



MARKET COMMENT (As of end of Dec. 2023)

During its last meeting of the year, the Federal Reserve left its key interest rate unchanged as expected and opened the door to rate cuts in 2024. The surprise came from the very dovish tone of its president, J. Powell, who suggested a faster than awaited timing. That was all it took to turn all indicators green and even tip over the markets into a year-end euphoria. In the aftermath, the European Central Bank's statement was much more measured. While the rate hike cycle appears to be over, questions remain about second-round inflation and about the balance sheet reduction in conjunction with rate cuts, as both have countervailing effects. In the end, Investors have postponed these questions to 2024, and December was a perfect continuation of November in the markets.

Over the month, 10-year yields lost -50bps in the U.S. and -45bps in Europe, which represents an easing of 10-year bond yields from their late October peak of 120bps for Treasuries and 100bps for the German Bund. This is comparable in magnitude (even higher for the Bund) to the easing in the first quarter of 2020 at the time of the Covid. In the days that followed, some analysts ventured to speak of a communication error from the Federal Reserve, which could have fueled an overreaction by investors. But in practice, as always, there are several potential answers: the poor positioning of certain strategies such as the CTAs in November, the good inflation figures that continue to fall month after month, the fear of a "hard landing" scenario that has completely disappeared from the markets, investor expectations that may or may not be too high, but also disappointing economic data. Indeed, the PMI, ISM and Leading Index indicators in the US are not very encouraging, while Europe has already put one foot in recession. It's also worth noting that the yield curve has steepened slightly over the past two months, which is not really a good indicator.

The equity markets have only had falling interest rates and inflation in mind, in addition to an averted "hard landing" scenario, to the extent that they gained +4.8% for the month and +11% for the quarter (represented by the MSCI World index). Technology stocks, which are most sensitive to duration, were the real drivers of the indices, with the Nasdaq index up 17% over two months and more than 50% over the year. AI and the euphoria that sometimes surrounds it continued to fuel this rise, while the disappointing results of companies such as Nike or Fedex, leading thermometers of the real economy, were pushed aside. It is interesting to note that the equity market target levels for the end of 2024, which many analysts were quick to revise upwards in October/November, have in fact already been reached. This leaves a small number of analysts who now see a small upside potential for 2024, while another small number of analysts see a real and dangerous risk asymmetry at current price levels, with real downside for year ahead. Earnings releases at the beginning of the year and corporate guidance will validate or invalidate implied earnings growth levels and current valuation multiples.

Risk parameters naturally continued to fall in this very "risk-on" environment. Investment Grade credit indices lost 8 bps over the month, 20bps over the quarter, returning to levels close to those seen at the end of December 2020. Equity volatility indices such as the Vix and V2X remained stable, having already reached extremely compressed levels at the end of November. These levels are surprising given the geopolitical context, which has not really improved over the past two months, whether in Ukraine or Taiwan, and given that the Middle East conflict continues to escalate slowly but surely, with targeted US strikes in Iraq and attacks on commercial vessels in the Red Sea, which will ultimately affect world trade.

Finally, the theme of 2024 is likely to be sovereign debt. Debt levels have literally exploded around the world since the Covid crisis, and this, combined with rising interest rates, is leading to potentially unsustainable trajectories, with the actual cost of debt interests only reaching record levels (over \$3,500 per capita in the US, according to some studies). Will we have another debt crisis or is it the markets' weak link? What is certain is that the various central banks may be tempted to rapidly lower real interest rates again to alleviate this burden. This could also explain the Federal Reserve's rapid change of tone as the US Treasury has to roll over a debt of 9,000 billion in 2024.

GUILLAUME DUPIN
Chief Investment Officer



Important Notice

This publication has been established on the basis of data, projections, forecasts, anticipations and hypotheses which are subjective or hypothetical in nature, do not reflect actual investments and are not a guarantee of future results. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. Past performance is not a guide to future performance. Investing involves risk, including possible loss of principal. The value of investments and the income from them can fluctuate and investors may not get back the amount originally invested. The analysis and conclusions contained in this publication are the expression of an opinion, based on available data at a specific date. Due to the subjective and indicative aspect of this analysis, the effective evolution of the economic variables and values of the financial markets could be significantly different from the indications (projections, forecasts, anticipations and hypotheses) contained in this publication. Furthermore, due to the subjective nature of these analyses and opinions, the data, projections, forecasts, anticipations and/or hypothesis included herein are not necessarily used or followed by LFIS' management teams or its affiliates who may act based on their own opinions and as independent departments within LFIS. This publication may be modified without notice and LFIS may, but shall not be obliged to, update or otherwise revise this publication. All information in this publication is based on data given or made public by official providers of economic and market statistics. LFIS, each of its affiliates and each other person involved in or related to compiling, computing or creating this publication disclaims any and all liability, whether direct or indirect, relating to a decision based on or for reliance on this publication.