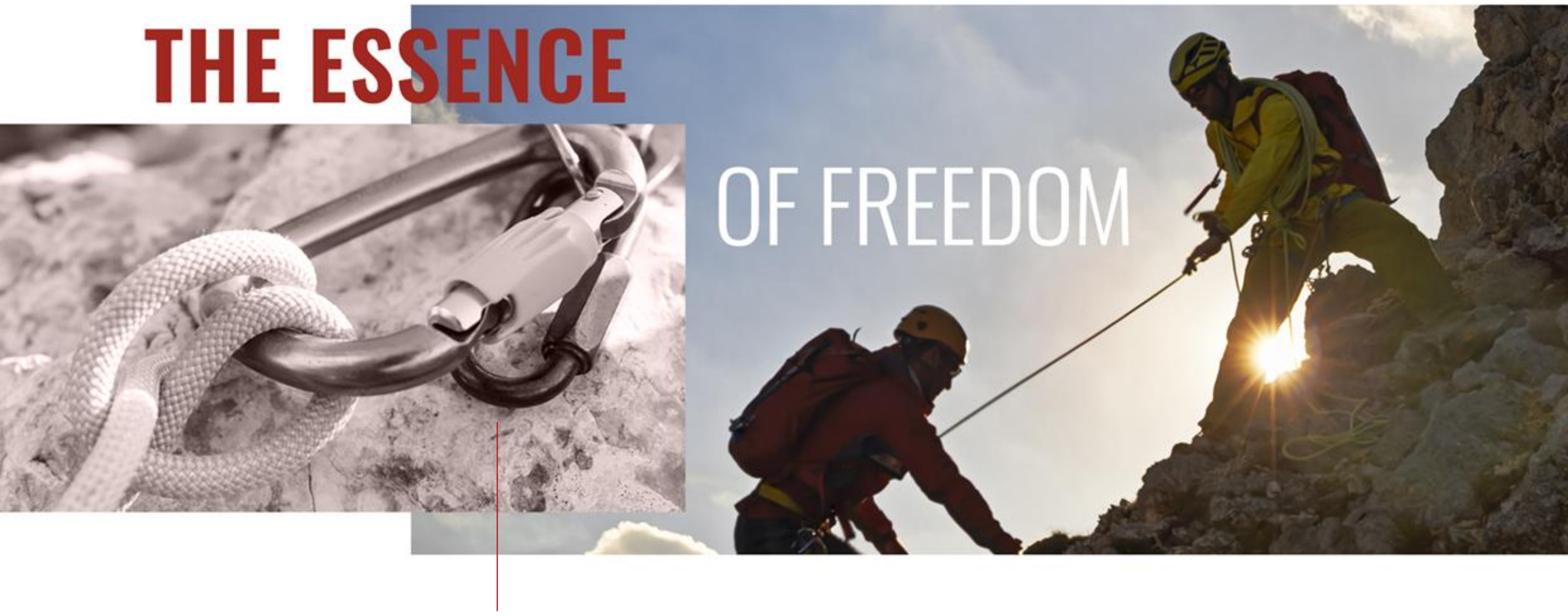
CITĒ GESTION
PRIVATE BANK

Newsletter: The Narrative “Higher For Longer” is Back / June 2024



Key Take-Aways

- Despite the high volatility in several economic indicators, we identify some trends: The US economy, while still robust is showing some signs of deceleration. Meanwhile the rest of the world is improving.

- Global inflation is not moving fast enough in the right direction, and this supports the narrative “higher for longer” among central bankers.

- Hopes for a quick return to the Fed’s 2% inflation target have been dashed. Fixed income investors are beginning to embrace a “higher for longer” scenario.

- May was volatile for fixed income with some data initially supporting bonds, but later a string of data pointing to a US labour market which is still in good shape. Longer yields have risen, and most bond indices posted negative returns.

- May saw a strong rally in the stock markets after the April correction, driven mainly by large-cap tech companies.

