SELVI & CIE

THE FINANCIAL LETTER

REVIEW, OPINIONS AND MARKETS' PERSPECTIVES

WINTER 2024-2025

Global landscape

Long-term macroeconomic regime. Irregular and volatile economic cycles

The weakness of the main structural factors (demographics, excessive debt and even productivity) will weigh on potential growth. The asymmetric risks of deflation or runaway inflation remain elevated. The uncertain pace of adoption of artificial intelligence adds to the uncertainty. The issues of deficit financing and debt reduction could disrupt long-term balances.

Cyclical outlook. Reflation is set to gain momentum

The US and China will lead the recovery in 2025. Europe and Japan will lag, while emerging markets will be scattered. S1 will be key as new US economic policies get set. A (too?) strong consensus on US exceptionalism has built.

Main indicators in 2024
(on December 19th)

Indicators	Variation %
Eurostoxx 50	+9.6
Swiss Market Index	+4.5
FTSE 100	+6.0
S&P 500	+23.0
Short-term rate EUR	2.3
Short-term rate USD	4.1
EURUSD	-5.9
EURCHF	+0.6
Barclays Euro Bonds	+3.2
Barclays US Bonds	+1.4

Geopolitics. Silver lining on the horizon?

The bold change in the US administration is reshuffling the deck. The probability of fat-tail events (positive and negative) is increasing. The resolve and cohesion of the so-called axis of evil (China, Russia, Iran, North Korea) will be tested. A de-escalation of the Ukraine conflict could ultimately benefit the EU.

The abundance of global liquidity will continue, short-term

Liquidity conditions are favorable, led by US financial engineering 3.0 and China.

Negative equity-bond correlation restored

The expectation of sub-3% CPI over next quarters is under review, depending essentially on the priorities and shape (implementation sequence) of future US administration economic policy. A new German government could also mean more flexible, active reflation in the EU.

Highly volatile investors’ sentiment and capital flows

Investors' cyclothymia has driven significant flows into risky assets. Signs of complacency have emerged.

¨Secular¨ Disruptions

- Climate / War efforts
- Technology / AI
- Inequalities

De-globalization

- Trade
- Re-onshoring
- De-dollarization

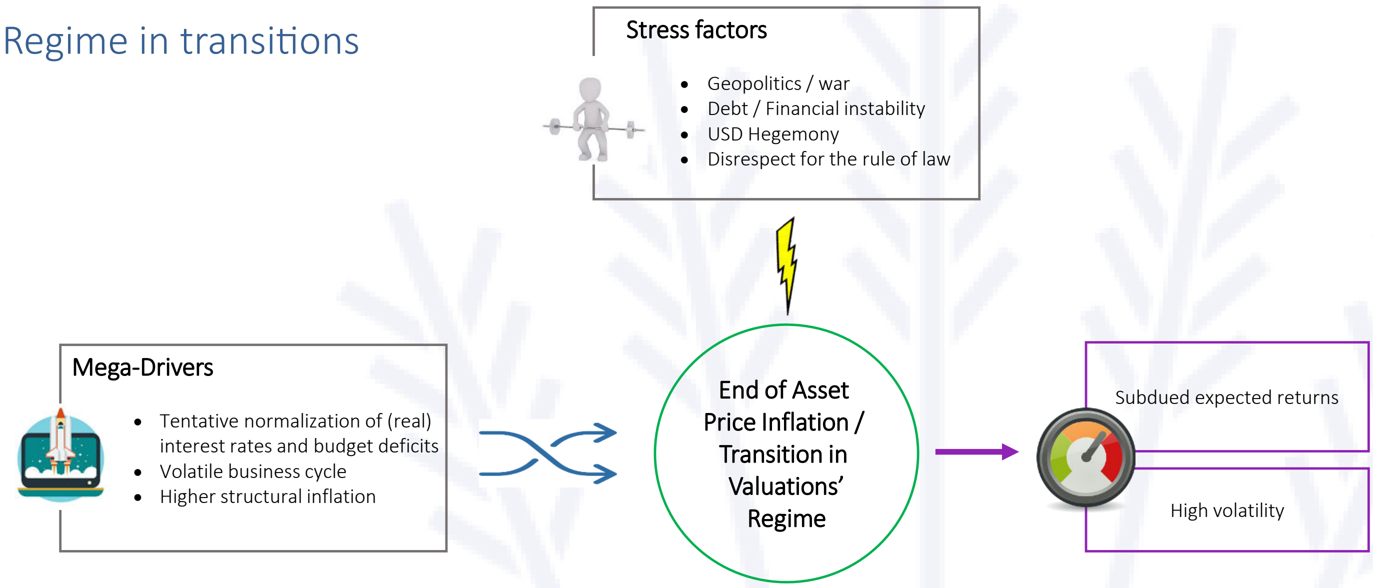
(Geo)-Politics

- New Multipolar World Order
- Emergence of Global South
- War at EU doorsteps

Economic Policies

- Sustainbility of positive real rates
- War economy
- From Wealth Effect to what?
- Central bank digital currenciers
- Debt Sustainability (Minsky)

Regime in transitions

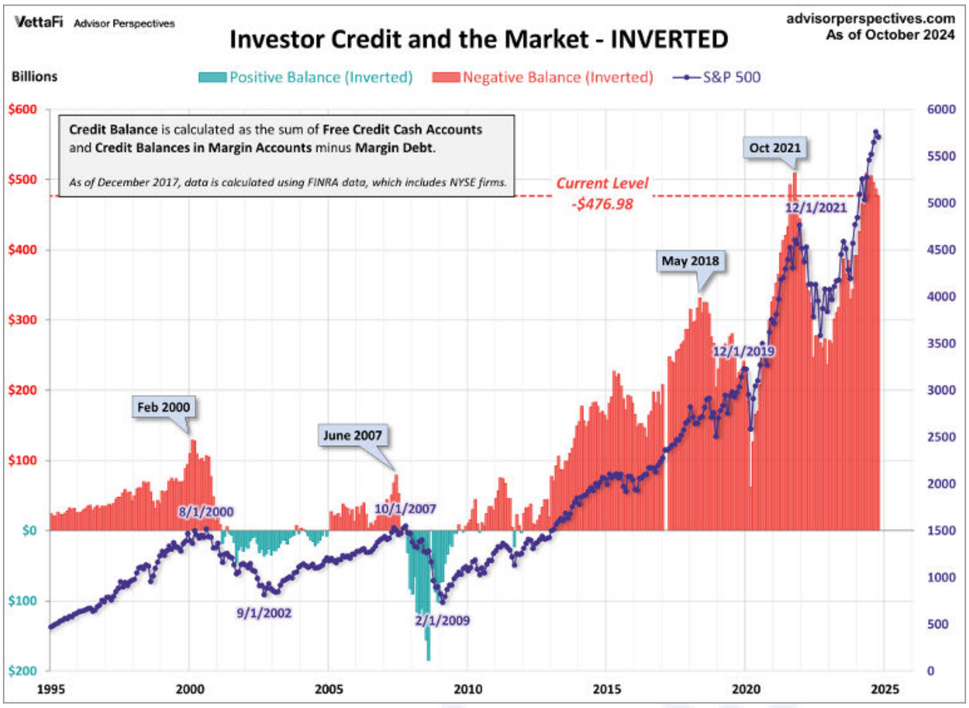


Re-risking with Donald

There is no doubt that the outcome of the US election has the potential to be market friendly. Deregulation, lower taxes for the private sector, as well as productivity-enhancing reforms (smaller government, more drilling, health care?). The rally in the USD, US equities and high-yield bonds in Q4 suggests that this tentative outcome is at least partly discounted. The sanguine post-election narrative has been reinforced by the - unexpected - political/societal calm and the appointment of reassuring people in key positions (S. Bessent).

International capital has been flowing at an unprecedented pace into US equity and BTC ETFs. According to the latest FINRA data, US households' (margin) debt level is $815.368 billion, the highest level since February 2022. Debt is up 28.4% year-on-year (YoY).

