Mt Fort Advisers
- Investment Strategy Update -

December 2023

Dear All,

We are excited to present our latest investment strategy update, crafted with insights from our independent macro strategist, Prof. Michel Girardin. You can access it by directly clicking here and use **MtFort2024** as the password.

“Time flies, but no two years are the same”. After an **extraordinary negative performance** across most asset classes in **2022** (a standard 60/40 portfolio would have lost about -19% on average), **2023** marked a strong **rebound** with a similar portfolio generating a gain of circa +15% YTD on average at the time of writing. Bonds returned to positive territory, while equities appreciated above average with the MSCI World All Country Index posting a gain of +21% YTD over the same period. It has not been a quiet sea however and the year performance has been very **contrasted**. Fuelled by the public awareness of the **Generative Artificial Intelligence** (GAI), symptomized by the launch of **Chat GPT** in December 2022, and thanks to superior earning growth, the “**magnificent 7**” (M7) have **cannibalized** most of the annual **performance** generated on the US equity markets with a stellar gain of +107% YTD on average. In a pale comparison, the S&P500 excluding the M7 achieved a gain of +7% over the same period. **NVIDIA** has been the ultimate **performer** of the group advancing a spectacular +235% YTD thanks to its massive revenue growth of its advanced graphics processing units. Its earnings almost doubled and tripled respectively in Q2 ($13.51bn) and Q3 ($18.12bn). More generally, US value stocks showed a raise of +19% YTD vs US growth stocks posting a gain of +27%. Not only the **dispersion in performances** has been remarkable, but it has been a **roller coaster** during the year with five successive waves taking place on the S&P500 as follow: a gain of circa +10% followed by a loss of -10% from January to February, a gain again of +20% from March to July, followed by a correction of -10% from August to October and finally the recent rally of +10% from November to now. An exceptional year in several aspects.

We can attribute those dramatic **gyrations** in the markets to **two** important **factors**: 1) a great deal of **confusion** among market participants as far as the overall macro situation is concerned, and 2) the major influence of systematic trading systems using **automated algorithms** driven by powerful computers.
The latter are now amplifying short term reactions to any types of events triggering huge trading volumes with no consistency over time, hence a sharp reversal could occur within hours or a few days after an important move in the opposite direction. According to a study

by Greenwich Associates published in 2023, **algo-driven trading** accounted for an estimated 70% of daily trading volume in the U.S.
The former relates to market expectations on the key macro aggregates, and predominantly the level of **inflation** and its impact on **interest rates**. Markets are adjusting to the extraordinary circumstances of the pandemic era, which distorted most macro aggregates. We are still in a **normalization** phase implying a certain level of confusion on where we stand in this economic and financial cycle. **Interest rate expectations** have been **gyrating** several times during the year affecting the direction of financial markets. The **trajectory** of inflation though has been unequivocally **down** with the US headline inflation receding to 3.1% (core inflation to 4%) after a peak level above 9% reached in June last year. This seems to confirm that inflation was **transitory** after all. It is however still far away from the 2% Fed target, and it remains to be confirmed if such a target is realistic in the current environment. The **Fed** maintained its hawkish posture during the year but **reduced** dramatically its **pace** with only one increase of 25bps in July 2023, against three hikes of 25bps during the first half of 2023, and a total of 550bps hikes in about 18 months since the start of the hiking cycle. Despite an initial negative reaction to another rate increase in July, the financial market started to convince itself of the Fed reaching **peak rate** and to price a **Fed pivot**. Future markets are currently pricing in some 110bps of Fed cuts in 2024. Equity and bond markets bounced back sharply in November consequently with the US 10y yield falling about 70bps in a month, producing its strongest rally in 40 years.

Where does this lead us for **2024**? 1) Will high **interest rates** start **biting** into economic growth? 2) Can **consumption** continue to be the engine of growth? 3) **Unemployment** rates to end their record lows? 4) **Inflation** to justify **"higher for longer" interest rates** or Fed pivot? 5) Financial markets to offer opportunities?

Many **macro aggregates** are at an **inflection** point and there is a case for looking at the **glass half full** or half empty. Prof. Michel Girardin is elaborating on some of his key proprietary indictors in our investment paper and points to the following facts: Unemployment is close to hit a recessionary level and we expect it to weaken ; Consumer confidence is still high; Consumption remains strong but excess saving is most likely not a driver anymore and consumption would fade if the labour markets start to weaken; For now, the US economy is still overheating with the unemployment below its NAIRU level; Wage growth is slowing down which is positive for inflation; In the EU, the economy is close to a recession, while China post pandemic reopening boom is being delayed (but the PBoC has still significant margin of manoeuvre via its monetary policy).

Our **base case** for 2024 anticipates therefore a **benign growth** environment in the US with continued but slower **decline in inflation**, a moderate rise in unemployment, and easing wage pressures. This environment should encourage the **Federal Reserve** to **cut rates** in the course of 2024, although it **might occur later than sooner** in the second half of the year. **Earnings** continue to **grow** albeit less than expected by financial analysts depending on Fed actions. That would look like a **goldilocks** scenario which supports both fixed income and equities, although we should expect some volatility depending on the gyrations of the Fed expectations and its effective actions.

