SUNLINE
WEALTH MANAGEMENT

December 2023

The Fixed Income High Tide that lifted (almost) all Boats

- some better inflation figures on both sides of the Atlantic
- increasing signs of a soft landing and a rebalancing labor market in the US
- improving European economic figures
- dovish commentaries from central bankers, particularly from ECB council member Isabel Schnabel

These elements were enough to ignite a powerful fixed income rally. In the US, we must go all the way back to 1985 to find the US aggregate rising that much, led by longer maturities: prices of 30-year US Treasuries rose by 10%. It was also the largest easing of financial conditions in any single month over at least the past four decades. Markets started to price deep rate cuts both in the Eurozone and the US: 150 basis points for 2024, starting in March of next year, for both. The reaction in equities was even more spectacular, as the S&P rose by 9%, led by the usual 'Magnificent 7', (we actually think they are 11), the MSCI Eurozone rose by 8%, led by cyclicals and Gold briefly touched an all-time high at 2,135 USD an ounce.

The missing boats are to be found in China, were the CSI 300 lost 2%, as doubts persist about the health of its economic engine, and its ability to reanimate the struggling real estate sector.

They can be found in energy markets, too, where the WTI lost over 6%: fears re expected future demand, and the loss of credibility of the OPEC+ cartel and the efficacy of their production cuts being the main reasons.

The Global Economy

United States:

US economic figures in general have been weaker than expected and are consistent with a soft landing. At the same time, US inflation dropped to 3.1%. Our readers know our doubts about surveys, due to the collapse in participation in them. However, there has been some consistency across the board when it relates to the job market, indicating a normalization, for example:

- Job openings dropped to 8.7 million, or 1.39 jobs per unemployed worker down from 2 in June 2022 and 1.23 pre-pandemic.
- The US composite employment index, with a reading of 49.7 – down from 51.3 - might indicate job shedding.
- More concretely, investment banks have been shedding jobs recently, as they face lower M&A and IPO activity: they are the early indicators that a wave of job cuts could follow in the cyclical industrial index, as they typically lead the job-shedding cycle.

We are not going to talk again in depth about the fragility of the American 'lambda' consumer that started to heavily hit credit cards amidst record interest rates, before resorting, for the holiday shopping period, to 'buy now and pay later', which again is more debt, as confirmed by leaders of the sector, such as the company Affirm.

More importantly, the US Federal Reserve 'Beige Book'* confirmed the slowing of consumer spending that we highlighted post the sugar high in late summer, brought on by the concerts of Beyonce and Taylor Swift, and the 'Barbenheimer' phenomenon, (the two movies Barbie and Oppenheimer).

The statement read: 'consumers pulled back on discretionary spending, labor demand continues to ease, it noted reductions in headcount (firings). Only a few districts continue to describe the labor market as 'tight'.'

*Summary of Commentary on Current Economic Conditions by Federal Reserve District. Commonly known as the Beige Book, this report is published eight times per year. Each Federal Reserve Bank gathers anecdotal information on current economic conditions in its District through reports from Bank and Branch directors and interviews with key business contacts, economists, market experts, and other sources. The Beige Book summarizes this information by District and sector.

Indicators of current economic activity, such as the Atlanta Fed GDPnow or the New York Fed Nowcast GDP, indicate a level of GDP growth of between 1.2 and 2.3%, well below the last 5.2% annualized print shown in Q3 that surprised everyone.

As we pointed out in the past, real rates of over 2 percent are a gift to bond buyers, but just too restrictive as the economy slows down, for both consumers and businesses.

Sure enough, at the latest FOMC meeting in December, the US central bank substantially modified its 'dot plot', the projections of where committee board members see interest rates. Chairman Powell announced three 25-basis points rate cuts for 2024, from the current target range of 5.25% to 5.5%, and four for 2025. The market's answer to that announcement was to imply 1.5% rate cuts for 2024, starting in March, furthering the collapse in bond yields, and a continuation of the rally in risk assets. That would be equivalent to a rate of 3.75% by the end of the year.

