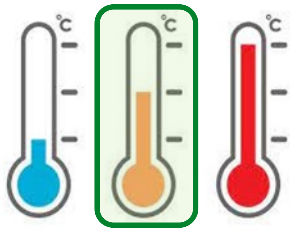
THE MONTHLY LETTER

Tactical update

NOVEMBER 2024

D-1 day

Global landscape



Stance: cyclical disinflation
Trend: stabilization process underway

Stance: below potential
Trend: stable

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 have increased. 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. A global and synchronized reflation cycle begins

US nominal growth will remain resilient thanks to pre-election fiscal largesse. China is shifting towards growing accommodation. The two countries will lead the 2025 recovery. Europe and Japan are lagging.

Geopolitics. A chaotic / recessionary landscape

Conflicts show little sign of abating. The spread of fighting in the Middle East is putting further pressure on shipping and weighing on prices. The Ukraine war enters a new regime with North-Korea.

Global liquidity pick-up to continue in the near term

Liquidity conditions are starting to become more favorable, led by US financial engineering 3.0 and China.

Negative equity-bond correlation tentatively restored

Cyclical disinflation finally emerged in the US. The odds of sub-3% CPI over next quarters have now become dominant. Still, sustainability of this virtuous outcome will depend on many factors, namely the shape of future US administration and Congress.

Highly volatile investors' sentiment and capital flows

Investors' cyclothymia is driving significant flows into and out of risky assets. Options' market confirm the looming fear, but risk appetite remains elevated.

At the time of writing…

US at the crossroad

A very close, much-hyped tipping point lies ahead. The outcome of the US election will have a profound impact on international relations, the global economy and the cohesion of US society. Certainly, polls have already proven to be particularly tricky when it comes to US elections. But even so, the unusual and wide gap between betting and ¨real¨ odds is an additional source of opacity. Still, the tightening of the polls, due to the US's bizarre electoral college system for electing the president, has increased the odds of a Trump victory.

Needless to say, financial markets will also be deeply affected. This assumption is all the more realistic given that the odds of an outright Republican victory - a sweep - seem to have risen dramatically of late.

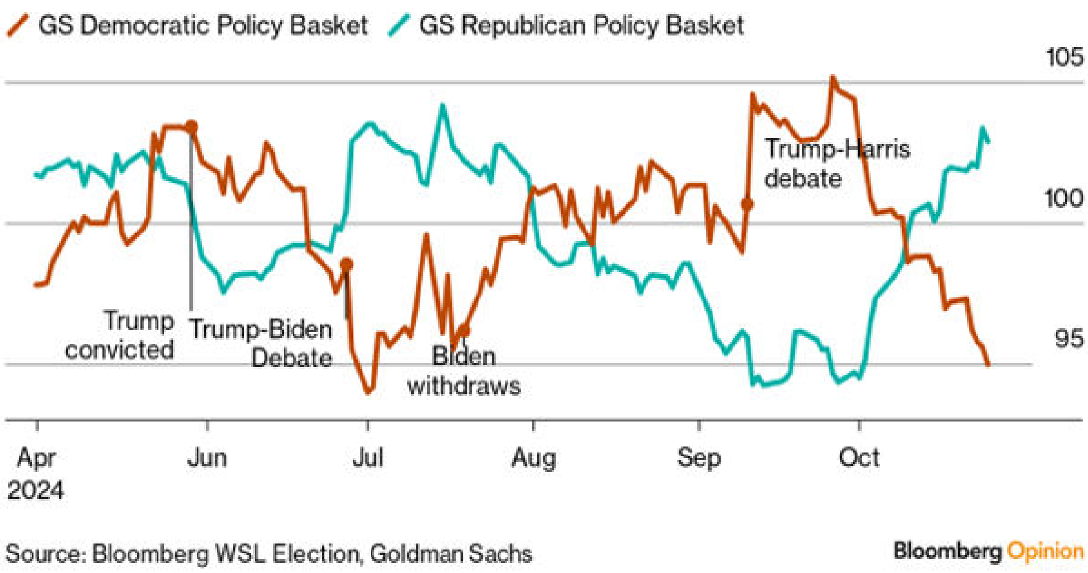
	Trump 2.0 (R sweep)	Trump Gridlock	Harris (D sweep)	Harris Gridlock
Scenario ranking	1	2-3	4	2-3
Recent trend	UP	Stable	Stable	DOWN

A disruptive Trump 2.0 and a "Trump gridlock" scenario are very different. In short, Trump gridlock would mean some of the tariffs and none of the Trump tax cuts or deregulation.

Markets are pricing in a Trump / Republicans' victory

In any case, investors will also need to pay close attention to how the House races play out

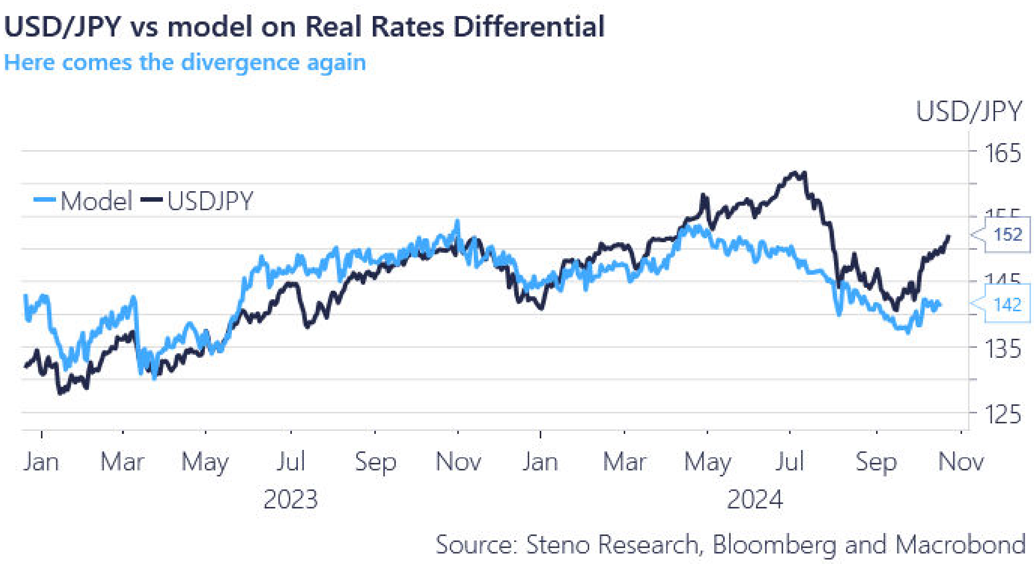
Red October - Stocks exposed to the election have moved sharply in Republican's favor



