MARKET INSIGHT

January 2025

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A Warning Shot from the Federal Reserve!

December was marked by a return of volatility in international financial markets, which came as no surprise to us.
In this context, the performance of major assets (stocks, bonds) declined, although this did not call into question their positive behavior in 2024, particularly stocks.

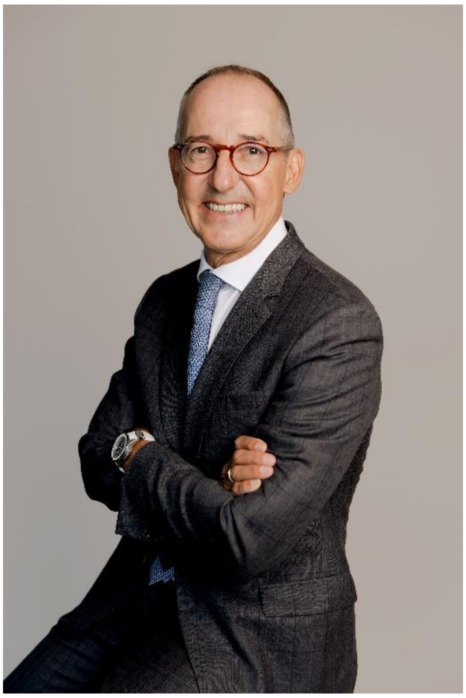
Indeed, the final weeks of the year were characterized by significant uncertainties, whether on the political front (collapse of the Barnier government, German parliament's vote of no confidence) or the geopolitical stage (failed negotiations on the Gaza situation, the emergence of a new power in Syria, and the intensification of the Russian offensive in Ukraine amid growing rumors of upcoming talks).

On the economic front, higher inflation figures in the U.S. and Europe, the growing threat of deflation in China, and "combative" statements by D. Trump (threats against Panama, pressure on Europe to avoid new tariffs) weighed on investor sentiment.

These elements contributed to increased market volatility. However, the primary driver of this phenomenon was the Federal Reserve.

While the Fed's decision to lower its benchmark rates was good news, the sharp revision of its monetary policy easing outlook for 2025 was far less favorable!

J. Powell and his colleagues acted logically: the persistence of robust economic growth (evident from upward revisions to Q3 GDP) and the slower-than-expected decline in inflation justified their decision.



"Our first challenge is to remain calm and manage the return of volatility."

FRANÇOIS SAVARY, CIO
GENVIL SA

Furthermore, the central bankers rightly factored in the uncertainties posed by D. Trump's economic program on domestic economic growth in 2025 (see our December letter on this topic).

We were not surprised by the Fed's "pivot." Last month, we mentioned our decision not to increase the duration of bond portfolios due to overly optimistic expectations about rate cuts and concerns over short-term U.S. inflation trends.

The sharp rise in 10-year yields following the Fed's announcements has validated our cautious approach to bond exposure. As a test of the 4.75% zone on 10-year U.S. Treasury yields looms, we cannot rule out reaching the 5% threshold in early 2025.

Overall, we maintain our stance of avoiding **a rush into "duration trades," as they still fail to provide sufficient diversification benefits for a balanced portfolio.**

Our questions about the implementation of D. Trump's economic program remain, especially regarding its short-term impact on U.S. inflation.

The swift rise in capital costs in the U.S. affected equities in December, though not due to fears over economic or earnings growth. However, in a context of full equity valuations (P/E ratios exceeding 22x 2025 earnings), **it is reasonable for risk assets to bear the brunt of rising interest rates. This is particularly true as equity risk premiums (the yield-to-earnings ratio relative to 10-year yields) hover near zero.**

It was precisely this concern that led us to refrain from increasing our equity exposure in recent months and adopt a more cautious stance toward high-duration stocks in portfolios.

As mentioned earlier, we cannot rule out 10-year U.S. yields flirting with 5% in the near term.

Therefore, increasing the overall weighting of equities does not seem appropriate despite their recent consolidation.

This point is especially pertinent as our overall allocation already favors equities over bonds.

However, since we do not foresee a significant slowdown in U.S. growth shortly, there is no justification for an "emergency" reduction in equity positions due to more erratic price movements.

In recent months, we highlighted the hypothesis of increased market volatility in our 2025 global scenario, which remains valid.

As long as signals for economic and earnings growth remain strong, **our primary challenge is to stay calm and manage market volatility effectively rather than adopting a defensive stance.**

Though less linear than the past 18 months, the upward trend in equities is likely to continue in 2025. Accordingly, we are not revising our 12-month target for the S&P 500 Index (6,400).

