SUNLINE

WEALTH MANAGEMENT

January 2024

2023, The Year That Never Was: A Recession And China's Economic Recovery

After a disastrous year for financial markets, and amidst a collapse in correlations for the classic balanced portfolio, most financial analysts and commentators started 2023 with two near certainties:

- A near certain recession, and
- a surge in Chinese economic activity after the abandonment of its Zero Covid Policy.

A year ago, in our 2023 outlook, we wrongly adhered to the positive view for China, while disagreeing with the recessionary view. We advocated for the return of the balanced portfolio, with a moderately positive view for financial markets. We believed that inflation had peaked already, and that it could surprise to the downside. We also mentioned that central banks were already much further along their tightening cycle. We also believed that earnings estimates in the US were likely to be revised downwards.

We thus began the year by being neutral the US Mega caps, underweight the US wider market, overweight the Eurozone. During the year we added to Japanese equities and credit risk. In Autumn we extended duration.

That view had been broadly correct until August, before a bond scare and the ensuing spectacular, and historic, rebound in November-December, which only has an equivalent going back to the early eighties. The rebound was caused by:

- A string of better news on the inflation front, on both sides of the Atlantic,
- evidence of a rebalancing of the US labor market, while employment is staying strong, and
- economic data pointing to a soft landing, where growth is neither too hot nor too weak.

Just perfect.

Financial markets moved quickly: they now imply close to 1.8% of rate cuts in the US in 2024, from a prediction of just 50 basis points back in mid-October.

The fixed income rebound essentially lifted all assets, delivering very strong results for all investment profiles.

In 2023, markets first worried about growth, but then quickly about sticky inflation: that would have meant rates higher-for-longer. That brought bank panic in Spring, followed by corporate credit concerns and commercial real estate risks coming to the fore. We then had two subsequent obsessions:

- AI, sparked by ChatGPT, that, for obvious reasons, lifted any stock linked to AI - such as Nvidia - and which greatly helped the S&P 500 achieve its 24% gain for the year.

- The obesity drug, led by Novo Nordisk and Ely Lily: Novo became Europe's biggest stock, while any pharmaceutical company that didn't have an obesity treatment, (at least in the pipeline) got punished, along with companies that do treat obesity linked diseases such as cardiovascular diseases. (which can also be found in one of our equity thematics, the Bionics, that suffered heavily as a result)

In 2023 we also had a decent dose of geopolitical events:

- The surging geopolitical divide on the war in Ukraine.

- The rising US-China tensions, with the US increasing the sanctions on Chinese companies.

- The Israel-Hamas war, which put the Middle East back into the spotlight. As a result, crude oil price volatility greatly increased - amidst OPEC+ production cuts, expected lower demand, and a potential widening of the conflict. Worries also exist about increased delivery costs, as currently the Red Sea has all but become forbidden waters for civilian navigation. A persistence of the situation could mean a resurgence of inflation, particularly in Europe.

- The US is hitting its debt ceiling again, setting off a political fight: that per se is nothing new. However, we are in an election year, and this year is very particular, what with infighting within the GOP, a weak Biden and, if nothing happens on the judiciary side, Trump likely being reelected. The withdrawal of US aid to Ukraine could have devastating effects for the country, and scare many European countries that have a border with it: this could force the deployment of large numbers of US troops to those countries to act as a deterrent. Financial markets are unlikely to like such an occurrence.

Financial Markets

For US equities 2023 was essentially a mirror image of 2022: in 2022, the mega caps were responsible for 2/3 of the S&P 500 18% fall, while in 2023 they were mostly responsible for its 26% rise. The now well-known 'Magnificent Seven', on an equal weight basis, rose over 100% for the year. The S&P 500 effectively now sits where it was two years ago.

In Europe, the avoidance of the energy crisis, coupled with strongly revised earnings, led to the outperformance of very cyclical companies, (that can be found in our European strategy, which surged over 27% in 2023). After technology, industrials led the charge, followed by financials and consumer services. In Europe the performance across the national indices varies, as their composition is very diverse: for example, French CAC heavyweights include luxury, energy, and pharma, while DAX heavyweights, (which in the meantime grew to include 40 companies), are engineering companies, technology and financials, (insurers and reinsurers). The UK and the Swiss market markedly underperformed: the UK is more dependent than others on China's economic evolution, while the Swiss market was notably very expensive on a comparative basis.

Japan's forgotten market was the outstanding story in 2023: on a EURO-hedged basis it rose close to 33%. A string of shareholder friendly decisions by the government and the Tokyo stock exchange, (with more to come in 2024), lead companies to be:

- More profitable,
- increase dividends,
- increase share buybacks, and
- to have financial ratios, such as price to book, closer to those of Western companies.

