de Pury Pictet Turrettini

Outlook

2nd Quarter 2024

April 2024

Looking Back at the First Quarter

In recent months, global economic data has shown a slight overall improvement and some broadening of the upturn, especially also in Europe. The reduction in inflation towards central bank targets is not yet complete, especially not in the services sector. Against this backdrop, the recent slightly higher-than-expected inflation figures in Europe and the US come as no surprise. Nevertheless, the outlook for slightly lower central-bank interest rates remains intact, with moderate interest-rate cuts due primarily in the second half of the year.

The decline of inflation, the prospects of interest rate cuts, positive economic growth, and the increase in corporate profits have allowed the rebound in stock markets, which began last autumn, to continue into the first quarter. The MSCI World All Countries stock index has thus advanced by 8.2% over the past 3 months.

In the United States, the S&P 500 has repeatedly reached record levels this year (22 times during the quarter, unprecedented since 1998), supported by resilient U.S. economic data and the rise of companies related to artificial intelligence. The values of technology giants are no longer the only ones supporting US indices: all sectors have started the year in the green, especially communication services, industry, energy, and finance. Despite a more subdued economic momentum, European indices are also well-oriented, up by 7%. However, defensive sectors are struggling in Europe since the beginning of the year, particularly utilities, notably affected by the rapid decline in electricity prices. In China, the stabilization of certain sectors of the economy after policymakers intensified their stimulus measures allowed Chinese stocks to attempt a timid rebound starting from February after a new plunge in January. Nevertheless, the performance and valuation gap compared to Western stock indices remains significant.

After a strong rebound at the end of 2023, government bonds experienced a slight correction during the first quarter of 2024. While inflation did decline, the pace of moderation was modest. Labour markets in the US and Europe remained buoyant, leading central bankers to push back on expectations for imminent rate cuts. Nevertheless, by the end of the quarter, the Federal Reserve (Fed) and the European Central Bank (ECB) signalled that rate cuts would begin by June.

Evolution of the main markets as of March 31st, 2024

Equities	Price	Ann. Var. as of 31/03*	Quart. Var. as of 31/03*
World			
MSCI World All Countries	419.9	8.2%	8.2%
Europe	-		
SMI (Switzerland)	11 730.4	5.3%	5.3%
Euro Stoxx 600	512.7	7.0%	7.0%
CAC 40 (France)	8 205.8	8.8%	8.8%
DAX (Germany)	18 492.5	10.4%	10.4%
United States	-		
S&P 500	5 254.4	10.2%	10.2%
Dow Jones	39 807.4	5.6%	5.6%
Nasdaq	18 254.7	8.5%	8.5%
Japan and Emerging Markets	-		
Nikkei 225 (Japan)	40 369.4	20.6%	20.6%
CSI 300 (China)	3 537.5	3.1%	3.1%
Hang Seng China Entr. Index	5 810.8	0.7%	0.7%
MSCI AC Asia Ex-Japan	567.4	2.1%	2.1%
MSCI Latam	613.9	-4.0%	-4.0%

Annual Var.: from 31/12/2023 to 31/03/2024

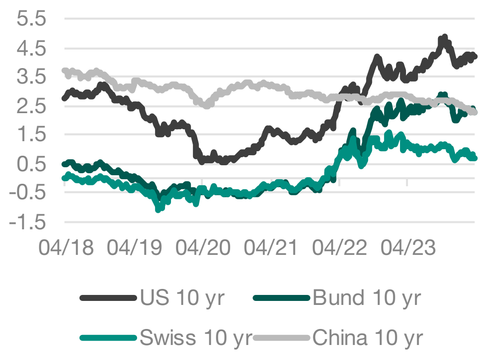
Other Asset Classes	Price	Ann. Var. as of 31/03*	Quart. Var. as of 31/03*
Sovereign Yields			
Switzerland 10 years	0.6870	0.01bps	-0.01bps
Germany 10 years	2.2980	0.27bps	0.27bps
France 10 years	2.8070	0.25bps	0.25bps
United States 10 years	4.2003	0.32bps	0.32bps
Bonds			
BB Barclays EU IG TR	197.0	-0.4%	-0.4%
BB Barclays EU HY TR	232.8	-0.3%	-0.3%
BB Barclays US IG TR	436.3	2.2%	2.2%
BB Barclays US HY TR	327.6	1.3%	1.3%
BB Barclays EM USD TR	182.9	-0.4%	-0.4%
Currencies			
EUR vs. USD	1.0790	-2.3%	-2.3%
EUR vs. CHF	0.9731	4.8%	4.8%
USD vs. CHF	0.9014	7.1%	7.1%
Commodities			
Oil (WTI)	83.2	15.3%	15.3%
Gold	2 229.9	8.1%	8.1%

