FFG
FORUM FINANCE
1994

OUTLOOK 2H 2024

JUNE 2024

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Outlook 2H 2024

We favour a more balanced positioning across and within asset classes. We believe that bond yields, including those on government bonds - something new for this segment - are attractive. Credit carry is attractive relative to corporate fundamentals, while long-dated government bonds offer protection in more difficult times in addition to their real yield.

Favourable economic data and the prospect of interest rate cuts, i.e. the ingredients of the soft-landing narrative, together with solid quarterly earnings, justify a constructive stance on equity markets. However, we would like to see a broader participation in the market rally to reduce the fragility of the bull cycle that started in early 2023.

While maintaining an allocation to the technology sector and the famous seven giants, we are balancing our portfolios with exposure to small/mid-caps and the value style, where valuations appear to offer significant catch-up potential.

Economic Outlook

Real GDP forecasts lowered for the US and Japan. China and euro area upgraded

Monetary easing becomes more widespread

Fed and Bank of England will remain on hold until September and August, respectively

FOMC dot plot implies only one 25 bps cut by year-end and four in 2025

Fannie Mae predicts that US mortgage rates will average 7% in 2024

Key Risks

Sharper slowdown in the US as labour market deteriorates sharply

US/China and EU/China trade war intensifies

Sovereign debt crisis forces governments to cut spending

Populist drift at the ballot box, testing the foundations of our democracies

Investment Convictions

Fixed income generally does well when the Fed pauses

Long-dated government bonds as a hedge against renewed recession fears

Inflation dynamics favour European over US rates (10-Year +)

EM corporate bonds offer wider spreads and diversification benefits

Prefer EU Fantastic Five to US Magnificent Seven

Small/Mid-Caps offer compelling valuation and economic sensitivity

Add value stocks for their relative valuation and diversification

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Executive Summary

Economic data releases in the first half of this year support the view that the US economy is on a soft-landing path around potential growth, while the euro area economy has turned, as evidenced by the evolution of the composite PMI index (above 50 for 10 months) and the euro area economic surprise index.

This robust and broadening growth environment is accompanied by a gradual disinflation, albeit slower than we expected at the beginning of the year, which should eventually bring us closer to the central banks' ultimate inflation target of 2%.

However, we are increasingly seeing divergences in monetary policy, both in terms of timing and amplitude, to address challenges in different regions. These divergences materialized in June with the first cut by the European Central Bank (ECB), the second by the Swiss National Bank (SNB), and the wait-and-see approach by the US Fed and the Bank of England (BoE).

Although there is still uncertainty about both the timing - perhaps September for the Fed's first cut - and the magnitude of the cuts - probably one or two in the US this year - market expectations appear more tempered than at the start of the year.

This "Goldilocks" environment has favoured risk assets, as evidenced by the performance of credit and equities. The US economic cycle remains strong, and signs of broader participation from regions such as Europe and China will help close the growth gap as US growth slows.

After being overly pessimistic, the consensus has now largely adopted the soft-landing thesis as the central scenario, with a probability above 60%. While we broadly agree with this central scenario, we recognize that it has become very consensual and has been adopted by a large part of the financial community. This broad consensus of an overall favourable cycle certainly explains the low level of volatility observed in equity markets.

However, many risks remain, some of which may be underestimated. After being on the lips of every commentator, the risk of a recession has almost disappeared from the radar, with a probability of barely 10%. Could the latest US employment figures be a sign that this scenario, which had given way to the "no landing" scenario, is making a comeback?

A brief review: 1H 2024

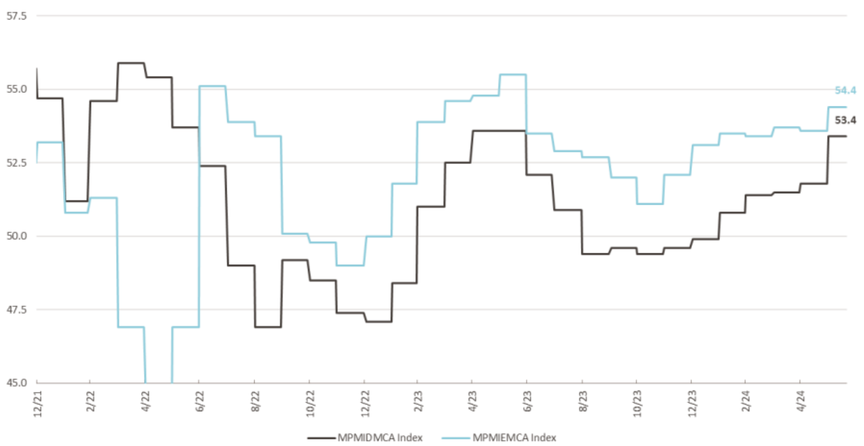
Global Growth: Robust Growth albeit Losing Some Momentum

The June flash PMI showed that the G4 major developed economies (US, UK, euro area and Japan) expanded for the seventh consecutive month in June. However, there were notable divergences in growth across regions, with continued robust growth in the US contrasting with a slowdown in Europe and Japan.

Emerging market (EM) economic growth accelerated in the second quarter to its fastest pace in a year, supported by solid improvements in both manufacturing and services. The growth momentum extended the streak of expansion to 17 months.

Alongside the improvement in developed markets (DM), global economic growth accelerated to a level consistent with an annualized growth rate of 3.4% according to PMI indicators.