This, coupled with the end of the multidecade-long deflationary state of the Japanese economy, as well as the ability of the Bank of Japan to maintain its zero rates policy and a weak YEN, contributed to the rise. The fact that long-term investor Buffett started to invest, (and then increased), in several Japanese trading companies back in Spring, put additional spotlight on this market.

Within fixed income, credit, in particular high yield outperformed, and had equity-like returns of 12 to 13%, while government debt, despite the recovery at the end of the year, lagged, but still delivered positive returns.

In currencies, as we mentioned above, the YEN weakened - by about 8% against the US Dollar - but the star performer has been the Swiss Franc, which rose 9% against the US Dollar, being a victim of its own success:

- A country with limited deficits even after Covid
- some growth,
- no inflation, (at least according to the official measures),
- low unemployment, and, of course,
- political stability.

The Swiss National Bank also changed strategy to tackle imported inflation: it started purchasing its own currency, a radical change from its previous stance of trying to weaken it to preserve the country's competitiveness.

In commodities, Gold shone and accelerated towards the end of the year on the 'pivot' to lower rates by the ECB and the US Federal Reserve. It ended the year up 13%.

On its side, crude oil disappointed, closing over 10% lower, despite the various production cuts by OPEC+, as demand from the West is waning, and China fails to kickstart its economy.

Outlook

Central banks and the economy:

- We believe the US and Europe will avoid a recession and will be experiencing a soft economic landing.
- US inflation should continue to decelerate.
- European inflation, because of substantial base effects, will tend to increase in early 2024, and subsequently retrace back down towards the 2% target again. The continued closure of the Red Sea route poses a risk, as it could increase shipping costs significantly.
- The US Federal Reserve is thus expected to cut rates starting in March: the market has now exceeded our view, seeing the central bank cutting rates by over 1.75% in 2024. This would imply a target rate of 3.75% by year end. We think 5 or 6 cuts of 25 basis points is more likely.
- In Europe, because of more resilient inflation, we believe the market is too optimistic that the ECB will cut in Spring. We rather believe it will start cutting rates in early Summer. We expect the ECB to cut rates by 1% in 2024, bringing them down to 3%, (the deposit facility).
- China's policy of addressing its multiple problems via a multitude of initiatives, both fiscal and monetary, is finally getting some traction. It is, however, unlikely to see its economy fully compensate for the drag from its real estate sector. GDP is still expected to grow close to 5%, decent, but far away from the double-digit growth experienced a few years ago.
- Japan, for the first time in decades, is facing a goldilocks economy. Japan is unlikely to change its Yield Curve Control and zero-rate policies before April-May, when it will have more data on wage-inflation and the national inflation figures, rather than just the Tokyo data.

Equities

For the moment, we continue to prefer Eurozone equities over the US, while having a neutral allocation to large US technology stocks. Contrary to 2023, though, we should start to see some dispersion in the performance of the US mega caps: there is some evidence that the financial performance of some companies might diverge negatively for the group, for example Apple and Tesla, which have seen multiple quarters of lower revenues. Our exposure to part of that group of companies might thus be reduced soon, in favor of the broader US market.

Another question regarding equities: is the potential of generative AI really that great? In a similar fashion to 2000, when companies were forced to add a '.com' to their name, even though they didn't have an internet strategy, we see them now talk about AI.

We are not AI specialists, but maybe it is already upon us, at least in certain sectors, looking at some micro news: for example, language-learning app Duolingo has been steadily firing contract writers and translators, replacing them with artificial intelligence, in one of the most high-profile instances yet of a company getting rid of human workers in favor of AI. In several waves of layoffs last year, including during the summer and in December, Duolingo cut contractors who had been writing lessons and coming up with potential ways to translate phrases from one language to another,

We also have an overweight in Japanese shares. On top of its economy, for the first time in history, the government and the stock exchange are taking initiatives that are extremely shareholder friendly.

Internationally, China is again facing questions about whether it is investable. We continue to wait before increasing our China allocation.

Fixed income

We recently extended duration and quality in our portfolios.

We continue to have exposure to investment grade credit, European high yield, hybrids, financials' subordinated debt, US municipal infrastructure and Asian hard currency debt.

Implications for portfolios

With declining inflation, increasing real wages, strong employment and central banks cutting rates, growth could surprise on the upside. This would result in a benign environment for risk assets. Fixed income and equities should outperform cash.

With investment grade yields in intermediate bonds, (4.7 years average maturity), in USD, of 5.05%, versus 2.4% 10 years ago, and an average rating of A- - BBB+, this sits versus a Federal Reserve rate of 5.25%. EURO equivalents. (3.9 years average maturity), are at 3.8%, versus 1.85% 10 years ago, and just 1.15% 5 years ago, (and 0.4% pre-pandemic), versus the ECB rate at 4%. A balanced portfolio has not been this symmetric and attractive since 2011 for EURO and 2009 in USD.