***Quarterly Var.: from 31/12/2023 to 31/03/2024*

Source: Bloomberg, PPT Calculation

Changes in expectations as well as the resilience of the U.S. economy have caused a 0.3% increase in U.S. 10-year yields, which are back above 4% (at 4.20%). German 10-year yields have followed a similar path and now stand at 2.3%. Corporate bonds continued to outperform as credit spreads tightened. However, some pockets of fragility began to emerge in March after negative announcements from some highly indebted European players (SFR, Intrum, or Ardagh). The risks are so far considered specific to these companies by the markets, and there has been no contagion to other segments at this stage.

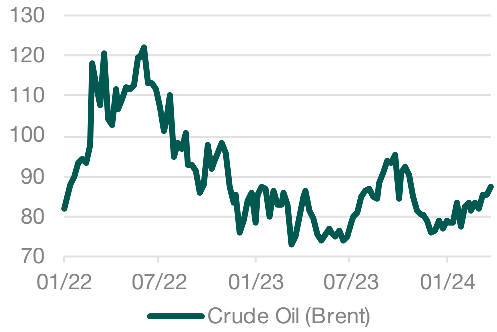
Evolution of Government Bond Yields



Source: Bloomberg

Commodities have experienced mixed fortunes in the early part of the year. The Middle East conflict and increased risks for shipping in the region have pushed up oil prices by 15% in 2024. However, the increase remains relatively modest considering the extension of supply reduction measures until the end of the semester by OPEC+ countries, led by Saudi Arabia, to avoid market oversupply. Agricultural commodity prices, on the other hand, have steadily declined over the past twelve months, contributing to reducing global inflation. One notable exception is the price of cocoa, which recently reached a record level, surpassing $10,000 per ton. This represents an increase of over 130% since the beginning of the year. Adverse weather conditions and tree diseases in West Africa, responsible for about two-thirds of the world's cocoa production, have severely affected production in countries like Ivory Coast and Ghana, the world's leading cocoa bean producers.

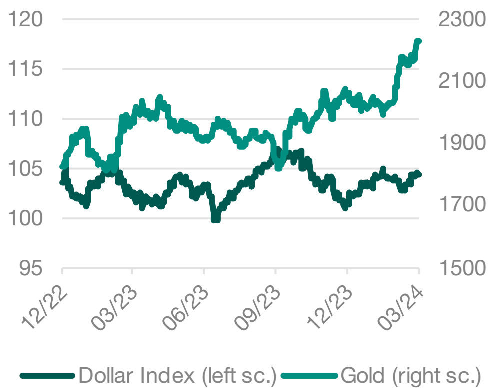
Evolution of futures contracts on oil (Brent)



Source: Bloomberg

Gold, on the other hand, crossed the $2,200 per ounce threshold at the end of March, a historic record. The increase of more than 20% observed since early October 2024 is explained notably by significant purchases made by central banks, especially in emerging markets, wishing to increase their gold reserves, as well as by a renewed interest from individuals who have recently increased their investments in exchange-traded funds (ETFs). The simultaneous and rapid decline in global inflation momentum, combined with the beginning of a new rate cut cycle by many major central banks, also constitutes a constructive development for the yellow metal.

