APRICUS FINANCE

WEALTH MANAGEMENT

February 2024

A Chaotic Start To The Year, At Least In Bonds

After two very strong months, financial markets were shunted once again by an increase in bond yield volatility, as:

- The US economy has been running a bit hotter than expected.
- The implosion of the New York Community Bancorp (NYCB), which wrote off its exposure to Commercial Real Estate (CRE), for an amount ten times larger than expected. This led to the reemergence of worries about the health of US regional banks, where 30% of the loan portfolio is tied to CREs: the KBW index of regional banks lost 10% in one week.
- An impressive chorus of both Federal Reserve and ECB central bankers calling for caution on the timing and the size of rate cuts.
- January inflation in the US showed that it is moving downwards, but more slowly than anticipated.

As a result, US 10-year yields moved from around 3.9% at the beginning of the year, to 4.15%, on stronger US economic data, to 3.88% after the NYCB episode, to 4.3% after central bank comments and the slightly higher inflation number.

Equity markets ended the month on a divergent note: 'forgotten' Japan continues to power ahead, followed by Eurozone and US equities, while emerging market equities ended the month sharply lower, led by a slump in Chinese large technology stocks and Brazil.

Western equity markets have weathered the extreme bond volatility thanks to strong US earnings: of the 77% of S&P 500 companies that have reported, 78% are beating net income expectations, while 55% are beating revenue estimates. Companies are also becoming leaner and more cost conscious: after the hiring frenzy of 2021, particularly by technology companies, there isn't one day that passes without a large public company announcing significant layoffs.

The themes leading the US stock market higher haven't changed in 2024: it is still A.I. and obesity drugs, (GLP – 1). The only difference with 2023, as we expected in our last newsletter, is that the Magnificent 7 are now only 4, (since the beginning of the year we lost Tesla and Apple, while Alphabet is doing moderately well), and now are joined by Eli Lily and Broadcom.

In Europe, the big four, Novo Nordisk, ASML, LVMH and SAP also continued to lead stock markets higher.

Early February showed a continuation of this trend, and Japan keeps outperforming, Eventually the S&P 500, the French CAC and the German DAX reached all-time highs, while the Japanese market is nearing its all-time high too: having been set in December 1989.

Another pattern continues as well: independent of size or sector, companies are disproportionately rewarded or penalized when their guidance disappoints, or their earnings fall too far short of estimates.

Of note, the extremely high volatility of US small caps, (Russel 2000), which are traditionally very sensitive to the path of future rate cuts, which by mid-month had lost over 5.5%, recovered those losses, returning to positive territory - at +1% YTD – only to slump 4% in a single day when the slightly hotter inflation number came out.

In the fixed income space, credit outperformed government bonds, with European high yield, European hybrids, and Asian hard currency bonds all in positive territory.

In currencies, with the recalibration of future rate cuts in the US, (more below), the Dollar strengthened across the board.

Chinese Equities

The Chinese government, likely via the 'National Team', started supporting the stock market around mid-January: this is evident from the domestic flows towards local index ETFs, and via offshore accounts using the 'Northbound trading' (Shanghai-Shenzhen-Hong Kong) connect program. This temporarily halted the vertical slide Chinese equities were experiencing ahead of the Chinese Lunar New Year holiday. The rebound also came after a raft of policy support measures, from wider trading curbs, to the state buying major bank stocks, to a short selling ban. News that President Xi Jinping was about to be briefed by the regulator also fueled optimism.

We believe this is not enough. The government needs to find a way to instill confidence in the consumer. A starting point would be to deliver the apartments that many Chinese have already paid for, and still aren't built.

As an indicator of the consumer being more cost conscious, look no further than travelling patterns. The Chinese are travelling again in droves, but, on the whole, travel domestically: in 2023 the number of domestic flights recovered to pre-pandemic levels while the number of international flights was about 30-40% below 2019 levels. So far this year, adjusting for the Lunar New Year calendar, the bifurcation accelerated: domestic flights are up 15% from pre-pandemic, while international flights are down 32%. (all data from Goldman Sachs). We also know that people are spending less on holidays.

As pointed out in the past, it is too early for us to increase our exposure to that market. We simply had too many 'false starts' since January 2023. The government needs to take a different approach to help its ailing economy - which is slowly falling into deflation again - starting with the consumer.

