



BANQUE
ERIC STURDZA

MONTHLY NEWSLETTER
MAY 2024

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1. EDITORIAL

WHEN HISTORY RHYMES...

In the not-too-distant past, when Alan Greenspan was still playing the Sphinx at the Federal Reserve, the Fed model was very much in vogue. Younger readers who have only been following the markets for a couple of decades may be unfamiliar with this partially obsolete concept. The idea behind the Fed model was to compare the S&P500 earnings yield* with the US 10-year yield. This provided an indication of the relative attractiveness of one asset class versus another. When 10-year yields are higher than earnings yields, bonds are more attractive than equities; when they are lower than earnings yields, equities should be preferred.

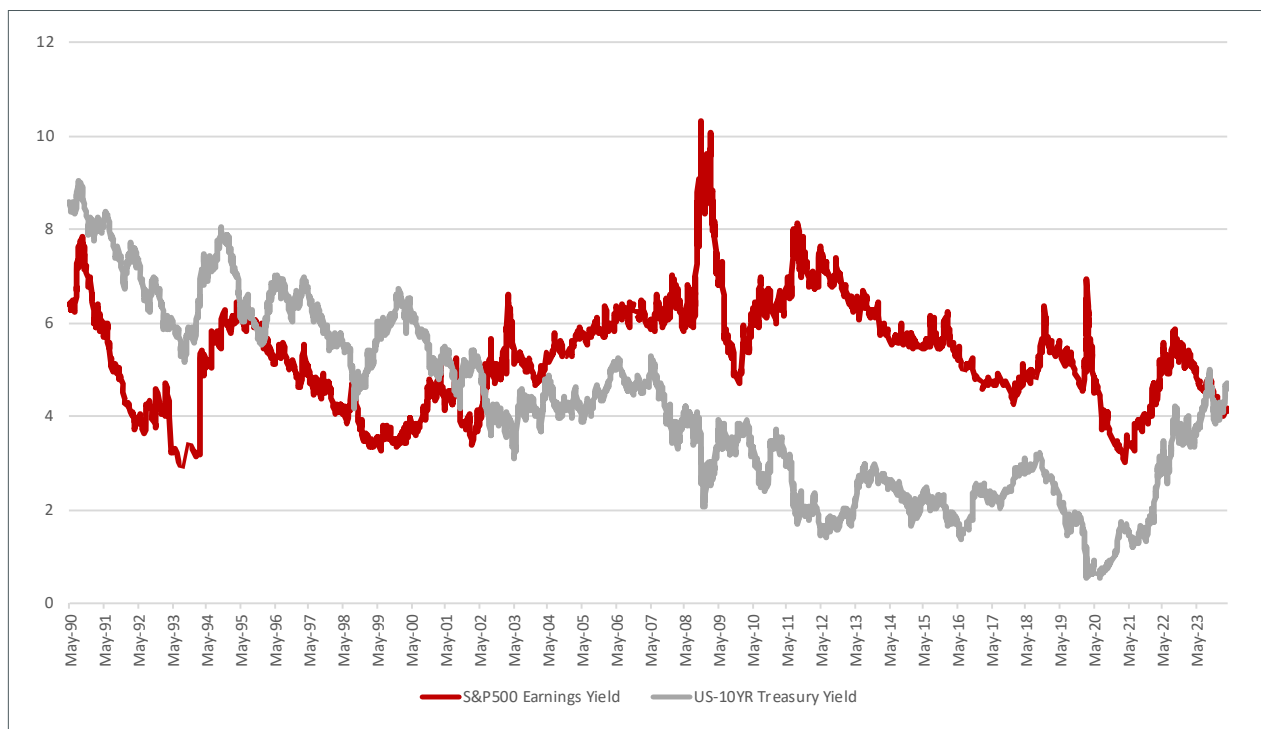
Since the early 2000s – two decades without inflation and with very low interest rates – the earn-

ings yield has been systematically higher than the bond yield. A barometer that never moves eventually wearies even the most patient, and it's easy to understand why the Fed model has been failing into disuse.

The recent rise in US 10-year yields, coupled with rising equity prices, has put an end to this fragile equilibrium: for the first time in 20 years, US Treasury bonds are yielding more than equities.

