Marketing Material

MONTHLY HOUSE VIEW

August/September 2023

Japan: is this time different?

Architects of Wealth

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MISSION: IMPOSSIBLE?

Delphine
DI PIZIO TIGER
Global Head
of Asset Management

Dear Reader,

3% is the level of US inflation over one year in June. Although it is still above the Federal Reserve's (Fed) target of 2%, it has fallen back to March 2021 levels. Has the Fed succeeded in its impossible mission of taming rising prices without sending the economy into recession?

By aggressively raising its key rates by 5% over just a year, the Fed has succeeded in taking this first step, and the inflation peak that had exceeded 9% in mid-2022 is now behind us. The energy component is now making a negative contribution over the year, which explains why inflation adjusted for the most volatile elements is still high. The Fed has won a battle, but not yet the war. The good news is that the spectre of recession is receding; the US economy is still creating 200'000 jobs a month. Historically, a US recession is systematically preceded by job creation of around 100'000 in the three to six months preceding the economic contraction.

It must be said that in order to emerge from the COVID-19 crisis and get the economy moving again, the United States put 26% of GDP on the table, twice as much as the Euro Area. According to the International Monetary Fund (IMF), 80% of post-COVID inflation in the United States was due to overheating, compared with just 6% in Europe. Today there is convergence between the two sides of the Atlantic, with inflation mainly linked to the price of local services.

While the challenge for the Fed and the European Central Bank (ECB) in the second half of the year will be to set a maximum pivot rate, probably around 5.5% and 4% respectively, the situation is quite different for the emerging countries. These countries were the first to raise rates. They are, once again, ahead of the developed countries in lowering rates, particularly in Latin America and Eastern Europe. Moreover, in Asia, the spectre of deflation looms over China, which is exporting less as the global economy slows. In June, factory gate prices in the Middle Kingdom fell by 5.4% year-on-year. Against this backdrop of mixed growth, the Chinese authorities are likely to decide to introduce measures to support activity, notably by cutting interest rates.

We still believe that the impact of the rate hikes of recent months will take longer to spread and materialise in the global economy. This is because the backlash against COVID-19, which partly justified the rate hikes, was accompanied by strong stimulus packages in many countries.

We are scrutinising all the weak signals that are already accumulating:

- The difficulties which faced pension funds in the UK at the end of 2022.
- The collapse of Silicon Valley Bank which sent shockwaves through the market last March. However, on the evidence of the first US bank results for the second quarter, that event too seems to be behind us.
- Recently, the UK utility sector, particularly the water one, which is now facing some financing difficulties. As they have issued large amounts of so called "inflation-linked bonds", the significant increase in UK inflation is directly leading to sharp increases in their debt servicing. At over GBP 40 billion in size, the UK market for inflation-linked corporate bond is the largest in the world.

What these three events have in common is that companies have failed to anticipate the impact of a sudden rise in inflation and interest rates on the management of their investments and debt. It is true that we are coming out of a 15-year period of low or even negative interest rates.

What will make the central banks' perilous mission possible is the use of the right tools at the right time, and the same applies to investors when it comes to their asset allocation. Today, the volatility of certain markets, such as equities, is very low, and this should not make us less vigilant. There are major contrarian positions on US debt, with speculative players anticipating a continuation of the uptrend in interest rates, while institutional investors are taking the opposite view. Again, this leaves us with some excellent opportunities to seize, enabling us to make the most of the forthcoming six-month period.

Wishing you an excellent read.

JAPAN: IS THIS TIME DIFFERENT?


Lucas MERIC
Investment Strategist


Stavya EPSTEIN
Multi Asset Portfolio Manager

Against a backdrop of encouraging growth prospects, an economy likely to emerge from decades of deflation, an accommodating policy mix and investor-friendly structural reforms, Japan could prove an attractive and diversifying investment as part of an asset allocation strategy.

DEVELOPED MARKETS: JAPAN, THE NEW LAND OF GROWTH?

For several months now, economists have been trying to anticipate the timing of the next recession in the United States or Europe. In the land of the rising sun, these concerns seem a long way off, with our forecasts pointing to average GDP growth of 1.2% between now and 2024. With a recovery that took place later than in other developed economies (health measures were significantly relaxed in March), Japan now appears, along with China, to be the other bet for reopening. This recovery should support domestic demand and offset a very likely weakening in external demand, against a backdrop of global economic slowdown. Japan should also benefit from the return of Chinese tourists, who accounted for a third of tourists to the country before the pandemic.

FROM DEFLATION TO INFLATION?

Unlike most economies, the post-pandemic rise in inflation seems more like good news in a country that has been mired in deflation for several decades, mainly due to excess corporate savings following its collapse in the early 1990s. At 3.2% year-on-year (YoY) in May, headline inflation is decelerating thanks to the fall in energy prices. However, core inflation (excluding energy and fresh food) accelerated to 4.3% YoY in May, its highest level since 1981. Beyond this record level, the question is whether inflation can be sustained in Japan. To do so, the implementation of price-wage loops seems to be the key factor in establishing a sustainable and endogenous domestic demand dynamic. In this respect, the tightness of the labour market (an unemployment rate of 2.6%) and wage dynamics (the spring 'Shunto' negotiations led to a 3.8% rise in wages, the biggest since 1993) clearly point in this direction.

UNDERLYING INFLATION:
+4.3%
YoY in May (highest level since 1981)

At the same time, the government has reaffirmed its intention to pursue the Abenomics[1] strategy, which involves accommodative monetary and fiscal policies, as well as a growth strategy aimed at stimulating private sector investment. The June Tankan survey of large companies revealed a 5.4% upward revision in capital expenditure plans, with growth of 13.4% in 2023.

Although base effects will cause core inflation to slow over time, increased investment spending and the establishment of price-wage loops should weigh on excess savings and thus limit structural deflationary forces, allowing inflation to settle around the Bank of Japan's 2% target.

THE LOST PARADISE OF MONETARY POLICY

We do not see the Bank of Japan accommodative stance changing for the time being. In our view, the risk in this scenario would be a more hawkish Fed, forcing the Bank of Japan to react to prevent the yen from collapsing. Even more so since, with the EUR/JPY parity at its highest level for 15 years, the yen - which has suffered greatly from the widening of interest rate differentials with other developed economies - is approaching the levels that have prompted the Bank of Japan to intervene on the foreign exchange market in recent years to support its currency.

JAPANESE EQUITIES: IS THIS TIME DIFFERENT?

Against a backdrop of encouraging growth and accommodative policies, Japan appears to be a particularly attractive investment.

However, Japanese equities have risen by 13.5% (Nikkei 225 in EUR) since the start of the year and, historically, Japan remains a market that often takes off fast and hard, without necessarily finding a second wind.

1 - Measures introduced by Shinzo Abe from 2013 to bring the country out of deflation.

