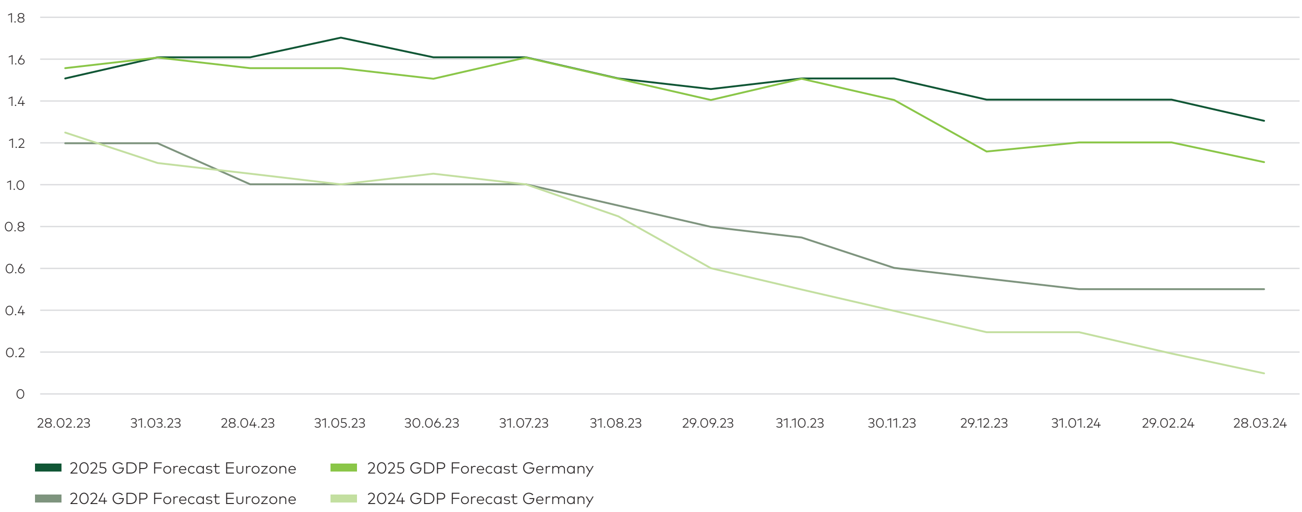
Ever experienced that unsettling sensation of uncertainty, where good news might, in fact, be bad news, and vice versa? We are currently grappling with just such ambiguity regarding GDP figures. What if GDP is showing improvement while interest rates remain elevated?

Since the onset of the year, European equities have displayed a commendable upward trajectory, boasting an impressive 8% return. Notably, this surge has predominantly favoured large-cap growth stocks, contrasting with the more modest 5% gain posted by value stocks and small- to mid-cap indices. Such performance discrepancy across market segments echoes the momentum observed towards the end of 2023.

But what has propelled this trend? The driving forces behind this performance are discernible: receding inflation, and resilience in services activity juxtaposed with manufacturing sector contraction – all signalling the necessity for central bank rate cuts, fostering a successful soft landing. These forces seem so powerful that Christine Lagarde has adopted much more dovish tone than last year. The transformation is rather remarkable, considering Europe's outlook less than 18 months ago, when energy shortages and recession loomed large. Despite the absence of a clear frontrunner in the AI frenzy, European equities have surged 50% over the period, matching the US performance. Valuations now slightly exceed historical averages, primarily due to a lag in EPS revisions. Has the market become overly exuberant? What potential pitfalls could hinder the soft-landing scenario?

With regards to ECB rate cuts, we maintain that two compelling reasons justify their current expected trajectory: receding inflation, including wage stagnation, and manufacturing sector contraction. The latter weighs

Germany's economic difficulties are one of the Eurozone's current main concerns



The probability of recession has fallen on both sides of the Atlantic

particularly on the German economy, compounded by subdued domestic consumption and heightened energy costs, placing the country in recession and dragging down overall Eurozone economic performance. In such a situation, providing support to the struggling major contributor –Germany – is imperative. The necessity for rate cuts is evident.

“By June we will have a new set of projections that will confirm whether the inflation path we foresaw in our March forecast remains valid”
(Christine Lagarde, BCE, 14 December 2023).

