



BANQUE
ERIC STURDZA

QUARTERLY OUTLOOK
1ST QUARTER 2024

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1. EDITORIAL

DISAPPOINTED IN GOOD?

One year ago, investors were dreading the arrival of a difficult 2023 against a backdrop of high inflation and a probable slowdown or even recession in the United States. However, neither geopolitical factors nor a major banking crisis managed to break US momentum. At nearly 2.5% for the year, US growth has more than held its own... The world's major indices are up 20%, and the US stock market is doing even better, with a 24% gain for S&P500, (even if its Equal Weighted version is posting a more modest 11.5% rise). 2023 will have “disappointed in a good way”, but even the most optimistic forecasters will have been left in the lurch by the strength of the markets.

Throughout the year, however, the fixed income world was very turbulent. Quite a series of reversals! Initially, central banks – in aggressive tightening mode – were perceived as “late” in breaking the inflation momentum. This period, briefly interrupted by the banking crisis, lasted until the autumn. Since then, a much more accommodating scenario has taken shape, with rate cuts in sight as early as the first half of 2024.

The battle against inflation seems to have been won, and animal spirits are back again as well as a renewed risk appetite, leading to a strong rise in equity markets since the end of October.

Technology and, in particular, the “Magnificent 7” (that almost doubled over the year) are certainly the big winners, but other asset classes should not be forgotten: from Bitcoin to high-yield bonds and Japanese equities, the risk-on mode mentioned earlier propelled many financial assets.

What can we learn from this astonishing uptrend?

- Never underestimate the American consumer and the United States (mea culpa, we too were a little too cautious!).
- More than ever, markets remain dependent on central bank policy and rate expectations. We’ve always believed this, and looking ahead to 2024 it’s essential to form an opinion on anticipated rate cuts. The market has been quick to adjust: in the United States, 5 to 6 rate cuts are now expected next year. This seems consistent to us with the inflation trajectory, but – barring a very sharp economic slowdown – no further rate cuts should be expected. The valuation adjustment we’ve been witnessing since the end of October should calm down now the party’s over.

If the consensus of a much more resilient economy proves to be correct, to us it seems that the slight catch-up seen recently of small caps could continue. The S&P Small Cap 600 in the US and equivalent indices in Europe are often trading at much attractive levels than large-cap stocks.

As for tactical preference, we remain convinced that the Barbell strategy between growth stocks and value and cyclical stocks should be maintained. From Novo Nordisk (50% YTD) to Unicredit Bank (85% YTD) and Stellantis (58% YTD), the three different investing styles were well represented in 2023, and we’re confident that the same will be true for 2024.

2. MACRO FOCUS

A YEAR FULL OF OPTICAL ILLUSIONS

As the year 2023 is now over, it's a good time to look back at last year's main lessons from a macroeconomic standpoint, and what we could learn from it for the year ahead.

The first lesson is that economic growth slowed in developed countries. In itself, this is no surprise: most forecasters were expecting a marked slowdown in the Eurozone and the United States, the former as a result of the energy crisis triggered by the Russian-Ukrainian war, and the latter as a result of the most severe monetary tightening engineered by the Federal Reserve in almost 40 years, in order to rein in galloping inflation. If there was a slowdown, it turned out to be less severe than anticipated. Thanks to a mild winter and pro-active policies to reduce consumption and diversify energy supplies, the Eurozone escaped the worst-case scenario, even if growth was sluggish and driven by Southern European countries. Even more surprisingly, US growth, expected at the start of the year to decelerate from 2.1% to 0.4% in 2023, is likely to end the year closer to 2.5%. Once again, the U.S. consumers proved more resilient than anticipated. First of all, they could still rely on subsidies granted during COVID that were not completely exhausted. More importantly, with a public deficit close to 7% of GDP - an historical high during peacetime if we exclude the COVID years – public spending helped to offset the deleterious effects of the monetary tightening orchestrated by the FED.

The odds are pretty high that in 2024 growth will remain elusive in the Euro Zone and below potential. Only a durable return of inflation below the 2% threshold so important to the ECB (whose sole mandate remains price stability), could let the central bank be more flexible and helps to revive growth through looser monetary policies. In the US,

the economy is likely to continue to decelerate, although recession should be avoided for now. The momentum is stronger there, and the Federal Reserve, which is also preoccupied by unemployment, could tolerate higher price levels and turn dovish sooner rather than later. That being said, two of last year's main drivers may prove more elusive. The savings pool built up during COVID is now depleted and household consumption may struggle to keep pace with higher interest rate levels. In addition to that, finding a consensus on new stimulus plan might be harder to find during an election year.