Exhibit 1: Global Purchasing Managers' Index (PMI)



Source: Bloomberg

***MPMIDMCA Index**: Developed Markets Composite PMI SA – **MPMIEMCA Index:** Emerging Markets Composite PMI SA*

Global inflation: Broadly Stable

In the G7, year-on-year inflation eased slightly to 2.9% in April, back to the levels seen in January and February 2024. Core inflation in the G7 fell from 3.5% in March to 3.3% in April, the lowest level since October 2021.

In the euro area, annual HICP[1] inflation was stable at 2.4% in April. Increases in food and energy were offset by a decline in core inflation, which has fallen for nine consecutive months.

[1] Harmonised Index of Consumer Prices

In the US, the consumer price index was unchanged in May, although it was 3.3% higher than a year earlier. Excluding volatile food and energy prices, the core CPI rose 0.2% on the month and 3.4% on the year. Price increases were held back by a 2% fall in the energy index and a mere 0.1% rise in the food index.

Monetary Policy: Diverging Path

June was an eagerly awaited month for markets, with a number of central bank meetings on the agenda. Canada's central bank was the first in the G7 to cut rates by 25 basis points to 4.75%. After more than five years of keeping rates high, the European Central Bank also began its monetary easing cycle with a long-awaited 25bp cut to 3.75%.

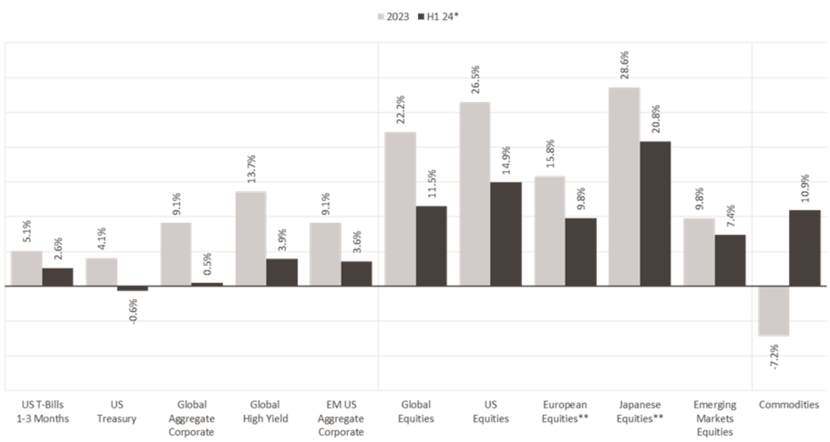
Among developed central banks, Switzerland has been at the forefront of the easing cycle, cutting rates for the second time this year to 1.25%, while the US Federal Reserve has kept rates unchanged in a range of 5.25% to 5.5%.

Despite these rate cuts, central banks have reiterated their cautious stance, stressing that they remain in a data-dependent mode and have not given clear signals about what will happen at the next few meetings.

Financial assets: Continued Strength for Risk Assets

In financial assets, the first half of the year was characterized by continued strength in risky assets, with several equity markets reaching all-time highs during the period.

Exhibit 2: Total Return in U.S. Dollar



*Source: Bloomberg - Note: * As of June 27,2024, ** In local currency*

Rates – U.S. Treasury yields rose across the curve, with the 10-year Treasury yield rising from 3.88% to 4.34% at the time of writing. Europe has not escaped this upward pressure. German 10-year yields rose 45 bps to 2.5%. Uncertainty about the political consequences of the dissolution of the French National Assembly led to an immediate widening of the credit spread between German and French 10-year yields. The spread partially normalized towards the end of June, but did not return to its initial level.

Credit – Most segments posted positive returns despite the sell-off in developed market government bonds. High yield bonds in the US and Europe delivered the strongest returns as credit spreads continued to tighten, offsetting the negative impact of higher government yields. In contrast, investment grade markets were broadly flat due to their higher sensitivity to movements in government bond yields.

EM sovereign bonds had a mixed performance, while **EM corporate bonds** had a strong first half. The local currency government bond index fell 1.5% in US dollar terms, driven entirely by emerging market currencies amid a stronger US dollar. The hard currency government bond market posted a solid return of 2.2%, driven entirely by high yield issuers. As in the developed bond markets, EM corporate bonds posted strong returns, driven by the tightening of credit spreads. This was particularly the case for high yield issuers, which led the index performance with a return of +6.2%.

Equities – In the US, the **large-cap equity** index posted another double-digit gain over the period, driven by artificial intelligence stocks, led by Nvidia, which alone is up more than 150% year-to-date. At the same time, the **equal-weighted** index was up just 4.6%, suggesting that the upside in the US market remains limited.

In local currency terms, **European equity** markets were on par with US equities at the end of May, thanks to a marked improvement in economic activity and the belief that the ECB would be the first to cut interest rates after the SNB. Everything was going according to plan and the ECB did indeed cut rates at its meeting in early June, but the surge of the far-right French RN in the EU parliamentary elections was to change everything. As soon as the results were known, the French President announced the dissolution of the National Assembly and called for early elections. European equities extended their broad sell-off amid rising political risk in France, with the French CAC 40 falling more than 6%, its worst weekly decline since Russia's invasion of Ukraine and wiping out its gains for 2024.

Although **emerging markets** ended the first half of the year in positive territory, buoyed by the optimism surrounding the scenario of a gradual slowdown in the US economy, the succession of new highs in US equity indices and the hype surrounding artificial intelligence (Taiwan and Korea), their performance still lagged that of developed market equities.

Commodities – Supported by Asian central bank buying, geopolitical tensions in the Middle East and the prospect of monetary easing**, gold** rose 11.4% from the start of the year. It reached its high for the period on 20 May at $2,438.5. Silver, which is considered more speculative, followed a similar trajectory, gaining 5% over the same period.