Japan’s Electoral Stalemate

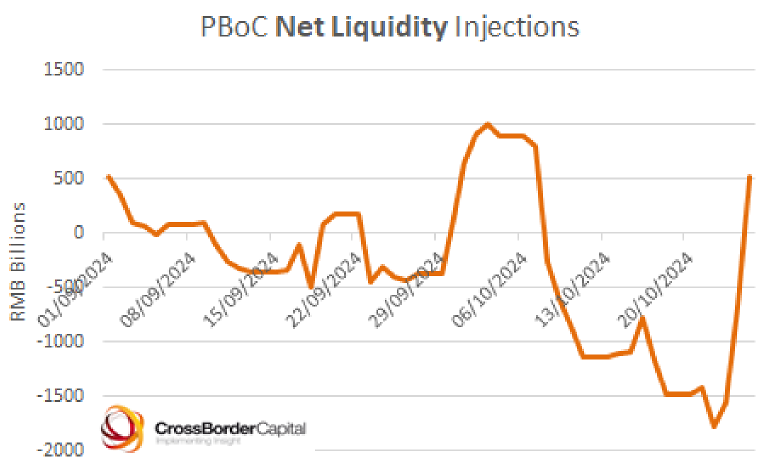
The ruling Liberal Democratic Party (LDP) and its coalition partner, Komeito, lost their majority in the Diet for the first time since 2009. Previous losses by the LDP have triggered significant shifts in Japan's political landscape. While the LDP's crushing defeat was partly due to the party's bribery scandal, voters also sanctioned rising inflation and higher yields, as well as plans to rethink fiscal policy. The government has paid the price for growing uncertainty about future economic policy.

JPY is experiencing ¨excess¨ weakness... again



The process of normalisation of the monetary policy pursued by the BoJ is becoming more hectic
Odds of a JPY/JGB crisis redux are rising

A new shot of financial engineering



For totally different reasons the two world’s largest economies are maneuvering to create favorable wealth effect. USD liquidity is accelerating thanks to the collapse of the Reverse Repo Facility (RRF); the TGA will also play its supporting role before the end of January. The reopening of the discount window and possibly the end of QT will be the icing on the cake. At the same time, the PBoC is opening the spigot. The alarming trend in M1, with negative year-on-year growth, couldn't be ignored by policymakers any longer. Beijing is jumping on the global reflation bandwagon.

Q424 and Q125 will confirm the emergence of a global, synchronized, reflation cycle

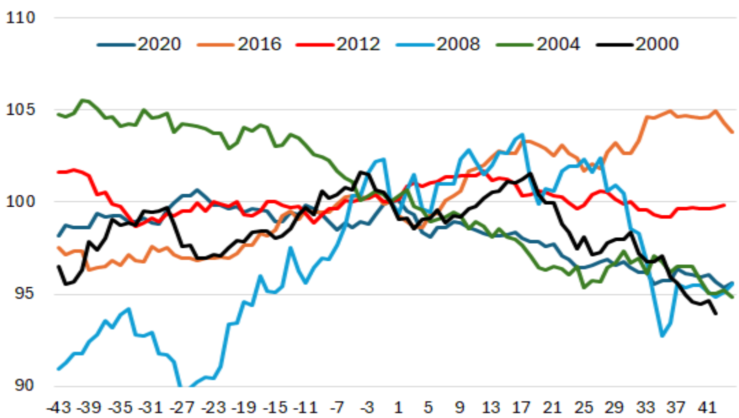
Investment takeaways

Rising (geo)political uncertainty collides with abundant liquidity/global reflation, spooking bond markets. The prevailing negative correlation between equities and bonds will continue to absorb short-term shocks / protect diversified portfolios. Early signs of a JPY carry trade are confirming the re-emergence of speculative positions in support of risky assets, short-term.

We remain fully invested for now, but ready to reconsider this positive view in the event of a red sweep in the US. Japan developments also deserve careful monitoring.