We thus think that 2024 should again be a positive year for a diversified balanced portfolio, although it is unlikely that it will match 2023, as probably some performance of 2024 has been front-loaded or steeled last year already. Gold should continue to play its role as a diversifier.

Threats

Amongst the usual threats we can think of, more unstable world geopolitics, and the unexpected 'black swan event', one thing is certain, 2024 will be the year of elections, which could determine policies for the next several years. More than 40% of the world's population, representing close to 50% of the world's GDP, will hold elections this year. While most of the world is already fixated with the US elections in November, India will go to the polls in April, the European Union and Mexico in June, the UK sometime in October/November and Egypt in December.

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.

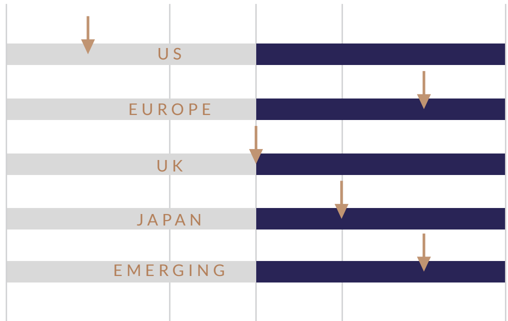
Currencies: Portfolios have a 5% USD exposure.

Commodities: Overweight

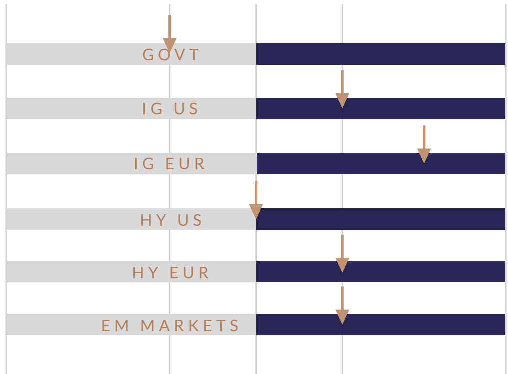
Long Gold.

Conviction thermometer

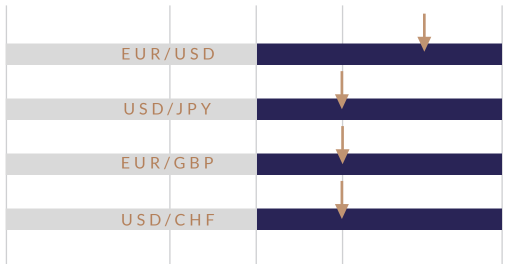
Equities



Bonds



Currencies



Commodities

Negative view Positive view

Market overview as of 31st December 2024

Equities (local ccies)	Level	5D	MTD	YTD	2022
MSCI WORLD	3 169,18	0,58%	4,94%	24,44%	-17,71%
US S&P500	4 769,83	0,34%	4,53%	26,26%	-18,13%
NASDAQ 100	16 825,93	0,30%	5,56%	55,13%	-32,38%
RUSSELL 2000	2 027,07	-0,26%	12,23%	16,88%	-20,46%
EUROPE EURO STOXX 50	4 521,44	0,00%	3,22%	23,21%	-8,55%
GERMANY DAX	16 751,64	0,27%	3,31%	20,31%	-12,35%
FRANCE CAC40	7 543,18	-0,34%	3,31%	20,10%	-6,71%
BELGIUM BEL20	3 707,77	0,76%	5,14%	3,51%	-11,47%
SWISS MARKET INDEX	11 137,79	-0,14%	2,61%	7,06%	7,06%
UK FTSE100	7 733,24	0,47%	3,85%	7,68%	4,57%
JAPAN TOPIX	2 366,39	1,41%	-0,23%	28,25%	-2,48%
MSCI EMERGING	1 023,74	3,18%	3,87%	10,12%	-19,80%
BRAZIL IBOVESPA	134 185	1,08%	5,38%	22,28%	4,69%
CHINA CSI 300	3 431,11	2,82%	-1,76%	-9,14%	-19,83%
HS TECH	3 764,29	6,09%	-3,36%	-8,25%	-26,66%
INDIA SENSEX	72 240,26	1,59%	7,84%	20,33%	5,77%
KOREA KOSPI	2 655,28	2,17%	4,76%	19,61%	-23,21%
HONG KONG HANG SENG	17 047,39	4,33%	0,16%	-10,46%	-12,56%
AUSTRALIA ALL-SHARE	4 232,01	0,46%	4,52%	7,70%	0,23%
SAUDI ARABIA TADAWUL	11931.92	2,67%	6,79%	17,75%	-4,96%