Oil was supported during the period by the decision of oil producing countries to extend voluntary production cuts, leading to fears that the oil market deficit later this year will be larger than previously forecast. Among industrials, copper was a strong performer, extending last year's positive momentum into the first half of 2024, as supply concerns outweighed disappointment over Chinese growth.

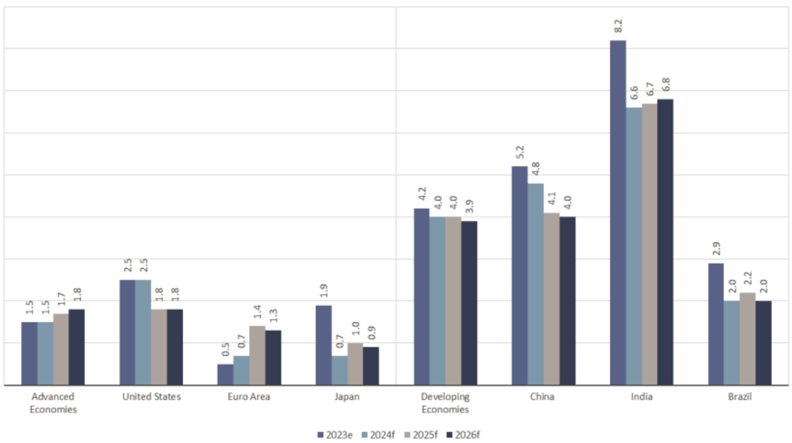
Mid-Year Outlook

Global Growth Outlook: Global Growth to Hold Steady

Global growth in advanced economies has slowed from 2.6% a year ago to 1.5% in 2023 and is expected to remain at that level in 2024, but with significant differences across regions, mainly reflecting sluggish domestic demand in Europe and Japan. This growth differential is expected to narrow in 2025, thanks to renewed vigour in the euro area, this time combined with a slight slowdown to around potential in the United States.

In the United States, the strong performance of the US economy has led to an upward revision of growth expectations. The expected growth rate for 2024 is now 2.5%, an upward revision of around 0.9% compared with previous forecasts. In 2025, growth will be more moderate at around 1.8%, in line with or slightly below the growth potential of the US economy.

Exhibit 3: Real GDP Growth Forecast (y/y, %)



Source: World Bank – Global Economic Prospcts – June 2024
Note: e = estimate; f = forecast

The reason for the expected slowdown in 2025 is largely explained by the cumulative effects of monetary tightening. The high level of real borrowing rates is likely to reduce the propensity of households to spend and invest, especially in housing. In addition, the easing of labour market conditions, with some early signs of softening, and its potential dampening effect on household incomes is also expected to contribute to this slowdown.

In the euro area, adverse conditions such as tight credit conditions, high energy prices and the sluggish recovery in China have weighed on economic activity. However, growth has undoubtedly bottomed out and there are encouraging signs of a pick-up in activity, including in manufacturing, on an aggregate basis. German industrial activity continues to show less than encouraging signs, which explains the anaemic improvement at the start of 2024. Growth expectations for the year are 0.7%, supported by real wage growth.

In 2025, growth should accelerate to 1.4% thanks to the expected recovery in exports and investment, the latter benefiting directly from the monetary easing expected from the European Central Bank. The renewed vigour of the euro area economy should continue into 2026, with growth expected to reach 1.3%, slightly above the estimated potential growth for the region.

In Japan, the economy contracted in the first quarter for the first time in two quarters. The economy is expected to slow to 0.7% in 2024 before reaching a cruising speed of 1% in 2025 and 2026. The end of unconventional monetary policy measures - yield curve control - but most importantly the end of negative interest rates will weigh on growth, especially if inflation falls, helped by a weak yen.

China's growth was stronger than initially expected at the start of 2024, helped by a positive contribution from net exports. These positive economic data mask sluggish domestic demand due to continued weakness in the housing market.

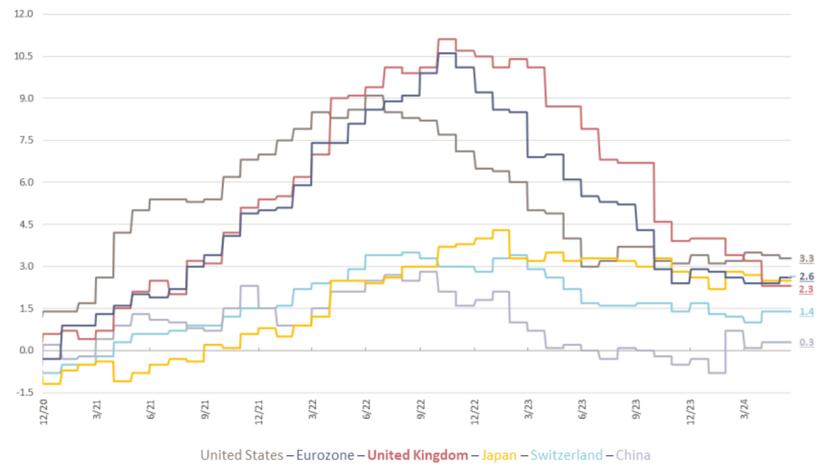
Further declines in house prices and sales volumes have weighed on household confidence, affecting consumption. As a result, retail sales are still below pre-pandemic averages. The authorities have issued new guidelines aimed at stimulating housing demand by lowering the initial down payment and eliminating the flat tax on residential property.

Debt levels and more limited productivity gains will weigh on future growth. Against this background, growth is expected to decline to 4 % between 2025 and 2030. In the longer term, potential growth is also likely to decline due to unfavourable demographics; China's population will decline for the second consecutive year due to a low and declining fertility rate.

