



Investment Strategy

January 2024



"THERE IS A BEAUTY THAT REMAINS
WITH US AFTER WE'VE STOPPED
LOOKING."

CORY RICHARDS,
PHOTOGRAPHER AND EXPLORER, WEARS THE
VACHERON CONSTANTIN OVERSEAS.


VACHERON CONSTANTIN | ONE OF
GENÈVE NOT MANY.

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INTRODUCTION

Letter to Investors - Investment Climate

- A highly volatile but ultimately positive 2023
- Radical change in stock market climate in Q4
- Pleasing deceleration in inflation offers new positive outlook
- An economic slowdown remains the central scenario
- New monetary policy paradigm for 2024
- More favorable environment for financial assets

The year 2023 ended with a particularly gratifying rise in stock market indices, but it was a highly volatile and difficult one to navigate for many investors and financial experts. It began with a degree of enthusiasm in January, as 2023 was supposed to be the year of recovery after a horrible 2022. But a series of bank failures in February quickly triggered a new crisis of confidence and called into question the stability of the US financial system, until the Federal Reserve intervened with liquidity injections of almost \$500 billion. The shockwave reached Europe and Switzerland, which was forced to organize an emergency rescue of its national banking system by offering UBS the opportunity to swallow CS, with the support of the Swiss Confederation and the SNB. Restrictive monetary policies and the ever-pessimistic comments of central bankers, who regularly raised the possibility of further key-rate hikes during the summer, then reinforced investors' fears once again, causing long-term yields to rise to as much as 5% on 10-year US Treasury yields. The consequences of this rise were massive for all asset classes. Equity indices (+7.88%) and commodities (+7.45%) erased most of their initial gains by the end of October, but maintained a positive performance, while bond indices (-3.38%) and real estate (-9.7%) plunged back into negative territory over ten months. In the end, the 4th quarter proved to be a saving grace, thanks to a fairly radical change in inflationary outlook and assessment of likely monetary policy trends. Having long feared further rate hikes, it became clear that the encouraging trend in inflation and the US labor market would certainly enable the Federal Reserve to adopt a less restrictive stance in the near future. Fears of rate hikes quickly turned to hopes of a rate cut by the 1st half of 2024, offering a new, more favorable outlook for the financial markets. Against this backdrop, the last two months of the year proved extremely satisfactory, with widespread price rebounds enabling the various asset classes to record positive performances. International equities ended the year up +23.79% (local currencies), while Swiss indices (+6.09%) remained penalized by the strength of the Swiss franc. Bond indices returned to positive results in Switzerland (+7.36%) and internationally (+5.72%), which also supported growth in securitized real estate globally (+8.67%) and in Switzerland (+5.03%). The prize for stock market recovery went to private equity, up +38.44%.

The year 2023 thus ended on a particularly volatile note, largely influenced by the extreme changes in economic forecasts and monetary policies that took place over the course of the year. The months of November and December thus played a decisive role in shaping overall performance, making a major contribution to the twelve-month result. Over the past few weeks, it has become increasingly clear that inflation is following an increasingly encouraging

trend, which will enable the various central banks to adjust their policies in 2024. In the United States, the fall in overall inflation and in indices excluding food and energy proved highly significant. By falling from 9% to just 3% in November, CPI came close to the Fed's target, a trend confirmed by November's negative monthly deflator (-0.1%), which reduced the inflation level of the main indicator observed by the Federal Reserve to just +2.6%. In Europe, too, inflation has decelerated more sharply than expected, underpinning the likely prospect of an end to this upward cycle in the USA, Europe and the UK. In the Eurozone, the -0.6% contraction in inflation in November lowered the year-on-year rise to +2.4%, while in the UK inflation declined by -0.1% to +3.9%. In both cases, these developments are particularly gratifying compared to the +10% rates recorded at the peak of 2022. At the same time, the fall in inflation has so far been achieved without causing a recession in either the USA or Europe. Consequently, the central economic scenario still seems to be that of a slowdown that will avoid a recession in the USA in 2024, even if one remains possible in Europe.