Currencies

No clear path is emerging around the elections



USD cycle remains intact

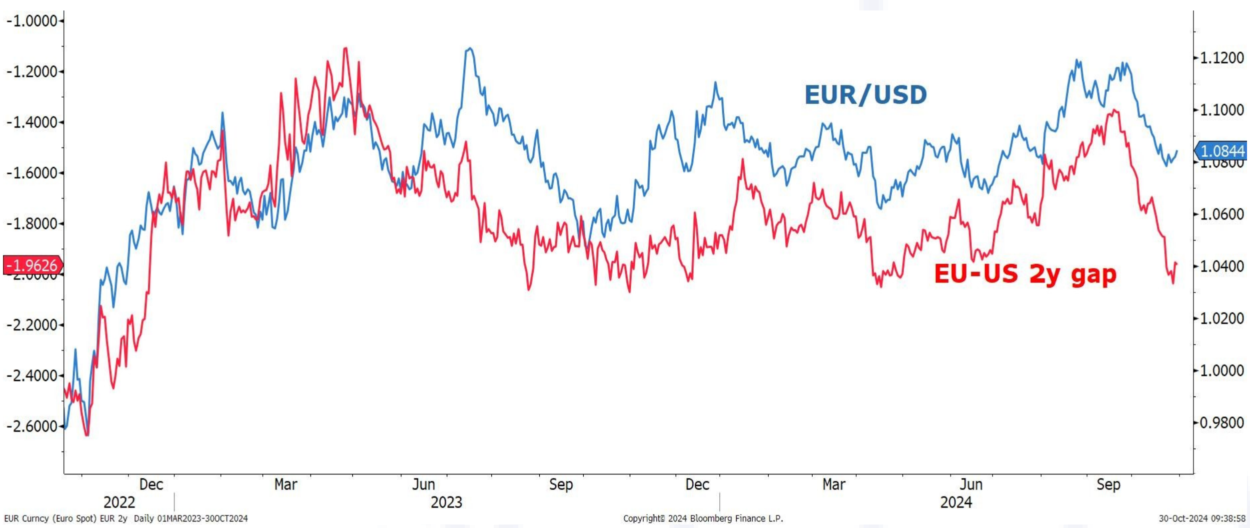
The USD gained more than 3% in October, driven by 2 main factors. The FOMC started its easing cycle with a bang but is likely to proceed at a slower pace. Since that meeting, US economic activity has surprised on the upside, suggesting continued resilience. The FOMC dot plot and better data do not suggest another 50bp cut. Real Fed Funds remain elevated. We still see a smaller cut path (25bps) towards the neutral rate of 3.5%.

The betting market has made Trump its favorite, pushing yields higher, given the large budget deficits expected. *The size of the move reflects the resilience of the US economy and expectations of a Republican sweep.*

Positioning also matters. USD short positions have been liquidated recently. This is particularly evident in the EUR. Speculators hold the largest net short EUR/USD position since October 2022.
A market over-positioned for a stronger USD risks a post-election reversal

A sweeping victory (with control of both chambers) for either party would have a greater impact on the USD than a divided Congress, which would make it difficult to pass legislation, especially fiscal policy. A surprise result (contrary to the polls) or a change in political party has tended to generate some short-term USD gains. The sustainability of these gains will depend on global economic conditions, the policies of the new administration and macroeconomic developments.

EUR/USD is in line with yield gap



The 2-year yield gap provided support for the USD. The gap reached its highest level since November 2023. This year, the correlation between the 2-year yield spread and EUR/USD is 0.88. Based on the spread alone, the pair is fairly valued. However, the market may have priced in too much of a US rate cut.

Irrespective of the outcome of the US elections, a relatively stronger growth momentum in the US compared to the euro area would lead to a downward trend in the EUR/USD. In the medium term, based on yield differentials, the EUR/USD should fall towards 1.05. In the short term, a rebound is likely given the overdone October move.

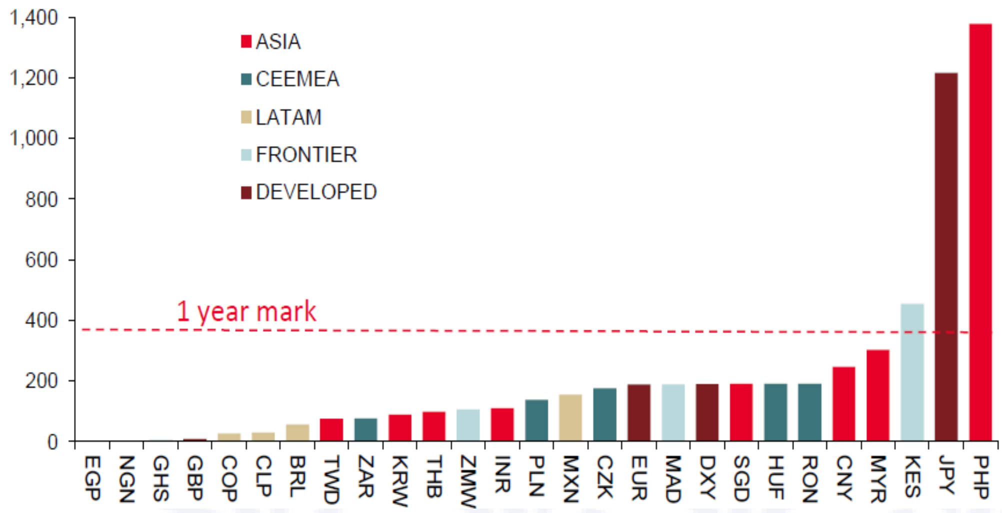
Trump victory: This too shall pass for EMFX

The consequences of the upcoming US elections will undoubtedly reverberate and influence the course of world events (global economic output, trade patterns, geopolitics, conflicts, monetary and fiscal policies in the DM and EM). Since mid-September, markets have been pricing in a higher probability of a Trump victory.

History suggests that the damaging consequences of a Trump victory for EM FX may prove temporary. Following the 2016 Trump election, EM FX broadly depreciated in the immediate aftermath, with a median decline of 6.0% against the USD. TRY, MXN and frontier market currencies were the most penalized, while Asian currencies, including CNY and TWD, were the most resilient.

Following this sell-off, most EM currencies rallied, even appreciating above their pre-election levels, as relative growth and interest rate expectations weighed on the USD. EM currencies gained 12%, more than double the size of the sell-off. The main beneficiaries were MXN, EGP, CEE3 FX and ZAR, while Asian FX were the least affected. Most currencies recovered to pre-2016 election levels within a year. The median was 110 days.