With a public deficit close to 7% of GDP, public spending helped to offset the deleterious effects of the monetary tightening engineered by the FED.

The corollary of this sluggish growth environment both in the Eurozone and in the United States is, of course, less inflationary pressures, and as a consequence a more dovish FED and ECB. It was this hope, particularly on the US side, that propelled the recent rally in both equities and fixed income. In a matter of a few weeks, market participants have adjusted and are now expecting 5-6 rate cuts from the FED. With such an abrupt turnaround, the risk of possible disappointment early next year may not be far off..

This year, Asia as a whole will have accounted for almost three quarters of global incremental growth. Next year, global growth should continue to be driven by this part of the world, with China at the forefront. Although Chinese growth has turned out to be weaker than expected with the announced reopening of the country, it should nonetheless average 5%, a level few economies were able to match this year. This somewhat decent economic performance contrasts with the abysmal performance of

Chinese markets. While the Chinese economy has shown itself to be fairly resilient, it was nonetheless handicapped by its domestic real estate crisis and the negative halo it created, as well as by tensions with the United States and the difficulties it caused for its tech companies. While much has been said about these relations, they are also opening up opportunities for other Asian countries: India, which is establishing itself as a new economic superpower (even if we need to be vigilant with the upcoming elections in 2024), and certain Southeast Asian countries such as Vietnam, which is benefiting from the redesign of global supply chains.

We're betting that 2024 will continue the trend seen in 2023: Yes, US growth should finally normalize, though recession should be avoided. Yes, central banks should be more lenient (although probably less so than markets are currently anticipating). And yes, Asia should assert itself as the main growth driver, expecting that "market" performance this year will be less disconnected from the macro-economic environment.

MACRO-ECONOMIC FORECASTS

Années	2017	2018	2019	Avg.	2020	2021	2022	2023e		2024e
								Initial	Final	
World	3,8%	3,6%	2,9%	3,4%	-3,1%	6,1%	3,4%	2,1%	2,9%	2,6%
USA	2,2%	2,9%	2,3%	2,5%	-3,4%	5,7%	2,1%	0,4%	2,4%	1,3%
Euro Zone	2,4%	1,9%	1,3%	1,9%	-6,4%	5,3%	3,5%	0,0%	0,5%	0,5%
Germany	2,2%	1,4%	0,6%	1,4%	-4,6%	2,9%	1,8%	-0,5%	-0,2%	0,3%
France	2,3%	1,7%	1,5%	1,8%	-7,9%	7,0%	2,6%	0,2%	0,8%	0,7%
Italy	1,7%	0,9%	0,3%	1,0%	-8,9%	6,6%	3,7%	0,0%	0,7%	0,5%
Spain	3,0%	2,6%	2,0%	2,5%	-10,8%	5,1%	5,5%	1,0%	2,4%	1,3%
Switzerland	1,7%	2,5%	1,3%	1,8%	-2,5%	3,8%	2,2%	0,6%	0,8%	1,1%
United Kingdom	1,8%	1,4%	1,4%	1,5%	-9,3%	7,2%	4,2%	-0,9%	0,5%	0,3%
Japan	1,9%	0,8%	0,7%	1,1%	-4,6%	1,8%	1,0%	1,3%	1,9%	0,8%
Emerging Economies	4,8%	4,5%	3,7%	4,3%	-0,6%	6,5%	3,6%	3,9%	3,8%	4,1%
Asia ex Japan	6,6%	6,4%	5,5%	6,2%	1,4%	5,6%	3,8%	4,7%	4,6%	4,6%
China	6,8%	6,6%	6,1%	6,5%	2,3%	8,1%	3,0%	4,8%	5,2%	4,5%
India	7,2%	6,8%	4,2%	6,1%	-6,6%	8,7%	6,9%	6,0%	6,6%	6,2%
Indonesia	5,1%	5,2%	5,0%	5,1%	-2,0%	3,7%	5,3%	4,9%	5,0%	5,0%
South Korea	3,2%	2,9%	2,0%	2,7%	-0,9%	4,0%	2,6%	1,6%	1,3%	2,1%
Vietnam	3,3%	2,8%	3,1%	3,1%	2,9%	2,6%	8,0%	4,0%	4,7%	6,0%
Latin America	2,0%	1,7%	1,2%	1,6%	-5,8%	8,2%	4,0%	1,1%	1,7%	1,5%
Brazil	1,3%	1,8%	1,2%	1,4%	-3,3%	5,2%	2,9%	0,8%	3,0%	1,6%
Mexico	2,1%	2,2%	-0,3%	1,3%	-8,2%	4,8%	3,1%	1,2%	3,4%	2,1%
EMEA	3,7%	3,3%	2,7%	3,2%	-2,5%	6,1%	0,9%	0,4%	2,3%	2,4%
Russia	1,8%	2,8%	2,0%	2,2%	-2,7%	5,6%	-2,1%	-2,8%	3,0%	1,4%
South Africa	1,2%	1,5%	0,1%	0,9%	-6,3%	5,5%	2,1%	1,2%	0,7%	1,2%
Turkey	7,5%	3,1%	0,9%	3,8%	1,6%	10,3%	5,2%	2,8%	4,1%	2,7%