The year 2024 thus begins under new, more favorable auspices, both in terms of the assessment of inflationary risks and the likely evolution of monetary policies. Price trends are set to continue, with the various measures confirming that inflation is heading towards the central banks' target levels. The Chairman of the Federal Reserve now seems convinced that the US deflator could already be approaching +2.3% by the end of March 2024, and subsequently touch its target of +2%. By indicating that he would not wait for annual inflation to fall below his target before lowering his key rates, he was implicitly admitting that a first rate cut could come as early as March 2024. In our view, the ECB and BoE are unlikely to be so quick to ease policy, but the risks of further rate hikes in euros and sterling are now also very low. The first few months of 2024 should see the emergence and wider dissemination of a global scenario based on the belief that a recession will be avoided and that falling inflation will trigger an easing of monetary policy. The current level of yield curves only partially takes these factors into account. A further fall in yields therefore seems likely, although its amplitude will certainly be limited from now on. These developments should benefit bond markets, equities, real estate and precious metals.



Alain Freymond
Partner & CEO
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BIG PICTURE

Main Convictions

- Inflation gradually returning to acceptable levels
- Monetary policies on the road to normalization
- Soft landing scenario supports yield curve adjustment
- Positive outlook for financial markets

Inflation gradually returning to acceptable levels

The inflation figures published for November in the United States confirm the new regime that has been in place for the past fifteen months. The CPI of +0.1% follows a stagnation in prices (0%) in October, allowing the year-on-year measure to slip to +3.1%. Inflation is easing significantly, returning to an increasingly satisfactory monthly pace. The price index excluding food and energy has joined this trend, with a reduced rise of +0.3% for a still slightly high annual increase of +4%. Among the elements that are still holding up well, we find almost exclusively the « rents » component, which is holding back the general downtrend somewhat, but we can also see that services have been making a reduced contribution for some months now. The expected gradual reduction in inflation to an « acceptable » level is therefore, in our view, an increasingly clear trend. More importantly for the Federal Reserve, its main indicator, the general PCE index, slipped by -0.1% in November, lowering its year-on-year level to +2.7%, while the core PCE index fell from +3.5% to +3.1%. Meanwhile, producer price indexes (excluding food and energy) have been stabilizing over the past year, averaging +0.2%/month and rising by only +2% year-on-year. While inflation already seems closer to reaching the +2% target set in the United States within the space of a few months, the situation in the Eurozone is also improving significantly. For several months now, inflation in the eurozone has been declining faster than expected.

Inflation in the eurozone fell by -0.6% in November, thanks to an almost generalized decline in all components. On an annual basis, CPI is now up by just +2.4% after peaking at +10.7% in October 2022, and is approaching the ECB's +2% target more rapidly than expected. Excluding food and energy, the index is declining more slowly and still stands at +3.6 (+4.2% in October). Inflationary pressures eased sharply in November, with a particularly encouraging decline in the services segment, which remains the slowest to adjust. On the producer price front, the situation improved markedly in 2023, even though October saw a slight monthly increase of +0.2%. On an annual basis, prices actually fell by -9.4%, which should give companies some flexibility to adjust their sales prices downwards. The sharp decline in producer prices should therefore soon have a noticeable effect on consumer price indices. Inflation in the eurozone is likely to weaken further, particularly with the confirmation of the expected economic slowdown. The ECB's inflation forecast for the year as a whole is still +5.4%. The current situation is therefore already relatively ahead of the ECB's forecast. CPI could quickly reach the 2% threshold in early 2024, while core inflation will probably take a little longer to approach it. In China, inflation is already negative year-on-year for both CPI and PPI. In Japan, inflation is still resisting, mainly due to imported inflation linked to the fall in the yen. Overall, however, inflation is now falling to a more acceptable level, even below +3%.

Monetary policies on the road to normalization

In the United States, the Fed has logically decided to leave rates unchanged for the 3rd time in December, which is probably already a sign of the end of the cycle. While FOMC members seem ready to consider a reversal of the cycle, we should not expect them to act too quickly. According to their comments, recent indicators do point to a slowdown in economic activity and a decline in inflation, which the Fed believes remains too high. But they also point out that the tightening of financial conditions on credit will weigh on the economy, employment and inflation. At this latest meeting, however, the Fed seems to us to have given a clearer signal of the end of the cycle, particularly in the comments made by Chairman Powell, who seemed to find it difficult to rejoice at having won the battle against inflation without plunging the economy into recession, and to refute the growing likelihood of a further rate cut. All FOMC members now seem more convinced that policy has been sufficiently restrictive and that no further rate hikes are on the cards. It is also interesting to note that J. Powell mentioned that the first rate cut will come before inflation reaches the 2% target. As a result, it is possible that the latter could occur as early as the end of March, when the six-month annualized PCE supercore inflation rate reaches +2.2%.