Global Inflation Outlook: Declining but Still Above 2%

The disinflationary trend is continuing, albeit at a slower pace. In the early stages of the decline, lower commodity prices and the standardization of supply chains were the main contributors. While consumer goods prices seem to have reached a level more in line with expectations, services prices remain high.

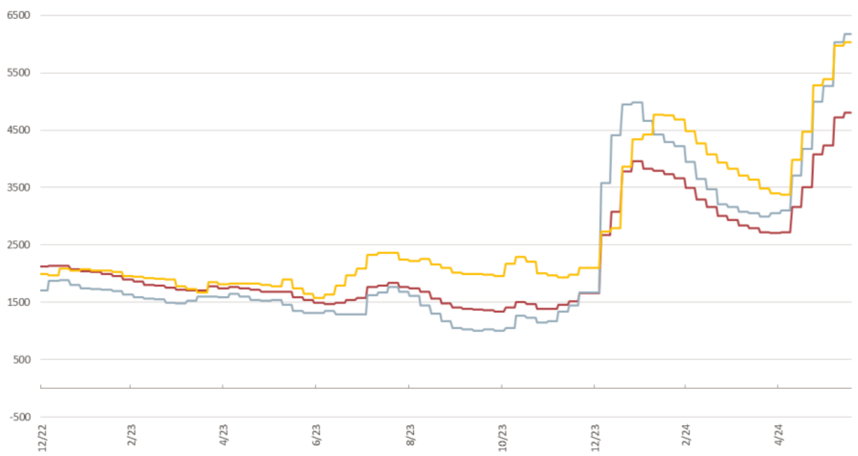
Exhibit 4: Consumer Price Index (y/y, %)



Source: Bloomberg

Recent geopolitical tensions, particularly around the Red Sea and the Panama Canal, have rekindled fears of a new phase of widespread price increases, particularly related to rising energy and food costs.

Exhibit 5: Container Freight Rate



Source: Bloomberg

***WCIDCOMP Index**: WCI Composite Container Freight Benchmark Rate per 40 Foot Box Drewry*

***WCIDSHRO Index**: WCI Shanghai to Rotterdam Container Freight Benchmark Rate per 40 Foot Box*

***WCIDSHLA Index**: WCI Shanghai to Los Angeles Container Freight Benchmark Rate per 40 Foot Box*

In the United States, a robust economy combined with rising shelter costs has kept service prices high, preventing core inflation indicators from showing a more marked decline. It should be noted that productivity gains, partly driven by artificial intelligence, have helped to mitigate the impact of wage increases on inflation, particularly in the services sector. Core inflation, which excludes food and energy prices, is indeed falling, but at a much slower pace.

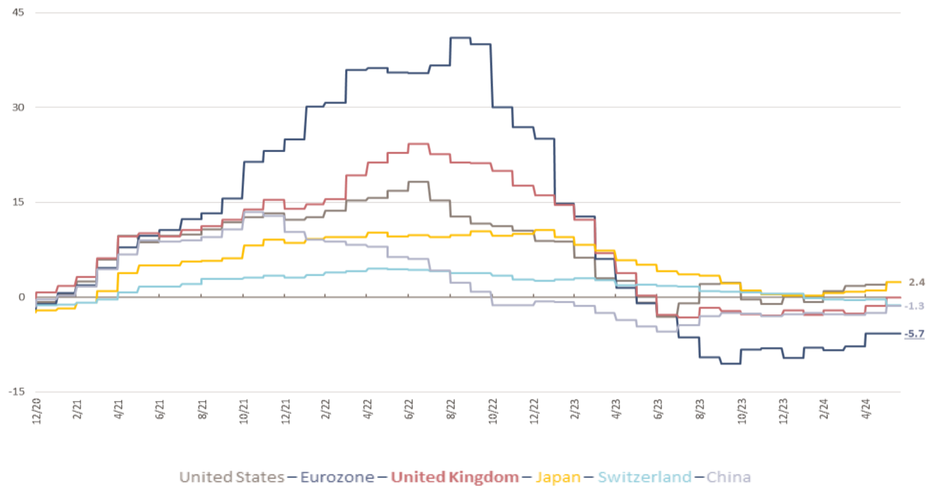
In the euro area, inflation is likely to hover around current levels in the second half of the year before converging towards the European Central Bank's target in the course of 2025. Looking at the various components, we should see the same trend for energy commodities and food. The non-energy and non-food version of the HICP is expected to remain above headline inflation for the next two years. The central assumption of this projection is explained by wage adjustment pressures in a still tight labour market. However, these are expected to be partly offset by productivity gains. As a result, the average annual rate of headline HICP inflation is projected to be 2.5% in 2024, 2.2% in 2025 and 1.9% in 2026.

In Japan, the nationwide core CPI rose 2.6% y/y in March, while the Tokyo core CPI rose 1.6% y/y in April, down sharply from +2.4% in March. Given the recent trend, inflation expectations have been revised down slightly, with core CPI expected to be 2.6% in FY2024 (down from 2.8%) and 2.0% in FY2025. In the shorter term, however, pressures remain on the upside, and we could see releases in the upper 2% range, partly due to the removal of subsidies on electricity and gas tariffs.

In China, the economy continues to suffer from the lingering negative effects of the real estate crisis, which is undermining business and consumer confidence. The Chinese authorities have announced measures to support the sector in the hope of boosting consumer confidence.