Nevertheless, two structural themes should underpin the long-term performance of Japanese equities:

- The end of a deflationary environment would give Japanese companies greater pricing power, which should boost earnings growth in the medium-term. It should be remembered that inflation is a factor that supports corporate margins, and hence equities.
- The Tokyo Stock Exchange (TSE) has launched a reform aimed at boosting shareholder returns. This reform is already beginning to bear fruit: the volume of share buybacks announced in the first quarter of 2023 reached its highest level for more than two decades (Chart 1). The increase in dividend yields should make Japanese equities more attractive, particularly to domestic investors, at a time when Japan is the only major market where the yield on the equity market is higher than that on government bonds. This yield should become even more attractive if share buybacks continue.

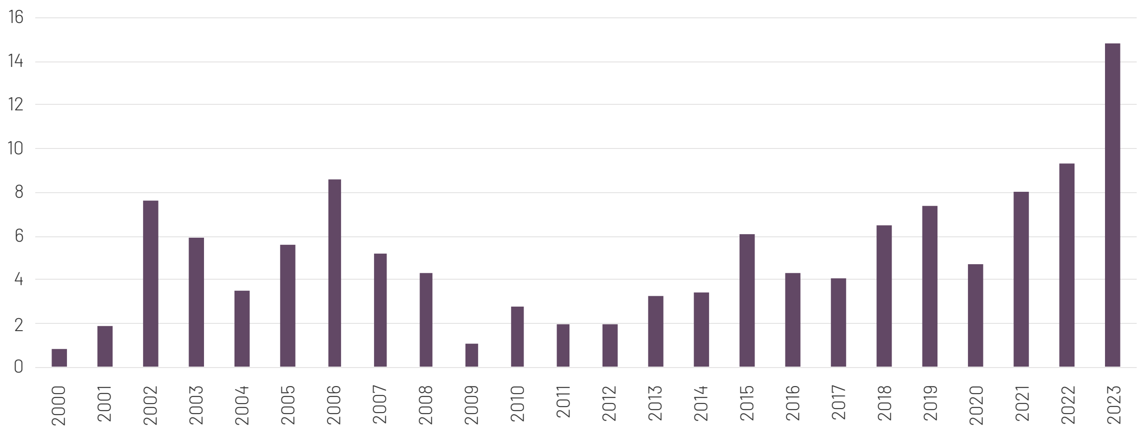
AN INTERESTING INVESTMENT CASE

In addition to these structural factors, several signals now seem to remain positive for the Japanese market:

- Corporate earnings are resilient, supported by domestic demand and inflation. Earnings revisions are trending upwards, with an expected earnings growth for the Topix of 7.3% in 2023 and 8.8% in 2024.
- Moreover, the price-to-book ratio[2] of Japanese equities relative to global equities is well below its historical median, with a still attractive price/earnings ratio of 13.6x. The reform of the TSE should lead to a rerating of Japanese equities.
- Global investors' underweighting of Japanese equities reached historic levels last year. However, the latest investor surveys show a reversal of this dynamic in recent months, with renewed interest and flows back into the Japanese market.
- The more defensive bias of Japanese equities provides attractive diversification in an asset allocation.

The depth of the Japanese market calls for a selective approach to benefit from the prospects of a recovery in domestic and quality stocks. Market dispersion suggests that the best opportunities lie in sectors that have not yet benefited from the market rally and which have good fundamentals.

CHART 1: SHARE BUYBACKS ANNOUNCED IN Q1 2023 (JPY 1'000 BILLION)



Source: JP Morgan, Indosuez Wealth Management.

2 - The price to net asset ratio measures the price of a share in relation to the book value of a company. When the ratio is excessively high, this may indicate that a company's shares are overvalued, particularly when the ratio is high compared with the same calculation for other companies in the same sector.

THE SHOW MIGHT GO ON

Lucas MERIC
Investment Strategist

Alexandre DRABOWICZ
Chief Investment Officer

We have raised our forecast for US growth in 2023, as the US economy continues to demonstrate its resilience. In China, weak demand is weighing on inflation and calling for more economic stimulus from the Chinese authorities, while growth in Europe should remain stable against a backdrop of low productivity.

UNITED STATES: THE US ECONOMY CONTINUES TO DEFY GRAVITY

Initially estimated at 1.1% quarter-on-quarter (QoQ) annualised in April, GDP growth in the first quarter of 2023 has been revised to 2%, symbolising a US economy that keeps bringing its share of positive surprises. This *momentum* should continue, according to the Fed real-time GDP estimate of 2.4% annualised QoQ in the second quarter of 2023. However, we still expect US growth to contract moderately in the second half of the year. Consumption *momentum* is undeniably slowing (retail sales decelerated to 1.5% YoY in June), excess household savings continue to shrink while credit card rates currently hover above 20%, the impact of rising mortgage rates is gradually being felt on the economy, and the cancellation of the *moratorium* on student debt should weigh on consumption. That said, we do not see US consumption collapsing for all that and have even revised upwards our growth forecasts for the second half of the year.

We are revising our US growth forecast for
2023
TO 1.5%
(+40 bps)

In fact, the labour market remains resilient, with job creation continuing at a brisk pace, while the disinflation process should support the purchasing power of US households. Households are also benefiting from positive wealth effects, thanks to the performance of US equity markets since the start of the year. Overall, more resilient consumption than we had previously anticipated for Q3/Q4 has led us to revise our growth forecast for 2023 to 1.5% (Table 1, page 7). However, we see a weaker rebound in Q1 2024 compared to our expectations last month. Headline inflation continued to decelerate in June (3% versus 4% in May) due to strong base effects on energy, which should start to fade after the summer. However, we expect the food and shelter components to take up the slack and support the disinflationary movement. In terms of monetary policy, we believe that the Fed should raise rates one last time before entering a plateau of high rates for several quarters.

CHINA: STIMULUS IS CALLING

The disappointing Chinese recovery of recent months was reflected in the second-quarter growth of 6.3% YoY (below expectations of 7.3%). Retail sales in June continued to slow to 3.1% YoY (versus 12.7% the previous month). Chinese consumer confidence remains severely undermined by the current weakness in the property sector (property investment contracted by 20.6% YoY in June) and youth employment (the unemployment rate for 18-24 year-olds stands at 21.3%), which is showing no signs of improvement, with a risk of this situation spreading to the rest of the working population. At the same time, the global economic slowdown continues to weigh on Chinese exports, which fell by 12.4% YoY in June despite the current weakness of the yuan. As a symbol of weak demand, the Chinese economy is flirting with deflation, the inflation rate standing at 0% YoY in June. Against this backdrop, the risks to our growth forecast of 5.6% in 2023 now appear to be tilted to the downside, while the weak *momentum* of recent weeks confirms the need for the Chinese authorities to ease economic policy further. The People's Bank of China (PBoC) already began cutting several short- and medium-term key interest rates at the start of the summer.

