Stenella PARTNERS

Summary of the third quarter 2024

Actor, humorist and philosopher Will Rogers once said: "There have been three great inventions since the beginning of time: the fire, the wheel and the central bank".

The third quarter of this year was marked by many diverse interventions by this third invention of modern times.

First of all, in Japan, the BoJ's surprise rate hike triggered adjustments linked to the end of the *carry trade*[1] .

Then the ECB rate cut of 25bps, for the second time this year, while lowering its growth forecast to 0.8% from 0.9%.

Then came the Fed, which made a "jumbo cut" in rates by 50bps, bringing effective rates down to a range of 4.75% - 5%, confident in economic growth and its ability to continue lowering inflation towards the 2% threshold.

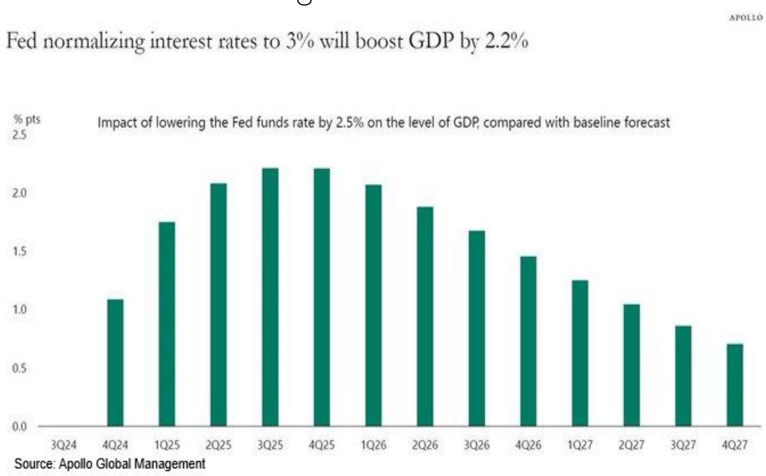
And finally, China's POBC surprised with a long series of very accommodating measures (lowering key rates, lowering reserve requirements for banks, which will inject $140bn into the economy, etc.).

While the effects of fire and wheel are well known, those of the third are more uncertain, as they can take a long time to diffuse into the real economy...

While it is generally accepted that injections of liquidity and rate cuts in financial markets contribute to its rise, we believe that they remain support measures.

Where do we really stand?

Once again, Mr. Powell did an excellent job in preparing the market to accept the idea that a 50 bps cut was not an emergency cut, judging growth to be solid and inflation to be on the right track. The justification for the rate cut is that it guarantees future US growth. Indeed, estimates suggest that the return to rate at the 3% level could provide a 2.2% boost to US growth.

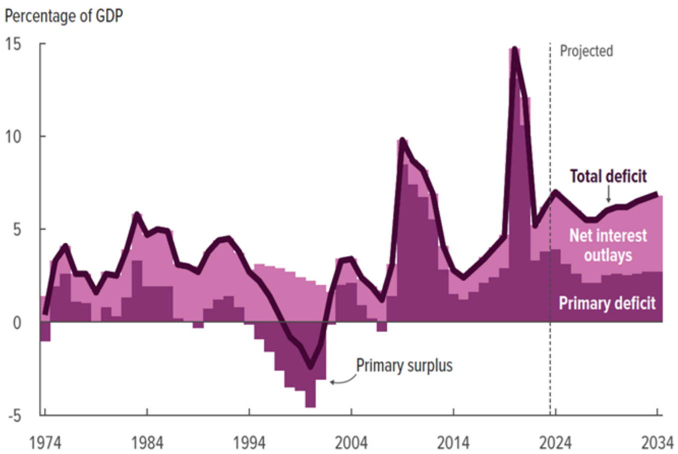


[1] Play on an interest-rate differential, in this case borrowing at a negative rate in yen and investing at the risk-free rate in $ or €.

Powell has made a risky bet: boosting economic growth while risking a return of inflation...

Remember that inflation lowers the real level of debt... so perhaps it's not such a bad thing when debt is over $33trn and interest charges are $890bn...

Be that as it may, the level of debt is certainly a cause for concern, as it is historically very high in absolute terms, but not unprecedented in relative terms (as a % of GDP).

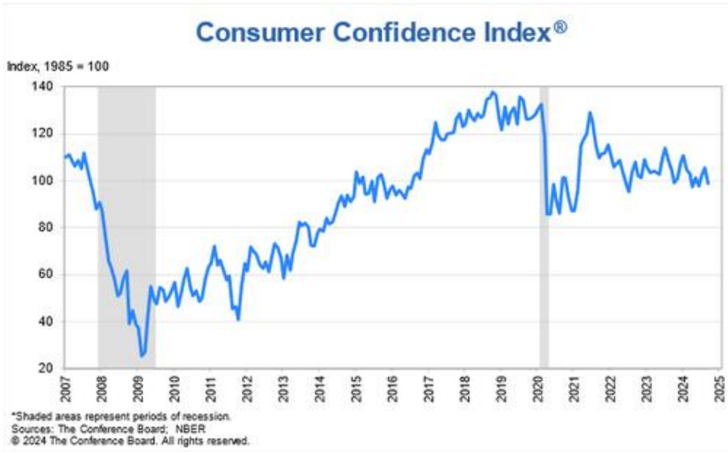


The "goldilocks" scenario is therefore materializing on the markets, with the spectre of recession receding and favoring a soft landing.