As per our proprietary indicators, we reckon that **equities** are not in greed territory following their peak level in April 2021. The MSCI World All Country Index is **fairly valued** trading at a forward price to earnings ratio of about 16x, below its historical average of circa 18x, while Chinese equities (11x, a 32% discount to World equities) and European equites (11x) are the cheapest markets trading much below their longer-term averages. US equity valuations are a tad richer trading at close to 24x, slightly above its historical average. Analyst consensus on 2024 earnings growth should support current multiple levels with US earning growth expected to reach 10% in 2024, 16% in Japan and a more modest 4% in the

EU zone. We would maintain a **diversified geographic exposure** through the US, Europe, and Japan, while building a satellite exposure to Latin American equities.
We would expect **growth stocks** to continue performing well thanks to solid earnings and the prospects of lower interest rates. Additionally, growth stocks are currently trading at a **reasonable 28% valuation premium** against a peak at 80%. This is also true for the magnificent seven, which are trading at a valuation premium of 65% against their peak at 170%. We are cognisant though of the still significant premium, which requires consistent and higher earning growth. We would therefore adopt a more **equally weighted** exposure within the growth sector. Rate cuts should act as a catalyst for growth stocks and its inherent volatility should be tolerated (or not) by investors. **Small caps** would be supported by a goldilocks scenario.

Bonds will naturally benefit from a falling interest environment. The **debt servicing** level is concerning though, reaching 5% on US government debt, 6% on US householder debt and 4% for US corporate debt. According to our indicators, those levels stand at a **recessionary level** or close to it. Credit defaults remain therefore a risk to monitor closely and we would stick to credit **quality** in the sovereign and investment grade space predominantly.

With interest rate differential less favourable to the **USD**, we would foresee a potential **weakening** of the USD, which would **bolster gold**, increasingly viewed as a primary risk-free asset. The PBoC has bought around 600mt of gold since the beginning of the year, representing circa 16% of the annual gold production.

The **risks** to our constructive base scenario are numerous with a global environment at an **inflection point** on many key aggregates. As we indicated earlier, there is very much a case of looking at the glass half full or **half empty**. The Fed and central banks generally will be instrumental in guiding the way forward. Our base case assumes a continued decline in **inflation**, whereas it could stop its decent and remain **sticky** above 3% and even bounce back due to a still tight labour market, wages going up, consumption remaining strong and economic growth still very resilient. In that context, central banks would certainly hold **interest rates higher for longer**, especially in Europe. Following the lessened inflationary pressures, the **Fed** has opened the door to interest rate cuts in 2024, with a decisively **hawkish** statement by the Fed chairman Jay Powell on December 13th. Markets are now positioned for the return of the **Goldilocks** scenario, with the global economy being « not too hot, not too cold ».
This very favourable scenario for 2024 rests on the **crucial condition** that **inflation remains in check**. We will keep monitoring **three factors** which in our view could potentially derail the disinflationary trend: 1) Oil prices need to remain clearly below the USD 100 per barrel; 2) Wage growth in Europe needs to follow its US counterpart and go at or even below headline inflation; 3) Sea transportation costs need to be closely monitored considering the ongoing problems with the Suez Canal access.
Even in the case of inflation receding, there is a risk of central banks not cutting interest rates sooner enough ("**overkill**") putting excessive strains on the **credit market**, which could show signs of **stress**. The virtuous cycle could quickly shift to a negative spiral and trigger a brutal correction in the financial markets.

Finally, we cannot not ignore the current ongoing **geopolitical tensions**, from the Ukrainian conflict to the Gaza situation and uncertainties around **Taiwan**, which remains a critical issue for China. Those could disrupt financial markets in case of major tensions as we have seen with the Ukrainian conflict, although its impact on the markets has been short-lived. With over half of the population in voting age going to elections next year, including Taiwan, India, Mexico, Russia, the UK and the **US presidential elections** in November, we could also see tensions and uncertainty rising. It is possible though that the Fed might be under political

pressure, despite its independence, to avoid triggering a recession in an election year and adopt a more dovish stance.

In this environment, and especially with the latest strong rally post Chair Powell FOMC speech during which a lot of good news might have been priced to hastily by market participants, we would keep a nimble approach and use **tactical hedges** via bear put spreads to protect long exposure, while keeping our long bias.

As always, we can only encourage investors to regularly review their **investment objectives** and ensure their portfolios are in adequation with their risk appetite and liquidity requirements factoring in any changes in their personal circumstances and perception of the overall environment. This is particularly sensitive considering the current economic inflection point, which could lead to dramatically different scenarios.

For a deeper dive into our strategies and Prof. Girardin's insights, you can access the full investment strategy update by clicking here.

We look forward to discussing these insights further and hearing your valuable thoughts.

In the meantime, the whole Mt Fort Advisers Team wishes you a happy holiday season and a prosperous 2024.

Thank you for your continued trust and support,

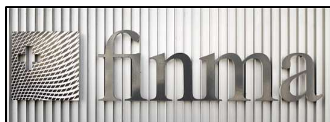
Your Research Team

MT FORT ADVISERS SA
Rue de la Cité 1
CH - 1204 Geneva

+41 22 568 10 01

www.mtfortadvisers.com

Regulated by :



Please consider the environment before printing this email

This e-mail and any attachments are confidential and may be legally privileged. They are intended only for the use of the named.If you are not the named or intended recipient, please notify us immediately. In such an event, you should not disclose the contents of this e-mail or any attachments to any other person, nor copy, print, store or use them in any manner whatsoever. Internet communications cannot be guaranteed to be timely, secure, error or virus-free. The sender does not accept liability for any errors or omissions. Thank you for your cooperation.