SUNLINE

WEALTH MANAGEMENT

April 2024

From Soft Landing to No Landing in the US, amidst rising Geopolitical Risks

Financial Markets were emerging from the month of March with yet another strong performance for a classical balanced portfolio, with positive performance contributions from equities, fixed income, and gold, before being caught up in the repricing of rate cut expectations and increased geopolitical risk in the Middle East.

US economic data has continued to show strength. GDP growth has been strong, with the US Federal Reserve (Fed) revising its growth forecast for 2024 upwards from 1.4 % to 2.1 %. Inflation surprised on the upside for the third month in a row, with stickiness in housing and services' prices. The labor market, at the headline level, continued to show robustness.

The Fed has thus become uneasy about the future path of inflation, and accordingly markets have further repriced rate cut expectations: the first rate cut is now only expected in September, and that with just a 50 % probability.

10-year US Treasuries also repriced sharply higher, with yields now up close to 80 basis points year-to-date: at 4.7 % they are now back to levels last seen in November of last year.

While we understand that some observers are even questioning whether rate cuts are appropriate this year, given the macroeconomic backdrop, we believe troubles in the labor market may lie ahead, which will put back the issue on the table later this year, and thus we think it is likely that the Fed will cut rates later this year.

The US labor market continues to rebalance. Every leading indicator we follow is pointing to weakness later this year. Hiring plans from the NFIB survey has hastily dropped to 2016 levels, the quit rate is below pre-pandemic, and layoffs are constantly announced, even though in the tech sector the pace appears to have slowed. Obviously, more observations are needed, however the indicators are all pointing towards a clear slowing in payroll growth in the second quarter and eventually worse for the third quarter.

On the US consumer: spending growth appears still to be quite strong, despite the clear downward trend in auto sales, and sluggish growth in core retail sales; nominal core sales rose about 1.7 % annualized in Q1, half the Q4 observation. Spending on discretionary services, however, has supported growth in overall consumption. Real income growth has likely grown just over 1 %, much less than the over 4 % in 2023, as the government's benefit payments recede.

Wealthier people spend more than poorer ones, but their spending is also less elastic.

Europe: Green Shoots are emerging, even in Germany!

As highlighted in the past, Europe remains an economic patchwork: Spain was again likely the star performer in Q1, with GDP expected to have grown by 0.6 % quarter on quarter, Italy was probably close behind, faring better than France and Germany, as construction investment rose again.

While in our last edition we mentioned the increasing propensity for spending by European consumers, who have been reluctant, so far, to spend much of their pandemic extra-savings, we are seeing encouraging signs in manufacturing, a key economic sector, particularly for battered Germany.

Industrial production in Germany climbed by 2.1 % month-on-month in February, extending the rise from a revised 1.3 % increase in January, well above the consensus for a 0.6 % rise. The year-on-year rate edged higher to -4.8 %, after -5.1 % in January. On its side, the seasonally adjusted trade surplus fell to €21.4B in February, after €27.5B in January.

Core manufacturing, (ex construction and energy), rose by 1.9 %, while production in consumer goods rose by 1.9 %. The increase in capital goods was led by gains in the automotive industry, up 5.7 %, while chemical production increased 4.6 %. The increase means that industrial production likely increased by over 0.5 % in Q1. That would be consistent with some manufacturing indicators in other major economies, at odds with factory orders, (we will not comment on the quality of the PMI surveys in this issue), but also consistent with alternative leading indicators of economic activity, such as the daily truck toll index* which has been spiking higher since March of this year.

Remember: unlike with shipping, in trucking, you pay by the weight, so you wouldn't purposefully put half-empty trucks on the road. We acknowledge that some of the spike could be attributed to the bad shape of the railway cargo system in Germany, however not in a such sudden way.

*The truck toll mileage index provides approximate indications of the development of industrial production in Germany at an early stage. The index developed by the Federal Office for Goods Transport traces the development of the mileage of large trucks (with four or more axles) on German motorways. It is calculated from digital process data of the truck toll collection system. It is used and published by the Statistisches Bundesamt. (Source: German Statistisches Bundesamt)

As for the European Central Bank, we mentioned in our last edition that they were likely to go ahead with rate cuts. Contrary to the US, in Europe the disinflation process continues. Indeed, at its recent meeting, and later in recent public comments from ECB officials, it said that it was 'delighted with ongoing disinflation'. As a result, it is with near certainty that markets are pricing a rate cut in June, followed by two others before year-end. The two other major central banks that should follow suit, on the path opened by the Swiss National Bank, are the Bank of England and the Bank of Canada.