Before selling your US equity portfolio to buy Treasuries, a closer look at the methodology is needed. If we want to be rigorous, real rates should be compared with earning yields, as corporate earnings are supposed to rise in concert with inflation. If we go back to the drawing board, we see that the curves broke off more than six months ago, and the con-

G1 : FED MODEL - S&P500 EARNINGS YIELD AND 10-YEAR US TREASURY BOND YIELD



Source: Bloomberg, Banque Eric Sturdza

clusion is the same: bonds have become more attractive by Fed standards.

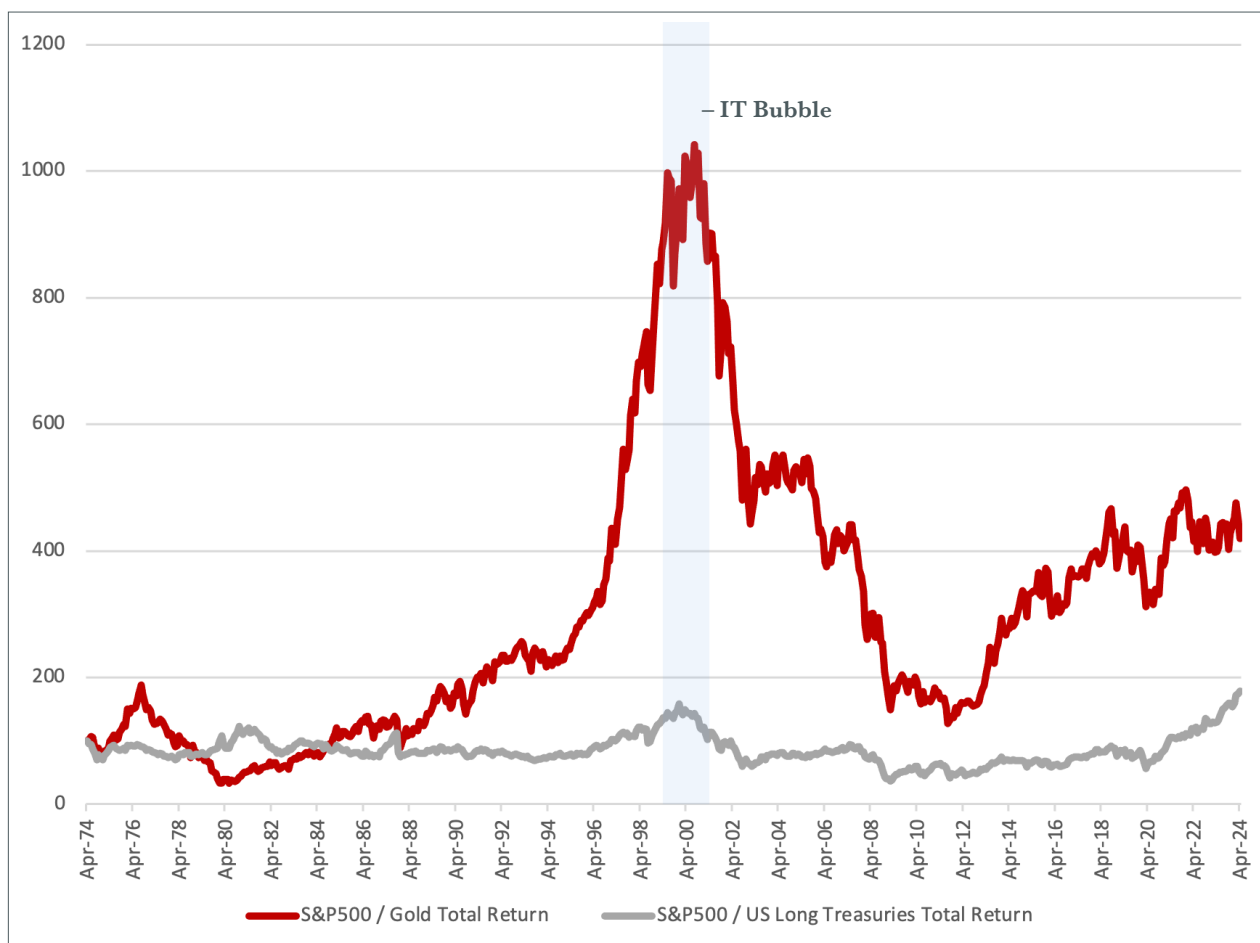
In the short term, the signal is worth heeding. Whereas until the beginning of April, yields rose without breaking the upward momentum of growth stocks, since the US 10-year broke through the 4.5% barrier, growth stocks (and technology stocks in particular) have been struggling. There has been a kind of threshold effect: the insensitivity of equity markets to interest rates only works... up to a certain point.

