Stenella
PARTNERS

2023 Review, 2024 outlook

Looking back to 2023

2023 began as a continuation of the uptrend of 2022. This initial rise was catalyzed by extremely low valuations (16x PE in October 2022), a still-resilient economy that continued to surprise on account of its strength throughout 2023, a return of inflation to encouraging levels, and finally expectations (more or less well-founded) of key rate cuts by the FED for 2024.

While it's true that equity market valuations were severely depressed at the end of 2022 and needed to catch up, the AI boom of 2023 has propelled US tech players to levels well above those seen in 2000 and 2008...

Global growth was also remarkably resilient, surprising many economists and coming in at 3%. US growth came in at +2.4%, thanks to a surprisingly robust labor market.

Inflation levels (both headline and core) peaked in June, and the downward trend continued unabated until December.

On the strength of this observation, the Fed opened the ball for the major central banks by announcing, not the end of its rate hike policy, but a pause, delighting the markets.

Against this backdrop, which was far less gloomy than anticipated at the start of the year, the S&P closed the year up 23%, at the same level as December 2021, its all-time high. The other indices also posted more than respectable performances.

Index	Performance
S&P 500	24,2%
Nasdaq	43,4%
Cac 40	16,5%
Stoxx 600	12,6%
€/$	3,20%

Our performance by allocation pocket

- On the equities side, our avowed caution led us to exit some positions as early as June/July 2023, coinciding with the near annual high. We have not re-exposed our portfolios to the lower interest rates that the market seems to have been forecasting since October, as we do not share this narrative. However, our tactical positioning (notably in real estate) has paid off. The performance of the equity portfolio amounts to around 20% over 2023.

- Our scenario of an increase in US key rates to 5-5.25% proved accurate in both level and timing. So, while we positioned ourselves on short rates at the start of the year, we began to build up a strong position on the long side, with an average entry at a rate of 4.8%, which enabled us to benefit from the rapid 100bps fall (i.e. +20% vs.

October high point). The performance of the bond portfolio amounted to 10% over the year.

- Our diversification within crypto-assets proved largely successful, with the pocket more than doubling in size with a performance of 122%, the main contributors being Bitcoin (+154%), Avalanche (+283%) and Chainlink (+146%). On the downside, we were not enthusiastic about Solana, which was up 900% over the year...

- Lastly, our cautious positioning has enabled us to take full advantage of the rise in interest rates on the cash portion, which pays around 3.5%.

<u>The performance of our portfolios by risk profile was :</u>

	Performance	SRRI*
Cautious	12.6%	3.4
Balanced	16.9%	3.8
Aggressive	20.8%	4.2

*Synthetic risk indicator max 7

<u>2024 scenario</u>

We remain more than cautious on equity markets at the start of the year, for several reasons:

- Firstly, we expect residual inflation to remain above the Fed's target for the long term. The market seems to be anticipating 6 rate cuts, as early as March 2024. True to the adage "don't fight the FED", we remain cautious and anticipate a first potential cut from June onwards,
- However, if there were an actual rate cut, we will remain extremely sensitive about it reason: a cut on the back of a low inflation is not equal to a cut for macro concerns..... the impact on the markets will obviously be very different.

Analysis of macro-economic factors does not seem to point to a return to vigorous growth in the months ahead, so regardless of market expectations, we believe that 3 scenarios are emerging for the new year, with their respective probabilities of occurrence:

- (i) Recession (cyclical or balance-sheet) 60% of sales

- (ii) 30% soft landing

- (iii) 10% No-landing

(i) Recession (60%)

Cyclical or balance sheet? This is the dichotomy that needs to be understood in order to adjust risk levels. Whatever the case, recession doesn't necessarily mean crisis in the 2008 style...

A "cyclical" recession starting in the second half of 2024, against a backdrop of slowing demand, falling employment and falling wages. This recession would have a limited impact, and would correct some of the excesses of overly accommodating monetary policies.

The temporary nature of this recession will be determined by the FED's ability to bring inflation down rapidly to the 2% target level, which is not yet a given. Indeed, the core component remains anchored at a high level, self-sustained by very strong employment and therefore high wages in a context of relatively normal participation rates. In addition, net household savings continue to fall, as US consumers draw on their savings to maintain their standard of living in the face of inflation.

With consumption accounting for around 70% of US GDP, we are cautious, even though the momentum seems to be reaching its limit... A drop in household consumption, following a fall in employment, will inevitably trigger a growth shock.