US: Sectors	Level	5D	MTD	YTD	2022
COMMUNICATION SVCS	246,00	-0,40%	4,81%	55,80%	-39,89%
CONSUMER DISCRETIONARY	1 418,09	-0,43%	6,10%	42,30%	-37,03%
CONSUMER STAPLES	762,32	1,11%	2,67%	0,52%	-0,62%
ENERGY	640,05	-1,37%	-0,08%	-1,42%	65,43%
FINANCIALS	626,35	0,74%	5,36%	12,10%	-10,57%
HEALTH CARE	1 590,36	0,97%	4,30%	2,06%	-1,95%
INDUSTRIALS	964,73	0,74%	6,96%	18,08%	-5,51%
INFORMATION TECHNOLOGY	3 397,16	0,27%	3,83%	57,84%	-28,19%
MATERIALS	539,62	-0,07%	4,56%	12,55%	-12,28%
REAL ESTATE	251,58	0,84%	8,70%	12,27%	-26,21%
UTILITIES	321,92	1,21%	1,91%	-7,08%	1,56%

EUROPE: Sectors	Level	5D	MTD	YTD	2022
BASIC MATERIALS	3 001,36	0,22%	5,55%	5,95%	-2,41%
CONSUMER GOODS	3 924,75	0,66%	0,24%	-2,43%	-7,73%
CONSUMER SERVICES	1 510,65	0,09%	4,34%	21,53%	-15,22%
FINANCIALS	899,71	0,27%	3,93%	25,42%	-1,93%
HEALTH CARE	3 514,98	0,84%	2,87%	8,75%	-3,72%
INDUSTRIALS	3 683,96	0,38%	7,69%	27,43%	-18,88%
OIL & GAS	1 519,44	0,05%	-0,35%	9,01%	30,59%
TECHNOLOGY	1 707,93	0,36%	3,26%	34,72%	-25,49%
TELECOMS	523,33	-0,54%	-0,37%	8,86%	-13,24%
UTILITIES	2 058,25	-0,23%	2,59%	14,75%	-6,99%

Market overview as of 31st December 2024

Fixed Income	Level	5D	MTD	YTD	2022
Pan-Euro 3-5 yrs IG	205,57	-0,04%	2,33%	6,68%	-11,37%
Euro Aggregate	237,51	-0,36%	3,33%	7,19%	-17,18%
Pan-Euro HY Hedged Eur	418,42	0,17%	2,89%	12,32%	-10,72%
Global Inflation hedged EUR	237,81	-0,35%	3,46%	2,02%	-18,94%
US Corp High Yield	2 264,90	0,40%	3,73%	13,45%	-11,19%
EM USD Aggregate TR	1 260,87	0,36%	4,20%	9,09%	-15,26%
EM Aggregate TR Local Ccy	146,33	1,09%	2,81%	6,91%	-8,44%
EUR Banks CoCo Tier 1	143,79	0,25%	4,37%	5,04%	-12,63%
EU GOVT HEDGED EUR	212,42	-0,51%	3,96%	6,31%	-20,38%
Global Aggregate	2 554,99	0,48%	4,16%	5,72%	5,72%

Commodities	Level	5D	MTD	YTD	2022
GOLD	2 062,98	0,48%	1,30%	13,10%	-3,64%
COPPER	389,05	-0,13%	1,61%	2,10%	26,84%
OIL WTI	71,65	-2,60%	-5,67%	-10,73%	55,01%
OIL BRENT	77,04	-2,57%	-6,99%	-10,32%	50,15%

Currencies	Rate	5D	MTD	YTD	2022
EURUSD	1,1039	0,23%	1,39%	3,12%	-6,93%
GBPUSD	1,2731	0,24%	0,85%	5,36%	-1,01%
USDJPY	141,0400	-0,96%	-4,83%	7,57%	11,46%
USDCHF	0,8414	-1,66%	-3,86%	-8,99%	3,13%
AUDUSD	0,6812	0,19%	3,13%	-0,01%	-5,60%
EURCHF	0,9289	-1,43%	-2,52%	-6,13%	-11,08%
USDCNY	7,2980	-0,50%	2,28%	5,79%	5,28%
USDKRW	1 294,20	-1.14%	0,32%	3,86%	4,22%
USDINR	83,2100	0,07%	-0,22%	0,57%	9,15%
USDIDR	15 397,00	-0,56%	-0,73%	-1,10%	7,42%
USDBRL	4,8572	-0.08%	-1,27%	-7,55%	7,26%
USDTRY	29,5280	0,98%	2,29%	57,82%	78,81%
BITCOIN	41 935,34	-4,14%	11,08%	152,94%	-64,30%

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