Markets
& Convictions

RJ Management

January 2024

In 2023, the stock market experienced a rapid and widespread rebound as interest rates began to sharply decline in early November. In a sign of controlled inflation, market participants then anticipated numerous interest rate cuts for 2024. Throughout this year, Western economies were fuelled by three main engines: private consumers benefited from the wealth effect of financial markets, businesses thrived, and expansive fiscal and budgetary policies were implemented. Ultimately, despite numerous geopolitical events, there was no noticeable effect on the confidence of international investors (for the time being). Looking ahead to 2024, the upcoming American presidential election presents a unique scenario, and the expectations of interest rate cuts may not always signal positive outcomes. Despite significant volatility in oil prices, we maintain a strong conviction in the energy sector. We've entered a multipolar geopolitical balance that poses major challenges, such as the utilization and pricing of raw materials. In this environment, our investment choices are diversified to establish varied sources of returns.

Macro

- With the decrease in interest rates, stock indices rebound strongly at the end of this year to show the following 2023 performances: S&P +24.23% / Nasdaq +53.81% / Euro Stoxx600 +12.74% / CAC 40 +16.52% / SMI +3.81% / Nikkei +28.24% / CSI 300 -11.38%.
- Inflation indices seem to indicate a situation under control with US CPI at 3.1% and in Europe at 4.3%.
- As a reminder, inflation is the central element explaining the rapid rise in interest rates, so if it decreases to move towards its target levels below 2%, it's good news.
- And the financial markets fully embrace this thesis...
- Despite a cautious speech from the Fed president regarding the end of the interest rate hike cycle, the markets seemed to ignore his message and immediately anticipated significant rate cuts.
- In just 1 month, expectations via futures markets show that financial actors have already priced in between 6 and 7 successive rate cuts in 2024!! Similarly, in long-term rates, the 10-year rate dropped from 5% to 3.72%.
- Geopolitical tensions and wars are still as sad and headline-grabbing. However, they hardly concern the financial markets.
- The scenario of a Middle East breakdown is clearly not priced in, as seen with oil trading at USD 85 before the Hamas attack and then plummeting to USD 72 in mid-December.
- Since tensions in the Red Sea, the barrel has risen back to the USD 80 zone.
- The year 2023 benefited from a trio of "consumers" that surprised with their vigor:

    1. The Western private consumer (middle and upper class) largely benefited from the wealth effect of the stock markets and the rise in interest rates on their savings.
    2. Companies were able to raise their prices more quickly than the increase in their costs and therefore posted significant revenue growth.
    3. States implemented fiscal and budgetary policies of an almost historically unprecedented level (the famous Bidenomics).

- This new year, 2024, will certainly be marked by a very unusual American presidential election.
- The current president enjoys an ideal economic situation (strong economic growth & record-low unemployment), yet his satisfaction rate as a sitting president is historically at its lowest!!!
- On the other hand, candidate D Trump risks being populist AND anti-establishment, and in the event of election, his new teams will certainly no longer be composed of former Goldman Sachs executives or army generals, the same individuals who testified against him in his various trials.

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Convictions

- Following the interventions and speeches of the Fed, markets currently anticipate significant interest rate cuts in the next 12 months. Ultimately, two scenarios are conceivable following this information:
    1. Either the bond/interest rate markets are correct, and a recession occurs with a certain magnitude (6 rate cuts already priced in). In which case, company profits will drastically decrease, and their current valuation (Price/Earnings ratio) is significantly too high → negative for stocks.
    2. Or economic growth will be stronger than expected, and the huge wealth effect created by the recent rise in financial markets (which anticipate 6 rate cuts) will fuel tomorrow's inflation. In which case, the Fed will not cut its rates as much as expected → negative for stocks that have risen due to the opposite effect.
- As a reminder, the Fed anticipated: end of 2021 → transient inflation / end of 2022 → American economic growth was expected to slow down / today the Fed believes that → the inflation phenomenon is under control.
- Why would they be right this year, 2024, when they were clearly wrong in the previous two...
- We anticipated a strongly slowing economic growth for 2023, which clearly did not play out during this year (discussed above with the 3 consumers).
- Yet our defensive approach in 2023 was a relatively good decision until the end of October when stock markets showed between -1% (SMI) and +6.5% (S&P500) in performance.
- It's undeniable that since then, the markets have soared.
- This rebound is almost solely due to rate cut expectations and not to the fundamentals of the economy or companies.
- Proof lies in these stock markets, which only declined between July and October 2023 (-11% for the S&P500, etc.) while company earnings were good, but the US 10-year rate was at 5%.
- At the end of October, rates literally collapsed following a speech by Janet Yellen, and stocks skyrocketed.
- We believe that this rally may still have "legs" and will especially benefit now the smaller and medium-sized companies (strong rebound of Sturdza Silver Star / Berenberg European Mid & Small Cap / GAM Swiss small & mid funds).
- Despite enormous volatility in oil prices during this year 2023, we remain very convinced about our energy theme (Volta / Wetsbeck / Discovery Certificate).
- Our historically unipolar world under the auspices of the American policeman has transformed in a few years into a multipolar world.
- Each local situation is the result of tensions that the US cannot / do not want to resolve anymore.
- We note from 2022-2023 that BRICS countries produce almost 2/3 of the raw materials to "run" our world.
- These raw materials have become a powerful strategic weapon in this "multipolar" world, and producing countries will not hesitate to use them, which should partly fuel inflationary pressures. (So, it's mostly a question of supply and not demand).
- We recently issued a new "Discovery" certificate that invests in exploration and energy production companies. This strategy aims to benefit from the re-rating of this sector and the wave of mergers and acquisitions, similar to the last two Pioneer Natural Resources or Hess deals.
- This election year should bring its share of surprises, and we note that polls have always tended to underestimate candidate Trump.
- In this context, gold remains a strong conviction in our allocation with another year of positive contribution to portfolios.
- The theme of American "big caps" has greatly benefited the Loomis US fund that we have held in our portfolio for many years.
- Among the negative contributors, we have the Vontobel EM Corp fund that suffered from its positioning in China; however, our recent exchanges with the manager reassure us about its ability to catch up.
- In conclusion, we observe that the long-awaited economic slowdown for 2023 did not happen despite the very strong rate hikes orchestrated by our central banks.
- The effect of a significantly inverted yield curve did not have the expected effect: savers were able to benefit from short-term rates by placing their liquidity → example Berkshire Hathaway: in 2021, its USD 300 billion in cash earned nothing, whereas today, they earn USD 15 billion placed at 5%!!!

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- We think that this yield curve could once again "steepen" (short-term rates lower than long-term rates) and be a source of economic slowdown (high long-term rates are the real cost of debt and thus a brake on the economy).
- In this context, we maintain a diversified allocation by seeking sources of returns in both specific high-yield.

The historical interest expenditure for the US federal debt since 1950: today, it's 1,000 billion per year !!