As for the probability of a recession in Europe, it currently stands below 50%, supported by the resilience of services and an uptick in global GDP forecasts. Notably, European economic activity is highly exposed to global GDP fluctuations. Leading indicators, such as Swedish exports, also hint at manufacturing sector relief. Our discussions with company managements indicate an anticipated slowdown in 2024, albeit not a nosedive. Most foresee a turning point by the end of summer, with some sectors, particularly construction, already witnessing signs of improvement.

The most significant risks to such scenario, we believe, stem from the US, where good news could morph into bad news. What if the US economy remains robust with unchecked inflation? Such a scenario could delay rate cuts, triggering a negative risk-off sentiment across financial markets. However, it could also signify heightened GDP potential. In our view, this would translate into increased volatility, without derailing European companies’ upward trajectory, particularly those tethered to global long-term trends.

As regards China, despite ongoing signs of stabilisation, it is essential to note the minimal anticipated tailwind for European companies – making for a latent opportunity.

In summary, despite our prior unsuccessful call for a better entry point last quarter, we reiterate such a strategy for investors already exposed to European equities: hold current positions and capitalise on entry opportunities. For those that are on the sidelines, dipping in now and incrementally building positions during episodes of volatility offers merit. Patience promises rewards. We consider such entry points to be crucial, given the appealing mid- to long-term prospects, especially for companies with a global market exposure.

UNITED STATES
STILL STRONG, FOR NOW

PETTERI PIHLAJA / ADVISOR // **ANTTI TILKANEN** / ADVISOR

The US labour market has remained resilient, keeping the "higher for longer" case in place. Payrolls were surprisingly positive early in the year, but leading indicators point towards a return to the slowing trend. Household finances are in good order, although retail sales are stagnating.

The US economy has demonstrated its remarkable resilience, with the household sector still strong despite higher interest rates. The economy has been also sustained by continued fiscal support, and forward GDP estimates have been increasing for the past six months.

Interest rates are being kept "higher for longer" to balance pressures from the strong household demand and tight labour market. Inflation remains above the 2% target but is inching closer to it. This favourable backdrop of high employment and moderate inflation has been in place for some time and continues, for now, to prevail. That said, despite the US economy being in a stellar condition relative to the rest of the world, there are some initial signs of weakening and predicting a "no landing" scenario seems rather premature.

The US labour market remains secularly tight. Unemployment is trending up very slightly but, at 3.9%, still essentially reflects a full employment situation. And the participation rate of working-age people has risen to levels not seen since the turn of the century. Although it has taken longer than usual for the economy to start responding to tight monetary conditions, this will eventually occur.

The pressure from higher wages persists, notwithstanding some easing. All signs point to this trend continuing well into 2024, as the mismatch between labour force demand and supply has diminished. Hourly wage growth is still quite high at 4.3% year-on-year, and the progress downwards is clear but slow.

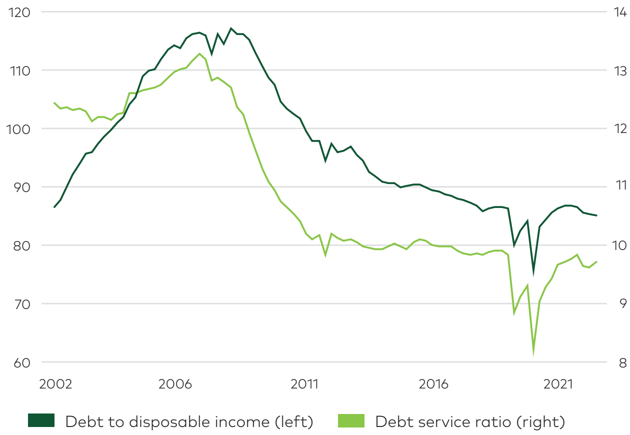
The early months of 2024 saw payrolls continue to surprise on the upside and the weakening trend appears to have paused. Monthly data tends, however, to be erratic and subject to material revisions. Quit rates and job openings continue to move down, signalling worse times ahead. The NFIB hiring intentions survey is a useful leading indicator, and it does not foretell a significant change in the weakening trend, making the sustainability of payroll strength questionable. This index leads actual payrolls by around four months meaning that, as spring progresses, we should see a continued weakening of the labour market – absent other surprises (graph 1).