Source: Banque Eric Sturdza, données consensus Bloomberg, FMI

3. FIXED INCOME

STOP OR MORE IN JANUARY?

A very market-friendly FOMC

The last FOMC meeting of the year finally validated the fixed income markets' expectations, beyond all expectations. Rates will indeed be cut in 2024, three times according to the Fed, but five to six according to market participants. This is a spectacular turnaround, since Jerome Powell had previously been firm in his comments: "higher for longer and no rate cuts in 2024". The fixed income rally, which had already been pretty significant since October 23 (the day when everything came to a head when the US 10-year briefly broke the 5% barrier), continued at an accelerated speed, with US long rates breaking the symbolic 4% threshold. In Europe, the German Bund fell back below 2%, even though the ECB proved much less dovish than its American counterpart. But the markets don't believe it for a second: part of the eurozone is already in recession, and if inflation figures remain encouraging, Madame Lagarde will adopt a tone closer to that of Mr Powell. In any case, she has no choice!

Any small correction should be used to extend duration.

A small correction in January is still a possibility!

The "hangover" effect of the aftermath of the holiday season could well be felt on the fixed-income markets at the start of the year. We have recently seen an accumulation of mind-boggling performances, dominated by glowing credit markets and a US 10-year falling sharply from 5% to 3.9%. Remember that in mid-October, we were still expecting to see the third consecutive year of negative returns on the Treasuries and Aggregate indices. This is not to be the case! Any small correction should be used to extend duration. Indeed, a slight rebound in yields would not call into question our central scenario, in which the 10-year yield should fall back to around 3.5% during the course of the year. In this scenario, the Treasury curve should evolve in the form of a "bullish steepening", a configuration in which rates fall on all segments of the curve, but more sharply on the short end than on the long end. To round off this atypical 2023 vintage in style, we can't resist the pleasure of mentioning the impressive performance of credit markets, which are in bullish mode, with a special mention for euro-denominated hybrid corporate debt, whose 2023 performance is over 9%.

4. EQUITIES

TIME TO TAKE STOCK

The year 2023 has left its mark in our minds, both geopolitically and economically. The financial markets went through a number of different phases, and the US soft landing was as unpredictable as ever.

Volatility marked by the VIX index (implied volatility of the S&P500) peaked above 30 and also trended down during “quiet periods” (as the one we’ve been experiencing for the past few weeks) to levels not seen since 2020 (below 13).

Long term rates also peaked with the US 10-year flirting with the 5% threshold - a level not seen since 2007- only to fall back below 4% in a matter of few days.

The US marker proved also pretty weak earlier in the year with the S&P500 trading at circa 3,800 at the beginning of January, before a strong rally led it to over 4,700 points at the time of writing in mid-December.