Margin debt and equity tend to move in sync

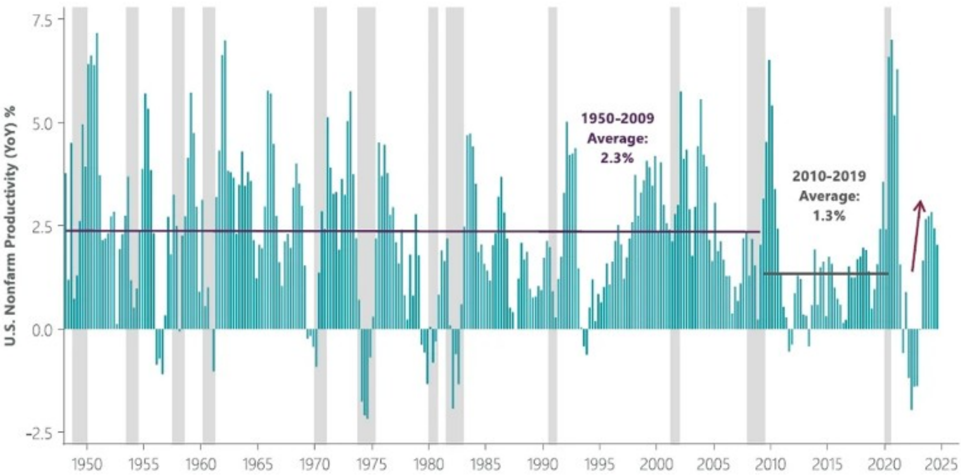


US exceptionalism, up to the limit?

US growth has undeniably outperformed, and signs of resilience continue to emerge. The pro-business bias of the Trump administration reinforces the narrative of a ¨no-landing¨ scenario. However, this economic success is due to extreme fiscal and monetary stimulus in the context and post pandemic. Neither is sustainable. And these excesses have prolonged relatively high inflation. Apart from Japan, the US is the only G20 economy where inflation could reaccelerate from mid-2025.

The miracle of Alternative Intelligence is in everybody's mind. The US has been at the epicentre of this new paradigm, thanks to a) its innovative technology giants and b) the flexible structure of its economy. Certainly, AI has the potential to disrupt previous economic equilibria and boost productivity in the medium term. But its adoption curve on a large scale may prove to be slower than extrapolated by forecasters. Especially considering the upcoming shocks from the new Trump administration, especially Musk with DOGE, Rubio on immigration, not to mention tariffs.

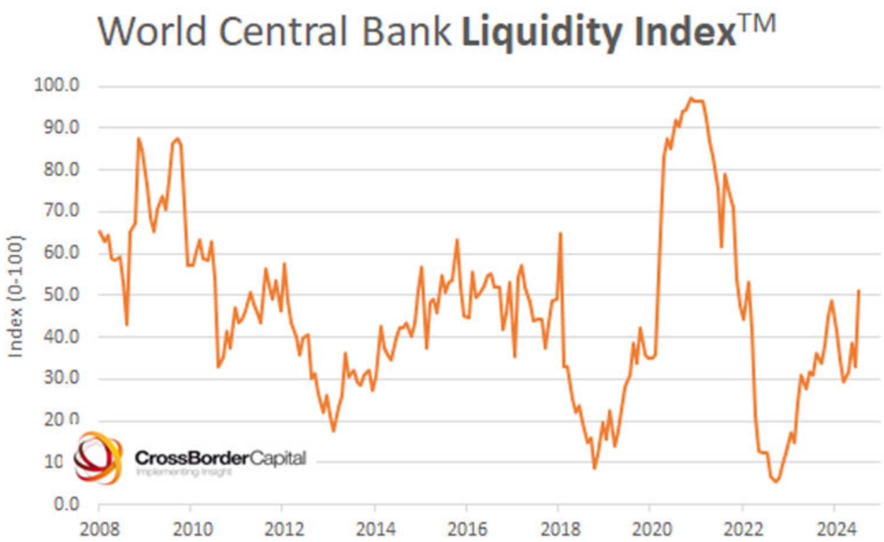
Productivity is coming back



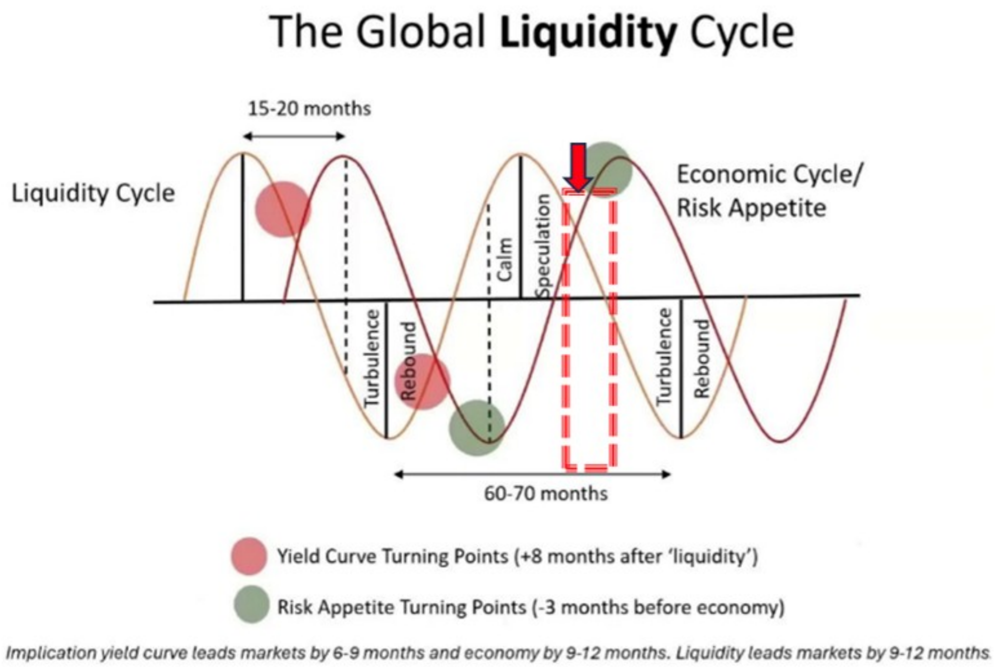
The outperformance of the US economy and markets in recent years has been breathtaking
Has the concept of US exceptionalism reached a point of complacency?

A comfortable liquidity landscape, for now

The world's central banks have entered a phase of accommodation. This has led to the creation of ample liquidity, which has supported financial markets, valuations and high-risk appetite. A global reflation cycle began last summer.



If a typical pattern of interrelationship between liquidity and the growth cycle unfolds, markets will increasingly experience headwinds. This is because economic resurging momentum tends to absorb excess liquidity, and central banks consequently reduce the production of excess liquidity as inflation risks reemerge. Such a tipping point is likely to occur during 2025.



Investment takeaways

Risk appetite may have recently plateaued, if not peaked. While the global investment backdrop is likely to remain fairly benign in the coming weeks/months, the medium-term landscape is more challenging.