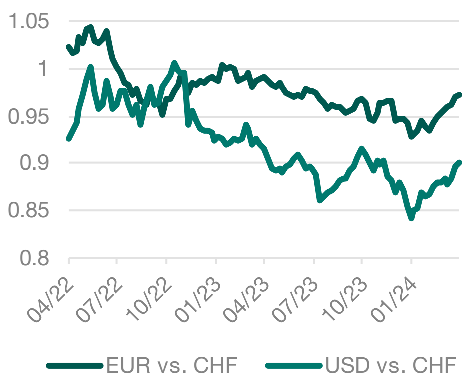
Evolution of the US Dollar and Gold



Source: Bloomberg

As for currencies, the euro/dollar pair is evolving in line with economic dynamics and currently volatile expectations of interest rate cuts. The dollar has thus modestly strengthened against the common currency since the beginning of the year (+2%). The CHF is declining (-7% against the USD and -5% against the EUR), notably following the surprise announcement by the Swiss National Bank (SNB) to reduce its reference interest rates by 0,25% to 1.5%, the first cut in nine years. The SNB seeks to support the Swiss economy, particularly through a lesser appreciation of the franc.

Evolution of the Swiss Franc



Source: Bloomberg

Outlook – 1st Quarter 2024

World Economy – On track, inflation trends uneven

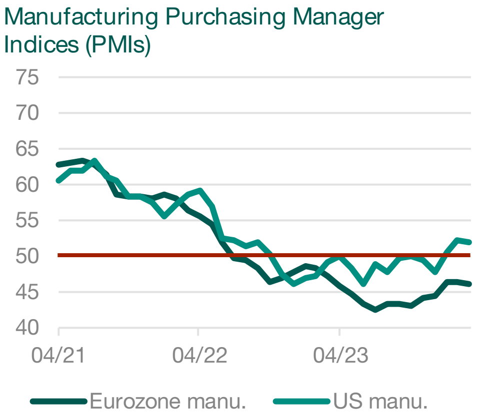
The scenario of a US recession is fading, with recent data pointing to a continuation of the recovery instead (or "no landing"). In Europe, the economy is subdued but shows few signs of pronounced weakness overall, which is consistent with a "soft landing". Economic surprises are currently generally favourable, prompting economists to revise their growth expectations for 2024 upwards. In the United States, these now reach 2%, up from 1.2% earlier in the year.

A more widespread global economic recovery, yet still fragile in Europe and China

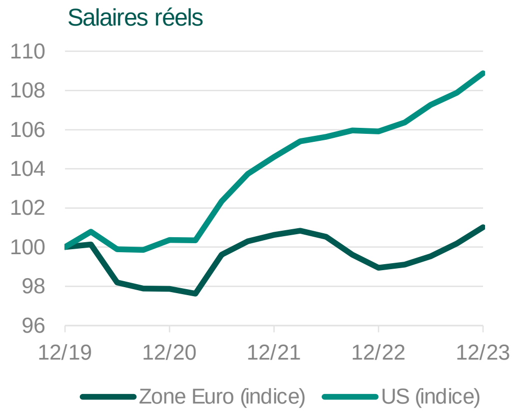
The global economy has experienced a moderate recovery in recent months, as evidenced by purchasing managers' surveys (PMI), which are now firmly above 50, marking the boundary between contraction and expansion. After the resilience observed in the services sector, industrial activity is also beginning to recover. In the United States, the manufacturing ISM index has thus risen above 50 for the first time since September 2022. A certain form of recovery is also observable in the Eurozone (excluding Germany), the United Kingdom, and, to a slightly lesser extent, in China. Recent data indeed suggest some broadening of the global upturn after last year's global growth was strongly driven by the US.

The factors driving private consumption remain supportive. In Europe and the US, full employment largely prevails, and inflation-adjusted purchasing power has been rising with inflation falling. From the pandemic, there are still excess savings available, which is benefiting US consumption in particular.

Real interest rates are positive in Europe and the US, which indicates a restrictive monetary policy. At the same time, there currently are hardly any signals that would indicate a burden on the economy as a whole due to high interest rates. However, avoiding recession would be a novelty from a historical perspective, given the sharp rise in central-bank interest rates and inverted yield curves (i.e. long-dated bonds yield significantly less than money-market interest rates). Nonetheless, special factors in connection with the pandemic and the structurally reduced interest rate sensitivity of Western economies put the risk of a recession into perspective.