A similar pattern occurred with fixed income indices. By mid-October, bond indices were on track to register their third consecutive year of negative

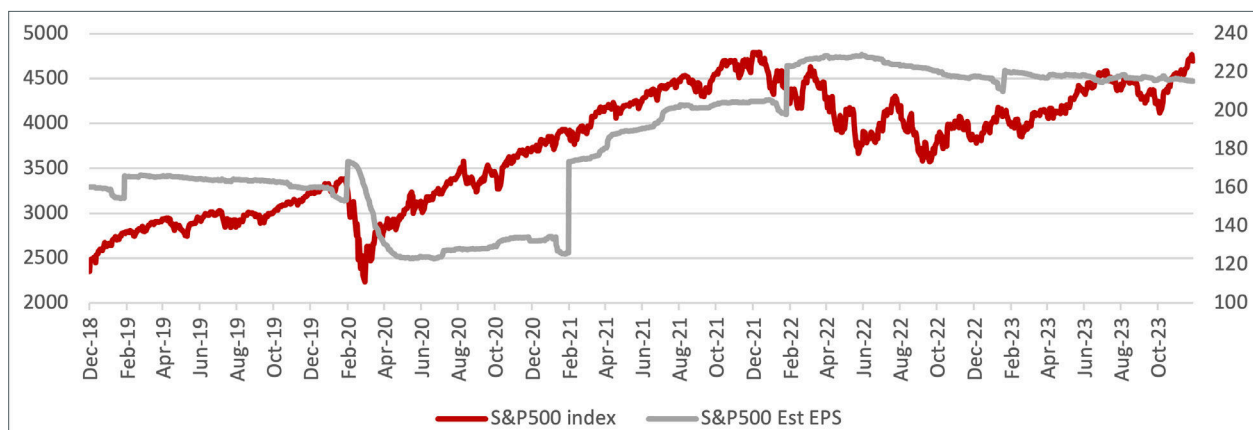
returns, before a powerful rally that followed Mr Powell dovish comments put them back in black.

All these moves were far from being linear and in some cases quite mind-boggling. The collapse of Silicon Valley Bank (SVB) in March is a good example of that : A confidence crisis amplified by social networks and poor risk management notably in asset liability management were enough to bring down this regional bank in just a few days. A similar confidence crisis also brought down Credit Suisse, the 2nd largest Swiss bank and led to its emergency rescue by UBS for a mere \$3 billion.

The Russian-Ukrainian war has set the pace in geopolitics, and the conflict seems to be getting increasingly bogged down in a battle that promises to be long and whose outcome is very uncertain. In the Middle East, the invasion of the Gaza strip by Israel following terrorist acts has the potential to destabilize the entire Gulf region and could have dire geopolitical implications just as the tensions between China and the USA appear to be easing.

Despite a rather turbulent year, stock markets have performed above expectations, with Emerging Mar-

G1 : S&P500 VS. S&P500 ESTIMATED EPS



Source: Banque Eric Sturdza, bloomberg

kets being the notable exception, dragged down by Chinese equities (-11.5% YTD) : The MSCI AC World ended up the year up 21%, the S&P500 up 24% (but a mere 11.5% in its Equal Weight version), the MSCI Europe up +12.5% and the Nikkei 225 up +28% in local currencies.

The impressive performance of the global and US markets can be explained by three main factors. The first one is a “catch-up effect” that is particularly visible for US growth stocks. The spectacular rise of the Nasdaq100 in 2023 (+53%) has to be balanced with the significant fall experienced by the same index in 2022 (-32%). This effect is very pronounced and accentuated for the “Magnificent 7” - Apple, Amazon, Alphabet, Microsoft, Meta Platforms, NVidia, Tesla - which alone represent circa 30% of the S&P500 capitalization and account for most of the gains registered by the US index.

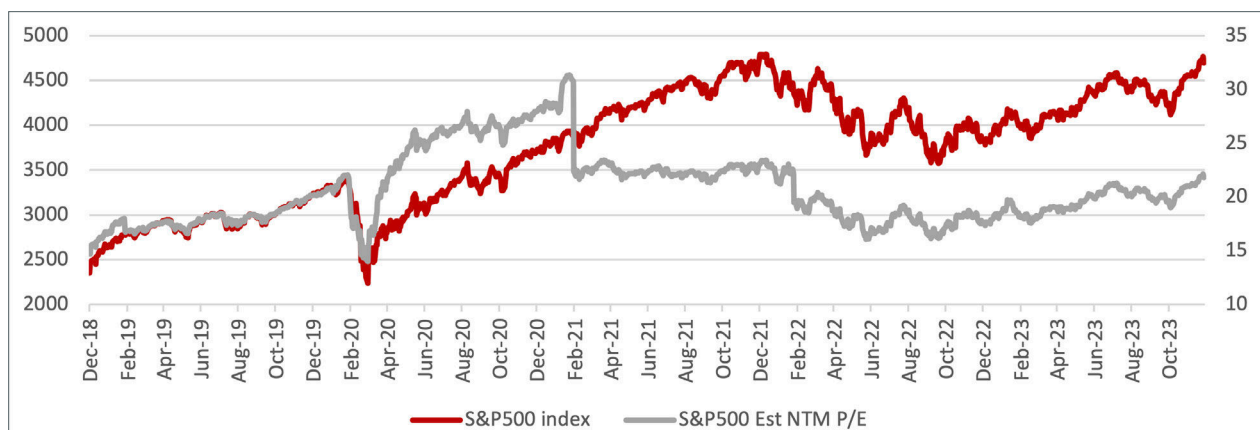
Secondly, and despite the severe monetary tightening implemented by central banks, the global economy, and the US one most notably, proved very resilient in 2023. This resilience was fuelled by factors such as continued robust consumer demand and the gradual easing of supply chain disruptions.