EURO AREA: LOW PRODUCTIVITY IN THE FIRING LINE

In Europe, consumer spending has been less vigorous than in the US over the past year, but this dynamic should be reversed by the end of the year. Indeed, we still believe that there is some pent-up demand on the tourism front for service-oriented economies, and the purchasing power of European consumers should also benefit from the ongoing disinflation in goods and food. The services component, which still accounts for 40% of total inflation, should start to lose ground after the summer, notably due to significant base effects on transport-related inflation in Germany. However, although the inflation outlook may improve in the short-term, the issue of wages remains central for the ECB, which expects wages to rise by 14% by the end of 2025. Labour costs have certainly shown signs of improvement, decelerating to 5% in the first quarter of 2023, but the primary cause of concern is weaker-than-expected productivity growth, which ultimately implies higher unit labour costs and additional inflationary pressure. Moreover, considering that the ECB has started its tightening cycle later than the other major central banks, we are expecting two more rate hikes in Europe, taking us to a terminal rate of 4%.

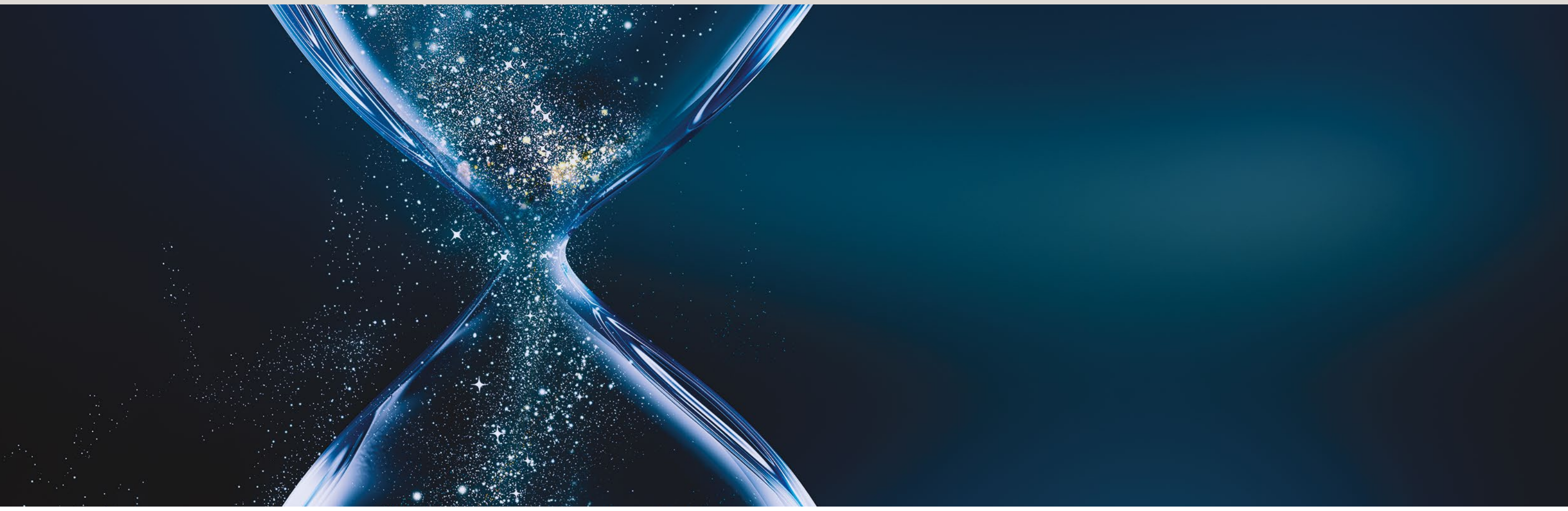
TABLE 1: MACROECONOMIC FORECAST 2023 - 2024, %

● Revised down since last month ● Revised up

	GDP		INFLATION	
	2023	2024	2023	2024
United States	1.5%	0.4%	4.0%	2.6%
Euro Area	0.5%	1.0%	5.5%	2.9%
China	5.6%	4.7%	1.3%	2.5%
Japan	1.3%	1.1%	2.8%	2.0%
India	6.0%	5.5%	5.5%	5.9%
Brazil	2.6%	1.3%	4.8%	4.0%
World	2.9%	2.6%	-	-

Source: Indosuez Wealth Management.

A LONG-TERM INVESTMENT



Thomas GIQUEL
Head of Fixed Income

With the contribution
of the Fixed Income Team

The end of monetary abundance does not mean the end of bond activity. Recent announcements of mega-mergers in the United States and the financing needs of all governments point to increased activity on the bond markets in the quarters ahead.

US BANK RESULTS: depositors demand higher rates!

CARRY STRATEGIES

In recent months, the so-called "carry" investment strategies have enabled retail investors to take a renewed interest in the bond markets. These markets, considered technical in Europe, seemed to be solely for institutional or sophisticated investors. Actually, retail investors were unknowingly investing in bonds through various channels: life insurance in France, pension funds and employee savings schemes. The rise in interest rates in 2022 restored the attractiveness of this investment, while bearing in mind that the return will only be delivered once all the bonds have been redeemed, i.e. at the end of the portfolio's lifetime. In the meantime, the value of the portfolio will fluctuate daily in line with market movements.

CENTRAL BANKS

Over the past few weeks, the US 2-Year yield has broken through the symbolic 5% barrier for the first time since the US regional bank crisis in March this year. To find this level again, we have to go back to June 2007.

The better-than-expected employment figures initially pushed rates up, before the positive surprise on inflation pushed them down: this was a long-awaited signal for investors, allowing them to anticipate the end of the Fed's rate hike cycle. This inflation figure triggered a rally across all asset classes. Still in anticipation of a recession that has yet to materialise, the short-term interest rate markets continue to incorporate aggressive rate cuts by the Fed from the start of 2024. We do not endorse this scenario, for the following reasons: on inflation, the buoyant property market is holding back a rapid fall in core inflation, the economic slowdown that is already being felt is widely anticipated and unlikely to last, and Fed officials are clearly waiting for unemployment to rise before considering easing their monetary policy. We are maintaining a scenario in which rate hikes are coming to an end, and the Fed will keep its key rates on a high plateau for as long as the post-COVID normalisation of all economic components requires.

In the Euro Area, the recession has already set in, albeit a mild one, but the German economy is dragging down the whole area, while Spain alone is not enough to offset the setbacks of the other countries. Inflation remains too high overall to stop the ECB: while the central bank is also nearing its peak in terms of interest rates, it is now busy withdrawing the massive liquidity injected during the pandemic. Of the EUR 4'000 billion in excess reserves in circulation, it is estimated that EUR 800 billion will be withdrawn in a few months, especially by repaying the TLTROs[3] granted to banks.