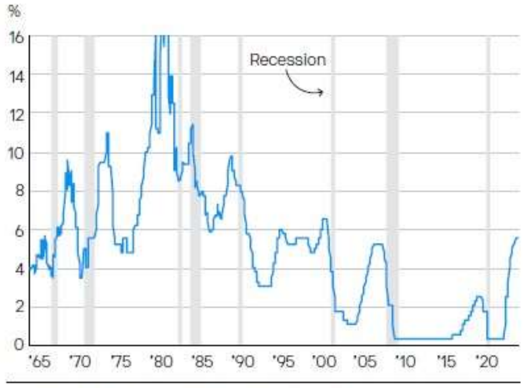
Macroeconomic leading indicators have continued to deteriorate over the last few quarters, leading us to believe that this is the most likely scenario. The difficulty lies in its unpredictability, but one thing is certain: the FED will not wait to act.

A "balance sheet" recession, triggered by excessive debt and interest charges, would have a much more severe and far-reaching impact. Between 2008 and 2022, the Fed's balance sheet grew from $1trn to $9trn. The rise in interest rates has obviously led to an increase in the interest charge, which has recently moved to the top spot in the US federal budget (beyond defence and social security). Although the FED has begun to reduce the size of its balance sheet ($7.8trn at the beginning of January), the interest charge remains colossal...

The US, thanks to its world leader position, can continue to run up debts, although budgetary adjustments to rebalance the balance will be necessary...but when? 2024 being an election year, it is unlikely that either candidate will have budgetary rigor/tax increases on their agenda. We therefore consider this scenario to be the least likely in the short to medium term.

In either recession scenario, the key will be the level of interest rates. The two important variables to consider will be: 1- when will the FED make its famous "pivot", and 2- what will be the attitude of debt buyers (e.g. China), who have shown less appetite in recent quarters...

We remain very cautious, as historically, a period of rapid interest rate hikes has always preceded a recession.



Source: Federal Reserve, LSEG Datastream, J.P. Morgan Asset Management. Periods of recession are defined using US National Bureau of Economic Research (NBER) business cycle dates. Data as of 15 November 2023.

Attributes of the recession scenario :

- A contraction in growth against a backdrop of falling employment,
- Inflation struggling to come down,
- But central banks will soon be taking action, with the FED in the driving seat.

While this scenario is central, we have adjusted our tactical positioning to take advantage of market downturns when they materialize.

(ii) Soft landing (20%)

A soft landing would occur if inflation were to fall sustainably below current levels and settle around the fateful 2% mark. This would follow a gentle contraction in manufacturing activity and resilience in US employment. The FED would then be in a position to make a rapid rate cut in line with its inflation targets. The effects of relieving financial pressure would fade very quickly, for governments and households alike, opening the door to a period of slowdown and an equally rapid recovery.

This is the scenario currently favored by the financial markets.

Attributes of the soft landing scenario:

- A soft landing of the economy, with no deep or lasting contraction,

- A rapid resumption of growth momentum,
- Up to 6 key rate cuts, starting in March 2024,
- A recovery in cyclical sectors and the most discounted equities, to the detriment of the Magnificent 7,
- More broadly, pressure on safe-havens (gold, $, etc.).

(iii) No-landing (10%)

This scenario foresees a rapid recovery of the Chinese and European economies, and a resilience of the US economy close to its current state. Inflation would remain a few points above central bank targets, maintaining the status quo on a potential rate cut.

Attributes of the no-landing scenario:

- Inflation remains high,
- Cyclical recovery ex-US,
- Transition from safe-haven to riskier but still high-quality assets.

Our tactical and strategic allocation

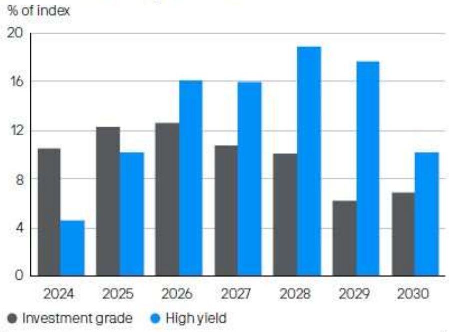
At the end of 2023, our preference remains for US sovereign investment-grade bonds. Our central scenario calls for lower growth and lower interest rates from mid-2024, so we have already increased the duration of our bond portfolio. Lower interest rates will help to boost bond valuations.

We'll be adding to the bond portfolio according to future developments, so we can't rule out adding High Yield or inflation-linked bonds depending on how the scenarios unfold.