In 2016, most currencies quickly returned to their pre-election levels



In 2016, Trump's victory came as a surprise. This time around, however, the result would be much less of a surprise. It should trigger less volatility and depreciation in EM currencies. Importantly, a new Trump administration is likely to be much better prepared, more aggressive in its negotiating tactics, stronger in its execution and will operate with fewer constraints.

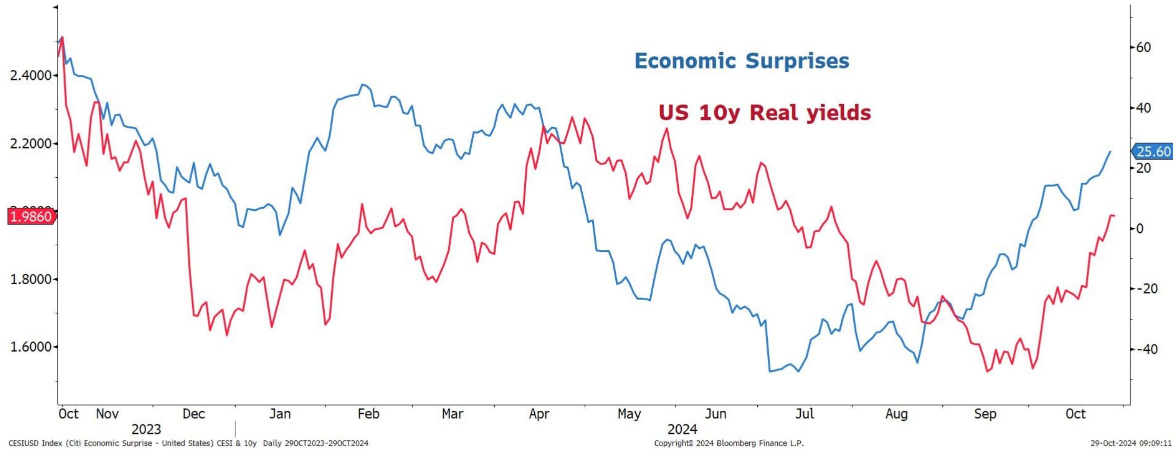
There are reasons to believe that the post-election weakness would be temporary. Recovery would be substantial

Bonds

What's behind the recent rise in US Treasury yields?

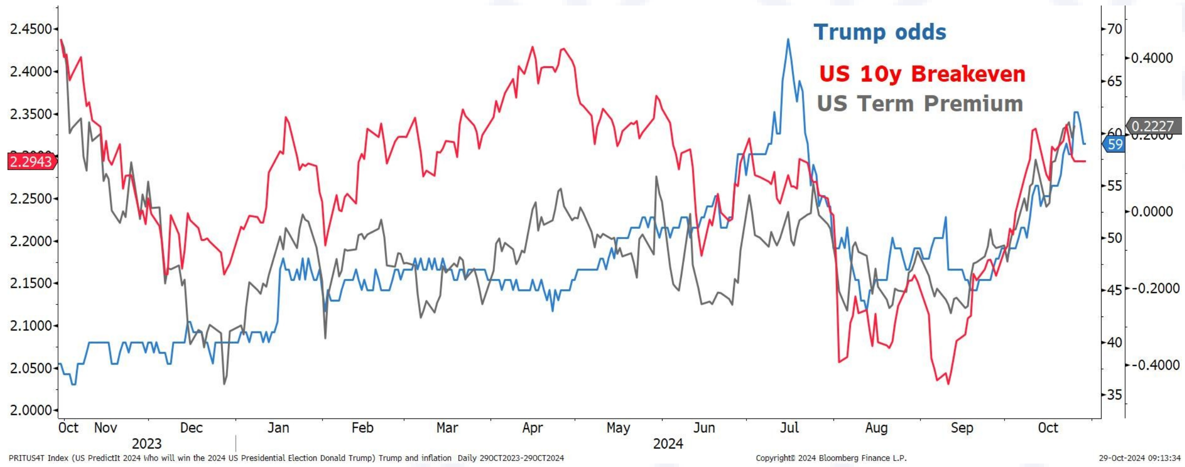
The US 10-year yield has risen by around 70bps since mid-September, immediately after the Fed cut borrowing costs by 50bps. As the Fed begins its easing cycle, it is counterintuitive that yields would move in the opposite direction. Two coinciding forces explain such a large move: the strength of the US economy and the US elections. Recent US macro data has been much better than expected, leading markets to reassess the outlook for the Fed's easing cycle. In September, expectations were for 3 more cuts this year. They have since been revised down to less than 2. The rise in the economic surprise index has roughly coincided with the rise in real 10-year yields. Expectations for the Fed funds rate at the end of the cycle have risen from below 2.8% to 3.5%, in line with the neutral rate estimate.

Economic surprises explain some of the recent move in long-end yields



The upcoming US elections are another factor. Markets are pricing in a higher probability of a scenario in which one party controls the White House and both chambers of Congress. It is likely to be more expansionary on fiscal policy, leading to higher deficits and inflation, and therefore higher yields. The chances of a Trump victory have increased. Republican budget deficits will rise twice as much as under a Harris victory. Higher import tariffs could push up inflation. Higher deficits and higher inflation are a toxic mix for bonds. This coincides with a rise in inflation expectations.

Higher inflation expectations are associated with a Trump victory



The bottom line is that a combination of solid macroeconomic data and policy has contributed to the rise in US yields The market has already discounted larger deficits in the future. Most of the damage is done

On this side of the Atlantic, things are less rosy

The ECB moved from quarterly 25bps rate cuts to cuts at every meeting. The message remained one of openness and data dependency. The risks are tilted towards a faster rate cut to 2.0%. While recent data have been weak, we need to see confirmation that both the inflation and growth momentum continue to slow.