China

China's industrial profits finally started to rise again. Profits at China's industrial firms jumped 10.2 % in January-February y/y, after a 2.3 % decline for the whole of 2023, National Bureau of Statistics data showed. This came after several better-than-expected economic indicators for the first two months of the year, including fixed asset investment, industrial production, and trade data. However, property-related figures remain sluggish, with sales down 29.3 % y/y and investment down 9 % y/y in the two-month period.

The latest data added to China's uneven picture of recovery, with industrials faring generally better than the consumer spending and demand segments due to the improving tech upcycle and policy support of manufacturing and infrastructure. The country has, in fact, announced a better-than-expected Q1 GDP growth of 5.3 % YoY, up 1.6 % QoQ and revised higher the Q4 to 1.2 % from 1 %.

We still expect incremental policy support from the government this year, although we have abandoned the idea, that we had last year, of strong actions to repower the consumer / property owner. Instead, it looks like, as a short-term measure to invigorate the economy, that Beijing has chosen to support its manufacturing sector and its exports. This suspicion was echoed by US Treasury's Janet Yellen, who warned China that it was too big to export its woes away. The central bank also seems intent on weakening its currency this year to help with the recovery, hurting regional currencies along with it.

Financial Markets

As mentioned above, stock indices have been hitting new highs over the last couple of weeks, before correcting ahead, and in the aftermath, of Iran launching its unprecedented attack on Israel. We think it is useful to have a look at the pecking order of how stocks have fared regionally, particularly in view of our exposure, which you can find summarized below:

- Japan, hedged, continues to be the top performer. As of today, it is up over 15 %.
- The Eurozone is up 7.6 %.
- The US S&P 500 is up 6.5 %.
- TheTechnology heavy Nasdaq 100 is up 5.3 %.
- UK and Swiss stocks are lagging the rest of Europe - up around 3 %.
- The MSCI Emerging Market is down 1 % in dollar terms, pulled lower by Latin America, -8 %, and kept afloat by Asia, led by China and India - up around 2 %.
- With rising rates, US non-profitable technology (GS index), almost entirely erased its rally from the peak in rates at the end of October of last year, (it was lifted almost 50 % by year-end), and is now down 23 % year-to-date.

In fixed income, as highlighted above, rates surged, leading to a negative year-to-date performance of the Global Aggregate indices - 2.2 % for the hedged versions. Those are rather long in maturity, at over 8 years, and heavily skewed towards government. In general, credit is doing better than duration and, as a result, we have several of our fixed income exposures that are still positive year-to-date, such as hybrids and subordinated bank debt.

Gold

Gold has been surprisingly resilient to spiking dollar rates. Gold's relative stability in the aftermath of last week's stronger than expected US inflation figure print means it is not being driven by the usual macro suspects anymore i.e. real rates, the dollar and growth expectations.

We talked about China as being a primary investor, along with other emerging market central banks, and retail investors, including in the US, as announced, for example, by Costco, buying physical gold. As we pointed out in the past, there is evidence that international investors have been exiting the market since late 2020. Rather, with recent intraday moves, we think two additional investors have been joining the party: hedge funds, such as momentum driven or CTAs, and Chinese retail investors:

- With gold spiking above its all-time high and pushing higher and gaining momentum, inevitably it lit up on the radar of this type of funds, which invest in already established trends, amplifying them, (the reverse is also true when they exit, and the gold market is not as liquid as other major currency pairs)
- There is evidence that Chinese retail investors have been piling into domestic Gold ETFs, some of them have seen outstanding shares increasing by 50 to 60 % since early March this year.

We continue to view gold as diversifier in a multi-asset portfolio. This year's performance has been nothing short of stellar: up 16 % in dollars, 17 % in Euro and over 20 % in Swiss Francs. We thus decided to trim our exposure, more on that in our chapter on 'Strategy'.

Positioning

We continue to have a constructive view for the 'Balanced Portfolio' for the next 6 to 9 months. In terms of risk, we cannot predict geopolitics. However, any exogenous shock, that is something that is not linked to economic performance - be it a pandemic, or tragically a war - that could trigger an energy crisis, has historically been a good entry point to purchase financial assets.

We will therefore continue to focus on where the potential risks, that could lay ahead, to our positioning are, so that we can, at least in part, control them:

- Peak in companies' earnings due to margin compression.
- Lower capital expenditures in Artificial Intelligence, which has been a leading theme since last year, in many sectors outside of pure technology.
- A worsening of the global economic situation, with the biggest risk coming from China, (although the IMF just upgraded the world's GDP for 2024).
- A failure of the disinflationary trend to continue.

Strategy

We decided to exit the position in US small caps, and to cut the drift in our gold holdings:

US Small Caps

Whilst in October 2020 we added Small Cap exposure on attractive fundamentals and streamlined cost structures following the pandemic, we kept the exposure unchanged, as Small Caps typically outperform at the beginning of a cycle of rate cuts. However, the change in our central scenario leads us to close our exposure: with companies facing a refinancing wall over the next 12 to 18 months, higher-for-longer interest rates could thus be a strong headwind for Small Caps (with higher than expected refinancing costs).