- Since the beginning of the year, we have seen a few biotech companies doubling their share price, which shows the renewed optimism in the sector.

- The US dollar is poised to maintain its strength due to higher interest rates and its safe haven appeal. The euro faces challenges from inflation and the ECB's dovish outlook.

- The British pound is well-positioned to gain from carry trade dynamics and a delayed BoE policy normalisation. The Swiss franc may continue to weaken unless significant shifts in ECB policy alter current market conditions.

Review
May Overview

In May, the markets as a whole performed well. As often, the Information Technology sector performed strongly, with the Nasdaq index posting a 6.98% gain. Notable performances also came from the SMI and the Russell 2000, which returned positive total return performances of 6.95% and 5.01% respectively. The only market (in the table) to finish with a negative performance was the CSI 300 China, which was down by 0.45% for the month.

The S&P 500 Total Return Index gained 4.96%, bringing year-to-date performance to 11.30%. Overall, the sectors performed well, with the exception of Energy and Consumer Discretionary, which returned -0.39% and 0.30% respectively. The three best performers were IT, Utilities and Communication Services. Notably, the strong performance in IT was driven by robust earnings reports. Additionally, the growing need for energy to support AI and data centres is expected to further boost the Utilities sector.

The table shows that the only bond asset class to have performed well since the start of the year is High Yield, with a YTD performance of 2.77% (BBG Global High Yield $). In contrast, the BBG Global Aggregate Treasuries Total Return Index is principally composed of sovereign issuers from North America, Europe, Asia-Pacific and Emerging Markets, excluding the US, and has suffered as rising market yields have corrected bond prices. Despite offering attractive yields, the index posted a negative total return of -4.72%.

The US dollar index eased last month, as evidenced by the EUR/USD rising by 1.71 basis points and the USD/CHF falling by 186 basis points. The Swiss franc slightly strengthened against the euro, with the EUR/CHF decreasing by 18 basis points. The GBP/USD pair increased by 200 basis points, while the USD/JPY slightly declined, ending at 157.31. It remains not far from its recent peak.

Bloomberg's commodity index rose by 1.30% last month, posting a year-to-date performance of 4.41%. In the commodities universe, WTI crude oil experienced a significant correction, dropping by 6.03%. Meanwhile, gold continued to perform well, achieving a monthly return of 1.80% and bringing its year-to-date performance to 12.81%.

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	5 278	0.81	4.23	4.96	0.67	11.30	19
Nasdaq	16 735	-0.01	6.61	6.98	2.30	11.83	24
Russell 2000	2 070	0.67	3.90	5.01	-2.38	2.68	19
Euro Stoxx 50	4 984	0.03	1.41	2.42	0.13	13.09	13
Stoxx 600 EUR	518	0.33	3.65	3.54	2.72	10.77	13
FTSE 100	8 275	0.54	3.41	2.03	4.81	8.98	11
SMI	12 001	1.10	6.10	6.95	4.04	11.08	17
NIKKEI 225	38 488	1.14	0.07	0.21	-4.66	15.89	20
CSI 300 China	3 580	-0.40	1.97	-0.45	1.55	4.70	11
MSCI EM Index	1 049	-0.84	1.73	0.59	1.02	3.50	11

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	5 278	0.81	4.23	4.96	0.67	11.30	19
UTILITIES	367	1.72	8.96	8.97	10.76	15.82	16
ENERGY	708	2.49	-3.06	-0.39	-1.15	12.38	12
TELECOM	296	0.57	3.33	6.58	4.36	20.88	17
CONS STAPLES	824	1.47	1.86	2.45	1.54	9.18	19
REAL ESTATE	238	1.88	3.81	5.08	-3.85	-4.37	17
CONS DISCRET	1 424	0.16	0.73	0.30	-4.04	0.73	22
MATERIALS	575	1.16	3.57	3.22	-1.51	7.30	19
HEALTH CARE	1 671	1.41	1.96	2.38	-2.82	5.78	17
INFO TECH	3 972	0.00	10.25	10.08	4.10	17.31	25
FINANCIALS	691	1.42	1.30	3.16	-1.16	11.15	15
INDUSTRIALS	1 043	1.19	1.14	1.65	-1.98	8.77	19

