SUNLINE

WEALTH MANAGEMENT

November 2023

Higher for longer: but not too long part 2

About a month ago we listed many reasons as to why we believed US rates couldn't stay this high for too long. As the entire US curve was trading at or above a 5% yield, we thus implemented a barbell in US rates: being already long short—term treasury notes we added long term US treasuries. The month was ending with yet another month of heavy stock and bond losses, respectively down 2.7% and 0.85%. The mindset of investors was that bad economic news, (but not too bad), would be good news for financial markets.

And then came a raft of softer economic data:

- US delinquency rates for credit cards and auto loans surged to levels higher than pre—pandemic.
- US unemployment was softer, and black unemployment is approaching 6% again.
- Conflicting US PMI manufacturing surveys on the same day: The S&P Global survey was neutral, while the ISM survey showed contraction in essentially all components. The market sided with the ISM survey.
- US senior loan officers' surveys again show weak credit demand.
- European credit demand, as measured by the Euro—area credit impulse indicator, is now at levels last seen during the 2008—2009 Global Financial Crisis.
- Generally, European inflation figures, although difficult to compare year-on-year, were benign. Italy, for example, printed 1.9%, however one year ago the country was grappling with sky-high energy prices.
- Softer and softening US CPI — even at the core level.
- Soft US retail sales, compatible with a soft landing.

These data were coupled with:

- Hints by major central banks, that, with the help of financial markets repricing rates, their job was probably done for this cycle.
- Not worse geopolitical news: a rare TV speech by Lebanon's Hezbollah leader Nasrallah indicated that, at least for now, the conflict wouldn't regionalize to Lebanon.
- An OK earnings season.
- China is giving signs of economic life, although the picture is still a bit blurred.
- A US shutdown has been averted, until January 2024.
- The downgrade of United States rating outlook to 'negative' by Moody's is a non-event.

The repricing of the US Federal Reserve's policy path and the repricing of term premium was violent. So was the stock market rebound:

- Within a week, the 10 to 30 year US treasury yields dropped by about 45 basis points. Yields rebounded before dropping again after the US CPI figures.
- The MSCI World also rebounded strongly, led by the usual US mega technology suspects: the group's leader has been Nvidia, up 22% since the end of October, and is now within a whisker of its all-time high.
- The MSCI World has now erased all of its losses recorded in September and October.

Central Banks and The Economy

With recent US inflation gradually coming into check, the market has now joined our central scenario for the US Federal Reserve to start cutting rates in March 2024, with 1 percent of rate cuts implied by January 2025. In the Eurozone, the market now also implies a first rate cut in March 2024, and a 50 basis points rate cut by June 2024.

As we wrote last month, we think, for Europe, this is probably a bit optimistic, unless the economy suddenly starts contracting, as inflation is uneven across countries, probably a bit stickier than in the US, and currently difficult to measure and compare in view of last year's energy crisis. Also, due to current different temporary anti-inflation initiatives at the country level.

Of note — also in connection to one of our comments last month — are the very different levels of 10-year real rates: in the US currently, they are still at 2.2%, whilst in Germany, just 0.4%.

2.2% real rates are unsustainable in the US with the current level of indebtedness of the government, corporates, and households. The current pace at which the US government itself is increasing its interest costs is alarming: in 2022 it paid 1.8% of GDP in interest, the highest level since 2001. Note that most US treasuries were issued in a low / zero rate environment in recent years and are now having to refinance at a higher rate, along with ballooning levels of debt new issuance.

Economy

United States:

Hard and soft data have been weakening since October, after a strong Q3 led by consumption, a few one-off notorious events such as the Taylor Swift and Beyoncé tours, and the 'Barbenheimer' phenomenon that attracted huge crowds willing to spend a lot to attend. October was also the month of the resumption of the payment of student debt, whereby debtors received injunctions to pay 70 billion dollars. Average hourly earnings came in at 4.1% year-on-year. While this seems high historically, taking the last three months, they dropped to 3.2% on an annualised basis. This is at pre-pandemic levels and consistent with 2.0% inflation, after correcting for productivity gains. As mentioned above, currently all data are consistent with a soft landing.