Our forecast for the evolution of key rates envisaged an initial phase of status quo that could last until the fourth quarter of 2023, before being followed by a new period of rate cuts leading to a flattening of the yield curve. This pause forecast has now been confirmed by the Fed, and we now consider the probability of a first rate cut as early as the beginning of Q2 2024 to be increasingly credible, given the current economic context and the FOMC's evolving assessment of the situation. Fed funds rates for March 2024 already suggest a dip to 5.21% from the current level of 5.33%. For June, the Fed funds rate is even significantly lower, at 4.64%, suggesting a sharp rate cut from the current 5.25% to 5.5%. The market's current expectations do not seem excessive to us, and are in fact in line with our own estimate of a change in monetary policy regarding key rates that will take place within a time horizon of three to four months. For the end of 2024, the FOMC is forecasting a reduction in Fed funds to 4.3%, slightly higher than our own estimate of 4%. The year 2024 will begin in a totally different monetary policy climate, with expectations of a rate cut of around 125bp. The easing is therefore expected, and all that remains is for it to be confirmed by economic statistics supporting this new policy. The ECB and BoE may also decide to follow suit, easing their policies at a later date. Overall, 2024 will be characterized by the implementation of less restrictive monetary policies and fairly widespread key rate cuts.

In the USA, key rates could be cut from the current level of 5.5% to 4.4% in September, and then significantly below 4% if inflation continues its downward trend. In the Eurozone, the potential decline in key rates could also be very significant in 2024. The expected rate correction for June 2024 is already close to 110 bps, which would position ECB rates at 3.3% in the next six months. The downward trend will also affect BoE rates, which could fall by 100 bps to 4.2% in September. In Japan, the central bank will also normalize its policy, but given the current negative level of its key rate, this normalization will take the form of a rate hike of just over 0%.

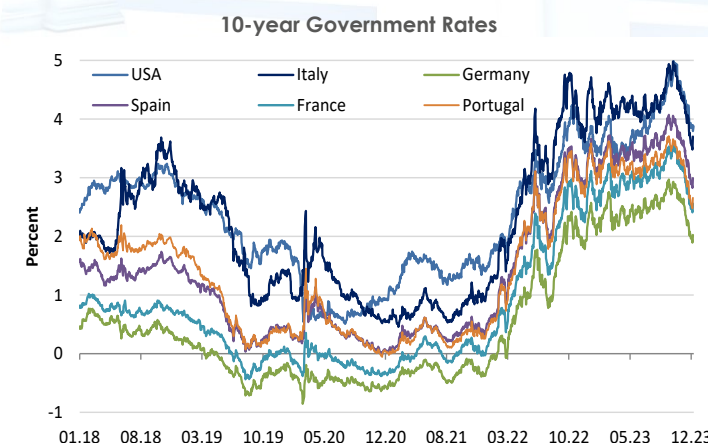
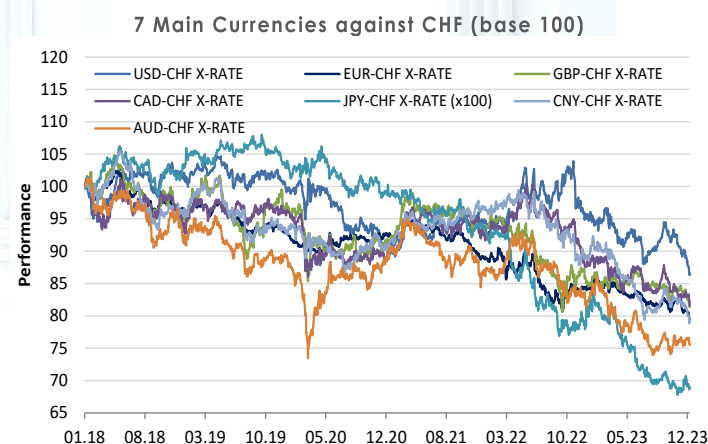
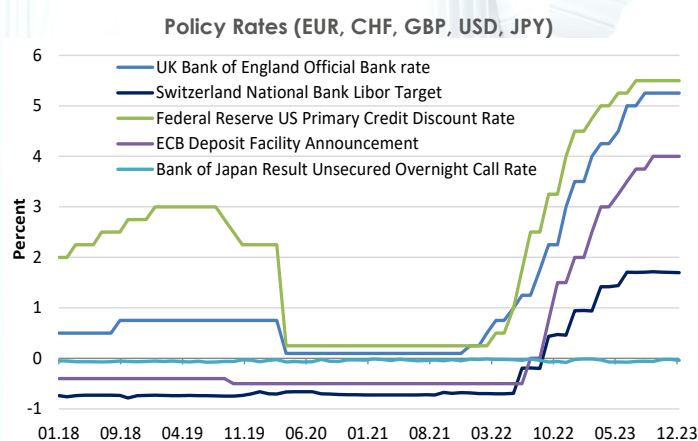
Soft landing scenario supports yield curve adjustment