Weaker hiring and greater firing are somewhat concerning, although there are no signs yet of distress in consumer confidence. But retail sales growth has ground to a halt in the past three months in dollar terms, implying that core

Payrolls and NFIB hiring intentions index

Core retail sales

Debt service ratio and debt to disposable income



retail sales are shrinking in real terms. Consumer spending – which accounts for 70% of GDP – has been fuelled by the strong labour market and rising real incomes, alongside the deployment of accumulated savings.

A significant stock of excess savings was accumulated by households during the pandemic, when spending opportunities were diminished relative to income levels. Over the past two years, drawing on those savings has boosted consumption demand by ca USD 2 trillion, which equals to roughly 7% of current annual GDP. The savings rate has been lower than usual, as incomes have been slow to catch up with elevated consumer prices. Excess savings have now been all but depleted, and the remaining portion belongs to the highest income deciles, where the propensity to consume will remain low.

Though, fundamentally, there is nothing unsustainable about the current lower-than-usual ca. 4% savings rate, households may start to prefer saving more as the outlook becomes more uncertain and saving is more lucrative. This would constitute an additional drag on consumption growth. Still, a steady positive growth is backed by growing incomes – meaning that some ebbing in consumption is not alarming in itself, as long as there are no cracks in the labour market. In any event, this is something that will need to be closely monitored. After all, US household consumption is the number one demand driver of the US – but also global – economy.

Despite the lower savings rate, household balance sheets remain healthy. Any distress within the lower income classes will be visible first in auto loan and credit card delinquency rates, which are clearly trending up. Overall, the debt servicing ratio (scheduled debt payments divided by disposable income) is virtually unchanged over the past 10 years (at around 10%) – thanks to largely fixed rate mortgages. Debt levels are historically low relative to income levels and household finances are generally very healthy, which shelters the US quite well from a severe recession.

ASIA

IS THE CHINESE CONSUMER BACK IN BUSINESS?

PETTERI PIHLAJA / ADVISOR // **ANTTI TILKANEN** / ADVISOR

Although recent Chinese demand-side data has been encouraging, it is too early to conclude that the worst is behind. Structural issues will persist for years, as highlighted by the very weak property market.

Chinese personal consumption expenditure and disposable income (YoY)

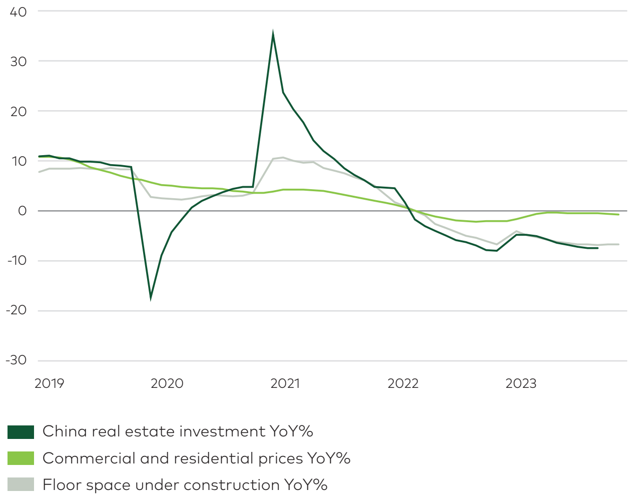
The Chinese government recently updated its growth objective for the current year. Nothing surprising was announced: a 5% rate is targeted, and the focus will be on high quality growth rather than wasteful spending. Top-level officials clearly understand the structural issues that the country faces but, as we have argued previously, addressing them is easier said than done. There have been some spring shoots in the high tech sector, though mostly focused on the semiconductor industry which continues to be hit by ever-increasing sanctions. The Chinese semiconductor cluster is currently growing out of necessity to counter US restrictions, but its scale is not yet sufficient to move the needle in terms of China's overall economic structural issues.

That said, we are starting to see some positive signs on the demand side of the economy. In the past, we have highlighted the need for China to grow consumption and income faster than investments or GDP, and this does indeed seem to be the case right now. Disposable income rose by 6% during the final quarter of 2023, which is very encouraging. Also, personal consumption grew by 9%, which is several percentage points higher than the pre-Covid long-term average of 5-7%. Obviously, this is a positive trend for China so long as such growth rates can be maintained over the long run. The recent spike in the consumer price index is also supporting the recovery in spending, although it should be noted that producer prices remain in steadily deflationary territory and imports are weak.