"We are not surprised by the Fed's pivot in December."

Given the clear dichotomy between U.S. economic conditions and those in other regions, particularly Europe, we continue to favor a strong allocation to U.S. equities.

That said, the significant underperformance of European stocks and **their attractive relative valuations prompt us to seek investment opportunities on the continent.** Our aim to diversify equity allocation beyond the leading market remains intact!

In this context, currency trends must also be considered. **Recent months have challenged our scenario of a general decline in the U.S. dollar**, particularly against the Euro. Testing parity on the EUR/USD exchange rate now seems highly likely.

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The economic cycle divergence between the two regions remains substantial, and monetary policy expectations reflect this.

While we believe expectations of European rate cuts to 1.75% in 2025 are excessive, the political instability in Europe and D. Trump's tariff threats make this scenario hard to dismiss.

The question then becomes how much of these risk factors are already priced into the exchange rate?

We argue that much of the market has already accounted for factors favorable to the U.S. dollar, particularly as the dollar is far from undervalued.
Moreover, U.S. monetary policy risks must also be considered. With the Fed's recent pivot, "surprise bias" now leans toward a more substantial easing than currently anticipated, following a sharper-than-expected domestic slowdown and/or a reversal of our views on U.S. inflation developments.

We maintain our scenario of moderate dollar weakness against the Euro in 2025 but adjust its timeline to the latter half of the year. Additionally, **we revise our year-end target to 1.10, with short-term ranges between 1.00 and 1.05.**

This brings us to gold and the **Swiss franc**, two safe havens we appreciate for their decorrelation potential in today's uncertain environment.
The Swiss National Bank's decisive action in December (a 50-basis-point rate cut) was partially surprising and temporarily weighed on the Swiss franc.

However, this relative weakness seems short-lived, given the strong fundamentals of the Swiss economy and an approaching end to monetary easing (one final rate cut in March is probable).

We remain unconvinced that a return to negative rates in Switzerland is on the table, especially as the December **decision likely aimed to preempt deflation risks. We maintain a target of 0.92, or even 0.90, against the Euro in the coming months.**

Gold has continued its consolidation phase after testing the USD 2,800 level in recent months. However, the extent of its decline has been limited, given the strength of the U.S. dollar and rising U.S. nominal interest rates.

This demonstrates that investors still recognize gold's protective qualities, especially as central banks, like China, continue diversifying their reserves.

Our scenario of gold testing USD 3,000 in 2025 is reaffirmed, with any approach to USD 2,600 seen as a buying opportunity for investors seeking to bolster their positions.

We remain overweight gold (6%) in our global allocation.

In conclusion, **we enter 2025 with certain defensive exposures** (cash, short-maturity bonds, liquid alternative products, and gold). These positions are balanced by slightly overweight equities relative to our benchmark, while bond exposure should remain cautious (total weight and duration) under current conditions.

We continue to emphasize the artificial intelligence theme and maintain financial stocks, aligning with our **broader dividend-seeking equity allocation strategy.**

Despite less favorable conditions in December, **small and mid-cap stocks offer**

diversification opportunities within the context of a soft landing for the global economy, which seems intact.

Furthermore, we do not believe U.S. sovereign yields can exceed 5% under prevailing economic conditions.

We have **several short-term allocation adjustments under consideration**, including:

- Introducing a **specific cryptocurrency strategy** in the alternative pocket.
- **Timing the extension of bond portfolio duration** as we approach our initial 4.75% target for 10-year U.S. Treasuries.
- **Increasing dollar risk protection and diversifying USD-denominated accounts.**
- **Enhancing European equity exposure** if negotiations over the Ukraine crisis gain traction.

We remain committed to managing volatility flexibly, as its recent rebound is unlikely to dissipate quickly.
While 2025 presents opportunities and risk asset potential remains intact, the exceptional performance of the past two years is unlikely to repeat in the coming months.

The challenges of delivering satisfaction in managing your assets and maintaining the trust you placed in us in 2024 are central to our efforts—rest assured!

As we approach the new year with humility and a strong determination to excel, we extend our best wishes to you and your loved ones for 2025.

Geneva, January 5, 2025

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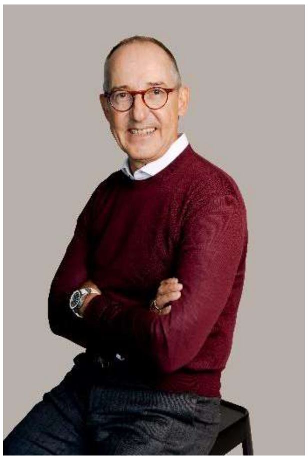

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