The economic slowdown now observed in many industrialized countries is in fact the logical and expected result of the policies pursued by these countries' central banks. The fight against inflation initiated in 2022 with restrictive policies was aimed precisely at curbing economic momentum in order to reduce excessive inflationary pressures. As inflation declined, growth gradually slowed and labor markets began to adjust to the new situation. As a result, the fear of inflation driven by wage rises diminished significantly. As a result, the soft landing scenario we favor for early 2024 will also support inflation normalization forecasts. The current inversion of yield curves in both the US and Europe is essentially due to the high level of key rates, and consequently of the short end of the yield curves. In an environment characterized by the normalization of monetary policies by 100 to 110 bps over the next nine months and a stabilization of rates on other maturities, the yield curve between short-term and 10-year Treasury maturities would remain inverted by -50 bps, as was the case in October. We estimate that, with inflation continuing to decline towards +2% and considering an economic slowdown in the first half of the year, long rates should slide a further 50 bps to 3.5%. In this environment, excluding a recession, a yield curve inversion could quickly be considered unjustified, which would imply a de facto even more substantial downward adjustment of Fed key rates. A flattening of the US yield curve centered on a yield of 3.5% seems likely to us, which would have the effect of lowering overall yields by around 50 bps. The situation in the eurozone is a little different, as the recent decline in inflation is accompanied by an economic performance that is still close to recession in the zone's twenty states. The recent fall in 10-year yields from 3% to 2% was similar to that seen in the USA and the UK, and thus in line with the same paradigm shift on the inflation front. We consider, however, that the inversion of the euro curve is still relatively well suited to the persistent risks of recession at the start of 2024. The likelihood of further declines in European long yields is supported by these persistent recession risks, but at current levels, the prospects of further declines no longer seem very high to us. Falling inflation and recession risks are now enough to put pressure on long yields, but these two factors have already been taken into account quite clearly. The inversion of the euro yield curve is therefore likely to be longer-lasting, due to the slower cut in key rates by the ECB, which will slow the movement on the short end. In the UK, there is a greater risk of recession, while inflation remains high despite its recent decline. However, long rates have reacted more sharply to the latter, losing 125 bps, which would imply a curve inversion of around 70 bps in the event of a cut in key rates from 5.25% to 4.2% in September. The UK should also see a persistent inversion of the yield curve, while the likelihood of further declines in long rates has also diminished.

Overall, we believe that the prospects for lower yields and capital gains are still better in the United States.

Positive outlook for financial markets

The economic scenario favoring a soft landing should be accompanied by positive statistics on the inflation front in the 1st half of 2024. The expected normalization of monetary policy could begin in March, and should have a positive impact on yield curves and investor sentiment. Lower rates will subsequently support a potential recovery in consumption and investment, but should initially have a fairly clear positive impact on the valuation levels of financial assets and whet investors' appetite for risk. This generally less uncertain backdrop should sustain the interest of investors, particularly those looking for opportunities to reinvest their maturing fiduciary deposits, whose associated yields have lost some of their appeal. Capital markets will benefit from the downward trend in yields and the influx of new capital seeking capital gains opportunities, while securitized real estate should be one of the big winners in this phase of readjustment of prospects and risks with equity markets.