Fed and ECB pricing has started to diverge

A lot is already priced in in the European bond market. We are neutral

Deficits still matter

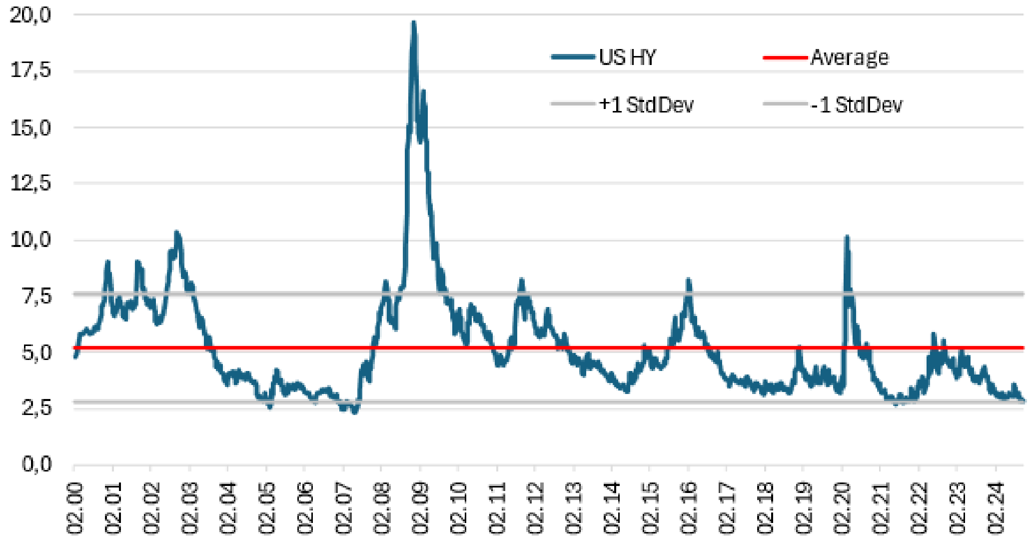
Initially, markets liked the new Labour budget as taxes will rise by £40bn (1.5% of GDP) per year and the Chancellor has pledged to balance the current budget within 3 years. However, borrowing will rise by an average of £36bn (1.3% of GDP) a year over the next 5 years. This will lead to a significant increase in bond issuance and higher yields. It's reminiscent of when Liz Truss, the short-lived chancellor, announced an unfunded tax cut: it was chaos. The central bank intervened.

The BoE is focusing on services inflation, which is below the Bank's expectations. This will continue and could accelerate the pace of cuts. The additional spending announced makes us less confident of a December move after the much-discounted November cut. However, the BoE's response to the fiscal loosening in 2023 and 2024 was muted. *The budget will not dramatically rewrite the BoE rate cut path. It will deliver more aggressive rate cuts than now expected*

High yield screams expensive

Investors chasing higher yields in credit markets are not being properly compensated for the risks. They are systematically overpaying for issuers offering above-average yields. The danger is growing.

US High Yield spread back to historical lows



US high yield credit spreads are close to their tightest levels since June 2007 and in the lowest quintile of historical data points. Investors are acting as if there will never be another default cycle. They are rushing in before further Fed easing starts to erode yields.

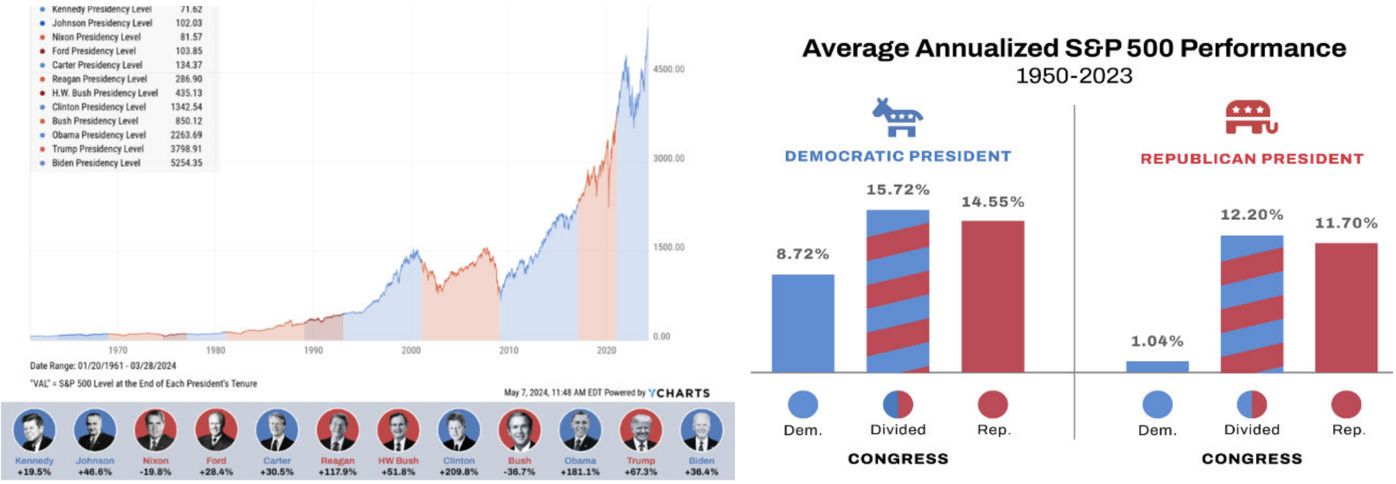
Credit risk is not being priced appropriately

Equities

Two dominant factors for the end of the year: Donald Trump and the "no-landing"

The race for the American presidential election is very tight. The color of Congress will also be important to know the latitude of action of the new president. The House of Representatives will be completely renewed and a third for the Senate. The outperformance of the financial sector and the rise in US rates suggest that the market anticipates a victory for Donald Trump. Most strategists believe that the best scenario for stocks would be a victory for Donald Trump with a divided Congress.