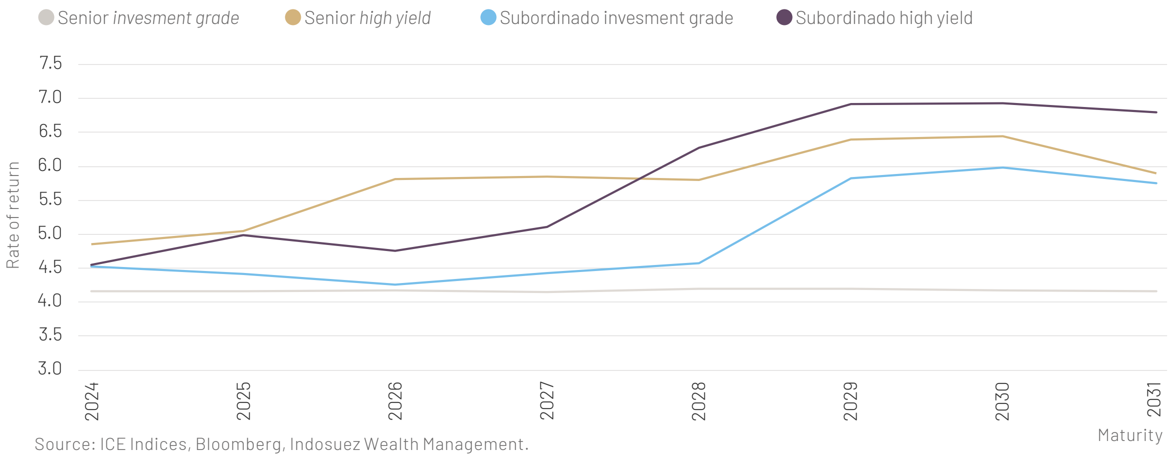
In the UK, the Bank of England's (BoE) long battle is finally beginning to bear fruit: for the first time in many quarters, published inflation is well below expectations. Governor Andrew Bailey is unlikely to declare victory too quickly, and will continue to raise rates, although without reaching the 6.5% level that the markets were expecting until recently.

What are the risks to the recent upturn in the bond markets? Unlike in 2022, investors now benefit from a carry that protects them over the medium-term. The main economic risk lies in an unanticipated acceleration of the US economy, pointing to persistent inflation because of gains in purchasing power if tensions on the labour market persist. The resilience of the property market, for example, raises questions.

CREDIT

On the credit market, specific risks are increasing in Europe and the United States. In both investment grade and high yield debt, the slightest negative news can have a major impact on risk premiums. The list of issuers on which investors are cutting their positions following profit warnings, governance issues or recapitalisation needs is growing. However, this increase in idiosyncratic risk does not spread to the whole market. Indices do not reflect this underlying noise. But portfolios, by construction more concentrated, are subject to increased volatility. The carry described above remains attractive to investors. The high yield market remains unattractive because it is relatively expensive. The refinancing wall that frightens some investors has been pushed back in recent years by opportunistic issuers who have taken advantage of low rates to extend the maturity of their debt. On the other hand, other companies no longer have access to refinancing through the markets, because of punitive interest rates, a consequence of their deteriorating financial health. It is uncertain that default rates will rise significantly, but recovery rates are likely to fall: companies that should have disappeared have benefited from a reprieve thanks to favourable financing conditions, which weakened their balance sheets. Automatically, risk premiums on high yield must take account of this new environment (Chart 2).

CHART 2: RETURNS ON EUR CREDIT INDICES BY YEAR AND MARKET SEGMENT



Source: ICE Indices, Bloomberg, Indosuez Wealth Management.

3 - Targeted longer-term refinancing operations.

A HIGHLY ANTICIPATED EARNINGS SEASON

Laura CORRIERAS
Equity Portfolio Manager

With the contribution of the Equity Team

Equity markets continued to rise, driven by the overall deceleration in inflation, which was stronger than expected, and by improving earnings revisions, particularly in the United States. The scenario of a soft landing is gaining strength in the financial world, which also explains the renewed appetite for risk. Will the earnings season starting in mid-July confirm the resilience of the economy?

US 12-month EARNINGS REVISIONS ON THE RISE

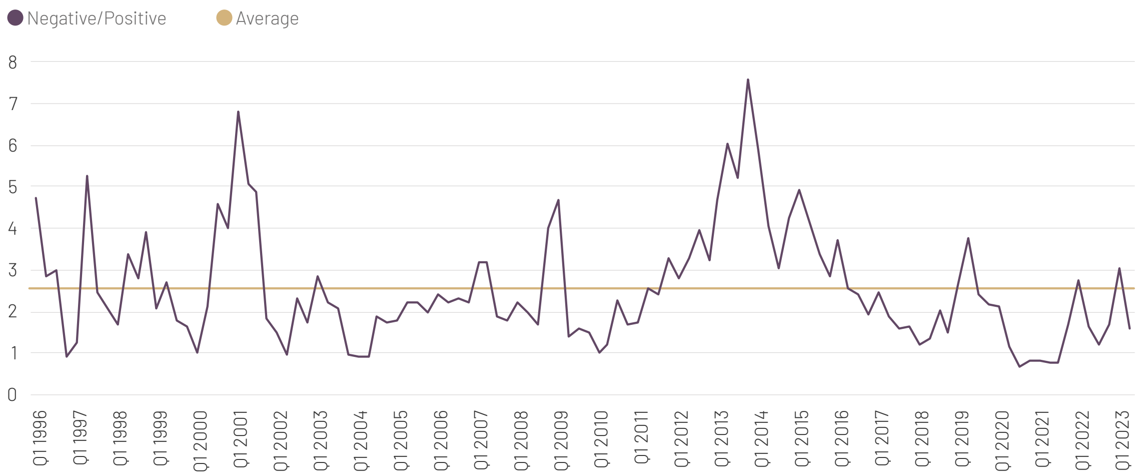
EARNINGS SEASON

The earnings season for the second quarter of 2023 began mid-July. The consensus expectation for the S&P 500 is a fall in earnings of around -7.2%. If this were the case, it would be the biggest fall in earnings recorded by the index since the second quarter of 2020 (-31.6%). However, in contrast to the main global indices, 12-month earnings revisions in the US have been trending upwards since May. Finally, as usual, we look at the negative to positive ratio of companies' pre-announcements before the beginning of the earnings season, and it is interesting to note that companies are fairly confident about their ability to deliver results in line with market expectations (Chart 3).

