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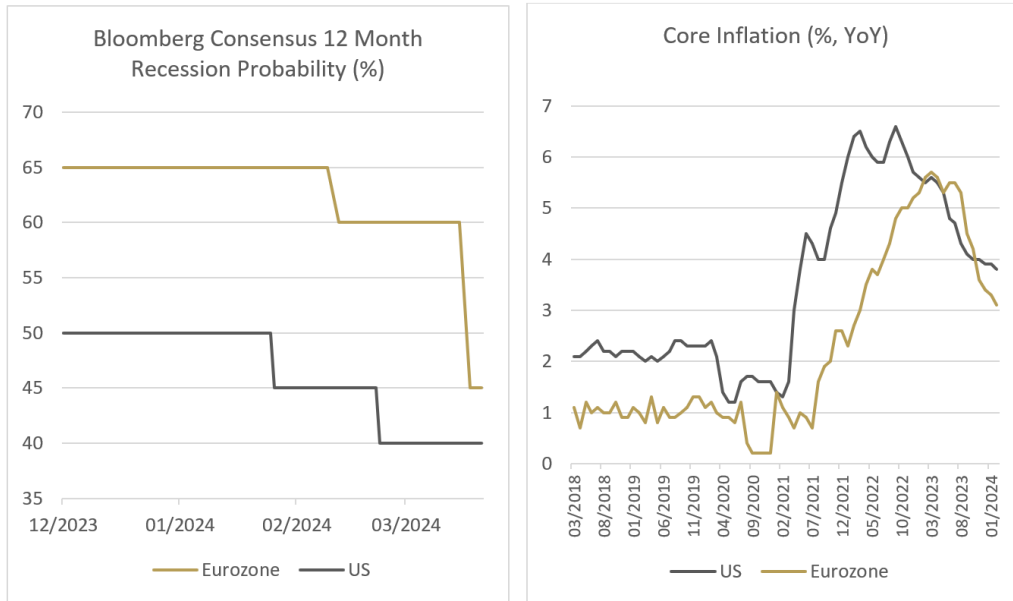
BILBoard April 2024 – Shifting sands in the investment landscape



The sands in the investment landscape have shifted in that it appears major central banks have tamed inflation without triggering a deep economic downturn. At the same time, market rate cut expectations have moderated, without disrupting markets. These developments, coupled with better-than-expected earnings results and AI enthusiasm, have pushed global equity indices to new all-time highs over the past month. The S&P 500, the Nasdaq, Japan's Nikkei 225, Germany's Dax and France's Cac 40, have all reached new peaks. While valuations are more expensive, momentum could continue in the near-term. In order to capture further potential upside, we increased our equity exposure mid-March. However, such a move requires a high risk tolerance and a willingness to accept volatility and as such, was only enacted in our high risk portfolios.

Macroeconomic Outlook

Incoming data points to a resilient macroeconomic backdrop and in turn, economists have watered down their recession expectations on both sides of the Atlantic.



Source: Bloomberg, BIL

In the **US**, growth is expected to slow from high levels this year (3.2% growth in Q4), with a **“no landing” scenario** becoming the reality. Core inflation continues its gradual downward trend and there are signs that the labour market is beginning to loosen up, making a June rate cut possible. While equities rallied late 2023 on the back of hopes that the Fed would cut interest rates as many as six times this year, the rally has continued even though investors have scaled back their expectations to only three or four cuts (the Fed's dot-plot suggests three). This rests on the fact that rate cuts are being priced out not because investors are overly worried about inflation, but because they are becoming more optimistic about the economy. Stronger-than-expected corporate earnings corroborate this idea, with S&P 500 companies beating estimates by 8% on aggregate.

In the **Eurozone**, not much is expected in the way of growth this year. However, it might be enough that a deeper recession has been avoided, with growth only very briefly dipping below zero in what might be considered a **soft landing**. The labour market is a key pillar of strength, with the unemployment rate falling to a new all-time low of 6.4%. Meanwhile, PMIs appear to be bottoming out, driven by services, and the European economic surprise index has turned positive for the first time since May. While Germany is still grappling with structural issues, some glints of improvement are appearing. For example, the IFO edged up in February as companies became less negative about future prospects, and German industrial production rose for the first time in nine months. In terms of monetary policy, the **ECB** has signalled that it could begin cutting rates in June. It is awaiting more data on wage settlements, as well as price re-setting by firms, which normally takes place at the beginning of the calendar year.

In **Japan**, the return of inflation and the subsequent exit from negative interest rate policy is a game changer. Macro data, which is weighed down by consumption, could start to brighten: in the annual spring wage negotiations (Shuntō), Japanese workers secured their biggest pay rise in three decades (an average of 4% after 3.6% last year).

The macroeconomic situation in **China** remains challenging. Investors had been hoping that the annual “two sessions” conference would deliver a concrete, big-ticket government stimulus package, but this didn't come to fruition.