US stocks perform better with a Democratic presidency



Last month, we highlighted a risk of recession with the re-steepening of the yield curve. But the "no-landing" scenario has strengthened with the resilience of the American economy and other economies as well. The Citi's indicators of economic surprises are recovering, showing that the published economic data are better than estimates. We are talking about reflation again. After its normalization, inflation no longer seems to be falling. Inflation is stabilizing, or even rising slightly.

According to the Joint Economic Committee (US government), the US economy performs better under a Democratic presidency. Of the last 11 recessions, 10 began under a Republican presidency.

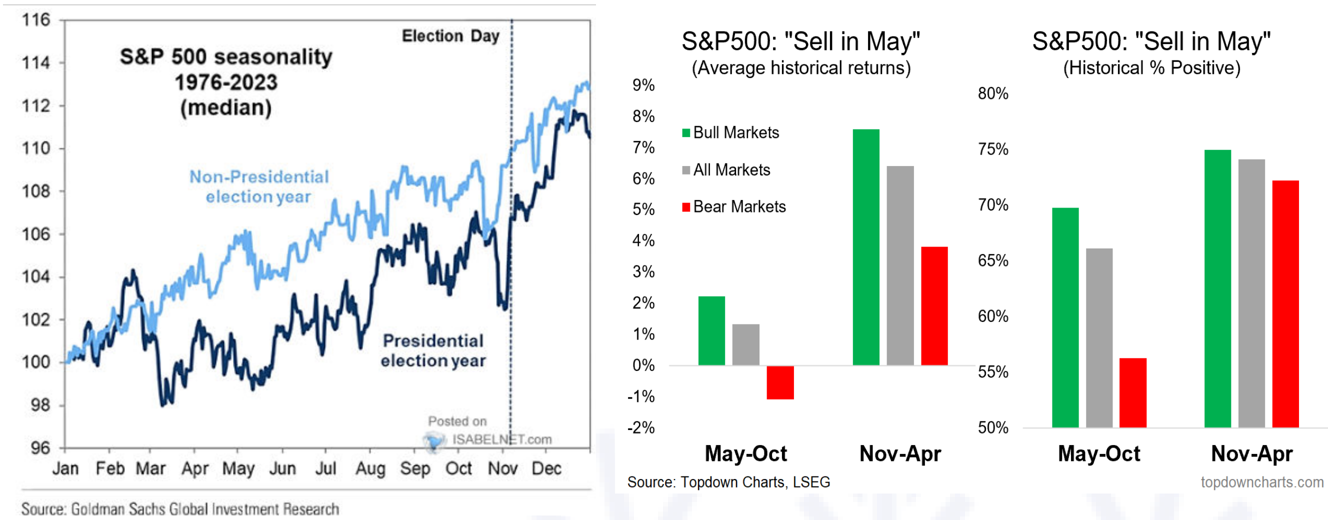
The consequence of these two factors was a sharp rise in the US 10-year, from 3.6% to 4.39% in a month and a half. The stock markets should have corrected, but like the economy, the stock markets are also resilient, supported by accommodative monetary policies and the increase in liquidity.

Nevertheless, we remain cautious about the end of the year. Technically, the US 10-year could test 4.5%. In general, a rise in rates weighs on valuations. But our greatest concern is about Donald Trump's victory, not on his legitimacy, but on his inflationary, conflictual and unpredictable program. Donald Trump's geopolitical vision could change, as Donald Trump appreciates authoritarian leaders, especially Putin, to the detriment of Europe, the weak link in a changing international order. Recently, Donald Trump called Europe a "mini China" that does not buy enough American products. European stock markets could underperform under Trump's blows.

The stock markets did not do much in September and October, which is already good given a difficult global environment, but with volatility, caught between reflation or soft-landing and Trump or Harris. However, two statistics are favorable :

1. A month before the US presidential election, the S&P 500 falls on average more sharply than in the previous 3 years at the same period, but then the rally is significant.
2. In November, we enter a 6-month period, *the best 6 months theory*, until April which has proven positive 76% of the time (calculations made since 1945 by CFRA Research) for the S&P 500 with an average increase of 7%, while the May-October period was positive only 66% of the time with an average increase of 2%. Another positive point: of the 10 times (still since 1945) that the S&P 500 had a gain of more than 10% (which is the case this year) between May and October, the index rose by 13% on average over the following 6 months 92% of the time. But once again, a situation that we have been highlighting for several months, the seasonality was the upside-down in 2024; the S&P 500 climbed by 22% in 2024, including 15% between May and October 25. It is therefore possible that the period from November 2024 to April 2025 will show a stock market performance below the historical average, at least during the last two months of the year.

Post-US Presidential Election Rally (Left) and the Best 6 Months Theory

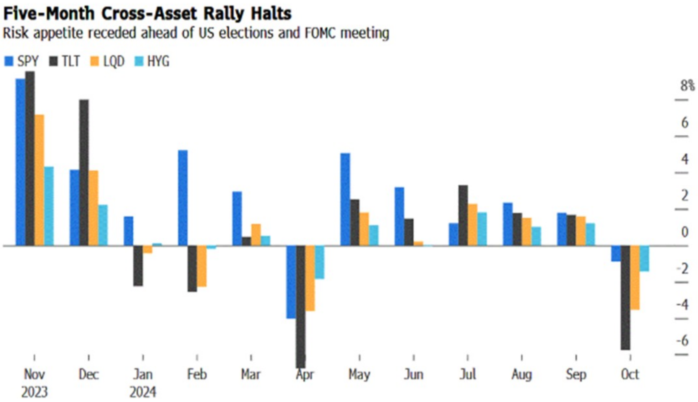


Profit growth remains solid. After a small scare in mid-October with a downward revision of profit growth, US profits in 3Q24 should grow more strongly than estimated. Factset estimates growth of 5.1% versus 4.3% in early October and Lipper Alpha LSEG 8.9% versus 5%. Revenues will increase by 5%. In 3Q24, the positive contributions came (once again) from Big Techs and the Discretionary and Industrial sectors. The main negative contribution came (a constant for several quarters) from the Energy sector, affected by the decline in oil prices and the sharp drop in refining margins; ex-Energy, profit growth would have been more than 11%. By stock, the strongest positive contributions were Alphabet, Meta, Amazon, Pfizer, and the negative contributions were Apple and Intel. Analysts did not revise downwards their estimates for the coming quarters, confident of a solid macro and microeconomy.