Currencies

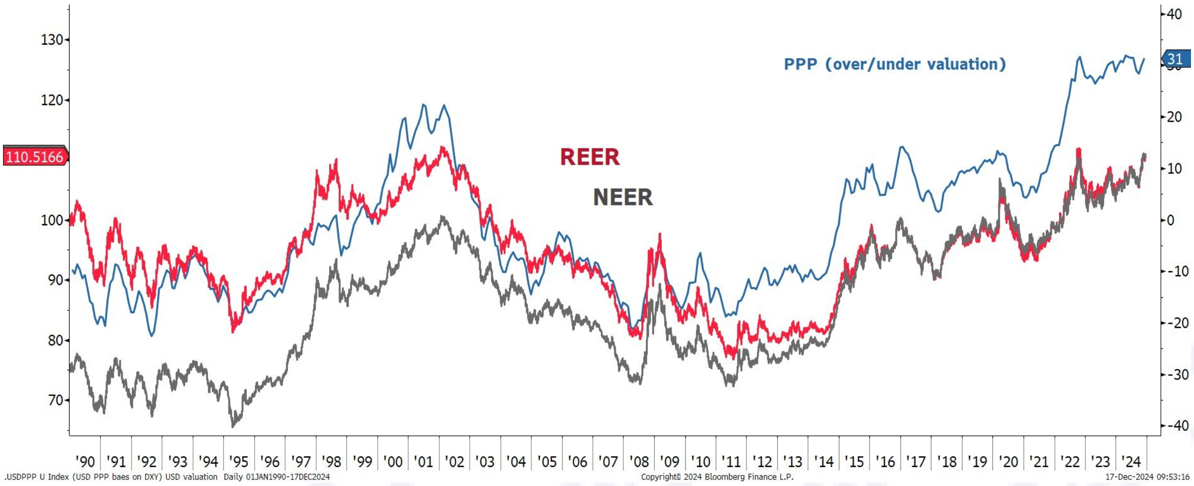
Market consensus looks too stretched

One of the most significant developments in financial markets in 2024 has been the resilience of the US dollar. It is on track for its biggest annual rally since 2015. The question is whether the current bullish sentiment will continue into 2025.

The gains have been driven by the election of Trump and the resilience of the US economy, which has left the Fed with less room to cut rates. Reasons for a reversal at some points include the budget deficit, which may start to affect sentiment, and Trump's tariffs, which may prove less far-reaching than initially anticipated. In addition, the global economy may remain stable following the decision by foreign central banks to ease monetary policy. The Trump administration's trade policies, if implemented, would theoretically lead to higher prices for imported goods.

The DXY is currently in a period of transition, with several important forces at play. On the USD-negative side, the trend in real interest rates will remain negative as central banks, especially the Fed, continue to reduce policy tightening. On the USD positive side, US trade policy - both actual tariffs and the risk premium associated with trade and geopolitical tensions - will play an important role in weighing on its peers. Trade will be the dominant near-term driver, supporting USD strength into year-end.

Since 1990s, the USD has rarely been that commonly expensive



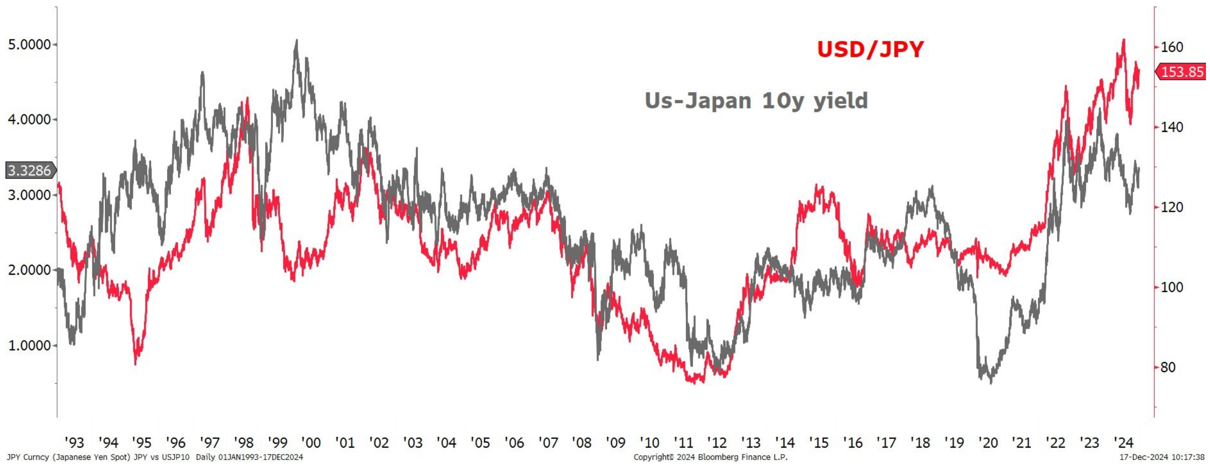
Our analysis suggests that the USD is currently overvalued, while the JPY is undervalued. The USD is currently trading at levels higher than implied by all valuation models. The currency's relative purchasing power parity suggests a premium of 30%, 11% in nominal terms (NEER) and 10% in real effective terms (REER). While the trade-weighted dollar typically strengthens after a peak in political uncertainty, the rising gold price suggests that the dollar's safe-haven status is waning. It is important to note that valuation models are not reliable market timing tools. They are only useful when market positioning is extreme, which is currently the case.

2025 could be a year of weaker USD and non-consensual trade
A significant risk to our USD forecasts is the possibility that the Fed will maintain higher interest rates for an extended period, which could make USD deposits more attractive.
The DXY is approaching its peak as the new administration's policy preferences become clearer, reducing uncertainty.

A contrasting stance from the BoJ

The JPY ends 2024 in a sub-optimal position. It is on track to be the worst performing DM currency for the year. This has been the case in previous years, namely 2023, 2022 and 2021. The JPY has returned to levels previously considered weak enough to prompt intervention by the Ministry of Finance and the Bank of Japan. However, this is due to the strength of the USD and higher US yields. The widening of the 10-year spread has led to a rise in the USD/JPY. There is growing concern among policymakers about this rise. In response, verbal intervention has increased and the likelihood of a BoJ rate hike has risen.

Weakening of the yield spread and currency correlation



It seems likely that the BoJ will continue its hiking cycle into 2025, which should provide further upside support for the JPY. Governor Ueda stressed that he is closely monitoring the impact of the exchange rate on the economy and inflation. The current economic situation would allow for a prompt decision. Core inflation reached 2.3%, which was higher than expected and marks 31 consecutive months above the 2% target. However, we do not expect the MoF or the BoJ to feel the need to actively intervene in the foreign exchange market. We would like to reiterate that unilateral intervention without international coordination is rarely successful.

One risk is the return of the yen carry trade, as still low Japanese interest rates encourage speculators to short the yen. Speculative positioning reached a record net short JPY position in July as the carry trade unwound. In November it is again significantly net short, but at only a third of its July peak.
Japan experienced decades of deflation, but this has recently changed. The pressure on the BoJ is intensifying, which has important implications for the global carry trade
While the correlation between the USD/JPY and the yield spread has recently weakened, the movement in yields remains a good indicator for USD/JPY

Bonds

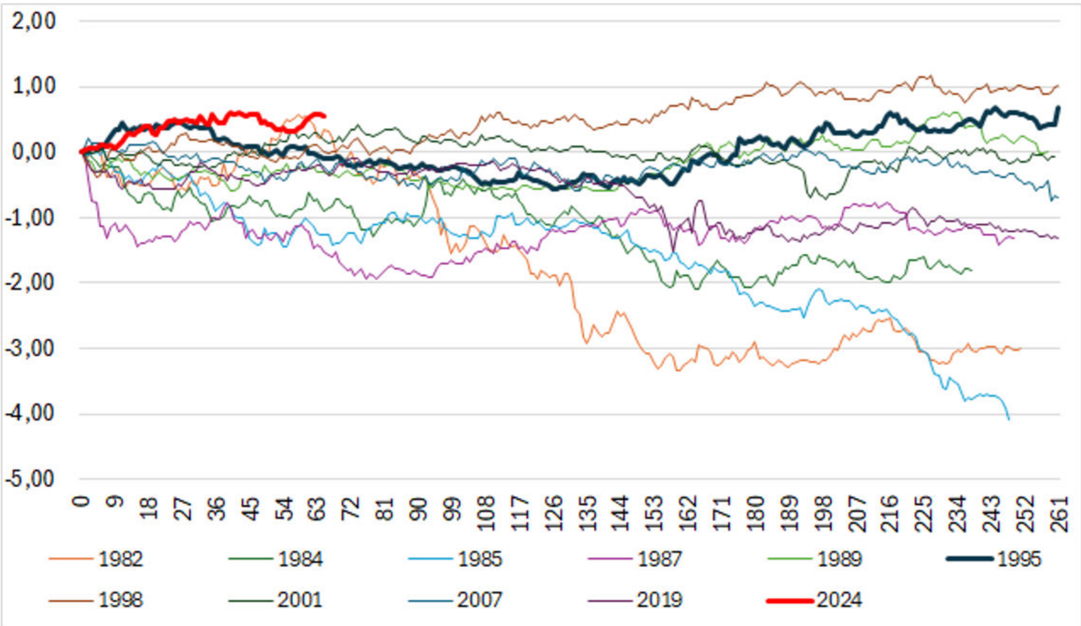
Historical data shows that over the past four decades, the US 30-year bond yield has typically declined by 10-50bps in the 2-3 months following the first Fed cut. In recent weeks, the US 30-year bond yield has risen by 40bps following the Fed's sharp cut in September.