UNITED STATES

Since the S&P 500 broke through its 4'200-point resistance barrier, the index has continued to rise. The market's performance can no longer be explained solely by that of the "Magnificent 7"[4] and Artificial Intelligence (AI), as recently even small and mid-caps have performed very well, following the example of the Russell 2000. Investors seem reassured that budget spending will continue (especially concerning the Inflation Reduction Act[5], which was called into question during the debate on the debt ceiling). The market has also been positively surprised by solid macroeconomic figures coupled with a sharper than expected fall in inflation. Finally, recent positive news on ongoing mega-mergers[6] have helped to boost valuations.

CHART 3: S&P 500 PRE-ANNOUNCEMENT RATIO (NEGATIVE TO POSITIVE)



Note: The negative/positive ratio for pre-announcements remains below the long-term average. This suggests that most companies are confident in their ability to publish results above their estimates.
Source: Refinitiv, Indosuez Wealth Management.

4 - Alphabet, Apple, Amazon, Meta, Microsoft, Nvidia and Tesla.
5 - Signed into law in 2022, it aims to curb inflation by reducing the US budget deficit, cutting healthcare costs and investing in domestic energy production.
6 - Microsoft's bid for Activision Blizzard and Broadcom's bid for VMware.

EUROPE

Despite some profit-taking on European equities, the Euro Area continues to be attractive, particularly in terms of valuations, and is trading at a record discount to the United States. In addition to the deceleration in inflation, which is also continuing in Europe, there has been a marked increase in the cash available to households, thanks to the fall in commodity prices and a very low take-up of savings, which should probably support consumption over the coming months.

Finally, after China's central bank paved the way for a new era of easing to support a weaker-than-expected post-COVID economy, the latest disappointing macroeconomic data suggests that the Chinese government may announce further stimulus measures, which should also benefit many European exporting companies.

EMERGING MARKETS

Investor sentiment remains negative towards China, with political tensions with the United States posing a threat. On the other hand, recent visits by senior US officials are encouraging. Government stimulus measures could be another positive, while Chinese consumer sentiment remains an important factor to watch.

Asia, excluding China, looks attractive at the moment: reduced risks in the US (notably inflation) and a weaker US dollar should be positive for Asian markets. Technology leaders in Taiwan and South Korea are key to the global AI supply chain and innovation. In addition, domestic demand and infrastructure in India appear to be attractive themes, along with ASEAN's[7] expanding middle class and young population. The domestic sectors in Indonesia and Singapore are also particularly interesting. Compared with other major markets, Asia remains an area of higher economic growth and discounted valuations.

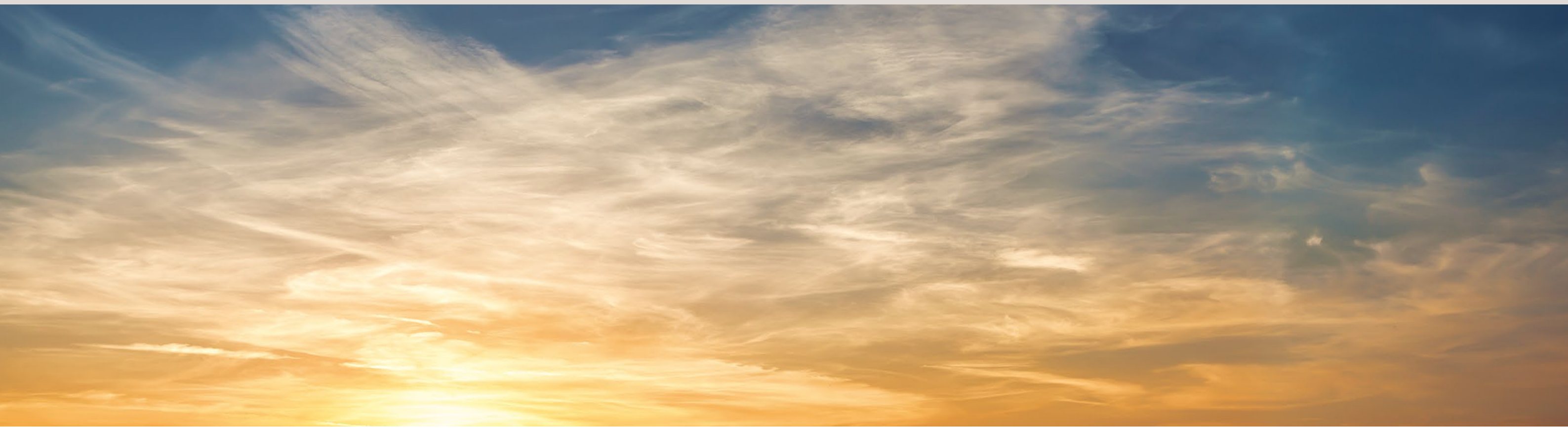
INVESTMENT STYLE

We remain constructive on the Growth style and continue to gradually increase our exposure. The improved macroeconomic outlook, coupled with the AI craze, are fueling the rally in US growth stocks, with the Nasdaq posting a year-to-date performance of +43%[8]. Value, meanwhile, has regained some of its colour thanks to the rebound in long-term interest rates, which is traditionally a positive catalyst for this segment. Besides, Value remains historically very cheap, both in absolute terms and relative to other styles.

7 - ASEAN: Association of Southeast Asian Nations.
8 - Performance in USD at 14.07.2023.

06 • Forex

THE SUMMER RESPITE WILL NOT OVERSHADOW THE LONG-TERM TREND



Maxime GARCIA
Investment Strategist

The dollar could recover this summer, although the underlying trend remains downwards. The euro is overheating and threatens to correct slightly, but the lag in the monetary cycle with the United States will provide support in the months ahead. The Swiss franc, yen and gold continue to be attractive safe havens in an uncertain environment, but their future movements will largely depend on central bank decisions.

USD

Technical factors and de-dollarisation

The dollar index (DXY Index) has fallen back below the 100 mark and is close to the level seen before the Fed began tightening monetary policy. With the latest inflation and non-farm payroll figures coming in below consensus, investors are expecting the Fed to be less restrictive than other central banks in the developed world. In addition, the easing of financial conditions in the United States has fuelled risk appetite in the markets. These two factors combined have led to a 3% fall in the DXY since the beginning of July. However, in the short-term, the downside risk remains limited due to technical factors that are more favourable to the dollar. The greenback could recover if risk sentiment were to deteriorate, or if the US economy were to become increasingly resilient. In the long-term though, the dollar's downward trend remains intact, and the de-dollarisation process already underway is acting as a burden on the currency.