Fixed Income - % Change	Price	5 days	MTD	QTD	YTD
BBG Global Agg Treasuries TR Index UNH $	193	0.66	0.93	-1.89	-4.72
BBG Global Aggregate TR Index Value $	456	1.12	1.31	-1.25	-3.30
BBG Global Aggregate Corporate TR $	283	1.40	1.42	-0.49	-0.39
BBG Global High Yield $	1 564	1.57	1.49	0.63	2.77
BBG US Treasury TR Unhedged $	2 235	1.32	1.46	-0.90	-1.85
BBG US Corporate TR Unhedged $	3 185	1.86	1.87	-0.72	-1.12
BBG EuroAgg Government TR Index UNH €	234	0.11	-0.08	-1.47	-2.07
BBG EuroAgg Corporate TR Index UNH €	246	0.21	0.27	-0.58	-0.12

Currency % Change	Price	1 day	5 days	MTD	QTD	YTD
DXY	104.671	-0.04	-1.12	-1.46	0.18	3.29
EUR-USD	1.0848	0.15	1.39	1.71	0.54	-1.73
USD-JPY	157.31	0.31	1.26	-0.31	3.94	11.54
USD-CHF	0.9023	-0.11	-1.40	-1.86	0.10	7.24
EUR-CHF	0.9789	0.04	-0.02	-0.18	0.60	5.39
GBP-USD	1.2742	0.08	2.23	2.00	0.94	0.09
EUR-GBP	0.8515	0.08	-0.81	-0.27	-0.39	-1.78
JP EM FX Index	46.66	-0.10	0.97	1.09	0.31	-3.07

Commodity % Change	Price	1 day	5 days	MTD	QTD	YTD
BBG Commo Index	103.0	-1.02	0.30	1.30	3.52	4.41
Gold Spot $/OZ	2 327.3	-0.67	0.48	1.80	4.37	12.81
Crude Oil WTI	77.0	-1.18	-8.53	-6.03	-7.43	7.45

Volatility	Price	1 day	5 days	MTD	QTD	YTD
VIX	12.9	-1.55	-3.05	-2.73	-0.69	0.47

Source: Bloomberg 05/31/2024

Macro & Rates

Global Economic Landscape is Changing

Despite the high volatility in several economic indicators, we identify some trends: The US economy, while still robust, is showing some signs of deceleration. Meanwhile, the rest of the world led by Europe is improving. Nevertheless, global inflation is not moving fast enough in the right direction, and this supports the narrative "higher for longer" among central bankers.

Is it the end of the "US exceptionalism" observed in the first quarter? We do not think so. However, the recent set of data suggests that the US economy, while still robust, is decelerating.

The Manufacturing sector does not offer any rebound from low levels, and the Services sector is showing some weakness. Consumer confidence is slowing down, and the job market is less hot than expected with fewer job creations than anticipated. The only indicator that is not slowing fast enough is inflation. The Federal Reserve is aware of it. From the FOMC minutes to various speeches from officials, the Fed's "higher for longer" narrative has been cemented.

If the Fed does not have the degree of confidence to cut rates now, they have instead reduced significantly their Quantitative Tightening programme, reducing pressure on the long end of the curve. The market is now anticipating that the Fed will cut rates by 35bps in 2024, that is to say less than two cuts of 25bps, and much less than the seven cuts expected at the beginning of the year.

The good news is that the rest of the world is improving bringing new engine for global growth.

The first estimates of the May PMIs (so called "flash PMIs") were positive. At the broad composite level, which combines manufacturing and services, indicators improved in Japan (52.4), the Eurozone (52.3) and India (61.7).

In Europe, the improvement is coming with a tick-up in inflation. While the ECB has committed itself a few months ago to a 25bps cut at their June meeting, we can expect the tone will be much more balanced now and expect the ECB to adopt the narrative "higher for longer" soon after their meeting.

