

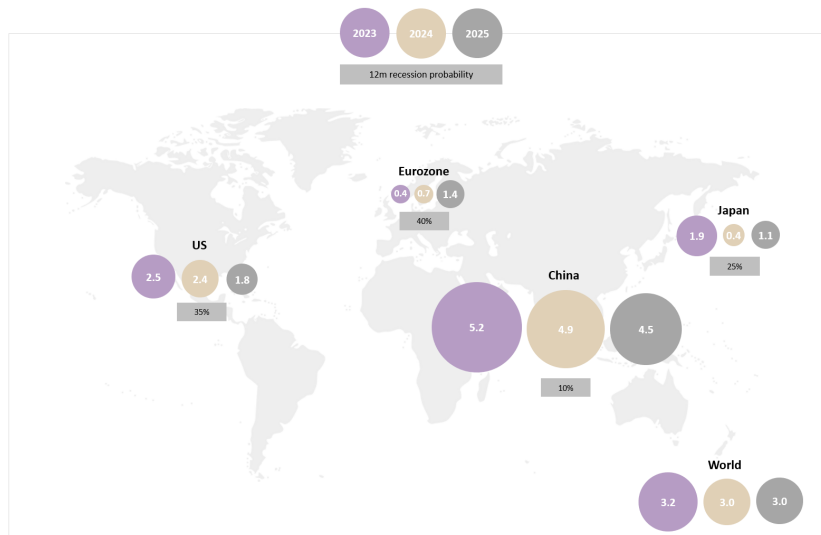
June 21, 2024

BILBoard – Summer 2024



Despite tight monetary conditions, the global economy held up remarkably well throughout the first half of 2024. From this point on, it appears to be regaining momentum and the onset of policy easing might provide an additional boost. Up to now, decent earnings growth and the AI theme have kept equities well-supported, though macro volatility and mercurial monetary policy expectations have at times hurt sentiment. As we enter the second half of the year, the disinflation, growth and policy trends should become clearer, making for a more amenable investment landscape...

Consensus Growth Expectations for Real GDP Growth (% YoY)



Source: Bloomberg, BH, 12/06/24

Macro Context

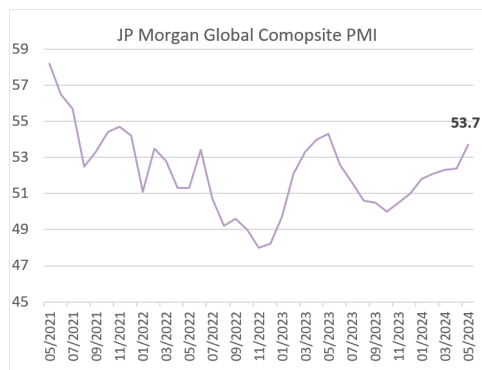
Zooming in on the **US**, Q1 growth undershot expectations, slowing from 3.4% to just 1.3% QoQ, versus 2.5% expected. We think that this soft reading, which was in a large part due to the volatile trade and inventory components, probably masks some underlying strength and that Q2 growth will come in stronger. While activity is still humming along nicely, particularly in services, there are some indications that US macro exceptionalism could fade in Q2 as the consumption engine slows. Excess savings have been spent, the labour market is weakening, and credit card delinquencies are rising, putting question marks over future spending.

In our 2024 Outlook, we surmised that the **Eurozone** might already be in recession. It avoided this by a hairline (0% growth QoQ in Q3 2023 and -0.1% growth in Q4), before staging a rebound in Q1 of this year (+0.3% QoQ). We still expect meagre growth throughout the course of 2024, but economic risks are now more tilted to the upside than the downside. This is due to successful short-term fixes to the energy situation and the fact that the manufacturing sector appears to be bottoming out. Rising real incomes and unspent pandemic savings pave the way for a gradual consumption rebound.