MACROECONOMIC SCENARIO



MACROECONOMIC SCENARIO

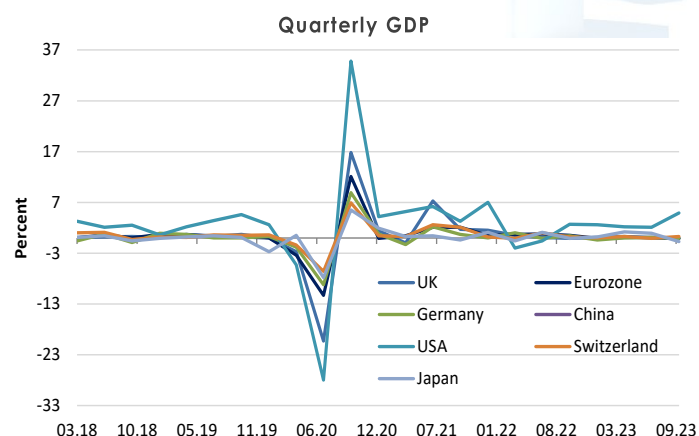
Global Outlook

- Global growth close to +3% in 2024
- Temporary slowdown in US momentum
- European growth still close to zero in early 2024
- UK recession postponed to early 2024
- Limited GDP growth in Japan in 2024
- Positive outlook limited to +1% for Japan

Global growth close to +3% in 2024

Growth in the global economy in 2023 will have been affected to a large extent in industrialized countries, in particular by the tightening of monetary policies since 2022 in North America and Europe. The effects expected by central banks on inflation trends have been slow to materialize sufficiently to approach the targets set, which has also weighed on economic momentum in most countries. However, despite the general rise in interest rates and financing costs, the resilience of the developed economies in 2023 proved remarkable. We expect the effects of these restrictive policies to be a little more visible in the winter of 2023-2024, but a rapid easing response from central banks will certainly limit the risks of too sharp a downturn in economic activity in 2024. Despite the estimated disappointing performance of the Chinese economy (+4.7%), its contribution to overall growth remained high. India (+6.1%), Indonesia (+5.2%) and other emerging economies outperformed OECD countries (+1.4%). The global economy was therefore driven by emerging countries in 2023, and will probably end the year with growth of +3%.

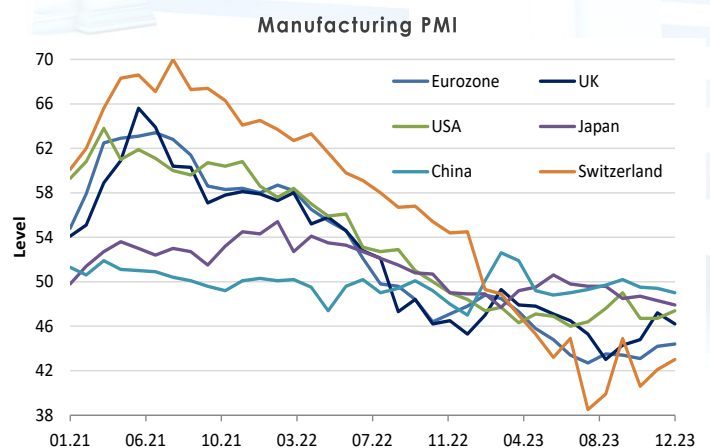
We believe that this trend will continue into 2024, with industrialized countries seeing their GDP growth rates decline somewhat initially, and emerging economies also benefiting from a gradual normalization of central bank monetary policies and lower credit costs. India and Indonesia will benefit even more from solid momentum, and could be followed by China, where growth will be slightly better than in 2023, particularly if the economic support measures adopted strengthen domestic activity as expected. The industrialized countries should initially experience some temporary weakness, before rebounding in the 2nd half, after a probable slowdown in the first part of the year, to



finally record GDP growth for the year as a whole above that of 2023. The easing of monetary conditions expected in Q2 2024 in the USA will be followed by less restrictive policies in Europe and clearly expansive policies in China and Japan. This more favorable interest rate environment will occur against a backdrop of more controlled inflation, and will certainly benefit emerging countries to a greater extent.