In addition to the American elections, investors will closely follow the meeting of the Communist Party committee that will take place from November 4 to 8. After the Chinese monetary measures taken in September, the Finance Minister Lan Fo announced in mid-October a major fiscal/budgetary plan to support the economy, real estate and the stock market, but without going into details, these being the prerogative of the Communist Party's Central Committee. In October 2023, the Communist Party had validated an increase in the budget deficit from 3% to 3.8%.

Until the end of the year, we remain cautious with the asymmetric risk of the US elections, in the event that Trump were to lose by a small margin, the rise of the US 10-year, investors' complacency, overbought situations (which are now turning around) and a historically high weight of equities in the wealth of American households. In the medium term, the bull market remains our base scenario with 2025 targets of 6,575 on the S&P 500, 565 on the Stoxx 600 and 5,400 on the Euro Stoxx 50.

Investor fears in October. Left chart: fall in risk appetite in October. Right chart: with the exception of 2008, the highest level of cross-asset volatility in 2024



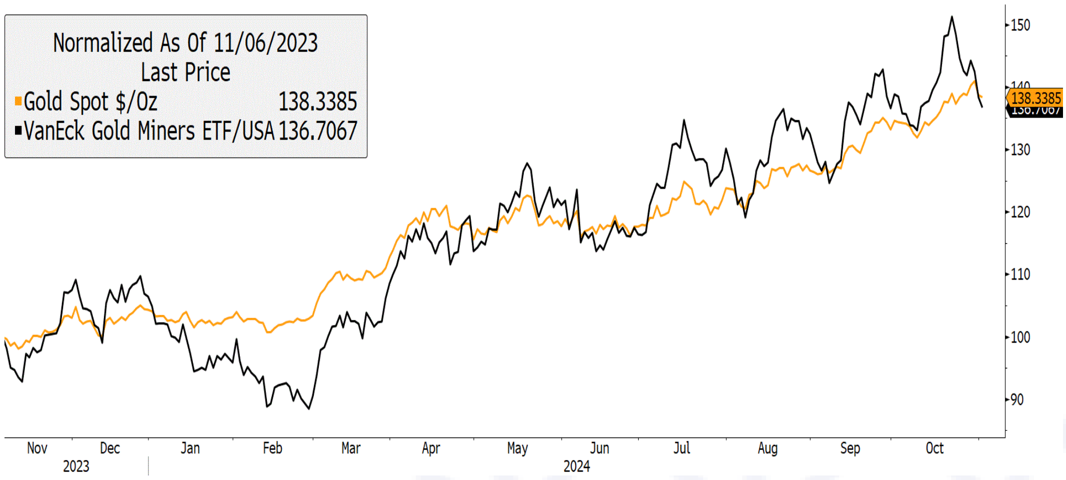
Alternative Investments

FOMO on gold. Potential for an increase in industrial metals. Oil, a hedge against a regional war in the Middle East

Since May, inflows into financial products invested in physical gold have been regular, while emerging central banks slowed down their purchases already in April due to a higher price per ounce of gold. Individual and institutional investors are in FOMO mood – fear of missing out - on the continued rise in prices with analysts and strategists' recommendations estimating a price of $3,000. Demand should continue to increase in the face of geopolitical risks, accommodative monetary policies, public debt and the desire of emerging central banks to diversify their foreign currency reserves by reducing the dollar.

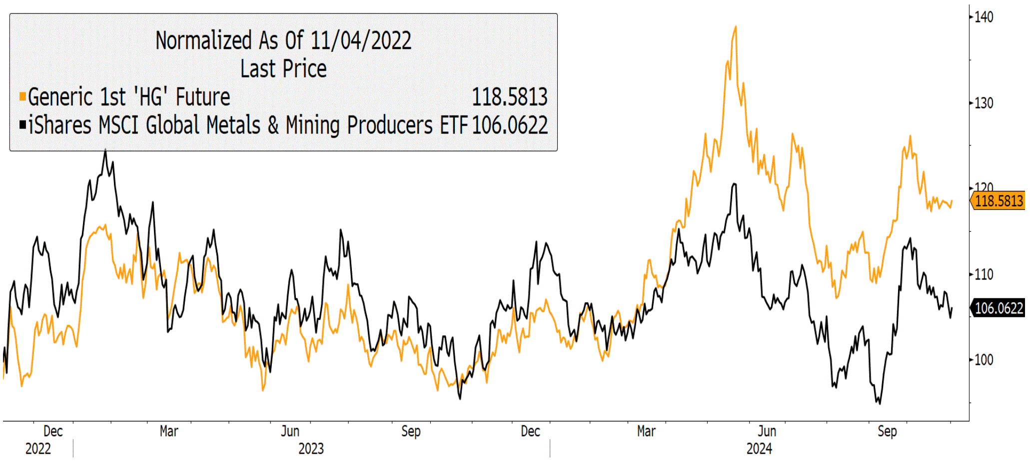
For 2 years, investors were absent from gold in their tactical allocation. The strained relations between the West and the Global South and the BRICS’ desire to create a new geopolitical and financial order will favor gold. The idea of an alternative to SWIFT, the *Brics Bridge*, will push emerging central banks to strengthen gold. We prefer physical gold to gold companies. Contrary to what we sometimes read or hear, gold companies are not lagging behind physical gold in terms of stock market performance; over a year, gold has risen by 37% and the GDX ETF (gold companies) by 35%, but gold company stocks offer much more volatility, 34 on a historical average over the last 4 years and 14 for gold. Technically, $2,640 are good buying levels.