DE-DOLLARISATION movement acts as A BURDEN ON THE DOLLAR

EUR

Monetary policy catch-up

The euro has risen sharply against the dollar, gaining 3% since the start of the month, supported by the favourable trend in the short-term interest rate differential between Europe and the United States, while the deterioration in macroeconomic *momentum* in the Euro Area has had no negative impact. At current levels, i.e. below 1.12, the level prior to the outbreak of the conflict in Ukraine, we prefer to remain cautious on the EUR/USD in the short-term. The single currency remains the most overbought currency in the G10, and the euro's nominal effective exchange rate recently hit a record high. The EUR/USD is vulnerable to a return of the correlation between currency performance and macro *momentum* and could return to the 1.10 level. Our long-term view remains positive, due to the lag in the tightening cycle, which should continue to have a positive effect on the transatlantic interest rate spread (Chart 4, page 13), and a dollar weakened by the diversification of foreign exchange reserves.

CHF

Less support to come from the SNB

The CHF has appreciated by 4% against the USD since the start of the month, a move underpinned by the Swiss National Bank's (SNB) latest rate hike of 25 basis points to 1.75%.

With the USD/CHF at 0.85, its lowest level since 2015, the downside risk is now limited, and we are taking a more cautious short-term view of the Swiss franc against the dollar. Indeed, Swiss inflation slowed to 1.7% in June, and the SNB has revised down its inflation expectations, which it believes should remain around the 2% target for 2023 and 2024. We also note that imported inflation has been flat this month, showing evidence that the Swiss franc has appreciated sufficiently to prevent a surge in import prices. For these reasons, the SNB's incentive to continue raising rates should now fade. We expect the Swiss franc to continue to trade in a range between 0.85 - 0.86 for the USD/CHF and 0.95-1.00 for the EUR/CHF. In the long-term, we maintain our positive view on the CHF, as its safe-haven status remains attractive as a hedge against macroeconomic risk.

JPY

Still on hold

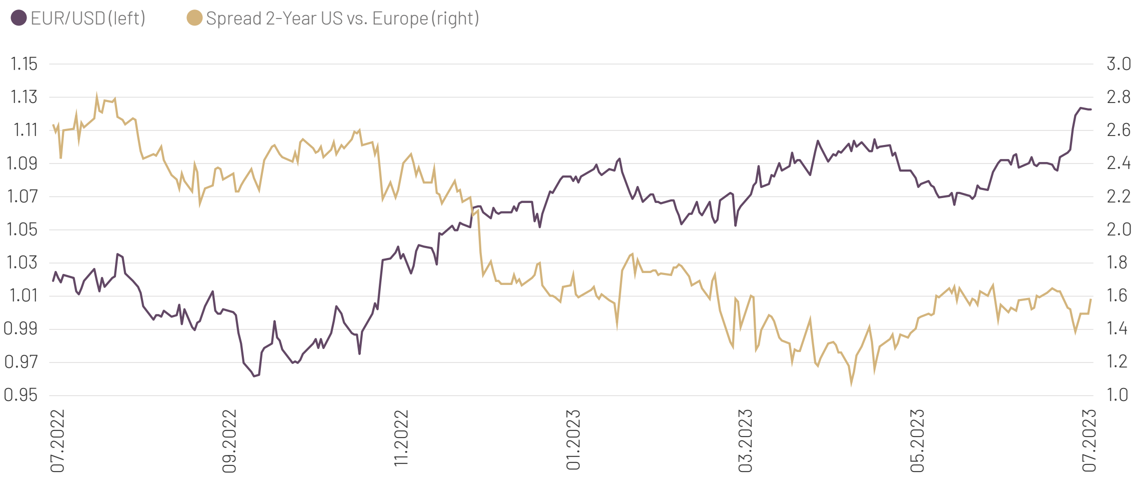
The yen rallied against the dollar this month, gaining 4%, driven by an acceleration in verbal interventions by the Ministry of Finance, followed by the unwinding of yen-financed carry trades. However, we remain cautious in the short-term since the interest-rate differential (which is unfavourable to the yen as long as the Bank of Japan maintains its accommodative monetary policy) remains the main factor in the yen's performance. Only a change in monetary policy could push the USD/JPY back towards 130. In the short-term, we do not see any significant change in monetary policy. Moreover, the currency's safe-haven status remains attractive in the current environment.

GOLD

Diversification of foreign exchange reserves and the monetary cycle

Gold has gained 2% since the start of the month but remains below its 2023 peak of USD 2050/ounce. In the short-term, we see little upside potential, with the yellow metal still affected by the lack of visibility on monetary tightening cycles, while investor demand is falling, as evidenced by outflows from gold ETFs. However, we remain positive in the long-term, with demand from central banks to diversify their foreign exchange reserves and gold's status as a safe haven remaining the main support factors.

CHART 4: THE US-EUROPE INTEREST RATE DIFFERENTIAL SHOULD CONTINUE TO SUPPORT THE EURO



Source: Datastream, Indosuez Wealth Management.

INVESTMENT SCENARIO AND ALLOCATION CONVICTIONS

Grégory STEINER
Global Head of Multi Asset

Adrien ROURE
Portfolio Manager

MORE RESILIENT GROWTH
than expected
in the United States

INVESTMENT SCENARIO

- **Growth:** global growth remains on a declining trend but is revised slightly upwards for this year (to around 3%) due to the US economy being more resilient than expected. The modest growth in Europe can be partly explained by the weakness of the European consumer combined with weak productivity gains. Emerging countries overall remain the driving force of global growth in 2023 and 2024, although we believe that the risk to economic activity in China is now tilted to the downside for next year.
- **Inflation:** the lifting of supply constraints in certain sectors and favourable base effects on energy prices continue to fuel a disinflationary process in the advanced economies in the short-term. The gradual disappearance of these technical factors after the summer and continued wage increases, particularly in Europe, should nevertheless keep inflation above central bank targets. We are maintaining our square-root shape scenario for the inflation trajectory.
- **Central banks:** the Fed and ECB are nearing the end of their rate hike cycle, with one and two more hikes expected respectively. We believe that interest rates will then plateau at least until the first half of next year. Balance sheet deleveraging continues, with a potential acceleration in the pace of quantitative tightening in the Euro Area.
- **Corporate earnings:** market expectations for the second-quarter earnings season seem conservative to us, but we will be keeping an eye on the dynamic of earnings revisions, particularly in Europe where *momentum* has lost steam, while margin levels could start to turn around gradually as unit costs rise and disinflation takes hold.
- **Risk environment:** equity market volatility continues to trend downwards, but vigilance remains the order of the day against a backdrop of persistently high uncertainty about monetary policy and many exogenous risk factors.

ALLOCATION CONVICTIONS

Equities

- We believe the current environment is more favourable to risky asset as the lifting of a number of macroeconomic risk factors, combined with better growth prospects across the Atlantic, is now supporting the equity markets. Nevertheless, we remain neutral on equities, given the tight valuation and technical indicators.
- From a geographical point of view, we continue to look for entry points in the US markets, where the *momentum* of earnings revisions is stronger, in line with the solidity of recent macroeconomic figures. Relative valuation levels in Europe remain attractive, but caution is called for in the short-term as we approach major resistance levels and sluggish earnings revisions.
- Emerging market equities remain a strong conviction, as they should benefit from a growth differential that favours developing economies over advanced economies. We are maintaining our conviction in Chinese equities, which could benefit from further government support, while market valuations appear to us to be excessively low.