The latest release of core inflation figures, which strip out the most volatile elements such as food and energy prices, confirmed the scale of the challenge facing Beijing in its efforts to stimulate domestic demand. Inflation rose 0.6% y/y in May, down from 0.7% in April. For the rest of the year, the persistence of industrial overcapacity should mean very modest consumer price growth, averaging 0.5% for the year.

Exhibit 6: Producer Price Index (y/y, %)

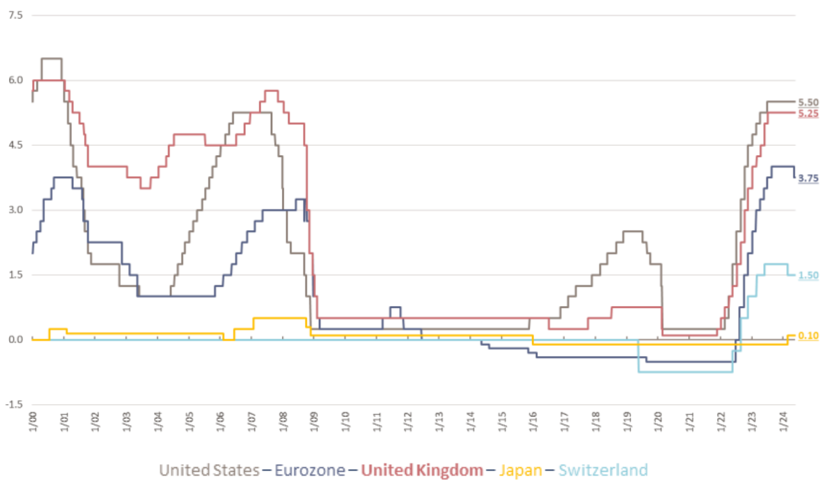


Source: Bloomberg

Monetary Policy Outlook: Fewer Cuts than Previously Estimated

In a desperate attempt to counter the dizzying rise in inflation following the financial crisis, the major central banks have embarked on an unprecedented and coordinated steep rise in their key interest rates. 2023 will mark the culmination of these increases, as well as an inflation point for expectations of possible and desired rate cuts in 2024. Of course, these expectations have been tempered by the resilience of the US economy, and we are now entering a phase of monetary policy divergence with the European Central Bank's first cut, reflecting a different disinflation cycle.

Exhibit 7: Policy Rates (%)



Source: Bloomberg

At its June meeting, the Federal Reserve left its key interest rate unchanged at a 23-year high of 5.25% to 5.5%. This more hawkish tone in terms of the number of rate cuts, with the Fed now expecting one cut this year, and the timing, with the market pricing in a 60% change for a September cut, is a logical response to the lack of progress on the inflation reduction front seen in recent months.

Delivering a hawkish message is undoubtedly a way for the Fed to avoid a euphoric reaction from the markets, as seen in the fourth quarter, and to take into account the still loose financial conditions. Indeed, when the encouraging inflation figures were released on June 12, the immediate market reaction - a fall in long-term interest rates and a sharp rise in equities - was equivalent to two-thirds of a rate cut.

Exhibit 8: US Financial Conditions

Source: Bloomberg
NFCIINDX Index: Chicago Fed National Financial Conditions Index

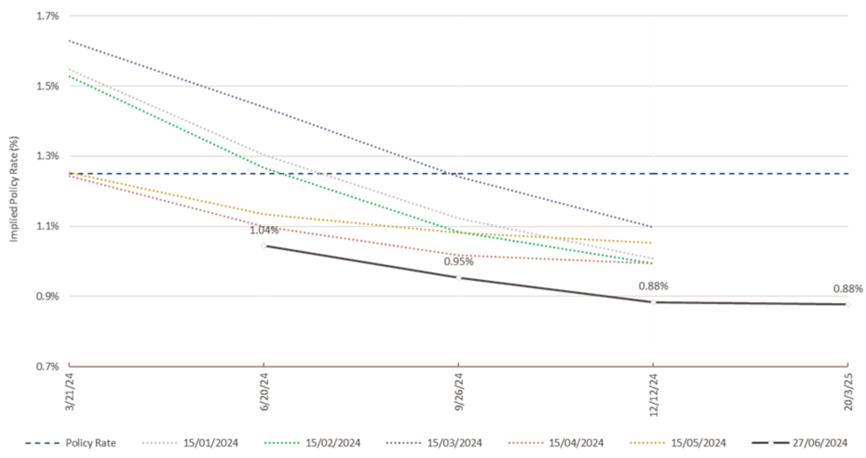
The U.S. economy remains on solid footing for now, including the labour market, but it's clear that some consumers are feeling the pinch as borrowing costs for everything from car loans to mortgage rates remain high. The new rate projections not only reduced the number of rate cuts expected this year, but also raised the long-term "neutral" rate needed to keep inflation in check while maintaining steady growth.

In June, the ECB joined the central banks of Canada, Sweden and Switzerland in cutting interest rates for the first time in nearly five years, signalling a shift away from its restrictive policy. This decision was made in response to falling inflation, although recent publications have cast some doubt on this decline. Despite this move, the ECB has remained very vague about its next steps, reiterating that rate cuts will be data driven.

Following the announcement, and particularly the lack of clarity surrounding the upcoming decisions, the market has adjusted its expectations for further rate cuts this year, with the odds of a cut in September and December now roughly equal.

In line with market expectations, the Swiss National Bank (SNB) lowered its key interest rate by 25 basis points to 1.25%, the second cut this year. The SNB cited easing inflationary pressures and the strength of the Swiss franc. A third-rate cut is likely this year, probably in September, if conditions permit.