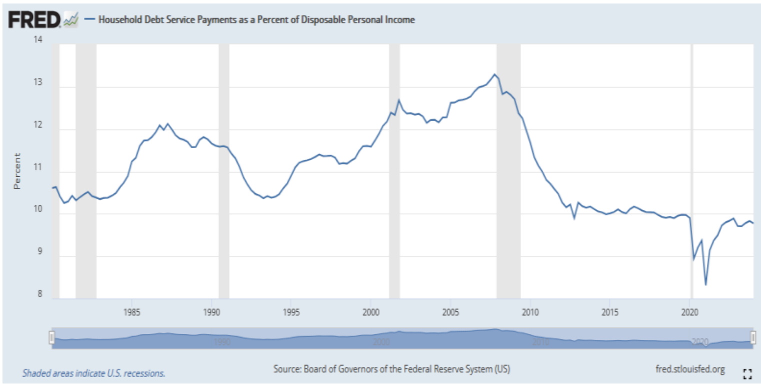
Once again, we remind you that around 68% of US GDP comes from consumption, while 20% comes from investment and 17% from government spending. The US has a negative trade balance (-5%).

<u>The consumer is therefore the key to US growth, and the cornerstone of the markets</u>.

Firstly, it seems that consumer confidence remains at high levels, certainly because of a financial market that regularly beats its all time highs (US households are heavily invested in equities), an election campaign in full swing and expectations of Fed rate cuts.



Moreover, household indebtedness remains at an acceptable level, with relatively low default rates and no particularly upward trend. Household debt servicing remains healthy.



The decisive factor is therefore the strength of employment. The unemployment rate stands at 4.6%, while slightly increasing, it is is not sufficient to define a sustained underlying trend. Households also seem more inclined to resort to multiple jobs (including temporary ones) in order to make up for price increases following the inflationary period.

The unemployment rate alone is obviously not the indicator to follow, as it is not predictive in nature. However, it would seem that we are seeing an acceleration in job rotation and an increase in the number of unemployed per vacancy (Jolts survey).

While there doesn't seem to be much cause for concern about the state of the US economy at the moment, the FED is in support, as reaffirmed by Mr Powell, and the US political calendar implies few coercive measures on the economy.

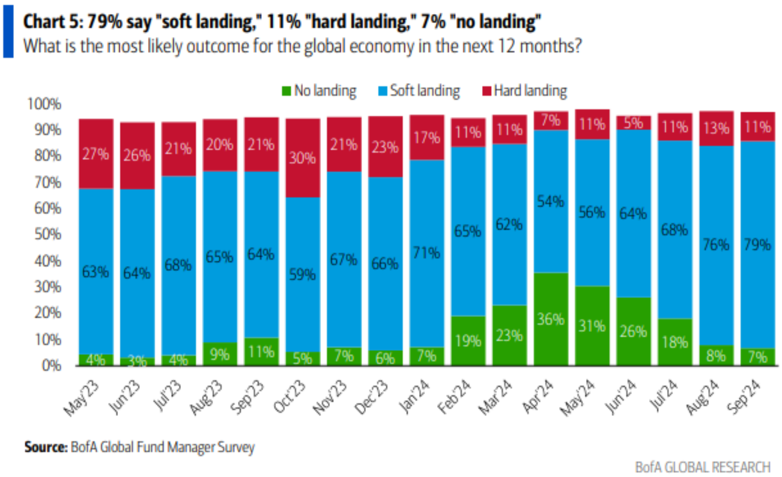
We remain cautious, however, as the past has repeatedly shown that employment can deteriorate very rapidly. We are paying close attention to activity indicators and weak signals, and we have been observing disparities in their behavior over the past few weeks.

The old continent is, as usual, in troubled waters, with economic growth at half-mast, impacted by the recession of the German "locomotive". In France, the Barnier government has already to cope with a colossal debt, assumptions being more in favor of new taxation than budgetary rigor, one or the other will necessarily have an impact on the country. Note that french debt is now trading at higher rates than its portuguese neighbors, and close to those of the greeks (on the 10-year rate).... The ECB's attitude will be decisive, and we expect it to follow in the FED's footsteps, as usual, with at least one 50bps rate cut between now and the end of 2024, with mid-October being the most likely.