But what are we to think over a longer time horizon? Food for thought, we can introduce a third piece of data – a shining one at last – the gold price.

If we repeat the exercise of comparing equity prices versus long term rates, we get a much smoother trajectory (the grey line in the G2 graph).

There's a lot of talk about how expensive US equities are, and that's the first thought that comes to mind when we look at the red line in the graph above, but the image lurking in the shadows is also important. And the counter message (not so well hidden!) is the weakness of the bond markets. In simple terms, it's at least as important to emphasise the depreciation of bonds as the appreciation of equity markets. At the risk of stating the obvious, a bond is a rate expressed in a currency. The rise in US yields is also a sign of the "debasement"

G2: S&P500/GOLD TR (RED LINE) & S&P500 / US LONG TREASURIES TR (GRAY LINE)



Source: Bloomberg, Gavekal, Banque Eric Sturdza

*Earnings yield d'un titre: résultat divisé par le cours de bourse, l'inverse du Price Earning.

of the currency that is starting to take place in the US (the same is certainly true of the eurozone, and has long been true of Japan).

In the short term, the crossover between earning yields and 10-year yields surely sends a cautious message: US equities have gone a little too fast compared with fixed income and we could see a return to the mean. It also reflects the fact that the S&P500 behaved like a two-speed market: to the stellar performances of the Magnificent 7 – or should we say Magnificent 5 – we could contrast with the more mixed results of the rest of US markets. In the longer term, the picture is more varied: the weakness of the US fixed income market, and the fact that US Treasuries are reacting less effectively as a “risk-off” asset, points to a more structural reality: the level of US indebtedness, hitherto unaffected by the appetite of debt buyers, is approaching a threshold that prompts more circumspection about government bonds, especially at a time inflation fears could make a comeback.

2. FIXED-INCOME

THE US ECONOMY AND ITS WORST CASE SCENARIO

Inflation no longer falling

After very disappointing CPI inflation figures, markets breathed a sigh of relief at the end of the month. The PCE deflator and Core PCE inflation indices (which the Fed favours in its analysis) were rather in line with investors' expectations, which was not bad in an anxiety-inducing environment. Against this backdrop, the 1 May FOMC meeting was already on everyone's minds. At the end of a very mixed April, let's ask ourselves the following question: what if all these inflation figures weren't the most important data after all? We have indeed had confirmation that inflation is no longer falling, but we already knew that. On the other hand, several economic statistics published at the end of the month led us to worry again about a potential economic slowdown.

ISMs were down, and well below expectations. Even though manufacturing activity now accounts for only around 15% of GDP, the contraction (to below 50) of the ISM Manufacturing cast a shadow. Then it was GDP's turn to disappoint. With growth of just 1.6% in the first quarter, and private consumption down from 3.3% to 2.5%, it looks like the beginning of a slowdown, especially as, unlike manufacturing, household consumption accounts for more than two-thirds of US GDP. The Fed could well find itself facing a worst-case scenario: inflation no longer falling (or even rising slightly) and growth beginning to weaken significantly. At this rate, we'll be talking about the risk of recession six months from now!

The Fed could well find itself facing a worst-case scenario: inflation no longer falling and growth beginning to falter.

Is duration back at last?

If the economic slowdown continues, we'll have to think about adding a little duration back into our portfolios. Today, this would be premature, as all the signals are converging for the 10-year to test again the key 5% level. But will we get there? The 2-year has already settled around this "pivot," but is reluctant to move higher, while the 5-year prefers to stay close to the 10-year level, leaving the 2-to-5-year slope resolutely negative (-35bp approx.). However, remaining "protected" on 1-year rates close to 5.3% is a very attractive option.

Six months ago, the 10-year hit a high of 5.02% on October 23. We didn't stay at this level for very long, which triggered massive buying. It also coincided with the Fed's dovish turn marking the start of the tremendous rally in US long rates in November-December. Of course, a double-top at 5% makes sense, but if we really are entering a phase of economic slowdown (to be confirmed), a 10-year from 4.80% is a conceivable investment opportunity.

3. EQUITIES

WILL THE HARVEST BE GOOD?

Here we are, in the middle of the 2024 first-quarter earnings season. Expectations are high, and there's very little room for disappointment. The last reporting season (Q4 2023) released by companies a few months ago, in January-February 2024, had already set the tone, with impressive, almost emotional reactions to the slightest positive or negative surprise.