Exhibit 9: Implied Policy Rate (%)



Source: Bloomberg

Fixed Income Valuation: All About Yield Curve

At mid-year, both short- and long-term interest rates (bond yields) are near their highs, reflecting the persistence of core inflation, particularly in the US. Bond investors are therefore faced with still high policy rates, particularly in the US, and a high degree of uncertainty about the timing and magnitude of future rate cuts. As a result, short-term investments, including leveraged loans, have performed well so far, while the conventional bond market, which has a broader interest rate component, has had more mixed results.

The relative stability of policy rates at their highest levels in two decades and the narrowing of spreads to the lower end of their historical range have made bonds an attractive asset class from an all-yield perspective. The current dominance of the interest rate component in expected returns has increased the importance of yield curve smoothing.

For the second half of the year, the credit segment fully reflects a balanced macroeconomic context, with growth close to potential and a gradual decline in inflation, which will give central banks more room to cut interest rates.

We started the year favouring corporate bonds, especially high yield, and were cautious on core fixed income, mainly due to market expectations of rate cuts. Since then, market expectations have adjusted, with at most two rate cuts in the US, the first in September. At these levels, we think it would be a good idea to increase our exposure to the intermediate part of the curve in order to benefit from its steepening.

At the same time, the increasing signs of slack in the US labour market, with its implications for inflation and growth, lead us to protect ourselves against a resurgence of recessionary fears or an unforeseen shock by taking a position at the long end of the curve (10 years +).

On the credit side, our position is more balanced, with investment grade, market duration and modest duration in high yield. For the rest of the year, we also think it would be a good idea to strengthen our geographic diversification, which we are doing by increasing our allocation to hard currency emerging market corporate bonds.

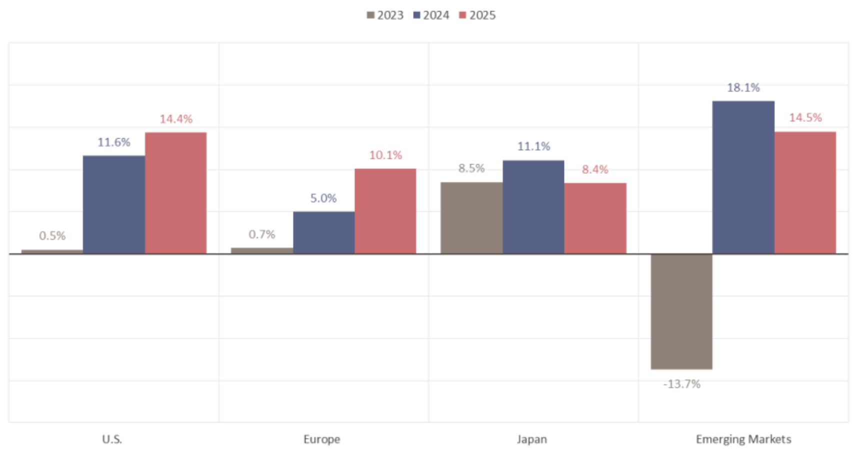
Equity Valuation: Look for Earnings Growth

After a strong start to the year, the consensus view on economic growth for the rest of this year and through 2025 looks quite supportive for equity markets. There are certainly risks that could derail this context of growth around potential, thanks to a healthy labour market that will support household consumption. The prospect of an expanded group of central banks in easing mode will also help. Finally, the solidity of corporate earnings suggests that the second half of the year will be a good one.

The Wall Street consensus is for earnings growth of more than 10%, perhaps a bit optimistically, with an acceleration through 2025. The bar is clearly set high, leaving the door open for disappointment. Outside the US, earnings growth is clearly lagging, with the exception of emerging markets.

In terms of valuation, the US market is trading well above its historical average over the past decade. Europe continues to trade below its historical average, while Japan is now trading above its historical 10-year P/E. As for emerging markets, their valuations are in line with those of the past 10 years.

Exhibit 10: Annual Earnings Growth



Source: Bloomberg,Capital Group, FactSet

US Equities: Valuation Overstretched

The S&P 500, widely considered the best single gauge of large-cap U.S. equities, is up nearly 14% this year and the Nasdaq 100 is up 16%, driven largely by a handful of mega-cap tech stocks. The current bull market is now 20 months old and has generated a gain of more than 50% from the lows of October 2023.

As nominal GDP growth slows, double-digit earnings growth becomes harder to achieve. Historically, when nominal GDP growth is between 4-6% - where it is today - earnings growth has averaged around 5%!

After reporting (year-over-year) earnings growth of 1.0% in 2023, analysts collectively forecast year-over-year earnings growth of 11.3% in 2024 and 14.4% in 2025. Removing the Magnificent Seven reveals that earnings have been flat since 2022.

If achieved, it would be only the third time in the past 15 years that the US large-cap index has posted double-digit earnings growth for two consecutive years. These expectations are very ambitious and leave little room for disappointment given current market valuations.

Current valuations appear stretched, with the index trading at a current P/E ratio of 23.0, above the median P/E ratio of 19.1 since 1990. Of course, valuation is not an indicator of timing, but a correction would not come as a big surprise given the macro backdrop, the November presidential election and rising geopolitical risks.

Exhibit 11: Valuation Metrics

		2024	2025	2026
U.S. Large Caps	EPS Growth	11.6	14.4	12.0
	P/E Ratio	22.5	19.7	17.5
	PEG	1.4	1.2	1.1
European Large Caps	EPS Growth	7.0	10.1	8.9
	P/E Ratio	14.1	12.8	11.8
	PEG	1.3	1.2	1.1

Source: FactSet

European Equities: Optimistic in a Pro-Cyclical Context

Before the outcome of the European elections and the unexpected dissolution of the National Assembly in France, the outlook looked brighter. The gradual decline in inflation allowed the ECB to start easing monetary policy, while the Fed remained on hold.

