PKB Investment Themes

January 2024

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PKB 2024 view

A period of instability is ending. The world is finally approaching a new normal.
According to the average forecast of economists, **inflation** in the US and Eurozone will finally come back to normal levels in 18-24 months. **Economic activity** will only stagnate for a few quarters and accelerate again. Central banks are set to ease their **monetary policies** from H2 2024.

This is encouraging and a credible outlook, as disinflation is well underway and central banks have room to offset unexpected falls in activity. It does not involve fractures, but risks and opportunities.

China could either regain its dynamism or continue to slowly slip into a deflationary spiral. Public debts in advanced economies may be consolidated in ways favourable to long-term growth or not. Some critical elections could generate disruptions in activity in the short-term and change long-term growth prospects.

Fair valuation and declining macro risks point to a **sideways** Euro/US Dollar. Looking cheap, the Euro / Swiss Franc has a **limited upside**, as the SNB will care again about imported inflation. In addition to protecting against **unforeseeable events**, Gold will be supported by the decline of real Dollar rates as the Fed relaxes its policy.

Following the rise of stocks in November and December 2023, we prefer to start 2024 **on a positive note** but without taking extreme bets in either direction, while constructively waiting for supporting catalysts.

Theme 1 - European bonds	***Value on credit on the belly of the curve*** Yields have rallied a lot in the last part of 2023; we expect a reality check before the central bank meetings in March/April, but the **downward trend** will remain in place. Credit risks have decreased, offering **attractive pickup on government bonds** **The belly of the curve (3-7 years) is the sweet spot**; it will offer participation when central banks start to cut, while the sensitivity in the event of a delay in central bank activity is offset by the buffer provided by yields. For the coming months, we prefer therefore to be **long credit** while avoiding excessive interest rate risk.
Theme 2 - Inflation	**Forecasts on inflation are too optimistic** **Market optimism** about the return of inflation to normal levels in the US and Europe could be partly tempered. The rapid decline of inflation observed in 2023 was mainly the result of **falling energy costs** and relaxing supply chains. The **stickier components** of inflation could decline more slowly than most forecasters believe. **Price risks** (energy transition, geopolitical tensions, globalization slowdown) are inflationary and, in our view, will lead to numbers between 2% and 3% rather than a linear continuation towards the Fed's 2% target.
Theme 3 – Japanese Yen	**BOJ's monetary policy transition is slow but will continue** The BOJ is slowly preparing the market for a change in **monetary policy** which could potentially have major impacts. Japan's economy is close to **full employment conditions** and entering the territory where inflation accelerates. The yen will remain **volatile**, due to the importance in carry trades, but over the year we expect a good **appreciation**. In 2024, the Japanese **equity market** may be perturbed by the BOJ's policy change and the resulting rise in the yen. They will still be supported, however, by structural factors. A **governance revolution** pushes companies to improve distribution policies via dividends and buybacks, so as to raise the still relatively low ROE and Price to Book ratios.
Theme 4 – Technologies	***AI & Robotics may create investment opportunities in 2024*** The past year has seen mass adoption of breakthrough technologies and generative artificial intelligence. We see opportunity as these technologies develop and use cases broaden. New technologies with the potential to disrupt large existing markets and to create new markets may create **investment opportunities in 2024**. Within the most disruptive and emerging technology companies, generative AI has the potential to unlock substantial value across the global economy. AI can help people **complete tasks** 25% quicker and improve their quality by up to 40%. Generative AI could account for **1% of US GDP by 2030**, if it were to grow at the same pace as software did in the 1990s.

Theme 5 – S&P 500 Equal Weighted	***Keeping a broader and balanced approach*** The artificial intelligence theme strongly favoured the **Magnificent Seven** last year. As often in the past, the rise in long-term growth expectations should be seen as temporary, not permanent as investors tend to believe. Alphabet, Amazon, Apple, Meta, Nvidia, Tesla, and Microsoft largely outperformed the rest of the market in 2023. The S&P 500 index rose by 24.2% and became even **more concentrated**, while the S&P 500 Equal Weighted only rose by 11.6%. We expect the **valuation premium** of the S&P 500 over the its Equal Weighted version **to shrink** this year and believe that switching to S&P 500 Equal Weighted represents a sound rebalancing strategy.
Theme 6 – Emerging Markets	**A different look at Emerging Markets** The pandemic highlighted the vulnerability of long supply chains. US-China competition increases risks of supply shocks. Onshoring and Friend-shoring will remain policy agendas for long. **Emerging Markets ex-China** represent therefore an attractive investment idea. Emerging markets ex-China have also a significant **commodity exposure**, in Latin America in particular. Growth in developed economies is set to reaccelerate in the second part of 2024, giving support to commodity markets. China's growth potential is declining due to a long list of structural problems. Growth remains however higher than in advanced countries. Those who believe that China's authorities will succeed in producing positive surprises in 2024 can take a **protected position** in **Chinese stocks**, whose valuations are depressed by historical standards.
Theme 7 – ESG	**A long-term approach which allows the investors to stay ahead of the evolving trends** 2023 turned out to be a lopsided market, with challenges for sustainability-focused investors in particular, as a host of clean energy stocks sold off while a very few AI-related stocks drove most of the market's returns. Higher rates raised costs for renewables projects, but waning interest rate pressure, policy tailwinds and improving economics strengthen the 2024 outlook for clean energy stocks, whose long-term prospects remain attractive despite recent macroeconomic headwinds. **Global decarbonization efforts remain a priority** as global consensus builds and acknowledges the necessary role that some heavier-emitting sectors can play. Innovation from public companies is key to improving life on earth and continually creates markets for long-term viable solutions, making sustainability investing as impactful as ever. Innovation is, of course, central to improving healthcare outcomes around the world. ESG factors will increasingly enable companies committed for a better world to generate higher returns in the long-term.

Theme 8 – Liquid alternatives

Uncorrelated to equities and bonds

Our current outlook is for hedge funds to produce a return stream in 2024 that outperforms cash and shows **no or low correlation to equities and bonds**. Given the high correlation of the latter two during the past two years, this should be a welcome diversification.

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