The positive trend is also visible in retail sales, which appear to be tracking income and spending growth rates. Recent online sales growth rates have been particularly encouraging. After many difficult years because of restrictions, e-commerce seems back to steady double-digit annual growth. Overall retail sales also grew in December, by more than 7%. We should point out that the Chinese New Year often distorts data, meaning that caution is in order before banking on stability at such growth levels. Preliminary data does, however, suggest that travel spending during the New Year period was especially strong, so it might not be over-optimistic to suggest that Chinese consumers are again willing to spend. Recent results released by the largest e-commerce players, notably Alibaba and JD.com, also give credence to this positive consumption trend. We will probably not see a return to the very strong topline growth that prevailed before Covid, but e-commerce could definitely continue to surprise on the upside, assuming no outside negative factors come into play.

Chinese retail sales and online sales (YoY)

Chinese real estate investments, commercial and residential prices, and floor space under construction (YoY)



The property market remains a huge drag on the Chinese economy. Real estate investments continue to decline year-on-year, at a current pace of nearly 10%. This represents a huge shift over a short period of time; just a few years ago the property market was one of the main drivers of GDP growth. Prices of newly built commercial and residential projects also continue to decline at a steady rate. And floor space under construction is falling like a stone, emphasising the fact that few new projects are being initiated, while the government is providing developers with minimal support to ensure completion of already prepaid projects.

E-commerce could definitely continue to surprise on the upside.

We are not exactly seeing a collapse of the property market, just a steady strategic shift by the central government to focus on a more productive model. Of course, this is not straightforward, since authorities are once again spending on infrastructure. Still, the ongoing restructuring of the property market is a long-term positive, despite the short-term pain. Over just a few years, the shift in government real estate measures has been quite remarkable. During Covid, there was vivid speculation regarding an all-out bailout of developers. This has now evolved to allowing defaults, and the government has even begun to press charges on Evergrande officials. Clearly, the general public is getting the message that real estate is for living purposes, not speculation.

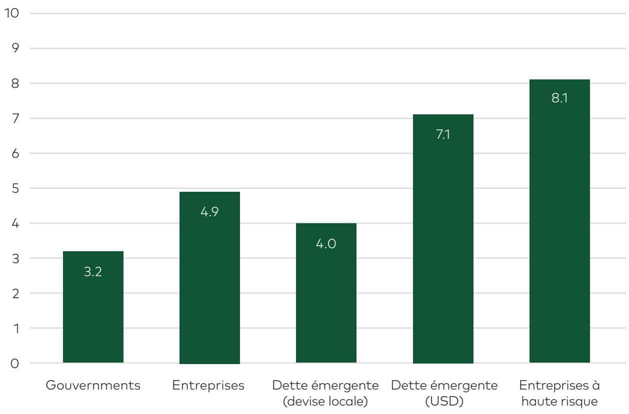
In summary, given the very negative wealth effect caused by declining investment activity and, especially, housing prices, the current strength of the Chinese consumer is noteworthy. We should of course not extrapolate too much from Chinese New Year data, but we can nonetheless conclude that the scenario of a Chinese economic collapse is not materialising. If anything, we could be in for positive surprises later this year.

FIXED INCOME

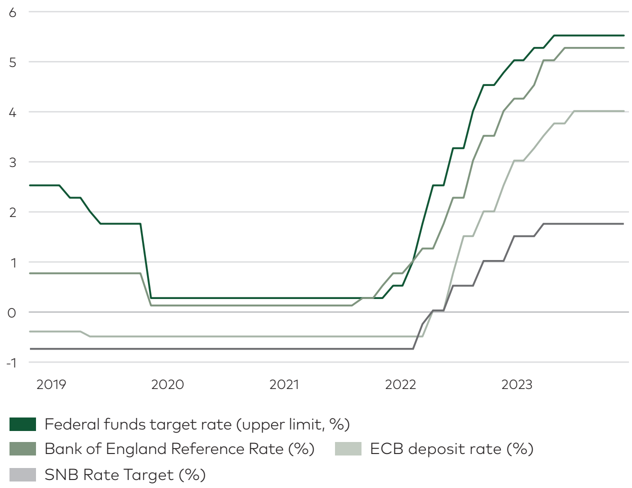
MANUEL STREIFF / ADVISOR

Inflation is declining globally, though the pace of moderation has been less than what economists and investors were forecasting at the end of 2023. Labour markets in the US and Europe have meanwhile remained buoyant, leading central bankers to push back on expectations of imminent rate cuts. By the end of the first quarter, both the US Federal Reserve (Fed) and the ECB had signalled that rate cuts will begin by June.