Eurozone:

The economy, regarding both inflation and growth, looks like patchwork, rendering the ECB's task more difficult. As a whole, growth is stalling, and inflation is falling, albeit at a slow pace. Regionally, peripheral countries such as Portugal, Spain, Italy and Greece are doing fine, while Germany and the Netherlands are struggling to avoid recession because of their energy intensive industrial fabric and dependence on China.

UK:

The unpopular Conservative government, ahead of elections next year, rejoiced at the GDP print of zero percent quarter on quarter growth: textbooks say the country has avoided recession so far — thanks to a zero GDP print. Looking at the different sub-indicators, however, tells us that the UK is already in recession, and was held up only because exports rose and, in particular, imports collapsed:

- Private consumption fell 0.4%
- Government expenditure fell 0.5%
- Fixed capital formation fell 2.0%
- Business investments fell 4.2%

This is not a healthy economy. Higher fuel costs, diminishing savings and less immigration — that have been compounded by Brexit and COVID — are all expected to hinder real household consumption growth.

China:

While the property sector continues to struggle — and the government multiplies its actions to address the issue — other indicators point to economic stabilization and even a pickup in the acceleration of growth, consistent with the government's 5.0% target for 2023. Retail sales accelerated to 7.6% in October, up from 5.5% in September. So did industrial production at 4.1%, from 4.0% in September, as industrial profits continued to recover from the trough in February of this year. Fiscal stimulus is also accelerating, as the government announced the issuance of 1 trillion Yuan of central government bonds, whose proceeds will be transferred to local governments for infrastructure projects, as well reconstruction post the devastation caused by the floods.

Strategy

Our central scenario continues to be that:

- The US will achieve a soft landing, inflation will slowly move towards target, and the central bank is done with hiking, and will be able to start cutting rates in spring.
- The Eurozone will avoid a recession, however economically it is likely to resemble a patchwork, both for inflation and growth: Germany and the Netherlands will likely enter one, while Italy will straddle the zero-growth line. Inflation in Europe is likely to be higher than target in 2024, however the ECB is likely done with hiking, as food prices, for example, are non-interest rate sensitive. The ECB will start to lower rates by summer, and not spring as the market implies.
- China looks like it is finally managing to pull its economy out from the doldrums. That should help Chinese and regional markets, and finally draw interest from foreign investors again.
- Japan is facing a reflationary dynamic it has waited to see for the last 30 years. It is uncertain whether the Bank of Japan will intervene to curb YEN weakness, as long as inflation is under control.
- As the world economy is expected to improve in 2024, we think that earnings revisions should continue higher. In the US, profit margins have been declining since 2021: we expect some stabilization. In Europe they have been stable to higher, and we expect some stagnation until China leads global growth again.
- As we highlighted last month, the leveraged community had historic shorts on the entire US yield curve ahead of this rally. The latest data shows that this segment of investors increased its shorts further as of November 6th. They might have been forced to close at least some shorts after the recent CPI data. The traditional asset manager community on its side, has likely been forced to extend duration closer to the benchmarks.
- In equities, positioning is extremely varied among both traditional as well as alternative asset managers, ranging from underweight to overweight. However, as interest rate volatility calms down, it is estimated that CTA and systematic funds will be forced to buy record amounts of equities over the next month. For the US stock market only, Goldman estimates that at least 140 billion dollars will be purchased, while UBS analysts put that figure at between 280 and 320 billion dollars.
- We thus continue to be positive about the performance of the classic 50/50 portfolio over the next couple of quarters.

Positioning

Overall Exposure

With the drift we are now Neutral Equities, and Neutral Fixed Income, with a Gold position, partially USD and JPY hedged.

Equity: Neutral

We have a very sizeable Overweight to the Eurozone and a very sizeable Underweight in US equities, Neutral US technology, Neutral UK, Overweight Japan, Overweight Asia ex Japan.

Thematic Equities

European Family Holdings, Asian Technology, Health Improving Technologies and Services, European Champions, the UN's 17 Sustainable Development Goals.

Fixed Income: Neutral

Long 1 to 3 years US Treasury Notes. Long 20+ years US Treasuries

Thematic Fixed Income

Overweight High Yield in EUR and Underweight in USD. Overweight Investment Grade EUR and USD Bonds, Underweight Sovereigns. Long US Municipal Infrastructure Bonds, Long Hybrids, Long Subordinated Financial Credit & Long Asian Bonds in hard currency.