From a market and economic perspective, there is only one historical parallel that can be drawn. The only known instance of a soft landing following a period of Fed rate hikes. As in 1995, the driving forces behind this trend are the continued strength of the US economy, the persistence of inflation above 2.5%, labour shortages and the Fed's easing policy despite robust economic performance.

Moreover, even in the most unfavourable scenario for the bond market (1982), long-end yields did not rise by more than 100 basis points in the full year following the first Fed rate cut. We are approaching that threshold.

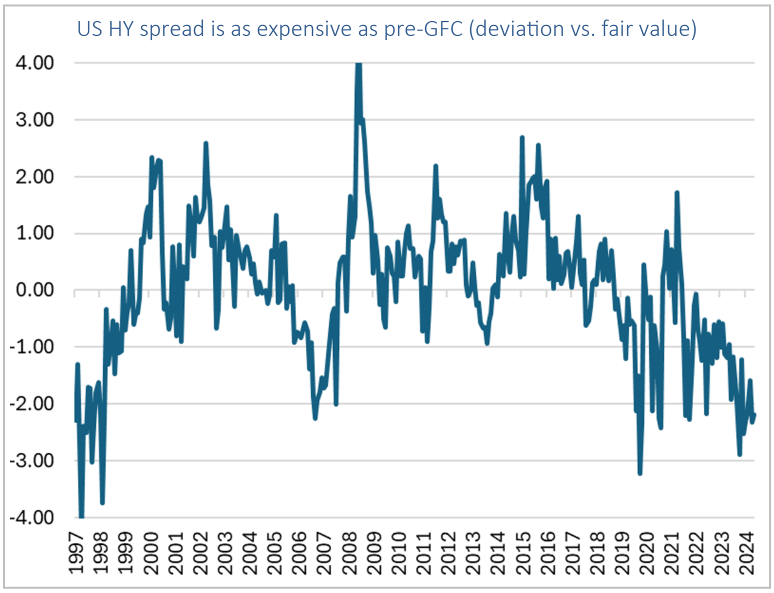
There is a risk that the Fed will lose control of the long end of the yield curve. The long end of the curve is not affected by the Fed's monetary policy decisions, but rather reacts to fiscal policy and its impact on the markets' inflation expectations. Unless Chairman Powell implements a yield curve control strategy, as the BoJ did until recently, there is not much he can do on the monetary front to bring down the long end of the curve if market participants expect higher inflation.

US long-end yields have never increased this much after the Fed first cut



Even in a very positive macroeconomic scenario, the bond market is ahead of it-self

In terms of credit quality, both investment grade (IG) and high yield (HY) have reached the lowest decile of spreads. Our HY fair value model suggests that the current market should trade at around 470bps. However, at 270bps, HY bonds are clearly indicating that their valuation levels are stretched. A similar valuation gap occurred in 2007. It then

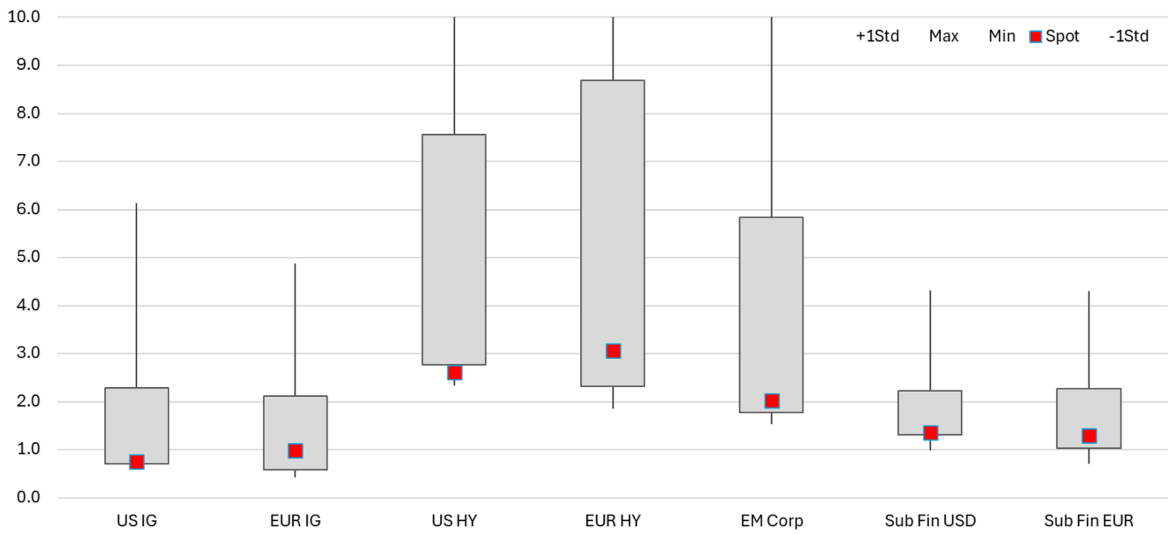


took another three months for spreads to widen towards fair value levels. Should financial conditions improve and the global manufacturing cycle recover, it is possible that spreads will remain at these levels from a liquidity and macroeconomic perspective.

With central banks expected to cut rates, technicals should remain supportive. Further declines in yields should lead to increased inflows into HY despite the low spread. A potential widening of the spread could negate the positive impact of a decline in the risk-free rate.

A further 9% of US GDP in outstanding loans will need to be refinanced next year. A widening of the spread on global HY bonds by 100-200 bps towards fair value would roughly correspond to an increase in refinancing risk.

Most spreads are trading at their lowest level since records began



US IG credit stands out with exceptionally tight spreads. In contrast, EUR IG credit appears more attractive relative to the US, as spreads hover just below the 20-year median. The spread compression between A and BBB rated bonds is near all-time lows in both areas

Equities

A young bull market.

After rising by 22% in 2023, the overall index is heading for a performance of over 20% in 2024. +42% in 2023-2024 and +60% since the start of the bull market in October 2022 may seem like a lot, but in fact this bull market is still young, both in terms of its duration and its scale. On average, a bull market on the S&P 500 lasts five and a half years, with a return of 192%. The current bull market has been active for 2 years and 2 months, with an increase of 70%.