Fixed Income

- With monetary tightening nearing an end, we believe that the market now offers entry points for reducing our underweight duration, particularly on the US yield curve. Conversely, we believe that there is still considerable risk on government bonds in the Euro Area, where the rate hike cycle is out of step with that in the United States.
- We continue to favour the short end of the yield curve in the Euro Area and the US, where the carry-to-volatility ratio is much more attractive.
- Investment grade corporate debt remains the best compromise in terms of risk/return, particularly for short maturities (as credit curves are relatively flat). Overall, we are staying away from the high-yield segment, where we believe valuations do not reflect the deterioration in fundamentals, particularly in the lower-rated segments.

Foreign exchange market

- As expected, the EUR/USD exchange rate has regained some of its lustre, but we believe that the appreciation is exaggerated given the divergence in economic fundamentals between the two zones. A retracement is possible in the short-term, but we remain positive on the euro towards the end of the year due to the lag in the monetary tightening cycle between the United States and the Euro Area.
- The Swiss franc has hit a high point against the greenback and the potential for further appreciation now seems limited, especially as the Swiss central bank nears the end of its monetary tightening cycle.
- The yen rallied on the back of the US rates decline. If the Bank of Japan remains accommodative, we believe it could change its policy later, albeit to a limited extent, which could support the currency. We also value the yen as a hedging asset in our portfolios.
- Gold continues to move in a range, with no major trend. While investor demand is falling and could weigh on short-term *momentum*, in the long-term the diversification of central bank reserves, particularly in emerging markets, is a supporting factor.

KEY CONVICTIONS

	TACTICAL VIEW (ST)	STRATEGIC VIEW (LT)
FIXED INCOME		
GOVERNMENTS		
EUR 2-Year	=	=/-
EUR 10-Year	=/-	=/-
EUR Periphery	=	=/-
US 2-Year	=/+	=/+
US 10-Year	=/-	=
EUR Breakevens Inflation	=	=/+
US Breakevens Inflation	=	=/+
CREDIT		
Investment grade EUR	=/+	+
High yield EUR	=/-	=
Financials Bonds EUR	=/-	=
Investment grade USD	=	+
High yield USD	-	=
EMERGING DEBT		
Hard Currencies	=/-	=/+
Local Currencies	=/+	=/+
EQUITIES		
GEOGRAPHIES		
Europe	=	=/+
United States	=	=
Japan	=/-	=
Latin America	=	=
Asia ex-China	=/+	=/+
China	=/+	=
STYLES	=/-	
Growth	=	=/+
Value	=	=/-
Quality	=/+	=
Cyclical	=	=/+
Defensive	=/-	=/-
FOREX		
United States (USD)	=	=/-
Euro Area (EUR)	=/-	=/+
United Kingdom (GBP)	=/-	=
Switzerland (CHF)	=	=/+
Japan (JPY)	=/+	=/+
China (CNY)	=	=
Gold (XAU)	=/-	=/+

Source: Indosuez Wealth Management.

OVERVIEW OF SELECTED MARKETS

DATA AS OF 20 JULY 2023

GOVERNMENT BONDS	YIELD	4 WEEKS CHANGE (BPS)	YTD CHANGE (BPS)
US Treasury 10-year	3.85%	5.57	-2.45
France 10-year	3.01%	-1.00	-9.40
Germany 10-year	2.48%	-0.80	-8.20
Spain 10-year	3.48%	3.80	-16.70
Switzerland 10-year	0.98%	-4.90	-63.80
Japan 10-year	0.46%	8.90	4.70

BONDS	LAST	4 WEEKS CHANGE	YTD CHANGE
Government Bonds Emerging Markets	37.65	1.24%	8.47%
Euro Government Bonds	195.99	0.36%	1.73%
Corporate EUR high yield	203.57	0.51%	5.19%
Corporate USD high yield	314.00	1.58%	5.83%
US Government Bonds	299.51	0.12%	1.40%
Corporate Emerging Markets	43.34	-0.21%	1.36%

CURRENCIES	LAST SPOT	4 WEEKS CHANGE	YTD CHANGE
EUR/CHF	0.9646	-1.60%	-2.52%
GBP/USD	1.2868	0.94%	6.50%
USD/CHF	0.8668	-3.13%	-6.24%
EUR/USD	1.1130	1.59%	3.97%
USD/JPY	140.07	-2.12%	6.83%

VOLATILITY INDEX	LAST	4 WEEKS CHANGE (POINTS)	YTD CHANGE (POINTS)
VIX	13.99	1.08	-7.68

EQUITY INDICES	LAST PRICE	4 WEEKS CHANGE	YTD CHANGE
S&P 500 (United States)	4'534.87	3.49%	18.11%
FTSE 100 (United Kingdom)	7'646.05	1.92%	2.61%
STOXX 600	463.93	2.03%	9.19%
Topix	2'260.90	-1.55%	19.52%
MSCI World	3'029.70	3.39%	16.41%
Shanghai SE Composite	3'823.70	-1.04%	-1.24%
MSCI Emerging Markets	1'018.06	1.69%	6.45%
MSCI Latam (Latin America)	2'480.39	0.46%	16.54%
MSCI EMEA (Europe. Middle East. Africa)	200.35	4.25%	4.36%
MSCI Asia Ex Japan	646.86	1.23%	4.46%
CAC 40 (France)	7'384.91	2.52%	14.07%
DAX (Germany)	16'204.22	1.35%	16.38%
MIB (Italy)	28'815.75	5.13%	21.55%
IBEX (Spain)	9'519.60	1.65%	15.68%
SMI (Switzerland)	11'201.55	0.16%	4.40%

COMMODITIES	LAST PRICE	4 WEEKS CHANGE	YTD CHANGE
Steel Rebar (CNY/Tonne)	3'746.00	-0.35%	-8.52%
Gold (USD/Oz)	1'969.53	2.90%	7.98%
Crude Oil WTI (USD/Bbl)	75.63	8.80%	-5.77%
Silver (USD/Oz)	24.81	10.41%	3.18%
Copper (USD/Tonne)	8'485.50	-1.03%	1.36%
Natural Gas (USD/MMBtu)	2.76	5.71%	-38.39%

Source: Bloomberg, Indosuez Wealth Management.
Past performance does not guarantee future performance.