Finally, the ability of market participants to look beyond a possible (mild) recession and anticipate a normalization of the economy with lower rates in 2024.

Central banks seem no longer to be all on the same line: Jerome Powell’s «dovish» tone contrasts with C. Lagarde’s more «hawkish» one. The challenge remains the same: Trying to curb inflation while preserving growth, but the rate hike cycle looks certainly well behind us. Add to this the fact that S&P 500 corporate earnings growth proved better than expected (see chart 1), as well as a serious phase of multiple expansion (see chart 2), and we find ourselves in the midst of a period of euphoria that could prove challenging in 2024, as it remains quite fragile from a fundamental point of view. The resilience of the global economy, marked above all by the American exceptionalism, remains impressive. The year 2024 should be punctuated by a series of major elections, including the US presidential election in November, which could also bring their share of surprises.

The road ahead remains hazardous, geopolitical uncertainties are also elevated, and some of the secondary effects of the monetary tightening policy could well just be deferred and surface again when market participants least expect it. In this environment, if we remain structurally long equities, we continue to focus on diversification both from a style and geographic standpoint and mark a preference for asymmetrical investment solutions taking advantage of structured products to build differentiated pay-offs.

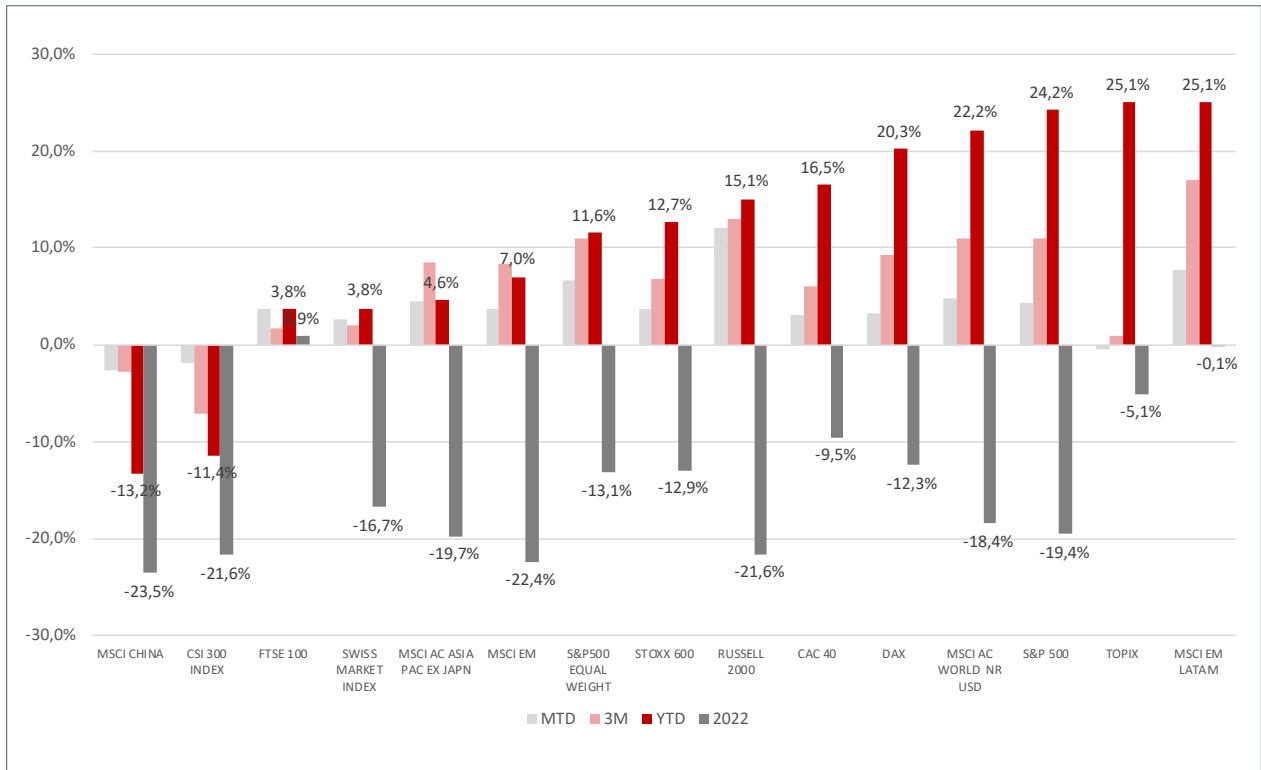
G2: S&P500 VS. S&P500 EST NTM P/E



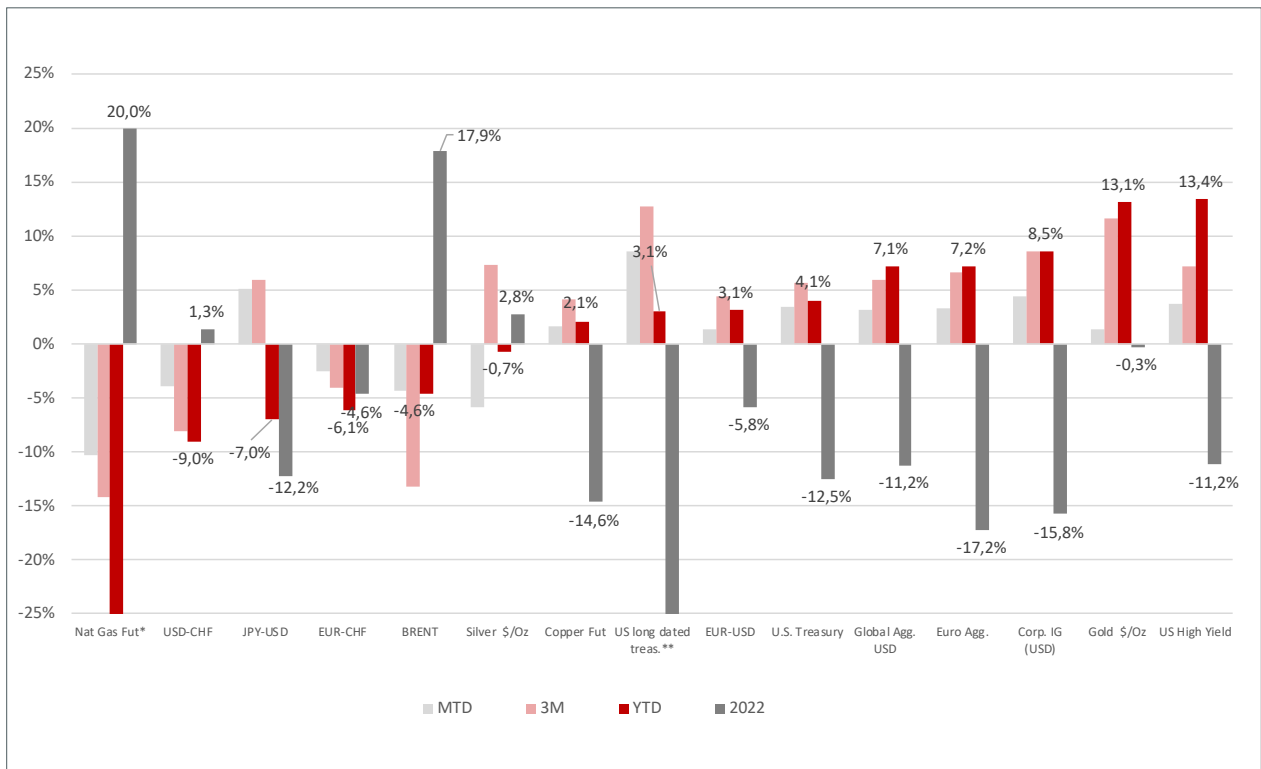
Source: Banque Eric Sturdza, bloomberg

6. PERFORMANCES

EQUITIES IN LOCAL CURRENCIES



FIXED INCOME, CURRENCIES AND COMMODITIES



Source : Bloomberg, Banque Eric Sturdza, 29/12/2023

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