Markets
& Convictions

October 2023

RJ Management

The stock indices show signs of fatigue with divergent performances. The recent acts of terrorism sadly remind us that global conflicts can also affect our economic balances. Historically high-interest rates have not yet slowed down economies overstimulated by a decade of easy money. However, interest rate increases have been significant, with direct impacts on consumers, but the rise in wages continues to support consumption despite inflationary pressure. In this context, markets are becoming aware of the issue of sovereign debt in Western economies: it is too high while the growth phase is good, and interest rates are rising rapidly. We remain very confident in our energy theme and short duration in the bond segment.

Macro

- Stock indices have been losing momentum for several months, with their Year to Date performance as follows: S&P 500 +9.83% / Nasdaq +24.38% / Europe Stoxx 600 +1.95% / SMI -3.70% / CSI 300 -9.83%.

Performance as of October 23rd 2023			
Index	Year to Date	Highest level reached in 2023	Since Top (2023)
S&P500	9.83%	July 31st	-8.10%
Nasdaq	24.38%	July 19th	-9.33%
Europe Stoxx 600	1.95%	July 27th	-8.17%
SMI	-3.70%	May 08th	-10.90%
CSI300	-9.83%	January 30th	-17.00%

- The deadly madness of terrorists that we have witnessed in recent weeks sadly reminds us that our world is experiencing deep and multiple conflicts that will also impact our economies (Ray Dalio's analyses are a reference).
- The historic rise in interest rates is taking time to slow down our economies, which have been "overstimulated" by easy money over the past 10 years.
- Inflation is the number one enemy (for now) of our central bankers, who have only one tool to combat it: raising short-term interest rates to make credit more expensive and thus slow down growth.
- These interest rate increases have been dramatic for Western countries: the Fed has gone from a rate of 0.25% in March 2022 to 5.50% today (0% to 4.50% for the ECB / -0.75% to 1.75% for the Swiss National Bank / 0.1% to 5.25% for the Bank of England).
- The impact on consumers is direct, for example, the average 30-year mortgage rate for an American has gone from 3% per year to nearly 8% today!
- Faced with this drastic credit tightening, inflation has indeed decreased, but it is still far from the famous 2% target (US: 9% in 2022 to 3.7% today / Europe: 10.6% to 4.3% today).
- For now, consumers are still willing to spend more. However, the surplus savings accumulated during the COVID pandemic has already been "used up," and the rise in interest rates is significantly reducing the use of consumer loans.
- Only wage increases can explain this capacity to consume today, and this seems to be still relevant: 23% negotiated wage increases for employees in the automotive sector, and Airbus is revising salaries upwards by 5.5%.
- The wage-price loop that we have often talked about in these lines over 18 months is firmly in place.
- The rebound in energy prices, as we enter the winter period, will undoubtedly put additional upward pressure on the next inflation figures.
- The same scenario as last year, commodity prices are subject to significant geopolitical and military tensions, which Europe is still paying the price for (new pipeline sabotage in Finland).
- The United Kingdom is to be closely monitored, with its economy heavily dependent on imports and a weak currency (the euro). Despite aggressive monetary tightening, inflation persists at 6.7%!

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Convictions

- Our defensive approach since 2021 is based on our scenario of "persistent" inflation. We continue to anticipate the long-term reversal of three essential factors: readily available and "cheap" labor, abundant and low-cost energy, and very low cost of capital.
- The beginning of 2023 hasn't proven us right in this approach, but we strongly believe that the elements have been aligning in our favor since last summer.
- The rise in short-term interest rates has not significantly slowed down our economies for now, but the increase in long-term rates will.
- We also believe that central banks will have to keep their rates in a restrictive territory for longer than anticipated by the markets (to break the wage-price loop).
- The US has a historic debt-to-GDP ratio of 120%, a budget deficit of over 7.6% of its GDP, even as its economy is in strong growth with historically low unemployment at 3.8%.
- What will governments and central banks do when we encounter a recession?
- The market seems to be waking up to this inextricable situation of refinancing Western sovereign debts, in a tense geopolitical context where historical major buyers are adopting a very different posture: China is significantly reducing its holdings of US bonds.
- The conflict in Ukraine has made nations/institutions/billionaires accustomed to financing the US deficit realize that this asset is no longer "risk-free." In a matter of hours, Russia and Russians saw their USD accounts and bonds frozen/expropriated.
- Globalization and the polarization of our world will have a lasting impact on our economies.
- This is why many countries will challenge the position of the US and the USD as the primary reserve and exchange currency (first digital CNY transaction for oil).
- We believe that long-term interest rates will have to rise further: Americans will refinance nearly 50% of all their debt in the next 3 years, and they will do so by issuing bonds with maturities of 2 years, 5 years, 10 years, and 30 years.
- Currently, you can lend to the US for 3 months at 5.5% or 10 years at 4.8%... Upon closer examination, investors realizing that inflation persists will demand a premium (rather than a discount) to finance 10-year debt.
- At the moment, we are witnessing more of a sovereign debt crisis than corporate or individual debt.
- The CHF is well aware of this, it is very strong against the EUR and USD, and this trend is expected to continue in the long term.
- This over-indebtedness situation is identical in Europe.
- We are convinced that the two options offered to our central banks will be negative for long-term interest rates:

  Either they decide to resume the QE program by printing money to buy their own government debt, causing long-term rates to rise in anticipation of even higher inflation.