This Bull Market Might Be Two, But It Is Still Young

S&P 500 Bull Markets (1950 - Current)

Bear Market Bottom	Bull Market Peak	S&P 500 Change	Years	Bull Start In October?
6/13/1949	8/2/1956	267.1%	7.1	No
10/22/1957	12/12/1961	86.4%	4.1	Yes
6/26/1962	2/9/1966	79.8%	3.6	No
10/7/1966	11/29/1968	48.0%	2.1	Yes
5/26/1970	1/11/1973	73.5%	2.6	No
10/3/1974	11/28/1980	125.6%	6.2	Yes
8/12/1982	8/25/1987	228.8%	5.0	No
12/4/1987	3/24/2000	582.1%	12.3	No
10/9/2002	10/9/2007	101.5%	5.0	Yes
3/9/2009	2/19/2020	400.5%	11.0	No
3/23/2020	1/3/2022	114.4%	1.8	No
10/12/2022	10/11/2024*	70%	2,2	Yes
Average		191.6%	5.5	5 of 12 Started October
Median		114.4%	5.0	

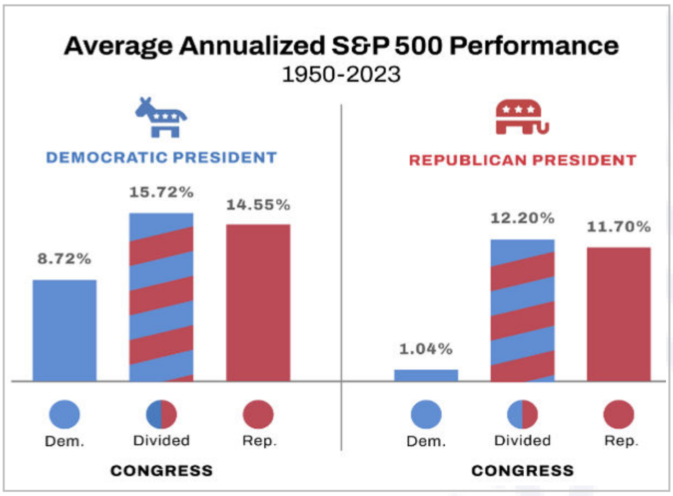
Posted on ISABELNET.com

Source: Carson Investment Research, YCharts 10/15/2024
* Most recent new all-time high was on 10/14/2024
@ryandetrick

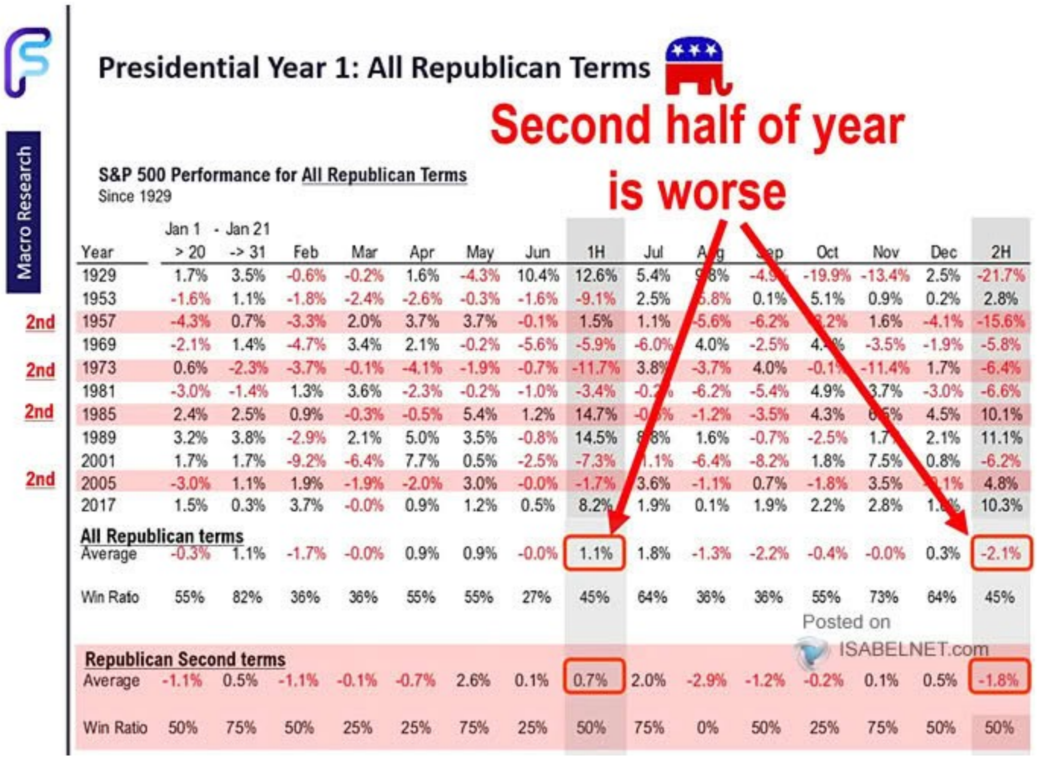
CARSON

Most major investment banks are positive for 2025, with S&P 500 targets ranging from 6,400 to 7,100. Ours is at 6,600. The main arguments are rising profits (+15% in 2025 and +13% in 2026), a solid US economy, a pro-growth, even libertarian 'Trumpian' policy, continued strong share buybacks, more mergers and acquisitions and accommodative monetary policies. AI and quantum advances are also themes that will drive the Big Tech / Magnificent 7, which currently account for 31% of the S&P 500 and 21% of the MSCI World.

Even so, there are still some fears about the inflationary risk of Trump's pro-growth policy and protectionist measures such as higher import tariffs and the dismissal of thousands of South American workers. There is also a risk of disruption to the business cycle if the countries 'under attack' respond by raising tariffs on US imports. There is therefore a risk to corporate profits and margins. Of the last 11 recessions, 10 began under a Republican presidency. However, the most positive believe that this risk of inflation will be offset by deregulation, the reduction in administrative burdens and Trump's desire to bring energy prices down drastically by increasing oil production from 3 million barrels/day to 16 million b/d.



It is worth noting that stock market performances are less good under an all-Republican presidency and Congress. Since 1929, the S&P 500 has fallen on average in the 2nd half of the 1st year of a Republican presidency, whereas the 1st half was fine with the economic and fiscal policy announcements. But reality returns in the 2nd half of the year.