The Fed's statement that "tighter financial and credit conditions for households and businesses are likely to weigh on economic activity, hiring, and inflation" also struck a chord with markets globally.

Since then, several FOMC members have been trying to explain the dovish shift, attempting to perhaps tone down market expectations, which have barely budged and continue to include a number of rate cuts double what the bank has just announced. The reason can be found in the history of the central bank itself: it is usually slow to react, on both the way up and on the way down, to rates and tends to exaggerate both ways after a 'pivot' in policy, as it realizes it needs to catch up and correct the situation. The last two opposite cycles, that started in 2019 and 2022, have not been different.

Europe:

In Europe early indicators of economic activity have been improving recently and exceeded expectations. Certain countries, such as Germany, have clearly been flirting with a recession. We delved into the two-speed European economy before. Certainly, business and consumer surveys continue to be gloomy, (surveys again), however investors and asset managers, while rating the current economic as bad, see a marked improvement down the road from the depth of the Summer, on lower rates, lower inflation and energy prices, and a potential awakening of the Chinese economy.

ECB's Lagarde steered clear of talking about potential rate cuts but said the next move will almost certainly be a reduction. Comments from ECB's Isabel Schnabel, a notorious hawk, who recently said, 'rate hike unlikely with inflation data', were enough to spark a fixed income rally on this side of the Atlantic.

At the same time, Eurozone inflation dropped to 2.4%. However, the basis effect for several countries - such as Italy, which reported dropping to 0.7%, and the Netherlands is huge - as a year ago those two countries were dealing with extremely elevated energy prices. Therefore, the likelihood that inflation in Europe ticks up again during the first quarter is high. We thus think that the European Central bank is likely to wait until April before cutting rates, as it will want to gather more evidence that the probable increase in inflation during the first months of the year is only due to temporary technical effects, and that the path to lower inflation will resume soon after. The market continues to imply a first rate cut in March, with a total of 1.5% before the end of the 2024, bringing the rate to 2.5%

Japan:

Japan abandoning its regime of negative rates and Yield Curve Control was subject of much speculation during the month of November. Volatility in the USDYEN currency pair increased substantially: USDYEN moved from above 151 to as low as 142, at the same time its equity market rally stalled. The Bank of Japan didn't change its policy at its last meeting, thus no pivot. In fact, Governor Ueda said that 'hard to show exit plans with certainty'. That sentence is likely to resume the previous trade: short YEN and long Japanese equities.

Financial Markets

The obvious driver of the rally in risk assets has been the US yield curve: the entire curve, starting from the 7-year maturity out to 30 years, has dropped by a massive 1% or more since the end of October. The move might have been exacerbated by a measure of US government bond liquidity, which is at the lowest since 2008, and lower than during the 'bond freeze' during the first few days of the Covid shutdown. The hedge fund community only very partially bought back their massive shorts and have put on a 'barbel' trade with massive new longs on SOFR futures, that bet directly on rate cuts.

It is well known that US money market funds hit a record 5.7 trillion in assets. That staggering amount hasn't been reduced during the recent bond rally. While during Summer it was a no brainer to park money in funds yielding 5%, a real alternative to bonds and equities, should our market expectations about the inflation outlook, and thus the rate cut scenario, play out, those assets are at great reinvestment risk and could help push the 10-year bond yield towards 3.25-3.5% from currently 3.9%.

Greece was recently upgraded to investment grade and Italy to stable. Markets were already expecting that, as Greek 2-year bonds trade below France and Spain and just 20 bps over Germany. Greece, as it still benefits from Brussels' cash infusions, is the only country in Europe that enjoys a primary surplus.

While the US market has been led by the 'Magnificent 11', the rally in Eurozone equities has continued to be more broad-based and led by cyclicals, industrials, financials, and technology.