Economy And Central Banks

Globally, the services sector is cooling while still staying strong, while the manufacturing sector is giving signs of life. Particularly in the US, the economy is likely to be running a bit too hot for the Federal Reserve's taste, even though there are some indications that the US consumer is starting to be more careful about spending:

- On the macro side, retail sales have recently disappointed.
- On the micro side companies such as PayPal or Affirm (the buy-now, pay-later company) are starting to see weaker spending patterns.

As a result, while all along we thought that expectations on the number of cuts by the US Federal Reserve were optimistic, we now think the central bank will conduct the first 25 bps cut in June, for a total of 4 in 2024, bringing the effective rate to 4.5%. The European Central Bank, on its side, is likely to start cutting in April, as the manufacturing sector is giving signs of life, but probably needs a little boost. The first main central bank to cut rates, in March, is likely to be the Swiss National Bank:

- The bank said in December that the policy of having a strong Swiss Franc to counter imported inflation was now deflationary.
- There is the suspicion that the central bank is selling its currency again.
- Core inflation has dropped to 1.2%, while headline inflation is at 1.3%, so well within the bank's target of 0 to 2%. Both are dropping fast.
- The SNB only meets quarterly, and so the next (post March) meeting at the end of June might be too late.

In Japan, it seems unlikely, after the weaker GDP and inflation data, that the Bank of Japan might alter its policy before June. They will also wait for the results and the effects of the wage negotiations in March, (called shunto in Japanese, or 'spring fight').

Politics: What If There Is A Trump 'Clean Sweep'?

The Biden team will head into the 2024 election touting success in bringing inflation under control and strong employment: all of this certainly is true for economists.

The trouble for the Democrats, is that voters may care more about the level change in prices since 2020, which tells a much less positive story.

One way to measure this is the simple 'misery index': unemployment plus inflation. Right now, the index is at 6.8%, and in the past 60 years the average ahead of elections when the incumbent won was 8.9%: all good then? (data: courtesy of S. Paul, Bloomberg).

Using the 4-year change in inflation, the index stands at a whopping 23%.

When inflation comes down it doesn't mean that prices go down, they simply increase less. Ahead of the Superbowl many interviewees, asked about what their plans were for game day, complained about beef prices and rightly so: data last week showed that the price of the top barbeque item, 'beef steak', increased almost 11% in a year. That is more than perceived inflation!

Coupled with the rise of delinquencies on credit cards and auto loans to levels last seen in 2009-2011, depending on which index you look at, compounds the issue: bottom line, low-income families are struggling. This may not affect the economy, as it is not that segment of the population that powers it, but it might explain how low Biden polls on the economy, even among many Democrats. Ultimately, sentiment could flip many battlegrounds, or swing states, to Republicans.

We do not want to speculate on the mental health of the candidates, or the outcome in tribunals, but we do have to think what the repercussions of a Trump's clean sweep would be, with Republicans taking the Presidency, the Senate, and the House.

It is likely that:

- Politically, the US commitment to NATO and particularly Ukraine might change: he actually, to the outrage of the Democrats, in part, already mentioned that.
- He mentioned 60% tariffs on imports from China: that would drive to zero the trade balance with China and likely increase inflation. We believe he might threaten Europe as well, however the threat might simply remain as no more than that.
- He is likely to cut taxes, particularly on corporates.
- He is likely to restrict even further his immigration policies, (which haven't been changed by Biden), leading to further labor shortages, and inverting the job market rebalancing process.

This is all potentially inflationary. This in turn could lead to a bear steepening of the curve, (when longer rates rise faster than short term rates). For corporates, and thus equities, higher labour costs might be partially or entirely compensated by lower taxes, depending on the sector: further restrictions on immigration are likely to bring labour-shortages and thus wage increases in low-income jobs.

Strategy

As mentioned in our latest newsletter, we expected to see some dispersion in performances within the US mega caps, and that we were likely to cut our exposure to the group, which we did later in January.

Equity

We keep an overweight in Eurozone equities versus the US broader market. Looking at the individual European stock market indices is not the correct way of looking at our overweight in the region, as all of them have their peculiarities in terms of sectors and weights. Perhaps a better way is to look at our basket of European Champions, a collection of about 25 names from the Eurozone, equal weighted, comprising of mostly cyclicals and industrials that are world leaders in their field: after a stellar performance of over 27% in 2023, the basket is already up over 6.5% in 2024.

We also keep an overweight in Japanese shares. Again, on top of its economy where policies are aimed at lifting the country from decades of deflation, for the first time in history, the government and the stock exchange are taking initiatives that are extremely shareholder friendly.

Fixed income

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

Gold

We continue to keep our allocation to Gold at 5%: while it doesn't provide any yield, it continues to be a good diversifier in a multi-asset portfolio.