A simple announcement of a lack of visibility on a business segment for 2024, for example, got the better of Adobe, a technology leader whose valuation seemed reasonable given market levels, and sent its share price down -15% in a single session. This was not an isolated case, but what about the latest period?

At present, almost half the companies in the S&P500 have announced their results. They are good, especially earnings, which are generally above expectations in all sectors.

However, the picture is different (for the time being) for earnings growth, which seems to be slowing compared with the previous quarter (+3.75% versus +8.02%).

A seasonal effect?

Certainly, but it's still enough to cause an air pocket for the S&P500, the flagship US stock index, perched on highs and valuation levels (P/E 21x) that are becoming hard to justify, even after the recent correction.

The S&P500 is now only registering mid-single digit gains year to date (+5.0%), having fallen by around 6% since its peak. This was caused in part

by inflation figures which are back on the rise in the US, notably the CPI recently exceeding expectations. All this are dampening rate cuts' expectations for the year.

In Europe, inflation remains on a downward slope. The Eurostoxx 50 (+8.8%) outperformed the S&P500 in local currency terms this year. European financials have even made a remarkable start to the year (+24%). The surprise, increasingly anticipated, could come from the European Central Bank, which could cut rates in June and so move before the Fed.

In the technology sector, we continue to see a significant premium on companies linked to Artificial Intelligence (AI) in one way or another. Some of the "Magnificent 7" are recovering. Even Tesla, which came close to de-railing this year, made a comeback (+37% between 22 and 29 April), buoyed by what may be an agreement with Baidu and the Chinese government for the deployment of autonomous driving in China. This announcement seems to offset, at least partially, the significant slowdown in the American automaker's car sales and the decline in its operating margins.

As for Meta (Facebook), it gave up almost 16% on the announcement of its quarterly figures, with profits nonetheless above expectations, but the market punished the group's growing capital spending on AI, and slightly disappointing forecasts.

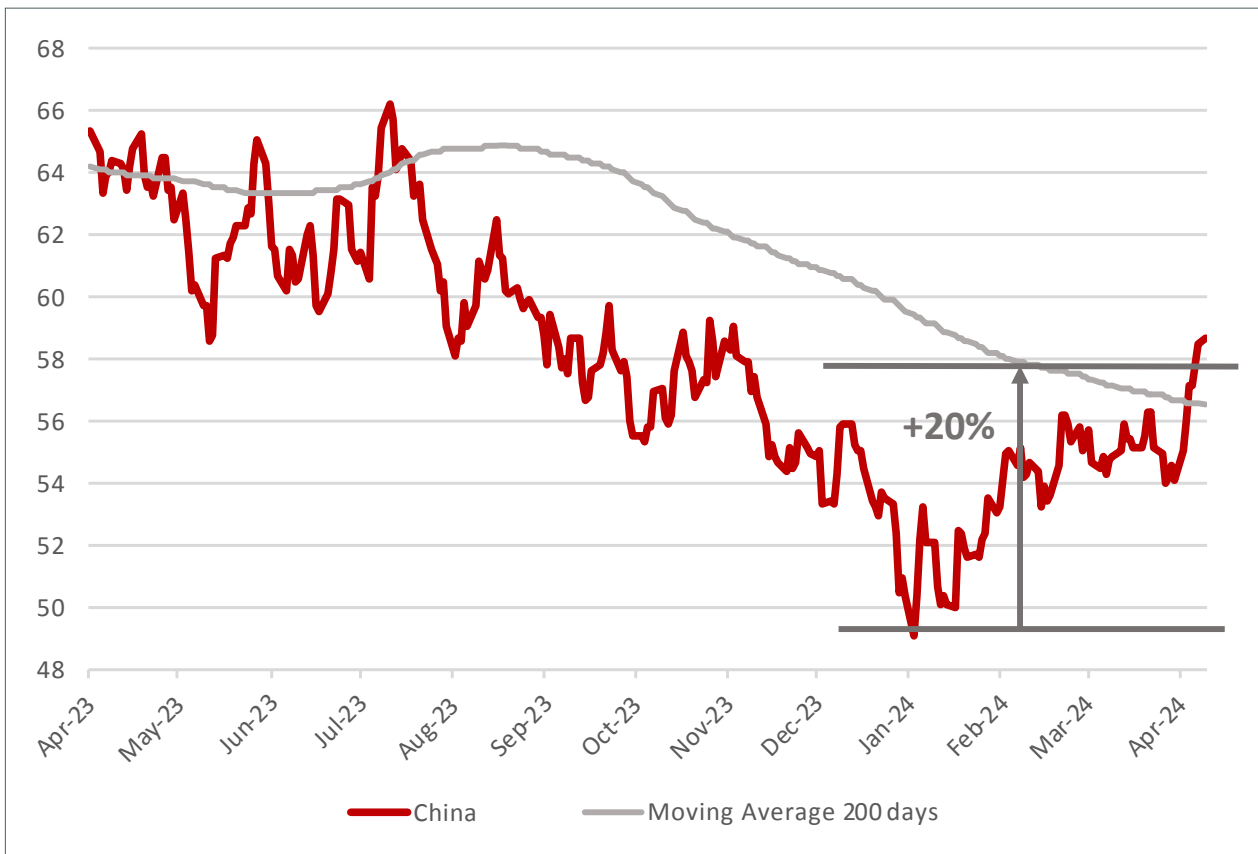
Be that as it may, the dispersion of the Magnificent 7 observed at the start of the year is still marked, and the concentration of these stocks in the main US indices also explains the current valuation level. Indeed, the equally weighted S&P index is trading at levels more in line with history (PE 18x). The