The stimulus package we, and many others, expected in **China** did not come to fruition. Domestic demand is weak, and the economy is flirting with deflation. A key pillar of support is the accelerating export sector – a pillar that looks quite shaky when considering new tariff announcements. Now, all eyes are on the July Politburo meeting which will provide more insight on policy intentions.

On balance, the global economic situation is brighter than many had expected at the beginning of the year. According to the worldwide composite PMI, the economic growth rate hit a 12-month high in May. The forward-looking new orders subindex is on an upward trajectory and,

encouragingly, new export orders have started to rise again, after being in a deep-freeze since February 2022. For the full year, the OECD expects global trade in goods and services to grow by 2.3% – more than double the 1% growth seen in 2023.



Source: Bloomberg, BIL as of 12/6/24

The services sector continues to serve as a pillar of strength, with business activity continuing to accelerate across the business, consumer, and financial services sectors. Prospects are also now brightening for manufacturing, which saw production growth hit a near two-and-a-half year high in May.

Overall, the PMI is consistent with global growth of 3.4% this year, with activity broadening out beyond services and across regions.

Monetary Policy

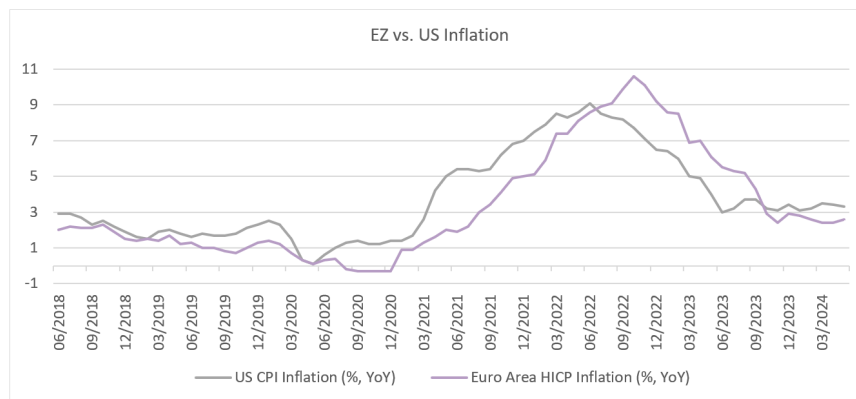
But good news on the economy has at times been bad news for markets in that it has meant higher rates for even longer. As we pointed out in our 2024 Outlook, markets were clearly too optimistic regarding the amount of rate cuts they expected this year – for example, futures markets were betting on 150bp worth of cuts in the US, double the amount signalled on the Fed's dot-plot at the time! Only now at midpoint of the year, are we starting to see G10 central banks slowly switch into easing mode.

Having made more convincing progress towards its inflation target, the ECB cut rates by 25bps in June, pre-empting the Fed. The fact that the ECB is easing into an improving situation means it is not in a hurry to continue lowering rates from here – roughly one 25bp cut per quarter is expected for this year.

US inflation has proven stickier than expected and leading indicators of both input and selling prices suggest the last mile to the 2% target won't be straightforward. The Fed's June dot-plot pencilled in only one rate cut this year, two less than in March. The good news is that market expectations are not out of sync with the dot-plot like they were at the beginning of the year.

While we do see inflation moderating as supply and demand factors fall into better alignment throughout the course of the year, central bank targets could remain elusive, especially in the

US. Indeed, the Fed thinks it will be 2026 before the 2% milestone is reached. That probably means higher policy rates and bond yields than we have experienced in recent history. The risk, however, is that if the Fed waits too long to start cutting, the more it puts the “no landing” scenario in jeopardy.



Source: Bloomberg, BIL

Global Risks

There are plenty of risks for investors to contend with from a global perspective.

Our expectation that 2024 would be characterized by heightened [geo]political uncertainty was accurate, with defence moving up political agendas in what is becoming an increasingly fragmented world.