Gold

Geopolitical events, coupled with central bank purchases - and raising demand by retail investors in EM countries - has pushed Gold towards new highs. Year to date, the precious metal is up ~15 % in USD terms and ~19 % in EUR.

We continue to believe Gold has a diversification role to play in a multi-asset portfolio, however, we are taking partial profits and are trimming back the current exposure to 5 % - our target weight.

Implications for Portfolios

I. Closing US Small Caps exposure in favor of Liquidities

- Reduce Equity drift, bringing the Equity exposure to Neutral.
- Increase the US Underweight, while reducing tracking error versus benchmark (US Small Caps account for only 3 % of the Total Market Cap)
- Reduce interest rate sensitivity of the equity allocation.
- Increase Liquidities

II. Reducing Gold in favor of Liquidities

- Profit taking on thematic (yes, as an out of benchmark asset, gold is a thematic)
- Increase Liquidities

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, Slight Underweight 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.

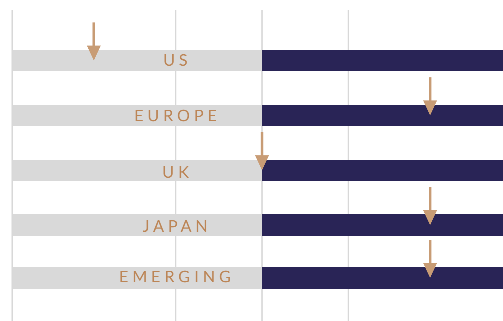
Currencies: Portfolios have a 5 % USD exposure.

Commodities: Overweight

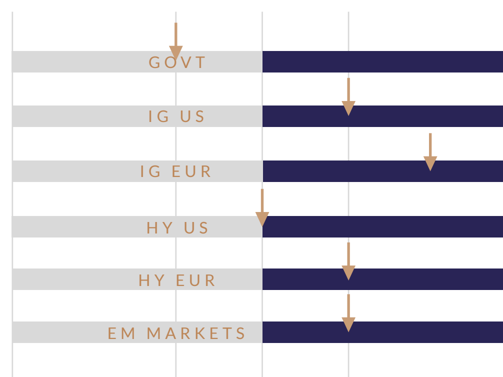
Long Gold.

Conviction thermometer

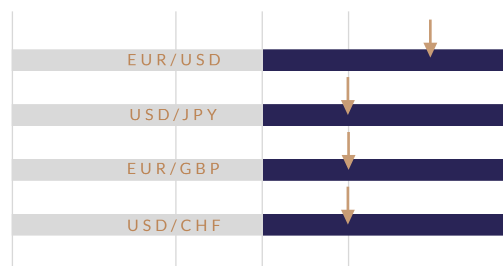
Equities



Bonds



Currencies



Commodities

Negative view   Positive view

Market overview as of 31st March 2024

Equities (local ccies)	Level	5D	MTD	YTD	2023
MSCI WORLD	3 436,78	0,16%	3,24%	8,98%	24,44%
US S&P500	5 254,35	0,26%	3,22%	10,55%	26,26%
NASDAQ 100	18 254,69	-0,35%	1,23%	8,72%	55,13%
RUSSELL 2000	2 124,55	1,30%	3,58%	5,17%	16,88%
EUROPE EURO STOXX 50	5 083,42	0,71%	4,38%	12,94%	23,21%
GERMANY DAX	18 492,49	1,72%	4,61%	10,39%	20,31%
FRANCE CAC40	8 205,81	0,32%	3,62%	9,04%	20,10%
BELGIUM BEL20	3 845,63	1,52%	5,03%	3,86%	3,51%
SWISS MARKET INDEX	11 730,43	0,43%	3,96%	6,77%	7,06%
UK FTSE100	7 952,62	0,94%	4,84%	3,98%	7,68%
JAPAN TOPIX	2 750,81	-0,78%	3,69%	17,28%	28,28%
MSCI EMERGING	1 040,39	-0,68%	2,22%	2,13%	10,20%
BRAZIL IBOVESPA	128 106	-0,04%	-0,71%	-4,53%	22,28%
CHINA CSI 300	3 520,97	-1,68%	0,14%	2,62%	-9,14%
HS TECH	3 477,55	-2,94%	1,41%	-7,56%	-8,25%
INDIA SENSEX	73 651,35	1,39%	1,59%	2,10%	20,33%
KOREA KOSPI	2 745,82	-0,12%	4,25%	3,96%	20,52%
HONG KONG HANG SENG	16 541,42	-1,90%	0,64%	-2,52%	-10,46%
AUSTRALIA ALL-SHARE	4 338,05	0,92%	4,75%	3,56%	7,70%
SAUDI ARABIA TADAWUL	12 565,89	-1,84%	0,00%	5,76%	18,10%