Evidence is emerging that the equity rally in the US is currently also broadening out, which would support further upside even if one or more of the mega caps stalls. To this extent, while media focus has been on Nvidia's monster earnings and outlook, except for Tesla, all other members of the 'mega' club have seen very strong results and upgrades. There is a lot of talk as to whether those stocks are now too pricey: earnings on average for our 7 stocks are now expected to climb 40% in 2024. If that is confirmed, then an average price-earnings ratio of 35 for the group is fully justified. Elsewhere, we know that currently the market punishes any earnings or outlook misses, even if it is a member of the 'Magnificent 7', and price-action can be quite brutal.

Semiconductors: world leader of vacuum pumps used in semiconductor production, Swiss company VAT Group, just announced it was stopping part-time working at the company. The company mentions it sees a rebound in demand. Similar comments from the likes of Samsung, means that the semiconductor industry, particularly dram chips, whose pricing has been depressed all year on lower demand for PCs and other gadgets, is likely poised for a recovery in 2024.

An indication that the market's rally is broadening out is the fact that the Dow Jones index, along with the French CAC and German DAX just hit an all-time high. At the other end, as pointed above, and highlighting the notorious difficulties of the Chinese economy delving with its many issues, the domestic CSI 300 just hit its lowest level since early 2019.

As a side note, AI is now mentioned by almost every company whenever that is possible: it reminds us of the period when every company was compelled to attach a .com to its name.

As a second side note: stocks have definitely exited the pandemic era. Poster-child pandemic-age stock darling Zoom has just been kicked out of the prestigious Nasdaq 100 index.

Change in Strategy

As a reminder, in October we added to long-term US Treasuries, citing high real rates. A record 5.7 trillion USD is sitting in money markets and these funds might face reinvestment risk at lower rates should the Federal Reserve embark in cutting rates (as expected by US financial markets). Also, asset managers were generally short duration, and the leveraged community was massively short the entire curve. In fact, real rates are still too high. Even with the recent move they are still at 1.7%: too high in view of the increasingly high indebtedness of consumers and with corporates renouncing, or diminishing, their investments.

In early December, the Investment Committee decided to exit the Mega Trend thematic, represented by the New Horizon fund. The reasons are:

- Macroeconomic: inflation and GDP growth uncertainty has been weighing on sustainability capex, prolonging a path to profitability for most companies in the investment universe.

- Microeconomic: Increased offering of sustainable alternatives has led to a product commoditization, reducing the pricing power of many companies.

- Regulation & Politics: lower than expected international support to incentivize clean energy transition.

The Investment Committee has decided to keep the Asset Allocation to equities neutral, and thus to replace the Mega Trends Thematic.

It was decided to replace it with an allocation to the Nasdaq 100 Equal Weight, thus reducing the US underweight.

Within the US Exposure, the switch will:

- Increase exposure to US Large Caps, and
- Reduce the (slight) overweight to US Mid-Caps.

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, Overweight Nasdaq 100 equal weight, Neutral UK, Overweight Japan, Overweight Asia ex Japan.

Thematic Equities

European Family Holdings, Asian Technology, Health Improving Technologies and Services, European Champions.

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.

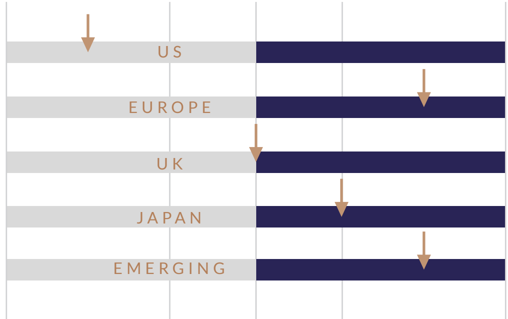
Currencies: Portfolios have a 5% USD exposure.