Impact on markets

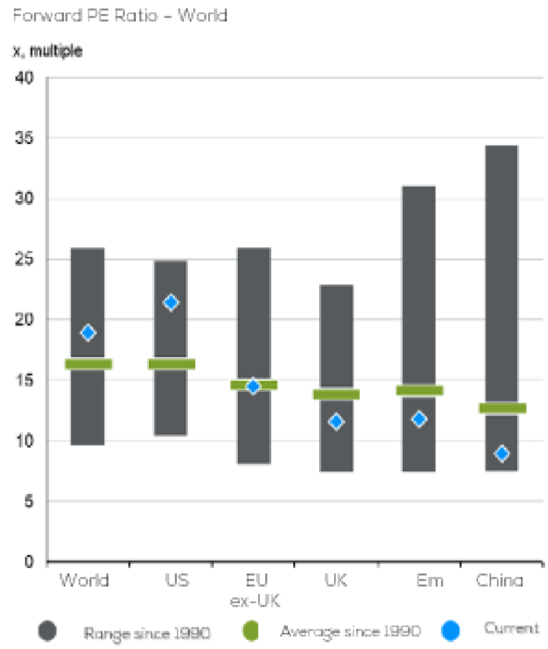
The japanes carry trade unwiding let to a drop in the market (-up to -10% on the major indices), which was indeed an opportunity to reinforce one's exposure. Hedging adjustments (some $20,000bn traded in a few days...) were quickly absorbed, a sign that market liquidity and risk appetite are alive and well.

The yield curve has finally steepened again (long rates > short rates), suggesting that the market is optimistic about the announced softlanding. This is indeed the prevailing mood, with most managers anticipating (or hoping for...) this scenario.



We are therefore warning against a possible market complacency, reminiscent of the euphoric phases preceding major regime changes...

In this context, we would point out that valuations, especially in the US, are stretched, at 23x expected earnings versus a historical average of 17x, but especially a maximum of 25x. With earnings growth unchanged (i.e. +15% by 2024) and in a "goldilocks" scenario, it is no longer unthinkable that the S&P could reach 6,300 points, which would reflect the maximum PE of 25x...reached in 2000 and 2008.



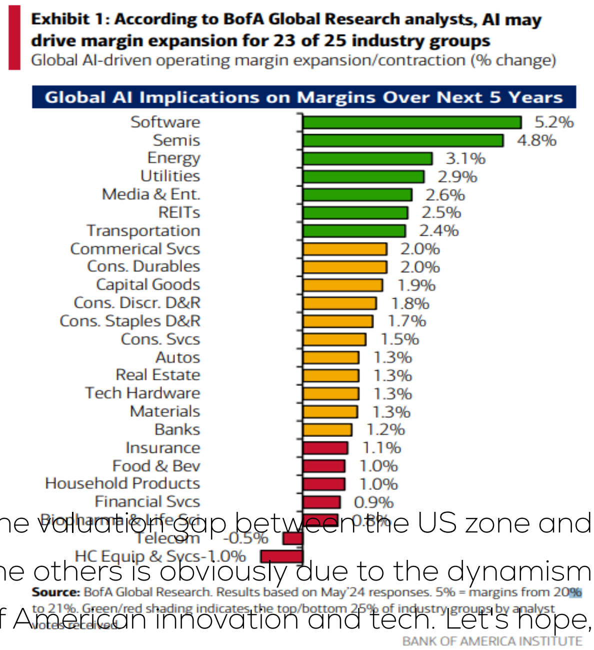
Source ; JP Morgan

The expansion of US multiples could be catalysed by a strong upturn in growth, a rapid fall in inflation, or a post-election effect.

A growing use of artificial intelligence applications by companies should be a real catalyst for the progression of operating margins. While adoption is relatively slow,

many players are still evaluating the real impact of implementing these new tools, which will obviously be a challenge as the integration of new systems can be difficult, especially in large organizations.

Margin progressions are obviously very disparate between sectors, our conviction is that we are only use cases and solutions are multiplying, and that technology is progressing day by day..



The valuation gap between the US zone and the others is obviously due to the dynamism of American innovation and tech. Let's hope, however, that the US leads the rest of the West, and that China rises from its abysmal lows following the support measures announced at the end of the quarter.

Our positioning

It's a time of relief, under the auspices of the Central Banks and their eternal support for an economy increasingly awash in liquidity.

Our cautiously optimistic positioning translates into a balance struck between different geographies, risk factors and styles. Thus, while we are heavily exposed to the US to take advantage of its capacity for innovation and economic dynamism, we are also balanced on more defensive/rate-sensitive sectors (consumer staples, utilities). Our exposure to Europe is similar, with a view to rationalizing the various pockets of risk.