Source: Bloomberg



Source: Eurostat

Inflation still expected to decline towards central banks' target despite recent setbacks

With growth holding up, the chances of a sustained reduction in inflation, particularly in the services sector, are diminishing somewhat. We would not overemphasize the current slightly higher than expected inflation data, especially as goods price inflation, the main driver of the current inflation episode, has normalised.

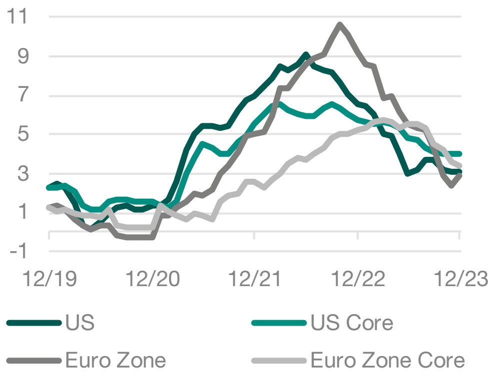
In Europe, another drop in natural gas prices and a stabilisation in the increase in renegotiated wages are incrementally positive factors. Global supply chain pressure appears also well contained. In the United States, core inflation measured by the Fed's preferred Consumer Expenditure Index has been at around 2% for several months, thus reaching the central bank's target. Rent inflation has been falling, while inflation for services excluding rents has recently risen again somewhat. Wage growth rates (see the Atlanta Fed wage index and the employment cost index) have slowed, which argues against a wage-price spiral.

The first-rate cuts expected for June in the United States and Europe

During its March meeting, the Fed maintained its expectations of three 0,25% rate cuts in 2024, despite upward revisions to its growth and underlying inflation forecasts for the same year. The recent stronger-than-expected rebound in monthly inflation has not changed the message from Chair J. Powell, who stated that price pressures will continue to ease and that it would likely be appropriate to cut rates at some point this year. Powell also stated that it would be appropriate to slow the pace at which the Fed is reducing its balance sheet "fairly quickly". Following these statements, money markets have adjusted upwards the probability of a first rate cut in June, from 50% to 68%. Investors expect somehow higher benchmark rates, slightly above 4,50% by the end of the year, representing between 2 and 3 cuts. Expectations are very similar on the ECB side, with three rate cuts currently anticipated for 2024.

The Swiss National Bank has already reduced its benchmark rate by 0,25%, to 1,50% from 1,75% previously, defying consensus expectations. The SNB is thus the first central bank among developed countries to ease its monetary policy. The decline in Swiss inflation, the strength of the CHF, and still weak prospects in the industrial sector, are the three main reasons justifying this move. Following the downward revision of inflation and growth forecasts by the SNB, money markets now anticipate two additional 0,25% rate cuts in 2024.

Consumer price indices

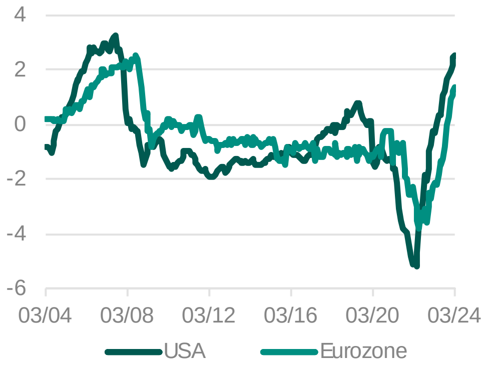


Source: Bloomberg

Global supply chain pressure

Source: Federal Reserve, New York

Real central bank rates (%)