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



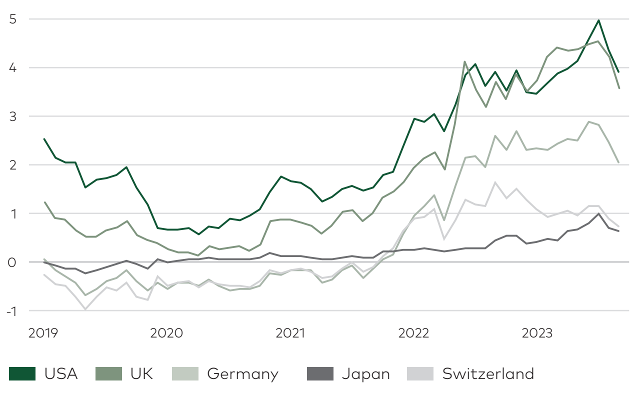
DEVELOPED MARKET SOVEREIGNS

US Treasury yields drifted gradually higher over the past quarter. Investors reduced and postponed their rate cut expectations, bringing them closer to the Fed's indication of three cuts in 2024. By the end of the quarter, yields on longer-maturity bonds had moved up slightly more than the front end of the curve, causing a sell-off in government bond indices.

While German government bond yields also rose, European yields rose by less than those in the US and most of the move was concentrated in shorter maturities. Italian and Spanish bond yields moved up less, making for significantly reduced spreads.

Japanese government bond yields increased during the quarter, as investors largely anticipated the Bank of Japan's exit from ultra-accommodative monetary policies. Swiss bonds were one of the quarter's best performers, boosted by the SNB's 0.25% rate cut at the end of March.

Sovereign yield to maturity (10Y benchmarks)



Global inflation-linked bonds lagged the rest of the bond market, mainly due to the poorer performance of non-US linkers. US inflation-protected securities outperformed Treasuries as inflation expectations increased.

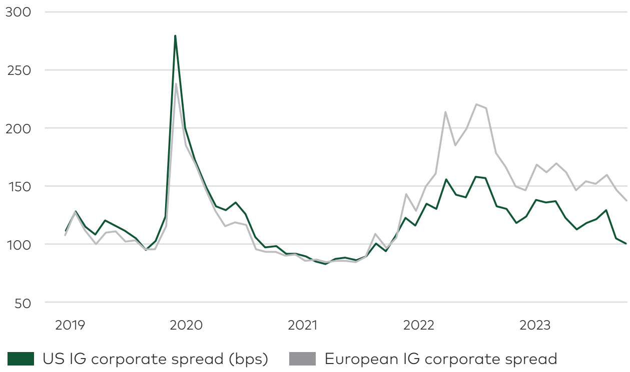
DEVELOPED MARKET CORPORATES

High-quality corporate bonds in developed markets hardly performed during the first quarter. Despite record issuance at the start of the year, credit spreads tightened further, offsetting the increase in government bond yields. We recommend investing in high quality 3- to 7-year maturities, in order to benefit from historically elevated yields, despite relatively tight credit spreads.

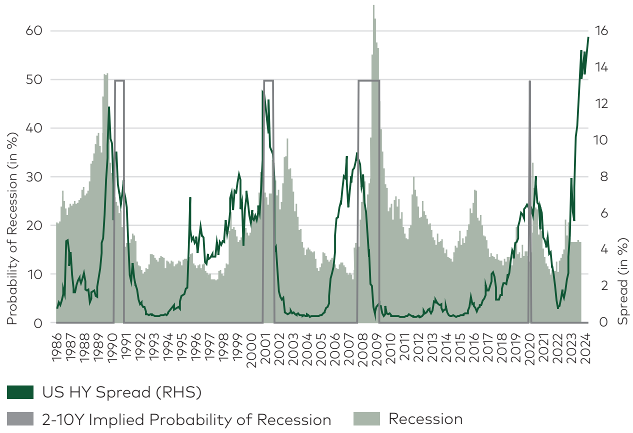
Hybrid bonds have been one of the best-performing bond market segments. Strong equity markets, as well as declining volatility in both the bond and equity markets, continue to favour this asset class.