2024 has also been volatile on the political front amid one of the busiest election calendars in decades. The European Parliamentary elections saw France's far-right *Rassemblement National* take victory, compelling President Macron to announce snap elections. This decision led to a sell-off in French equities (particularly banks) and bonds, while the euro lost ground against the dollar. Volatility and euro weakness is likely to persist until France's fate is known (voters will go to the polls on June 30, with a second round on July 7).

Looking to the US, the highly-polarised presidential election in November could have both economic and market implications, which no one can predict with certainty. From an investor's point of view, the most important policy floated thus far may be Trump's proposal to impose a tariff of up to 10% on all imported goods, especially given the potential impact on inflation at such a crucial moment for monetary policy.

Tariffs and trade frictions present another risk to our 2024 macro scenario. Potential retaliation from China in response to recent moves by the US and Europe could backfire on firms that sell their goods in China's vast market. More broadly, continued protectionism could curtail the upturn in global trade.

Investment Strategy

Equities

We enter the second half of 2024 broadly **neutral on equities**. As downside risks in Europe eased while prospects brightened, we have taken incremental steps throughout the course of the year to achieve a more **balanced allocation between US and European equities** (i.e. we sized opportunities to crystallise gains on our US overweight, while continuing to top up our underweight to Europe).

Equities: Regions

US firms have been delivering strong profit growth, with Q1 earnings growth coming in at more than double estimates (+7.7% YoY vs +3.8%). However, if you strip out the Magnificent Seven stocks, the picture is less impressive: -0.2%! The problem is that from here, the expectations hurdle is very high; analysts see 2024 US earnings going up by 10.5%. This could be challenging in a slowing macro environment, even if we consider an expected margin boost from layoffs and lower commodity prices. The AI revolution is still playing out, and momentum clearly continues to favour companies linked to the theme and large blue chips. For this reason, at our June allocation, we switched remaining exposure to US equally-weighted products into **market-cap weighted** equivalents.

Believing that euro volatility and weakness is likely to persist in the short-term, we also used this switch to remove currency hedging. This continues a move initiated in May, to **increase our dollar exposure** given the Fed's higher-for-longer stance and to hedge EU political risk.

Earnings expectations in Europe are more manageable at 4.3% for this year. A typical boost from interest rate cuts, a pick-up in domestic demand and an improving earnings outlook could support European stocks into the year-end. That said, Europe remains vulnerable to global trade momentum, and we should not be so complacent as to consider the energy crisis done and dusted. While the situation has ameliorated considerably (in large part thanks to warm weather and demand reduction at home and in China), Europe must now turn to volatile and competitive international markets to meet its energy needs.

We remain neutral on Japan and Emerging Markets ex-China, while being underweight China.

Equities: Sectors

NEGATIVE	NEUTRAL	POSITIVE
	EUR Communication Services	IT
	Financials	Utilities
	Healthcare	EUR Industrials
	Consumer Staples	Real Estate
	US Industrials	US Communication Services
	Energy	
	Materials	
	Consumer Discretionary	

Entering the second half, we have decided to downgrade **European Consumer Discretionary** to

neutral. The sector consists of several sub-segments, luxury, cars and consumer discretionary retail, and performance across them is heterogenous.

In **luxury**, demand is struggling to keep up with ever-higher prices. Since 2019, major luxury players have increased prices by 33%, on average. But as the cost of living has skyrocketed around the world, consumers have become more discerning, questioning these pricing strategies. We fear that price increases have excluded or alienated consumers and that brands have limited growth levers in the short term.

Carmakers warn of a challenging year on rising costs and muted EV demand, while the price war in China is getting tougher every day. European car producers are vulnerable to China's retaliation to new EV tariffs imposed by the European Commission.

Retail, on the other hand, is a bright spot. Current trading among high street names is better than expected and growth opportunities are still there. Given the diversity of the sector, we bring our opinion down to Neutral, opting to cherry-pick retail names while reducing exposure to the car sector and luxury companies.