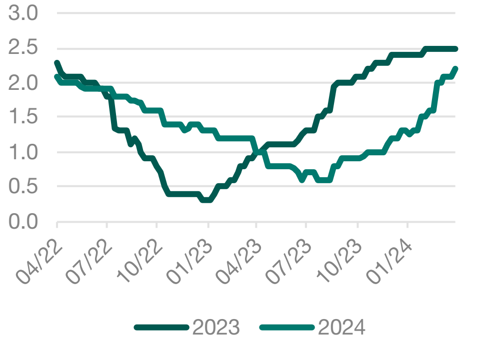


Source: Federal Reserve, European Central Bank

Regional perspectives

Economic momentum will remain robust in the **United States** in the first half of this year, albeit at a less vigorous pace than in the second half of 2023, with growth expected to be around 2-2.5% in the first quarter of 2024. Growth constraints will certainly be felt this year, including less expansive fiscal policy, less pronounced infrastructure investments following the impetus provided by last year's Inflation Reduction Act, and limited potential for household savings to decrease. However, consumer spending remains resilient, and business investment is holding up. Moreover, the decline in inventories that was weighing on manufacturing production seems to have come to an end.

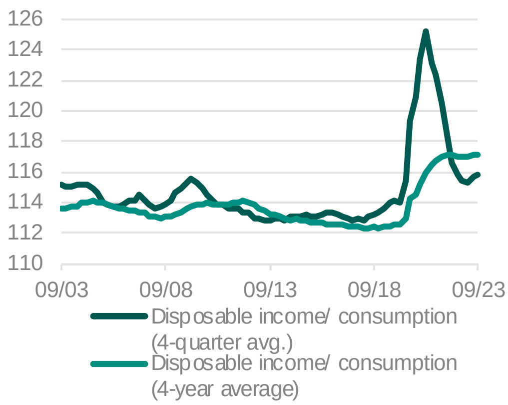
Expected US GDP Growth (consensus)



Source: Bloomberg

In **Europe**, private consumption increased only slightly in 2023. With real wages rising, good labour market conditions (given a record-low unemployment rate in theEUR area) and high savings, the conditions for an higher growth rate in private consumption would be in place. A high proportion of fixed-rate mortgages also puts the burden placed on households by higher interest rates into perspective. Activity is expected to remain highly heterogeneous across countries. Germany is still mired in a slight recession, while southern countries show more pronounced dynamism.

Euro area: Private households



Source: European Central Bank, Eurostat

Just like in the EUR area and the United States, the **Swiss** economy is largely at full employment, but with a manufacturing purchasing managers' index still firmly entrenched in contraction territory, indicating economic growth below its potential. The Swiss National Bank (SNB) was the first central bank among major developed countries to ease its monetary policy. During its March meeting, it set new targets: an inflation rate of 1.4% in 2024 and 1.2% in 2025, well below the 2% target that remains its long-term goal, with a growth forecast of only 1.0% in 2024, up from 0.6% in 2023. Thus, it has transitioned from fighting inflation to supporting its economy.

Inflation Switzerland

Source: Bloomberg

In **China**, available data (satisfactory activity during the Lunar New Year holidays, recovery in PMI surveys, and normalization of high-frequency indicators) suggest a slight acceleration in activity at the beginning of the year. However, the trajectory of growth beyond this point will depend on economic policy decisions. In this regard, the growth target of 5% for 2024 announced during the National People's Congress implies the necessity of continuing accommodative policies. Nevertheless, the absence of concrete and immediate measures (especially aimed at households) is detrimental to restoring confidence, a prerequisite for achieving a sustainable stabilization of growth.

Equities – The fundamentals remain favourable, but the outlook becomes more symmetric

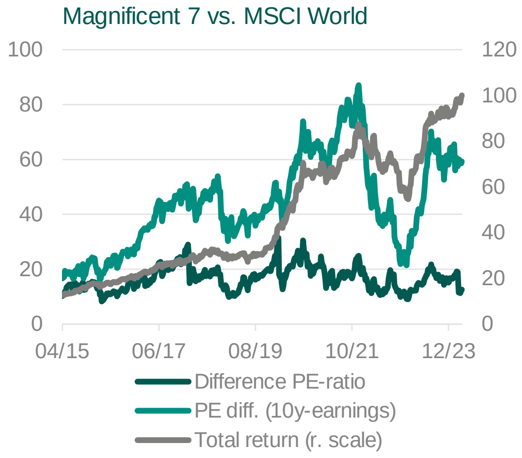
The decline in inflation, the imminent start of a new rate cut cycle, positive economic growth, and strong corporate earnings should continue to support stock indices in the coming months. However, many positive developments are already priced in, making the outlook more symmetric. We continue to see opportunities in quality and growth stocks, including in the US technology sector.