However, the UK and Japan are on the sidelines.

In Japan, the first quarter GDP contracted -2%, worse than expected, and authorities are facing a dilemma. Japan wanted inflation at any cost but has now tonnes of debt and therefore wants to keep interest low. The consequence is that thanks to the interest rate differential the yen is falling, and Japan is now forced to intervene. They once again spent several billions in FX intervention which has been inefficient to say the least. The goal here is just to slow the yen depreciation. But at the end of the day, this creates uncertainties and markets do not like that.

The UK is also facing challenges. The recent economic data suggests some weakness and an uptick in inflation. Meanwhile, the Bank of England has promised a rate cut soon. On top of that, the surprise announcement of general elections in July also complicates the task of the Bank of England.

The macro economic landscape is changing with economies, like US and Japan showing some signs of deceleration and others like Europe and China showing some signs of bottoming if not strengthening. Nevertheless, they are all sharing the same structural forces of inflation, which remains sticky everywhere. The narrative "higher for longer" will likely broaden for all central banks.

Fixed Income

A New Era of Higher Inflation?

As expected, the Fed did not cut interest rates on 1 May. Apart from that, however, May was somewhat of a roller-coaster for fixed income markets. At the beginning of the month, a much weaker change in payrolls (nonfarm: 175k vs. 240k; private: 167k vs. 193k) lifted bonds. The US unemployment rate also ticked up from 3.8% to 3.9%. Slightly worse than expected ISM and University of Michigan indices supported this short-lived "euphoria" up until mid-month. The US 10-year Treasury yield fell from 4.7% to as low as 4.3% on 16 May only to trade above 4.6% two weeks later.

Then came the April CPI figures which were basically in-line with expectations – which means that inflation continues to be stuck at a relatively elevated level of 3.4% YoY, well above the Fed's 2% target. The next three readings of jobless claims all came in the 215k to 222k range – which in turn points to no major weakness in the US job market.

On the back of this latest data, the market has once again re-priced the path of expected rate cuts by the Fed. Still, a maximum of two rate cuts is expected in 2024 but the first and maybe even only one is now expected to happen as late as September, and potentially a second one in November. As investors come to terms with a "higher for longer" inflation scenario, the US yield curve has steepened again with longer rates rising more than short ones over the last two weeks of the month.

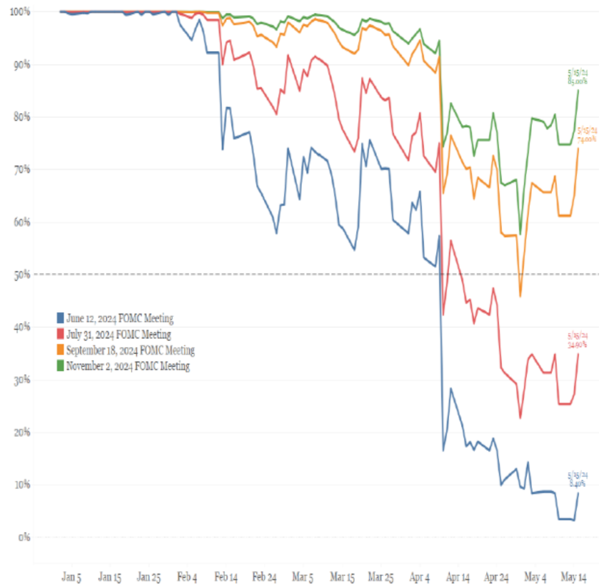
Is the Fed's 2% inflation target going to be replaced with a "2% floor"? In any case, long duration bonds increasingly look vulnerable again. If we enter into an era of permanently higher inflation of between 2% and 4% in the US, then the longer part of the US yield curve could well continue to rise.

Therefore, the short end of the curve, which offers still the highest yields, remains the most attractive: 3-month Treasury bills yield 5.36% while the 10-year Treasury pays only 4.5%. As long as there are no clear signs that the US economy enters recession or that inflation falls further, there is no point in taking too much duration risk right now.