We have also upgraded **European Industrials** to overweight. Portfolios have a defensive/bond proxy tilt thanks to our **Utilities** overweight, and we wanted to counterbalance this with Industrials, a sector that is more cyclical in nature. In terms of weightings in the index, Industrials is Europe's third most important sector, behind financials and health care. The sector has already had a good run this year, but we think there is more to come. Sales and growth are both a few percentage points higher than what we see for the rest of the market because industrial firms are benefiting from new, higher-growth trends: selling products to makers of EVs, clean energy projects, data centres and defence spending.

Fixed Income

Bond markets have had a difficult start to the year with only **credit** managing to post positive returns.

With rate-cut expectations priced increasingly further out, there has been upward pressure on rates. At our June allocation, in high-risk profiles we reduced European Government bond exposure in favour of increasing US and European equities. This meant we could continue building positions that are better aligned with the new strategic equity weights implemented in April.

"Higher for longer" makes us **cautious when it comes to further adding duration**. The ECB delivered what was considered a "hawkish cut" while increasing its growth and inflation forecasts for this year and signalling a gradual pace of easing. In the US, although we are still of the opinion that the cracks in the US job market could widen, leading to a more convincing reaction by central banks which should bring rates down eventually, we believe it is still

premature to make a call on duration. Accordingly, we maintain a neutral duration stance and continue to monitor how the curve evolves.

Credit markets are signalling that they can handle “higher for longer”, providing that rate hikes remain off the table. We consequently continue to **overweight investment grade (IG) credit** which still offers high yields relative to history. The current macro outlook implies that corporate profitability can hold up, while technicals remain very strong with heavy inflows into IG funds leading to very tight spreads. US spreads are at the tightest level this century, but European spreads still have room for further tightening, hence our preference for the latter region.

We also like **high-quality high yield**. Though spreads are historically tight on both sides of the Atlantic, the asset class remains supported by high yields and a Goldilocks macro situation in which data is supportive of corporate fundamentals without running so hot as to pose a risk to the disinflation process. Defaults in HY have remained remarkably low, despite the fact that firms in this segment are having to pay much higher coupons following one of the fastest rate-hiking campaigns in decades.

Higher US borrowing costs and a stronger dollar could produce a range of negative effects in emerging economies, dictating our underweight stance on Emerging Market Debt. With regard to the small exposure we do hold, we keep our preference for **EM sovereign bonds** which trade at a wide differential to corporates.

Commodities

We are constructive on **gold** over the longer term, but acknowledge that the “higher for longer” narrative might pose some hurdles for this non-yielding asset class in the short term. Just recently, a stronger than expected US jobs report (US nonfarm payrolls at +272,000 versus the forecast of +190,000) and an apparent pause in the PBoC’s bullion buying campaign for the first time in 18 months caused gold’s largest daily drop in three and a half years. Astute investors may wish to take advantage of such pullbacks to build long-term positions.

After an impressive Q1 performance (+16.1%) amid geopolitical tensions and reduced supply, **oil** registered losses in April (-1.50%) and May (-6%). In early June OPEC+ surprised markets, stating that it intended to gradually unwind voluntary cuts of 2.2 million bpd starting in October 2024. These cuts, however, will remain in place during the summer driving season when demand typically rises. Other supply reduction measures remain in place through 2025 and the alliance has reiterated its flexibility to react to market developments.

Cash

In the short term, cash remains an attractive solution for those unnerved by geopolitical noise (we are not). However, reinvestment risk is rising, as the ECB has already begun to lower rates. This makes cash-like solutions that offer visibility on the yield from a medium-to-long term

perspective increasingly more palatable.

Conclusion

While the European summer has been much greyer than anyone could have expected this year, the opposite is true for the global macro picture. Here things are brighter than most economists forecasted at the onset of the year. Growth has held up remarkably well, despite tight monetary policy and inflation in developed economies is now on a path to normalization. This is allowing G10 central banks to begin – or contemplate – rate cuts. This should take the shine off cash, give bonds a renewed role in portfolios and keep risk assets supported.