MONTHLY INVESTMENT RETURNS, PRICE INDEX

FTSE 100 · Topix · MSCI World · MSCI EMEA · MSCI Emerging Markets
STOXX 600 · S&P 500 · Shanghai SE Composite · MSCI Latam · MSCI Asia Ex Japan

	APRIL 2023	MAY 2023	JUNE 2023	4 WEEKS CHANGE	YTD (20.07.2023)
BEST PERFORMING +	3.51%	1.46%	11.00%	4.25%	19.52%
	3.29%	3.13%	7.41%	3.49%	18.11%
	2.83%	1.92%	6.47%	3.39%	16.54%
	2.73%	2.69%	5.93%	2.03%	16.41%
	0.51%	1.59%	4.85%	1.92%	9.19%
	0.36%	-0.54%	3.23%	1.69%	6.45%
	0.04%	-1.34%	2.25%	1.23%	4.46%
	-0.46%	1.63%	2.17%	0.46%	4.36%
	-0.71%	3.48%	1.16%	-1.04%	2.61%
− WORST PERFORMING	-3.10%	-2.19%	1.15%	-1.55%	-1.24%

Source: Bloomberg, Indosuez Wealth Management.
Past performance does not guarantee future performance.

09 • Glossary

Basis point (bps): 1 basis point = 0.01%.

Blockchain: A technology for storing and transmitting information. It takes the form of a database which has the particularity of being shared simultaneously with all its users and generally does not depend on any central body.

BLS: Bureau of Labor Statistics.

BNEF: Bloomberg New Energy Finance.

Brent: A type of sweet crude oil, often used as a benchmark for the price of crude oil in Europe.

CPI (Consumer Price Index): The CPI estimates the general price level faced by a typical household based on an average consumption basket of goods and services. The CPI tends to be the most commonly used measure of price inflation.

Cyclicals: Cyclicals refers to companies that are dependent on the changes in the overall economy. These stocks represent the companies whose profit is higher when the economy is prospering.

Defensives: Defensives refers to companies that are more or less immune to the changes in the economic conditions.

Deflation: Deflation is the opposite of inflation. Contrary to inflation, it is characterised by a sustained decrease in general price levels over an extended period.

Duration: Reflects the sensitivity of a bond or bond fund to changes in interest rates. This value is expressed in years. The longer the duration of a bond, the more sensitive its price is to interest rate changes.

EBIT (Earnings Before Interest and Taxes): Refers to earnings generated before any financial interest and taxes are taken into account. It takes earnings and subtracts operating expenses and thus also corresponds to non-operating expenses.

EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortisation): EBITDA takes net income and adds interest, taxes, depreciation and amortisation expenses back to it. It is used to measure a company's operating profitability before non-operating expenses and non-cash charges.

ECB: The European Central Bank, which governs the euro and Euro Area member countries' monetary policy.

Economic Surprises Index: Measures the degree of variation in macro-economic data published versus forecasters' expectations.

Economies of scale: Decrease in a product's unit cost that a company obtains by increasing the quantity of its production.

EPS: Earnings per share.

ESG: Non-financial corporate rating system based on environmental, social and governance criteria. It is used to evaluate the sustainability and ethical impact of an investment in a company.

Fed: The US Federal Reserve, i.e. the central bank of the United States.

FOMC (Federal Open Market Committee): The US Federal Reserve's monetary policy body.

GDP (Gross Domestic Product): GDP measures a country's yearly production of goods and services by operators residing within the national territory.

Growth: Growth style refers to companies expected to grow sales and earnings at a faster rate than the market average. As such, growth stocks are generally characterised by a higher valuation than the market as a whole.

IEA: International Energy Agency.

IMF: The International Monetary Fund.

Inflation breakeven: Level of inflation where nominal bonds have the same return as inflation-linked bonds (of the same maturity and grade). In other words, it is the level of inflation at which it makes no difference if an investor owns a nominal bond or an inflation-linked bond. It therefore represents inflation expectations in a geographic region for a specific maturity.

Inflation swap rate 5-Year, 5-Year: A market measure of what 5-Year inflation expectations will be in five years' time. It provides a window into how inflation expectations may change in the future.

IPPC: The Intergovernmental Panel on Climate Change.

IRENA: International Renewable Energy Agency.

ISM: Institute for Supply Management.

Japanification of the economy: Refers to the stagnation the Japanese economy has faced in the last three decades, and is generally used to refer to economists' fears that other developed countries will follow suit.

Metaverse: A metaverse (portmanteau of meta and universe) is a fictional virtual world. The term is regularly used to describe a future version of the internet where virtual, persistent and shared spaces are accessible via 3D interaction.

OECD: Organisation for Economic Co-operation and Development.

Oligopoly: An oligopoly occurs when there is a small number of producers (supply) with a certain amount of market power and a large number of customers (demand) on a market.

OPEC: Organization of the Petroleum Exporting Countries; 14 members.

OPEC+: OPEC plus 10 additional countries, notably Russia, Mexico, and Kazakhstan.

PMI: Purchasing Managers' Index.

Policy mix: The economic strategy adopted by a state depending on the economic environment and its objectives, mainly consisting of a combination of monetary and fiscal policy.

Pricing power: Refers to the ability of a company or brand to increase its prices without affecting demand for its products.

Quality: Quality stocks refers to companies with higher and more reliable profits, low debt and other measures of stable earnings and strong governance. Common characteristics of Quality stocks are high return to equity, debt to equity and earnings variability.

Quantitative easing (QE): A monetary policy tool by which the central bank acquires assets such as bonds, in order to inject liquidity into the economy.

SEC (Securities and Exchange Commission): The SEC is an independent federal agency with responsibility for the orderly functioning of US securities markets.

Spread (or credit spread): A spread is the difference between two assets, typically between interest rates, such as those of corporate bonds over a government bond.

Secular stagnation: Refers to an extended period of little or no economic growth.

SRI: Sustainable and Responsible Investments.

Stagflation: Stagflation refers to an economy that is experiencing simultaneously an increase in inflation and stagnation of economic output.

TPI : An addition to the Eurosystem's toolkit that can be activated by the ECB to counter unwarranted, disorderly market developments if these pose a serious threat to the smooth transmission of monetary policy across the euro area. The ECB Governing Council approved the instrument on the 21 July 2022.

Uberisation: Term derived from the name of US company Uber which develops and operates digital platforms that connect drivers and riders. It refers to a new business model that leverages new digital technologies and is part of the sharing economy, insofar as it puts customers in direct contact with service providers, at a reduced cost and with lower prices.

Value: Value style refers to companies that appear to trade at a lower price relative to its fundamentals. Common characteristics of value stocks include high dividend yield, low price-to-book ratio, and a low price-to-earnings ratio.

VIX: The index of implied volatility in the S&P 500 Index. It measures market operators' expectations of 30-day volatility, based on index options.

WTI (West Texas Intermediate): Along with Brent crude, the WTI is a benchmark for crude oil prices. WTI crude is produced in America and is a blend of several sweet crude oils.

WTO: World Trade Organization.

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