We had increased our exposure to China since March, in anticipation of Beijing's measures, thus contributing to the strong performance (+24% since the 09/23 announcements). We also "took advantage" of the air pocket created by the Japanese episode in August to strengthen the non-cyclical and value parts of the equity portfolio, which also performed well in an environment of sector rotation.

On the bond side, we favored the short end of the yield curve, while gradually and marginally strengthening the corporate and high-yield portions (which are riskier than sovereign bonds), while maintaining a moderate duration (6 years on average), reflecting a will to maintain exposure, in a rate decreasing/macro weakening environment. We have kept an inflation-indexed pocket, predominantly US, to safeguard against a return of inflation.

Against this backdrop, performance at the end of the quarter was as follows :

Profile	Security	Prudent	Balanced	Dynamic
Perf 24	3,94%	10,20%	11,40%	13,06%
Risk[2]	1,66	3,44	3,91	4,41

Performance by asset class was mixed, with the equity portfolio up by around 15%. Bonds were up 2.9%, while crypto was up 3.5%, reflecting its volatility.

Considering that the market is partly "priced for perfection", we remain cautious, as market reactions are likely to be violent if disappointments arise from macro figures deemed to be light, or from corporate earnings downturns, not to mention potential exogenous shocks (Ukraine-Russia war, Middle East ablaze, renewed tension between China and Taiwan...).

The two previous phases of rapid rate cuts, in 2000 and 2008, were the precursors of sudden and violent stock market shocks. Comparison is no reason, however prudence remains a valid strategy, given the many uncertainties and the significant restoring forces. In Q4, we will therefore begin a phase of active hedging of the equity portfolio in order to protect performance by reducing the net exposure.

Although the mood remains upbeat, Keynes's barbaric relic (editor's note: gold) is at its highest level ever, a sign that safe-haven assets remain attractive.

Crypto-assets

The crypto universe is not experiencing the same craze as last year, at least in terms of price progression. We're seeing digital gold react very sharply to central bank announcements. However, the structural

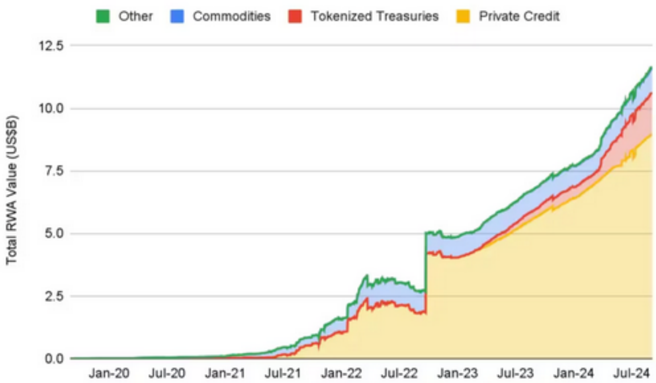
[2] Priips methodology

trend towards adoption is very much in evidence.

We're also seeing a shift in the attitudes of the major commercial banks, who as well as creating new products backed by the biggest cryptocurrencies, appear to be rolling out solutions for their customers.

Bitcoin is also at the heart of the US election campaign, with statements from both candidates in favor of blockchain technology...

While the adoption trend remains marginal, with tokenization of real assets "only" reaching $10bn, we believe that the growth of this underlying is still in its infancy and should continue, as use cases multiply and are discovered.



Valeur marchande des RWA onchain. (Binance Research)

Finally, the SEC, through its chairman Mr. Gensler, has authorized the trading of crypto ETF options, and classified bitcoin as a commodity, not a security.

<u>This has major implications:</u> it validates the concept of decentralization and the absence of a central authority benefiting from its exploitation.

We continue to take a positive view of the position of the regulator, who, unlike regulating, could have prohibited.

Central banks' forthcoming injections into monetary systems are contributing to a recovery in digital asset prices. Once again, we are positioned to capture some of the upside, but will remain extremely vigilant for any signs of a runaway trend.

Conclusion

Overconfidence leads to disasters, and overcautiousness brings no material changes. If this paradigm is true for the financial world, it is equally true for any business, and even for everyday life;

Stenella Partners' aim is to navigate the financial markets pragmatically and rationally. This flexible, sophisticated and optimized management approach, combined with tax optimization, is a powerful tool, made possible by the architecture of Luxembourg contracts,

Creating value by moving into uncharted territory - that's the challenge facing every entrepreneur, and that's the challenge facing Stenella Partners. Our expertise in the financial markets, combined with our determination to rethink the business of traditional private banking, form the basis of our unique and original positioning. The value we create is the value we pass on to our customers, in the form of an alignment of interests that translates into improved performance and absolute transparency.

We close this quarterly review as we began it, with a quote from Will Rogers: "If you want to succeed, know what you do, love what you do and believe in what you do", which we believe is the key to success!

Bertil Aubrun

Chairman

Completed on 01/10/2024

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