European market, at 15x earnings, is slightly above its historical average, and Asia still offers a significant discount, impacted by China, which is trading at very low levels around 10x earnings.

Japan dominates the stock market indices, with the Nikkei 225 up 16% year-to-date, despite a recent decline of around 7% from its peak. This surge contrasts with the constant depreciation of the yen that broke the symbolic 150-151 JPY/USD barrier and even flirted with 160 JPY at the end of the month. The new threshold for intervention by the Japanese authorities to support their currency now seems to be 160 yen per dollar. Inflation being a boon for Japan, the government certainly doesn't want to break this dynamic after two decades of endemic deflation, and is instead making the most of imported inflation to support price levels in its economy. So far, it does not seem critical enough to generate a pushback from Japanese households.

Optimism is still the order of the day, as economic surprises and corporate earnings remain on track. Still-high valuations in the US could be partly justified by the country's extraordinary economic momentum and superior profitability of US companies, lending credence to the "no landing" scenario. In this environment, in which volatility remains pretty cheap, we cut our equity risk exposure by adding some market hedging through derivatives. On a more positive note, we are taking full advantage of the rebound in the Chinese market, with its representative indices up 20% since their low point at the end of January, and obviously of the surge of the Japanese market, whose appreciation more than offsets the yen's depreciation. We remain cautious on Western equity markets and vigilant on macroeconomic and micro fundamentals.

G3: CHINESE MARKET: TOWARDS A NEW BULL MARKET?