US: Sectors	Level	5D	MTD	YTD	2023
COMMUNICATION SVCS	284,29	0,09%	4,34%	15,82%	55,80%
CONSUMER DISCRETIONARY	1 485,49	0,07%	0,10%	4,98%	42,30%
CONSUMER STAPLES	814,23	0,46%	3,49%	7,52%	0,52%
ENERGY	721,24	2,00%	10,60%	13,69%	-1,42%
FINANCIALS	701,32	0,50%	4,77%	12,45%	12,10%
HEALTH CARE	1 723,97	1,47%	2,38%	8,85%	2,06%
INDUSTRIALS	1 066,71	0,29%	4,41%	10,97%	18,08%
INFORMATION TECHNOLOGY	3 821,05	-0,82%	1,97%	12,69%	57,84%
MATERIALS	585,16	1,09%	6,50%	8,95%	12,55%
REAL ESTATE	248,16	1,14%	1,77%	-0,55%	12,27%
UTILITIES	333,49	3,00%	6,62%	4,57%	-7,08%

EUROPE: Sectors	Level	5D	MTD	YTD	2023
BASIC MATERIALS	2 995,88	0,57%	7,39%	0,69%	5,95%
CONSUMER GOODS	3 874,95	1,96%	1,36%	-0,76%	-2,43%
CONSUMER SERVICES	1 687,63	0,08%	1,15%	11,83%	21,53%
FINANCIALS	996,32	1,30%	7,86%	11,85%	25,42%
HEALTH CARE	3 764,98	1,13%	4,08%	8,57%	8,75%
INDUSTRIALS	4 068,66	0,00%	3,55%	11,06%	27,43%
OIL & GAS	1 554,44	0,71%	6,93%	3,78%	9,01%
TECHNOLOGY	2 008,78	-1,57%	1,80%	17,83%	34,72%
TELECOMS	535,34	2,25%	2,54%	2,36%	8,86%
UTILITIES	1 945,37	2,23%	4,37%	-4,57%	14,75%

Market overview as of 31st March 2024

Fixed Income	Level	5D	MTD	YTD	2023
Pan-Euro 3-5 yrs IG	204,84	0,27%	0,72%	-0,36%	6,68%
Euro Aggregate	236,72	0,50%	1,09%	-0,33%	7,19%
Pan-Euro HY Hedged Eur	425,23	0,00%	0,40%	1,63%	12,32%
Global Inflation hedged EUR	235,79	0,63%	1,16%	-0,85%	2,02%
US Corp High Yield	2 264,90	0,15%	1,18%	1,47%	13,45%
EM USD Aggregate TR	1 260,87	0,47%	1,72%	1,53%	9,09%
EM Aggregate TR Local Ccy	144,72	-0,59%	-0,23%	-1,11%	6,91%
EUR Banks CoCo Tier 1	148,54	0,11%	2,35%	3,30%	5,04%
EU GOVT HEDGED EUR	210,48	0,47%	1,12%	-0,91%	6,31%
Global Aggregate	2 554,99	0,24%	0,56%	-2,07%	5,72%

Commodities	Level	5D	MTD	YTD	2023
GOLD	2 229,87	2,23%	8,09%	8,09%	13,10%
COPPER	400,70	0,98%	2,99%	2,99%	2,10%
OIL WTI	83,17	2,59%	16,08%	16,08%	-10,73%
OIL BRENT	87,48	1,98%	13,55%	13,55%	-10,32%

Currencies	Rate	5D	MTD	YTD	2023
EURUSD	1,0789	-0,65%	-2,26%	-2,26%	3,12%
GBPUSD	1,2624	-0,27%	-0,84%	-0,84%	5,36%
USDJPY	151,3800	-0,16%	7,33%	7,33%	7,57%
USDCHF	0,9017	0,47%	7,17%	7,17%	-8,99%
AUDUSD	0,6516	-0,82%	-4,35%	-4,35%	-0,01%
EURCHF	0,9727	-0,21%	4,72%	4,72%	-11,08%
USDCNY	7,2980	0,38%	2,79%	2,79%	5,28%
USDKRW	1 339,55	-1.14%	N.A.	3,86%	4,22%
USDINR	83,4037	0,30%	0,23%	0,23%	9,15%
USDIDR	15 855,00	1,25%	2,97%	2,97%	7,42%
USDBRL	4,8572	-0.08%	-1,27%	-7,55%	-8,01%
USDTRY	32,3443	0,96%	9,54%	9,54%	57,82%
BITCOIN	70 712,89	8,01%	68,62%	68,62%	152,94%

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