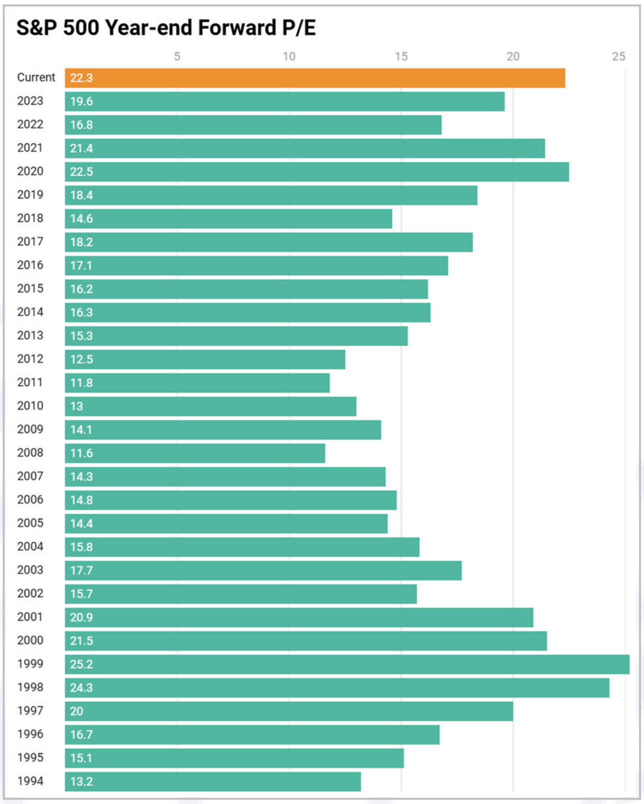


S&P 500 Performance for All Republican Terms
Since 1929

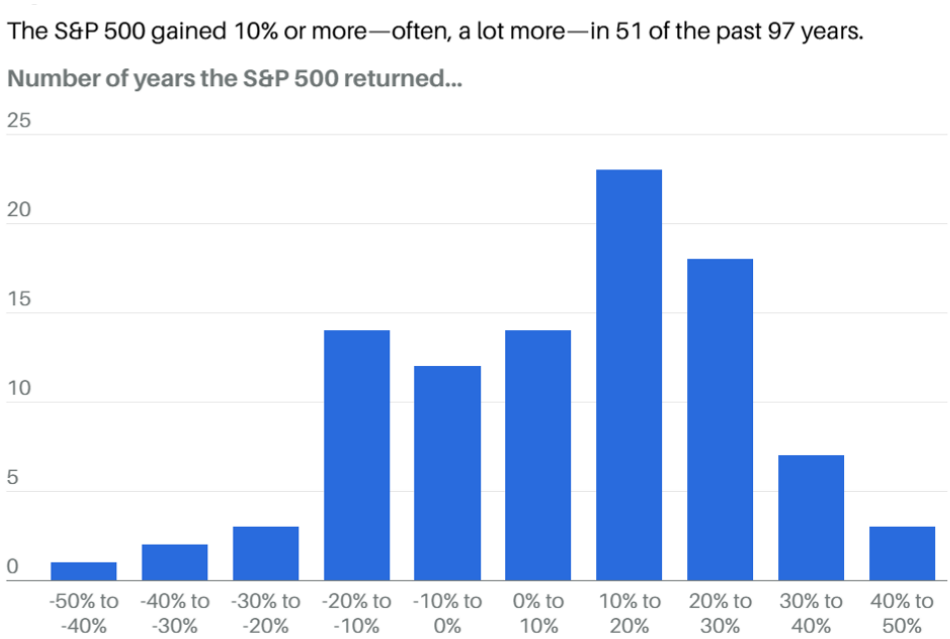
	Year	Jan 1 > 20	Jan 21 -> 31	Feb	Mar	Apr	May	Jun	1H	Jul	Aug	Sep	Oct	Nov	Dec	2H
	1929	1.7%	3.5%	-0.6%	-0.2%	1.6%	-4.3%	10.4%	12.6%	5.4%	[illegible]	[illegible]	-19.9%	-13.4%	2.5%	-21.7%
	1953	-1.6%	1.1%	-1.8%	-2.4%	-2.6%	-0.3%	-1.6%	-9.1%	2.5%	[illegible]	0.1%	5.1%	0.9%	0.2%	2.8%
2nd	1957	-4.3%	0.7%	-3.3%	2.0%	3.7%	3.7%	-0.1%	1.5%	1.1%	-5.6%	-6.2%	[illegible]	1.6%	-4.1%	-15.6%
	1969	-2.1%	1.4%	-4.7%	3.4%	2.1%	-0.2%	-5.6%	-5.9%	-6.0%	4.0%	-2.5%	[illegible]	-3.5%	-1.9%	-5.8%
2nd	1973	0.6%	-2.3%	-3.7%	-0.1%	-4.1%	-1.9%	-0.7%	-11.7%	3.8%	-3.7%	4.0%	-0.1%	-11.4%	1.7%	-6.4%
	1981	-3.0%	-1.4%	1.3%	3.6%	-2.3%	-0.2%	-1.0%	-3.4%	[illegible]	-6.2%	-5.4%	4.9%	3.7%	-3.0%	-6.6%
2nd	1985	2.4%	2.5%	0.9%	-0.3%	-0.5%	5.4%	1.2%	14.7%	[illegible]	-1.2%	-3.5%	4.3%	[illegible]	4.5%	10.1%
	1989	3.2%	3.8%	-2.9%	2.1%	5.0%	3.5%	-0.8%	14.5%	[illegible]	1.6%	-0.7%	-2.5%	[illegible]	2.1%	11.1%
	2001	1.7%	1.7%	-9.2%	-6.4%	7.7%	0.5%	-2.5%	-7.3%	[illegible]	-6.4%	-8.2%	1.8%	7.5%	0.8%	-6.2%
2nd	2005	-3.0%	1.1%	1.9%	-1.9%	-2.0%	3.0%	-0.0%	-1.7%	3.6%	-1.1%	0.7%	-1.8%	3.5%	[illegible]	4.8%
	2017	1.5%	0.3%	3.7%	-0.0%	0.9%	1.2%	0.5%	8.2%	1.9%	0.1%	1.9%	2.2%	2.8%	[illegible]	10.3%
	All Republican terms Average	-0.3%	1.1%	-1.7%	-0.0%	0.9%	0.9%	-0.0%	1.1%	1.8%	-1.3%	-2.2%	-0.4%	-0.0%	0.3%	-2.1%
	Win Ratio	55%	82%	36%	36%	55%	55%	27%	45%	64%	36%	36%	55%	73%	64%	45%
	Republican Second terms Average	-1.1%	0.5%	-1.1%	-0.1%	-0.7%	2.6%	0.1%	0.7%	2.0%	-2.9%	-1.2%	-0.2%	0.1%	0.5%	-1.8%
	Win Ratio	50%	75%	50%	25%	25%	75%	25%	50%	75%	0%	50%	25%	75%	50%	50%

It is therefore possible that the S&P 500 targets will be exceeded in mid-2025, at around 7,000 for example, and that the S&P 500 will then correct back to our target of 6,600.

The S&P 500 has a generous valuation on a historical basis, but the index has a greater weighting towards high-quality growth stocks. Today, 42% of the S&P 500 is made up of the Growth segment (Technology, Communications, Amazon and Tesla), compared with 36% in 1999, for example, but at that time some of the companies were loss-making and had much weaker balance sheets. Wells Fargo strategist Christopher Haley, who has a target of 7,000 on the S&P 500, believes that the structure of the index merits higher valuations. We agree with him.

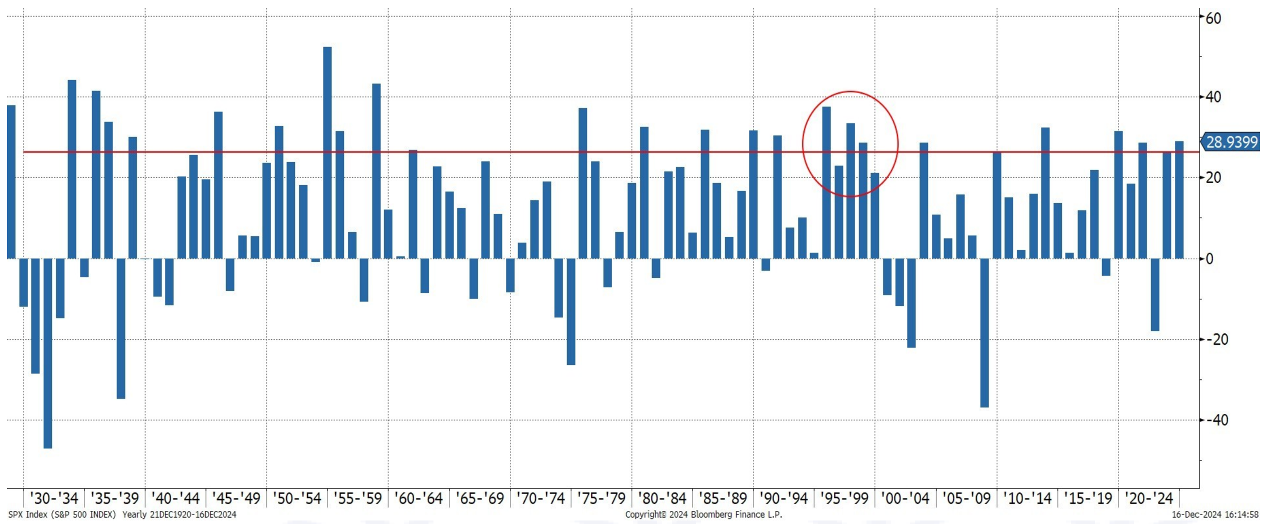


With our sometimes *contrarian* approach, it is possible that indices will not evolve as expected. In 2023 and 2024, many investors, analysts and strategists were (very) cautious, with index targets for the new year below the levels seen at the end of 2022 and 2023. At present, almost all investors and strategists are expecting the indices to rise by between 10% and 18%. But history is rarely reasonable. According to Deutsche Bank's calculations, the market has most often recorded gains of between 10% and 20% annually rather than between 0% and 10%. 39% of the time, the S&P 500 has gained 20% or more.



Now what reinforces our *contrarian* approach is that after two consecutive years of annual rises in excess of 25%, it is rare to have such a performance in the 3rd year. Only the period 95-99 was an exception to this rule. We are not saying that we will have a correction, but repeating a rise of more than 25% is extremely rare. Unless we have a paradigm shift with AI, re-industrialization and the energy transition.