Temporary slowdown in US momentum

Q4 should be much less resilient than the very dynamic Q3 (+4.9%), with real annualized growth below +1%. The downturn expected at the end of 2023 and beginning of 2024 should be caused primarily by an adjustment in consumption and a reduction in public spending. However, consumer confidence may be more sensitive to the particularly favorable trend in inflation and the reversal in interest rates than to the evolution of some less favorable parameters in other segments. The fall in interest rates will perhaps have a greater than expected impact on household credit, which had contracted sharply in recent months. The decline in overall lending (net of foreign exchange) in October from 12.25 billion to just 5.13 billion may turn out to be only temporary. However, as the level of average rates (22%) charged on credit cards has not been lowered, despite the fall in capital market rates, we believe that this factor will continue to weigh on households' ability to support their consumption by continuing to use their credit cards to the same extent. Consumer credit has therefore collapsed, and the banking sector is clearly confirming this trend, which is putting the brakes on household demand.

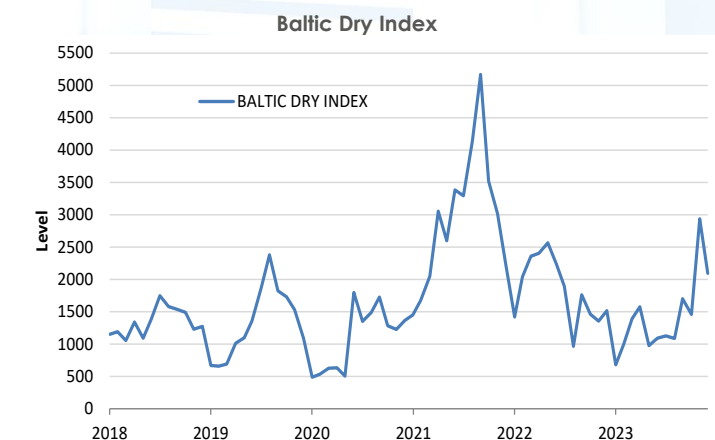
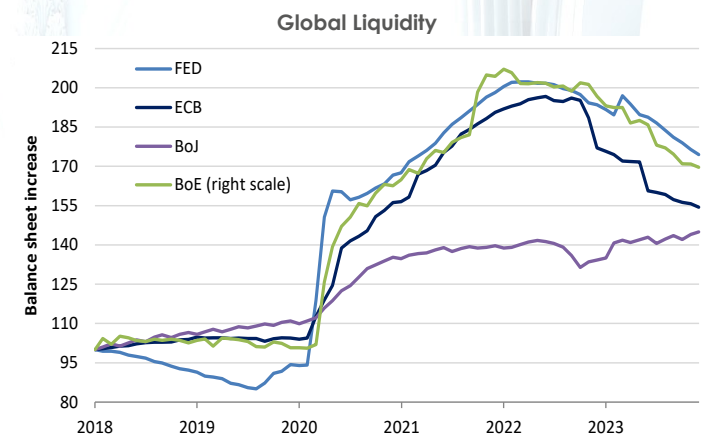
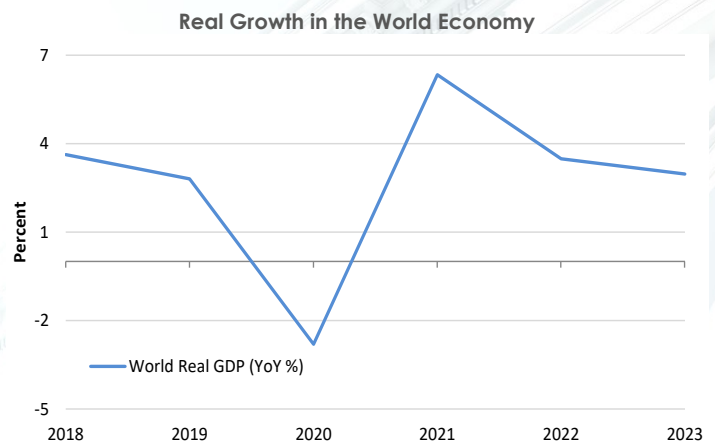


The real estate sector has also been hit hard by rising financing costs, while retailers are also facing growing uncertainty over their sales trends. US households initially resisted the rise in interest rates and inflation by resorting to savings to maintain their purchasing power and consumption, but rising credit costs will no doubt put a brake on this trend. Monetary policy has also become more restrictive, with the Fed's balance sheet shrinking by almost 14% to date, while key interest rates have remained high despite a much more favorable inflation trend than the Federal Reserve had expected. The 1st quarter of 2024 should therefore disappoint, with growth estimated at less than +0.5%. Such a slowdown is likely to increase uncertainty and raise the risk of recession beyond 50%. That said, PMI indices continue to stabilize above the growth threshold for the services PMI and the global PMI. The preliminary PMI for the manufacturing segment (48.2) remains highly uncertain and slipped again in December. The services index, meanwhile, stabilized somewhat after a worrying decline over the summer, and ended the year in a more optimistic zone. The composite indicator is therefore in balance at 50.1. Uncertainty remains for the start of 2024, with leading indicators not yet ready to confirm the risks of recession. The consumer confidence index seems more optimistic, with a rebound in December.