What sets us apart from the market: we do not believe in 6 rate cuts as early as March 2024, and believe that long-term rates can be readjusted by around 25-50bps, hence our dynamic approach to this pocket. What's more, we remain wary of refinancing bonds maturing this year: indeed, if large buyers of Treasuries were to reduce their purchases, market rates would rise significantly.

Exhibit 14: The wall of refinancing

Global credit maturity schedule



Source: Bloomberg, BofA, J.P. Morgan Asset Management. Global Investment Grade: BofA Global Corporate Index; Global High Yield: BofA Global Developed Market Non-Financial High Yield Constrained Index. 2024 maturities include bonds that have now dropped out of the index given less than one year until maturity. Past performance is not a reliable indicator of current and future results. Data as of 15 November 2023.

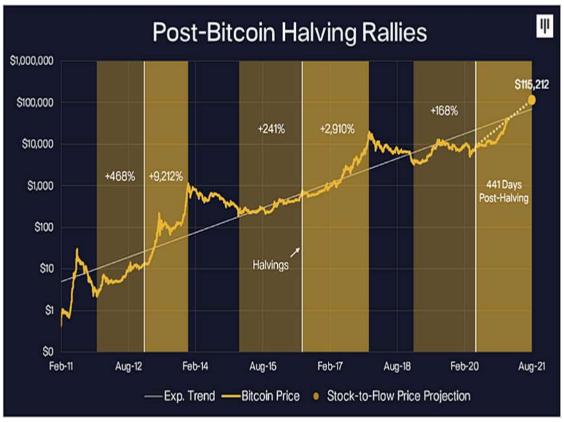
We believe that maintaining liquidity through cash instruments is a good idea, in order to build up a reserve that can be redeployed as risky assets correct, in a context of favorable interest rates.

As far as equity indices are concerned, we remain convinced that the recent rise, centred almost exclusively on a few large stocks, in reality masks a flight-to-quality situation in a context of persistently high liquidity. What's more, we believe that overall valuations are too high in view of future growth. As a result, we will be seeking to desensitize net exposure in order to take advantage of interesting future entry points, as well as new themes and sector exposures. We reiterate our positive view on India, and more moderately on the Philippines. We are less negative on European equities, notably due to a rhetoric essentially linked to valuations, even though the region's growth remains at half-mast; we are, however, underweight, as on other regions.

We expect 2024 to be a fairly volatile year, with market expectations of rate cuts. Our scenario calls for 3 rate cuts, starting in June, which is not currently the market's central scenario.

We believe that the market's optimism, which spent most of 2023 delaying the FED's final rate hike from month to month, will be repeated in 2024. Indeed, the same market is anticipating the first rate cuts as early as March...even though Mr. Powell has set his sights on June. So we need to remain tactical and reactive.

On the crypto-asset side, the fine performance achieved in 2023 is the fruit of 2 events: firstly, the possibility of creating cryptocurrency ETFs in the US, which will be decided by the SEC in early January 2024; and secondly, the occurrence of halving, which will be effective in April 2024. Halving has historically triggered a price boom.



Buoyed by Bitcoin's performance, we're taking some profits in order to secure and reallocate, notably on Ethereum and Avalanche. While the former is now a key blockchain player, the latter (like Solana) is becoming an increasingly effective competitor.

While the SEC's approval of ETFs in the U.S. has been a major driving force behind the market in recent months, it is not yet a done deal, and a delay would weigh heavily on prices. Conversely, the arrival of institutional capital would provide an exceptional boost to prices, for an industry that is still in its early days.

Finally, we are seeing the arrival of MiCA regulations and the status of PSAN as key elements. The advent of global regulation around cryptoassets should help make the adoption of blockchain technology credible in the eyes of investors. We continue to believe that this technology is a truly disruptive technology with the potential to bring about profound changes to the scale of internet adoption in the 2000s.

The year 2023 was exceptional: the performance of risky assets went far beyond what operators could have anticipated. This reminds us of the importance of remaining objective and dynamic, in order to take advantage of new trends (AI, high rates...), and to break out of dynamics that have been well lived.

2024 will certainly be another year of surprises (after all, they all are...), but we remain convinced that the only model that combines performance, risk control and alignment of interests is the one we propose. This trinity is the key to guaranteeing a dynamic, rigorous, opportunistic and therefore high-performance allocation. It is also the guarantee that we strive every day to seek out the best investment opportunities, challenging pre-established models in the service of developing your assets.

We wish you all the best for 2024!

Completed on 12/01/2024

Bertil Aubrun

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