Equity markets have risen significantly since the end of last October. The rally has been driven by a slight improvement in the global economy, comparatively favourable valuations and an improving mood among many investors.

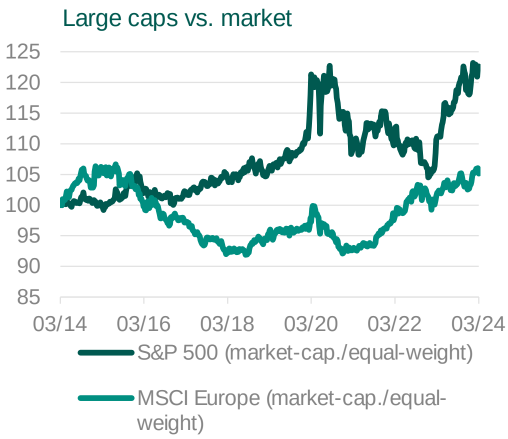
Stock market performance in both Europe and the USA has recently been strongly correlated with the economic momentum as reflected in the 12-month change in the PMIs. All in all, the slight improvement in the economic and corporate earnings environment now appears largely priced in. The market outlook thus is becoming more symmetrical, after opportunities quite clearly outweighed risks a few months ago.

Quality growth stocks (characterized by strong balance sheets, high profitability, and resilient earnings) typically outperform when economic growth is positive but relatively weak and bond yields are stable or declining (as is currently the case). Therefore, we maintain our bias towards such companies at the expense of more cyclical names and so-called "value" stocks. While the MSCI Growth Index has indeed significantly outperformed the MSCI Value Index in the United States over the past 12 months, this trend has not yet been observed in Europe. In the United States, this outperformance can be attributed to a few large technology companies for which earnings dynamics are expected to remain favourable in the coming months.

Sector-wise, we remain positive for the healthcare sector this year. For a number of companies, 2023 was a transition year as the high sales during the pandemic (especially for Covid-19 tests and vaccines) collapsed. In 2024, these companies are likely to face normal demand trends, attracting renewed investor interest. The rate cuts should also spark renewed interest in themes related to energy transition. Lastly, we believe that artificial intelligence (AI) will remain a dominant theme that continues to support tech giants due to their dominant presence across various levels of the AI value chain, their ability to invest and attract talent, and their access to monetizable data.



Source: MSCI, Bloomberg



Source: S&P, MSCI

Bonds – Still attractive yields as a new monetary policy cycle begins

With the Swiss National Bank (SNB) initiating the first interest rate cut among central banks in developed markets, a new monetary policy cycle has begun. The recent rise in rates in the United States and Europe presents a fresh opportunity to lock in attractive long-term yields before yield curves more clearly reflect this new reality.

The rate reduction cycle has begun. The Swiss National Bank set the signal for lower rates among Developed Market policymakers. We expect other Central Banks to follow starting in June. The decline in inflation mechanically increases the burden of the higher rates on businesses and households, allowing Central Banks to cut rates without overstimulating the economy. What was notable from Central Bank commentary is that, unlike most previous episodes of rapid rate hikes, a recession is no longer a prerequisite for easing monetary policy.

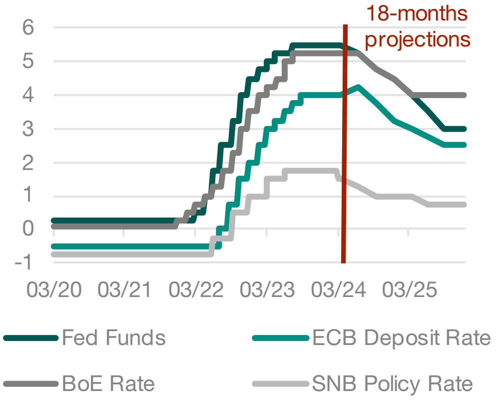
Stronger equities, more stable bond yields, and a diminished recession risk will continue to support financial conditions, which will be positive for emerging markets and hybrid bonds. Both bond segments have only recently started normalizing from their 2023 undervaluation.