European growth still close to zero in early 2024

Eurozone aggregate GDP growth is likely to be 0% at best in Q3 and Q4 2023. In this eventuality, annual growth should hardly rise above +0.5%. Our forecast today is scarcely different from that at the start of the year, and we still believe that the eurozone will barely avoid a recession, ending the year with weak GDP growth of +0.3% to +0.4%. In contrast to our outlook for stagnation in the European economy over the coming months, which is likely to weigh on the full-year result, the ECB's adjusted forecasts seem more optimistic and certainly subject to disappointment. The ECB still believes that GDP growth for the year as a whole could be close to +0.7%, after long believing that an increase of +1% was likely. Without government support, this growth forecast will struggle to materialize. However, even if a slight increase were possible, we believe it would certainly be offset by a fall in household spending. The services sector will undoubtedly be hardest hit by the loss of household purchasing power. In the short term, we are already seeing a further decline in industrial production in the eurozone of -1.1% in July, following a slight recovery in April and June. Monthly data remain volatile and do not yet allow us to detect a real trend, but the rise in industrial production is a positive sign. Another very weak start to Q3 suggests that the manufacturing sector remains fragile and could yet weigh on eurozone GDP. The same trends can be seen at the start of Q3 as in the Q2 national GDP data, with German and Italian industrial output weakening, while French and Spanish output is rising. The trend in PMIs suggests that the eurozone economy will find it difficult to record growth towards the end of the year, as it continues to be affected by higher interest rates and credit costs. Trends in the main parameters used to assess credit conditions also suggest that they are deteriorating for both households and businesses, thus increasing the risk of a weakening in the economy and consumption.

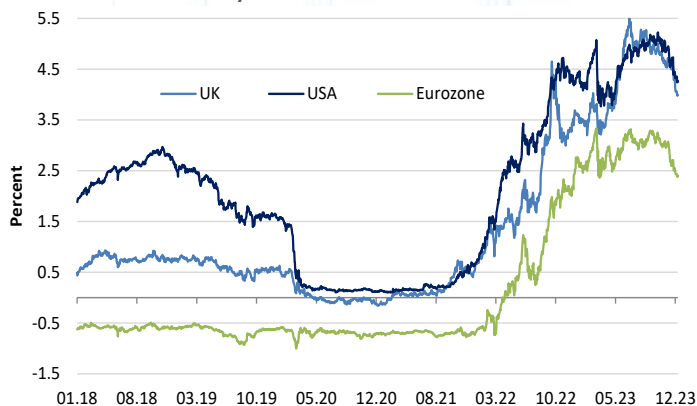
That said, the latest positive developments observed since November on the inflation and interest rate fronts could temper negative estimates of falling demand and also support a rebound in leading indicators over the coming weeks. As a result, our growth forecasts for the 1st half of 2024 are slightly positive, with global GDP also set to grow by +0.7% in 2024.