Conclusion

The backdrop of higher economic growth revisions and continuing disinflationary trends is supportive for equity markets, fixed income, and thus a balanced portfolio.

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.

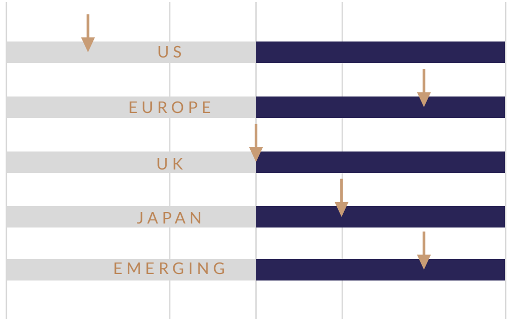
Currencies: Portfolios have a 5% USD exposure.

Commodities: Overweight

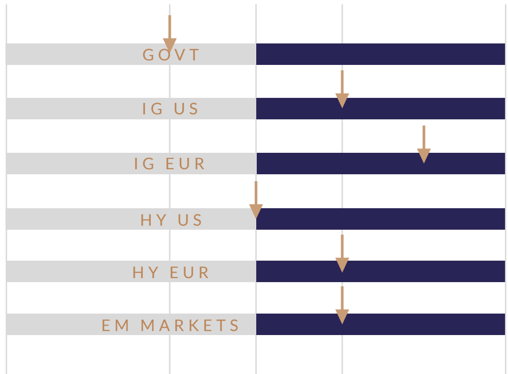
Long Gold.

Conviction thermometer

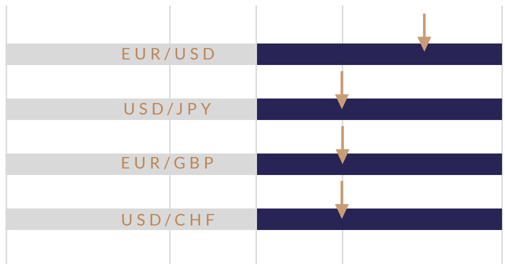
Equities



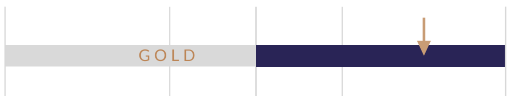
Bonds



Currencies



Commodities



Negative view Positive view

Market overview as of 31st January 2024

Equities (local ccies)	Level	5D	MTD	YTD	2023
MSCI WORLD	3 205,32	0,07%	1,23%	1,23%	24,44%
US S&P500	4 845,65	-0,45%	1,68%	1,68%	26,26%
NASDAQ 100	17 137,24	-2,06%	1,89%	1,89%	55,13%
RUSSELL 2000	1 947,34	-0,73%	-3,89%	-3,89%	16,88%
EUROPE EURO STOXX 50	4 648,40	1,85%	2,97%	2,97%	23,21%
GERMANY DAX	16 903,76	0,08%	0,91%	0,91%	20,31%
FRANCE CAC40	7 656,75	2,70%	1,63%	1,63%	20,10%
BELGIUM BEL20	3 662,96	0,88%	-1,10%	-1,10%	3,51%
SWISS MARKET INDEX	11 333,38	1,22%	1,76%	1,76%	7,06%
UK FTSE100	7 630,57	1,37%	-1,27%	-1,27%	7,68%
JAPAN TOPIX	2 551,10	0,87%	7,81%	7,81%	28,25%
MSCI EMERGING	975,80	-0,66%	-4,64%	-4,64%	10,16%
BRAZIL IBOVESPA	127 752	-0,05%	-4,79%	-4,79%	22,28%
CHINA CSI 300	3 215,35	-1,88%	-6,29%	-6,29%	-9,14%
HS TECH	3 005,80	-8,39%	-20,15%	-20,15%	-8,25%
INDIA SENSEX	71 752,11	0,97%	-0,65%	-0,65%	20,33%
KOREA KOSPI	2 497,09	1,11%	-5,96%	-5,96%	19,97%
HONG KONG HANG SENG	15 485,07	-2,61%	-9,16%	-9,16%	-10,46%
AUSTRALIA ALL-SHARE	4 173,06	1,29%	-1,32%	-1,32%	7,70%
SAUDI ARABIA TADAWUL	11 796,63	-3,10%	-1,41%	-1,41%	18,10%