Asset Class	Bonds: 100%			Equities: 15% - 45%			Equities: 25% - 75%			Equities: 40% - 100%		
	Strategic Weight	Tactical Allocation		Strategic Weight	Tactical Allocation		Strategic Weight	Tactical Allocation		Strategic Weight	Tactical Allocation	
		Previous	New		Change	Previous		New	Change		Previous	New
Equities												
Fixed Income	100.0%	97.0%	97.0%	⇒ 0.0%	30.0%	30.0%	30.0%	⇒ 0.0%	50.0%	50.0%	50.0%	⇒ 0.0%
Cash & cash equivalents	0.0%	0.5%	0.5%	⇒ 0.0%	0.0%	1.5%	1.5%	⇒ 0.0%	0.0%	1.0%	1.0%	⇒ 0.0%
Other	0.0%	2.5%	2.5%	⇒ 0.0%	5.0%	5.0%	5.0%	⇒ 0.0%	8.0%	5.0%	5.0%	⇒ 0.0%
Equities												
USA					12.0%	12.0%	12.0%	⇒ 0.0%	20.0%	21.0%	21.0%	⇒ 0.0%
Europe					12.0%	12.0%	12.0%	⇒ 0.0%	20.0%	20.0%	20.0%	⇒ 0.0%
Japan					3.0%	3.0%	3.0%	⇒ 0.0%	5.0%	5.0%	5.0%	⇒ 0.0%
China					1.0%	0.5%	0.5%	⇒ 0.0%	2.0%	1.0%	1.0%	⇒ 0.0%
Emerging Markets Ex-China					2.0%	2.5%	2.5%	⇒ 0.0%	3.0%	3.0%	3.0%	⇒ 0.0%
Fixed Income												
Government Bonds - Developed	50.0%	39.0%	39.0%	⇒ 0.0%	30.0%	26.0%	26.0%	⇒ 0.0%	20.0%	19.5%	19.5%	⇒ 0.0%
Emerging Market Debt	7.0%	4.0%	4.0%	⇒ 0.0%	5.0%	3.0%	3.0%	⇒ 0.0%	3.0%	2.0%	2.0%	⇒ 0.0%
Corporate - Investment Grade	33.0%	41.0%	41.0%	⇒ 0.0%	23.0%	25.5%	25.5%	⇒ 0.0%	14.0%	16.5%	16.5%	⇒ 0.0%
Corporate - High Yield	10.0%	13.0%	13.0%	⇒ 0.0%	7.0%	9.0%	9.0%	⇒ 0.0%	5.0%	6.0%	6.0%	⇒ 0.0%
Other												
Gold					5.0%	2.5%	2.5%	⇒ 0.0%	8.0%	2.5%	2.5%	⇒ 0.0%
Total Return	0.0%	2.5%	2.5%	⇒ 0.0%	0.0%	2.5%	2.5%	⇒ 0.0%	0.0%	2.5%	2.5%	⇒ 0.0%
Currency Exposure												
EUR	100.0%	98.0%	98.0%	⇒ 0.0%	77.0%	79.5%	79.5%	⇒ 0.0%	62.0%	71.0%	70.0%	⇒ -1.0%
Other FX	0.0%	0.0%	0.0%	⇒ 0.0%	6.0%	4.5%	4.5%	⇒ 0.0%	10.0%	6.5%	6.5%	⇒ 0.0%
USD	0.0%	2.0%	2.0%	⇒ 0.0%	12.0%	13.5%	13.5%	⇒ 0.0%	20.0%	20.0%	21.0%	⇒ 1.0%
Gold (in USD)	0.0%	0.0%	0.0%	⇒ 0.0%	5.0%	2.5%	2.5%	⇒ 0.0%	8.0%	2.5%	2.5%	⇒ 0.0%

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