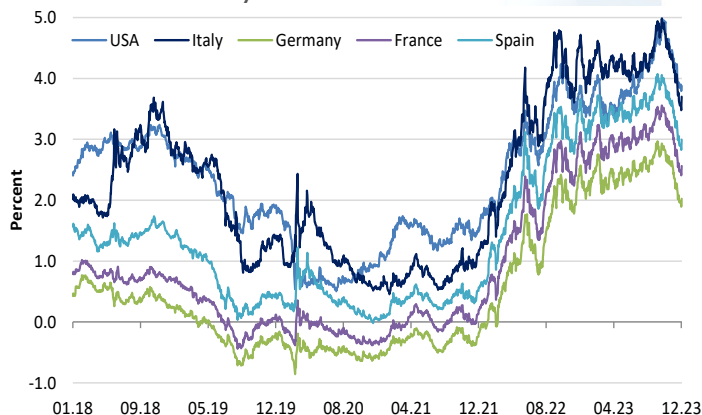
UK recession postponed to early 2024

Household resilience is stalling at a time when government spending is also contracting. As a result, a real slowdown is likely to take place in the coming months and continue into early 2024. The publication of GDP for October (-0.3%) does indeed point in this direction, and the statistics for November and December should further confirm this forecast of declining activity in the UK. The UK economy recorded a decline of -0.3%, which could well continue over the full quarter. This likely development could, however, be slowed by an improvement in inflation, which finally seems to be slowing, as suggested by the November CPI (-0.2%), the retail price index (-0.1%) and producer prices (-0.1%). Consumer confidence is low, but no longer deteriorating, as is the trend in house prices, which stabilized in December. The decline in activity finally appears to be limited at the start of Q4, which could well enable UK GDP to withstand another quarter of recessionary forecasts. Our GDP growth forecast for the year is still positive, but just above zero for the period as a whole (+0.1%). As we approach the end of December, the leading indicators published confirm expectations of economic decline, but do not point to a clear downward trend in activity. The manufacturing PMI rebounded from its August low of 43 to stand at 47.5 in December, closer to its growth threshold than two months ago. The services PMI also rebounded from 49.3 to 52.7, back above the growth threshold. The composite indicator therefore logically improved to 51.7, back above the growth threshold of 50. As the PMI measures do not include the public sector, we believe that declining public spending should not be able to compensate for the drop in activity expected in the private sectors. The PMI indicators are therefore less negative, but are still a long way from heralding the hoped-for economic recovery. The British economy could still surprise at the start of 2024, showing the same resilience as in 2023 and avoiding falling into recession once again. Our outlook for the coming months is still based on a stabilization of GDP.

2-year Government Rates



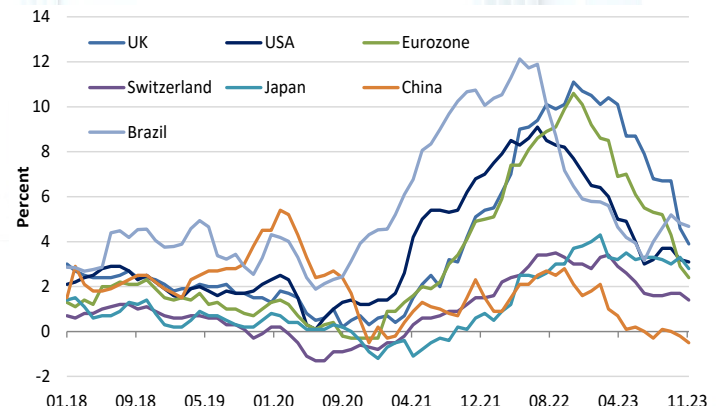
10-year Government Rates



Limited GDP growth in 2024 in Japan.

With just a few weeks to go before the end of the year, Japanese GDP remains more than ever over-dependent on international demand, while domestic consumption is still struggling to recover. The economy is weakened by sluggish household consumption and exports that are totally dependent on international trends. It will be difficult for the Land of the Rising Sun to end the year with an acceleration in economic momentum. In the absence of a revival in external demand, Japan's economic situation will have to be supported by stimulating monetary policies. In the current context, the decline in consumer purchasing power, following the steady decline in disposable income and ongoing inflation, can only be stabilized very gradually. The same applies to Japanese companies, which are still reluctant to make new investments. Growing consumer spending by foreign travellers to Japan will provide only modest support, and will not significantly influence the overall level of consumer spending. Japan would greatly benefit from an economic revival in China, which could counteract the weakening seen in its other major partners, but the Chinese economy is also unable to strengthen significantly for the time being. With global demand weakening, the short-term economic outlook for Japan remains highly uncertain. Against this backdrop of persistently gloomy prospects for both domestic consumption and foreign demand in Q4, Japanese exports are likely to weaken along with domestic consumption and business investment. Q4 GDP could therefore once again be negative. The outlook remains relatively moderate for early 2024, and still highly dependent on the declining international economy. The yen's weakness will probably support Japanese exports in Q1, but the impact will remain temporary and limited without sufficient economic recovery in the USA, Europe and China. On the domestic front, retail sales showed a slight improvement at the end of the year, offset by a further dip in industrial production.

Inflation - CPI Indices



Inflation - PPI Indices