Physical gold and Gold companies ETF. Performance (base 100) over 1 year

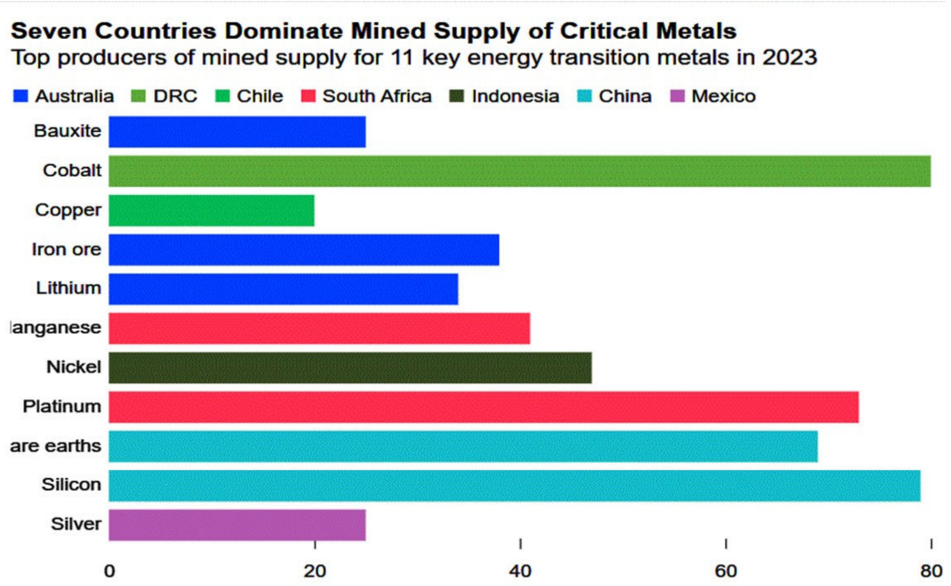


Conversely, mining companies are lagging behind copper. But this is due to the heterogeneous performance of industrial metals. Copper, aluminum and zinc have seen their prices rise, while those of iron ore and nickel have fallen. We are buyers on industrial metals, through mining companies in the medium term with the reindustrialization of the United States, the energy transition and massive investments in defense. From November 4 to 8, the central committee of the Chinese Communist Party will meet to decide on fiscal measures to support the economy and real estate, but it is waiting for the American election. The choice of the new American president could have an influence on the global economy and trade relations, but also on investments in the energy transition.

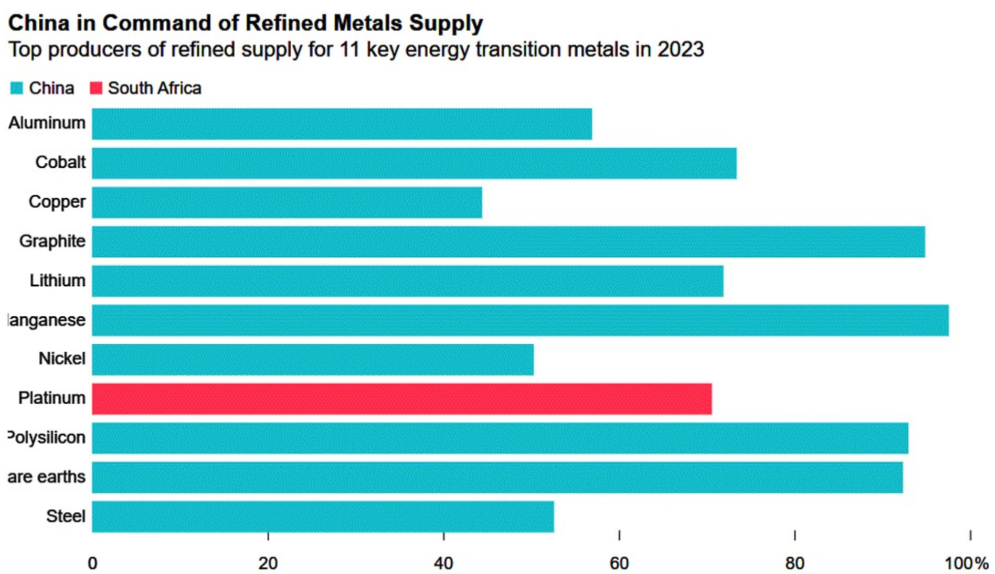
Copper and Mining producers ETF. Performance (base 100) over 1 year.



8 out of 11 metals needed for the energy transition present risks of production concentration



The situation is even more critical in metals refining, with China clearly in the lead



Energy prices are under pressure with weaker than expected global demand, a surplus of supply from non-OPEC producing countries (United States, Canada, Brazil, Guyana) and temperatures in the northern hemisphere below seasonal norms. Sometimes, prices rise when tensions return between Iran and Israel, as was the case last week with Iranian threats. Trump's election could weigh on final prices to American consumers if customs duties increase by at least 20% as the candidate had said, pushing refining groups to buy less oil.

For both energy and industrial metals, a Donald Trump election would warrant some time to think about what he will really do. This situation explains our general caution for the end of the year. In the case of a Kamala Harris election, it would be *business as usual*.