Commodities: Overweight

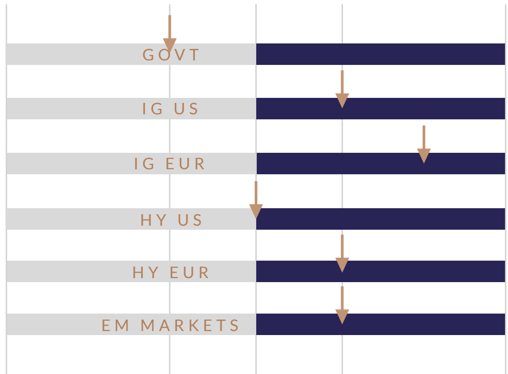
Long Gold.

Conviction thermometer

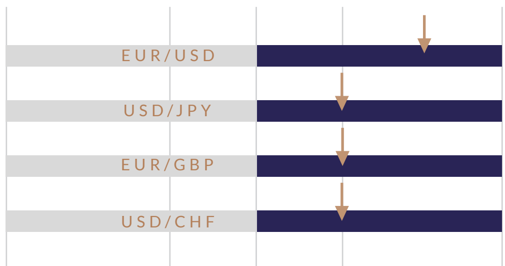
Equities



Bonds



Currencies



Commodities

Market overview as of 30th November 2023

Equities (local ccies)	Level	5D	MTD	YTD	2022
MSCI WORLD	3 023,63	0,54%	9,43%	18,58%	-17,71%
US S&P500	4 567,80	0,30%	9,13%	20,79%	-18,13%
NASDAQ 100	15 947,87	-0,30%	10,82%	46,96%	-32,38%
RUSSELL 2000	1 809,02	0,80%	9,03%	4,14%	-20,46%
EUROPE EURO STOXX 50	4 382,47	0,50%	8,08%	19,37%	-8,55%
GERMANY DAX	16 215,43	1,38%	9,49%	16,46%	-12,35%
FRANCE CAC40	7 310,77	0,48%	6,25%	16,25%	-6,71%
BELGIUM BEL20	3 529,02	-1,15%	5,38%	-1,55%	-11,47%
SWISS MARKET INDEX	10 854,32	0,02%	4,46%	4,33%	-14,29%
UK FTSE100	7 453,75	-0,38%	2,29%	3,68%	4,57%
JAPAN TOPIX	2 374,93	-0,13%	5,38%	28,55%	-2,48%
MSCI EMERGING	987,10	-0,08%	8,01%	6,01%	-19,80%
BRAZIL IBOVESPA	127 331	0,60%	12,54%	16,04%	4,69%
CHINA CSI 300	3 496,20	-1,83%	-2,11%	-7,51%	-19,83%
HS TECH	3 899,64	-5,23%	3,80%	-5,06%	-26,66%
INDIA SENSEX	66 988,44	1,47%	4,96%	11,58%	5,77%
KOREA KOSPI	2 535,29	0,81%	11,30%	14,17%	-23,21%
HONG KONG HANG SENG	17 042,88	-4,83%	-0,16%	-10,61%	-12,56%
AUSTRALIA ALL-SHARE	4 053,80	-0,51%	2,99%	3,05%	0,23%
SAUDI ARABIA TADAWUL	11 177,48	0,90%	4,86%	10,26%	-4,96%

US: Sectors	Level	5D	MTD	YTD	2022
COMMUNICATION SVCS	234,77	-2,90%	7,83%	48,66%	-39,89%
CONSUMER DISCRETIONARY	1 336,91	0,44%	10,91%	34,12%	-37,03%
CONSUMER STAPLES	744,26	0,74%	4,06%	-2,09%	-0,62%
ENERGY	641,28	-0,10%	-1,00%	-1,34%	65,43%
FINANCIALS	595,09	1,76%	10,92%	6,40%	-10,57%
HEALTH CARE	1 527,10	0,64%	5,41%	-2,15%	-1,95%
INDUSTRIALS	902,92	0,92%	8,82%	10,39%	-5,51%
INFORMATION TECHNOLOGY	3 273,08	-0,14%	12,87%	52,02%	-28,19%
MATERIALS	517,20	1,98%	8,36%	7,64%	-12,28%
REAL ESTATE	233,02	2,88%	12,46%	3,29%	-26,21%
UTILITIES	316,57	0,40%	5,17%	-8,83%	1,56%