Being long IG bonds, however, makes sense because from a valuation point of view, investors are better remunerated for the risks they take than by investing in equities. US and European equity earnings yields are close to their lowest in at least a decade vs. bond yields.

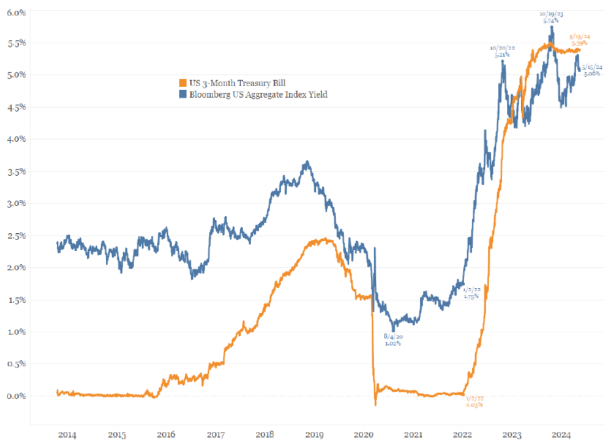
On 31.05.24, US Personal spending was lower, and PCE Deflators were in-line with expectations, and this gave some support to bonds. The beginning of June will provide more clarity on what to expect from the Fed: on 4 June, JOLTs job openings will be published followed by the ADP Employment the next day. On 6 and 7 June, the jobless claims and change in payrolls will shed more light on when to expect the first rate cut of the Fed. US CPI for May will be released on 12 June.

When will the Fed start hiking rates?



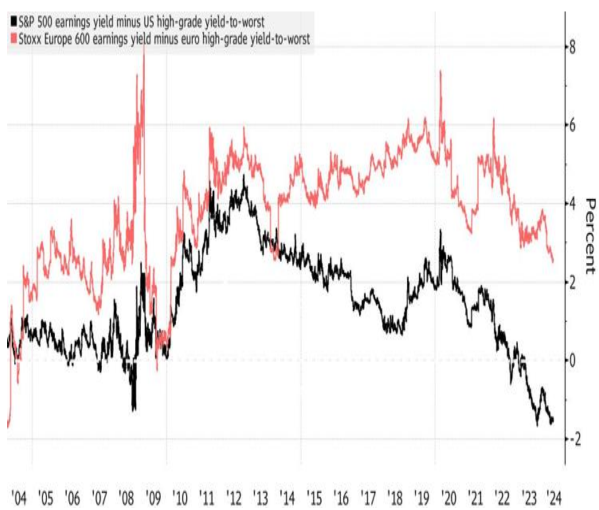
Source: Bianco Research LLC

Bloomberg US Aggregate vs. 3m T-bill yield



Source: Bianco Research LLC

Equity earnings yield minus high-grade YTW



Source: Bloomberg

Equity

Earnings Great Again

May saw a strong rally in the stock markets, after the April correction. Investors are still hoping for a central bank rate cut to benefit corporate concerns.

Gains amidst strong earnings

May was a month of consistent gains, although markets paused for a week, and saw Apple beat expectations, as well as the impressive earnings (again) from AI leader NVIDIA. The S&P 500 Index was up by 4.96% this month, while it is up by 11.30% YTD. A consolidation after the recent strong performance can be seen as a positive development.

Tech leads

Overall, large-cap technology continues to drive market momentum, but there has been some early signs of broadening across cyclical sectors and notably in international markets, which have recently started to catch up. Further broadening is expected as inflation potentially eases, earnings growth remains robust, and the benefits of AI spread across various sectors.