Rising consumer confidence in Europe and further interest rate cuts should support household spending. In addition to the expected rebound in consumer spending, the composite PMIs and especially the manufacturing PMIs, which are reliable leading indicators of future economic growth, have continued to recover and are now in expansionary territory since March 2024. A favourable business and investment environment.

Investment convictions: 2H 2024

#1 – Long-Dated Government Bond: Yield with Hedging Attributes

After predicting a recession for the whole of 2023, partly due to the impact of rising interest rates on the economy, leading to an inversion of the yield curve, which historically heralds a recession, forecasts have moved away from this prediction, recognizing that this cycle may have been altered by the measures taken in the COVID era.

However, it seems to us that the 10% probability attached to the risk of recession could be revised upwards. In fact, so far a slightly weaker release has been seen as good news, as it increases the probability that interest rates will fall. However, if we were to enter a softer phase, we could see a reassessment of the probabilities of each scenario.

After major market rallies and rebalancing, it seems appropriate to review the intrinsic attractiveness of each asset class, the strategies and their interaction with the rest of the portfolio. After several quarters of absence, government bonds are back, offering a decent yield and, above all, the ability to protect against turbulence and market downturns.

How to maximize performance when the yield curve changes?

After credit, the success of the bond portfolio's performance undoubtedly lies in the management of curve dynamics. Initially presented as the trade for 2024, the steepening trade turned out to be a flop. The constant postponement of US rate cuts was a headwind for this position. Even though swap contracts are pricing in a September cut, if the steepening does not happen quickly, it will not be easy to achieve positive performance in this trade due to carry costs.

After a historic bear market in long-term bonds ended in October 2023, the rally was short-lived as the early months of 2024 brought renewed scepticism about the continuation of the disinflationary trend and hence the expected rate cuts in 2024 and 2025. As we have said before, long-dated bonds will rise sharply if recessionary risks reappear, or disinflation accelerates. We therefore think it would be prudent to build a position in this segment, not only to secure an attractive yield but also to benefit from an acceleration in the decline in inflation and, ultimately, from a more pronounced economic slowdown.

#2 – Emerging Market Corporate Debt (Hard Currency): Attractive Yield and Fundamentals

After a favourable first half for emerging market corporate credit, we are adding this thesis to our high conviction list for the second half as the potential for high value creation remains intact. The tailwinds are still in place: an attractive yield, robust and broad-based global growth and central banks that have started their easing cycle to provide support.

On the growth front, the growth differential between emerging and developed markets, commonly referred to as the "economic growth premium", is likely to become more pronounced in the second half of 2024.

Historically, the widening of this growth premium has led to broadly positive returns for emerging bond markets, particularly for corporate issuers, as shown in the returns achieved between 2002 and 2023 below:

Exhibit 12: Average Annual Return during years of accelerating EM GDP growth premium

Emerging Market Corporate Debt		
Investment Grade (IG)	Market	High Yield (HY)
6.6%	7.9%	11.9%

Source: Source: J.P. Morgan, Bloomberg as of December 31, 2023

While the timing and extent of the Fed's easing cycle remains uncertain, the emerging market debt segment has historically performed well when US interest rates are falling. As such, the Fed's expected rate cuts, even if delayed until September, will provide an additional catalyst and traction for investor flows.

EM corporate balance sheets are strong with leverage that compares favourably with the US equivalent, e.g. net leverage of 1.0x versus 2.8x for IG and 2.3x versus 3.5x for HY. They therefore offer better yield, spread and fundamental risk characteristics that make them particularly attractive on the eve of a cycle of monetary easing by the Federal Reserve.

Exhibit 13: EM Corporate Metrics

	Yield to Worst (%)	Modified Duration (years)	Spread (bps)
EM Corporate HY[2]	8.96	3.44	485
US Corporate HY[3]	7.93	3.98	296

Source: Bloomberg, Amundi as of May 31, 2024

#3 – « EU Fantastic Five »[4] preferred over «US Magnificent Seven »[5]

When we talk about growth companies, we often refer to the most influential companies in their geographic area-the Magnificent Seven (Mag 7) in the U.S. and the Fantastic Five (Fan 5) in Europe.

[2] J.P. Morgan CEMBI Broad Diversified Non-IG Index (as of May 31, 2024)
[3] S&P U.S. High Yield Corporate Index (as of May 31, 2024)
[4] ASML holding, AstraZeneca, Novo Nordisk, LVMH and SAP
[5] Apple, Alphabet, Amazon, Meta, Microsoft, Nvidia and Tesla

The Mag 7 are heavily exposed to the technology sector and are at the forefront of the artificial intelligence and cloud computing revolutions. In contrast to their U.S. counterparts, the Fan 5 consist of five global leaders that are diversified across sectors, providing exposure to healthcare, technology, and consumers, as well as countries.

Historical earnings growth has been stronger for the Mag 7 thanks to Nvidia's exceptional growth. But what about forward earnings growth? Consensus forecasts call for Fan 5 to outperform Mag 7, with earnings growth of 18% per year over the next three years, compared to 14% for Mag 7. The fastest earnings growth in the European basket is driven by Novo Nordisk's advantage in the fast-growing market for GLP-1 diabetes and obesity drugs.