Investment Strategy

Growing optimism about the world economy and decent earnings have helped drive equity markets higher. Market breadth is improving, and we believe momentum could continue in the near-term as investors look beyond just a handful of AI winners to consider opportunities in other sectors and regions outside of the US.

Given that rate cuts which are not quickly followed by a recession tend to push equity markets higher, it makes sense to start adding exposure to developed market equities, where risk appetite permits.

To this end, in **high risk profiles** we increased our overall equity overweight by:

- **Topping up exposure to the US** – the region offers unique exposure to structural themes such as AI and digitalisation, while earnings could continue to surprise positively in 2024 on economic resilience, falling rates and a softer USD.
- **Decreasing our underweight to European equities** – valuations are low and bright spots are emerging in certain sectors. For example, a handful of luxury companies are doing well despite weakness in China, and some companies have a near-monopoly along parts of the semiconductor supply chain. Note that we focus on core-Europe, avoiding the UK and Swiss stocks for the time being.
- **Bringing Japan from neutral to overweight** – while macro data is coming in better than feared, corporate governance reforms are promoting shareholder value and driving return on equity

To fund these purchases, we cut exposure to credit markets, thereby **increasing the overall duration of the high-risk portfolio**.

In low- and medium-risk portfolios, we believe we have adequate equity exposure with a neutral stance overall. Therein, lower equity weights are compensated with an **overweight stance on European investment grade corporate bonds** and on **US high-yield**.

Sector Preferences

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

We also used our March meeting to reshuffle our sector preferences to reflect ongoing developments.

Real estate was moved from neutral to positive, with lower rates set to offer the sector breathing room. Note that we avoid commercial real estate and focus on logistics and residential real estate.

European consumer discretionary was also upgraded from neutral to positive, with the sector benefitting from renewed confidence in luxury and autos. Moreover, lower inflation and unspent excess savings should help foster a recovery in European consumption throughout the latter half of 2024.

Simultaneously, the **consumer staples sector was downgraded to neutral**. In the US, a chasm between the prosperous economy and lower-income households is evident; companies that cater to the low-end consumer are feeling the pressure. There is also the risk that the market over-extrapolates the impact of weight-loss drugs on food and snack consumption. Even if the market shifts to a risk-off mood, we might not see this defensive sector strengthen as much as in the past, given the threat to earnings from the limited volume recovery and the perceived crimping of food and alcohol consumption.

The Materials sector was moved from negative to neutral. We particularly like the **building materials** sub-sector as producers are managing to raise prices, while their input costs fall: energy (electricity, natural gas and coal), steel and other costs are all down compared to 2023 levels. We might still see flat-ish volume trends in the coming months, but rate cuts should improve the level of building permits and housing starts, and hence help boost volumes. Note that the mining category remains under pressure due to the continued weakness of Chinese real estate. Iron ore is nearing a seven-month low, negatively impacting firms in the sub-sector.

Conclusion

Movie fans might have sensed that some inspiration for this month's BILBoard was drawn from the blockbuster, *Dune: Part Two*. As is the case on planet Arrakis with its shifting sands, there are still risks lurking under the surface, and like the toothed sandworms from the movie, you never know when they will rear their head. While the macro outlook is benign for now, we cannot rule out an unexpected shock as financial conditions tighten, with commercial real estate looking particularly vulnerable. At the same time, the geopolitical landscape is unstable. Perhaps the biggest risk, however, is that sentiment is fickle and can turn quite quickly.

For this reason, we only attempt to capture further upside in profiles with a high risk tolerance. We take comfort in the fact that the lion's share of our equity overweight is in the US, a region where we have purchased substantial downside protection via options which do not expire until after the June FOMC.

12/03/2024	DEFENSIVE			LOW			MEDIUM			HIGH					
	Bonds: 100%			Equities: 15% - 45% Bonds: 55% - 85%			Equities: 25% - 75% Bonds: 25% - 75%			Equities: 40% - 100% Bonds: 0% - 60%					
	Strategic Weight	Tactical Allocation		Strategic Weight	Tactical Allocation		Strategic Weight	Tactical Allocation		Strategic Weight	Tactical Allocation				
	Previous	New	Change		Previous	New	Change		Previous	New	Change				
Equities															
Fixed Income	100,0%	97,0%	97,0%	⇒	0,0%	30,0%	30,0%	⇒	0,0%	50,0%	50,0%	⇒	0,0%		
Cash & cash equivalents	0,0%	0,5%	0,5%	⇒	0,0%	0,0%	1,5%	⇒	0,0%	0,0%	0,0%	⇒	0,0%		
Other	0,0%	2,5%	2,5%	⇒	0,0%	5,0%	5,0%	⇒	0,0%	8,0%	5,0%	⇒	0,0%		
Equities															
USA					12,0%	14,5%	14,5%	⇒	0,0%	20,0%	25,5%	25,5%	⇒	0,0%	
Europe					12,0%	9,5%	9,5%	⇒	0,0%	20,0%	15,5%	15,5%	⇒	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%	71,0%	⇒	0,0%
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%	20,0%	⇒	0,0%
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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