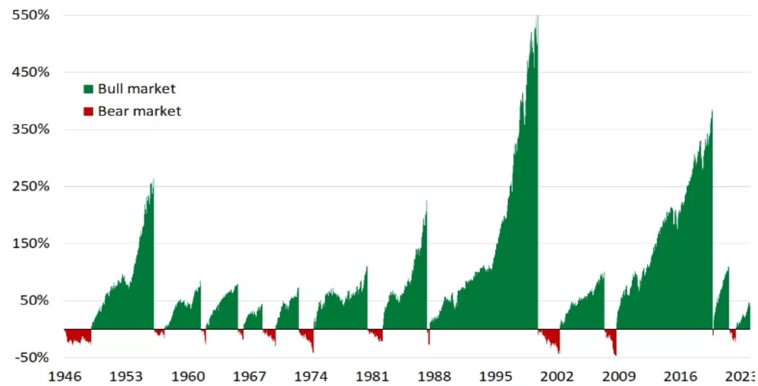
Broadening expected

Although markets experienced a major 5% correction in April, this probably won't be the year's last correction. For long-term investors, the critical question is whether these periods of volatility will lead to deeper or more extended bear markets. That is not the envisaged scenario at the moment, and three key factors must be continually monitored to assess the bull market's durability: the trajectory of the Fed and inflation, economic and earnings growth, and the sustainability of the technology sector's performance.

Biotechs strike again

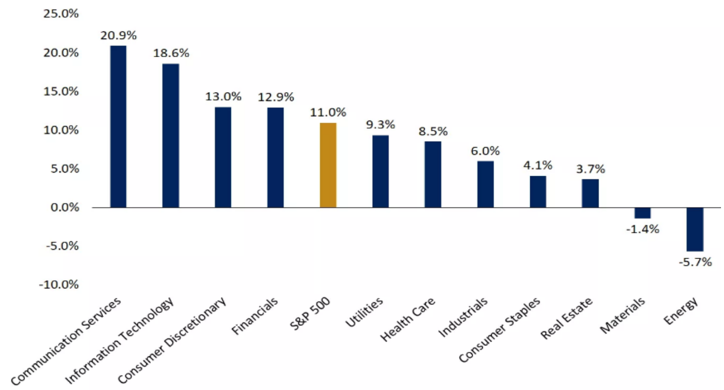
Only a handful of biotech companies have jumped more than 100% on clinical results this year. Interestingly, this kind of positive reaction did not occur over 2021-2023. Not that companies did not report positive results, but rather investors - in a rising interest rates environment - were not willing to give full credit to companies. Times are changing in 2024, with Fed rates now stable since July 2023, and markets wondering when officials will start cutting. In this context, some small mid cap biotech companies are now able to deliver strong returns, supporting our positive view on the segment. Amongst those 100%+ stocks was Viking Therapeutics, a company we like - up 120% in February the day it published strong Phase 1 subcutaneous data for VK2735, its obesity compound, showing better efficacy than Novo-Nordisk and Lilly's marketed GLP1s. In May, another company we like, Insmed, posted a 118% rise after posting positive Ph3 data for brensocatib, in bronchiectasis. This is a serious, chronic lung disease, affecting 450,000 people in the US, 400,000 in Europe and 150,000 in Japan. Brensocatib showed a 19-21% annualised pulmonary exacerbations reduction vs placebo, with side effects and tolerability in line with placebo. These results are transformative for patients as there is no treatment for this condition. Pending approval by health authorities, the drug should be launched in the US in mid-2025, followed by Europe and Japan in H1 2026. In addition, this positive data validates a new mechanism of action, DPP1 inhibition, that could apply to other neutrophil-driven inflammatory diseases – management is studying some in several Phase 2 trials, for which there is no available treatment. So, more to come.

Bull and bear markets: Since 1946, the average bull market has lasted about 5.6 years and has gained about 192%



Source: FactSet, S&P 500 Index and Edward Jones. May 1946 - May 2024.

Positive S&P 500 earnings growth is expected across multiple sectors this year
(2024 earnings growth forecast, YoY%)



Source: FactSet as of May 2024.

Forex And Commodities

USD in the Driving Seat, Spotlight on the Pound & EUR/CHF Back to Parity?