  Or they continue their fight against inflation and issue these historic quantities of bonds that will need to be absorbed by the market, leading to investors demanding a premium and causing long-term rates to rise.

- In any case, this should also significantly favor our gold holdings: we believe that the historical level of USD 2,040 should be quickly challenged or broken...
- The combination of all these factors has made us pessimistic about debt-based assets such as PE/VC and real estate for over 18 months... We will see an acceleration of defaults in these sectors in the coming months, the so-called zombie companies.
- Our conviction regarding the energy sector remains strong: our historical positions in TotalEnergies, Shell, BP, or ENI are once again strong contributors to performance (capital + dividend).
- Since January 2021, the share price of TotalEnergies has gone from EUR 35 to EUR 62 (+77% without taking into account dividends), while over the same period, its P/E (price-to-earnings ratio) has gone from 14x to 7x.

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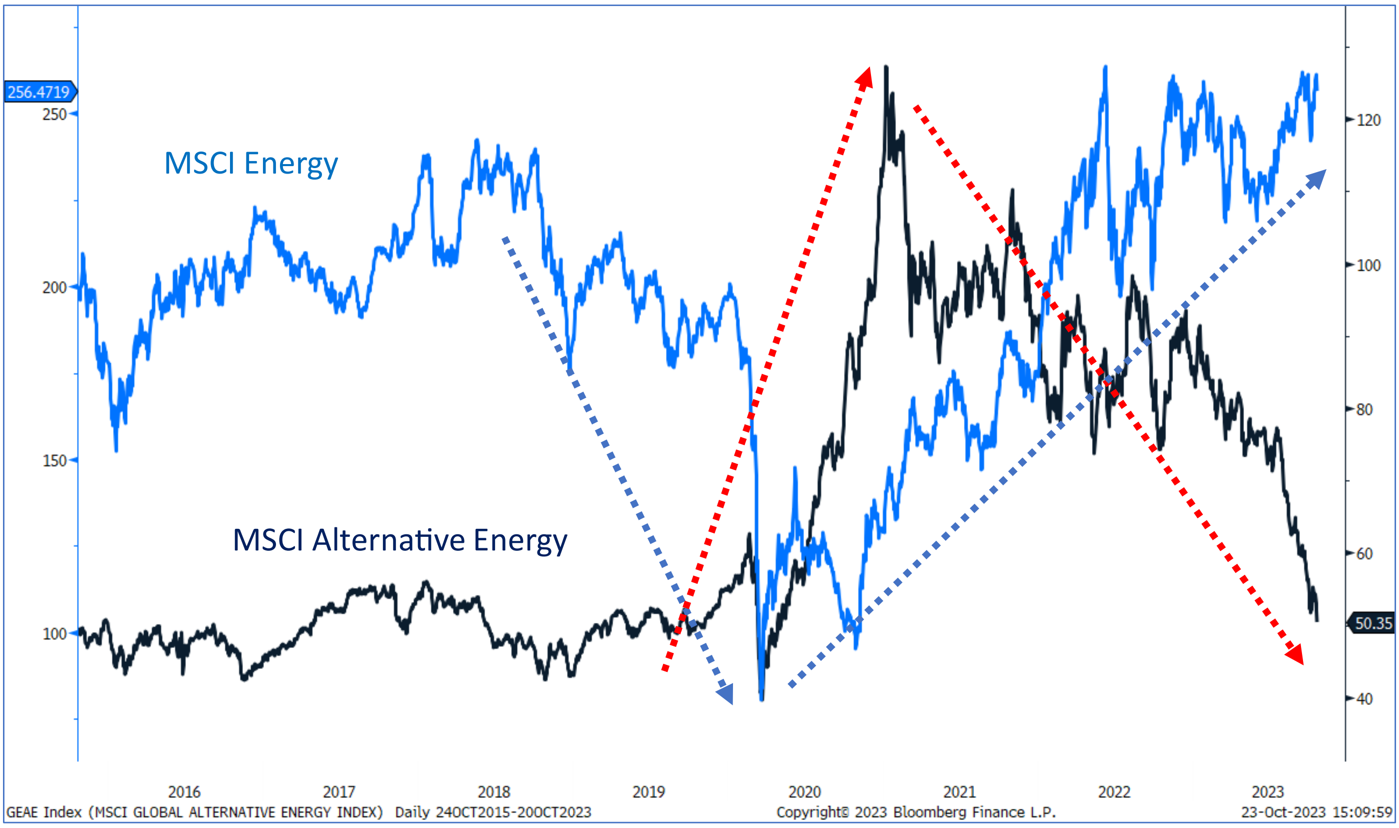
- Therefore, it is only the spectacular profit growth that explains the rise in the share price... Investors are still not convinced by this sector, as they are willing to pay it half as much today as in 2021.
- This reinforces our conviction, which is significantly amplified by poorly applied/understood energy transition policies: renewable energy players are opening their eyes to an economically unviable reality.
- We believe that the most popular (expensive) sectors are the most at risk.
- Like LVMH, which is the type of stock held by many investors who take for granted the pace of post-Covid growth and are therefore willing to pay dearly for this future growth.
- In reality, the company shows positive but significantly below-expectation growth, and its stock is down more than -26% from its highs in May last year.
- We will also have to "get used to" geopolitical tensions, such as the recent meeting between Putin and Xi Jinping, all in a US election year.
- In this context, we believe it is essential to remain cautious, diversified, and focused on your investment analysis and theme selection methodology.

The magic of alternative energies in 2019-2020 and the complete disillusionment in 2023



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