Annual growth % of S&P 500

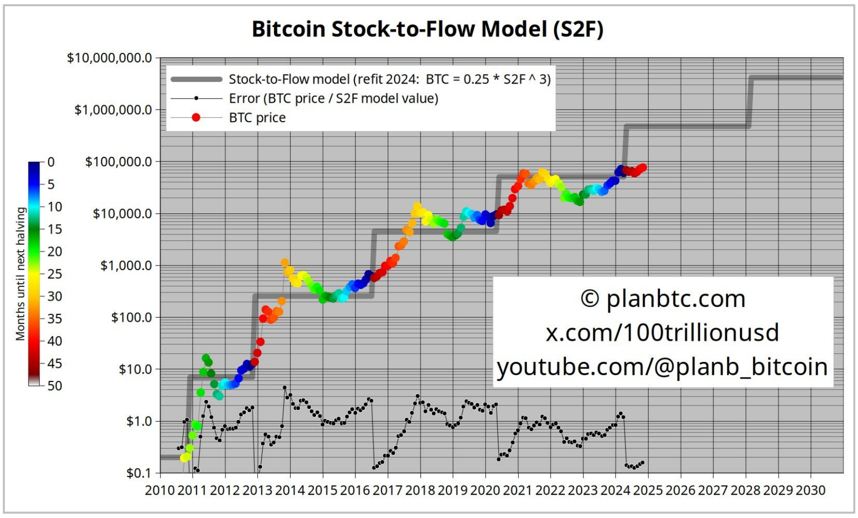


There is also a broad consensus to underweight defensive sectors, healthcare and consumer staples.

Alternative Investments

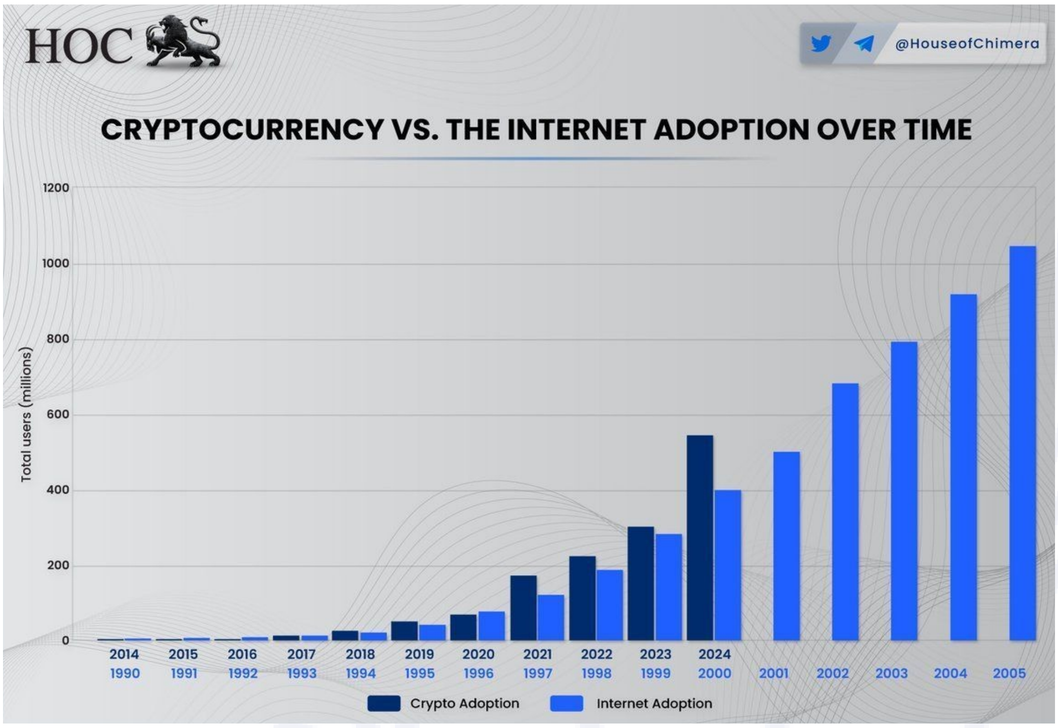
The bitcoin rocket and gold's resistance

A pro-crypto US government, a future boss of the US Securities Exchange Commission, Paul Atkins, known for his support for crypto-currencies, new legislation in Texas establishing a strategic bitcoin reserve and Donald Trump also in favor of a strategic bitcoin reserve have pushed the BTC price above $100,000. Some analysts are predicting a BTC market capitalization of $15,000 billion by the end of 2025, compared with $2,000 billion today.

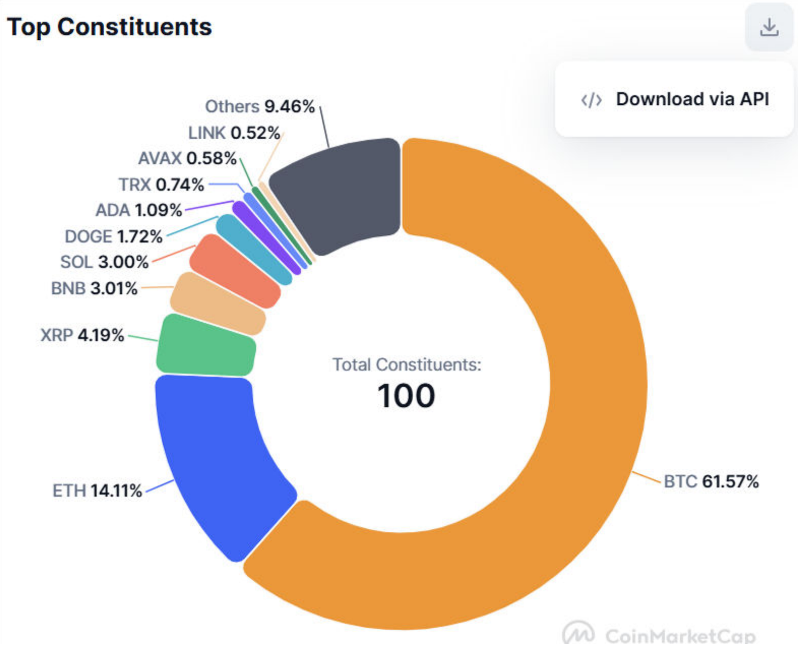


Trump's clear victory has certainly favored bitcoin, but already this spring some experts were predicting such a development, based on the *halving of* April 2024 and previous halvings (2020, 2016, 2012). The model used to value this digital asset, whose quantity is limited to 21 million, is Stock-to-flow, which is appropriate for scarcity assets such as gold. This model values bitcoin at between $400,000 and $3,000,000 between 2025 and 2030!

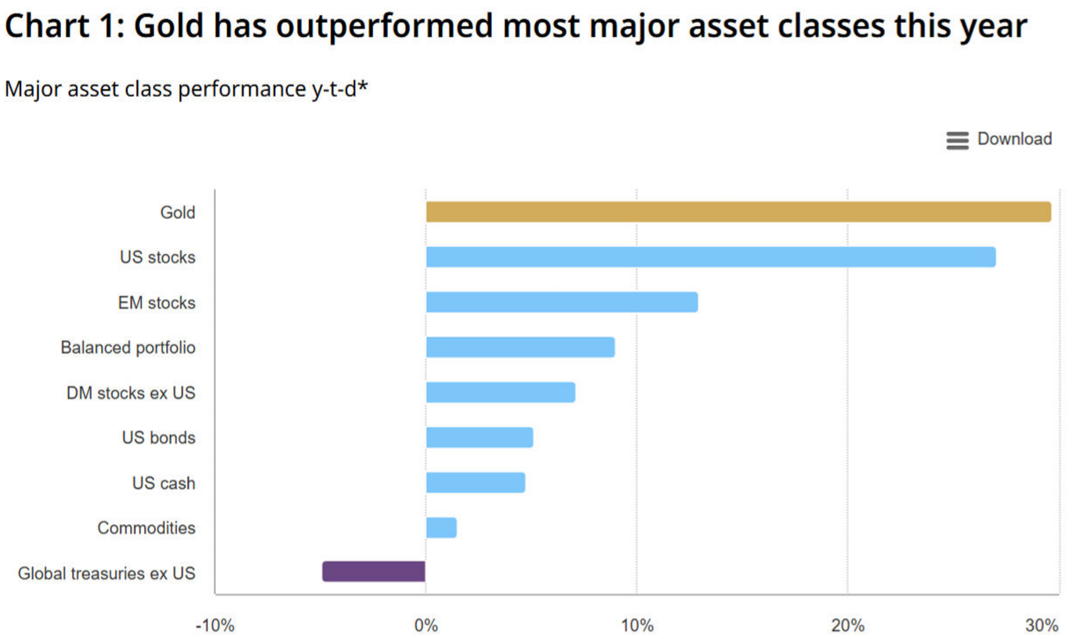
Compared with the arrival of the internet, the adoption curve for bitcoin seems to be faster.