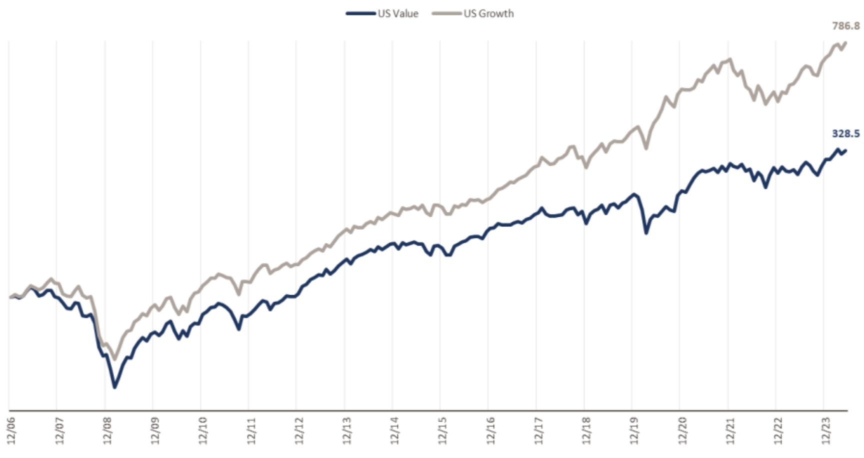
Contrary to what we might think, the Mag 7 is slightly cheaper on consensus earnings estimates for 2024, trading at 32x forward earnings versus 34x for the Fan 5. Thanks to its superior growth over the next few years, the Fan 5's P/E multiple will rapidly decline to parity by 2025 and then to a discount thereafter.

In this context, the Fantastic Five have a role to play in a portfolio as they offer complementary resilience characteristics and a less exuberant profile than the Magnificent Seven.

#4 – Adding Some Diversification to our Portfolios

Since 2007, economic conditions have created an environment in which, with the notable exception of 2022, growth stocks have flourished while value stocks have lagged miserably. This phenomenon has been exacerbated by the impressive performance of a limited number of growth stocks, such as the Magnificent Seven in the US and the Fantastic Five in Europe. The dichotomy of results between these two approaches has reignited the debate among investors about the merits, if not the raison d'être, of the value approach.

Exhibit 14: US Value and Growth Index Total Return



Source: Bloomberg, FFGG calculations

What is the possible origin of this discrepancy?

After more than a decade of low interest rates, 2022 marked the end of this paradigm, which has supported and favoured long-term assets such as equities, and particularly the subset of growth companies. The initial phase of the rapid and unprecedented rise in policy rates had a significant impact on the share prices of technology companies at the start of this monetary tightening cycle.

Many thought that 2022 would be the year of reckoning. This proved to be the case as the global growth index plunged by almost 30%, while the global value index lost only around 8.5%. Unfortunately, the comeback was short-lived, as the following year the growth index posted an impressive performance, with a gap - second only to 2020 - that was the largest in 25 years.

By the end of 2023, value stocks were the cheapest segment of the market. This was even more pronounced in the small-cap value category. After years of dominance by large-cap growth names, it's probably time to consider adding some diversification to our portfolios.

#5 – European and US Mid/Small Caps: Primed for a Rebound

One of our convictions in the first half of the year was to reiterate our belief in the opportunity presented by small and mid-cap companies. Why maintain that conviction after a very contrarian six months for this market segment?

Over the last 2.5 years, both in the US and in Europe, small and mid-caps have underperformed the main indices such as the S&P 500 and the Stoxx 600. The size of the performance gap is partly explained by the exceptional performance of a limited number of stocks.

This situation is partly due to high inflation, which has forced central banks to raise interest rates to curb this phenomenon, leading to an increase in the cost of debt and therefore the cost of capital. The new interest rate environment has had a disproportionate impact on small and mid-cap companies, which often have weaker balance sheets, more short-term financing and less pricing power. As a result, they have been perceived as riskier by investors, who have turned to the greater security offered by large caps.

The success of central banks in fighting inflation should allow for some monetary easing, which has already begun in Switzerland and the eurozone. This easing should directly support mid/small caps by reversing the trend in interest costs and thereby rekindling investor interest.

Having long traded at a premium to large caps, recent relative performance has reversed the trend, with small-caps now trading at a discount. This situation is clearly out of line with historical norms and, while somewhat contrarian given the focus on mega-caps, offers undeniable catch-up potential for the second half of the year.

Asset Class Views – 2H 2024: Shifting to Neutral

Asset Class

	H1 24	**H2 24**
Cash	=/+	**+**
Fixed Income	-/=	**=**
Equity	+	**=**
Alternatives	-/=	**-/=**
Currencies (USD vs. G10)	=	**=/+**
Commodities	-/=	**-**

Fixed Income

		H1 24	**H2 24**
Government Bonds	US	=/+	**+**
	EU	=/+	**+**
	UK	=	**=**
	CH	-	**=**
Corporate Bonds	US IG	+	**+**
	EU IG	+	**+**
	US HY	+	**+**
	EU HY	+	**+**
Emerging Market Debt	Sovereign HC	-/=	**=**
	Sovereign LC	=	**=**
	Corporate IG – HY	+	**+**

Equity

		H1 24	**H2 24**
U.S.	Large	-/=	**-/=**
	Small	=/+	**=**
Europe	EU Large	=/+	**+**
	EU Small	+	**+**
	CH Large	=	**=**
	CH Small	+	**+**
	UK	=	**=**
Others	Japan	-	**-**
	China	+	**=/+**
	India	=	**=**
	Other EM	=	**=**

(-) Underweight, (=) Neutral, (+) Overweight

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The Forum Finance Group SA
65, rue du Rhône — CH-1204 Geneva — P.O Box 3309 — CH-1211 Geneva 3 — T +41 22 552 83 00

FFGG.COM