EUROPE: Sectors	Level	5D	MTD	YTD	2022
BASIC MATERIALS	2 843,67	-0,23%	4,70%	0,38%	-2,41%
CONSUMER GOODS	3 922,40	0,14%	1,29%	-2,66%	-7,73%
CONSUMER SERVICES	1 450,20	-0,02%	6,90%	16,48%	-15,22%
FINANCIALS	865,75	1,21%	7,40%	20,67%	-1,93%
HEALTH CARE	3 417,65	-0,54%	2,23%	5,72%	-3,72%
INDUSTRIALS	3 423,34	1,82%	12,06%	18,34%	-18,88%
OIL & GAS	1 524,76	0,50%	-0,09%	9,39%	30,59%
TECHNOLOGY	1 654,07	0,90%	14,40%	30,47%	-25,49%
TELECOMS	528,74	1,24%	6,08%	9,27%	-13,24%
UTILITIES	2 007,11	2,32%	7,68%	11,85%	-6,99%

Market overview as of 30th November 2023

Fixed Income	Level	5D	MTD	YTD	2022
Pan-Euro 3-5 yrs IG	200,90	0,94%	1,77%	4,26%	-11,37%
Euro Aggregate	229,84	1,03%	2,72%	3,74%	-17,18%
Pan-Euro HY Hedged Eur	406,68	0,84%	2,89%	9,17%	-10,72%
Global Inflation hedged EUR	229,86	0,30%	2,82%	-1,39%	-18,94%
US Corp High Yield	2 264,90	0,97%	4,53%	9,37%	-11,19%
EM USD Aggregate TR	1 260,87	1,09%	5,30%	4,69%	-15,26%
EM Aggregate TR Local Ccy	142,33	0,39%	4,80%	3,99%	-8,44%
EUR Banks CoCo Tier 1	137,78	0,72%	4,80%	0,65%	-12,63%
EU GOVT HEDGED EUR	204,34	0,95%	2,96%	2,27%	-20,38%
Global Aggregate	2 554,99	0,93%	5,04%	1,50%	-16,25%

Commodities	Level	5D	MTD	YTD	2022
GOLD	2 036,41	2,22%	2,65%	11,64%	-3,64%
COPPER	382,90	N.A.	4,93%	0,49%	26,84%
OIL WTI	75,96	N.A.	-6,25%	-5,36%	55,01%
OIL BRENT	82,83	1,73%	-5,24%	-3,59%	50,15%

Currencies	Rate	5D	MTD	YTD	2022
EURUSD	1,0888	-0,16%	2,96%	1,71%	-6,93%
GBPUSD	1,2624	0,72%	3,88%	4,48%	-1,01%
USDJPY	148,2000	-0,91%	-2,29%	13,03%	11,46%
USDCHF	0,8752	-1,02%	-3,87%	-5,33%	3,13%
AUDUSD	0,6605	0,72%	4,23%	-3,05%	-5,60%
EURCHF	0,9529	-1,18%	-1,03%	-3,70%	-11,08%
USDCNY	7,2980	-0,18%	-0,25%	5,79%	5,28%
USDKRW	1 293,80	-0,57%	-4,21%	3,86%	4,22%
USDINR	83,3950	0,06%	0,17%	0,80%	9,15%
USDIDR	15 510,00	-0,29%	-2,36%	-0,37%	7,42%
USDBRL	4,9195	0,32%	-2,35%	-7,55%	7,26%
USDTRY	28,8660	0,14%	1,99%	54,28%	78,81%
BITCOIN	37 750,77	1,33%	8,95%	127,70%	-64,30%

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