Source: Bloomberg, Banque Eric Sturdza

5. PERFORMANCES

EQUITIES	30.04.24	CURRENT	1 M	3M	6M	YTD	2023	2022	2021	2020	2019
MSCI WORLD	MSCI WORLD	3 305	-3,8%	3,1%	19,4%	4,3%	24,4%	-17,7%	22,4%	16,5%	28,4%
	MSCI WORLD GROWTH	4 866	-4,1%	3,4%	22,5%	5,5%	37,3%	-29,0%	21,4%	34,2%	34,2%
	MSCI WORLD VALUE	3 474	-3,6%	2,9%	16,1%	3,0%	12,4%	-5,8%	22,8%	-0,3%	22,8%
WORLD & US	DOW JONES	37 816	-5,0%	-0,9%	14,4%	0,3%	16,2%	-6,9%	20,9%	9,7%	25,3%
	S&P 500	5 036	-4,2%	3,9%	20,1%	5,6%	26,3%	-18,1%	28,7%	18,4%	31,5%
	S&P500 EW	6 535	-5,0%	3,0%	18,5%	2,1%	13,8%	-11,5%	29,6%	12,8%	29,2%
	NASDAQ 100	17 441	-4,5%	1,8%	21,0%	3,7%	55,1%	-32,4%	27,5%	48,9%	39,5%
EUROPE	STOXX 600	505	-1,5%	4,0%	16,4%	5,4%	16,6%	-9,9%	25,8%	-1,4%	27,9%
	FTSE 100	8 144	2,4%	6,7%	11,2%	5,3%	7,7%	4,6%	18,4%	-11,4%	17,2%
	CAC 40	7 985	-2,7%	4,3%	16,0%	5,9%	20,1%	-6,7%	31,9%	-5,0%	30,5%
	DAX	17 932	-3,0%	6,1%	21,1%	7,0%	20,3%	-12,3%	15,8%	3,5%	25,5%
	IBEX 35	10 854	-2,0%	7,7%	20,4%	7,4%	28,1%	-2,0%	10,5%	-12,7%	16,5%
	SWISS MARKET	11 261	-4,0%	-0,6%	8,4%	1,1%	7,1%	-14,3%	23,7%	4,3%	30,2%
ASIA	SPI SWISS	15 067	-2,4%	2,0%	10,7%	3,4%	6,1%	-16,5%	23,4%	3,8%	30,6%
	MSCI EM	1 046	0,5%	7,2%	14,3%	2,2%	10,2%	-19,8%	-2,3%	18,8%	18,8%
	TOPIX	2 743	-0,3%	7,5%	21,7%	15,9%	28,3%	-2,5%	12,8%	7,4%	18,1%
	HANG SENG	17 763	7,4%	14,7%	3,8%	4,2%	-10,5%	-12,6%	-11,8%	-0,2%	13,0%
	CSI 300	3 604	2,4%	12,1%	0,9%	5,1%	-9,1%	-19,8%	-3,5%	29,9%	39,2%
FX & COMMODITIES	30.04.24	CURRENT	1 M	3M	6M	YTD	2023	2022	2021	2020	2019
CURRENCIES	EUR-USD	1,067	-1,1%	-1,4%	0,9%	-3,4%	3,1%	-5,9%	-6,9%	8,9%	-2,2%
	EUR-CHF	0,981	0,8%	5,2%	1,9%	5,6%	-6,1%	-4,6%	-4,0%	-0,4%	-3,6%
	USD-CHF	0,919	2,0%	6,7%	1,0%	9,3%	-9,0%	1,3%	3,1%	-8,4%	-1,6%
	USD INDEX	106,22	1,6%	2,9%	-0,4%	4,8%	-	8,2%	7,0%	-7,3%	1,2%
COMMODITIES	Gold	2286,25	2,5%	12,1%	15,2%	10,8%	13,1%	-0,3%	-4,2%	25,0%	18,3%
	Silver	26,29	5,3%	14,5%	15,1%	10,5%	2,8%	2,8%	-13,6%	48,7%	12,7%
	WTI Crude Oil	81,93	-1,5%	8,0%	1,1%	14,3%	-10,7%	6,7%	59,1%	-21,5%	11,6%
	Natural Gas	1,99	12,9%	-5,2%	-44,3%	-20,8%	-43,8%	20,0%	46,9%	16,0%	-25,5%
	Copper	9892,40	12,8%	16,4%	23,2%	16,9%	0,9%	-14,1%	25,7%	26,0%	3,4%
FIXED INCOME	30.04.24	CURRENT	1 M	3M	6M	YTD	2023	2022	2021	2020	2019
RATES	US 10 year gvt	4,68	0,48	0,77	(0,25)	0,80	0 bps	237 bps	60 bps	-100 bps	-77 bps
	German 10 year gvt	2,58	0,29	0,42	(0,22)	0,56	-54bps	275 bps	39 bps	-38 bps	-43 bps
BONDS	Global Aggregate USD hdg.	552,2	-1,6%	-1,4%	5,0%	-1,6%	7,1%	-11,2%	-1,4%	5,6%	8,2%
	US Treasuries	2202,8	-2,3%	-3,0%	3,5%	-3,3%	4,1%	-12,5%	-2,3%	8,0%	6,9%
	US IG Corporates	3126,6	-2,5%	-2,8%	7,3%	-2,9%	8,5%	-15,8%	-1,0%	9,9%	14,5%
	US High Yield	2492,9	-0,9%	0,5%	9,0%	0,5%	13,4%	-11,2%	5,3%	7,1%	14,3%
	Euro Government	233,7	-1,4%	-1,5%	4,5%	-2,0%	7,1%	-18,2%	-3,4%	4,7%	6,3%
	Euro IG Corporates	245,4	-0,8%	-0,5%	4,7%	-0,4%	8,2%	-13,6%	-1,0%	2,8%	6,2%
	Euro High Yield	446,5	-0,1%	0,7%	7,8%	1,7%	12,8%	-11,1%	4,2%	1,8%	12,3%
	EM USD Aggregate	1169,4	-1,6%	0,4%	9,6%	-0,1%	9,1%	-15,3%	-1,7%	6,5%	13,1%

Source: Bloomberg, 30/04/24

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Sent to press on

30/04/2024

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