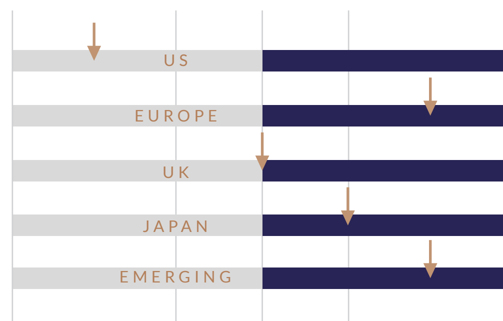
Currencies: Portfolios have a 5% USD exposure.

Commodities: Overweight

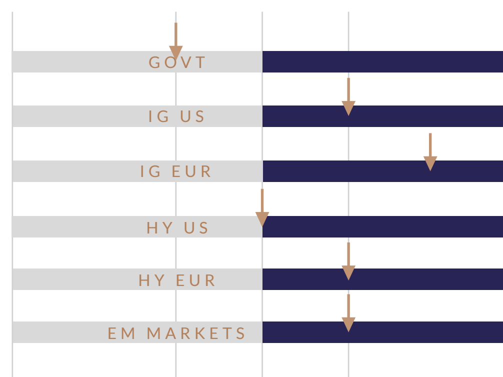
Long Gold.

Conviction thermometer

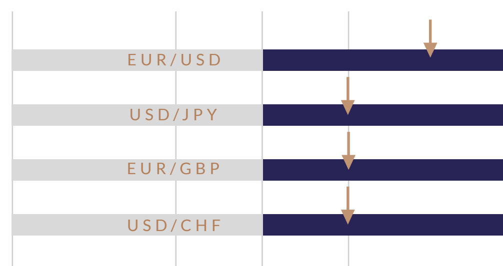
Equities



Bonds



Currencies



Commodities

Negative view   Positive view

Market overview as of 31st October 2023

Equities (local ccies)	Level	5D	MTD	YTD	2022
MSCI WORLD	2 768,62	-1,17%	-2,88%	8,36%	-17,71%
US S&P500	4 193,80	-1,25%	-2,10%	10,68%	-18,13%
NASDAQ 100	14 409,78	-2,27%	-2,04%	32,61%	-32,38%
RUSSELL 2000	1 662,28	-1,01%	-6,82%	-4,48%	-20,46%
EUROPE EURO STOXX 50	4 061,12	-0,04%	-2,62%	10,45%	-8,55%
GERMANY DAX	14 810,34	-0,47%	-3,75%	6,37%	-12,35%
FRANCE CAC40	6 885,65	-0,12%	-3,50%	9,41%	-6,71%
BELGIUM BEL20	3 356,76	0,75%	-5,25%	-6,58%	-11,47%
SWISS MARKET INDEX	10 391,16	0,14%	-5,22%	-0,12%	-14,29%
UK FTSE100	7 321,72	-0,92%	-3,69%	1,36%	4,57%
JAPAN TOPIX	2 253,72	0,58%	-3,00%	21,98%	-2,48%
MSCI EMERGING	915,20	-0,57%	-3,88%	-1,85%	-19,81%
BRAZIL IBOVESPA	113 144	-0,54%	-2,94%	3,11%	4,69%
CHINA CSI 300	4 563,77	2,52%	-3,10%	-5,52%	-19,83%
HS TECH	3 759,16	3,76%	-4,12%	-8,54%	-26,66%
INDIA SENSEX	63 874,93	-0,99%	-2,85%	6,31%	5,77%
KOREA KOSPI	2 663,34	-4,42%	-7,58%	2,59%	-23,21%
HONG KONG HANG SENG	17 112,48	0,71%	-3,91%	-10,47%	-12,56%
AUSTRALIA ALL-SHARE	3 954,35	-0,72%	-4,09%	0,06%	0,23%
SAUDI ARABIA TADAWUL	10 690,09	2,99%	-3,29%	5,15%	-4,96%