US: Sectors	Level	5D	MTD	YTD	2023
COMMUNICATION SVCS	257,91	-1,60%	5,02%	5,02%	55,80%
CONSUMER DISCRETIONARY	1 367,70	-1,22%	-3,53%	-3,53%	42,30%
CONSUMER STAPLES	772,80	1,88%	1,54%	1,54%	0,52%
ENERGY	636,73	1,98%	-0,38%	-0,38%	-1,42%
FINANCIALS	644,54	1,13%	3,04%	3,04%	12,10%
HEALTH CARE	1 635,58	1,23%	3,01%	3,01%	2,06%
INDUSTRIALS	955,86	0,36%	-0,88%	-0,88%	18,08%
INFORMATION TECHNOLOGY	3 529,92	-2,56%	3,95%	3,95%	57,84%
MATERIALS	518,41	0,77%	-3,91%	-3,91%	12,55%
REAL ESTATE	239,54	0,00%	-4,74%	-4,74%	12,27%
UTILITIES	312,07	2,49%	-3,01%	-3,01%	-7,08%

EUROPE: Sectors	Level	5D	MTD	YTD	2023
BASIC MATERIALS	2 876,39	1,68%	-4,16%	-4,16%	5,95%
CONSUMER GOODS	3 987,44	3,01%	1,61%	1,61%	-2,43%
CONSUMER SERVICES	1 551,20	4,65%	2,77%	2,77%	21,53%
FINANCIALS	910,75	1,24%	1,25%	1,25%	25,42%
HEALTH CARE	3 651,71	1,75%	3,89%	3,89%	8,75%
INDUSTRIALS	3 691,47	0,98%	0,23%	0,23%	27,43%
OIL & GAS	1 483,74	2,39%	-1,95%	-1,95%	9,01%
TECHNOLOGY	1 871,85	0,85%	9,65%	9,65%	34,72%
TELECOMS	535,47	-0,85%	2,39%	2,39%	8,86%
UTILITIES	1 977,42	-0,29%	-3,07%	-3,07%	14,75%

Market overview as of 31st January 2024

Fixed Income	Level	5D	MTD	YTD	2023
Pan-Euro 3-5 yrs IG	205,63	0,91%	0,03%	0,03%	6,68%
Euro Aggregate	236,73	1,16%	-0,33%	-0,33%	7,19%
Pan-Euro HY Hedged Eur	421,89	0,24%	0,83%	0,83%	12,32%
Global Inflation hedged EUR	234,74	1,52%	-1,29%	-1,29%	2,02%
US Corp High Yield	2 264,90	0,39%	0,00%	0,00%	13,45%
EM USD Aggregate TR	1 260,87	1,02%	-0,56%	-0,56%	9,09%
EM Aggregate TR Local Ccy	144,69	0,45%	-1,12%	-1,12%	6,91%
EUR Banks CoCo Tier 1	144,89	0,76%	0,76%	0,76%	5,04%
EU GOVT HEDGED EUR	210,60	1,28%	-0,86%	-0,86%	6,31%
Global Aggregate	2 554,99	1,01%	-1,38%	-1,38%	5,72%

Commodities	Level	5D	MTD	YTD	2023
GOLD	2 039,52	1,27%	-1,14%	-1,14%	13,10%
COPPER	390,60	0,51%	0,40%	0,40%	2,10%
OIL WTI	75,85	1,01%	5,86%	5,86%	-10,73%
OIL BRENT	81,71	2,09%	6,06%	6,06%	-10,32%

Currencies	Rate	5D	MTD	YTD	2023
EURUSD	1,0818	-0,62%	-2,00%	-2,00%	3,12%
GBPUSD	1,2688	-0,30%	-0,34%	-0,34%	5,36%
USDJPY	146,9200	-0,40%	4,17%	4,17%	7,57%
USDCHF	0,8614	-0,16%	2,38%	2,38%	-8,99%
AUDUSD	0,6568	-0,14%	-3,58%	-3,58%	-0,01%
EURCHF	0,9319	-0,78%	0,32%	0,32%	-11,08%
USDCNY	7,2980	0,15%	2,79%	2,79%	5,28%
USDKRW	1 335,65	-1.14%	N.A.	3,86%	4,22%
USDINR	83,0412	-0,11%	-0,20%	-0,20%	9,15%
USDIDR	15 780,00	0,45%	2,49%	2,49%	7,42%
USDBRL	4,8572	-0.08%	-1,27%	-7,55%	-8,01%
USDTRY	30,3398	0,31%	2,75%	2,75%	57,82%
BITCOIN	42 458,43	6,77%	1,25%	1,25%	152,94%

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