Today, bitcoin accounts for 57% of the market capitalization of cryptocurrencies and ethereum for 13%. The total market capitalization is $3,730 billion.



Gold is holding up well despite the strong dollar and competition from bitcoin. Gold is one of the best performers among the main asset classes in 2024 (as at 30.11.2024).



For 2025, the consensus (source: World Gold) is for a stable to bullish gold price. We remain convinced that the $3,000 mark will be reached in 1H25. All eyes will be on Trump and his pro-growth measures. The Fed and the dollar will be important for gold.

Figure 2: Market consensus suggests rangebound performance for gold in 2025

Consensus expectations and select gold drivers*

Expected Fed funds rate	Current 4.5% - 4.75% 100bp lower by year end
Economic scenario	**Below trend recovery**
Opportunity cost	10yr: stable, marginally down
	Dollar: flat to slightly down (normalisation)
Economic expansion	Below-trend growth
Risk and uncertainty	Inflation falls but slightly above target
	Risk-on positioning
	Geopolitical risks elevated
Momentum	Commodities down marginally
	Gold net positioning normalises
Implied gold performance	Rangebound with slight upside

Colour key (effect on gold):	Positive		Neutral		Negative

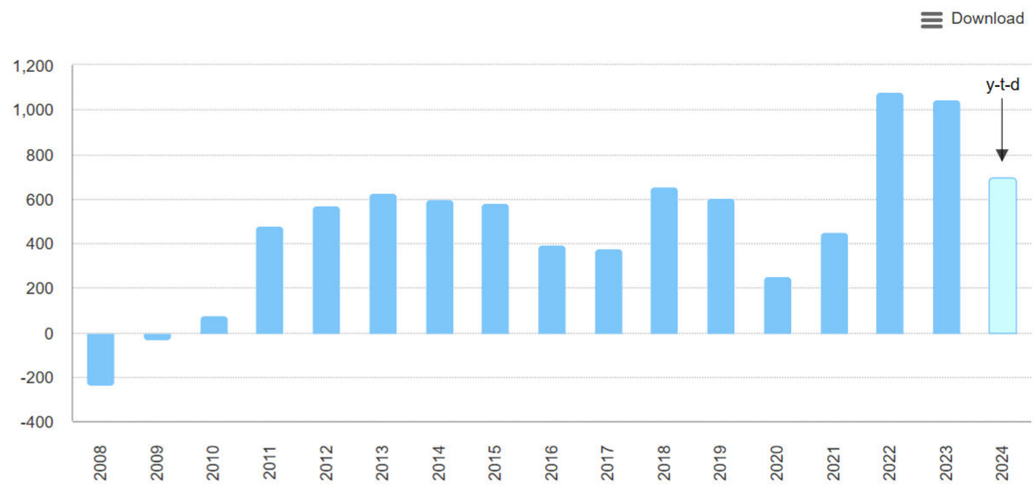
Source: Bloomberg, Oxford Economics, World Gold Council
*Based on market consensus and other indicators as of 30 Nov 2024. Impact on gold performance based on average annual prices as implied by the Gold Valuation Framework. See Figure 3 for details.

Excluding central banks, China and India each account for 20% of global gold demand, and Asia for 60%. Indian households increased their gold purchases in 2024 with the significant reduction in import taxes, as did Chinese households as a result of the property debacle and caution about the economy.

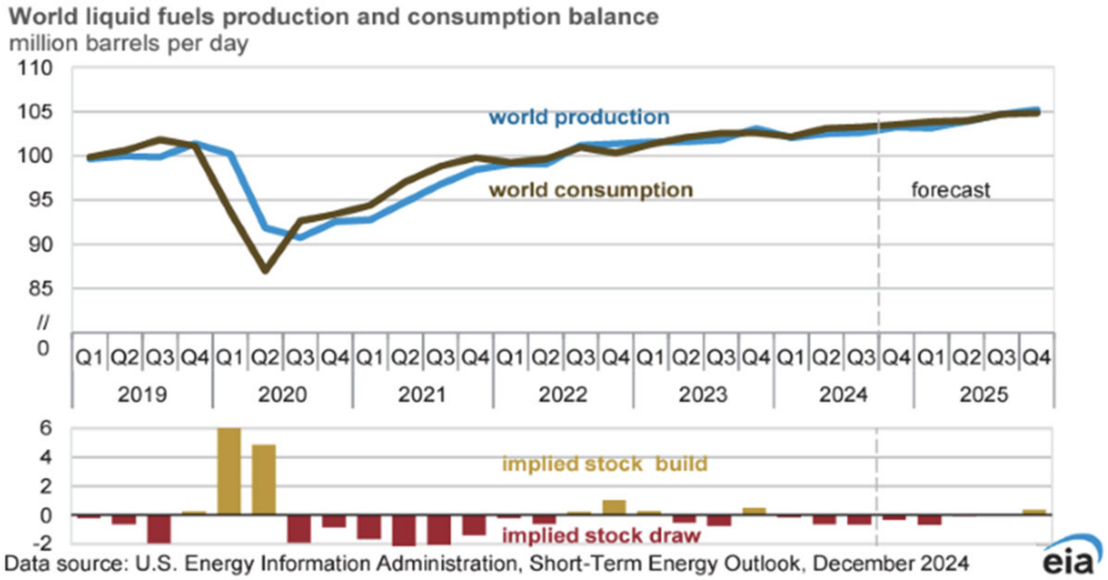
Emerging central banks continue to buy gold, but at a slower pace than in 2022 and 2023. A World Gold survey shows that 66% of central banks will continue to buy gold over the next 5 years.

Chart 3: Central banks have been net buyers since Q2 2009

Annual central bank and official sector demand*

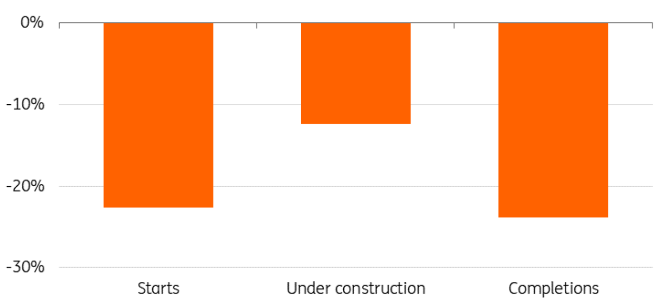


Oil prices are under pressure due to sluggish global economic growth and overproduction in non-OPEC countries such as the US, Canada, Brazil and Guyana, where Exxon Mobil and Chevron are investing heavily. The Trump administration's objective will be to produce an additional 3 million bpd to 16 million bpd and drastically lower energy prices for Americans. Saudi Arabia is stuck between keeping production low to keep Brent above $70 and increasing production to avoid losing market share. Only a major geopolitical crisis in the Middle East could push up crude prices, but the central scenario remains a Brent price of between $60 and $70 in 2025.



The risks of a fall in copper prices are increasing with the potential increase in US customs duties and the rise in the dollar, as well as China's insufficient efforts, for the time being, to revive the economy. Chinese demand, China being the largest consumer of industrial metals, is well below 2018-2019 levels. The real estate downturn began before the pandemic.

China's property sector still struggling



The global supply surplus will continue into 2025. Chilean production has risen by 20% since March