US: Sectors	Level	5D	MTD	YTD	2022
COMMUNICATION SVCS	217,76	-6,17%	-1,82%	37,87%	-39,89%
CONSUMER DISCRETIONARY	1 207,03	-0,34%	-4,47%	20,92%	-37,03%
CONSUMER STAPLES	717,39	0,24%	-1,21%	-5,92%	-0,62%
ENERGY	652,01	-2,65%	-5,97%	-0,34%	65,43%
FINANCIALS	537,67	0,44%	-2,47%	-4,08%	-10,57%
HEALTH CARE	1 451,16	-2,40%	-3,21%	-7,17%	-1,95%
INDUSTRIALS	832,11	-0,60%	-2,92%	1,45%	-5,51%
INFORMATION TECHNOLOGY	2 903,54	-1,05%	-0,02%	34,69%	-28,19%
MATERIALS	478,64	0,95%	-3,18%	-0,66%	-12,28%
REAL ESTATE	207,55	0,77%	-2,79%	-8,15%	-26,21%
UTILITIES	302,87	1,11%	1,29%	-13,31%	1,56%

EUROPE: Sectors	Level	5D	MTD	YTD	2022
BASIC MATERIALS	2 716,69	3,27%	-2,47%	-4,13%	-2,41%
CONSUMER GOODS	3 881,69	-0,44%	-1,92%	-3,90%	-7,73%
CONSUMER SERVICES	1 356,82	-1,49%	-3,89%	8,96%	-15,22%
FINANCIALS	809,03	-0,02%	-4,07%	12,35%	-1,93%
HEALTH CARE	3 344,70	-2,55%	-5,23%	3,41%	-3,72%
INDUSTRIALS	3 056,80	0,24%	-5,87%	5,60%	-18,88%
OIL & GAS	1 536,99	-1,60%	-0,71%	9,49%	30,59%
TECHNOLOGY	1 447,19	0,42%	-0,54%	14,04%	-25,49%
TELECOMS	500,67	1,37%	-2,72%	3,00%	-13,24%
UTILITIES	1 869,57	1,52%	0,15%	3,87%	-6,99%

Market overview as of 31st October 2023

Fixed Income	Level	5D	MTD	YTD	2022
Pan-Euro 3-5 yrs IG	197,39	0,44%	0,60%	2,44%	-11,37%
Euro Aggregate	223,76	0,42%	0,40%	0,99%	-17,18%
Pan-Euro HY Hedged Eur	395,26	0,41%	-0,26%	6,10%	-10,72%
Global Inflation hedged EUR	223,55	0,03%	-0,82%	-4,10%	-18,94%
US Corp High Yield	2 264,90	0,13%	-1,16%	4,63%	-11,19%
EM USD Aggregate TR	1 260,87	-0,02%	-1,48%	-0,58%	-15,26%
EM Aggregate TR Local Ccy	135,81	0,20%	-0,74%	-0,78%	-8,44%
EUR Banks CoCo Tier 1	131,47	0,34%	-0,17%	-3,96%	-12,63%
EU GOVT HEDGED EUR	198,46	0,41%	0,23%	-0,67%	-20,38%
Global Aggregate	2 554,99	-0,34%	-1,20%	-3,38%	-16,25%

Commodities	Level	5D	MTD	YTD	2022
GOLD	1 983,88	0,66%	7,32%	8,76%	-3,64%
COPPER	364,90	0,69%	-2,37%	-4,24%	26,84%
OIL WTI	81,02	-3,25%	-10,76%	0,95%	55,01%
OIL BRENT	87,41	-0,75%	-8,29%	1,75%	50,15%

Currencies	Rate	5D	MTD	YTD	2022
EURUSD	1,0575	-0,14%	0,02%	-1,21%	-6,93%
GBPUSD	1,2153	-0,06%	-0,38%	0,58%	-1,01%
USDJPY	151,6800	1,18%	1,55%	15,68%	11,46%
USDCHF	0,9104	1,93%	-0,54%	-1,53%	3,13%
AUDUSD	0,6337	-0,28%	-1,52%	-6,99%	-5,60%
EURCHF	0,9628	1,78%	-0,50%	-2,70%	-11,08%
USDCNY	7,2980	0,07%	0,25%	5,79%	5,28%
USDKRW	1 350,83	0,59%	9,00%	3,86%	4,22%
USDINR	83,2562	0,15%	0,26%	0,63%	9,13%
USDIDR	15 885,00	0,23%	2,75%	2,00%	7,42%
USDBRL	5,0378	0,90%	0,11%	-7,55%	7,26%
USDTRY	28,3021	0,70%	3,21%	51,27%	78,81%
BITCOIN	34 650,56	2,97%	28,80%	109,00%	-64,30%

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