High-yield bonds also posted a very strong quarterly performance. However, short-term high-yielding debt issued by companies with manageable financing profiles remains attractive. Even though spreads have narrowed, the front end of the US yield curve still offers high total yields.

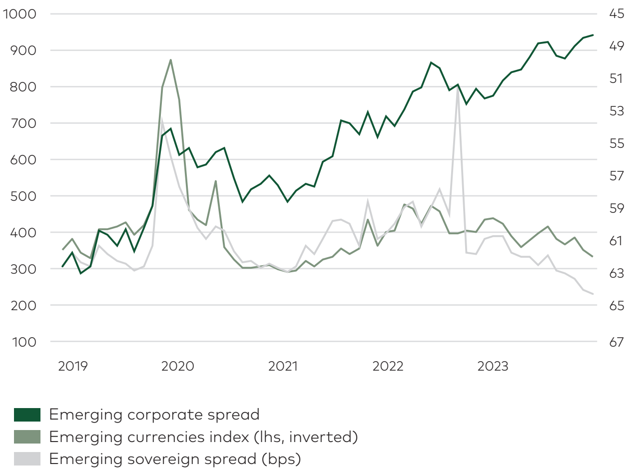
US and European Corporate Spreads (Investment Grade)



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



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



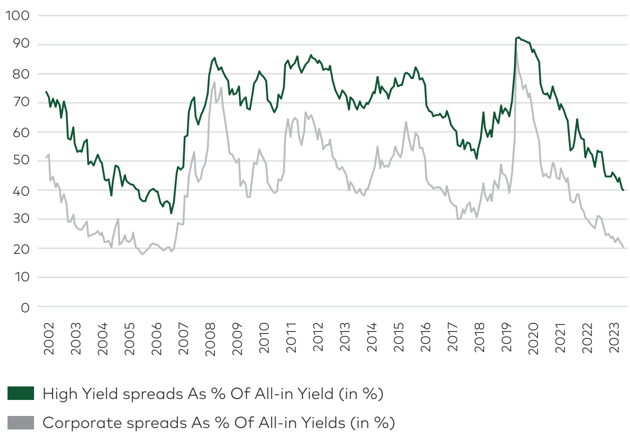
HARD CURRENCY EMERGING MARKET DEBT

The stabilisation of growth and the ongoing pause decided by many major central banks have supported emerging market debt. Even as US Treasury yields rose, emerging spreads compressed significantly, leading to a healthy overall quarterly performance.

LOCAL CURRENCY EMERGING MARKET DEBT

The delay in the Fed and the ECB's easing cycle has negatively impacted local currency EM debt, through US dollar appreciation and a slower pace in EM central bank rate cuts. We continue to favour bonds of countries with high real yields, as we expect further rate cuts and stronger currencies. Brazilian or Mexican local debt offer high yields, both in absolute terms and relative to the US or Europe. Stable to appreciating currencies further enhance the capital gain potential of such investments.

Credit Spreads as % of all-in Yields



FIXED INCOME PROJECTION

Segments	Yeld (%)			Return View (12m horizon)
	USD	EUR	CHF	
Cash	5,36	3,43	1,28	↘
Short-Term High-Yielding	6,17	4,58	1,81	↗
10y Government Bonds	4,23	2,35	0,72	→
10y Government Inflation-Linkers	1,90	0,25	n.a.	→

Segments	Spread over Sovereigns (bps)	Return View (12m horizon)
Developed Corporates	101	↗
Corporate Hybrids	181	→
Developed High Yield	382	→
Emerging Sovereigns	323	→
Emerging Corporates	227	→
Emerging Local-Currency Debt	n.s.	↗

Source: Bloomberg indices hedged in the respective currency

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