Many Central Banks are reducing the size of their balance sheets, eventually reducing the amount of liquidity in the system. Lower inflation and tightening liquidity will nudge rate-setters to cut rates sooner rather than later. Shorter maturity yields should decline faster than longer yields and will therefore not remain at current high levels for much longer. Following the recent rise in longer-term rates, there is still time to benefit from high yields, with potential capital gains if yields decline.

With the decline in inflation, the correlation between bonds and equities has reverted to more normal levels. During the high inflation period in the past two years, bonds and equities moved in lockstep, reducing the benefits of a diversified portfolio. This has changed over the past quarters, which should benefit investors.

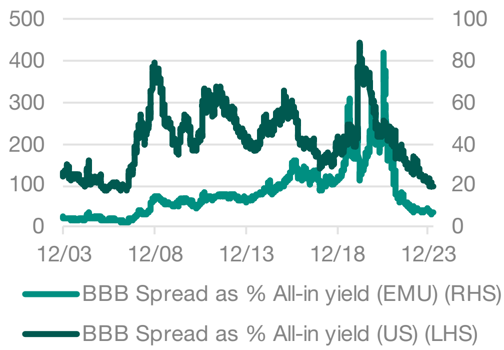
Yields on inflation-linked securities are close to their highest levels in two decades. We expect them to perform well while offering investors protection in the case that inflation rises once again. Overall, we favour a balanced allocation with combination of high-quality corporates anchored on 3-7 years in terms of maturity, with a diversification in short-dated high yielding bonds, corporate hybrids, selective emerging bonds as well as an exposure in inflation indexed sovereign bonds.

Evolution of Key Central Bank Rates



Source: Bloomberg

Credit spreads as % of all -in yields (BBB)



Source: Bloomberg

Our Positioning

Bond prices have recently corrected, yet the medium-term outlook remains positive. Despite the uptrend since last October, equity markets are currently lacking fresh catalysts, rendering them more vulnerable to a correction. Conversely, fundamentally intact conditions argue against a significant market downturn.

Slightly higher than expected inflation rates and most investors shifting their expectations for central bank interest rate cuts to the second half of the year have weighed on the bond markets in the first months of the year. We continue to forecast inflation rates in line with the central bank targets of 2% (European Central Bank and US Federal Reserve) and lower central bank interest rates in the medium term. Against this backdrop, the medium-term environment for bonds remains favourable. We maintain a preference for high-quality bonds with maturities of 3 to 7 years and uphold our underexposure to high-yield bonds. Recently displayed vulnerability in certain heavily indebted European groups could indeed signal broader-scale difficulties.

The news flow for the equity markets has recently been somewhat more positive than for bonds as the modestly deteriorating monetary environment (inflation and delayed interest rate cuts) was offset by decent economic data and a slightly better corporate reporting season for the final quarter of 2023 than many investors had expected. Following a fairly strong price increase on the stock markets since last October, the roughly intact economic environment now appears largely priced in. The outlook is therefore becoming more symmetrical, i.e. opportunities and risks are more balanced, after the opportunities clearly outweighed the risks in late autumn 2023.

The equity allocation remains relatively high, although profit-taking may be considered. The primary focus remains on the United States, which still maintains a structural advantage over Europe due to the high weighting of technology-oriented sectors. American companies are also expected to record more significant productivity gains, particularly due to the rise of generative artificial intelligence, leading analysts to revise upward their earnings expectations. This trend could further accelerate with the confirmed rebound in manufacturing activity. We also maintain our bias towards quality and growth stocks.

We also keep our positive view on gold, which should continue to benefit from a more favourable rate environment, especially in the event of real rate declines. Central bank demand, with gold reserves representing only 5% of total reserves, is expected to remain robust as geopolitical tensions persist. In recent months, central banks, especially those of emerging economies, have been the largest buyers in the market.

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