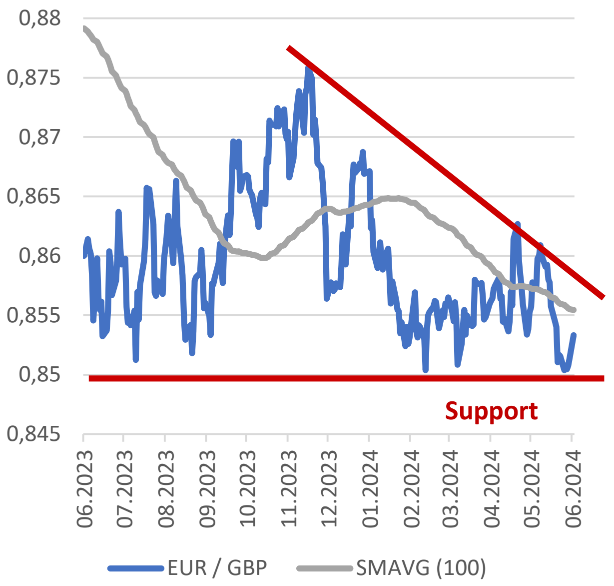
As we are approaching the second half of 2024, the short- to medium-term outlook for the US dollar remains favourable. The bullish sentiment is predominantly driven by the higher interest rates in the United States. The continued economic exceptionalism of the US and the dollar's status as a safe haven asset further solidify its position as the preeminent global currency.

Conversely, the euro exhibits signs of persistent weakness. Contributing factors include principally the European Central Bank (ECB) that has signalled a potential initiation of interest rate cuts in June. However, latest data from Germany showing inflation higher than expected at the end of May, is creating more uncertainty about future ECB's monetary policy actions. In the short term, this dovish stance is likely to exert downward pressure on the euro. Therefore, within the prevailing macroeconomic context, it is unlikely that the EUR/USD will surpass the key resistance level of 1.10 in June. Although there was a significant rebound at the end of May, pushing the rate above the 200-day simple moving average (SMA), technical resistance at May's peak of 1.0895 could cap further gains. Should this resistance remain intact, the negative momentum may resume, potentially driving the exchange rate towards 1.07.

As for the British pound, it stands to benefit considerably from the expected monetary easing by other central banks. Sterling has capitalised on favourable carry trade conditions and has emerged as one of the top-performing currencies within the G10 group this year, achieving its highest valuation against the euro in nearly two years. The carry trade dynamics should continue to create a positive environment for the GBP, with anticipations that the Bank of England (BoE) will be among the last of the central banks to initiate policy normalisation, with market expectations limited to a single quarter-point rate reduction by the BoE later this year, likely in November. Market analysts project that USD/GBP could reach 1.30 in the mid-term. Technical indicators support this outlook, with the pound having surpassed all major moving average resistances, providing a pathway towards the 2023 high of 1.314. For EUR/GBP, critical support at 0.85 remains under scrutiny. If this support level doesn't hold, the pound could continue its upward trajectory against the euro, reinforcing its robust performance among G10 currencies.

In contrast, the Swiss franc has experienced depreciation following the Swiss National Bank's proactive interest rate cut in March, positioning itself ahead of other major central banks. EUR/CHF is approaching parity, a key resistance level. Currently, the pair has failed to break above the parity threshold (0.993) and is retracing towards its nearest support at the 50-day SMA (0.98). The ECB's trajectory towards rate cuts is likely to mitigate further CHF depreciation. Consequently, EUR/CHF might stabilise within the 0.96-0.99 range, contingent on the ECB's policy stance and its impact on the euro. For USD/CHF, resistance might be encountered at 0.925, with a potential pullback to 0.90 presenting a buying opportunity.

More downward pressure for the EUR/GBP?



Source: Bloomberg

Could EUR/CHF break the parity?

Source: Bloomberg

By choosing Cité Gestion, you will benefit from our unique business model which sets us apart from most traditional wealth managers. Learn more on our website : www.cite-gestion.com

And follow us on LinkedIn to stay connected to all market news and perspectives.

Disclaimer and important information